CA Foundation-

Principles & Practice of Accounting Notes

Compiled by -
https://cablogindia.com/

Join us on telegram -
https://t.me/charteredaccountantsguide

Index

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Theoretical Framework

SINCE 1997

NAVKAR
A Symbol of Success

NAVKAR INSTITUTE® | We believe in the best

CHAPTER-1
THEORETICAL FRAMEWORK

UNIT : 1
MEANING AND SCOPE OF ACCOUNTING

INTRODUCTION

Every individual performs some kind of economic activity. A salaried person gets salary and spends to buy provisions and clothing, for children's education, construction of house, etc. A sports club formed by a group of individuals, a business run by an individual or a group of individuals, a local authority like Calcutta Municipal Corporation, Delhi Development Authority, Governments, either Central or State, all are carrying some kind of economic activities. Not necessarily all the economic activities are run for any individual benefit; such economic activities may create social benefit i.e. benefit for the public, at large. Anyway such economic activities are performed through '**transactions and events**'. **Transaction** is used to mean 'a business, performance of an act, an agreement' while event is used to mean 'a happening, as a consequence of transaction(s), a result'.

1. Definition of Accounting

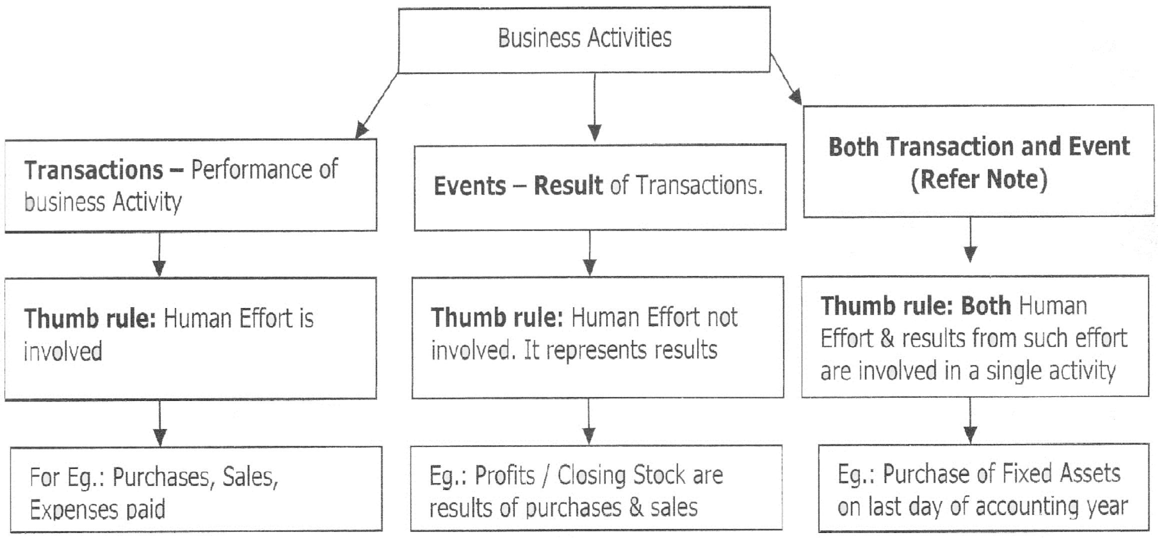
1. **As per the American Institute of Certified Public Accountants (AICPA)** - Accounting is an **art** of recording, classifying and summarizing **transactions and events** which are in part atleast of **financial character,** in a **significant manner** and in terms of **money,** and **interpreting** the results thereof.

2. Accounting also involves **analyzing** and interpreting the **financial transactions** and **communicating** the results to the persons interested in such information.

3. Accounting is considered as an **"Information System',** as the function of Accounting is to provide **quantitative information,** primarily financial in nature about the business organisation.

2. Transactions Vs Events, Financial Vs Non-Financial

Transactions and Events: In a business or economic scenario.



Note Both Transaction and Event: Purchase of Fixed Assets on the last day of the financial year is a transaction, since it is a business activity. It is also an event as a fixed asset exists as a result of such purchase.

Example: Vignesh Traders buys and sells books. During January, the Firm purchased goods for ` 1,00,000 and sold the entire stock for ` 1,40,000. During the month, it paid salary to its Shop Manager ` 10,000 and Rent ` 6,000.

Particulars	`	`
Sales		
Less: Cost of Goods purchased and sold	1,00,000	1,40,000
Expenses paid (Salary ` 10,000 + Rent ` 6,000)	16,000	(1,16,000)
Surplus - Profit		**24,000**

- Purchase and Sale of goods, and Payment of Salary and Rent Expenses are **"Transactions".**
- Earning Surplus / Profit is an **"Event".**

2. **Types of Transactions - 2 Types:**

Financial Transaction

When a business transaction involves a transfer of **money or moneys' worth,** then the transaction is called "Financial Transaction".

Ex. When a business transaction does not involve money or money's worth

1. Cash and Credit Transaction (Refer Point 4)

Non-Financial Transaction

Purchase and Sale of goods, Payment of Expenses, Purchase of Assets, Goods lost by fire etc.

Ex. Quarrel between 2 Managers, Death of an employee etc.

1. No such classification

3. **Financial Transactions - Meaning of Money or Money's worth:**

   Money : Cash - Rupee Notes / Coins;

   Money's Worth : Cheque/ **Obligation to pay,** but actual payment to be made later (credit transactions)/ Bill of Exchange / Promissory Note / Setting off one liability against another receivable / Exchange of assets / Debit Note / Credit Note

   Notes: Hence, a transaction can be regarded as financial transaction even if money is not involved. It is sufficient that it involves money's worth. Further note that Accounting is concerned with only financial transactions. Non-Financial transactions are not considered.

   Barter - It refers to exchange of goods among persons. For eg. A sells pen to B. B sells pencil to A.

4. **Cash & Credit Transaction:** Financial Transaction can be classified into two types -

   Cash Transaction : If the Financial transaction involves Cash / Cheque / Other modes of immediate settlement.

   Ex. Cash received from debtors / Cash Sales

   Credit Transaction

   If the Financial Transaction does not involve immediate settlement, but there is an **obligation to pay in future,** it is called as credit transaction. The actual settlement in cash will be made later.

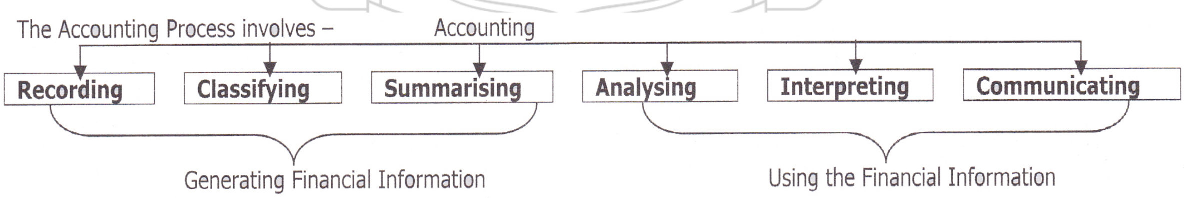
   Ex. Sales made to Mr.A on condition that -will pay after 60 days, Debit Note -**Credit Sales.**

Students' Notes:

1. It is to be noted that if the financial transaction involves Money / Money's worth **(other than Obligation to pay), then it is considered as Cash Transaction.**

2. **Cash transaction does not mean that cash must be involved.**

3. Hence, if the transaction involves settlement by a Bill of Exchange / Promissory Note / Setting off one liability against another receivable / Exchange of assets, it shall be considered as Cash Transaction only.



3. Processes or Generating Financial information

1. Recording:

Meaning : All **business transactions** which are of **financial nature** (i.e. expressed in terms of money) are recorded in the books of accounts.

Purpose : A businessman cannot keep in his memory all the business activities carried out by him. Hence, there is a need for keeping track of such activities in a separate record.

Basis of Recording : All transactions must be evidenced by supporting documents like Sales Invoice, Purchase Bill, Receipts, Pay Slip, etc. ***(These are called Vouchers).***

Relevant A/cs Book : The Books in which primary entry is made is called **"Journal",** which is further sub-divided into several **Subsidiary Books** for Sales, Purchases, Cash & Bank, etc. according to the nature and size of the business.

Checkpoint : It is to be noted that Accounts is concerned with only **FINANCIAL TRANSACTION.** Accounting will not record non-financial transactions in its books.

Example

- **Salary paid to Manager** will be recorded in the books of accounts.
- But, good health of the Manager, even if it is of great use to the business, has no financial character and no economic value, and therefore, will not be considered in Accounting.

2 Classifying:

Meaning : Classifying involves grouping transactions of a similar nature at one place, such that information will be compressed and presented in useable form.

Purpose : While the process of recording ensures that all financial transactions are recorded, one cannot make any observations unless all the transactions are grouped together under different categories.

Basis : Classification is based on the transactions recorded in the Journal / Subsidiary Books.

Relevant A/cs Book : The book containing the classified information of transactions is called **"Ledger".** Each page in the Ledger is called as **"Folio".** In each folio (Page No.), an individual Account Head and all transactions relating to that Account Head is recorded / posted.

Checkpoint : Ledger can be prepared only after the preparation of Journal / Subsidiary Books.

Example

- At recording stage, all transactions are normally recorded chronologically (i.e. date-wise).
- Assuming a businessman made 10 sale transactions (out of which 6 are on credit), paid telephone charges, rent etc., received payments from 3 debtors in a week, it is not possible to ascertain the exact position of each item unless they are grouped as "Sales A/c, Telephone Charges A/c, Rent A/ c, Debtors A/c etc."
- This will help in finding out Total Sales (Cash and Credit sales) / Expenditure / Amounts due from debtors etc.

3 Summarizing:

Meaning : This involves presentation and preparation of the classified information in a manner useful to the internal and external users of Financial Statements.

Accounts Books : It involves preparation of Trial Balance, and Financial Statements therefrom, viz. (i) Profit and Loss Account (used to find out profits / losses for the business), (ii) Balance Sheet (used to ascertain the financial position), and (iii) Cash Flow Statement (used to determine the factors for increase or decrease in cash & bank balances)

Basis : Summarizing is based on the classified transactions presented in Ledger

4. Analysing:

Meaning : Analysis involves **methodical classification** of the data given in the **Financial Statements.**

Nature of process : Analysis is concerned with the determining the relationship between the items in the Profit and Loss Account and Balance Sheet (i.e. Ratio Analysis). Thus, it **provides the basis for interpretation.** Further, analysis involves comparing current year figures with the previous year figures

Basis : Financial Statements generated above in summarizing

Example : Net Profit Ratio - The Sales and Net Profit is compared to find out the % of Net Profit earned on Sales. This helps to ascertain how much sales have to be achieved, to make specified net profits.

For Eg. If NP Ratio is 20% on sales and a businessman wants to achieve net profits of ` 20 Lakhs in a year, then he must make a sale of ` 100 Lakhs (20 Lakhs / 20%) during that year.

5. Interpreting:

Meaning : Drawing observations from the items in the financial statements and also from relationships determined in analyzing process

Purpose : The recorded financial data is analysed and interpreted in the manner that will enable the data users to make a meaningful judgment about the financial condition and profitability of the business operation.

Nature of process : Financial Statements are interpreted to explain **what had** happened, **why** it had happened and **what is likely** to happen under specified conditions.

Based on analysed information, interpretation shall be done.

Basis : Financial Statements generated in summarizing process and relationships determined in Analyzing process.

Example : Assuming the NP ratio for 2011 is 20% on sales, whereas it was 15% in 2010. Similarly the expenses ratio for 2011 is 80% on sales, whereas it was 85% in 2010.

This means the profit has increased mainly due to decrease in expenses, (so the increase is not due to increase in sales)

6. Communicating:

Meaning : It is concerned with the transmission of summarised analysed and interpreted information to the end user to enable them to make rational decisions.

Modes : This is done through preparation and distribution of Accounting Reports, which includes Profit and Loss Account and Balance Sheet, additional information in the form of Accounting Ratios, Graphs, Diagrams, Funds Flow Statement, etc.

4. Objectives and Functions of Accounting

The objectives of Accounting are -

1. To have a **systematic record all business transactions** which are of financial nature.
2. To know the **result of business operations** for a particular period of time. If Revenue / Income exceeds the Expenses, then it is said that the business is running profitably, but if the Expenses exceed the Revenue, then the business is operating at a loss.
3. To know the **financial position** of the business. This will help answer questions like how much Assets and Liabilities that the business has on any date, whether the business is solvent, i.e. ability to meet its liabilities in the short run and also in the long run as and when they fall due.
4. To provide **information to Users for decision making.** Accounting, as the language of business, communicates the financial result of enterprises, to various Users. Accounting aims to meet the information needs of the decision maker **and help them in rational decision making.**

Objectives of Accounting

Systematic record of all business transactions : Book-keeping, i.e. Journal, Ledger and Trial Balance

Ascertainment of results of business operation : Trading and Profit & Loss Account

Ascertainment of financial position : Balance Sheet

Providing information to Users : Financial Statements and Reports

5. Functions of Accounting

The **American Principles Board** of the **AICPA** enumerated the following functions of accounting:

1. **Measurement:** Accounting measures the performance of the business entity and depicts its current financial position.
2. **Forecasting:** Accounting helps in forecasting future performance and financial position of enterprise using past data.
3. **Decision-making:** Accounting provides relevant information to the Users of accounts to aid rational decision-making.
4. **Comparison & Evaluation:** Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and Contingent Liabilities, which play an important role in predicting, comparing and evaluating the financial results.
5. **Control:** Accounting identifies weaknesses in the operational system and provides feedback regarding effectiveness of measures to rectify such weaknesses.
6. **Government Regulation:** Accounting provides necessary information to the Government, to exercise control on the entity as well as in collection of direct and indirect tax revenues.

6. Book-Keeping - Meaning and Features

Meaning : It is an activity of **recording and classifying** the financial data relating to business operations in a significant and orderly manner.

Objective :

- Complete recording of transactions.
- Ascertainment of financial effect on the business.

Features :

- It is an art of scientifically **recording** the transactions.
- The recording is done only in **monetary terms.**
- Recording of transaction is restricted only to that of a **particular enterprise.**
- The recordings are made in a given set of **books.**

Advantages :

- From the Financial Statements, financial information is **readily available** to the Users.
- **Qualitative financial decisions** can be taken, since the financial information is reliable.
- Valuable **conclusions** can be drawn on comparing the books of different years of the same, enterprise, or comparing books of the same period for different enterprise.
- Financial accounts of an enterprise are treated as **evidence** in a Court of Law.
- Maintaining records of various assets helps **control,** i.e. to ensure there is no unauthorized use or disposal of any asset or property of the business.

7. Book-Keeping Vs Accounting

	Basis	Book-keeping	Accounting
1	**Scope**	Book-keeping involves - (a) Identifying the transactions, (b) Measuring the identified transactions, (c) Recording the measured transactions, (d) Classifying the recorded transactions.	In addition to book-keeping, Accounting involves- (a) Summarizing the classified transactions, (b) Analyzing the summarized results, (c) Interpreting the analysed results, and (d) Communicating the information to interested parties.
2	**Stage**	Book-keeping is the primary stage, (i.e. record-keeping phase)	Accounting is the secondary (summarizing) stage. It starts where book-keeping ends.
3	**Basic Objective**	To maintain systematic records of financial transactions.	To ascertain net results of operations and financial position and to communicate information to the interested parties.
4	**Person**	Book-keeping is done by Junior Staff.	Accounting work is performed by Senior Staff.
5	**Knowledge level**	Book-Keeper is not required to have higher level of knowledge than an accountant.	Accountant is required to have higher level of knowledge than that of Book-Keeper.
6	**Analytical skills**	Book-Keeper may or may not possess analytical skills.	Accountant is required to possess analytical skills.
7	**Nature of job**	The job of a Book-Keeper is often routine and clerical in nature.	The job of an Accountant is analytical in nature.
8	**Designing of System**	It does not cover designing of accounts system.	It covers designing of accounting system.
9	**Supervision**	The Book-Keeper does not supervise and check the work of an Accountant.	An Accountant supervises and checks the work of a Book-Keeper.
10	**Financial**	Financial position of the business cannot be ascertained through book keeping	Financial position of the business is ascertained based on the accounting reports.
11	**Financial Statements**	Financial Statements do not form a part of the book-keeping process.	Financial Statements are part of the accounting process. These Statements are prepared based on book-keeping records.
12	**Managerial decision**	Managerial decision cannot be taken with the help of book-keeping records alone.	Management can take decision on the basis of accounting records and statements.
13	**Sub-fields**	There are no sub-fields for Book-Keeping.	It has several sub-fields such as Financial Accounting, Management Accounting, etc.

Notes In terms of scope, Book-Keeping < Accounting < Accountancy.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. Which of the following is not a subfield of accounting?
(a) Management accounting.
(b) Cost accounting.
(c) Book-keeping

2. Purposes of an accounting system include all the following except
(a) Interpret and record the effects of business transaction.
(b) Classify the effects of transactions to facilitate the preparation of reports.
(c) Dictate the specific types of business enterprise transactions that the enterprises may engage in.

3. Bookkeeping is mainly concerned with
(a) Recording of financial data.
(b) Designing the systems in recording, classifying and summarising the recorded data.
(c) Interpreting the data for internal and external users.

4. All of the following are functions of Accounting except
(a) Decision making.
(b) Ledger posting.
(c) Forecasting.

5. Financial statements are part of
(a) Accounting.
(b) Bookkeeping.
(c) Management Accounting.

6. Financial position of the business is ascertained on the basis of
(a) Records prepared under bookkeeping process.
(b) Trial balance.
(c) Balance Sheet.

7. Users of accounting information include
(a) Creditors/Suppliers
(b) Lenders/ Customers
(c) Both (a) and (b)

8. Financial statements do not consider
(a) Assets expressed in monetary terms.
(b) Liabilities expressed in monetary terms.
(c) Assets and liabilities expressed in non-monetary terms

9. On January 1, Sohan paid rent of ` 5,000. This can be classified as
(a) An event.
(b) A transaction.
(c) A transaction as well as an event.

10. On March 31, 2015 after sale of goods worth ` 2,000, he is left with the closing inventory of ` 10,000. This is
(a) An event.
(b) A transaction.
(c) A transaction as well as an event.

HOME WORK

THEORY QUESTIONS

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

2. Who are the users of accounts?

3. Discuss briefly the relationship of accounting with

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

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

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

UNIT : 2
ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

INTRODUCTION

Accounting is a language of the business. Financial statements prepared by the accountant communicate financial information to the various stakeholders for decision-making purpose. Therefore, it is important that financial statements prepared by different organizations should be prepared on uniform basis. Also there should be consistency over a period of time in the preparation of these financial statements. If every accountant starts following his own norms and notions for accounting of different items then there will be an utter confusion.

1. Fundamental Accounting Assumptions

1. Going Concern:

(a) The enterprise is normally viewed as Going Concern, i.e. **continuing** in operation for the foreseeable future (endlessly)..

(b) It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of reducing substantially its level of operations.

(c) **For Example** - When we invest in shares of Reliance Company, we normally assume that the company's operations will be continued. We do not expect the company to be closed.

(d) **Exception to Going Concern Assumption** - Joint Venture (Which is created for specific purpose / period)

(e) *Going Concern is also considered as one of the accounting concepts.*

(f) **Significance:**

➲ The Going Concern Convention is important for valuation of assets and liabilities.

➲ It indicates the need to value the assets based on the future returns that can be earned from such assets.

➲ Based on Going Concern Assumption, Historical Cost is used for measuring / valuing Fixed Assets. If the Going Concern assumption becomes inappropriate (i.e. if the enterprise cannot be taken as a going concern) then assets should be valued at their Net Realisable Value, i.e. if the business is to be closed, then the assets must be valued at Market Values and not at cost.

2. **Consistency:**

(a) **Meaning:** The accounting principles followed by the entity shall be consistent i.e. the same, over a period of time. Frequent changes in accounting policies will distort comparison.

(b) **Example:** If one year, a particular payment is treated as expense, then the assumption is that the subsequent years also it shall be treated only as an expense,

(c) Consistency is also considered as one of the Accounting Concepts.

(d) **Exception:** As per Consistency Concept, a change in an accounting policy should be made only -

- If the adoption of a different accounting policy is required by Statute, or
- For compliance with an Accounting Standard, or

- If it is considered that the change would result in a more appropriate presentation of the Financial Statements of the enterprise.

3. **Accrual:**

   (a) Revenue and Costs are **"accrued",** i.e. recognized as they are earned or incurred and recorded in the Financial Statements of the period to which they **relate,** and not when money is received or paid.

   (b) For Eg. If a sale for ` 10,000 is made on credit to a person in 2011, but the settlement is received in 2012. In this case, ` 10,000 shall be treated as income in 2011 (in the year of accrual) and not in 2012. (year of receipt)

   (c) *Accrual is also treated as **one of the Accounting Concepts.***

Disclosure Requirements

If the above assumptions are **followed in** preparing accounts	If the above assumptions are **not followed**
Separate disclosure is **not required,** since their acceptance and use **are assumed.**	Disclosure is **necessary,** *specifying that the general* accounting assumptions are not followed

Students' Note: Accrual Vs Receipt

(a) "Accrual" means "right to **receive/obligation to pay** money". "Receipt" means **"Actual Receipt/Payment** of money"

(b) "Accrual Basis" is otherwise called as "Mercantile Basis"

(c) **Example:** B Sold to A for ` 10,000 on 01.01.2011 on credit for 60 days. In this case, B has a right to receive money from A but he can actually receive money only on 02.03.2011 (after 60 days). Hence, ` 10,000 has accrued on 01.01.2011, but it is received on 02.03.2011. Sales will be recorded on 01.01.2011 and not on 02.03.2011.

2. Accounting Concepts

Business Entity

1. **Meaning:** The business enterprise is a **separate identity and distinct** from that of its Owners or Managers. The Owner of the business and the business as such is treated as two different persons.

2. **Impact of above concept:** All transactions are classified into - (a) Business Transactions, and (b) Personal Transactions. Business Transactions are recorded in the books of accounts of the business. Owner's Personal transactions are recorded in his personal book of account and not in the books of the business.

3. **Example:**

   (a) Mr.A is a owner of a CA firm "M/s A & Co." The profits arising from M/s A & Co. belong to Mr.A only. However, for accounting purposes, Mr.A is a different person and M/s A & Co. is a different person.

   (b) Accounting will be done only for the transactions in which M/s A & Co is involved and not for A's personal transactions

4. **Accounting Entity:** The entity for which the accounting is to be made may be

   Business Undertakings : (a) Business Unit itself (i.e. Sole Proprietorship Firm, Partnership Firm, Company or Government Undertaking), or (b) a defined part of a business (i.e. a department), or (c) a combination of related businesses (i.e. Holding and Subsidiary Company) depending on the User's needs.

Non-Business Undertakings : Trusts, Club, Religious Bodies or Government

5. **Impact on Accounting:** The entity concept has the following impact for accounting -

(a) **Business Viewpoint:** All transactions are recorded from the viewpoint of the entity itself and not from the viewpoint of other parties such as Owners, Managers or Customers.

(b) **Owner-Business transactions:** This concept leads to Lender - Borrower relationship between the business and the owner of the business.

Event	**From Business' View**	**Treatment**
Owner invests money in business	It is money borrowed by business from the owner and hence is a liability	Capital (Note)
Owner withdraws money from business	It is repayment of loan by the business to the owner	Drawings (Note)
Profits of the Business	Whatever profits earned by the business belong to the owner. Hence, profits are also considered as liability of the business to the owner.	Added to Capital
Losses of the Business	Similar to profits, losses also belong to the owner. But, losses will reduce the amount due to the owner	Reduced from Capital

Note: The above terms are used to distinguish the owners loans /repayments from other persons'loans / repayment.

(c) **Owner Vs Business Transactions:**

- The Owner's Personal transactions are not recorded in the Books of Accounts of the Business.
- For eg. If the owner purchases Television for his home, it shall not be recorded in the books of the business **(Reason:** This is to find out the true profits and true financial position of the business. If the owner's personal-a transactions are combined with business transactions, then the every purpose of accounts will be lost)

(d) **Payments to Owners Vs Payments to Others:**

- Payments to outsiders represent the expenses for operating the business. For eg. Rent, Interest on Loans etc
- Payments of profits to the owners like dividend etc. are not treated as expenses

(e) The Entity Concept gives meaning to the basic accounting equation - Equity + Liabilities = Assets.

Money Measurement

1. **Meaning:** Accounting data must be quantified so that data can be aggregated and hence summarized. Hence transactions and events should be measured in terms of money. Transactions are recorded in books of account, in the **ruling currency of the country where the books of accounts are prepared.**

2. **Common Unit:** A common measuring unit in terms of money helps to - (a) quantify data, and (b) enable determination of profit / loss and financial position. For example, the **Rupee** is the common unit of measurement for economic events and transactions in India. It is the legal tender used as the medium of exchange in market transactions.

3. **Justification of Money Measurement:**

(a) All transactions should be measured in terms of money.

(b) Managerial planning and control must take shape in monetary terms. The profit objective should be stated in monetary denominations in order to make performance evaluation meaningful.

(c) It is used for providing financial information to Shareholders, employees and a variety of other users who -need such information for decision-making.

4. **Criticism of Money Measurement:**

(a) **Value of money erodes** over a period of time. Future Cash Flows have a lower value than the Present Cash Flows. Hence, money by it self is not a meaningful measurement base.

Example: One kg of Onion in 2010 was ` 40; But the same one kg of onion in 2011 is ` 80. This implies that the **real value of money has gone down.** However, this is not reflected in money measurement concept.

(b) **Exchange value of a currency** (e.g. Rupee) in relation to other currency **is not constant** over a time period. Hence, money does not provide a stable measurement yardstick.

(c) **Many material transactions and events are not recorded** in the books of accounts just because they **cannot be measured** in terms of **money.** For eg. Appointment of new Chairman for the Company.

5. **Impact on Accounting:**

(a) As per Money Measurement Concept, only those transaction, which are capable of being measured in terms of money are recorded in the books of accounts, that too in the ruling currency of the country, e.g. in Rupees in India, in Dollars in USA, in Pounds in UK.

(b) Transactions which are not in monetary terms, even if they affect the results of the business materially, are not recorded in the book of accounts.

Note: Entity and Money Measurement Concepts are the **basic concepts** on which the other procedural concepts depend.

Periodicity or Accounting Period

1. **Need:** As per the Going Concern Assumption, the enterprise has an indefinite life. However, it is necessary to sub-**divide such indefinite period** into a **smaller time units** for (a) measurement of performance; (b) understanding the financial position of the enterprise and (c) control over operations. Such smaller and usable time-frame for reporting purposes is called **Accounting Period.**

2. **Meaning:**

(a) Hence, during the life-time of an entity, Financial Statements can be prepared in periodic intervals of time. The economic life of an enterprise is split into the periodic interval (being a financial year).

(b) As per Periodicity Concept, the Financial Statements should be prepared after **every accounting / financial period, and not at the end of the life of the entity.**

(c) Generally, a period of 12 months (i.e. one year) is considered as the accounting period, by most enterprises. In the corporate sector, Interim Financial Reporting is also prevalent. The length of the accounting period is also determined by the statute in certain cases.

Note: Normally the term “Financial Year” refers to the period for which the accounts are prepared. It is usually taken as the period from 1st April to 31st March of the next year.

3. **Periodicity Concept facilitates in -**
   (a) Comparison of Financial Statements of different periods,
   (b) Uniform and consistent accounting treatment for ascertaining the profit and assets of the business,
   (c) Matching periodic revenues with expenses for getting correct result of the business operations.
4. **Expense Classification:** Based on the Periodicity Concept, expenses are classified into
   (a) Capital : They create an enduring benefit, (say, for 7 to 10 years) **Example:** Factory Building, Machinery, Motor Car, Land etc. ***They are otherwise called as "Fixed Assets".***

   They are **deducted** from Income **over their useful** in **a specified proportion. This deduction is otherwise called as "Depreciation".**

   (b) Revenue : They result in benefit which is fully used within **one** financial period

   Example: Rent, Repairs, Insurance, Salary etc. They are otherwise called as **"Expenses"**

   They are **deducted** from Income **in FULL** in the **period in which they are incurred.**

   (c) Deferred Revenue : They take the nature of both revenue and capital expenditure. They are **revenue expenditure which provide benefits for 3 to 5 years.**

   Example: Advertisement. It is strictly a revenue expenditure, but as the benefits from advertisement may arise for 3 to 5 years, it is *deferred and treated as revenue in 3 to 5 years*

They are **deducted** from Income over the periods in which the benefits arise.

Exception: In Joint Venture Accounting, the above classification of Capital and Revenue Expenditure is not applicable, **as the Venture is only for a specific duration, and not on long-term basis.**

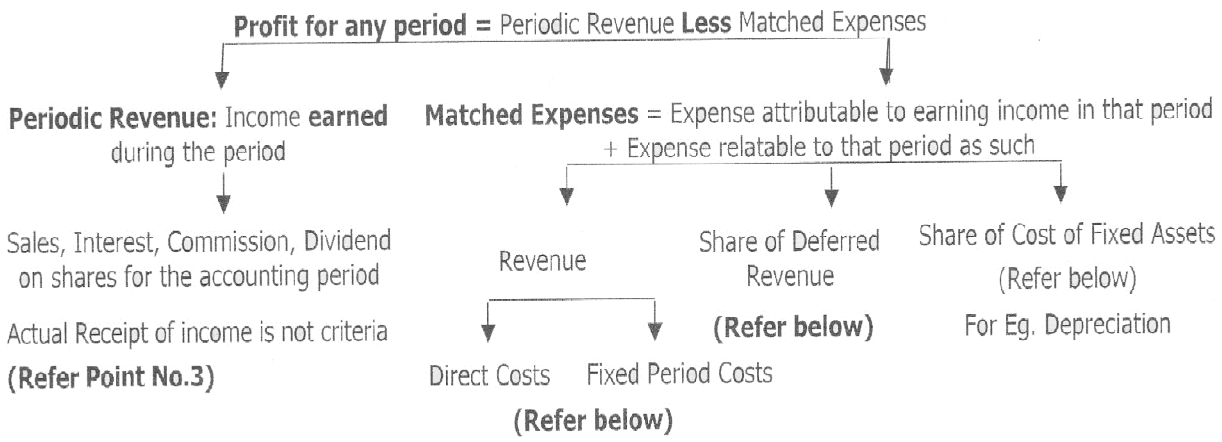
Accrual

1. **Meaning :** "Accrual" means recognition of revenue as they are earned and the cost as they are incurred and not when money is received or paid. This Concept relates to measurement of income, identifying assets and liabilities.
2. **Method :** Under Accrual Concept, all transactions and events are recognized on **mercantile basis,** i.e. as they are earned or incurred, and recorded in the Financial Statements of the period to which they **relate,** and not when cash **is** actually received or paid.
3. As per Accrual Concept, **Profits = Revenue - Expenses**
   (a) **Revenue** = Gross Inflow of Cash, Receivables and other consideration arising in the course of ordinary activities *of* an enterprise from sale of goods, from rendering services, and from the use by others of enterprise's resources yielding interest, royalties and dividends.
   (b) **Expenses** = Cost relating to the operations of an accounting period, or to the revenue earned during the period, or the benefits of which do not extend beyond that period.

Matching

1. **Meaning:**
   (a) Performance of a business entity is measured with reference to a specific accounting period.
   (b) Hence, to determine the profits for a particular period, Revenue **earned** in that period **should be matched** the expenses **incurred** for earning such revenue.

2. **Impact of Matching Concept:** As per Matching Concept.



Notes:

(a) **Direct Costs** - Expenses directly related to output / sales of an enterprise, e.g. Materials Consumed, Labour etc.

(b) **Fixed Period Costs** - Expenses incurred over the period and not directly related to the goods / services sold/rendered by the enterprise. It may be difficult to relate such expenditure with the revenue earned, e.g.Salaries,
Office Rent, Insurance Premium etc.

(c) **Deferred Revenue Expenditure - Refer Periodicity Concept:** e.g. Advertisement, Research & Development etc.

(d) **Fixed Assets** - Expenses spent on fixed assets for the production of goods and services, for a longer time frame The cost of assets to be charged as depreciation against the revenue of a particular period is a matter of judgment.

3. **Nature of Income / Expenses:**

Particulars	**Income**	**Expenses**
Inclusions	**Sale/Service ren**dered but money not received. **Outstanding Income / Accrued Income)**	Services received / purchases made but money **not paid (Outstanding Expenses / Sundry Creditors)**
Exclusions	Advances received before sale / service is not income **(Income received in advance)**	Advances paid before purchases made / services received **(Prepaid Expenses/ Expenses paid in advance)**

4. **Impact:** The Accrual Concept, together with Periodicity and Matching concepts, give rise to the recognition of -(a) Prepaid Expenses (b) Outstanding Expenses (c) Income Receivable and (d) Income Received in Advance.

Cost

1. **Meaning:** As per Cost Concept, Value of an asset as shown in the Balance Sheet must be its Historical Cost, i.e. Acquisition Cost. This is the conventionally adopted measurement base for valuation of assets.

2. **Significance / Merits:**
   (a) Historical Cost is **objective** and free from bias.
   (b) Historical Cost is **easier to ascertain** than Current Cost, Present Value, etc.
   (c) Historical Cost represents an **actual figure** / outflow of resources for acquiring the asset, and does not reflect a hypothetical or notional figure.

3. **Criticism:** Historical Cost is criticized on the following grounds -(a) Historical Cost **does not reflect the true value** of the asset, particularly in an inflationary situation.(b) Financial Statements prepared on the basis of Cost Concept loses comparability.(c) Many assets (like Human Resources) do not have acquisition costs. Cost Concept fails to recognize such assets.

   Note: Due to the above criticism, other measurement bases like Current Costs, Net Realisable Value, Present Value, etc. are suggested.

Realisation

1. **Meaning:** As per Realisation Concept, An asset is recorded at its Historical Cost and any change in its value should only be recognised when it is realized, i.e. at the time of its actual sale / disposal.
2. **Concept:** It emphasises that there is no certainty of income until a sale has been made and hence increases in value of the asset should not be taken into account unless it is actually realised.
3. **Criticism:** However, Realisation Concept is criticised by arguing that if the value of an asset has been permanently changed, Profit or Loss arising out of such change should be considered to reflect true and fair financial position of the enterprise. Otherwise, accounting will become distorted and meaningless.
4. **Revaluation:** So, Fixed Assets may be revalued periodically. However, selective revaluation of an asset may lead to unrepresentative or misleading amounts being reported in Financial Statements. Hence, revaluation of assets should be done on a systematic basis. For Example, all machineries shall be revalued rather than a single machinery.

   Fair Value: *Thus the Realisation Concept is slowly being replaced by the recognition of assets at their Fair Market Value (Fair Value Accounting Concept). However Accountants follow a more conservative path. They try to cover all probable losses but do not count probable gains.*

Dual Aspect

1 **Meaning:** The Dual Aspect Concept is the **core of double entry book-keeping.**
2. **Basis:** As per this concept, **every transaction or event has two aspects,** which have to be recorded in the books. The amounts of both the aspects are equal.
3. The possible combinations of the effects of each transaction is as under -

1st Aspect	2nd Aspect	Example	Effect of Transaction
Increase in one Asset	Decrease in another Asset	Purchase of Machine for ` 40,000 by paying cash.	• Machinery A/c increased by `40,000 • Cash A/c decreased, by `40,000.
Increases an Asset	Increases a Liability	Purchase of goods for ` 90,000 on credit.	• Stock A/c increased, by 90,000, & • Creditors A/c increased by ` 90,000.
Decreases an Asset	Decreases a Liability to Creditors	Payment of Cash `20,000	• Cash A/c decreased, by ` 20,000 & • Creditors A/c decrease ` 20,000.
Increases one Liability	Decreases another Liability	Creditors paid from Bank Overdraft ` 10,000	• Bank O/D increased by ` 10,000 • Creditors Decrease by ` 10,000

4. **Significance:** This concept gives rise to the accounting equation: **"CAPITAL + LIABILITIES = ASSETS".** This equation can take many forms, and some forms are given below -

Capital + Liabilities	=	Assets
Equity (i.e. Capital) + External Liabilities	=	Fixed Assets + Current Assets
Equity + Long Term Liabilities + Current Liabilities	=	Fixed Assets + Current Assets
Equity + Long Term Liabilities	=	Fixed Assets + (Current Assets - Current Liabilities)
Equity + Long Term Liabilities	=	Fixed Assets + Net Working Capital
Equity	=	Fixed Assets + Net Working Capital - Long Term Liabilities
Capital + Income / Profits + Liabilities	=	Assets + Net Loss + Expenses

Note: Closing Capital = Opening Capital (±) Profits/(Losses) during the year (+) Additional Capital (-) Drawings (+) Interest on Capital (-) Interest on Drawings

Note: Capital is otherwise called as Equity. Both the sides of the equations shall always tally.

Full Disclosure

Meaning: As per this concept, all the events and transactions which are relevant shall be **disclosed** in the Books of Accounts and the Financial Statements. The events may relate to the current or the subsequent Accounting Periods.

Purpose: The users of the Financial Statements must be aware of all relevant events and transactions to understand the real position of the business.

Disclosure: The term "Disclosure" means that **a statement describing the event / transaction** (including the amount involved) should be added to the financial statements **as a note therein.** *(Disclosure is not same as accounting. Accounting means Accounting Entries will be passed, whereas in disclosure, a mere statement is given; Journal Entry not passed.)*

Example: The legal suit filed against a company for violation of copyrights shall be disclosed as part of the financial statements, though it cannot be measured accurately.

Exception: The **Conventions of Materiality and Conservatism are exceptions to the Concept of Full Disclosure,**due to following reasons:

(a) **Materiality Vs Full Disclosure: (Refer Materiality Convention below)**
- As per Full Disclosure, **all relevant events and transactions** must be disclosed.
- As per Materiality, Accounting Principles to be applied **only for MATERIAL events & transactions and not for all.**

(b) Conservatism **Vs Full Disclosure: (Refer Conservatism Convention below)**
- *As per* Full Disclosure, **all relevant events and transactions** must be disclosed
- As per Conservatism, only those events and transactions which lead to **Possible Losses** must be accounted and disclosed . **Unrealised profits shall not be accounted / disclosed.**

Substance over Legal Form

1. **Meaning:** The accounting treatment presentation in Financial Statements, of transactions and events, should be ***governed by their substance and not merely by the legal form.***
2. **For Example,**
   (a) **Sale of Land & Building without Registration;** If the Firm has sold its Land and Building, received the consideration and handed over the possession to the Buyer, it **should be recorded as Sale** of Land and Building. This recognition **cannot be postponed for mere procedural formality** pending, e.g. registration of Sale Deed.
   (b) **Hire Purchase - Considered as sale:** In case of an asset required on Hire Purchase, ownership is not transferred till last installment is paid. However, the asset is shown in the books of the Hire Purchaser.
   (c) **Financing Agreement:** A Ltd enters into an agreement with B Ltd for sale goods at `2,50,000. However, the same goods are to be repurchased in the next year for `2,75,000. This is **not** a **trading** transaction, and effectively **reflects a financing transaction.** It should be recorded only as a **financing transaction.**

3. Accounting Conventions

Conservatism Convention

1. **Meaning:**(a) Conservatism or Prudence demands that **unrealised profits and gains should not be recognised** in accounts. However, **provision** should be **made for all actual and possible losses.**(b) The Accountants should not anticipate income, but should provide all possible losses.
2. **Example:** Assume that Mr.Z is dealing in two commodities - Pen and Pencil. The following details are given -

Particulars	**Pen**	**Pencil**
Quantity in Stock on 31.03.2011	10,000 Nos.	15,000 Nos.
Cost of purchase of above stocks	` 10 / Pen	` 5 / Pencil
Market Value of stock on 31.3.2011	` 8 / Pen	` 8 / Pencil
Relevant amount for valuation	` 8 / Pen	` 5 / Pencil
Stock Value on 31.03.2011	` 80,000	` 75,000
Treatment	Expected Loss to be recognised	Unrealized loss not to be recognised
Reasoning	There is a Possible loss of `2/Pen, totaling upto `20,000	There is an expected gain of ` 3/pen, but that will not be considered as it is not sold

3. **Applications of Conservatism Convention:**
   (a) **Choice among different methods of Valuation:** If there is a choice between two methods of valuing an asset, the Accountant should choose a method which leads to the lesser value, e.g. Current Assets are valued at Cost or NRV, whichever is lower.
   (b) **Market Value Vs Book Value:** If the market value of the fixed assets is greater than the Book Value of fixed assets, then the difference between Market Value and Book Value shall not be recorded in the books of accounts as it is not realized profits.
   (c) This concept prohibits Window Dressing. **(It means manipulating the financial statements to make them attractive viz. inflating the profits, suppressing expenses, treating revenue expenditure as capital expenditure etc.)**
   (d) **Exceptions:** It is considered as an exception to (a) Full Disclosure Concept (b) Consistency Concept.
4. **Advantages:** This Concept has led to the following qualitative characteristics of Financial Statements - (a) Prudence, (b) Neutrality, and (c) Faithful representation of alternative values.
5. **Disadvantages:**
   (a) Conservatism is **subjective** as the amount of possible losses may be quantified by different persons in a different manner and hence the loss amount determined by different persons **may not be the same.**
   (b) If the principle of Conservatism is **stretched without reservation,** it may result in - (a) Creation of Secret Reserves, (b) Violation of the Doctrine of Full Disclosure, and (c) Reported Profits being less than Actual Profits.
   (c) Conservatism is an exception to the doctrine of full disclosure **(Refer Exception under Full Disclosure)**

Materiality Convention

1 **Meaning:** As per Materiality Concept, all items having **significant** economic effect on the business should be disclosed in the Financial Statements.
2. **Material items** refer to the items in the financial statements the knowledge of which might influence the decisions **of** the users of Financial Statements.
3. **Examples:**
   (a) **Stationery** (like Notebooks, Calculator) purchased by the Firm, though not used fully in the accounting year purchased, is still shown as an expense of that year because of the Materiality concept. This is because the amount of such Stationery is very small to be shown as asset though it constitutes Assets of the Firm.
   (b) Payment of penalties/fines for violation of law should be disclosed separately, even if the amount **is** negligible. It should not be clubbed together with "Office Expenses" or "Miscellaneous Expenses".
4. **Factors:** Materiality depends on the size and nature of the items or errors, judged in the particular circumstances of its misstatement.
5. **Advantage:** Materiality provides a threshold or cut-off point for classifying the amounts into assets or expenses.
6. **Exception:** This principle is an exception to the full disclosure principle.
7. **Disadvantage:** Materiality is more a subjective and a judgmental principle.
   Example, ` 10,000 spent on advertisement may be material for a small firm with sales of ` 1 Lakh; However, the same amount is not material for a company like reliance.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. All the following items are classified as fundamental accounting assumptions except

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

2. Two primary qualitative characteristics of financial statements are

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

(c) Neutrality and understandability.

3. Kanika Enterprises follows the written down value method of depreciating machinery year after year due to

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

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

(a) Total assets increased by ` 5,00,000.

(b) Total liabilities increased by ` 4,00,000.

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

5. Mohan purchased goods for `15,00,000 and sold 4/5th of the goods amounting `18,00,000 and met expenses amounting ` 2,50,000 during the year, 2015. He counted net profit as ` 3,50,000.

Which of the accounting concept was followed by him?

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

6. A businessman purchased goods for ` 25,00,000 and sold 80% of such goods during the accounting year ended 31st March, 2017. The market value of the remaining goods was ` 4,00,000. He valued the closing Inventory at cost. He violated the concept of

(a) Money measurement. (b) Conservatism. (c) Cost.

7. Capital brought in by the proprietor is an example of

(a) Increase in asset and increase in liability.

(b) Increase in liability and decrease in asset.

(c) Increase in asset and decrease in liability

8. Assets are held in the business for the purpose of

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

9. Revenue from sale of products, is generally, realized in the period in which

(a) Cash is collected. (b) Sale is made.

(c) Products are manufactured.

10. The concept of conservatism when applied to the balance sheet results in

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

(c) Overstatement of capital.

11. Decrease in the amount of trade payables results in
(a) Increase in cash. (b) Decrease in bank over draft account.
(c) Decrease in assets.

12. The determination of expenses for an accounting period is based on the principle of
(a) Objectivity. (b) Materiality. (c) Matching.

13. Economic life of an enterprise is split into the periodic interval to measure its performance is as per
(a) Entity. (b) Matching. (c) Periodicity.

14. If an individual asset is increased, there will be a corresponding
(a) Increase of another asset or increase of capital.
(b) Decrease of another asset or increase of liability.
(c) Decrease of specific liability or decrease of capital.

15. Purchase of machinery for cash
(a) Decreases total assets.
(b) Increases total assets.
(c) Retains total assets unchanged.

16. Consider the following data pertaining to Alpha Ltd.:

Particulars	`
Cost of machinery purchased on 1st April, 2016	10,00,000
Installation charges	1,00,000
Market value as on 31st March, 2017	12,00,000

While finalizing the annual accounts, if the company values the machinery at ` 12,00,000. Which of the following concepts is violated by the Alpha Ltd.?
(a) Cost. (b) Matching. (c) Accrual

HOME WORK

THEORETICAL QUESTIONS

1. Write short notes on:
(i) Fundamental accounting assumptions.
(ii) Periodicity concept.
(iii) Accounting conventions.

2. Distinguish between:
(i) Money measurement concept and matching concept
(ii) Going concern and cost concept

3. Brifley explain the qualitative characteristics of the financial statements.

UNIT : 3
ACCOUNTING TERMINOLOGY - GLOSSARY

GLOSSARY OF SIGNIFICANT TERMS

INTRODUCATION

Business

- It represents the **set of activities** which are regularly carried on by a person or an organisation for the **purpose of earning profits** from such activities.
- **For Example -**
  - (i) A Tea shop owner regularly prepares tea and sells it in glasses to his customers.
  - (ii) Reliance Communications regularly sells mobile phones to the customers.
- Profit Motive is involved in Business. ***(Note:** The business may actually lead to losses. But motive is to earn profits)*
- Business may be
  - (i) **Manufacturing** - Purchasing Raw Materials, Converting them into Finished Goods and selling the goods.
  - (ii) **Trading** - Buying Finished Goods and selling them **as such** without any conversion.
  - (iii) **Service** - Rendering services to clients Eg. Doctors, Chartered Accountants etc. **(Note:** No Goods)

Goods

- Items / Products / Articles which are **regularly** traded by the businessman are called "Goods".
- Eg. For a Mobile Shop owner, mobile phones are "goods", as he regularly purchases and sells them.
- However, for the same mobile shop owner, if he purchases one motor bike for carrying the mobile phones, then the motor bike is **not considered** as goods for him.

Cost/ - HIstorical Cost

- It represents the **amount actually spent** or the **liability actually incurred.**
- For eg. Assume that a land is purchased for ` 100 Lakhs, but its market value is ` 150 Lakhs. In this case, the Historical Cost is ` 100 Lakhs only.

Purchases : (From Buyer's angle) It refers to **Buying of Finished Goods / Raw Materials** by one person from another person for consideration. **[Note:** Sale by one party is the purchase for another party.]

FInished Goods : It refers to the **products manufactured** by the manufacturer. For a trader, the goods purchased and sold by him are called finished goods.

Sales (from the angle of seller)

- "Sales" refers to "Transfer of **ownership in goods** from one person to another for a consideration"
- Hence, 3 Conditions for sale are - (a) Transfer of **Ownership** (b) Ownership must be in **goods** (c) Consideration - Some money or money's worth must be given by one person to another.
- **Transfer of Ownership:** Ownership in goods is transferred when the risks of loss and rewards relating to such goods are transferred.
- **Example:**
  - (i) Mr.X buys one Mobile phone from Mr.Y. When Mr.X comes out of Y's shop, somebody stole the

mobile phone. In this case, the **loss of mobile phone due to theft is to be borne by Mr.X and NOT by Mr.Y.**

(ii) However, if the same mobile phone is stolen when it is kept in the display of Mr.Y's shop, then Mr.Y shall bear the loss of mobile phone.

(iii) Thus in the above case, there is a transfer of **risk of loss** from Mr.Y to Mr.X after the purchase of mobile phone. When there is transfer of risk, it is considered as transfer of ownership and ence sate.

- **Sale of properties other than goods:** If **items other than goods** are sold (For eg. Motor Car), then it is not considered as "Sales" for Accounting purposes. It is referred by the name of the respective iter. Hence, if mobile phone dealer sells motor car, it is **NOT referred by the general name** of "Sales", **but is referred** as "Motor Car Sold".

Raw Materials : (Applicable only for manufacturing business) It refers to the base materials from which finished goods are manufactured. [For Eg - Water Bottles are made from Plastics. In this case, water bottles are finished goods whereas plastics are raw materials.]. For a trader, there is no raw material as he does not produce anything.

Stock

- It refer the **balance Finished Goods / Raw Materials** existing at the beginning or end of = specified period.
- Closing Stock - Stock at the end of a specified period.
- Opening Stock - Stock at the beginning of the period.
- **Example** - Mr.A purchased 10,000 kgs of sugar in 2011. He sold 8,000 kgs throughout 2011. In this case, the stock on 31.12.2011 is 2,000 kgs of Sugar. This is closing stock on 31.12.2011.

  On 01.01.2012, the above stock of 2,000 kgs is carried forward from 2011. This is Opening Stock *on* 01.01.2012.

Assets

(i) **Technical Definition:** An Asset is a resource controlled by the enterprise as a result of past events are from which future economic benefits are expected to flow to the enterprise.

(ii) **General Definition:** Properties of the business / Amounts receivable from others by the business Eg Stock, Land, Building, Debtors etc. (Detailed Meaning in the next chapter)

Debtors : Persons from whom the business has to receive money, due to **credit sales** made to them.

Liabilities : Amounts payable by the business to outsiders and includes capital. For eg. Bank Loans, Expenses not yet paid.

Creditors : Persons to whom the business has to pay money due to **credit purchases** made from them.

Capital : Amount invested by the owner into the business

Drawings : Cash / Goods **drawn** by the owner for his **personal purposes.** It decreases the capital.

Profits : Incomes - Expenses

Income/ Revenue : Amount receivable due to Sales / any other amount receivable arising out of the regular operations of the business. For Eg. Interest, Commission etc. ***(Note:** This excludes loan amounts received/ amounts received from debtors).*

Expenses : Amount spent to derive benefit for an accounting period. For Eg. Rent paid for the benefit of occupying a building for 12 Months.

Losses : Amount spent but no benefit is derived / Amount not recoverable from debtors. For eg. Stocks lost due to fire.

Bank Overdraft : It is Bank Account. However, in this account, the *account* holder is *allowed to withdraw over and above the* existing balance. For Eg. Assume that Mr.A has a balance of ` 10,000 in his Bank Account. If he draws a cheque for ` 15,000, normally it will be rejected by the bank. However, if the account has Overdraft

facility, then the bank will pay ` 15,000 on the cheque, despite the insufficient balance.
It is in the nature of Current Liability

Equity : Capital is otherwise called as equity.

Working Capital : Current Assets **Less** Current Liabilities. Also called as "Net Working Capital".

Current Assets : It refers to the assets which are easily convertible into cash or cash equivalents within a single accounting period. For Eg. Bank, Debtors etc.

Current Liabilities : It refers to the liabilities which are payable within the single accounting period. For eg. Creditors, Bank Overdraft etc.

Fixed Assets : Represents Long Term Assets which are expected to be used in the business for a longer period of time. They are meant for usage in the business for production / rendering of services etc. Eg. Machinery, Building.

Disclosure : The term "Disclosure" means that **a statement describing the event / transaction** (included the amount involved) should be added to the financial statements **as a note therein.** (Disclosure is not same as accounting. Accounting means Accounting Entries will be passed, whereas in disclosure, a mere statement is given; Journal Entry not passed.)

Incurred : It refers to the creation / existence of liability for expenses. For rent paid ` 12,000 for 12 months is otherwise called as "rent incurred". Mere payment of advances is not considered as "incurred".

Inventory : Technical term for "Stock". It includes Raw Material Stock, Work in Progress and Finished Goods Stock

Depreciation : Gradual Decrease in the value of **Fixed Assets** due to wear and tear, use, passage of time, obsolescence and other related factors.

Hire Purchase : It refers to the transaction wherein the goods are delivered by the seller to the buyer on condition that the settlement has to be made in specified installments. On payment of the last installment, the goods shall be treated as owned by the buyer. Till the last installment, the goods are owned by the seller. In case of default of any installment, the seller can get back the goods delivered.

Liquidity : Ability of the business to meet its Short-Term Liabilities. **Current Assets > Current Liabilities**

Solvency : Ability of the business to meet its Total Liabilities, i.e. **Assets > Liabilities**

Window Dressing : It means manipulating the financial statements to make them attractive viz. inflating the incomes, suppressing the expenses, treating revenue expenditure as capital expenditure etc.

Holding Gains : It refers to the notional gains arising due to increase in prices of stocks held in the business. For Eg. A has 10,000 Kgs of Steel in Stock. They are bought at ` 100/Kg. They are not sold for one month. At the end of one month, their market price is ` 180/Kg. In this case, if the stocks are sold at the end of one month, then A can earn a profit of ` 80/Kg. This is not realized as sale is not actually made and they are just kept in stock.

Notional : It is not realized and may be earned if some event happens. In the above case, if sale happened then ` 80 is earned. Till the actual sale, it is only a notional profit.

HOME WORK

THEORY QUESTIONS

1. Define following terms:
1. Accrual Basis of Accounting
2. Amortisation
3. Contingent Asset
4. Contingent Liability

UNIT : 4
CAPITAL AND REVENUE EXPENDITURE AND RECEIPTS

INTRODUCTION

The distinction of transaction into revenue and capital is done for the purpose of placing them in Profit and Loss account or in the Balance Sheet. For example: revenue expenditures are shown in the profit and loss account as their benefits are for one accounting period i.e. in which they are incurred while capital expenditures are placed on the asset side of the balance sheet as they will generate benefits for more than one accounting period and will be transferred to profit and loss account of the year on the basis of utilization of that benefit in particular accounting year. Hence, both capital and revenue expenditures are ultimately transferred to profit and loss account.

Revenue expenditures are transferred to profit and loss account in the year of spending while capital expenditures are transferred to profit and loss account of the year in which their benefits are utilized.

Therefore we can conclude that it is the time factor, which is the main determinant for transferring the expenditure to profit and loss account. Also expenses are recognized in profit and loss account through matching concept which tells us when and how much of the expenses to be charged against revenue.

However, distinction between capital and revenue creates a considerable difficulty. In many cases borderline between the two is very thin.

1. Distinguish between Capital Expenditure & Revenue Expenditure

Particulars	**Capital Expenditure**	**Revenue Expenditure**
	It is an expenditure incurred for the purpose of-	It is an expenditure,the benefit of which is **immediately (normally**
1. **Meaning**	(a) Purchase/Creation/ Improvement of Fixed Assets or (b) Expenses necessary for the above purchase/Creation (c) Increasing the earning capacity of the business.	**within one year) exhausted in the** process of earning revenue.
2. Purpose	(a) Acquiring Fixed Assets,which are held not resale, but for use with a view to earn profits. (b) Making additions to the existing Fixed Assets (c) Increasing earning capacity of the business by improved facilities and equipments (d) Reducing the cost of production. (e) Acquiring benefit of enduring nature of valuable right.	(a) Actual day-to-day running of the business, (b) Maintaining the capital assets in an efficient manner. (c) Cost of Material & Stores (d) Salary and Wages of employees (e) Administrative Exp. Like Stationery, Rent Telephone and Insurance.

3. Treatment in Financial statement	➲ Capital Expenditure is **displayed as asset** in Balance Sheet. Only depreciation portion is debited to P&L A/c. ➲ It is **NOT directly reduced** from Incomes.	➲ Expenditure is charged fully in the Profit and Loss Account. ➲ It is **fully REDUCED** from income
4. **Wrong treatment**	If wrongly treated as revenue, profits will be **understated or reduced.**	If wrongly capitalized, profits will be **inflated or overstated.**
5. **Matching**	Capital Expenditure is **not matched** with Capital Receipts	Revenue Expenditure is matched with Revenue Receipts.
6. **Time of incurrence**	Capital Expenditure may be incurred before or after the commencement of the business.	It is incurred after the commencement of the business.
7. **Recurring Nature**	Normally Capital Expenditure is generally non-recurring in nature. However, certain Capital Expenditure is required once in 2-5 years. E.g. modernization of Machinery, etc.	Revenue Expenditure is of recurring / repetitive nature. It is incurred every year by the business.
8. **Interest on borrowing**	If interest on borrowings is payable for the period prior to the commencement of the business / Production	If interest on borrowings is payable for the period on or after commencement of business / production

Note: Amount involved in a transaction is not relevant for Capital vs Revenue distinction. Hence, even a transaction involving a huge amount say ` 5 Crores, maybe considered as Revenue Expenditure.

2. Deferred Revenue Expenditure

1. **Meaning :** It is an expenditure **primarily of revenue nature,** but the benefit whereof extends to periods more than the year of incurrence.
2. **Inclusion :** It also includes expenditure which gives benefits for 2 / 3 years, but does not result in creation or improvement of fixed assets. For Eg. Shifting of business from one location to a convenient location. This results in increase in benefits for many years, but do not result in creation of any fixed asset.
3. **Examples :**
   (a) Expenditure on an advertisement campaign to introduce a product in the market,
   (b) Discount allowed on issue of Debentures,
   (c) Development Expenses in the case of Mines and Plantations.
   (d) Cost of construction / extension to a leased building (Since the building has to be returned after the lease period is over, its benefits are for only a limited period.)

4. **Time Period :** Benefit of such expenditure relates to many years, i.e. relating to the future period.
5. **Treatment :** Written off in parts over the period during which the benefit will accrue. Balance portion is shown as an "Asset" in the Balance Sheet till the period of benefit.

Notes:

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

3. Capital Expenditure Vs Deferred Revenue Expenditure

1. **Meaning**

   Capital Expenditure : It is an expenditure incurred for the purpose of - (a) acquiring, extending or improving assets of a permanent nature for carrying on the business, or (b) increasing the earning capacity of the business.

   Deferred Revenue Expenditure : It is an expenditure primarily of revenue nature, but the benefit whereof extends to periods more than the year of incurrence.

2. **Treatment**

   Capital Expenditure : Asset is displayed in the Balance Sheet. Only depreciation portion thereon is debited to P&L A/c.

   Deferred Revenue Expenditure : Written off in parts over the period in which benefit will accrue. Balance portion is shown as an "Asset" in the Balance Sheet till the period of benefit.

3. **Example**

   Capital Expenditure : Purchase of Factory Building for use in the business.

   Deferred Revenue Expenditure : Advertisment Expenditure

4. Criteria / Considerations for Capital Vs Revenue

1. **Nature of Business**

   Capital Expenditure if ..... : Expenditure relates to purchase of a Fixed Asset (e.g. Land purchased by a Manufacturing Firm).

   Revenue Expenditure if ..... : Expenditure relates to purchase of a Current Asset (e.g. Land purchased by a Construction Company).

2. **Recurring Nature**

   Capital Expenditure if ..... : Expenditure is incurred infrequently, or once in 2-5 years (e.g. purchase of assets.)

   Revenue Expenditure if ..... : Expenditure is incurred frequently / regularly, in the normal course of business (e.g. Salary, Rent, etc.)

3. **Purpose of Expenses**

   Capital Expenditure if ..... : Expenditure is for acquiring / creating capital assets or increasing their productive capacity.

   Revenue Expenditure if ..... : Expenditure is for maintaining the capital assets in an efficient manner.

4. **Period of Benefit**

   Capital Expenditure if ..... : Expenditure helps to generate revenue over more than one accounting period

   Revenue Expenditure if ..... : Expenditure helps to generate income / revenue in the current period only.

5. Materiality

Capital Expenditure if ..... : Expenditure is material / significant.

Revenue Expenditure if ..... : Expenditure is not material, i.e. insignificant.

5. Examples for Capital and Revenue Expenditures

Capital Expenditure

1. Purchase of Fixed Asset (Land, Building, etc.)
2. Purchase of Second-hand Asset (e.g. Vehicle, Furniture, etc.)
3. Overhaul Expenses to put second-hand machinery in working condition. -
4. Repairing & Painting of Old Building purchased recently by the Firm.
5. Expenditure incurred to reduce working expenses / operating expenses.
6. Legal Fee paid to acquire new property.
7. Licence Fee paid by Cinema Theatre to commence its business.
8. Cost of constructing Temporary Huts which were necessary for Factory Building Construction, which were demolished when the Factory was ready.

Revenue Expenditure

1. Expenditure for replacement of worn-out part of an existing asset.
2. Regular Advertisement Expenses in respect of products and services.
3. Expenditure on removal of stock to new site.
4. Legal Fees incurred to file suit against a Customer from whom money is due.

6. Capital Vs Revenue Receipts

(1) Meaning

Capital Receipt : Capital Receipts refer to receipts other than Revenue Receipts.

Revenue Receipt : Revenue Receipts are moneys received in the course of normal business activities, and are recurring in nature.

(2) Example

Capital Receipt : Capital contribution by Owner, Issue of Shares / Debentures, Sale Proceeds of Fixed Assets, etc.

Revenue Receipt : Sales, Interest and Other Income Received, Bad Debts Recovered, etc.

(3) Purpose

Capital Receipt : Capital Receipts relate to specific purpose, e.g. Capital Contribution for commencing business or expanding business, Loans taken for acquiring Fixed Assets, etc.

Revenue Receipt : Revenue Receipts relate to general business purpose, and are not specifically identifiable to any purpose as such.

(4) Effect on Profit

Capital Receipt : Capital Receipts do not affect profit.

Revenue Receipt : Revenue Receipts have a direct impact on the profits.

(5) Disclosure

Capital Receipt : They are shown as Liability or Reduction from the Asset in the Balance Sheet.

Revenue Receipt : They are shown on the Credit Side of the Profit and Loss Account.

(6) Matching

Capital Receipt : Capital Receipts are **not** matched with Capital Expenditure, in all cases.

Revenue Receipt : Revenue Receipts is generally matched with Revenue Expenditure.

1. **Revenue Receipts x Cash Receipts.** "Revenue Receipts" refers to Total Income in the period (e.g. Total Sales on & Credit) while "Cash Receipts" refers to Cash Collections (i.e. Cash Sales + Collection from Debtors) in the period.
2. **Deposit of Money with other persons $\neq$ Expenditure:**
   - **Deposit of money** is **not considered as an expenditure** as the money is just kept with another person and it . is to be recovered from that person.
   - Expenditure refers to the amount spent to earn benefit. Deposit is **not considered as amount spent**

7. Capital Vs Revenue Profits

(1) Meaning

Capital Profits : Profits arising on issue / repayment of capital, borrowings or sale of fixed assets

Revenue Profits : Profits arising out of the regular operations of the business

(2) Examples

Capital Profits :

(a) Premium on issue of shares / debentures
(b) Discount on redemption of shares
(c) Profits on sale of Fixed Assets (exceeding cost)

Revenue Profits :

(a) Profits arising out of normal trading operations
(b) Profits on sale of Fixed Assets (exceeding Book Value but less than cost)

(3) Treatment

Capital Profits : Taken to **Capital Reserve or under any other head** in Balance Sheet (unless realized in cash)

Revenue Profits : Revenue Profits taken to **Profit & Loss Account**

8. Capital Vs Revenue Losses

(1) Meaning

Capital Losses : Loss on issue / repayment of capital, borrowings, Loss of Fixed Assets due to fire / accidents.

Revenue Losses : Losses arising out of the regular operations of the business

(2) Examples

Capital Losses :

(a) Discount on issue of shares / debentures
(b) Premium on redemption of shares
(c) Loss of Fixed Assets

Revenue Losses :

(a) Losses on normal trading operations
(b) Bad Debts
(c) Losses on sale of Fixed Assets (S.V. < B.V.)

(3) **Treatment :**

Capital Losses : Taken to Profit and Loss Account. However, a specific note shall be given that the profits / losses are arrived after considering the capital loss

Revenue Losses : Taken to Profit and Loss Account.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

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

(a) Capital expenditures (b) Revenue expenditures

(c) Prepaid revenue expenditures

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

(a) Capital expenditures (b) Revenue expenditures

(c) Prepaid revenue expenditures

3. Entrance fee of ` 2,000 received by Ram and Shyam Social Club is

(a) Capital receipt (b) Revenue receipt

(c) Capital expenditures

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

(a) Capital receipt (c) Capital expenditures

(b) Revenue receipt

5. Insurance claim received on account of machinery damaged completely by fire is

(a) Capital receipt (b) Revenue receipt

(c) Capital expenditures

6. Interest on investments received from UTI is

(a) Capital receipt (b) Revenue receipt

(c) Capital expenditures

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

(a) Capital expenditures (b) Revenue expenditures

(c) Capital receipt

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

(a) The sale is made. (b) The cash is collected.

(c) The products are manufactured.

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

(a) ` 2,99,000. (b) ` 44,000. (c) ` 30,000.

HOME WORK

THEORETICAL QUESTIONS

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

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

UNIT : 5
CONTINGENT ASSETS AND CONTINGENT LIABILITIES

INTRODUCTION

As per the concept of prudence as well as the present accounting standards, an enterprise should not recognise a contingent asset. These assets are uncertain and may arise from a claim which an enterprise pursues through a legal proceeding. There is uncertainty in realisation of claim. It is possible that recognition of contingent assets may result in recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.

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

1. PROVISIONS

(1) Meaning : A Provision is “a Present Obligation, as a result of past events, which leads to probable outflow of resources embodying economic benefits and a reliable estimate of the amount of the obligation can be made”.

(2) Features :

(a) Provision is a **present liability** of a certain / uncertain amount.

(b) Provision **can** be reasonably measured using a substantial degree of estimation.

(3) Treatment : Provision should be **recognized** in the Books of Accounts and **also disclosed.**

(4) Impact on Profits : Provision should be **recognized** in the Books of Accounts and **also disclosed.**

(5) Nature of Account : Provision is made for liability; Hence, it is in the nature of **Representative Personal Account,** which indirectly represents a person / creditor

(6) Journal Entry :

Debit - Profit and Loss A/c Dr.

Credit -To Provisions for Liabilities A/c

(7) Reasoning : Debit Aspect: Provision is an expense / loss, which reduces the profits of the enterprise. Hence, Profit and Loss A/c is debited. (Debit all expenses and losses)

Credit Aspect: Provision is a liability payable in future. Hence, it is credited (Credit the giver of benefit)

(8) Disclosure : For every Provision, following should be disclosed - (a) Opening and Closing Balance, (b) Addition in the year, (c) Amount used, (d) Unused amount reversed during the period.

(9) Balance Sheet : Provision is **either shown** (a) **on the liabilities** side **(or)** (b) on the **assets side - as** a **deduction from the relevant asset.**

(10) Examples

(a) Provision for Guarantees Given, when the original debtor becomes insolvent.

(b) Provision for Warranties

(c) Provision for Discount on Debtors

(d) Provision for Bad and Doubtful Debts

(e) Other Similar Provisions

(11) Approving Authority : Persons who approve and authenticate the Financial Statements of an enterprise. **Example:** Proprietorship Firm - Proprietor; Partnership Firm - Partner; Company - Board of Directors

2. Illustration for Provisions

1. **Situation:** M/s A and Co. is involved in extraction of coals from coal mines. While operating in a particular *mine,* landslide happened and because of this 10 employees of M/s A and Co. died on 15.03.2011. The Financial Position Assets and Liabilities is ascertained on 31.03.2011.
2. **Analysis:** In this situation, M/s A and Co. has an obligation to compensate the families of the dead employees **as the** deaths happened while working at its site. Though, A & Co. has not actually compensated the families, it has an **obligation to compensate them.**
3. **Explanation:** The question is whether the **obligation to compensate to be treated as liability** on 31.03-2011. The answer is "YES" i.e. it should be treated as liability as it satisfies the definition of the term "Provision", (as given below.)

Conditions from Definition

(a) **Present Obligation**

- On 31.03.2011, Sufficient evidence is available that M/s A & Co. will compensate the families of dead employees **in future.**
- If it does not compensate, then anyway the court will intervene and ask the *concern* to compensate the families

(b) **As a result of Past Events :** The obligation to pay compensation arises because of the death of the employees on 15.03.2011. The event of landslide on 15.03.2011 is a past event on 31.03.2011.

(c) **Probable Outflow of Economic Resources :** Due to above obligation, M/s A and Co. has to pay cash / other considerations to the families.

(d) **Reliable estimate of obligation :** M/s A & Co. can determine the **AMOUNT of liability that should be paid. It will be** able to **ESTIMATE** the amount to be paid. Accurate calculations are not required

For eg. No. of employees dead x Compensation per dead = 10 x 5 Lakhs = `50 Lakhs .

Note: If all the four conditions are satisfied, then a provision has to be created. Hence, in the given example, "**Provision for Compensation to employees"** has to be created for `50 Lakhs.

Journal Entry: Profit and Loss A/c Dr. 50 Lakhs

To Provision for Compensation to Employees A/c 50 Lakhs

3. Contingent Liability

The term 'Contingent liability' can be dened as

Possible Obligation : that arises from past events and the existence of which will be conrmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

Present Obligation : that arises from past events but is not recognised because:

(i) it is not probable that an out ow of resources embodying economic benets will be required to settle the obligation; or

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

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

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

4. Features of Contingent Liability

(a) No Recognition : An Enterprise **should NOT RECOGNISE** a Contingent Liability.

(b) Disclosure : A Contingent Liability should be **DISCLOSED as a FOOT NOTE to the Balance Sheet.**

(c) Periodical Review : Contingent Liability should be **periodically reviewed.** On such review, if the character of the Contingent Liability is found to be changed and there is a probable outflow resources, then it will be recognized as a Provision and treated accordingly.

(d) Impact : Contingent Liability **will NOT AFFECT the profits** of the concern, as it is not accounted in Books.

(e) Examples

(i) Outcome of a law suit

(ii) Claims against the business, not acknowledged as debts

(iii) Guarantees given, if the principal debtor is solvent

(iv) Uncalled Liability on Partly Paid shares

(v) Arrears of Fixed Cumulative dividends

(vi) Workmen Compensations under Dispute

(vii) Unspecified Business Risk

(viii) Liability on Bills Discounted

Note: Students may note the difference between Recognition & Disclosure. A Provision should be **recognised** and also disclosed. However, a Contingent Liability should **not be recognized, but only disclosed.**

5. Illustration for Contingent Liability

1. **Situation:** M/s A & Co. produced and sold "MS Windows" software. Microsoft filed a legal suit against A & Co. for violation of copyrights. Microsoft also claimed damages from A & Co. for the producing without its permission. M/s A & ***Co. argued*** **in** the court that it has not violated the copyrights. On 31.03.2011, this case is pending at the Court.

2. **Analysis:** The liability for M/s A & Co. may or may not arise based on the decision of the Court. The Court's decision cannot be controlled by A & Co. nor can it be influenced. If the Court decides that A & Co. has not violated any copyrights, then there is no liability for A & Co.

3. **Explanation:** The liability of M/s A & Co. under the above legal suit is a contingent liability and **NOT provision** due to following reason:

<u>Conditions from DEFINITION</u>

(a) Possible Obligation : On 31.03.2011, Sufficient evidence is **NOT** available that A & Co. will pay damages to Microsoft. It is not conclusive whether the Court's decision will be favourable or unfavourable to A & Co. Hence, there is **no probability** of any **future liability.**

(b) **As a result of Past Events :** The above legal suit is due to the sales of software by the concern in the past.

(c) **Existence confirmed by occurrence or non-occurrence of uncertain future event :** M/s A & Co. may or may not have the liability due to copyright violation. This is based on the favourable or unfavourable decision of the Court. One cannot predict the decision of the Court and hence it is an uncertain event.

(d) **Not within the control of the enterprise :** The decision of the Court is not within the control of M/s A & Co. The Court will decide based on the facts of the case, the arguments of the parties and its knowledge.

Note: If all the above 4 conditions are satisfied, then the liability is in the nature of **"Contingent Liability".** Hence in the example, **"Contingent Liability due to legal suits pending at the Court"** has to be **disclosed** as a **foot note** *to the* Balance Sheet. There is no Journal Entry. Only a statement describing the liability is given at the end of Balance Sheet.

6. Provisions Vs Contingent Liabilities

1. **Meaning** :

   Provision : Provision is a **present Obligation** of a certain / uncertain amount.

   Contingent Liabilities : It is a **possible obligation** which arises ***from*** past event.

2. **Measurement :**

   Provision : Provision **can** be reasonably measured using a substantial degree of estimation. **Contingent Liabilities :** Contingent Liability **cannot** be reasonably measured.

3. **Recognition :**

   Provision : Provision should be **recognized** in the Books of Accounts.

   Contingent Liabilities : Contingent Liability should **not** be recognized in the Books of Accounts.

4. **Impact on Profit :**

   Provision : A known liability is accounted. Hence, a Provision **reduces** the profit.

   Contingent Liabilities : Contingent Liability is **not** accounted. It has no **impact** on profits for the period.

5. **Disclosure :**

   Provision : For every Provision, the following **should also be disclosed** - (a) Opening & Closing Balance, (b) Addition during the year, (c) Amount used, **(d)** Unused amount reversed during the period.

   Contingent Liabilities : Contingent Liability is **only disclosed** by ***way*** **of a Footnote to the Balance Sheet** separate Schedule / Annexure thereto.

7. CONTINGENT ASSETS - Meaning and Features

1. **Meaning** : A Contingent Asset is a **POSSIBLE ASSET** that **arises from past events,** existence of which **will be confirmed only by occurrence / non-occurrence** of one or more **uncertain future events not wholly within the control** of the enterprise.
2. **Treatment :** An enterprise **SHOULD NOT RECOGNISE** a Contingent Asset due to **CONSERVATISM** Convention. Because this may result in recognition of income that may never be realized.
3. **Impact :** Contingent Assets will not affect the profits of the enterprise as it is not accounted in the books.
4. **Certainty :** If the realisation of income is certain, then it is not a Contingent Asset and the same shall be recognized in the Financial Statements.

5. **Disclosure :** Contingent Assets **should not be disclosed in the Financial Statements** but **may be disclose in** the **Report of the Approving Authority.**

6. **Examples**
   (i) Unplanned or unexpected events leading to possibility of inflow of economic benefits.
   (ii) Expected Gain from a legal suit.
   (iii) Insurance claims for damage of a property.

8. Illustration for Contingent Assets

1. **Situation: Take the same situation as given under Contingent Liabilities.** Microsoft filed a legal suit against A & Co. for violation of copyrights. Microsoft also claimed damages from A & Co. for the producing without its permission . M/s A & Co. argued in court that it has not violated the copyrights. On 31.03.2011, this case is pending at the Court.
2. **Analysis: FROM THE VIEW OF MICROSOFT,** it may or may not receive compensation from M/s A & Co. based on the decision of the Court. The Compensation is a **possible gain for Microsoft.**
3. **Explanation:** The Compensation from M/s A &. Co. is a **Contingent Asset for Microsoft** due to following reasons -

Conditions from Definition Description

Possible Obligation : On 31.03.2011, Sufficient evidence is **NOT** available that Microsoft will receive money from M/s A & Co. Hence it is only a possible asset.

As a result of Past Events : The above gains may arise because M/s A & Co. has violated the copyrights in the past.

Existence confirmed by occurrence or non-occurrence of uncertain future events : Microsoft may or may not receive money from M/s A & Co. This is based on the favourable or unfavourable decision of the Court. One cannot predict the future decision of the Court and hence it is an uncertain event.

Not within the control of the enterprise : The decision of the Court is not within the control of M/s A & Co. The Court will decide based on the facts of the case, the arguments of the parties and its knowledge.

Note: If all the above 4 conditions are satisfied, then the **Gains** are in the nature of **"Contingent Asset".** Hence, in the example, **"Contingent Asset due to Legal Suit filed for Copyrights Violation" MAY** be **disclosed** in the report of the **Board of Directors of Microsoft.** It is not accounted / disclosed in accounts books.

9. Principles behind Provisions, Contingent Liabilities and Assets

1. **Provision :** Matching Concept, Conservatism Convention
2. **Contingent Liability :** Full Disclosure Concept
3. **Contingent Asset :** Conservatism Convention

10. Contingent Assets Vs Contingent Liabilities

(1) Nature :
Contingent Asset : Contingent Asset is a possible asset.
Contingent Liability : Contingent Liability is a possible obligation

(2) Recognition :
Contingent Asset : Should **not** be recognized in the Balance Sheet.
Contingent Liability : Should be recognized in the Balance Sheet.

(3) **Disclosure :**
Contingent Asset : Should **not** be disclosed in the Balance Sheet But it may be disclosed in the report of the approving authority.

Contingent Liability : Should be **disclosed** in the Balance Sheet, as a Footnote or as a separate Schedule.

Note: Contingent Situation is a situation, in which the ultimate outcome, (whether gain or loss) one will known only on the occurence or non-occurrence, of one or more uncertain future event. So, both Contingent Assets and Contingent Liabilities -

(a) arise from past events,

(b) existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future event, and

(c) Such event is not wholly within the control of the enterprise.

11. Liabilities Vs Contingent Liabilities

1 Meaning :

Liabilities : It is the **present** financial obligation of an enterprise, which arises from past events.

Contingent Liabilities : Contingent Liability is a **Possible** obligation which arises from a past event.

2. Example :

Liabilities : Wages, Salaries, Rent, Electricity, etc. for the last month of the financial year, but paid in first month of next financial year.

Contingent Liabilities : Claims against enterprise not acknowledged as Debts. Guarantees given in respect of third parties, Liability in respect of Bills Discounted.

3. Measurement :

Liabilities : It **can** be measured with a reasonable degree of estimation.

Contingent Liabilities : It **cannot** be measured with a reasonable degree of estimation.

4. Disclosure :

Liabilities : Disclosed in the Liability Side of the Balance Sheet and hence it is part of Balance Sheet.

Contingent Liabilities : Not a part of Balance Sheet. It is only disclosed by way of Footnote to the Balance Sheet.

5. Effect on Profit :

Liabilities : A known liability is provided for, i.e. it **reduces** the profit.

Contingent Liabilities : Contingent Liability is **not** provided for. It has **no impact** on profits for the period.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

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

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

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

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

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

(a) In the financial statements.

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

(c) In the cash flow statement.

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

(a) Liability (c) Contingent liabilities

(b) Provision

4. Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as ________.

(a) Provision. (b) Liability.

(c) Contingent liability.

5. In the financial statements, contingent liability is

(a) Recognized.

(b) Not recognised.

(c) Adjusted.

HOME WORK

THEORETICAL QUESTIONS

1. Differentiate between:

(i) Provision and Contingent Liability.

(ii) Liability and Contingent liability

UNIT : 6
ACCOUNTING POLICIES

INTRODUCTION

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

1. Meaning and Need of Accounting Policies

1. Accounting Policies refer to - (a) the specific accounting **principles,** and (b) the **methods** of applying those principles, adopted by the enterprise in the preparation and presentation of Financial Statements.
2. **Example:** Inventory is valued at Cost or Net Realisable Value, whichever is lower. This is a principle. Cost can be determined either by First in First out (FIFO) method or Weighted Average Cost (WAC) or other suitable **methods.**
3. **Need for disclosure:** Accounting Policies should be disclosed in the Financial Statements due to following reasons -
   (a) To promote better understanding of Financial Statements.
   (b) To provide meaningful Inter-Firm Comparison.
   (c) To ensure compliance with Law, for example, where in case of Companies, disclosure is mandatory.
   (d) To comply with ICAI Requirements, in order to bring uniformity in disclosure.

2. Choice of Accounting Policies

1. **Alternative accounting policies:** The differing circumstances in which enterprises operate and the situation of diverse and complex economic activities of the Company has given rise to acceptability of alternative accounting principles and methods of applying those principles.

2. **Decision Making:** The choice of the alternative principles and methods calls for considerable judgement by the management of the enterprise.

3. **Reduction in alternatives:** Various Statements issued by ICAI, together with the measures of Government, other regulatory agencies and progressive managements have reduced the number of acceptable alternatives, particularly for corporate enterprises. However, the availability of alternative accounting policies can at best be reduced, **not eliminated,** as different enterprises operate in differing circumstances.

4. Illustrative List of areas of alternative accounting policies:
   (a) Methods of Depreciation, depletion and amortisation.

(b) Conversion or translation of Foreign Currency items.

(c) Recognition of profit on Long-Term contracts.

(d) Treatment of - (i) Expenditure during construction, (ii) Goodwill, (iii) Retirement Benefits, and (iv) Contingent Liabilities.

(e) Valuation of - (i) Inventories, (ii) Investments, and (iii) Fixed Assets.

Note: Generally Companies disclose these accounting policies in the Notes on Accounts.

3. Principles for Selection of Accounting Policies

True and Fair View: The **primary consideration** in the selection of Accounting Policies by an enterprise is that the Financial Statements prepared and presented should represent a **true and fair view** as under -

In the case of the Balance Sheet	Of the **State of Affairs** of the enterprise as on a certain date.
In the case of Profit & Loss Account	Of the **Profit or Loss** for the period ended on that date.

Factors: To select and apply an accounting policy, the following points are considered - **(Secondary Consideration)**

(a) Prudence (b) Substance over Form (c) Materiality

3. Change in Accounting Policies: Accounting policies have to be consistent from year to year. However, change in accounting policies can be made in the following situations -

(a) If the adoption of a different accounting policy is required by Statute, or

(b) For compliance with an Accounting Standard, or

(c) If it is considered that the change would result in a more appropriate presentation of the Financial Statements.

4. Disclosure of Accounting Policies

1. **Disclosure of Accounting Policies: All significant accounting policies** adopted in the preparation and presentation of Financial Statements should be **disclosed** to facilitate better understanding of the Financial Statements.

2. **Place of Disclosure:** Disclosures should form part of the Financial Statements. It should be disclosed at **one place,**instead of being scattered over several Statements, Schedules and Notes.

3. **Change in Accounting Policies:** Change in an accounting policy should be disclosed -

   (a) When such change has a material effect in the current period and

   (b) When such change is reasonably expected to have a material effect in later periods.

4. **Manner of Disclosure of change in accounting policies**

   Effect in Current Period : The impact of change on the Profit / Loss and the Balance Sheet items in current period should be quantified, to the extent ascertainable.

   Where quantification is not possible, either wholly or in part, the **fact of such change** having a material effect should be disclosed.

   Expected Effect in later periods : The fact of such change, and The fact that it is likely to have effect in later periods, should be appropriately disclosed in the period in which the change is adopted.

5. **Disclosure of Accounting Assumptions:** Fundamental Accounting Assumptions viz. Going Concern, Consistency and Accrual, if followed, need not be disclosed. Even if one of them is not followed, the fact should be disclosed. :

6. **Disclosure is not a Remedy:** Disclosure of Accounting Policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

5. Accounting Estimates

(a) Meaning: "Accounting Estimate" means an **approximation** of the amount of an item in the absence of a precise means of measurement.

(b) **Examples:** Depreciation - In this case, rate of depreciation is estimated based on the useful life of the asset.

(c) Other examples are -

1. Reduction in the value of Inventory and Debtors to their estimated realisable value.
2. Provision for Taxation.
3. Accrued Revenue.
4. Provision for a loss from a lawsuit.
5. Provision to meet Warranty Claims.
6. Amortisation of certain items like Goodwill and Deferred Revenue Expenditure.
7. Insurer's liability for Outstanding Claims.
8. Provision for Retirement Benefits in the Financial Statements of Employers. For eg. Gratuity\
9. Losses on Construction Contracts in Progress.

6. Fundamental Accounting Assumption Vs Accounting Policy

Point Fundamental	**Accounting Assumption**	**Accounting Policy**
Number	3	No specified list
Disclosure	Not required if followed	Required
If not followed /Changed	The fact to be disclosed with reasons	The fact of change in the accounting policy along with the effect of change to be disclosed
Choice	Mandatory from.	The Entity has an option to choose

7. Accounting Estimates Vs Accounting Policies

Particulars	**Accounting Estimate**	**Accounting Policy**
Meaning	Accounting Estimates refer to Financial Statement items, which cannot be measured with precision, but can be estimated	A Policy refers to a accounting principle and the method of applying that principle.

	based on informed judgments.	
Frequency	Change in Accounting Estimate is a **routine matter** in accounting which is substantially based on estimates. For example an estimate of Bad Debts is made on the basis of information at subsequent date, i.e. insolvency of a Debtor known afterwards.	Change in Accounting Policy is **infrequent** and amounts to almost a permanent change in the basis of accounting in the concerned area. For example, the accounting policy for charging depreciation may be changed from SLM to WDV Method.
Causes / Reasons	Change in A/cing Estimate arises due to - ➲ change in circumstances on which the estimate was based, or ➲ availability of new information, etc.	Change in A/cing Policy is possible only for - ➲ ensuring statutory compliance, or ➲ ensuring compliance with another AS, or ➲ more appropriate presentation of the Financial Statements.
Materiality	The accounting picture **may not get substantially altered** by the change in the Accounting Estimate.	A change in Accounting Policy, generally, has a far reaching, material and **long-term effect.**
Disclosure	The nature and amount of a change in Accounting Estimate which has a material effect in the current period or expected material effect in future should be disclosed in the Financial Statements.	A change in Accounting Policy which has a material effect should be disclosed,along with the impact of, and adjustments resulting from that change in the current period Financial Statements.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. A change in accounting policy is justified

(a) To comply with accounting standard and law.

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

(c) All of the above.

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

(a) Materiality.

(b) Prudence.

(c) Substance over form.

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

(a) Providing depreciation.

(b) Valuation of inventories.

(c) Both the option.

4. Selection of an inappropriate accounting policy decision may

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

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

(c) Overstate the performance of a business entity

5. Accounting policies refer to specific accounting

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

(b) Methods of applying those principles.

HOME WORK

1. Deflne Accounting Policies in brief. Identify few areas wherein different accounting policies are frequently encountered.

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

UNIT : 7
ACCOUNTING AS A MEASUREMENT DISCIPLINE

INTRODUCATION

Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Any measurement discipline deals with three basic elements of measurement viz., identification of objects and events to be measured, selection of standard or scale to be used, and evaluation of dimension of measurement standards or scale.

1. Elements of a Measurement Discipline

The three elements of Measurement Discipline and how Accounting satisfies these elements are as under -

	Element / Condition	Does Accounting satisfy the condition?
1.	Identification of objects or events to be measured.	Financial Transactions and Events are measured in Accounting. Non-financial transactions, however significant, are not considered.
2.	Selection of Standard or Scale to be used.	The ruling currency of the country is used as the basis of money measurement, in Accounting. However - (a) Money is not a stable scale having universal applicability. (b) Exchange Rates between different currencies are not constant.
3.	Evaluation of dimension of measurement standard	Money, as a valuation base, loses its value over period time. Hence, it is **not stable** in the dimension.

Conclusion: However, Accounting is not an exact measurement discipline because accounting measures information mostly in money terms which is - (a) not a stable scale (b) Not having universal applicability and (c) not stable in dimension for comparison over time.

2. Measurement Based in Accounting

	Base	Assets	Liabilities
1.	Historical Cost	Cash or Cash Equivalent paid, or Fair value of the Asset at the time of acquisition	Proceeds received in exchange for the obligation,or the amount of cash/cash equivalent expected to be paid to satisfy it in the normal course of business.
2.	Current Cost	cash or cash equivalent which is to be paid if the same or an equivalent asset was acquired currently (PURCHASE ANGLE)	Undiscounted amounts of Cash and Cash Equivalent that would be required to settle the obligation currently.
3.	Realisable value	Cash or Cash Equivalent that could currently be obtained by selling the assets in an orderly disposal (SALE ANGLE)	Undiscounted amounts of Cash and Cash Equivalent that would be required to settle the obligation in the normal course of business.
4.	Present Value	Present Discounted Value of Cash Inflows expected to be derived from such asset over its useful life	Present Discounted Value of cash Outflows expected to be required to settle the liabilities in the normal course of business.

Note:Different measurement based ,like Historical cost /Current Cost/Net Realiable Value /Present Value, are used according to suitability(i.e.the situational needs) to depict true and fair view of the financial position of the respoting entity

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. Measurement discipline deals with
(a) Identification of objects and events.
(b) Selection of scale.
(c) Both (a) and (b)

2. All of the following are valuation principles except
(a) Historical cost. (b) Present value.
(c) Future value.

3. Book value of machinery on 31st March, 2016 ` 10,00,000 Market value as on 31st March, 2016 if sold ` 11,00,000
As on 31st March, 2016, if the company values the machinery at ` 11,00,000, which of the following valuation principle is being followed?
(a) Historical Cost. (b) Present Value. (c) Realisable Value.

4. Mohan purchased a machinery amounting ` 10,00,000 on 1st April, 2001. On 31st March, 2016, similar machinery could be purchased for ` 20,00,000 but the realizable value of the machinery (purchased on 1.4.2001) was estimated at ` 15,00,000. The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business, was calculated as ` 12,00,000.
(i) The current cost of the machinery is
(a) ` 10,00,000. (b) ` 20,00,000. (c) ` 15,00,000.
(ii) The present value of machinery is
(a) ` 10,00,000. (b) ` 20,00,000. (c) ` 12,00,000.
(iii) The historical cost of machinery is
(a) ` 10,00,000. (b) ` 20,00,000. (c) ` 15,00,000.
(iv) The realizable value of machinery is
(a) ` 10,00,000. (b) ` 20,00,000. (c) ` 15,00,000.

HOME WORK

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

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

UNIT : 8
ACCOUNTING STANDARDS

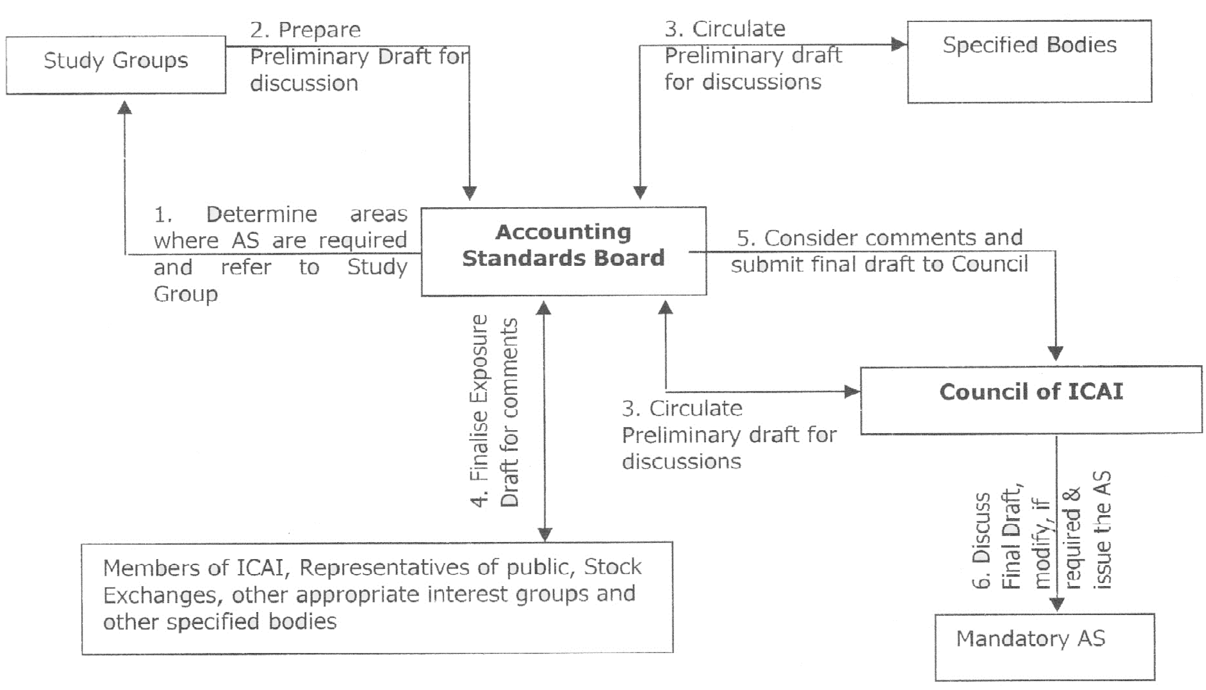
INTRODUCTION

Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of financial statements. If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business, rather than the true. To ensure transparency, consistency, comparability,
adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies. Accounting Standards (ASs) provide framework and standard accounting policies for treatment of transactions and events so that the financial statements of different enterprises become comparable.

1. Accounting Standards

1. **Meaning :** Accounting Standards (AS)" represents the statements issued by the Institute of Chartered of Accountants of India (ICAI), which contain basic principles for Accounting / disclosure for specific items in the Financial Statements.
2. **Applicability:** They shall apply to the General Purpose Financial Statements and other financial reporting
3. **Background**:At the international level, these accounting Standards are called as "International Accounting Standards (IAS) / International Financial Reporting Standards **(IFRS)".** Such standards are set up by the **International Accounting Standards Committee (IASC).**
4. **Procedure:** The Accounting Standards Board (ASB) of the ICAI is responsible for identification and issue of Accounting Standards.

The procedure for issue of Accounting Standards is as under -



Advantages and Disadvantages of Accounting Standards

	Objectives / Advantages		Disadvantages
1	To promote the dissemination of timely and useful financial information to all Stakeholders having an interest in a Company's economic performance	1.	Where there are alternative solutions to specific accounting problems, each of these solutions may also be appropriate on the basis of sound arguments. A Standard which insists on one particular solution may be unduly
2.	To reduce (or eliminate if possible), confusing variations in the accounting treatments used to prepare Financial Statements.	2.	AS may be applied in a rigid and inflexible manner, since the demand for Standards comes largely from an insatiable appetite for rules, and lack of reliance on judgement in technical accounting matters.
3.	To ensure disclosure of accounting principles and treatments where important information are not statutorily required to be disclosed.	3.	AS cannot override the laws of the land. Where there are conflicts between the AS and the law, the AS may be purposeless
4.	To facilitate comparison of financial statements of various enterprises in the same country or different countries.		

List of Accounting Standards

Sl. No.	Number of the Accounting Standard (AS)	Title of the Accounting Standard
1.	AS 1	Disclosure of Accounting Policies
2.	AS 2 (Revised)	Valuation of Inventories
3.	AS 3 (Revised)	Cash Flow Statements
4.	AS 4 (Revised) Sheet Date	Contingencies and Events Occurring after the Balance
5.	AS 5 (Revised) Changes in Accounting Policies	Net Prot or Loss for the Period, Prior Period Items and

4.	AS 6 (withdrawn pursuant to issuance of AS 10 on Property, Plant and Equipment 2016)	Depreciation Accounting
7.	AS 7 (Revised)	Accounting for Construction Contracts
8.	AS 8 (withdrawn pursuant to AS 26 becoming mandatory)	Accounting for Research and Development
9.	AS 9	Revenue Recognition
10.	AS 10	Property, Plant and Equipment
11.	AS 11	(Revised) The Effects of Changes in Foreign Exchange Rates
12.	AS 12	Accounting for Government Grants
13.	AS 13	Accounting for Investments
14.	AS 14	Accounting for Amalgamations
15.	AS 15	(Revised) Employee Benefits
14.	AS 16	Borrowing Costs
17.	AS 17	Segment Reporting
18.	AS 18	Related Party Disclosures
19.	AS 19	Leases
20.	AS 20	Earnings Per Share
21.	AS 21	Consolidated Financial Statements
22.	AS 22	Accounting for Taxes on Income
23.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
24.	AS 24	Discontinuing Operations
25.	AS 25	Interim Financial Reporting
24.	AS 26	Intangible Assets
27.	AS 27	Financial Reporting of Interests in Joint Ventures
28.	AS 28	Impairment of Assets
29	AS 29	Provisions, Contingent Liabilities & Contingent Assets

* Note: The list of accounting standards given above does not form part of syllabus. It has been given here for the knowledge of students only.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

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

(a) Central Govt. (b) State Govt.

(c) Institute of Chartered Accountants of India.

(d) Reserve Bank of India.

2. Accounting Standards

(a) Harmonies accounting policies.

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

(c) Improve the reliability of financial statements.

(d) All the three.

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

(a) Transparency. (b) Consistency.

(c) Comparability. (d) All the three.

HOME WORK

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

2. State the advantages of setting Accounting Standards.

UNIT : 9
INDIAN ACCOUNTING STANDARDS

INTRODUCTION

Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin. Therefore translation and reinstatements are of utmost importance in a world that is rapidly globalising in all ways. In themselves also, the accounting standards and principle need to be robust so that the larger society develops degree of confidence in the financial statements, which are put forward by organizations.

NEED FOR CONVERGENCE TOWARDS GLOBAL STANDARDS

The last decade has witnessed a sea change in the global economic scenario. The emergence of trans-national corporations in search of money, not only for fueling growth, but to sustain on going activities has necessitated raising of capital from all parts of the world, cutting across frontiers.

International analysts and investors would like to compare financial statements based on similar accounting standards, and this has led to the growing support for an internationally accepted set of accounting standards for cross-border lings. The harmonization of financial reporting around the world will help to raise confidence of investors generally in the information they are using to make their decisions and assess their risks.

Also a strong need was felt by legislation to bring about uniformity, rationalization, comparability, transparency and adaptability in financial statements. Having a multiplicity of accounting standards around the world is against the public interest. If accounting for the same events and information produces different reported numbers, depending on the system of standards that are being used, then it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers. It creates confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of global standards, of the highest quality, set in the interest of public. Global Standards facilitate cross border flow of money, global listing in different bourses and comparability of financial statements.

The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements say reinstatement of financial statements. It has the potential to create a new standard of accountability and greater transparency, which are values of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards. It creates an unprecedented opportunity for standard setters and other stakeholders to improve the reporting model. For the companies with joint listings in both domestic and foreign country, the convergence is very much significant.

BENEFITS OF CONVERGENCE WITH IFRSs

There are many beneficiaries of convergence with IFRSs such as the economy, investors, industry etc.

The Economy : When the markets expand globally the need for convergence increases since the convergence benefits the economy by increasing growth of its international business. It facilitates maintenance of orderly and cient capital markets and also helps to increase the capital formation and thereby economic growth.

It encourages international investing and thereby leads to more foreign capital flows to the country.

Investors: A strong case for convergence can be made from the viewpoint of the investors who wish to invest outside their own country. Investors want the information that is more relevant, reliable, timely and comparable across the jurisdictions. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards. Investors' confidence is strong when accounting standards used are globally accepted. Convergence with IFRS contributes to investors' understanding and confidence in high quality financial statements.

The Industry : A major force in the movement towards convergence has been the interest of the industry. The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. With the diversity in accounting standards from country to country, enterprises which operate in different countries face a multitude of accounting requirements prevailing in the countries. The burden of financial reporting is lessened with convergence of accounting standards because it simplies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of accounting standards.

DEVELOPMENT IN INDIAN ACCOUNTING STANDARDS (IND AS)

1 **First Step towards IFRSs :** The Institute of Chartered Accountants of India (ICAI) being the accounting standards-setting body in India, way back in 2006, initiated the process of moving towards the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) with a view to enhance acceptability and transparency of the financial information communicated by the Indian corporates through their financial statements. This move towards IFRS was subsequently accepted by the Government of India.

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRSs issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders. Accordingly, while formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as, various terminology related changes have been made to make it consistent with the terminology used in law. Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS.

2 **What are Indian Accounting Standards (Ind AS)?**

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).

National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

3. **Government of India - Commitment to IFRS Converged Ind AS**

Initially Ind AS were expected to be implemented from the year 2011. However, keeping in view the fact that certain issues including tax issues were still to be addressed, the Ministry of Corporate Affairs decided to postpone the date of implementation of Ind AS.

In July 2014, the Finance Minister of India at that time, Shri Arun Jaitely ji, in his Budget Speech, announced an urgency to converge the existing accounting standards with the International Financial Reporting Standards (IFRS) through adoption of the new Indian Accounting Standards (Ind AS) by the Indian companies.

Pursuant to the above announcement, various steps have been taken to facilitate the implementation of IFRS-converged Indian Accounting Standards (Ind AS). Moving in this direction, the Ministry of Corporate A airs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 covering the revised roadmap of implementation of Ind AS for companies other than Banking companies, Insurance Companies and NBFCs and Indian Accounting Standards (Ind AS). As per the Notification, Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) shall be implemented on voluntary basis from 1st April, 2015 and mandatory from 1st April, 2016. Later on, in 2016 MCA notified roadmap for NBFC announcing implementation date for Ind AS.

Similarly, Banking and Insurance regulatory authority have issued separate roadmaps for implementation of Ind AS for Banking and Insurance companies respectively.

4. LIST OF IND AS

Ind AS	Title of Ind AS
101	First Time Adoption of Indian Accounting Standards
102	Share Based Payment
103	Business Combinations
104	Insurance Contracts
105	Non-current Assets Held for Sale and Discontinued Operations
106	Exploration for and Evaluation of Mineral Resources
107	Financial Instruments: Disclosures
108	Operating Segments
109	Financial Instruments
110	Consolidated Financial Statements
111	Joint Arrangements
112	Disclosure of Interests in Other Entities
113	Fair Value Measurement
114	Regulatory Deferral Accounts
1	Presentation of Financial Statements
2	Inventories
7	Statement of Cash Flows
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events after the Reporting Period
11	Construction Contracts
12	Income Taxes

16	Property, Plant and Equipment
17	Leases
18	Revenue
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
27	Separate Financial Statements
28	Investment in Associates and Joint Ventures
29	Financial Reporting in Hyperinflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

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

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. Global Standards facilitate
(a) Cross border flow of money.
(b) Global listing in different bourses.
(c) Comparability of financial statements.
(d) All the three

2. The Government of India in consultation with the ICAI decided to
(a) Adapt with IFRS.
(b) Converge with IFRS.
(c) apply IFRS in India.
(d) notify IFRS in India

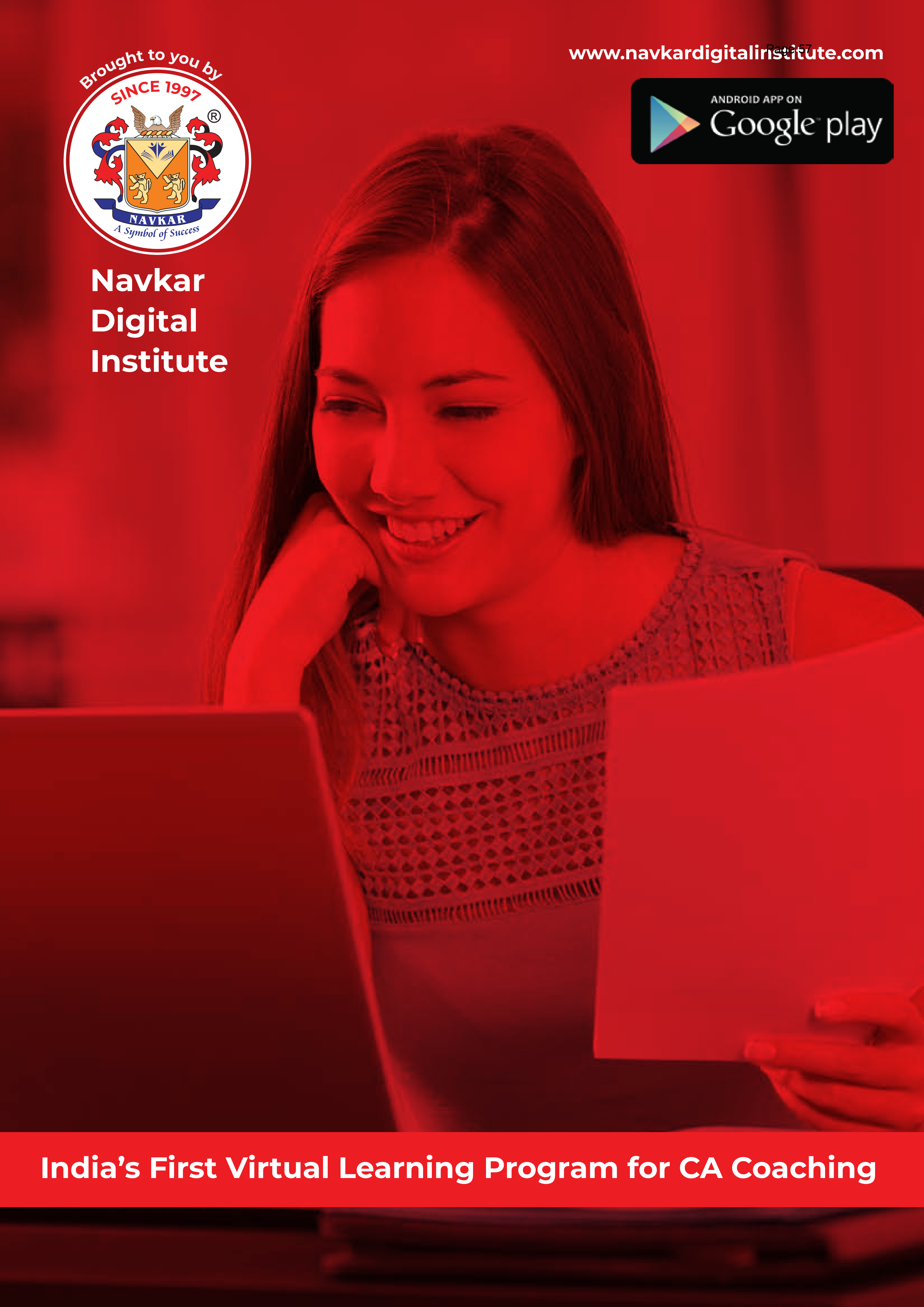
3. Convergence with IFRSs
(a) Simplifies the process of preparing the financial statements.
(b) Reduces the costs of preparing the financial statements.
(c) Both (a) and (b).
(d) Facilitates global investors' understanding and confidence in high quality financial statements.

HOME WORK

1. Explain the need of convergence rather adoption of IFRS as Global Standards.

2. What is the significance of issue of Indian Accounting Standards? Explain in brief.

❑


www.navkardigitalinstitute.com
ANDROID APP ON
Google play
Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar
Digital
Institute
India's First Virtual Learning Program for CA Coaching

Principles & Practice of Accounting

Accounting Process

CHAPTER-2
ACCOUNTING PROCESS

UNIT : 1
BASIC ACCOUNTING PROCEDURES - JOURNAL ENTRIES

INTRODUCTION

Double entry system of accounting is more than 500 years old. "Luca Pacioli" an Italian friar & mathematician published Summa de Arithmetic, Geometria, Proportioni, et Proportionalita ("Everything about Arithemetic Geometry and proportions"). The first book that described a double entry accounting system. Double entry system of bookkeeping has emerged in the process of evolution of various accounting techniques. It is the only scientific system of accounting. According to it, every transaction has two-fold aspects–debit and credit and both the aspects are to be recorded in the books of accounts. Therefore, in every transaction at least two accounts are effected.

For example, on purchase of furniture either the cash balance will be reduced or a liability to the supplier will arise. and new asset furniture is acquired . This has been made clear already, the Double Entry System records both the aspects. It may be defined as the system which recognizes and records both the aspects of transactions. This system has proved to be systematic and has been found of great use for recording the financial affairs for all institutions requiring use of money.

1. Account - Meaning

1. **Meaning:** Under the Double Entry System, the Dual Aspects (Debit and Credit) relating to each transaction under each of Assets / Liabilities / Incomes / Expenses are presented in a **"T" Form.** This is called as an **Account.**
2. An "Account" represents a detailed record of transactions and changes that have occurred in a particular Asset, Liability, Expense, Loss, Gain or Capital during an accounting period.
3. The Left Hand Side of the "T" Form Account is called **Debit side (in short Dr.),** and the Right Hand Side of the "T" Form Account is called as **Credit Side (in short Cr.).**
4. The terms Debit (Dr.) and Credit (Cr.) only describe the **two sides** of the Account. **(Note:** Debit and Credit does **not** -mean unfavourable and favourable respectively.)

Model Format of an "Account"

Dr. ←→ Left Side ←→ Account ←→ Right Side ←→ Cr.

Date	Particulars	Ref.	Amount (₹)	Date	Particulars	Ref.	Amount (₹)
	Opening Balance		xxx		---- Transactions		xxx
			xxx				xxx
	---- Transactions		xxx				xxx
			xxx		Closing Balance		**xxx**
	Total		**xxxxx**		**Total**		**xxxxx**

Notes:

(a) "Ref." represents 'Reference" - The source from which the transactions are recorded in the Account,

(b) Entries on the left side are prefixed by **"TO".** Entries on the right side are **"BY".**

(c) Opening Balance will be on the left side for Debit Balance accounts. It will be on credit side for Credit Balance Accounts.

Example: If a Cash Account is prepared, it has the following features:

- It will contain all transactions which involve cash.
- It will also show the **status of the cash balance** i.e how much cash is left in the business.
- The transactions are recorded date wise (Otherwise called as **"Chronological Order")**

2. Approaches to Accounting - 2 Methods

To analyse the Dual Aspect of each transaction, the following approaches can be applied -

1. **Accounting Equation Approach:** Here, the dual aspect of each transaction is identified by reference to the impact on the basic accounting equation, i.e. Equity + Liabilities = Assets.
2. **Traditional Approach:** Each transaction is recorded in the books by reference to the rules of Debit and Credit only. These Rules are called **Golden Rules of Accounting.** (See below for **Rules)**

3. Accounting Equation Approach

1. **Basic:** The transactions that are to be recorded on the debit side (left side) and on the credit side(right side) depends on the nature of item for which account is to be prepared, i.e. whether the account represents an Asset / Liability / Expense / Income / Capital.

2. The rules for debiting / crediting the various account types are given below - **(Accounting Equation Approach)**

Account Type	**Transactions entered on Left Side (i.e. DEBITED)**	**Transactions entered on Right Side (i.e. CREDITED)**
(a) Assets	**All transactions which INCREASE the balances of Assets** i.e. Purchase of Fixed Assets, Investments, Stock, etc.	**All transactions which DECREASE the balances of Assets** i.e. Sale of Fixed Assets Investments, Stock, etc.
(b) Liabilities	**Transactions which DECREASE the liabilities** i.e. Payment to Creditors, repayment of Loans taken, etc.	**All transactions which INCREASE the balances of Liabilities.** Purchase of goods on credit, taking fresh loans, etc.
(c) Equity/ **Capital**	**Transactions which DECREASE the Capital** i.e. withdrawal of Capital by Proprietor, Partners, etc.	**Transactions which INCREASE the Capital,** i.e. Introduction of fresh Capital.
(d) Incomes/ Gains	**Transactions which DECREASE the Incomes,** i.e. Sales Returns, etc.	**Transactions which INCREASE the Incomes,** i.e. Sale of goods, Interest, Rent Dividends, Discount earned, etc.
(e) Expenses/ Losses	**Transactions which INCREASE the Expenses,** i.e. incurring Salary, Rent, Interest, and Other Expenses.	**Transactions which DECREASE the Expenses,** reimbursement of expenditure by way of grants, etc.

3. **Summary of above table:**
   (a) Increase in Equity / Liabilities / Incomes represent Credits, while decreases thereof are Debits.
   (b) Increase in Assets / Expenses represent Debits, while decreases thereof are Credits.

4. Example for Accounting using Accounting Equation Approach

Mr.X has the following transactions. Show how the following transactions are to be shown under Cash Account

	Particulars	Impact on Cash	Side (Note)
(a)	Cash introduced into the business by X ` 1,00,000	Increases (comes into business)	Debit
(b)	Cash Purchases made for ` 10,000	Decreases (cash goes to supplier)	Credit
(c)	Credit Purchases made for ` 12,000	No Impact (no cash in involved)	N.A.
(d)	Cash paid to Creditors ` 5,000	Decreases (cash goes to creditor)	Credit
(e)	Cash Sales: `14,000	Increases (cash recd, from customers)	Debt
(f)	Credit Sales: `10,000	No Impact (no cash in involved)	*N.A*
(g)	Cash received from debtors: ` 7,000	Increases (cash recd, from customers)	Debit
(h)	Expenses paid in cash: ` 5,000	Decreases (cash paid to customers)	Credit

Not: Since cash is an asset, the cash account shall be debited if cash increase.It shall be credited if it decreases

Hence, the Cash Account will look as below -

Dr.		Cash Account				Cr.	
Date	**Particulars**	**Ref.**	**Amt.(`)**	**Date**	**Particulars**	**Ref.**	**Amt.(`)**
	Opening Balance		Nil		By Cash Purchases		10,000
	To Cash introduced		1,00,000		By Cash paid to Creditors		5,000
	To Cash Sales		14,000		By Expenses paid in cash		5,000

Notes:

1. Closing Balance =
   (a) Debit Side Total - Credit Side Total (if Debit Side Total is higher)
   (b) Credit Side Total - Debit Side Total (if Credit Side Total is higher)
2. The Closing Balance is entered on the side whose total is lower. In the above case, Debit side total is ` 1,21,000, while the credit side total is `20,000 only. Hence, the debit side total is greater than the credit side total. So, the closing balance has to be entered on the credit side.
3. The above balance implies that the business of Mr.X has a cash balance of `1,01,000.

5. Nature of Balance in each Nature of Account

1. **Nature of Balance:** An A/c may have **any ONE of the following balances** - (Only one type of balance possible at a time)

(a)	"Debit Balance Account"	**Total of Debit Side > Total of Credit Side**
(b)	"Credit Balance Account"	**Total of Credit Side > Total of Debit Side**
(c)	"Nil Balance Account"	**Total of Debit Side = Total of Credit Side**

2 **Type of Account and Nature of Balance:**

Type of Account	Debit Side Records	Credit Side Records	Nature of Balance
Assets	Increases	Decreases	Debit Balance
Liabilities	Decreases	Increases	Credit Balance
Capital	Decreases	Increases	Credit Balance
Incomes	Decreases	Increases	Credit Balance
Expenses	Increases	Decreases	Debit Balance

Illustration: Refer Cash A/c above. Cash Account is in the nature of Asset Account. So, it has debit balance.

6. Traditional Approach - Golden Rules of Accounting

1. This is the commonly used method for accounting the transactions. These rules form basis for accounting.
2. **Principle:** The **Golden Rules of Accounting** in respect of the Double Entry System are -

	Nature of Account	When Debited	When Credited
1.	Personal Account	Debit the Receiver of Benefit	Credit the Giver of Benefit
2.	Real Account	Debit What comes in	Credit What goes out
3.	Nominal Account	Debit All Expenses and Losses	Credit All Incomes and Gains

Note: Also Refer meaning of the above rules below

3. The entries that should come on the debit and credit side of an account are based on the nature of that account. **Hence,** it is essential to understand the meaning of the nature of the accounts (Refer below)

7. Common Sense Rules for Accounting (Additional Rules)

1. The following rules are in addition to Golden Rules specified above. These will be useful in accounting the transaction-
2. They are as follows -
   (a) If a Debit Balance Account has to be increased, further debit that Account, (write on left side of the account)
   (b) If a Debit Balance Account has to be decreased, then credit that account, (write on right side of the account)
   (c) If a Credit Balance Account has to be increased, further credit that Account, (write on right side of the account)
   (d) If a Credit Balance Account has to be decreased, then debit that Account, (write on left side of the account)

Students' Notes:

- **Area of Usage:** The Golden Rules and also the Common Sense Rules are applicable for accounting the transactions : - Journal and Subsidiary Books. (Discussed later in this chapter).

* Students are advised to remember the above rules clearly to get control over the subject of Accountancy.

8. Type of Account

Personal Accounts

(a) Natural Personal Accounts

* All Accounts which record transactions of **Natural human beings,** i.e. Ram, Lakshman, Krishna, Joseph, Kabir, Debtors, Creditors etc.

(b) Artificial (Legal) Personal Accounts

* All Accounts which record the transactions with **other business entities** having **separate legal status for accounting** purposes, i.e. Ram Industries Limited (Company), Aditya & Co, (Partnership Firm), Krishna & Co. (say Proprietary Firm), Co-operative Societies, Clubs, Government, Banks, Debtors, Creditors etc.

(c) Representative Personal Accounts

* All Accounts which **indirectly** represent the **persons. For Example -**

Name of the Account	**Indirectly represents**
Capital Account	**Owner**
Outstanding Expenses Account	Service Provider / Supplier(For Eg - O/s Rent represents landlord)
Prepaid Expenses/Expenses paid in advance A/c	Service Provider / Supplier
Accrued Incomes	Customers
Incomes received in advance	Customer.

Note: All Liabilities will fall under "Personal Accounts"

* **Impersonal Accounts**

(a) Real Accounts

All Accounts which record transactions relating to **Assets of the Firm (but not except those covered under Personal A/c above - i.e. Debtors, Prepaid expenses etc. For Example:** Building, Machinery, Other Fixed Assets, Investments, Cash, Bank, etc.

(b) Nominal Accounts

All Accounts which record transactions relating to -

- **Incomes / Gains,** e.g. Sales, Rent / Interest / Dividend / Commission Receive/ Profit on Sale of Fixed Assets / Investments, etc.
- **Expenses / Losses,** e.g. Salary, Wages, Rent Paid, Insurance, Bad Debts / Depreciation, Discounts allowed, etc.

Note: For the sake of convenience in accounting, the above type of accounts are summarized as - **(a) Personal Accounts, (b) Real Accounts, and (c) Nominal Accounts.**

9. Determination of Profits and Losses - 2 Approaches

Meaning of Profits / Losses and Financial Position

Profit / Losses: The Main Purpose of a business is to achieve profits. "Profits" means Excess of Incomes over expenses. "Losses" refers to excess of Expenses over Incomes. Hence, **Profits / Losses are concerned with Incomes / Gains and Expenses / Losses of the business. (Otherwise called as Operating Results)**

Financial Position: It refers the wealth of the business. A business is wealthier when it has more assets and less outside liabilities. Hence, **Financial Position is concerned with the assets and Liabilities of the business.**

10. Determination of Profits / Losses and Financial Position

1. The Operating Results and Financial Position of the business can be determined through any of the following **methods** (a) Accounting Equation Approach (b) Traditional Approach.

2. **Using Accounting Equation Approach:**

Purpose	Method of Determination
Determination of Profits / Losses	**Step I:** Find the difference between **[Closing Capital - Opening Capital]** **Step II:** If above difference > 0 => Profits; If Difference < 0 Losses **Note:** Capital = Total Assets - Total Liabilities
Determination of Financial Position :	A **Statement** is prepared showing all **ASSETS on right side** and **at LIABILITIES on left side.** The Total of Assets and Liabilities shall be equal

3. **Using Traditional Approach: (This is the popular method)**

Purpose	Method of Determination
Determination of Profits / Losses	**Two Accounts -"Trading Account and Profit & Loss Account"** prepared Those two accounts compare the Incomes and Expenses to ascertain the profits.
Determination of Financial Position	**Balance Sheet** is prepared: It is a **Statement** showing all **ASSETS on right side** and: all **LIABILITIES on left side.** The Total of Assets and Liabilities shall be equal.

11. JPURNAL - Phases in the Accounting Process - Traditional Approach

The following Accounts Books / Phases to be followed for determination of Profits / Financial Position of the business.

Source Documents	Book of Original Entry	Ledger Posting	Trial Balance	Final Accounts
Vouchers	Journal and Subsidiary Books	Ledger	Trial Balance	P&L A/c and Balance Sheet

1. **Journalisation of Transactions and Events: Journal** is the **Initial Accounts Book** in which the transactions are **RECORDED** on their occurrence. It is similar to a **Financial Diary. Here Transaction is recorded date-wise. In certain cases, Subsidiary Books** are prepared instead of Journal.
2. **Ledger Posting and Balancing:** Based on the entries in the Journal, **Accounts are prepared** in the Ledger. Here, all transactions related to a particular Account Head are grouped under a particular account. For Example, all transactions involving cash will be recorded under "Cash Account". Bank transactions recorded under "Bank Account".
3. **Preparation of Trial Balance:** After ledger posting, a **Statement** called as **"Trial Balance"** is prepared, which contains the balances in all the ledger accounts. Debit Balances and Credit Balances are grouped under separate columns. The total of Debit Balance Column must be equal to the Total of the Credit

Balance Column. Hence, Trial Balance is a consolidation of all ledger account balances.

4. **Preparation of Financial Statements:** For Determination of Operating Results and the Financial Position of the business, the following accounts or statements are prepared -
   (a) **Performance Statement** i.e. Trading Account and Profit & Loss Account : To find out the profit made or loss sustained in a particular accounting period through transactions and events,
   (b) **Position Statement,** i.e. the Balance Sheet : To explain the financial position of the reporting entity at the end of the accounting period, and
   (c) **Cash Flow Statement :** To analyse the pattern of movement in cash and Bank

12. Meaning of journal

1. **Meaning:**
   (a) **Journal is the Book of Primary Entry / Book of Original Entry.**
   (b) It is the **Initial Accounts Book** in which the transactions are **RECORDED** on their occurrence.
   (c) **Entry** is made in this book to show which Account should be debited and which Account should be credited.
2. **Features of Journal:**
   (a) Once a transaction happens, it is analysed to determine the Debit aspect and Credit aspect and entered in Journal.
   (b) All transactions are first recorded in the Journal Book as and when they occur. Hence, the Journal is maintained in **chronological,** i.e. Date-wise order.
   (c) The Journal is referred to as **Subsidiary Book** (as entries are posted from this book into **Ledger** subsequently.)
3. **Purposes of Journal:** Based on Dual Aspect Concept, every transaction has two equal aspects - Debit and Credit.

   Hence, it is essential to identify the accounts which are involved and to decide the accounts to be debited / credited.
4. **Journalising:** Recording entries in Journal is called “Journalising the Entries”. Each entry is called as “Journal Entry”.
5. **Source for recording:** The sources available for recording in the Journal are (a) Vouchers (b) Documents (c) Invoices.
6. **The format of Journal is as under -**

Date	Particulars	Ledger Folio (LF)	Debit Amt (₹)	Credit Amt (₹)
(1)	(2)	(3)	(4)	(5)
31.01.11	Cash A/c　　Dr.	100	10,000	
	To Ramesh A/c	250		10,000
	(Being Cash received from Ramesh)			

Narration

Cash A/c is in 100th Page in Ledger

EQUAL

Column　Explanation

(1) Date on which the particular transaction happens

(2) Debit of which account is to be debited and credited is give here.

- Debit Account is written first as ...... Cash A/c Dr.
- Credit Account is written next as ... To Ramesh A/c
- explanation relating to the transaction is given in brief. This is called Narration. This is very crucial for understanding the Journal Entry. An Entry without Narration is not valid.

(3) This Column stands for the Page Number in the Ledger in which the posting is given subsequently. This Column is intended only to track and trace the entry into the Ledger.

(4) Amounts to be debited in the various accounts are recorded in this Column.

(5) Amounts to be credited in the various accounts are recorded in this Column.

Notes :

(a) Debit and Credit Totals of the Journal Entry should always tally.

(b) When Journal Entries run to various pages, the total of each page (debit and credit totals separately)

7. Types of Journal Entries :

Simple Journal Entry : One Debit and One Credit present for equal amount

Compound Journal Entry : It is a journal entry which contains one debit and two or more credits / two or more debits and one credit / two or more debits and credits.

8. Advantages of Journal :

(a) Since Journal is maintained in chronological, i.e. datewise order, **complete information** on day-to-day» transactions can be obtained.

(b) Journal forms the basis for posting the entries into the **Ledger** subsequently.

(c) Narration to Journal Entries provides explanation for the **nature and purpose** of transaction.

9. Subsidiary Books : In certain cases, instead of Journal, Subsidiary Books are maintained.

13. Steps for a Journal Entry

Steps

Step I: Determine whether a transaction is Financial/Non-Financial transaction. **Only Financial Transaction is recorded in the Journal.**

Step II : Analyse the transaction to **identify** what are the **two Aspects / accounts** involved in the transaction.

(a) One Aspect / Account can be easily **identified from the reading** of the transaction itself

(b) Second Account can be found out by **asking any of the questions - "For What/ By What/ Of What = Whom / By Whom / To Whom / On What" - Answer to these questions will identify another A/c**

Step III : Determine the nature of the each of the two accounts involved in the transaction, i.e. whether the account belongs to Personal Account / Real Account / Nominal Account. **(For classification, refer earlier discussions)**

Step IV : Determine the accounts which are to be Debited and Credited.

For this, **Apply** the **Golden Rules / Common Sense Rules of Accounting based on the nature of accounts** (as identified above). **(For Golden Rules and Common Sense Rules, Refer earlier discussions)**

Step V : Identify the amount involved. Ensure that the amount of debit and credit must be equal. Then write the Journal Entry along with the narration in the **format mentioned above**

14. Meaning of the Golden Rules of Accounting

Personal A/c

Rule : Debit the Receiver of Benefit,

Credit the Giver of Benefit

Meaning of the Rule : Write on the Debit / Left side of an Account which represents a person, if that person **receives money from the business.**

Meaning of the Rule : Write on the Credit / Right side of an Account which represents a person, if that person **gives money to the business.**

Real Account

Rule : Debit What Comes In

Meaning of the Rule : Write on the Debit / Left side of a Real A/c, if an asset comes into business (Increases)

Rule : Credit What Goes out

Meaning of the Rule : Write on the Credit / Right side of a Real A/c, if an asset goes out of business (Decreases)

Nominal Account

Rule : Debit all Expenses and Losses

Meaning of the Rule : Write on the Debit / Left side of an account, which represents an expense / loss.

Note: Reduction in incomes is considered as Expenses / Losses (For eg. Sales Returns)

Rule : Credit all Incomes and Gains

Meaning of the Rule : Write on the Credit / Right side of an account, which represents an income / gain

Note: Reduction in Expenses / Losses is considered as Incomes. (For eg. goods purchased drawn for personal use, Purchase Returns)

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. The rent paid to landlord is credited to

(a) Landlord's account. (b) Rent account.

(c) Cash account.

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

(a) Trade receivables account. (b) Bad debts account.

(c) Cash account.

3. A Ltd. has a ` 35,000 account receivable from Mohan. On January 20, Mohan makes a partial payment of ` 21,000 to A Ltd. The journal entry made on January 20 by A Ltd. to record this transaction includes:

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

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

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

4. Which financial statement represents the accounting equation -

Assets = Liabilities + Owner's equity:

(a) Income Statement

(b) Statement of Cash flows

(c) Balance Sheet.

5. Which account is the odd one out?

(a) Office furniture & Equipment.

(b) Freehold land and Buildings.

(c) Inventory of materials.

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

(a) Credited to Bad Debts Recovered Account

(b) Credited to Trade receivables Account.

(c) Debited to Profit and Loss Account.

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

(a) Two accounts

(b) Two sides of the same account.

(c) The same account on two different dates.

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

(a) Ram (b) Cash (c) Sales

THEORETICAL QUESTIONS

1. Write short note on classification of accounts.

2. Distinguish between Real account and nominal account.

HOME WORK

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

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

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

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

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

(iii) Income tax liability of proprietor ` 1,17000 was paid out of petty cash.

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

3. Calculate the missing amount for the following

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

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

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

Also give reasons for your answers.

5. Following is the information provided by Mr. Gopi pertaining to year ended 31st March 2017. Find the unknowns, showing computation to support your answer:

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

Additional Information: During the year sales of ` 15,55,000 was made of which ` 15,00,000 have been received.

UNIT : 2
LEDGER

INTRODUCTION

After recording the transactions in the journal, recorded entries are classified and grouped into by preparation of accounts. The book which contains all set of accounts (viz. personal, real and nominal accounts), is known as Ledger. It is known as principal books of account in which account-wise balance of each account is determined.

1. Meaning and Significance of Ledger

(1) **Meaning:** Ledger is an Accounts Book which contains all Account Heads, which are opened in Journal / Subsidiary Books,

(2) **Significance:**

(a) Ledger helps to identify the list of transactions under a particular Account Head and also show the balances in each *of the* ledger accounts. This helps in ascertaining the status of that account.

(b) For Example, Cash Account contains all transactions involving cash. Hence, by looking at the cash account, the can find out the sources from which cash is received and also the reasons for use of such cash. It also **shows** the cash balance in the business on a specified date.

(3) **Other Names for Ledger :**

Principal Book : Debit and Credit aspect of each transaction is recorded here, and constitutes the basis for preparation of Trial Balance and Final Accounts.

Secondary Book of Entry : It is the second stage in the Accounting Process.

Book of Final Entry : The Ledger is the **Final Destination** of all transactions.

(4) **Sources of Ledger :**

(a) The Entiries in the **Journal / Subsidiary Books** form the basis for preparation of Ledger.

(b) without **Passing an Entry in the Journal / Subsidiary Books, an entry cannot appear in the ledger.**

(c) Transactions in the ledger are recorded in an analytical order.

2. Format of Ledger Accounts

1. **Basic Process:**

(a) **Posting:** After recording the transactions in the Journal, the debit and credit aspects of each of the journal entries are then transferred to the appropriate Account Head in the Ledger. **(This process is known as "Ledger Posting", or simply "Posting")**

(b) The Journal Entries are classified and grouped appropriately, by preparation of Accounts, in the Ledger.

2. The format of the Ledger Account Book is as under - (**Note:** Ledger Accounts Books contains all the Ledger Accounts).

Model Format of a Ledger "Account"

Dr. ⟵⟶ Left Side ⟵⟶ Account ⟵⟶ Right Side ⟵⟶ Cr.

Date	Particulars	Journal Folio	Amount (₹)	Date	Particulars	Journal Folio	Amount (₹)
	Opening Balance		xxx		By --- Transactions		xxx
	To --- Transactions		xxx				xxx
			xxx				xxx
			xxx		Closing Balance		xxx
	Total		xxxxx		Total		xxxxx

3. Description of the Format of the Ledger Account:

(a) **Separate Account** is opened in the Ledger Book for **each Account Type,** e.g. Capital, Loan, Machinery Furniture, Sales, Purchases, Rent, Salary, Commission, Electricity, Discount received etc.

(b) Every Ledger Account has **two sides** - (i) LHS = Debit Side, and (ii) RHS = Credit Side.

(c) **Ledger Posting** is done based on the a/c to be debited and credited as per the Journal Entry.

(d) Entries on the **left side** are prefixed by **"TO".** Entries on the **right side** are **prefixed with "BY".**

(e) The Column **(Journal Folio)** is used to indicate the **Page Number in the Journal Book where the relevant journal entry is found.** This is used to track and trace the entry in the Journal Book.

(f) **Opening Balance** will be on written on the Left Side for Debit Balance accounts. It will be on written on the Credit Side for Credit Balance Accounts.

The Ledger Accounts are broadly classified into - (a) Assets, (b) Liabilities, (c) Incomes and (d) Expenses.

1.3 Posting of Journal Entries to Ledger Accounts - Guidelines

The following steps are involved in the posting of Journal Entries to Ledger Accounts:

Step I : Identify the Accounts debited and Credited in the Journal Entry.

Step II

(a) **If an Account is debited in the Journal Entry** - This implies that under the ledger account which is specifically opened for that item, the accountant has to write on the **debit side of that ledger account "To........A/c"** (which is the **other aspect credited** in the Journal Entry)

(b) **For the other Account which is credited in that Journal Entry** - Write on the Credit side relevant ledger account in the ledger as **"By ...... A/c"** (Which is the **aspect debited** in the Journal entry)

Step III

All the Journal Entries are **periodically posted to the ledger** account from the journal book. Thus a ledger account may consist of entries on both sides of that account.

Note: Where an Account is already present in the ledger, the journal entry should be updated in that ledger account itself. If it does not exist, then a fresh account to be opened in the ledger book.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

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

(a) Posting (b) Purchase

(c) Balancing of an account

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

(a) Posting (b) Purchase

(c) Balancing of an account

3. Journal and ledger records transactions in

(a) A chronological order and analytical order respectively.

(b) An analytical order and chronological order respectively.

(c) A chronological order only

4. Ledger book is popularly known as

(a) Secondary book of accounts

(b) Principal book of accounts

(c) Subsidiary book of accounts

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

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

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

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

THEORETICAL QUESTIONS

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

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

HOME WORK

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

1. X started business with a capital of ` 20,000
2. He purchased goods from Y on credit ` 4,000
3. He paid cash to Y ` 2,000
4. He sold goods to Z ` 4,000
5. He received cash from Z ` 6,000
6. He further purchased goods from Y ` 4,000
7. He paid cash to Y ` 2,000
8. He further sold goods to Z ` 4,000

9 He received cash form Z ` 2,000

UNIT : 3
TRIAL BALANCE

INTRODUCTION

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance. It may also be prepared by listing each and every account and entering in separate columns the totals of the debit and credit sides. Whichever way it is prepared, the totals of the two columns should agree. An agreement indicates reasonable accuracy of the accounting work; if the two sides do not agree, then there is simply an arithmetic error(s).

1. Meaning and Purpose of Trial Balance

1. **Meaning:** Trial Balance is a **statement** which lists down the **debit and credit balances** of all accounts, as **at a particular date** (i.e. end of the period) under two **separate columns.**
2. **Features:**
   (a) Trial Balance is a statement and not an Account.
   (b) The Totals of all Debit Balances and Credit Balances will be equal. **(Explained in the next page)**
   (c) It has **two columns - Debit Column and Credit Column.**
   (d) It is the third stage in the Accounting Process
   (e) Trial Balance can be prepared **on any day of the accounting period.** It shows the balances on that date.
3. **Objectives / Advantages:** The 3rd phase in the accounting process, i.e. preparation of Trial Balance
   (a) It summarises the Ledger balances in four columns.
   (b) The Ledger itself may be referred to only when further details are required in respect of that Account.
   (c) Serves as a **check on Arithmetical Accuracy of books,** since **Debit and Credit Totals must agree.**
   (d) Provides the basis of preparation of Final Accounts, i.e. Financial Statements - P&L A/c & B/Sheet.
4. **Source for Trial Balance:** Ledger Accounts
5 **Limitations:** Mere tallying / agreement of Trial Balance is not a conclusive proof of arithmetical accuracy. The Trial Balance may still tally with the following errors -
   (a) Complete omission of a transaction, either in journalizing or in ledger posting therefrom,
   (b) Recording of a transaction at a wrong amount,
   (c) Debiting or Crediting correctly in the Ledger, but in the wrong account head,
   (d) Compensating Errors, i.e. errors whose effects nullify each other.

2. Format of Trial Balance

1. **Methods of preparation of Trial Balance:** Trial Balance may be prepared as under -

Methods

(a) **Total Method:**

What is written in Trial Balance ?

The **Total of Debit and Credit Side of each Ledger Account** is recorded in the Trial Balance, in the respective columns.

Remarks :

Merit: Time taken to balance each Ledger A/c is saved.

Demerit: Not useful for preparation of Final Accounts.

(b) **Balances Method:**

What is written in Trial Balance ?

Here, only the balance in each Ledger A/c is recorded in Trial Balance. Some accounts may have Dr. Balance while others have Cr. Balance.

Remarks : Most popularly used method, since it helps in preparation of Final Accounts / Financial statements.

(c) **Total & Balances Method:**

What is written in Trial Balance ?

This is a combination of above 2 methods. Both Totals and Balances are indicated in separate columns in Trial Balance.

Remarks : Not regularly used.

2. **Format of Trial Balance**

Particulars (i.e.Name of the Account)	Ledger Folio	Dr. Amt (`)	Cr. Amt (`)
(1)	(2)	(3)	(4)

Notes:

- In Column 1, Name of the Ledger A/c is given, e.g. Capital, Machinery, Sales, Purchases, Bank, etc.
- In Column 2, the Page Number of the Ledger is given for tracking and tracing purposes.
- In Column 3 & 4, - (a) the Dr. and Cr. Totals of the Ledger A/c are given (in Total Method), and (b) the balances of each Ledger A/c are given (in Balances Method). Under Total and Balances Method, additional columns are added, to indicate Totals and Balances separately.

3. Features of Trial Balance - Dr. Total = Cr. Total

1. The total of Debit Balances is equal to the total of Credit Balances at a particular point of time. The balances are tallied in this statement to assess whether the Fundamental Accounting Equation is satisfied or not.
2. Both the totals match due to the following reasons:
   (a) Trial Balance is prepared based on Ledger Accounts. Entries are made in each ledger accounts based on Journal.
   (b) Each Journal Entry contains **two aspects of equal amount** - Debit and Credit.
   (c) Hence, where there is a debit to a particular account for a specified amount, there will also be a credit for the same amount in another Account.
   (d) This leads to the equality of debit balance and credit balance.
3. **For Example:** Refer below for detailed example on preparation of Trial Balance

Important Notes in preparing Trial Balance

- Accounts with Nil balance will **not** be shown in the Trial Balance.
- All Accounts with balances, i.e. whether Real, Personal or Nominal, will be shown in the Trial Balance.
- Accounts relating to - (a) Assets, (b) Expenses, (c) Losses, (d) Drawings, (e) Cash, have Dr. Balance.
- Accounts relating to - (a) Capital, (b) Loans & Liabilities, (c) Incomes, (d) Gains, have Cr. Balance.
- If the Trial Balance does not agree, it may be tallied by transferring the difference of Debit or Credit to an Account known as **Suspense Account.** This is a temporary account opened to proceed further and to prepare the Financial Statements in a timely manner. [Such a TB may be called as **Adjusted TB.]**

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. A trial balance will not balance if __________.
 (a) Correct journal entry is posted twice.
 (b) The purchase on credit basis is debited to purchases and credited to cash.
 (c) ` 500 cash payment to creditor is debited to Trade payables for ` 50 and credited to cash as ` 500.

2. ` 1, 500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance __________
 (a) The debit total will be greater by ` 3,000 than the credit total.
 (b) The debit total will be greater by ` 1,500 than the credit total.
 (c) Subject to other entries being correct the total will agree.

3. After the preparation of ledgers, the next step is the preparation of __________
 (a) Trading accounts
 (b) Trial balance
 (c) Profit and loss account

4. After preparing the trial balance the accountant finds that the total of debit side is short by ` 1,500. This diff erence will be ______________
 (a) Credited to suspense account
 (b) Debited to suspense account
 (c) Adjusted to any of the debit balance account

5.

S.No.	**Account heads**	**Debit (`)**	**Credit (`)**
1.	Sales		15,000
2.	Purchases	10,000	
3.	Miscellaneous expenses	2,500	
4.	Salaries		2,500
	Total	12,500	17,500

The difference in trial balance is due to ______________________________
 (a) Wrong placing of sales account (b) Wrong placing of salaries account
 (c) Wrong placing of miscellaneous expenses account

THEORETICAL QUESTIONS

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

2. Explain objectives of preparation of trial balance.

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

HOME WORK

1. An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2017.

	Debit (`)	Credit (`)
Provision For Doubtful Debts	200	–
Bank Overdraft	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
General Expenses	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	364	–
Total	**24,983**	**25,002**

Required:

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

UNIT : 4
SUBSIDIARY BOOKS

INTRODUCTION

In a business, most of the transactions generally relate to receipts and payments of cash, sale of goods and their purchase. It is convenient to keep a separate register for each such class of transactions one for receipts and payments of cash, one for purchase of goods and one for sale of goods. A register of this type is called a book of original entry or of prime entry. For transactions recorded in such books there will be no journal entry. The system by which transactions of a class are first recorded in the book, specially meant for it and on the basis of which ledger accounts are then prepared is known as the Practical System of Book keeping or even the English System. It should be noted that in this system, there is no departure from the rules of the double entry system.

1. Subsidiary Books - Meaning

1. **Meaning**

   (a) "Subsidiary Books" refer to Specific Purpose Books maintained for recording **Specific Business transactions.**

   (b) **The** special transactions of each type are **listed** in the respective books. There is **NO Journal Entry.** From each Subsidiary Book, the total of transactions for each period (e.g. a month), are posted into Ledger.

   (c) These books are also called as **"Books of Original Entry"** or **"Books of Prime Entry". or Subsidiary Books:**

2. Need for Subsidiary Books:

   (a) When transactions are few in number, they are journalised individually in **one Journal Book,** but when transactions are many, it is inconvenient to record all the transactions in one Journal Book.

   (b) To avoid the Journal Book from becoming bulky and voluminous, the Journal Book is sub-divided into **Subsidiary** books, (also known as **Special Journals / Subsidiary Journals / Day Books / Journals).**

   (c) Each Subsidiary Book records a specific type of transaction. The purposes for which the separate books will be Prepared are identified based on the volume and importance of such purposes.

2. Subsidiary Books - Types

The various types of Subsidiary Books for recording specific types of transactions are .

(a) **Purchases Day Book :** To record transactions relating to **Credit Purchases**

(b) **Sales Day Book :** To record transactions relating to **Credit Sales**

(c) **Purchases Return Book :** To record transactions relating to **Purchase Returns made to Suppliers (Cash is not involved).**

(d) **Sales Return Book :** To record transactions relating to Sales Returns made by Customers, **(cash** is not **involved)**

(e) **Cash Book :** To record **Cash, Bank and Discount** transactions.

(f) **Bills Receivable Book :** To record transactions in respect of Bills Receivable, (i.e. Promissory Notes, Bills of Exchange and Hundies from Debtors / other parties)

(g) **Bills Payable Book :** To record transactions in respect of Bills Payable, (i.e. Promissory Notes, Bills of Exchange and Hundies issued to Creditors / other parties)

(h) **Journal Proper :** To record other transactions for which no specific book is maintained.

Note: The format of Journal and Journal Proper is the same.

(Note that Journal and Journal Entry are different. The former refers to the Book containing the entries, the latter refer(s) the entry consisting of Debit and Credit aspects.)

Financial Books of Account

Principal Books	**Subsidiary Books**
1. Ledger	1. Purchases Book,
2. **Cash Book (See Note below)**	2. Sales Book,
• Simple Cash Book (Cash Column only)	3. Purchase Returns Book,
• Cash and Bank Book (2-Column)	4. Sales Returns Book,
• Cash Book with Discount Column	**5. Cash Book**
• Cash Book with Bank & Discount Columns (3-Column)	6. Bills Receivable Book,
• Petty Cash Book	7. Bills Payable Book,
	8. Journal Proper.

Note: The Cash Book is both a Principal Book (since Debit and Credit Aspects are involved therein), as well as a Subsidiary' Book (since all Cash and Bank transactions are first recorded therein).

3 Purchases and Sales Book - Features

1. Purpose / Inclusions

Purchase Books : To record all **Credit Purchases of** goods and materials.

Sales Books : To record all **Credit Sales of goods &** materials.

2. Omissions / Exclusions

Purchase Books :

(a) **Cash Purchases** are **not** recorded here. There are directly recorded in the **Cash Book.**

(b) **Credit Purchases of Capital Assets/Items**

e.g. Machinery, Furniture, etc. are **not** recorded. They are recorded through the **Journal Proper.**

Sales Books :

(a) **Cash Sales** are **not** recorded here. They are directly recorded in **Cash Book.**

(b) **Credit Sales of Capital Assets / Item** e.g. Machinery, Furniture, are **not** recorded. They are recorded in **Journal Proper.**

3. Entry in Subsidiary Book

Purchase Books : Individual items of Credit Purchases are posted in this book along with the date and amount. **Trade Discount if any, is reduced,** and only the net amount is recorded in the Purchases Book.

Sales Books : Individual items of Credit Sales are posted: this book along with the date and a~ **Trade Discount if any, is reduced,** a the net amount is recorded in the Sales Book.

4. **Source**

Purchase Books : Purchase Invoice is the base document.

Sales Books : Sales Invoice is the base document.

5. **Posting in Parties Ledger A/c**

Purchase Books : Suppliers' / Creditors' Account will be credited for the amount of credit purchases as **"By Purchases Account".** This posting is on **individual basis.**

Sales Books : Customers' / Debtors/s A/c will be debited for the amount of credit sales as "To Sales Account". This posting is on **individual basis.**

6. **Posting *in* Nominal A/c**

Purchase Books : Total of Purchases Book is posted to the **debit** side of Purchases A/c as "To Sundries as per Purchases Book".

Sales Book : Total of Sales Book is posted to **credit** side of Sales A/c as "By Sundries as per Sales Book".

Note: Refer the method of posting from Subsidiary Books to Ledger Accounts at the end of this Chapter.

4. Purchase Returns and Sales Returns Books - Features

1. **Purpose/ Inclusions**

Purchase Returns Book (also called Returns Outward Book) : When goods / materials **earlier purchased on credit are returned by the Firm** to the Supplier, they are recorded in Purchase Returns book.

Sales Returns Book (also called returns Inward Book) : When goods / materials **earlier sold on credit are returned to the Firm** by the Customer, they are recorded in Sales Returns book.

2. **Entry in Subsidiary Book**

Purchase Returns Book : Individual items of Purchases Returns are posted in this book along with the date and amount.

Sales Returns Book : Individual items of Sales Returns are posted in this book along with the date and amount.

3. **Omission/ Exclusions**

Purchase Returns Book :

(a) Goods returned to supplier & **cash received**

(b) Fixed Assets returned to the supplier

(c) Goods earlier purchased for Cash

Sales Returns Book :

1. Goods received from the buyer & cash paid
2. Fixed Assets received from back from buyer
3. Goods earlier sold for cash

4. **Source**

Purchase Returns Book : Debit Note

Sales Returns Book : Credit Note

5. **Positing in Parties Ledger A/c**

Purchase Returns Book : Suppliers' / Creditors' A/c will be debited for the amount of purchase returns as **"To Purchases Returns A/c".** This posting is on **individual basis.**

Sales Returns Book : Customers' / Debtors' A/c will be credited for the amount of sales returns as **"By Sales Returns A/c".** This posting is on **individual basis.**

6. Positing in Norminal Account

Purchase Returns Book : Total of Purchases Returns Book is posted in the credit side of Purchases Returns A/c as "By Sundries as per Purchase Returns Book".

Sales Returns Book : Total of Sales Returns Book is posted in the debit side of Sales Returns A/c as "To Sundries as per **Sales Returns Book".**

7. Format

Purchase Returns Book : Format is the same as Purchases Book, except that Debit Note will appear instead of Invoice.

Sales Returns Book : Format is the same as Sales Book, except that Credit Note will appear instead of Invoice.

5. Trade Discount Vs Cash Discount

1. Trade Discount:

(a) Trade Discount refers to reduction in price offered by the seller for HIGHER QUANTITY of purchases,.

(b) It is allowed as deduction from the List Price. (Trade Discount = % of discount x List Price)

(c) The price after deducting the trade discount is called Invoice Price.

(d) Trade Discount is not recorded in Accounts Books, i.e. directly Invoice Price itself is recorded in Accounts Books.

2. **Cash Discount:**

(a) Cash Discount refers to **reduction** in **AMOUNT DUE** offered by seller if **payment is received before due date.**

(b) It is some times technically referred as **"2/10 net 30".** This implies 2% cash discount is allowed if payment made within in 10 days. Otherwise payment has to be made within 30 days from date of sale.

(c) Cash Discount is **recorded** in Accounts Books, i.e. It is an **Expense** for the **seller / Income** for the **buyer.**

(d) It is recorded in the books under the head "Discount allowed" (for Supplier) / "Discount Received (for Buyer).

(e) **Cash Discount = % of discount x Amount actually payable (Invoice Price)**

3. **Example:**

Goods worth ` 5,000 sold by Lakshman @ 10% trade discount and @ 1% cash discount on payment with in 10 daws. Lakshman received payment from debtor with in 7 days. Calculate the amount payable

Particulars	(`)	**Books of Seller**		**Books of Buyer**
List Price	5,000	Not Passed		Not Present
Less: Trade Discount @ 10% of ` 5,000	(500)	Not Passed		Not Passed
Invoice Price - Amount recorded as Sales	4,500	Debtor A/c Dr.	4,500	Purchases A/c Dr. 4500
		To Sales	4,500	To Creditor 4500
Less: Cash Discount @ 1% of ` 4,500	(45)	Cash A/c Dr.	4,455	Creditor A/c Dr. 4500
Net Amount received ,If payment made in 7 days	4,455	Discount All. Dr,	45	To Disc.Recd.45
		To Cash	4,500	To Cash 4,455

Note: If Subsidiary Books are maintained - Books of Seller

- **During Sales** - Lakshman records only `4,500 as sales in his "Sales Book".
- **During Settlement** - Lakshman records ` 45 as expense under "Discount Allowed" along with receipt of `4,455
- In the **Books of the buyer,** Purchases is recorded for ` 4,500 and "Discount received" recorded for `45.

6. Journal Proper - Features

1. Significance: "Journal Proper" is used to record those transactions which cannot be recorded in any of the specific Subsidiary Books.
2. **Features:**
   (a) Journal Proper is a **Residuary Subsidiary Book** to record the residuary transactions.
   (b) The **format** of Journal is **exactly similar to the format of a normal Journal Book (Refer Chapter 2A).**
3. **Transactions recorded in Journal Proper:** More particularly, the following transactions are recorded -
   (i) **Opening Entries**
   - Normally, while moving from one accounting year to another, the old accounts books are closed and a fresh set of accounts books are opened for the new Accounting year.
   - Hence, it becomes necessary to carry forward all the assets and liabilities of the business, which exist or re last day of the previous accounting period from the past accounts books to the current accounts books.
   - Thus the opening balances of assets and liabilities are brought forward from the previous accounting period by passing opening entries.
   - **Journal Entry for recording of opening balances -**

Particulars		**Debit**	**Credit**
Assets A/c	Dr.	XXX	
To Liabilities A/c			XXX
To Capital A/c			XXX

   (ii) **Closing Entries:** At the end of the year the Trading Account and Profit & Loss Account are prepared to determine profits / losses of the business. To determine such profits, all the nominal account balances must be transferred above accounts. Such entries are called Closing entries.
   - For transferring Expenses / Losses to Trading Account / Profit and Loss A/c -

     Trading Account / Profit and Loss Account Dr.
     To Expenses A/c / Losses A/c

     Reason: All expenses / Losses Accounts are to be CLOSED by transfer to Trading A/c / P & L A/c. Expenses A/c will have debit balance in the respective accounts. If a debit balance account is to be closed, then it has to be credited (as per common sense rule).Hence,the other aspect" Trading A/c /P& L A/c" has to be credited.
   - For transferring Incomes / Gains to Trading Account / Profit and Loss A/c -

     Incomes A/c / Gains A/c Dr.
     To Trading A/c / Profit & Loss A/c

Reason: All Incomes / Gains Accounts are to be CLOSED by transfer to Trading A/c / P & L A/c. Incomes A/c will have creid balance in the respective accounts. If a Credit balance account is to be closed, then it has to be debited (as per common sense rule).Hence,the other aspect "Trading A/c /P& L A/c" has to be debited.

(iii) **Rectification entries:** Entries passed to rectify the errors occurred during the accounting process.

(iv) **Transfer Entries:** If some amount is to be transferred from one account to another account, the transfer will be made through a Journal Entry. **For Example,** when goods purchased worth ` 50,000 are used for construction of a building then a transfer entry has to be made for transferring ` 50,000 from Purchases A/c to Building A/c.

(v) **Adjusting Entries**: Adjusting entries refer to entries passed to adjust the incomes / expenses for the current ensure that only current year's incomes and expenses are matched. Hence, entries passed for the following purposes are called "Adjusting Entries". ***(For journal entries, refer Chapter 2A - Journal)***

Prepaid Expenses	Outstanding Expenses	Accrued Incomes
Incomes received in Advance	Depreciation	Interest on Capital / Interest on Drawings
Provision for Bad Debts	Provision for Discount on Debtors	Provision for Discount on Creditors

(vi) **Miscellaneous Entries:**

(a) Introduction of capital in kind i.e. motor car / goods introduced as capital into business.

(b) Credit Purchase of assets,

(c) Credit / Debit Notes towards allowances, adjustments, discounts from / to Suppliers / Customers,

(d) Entries on dishonour of Bills Receivable,

(e) Receipt of Promissory Notes / Bills of Exchange or their issue if separate Subsidiary Books are not maintained.

(f) Entries for Discount received / allowed, if double column Cash Book is prepared without Discount columns.

(g) Good originally purchased for cash, now returned to supplier. Cash is not received immediately. Such transaction is recorded in Journal Proper and not in Purchase Returns Book.

(h) Goods originally sold for cash, now returned by the customer. Cash is not paid immediately. Such transaction is recorded in Journal Proper and not in Sales Returns Book.

7. Subsidiary Books - Advantages

1. **Information Management:** Since a separate register or book is kept for each class of transactions, the information relating to each class of transactions will be available at one place.

2. **Division of Work:** The accounting work may be divided amongst a number of clerks since there will be separate books for recording various transactions.

3. **Specialisation:** When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.

4. **Saving of time:** Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.

5. **Control:** When the Trial Balance does not agree, the location of the error(s) is facilitated by the existence of separate books. Further, the possibility of errors and frauds will be checked by the use of various Subsidiary Books.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. In Purchases Book the record is in respect of ___________

(a) Cash purchase of goods.
(b) Credit purchase of goods dealt in.
(c) All purchases of goods.

2. The Sales Returns Book records ______________

(a) The return of goods purchased.
(b) Return of anything purchased.
(c) Return of goods sold.

3. The Sales Book ______________

(a) Is a part of journal.
(b) Is a part of the ledger.
(c) Is a part of the balance sheet.

4. The weekly or monthly total of the Purchase Book is __________

(a) Posted to the debit of the Purchases Account.
(b) Posted to the debit of the Sales Account.
(c) Posted to the credit of the Purchases Account.

5. The total of the Sales Book is posted to ____________

(a) Credit of the Sales Account.
(b) Credit of the Purchases Account.
(c) Credit of the Capital Account.

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

(a) Sales Book
(b) Cash Book
(c) Journal Proper (General Journal)

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

(a) Journal Proper (General Journal)
(b) Sales Book
(c) Cash Book
(d) Purchase Book

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

(a) Purchases Return Book
(b) Bills Receivable Book
(c) Journal Proper (General Journal)

THEORETICAL QUESTIONS

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

2. What are the advantages of subsidiary books?

HOME WORK

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

2016

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

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

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

2. Post into the ledger the entries of Sales Book prepared in above Question.

UNIT : 5
CASH BOOK

INTRODUCTION

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

1. Cash Book - Meaning and Features

1. **Meaning of Cash Book:** Cash Book is one of the Subsidiary Books which directly records transactions **involving cash.** Hence, it groups together all cash related transactions.
2. **Features:**
   (a) **Subsidiary Book:** On the occurrence of cash transactions, they are **recorded in Cash Book directly. —Hence** no Journal Entry is passed. From cash book, the other aspect of the same transaction is posted to Ledger Accout
   (b) **Principal Book:** The Cash Book itself serves as an Account since the balances are entered in the Trial *Balance* directly. Hence, the Cash Book is part of the Ledger also and should also be regarded as a Principal Book, format of cash book is also in the form of a ledger account.
   (c) The Cash Book is thus both a Subsidiary Book and a Principal Book
3. **Various types of Cash Book:** The main Cash Book may be of **three types -**
   (a) Single Cash Book - Having **Cash Column only** on both sides.
   (b) Two-Column Cash Book - Having **Cash and Discount columns / Cash and Bank Columns** on both sides
   (c) Three-Column Cash Book - Having **Cash, Bank and Discount columns** on both sides.
4. **Debit and Credit Aspects:**
   (a) **Debit Side** of Cash Book is for recording **Receipts** of Cash / Cheques (by way of Capital introduced, Loans taken. Cash Sales, Collection from Debtors, Income by way of Interest / Rent etc. received, Bad Debts recovered, Sale of Fixed Assets or Investments, etc.)
   (b) **Credit Side** of Cash Book is for recording **Payments** of Cash / Cheques (by way of Drawings, Loans repaid: : Purchases, Payment to Creditors, Expenses like Salary, Rent, Advertisement paid, Purchase of Fixed Assets or Investments, etc.)

2. Simple Cash Book

1. **Meaning:** Simple Cash Book is also called as Single Column Cash Book. It appears like an ordinary Ledger Account one amount column on each side.
2. **Contents:** Dr. Side is for recording all Cash Receipts while Cr. Side is for recording all Cash Payments.
3. The difference between Debit and Credit side (i.e. Closing Balance) is written as “By balance c/d” on the **credit side -**the Cash Book. ***[Note: Cash balance cannot be negative, i.e. Cash Payments cannot exceed Cash Receipts;***

4. The Closing Balance of this period will be brought forward to the subsequent period by writing as "To Balance b/d *on* the Debit Side of the Cash Book in the next period.

5. **Format of Single Column Cash Book:**

Dr. Cash Book for the period ended Cr.

Date	Receipts	L.F.	Amount	Date	Payments	L.F.	Amount
Beginning	To Balance b/d		XXX	During the month	By Payments		XXXX
During the month	To Receipts			XXXX			
			Month End	**By Balance c/d**		**xxx**	
Total		xxxx		Total		xxxx	

[Note: There is no Journal Entry passed for recording in Cash Book. One aspect involving cash is directly **recorded in Cash Book and another aspect is directly recorded in the relevant ledger account]**

3. Double Column Cash Book

1. **Meaning:** Double Column Cash Book has **two amount columns** on both side, i.e. two each on Dr. and Cr. Side.

2. **Types:** Double Column Cash Book may be maintained in any of the following ways -

	Type of Double Column	Dr. Side is for recording	Cr. Side is for recording
(a)	Cash & Bank Columns	Cash and Cheque Receipts	Cash and Cheque Payments
(b)	Cash & Discount Columns	Cash Receipts and Discount Allowed to Customers / Debtors	Cash Payments & Discount Received from Suppliers / Creditors

Notes:

1. If Cash and Bank Columns are maintained in Cash Book, then discount transactions are recorded in Journal Proper
2. If Cash and Discount Columns are maintained in Cash Book, then bank transactions are recorded in Journal Proper

3. **Nature of Accounts / Columns:**

(a) Cash

Nature : Cash Column represents Cash Account.It is a **Real Account.**

Closing Balance : Cash balances cannot be negative, since payments of cash cannot exceed receipts thereof. So, this column will always have Dr. Side total greater than Cr. Side. Closing Balance is written on the credit side as "By balance c/d"

(b) Bank

Nature : Bank Column represents Bank Account. It is a **Personal Account.**

Closing Balance :

- If Dr. Side > Cr. Side, it means there is a favourable Bank Balance, written on the credit side as "By balance c/d".
- If Cr.Side > Dr. Side, it means that there is an Overdraft balance, which is written on the debit side as "To balance c/d".

(c) Discount

Nature : Discount Column represents Discount Allowed / Received.

Closing Balance :

- Discount Columns are **not balanced.** They are totaled and entered in the Discount Account in the Ledger.
- Total of Discount Column on the Receipts Side (i.e. Dr. Side) shows total Discount Allowed to Customers.
- Total of Discount Column on Payments Side (i.e. Cr. Side) shows total Discount Received from Suppliers.

Students 'Notes:

1. Cash / Bank is an account, since they have debit and credit columns on both sides of cash book
2. However, discount allowed and discount received are not accounts as they do not have columns on both sides. For discount allowed, one column exists on debit side and for discount received one column exists on credit side. Hence, a separate ledger account is to be opened for Discount Received/ Discount allowed in the ledger.
4. Format of Two-Column Cash Book:

(a) Cash and Discount Columns

Date	Receipts	L.F.	Discount allowed	Cash	Date	Payments	L.F.	Discount Received	Cash
	To Balance b/d		N.A.	xxx		By Payments		xx	xxxx
	To Receipts		xx	xxxx		By Creditors		xx	xxxx
	To Debtors		xx	xxxx		By Balance c/d			xxxx
	Total		xx	xxxx		Total		xx	xxxx

(b) Cash and Bank Columns

Date	Receipts	L.F.	Bank	Cash	Date	Payments	L.F.	Bank	Cash
Note	To Balance b/d		xxx	xxx	**Note**	By Balance b/d		xxx	N.A.
	To Receipts		xxxx	xxxx		By Payments		xxxx	xxxx
	To Debtors			xxxx		By Creditors		xxxx	xxxx
Note	To Balance c/d	xxx	xxxx			Total	xxxx	xxxx	

Note: Closing Balances of bank may be debit or credit balance. Both debit and credit balance cannot exist at 7.5 However, for cash, its always debit balance only.

4. Triple Column Cash Book

1. **Meaning:** Three Column Cash Book has **three amount columns** on both sides i.e. Cash, Bank and Discount amount

   [Note: The principles for recording are the same as for Two Column Cash Book as described in the previous question.]

2. **Format:**

Date	Receipts	L.F.	Discount allowed	Cash	Bank	Date	Payments	L.F.	Discount Received	Cash	Bank

3. **Advantages:**

   (a) Cash and Bank Accounts are prepared simultaneously, so there is saving in time.

   (b) Information regarding Cash in Hand and Bank Balances can be obtained simultaneously.

   (c) If there are two or more Bank Accounts, the Firm can introduce multi-column Cash Book, one each for the **various** Bank Accounts.

5. Contra Entry

I. **Meaning:** Inter-Column transactions, i.e. Cash deposited into Bank, Cash withdrawn from Bank for business **etc.are** recorded on both Dr. and Cr. sides of the same Cash Book in appropriate columns. They are called **"Contra Entries**

2. **Need:** Contra Entries arise in Two-Column Cash Book (with Cash and Bank Columns) or Three- Column Cash Book.

3. **Treatment:** In case of Contra Entries, the amount is entered in the Bank Column and the Cash Column on the appropriate (Dr. or Cr) sides. Such entries will be marked as **"C"** in the **Ledger Folio** Column to indicate that tress transaction and **no further posting is required.**

Transaction	**In Bank Cloumn**	**In Cash Column**
Cash deposited into Bank	**Debit** Bank Column of Cash Book.	**Credit** Cash Column of Cash Book.
Cash withdrawn from Bank	**Credit** Bank Column of Cash Book.	**Debit** Cash Column of Cash Book.

Note: Cash **withdrawn from bank for personal purposes** will be treated as drawings and is **not a contra entry.**

Credit Bank Column of Cash Book; **Debit** Drawings A/c.

4. **Student's Notes**: Cheque received from the Customers on a day and deposited on subsequent days -

   (a) In certain cases, when the cheque is received from a customer, it is treated as if it is a cash receipt, Hence, **It is** recorded in the cash column of the Cash Book.
   Journal Entry for Cheque Receipt - Cash A/c Dr.
   To Customer A/c

   (b) When the same cheque is deposited into bank, it is recorded by a contra entry as if cash is deposited
   Journal Entry passed for Deposit -Bank A/c Dr.
   To Cash A/c

   (c) *Students are advised to follow the above journal entries cheque receipt and subsequent deposit.*

   (d) However, If Cheque is received & deposited on the same day, Bank A/c is directly debited. Cask A/ c will not be involved.

6. Petty Cash Book and Imprest System

1. **Meaning:** Petty Cash Book is used to maintain the record of all **petty cash expenses,** i.e. **expenses *of small* amount** say upto **`100,** e.g. Auto Fare, Postage Stamps purchase, Minor Repairs, etc. **Petty Cash balance asset for the business are shown directly on the assets side of the balance sheet under "Cash Balances"**

2. **Purpose/Advantages:**

   (a) Saving of time of the Chief Cashier.

   (b) Saving in labour in writing up the Cash Book and posting into the Ledger, and

   (c) Effective Control over small payments.

3. Format Anaytical Petty Cash Book

Receipts `	**Date**	**Voucher Number**	**Particulars**	**Total Payments**	**Expense 1** `	**Expense 2** `	**Expense 3** `	**Expense 4** `

Note: Generally, a "Sundries" Column is provided on right side, which is analysed at the end of the month or week.

4. **Imprest System:** The Petty Cashier is entrusted with a certain amount of Cash, say `500 to pay petty expenses during a period, say a week. After that week, the Petty Cashier submits a statement of expenses paid by him, e.g. `430, which will be reimbursed to him by the Main Cashier. Thus, the Petty Cashier will have `500 again with him (`70 Petty Cash in Hand + `430 Reimbursement received), to meet expenses during the next week. This reimbursement system is called **Imprest System.**

7. Sale through Credit / Debit Cards

1. **Card Contents:** Credit Card / Debit Card issued by a Bank is a small plastic card containing - (a) Name of the Cardholder, (b) Card Number (16 digit Number), (c) Date of Issue, (d) Date of Expiry, and (e) Magnetic Strip at the back.

2. **Debit vs Credit Card:** In a Credit Card, the Cardholder can buy now and pay later, whereas in a Debit Card, the Cardholder has to pay earlier (i.e. have a minimum balance in his account) in order to buy now. Nowadays, ATM Cards issued by a Bank can also be used as Debit Card.

3. **Parties involved:**

   (a) Cardholder (Who buys goods using a Credit / Debit Card)

   (b) Merchant (Who sells goods to a customer using a Credit / Debit Card)

   (c) Issuing Bank (A bank who has issued a card to the Cardholder Eg. Standard Chartered Bank)

   (d) Acquiring Bank (A bank with whom the merchant has an account Eg. HSBC Bank)

   (e) Member Service Provider (Visa / Master)

4. **Process Flow of Card Transactions:**

Purchase by Cardholder	Card swiped in "point of sale" machine	Charge Slip generated in 3 copies	Customer signs 3 charge slips & gives back 2 to merchant
Recovery: Debit Card - immediately Credit Card - after specified period	Issuing bank pays money to acquiring bank & recovers from customer	Acquiring Bank forwards slip to Issuing bank through member service provider	Merchant forwards 1 slip to acquiring bank & receives money

5. **Accounting Entries in the books of the Merchant:**

   (a) For recording Sales

   Bank Account Dr.
   To Sales Account

   (b) For recording Commission charged by Bank

   Commission Account Dr.
   To Bank Account

   Bank has to pay the money to the merchant. Commission charged by the bank is an expense for
   Hence bank becomes a debtor. Sales is the business and it is payable to the Bank.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the ___________________________
   (a) Credit of the discount allowed account.
   (b) Debit of the discount allowed account
   (c) Credit of the discount received account.
2. Cash book is a type of __________ but treated as a ____________ of accounts.
   (a) Subsidiary book, principal book (b) Principal book, subsidiary book
   (c) Subsidiary book, subsidiary book
3. Which of the following is not a column of a three-column cash book?
   (a) Cash column (b) Bank column
   (c) Petty cash column
4. Contra entries are passed only when ___________________________
   (a) Double-column cash book is prepared
   (b) Three-column cash book is prepared
   (c) Simple cash book is prepared
5. The Cash Book records ___________________________
   (a) All cash receipts
   (b) All cash payments
   (c) All cash receipts and payments
6. The balance in the petty cash book is ___________________________
   (a) An expense (b) A prot (c) An asset
7. If Ram has sold goods for cash, the entry will be recorded ___________________________
   (a) In the Cash Book (b) In the Sales Book
   (c) In the Journal

THEORETICAL QUESTIONS

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

2. What are the various kinds of cash book?

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

HOME WORK

1. Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is ` 500. From the following information, show how his Petty Cash Book would appear for the week ended 12th September, 2015:

		`
7-9-2015	Balance in hand	134.90
	Received Cash reimbursement to make up the imprest	365.10
	Stationery	49.80
8-9-2015	Miscellaneous Expenses	20.90
9-9-2015	Repairs	156.70
10-9-2015	Travelling	68.50
11-9-2015	Stationery	71.40
12-9-2015	Miscellaneous Expenses	6.30
	Repairs	48.30

UNIT : 6

RETIFICATION OF ERRORS

INTRODUCATION

Unintentional omission or commission of amounts and accounts in the process of recording the transactions are commonly known as errors. Also errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight. To check the arithmetic accuracy of the journal and ledger accounts, trial balance is prepared. If the trial balance does not tally, then it can be said that there are errors in the accounts which require rectification thereof.

Errors may occur at any of the following stages of the accounting process:

AT THE STAGE OF RECORDING THE TRANSACTIONS IN JOURNAL

Following types of errors may happen at this stage:

(i) Errors of principle,

(ii) Errors of omission,

(iii) Errors of commission.

AT THE STAGE OF POSTING THE ENTRIES IN LEDGER

(i) Errors of omission:
 - (a) Partial omission,
 - (b) Complete omission.

(ii) Errors of commission:
 - (a) Posting to wrong account,
 - (b) Posting on the wrong side,
 - (c) Posting of wrong amount.

AT THE STAGE OF BALANCING THE LEDGER ACCOUNTS

- (a) Wrong Totalling of accounts,
- (b) Wrong Balancing of accounts.

AT THE STAGE OF PREPARING THE TRIAL BALANCE

- (a) Errors of omission,
- (b) Errors of commission:
  1. Taking wrong account,
  2. Taking wrong amount,
  3. Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,

4. Compensating Errors.

3 Types of Errors

Basically errors are of two types:

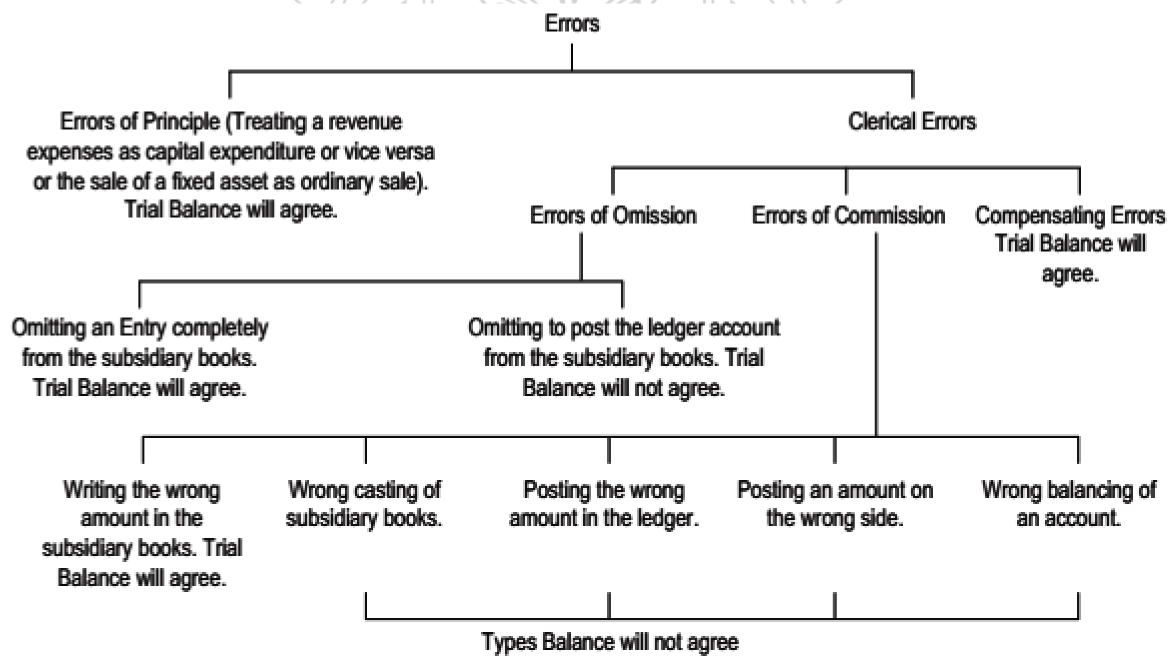
(a) Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong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

(b) Clerical errors: These errors arise because of mistake committed in the ordinary course of the accounting work. These are of three types:

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

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

(iii) **Compensating Errors:** If the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of `10 received from A is not credited to his account and the total of the sales book is `10 in excess. The omission of credit to A's account will be made up by the increased credit to the Sales Account.



5 Rectification of Errors

An error can be detected at any one of the following stages:

(a) Before preparation of Trial Balance.

(b) After Trial Balance but before the final accounts are drawn.

(c) After final accounts, i.e., in the next accounting period.

CLASS WORK

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED BEFORE PREPARATION OF TRIAL BALANCE :

Q-1 How would you rectify the following errors in the book of Bablu & Co., if the errors were detected before preparation of trial balance?

1. The total to the Purchases Book has been undercast by `100.
2. The Returns Inward Book has been undercast by ` 50.
3. A sum of ` 250 written off as depreciation on Machinery has not been debited to Depreciation account.
4. A payment of ` 75 for salaries (to Lallu) has been posted twice to Salaries Account.
5. The total of Bills Receivable Book ` 1,500 has been posted to the credit of Bills Receivable Account.
6. An amount of `151 for a credit sale to Hari, although correctly entered in the Sales Book, has been posted as ` 115.
7. Discount allowed to Satish ` 25 has not been entered in the Discount Column of the Cash Book. the amount has been posted correctly to the credit of his personal account.

Q-2 The following errors were found in the book of Abba. Give the necessary entries to correct them.

(1) ` 500 paid for furniture purchased has been charged to ordinary Purchases Account.

(2) Repairs made were debited to Building Account for ` 50.

(3) An amount of `100 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.

(4) `100 paid for rent debited to Landlord's Account.

(5) Salary `125 paid to a clerk due to him has been debited to his personal account.

(6) `100 received from Shah & Co. has been wrongly entered as from Shaw & Co.

(7) ` 700 paid in cash for a typewriter was charged to Office Expenses Account.

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED AFTER PREPARATION OF TRIAL BALANCE BUT BEFORE PREPARATION OF FINAL ACCOUNTS :

Q-3 The trial balance of Mr. Lallu failed to agree and the difference `20,570 was put into suspense pending investigation which disclosed that:

(i) Purchase returns day book had been correctly entered and totalled at `6,160, but had been posted to the ledger.

(ii) Discounts received `1,320 had been debited to discounts allowed.

(iii) The Sales account had been under added by `10,000.

(iv) A credit sale of `1,470 had been debited to a customer account at `1,740.

(v) A vehicle bought originally for `7,000 four years ago and depreciated to `1,200 had not been sold for `1,500 in the beginning of the year but no entries, other than in the bank account had been passed through the books.

(vi) An accrual of `560 for telephone charges had been completely omitted.

(vii) A bad debt of `1,560 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at `23,390 with a credit provision for bad debts at `2,320.

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

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

Required:

(i) Pass rectification entries without narration to correct the above errors before preparing annual accounts.

(ii) Prepare a statement showing effect of rectification on the reported net profit before correction of these errors.

Q-4 On going through the Trial balance of Zandu Ltd., it were found that the debit is in excess by `150. This was credited to "Suspense Account". On a close scrutiny of the books the following mistakes were noticed:

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

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

(3) One item of purchase of `25 has been posted from the day book to ledger as `250.

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

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

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

You are required to :

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

(ii) Show how they affect the Profits; and

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

Q-5 On 31st March 2001, a book-keeper finds the difference in the Trial Balance and he puts it in the Suspense Account later on he detects the following errors:

(i) Rs. 50,000 received from A was posted to the debit of his account.

(ii) Rs. 20,000 being purchase returns were posted to the debit of Purchases Account.

(iii) Discount of Rs. 8,000 received were posted to the debit of discount Account.

(iv) Rs. 9,060 paid for repairs of Motor Car was debited to Motor Car Account as Rs. 7,060.

(v) Rs. 40,000 paid to B was debited to A's Account.

Give journal Entries to rectify the above errors and ascertain the amount transferred to Suspense Account on 31st March, 2001 by showing the Suspense Account assuming that the Suspense Account is balance after the above corrections.

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED AFTER PREPARATION OF FINAL ACCOUNTS I.E. IN NEXT ACCOUNTING PERIOD

Q-6 A merchant's trial balance as on June 30, 2015 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:

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

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

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

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

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

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

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

Q-7 A book-keeper while preparing his trial balance finds that the debit exceeds by Rs. 7,250. Being required to prepare the final account he places the difference to a Suspense Account. In the next year the following mistakes were discovered;

(a) A sale of Rs. 4,000 has been passed through the purchase Day-book. The entry in customer's account has been correctly recorded.

(b) Goods worth Rs. 2,500 taken away by the proprietor for his use has been debited to Repairs Account.

(c) A bill Receivable for Rs. 1,300 received from Bhula has been dishonored on maturity but no entry passed.

(d) Salary Rs. 650 paid to a clerk has been debited to his Personal Account.

(e) Purchases of Rs. 750 from Raghubir has been debited to his account. Purchases Account has been correctly debited.

(f) A sum of Rs. 2,250 written off as depreciation on furniture has not been debited to Depreciation Account.

Draft the Journal entries for rectifying the above mistakes and prepare Suspense Account.

Q-8 The Trial Balance of Tuktuk Ltd. as on Dec. 31^{st} 2002 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:

(i) The total of the Sales-book of one page Rs. 6,531 was carried forward to the next page as Rs. 6,351.

(ii) Goods returned by a customer for Rs. 1,200, but entered in purchase Return Book.

(iii) Personal Car Expenses amounting to Rs. 250 were debited to Trade Expenses.

(iv) Sales Return Book was undercast by Rs. 2,750.

(v) Rs. 50 discount allowed by a supplier, was wrongly posted to debit side of Discount Account.

(vi) An item of purchase of Rs. 151 was entered in purchases Book as Rs. 15 and posted to Supplier's account as Rs. 51.

You are required to give Journal entries to rectify the errors through Profit and Loss Adjustment A/c in a was so as to show the Current year `s profit or loss correctly.

MULTIPLE CHOICE QUESTIONS

1. Goods purchased from A for `10,000 passed through the sales book. The error will result in
(a) Increase in gross profit. (b) Decrease in gross profit.
(c) No effect on gross profit.

2. If a purchase return of ` 1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the
(a) Trial balance would show the debit side to be ` 1,000 more than the credit.
(b) Trial balance would show the credit side to be ` 1,000 more than the debit.
(c) The debit side of the trial balance will be ` 2,000 more than the credit side.

3. If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called
(a) Error of omission. (b) Error of commission.
(c) Error of principle.

4. ` 200 paid as wages for erecting a machine should be debited to
(a) Repair account. (b) Machine account.
(c) Capital account.

5. On purchase of old furniture, the amount of ` 1,000 spent on its repair should be debited to
(a) Repair account. (b) Furniture account.
(c) Cash account.

6. Goods worth ` 50 given as charity should be credited to
(a) Charity account. (b) Sales account.
(c) Purchase account.

7. Goods worth ` 100 taken by proprietor for domestic use should be credited to
(a) Sales account. (b) Proprietor's personal expenses.
(c) Purchases account.

8. Sales of office furniture should be credited to
(a) Sales Account. (b) Furniture Account.
(c) Purchase Account.

9. The preparation of a trial balance is for:
(a) Locating errors of commission. (b) Locating errors of principle.
(c) Locating clerical errors.

10. ` 200 received from Smith whose account, was written off as a bad debt should be credited to:
(a) Bad Debts Recovered account. (b) Smith's account.
(c) Cash account.

11. Purchase of office furniture ` 1,200 has been debited to General Expense Account. It is:
(a) A clerical error. (b) An error of principle.
(c) An error of omission.

THEORETICAL QUESTIONS

1. How does errors of omission differ from errors of commission?
2. What is error of principle and how does it affect Trial Balance?
3. When and how is Suspense account used to rectify errors?

HOME WORK

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED BEFORE PREPARATION TRIAL BALANCE :

Q-1 Give journal entries to rectify the following:

(1) A purchase of goods from Ram amounting to `150 has been wrongly entered through the Sales Book.

(2) A Credit sale of goods amounting `120 to Ramesh has been wrongly passed through the Purchase Book.

(3) On 31st December, 2016 goods of the value of `300 were returned by Hari Saran and were taken inventory on the same date but no entry was passed in the books.

(4) An amount of ` 200 due from Mahesh Chand, which had been written of as a Bad Debt in a previous year, was unexpectedly recovered, and had been posted to the personal account of Mahesh Chand.

(5) A Cheque for `100 received from Man Mohan was dishonoured and had been posted to the debit of Sales Returns Account.

Ans.

(1) wrong entry in the sales Book for a purchases of goods from Ram)

(2) wrong entry in the Purchases Book of a credit sale of goods to Ram)

(3) goods returned by him and taken in inventory omitted from records)

(4) wrong credit to Personal A/c in respect of recovery of previously written off bad debts)

(5) wrong debit to Sales Returns A/c for dishonour of cheque received from Man Mohan)

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED AFTER PREPARATION OF TRIAL BALANCE BUT BEFORE PREPARATION OF FINAL ACCOUNTS

Q-2 *Correct the following errors.*

(a) The Sales Book has been totalled `100 short.

(b) Goods worth `150 returned by Green & Co. have not been recorded anywhere.

(c) Goods purchased `250 have been posted to the debit of the supplier Gupta & Co.

(d) Furniture purchased from Gulab & Bros, `1,000 has been entered in Purchases Day Book.

(e) Discount received from Red & Black `15 has not been entered in the Discount Column of the Cash Book.

(f) Discount allowed to G. Mohan & Co. `18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Ans.

(a) under- casting of Sales Day Book

(b) recording of unrecorded returns)

(c) Gupta & Co. was debited instead of being credited by ` 250).

(d) recording purchase of furniture as ordinary purchases)

(e) discount omitted to be recorded

(f) omission of the discount allowed from Cash Book customer's account already posted correctly

Suspense Account

Dr. **Date**	Particulars	Amount `	Date	Particulars	Cr. **Amount** `
	To Sales A/c	100		By Difference in	
	To Gupta & Co.	500		Trial Balance	582
				By Discount A/c	18
		600			600

One should note that the opening balance in the Suspense Account will be equal to the difference in the trial balance.

Q-3 Correct the following errors found in the books of Mr. Dattu. The Trial Balance was out by ` 493 excess credit. The difference thus has been posted to a Suspense Account.

(a) An amount of `100 was received from D. Das on 31st December, 2015 but has been omitted to enter in the Cash Book.

(b) The total of Returns Inward Book for December has been cast `100 short.

(c) The purchase of an office table costing ` 300 has been passed through the Purchases Day Book.

(d) ` 375 paid for Wages to workmen for making show-cases had been charged to "Wages Account".

(e) A purchase of ` 67 had been posted to the trade payables' account as ` 60.

(f) A cheque for ` 200 received from P. C. Joshi had been dishonoured and was passed to the debit of "Allowances Account".

(g) ` 1,000 paid for the purchase of a motor cycle for Mr. Dattu had been charged to "Miscellaneous Expenses Account".

(h) Goods amounting to `100 had been returned by customer and were taken in to inventory, but no entry in respect there of, was made into the books.

(i) A sale of ` 200 to Singh & Co. was wrongly credited to their account. Entry was made correctly made in sales book.

Ans.

(a) Amount received omitted

(c) purchase of furniture was entered in Purchases book and hence debited to Purchases Account.

(d) wages paid to workmen for making show-cases which should be capitalised and not to be charged to Wages Account

(e) mistake in crediting the Trade payables Account less by ` 7

(f) cheque of P.C. Joshi dishonoured, previously debited to Allowances Account

(g) Motor car purchased for personal use debited to misc. expenses a/c

(h) omission to record return of goods by customers)

(i) account of Singh & Co. was credited by ` 200 instead of being debited)

Suspense Account

Dr.					Cr.
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
2015		`	2015		`
Dec.31	To Difference in Trial Balance	493	Dec. 31	By Returns Inwards A/c	100
" "	To Trade Payables A/c	7	" "	By Singh & Co.	400
		500			**500**

Q-4 Write out the Journal Entries to rectify the following errors, using a Suspense Account.

(1) Goods of the value of `100 returned by Mr. Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account;

(2) An amount of `150 entered in the Sales Returns Book, has been posted to the debit of Mr. Philip, who returned the goods;

(3) A sale of ` 200 made to Mr. Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Radheshyam as ` 20;

(4) Bad Debts aggregating `450 were written off during the year in the Sales ledger but were not adjusted in the General Ledger; and

(5) The total of "Discount Allowed" column in the Cash Book for the month of September, 2015 amounting to ` 250 was not posted.

Ans.

(1) The value of goods returned by Mr. Sharma wrongly posted to Sales and omission of debit to Sales Returns Account

(2) Wrong debit to Mr. Philip for goods returned by him

(3) Omission of debit to Mr. Ghanshyam and wrong credit to Mr. Radhesham for sale of ` 200

(4) The amount of Bad Debts written off not adjusted in General Ledger, now rectied)

(5) The total of Discount allowed during September, 2015 not posted from the Cash Book

RECTIFICATION ENTRIES IF ERRORS ARE DETECTED AFTER PREPARATION OF FINAL ACCOUNTS

Q-5 Mr. Roy was unable to agree the Trial Balance last year and wrote off the difference to the suspense account of that year. Next Year, he appointed a Chartered Accountant who examined the old books and found the following mistakes:

(1) Purchase of a scooter was debited to conveyance account `3,000.

(2) Purchase account was over-cast by `10,000.

(3) A credit purchase of goods from Mr. P for `2,000 entered as a sale.

(4) Receipt of cash from Mr. A was posted to the account of Mr. B `1,000.

(5) Receipt of cash from Mr. C was posted to the debit of his account, `500.

(6) ` 500 due by Mr. Q was omitted to be taken to the trial balance.

(7) Sale of goods to Mr. R for `2,000 was omitted to be recorded.

(8) Amount of `2,395 of purchase was wrongly posted as `2,593.

Mr. Roy used 10% depreciation on vehicles. Suggest the necessary rectification entries.

Ans.

(1) Purchase of scooter wrongly debited to conveyance account

(2) Purchase Account overcast in the previous year;

(3) Credit purchase from P ` 2,000, entered as sales last year

(4) Amount received from A wrongly posted to the account of B

(5) ` 500 received from C wrongly debited to his account;

(6) ` 500 due by Q not taken into trial balance;

(7) Sales to R omitted last year

(8) Excess posting to purchase account last year, ` 2,593, instead of ` 2,395, now adjusted)

(9)

Profit & Loss Adjustment A/c	Dr.	10,898	
To Roy's Capital Account			10,898
(Balance of Profit & Loss Adjustment A/c transferred to Capital Account)			

Q-6 Mr. Bablu closed his books of account on September 30, 2014 in spite of a difference in the trial balance. The difference was ` 830 the credits being short; it was carried forward in a Suspense Account. In 2015 following errors were located:

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

(ii) The total of the Returns Inward Book for July, 2014 ` 1,240 was not posted in the ledger.

(iii) Freight paid on a machine `5,600 was posted to the Freight Account as ` 6,500.

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

(v) A sale of machine on credit to Mr. Mehta for ` 9,000 on 30th sept. 2014 was not entered in the books at all. The book value of the machine was ` 6,750.

Pass journal entries to rectify the errors. Mr. Bablu charged 10% Depreciation on machine.

Ans.

1. freight paid for a machine ` 5,600 was posted to Freight Account at ` 6,500 instead of capitalising it

2. wrong carry forward of total in the purchase Account to the next page ` 65,590 instead of ` 56,950

3. omission of a sale of machine on credit to Mr. Mehta for ` 9,000

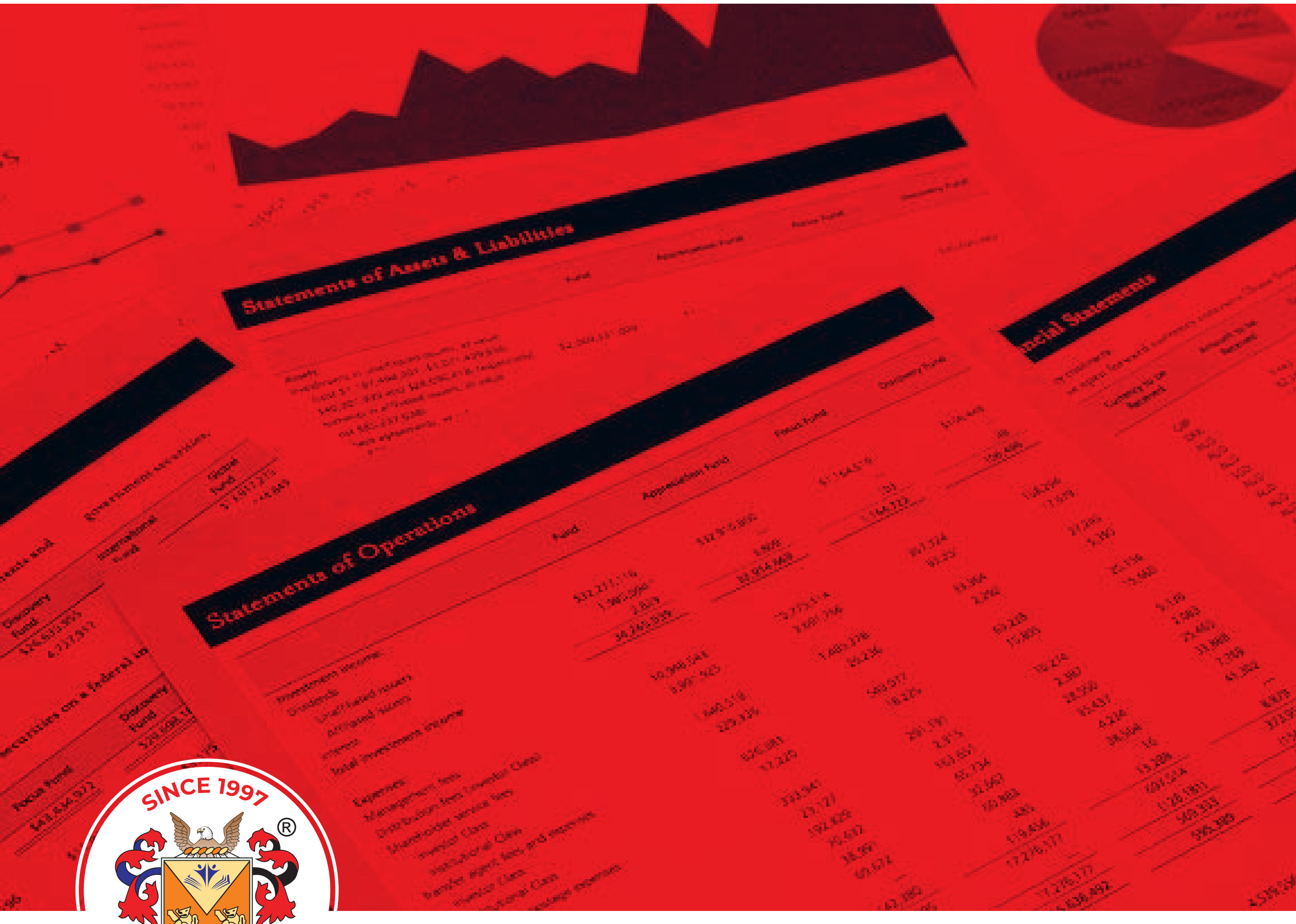
❑

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Bank Reconciliation Statement



SINCE 1997

NAVKAR
A Symbol of Success

NAVKAR INSTITUTE® | We believe in the best

CHAPTER 3
BANK RECONCILIATION STATEMENT

INTRODUCTION

Banks are essential institutions in a modern society. With the increase in volume of trade, commerce and business, business entities faced difficulty in transacting in cash for each business activity. They discovered that dealing through bank, on regular basis, would be the better and safer option and finally large business entities switched over to banking transactions instead of dealing in cash. Now-a-days, most of the transactions of the business are done through bank whether it is a receipt or a payment. Rather, it is legally necessary to operate the transactions through bank after a certain limit. A Bank accepts from people, in general, deposits in various forms, and lends funds to those who need; it also invests some funds in profitable investments. Thus, money which would have been otherwise idle is put to use and is made available to those who need it. Those who deposit the money are able to withdraw it according to the settled terms and conditions. Apart from receiving deposits from and handling cash transactions on behalf of its customers, the bank also renders some other useful services as indicated below:

(i) The bank discounts promissory notes or hundies, i.e., it enables a customer to receive the cash before the due date in consideration of a small charge called discount.

(ii) The bank allows overdraft to its good customers so that they can make payments even when they do not have sufficient balance at the bank. Of course, the overdraft must be cleared later.

(iii) The bank gives loans for a year or so, to its customers so that they can continue their operations. Such financial assistance is of great help for business.

(iv) The bank on behalf of the customer collects the amount of dividend warrants or interest on securities etc.

(v) On instruction of the customer, the bank makes payments of insurance premium, rent etc. on the due dates.

(vi) The bank sells and purchases shares, debentures or government securities on behalf of its customers.

(vii) Money can be remitted to another place or persons through the bank at a low cost.

BANK PASS BOOK

Bank pass book is merely a copy of the customer's account in the book of a bank. The bank either sends periodical statements of account or gives a pass book to its customer in which all deposits and withdrawals made by the customer during the particular period is recorded. Both represent almost a copy of the ledger account of the customer in the books of the bank. Thus, it is the bank's way of keeping the customers informed of the entries made in his account. It is the customer's duty to check the entries and immediately inform the bank of any error that he may notice.

BANK RECONCILIATION STATEMENT

To reconcile means to reason or find out the difference between two and eliminating that difference. Whenever we deposit or withdraws money from banks, it is always recorded at two places:-

1. Bank column of the cash book; and
2. Bank statement (pass book)

The cash book is maintained by the person having the bank account whereas the bank statement is prepared by the bank. Therefore, the balance in both should be equal and opposite in nature. For eg:- if Mr. A deposited ` 2,00,000 in his bank account it will be recorded on the Dr. side of his cash book, but for the bank it's a receipt so it will recorded as a Cr. Entry in the bank statement or the pass book. But most of the times these two balances do not match. The reasons for difference in balances can be many and are explained later in this chapter. It is possible to eliminate this difference by matching all the facts and figures of the two statements. The process of eliminating this difference and bringing the two statements in line with each other is known as "Reconciliation" , and the statement which reconciles the bank balance as per cash book with the balance as per the pass book by showing all the causes of difference is known as "BANK RECONCILIATION STATEMENT".

CAUSES OF DIFFERENCE : The difference in the both balances (bank balance as per cash book and pass book) may arise because of the following reasons:-

1. **TIMING: -** Sometimes a transaction is recorded at two different times in cash book and the pass book. This may happen in the following cases:-

   Mr. A has issued a cheque to PQR ltd., now it will be recorded in his cash book immediately but the bank will recognize this transaction only when the same cheque will be presented to it by PQR ltd. w Similarly for PQR ltd. , entry in the cash book will be made immediately as the cheque is received from Mr. A but the bank account will be credited when it collects money in respect of that cheque.

2. **TRANSACTIONS: -** There are various transactions which the bank carries out by itself without intimating the customer. For e.g.:- interest received on a savings bank account, it will be credited by the bank immediately but the entry in the cash book will be made only when the customer comes to know about it, which is usually at a later stage. Similar is the case with Bank charges (which are debited from the customer account by bank).

3. **ERRORS: -** Mistakes or errors made in preparing the accounts either by the bank or the

   customer can also result in disagreement of the two statements. For this reason rectification of errors is required to be done in both the statements before preparing any Bank Reconciliation Statement.

HOME WORK

Q-1 From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st December, 2018.

(1) The bank overdraft as per Cash Book on 31st December, 2018 ` 6,340.

(2) Interest on overdraft for 6 months ending 31st December, 2018` 160 is entered in Pass Bo(3)

(3) Bank charges of` 30 are debited in the Pass Book only.

(4) Cheques issued but not cashed prior to 31st December, 2018, amounted to ` 1,168.

(5) Cheques paid into bank but not cleared before 31st December, 2018 were for ` 2,170.

(6) Interest on investments collected by the bank and credited in the Pass Book ` 1,200.

Q-2 On 30th September, 2018, the bank account of X, according to the bank column of the Cash- Book, was overdrawn to the extent of ` 4,062. On the same date the bank statement showed a balance of ` 1,400 in favour of X. An examination of the Cash Book and Bank Statement reveals the following :

1. A cheque for ` 1,140 deposited on 29th September, 2018 was credited by the bank only on 3rd October, 2018.
2. A payment by cheque for ` 160 has been entered twice in the Cash Book.
3. On 29th September, 2018, the bank credited an amount of ` 1,740 received from a customerof X, but the advice was not received by X until 1st October, 2018.
4. Bank charges amounting to` 58 had not been entered in the Cash Book.
5. On 6th September, 2018, the bank credited ` 2,000 to X in error.
6. A bill of exchange for ` 1,000 was discounted by X with his bank. This bill was dishonoured on 28th September, 2018 but no entry had been made in the books of X.
7. Cheques issued upto 30th September, 2018 but not presented for payment upto that date totalled ` 3,760.

You are required : (a) to show the appropriate rectifications required in the Cash Book of X, to arrive at the correct balance on 30th September, 2011 and (b) to prepare a bank reconciliation statement as on that date.

Q-3 On 30th December, 2018 the bank column of A. Philip's cash book showed a debit balance of ` 461. On examination of the cash book and bank statement you find that :

1. Cheques amounting to ` 630 which were issued to trade payables and entered in the cash book before 30th December, 2018 were not presented for payment until that date.
2. Cheques amounting to ` 250 had been recorded in the cash book as having been paid into the bank on 30th December, 2018, but were entered in the bank statement on 1st January, 2019.
3. A cheque for ` 73 had been dishonoured prior to 30th December, 2018, but no record of this fact appeared in the cash book.
4. A dividend of ` 38, paid direct to the bank had not been recorded in the cash book.

5. Bank interest and charges amounting to ` 42 had been charged in the bank statement but not entered in the cash book.
6. No entry had been made in the cash book for a trade subscription of ` 10 paid vide banker's order in December, 2018.
7. A cheque for ` 27 drawn by B. Philip had been charged to A. Philip's bank account by mistake in December, 2018.

You are required : (a) to make appropriate adjustments in the cash book bringing down the correct balance, and (b) to prepare a statement reconciling the adjusted balance in the cash book with the balance shown in the bank statement.

Q-4 From the following information, prepare a Bank reconciliation statement as at 31st December, 2018 for Messrs New Steel Limited :

(1) Bank overdraft as per Cash Book on 31st December, 2018 2,45,900
(2) Interest debited by Bank on 26th December, 2018 but no advice received 27,870
(3) Cheque issued before 31st December, 2018 but not yet presented to Bank 66,000
(4) Transport subsidy received from the State Government directly by the Bank but not advised to the company 42,500
(5) Draft deposited in the Bank, but not credited till 31st December, 2018 13,500
(6) Bills for collection credited by the Bank till 31st December, 2018 but no advice received by the company 83,600
(7) Amount wrongly debited to company account by the Bank, for which no details are available 7,400

Q-5 The Cash Book of Mr. G shows ` 8,364 as the balance at Bank as on 31st December, 2018, but you find that it does not agree with the balance as per the Bank Pass Book. On scrutiny,

you find the following discrepancies :

(1) On 15th December, 2018 the payment side of the Cash Book was undercast by ` 100.
(2) A cheque for ` 131 issued on 25th December, 2018 was not taken in the bank column.
(3) One deposit of ` 150 was recorded in the Cash Book as if there is no bank column therein.
(4) On 18th December, 2018 the debit balance of ` 1,526 as on the previous day, was brought forward as credit balance.
(5) Of the total cheques amounting to ` 11,514 drawn in the last week of December, 2018, cheques aggregating ` 7,815 were encashed in December.
(6) Dividends of ` 250 collected by the Bank and subscription of ` 100 paid by it were not recorded in the Cash Book.
(7) One out-going Cheque of ` 350 was recorded twice in the Cash Book. Prepare a Reconciliation Statement.

Q-6 When Nikki & Co. received a Bank Statement showing a favourable balance of ` 10,392 for the period ended on 30th June, 2018, this did not agree with the balance in the cash book.

An examination of the Cash Book and Bank Statement disclosed the following-

1. A deposit of ` 3,092 paid on 29th June, 2018 had not been credited by the Bank until 1st July, 2018.
2. On 30th March, 2018 the company had entered into hire purchase agreement to pay by bank order a sum of` 3,000 on the 10th of each month, commencing from April, 2018. No entries had been made in Cash Book.

3. A customer of the firm, who received a cash discount of 4% on his account of ` 4,000 paid the firm a cheque on 12th June. The cashier erroneously entered the gross amount in the bank column of the Cash Book.
4. Bank charges amounting to ` 300 had not been entered in Cash-Book.
5. On 28th June, a customer of the company directly deposited the amount in the bank ` 4,000, but no entry had been made in the Cash Book.
6. ` 1,200 paid into the bank had been entered twice in the Cash Book.
7. A debit of `100 appeared in the Bank Statement for an unpaid cheque, which had been returned marked 'out of date'. The cheque had been re-dated by the customer and paid into Bank again on 5th July, 2018.

Prepare Bank Reconciliation Statement on 30 June, 2018.

Q-7 The bank account of Mukesh was balanced on 31st March, 2018. It showed an overdraft of ` 5,000. The bank statement of Mukesh showed a credit balance of ` 76,750. Prepare a bank reconciliation statement taking the following into account :

(1) Cheques issued but not presented for payment till 31.3.2018 ` 12,000.

(2) Cheques deposited but not collected by bank till 31.3.2018 ` 20,000.

(3) Interest on term-loan ` 10,000 debited by bank on 31.3.2018 but not accounted in Mukesh's book.

(4) Bank charges ` 250 was debited by bank during March, 2018 but accounted in the books of Mukesh on 4.4.2018.

(5) An amount of ` 1,00,000 representing collection of Murukesh's cheque was wrongly credited to the account of Mukesh by the bank in their bank statement.

Q-8 From the following information (as on 31.3.2018), prepare a bank reconciliation statement after making necessary amendments in the cash book.

Bank balances as per the cash book (Dr.) 3,25,000

Cheques deposited, but not yet credited 4,47,500

Cheques issued but not yet presented for payment 3,56,200

Bank charges debited by bank but not recorded in the cash-book 1,250

Dividend directly collected by the bank 12,500

Insurance premium paid by bank as per standing instruction not intimated 15,900

Cash sales wrongly recorded in the Bank column of the cash-book 25,500

Customer's cheque dishonoured by bank not recorded in the cash-book 13,000

Wrong credit given by the bank 15,000

Also show the bank balance that will appear in the trial balance as on 31.3.2018.

Q-9 On 31st March, 2018 the pass-book of a trader showed a credit balance of ` 1,565, but the pass book balance was different for the following reasons from the cash book balance:

1. Cheques issued to 'X' for ` 600 and to 'Y' for ` 384 were not yet presented for payment.
2. Bank charged` 35 for bank charges and 'Z' directly deposited ` 816 into the bank account, which were not entered in the cash book.

3. Two cheques one from ‘A’ for ` 515 and another from ‘B’ for ` 1,250 were collected in the first week of April, 2018 although they were banked on 25.03.2018.
4. Interest allowed by bank ` 45.

Prepare a bank reconciliation statement as on 31st March, 2018.

Q-10 From the following particulars prepare a bank reconciliation statement as on 31st December 2018:

(i) On 31st December, 2018 the cash-book of a firm showed a bank balance of ` 60,000 (debit balance).

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

(iii) Cheques worth ` 11,40,000 were deposited in the bank on 28th December,2018 but had not been credited by the bank. In addition to this, one cheque for` 5,00,000 was entered in the cash book on 30th December, 2018 but was banked on 3rd January, 2019.

(iv) A cheque from Susan for ` 4,00,000 was deposited in the bank on 26th December 2018 but was dishonoured and the advice was received on 2nd January, 2019.

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

(vi) One of the debtors deposited a sum of ` 5,00,000 in the bank account of the firm on 20th December, 2018 but the intimation in this respect was received from the bank on 2nd January, 2019.

(vii) Bank pass-book showed a debit balance of ` 3,82,000 on 31st December, 2018.

Q-11 According to the cash-book of Gopi, there was a balance of` 44,50,000 in his bank on 30th June, 2018. On investigation you find that :

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

(ii) Cheques paid into bank amounting to ` 11,05,000 out of which cheques amounting to ` 5,50,000 only collected by the bank up to 30th June 2018.

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

(iv) Insurance premium (up to 31st December, 2018) paid by the bank ` 27,000 not entered in the cash book.

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

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

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

Q-12 Prepare a bank reconciliation statement as on 30th September, 2018 from the following particulars:

Bank balance as per pass-book 10,00,000

Cheque deposited into the bank, but no entry was passed in the cash-book 5,00,000

Cheque received, but not sent to bank 11,20,000

Credit side of the bank column cast short 2,000

Insurance premium paid directly by the bank under the standing advice 60,000

Bank charges entered twice in the cash book 2,000

Cheque issued, but not presented to the bank for payment 5,00,000

Cheque received entered twice in the cash book 10,000

Bills discounted dishonoured not recorded in the cash book. 5,00,000

Q-13 Prepare a bank reconciliation statement from the following particulars on 31st March, 2018:

Debit balance as per bank column of the cash book 37,20,000

Cheque issued to creditors but not yet presented to the bank for payment 7,20,000

Dividend received by the bank but not yet entered in the cash book 5,00,000

Interest allowed by the bank 12,500

Cheques deposited into bank for collection but not collected by bank up to this date. 15,40,000

Bank charges 2,000

A cheque deposited into bank was dishonoured, but no intimation received 3,20,000

Bank paid house tax on our behalf, but no information received from bank in this connection. 3,50,000

MULTIPLE CHOICE QUESTIONS

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

(a) Added (b) Subtracted (c) Not required to be adjusted.

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

(a) A debit balance in the Bank Statement.

(b) A credit balance in the Bank Statement.

(c) An overdrawn balance in the Bank Statement.

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

(a) Added (b) Subtracted (c) Not required to be adjusted.

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

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

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

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

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

(a) ` 1,10,000 (b) ` 2,17,500 (c) ` 1,26,500

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

(a) Added; (b) Deducted; (c) Not required to be adjusted.

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

1. Cheque issued but not presented to bank
2. B/R collected directly by bank
3. Overcasting of the Dr. Side of bank A/c in the cash book.

(a) only 1 (b) only 1& 2 (c) all of the above (d) only 3.

HOME WORK

Q-1 From the following particulars, prepare a Bank Reconciliation Statement for J Ltd.

(1) Balance as per cash book is ` 2,40,000

(2) Cheques issued but not presented in the bank amounts to ` 1,36,000.

(3) Cheques deposited in bank but not yet cleared amounts to ` 90,000.

(4) Bank charges amounts to ` 300.

(5) Interest credited by bank amounts to ` 1,250.

(6) The balance as per pass book is ` 2,86,950.

Ans . Hint : Balance as per pass book 28,6950

Q-2 On 31st March 2018, the Bank Pass Book of Ms. Gupta. showed a balance of ` 1,50,000 to her credit while balance as per cash book was ` 1,12,050. On scrutiny of the two books, she ascertained the following causes of difference:

i) She has issued cheques amounting to ` 80,000 out of which only ` 32,000 were presented for payment.

ii) She received a cheque of ` 5,000 which she recorded in her cash book but forgot to deposit in the bank.

iii) A cheque of ` 22,000 deposited by her has not been cleared yet.

iv) Ms. Gupta deposited an amount of ` 15,700 in her bank which has not been recorded by her in Cash Book yet.

v) Bank has credit an interest of ` 1,500 while charging ` 250 as bank charges.

Prepare a bank reconciliation statement.

Ans . Hint : Balance as per cash book 112050

Q-3 From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st_December, 2018.

(1) The bank overdraft as per Cash Book on 31st December, 2018 ` 6,340.

(2) Interest on overdraft for 6 months ending 31st December, 2018 ` 160 is entered in Pass Book.

(3) Bank charges of ` 400 are debited in the Pass Book only.

(4) Cheques issued but not cashed prior to 31st December, 2018, amounted to ` 11,68,000.

(5) Cheques paid into bank but not cleared before 31st December, 2018 were for ` 22,17,000.

(6) Interest on investments collected by the bank and credited in the Pass Book ` 12,00,000.

Ans . Hint : **Balance as per passbook 144100**

Q-4 On 30th September, 2018, the bank account of X, according to the bank column of the Cash- Book, was overdrawn to the extent of` 4,062. On the same date the bank statement showed a debit balance of ` 20,758 in favour of X. An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for ` 13,14,000 deposited on 29th September, 2018 was credited by the bank only on 3rd October, 2018
2. A payment by cheque for ` 16,000 has been entered twice in the Cash Book.
3. On 29th September, 2018, the bank credited an amount of ` 1,17,400 received from a customer of X, but the advice was not received by X until 1st October, 2018.
4. Bank charges amounting to ` 580 had not been entered in the Cash Book.
5. On 6th September, 2018, the bank credited ` 20,000 to X in error.
6. A bill of exchange for` 1,40,000 was discounted by X with his bank. This bill was dishonoured on 28th September, 2018 but no entry had been made in the books of X.
7. Cheques issued upto 30th September, 2018 but not presented for payment upto that date totalled ` 13,26,000.

You are required : (a) to show the appropriate rectifications required in the Cash Book of X, to arrive at the correct balance on 30th September, 2018 and (b) to prepare a bank reconciliation statement as on that date.

Ans . Hint : Balance as per pass book 20758

Q-5 From the following information, prepare a Bank reconciliation statement as at 31st December, 2018 for Messrs New Steel Limited :`

(1) Bank overdraft as per Cash Book on 31st December, 2018 = 22,45,900

(2) Interest debited by Bank on 26th December, 2018 but no advice received 2,78,700

(3) Cheque issued before 31st December, 2018 but not yet presented to Bank 6,60,000

(4) Transport subsidy received from the State Government directly by the Bank but not advised to the company 14,25,000

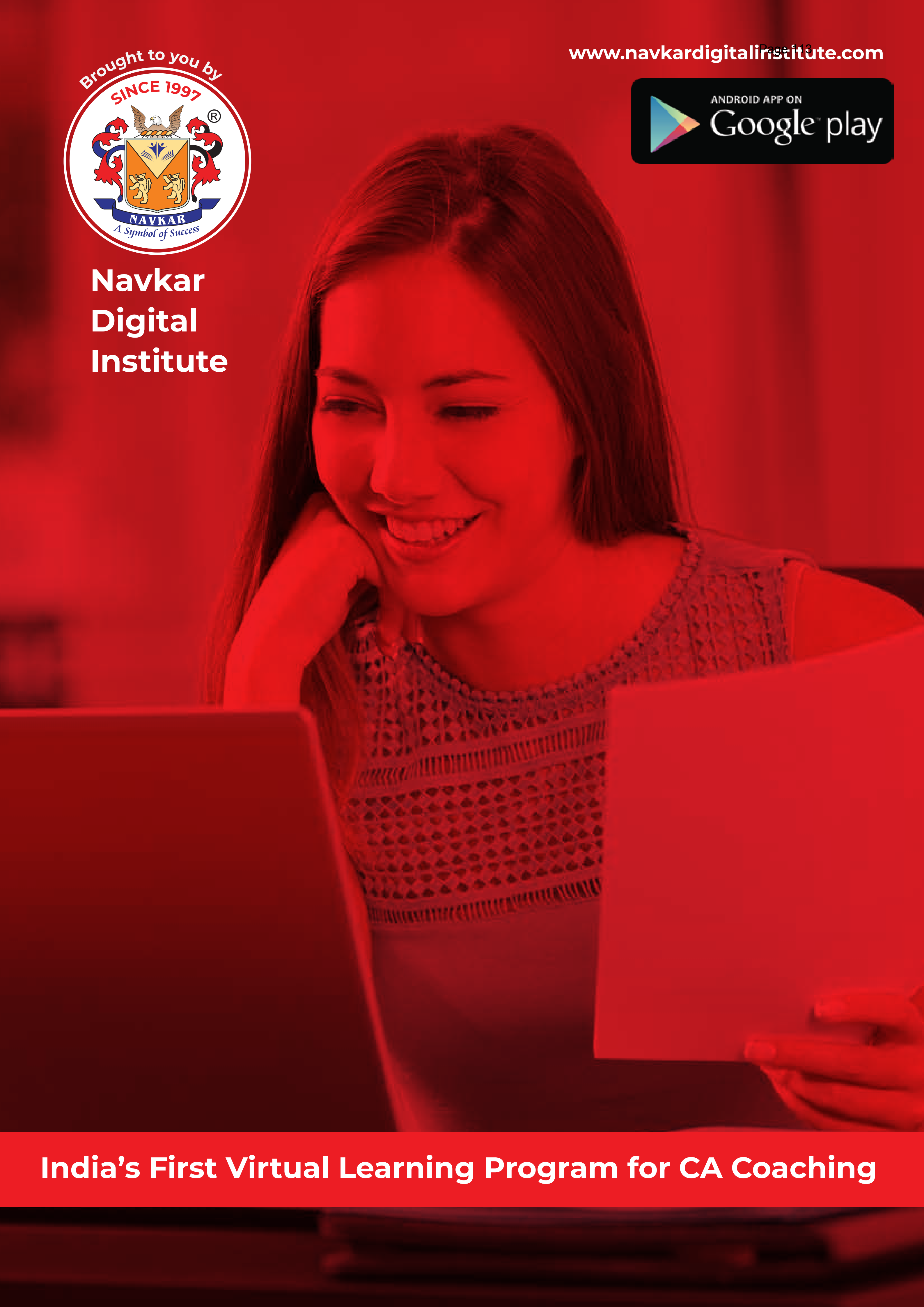
(5) Draft deposited in the Bank, but not credited till 31st December, 2018 13,50,000

(6) Bills for collection credited by the Bank till 31st December, 2018 but no advice received by the company 8,36,000

(7) Amount wrongly debited to company account by the Bank, for which no details are available 7,40,000.

Ans . Hint : OD as per passbook 1693600

❑



www.navkardigitalinstitute.com
Page 113
ANDROID APP ON
Google play
Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar
Digital
Institute
India's First Virtual Learning Program for CA Coaching

www.navkardigitalinstitute.com

CA FOUNDATION

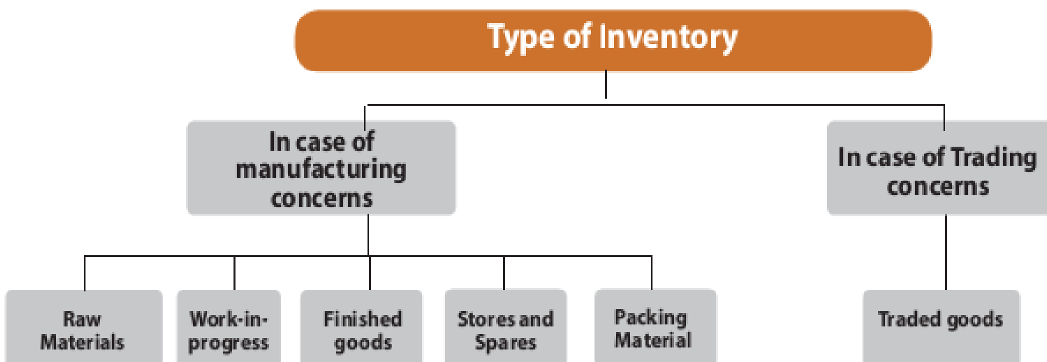
Principles & Practice of Accounting

Inventories

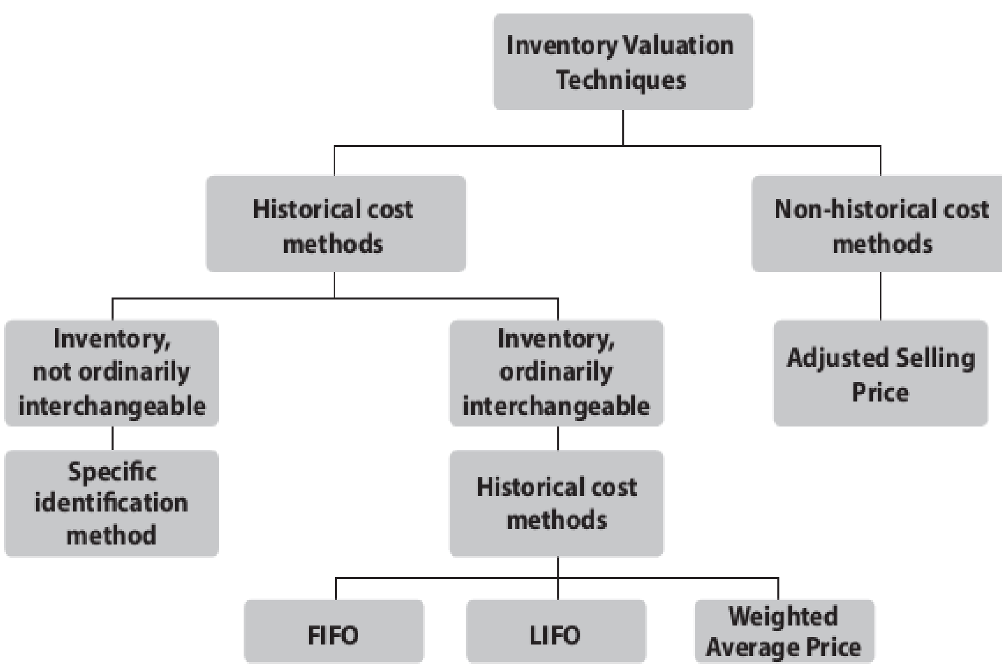
NAVKAR INSTITUTE® | We believe in the best

CHAPTER-4
INVENTORIES

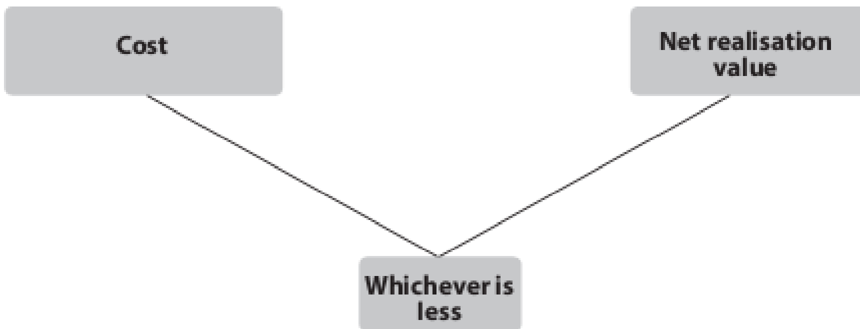
INTRODUCTION



Formulae for Determining Cost of Inventory



Basis of Inventory Valuation



➲ MEANING

Inventory can be defined as assets held

- for sale in the ordinary course of business, or
- in the process of production for such sale, or
- for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment.

There can be different types of inventory based on nature of business of an enterprise. The inventories of a trading concern consist primarily of products purchased for resale in their existing form. The inventories of manufacturing concern consist of several types of inventories: raw material (which will become part of the goods to be produced), work-in-process (partially completed products in the factory) and finished products. In manufacturing concerns inventories will also include maintenance supplies, consumables, loose tools and spare parts. However, inventories do not include spare parts, servicing equipment and standby equipment which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are generally accounted for as fixed assets.

At the year-end every business entity needs to ascertain the closing balance of Inventory which comprise of Inventory of raw material, work-in-progress, finished goods and other consumable items. Value of closing Inventory is put at the credit side of the Trading Account and asset side of the Balance Sheet. So before preparation of final accounts, the accountant should know the value of Inventory of the business entity.

However, we shall restrict our discussion on inventory valuation of a manufacturing concern and goods of a trading concern.

➲ OBJECTIVES OF INVENTORY VALUATION

The significance of inventory valuation arises due to various reasons as explained in the following points:

(i) **Determination of Income :** The valuation of inventory is necessary for determining the true income earned by a business entity during a particular period.

(ii) **Ascertainment of Financial Position :** Inventories are classified as **current assets**. The value of inventory on the date of balance sheet is required to determine the financial position of the business. In case the inventory is not properly valued, the balance sheet will not disclose the truthful financial position of the business.

(iii) **Liquidity Analysis :** Inventory is classified as a current asset, it is one of the components of net working capital which reveals the liquidity position of the business. Current ratio which studies the relationship between current assets and current liabilities is significantly affected by the value of inventory.

(iv) **Statutory Compliance : Schedule III to the Companies Act, 2013** requires valuation of each class of goods i.e. raw material, work-in-progress and finished goods under broad head to be disclosed in the financial statements.

➲ INVENTORY RECORD SYSTEMS

- PERIODIC INVENTORY SYSTEM
- PERPETUAL INVENTORY SYSTEM

S. No.	Periodic Inventory System	Perpetual Inventory System
1.	This system is based on physical verication.	It is based on book records.
2.	This system provides information about inventory and cost of goods sold at a particular date.	It provides continuous information about inventory and cost of sales.
3.	This system determines inventory and takes cost of goods sold as residual figure.	It directly determines cost of goods sold and computes inventory as balancing figure.
4.	Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold.	Closing inventory includes loss of goods as all unsold goods are assumed to be in Inventory.
5.	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
6.	This system is simple and less expensive.	It is costlier method.
7.	Periodic system requires closure of business for acounting of inventory.	Inventory can be determined without affecting the operations of the business.

➲ INVENTORIES TAKING

Normally, enterprises prefer to perform inventory taking closing day, however, sometimes inventory taking cannot be carried out on the closing day. It is carried out a few days later or sometimes even a few days earlier. In such a case, the actual value of the inventory must be so adjusted as to relate it to the end of the year concerned. For doing so, it will be necessary to take into account the goods that have come in (purchases and sales returns) and those that have gone out (sales and purchase returns) during the interval between the close of the year and the date of actual inventory taking. Further, the adjustment of all goods must be on the basis of cost. Suppose, a firm that closes its books on 31st December, carried out the inventory taking on the 7th January next year and actual inventory was of the cost of `7,85,000, during the period January 1 to 7 purchases were `1,53,000 and sales `2,50,000, the mark up being 25% on cost. The inventory on 31st December would be ` 8,32,000 as shown below:

	`
Inventory ascertained on January 7	7,85,000
Less: Purchases during the period Jan. 1 to 7	1,53,000
	6,32,000
Add: Cost of goods sold during the period :	
2,50,000 × (100/125)	2,00,000
	8,32,000

CLASS WORK

A. INVENTORY TAKING

1. Mrs. Pyari who was closing his books on 31.3.2016 failed to take the actual stock which she did only on 9th April, 2016, when it was ascertained by her to be worth ` 2,50,000.

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

It was found that sales between 31.3.2016 and 9.4.2016 as per the sales day book are ` 17,200. Purchases between 31.3.2016 and 9.4.2016 as per purchases day book are ` 1,200, out of these goods amounting to ` 500 were not received until after the stock was taken.

Goods invoiced during the month of March, 2016 but goods received only on 4th April, 2016 amounted to ` 1,000. Rate of gross profit is 33-1/3% on cost.

Ascertain the value of physical stock as on 31.3.2016.

2. From the following information, ascertain the value of stock as on 31.3.2017:

	`
Value of stock on 1.4.2016	7,00,000
Purchases during the period from 1.4.2016 to 31.3.2017	34,60,000
Manufacturing expenses during the above period	7,00,000
Sales during the same period	52,20,000

At the time of valuing stock on 31.3.2016 a sum of ` 60,000 was written off a particular item which was originally purchased for ` 2,00,000 and was sold for ` 1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

3. The Profit and loss account of Halwaivala showed a net profit of ` 6,00,000, after considering the closing stock of ` 3,75,000 on 31st March, 2016. Subsequently the following information was obtained from scrutiny of the books:

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

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

(iii) Invoices for goods amounting to ` 2,50,000 have been entered on 27th March, 2016, but the goods were not included in stock.

(iv) In March, 2016 goods of ` 2,00,000 sold and delivered were taken in the sales for April, 2016.

(v) Goods costing ` 75,000 were sent on sale or return in March, 2016 at a margin of profit of 33-1/3% on cost. Though approval was given in April, 2016 these were taken as sales for March, 2016.

Calculate the value of stock on 31st March, 2016 and the adjusted net profit for the year ended on that date.

4. Physical verification of stock in a business was done on 23rd June, 2016. The value of the stock was ` 48,00,000. The following transactions took place between 23rd June to 30th June, 2016:

(i) Out of the goods sent on consignment, goods at cost worth ` 2,40,000 were unsold.

(ii) Purchases of ` 4,00,000 were made out of which goods worth ` 1,60,000 were delivered on 5th July, 2016.

(iii) Sales were ` 13,60,000, which include goods worth ` 3,20,000 sent on approval. Half of these goods were returned before 30th June, 2016, but no information is available regarding the remaining goods.

(iv) Goods are sold at cost plus 25%. However goods costing ` 2,40,000 had been sold for ` 1,20,000. Determine the value of stock on 30th June, 2016.

5. From the following information ascertain the value of stock as on 31st March, 2016 and also the profit for the year:

	`
Stock as on 1.4.2015	1,42,500
Purchases	7,62,500
Manufacturing expenses	1,50,000
Selling expenses	60,500
Administrative expenses	30,000
Financial charges	21,500
Sales	12,45,000

At the time of valuing stock as on 31st March, 2015, a sum of ` 17,500 was written off on a particular item, which was originally purchased for ` 50,000 and was sold during the year at ` 45,000. Barring the transaction relating to this item, the gross profit earned during the year.

B. VALUATION OF CL.INVENTORY USING DIFFERENT METHODS

<u>Historical Cost Method of Valuation :</u>

1. Bakbak Ltd. has furnished the following details:

Date	**Particulars**	**Units**	**Rate (`)**
01.03.2006	Opening stock	100	1.75
05.03.2006	Purchased	150	1.50
12.03.2006	Purchased	300	1.60
08.03.2006	Issued	200	-
18.03.2006	Issued	250	-

(i) What is the value of closing stock using FIFO method:

(a) ` 170 (b) ` 160 (c) ` 150 (d) ` 180

(ii) Using the information given in the problem, the value of issues using FIFO method:

(a) ` 700 (b) ` 580 (c) ` 605 (d) ` 720

(iii) Using the information given in problem, the value of closing stock as per LIFO method:

(a) ` 172.50 (b) ` 225 (c) ` 160 (d) ` 167.50

(iv) Using the information given in problem, the value of issues using LIFO method:

(a) ` 712.50 (b) ` 515.50 (c) ` 620 (d) ` 575.50

(v) Using the information given in problem, the value of closing stock as per weighted average method :

(a) ` 160 (b) ` 175.50 (c) ` 150 (d) ` 225.50

(vi) Using the information given in problem, the value of issues using weighted average method :

(a) `600.50 (b) `580 (c) `620 (d) `720

2. Bharat Indian Oil is a bulk distributor of petrol. A periodic inventory of petrol on hand is taken when the books are closed at the end of each month. The following summary of information is available for the month:

Sales ` 9,45,000

General administration cost ` 25,000

Opening Stock : 1,00,000 litres @ ` 3 per litre ` 3,00,000

Purcases (including freight inward) :

June 1 2,00,000 litres @ ` 2.85 per litre

June 30 1,00,000 litres @ ` 3.03 per litre

June 30 Closing litres 1,30,000 litres

(i) Compute the value of inventory on June 30 using FIFO method of inventory costing.

(a) ` 3,88,500 (b) ` 4,18,500 (c) `2,58,000 (d) ` 3,60,500

(ii) Using the information given in problem, comptue the amount of cost of goods sold for June using FIFO principle.

(a) ` 784,500 (b) ` 685,000 (c) ` 388,500 (d) ` 758,000

(iii) Compute the Net Profit or loss for June using FIFO method of inventory costing.

(a) ` 160,000 (b) ` 115,500 (c) ` 125,000 (d) ` 135,500

(iv) Compute the value of inventory on June 30 using weighted average method of inventory costing.

(a) ` 3,75,000 (b) ` 3,81,225 (c) ` 2,80,000 (d) ` 4,10,000

(v) Using the information given in problem, compute the amount of cost of goods sold for June using weighted average method.

(a) ` 8,15,000 (b) ` 7,52,000 (c) ` 7,91,775 (d) ` 6,79,000

(vi) Compute the Gross Profit of loss for June using weighted average method of inventory costing.

(a) ` 1,20,000 (b) ` 2,15,000 (c) ` 1,53,225 (d) ` 129,000

(vii) Compute the value of inventory on June 30 using LIFO method of inventory costing.

(a) ` 3,85,500 (b) ` 3,69,000 (c) ` 2,97,000 (d) ` 4,18,000

(viii) Using the information given in problem, compute the amount of cost of goods sold for June using LIFO principle.

(a) ` 7,87,500 (b) ` 6,75,000 (c) ` 8,15,000 (d) ` 7,95,000

(ix) Compute the Gross Profit or loss for June using LIFO method of inventory costing :

(a) ` 1,95,500 (b) 165,000 (c) ` 1,57,500 (d) ` 1,95,000

Non Historical Cost Method of Valuation :

Q-3 M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2016:

Goods received from suppliers		
(subject to trade discount and taxes)	`	15,75,500
Trade discount 3% and sales tax 11%		
Packaging and transportation charges	`	87,500
Sales during the year	`	22,45,500
Sales price of closing inventories	`	2,35,000

Find out the cost of inventories using adjusted selling price method.

C. OBJECTIVE QUESTIONS

1. The amount of purchase if Cost of goods sold is ` 80,700
   Opening Inventory ` 5,800
   Closing Inventory ` 6,000
   (a) ` 80,500 (b) ` 74,900 (c) ` 80,900.
2. Average Inventory = ` 12,000. Closing Inventory is ` 3,000 more than opening Inventory. The value of closing Inventory = ______.
   (a) ` 12,000 (b) ` 24,000 (c) ` 13,500.
3. While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by ` 50,000. As a result
   (a) Previous year's profit is overstated and current year's profit is also overstated
   (b) Previous year's profit is overstated and current year's profit is understated
   (c) Previous year's profit is understated and current year's profit is also understated
4. Consider the following for Q Co. for the year 2015-16:

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

   Closing inventory of goods for the year 2015-16 as
   (a) ` 80,000 (b) ` 60,000 (c) ` 40,000
5. Average Inventory = ` 12,000. Closing Inventory is ` 3,000 more than opening Inventory. The value of closing Inventory = ______.
   (a) ` 12,000 (b) ` 24,000 (c) ` 13,500

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

   (a) 25% of the sales price   (b) 33% of the sales price

   (c) 20% of the sales price

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

   (a) ` 20,000    (b) ` 10,000   (c) ` 25,000

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

   1.12.2015 opening Inventory 50 units value ` 2,200.

   2.12.2015 purchased 100 units @ `47.

   4.12.2015 issued 50 units.

   5.12.2015 purchased 200 units @ ` 48.

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

   (a) ` 14,200 – ` 47.33   (b) ` 14,300 – ` 47.67   (c) ` 14,000 – ` 46.66

9. The cost of sales is equal to

   (a) Opening stock plus purchases   (b) Purchases minus Closing stock

   (c) Opening stock plus purchases minus closing stock.

10. Inventory is disclosed in financial statements under:

    (a) Fixed Assets   (b) Current Assets

    (c) Current Liabilities

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

    (a) FIFO   (b) Average cost   (c) LIFO

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

    (a) FIFO   (b) LIFO   (c) Weighted average cost

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

    (a) Consistency   (b) Conservatism   (c) Going concern

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

    (a) FIFO   (b) Weighted average   (c) LIFO

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

    (a) Weighted average   (b) FIFO   (c) Retail price method

HOME WORK

INVENTORIES TAKING

Q-1 A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no inventory taking could be possible till 15th April, 2017 on which date the total cost of goods in his godown came to ` 5,00,000. The following facts were established between 31st March and 15th April, 2017.

(i) Sales ` 4,10,000 (including cash sales ` 1,00,000)

(ii) Purchases ` 50,340 (including cash purchases ` 19,900)

(iii) Sales Return ` 10,000.

Goods are sold by the trader at a profit of 20% on sales.

You are required to ascertain the value of inventory as on 31st March, 2017.

Ans **Total : 7,69,660**

Q-2 Inventory taking for the year ended 31st March, 2016 was completed by 10th April' 2016, the valuation of which showed a inventory figure of ` 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales for the next year were made for ` 68,750, profit margin being 33.33 percent on cost. Purchases for the next year included in the inventory amounted to ` 90,000 at cost less trade discount 10 percent. During this period, goods were added to inventory at the mark up price of ` 3,000 in respect of sales returns. After inventory taking it was found that there were certain very old slow moving items costing ` 11,250, which should be taken at ` 5,250 to ensure disposal to an interested customer. Due to heavy flood, certain goods costing ` 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be ` 12,500 on 31st March. Compute the value of inventory for inclusion in the final accounts for the year ended 30th March, 2016.

Ans **Total : 16,34,310**

Q-3 Gee Ltd. follows perpetual inventory system. On March 31st 2014, the company took physical inventory verification and found the value of inventory as per records different from the value as per the physical inventory due to:

Goods purchased for ` 10,000 were received and included in the physical inventory but no entry were made in the books. Goods costing ` 30,000 were sold and entered in the books but the goods are yet to be delivered.

Goods worth ` 5,000 are returned to the supplier but is omitted to be recorded. If the inventory is valued in the books at ` 1,50,000, the value of the physical inventory is ?.

Ans **Total : 1,85,000**

Q-4 Kanika traders close their books of accounts on 31st March every year. As stores manager was on leave inventory taking was done on 7th April, 2014. On this date, cost of goods in godown was ` 44,500. During 1st April, 2014 to 7th April, 2014 sales were ` 1,76,000, Purchases ` 1,12,000. Purchase returns ` 8,630. Sales return ` 4,200. Gross Profit earned during the year was 25% on cost. Calculate the value of inventory as on 31st March, 2014.

Ans **Total : 78,570**

Q-5 Veeru makes up his annual accounts to 31st December each year. He was unable to take stock of physical inventory till January 9, 2016 on which date the physical stock at cost was valued at Rs.70,000. You are required to ascertain the value of physical stock at cost on 31st December, 2015 from the following information regarding period from 1st January, 2016 to 9 January, 2016.

Sale of goods amounted to Rs.48,000 of which goods of a sale value of Rs.5,000 had not been delivered at the time of verification and goods of a sale value of Rs.3,000 had been delivered on 29.12.2015.

The rate of gross profit was 25% on the cost price.

Ans **Total : 1,02,000**

Q-6 Mr. A, a dealer of construction material, due to unavoidable reasons took physical stock of inventories on 11th April. The cost of stock was ` 4,20,000 (including goods received on consignment).

The dealer received goods costing ` 1,00,000 in March for sale on consignment basis. 20% of the goods had been sold before 31st March and 60% between 1st April & 10th April. What was the cost of stock as at 31st March?

Ans **Total : 4,00,000**

VALUATION OF CL.INVENTORY USING DIFFERENT METHODS

Historical Cost Methods of Valuation :

Q-7 The following are the details of a spare part of Sriram mills:

1-1-2016	Opening Inventory	Nil
1-1-2016	Purchases	100 units @ ` 30 per unit
15-1-2016	Issued for consumption	50 units
1-2-2016	Purchases	200 units @ ` 40 per unit
15-2-2016	Issued for consumption	100 units
20-2-2016	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2016 if the company follows First in first out basis.

Ans **Total : Value of Inventory= Rs. 2,000**

Q-8 The following are the details of a spare part of Sriram Mills:

1-1-2016	Opening Inventory	Nil
1-1-2016	Purchases	100 units @ ` 30 per unit
15-1-2016	Issued for consumption	50 units
1-2-2016	Purchases	200 units @ ` 40 per unit
15-2-2016	Issued for consumption	100 units
20-2-2016	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2016 if the company follows Weighted Average basis.

Ans **Total : Value of Inventory = Rs. 1,900**

Non Historical Cost Method of Valuation :

Q-9 From the following information, calculate the historical cost of inventories using adjusted selling price method:

	`
Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening inventory	Nil
Closing inventory at selling price	50,000

Ans **Total : Cost of closing inventory = Rs. 40,000**

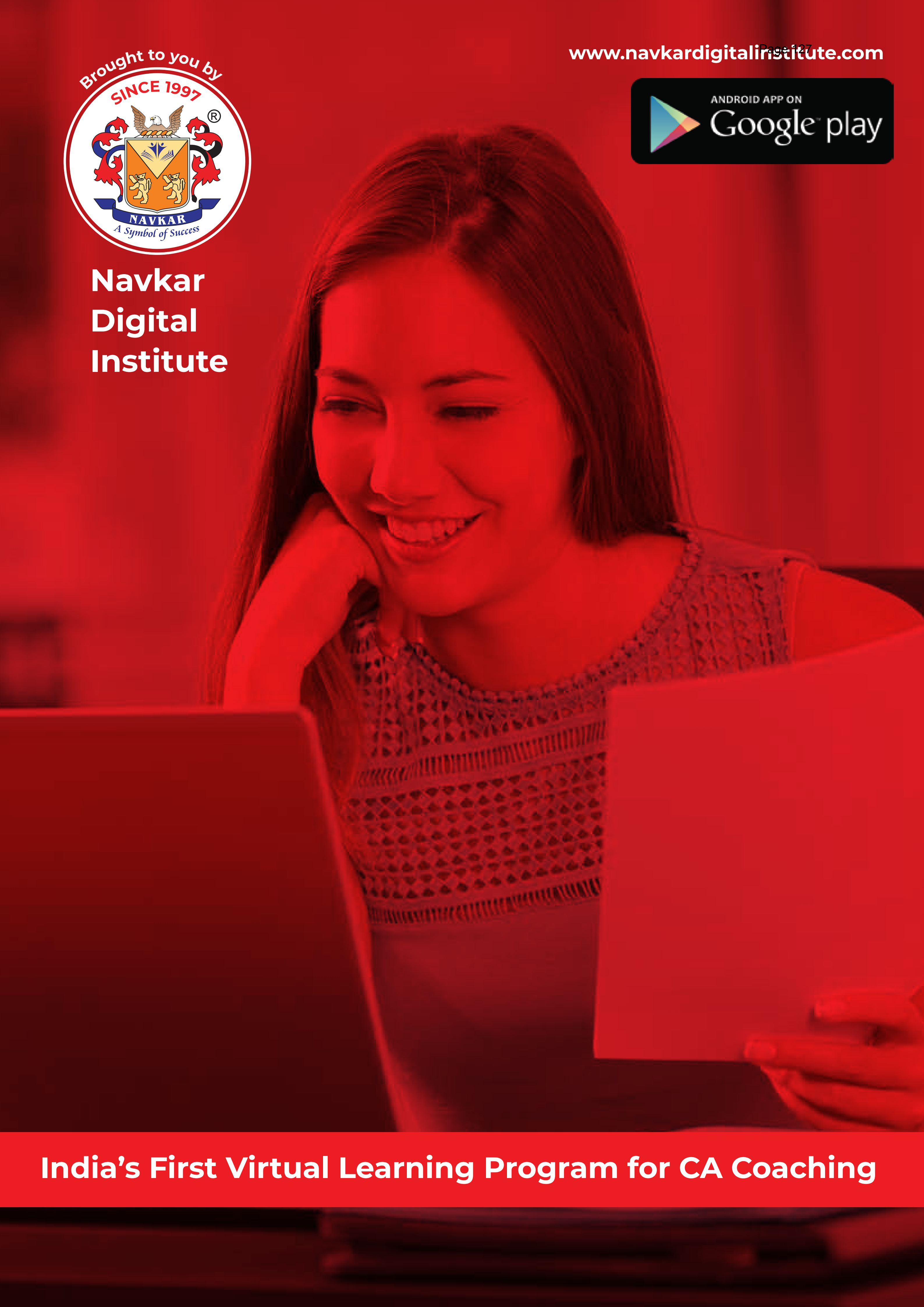
Q-10 X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2014.

Goods received from suppliers	` 18,00,000
(Subject to trade discount & taxes)	
Trade discount 3% and sales tax @ 11%	
Packaging and transportation charges	` 80,000
Sates during the year	` 25,00,000
Sates price of closing stock	` 4,00,000

Find out the historical cost of inventories using adjusted selling price method.

Ans **Total : Cost of Closing stock = Rs. 2,78,360.**

---0---0---


www.navkardigitalinstitute.com
ANDROID APP ON
Google play
Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar
Digital
Institute
India's First Virtual Learning Program for CA Coaching

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Concept and Accounting of Depreciation

SINCE 1997
NAVKAR
A Symbol of Success

NAVKAR INSTITUTE® | We believe in the best

CHAPTER 5
CONCEPT AND ACCOUNTING OF DEPRECIATION

INTRODUCTION

Property, plan and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than a period of twelve months.

These are also called xed assets in common parlance. When a xed asset is purchased, it is recorded in books of account at it original or acquisition/purchase cost. However xed assets are used to earn revenues for a number of accounting periods in future with the same acquisition cost until the concerned fixed asset is sold or discarded. It is therefore necessary that a part of the acquisition cost of the xed assets is treated or allocated as an expense in each of the accounting period in which the asset is utilized. The amount or value of xed assets allocated in such manner to respective accounting period is called depreciation. Value of such assets decreases with passage of time mainly due to following reasons.

1. Wear and tear due to its use in business
2. Efflux of time even when it is not being used
3. Obsolescence due to technological or other changes
4. Decrease in market value
5. Depletion mainly in case of mines and other natural reserves

It is important to account for value of portion of property, plant and equipment utilized for generating revenue during an accounting year to ascertain true income. This portion of cost of Property, Plant & Equipment allocated to an accounting year is called depreciation.

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

Depreciation	1. Depreciation is permanent and continuous decrease in the book value of fixed assets due to use , efflux ion of time ,obsolescence ,expiration of legal rights or any other cause 2. Depreciation is non cash operating expenses which is to be provided whether there are profits or losses . 3. Depreciation is concerned with historical cost and not with the fluctuations in market price .
Depletion	Depletion refers to physical deterioration of natural resources like over deposits in mines , oil wells
Amortization	Amortization refers to the economic deterioration of intangible assets like goodwill ,patent obsolescence .
Obsolescence	Obsolescence refers to economic deterioration by change in technology or taste or fashion .
Depreciation Accounting	Depreciation Accounting is the process of allocation and not valuation .

DISTINCTION BETWEEN STRAIGHT LINE METHOD AND WRITTEN DOWN VALUE METHOD

Basis of Distinction	Straight Line	Written Down Value Method
1. Basic of calculation	Depreciation is calculated at a fixed percentage on the original cost.	Depreciation is calculated at a fixed percentage on original cost (in first year) and on written down value (in subsequent years)
2. Amount of Depreciation	The amount of depreciation remain constant.	The amount of depreciation goes on decreasing .
3. Total Charge (I.e. depreciation plus repairs)	Total charges in later years is more as compared to that in earlier years since renewals goes on increasing as the asset grows older , whereas the amount of depreciation remains constant year after year .	Total charge remain almost uniform year after year , since in earlier years the amount of depreciation is more and the amount of repairs and renewals is less whereas in latter years ,the amount of depreciation is less and the amount of repairs & renewals is more

HOW TO CALCULATE AMOUNT AND RATE OF DEPRECIATION UNDER VARIOUS METHODS

Method of Depreciation	Amount and Rate of Depreciation
1. Straight Line Method (SLM)	Amount of Depreciation = $\frac{\text{Original Cost less Residual Value}}{\text{Expected Useful Life of the Assets}}$
	$\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation} \times 100}{\text{Original Cost}}$

2. Written Down Value (WDV)

$$\text{Rate of Depreciation} = \left(1 - \sqrt[n]{\frac{S}{C}}\right) \times 100$$

Where , n = Useful life of the asset (in years)

S = Scarp value at the end of useful life of the as

C = Cost of Asse

Amount of Depreciation = Book Value of the Asset × Rate of Depreciation .

3. Annuity Method

Fixed Amount of Depreciation = [Original Cost less Scrap Value × (Value of Annuity for a given period at a given rate of interest] Plus Interest on Scrap value (if any) for a year at a given rate of interest.

4. Depletion Method

Rate per Depreciation per Unit = Original Cost less Residual Value .

Useful Life in terms of Effective Hours

Amount of Depreciation = Actual Output (in units) × Rate of Depreciation per Unit.

5. Machine Hour Method

Rate per Hour = Original Cost less Residual Value .
Useful Life in terms of Effective Hours

Amount of Depreciation = Actual Hours × Rate of Depreciation per Hour.

6. Production Units Method

Rate per Depreciation per Unit = Original Cost less Residual Value .

Useful Life in terms of Productive output

Amount of Depreciation = Actual Production (in units) × Rate of Depreciation per Unit.

7 Sum of years 'Digits Method (SYD)

Rate per Depreciation

For 1st Year = $\frac{\text{nth year}}{\text{Sum of year's Digits}} \times 100 = ...\%$

For 2nd Year = $\frac{\text{(n-1)th year}}{\text{Sum of year's Digits}} \times 100 = ...\%$

For 3rd Year = $\frac{\text{(n-2) nth year}}{\text{Sum of year's Digits}} \times 100 = ...\%$

For nth Year = $\frac{\text{nth year}}{\text{Sum of year's Digits}} \times 100 = ...\%$

Note :- sum of Year's Digits = n(n+1)

2Where 'n' refers to useful life of the assets (in years) .
Amount of Depreciation= (Original Cost less Estimated scarp Value) × Respective

Rate of depreciation for the given year .

CLASS WORK

SLM

Q-1 Cost of asset purchased Rs. 500000, Date of purchase- 01/04/2014

Installation exps. Rs. 100000

Rate of depreciation 10% p.a. as per SLM.

Prepare Assets A/c. and Depreciation A/c. upto 31/03/17.

Q-2 Cost of asset purchased Rs. 1500000, Date of purchase- 01/07/2013

Installation exps. Rs.150000

Rate of depreciation 8% p.a. as per SLM.

Date of sale 1/1/2016, sale value- 650000

Prepare Assets A/c.

Q-3 Cost of asset purchased Rs. 1200000 and 800000, Date of purchase- 01/07/2012 and 01/10/2013

Rate of depreciation 6% p.a. as per SLM.

Date of sale – 1st Asset 1/1/2016 , sale value- 550000

Prepare Assets A/c upto 31/03/16.

Q-4 The LG Transport company purchased 10 trucks at ` 45,00,000 each on 1st April 2014. On October 1st, 2016, one of the trucks is involved in an accident and is completely destroyed and ` 27,00,000 is received from the insurance in full settlement. On the same date another truck is purchased by the company for the sum of ` 50,00,000. The company write o 20% on the original cost per annum. The company observe the calendar year as its -nancial year.

Give the motor truck account for two year ending 31 Dec, 2017**.**

Q-5 M/s. Prabha Pharmaceuticals has imported a machine on 1st July, 2014, for Pound 8,000, paid custom duty and freight ` 80,000 and incurred erection charges ` 60,000. Another local machinery costing `1,00,000 was purchased on 1st Jan 2015. On 1st July, 2016, a portion of the imported machinery (value one-third) got out of order and was sold for ` 1,34,800. Another machinery was purchased to replace the same for ` 50,000. Depreciation is to be calculated at 20% p.a on cost. Show the machinery account for 2014, 2015, and 2016. Exchange rate is ` 80 per pound.

Q-6 A firm's plant and machinery account at 31st December, 2015 and the corresponding depreciation provision account, broken down by year of purchase are as follows:

Year of Purchase	Plant and Machinery at cost `	Depreciation Provision `
1998	2,00,000	2,00,000
2004	3,00,000	3,00,000
2005	10,00,000	9,50,000
2006	7,00,000	5,95,000
2013	5,00,000	75,000
2014	3,00,000	15,000
	30,00,000	**21,35,000**

Depreciation is at the rate of 10% per annum on cost. It is the Company's policy to assume that all purchases, sales or disposal of plant occurred on 30th June in the relevant year for the purpose of calculating depreciation, irrespective of the precise date on which these events occurred.

During 2015 the following transactions took place:

1. Purchase of plant and machinery amounted to ` 15,00,000
2. Plant that had been bought in 2004 for ` 170,000 was scrapped.
3. Plant that had been bought in 2005 for ` 90,000 was sold for ` 5,000.
4. Plant that had been bought in 2006 for ` 2,40,000 was sold for ` 15,000.

You are required to :

Calculate the provision for depreciation of plant and machinery for the year ended 31st December, 2015. In calculating this provision you should bear in mind that it is the company's policy to show any prot or loss on the sale or disposal of plant as a completely separate item in the Prot and Loss Account. You are also required to prepare the following ledger accounts during 2015.

(i) Plant and machinery at cost;

(ii) Depreciation provision;

(iii) Sales or disposal of plant and machinery.

WDV

Q-7 Cost of asset purchased Rs. 1000000 and 600000, Date of purchase- 01/05/2012 and 01/12/2013

Rate of depreciation 8% p.a. as per WDV.

Date of sale – 1St Asset 1/11/2015 , sale value- 550000

Prepare Assets A/c upto 31/03/16.

Q-8 The Machinery Account of a Factory showed a balance of ` 19,00,000 on 1st January, 2015. Its accounts were made up on 31st December each year and depreciation is written oat 10% p.a. under the Diminishing Balance Method.

On 1st June 2015, a new machinery was acquired at a cost of ` 2,80,000 and installation charges incurred in erecting the machine works out to ` 8,920 on the same date. On 1st June, 2015 a machine which had cost ` 4,37,400 on 1st January 2013 was sold for ` 75,000. Another machine which had cost ` 4,37,000 on 1st January, 2014 was scrapped on the same date and it realised nothing. Write a plant and machinery account for the year 2015, allowing the same rate of depreciation as in the past calculating depreciation to the nearest multiple of a Rupee.

Provision for Depreciation

Q-9 Cost of asset purchased Rs. 2000000 and 900000, Date of purchase- 01/10/2012 and 01/12/2013

Rate of depreciation 10% p.a. as per SLM.

Date of sale – 1st Asset 1/2/2016 , sale value- 850000

Prepare Assets A/c, provision for depreciation account and asset disposal account upto 31/03/16.

Q-10 In question no.4 prepare Assets a/c, provision for dep. a/c. and asset disposal a/c as per provision for depreciation method.

Change in method of Depreciation

Q-11 Cost of asset purchase Rs. 400000,

Date of purchase – 01/04/2014, rate of dep.15% p.a. as per SLM

Company wants to change method of dep. From SLM to WDV from year 16-17 @ 10% p.a.

Prepare asset account upto 31/03/17.

Q-12 M/s Anshul & Co. commenced business on 1st January 2011, when they purchased plant and equipment for `7,00,000. They adopted a policy of charging depreciation at 15% per annum on diminishing balance basis and Over the years, their purchases of plant have been:

Date	Amount `
1-1-2012	1,50,000
1-1-2015	2,00,000

On 1-1-2015 it was decided to change the method and rate of depreciation to straight line basis. On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2015 with no scrap value and 10 years for the asset purchased on 1.1.2015.

Change in estimation of life

Q-13 A Machine costing ` 6,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Required to Calculate depreciation for the fourth year.

Q-14 A Machine costing ` 12,00,000 is depreciated on straight line basis, estimated scrap value is Rs. 200000, assuming 5 years working life, company has provided depreciation for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Required to Calculate depreciation for the fourth year.

Annuity method

Q-15 A lease is purchased on 1st April, 2012 for 4 years at a cost of ` 2,00,000. It is proposed to depreciate the lease by the annuity method charging 5 percent interest. A reference to the annuity table shows that to depreciate ` 1 by annuity method over 4 years charging 5% interest, one must write o a sum of ` 0.282012 Required Show the Lease Account for four years and also the relevant entries in the pro-fit and loss account.

Machine Hour Method/Production unit method/Depletion method

Q-16 A machine was purchased for ` 30,00,000 having an estimated total working of 2,40,000 hours. The scrap value is expected to be ` 2,00,000 and anticipated pattern of distribution of effective hours is as follows :

Year

1 – 3 3,000 hours per year

4 - 6 2,600 hours per year

7 - 10 1,800 hours per year

Required to Determine Annual Depreciation under Machine Hour Rate Method.

Q-17 A machine is purchased for ` 20,00,000. Its estimated useful life is 10 years with a residual value of ` 2,00,000. The machine is expected to produce 1.5 lakh units during its life time. Expected distribution pattern of production is as follows:

Year Production

1-3 20,000 units per year

4-7 15,000 units per year

8-10 10,000 units per year

Required to Determine the value of depreciation for each year using production units method.

Sum of digit method

Q-18 Cost of purchase Rs. 700000, estimated scrap value Rs. 100000, estimated life 5 years, calculate depreciation as per sum of digit method.

Q-19 Cost of purchase Rs. 1200000, estimated scrap value Rs. 200000, estimated life 4 years, calculate depreciation as per sum of digit method.

MULTIPLE CHOICE QUESTIONS

1. Original cost = `12,60,000; Salvage value = Nil; Useful life = 6 years. Depreciation for the first year under sum of years digits method will be
   (a) ` 3,60,000 (b) ` 1,20,000 (c) `1,80,000
2. Obsolescence of a depreciable asset may be caused by:
   I. Technological changes.
   II. Improvement in production method.
   III. Change in market demand for the product or service output.
   IV. Legal or other restrictions.
   (a) Only (I) above (b) Both (I) and (II) above
   (c) All (I), (II), (III) and (IV) above
3. The number of production of similar units expected to be obtained from the use of an asset by an enterprise is called as
   (a) Unit life (b) Useful life (c) Production life
4. If a concern proposes to discontinue its business from March 2015 and decides to dispose of all its plants within a period of 4 months, the Balance Sheet as on March 31, 2015 should indicate the plants at their
   (a) Historical cost (b) Net realizable value (c) Cost less depreciation
5. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is
   (a) Plant account (b) Revaluation Reserve (c) Profit & Loss account
6. The portion of the acquisition cost of the tangible asset, yet to be allocated is known as
   (a) Written down value (b) Accumulated value (c) Realisable value
7. The main objective of providing depreciation is to
   (a) Create secret reserve (b) Reduce the book value of assets
   (c) Allocate cost of the assets
8. Original cost of a machine was ` 25,20,000 salvage value was ` 1,20,000, useful life was 6 years. Annual depreciation under Straight Line Method
   (a) ` 4,20,000 (b) ` 4,00,000 (c) ` 3,00,000
9. The cost of a machine is `20,00,000. Two years later the book value is ` 10,00,000. The Straight-line percentage depreciation is
   (a) 50% (b) 33-1/3% (c) 25%
10. Original cost `13,00,000, Salvage value `40,000, Useful life 6 years. Depreciation for the first year under sum-of-years digit methods will be
    (a) ` 60,000 (b) ` 1,20,000 (c) ` 3,60,000
11. Which of the following assets does not depreciate?
    (a) Machinery and equipment (b) Patents
    (c) Land
12. A company purchased a machinery on April 01, 2010, for ` 15,00,000. It is estimated that the machinery will have a useful life of 5 years after which it will have no salvage value. The depreciation charged during the year 2014-15 was
    (a) ` 5,00,00 (b) ` 4,00,000 (c) ` 3,00,000
13. If the equipment account has a balance of Rs. 22,50,000 and the accumulated depreciation account has a balance of Rs. 14,00,000, the book value of the equipment is
    (a) ` 36,50,000 (b) ` 8,50,000 (c) ` 14,00,000

HOME WORK

Q-1 A firm purchased on 1st January, 2015 certain machinery for ` 5,82,000 and spent ` 18,000 on its erection. On July 1, 2015 another machinery for ` 2,00,000 was acquired. On 1st July, 2016 the machinery purchased on 1st January, 2015 having become obsolete was auctioned for ` 38,600 and on the same date fresh machinery was purchased at a cost of ` 4,00,000.

Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value.

Required to Prepare machinery account.

Ans: Closing balance Rs.5, 51,000, loss 1, 27,000

Q-2 Jain Bros. acquired a machine on 1st July, 2015 at a cost of ` 14,00,000 and spent ` 1,00,000 on its installation. The -rm writes o depreciation at 10% p.a. of the original cost every year. The books are closed on 31st December every year.

Required to Show the Machinery Account and Depreciation Account for the year 2015 and 2016.

Ans: Closing balance of assets a/c. 12, 75,000

Q-3 Jain Bros. acquired a machine on 1st July, 2015 at a cost of ` 14,00,000 and spent ` 1,00,000 on its installation. The -firm writes of depreciation at 10% p.a. every year. The books are closed on 31st December every year.

Required to Show the Machinery Account on diminishing balance method for the year 2015 and 2016.

Ans: Closing balance of assets a/c. 12, 82,500

Q-4 Cost of asset purchased Rs. 300000 and 200000, Date of purchase- 01/5/2012 and 01/6/2013

Rate of depreciation 12% p.a. as per WDV.

Date of sale – 1st Asset 1/7/2016 , sale value- 75000

Prepare Assets A/c, provision for depreciation account and asset disposal account upto 31/03/17.

Ans: Closing balance assets a/c. 200000, closing bal. of provision for dep. a/c. 77,335

Q-5 A Machine costing ` 2,00,000 is depreciated on straight line basis, estimated scrap value is Rs. 10,000, assuming 5 years working life, company has provided depreciation for two years. The estimate of remaining useful life after two years was reassessed at 4 years.

Required to Calculate depreciation for the third year.

Ans: 28,500

Q-6 M/s Akash purchased a machine for ` 10,00,000. Estimated useful life and scrap value were 10 years and ` 1,20,000 respectively. The machine was put to use on 1.1.2010.

Required : Show Machinery Account and Depreciation Account in their books for 2015 by using sum of years digits method.

Q-7 A lease is purchased on 1st April, 2012 for 4 years at a cost of ` 2,00,000. It is proposed to depreciate the lease by the annuity method charging 5 percent interest. A reference to the annuity table shows that to depreciate ` 1 by annuity method over 4 years charging 5% interest, one must write off a sum of ` 0.282012 [To write off ` 2,00,000 one has to write off every year ` 56,402.40 i.e. 0.282012 × 2,00,000].

Required : Show the Lease Account for four years and also the relevant entries in the profit and loss account.

Q-8 A machine was purchased for ` 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be ` 2,00,000 and anticipated pattern of distribution of effective hours is as follows :

Year	
1 – 3	3,000 hours per year
4 - 6	2,600 hours per year
7 - 10	1,800 hours per year

Required : Determine Annual Depreciation under Machine Hour Rate Method

Q-9 A machine is purchased for ` 20,00,000. Its estimated useful life is 10 years with a residual value of ` 2,00,000. The machine is expected to produce 1.5 lakh units during its life time. Expected distribution pattern of production is as follows:

Year	**Production**
1-3	20,000 units per year
4-7	15,000 units per year
8-10	10,000 units per year

Required : Determine the value of depreciation for each year using production units method.

Q-10 M/s Surya took lease of a quarry on 1-1-2013 for ` 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes. Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year	**Quantity of Mineral extracted**
2013	2,000 tonnes
2014	10,000 tonnes
2015	15,000 tonnes

Required : Show the Quarry Lease Account and Depreciation Account for each year from 2013 to 2015.

Q-11 A firm purchased on 1st January, 2015 certain machinery for ` 5,82,000 and spent ` 18,000 on its erection. On July 1, 2015 another machinery for ` 2,00,000 was acquired. On 1st July, 2016 the machinery purchased on 1st January, 2015 having become obsolete was auctioned for ` 3,86,000 and on the same date fresh machinery was purchased at a cost of ` 4,00,000.

Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value.

Required : Prepare machinery account.

Q-12 M/s Anshul commenced business on 1st January 2011, when they purchased plant and equipment for ` 7,00,000. They adopted a policy of charging depreciation at 15% per annum on diminishing balance basis and over the years, their purchases of plant have been:

Date	Amount
	`
1-1-2012	1,50,000
1-1-2015	2,00,000

On 1-1-2015 it was decided to change the method and rate of depreciation to straight line basis. On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2015 and 10 years for the asset purchased on 1.1.2015 with no scrap value.

Required : Calculate the difference in depreciation to be adjusted in the Plant and Equipment Account for the year ending 31st December, 2015.

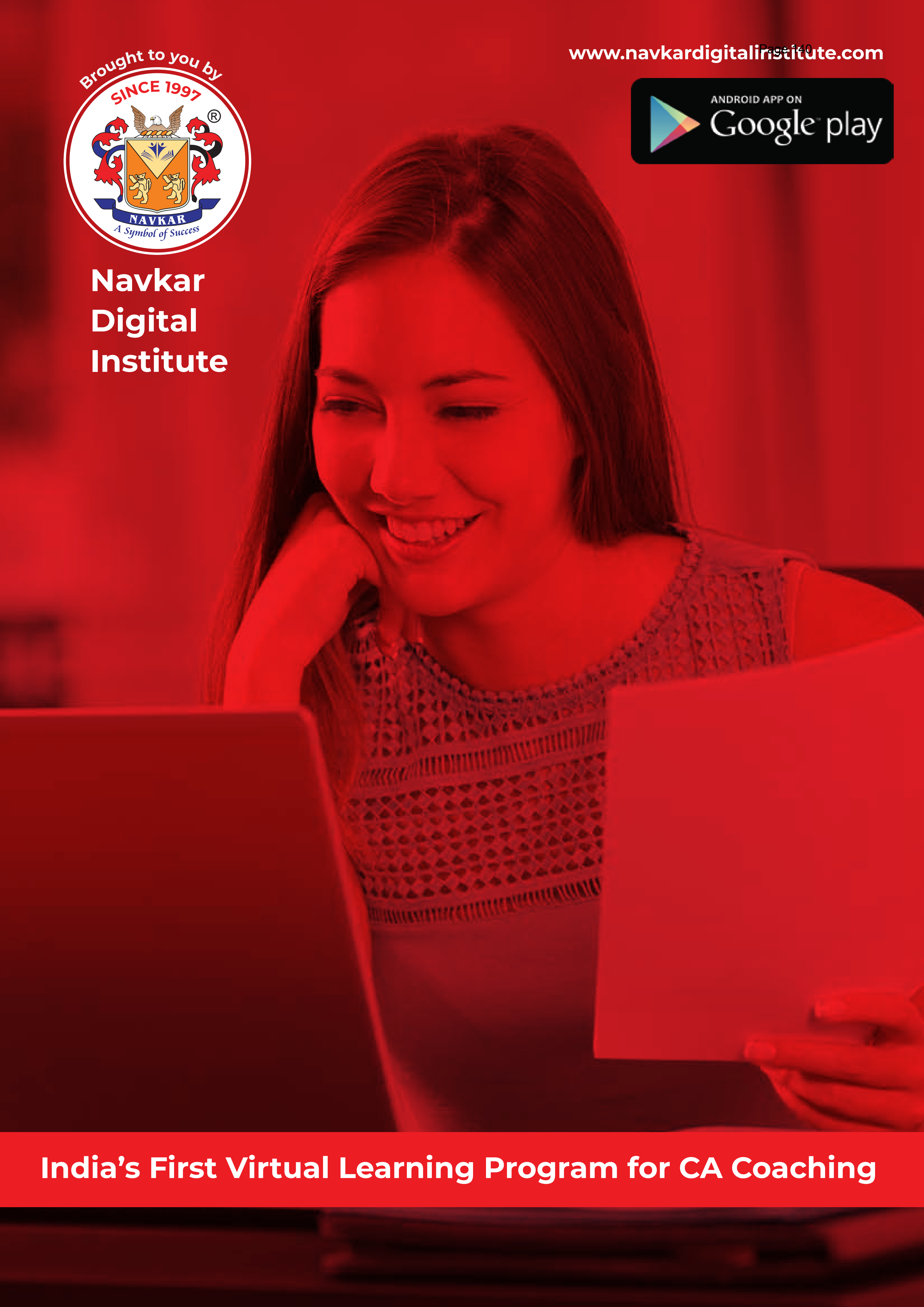
Q-13 A Machine costing ` 6,00,000 is depreciated on straight line basis, assuming 10 years working life and Nil residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years.

Required : Calculate depreciation for the fourth year.

Q-14 A machine of cost ` 12,00,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. At the end of third year, the machine was revalued upwards by ` 60,000 the remaining useful life was reassessed at 9 years.

Required : Calculate depreciation for the fourth year.

❑


www.navkardigitalinstitute.com
ANDROID APP ON
Google play
Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar Digital Institute
India's First Virtual Learning Program for CA Coaching

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Accounting for Special Transaction

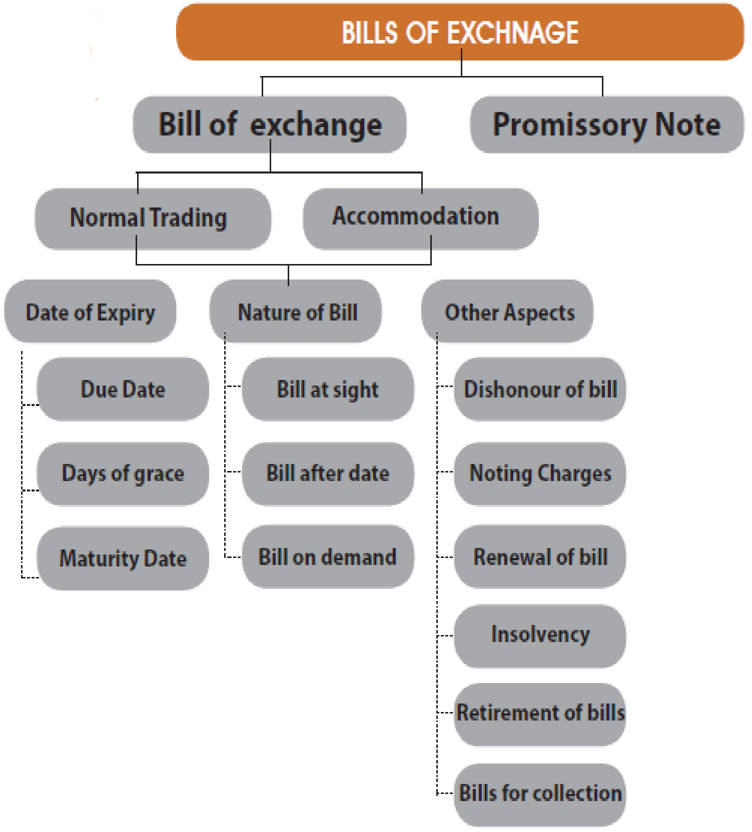
NAVKAR INSTITUTE® | We believe in the best

SINCE 1997 NAVKAR A Symbol of Success

CHAPTER-6
ACCOUNTING FOR SPECIAL TRANSACTION

UNIT : 1
BILLS OF EXCHANGE AND PROMISSORY NOTES

INTRODUCTION



1. Promissory Note - Definition and Features

Meaning: As per Sec.4 of the Negotiable Instruments Act, 1881, a Promissory Note (P/N or Pro-Note) is

- an instrument in **writing** (not being a Bank Note or a Currency Note),
- containing an **unconditional undertaking,**
- **signed** by the Maker,
- to pay a certain sum of **money** only,
- to, or to the order of a certain **person** or to the **Bearer** of the instrument, (see **Note** below)

Note: A Promissory Note **cannot** be made payable to **Bearer.** Sec.31 of the RBI Act, 1934, permits only RBI and Central v .eminent to make a P/N payable to Bearer on demand.

2. **Features of a Promissory Note:**
   (a) P/N must be in **writing.**
   (b) Generally, the consideration, place and date of making **need not** be mentioned on the P/N.
   (c) A P/N must contain an undertaking / promise to pay. Mere acknowledgment of debt is not sufficient.
   (d) The undertaking / promise to pay should be **unconditional** and **definite** (and not vague).
   (e) P/N should be **signed** by the Maker himself.
   (f) P/N should **specify the Payee** in clear terms i.e. by name, son of, and resident of, etc. The Payee can also be identified by description, e.g. a Promissory Note shall be made payable to the Managing Director of Ram- Industries Ltd.
   (g) Sum payable must be certain or capable of being made certain. Along with principal, interest rate can also be specified.
   (h) There must be a promise to pay only money and not other consideration.
   (i) P/N must be duly stamped and dated. If the P/N is not dated, it is presumed to have been made on the date of its delivery.

Format of a Promissory Note

` **1,00,000 only** **Krishnakumar,**
34, New Street, Chennai

Three months after date, I promise to pay **Ramkumar** or his order, a sum of ` 1,00,000 only, for value received.

To Stamp

Sri. **Ramkumar** Signature of Krishnakumar

43, Old Street, Madurai. **Date:** 15th February 2009

Note: Here, **Maker** = Krishnakumar, **Payee** = Ramkumar.

2. Bills of Exchange-Meaning and Features

1. **Meaning:** As per Sec.5 of the Negotiable Instruments Act, 1881, a **Bill of Exchange** (B/E) is -
   - an instrument in **writing,**
   - containing an unconditional **order,**
   - **signed** by the Maker,
   - **directing** a certain person,

- to pay a certain sum of **money only,**
- to, or to the order of a certain **person** or to the **Bearer** of the instrument.

Note: When prepared by the **Maker** (i.e. Seller of Goods), it is called **Draft.** Once it is accepted by the **Acceptor -**Buyer of Goods), it becomes a valid Bill of Exchange.

2. **Features of Bill of Exchange:**

(a) It must be in **writing.**

(b) It must contain an **order** to pay. Order must be **unconditional.**

(c) It must be dated.

(d) The instrument must be to pay **money only** and the amount of money payable must be **certain.**

(e) The party must **sign** the instrument.

(f) It must be properly **stamped** and all the three parties to a Bill (i.e. Drawer, Drawee and Payee) must be = with reasonable **certainty.**

3. **Parties involved:**

(a) The person who **makes** the order is known as the **Drawer** (or Maker), i.e. Seller of Goods.

(b) The person who **accepts** the order is known as the **Acceptor/ Drawee,** i.e. Buyer of Goods.

(c) The person to whom the amount is payable is known as the **Payee. [Note:** The Drawer and Payee -: same person. Sometimes, the Drawer may order the payment to a third party, i.e. Payee.]

4. **Example:** Ram sold goods to Laxman on credit for `50,000 on 1st January, payable after credit period of three months. On the same date, Ram draws a B/E to be paid 3 months after date and sends the draft to Laxman for acceptance. After Ram's acceptance, this draft becomes a valid B/E (i.e. Bills Receivable for Ram, and Bills Payable for Laxman). In the following B/E, Ram is the **Drawer,** Laxman is the **Acceptor,** and Krishna is the **Payee.**

Format of a Bill of Exchange

` 1,00,000 only Chennai, 15th February 2009

Three months after date, pay to Sri. **Krishna** or his order, a sum of ?1,00,000 only, for value received.

Stamp

To Accepted by me. Signature of **Ram**

Sri. Laxman

43,Old Street, Madurai. Signature of Laxman

3. Foreign Bill

An instrument which is **not** an Inland Instrument, is deemed to be a **Foreign Instrument.** So, the following are examples of Foreign Bills -

1 B/E drawn in India on a person resident **outside** India and made payable **outside** India.

2 B/E drawn **outside** India on a person resident **outside** India.

3. B/E drawn **outside** India and made payable in India.

4 B/E drawn **outside** India and made payable **outside** India.

4. Identify whether the following are Inland or Foreign Instruments

Description	Type	Reason
A bill drawn in Pune on a businessman in Chennai **Bid** accepted payable in California.	Inland	It is drawn in India plus drawn upon a Person resident in India.
A bill drawn in London on a trader in Chennai and accepted payable in Chennai.	Foreign	Drawn outside India.
A bill drawn in Lucknow on a trader in London and accepted payable in Chennai.	Inland	It is drawn in India plus Accepted Payable in India.
A bill drawn in Chennai on trader in America made payable in America.	Foreign	Drawn in India but neither it is made payable in India nor it is drawn upon a Person Resident in India.

5. Possible ways a Drawer can deal with a Bill of Exchange

After its acceptance, the Drawer of the Bill of Exchange, has the following options -

1 **Retention till maturity :** Drawer may retain the Bill upto the date of maturity with him. The B/E will be presented on due date by the Drawer himself.

2 Discounting with Bank

- Drawer may discount the Bill with his Bank, to get funds immediately.
- B/E for `1,00,000 payable after 3 months is discounted with Bank at 18%. Here, Discount Charges deducted by Bank = 1,00,000 x 18% x 3/12 = `4,500. So, Drawer will get ` 1,00,000 -`4,500 = `95,500, as funds immediately. This money can be circulated in his business.

3. **Endorsement :** Drawer may endorse the B/E in favour of a Third Party (i.e. his own Creditor), by signing on the back of the instrument. The person who endorses is called as the **Endorser,** and the person so entitled to payment is called **Endorsee.**

4. **Sent for Collection**

- For safety purposes, the Drawer may deposit the B/E with his Bank with clear instruction that the B/E should be retained till maturity, and should be realized on the due date.
- Here, there is no discounting, only deposit of the Bill with Bank. If the B/E is se" such instructions, it is called "Bills sent for Collection."

5. **Pledge**

Drawer may pledge the B/E with any Bank or Other Party for taking a Loan.

Note: Based on the above treatments, appropriate Journal Entries will be passed in the Drawer's books.

6. Maturity Date for P/N and B/E

1. **Maturity:** The Maturity of a Promissory Note or Bill of Exchange is the **date on which it falls due.**
2. **Days of Grace:** In calculating the maturity of a P/N or a B/E which is **not** payable on demand, presentment, **3 days of grace** shall be added to the date on which the instrument is expressed to be : -
3. **Instruments entitled to Days of Grace:**

(a) A Note or Bill payable on a specified date.

(b) A Note or Bill payable after sight.

(c) A Note or Bill payable after certain period of time.

(d) A Note or Bill payable after a certain period or after the happening of a certain event.

(e) Where a Note or Bill is payable in installments, days of grace are allowed on each instalment.

4. **Meaning of “At Sight”, “On Presentment” and “After Sight”:**

(a) In a P/N or B/E, the expressions “at sight” and “on presentment” mean, **“on demand”.**

(b) In a P/N, the expression “after sight” means, **after** presentment for sight.

(c) In a B/E, the expression “after sight” means, **after acceptance,** or noting for non-acceptance or protest for non-acceptance..

5. **Provisions as to calculation of Maturity:**

Payable after	Maturity is at -
Stated number of months- ➲ **After date, or** ➲ **After sight, or** ➲ **After a certain event.**	➲ 3 days after corresponding date of the month after the **stated number of months** **Example: B/E dated 30th August ,is made payable 3 months after date. It matures on 3rd December** ➲ If the month in which the period terminates has on the last day of such month. 3 days of grace is added. **Example:** B E dated 30th January is payable 1 month after date. It falls due on 3rd March.
A certain number of days - ➲ After date, or ➲ After sight, or ➲ After a certain event.	➲ It shall be at maturity on the 3rd day after the specified day. ➲ While calculating the date at which a P/N or B/E made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date,or of : presentment for acceptance or sight, or of protest for non - acceptance, or on which the event happens shall be excluded. **Example:** B/E dated 1st November is made payable 15 days after date. The period of 15 days will be days counted from 2nd November and the B/E will be at maturity On 19th November.
On a day when day of maturity is a Public Holiday. Official Gazette, to be a Public Holiday.	➲ Public holiday includes Sundays and any other day declared by the Central Government by notification in the ➲ A P/N or B/E which matures on a public holiday shall be deemed to fall due on the next preceding business day, e.g. if a B/E falls due on Sunday, it shall be deemed to be : on Saturday. ➲ A B/E which falls due on emergency holiday shall be deemed to be due on the ne succeeding business day.

7. Dishonour of B/E and payment of Noting Charges

Dishonour: Non-payment of Bill of Exchange on the due date is called **Dishonour.**

Noting: In case of dishonour of a B/E on the due date, the fact of dishonour, and the causes of dishonour should be ascertained and recorded on the B/E itself. Otherwise, the Acceptor may prove that the B/E was not properly presented to him on the due date and hence can escape from his liability.

Charges: Noting Charges refers to the fees paid to a Public Official known as **"Notary Public",** who records the fact 2nd causes of dishonour of B/E.

Accounting: Noting Charges is incurred by the person presenting the B/E on the due date, and is recoverable from the person causing the dishonour, i.e. the Acceptor.

8. Renewal of B/E

1. **Reason for Renewal**

➲ Sometimes, the Acceptor of a B/E is unable to pay **the** amount on the due date.

➲ In such case, the Acceptor may request the Drawer for an **extension** of time period,

➲ This constitutes Renewal of bill.

2. **Accounting for Renewal**

➲ Old B/E will be cancelled. So, the earlier Journal Entry relating to acceptance of Old B/E will be reversed.

➲ New B/E will be made out. Journal Entries are passed for recording the New B/E.

Sometimes, the value of New B/E = Value of Old B/E + Interest, if any.

9. Retirement of B/E

1. **Reason for Retirement**

➲ Sometimes, the Acceptor of a B/E is ready to pay re amount, even before the due date.

➲ So, the Acceptor may request the Payee, for settling the payment before due date.

➲ constitutes **Retirement of Bill.**

2. **Accounting for Retirement**

➲ Acceptor is entitled to receive certain Interest or Discount (called **Rebate)** for making payment before the due date.

➲ This **Rebate** on Bills Retired before due date, constitutes Income of Acceptor, and Expense of Payee.

10. Accommodation Bills

1. **Meaning:**

(a) Generally, B/E is drawn in support of a trade transaction, i.e. credit sales. However, B/E can **also** be utilized for raising finance (i.e. without a trade transaction).

(b) When B/E is used for financing purposes, it is called as Accommodation Bill. **(Note:** An Accommodation Bill is also referred to as **"Kite".)**

2. **Example:**

(a) Assume Abhinav & Balram are in need of funds, say ` 3,00,000 and ` 2,00,000, temporarily in business (3 months). Both draw a B/E on each other for ` 3,00,000 and ` 2,00,000 respectively, and discount the same with their respective Bankers. (Sometimes, a single B/E may also be drawn by one party on the other and discounted with the Bank, the proceeds will be shared by both parties in agreed ratio)

(c) On the respective due dates of the B/E, both parties pay their respective dues to the Bank.

11. Dealing with Insolvency of Drawee

1. **Meaning:** Insolvency of the Drawee means that he will be unable to pay his liabilities. This means that bills accepted - m will be dishonored on the due date.
2. **Accounting:** In the books of the Drawer, the following Journal Entries have to be passed

(a) For dishonour of B/R	Drawee A/c Dr. To Bills Receivable A/c
(b) For recording final amount, if any, received	Cash A/c Dr. (Amt actually received) To Drawee Account (Total Amount due)

12. Bills Receivable Book and Bills Payable Book

Point	Bills Receivable Book	Bills Payable Book
Purpose	To record all the bills received from Debtors	To record all the bills issued to the Creditors
Dishonour	Dishonour of B/E shall be recorded	Dishonour of B/E shall be recorded

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. On 1.1.2017, A draws a bill on B for `1,20,000 for 3 months' maturity date of the bill will be:

   (a) 1.4.2017 (b) 3.4.2017 (c) 4.4.2017

2. On 16.6.2016 P draws a bill on Q for `1,25,000 for 30 days. 19th July is a public holiday, maturity date of the bill will be:

   (a) 19th July (b) 18th July (c) 17th July

3. PQ draws a bill on XY for `130,000 on 1.1.2017. X accepts the same on 4.1.2017 for period of 3 months after date. What will be the maturity date of the bill:

   (a) 4.4.2017 (b) 3.4.2017 (c) 7.4.2017

4. A draws a bill on B. A endorsed the bill to C. The payee of the bill will be

   (a) A (b) B (c) C

5. A bill of ` 120,000 was discounted by Saras with the banker for `1,18,800. At maturity, the bill returned dishonored, noting charges ` 200. How much amount will the bank deduct from Saras's bank balance at the time of such dishonor?

   (a) `1,20,000 (b) `1,18,800 (c) `1,20,200

6. X draws a bill on Y for `300,000 on 1.1.2016 for 3 months after sight, date of acceptance is 6.1.2016.

   Maturity date of the bill will be:

   (a) 8.4.2016 (b) 9.4.2016 (c) 10.4.2016

7. X sold goods to Y for ` 5,00,000. Y paid cash `4,30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:

   (a) ` 98,000 (b) ` 68,000 (c) ` 68,600

8. On 1.1.2017, X draws a bill on Y for ` 5,00,000 for 3 months. X got the bill discounted 4.1.2017 at 12% rate. The amount of discount on bill will be:

   (a) ` 15,000 (b) ` 16,000 (c) ` 18,000

9. Mr. Jay draws a bill on Mr. John for ` 3,00,000 on 1.1.2017 for 3 months. On 4.2.2017, John got the bill discounted at 12% rate. The amount of discount will be:

   (a) ` 9,000 (b) ` 6,000 (c) ` 3,000

10. XZ draws a bill on YZ for ` 2,00,000 for 3 months on 1.1.2017. The bill is discounted with banker at a charge of `1,000. At maturity the bill return dishonoured. In the books of XZ, for dishonour, the bank account will be credited by:

    (a) `199,000 (b) ` 200,000 (c) ` 201,000

11. On 1.1.2017, XA draws a bill on YB for ` 1,00,000. At maturity YB request XA to renew the bill for 2 month at 12% p.a. interest. Amount of interest will be:
    (a) ` 2,000 (b) ` 1,500 (c) ` 1,800

12. A bill of exchange is drawn by a
    (a) Creditor (b) Debtor (c) Debenture holder

13. At the time of drawing a bill, the drawer credits
    (a) Bills Receivables A/c (b) Bills Payable A/c
    (c) Debtor's A/c

14. A promissory note is made by a
    (a) Seller (b) Purchaser (c) Endorsee

15. A bill of exchange contains
    (a) An unconditional order (b) A promise
    (c) A request to deliver the goods

16. A promissory note contains
    (a) An unconditional order (b) A promise
    (c) A request to deliver the goods

17. The rebate on the bill shows that
    (a) It has been endorsed
    (b) It has been paid after the date of maturity
    (c) It has been paid before the date of maturity

18. Notary Public may charge his fee from the
    (a) Holder of bill of exchange (b) Drawer (c) None

THEORETICAL QUESTIONS

1 Write short notes on:
    (a) Accommodation bill.
    (b) Renewal of bill.
    (c) Noting charges.

2 What is bill of exchange? How does it diff er from Promissory Note?

HOME WORK

Q-1 On 1st January, 2016, A sells goods for `10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 2016, B retires his acceptance under rebate of 12% per annum. Record these transactions in the journals of B.

Q-2 A draws upon B three Bills of Exchange of ` 3,000, ` 2,000 and ` 1,000 respectively. A week later his first bill was mutually cancelled, B agreeing to pay 50% of the amount in cash immediately and for the balance plus interest `100, he accepted a fresh Bill drawn by A. This new bill was endorsed to C who discounted the same with his bankers for `1,500. The second bill was discounted by A at 5%. This bill on maturity was returned dishonored (nothing charge being `30). The third bill was retained till maturity when it was duly met.

Give the necessary journal entries recording the above transactions in the books of A.

Q-3 Journalize the following in the books of Don:

(i) Bob informs Don that Ray's acceptance for ` 3,000 has been dishonored and noting charges are ` 40. Bob accepts ` 1,000 cash and the balance as bill at three months at interest of 10%.Don accepts from Ray his acceptance at two months plus interest @ 12% p.a.

(ii) James owes Don ` 3,200; he sends Don's own acceptance in favour of Ralph for ` 3,160; in full settlement.

(iii) Don meets his acceptance in favour of Singh for ` 4,500 by endorsing John's acceptance for ` 4,450 in full settlement.

(iv) Ray's acceptance in favour of Don retired one month before due date, interest is taken at the rate of 6% p.a.

UNIT : 2
SALE OF GOODS ON APPROVAL OR RETURN BASIS

INTRODUCTION

Under normal course of business, goods sold to customers is treated as sale immediately when the goods are sold, with corresponding revenue from such sale being recognized in the profit and loss account. However, when a businessman wants to increase his sales or introduce a new product in the market, he usually faces hardship due to competition prevailing in the market. To counter it, goods are sometimes sent to the customers on sale or return basis. Here, goods sent on 'approval' or 'on return' basis means goods are delivered to the customers with the option to retain or return them within a specified period. Generally, these transactions take place between a manufacturer (or a wholesaler) and a retailer. In current scenario, this practice is prevalent in case of online sales, where the buyer is given time of few days to return the goods if the buyer believes that the specifications of goods are different from the same mentioned on website at the time of sale. There may be certain terms and conditions to administrate the return of goods. Following are essentially the features of sale of goods on approval or return basis:

(a) There is a change in the possession of goods from one person to another.

(b) It does not involve transfer of ownership of goods. The ownership is passed only when the buyer gives his approval or if the goods are not returned within that specified period.

(c) The customer does not incur any liability when the goods are merely sent to him. In case of online transactions, sometimes customers are given choice to pay on receipt of goods and in some cases they are required to pay in advance and then seller ships the goods to buyer. Even in case the buyer has paid in advance, it retains the right of refund if the goods are returned as per the terms and conditions agreed between seller and buyer.

As per the definition given under the Sale of Goods Act, 1930, in respect of such goods, the sale will take place or the property in the goods pass to the buyer:

(i) When he signifies his approval or acceptance to the seller;

(ii) When he does some act adopting the transaction;

(iii) If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, on the expiry of the specified time (if a time has been expired) or on the expiry of a reasonable time (if no time has been expired).

Accounting entries depend on the fact whether the business sends goods on sale or return basis (i) casually; (ii) frequently; and (iii) numerously.

WHEN THE BUSINESS SENDS GOODS CASUALLY ON SALE OR RETURN BASIS

When the transactions are few, the seller on sending the goods, treats them as an ordinary sale. If the goods are accepted or not returned or the business receives no intimation within the specified time limit, no extra entry is required to be passed because the entry for sale (passed at the time of sending goods) becomes the usual entry after the expiry of the specified period. If the goods are returned within a specified time limit, a reverse entry is passed to cancel the previous transaction. If, at the year-end, goods are still lying with the customers and the specified time limit is yet to expire, the entry for sales made earlier is cancelled and the value of the goods lying with the customers must be reduced from the selling price to the cost price, and treated as ordinary Inventories for Balance Sheet purposes.

Journal Entries:

1. When goods are sent on sale or return basis:
   Trade receivables / Customers Account Dr. [Invoice price]
   To Sales Account
2. When goods are rejected or returned within the specified time:
   Sales/Return Inwards Account Dr. [Invoice price]
   To Customers/Trade receivables Account
3. When goods are accepted at invoice price:
   [No entry]
4. When goods are accepted at a higher price than invoice price:
   Trade receivables / Customers Account Dr.
   To Sales Account [Difference in price]
5. When goods are accepted at a lower price than the invoice price:
   Sales Account Dr.
   To Trade receivables / Customers Account [Difference in price]
6. (i) At the year-end, when goods are lying with customers and the specified time limit is yet to expire:
   Sales Account Dr. [Invoice price]
   To Trade receivables / Customers Account

(ii) These goods should be considered as Inventories with customers and in addition to the above, the following adjustment entry is to be passed:
Inventories with Customers on Sale or Return Account Dr.
To Trading Account [Cost price or market price whichever is less]

No entry is to be passed for goods returned by the customers on a subsequent date.

WHEN THE BUSINESS SENDS GOODS FREQUENTLY ON SALE OR RETURN BASIS

When a business sends goods on sale or return on a frequent basis, an immediate sale does not take place. Only when the customer signifies his intention to purchase the goods or takes some action whereby it is indicated that he has decided to purchase the goods, the property in the goods passes to the buyer. So long as the property does not pass to the buyer, the seller does not record it as a sale and, therefore, does not debit the customer with the sales price. Under this method, record of goods sent is maintained in a specially ruled Sale or Return Journal / Day Book instead of passing entry for sale of goods. This Day Book is divided into 4 main columns –

(1) Goods sent on Approval; (2) Goods Returned: (3) Goods Approved; and (4) Balance.

Goods sent on approval				Goods returned				Goods approved				Balance
1	2	3	4	5	6	7	8	9	10	11	12	13
Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Amt.

CLASS WORK

Q-1 Goods of Rs. 500000 of sale value sent to customer on sale or return basis out of which customer accepted goods of Rs. 300000 and rejected goods of Rs. 150000, for the remaining goods no approval received from customer upto year end. Also specified time limit has not expired yet on such goods. Cost of remaining goods is 40000. Pass journal entries.

Q-2 Goods of Rs. 800000 of sale value sent to customer on sale or return basis out of which customer accepted goods of Rs. 500000 and rejected goods of Rs. 150000, for the remaining goods no approval received from customer upto year end. Also specified time limit has not expired yet on such goods. Profit margin on goods is 25% on cost. Pass journal entries.

Q-3 Goods of Rs. 1500000 of sale value sent to customer on sale or return basis out of which customer accepted goods of Rs. 1000000 when price was 10% higher and rejected goods of Rs. 300000, when price was 5% higher, for the remaining goods no approval received from customer upto year end. Also specified time limit has not expired yet on such goods. Profit margin on goods is 30% on cost. Pass journal entries.

Q-4 Goods of Rs. 600000 of cost price sent to customer on sale or return basis out of which customer accepted 50% goods and rejected 30% goods, for the remaining goods no approval received from customer upto year end. Also specified time limit has not expired yet on such goods. Profit margin on goods is 20% on cost. Pass journal entries.

Q-5 Goods of Rs. 1000000 of cost price sent to customer on sale or return basis out of which customer accepted 60%, when price was 10% lower, and rejected 30% goods, for the remaining goods no approval received from customer upto year end. Also specified time limit has not expired yet on such goods. Profit margin on goods is 10% on cost. Pass journal entries.

Q-6 A firm sends goods on sale or return basis. Customers having the choice of returning the goods within a month. During May 2016, the following are the details of goods sent:

Date (May)	2	8	12	18	20	27
Customers	P	B	Q	D	E	R
Value (`)	15,000	20,000	28,000	3,000	1,000	26,000

Within the stipulated time, P and Q returned the goods and B, D, and E signified that they have accepted the goods.

Show in the books of the firm, the Sale or Return Account and Customer- P for Sale or Return Account on 15th June, 2016.

Q-7 On 31st December, 2016 goods sold at a sale price of ` 3,000 were lying with customer, Ritu to whom these goods were sold on 'sale or return basis' were recorded as actual sales. Since no consent has been received from Ritu, you are required to pass adjustment entries presuming goods were sent on approval at a profit of cost plus 20%. Present market price is 10% less than the cost price.

Q-8 X supplied goods on sale or return basis to customers, the particulars of which are as under.

Date of dispatch	**Party's name**	**Amount**	**Remarks**
		`	
10.12.2016	M/s. ABC	10,000	No information till 31.12.2016
12.12.2016	M/s. DEF	15,000	Returned on 16.12.2016
15.12.2016	M/s. GHI	12,000	Goods worth ` 2,000 returned on 20.12.2016
20.12.2016	M/s. DEF	16,000	Goods Retained on 24.12.2016
25.12.2016	M/s. ABC	11,000	Good Retained on 28.12.2016
30.12.2016	M/s. GHI	13,000	No information till 31.12.2016

Goods are to be returned within 15 days from the dispatch, failing which it will be treated as sales. The books of 'X' are closed on the 31st December, 2016.

Prepare the following accounts in the books of 'X'.

MULTIPLE CHOICE QUESTIONS

1. When a large number of articles are sent frequently on a sale or return basis, it is necessary to maintain

(a) Sale journal (b) Goods returned journal (c) Sale or return journal

2. Sale or Return Day Book and Sale or Return Ledger are known as

(a) principal books (b) subsidiary books (c) memorandum books

3. A sent some goods costing ` 3,500 at a profit of 25% on sale to B on sale or return basis. B returned goods costing ` 800. At the end of the accounting period i.e. on 31st December, 2016, the remaining goods were neither returned nor were approved by him. The Inventories on approval will be shown in the balance sheet at

(a) 2,000. (b) 2,700 (c) 2,700 less 25% of 2,700.

4. A merchant sends out his goods casually to his dealers on approval basis. All such transactions are, however, recorded as actual sales and are passed through the sales book. On 31-12-2016, it was found that 100 articles at a sale price of 200 each sent on approval basis were recorded as actual sales at that price. The sale price was made at cost plus 25%. The amount of Inventories on approval will be amounting

(a) ` 16,000. (b) ` 20,000. (c) ` 15,000.

5. Umesh sends goods on approval basis as follows:

Date January, 2016	**Customer's Name**	**Sale price of Goods Sent**	**Goods Accepted**	**Goods Returned**
		`		
8	Anna	3,500	3,000	500
10	Babu	2,800	2,800	–
15	Chandra	3,680	–	3,680
22	Desai	1,260	1,000	260

The Inventories of goods sent on approval basis on 31st January will be

(a) ` 500. (b) Nil. (c) ` 260.

6. A company sends its cars to dealers on ` sale or return' basis. All such transactions are however treated like actual sales and are passed through the sales day book. Just before the end of the financial year, two cars which had cost ` 55,000 each have been sent on 'sale or return' and have been debited to customers at ` 75,000 each, cost of goods lying with the customers will be

(a) ` 1,10,000. (b) ` 55,000. (c) ` 75,000.

7. A trader has credited certain items of sales on approval aggregating ` 60,000 to Sales Account. Of these, goods of the value of ` 16,000 have been returned and taken into Inventories at cost ` 8,000 though the record of return was omitted in the accounts. In respect of another parcel of `12,000 (cost being ` 6,000) the period of approval did not expire on the closing date. Cost of goods lying with customers should be

(a) ` 12,000. (b) ` 54,000. (c) ` 6,000.

8. Under sales on return or approval basis, the ownership of goods is passed only

(a) when the retailer gives his approval

(b) if the goods are not returned within specified period.

(c) Both (a) and (b)

9. Under sales on return or approval basis, when transactions are few, the seller, while sending the goods, treats them as

(a) an ordinary sale but no entry is passed in the books

(b) an ordinary sale and entry for normal sale is passed in the books

(c) Approval sale and no entry is passed

10. Under sales on return or approval basis, when transactions are few and the seller at the end of the accounting year reverse the sale entry, then what will be the accounting treatment for the goods returned by the customers on a subsequent date?

(a) No entry will be passed for such return of goods

(b) Entry for return of goods is passed by the seller

(c) Only the Inventories account will be adjusted

HOME WORK

Q-1 CE sends goods to his customers on Sale or Return. The following transactions took place during 2017:

Sept. 15	Sent goods to customers on sale or return basis at cost plus 33-1/3%	Rs. 1,00,000
Oct. 20	Goods returned by customers	40,000
Nov. 25	Received letters of approval from customers	40,000
Dec. 31	Goods with customers awaiting approval	20,000

CE records sale or return transactions as ordinary sales. You are required to pass the necessary Journal Entries in the books of CE assuming that accounting year closes on 31st December, 2017.

Q-2 S. Ltd. Sends out its goods to dealers on Sale or Return. All such transactions are, however, treated s actual sales and are passed through the Day Book. Just before the end of the accounting year on 31.12.2017, 200 such goods have been sent to a dealer at Rs. 250 each (cost Rs. 200 each) on sale or return and debited to his account. Of these goods, on 31.12.2005, 50 were returned and 70 were sold, for the other goods date of return has not yet expired.

Q-3 Caly Company sends out its gas containers to dealers on Sale or Return. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the financial year, 100 gas containers, which cost them Rs. 900 each have been sent to the dealer on ` sale or return' and have been debited to his account at Rs. 1,200 each. Out of this only 20 gas containers are sold at Rs. 1,500 each.

Q-4 E Ltd. Sends out its accounting machines costing Rs. 200 each to their customers on Sales or Return. All such transactions are, however treated like actual sales and are passed through the Day Book. Just before the end of the financial year i.e., on December 24, 2017, 300 such accounting machines were sent out at an invoice price of Rs. 280 each, out of which only 90 accounting machines are accepted by the customers Rs. 250 each and as to the rest no report is forthcoming.

Show the Journal Entries in the books of the company for the purpose of preparing Final Accounts for the year ended December 31, 2017.

UNIT : 3
CONSIGNMENT

INTRODUCTION

MEANING OF CONSIGNMENT ACCOUNT

To consign means to send. In Accounting, the term "consignment account" relates to accounts dealing with a situation where one person (or firm) sends goods to another person (or firm) on the basis that the goods will be sold on behalf of and at the risk of the former. The following should be noted carefully:

(i) The party which sends the goods (consignor) is called principal.

(ii) The party to whom goods are sent (consignee) is called agent.

(iii) The ownership of the goods, i.e., the property in the goods, remains with the consignor or the principal – the agent or the consignee does not become their owner even though goods are in his possession. On sale, of course, the buyer will become the owner.

(iv) The consignor does not send an invoice to the consignee. He sends only a **proforma invoice**, a statement that looks like an invoice but is really not one. The object of the proforma invoice is only to convey information to the consignee regarding particulars of the goods sent.

(v) Usually, the consignee recovers from the consignor all expenses incurred by him on the consignment.

(vi) It is also usual for the consignee to give an advance to the consignor in the form of cash or a bill of exchange. It is adjusted against the sale proceeds of the goods.

(vii) For his work, the consignee receives a commission calculated on the basis of gross sale. For ordinary commission the consignee is not responsible for any bad debt that may arise. If the agent is to be made responsible for bad debts, he is to be paid a commission called del-credere commission. It is calculated on total sales, not merely on credit sales until and unless agreed.

(viii) Periodically, the consignees sends to the consignor a statement called Account Sales. It sets out the sales made by the consignee, the expenses incurred on behalf of the consignor, the commission earned by the consignee and the balance due to the consignor.

DISTINCTIONS

1. CONSIGNMENT AND SALE

S.No.	Consignment	Sale
1.	Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee.	The ownership of the goods transfers with the transfer of goods from the seller to the buyer
2.	The consignee can return the unsold goods to the consignor.	Goods sold are the property of the buyer and can be returned only if the seller agrees.
3.	Consignor bears the loss of goods held with the consignee.	It is the buyer who will bear the loss if any, after the transfer of goods.

4.	The relationship between the consignor and the consignee is that of a principal and agent.	The relationship between the seller and the buyer is that of a creditor and a debtor.
5.	Expenses done by the consignee to receive the goods and to keep it safely are borne by the consignor unless there is any other agreement.	Expenses incurred by the buyer are to be borne by the buyer itself after the transfer of goods.

2. DISTINCTION BETWEEN COMMISSION AND DISCOUNT

Commission	Discount
Commission may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved.	The term discount refers to any reduction or rebate allowed and is used to express one of the following situations: An allowance given for the settlement of a debt be fore it is due i.e. cash discount.
Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.	An allowance given to the whole sellers or bulk buyers on the list price or retail price, known as trade discount. A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.

VALUATION OF INVENTORIES

- The principle is that inventories should be valued at cost or net realizable value whichever is lower, the same principle as is practised for preparing final accounts.
- In the case of consignment, cost means not only the cost of the goods as such to the consignor but also all expenses incurred till the goods reach the premises of the consignee. Such expenses include packaging, freight, cartage, insurance in transit, octroi, import duty etc.
- But expenses incurred after the goods have reached the consignee's godown (such as godown rent, insurance of godown, delivery charges,salesman salaries) are not treated as part of the cost of purchase for valuing inventories on hand.

  If details of expenses, if details are not available, then for valuing inventories the expenses incurred by the consignor should be treated as part of cost while those incurred by the consignee should be ignored. If the expected selling price of inventories on hand is lower than the cost, the inventories should be valued at expected net selling price only, i.e. expected selling price less delivery expenses, etc.

3. ACCOUNTING FOR CONSIGNMENT TRANSACTIONS AND EVENTS IN THE BOOKS OF THE CONSIGNOR

For ascertaining profit or loss on any transaction (or series of transactions) there is one golden rule; open an account for the transaction (or series of transactions) and (i) put down the cost of goods and other expenses incurred or to be incurred on the debit side; and (ii) enter the sale proceeds as also the cost of goods remaining unsold on the right hand side or the credit side. The difference between the total of the two sides will reveal profit or loss. There is profit if the credit side is more.

The consignor records the following transactions in his book of accounts :

1. When goods are consigned or dispatched:

   Consignment Account Dr.

   To Goods Sent on Consignment Account

2. Expenses incurred by consignor:

   Consignment Account Dr.

   To Supplier Account/Bank/Cash

3. When advance is received from the consignee: The consignee may remit some advance to consignor. The following entry is recorded:

   Bank/Cash Account Dr.

   To Consignee's Personal Account

4. On receipt of account sales from the consignee: Account sales contains details of sales made by consignee, expenses incurred by consignee. Following entries are recorded

   For sales proceeds

   Consignee's Personal Account Dr.

   To Consignment Account

   For expenses incurred by consignee

   Consignment Account Dr.

   To Consignee's Personal Account

5. Cash or cheque or bank draft or bill of exchange/promissory note received from the consignee as settlement:

   Cash/Bank/Bills Receivable Account Dr.

   To Consignee's Personal Account

6. For bad debts: The accounting entry for bad debts will depend on whether del-credere commission is paid to the consignee

   i. When del-credere commission is not paid to the consignee

      Consignment Account Dr.

      To Consignee's Personal Account

   ii. When del-credere commission is paid to the consignee

      No entry is recorded as bad debts is to be borne by consignee.

7. For the goods taken over by the consignee

   Consignee's Personal Account Dr.

   To Consignment Account

8. For unsold consignment stock:

   Consignment Stock Account Dr.

   To Consignment Account

9. For commission payable to consignee
   Consignment Account Dr.
   To Consignee's Personal Account.

4. GOODS INVOICED ABOVE COST

- Sometimes the proforma invoice is made out at a value higher than the cost and entries in the books of the consignor are made out on that basis – even the inventories remaining unsold will initially be valued on the basis of the invoice price.
- It must be remembered, however, that the profit or loss can be ascertained only if sale proceeds (plus) inventories on hand, valued on cost basis, is compared with the cost of the goods concerned together with expenses. Hence, if entries are first made on invoice basis, the effect of the loading (i.e., amount added to arrive at the invoice price) must be removed by additional entries as follows.

(i) To eliminate loading from opening stock
   Stock Reserve A/c Dr.
   To consignment A/c

(ii) To eliminate loading from Goods sent on consignment
   Goods sent on consignment Dr.
   To consignment A/c

(iii) To eliminate loading from cl.stock
   Consignment A/c Dr.
   To stock reserve a/c

5. NORMAL LOSS

If some loss is unavoidable, it would be spread over the entire consignment while valuing inventories. The total cost plus expenses incurred should be divided by the quantity available after the normal loss to ascertain the cost per unit.

6. ABNORMAL LOSS

any accidental or unnecessary loss occurs, the proper thing to do is to find out the cost of the goods thus lost and then to credit the Consignment Account and debit the Profit and Loss Account – this will enable the consignor to know what profit would have been earned had the loss not taken place.

Distinctions between normal and abnormal loss

Normal loss	Abnormal loss
Normal loss occurs due to inherent nature of the goods being shipped e.g. leakage, evaporation, loss of perishable goods etc.	Abnormal loss occurs mainly because of unforeseen events e.g. accident or natural calamity etc.
Normal loss is not accounted for immediately and is loaded on the remaining goods. It gets accounted for as cost of remaining goods as and when they are sold	Abnormal loss is accounted for immediately in profit and loss account.
As normal loss is added to cost of remaining goods, it impact gross profit	Abnormal loss does not impact gross profit.

Insurance companies generally do not cover normal loss as it is expected to be incurred on each consignment or storage of goods.	Insurance is generally available for abnormal losses
Normal loss is almost certain however it may vary from time to time.	Abnormal loss is because of unforeseen events and there is not certain.

Following entry is recorded for abnormal loss :

Abnormal Loss Account Dr.
To Consignment Account

If abnormal loss is recoverable from the insurance company

Insurance Company's Account Dr.
To Abnormal Loss Account

If abnormal loss is recoverable from the consignee

Consignee's Personal Account Dr.
To Abnormal Loss Account.

7. COMMISSION

Commission is the remuneration paid by the consignor to the consignee for the services rendered to the former for selling the consigned goods. Three types of commission can be provided by the consignor to the consignee, as per the agreement, either simultaneously or in isolation. They are:

1. Ordinary Commission

- **commission simply denotes ordinary commission**.
- It is based on fixed percentage of the gross sales proceeds made by the consignee.
- It is given by the consignor regardless of whether the consignee is making credit sales or not. This type of commission does not give any protection to the consignor from bad debts and is provided on total sales.

2. Del-credere Commission

- To **increase the sale and to encourage the consignee to make credit sales,**
- the consignor provides an additional commission generally known as **del-credere commission.**
- This additional commission when provided to the consignee gives a protection to the consignor against bad debts. In other words, after providing the del-credere commission, bad debts is no more the loss of the consignor.
- It is calculated on total sales unless there is any agreement between the consignor and the consignee to provide it on credit sales only.

3. Over-riding Commission

- It is an extra commission allowed by the consignor to the consignee to promote sales at higher price then specified or to encourage the consignee to put hard work in introducing new product in the market.

➲ Depending on the agreement it is calculated on total sales or on the difference between actual sales and sales at invoice price or any specified price. In order to encourage the consignee to earn higher margins, it can also be in the form of share of additional profits made by consignee on sale of goods.

8. ACCOUNT SALES

An account sale is the periodical summary statement sent by the consignee to the consignor. It contains details regarding –

(a) sales made,

(b) expenses incurred on behalf of the consignor,

(c) commission earned,

(d) unsold inventories left with the consignee,

(e) advance payment or security deposited with the consignor and the extent to which it has been adjusted,

(f) balance payment due or remitted.

It is a summary statement and is different from Sales Account.

9. ACCOUNTING IN THE BOOKS OF THE CONSIGNEE

Following entries are recorded in the books of consignee:

1. On making sales

   Cash/Bank Account/Debtors Dr.

   To Consignor's Personal Account

2. For expenses incurred and his commission

   Consignor's Personal Account Dr.

   To Bank Account

3. For advance paid to consignor

   Consignor's Personal Account Dr.

   To Bank Account

4. For recording bad debts

   Bad Debts Account Dr.

   To Customer's Account

5. For writing off bad debts

   (a) When del-credere commission is not allowed

   Consignor's Personal Account Dr.

   To Bad Debts Account

   (b) When del-credere commission is allowed

   Commission Account Dr.

   To Bad Debts Account

CLASS WORK

Preparation of necessary accounts in the books of consinor i.e. consignment account, goods sent on consignment account, consignee's personal account, trading & profit & loss account etc.

Q-1 Mr. Y consigned 800 packets of toothpaste, each packet containing 100 toothpastes. Cost price of each packet was `900. Mr. Y Spent `100 per packet as cartage, freight, insurance and forwarding charges. One packet was lost on the way and Mr. Y lodged claim with the insurance company and could get ` 570 as claim on average basis. Consignee took delivery of the rest of the packets and spent `39,950 as other non-recurring expenses and `22,500 as recurring expenses. He sold 740 packets at the rate of `12 per toothpaste. He was entitled to 2% commission on sales plus 1% del-credere commission.

You are required to prepare Consignment Account. Calculate the cost of inventories at the end, abnormal loss and profit or loss on consignment.

Q-2 A of Agra sent on consignment goods valued `1,00,000 to B of Mumbai on 1st March, 2016. He incurred the expenditure of `12,000 on freight and insurance. A's accounting year closes on 31st December. B was entitled to a commission of 5% on gross sales plus a del-credere commission of 3%. B took delivery of the consignment by incurring expenses of `3,000 for goods consigned.

On 31.12.2016, B informed on phone that he had sold all the goods for `1,50,000 by incurring selling expenses of `2,000. He further informed that only `1,48,000 had been realized and rest was considered irrecoverable, and would be sending the cheque in a day or so for the amount due along with the accounts sale.

On 5.1.2017, A received the cheque for the amount due from B and incurred bank charges of `260 for collecting the cheque. The amount was credited by the bank on 9.1.2017.

Write up the consignment account finding out the profit/loss on the consignment, B's account, Provision for expenses account and Bank account in the books of the consignor, recording the transactions up to the receipt and collection of the cheque.

Q-3 Miss Rakhi consigned 1,000 radio sets costing ` 900 each to Miss Geeta, her agent on 1st July,2016. Miss Rakhi incurred the following expenditure on sending the consignment.

Freight	`7,650
Insurance	`3,250

Miss Geeta received the delivery of 950 radio sets. An account sale dated 30th November,2016 showed that 750 sets were sold for ` 9,00,000 and Miss Geeta incurred ` 10,500 for carriage.

Miss Geeta was entitled to commission 6% on the sales effected by her. She incurred expenses amounting to ` 2,500 for repairing the damaged radio sets remaining in the inventories.

Miss Rakhi lodged a claim with the insurance company which was admitted at ` 35,000. Show the Consignment Account and Miss Geeta's Account in the books of Miss Rakhi.

Q-4 Vikram Milk Foods Co. Ltd. of Vikrampur sent to Sunder Stores, Sonepuri 5,000 kgs of baby food packed in 2,000 tins of net weight 1 kg and 6,000 packets of net weight 1/2 kg for sale on consignment basis. The consignee's commission was xed at 5% of sale proceeds. The cost price and selling price of the product were as under:

	1 kg. tin	1/2 kg. packet
	`	`
Cost Price	10	6
Selling Price	15	7

The consignment was booked on freight "To Pay" basis, and freight charges came to 2% of selling value. One case containing 50 1kg. tins was lost in transit and the transport carrier admitted a claim of `450.

At the end of the first half-year, the following information is gathered from the "Account Sales" sent by the consignee:

(i) Sale proceeds: 1,500 1 kg. tins
4,000 1/2 kg. packets

(ii) Store rent and insurance charges `600.

Find out the value of closing inventory on consignment.

Show the Consignment A/c and the Consignee's A/c in the books of Vikram Milk Food Co. Ltd. assuming that the consignee had paid the amount due from him.

Q-5 From the following two statements and other information prepare a Consignment Account and Consignee's Account in the books of the consignor and also Consignor's Account in the books of the consignee :

Statmenet - 1

Proforma Invoice - No. 5

Royal Furniture House

Kalikund Road, Dhavalpur

Proforma invoice of the goods sent on consignment to A-One Furniture Mart, on our behalf :

Particulars	**Rate Rs.**	**Total Amount Rs.**
100 Chairs	300	30,000
Add: Expenses :		
Freight	1,000	
Insurance Premium	200	
Wages 300	1,500	
		31,500
E. & O. E.	S/d-	
Place : Dhavalpur	(Vijay Mistry)	
Date : 1-1-2010 Manager		

Statement - 2

Account Sales A-One Furniture Mart

Dharanidhar Road, Vasana, Ahmedabad-7

Account sales of the goods received from Royal Furniture House,

Dhavalpuar to be sold on commission :

Particulars	**Rate**		**Total Amount**
		Rs.	**Rs.**
Cash sales of 50 chairs	450	500	
Credit sales of 30 chairs		500	15,000
			37,500
Less : Expenses and commission :			
		Rs.	
Octroi		1,000	
Carriage		2,250	
Wages		250	
Advertisement expenses		2,250	
General commission		3,750	
Del credere commission		300	9,800
			27,700
Less : A bill for four months accepted on 1-1-2010			20,000
			7,700
Less : A bank draft No. 02370 enclosed herewith			7,700
E. & O. E.		S/d-	
Place : Ahmedabad		(Chandrakant Rana)	
Date : 31-3-2010			

Additional Information :

(1) After one month, the consignor discounted the bill accepted by the consignee at the rate of 9% of discount per annum in a bank.

(2) Two chiars were stolen away from the godown of the consignee against which the insurance company accepted a claim of Rs. 600.

(3) Out of the credit sales made by the consignee, one customer was declared insolvent and Rs. 2,000 were written off as bad debt.

Q-6 D of Delhi appointed A of Agra as its selling agent on the following terms:

Goods to be sold at invoice price or over.

A to be entitled to a commission of 7.5% on the invoice price and 20% of any surplus price realized over invoice price

The principals to draw on the agent a 30 days bill for 80% of the invoice price.

On 1st February, 2016, 1,000 cycles were consigned to A, each cycle costing `640 including freight and invoiced at `800.

Before 31st March, 2016, (when the principal's books are closed) A met his acceptance on the due date; sold off 820 cycles at an average price of `930 per cycle, the sale expenses being `12,500; and remitted the amount due by means of Bank draft.

Twenty of the unsold cycles were shop-spoiled and were to be valued at a depreciation of 50% of cost.

Show by means of ledger accounts how these transactions would be recorded in the books of A and find out the value of closing inventory with A to be recorded in the books of D at cost.

Q-7 X of Delhi purchased 10,000 metres of cloth for ` 2,00,000 of which 5,000 metres were sent on consignment to Y of Agra at the selling price of `30 per metre. X paid `5,000 for freight and `500 for packing etc.

Y sold 4,000 metre at `40 per metre and incurred `2,000 for selling expenses. Y is entitled to a commission of 5% on total sales proceeds plus a further 20% on any surplus price realised over `30 per metre. 3,000 metres were sold at Delhi at `30 per metre less `3,000 for expenses and commission. Owing to fall in market price, the inventories of cloth in hand is to be reduced by 10%.

Prepare the Consignment Account and Trading and Profit & Loss Account in books of X.

Q-8 Amit Traders of Ahmedabad consigned 20 air-conditioner sets to Mitesh Brothers of Mumbai at an invoice price of Rs. 25.000 each on 1-4-2009. The invoice price is fixed after adding 25% on cost price. Amit Traders paid Rs. 3.000 for freight and insurance, while sending the goods.

On 1-4-2009 Amit Traders drew a bill of Rs. 3,00,000 for three months on Mitesh Brothers, which was, immediately returned by the latter, duly accepted. Amit Traders discounted this bill in a bank on 4-5-2009, at annum.

Mitesh Brothers is entitled to get general commission at the rate of 5% and del credere commission at the rate of 2%.

On 31-3-2010 Mitesh Brothers sent an account sale and a bank after for the amount due from him. He reported in the account sale that :

(i) He paid Rs. 2,000 for octroi, Rs. 8,750 for carriage and Rs.8,750 for advertisement.

(ii) He sold 10 airconditioner sets at the rate of Rs.26,000 each for cash.

(iii) He sold 4 airconditioner sets at the rate of Rs. 30,000 each to Garibdas on credit.

(iv) He purchased one airconditioner set for his personal use, at the invoice price.

(v) Garibdas was declared insolvent and 80 paise in a rupee could be recovered from him as a final dividend.

(vi) During the course of the year, fire took place in his godown and one airconditioner set was completely destroyed, against which the insurance company accepted a claim of Rs.18,000.

(vii) Out of the unsold airconditioner sets, two sets were damaged and Rs. 1,600 were estimated as repairing expense to make them saleble.

From the above particulars prepare Consignment Account and Mitesh Brothers Account in the books of Amit Traders.

Q-9 Shree Oil Mill of Rajpar consigned 2,000 kg. of groundnut oil to Naresh Brothers of Ahmedabad at Rs. 40 per kg. They paid Rs. 4,000 for expenses. The consignee accepted a bill of Rs. 48,000 drawn by the consignor for three months which the latter discounted at Rs. 800 as discount.

100 kg. groundnut oil was destroyed in transit for which the insurance co. paid a claim of Rs. 2,400. Naresh Brothers paid Rs 4,800 as sales expenses.

From the account sales received from the consignee, it was seen that 1,600 kg. groundnut oil were sold at Rs. 50 and there was a shortage of 50 kg. due to natural causes. The consignee was entitled to a commission of 5 percent and a del-credere Commission of 2 percent. The consignee sent a bank draft for the balance alongwith the account sales. A customer to whom the consignee has sold goods for Rs. 2,500 on credit was declared bankrupt and only 50 paise in a rupee could be recovered from his estate.

Prepare necessary accounts in the books of Shree Oil Mill.

MULTIPLE CHOICE QUESTIONS

1 P of Delhi sends out 1,000 boxes of toothpaste costing `200 each. Each box consist of 12 packets. 600 boxes were sold by consignee at `20 per packet. Amount of sale value will be:

(a) `1,44,000 (b) `1,20,000 (c) ` 1,32,000

2 X of Kolkata sends out 2,000 boxes to Y of Delhi costing `100 each. Consignor's expenses `5,000. 1/10th of the boxes were lost in consignee's godown and treated as normal loss. 1,200 boxes were sold by consignee. The value of consignment Inventories will be:

(a) `68,333 (b) `61,500 (c) `60,000

3 Which of the following statement is not true:

(a) If del-credere commission is allowed, bad debt will not be recorded in the books of consignor

(b) If del-credere commission is allowed, bad debt will be debited in consignment account

(c) Del-credere commission is provided by consignor to consignee

4 X of Kolkata sent out 2,000 boxes costing 100 each with the instruction that sales are to be made at cost + 45%. X draws a bill on Y for an amount equivalent to 60% of sales value. The amount of bill will be:

(a) `1,74,000 (b) `2,00,000 (c) `2,90,000

5 Which of the following statement is wrong:

(a) Consignor is the owner of the consignment Inventories

(b) Del-credere commission is allowed by consignor to protect himself from bad debt

(c) All proportionate consignee's expenses will be added up for valuation of consignment Inventories.

6 Out of the following at which point the treatment of "Sales" and "Consignment" is same:

(a) Ownership transfer.

(b) Money receive.

(c) Inventories out flow.

7 If del-credere commission is allowed for bad debt, consignee will debit the bad debt amount to:

(a) Commission Earned A/c

(b) Consignor's A/c

(c) Trade receivables (Customers) A/c

8 A proforma invoice is sent by:

(a) Consignee to Consignor

(b) Consignor to Consignee

(c) Customer/Debtors to Consignee

9 Which of the following statement is correct:

(a) Consignee will pass a journal entry in his books at the time of receiving goods from consignor.

(b) Consignee will not pass any journal entry in his books at the time of receiving goods from consignor.

(c) The ownership of goods will be transferred to consignee at the time of receiving the goods.

10 Consignment Inventories will be recorded in the balance sheet of consignor on asset side at:

(a) Invoice Value

(b) At Invoice value less Inventories reserve

(c) At lower than cost price

11 Which of the following expenses of consignee will be considered as non-selling expenses:

(a) Advertisement

(b) Insurance on freight inward

(c) Selling Expenses

12 The consignment accounting is made on the following basis:

(a) Accrual

(b) Realisation

(c) Cash Basis

13 Which of the following item is not credited to consignment account?

(a) Cash sales made by consignee

(b) Credit sales made by consignee

(c) Inventories Reserve on closing consignment Inventories.

HOME WORK

Q-1 Exe sent on 1st July,2016 to Wye goods costing `50,000 and spent `1,000 on packing etc. On 3rd July,2016, Wye received the goods and sent his acceptance to Exe for `30,000 payable at 3 months. Wye spent `2,000 on freight and cartage, `500 on godown rent and `300 on insurance. On 31st December,2016 he sent his Account Sales (along with the amount due to Exe) showing that 4/5 of the goods had been sold for `55,000. Wye is entitled to a commission of 10%. One of the customers turned insolvent and could not pay `600 due from him. Show the necessary journal entries in the books of consignor. Also prepare ledger accounts.

Q-2 Exe sent on 1st July, 2016 to Wye goods costing ` 50,000 and spent ` 1,000 on packing etc. On 3rd July,2016, Wye received the goods and sent his acceptance to Exe for ` 30,000 payable at 3 months. Wye spent ` 2,000 on freight and cartage, ` 500 on godown rent and ` 300 on insurance. On 31st December,2016 he sent his Account Sales (along with the amount due to Exe) showing that 4/5 of the goods had been sold for ` 55,000. Wye is entitled to a commission of 10%. One of the customers turned insolvent and could not pay ` 600 due from him. Show the necessary journal entries in the consignee's book.

Q-3 Ajay of Mumbai consigned to Vijay of Delhi, goods to be sold at invoice price which represents 125% of cost. Vijay is entitled to a commission of 10% on sales at invoice price and 25% of any excess realised over invoice price. The expenses on freight and insurance incurred by Ajay were ` 10,000. The account sales received by Ajay shows that Vijay has e ected sales amounting to ` 1,00,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were `8,000. 10% of consignment goods of the value of ` 12,500 were destroyed in re at the Delhi godown and the insurance company paid ` 12,000 net of salvage. Vijay remitted the balance in favour of Ajay. Prepare consignment account and the account of Vijay in the books of Ajay along with the necessary calculations.

Ans. Losson consignment-` 1,438

Remittance - ` 81,062

Closing Investory(At Invoice Value)- `20,250

Inventory Reserve ` 3,750

Commission - ` 10937.5 or 10,938

Q-4 Tulsian Traders of Delhi purchased 10,000 pieces of sarees @ Rs. 100 per saree. Out of these sarees, 6,000 sarees were sent on consignment to Vastralaya of Jablapur at the selling price of Rs. 120 per saree. The consignors paid Rs. 3,000 for packaging and freight Vastralaya sold 5,000 sarees @ Rs. 125 per saree and incurred Rs. 1,000 for selling expenses and remitted Rs. 5,00,000 to Delhi on account. They are entitled to a commission of 5% on total sales *Plus* a further 20% commission on any surplus price realised over Rs. 120 per saree. 3,000 sarees were sold at Rs. 110 per saree. Owing to depression in the market the selling price (Rs. 120) of sarees has come down by 10%. Prepare the Consignment Account and Trading. Profit and Loss Account in the books of Tulsian Traders and their account in the books of the agents Masers vastralaya of jabalpur.

Ans. Profit on consignment- ` 85,250

Net profit in P & L A/C - ` 1,15,250

Commission - ` 36,250

Consignment closing Inventory in Trading - ` 1,00,500

Closing Inventory in Trading A/c -` 1,00,000

Amount due - ` 87,750

Q-5 Ramesh consigned 2,000 MT of chemicals at a cost of Rs 800 per MT to John, Ramesh paid freight and insurance charges of Rs. 20,000. Of the above 500 MT of chemicals were destroyed by fire during transit. John cleared the balance of 1,500 MT of chemicals and sold 1,000 MT at an average price of Rs. 1,000 per MT. John incurred the following expenses. Godown Rent Rs. 5,000, Insurance Rs. 3,000, Clearing Charges Rs. 4,500. Insurance claim received against fire Rs. 4,00,000 after admitting the salvage value of Stock destroyed by fire at Rs. 10,000. John was entitled to a commission of 10% on sales proceeds. John sends the balance to Ramesh after adjusting his commission and expense out of the sales proceeds, Prepare a Consignment Account and John's Account and John's Account in the books of Ramesh.

Ans. Profit on Consignment -` 79,000

Remittance - ` 87,500

Closing Inventory - ` 4,06,500

Q-6 X of Delhi purchased 10,000 meters of cloth for Rs. 2,00,000 of which 5,000 meters were sent on consignment to Y of Agra at the selling price of Rs.30 per meter. X paid Rs. 5,000 for freight and Rs. 500 for packing, etc. Y sold 4,000 meters at Rs. 40 per meter and incurred Rs. 2,000 for selling expenses Y is entitled to a commission of 5% on total sales proceeds plus a further 20 per cent on any surplus price realised over Rs. 30 per meter. 3,000 meters were sold at Delhi @ Rs. 30 per meter less Rs. 3,000 for expenses and commission. Owing to fall in market price, the stock of cloth in hand is to be reduced by 10 per cent. Prepare the Consignment Account and Trading and Profit & Loss Account in Books of X and his account in the books of Y.

Ans. Profit on consignmenrt - ` 55,490

Net Profit in P& L A/C -` 78,490

Amount due - ` 1,42,000

Q-7 M/s Ram & Co. of Delhi purchased 20,000 pieces of sarees @ Rs. 200 per saree. Out of these, 12,000 sarees were sent on consignment to M/s Laxman Traders of Bombay at the selling price of Rs. 240 per saree. The consignors paid Rs. 6,000 for packing and freight.

M/s Laxman Traders sold 10,000 sarees @ Rs. 250 per saree and incurred Rs. 2,000 towards selling expenses and remitted Rs. 10,00,000 to Delhi on account. M/s Laxman Traders are entitled to a commission of 5 per cent on total sales plus a further 20 per cent commission on any surplus price realised over Rs. 240 per saree.

6,000 sarees were sold Rs. 220 per saree by the consignor. Owing to fall in the market price, the value of stock of sarees in hand is to be reduced by 10 per cent.

Prepare the consignment Account and the account of M/s Laxman Traders in the books of the consignor.

Ans. Profit on Consignment - ` 3,07,900

Amount due - ` 13,53,000

Q-8 X of Calcutta on 15th January sent to Y of Bombay a consignment of 250 televisions costing Rs. 10,000 each. Expenses of Rs. 7,000 were met by the consignor. Y of Bombay spent Rs. 4,500 for clearance on 30th January and the selling expenses were Rs. 500 per television as and when the sale made by Y.

Y sold. On 4th March, 150 televisions @ Rs.14,000 per television and again on 10th April, 75 televisions @ Rs. 14,400.

Mr. Y was entitled to a commission of Rs. 500 per television sold *plus* one-fourth of the amount by which the gross sale proceeds *less* total commission there on exceeded a sum calculated at the rate of Rs. 12,500 per television sold. Y sent the account sale and the amount due to X on 30th April by bank demand draft.

You are required to show the consignment Account and Y's account in the books of X.

Ans. Profit on consignment -` 6,43,650

Amount due /Remittance - ` 28,99,500

Commission - ` 1,63,500

Q-9 Shri Mehta of Mumbai consigns 1,000 cases of goods costing `1,000 each to Shri Sundaram of Chennai. Shri Mehta pays the following expenses in connection with consignment:

	`
Carriage	10,000
Freight	30,000
Loading charges	10,000
Shri Sundaram sells 700 cases at `140 per case and incurs the following expenses:	
Clearing charges	8,500
Warehousing and storage	17,000
Packing and selling expenses	6,000

It is found that 50 cases have been lost in transit and 100 cases are still in transit.

Shri Sundaram is entitled to a commission of 10% on gross sales. Draw up the Consignment Account and Sundaram's Account in the books of Shri Mehta.

Ans. Profit on consignment - ` 1,17,000

Closing Inventories -

In Hand 150 @ ` 1060 each	159000
In Transit 100 @ ` 1050 each	105000
	264000

Remittance / Amount Due - ` 8,50,500

UNIT : 4
JOINT VENTURES

INTRODUCTION

1. MEANING :

Joining hands may be for finance, for technical know-how, for sharing risk etc. When two or more persons join together to carry out a specific business and share the profits or losses on predetermined basis, it is known as a Joint Venture. As per Accounting Standard a joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. Further, joint control is defined as contractually agreed sharing of control over economic activity.

A Joint Venture is a specific duration "business" (generally, concerned to a single transaction, like, developing some housing project and selling the same or mining of a particular coal mine) entered into by two or more persons jointly which comes to an end as soon as specific period elapses or the joint purpose/business is completed. Joint Venture may be described as a temporary partnership between two or more persons without the use of the firm name, for a limited purpose. In other words, under Joint Venture, two or more persons agree to undertake a particular venture (e.g. Joint consignment of goods, Joint construction of a building, Joint underwriting of a particular issue of shares or debentures) and to share the profits and losses thereof in an agreed ratio (if agreement is silent on this point, then in equal ratio). Venture may be for the construction of a building or a bridge, for the supply of certain quantity of materials or labour and even for the supply of technical services.

The persons who have so agreed to undertake a Joint Venture are known as ` Joint Venturers' or ` Co-Venturers' and their liability is limited to the project or activity concerned for which they agree to contribute capital and share profits or losses. This limited partnership automatically expires on the completion of the venture for which it was formed. During the duration of the venture, the co-venturers are are generally engaged in their own business as usual as well (unless agreed otherwise).If the co-venturers are in business, then they often supply goods from their regular business for achieving objective of the venture.

Example 1: A and B decided to purchase Assam Teak in Guwahati and send to Delhi. A of Guwahati purchased Teak of ` 1,00,000, spent ` 20,000 for transportation and ` 8,000 for transit insurance. B of Delhi received the goods. B spent ` 2,000 for unloading, ` 6,000 for godown rent and ` 4,000 for selling expenses. He sold the entire lot for ` 1,75,000. They agreed to share profit of the venture in the ratio of A:B = 3:2.

In the above example, A and B are co-venturers. The venture was for sale of a certain quantity of Assam Teak. The venture would be over on sale of such Teak. Obviously some accounting is necessary to nd out pro t/ loss of the venture and settlement of claims of the co-venturers.

2 FEATURES OF JOINT VENTURE

Some important characteristics of joint venture business are as follows:

(i) It is specific duration special purpose partnership.

(ii) Two or more parties come together for a specific purpose and are bound by an agreement. Parties in venture are called co-venturers.

(iii) The agreement between co-venturers establishes joint control.

(iv) The joint venture may or may not have a specific name. Joint ventures may also be created in the form of a company where co-venturers contribute to its share capital.

(v) Co-venturers may contribute funds for running the venture or supply Inventories from their regular business.

(vi) Co-venturers share profit/loss of the venture at an agreed ratio likewise partnership.

(vii) The co-ventures are free to continue with their own business unless agreed otherwise during the life of joint venture.

(viii) Joint venture terminates on completion of purpose for which it was created.

(ix) Generally profit/loss of the venture is computed on completion of the venture, however, for a joint venture which is expected to run for a long period, profit/loss is computed annually.

3 DISTINCTION OF JOINT VENTURE WITH PARTNERSHIP

Joint Venture differs from Partnership in the following respects:

Basis of Distinction	Joint Venture	Partnership
1. Scope	It is limited to a specific venture, and comes to an end on completion of such venture	It is not limited to a specific venture.
2. Persons involved	The persons carrying on business are called co-venturers.	The persons carrying on business are called partners.
3. Name of entity	Joint venture does not necessarily require	A partnership rm always has a distinct rm name.
4. Ascertainment of profit/loss	The profits/losses are ascertained at the end of specifi c venture (if venture continues for a short period) or on interim basis annually (if venture continues for a longer period).	The profits/losses are ascertained on an annual basis.
5. Separate set of Books	There is no need for a separate set of books. The accounts can be maintained even in one of the Co-venturer's books only.	Separate set of books have to be maintained.
6. Competition	It is a rule rather than exception that chances of co-venturers in the competing business are very high.	Partners generally do not involve in competing business.

7.	Closure	Joint venture will be closed automatically on the completion of the venture i.e. achievement of purpose for which joint formed.	Partnership can be dissolved by mutual consent of the partners or under certain circumstances venture was

4 DISTINCTION OF JOINT VENTURE WITH CONSIGNMENT

Joint venture and consignment are in the nature of an agreement between different parties but there are many points of differences between the two.

Some of these are given below.

	Basis of Distinction	Joint Venture	Consignment
1.	Purpose	It may be for sale of goods or for carrying out any other activity like construction. of building, investment in shares, etc.	It generally involves sale of movable goods.
2.	Persons involved	The persons carrying on business are called co-venturers.	The persons in the trade are called consignor and consignee
3.	Tenure	The relationship comes to an end as soon as the venture is completed.	The arrangement may continue for a long period of time.
4.	Contribution of funds	All the co-venturers contribute funds to a common pool.	The funds are provided by the consignor only.
5.	Sharing of profit/ loss	The profit/loss is shared by all the co-venturers in the agreed ratio (in equal ratio if agreement is silent)	The profit/loss belongs to consignor only. The consignee is entitled only to commission
6.	Ownership	There is joint ownership.	The consignor owns the goods.
7.	Relationship	The relationship between co-venturers is as partners to common purpose	The relationship between consignor and consignee is as principle and agent.

5 METHODS OF MAINTAINING JOINT VENTURE ACCOUNTS

<u>1. When Separate Set of Books are maintained</u>

When size of the venture is fairly big, the co-venturers keep separate set of books of account for the joint venture. Joint venture is considered a separate entity for the purpose of accounting and hence, its transactions are recorded separately from their regular business activities. This method is similar to a partnership agreement being entered into by the partners of a rm.

In the books of Joint Venture, the following accounts are opened:

(i) Joint Bank Account.

(ii) Joint Venture Account.

(iii) Personal Accounts of the Co-venturers (or Co-venturers' Accounts).

(i) Joint Bank Account: The co-venturers open a separate bank account for the venture transactions by making initial contributions. The bank account is generally operated jointly. Expenses are met from this Joint Bank Account. Also sales or collections from transactions are deposited into this account. However, sometimes the co-venturers may make direct payments and direct collections; in such a case they get due credit/ debit in their Personal Accounts for the transactions done. On completion of the venture the Joint Bank Account is closed by paying the balance to co-venturers.

(ii) Joint Venture Account: This account is prepared for measurement of venture profit. This account is debited with all venture expenses and credited with all sales or collections. If credit side of this account is greater than the debit side, the difference represents profit on joint venture and vice versa in the opposite case which is transferred to co-venturers' accounts in the profit-sharing ratio.

(iii) Co-venturers' Accounts: Personal accounts of the venturers are maintained to keep record of their contributions of cash, goods or meeting venture expenditure directly and direct payment received by them on venture transactions. The profit or loss so made on venture is transferred to this account in profit sharing ratio. This account is also closed simultaneously with the closure of joint bank account.

The following journal entries are necessary in the books of joint venture:

Journal Entries

(a) For initial contribution by the co-venturers in Joint Bank Account

Joint Bank A/c Dr.

To Co-venturers' A/c

(b) For purchases made or expenses incurred

Joint Venture A/c Dr.

To Joint Bank A/c (for cash purchase)/Creditors A/c (for credit purchase)

(c) For material supplied by venturers or direct payment made by venturers

Joint Venture A/c Dr.

To Co-venturers' A/cs

(d) For sale made

Joint Bank A/c (for cash sales)/Debtors A/c (for credit sales) Dr.

To Joint Venture A/c

(e) For sale or payment received directly by the venturers.

Co-venturers' A/c Dr.

To Joint Venture A/c

(f) For payment made to creditors

Creditors A/c Dr.

To Joint Bank A/c

(g) For payment received from debtors

Joint Bank A/c Dr.

To Debtors' A/c

(h) For pro t on Joint Venture

Joint Venture A/c Dr.

To Co-venturers' A/c

or *For loss on Joint Venture*

Co-venturers' A/c Dr.

To Joint Venture A/c

(i) For closing the Joint Bank A/c

Co-venturers' A/c Dr.

To Joint Bank A/c

Form above transactions, it may be noted that all sales, incomes, purchases and expenses are recorded in Joint Venture A/c directly. Difference between total revenues and total expenses becomes profit/ loss of the joint venture and is shared by co-venturers.

2. When no separate set of Books are maintained

- When no separate set of books of accounts are maintained for joint venture, each venturer maintains accounts independently for the venture transactions.
- Co-vernturers are generally engaged in their own business for which they have their books of accounts. Additional accounts with respect to join venture transactions are opened in their respective books of accounts.
- The standard practice is to keep full records of own transactions as well as transactions of the co-venturer relating to the venture.
- But sometimes the parties to a venture keep record of their own transactions only. In that case a Memorandum Joint Venture Account is prepared by the parties.
- Sometimes, a bill of exchange is drawn by one of the parties and is discounted. In such a case the discount on the bill should be charged to Joint Venture Account.
- Also, since joint venture is considered separate from the business of the co-venturers, the co-venturers are credited (or debited) for any goods or material supplied (or taken) to (or from) the joint venture out of their own business(es).
- Usually the co-venturers invest money in Joint venture business and receive back the amounts on different dates. It is quite usual for them to agree to calculate interest at a certain rate. Each co-venturers is entitled to receive interest on the amounts invested by him and pay interest on the amounts received by him. Only net interest receivable from or payable to the co-venturer is recorded in the joint venture account. Thus, the net amount of interest is also taken into amount before ascertaining the profit or loss on joint venture.

3. When each Co-venturer keeps records of all transactions

Under this method, the following accounts are prepared by each co-venturer:

(i) Joint Venture Account.

(ii) Co-venturer's Account.

When venturers maintain full records of joint venture, the following journal entries are necessary:

Journal Entries

(i) For supply of goods to venture out of business Inventories

Joint Venture A/c Dr.

To Purchase A/c

(ii) For meeting expenses or purchases of venture

Joint Venture A/c Dr.

To Bank A/c/Creditors A/c

(iii) When co-venturer supplies goods and incurs expenses for venture

Joint Venture A/c Dr.

To Co-venturer A/c

(iv) For venture sale

Bank A/c/Debtors A/c Dr.

To Joint Venture A/c

(v) For venture sale made by the co-venturer

Co-venturer A/c Dr.

To Joint Venture A/c

(vi) For Bill of Exchange drawn on co-venturer

Bills Receivable A/c Dr.

To Co-venturer A/c

(vii) For discounting the Bill of Exchange

Bank A/cDr.

Joint Venture A/c Dr.

To Bills Receivable A/c

(viii) For accepting the Bill of Exchange drawn by co-venturer

Co-venturer A/c Dr.

To Bills Payable A/c

(ix) For Bill of Exchange discounted by co-venturer

Joint Venture A/c Dr.

To Co-venturer A/c

(x) For venture pro t

Joint Venture A/c Dr.

To Pro t and Loss A/c (for own shares)

To Co-venturer A/c (for co-venturer's share)

(xi) For venture loss

Pro t and Loss A/c Dr. (for own share)

Co-venturer A/c Dr. (forco-venturer's share)

To Joint Venture A/c

(xii) For settlement of claims
When payment is due to co-venturer
Co-venturer A/c Dr.
To Bank A/c

(xiii) When payment is due from co-venturer
Bank A/cDr.
To Co-venturer A/c

4. <u>When each Co-venturer keeps records of their own transactions only:</u>

Sometimes the venturers it wasteful to keep full record of venture transactions; rather it is considered convenient to keep record of own transactions only. For this purpose, it is necessary to open ` Joint Venture with Co-venturer A/c'. All expenses incurred, materials sent, etc. are debited to this account. Profit earned is also debited to this account while the loss sustained is credited. Any receipt from joint venture or from co-venturer is credited to this account, while any payment to the co-venturer is debited to this account.

However, profit/loss on joint venture cannot be determined from this account, for which a Memorandum Joint Venture Account is prepared. Memorandum Joint Venture Account is statement prepared by the venturers for determination of venture profit when they just keep record of own transactions and do not maintain full records of venture transactions in the books of accounts. It contains cost of goods, expenses etc. in the debit side and sales and closing stock in the credit side. Balance of Memorandum Joint Venture.

Account shows profit or loss on joint venture. Entries in Memorandum Joint Venture Account are directly recorded without going through the process of journal.

Venturers usually pass the following journal entries.

Journal Entries

(a) For supply of material from stores:
Joint Venture with X A/c Dr.
To Purchases A/c

(b) For payment of expenses
Joint Venture with X A/c Dr.
To Bank/Cash A/c

(c) For sale on venture
Bank A/c Dr.
To Joint Venture with X A/c

(d) For profit on venture
Joint Venture with X A/c Dr.
To Profit & Loss A/c
or For loss on venture
Profit & Loss A/c Dr.
To Joint Venture with X A/c

(e) For final payment to co-venturer
Joint Venture with X A/c Dr.
To Bank A/c

or For final payment made by co-venturer
Bank A/c Dr.
To Joint Venture with X A/c

Let us now take some illustrations to understand the book keeping system of joint venture, when venturers maintain records of their own transactions only.

Our next comprehensive example aims to perfectly establish this methodof maintenance of joint venture accounts in your mind.

CLASS WORK

Q-1 B and C enter a joint venture to prepare a dam for the Government. The Government agrees to pay `1,00,000. B contributes ` 10,000 and C contributes `15,000. These amounts are paid into a Joint Bank Account. Payments made out of the joint bank account were:

	`
Purchase of equipment	6,000
Hire of equipment	5,000
Wages	45,000
Materials	10,000
Office expenses	5,000

B paid `2,000 as licensing fees. On completion, the lm was found defective and Government made a deduction of `10,000. The equipment was taken over by C at a valuation of `2,000.

Separate books were maintained for the joint venture whose pro ts were divided in the ratio of B-2/5 and C-3/5.

Required : Give ledger accounts

Q-2 Rajiv and Sanjiv enter into a joint venture as dealers in land and opened a Joint Bank Account with ` 75,000 towards which Rajeev contributed ` 50,000. They agree to share pro ts and losses in proportion to their cash contribution. They purchased a plot of land measuring 5,000 square yards for `50,000. It was decided to sell the land in smaller plots and a plan was got prepared at a cost of ` 5,700.

In the said plan 1/5th of the total area of the land was left over for public roads and the remaining land was divided into 8 plots of equal size. Out of 8 plots, 3 plots were sold @ `15 per square yard and the remaining 5 plots were sold @ `20 per square yard. Expenses incurred in connection with the plots were: Registration Expenses ` 6,000, Stamp Duty `600 and *Other Expenses `2,500. Allow 5% on the sale proceeds as a commission to Rajiv.*

Required : Journalize the above transactions and prepare the necessary ledger accounts.

Q-3 A and B enter into a joint venture to sell a consignment of timber sharing pro ts and losses equally. A provides timber from stock at mutually agreed value of ` 5,000. He pays expenses amounting to ` 250. B incurs further expenses on cartage, storage, and coolie charges of `650 and receives cash or sales `3,000.

He also takes over goods to the value of balance stock in hand which is valued at `1,000 for his use in his own business. At the close, A takes over the ` 1,100.

Required : *P*repare joint venture account and Co-venturer's account in the books of A.

Q-4 A and B entered into a joint venture of underwriting the subscription of the entire share capital of the Copper Mines Ltd. consisting of 1,00,000 equity shares of `10 each and to pay all expenses upto allotment. The pro ts were to be shared by them in proportions of 3/5ths and 2/5ths. The consideration in return for this agreement was the allotment of 12,000 other shares of ` 10 each to be issued to them as fully paid. A provided funds for registration fees `12,000, advertising expenses of `11,000, for expenses on printing and distributing the prospectus amounting to ` 7,500 and other printing and stationery expenses of ` 2,000. B contributed towards payment of o ce rent ` 3,000, legal charges `13,750, salary to clerical staff ` 9,000 and other petty disbursements of `1,750. The prospectus was issued and applications fell short by 15,000 shares. A took over these on joint account and paid for the same in full. The venturers received the 12,000 fully paid shares as underwriting commission. They sold their entire holding at

`12.50 less 50 paise brokerage per share. The net proceeds were received by A for 15,000 shares and B for 12,000 shares.

Required : Write out the necessar*y accounts in the books of A showing the nal adjustments.*

Q-5 A and B enter into a joint venture sharing pro ts and losses equally. A purchased goods for `5,000 for cash on January 1, 2016. On the same day, B bought goods for `10,000 on credit and spent `1,000 on freight etc.

Further expenses were incurred as follows :

On 1.2.2016 `1,500 by B

On 12.3.2016 `500 by A

Sales were made by each one of them as follows :

15.1.2016 `3,000 by A

13.1.2016 `6,000 by B

15.2.2016 `3,000 by A

1.3.2016 `4,000 by B

Creditors for goods were paid as follows:

1.2.2016 `5,000 by A

1.3.2016 `5,000 by B

On March 31, 2016 the balance of stock was taken over by B at `9,000.

The accounts between the co-venturers were settled by cash payment on this date. The co-venturers are entitled to interest at 12% per annum.

Required : Prepare necessary ledger accounts in the books of assuming that he maintains record of all venture transactions.

Q-6 A and B entered into a joint venture agreement to share the pro ts and losses in the ratio of 2:1. A supplied goods worth ` 60,000 to B incurring expenses amounting to ` 2,000 for freight and insurance. During transit goods costing ` 5,000 became damaged and a sum of `3,000 was recovered from the insurance company. B reported that 90% of the remaining goods were sold at a pro t of 30% of their original cost. Towards the end of the venture, a re occurred and as a result the balance Inventories lying unsold with B was damaged. The goods were not insured and B agreed to compensate A by paying in cash 80% of the aggregate of the original cost of such goods plus proportionate expenses incurred by A. Apart from the share of pro t of the joint venture, B was also entitled under the agreement to a commission of 5% of net pro ts of joint venture after charging such commission. Selling expenses incurred by B totalled `1,000. B had earlier remitted an advance of `10,000. B duly paid the balance due to A by Bank Draft.

You are required to prepare

(i) Joint Venture Account and

(ii) B's Account. in A's books.

Q-7 Ram and Gautham entered into a joint venture to buy and sell TV sets, on 1st July, 2016.

On 1.7.2016, Ram sent a draft for ` 2,50,000 in favour of Gautham, and on 4.7.2016, the latter purchased 200 sets each at a cost of ` 2,000 each. The sets were sent to Ram by lorry under freight "to pay" for ` 2,000 and were cleared by Ram on 15.7.2016.

Ram effected sales in the following manner:

Date	**No. of sets**	**Sale price per set**	**Discount on sales price**
16.7.2016	20	3,000	10%
31.7.2016	100	2,800	-
15.8.2016	80	2,700	5%

On 25.8.2016, Ram settled the account by sending a draft in favour of Gautham, pro ts being shared equally.

Gautham does not maintain any books. Show in Ram's book:

(i) Joint Venture with Gautham A/c; and

(ii) Memorandum Joint Venture A/c.

Q-8 D of Delhi and M of Mumbai entered into a joint venture for the purpose of buying and selling second-hand computers, M to make purchases and D to e ect sales. The pro t and loss was to be shared equally by D and M. A sum of `1,50,000 was remitted by D to M towards the venture.

M purchased 22 old computers for `1,50,000 and paid `90,000 for their reconditioning and sent them to Delhi.

His other expenses were: Buying commission `10,000; Cartage ` 2,000 and Miscellaneous `1,000.

D took delivery of the computers and paid ` 2,700 for Octroi and ` 1,000 for Cartage. He sold 12 computers at `22,000 each; 4 computers at ` 1,000 each and 3 computers at ` 20,000 each. He retained remaining computers for his personal use at an agreed value of ` 15,000. His other expenses – Insurance `2,500; Rent `4,000; Brokerage `12,000 and Miscellaneous `2,000.

Each party's ledger contains a record of his own transactions on account of joint venture. Prepare a statement showing the result of the ven*ture and the account of the venturer in D's ledger as it will nally appear, assuming that the matter was nally settled between the parties.*

Q-9 David of Mumbai and Khosla of Delhi entered into a joint venture for the purpose of buying and selling second-hand motor cars: David to make purchases and Khosla to e ect sales. The pro t and loss was to be shared equally. Khosla remitted a sum of ` 1,50,000 to David towards the venture.

David purchased 5 cars for `1,60,000 and paid `60,000 for their reconditioning and sent them to Delhi. He also incurred an expense of `5,000 in transporting the cars to Delhi.

Khosla sold 4 cars for `2,40,000 and retained the fth car for himself at an agreed value of ` 50,000. His expenses were: Insurance `1,000; Garage Rent ` 2,000; Brokerage ` 2,000; and Sundry Expenses ` 400.

Each party's ledger contains a record of his own transactions on account of joint venture.

Required : Prepare a Memorandum Joint Venture Account showing the result of the venture and the joint venture account with David in the books of Khosla as it will appear, assuming that the matter was nally settled between the parties.

HOME WORK

Q-1 A of Delhi and B of Bangalore entered into a joint venture for purchase and sale of one lot of mopeds. The cost of each moped was `3,600 and the xed retail selling price; `4,500. The following were the recorded transactions.

2016

Jan 1 A purchased 100 mopeds paying `72,000 in cash on account.

A raised a loan from X Bank for ` 50,000 at 18% p.a., interest repayable with loan amount on 1.3.2016.

A forwarded 80 mopeds to B incurring `2,880 as forwarding and insurance charges.

Jan. 7 B received the consignment and paid `720 as clearing charges.

A sold 5 mopeds for cash.

B sold 20 mopeds for cash.

Feb. 1 B raised a loan of `1,50,000 from Y Bank, repayable with interest at 18% p.a on 1.3.2016.

B telegraphically transferred `1,50,000 to A incurring charges of `50. A paid balance due for the mopeds.

Feb. 26 A sold the balance mopeds for cash.

B sold balance mopeds for cash.

A paid selling expenses ` 5,000.

B paid selling expenses ` 20,000.

Mar. 1 Accounts settled between the venturer and loans repaid, pro t being appropriated equally.

You are required to show Memorandum Joint Venture A/c. You are also required to show

(1) Joint Venture with B A/c in A's books; and

(2) Joint Venture with A A/c in B's books.

Assume each venturer recorded only such transactions as concluded by him.

Ans. Hint :

Net profit = Rs. 57,600

Q-2 K and A of Nagpur entered into a joint venture to trade in silk goods in the ratio 2:1. On June 1, 2016, K bought goods worth ` 7,200 and handed over half of the goods to A. On July 1, 2016, K bought another lot of goods costing ` 2,400 and paid ` 180 as expenses. On September 1, A purchased goods for ` 4,500 and on the same day he sent to K a part of these goods costing ` 1,800 and paid `240 towards expenses. On the same day K remitted ` 1,800 to A. The goods were invariably sold by the venturers at a uniform price of 33.33% above cost price excluding expenses. Each of the venturers collected cash proceeds on sales excepting an amount of ` 250 owing to K by a customer and this was written o as a loss relating to the venture. In addition, goods costing ` 600 in possession of A were destroyed by re and an amount of `500.

Ans. Hint :

Net profit = Rs. 2,930

MULTIPLE CHOICE QUESTIONS

1. M and N enter into a Joint venture where M supplies goods worth ` 6,000 and spends ` 100 on various expenses. N sells the entire lot for ` 7,500 meeting selling expenses amounting to ` 200. Profit sharing ratio is equal. N remits to M the amount due. The amount of remittance will be:
(a) ` 6,700 (b) ` 7,300 (c) ` 6,400

2. A purchased goods costing ` 42,500. B sold goods costing ` 40,000 at ` 50,000. Balance goods were taken over by A at same gross profi t percentage as in case of sale. The amount of goods taken over will be:
(a) ` 3,125 (b) ` 2,500 (c) ` 3,000

3. For material supplied from own Inventories by any of the venturer, the correct journal entry will be: (In case of separate sets of books)
(a) Joint Venture A/c will be debited and Venturers Capital A/c will be credited
(b) Joint Venture A/c will be debited and Joint Bank A/c will be credited
(c) Joint Venture A/c will be debited and Material A/c will be credited

4. A and B enter into a joint venture to underwrite the shares of K Ltd. K Ltd make an equity issue of 1,00,000 equity shares of `10 each. 80% of the issue was subscribed by the public. The profit sharing ratio between A and B is 3:2. The balance shares not subscribed by the public, purchased by A and B in profit sharing ratio. How many shares to be purchased by A.
(a) 80,000 shares (b) 72,000 shares (c) 12,000 shares

5. A and B enter into a joint venture to underwrite shares of K Ltd. K Ltd make an equity issue of 2,00,000 equity shares. 80% of the shares underwritten by the venturer. 1,60,000 shares are subscribed by the public. How many shares are to be subscribed by the venturer?
(a) 40,000 shares (b) 36,000 shares (c) 32,000 shares

6. P and Q enter into a Joint Venture sharing profi ts and losses in the ratio 3:2. P purchased goods costing `2,00,000. Other expenses of P ` 10,000. Q sold the goods for 180,000. Remaining goods were taken over by Q at ` 20,000. The amount of final remittance to be paid by Q to P will be:
(a) ` 2,15,000 (b) ` 2,04,000 (c) ` 2,10,000

7. C and D entered into a Joint Venture to construct a bridge. They did not open separate set of books. They shared profits and losses as 3:2. C contributed ` 1,50,000 for purchase of materials. D paid wages amounting to ` 80,000. Other expenses were paid as:
C – ` 5,000 D – ` 15,000
C purchased one machine for ` 20,000. The machine was taken over by C for `10,000. Total contract value of ` 3,00,000 was received by D. What will be the profit on venture?
(a) ` 30,000 (b) ` 40,000 (c) ` 20,000

8. R and M entered into a joint venture to purchase and sell new year gifts. They agreed to share the profit and losses equally. R purchased goods worth ` 1,00,000 and spent ` 10,000 in sending the goods to M. He also paid ` 5,000 for insurance. M spent ` 10,000 as selling expenses and sold goods for ` 2,00,000. Remaining goods were taken over by him at ` 5000. What will be the amount to be remitted by M to R as final settlement?
(a) ` 1,55,000 (b) ` 1,50,000 (c) ` 11,5000

9. A and B enter into a joint venture sharing profit and losses in the ratio 3:2. A will purchase goods and B will affect the sale. A purchase goods costing ` 200,000. B sold it for ` 3,00,000. The venture is terminated after 3 months. A is entitled to get 10% interest on capital invested irrespective of utilization period. The amount of interest received by A will be
(a) ` 15,000 (b) ` 10,000 (c) ` 20,000

10. If any Inventories is taken over by the venturer, it will be treated as an:
(a) Income of the joint venture, hence credited to Joint Venture Account
(b) Expenses of Joint Venture, hence debited to Joint Venture Account
(c) To be ignored as Joint Venture Transaction

UNIT : 5

ROYALTY ACCOUNTS

INTRODUCTION

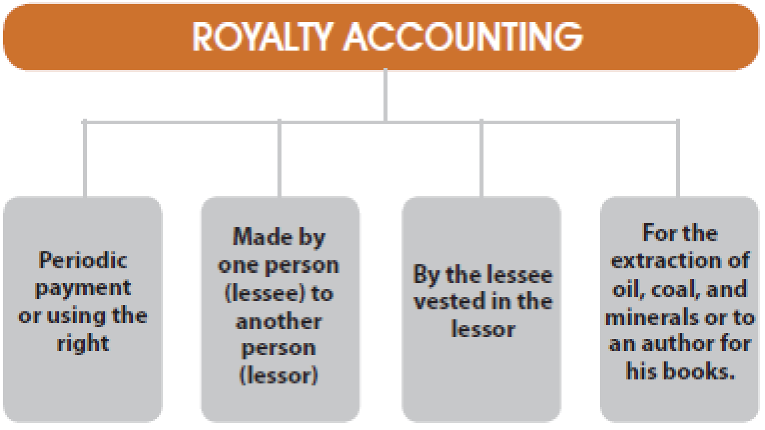
Study Objectives as under :

➲ Understand the meaning of the term “Royalty”.

➲ Familiarize yourself with the Terminology related to Royalty Accounting:

- Minimum Rent
- Short-workings and Recoupment of Short-workings
  - Fixed
  - Floating

➲ Understand the Accounting Treatment in the books of Lessee and Lessor.



“Royalty” may be defined as:

- Periodic payment
- Made by one person (lessee) to another person (lessor)
- For using the right by the lessee vested in the lessor.

Examples:

1. For the extraction of oil, coal, and minerals.
2. To an author for sale of his books.
3. To a patentee for the use of patent.
4. For use of technical know-how developed by a party

Thus, royalty means sum payable, generally based on output or sale, to the owner of mine, a patentee or an author or any other such person for use of rights vested in him.

Lease

Lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The party who conveys the rights is lessor and the one who is being granted the right to use in return for a series of payments is lessee.

Minimum Rent/Dead Rent/Rock Rent/Fixed Rent

Amount of Rent/Royalty which the lessee is required to pay to the lessor Irrespective of Actual Royalty/ Rent Payable is Lower.

(**Note**: Minimum Rent/royalty may be the same for each year or may be different in different years according to the terms of agreement.)

Example : 1

A landlord granted a lease to mining company whereby he is to receive $0.05 per ton of ore mined.

The output for the first 3 years is:

1st year - 10,000 tons

2nd year - 20,000 tons

3rd year - 24,000 tons

Assume that the minimum rent is $800.

Ans :

Year	Calculation of Royalty (Actual Royalty)	Minimum rent	Payment
1	10,000x$0.05 = $500	800	
2	20,000x$0.05 = $1,000	800	
3	24,000x$0.05 = $1,200	800	

Short Workings

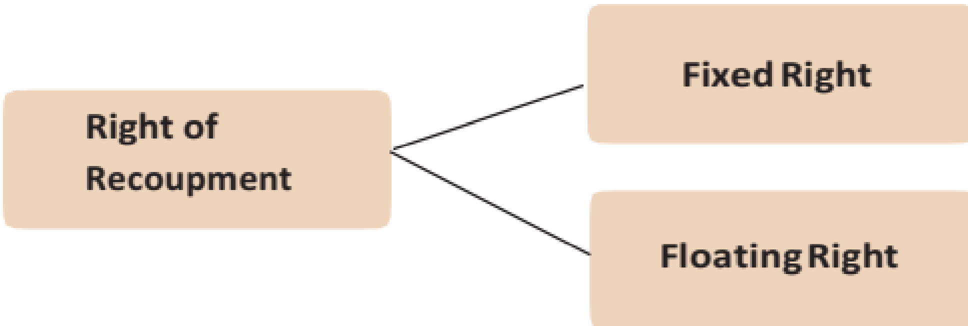
Short-workings = Minimum Rent – Actual Royalty

- Short- workings will only arise when the Actual royalty is less than the Minimum Rent.
- Also, short-workings will arise only when the same are allowed to be adjusted against future royalties.
- If the agreement is such that amount short-workings (minimum rent in excess of royalty computed as per agreement) cannot be adjusted in future years, then minimum rent will become expense of the lessee for that particular year.

Recoupment of Short-workings

Recoupment implies that lessor allows the lessee the **right to carry forward and set off** the short-workings against the excess or surplus of royalties over the Minimum Rent in the subsequent years.

This right is known as the right of Recoupment of Short-working.***(Aaj Actual se jayda jo bhi Pay Kiya usko Future years me If Actual royalty Minimum se Jyada aaye To utnaa Kum pay karne kaa)***



Case I: Fixed Right of Recoupment

If the lessor promises the lessee to compensate the loss (short working) only for a fixed time period

Example:

If lessor promises to compensate the loss only during the first 4 years, the right is said to be fixed.

Case II: Floating Right of Recoupment

If the lessor promises the lessee to compensate the short working of **any year** in the next two or three years

Example : 2

If lessor promises to compensate the (short-working) of any year in coming 2 years, then short-workings of 3rd year can be recouped in 4th and 5th year and short-workings of 8th year in 9th and 10th year.

With a minimum rent – also with the rights to recoup short-workings

A Lessor granted a lease to mining company whereby he is to receive $0.05 per ton of ore mined.

The output for the first 3 years is:

1st year - 10,000 tons

2nd year - 20,000 tons

3rd year - 24,000 tons

Assume that the minimum rent is $800.

Solution :

Year	Calculation of Royalty	Minimum rent	Payment	Short workings Current	Short workings Written off	Short workings Recoverable
1	10,000x40.05 = $500	800	800	-	-	-
2	20,000x$0.05 = $1,000	800	800	-	-	-
3	24,000x40.05 = $1,200	800	1,100	-	-	-

Accounting In the Books Of Lessee

When Short working is Allowed

Entry 1: When Royalty is Payable:

Entry 2: For Payment to Landlord:

Entry 3: For Transferring Royalty:

Entry 4:When Short-workings is recouped:

Entry 5:

For Irrecoverable Short-workings to Trading/P&L/Mfg/Production A/c:

Summary

- Actual amount se royalty Debit karo
- Minimum rent se Lessor ko Payable karke , Pay bhi Karo
- Diff. of Minimum and Actual Rent ko Shortworking me Debit karo..
- Pehle Shortworking ko debit kiya tha Ab credit karo And actual royalty ko Exps. Debit karke baaki kaa payable credit karo
- Ab koi bhi shortworking balance he wo credit karke Trading /P&L / Mfg/ Production A/c me debit karo.

ACCOUNTING IN THE BOOKS OF LESSOR

Entry 1:When Royalty is due:

Entry 2:When money is received:

Entry 3:When short-workings is recouped:

Entry 4:For Irrecoverable amount of Short-workings

Entry 5:For Transferring Royalty Receivable to Trading/P&L/Mfg/Production A/c:

Summary

- ❖ Actual amount se royalty Credit karo
- ❖ Minimum rent se Lessee ko Receivable karke , Received ki entry Karo
- ❖ Diff. of Minimum and Actual Rent ko Shortworking me Credit karo..
- ❖ Pehle Shortworking ko Credit kiya tha Ab Debit karo
- ❖ And actual royalty Income Credit karke baaki kaa Receivable ki entry Karo
- ❖ Ab koi bhi shortworking balance he wo Debit karke Trading /P&L / Mfg/ Production A/c me Credit karo.

CLASS WORK

Q-1 A grants a mine on lease to B on 31.3.13 a royalty of ` 2 per tonne of the coal produced. The following is the quantum of output for each year :

For the year ended 31st March,	2014	3,000 tonnes
	2015	3,200 tonnes
	2016	4,000 tonnes
	2017	5,000 tonnes

The minimum rent is fixed at ` 7,000 and short-workings recoupment is allowable throughout the period of lease. Compute the amount of royalty payable for the years ended 31st March, 2014, 2015, 2016 and 2017 and do accounting in books of both the parties.

Q-2 ABC Collieries Co. Ltd. took from M/s XYZ. a lease of coal field for a period of 25 years from 1st April, 2010 on a royalty of ` 25 per tonne of coal extracted with a Dead Rent of ` 2,20,000 a year with power to recoup short - workings during the first five years of the lease. The company closes its books of account on 31st March every year.

The output in the first five years of the lease was as follows:-

Year ended 31st March, 2011	2,000	tonnes
Year ended 31st March, 2012	3,600	tonnes
Year ended 31st March, 2013	9,000	tonnes
Year ended 31st March, 2014	15,000	tonnes
Year ended 31st March, 2015	20,000	tonnes

You are required to give journal entries for all the transactions relating to royalties for the five years in the books of ABC Collieries Co. Ltd.

HOME WORK

Q-1 On January 1, 1984, A brick Co.acquired a lease of 15 years from Mr.X on lease for getting earth extraction. Terms of the lease are.

(a) annual rate of royalty is 10 paise per 100 cubic feet of earth taken out.

(b) minimum rent is Rs. 1,200 per annum.

(c) short workings can be recouped during first 4 years only.

(d) annual royalty is paid on 31st December,each year.

Brick making company extracted earth in the following manner:

Year	1984	1985	1986	1987
Earth in cubic feet	10,00,000	15,00,000	9,00,000	14,00,000

Open Required ledger accounts in the books of Brick Co. (Lessee) and also pass journal Entries in his books .

Q-2 Kabir took a lease of coal mine @16 per ton of coal extracted subject to a minimum rent of Rs.70,000 p.a. with aright to recoup shortworkings over the first three years of the lease. From thefollowing information, **Prepare anaytical table to show amount of royalty payable to the landlord.**

Year	1	2	3	4	5
Output (tons)	2500	3500	5500	5000	8600

Q-3 A obtained from B, a lease of some coal bearing land,the terms being a royalty of Rs.15 per ton of coal extracted subject to a minimum rent of Rs. 75,000 per annum with a right to recoupment of shortworkings over the first four years of the books of A.

Year	1997	1998	1999	2000	2001
sales(Tones)	2000	3500	4800	5600	8000
Closing Stock(Tonnes)	300	400	600	500	800

Make Table of calculation of Royalty payable and Shortworking Raised/recouped.

Q-4 Sachin obtained a lease of a coal mine for 5 years at a minimum rent of Rs. 3,000 per year merging in to a royalty of 50 paise per ton .The shortworkings of any year could be recouped out of excess of subsequent two years.The output was as follows.

1998	Nil
1999	1,200 tons
2000	4,800 tons
2001	12,000 tons
2002	9,000 tons

Make necessary ledger accounts and also Journalize the above in the books of both, Lessor and Lessee

UNIT : 6
AVERAGE DUE DATE

INTRODUCTION

In business enterprises, a large number of receipts and payments by and from a single party may occur at different points of time. To simplify the calculation of interest involved for such transactions, the idea of average due date has been developed. Average Due Date is one on which the net amount payable can be settled without causing loss of interest either to the borrower or the lender. In this unit, we shall elaborate the underlying principle of determining average due date covering the cases where the amount is lent in various instalments but repayment is made in a single instalment as well as where the amount is lent in one instalment but repayment is made by various instalments. The technique of average due date is also useful for calculating interest on drawings made by the proprietors or partners of a business firm at several points of time.

Due Date

The due date of a bill of exchange/invoice is the date when the amount of a bill/invoice is payable by the drawee/ creditor to drawer/ debtor.

Calculation of Due Date after Taking into Consideration Days of Grace: A Bill of exchange or promissory note matures on the date on which it falls due. And every promissory note or bill of exchange (other than those payable on demand or at sight or on presentment) falls due on the third day after on which it is expressed to be payable.

Examples

(i) A bill dated 30th September is made payable three months after date. It falls due on 2nd January.

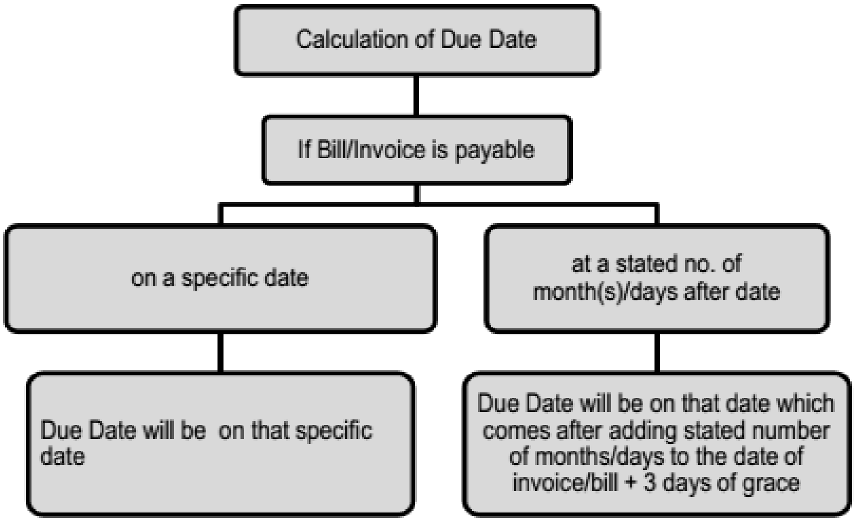
(ii) A note dated 1st January is payable one month after sight. It falls due on 4th February.

Calculating Due Date of Bill or Note Payable Few Months after Date or Sight

When the bill is made payable at a stated number of months after date or after sight or after certain events, then the period stated shall be held to terminate on the date of the month which corresponds with the day on which the instrument is dated. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

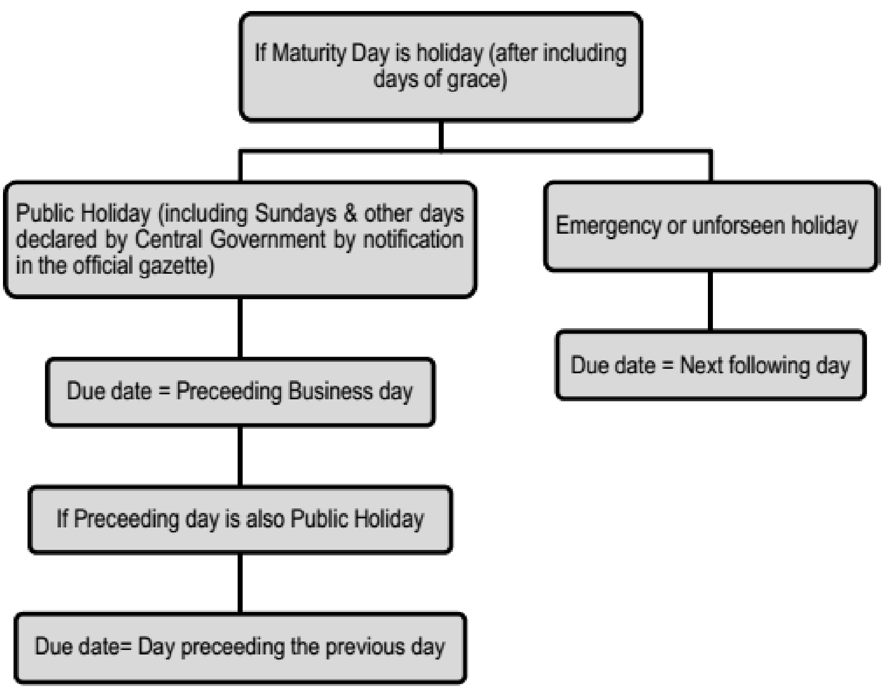
Example:

A Bill due on 29th January, 2011 is made payable at one month after date. The due date of instrument is 3rd day after 28th February, i.e., 3rd March (in 2011, February is of 28 days only).



Calculation of Due Date when the Maturity Day is a Holiday

When the day on which a promissory note or bill of exchange is at maturity (after including days of grace) is a public holiday, the instrument shall be deemed to be due on the preceding business day. The expression "public holiday" includes Sundays and other days declared bythe Central Government by notification in the official gazette, to be a public holiday. And now if the preceding day is also a public holiday, it will fall on the day preceding the previous day. But if the holiday happens to be emergency or unforeseen holiday then the date shall be the next following day.

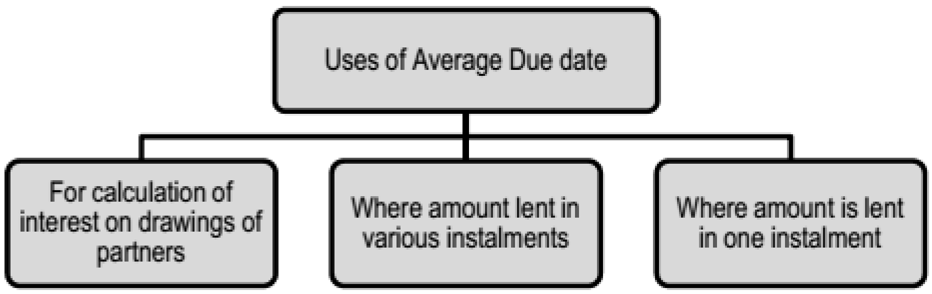


Types of Problems

There are two types of problems:

(1) Calculation of equated date when amount is lent in various instalments and repayment is made in one instalment.

(2) Calculation of equated date when amount is lent in one instalment and repayment is made in various instalments



Case 1. Where amount is lent in various instalments

Calculation of average due date: Under this type of problem, average due date is calculated as follows :

a. Take the earliest due date as starting day or base date or "O" day for convenience. Any date whatsoever, may also be taken as "O" day.

b. Consider the number of days from base date up to each due date. Calculations may also be made in month.

c. Multiply the number of days by the corresponding amounts. (Product will be find multiplying)

d. Divide the "Product total" by "Amount total" and get result approximately up to a whole number.

e. This number is added in the base date to find the average due date.

Thus the formula for the average due date can be under.

$$\text{Average due date} = \text{Base date} \pm \frac{\text{Total of products}}{\text{Total amounts}}$$

Note: For calculation of no. of days, no. of days in each respective month involved are to be considered individually.

CLASS WORK

Q-1 X has accepted the following bills payable on different dates. He wants accept only one bill on average due date and requests you to find out that date.

Serial No.	Date of Drawing	Amount (`)	Payable After
101	30.01.2014	1,000	30 days
102	31.01.2014	2,000	1 month
103	12.07.2014	1,000	1 month
104	27.08.2014	1,000	1 month

Note : On 1st July, 2014 the day was Friday.

Q-2 X and Y had the following mutual dealings and desire to settle their account on the average due date :

01.01.2014	Balance owing by Mr. X	` 5,000
30.01.2014	Goods sold to Y (credit period 30 days)	` 1,000
31.01.2014	Goods purchased by X (credit period I month)	` 2,000
13.07.2014	Goods sold to Y (credit period 30 days)	` 1,000
28.09.2014	Goods purchased by X (credit period 3 months)	` 1,000

Ascertain the average due date

Q-3 X owes Y ` 10,000. The average due date of mutual transactions is 2nd June 2014. Calculate the date on which X has to make the payment if X wants to pay (a) ` 10,000 only (b) ` 10,360 (c) ` 9,640. Interest is charged @) 18% p.a.

MULTIPLE CHOICE QUESTIONS

1. If payment is made on the average due date it results in-
(a) Loss of interest to the creditor.
(b) Loss of interest to the debtor.
(c) No loss of interest to either of them.

2. A mean date is calculated
(a) In connection with the settlement of contra accounts.
(b) For a lump sum payment.
(c) For several payments on different dates.

3. If payment is made after average due date, the party entitled to interest is
(a) Creditor (b) Debtor (c) Bank

4. When due date is a public holiday, then the due date will be.
(a) Succeeding business day
(b) Preceding business day
(c) Due date will not change and will remain same.

5. A Bill due on 29th January, 2015 is made payable at one month after date. The due date of instrument
(a) 28th February, 2015. (b) 29th February, 2015.
(c) 3rd March, 2015.

THEORETICAL QUESTIONS

1. Define Average Due Date.

2. List out the various instances when Average Due Date can be used.

HOME WORK

Q-1 Mr. Yash and Mr. Harsh are partners in a firm. They had drawn the following amounts from the firm during the year ended 31.03.2016:

Date	Amount `	Drawn by `
01.05.2015	75,000	Mr. Yash
30.06.2015	20,000	Mr. Yash
14.08.2015	60,000	Mr. Harsh
31.12.2015	50,000	Mr. Harsh
04.03.2016	75,000	Mr. Harsh
31.03.2016	15,000	Mr. Yash

Interest is charged @ 10% p.a. on all drawings. Calculate interest chargeable from each partner by using Average due date system. (Consider 1st May as base date)

Q-2 Anand purchased goods from Amirtha, the average due date for payment in cash is 10.08.2016 and the total amount due is ` 67,500. How much amount should be paid by Anand to Amirtha, if total payment is made on following dates and interest is to be considered at the rate of 12% p.a.

(i) On average due date.

(ii) On 25th August, 2016.

(iii) On 30th July, 2016.

UNIT : 7
ACCOUNT CURRENT

INTRODUCTION

An Account Current is a running statement of transactions between parties for a given period of time and includes interest allowed or charged on various items. It takes the form of an ledger account.

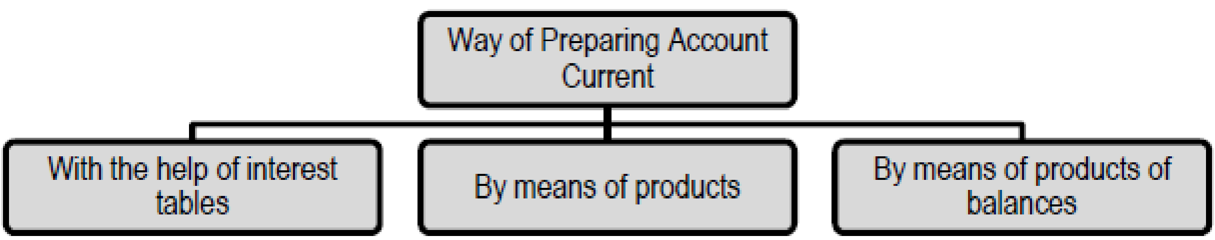
Some of the situations when account current is prepared are:

1. It is prepared when frequent transactions regularly take place between two parties. An example is of a manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals and charges interest on the amount which remains outstanding.
2. A consignee of goods can also prepare an Account Current, if the latter is to settle the account at the end of the consignment & interest is chargeable on outstanding balance.
3. An Account Current also is frequently prepared to set out the transactions taking place between a banker and his customer.
4. It is prepared when two or more persons are in joint venture and each co-venture is entitled to interest on their investment. Also, no separate set of book is maintained for it.

An Account Current has two parties - one who renders the account and the other to whom the account is rendered. This is indicated in the heading of an Account Current, which is like the following: "A in Account Current with B". It implies that A is the customer, and the account is being rendered to him by B.

Preparation of Account Current

There are three ways of preparing an Account Current:



Preparation of Account Current with the help of Interest Tables

According to this method, all the transactions are arranged in the form of an account. There are two additional columns on both the sides of such an account.

(a) One column is meant to indicate the number of days counted from the due date of each transaction to the date of rendering the account. If no specific date is mentioned as the date on which payment is due, the date of the transactions is presumed to be the due date.

(b) The other column is meant for writing interest.

With the help of ready made tables, interest due on different amounts at given rates for different periods of time is found out and this is entered against each item separately.

The interest columns of both the sides are totalled up and the balance is drawn.

CLASS WORK

Q-1 From the following particulars make up an Account Current to be rendered by S. Dasgupta to A. Halder at 31st Dec. reckoning interest at 5% p.a.

2014		`
June 30	Balance owing by A. Halder	520
July 17	Goods sold to A. Halder	40
Aug. 1	Cash received from A. Halder	500
Aug. 19	Goods sold to A. Halder	720
Aug. 30	Goods sold to A. Halder	50
Sept. 1	Cash received from A. Halder	400
Sept. 1	A. Halder accepted Dasgupta.s Bill at 3 month date for	300
Oct. 22	Goods bought from A. Halder	20
Nov. 12	Goods sold to A. Halder	14
Dec. 14	Cash received from A. Halder	50

Q-2 Following transaction took place between X and Y during the month of April, 2014.

		`
April 1	Amount payable by X to Y	10,000
7	Received acceptance of X to Y for 2 months	5,000
10	Bills receivable (accepted by Y) on 7.2.2014 is honoured on this due date	
10	X sold goods to Y (invoice dated 10.5.2014)	15,000
12	X received cheque form Y dated 15.5.2014	7,500
15	Y sold goods to X (invoice dated 15.5.2014)	6,000
20	X returned goods sold by Y on 15.4.2014	1,000
20	Bill accepted by Y is dishonoured on this due date	5,000

You are required to make out an account current by products method to be rendered by X to Y as on 30.4.2014, taking interest into account @ 10% p.a.

Q-3 On 2nd January, 2014 Vinod opened a current account with the Allahabad Bank Limited; and deposited a sum of ` 30,000. He further deposited the following amounts :

15th January	` 12,000
12th March	` 8,000
10th May	` 16,000

His withdrawals were as follows :

15th February	` 26,000
10th April	` 30,000
15th June	` 14,000

Show Vinod.s a/c in the ledger of the Allahabad Bank. Interest is to be calculated at 5% on the debit balance and 2% on credit balance. The account is to be prepared as on 30th June, 2014. Calculation may be made correct to the nearest rupee.

MULTIPLE CHOICE QUESTIONS

1 Red ink interest is
   (a) really not interest
   (b) negative interest
   (c) used in connection with average due date.

2 An account current is a statement of mutual transactions
   (a) between two parties
   (b) in lieu of average due date
   (c) prepared for a particular accounting period.

3 In account current, while counting the number of days, the due date is ignored and date up to which the accounts are prepared, is
   (a) included (b) excluded (c) ignored

THEORETICAL QUESTIONS

1. Define Account Current. Explain ways of preparing an Account Current
2. Write short note on Red-ink interest.

HOME WORK

1. Roshan has a current account with partnership firm. It has debit balance of ` 75,000 as on 01-07-2016. He has further deposited the following amounts:

Date	Amount (`)
14-07-2016	1,38,000
18-08-2016	22,000

He withdrew the following amounts :

Date	Amount (`)
29-07-2016	97,000
09-09-2016	11,000

Show Roshan's A/c in the ledger of the firm. Interest is to be calculated at 10% on debit balance and 8% on credit balance. You are required to prepare current account as on 30th September, 2016 by means of product of balances method.

2. From the following particulars prepare a account current, as sent by Mr. Ram to Mr. Siva as on 31st October 2016 by means of product method charging interest @ 5% p.a.

2016	Particulars	`
1st July	Balance due from Siva	750
15th August	Sold goods to Siva	1250
20th August	Goods returned by Siva	200
22nd Sep	Siva paid by cheque	800
15th Oct	Received cash from Siva	500

❑

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Final Accounts of Sole Proprietors

SINCE 1997

NAVKAR

A Symbol of Success

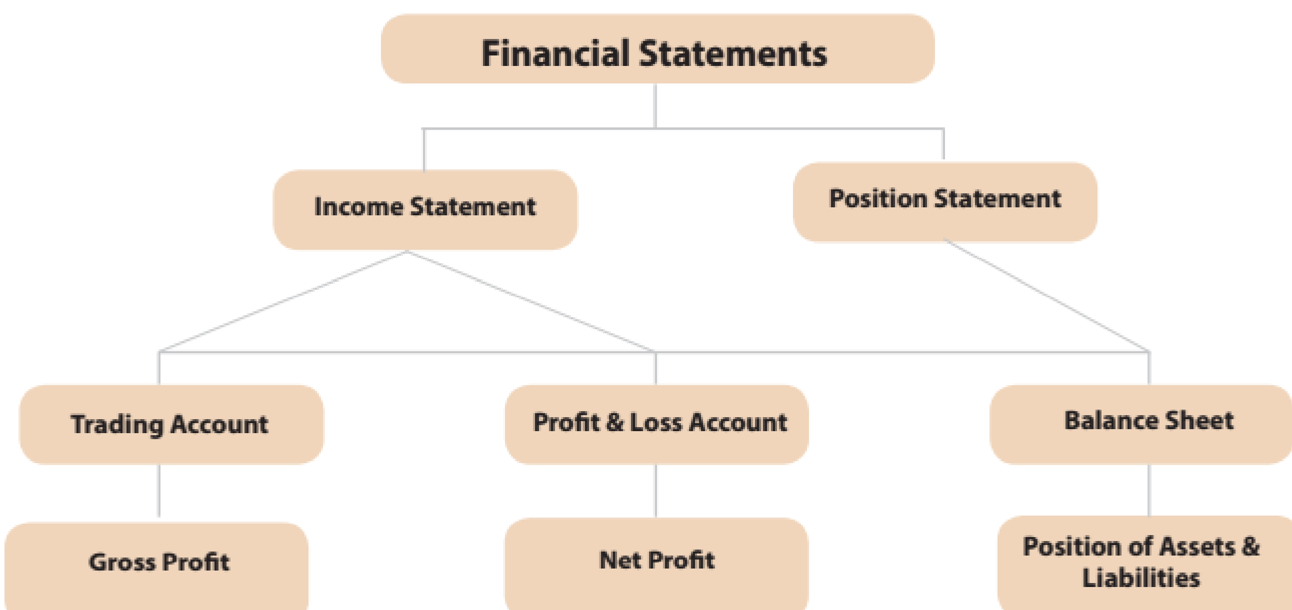
NAVKAR INSTITUTE® | We believe in the best

CHAPTER-7
PREPARATION OF FINAL ACCOUNTS OF SOLE PROPRIETORS

UNIT : 1
FINAL ACCOUNTS OF NON-MANUFACTURING ENTITIES

INTRODUCTION

Non-manufacturing entities are the trading entities, which are engaged in the purchase and sale of goods at profit without changing the form of the goods. In other words, non-manufacturing entities do not process the goods purchased and sell them in its original form. Meanwhile it indulges in some liabilities, makes some assets and also incurs some expenses like salaries, stationery expenses, advertisement, rent etc. to run the business. At the end of the accounting year, the entity must be interested in knowing the results of the business. To ascertain the final outcome of the business i.e., the income and financial position, they prepare financial statements at the end of the year.



➲ TRADING ACCOUNT

At the end of the year, as has been seen above, it is necessary to ascertain the net profit or the net loss. For this purpose, it is necessary to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the cost of the goods sold. For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still on hand at the end of the year against the purchases. It is done as follow:-

Opening Stock	***
Add:- Purchases (Net)	**
Add:- Direct Expenses	**
	***
Less :- Cost of Goods Sold	(**)
Closing Stock	***

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

Rs.	By Sales	XXX	
To Opening Stock	XXX	*Less*: Returns Inwards	XXX
XXX			
To Purchases	XXX	XXX	
XXX			
Less: Returns outwards		By Closing Stock	XXX
To Direct expenses:	XXX	By Gross Loss c/d*	
Freight & Carriage	XXX		
Customs & Insurance	XXX		
Wages	XXX		
Gas, Water			
& Fuel	XXX		
Factory			
Expenses	XXX	XXX	
Royalty on production			
	XXX		
	XXX		XXX
To Gross Profit c/d*			

*Only one will appear

Points to Remember:-

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

If Closing Stock appears in the Trial balance:-

- The closing inventory is then not entered in the trading account, it is shown only in the balance sheet. This is because it has already been adjusted to arrive at Cost of Goods Sold
- The valuation principle is cost or net realisable value whichever is lower.

CLOSING ENTRIES IN RESPECT OF TRADING ACCOUNT

The following entries will be required:

(i) For opening Inventory: Debit Trading Account and Credit inventory Account.

(ii) For purchases returns: Debit Returns Outward Account and Credit Purchases Account.

For returns inward: Debit Sales Account and Credit Returns Inwards Account. (In the trading account information is usually given both in respect of gross sales; and purchases and the respective returns).

(iii) For purchases account: Debit Trading Account and Credit Purchases Account, the amount being the net amount after return.

(iv) For expenses to be debited to the Trading Account, for example wages etc. Debit Trading Account and credit the concerned expenses accounts individually.

(v) For sales: Debit Sales Account with the net amount after returns, and Credit Trading Account.

The student will see that all the accounts mentioned above will be closed except for the Trading Account.

(vi) For closing Inventory: Debit Inventory Account and Credit Trading Account. The inventory Account will be carried forward to the next year.

Except entries mentioned in (ii) above, the other entries are usually summarised as follows:

(1) Trading Account Dr.

    To Opening Inventory Account

    To Purchases Account

    To Wages Account

    To Freight on Purchases Account, etc.

(2) Sales Account Dr.

Closing Inventory Account Dr.

    To Trading Account

At this stage Trading Account will reveal the gross profit, if the credit side is more, or gross loss if the credit side is less. The gross profit will be transferred to the Profit and Loss Account.

- **PROFIT AND LOSS ACCOUNT**

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

Particulars	**Rs.**	**Particulars**	**Rs.**
To Gross Loss b/d		By Gross Profit b/d	
Management expenses		**Other Income**	
To Salaries (administrative)		By Discount Received	
To Office rent, rates and taxes		By Commission Received	
To Printing and stationery		**Non-trading Income**	

To Telephone charges		By Bank Interest	
To Postage and telegrams		By Rent of property let-out	
To Insurance		By Dividend from shares	
To Audit Fees		**Abnormal Gains**	
To Legal Charges		By Profit on sale of machinery	
To Electricity Charges		By Profit on sale of investment	
Maintenance expenses			
To Repairs & renewals		**By Net Loss (transferred to capital A/c)**	
To Depreciation on:			
Office equipment			
Office furniture			
Office Buildings			
Selling and Distribution expenses			
To Salaries (selling staff)			
To Advertisement			
To Godown rent			
To Carriage Outward			
To Bad Debts			
To Provision for bad debts			
To Selling commission			
Financial expenses			
To Bank charges			
To Interest on loans			
To Discount on bills			
To discount allowed to customers			
Abnormal Losses			
To Loss on sale of machinery			
To Loss on sale of investment			
To loss by fire			
To Net Profit (transferred to Capital A/c)			

We shall now consider a few items individually:

(i) Drawings: Drawings are not expenses for the firm but reduction of capital and therefore should not be debited to the Profit and Loss Account but to Capital account of the proprietor.

Capital A/c Dr.

To Drawings

If the proprietor has enjoyed some benefit personally, like use of the firm's car, a suitable amount should be treated as drawing and to that extent the charge to the Profit and Loss Account will be reduced, Drawings are debited to the proprietor's capital account.

(ii) Income Tax: In case of companies, the income tax payable is treated like other expenses. But in the case of sole proprietorship, income tax is treated as a personal expense. It is debited to the Capital Account and not to the Profit and Loss Account.

Capital A/c Dr.

To Income Tax A/c

This is because the amount of the tax will depend on the total income of the partners or proprietor besides the profit of the firm. In case of partnership business, firm's tax liability is to be debited to profit and loss account of the firm but partners' tax liability are not to be borne by the firm. Therefore if the firm pays income tax on behalf of partners, such payment of personal income tax should be treated as drawings.

(iv) Bad Debts: When a customer does not pay the amount due from him and all hopes of recovering the amount are lost, it is said to be a bad debt. It is a loss to the rm. Therefore, the bad debts account is debited, which is later on written in the Profit and Loss Account on the debit side. Since it is no use showing the amount due still as an asset, the account of the customer concerned is closed by being credited. The entry

Bad Debts Account Dr.

To Debtor's / Customer (by name) Account

Profit/Loss Account Dr.

To Bad Debts A/c

In case of Provision for Bad debts has already been prepared then bad debts should be written off Entry for it will be:

Provision for Bad Debts a/c Dr.

To Bad Debts a/c

If later on, the amount is recovered, it should be treated as a gain. It should not be credited to the party paying it. It should be credited to Bad Debts Recovered Account. It will be entered in the Profit and Loss Account on the credit side.

Bad Debts Recovered Account Dr.

To Profit/Loss Account

CLOSING ENTRIES

The entries that have to be made in the journal for preparing the Trading and the Profit and Loss Account that is for transferring the various accounts to these two accounts are known as closing entries. We have already seen the entries required for preparing the Trading Account and for transferring the gross profit to the profit and Loss Account. Now to complete the Profit and Loss Account, the under mentioned three entries will be necessary.

(a) For items to be debited to the Profit and Loss Account this account will be debited and the various accounts concerned will be credited. For example,

Profit and Loss Account Dr.

To Salaries Account

To Rent Account

To Interest Account

To Other Expenses Account

(b) Items of income or gain such as interest received or miscellaneous income will be credited to Profit and Loss Account.

Discount Received Account Dr.

Bad debts Recovered Account Dr.

To Profit and Loss Account

(c) At this stage, the Profit and Loss Account will show net profit or net loss. Both have to be transferred to the Capital Account. In case of net profit, i.e., when the credit side is bigger than the debit side, the entry is:

Profit and Loss Account Dr.

To Capital Account

In the case of net loss, the entry will be

Capital Account Dr.

To Profit and Loss Account

Commission based on profit: Sometimes commission is payable to manager based on net profit; in such a case calculation is done as follows:

(i) Commission on net profit before charging such commission =

$$\text{Profit before commission} \times \frac{\text{Rate of commission}}{100}$$

(ii) Commission on net profit **after** charging such commission =

$$\text{Profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{rate of commission}}$$

BALANCE SHEET

ARRANGEMENTS OF ASSETS AND LIABILITIES

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

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

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

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

Balance Sheet as at

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

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

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

CLASSIFICATION OF ASSETS AND LIABILITIES

Assets are basically of two types:

Current Assets: - these assets are meant to be converted into cash as quickly as possible. Generally within one year. For Example:- Cash in hand, Cash at Bank, Trade receivables, Inventories.

Long Term firm Assets: - Those that are meant to be used by the firm over a long period and not sold the former type of assets is also called fixed assets. For Example Machinery, Building, Long term firm Investment.

Intangible Assets: - the assets which have no physical existence and cannot be seen or touched are called as Intangible Assets. For example Patents, Copyrights etc.

It is desirable that in the balance sheet the two types of assets should be shown separately and prominently.

This would give meaningful and logical information.

Liabilities to outsider will be of two types:

Current Liabilities: - this liability must be settled in one year or less. It is also called as short term firm liability.

For Example:- Creditors, Bills Payable etc.

Long Term firm Liability: - those liabilities which exists for more than one year are Long term firm liabilities. For example long term firm loans from banks. Of course, it will include undistributed profits also.

Sole proprietors generally present Balance Sheet in a horizontal form with "Capital and Liabilities" on the left hand side and 'Assets' on the right-hand side. In the Balance Sheet the various items should be grouped suitably as indicated below:

Balance Sheet as on

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Capital A/c:		Tangible Fixed Assets :	
Balance		Land and Building	
Add : Net Profit/*Less*: Net Loss		Plant and Machinery	
Less : Drawings		Furniture and Fixture	
Long Term Loans :		Vehicles	
Term Loans		Intangibles :	
Other Loans			
Goodwill			
Short Term Loans :		Patent Rights	
Cash Credit		Designs and Brand Names	
Overdrafts			
Other Loans		Investments	
Current Liabilities :		Long term investments	
Trade payables		Current Assets :	
Outstanding Expenses		Inventory in Trade	
Advances Taken		Trade receivables	
Provision :		Short term investments	
Provision for Bad debts		Prepayments	
Provision for Retirement Benefits		Advances	
Provision for Taxation		Bank Balances	
		Cash In Hand	

➲ SEQUENCE OF ACCOUNTING PROCEDURE OR THE ACCOUNTING CYCLE

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

(i) recording the transactions in the journal or journalising;

(ii) preparing ledger accounts on the basis of the journal or posting into the ledger;

(iii) taking out the trial balance to check arithmetical accuracy;

(iv) preparing the trading and profit and loss account or the income statement for the period concerned; and

(v) preparing the balance sheet to show the financial position at the end of the period.

➲ PROVISIONS AND RESERVES

Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy". A provision is a liability which can be measured only by using a substantial degree of estimation.

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

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

(1) Amount provided for meeting claims which are admissible in principle but the amount whereof has not been ascertained.

(2) An appropriation made for payment of taxes still to be assessed.

(3) Amount set aside for writing o bad debts or payment of discounts.

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

Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

CLASS WORK

Q-1 From the following particulars extracted from the books of Ganguli, prepare trading and profit and loss account and balance sheet as at 31st March, 2016 after making the necessary adjustments:

Ganguli's capital account (Cr.)	5,40,500	Interest received	7250
Stock on 1.4.2015	2,34,000	Cash with Traders Bank Ltd.	40,000
Sales	14,48,000	Discounts received	14,950
Sales return	43,000	Investments (at 5%) as on 1.4.2015	25,000
Purchases	12,15,500	Furniture as on 1-4-2015	9,000
Purchases return	29,000	Discounts allowed	37,700
Carriage inwards	93,000	General expenses	19,600
Rent	28,500	Audit fees	3,500
Salaries	46,500	Fire insurance premium	3,000
Sundry debtors	1,20,000	Travelling expenses	11,650
Sundry creditors	74,000	Postage and telegrams	4,350
Loan from Dena Bank Ltd. (at 12%)	1,00,000	Cash in hand	1,900
Interest paid	4,500	Deposits at 10% as on 1-4-2015 (Dr.)	1,50,000
Printing and stationery	17,000	Drawings	50,000
Advertisement	56,000		

(1) Value of stock as on 31st March, 2016 is Rs. 3,93,000. This includes goods returned by customers on 31st March, 2016 to the value of Rs. 15,000 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 2016 for Rs.10,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The loan account from Dena bank in the books of Ganguli appears as follows

31.3.2016 To Balance c/d	1,00,000	1.4.2015 By Balance b/d	50,000
		31.3.2016 By Bank	50,000
	1,00,000		1,00,000

(5) Sundry debtors include Rs. 20,000 due from Robert and sundry creditors include Rs. 10,000 due to him.

(6) Interest paid include Rs. 3,000 paid to Dena bank.

(7) Interest received represents Rs. 1,000 from the sundry debtors and the balance on investments and deposits.

(8) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.

(9) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Q-2 Sengupta & Co. employs a team of eight workers who were paid Rs.30,000 per month each in the year ending 31st December, 2015. At the start of 2016, the company raised salaries by 10% to Rs.33,000 per month each.

On July 1, 2016 the company hired two trainees at salary of Rs.21,000 per month each. The work force are paid salary on the rst working day of every month, one month in arrears, so that the employees receive their salary for January on the rst working day of February etc.

You are required to calculate:

(i) Amount of salaries which would be charged to the profit and loss for the year ended 31st December, 2016.

(ii) Amount actually paid as salaries during 2016 Outstanding Salaries as on 31st December, 2016

Q-3 Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2017 has been given below:

On 1.4.2016 he had a balance of Rs. 2,00,000 advance from customers of which Rs. 1,50,000 is related to year 2016-17 while remaining pertains to year 2017-18. During the year 2016-17 he made cash sales of Rs. 5,00,000. You are required to compute:

i) Total income for the year 2016-17.

ii) Total money received during the year if the closing balance in advance from customers account is Rs. 1,70,000.

Q-4 Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Trading and P&L A/c for the year ended 31st March, 2017

Particulars	**Rs.**	**Particulars**	**Rs.**
To Cost of Goods Sold	45,00,000	By Sales	C
To Gross Profit c/d	D		
	F		
			F
To Rent A/c	26,00,000	By Gross Profit b/d	D
To Office Expenses	13,00,000	By Miscellaneous Income	E
To Selling Expenses	B		
To Commission to Manager			
(on Net Profit	2,00,000		
before charging such commission)			
To Net Profit	A		
	G		60,00,000

Commission is charged at the rate of 10%.

Selling Expenses amount to 1% of total sales.

You are required to compute the missing figures.

Q-5 On 1st Jan. 2017 provision for Doubtful Debts existed at Rs. 40,000. Trade receivables on 31.12.2017 were Rs. 15,00,000; bad debts totalled Rs. 1,00,000. It is required to write o the bad debts and create a provision equal to 5% of the Trade receivables' balances.

Required

Show how you would compute the amount debited to the Profit and Loss Account.

Q.6 The balance sheet of Thapar on 1st January, 2017 was as follows:

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Trade payables	15,00,000	Plant & Machinery	30,00,000
Expenses Payable	1,50,000	Furniture & Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	*13,000,000*
	66,50,000		**66,50,000**

During 2017, his Profit and Loss Account revealed a net profit of Rs.15,30,000. This was after allowing for the following :

(a) Interest on capital @ 6% p.a.

(b) Depreciation on Plant and Machinery @ 10% and on Furniture and Fixtures @ 5%.

(c) A provision for Doubtful Debts @ 5% of the trade receivables as at 31st December, 2017.

But while preparing the Profit and Loss Account he had forgotten to provide for (1) outstanding expenses totaling Rs.1,80,000 and (2) prepaid insurance to the extent of Rs.20,000.

His current assets and liabilities on 31st December, 2017 were : Inventories Rs. 14,50,000; Trade receivables 20,00,000; Cash at Bank Rs. 10,35,000 and Trade payables Rs. 11,40,000. During the year he withdrew Rs.6,00,000 for domestic use.

Q-7 The following is the schedule of balances as on 31.3.17 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Bombay:

Particulars	**Dr. Rs.**	**Cr. Rs.**
Cash in hand	14,000	
Cash at bank	26,000	
Sundry Debtors	8,60,000	
Stock on 1.4.2016	6,20,000	
Furniture & xtures	2,14,000	
office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	
Sundry Creditors		4,30,000
Loan from Viswanath		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	
Salaries	1,10,000	
Rent for Godown	55,000	
Interest on loan from Viswanath	27,000	

Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount received from Creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General o ce expenses	30,000	
Bad Debts	20,000	
Bank charges	16,000	
Motor car expenses	36,000	
Capital A/c		16,20,000
TOTAL	**47,22,000**	**47,22,000**

Prepare Trading and Profit and Loss Account for the year ended 31st March 2017 and the Balance Sheet as at that date after making provision for the following:

1. Depreciate: (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for Rs. 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for Rs. 40,000 has been wrongly debited to purchase; and (d) Motor car by 20%.
2. Value of stock at the close of the year was Rs. 4,40,000.
3. Two month's rent for godown is outstanding.
4. Interest on loan from Viswanath is payable at 12 percent per annum, this loan was taken on 1.5.2016.
5. Reserve for bad debts is to be maintained at 5 percent of Sundry Debtors.
6. Insurance premium includes Rs. 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2016 to 30.6.17.

HOME WORK

Q-1 You are required, prepare a Trading and Profit and Loss Account for the year ending 31st March, 2016 and a Balance Sheet as on that date from the Trial Balance given below:

Particulars	**Rs.**	**Particulars**	**Rs.**
Debit Balance:			
Trade receivables	3,50,000	Salaries	2,20,000
Inventory 1st April, 2015	5,00,000	Purchases	12,50,000
Cash in Hand	5,60,000	Plant and Machinery	15,70,000
Wages	3,00,000	Credit Balance:	
Bad Debts	50,000	Capital	25,00,000
Furniture and Fixtures	1,50,000	Trade payables	9,00,000
Depreciation	1,50,000	Sales	17,00,000

On 31st March, 2016 the Inventory was valued at Rs.10,00,000.

Ans. Hint :

Gross Profit = Rs.6,50,000

Net profit = Rs. 2,30,000

Total balance sheet = 36,30,000

Q-2

	Rs.
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

Required

From the above information, prepare a Trading Account of M/s. ABC Traders for the year ended 31st March, 2017 and Pass necessary closing entries in the journal proper of M/s. ABC Traders.

Ans. Hint :

Gross Profit = Rs.4,20,000

CLASS WORK

MULTIPLE CHOICE QUESTIONS

(1) A debit to an account may

(a) increase expense (b) decrease an asset.

(c) increase a liability. (d) increase income.

(2) Prepayment of insurance premium will appear in the Balance Sheet and in the Insurance Account respectively as:

(a) a liability and a debit balance. (b) an asset and a debit balance.

(c) an asset and a credit balance. (d) a liability and a credit balance.

(3) Gross profit is the diff erence between:

(a) sales and purchases (b) sales and cost of sales.

(c) sales and total expenses. (d) Sales and total liabilities.

(4) Payment made to a creditor subject to cash discount will :

(a) reduce a liability, reduce an asset and add to expenses.

(b) reduce a liability, add to an asset, and add to revenue.

(c) reduce an asset, reduce a liability, and add to revenue.

(d) reduce a liability, reduce an asset and decrease expenses.

(5) A customer returns goods already charged to him. We should:

(a) debit his account. (b) credit his account.

(c) make no entry on his account. (d) None of the above.

(6) Capital is the difference between

(a) Income and expenses (b) Sales and Cost of goods sold

(c) Assets and liabilities (d) None of the above.

(7) The capital of a sole trader would change as a result of:

(a) A creditor being paid his account by cheque.

(b) Raw materials being purchased on credit.

(c) Fixed assets being purchased on credit.

(d) Wages being paid in cash.

(8) A decrease in the provision for doubtful debts would result in:

(a) An increase in liabilities. (b) A decrease in working capital.

(c) An increase in net profit. (d) None of the three.

(9) A Company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark up on cost, which will achieve the required profit margin?

(a) 33% (b) 25% (c) 20% (d) 30%

(10) If sales is ` 2,000 and the rate of gross profit on cost of goods sold is 25%, then the cost of goods sold will be

(a) ` 2,000. (b) ` 1,500. (c) ` 1,600. (d) ` 1,000.

(11) Sales for the year ended 31st March, 2016 amounted to ` 10,00,000. Sales included goods sold to Mr. A for ` 50,000 at a profit of 20% on cost. Such goods are still lying in the godown at the buyer's risk. Therefore, such goods should be treated as part of

(a) Sales. (b) Closing Inventory.

(c) Goods in transit. (d) None of the above.

(12) If sales revenues are `4,00,000; cost of goods sold is ` 3,10,000 and expenses are `60,000, the gross profit is

(a) ` 30,000. (b) ` 90,000.

(c) ` 3,40,000. (d) ` 4,00,000.

UNIT : 2

FINAL ACCOUNTS OF MANUFACTURING ENTITIES

INTRODUCTION

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

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

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

➲ MANUFACTURING COSTS

Manufacturing costs are classified into :

\+ Raw Material Consumed

\+ Direct Manufacturing Wages ....

\+ Direct Manufacturing Expenses Direct Manufacturing Cost

\+ Indirect Manufacturing expenses or Manufacturing Overhead

= Total Manufacturing Cost

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

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

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

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

Direct Manufacturing Expenses

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

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

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

INDIRECT MANUFACTURING EXPENSES OR OVERHEAD EXPENSES

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

Overhead = Indirect Material + Indirect Wages + Indirect Expenses

Indirect material means materials which cannot be linked directly with the units produced, for example, stores consumed for repair and maintenance work, small tools, fuel and lubricating oil, etc.

Indirect wages are those which cannot be directly linked to the units produced, for example, wages for maintenance works, holding pay, etc.

Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

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

BY-PRODUCTS

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

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

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

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

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realizable value,** if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

DESIGN OF A MANUFACTURING ACCOUNT

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

Manufacturing Account

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

Tutorial Note: Frequently, problems are set, in which all the ledger balances are not given. Instead, details are given regarding the number of items in Inventories, quantity manufactured etc. the figures for Inventories, sales etc., would therefore have to be worked out independently from the data given.

The following general rules may be observed.

(a) The Manufacturing Account should have columns showing the quantities and values. Frequently, all the quantities are not given and the quantities applicable to one or more of the items would have to be worked out. For example, if the question does not state the total number of items sold, the quantity can be worked out by adding opening inventory and units manufactured and deducting closing inventory. It is, therefore, useful to have quantity columns in the account so that it can be seen that both sides balance.

(b) The Manufacturing Account will show the quantity of raw materials in inventory at the beginning and at the end of the year and the purchases during the year. As regards finished goods, it will only show the quantity manufactured and, as regards work-in-progress, the opening and closing amounts

(c) The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.

(d) For determining the value of closing inventory, in the absence of specific instruction to the contrary, it must be assumed that sales have been on " first in- first out" basis, that is, the closing inventory consists as far as possible of goods produced during the year, the opening inventory being sold out.

It may be mentioned here that nowadays no manufacturing business entity prepares manufacturing account as part of its final set of accounts. Even the items of manufacturing account are shown either in trading account (in case of non-corporate entities) or in Statement of Profit and loss (in case of corporate entities).

The procedure of preparation of Trading Account, Profit and Loss Account and Balance Sheet have already been explained in earlier chapter. Students should refer the earlier unit for attempting the problems based on the preparation of complete set of final accounts of a sole proprietor.

Indirect expenses are those which cannot be directly linked to the units produced, for example, training expenses, depreciation of plant and machinery, depreciation of factory shed, insurance premium for plant and machinery, factory shed, etc.

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

BY-PRODUCTS

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

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

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

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

By-products generally have insignificant value as compared to the value of main product. They are **generally valued at net realizable value,** if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

DESIGN OF A MANUFACTURING ACCOUNT

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

Manufacturing Account

Particulars	Units	Amount	Particulars	Units	Amount
To Raw Material Consumed:			By By-products at net realizable value		
Opening inventory			By Closing Work-in- Process		
Add: Purchases			By Trading A/c		
Less: Closing inventory			Cost of production		
To Direct Wages					
To Direct expenses:					
Prime cost					

To Factory overheads:					
Royalty					
Hire charges					
To Indirect expenses:					
Repairs & Maintenance					
Depreciation					
Factory cost					
To Opening Work-in-process					

Tutorial Note: Frequently, problems are set, in which all the ledger balances are not given. Instead, details are given regarding the number of items in Inventories, quantity manufactured etc. the figures for Inventories, sales etc., would therefore have to be worked out independently from the data given.

The following general rules may be observed.

(a) The Manufacturing Account should have columns showing the quantities and values. Frequently, all the quantities are not given and the quantities applicable to one or more of the items would have to be worked out. For example, if the question does not state the total number of items sold, the quantity can be worked out by adding opening inventory and units manufactured and deducting closing inventory. It is, therefore, useful to have quantity columns in the account so that it can be seen that both sides balance.

(b) The Manufacturing Account will show the quantity of raw materials in inventory at the beginning and at the end of the year and the purchases during the year. As regards finished goods, it will only show the quantity manufactured and, as regards work-in-progress, the opening and closing amounts

(c) The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.

(d) For determining the value of closing inventory, in the absence of specific instruction to the contrary, it must be assumed that sales have been on " first in- first out" basis, that is, the closing inventory consists as far as possible of goods produced during the year, the opening inventory being sold out.

It may be mentioned here that nowadays no manufacturing business entity prepares manufacturing account as part of its final set of accounts. Even the items of manufacturing account are shown either in trading account (in case of non-corporate entities) or in Statement of Profit and loss (in case of corporate entities).

The procedure of preparation of Trading Account, Profit and Loss Account and Balance Sheet have already been explained in earlier chapter. Students should refer the earlier unit for attempting the problems based on the preparation of complete set of final accounts of a sole proprietor.

CLASS WORK

Q-1 Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for the year ended on 31.3.2016:

Opening Work-in-Process (10,000 units)	16,000
Closing Work-in-Process (12,000 units)	20,000
Opening inventory of Raw Materials	1,70,000
Closing inventory of Raw Materials	1,90,000
Purchases	8,20,000
Hire charges of machine @ Rs. 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ Rs. 0.80 per unit manufactured and	
@ Rs. 0.40 per unit of Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced – 5,00,000 units	

Required

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2016.

Q-2 Mr. Pankaj runs a factory which produces motor spares of export quality. The following details were obtained about his manufacturing expenses for the year ended on 31.3.2016.

W.I.P.	- Opening	3,90,000	
	- Closing		5,07,000
Raw Materials	- Purchases		12,10,000
	- Opening		3,02,000
	- Closing		3,10,000
	- Returned		18,000
	- Indirect material		16,000
Wages	- direct		2,10,000
	- indirect		48,000
Direct expenses	- Royalty on production		1,30,000
		- Repairs and maintenance	2,30,000
		- Depreciation on factory shed	40,000
		- Depreciation on plant & machinery	60,000

By-product at selling price 20,000

You are required to prepare Manufacturing Account of Mr. Pankaj for the year ended on 31.3.2016.

Q-3 Following are the Manufacturing A/c, Creditors A/c and Trading A/c provided by Ms. Shivi related to 2016-17. There are certain figures missing from these accounts.

Raw Material A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To Opening Stock A/c	1,00,000	By	Raw Material Consumed	
	To Creditors A/c				
				By Closing Stock A/c	

Creditors A/c

Date	Particulars	Amount `	Date	Particulars	Amount `
	To Bank A/c	22,00,000		By Balance b/d	15,00,000
	To Balance c/d	6,00,000			

Manufacturing A/c

Particulars	Amount `	Particulars	Amount `
To Raw Material Consumed		By Trading A/c	17,94,000
To Wages	3,50,000		
To Depreciation	2,00,000		
To Direct Expenses	2,44,000		

Additional Information:

1) Purchase of machinery worth Rs. 10,00,000 has been omitted. Machinery are chargeable at a depreciation rate of 10%.
2) Wages include the following

   Paid to Factory Workers - Rs. 3,00,000

   Paid to labour at force 50,000
3) Direct Expenses include following:

   Electricity charges of Rs. 80,000 of which 30% pertained to

   office Fuel Charges of Rs. 20,000

   Freight Inwards of Rs. 35,000

   Delivery charges to customers - Rs. 20,000.

   You are required to prepare revised Manufacturing A/c, and Raw Material A/c.

MULTIPLE CHOICE QUESTIONS

1. Under-statement of closing work in progress in the period will

(a) Understate cost of goods manufactured in that period.

(b) Overstate current assets.

(c) Understate net income in that period.

(d) None of the three.

2. Sales is equal to

(a) Cost of goods sold – Gross prot.   (b) Cost of goods sold + Gross prot.

(c) Gross prot – Cost of goods sold.   (d) Net prot + cost of goods sold.

3. Indirect Manufacturing expenses are also called

(a) Manufacturing overhead.   (b) Production overhead.

(c) Works overhead.   (d) All the three.

4. Sale value of the by-product is credited to

(a) Manufacturing account.   (b) Capital account.

(c) Overheads account.   (d) Trading account.

5. Manufacturing account shows

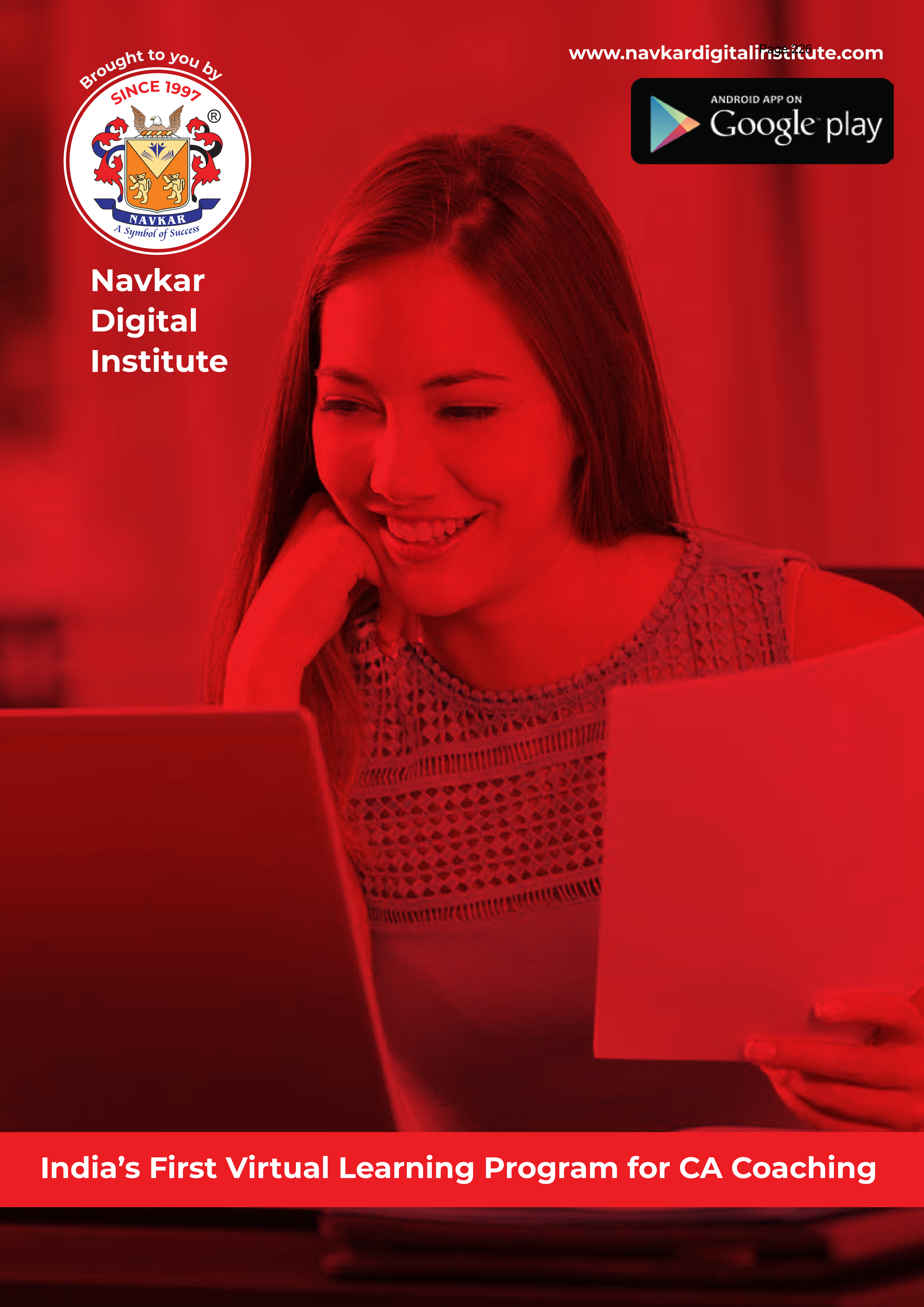
(a) Total cost of manufacturing the nished products.

(b) It provides details of factory cost.

(c) It facilitates reconciliation of nancial books with cost records.

(d) All the three.

❑


Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar
Digital
Institute
www.navkardigitalinstitute.com
Page 226
ANDROID APP ON
Google play
India's First Virtual Learning Program for CA Coaching

CA FOUNDATION

Principles & Practice of Accounting

Partnership Accounts

SINCE 1997

NAVKAR

A Symbol of Success

CHAPTER-8
PATNERSHIP ACCOUNT

INTRODUCTION

An individual i.e., a sole proprietor may not be in a position to cope with the financial and managerial demands of the present day business world. As a result, two or more individuals may decide to pool their financial and non-financial resources to carry on a business. The preparation of final accounts of sole proprietors have already been discussed in chapter 6. The final accounts of partnership firms including basic concepts of accounting for admission of a partner, retirement and death of a partner have been discussed in succeeding units of this chapter.

As per **Section 4** of the Partnership Act, 1932:

"Partnership is the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all."

➲ Features of a partnership :

(i) **Existence of an agreement: As per section 5 of the Indian Partnership Act, 1932.** The relation of partnership arises from contract between parties and not from status as it happens in case of HUF (Hindu Undivided Family). **A formal or written agreement is not necessary to create a partnership.**

(ii) **Business:** A partnership can exist only in business. Thus, it is not the agreement alone which creates a partnership. A partnership comes into existence only when partners begin to carry on business in accordance with their agreement. **Section 2 (b)of Indian Partnership Act, 1932 only states that business includes every trade, occupation and profession.**

(iii) **Sharing of profit :** The persons concerned must agree to **share the profits of the business.** Because no person is a partner unless he or she has the right to share the profits of the business. **Section 4 of Indian Partnership Act, 1932** does not insist upon sharing of losses. Thus, a provision for sharing of loss is not necessary.

(iv) **Mutual agency:** It means that the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

Number of Partners: Minimum Partners: Two

Maximum Partners: Section 464 of the Companies Act, 2013, no association or partnership consisting of more than 100 number of persons as may be prescribed shall be formed for the purpose of carrying on any business. Rule 10 of Companies (incorporation) Rules 2014 specifies the limit as 50 .Thus, maximum number of members in a partnership -firm are 50.

DISTINCTION BETWEEN AN ORDINARY PARTNERSHIP FIRM AND AN LLP

	Key Elements	Partnerships	LLPs
1	Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2	Registration	Optional	Compulsory with ROC
3	Creation	Created by an Agreement	Created by Law
4	Body Corporate	No	Yes
5	Separate Legal Entity	No	Yes
6	Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
7	Number of Partners	Minimum 2 and Maximum 50	Minimum 2 but no maximum limit
8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the rm	The LLP as an independent entity can own assets
9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the rm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the rm only and not of other partners

➲ MAIN CLAUSES IN A PARTNERSHIP DEED :

The relation between the partners is governed by mutual agreement known as partnership deed. It should be comprehensive to avoid disputes later on. It is usual therefore, to and the following clauses in a Partnership Deed which may or may not be registered.

1. Name of the -firm and the partners;
2. Commencement and duration of business;
3. Amount of capital to be contributed by each partner;
4. Amount to be allowed to each partner as drawings and the timings of such drawings;
5. Rate of interest to be allowed to each partner on his capital and on his loan to the -firm, and to be charged on his drawings;
6. The ratio in which profits or losses are to be shared;
7. Whether a partner will be allowed to draw any salary;
8. Any variations in the mutual rights and duties of partners;

9. Method of valuing goodwill on the occasions of changes in the constitution of the fi-rm;
10. Procedure by which a partner may retire and the method of payment of his dues;
11. Basis of the determination of the executors of a deceased partner and the method of payment;
12. Treatment of losses arising out of the insolvency of a partner;
13. Procedure to be allowed for settlement of disputes among partners;
14. Preparation of accounts and their audit.

Registration of the firm is not compulsory, but non-registration restricts the partners or the firm from taking any legal action. Often there is no written Partnership Deed or, if there is one, it may be silent on a particular point. In that case the relevant sections of the Partnership Act will apply. If on any point the Partnership Deed contains a clause, it will hold good; otherwise the provisions of the Act relating to the questions will apply.

➲ Rules in the absence of Partnership Deed

In the absence of any agreement to the contrary;

1. No partner has the right to a salary,
2. No interest is to be allowed on capital,
3. No interest is to be charged on the drawings,
4. Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm, and
5. Profits and losses are to be shared equally.

Note: In the absence of an agreement, the interest and salary payable to a partner will be paid only if there is profit.

PRACTICAL

(A) Interest on drawings:

(1) Calculate the interest on drawings of X @ 10% p.a. for the year ending 31/03/2017 in following cases:

a) If his drawings during the year were Rs. 24000.
b) If he withdrew Rs.2000 p.m. in the beginning of every month.
c) If he withdrew Rs.2000 p.m. at the end of every month.
d) If he withdrew Rs. 2000 p.m.
e) If he withdrew the following amounts:
Jan-31 – Rs.6000, Mar-31- Rs.4000, July 1st – Rs. 8000
Sept-30-Rs.3000, Nov-1st - Rs 5000.
f) If he withdrew Rs.6000 in the beginning of every quarter.
g) If he withdrew Rs.6000 in the end of every quarter.
h) If he withdrew Rs.6000 in the middle of every month.

(2) X and Y started business on 1/7/2016, Calculate the interest on drawings of X @ 10% p.a. for the year ending 31/03/2017 in following cases:

a) If his drawings during the year were Rs. 18000.
b) If he withdrew Rs.2000 p.m. in the beginning of every month.
c) If he withdrew Rs.2000 p.m. at the end of every month.
d) If he withdrew Rs. 2000 p.m.
e) If he withdrew Rs.6000 in the beginning of every quarter.
f) If he withdrew Rs.6000 in the end of every quarter..
g) If he withdrew Rs. 6000 per quarter.

(3) X and Y started business on 1/7/2016 with the capital of Rs.500000 and Rs. 300000 respectively. Calculate the interest on drawings of X @ 10% p.a. for year ended 31/3/2017 if he withdrew as follows:

a) During the first three months he withdrew Rs. 2000 in the beginning of every month.
b) During the next three months he withdrew Rs. 2000 at the end of every month.
c) During the remaining months he withdrew Rs. 2000 p.m.

(4) Calculate the interest on X's drawings @ 10% if he withdrew Rs.24000 during the year.

(B) Interest on capital

(5) X and Y started business on 1/4/2016 with the capitals of Rs. 500000 and Rs. 300000 respectively. There is no withdrawal or addition of capital during the year. Calculate the interests on capital @12% p.a. if the books of accounts are closed on a) 31st march b) 31st December.

(6) X and Y started business on 1/4/2016 with the capitals of Rs. 500000 and Rs. 300000 respectively. On 1/5/16 X introduced an additional capital of Rs. 100000 and Y withdrew Rs. 50000 from his capital. On 1/10/2016, X withdrew Rs. 200000 from his capital and Y introduced Rs. 250000. Interest on capital is allowed @6% p.a. calculate the interest on capital for the year ending 31/3/2017.

(7) X and Y started business on 1/4/2016 with capitals of Rs. 250000 and 150000 respectively. On 1/10/2016 they decided that their capitals should be Rs. 200000 each. The necessary adj. in the capitals was made by introducing or withdrawing cash. Interest on capital is allowed at 8% p.a. calculate the interest on capital for the year ending 31/3/17.

(C) Profit Distribution

(8) X and Y are partners sharing the profits and losses in the ratio of 2:3 with capitals of Rs. 20000 and Rs. 10000 respectively. Show the distribution of profit/losses for the year 31/3/2017 by preparing relevant accounts (abstract only)

a) If the partnership deed is silent as to the interest on capital and the trading profits for the year are RS. 1500.

b) If the partnership deed provides for interest on capital @6% p.a. and trading losses for the year are Rs. 1500.

c) If the partnership deed provides for interest on capital @6% p.a. and trading profits for the year are Rs. 2100.

d) If the partnership deed provides for interest on capital @6% p.a. and trading profits for the year are Rs. 1500.

e) If the partnership deed provides for interest on capital @6% p.a. even if it involves the firm in loss and the trading profits for the year are Rs. 1500.

(9) X and Y are partners sharing the profits and losses in the ratio of 2:3 with capitals of Rs. 20000 and Rs. 10000 respectively. On 1/7/2016 X and Y granted loans of Rs. 40000 and Rs. 20000 respectively to the firm. Show the distribution of profits/losses for the year ending on 31/3/2017 in following cases:

a) If the profits before any interest for the year amounted to Rs. 2100.

b) If the profits before any interest for the year amounted to Rs. 1500.

c) If the losses before any interest for the year amounted to Rs 1500.

(D) Past Adjustments:

(10) X and Y are partners in a firm sharing profits and losses equally. Their capital accounts as on 31/3/2016 showed a balance of Rs. 70000 and Rs. 60000 respectively. The drawings of X and Y during the year 16-17 were Rs. 8000 and Rs. 6000 respectively. After taking into accounts the profits of the year 31/03/2017.

which amounted to Rs. 40000. It was subsequently found that the following items have been left out while preparing the final accounts of the year ended 31/03/2017.

1) The partners were entitled interest on capital @ 6% p.a.

2) The interest on drawings was also to be charged @ 5% p.a.

3) X was entitled to salary of Rs. 10000 and Y a commission of Rs. 4000 for the whole year.

It was decided to make the necessary adjustments to record the above omissions. Pass journal entry to record the above adjustments.

(11) X, Y and Z are partners. Their fixed capitals as on 31/03/2016 were X-50000, Y-100000 and Z-150000. Profits for the year 16-17 amounting to Rs. 60000 were distributed. Give journal entries in following cases.

a) Interest on capital was credited @10% p.a. though there was no such provision in the partnership deed.

b) Interest on capital was not credited @10% p.a. though there was such provision in the partnership deed.

c) Interest on capital was credited @ 10% p.a. instead of 12% p.a.

d) Interest on capital was credited @ 12% p.a. instead of 10% p.a.

(E) Goodwill :

(i) Simple Average:

(12) Calculate the value of goodwill as on 1/1/2017 on the basis of three years of purchase of the average profits of last five years.

Profits are as under.

2011- 30000	2013-92000	2015-70000
2012- loss 40000	2014-55000	2016-90000

(13) If in Ques-13 profit on sale of fixed asset during 2012 amounted to Rs.2000, during 2014 amounted to Rs.5000, loss on sale of a fixed assets during 2016 amounted to Rs. 5000. Calculate the value of goodwill.

(14) The following were the profits of a firm for last three years.

Year	Profits	
2011	500000	(including an abnormal gain of Rs. 150000)
2012	400000	(After charging abnormal loss of Rs. 200000)
2013	600000	(excluding Rs. 200000 payable on the insurance)

Calculate the value of goodwill on the basis of four years purchase of the average profits for the last three years.

(ii) Weighted Average Method:

(15) The profits of a firm for the year ended 31st march for the last five years were as follows:

Year	Profits
2011	20000
2012	30000
2013	40000
2014	50000
2015	55000

Calculate the value of goodwill on the basis of three years purchase of weighted average.

(16) Calculate goodwill of a firm on the basis of three years purchase of the weighted average profits of last four years. The profits of last four years are as under.

2011-25000	2013-46900
2012-27000	2014-53810

Following other information is given:

1) On 1/1/2012 a major plant repair was undertaken for Rs. 10000 which was charged to revenue. The said sum is to be capitalized for goodwill calculation subject to adjustment of 10% depreciation on WDV method.

2) The closing stock for the year 2012 and 2013 were overvalued by Rs. 1000 and Rs. 2000 respectively

3) To cover management cost an annual charge of Rs. 5000 should be made for the purpose of goodwill valuation.

(iii) Super profit method:

(17) The profits and losses for the last years are –

2011-10000	2013-50000
2012- loss 17000	2014-75000

The Average capital employed in the business is Rs. 200000. The rate of interest expected from capital invested is 10%. The remuneration of partners is estimated to be Rs. 6000 p.a. calculate the value of goodwill on the basis of 2 years purchase of super profit based on the average of 3 years.

(18) On 1/4/11 an existing firm had assets of Rs. 75000 including cash of Rs. 5000. Its creditors amounted to Rs. 5000 on that date. The firm had a reserve fund of Rs. 10000 while partner's capital accounts showed a balance of Rs. 60000. If the normal rate of return is 20% and the goodwill of the firm is valued at Rs. 24000 at four years purchase of super profits, find the average profits per year, of the existing firm.

(iv) Present value of Super profit/ Annuity method

(19) The expected profits of a firm for the next 5 years are as under.

Year	1	2	3	4	5
Profits	100000	200000	300000	400000	500000

The total assets of the firm are Rs. 2000000 and outside liabilities are Rs. 1100000. The present value factors at 10% are as follows.

Year	1	2	3	4	5
PVIF	0.9091	0.8264	0.7513	0.6830	0.6209

Calculate amount of goodwill.

(v) Capitalization of super profit method

(20) A firm earns profits of Rs. 100000. The normal rate of return in similar types of business is 10%. The value of total assets (Other than goodwill) and total outside liabilities as on the date of valuation of goodwill are Rs. 1100000 and Rs. 280000 respectively. Calculate the value of goodwill according to capitalization of super profit method.

(vi) Capitalization of average profits:

(21) Calculate the value of goodwill according to capitalization of average profit method in Ques-21.

(VII) Change in profit sharing ratio

1) X and Y are partners sharing profits and losses in the ratio of 7:5. They admit Z a new partner, who acquires his share as 1/12th from X and 1/8th from Y. calculate the new profit sharing ratio and sacrificing ratio.

2) X and Y are partners sharing profits and losses in the ratio of 3:2. Z is admitted as partner with 1/4th share in profits. Z acquires his share from X and Y in the ratio of 2:1. Calculate the new profit sharing ratio.

3) X and Y are partners sharing profits and losses in the ratio of 3:2. Z is admitted as partner with 1/5th share in profits. Calculate the new profit sharing ratio and sacrificing ratio.

4) X and Y are partners sharing profits and losses in the ratio of 7:3. X surrenders 1/7th **of** his share and Y surrenders 1/3rd **of** his share in favour of Z, a new partner. Calculate the new profit sharing ratio and the sacrificing ratio.

5) X and Y are partners sharing profits and losses in the ratio 7:3. X surrenders 1/7th **from** his share and

Y surrenders 1/3rd **of** his share in favour of Z, a new partner. Calculate the new profit sharing ratio and sacrificing ratio.

6) X and Y are partners sharing profits and losses in the ratio of 4:3. Z joins the firm as a new partner. The new profit sharing ratio of X,Y & Z is agreed at 7:4:3 respectively. Calculate the sacrificing ratio and the share of incoming partner.
7) X and Y are partners in a firm sharing profits and losses in the ratio of 3:2. Z is admitted with 1/8th share in profits. It is decided that X and Y will share profits and losses in the future in the ratio of 4:3. Calculate the new profit sharing ratio and sacrificing ratio.
8) X, Y and Z are partners in the ratio of 3:2:1. W is admitted with 1/6th share in profits. Z would retain his original share. Find out new profit sharing ratio.
9) X and Y are partners sharing profit and losses in the ratio of 3:2. Z is admitted for 1/4th share. Thereafter W enters for 20 paise in a rupee. Compute the profit sharing ratio of X, Y, Z and W after W's admission.
10) A and B are partners sharing profits in the ratio of 3:2. They admit C for 1/5th share in the profits. C acquires 1/5th of his share from A. calculate the new profit sharing ratio.
11) X, Y and Z are partners sharing profits and losses in the ratio of 1/5, 1/3 and 7/15 respectively. Z retires and his share is taken up by X and Y in the ratio of 3:2. Calculate the new profit sharing ratio and the gaining ratio.
12) W, X, Y & Z are partners sharing profit and losses in the ratio of 1/3, 1/6, 1/3 and 1/6 respectively. Y retires and W, X & Z decide to share the profits and losses equally in the future. Calculate the gaining ratio.
13) X, Y and Z are partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5 respectively. Z retires and X & Y decide to share the future profits and losses in the ratio of 2:1 respectively. Calculate the gaining ratio.
14) X, Y and Z are partners sharing profit and losses in the ratio of 4/9:1/3:2/9. Y retires and surrenders 1/9th of his share in favour of X and the remaining in favour of Z. calculate the new profit sharing ratio and the gaining ratio.

(F) Joint Life Policy (JLP)

(22) A and B sharing profits and losses in the ratio of 2:3 took out a joint life policy on 1/1/2011 for Rs. 10000 for 10years. The premium for the whole year is Rs.1000. B died on 1/3/2014 and policy amount was received on 1/5/2014. Prepare necessary accounts as per

1. JLP expense method
2. JLP surrender value method
3. JLP reserve method

Surrender Values are as under :

1st year	=	Nil
2nd year	=	200
3rd year	=	600

(G) Application of Sec.37 of Partnership Act 1932

(23) A, B and C were partners sharing profits and losses in the ratio of 2:2:1. C retired on 1/7/2012 on which date the capital of A, B and C after all necessary adjustments stood at Rs. 73875, Rs. 63875 and 42250 respectively. A and B continued to carry on the business for 6 months without settling accounts of C. during the period of 6 months from 1/7/2012 a profit of Rs. 20500 is earned. State which two options are available u/s. 37 of partnership act 1932 for C.

(H) Goodwill Valuation Admission of partner:

(i) When new partner brings his share of goodwill in cash.

1) X and y are patners in a firm sharing profits and losses in the ratio of 3:2 They admit Z as a partner for 1/5th share. Z acquires his share from X and y in the ratio of 2:3 .The goodwill of the firm has been valued are Rs. 25,000. Z brings in the necessary amount in cash as his share of firm's goodwill and Rs.1,00,000 as his capital. Pass the necessary journal entries under each of the following alternative cases:

Case (a) : When no goodwill appears in the books and the amount of goodwill is retained in the firm

Case (b) : When no goodwill appears in the books and the amount of goodwill is withdrawn by the concerned partners to the extent of 30% of what is credited to them.

Case (c) : When goodwill appears in the books at the Rs.20,000

(ii) When new partner brings his share of goodwill in kind:

X and Y are patners in a firm sharing profits in the ratio of 3:2 On April 1,2007 they admit Z as a new partner for 3/13 share in the profits The new ratio will be 5:5:3. Z contributed the following assets towards his capital and for his share of goodwill: Rs. 90,000 Record necessary journal entires in the books of the firm on Z admission .

(iii) When new partner brings in only part of his share of goodwill in cash:

X and Y are patners in a firm sharing profits and losses in the ratio of 3:2 .They admit Z as a partner for 1/5th share, Z acquires his share from X and Y in the ratio of 2:3. The goodwill of the firm has been valued at Rs.25,000. Z brings in only 60% of the requisite share of firm 's goodwill and Rs.1,00,000 ass Capital in cash. Pass the necessary journal entries under each of the following alternative Cases:

Case(a) : When no goodwill appears in the books and the amount of goodwill brought in is retained in the firm.

Case(b) : When no goodwill appears in the books and the amount of goodwill brought in cash is withdrawn by the concerned partners to the extent of 30% of what is credited to them.

Case(c) : When goodwill appears in the books at 20,000.

(iv) Hidden Goodwill:

A and B are patners with capitals of Rs. 5,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings Rs. 8,000 as his share of capital.

The Profit and Loss Account showed a credit balance of Rs.4,000 as on date of admission of C. Give the necessary journal entry to record goodwill.

CLASS WORK

UNIT - 1

Q-1 Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 % per annum. (No interest will be charged/allowed on Current Accounts).

The following are the particulars of the Capital and Drawings Accounts of the partners:

	Weak	Able	Lazy
	`	`	`
Capital (1.1.2016)	75,000	40,000	30,000
Current Account (1.1.2016)	10,000	5,000	(Dr.) 5,000
Drawings	15,000	10,000	10,000

The draft accounts for 2016 showed a net profit of ` 60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

(a) Life Insurance premium of Weak amounting to ` 750 paid by the firm on 30th June, 2016 has been charged to Miscellaneous Expenditure A/c.

(b) Repairs of Machinery amounting to ` 10,000 has been debited to Plant Account and depreciation thereon charged @ 20%.

(c) Travelling expenses of ` 3,000 of Able for a pleasure trip to U.K. paid by the firm on 30th June, 2016 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account, Current Accounts of partners Weak, Able and Lazy for the year ended 31st December, 2016.

Q-2 Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2016, and becomes entitled to 1/10 th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

Before becoming a partner, Ratan was getting a salary of ` 500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission.

It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits.

The net profit for the year ended December 31, 2016 is ` 1,10,000. Show the distribution of net profit amongst the partners.

Q-3 X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charge on drawing at 10% p.a. X withdrew Rs.40,000 pm at the end of each month and Y withdrew Rs. 120,000 at the end of each quarter. You are required to fill the missing figures in following accounts:

Profit and Loss Appropriation Account for the year ended March 31, 2017

Particulars		`	Particulars		`
To ...?			By Profit and Loss A/c (Net profit)		?
To Interest on Capital A/c			By Intrested on Drawings A/c		
X	160,000		X	?	
Y	?	288,000	Y	?	?
To profit transferred to Capital A/c					
X (2/3)	?				
Y (1/3)	280,000	?			
		?			?

Partner's Capital Accounts

Particulars	X	Y	Particulars	X	Y
To ...?	?	?	By .....?	?	?
To ...?	?	?	By Salary A/c	3,60,000	?
To ...?	?	?	By .....?	?	?
	?	?	By .....?	?	?

UNIT - 2

Q-4 Wise, Clever and Dull were trading in partnership sharing profits and losses 4:3:3 respectively. The accounts of the firm are made upto 31st December every year. The partnership provided, interalia, that: On the death of a partner the goodwill was to be valued at three years' purchase of average profits of the three years upto the date of the death after deducting interest @8 percent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year. On 30th June, 2016, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. It was agreed for the purpose of valuation of goodwill that the fair remuneration for work done by each partner would be `15,000 per annum and that the capital employed would be `1,56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after the death of Wise. The following were the amounts of profits of earlier years before charging interest on capital employed.

	`
2013	67,200
2014	75,600
2015	72,000
2016	62,400

You are required to compute the value of goodwill and show the adjustment there of in the books of the firm.

UNIT - 3

Q-5 The following was the balance sheet of A, B and C who were equal partners on January 1, 2017

Liabilities	`	**Assets**	`
Bills Payable	3,000	Cash	1,000
Creditors	6,000	Debtors	10,000
Capital Accounts : Stock	12,000	Stock	12,000
A	20,000	Furniture	5,000
B	15,000	Buildings	25,000
C	10,000	Bills Receivable	1,000
	54,000		54,000

They agree to take D into partnership and give him a 1/4 share in the profits on the following terms:

(1) that D should bring in ` 6,000 for goodwill and ` 10,000 as capital;

(2) that one-half of the goodwill shall be withdrawn by old partners;

(3) that stock and furniture be depreciated by 10%.

(4) that a liability of ` 1,300 be created against bills discounted; (5) that the building be valued at ` 40,000;

(6) that the values of liabilities and assets other than cash are not to be altered.

Give the necessary entries to give effect to the above arrangement; prepare revaluation account and opening balance sheet of the firm as newly constituted.

Q-6 Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms' balance sheet as on 31.03.2016 was as follows:

Liabilities	`	**Assets**	`
Capital accounts:			
Gopal	1,20,000	Fixed assets	3,00,000
Govind	80,000	Investments	50,000
Long term loan	2,00,000	Current assets	2,00,000
Current liabilities	2,50,000	Loans and advances	1,00,000
	6,50,000		**6,50,000**

Due to financial difficulties, they have decided to admit

Guru as partner in the firm from 01.04.2016 on the following terms:

Guru will be paid 40% of the profits.

Guru will bring in cash ` 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows:

For the year ended 31.3.2014: profit ` 20,000 (includes insurance claim received of ` 40,000).

For the year ended 31.3.2015: loss ` 80,000 (includes voluntary retirement compensation paid `1,10,000).
For the year ended 31.3.2016: profit of ` 1,05,000 (includes a profit of ` 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2016 as follows:

	`
Fixed assets (net)	4,00,000
Investments	Nil
Current assets	1,80,000
Loans and advances	1,00,000

The new profit sharing ratio after the admission of Guru was 35:25:40.

Pass journal entries on admission, show goodwill calculation and prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2016 after the admission of Guru.

Q-7 A, B and C were in partnership, sharing prots and losses as to A one-half, B one- third and C one- sixth. As from 1st January, 2016 they admitted D into partnership on the following terms:

D to have a one –sixth share which he purchased entirely from A paying A `8,000 for that share of goodwill. Of this amount, A had withdrawn `6,000 and put the balance in the rm as additional capital. As a condition to admission of D as a partner, D also brought `5,000 capital into the rm. It was further agreed that the investments should be valued at its market value of `3,600 and plant be valued at` 5,800.

The balance sheet of the old rm on 31.12.2015 was as follows:

Cash at bank `8,000; debtors`12,000; stock `10,000; investments at cost `6,000; furniture` 2,000; plant `7,000; creditors `21,000; capital: A `12,000; B `8,000 and C `4,000.

The prots for the year 2016 were` 12,000 and the drawings were A `6,000, B` `6,000, C `3,000 and D ` 3,000. You are required to journalise the opening adjustments, prepare the opening balance sheet of the new rm as on 1st January, 2016 and give the capital account of each partner as on 31st December, 2016.

UNIT - 4

Q-8 On 31st March, 2016, the balance sheet of M/s Ram, Rahul and Rohit sharing prots and losses in proportion to their capital, stood as follows:

	`	`		`
Capital accounts:			Land & building	2,00,000
Ram	3,00,000		Machinery	2,00,000
Rahul	2,00,000		Closing stock	1,00,000
Rohit	1,00,000	6,00,000	Sundry debtors	2,00,000
Sundry creditors		2,00,000	Cash and bank balances	1,00,000
		8,00,000		**8,00,000**

On 31st March, 2016, Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:-

1. Land and buildings be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Closing stock to be valued at ` 80,000.
4. Provision for bad debts be made at 5%.
5. Old credit balances of sundry creditors ` 10,000 be written back.
6. Joint life policy of the partners surrendered and cash obtained ` 60,000.
7. Goodwill of the entire firm be valued at `1,80,000 and Ram's share of the goodwill be adjusted in the accounts of Rahul and Rohit who share the future profits equally. No goodwill account being raised.
8. The total capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.
9. Amount due to Ram is to be settled on the following basis:-

   50% on retirement and the balance 50% within one year

Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2016 of M/s Rahul and Rohit.

Q-9 A,B,C were in partnership sharing profits and losses in the ratio of 3:2:1. The balance sheet of the firm as on 31.2.2016 was as under:

Liabilities	`		**Assets**	`
Capital accounts:			Goodwill	40,000
A	1,50,000		Fixtures	30,000
B	1,00,000		Stock	1,70,000
C	50,000	3,00,000	Sundry debtors	90,000
Sundry creditors		40,000	Cash	10,000
		3,40,000		**3,40,000**

A, on account of ill-health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered as on 31.3.2016, the terms of which were as follows:

(a) The profit and loss account for the year ended 31.3.2016, which showed a net profit of ` 42,000 was to be reopened. B was to be credited with ` 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio is to be 2:3:1 as and from 1st April 2015.

(b) Goodwill was to be valued at two years' purchase of the average profits of five years. Profits for these five years ending on 31st March were as under:

	`
31.3.2012	15,000
31.3.2013	23,000
31.3.2014	25,000
31.3.2015	35,000
31.3.2016	42,000

(c) Fixtures are to be valued at ` 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.

(d) That the amount payable to A shall be paid by B.

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3:1 and decided to eliminate goodwill from balance sheet, to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6 %. Total capital of the firm will be `3 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare capital accounts of partners, cash account and balance sheet of B and C after giving effect to the above arrangements on the retirement of A.

UNIT - 5

Q-10 The Balance Sheet of Seed, Plant and Flower as at 31st December, 2016 was as under :

Liabilities		`	**Assets**	`
Trade payables		20,000	Fixed Assets	40,000
General Reserve		5,000	Debtors	10,000
Capital:			Bills Receivable	4,000
Seed	25,000		Inventories	16,000
Plant	15,000		Cash at Bank	10,000
Flower	15,000	55,000		
		80,000		**80,000**

The profit sharing ratio was: Seed 5/10, Plant 3/10 and Flower 2/10. On 1st May, 2016 Plant died. It was agreed that:

(a) Goodwill should be valued at 3 years purchase of the average profits for 4 years. The profits were:

2012	` 10,000	2014	` 12,000
2013	` 13,000	2015	` 15,000

(b) The deceased partner to be given share of profits up to the date of death on the basis of the previous year.

(c) Fixed Assets were to be depreciated by 10%. A bill for ` 1,000 was found to be worthless. These are not to affect goodwill.

(d) A sum of ` 7,750 was to be paid immediately, the balance was to remain as a loan with the firm at 9% p.a. as interest.

Seed and Flower agreed to share profits and losses in future in the ratio of 3: 2.

Give necessary journal entries.

Q-11 Peter, Paul and Prince were partners sharing profits and losses in the ratio 2:1:1. It was provided in the partnership deed that in the event of retirement /death of a partner he/his legal representatives would be paid:-

(i) The balance in the capital Account

(ii) His share of goodwill of the firm valued at two years purchase of normal average profits (after charging interest on xed capital) for the last three years to 31st December preceding the retirement or death.

(iii) His share of profits from the beginning of the accounting year of to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous year as increased by 25%

(iv) Interest on xed capital at 10% p.a. though payable to the partners will not be payable in the year of death or retirement.

(v) All the asset are to be revalued on the date of retirement or death and the profit and loss be debited/ credited to the Capital Accounts in the profit sharing ratio.

Peter died on 30th September, 2016. The books of Account are closed on calendar yea basis form 1st January to 31st December.

The balance in the Fixed Capital Accounts as on 1st January, 2016 were Peter ` 10,000, Paul ` 5,000 and Prince ` 5,000. The balance in the Current Account as on 1st January, 2016 were Peter ` 20,000, Paul ` 10,000 and Prince ` 7,000. Drawings of Peter till 30th September, 2016 were ` 10,000. The profits of the firm before charging interest on capital for the calendar years 2013, 2014 and 2015 were ` 1,00,000, ` 1,20,000 and ` 1,50,000 respectively. The profits include the following abnormal items of credit:-

	2013	2014	2015
	`	`	`
Profit on sale of assets	5,000	7,000	10,000
Insurance claim received	3,000	-	12,000

The Firm has taken out a Joint Life Policy for `1,00,000. Besides the partners had severally insured their lives for ` 50,000 each, the premium in respect thereof being charged to the Profit and Loss account. The surrender value of the Policies were 30% of the face value. On 30th June, 2016 the firm received notice from the insurance company that the insurance premium in respect of fire policy had been undercharged to the extent of ` 6,000 in the year 2015 and the firm has to pay immediately. The revaluation of the assets indicates an upward revision in value of assets to the extent of ` 20,000. Prepare an account showing the amount due to Peter's Legal representatives as on 30th September, 2016 along with necessary workings.

MULTIPLE CHOICE QUESTIONS

1 If a firm prefers Partners' Capital Accounts to be shown at the amount introduced by the partners as capital in firm then entries for salary, interest, drawings, interest on capital and drawings and profits are made in

(a) Trading Account (b) Profit and Loss Account (c) Partners' Current Account

2 In the absence of any agreement, partners are liable to receive interest on their Loans @

(a) 12% p.a. (b) 10% p.a. (c) 6% p.a.

3 The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as ....

(a) Partnership. (b) Joint Venture.

(c) Association of Persons.

4 Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in ....

(a) Profit sharing of the partners. (b) Calculation of the goodwill. (c) Both.

5 In the absence of an agreement, partners are entitled to

(a) Interest on Loan and Advances. (b) Commission. (c) Salary

6 Partners are supposed to pay interest on drawings only when .... by the ....

(a) Provided, Agreement. (b) Agreed, Partners

(c) Both (a) & (b) above.

7 When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by

(a) Partner who gave the guarantee (b) All the other partners.

(c) Partnership firm.

8 Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their.........ratio.

(a) Capital. (b) New Profit Sharing. (c) Sacricing.

9 A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings `70,000 cash and `48,000 against goodwill. New profit sharing ratio between A, B and C are 7:5:4. Find the sacricing ratio of A:B.

(a) 3:1. (b) 4:7. (c) 5:4.

10 Following are the factors affecting goodwill except:

(a) Nature of business.

(b) Efficiency of management.

(c) Location of the customers.

11 Weighted average method of calculating goodwill should be followed when:

(a) Profits has increasing trend.

(b) Profits has decreasing trend.

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

12 In the absence of any provision in the partnership agreement, profits and losses are shared

(a) In the ratio of capitals.

(b) Equally.

(c) In the ratio of loans given by them to the partnership firm.

13 A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?

(a) 35:42:17. (b) 35:21:24. (c) 49:22:29.

14 A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5 from A and 1/10 from B, new profit sharing ratio will be:

(a) 5:6:3. (b) 2:4:6. (c) 17:11:12

15 C was admitted in a firm with 1/4th share of the profits of the firm. C contributes `15,000 as his capital, A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A and B, if capital should be in profit sharing ratio taking C's as base capital:

(a) `27,000 and `16,000 for A and B respectively.

(b) `27,000 and `18,000 for A and B respectively.

(c) `32,000 and `21,000 for A and B respectively.

16 A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take D into partnership for 1/8th share of profits. Find the new profit sharing ratio.

(a) 12:27:36:42. (b) 14:7:7:4. (c) 1:2:3:4.

17 A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is ` 30,000 and B's Capital is `15,000). They admitted C and agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?

(a) `9,000. (b) `12,000. (c) `11,250

18 A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who brings in `25,000 against capital and `10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.

(a) `8,000: `2,000. (b) `5,000: `5,000.

(c) Old partners will not get any share in the goodwill brought in by C.A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring `25,000 against capital and `10,000 against goodwill. New profit sharing ratio is 7 1:1:1. C brought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.

(a) Cash brought in by C will only be credited to his capital account.

(b) Goodwill will be raised to full value in old ratio.

(c) Goodwill will be raised to full value in new ratio.

19 X and Y are partners sharing profits in the ratio of 3: 1. They admit Z as a partner who pays `4,000 as Goodwill the new profit sharing ratio being 2:1: 1 among X, Y and Z respectively. The amount of goodwill will be credited to:

(a) X and Y as `3,000 and `1,000 respectively.

(b) X only

(c) Y only

20. A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?

(a) 35:42:17. (b) 35:21:24. (c) 49:22:29.

21. C, D and E are partners sharing profits and losses in the proportion of ½, 1/3 and 1/6. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of ` 12,000 is divided among the partners in the ratio:

(a) ` 2,000: ` 4,000: ` 6,000.

(b) ` 5,000: ` 5,000: ` 2,000.

(c) ` 6,000: ` 4,000: ` 2,000.

22. A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of `2,50,000 with the surrender value ` 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?

(a) ` 50,000 credited to all the partners in old ratio.

(b) `2,50,000 credited to all the partners in old ratio.

(c) `2,00,000 credited to all the partners in old ratio.

23. A, B and C takes a Joint Life Policy, after five years, B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of `2,50,000 with the surrender value ` 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at the surrender value?

(a) ` 50,000 credited to all the partners in old ratio.

(b) `2,50,000 credited to all the partners in old ratio.

(c) No treatment is required.

24. A, B and C are partners sharing profits in the ratio 2:2:1. On retirement of B, goodwill was valued as ` 30,000. Find the contribution of A and C to compensate B.

(a) ` 20,000 and ` 10,000.

(b) ` 8,000 and ` 4,000.

(c) They will not contribute anything.

25. A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of ` 50,000 for A and B, for C ` 25,000. B declared to retire from the firm and balance in reserve on the date was ` 15,000. If goodwill of the firm was valued as ` 30,000 and profit on revaluation was ` 7,050 then what amount will be transferred to the loan account of B.

(a) ` 70,820. (b) ` 50,820. (c) ` 25,820.

26. A, B and C are partners sharing profits and losses in the ratio of 3:2:1. C retires on a decided date and Goodwill of the firm is to be valued at ` 60,000. Find the amount payable to retiring partner on account of goodwill.

(a) ` 30,000. (b) ` 20,000. (c) ` 10,000.

27. A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at ` 24,000. What will be the treatment for goodwill?

(a) Credited to Revaluation Account at ` 24,000.
(b) Adjusted through partners' capital accounts in gaining/sacricing ratio.
(c) Only A's capital account credited with ` 12,000.

28. Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A - `2,00,000; B - `3,00,000 and C - `2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at `1,40,000 and no Goodwill account being raised.

(a) Credit Partner's Capital Account with old profit sharing ratio for `1,40,000.
(b) Credit Partner's Capital Account with new profit sharing ratio for `1,40,000.
(c) Credit A's Account with ` 40,000 and debit B's Capital Account with ` 10,000 and C's Capital Account with ` 30,000.

29. In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in

(a) Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.
(b) Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.
(c) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

30 A, B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of `1,20,000 and in the balance sheet it is appearing at the surrender value i.e. ` 20,000. On the death of A, how this JLP will be shared among the partners.

(a) ` 50,000: ` 25,000: ` 25,000.
(b) ` 60,000: ` 30,000: ` 30,000.
(c) ` 40,000: ` 35,000: ` 25,000.

31 R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2011. It was decided to value the goodwill on the basis of three year's purchase of last five years average profits. If the profits are ` 29,600; ` 28,700; ` 28,900; ` 24,000 and ` 26,800. What will be D's share of goodwill?

(a) ` 20,700. (b) ` 27,600. (c) ` 82,800.

32 R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2011 and profits for the accounting year 2010-2011 were ` 24,000. How much share in prots for the period 1st April 2011 to 30th June 2011 will be credited to D's Account.

(a) ` 6,000. (b) ` 1,500. (c) ` 2,000.

UNIT - 1

Q-1 A and B start business on 1st January, 2016, with capitals of ` 30,000 and ` 20,000. According to the Partnership Deed, B is entitled to a salary of ` 500 per month and interest is to be allowed on capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2016 the firm earned a profit, before charging salary to B and interest on capital amounting to ` 25,000. During the year A withdrew ` 8,000 and B withdrew ` 10,000 for domestic purposes. Give journal entries relating to division of profit.

Q-2 *Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims:*

(i) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Rahim and Karim do not agree.

(ii) Rahim has devoted full time for running the business and demands salary at the rate of ` 500 p.m. But Ram and Karim do not agree.

(iii) Karim demands interest on loan of ` 2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ` 45,000 at the end of the first year of their business.

Q-3 A and B start business on 1st January, 2016, with capitals of ` 30,000 and ` 20,000. According to the Partnership Deed, B is entitled to a salary of ` 500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2016 the firm earned a profit, before charging salary to B and interest on capital amounting to ` 25,000. During the year A withdrew ` 8,000 and B withdrew ` 10,000 for domestic purposes.

Prepare Profit and Loss Appropriation Account.

Q-4 A and B start business on 1st January, 2016, with capitals of ` 30,000 and ` 20,000. According to the Partnership Deed, B is entitled to a salary of ` 500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2016, the firm earned a profit, before charging salary to B and interest on capital amounting to ` 25,000. During t*he year A withdrew ` 8,000 and B withdrew ` 10,000 for domestic purposes.*

Prepare Capital Accounts of Partners A and B.

Q-5 A and B are partners sharing profits and losses in the ratio of their effective capital. They had ` 1,00,000 and ` 60,000 respectively in their Capital Accounts as on 1st January, 2016.

A introduced a further capital of ` 10,000 on 1st April, 2016 and another ` 5,000 on 1st July, 2016. On 30th September, 2016 A withdrew ` 40,000.

On 1st July, 2016, B introduced further capital of ` 30,000.

The partners drew the following amounts in anticipation of profit.

A drew ` 1,000 per month at the end of each month beginning from January, 2016. B drew ` 1,000 on 30th June, and ` 5,000 on 30th September, 2016.

12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2016. Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

Q-6 *R*am and Rahim start business with capital of ` 50,000 and ` 30,000 on 1st January, 2016. Rahim is entitled to a salary of ` 400 per month. Interest is allowed on capitals and is charged on drawings at 6% per annum. Profits are to be distributed equally after the above noted adjustments. During the year, Ram withdrew ` 8,000 and Rahim withdrew ` 10,000. The profit for the year before allowing for the terms of the Partnership Deed came to ` 30,000. Assuming the capitals to be xed, prepare the Profit and Loss Appropriation Account and the Capital and Current Accounts relating to the partners.

Q-7 With the help of same information given in illustration 6, let us prepare the Capital and Current Accounts of Ram and Rahim.

Q-8 and guaranteed that his share of profits will not be less than ` 250,00,000. Total profits of the firm for the year ended 31st March, 2017 were ` 900,00,000. Calculate share of profits for each partner when:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally.

UNIT - 2

Q-9 Lee and Lawson are in equal partnership. They agreed to take Hicks as one-fourth partner. For this it was decided to find out the value of goodwill. M/s. Lee and Lawson earned profits during 2013-2016 as follows:

Year	**Profits** `
2013	1,20,000
2014	1,25,000
2015	1,30,000
2016	1,50,000

On 31.12.2016 capital employed by M/s. Lee and Lawson was ` 5,00,000. Rate of normal profit is 20%.

Required

Find out the value of goodwill following various methods.

Q-10 The following particulars are available in respect of the business carried on by Rathore

			`
(1)	Capital Invested 1,50,000		
(2)	Trading Results:		
	2013	Profit	40,000
	2014	Profit	36,000
	2015	Loss	6,000
	2016	Profit	50,000
(3)	Market Rate of interest on investment	10%	
(4)	Rate of risk return on capital invested in business	2%	
(5)	Remuneration from alternative employment of the proprietor (if not engaged in business).	` 6,000 per annum	

You are required to compute the value of goodwill on the basis of 5 years purchase of super profit of the business calculated on the average profits of the last four years.

Q-11 The following is the Balance Sheet of Yellow and Green as at 31st December, 2016:

Liabilities	`	**Assets**	`
Trade payables	20,000	Cash at Bank	10,000

Capital:		Sundry Assets	55,000
Yellow	25,000		
Green	20,000		
	65,000		65,000

The partners shared profits and losses in the ratio 3:2. On the above date, Black was admitted as partner on the condition that he would pay ` 20,000 as Capital. Goodwill was to be valued at 3 years' purchase of the average of
four years' profits which were:

	`		`
2012	9,000	2014	12,000
2013	14,000	2015	13,000

The new profit sharing ratio is 6:5:5.

Give journal entries and Balance Sheet if goodwill is adjusted through partners' capital accounts.

Q-12 With the information given in illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is brought in cash.

Q-13 Continuing with the same illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is brought in cash, but withdrawn.

Q-14 On the basis of information given in illustration 3, let us give journal entries and prepare balance sheet assuming that goodwill is paid privately.

Q-15 A, B & C are equal partners. They wanted to change the profit sharing ratio into 4:3:2. Make the necessary journal entries. Goodwill of the firm is valued at ` 90,000.

Q-16 A, B and C are in partnership sharing profits and losses in the ratio of 4:3:3. They decided to change the profit sharing ratio to 7:7:6. Goodwill of the firm is valued at ` 20,000. Calculate the sacrifice / gain by the partners and make the necessary journal entry

Q-17 A, B, C and D are in partnership sharing profits and losses equally. They mutually agreed to change the profit sharing ratio to 3:3:2:2. Give necessary journal entry.

UNIT - 3

Q-18 The following is the Balance Sheet of Ram and Mohan, who share profits in the ratio of 3:2 as on 1st January,
2016:

Liabilities	`	Assets	`
Trade payables	15,000	Buildings	18,000
Ram's Capital	20,000	Plant and Machinery	15,000
Mohan's Capital	25,000	Inventories	12,000
		Trade receivables	10,000
		Bank	5,000
	60,000		**60,000**

On this date Shyam was admitted on the following:

1. He is to pay ` 25,000 as his capital and ` 10,000 as his share of goodwill for one fifth share in profits.
2. The new profits sharing ratio will be 5:3:2.

3. The assets are to be revalued as under:

	`
Building	25,000
Plant and Machinery	12,000
Inventories	12,000
Trade receivables (because of doubtful debts)	9,500

4. It was found that there was a liability for `1,500 for goods received but not recorded in books.

Give journal entries to record the above. Also, give the Balance Sheet of the partnership firm after Shyam's admission.

Q-19 A and B are partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet as on 31.3.2016 is given below:

Liabilities	`	Assets	`
Trade payables	50,000	Freehold premises	2,00,000
Capital Accounts:		Plant	40,000
A	2,00,000	Furniture	20,000
B	1,00,000	Office equipment	25,000
		Inventories	30,000
		Trade receivables	25,000
		Bank	10,000
	3,50,000		3,50,000

On 1.4.2016 they admit C on the following terms:

(1) C will bring ` 50,000 as a capital and ` 10,000 for goodwill for 1/5 share;

(2) Provision for doubtful debts is to be made on Trade receivables @ 2%

(3) Inventory to be written down by 10%.

(4) Freehold premises is to be revalued at `2,40,000, plant at ` 35,000, furniture ` 25,000 and office equipment ` 27,500.

(5) Partners agreed that the values of the assets and liabilities remain the same and, as such, there should not be

any change in their book values as a result of the above mentioned adjustments.

You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

Q-20 A and B are partners in a firm, sharing profits and losses in the ratio of 3:2. The Balance Sheet of A and B as on 1.1.2016 was as follows:

Liabilities	`	**Amount** `	**Assets**	`	**Amount** `
Trade payables		17,000	Building		26,000
Furniture		5,800			
Bank overdraft		9,000	Inventories		21,400
Capital accounts:			Trade receivables	35,000	
A	44,000		Less: Provision	(200)	34,800
B	36,000	80,000	Investment		2,500
			Cash		15,500
		1,06,000			**1,06,000**

`C' was admitted to the firm on the above date on the following terms:

(i) C is admitted for 1/6 share in the future profits and to introduce a capital of `25,000.

(ii) The new profit sharing ratio of A, B and C will be 3:2:1 respectively.

(iii) `C' is unable to bring in cash for his share of goodwill, they decide to calculate goodwill on the basis of C's share in the profits and the capital contribution made by him to the firm.

(iv) Furniture is to be written down by `870 and Inventory to be depreciated by 5%. A provision is required for trade receivables @ 5% for bad debts. A provision would also be made for outstanding wages for `1,560. The value of buildings having appreciated be brought up to `29,200. The value of investments is increased by `450.

(v) It is found that the trade payables included a sum of `1,400, which is not to be paid off Prepare the following:

(i) Revaluation account. (ii) Partners' capital accounts.

Q-21 *Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March, 2016 is as below:*

Liabilities		`	**Assets**	`
Trade payables		12,850	Land and Buildings	25,000
Outstanding Liabilities		1,500	Furniture 6,500	
General Reserve		6,500	Inventory of goods	11,750
Capital Account :			Trade receivables	5,500
Mr. Dalal	12,000		Cash in hand	140
Mr. Banerji	12,000		Cash at Bank	960
Mr. Mallick	5,000	29,000		
		49,850		**49,850**

The partners have agreed to take Mr. Mistri as a partner with eff ect from 1st April, 2016 on the following terms :

(1) Mr. Mistri shall bring `5,000 towards his capital.

(2) The value of Inventory should be increased by `2,500 and Furniture should be depreciated by 10%.

(3) Reserve for bad and doubtful debts should be provided at 10% of the Trade receivables.

(4) The value of land and buildings should be enhanced by 20% and the value of the goodwill be fixed at `15,000.

(5) The value of the goodwill be fixed at `15,000.

(6) General Reserve will be transferred to the Partners' Capital Accounts.

(7) The new profit sharing ratio shall be: Mr. Dalal 5/15, Mr. Banerji 5/15, Mr. Mallick 3/15 and Mr.. Mistri 2/15. The outstanding liabilities include `1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books.

Prepare (i) Revaluation Account, (ii) The Capital Accounts of the partners, (iii) Balance Sheet of the firm after admission of Mr. Mistri.

Q-22 *A* and B are in partnership sharing profits and losses at the ratio 3:2. They take C as a new partner. Calculate the new profit sharing ratio if -

(i) C purchases 1/10 share from A

(ii) A and B agree to sacrifice 1/10th share to C in the ratio of 2: 3

(iii) Simply gets 1/10th share of profit.

Q-23 A and B are in the partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their balance sheet as on 31st March, 2016 was as follows:

Cash `1,000; trade receivables `25,000; Inventory `22,000; plant and machinery `4,000; trade payables `12,000; bank overdraft `15,000; A's capital `15,000; B's capital `10,000.

On 1st April, 2016, they admitted C into partnership on the following terms:

(i) C to purchase one–third of the goodwill for `2,000 and provide `10,000 as capital. Goodwill not to appear in books.

(ii) Further profits and losses are to be shared by A, B and C equally.

(iii) Plant and machinery is to be reduced by 10% and `500 is to be provided for estimated bad debts. Inventory is to be taken at a valuation of `24,940.

(iv) By bringing in or withdrawing cash and capitals of A and B are to be made proportionate to that of C on their profit-sharing basis.

Set out entries to the above arrangement in the firm's journal and give the partners' capital accounts in tabular form.

Q-24 A and B are partners of X & Co. sharing profits and losses in 3:2 ratio between themselves. On 31st March, 2016, the balance sheet of the firm was as follows:

Balance Sheet of X & Co. as at 31.3.2016

Liabilities	`	`	Assets	`
Capital accounts:			Plant and machinery	20,000
A	37,000		Furniture and fittings 5,000	
B	28,000			
		65,000	Inventories	15,000
Trade payables		5,000	Trade receivables	20,000
			Cash in hand	10,000
		70,000		**70,000**

X agrees to join the business on the following conditions as and from 1.4.2016:

(a) He will introduce `25,000 as his capital and pay `15,000 to the partners as premium for goodwill for 1/3rd share of the future profits of the firm.

(b) A revaluation of assets of the firm will be made by reducing the value of plant and machinery to `15,000, Inventory by 10%, furniture and fitting by `1,000 and by making a provision of bad and doubtful debts at `750 on trade receivables.

Prepare profit and loss adjustment account, capital accounts of partners including the incoming partner X assuming that the relative ratios of the old partners will be in equal proportion after admission.

Q-25 A and B are partners with capitals of `7,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings `8,000 as his share of capital. Give the necessary journal entry to record goodwill.

Q-26 A and B are in partnership sharing profits and losses equally. The Balance Sheet M/s. A and B as on 31.12.2016, was as follows:

Liabilities	`	**Assets**	`
Capital A/cs		Sundry Fixed Assets	60,000
A	45,000	Inventories	30,000
B	45,000	Bank	20,000
Trade payables	20,000		
	1,10,000		1,10,000

On 1.1.2017 they agreed to take C as 1/3rd partner to increase the capital base to `1,35,000.

C agrees to pay `60,000. Show the necessary journal entries and prepare partners' capital accounts.

UNIT - 4

Q-27 A and B are partners in a business sharing profit and losses as A-3/5th and B-2/5th. Their balance sheet as on 1st January, 2015 is given below:

Liabilities		`	**Assets**	`
Capital Accounts			Plant and Machinery	20,000
A	20,000		Inventories	16,000
B	15,000	35,000	Trade receivables	15,000
Reserve Account		15,000	Balance at Bank	6,000
Trade payables		7,500	Cash in hand	500
		57,500		**57,500**

B retires from the business owing to illness and A takes it over. The following revaluation was made:

(1) The goodwill of the firm is valued at `25,000.

(2) Depreciate Plant & Machinery by 7.5% and Inventories by 15%.

(3) Doubtful debts provision is raised against trade receivables at 5% and a discount reserve against trade payables at 2%.

Required:

Journalize the above transactions in the books of the firm and close the Partners' Accounts as on 1st January 2015. Give also the opening Balance Sheet of A.

Q-28 F, G and K were partners sharing profits and losses at the 2:2: 1. K wants to retire on 31.12.2015. Given below is the Balance Sheet of the partnership as well as other information:

Balance Sheet as on 31.12.2015

Liabilities	`	Assets	`
Capital A/cs	1,20,000	Sundry Fixed Assets	1,50,000
F	80,000	Inventories	50,000
G	60,000	Trade receivables	70,000
K	10,000	(Including Bills Receivable 20,000)	
Reserve	50,000	Bank	50,000
Trade payables	**3,20,000**		**3,20,000**

F and G agree to share profits and losses at the ratio of 3: 2 in future. Value of Goodwill is taken to be ` 50,000. Sundry Fixed Assets are revalued upward by `30,000 and Inventories by `10,000. Bills Receivable dishonoured `5,000 on 31.12.2015 but not recorded in the books. Dishonour of bill was due to insolvency of the customer. F and G agree to bring sufficient cash to discharge claim of K and to make their capital proportionate. Also they wanted to maintain `75,000 bank balance for working capital.

Required:

Pass necessary journal entries and draft the Balance Sheet of M/s F & G. Also prepare capital accounts of partners and draft the Balance Sheet of Ms/ F & G after K's retirement.

Q-29 A, B & C were in partnership sharing profits in the proportions of 5:4:3. The balance sheet of the firm as on 31st March, 2015 was as under:

Liabilities	`	**Assets**	`
Capital accounts:		Goodwill	40,000
A	1,35,930	Fixtures	8,200
B	95,120	Inventories	1,57,300
C	61,170	Trade receivables	93,500
Trade payables	41,690	Cash	34,910
	3,33,910		**3,33,910**

A had been su ffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 2015, the terms of which were as follows:

(i) The profit and loss account for the year ended 31st March, 2015 which showed a net profit of `48,000 was to be reopened. B was to be credited with `4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing was to be revised from 1st April, 2014, as 3:4:4.

(ii) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The fixtures were to be valued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

The valuations arising out of the above agreement were goodwill `56,800 and fixtures `10,980. B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate goodwill from the balance sheet, to retain the fixtures on the books at the revised value, and to increase the provision for doubtful debts to 6%.

Required:

Submit the journal entries necessary to give effect to the above arrangements and to draw up the capital account of the partners after carrying out all adjusting entries as stated above.

Q-30 K, L & M are partners sharing profits and losses in the ratio 5:3:2. Due to illness, L wanted to retire from the firm on 31.3.2015 and admit his son N in his place.

Balance Sheet of K, L and M as on 31.3.2015

Liabilities	`	`	Assets	`
Capital:			Goodwill	30,000
K	40,000		Furniture	20,000
L	60,000		Trade receivables	50,000
M	30,000	1,30,000	Inventory in Trade	50,000
Reserve		50,000	Cash and Bank balances	50,000
Trade payables		20,000		
		2,00,000		**2,00,000**

On retirement of L assets were revalued: Goodwill `50,000, furniture `10,000 and Inventory in trade `30,000.

50% of the amount due to L was paid off in cash and the balance was retained in the firm as capital of N. On admission of the new partner, goodwill has been written off. M is paid o his extra balance to make capital proportionate.

You are required to give:

(i) Necessary journal entries; (ii) balance sheet of M/s K, M and N as on 1.4.2015; (iii) capital accounts of partners.

Q-31 Dowell & Co. is a partnership firm with partners Mr. A, Mr. B and Mr., C, sharing profits and losses in the ratio of 10:6:4. The balance sheet of the firm as at 31st March, 2015 is as under:

Liabilities		`	Assets	`
Capitals :			Land	10,000
Mr. A	80,000		Buildings	2,00,000
Mr. B	20,000		Plant and Machinery	1,30,000
Mr. C	30,000	1,30,000	Furniture 43,000	
Reserves			Investments	12,000
(unappropriated profit)		20,000	Inventories	1,30,000
Long Term Debt		3,00,000	Trade receivables	1,39,000
Bank Overdraft		44,000		
Trade payables		1,70,000		
		6,64,000		**6,64,000**

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2015. For this purpose, the following adjustments are to be made:

(a) Goodwill is to be valued at `1 lakh but the same will not appear as an asset in the books of the reconstituted firm.

(b) Buildings and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at `15,000. Provision of 20% is to be made on Trade receivables to cover doubtful debts.

(c) In the reconstituted firm, the total capital will be `2 lakhs which will be contributed by

Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2:2:1.

(i) The surplus funds, if any, will be used for repaying bank overdraft.

(ii) The amount due to retiring partner shall be transferred to his loan account.

Required:

Prepare

(a) Revaluation account;

(b) Partners' capital accounts;

(c) Bank account; and

(d) Balance sheet of the reconstituted firm as on 1st April, 2015.

Q-32 M/s X and Co. is a partnership firm with the partners A, B and C sharing profits and losses in the ratio of 3:2:5. The balance sheet of the firm as on 30th June 2015, was as under:

Balance Sheet of X and Co. as on 30.06.2015

Liabilities	`	**Assets**	`
A's Capital A/c	1,04,000	Land	1,00,000
B's Capital A/c	76,000	Building	2,00,000
C's Capital A/c	1,40,000	Plant and Machinery	3,80,000
Long Term Loan	4,00,000	Investments	22,000
Bank Overdraft	44,000	Inventories	1,16,000
Trade payables	1,93,000	Trade receivables	1,39,000
	9,57,000		9,57,000

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st July, 2015. For this purpose, the following adjustments are to be made:

(a) Goodwill of the firm is to be valued at `2 lakhs due to the firm's locational advantage but the same will not appear as an asset in the books of the reconstituted firm.

(b) Buildings and plant and machinery are to be valued at 90% and 85% of the respective balance sheet values. Investments are to be taken over by the retiring partner at `25,000. Trade receivables are considered good only up to 90% of balance sheet figure. Balance be considered bad.

(c) In the reconstituted firm, the total capital will be `3 lakhs, which will be contributed by A, C and D in their new profit sharing ratio, which is 3:4:3.

(d) The amount due to retiring partner shall be transferred to his loan account.

Required:

Prepare Revaluation Account and Partners' Capital Accounts.

Q-33 Red, White and Black shared profits and losses in the ratio of 5:3:2. They took out a joint life Policy in 2011 for `50,000, a premium of `3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2011 nil; 2012 ` 900; 2013 ` 2,000; 2014 ` 3,600.

Black retires on 15th April, 2015.

Required

Prepare ledger accounts assuming no Joint Life Policy Account is maintained.

Q-34 Red, White and Black shared profits and losses in the ratio of 5: 3: 2. They took out a Joint Life Policy in 2007 for `50,000, a premium of ` 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2011 nil; 2012 ` 900: 2013 ` 2,000; 2014 ` 3,600. Black retires on 15th April, 2015.

Required:

Prepare ledger accounts assuming Joint Life Policy Account is maintained on surrender value basis.

Q-35 A, B and C are in partnership sharing profits and losses at the ratio of 5:3: 2. The balance sheet of the firm on 31.12.2015 was as follows:

Balance Sheet

Liabilities	`	**Assets**	`
Capital A/cs:		Sundry Fixed Assets	80,000
A	50,000	Inventories	50,000
B	40,000	Trade receivables	30,000
C	30,000	Joint Life Policy	20,000
Bank Loan	40,000	Bank	10,000
Trade payables	30,000		
	1,90,000		**1,90,000**

On 1.1.2016, A wants to retire, B and C agreed to continue at 2:1. Joint Life Policy was taken on 1.1.2010 for ` 1,00,000 and its surrender value as on 31.12.2015 was ` 25,000. For the purpose of A's retirement goodwill was raised for ` 1,00,000. Sundry Fixed Assets was revalued for ` 1,10,000. But B and C did not prefer to show such increase in assets in the Balance Sheet. Also they agreed to bring necessary cash to discharge 50% of the A's claim, to make the bank balance `25,000 and to make their capital proportionate.

Required:

Prepare necessary journal entries.

UNIT - 5

Q-36 The following was the Balance Sheet of Om & Co. in which X, Y, Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.2016. Mr. Z died on 31st December, 2016. His account has to be settled under the following terms.

Balance Sheet of Om & Co. as on 31.3.2016

Liabilities	`	`	**Assets**	`
Trade payables	20,000		Goodwill	30,000
Bank loan		50,000	Building	1,20,000
General reserve		30,000	Computers	80,000
Capital accounts:			Inventories	20,000
X	40,000		Trade receivables	20,000
Y	80,000		Cash at bank	20,000
Z	80,000	2,00,000	Investments	10,000
		3,00,000		**3,00,000**

Goodwill is to be calculated at the rate of two years purchase on the basis of average of three years' profits and losses. The profits and losses for the three years were detailed as below:

Year ending on	**profit/loss**
31.3.2016	30,000
31.3.2015	20,000
31.3.2014	(10,000) Loss

Profit for the period from 1.4.2016 to 31.12.2016 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31.3.2016 a car costing `40,000 was purchased on 1.4.2015 and debited to traveling expenses account on which depreciation is to be calculated at 20% p.a. This asset is to be brought into account

at the depreciated value.

Other values of assets were agreed as follows:

Inventory at `16,000, building at `1,40,000, computers at `50,000; investments at `6,000. Trade receivables were considered good.

Required:

(i) Calculate goodwill and Z's share in the profits of the firm for the period 1.4.2016 to 31.12.2016.

(ii) Prepare revaluation account assuming that other items of assets and liabilities remained the same.

(iii) Prepare partners' capital accounts and balance sheet of the firm Om & Co. as on 31.12.2016

Q-37 The partnership agreement of a firm consisting of three partners - A, B and C (who share profits in proportion of ½, ¼ and ¼ and whose xed capitals are `10,000; `6,000 and `4,000 respectively) provides as follows:

(a) That partners be allowed interest at 10 per cent per annum on their xed capitals, but no interest be allowed on undrawn profits or charged on drawings.

(b) `That upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.

(c) That an insurance policy of `10,000 each to be taken in individual names of each partner, the premium is to be charged against the profit of the firm.

(d) Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals etc. calculated upon 31st December following his death.

(e) That the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.

(f) That the partnership books be closed annually on 31st December.

A died on 30th September 2016, the amount standing to the credit of his current account on 31st December, 2015 was `450 and from that date to the date of death he had withdrawn `3,000 from the business.

An unrecorded liability of `2,000 was discovered on 30th September, 2016. It was decided to record it and be immediately paid off .

The trading result of the firm (before charging interest on capital) had been as follows: 2013 Profit `9,640; 2014 Profit `6,720; 2015 Loss `640; 2016 Profit `3,670.

Assuming the surrender value of the policy to be 20 percent of the sum assured.

Required

Prepare an account showing the amount due to A's legal representative as on 31st December, 2016.

Q-38 The following is the Balance Sheet of M/s. ABC Bros as at 31st December, 2015.

Balance Sheet as at 31st December, 2015

Liabilities	`	**Assets**		`
Capital		Machinery		5,000
A	4,100	Furniture		2,800
B	4,100	Fixture		2,100
C	4,500	Cash		1,500
General Reserve	1,500	Inventories		950
Trade payables	2,350	Trade receivables	4,500	
		Less: Provision for Doubtful debts	300	4,200
	16,550			**16,550**

C died on 3rd January, 2016 and the following agreement was to be put into effect.

(a) Assets were to be revalued: Machinery to ` 5,850; Furniture to ` 2,300; Inventory to ` 750.

(b) Goodwill was valued at ` 3,000 and was to be credited with his share, without using a Goodwill Account

(c) ` 1,000 was to be paid away to the executors of the dead partner on 5th January, 2016.

Required to show:

(i) The Journal Entry for Goodwill adjustment.

(ii) The Revaluation Account and Capital Accounts of the partners.

(iii) Which account would be debited and which account credited if the provision for doubtful debts in the Balance Sheet was to be found unnecessary to maintain at the death of C.

Q-39 B and N were partners. The partnership deed provides inter alia:

(i) That the accounts be balanced on 31st December each year.

(ii) That the profits be divided as follows:
B: One-half; N: One-third; and carried to Reserve Account: One-sixth

(iii) That in the event of death of a partner, his executor will be entitled to the following:

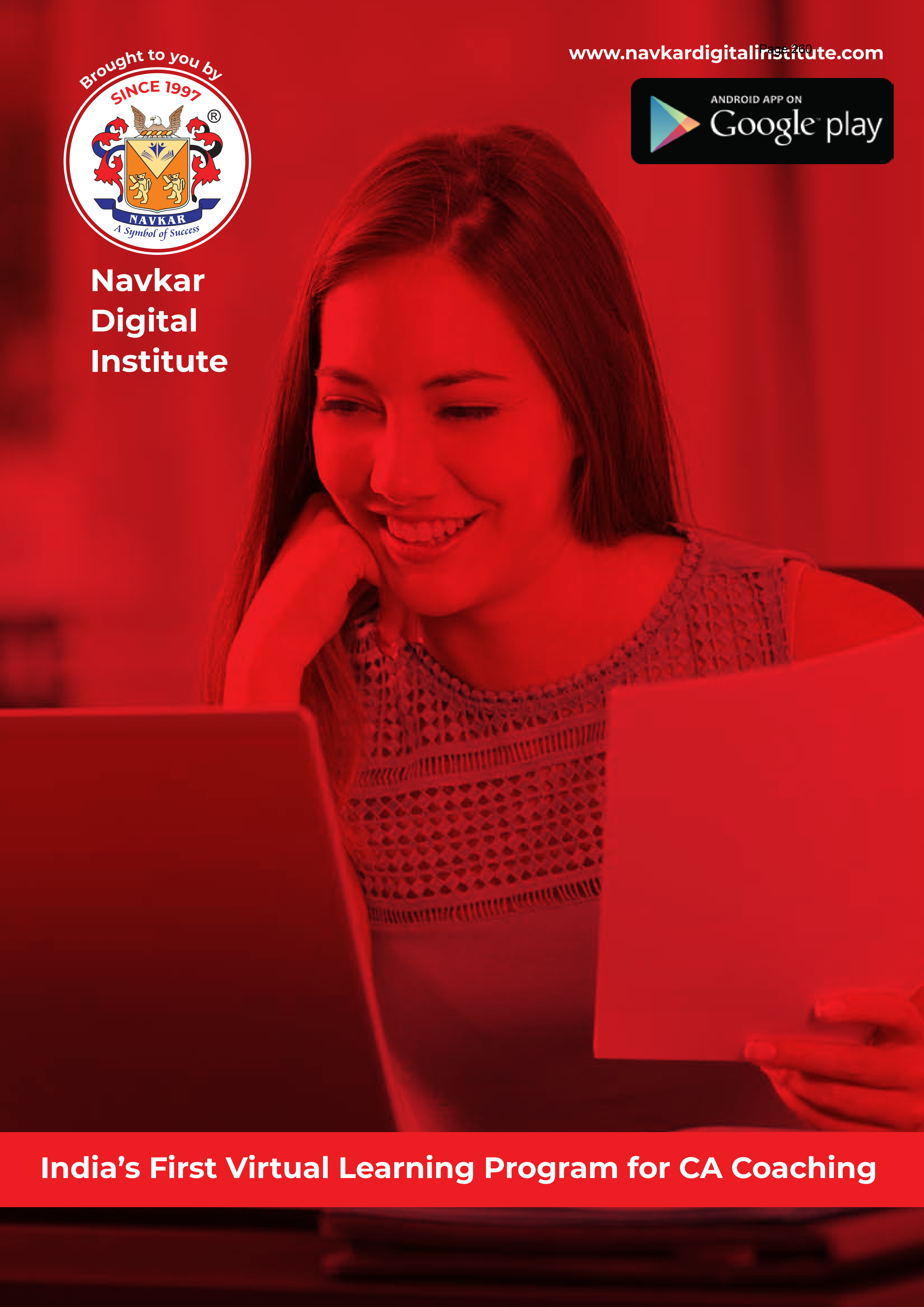
(a) the capital to his credit at the date of death; (b) his proportion of profit to date of death based on the average profits of the last three completed years; (c) his share of goodwill based on three years' purchases of the average profits for the three preceding completed years.

Trial Balance on 31st December, 2015

Particulars	**Dr. (`)**	**Cr. (`)**
B's Capital		90,000
N's Capital		60,000
Reserve		30,000
Bills receivable	50,000	
Investments	40,000	
Cash	1,10,000	
Trade payables		20,000
Total	2,00,000	2,00,000

The profits for the three years were 2013: ` 42,000; 2014: ` 39,000 and 2015: ` 45,000. N died on 1st May, 2016. Show the calculation of N (i) Share of Prots; (ii) Share of Goodwill; (iii) Draw up N's Executors Account as would appear in the firm's ledger transferring the amount to the Loan Account.

❑


Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar Digital Institute
www.navkardigitalinstitute.com
ANDROID APP ON
Google play
India's First Virtual Learning Program for CA Coaching

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Financial Statements of Not-for-profit Organisations

SINCE 1997

NAVKAR
A Symbol of Success

NAVKAR INSTITUTE® | We believe in the best

CHAPTER-9
FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANIZATIONS

INTRODUCTION

A non profit organization is a legal and accounting entity that is operated for the benefit of the society as a whole, rather than for the benefit of a sole proprietor or a group of partners or shareholders.

Non-profit making organisations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipts and Payments Account and Income and Expenditure Account to show periodic performance and Balance Sheet to show financial position at the end of the period.

Features:

- It is the summary of the cash and bank transactions like cash book, all the receipts (**capital or revenue**) are debited, similarly, all the expenditures (**capital or revenue**) are credited.
- It starts with opening cash and bank balances and also ends with their closing balances.
- This account is usually not a part of the double entry system.
- It includes all cash and bank receipts and payments, whether they are related to current, past or future periods.
- Surplus or deficit for an accounting period cannot be ascertained from this account, since, it shows only the Cash/Bank position and excludes all non cash items.

Limitations of Receipts and Payments Account

- The increase in the cash and bank balances at the end of the year, as compared to those in beginning, does not truly represent the surplus for the year since it does not take into account the cost of construction of the pavilion, which is in excess of the donation received, the outstanding subscription or those which were collected in advance, etc. Ordinarily one must ascertain whether for a current year income is sufficient to meet the current expenses.
- The Receipts and Payments Account includes items relating to all periods or of all types, it does not serve the purpose mentioned above. Due to these drawbacks, the preparation of Receipts and Payments Account is not favoured except where the activities of the organization, the results of which are to be exhibited, are simple and modest, involve no carry over from one period to the next and it has no assets, apart from cash balance and no liabilities.

INCOME AND EXPENDITURE ACCOUNT

Features:

- It is a **revenue account** prepared at the end of the accounting period for finding out the surplus or deficit of that period.
- It is prepared by matching expenses against the revenue of that period concerned.
- Both cash and non-cash items, such as depreciation, are taken into consideration.
- All capital expenditures and incomes are excluded.
- Only current years' income and expenses are considered.

1 Main Sources of Income

- These are subscriptions, ordinary donations, membership fees or entrances fees (if the amount is normal or provided according to by-laws of the society), recurring grants from local authorities and income from investments, etc. Any amount raised for a special activity, e.g. on sale of match tickets, is deducted from the expenditure of that activity and net amount is shown in the income and expenditure account.
- Any receipt of capital nature shall not be shown as income but will be credited to the Capital Fund or special purpose fund e.g. "Building Fund' or if the receipts is on account of sale of a fixed asset, it shall be credited to the asset account.

Examples:

Hospital - medicines and cost of tests and investigations.

Sports Club - sports materials, tournament expenses, etc.

Drama Club - expenses of staging plays, rent of the hall, payment to artists, etc.

Educational Societies - award of scholarships, organisation of seminars, etc.

Library Societies - newspapers and magazines.

Any expenditure for acquisition of a fixed asset will be capitalised, though the amount of annual depreciation shall be debited to revenue expenditure.

2 Distinction between Receipts and Payments Account and Income and Expenditure Account

- Not for profit organizations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period. The distinguishing features of both the accounts can be summarized as:
- Receipt and Payment Account is an elementary form of account consisting of a classified summary of cash receipts and payments over a certain period together with cash balances at the beginning and close of the period.
- The receipts are entered on the left hand side and payments on the right hand side i.e. same sides as those on which they appear in cash book.
- All the receipts and payments whether of revenue or capital nature are included in this account. The balance of the account at the end of a period represents the difference between the amount of cash received and paid up. It is always in debit since it is made up of cash in hand and at bank.
- Income and Expenditure Account **resembles a Profit and Loss Account** and serves the same function in respect of a non-profit making concern as the last mentioned account does for a firm, carrying on business or trade.

- Income and Expenditure Account is drawn up in the same form as the Profit and Loss Account. Expenditure of revenue nature is shown on the debit side, income and gains of revenue nature are shown on the credit side.
- Income and Expenditure Account contains all the items of income and expenditure relevant to the period of account, whether received or paid out as well as that which have fallen due for recovery or payment. Capital Receipts, prepayments of income and capital expenditures, prepaid expenses are excluded. It does not start with any opening balance. The closing balance represents the amount by which the income exceeds the expenditure only or vice versa.

3 Preparation of Income and Expenditure Account from Receipts and Payments Account

The procedure which should be followed.

(i) Compute the opening balance of the Accumulated Fund, or Capital Fund of the Institution with the help of making opening balance sheet. It will be excess of the total value of the assets over that of the liabilities at the commencement of the period.

(ii) Open ledger accounts in respect of various items of income and expenditure (e.g. subscription, rents, printing, purchase of sports materials etc.) in which accruals or outstanding at the beginning or at the end of period have to be adjusted. Enter therein any accrual or outstanding at the end of the period as well as amounts which relate to an earlier period or the following period. The balance of the ledger accounts therefore will represent the amounts or income or expenditure pertaining to the period. These should be transferred to the Income and Expenditure Account.

(iii) Post from the debit of the Receipts & Payments Account to the credit of the Income and Expenditure Account other items of income wherein accruals and outstanding amount have to be adjusted. Likewise, post item of expenses in which no adjustment is to be made directly to debit of income and Expenditure Account.

(iv) Transfer the balance of Income and Expenditure Account to the Accumulated Fund/Capital Fund Account.

(v) Post the receipts and payments of capital nature from the Receipts and Payments Account to the appropriate asset or liability account for incorporating in the Balance Sheet. If a part or whole of an asset has been sold, the capital profit/loss, if any, is credited / debited in the Income and Expenditure Account. The balance of Income and Expenditure Account should be transferred to the Accumulated Fund/Capital Fund Account.

(vi) Prepare a Balance Sheet by including therein all the balances left over after transfers to the Income and Expenditure Account have been made.

4. BALANCE SHEET

- A Balance Sheet is the **statement** of assets and liabilities of an accounting unit at a given date.
- It is generally prepared at the end of an accounting period after the Income and Expenditure Account has been prepared.
- It is classified summary of the ledger balances left over, after accounts of all the revenue items have been closed off by transfer to the Income and Expenditure Account.
- In not for profit organizations, the excess of total assets over total outside liabilities is known as **Capital Fund**.
- The Capital fund represents the amount contributed by members, legacies, special donations, entrance fees and accumulated surplus over the years. If however, members have not contributed any amount, the name should be Accumulated Fund. The surplus or deficit, if any, on the year's

working as disclosed by the Income and Expenditure Account is shown either as an addition to or deduction from the Capital / Accumulated Fund brought forward from the previous period.

Accounting Treatment of Some Special Items

1 Donations:

- These may have been raised either for meeting some revenue or capital expenditure;
- those intended for the first mentioned purpose are credited directly to the Income and Expenditure Account .
- If the donors have declared their specific intention, are credited to special fund account and in the absence thereof, to the Capital Fund Account. If any investments are purchased out of a special fund or an asset is acquired therefrom, these are disclosed separately.
- Any income received from such investments or any donations collected for a special purpose are credited to an account indicating the purpose and correspondingly the expenditure incurred in carrying out the purpose of the fund is debited to this account.
- On no account any such expense is charged to the Income and Expenditure Account. **The term "Fund" is strictly applicable to the amounts collected for a special purpose when these are invested, e.g. Scholarship Fund, Prize Fund etc.** In other cases, when the amounts collected are not invested in securities or assets distinguishable from those belonging to the institution, the word "Account" is more appropriate e.g. Building Account, Tournament Account etc.

2 Entrance and Admission Fees:

- Such fees which are payable by a member on admission to club or society are normally considered capital receipts and credited to Capital Fund.
- This is because these do not give rise to any special obligation towards the member who is entitled to the same privileges as others who have paid only their annual subscription.
- Nevertheless, where the amount is small, meant to cover expenses concerning admission, or the rules of the society provided that such fees could be treated as income of the society, these amounts may be included in the Income and Expenditure Account. The treatment depends upon the requirement of question. If the question is silent then always take it to be capital receipt.

3 Subscription:

- Subscriptions being an income should be allocated over the period of their accrual.
- If some subscriptions have been received in advance, their amount is also indicated. In such cases, it is always desirable to set up a Subscription Account for determining the amount of subscription pertaining for the period for which accounts are being prepared.

4 Life Membership Fee: Fees received for life membership is a **capital receipt** as it is of non-recurring nature. It is **directly added to capital fund** or general fund.

For adjusting lump sum subscription collected from the life members, one of the following methods can be adopted:

(1) The entire amount may be carried forward in a special account until the member dies, when the same may be transferred to the credit of the Accumulated Fund.

(2) An amount equal to the normal annual subscription may be transferred every year to the Income and Expenditure Account and balance carried forward till it is exhausted. If, however, the life member dies before the whole of the amount paid by him has been transferred in this way, the balance should be transferred to the Accumulated Fund on the date of his death.

(3) An amount, calculated according to the age and average life of the member, may annually be transferred to the credit of Income and Expenditure Account.

Other concepts

Treatment of Important Items in Not For Profit Organization

1. **Donation:** it is **gift** in **cash** or **kind** from some person. It may be of two types:
   - **(a) Specific Donation:** It is received for certain specific purpose like Building Donation, Library Books donation etc. It should be capitalized and shown on the liabilities side of the balance sheet.
   - **(b) General Donation:** It is not received for any specific purpose and shown on the credit side of Income and Expenditure Account.
2. **Entrance Fees:** It may also be known as admission fees. **Entrance Fees should be capitalized** and added to the capital fund for all organization. If the question gives any specific treatment of Entrance fees, then it should be followed accordingly.
3. **Legacy:** It is an amount received by an organization as per the **will** of the person after the death of the person. It should be capitalized and shown on the liabilities side of the balance sheet by adding to the Capital Fund.
4. **Life Membership Fees:** It should **be capitalized** and shown on the liabilities side of the balance sheet. If the question gives any specific treatment of Life membership Fees, then it should be followed accordingly.
5. **Endowment Fund Donation:** It is a donation received and **only income from that donation is to be used for certain specific purpose**. In such cases income relating to special funds should be added to these funds on the liabilities side of the B/S. All the expenses should be deducted from that fund on the liabilities side of the Balance Sheet.
6. **Treatment of Sale of Old Newspaper and Periodicals:** The amount received on such sale is shown as Income on the credit side of income and expenditure account.
7. **Sale of old Fixed Assets:** The Sale proceeds of old Fixed Assets are treated as **capital receipts**. The profit or loss on sale of fixed asset is shown in the Income and Expenditure A/c
8. **Honorarium:** It is paid to someone for receiving any services from person who are **not the employees** of the Not for Profit Organisation.

EDUCATIONAL INSTITUTIONS

Salient Features

The basic tenets pre-suppose, that part of the expenses of the educational institutions are met from the funds raised by the educational institutions themselves, either from donations, or from charities, collected from benevolent citizens in the country.

The State Governments through grant-in-aid-code have evolved different patterns of giving assistance to the educational institutions. There is, as such, no uniformity in the giving of assistance to the educational institutions in the form of grants.

All the educational institutions follow financial year as their accounting year.

1 Sources of Finance for Running the Educational Institution

There are three main sources through which amounts are collected by the educational institutions. These are:

(1) Donation from Public;

(2) Fees in the form of annual tuition fees, term fees, admission fees, laboratory fee etc., and

(3) Grants received from the Government.

The Government grants are of four kinds namely Maintenance Grant, Equipment grant, Building Grant and such other grants as may be sanctioned by the Government from time to time.

2 Specific items

(a) Donation from Public : These are received either for recurring or non-recurring purposes. Donations are received either in cash or in kind. The 'in kind' donations are in the form of land and building, shares and securities, utensils, furniture and fixtures and the like, generally with a desire to perpetuate the memory of a distinguished member of the family of the donor.

(b) Capitation fees or admission fees : Amounts are collected from parents/guardians of the students who seek admission in the educational institution. These are either in the form of capitation fees or admission fees and are generally collected by the Parent Body which runs the institution. In recent times, such collections have been a matter of severe attack and ban.

(c) Laboratory and Library deposit : These are generally collected by schools and colleges and they remain with the institution till the student finally leaves it.

The School Code prescribes the rates of tuition and other fees, to be charged from the students.

(d) Use of Term Fees : A separate account of receipts and expenditures shall be maintained and surplus carried over to the next year. The following are main items on which term fee can be used:

(1) Medical Inspection.

(2) School Magazine-manuscript and/or printing.

(3) Examination expenses i.e. printing, of question papers and supply of answer books if there is sufficient balance.

(4) Contribution to athletic and cultural associations, connected with school activities.

(5) School functions and festivals.

(6) Inter-class and Inter-school tournaments.

(7) Sports and Games-major and minor.

(8) Newspapers and magazines.

(9) Extra-curricular excursion and visits.

(10) School competition such as elocution competition etc.

(11) Scouting and Guiding.

(12) School Band.

(13) Social and Cultural activities and equipment required for the same.

(14) Vocational Guidance in general.

(15) Prizes for Co-curricular activities.

(16) Any other extra-curricular or co-curricular activities.

(17) Maintenance of playground.

(18) Purchase of books for Pupils Library.

(19) Drawing and Craft material.

(20) Audio-Visual Education.

(21) Curricular visits and excursions.

(22) Equipment for Physical education

(e) Recurring grants : Recurring grants in the form of Maintenance Grants are received in instalments spread out throughout the year.

(f) Use of grant-in-aid : The School Code provides a detailed list of items of expenditure which are admissible for grant-in-aid:

(1) Staff salaries and allowances

(2) Leave Allowance.

(3) Bad Climate Allowance.

(4) Water Allowance.

(5) Leave Salary.

(6) Expenditure on training of teachers.

(7) Pension and Gratuity as may be applicable.

(8) Expenditure on the appointment of Librarian.

(9) Rent, Taxes and Insurance.

(10) Other Contingencies: expenditure of printing and stationery, conveyance expenditure, expenditure on purchase of books and furniture equipment.

(11) Current repairs.

(12) Miscellaneous Expenses: e.g. School Garden, Physical Education.

(13) Prizes.

(14) Expenditure on co-operative stores.

(15) Registration fee paid to the Board for recognition.

(16) Maintenance of Tiffin Rooms.

(17) Bonus to Teachers.

(18) Electrical charges.

(19) Telephone Charges.

(20) Expenditure in connection with Conferences.

(21) Subscription to educational Association etc.

(22) Medical charges.

(23) Audit fees of the auditors in accordance with prescribed scale.

(24) Sales-tax and General tax on purchase of the school requirements.

(25) Payments for merit scholarships.

CLASS WORK

Q-1 During the year ended 31st March, 2016, Sachin Cricket Club received subscriptions as follows:

	`
For year ending 31st March, 2015	12,000
For year ending 31st March, 2016	6,15,000
For year ending 31st March, 2017	18,000
Total	6,45,000

There are 500 members and annual subscription is ` 1,500 per member.

On 31st March, 2016, a sum of ` 15,000 was still in arrears for subscriptions for the year ended 31st March, 2015.

Ascertain the amount of subscriptions that will appear on the credit side of Income and Expenditure Account for the year ended 31st March, 2016. Also show how the items would appear in the Balance Sheet as on 31st March, 2015 and the Balance Sheet as on 31st March, 2017.

Q-2 Summary of receipts and payments of Bombay Medical Aid society for the year ended 31.12.2016 are as follows:

Opening cash balance in hand ` 8,000, subscription ` 50,000, donation ` 15,000 (raised for meeting revenue expenditure), interest on investments @ 9% p.a. ` 9000, payments for medicine supply ` 30,000 Honorarium to doctor ` 10,000, salaries ` 28,000, sundry expenses ` 1,000, equipment purchase ` 15,000, charity show expenses ` 1,500, charity show collections ` 12,500.

Additional information:

	1.1.2016	31.12.2016
Subscription due	1,500	2,200
Subscription received in advance	1,200	700
Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

You are required to prepare receipts and payments account and income and expenditure account for the year ended 31.12.2016 and balance sheet as on 31.12.2016.

Q-3 The receipts and payments account and the income and expenditure account of a Club for the year ended 31st December, 2016 were as follows:

Receipts and Payments Account

Receipts	`	`	***Payments***	`
To Balance b/d		2,500	By Books purchased	1,000
To Subscriptions:			By Printing and Stationery	200
2015	600		By Salary	1,500
2016	<u>4,300</u>	4,900	By Advertisement	200
To Interest		500	By Electric Charge	400

To Donation for special fund		300	By Balance c/d	7,350
To Rent:				
2015	150			
2016	300	450		
To Govt. Grants		2,000		
		10,650		**10,650**

Income and Expenditure Account

Expenditure	`	***Income***	`
To Salary	2,800	By Interest	400
To Tent Hire	200	By Subscription	4,800
To Electric charges	400	By Rent	2,300
To Depreciation on Building	750	By Govt. Grant	2,000
To Printing and Stationery	200		
To Advertisement	150		
To Surplus	5,000		
	9,500		9,500

The club's assets as on 1st January 2016 were :

Building ` 15,000; Books `10,000

Furniture `4,000; Investments `10,000

Liabilities as on that date were `50 for advertisement and `100 for salary.

Required

Prepare the balance sheet of the club on 31st December, 2015 and 31st December, 2016

Q-4 From the following data, prepare an Income and Expenditure Account for the year ended 31st December, 2016, and Balance Sheet as at that date of the Mayura Hospital.

Receipts and Payments Account for the year ended 31 December, 2016

	Receipts	`	`		**Payments**	`	`
To	Balance b/d			By	Salaries :		
	Cash	400			(`3,600 for 2015)		15,600
	Bank	2,600	3,000	By	Hospital Equipment		8,500
To	Subscriptions :			By	Furniture purchased		3,000
	For 2015		2,550	By	Additions to Building		25,000
	For 2016		12,250	By	Printing & Stationery		1,200
	For 2017		1,200				
To	Government Grant :			By	Diet expenses		7,800
	For building		40,000	By	Rent and rates		
	For maintenance		10,000		(`150 for 2017)		1,000
	Fees from sundry			By	Electricity and water		

	Patients	*2,400*		*charges*		*1,200*
To	Donations (not to be capitalised)	4,000	By	office expenses		1,000
			By	Investments		10,000
To	Net collections from benefit shows	3,000	By	Balances :		
				Cash	700	
				Bank	3,400	4,100
		78,400				**78,400**

Additional information :

	`
Value of building under construction as on 31.12.2016	70,000
Value of hospital equipment on 31.12.2016	25,500
Building Fund as on 1.1. 2016	40,000
Subscriptions in arrears as on 31.12.2015	3,250

Investments in 8% Govt. securities were made on 1st July, 2016.

Q-5 The following is the Receipts and Payments Account of Lion Club for the year ended 31st March, 2016.

Receipts	`	**Payments**	`
Opening balance:		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and stationary	70,000
Subscription received	2,02,750	Postage	40,000
Entrance donation	1,00,000	Telephones and telex	52,000
Interest received	58,000	Repairs and maintenance	48,000
Sale of assets	8,000	Glass and table linen	12,000
Miscellaneous income	9,000	Crockery and cutlery	14,000
Receipts at		Garden upkeep	8,000
Coffee room	10,70,000	Membership fees	4,000
Soft drinks	5,10,000	Insurance	5,000
Swimming pool	80,000	Electricity	28,000
Tennis court	1,02,000	Closing balance:	
		Cash	8,000
		Bank	2,24,600
	21,53,600		**21,53,600**

The assets and liabilities as on 1.4.2015 were as follows :

Fixed assets (net)	5,00,000
Stock	3,80,000
Investment in 12% Government securities	5,00,000
Outstanding subscription	12,000

Prepaid insurance	1,000
Sundry creditors	1,12,000
Subscription received in advance	15,000
Entrance donation received pending membership	1,00,000
Gratuity fund	1,50,000

The following adjustments are to be made while drawing up the accounts:

(i) Subscription received in advance as on 31st March, 2016 was ` 18,000.

(ii) Outstanding subscription as on 31st March, 2016 was ` 7,000.

(iii) Outstanding expenses are salaries ` 8,000 and electricity ` 15,000.

(iv) 50% of the entrance donation was to be capitalized. There was no pending membership as on 31st March, 2016.

(v) The cost of assets sold net as on 1.4.2015 was ` 10,000.

(vi) Depreciation is to be provided at the rate of 10% on assets.

(vii) A sum of ` 20,000 received in October 2015 as entrance donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 3.6.2016.

(viii) Purchases made during the year amounted ` 15,00,000.

(ix) The value of closing stock was ` 2,10,000.

(x) The club as a matter of policy, charges off to income and expenditure account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2016 and the Balance Sheet as on 31st March, 2016 along with necessary workings.

Q-6 From the following balances and particulars of Republic College, prepare Income & Expenditure Account for the year ended March, 2016 and a Balance Sheet as on the date :

Seminars & Conference Receipts		4,80,000
Consultancy Receipts		1,28,000
Security Deposit - Students		1,50,000
Capital Fund		16,06,000
Research Fund		8,00,000
Building Fund		25,00,000
Provident Fund		5,10,000
Tuition Fee Received		8,00,000
Government Grants		5,00,000
Donations		50,000
Interest & Dividends on Investments		1,85,000
Hostel Room Rent		1,75,000
Mess Receipts (Net)		2,00,000
College Stores-Sales		7,50,000
Outstanding expenses		2,25,000
Stock of-stores and Supplies (opening)	3,00,000	

Purchases - Stores & Supplies	8,00,000	
Salaries - Teaching	8,50,000	
Research	1,20,000	
Scholarships	80,000	
Students Welfare expenses	38,000	
Repairs & Maintenance	1,12,000	
Games & Sports Expenses	50,000	
Misc. Expenses	65,000	
Research Fund Investments	8,00,000	
Other Investments	18,50,000	
Provident Fund Investment	5,10,000	
Seminar & Conference Expenses	4,50,000	
Consultancy Expenses	28,000	
Land	1,00,000	
Building	16,00,000	
Plant and Machinery	8,50,000	
Furniture and Fittings	6,00,000	
Motor Vehicle	1,80,000	
Provision for Depreciation:		
Building		4,80,000
Plant & Equipment		5,10,000
Furniture & Fittings		3,36,000
Cash at Bank	6,42,000	
Library	3,60,000	
	1,03,85,000	1,03,85,000

Adjustments:

(1) Materials & Supplies consumed: (From college stores)

Teaching	50,000
Research	1,50,000
Students Welfare	75,000
Games or Sports	25,000

(2) Tuition fee receivable from Government for backward class Scholars 80,000

(3) Stores selling prices are xed to give a net profit of 10% on selling price

(4) Depreciation is provided on straight line basis at the following rates:

(1)	Building	5%
(2)	Plant & Equipment	10%
(3)	Furniture & Fixtures	10%
(4)	Motor Vehicle	20%

Q-7 *The Income and Expenditure Account of the Youth Club for the Year 2016 is as ws:*

	Expenditure	`	**Income**	`
To	Salaries	4,750	By Subscription	7,500
To	General Expenses	500	By Entrance Fees	250
To	Audit Fee	250	By Contribution for	
To	Secretary's Honorarium	1,000	annual dinner	1,000
To	Stationery & Printing	450	By Annual Sport meet	
To	Annual Dinner Expenses	1,500	receipts	750 To
	Interest & Bank Charges	150		
To	Depreciation	300		
To	Surplus	600		
		9,500		**9,500**

This account had been prepared after the following adjustments:

	`
Subscription outstanding at the end of 2015	600
Subscription received in Advance on 31st December, 2015	450
Subscription received in advance on 31st December, 2016	270
Subscription outstanding on 31st December, 2016	*750*

Salaries Outstanding at the beginning and the end of 2016 were respectively ` 400 and `450. General Expenses include insurance prepaid to the extent of `60. Audit fee for 2016 is as yet unpaid. During 2016 audit fee for 2015 was paid amounting to `200.

The Club owned a freehold lease of ground valued at `10,000. The club had sports equipment on 1st January, 2016 valued at ` 2,600. At the end of the year, after depreciation, this equipment amounted to `2,700. In 2015, the Club has raised a bank loan of ` 2,000. This was outstanding throughout 2016. On 31st December, 2016 cash in hand amounted to `1,600.

Required

Prepare the Receipts and Payments Account for 2016 and Balance Sheet as at the end of the year.

MULTIPLE CHOICE QUESTIONS

1. Scholarship granted to students out of specific funds provided by Government will be debited to

(a) Income and Expenditure Account.

(b) Receipts and payments Account.

(c) Funds.

(d) None of the three.

2. In case of NPO, excess of total assets over liabilities is known as

(a) Profits. (b) Surplus (c) Capital Fund. (d) Accumulated Fund.

3. General donations and legacies are credited to

(a) Receipts and Payments Account. (b) Income and Expenditure Account.

(c) Capital Fund. (d) Fund Account.

4. Interest on prize funds is

(a) Credited to Income and Expenditure Account.

(b) Credited to Receipts and Payments Account.

(c) Capital Fund.

(d) Added to prize fund.

5. Special aids are

(a) Treated as capital receipts. (b) Treated as revenue receipts.

(c) Added to Capital Fund. (d) Both (a) and (c).

HOME WORK

Q-1 During 2016, subscription received in cash is ₹42,000. It includes ₹1,600 for 2015 and ₹600 for 2017. Also ₹3,000 has still to be received for 2016.

Required

Calculate the amount to be credited to Income and Expenditure Account in respect of subscription.

Ans. Amount to be credited to Income & Expenditure A/C in respect of subscription is ₹ 42,800

Subscription outstanding A/C closing Bal. ₹ 3,000

Subscription Received in Advance A/C Closing Bal. ₹ 600

Q-2 Suppose salaries paid during 2016 were ₹23,000. The following further information is available:

					₹
	Salaries unpaid on	31st March,		2015	1,400
"	pre-paid on	"	"	2015	400
"	un-paid on	"	"	2016	1,800
"	pre-paid	"	"	2016	600

Required

Calculate the amount to be debited to Income and expenditure account in respect of salaries and also show necessary ledger accounts.

Ans. Amount to be debited to Income & Expenditure A/C in respect of salaries - `23,200

Q-3 The receipts and payments for the Swaraj Club for the year ended March 31, 2016 were: Entrance fees `300; Membership Fees `3,000; Donation for Club Pavilion `10,000, Foodstu sales `1,200; Salaries and Wages `1,200 Purchase of Foodstu ` 800; Construction of Club Pavilion `11,000; General Expenses `600; Rent and Taxes `400; Bank Charges `160.

Cash in hand–April. 1st `200, March. 31st `350

Cash in Bank–April. 1st `400; March. 31st `590

You are required to prepare Receipts and Payment Account.

Ans. Receipts & Payments A/CClosing Balance

Cash in Hand -	` 350
Cash in Bank -	` 590
	` 940

Q-4 The following was the Receipts and Payments Account of Exe Club for the year ended March. 31, 2016

All the figures in thousands

Receipts	`	**Payments**	`
Cash in hand	100	Groundsman's Fee	750
Balance at Bank as per Pass Book:		Moving Machine	1,500
Deposit Account	2,230	Rent of Ground	250
Current Account	600	Cost of Teas	250
Bank Interest	30	Fares	400
Donations and Subscriptions	2,600	Printing & Office Expenses	280
Receipts from teas	300	Repairs to Equipment	500
Contribution to fares	100	Honorarium to Secretary and	
Sale of Equipment	80	Treasurer of 2015	400
Net proceeds of Variety		Balance at Bank as per Pass Book:	
Entertainment	780	Deposit Account	3,090
Donation for forth coming		Current Account	150
Tournament	1,000	Cash in hand	250
	7,820		**7,820**

You are given the following additional information:

	April, 1, 2015	**March, 31, 201**
	`	`
Subscription due	150	100
Amount due for printing etc.	100	80
Cheques unpresented being payment for repairs	300	260
Estimated value of machinery and equipment	800	1,750

Interest not yet entered in the Pass book	20
Bonus to Groundsman o/s.	*200*

For the year ended March. 31, 2016, the honorarium to the Secretary and Treasurer are to be increased by a total of `200.

Required

Prepare the Income and Expenditure Account for period ending 31-03-2016 and the relevant Balance Sheet.

Ans. Surplus in Income & Expenditure A/C- ` 40,000

Total Balance sheet as on 31.3.2016 - ` 52,10,000

Q-5 From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account and Subscription Account for the year ended 31st March, 2016:

Income & Expenditure Account for the year 2015-16

		`		`
To	Upkeep of Ground	10,000	By Subscriptions	17,320
To	Printing	1,000	By Sale of Newspapers (Old)	260
To	Salaries	11,000	By Lectures	1,500
To	Depreciation on Furniture	1,000	By Entrance Fee	1,300
To	Rent	600	By Misc. Income	400
			By Deficit	2,820
		23,600		**23,600**

Balance Sheet as at 31st March, 2016

Liabilities		`	*Assets*	`
Subscription in Advance			Furniture	9,000
(2016-17)		100	Ground and Building	47,000
Prize Fund :			Prize Fund Investment	20,000
Opening Balance	25,000		Cash in Hand	2,300
Add : Interest	1,000		Subscription (outstanding) (2015-16)	700
	26,000			
Less : Prizes	(2,000)	24,000		
General Fund :				
Opening Balance	56,420			
Less : Deficit	(2,820)			
	53,600			
Add : Entrance Fee	1,300	54,900		
		79,000		**79,000**

The following adjustments have been made in the above accounts:

(1) Upkeep of ground ` 600 and Printing ` 240 relating to 2014-2015 were paid in 2015-16.

(2) One-half of entrance fee has been capitalised by transfer to General Fund.

(3) Subscription outstanding in 2014-15 was ` 800 and for 2015-16 ` 700.

(4) Subscription received in advance in 2014-15 was `200 and in 2015-16 for 2016-17 ` 100.

Ans. Receipts & payments A/C Opening Balance - ` 4660 Subscription Received - ` 17,320

Q-6 The Sportwriters Club gives the following Receipts and Payments Account for the year ended March 31, 2016:

Receipts and Payments Account

	Receipts	`		**Payments**	`
To	Balance b/d	4,820	By	Salaries	12,000
To	Subscriptions	28,600	By	Rent and electricity	7,220
To	Miscellaneous income	700	By	Library books	1,000
To	Interest on Fixed deposit	2,000	By	Magazines and newspapers	2,172
			By	Sundry expenses	10,278
			By	Sports equipments	1,000
			By	Balance c/d	2,450
		36,120			**36,120**

Figures of other assets and liabilities are furnished as follows:

	As at March 31	
	`	`
	2015	**2016**
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines and newspapers	226	340
Fixed Deposit (10%) with bank	20,000	20,000
Interest accrued thereon	500	500
Subscription receivable	1,263	1,575
Prepaid expenses	417	620
Furniture	9,600	
Sports equipments	7,200	
Library books	5,000	

The closing values of furniture and sports equipments are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The Club's library books are revalued at the end of every year and the value at the end of March 31, 2016 was ` 5,250.

Required

From the above information you are required to prepare:

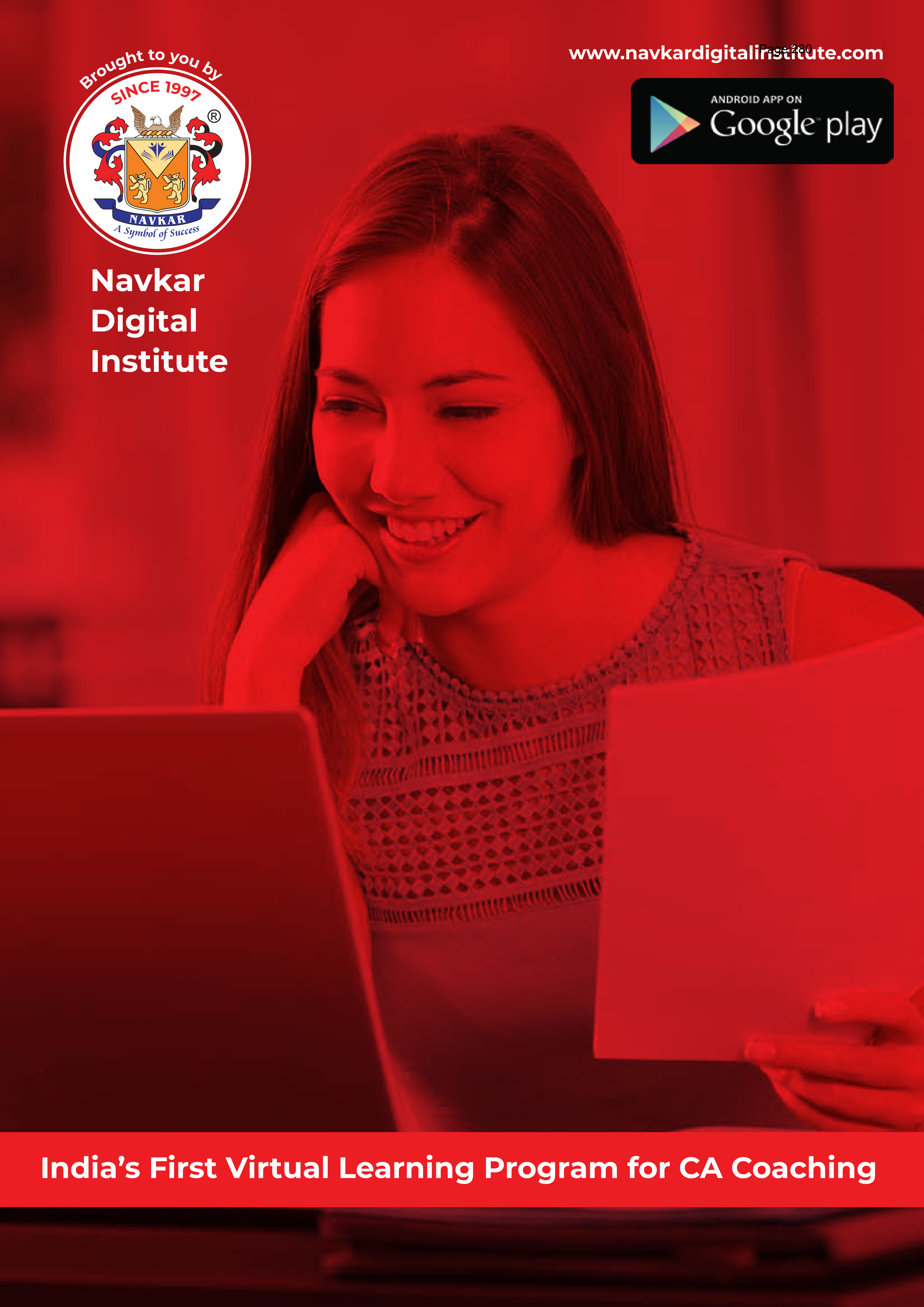
(a) The Club's Balance Sheet as at March 31, 2015;

(b) The Club's Income and Expenditure Account for the year ended March 31, 2016.

(c) The Club's Closing Balance Sheet as at March 31, 2016.

Ans.	Total of Balance sheet as on 31.3.2015 -	` 48,800
	Capital Fund as on 31.3.2015 -	` 47,000
	Total of Balancesheet as on 31.3.2016 -	` 45,595
	Deficit in Income & Exp. A/C -	` 2,888

❑


Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar
Digital
Institute
www.navkardigitalinstitute.com
ANDROID APP ON
Google play
India's First Virtual Learning Program for CA Coaching

www.navkardigitalinstitute.com

CA FOUNDATION

Principles & Practice of Accounting

Introduction to Company Accounts

SINCE 1997

NAVKAR

A Symbol of Success

NAVKAR INSTITUTE®

We believe in the best

CHAPTER-10
COMPANY ACCOUNTS

UNIT : 1

COMPANY ACCOUNTS

INTRODUCTION

1. Definition - A Company

Definitions as per Judicial Decisions

Haney : A Company is an Incorporated Association, which is an Artificial Person created by law, having a Separate Entity, with a Perpetual Succession and a Common Seal.

Marshall : A Company is a person, artificial, invisible, intangible and existing only in the eyes of Law. Being a mere creature of law, it possesses only those properties which the Charter of its creation confers upon it, either expressly or as incidental to its very existence.

Lindley

- A Company is an **association** of many persons, who contribute money or money's worth to a **common stock,** and employ it in some common **trade or business,** and who **share** the profit or loss (as the case may be) arising therefrom.
- The Common Stock so contributed is denoted in money, & is the **Capital** of the Company.
- The Persons who contribute it, or to whom it belongs, are **Members.**
- The Proportion of Capital to which each Member is entitled is his **Share.**
- Shares are always **transferable** although the right to transfer them is often more or less restricted.

2. Characteristic features of a Company [Sec.9]

1. **Artificial Person**
   (a) A Company comes into existence by the operation of law.
   (b) By sanction of law, a Company is granted certain rights and obligations as that of a person. Thus, Company is an artificial person, incorporated under law.
2. **Separate Legal Entity**
   (a) The Company is a separate legal entity and an artificial person known by its own name. Members cannot in any way, claim to be the same as that of Company.

(b) Upon Registration, the Association of Persons becomes a Body Corporate by the Name contained in the Memorandum of Association.

(c) A Company is **distinct and separate** from the members who constitute it.

3. **Person, not Citizen**

(a) A Company is not a citizen either under - (a) the Constitution of India or (b) the Citizenship Act, 1955.

(b) The Constitution provides certain fundamental rights to its citizens. A Company cannot enjoy those fundamental rights, which are expressly available to **citizens** only.

(c) However, the Company can claim those fundamental rights which are available to all **persons,** whether citizens or not, e.g. Right to own property, Right to Equality, etc.

4. **Perpetual Succession**

(a) A Company is an artificial person and has a separate legal entity.

(b) Hence, death, insolvency or retirement of its Members does not affect the Company.

(c) The shares of a Company being transferable, members may change during the lifetime of the Company. However, that does not change the status of the Company.

(d) The Company goes on forever and continues to exist, till it is wound up and dissolved.

5. **Separate Property**

(a) As per law, the Shareholders of a Company are **not part owners** of the undertaking.

(b) The Company, being a separate entity, is entitled to hold property in its **own name.**

(c) Members of the Company cannot claim ownership of Company's property.

(d) Dealings by or with the Company are carried out in its own name and not as the collective agent of its Shareholders.

6. **Common Seal**

(a) Common Seal is the official signature of a Company. The Company's name is engraved on the Seal.

(b) The Articles of Association may provide for the documents that require the signature of-the Company, i.e. the Common Seal. Where any document is affixed with the Common Seal, it amounts to being signed by the Company.

7. **Capacity to Sue**

(a) The Company is a separate legal entity known by its name and hence all actions of the Company shall be done in its name. In any suit, the Company shall sue or be sued in its **own name.**

(b) When the Creditors remain unpaid, their action as to claim stops with the Company. They cannot proceed against the Shareholders, individually or as a Group.

8. **Ownership vs Management**

(a) The Board of Directors is the elected representative body of the Shareholders of the Company, and manages the affairs of the Company.

(b) Generally, every Shareholder / Member does not participate in the day-to-day affairs of working and administration of the Company. Hence, Ownership of Company is different from that of its Management.

9. **Right of Access**

Shareholders are entitled to have access to information, and inspect the Registers and Records maintained by the Company, in the manner specified in the Companies Act.

10. **Limited**
   (a) The liability of a Member of a Company may **be limited by Shares or Guarantee. (In rare cases, the liability may be defined as unlimited by its Memorandum).**
   (b) In case of Company limited by Shares, the Member's liability is **limited** to the amount unpaid on Shares. If such Shares are fully paid, he has no further liability.
   (c) In case of Company limited by Guarantee, the Member's liability is **limited** to the amount guaranteed by him in the Memorandum.

11. **Transfer ability of Shares**
   (a) Shares of a Company are always transferable, although the right to transfer them is sometimes restricted, e.g. in the case of a Private Company.
   (b) Since Shares are transferable, Members can dissociate themselves from the Company by transferring their Shares at any time, in the manner provided in its Articles.

12. **Accounts and Audit**
   (a) **Accounts:** A Company has to maintain the prescribed books of accounts under accrual system, and double-entry system of book-keeping only.
   (b) **Audit:** A Company's accounts are subject to annual audit. The appointment of Auditors shall be in accordance with the provisions of the Companies Act.

Note: In case of Company does not frame its Article of Association, the Format of AOA shall be adopted from **Schedule I** u/s 5(6) of Companies Act, 2013.

3. Kinds of Companies

(1) Incorporation

- **Chartered Companies** -Formed by a Charter, i.e. Order of the King or Queen.
- **Statutory Companies** - Formed by or under a Statute of the Legislature / Parliament, e.g. LIC, Reserve Bank of India, State Bank of India, etc.
- **Registered Companies** - Formed and Registered under the Companies Act, 2013 or any earlier Companies Act.

(2) Owner-ship

- **Government Companies** - Means not less than **51%** of a Paid-Up Capital of a Company is held by the Central Government, or any State Government(s), Governments, or partly by Central Government and partly by one or more State Governments and includes a company which is a subsidiary Company of such a Government Company.
- **Companies controlled by others,** i.e. Regular Registered Companies.

(3) Liability

- **Limited Companies** - Liability of Members is limited, either - (a) By Shares, (b) By Guarantee.
- **Unlimited Companies** - Liability of Members is unlimited.

(4) Share Capital

- Companies **with** Share Capital.
- Companies **without** Share Capital.

Note: Only Public / Private Companies having Unlimited Liability or Limited by Guarantee can be formed without Share Capital.

(5) Listing

- **Listed Companies** - A Public Company which has any of its Securities listed in any recognized Stock Exchange.
- **Unlisted Companies** - A Company whose Securities are not listed on any recognized Stock Exchange. **[Note:** Shares of Private Companies are not listed in any Stock Exchange.]

(6) Member-ship

- Public Companies.
- Private Companies.
- One Person Company (OPC)

(7) Control

- Holding Company.
- Subsidiary Company.
- Associate Company.

(8) Others

- Foreign Companies - Incorporated outside India, and has a place of business in India
- Sec.8 Companies - Association with Charitable Objects.
- Other Definitions - Banking Company, Listed Company, Small Company

4. Holding Company and its Subsidiary

1. **Holding Company [Sec.2(46)]:** in relation to one or more other Companies, means a Company of which such Companies are Subsidiary Companies.
2. **Subsidiary Company or Subsidiary [Sec.2(87)]:** in relation to any other Company (that is to say the Holding Company), means 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.

Note:

- A Company shall be deemed to be a Subsidiary Company of the Holding Company even if the control referred to above is of another Subsidiary Company of the Holding Company.
- The composition of a Company's Board of Directors shall be deemed to be controlled by another Company, If that other Company by exercise of some power exercisable by it at its discretion can appoint or remove = majority of the Directors.
- The expression "Company" includes any Body Corporate.
- "Total Share Capital" means, the aggregate of - (a) Paid-up Equity Share Capital, and (b) Convertible Preference Share Capital.
- Shares held by a Company or power exercisable by it in another Company in a 'fiduciary capacity' shall not be counted for the purpose of determining the Holding-Subsidiary or Associate relationship.

5. 'Private Company'; `Public Company'; One Person Company

(1) Private Company [Sec.2(68)]

Company having a minimum Paid-Up share Capital of ` **1,00,000** or such higher prescribed amount, and which by its Articles-

1. **Restricts** the right to transfer it-Shares,
2. **Limits** the number of its Members to 200 [except in case of an OPC],
3. **Prohibits** any invitation to the public to subscribe for any Securities of the Company.

(2) Public Company [Sec. 2(71)]

Company which -

1. is **not** a Private Company,
2. has a minimum Paid-Up Capital of ` **5 Lakhs,** or such higher amount, as may be prescribed,
3. is a Private Company which is a **Subsidiary** of a Public Company

(3) One Person Company [Sec,3]

Meaning: One Person Company (OPC) is a type of Private Company formed by 1 person subscribing his name to a Memorandum, *and complaying* with the other requirement of the Act and rules. **Sole Member:**

(a) OPC requires a subscriber to incorporate (i.e. Sole Member) and a Nominee for the Sole Member.

(b) Memorandum of OPC shall indicate the names of the other-person (Nominee), who shall, in the event of the subscriber's death or his incapacity to contract, become the Member of that OPC.

Notes:

(a) Where two or more persons hold one or more shares in a Company **jointly,** they shall, for the purpose of membership, be treated a single member.

(b) Companies Act makes only a **restriction** on transfer of shares in case of Private Company but does not **prohibit** transfer.

(c) If a Company, private or public, fails to enhance its Minimum Paid-Up Capital to the required amount (i.e. ` 1 Lakh or ` 5 Lakhs, as the case may be) each Director / Manager / Shareholder will have **unlimited liability.**

6. Books of Accounts to be maintained by a Company [Sec. 128]

1. **Proper Books of Account:** Sec.128 requires that a Company shall maintain proper books of account with respect to the following items -

   (aj all sums of money received and expended by the Company and matters in respect of which receipt and expenditure take Place.

   (b) all sales and Purchases of goods by the Company,

   (c) the assets and liabilities of the Company ,and

2. **Nature of Books:** A Company shall keep proper books of account -

   (a) to give a **true and fair view** of the state of the affairs of the Company or Branch Office, as the case may be, and to explain its transactions, and

   (b) on **accrual** basis, and

   (c) according to the **double entry** system of accounting.

7. Preparation of Financial Statements by a Company

1. **Annual Accounts and Balance Sheet:** The Board of Directors shall lay before the Company at every Annual General Meeting (AGM) -

(a) a **Balance Sheet** as at the end of the period, and

(b) a **Profit and Loss Account** for that period.

[Note: For a Company not carrying on business for profit, an Income and Expenditure Account shall be laid at the AGM, instead of the P & L Account.]

2. **Provisions as to Balance Sheet and P&L Account:**

	Particulars	**Balance Sheet**	**P&L Account**
(a)	Contents	Compliance with Schedule III, **Part I** is required.	Compliance with Explanations in Schedule III, **Part II** is required.
(b)	Focus	B/S sheet should give true and fair view of the state of affairs of the Company.	P&L A/c should give true and fair view of the profit and loss for the financial year.

8. FORM OF BALANCE SHEET -Schedule III, Part I

Particulars	**Note**	**Figures as at the end of Current Reporting Period**	**Figures as at the end of the Previous Reporting Period**
1	**2**	**3**	4
I. EQUITY AND LIABILITIES			
(1) **Shareholders' Funds**			
(a) Share Capital			
(b) Reserves & Surplus			
(c) Money Received against Share Warrants			
(2) Share Application money pending allotment			
(3) Non-Current Liabilities			
(a) Long Term Borrowings			
(b) DTL (Net)			
(c) Other Long Term Liabilities			
(d) Long Term Provisions			
(4) **Current Liabilities**			
(a) Short Term Borrowings			
(b) Trade Payables			
(c) Other Current Liabilities			
(d) Short Term Provisions			
TOTAL			

	Particulars Note	**Figures as at the**	**Figures as at the end of Current Reporting Period**	**end of the Previous Reporting Period**
1		**2**	**3**	4
II	**ASSETS**			
1.	**Non -Current Assets**			
	(a) Fixed Assets			
	(i) Tangible Assets			
	(ii) Intangible Assets			
	(iii) Capital WIP			
	(iv) Intangible Assets under Development			
	(b) Non-Current Investments			
	(c) DTA (Net)			
	(d) Long Term Loans & Advances			
	(e) Other Non-Current Assets			
II	**Current Assets**			
	(a) Current Investments			
	(b) Inventories			
	(c) Trade Receivables			
	(d) Cash & Cash Equivalents			
	(e) Short Term Loans & Advances			
	(f) Other Current Assets			
	TOTAL			

9. STATEMENT OF PROFIT AND LOSS - Schedule III, Part II

	Particulars Note	**Figures as at the**	**Figures as at the end of Current Reporting Period**	**end of the Previous Reporting Period**
1		**2**	**3**	**4**
i	Revenue from Operations		XXX	**xxx**
ii	Other Income		XXX	**xxx**
in	Total Revenue (i + ii)		**XXX**	**XXX**
iv	**Expenses:**			
	Cost of Materials Consumed		XXX	XXX
	Purchases of Stock-In-Trade		XXX	XXX
	Changes in Inventories of Finished Goods / Work-in-Progress and Stock-In-Trade		XXX	XXX
	Employee Benefits Expense			

	Finance Cost		
	Depreciation and Amortization Expense		
	Other Expenses		
	Total Expenses	**XXX**	**XXX**
v	Profit before Exceptional &		
	Extraordinary Items & Tax (III-IV)	XXX	XXX
vi	Exceptional items	xxx	xxx
vii	Profit before Extraordinary Items		
	and Tax (v-vi)	xxx	xxx
viii	Extraordinary Items	xxx	xxx
	Profit before Tax (VII-VIII)	xxx	xxx
X	Tax Expense:		
	(1) Current Tax	xxx	xxx
	(2) Deferred Tax	xxx	xxx
xi	Profit/(Loss) from Discontinuing Operations (After Tax)	XXX	XXX
	(XII-XIII)		
XII	Profit / (Loss) from Discontinuing OperationsXXX	XXX	
XIII	Tax Expense of Discontinuing Operations	XXX	XXX
XVI	Earnings per Equity Share:	xxx	xxx
	(1) Basic	xxx	xxx
	(2) Diluted xxx	xxx	

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. Which of the following statement is not a feature of a Company?
   (a) Separate legal entity
   (b) Perpetual Existence
   (c) Members have unlimited liability
2. In a Government Company, the holding of the Central Government in paid-up capital should not be less than
   (a) 25% (b) 50 % (c) 51%
3. Which of the following statement is true in case of a Foreign Company?
   (a) A Company incorporated in India and has place of business outside India.
   (b) A Company incorporated outside India and has a place of business in India.
   (c) A Company incorporated in India and has a place of business in India.
4. Which of the following statements is not a feature of a private company?
   (a) Restricts the rights of members to transfer its shares.
   (b) Does not restrict on the number of its members to any limit.
   (c) Does not involve participation of public in general.

HOME WORK

1. Explain salient features of a company in brief.
2. Write short note on:
   (i) Foreign company.
   (ii) Small company.
   (iii) Company limited by guarantee.

UNIT : 2

ISSUE, FORFEITURE AND RE-ISSUE OF SHARES

INTRODUCTION

Funds provided by the owner(s) into a business are recorded as capital. Capital of the business depends upon the form of business organisation. Proprietor provides capital in a sole-proprietorship business. In case of a partnership, there is more than one proprietor, called partners. Partners introduce capital in a partnership firm. As the maximum number of members in a partnership rm is restricted, therefore only limited capital can be provided in such form of businesses. Moreover, the liability of the proprietor(s) is unlimited in case of non-corporate business, namely, sole-proprietorship and partnership.

1. Share

Meaning : Share" is the basic unit into which the Capital of a Company is divided. It is an interest measured by a **sum of** money. **Example:** A Company with a Total Capital of ` 1 Crore is divided into 1 Lakh Units of ` 100 Each unit of ` 100 is called a Share of the Company.

Sec. 2(84) : A Share is a Share in the Share Capital of the Company, and includes Stock

2. Two kinds of Shares recognized in the Companies Act, 2013

The Share Capital of a Company limited by Shares can only be of two kinds -

1. **Equity Share Capital** - (a) with Voting Rights, or (b) with differential rights as to dividend, voting or otherwise in accordance with the prescribed Rules i.e. Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001.
2. **Preference Share Capital,** i.e. Priority for Dividend at Fixed Rate + Priority for repayment of Capital.

3. Preference Share Capital and Equity Share Capital

(1) Preference Share Capital [PSC] :

Carries a Preferential Right as to -

(a) **Dividend:** Either a Fixed Amount or at a Fixed Rate, free or subject to Income Tax, and

(b) **Capital:** Upon a winding up or repayment of Capital, preference as to repayment of amount of Paid-Up Capital, whether or not there is a preferential right to payment of -

- **Dividends remaining Unpaid** Upto date of winding up or repayment of Capital, and
- Fixed Premium specified in the MOA or AOA of the Company.

(2) Deemed Preference Capital :

Capital is **deemed** to be Preference Capital, if they fulfil the above conditions, irrespective of whether it **is** entitled to any of the following additional rights -

- **Dividend:** Participation, with Equity Shares in profits (fully or to limited extent) of the Company after-payment of Dividends to Equity Shares. **Example:** After payment of dividend of 25% to Equity Shares, balance surplus will be shared equally by Preference and Equity Shareholders.
- **Capital:** Participation (fully or to limited extent) with Ordinary Capital in any surplus remaining after repayment of entire capital. They are **entitled to surplus assets** of the Company after repayment of Equity Capital.

(3) Equity Share Capital :

(a) **Meaning:** All such Share Capital that is **not** Preference Share Capital is called Equity Share Capital.

(b) **Features:** It may be with - (i) Voting Rights, or (ii) Differential Rights as to Dividend, Voting or otherwise in accordance with rules and subject to prescribed conditions.

4. Preference Shares and Equity Shares

(1) Definition

Preference Shares : Shares that carry a Preferential Right as to payment of - (a) Dividend, and (b) Repayment of Capital.

Equity Shares : Shares that are not Preference Shares are called Equity Shares.

(2) Return

Preference Shares : Fixed Rate or Fixed Amount.

Equity Shares : Based on profits available for distribution.

(3) Dividend

Preference Shares : Priority over Equity Dividend, i.e. paid first.

Equity Shares : After payment of Preference Dividend.

(4) Repayment of Capital

Preference Shares : Paid before repayment of Equity Capital.

Equity Shares : Paid after entire Preference Capital is repaid.

(5) Arrears of Dividend

Preference Shares : Generally accumulates unless specifically said to be non-cumulative.

Equity Shares : No accumulation of Unpaid Dividend. No Profits means no Dividend.

(6) Redemption

Preference Shares : Redeemable as per terms of issue and provisions of Act.

Equity Shares : Not Redeemable till winding-up. Even in winding-up, will be repaid after Pref.Shares.

(7) Voting Rights

Preference Shares : Generally restricted. Carries right to vote on all matters if dividend remains unpaid for the prescribed period.

Equity Shares : Unrestricted, i.e. Holder can vote at any matter at any Meeting, or the Shares may be issued with varying voting rights.

(8) Further Issue of Shares

Preference Shares : Principles relating to Rights or Bonus Issue is Not Applicable.

Equity Shares : Fresh Issue to be offered first to existing holders, i.e. Rights Issue and fully paid Bonus Shares offered to all members.

(9) Control / Management

Preference Shares : No right to take part in Management.

Equity Shares : Equity Shareholders are the real owners, hence have a right to control the Management of Company.

5. Different types of Share Capital

(i) Authorised Share Capital [Sec.2(8)]

(a) It is the maximum amount of Share Capital which can be raised by the Company.

(b) The Authorised Share Capital is also known as the **"Registered Capital"** or **"Nominal Capital"** and is authorised by Memorandum of Association of Company.

(c) Authorised Capital is shown in the Balance Sheet at **Nominal Value** (Face Value).

(d) **Example:** Authorised Capital = 10,000 Shares of ` 100 each, Total = ` 10,00,000.

(ii) Issued Share Capital [Sec.2(50)]

(a) It represents that part of Authorised Share Capital which has been given or issued or offered to Shareholders.

(b) Issued Capital includes Shares issued for - (i) Cash, and (ii) Consideration other than cash, to Promoters and Others.

(c) Issued Share Capital is shown in the Balance Sheet at Nominal Value (Face Value).

(d) **Example:** Issued Capital = 9,000 Shares of ` 100 each, Total = ` 9,00,000.

Note: The remaining portion of Authorised Capital, which is not issued for cash or other consideration, is called as **Unissued Capital.** It is **not shown** in the Balance Sheet.

(iii) Subscribed Share Capital [Sec 2(86)]

(a) Subscribed Capital is the part of Issued Share Capital which has been subscribed (i.e. applied for) by the Public / Shareholders, and allotted by the Company.

(b) **Example:** Out of 9,000 Shares issued 8,000 Shares are subscribed by public.

Note: The remaining portion of Issued Capital, which is not subscribed, is **not shown** in the Balance Sheet.

(iv) Called Up Share Capital [Sec.2(15)]

(a) Companies generally receive the Issue Price of Shares in instalments, e.g. application stage, allotment stage, First Call, Second Call, etc.

(b) The portion of the Face Value of Shares which a Company has demanded or called from Shareholders is known as "Called-Up Capital".

(c) The balance portion which the Company has decided to call / demand in future is called as **Uncalled Capital.**

(d) **Example:** Out of ` 100 per Share, the Company has called up ? 70 per Share. In such case, the Uncalled Capital is ` 30 per Share.

(v) Paid-Up Capital [Sec. 2(64)]

(a) It is that portion of Called Capital which has been actually paid by the Shareholders.

(b) The unpaid portion is called **"Unpaid Calls"** or **"Calls in Arrears".**

(c) So, Paid Up Capital = Called up Capital **-** Calls in Arrears.

(d) **Example:** If out of ` 70 per Share called up, only ` 60 has been paid by Shareholders, the remaining ` 10 per Share constitutes Calls in Arrears.

(vi) Reserve Capital [Sec. 65]

(a) a Company may decide by passing a special resolution, that a certain portion of Subscribed Uncalled Capital shall be called up only in the event of winding-up / liquidation.

(b) That portion is called **Reserve Capital.** It is **not shown** in the Balance Sheet.

6. Procedure for Issue of Shares for Cash

1.

(a) Public Company shall issue a **Prospectus,** i.e. invitation to general public, to subscribe for Shares.

(b) Prospectus shall comply with the provisions of Companies Act, and SEBI Guidelines..

(c) Private Companies do not issue Prospectus. They depend upon "Private Placement" of Shares.

2.

(a) On the basis of Prospectus, **Applications** are deposited in a Scheduled Bank by the interested parties along with the amount payable at the time of application.

(b) Minimum Application Money is as specified in the Companies Act and as per SEBI Guidelines. **[Note:** Companies Act is applicable for all Companies, while SEBI Guidelines is applicable only for Listed Companies]

3.

(a) After the last date for filing applications (i.e. Closing Date), the Company decides about Allotment of Shares in consultation with SEBI and Stock Exchange concerned.

(b) Allotment is the **acceptance of a Company to give Shares to the Investor** in response to an offer for purchase of Shares made by him for a consideration.

(c) Allotment can be done only when Minimum Subscription has been received by the Company

4.

(a) Successful Applicants become Shareholders of the Company and are required to pay the next instalment which is known as **"Allotment Money".** Unsuccessful Applicants get back their money.

(b) In case of delay in refunding the excess money, the Company is liable to pay interest at 15 % p.a. on the amount of refund.

(c) Retention of Over-Subscription is **not** allowed under any circumstances except to the extent necessary because of proportional allotment, but not exceeding 10% of Issue Size.

5.

(a) The Company calls up the balance amount from the Shareholders, called **"Calls".** Call refers to the **demand** for Share Money other than those by *way* of application and allotment.

(b) Call may be made at any time - *(i) during the lifetime of the Company, or (ii) during its winding* up.

(c) When Issue Size exceeds ` 500 Crores, amount to be called up on application, allotment and on various calls **should not exceed 25%** of the Total Quantum of Issue in each case.

(d) Generally, the following conditions in Table A of Companies Act, 1956 will apply -

- A period of **1 month** must elapse between two calls.
- A notice of 14 days period should be given to the Shareholders to pay the amount.
- Calls should be on uniform basis, within Shares of the same class.
- The amount of one calls should not be more than 25% of the Face Value of the Share.

7. Minimum Subscription

1. **Meaning:** Minimum Subscription is the **minimum** amount stated in the Prospectus, which in the opinion of Directors, must be raised by the issue of Share Capital to start with.

2. **Requirement under Companies Act and SEBI Guidelines:**

Minimum Subscription [Sec.39(I)]

Companies Act

Condition: Allotment of Securities can be made only if the amount stated in the prospectus as minimum subscription is received.

Quantum: Amount stated in prospectus

Time Limit: 30 days from date of issue (or) Time limit given under SEBI Guidelines

Effect of Non-Receipt: Application Money shall be refunded within 15 days from the date of closure.

SEBI Guidelines

(a) Quantum : 90% of Total issue size

(b) If Issue underwritten:

- **Time limit:** Date of Closure (i.e) Closing of subscription list
- **Effect of Non-Receipt:** Application Money shall be refunded within 15 days from the date of closure.

(c) If Issue is not underwritten:

- **Time limit:** within 6o days from the date of closure
- **Effect of Non-Receipt:** Application Money shall be refunded within 10 days. Any refund after 70 days it shall be made with interest @ 15% P.A.

Note: Any Default in repayment of Minimum Subscription, all Directors of company who are officers in default will be Joint & Severally Liable with interest.

Application Money [sec.39(2)]

Quantum: Minimum Amount Payable on application of any security shall be

- Not less than 5% of nominal amount of security or
- Percentage or amount specified by SEBI

Quantum:

- Minimum amount payable on application shall be **25% of nominal value of security**
- Minimum amount for subscription shall be **` 10,000/-**

Note: Penalty for default [Sec.39(5)]: ` 1000 per day of default up to maximum of ` 1 lakh

3. **Application of Minimum Subscription:** Amount should be utilised to meet the following expenditure

(a) Purchase Price of Property bought or to be bought,

(b) Any Preliminary Expenses,

(c) Underwriting Commission,

(d) Repayment of money borrowed by the Company for the above purposes,

(e) Working Capital, and

(f) Any other expenditure stating the nature and purpose with estimated amount in each case.

8. Issue of Shares at Premium. [Sec.52]

1. **Meaning:** Premium refers to the **excess** of the Share Issue Price over its Face Value / Par Value. A Company can issue Shares at a premium, i.e. at a price above its Face Value. **Example:** If a Share of Face Value ` 10 is issued at a price of ` 120, there is a premium of ` 110 per Share.
2. **Cash or Kind:** Shares can be issued at a Premium which may be received in Cash or in Kind. Sec.52 of the Act uses the words "at a premium, whether for cash or otherwise". **[Head Henry & Co. Ltd. vs. Ropner Holding Ltd]**
3. **Rate of Premium:** Rate or Amount of Premium is decided by the Board of Directors. Under SEBI Guidelines, justification for the premium should be disclosed in the **Offer Document.**
4. **Securities Premium Account:** The aggregate amount / value of the Premiums received should be transferred to Securities Premium Account. The provisions of the Act relating to reduction of Share Capital shall apply, as if the Securities Premium were Paid-Up Share Capital of the Company.
5. **Application of Securities Premium:** Securities Premium Account can he used only for -
   (a) Issuing **Fully Paid Bonus Shares** to Members.
   (b) Writing-off the **Preliminary Expenses** of the Company.
   (c) Writing off the - (i) Expenses Incurred, or (ii) Commission Paid, or (iii) Discount Allowed, on the Issue of Shares or Debentures of the Company
   (d) Providing for **premium payable** on redemption of any Redeemable Preference Shares or Debentures of the Company.
   (e) **Buy-back** of own Shares or Other Securities u/s 68.

   Note: For **specified class of Companies** whose Financial Statements comply with the Accounting Standards prescribed u/s 133, Securities Premium can be used only for___
   (a) Issuing **Fully Paid Bonus Shares** to Members.
   (b) Writing off the - (i) Expenses Incurred, or (ii) Commission Paid, or (iii) Discount Allowed, on the Issue of **Equity** Shares of the Company
   (c) **Buy-back** of own Shares or Other Securities u/s 68.

9. Prohibition on Issue of Shares at a Discount [Sec.53]

Prohibition : A Company **shall not** issue shares at a Discount except as Sweat Equity shares U/s 54.

Void : Any Share issued by a company at a discounted price shall be void, (except for Sweat Equity)

Effect of Default

(a) Company is punishable with fine of Minimum ` 1,00,000 and Maximum ` 5,00,000
(b) Every officer in default is Punishable with -
- Imprisonment of maximum 6 months or
- Fine of Minimum ` 1,00,000 and Maximum ` 5,00,000 or
- both

10. Calls in Advance [Sec.50]

1. **Meaning:** Calls in Advance is the surplus money received by the Company from the allottees, i.e. its Shareholders.

2. **Calls in Advance:** A Company, if permitted by its Articles, may accept from members either the whole or part of the amount remaining unpaid on any shares held by him as Calls in Advance.
3. **No Voting Rights:** The Member shall not be entitled to any voting rights on Calls in Advance, until the same becomes presently payable and duly appropriated.
4. **Disclosure:** Calls in Advance will always have a Credit Balance and will be shown under the Liabilities Side. It is **not added** to the amount of Paid-Up Capital.
5. **Interest:** The Company is liable to pay interest on the amount of Calls in Advance from the date of receipt till the date when the Call is due for payment, at the Maximum rate of 12% p.a. the amount received in advance of calls is not refundable.
6. **Dividend [Sec. 51]:** A Company, if so authorised by its Articles, it can pay dividends on advance money received on calls
7. **Priority:** In the event of winding up the shareholder ranks after the creditors but calls in advance must be paid along with the interest if any before the other shareholders are paid off.

11. Calls in Arrears

1. **Meaning:** Calls in Arrears is the money remaining unpaid by the shareholder on the calls raised by the Company in respect of the shares held by him.
2. **Disclosure:** Calls in Arrears always have a Debit Balance and are shown as a deduction from Share Capital in the Liabilities Side of the Balance Sheet.
3. **Interest:** The Company can recover interest on the amount of calls in arrears from the date it became due till the date when the call is received at the rate not exceeding 10% p.a. (if Table F is adopted as Articles of Association).
4. **Waiver of Interest:** The Directors may also be empowered to waive the Interest on Calls in Arrears, subject to certain conditions laid down in the Articles.

12. Shares issued for Consideration other than Cash

1. **Meaning:** A Company can issue shares for valuable Consideration other than Cash. For example, Shares may be issued to - (a) Vendors towards payment of Purchase Consideration, (b) Promoters towards reimbursement of Preliminary Expenses incurred by them for incorporation, (c) Underwriters towards payment of Underwriting Commission, etc.
2. **Disclosure:** Shares issued for Consideration other than Cash shall be separately disclosed in the Balance Sheet of the Company, as required by Part I of Schedule III.
3. **Deemed Cash Receipt:** Where allotment is made in adjustment of a bonafide debt payable in money at once, the allotment should be considered as against cash. **[Spargo's Case]**
4. **Subsequent Cash Receipt:** Where Shares are allotted on cash basis, it will constitute a issue for cash, even if the amount is received by the later, in the normal course of its activity.

13. Forfeiture of Shares

1. **Meaning:** Forfeit = Taking away of property, on breach (non-fulfillment) of a condition. In the context of Shares, Forfeiture of Shares refers to the action taken by the Company, to cancel the Shares.

2. **Situation:** When Shareholders fail to pay Allotment or Call Money due, the Directors may forfeit the Shares in the bonafide interests of the Company, and in accordance with the Articles of Association. Proper Notice should be served to the defaulting Shareholder, before forfeiture.
3. **Effect:** When Shares are forfeited, the title of such Shareholder is extinguished, but the amount paid by him till such forfeiture, is not refunded to him. The Shareholder has no further claim on the Company. The amount actually received from the Shareholder is transferred to "Shares Forfeited A/c".
4. **Treatment:** Till Forfeited Shares are re-issued, the amount is shown as an addition to Share Capital, on the Liabilities Side of the Balance Sheet.

14. Re-issue of Forfeited Shares

Shares forfeited is re-issued by the Company, subject to the following considerations -

1. **Sale, not Allotment:** Re-issue of Forfeited Shares is **not an allotment,** it is only a Sale. So, the Company need not file a Return of Allotment, with the Registrar of Companies.
2. **Auction Sale:** After *forfeiture, the Forfeited Shares vest in the Company for the purpose of sale. The* Company is under an obligation to dispose it off, generally by auction.
3. **Minimum Re-Issue Price:** Forfeited Shares may be re-issued at any price, but the Total sum paid by Former Shareholder + Amount paid by Acquirer on Re-Issue + Amount remaining unpaid on the shares should **not** be less than face value of the shares. It is less than Face Value , it would amount to issue at a discount and discount on Re-issue should not exceed the amount forfeited on those shares.
4. **Loss on Re-issue:** Loss on Re-issue shall be debited to "Forfeited Shares" A/c.
5. **Condition for Re-issue:** Loss on Re-issue of Forfeited Shares should **not** exceed the Forfeited Amount, i.e. amount paid by Original Allottee, excluding premium, if any.
6. **Surplus:** Surplus arising on the Re-issue of Forfeited Shares (i.e. Forfeited Amount > Loss on Re-issue), should be transferred to **Capital Reserve A/c.** In case only a portion of Shares are re-issue, the amount of profit attributable to such Re-issued Shares should only be transferred to Capital Reserve Account.
7. **Re-issue at Premium:** When Forfeited Shares are re-issued at a **price higher than its Face Value,** the excess amount should be credited to **Securities Premium A/c.** However, if the Re-issued Amount + Forfeited Amount exceeds the Face Value, it is not necessary to transfer such amount to Securities Premium Account.

CLASS WORK

MULTIPLE CHOICE QUESTIONS

1. The excess price received over the par value of shares, should be credited to __________.
   (a) Calls-in-advance account
   (b) Share capital account
   (c) Securities premium account
2. The Securities Premium amount may be utilized by a company for __________.
   (a) Writing off any loss on sale of xed asset
   (b) Writing off any loss of revenue nature
   (c) Writing off the expenses/discount on the issue of debentures
3. When shares are forfeited, the share capital account is debited with ________ and the share forfeiture account is credited with __________.
   (a) Paid-up capital of shares forfeited; Called up capital of shares forfeited
   (b) Called up capital of shares forfeited; Calls in arrear of shares forfeited
   (c) Called up capital of shares forfeited; Amount received on shares forfeited
4. T Ltd. proposed to issue 6,000 equity shares of `100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013
   (a) `5.00 (b) `6.00 (c) `7.00
5. Dividends are usually paid as a percentage of ______.
   (a) Authorized share capital (b) Net profit (c) Paid-up capital
6. As per the SEBI guidelines, on issue of shares, the application money should not be less than
   (a) 2.5% of the nominal value of shares
   (b) 2.5% of the issue price of shares
   (c) 25.0% of the issue price of shares
7. G Ltd. acquired assets worth `7,50,000 from H Ltd. by issue of shares of `100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle the purchase consideration = ?
   (a) 6,000 shares (b) 7,500 shares (c) 9,375 shares

THEORETICAL QUESTIONS

1. Write short notes on:
   (i) Utilization of securities premium account
   (ii) Re-issue of forfeited shares
2. Distinguish between:
   (i) Calls-in-Arrears and Calls-in-advance
   (ii) Issue of shares for cash and Issue of Shares for Consideration other than Cash
3. Can a company issue shares at discount?

HOME WORK

Q-1 X Ltd. invited applications for 10 lakhs shares of ` 100 each payable as follows :

	`
On Application	20
On Allotment (on 1st May, 2016)	30
On First Call (on 1st Oct., 2016)	30
On Final Call (on 1st Feb., 2017)	20

All the shares were applied for and allotted. A shareholder holding 20,000 shares paid the whole of the amount due along with allotment. Journalise the transactions, assuming all sums due were received. Interest was paid to the shareholder concerned on 1st February, 2017.

Q-2 A limited Company, with an authorized capital of ` 20,00,000 divided into shares of ` 100 each, issued for subscription 10,000 shares payable at ` 25 per share on application, ` 30 per share on allotment, `20 per share on first call three months after allotment and the balance as and when required.

The subscription list closed on January 31, 2016 when application money on 10,000 shares was duly received and allotment was made on March 1, 2016.

The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 1,000 shares held by him and another shareholder with 500 shares paid the entire amount on his shares.

Give journal entries in the books of the Company to record these share capital transactions assuming that all amounts due were received within one month of the date they were called.

Q-3 B Ltd. issued 20,000 equity shares of ` 100 each at a premium of ` 20 per share payable as follows: on application ` 50; on allotment `50 (including premium); on final call ` 20. Applications were received for 24,000 shares. Letters of regret were issued to applicants for 4,000 shares and shares were allotted to all the other applicants. Mr. A, the holder of 150 shares, failed to pay the allotment and call money, the shares were forfeited. Show the Journal Entries and Cash Book in the books of B Ltd.

ISSUE OF DEBENTURES

INTRODUCTION

In the earlier units of this chapter, we have studied the issue of share capital as a means of raising funds for financing the business activities. But with increasing and ever growing needs of the corporate expansion and growth, equity source of financing is not sufficient. Hence corporates turn to debt financing through various means. Issuing debt instruments by offering the same for public subscription is one of the sources of financing the business activities. Debt financing does not only helps in reducing the cost of the capital but also helps in designing appropriate capital structure of the company. Debenture is one of the most commonly used debt instrument issued by the company to raise funds for the business.

1. Debenture - Definition and its important features

1. **Definition:**

(a) Debenture includes Debenture Stock, Bonds and any other instrument of a Company evidencing a debt, whether constituting a charge on the assets of the Company or not. **[Sec. 2(30)]**

(b) It is a document issued by a Company indicating its **indebtedness.**

2. **Features:**

(a) **Debt:** Debenture is a document which evidences a loan made to a Company. The term Debenture refers to an acknowledgment of a debt, and obligation to repay, which is accompanied by some charge or security.

(b) **Under Common Seal:** Though not mandatory, a Debenture is issued under the Company's Seal.

(c) **Interest:** The Company pays a fixed rate of interest on Debentures, due on specific dates. Such interest is payable, irrespective of whether the Company has earned profit or not.

(d) **Date of maturity / redemption:** Generally Debentures are issued for a specified period of time, after which they ***mature or have to*** **be** redeemed ***by the Company by paying the*** money. Sometimes, they may **be** converted into Equity Shares, after .the maturity period.

(e) **Creation of Charge:** Most Debentures are secured by way of a charge on the assets / part of the assets of the Company. However, there may also be unsecured Debentures.

(f) **Movable Property [Sec.44]:** Like Shares, Debentures are also movable property, capable of being transferred in the manner provided in the AOA of the Company.

(g) **Trading:** Debentures may be bought or sold through the Stock Exchange, at a price above or below the face value. Hence, Debentures may be traded, in the same manner as Shares.

(h) **No Voting Rights [Sec. 71(2)]:** Debenture Holders are mere lenders to the Company, who are generally secured for payment. Hence they **do not have any right as to voting** in meetings. The Company shall not issue any Debentures carrying voting rights.

(i) **Specific performance [Sec.71(12)] :** A contract with a company to take up and pay for any debentures of the company may be enforced by a decree of Specific Performance.

2. Issue of Debentures as Collateral Security

1 Meaning:

(a) Collateral Security means **secondary or supporting security** for a loan, which can be realized by the Lender, when the original loan is not paid on due date.

(b) Companies may issue their Own Debentures as Collateral Security for a Loan or Overdraft facility taken from Bank / other Lenders.

2. **Effect:**

(a) If the Company repays the loan on the due dates, the Debentures will be released, along with the main security.

(b) If the Company is not able to repay the loan or the interest thereon, the Lender will become the Debentureholder of the Company. However, such Debentureholder will receive interest only to the extent of Loan Amount, and not on the amount of debentures.

Note: The Holder of Debentures are entitled to interest only on amount of loan but not on value of Debentures.

3. **Accounting Treatment:** There are two methods of showing Debentures issued as Collateral Security

Situation	**Method I**	**Method II**
Journal Entry for issue of Debentures as Collateral Security	No Entry. It is only a Memorandum Method.	Debenture Suspense A/c Dr. To ....% Debentures A/c
Disclosure in the Balance Sheet till Loan is settled	The issue of Debentures and Loan Outstanding is shown as a **Note** under "Secured Loans".	➲ Debenture Suspense A/c will appear **on** the Assets Side. ➲ Debentures A/c will appear on **the** Liabilities Side under Secured Loans.
Treatment after settlement of Loan	The Note given as above will be discontinued.	The Journal Entry given above will **be reversed** in order to cancel Debentures.

3. Treatment for Discount / Loss on Issue of Debentures.

1. **Treatment:** Discount / Loss on Issue of Debentures is **written-off** or **amortized** over the period between the date of issue and date of redemption.

2. **Determination of write-off amount:**

Situation	**Amount written off is computed as under -**
(a) Debentures redeemed at lumpsum at the end of a given period	Total Amount of Discount / Loss should be written off **equally** over **the** life of debentures, i.e. **Straight Line Method** is used

(b)	Debentures redeemed in different / unequal instalments	Total Amount of Discount / Loss should be written off in in the **ratio of benefit derived** from Debenture Loan in any particular year, i.e. **Sum of Digits Method** is used in this case.
(c)	Debentures are irredeemable	Total Amount of Discount / Loss should be written off gradually over a **long period.**

3. **Journal Entry:**

Profit and Loss Account Dr.

To Discount / Loss on Issue of Debentures A/c

Note: The unamortized amount is shown on the Assets Side of the Balance Sheet, under the heading Miscellaneous Expenditure (to the extent not written off or adjusted)

4. Accounting treatment for payment of Interest on Debentures

1. **Interest:** Interest on Debentures is a charge against the profits of the Company. Interest is paid at specified dates, (e.g. on half-yearly or annual basis) on the **Nominal Value** of Debenture.
2. **Tax Deducted at Source:** The Company will pay interest to the Debentureholders after deducting the amount of tax, as specified in the Income Tax Rules. The Company is under an obligation to deduct tax at source and deposit the deducted tax amount with the Income Tax Authorities.
3. **Journal Entries:**

	Transaction	**Journal Entry**
(a)	Debentures redeemed at lumpsum at the end of a given period	Interest on Debentures A/c Dr. To To Debentureholders A/c
(b)	Payment of Interest after deduction of tax at source (TDS)	Debentureholders A/c Dr. To TDS Payable A/c To Bank A/c
(c)	Remittance Tax Deducted at Source with Government	TDS Payable A/c Dr. To Bank A/c
(d)	Transfer of Interest on Debentures to P& L A/c	Profit and Loss A/c Dr. To Interest on Debentures A/c

MULTIPLE CHOICE QUESTIONS

1. Premium on redemption of debentures account appearing in the balance sheet is _______.
- (a) A nominal account - expenditure
- (b) A nominal account - income
- (c) A personal account ______.

2. Debenture interest
- (a) Is payable before the payment of any dividend on shares
- (b) Accumulates in case of losses or inadequate profits
- (c) Is payable after the payment of preference dividend but before the payment of equity dividend ___.

3. F Ltd. purchased Machinery from G Company for a book value of ` 4,00,000. The consideration was paid by issue of 10% debentures of ` 100 each at a premium of 25%. The debenture account was credited with ______.

(a) ` 4,00,000 (b) ` 5,00,000 (c) ` 3,20,000

4. Which of the following is not a characteristic of Bearer Debentures?
- (a) They are treated as negotiable instruments
- (b) Their transfer requires a deed of transfer
- (c) They are transferable by mere delivery

5. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is __________.
- (a) Credit Debentures A/c and debit Cash A/c.
- (b) Debit Debenture suspense A/c and credit Cash A/c.
- (c) Debit Debenture suspense A/c and credit Debentures A/c.

6. When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off
- (a) Every year by applying the sum of the year's digit method
- (b) Every year by applying the straight line method
- (c) To profit and loss account in full in the year of final or last redemption

THEORY QUESTIONS

1. Distinguish between debentures and shares.

2. Explain the purpose for raising of debenture by the company. Also give the main features of debentures.

HOME WORK

Q-1 Country Crafts Ltd. issued 1,00,000, 8% debentures of ` 100 each at premium of 5% payable fully on application and redeemable at premium of ` 10 Pass necessary journal entries at the time of issue.

Q-2 Koinal Chemicals Ltd. issued 20,00,000, 10% debentures of `50 each at premium of 10%, payable as ` 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in allotment money.

Q-3 Kapil Ltd. issued 50,000, 12% Debentures of `100 each at a premium of 10% payable in full on application by 1st March, 2017. The issue was fully subscribed and debentures were allotted on 9th March, 2017.

Pass necessary Journal Entries (including cash transactions).

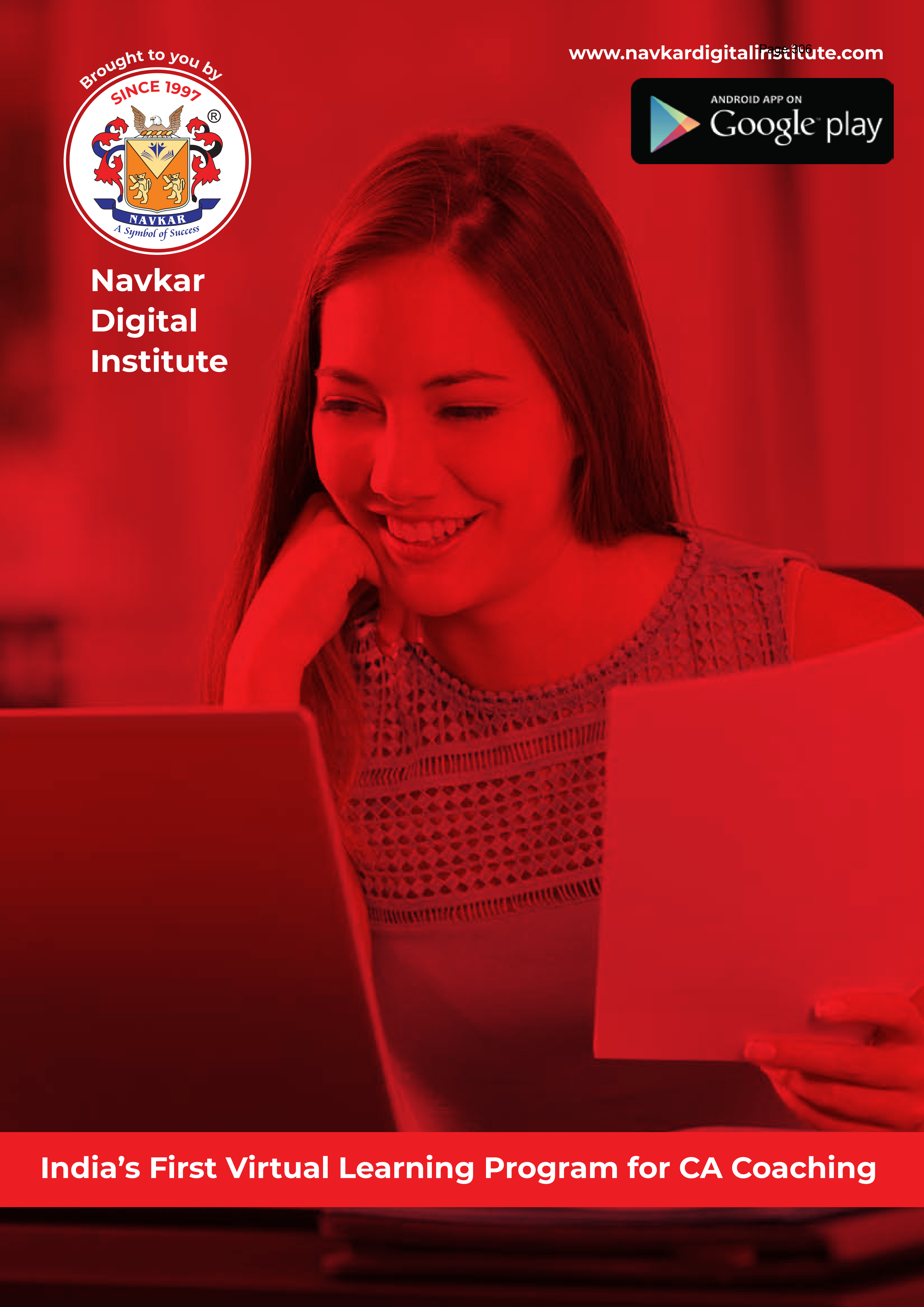
Q-4 On 1st April 2017 Sheru Ltd. issued 1,00,000 12% debentures of `100 each at a discount of 5%, redeemable on 31 March 2022. Issue was oversubscribed by 20,000 debentures, who were refunded their money. Interest is paid annually on 31 March. You are required to prepare:

(i) Journal Entries at the time of issue of debentures.

(ii) Discount on issue of Debenture Account

(iii) Interest account and Debenture holder Account assuming TDS is deducted @ 10%.

---0---0---



Brought to you by
SINCE 1997
NAVKAR
A Symbol of Success
Navkar Digital Institute
www.navkardigitalinstitute.com
Page 306
ANDROID APP ON
Google play
India's First Virtual Learning Program for CA Coaching