EDNOVATE

# SCARED OF ACCOUNTING?

*No More Now...*

## REVISE ALL CONCEPTS

in

## Just 8 Hours!

7273 967 967

# Twins Shine bright in FINAL CA!

**AIR 2**

**AIR 8**

*"I thoroughly enjoyed the lectures and appreciated the clarity of the concepts presented. The lectures were engaging and fun, which helped me retain the information better. I particularly enjoyed Dhawal sir's sense of humor and appreciated Sagar sir's discipline. I am grateful to the entire Endnovate team for their efforts."*

**CA SANSKRUTI PAROLIA** | FINAL CA NOV'23 RANKERS

*"Good Conceptual Teaching*
*Regular Test Series - Timely and accurate checking*
*Good Summary books especially for DT SFM and costing*
*Thank you to the entire Ednovate team, including teachers, support staff etc."*

**CA SHRUTI PAROLIA** | FINAL CA NOV'23 RANKERS

# Our AIRs
## CA INTER MAY'22, MAY'23, NOV'23 & MAY'24

AIR 13

**JUHI KAJARIA**
CA INTER MAY'22

MANAN SHAH
CA INTER MAY'22
AIR 14

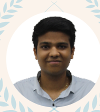
NAMAN GABHAWALA
CA INTER MAY'24
AIR 14

PRACHI NANDU
CA INTER MAY'23
AIR 24

RESHI KOTHARI
CA INTER MAY'24
AIR 28

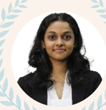
MANSI DUDANI
CA INTER MAY'24
AIR 30

VATSAL MEHTA
CA INTER MAY'23
AIR 33



PIYUSH KOTHARI
CA INTER MAY'23
AIR 34

RAYNA DOSHI
CA INTER MAY'24
AIR 35



HIMANSHI CHHAJED
CA INTER MAY'23
AIR 39

YUKTA SATPALKAR
CA INTER MAY'22
AIR 40

MARVI LODHA
CA INTER MAY'23
AIR 40

ARYAN HOSANGADY
CA INTER MAY'22
AIR 41

DHAIRYA DOSHI
CA INTER MAY'24
AIR 41

VANSHIKA LOHANA
CA INTER MAY'22
AIR 46

PRANJAL MUNDRA
CA INTER MAY'23
AIR 46

SANJEEV JAIN
CA INTER MAY'22
AIR 47

RISHABH JAIN
CA INTER MAY'23
AIR 47

SHRUTI SHIVARAM
CA INTER NOV'23
AIR 47

OMKAR CHACHAD
CA INTER MAY'24
AIR 47

KAVYA SHAH
CA INTER MAY'24
AIR 50

# Our AIRs
## CA FINAL MAY'22, NOV'23

AIR 2

**SANSKRUTI PAROLIA**
CA FINAL NOV'23

**MAHESH TAPADIYA**
CA FINAL MAY'22
AIR 6

**SHRUTI PAROLIA**
CA FINAL NOV'23
AIR 8

**MAYANK HOLANI**
CA FINAL NOV'23
AIR 17

**KUSHAGRA AGARWAL**
CA FINAL MAY'22
AIR 20

**RITIK SANGHAVI**
CA FINAL MAY'22
AIR 22

**PARTHIV CHABRIA**
CA FINAL NOV'23
AIR 32

**PINAL KHETAN**
CA FINAL NOV'23
AIR 35

**SHOURYA TIBREWALA**
CA FINAL MAY'22
AIR 39

**DEEPAK LADHA**
CA FINAL NOV'23
AIR 40

**HIMANSHU KHATRI**
CA FINAL MAY'22
AIR 41

**SHRAVAN MUNDRA**
CA FINAL NOV'23
AIR 45

**DEEPTHI PACHIPULUSU**
CA FINAL MAY'22
AIR 46

**SHREY AGARWAL**
CA FINAL MAY'22
AIR 48

EDNOVATE

# Why Early Bird?

"Early bird batch will have a clear one month lead over the regular batch. This extra month will prove to be a big bonus for one extra revision of the entire syllabus and taking up the test series after full preparation.

This additional time will remove all your last minute tensions and anxiety and will make you more confident for the examination."

## INTER CA SEPT'25

| LECTURE SCHEDULE | | |
|---|---|---|
| COMMENCEMENT | COMPLETION | TIMING |
| 26.09.2024 | 30.05.2025 | 7-8 HOURS/DAY |

| TEST SCHEDULE | | |
|---|---|---|
| MONTHS | NO. OF TESTS | MARKS |
| Oct - Apr | 14 (2 Test / Month) | 50 |
| May - Aug | 12 (6 Subjects x 2) | 50 |
| | 12 (6 Subjects x 2) | 100 |

**Only Classes to conduct 38 tests with KNOW YOUR MISTAKE Report**

7273 967 967

EDNOVATE
Innovating Education

# CA Foundation

# Accounts

Ednovate
ednovateofficial
Ednovate Official
Ednovate Classes

# PREFACE

Hello Friends,
Team Ednovate at the very outset extends its warm Welcome to You ALL in the Magical world of Chartered Accountancy.

This Enriching journey will be sometimes Tiring, sometimes Complex but it's our promise to you that it will Certainly be Enjoyable and Worthy of your time and efforts.

Through this book and lectures we intend to provide you with:

1. Exam oriented Exhaustive, Amended and Easy to understand Content.
2. Questions are selected from ICAI study material, past examinations and various other relevant sources.
3. Seamless Conceptual Understanding of the subject with Real Life Practical Examples.

As per a Famous Saying,
"A journey of a Thousand miles begins with a Single Step"
So let's take our First step towards unwinding CA Foundation and come out of it as a PRO.

Wish you All the Best
**Team Ednovate**

**CAFC Last Day Revison Sept. 24 : Principles and Practice of Accounting**

INDEX

^ **Introduction to Journal**

Journal is the **Primary book of account** in which financial transactions are **first recorded** in a chronological order i.e. in the sequence they are entered into. The basic book of accounting is called Journal. Precisely, it is the **book of prime entry** which means **Day Book**. Trader records his total daily transactions in it. Transactions are recorded in the Journal book from **accounting vouchers** that are prepared on the basis of **source vouchers** / documents.

^ Journal is **sub-divided into** a number of subsidiary books which are as follows.

| | Name of the Journal | Transactions to be recorded |
|---|---|---|
| I ) | Cash Book | Cash, Bank & Discount ( TCCB ) |
| | | Cash & Bank / Cash or Bank & Discount ( DCCB ) |
| | | Simple Cash Book / Single Column Cash Book ( SCCB ) |
| II ) | Purchases Book | **Credit** Purchases of Goods |
| | Sales Book | **Credit** Sales of Goods |
| | Purchases Return Book | Purchases Returns ( out of **credit** purchases ) |
| | Sales Return Book | Sales Returns ( out of **credit** sales ) |
| III ) | Journal Proper | All other transactions |

**Notes** :

1. **I )** Cash Book includes Petty Cash Book as well
2. **II )** are also called Goods Journals
3. **I ) & II )** are called Special Journals, as specific transactions as defined are recorded in each of these.
4. **Besides above**, Bills Receivable Book & Bills Payable Book are also maintained if the volume of acceptances received & acceptances given is high.
5. **III )** Journal proper is also called General Journal , as it records all the remaining transactions which cannot be recorded in any of the above Special Journals. These **are those transactions** for which separate Journal is **not** prepared as volume of such transactions is relatively low.

^ **Cash Book**

Cash Book is a **book of primary entry** in which cash and bank transactions of a business are recorded in chronological order, i.e. as they are entered into. Recording of transactions in the cash book **takes form of a** ledger account. **In other words**, cash books itself serves as cash account and bank account. Hence, there is **no need to prepare** separate Cash A/c and Bank A/c in ledger.

^ **Introduction to Ledger**

Ledger is Secondary book of account **or** Principal book of account **or**
Book of Final Entry.

**After recording the transaction in Journal(s),**
it is then posted into respective accounts maintained in ledger.

In Ledger, **all** accounts **( Personal, Real, Nominal )** are maintained **i.e.**
A/c's of **all** Assets, Liabilities, Capital - Drawings, Expenses & Incomes are maintained.

The process of transfer of Journal entry to a ledger account is called **Posting**.

* **Ledger Accounts Balances**

**1. Personal Accounts**

* If Account of any person **shows debit balance**, it means such person is **our Debtor** i.e. money / money's worth is receivable in future **( Assets )**

* If Account of any person **shows credit balance**, it means such person is **our Creditor** i.e. money / money's worth is payable in future **( Liabilities )**

**2. Real Accounts**

Real Accounts **shows Debit balance**, which indicates value of property / thing in hand as on date. **( Assets )**

**3. Nominal Accounts**

* Account of Expenses / Losses **shows Debit balance**, which indicates Expense incurred / Loss suffered till the date in current period.

* Account of Incomes / Gains **shows Credit balance**, which indicates Income / Profit earned till the date in current period.

** **Depending upon volume,** for convenience, **Ledger can be bifurcated into 3 parts :**
**1)** Sales ( Debtors ) Ledger **2)** Purchases ( Creditors ) Ledger **3)** General Ledger

^ **Introduction to Trial Balance**

After posting of all the transactions in the Ledger in respective accounts is completed and all accounts are balanced, it becomes necessary to **check the arithmetical accuracy** of the accounting work.

For this purpose, the balance of each and every account in the Ledger is put on a list.
The list so prepared **is called** Trial Balance ( TB ).

"A Trial balance is **the list** of debit and credit balances, taken out from the Ledger.
**It also** includes **the balances of Cash and Bank** taken from **the Cash Book**."

^ **Q. 1** : Prepare a Triple Column Cash Book from the following transactions of M/s Raj Agencies and bring down the balance for the start of next month.

| Mar-22 | | (`) |
|---|---|---|
| 1 | Cash in hand | 30,000 |
| 2 | Cash at bank | 1,20,000 |
| 2 | Paid into bank | 10,000 |
| 5 | Bought Furniture and issued cheque | 15,000 |
| 8 | Purchased goods for cash | 5,000 |
| 8 | Received cash from Mohan | 9,800 |
| | Discount allowed to him | 200 |
| 14 | Cash sales | 50,000 |
| 16 | Paid to Lata by cheque | 14,500 |
| | Discount received | 500 |
| 19 | Paid into bank | 5,000 |
| 23 | Withdrawn from bank for private expenses | 6,000 |
| 24 | Received cheque from Gupta | 14,300 |
| | Allowed him discount | 200 |
| 26 | Deposited Gupta's cheque into bank | |
| 28 | Withdrew cash from bank for office use | 20,000 |
| 30 | Paid Rent by cheque | 8,000 |

^ **Q. 2** : Journalise the following transactions in the books of Mr. Rohit.

| | |
|---|---|
| 1 | Purchased goods from Sam for ₹ 40,000 at a trade discount of 10% plus CGST and SGST @ 9% each. ₹ 20,000 was paid immediately & balance payable after 3 months. |
| 2 | Paid rent to Gagandeep for ₹ 30,000 plus CGST and SGST 6% each. |
| 3 | Purchased furniture for ₹ 44,800 including IGST @ 12%. |
| 4 | Goods costing ₹ 20,000 withdrawn for personal use. Such goods were purchased by paying CGST and SGST @ 9% each. |
| 5 | Goods costing ₹ 5,000 ( before T.D. of 10% ) returned to Sam. Such goods were purchased by paying CGST and SGST @ 9% each. |
| 6 | Sold goods to Surjeet for ₹ 28,000 including CGST and SGST @ 6% each. |
| 7 | Received ₹ 25,200 from Surjeet in full settlement of his account of ₹ 28,000. |
| 8 | Sold goods to Kapil for ₹ 30,000 charged IGST @ 12%. Received ₹ 12,000 immediately and balance to be received after one month. |
| 9 | Kapil was allowed rebate of ₹ 5,000 as goods supplied to him were defective. These goods were sold by charging IGST @ 12%. |

^ **Goods and Services Tax ( GST )**

GST is an Indirect Tax ( IDT ) levied / charged at prescribed rate on **every supply** of goods & services, by the tax payers registered under GST.
( Supply : Sale of goods & rendering of services )

* GST is levied at the **same** rate on **similar** goods & services across all States & Union Territories. ( Union Territories : Andaman & Nicobar Islands, Dadra & Nagar Haveli, Chandigarh, Lakshadweep, Daman & diu )

**For eg.** :
GST is applied on Electronic goods **across India** at the rate of 18%

* Goods & / or Services are grouped in **five categories** for the purpose of levy of GST.
GST is applied on goods &/or services at the **rates as specified** on that category.
**The rates prescribed are** : 0%, 5%, 12%, 18% & 28%
Rates and types of GST as prescribed by the government are subject to change.

* **Levy ( charging ) of GST**

GST is of following 3 types / categories

i) CGST : Central GST
ii) SGST : State GST ( UTGST : Union Territory GST )
iii) IGST : Integrated GST

* Various relevant transactions are divided into 2 parts for the purpose of levy of GST.

**1) GST on transactions with-in the same state ( Intra state transactions )**

When the supply ( sale ) of goods &/or services are with-in the same state, **both CGST & SGST**, each, are levied / charged **at half the prescribed rate** for such goods &/or service.
For eg. : If the prescribed rate of GST is 12%,
both CGST & SGST will be charged at 6% each on the value of supply ( sale ).
CGST will go the CG and SGST will go to the SG.

**2) GST on transactions outside the state ( Inter state transactions )**

When the supply ( sale ) of goods &/or services are outside the state,
**IGST** is levied / charged at the prescribed rate for such goods &/or service.
For eg. : If the prescribed rate of GST is 12%, IGST will be charged at 12% on the value of supply ( sale ).
Though IGST is collected by the CG, Revenue collected under IGST will be divided between CG & SG as per the rates prescribed by the Government.

* **GST Paid**

GST is paid on purchase of goods &/or services. It is called **Input GST**.

In most cases,
GST paid ( Input GST ) can be set-off against GST collected ( Output GST ),
it is accounted for **an Asset** and hence, **Input GST A/c is debited** when such goods &/or services are purchased.

* **GST Collected**

GST is received / collected on sale of goods &/or services. It is called **Output GST**.
Output GST can **never be treated** as our Income.
It is our **Liability** since it is collected by us on behalf of the Government.

**Output GST A/c is credited** when such goods are sold.

**After setting off** Input GST against Output GST [ **after claiming** Input Tax Credit ( ITC ) ],
excess Output GST is payable to the Government & hence,
it is **Liability** of the business.

* **Reversal / Cancellation of GST paid & debited to Input GST A/c**

**i)** GST paid & claimed as Input GST is reversed in case of **Purchase Returns** as, in effect, purchases have reduced.

**ii)** **When goods are NOT sold further**

**eg.** Other outgoings of goods
( Goods withdrawn by proprietor for personal use,
Goods distributed as free samples, Goods lost by fire, theft etc. )

* **Reversal / Cancellation of GST received & credited to Output GST A/c**

GST received and credited to Output GST A/c is reversed in case of :

i) Sales Returns, as, in effect, sales have reduced.

ii) Rebate allowed for defective goods

## I. Transactions between Business firm and Bank

^ Usually, business firm opens a **Current account** with bank and all the transactions entered into with bank are recorded in **Bank column** of **Cash Book**.
Such bank column in cash book plays a dual role of Journal for recording bank transactions as well as Bank A/c.
Likewise, Bank opens a ledger account of every customer in its books and records all such transactions in such account. Periodically, bank supplies copy of the firm's A/c, in its ledger, to the firm for information and confirmation. This **copy of firm's account** in the books of bank is called **Pass Book** or **Bank Statement**.

^ **Receipts ( bank balance increases )**

All receipts are recorded on debit side of cash book and credit side of pass book
i.e. are said to be **debited** in cash book and **credited** in pass book

^ **Payments ( bank balance decreases )**

All payments are recorded on credit side of cash book and debit side of pass book
i.e. are said to be **credited** in cash book and **debited** in pass book

Cash Book ( Bank Column )

Dr. **Bank A/c** in our books Cr.

| Receipts<br>( Bank balance Increases ) | Payments<br>( Bank balance Decreases ) |
|---|---|

Pass Book

Dr. **Our A/c** in the books of bank Cr.

| Withdrawals<br>( Bank balance Decreases ) | Deposits<br>( Bank balance Increases ) |
|---|---|

^ **Regular Bank balance**

It indicates our money lying in bank account.
**In our ( firm's ) books**, Bank A/c will have Debit balance as Bank is our Debtor
**In the books of Bank**, Our A/c will have Credit balance as we are Creditor for Bank.

^ **Overdraft balance**

It indicates more amount withdrawn by us from bank than deposits
**In our ( firm's ) books**, Bank A/c will have Credit balance as Bank is our Creditor
**In the books of Bank**, Our A/c will have Debit balance as we are Debtor for Bank.

^

| | Regular balance | Overdraft balance |
|---|---|---|
| **Dr. balance** as per Cash Book | ● | |
| **Cr. Balance** as per Pass Book | ● | |
| **Cr. Balance** as per Cash Book | | ● |
| **Dr. balance** as per Pass Book | | ● |

## II. Bank Reconciliation Statement ( BRS )

Since all the transactions entered into by firm with the bank are recorded by both the parties, there should be no difference in balances shown by cash book and pass book. Since all the entries recorded on Debit side of cash book are recorded on Credit side of pass book & vice versa, bank balance as per Cash Book & bank balance as per Pass book must tally, as on any date.

**However,**

sometimes it is possible that both the balances **as on particular date** does not tally. It can be due to one or more of the following reasons.

**1)** Transactions recorded by one party but yet not recorded by other party ( timing difference in recording )

**2)** Error committed by either party

Hence, a statement is prepared at the **end of specified period**, to identify the reasons of difference & to reconcile the balances of two books.

Such a statement is called **'Bank Reconciliation Statement'**.

**Thus**, BRS is a statement prepared mainly **to reconcile** the difference between

**i)** Bank balance as per Cash Book and

**ii)** Bank balance as per Pass Book, **as on particular date**.

## ^ Need and Importance of BRS

1. Errors, if any, committed in recording transactions either by us in cash book or by bank in pass book are identified and can be rectified in time accordingly.
2. By preparing a BRS, firm becomes sure about the correctness of bank balance shown by CB. It helps in making further transactions with the bank, especially payments.
3. BRS facilitates updation of cash book from time to time, by recording transactions which were recorded by bank only but not recorded in cash book.

* It should be noted that it is neither compulsory to prepare BRS nor there is any fixed date / frequency for preparing BRS.

It is **not** even part of Double Entry System ( DES ) of Accounting.

It is **off the record statement**, prepared periodically, for reasons as stated.

^ **Q. 3 :** Prepare a bank reconciliation statement from the following particulars as on 31st March, 2022 :

| Particulars | Amt. (`) |
|---|---|
| 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 |

^ **Q. 4 :** From the following information, prepare a bank reconciliation statement as at 31st December, 2022 for Messrs New Steel Limited :

| Sr. No. | Particulars | ` |
|---|---|---|
| 1 | Bank overdraft as per Cash Book on 31st December, 2022 | 22,45,900 |
| 2 | Interest debited by Bank on 26th December, 2022 but no advice received | 2,78,700 |
| 3 | Cheque issued before 31st December, 2022 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, 2022 | 13,50,000 |
| 6 | Bills for collection credited by the Bank till 31st December, 2022 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 |

^ **Adjusted Cash Book**

When the **balance in the cash book** is first adjusted for certain adjustments before taking it to the bank reconciliation statement,
then it is known as **adjusted cash book balance.**

**While adjusting the cash-book,**

the following adjustments are considered:-

(1) **All the errors in Cash Book** ( like incorrect amount recorded in the cash-book, entry posted twice in the cash-book, over/undercasting of the balance etc.) and

(2) **Omissions in Cash Book** ( like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonour of cheques/bills etc.) / by the cash-book are taken into care.

**Remember**

* **Adjusted** Cash Book balance **is taken to** BRS.
* Errors occuring in the P.B. are **not considered** in adjusted C.B.
* Any delay in recording in P.B. due to timing difference are **not considered** in adjusted C.B.

Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months.

**But**, if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

^ **Q. 5 :** According to the cash-book of Gopi, there was a balance of ` 44,50,000 in his bank on 30th June, 2022. On investigation you find that:

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

(2) 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 2022.

(3) 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.

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

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

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

(7) 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.

Required :

(a) prepare BRS as on 30 th June, 2022 without adjusting the Cash Book

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

(b) to prepare a statement reconciling adjusted cash book balance with the pass book.

^ **Process of Accounting / Accounting Cycle**

It includes various stages, which are as follows

1) Classification of various Events **between Transactions & Non- Transactions**

**Non - Transactions,** though could be very important for business and may affect business in long run, but, are **not recorded in** books of accounts since it doesn't affect any of the Personal, Real **or** Nominal Accounts as on today.

It's effect cann't be measured in terms of money.

2) Classification of Transactions between **Business & Personal Transactions**

**Personal Transactions** of proprietor which doesn't affect any of the Personal, Real **or** Nominal Accounts of business **are not recorded** in the books of accounts

3) **Various Business Transactions** as entered into throught the year **are :**

* **Firstly,** recorded in Primary Book of Account / Book of Original Entry called Journal or sub-division of such Journal called Subsidiary books.

Such recording is based on scientific principle called **Double Entry System** ( DES ) of book keeping, following dual aspect concept, as per which,

**for every debit,** there has to be **corresponding credit of the same amount**

* **Secondly,** such transactions are posted from Journal to Secondary / Principal book of account called Ledger.

It includes Posting, Casting & Balancing of various Ledger Accounts

**Both the above steps** ( Journal & Ledger ) includes Casting ( totalling ) & Carrying forward a total of one page to another page.

4) **At the end of Accounting period / year,**

* All Books & Ledger Accounts are closed, closing balance of each & every Account is put on a list called Trial Balance, to check the Arithmetical accuracy of accounting work.

DES of Accounting requires that for every debit, there is corresponding credit of the same amount. **If above principle is followed correctly,** throughout the period / year, for each & every transaction in books of accounts, Trial Balance ( TB ) tallies i.e. Total of debit column of TB is **equal to** total of credit column of TB.

* Then, **Final Accounts** are prepared consisting of :

1) Trading Account for the year ended ……… ( last day of year )
2) Profit & Loss Account for the year ended ……… ( last day of year )
3) Balance Sheet as on ……… ( last day of year )

## ^ **Introduction**

Accounting is **often regarded as** a language of business.
Since the main aim of a language **is to serve as a** means of communication,
Accounting **communicates the result of business activities** to various interested parties like owners, management, creditors, lenders, government, employees etc.
These users **use accounting information** in order to satisfy some of their varied needs for information.
**Hence,**
it is very important that information provided by books of accounts is True & Fair and
**it does not contain one or more errors,** thereby resulting into giving
Incorrect / misleading information to various users of accounting information.

## ^ **Error**

Error can be defined as an unintentional mistake.
Such errors can be **at any stage** in accounting process.
It can be error in recording the transaction, error in posting, error in casting,
error in balancing, error in carrying forward, error in writing balance in trial balance etc
Such errors **may not** affect tallying of Trial balance **or** may affect the trial triance,
**depending upon** whether DES of accounting is followed properly or not.

Accordingly, **a particular error** can be **either** termed as :
**1)** Two sided error ( If it doesn't affect tallying of the Trial balance ) **or**
**2)** One sided error ( If it affects tallying of the Trial balance )

## ^ **Rectification of Errors**

Errors, whether affecting the trial balance or not, **must be detected and corrected,**
**to enable books of accounts giving**
True & Fair view of operating results **( Profit or Loss )** and
Financial Position **( Assets, External Liabilities & Capital ).**

The procedure followed to rectify the errors & to set right accounting records is called
**Rectification of Errors.**
**Journal Entry** passed to rectify any error is called a **Rectification Entry.**
Rectification Entries are recorded in **Journal Proper.**
**Rectification of Errors can be :**
* **Before** preparation of Trial Balance **or**
* **After** preparation of Trial Balance ;

**depending upon** at what stage such error is detected.

^ **Types of Errors**

I ) **Errors of Principle**

Transactions recorded without following the accounting principles and rules are known as errors of principle. These errors are caused **due to the violation of** one or more fundamental accounting principles.

An error of principle may occur due to incorrect classification of expenditure or receipt between Capital and Revenue or due to any other violation of accounting rule(s).

These errors doesn't affect tallying of Trial balance ( **two sided errors** ) since DES of accounting is not violated.

II ) **Errors of Omission**

a) **Errors of Complete Omission**

Such error occurs when a transaction is completely omitted to be recorded in books of accounts. These errors doesn't affect tallying of Trial balance ( **two sided errors** ) since DES of accounting is not violated.

b) **Errors of Partial Omission**

An error of omission other than error of complete omission is error of partial ommission.

These errors affects tallying of Trial balance ( **one sided errors** ) since DES of accounting is violated.

( continued on next page )

^ **Q. 6 :** The following mistakes were located in the books of a concern after its books were closed and a Suspense Account was opened in order to get the Trial Balance agreed:

| | |
|---|---|
| (i) | Sales Day Book was overcast by ` 1,000. |
| (ii) | A sale of ` 5,000 to X was wrongly debited to the Account of Y. |
| (iii) | General expenses ` 180 was posted in the General Ledger as ` 810. |
| (iv) | A Bill Receivable for ` 1,550 was passed through Bills Payable Book. The bill was given by P. |
| (v) | Legal Expenses ` 1,190 paid to Mrs. Neetu was debited to her personal account. |
| (vi) | Cash received from Ram was debited to Shyam ` 1,500. |
| (vii) | While carrying forward the total of one page of the Purchases Book to the next, the amount of ` 1,235 was written as ` 1,325. |

Find out the amount of the Suspense Account and pass entries ( without narration ) for the rectification of the above errors in the subsequent year's books.

## III ) Errors of Commission

| Types of Errors | | One sided Errors | Two sided Errors |
|---|---|---|---|
| a) | **Error of recording**<br>This error arises when any transaction is recorded incorrectly in the books of original entry i.e. double effect given, but both effects are for wrong amount or recorded in wrong book<br>eg. Goods purchased on credit from Mohan for ₹ 500 recorded in Purchase Book as ₹ 5,000 | | ● |
| b) | **Error of casting**<br>This error arises when mistake is committed in totalling the books of original entry | ● | |
| c) | **Error in carrying forward**<br>This error arises when mistake is committed in carrying forward a total of one page to another page | ● | |
| d) | **Error in Posting** | | |
| i) | **Errors of posting NOT affecting the TB**<br>eg. posting correct amount on correct side, but in wrong account, posting wrong amount in both affected accounts ( from Journal proper ) | | ● |
| ii) | **Errors of posting affecting the TB**<br>Posting wrong amount from Special Journals, posting on wrong side of the account, posting twice in one account | ● | |
| e) | **Error in balancing of an account** | ● | |

## IV) Compensating Errors

| | | |
|---|---|---|
| These are the errors in which effect of one error is nullified by the effect of another error in such a way that trial balance tallies. **This is pure coincidence.**<br>**eg.** Purchase book was undercast by ₹ 2,000 & Sales Returns book was overcast by ₹ 2,000 ; Credit sales of ₹ 7,956 debited to Shyam's A/c as ₹ 7,965 and credit purchase of ₹ 2,412 credited to Ram's A/c as ₹ 2,421 | | ● |

^ **Q. 6** : In the books of a concern

| ROE I | ROE II | ROE III |
|---|---|---|

**i)** Sales Day Book was overcast by Rs. 1,000 ( **sided error )**

**ii)** Sales of Rs. 5,000 to X was wrongly debited to the A/c of Y ( **sided error )**

**iii)** General expenses of Rs. 180 posted in the General Ledger as Rs. 810 ( **sided )**

**iv)** A Bills Receivable of Rs. 1,550 was passed through Bills Payable Book.
The bill was given by Mr. P

**v)** Legal expenses Rs. 1,190 paid to Mrs. Neetu debited to her Personal A/c

**vi)** Cash received from Ram was debited to Shyam Rs. 1,500

**vii)** While carrying forward the total of one page of the Purchase Book to the next, the amount of Rs. 1,235 was written off as Rs. 1,325

^ **Q. 6 :** **In the books of a concern**

JOURNAL

| Date | Particulars | L.F. | Debit (₹) | Credit (₹) |
|---|---|---|---|---|
| i) | | | | |
| | | | | |
| | | | | |
| ii) | | | | |
| | | | | |
| | | | | |
| iii) | | | | |
| | | | | |
| | | | | |
| iv) | | | | |
| | | | | |
| | | | | |
| | | | | |
| v) | | | | |
| | | | | |
| | | | | |
| vi) | | | | |
| | | | | |
| | | | | |
| | | | | |
| vii) | | | | |
| | | | | |
| | | | | |
| viii) | | | | |
| | | | | |

^ **Dr.** **Suspense A/c** **Cr.**

| Date | Particulars | J.F. | ₹ | Date | Particulars | J.F. | ₹ |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |

^ ## Introduction

In modern times, large number of business transactions are made on credit basis.
When goods or services are obtained and payment will be made in future,
it is known as **credit transaction**.
Credit transactions **plays significant role** in the world of business.
Credit **motivates the customers** to increase the amount of their spending.
Moreover, business enterprises offer credit **to gain a competitive advantage** in the market.

To balance the potential for increased sales with the risk of decreased cash flow and large outstanding debts, the seller requires some sort of promise or commitment from the customer that he would pay the amount of goods due from him on a particular date in future.
**In such a case**, the seller would like to get a **written undertaking** from the buyer to get the payment after a fixed specified period.
As such, the seller **prepares a document** in which he puts in writing all the terms and conditions relating to sale of goods such as amount required to be paid, date of payment, place of payment and other relevant details.
Seller **signs such document** and sends it to buyer for **his acceptance ( signature )**.
Buyer puts his signature on the document and it is known as **'Bill of Exchange'**

The bills of exchange are **instruments of credit** which facilitate the credit sale of goods.
BOE along with Promissory Note & Cheque are called **Negotiable Instruments** ( NI )
and are governed by the **Indian Negotiable Instruments Act, 1881**.
Such Act **has defined Negotiable Instrument** as follows
"Negotiable Instrument means a Bill of Exchange, Promissory Note or Cheque payable either to bearer or to order."

^ ## Bill of Exchange ( BOE )

Section 5 of the Indian Negotiable Instruments Act, 1881 defines a BOE as follows.

**A Bill of Exchange**

* is an instrument in writing,
* containing an unconditional order,
* signed by the maker,
* directing a certain person to pay certain sum of money
* only to, or to the order of, a certain person
* or to the bearer of the instrument.

* **Ex.** Prepare a bill of exchange from the following details.

(1) Drawer : Ms. Sucheta Gujarathi, Panama Apt., Dwarka, Nashik.
(2) Drawee : Vishal Bhardwaj, 506, Matange Colony, Satara.
(3) Period : 3 months
(4) Amount : ₹ 35,000
(5) Date of bill : 22nd August, 2022.
(6) Accepted on : 25th August, 2022.

**BILL OF EXCHANGE**

Ms. Sucheta Gujarathi,
Panama Apt.,
Dwarka, Nashik.
Date : 22nd August, 2022

| STAMP |
|---|
| ₹ 35,000 |

Three months after date pay to me or my order the sum of Rupees Thirty Five Thousand only, for the value received.

Sd/-
( Ms. Sucheta Gujarathi )

To,
Vishal Bhardwaj,
506, Matange Colony,
Satara.

"Accepted"
Sd/-
( Vishal Bhardwaj )
Date : 25th August, 2022.

^ **Features of BOE**

**1.** It is drawn ( prepared ) and signed by the maker, called as **Drawer** of the bill.
He is the person who has granted credit to the person on whom the BOE is drawn.
**In credit sales**, seller of the goods draws the bill on buyer of the goods.
In above example, Mr. Prakash Rao is the drawer of the bill.

**2.** It must be **accepted** by the the person on whom such bill is drawn, to make it a legal document. Such person who accepts the bill drawn by the drawer is called the **Drawee** of the bill. In above example, Mr. Rahul Deo is the drawee of the bill.
Before acceptance of such bill by the drawee, it is called draft.
It becomes legal document ( BOE ) **only on its** acceptance by the drawee.

**3.** A BOE is a written order.

**4.** It is an unconditional order to the drawee to pay the specified amount.

**5.** The specified amount is payable to the person named in the bill or to his order . or to the bearer. Such person to whom amount of the bill is to be paid is called **Payee**.

* Payee may be the drawer himself **or** a third person.

**6.** The last words in description **'for value received'** indicate that the bill is being drawn by the drawer on the drawee in consideration of the goods sold to the drawee on credit.

^ **Payee of the Bill**

= Holder of the bill on the due date of the bill.

Drawer of the bill has **following 4 options** to deal with the bill.

* **Option I**

He can **retain the bill** till maturity / due date with himself in which case he will be the **Payee**, as he is the holder of the bill on due date of the bill.

* **Option II**

He can **discount the bill** with the bank. BOE serves as a source of finance for the drawer. He need not wait till the due date of the bill to get the amount. If he needs money before the due date, he can get the bill discounted with the bank.
Bank deducts charges called as 'Discounting Charges' & gives balance amount to the drawer. Such charges depends upon the rate of interest & the period left for maturity.

In such case, bank will be the **Payee**, as bank will be the holder of the bill on due date of the bill.

* **Option III**

He can **endorse the bill** in favour of a creditor. The person who endorses the bill is called the **endorser**. The person in favour of whom bill is endorsed is called the **endorsee**. In such case, endorsee / creditor will be the **Payee**, as he will be the holder of the bill on due date of the bill.

* **Option IV**

He can send the bill to **bank for collection**.

In such case, bank will retain the bill in it's safe custody till the due date and present it for payment on due date. Bank will credit the amount in the account of the customer ( drawer ) after deduction of service charges, if any.

^ **Due date of the bill** or **Maturity Date**

* Due date is the date on which the payment of the bill is due.
It is the date on which drawee of the bill is liable to pay amount of the bill to the payee of the bill. It is also known as date of maturity.

* Due date calculation **depends upon** the type of bill.
**Bill after date** or **Bill after sight**

^ **Bill after date** is the bill in which the period is counted from the **date of drawing** of the bill.

^ **Bill after sight** is the bill in which the period is counted from the **date of acceptance** of the bill.

* In both the above cases,
**3 Days of Grace** are added to the period of bill to calculate the due date of the bill.

^ Following points to be remembered **while calculating** due date of the bill

* **When the period of the bill is stated in days,**
the calculation of maturity date will be in days.
Date of transaction to be excluded and date of payment to be included.

**For eg.** A bill dated 01.01.21 is payable 60 days after date.
Add 63 days ( including 3 days of grace ) to calculate the due date.

**Due date** = 30 days of Jan. + 28 days of Feb. + 5 days of Mar. = **5th March**
( **2021** : not leap year )

* **When the period of the bill is stated in months,**
the calculation of due date will be in months, ignoring the number of days in a month.

**For eg.** A bill dated 01.01.21 is payable 3 months after date.

**Due date** = 01.01.21 + 3 months = 01.04.21 + 3 days of grace = **04.04.21**

* If the maturity date falls on **sunday** or **public holiday,** it should be taken as **immediately preceding** working day.

* If the maturity date is declared as **emergency holiday**, it should be taken as **immediately following** working day.

* Date calculated **without adding** days of grace is called as **Nominal Due Date**.

* Date calculated **after adding** days of grace is called as **Due Date ( Legal Due Date )**.

* **Honour of the bill on due date**

  When drawee of the bill **pays** the amount of the bill **on** the due date of the bill **to** the holder of the bill, bill is said to be **honoured**.

* **Retirement of the bill**

  When drawee of the bill **pays** the amount of the bill **before** the due date of the bill, bill is said to be **retired**. If drawee wishes to pay the amount of the bill before due date, it is called **Retiring the bill**. Usually, the holder of the bill, in such case, would be willing to allow a reduction in amount, may be to the extent of interest, for early payment. Such reduction is called **Rebate**.

* **Dishonour of the bill on due date**

  When drawee of the bill **does not pay** the amount of the bill on the due date of the bill, bill is said to be dishonoured.

**Noting and Protesting of bill**

To **establish the fact** that the bill was properly presented for payment to the drawee and was dishonoured, the bill is again presented for payment through a person called **Notary Public** ( an official appointed under law ). On drawee refusing to make the payment of bill, the notary public notes down the fact of dishonour of bill. Such act of notary public is called **"Noting"**. For rendering these services, notary public charges a small fee called **Noting Charges**. Noting charges is the fees paid to the notary public for authenticating the fact of dishonour of bill.

**Noting will consist of the following**

i) That the bill has been dishonoured

ii) The date of the dishonour

iii) The reason, if any, for the dishonour

iv) The fee charged by the notary public i.e. Noting charges

Thus, **Noting** is the process of recording the fact and reasons of dishonor by the notary public.

**Protest** is **a certificate** issued by a notary public **attesting the fact** of dishonour recorded upon the Instrument.

**^ Who pays the Noting Charges to the notary public ?**

Holder of the bill on due date of the bill ( Drawer or Bank or Creditor / Endorsee )

**^ Is Holder of the bill liable to bear Noting Charges ?**

No. Holder will recover such charges from the drawer, who in turn, will recover it from the drawee.

**^ Who finally bears Noting Charges ?**

Drawee ( since bill is dishonoured by him )

**^ Noting Charges are expense for whom ?**

Noting charges are expense for the Drawee ( and Income for Notary Public )

* **Renewal of Bill**

= Dishonour ( cancellation ) of existing bill ( by mutual consent )

+

Acceptance of new bill

An accepter of bill ( drawee ) may not be able to meet ( honour ) the bill on the due date and may request to renew the bill. **The purpose is to get extension of time.** If the drawer agrees, the old ( existing ) bill is cancelled and new bill is drawn & accepted by the drawee. This **process** is called **Renewal of the bill**. In such case, bill may not be **noted** as drawee himself makes the request for cancellation of old bill.

**Normally**, drawer may agree for renewal of the bill, subject to one or more of the following terms.

i ) New bill **may not be** for full amount due. Drawer may insist upon drawee to make part payment immediately & for balance amount due, new bill can be drawn & accepted.

ii ) Drawer will charge **Interest** for the extension of time. Such Interest will depend on the amount of new bill, rate of interest and period of such new bill.

iii ) **The amount of Interest** may be paid in cash immediately or may get added in new bill amount, as may be mutually decided between drawer and drawee.

^ **Q. 7 :** On 12th May, 2020 A sold goods to B for ` 36,470 and drew upon the later two bills one for ` 16,470 at one month and the other for ` 20,000 at three months.
B accepted both the bills.
On 5th June, 2020 A sent both the bills to his banker for collection on the due dates.
The first bill was duly met. But due to some temporary financial difficulties, B failed to honour the second bill on the due date and the bank had to pay ` 20 as noting charges.
However, on 16th August, 2020 it was agreed between A & B that B would immediately pay ` 8,020 in cash and accept a new bill at 3 months for ` 12,480 which included interest for postponement of the part payment of the dishonoured bill. A immediately sent new acceptance to its bank for collection on the due date. On 1st October, 2020, B approached A offering ` 12,240 for retirement of his acceptance.
A accepted the request.
Pass journal entries of all the above transactions in the books of A.

^ **Accommodation Bills**

Bills of exchange are usually drawn to facilitate trade transaction, i.e. bills are meant to finance actual purchase and sale of goods. But the mechanism can be used to raise finance also.
An accommodation bill is a bill which is drawn and accepted or endorsed not in the ordinary course of business, but for the **specific purpose of temporary financial help** of one party or both the parties.
In case of an accommodation bill, the relationship between drawer and acceptor is not that of a creditor and debtor because an accommodation bill is not supported by any genuine transaction.

^ **Q. 8 :** X draws on Y a bill of exchange for ` 30,000 on 1st April, 2022 for 3 months.
Y accepts the bill and sends it to X who gets it discounted for @ 16% p.a.
X immediately remits ` 9,600 to Y. On the due date, X, being unable to remit the amount due, accepts a bill for ` 42,000 for three months which is discounted by Y for ` 40,110. Y sends ` 6,740 to X. Before the maturity of the bill X becomes bankrupt, his estate paying fifty paise in the rupee. Give the journal entries in the books of X and Y.

^ **Q. 9 :** Anil draws a bill of Rs. 90,000 on Sanjay on 1 st April for 3 months.
After Sanjay's acceptance, Anil discounts it with his bank for Rs. 88,200 and remits 1/3 rd of the amount to Sanjay.
On the due date, Anil fails to remit the amount due to Sanjay, but he accepts a bill for Rs. 1,26,000 for 3 months, which Sanjay discounts for Rs. 1,23,300 and remits Rs. 38,640 to Anil. Before the maturity of the new bill, Anil becomes insolvent and only 40% was realised from his estate on 15 th October.
Pass necessary Journal entries in the books of Anil.

^ **Depreciation**

The term 'Depreciation' is used **in relation to** Fixed Asset ( FA )
& **not** in relation to Goods.

The word 'depreciation' is derived from the **Latin word** 'Depretium' ,
which means **reduction**.

All FA **except Freehold Land** has limited working Life and hence value of FA keeps on reducing with passage of time. Such reduction in the value of FA **mainly** due to its **use in the business** is called Depreciation.

Thus, it can be defined as follows :
Depreciation is **gradual**, **continuous** and **permanent** reduction in the value of fixed asset, mainly due to use of such fixed asset in the business.

^ Causes **or** Reasons of Depreciation ( fall in value )

**i)** **Normal & Natural Wear & Tear**

As we keep on using such FA in business, its value will keep on reducing due to wear & tear. More we use it, more will be the wear & tear and faster its value will reduce.

**ii)** **Passage of time :**

FA gets depreciated due to passage / efflux of time, so it is necessary to depreciate them even if they are not in use.

Some assets have a definite life period like lease. On the expiry of life, asset will cease to exist. Other assets like plant and machinery may not have definite life. In their case, life is estimated.

**iii)** **Obsolescence :**

It means a state when an asset becomes obsolete due to product of better quality being available, due to technological developments etc.

If a better machine leading to lower cost of production comes in the market, value of old machines will fall down & old machines may have to be scrapped even though they are capable of being used.

**iv)** **Accidents / natural Calamities :**

Loss in value of FA due to accidents or natural calamities is permanent, though it is not continuous and gradual. Such redcution in value is also accounted in the books of accounts.

^ **Original Cost of the FA**

Purchase Price of FA **Plus** Capital Expenditure on such FA

Any expenditure **incurred** at the time of purchase of such fixed asset, **before such asset is put to use**, is **called Capital Expenditure** and is to be **added** while arriving at the cost of such fixed asset.

**eg.** expenditure incurred on carriage and installation of machinery,
expenditure incurred on construction / renovation of building (raw materials, wages etc)
expenditure incurred on purchase of building ( stamp duty, registration, brokerage etc )

Any Expenditure incurred on asset **after asset is put to use** like ^ periodic repairs, maintainance, Insurance premium etc is called **Revenue Expenditure.**
^ such expenses are incurred to maintain asset in proper working condition. It is regular business expense and should be **debited to Expense A/c** ( & not FA a/c )

**Note :** GST paid on purchase of fixed asset is **not** the cost of purchase of FA
& it **cannot be added** while determining **Original Cost** of the FA.
( If such GST paid **can be set-off** against GST collected )
Hence, such GST paid is **debited to** Input GST A/c **and not to** Fixed Asset A/c

^ **Estimated** useful or economic life **of the FA**

It refers to the **number of years** for which such FA is estimated to be useful in the business. It is usually lesser than the physical life of FA.

^ **Estimated** Scrap **or** Residual **or** Terminal **value of the FA**

It refers to the estimated scrap value **expected to be received** from the sale / scrap of such FA **at the end of its useful life**

** **O**riginal cost, **E**stimated useful life and **E**stimated scrap value
**are the factors to be considered**
while charging / deciding the amount depreciation every year

^ **Written Down Value / Book value of the FA**

It refers to the **reduced value of FA** in our books **after charging depreciation**.

^ **Methods of Calculating Depreciation**

**Method I : Original Cost Method ( OCM )**

Under this method, depreciation is charged every year **on the OC** of the FA

It is also called Fixed Instalment Method ( FIM ) **or** Straight Line Method ( SLM )

**Calculation of Depreciation**

It is calculated **either** at a specified % as given

**or** to be calculated if estimated useful life & scrap value is given

$$\text{Depreciation p.a.} = \frac{\text{Cost of Asset - Estimated Scrap Value}}{\text{Estimated Useful Life ( in years )}}$$

$$\text{Straight Line Depreciation Rate} = \frac{\text{Straight line depreciation}}{\text{Cost of Asset}} \times 100$$

* **Method II : Written Down Value Method ( WDVM )**

Under this method, depreciation is charged every year **on the WDV** of the FA. It is also called Reducing Balance Method ( RBM ) **or** Diminishing Balance Method ( DBM ).

**Calculation of Depreciation**

It is calculated at a specified %.

^ **Methods of Accounting for Depreciation**

1) Normal Method

2) **Provision for Depreciation method**

This is the method of **accounting for depreciation** & not the method for calculation of depreciation. Under this method, a separate Provision for Deprecation A/c is maintained and amount of depreciation is transferred to the credit of Provision for Depreciation A/c instead of credit to Assets A/c.

At the end of accounting period, Assets A/c and Provision for Depreciation A/c are balanced and balances carried forward to next period.

Under this method, Asset A/c shows the debit balance equal to original cost of asset at the end every of accounting period and Provision for Depreciation A/c shows total amount of depreciation written off on the concerned asset till that date.

**Journal Entries**

| Date | Particulars | L.F. | Debit ` | Credit ` |
|---|---|---|---|---|
| 1 | **For charging depreciation** | | | |
| | Depreciation A/c Dr. | | | |
| | To Provision for Depreciation A/c | | | |

| No. | Particulars | | | |
|---|---|---|---|---|
| | | | | |
| 2 | **<u>For transfer of depreciation to Profit & Loss A/c</u>** | | | |
| | Profit & Loss A/c Dr. | | | |
| | To Depreciation A/c | | | |
| | | | | |
| 3 | **<u>For charging depreciation on SOLD fixed asset</u>** | | | |
| | **<u>till the date of sale</u>** | | | |
| | Depreciation A/c Dr. | | | |
| | To Provision for Depreciation A/c | | | |
| | | | | |
| 4 | **<u>For transfer of cost from asset to Asset Disposal A/c</u>** | | | |
| | Asset Disposal A/c Dr. | | | |
| | To Asset A/c | | | |
| | | | | |
| 5 | **<u>For transfer of depreciation from provision for</u>** | | | |
| | **<u>depreciation A/c</u>** | | | |
| | Provision for depreciation A/c Dr. | | | |
| | To Asset Disposal A/c | | | |
| | ( Amount = Total Depreciation charged till the date of | | | |
| | sale / disposal ) | | | |
| | | | | |
| 6 | **<u>For sale of fixed asset</u>** | | | |
| | Bank A/c **<u>or</u>** Cash A/c Dr. | | | |
| | To Asset Disposal A/c | | | |
| | | | | |
| 7 | **<u>For Profit on sale of fixed asset</u>** | | | |
| | Asset Disposal A/c Dr. | | | |
| | To Profit on Sale of Fixed Asset A/c | | | |
| | | | | |
| 8 | **<u>For closure of profit on ....... A/c</u>** <u>at the end of period</u> | | | |
| | Profit on Sale of Fixed Asset A/c Dr. | | | |
| | To Profit & Loss A/c | | | |
| <u>OR</u> | | | | |
| 7 | **<u>For Loss on sale of fixed asset</u>** | | | |
| | Loss on Sale of Fixed Asset A/c Dr. | | | |
| | To Asset Disposal A/c | | | |
| | | | | |
| 8 | **<u>For closure of loss on ....... A/c</u>** <u>at the end of period</u> | | | |
| | Profit & Loss A/c Dr. | | | |
| | To Loss on Sale of Fixed Asset A/c | | | |

^ **Q. 10 :** On April 1, 2019 a firm purchased a machinery for ` 2,00,000. On 1st October in the same accounting year, additional machinery costing ` 1,00,000 was purchased. On 1st October, 2020, the machinery purchased on 1st April 2019, having become obsolete was sold off for ` 90,000. On October 1, 2021, new machinery was purchased for ` 2,50,000 while the machinery purchased on 1st October 2019 was sold for ` 85,000 on the same day. The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year.
Show Machinery Account, Provision for Depreciation Account, Machine Disposal A/c and Depreciation A/c for the period of three accounting years ending March 31, 2022.

^ **Change in Method of Depreciation**

The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Whenever any change in depreciation method is made, such change in method is treated as **change in accounting estimate** as per Accounting Standards. Its effect needs to be quantified and disclosed separately. A change in an accounting estimate may affect the current period only or both the current period and future periods.

^ **Q. 11 :** A Firm purchased an old machinery for ` 37,000 on 1st January,2019 and spent ` 3,000 on its overhauling. On 1st July 2020, another machine was purchased for ` 10,000. On 1st July 2021, the machinery which was purchased on 1st January 2019, was sold for ` 28,000 and the same day a new machinery costing ` 25,000 was purchased. On 1st July,2022, the machine which was purchased on 1st July,2020 was sold for ` 2,000. Depreciation is charged @ 10% p.a. on straight line method. The firm changed the method & adopted D.B.M. with effect from 1st January, 2020 & the rate was increased to 15% p.a. The books are closed on 31st December every year. Prepare Machinery account for four years from 1st January, 2019.

^ **Q. 12 :** 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. 13 :** A machine of cost ` 12,00,000 is depreciated straight-line assuming 10 year working life & 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.

^ **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.

^ **Basis of Inventory Valuation**

Inventories should be generally valued at the **lower of cost or net realizable value.**

This principle is governed by **'Principle of Conservative Accounting'** under which any expenses or losses from transactions entered or event occurred are to be recognized immediately, however, any gains or profits are not recognized until it becomes due or are actually realized.

Under the principle of 'lower of cost or net realizable value' any loss due to decrease in sales price of the inventory below its cost is recognized immediately as it is anticipated that the enterprise will make losses whenever it will sell.

^ **Q. 14 :** X who was closing his books on 31.3.2022 failed to take the actual stock which he did only on 9th April, 2022, when it was ascertained by him to be worth ` 2,50,000.

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

Purchases are entered in the purchases day book once the invoices are received.

It was found that sales between 31.3.2022 and 9.4.2022 as per the sales day book are ` 17,200. Purchases between 31.3.2022 and 9.4.2022 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, 2022 but goods received only on 4th April, 2022 amounted to ` 1,000. Rate of gross profit is 33-1/3% on cost.

Ascertain the value of physical stock as on 31.3.2022.

^ **Q. 15 :** A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no stock taking could be possible till 15th April, 2022 on which date total cost of goods in his godown came to ` 50,000. The following facts were established between 31st March and 15th April, 2022.

(i) Sales ` 41,000 (including cash sales ` 10,000).

(ii) Purchases ` 5,034 (including cash purchases ` 1,990).

(iii) Sales return ` 1,000.

(iv) On 15th March, goods of the sale value of ` 10,000 were sent on sale or return basis to a customer, the period of approval being four weeks. He returned 40% of the goods on 10th April, approving the rest; the customer was billed on 16th April.

(v) The trader had also received goods costing ` 8,000 in March, for sale on consignment basis. 20% of the goods had been sold by 31st March, and another 50% by the 15th April. These sales are not included in above sales.

Goods are sold by the trader at a profit of 20% on sales.

You are required to ascertain the value of inventory as on 31st March, 2022.

^ **Q. 16 :** Physical verification of stock in a business was done on 23rd June, 2022. The value of the stock was ` 48,00,000. The following transactions took place between 23rd June to 30th June, 2022:

(i) Out of the goods sent on consignment, goods at cost worth ` 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, 2022.

(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, 2022.

(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, 2022.

^ **Q. 17 :** From the following particulars ascertain the value of inventories as on 31st March, 2022:

| | (`) | | (`) |
|---|---|---|---|
| Inventory as on 1.4.2021 | 1,42,500 | Administrative Expenses | 30,000 |
| Purchases | 7,62,500 | Financial Charges | 21,500 |
| Manufacturing Expenses | 1,50,000 | Sales | 12,45,000 |
| Selling Expenses | 60,500 | | |

At the time of valuing inventory as on 31st March, 2021, 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 for ` 45,000. Barring the transaction relating to this item, the gross profit earned during the year was 20 % on sales.

^ **Inventory Record Systems**

There are **two** principal systems of determining the physical quantities and monetary value of inventories sold and in hand. One system is known as 'Periodic Inventory System' and the other as the 'Perpetual Inventory System'. The periodic system is less expensive to use than the perpetual method. But the useful information obtained from perpetual system is more than cost incurred on it. These systems are distinguished on the basis of the actual records kept to ascertain the cost of goods sold and the closing inventory valuations.

1 **Periodic Inventory System**

Periodic inventory system is a method of ascertaining inventory by taking an actual physical count (or measure or weight) of all the inventory items on hand at a particular date on which inventory is valued. It is because of actual physical count that the system is also called physical inventory system. The cost of goods sold is determined as shown below:

Opening inventory + Purchases (known) - Closing Inventory (physically = Cost of goods sold

Periodic inventory system is simple and less expensive than the perpetual system. In this system, inventory account is adjusted at the end of the accounting period to determine cost of goods sold. This system suffers from various limitations :

(i) Physical inventory taking is required more than once a year for preparation of quarterly or half yearly financial statements thereby making this system more expensive.

(ii) Physical count of goods requires closure of normal operations of business.

(iii) As cost of goods sold is taken as residual figure, it is not possible to identify loss of goods due to pilferage, damage or even fraud.

(iv) Inventory control is not possible under this system.

(v) Books of accounts does not reflect inventory in hand and its value therefore, it is difficult to plan operations e.g. how much or when to order/manufacture.

This system is used by small enterprises where it is easy to control physical inventory. This system is not considered suitable for medium or larger enterprises which generally use Perpetual Inventory system.

## 2 Perpetual Inventory System

Perpetual inventory system is a system of recording inventory balances after each receipt and issue. In order to ensure accuracy of perpetual inventory records, physical inventory should be checked and compared with recorded balances. Under this system, cost of goods issued is directly determined and inventory of goods is taken as residual figure with the help of inventory ledger in which flow of goods is recorded on continuous basis. The basic feature of this system is the maintenance of inventory ledger to have records of goods on continuous basis.

Under perpetual inventory system, closing inventory is determined as follows :

Opening inventory (known) + Purchases during the period (known) - Cost of Goods Sold (Known) = Closing Stock (balancing figure)

Perpetual inventory system helps to overcome the limitations of periodic system. As inventory is taken as residual figure, it includes loss of goods. However, the main limiting factor is the high cost of using this system.

### Distinction between Periodic Inventory System and Perpetual Inventory System

Both the systems - Periodic Inventory System and Perpetual Inventory System are not mutually exclusive and complementary in nature.

Distinction between both the systems can be explained as follows:

| S. No. | Periodic Inventory System | Perpetual Inventory System |
|---|---|---|
| 1 | This system verification is based on physical verification. | 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. |

^ **Final Accounts of Manufacturing Entities**

The manufacturing entities generally prepare a separate **Manufacturing Account**, as a part of Final accounts in addition to Trading Account, Profit and Loss A/c 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 A/c to Trading A/c.

^ **Purpose**

1) It shows the total cost of manufacturing the finished products and sets out in detail, with appropriate classifications, the constituent elements of such cost. It is, therefore, **debited with** the cost of materials, manufacturing wages and expenses incurred directly or indirectly on manufacture.

2) It provides details of factory cost and facilitates **reconciliation** of financial books with cost records and also serves as a basis of **comparison** of manufacturing operations from year to year.

3) The Manufacturing A/c may also be used for various purposes. For example, if the output is carried to the Trading Account at market prices, it discloses the profit or loss on manufacture. Similarly, it may also be used to fix the amount of production linked bonus when such schemes are in force.

^ **Manufacturing Costs**

| **Particulars** | ` |
|---|---|
| Raw material consumed | xxx |
| Add : Direct manufacturing wages | xxx |
| Add : Direct manufacturing expenses | xxx |
| Add : Indirect manufacturing expenses or **manufacturing overheads** | xxx |
| **Total Manufacturing Costs** | **xxx** |

* **Raw material consumed**

= Opening stock of raw materials + Purchase of raw material + Expenses on Pur. of R/M - Closing stock of raw material

* If there remains unfinished goods at the beginning &/or end of the accounting period, cost of such unfinished goods i.e. work-in-progress is shown in Manufacturing A/c.

**Opening inventory of work-in-progress** is posted on the **debit** of Manufacturing Account.

**Closing inventory of work-in-progress** is posted on the **credit** of 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 :**

(i) Royalties for using license or technology if based on units produced,

(ii) Hire charge of 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 overheads or Production overheads or Works overheads.

**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.

^ **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.

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.

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.

^

## FORMAT OF A MANUFACTURING ACCOUNT

**Dr.** **Manufacturing Account for the year ended ..........** **Cr.**

| Particulars | ` | ` | Particulars | ` | ` |
|---|---|---|---|---|---|
| To Opening work-in- | | | By By-products at | | |
| progress | | xx | Net Realisable Value | | xx |
| To Raw Materials | | | By Closing work-in- | | |
| Consumed | | | progress | | xx |
| Opening Stock | xx | | | | |
| Add : Purchases (Net) | xx | | **By Cost of Goods** | | |
| Add : Carriage etc. | xx | | **Manufactured** | | |
| Less : Closing Stock | (xx) | xxx | transferred to | | |
| To Direct Wages | | xxx | Trading A/c | | **xxx** |
| To Direct Expenses | | xx | | | |
| To Factory Overheads | | xxx | | | |
| (indirect manufacturing | | | | | |
| expenses) | | | | | |
| | | | | | |
| | | **xxx** | | | **xxx** |

^ **Q. 18 :** 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 31.03.2023 :

| | | | ` |
|---|---|---|---|
| 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 and | |
| | | 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 31.3.2023.

**Q. 19 :** The following is the trial balance of Mr. Pandit for the year ended 31.03.2022.

| Particulars | Dr. (`) | Particulars | Cr. (`) |
|---|---|---|---|
| **Opening Stock :** | | Sundry Creditors | 50,000 |
| Raw Materials | 1,50,000 | Purchase Returns | 5,000 |
| Finished goods | 75,000 | Capital | 1,00,000 |
| Purchase of Raw Materials | 5,00,000 | Bills Payable | 24,000 |
| Land & Building | 1,00,000 | Long-Term Loan | 2,00,000 |
| Loose tools | 30,000 | Provision for Bad and | |
| Plant & Machinery | 30,000 | Doubtful Debts | 2,000 |
| Investments | 25,000 | Sales | 8,50,000 |
| Cash in Hand | 20,000 | Bank Overdraft | 23,000 |
| Cash at Bank | 5,000 | | |
| Furniture & Fixtures | 15,000 | | |
| Bills Receivable | 15,000 | | |
| Sundry Debtors | 40,000 | | |
| Drawings | 20,000 | | |
| Salaries | 20,000 | | |
| Coal and Fuel | 15,000 | | |
| Factory rent & rates | 20,000 | | |
| General Expenses | 4,000 | | |
| Advertisement | 5,000 | | |
| Sales Return | 10,000 | | |
| Bad Debts | 4,000 | | |
| Direct Wages (Factory) | 80,000 | | |
| Power | 30,000 | | |
| Interest Paid | 7,000 | | |
| Discount Allowed | 3,000 | | |
| Carriage Inwards | 15,000 | | |
| Carriage Outwards | 7,000 | | |
| Commission Paid | 9,000 | | |
| | **12,54,000** | | **12,54,000** |

1. Stock of finished goods at the end of the year ` 1,00,000.
2. A provision for doubtful debts is to be created at 5% on Sundry Debtors.
3. Depreciation on building ` 1,000 and ` 3,000 on Plant & Machinery to be provided.
4. Accrued commission of ` 12,500 is to be received for the year.
5. Interest has accrued on investment ` 15,000.
6. Salary Outstanding ` 2,000 and Prepaid Interest ` 1,500.

Prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31.03.2022

^ **Introduction**

In all the chapters studied, we have discussed how to prepare Books of Accounts following the Double Entry System ( DES ) of accounting.

Accounting records which are **not prepared** in accordance with the DES are known as **Incomplete Records.**

In other words, any accounting records which falls short of DES ( i.e. under which both the aspects of each & every transaction is not recorded ) are called Incomplete records.

Sometimes, it is termed as **Single Entry System** ( SES ) of accounting.

It should be noted that there are **no set rules** to be followed under SES of accounting, even books of accounts to be maintained are **not certain**.

It can simply be termed as **absence of DES** of accounting.

* **Features of Single Entry System**

1 It is an inaccurate, unscientific & unsystematic system of recording business transactions.

2 There is generally no record of real and nominal Accounts.
It is either **Pure SES** in which only Personal A/c's are maintained
or **Simple SES** in which Personal A/c's & Cash Book are maintained
or **Quasi SES** in which Personal A/c's, Cash Book & Subsidiary Books are maintained

3 Cash Book mixes up business and personal transactions of the owners

4 There is no uniformity in maintaining the records and system differs from firm to firm, depending upon the requirement and convenience of each firm.

5 Profitability & Financial Position under this system is only an estimate based.

II. **Ascertainment of Profit from Incomplete records**

Despite the records being incomplete, the business owner would like to know profits earned or loss incurred at periodic intervals, generally a year.

**Also**, he would like to know financial position at the end of the period.

Final A/c's **cannot be prepared in the usual manner** , since all the required information is not available.

In such a situation,
there are **two methods** used for ascertaining profits of the business.

**1.** Statement of Affairs Method **or** Net Worth Method **or** Capitals Comparision Method

**2.** Conversion Method ( Conversion **of** Single Entry **into** Double Entry )

## Statement of Affairs Method or Net Worth Method

Usually,

**Closing Capital** = Opening Capital + Capital Introduced - Drawings + Profit

Hence,

**Profit** = Closing Capital + Drawings - Opening Capital - Capital Introduced

**Q. 20** : Raju does not maintain his book of accounts under the Double Entry System, but keeps slips of papers from which he makes up his annual accounts. He has borrowed moneys from a Bank to whom he has to render figures of profits every year. He has given the Bank the following profit figures -

| Year ending 31st Dec. | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Profit in (`) | 20,000 | 32,000 | 35,000 | 48,000 | 55,000 |

The Bank appoints you to audit the statements and verify whether the figures of profits reported are correct or not. For this purpose the following figures are made available to you:

(a) Position as on 31.12.2018 : Sundry Debtors ` 20,000, Stock in Trade (at 95% of Cost) ` 47,500, Cash on Hand and at Bank ` 12,600, Trade Creditors ` 6,000, Expenses Due - ` 1,600.

(b) He had borrowed ` 5,000 from his wife on 30.9.2018 on which he had agreed to pay simple interest at 12% p.a. The loan was repaid along with interest on 31.3.2020.

(c) In December 2019, he had advanced ` 8,000 to Raghav for purchase of a vacant land. The property was registered in March 2021 after payment of balance consideration of ` 32,000. Cost of registration incurred for this were ₹ 7,500.

(d) Raju purchased jewellery for ` 15,000 for his daughter in October 2021. Marriage expenses incurred in January 2022 were ` 24,000.

(e) A new DVD Player was purchased by him in March 2022 for ` 18,000 & presented by him to his friend in November 2023.

(f) His annual household expenses amounted to a minimum of ` 24,000.

(g) The position of Assets and Liabilities as on 31.12.2023 was found to be :
Overdraft with Bank (Secured against property) ` 12,000
Trade Creditors ` 10,000, Expenses payable ` 600
Sundry Debtors ` 28,800 ( including ` 600 due from a person declared insolvent )
Stock in Trade ( at 125% of cost to reflect market value ) ` 60,000,
Cash-in-Hand - ` 250.

^ **Conversion Method**

This method can be followed when, though complete DES is not followed, substantial information / records are available / kept, such that missing informations / transactions can be found out as a **Balancing Figure** by preparing relevant accounts, thereby **converting it** into DES of accounting.

**Final Accounts consists of** :

1) Trading A/c for the year ended…………
2) Profit & Loss A/c for the year ended……………
3) Balance Sheet as on …………

**In addition,**

one or more of the following **may be** required be prepared **to get missing figures**

1) **( Opening ) Balance Sheet at the start of the year**
( To get opening capital or cash / bank or any other opening balance )

2) **Cash & Bank A/c or Columner Cash Book : separate column for Cash & Bank**
( To get closing balance or cash sales or collection from debtors
or payment to creditors or any other missing information )

3) Total Debtors A/c
4) Total Creditors A/c
5) Bills Receivable A/c
6) Bills Payable A/c etc.

^ 

## Total Debtors A/c

| Particulars | ` | Particulars | ` |
|---|---|---|---|
| To Balance b/d | xxx | | |
| ( Opening Dr. Balance ) | | | |
| To Sales A/c | xxx | By Sales Returns A/c | xxx |
| ( Credit Sales ) | | ( Returns Inward ) | |
| To Bank A/c | xxx | By Cash / Bank A/c | xxx |
| ( dishonour of cheque ) | | ( Collection from Debtors ) | |
| To ( dishonour of B/R ) A/c | xxx | By Bills Receivable A/c | xxx |
| ( with noting charges ) | | ( acceptances received ) | |
| To Cash / Bank A/c | xxx | By Discount Allowed A/c | xxx |
| ( Expense paid / charged ) | | (for receipt before due date) | |
| | | By Baddebts A/c | xxx |
| | | (on insolvency / otherwise) | |
| | | By Balance c/d | xxx |
| | | ( Closing Dr. Balance ) | |
| | XXXX | | XXXX |

* Above A/c is prepared **to find out** Credit Sales / Collection / Closing balance or any other missing figure

^ 

## Total Creditors A/c

| Particulars | ` | Particulars | ` |
|---|---|---|---|
| | | By Balance b/d | xxx |
| | | ( Opening Cr. Balance ) | |
| To Purchase Returns A/c | xxx | By Purchases A/c | xxx |
| ( Returned Outward ) | | ( Credit Purchases ) | |
| To Cash / Bank A/c | xxx | By Bank A/c | xxx |
| ( Payment to Creditors ) | | (Cheque issued dishonoured) | |
| To Bills Payable A/c | xxx | By Bills Payable A/c | xxx |
| ( acceptances given ) | | ( Dishonour ) | |
| To Discount Received A/c | xxx | By Expense A/c | xxx |
| (for payment before due date) | | (charged / paid on our behalf) | |
| To Bills Receivable A/c | | By Debtors A/c | xxx |
| ( B/R endorsed ) | | ( Endorsed B/R dishonoured ) | |
| To Balance c/d | xxx | | |
| ( Closing Cr. Balance ) | | | |
| | XXXX | | XXXX |

* Above A/c is prepared **to find out** Credit Purchases / Payment / Closing balance or any other missing figure

^ **Bills Receivable A/c**

| Particulars | ` | Particulars | ` |
|---|---|---|---|
| **To Balance b/d** | **xxx** | **By Cash / Bank A/c** | **xxx** |
| ( Opening Dr. Balance ) | | (Honour / Retirement of B/R) | |
| **To Total Debtors A/c** | **xxx** | **By Rebate A/c** | **xxx** |
| ( acceptances received ) | | ( on retirement of bill ) | |
| | | **By Bank A/c** | **xxx** |
| | | **By Discount A/c** | **xxx** |
| | | ( Bills discounted ) | |
| | | **By Total Creditors A/c** | **xxx** |
| | | ( Bills endorsed ) | |
| | | **By Bill sent for Collection A/c** | **xxx** |
| | | ( Bills sent for B.F.C. ) | |
| | | **By Total Debtors A/c** | **xxx** |
| | | ( Retained bill dishonoured ) | |
| | | **By Balance c/d** | **xxx** |
| | | ( Closing Dr. Balance ) | |
| | **XXXX** | | **XXXX** |

* Above A/c is prepared **to find out** acceptances received / closing balance **or** any other missing figure

^ **Bills Payable A/c**

| Particulars | ` | Particulars | ` |
|---|---|---|---|
| **To Cash / Bank A/c** | **xxx** | **By Balance b/d** | **xxx** |
| ( Honour / Retirement ) | | ( Opening Cr. Balance ) | |
| **To Rebate A/c** | **xxx** | **By Total Creditors A/c** | **xxx** |
| ( on retirement of bill ) | | ( acceptances given ) | |
| **To Total Creditors A/c** | **xxx** | | |
| ( Dishonour ) | | | |
| **To Balance c/d** | **xxx** | | |
| ( Closing Cr. Balance ) | | | |
| | **XXXX** | | **XXXX** |

* Above A/c is prepared **to find out** acceptances given / closing balance **or** any other missing figure

^ **Q. 21 :** Mr. Anup runs a wholesale business where in all purchases and sales are made on credit. He furnishes the following closing balances:

| | **31st March 2021** | **31st March 2022** |
|---|---|---|
| Sundry Debtors | 70,000 | 92,000 |
| Bills Receivable | 15,000 | 6,000 |
| Bills Payable | 12,000 | 14,000 |
| Sundry Creditors | 40,000 | 56,000 |
| Inventory | 1,10,000 | 1,90,000 |
| Bank | 90,000 | 87,000 |
| Cash | 5,200 | 5,300 |

Summary of cash transactions during the year 2021-2022 :

(i) Deposited to bank after payment of shop expenses @ ` 600 p.m., salary @ ` 9,200 p.m. and personal expenses @ ` 1,400 p.m. ` 7,62,750.

(ii) Cash withdrawn from bank ` 1,21,000.

(iii) Cash payment to suppliers ` 77,200 for supplies and ` 25,000 for furniture.

(iv) Cheques collected from customers but dishonoured ` 5,700.

(v) Bills accepted by customers ` 40,000.

(vi) Bills endorsed ` 10,000.

(vii) Bills discounted ` 20,000, discount ` 750.

(viii) Bills matured and duly collected ` 16,000.

(ix) Bills accepted ` 24,000.

(x) Paid suppliers by cheque ` 3,20,000.

(xi) Received ` 20,000 on maturity of one LIC policy of the proprietor by cheque.

(xii) Rent received ` 14,000 by cheque for the premises owned by proprietor.

(xiii) A building was purchased on 30-11-2021 for opening a branch for ` 3,50,000 and some expenses were incurred on this building, details of which are not maintained.

(xiv) Electricity and telephone bills paid by cash ` 18,700, due ` 2,200.

Other transactions :

(i) Claim against the firm for damage ` 1,55,000 is under legal dispute. Legal expenses ` 17,000. The firm anticipates defeat in the suit.

(ii) Goods returned to suppliers ` 4,200.

(iii) Goods returned by customers ` 1,200.

(iv) Discount offered by suppliers ` 2,700.

(v) Discount offered to the customers ` 2,400.

(vi) The business is carried on at the rented premises for an annual rent of ` 20,000 which is outstanding at the year end.

Prepare Trading and Profit & Loss Account of Mr. Anup for the year ended 31st March 2022 and Balance Sheet as on that date.

^ **Q. 22 :** 'A' and 'B' are in partnership, sharing profits and losses equally. They keep their books by Single Entry System. The following balances are available from their books :

| Particulars | Opening (`) | Closing (`) |
|---|---|---|
| Building | 1,50,000 | 1,50,000 |
| Equipments | 2,40,000 | 2,72,000 |
| Furniture | 25,000 | 25,000 |
| Debtors | ? | 1,00,000 |
| Creditors | 65,000 | ? |
| Stock | ? | 70,000 |
| Bank Loan | 45,000 | 35,000 |
| Cash balance | 60,000 | ? |

The transactions during the year were the following :

| Particulars | (`) |
|---|---|
| Collection from Debtors | 3,80,000 |
| Payment to Creditors | 2,50,000 |
| Cash Purchases | 65,000 |
| Expenses paid | 40,000 |
| Drawings by 'A' | 30,000 |

1. On 1st April, an Equipment of book value ` 20,000 was sold for ` 15,000.
   On 1st October, some more extra equipments were purchased.
2. Cash Sales amounted to 10% of Sales.
3. Credit Sales amounted to ₹ 4,50,000.
4. Credit Purchases were 80% of Total Purchases.
5. The Firm sells goods at cost plus 25%.
6. Discount Allowed ` 5,500 during the year.
7. Discount Earned ` 4,800 during the year.
8. Outstanding Expenses ` 3,000 as at year end.
9. Capital of 'A' as at the beginning of the year was ` 15,000 more than the Capital of 'B',
10. Equipments and Furniture to be depreciated at 10% p.a. and Building at 2% p.a.

Prepare the Trading and Profit and Loss Account for the year ended 31st March and a Balance Sheet as on that date.

^ **Introduction**

There are two types of organisations

**1)** Trading organisations **or** Profit making organisations

**2)** Non Trading Organisations ( NTO ) **or** Not for Profit Organisations ( NPO ).

* **Characteristics** or **Features of NPO**

i) **Purpose :**

A non-profit organisation is a **legal accounting entity** that is operated for the benefit of society as a whole, rather than for the benefit of a sole proprietor or a group of partners or group of shareholders.

The **main motive** behind such organisation is **to render service** to the society or the members of the organisation.

These are not business organisations operating with an intention to earn profits. These are set up with the **main objective** to provide qualitative service to its members and society at minimum charges and to promote art, culture, sports, education, charity, health etc. **Examples of NPO are** : Public Educational Institutions, Sports clubs, Public Hospitals, Religious Concerns ( Temples, Churches etc ), Trusts, Social Welfare Associations, Libraries etc. Such Not for profit organisations are **managed by** a group of individuals often called Trustees or Managing Committee.

ii) **Profit, not the Objective :**

Though NPO doesnot function with the objective to earn profit, it doesn't mean that it cannot earn profits. It also earns profits, termed as **surplus**, which is necessary to maintain its assets and also operations. Surplus is used for the objects for which it is set up and is not distributed amongst its members.

iii) **Financial Statements :**

NPO **prepares** its **final accounts** / financial statements annually showing the summary of financial transactions for its members, government departments, donors **etc**.

**a)** to comply with the statutory requirements,

**b)** for seeking grants from the government **and**

**c)** for getting confidence of donors and public at large.

^ **Final Accounts of NPO :**

* **Usually given**

a) Receipts and Payments A/c ( **summarised** Cash & Bank A/c )

It records **ALL** Receipts and Payments of money **during the year**,

**whether**

Capital or Revenue **OR** whether relating to Current Year, Past Years or Next Years

b) Other relevant informations and adjustments

* **Usually to be prepared**

**1.** Income and Expenditure A/c ( similar to Profit & Loss A/c )

**2.** Balance Sheet

Such final accounts are prepared more or less in **usual way**, following **accrual concept**.

^ **Incomes received by such NPO**

A. **If such Income** is for **general purpose ( NOT specified** to be for **specific purpose )**

It includes various receipts which are either recurring or non recurring in nature

| | Main sources of Incomes | **Treatment, unless otherwise given** or **warranted** due to nature of organisation |
|---|---|---|
| 1 | **Periodic Subscriptions** | I & E A/c, Income side |
| | amount paid by the members of NPO periodically to keep membership alive | |
| 2 | **Donations** | I & E A/c, Income side |
| 3 | **Grants received from Govt.** | I & E A/c, Income side |
| 4 | **Sundry Other Incomes** | I & E A/c, Income side |
| | Sale of old news papers, Interest received, Rent received, Profit on sale of FA etc | |
| 5 | **Corpus Donations** | Add to Capital Fund, Liability side |
| | Contributions by different parties for commencement & expansion of NPO | |
| 6 | **Entrance / Admission Fees** | Add to Capital Fund, Liability side |
| | amount paid by a person at the time of becoming member of a NPO | |
| 7 | **Life Membership Fees** | Add to Capital Fund, Liability side |
| | Lumpsum amount paid by a member **instead of** periodic subscription | |
| 8 | **Legacy** | Add to Capital Fund, Liability side |
| | the amount received as donation **under WILL** of a deceased person | |

**Note : Capital Fund**, also known as General Fund / **Accumulated Fund**,
is an unrestricted fund which can be used by the management for any purpose of such NPO as may be considered appropriate.
Surplus or Deficit **from I & E A/c** every year is also transferred to Capital Fund.

**B.** If **such Income** is for a **Specific Purpose**

* **If it is for a Specific Event**, for which NO seperate / specific fund is to be created

These are the contributions of amount for a specific event like annual dinner, cultural program, exhibition, entertainment show, tournament etc.
Such receipt is to be **compared with** related expenses of such event and it may result into some ( **net** ) surplus **or** deficit from such event, which is to be **transferred to** I & E A/c.

* **If** Seperate / Specific **Fund is to be created** for such purpose

In such case, all the Incomes received for such purpose are to be **added to such fund** and such specific fund is shown on the **Liability side of the Balance Sheet**.
Such Incomes includes Donations - Legacy - Government Grants received etc. **for a specific purpose**.
**Fund** means amount received **or** set aside by a NPO for a specific purpose.
**In such case**, Fund amount, along with the income earned on the fund ( **Income from Investments** made from **such fund** ), cannot be used for purposes other than those for which such fund is created.
**Use of such fund is restricted** for a specific purpose **either** by the management **or** by the donor / government.
Purpose of such specific funds can be **Revex** or **Capex** to be incurred in future.

* **Funds created for Revex to be incurred in future**

Prize Fund, Sports Fund, Tournament Fund, Endowment Fund, Annuity Fund etc.
Contributions received towards such fund & Income earned on such fund Investments is to be **added to the** respective fund, where as related expenses ( Revex ) incurred during the year is to be **deducted from** such fund.

* **Funds created for Capex to be incurred in future**

eg. Building Fund
Contributions received towards such fund & Income earned on such fund Investments is to be **added to** the respective fund.
**Amount spent on Purchase / Construction of FA during the year** is to be **deducted** from such fund & **added** to the Capital fund.

^ **Q. 23 :** Summary of receipts and payments of Bombay Medical Aid society for the year ended 31.12.2022 are as follows :
Opening cash balance in hand ` 8,000, subscription ` 50,000, donation ` 15,000 (raised for meeting revenue expenditure), interest on investments @ 9% p.a. ` 9,000, 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 :**

| | **01.04.2022** | **31.12.2022** |
|---|---|---|
| | ₹ | ₹ |
| 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 & income and expenditure account for the year ended 31.12.2022 and balance sheet as on 31.12.2022.

^ **Donation ( D ) / Government Grant ( GG )**, for specific purpose

| Case III ( For Specific Revex ) | | Case IV ( For Specific Capex ) | |
|---|---|---|---|
| **eg. Prize Fund** | | **eg. Buiding Fund** | |

a) **When** Donation ( D ) / Government Grant ( GG ) **is received**

| | | | |
|---|---|---|---|
| Cash / Bank A/c | Dr. | Cash / Bank A/c | Dr. |
| To D / GG A/c | | To D / GG A/c | |

**When** Donation ( D ) / Government Grant ( GG ) **A/c is closed / Transferred**

| | | | |
|---|---|---|---|
| D / GG A/c | Dr. | D / GG A/c | Dr. |
| To Prize Fund A/c | | To Building Fund A/c | |

b) For Purchase of **Such Fund Investments**

| | | | |
|---|---|---|---|
| Prize Fund Investments A/c | Dr | Building Fund Investments A/c | Dr |
| To Cash / Bank A/c | | To Cash / Bank A/c | |

c) For **Receipt** of Interest on **Such Fund Investments**

| | | | |
|---|---|---|---|
| Cash / Bank A/c | Dr. | Cash / Bank A/c | Dr. |
| To Interest on Investments A/c | | To Interest on Investments A/c | |

For **Transfer** of **Interest on Such Fund Investments**

| | | | |
|---|---|---|---|
| Interest on Investments A/c | Dr. | Interest on Investments A/c | Dr. |
| To Prize Fund A/c | | To Building Fund A/c | |

d) For Sale of **Such Fund Investments**

| | | | |
|---|---|---|---|
| Cash / Bank A/c | Dr. | Cash / Bank A/c | Dr. |
| To Prize Fund Investments A/c | | To Building Fund Investments A/c | |

* Profit or Loss **on sale** of Investments, **if any**, to be transferred to **Such Fund A/c**

( unless otherwise specified )

e) When **Money is spent** for such purpose

| | | | |
|---|---|---|---|
| Prize Fund A/c | Dr | Building A/c | Dr |
| To Cash / Bank A/c | | To Cash / Bank A/c | |
| **Since Prizes given is Revex,** it will reduce Reserve ( Prize Fund ) | | **Since Construction / Purchase of Building is Capex,** it will **NOT** reduce Reserve (Building Fund) | |
| ~ | | Building Fund A/c | Dr |
| | | To Capital Fund A/c | |

^ **Q. 24 :** From the following data, prepare an Income and Expenditure Account for the year ended 31st December 2019, and Balance Sheet as at that date of the Jeevan Hospital:

**Receipts and Payments Account for the year ended 31 December, 2019**

| Receipts | (₹) | Payments | (₹) |
|---|---|---|---|
| To Balance b/d | | By Salaries: | |
| Cash 800 | | (₹7,200 for 2018) | 31,200 |
| Bank 5,200 | 6,000 | By Hospital Equipment | 17,000 |
| To Subscriptions: | | By Furniture purchased | 6,000 |
| For 2018 | 5,100 | By Additions to Building | 50,000 |
| For 2019 | 24,500 | By Printing and Stationery | 2,400 |
| For 2020 | 2,400 | By Diet expenses | 15,600 |
| To Government Grant: | | By Rent and rates | |
| For building | 80,000 | (₹ 300 for 2020) | 2,000 |
| For maintenance | 20,000 | By Electricity and water | |
| Fees from sundry | | charges | 2,400 |
| patients | 4,800 | By Office expenses | 2,000 |
| To Donations (not to be | | By Investments | 20,000 |
| capitalized) | 8,000 | By Balances: | |
| To Net collections from | | Cash 1,400 | |
| benefit shows | 6,000 | Bank 6,800 | 8,200 |
| | **1,56,800** | | **1,56,800** |

| **Additional information:** | ₹ |
|---|---|
| Value of building under construction as on 31.12.2019 | 1,40,000 |
| Value of hospital equipment on 31.12.2019 | 51,000 |
| Building Fund as on 1.1.2019 | 80,000 |
| Subscriptions in arrears as on 31.12.2018 | 6,500 |

Investments in 8% Govt. securities were made on 1st July, 2019.

**Q. 25 :** The Income and Expenditure Account of the Youth Club for the Year 2022 is as follows:

| 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 annual | |
| To Secretary's Honorarium | 1,000 | 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 2021 | 600 |
| Subscription received in advance on 31st December, 2021 | 450 |
| Subscription received in advance on 31st December, 2022 | 270 |
| Subscription outstanding on 31st December, 2022 | 750 |

Salaries outstanding at the beginning and the end of 2022 were respectively ` 400 and ` 450. General Expenses include insurance prepaid to the extent of ` 60. Audit fee for 2022 is as yet unpaid. During 2022 audit fee for 2021 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, 2022 valued at ` 2,600. At the end of the year, after depreciation, this equipment amounted to ` 2,700. In 2021, the Club has raised a bank loan of ` 2,000. This was outstanding throughout 2022. On 31st December, 2022 cash in hand amounted to ` 1,600.

Prepare the Receipts and Payments Account for 2022 and Balance Sheet as at the end of the year.

^ **Meaning / Definition and Features of Partnership**

"Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". ( **Section 4** of the IPA, 1932 )

**In India**, partnership is regulated by **the Indian Partnership Act, 1932.** ( IPA, 1932 )

The persons who have entered into partnership are individually known as **partners** and collectively as a **firm**.

The name under which the business is conducted is known as **firm's name**.

^ **Features / Characteristics of Partnership**

i) **Association of two or more persons**

Partnership is an association of two or more persons.
**Minimum 2** partners are required to form a partnership.
**Maximum 50** partners are allowed in a firm, as prescribed by The Companies Act, 2013 vide section 464 and as specified in Rule 10 of the Companies Rules, 2014.

ii) **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.

Partnership comes into existence by an agreement, **either** written **or** oral.
The terms & conditions of the agreement amongst partners is the basis of their relationship.

* **Contents of the Partnership Deed** usually may include **:**

**1)** Name and adress of the firm and its main business
**2)** Name and adress of all partners
**3)** Duration of the partnership
**4)** Rights, duties and liabilities of partners
**5)** Capital contribution by partners
**6)** Ratio in which profits ( & losses ) are to be shared amongst partners
**7)** Rate of interest ( if any ) on capital, loan, drawings etc.
**8)** Salary, Commission etc ( if any ) payable to partners.
**9)** Provisions relating to admission, retirement and death etc. of a partner
**10)** Settlement of accounts on dissolution of firm

**11)** Method of settlement of disputes amongst partners

**12)** Any other matter relating to the conduct of business

It is advisable to have a **registered** written agreement i.e. partnership deed, to avoid disputes in the future amongst the partners.

**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)** **Minor as a partner** : A minor can be added in partnership firm, but the condition is that he can be admitted to share profit only. He cannot be made to share losses of the firm. If the partnership firm suffers loss than it will be borne by other major partners is their profit-sharing ratio.

**v)** **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.

Business of the partnership should be **Lawful** & such business may be carried on by all or any of them acting for all. Such **Principle of mutual agency** means partners are principals and also agents of each other.

It means each partner is bound by the acts of other partner(s).

**vi)** **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.

**vii)** **Unlimited Liability :**

From accounting point of view, partnership firm is a separate business entity.

However, **Liability of partners is unlimited**.

Partners are **jointly & severally** liable for the debts of the business, in case firm is unable to meet its liabilities, due to its bankruptcy / insolvency.

In such case,

**net** private assets of a partner can be used to pay firm's balance debts.

^ **Appropriations out of Profits**

It means **distribution** of Profit amongst the Partners ( Owners of business )

a) **Transfer to Reserves**

Reserves are undistributed / accumulated profits.

These are past profits which are **yet not** distributed to the owners / partners,
but are kept in the business for future uncertainities / requirements.

In order to strengthen the financial position of the business and with a view to meet all eventualities, it is desirable that entire profits should not be distributed amongst the owners of the business. Some portion of profit should be kept in the business for meeting unknown liabilities / losses in future.

This is done by **creating Reserves** at the time of preparing Final accounts.

* **Journal Entry** for creation of **Reserves out of Profits**

Profit & Loss Appropriation A/c **Dr.**
    **To** Reserves A/c

Reserves means the amounts **set aside out of profits** & other surpluses, **which are not earmarked in any way** to meet any particular liability known to exist on the date of the Balance Sheet.

**The Reserves may be created for**

Expansion of business ( ploughing back of the profits ), better financial position, meeting unforeseen contingencies etc.

**Examples of Reserves**

i) General Reserve
ii) Reserve Fund
iii) Profit & Loss A/c ( credit balance )
iv) Investment Fluctuation Fund
v) Workmen Compensation Fund
vi) Capital Reserve **etc.**

It should be clearly understood that the amount of Reserve **does not represent** any expense / loss / liability.

It represents undistributed profits, **belonging to** the owners of the business.

b) **Interest on Capital ( IOC )** / Salary / Remuneration / Commission **etc**

Payable **by** the Firm **to** Partners, **as** may have been **agreed amongst partners**

i) **For IOC** etc **Allowed / Payable**

IOC / S / R / C etc A/c **Dr.**

**To** Partners Capital A/c's

ii) To close **IOC** etc **A/c**

Profit & Loss Appropriation A/c **Dr.**

**To** IOC / S / R / C etc A/c

c) **Interest on Drawings ( IOD )** Charged / Payable **by** Partners **to** the Firm,

**as** may have been **agreed amongst partners**

i) **For IOD Charged / Receivable**

Partners Capital A/c's **Dr.**

**To** Interest on Drawings A/c

ii) To close **IOD A/c**

Interest on Drawings A/c **Dr.**

**To** Profit & Loss Appropriation A/c

d) Balance **Profit to be distributed** to the Partners **in agreed P.S.R.**

Profit & Loss Appropriation A/c **Dr.**

**To** Partners Capital A/c's

**Dr.** **Profit & Loss Appropriation A/c** for the year ended …… **Cr.**

| | ₹ | ₹ | | ₹ | ₹ |
|---|---|---|---|---|---|
| | | | **By Net Profit b/d** | | xxx |
| **To Reserves A/c** | | xxx | **By IOD A/c** | | |
| ( % of N.P. **or** as given ) | | | A | xx | |
| | | | B | xx | xxx |
| **To IOC / S/R/C etc A/c** | | | | | |
| A | xx | | | | |
| B | xx | xxx | | | |
| | | | | | |
| To Partners Capital A/c's | | | | | |
| A | xx | | | | |
| B | xx | xxx | | | |
| **( Balance Profit )** | | | | | |
| | | **XXX** | | | **XXX** |

^ **Key Points**

1) Appropriations means **distribution** of Profit amongst the Partners / Owners.
Hence, existence of profits is **MUST** for appropriations.
**In any case**,
appropriations **cannot exceed** profits, unless otherwise agreed amongst partners.

2) Rent payable by the firm to Partner & **Interest on Partners Loan**
These are **Charge against Profits**, NOT appropriations and hence,
will be recorded in Profit & Loss A/c, **NOT in** P & L Appropriation A/c

^ **Provisions of IPA, 1932**

When there is **NO** oral / written agreement amongst partners ( **NO** Partnership deed )
**OR** such deed doesn't have a clause **( deed is silent )** on a particular matter,
**then**, the Provisions of **IPA 1932 shall apply,** as follows.

* **Provisions of the IPA, 1932** ( to be followed, **only if** problem is silent )

| | | |
|---|---|---|
| 1 | Sharing of Profits & Losses : **P.S.R.** | **EQUAL** amongst all partners |
| | Payable **by** Firm **to** Partner | |
| 2 | Interest on Partners Capital / Current A/c's | **NOT** allowed |
| | Salary / Remuneration / Commission to Partners | **NOT** allowed |
| | Interest on Loan **by** Partner **to** the Firm | allowed at **6% p.a.** |
| 3 | Payable **by** Partner **to** the Firm | |
| | Interest on Partners Drawings | **NOT** charged |
| | Interest on Loan **by** the Firm **to** Partner | **NOT** charged |

^ **Calculation of Interest on Partners Capital A/c's ( IOC )**

* It is allowed / payable only if specifically **agreed** amongst the partners
* It is **appropriation out of profits** and hence, payable only if there are profits
* Following **should be taken into account** while calculating IOC

**i)** Opening Capital

**ii)** Further Capital Introduced

**iii)** Drawings **out of** Capital ( as clearly specified )

( Drawings should be assumed to be out of profits, if no information given )

^ **Calculation of Interest on Partners Drawings ( IOD )**

* Interest on drawings is charged only if specifically **agreed** amongst the partners

It is charged on drawings out of profits ( & **not on** drawings out of capital )

Drawings by partners should be assumed to be out of profits, if no information given.

* **When** amount of drawings **&/or** time interval between the 2 drawings is **NOT** uniform.

IOD is to be calculated at agreed rate, on each drawings seperately,

for a period depending upon actual date of each drawings.

* **When** amount of drawings **&** time interval between the 2 drawings **is uniform**,

average method can be followed as follows.

| | **If drawings are made** | **Interest on total drawings to be for** | |
|---|---|---|---|
| **2** | uniformly throughout the period | 6 months ( half of total period ) | |
| | in the middle of every month | | |
| | no info is given in the problem | | |
| **2** | At the beginning of every month | 6 1/2 months | [ ( 12 + 1 ) / 2 ] |
| **3** | At the end of every month | 5 1/2 months | [ ( 11 + 0 ) / 2 ] |
| **4** | At the beginning of every quarter | 7 1/2 months | [ ( 12 + 3 ) / 2 ] |
| **5** | At the end of every quarter | 4 1/2 months | [ ( 9 + 0 ) / 2 ] |

^ **Partners Capital Accounts**

* Partners introduces capital in the business when the business is started and also in future as and when needed.
* Partners may withdraw capital in future or total capital of the firm may be increased or decreased, as per mutual consent of partners.
* Capitals of partners may not be in equal proportion or in their P.S.R.
* Capital may be contributed by partner in cash or in kind.

  Capital brought in in kind is recorded in books of accounts at agreed values.

* **Methods of maintaining Partners Capital A/c's**

Capital account for each partner is maintained seperately.
Such Capital account of each partner can be maintained following
**either**
Fluctuating Capital Accounts Method
**or**
Fixed Capital Accounts Method

**Under both the methods,**
Loan given by partner to firm & Interest due on such loan is recorded in
**Loan by Partner A/c** and is shown seperately on the Liability side.

* **a) Fluctuating Capital Accounts Method**

Under this method,
**only Capital account** is maintained for each partner and hence,
all transactions of a partner are shown in the Capital account of the partner.
**As a result**,
balance in capital account keeps **Fluctuating** with every transaction.

**Note** : In the absence of any information,
Fluctuating Capital Accounts method is followed.

* **b) Fixed Capital Accounts Method**

Under this method, two accounts are maintained for each partner
**i)** Partners Capital Account **ii)** Partners Current Account

Under this method, Capital accounts of partners is intended to be kept **Fixed**.
It shows same balance year after year, **except when**
additional capital is introduced **or** part capital is withdrawn by the partner.
**Hence**, all transactions relating to partner, **except** introduction or withdrawl of capital,
are recorded in the separate account for each partner called Partners Current A/c.
**As a result, Capital A/c** under this method will have credit balance **( Liability side )**
**Current A/c** under this method can have credit balance **or** debit balance.
**Credit balance** is shown on the **Liability side** indicating amount payable to the partner.
**Debit balance** is shown on the **Asset side** indicating amount receivable from the partner.

**Note**: Fixed Capital Method is followed **only when** it is specifically given in the problem,
either directly or indirectly ( by giving Partners Current A/c's balances ).

^ **Capital Ratio**

Partners may agree to share profits and losses in the capital ratio.

**When capitals are fixed**, profits will be shared in the ratio of given capitals.

**But if capitals are fluctuating** & partners introduce or withdraw capitals during the year, the capitals for the purpose of ratio would be determined with reference to time on the basis of weighted average method.

^ **Q. 26 :** A and B are partners sharing profits and losses in the ratio of their effective capital. They had ` 1,00,000 & ` 60,000 respectively in their Capital A/c's on 1.1.2022.
A introduced a further capital of ` 10,000 on 1st April, 2022 and another ` 5,000 on 1st July, 2022. On 30th September, 2022 A withdrew ` 40,000.
On 1st July, 2022, 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, 2022.
B drew ` 1,000 on 30th June and ` 5,000 on 30th September, 2022.
12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2022. Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

^ **Q. 27 :** Weak, Able & 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 & 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 (1.1.2022) | 75,000 | 40,000 | 30,000 |
| Current Account (1.1.2022) | 10,000 | 5,000 | (Dr.) 5,000 |
| Drawings | 15,000 | 10,000 | 10,000 |

The draft accounts for 2022 showed a net profit of ` 60,000 before taking into account

(a) Life Insurance premium of Weak amounting to ` 750 paid by the firm on 30th June, 2022 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, 2022 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account, Current Accounts of partners Weak, Able and Lazy for the year ended 31st December, 2022.

^ **Introduction**

* Goodwill is **reputation** of business **expressed in terms** of money.

* If a firm is **expected to earn** more profits in future ( super profits ) **than** normal profits due to efforts made by the existing ( old ) partners in past, it is said to have **Goodwill**. The goodwill so generated is called **self- generated goodwill** .

It is the goodwill which is **not purchased** for a consideration.

It is earned / internally created by the consistent efforts of the old partners over long period of time, due to which business firm is **able to earn** higher profits than normal.

* Goodwill is an **Intangible Asset**.
Though it can not be touched, can not be seen, can not be transported physically, it is very much **Real Asset** since it has monetary / saleable value.

* **Super profits** implies excess profits earned by the firm over and above normal profits earned by similar firms in the same locality.
It is **future capability** of the business to earn more profit **than the** normal profit.
It may be **due to** locational advantage, quality of goods sold, personal reputation of owners / partners to attract more customers, better customer service, presence of managerial skill, possession of special contracts to get quality materials at cheaper prices etc.

* **Features / Characteristics of Goodwill**

1. Goodwill is an **intangible asset** i.e. an asset which cannot be touched or seen.

2. Though it cannot be touched or seen, it is a **Real Asset** ( not fictitious asset ), since it can be sold off in future and converted into money or moneys worth.
   However, ( generally ) Goodwill cannot be sold in isolation as it does not have an existence separate from that of an enterprise ( business firm ).
   Hence, it can be sold / generally have realisable value when the business firm is sold.

3. It comes into existence **due to various factors** like efficient management, favourable location, consistently good quality of goods &/or services etc.

4. Goodwill helps the firm **to earn higher profits** as compared to new / other firms in the same line of business. Strictly, there is no goodwill, if firm is able to earn the same profits as other similar firms.

5. Value of goodwill is **subjective**. It depends upon the purpose of valuation and judgement / assessment of the Valuer. Value of goodwill is **not constant** throughout the life of the business. It fluctuates with the change in the fortunes of the firm.

^ **Situations**, which may involve valuation of goodwill in case of **Partnership Firms**
**( Need for valuation of Goodwill )**

The following are the **situations warranting valuation** of Goodwill in case of partnership firms

1. When there is a change in PSR ( Profit Sharing Ratio ) amongst the partners
2. When a new partner is admitted.
3. When an existing partner retires **or** dies.

**In all the above cases**, there is change in P.S.R. amongst the partners in future, due to which one or more partner **sacrifices** and one or more partners **gains**.
**Hence**, gaining partners **will have to compensate** sacrifing partners for Goodwill.

4. When partnership firm is dissolved / sold as a going concern
5. When there is amalgamation of two or more firms
6. When a partnership firm is converted into a company

^ **Steps** to be followed for **Valuation** of Goodwill

**Valuation based on F.M.P.**

I Calculation of Future Maintainable Profit ( FMP )
** Valuation of Goodwill based on F.M.P.

**Valuation based on Super Profit**

I Calculation of Future Maintainable Profit ( FMP )
II Calculation of Normal Profit
III Calculation of Super Profit
** Valuation of Goodwill based on Super Profit

## I Calculation of Future Maintainable Profit ( FMP )

* FMP is **estimated** normal business profits **expected to be earned in future**.
* Such estimation of future maintainable profit
is **based on** profits of past few years, **adjusted for** known changes in future.

* Profits of each of the past few years ( eg. 3 years ) is adjusted as follows

| | | Past years | 1 | 2 | 3 |
|---|---|---|---|---|---|
| | | **Profits as given** | **xxx** | **xxx** | **xxx** |
| | | **( Rectification of errors )** | | | |
| i) | | Purchase of machinery debited to purchases | | | |
| | | Depreciation on machinery, yet not provided | | | |
| ii) | | Repairs to car debited to vehicles | | | |
| | | Depreciation on repairs to car wrongly capitalised | | | |
| iii) | | Under valuation of closing stock | | | |
| | | Under valuation of opening stock | | | |
| iv) | | Over valuation of closing stock | | | |
| | | Over valuation of opening stock | | | |
| v) | | IOC, salary to partner etc. yet not provided | | | |
| | | IOD yet not provided | | | |
| | | | | | |
| | | **( Adjust for known changes in future )** | | | |
| i) | | Non recurring expenses, Non operating expenses, | | | |
| | | Abnormal losses etc **incurred in past**, | | | |
| | | **not expected** to be incurred in future | | | |
| | | **eg.** Loss by fire / theft, Loss on sale of FA etc | | | |
| | | | | | |
| ii) | | Non recurring Incomes, Non operating incomes, | | | |
| | | Abnormal gains **earned in past**, | | | |
| | | **not expected** to be earned in future | | | |
| | | **eg.** Profit on sale of FA / Invt.s etc | | | |
| | | | | | |
| iii) | | Expenses, **not incurred in past,** | | | |
| | | **expected** to be incurred in future | | | |
| | | | | | |
| iv) | | Incomes, **not earned in past,** | | | |
| | | **expected** to be earned in future | | | |
| | | | | | |
| | | **Adjusted Profits** | **xxx** | **xxx** | **xxx** |

FMP **= Average** adjusted profits of past few years

Such **average** can be **simple / normal** average or **weighted** average

**Simple average** is suitable when there is **no clear trend** in past years profits, in which case equal weight is given to profits of each past year

If there is noticeable **clear trend** in past profits, then **weighted average** may be used **assigning** more weight to the profit of recent year as it indicates the most likely profits in future.

** Valuation of Goodwill **based on F.M.P.**

This method is **based on the assumption** that a newly started business will not earn any profit during the initial years of its operations.

Hence, one who purchases a running business or becomes a partner in existing business pays for goodwill for being in a position to earn profit in the initial years of business.

* **Method 1 : Number of Years of Purchase Method**

Number of years of purchase **means** the number of years for which the firm is likely to earn same amount of profit because of efforts put in the past.

**Goodwill** = Number of years of purchase * FMP

**II Calculation of Normal Profit**

**Normal Profit** = $\frac{NRR}{100}$ x Capital Employed

**a. Capital Employed**

Capital employed means capital invested in the firm to carry on the business.

If Opening C.E. is given, Average C.E. = $\frac{(\text{Op. C.E} + \text{Cl. C.E.})}{2}$

**b. Normal Rate of Return ( NRR )**

It is the rate at which profit is earned by similar business entities in the industry under normal circumstances. It is usually given in the problem.

**c. Normal Profit** = $\frac{NRR}{100}$ x Capital Employed

III **Calculation of Super Profit**

Super Profits are excess ( surplus ) profit expected to be earned by a firm, in comparision to average profit normally earned by other comparable firms.

**Super Profit** = FMP - Normal Profit

IV Valuation of Goodwill **based on Super Profit**

* **Method 1 : Number of Years of Purchase Method**

**Goodwill** = Number of years of purchase * Super Profit

* **Method 2 : Capitalisation Method**

When super profits are expected to earn for many more number of years in future because of the efforts put in the past, this method may be followed.

$$\text{Goodwill} = \frac{\text{Super Profit}}{\text{NRR}} \times 100$$

**OR**

$$\text{Goodwill} = \frac{\text{FMP}}{\text{NRR}} \times 100 - \text{Capital Employed}$$

( Total capitalised value of the business / firm **Less** Capital employed )

* **Method 3 : Annuity Method**

The **major drawback** of number of years of purchase method **is that time value of money** is not considered.

**Hence**, discounted value of super profits for certain no of years is considered for calculating value of Goodwill under Annuity Method.

^ **Q. 28 :** 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 2019-2022 as follows:

| Year | Profits (`) |
|---|---|
| 2019 | 1,20,000 |
| 2020 | 1,25,000 |
| 2021 | 1,30,000 |
| 2022 | 1,50,000 |

On 31.12.2022 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.

Write assumptions clearly wherever required.

^ **Q. 29 :**

a) Nigam and Dhameja are in partnership sharing profits and losses equally. They agreed to take Ghosh as one third partner. The new profit sharing ratio will be 4:2:3. Goodwill of the firm is valued at ` 27,000. Pass necessary journal entry.

b) A and B are equal partners. They wanted to take C as a third partner and for this purpose goodwill was valued at ` 1,20,000.
What will be journal entry for adjustment of goodwill through partners capital accounts.

c) A and B are equal partners. They wanted to admit C as 1/6 th partner who brought ` 60,000 as goodwill. The new P.S.R. will be 3:2:1. Pass necessary journal entry.

d) A, B and C are equal partners. They decided to take D who brought in ` 36,000 as goodwill. The new P.S.R. is 3:3:2:2. Pass necessary journal entry.

^ **Introduction**

Admission of a Partner **means** a new partner is admitted in the firm for the benefit of the partnership firm.

* A person can be admitted as a new partner **either** as per the terms of partnership deed **or** only with the consent of all existing partners.

* Admission of a partner is a **mode of reconstituting the firm**
**under which**
old partnership relation comes to an end
**and**
new partnership relation amongst all the partners including **Incoming ( newly admitted ) partner** begins.

However, **Partnership firm** continues, **DOES NOT** get dissolved.

* A new partner can be admitted in the firm for **one or more reasons** like more capital requirement, expansion of business, special skill possessed by incoming partner, strengthening the management of the firm etc.

^ **Summary of Steps to be followed**

| | |
|---|---|
| I | Calculate **Missing Ratio's** and Write **Opening balances** in Ledger Accounts<br>( Accounts prepared as asked **or** prepared in working notes ) |
| II | **Distribute** Reserves and **Write off** Accumulated Losses **( O O )**<br>( even if problem is silent on this matter ) |
| III | Record **Revaluation** of Assets ( excluding Goodwill ) & Reassessment of Liabilities<br>( **including recording** unrecorded assets and liabilities )<br>**Note** :<br>Final Profit or Loss to be distributed amongst **Old** Partners in **Old** Ratio **( O O )** |
| IV | Record **Capital brought in** by newly admitted partner |
| V | Adjustment / Treatment of **Goodwill** |
| VI | Record **Sundry Other Transactions**, if any |
| VII | Adjustment of **Partners Capitals in New Ratio**, as specified in the problem |
| VIII | **Closing Steps** |

^ **Q. 30 :** Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms balance sheet as on 31.03.2022 was as follows:

| Liabilities | (`) | Assets | (`) |
|---|---|---|---|
| Capital accounts: | | Fixed assets | 3,00,000 |
| Gopal | 1,20,000 | Investments | 50,000 |
| Govind | 80,000 | Current assets | 2,00,000 |
| Long term loan | 2,00,000 | Loans and advances | 1,00,000 |
| Current liabilities | 2,50,000 | | |
| | 6,50,000 | | 6,50,000 |

Due to financial difficulties, they have decided to admit Guru as partner in the firm from 01.04.2022 on the following terms : Guru will be paid 40% of the profits.
Guru will bring in cash ` 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.
The profits of the previous three years were as follows:
For the year ended 31.3.2020: profit ` 20,000 (includes insurance claim received of `40,000).
For the year ended 31.3.2021: loss ` 80,000 (includes voluntary retirement compensation paid ` 1,10,000).
For the year ended 31.3.2022: profit of ` 1,05,000 (includes a profit of ` 25,000 on the sale of assets).
It was decided to revalue the assets on 31.03.2022 as follows:

| | (`) |
|---|---|
| Fixed assets (net) | 4,00,000 |
| Investments | Nil |
| Current assets | 1,80,000 |
| Loans and advances | 1,00,000 |

The new profit sharing ratio after the admission of Guru was 35:25:40.
Show goodwill calculation and prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2022 after the admission of Guru.

^ **When the revised values are NOT TO BE recognised in the books**

i.e. when all the partners have decided to that **revalued figures** of assets & liabilities **are not to be shown** in the new Balance sheet, but they **should appear** at old values

The partners may decide that the values of assets and liabilities are not to change i.e. shall continue to appear in the books at their old values.

**If it is so**, they may decide to open **Memorandum Revaluation A/c**

^ **Q. 31 :** A and B are partners sharing profits and losses in the ratio of 3:2.

On 1.4.2022, 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.

Their Balance Sheet as on 31.3.2022 is given below:

| Liabilities | Amt (`) | Assets | Amt (`) |
|---|---|---|---|
| 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 |

You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

^ **Retirement of a Partner**

Retirement of a partner **means** that the partner does not remain a partner
i.e. **ceases to be a partner** of the firm
and the **remaining partners continue** to carry on the business of the firm.

Partner **may retire** due to old age, illness, misunderstandings amongst the partners,
loss in business or want to start business venture etc.

A partner **may retire** from the firm

**1)** By giving notice as required, to the other partners of his / her intention to retire, in the case of partnership at will.
**2)** In accordance with the existing agreement to that effect.
**3)** With the consent of all the partners.

^ A partner will cease to be a partner on his / her death
and hence death is considered as **Compulsory Retirement**.

^ Retirement or Death of a partner results into **Reconstitution of the firm**
**under which**
old partnership relation comes to an end
**and**
new partnership relation amongst remaining partners ( **minimum 2** ),
**excluding retiring / deceased ( outgoing ) partner,** begins.

^ **Does** Partnership Firm **gets dissolved** on Retirement **or** Death ?

* **Retirement of a partner**

Usually, Partnership firm continues, DOES NOT get dissolved.

* **Death of a partner**

Unless otherwise agreed by the partners in the Partnership Deed,
a firm is dissolved on the death of a partner **( IPA, 1932 )**
**In most cases**,
partners will have such clause in the partnership deed **such that** firm doesn't get
dissolved on death of a partner and remaining partners ( minimum 2 ) can continue
the business post death of a partner.

^ **In case of retirement,**
payment of the amount due is to be made to the retiring partner,
**whereas in case of death,**
amount due is payable to the Executors **or** Legal heirs of the deceased partner
and hence,
it is to be transferred to Deceased Partners **Executors / Legal heirs Loan A/c**

^ **Retirement**, in most cases, can be planned on the date of Balance Sheet,
but sometimes, it can happen during the year as well

**Death**, in almost all cases, can happen on any day during the year,
but rarely, it can happen on the date of Balance Sheet as well

* **Summary** of Steps to be followed

| | |
|---|---|
| I | Calculate **Missing Ratio's** and Write **Opening balances** in Ledger Accounts<br>( Accounts prepared as asked **or** prepared in working notes ) |
| II | **Distribute** Reserves and **Write off** Accumulated Losses **( O O )**<br>( even if problem is silent on this matter ) |
| III | Record **Revaluation** of Assets **( excluding Goodwill )** & Reassessment of Liabilities<br>( **including recording** unrecorded assets and liabilities )<br>** Final Profit or Loss to be distributed amongst **Old** Partners in **Old** Ratio **( O O )** |
| IV | Adjustment / Treatment of **Goodwill** |
| V | Record **Sundry Other Transactions**, if any |
| VI | Treatment of **final amount payable** to Retiring / Deceased Partner |
| VII | Adjustment of remaining **Partners Capitals in New Ratio**, as specified. |
| VIII | **Closing Steps** |

^ **Q. 32 :** F, G & K were partners in LLP sharing profits and losses at the 2:2:1. K wants to retire on 31.12.2022.

Given below is the Balance Sheet of the partnership as well as other information:

**Balance Sheet as on 31.12.2022**

| Liabilities | (₹) | Assets | (₹) |
|---|---|---|---|
| Capital A/cs | | Sundry Fixed Assets | 1,50,000 |
| F | 1,20,000 | Inventories | 50,000 |
| G | 80,000 | Trade receivables | 70,000 |
| K | 60,000 | (Including Bills Receivable | |
| Reserve | 10,000 | 20,000) | |
| Trade payables | 50,000 | Bank | 50,000 |
| | 3,20,000 | | 3,20,000 |

F and G agree to share profits & 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 31.12.2022 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 LLP after K's retirement. Also prepare capital accounts of partners.

^ **Q. 33 :** On 31st March, 2022, the balance sheet of M/s Ram, Rahul and Rohit sharing profits and losses in proportion to their capital, stood as follows:

| Liabilities | | (₹) | Assets | (₹) |
|---|---|---|---|---|
| Capital accounts: | | | Land & building | 2,00,000 |
| Ram | 3,00,000 | | Machinery | 2,00,000 |
| Rahul | 2,00,000 | | Closing stock | 1,00,000 |
| Rohit | 1,00,000 | 6,00,000 | Sundry debtors | 2,00,000 |
| Sundry creditors | | 2,00,000 | Cash and bank balances | 1,00,000 |
| | | 8,00,000 | | 8,00,000 |

On 31st March, 2022, Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:-

1. Land and buildings be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Closing stock to be valued at ₹ 80,000.
4. Provision for bad debts be made at 5%.
5. Old credit balances of sundry creditors ₹ 10,000 be written off.
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 as 50% on retirement and the balance 50% within one year.

Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2022 of M/s Rahul and Rohit.

^ Dr. **( Receivable )** <u>**Deceased**</u> Partner's Capital A/c **( Payable )** **Cr.**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| | | **By** Balance b/d ( Op. Bal. ) | xxx |
| **To** Accumulated Losses A/c | xxx | **By** Reserves A/c | xxx |
| **To** Revaluation A/c ( loss ) | xxx | **By** Revaluation A/c ( profit ) | xxx |
| | | | |
| **To** Drawings A/c | xxx | **By** Cash <u>or</u> Bank A/c | xxx |
| | | ( Capital Introduced ) | |
| | | | |
| **To** Goodwill A/c ( <u>old</u> Goodwill ) | xxx | **By**..........................A/c | xxx |
| ( method II & III ) | | ( share of Goodwill ) | |
| | | | |
| | | **By** Profit & Loss Suspense A/c | xxx |
| | | ( Share in Profit ) | |
| **To** Interest on Drawings A/c | | **By** I.O.C. / Salary **etc.** A/c | xxx |
| | | | |
| **To** Deceased Partners | | | |
| Executors / Legal heirs | | | |
| Loan A/c | xxx | | |
| | | | |
| | <u>**xxx**</u> | | <u>**xxx**</u> |

^ **Profit & Loss Suspense A/c**

| Particulars | ₹ | ₹ | Particulars | ₹ | ₹ |
|---|---|---|---|---|---|
| **To** Deceased Partners | | | **By** I.O.D. A/c | | xxx |
| Capital A/c | | xxx | | | |
| ( Share in Profit ) | | | **By** Balance c/d ** | | **xxx** |
| **To** I.O.C. / Salary etc. A/c | | xxx | ( closing **Dr.** balance ) | | |
| | | | | | |
| | | <u>**xxx**</u> | | | <u>**xxx**</u> |

** Such closing **Dr. balance** <u>will appear temporarily</u> on the **Asset side** of the B S.

* <u>**At the end of Accounting Year**</u>

| | | | | |
|---|---|---|---|---|
| | <u>**Close**</u> <u>Profit & Loss Suspense A/c</u> | | | |
| | | | | |
| | | | | |
| | | | | |

^ **Q. 34 :** 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 31.3.2022. Mr. Z died on 31st December, 2022. His account has to be settled under the following terms.

**Balance Sheet of Om & Co. as on 31.3.2022**

| Liabilities | | (₹) | Assets | (₹) |
|---|---|---|---|---|
| Trade payables | | 20,000 | Building | 1,20,000 |
| Bank loan | | 50,000 | Computers | 80,000 |
| General reserve | | 30,000 | Inventories | 20,000 |
| Capital accounts: | | | Trade receivables | 20,000 |
| X | 40,000 | | Cash at bank | 50,000 |
| Y | 80,000 | | Investments | 10,000 |
| Z | 80,000 | 2,00,000 | | |
| | | **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** |
|---|---|
| 31.3.2022 | 30,000 |
| 31.3.2021 | 20,000 |
| 31.3.2020 | (10,000) Loss |

Profit for the period from 1.4.2022 to 31.12.2022 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending 31.3.2022, a car costing ₹ 40,000 was purchased on 1.4.2021 and debited to traveling expenses account on which depreciation is to be calculated at 20% p.a. at written down value method. 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 1.4.2022 to 31.12.2022.

(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 31.12.2022.

^ **Introduction**

"Dissolution of the firm means dissolution of partnership amongst all the partners in the firm." ( Section 39 of the IPA, 1932 )

Dissolution of the firm means relationship amongst all the partners coming to an end **which leads to** closure of business and also the firm.

* **Circumstances leading to Dissolution**

( Reasons for which a partnership could be dissolved )

a) On the expiry of the term, where the firm is constituted for a fixed term.

b) On completion of the specific venture, where the firm is constituted to carry out one or more ventures or undertaking.

c) On the death of a partner ( unless otherwise agreed amongst the partners )

d) On the adjudication of a partner as an insolvent ( unless otherwise agreed )

* A firm **stands dissolved** in the following cases

( Reasons when a firm stands dissolved )

i) The partners agree that the firm should be dissolved

ii) Dissolution by notice, in case partnership is at Will

iii) When all the partners or all except one become insolvent.

iv) When business becomes unlawful / illegal on happening of some event.

v) Dissolution with the Court order

The court has the option to order dissolution of a firm in the following circumstances

a) When a partner has become of unsound mind

b) When a partner suffers from permanent incapacity

c) Where a partner is guilty of misconduct of the business

d) Where a partner persistently disregards the partnership agreement

e) Where a partner transfers his interest or share to a third party

f) Where the business cannot be carried on except at a loss

d) Where it appears to be just and equitable

* Dissolution of Partnership **may** or **may not** result into Dissolution of Firm.

**In Dissolution of Partnership**, business may continue.

However, it will lead to reconstitution of partnership ( Admission of a Partner, Retirement of a Partner, Death of a Partner ).

* **On Dissolution of Firm.**

1) Real Assets **( Recorded & Unrecorded )** are disposed off at their current values

2) Outsiders Liabilities **( Recorded & Unrecorded )** are paid off / settled at agreed values

3) Loan taken from Partner is paid off / settled at agreed value

4) Final balance in Partners Capital A/c's is paid to / received from Partner.

## Summary : Steps to be followed

| | |
|---|---|
| I | Close / Transfer all Balance Sheet A/c's ( at **BOOK values** ) |
| | |
| II | Record disposal of various recorded & unrecorded assets ( at **CURRENT Values** ) |
| III | Record settlement of various recorded & unrecorded Liabilities ( at **CURRENT Values** )<br>(Including Realisation / Dissolution expenses) |
| IV | Settlement / Payment of Loan from Partner |
| | |
| V | Close Realisation A/c |
| VI | Settlement of Partners Capitals |
| | *** **Cash A/c or Bank A/c will TALLY.** |

**Dr.** **Realisation A/c** **Cr.**

| | Particulars | ₹ | ₹ | Particulars | ₹ | ₹ |
|---|---|---|---|---|---|---|
| I | To Sundry Assets A/c | | | By Sundry Liabilities A/c | | |
| | **( Book Values )** | xxx | | **( Book Values )** | xxx | |
| | | xxx | | | xxx | XXX |
| | | xxx | | By Provision / Reserve / | | |
| | | xxx | | Fund against Asset A/c | | XXX |
| | | xxx | | **( Book Values )** | | |
| | | xxx | XXX | | | |
| II & III | To Cash or Bank A/c | | | By Cash or Bank A/c | | |
| | or Partners Capital A/c | | | or Partners Capital A/c | | |
| | **( Current Values )** | xxx | | **( Current Values )** | xxx | |
| | | xxx | XXX | | xxx | |
| | | | | | xxx | |
| | | | | | xxx | XXX |
| | | | | | | |
| IV | To Loan from Partner A/c | | XXX | By Loan from Partner A/c | | XXX |
| | ( If settled for more ) | | | ( If settled for less ) | | |
| | | | | | | |
| V | To Partners Capital A/c's | | | By Partners Capital A/c's | | |
| | A | xxx | | A | xxx | |
| | B | xxx | XXX | B | xxx | XXX |
| | **( Dissolution Profit )** | | | **( Dissolution Loss )** | | |
| | | | | | | |
| | | | XXX | | | XXX |

^ **When** one or more Partner **become Insolvent**

If any partner is unable to pay his dues to the firm ( due to his / her insolvency ), such Partner's **Capital Deficiency** is borne by other partners.

## * Garner v/s Murray Rule

1 It was laid down in famous English case in 1904 & is applicable in India as well, as there has been no case law in India to deal with such situation.

2 It is applicable **only when** there is no agreement between the partners for sharing the **Insolvency Loss** or **Capital Deficiency** in the A/c of Insolvent Partner.

3 Such Loss arises when there is **Debit balance** in Insolvent Partners Capital A/c which such partner is **unable to** pay / bring money in the firm.

## * KEY POINTS : Garner v/s Murray Rule

1 Such Loss, being capital loss, to be beared by Solvent Partners in their **Capital Ratio**, such capital being capital **on the** date of dissolution.
**Since such Loss is to be beared in Capital Ratio** ,
Solvent Partner having **Debit balance** in Capital on the date of dissolution **will not share** Insolvency Loss.
It should be noted that if capital on the date of dissolution contains **one or more error**, it must be **rectified first**, to get correct amout of capital on the date of dissolution, **before determining Capital Ratio**.

2 **Under Fixed Capital Method,**
It should be in Fixed Capitals Ratio **on the** date of dissolution

3 **Under Fluctuating Capital Method**,
It should be in **adjusted Capital Ratio** on the date of dissolution
( Capitals + Reserves - Accumulated Losses )

4 **ALL** Solvent Partners should **bring in** Cash equal to Realisation Loss, **if any**

Cash or Bank A/c Dr.
    To **Solvent** Partners Capital A/c's

^ **Q. 35 :** 'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2022 their Balance Sheet was as follows:

| **Liabilities** | | **Amt. ₹** | **Assets** | **Amt. ₹** |
|---|---|---|---|---|
| Capital Accounts: | | | Premises | 50,000 |
| Thin | 80,000 | | Fixtures | 1,25,000 |
| Short | 50,000 | | Plant | 32,500 |
| Fat | 20,000 | 1,50,000 | Stock | 43,200 |
| Current Accounts: | | | Debtors | 54,780 |
| Thin | 29,700 | | Current Account | |
| Short | 11,300 | 40,000 | Fat | 14,500 |
| Sundry Creditors | | 84,650 | | |
| Bank Overdraft | | 44,330 | | |
| | | 3,18,980 | | 3,19,980 |

'Thin' decides to retire on 30th September, 2022 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from 30th September, 2022. It then transpires that 'Fat' has no private assets whatsoever. The premises are sold for ` 60,000 and the plant for ` 1,07,500. The fixtures realize ` 20,000 and the stock is acquired by another firm at a book value less 5%. Debtors realize ` 45,900. Realization expenses amount to ` 4,500. The bank overdraft is discharged and the creditors are also paid in full. You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:

(i) Realization Account;

(ii) Partners' Current Accounts;

(iii) Partners' Capital Accounts showing the closing of the firm's books.

^ **Piecemeal Distribution**

Generally, on dissolution of firm, assets of the firm are realised, **piece by piece**, in instalments, over a period of few months.

In such a case,
there are two options for payment of liabilities.

* **Option I** :
Distribute cash available also, **piece by piece**, in instalments, to various liabilities in the **prescribed order of payment**, as soon as collected from realisation of assets.

* **Option II** :
Wait for the whole amount to be collected from realisation of all assets and then pay all liabilities together in the prescribed order.

In most cases, the **first option** is preferred.

^ **Prescribed Order of Payment**

The amount realised from the disposal of assets of the firm on dissolution of the firm should be applied / used in the following manner.

I **Realisation / Dissolution Expenses**

There are 3 possibilities

a **If Total Realisation expenses are given / known**

Pay it fully out of available Cash / Bank balance or out of first realisation

b **Estimated Realisation expenses are given**

i) Keep aside amount equal to **estimated** total realisaion expenses, out of available Cash / Bank balance **or** out of first realisation

ii) **Compare** estimated realisation expenses **with** actual realisation expenses at the end and **difference** to be added to / deducted from **last realisation** amount.

c **When Realisation expenses are given at each stage of realisation**

Since realisation of assets is piece by piece in instalments, expenses also might be given / incurred at each stage of realisation.
In such case, **net** realisation only should be used for repayment of liabilities.

II **Secured Loans** should be paid out of amount realised from sale of such security.
If excess amount is realised, balance amount to be utilised for payment of other liabilities.
If lesser amount is realised, treat balance secured loan as unsecured, at par with other unsecured liabilities.

| | |
|---|---|
| **III** | **Other Outsiders Liabilities** |
| * | Preferential Liabilities like Government dues, Employees dues to be paid off first |
| * | Other unsecured liabilities should be paid in Liability Ratio. |
| | |
| **IV** | **Loan given by Partner to the firm** |
| | It can be paid off only after ALL outsiders liabilities are paid off fully. |
| | |
| **V** | **Adjusted** Capitals of Partners |
| | Finally, payment can made to partners towards their Capitals, which can be |
| | calculated **after adjusting it for** |
| | i) Current A/c balances, |
| | ii) Loan by firm to the partner, |
| | iii) Reserves and |
| | iv) Accumulated Losses, |
| | **on the date of dissolution**. |
| | |
| * | **Adjusted Capitals** of Partners can be paid off by following any one of the following |
| | **two methods**, as may be decided / given in the problem |
| | |
| **1** | Excess/Surplus Capital Method **or** Highest Relative Capital Method **or** Quotient Method |
| **2** | Maximum **or** Notional Loss Method |
| | |
| **1** | **Excess / Surplus Capital Method** |
| | When Actual adjusted Capital of any partner is more than Proportionate Capital, |
| | such partner is said to be having **Excess** or **Surplus capital**. |
| | Such excess / surplus capital should be **paid off first**, so that, post that, |
| | all partners capitals comes in P.S.R. **& then**, all partners can be paid off in their P.S.R. |

^ **Q. 36 :** A partnership firm was dissolved on 30th June, 2022. Its Balance Sheet on the date of dissolution was as follows :

| **Liabilities** | | **Amt. (`)** | **Assets** | **Amt. (`)** |
|---|---|---|---|---|
| Capitals : | | | Cash | 10,800 |
| A | 76,000 | | Sundry Assets | 1,89,200 |
| B | 48,000 | | | |
| C | 36,000 | 1,60,000 | | |
| Loan A/c – B | | 10,000 | | |
| Sundry Creditors | | 30,000 | | |
| | | **2,00,000** | | **2,00,000** |

The assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ` 29,000 in full settlement of their account. Expenses of realization were estimated to be ` 5,400 but actual amount spent was ` 4,000. This amount was paid on 15th September. Draw up a statement showing distribution of cash, which was realized as follows:

| | (`) |
|---|---|
| On 5th July, 2022 | 25,200 |
| On 30th August, 2022 | 60,000 |
| On 15th September, 2022 | 80,000 |

The partners shared profits and losses in the ratio of 2 : 2 : 1. Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital' method.

2 **Maximum or Notional Loss Method**

* **Pay** till Partners Loan ( Loan from Partner ) **in usual way**.

* **For payment to Partners** towards their **Adjusted Capitals**,
following steps should be followed under this method, on every realisation.

a) **Assume** cash available / current instalment as final / last realisation.

b) Accordingly,
calculate **Realisation Loss** & distribute the same amongst partners in their **P.S.R.**

c) If any partners **capital** shows **negative balance**,
assume such partner to be Insolvent, unable to contribute anything and accordingly,
distribute **Capital Deficiency / Insolvency Loss** following **Garner v/s Murray**.

* Repeat the process till no partner is having negative capital balance.

* **At this stage**, Capital balances and cash available will be the same.

d) **Pay** available cash to partners towards their capitals.

e) **Balance Capital** = Capital balance before this realisation **Less** payment made

^ **Q. 37 :** E, F and G were partners in a Firm, sharing profits and losses in the ratio of 3:2:1 respectively. Due to extreme competition, it was decided to dissolve the Partnership on 31st December. The Balance Sheet on that date was as followsv:

| Liabilities | | | Amt. (`) | Assets | Amt. (`) |
|---|---|---|---|---|---|
| Capital A/c's : | E | 1,13,100 | | Machinery | 1,54,000 |
| | F | 35,400 | | Furniture & Fittings | 25,800 |
| | G | 31,500 | 1,80,000 | Investments | 5,400 |
| Current A/c's : | E | 26,400 | | Stock | 97,700 |
| | G | 6,000 | 32,400 | Debtors | 56,400 |
| Reserves | | | 1,08,000 | Bank | 29,700 |
| Loan Account : G | | | 15,000 | Current Account : F | 18,000 |
| Creditors | | | 51,600 | | |
| | | | 3,87,000 | | 3,87,000 |

The realization of assets is spread over the next few months as follows:

February : Debtors ` 51,900;

March : Machinery ` 1,39,500;

April : Furniture etc. ` 18,000

May : G agreed to take over Investment at ₹ 6,300;

June : Stock ` 96,000.

Dissolution Expenses, originally provided were ` 13,500, but actually amounted to ` 9,600 and were paid on 30th April. The partners decide that after Creditors were settled for ` 50,400, all cash received should be distributed at the end of each month in the most equitable manner.

Prepare a statement of actual cash distribution as received using "Maximum Loss basis".

^ **Introduction**

The word **'Company'** is defined as a company
formed and registered / incorporated under **the Companies Act, 2013**
**or** an existing company which is formed & incorporated under any of the previous company laws.

As per the definition,
there must be group of persons who agree to form a company under the law
**and once so formed,**
it becomes a **separate legal entity** having **perpetual succession** with a distinct name of its own and a **common seal**.
Its **existence** is **not affected** by the change of members.
A company ( Joint stock company ) is an entity created by a group of persons
**through the process of law** for usually undertaking a business.
It is **an artificial person** separate from its members / shareholders / owners.
A company is an **artificial person** created by law having common seal and perpetual succession.

^ **Salient Features of a Company**

**1)** Incorporated Association
**2)** Separate Legal Entity
**3)** Common Seal
**4)** Perpetual Existence
**5)** Limited Liability
**6)** Distinction between Ownership and Management
**7)** Transferability of Shares
**8)** Not a citizen
**9)** Maintenance of Books
**10)** Periodic Audit
**11)** Right of Access to Information

^ **Issue of Shares**

* **Capital** refers to money or money's worth invested in the business **by the proprietor** of the business. For the Business Organization / Entity,
Capital is treated as **liability towards** the proprietor of the business.
It can be viewed as amount due to / payable by the business to the proprietor of the business. Hence, Capital is Internal **Liability** of the business.

* Capital, **in case of a company**, is called as **Share Capital**.
Capital of a company is divided into units of smaller denominations ( say ₹ 1, 2, 5, 10, 50 or 100 ) and each such unit is called a **Share**.
**For example**, in a company, total capital of ₹ 50,00,000 is divided into 5,00,000 shares of ₹ 10 each, then each such unit of ₹ 10 each is called a Share.
₹ 10 in above case is known as **face value** or **nominal value** of the share.
Share simply means a share in the share capital of a company.
**The persons** who **owns** the shares are called **shareholders**

*

| Business Organisation | Ownership | Type of Capital | Liability of Owners |
|---|---|---|---|
| Sole Proprietorship | Single Proprietor | Capital | Unlimited |
| Partnership | Partners | Partners Capital | Unlimited |
| Company | Shareholders | Share Capital | Limited to the issue price of shares held |

^ **Types of Share Capital**

The different types of share capital are as follows :

i) **Authorised or Nominal or Registered Capital**

A company estimates its **maximum** capital requirements.
This amount of capital is mentioned in **'Capital Clause'** of **'Memorandum of Association'** registered with the Registrar of Companies.
It puts a limit on the amount of capital, **which a company is authorised** to raise during its life time and is called **Authorised Capital**. The Authorised Capital can be increased or decreased by adopting the prescribed legal procedure.

ii) **Issued Capital**

Issued Capital is a **part of the Authorised Capital** that is issued for subscription.
It should be noted that total Issued Capital ( all inclusive ) **cannot exceed** the Company's Authorised Share Capital.
The part of Authorised capital which is not issued till date is known as Unissued capital.

iii) **Subscribed Capital**

means such part of the issued capital which is subscribed by the members of a company. **When shares issued for subscription are wholly subscribed**, Issued capital and Subscribed capital would be the same.
**In case of under subscription**, the part of the issued capital which is not subscribed by the public are known as Unsubscribed capital.

iv) **Called up Capital**

It is that part of the subscribed capital which is actually called up / demanded from the shareholders till the date.

The part of subscribed capital which is not called up till the date is called Uncalled Capital.

v) **Paid up Capital**

It is that portion of called up capital which is actually been paid by the shareholders.

Paid up capital = Called up capital **less** calls in arrears.

vi) **Reserve Capital**

Reserve Capital is that part of the subscribed capital remaining uncalled, that a company resolves, by a Special Resolution, **not to call** except in the event of winding up of the company. The term Reserve Capital and **Capital Reserve** are two different terms. **Capital Reserve** is a reserve created out of capital profits and is shown under the head **Reserves and Surplus** .

^ **A/c's in the Balance Sheet of a Company**

| | Account | Balance | Balance Sheet | |
|---|---|---|---|---|
| 1 | Share Capital | Credit | L | Called up & Paid up Share Capital |
| 2 | Calls in Arrears | **Debit** | L | **Deduct from** Called up Capital |
| | ( if overdue money **yet not** received & also, shares **yet not** cancelled / forfeited ) | | | |
| 3 | Share Forfeiture | Credit | L | **Add to** Paid up Capital |
| | ( if shares are forfeited **but yet not** reissued ) | | | |
| 4 | Securities Premium<br>Capital Reserve | Credit | L | Reserves & Surplus |
| 5 | Calls in Advance | Credit | L | Current Liabilities |
| | ( if **yet not** adjusted against respective call ) | | | |
| 6 | Bank | **Debit** | A | Current Assets |
| 7 | Expenses on Issue of Shares<br>Discount on Issue of Shares | **Debit** | A | Current Assets |
| | ( if **yet not** written off ) ( These are fictitious assets ) | | | |

* Accounts **NOT shown** in the Balance Sheet, **NIL balance**

**1)** Share Application / Allotment / Call A/c, generally gets cancelled

**2)** Calls in Arrears A/c, if overdue money already received **or** shares already forfeited

**3)** Calls in Advance A/c, if already adjusted against respective call

**4)** Share Forfeiture A/c, if forfeited shares are already reissued

^

# Name of the Company ...

Balance Sheet as at ....... ( ₹ in ......)

| Sr. No. | | Particulars | Note No. | Figures at the end of Current Reporting Period | Figures at the end of Previous Reporting Period |
|---|---|---|---|---|---|
| I. | | **EQUITY AND LIABILITIES** | | | |
| | 1 | Shareholders Funds | | | |
| | | (a) Share Capital | | xxx | |
| | | (b) Reserves and Surplus | | xxx | |
| | | (c) Money received against Share warrants | | xxx | |
| | 2 | **Share Application money pending Allotment** | | xxx | |
| | 3 | **Non-Current Liabilities** | | | |
| | | (a) Long-term Borrowings | | xxx | |
| | | (b) Deferred Tax Liabilities (net) | | xxx | |
| | | (c) Other Long Term Liabilities | | xxx | |
| | | (d) Long-term Provisions | | xxx | |
| | 4 | **Current Liabilities** | | | |
| | | (a) Short-term Borrowings | | xxx | |
| | | (b) Trade Payables | | xxx | |
| | | (c) Other Current Liabilities | | xxx | |
| | | (d) Short-term Provisions | | xxx | |
| | | **Total** | | **XXX** | |
| II. | | **ASSETS** | | | |
| | 1 | **Non-Current Assets** | | | |
| | | (a) i) Property, Plant and Equipment | | xxx | |
| | | ii) Intangible Assets | | xxx | |
| | | iii) Capital Work-in-Progress | | xxx | |
| | | iv) Intangible Assets under Development | | xxx | |
| | | (b) Non-Current Investments | | xxx | |
| | | (c) Deferred Tax Assets (net) | | xxx | |
| | | (d) Long-term Loans and Advances | | xxx | |
| | | (e) Other Non-Current Assets | | xxx | |
| | 2 | **Current Assets** | | | |
| | | (a) Current Investments | | xxx | |
| | | (b) Inventories | | xxx | |
| | | (c) Trade Receivables | | xxx | |
| | | (d) Cash and Cash Equivalents | | xxx | |
| | | (e) Short-term Loans and Advances | | **xxx** | |
| | | (f) Other Current Assets | | **xxx** | |
| | | **Total** | | **XXX** | |

^ **Schedule III, Part I ( of the Companies Act, 2013 )**

As per Section 129 of the Companies Act, 2013, Financial statements shall give a true and fair view of the state of affairs of the company or companies and comply with the accounting standards notified under Section133 and shall be in the form or forms as may be provided for different class or classes of companies in Division I of Schedule III under the Act.

* **Classes / kinds / types of shares**

Shares of a company can be of two types

**1.** Preference Shares

**2.** Equity Shares

**Preference shares** are the shares which carry the following **two preferential rights** ;
**first** regarding payment of dividend at fixed % and
**second** regarding repayment of capital, in case of winding up / liquidation of the company.

**Equity shares** are those shares which **are not** preference shares.
Equity shares are the **most commonly issued** type of shares which carry the maximum risks & rewards of the business.

The **risks** being losing part or all of the value of shares if business incurs losses ;
the **rewards** being payment of higher dividends and appreciation in the market value of shares, if there is profitable growth of business.

* **A company may Issue shares**

**i)** for cash **or**

**ii)** for consideration other than cash

* **Issue of shares for cash consideration**

Shares are said to be issued for cash when the company receives amount by cheque or any other banking instrument / mode against shares issued.

**The amount of shares may be payable**

**either** in lumpsum along with the application

**or** in instalments at different stages

i.e. partly on application, partly on allotment and balance on one or more calls.

^ Such shares can be issued at Par **or** at Premium **or** at Discount.

* **At Par** :

When shares are issued at its face value, it is said to be an issue at par.

* **At Premium** :

When shares are issued at a price more than the face value,
it is said to be an issue at premium.

* **At Discount** :

When shares are issued at a price less than the face value,
it is said to be an issue at discount.

^ Issue of **Equity Shares** for cash by **Public Company**

Public companies issues a 'Prospectus' and invites general public to subscribe
for its shares.

^ **Calls - in - Arrears**

Amount **called** by the company towards issue price of shares ( either as allotment or
as call money ) **but yet not received** by the company from one or more shareholders
is called **Calls in Arrears.**
Such amount is receivable from such defaulting shareholder(s) in future, hence such
defaulting shareholders becomes debtor for the company & hence their A/c is debited.
Calls-in-Arrears A/c is a **Representative Personal A/c** of all defaulting shareholders.

^ **Over-subscription of shares**

means applications received for shares are more than the shares offered ( issued )
for subscription. A company, usually, cannot allot shares more than the shares
it has issued / offered for subscription.

**In such case**,
company can allot shares in **any of** the following **3 ways**.

**i)** company can **reject** excess applications and **refund** application money received on such rejected applications

**or**

**ii)** company can do **pro-rata ( proportionate ) allotment** to all the applicants

**or**

**iii)** company can accept some applications in full, reject some applications and do pro-rata allotment on balance.

^ **Issue of Equity shares AT PAR - basic entries**

| | | |
|---|---|---|
| I | **For Receipt of Share Applications** | **For Disposal of Share Applications** |
| | Bank A/c Dr. | Equity Share Application A/c Dr. |
| | To Equity Share Application A/c | To Equity Share Capital A/c |
| | | To Bank A/c |
| | | To Equity Share Allotment A/c |
| II | **For Allotment moneys due / receivable** | **For Allotment moneys received** |
| | Equity Share Allotment A/c Dr. | Bank A/c Dr. |
| | To Equity Share Capital A/c | Calls in Arrears A/c Dr. |
| | | To Equity Share Allotment A/c |
| | **At any stage** | **For Receipt of Calls in Advance** |
| | | Bank A/c Dr. |
| | | To Calls in Advance A/c |
| III IV etc. | **For Call moneys due / receivable** | **For Call moneys received** |
| | Equity Share......... Call A/c Dr. | Bank A/c Dr. |
| | To Equity Share Capital A/c | Calls in Arrears A/c Dr. |
| | | Calls in Advance A/c Dr. |
| | | To Equity Share........Call A/c |
| | **For Receipt of Calls in Arrears** | **For Expenses on Issue of Shares** |
| | Bank A/c Dr. | Expenses on Issue of Shares A/c Dr. |
| | To Calls in Arrears A/c | To Bank A/c |

^ **Issue of Preference Shares**

Journal entries for issue of preference shares are very similar to that of equity shares.

^ **Undersubscription of Shares**

means applications received by the company are for shares **less than** the shares issued / offered for subscription.

In this case,

**journal entries are to be passed for** number of shares applied & allotted only,

**not for** shares issued / offered for subscription.

^ **Minimum Subscription**

A public limited company cannot make any allotment of shares unless the amount of **minimum subscription** stated in the prospectus has been subscribed and the sum payable as application money for such shares has been paid to & received by the company.

Every company offering shares to public for subscription is required to state in its prospectus the **minimum subscription**. The Companies Act, 2013 allows the company to decide minimum subscription. **SEBI** ( Securities & Exchange Board of India ) has prescribed minimum subscription to be **90% of the issue of shares.**
It means, companies issuing shares to public should receive atleast 90% of the application money payable on shares issued for subscription before alloting any shares.

^ **Q. 38 :** JHP Limited is a company with an authorised share capital of ₹ 10,00,000 in equity shares of ` 10 each, of which 6,00,000 shares had been issued and fully paid on 30th June, 2021.
The company proposed to make a further issue of 1,00,000 of these ` 10 shares at a price of ` 14 each, the arrangements for payment being :
(a) ` 2 per share payable on application, to be received by 1st July, 2021;
(b) Allotment to be made on 10th July, 2021 and a further ` 5 per share (including the premium) to be payable;
(c) The final call for the balance to be made, & the money received by 30th April, 2022.
Applications were received for 3,55,000 shares and were dealt with as follows :
(i) Applicants for 5,000 shares received allotment in full;
(ii) Applicants for 30,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;
(iii) Applicants for 3,20,000 shares received an allotment of one share for every four applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and
(iv) the money due on final call was received on the due date.
You are required to record these transactions (including cash items) in the Journal.

^ **Q. 39 :** A Company issued 50,000 equity shares of Rs. 100 each at premium of 25%, received applications for 1,10,000 shares and allotment was made as follows :

**Allotment Table**

| Category | | Applied | Allotted | Rejected |
|---|---|---|---|---|
| 1 | Fully Rejected | 10,000 | 0 | 10,000 |
| 2 | Fully Allotted | 20,000 | 20,000 | 0 |
| 3 | Pro Rata ( all remaining applications ) | 80,000 | 30,000 | 50,000 |
| | | **1,10,000** | **50,000** | **60,000** |

Amount payable per share 30, 60 & balance on call.

Mr. A who was allotted 300 shares on 800 shares he had applied for failed to pay any money after application.

His shares were forfeited after call and subsequently 60% of his shares were reissued at a discount of 10%.

Pass Journal entries to record all the above transactions.

^ **Q. 40 :** R Ltd. took over assets worth ₹ 4,00,000 & liabilities worth ₹ 1,30,000 of Akshya Enterprise. The vendors were issued fully paid equity shares of ₹ 10 each. Pass journal entries in the following cases :

a) if such shares were issued at par

b) if such shares were issued at 20% premium

^ **Interest on calls-in-arrears and calls-in-advance**

Interest on calls in arrears is recoverable and that in respect of calls in advance is payable, according to provisions in this regard in the articles of the company, at the rates mentioned therein or those to be fixed by the directors, within the limits prescribed by the Articles.

**Table F** prescribes the **maximum** rates as :

**Charge 10% p.a.** Int. on calls in arrears & **Allow 12% p.a.** Int. on calls in advance.

^ **Q. 41 :** A Limited issued 20,000 equity shares of, 10 each at a premium of 10%, payable ` 2 on application; ` 4 on allotment (including premium); ` 2 on first call and balance on the final call. All the shares were fully subscribed. Mr. M who held 2,000 shares paid full remaining amount on first call itself. The final call which was made after 4 months from the first call was fully paid except a shareholder having 200 shares and one another shareholder having 100 shares. They paid their due amount after 3 months and 4 months respectively alongwith interest on calls in arrears, Company also paid interest on calls in advance to Mr. M. The Company maintains Calls in Arrear and Calls in Advance A/c. Give journal entries to record these transactions. Show workings of interest calculation. (Ignore dates).

^ **Debentures**

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

**Section 2(30)** of the Companies Act, 2013 **defines debentures as** :
"Debenture" includes debenture stock, bonds, or any other instrument of the company **evidencing a debt**, whether constituting a charge on the assets of the company or not.

* **Features of Debentures**

1 It is document which **evidences** a loan made / given to a company

2 It is a fixed **interest** bearing security where interest falls due on specific dates. Such interest is payable at **fixed rate** on **fixed date**, regardless of profit or loss.

3 Such debentures can be **issued** at par, premium **or** discount and **are redeemable** at future date at par, premium **or** discount.

4 Amount due can be repaid **or** is converted into shares **or** other debentures **or** any combination of above, as pre-decided.

5 It may **or** may not create charge on the assets of the company as security ( debentures may be secured debentures or unsecured debentures )

6 No Company **shall issue any debentures** carrying any voting rights.

7 Debentures are generally bought or sold **through the stock exchange** and it might be traded at a price above or below its face value.

^ **Journal entries for Issue of Redeemable Debentures ( in Lumpsum )**

It can be divided into 6 categories as follows

| | **Issue at** | **Redeemable at** | |
|---|---|---|---|
| 1 | Par | Par / Discount * | * Redemption at discount is **very rare** in practical life |
| 2 | Premium | | |
| 3 | Discount | | |
| 4 | Par | Premium | |
| 5 | Premium | | |
| 6 | Discount | | |

^ **Q. 42 :** Koinai Chemicals Ltd. issued 40,00,000, 11% debentures of `50 each, redeemable anytime after 3 years from the date of issue.

Pass Journal entries in each of the following cases :

1) Issue at par redeemable at par
2) Issue at 8% premium redeemable at par
3) Issue at 3% discount redeemable at par
4) Issue at par redeemable at 2% premium
5) Issue at 8% premium redeemable at 2% premium
6) Issue at 3% discount redeemable at 2% premium

## * Treatment of Discount / Loss on Issue of Debentures

^ **Q. 43 :** HDC Ltd issues 1,00,000, 12% Debentures of `100 each at `94 on 1-1-2022. Under the terms of issue, the debentures are redeemable at the end of 5 years from the date of the issue. Calculate the amount of discount to be written-off in each of the 5 years.

^ **Q. 44 :** HDC Ltd. issues 2,00,000, 12% Debentures of `10 each at `9.40 on 1-1-2022. Under the terms of issue, 1/5th of the debentures are annually redeemable by drawings, the first redemption occurring on 31st December, 2022. Calculate the amount of discount to be written-off from 2022 to 2026.

## * Interest on Debentures

^ **Q. 45 :** A company issued 12% debentures of the face value of `10,00,000 at 10% discount on 1-1-2022. Debenture interest after deducting tax at source @ 10% was payable on 30th June and 31st of December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.

Pass journal entries for the accounting year 2022.

^ **R**edemption of **P**reference **S**hares **( RPS )**

Redemption = Repayment

Redemption of PS means **R**edemption of **P**reference **S**hare Capital ( **RPSC** )

RPSC means repaying the Capital back to the preference shareholders,
**at an** agreed amount, **at an** agreed rate.

Redemption period / maturity date and amount is **known** to all concerned
**at the time of** Issue of such securities, so that it is easy to attract Investors.

Company **cannot issue** Irredeemable PS. Maximum time limit for RPS is 20 years, which can be extended upto 30 years for companies engaged in setting up and dealing with of Infrastructural projects.

PS are redeemed **either** at par **or** at premium, but not at discount.

^ **Conditions for Redemption of PSC**

1 **ONLY fully paid up** PS can be redeeemd

Partly paid up preference shares cannot be redeemed.
If company has partly paid up PS, it must be first converted into fully paid up and then only such PS can be redeemed.

* **If final call is yet not made**, make final call and receive all money.
* **If there are calls in arrears**, either receive calls in arrears or forfeit such shares.
Reissue such forfeited shares, if given in the problem.

2 Redemption of **PSC MUST NOT** result into **Reduction of Capital**

* **Option I** : Fresh Issue of shares for this ( Capital **to be replaced by** Capital )
In such case, **either** fresh equity shares **or** preference shares can be issued.
Issue of debentures etc **not allowed** for this purpose.
Also, if such fresh shares are issued at premium, securities premium **cannot be** considered for replacement, as capital must be replaced by capital.

* **Option II** : **Create** Capital Redemption Reserve ( CRR ) **out of** Divisible Profits

CRR = Face value of PS to be redeemed **Less** Face value of fresh issue of shares

## Divisible Profits / Distributable Profits

= Profits otherwise **available for distribution** as dividend to shareholders

**Examples of Divisible Profits**

**G**eneral **R**eserve, **R**eserve **F**und, **R**evenue Reserves,

**D**ividend Equilisation Reserve etc.

**P**rofit & Loss A/c ( Surplus in P & L A/c )

** CRR can be **used** in the future, **ONLY FOR**, Issue of **Fully paid up Bonus Shares** and no other purpose. The provisions of the Act relating to reduction of capital shall apply to CRR also, as if the CRR were Paid-Up Capital of the Company.

3 Premium on Redemption of PS, if any, must be **written off immediately** **out of** Divisible Profits ( use Securities Premium, only if, specified in the problem )

^ **Q. 46 :** The Balance Sheet of XYZ Ltd. as at 31st December, 2021 inter alia includes the following information:

| | (`) |
|---|---:|
| 50,000, 8% Preference Shares of ` 100 each, ` 70 paid up | 35,00,000 |
| 1,00,000 Equity Shares of ` 100 each fully paid up | 1,00,00,000 |
| Securities Premium | 5,00,000 |
| Capital Redemption Reserve | 20,00,000 |
| General Reserve | 50,00,000 |
| Bank | 15,00,000 |

Under the terms of their issue, the preference shares are redeemable on 31st March, 2022 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of ` 100 each at ` 110 per share, ` 20 being payable on application, ` 35 (including premium) on allotment & the balance on 1st January, 2023. The issue was fully subscribed & allotment made on 1st March, 2022. The money due on allotment were duly received by 31st March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass necessary journal entries assuming that preference shareholder holding 2,000 shares failed to pay the final call and hence such shares are forfeited after giving proper notices ( Ignore date column ).

Also, show relevant extracts from the Balance Sheet as at end of the year with the corresponding figures.

^ **Q. 47 :** X Ltd. gives you the following information as at 31st March, 2023:

| | Particulars | (`) |
|---|---|---|
| | **EQUITY AND LIABILITIES** | |
| **1** | **Shareholders' funds** | |
| | a. Share capital | 2,90,000 |
| | b. Reserves and Surplus | 48,000 |
| **2** | **Current liabilities** | |
| | Trade Payables | 56,500 |
| | | **3,94,500** |
| | **ASSETS** | |
| **1** | **Property, Plant and Equipment** | 3,45,000 |
| **2** | **Non-current investments** | 18,500 |
| **3** | **Current Assets** | |
| | Cash and cash equivalents (bank) | 31,000 |
| | | **3,94,500** |

The share capital of the company consists of ` 50 each equity shares of ` 2,25,000 & ` 100 each Preference shares of ` 65,000 (issued on 1.4.2021). Reserves & Surplus comprises Profit and Loss Account only.

In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) to sell all the investments for ` 15,000.

(b) to finance part of redemption from company funds, subject to, leaving a bank balance of ` 12,000.

(c) to issue minimum equity share of ` 50 each share to raise the balance of funds required.

Pass the necessary journal entries to record the above transactions.

^ **Issue of Bonus Shares**

* It is **appropriation out of profits** i.e. one of the way of distribution of profits to the existing shareholders.
It is done by **capitalising profits** i.e. Converting Reserves into Share Capital

* It can be done in **any one** of the following two or **both** ways

A) **Bonus Dividend**

Conversion of partly paid up shares into fully paid up,
without shareholders being required to pay for the same.

^ **Ex. 1 :** A Limited company with subscribed capital of `5,00,000 consisting of 50,000 equity shares of `10 each; called up capital of `7.50 per share. A bonus was declared out of reserves to be applied in making the existing shares fully paid up.

**JOURNAL**

| Date | Particulars | L.F. | Debit (`) | Credit (`) |
|---|---|---|---|---|
| 1 | | | | |
| | | | | |
| | ( Being equity share final call due on 50,000 equity shares @ `2.50 per share as per board's resolution No. …… dated …… ) | | | |
| | | | | |
| 2 | | | | |
| | | | | |
| | ( Being bonus declared for making partly paid up equity shares into fully paid up as per share as per shareholders resolution no.....dated …… ) | | | |
| | | | | |
| 3 | | | | |
| | | | | |
| | ( Being bonus applied for making partly paid up equity shares fully paid up ) | | | |

B) **Issue of Fully paid up Bonus shares to the existing shareholders**

These are additional shares issued to existing shareholders, free of cost
i.e. without shareholders being required to pay for the same.

^ **Ex. 2 :** A Limited company having fully paid capital of 50,00,000 consisting of Equity shares of `10 each, had Reserves of `9,00,000. It was resolved to capitalise part of the reserves by issuing fully paid up bonus shares at the rate of one share for every ten shares held.

**JOURNAL**

| Date | Particulars | L.F. | Debit (`) | Credit (`) |
|---|---|---|---|---|
| 1 | | | | |
| | | | | |
| | ( Being bonus declared for issuing fully paid up equity shares, at one share for every ten shares held, as per shareholders resolution no..… dated....) | | | |
| | | | | |
| 2 | | | | |
| | | | | |
| | ( Being 15,000 equity shares of 10 each fully paid up issued as bonus shares ) | | | |

^ **Other conditions for Issue of Bonus Shares**

1 **Partly paid up shares**, if any, MUST be **made fully paid** up first

2 It is authorised by A-O-A of the company

3 It is, on recommendation of the Board, authorised in the general meeting of the company.

4 **Company has NOT defaulted in respect of the payment of**

**a)** interest or principal in respect of Fixed deposits or debts issued by the company

**b)** statutory dues of the employees ( contribution to provident fund, gratuity, bonus )

5 Bonus, once announced / approved, shall not be withdrawn by the company.

6 Such other conditions as may be prescribed

^ **Divisible Profits ( DP ) ( Free Reserves )**

means Reserves, which are **available for distribution as dividend.**

<table>
<tr><td></td><td></td><td></td><td colspan="2">Redemption of PSC</td><td colspan="2">Bonus</td></tr>
<tr><td></td><td>Reserves to be utilised, in that order</td><td>DP</td><td>For creation of CRR</td><td>To Write Off Premium on ROPS</td><td>Bonus Dividend</td><td>Issue of Fully paid up Bonus</td></tr>
<tr><td>*</td><td colspan="6">Capital Profits</td></tr>
<tr><td>1</td><td>Capital Redemption Reserve</td><td rowspan="2">×</td><td colspan="2">No</td><td rowspan="2">No</td><td>Yes</td></tr>
<tr><td>2</td><td>Securities Premium</td><td>No</td><td>Yes, if given</td><td>Yes, if realised</td></tr>
<tr><td>3</td><td>Capital Reserve, being profit on sale of Fixed Assets</td><td>A)</td><td colspan="4">Yes ( if divisible profit / if no information given ) ;<br>No ( if non divisible profit )</td></tr>
<tr><td>4</td><td>Capital Reserve B)</td><td rowspan="5">×</td><td colspan="4" rowspan="5">No</td></tr>
<tr><td>5</td><td>Revaluation Reserve (Unrealised / Notional Gains)</td></tr>
<tr><td rowspan="3">6</td><td>Development Rebate Reserve</td></tr>
<tr><td>Investment Allowance Reserve</td></tr>
<tr><td>Export Profit Reserve</td></tr>
<tr><td>*</td><td colspan="6">Revenue Profits</td></tr>
<tr><td>7</td><td>Profit on sale of Investments</td><td rowspan="7">✓</td><td colspan="4" rowspan="7">Yes</td></tr>
<tr><td>8</td><td>General Reserve</td></tr>
<tr><td>9</td><td>Reserve Fund</td></tr>
<tr><td>10</td><td>Revenue Reserves</td></tr>
<tr><td>11</td><td>Dividend Equilisation Reserve</td></tr>
<tr><td>12</td><td>Investment Fluctuation Fund</td></tr>
<tr><td>13</td><td>Profit & Loss A/c ( Surplus )</td></tr>
</table>

**A)** **Capital Reserve**, being Capital Profit on sale of Fixed Assets

DP **only if i)** such profit is realised **ii)** such profit is not likely to be wiped out by deficiency on revaluation of other assets & **iii)** AOA doesn't prohibit distribution of such profit as dividend.

**B)** **Capital Reserve**

Capital Reserve is a Reserve which **does not include** any amount regarded as free for distribution as dividend.

Generally, only Profits or Surplus **of a capital nature** can be created as capital Reserve.

**Examples**

**1)** Profits **Prior to Incorporation**

2) **( net )** Profit on **Re-issue** of Forfeited shares

3) **Excess of** Value of Net Assets Taken Over **( NATO )** **over** Purchase Consideration **( PC )** Paid for the **acquision of a business.**

4) Credit Balance in Capital Reduction A/c, when there has been a Reduction of Capital ( **Internal Reconstruction** ), with the consent of the court / NCLT etc.

^ **Q. 48 :** The following is the Balance Sheet of R Limited as at 31st March -

| Sources of Funds | (`) | Application of Funds: | (`) |
|---|---|---|---|
| **Authorized Capital :** | | Property, Plant & Equipment | 31,60,000 |
| 1,50,000 Equity Shares of | | Investments | 14,70,000 |
| ` 10 each | 15,00,000 | (Market Value ₹ 17,40,000) | |
| 30,000 Preference Shares of | | Sundry Debtors | 17,60,000 |
| ₹ 100 each | 30,00,000 | Cash & Bank Balances | 5,42,500 |
| **Issued and Paid Up Capital :** | | | |
| 90,000 Equity Shares of | | | |
| ₹ 10 each | 9,00,000 | | |
| 15,000 Preference Shares of | | | |
| ₹ 100 each | 15,00,000 | | |
| **Reserves & Surplus :** | | | |
| Securities Premium | 18,00,000 | | |
| General Reserve | 16,50,000 | | |
| Profit & Loss A/c | 1,20,000 | | |
| 7,500 9% Debentures of | | | |
| ₹ 100 each | 7,50,000 | | |
| Sundry Creditors | 2,12,500 | | |
| | 69,32,500 | | 69,32,500 |

In the Annual General Meeting held on 15th May, the Company passed the following resolutions :

(a) To redeem 10% Preference Shares at a premium of 5%.

(b) To redeem 9% Debentures by making offer to debenture holders to convert their holdings into equity shares at ` 40 per share or accept cash on redemption.

(c) To issue fully paid bonus shares in the ratio of one equity share for every 3 shares held on 31st March.

(d) Redemption of preference shares and debentures will be paid through company's cash & bank balance subject to leaving a minimum cash & bank balance of ` 2,00,000.

(e) To issue sufficient number of equity shares @ ` 40 per share as required to finance redemption of Preference Shareholders and Debenture holders.

On 5 June, Investments were sold for 16,80,000 & preference shares were redeemed. 30% of Debenture holders exercised their option to accept cash and their claims were settled on 1st August. The bonus issue was concluded by 10th August.

You are required to journalize the above transactions including cash transactions and Balance Sheet as at 30th September.

All working notes should form part of your answer.

## Right Issue of Shares

^ **When a company intends to issue new shares**, since it needs additional capital for business, Companies Act, 2013 allows existing shareholders ( except few exceptions ) to preserve their position ( financial & governance interest in the company ), by offering those newly issued shares at the first instance to them.

The existing shareholders **are given a right** to subscribe these shares, if they like so, **so that** voting and governance rights of the existing shareholders is not diluted.

Such **right** to subscribe new shares is in **proportion** to their existing holding for shares.

Normally,

such right issue of shares **is at discounted price** from the current market price, to evoke positive response as well as to reward the existing shareholders.

**Unless the A-O-A of the company specifically prohibits,**

they have an implicit right to renounce ( transfer ) this right in favour of anyone else.

**In other words**,

the existing shareholders have right of first refusal, i.e. they have a right to **either** subscribe for these shares **or** sell their rights **or** reject the offer.

^ **Accounting** for Right Issue

**is exactly same** as that of Issue of Shares to Public.

^ **Right of Renunciation**

It refers to the right of the shareholder to surrender his right to buy the securities and transfer such right to any other person ( by selling it to such other person ).

* **Value of right**

The renunciation of the right is valuable & can be monetised by the existing shareholders in well-functioning capital market.

The monetised value available to the existing shareholders due to the right issue is known as **'value of right'**

^ **Q. 49 :** Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 2022:

| | (`) |
|---|---|
| **Authorised Capital :** | |
| 50,000 12% Preference Shares of ` 10 each | 5,00,000 |
| 5,00,000 Equity Shares of ` 10 each | 50,00,000 |
| | 55,00,000 |
| **Issued and Subscribed Capital :** | |
| 50,000 12% Preference shares of ` 10 each fully paid | 5,00,000 |
| 4,00,000 Equity shares of ` 10 each, ` 8 paid up | 32,00,000 |
| **Reserves and Surplus :** | |
| General Reserve | 1,60,000 |
| Capital Redemption Reserve | 2,40,000 |
| Securities premium (collected in cash) | 2,75,000 |
| Revaluation Reserve | 1,00,000 |
| Profit and Loss Account | 16,00,000 |

On 1st April, 2022, the Company has made final call @ ` 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2022. Thereafter, on 1st May 2022 the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held, it decided that there should be minimum reduction in free reserves. On 1st June 2022, the Company issued Rights shares at the rate of two shares for every five shares held on that date at issue price of ` 12 per share. All the rights shares were accepted by the existing shareholders and the money was duly received by 20th June 2022. Show necessary journal entries in the books of the company for bonus issue and rights issue.

^ **Q. 50 :** The share of Galaxy Ltd of a face value of ` 10 is being quoted at ` 24. The company has a plan to make a rights issue of one equity share for every four shares currently held at a premium of 40% per Share. You are required to -

1. Determine the Minimum Price that can be expected of share after the issue.
2. Calculate the Theoretical Value of the Rights alone.
3. Show the effect of the right issue on the wealth of a shareholder who has 1,500 Shares, if (a) He sells the entire rights, and (b) He ignores the rights.

^ **Redemption of Redeemable Debentures ( ROD )**

Based on the **Terms of the IOD**,
Debentures are usually redeemable ( Liability on debentures can be settled )
**in any of the following ways**

1) At the end of the stipulated period **i.e.** after a fixed number of years
2) Anytime after a certain number of years has elapsed since their issue
3) In equal annual instalments ( redemption by annual drawing )

**Such debentures can be redeemable**
either by payment in cash or by conversion into shares or combination of both

* **Note :** A Company may **purchase its own debentures** from the open market,
when such debentures are **quoted at a discount** on the stock exchange.
It may be profitable for company **to purchase and cancel** them.
ROD by purchase of own debentures is **specifically excluded** at Foundation level.

^ **Debenture Redemption Reserve ( DRR )**

A Company issuing debentures **may be** required to create DRR **out of** Divisible Profits.
**An appropriate amount** is transferred from profits every year to DRR and then,
is invested in specified earmarked securities. **This is repeated every year.**
Such Investments are called : Debenture Redemption Reserve Investment **( DRRI )**.

**In the last year** or **at the time of ROD,**
DRRI are encashed and amount so obtained is used for ROD.

^ **Adequacy of DRR**

Companies, except exempt companies, are required to ensure DRR shall be
**atleast 10% of value of Outstanding Debentures**

^ **Investment in Earmarked / Specified Securities**

Companies, except exempt companies, **must invest** or **deposit**, on or before
30th April each year, **atleast 15%** of the Nominal / Face value of its debentures
**maturing during** the year ending on the **31 st March of the next year**

** Provided that the amount remaining deposited or invested, shall not at anytime fall below
15% of the amount of Debentures maturing during the 31 st day of March of next year.

| | | DRR | DRRI |
|---|---|---|---|
| I | All India Financial Institutions ( AIFIs ) | Exempt | Exempt |
| | Banking Companies | | |
| | Other Financial Institutions | | |
| II | Listed registered NBFC's | | Yes |
| | Listed registered HFC's | | |
| | Other Listed Companies | | |
| III | Unlisted registered NBFC's | | Exempt |
| | Unlisted registered HFC's | | |
| | **Other Unlisted Companies** | Yes | Yes |

In case of **Partly** Convertible Debentures,

**DRR** shall be created in respect of **non-convertible** portion of Debenture Issue.

^ **Q. 51 :** The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2021 is as under:

| Particulars | Note No | (`) |
|---|---|---|
| **I. Equity and liabilities** | | |
| **(1) Shareholder's Funds** | | |
| (a) Share Capital | 1 | 2,00,000 |
| (b) Reserves and Surplus | 2 | 1,20,000 |
| **(2) Non-current liabilities** | | |
| (a) Long term borrowings | 3 | 1,20,000 |
| **(3) Current Liabilities** | | |
| (a) Trade payables | | 1,15,000 |
| | | **5,55,000** |
| **II. Assets** | | |
| **(1) Non-current assets** | | |
| (a) Property, Plant and Equipment | 4 | 1,15,000 |
| **(2) Current assets** | | |
| (a) Inventories | | 1,35,000 |
| (b) Trade receivables | | 75,000 |
| (c) Cash and bank balances | 5 | 2,30,000 |
| | | 5,55,000 |

Notes to Accounts

| | | | (`) |
|---|---|---|---|
| 1 | **Share Capital** | | |
| | **Authorised share capital** | | |
| | 30,000 shares of `10 each fully paid | | 3,00,000 |
| | **Issued and subscribed share capital** | | |
| | 20,000 shares of `10 each fully paid | | 2,00,000 |
| 2 | **Reserve and Surplus** | | |
| | Profit & Loss Account | | 1,20,000 |
| 3 | **Long term borrowings** | | |
| | 12% Debentures | | 1,20,000 |
| 4 | **Property, Plant and Equipment** | | |
| | Freehold property | | 1,15,000 |
| 5 | **Cash and bank balances** | | |
| | Cash at bank | 2,00,000 | |
| | Cash in hand | 30,000 | 2,30,000 |

At the Annual General Meeting, it was resolved:

(a) To give existing shareholders the option to purchase one `10 share at `15 for every four shares (held prior to the bonus distribution). This option was taken up by all the shareholders.

(b) To issue one bonus share for every five shares held.

(c) To repay the debentures at a premium of 3%.

Give the necessary journal entries for these transactions.

^ **Q. 52 :** M Limited recently made a public issue of Debentures. The following information is available in respect of the issue -

(i) 3,00,000 Partly Convertible Debentures of face value and issue price of ₹ 100 per debenture were issued.

(ii) Conversion of 50% of each debenture is to be done on expiry of 6 months from date of close of issue.

(iii) Date of closure of subscription list is 1st June. Date of allotment is 1st July.

(iv) Interest on Debentures at the rate of 12% is payable from the date of allotment.

(v) Equity Share of ₹ 10 each are issued at ` 50 per share for the purpose of conversion.

(vi) Underwriting Commission is 2%.

(vii) 2,25,000 Debentures were applied for.

(viii) Interest on Debentures is payable half-yearly on 30th September and 31st March.

Give journal entries for all transactions relating to above, including Cash & Bank entries for the year ended 31st March.

^ **Q. 53 :** The Balance Sheet of Ram Limited on 31st March, was as follows:

| Equity & Liabilities | (`) | Assets | (`) |
|---|---|---|---|
| Share Capital : | | Property, Plant & Equipment | 8,00,000 |
| Authorised Capital : | | Debenture Redemption | |
| 50,000 Equity Shares of | | Investments | 2,00,000 |
| `10 each | 5,00,000 | | |
| Issued Capital : | | Cash Balance | 2,50,000 |
| 25,000 Equity Shares of | | Other Current Assets | 10,00,000 |
| `10 fully paid up | 2,50,000 | | |
| Reserves and Surplus : | | | |
| General Reserve | 2,75,000 | | |
| Profit & Loss A/c | 1,00,000 | | |
| Debenture Redemption | | | |
| Reserve | 2,50,000 | | |
| Secured Loans : | | | |
| Other Secured Loans | 2,50,000 | | |
| 12% Convertible Debentures | 5,00,000 | | |
| (5,000 Deb. of ₹ 100 each) | | | |
| Current Liabilities and | | | |
| Provisions | 6,00,000 | | |
| Dividend | 25,000 | | |
| | 22,50,000 | | 22,50,000 |

At the General Meeting, it was resolved to -

1. Pay dividend of 10% in cash.
2. Give existing shareholders, the option to purchase one share of ₹ 10 each at ` 15 for every five shares held. This option was taken up by all the shareholders.
3. Redeem the debentures at a premium of 5% and also confer option to the Debentureholders to convert 50% of their holding into equity shares at a pre-determined price of ` 15 per share and balance payment to be made in cash.
4. Holders of 3,000 Debentures opted to get their debentures redeemed in cash only while the rest opted for getting the same converted into equity shares as per the terms of issue. Debenture Redemption Investments realized ` 1,80,000 on sales.

You are required to redraft the Balance Sheet after giving effects to the Rights Issue and Redemption of Debentures. Also show the calculations in respect of number of equity shares issued and cash payment.