INDEX

		MCQ's & True/False		11C.10 – 11C.11
		Homework Questions	20	11C.12 – 11C.14
11D.	Accounting for Bonus Issue & Right Issue	Concept		11D.1 – 11D.2
		Class Questions	10	11D.3 – 11D.6
		MCQ's & True/False		11D.7 – 11D.8
		Homework Questions	18	11D.9 – 11D.13
11E.	Redemption of Preference Shares	Concept		11E.1 – 11E.5
		Class Questions	12	11E.6 – 11E.9
		MCQ's & True/False		11E.10 – 11E.11
		Homework Questions	11	11E.12 – 11E.14
11F.	Redemption of Debentures	Concept		11F.1 – 11F.2
		Class Questions	7	11F.3 – 11F.5
		MCQ's & True/False		11F.6
		Homework Questions	9	11F.7 – 11F.9
12.	Accounting Terminology	Concept		12.1 – 12.10
		True/False & Questions		12.11 – 12.12

THEORETICAL FRAMEWORK

CH 1

"One second, One minute, One hour, One day, One week, One month, One year and you are one year older. Make full use of your time."

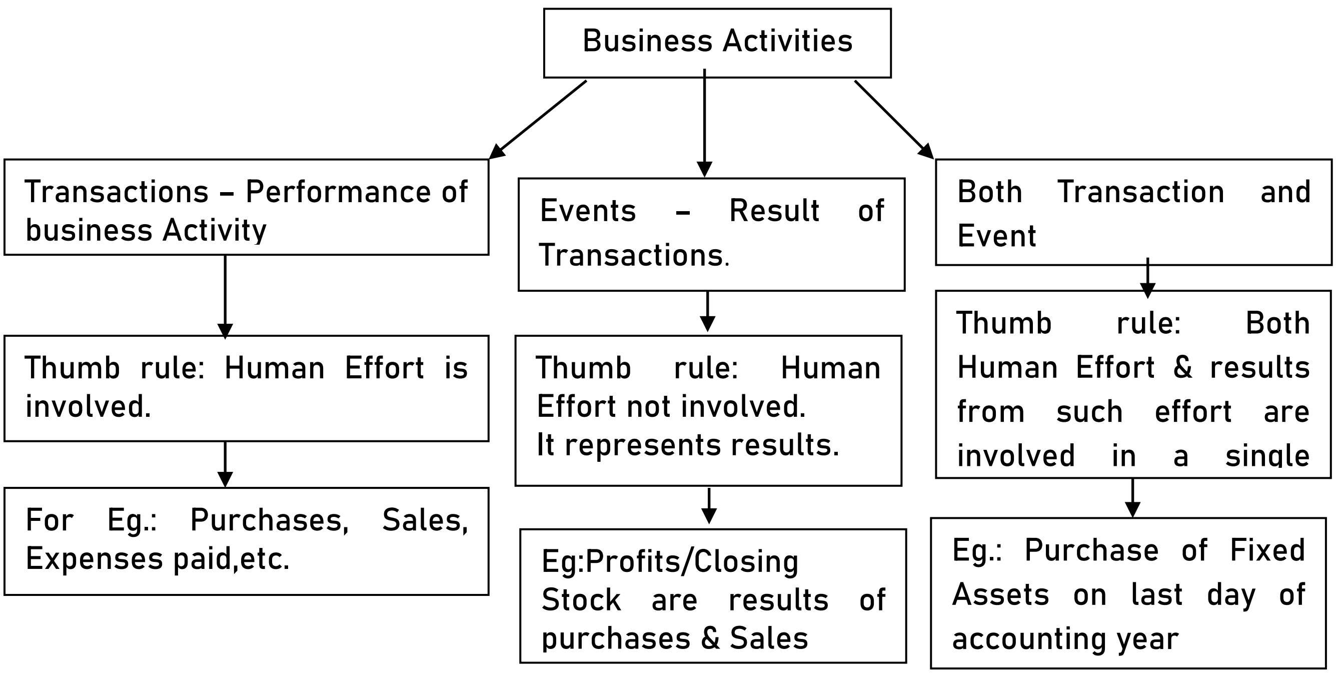
MEANING AND SCOPE OF ACCOUNTING

MEANING OF ACCOUNTING

1) As per the American Institute of Certified Public Accountants (AICPA) – Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of financial character, and interpreting the results thereof.
2) Accounting also involves analyzing and interpreting financial transactions and communicating the results to the persons interested in such information.
3) As per American Accounting Association- Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounts.
4) Accounting is considered as an 'Information System', as the function of Accounting is to provide quantitative information, primarily financial in nature about the business organization.

TRANSACTIONS VS EVENTS, FINANCIAL VS NON- FINANCIAL

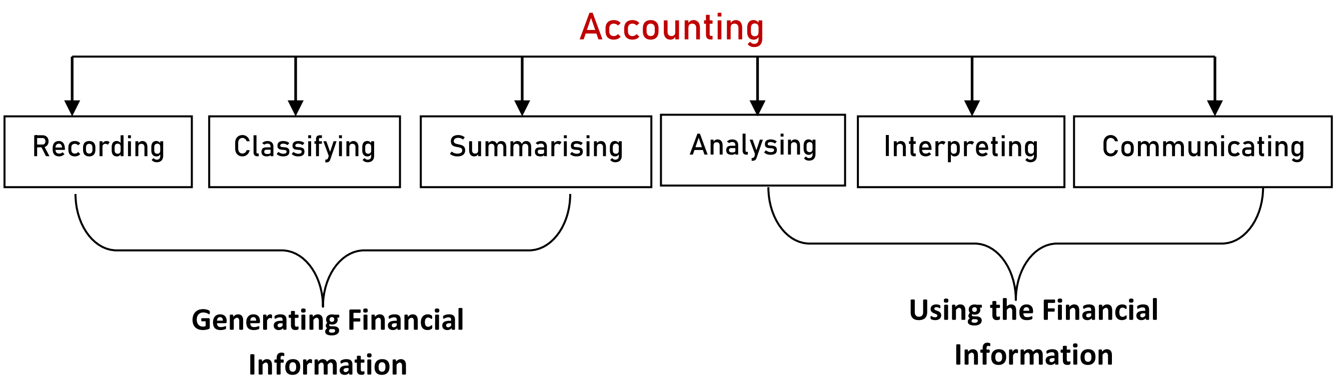
1. Transactions and Events: In a business or economic scenario.



2. Types of Transactions – 2 Types:

Types	Financial Transaction	Non – Financial Transaction
Meaning	When a business transaction involves a transfer of money or moneys' worth, then the transaction is called "Financial Transaction"	When a business transaction does not involve money or money's worth
Example	Purchase and Sale of goods, Payment of Expenses, Purchase of Assets, Goods lost by fire etc.	Quarrel between 2 Managers, Death of an employee etc.
Types	Cash and Credit Transaction	No such classification

ACCOUNTING PROCESS



Processes of Generating Financial Information (3 processes)

1. Recording:

Meaning	All business transactions which are of financial nature (i.e. expressed in terms of money) are recorded in the books of accounts.
Purpose	A businessman cannot keep in his memory all the business activities carried out by 'him. Hence, there is a need for keeping track of such activities in a separate record.
Basis of Recording	All transactions must be evidenced by supporting documents like Sales Invoice, Purchase Bill, Receipts, Pay Slip, etc. (These are called Vouchers)
Relevant A/cs Book	The Books in which primary entry is made is called "Journal", which is further sub—divided into several Subsidiary Books for Sales, Purchases, Cash & Bank, etc. according to the nature and size of the business.
Checkpoint	It is to be noted that Accounts is concerned with only FINANCIAL Transactions. Accounting will not record non—financial transactions in its books.
Example	• Salary paid to Manager will be recorded in the books of accounts. • But, good health of the Manager, even if it is of great use to the business, has no financial character and no economic value, and therefore, will not be considered in Accounting.

2. Classifying:

Meaning	Classifying involves grouping transactions of a similar nature at one place, such that information will be compressed and presented in useable form.
Purpose	While the process of recording ensures that all financial transactions are recorded, one cannot make any observations unless all the transactions are grouped together under different categories.
Basis of Recording	Classification is based on the transactions recorded in the Journal / Subsidiary Books.
Relevant A/cs Book	The book containing the classified information of transactions is called 'Ledger". Each page in the Ledger is called as "Folio". In each folio (Page No.), an individual Account Head and all transactions relating to that Account Head is recorded / posted.
Checkpoint	Ledger can be prepared only after the preparation of Journal / Subsidiary Books
Example	• At recording stage, all transactions are normally recorded chronologically (i.e. date—wise). • Assuming a businessman made 10 sale transactions (out of which 6 are on credit), paid telephone charges. Rent etc., received payments from 3 debtors in a week, it is not possible to ascertain the exact position of each item unless they are grouped as "Sales A/c, Telephone Charges A/c, Rent A/c, Debtors A/c etc."

3. Summarizing:

Meaning	This involves presentation and preparation of the classified information in a manner useful to the internal and external users of Financial Statements.
Accounts Books	It involves preparation of Trial Balance, and Financial Statements there from, viz. (i) Profit and Loss Account (used to find out profits / losses for the business), (ii) Balance Sheet (used to ascertain the financial position), and (ii) Cash Flow Statement (used to determine the factors for increase or decrease in cash & bank balances)
Basis	Summarizing is based on the classified transactions presented in Ledger

Usage of Financial Information (generated through above 3 processes)

4. Analysing:

Meaning	Analysis involves methodical classification of data given in the Financial Statements.
Nature of process	Analysis is concerned with determining the relationship between the items in the Profit and Loss Account and Balance Sheet (i.e. Ratio Analysis). Thus, it provides the basis for interpretation. Further, analysis involves comparing current year figures with the previous year figures
Basis	Financial Statements generated above in summarizing.

5. Interpreting:

Meaning	Drawing observations from the items in the financial statements and also from relationships determined in analyzing process
Purpose	The recorded financial data is analysed and interpreted in the manner that will enable the data users to make a meaningful judgment about the financial condition and profitability of the business operation.

Nature of process	Financial Statements are interpreted to explain what had happened, why it had happened and what is likely to happen under specified conditions.
Basis	Financial Statements generated in summarizing process and relationships determined in Analyzing process.
Example	Assuming the NP ratio for 2023 is 20% on sales, whereas it was 15% in 2022. After analysing different ratios it was interpreted that the profit has increased mainly due to decrease in expenses & not due to increase in sales.

6. Communicating:

Meaning	It is concerned with the transmission of summarised, analysed and interpreted information to the end user to enable them to make rational decisions.
Modes	This is done through preparation and distribution of Accounting Reports, which includes Profit and Loss Account and Balance Sheet, additional information in the form of Accounting Ratios, Graphs, Diagrams, Funds Flow Statement, etc.

EVOLUTION OF ACCOUNTING AS SOCIAL SCIENCE

Accounting finds its roots as early as around 4000 BC, where Egyptians used some form of accounting for their treasuries. The in-charge of treasuries had to send day wise reports to their superiors known as Wazirs and monthly reports were sent to kings. Babylonia, known as the city of commerce, used accounting for business to identify the losses that took place due to frauds and lack of efficiency. Greece used accounting to divide the revenues received among treasuries, maintaining receipts, payments and balance of government financial transactions. Accounting practices in India could be traced back to a period where, Kautilya, a minister in Chandragupta's kingdom wrote a book named Arthashasthra, which also described how accounting records had to be maintained

In its oldest form, accounting aided the stewards to discharge their stewardship function. The wealthy men employed stewards to manage their property; the stewards in turn rendered an account periodically of their stewardship. This *'Stewardship Accounting' was the root of financial accounting system*.

Social Science study man as a member of society; they concern about social processes and the results and consequences of social relationships. The usefulness of accounting to society as a whole is the fundamental criterion to treat it as a social science.

OBJECTIVES OF ACCOUNTING

1. To have a systematic record of all business transactions which are of financial nature.
2. To know the result of business operations for a particular period of time. If Revenue / Income exceeds the Expenses, then it is said that the business is running profitably, but if the Expenses exceed the Revenue, then the business is operating at a loss.
3. To know the financial position of the business. This will help answer questions like how much Assets and Liabilities that the business has on any date. The Balance sheet is a statement of assets & liabilities of the business at a particular point of time & helps in ascertaining the financial health of business.
4. To provide information to Users for decision making. Accounting, as the language of business, communicates the financial result of enterprises, to various Users. Accounting aims to meet the information needs of the decision maker and help them in rational decision making.

5. To know the solvency position: Balance sheet also helps to know whether the business is solvent, i.e. ability to meet its liabilities in short run & in long run as and when they fall due.

Objectives of Accounting

Systematic recording of transactions	Ascertainment of results	Ascertainment of financial position	Communicating information to Users
↓	↓	↓	↓
Book-Keeping, i.e. Journal, Ledger and trial Balance	Manufacturing, Trading, Profit & Loss Account	Balance Sheet	Financial Reports

FUNCTIONS OF ACCOUNTING

Measurement	Accounting measures the performance of the business entity and depicts its current financial position.
Forecasting	Accounting helps in forecasting future performance and financial position of enterprise using past data.
Decision-making	Accounting provides relevant information to the Users of accounts to aid rational decision-making.
Comparison & Evaluation	Accounting assesses performance achieved in relation to targets and discloses information which plays important role in comparing & evaluating financial results.
Control	Accounting identifies weaknesses in the operational system and provides feedback regarding effectiveness of measures to rectify such weaknesses.
Government Regulation & Taxation	Accounting provides necessary information to the Government, to exercise control on the entity as well as in collection of tax revenues.

BOOK-KEEPING – MEANING AND FEATURES

Meaning	It is an activity of recording and classifying the financial data relating to business operations in a significant and orderly manner.
Objective	• Complete recording of transactions. • Ascertainment of financial effect on the business.
Features	• It is art of scientifically recording the transactions. • Recording of transactions is restricted only to that of particular enterprise • The recordings are made in a given set of books.
Advantages	• From Financial Statements, financial information is readily available to Users • Qualitative financial decisions can be taken, since information is reliable • Valuable conclusions can be drawn on comparing books of different years of the same enterprise or comparing books of same period for different enterprises. • Financial accounts of an enterprise are treated as evidence in a Court of Law.

BOOK-KEEPING V/S ACCOUNTING

Basis	Book-Keeping	Accounting
Scope	It is a process concerned with recording of transactions	It is a process concerned with summarising of the recorded transactions.
Stage	Book-Keeping is the primary stage. It constitutes as the base for accounting.	Accounting is the secondary stage. It constitutes as a language of the business.
Basic Objectives	To maintain systematic records of financial transactions	To ascertain net results of operations and financial position and to communicate information to the interested parties.
Financial position	Financial position of the business cannot be ascertained through book-keeping	Financial position of the business is ascertained based on the accounting reports
Financial Statements	Financial Statements do not form part of this process.	Financial statements are prepared on the basis of book-keeping records.
Managerial decision	Managerial decision cannot be taken with the help of these records.	Management can take decision on the basis of these records.
Sub-fields	There are no-sub fields for Book-Keeping	It has several sub-fields such as Financial Accounting, Management ,etc.

Note: In terms of scope, Book-Keeping < Accounting

SUB FIELDS OF ACCOUNTING

Financial Accounting	It covers the preparation and interpretation of financial statement (i.e. P&L Account and Balance Sheet) and communication thereof, to the user of accounts. It is historical in nature as it records transactions which has already occurred. It primarily helps in determination of the net result for an accounting period and the financial position as on a given date.
Management Accounting	It is used for internal reporting to the Management of a business unit. The different ways of grouping information and preparing reports as desired by the Managers for discharging their functions and referred to as Management Accounting.
Cost Accounting	It is the process of accounting for cost and determination of overall cost of the product or service. The study of the behavioural pattern of cost will enable to control cost.
Social Responsibility Accounting	It is concerned with accounting for social costs incurred by the enterprise and social benefits created.
Human Resource Accounting	It seeks to identify, qualify and report investments made in human resources of an organization that are not presently accounted under any conventional accounting practice.

USERS OF FINANCIAL INFORMATION

Users	Purpose
Management	For day-to-day decision-making and performance evaluation.
Investors	To analyze performance, profitability and financial position. Note: Prospective investors are interested in the track record of the company
Lenders	They are interested to know whether their loan-principal and interest will be paid back when due
Suppliers	To determine the credit worthiness of the Company.
Customers	To know general business viability before entering into long-term contracts and arrangements
Employees	To know stability, continuity & growth of the enterprises, and its ability to pay remuneration, retirement & Other benefits & to enhance career opportunities.
Government	To ensure prompt collection of Direct and Indirect Tax revenues & to evaluate performance and contribution to social objectives
Public at Large	To see whether the enterprise is making a reasonable/ substantial contribution to local economy, e.g. employment opportunities, patronage of local suppliers

RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINE

Auditing	Auditing process review the Financial Statements, which are the outcome of the accounting process. Thus, Auditor should have a through & sound knowledge of accounting Standards & GAAP of reviewing the Financial statement.
Economics	• Economics uses the database provided by Accounting System, for developing decision-models and for rational decision-making on the use of scarce resources. • Economic Theories have influenced the development of decision-making tools used in accounting. • However, there are differences between the Economists' and Accountants concepts of Income, Capital and Valuation of assets
Law	• Transactions and events are governed by the laws of the land like The Contract Act, Sale of Goods Act, Negotiable Instruments Act and Taxation Laws. • The entity itself is governed by specific status like Partnership Act, Companies Act, Co-operative Societies Act, which have a bearing on maintenance of account books
Mathematics	• Knowledge of arithmetic and algebra is a pre-requisite for accounting computation and measurement, e.g. Depreciation, Use of Interest and annuity tables, lease Rentals, Hire Purchase Installments etc. • Ratios, Graphs & Operation Research Models have been widely used in accounting
Management	Management relies on accounting and other data for effective decision-making. Since an accountant plays an active role in management, he understands the data requirements, so the accounting System can be designed to serve management purpose.

Statistics	In accounting many ratios and financial calculations are based on statistical methods, which help in averaging them over a period of time. Thus, Statistics is helpful in development of accounting data and in their interpretation using Pie-charts, Graphs and Trend Curve Diagram etc

LIMITATIONS OF ACCOUNTING

1. Accounting involves different assumptions and conventions on which it is based. These assumptions, by themselves become a limitation for accounting. Hence, Accounting is considered only as an art and not as pure science.
2. There are different accounting policies for the treatment of the same item, e.g. Depreciation, Valuation of Stocks, etc. This may not ensure comparability among financial statements of various firms.
3. Certain accounting estimates are based on the personal judgement of the accountant e.g. provision for doubtful debts, capital vs revenue expenditure, writing off intangible assets, etc. This may lead to the possibility of manipulation.
4. The financial position of the business as depicted by accounts is static and not dynamic i.e. it gives the position on a particular day on which it is prepared and does not predict future position.
5. Inflation effect is not considered in the general purpose financial statements i.e. Accounting ignores changes in some money factors
6. The worth of an entity may be assessed by various factors but all cannot be measured in terms of money.
7. Accounting ignores the real assets which cannot be measured in terms of money, i.e., Employees. There is no generally accepted formula for the valuation of Human Resources in terms of money. Financial statements consider those assets which can be expressed in monetary terms.
8. There are occasions when accounting principles conflict with each other.

ROLE OF ACCOUNTANT IN THE SOCIETY

Areas of Service

Maintenance of Books of Accounts	An accountant is able to maintain a systematic record of financial transactions in order to establish the net result of the transactions entered into during a period and to state the financial position of the concern as at a particular date
Statutory Audit	Every limited company is required to appoint a chartered accountant or a firm of chartered accountants as their auditor who are statutorily required to report each year whether in their opinion the balance sheet shows a true & fair view of the state of affairs on balance sheet date, and Profit & Loss A/c shows a true & fair view of profit or loss for the year.
Internal Audit	Now-a-days internal auditing has developed as a service to management. The internal auditor constructively contributes in improving the operational efficiency of the business through an independent review and appraisal of all business operations.

Taxation	An accountant can handle taxation matters of a business or a person and he can represent that business or person before the tax authorities and settle the tax liability under the statute prevailing. He can also assist in avoiding or reducing tax burden by proper planning of tax affairs.
Management Accounting and Consultancy Services	Accountant provides management consultancy services in the areas of management information system, expenditure control and evaluation of appraisal techniques for new investments and divestments, working capital management, corporate planning etc.
Financial Advice	Some of the areas in which accountant can render financial advice are: ➢ Investments ➢ Business Expansion ➢ Insurance ➢ Investigations ➢ Pension schemes
Other Services	Secretarial Work, Share Registration Work, Company Formation, Receiverships, Liquidations, etc

Chartered Accountant in Industry

He works with the functional departments and translates the organisation's aims in terms of financial expectations.
A qualified accountant will be able to play an important role in performing important functions of a business relating to accounting, costing and budgetary control, estimating and treasury.

Chartered Accountant in Public Sector Enterprises

It is the duty of the accountants to prepare the accounts and reports of these public corporations in such a way that they enable the general public to know how far the items appearing in the various types of records and financial statements justify their existence.

Chartered Accountant in Framing Fiscal Policies

Accountants have a positive role to play in the determination of proper fiscal policies and advancement of trade, commerce and industry. They should develop new techniques and prepare themselves for new fields of service towards their commitment to the concept of the public goods and services.

Chartered Accountant and Economic Growth

In the present times accountants should conceive their duties as broadly as the conditions might require and do not restrict them to only literal compliance of the law. Their aim should be not to allow any individual to gain at the cost of the nation. Accountants have to accept a positive role and do their best to encourage efficiency in individual business units and encourage those social objectives which form the main foundation of a welfare state.

MULTIPLE CHOICE QUESTIONS

1) Which of the following is not a subfield of accounting?
   (a) Management accounting.
   (b) Cost accounting.
   (c) Book-keeping
2) Purposes of an accounting system include all the following except
   (a) Interpret and record the effects of business transaction.
   (b) Classify the effects of transactions to facilitate the preparation of reports.
   (c) Dictate the specific types of business enterprise transactions that the enterprises may engage in.
3) Book-keeping is mainly concerned with
   (a) Recording of financial data.
   (b) Designing the systems in recording, classifying & summarizing the recorded data.
   (c) Interpreting the data for internal and external users.
4) All of the following are functions of Accounting except
   (a) Decision making.
   (b) Ledger posting.
   (c) Forecasting.
5) Financial statements are part of
   (a) Accounting.
   (b) Book-keeping.
   (c) Management Accounting.
6) Financial position of the business is ascertained on the basis of
   (a) Records prepared under book-keeping process.
   (b) Trial balance.
   (c) Balance Sheet
7) Users of accounting information include
   (a) Creditors/Suppliers
   (b) Lenders/ Customers
   (c) Both (a) and (b)
8) Financial statements do not consider
   (a) Assets expressed in monetary terms.
   (b) Liabilities expressed in monetary terms.
   (c) Assets and liabilities expressed in non-monetary terms
9) On January 1, Sohan paid rent of ₹ 5,000. This can be classified as
   (a) An event.
   (b) A transaction.
   (c) A transaction as well as an event.
10) On March 31, 2023 after sale of goods worth ₹ 2,000, he is left with the closing inventory of ₹ 10,000. This is
   (a) An event.
   (b) A transaction.
   (c) A transaction as well as an event.
11) Which of the following is not a business transaction?
   (a) Bought a machine of ₹10,000 for business
   (b) Paid towards salaries of employees ₹ 5,000
   (c) Paid son's fees from her personal bank account ₹ 8,000

12) Which qualitative characteristics of accounting information is reflected when accounting information is clearly presented?
    (a) Understandability
    (b) Relevance
    (c) Comparability

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) There is no difference between book keeping and accounting, both are same.
2) Management Accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.
3) Financial accounting is concerned with internal reporting to managers of business unit.
4) Customers of business should not be considered as users of accounts prepared by business. They are not interested to know performance of the business
5) Summarizing is the basic function of accounting. All business transactions of a financial characters evidenced by some documents such as sales bill, pass book, salary slip etc. are recorded in the books of account.
6) Balance sheet shows the position of the business on the day of its preparation and not on the future date.
7) Objectives of book-keeping are complete recording of transactions & ascertainment of financial effect on the business.
8) Accounting can be viewed as information system which has its input, processing methods & output.
9) Accounting involves communication.

Solution

1) False: Book-keeping and accounting are different from each other. Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by book-keeping records. Book-keeping is the recording phase while accounting is concerned with the summarizing phase of an accounting system.
2) False: Financial accounting covers the preparation and interpretation of financial statements and communication to the users of accounts.
3) False: Management accounting is concerned with internal reporting to managers of a business unit.
4) False: Customers are also concerned with the stability and profitability of the enterprise because their functioning is more or less dependent on the supply of goods
5) False: Recording is the basic function of accounting. Summarising is concerned with the preparation and presentation of the classified data in a manner useful to the internal as well as the external users of financial statements.
6) True: Balance Sheet is a statement of financial position of an enterprise at a given date.
7) True: Book-keeping is concerned with complete recording and combined effect of transactions made during the accounting period.
8) True: Accounting is a processing system whose input is financial transaction and output is financial statement communicating various information to various interested groups.
9) True: Accounting starts only when there is a communication of business transactions to the accounting department. It also communicates the results obtained from arranging of data to interested parties like investors, creditors, employees etc.

ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

	Item	Descriptions
1.	Accounting Assumptions	(a) "Assumptions" refers to the Fundamental conditions based on which the entire accounting process is carried out. (b) In accounting there are 3 fundamental Accounting Assumptions. (c) For e.g. when a person started a particular business, we assume that the person started the business for continuing it to earn profits and not for closing it.
2.	Accounting Principles	(a) Accounting Principles refers to the set of doctrines associated with the theory and procedures of accounting. (b) They serve as an explanation of currently practices and as a guide for selection of conventions or procedures where alternatives exist. (c) Accounting principles should be- (i) based on real assumptions, (ii) simpler and easily understandable, (iii) consistently followed, (iv) informational to the Users, and (v) able to reflect future predictions.
3.	Accounting Concepts	(a) "Concept" means any idea or notion, which has universal application. (b) Accounting Concepts are the basic conditions which lay down the foundation for formulating the accounting principles. (c) They are clearly defined and supported by reasoning. Certain concepts are perceived, assumed & accepted in accounting to provide a unifying structure and internal logic to accounting process
4.	Accounting Conventions	(a) Accounting Conventions are the general procedures emerging out of usage and practice of accounting principles. (b) Conventions may not have universal application. (c) Denote circumstances or traditions which guide the accountants while preparing the accounting statements. (d) Further, certain conventions may be changed over a period by Accounting Bodies like ICAI, to improve quality of financial statement. (e) Eg: In India, pedestrians walk on the left side and vehicles go on the right side of the road. This is traditionally accepted practice, and everybody follows it
Concepts Vs Conventions: (a) Concepts are clearly defined & supported by reasoning while conventions may not be clearly defined. (b) Concepts support the principles whereas Conventions may contradict the principles		

Note: Above terms Concepts, Principles & Conventions are sometimes used interchangeably

LIST OF ACCOUNTING ASSUMPTIONS / CONCEPTS / CONVENTIONS

1. Fundamental Accounting Assumptions: Only 3- (a) Going concern, (b) Consistency and (c) Accrual. (They are also considered as part of accounting concepts)
2. Accounting Concepts:

1. Business Entity	6. Going Concern
2. Money Measurement	7. Cost
3. Accounting Period/Periodicity	8. Realization
4. Accrual	9. Dual Aspect
5. Matching	10. Consistency

3. Accounting Conventions: (a)Consistency (b)Full Disclosure (c)Conservatism (d)Materiality

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

1. Going Concern:

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

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

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

Exception to Assumption: Joint Venture (Which is created for specific purpose/ period)

(c) Going concern is also considered as one of the accounting concepts.

(d) Based on Going Concern assumption becomes inappropriate (i.e. if the enterprise cannot be taken as a going concern) then assets should be valued at their Net Realizable Value. i.e. if the business is to be closed, then the assets must be valued at Market Values and not at cost.

2. Consistency:

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

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

(b) Consistency is also considered as one of the accounting concepts.

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

- If the adoption of a different accounting policy is required by Statute, or
- For compliance with an Accounting Standard, or
- If it is considered that the change would result in a more appropriate presentation of the Financial Statement of the enterprises.

3. Accrual:

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

Example: If a sale for ₹ 10,000 is made on credit to a person in 2022 but the settlement is received in 2023. In this case ₹ 10,000 shall be treated as income in 2022 (in the year of accrual) and not in 2023. (year of receipt)

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

Disclosure Requirements

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

ACCOUNTING CONCEPTS & CONVENTIONS

BUSINESS ENTITY

1. Meaning: The business enterprise is a separate identity and distinct from that of its Owners or Managers. The Owner of the business and the business as such is treated as two different persons.
2. Impact of above concept: All transactions are classified into – (a) Business Transactions, and (b) Personal Transactions. Business transactions are recorded in the books of accounts of the business. Owner's Personal transactions are recorded in his personal book of accounts and not in the books of the business.
3. Example:
   (a) Mr. A is an owner of a CA firm "M/s A & Co." The profits arising from M/s A & Co. belong to Mr. A only. However, for accounting purpose, Mr. A is a different person and M/s A & Co. is a different person.
   (b) Accounting will be done only for the transactions in which M/s A & Co. is involved and not for A's personal transactions.

MONEY MEASUREMENT

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

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

3. Criticism of Money Measurement:
   (a) Value of Money erodes over a period of time. Future Cash Flows have a lower value than the Present Cash Flows. Hence money by itself is not a meaning full measurement base.
   Example: One kg of Onion in 2022 was ₹ 40; But the same one kg of onion in 2023 is ₹ 80. This implies that the real value of money has gone down.
   (b) Exchange value of a currency (e.g. Rupee) in relation to other currency is not constant over a time period. Hence, money does not provide a stable measurement yardstick.
   (c) Many material transactions and events are not recorded in the books of accounts just because they cannot be measured in terms of money. E.g. appointment of new Chairman for the company.

4. Impact on Accounting:
   (a) As per Money Measurement Concept, only those transactions which are capable of being measured in terms of money are recorded in the books of accounts, that too in the ruling currency of the country. E.g. in Rupees in India, in Dollars in USA, in Pounds in UK.
   (b) Transactions which are not in monetary terms, even if they affect the results of the business materially, are not recorded in the books of accounts.

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

PERIODICITY OR ACCOUNTING PERIOD

1. Need: As per the Going Concern Assumption, the enterprise has an indefinite life. However, it is necessary to sub-divide such indefinite period into smaller time units for (a) measurement of performance; (b) understanding the financial position of the enterprise and (c) control over operations. Such smaller and usable time-frame for reporting purpose is called Accounting Period.
2. Meaning:
   (a) Hence, during the life-time of an entity, Financial Statement can be prepared in periodic intervals of time. The economic life of an enterprise is split into the periodic interval (being a financial year).
   (b) As per Periodicity Concept, the financial Statements should be prepared after every accounting/ financial period, and not at the end of the life of the entity.
   (c) Generally a period of 12 months (i.e. one year) is considered as the accounting period by most enterprises. In the corporate sector, Interim Financial Reporting is also prevalent. The length is also determined by the statute in certain cases.
   Note: Normally the term "Financial Year" refers to the period for which the accounts are prepared. it is usually taken as the period from 1st April to 31st March of the next year.
3. Periodically Concept facilitates in-
   (a) Comparison of financial statements of different periods.
   (b) Uniform and consistent accounting treatment for ascertaining the profit and assets of the business.
   (c) Matching periodic revenue with expenses for getting correct result of the business operations.

ACCRUAL

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

MATCHING

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

2. Impact of Matching Concept: As per Matching Concept
   Periodic Profit = Periodic Revenue – Matched Expenses
   From the revenue of an accounting period such expenses are deducted which are expended to generate the revenue to determine profit of that period.

3. Nature of Income / Expenses

Particular	Income	Expenses
Inclusions	Sales/Service rendered but money not received (Outstanding Income/Accrued Income)	Services received/ purchases made but money not paid (Outstanding Expenses /Sundry Creditors)
Exclusions	Advances received before sale/service is not income (Income received in advance)	Advance paid before purchases made/services received (Prepaid Expenses/Expenses paid in advance)

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

COST

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

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

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

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

REALISATION

1. Meaning: As per Realisation Concept, An asset is recorded at its Historical Cost and any change in its value should only be recognized when it is realized, i.e. at the time of its actual sale/disposal.
2. Concept: It emphasized that there is no certainty of income until a sale has been made and hence increase in value of the assets should not be taken into account unless it is actually realised.
3. Criticism: However, Realisation concept is criticized by arguing that if the value of an asset has been permanently changed, Profit or loss arising out of such change be considered to reflect true and fair financial position of the enterprise. Otherwise, accounting will become distorted and meaningless.

4. Revaluation: So, fixed assets may be revalued periodically. However, selective revaluation of an asset may lead to unrepresentative or misleading amounts being reported in financial statements. Hence revaluation of assets should be done on a systematic basis. for example, all machineries shall be revalued rather than a single machinery.

> Fair Value: Thus, the Realisation Concept is slowly being replaced by the recognition of assets at their fair market value (Fair value accounting concept). However, Accountants follow a more conservative path. They try to cover all probable losses but do not count probable gains.

DUAL ASPECT

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

1st Aspect	2nd Aspect	Example
Increase in one asset	Decrease in another asset	Purchase of Machine by cash
Increase in asset	Increase in liability	Purchase of Machine on credit
Decrease in asset	Decrease in liability	Payment of Cash to Creditors
Increase in one liability	Decrease in another liability	Creditors paid from bank Overdraft

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

Equity (i.e. Capital) + Liabilities	=	Assets
Equity + Long term liabilities + Current liabilities	=	Fixed Assets + Current Assets
Equity + Long Term Liabilities	=	Fixed Assets + (Current Assets – Current Liabilities)
Equity + Long Term Liabilities	=	Fixed Assets + Working Capital
Equity	=	Fixed Assets + Working Capital– Long Term Liabilities
Note: Closing Capital = Opening capital (±) Profits/ (Losses) during the year (+) Additional Capital (-) Drawings (+) Interest on capital (-) Interest on drawings		

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

FULL DISCLOSURE

1. Meaning: As per this concept all the events and transactions which are relevant shall be disclosed in the books of accounts and the financial statement. The events may relate to the current or the subsequent accounting periods.
2. Purpose: The users of the financial statements must be aware of all relevant events and transactions to understand real position of the business.
3. Disclosure: It means that a statement describing the event/ transaction (including the amount involved) should be added to the financial statements as a note therein. (Disclosure is not same as accounting. Accounting means Accounting Entries will be passed, whereas in disclosure a mere statement is given Journal Entry not passed.)
   Example: The legal suit filed against a company for violation of copyrights shall be disclosed as part of the financial statements though it cannot be measured accurately.

CONSERVATISM

1. Meaning:
   (a) Conservatism or Prudence demands that unrealized profits and gain should not be recognized in the accounts. However, provision should be made for all actual and possible losses.
   (b) The accountants should not anticipate income but should provide all possible losses.

2. Application of Conservatism Convention:
   (a) Choice among different methods of valuation: If there is a choice between two methods of valuing an asset, the Accountant should choose a method which leads to the lesser value, e.g. Current Assets are valued at Cost or NRV, whichever is lower
   (b) This concept prohibits Window Dressing. (It means manipulating the financial statements to make them attractive viz. inflating the profits, suppressing expenses, treating revenue expenditure as Capital expenditure etc.)

3. Advantages: This Concept has led to the following qualitative characteristics of Financial Statements – (a) Prudence, (b) Neutrality, and (c) Faithful representation of alternative values.

MATERIALITY

1. Meaning: As per Materiality Concept, all items having significant economic effect on the business should be disclosed in the financial statement.
2. Material items refer to the items in the financial statements the knowledge of which might influence the decision of the users of financial statement.
3. Factors: Materiality depends on the size and nature of the items or error, judged in the particular circumstances of its misstatement.
4. Advantage: Materiality provides a threshold or cut-off point for classifying the amounts into assets or expenses
5. Exception: This principle is an exception to the full disclosure principle.

SUBSTANCE OVER LEGAL FORM

1. Meaning: The accounting treatment and presentation in financial statements of transactions and events, should be governed by their substance and not merely by the legal form.

2. For Example:
   (a) Sale of Land & Buildings without Registration: If the Firm has sold its land and Building, received consideration and handed over the possession to the buyer, it should be recorded as sale of land and building this recognition cannot be postponed for mere procedural formality pending e.g registration of sale deed.
   (b) Hire Purchase-Considered as Sale: In case of an asset required on hire purchase, ownership is not transferred till last installment is paid. However, asset is shown in the books of the hire purchaser.

BASIS OF ACCOUNTING

1. Meaning: "Basis of Accounting" refers to the stage at which incomes and expenses are recorded in the books of accounts.

2. Types: There are 3 basis of Accounting- (a) Cash Basis (b) Accrual Basis and (c) Hybrid Basis.

Cash Basis	Accrual Basis (Otherwise called as Mercantile Basis)
Profit = Cash received in normal course of business (-) Cash paid in normal course of business	Profit = Revenue (earned) (-) Expenses (incurred)
Cash Receipts of any year may relate to (a) previous year (b) current year or (c) future years. No distinction is drawn for calculating profits/surplus	When cash and revenue flow at different times, it is treated as under (a) Cash received before revenue is earned = Income Received in Advance = Liability. (b) Cash received after revenue is earned = Income Receivable = Assets
Cash payments of any year may relate to – (a) previous years, (b) current year or (c) future years. No distinction is drawn for calculating profits/surplus	When cash and expense are recognized at different times, it is treated as under- (a) Cash paid before expense is incurred= Prepaid expenses = Assets. (b) Cash paid after expense is incurred = Payables / Outstanding Liabilities = Liability
Companies Act, 2013 does not permit the use of cash basis of accounting	Companies Act 2013 specifically requires the use of accrual basis of accounting

Hybrid System or Modified Accrual System: In this method, the revenue is recognized on cash basis and expenses are recognized on Accrual Basis.

QUALITATIVE CHARACTERSTICS OF FINANCIAL STATEMENTS

Financial Statements are prepared to ascertain the operating results and the financial position of the business. They should have the following features:

Relevance	Information must be relevant to the decision-making needs of the users
Reliability	Information in financial statements must be reliable, i.e. (a) free from material error and bias, and (b) can be depended upon by the user to faithfully represent the correct position
Understandability	Financial statements must be understandable to users. However, the required information should not be excluded, just because it may be complex or difficult for the users to understand.
Comparability	Information in financial statements should be comparable (both for inter-firm and intra-firm comparison). This is possible only when consistency concept is applied and accounting policies and changes therein are adequately disclosed

Materiality	All material information should be disclosed in the financial statements. Information is material if its misstatement (i.e. Omission/erroneous) could influence the economic decision of users.
Faithful Representation	Information must faithfully represent the transactions & events which it represents. It should represent the balance of assets and liabilities which can be used for analysis in good faith
Substance over from	The financial statement should reflect the substance of the transaction than the mere legal form thereof.
Neutrality	Information in financial statement must be free from bias, i.e. it should not influence the decision or judgment of the user, in order to achieve a pre-determined results or outcome.
Prudence	Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty. Hence assets and incomes should not be over-stated, and liabilities and expenses should not be under-stated.
Disclosure	All material items must be fully, fairly and adequately disclosed in the financial statements. Fullness implies nothing material should be omitted. Fairness implies true and fair view of financial statements. Adequacy implies disclosure of proper details and in a sensible manner.
Completeness	Information in financial statements must be complete within the limitations set by materiality & cost. An omission can cause information to be misleading, unreliable and irrelevant

MULTIPLE CHOICE QUESTIONS

1) All the following items are classified as fundamental accounting assumptions except
   (a) Consistency.
   (b) Business entity.
   (c) Going concern.

2) Two primary qualitative characteristics of financial statements are
   (a) Understandability and materiality.
   (b) Relevance and reliability.
   (c) Neutrality and understandability.

3) Kanika Enterprises follows written down value method of depreciating machinery year after year due to
   (a) Comparability.
   (b) Convenience.
   (c) Consistency.

4) A purchased a car for ₹ 5,00,000, making a down payment of ₹ 1,00,000 and signing a ₹ 4,00,000 bill payable due in 60 days. As a result of this transaction
   (a) Total assets increased by ₹ 5,00,000.
   (b) Total liabilities increased by ₹ 4,00,000.
   (c) Total assets increased by ₹ 4,00,000 with corresponding increase in liabilities by ₹ 4,00,000

5) Mohan purchased goods for ₹15,00,000 and sold 4/5th of the goods amounting ₹18,00,000 and met expenses amounting ₹ 2,50,000 during the year, 2023. He counted net profit as ₹ 3,50,000. Which of the accounting concept was followed by him?
   (a) Entity.
   (b) Periodicity.
   (c) Matching.

6) A businessman purchased goods for ₹ 25,00,000 and sold 80% of such goods during the accounting year ended 31st March, 2023. The market value of the remaining goods was ₹ 4,00,000. He valued the closing Inventory at cost. He violated the concept of
   (a) Money measurement.
   (b) Conservatism.
   (c) Cost.

7) Capital brought in by the proprietor is an example of
   (a) Increase in asset and increase in liability.
   (b) Increase in liability and decrease in asset.
   (c) Increase in asset and decrease in liability.

8) During the life-time of an entity, accounting provides financial statements in accordance with which basic accounting concept:
   (a) Conservatism
   (b) Matching
   (c) Accounting period

9) A concept that a business enterprise will not be liquidated in the near future is known as :
   (a) Going concern
   (b) Economic entity
   (c) Monetary unit

10) Assets are held in the business for the purpose of
    (a) Resale.
    (b) Conversion into cash.
    (c) Earning revenue.

11) Revenue from sale of products, is generally, realized in the period in which
    (a) Cash is collected.
    (b) Sale is made.
    (c) Products are manufactured.

12) The concept of conservatism when applied to the balance sheet results in
    (a) Understatement of assets.
    (b) Overstatement of assets.
    (c) Overstatement of capital.

13) Decrease in the amount of trade payables results in
    (a) Increase in cash.
    (b) Decrease in bank overdraft account.
    (c) Decrease in assets.

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

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

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

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

18) Consider the following data pertaining to Alpha Ltd:

Cost of machinery purchased on 1st April, 2022	10,00,000
Installation charges	1,00,000
Market value as on 31st March, 2023	12,00,000

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

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) The concept helps in keeping business affairs free from the influence of the personal affairs of the owner is known as the matching concept.
2) Entity concept means that the enterprise is liable to the owner for capital investment made by the owner.
3) Accrual means recognition as money is received or paid and not of revenue and costs as they are earned or incurred.
4) The Conservatism Concept states that no change should be counted unless it has materialized.
5) The concept of consistency implies non-flexibility as not to allow the introduction of improved method of accounting.
6) The materiality depends only upon the amount of the item and not upon the size of the business, nature and level of information, level of the person making the decision etc.
7) Accrual basis of accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.
8) The financial statements are not prepared on the assumption that an enterprise is a going concern and will continue its operation for the foreseeable future. *(Dec 2022)*
9) A concern proposes to discontinue its business from December 2020 and decides to dispose of all its plants within a period of 3 months. The Balance Sheet as on 31st December 2020 should continue to indicate the plants at its historical costs as the assets will be disposed off after the Balance Sheet date. *(Nov 2020)*
10) As per the concept of conservatism, the accountant should provide for all possible losses, but should not anticipate income. *(June 2023)*
11) Revenues are matched with expenses in accordance with the matching principle.
12) The financial statement must also disclose the relevant and reliable information in accordance with the Full Disclosure Principle.
13) The concept of conservatism when applied to the balance sheet results in understatement of assets.
14) Accrual concept implies accounting on cash basis.
15) Accounting principle is general rule followed in preparation of Financial Statements.
16) In double entry accounting, all business transaction are recorded as having dual aspect.
17) Transactions and events are guides by generally accepted accounting principles
18) The value of human resources is generally shown as assets in the Balance Sheet.
19) The results and position disclosed by final accounts are not exact.

Solution

1) False: Under matching concept all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.
2) True: Since the owner invested capital, he has claim on the profits of the enterprise.
3) False: Under accrual concept, the effects of transactions and other events are recognised on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
4) False: The Realisation Concept also states that no change should be counted unless it has materialised.

5) False: The concept of consistency does not imply non-flexibility as not to allow the introduction of improved method of accounting.
6) False: As per materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements
7) False: Cash Basis of Accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.
8) False: The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future.
9) False: If the fundamental accounting assumption of going concern is not followed, then the assets and liabilities should be stated at realizable value not historical cost.
10) True: Concept of conservation states that all the accountants should not anticipate income and should provide for all possible losses.
11) True: The matching concept involves that the revenue earned in an accounting year is matched with the expenses incurred during the same period to generate that revenue.
12) True: The financial statement must also disclose the relevant and reliable information
13) True: Conservatism states that the accountant/entity should not anticipate any future income. However they should provide for all possible / probable losses. Use of this concept leads to understatement of income & assets.
14) False: Accrual concept implies accounting done on due or accrual basis. It involves the recognition of revenues and costs as they accrue irrespective of the actual receipts or payments.
15) True: Accounting principles suggests the rules of action, which are universally accepted by the accountants for the recording of accounting transactions.
16) True: In double entry book-keeping system, every transaction has a dual aspect or a twofold effect in accounting where one account is debited by an amount and the other is credited by the same.
17) True: Every country adopts some generally accepted accounting principles and the transactions and events are guided by those principles.
18) False: The value of human resources cannot be measured in monetary terms, thus it will not be shown in the balance sheet.
19) True: They are prepared on the basis of assumptions, conventions, concepts and personal judgements of the person who prepare them.

CAPITAL & REVENUE EXPENDITURE AND RECEIPTS

CAPITAL EXPENDITURE VS REVENUE EXPENDITURE

Particulars	Capital Expenditure	Revenue Expenditure
Meaning	It is expenditure incurred for the purpose of- (a) Purchase/ Creation / Improvement of Fixed Assets (b) Expenses necessary for the above purchase / Creation (c) Increasing the earning capacity of business.	It is an expenditure, the benefit of which is immediately (normally within one year) exhausted in the process of earning revenue.
Period of benefit	Any expenditure incurred to provide a benefit over a long-term period is capital expenditure.	Any expenditure incurred to provide benefit during the current period is revenue expenditure.
Enhancement vs Maintenance	Capital expenditure is incurred for the purpose of increasing the capacity of the business. Alternatively, it also includes an expenditure to reduce the costs of the business	Revenue expenditure is incurred to maintain the earning capacity of the business.
Examples	Purchase of machine, car, furniture, etc.	Repairs and maintenance, salary of accounting staff, etc.
Treatment in Financial Statement	Capital Expenditure is shown as asset in Balance Sheet. Only depreciation portion is debited to P&L A/c.	Expenditure is charged fully in the Profit and Loss Account.

CRITERIA / CONSIDERATIONS FOR CAPITAL VS REVENUE

Whether an expenditure is Capital or Revenue in nature, depends upon the following factors-

Factor	Capital Expenditure if.....	Revenue Expenditure if.......
Nature of Business	Expenditure relates to purchase of a Fixed Asset (e.g. Furniture purchased by a trader).	Expenditure relates to purchase of a Current Asset (e.g. Furniture purchased by a trader dealing in furniture).
Recurring Nature	Expenditure is incurred infrequently, or once in 2-5years (e.g. purchase of assets.)	Expenditure is incurred frequently / regularly, in the normal course of business (e.g. Salary, Rent, etc.)
Purpose of Expenses	Expenditure is for acquiring / creating capital assets or increasing their productive capacity.	Expenditure is for maintaining the capital assets.
Period of Benefit	Expenditure helps to generate revenue over more than one accounting period	Expenditure helps to generate income / revenue in the current period only.
Materiality	Expenditure is material / significant.	Expenditure is not material, i.e. insignificant.

EXAMPLES FOR CAPITAL AND REVENUE EXPENDITURES

Capital Expenditure	Revenue Expenditure
1. Purchase of Fixed Asset (Land, Building, etc.) 2. Purchase of Second hand Asset (e.g. Vehicle, Furniture, etc.) 3. Overhaul Expenses to put secondhand machinery in working condition. 4. Repairing & Painting of Old Building purchased recently by the Firm. 5. Expenditure incurred to reduce working expenses / operating expenses which generate long term benefits to the entity 6. Legal Fee paid to acquire new property. 7. Licence Fee paid by Cinema Theatre to commence its business. 8. Cost of constructing Temporary Huts which were necessary for Factory Building Construction, which were demolished when the Factory was ready.	1. Expenditure for replacement of worn—out part of an existing asset. 2. Regular Advertisement Expenses in respect of products and services. 3. Expenditure on removal of stock to new site. 4. Legal Fees incurred to file suit against a Customer from whom money is due.

CAPITAL VS REVENUE RECIEPTS

Particulars	Capital Receipt	Revenue Receipt
Meaning	Capital Receipts refer to receipts other than Revenue Receipts.	Revenue Receipts are moneys received in course of normal business activities and are recurring in nature.
Example	Capital contribution by Owner, Issue of Shares /Debentures, Sale Proceeds of Fixed Assets, etc.	Sales, Interest and Other Income Received, Bad Debts Recovered, etc.
Purpose	Capital Receipts relate to specific purpose, e.g. Capital Contribution for commencing business or expanding business, Loans taken for acquiring Fixed Assets, etc.	Revenue Receipts relate to general business purpose and are not specifically identifiable to any purpose as such.
Effect on Profit	Capital Receipts do not affect profit.	Revenue Receipts have a direct impact on the profits.
Disclosure	They are shown as Liability or Reduction from the Asset in the Balance Sheet.	They are shown on the Credit Side of the Profit and Loss Account.

Question 1 *(ICAI Study Material)*

State with reasons whether the following statements are 'True' or 'False'.

(1) Overhaul expenses of second-hand machinery purchased are Revenue Expenditure.
(2) Money spent to reduce working expenses is Revenue Expenditure.
(3) Legal fees to acquire property is Capital Expenditure.
(4) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is Capital Expenditure.

(5) Amount spent for replacement of worn out part of machine is Capital Expenditure.
(6) Expense incurred on the repairs and white washing for the first time on purchase of an old building are Revenue Expenses.
(7) Expenses in connection with obtaining a license for running the cinema is Capital Expenditure.
(8) Amount spent for the construction of temporary huts, which were necessary for construction of the Cinema House and were demolished when the cinema house was ready, is Capital Expenditure.

Solution:
(1) False: Overhaul expenses are incurred to put second-hand machinery in working condition to derive endurable long-term advantage. So it should be capitalised.
(2) False: It may be reasonably presumed that money spent for reducing revenue expenditure would have generated long-term benefits to the entity. So this is capital expenditure.
(3) True: Legal fee paid to acquire any property is part of the cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.
(4) False: Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset. By this expense, neither any endurable benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased. Maintenance expenditure in relation to an asset is revenue expenditure.
(5) False: Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.
(6) False: Repairing and white washing expenses for the first time of an old building are incurred to put the building in usable condition. These are part of the cost of building. Accordingly, these are capital expenditure.
(7) True: Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense which is capitalised. Such expenses are amortised over a period of time.
(8) True: Cost of temporary huts constructed which were necessary for the construction of the cinema house is part of the construction cost of the cinema house. Therefore such costs are to be capitalised

Question 2 *(ICAI Study Material)*

State with reasons whether the following are Capital or Revenue Expenditure:
(1) Expenses incurred in connection with obtaining a license for starting the factory for ₹ 10,000.
(2) ₹ 1,000 paid for removal of Inventory to a new site.
(3) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency.
(4) Money paid to Mahanagar Telephone Nigam Ltd. ₹ 8,000 for installing telephone in the office.
(5) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred in the construction of temporary huts for storing building material.

Solution:
(1) Money paid ₹ 10,000 for obtaining license to start a factory is a capital expenditure. This is an item of expenditure incurred to acquire the right to carry on business.
(2) ₹ 1,000 paid for removal of Inventory to a new site is revenue expenditure. This is neither bringing enduring benefit nor enhancing the value of the asset.

(3) ₹ 5,000 spent in changing Rings and Pistons of an engine to get fuel efficiency is capital expenditure. This is an expenditure on improvement of a fixed asset. It results in increasing profit-earning capacity of the business by cost reduction.
(4) Money deposited with MTNL for installation of telephone in office is not expenditure. This is treated as an asset and the same is adjusted over a period of time against actual telephone bills.
(5) Cost of construction of building including cost of temporary huts is capital expenditure. Building is fixed asset which will generate enduring benefit to the business over more than one accounting period. Construction of temporary huts is incidental to the main construction. Such cost is also capitalised with the cost of building.

Question 3 *(ICAI Study Material)*

Best Tech Solutions buys and sells computers as a part of its business. It purchased 20 computers for resale to its customers. Cost of each computer is ₹ 20,000. It also purchased a computer costing ₹24,000 for its accountant to be able to maintain the accounting records and printing of invoices. Suggest whether above transactions qualify as capital expenditure or revenue expenditure transactions?

Solution:

Best Tech Solutions is in the business of buying and selling of computers. Any computers purchased for resale to its customers will qualify as revenue expenditure. Hence, a purchase of 20,000 x 20 = ₹4,00,000 will be a part of revenue expenditure. At the same time, the computer purchased for maintaining the records and invoicing is to be able to operate the business for a longer period of time. Therefore, the purchase of ₹24,000 qualifies as a capital expenditure. This amount will be a part of assets in the Balance Sheet.

Question 4 *(ICAI Study Material)*

State with reasons whether the below items relating to the business of AB Ltd are capital or revenue receipts?

(a) A machine with a book value of ₹ 10 lakh is sold for ₹ 12 lakh.
(b) Premium amounting to ₹ 1 Lakh received on issue of shares.
(c) An amount of ₹ 20,000 received from goods sold in cash.
(d) An amount of ₹ 5 lac received on the maturity of fixed deposit from bank. Also, an interest of ₹40,000 was received in addition to the maturity amount of the fixed deposits.

Solution:

(a) The amount of ₹ 12 lac is a capital receipt. There is a profit on sale of the machine to the extent of ₹ 2 lac (12 – 10)
(b) Premium received on issue of shares is an example of capital receipt.
(c) Amount received from cash sale is a revenue receipt.
(d) Amount received on the maturity of fixed deposit is the recovery of the deposit amount and is a capital receipt. Interest income is an example of revenue receipt.

Question 5 *(ICAI Study Material)*

Good Pictures Ltd., constructs a cinema house and incurs the following expenditure during the first year ending 31st March, 2023.

a) Second-hand furniture worth ₹ 9,000 was purchased; repainting of the furniture costs ₹ 1,000. The furniture was installed by own workmen, wages for this being ₹ 200.

b) Expenses in connection with obtaining a license for running the cinema worth ₹ 20,000. During the course of the year the cinema company was fined ₹ 1,000, for contravening rules. Renewal fee ₹ 2,000 for next year also paid.
c) Fire insurance, ₹ 1,000 was paid on 1st October, 2022 for one year.
d) Temporary huts were constructed costing ₹ 1,200. They were necessary for the construction of the cinema. They were demolished when the cinema was ready.

Point out how you would classify the above items.

Solution:

a) The total cost of the furniture should be treated as ₹ 10,200 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use.
b) License for running the cinema house is necessary, hence its cost should be capitalised. But the fine of ₹ 1,000 is revenue expenditure. The renewal fee for the next year is also revenue expenditure but pertains to the next year; hence, it is a prepaid expense.
c) Half of the insurance premium pertains to the year beginning on 1st April, 2023. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
d) Since the temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.

Question 6 *(ICAI Study Material)*

State with reasons, how you would classify the following items of expenditure:

1) Overhauling expenses of ₹ 25,000 for the engine of motor car to get better fuel efficiency.
2) Inauguration expenses of ₹ 25 lacs incurred on the opening of a new manufacturing unit in an existing business.
3) Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement.

Solution:

1) Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long-term advantage. So this expenditure should be capitalised.
2) Inauguration expenses incurred on the opening of a new unit may help to explore more customers This expenditure is in the nature of revenue expenditure, as the expenditure may not generate any enduring benefit to the business over more than one accounting period.
3) The amount paid to workers on voluntary retirement is in nature of revenue expenditure. Since the magnitude of the amount of expenditure is very significant, it may be better to defer it over future years.

Question 7 *(ICAI Study Material)*

Classify the following expenditures and receipts as capital or revenue:

(i) ₹ 10,000 spent as travelling expenses of the directors on trips abroad for purchase of capital assets.
(ii) Amount received from Trade receivables during the year.
(iii) Amount spent on demolition of building to construct a bigger building on the same site.
(iv) Insurance claim received on account of machinery damaged by fire.

Solution:

(i) Capital expenditure. (ii) Revenue receipt. (iii) Capital expenditure. (iv) Capital receipt.

Question 8 ***(ICAI Study Material)***

Are the following expenditures capital in nature?

(i) M/s ABC & Co. run a restaurant. They renovate some of the old cabins. Because of this renovation some space was made free and number of cabins was increased from 10 to 13. The total expenditure was ₹ 20,000.

(ii) M/s New Delhi Financing Co. sold certain goods on installment payment basis. Five customers did not pay installments. To recover such outstanding installments, the firm spent ₹ 10,000 on account of legal expenses.

(iii) M/s Ballav & Co. of Delhi purchased a machinery from M/s Shah & Co. of Ahmedabad. M/s Ballav & Co. spent ₹ 40,000 for transportation of such machinery. The year ending is 31st Dec, 2023.

Solution:

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

(ii) Expense incurred to recover installments due from customer do not increase the revenue generating capability in future. It is normal recurring expense of the business. Thus the legal expenses incurred in this case is revenue expenditure in nature.

(iii) Expenses incurred on account of transportation of fixed asset is capital expenditure in nature.

Question 9 ***(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2020) / (RTP Nov 2023) (Similar)***

Classify the following expenditures as capital or revenue expenditure:

(i) Amount spent on making a few more exits in a Cinema Hall to comply with Government orders.

(ii) Travelling expenses of the directors for trips abroad for purchase of capital assets.

(iii) Amount spent to reduce working expenses.

(iv) Amount paid for removal of stock to a new site.

(v) Cost of repairs on second-hand car purchased to bring it into working condition.

Solution:

(i) Revenue Expenditure (ii) Capital Expenditure (iii) Revenue Expenditure if short term benefit and Capital Expenditure if long term benefit to entity (iv) Revenue Expenditure (v) Capital Expenditure

Question 10 ***(RTP May 2018) (RTP May 2021) / (RTP Nov 2021)***

Classify each of the following transactions into capital or revenue transactions:

a) Complete repaint of existing building.

b) Installation of a new central heating system.

c) Repainting of a delivery van.

d) Providing drainage for a new piece of water-extraction equipment.

e) Legal fees on the acquisition of land.

f) Carriage costs on a replacement part for a piece of machinery.

g) Inauguration expenses of a new manufacturing unit in an existing Business.

Solution:

(a) Revenue Expenditure (b) Capital Expenditure (c) Revenue Expenditure (d) Capital Expenditure (e) Capital Expenditure (f) Revenue Expenditure (g) Revenue Expenditure

Question 11 *(RTP May 2019)*

Classify the following expenditures and receipts as capital or revenue:

(i) ₹ 10,000 spent as import duty on machinery purchased.
(ii) Amount received from debtors during the year.
(iii) Cost of testing whether the equipment is functioning properly.
(iv) Insurance claim received on account of machinery damaged by fire.

Solution

(i) Capital expenditure (ii) Revenue receipt. (iii) Capital expenditure. (iv) Capital receipt.

Question 12 *(RTP May 2020)*

Classify the following expenditures as capital or revenue expenditure.

(i) Money spent to reduce working expenses.
(ii) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land.
(iii) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get fuel efficiency.
(iv) Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement.

Solution

(i) Capital expenditure if long term benefit (ii) Revenue expenditure. (iii) Capital expenditure. (iv) Revenue expenditure.

Question 13 *(RTP May 2022)*

Classify the following expenditures as capital or revenue expenditure:

(i) An extension of railway tracks in the factory area.
(ii) Amount spent on painting the factory
(iii) Payment of wages for building a new office extension.
(iv) Amount paid for removal of stock to a new site.
(v) Rings and Pistons of an engine were changed to get full efficiency

Solution

(i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than 1 accounting period.
(ii) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
(iii) Payment of wages for building new office extension should be treated as Capital Expenditure.
(iv) Amount paid for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of any asset.
(v) Expenditure incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

Question 14 *(RTP Nov 2022)*

Classify the following expenditures as capital or revenue expenditure:

(i) Expenses incurred to keep the machine in working condition.
(ii) Registration fees paid at the time of purchase of a building.
(iii) Expenses incurred for advertisement in newspaper.
(iv) Amount spent on renewal fee of patent rights.
(v) Cost of repairs on second-hand car purchased to bring it into working condition.

Solution

(i) Revenue Expenditure. (ii) Capital Expenditure. (iii) Revenue Expenditure. (iv) Revenue Expenditure. (v) Capital Expenditure.

Question 15 *(RTP May 2023)*

Classify the following expenditures as capital or revenue expenditure:

(i) Insurance claim received on account of inventory damaged by fire.

(ii) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land.

(iii) Travelling expenses of the chief financial officer on trips abroad for purchase of special machinery.

(iv) Dividend received from XYZ limited during the year.

Solution

(i) Revenue Receipt. (ii) Revenue Expenditure. (iii) Capital Expenditure. (iv) Revenue Receipt.

Question 16 *(MTP Dec 2022)*

Classify the following expenditures as capital or revenue expenditure:

(i) Amount spent for replacement of a petrol driven engine by CNG kits.

(ii) Travelling expenses of the directors for trips abroad for purchase of capital assets.

(iii) Amount spent to reduce working expenses.

(iv) Insurance claim received on account of inventory damaged by fire.

(v) Expenses incurred on the repairs and white washing for the first time on purchase of an old factory.

Solution

(i) Capital Expenditure. (ii) Capital Expenditure. (iii) Capital Expenditure (assuming long term benefit) (iv) Revenue Expenditure. (v) Capital Expenditure.

MULTIPLE CHOICE QUESTIONS

1) Money spent ₹ 10,000 as traveling expenses of the directors on trips abroad for purchase of capital assets is
   (a) Capital expenditures
   (b) Revenue expenditures
   (c) Prepaid revenue expenditures

2) Amount of ₹ 5,000 spent as lawyers' fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
   (a) Capital expenditures
   (b) Revenue expenditures
   (c) Prepaid revenue expenditures

3) Entrance fee of ₹ 2,000 received by Ram and Shyam Social Club is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures

4) Subsidy of ₹ 40,000 received from government for working capital by a manufacturing concern is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures

5) Insurance claim received on account of machinery damaged completely by fire is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures

6) Interest on investments received from UTI is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures

7) Amount received from IDBI as a medium term loan for augmenting working capital is
   (a) Capital expenditures
   (b) Revenue expenditures
   (c) Capital receipt

8) Revenue from sale of products, ordinarily, is reported as part of the earning in the period in which
   (a) The sale is made.
   (b) The cash is collected.
   (c) The products are manufactured.

9) If repair cost is ₹ 25,000, whitewash expenses are ₹ 5,000, (both these expenses relate to presently used building) cost of extension of building is ₹ 2,50,000 and cost of improvement in electrical wiring system is ₹ 19,000; the amount to be expensed is
   (a) ₹ 2,99,000.
   (b) ₹ 44,000.
   (c) ₹ 30,000.

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) The nature of business is not an important criteria in separating an expenditure between capital and revenue.
2) Expenditure incurred for major repair of the asset so as to increase its productive capacity is Revenue in nature.
3) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is Capital Expenditure.
4) Amount spent for replacement of worn out part of a machine is Capital Expenditure. *(June 2022)*
5) Legal fees to acquire property is Capital Expenditure.
6) Amount spent for the construction of temporary huts, which were necessary for construction of the cinema house and were demolished when the cinema house was ready, is Capital Expenditure. *(May 2019)*
7) Wages paid for erection of machinery are debited to Profit and Loss account.
8) Amount paid for acquiring goodwill is revenue expenditure.
9) Overhead expenses of second hand machinery purchased are revenue expenditure.
10) Motor repairs charges including replacement of certain worn out parts incurred before using a second hand car purchased recently is a capital expenditure.
11) An expenditure intended to benefit beyond the current period is revenue expenditure.
12) Expenditure which results in acquisition of a permanent asset of enduring benefit to the business is capital expenditure.
13) Wages paid to workers to produce a tool to be captively consumed is capital expenditure.
14) Expenses incurred on white-washing of factory building after every 6 months are revenue expenditure.
15) Temporary shed put up at project site to house materials is a capital expenditure.
16) Heavy advertising to introduce a new product is a capital expenditure.
17) Expenditure on renovation of a theatre which has increased the seating capacity by 10% is revenue expenditure.
18) Travelling expenses of ₹ 80,000 paid to a technician for the installation of a new machine is debited to Profit and Loss Account.
19) Amount paid to Management company for consultancy to reduce the working expenses is capital expenditure if the reduced working expenses will generate long term benefits to the entity.
20) Expenses in connection with obtaining a license for running the Cinema Hall is Revenue Expenditure *(May 2018) / (June 2023)*
21) Overhauling expenses for the engine of motor car to get better fuel efficiency is revenue expenditure. *(Nov 2018)*
22) M/s. XYZ & Co. runs a café. They renovated some of the old cabins. Because of this renovation some space was made free & number of cabins was increased from 15 to 18. The total expenditure incurred was ₹ 30,000 and was treated as a revenue expenditure. *(Nov 2019)*
23) Insurance claim received on account of plant and machinery completely damaged by fire is a capital receipt. *(Nov 2020)*
24) Subsidy received from the government for working capital by a manufacturing concern is a revenue receipt. *(Jan 2021)*
25) Any amount spent to minimize the working expenses is revenue expenditure. *(Dec 2021)*
26) Expenses incurred on the repairs for the first time on purchase of an old building are capital expenditure. *(Dec 2021)*
27) Sale of office furniture should be credited to Sales A/c.

Solution

1) False: The nature of business is a very important criteria in separating an expenditure between capital and revenue. For example- For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset.
2) False: Expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.
3) False: Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff is maintenance expenditure of the asset. By this expense, neither any endurable benefit can be obtained in future in addition to that what is presently available nor the capacity of the asset will be increased. Maintenance expenditure in relation to an asset is revenue expenditure.
4) False: Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.
5) True: Legal fee paid to acquire any property is a part of cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.
6) True: Since temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised
7) False: - It is a capital expenditure and hence should be debited to Machinery A/c.
8) False: - It is a capital expenditure since it involves acquisition of an intangible asset, which is a fixed asset.
9) False: - Such expenses are incurred to derive long-term benefits of enduring nature. So it is a capital expenditure.
10) True: - As these charges were incurred to derive a long-term benefit.
11) False: - Revenue expenditure is that expenditure which benefits the period in which it is incurred i.e. current period.
12) True: - Because it will generate enduring benefits and help to generate revenue for more than one accounting period.
13) True: - Wages paid to workers for creating an asset to be used in business is capital expenditure.
14) True: - As they are incurred in the normal maintenance course of the asset.
15) True: - Because it is incidental to the main construction and the expenditure on it is a part of construction cost.
16) False: - Since it does not create any property of tangible or intangible nature
17) False: It is a capital expenditure as it has contributed to the revenue earning capacity of the business over more than one accounting period.
18) False: It is a capital expenditure since it has been incurred to put the asset in working condition.
19) True: Amount paid to management company for consultancy to reduce the working expenses is capital expenditure as this expenditure will generate long-term benefit to the entity.
20) False: The Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense which is capitalized. Such expenses are not revenue and amortized over a period of time.
21) False: Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long-term advantage. So this expenditure should be capitalised.

22) False: Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus the renovation expense is capital expenditure in nature.
23) True: Insurance claim received on account of plant and machinery completely damaged by fire is a capital receipt as it is not obtained in course of normal business activities.
24) True: Subsidy received from the government for working capital by a manufacturing concern is a revenue receipt because it has no effect on improvement of future capability of business in revenue generation.
25) False: It may be reasonably presumed that money spent for reducing revenue expenditure would have generated long-term benefits to the entity. So this is capital expenditure.
26) True: Repairs for the first time of an old building are incurred to put the building in usable condition. This is a part of the cost of building. Accordingly, this is a capital expenditure.
27) False: It should be credited to Furniture A/c because it is a capital receipt.

CONTINGENT ASSETS AND CONTINGENT LIABILITIES

GLOSSARY OF SIGNIFICANT TERMS

Contingency	A situation, which has not actually occurred but which is expected to happen in the near future.
Liability	Obligation to pay for any expenses / losses i.e. It represents outflow of business resources. Present financial obligation of an enterprise which arises from past events.
Probable	Chance of occurrence of an event is 50%. i.e. an event is more likely to happen
Possible	Chance of occurrence of an event is < 50% i.e. an event may or may not happen. It cannot be determined.
Present Obligation	An obligation which is probable i.e. it is more than likely that such obligation exists on the date of balance sheet is called "Present Obligation"
Possible Obligation	An obligation which is not probable i.e. on the balance date, it is not likely that such obligation may arise in future

PROVISIONS

Meaning	A Provision is "a Present Obligation, as a result of past events, which leads to probable outflow of resources embodying economic benefits and a reliable estimate of the amount of the obligation can be made"
Features	(a) Provision is a present liability of a certain / uncertain amount. (b) Provision can be reasonably measured using a substantial degree of estimation.
Treatment	Provision should be recognized in the Books of Account.
Impact on Profits	Provision represents liability for expense/loss; So, Provision reduces the profit.
Journal Entry	Debit – Profit and Loss A/c Dr. Credit – To Provisions for Liabilities A/c
Reasoning	<u>Debit Aspect:</u> Provision is an expense / loss, which reduces the profits of the enterprise Hence, Profit and Loss A/c is debited. (Debit all expenses and losses) <u>Credit Aspect:</u> Provision is a liability payable in future. Hence, it is credited
Balance Sheet	Provision is either shown (a) on the liabilities side (or) (b) on the assets side – as a deduction from the relevant asset.
Examples	(a) Provision for Guarantees Given, when the original debtor becomes insolvent. (b) Provision for Warranties (c) Provision for Discount on Debtors (d) Provision for Bad and Doubtful Debts

CONTINGENT LIABILITY

A Possible Obligation
That arises from past events and the existence of which will be confirmed only by the occurrence or non—occurrence of one or more uncertain future events not wholly within the control of the enterprise

Or

Present Obligation
That arises from past events but is not recognized because —
- it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or

reliable estimate of the amount of obligation cannot be made.

Note: Possible Obligation is always a Contingent Liability, whereas Present Obligation becomes a Contingent Liability if the recognition criteria of Provision are not satisfied.

Elements		Cases				
1.	Possible obligation	X	X	X	X	√
2.	Present obligation from past events	√	√	√	√	NA
3.	Expected outflow	√	√	X	X	NA
4.	Measurability (using substantial degree of estimation)	√	X	√	X	NA
5.	Whether: Provision(P) or Contingent Liability (CL)	P	CL	CL	CL	CL

FEATURES OF CONTINGENT LIABILITY

1. Recognition	An Enterprise should NOT RECOGNISE a Contingent Liability.
2. Disclosure	A Contingent Liability should be DISCLOSED in the notes to accounts unless possibility of outflow of a resource embodying economic benefits is remote.
3. Periodical Review	Contingent Liability should be periodically reviewed. On such review, if the character of the Contingent Liability is found to be changed and there is a probable outflow of resources, then it will be recognized as Provision and treated accordingly.
4. Impact	Contingent Liability will NOT AFFECT the profits of the concern, as it is not accounted in Books.
5. Examples	• Claims against the business, not acknowledged as debts • Guarantees given, if the principal debtor is solvent • Uncalled Liability on Partly Paid shares • Arrears of Fixed Cumulative dividends • Liability on Bills Discounted

CONTINGENT ASSETS

1. Meaning	A Contingent Asset is a POSSIBLE ASSET that arises from past events, existence of which will be confirmed only by occurrence / non-occurrence of one or more uncertain future events, not wholly within the control of the enterprise.

2. Treatment	An enterprise SHOULD NOT RECOGNISE a Contingent Asset due to CONSERVATISM Convention. Because this may result in recognition of income that may never be realized.
3. Impact	Contingent Assets will not affect the profits of the enterprise as it is not accounted in the books.
4. Certainty	If the realisation of income is certain, then it is not a Contingent Asset and the same shall be recognized in the Financial Statements.
5. Disclosure	Contingent Assets should not be disclosed in the Financial Statements but may be disclosed in the Report of the Approving Authority.
6. Examples	• Unplanned or unexpected events leading to possibility of inflow of economic benefits • Expected Gain from a legal suit. • Insurance claims for damage of a property

PRINCIPLES BEHIND PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

Nature	Principle
1. Provision	Matching Concept, Conservatism Convention
2. Contingent Liability	Full Disclosure Concept
3. Contingent Asset	Conservatism Convention

MULTIPLE CHOICE QUESTIONS

1) Contingent asset usually arises from unplanned or unexpected events that give rise to
   (a) The possibility of an inflow of economic benefits to the business entity.
   (b) The possibility of an outflow of economic benefits to the business entity.
   (c) Either (a) or (b).
2) If an inflow of economic benefits is probable then a contingent asset is disclosed
   (a) In the financial statements.
   (b) In the report of approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).
   (c) In the cash flow statement.
3) In the case of __________, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.
   (a) Liability
   (b) Provision
   (c) Contingent liabilities
4) Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as _______.
   (a) Provision.
   (b) Liability.
   (c) Contingent liability.
5) In the financial statements, contingent liability is
   (a) Recognised.
   (b) Not recognised.
   (c) Adjusted.

ANSWERS MCQs

1. (a) 2. (b) 3. (c) 4. (a) 5. (b)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) A contingent liability need not be disclosed in the financial statements.
2) A Provision fails to meet the recognition criteria.
3) A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent liability. *(June 2022)*
4) When it is probable that the firm will need to pay off the obligation, this gives rise to Contingent liability.
5) Present financial obligation of an enterprise, which arises from past event is termed as contingent liability.

Solution

1) False: A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.
2) False: A contingent liability fails to meet the recognition criteria.
3) False: A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset
4) False: When it is probable that the firm will need to pay off the obligation, this gives rise to provision.
5) False: Present Financial obligation of an enterprise, which arises from past events is termed as liability

ACCOUNTING POLICIES

MEANING

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

CHOICE OF ACCOUNTING POLICIES

1. Alternative accounting policies: The different circumstances in which enterprises operate and the situation of diverse and complex economic activities of the company has given rise to acceptability of alternative accounting principles & methods of applying those principles.
2. Decision Making: The choice of the alternatives principles & methods calls for considerable judgment by the management of the enterprises.
3. Reduction in alternatives: Various statements issued by ICAI, together with the measures of Governments, other regulatory agencies, etc. has reduced the number of acceptable policies can at best be reduced, not eliminated, as different enterprises operate in differing circumstances.
4. Illustration List of areas of alternative accounting policies.
   (a) Conversion or translation of foreign Currency items.
   (b) Treatment of – (i) Expenditure during construction.
   (c) Valuation of – (i) Inventories, (ii) Investments.

Note: Generally Companies disclose these accounting policies in the Notes of Accounting.

PRINCIPLES FOR SELECTION OF ACCOUNTING POLICIES

1. True and Fair View: Primary consideration in the selection of Accounting Policies is that financial statements prepared & presented should represent a true & fair view as under-

Balance sheet	Of the State of Affairs of the enterprises as on a certain date.
Profit & Loss Account	Of the Profit or Loss for the period ended on that date.

2. Factors: To select & apply accounting policy, the following points are considered (Secondary Consideration)

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

3. Change in Accounting Policies: Accounting policies have to be consistent from year to year. However, change in accounting policies can be made in the following situations-
   (a) If the adoption of a different accounting policy is required by Statute, or
   (b) For compliance with an Accounting Standard, or
   (c) If it is considered that the change would result in a more appropriate presentation of the financial Statements.

DISCLOSURE OF ACCOUNTING POLICIES

1. Disclosure of Accounting Policies: All significant accounting policies adopted in the preparation and presentation of financial statement should be disclosed to facilitate better understanding of the financial statements.
2. Place of Disclosure: Disclosures should form part of the financial Statements. It should be disclosed at one place, instead of being scattered over several statements.
3. Change in Accounting Policies: Change in an accounting policy should be disclosed-
   (a) When such change has a material effect in the current period and
   (b) When such change is reasonably expected to have a material effect in later periods.
4. Manner of Disclosure of change in accounting policies:

Effect in Current Period	Expected Effect in later periods
• Impact of change on Profit/Loss & Balance Sheet items in the current period should be quantified, to the extent ascertainable. • Where quantification is not possible, either wholly or in part, the fact should be disclosed	• The fact of such change, and • The fact that it is likely to have effect in later periods. Should be appropriately disclosed in the period in which the change is adopted

Case:

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

Answer

Change in accounting policy may have a material effect on the items of financial statements. For example, if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is changed to inventory which was earlier not the practice, all these may increase or decrease the net profit. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit/loss.

Examples in this regard may be given as follows: "Omega Enterprises revised its accounting policy relating to valuation of inventories to include applicable production overheads."

MULTIPLE CHOICE QUESTIONS

1) A change in accounting policy is justified
   (a) To comply with accounting standard and law.
   (b) To ensure more appropriate presentation of the financial statement of enterprise.
   (c) All of the above.

2) Accounting policy for inventories of Xeta Enterprises states that inventories are valued at the lower of cost determined on weighted average basis or net realizable value. Which accounting principle is followed in adopting the above policy?
   (a) Materiality.
   (b) Prudence.
   (c) Substance over form.

3) The areas wherein different accounting policies can be adopted are
   (a) Providing depreciation.
   (b) Valuation of inventories.
   (c) Both the options

4) Selection of an inappropriate accounting policy decision may
   (a) Overstate the performance and financial position of a business entity.
   (b) Understate/overstate the performance and financial position of a business entity.
   (c) Overstate the performance of a business entity.

5) Accounting policies refer to specific accounting
   (a) Principles.
   (b) Methods of applying those principles.
   (c) Both (a) and (b).

ANSWERS MCQs

1. (c) 2. (b) 3. (b) 4. (b) 5. (c)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) There is a single list of accounting policies, which are applicable to all enterprises in all circumstances.
2) Selection of accounting policy doesn't impact financial performance and financial position of the business.
3) A change in accounting policies should be made as and when business like to show result as per their choice.
4) Choosing FIFO or weighted average method for inventory valuation is selection of accounting policy.
5) Selection of an inappropriate accounting policy decision will overstate the performance and financial position of a business entity every time.

Solution

1) False: There cannot be single list of accounting policies, which are applicable to all enterprises in all circumstances. There would always be different policies chosen by different industries under different circumstances.
2) False: Accounting policy has big impact on value of items goes under financial statements, hence it impacts financial performance and financial position of the business.

3) False: A change in accounting policies should be made in the following conditions:
   (a) It is required by some statute or for compliance with an Accounting Standard.
   (b) Change would result in more appropriate presentation of financial statement.
4) True: An enterprise may adopt FIFO or weighted average method for inventory valuation and the method selected for valuation is called an accounting policy.
5) False: It could understate/overstate the performance and financial position of a business entity.

ACCOUNTING AS A MEASUREMENT DISCIPLINE - VALUATION PRINCIPLES, ACCOUNTING ESTIMATES

ELEMENTS OF MEASUREMENT DISCIPLINE

Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Measurement is the process of determining money value at which an element can be recognized in the balance sheet or statement of profit & loss.

The 3 elements of Measurement discipline and how accounting satisfies these elements are as under-

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

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

MEASUREMENT BASES (OR VALUATION PRINCIPLES) IN ACCOUNTING

The measurement bases or valuation principles used in accounting are-

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

Note: Different measurement bases are used according to suitability (i.e. the situational need) to depict the true and fair view of the financial position of the reporting entity.

Example:
Mohan purchased a machinery amounting ₹ 10,00,000 on 1st April, 2005. On 31st March, 2023, similar machinery could be purchased for ₹ 20,00,000 but the realizable value of the machinery (purchased on 1.4.2005) was estimated at ₹ 15,00,000. The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business, was calculated as ₹ 12,00,000.

1) The current cost of the machinery is	(a) ₹ 10,00,000.	(b) ₹ 20,00,000.	(c) ₹ 15,00,000.
2) The present value of machinery is	(a) ₹ 10,00,000.	(b) ₹ 20,00,000.	(c) ₹ 12,00,000.
3) The historical cost of machinery is	(a) ₹ 10,00,000.	(b) ₹ 20,00,000.	(c) ₹ 15,00,000.
4) The realizable value of machinery is	(a) ₹ 10,00,000.	(b) ₹ 20,00,000.	(c) ₹ 15,00,000.

ACCOUNTING ESTIMATES

(a) Meaning: "Accounting Estimate" means an approximation of the amount of an item in the absence of a precise means of measurement.
As a result of uncertainties inherent in business activities, many financial statement items cannot be measured with precisions but can only be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

(b) Example:
- Estimate of bad debts
- Useful life and Residual value of depreciable assets
- Estimates of inventory obsolescence

(c) Change in Accounting Estimate: Change can occur in the following scenarios:
- As a result of new information
- As a result of more experience
- As a result of subsequent development

MULTIPLE CHOICE QUESTIONS

1) Measurement discipline deals with
   (a) Identification of objects and events.
   (b) Selection of scale.
   (c) Both (a) and (b)
2) All of the following are valuation principles except
   (a) Historical cost.
   (b) Present value.
   (c) Future value.
3) Book value of machinery on 31st March, 2023 ₹10,00,000 Market value as on 31st March, 2023 if sold ₹ 11,00,000 As on 31st March, 2023, if the company values the machinery at ₹ 11,00,000, which of the following valuation principle is being followed?
   (a) Historical Cost.
   (b) Present Value.
   (c) Realisable Value.

ANSWERS MCQs

1. (c) 2. (c) 3. (c)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) There are four generally accepted measurement bases. (i) Historical Cost; (ii) Current Cost; (iii) Realizable Value; (iv) Future Value.
2) Historical Cost means price paid at time acquisition.
3) As per future value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.
4) At Present value, liabilities are carried at the value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.
5) ABC purchased machinery amounting 10 Lakhs on 1st April, 2001. On 31st Mar, 23, similar machinery could be purchased for 20 Lakhs. Historical cost of machine is 20 Lakhs.
6) ABC purchased a machinery amounting 10 Lakhs on 1st April, 2001. On 31st Mar, 23, similar machinery could be purchased for ₹ 20 Lakhs. Current cost of machine is ₹ 20 Lakhs
7) Change in accounting estimate has to be given retrospective effect.
8) Current cost gives an alternative measurement base.

Solution

1) False: There are four generally accepted measurement bases. (i) Historical Cost; (ii) Current Cost; (iii) Realizable Value; (iv) Present Value.
2) True: Historical cost means the acquisition price.
3) False: At Realisable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal.
4) False: Liabilities are carried at the present discounted value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.
5) False: Historical cost is ₹10,00,000.
6) True: Since similar machine is purchased at 20,00,000, the current cost of machine is ₹ 20,00,000
7) False: Change in accounting estimate has not to be given retrospective effect.
8) True: Generally the value of an asset is determined on the basis of cost of acquisition. Current cost is also an alternative measurement base which means Cash and cash equivalent which is to be paid if same or an equivalent asset was acquired currently.

ACCOUNTING STANDARDS

Meaning	Accounting standards are written policy documents issued by expert accounting body or by government or other regulatory body (e.g. MCA issuing AS for corporates in consultation with NACAS) covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements.
Issues dealt by AS	➢ Recognition of events and transactions in financial statements. ➢ Measurement of these transactions and events. ➢ Presentation of these transactions & events in the financial statements in a manner that is meaningful and understandable to the reader. ➢ The disclosure requirements which should be there to enable public at large, the stakeholders and potential investors in particular, to get an insight in to what these financial statements are trying to reflect and thereby facilitating them to take prudent & informed business decisions.
Objectives	➢ The primary objective is to establish standards which have to be complied with to ensure that the financial statements are prepared in accordance with generally accepted accounting principles. ➢ To provide a standard for the diverse accounting policies and principles. ➢ To eliminate the non-comparability of financial statements. ➢ To increase/improve the reliability of the financial statements. ➢ To provide standards which are transparent for users.
Benefits	➢ Standardization of alternative accounting treatment (Reduce/eliminate the confusing variations in the accounting treatments used to prepare the financial statements) ➢ Requirement for additional disclosures. (disclosures which are not statutorily required) ➢ Comparability of financial statements.
Limitations	➢ Difficulties in making choice between different treatments. ➢ Lack of flexibilities ➢ Restricted scope (accounting standards cannot override the statute)
Formulation of AS	ICAI has constituted the Accounting Standard Board (ASB) in 1977. ASB is responsible for setting accounting standards. Although ASB is a body constituted by council of ICAI, it is independent in the formulation of AS & council of ICAI is not empowered to make any modifications in the draft AS formulated by ASB without consulting with the ASB.
Process	➢ Identification of area (where standardization is required) ➢ Constitution of study groups (for research) ➢ Preparation of draft and its circulation ➢ Ascertainment of views of different bodies (like SEBI, CBDT, C&AG) ➢ Finalization of exposure draft ➢ Comments reviewed on exposure draft (public comments) ➢ Modification of the draft ➢ Issue of AS • For Non Corporate Entities by ICAI • For Corporate Entities by Central Government of India

OVERVIEW OF ACCOUNTING STANDARDS (AS) IN INDIA

AS	AS TITLE	AS	AS TITLE
1	Disclosure of Accounting Policies	16	Borrowing Costs
2	Valuation of Inventories	17	Segment Reporting
3	Cash Flow Statements	18	Related Party Disclosures
4	Events Occurring after Balance Sheet Date	19	Leases
5	Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies	20	Earnings Per Share
6	Depreciation Accounting -Withdrawn-	21	Consolidated Financial Statements (CFS)
7	Construction Contracts	22	Accounting for Taxes on Income
8	-Withdrawn-	23	Accounting for Investment in Associates in CFS
9	Revenue Recognition	24	Discontinuing Operations
10	Accounting for fixed assets Property, Plant & Equipment	25	Interims Financial Reporting
11	Effects of changes in Foreign Exchange Rates	26	Intangible assets
12	Accounting for Government Grants	27	Financial Reporting of Interest in Joint Ventures
13	Accounting for Investments	28	Impairment of assets
14	Accounting for Amalgamation	29	Provisions, Contingent Liabilities and Contingent Assets
15	Employee Benefits		

MULTIPLE CHOICE QUESTIONS

1) Accounting Standards for Non-Corporate entities in India are issued by
   (a) Central Govt.
   (b) State Govt.
   (c) Institute of Chartered Accountants of India.

2) Accounting Standards
   (a) Harmonise accounting policies.
   (b) Eliminate the non-comparability of financial statements.
   (c) Both the above.

3) It is essential to standardize the accounting principles and policies in order to ensure
   (a) Transparency.
   (b) Consistency.
   (c) Both the above.

ANSWERS MCQs

1. (c) 2. (c) 3. (c)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Accounting standards are written policy documents issued by the expert accounting body or by the government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.
2) Accounting standards can override the statute.
3) Difficulties in making choice between different treatments is one of the benefits of accounting standards.
4) Requirements for additional disclosures is limitation of accounting standards.
5) ASB stands for Accounting standardization benchmarking.
6) There are no limitation to accounting standards.
7) Accounting Standards for non-corporate entities in India are issued by the Central Government. *(Jan 2021)*

Solution

1) True: Accounting standards are documents covering recognition, measurement, presentation and disclosure of accounting transactions and events in the financial statements.
2) False: Accounting standards can never override the statute. The standards are required to be framed within the ambit of prevailing statutes.
3) False: Difficulties in making choice between different treatments is one of the limitation of accounting standard.
4) False: Benefits of accounting standards are:
   - Standardization of alternative accounting treatments
   - Comparability of financial statements
   - Requirements for additional disclosures
5) False: ASB stands for Accounting standard Board.
6) False: Limitations of accounting standards ▪ Difficulties in making choice between different treatments ▪ Restricted scope
7) False: Accounting Standards for non-corporate entities in India are issued by the Institute of Chartered Accountants of India (ICAI).

THEORY QUESTIONS

Question 1 *(RTP Questions)*

a) Define Accounting Policies in brief. Identify few areas wherein different accounting policies are frequently encountered.
b) Discuss the limitations which must be kept in mind while evaluating the Financial Statements. *(CA Foundation Nov 2018) (4 Marks)*
c) Define revenue receipts and give examples. How are these receipts treated? Explain.
d) Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.
e) State the advantages of setting Accounting Standards
f) Distinguish between Money measurement concept and matching concept.
g) Explain Cash and Mercantile system of accounting.
h) Differentiate between Liability and Contingent Liability
i) Write short notes on
   (i) Fundamental Accounting Assumptions.
   (ii) Accounting conventions
   (iii) Measurement
   (iv) Going Concern Concept

Solution

a) Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements. Policies are based on various accounting concepts. There is no single list of accounting policies, which are applicable to all enterprises in all circumstances. Enterprises operate in diverse and complex environmental situations and so they have to adopt various policies. The choice of specific accounting policy appropriate to the specific circumstances in which the enterprise is operating, calls for considerate judgement by the management. Different accounting policies are frequently encountered in the areas like valuation of inventory and investments etc.

b) Limitations which must be kept in mind while evaluating the Financial Statements are as follows:
- The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
- Balance Sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in long run and not for the past date.
- Accounting ignores changes in some money factors like inflation etc.
- There are occasions when accounting principles conflict with each other.
- Certain accounting estimates depend on the sheer personal judgement of the accountant.
- Different accounting policies for treatment of same item add to the probability of manipulations.

c) Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.). Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.

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

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

f) Distinction between Money measurement concept and matching concept
As per Money Measurement concept, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions and events that cannot be expressed in terms of money are not recorded in the business books.
In Matching concept, all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

g) Cash and mercantile system:
Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.
On the other hand, mercantile system of accounting is a system of classifying and summarizing transactions into assets, liabilities, equity (owner's fund), costs, revenues and recording thereof. A transaction is recognized when either a liability is created/ impaired and an asset is created /impaired. A record is made on the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually. Mercantile system of accounting is generally accepted accounting system by business entities

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

i)

(i) <u>Fundamental Accounting Assumptions</u>: Fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

a. Going Concern: The enterprise is normally viewed as a going concern, i.e., as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

b. Consistency: It is assumed that accounting policies are consistent from one period to another.
c. Accrual: Revenues and costs are accrued, i.e. recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

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

(iii) Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Any measurement discipline deals with three basic elements of measurement viz., identification of objects and events to be measured, selection of standard or scale to be used, and evaluation of dimension of measurement standards or scale. Kohler defined measurement as the assignment of a system of ordinal or cardinal numbers to the results of a scheme of inquiry or apparatus of observations in accordance with logical or mathematical rules.
Three important elements of measurement are:
(1) Identification of objects and events to be measured;
(2) Selection of standard or scale to be used;
(3) Evaluation of dimension of measurement standard or scale.

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

Question 2 *(CA Foundation May 2019) (4 Marks) / (RTP May 2023)*

Distinguish between Going Concern concept and Cost concept.

Solution

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

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

Question 3 *(CA Foundation May 18) / (Nov 19) / (Dec 22) (4 Marks) / (RTP May 20) / (Nov 23)*

Distinguish between Provision and Contingent Liability.

Solution

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

Question 4 *(CA Foundation Nov 2020) (4 Marks)*

What services can a Chartered Accountant provide to the society?

Solution

The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Chartered Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems.

a) Some of the services rendered by chartered accountants to the society are briefly mentioned hereunder: Maintenance of books of accounts;
b) Statutory audit;
c) Internal Audit;
d) Taxation;
e) Management accounting and consultancy services;
f) Financial advice and financial investigations etc.
g) Other services like secretarial work, share registration work, company formation receiverships, arbitrations etc

Question 5 *(CA Foundation July 2021) (4 Marks)*

Discuss the basic considerations in distinguishing between capital and revenue expenditure.

Solution

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

(a) Nature of business: For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset. Therefore, the nature of business is a very important criterion in separating expenditure between capital and revenue.

(b) Recurring nature of expenditure: If the frequency of an expense is quite often in an accounting year then it is said to be an expenditure of revenue nature while non-recurring expenditure is infrequent in nature and do not occur often in an accounting year. Monthly salary or rent is the example of revenue expenditure as they are incurred every month while purchase of assets is not the transaction done regularly therefore, classified as capital expenditure unless materiality criteria defines it as revenue expenditure.

(c) Purpose of expenses: Expenses for repairs of machine may be incurred in course of normal maintenance of the asset. Such expenses are revenue in nature. On the other hand, expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.

(d) Effect on revenue generating capacity of business: The expenses which help to generate income/revenue in the current period are revenue in nature and should be matched against the revenue earned in the current period. On the other hand, if expenditure helps to generate revenue over more than one accounting period, it is generally called capital expenditure.

(e) Materiality of the amount involved: Relative proportion of the amount involved is another important consideration in distinction between revenue and capital.

Question 6 *(CA Foundation June 2022) (4 Marks)*

Briefly explain the following Concepts of Accounting:

(i) Money Measurement Concept
(ii) Periodicity Concept.

Solution

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

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

Unit 1: Basic Accounting Procedures: Journal Entries

CH 2A

"Experience are like waves, they come to you on shore of life, drag the sand from beneath your feet, but each wave makes you stand on a new base,"

DOUBLE ENTRY SYSTEM OF ACCOUNTING

1. Origin: Modern Accounting is based on Double Entry System which was developed in the 15th Century in Italy by Luca Pacioli, a philosopher turned mathematician. His work / treatise "Summa de Arithmetica, Geometria and Proportioni et Proportionalita" ("Everything about Arithmetic Geometry, Proportions and Proportionality"), forms the basis of present-day double entry system.
2. Meaning:
   (a) The Double Entry System is a system which analyses transactions and events into two aspects, as per the Dual Aspect Concept. In accounting terms, these two aspects are called Debit and Credit.
   (b) The Double Entry system recognizes and records both the aspects (i.e. Debit and Credit) of every transaction and event in a systematic manner.
3. Significance / Advantages: The Double Entry System -
   (a) Ensures arithmetical accuracy of accounting process, so that at all points of time the total of Debits equal to the sum of Credits.
   (b) Provides basis for the fundamental accounting equation, i.e. Equity + Liabilities= Assets.
   (c) Permits maintenance of accounts, in as much details as necessary, and provides a useful information system for decision -making process.
   (d) Provides smooth and effective comparison of financial information over various time periods.
   (e) Helps in ascertainment of the correct profit / loss; along with details thereof, i.e. result of operations or performance during the period.
   (f) Aids in reporting the financial position as on a particular date, i.e. Balance Sheet can be prepared.
   (g) Ensures compliance with legal requirements, e.g. Companies Act requires maintenance of -accounting records under Double-Entry System only.

ACCOUNT - MEANING

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

Model Format of an "Account"

Dr. ◄——► Left Side ◄————► Account ◄————► Right Side ◄——► Cr.

Date	Particulars	Ref.	Amount (₹)	Date	Particulars	Ref.	Amount (₹)
	Opening Bal.		XXX		----		XXX
	----		XXX		Transactions		XXX
	Transactions		XXX				XXX
			XXX		Closing Bal.		XXX
	Total		XXXXX		Total		XXXXX

Notes:

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

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

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

APPROACHES TO ACCOUNTING – 2 METHODS

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

1. Accounting Equation Approach: Here, the dual aspect of each transaction is identified by reference to the impact on the basic accounting equation, i.e. Equity + Liabilities = Assets.

2. Traditional Approach: Each transaction is recorded in the books by reference to the rules of Debit and Credit only. These Rules are called Golden Rules of Accounting.

ACCOUNTING EQUATION APPROACH

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

2. The rules for debiting / crediting the various account types are given below
   (a) Increase in Equity / Liabilities / Incomes represent Credits, while decreases thereof are Debits.
   (b) Increase in Assets / Expenses represent Debits, while decreases thereof are Credits.

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

"Debit Balance Account"	Total of Debit Side > Total of Credit Side
"Credit Balance Account"	Total of Credit Side > Total of Debit Side
"Nil Balance Account"	Total of Debit Side = Total of Credit Side

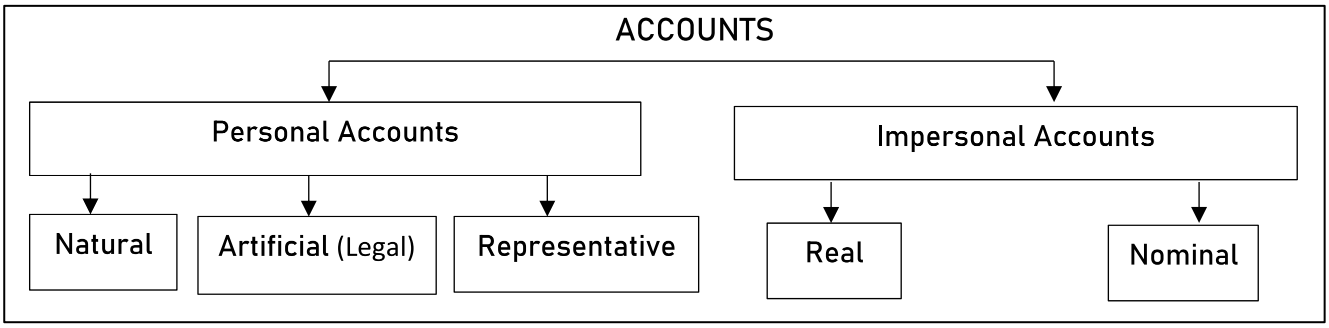
4. Type of Account and Nature of Balance:

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

TRADITIONAL APPROACH – GOLDEN RULES OF ACCOUNTING

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

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



	Type of Account	Description and Examples
Personal Accounts	Natural Personal Accounts	All Accounts which record transactions of Natural human beings, i.e. Ram, Lakshman, Krishna, Joseph, Kabir, Debtors, Creditors etc.
	Artificial (Legal) Personal Accounts	All Accounts which record the transactions with other business entities having separate legal status for accounting purposes, i.e. Ram Industries Ltd. (Company), Government, Co-operative Societies, Clubs, etc.
	Representative Personal Accounts	All Accounts which indirectly represent persons. *For Example* **Name of the Account** — **Indirectly represents** Capital Account — Owner Outstanding Expenses — Service Provider / Supplier Prepaid Expenses — Service Provider / Supplier Accrued Incomes — Customers Pre Received Income — Customers
Impersonal Accounts	Real Accounts	All Accounts which record transactions relating to Assets of the Firm (but not except those covered under Personal A/c above - i.e. Debtors, Prepaid expenses etc.) *For Example*: Building, Machinery, Cash, Investments, etc.
	Nominal Accounts	All Accounts which record transactions relating to – • Incomes / Gains, e.g. Sales, Rent / Interest / Dividend / Commission Received, Profit on Sale of Fixed Assets, etc. • Expenses / Losses, e.g. Salary, Wages, Rent Paid, Insurance, Bad Debts, Depreciation, Discounts allowed, etc.

MEANING OF PROFITS / LOSSES AND FINANCIAL POSITION

1. Profit / Losses: The Main Purpose of a business is to achieve profits. "Profits" means Excess of Incomes over expenses. "Losses" refers to excess of Expenses over Incomes. Hence, Profits / Losses are concerned with Incomes / Gains and Expenses / Losses of the business. (Otherwise called as Operating Results)
2. Financial Position: It refers the wealth of the business. A business is wealthier when it has more assets and less outside liabilities. Hence, Financial Position is concerned with the assets and Liabilities of the business.

DETERMINATION OF PROFITS / LOSSES AND FINANCIAL POSITION

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

2. Using Accounting Equation Approach:

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

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

Purpose	Method of Determination
Determination of Profits / Losses	2 Accounts –"Trading Account & Profit & Loss Account' prepared Those two accounts compare the Incomes and Expenses to ascertain the profits.
Determination of Financial Position	Balance Sheet is prepared: It is a Statement showing all ASSETS on right side and of all LIABILITIES on left side. The Total of Assets and Liabilities shall be equal.

JOURNAL - MEANING

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

3. Purposes of Journal: Based on Dual Aspect Concept, every transaction has two equal aspects - Debit and Credit. Hence, it is essential to identify the accounts which are involved and to decide the accounts to be debited / credited.
4. Journalising: Recording entries in Journal is called "Journalising the Entries". Each entry is called as "Journal Entry".
5. Source for recording: The sources available for recording in the Journal are (a) Vouchers (b) Documents (c) Invoices.
   (Note: Source documents means all documents in books which contain financial records & act as evidence of transactions)
6. The format of the Journal is as under –

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

Narration

Cash A/c is in 100th Page in Ledger

EQUAL

7. Types of Journal Entries:

Type	Meaning
Simple Journal Entry	One Debit and One Credit present for equal amount
Compound Journal Entry	It is a journal entry which contains one debit and two or more credits / two or more debits and one credit/ two or more debits and credits.

8. Advantages of Journal:
   (a) Since Journal is maintained in chronological, i.e. date wise order, complete information on day-to-day transactions can be obtained.
   (b) Journal forms the basis for posting the entries into the Ledger subsequently.
   (c) Narration to Journal Entries provides explanation for the nature and purpose of transaction.

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

ACCOUNTING FOR GST

Introduction to GST

Goods and Services Tax (GST) is a comprehensive Indirect Tax* which has subsumed multiple Indirect Taxes in India such as State Value added Tax (VAT) which was levied on sale of goods, Excise Duty, which was levied on manufacture or production of goods, Service Tax which was levied on provision of services etc. GST is a single tax on the supply of goods and services, right from the manufacturer to consumer.

** An indirect tax is a tax whose incidence is borne by the consumers who ultimately consume the product or service. The immediate liability to pay the tax may fall upon another person such as a manufacturer or provider of service or seller of goods, but the same is collected from the person purchasing the goods (recipient of goods or services).*

Salient features of GST

a) GST is levied on supply i.e., manufacture or sale of goods and provision of services. In other words, supply is taxable event which own its occurrence creates or attracts the liability to pay tax.
b) Under GST, tax is levied only on the value added at each stage of the supply chain.
c) GST is a destination-based consumption tax, i.e. the tax is levied at the place where the goods or services are consumed, rather than the place where they are produced.
d) There is no tax on tax or cascading of taxes under GST system.
e) Under GST, there is a harmonization of laws, procedures and rates of tax across the country.

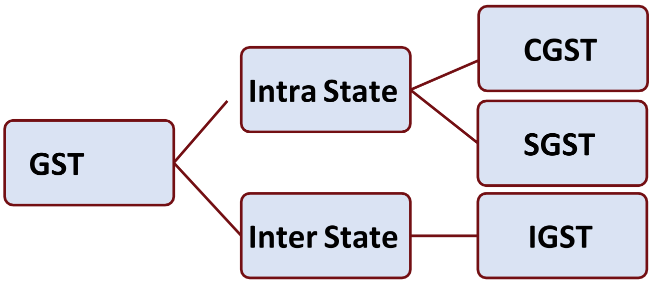
Types of Taxes under GST

Before going through the types of taxes under GST, it is important to understand the concept of intra-State supply and inter-State supply under GST which determines the type of tax to be charged by the supplier. The Concept of intra-state supply & inter-state supply depends upon on the location of the supplier & place of supply (place where goods/services are consumed. As a general rule, where the location of the supplier and the place of supply of goods or services are in the same State/Union territory, it is treated as intra-State supply of goods or services respectively.
Similarly, where the location of the supplier and the place of supply of goods or services are in (i) two different States or (ii) two different Union Territories or (iii) a State and a Union territory, it is treated as inter-State supply of goods or services respectively.

GST has a dual aspect with the Centre and States simultaneously levying on a common tax base. There are three main components of GST which are:

a) Central Goods and Service Tax (CGST) is levied and collected by the Centre on the "Intra - State" supply of goods and services.
b) State Goods and Services Tax (SGST) is levied and collected by the State Governments (including Union Territories with legislature, for example Delhi, Pondicherry, Jammu and Kashmir) on "Intra state" supply of goods and services
c) Union Territory Goods and Service Tax (UTGST) is levied and collected by Union Territories without Legislatures [i.e. Andaman and Nicobar Islands, Lakshadweep, Ladakh, Dadra and Nagar Haveli & Daman and Diu and Chandigarh] on "intra-state" supply of goods and services.
d) Integrated Goods and services tax (IGST): It is the GST levied on the "inter state" supply of goods and services and is collected by the Centre. IGST is equivalent to the sum total of CGST and SGST.

GST is a "Consumption Based Tax" i.e. the tax is received by the State in which the goods or services are consumed & not by the state in which the goods and services are manufactured.



Input and Output GST

The tax paid by the recipient on procurement of goods /services is called Input tax. An entity at each stage is permitted to avail credit of GST paid on the purchase of goods and /or availment of services and can set off this credit against the GST payable on the goods and/or services supplied by him. Thus, the final consumer bears the GST charged in the supply chain, with set-off benefits at all the previous stages. Hence, the tax will be levied only on the value added, which results in avoiding double taxation.

For example, if tax payable by a manufacturer on the output, i.e. final product is ₹750 and he has already paid tax on ₹500 on input, i.e. purchases, then he can claim 'Input Credit' of ₹500 and he needs to deposit only ₹250 in cash.

Output tax means the GST charged on supply of goods or services made by a supplier.

Input tax means the credit of Input tax already paid.

Utilisation of Input Tax Credit under GST

Tax credit of CGST, SGST and IGST can be utilized in the following manner:

- Utilization of IGST Credit: IGST credit has to be first utilized against IGST liability and if any balance is still available, the same can be utilized against CGST or/and SGST in any order and in any proportion.
- Utilization of CGST Credit: CGST credit has to be first utilized against CGST liability and if any balance is available, same can be utilized against IGST. However, CGST credit cannot be utilized against SGST.
- Utilization of SGST Credit: SGST credit has to be first utilized against SGST liability and if any balance is available, same can be utilized against IGST. However, SGST credit cannot be utilized against CGST.

	Input GST (credit can be availed, hence asset)	Output GST (charged to the consumer, payable by the supplier, hence liability)
Nature	At the time of purchases of goods (including fixed assets) or services, Input GST A/c (CGST & SGST or IGST) is debited.	At the time of sale of goods/assets or supply of services, Output GST A/c (CGST & SGST or IGST) is credited.
Intra-state transaction	CGST paid is debited to "Input CGST A/c" & SGST paid is debited to Input SGST".	CGST charged is credited to "Output CGST A/c" and SGST charged is credited to "Output SGST A/c "
Inter-state transaction	IGST paid is debited to "Input IGST A/c".	IGST charged is credited to "Output IGST A/c"

Reversal of GST	Input GST paid at the time of purchase are reversed in the following situations: • Purchases Return • Drawings • Goods distributed as free samples • Goods distributed as gift (if the same does not qualify as "supply under GST"). • Goods lost in fire or theft. • Input tax credit of supplies which are not allowed to be availed by recipient.	Output GST charged is reversed when the goods are returned by the purchaser.
Utilization of Input tax credit	Input GST A/c is credited when tax is paid by utilizing input tax.	

Double entry book-keeping with GST

The Double entry book-keeping records need to show the GST values separately so that the purchases, expenses and sales are posted net i.e. without the addition of GST.

Journal entry in case of Purchase of Goods or services

Purchases A/c Dr. Net Amount (excluding GST)
Input GST A/c Dr. Amount of GST
To Account Payable/Creditors Gross Amount (including GST)

Journal entry in case of Sales of Goods or services

Account Receivable/Debtors A/c Dr. Gross Amount (including GST)
To Sales A/c Net Amount (excluding GST)
To Output GST Amount of GST

Journal entry in case of Utilization of Input Tax Credit towards payment of Output Tax

Output CGST A/c Dr.	Amount of GST liability
Output SGST A/c Dr.	Amount of GST liability
Output IGST A/c Dr.	Amount of GST liability
To Input CGST A/c	Amount of output GST liability paid utilizing Input CGST
To Input SGST A/c	Amount of output GST liability paid utilizing Input SGST
To Input IGST A/c	Amount of output GST liability paid utilizing Input IGST

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Following are the transactions entered into by R after he started his business. Show how various accounts will be affected by these transactions:

2023 April		(₹ in 000)
1.	R started business with	5,000
2.	He purchased furniture for	1,200
3.	Paid salary to his clerk	1,100
4.	Paid rent	1,150
5.	Received interest	2,000

Solution

2023 April	Explanation	Accounts Involved	Nature of Accounts	How affected	Debit (₹ in 000)	Credit (₹ in 000)
1.	₹ 5,000 cash invested in business	Bank and R's Capital	Asset Capital	Increased Increased	5,000	 5,000
2.	Purchased furniture for ₹ 1,200	Furniture and Bank	Asset Asset	Increased Decreased	1,200	 1,200
3.	Paid ₹ 1,100 salary to employee	Salary & Bank	Expense Asset	Increased Decreased	1,100	 1,100
4.	Paid Rent ₹ 1,150	Rent & Bank	Expense Asset	Increased Decreased	1,150	 1,150
5.	Received interest ₹ 2,000	Cash & Interest	Asset Income	Increased Increased	2,000	 2,000

Question 2 *(ICAI Study Material)* *Pg no._____*

Make accounting equation from following information available at the beginning of accounting period:

Particulars	(₹ in 000)
Capital	51,000
Loan	11,500
Trade payables	5,700
Fixed Assets	12,800
Inventory	22,600
Trade receivables	17,500
Cash and Bank	15,300

At the end of the accounting period the balances appear as follows:

Particulars	(₹ in 000)
Capital	?
Loan	11,500
Trade payables	5,800
Fixed Assets	12,720
Inventory	22,900
Trade receivables	17,500
Cash and Bank	15,600

(a) Reset the equation and find out profit.

(b) Prepare Balance Sheet at the end of the accounting period.

Question 3 *(ICAI Study Material)/(RTP May 2018)/(May 2021)/(Nov 2022) (Similar)* *Pg no._____*

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

a) Employees had taken inventory worth ₹ 1,00,000 (Cost price ₹ 75,000) on the eve of Deepawali and the same was deducted from their salaries in the subsequent month.
b) Wages paid for erection of Machinery ₹ 18,000
c) Income tax liability of proprietor ₹ 17,000 was paid out of petty cash.
d) Purchase of goods from Naveen of the list price of ₹ 2,00,000. He allowed 10% trade discount, ₹ 5,000 cash discount was also allowed for quick payment.

Question 4 *(ICAI Study Material)* *Pg no._____*

Mr. Dravid has provided following details related to his financials. Find out the missing figures:

Particulars	(₹ in 000)
Profits earned during the year	5,000
Assets at the beginning of year	A
Liabilities at the beginning of year	12,000
Assets at the end of the year	B
Liabilities at the end of the year	C
Closing capital	35,000
Total liabilities including capital at the end of the year	50,000

Question 5 *(RTP Nov 2018) / (Nov 2019) / (Nov 2020) / (May 2023) (Similar)* *Pg no._____*

Pass journal entry in each of the following cases.

a) A running business purchased by Mohan with following assets & liabilities: Cash ₹ 2,000, Land ₹ 4,000, Furniture ₹ 1,000, Stock ₹ 2,000, Creditors ₹ 1,000, Bank Overdraft ₹ 2,000.
b) Goods distributed by way of free samples, ₹ 1,000.
c) Rahim became insolvent & could pay only 50 paise in a rupee. Amount due from him ₹ 600.

Question 6 *(ICAI Study Material)* *Pg no._____*

Journalise the following transactions in the books of Mr. Rohit:

i. Purchased goods from Sahil for ₹ 50,000 plus CGST and SGST @ 9% each.
ii. Purchased goods from Sam for ₹ 40,000 at a trade discount of 10% plus CGST and SGST @ 9% each. ₹ 20,000 was paid immediately and balance payable after 3 months.
iii. Goods costing ₹ 20,000 withdrawn for personal use. Such goods were purchased by paying CGST and SGST @ 9% each.
iv. Paid rent to Gagandeep for ₹ 20,000 plus CGST and SGST @ 6% each.
v. Goods costing ₹ 5,000 (before trade discount of 10%) returned to Sam. Such goods were purchased by paying CGST and SGST @ 9% each.
vi. Purchased furniture for ₹ 44,800 including IGST @ 12%.
vii. Purchased machinery from M/s Symphony industries for ₹ 1,40,000 plus CGST and SGST @ 9% each. Paid ₹ 1,00,000 immediately and balance to be paid after two months.

Solution

In the books of Mr. Rohit

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Purchases A/c Dr.		50,000	
	Input CGST A/c (50,000 x 9%) Dr.		4,500	
	Input SGST A/c (50,000 x 9%) Dr.		4,500	
	To Sahil's A/c			59,000

	(Being goods purchased from Sahil, CGST and SGST paid @ 9% each)			
(ii)	Purchases A/c (40,000 x 90%) Dr.		36,000	
	Input CGST A/c (36,000 x 9%) Dr.		3,240	
	Input SGST A/c (36,000 x 9%) Dr.		3,240	
	To Sam's A/c			22,480
	To Bank A/c			20,000
	(Being goods purchased from Sam, CGST and SGST payable @ 9% each)			
(iii)	Drawings A/c* Dr.		23,600	
	To Purchase A/c			20,000
	To Input CGST A/c (20,000 x 9%)			1,800
	To Input SGST A/c (20,000 x 9%)			1,800
	(Being goods withdrawn for personal use and input GST and input SGST debited at the time of purchase reversed)			
(iv)	Rent A/c Dr.		30,000	
	Input CGST A/c (30,000 x 6%) Dr.		1,800	
	Input SGST A/c (30,000 x 6%) Dr.		1,800	
	To Gagandeep A/c			33,600
	(Being rent paid to Gagandeep)			
(v)	Sam's A/c Dr.		5,310	
	To Purchases Return A/c ** (5,000 – 10% trade Discount)			4,500
	To Input CGST A/c (4,500 x 9%)			405
	To Input SGST A/c (4,500 x 9%)			405
	(Being goods returned to Sam and input CGST & SGST debited at the time of purchases reversed)			
(vi)	Furniture A/c (WN 1) Dr.		40,000	
	Input IGST A/c Dr.		4,800	
	To Bank A/c			44,800
	(Being furniture purchased paid IGST @ 12%)			
(vii)	Machinery A/c Dr.		1,40,000	
	Input CGST A/c (1,40,000 x 9%) Dr.		12,600	
	Input SGST A/c (1,40,000 x 9%) Dr.		12,600	
	To Bank A/c			1,00,000
	To Symphony Industries			65,200
	(Being machinery purchased and paid ₹ 1,00,000 immediately, CGST and SGST @ 9% each)			

* The input tax availed earlier is reversed, because these goods are 'consumed' by Mr. Rohit himself. Since he cannot 'sell' goods to himself and charged output tax, the input tax thereon is reversed, since in this case Mr. Rohit himself is the ultimate consumer of those goods.

** Since goods are returned to the supplier, the input tax credit availed earlier on those goods is to be reversed, since these goods are no longer available to be sold.

Working Note:

1. Furniture purchased is including IGST @ 12%. So, value of furniture excluding IGST = ₹ 44,800 × 100/112 = ₹ 40,000. IGST = ₹ 40,000 × 12% = ₹ 4,800.

Question 7 *(ICAI Study Material)* *Pg no._____*

Journalise the following transactions in the books of Ms. Nidhi traders for the month of July, 2022

3 Sold Goods for ₹ 50,000, charged CGST and SGST @ 6% each.
4 Sold goods to Surjeet for ₹ 28,000 including CGST and SGST @ 6% each.
5 Received ₹ 25,200 from Surjeet in full settlement of his account of ₹ 28,000.
6 Sold goods to Kapil for ₹ 30,000 charged IGST @ 12%. Received ₹ 12,000 immediately and balance to be received after one month.
10 Kapil was allowed rebate of ₹ 5,000 as goods supplied to him were defective. These goods were sold by charging IGST @ 12%.
12 Sold goods to Manpreet for ₹ 1,00,000 at trade discount of 20% and charged IGST @ 12%
13 Goods of list price ₹ 20,000 returned by Manpreet.
17 Received commission of ₹ 15,000, charged CGST and SGST @ 6% each.

Solution

In the Books of Ms. Nidhi
Journal

July 2022	Particulars	L.F.	Dr. (₹)	Cr. (₹)
3	Bank A/c Dr.		56,000	
	To Sales A/c			50,000
	To Output CGST A/c			3,000
	To Output SGST A/c			3,000
	(Being goods sold for cash, charged CGST and SGST @ 6% each)			
4	Surjeet's A/c Dr.		28,000	
	To Sales A/c			25,000
	To Output CGST A/c			1,500
	To Output SGST A/c			1,500
	(Being goods sold to Surjeet, charged CGST and SGST @ 6% each)(refer W.N.)			
5	Bank A/c Dr.		25,200	
	Discount Allowed A/c Dr.		2,800	
	To Surjeet A/c			28,000
	(Being amount received from Surjeet in full settlement of ₹ 14,000 after allowing him discount of ₹ 1,400)			
6	Bank A/c Dr.		12,000	
	Kapil's A/c Dr.		21,600	
	To Sales A/c			30,000
	To Output IGST A/c			3,600
	(Being goods sold to Kapil, charged IGST @ 12% and received ₹ 12,000 in cash and balance receivable after one month)			
10	Rebate A/c * Dr.		5,000	
	Output IGST A/c Dr.		600	
	To Kapil's A/c			5,600
	(Being rebate allowed on goods sold to Kapil, Output IGST charged at the time of sales, now reversed)			

12	Manpreet's A/c Dr.		89,600	
	To Sales A/c (1,00,000 x 80%)			80,000
	To Output IGST A/c (80,000 x 12%)			9,600
	(Being goods sold to Manpreet at trade discount of 20% and charged IGST @ 12%)			
13	Sales Return A/c Dr.		16,000	
	Output IGST A/c Dr.		1,920	
	To Manpreet A/c			17,920
	(Being goods returned by Manpreet and Output IGST charged at the time of sales now reversed)			
17	Cash A/c Dr.		16,800	
	To Commission A/c			15,000
	To Output CGST A/c (15,000 x 6%)			900
	To Output SGST A/c (15,000 x 6%)			900
	(Being commission received charged CGST and SGST @ 6% each)			

*Since rebate is on account of defective goods which cannot be sold/utilized further by Kapil, the output GST charged thereon is also reversed. This treatment is like that of Sales Return. If rebate was on account of other reasons (such as prompt payment), Output IGST would not be reversed.

Working Note:

Goods sold to Surjeet is including CGST and SGST @ 6% each. So, sales excluding CGST and SGST = ₹ 28,000 × 100/112 = ₹ 25,000. CGST and SGST = ₹ 25,000 × 6% = ₹ 1,500 each.

Question 8 *(ICAI Study Material)* Pg no.______

Record the following transactions in a Journal, assuming CGST and SGST@ 6% each.

(i) Sold goods to Mukesh at the list price of ₹ 50,000 less 20% trade discount.

(ii) Sold goods to Mukesh at the list price of ₹ 1,00,000 less 20% trade discount and 5% cash discount.

(iii) Sold goods to Mukesh at the list price of ₹ 1,50,000 less 20% trade discount and 5% cash discount. Out of the amount due 60% is received out of which three-fourth is received by cheque.

Solution

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Mukesh A/c Dr.		44,800	
	To Sales A/c			40,000
	To Output CGST A/c			2,400
	To Output SGST A/c			2,400
	(Being goods sold to Mukesh at a trade discount of 20% charged CGST and SGST @ 6% each)			
(ii)	Discount Allowed A/c Dr.		4,000	
	Bank A/c Dr.		85,600	
	To Sales A/c			80,000
	To Output CGST A/c			4,800
	To Output SGST A/c			4,800
	(Being goods sold to Mukesh at a trade discount of 20% and 5% cash discount, charged CGST and SGST @ 6% each)*			

(iii)	Discount Allowed A/c (1,20,000 x 5%) Dr.		6,000	
	Bank A/c Dr.		57,780	
	Cash A/c Dr.		19,260	
	Mukesh's A/c (refer W. N.) Dr.		51,360	
	To Sales A/c (1,50,000 x 80%)			1,20,000
	To Output CGST A/c (1,20,000 x 6%)			7,200
	To Output SGST A/c (1,20,000 x 6%)			7,200
	(Being goods sold to Mukesh at a trade discount of 20% and 5% cash discount and received 60%, charged CGST and SGST @ 6% each)			

Note: After allowing cash discount of ₹ 4,000 (₹ 80,000 × 5%), the balance of ₹ 85,600 is received. Since discount is on account of prompt payment, output CGST and SGST is computed on value determine after deducting trade discount.

Working Note: After allowing cash discount of ₹ 6,000 on ₹ 1,20,000, 60% of the balance amount i.e. ₹ 1,28,400 (₹ 1,20,000 + 12% GST ₹ 14,400 – discount ₹ 6,000) is paid in cash and by cheque.
Hence, the amount paid in cash and cheque = ₹ 1,28,400 × 60% = 77,040.
Amount paid by cheque = ₹ 77,040 × 3/4 = ₹ 57,780
Amount paid in cash = ₹ 77,040 x 1/4 = 19,260
Mukesh's A/c = (₹ 1,20,000 + ₹ 14,400 – ₹ 6,000 – ₹ 57,780 – ₹ 19,260) = ₹ 51,360

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) The rent paid to landlord is credited to
   a) Landlord's account
   b) Rent account
   c) Cash account

2) In case of a debt becoming bad, the amount should be credited to
   a) Trade receivables account
   b) Bad debts account
   c) Cash account

3) A Ltd. has a ₹ 35,000 account receivable from Mohan. On January 22, Mohan makes a partial payment of ₹ 21,000 to A Ltd. The journal entry made on January 22 by A Ltd. to record this transaction includes:
   a) A credit to the cash received account of ₹ 21,000
   b) A credit to the Accounts receivable account of ₹ 21,000
   c) A debit to the cash account of ₹ 14,000

4) Which financial statement represents the accounting equation – Assets = Liabilities + Owner's equity:
   a) Income Statement
   b) Statement of Cash flows
   c) Balance Sheet.

5) Which account is the odd one out?
   a) Office furniture & Equipment.
   b) Freehold land and Buildings.
   c) Inventory of materials.

6) The debts written off as bad, if recovered subsequently are
   a) Credited to Bad Debts Recovered Account
   b) Credited to Trade receivables Account.
   c) Debited to Profit and Loss Account.

7) In Double Entry System of Book-keeping every business transaction affects:
   a) Two accounts
   b) Two sides of the same account.
   c) The same account on two different dates.

8) A sale of goods to Ram for cash should be debited to:
   a) Ram
   b) Cash
   c) Sales

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) In Accounting Equation Approach, Equity + Long Term Liabilities = Fixed Assets + Current Assets – Current Liabilities
2) In the Traditional Approach, a debtor becomes receiver.
3) The rule of nominal account states that all expenses & losses are recorded on credit side.
4) Journal Proper is also called subsidiary book.
5) Capital account has a debit balance.
6) Purchase account is a nominal account.
7) All the personal & real account are recorded in P&L Acc.
8) Asset side of balance sheet contains all the personal & nominal accounts.
9) Capital account is personal account.
10) Journal is also known as book of original entry.
11) Patent Rights is in the nature of Nominal Account.
12) Goodwill is not a fictitious asset.
13) Goodwill is a current asset.
14) Outstanding expenditure is a nominal account.
15) Patent Right is in the nature of Real Account.
16) The return of goods by a customer should be debited to Return Outward Account.
17) Goods worth ₹ 600 taken by the proprietor for personal use should be credited to purchase account.
18) Rent paid account is a Nominal Account whereas, Rent received account is a Real Account.
19) Goods worth ₹ 600 taken by the proprietor for personal use should be credited to Capital Account.
20) Capital + Long Term Liabilities = Fixed Assets + Current Assets + Cash – Current Liabilities

Solution

1) True: As per modern accounting equation approach-it is the basic formula in the accounting process.
2) True: In the traditional approach, a debtor becomes receiver.
3) False: The rule of nominal account states that all expenses & losses are recorded on debit side
4) True: It is one of the books where in the transactions not entered in other books are entered in this book
5) False: Capital account has a credit balance
6) True: As it is considered as an expense.
7) False: All the personal & real accounts are recorded in balance sheet
8) False: Asset side of balance sheet contains all the personal & real accounts
9) True: As it in the name of the proprietor who is bringing in the capital to the business
10) True: As the transactions are entered first in this book as a first hand record.
11) False: - It is a Real A/c because it is an intangible asset.
12) True: - Goodwill is an intangible asset.
13) False: - Goodwill is a fixed asset and is in the nature of Real A/c. It is not a fictitious asset but an intangible asset.
14) False: - It is a personal account as it represents a liability due to some person.
15) True: - It is an intangible asset and is in the nature of Real account.
16) False: - It is debited to Return Inwards A/c.
17) True: - Goods taken by the proprietor for personal use should be debited to Drawings Account and Credited to Purchase Account.

18) False: - Rent is an either income or expense so it is a nominal account whether it is received or receivable or paid or payables.
19) False: Goods taken by the proprietor for personal use should be credited to Purchases Account as less goods are left in the business for sale.
20) False: The right hand side of the equation includes cash twice – once as part of current assets and another separately. The basic accounting equation is Equity + Long Term Liabilities = Fixed Assets + Current Assets – Current Liabilities

SHORT NOTE ON CLASSIFICATION OF ACCOUNTS

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

1) Assets: These are resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise, namely cash, stock of goods, land, buildings, machinery etc.
2) Liabilities: These are financial obligations of an enterprise other than owner's equity namely long term loans, creditors, outstanding expenses etc.
3) Capital: It generally refer to the amounts invested in an enterprise by its owner(s), the accretion to it or a reduction in it. Since capital is affected by expenses and incomes of revenue nature, there are two more categories of accounts, namely expenses and incomes. The difference between incomes and expenses are taken into capital account.
    - Expenses: These represents those accounts which show the amount spent or even lost in carrying on operations.
    - Incomes: These represent those accounts which show the revenue amounts earned by the enterprise.

However, traditionally accounts are classified as follows:

1) Personal Accounts: These accounts relate to persons, institutions, debtors or creditors.
2) Impersonal Accounts: These represent accounts which are not personal. These can be further sub-divided as follows:
    - Real Accounts: These accounts relate to assets of the firm but not debt e.g. accounts relating to land, buildings, cash in hand etc.
    - Nominal accounts: These accounts relate to expenses, losses, gains, revenues etc.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

Analyse transactions of M/s Sahil & Co. for the month of March, 2023 on the basis of double entry system by adopting the following approaches:
(A) Accounting Equation Approach.
(B) Traditional Approach.
Transactions for the month of March, 2023 were as follows (figures are in '000):
1. Sahil introduced capital through bank of ₹ 4,000.
2. Cash withdrawn from the City Bank ₹ 200.
3. Loan of ₹ 500 taken from Mr. Y.
4. Salaries paid for the month of March, 2023, ₹ 300 and ₹ 100 is still payable for the month of March, 2023.
5. Furniture purchased ₹ 500.

What conclusions one can draw from the above analysis?

Question 2 *(ICAI Study Material)* Pg no._____

Journalise the following transactions. Also state the nature of each account involved in the Journal entry.
1) December 1, 2023, Ajit started business with capital ₹ 4,00,000
2) December 3, he withdrew cash for business from the Bank ₹ 2,000.
3) December 5, he purchased goods making payment through bank ₹ 15,000.
4) December 8, he sold goods ₹ 16,000 and received payment through bank.
5) December 10, he purchased furniture and paid by cheque ₹ 2,500.
6) December 12, he sold goods to Arvind ₹ 2,400.
7) December 14, he purchased goods from Amrit ₹ 10,000.
8) December 15, he returned goods to Amrit ₹ 500.
9) December 16, he received from Arvind ₹ 2,300 in full settlement.
10) December 18, he withdrew goods for personal use ₹ 1,000.
11) December 20, he withdrew cash from business for personal use ₹ 2,000.
12) December 24, he paid telephone charges ₹ 110.
13) December 26, amount paid to Amrit in full settlement ₹ 9,450.
14) December 31, paid for stationery ₹ 200, rent ₹5,000 and salaries to staff ₹ 2,000 from bank
15) December 31, goods distributed by way of free samples ₹ 2,000.

Question 3 *(ICAI Study Material)* Pg no._____

Show the classification of the following Accounts under traditional and accounting equation approach: (a) Building; (b) Purchases; (c) Sales; (d) Bank Fixed Deposit; (e) Rent; (f) Rent Outstanding; (g) Cash; (h) Adjusted Purchases; (i) Closing Inventory; (j) Investments; (k) Trade receivables; (l) Sales Tax Payable, (m) Discount Allowed; (n) Bad Debts; (o) Capital; (p) Drawings; (q) Interest Receivable account; (r) Rent received in advance account; (s) Prepaid salary account; (t) Bad debts recovered account; (u) Depreciation account, (v) Personal income-tax account.

Question 4 *(ICAI Study Material)* Pg no._____

Transactions of Ramesh for April are given below. Journalise them.

2023	Particulars	Amount
April 1	Ramesh started business with	10,00,000
April 3	Bought goods for cash	50,000

April 5	Drew cash from bank	10,000
April 13	Sold to Krishna- goods on credit	1,50,000
April 20	Bought from Shyam goods on credit	2,25,000
April 24	Received payment from Krishna Allowed him discount	1,45,000 5,000
April 28	Paid Shyam cash Discount allowed	2,15,000 10,000
April 30	Cash sales for the month	8,00,000
	Paid Rent	50,000
	Paid Salary	1,00,000

Question 5 *(ICAI Study Material)* Pg no.______

Calculate the missing amount for the following

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

Question 6 *(ICAI Study Material)* Pg no.______

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

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

Also give reasons for your answers.

Question 7 *(ICAI Study Material)* Pg no.______

Following is the information provided by Mr. Gopi pertaining to year ended 31st March 2023. Find the unknowns, showing computation to support your answer:

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

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

Question 8 Pg no.______

Find out the profit for the year through accounting equation approach:-

Particulars	31.03.2020	31.03.2021
Capital	1,00,000	?
12% Bank Loan	1,00,000	1,00,000
Trade Payables	75,000	70,000
Fixed Assets	1,25,000	1,10,000
Trade Receivables	75,000	80,000
Inventory	70,000	80,000
Cash & Bank	5,000	6,000

Question 9 *(RTP May 2022)* *Pg no._____*

You are required to pass necessary journal entries in the books of Kewal:

a) Cheque amounting ₹ 9,000 from Hari Krishan in full settlement of his account for ₹ 10,000.
b) Withdrawn for personal use: Goods (Sales Price ₹ 8,000, Cost ₹ 6,000), cash ₹1,000
c) Goods costing ₹ 3,000 (Sale price ₹4,000) distributed as free samples.
d) Received commission ₹ 10,000, half of which does not relate of current year and is received in advance.
e) Purchased second hand machinery from Jawahar for ₹30,000 against a cheque. Goods of ₹ 12,000 (Cost ₹ 9,000) used in repairs of this machinery which is necessary to make it ready for working.

Question 10 *(RTP May 2023)* *Pg no._____*

Write a short note on Journal.

Question 11 *(CA Foundation June 2023) (5 Marks)* *Pg no._____*

What are the importance of Journal?

Unit 2: LEDGERS

CH 2B

The 4 Look- Look Back and get experience, Look Forward and see hope!, Look Around and find reality!, Look Within and find confidence!"

MEANING

Meaning:

It is an Account Book which contains all Account Heads, which are opened in Journal/ Subsidiary Books

Significance:

Ledger helps to identify the list of transactions under a particular Account Head & also show the Balances in each of ledger accounts. This helps in ascertaining the status of that Account. For example: Cash Account contains all transactions involving cash. Hence, by looking at the cash account, the reader can find out the sources from which cash is received and also the reasons for use of such cash. It also shows cash balance in the business on a specified date.

Other Names for Ledger:

Principal Book	Debit and Credit aspect of each transaction is recorded here and constitute basis for preparation of Trial Balance & Final Accounts.
Secondary Book of Entry	It is the second stage in the Accounting Process.
Book of Final Entry	The Ledger is the Final Destination of all transactions.

Source of Ledger:

- The Entries in the Journal/ Subsidiary Books forms the basis for preparation of ledger.
- Without passing an entry in the Journal/Subsidiary Books, an entry cannot appear in ledger.
- Transactions in the ledger are recorded in an analytical order.

POSTING

Posting: The process of transferring the debit and credit items from journal to classified accounts in the ledger is known as posting.

Rules Regarding Posting of Entries in Ledger *(RTP Nov 2019/Nov 2023)*

a) Separate account is opened in ledger book for each account and entries from ledger posted to respective account accordingly.

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

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

Model Format of a Ledger "Account"

<table>
<tr><th>Date</th><th>Particulars</th><th>Journal Folio</th><th>Amount (₹)</th><th>Date</th><th>Particulars</th><th>Journal Folio</th><th>Amount (₹)</th></tr>
<tr><td></td><td>Opening Balance</td><td></td><td>XXX</td><td></td><td rowspan="3">By-Transactions</td><td></td><td>XXX</td></tr>
<tr><td></td><td rowspan="3">To-Transactions</td><td></td><td>XXX</td><td></td><td></td><td>XXX</td></tr>
<tr><td></td><td></td><td>XXX</td><td></td><td></td><td>XXX</td></tr>
<tr><td></td><td></td><td>XXX</td><td></td><td>Closing Balance</td><td></td><td>XXX</td></tr>
<tr><td></td><td>Total</td><td></td><td>XXXX</td><td></td><td>Total</td><td></td><td>XXXX</td></tr>
</table>

Description of the format of Ledger Account:

a) Separate Account is opened in the ledger Book for each Account Type, e.g. Capital, Machinery, Furniture, Loan, Sales, Purchases, Rent, Salary, Commission, Electricity, Discount received etc.
b) Every Ledger Account has two sides- (i) LHS = Debit Side, and (ii) RHS= Credit side.
c) Ledger Posting is done based on the A/c to be debited & credited as per the Journal Entry.
d) Entries on the left side are prefixed by "TO". Entries on the right side are prefixed with "BY".
e) The Colum (Journal Folio) is used to indicate the Page number in the Journal Book where the relevant journal entry is found. This is used to track & trace the entry in Journal Book.
f) Opening Balance will be on written on the left side for debit balance accounts. It will be on written on the credit side for credit balance accounts.

Ledger Accounts are broadly classified into (a) Assets (b) Liabilities (c) Incomes (d) Expenses

BALANCING OF LEDGER ACCOUNT

Meaning:

A Ledger has two sides viz. Debit and Credit. Balancing is the process by which, we find out which side is higher.
To ascertain the balance in any Account, we obtain the amount total of each side and ascertain the difference. That difference is called the Ledger Account Balance

Significance:

After all transactions are posted from Journal to Ledger, the two side totals are compared and difference is found out. This helps to know the status of each of the ledger accounts.

Nature of Balances (at the end of the period):

(Balance at the end of the period is called as Closing Balance)

Situation	Nature of Balance	Written in Ledger A/c as	Written on-
Dr. Total > Cr. Total	Debit Balance	By balance c/d	Credit Side (RHS)
Cr. Total > Dr. Total	Credit Balance	To balance c/d	Debit Side (LHS)
Note: The Closing Balance is ascertained and is written on the side whose total is lower			

Closing Balances = Opening Balances: Closing Balances at the end of one period become the opening Balances for the next period. Hence, the closing balances in ledger are Brought Forward to the next period as follows:

If Cl. Bal. = Op. Bal. is	Written in Ledger as	Written on	Points to be noted
Debit Balance	To Balance b/d	Debit Side (LHS)	Assets Accounts (e.g. Furniture, Stock, etc.). have Dr. Balance
Credit Balance	By Balance b/d	Credit Side (RHS)	Liability Accounts (e.g. Capital, loan, Debentures, etc.) have Cr. Balance

Note: "b/d" = "brought down/brought forward". "c/d" = "carried down/carried forward".

Important Note in Balancing

- However, during the accounting period, the above method of balancing is applicable for all types of accounts.
- At the end of the accounting period the balances in Real and Personal Accounts are shown in Balance sheet.
- Nominal Accounts are not balanced in the above manner; the total of the Nominal Account (i.e. Income/Gain or Expenses/Loss) is transferred to Trading or Profit & Loss Account.
- Hence, Opening Balances for the next accounting period will arise only for Assets and Liabilities.

ASSIGNMENT QUESTIONS

Question 1 (ICAI Study Material) Pg no.______

The following data is given by Mr. S, the owner, with a request to compile only the two personal accounts of Mr. H and Mr. R, in his ledger, for the month of April, 2023.

April 1	Mr. S owes Mr. R ₹ 15,000; Mr. H owes Mr. S ₹ 20,000.
April 4	Mr. R sold goods worth ₹ 60,000 @ 10% trade discount to Mr. S.
April 5	Mr. S sold to Mr. H goods prices at ₹ 30,000.
April 17	Record a purchase of ₹ 25,000 net from R, which were sold to H at a profit of ₹15,000.
April 18	Mr. S rejected 10% of Mr. R's goods of 4th April.
April 19	Mr. S issued a cash memo for ₹10,000 to Mr. H who came personally for this consignment of goods, urgently needed by him.
April 22	Mr. H cleared half his total dues to Mr. S, enjoying a ½% cash discount (of the payment received, ₹ 20,000 was by cheque).
April 26	R's total dues (less ₹10,000 held back) were cleared by cheque, enjoying a cash discount of ₹1,000 on the payment made
April 29	Close H's Account to record the fact that all but ₹ 5,000 was cleared by him, by a cheque, because he was declared bankrupt.
April 30	Balance R's Account.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) The process of transferring the debit and credit items from a Journal to their respective accounts in the ledger is termed as
   a) Posting
   b) Purchase
   c) Balancing of an account

2) The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as
   a) Posting
   b) Purchase
   c) Balancing of an account

3) Journal and ledger records transactions in
   a) A chronological order and analytical order respectively.
   b) An analytical order and chronological order respectively.
   c) A chronological order only

4) Ledger book is popularly known as
   a) Secondary book of accounts
   b) Principal book of accounts
   c) Subsidiary book of accounts

5) At the end of the accounting year all the nominal accounts of the ledger book are
   a) Balanced but not transferred to profit and loss account
   b) Not balanced and also the balance is not transferred to the profit and loss account
   c) Not balanced and their balance is transferred to the profit and loss account.

ANSWERS MCQs

1. (a) 2. (c) 3. (a) 4. (b) 5. (c)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Ledger is also known as the principal book of accounts.
2) Cash account has a debit balance.
3) Posting is the process of transferring the accounts from ledger to journal.
4) At the end of the accounting year, all the nominal accounts of the ledger book are balanced. *(June 2022)*
5) Ledger records the transactions in a chronological order.
6) If the total debit side is greater than the total of credit side, we get a credit balance as opening balance.
7) Ledger accounts of assets will always be debited when they are increased.
8) The Balance of an account is always known by the side which is shorter.
9) Ledger is also known as book of primary entry.
10) Nominal Accounts are balanced in the end of the accounting year.

Solution

1) True: Since it classifies all the amounts related to a particular account & then it is used as the base for preparing the Trial Balance, a ledger is also known as the principal book of accounts.
2) True: Being an asset under the modern equation approach, cash account has a debit balance.
3) False: Posting is the process of transferring the balances from journal to ledger
4) False: At the end of accounting year, all the nominal accounts of the ledger book are totalled and transferred to Trading/P&L Account
5) False: Ledger records the transactions in Analytical order, but journal records the transactions in a chronological order.
6) False: If the total debit side is greater than the total of credit side, we get a debit balance as the opening balance.
7) True: The increase to an asset shall be debited since the original balance is also debit.
8) False: - The balance of an account is known by the side which is larger.
9) False: Ledger is also known as book of secondary entry.
10) False: - The balances of Nominal Accounts are transferred to Profit & Loss A/c. They are not balanced.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Prepare the ledger accounts on the basis of following transactions in the books of a trader.
Debit Balances on January 1, 2023:
Cash in Hand ₹ 8,000, Cash at Bank ₹ 25,000, Inventory of Goods ₹ 20,000, Building ₹ 10,000.
Trade receivables: Vijay ₹ 2,000 and Madhu ₹ 2,000.
Credit Balances on January 1, 2023:
Trade payables: Anand ₹ 5,000, Kapil ₹ 7,000, Capital ₹ 55,000
Following were further transactions in the month of January, 2023:

Jan. 1	Purchased goods worth ₹ 5,000 (payable at later date) for cash less 20% trade discount and 5% cash discount.
Jan. 4	Received ₹ 1,980 from Vijay and allowed him ₹ 20 as discount.
Jan. 8	Purchased plant from Mukesh for ₹5,000 and paid ₹100 as cartage for bringing the plant to the factory and another ₹200 as installation charges.
Jan. 12	Sold goods to Rahim on credit ₹ 600
Jan. 15	Rahim became insolvent and could pay only 50 paise in a rupee.
Jan. 18	Sold goods to Ram for cash ₹1,000.

Question 2 *(ICAI Study Material)* *Pg no._____*

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

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

Question 3 *(ICAI Study Material)* *Pg no._____*

Prepare the Stationary Account for the month of Jan 2023 duly balanced off from the following details:

2023		Amount
Jan. 1	Inventory of Stationary	480
Jan 5	Purchase of Stationary by cheque	800
Jan 15	Purchase of Stationary on credit from Five star stationary mart	1,280

Question 4 *(CA Foundation Dec 2021) (5 Marks)* *Pg no._____*

Discuss the following:
(i) What do you mean by principal books of accounts?
(ii) What are the rules of posting of journal entries into the Leger?

Unit 3: TRIAL BALANCE

CH 2C

"Confident walking is more successful than confused running. Follow no one but learn from everyone."

MEANING AND PURPOSE OF TRIAL BALANCE

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

FORMAT OF TRIAL BALANCE

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

Method	What is written in Trial Balance?	Remarks
(a) Total Method	The Total of Debit & Credit Side of each Ledger Account is recorded in the Trial Balance, in the respective columns.	Merit: Time taken to balance each Ledger A/c is saved. Demerit: Not useful for preparation of Final Accounts.
(b) Balances Method	Here, only the balance in each Ledger A/c is recorded in Trial Balance. Some accounts may have Dr. Balance while others have Cr. Balance.	Most popularly used method since it helps in preparation of Final Accounts / Financial Statements

(c) Total & Balances Method	This is a combination of above 2 methods. Both Totals and Balances are indicated in separate columns in Trial Balance.	Not regularly used.

2. Format of Trial Balance:

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

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

FEATURES OF TRIAL BALANCE :- DR. TOTAL = CR. TOTAL

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

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

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2022. You are required to prepare the Trial Balance by the Total Amount Method.

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	7,500
	35,500		35,500

Dr. Furniture Account Cr.

Particulars	₹	Particulars	₹
To Cash A/c	3,000	By Balance c/d	3,000
	3,000		3,000

Dr. Salaries Account Cr.

Particulars	₹	Particulars	₹
To Cash A/c	2,500	By Balance c/d	2,500
	2,500		2,500

Dr. Shyam's Account Cr.

Particulars	₹	Particulars	₹
To Cash A/c	21,000	By Purchases A/c (Credit Purchase)	25,000
To Purchase Returns A/c	500		
To Balance c/d	3,500		–
	25,000		25,000

Dr. Purchases Account Cr.

Particulars	₹	Particulars	₹
To Cash A/c (Cash Purchases)	1,000	By Balance c/d	26,000
To Sundries as per Purchases Book (Credit Purchases)	25,000		
	26,000		26,000

Dr. Purchases Returns Account Cr.

Particulars	₹	Particulars	₹
To Balance c/d	500	By Sundries as per Purchases Return Book	500
	500		500

Dr. Ram's Account Cr.

Particulars	₹	Particulars	₹
To Sales A/c (Credit Sales)	30,000	By Sales Returns A/c	100
		By Cash A/c	25,000
		By Balance c/d	4,900
	30,000		30,000

Dr. Sales Account Cr.

Particulars	₹	Particulars	₹
To Balance c/d	30,500	By Cash A/c (Cash Sales)	500
		By Sundries as per Sales Book (Credit Sales)	30,000
	30,500		30,500

Dr. Sales Returns Account Cr.

Particulars	₹	Particulars	₹
To Sundries as per Sales Returns Book	100	By Balance c/d	100
	100		100

Dr. Capital Account Cr.

Particulars	₹	Particulars	₹
To Cash A/c	500	By Cash A/c	10,000
To Balance c/d	9,500		
	10,000		10,000

Solution

Trial Balance of X and Co. as at 31.03.2022

S. No.	Name of Account	Total Debit ₹	Total Credit ₹
1.	Cash A/c	35,500	28,000
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c	21,500	25,000
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	30,000	25,100
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	500	10,000
		1,19,100	1,19,100

Question 2 ***(ICAI Study Material)*** *Pg no._____*

Taking the same information as given in Question 1, prepare Trial Balance by Balance Method.

Solution

Trial Balance of X and Co. as at 31.03.2022

S. No.	Name of Account	Debit Balance ₹	Credit Balance ₹
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c		3,500
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	4,900	
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c		9,500
		44,000	44,000

Question 3 *(CA Foundation Nov 2019) (5 Marks) / (ICAI Study Material) (Similar)* Pg no._____

An inexperienced bookkeeper has drawn up Trial Balance for the year ended 31st March 2023.

	Dr. Balance	Cr. Balance
Provision For Doubtful Debts	250	
Bank Overdraft	1,654	
Capital		4,591
Trade payables		1,637
Trade receivables	2,983	
Discount Received	252	
Discount Allowed		733
Drawings	1,200	
Office Furniture	2,155	
General Expenses		829
Purchases	10,923	
Returns Inward		330
Rent & Rates	314	
Salaries	2,520	
Sales		16,882
Inventory	2,418	
Provision for Dep. on Furniture	364	
	25,033	25,002

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

Question 4 *(ICAI Study Material)* Pg no._____

The following trial balance as on 31st March, 2022 was drawn from the books of fintech traders:

	L.F.	Dr. Balance (₹)	Cr. Balance (₹)
Building		60,000	-
Machinery		17,000	-
Return Outward		2,600	-
Bad Debts		2,800	-
Cash		400	-
Discount Received		3,000	-
Bank Overdraft		10,000	-
Creditors		50,000	-
Purchases		1,00,000	-
Capital		-	73,600
Fixtures		-	5,600
Sales		-	1,04,000
Debtors		-	60,000
Interest Received		-	2,600
Input CGST A/c		-	3,000
Input SGST A/c		-	3,000
Input IGST A/c		-	4,800
Output CGST A/c		5,400	-
Output SGST A/c		5,400	-
Total		2,56,600	2,56,600

Even though the debit and credit sides agree, the trial Balance contains certain errors. Check the accuracy of trial balance.

Solution

Corrected Trial Balance of Fintech traders as on 31st March, 2022

	L.F.	Dr. Balance (₹)	Cr. Balance (₹)
Building		60,000	-
Machinery		17,000	-
Return Outward		-	2,600
Bad Debts		2,800	-
Cash		400	-
Discount Received		-	3,000
Bank Overdraft		-	10,000
Creditors		-	50,000
Purchases		1,00,000	-
Capital		-	73,600
Fixtures		5,600	-
Sales		-	1,04,000
Debtors		60,000	-
Interest Received		-	2,600
Input CGST A/c		3,000	-
Input SGST A/c		3,000	-
Input IGST A/c		4,800	-
Output CGST A/c		-	5,400
Output SGST A/c		-	5,400
		2,56,600	2,56,600

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

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

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

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

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

5)

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

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

ANSWERS MCQs

1. (c) 2. (a) 3. (b) 4. (b) 5. (b)

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Preparing trial balance is the third phase of accounting process.
2) Trial balance forms a base for the preparation of Financial statements.
3) Agreement of trial balance is a conclusive proof of accuracy.
4) A trial balance will tally in case of compensating errors.
5) A trial balance can find the missing entry from the journal.
6) Suspense account opened in a trial balance is a permanent account.
7) The balance of purchase return account has a credit balance.

8) Trial Balance is prepared after preparing the Profit and Loss A/c.
9) The Trial Balance checks the honesty of the book-keeper.
10) The Trial Balance ensures the arithmetical accuracy of the books.
11) Trial Balance is an absolute proof of the accuracy of the books of accounts.
12) Rectification of errors are necessary to tally the trial balance.
13) A tallied trial balance means that the books of accounts have been prepared as per accepted accounting principles.
14) The rationale behind the opening of a suspense account is to tally the trial balance

Solution

1) True: Trial balance is the third phase of accounting process which forms the base for the preparation of the final accounts.
2) True: Based on trial balance only, we can prepare financial statement.
3) False: Agreement of trial balance gives only arithmetical accuracy, there can still be errors in preparing the trial balance
4) True: Since compensating errors cancel out of due to their compensating nature of amounts, hence trial balance still agree in such case.
5) False: A trial balance cannot find the missing entry from the journal
6) False: Suspense account opened in a trial balance is a temporary account
7) True: The balance of purchase return account has a credit balance. As purchases are debited, any returns shall be credited.
8) False: Trial Balance is prepared before Profit & Loss A/c because all ledger balances are put on trial to ascertain the maintenance of debit and credit equality.
9) False: The trial balance helps to establish the arithmetical accuracy of ledger books.
10) True: The trial balance helps to establish the arithmetical accuracy of ledger balances.
11) False: Equal balance of trial balance is not a proof of complete accuracy e.g. trial balance cannot detect error of principle, compensating error etc.
12) False: There is no need to rectify the error in order to tally the trial balance. Trial Balance can be tallied by debiting or crediting the difference amount to the suspense account.
13) False: Trial balance only checks the arithmetical accuracy of the books. Errors of principle and errors of commission will not affect the agreement of the trial balance.
14) False: The rationale behind the opening of a suspense account is to avoid delay in the preparation of financial statements

OBJECTIVES OF PREPARING TRIAL BALANCE

1) Checking of the arithmetical accuracy of the accounting entries: Trial Balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish the arithmetical accuracy of the books.
2) Basis for preparation of financial statements: Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.
3) Summarized ledger: Trial Balance contains the ledger balances on a particular position of a particular account can be judged simply by looking at the Trial Balance. The ledger may be seen only when details regarding the accounts are required.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no.______*

From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March, 2023

Account Head	₹
Capital	1,00,000
Sales	1,66,000
Purchases	1,50,000
Sales return	1,000
Discount allowed	2,000
Expenses	10,000
Trade receivables	75,000
Trade payables	25,000
Investments	15,000
Cash at bank and in hand	37,000
Interest received on investments	1,500
Insurance paid	2,500

Question 2 *(ICAI Study Material)* *Pg no.______*

One of your clients, Mr. Singhania has asked you to finalize his accounts for the year ended 31st March, 2023. Till date, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnished you with the following statement.

	Dr. Balance	Cr. Balance
Singhania's Capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750
Due from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Trade payables	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Inventories (1.4.2022)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

The closing inventory on 31st March, 2023 was valued at ₹ 574. Mr. Singhania claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

Question 3 *(CA Foundation Dec 2021) (5 Marks)* *Pg no._____*

From the following information, draw up a Trial Balance in the books of Shri M as on 31st March,2023:

Particulars	Amount	Particulars	Amount
Capital	1,40,000	Purchases	36,000
Discount Allowed	1,200	Carriage Inward	8,700
Carriage Outwards	2,300	Sales	60,000
Return Inward	300	Return Outwards	700
Rent and Taxes	1,200	Plant and Machinery	80,700
Stock on 1st April 2022	15,500	Sundry Debtors	20,200
Sundry Creditors	12,000	Investments	3,600
Commission Received	1,800	Cash in Hand	100
Cash at bank	10,100	Motor Cycle	34,600
Stock on 31st March, 2023	20,500		

Question 4 *(CA Foundation June 2022) (4 Marks)* *Pg no._____*

One of your clients Mr. X asked you to finalize his account for the year ended 31st March,2022. As a basis for audit, Mr. X furnished you with the following statement:

	Dr.	Cr.
X's Capital		4,668
X's Drawings	1,692	
Leasehold Premises	2,250	
Sales		8,250
Due from customers		1,590
Purchases	3,777	
Purchase Return	792	
Loan from Bank		768
Trade Expense	2,100	
Trade Payable	1,584	
Bills Payable	300	
Salaries and Wages	1,800	
Cash at Bank	678	
Opening Inventory		792
Rent and Rates	1,389	
Sales Return		294
	16,362	16,362

The closing inventory was ₹ 1,722. Mr. X claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance and give reasons for the errors, if any.

Unit 4: SUBSIDIARY BOOKS

CH 2D

"If you translate every mistake of your life into a positive one, You will never be a prisoner of your past, but a designer of your future."

MEANING & ADVANTAGES

1. Meaning:
   (a) "Subsidiary Books" refer to Specific Purpose Books maintained for recording Specific Business transactions.
   (b) The special transactions of each type are listed in the respective books. There is NO Journal Entry. From each Subsidiary Book, the total of transactions for each period (e.g. a month), are posted into Ledger.
   (c) These books are also called as "Books of Original" or "Books of Prime Entry".

2. Need for Subsidiary Books:
   (a) When transactions are few in number, they are journalized individually in one Journal Book, but when transactions are many, it is inconvenient to record all the transactions in one Journal Book.
   (b) To avoid the Journal Book from becoming bulky & voluminous, the Journal Book is sub -divided into Subsidiary Books.
   (c) Each Subsidiary Book records a specific type of transaction. Purpose for which separate books will be prepared are identified based on volume & importance of such purposes.

3. Advantages of Subsidiary Books *(RTP May 2020) / (CA Foundation July 2021) (5 Marks)*
   (a) Information Management: Since a separate register / book is kept for each class of transaction, information relating to each class will be available at one place.
   (b) Division of Work: The accounting work may be divided amongst a number of clerks since there will be separate books for recording various transactions.
   (c) Specialization: When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it.
   (d) Saving of time: Various accounting processes can be undertaken simultaneously because of use of number of books. This will lead to the work being completed quickly.
   (e) Control/Facility in Checking: When the Trial Balance does not agree, the location of the error(s) is facilitated by the existence of separate books. Further, the possibility of errors and frauds will be checked by the use of various Subsidiary Books.

Financial Books

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

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

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

Journal	Purpose
(a) Purchases Book	To record transactions relating to Credit Purchases
(b) Sales Book	To record transactions relating to Credit Sales
(c) Purchases Return Book	To record transactions relating to Purchase Returns made to Suppliers. (cash is not involved).
(d) Sales Return Book	To record transactions relating to Sales Returns made by Customers. (cash is not involved)
(e) Cash Book	To record Cash, Bank and Discount transactions.
(f) Bills Receivable Book	To record transactions in respect of Bills Receivable. (i.e. Promissory Notes, Bills of Exchange from Debtors / other parties)
(g) Bills Payable Book	To record transactions in respect of Bills Payable, (i.e. Promissory Notes, Bills of Exchange issued to Creditors / other parties)
(h) Journal Proper	To record other transactions for which no specific book is maintained. Note: The format of Journal & Journal Proper is same.

PURCHASES AND SALES BOOK - FEATURES

Book	Purchase Book	Sales Book
1. Purpose / Inclusions	To record all Credit Purchases of goods and materials.	To record all Credit Sales of goods and materials.
2. Omissions /Exclusions	(a) Cash Purchases are not recorded. These are recorded in Cash Book (b) Credit Purchases of Capital Assets e.g. Machinery, Furniture, etc. are not recorded. They are recorded in Journal Proper.	(a) Cash Sales are not recorded here. These are recorded in Cash Book. (b) Credit Sales of Capital Assets, e.g. Machinery, Furniture etc, are not recorded. They are recorded in Journal Proper.
3. Entry in Subsidiary Book	Individual items of Credit Purchases are posted in this book along with the date & amount. Trade Discount if any, is reduced, and only the net amount is recorded in the Purchases Book.	Individual items of Credit Sales are posted in this book along with the date & amount. Trade Discount if any, is reduced, & only net amount is recorded in the Sales Book.
4. Source	Purchase Invoice is base document	Sales Invoice is base document
5. Posting in Parties Ledger A/c	Suppliers' / Creditors' A/c will be credited for the amount of credit purchases as "By Purchases A/c". This posting is on individual basis.	Customers' / Debtors' A/c will be debited for the amount of credit sales as "To Sales A/c". This posting is on individual basis.
6. Posting in Purchase/ Sale A/c	Total of Purchases Book is posted to the debit side of Purchases A/c as "To Sundries as per Purchases Book".	Total of Sales Book is posted to credit side of Sales A/c as "By Sundries as per Sales Book".

Note - Recording of Sales Tax/GST: In both Purchases and Sales Book, separate amount columns may be used to record Sales Tax/GST on Purchases (Credit Available) and Sales Tax/GST on Sales (Tax Payable), so that they can be reconciled and settled at the end of every period (say, a month).

Format of Purchase Book

Date	Supplier Name	L.F.	Inv. No.	Qty	Gross Amount	Trade Discount	Net Value	Tax	Total Value
22.01.2023	Ravi (Note)	-	315	2,000 kgs	26,000	1,000	25,000	2,000	27,000
	TOTAL			xxx	XXXXX	XXXXX	XXXXX	xxx	XXXXX

(Note: It represents purchases of 2000 kgs on credit from Ravi on 22.01.2023 for ₹ 27,000 including Sales Tax.)

Format of Sales Book

Date	Customer Name	L.F.	Inv. No.	Qty	Gross Amount	Trade Discount	Net Value	Tax	Total Value
15.01.2023	Ramesh (Note)		251	500 kgs	61,500	1,500	60,000	3,200	63,200
	TOTAL			xxx	XXXXX	XXXXX	XXXXX	xxx	XXXXX

(Note: It represents sale of 500 kgs on credit to Ramesh on 15.01.2023 for 63,200 including Sales Tax)

PURCHASE RETURNS AND SALES RETURNS BOOKS - FEATURES

Book	Purchase Returns Book (also called Returns Outward Book)	Sales Returns Book (also called Returns Inward Book)
1. Purpose / Inclusions	When goods / materials earlier purchased on credit are returned by the Firm to the Supplier, they are recorded in Purchase Returns book.	When goods / materials earlier sold on credit are returned to the Firm by the Customer they are recorded in Sales Returns book.
2. Omissions / Exclusions	• Goods returned to supplier & cash received • Fixed Assets returned to supplier • Goods earlier purchased for Cash	• Goods received from the buyer & cash paid • Fixed Assets received back. • Goods earlier sold for cash
3. Entry in Subsidiary Book	Individual items of Purchases Returns are posted in this book along with the date and amount.	Individual items of Sales Returns are posted in this book along with the date and amount.
4. Source	Debit Note	Credit Note
5. Posting in Parties Ledger A/c	Suppliers' / Creditors' A/c will be debited for the amount of purchase returns as "To Purchase Returns A/c". This posting is on individual basis.	Customers' / Debtors' A/c will be credited for the amount of sales returns as "By Sales Return' A/c". This posting is on individual basis.
6. Posting in A/c	Total of Purchases Returns Book is posted in credit side of Purchases Returns A/c as "By Sundries as per Purchase Returns Book".	Total of Sales Returns Book is posted in the debit side of Sales Returns A/c as "To Sundries as per Sales Returns Book".
7. Format	Format is the same as Purchases Book, except that Debit Note will appear instead of Invoice.	Format is the same as Sales Book, except that Credit Note will appear instead of Invoice.

TRADE DISCOUNT VS CASH DISCOUNT

1. Trade Discount:
   (a) Trade Discount refers to reduction in price offered by the seller for HIGHER QUANTITY of purchases.
   (b) It is allowed as deduction from List Price. (Trade Discount = % of discount x List Price)
   (c) The price after deducting the trade discount is called Invoice Price.
   (d) Trade Discount is not recorded in Accounts Books. i.e. directly Invoice Price itself is recorded in Accounts Books.

2. Cash Discount:
   (a) Cash Discount refers to reduction in AMOUNT DUE offered by seller if payment is received before due date.
   (b) It is sometimes technically referred as "2/10 net 30". This implies 2% cash discount is allowed if payment is made within in 10 days. Otherwise payment has to be made within 30 days from date of sale.
   (c) Cash Discount is recorded in Accounts Books. i.e. It is an Expense for the seller / Income for the buyer.
   (d) It is recorded in the books under the head "Discount allowed" (for Supplier) / "Discount Received (for Buyer).
   (e) Cash Discount = % of discount x Amount actually payable (Invoice Price)

3. Example:
   Goods worth 5,000 sold by Lakshman @ 10% trade discount and @ 1% cash discount on payment within 10 days. Lakshman received payment from debtor within 7 days. Calculate the amount payable

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

Note: If Subsidiary Books are maintained - Books of Seller
- During Sales - Lakshman records only 4,500 as sales in his "Sales Book".
- During Settlement - Lakshman records 45 as expense under "Discount Allowed" along with receipt of 4,455
- In the Books of buyer, Purchases is recorded for 4,500 and "Discount received" recorded for Z 45

JOURNAL PROPER - FEATURES

1. Significance: "Journal Proper" is used to record those transactions which cannot be recorded in-any-of-the Specific Subsidiary Books.
2. Features:
   (a) Journal Proper is a Residuary Subsidiary Book to record the residuary transactions.
   (b) The format of Journal is exactly similar to the format of a normal Journal Book
3. Transactions recorded in Journal Proper:
   (i) Opening Entries
   - Opening balances of assets and liabilities are brought forward from the previous accounting period by passing opening entries. Journal Entry for recording–

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

(ii) Closing Entries: At the end of the year Trading Account and Profit & Loss Account are prepared to determine the profits / losses of the business. All nominal account balances must be transferred to the above accounts. Such entries are called Closing entries.

- For transferring Expenses / Losses to Trading Account / Profit and Loss A/c -
  Trading Account / Profit and Loss Account Dr.
  To Expenses A/c / Losses A/c
- For transferring Incomes / Gains to Trading Account / Profit and Loss A/c -
  Incomes A/c / Gains A/c Dr.
  To Trading A/c / Profit & Loss A/c

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

(iv) Transfer Entries: If some amount is to be transferred from one account to another account, the transfer will be made through a Journal Entry.
E.g: When goods purchased 80,000 are used for construction of building, then transfer entry has to be made for transferring 80,000 from Purchase A/c to Building A/c.

(v) Adjusting Entries: Adjusting entries refer to entries passed to adjust the incomes / expenses for the current period, to ensure that only current year's incomes and expenses are matched. Hence, entries passed for the following purposes are called "Adjusting Entries". It includes Outstanding Expenses, Prepaid Expenses, Accrued Income & Income Received in Advance etc.

(vi) Miscellaneous Entries:
- Introduction of capital in kind i.e. motor car / goods introduced as capital.
- Credit Purchase of Fixed assets,
- Entries on dishonour of Bills Receivable,
- Entries for Discount received / allowed, if double column Cash Book is prepared without Discount columns.
- On an amount becoming irrecoverable, because of the customer becoming insolvent
- Effects of accidents like loss of property by fire

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no.______

Enter the following transactions in Purchase Book & post them into Ledger

2023

April 4 Purchased from Ajay Enterprises, Delhi
100 Doz. Rexona Hawai Chappal @ ₹120 per doz.
200 Doz. Palki Leather Chappal @ ₹300 per Doz.
Less : Trade discount @ 10%
Freight charged ₹150.

April 15 Purchased from Balaji Traders, Delhi
50 doz. Max Shoes @ ₹400 per doz.
100 pair Sports Shoes. @ ₹140 per pair.
Less : Trade discount @ 10%.
Freight charged ₹200

April 28 Purchased from Tripti Industries, Bahadurgarh
40 pair leather shoes @ ₹400 per pair
100 doz. Rosy Hawai Chappal @ ₹180 per doz.
Less : Trade discount @ 10%.
Freight charged ₹100.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) In Purchases Book the record is in respect of ________________________
   (a) Cash purchase of goods.
   (b) Credit purchase of goods dealt in.
   (c) All purchases of goods.

2) The Sales Returns Book records ________________________
   (a) The return of goods purchased.
   (b) Return of anything purchased.
   (c) Return of goods sold.

3) The Sales Book ________________________
   (a) Is a part of journal.
   (b) Is a part of the ledger.
   (c) Is a part of the balance sheet.

4) The weekly or monthly total of the Purchase Book is ________________________
   (a) Posted to the debit of the Purchases Account.
   (b) Posted to the debit of the Sales Account.
   (c) Posted to the credit of the Purchases Account.

5) The total of the Sales Book is posted to ________________________
   (a) Credit of the Sales Account.
   (b) Credit of the Purchases Account.
   (c) Credit of the Capital Account.

6) In which book of original entry, will you record an allowance of ₹50 was offered for an early payment of cash of ₹1,050 ________________________.
   (a) Sales Book
   (b) Cash Book
   (c) Journal Proper (General Journal)

7) A second hand motor car was purchased on credit from B Brothers for ₹10,000 will be recorded in _____
   (a) Journal Proper (General Journal)
   (b) Sales Book
   (c) Cash Book
   (d) Purchase Book

8) In which book of original entry, will you record a bills receivable of ₹1,000, which was received from a debtor in full settlement for a claim of ₹1,100, is dishonoured ______
   (a) Purchases Return Book
   (b) Bills Receivable Book
   (c) Journal Proper (General Journal)

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Transactions recorded in the purchase book include only purchases of goods on credit transactions.
2) Transactions regarding the purchase of fixed asset are recorded in the purchase book
3) Cash Sales are recorded in Sales book
4) Subsidiary books are also known as the books of original entry
5) Bill receivable book is a subsidiary book
6) Return inward book is also known as purchase return book
7) Purchase of second hand machinery will be recorded in purchase book
8) Total of sales return book is posted to the debit side of sales return account
9) If the sales are on frequent basis, the transactions are recorded in the sales book.
10) Purchase Book records all purchases of goods.
11) The Purchase Day Book is a part of the Ledger.
12) The Sales Day Book is a part of the ledger.
13) Purchase Books records all the credit purchase of goods.
14) The sales-Book is kept to record both cash and credit sales. *(Jan 2021)*
15) The debit notes issued are used to prepare Sales Return Book.
16) Closing entries are recorded in journal proper.
17) Where subsidiary books are maintained journal is not required.
18) Trade Discount is a reduction granted by a supplier from the list price of goods or services on business considerations for prompt payment. *(Nov 2019)*
19) Gauri purchased goods worth ₹75,800 at 5% trade discount and she paid half of the amount in cash. The amount appearing in the purchase book is ₹36,005.

Solution

1) True: Since cash purchases are taken to the cash book, it is only credit transactions that are recorded in the purchases book.
2) False: Transactions regarding the purchase of fixed asset are not recorded in the purchase book, only the credit purchase of goods are recorded in it
3) False: Credit sales are recorded in sales book
4) True: They are maintained as an alternate to journal
5) True: Bill receivable book is one of the subsidiary book
6) False: Return inward book is also known as sales return book
7) False: Purchase of second hand machinery will not be recorded in purchase book
8) True: Total of sales return book is posted to the debit side of sales return account
9) True: When there are numerous transactions then there are subsidiary books like the sales book where there are recorded instead of regular journal entries.
10) False: - It records only credit purchases of goods.
11) False: - It is a book of original entry so it is a part of the journal.
12) False: - Sales Day Book is a book of original entry and hence it is part of journal.
13) True: - It records all the credit purchases of goods and materials to be used by the factory.
14) False: - Sales Book is a register specially kept for recording credit sales of goods dealt in by the firm, cash sales are entered in the Cash Book and not in the Sales Book.
15) False: - The source document for this book is credit note. When goods are received along with the debit note, the seller acknowledges the same by sending the credit note to the customer. The debit notes issued are used to prepare purchases return book.

16) True: - As these entries cover the items of the account which cannot be closed by any corresponding debit or credit.
17) False: - Journal is required even when subsidiary books are maintained. This is so because many entries such as opening and closing entry, rectification entry etc. are recorded in journal.
18) False: Trade Discount is a reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment. It refers to reduction in price offered by the seller for higher quantity of purchases.
19) True: Trade discount is to be deducted from total value of ₹75,800. Amount paid in cash includes cash purchases & only credit purchase will be shown in the purchases book 36,005 (72,010 x 50%)

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

The Rough Book of M/s. Narain & Co. contains the following:
Feb 2023

1. Purchased from Brown & Co. on credit:
   5 gross pencils @ ₹100 per gross,
   1 gross registers @ ₹ 240 per doz.
   Less : Trade Discount @ 10%
1. Purchased for cash from the Stationery Mart;
   10 gross exercise books @ ₹ 300 per doz.
2. Purchased computer for office use from M/s. office
   Goods Co. on credit for ₹ 30,000.
3. Purchased on credit from The Paper Co.
   5 reams of white paper @ ₹100 per ream.
   10 reams of ruled paper @ ₹150 per ream.
   Less : Trade Discount @ 10%
4. Purchased one dozen gel pens @ ₹15 each from
   M/s. Verma Bros. on credit.

Make out the Purchase Book of M/s. Narain & Co (1 Gross =12 Dozen)

Question 2 *(ICAI Study Material)* *Pg no._____*

The following are some of the transaction of M/s Kishore & Sons of the year 2023 as per their Book. Make out their Sales Book.

Sold to M/s. Gupta & Verma on credit:
30 shirts @ ₹ 800 per shirt.
20 trousers @ ₹1,000 per trouser.
Less : Trade Discount @ 10%

Sold furniture to M/s. Sehgal & Co. on credit ₹8,000.
Sold 50 shirts of M/s. Jain & Sons @ ₹800 per shirt.
Sold 13 shirts to Cheap Stores @ ₹750 each for cash.
Sold on credit to M/s. Mathur & Jain.
100 shirts @ ₹750 per shirt
10 overcoats @ ₹5,000 per overcoat.
Less: Trade Discount @ 10%

Question 3 *(ICAI Study Material)* *Pg no._____*

Post the following into the ledger
Returns Outward Book

Date 2023	Particulars	L.F.	Details	Amount
Nov. 20	Rajindra Prakash & Sons One 36” Usha Ceiling Fan Less : Trade Discount @ 10%		 200.00 (20.00)	 180.00
Nov. 30	Modern Electric Company			100.00
				280.00

Question 4 *(ICAI Study Material) / (RTP May 2019)/(Nov 2020)/(Nov 2022) (Similar)* *Pg no._____*

From the following transactions, prepare the Purchases Returns Book of Alpha & Co., a saree dealer:

Date	Debit Note No	Particulars
04.01.2023	101	Returned to Goyal Mills, Surat - 5 polyester sarees @ ₹ 1,000.
09.01.2023		Garg Mills, Kota - accepted the return of goods (which were purchased for cash) from us - 5 Kota sarees @ ₹ 400.
16.01.2023	102	Returned to Mittal Mills, Bangalore - 5 silk sarees @ ₹2,600.
30.01.2023		Returned one computer (being defective) @ ₹35,000 to B & Co.

Question 5 *(ICAI Study Material)* *Pg no.______*

Enter the following transactions in Sales Book of M/s. Pranat Engineers Ltd., Delhi & post into ledger.

Jan 2023

2 Sold to M/s Ajanta Electricals, Delhi 5 pieces of Ovens @₹6000 each less Trade disc. @ 10%

8 Sold to M/s Electronics Plaza, 10 pieces of Tablets @ ₹ 8000 each less trade discount 5%.

15 Sold to M/s Haryana Traders, 5 pieces of Juicers @ ₹3500 each less trade discount @ 10%

Question 6 *(CA Foundation Nov 2020) (4 Marks)* *Pg no.______*

The following are some of the transactions of M/s. Kamal & Sons for the year ended 31st March, 2020. You are required to make out their Sales Book.

(a) Sold to M/s. Ashok & Mukesh on Credit:
 40 Shirts @ ₹ 900 per shirt
 30 trousers @ ₹ 1,000 per trouser
 Less: Trade discount @ 10%

(b) Sold furniture to M/s. XYZ & Co. on credit ₹ 8,000

(c) Sold 15 shirts to Aman @ ₹ 750 each for cash.

Question 7 *(CA Foundation July 2021) (5 Marks)* *Pg no.______*

From the following information prepare the Purchase Book of Mis. Shyam & Company:

(a) Purchased from Red & Company on credit:
 10 pairs of black shoes.@ ₹ 800 per Pair.
 5 pairs of brown shoes @ 900 per pair
 Less: Trade Discount @ 10%

(b) Purchased Computer from M/s. Rahul. Enterprises on credit for ₹ 40,000.

(c) Purchased from Blue & Company in cash:
 5 pairs of black shoes @ ₹ 700 per pair
 15 pairs of brown shoes@ ₹ 100 per pair
 Less: Trade Discount @ 15%

Question 8 *(CA Foundation June 2023) (4 Marks)* *Pg no.______*

Enter the following transactions in Sales Book of Gurgaon Engineers, Gurgaon for January 2022:

2022	
Jan 5	Sold to Praneet Electricals 10 pieces of microwaves@ ₹ 8,500/- each less trade discount 15%
Jan 10	Sold to Ajanta plaza 8 pieces of Mixer grinders@ ₹ 12,500/- each less trade discount 10%.
Jan 20	Sold to Naveen traders, 15 pieces of juicers@ ₹ 5,500/- each less trade discount 5%

Unit 5: CASH BOOK

CH 2E

"If you want to enjoy anything, always think today is the first day, But if you want to achieve anything, always think today is the last day."

MEANING AND FEATURES

1. Meaning of Cash Book: Cash Book is one of the Subsidiary Books which directly records transactions involving cash. Hence, it groups together all cash related transactions.
2. Features:
   (a) Subsidiary Book: On the occurrence of cash transactions, they are recorded in Cash Book directly. Hence, no Journal Entry is passed. From cash book, the other aspect of the same transaction is posted to Ledger Accounts.
   (b) Principal Book: The Cash Book itself serves as an Account since the balances are entered in the Trial Balance directly. Hence, the Cash Book is part of the Ledger also and should also be regarded as a Principal Book. The format of cash book is also in the form of a ledger account.
   (c) The Cash Book is thus both a Subsidiary Book and a Principal Book
3. Various types of Cash Book: The main Cash Book may be of three types —
   (a) Simple Cash Book — Having Cash Column only on both sides.
   (b) Two Column Cash Book — Having Cash and Discount Columns / Cash and Bank Columns on both sides
   (c) Three Column Cash Book — Having Cash, Bank and Discount columns on both sides.

Certain enterprises maintain "Petty Cash Book" on imprest basis, which is purely a Subsidiary Book.

4. Debit and Credit Aspects:
   (a) Debit Side of Cash Book is for recording Receipts of Cash / Cheques (by way of Capital introduced, Loans taken, Cash Sales, Collection from Debtors, Income by way of Interest / Rent etc. received, Bad Debts recovered, Sale of Fixed Assets or Investments, etc.)
   (b) Credit Side of Cash Book is for recording Payments of Cash / Cheques (by way of Drawings, Loans repaid, Cash Purchases, Payment to Creditors, Expenses like Salary, Rent, Advertisement paid, Purchase of Fixed Assets or Investments, etc.)

SIMPLE CASH BOOK

1. Meaning: Simple Cash Book is also called as Single Column Cash Book. It appears like an ordinary Ledger Account with one amount column on each side.
2. Contents: Dr. Side is for recording all Cash Receipts while Cr. Side is for recording all Cash Payments.
3. The difference between Debit and Credit side (i.e. Closing Balance) is written as "By balance c/d" on the credit side of the Cash Book. [Note: Cash balance cannot be negative, i.e. Cash Payments cannot exceed Cash Receipts]
4. The Closing Balance of this period will be brought forward to the subsequent period by writing as "To Balance b/d" on debit Side of the Cash Book in the next period.

5. Format of Single Column Cash Book:

Dr. Cash Book for the period ended Cr.

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

[Note: There is no Journal Entry passed for recording in Cash Book. One aspect involving cash is directly recorded in Cash Book & another aspect is directly recorded in relevant ledger A/c]

DOUBLE COLUMN CASH BOOK

1. Meaning: Double Column Cash Book has two amount columns on both side, i.e. two each on Dr. and Cr. Side.
2. Types: Double Column Cash Book may be maintained in any of the following ways —

Type of Double Column	Dr. Side is for recording	Cr. Side is for recording
(a) Cash & Bank Columns	Cash and Bank Receipts	Cash and Bank Payments
(b) Cash & Discount Columns	Cash Receipts & Discount Allowed to Customers /Debtors	Cash Payments & Discount Received from Suppliers/Creditors
Notes: 1. If Cash and Bank Columns are maintained in Cash Book, then discount transactions are recorded in Journal Proper 2. If Cash and Discount Columns are maintained in Cash Book, then bank transactions are recorded in Journal Proper		

3. Nature of Accounts / Columns:

Column	Nature	Closing Balance
Cash	Cash Column represents Cash Account.	• Cash balance cannot be negative, since cash payments cannot exceed receipts. This column will always have Dr. balance. Closing Balance is written on the credit side as “By balance c/d”.
Bank	Bank Column represents Bank Account.	• If Dr. Side > Cr. Side, it means there is a favourable Bank Balance, written on the credit side as "By balance c/d". • If Cr. Side > Dr. Side, it means that there is an Overdraft balance, written on the debit side as "To balance c/d".
Discount	Discount Column represents Discount Allowed/Received.	• Discount Columns are not balanced. They are totaled and entered in the Discount Account in the Ledger. • Total of Discount Column on the Receipts Side (i.e. Dr. Side) shows total Discount Allowed to Customers. • Total of Discount Column on Payments Side (i.e. Cr. Side) shows total Discount Received from Suppliers.

Notes:

(a) Cash/Bank is account since they have debit & credit columns on both sides of cash book

(b) However, discount allowed and discount received are not accounts as they do not have columns on both sides. For discount allowed, one column exists on debit side and for discount received one column exists on credit side. Hence, a separate ledger account is to be opened for Discount Received/ Discount allowed in the ledger.

4. Format of Two—Column Cash Book:

(a) Cash and Discount Columns

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

(b) Cash and Bank Columns

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

Note: Opening / Closing Balances of bank may be debit or credit balance. Both debit and credit balance cannot exist at the same time. However, for cash, it's always debit balance only.

TRIPLE COLUMN CASH BOOK

1. **Meaning**: Three Column Cash Book has three amount columns on both sides i.e. Cash, Bank and Discount amounts.
   [Note: The principles for recording are the same as for Two Column Cash Book as described in the previous question.]
2. **Format**:

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

3. **Advantages**:
   (a) Cash and Bank Accounts are prepared simultaneously, so there is saving in time.
   (b) Information regarding Cash in Hand and Bank Balances can be obtained simultaneously.
   (c) If there are two or more Bank Accounts, the Firm can introduce multi -column Cash Book, one each for the various Bank Accounts.

CONTRA ENTRY

1. **Meaning:** Inter -Column transactions, i.e. Cash deposited into Bank, Cash withdrawn from Bank for business etc. are recorded on both Dr. and Cr. sides of the same Cash Book in appropriate columns. They are called "Contra Entries".
2. **Need**: Contra Entries arise in two -Column Cash Book (with Cash and Bank Columns) or Three- Column Cash Book.
3. **Treatment**: In case of Contra Entries, the amount is entered in Bank Column & Cash Column on the appropriate (Dr. or Cr) sides. Such entries will be marked as "C" in the Ledger Folio Column to indicate that these are contra transactions and no further posting is required.

Transaction	In Bank Column	In Cash Column
Cash deposited into Bank	Debit Bank Column of Cash Book	Credit Cash Column of Cash Book
Cash withdrawn from Bank	Credit Bank Column of Cash Book	Debit Cash Column of Cash Book
Note: Cash withdrawn from bank for personal purposes will be treated as drawings and is not a contra entry. Credit Bank Column of Cash Book; Debit Drawings A/c		

PETTY CASH BOOK AND IMPREST SYSTEM

1. Meaning: Petty Cash Book is used to maintain the record of all petty cash expenses, i.e. expenses of small amount say upto ₹ 100, e.g. Auto Fare, Postage Stamps purchase Minor Repairs, etc. Petty Cash balance is an asset for the business and shown directly on the assets side of the balance sheet under "Cash Balances".
2. Purposes / Advantages:
   (a) Saving of time of the Chief Cashier.
   (b) Saving in labour in writing up the Cash Book and posting into the Ledger, and
   (c) Effective Control over small payments.
3. Format:

ANALYTICAL PETTY CASH BOOK

Receipts ₹	Date	Voucher Number	Particulars	Total Payments ₹	Expense 1 ₹	Expense 2 ₹	Expense 3 ₹	Expense 4 ₹

Note: Generally, a "Sundries" Column is provided on right side, which is analysed at the end of the month or week.

4. Imprest System: The Petty Cashier is entrusted with a certain amount of Cash, say ₹ 500 to pay petty expenses during a period, say a week. After that week, the Petty Cashier submits a statement of expenses paid by him, e.g. ₹ 430, which will be reimbursed to him by the Main Cashier. Thus, the Petty Cashier will have 500 again with him (₹ 70 Petty Cash in Hand + ₹ 430 Reimbursement received), to meet expenses during the next week. This reimbursement system is called Imprest System.

SALE THROUGH CREDIT / DEBIT CARDS

1. Card Contents: Credit Card / Debit Card issued by a Bank is a small plastic card containing – (a) Name of the Cardholder (b) Card Number (16 digit Number), c) Date of Issue, (d) Date of Expiry, and (e) Magnetic Strip at the back.

2. Debit vs Credit Card: In a Credit Card, the Cardholder can buy now & pay later, whereas in a Debit Card, the Cardholder has to pay earlier (i.e. have a minimum balance in his account) in order to buy now. Nowadays, ATM Card issued by a Bank can also be used as Debit Card

3. Parties involved:
   (a) Cardholder (Who buys goods using a Credit / Debit Card)
   (b) Merchant (Who sells goods to a customer using a Credit / Debit Card)
   (c) Issuing Bank (A bank who has issued a card to Cardholder Eg: ICICI Bank)
   (d) Acquiring Bank (A bank with whom the merchant has an account Eg: HSBC Bank)
   (e) Member Service Provider (Visa / Master)

Note: The bank issuing Card, charges commission for each such transaction, which varies between 1% to 4% & is debited to Seller/merchant bank account

4. Accounting Entries in the books of the Merchant:

For recording Sales	For recording Commission charged by Bank
Bank Account Dr. To Sales Account	Commission Account Dr. To Bank Account Commission charged by the bank treated as selling expense

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no.______

Enter the following transactions in Cash Book with Discount and Bank Columns. Cheques are first treated as cash receipt.

2023	Particulars	Amount
Jan. 1	Ravi commences business with Cash	20,000
Jan. 3	He paid into Current A/c	19,000
Jan. 4	He received cheque from Kirti & Co. on account	600
Jan. 7	He pays in bank Kirti & Co.'s cheque	600
Jan. 10	He pays Rattan & Co. by cheque and is allowed discount ₹ 20	330
Jan. 12	Tripathi & Co. pays into his Bank A/c	475
Jan. 15	He receives cheque from Warshi and allows him discount ₹ 35	450
Jan. 20	He receives cash ₹ 75 and cheque ₹ 100 for cash sale	-
Jan. 25	He pays into Bank, including cheques received on 15th and 20th	1,000
Jan. 27	He pays for cash purchase	275
Jan. 30	He pays sundry expenses in cash	50

Question 2 *(ICAI Study Material)* Pg no.______

Enter the following transaction in Cash Book with Discount and Bank columns. Cheques are first treated as cash receipts

2023	Particulars	Amount
March 1	Cash in Hand	15,000
	Overdraft in Bank	500
March 2	Cash Sales	3,000
March 3	Paid to Sushil Bros. by cheque	3,400
	Discount received	100
March 5	Sales through credit card	2,800
March 6	Received cheque from Srijan	6,200
March 7	Endorsed Srijan's cheque in favour of Adit	
March 9	Deposit into Bank	6,800
March 10	Received cheque from Aviral and deposited the same into Bank by allowing discount of ₹50	3,600
March 11	Adit informed that Srijan's cheque is dishonoured. Now cash is received from Srijan and amount is paid to Adit through own cheque	
March 15	Sales through Debit Card	3,200
March 24	Withdrawn from Bank	1,800
March 28	Paid to Sanchit by cheque	3,000
March 30	Bank charged 1% commission on sales through Debit/Credit Cards	

Question 3 *(ICAI Study Material)* Pg no._____

Shri Ramaswamy maintains a Columnar Petty Cash Book on the Imprest System. The imprest amount is ₹ 500. From the following information, show how his Petty Cash Book would appear for the week ended 12th September, 2023:

Date	Particulars	Amount
7-09-2023	Balance in hand	134.90
	Received Cash reimbursement to make up the imprest	365.10
	Stationery	49.80
8-09-2023	Miscellaneous Expenses	20.90
9-09-2023	Repairs	156.70
10-09-2023	Travelling	68.50
11-09-2023	Stationery	71.40
12-09-2023	Miscellaneous Expenses	6.30
13-09-2023	Repairs	48.30

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the ________
   (a) Credit of the discount allowed account.
   (b) Debit of the discount allowed account
   (c) Credit of the discount received account.

2) Cash book is a type of _________ but treated as a ___________ of accounts.
   (a) Subsidiary book, principal book
   (b) Principal book, subsidiary book
   (c) Subsidiary book, subsidiary book

3) Which of the following is not a column of a three-column cash book?
   (a) Cash column
   (b) Bank column
   (c) Petty cash column

4) Contra entries are passed only when _________________________
   (a) Double-column cash book is prepared
   (b) Three-column cash book is prepared
   (c) Simple cash book is prepared

5) The Cash Book records _________________________
   (a) All cash receipts
   (b) All cash payments
   (c) All cash receipts and payments

6) The balance in the petty cash book is _________________________
   (a) An expense
   (b) A profit
   (c) An asset

7) If Ram has sold goods for cash, the entry will be recorded _________________________
   (a) In the Cash Book
   (b) In the Sales Book
   (c) In the Journal

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Cash book is a subsidiary book as well as a principal book. *(July 2021)*
2) Two column cash book consists of two columns.
3) Discount column of cash book is never balanced. *(Dec 2021)*
4) Contra entry is passed in a two column cash book.
5) If the bank column is showing the opening balance on credit side, it is an overdraft.
6) A Cash book records cash transactions as well as credit transactions.
7) Discount column of cash book records the trade discount.
8) The balance in the Cash Book shows net income.
9) Discount account should be balanced in the Cash Book.
10) The balance in the Petty Cash Book represents the amount spent.
11) Petty cash is an expense.
12) The balance in petty cash book represents an asset
13) A crossed cheque is always payable across the bank counter.
14) If a cheque received is further endorsed, it must be entered on both sides of the Cash Book.

Solution

1) True: Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account; the balances are entered in the trial balance directly. The Cash Book therefore, is part of the ledger also. Hence, it has also to be treated as a principal book. The Cash Book is thus both a subsidiary book and a principal book.
2) True: Two column cash book consists of two columns either cash column and discount column or cash column and Bank column.
3) True: Discount column is totalled and transferred to Discount Allowed/Received Account
4) False: Contra Entry is passed in 3 column cash book & in 2 column cash book only when cash and bank columns are there
5) True: If the bank column is showing the opening balance on credit side, it is an overdraft (unfavourable balance)
6) False: Cash book records only cash transactions
7) False: Discount column of cash book records the cash discount. Trade discount is not shown in the books of accounts.
8) False: The balance in the Cash Book shows cash in hand.
9) False: Discount account is maintained in Double columnar or Three columnar Cash Book. These columns are not balanced but are only totalled.
10) False: The balance in the Petty Cash Book represents the cash balance lying with the Petty Cashier.
11) False: Petty cash is real account & current asset, and it is shown on asset side of the balance sheet.
12) True: The balance represents the cash physically in existence and is therefore an asset.
13) False: A crossed cheque is always payable to the recipient's account directly.
14) True: When the cheque is received it is debited and when further endorsed it is credited.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Enter the following transactions in a Simple Cash Book:

2023	Particulars	Amount
Jan.1	Cash in hand	1,200
Jan.5	Received from Ram	300
Jan.7	Paid Rent	30
Jan.8	Sold goods for cash	300
Jan.10	Paid to Shyam	700
Jan.27	Purchased Furniture	200
Jan.31	Paid Salaries	100
Jan.31	Rent due, not yet paid, for January	30

Question 2 *(ICAI Study Material)* *Pg no._____*

Ganesh commenced business on 1st April, 2023 with ₹ 2,000 as capital. He had the following cash transactions in the month of April 2023:

Date	Particulars	Amount
April 1	Purchased furniture and paid cash	250
April 2	Purchased goods	500
April 4	Sold goods for cash	950
April 5	Paid cash to Ram Mohan	560
April 5	He allowed discount	10
April 6	Received cash from Krishna & Co. & allowed discount ₹ 20	600
April 7	Paid for petty expenses	15
April 8	Cash purchases	150
April 13	Paid for labour	1,000
April 14	Paid Ali & Sons	400
April 14	They allowed discount	8

Make out the two-column Cash Book (Cash and discount column) for the month of April, 2023.

Question 3 *(RTP May 2023)/(May 18)/(Nov 18)/(May 20)/(May 21)/(Nov 23) (Similar)* *Pg no._____*

Prepare a Triple Column Cash Book for the month of April 2022 from the following transactions and bring down the balance for the start of next month:

Date	Particulars	Amount
1	Cash in hand	9,000
1	Cash at bank	36,000
2	Paid into bank	3,000
5	Bought furniture and issued cheque	4,500
8	Purchased goods for cash	1,500
12	Received cash from Ms. Kamini	2,940
	Discount allowed to her	60
14	Cash sales	15,000
16	Paid to Ms. Shikha by cheque	4,350
	Discount received	150
19	Paid into Bank	1,500
20	Sales through Credit Card	4,000
23	Withdrawn from Bank for Private expenses	1,800

24	Received cheque from Ms. Reema	4,290
	Allowed her discount	60
26	Deposited Reema's cheque into Bank	
28	Withdraw cash from Bank for Office use	6,000
30	Paid rent by cheque	2,400
30	Bank charged 1% commission on sales through Debit/Credit Cards	

Question 4 *(ICAI Study Material)* *Pg no._____*

Prepare a Petty Cash Book on the Imprest System from the following:

2023	Particulars	Amount
Jan. 1	Received ₹10000 for petty cash	
Jan. 2	Paid bus fare	50
Jan. 2	Paid cartage	250
Jan. 3	Paid for Postage & Telegrams	500
Jan. 3	Paid wages for casual labourers	600
Jan. 4	Paid for stationery	400
Jan. 4	Paid bus charges	200
Jan. 5	Paid for the repairs to chairs	1,500
Jan. 5	Bus fare	100
Jan. 5	Cartage	400
Jan. 6	Postage and Telegrams	700
Jan. 6	Bus charges	300
Jan. 6	Cartage	300
Jan. 6	Stationery	200
Jan. 6	Refreshments to customers	500

Question 5 *(RTP May 2019) / (RTP Nov 2021) (Similar) / (RTP May 2022) (Similar)* *Pg no._____*

Prepare a Petty Cash Book on the Imprest System from the following:

Date (2021)	Particulars	Amount
April 1	Received ₹20000 for petty cash	
April 2	Paid auto fare	500
April 3	Paid cartage	2,500
April 4	Paid for Postage & Telegrams	500
April 5	Paid wages	600
April 5	Paid for stationery	400
April 6	Paid for the repairs to machinery	1,500
April 6	Bus fare	100
April 7	Cartage	400
April 7	Postage and Telegrams	700
April 8	Cartage	3,000
April 9	Stationery	2,000
April 10	Refreshments to customers	5,000

Question 6 *(CA Foundation June 2022) (5 Marks)* *Pg no._____*

What is petty cash book? Write it's any two advantages.

Question 7 *(CA Foundation Dec 2022) (5 Marks)* Pg no._____

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:

2022		₹
March 1	Cash in hand	30,000
1	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
12	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

Unit 6: RECTIFICATION OF ERRORS

CH 2F

"You must have long range goals to keep you from being frustrated by short range failures."

- Accountant, as a normal human being is likely to commit mistakes while recording the transactions in the books of original entry, posting them to Ledger accounts or in preparing a Trial balance itself.
- It is essential to locate & rectify errors else Profit & Loss A/c and Balance sheet will not disclose true profit/loss and true financial position of the business respectively.

TYPE OF ERRORS

Errors in Accounting

- Errors of Principle (Type 1)
- Clerical Errors
  - Errors of Omission
    (a) Complete Omission (Type 1)
    (b) Partial Omission (Type 2)
  - Errors of Commission (Type 1 and 2)
  - Compensating Errors (Type 1)

Note: Type 1 Error = Trial balance will still agree. Type 2 Error = Trial balance will not agree.

ERRORS OF PRINCIPLE

Meaning	It arises when a financial transaction is recorded in the books in an incorrect manner. i.e., Journal Entry is not as per the Accounting Principles
Example	Capital Expenditure is treated as revenue expenditure or vice versa, E.g. Repairs to machinery wrongly treated as capital expenditure and debited to Machinery Account instead of Machinery Repairs A/c.
Stage	Such errors are normally committed while recording in the journal
Effect	Such errors will not affect the Trial Balance.

ERRORS OF OMISSION

<table>
<tr><td>Meaning</td><td colspan="2">Error of Omission means that a transaction is not recorded/posted/transferred either wholly or partially, in the books of accounts.</td></tr>
<tr><td rowspan="4">Types</td><td colspan="2">They may be further analyzed into-</td></tr>
<tr><td>Partial Omission</td><td>Complete Omission</td></tr>
<tr><td>(a) One aspect of the transaction, either debit or credit, omitted to be posted</td><td>Both aspects of transaction, debit & credit omitted to be recorded/posted.</td></tr>
<tr><td>(b) Trial Balance will not agree.</td><td>Trial Balance will still agree</td></tr>
</table>

	(c) Arises from posting on one side & omission of other side entry.	Arises from omission-either in the book of original entry or in the ledger.
Stage	(a) Complete Omission: (i) While recording in Journal (ii) Posting to Ledger (b) Partial Omission: (i) While Posting to ledger	
Effect	(a) Complete Omission – will NOT affect Trial Balance. (b) Partial Omission in Posting – will affect Trial Balance	

ERRORS OF COMMISSION

Meaning	A transaction is recorded wrongly or incorrectly in the books. It also includes all clerical errors during the Accounting process.
Types & Effect on Trial balance	These may be categorized into- (a) Recording Error: writing the wrong amount in subsidiary books. Trial balance will agree. (b) Posting Error: wrong account, wrong amount, wrong side, etc. Trial Balance may or may not agree. (c) Casting Error: wrong totaling or balancing. Trial Balance will not agree. (d) Carry Forward Error: carrying forward a wrong amount, wrong side, etc. Trial Balance will not agree. (e) Duplication Error: recording the same transactions twice in the original book of entry and posting it to the ledger. Trial balance will agree.

COMPENSATING ERRORS

Meaning	One set of errors on the debit side for a specified amount is counter-balanced by another set of errors for the same amount on credit side. Due to this the trial Balance is not affected.
Example	Goods worth 10,000 sold to Ram but posted to Rohit's Account as 1,000 and goods worth 1,000 sold to Rohit but posted to Ram's Account as 10,000
Effect	Such errors will not affect the Trial Balance

STAGES OF OCCURRENCE OF ERRORS

While recording the transactions in journal
- Errors of Principle
- Errors of Omission
- Errors of Commission

While posting the entries in the Ledger
- Errors of Omission
  - (a) Partial Omission
  - (b) Complete Omission
- Errors of Commission
  - (a) Posting to wrong A/c
  - (b) Posting on wrong side
  - (c) Posting of wrong amount

While balancing Ledger Accounts
- Wrong Totaling
- Wrong balancing

While Preparing the Trial balance
- Errors of Omission
- Errors of Commission
  - (a) Taking wrong A/c
  - (b) Taking wrong Amt.
  - (c) Taking to wrong side

TRIAL BALANCE AND IDENTIFICATION OF ERRORS

1. Purpose:
   (a) The purpose of Trial Balance is to ensure arithmetical accuracy of books of Accounts.
   (b) Hence, Trial Balance can be used to identify the errors made during the accounting process.
2. Method of Identification of errors: Errors are identified if Debit Column Total ≠ Credit Column Total

Errors Affecting Trial Balance:

- Error of Casting
- Error of Carrying Forward
- Error of balancing
- Posting to wrong side of the correct amount
- Posting to the correct side with the wrong amount
- Error of partial omission

Errors Not Affecting Trial Balance:

- Error of Principle
- Error of Complete Omission (Recording or Posting)
- Compensating Errors
- Wrong amount recorded in books of original entry
- Posting to the wrong account but on correct side

SUSPENSE ACCOUNT

1. Meaning: When the Trial Balance does not tally, then it is essential to create an account named "Suspense Account" on the column whose total is lower
2. Purpose:
   (a) The Suspense Account is opened for the differential amount on the column which is lower to make the trial balance artificially tally. (i.e., Trial Balance is temporarily tallied by opening the suspense account).
   (b) It is kept till the errors are identified and rectified. After the rectification, Suspense A/c balance will become zero.
3. Type: Suspense A/c is a combination of Real, Personal and Nominal Accounts. It is a temporary Account.
4. Nature of balance in Suspense Account:

Situation	Suspense A/c will appear on	Nature of Balance
If Debit Column Total < Credit Column Total	Debit Column	Debit Balance
If Credit Column Total < Debit Column Total	Credit Column	Credit Balance
Note: Suspense account will appear on the Column whose total is lower		

5. Hence, Suspense Account will appear only when error affects the Trial Balance.
6. Disclosure in Balance Sheet:

Nature of Suspense A/c Balance	Shown in	Side
Debit Balance in Suspense A/c	Balance sheet	Assets
Credit Balance in Suspense A/c	Balance sheet	Liabilities

STAGES OF RECTIFICATION OF ERRORS

- Before Preparation of Trial Balance
- After Trial Balance but before Final Accounts are prepared
- After Final Accounts i.e. in next trading/Accounting period

Stage	Treatment
1. Before preparation of Trial Balance	• Errors affecting Trial Balance: Direct rectification is done in relevant account. No use of Suspense Account (E.g. Error of Partial Omission) • Errors not affecting Trial Balance: Rectified journal entry is passed (E.g. Error of Complete Omission, Error of Principle etc.) Note: Errors of Commission are rectified based on the nature of error.
2. After Trial Balance but before Final Accounts are prepared	• Errors affecting Trial Balance: Suspense Account used while passing Journal entry. (E.g. Error of Partial Omission) • Errors not affecting Trial Balance: Rectified journal entry is passed (E.g. Error of Complete Omission, Error of Principle etc.) Note: Errors of Commission are rectified based on the nature of error.

Rectification of Errors (Few Examples)

	Before Trial Balance	After Trial Balance
1) Cash received from A, 1000 wrongly credited to B		
2) Cash received from A, 1000		
a) Not credited to A		
b) Debited to his account		
c) Credited to his account, 100		
d) Credited to his account, 10000		
e) Debited to his account 100		
f) Debited to B's Account		
3) Repairs to Machinery 5000 wrongly capitalised		
4) Total of Sales Book undercast by 500		

3. Rectification of Error After Final Accounts i.e., in the Next Trading/Accounting period

- Errors which have an impact on Profit (Nominal Accounts) are rectified by using the P&L Adjustment Account (Prior Period Item).
- Instead of Nominal Accounts, P&L Adjustment Account debited or credited.
- The balance in this account should be transferred to Profit & Loss A/c (or Capital A/c)
- Prior Period items should be separately disclosed in the current statement of Profit & Loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived.

Rectification of Errors (Few Examples)

	Before Trial Balance	After Trial Balance	After Final Accounts
1) Cash received from A, 1000 wrongly credited to B			
2) Cash received from A, 1000 a) Not credited to A b) Debited to his account			
3) Repairs to Machinery 5000 wrongly capitalised			
4) Total of Sales Book undercast by 500			
5) Purchase of A, 1000 wrongly recorded in Sales Book but correctly posted to A's Account.			

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

How would you rectify the following errors in the book of Rama & Co.? (without opening suspense A/c)

1. The total to the Purchases Book has been undercast by ₹100.
2. The Returns Inward Book has been undercast by ₹ 50.
3. A sum of ₹ 250 written off as depreciation on Machinery has not been debited to Depreciation Account.
4. A payment of ₹ 75 for salaries (to Mohan) has been posted twice to Salaries Account.
5. The total of Bills Receivable Book ₹ 1,500 has been posted to the credit of Bills Receivable Account.
6. An amount of ₹151 for a credit sale to Hari, although correctly entered in the Sales Book, has been posted as ₹ 115.
7. Discount allowed to Satish ₹ 25 has not been entered in the Discount Column of the Cash Book. The amount has been posted correctly to the credit of his personal account.

Question 2 *(ICAI Study Material)* Pg no._____

The following errors, affecting the account for the year 2023 were detected in the books of Jain Brothers, Delhi:

(1) Sale of old Furniture ₹150 treated as sale of goods.
(2) Receipt of ₹ 500 from Ram Mohan credited to Shyam Sunder.
(3) Goods worth ₹100 brought from Mohan Narain have remained unrecorded so far.
(4) A return of ₹120 from Mukesh posted to his debit.
(5) A return of ₹ 90 to Shyam Sunder posted as ₹ 9 in his account.
(6) Rent of proprietor's residence, ₹ 600 debited to rent A/c.
(7) A payment of ₹ 215 to Mohammad Sadiq posted to his credit as ₹125.
(8) Sales Book casted short by ₹ 900.
(9) The total of Bills Receivable Book ₹ 1,500 left unposted.

You are required to pass the necessary rectifying entries and show how the trial balance would be affected by the errors.

Question 3 *(RTP May 2019) / (RTP Nov 2021) (Similar) / (RTP Nov 2023)* Pg no._____

M/s Suman & Co. find the following errors in their books of account before preparation of Trial Balance. You are required to pass necessary journal entries:

(i) A purchase of ₹ 5,600 from M/s Minu & Co. was recorded in the accounts of M/s Mintu & Co. as ₹ 6,500. Day Book entry has also been passed incorrectly.
(ii) A sale of ₹ 9,800 to M/s Bantu Bros. was recorded in M/s Bindu & Co.'s account as ₹ 8,900. Day Book entry has also been incorrectly passed.
(iii) Discount allowed ₹ 560 (as per Cash Book) has been posted to Commission Account. But the Cash Book total should be ₹ 650, because discount allowed of ₹ 90 to M/s Bantu Bros. has been omitted
(iv) A cheque of ₹ 9,700 drawn by M/s Bantu Bros. has been dishonoured, but wrongly debited to M/s Bhakt & Co.

Should the Trial Balance tally without rectification of errors?

Question 4 *(ICAI Study Material)* Pg no._____

Correct the following errors (i) without opening a Suspense Account and (ii) opening a Suspense Account:

(a) The Sales Book has been totalled ₹100 short.
(b) Goods worth ₹150 returned by Green & Co. have not been recorded anywhere.
(c) Goods purchased ₹250 have been posted to the debit of the supplier Gupta & Co.
(d) Furniture purchased from Gulab & Bros, ₹1,000 has been entered in Purchases Day Book.
(e) Discount received from Red & Black ₹15 has not been entered in the Discount Column of the Cash Book.
(f) Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

Question 5 ***(ICAI Study Material)*** *Pg no._____*

The following errors were found in books of Ram Prasad & Sons. Give the necessary entries to correct them.
(1) ₹ 500 paid for furniture purchased has been charged to ordinary Purchases Account.
(2) Repairs made were debited to Building Account for ₹ 50.
(3) An amount of ₹100 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.
(4) ₹100 paid for rent debited to Landlord's Account.
(5) Salary ₹125 paid to a clerk due to him has been debited to his personal account.
(6) ₹100 received from Shah & Co. has been wrongly entered as from Shaw & Co.
(7) ₹ 700 paid in cash for a typewriter was charged to Office Expenses Account.

Question 6 *Pg no._____*

On 31st March 2023, a book-keeper finds the difference in the Trial Balance and the puts it in the Suspense Account. Later on he detects the following errors:-
a) ₹ 50,000 received from A was posted to the debit of his account.
b) ₹ 20,000 being purchases returns were posted to the debit of Purchases Account.
c) Discount of ₹ 8,000 received were posted to the debit of Discount Account.
d) ₹ 9,060 paid to repairs of Motor Car was debited to Motor Car Account as ₹ 7,060.
e) ₹ 40,000 paid to B was debited to A's Account.
Give Journal Entries to rectify the errors & ascertain the amount transferred to Suspense Account, assuming that the Suspense Account is balanced after the above corrections.

Question 7 *Pg no._____*

A book keeper finds the differences in the Trial Balance amounting to ₹ 1,000 and puts it in the Suspense Account.
Later on he detects the following errors:-
a) Purchased goods from Ravi ₹ 15,000 but entered into Sales Book.
b) Received one bill for ₹ 25,000 from Arun but recorded in Bills Payable Book.
c) An item of ₹ 3,500 relating to prepaid rent account was omitted to be brought forward.
d) An item of ₹ 2,000 in respect of purchase returns, had been wrongly entered in the purchase book.
e) ₹ 25,000 paid to Harish against our acceptance were debited to Harish's Account.
f) Bills (invoice) received from Janki for repairs done to radio ₹ 2,500 and radio supplied for ₹ 45,000 were entered in the Purchase Book as ₹ 46,000.
g) Bad Debts aggregating ₹500 were written off during the year in the Sales ledger but were not adjusted in the General Ledger.
Give rectifying journal entries and prepare Suspense Account.

Question 8 *(ICAI Study Material)* *Pg no._____*

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

a) Purchase returns day book had been correctly entered and totalled at ₹6,160, but had not been posted to the ledger.
b) Discounts received ₹1,320 had been debited to discounts allowed.
c) The Sales account had been under added by ₹10,000.
d) A credit sale of ₹1,470 had been debited to a customer account at ₹1,740.
e) A vehicle bought originally for ₹7,000 four years ago and depreciated to ₹1,200 had been sold for ₹1,500 in the beginning of the year but no entries, other than in the bank account had been passed through the books.
f) An accrual of ₹560 for telephone charges had been completely omitted.
g) A bad debt of ₹1,560 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at ₹23,390 with a credit provision for bad debts at ₹2,320.
h) Tools bought for ₹1,200 had been inadvertently debited to purchases.
i) The proprietor had withdrawn, for personal use, goods worth ₹1,960. No entries had been made in the books.

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

Question 9 *(ICAI Study Material)* *Pg no._____*

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

a) The totals of debit side of "Expenses Account" have been casted in excess by ₹ 50.
b) The "Sales Account" has been totalled in short by ₹100.
c) Supplier account has been overcasted by ₹225.
d) The sale return of ₹100 from a party has not been posted to that account though the Party's account has been credited.
e) A cheque of ₹500 issued to the Suppliers' account (shown under Trade payables) towards his dues has been wrongly debited to the purchases.
f) A credit sale of ₹50 has been credited to the Sales and also to the Trade receivables Account.

You are required to

1) Pass necessary journal entries for correcting the above;
2) Show how they affect the Profits; and
3) Prepare the "Suspense Account" as it would appear in the ledger.

Question 10 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2020)* *Pg no._____*

The following errors were committed by the Accountant of Geete Dye-Chem.

a) Credit sale of ₹ 400 to Trivedi & Co. was posted to the credit of their account.
b) Purchase of ₹ 420 from Mantri & Co. passed through Sales Day Book as ₹ 240

How would you rectify the errors assuming that:

1) they were detected before preparation of Trial Balance.
2) they were detected after preparation of Trial Balance but before preparing Final Accounts, the difference was taken to Suspense A/c.
3) they were detected after preparing Final Accounts.

Question 11 *Pg no._____*

The Trial Balance of ABC Ltd., as on Dec 31st, 2022 did not agree. The difference was put to a Suspense Account. During the next trading period, the following were discovered:

a) The total of the Sales-book of one page ₹ 6,531 was carried forward to the next page as ₹ 6,351.
b) Goods returned by a customer for ₹1,200, but entered in Purchases Return Book.
c) Personal Car Expenses amounting to ₹ 250 were debited to Trade Expenses.
d) Sales Return Book was under cast by ₹ 2,750.
e) ₹ 50 discount allowed by a supplier, was wrongly posted to debit side of Discount Account.
f) An item of Purchases of ₹ 151 was entered in Purchases Book as ₹ 15 and posted to Supplier's Account as ₹ 51.

You are required to give journal entries to rectify the errors through Profit & Loss Adjustment A/c in a way so as to show the current year's profit or loss correctly.

Question 12 *(ICAI Study Material)* *Pg no._____*

Mr. Roy was unable to agree the Trial Balance last year and wrote off the difference to the Profit and Loss Account of that year. Next Year, he appointed a Chartered Accountant who examined the old books and found the following mistakes:

(1) Purchase of a scooter was debited to conveyance account ₹3,000.
(2) Purchase account was over-cast by ₹10,000.
(3) A credit purchase of goods from Mr. P for ₹2,000 entered as a sale.
(4) Receipt of cash from Mr. A was posted to the account of Mr. B ₹1,000.
(5) Receipt of cash from Mr. C was posted to the debit of his account, ₹500.
(6) ₹ 500 due by Mr. Q was omitted to be taken to the trial balance.
(7) Sale of goods to Mr. R for ₹2,000 was omitted to be recorded.
(8) Amount of ₹2,395 of purchase was wrongly posted as ₹2,593.

Mr. Roy used 10% depreciation on vehicles. Suggest the necessary rectification entries.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Goods purchased from A for ₹10,000 passed through sales book. The error will result in
   (a) Increase in gross profit.
   (b) Decrease in gross profit.
   (c) No effect on gross profit.

2) If a purchase return of ₹1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the
   (a) Trial balance would show the debit side to be ₹1,000 more than the credit.
   (b) Trial balance would show the credit side to be ₹1,000 more than the debit.
   (c) The debit side of the trial balance will be ₹2,000 more than the credit side.

3) If amount is posted in wrong a/c or it is written on the wrong side of the account, it is called
   (a) Error of omission.
   (b) Error of commission.
   (c) Error of principle.

4) ₹200 paid as wages for erecting a machine should be debited to
   (a) Repair account.
   (b) Machine account.
   (c) Capital account.

5) On purchase of old furniture, the amount of ₹1,000 spent on its repair should be debited to
   (a) Repair account.
   (b) Furniture account.
   (c) Cash account.

6) Goods worth ₹50 given as charity should be credited to
   (a) Charity account.
   (b) Sales account.
   (c) Purchase account.

7) Goods worth ₹100 taken by proprietor for domestic use should be credited to
   (a) Sales account.
   (b) Proprietor's personal expenses.
   (c) Purchases account

8) Sales of office furniture should be credited to
   (a) Sales Account.
   (b) Furniture Account.
   (c) Purchase Account.

9) The preparation of a trial balance is for:
   (a) Locating errors of commission.
   (b) Locating errors of principle.
   (c) Locating clerical errors.

10) 200 received from Smith whose account was written off as bad debt should be credited to
   (a) Bad Debts Recovered account.
   (b) Smith's account.
   (c) Cash account.

11) Purchase of office furniture ₹1,200 has been debited to General Expense Account. It is:
    (a) A clerical error.
    (b) An error of principle.
    (c) An error of omission.

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) The method of rectification of errors depends on the stage at which are errors are detected.
2) In case of errors of complete omission, the trial balance does not tally
3) When errors are detected after preparation of trial balance, suspense account is opened
4) When purchase of an asset is treated as an expense, it is known as error of principle
5) Trial balance agrees in case of compensating errors
6) When amount is written on wrong side, it is known as an error of principle
7) On purchase of old furniture, the amount spent on repairs should be debited to repairs account
8) Profit & Loss Adjustment account is opened to rectify the errors detected in the current accounting period
9) Rent paid to Landlord of the proprietor house must be debited to Rent account
10) If the errors are detected after preparing trial balance, then all the errors are rectified through suspense account. *(June 2022)/ (Dec 2022)*
11) Any type of error affects the agreement of Trial Balance.
12) Error of carry forward of totals of Purchase Journal affects two accounts.
13) The debts written off as bad if recovered subsequently are credited to debtors account.
14) Error of principle involves an incorrect allocation of expenditure or receipt between capital and revenue.
15) Freight & cartage expenses paid on purchase of goods is added to amount of purchases.
16) If the amount is posted in the wrong account or it is written on the wrong side of an account it is called error of omission.
17) Tallying of the Trial Balance only proves the arithmetical accuracy.
18) A tallied balance means that the books of accounts have been prepared as per accepted accounting principles.
19) Compensating errors do not disturb agreement of Trial Balance.
20) The trial balance does not ensure the arithmetical accuracy of the books.
21) Under or overcasting of subsidiary book is example of error of Commission. *(June 2023)*
22) Rectifying errors in subsequent accounting period always affects the profit or loss of that period.
23) If the effect of errors committed cancel out, the errors will be called compensating errors and the trial balance will disagree. *(May 2018)*
24) The rationale behind the opening of a suspense account is to tally the trial balance.
25) If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called error of principle. *(May 2019)*
26) Sale of Office Furniture should be credited to Profit & Loss Account.
27) Purchase of office furniture & fixtures of ₹ 2,500 has been debited to General Expense Account. It is an error of omission. *(Nov 2020)*
28) Prior period items need not be separately disclosed in current statement of profit & loss.

Solution

1) True: There are 3 different stages when the mistakes are identified and then the rectification depends on the stage of identification
2) False: In case of error of complete omission, the trial balance tallies
3) True: In order to balance difference of balances in trial balance suspense a/c is opened.
4) True: Where the accounts being debited is principally incorrect it is termed as error of principle
5) True: Compensating errors cancel out each other when Trial balance is prepared as the mistake pertains to the same amount being credited and later debited on account of two different mistakes
6) False: When amount is written on wrong side, it is known as error of commission
7) False: On purchase of furniture, the amount spent on repairs should be debited to furniture account as it is a capital expense
8) False: Profit & Loss Adjustment account is opened to rectify the errors detected in the next accounting period
9) False: Rent paid to Landlord of the proprietor house must be debited to Drawings account
10) False: If the errors are detected after preparing trial balance, then all the errors are not rectified through suspense account. There may be Errors of Principle, Compensating errors, Errors of complete omission which can be rectified without opening a suspense account.
11) False: - Any type of error does not affect the agreement of trial balance e.g. compensating errors do not affect the Trial Balance.
12) False: - Error of carry-forward of totals of Purchase Journal will affect only one account i.e. Purchases A/c and finally it will result in disagreement of Trial Balance.
13) False: - The debts written off as bad if recovered subsequently shall be treated as gain and be credited to Profit & Loss A/c or to Bad debts Recovered A/c.
14) True: - Recording the transaction in a fundamentally incorrect manner in contravention of accounting principles is an error of principle.
15) True: - Freight and cartage expenses paid to bring goods purchased into the business premises factory are included in the 'Cost of Purchases'.
16) False: - Posting amount on wrong side or to wrong a/c is called an error of commission.
17) True: - Trial Balance helps to establish the arithmetical accuracy of ledger books. A tallied trial balance will not reveal errors of principle and compensating errors.
18) False: - The balance only checks the arithmetical accuracy of books. Errors of principles and errors of omission will not affect the agreement of trial balance.
19) True: - In cases of compensating errors, the effect of errors committed cancel out, and thus errors do not disturb agreement of trial balance.
20) False: - Trial balance helps to establish the arithmetical accuracy of ledger balances. However, a tallied trial balance will not reveal error of principle and compensating errors.
21) True: - If an amount is posted in the wrong account or it is written on the wrong side or totals are wrong or wrong balance is struck, it will be a case of "errors of commission." Thus, under or over casting of subsidiary books is an example of error of commission.
22) False: - If errors are rectified in the subsequent accounting period as prior period items, profit of subsequent period is not affected.
23) False: If the effect of errors committed cancel out, the errors will be called compensating errors and the trial balance will agree.
24) False: The rationale behind the opening of a suspense account is to avoid delay in the preparation of financial statements.
25) False: If an amount is posted in the wrong account or is written on the wrong side of the correct account, it is case of "errors of commission" and is not "error of principle".

26) False: Sale of Office Furniture should be credited to Furniture Account since it is a capital receipt
27) False: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. Purchase of office furniture and fixtures is a capital expenditure, if debited to General Expenses account, is an error of principle and not an error of omission.
28) False: Prior Period Items should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived

HOMEWORK QUESTIONS

Question 1 *(CA Foundation Nov 2019) (10 Marks)* *Pg no._____*

Correct the following errors (i) without opening a Suspense Account and (ii) with opening a Suspense Account:

1) The sales book has been totalled ₹ 2,100 short.
2) Goods worth ₹ 1,800 returned by Gaurav & Co. have not been recorded anywhere.
3) Goods purchased ₹ 2,250 have been posted to the debit of the supplier Sen Brothers.
4) Furniture purchased from Mary Associates, ₹ 15,000 has been entered in the purchase Daybook.
5) Discount received from Black and White ₹ 1,200 has not been entered in the books.
6) Discount allowed to Radhe Mohan & Co. ₹ 180 has not been entered in the Discount Column of the Cashbook. The account of Radhe Mohan & Co. has, however, been correctly posted.

Question 2 *(ICAI Study Material)* *Pg no._____*

Give journal entries to rectify the following:

(1) A purchase of goods from Ram amounting to ₹150 has been wrongly entered through the Sales Book.

(2) A Credit sale of goods amounting ₹120 to Ramesh has been wrongly passed through the Purchase Book.

(3) On 31st December, 2023 goods of the value of ₹300 were returned by Hari Saran and were taken inventory on the same date but no entry was passed in the books.

(4) An amount of ₹ 200 due from Mahesh Chand, which had been written off as a Bad Debt in a previous year, was unexpectedly recovered, and had been posted to the personal account of Mahesh Chand.

(5) A Cheque for ₹100 received from Man Mohan was dishonoured and had been posted to the debit of Sales Returns Account.

Question 3 *Pg no._____*

The accountant of X prepared the Trial Balance for the year ended 31st March, 2023. But there was a difference and the accountant put the difference in Suspense Account.
Rectify the following errors found and prepare the Suspense Account.

a) The total of the Returns outward book, ₹ 420 has not been posted to the ledger.
b) A purchase of ₹ 350 from Y has been entered in the sales book. However Y's account has been correctly entered.
c) A sale of ₹ 390 to Z has been credited to his account as ₹ 290.
d) Old furniture sold for ₹ 5,400 had been entered as ₹ 4,500 in sales account.
e) Goods taken by the proprietor, ₹ 500 have not been entered in the books at all.

Question 4 *(ICAI Study Material) / (RTP May 2019)/(May 2021)/(Nov 2023) (Similar)* *Pg no._____*

Write out the Journal Entries to rectify the following errors, using a Suspense Account.

(1) Goods of the value of ₹100 returned by Mr. Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account;

(2) An amount of ₹150 entered in the Sales Returns Book, has been posted to the debit of Mr. Philip, who returned the goods;

(3) A sale of ₹ 200 made to Mr. Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Radheshyam as ₹ 20;

(4) The total of "Discount Allowed" column in the Cash Book for the month of September, 2023 amounting to ₹ 250 was not posted.

Question 5 *(CA Foundation May 2018) (4 Marks) / (RTP May 2020)* Pg no._____

Give journal entries (narrations not required) to rectify the following:

a) Purchase of Furniture on credit from Nigam for ₹ 3,000 posted to Subham account as ₹ 300.

b) A Sales Return of ₹ 5,000 to Jyothy was not entered in the financial accounts though it was duly taken in the stock book.

c) Investments were sold for ₹ 75,000 at a profit of ₹ 15,000 and passed through Sales account.

d) An amount of ₹ 10,000 withdrawn by the proprietor (Darshan) for his personal use has been debited to Trade Expenses account.

Question 6 Pg no._____

The difference in Trial Balance is kept by Rajesh in Suspense Account. Before preparing the Final Accounts, the following errors were detected by him:

a) Purchase for ₹ 1,080 was written in Sales day book, but was posted to the correct side of the Party's account.

b) Salary account total ₹ 25,200 was carried over to the next page as ₹ 2,520 on the wrong side.

c) Interest on Overdraft ₹ 1,300 was not posted to the Ledger from the Cash-book.

Pass the Rectification entries and prepare the suspense account.

Question 7 *(RTP Nov 2018) / (RTP Nov 2021)* Pg no._____

Classify the following errors under the three categories – Errors of Omission, Errors of Commission and Errors of Principle.

a) Sale of furniture credited to Sales Account.

b) Purchase worth ₹ 4,500 from M not recorded in subsidiary books.

c) Credit sale wrongly passed through the Purchase Book.

d) Machinery sold on credit to Mohan recorded in Journal Proper but omitted to be posted.

e) Goods worth ₹ 5000 purchased on credit from Ram recorded in the Purchase Book as ₹ 500.

Question 8 *(CA Foundation May 2019) (4 Marks) / (RTP Nov 2022)* Pg no._____

Give journal entries (with narrations) to rectify the following errors located in the books of a Trader after preparing the Trial Balance:

(i) An amount of ₹ 4,500 received on account of Interest was credited to Commission account.

(ii) A sale of ₹ 2,760 was posted from Sales Book to the Debit of M/s Sobhag Traders at ₹ 2,670

(iii) ₹ 35,000 paid for purchase of Air conditioner for the personal use of proprietor debited to Machinery A/c.

(iv) Goods returned by customer for ₹ 5,000. The same have been taken into stock but no entry passed in the books of accounts

Question 9 *(ICAI Study Material)* Pg no._____

Correct the following errors found in the books of Mr. Dutt. The Trial Balance was out by ₹ 493 excess credit. The difference thus has been posted to a Suspense Account.

a) An amount of ₹100 was received from D.Das on 31st December, 2023 but has been omitted to enter in the Cash Book.

b) The total of Returns Inward Book for December has been casted short by ₹100.

c) The purchase of an office table costing ₹ 300 has been passed through the Purchases Day Book.
d) ₹ 375 paid for Wages to workmen for making show-cases had been charged to "Wages Account".
e) A purchase of ₹ 67 had been posted to the trade payables' account as ₹ 60.
f) A cheque for ₹ 200 received from P.C. Joshi had been dishonoured and was passed to the debit of "Allowances Account".
g) ₹ 1,000 paid for the purchase of a motorcycle for Mr. Dutt for his personal use had been charged to "Miscellaneous Expenses Account".
h) Goods amounting to ₹100 had been returned by customer and were taken into inventory, but no entry in respect there of, was made into the books.
i) A sale of ₹ 200 to Singh & Co. was wrongly credited to their account. Entry was made correctly made in sales book.

Question 10 *(CA Foundation Dec 2021) (5 Marks)* *Pg no._____*

Pass the Journal entries to rectify the following errors detected during preparation of the Trial Balance:
(i) Wages paid for construction of office building debited to wages account ₹ 20,000.
(ii) A credit sale of goods ₹ 1,200 to Ramesh has been wrongly passed through the Purchase Book.
(iii) An amount of ₹ 2,000 due from Mahesh Chand which had been written off as a bad debit in the previous year was unexpectedly recovered and has been posted to the personal account of Mahesh Chand.
(iv) Goods (Cost being ₹ 5,000 and Sales price being ₹ 6,000) distributed as free samples amount prospective customers were not recorded anywhere.
(v) Goods worth ₹ 1,500 returned by Green have not been recorded anywhere.

Question 11 *(CA Foundation Dec 2022) (10 Marks)* *Pg no._____*

Before preparation of the Trial Balance, the following errors were found in the books of Hare Rama & Sons. Give the necessary entries to correct them.

a. Minor Repairs made to the building amounting to ₹ 1,850 were debited to the Building Account.
b. An amount of ₹ 3,000 due from Shayam Lal, which had been written off as bad debts in the previous year, recovered in the current year, and had been posted to the personal Account of Shayam Lal.
c. Furniture purchased for office use amounting to ₹ 20,000 has been entered in the purchase day book.
d. Goods purchased from Ram Singh amounting to ₹ 8,000 have remained unrecorded so far.
e. College fees of proprietor's son, ₹ 15,000 debited to the Audit fees Account.
f. Receipt of ₹ 4,500 from Meet Kumar credited to the Pinki Rani.
g. Goods amounting to ₹ 6,200 had been returned by a customer and were taken into inventory, but no entry was made in the books.
h. ₹ 1500 paid for wages to workmen for making office furniture had been charged to wages account.
i. Salary paid to a clerk ₹ 12,000 has been debited to his personal account.
j. A purchase of goods from Raghav amounting to ₹ 20,000 has been wrongly entered through the sales book.

Question 12 *(ICAI Study Material)* Pg no._____

Mr. A closed his books of account on September 30, 2022 in spite of a difference in the trial balance. The difference was ₹830 the credits being short; it was carried forward in a Suspense Account. In 2023 following errors were located:

a) A sale of ₹2,300 to Mr. Lala was posted to the credit of Mrs. Mala.
b) The total of the Returns Inward Book for July, 2022 ₹1,240 was not posted in the ledger.
c) Freight paid on a machine ₹5,600 was posted to the Freight Account as ₹6,500. 10% Depreciation is charged on this machine.
d) While carrying forward the total in the Purchases Account to the next page, ₹65,590 was written instead of ₹56,950.
e) A sale of machine on credit to Mr. Mehta for ₹9,000 on 30th Sept. 2022 was not entered in the books at all. The book value of the machine was ₹6,750.

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

Question 13 *(CA Foundation Nov 2018) (10 Marks) / (RTP May 2020)* Pg no._____

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:

a) Sales Day Book was overcast by ₹ 1,000
b) A Sale of ₹ 5,000 to X was wrongly debited to the account of Y
c) General expenses ₹ 180 was posted in the General Ledger as ₹ 810
d) Bill Receivable for ₹ 1,550 was passed through Bills Payable Book. The bill was given by P
e) Legal Expenses ₹ 1,190 paid to Mrs. Neetu was debited to her personal account.
f) Cash received from Ram was debited to Shyam ₹ 1,500
g) While carrying forward the total of one page of the Purchases Book to the next, the amount of ₹ 1,235 was written as ₹ 1,325.

Find out the nature and amount of the Suspense Account and pass entries (including narration) for the rectification of the above errors in the subsequent year's books.

Question 14 *(ICAI Study Material)* Pg no._____

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

a) The total of the Purchases Book of one page, ₹4,539 was carried forward to the next page as ₹4,593.
b) A sale of ₹573 was entered in the Sales Book as ₹753 and posted to the credit of the customer.
c) A return to a creditor, ₹510 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.
d) Cash received from C. Dass, ₹620 was posted to the debit of G. Dass.
e) Goods worth ₹840 were despatched to a customer before the close of the year but no invoice was made out.
f) Goods worth ₹1,000 were sent on sale or return basis to a customer and entered in the Sales Book. At the close of the year, the customer still had the option to return the goods. The sale price was 25% above cost.

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

Question 15 *(RTP May 2022)* Pg no._____

The books of accounts of Dime Ltd. for the year ending 31.3.2023 were closed with a difference in books carried forward. The following errors were detected subsequently:

(i) Return outward book was under cast by ₹ 100.
(ii) ₹ 1,500 being the total of discount column on the credit side of the cash book was not posted.
(iii) ₹ 6,000 being the cost of purchase of office furniture was debited to Purchase A/c.
(iv) A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the customers' A/c. in the sales ledger.
(v) The Sales of ₹ 10,000 was omitted to be recorded.

Pass rectification entries in the next year.

Question 16 *(CA Foundation Nov 2020) (5 Marks)* *Pg no._____*

M/s. Applied Laboratories were unable to agree the Trial Balance as on 31st March, 2023 and have raised a suspense account for the difference. Next year the following errors were discovered:
(i) Repairs made during the year were wrongly debited to the building A/c - ₹ 12,500.
(ii) The addition of the 'Freight' column in the purchase journal was short by ₹ 1,500.
(iii) Goods to the value of ₹ 1,050 returned by a customer, Rani & Co., had been posted to the debit of Rani & Co. and also to sales returns.
(iv) Sundry items of furniture sold for ₹ 30,000 had been entered in the sales book, the total of which had been posted to sales account.
(v) A bill of exchange (received from Raja & Co.) for ₹ 20,000 had been returned by the bank as. dishonoured and had been credited to the bank and debited to bills receivable account.

You are required to pass journal entries to rectify the above mistakes.

Question 17 *(CA Foundation Jan 2021) (10 Marks)* *Pg no._____*

Mr. Joshi's trial balance as on 31st March, 2023 did not agree. The difference was put to a Suspense Account. During the next trading period, the following errors were discovered:
a) The total of the Purchases Book of one page, ₹ 5,615 was carried forward to the next page as ₹ 6,551.
b) A sale of ₹ 281 was entered in the Sales Book as ₹ 821 and posted to the credit of the customer.
c) A return to creditor, ₹ 295 was entered in the Returns Inward Book; however, the creditor's account was correctly posted.
d) Cash received from Senu, ₹ 895 was posted to debit of Sethu.
e) Goods worth ₹ 1,400 were dispatched to a customer before the close of the year but no invoice was made out.
f) Goods worth ₹ 1,600 were sent on sale or return basis to a customer and entered in the Sales Book at the close of the year, the customer still had the option to return the goods. The gross profit margin was 20% on Sale.
g) ₹ 600 due from Mr. Q was omitted to be taken ·to the trial balance.
h) Sale of goods to Mr. R for ₹ 3,000 was omitted to be recorded.

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

Question 18 *(CA Foundation May 2018) (10 Marks) / (RTP May 2023) (Similar)* *Pg no._____*

Miss Daisy was unable to agree the Trial Balance last year and wrote off the difference to the profit and loss account of that year. On verifying the old books by a Chartered Accountant next year, the following mistakes were found.
a) Purchase account was undercast by ₹ 8,000.
b) Sale of goods to Mr. Rahim for ₹ 2,500 was omitted to be recorded.
c) Receipt of cash from Mr. Asok was posted to the account of Mr. Anbu ₹ 1,200.

d) Amount of ₹ 4,167 of sales was wrongly posted as ₹ 4,617.
e) Repairs to Machinery was debited to Machinery Account ₹ 1,800.
f) A credit purchase of goods from Mr. Paul for ₹ 3,000 entered as sale.
Suggest the necessary rectification entries.

Question 19 *(CA Foundation July 2021) (10 Marks)* *Pg no._____*

Mr. Ratan was unable to agree the Trial Balance last year and wrote off the difference to the Profit and Loss Account of that year. Next year, he appointed a Chartered Accountant who examined the old books and found the following mistakes:

a) Purchase of a scooter was debited to conveyance account ₹ 30,000. Mr. Ratan charges 10% depreciation on scooter.
b) Purchase account was over cast by ₹ 1,00,000.
c) A credit purchase of goods from Mr. X for ₹ 20,000 was entered as sale.
d) Receipt of cash from Mr. Anand was posted to the account of Mr. Bhaskar ₹ 10,000.
e) Receipt of cash from Mr. Chandu was posted to the debit of his account, ₹ 5,000.
f) ₹ 5,000 due by Mr. Ramesh was omitted to be taken to the Trial Balance.
g) Sale of goods to Mr. Ram for ₹ 20,000 was omitted to be recorded.
h) Amount of ₹ 23,950 of purchase was wrongly posted as ₹ 25,930.

Suggest the necessary rectification entries.

BANK RECONCILIATION STATEMENT

CH 3

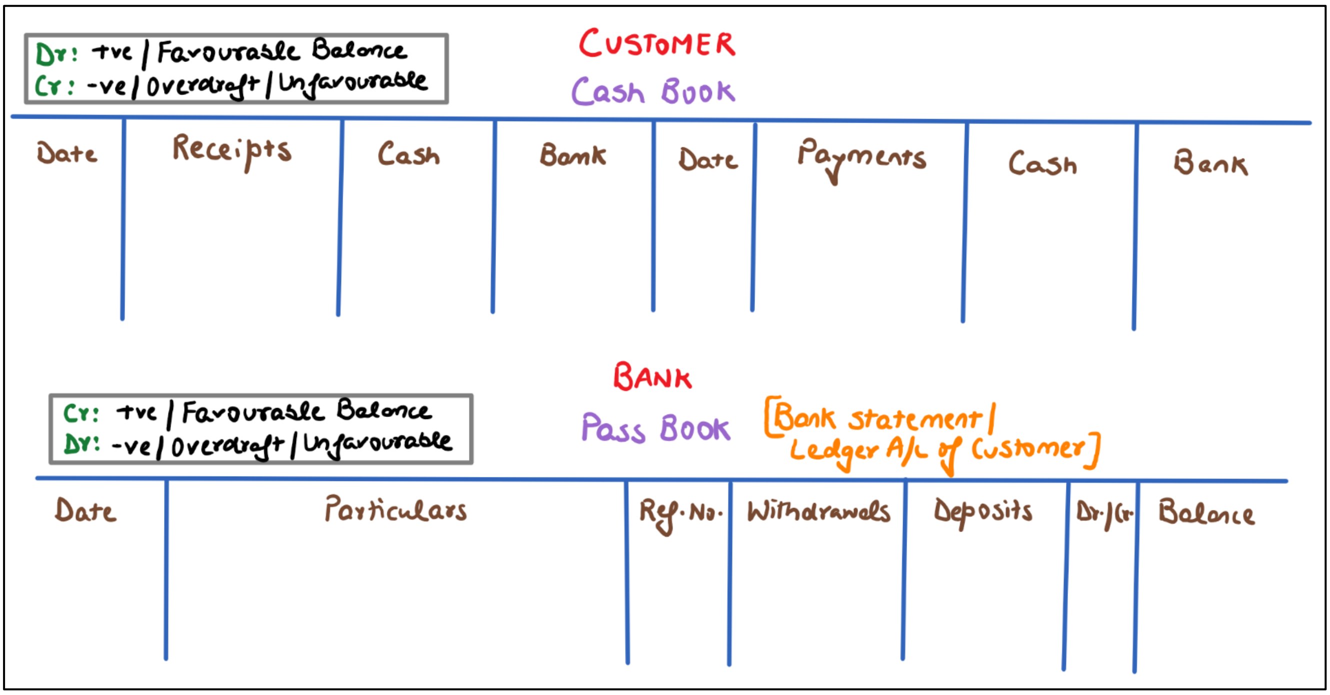
The Kite gives a wonderful message. Fly high & high. But stay connected to the ground to our roots or else you will be lost.

ACTIVITIES OF BANK

Acceptance of Deposits	Bank accepts various deposits like Term Deposits, Fixed Deposits, Recurring deposits etc.
Loans	Lending of money is the major revenue earning activity for a bank, e.g., Machinery loan, Housing loan, Vehicle loan and Personal loan etc.
Discounting	Discounting is a process by which the Bank enables its customer to receive the cash before the due date, in consideration of a small charge called discount, e.g.. Bills of Exchange/Pro-Note Discounting.
Overdraft	Bank allows overdrafts to its good customers so that they can make payment even when they do not have sufficient balance in their account at the Bank.
Guarantee	The Bank furnishes securities or guarantee for its customers whose credit is good. The Bank charges commission for this service.
Standing Instructions	As per the instructions of the customer and on his behalf, a Bank makes payment to various parties on the due date, e.g. Telephone Bills, Insurance Premium, Credit Card Dues, etc.
Demand Draft	Banks issue Demand Draft based on its customer's request. Demand Draft is also called as Banker's Cheque, Pay Order, etc. in some cases.

BANK PASS BOOK OR STATEMENT

1. Bank Pass Book (also known as Bank Statement) is an extract of the Ledger Account of the customer, as per the Bank's books of Accounts.
2. It is a periodical statement of account in which all transactions, i.e, deposits and withdrawals made by the customer during the particular period is recorded.



3. A comparative analysis of the Cash Book (Bank Column) and Bank Pass Book is given below

Point	In Cash Book of Customer	In Bank Pass Book
Debit Entries in Cash Book	• Deposits of cash into Bank • Receipt of cheques from debtors • Other Incomes/Receipts, e.g. Interest, Dividend, Capital introduced, etc. • B/R Collection, Income on Investment, etc. by the Bank.	These are recorded as "Deposits" in the Pass Book, i.e. on the credit side of the Pass book
Credit Entries in Cash Book	• Withdrawal of cash from Bank • Payment to Creditors/ of Expenses • Bank Interest, Charges by the Bank • Payment as per standing instructions	These are recorded as "Withdrawals" in the Pass book, i.e. on the debit side of the Pass book
Favourable Balance	Such balance will normally appear on the debit side of cash book (Bank column)	Credit Balance in Pass Book represents a favourable balance, i.e. Normal Balance
Overdraft balance	Such balance will normally appear on the credit side of Cash Book (Bank column)	Debit Balance in Pass Book represents an unfavourable balance i.e. Overdraft Bal.

Note:
For each entry in the Cash Book, there should be corresponding opposite entry in Pass book. This is because the business enterprises treat the Bank as Debtor A/c (Receivable/Asset) and bank treats the business enterprises as a Creditor (i.e. Payable/Liability).

BANK RECONCILIATION STATEMENT

1. Bank Reconciliation Statement: At periodical intervals, the customer/ business entity (i.e. Account Holder in the Bank), should compare the balance in Bank as shown by the Cash Book with the Pass Book. In case of any differences between the two, they should be analyzed by listing out the various reasons for such difference. Such a statement is called Bank Reconciliation Statement (BRS).
   It is prepared by Customer/Bank Account holder. It is prepared to know the causes for difference between balance as per Bank Column of Cash Book & Pass Book/Bank Statement.
2. Advantages: The advantages of Bank reconciliation statement are-
   (a) To record entries which have been missed out in the Cash Book, e.g. Interest charged/allowed by the bank, bank charges, and direct collection by bank etc.
   (b) To identify any errors that may been committed either in cash book or in bank statement,
   (c) To identify any undue delay in the clearance of cheque and
   (d) To act as a deterrent against embezzlement frauds.

DIFFERENCES BETWEEN BANK STATEMENT AND CASH BOOK

Causes of Difference

Timing
Transaction recorded at 2 different times in cash book & Pass book
* Cheque issued but not presented
* Cheque deposited but not cleared

Transaction
Transactions which bank carries out itself without intimating the customer
* Interest allowed by bank
* Bank charges debited by bank

Error
Mistakes or errors in preparing accounts either in cash book or Pass book

The common reasons for difference between the balances as per cash book and the bank statement are-

1	Cheques issued but not yet presented for payment	Payment is recorded in the cash book immediately on issue of a cheque. However, the bank debits the Customer's (i.e. Account Holders') Account only when the cheque is presented for payment. There may be a time gap between the entry in the cash book and in the bank statement.
2	Cheques deposited into bank not yet credited/cleared	Receipts are recorded in the cash book when the cheques are sent to the Bank. However, the bank would credit the account only when they have been cleared

3	Interest allowed/credited by bank	Interest credited by the Bank in the account (if any) will be reflected only in the bank pass book. They will have to be recorded in the cash book only after receiving the pass book.
4	Interest & Dividends collected by Bank	When investments are kept with the bank for safe custody, the income thereon may be collected by the bank directly. This will be recorded in the cash book later.
5	Direct payments into Bank by a customer	Amount directly received by the bank from the Company's customer will be recorded in the cash book only after analyzing the pass book.
6	Bills Receivables collected by Bank on behalf of the customer	The bank collects the proceed of bills receivable when the documents of title are sent through it. On collection, the bank will credit the customer's account. The customer may make the entry only on receiving the bank statement at the end of the period.
7	Interest & Expenses charged by bank	Interest and expenses charged by bank (for Cheque Book, Demand draft, outstation cheque collection, etc.) will be recorded by the customer company only after seeing the pass book.
8	Direct payment by bank	When standing Instructions for certain payments, e.g. Insurance premium, telephone bills, etc. are given to the Bank; the company may come to know of the actual payment only on seeing the Pass Book at the end of the period.
9	Dishonour of a bill discounted with the Bank	If the Bank is not able to receive payment on Bills of Exchange discounted by it, it wills debit the customer's account together with any charges thereon. The customer will make the entry only when he sees the Bank statement.
10	Error in Pass Book/Cash Book	Errors committed in the Pass Book/ Cash Book will also contribute to difference between the balances shown by the books.

Note:
- Items 1 & 2 are recorded in the Cash Book first, and later on reflected in the Bank Pass Book/Statement.
- Items 3 to 9 are recorded first in Pass Book, and later recorded in Cash Book. Out of these, Item 3,4,5 and 6 constitute receipts into Bank Account and Items 7,8 and 9 constitute Payments out of Bank A/c.

PROCEDURE FOR BANK RECONCILIATION STATEMENT

BRS may be prepared in two ways-

(a) Without adjusting the Cash Book, i.e. Preparation of BRS only.

(b) After adjusting Cash Book for Items 3 to 10 given above, i.e. Preparation of Adjusted Cash Book and BRS.

The Procedures for preparing the BRS is explained below-

METHOD 1: PREPARATION OF BRS ONLY (i.e. WITHOUT ADJUSTING CASH BOOK)

Starting Point	Cash Book Balance		Pass Book Balance	
Balance as per Starting Point	Dr. Balance in Cash Book (Favourable)	Cr. Balance in Cash Book (Overdraft)	Dr. Balance in Pass Book (Overdraft)	Cr. Balance in Pass Book (Favourable)
1. Cheques issued but not yet presented for payment (Item 1)	Add	Subtract	Add	Subtract
2. Cheques deposited into Bank but not yet credited /cleared (Item 2)	Subtract	Add	Subtract	Add
3. Interest allowed by Bank (Item 3)	Add	Subtract	Add	Subtract
4. Interest & Dividends collected by Bank (Item 4)	Add	Subtract	Add	Subtract
5. Direct payments into Bank by a customer (Item 5)	Add	Subtract	Add	Subtract
6. Bill Receivable collected by bank on behalf of the customer (Item 6)	Add	Subtract	Add	Subtract
7. Interest & Expenses charged by Bank (Item 7)	Subtract	Add	Subtract	Add
8. Direct Payments by bank (Item 8)	Subtract	Add	Subtract	Add
9. Dishonour of a bill discounted with the Bank (Item 9)	Subtract	Add	Subtract	Add
10. Wrong Entries (Item 10)				
(a) Wrong Debit in Cash Book or in Pass Book, under-casting of Cr. Side of Cash Book, overcasting of Dr. side of cash book etc.	Subtract	Add	Subtract	Add
(b) Wrong Credit in Cash Book or Pass Book, overcasting of Cr. side of Cash book, undercasting of Dr. side of cash book	Add	Subtract	Add	Subtract
Balances as per End Point	Pass Book Balance		Cash Book Balance	
Positive (+) End Point balance indicates	Favourable i.e Cr. Bal. as per Pass Book	Overdraft i.e. Dr. Bal. as per Pass Book	Overdraft i.e. Cr. Bal. as per Cash Book	Favourable i.e. Dr. Bal. as per Cash Book
Negative (-) End Point balance indicates	Overdraft i.e. Dr. Bal. as per Pass Book	Favourable i.e. Cr. Bal. as per Pass Book	Favourable i.e Dr. Bal. as per Cash Book	Overdraft i.e. Cr. Bal. as per Cash Book

METHOD 2: PREPARATION OF ADJUSTED CASH BOOK AND BRS

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. 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.

Errors occurring in the pass-book are not to be adjusted in the cash book. All the adjustments considered in the adjusted cash-book are not carried again to the Bank Reconciliation Statement.

Step 1:

Prepare Adjusted Cash Book with the following Debits and Credits

Receipts	₹	Payments	₹
To balance b/d (in case of Favourable Bal. as per Cash Book)		By balance b/d (in case of Overdraft Bal. as per Cash Book)	
To Interest allowed by Bank	Item 3	By Interest & Expenses charged by bank	Item 7
To Interest & Dividends collected by Bank	Item 4	By Direct payments by bank as per Standing Instructions	Item 8
To Direct Payments into Bank by firm's customers	Item 5	By dishonour of a bill discounted with the bank	Item 9
To Bill Receivable collected by bank on behalf of firm	Item 6		
To Rectification of Error in Cash Book, e.g. double credit posting, credit overcast, debit under cast, debit entry omission etc.	Item 10	By Rectification of Error in cash book, e.g. double debit posting, debit overcast, credit undercast, credit entry omission etc.	Item 10
To balance c/d (in case of Overdraft bal. as per Cash Book)		By balance c/d (in case of Favourable bal. as per Cash Book)	
Total		Total	

Note:

- The closing balance in the above Adjusted Cash Book is called Adjusted Cash Balance. This will be taken to the BRS.
- Prepared under Step 2 below.
- In Item 10, Errors made in Cash Book will be adjusted, but errors made in Pass Book will not be given effect in Cash Book.

Step 2:

Prepare Bank Reconciliation Statement as under-

Starting Point	Cash Book Balance		Pass Book Balance	
Balance as per Starting Point	Dr. Balance in Cash Book (Favourable)	Cr. Balance in Cash Book (Overdraft)	Dr. Balance in Pass Book (Overdraft)	Cr. Balance in Pass Book (Favourable)
1. Cheques issued but not yet presented for payment (Item 1)	Add	Subtract	Add	Subtract
2. Cheques deposited into Bank but not yet credited/cleared (Item 2)	Subtract	Add	Subtract	Add
3. Wrong Cr. in Pass Book (Item10)	Add	Subtract	Add	Subtract
4. Wrong Dr. in Pass Book (Item10)	Subtract	Add	Subtract	Add
Balance as per End Point	Pass Book Balance		Cash Book Balance	
Positive (+) End point balance indicates	Favourable i.e. Cr. bal. as per pass book	Overdraft i.e. Dr. Bal, as per Pass Book	Overdraft i.e. Cr. Bal. as per Cash Book	Favourable Dr. Bal. as per Cash Book
Negative (-) End Point balance indicates	Overdraft i.e. Dr. Bal. as per Pass Book	Favourable i.e. Cr. Bal. as per Pass Book	Favourable i.e. Dr. Bal. as per Cash Book	Overdraft i.e. Cr. Bal as per Cash Book

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

On 30th June 2023, the Bank Pass Book of Namrata showed a balance of ₹ 1,50,000 to her credit while balance as per cash book was ₹ 1,12,050.

On scrutiny of the two books, she ascertained the following causes of difference:

a) She has issued cheques amounting to ₹ 80,000 out of which only ₹ 32,000 were presented for payment.
b) She received a cheque of ₹ 5,000 which she recorded in her cash book but forgot to deposit in bank.
c) A cheque of ₹ 22,000 deposited by her has not been cleared yet.
d) Mr. Gupta deposited an amount of ₹ 15,700 in her bank which has not been recorded by her in Cash Book yet.
e) Bank has credited an interest of ₹ 1,500 while charging ₹ 250 as bank charges.

Prepare a bank reconciliation statement.

Question 2 *(RTP Nov 2021) (Similar)* *Pg no._____*

On 31st March, 2023 the pass-book of a trader showed a credit balance of ₹15,65,000 but the passbook balance was different for the following reasons from the cash book balance:

1. Cheques issued to 'X' for ₹ 60,000 and to 'Y' for ₹3,84,000 were not yet presented for payment.
2. Bank charged ₹350 for bank charges and 'Z' directly deposited ₹1,816 into the bank account, which were not entered in the cash book.
3. Two cheques-one from 'A' for ₹ 5,15,000 and another from 'B' for ₹ 12,500 were collected in the first week of April, 2023 although they were banked on 25.03.2023.
4. Interest allowed by bank ₹ 4,500
5. Wrong credit by Bank ₹ 20,000
6. Amount wrongly debited to trader account by the Bank ₹ 15,000
7. Bank paid house tax ₹ 5,000 on our behalf, but no information received from bank in this connection.

Prepare a bank reconciliation statement as on 31st March, 2023.

Question 3 *(ICAI Study Material)* *Pg no._____*

Prepare a bank reconciliation statement as on 30th September, 2023 from the following particulars:

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

Question 4 *Pg no._____*

Prepare Bank Reconciliation Statement as on 30th September, 2023:

	Amount
Bank overdraft as per Pass-Book	21,494
A cheque deposited as per Pass-Book, but not recoded in Cash-book	700
Debit side of Bank column undercast	100
A cheque of ₹ 5,000 deposited, but credited in Pass book as	4,996
A party's cheque returned dishonored as per Pass-book only	530
Bill collected directly by the Bank	3,500
Bank charges recorded twice in the Cash-book	25
A Bill for ₹ 8,000 discounted for ₹ 7,960 returned dishonored by the Bank. Noting charges being	15
Cheque deposited, but not yet collected by the Bank	2,320
Cheque issued, but not yet presented to the bank for payment	1,250

Question 5 *(RTP May 2018)/(RTP Nov 2022) (Similar)* *Pg no._____*

The Cash-book of M/s ABC shows ₹ 27,570 as the balance at Bank as on 30th September, 2023. But this does not agree with balance as per the Bank Statement. On scrutiny following discrepancies were found:

a) Subsidy ₹ 10,250 received from government directly by bank, but not advised to company
b) On 15th September, 2023 the payments side of the Cash-book was under cast by ₹ 350.
c) On 20th September, 2023 the debit balance of ₹ 2,156 as on the previous day, was brought forward as credit balance in Cash-book.
d) A customer of the M/s ABC, who received a cash discount of 5% on his account of ₹ 2,000, paid to M/s ABC a cheque on 24th September, 2023. The cashier erroneously entered the gross amount in the Cash-Book.
e) On 10th September, 2023 a bill for ₹ 5,700 was discounted from the bank, entered in Cash-book, but proceeds credited in Bank Statement amounted to ₹ 5,500 only.
f) A cheque issued amounting to ₹ 1,725 returned marked 'out of date'. No entry made in Cash-book.
g) Insurance premium ₹ 756 paid directly by bank under standing order. No entry made in cash-book.
h) A bill receivable for ₹ 1,530 discounted for ₹ 1,500 with the bank had been dishonoured on 30th September, 2023, but advice was received on 1st October, 2023.
i) Bank recorded a Cash deposit of ₹ 1,550 as ₹ 1,505.

Prepare Bank Reconciliation Statement on 30th September, 2023.

Question 6 *(RTP Nov 2018) / (RTP Nov 2020)* *Pg no._____*

Prepare a Bank Reconciliation Statement of Shri Hari as on 31st March, 2023:

(i) Balance as per Pass Book is ₹ 10,000.
(ii) Bank collected a cheque of ₹ 500 on behalf of Shri Hari but wrongly credited it to Shri Hari's Account (another customer of bank).
(iii) Bank recorded a cash deposit of ₹ 1,589 as ₹ 1,598.
(iv) Withdrawal column of the Pass Book undercast by ₹ 100.
(v) The credit balance of ₹ 1,500 on page 5 was recorded on page 6 as debit balance.
(vi) The payment of a cheque of ₹ 350 was recorded twice in the Pass Book.
(vii) The Pass Book showed a credit for a cheque of ₹ 1,000 deposited by Shri Hari (another customer of the bank).

Question 7 *(ICAI Study Material)* Pg no.______

The Cash Book of Mr. Gadbadwala shows ₹ 8,36,400 as the balance at Bank as on 31st December, 2023, but you find that it does not agree with the balance as per the Bank Pass Book. On scrutiny, you find the following discrepancies:

(1) On 15th December, 2023 the payment side of the Cash Book was undercast by ₹10,000.
(2) A cheque for ₹1,31,000 issued on 25th December, 2023 was not taken in the bank column.
(3) One deposit of ₹1,50,000 was recorded in the Cash Book as if there is no bank column therein.
(4) On 18th December, 2023 the debit balance of ₹15,260 as on the previous day, was brought forward as credit balance in the Cash Book.
(5) Of the total cheques amounting to ₹11,514 drawn in the last week of December, 2023, cheques aggregating ₹7,815 were encashed in December.
(6) Dividends of ₹25,000 collected by the Bank and subscription of ₹1,000 paid by it were not recorded in the Cash Book.
(7) One out-going Cheque of ₹3,50,000 was recorded twice in the Cash Book.

Prepare a Reconciliation Statement.

Question 8 *(ICAI Study Material)* Pg no.______

The following are the Cash Book (bank column) and Pass Book of Jain for the months of March, 2023 and April, 2023:

Cash Book (Bank Column only)

Date	Particulars	Amount	Date	Particulars	Amount
1/3/23	To Balance b/d	60,000	3/3/23	By Cash A/c	2,00,000
6/3/23	To Sales A/c	3,00,000	7/3/23	By Modi	60,000
10/3/23	To Ram	65,000	12/3/23	By Patil	30,000
18/3/23	To Singhal	2,70,000	18/3/23	By Suresh	40,000
25/3/23	To Goyal	33,000	24/3/23	By Ramesh	1,50,000
31/3/23	To Patel	65,000	31/3/23	By Balance c/d	3,13,000
		7,93,000			7,93,000

Pass Book

Date	Particulars	Amount (Dr.)	Amount (Cr.)	Dr. or Cr.	Balance
1/4/23	By Balance b/d		3,65,000	Cr.	3,65,000
3/4/23	By Goyal		33,000	Cr.	3,98,000
5/4/23	By Patel		65,000	Cr.	4,63,000
7/4/23	To Naresh	2,80,000		Cr.	1,83,000
12/4/23	To Ramesh	1,50,000		Cr.	33,000
15/4/23	To Bank Charges	200		Cr.	32,800
20/4/23	By Usha		17,000	Cr.	49,800
25/4/23	By Kalpana		38,000	Cr.	87,800
30/4/23	To Sunil	6,200		Cr.	81,600

Reconcile the balance of cash book on 31/3/2023.

Question 9 *(ICAI Study Material)* Pg no.______

Prepare a bank reconciliation statement from the following particulars on 31st March, 2023 and show the balance as per cash book:

a) Overdraft as per passbook on March 31, 2023, is ₹ 3,00,000.
b) Interest on bank overdraft not entered in the cash book ₹ 36,500

c) Insurance premium of ₹ 17,950 was due and paid by the bank but same has not been accounted in the books.
d) Cheques drawn in the last week of March,2023, but not cleared till date for ₹ 13,000 and ₹ 23,500.
e) Cheques deposited into bank on February,2023, but yet to be credited on dated March 31, 2023 ₹ 56,000.
f) Amount of ₹ 20,500 is wrongly debited by the bank
g) Interest on Investment ₹ 83,800 collected and credited by bank but the same has not been entered in the Cash Book

Question 10 *(CA Foundation May 2018) (10 Marks)* *Pg no._____*

The Bank Pass Book of Account No.5678 of Mrs. Rani showed an overdraft of ₹ 33,575 on 31st March 2023. On going through the Pass Book, the accountant found the following:

(i) A Cheque of ₹ 1,080 credited in the pass book on 28th March 2023 being dishonoured is debited again in the pass book on 1st April 2023. There was no entry in the cash book about the dishonour of the cheque until 15th April 2023.
(ii) Bankers had credited her account with ₹ 2,800 for interest collected by them on her behalf, but the same has not been entered in her cash book.
(iii) Out of ₹ 20,500 paid in by Mrs. Rani in cash and by cheques on 31st March 2023 cheques amounting to ₹ 7,500 were collected on 7th April, 2023.
(iv) Out of Cheques amounting to ₹ 7,800 drawn by her on 27th March, 2023 a cheque for ₹ 2,500 was encashed on 3rd April, 2023.
(v) Bankers seems to have given here wrong credit for ₹ 500 paid in by her in Account No. 8765 and a wrong debit in respect of a cheque for ₹ 300 against her account No.8765.
(vi) A cheque for ₹ 1,000 entered in Cash Book but omitted to be banked on 31st March, 2023.
(vii) A Bill Receivable for ₹ 5,200 previously discounted (Discount ₹ 200) with the Bank had been dishonoured but advice was received on 1st April, 2023.
(viii) A Bill for ₹ 10,000 was retired /paid by the bank under a rebate of ₹ 175 but the full amount of the bill was credited in the bank column of the Cash Book.
(ix) A Cheque for ₹ 2,400 deposited into bank but omitted to be recorded in Cash Book and was collected by the bank on 31st March, 2023.

Prepare Bank Reconciliation Statement as on 31st March, 2023.

Question 11 *(ICAI Study Material)* *Pg no._____*

When Nikki & Co. received a Bank Statement showing a favourable balance of ₹10,39,200 for the period ended on 30th June, 2023, this did not agree with the balance in the cash book. An examination of the Cash Book and Bank Statement disclosed the following:

a) A deposit of ₹3,09,200 paid on 29th June, 2023 had not been credited by Bank until 1st July, 2023.
b) On 30th March, 2023 the company had entered into hire purchase agreement to pay by bank order a sum of ₹3,00,000 on the 10th of each month, commencing from April, 2023. No entries had been made in Cash Book.
c) A customer of the firm, who received a cash discount of 4% on his account of ₹4,00,000 paid the firm a cheque on 12th June. The cashier erroneously entered the gross amount in the bank column of the Cash Book.
d) Bank charges amounting to ₹3,000 had not been entered in Cash-Book.
e) On 28th June, a customer of the company directly deposited the amount in the bank ₹ 4,00,000, but no entry had been made in the Cash Book.
f) ₹11,200 paid into the bank had been entered twice in the Cash Book.

g) A debit of ₹ 11,00,000 appeared in the Bank Statement for an unpaid cheque, which had been returned marked 'out of date'. The cheque had been re-dated by the customer and paid into Bank again on 5th July, 2023.

Prepare Bank Reconciliation Statement on 30 June, 2023.

Question 12 *(ICAI Study Material)* *Pg no.____*

According to the cash-book of Gopi, there was a balance of ₹ 44,50,000 in his bank on 30th June, 2023. On investigation you find that :

a) Cheques amounting to ₹ 6,00,000 issued to creditors have not been presented for payment till date.
b) 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 2023.
c) 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.
d) Insurance premium (up to 31st Dec, 2023) paid by the bank ₹ 27,000 not entered in the cash book.
e) The payment side of the cash book had been under casted by ₹ 5,000.
f) Bank charges ₹ 1,500 shown in the pass book had not been entered in the cash book.
g) 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) to make the appropriate adjustments in the cash book, and

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

Question 13 *(ICAI Study Material)/(RTP Nov 2019)/(Nov 2023) (Similar)* *Pg no.____*

On 30th September, 2023, the bank account of X, according to the bank column of the Cash-Book, was overdrawn to the extent of ₹ 4,062. On the same date the bank statement showed a credit balance of ₹ 20,758 in favour of X. An examination of the Cash Book and Bank Statement reveals the following:

1. A cheque for ₹13,14,000 deposited on 29th September, 2023 was credited by the bank only on 3rd October, 2023
2. A payment by cheque for ₹16,000 has been entered twice in the Cash Book.
3. On 29th September, 2023, the bank credited an amount of ₹1,17,400 received from a customer of X, but the advice was not received by X until 1st October, 2023.
4. Bank charges amounting to ₹580 had not been entered in the Cash Book.
5. On 6th September, 2023, the bank credited ₹20,000 to X in error.
6. A bill of exchange for ₹1,40,000 was discounted by X with his bank. This bill was dishonoured on 28th September, 2023 but no entry had been made in the books of X.
7. Cheques issued upto 30th September, 2023 but not presented for payment upto that date totalled ₹ 13,26,000.

You are required:

a) to show the appropriate rectifications required in the Cash Book of X, to arrive at the correct balance on 30th September, 2023 and
b) to prepare a bank reconciliation statement as on that date.

Question 14 *(MTP March 2022)* *Pg no.____*

On 30th June. 2023, Cash Book of Ms. Suman (Bank Column of Account No. 1) shows a Bank Overdraft of ₹ 1,97,400. On going through the Bank Pass book for reconciling the Balance, she found the following:

(a) Out of cheques drawn on 26th June, those for ₹ 14,800 were cashed by the bankers on 2nd July.
(b) A crossed cheque for ₹ 3000 given to Abdul was returned by him and a bearer cheque was issued to him in lieu on 1st July.
(c) Cash and cheques amounting to ₹ 13,600 were deposited in the Bank on 29th June., but cheques worth ₹ 5,200 were cleared by the Bank on 1st July., and one cheque for ₹ 1,000 was returned by them as dishonoured on the latter date.
(d) According to Suman's standing instructions, the bankers have on 30th June, paid ₹ 1,280 as interest to her creditors, paid quarterly premium on her policy amounting to ₹ 640 and have paid a second call of ₹ 2,400 on shares held by her and lodged with the bankers for safe custody. They have also received ₹ 600 as dividend on her shares and recovered an Insurance Claim of ₹ 3,200, as their charges and commission charged on the above being ₹ 400. On receipt of information of the above transaction, she has passed necessary entries in her Cash Book on 1st July.
(e) Bankers seem to have given a wrong credit for ₹ 2,000 paid in by her in No. 2 account and wrong debit in respect of a cheque for ₹ 1,200 drawn against her No. 2 account.

Prepare a Bank Reconciliation Statement as on 30th June, 2023.

Question 15 *(ICAI Study Material)* *Pg no._____*

Mr. Manoj is employed by Century Rayon and Carpets Pvt Ltd. as their cashier. The main responsibility of Mr. Manoj is to maintain the company's cash book and prepare a bank reconciliation statement at the end of each month. The cash book (only bank column) is set out below together with a copy of the bank statement for the month of February 2023.

You are required to :

a) Reconcile the cash book with the bank statement.
b) Make necessary entries to update the cash book.
c) Start with the balance as per cash book, list any unpresented cheques and sub-total on the reconciliation statement.

Century Rayon and Carpets Pvt Ltd
Cash Book (Bank Column only)

Date	Particulars	Amount	Date	Particulars	Amount
1/2/23	To Balance b/d	1,42,500	3/2/23	By Bhagwandas	1,980
1/2/23	To Blue & Co.	1,570	5/2/23	By Maruti Ltd. (400460)	1,500
4/2/23	To GM Ltd.	2,430	12/2/23	By Jackson Ltd. (400461)	54,000
8/2/23	To Robinson Ltd.	910	18/2/23	By PC Computers (400462)	1,420
13/2/23	To Donald	750	21/2/23	By Shiv Garage (400463)	49,000
20/2/23	To Avenue Super Mart	4,200	26/2/23	By Petty Cash (400465)	1,500
28/2/23	To Sleep Well Ltd.	940	26/2/23	By Shweta & Co. (400464)	2,100
			26/2/23	By AV Partners (400466)	5,200
			28/2/23	By Balance c/d	36,600
		1,53,300			1,53,300

Customer: Century Rayon and Carpets Pvt Ltd
Account No – xxxxx0439
Account Statement for the month of February 2023

Date	Particulars	Amount (Dr.)	Amount (Cr.)	Dr. or Cr.	Balance
1/2/23	Balance b/d			Cr.	1,42,500
3/3/23	Cheques		1,570	Cr.	1,44,070
6/2/23	Maruti Ltd.	1,500		Cr.	1,42,570
7/4/23	Bhagwandas	1,980		Cr.	1,40,590
12/2/23	GM Ltd.		2,430	Cr.	1,43,020
15/2/23	Robinson Ltd.		910	Cr.	1,43,930
20/2/23	Premium of New India Insurance Ltd.	3,800		Cr.	1,40,130
22/2/23	Donald		750	Cr.	1,40,880
22/2/23	400463	49,000		Cr.	91,880
23/2/23	Cheques		4,200	Cr.	96,080
26/2/23	Savita	1,030		Cr.	95,050
26/2/23	400465	1,500		Cr.	93,550
27/2/23	Shreya		2,200	Cr.	95,750
28/2/23	Bank Charges	2,538		Cr.	93,212

Question 16 *(CA Foundation June 2023) (5 Marks)* Pg no._____

From the following information prepare a Bank Reconciliation Statement as on 31st March 2023 for A Ltd.

		₹
	Bank overdraft as per cash book as 31st March, 2023	15,50,750
1.	Cheques deposited on 15th February, 2023 credited on 5th April, 2023	12,50,000
2.	Interest debited by bank on 31st March, 2023 but not entered in Cash Book	1,75,500
3.	Cheques issued before 31st March, 2023 but not yet presented	7,75,000
4.	On 10th March, 2023 bank credited to A Ltd. in error	1,50,000
5.	Draft deposited in bank but not credited till 31st March, 2023	12,75,000
6.	Bills for collection credited by bank but no advice received by the company	9,45,000
7.	Bank charges charged by bank but not entered in cash book	2,85,000
8.	Transport subsidy received from the state government directly by the bank not advised to the company	17,50,000

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1. When the balance as per Cash Book is the starting point, direct deposits by customers are:
(a) Added
(b) Subtracted
(c) Not required to be adjusted.

2. A debit balance in the depositor's Cash Book will be shown as:
(a) A debit balance in the Bank Statement.
(b) A credit balance in the Bank Statement.
(c) An overdrawn balance in the Bank Statement.

3. When balance as per Pass Book is the starting point, interest allowed by Bank is
(a) Added
(b) Subtracted
(c) Not required to be adjusted.

4. A Bank Reconciliation Statement is prepared with the help of:
(a) Bank statement and bank column of the Cash Book.
(b) Bank statement and cash column of the Cash Book
(c) Bank column of the Cash Book and cash column of the Cash Book.

5. The cash book showed an overdraft of ₹1,50,000, but the pass book made up to the same date showed that cheques of ₹ 10,000, ₹ 5,000 and ₹ 12,500 respectively had not been presented for payments; and the cheque of ₹ 4,000 paid into account had not been cleared. The balance as per the pass book will be:
(a) ₹ 1,10,000
(b) ₹ 2,17,500
(c) ₹ 1,26,500

6. When drawing up a Bank Reconciliation Statement, if you start with a debit balance as per the Bank Statement, the unpresented cheques should be:
(a) Added;
(b) Deducted;
(c) Not required to be adjusted.

7. When drawing up a BRS if you start with a Dr. Balance as per Bank Statement, the following are added:
1. Cheque issued but not presented to bank
2. B/R collected directly by bank
3. Overcasting of the Dr. Side of bank A/c in the cash book.

(a) only 1
(b) only 1& 2
(c) all of the above

8. A bank reconciliation statement is mainly prepared to:
(a) Reconcile the cash balance of the cash book
(b) Reconcile the difference between bank balance shown by cash book and bank passbook
(c) both a & b

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Bank Reconciliation is the process of reconciling cash column of the cash book and bank column of the cash book.
2) There are 3 types of differences between cash book and pass book namely Timing, Transactions & Errors.
3) Adjusting the cash book for any errors and/or omissions before preparing bank reconciliation is optional when the reconciliation is done at the end of the financial year.
4) Debit balance in cash book is same as overdraft as per pass book.
5) Bank charges debited by the bank is an example of timing difference for the purposes of bank reconciliation.
6) Overcasting of the debit side of the cash book is an example of a difference that is due to Error.
7) When we start bank reconciliation with a debit balance in cash book, then cheques issued but not yet presented should be added back to arrive at the balance as per pass book.
8) The bank charges charged by the bank should be deducted when bank reconciliation statement is being prepared starting from a credit balance of pass book.
9) When the causes of differences between pass book balance and cash book is not known, then the bank reconciliation statement can be prepared by matching the two books and identifying any unticked items in both sets.
10) While preparing the bank reconciliation statement starting with debit balance as per pass book or bank statement, the deposited cheques that are not yet cleared need not be adjusted.
11) Cash book shows a debit balance of ₹ 50,000 and the only difference from the balance as shown in pass book relates to cheques issued for ₹ 60,000 but not yet presented for payment. The balance as per pass book should be ₹ 1,10,000.
12) Overcasting of credit side of the cash book shall result in a higher bank balance in cash book when compared with pass book balance.
13) A cheque for ₹ 25,000 that was issued and was also presented for payment in same month but erroneously recorded on debit side of the cash book would cause a difference of ₹ 50,000 from the balance in pass book.
14) A direct debit by bank on account of any payment as may be instructed by customer should be recorded on credit side of cash book.
15) Bank Reconciliation Statement can be prepared in two formats – "Balance" presentation and "Plus & Minus" presentation.
16) The difference between cash book & pass book that relates to errors are those mostly made by Bank.
17) A cheque for ₹ 80,000 that was discounted from bank was dishonoured and the bank charged ₹ 1,600 as the charges on account of same. While starting with debit balance in cash book for preparing bank reconciliation statement, we need to deduct ₹ 78,400 to reconcile with pass book.

18) Interest on savings bank that is allowed or credited by bank is generally recorded in cash book prior to it being recorded by bank.
19) A regular bank reconciliation discourages the accountants to be involved in any kind of funds embezzlement.
20) Timing difference relates to the transactions that are recorded in the same period in both cash book and also the bank pass book.
21) Interest charged by the bank will be deducted, when the overdraft as per the cash book is made the starting point for the making the bank reconciliation statement.
22) Interest charged by the bank will be deducted when the overdraft as per pass book is the starting point for preparing the Bank Reconciliation Statement to arrive at the balance as per cash book at the end.
23) Bank Reconciliation Statement is prepared to arrive at the bank Balance.
24) If the balance as per Cash Book & Pass Book are the same, there is no need to prepare a Reconciliation Statement.
25) Bank reconciliation statement is not prepared to arrive at the bank balance.
26) Direct collection received by the bank on behalf of its customers will increase the balance as per the Bank Pass-book as compared to the balance as per the Cash-book.

Solution

1) False: Bank Reconciliation Statement reconciles bank column of cash book with the balance in the pass book i.e. customer account in the books of bank.
2) True: These are the three broad categories.
3) False: Adjusting the cash book is mandatory when bank reconciliation is done at the end of the financial year.
4) False: Debit balance as per cash book should be represented by credit or favourable balance in pass book.
5) False: Bank charges are example of the transactions that bank carries out by itself and the same has not been recorded in the cashbook until statement is obtained from the bank.
6) True: Overcasting is an example of an error.
7) True: Since the cheques issued would have been recorded as payments and bank balance was credited in cash book, we need to add it back as the same is not yet deducted from our bank balance.
8) False: Bank charges should be added when we start with credit or favourable balance in pass book as bank would have debited the charges.
9) True: Since, we don't know the causes of difference, matching the two statements is only efficient way to identify the difference.
10) False: Cheques deposited but not yet cleared should be subtracted from debit or unfavourable balance in pass book.
11) True: Cheques issued but not yet presented should be added back to a debit balance in cash book to arrive at pass book balance i.e. ₹ 50,000 + ₹ 60,000 = ₹ 1,10,000.
12) False: Overcasting of credit side means excessive payments are recorded and hence would lower the bank balance.
13) True: ₹ 25,000 payment is recorded as a receipt and hence it will have to be adjusted twice (once to nullify and then once to record actual payment) hence causing the difference of double amount.
14) True: It is an example of a payment instructed by customer to be directly debited by bank, and hence credited in the cash book.
15) True: Reconciliation statement can be prepared in either of the two formats.
16) False: Bank rarely makes mistakes, and hence differences that relate to errors are generally made in cash book.

17) False: We need to deduct 81,600 (i.e. both cheque returned & charges) from debit balance in cash book to arrive at balance as per pass book.
18) False: Interest allowed by bank is mostly recorded in cash book after the entry has been made in the pass book or bank statement.
19) True: In absence of any reconciliation, the accountants can mis-utilize the funds temporarily by recording the entry without actual depositing the cash.
20) False: Timing differences relate to the transactions that are recorded in cash book and pass book in two different periods.
21) False :- Interest charged by the bank will be added when the overdraft as per the Cash Book is made the starting point in preparing Bank Reconciliation Statement.
22) True: - Interest charged by the bank had resulted in increased overdraft balance as shown by the Pass Book. Therefore, it will be deducted from this balance in bank reconciliation statement to arrive at the balance as per cash book at the end.
23) False: - Bank reconciliation statement is prepared to reconcile and explain the causes of difference between bank balance as per cash book and the same as per bank statement as on a particular date.
24) True: - The reconciliation statement is prepared only when any difference in the balances arises.
25) True: - Object of preparation of BRS is to reconcile the pass book balance and the cash book balance in order to find out the causes of differences between these two books on a particular date.
26) True: - Direct collection received by the bank on behalf of its customer will increases the balance of pass book, as compared to balance as per cash book till the customer gets intimation from the bank.

SALIENT FEATURES OF BANK RECONCILIATION STATEMENT:

- The reconciliation will bring out any errors that may have been committed either in the cash book or in the pass book;
- Any undue delay in the clearance of cheques will be shown up by the reconciliation;
- A regular reconciliation discourages the accountant of the bank from embezzlement. There have been many cases when the cashiers merely made entries in the cash book but never deposited the cash in the bank; they were able to get away with it only because of lack of reconciliation.
- It helps in finding out the actual position of the bank balance.

IMPORTANCE OF BANK RECONCILIATION TO AN INDUSTRIAL UNIT

Banks are essential to modern society, but for an industrial unit, it serves as a necessary instrument in the commercial world. Most of the transactions of the business are done through bank whether it is a receipt or payment. Rather, it is legally necessary to operate the transactions through bank after a certain limit. All the transactions, which have been operated through bank, if not verified properly, the industrial unit may not be sure about its liquidity position in the bank on a particular date. There may be some cheques which have been issued, but not presented for payment, as well as there may be some deposits which has been deposited in the bank, but not collected or credited so far. Some expenses might have been debited or bills might have been dishonoured. It is not known to the industrial unit in time, it may lead to wrong conclusions. The errors committed by bank may not be known without preparing bank reconciliation statement. Preparation of bank reconciliation statement prevents the chances of embezzlement. Hence, bank reconciliation statement is very important and is a necessity of an industrial unit as it plays a key role in the liquidity control of the industry.

HOMEWORK QUESTIONS

Question 1 Pg no._____

From the following particulars, prepare a Bank Reconciliation Statement for Pathak Ltd. as on 30.6.2023

(1) Balance as per cash book is ₹ 1,20,000.
(2) Cheques issued but not presented in the bank amounts to ₹ 68,000.
(3) Bank charges amounts to ₹ 300.
(4) Interest credited by bank amounts to ₹ 1,500

Question 2 *(ICAI Study Material)* Pg no._____

From the following particulars, prepare a Bank Reconciliation Statement for Jindal Offset Ltd.

(1) Balance as per cash book is ₹ 2,40,000
(2) Cheques issued but not presented in the bank amounts to ₹ 1,36,000.
(3) Cheques deposited in bank but not yet cleared amounts to ₹ 90,000.
(4) Bank charges amounts to ₹ 300.
(5) Interest credited by bank amounts to ₹ 1,250.
(6) The balance as per pass book is ₹ 2,86,950

Question 3 *(ICAI Study Material)* Pg no._____

From the following particulars ascertain the balance that would appear in the Bank Pass Book of A on 31st December, 2023.

a) The bank overdraft as per Cash Book on 31st December, 2023 ₹6,340.
b) Interest on overdraft for 6 months ending 31st December, 2023 ₹160 is entered in Pass Book.
c) Bank charges of ₹400 are debited in the Pass Book only.
d) Cheques issued but not cashed prior to 31st December, 2023, amounted to ₹ 11,68,000.
e) Cheques paid into bank but not cleared before 31st December, 2023 were for ₹ 22,17,000.
f) Interest on investments collected by the bank and credited in the Pass Book ₹12,00,000.

Question 4 *(ICAI Study Material)* Pg no._____

From the following information, prepare a Bank reconciliation statement as at 31st December, 2023 for M/s New Steel Limited:

1	Bank overdraft as per Cash Book on 31st December, 2023	22,45,900
2	Interest debited by Bank on 26th December, 2023 but no advice received	2,78,700
3	Cheque issued before 31st December, 2023 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, 2023	13,50,000
6	Bills for collection credited by the Bank till 31st December, 2023 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

Question 5 *(CA Foundation July 2021) (5 Marks)* Pg no._____

From the following information, ascertain the Cash Book balance of Mr. Bajaj as on 31st March, 2023:

a) Debit balance as per Bank Pass Book ₹ 3,500.

b) A cheque amounting to ₹ 2,500 deposited on 15th March, but the same was returned by the Bank on 24th March for which no entry was passed in the Cash Book.
c) During March, two bills amounting to ₹ 2,500 and ₹ 500 were collected by the Bank but no entry was made in the Cash Book.
d) A bill for ₹ 5,000 due from Mr. Balaji previously discounted for ₹ 4,800 was dishonored. The Bank debited the account, but no entry was passed in the Cash Book
e) A Cheque for ₹ 1,500 was debited twice in the cash book.

Question 6 *(ICAI Study Material)* *Pg no.______*

From the following particulars prepare a bank reconciliation statement as on 31st December 2023:
a) On 31st December, 2023 cash-book of a firm showed a bank balance of ₹ 60,000 (debit balance).
b) Cheques had been issued for ₹ 15,00,000, out of which cheques worth ₹ 4,00,000 only were presented for payment.
c) Cheques worth ₹ 11,40,000 were deposited in the bank on 28th December,2023 but had not been credited by the bank. In addition to this, one cheque for ₹ 5,00,000 was entered in the cash book on 30th December, 2023 but was banked on 3rd January, 2024.
d) A cheque from Susan for ₹ 4,00,000 was deposited in the bank on 26th December 2023 but was dishonoured and the advice was received on 2nd January, 2024.
e) Pass-book showed bank charges of ₹ 2,000 debited by the bank.
f) One of the debtors deposited a sum of ₹ 5,00,000 in the bank account of the firm on 20th December, 2023 but the intimation in this respect was received from the bank on 2nd January, 2024.
g) Bank pass-book showed a debit balance of ₹ 3,82,000 on 31st December, 2023

Question 7 *(ICAI Study Material)* *Pg no.______*

Prepare a bank reconciliation statement from the following particulars on 30th September, 2023:

Particulars	Amount
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 not entered in Cash Book	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

Question 8 *(CA Foundation June 2022) (5 Marks)* *Pg no.______*

From the following particulars, prepare a Bank Reconciliation Statement on 31st March 2023

Particulars	Amount (₹)
Bank balance as per Pass Book	25,00,000
Bills discounted dishonored not recorded in Cash Book	12,50,000
Cheque received entered twice in Cash Book	25,000
Bank charges entered twice in Cash Book	5,000
Insurance premium paid directly by Bank under-standing instruction	1,50,000

Cheque issued but not presented to Bank for payment	12,50,000
Cheque received, but not sent to Bank	28,00,000
Cheque deposited in Bank, but no entry passed in the Cash Book	12,50,000
Credit side of the Bank column cast short	5,000

Question 9 *(CA Foundation Nov 2018) (10 Marks) / (RTP May 2020)* Pg no.______

Prepare a Bank Reconciliation Statement from the following particulars as on 30th September, 2023:

Particulars	Amount
Debit balance as per bank column of the cash book	18,60,000
Cheque issued to creditors but not yet presented to the bank for payment	3,60,000
Dividend received by the bank but not entered in the Cash book	2,50,000
Interest allowed by the Bank	6,250
Cheques deposited into the bank for collection but not collected by bank upto this date	7,70,000
Bank Charges not entered in Cash Book	1,000
A cheque deposited into bank was dishonored but no intimation received	1,60,000
Bank paid house tax on our behalf but no intimation received from bank in this connection	1,75,000

Question 10 *(RTP May 2019)/(RTP May 2023) (Similar)* Pg no.______

On 30th November, 2023, the Cash Book of Mr. Hari showed an overdrawn position of ₹ 4,480 although his Bank Statement showed only ₹ 3,200 overdrawn. An examination of the two records showed the following errors:

(i) The debit side of the Cash Book was undercast by ₹ 400.

(ii) A cheque for ₹ 1,600 in favour of Y suppliers Ltd. was omitted by the bank from the statement, the cheque was debited to another customer's Account.

(iii) A cheque for ₹ 172 drawn for payment of telephone bill was recorded in the Cash Book as ₹ 127 but was shown correctly in the Bank Statement.

(iv) A cheque for ₹ 425 from Mr. Pal paid into bank was dishonoured and shown as such on the Bank Statement, although no entry relating to the dishonoured cheque was made in the Cash Book.

(v) The Bank had debited a cheque for ₹ 150 to Mr. Hari's Account by mistake, it should have been debited by them to Mr. Kar's Account.

(vi) A dividend of ₹ 100 was collected by the bank but not entered in the Cash Book.

(vii) Cheques totalling ₹ 1,300 drawn on November was not presented for payment.

(viii) Cheque for ₹ 1,200 deposited on 30th November was not credited by the Bank.

(ix) Interest amounting to ₹ 300 was debited by the Bank but yet to be entered in the Cash Book.

You are required to prepare a Bank Reconciliation Statement on 30th November, 2023.

Question 11 *(CA Foundation May 2019) (10 Marks)* Pg no.______

Prepare the Bank Reconciliation Statement of M/s. R.K. Brothers on 30th June 2023 from the particulars given below:

(i) The Bank Pass Book had a debit balance of ₹ 25,000 on 30th June, 2023.

(ii) A cheque worth ₹400 directly deposited into Bank by customer but no entry was made in Cash Book

(iii) Out of cheques issued worth ₹ 34,000, cheques amounting to ₹ 20,000 only were presented for payment till 30th June, 2023.

(iv) A cheque for ₹ 4,000 received and entered in the Cash Book but it was not sent to the Bank.

(v) Cheques worth ₹ 20,000 had been sent to Bank for collection but the collection was reported by the Bank as under.
(1) Cheques collected before 30th June, 2023, ₹ 14,000
(2) Cheques collected on 10th July, 2023, ₹ 4,000
(3) Cheques collected on 12th July, 2023, ₹ 2,000.

(vi) The Bank made a direct payment of ₹ 600 which was not recorded in the Cash Book.

(vii) Interest on Overdraft charged by the bank ₹ 1,600 was not recorded in the Cash Book.

(viii) Bank charges worth ₹ 80 have been entered twice in the cash book whereas Insurance charges for ₹ 70 directly paid by Bank was not at all entered in the Cash Book.

(ix) The credit side of bank column of Cash Book was under cast by ₹ 2,000.

Question 12 *(ICAI Study Material)* *Pg no._____*

On 30th December, 2023 the bank column of A. Philip's cash book showed a debit balance of ₹ 4,610. On examination of the cash book and bank statement you find that:

1) Cheques amounting to ₹ 6,30,000 which were issued to trade payables and entered in the cash book before 30th December, 2023 were not presented for payment until that date.
2) Cheques amounting to ₹ 2,50,000 had been recorded in the cash book as having been paid into the bank on 30th December, 2023, but were entered in the bank statement on 1st January, 2024.
3) A cheque for ₹ 73,000 had been dishonoured prior to 30th December, 2023, but no record of this fact appeared in the cash book.
4) A dividend of ₹ 3,80,000, paid direct to the bank had not been recorded in the cash book.
5) Bank interest and charges amounting to ₹ 4,200 had been charged in the bank statement but not entered in the cash book.
6) No entry had been made in the cash book for a trade subscription of ₹ 10,000 paid vide banker's order in November, 2023.
7) A cheque for ₹ 27,000 drawn by B. Philip had been charged to A. Philip's bank account by mistake in December, 2023.

You are required:

a) to make appropriate adjustments in the cash book bringing down the correct balance, and
b) to prepare a statement reconciling the adjusted balance in the cash book with the balance shown in the bank statement.

Question 13 *(RTP May 2021)* *Pg no._____*

From the following information (as on 31.3.2023), prepare a bank reconciliation statement after making necessary amendments in the cash book:

Particulars	Amount
Bank balances as per the cash book (Dr.)	32,50,000
Cheques deposited, but not yet credited	44,75,000
Cheques issued but not yet presented for payment	35,62,000
Bank charges debited by bank but not recorded in the cash-book	12,500
Dividend directly collected by the bank	1,25,000
Insurance premium paid by bank as per standing instruction not intimated	15,900
Cash sales wrongly recorded in the Bank column of the cash-book	2,55,000
Customer's cheque dishonoured by bank not recorded in the cash-book	1,30,000
Wrong credit given by the bank	1,50,000

Also show the bank balance that will appear in the trial balance as on 31.3.2023.

Question 14 *(CA Foundation Nov 2019) (10 Marks)* *Pg no._____*

On 30th September, 2023, the bank account of XYZ, according to the bank column of the cash book, was overdrawn to the extent of ₹ 8,062. An examination of the Cash book and Bank Statement reveals the following:

a) A cheque for ₹ 11,14,000 deposited on 29th September, 2023 was credited by the bank only on 3rd October, 2023.
b) A payment by cheque for ₹ 18,000 has been entered twice in the Cash book
c) On 29th September, 2023, the bank credited an amount of 1,15,400 received from a customer of XYZ, but the advice was not received by XYZ until 1st October, 2023.
d) Bank charges amounting to ₹ 280 had not been entered in the cash book.
e) On 6th September 2023, the bank credited ₹ 30,000 to XYZ in error.
f) A bill of exchange for ₹ 1,60,000 was discounted by XYZ with his bank. The bill was dishonoured on 28th September, 2023 but no entry had been made in the books of XYZ.
g) Cheques issued upto 30th September, 2023 but not presented for payment upto that date totalled ₹ 13,46,000.
h) A bill payable of ₹ 2,00,000 had been paid by the bank but was not entered in the cash book and bill receivable for ₹ 60,000 had been discounted with the bank at a cost of ₹ 1,000 which had also not been recorded in cash book.

You are required:

To show the appropriate rectifications required in the cash book of XYZ, to arrive at the correct balance on 30th September, 2023 and to prepare a Bank Reconciliation Statement as on that date.

Question 15 *(RTP May 2022)* *Pg no._____*

From the following particulars of M/s Swapnil enterprises, prepare a Bank reconciliation statement:

(1) Bank overdraft as per Pass Book as on 31st March, 2023 was ₹ 8,800
(2) Cheques deposited in Bank for ₹ 5,800 but only ₹ 2,000 were cleared till 31st March.
(3) Cheques issued were ₹ 2,500, ₹ 3,800 and ₹ 2,000 during the month. The cheque of ₹ 5,800 is still with supplier.
(4) Dividend collected by Bank ₹ 1,250 was wrongly entered as ₹ 1,520 in Cash Book.
(5) Amount transferred from fixed deposit A/c into the current A/c ₹ 2,000 appeared only in Pass Book
(6) Interest on overdraft ₹ 930 was debited by Bank in Pass Book and the information was received only on 3rd April 2023.
(7) Direct deposit by M/s Rajesh Trader ₹ 400 not entered in Cash Book.
(8) Corporation tax ₹ 1,200 paid by Bank as per standing instruction appears in Pass Book only.

Question 16 *(CA Foundation Nov 2020) (10 Marks)* *Pg no._____*

On 31-3-2023, Mahesh's Cash Book showed a Bank overdraft of ₹ 98,700. On comparison he finds the following:

1) Out of the total cheques of ₹ 8,900 issued on 27th March, one cheque of ₹ 7,400 was presented for payment on 4th April and the other cheque of ₹ 1,500 handed over to the customer, was returned by him and in lieu of that a new cheque of the same amount was issued to him on 1st April. No entry for the return was made.
2) Out of total cash and cheques of ₹ 6,800 deposited in the Bank on 24th March, one cheque of ₹ 2,600 was cleared on 3rd April & other cheque of ₹ 500 was returned dishonoured by the bank on 4th April.

3) Bank charges ₹ 35 and Bank interest ₹ 2,860 charged by the bank appearing in the passbook are not yet recorded in the cash book.
4) A cheque deposited in his another account of ₹ 1,550 wrongly credited to this account by the bank.
5) A cheque of ₹ 800, drawn on this account, was wrongly debited in another account by the bank.
6) A debit of ₹ 3,500 appearing in the bank statement for an unpaid cheque returned for being 'out of date' had been re-dated and deposited in the bank account again on 5th April 2023.
7) The bank allowed interest on deposit ₹ 1,000.
8) A customer who received a cash discount of 4% on his account of ₹ 1,00,000 paid a cheque on 20th March, 2023. The cashier erroneously entered the gross amount in the bank column of the Cash Book.

Prepare Bank Reconciliation Statement as on 31-3-2023

Question 17 (CA Foundation Jan 2021) (4 Marks) *Pg no._____*

Prepare a Bank Reconciliation Statement from the following particulars as on 31st December, 2023:

Particulars	Amount
Bank Balance as per Cash Book (Debit)	1,98,000
Bank Charges debited by the bank not recorded in Cash Book	34,000
Received from debtors vide RTGS on 31st December, 2023 not recorded in Cash Book	1,00,000
Cheque issued but not presented for payment	45,000
Cheque deposited but not cleared	25,000
Cheque received and deposited but dishonoured. Entry for dishonour not made in the Cash Book	5,000
Instruction for payment given to the bank on 31st December, 2023 but the same effected by the Bank on 01st January, 2024	4,000

Question 18 (CA Foundation Dec 2021) (10 Marks) *Pg no._____*

According to the cash-book of G there was balance of ₹ 4,45,000 in his bank on 30th June, 2023. On investigation you find that:

(i) Cheques amounting to ₹ 60,000 issued to creditors have not been presented for payment till the date
(ii) Cheques paid into bank amounting to ₹ 1,10,500 out of which cheques amounting to ₹ 55,000 only collected by bank up to 30th June 2023
(iii) A dividend of ₹ 4,000 and rent amounting to ₹ 60,000 received by the bank and entered in the pass-book but not recorded in the cash book.
(iv) Insurance premium (up to 31st December, 2023) paid by the bank ₹ 2,700 not entered in the cash book.
(v) The payment side of the cash book had been under cast by ₹ 500
(vi) Bank charges ₹ 150 shown in the pass book had not been entered in the cash book.
(vii) A bill payable of ₹ 20,000 had been paid by the bank but was not entered in the cash book and bill receivable for ₹ 6,000 had been discounted with the bank at a cost of ₹ 100 which had also not been recorded in cash book.

You are required:

(1) To make the appropriate adjustments in the cash book, and
(2) To prepare a statement reconciling it with the bank pass book

Question 19 *(MTP October 2021)* Pg no._____

Prepare a Bank Reconciliation statement for Satyam Traders as on 31st March,2023 The cash book of Satyam Traders shows a debit balance of ₹ 4,12,200 at bank as on 31st March,2023, but you find that it does not agree with the balance as per Pass Book. After checking you find the following:

1. On 12th March, 2023 the payment side of the Cash Book was under cast by ₹ 12,000/-
2. A cheque of ₹ 85,000 issued on 20th March, 2023 was not taken in the bank column
3. On 22nd March, 2023 the debit balance of ₹ 18,500 as on the previous day, was brought forwards as credit balance.
4. Out of the total cheques amounting to ₹ 42,000 issued in, the last week of March, 2023, cheques aggregating ₹ 28,500 were encashed in March, 2023.
5. Dividends of ₹ 35,000 collected by the Bank and Fire insurance premium of ₹ 20,000 paid by it were not recorded in the cash book.
6. One cheque issued to a Creditor of ₹ 1,29,000 was recorded twice in the Cash book.
7. A debtor Mr. A has deposited the Cheque for ₹ 32,000 into the bank directly in the month of March, 2023 without intimating to Satyam Traders and the same cheque was dishonored by the bank due to insufficient funds in the month of March itself.
8. A cheque from customer for ₹ 5,000 was deposited in bank on 28th March,2023 but was dishonored and advice received from bank on 3rd April, 2023.
9. Bank paid credit card bill of ₹ 2,500 which is not recorded in cash book.
10. Bank wrongly credited cheque of ₹ 25,000 of other customer in our account.
11. Bank credited cheque of ₹ 2,000 in savings account of proprietor of Satyam Traders instead of crediting cheque in current account of Satyam Traders.
12. ₹ 500 discount received wrongly entered in bank column in cash book.
13. Bank debited charges ₹ 200 on 25th March for which no intimation received till 31st March.

Note: Do not make adjusted cash book.

Question 20 – *(CA Foundation Dec 2022) (10 Marks)* Pg no._____

The cash book of Mr. Karan shows ₹ 2,60,400 as the balance of bank as on 31st December, 2023 but you find that it does not agree with the balance as per the bank pass book. On analysis, you found the following discrepancies:

a. On 15th December, 2023 the payment side of the cash book was overcast by ₹ 10,000.
b. A Cheque for ₹ 1,18,000 issued on 6th December, 2023 was not taken in the bank Column.
c. On 20th December, 2023 the debit balance of ₹ 8,460 as on the previous day, was brought forward as credit balance in the cash book.
d. Of the total cheques amounting to ₹ 12,370 drawn in the last week of December 2023, cheques aggregating ₹ 9,360 were encashed in December, 2023.
e. Dividends of ₹ 35,000 collected by the bank and fire insurance premium of ₹ 7,900 paid by the bank were not recorded in the cash book.
f. A Cheque issued to a creditor of ₹ 1,75,000 was recorded twice in the cash book.
g. Bill for collection amounting to ₹ 53,000 credited by the bank on 21st December, 2023 but no advice was received by Mr. Karan till 31st December, 2023.
h. A Customer, who received a cash discount of 3% on his account of ₹ 60,000 paid a cheque on 10th December, 2023. The cashier erroneously entered the gross amount in the bank column of the cash book.

You are required to prepare the bank reconciliation statement as on 31st December, 2023.

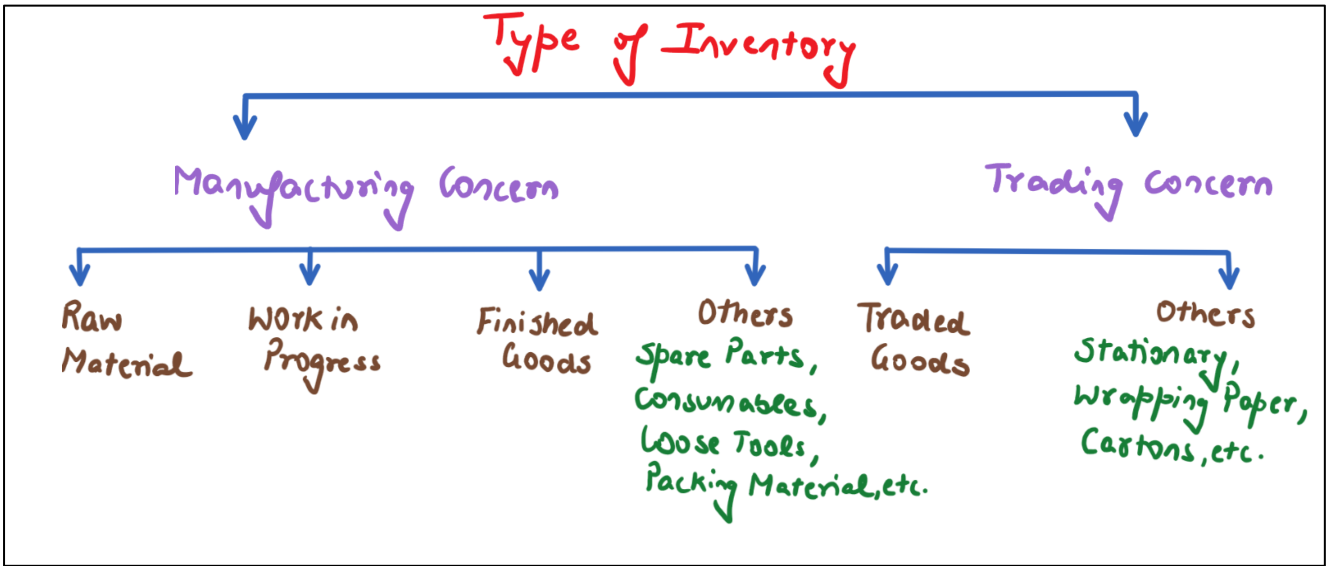
INVENTORIES

CH 4

"Education is not preparation for life, It is Life itself"

DEFINITION

Nature of Inventory	Description
Held for sale in the ordinary course of business, or	Finished goods
In the process of production for such sale, or	Work in progress
In the form of materials or supplies to be consumed in production process or in the rendering of services	Raw Material – incl. consumables & Loose Tools used in production process



SIGNIFICANCE OF INVENTORY VALUATION

Inventory Valuation is important / significant due to the following reasons-

Purpose	Explanation
To ascertain the true income earned by the entity during the accounting period.	See *separate note* below this table
To determine the true financial position of the entity as on the Balance sheet date.	Inventory is classified as "Current Assets". Balance sheet will disclose the correct financial position, only if Inventory is properly valued.
To analyze the liquidity of the enterprise. (Note: Liquidity = Ability to meet short-term commitment	Liquidity is analyzed in the terms of Net Working capital (Current Assets Less Current liabilities), and Current Ratio (Current Assets divided by current liabilities). Inventory forms an important part of Current Assets
To ensure compliance with disclosure requirements	As per AS-2, the financial Statements should disclose- (a) the accounting policies adopted in measuring inventories,

under AS- 2, and applicable Statutes like Companies Act, 2013	including the cost formula used and (b) the total carrying amount of inventories and its classification appropriate to the enterprise. Schedule III to the Companies Act, 2013, requires valuation of each class of goods i.e. Raw material, WIP and finished goods under broad head to be disclosed in the financial statements.

Note: Effect of wrong valuation of inventory on Profits and Balance Sheet position

Situation	Effect on Profit	Effect on Balance sheet	Effect on liquidity
Closing stock overstated	Overstated	Higher Current Assets	High
Closing stock understated	Understated	Lower Current Assets	Low
Opening stock overstated	Understated	-	-
Opening stock understated	Overstated	-	-

MEASUREMENT OR VALUATION OF INVENTORY

Inventories should be valued at – (a) Cost, or (b) Net Realizable Value, whichever is lower.

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 recognized until its becomes due or are actually realized.

COMPONENTS OF COST

Meaning of Cost: The Cost of Inventories shall comprise all-

Cost

- Purchase Cost
  - Purchase Price
  - \+ Non Refundable Taxes & Duties
  - \+ Freight Inwards
  - \+ Directly Attributable Expenditure [Eg. Transit Insurance, Buying Commission, etc.]
  - (–) Trade Discount / Rebate, etc.
- Conversion Cost
  - Direct Cost
    - Direct Labour
  - Indirect Cost (O/Hs)
    - Fixed Overheads
    - Variable Overheads
- Other Costs
  - Costs incurred in bringing inventories to their present location & condition [Eg. Design Costs]

Cost of Purchase is determined as under-

Particulars	Amount
Purchase price including duties and taxes (excluding tax refunds/credits)	XXX
Add: Freight Inwards	XXX
Add: Other Expenditure directly attributable to the purchase (See Note)	XXX
Less: Trade Discounts and Rebates	(XXX)
Costs of Purchase	XXX

Note: Examples of expenditure directly attributable for purchases are- (a) Costs of Containers (b) Transit Insurance, (c) Buying Commission where purchase of material is possible only through buying agents.

Costs of Conversion includes

Types of Cost	Cost directly related to the units of production	Variable Production Overheads	Fixed Production Overheads
Description / Example	E.g., Direct Labour, i.e., cost of workers who are directly associated in production process.	Indirect costs which vary directly with volume of output, e.g., Indirect Materials, Indirect Labour.	Indirect costs which remain relatively constant regardless of the level of output, e.g., Factory Rent, Salary, etc.

Other Costs

Included in the cost of inventories only to the extent they are incurred in bringing the inventories to their present location and condition.

Items includible as "Other Costs"	Items excludible from "Other Costs"
• Costs of designing products for specific customers • Non-production Overheads incurred for bringing inventories to their present location	• Interest and other Borrowing Costs. • Overheads incurred after inventories are brought to their present location and condition

EXCLUSIONS FROM COST

- ❖ Abnormal amount of wasted materials, labour or other production cost
- ❖ Storage cost unless those are necessary in the production process prior to a further production stage.
- ❖ Administrative overheads that do not contribute to bringing the inventories to their present location and condition
- ❖ Selling and distribution cost

NET REALIZABLE VALUE

Estimated Selling Price	XX
Less: Estimated selling expenses	(XX)
Less: Estimated cost of completion	(XX)
NRV	XX

- ➢ Inventories are usually written down to Net Realizable value on an item-by-item basis (individual basis) & not on global basis
- ➢ In case of firm/committed contract of sale, NRV shall be calculated at the contract price.

Example ***(ICAI Study Material)***

Surekha Ltd deals in 3 products P, Q & R neither similar nor interchangeable. At the end of year, the Historical Cost and NRV of items of closing stock are given below. Determine the value of closing stock.

Items	Historical Cost (in Lakhs)	Net Realizable Value (in Lakhs)
P	38	42
Q	29	29
R	17	14

Example

Closing Stock: 3,000 units. Cost per Unit 40. Selling Price per Unit 45.
There is firm contract for 1,000 units @ 37 per unit.

INVENTORY SYSTEMS

Inventory System refers to – (a) system of recording receipts and issues of inventory, and physical counting of actual stock available at the period end and (c) comparing physical stock as per books and records to ascertain discrepancies if any.

There are two broad Inventory system, – (1) Periodic Inventory System, and (2) Perpetual Inventory System. The salient features/ difference between these two methods are–

Particulars	Periodic Inventory System	Perpetual Inventory System
1. Meaning	This involves ascertaining inventory value by actual physical count. It is also called as Physical Inventory System	This involves ascertaining inventory value by keeping upto date records & finding the value from such Books and Records
2. COGS	Cost of Goods Sold (COGS) = Opening Inventory (Known) + Purchases during year (known) - Closing Inventory (by Physical count)	Cost of Goods Sold (COGS) is determined from the books, since each receipt and issue of materials is recorded on an immediate basis.
3. COGS v/s Stock	This system determines Inventory Value, and calculates COGS as balancing figure	This system determines COGS for every issue & determines Inventory Value as Balancing figure.
4. Treatment of Loss	COGS includes loss of goods, as goods not in stock are assumed to be sold	Closing Inventory include loss of goods as all unsold goods are assumed to be in Inventory

5. Stock taking	Stock verification takes place at the end of a financial period, say a year	Stocks are verified at regular intervals in the year, therefore also called as Continuous stock taking
6. Coverage in stock taking	All items of stock are covered in a single stretch of verification, say over two or three days	In each verification, two or three items are covered on random basis. In entire period, all items are covered on rotation basis.
7. Effect on Work	Requires closure of business for counting of inventory	Inventory can be determined without affecting the business operations
8. Control	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
9. Cost	This is simple and less costly method.	This is a relatively costly method

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

TECHNIQUES / FORMULA FOR INVENTORY VALUATION

Techniques of Inventory Valuation

Historical Cost Methods
1) Specific Identification Method (Items not ordinarily interchangeable)
2) First in First Out (FIFO)
3) Last in First Out (LIFO)
4) Simple Average
5) Weighted Average

Non Historical Cost Methods
1) Adjusted Selling Price/ Retail Inventory Method
2) Standard cost Method

SPECIFIC IDENTIFICATION OF COST

Meaning	❖ Specific Identification of Cost means that specific costs are attributed to specific or identified items of inventory. ❖ This applies for items that are segregated or identified for a specific project. ❖ When there are large numbers of items of inventory, which are ordinarily interchangeable, specific identification of costs should not be applied.

FIRST-IN-FIRST-OUT (FIFO)

Meaning	❖ FIFO is a method of pricing the issues of materials, in the order in which they are purchased. The earliest prices at which materials were received are exhausted first before subsequent prices are taken up. ❖ Hence, closing stock will be valued at the price relating to the latest consignments
Merits	(a) It is simple to understand and easy to operate (b) Closing stock of material will be represented very closely at current market price.
Demerits	This method may lead to clerical errors, when the prices fluctuate frequently.
Impact	Cost of Goods sold (COGS) will consist of the Oldest Prices, while closing stock will be valued at most recent price.

LAST-IN-FIRST-OUT (LIFO)

Meaning	❖ It is a method of pricing the issues of materials, in the reverse order in which they are purchased. Closing stock will be generally valued at earliest prices. ❖ The prices of the most recently received consignment i.e., immediately last available consignment are exhausted first before previous consignment prices are taken up.
Merits	a. Cost of materials issued will reflect the current market price approximately. This enables the matching of cost of production with current sale revenue. b. Use of LIFO method during the period of rising prices does not reflect undue high profit in the income statement.
Demerits	a. Calculation becomes complicated and cumbersome when frequent purchases are made at highly fluctuating rates. b. This method is not acceptable under Accounting Standards or to Income Tax Authorities
Impact	COGS will consist of Recent Prices, while Closing stock will be valued at Older Prices.

SIMPLE AVERAGE PRICE

Meaning	Closing stock is valued at Average Price. This method is generally followed by the entities using periodic inventory method. Simple Avg Price = $\frac{\text{Total of Unit Prices of each purchase}}{\text{Total no. of purchases}}$ Example: If there were three consignments with prices of ₹ 20, ₹ 27 and ₹ 22, the Simple Average Price would be (₹ 20 + 27 + 22) ÷ 3 = ₹23
Merits	(a) Useful when materials are received in uniform lots of similar quantity. (b) Useful when purchased prices do not fluctuate considerably. (c) Simple to understand and easy to operate.

Demerits	(a) Materials Issue Cost does not represent actual cost price. Since the material are issued at a price obtained by averaging cost prices (b) This method will give incorrect results, if the prices of materials fluctuate frequently. (c) The price determination is unscientific, since there is averaging of prices without considering quantity.

WEIGHTED AVERAGE PRICE

Meaning	Weighted Average Price Method gives due weightage to quantities purchased and the purchase price to determine the issue price. Closing stock is valued at Weighted Average Cost, calculated as under- Total Cost of Goods received ÷ Total Quantity purchased
Merits	(a) It smoothens the price fluctuations, if any, due to material purchases (b) Issue prices need not be calculated for each issue unless new lot of material is received
Demerits	(a) It may be difficult to compute since every new lot received would require recomputation of issue prices.

ADJUSTED SELLING PRICE / RETAIL METHOD

1. Applicability: This method is applicable in the following situations
   (a) Retail trade (c) Inventories of large numbers of rapidly changing items,
   (b) Similar profit margins (d) Impracticable to use other costing methods
2. Retail Method may be used for convenience if the results approximate the actual cost.
3. Measurement: Cost of Inventory = Sales Value of Inventory Less Appropriate Gross Margin%

Note: Adjusted GP Percentage is used for inventories marked down to below its Original Selling Price. An average percentage for each Retail Departments is often used.

Cost + Profit = Sales	So, the relationship to be remembered is-
100% + 50% = 150%	(50÷100) = 1/2nd on Cost = 1/3rd on Sales = (50÷150)
100%+33 1/3%=133 1/3%	(33 1/3÷100) = 1/3rd on Cost = 1/4th on Sales = (33 1/3÷133 1/3)
100% + 25% = 125%	(25÷100) = 1/4th on Cost = 1/5th on Sales = (25÷125)
100% + 20% = 120%	(20÷100) = 1/5th on Cost = 1/6th on Sales = (20÷120)

STANDARD COST METHOD

This method is used when there is frequent change in the price per unit of the goods and goods are purchased frequently by the business e.g. crude oil. Based on the experience a standard cost is determined on the basis of frequent changes in prices and inventory is valued on that price per unit.

PHYSICAL STOCK v/s BOOK STOCK

Wherever required the following adjustments are carried out in respect of value of Physical stock, to arrive at the value of Inventory as per the Balance sheet

	Value of Physical Stocks on the Closing Date	XXX
Add	Goods in Transit, i.e. goods in respect of which the Firm has the title and ownership, but lying with the Transporter/ Carrier, pending delivery.	XXX.
Add	Goods held by other Entities on our behalf (e.g. Our stock held by Agent, Sub-Contractor, Job Worker, etc.)	XXX
Add	Goods sent on approval for which confirmation not received from customer.	XXX
Less	Any goods sold in respect of title has been transferred to the Buyer, but delivery pending at Buyer's request.	(XXX)
Less	Goods held by us on behalf of other Entities (e.g. As agent, as Sub-Contractor, as Job Worker, etc)	(XXX)
Less	Adjustments required to mark-down defectives/Obsolete items etc, to their NRV, if any.	(XXX)
	Value of Stocks as per Balance sheet	XXX

VERIFICATION OF STOCK ON OTHER THAN BALANCE SHEET DATE

Generally, Physical Stock Verification and Valuation is done at the end of the last day of the accounting year. Sometimes, in big organizations, it may not be possible to verify the stocks exactly on the last date of the accounting period. In such cases, stock is taken either few days earlier or later, according to the situation. The following adjustments are carried out in order to arrive at the Stock Value on the Balance Sheet date-

Stock Taking after Balance Sheet date	
Value of Stocks on verification date (e.g. 6th April)	XXX
(+) Cost of Sales made during the interim period	XXX
(+) Purchase Returns during the interim period	XXX
(-) Purchases made during the interim period	(XXX)
(-) Sales Return (at cost price) during the period	(XXX)
Value of Stocks on B/S date i.e., 31st March	XXX

Stock Taking before Balance Sheet date	
Value of Stocks on verification date (e.g. 25thMarch)	XXX
(+) Purchases made during the interim period	XXX
(+) Sales Return (at Cost price) during the period	XXX
(-) Cost of Sales made during the interim period	(XXX)
(-) Purchase Return during the interim period	(XXX)
Value of Stocks on B/S date i.e., 31st March	XXX

ASSIGNMENT QUESTIONS

Question 1 *Pg no._____*

A manufacturer has following record of purchases of material which he uses while manufacturing TV set

Date	Quantity (units)	Price per unit
Dec. 5	900	50
Dec. 11	600	55
Dec. 26	300	60
Dec. 29	800	71
	2,600	

1,600 units were issued during the month of December as follows:

<u>Record of issues</u>

Date	Quantity (units)
Dec. 6	500
Dec. 21	600
Dec. 30	500
	1,600

Find out value of inventory by following methods:

1) FIFO Method
2) LIFO Method
3) Weighted Average Cost Method
4) Simple Average Method

Also find inventory value if computed by Periodic inventory system.

Question 2 *Pg no._____*

Information has been given relating to petrol pump for the month of October 2023:

Sales	9,45,000
Administrative Cost	25,000

Inventory

Opening (1/10)	1,00,000 litres @ ₹ 3/litre
Purchases	
1/10	2,00,000 litres @ ₹ 2.85/litre
31/10	1,00,000 litres @ ₹ 3.03/litre
Closing	1,30,000 litres

Compute Closing Inventory, Cost of Goods Sold, Gross Profit and Net Profit as per FIFO, LIFO & Weighted average methods.

Question 3 *<u>(ICAI Study Material)</u>* *Pg no._____*

From the following information, calculate the non-historical cost of closing inventories using adjusted selling price method:

Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening inventory	Nil
Closing inventory at selling price	50,000

Question 4 *(ICAI Study Material)* *Pg no._____*

M/s X, Y and Z are in retail business, following information are obtained from their records for the year ended 31st March, 2023:

Goods received from suppliers (subject to trade discount and taxes)	15,75,500
Trade discount 3% and GST 11%	
Packaging and transportation charges	87,500
Sales during the year	22,45,500
Sales price of closing inventories	2,35,000

Find out the non-historical cost of inventories using adjusted selling price method.

Question 5 *Pg no._____*

Y sells goods at a Gross Profit of 20% on Cost. He provides following data during a period-

- Opening Inventory at Market Price = ₹ 1,20,000 (Cost = ?)
- Sales made during the period = ₹ 38,40,000
- Purchases during the period (at cost) = ₹ 34,00,000

Find out the value of Closing Inventory

Question 6 *(ICAI Study Material)* *Pg no._____*

From the following particulars ascertain the value of Inventories as on 31st March, 2023:

Inventory as on 1.4.2022	1,42,500
Purchases	7,62,500
Manufacturing Expenses	1,50,000
Selling Expenses	60,500
Administrative Expenses	30,000
Financial Charges	21,500
Sales	12,45,000

At the time of valuing inventory as on 31st March, 2022, 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.

Question 7 *Pg no._____*

X Bros could organize their stock- taking only on 12th April, even though their financial year ended on 31st March. The following data is provided for the period 1st April to 12th April-

Sales during the period (at an average Gross Profit of 25% on cost)	10,00,000
Purchases during the period (including Cash Purchases ₹ 3,80,000)	7,80,000
Purchase Returns (only out of Credit Purchases)	80,000
Sales Return by customers (at Market Prices)	1,00,000

Value of Physical Stock as per Stock-taking was ₹ 30,00,000. What would be value of inventory for B/s purposes?

Question 8 *(ICAI SM)/(RTP May 2018)/(Nov 2019)/(May 2021)/(Nov 2023) (Similar)* *Pg no._____*

Inventory taking for the year ended 31st March, 2023 was completed by 10th April, 2023, the valuation of which showed a stock figure of ₹ 16,75,000 at cost as on the completion date. After the end of the accounting year and till the date of completion of inventory taking, sales

for the next year were made for ₹ 68,750, profit margin being 33.33% on cost. Purchases for the next year included in the inventory amounted to ₹ 90,000 at cost less trade discount 10%. During this period, goods were added to inventory of the mark up price of ₹ 3,000 in respect of sales returns.
After inventory taking it was found that there were certain very old slow moving items costing ₹ 11,250 which should be taken at ₹ 5,250 to ensure disposal to an interested customer. Due to heavy floods, certain goods costing ₹ 15,500 were received from the supplier beyond the delivery date of customer. As a result, the customer refused to take delivery and net realizable value of the goods was estimated to be ₹ 12,500 on 31st March, 2023.
Calculate the value of inventory for inclusion in the final accounts for the year ended 31st March, 2023.

Question 9 *(ICAI Study Material)* *Pg no._____*

X who was closing his books on 31.3.2023 failed to take the actual stock which he did only on 9th April, 2023, 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 31.3.2023 and 9.4.2023 as per the sales day book are ₹ 17,200.
Purchases between 31.3.2023 and 9.4.2023 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, 2023 but goods received only on 4th April, 2023 amounted to ₹ 1,000. Rate of gross profit is 33-1/3% on cost.
Ascertain the value of physical stock as on 31.3.2023.

Question 10 *(ICAI Study Material)* *Pg no._____*

The Profit and loss account of Hanuman showed a net profit of ₹ 6,00,000, after considering the closing stock of ₹ 3,75,000 on 31st March, 2023. Subsequently the following information was obtained from scrutiny of the books:
a) Purchases for the year included ₹ 15,000 paid for new electric fittings for the shop.
b) Hanuman gave away goods valued at ₹ 40,000 as free samples for which no entry was made in the books of accounts.
c) Invoices for goods amounting to ₹ 2,50,000 have been entered on 27th March, 2023, but the goods were not included in stock.
d) In March, 2023 goods of ₹ 2,00,000 sold and delivered were taken in the sales for April, 2023.
e) Goods costing ₹ 75,000 were sent on sale or return in March, 2023 at a margin of profit of 33-1/3% on cost. Though approval was given in April, 2023 these were taken as sales for March, 2023.

Calculate value of stock on 31st March, 2023 and the adjusted net profit for the year ended on that date.

Question 11 *(ICAI SM)/(RTP May 2019)/(Nov 2020)/(May 2022)/(Nov 2022) (Similar)* *Pg no._____*

A trader prepares his account on 31st March each year. Due to some avoidable reasons, no stocktaking could be possible till 15th April 2023. 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 2023.
a) Sales ₹ 41,000 (including cash sales ₹ 10,000)
b) Purchase ₹ 5,034 (including cash purchase ₹ 1,990)
c) Sales Return ₹ 1,000

d) On 15th March goods of the sale value of ₹ 10,000 were sent on sale or return basis to customer, the period of approval being four weeks. He returned 40% of the goods on 10th April approving the rest. The customer was billed on 16th April.
e) The trader had also received goods costing ₹ 8,000 in March, for sale on consignment basis, 20% of the goods had been sold by 31st March, and another 50% by 15th April. These sales are not included in above sales.

Goods are sold by the trader at a profit of 20% on sales.
You are required to ascertain the value of inventory as on 31st March 2023.

Question 12 *(ICAI Study Material)* Pg no._____

Physical verification of stock in a business was done on 23rd June, 2023. The value of the stock was ₹ 48,00,000. The following transactions took place between 23rd June to 30th June, 2023:
a) Out of the goods sent on consignment, goods at cost worth ₹ 2,40,000 were unsold.
b) Purchases of ₹ 4,00,000 were made out of which goods worth ₹ 1,60,000 were delivered on 5th July, 2023.
c) Sales were ₹ 13,60,000, which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 30th June 2023.
d) 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, 2023.

Question 13 *(CA Foundation May 2019) (5 Marks) /(RTP May 2023) (Similar)* Pg no._____

Raj Ltd. prepared their accounts financial year ended on 31st March 2023. Due to unavoidable circumstances actual stock has been taken on 10th April 2023, when it was ascertained at ₹ 1,25,000. It has been found that;
(i) Sales are entered in the Sales Book on the day of dispatch and return inwards in the Returns Inward Book on the day of the goods received back.
(ii) Purchases are entered in the Purchase Book on the day the Invoices are received.
(iii) Sales between 1st April 2023 to 9th April 2023 amounting to ₹ 20,000 as per Sales Day Book.
(iv) Free samples for business promotion issued during 1st April 2023 to 9th April 2023 amounting to ₹ 4,000 at cost.
(v) Purchases during 1st April 2023 to 9th April 2023 amounting to ₹ 10,000 but goods amounts to ₹ 2,000 not received till the date of stock taking.
(vi) Invoices for goods purchased amounting to ₹ 20,000 were entered on 28th March 2023 but the goods were not included in stock.

Rate of Gross Profit is 25% on cost. Ascertain the value of Stock as on 31st March 2023.

Question 14 *(RTP Nov 2018) / (RTP May 2020) /(RTP Nov 2021) (Similar)* Pg no._____

Sky Ltd. keeps no stock records but a physical inventory of stock is made at the end of each quarter and the valuation is taken at cost. The company's year ends on 31st March, 2023 and their accounts have been prepared to that date. The stock valuation taken on 31st March, 2023 was however, misleading and you have been advised to value the closing stocks as on 31st March, 2023 with the stock figure as on 31st December, 2022 and some other information is available to you:
(i) The cost of stock on 31st December, 2022 as shown by the inventory sheet was ₹ 80,000.
(ii) On 31st December, stock sheet showed the following discrepancies:
  (a) A page total of ₹ 5,000 had been carried to summary sheet as ₹ 6,000.
  (b) The total of a page had been undercast by ₹ 200.

(iii) Invoice of purchases entered in the Purchase Book during the quarter from January to March, 2023 totalled ₹ 70,000. Out of this ₹ 3,000 related to goods received prior to 31st December, 2022. Invoices entered in April 2023 relating to goods received in March, 2023 totalled ₹ 4,000.

(iv) Sales invoiced to customers totalled ₹ 90,000 from January to March, 2023. Of this ₹ 5,000 related to goods dispatched before 31st December, 2022. Goods dispatched to customers before 31st March, 2023 but invoiced in April, 2023 totalled ₹ 4,000.

(v) During the final quarter, credit notes at invoiced value of ₹ 1,000 had been issued to customers in respect of goods returned during that period. The gross margin earned by the company is 25% of cost.

You are required to prepare a statement showing the amount of stock at cost as on 31st March, 2023.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) The amount of purchase if
Cost of goods sold is ₹ 80,700
Opening Inventory ₹ 5,800
Closing Inventory ₹ 6,000
   (a) ₹ 80,500
   (b) ₹ 74,900
   (c) ₹ 80,900

2) Average Inventory = ₹ 12,000. Closing Inventory is ₹ 3,000 more than opening Inventory. The value of closing Inventory = ______.
   (a) ₹ 12,000
   (b) ₹ 24,000
   (c) ₹ 13,500

3) While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by ₹ 50,000. As a result
   (a) Previous year's profit is overstated and current year's profit is also overstated
   (b) Previous year's profit is overstated and current year's profit is understated
   (c) Previous year's profit is understated and current year's profit is also understated

4) Consider the following for Q Co. for the year 2022-23:

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

Closing inventory of goods for the year 2022-23 as
   (a) ₹ 80,000
   (b) ₹ 60,000
   (c) ₹ 40,000

5) If the profit is 25% of the cost price then it is
   (a) 25% of the sales price
   (b) 33% of the sales price
   (c) 20% of the sales price

6) Goods purchased ₹ 1,00,000. Sales ₹ 90,000. Margin 20% on cost. Closing Inventory = ?
   (a) ₹ 20,000
   (b) ₹ 10,000
   (c) ₹ 25,000

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

1.12.2023	Opening Inventory 50 units value ₹ 2,200.
2.12.2023	Purchased 100 units @ ₹47.

4.12.2023 Issued 50 units.
5.12.2023 Purchased 200 units @ ₹ 48.
The value of inventory at the end of the week and the unit weighted average costs is
(a) ₹ 14,200 – ₹ 47.33
(b) ₹ 14,300 – ₹ 47.67
(c) ₹ 14,000 – ₹ 46.66

8) The cost of sales is equal to
(a) Opening stock plus purchases
(b) Purchases minus Closing stock
(c) Opening stock plus purchases minus closing stock

9) Inventory is disclosed in financial statements under:
(a) Fixed Assets
(b) Current Assets
(c) Current Liabilities

10) Accounting Standards do not permit following method of inventory valuation
(a) FIFO
(b) Average cost
(c) LIFO

11) Which inventory costing formula calculates value of closing inventory considering that inventory most recently purchased has not been sold?
(a) FIFO
(b) LIFO
(c) Weighted average cost

12) Valuing inventory at cost or net realisable value is based on which principle
(a) Consistency
(b) Conservatism
(c) Going concern

13) Under inflationary trend, which of the methods will show highest value of inventory?
(a) FIFO
(b) Weighted average
(c) LIFO

14) Which of the following methods does not consider historical cost of inventory?
(a) Weighted average
(b) FIFO
(c) Retail price method

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Inventories are stocks of goods and materials that are maintained for mainly the purpose of revenue generation.
2) A building is considered inventory in a construction business.
3) Inventory is valued as carrying cost less percentage decreases.
4) Management has daily information about the quantity and valuation of closing stock under Physical Inventory System.
5) Periodic Inventory System is more suitable for small enterprises.
6) When closing inventory is overstated, net income for the accounting period will be understated.
7) Closing inventory = Opening inventory + Purchases + Direct expenses + Cost of goods sold.
8) Cost of inventories should comprise all cost of purchase.
9) Costs of conversion of inventories include costs directly related to the units of production. They include allocation of fixed overheads only.
10) Abnormal amounts of wasted materials, labour or other production overheads expenses are included in the costs of inventories.
11) Perpetual system requires closure of business for counting of inventory.
12) Periodic inventory system is a method of ascertaining inventory by taking an actual physical count. *(Dec 2022)*
13) The value of closing inventory under average method is realistic as compare to LIFO.
14) The value of stock is shown on the assets side of the balance-sheet as fixed assets.
15) Under inflationary conditions, FIFO will not show lowest value of cost of goods sold.
16) Under LIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.
17) Valuation of inventory at cost or net realizable value whichever is less, is based on principle of Conservatism. *(Nov 2019)*
18) Finished goods are normally valued at cost or market price, whichever is higher.
19) Warehouse rent paid for storage of finished inventory should be included in the cost of finished inventory. *(July 2021)*
20) Loss of stock is said to be abnormal loss when such loss is due to inherent characteristics of the commodities.
21) The proprietor of a shop feels that he has made a loss due to closing stock being zero.
22) Finished goods are normally valued at cost or market price, whichever is lower.
23) Damaged inventory should be valued at cost or market price; whichever is lower.
24) The inventory under AS-2 is valued on the basis of cost price or current replacement cost, whichever is less.

Solution

1) True: Inventories refers to stocks of goods and materials that are maintained in business for revenue generation.
2) True: For a construction business a building under construction will be inventory. The building is being built in the normal course of business and will eventually be sold as well as inventory.
3) False: Inventory is valued at lower of cost or net realizable value.
4) False: Under Perpetual Inventory System management have daily information of closing stock.

5) True: A periodic inventory system is suitable to small and micro enterprises, where physical counting of inventory is not a tedious process.
6) False: When closing inventory is overstated, net income for the accounting period will be overstated.
7) False: Closing stock = Cost of goods sold - (Opening inventory + Purchases + Direct expenses).
8) False: Cost of inventories should comprise all cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
9) False: Costs of conversion of inventories include costs directly related to the units of production. They also include a systematic allocation of fixed and variable overheads.
10) False: Abnormal amounts of wasted materials, labour or other production overheads expenses are generally not included in the costs of inventories.
11) False: Periodic system requires closure of business for counting of inventory.
12) True: Under Periodic inventory system actual physical count of inventory is taken of all the inventory on hand at a particular date.
13) True: Value of Closing stock as per average method is more realistic then LIFO.
14) False: The value of stock is shown on the assets side of the balance-sheet as current assets as it is realisable within 12 months.
15) False: Under inflationary conditions, LIFO and weighted average will not show lowest value of cost of goods sold.
16) False: Under FIFO, valuation of inventory is based on the assumption that costs are charged against revenue in the order in which they occur.
17) True: The conservatism concept states that one shall not account for anticipated profits but shall provide all prospective losses. Valuing inventory at cost or net realisable value whichever is less, therefore is based on principle of Conservatism.
18) False: Finished goods are normally valued at cost or NRV, whichever is lower
19) False: Warehousing costs related to finished goods are expensed when incurred and are not included in inventory costs unless storage is incurred for getting the inventory ready for sale i.e. until and unless storage is required as a part of process of production of inventory like in case of wine
20) False: Loss of stock is normal loss when the loss is attributable to the inherent features of the goods. The abnormal loss is usually caused by fire, theft abnormal spoilage etc.
21) False: Since the closing stock does not determine the profit directly but the operational efficiency and other factors determine it.
22) True: Finished goods are normally valued at cost or NRV, whichever is lower, as also adopted by AS-2.
23) True: As per AS-2, the inventory should be valued at cost or market price, whichever is less.
24) False: As per AS-2 inventory is valued at lower of cost or net realisable value.

HOMEWORK QUESTIONS

Question 1 Pg no.______

Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2023, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	Historical cost	Net realizable value
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock for the year ending 31st March, 2023 as per AS 2.

Question 2 *(ICAI Study Material)* Pg no.______

The following are the details of a spare part of Sriram mills:

Date	Quantity (units)	Price per unit
1-1-2023	Opening Inventory	Nil
1-1-2023	Purchases	100 units @ ₹ 30 per unit
15-1-2023	Issued for consumption	50 units
1-2-2023	Purchases	200 units @ ₹ 40 per unit
15-2-2023	Issued for consumption	100 units
20-2-2023	Issued for consumption	100 units

Find out the value of Inventory as on 31-3-2023 if the company follows

a) First in first out basis
b) Weighted Average basis

Question 3 *(ICAI Study Material)* Pg no.______

A manufacturer has the following record of purchases of a condenser, which he uses while manufacturing radio sets

Date	Quantity (units)	Price per unit
Dec. 4	900	50
Dec. 10	400	55
Dec. 11	300	55
Dec. 19	200	60
Dec. 28	800	47
	2,600	

Record of issues

Date	Quantity (units)
Dec. 5	500
Dec. 20	600
Dec. 29	500
	1,600

Find out value of inventory by following methods:

1) FIFO Method
2) LIFO Method
3) Simple Average Method
4) Weighted Average Cost Method

Also find inventory value if computed by Periodic inventory system.

Question 4 Pg no._____

A Company has the following record of purchases-

Date	December 4	December 10	December 24
Quantity (units)	900	700	600
Price p.u. (₹)	50	55	60

Sales were made as under:

Date	December 5	December 12	December 29
Quantity (Units)	600	500	600

Compute the value of Closing Inventory under –

(a) FIFO,

(b) LIFO

(c) Simple Average Cost,

(d) Weighted Average Cost.

Question 5 *(CA Foundation Dec 2021) (4 Marks)* Pg no._____

The following are the details of a spare part of an Oil Mill:

Date	Quantity (units)	Price per unit
1-1-2023	Opening Inventory	Nil
1-1-2023	Purchases	10 units @ ₹ 300 per unit
15-1-2023	Issued for consumption	5 units
1-2-2023	Purchases	20 units @ ₹ 400 per unit
15-2-2023	Issued for consumption	10 units
20-2-2023	Issued for consumption	10 units

Find out the value of Inventory as on 31-3-2023 if the company follows Weighted Average Method.

Question 6 Pg no._____

Suraj Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:
Opening Inventory ₹ 50,000; Purchases ₹ 3,60,000; Purchase Returns ₹ 10,000; Freight Inwards ₹ 10,000; Gross Sales ₹ 4,50,000; Sales Returns ₹ 11,250; Carriage Outwards ₹ 5,000.
Compute the estimated cost of the inventory on the closing date.

Question 7 *(CA Foundation July 2021) (5 Marks)* Pg no._____

From the following information, calculate the historical cost of closing inventories using adjusted selling price method:

Purchase during the year	5,00,000
Sales during the year	7,50,000
Opening inventory	Nil
Closing inventory at selling price	1,00,000

Question 8 *(ICAI Study Material)* Pg no._____

From the following information, ascertain the value of stock as on 31.3.2023:

Value of stock on 1.4.2022	7,00,000
Purchases during the period from 1.4.2022 to 31.3.2023	34,60,000

Manufacturing expenses during the above period	7,00,000
Sales during the same period	52,20,000

At the time of valuing stock on 31.3.2022 a sum of ₹ 60,000 was written off a particular item which was originally purchased for ₹ 2,00,000 and was sold for ₹ 1,60,000. But for the above transaction the gross profit earned during the year was 25% on cost.

Question 9 (CA Foundation Jan 2021) (5 Marks) Pg no._____

From the following particulars ascertain the value of Inventories as on 31st March, 2023:

Inventory as on 1.4.2022	3,50,000
Purchases	12,00,000
Sales	18,50,000
Manufacturing Expenses	1,00,000
Selling & Distribution Expenses	50,000
Administrative Expenses	80,000

At the time of valuing inventory as on 31st March, 2022, a sum of ₹ 20,000 was written off on a particular item which was originally purchased for ₹ 55,000 and was sold during the year for ₹ 50,000. Except the above mentioned transaction, gross profit earned during the year was 20% on sales.

Question 10 (CA Foundation June 2022) (5 Marks) Pg no._____

Zed Enterprises furnishes the following information for the year ended 31st March,2023.

Particulars	Amount (₹)
Value of Stock as on 1st April,2022	28,00,000
Purchases during the year	1,38,40,000
Manufacturing Expenses during the year	28,00,000
Sales during the year	2,08,80,000

The following further information is also provided:

a) At the time of valuing stock on 31st March,2022 a sum of ₹ 2,40,000 was written off for a particular item which was originally purchased for ₹ 8,00,000. This item was sold during the year ended 31st March,2023 for ₹ 6,40,000.

b) Except for the above transaction, the rate of gross profit during the year was 1/3rd on cost.

Ascertain the value of Stock as on 31st March,2023.

Question 11 Pg no._____

A trader prepared his accounts on 31st March, each year. Due to some unavoidable reasons, no inventory taking could be possible till 15th April, 2023 on which date the total cost of goods in his godown came to ₹ 5,00,000. The following facts were established between 31st March & 15th April, 2023

a) Sales ₹ 4,10,000 (including cash sales ₹ 1,00,000)

b) Purchases ₹ 50,340 (including cash purchases ₹ 19,900)

c) Sales Return ₹ 10,000.

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

You are required to ascertain the value of inventory as on 31st March, 2023.

Question 12 (CA Foundation June 2023) (5 Marks) Pg no._____

The Profit and Loss account of Ram showed a net profit of ₹ 5,75,000 after considering the closing stock of ₹ 2,55,000 on 31st March 2023. Subsequently the following information was obtained from scrutiny of the books.

a. Purchases for the year included ₹ 10,500 paid for electrical fittings of the shop.
b. Ram gave goods worth of ₹ 25,000 as free samples for which no entry was made.
c. Invoices for goods amounting to ₹ 1,85,000 have been entered on 29th March 2023 but were not included in the stock.
d. Sales amounting to ₹ 2,05,000 were dispatched on 27th March but were included in sales of April, 2023.
e. Goods costing ₹ 55,000 were sent on sale or return basis in March, 2023 at a margin of profit of 33½ % on cost. Approval was given in April, 2023 but these were considered as sales in March, 2023.

Calculate. the value of stock as on 31st March, 2023 and the adjusted net profit for the year ended on that date.

Question 13 *(CA Foundation Nov 2020) (10 Marks)* *Pg no.*_____

Physical verification of stock in a business was done on 23rd February, 2020. The value of the stock was ₹ 28,00,000. The following transactions took place from 23rd February to 29th February, 2020 :

(1) Out of the goods sent on consignment, goods at cost worth ₹ 2,30,000 were unsold.
(2) Purchases of ₹ 3,00,000 were made out of which goods worth ₹ 1,20,000 were delivered on 5th March, 2020.
(3) Sales were ₹ 13,60,000 which include goods worth ₹ 3,20,000 sent on approval. Half of these goods were returned before 29th February, 2020, but no information is available regarding the remaining goods.
(4) Goods are sold at cost plus 25%. However goods costing ₹ 2,40,000 had been sold for ₹ 1,50,000.

Determine the value of stock on 29th February, 2020.

Question 14 *(CA Foundation Nov 2019) (5 Marks)* *Pg no.*_____

Distinguish between Periodic Inventory System and Perpetual Inventory System.

Question 15 *Pg no.*_____

Explain the Periodic Inventory system and its limitations.

DEPRECIATION and AMORTISATION

CH 5

"What you do makes a difference, and you have to decide what kind of difference you want to make."

CONCEPT OF DEPRECIATION

Property, plant and equipment are tangible items that:
(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
(b) are expected to be used during more than a period of 12 months.

It is necessary that part of the acquisition cost of the fixed assets is treated or allocated as an expense in each of the accounting period in which the asset is utilized. The amount of fixed assets allocated in such manner to respective accounting period is called depreciation.

Value of such assets decreases with passage of time mainly due to following reasons.
1. Wear and tear due to its use in business.
2. Efflux of time even when it is not being used.
3. Obsolescence due to technological or other changes.
4. Decrease in market value.
5. Depletion mainly in case of mines & other natural reserves.

Meaning of Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Depreciation starts from the day asset is available for use.

Depreciation on components of an assets

Each part of an item of Property, Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
An enterprise should allocate the amount initially recognised in respect of an item of asset to its significant parts/components and should depreciate each such part separately based on the useful life and residual value of each particular component.
For Example - Aircraft is a classic example of such an asset. The airframe (i.e. the body of the aircraft), the engines and the interiors have different individual useful lives.

OBJECTIVES FOR PROVIDING DEPRECIATION

True cost of production	The depletion of asset value due to usage should be charged in the account for determination of the true Cost of Production. This is done by charging depreciation.
Income measurement	Profits can be properly ascertained only after writing off the expense represented by the loss in value of Property, Plant & Equipment arising on their use.
True Position Statement	Original Cost of assets decreases due to many factors and hence assets cannot be presented at their original costs. The amount of accumulated

	depreciation is deducted there from to reflect in the Balance Sheet, a true and fair value of the Property, Plant & Equipment.
Funds for replacement	As the amount of depreciation charged in the P&L A/c is retained in the business (and not distributed as dividend), it goes on accumulating and eventually provides funds for replacement of Property, Plant & Equipment when their useful life is over.

FACTORS FOR DEPRECIATION

Assessment of depreciation & amount of depreciation are usually based on the following three factors

- **Historical Cost** or other amount substituted for the Historical Cost of the Asset when revalued.
- **Estimated Useful Life**
- **Estimated Residual Value**

These factors are explained as follows –

1. Historical Cost:

Purchase price	XX
Add : Other Non-refundable taxes & duties	XX
Add: Any directly attributable cost of bringing the asset to its working condition for its intended use. Example: Costs of site preparation, Initial delivery & handling costs, Installation and assemble costs, professional fees, etc.	XX
Add: Estimated dismantling, restoration costs	XX
Less: Trade discount & rebates	(XX)
Cost of Asset	XX

2. 'Useful Life' is either –
   (a) The period over which a depreciable asset is expected to be used by the enterprise, or
   (b) The number of production or similar units expected to be obtained from the use of the asset by the enterprise.

   Note :
   - Useful Life is generally shorter than the physical life of an asset.
   - 'Determination of the Useful Life of a depreciable asset is a matter of estimation and is normally based on various factors including experience with similar types of assets.

3. Residual/Scrap Value is the amount likely to be obtained by the disposal of the Fixed Asset at the end of its Useful Life.
   (a) If Residual Value of an asset is insignificant, it is normally regarded as Nil.
   (b) If Residual Value is significant, it is estimated either –
      (i) at the time of acquisition/installation, or
      (ii) at the time of subsequent revaluation of the asset.

DEPRECIABLE AMOUNT

'Depreciable Amount' of a Depreciable Asset is determined as under -

Particulars	Amount
Historical Cost, or other amount substituted for it in the Financial Statements Less: Estimated Residual Value	XX (XX)
Depreciable Amount	XX

Example :

An item of Machinery was purchased by A Ltd for ₹ 18 Lakhs. It can be sold for ₹ 2 Lakhs after 8 years, which is the useful life of the asset.

The Depreciable Amount of the machinery will be ₹ 18 Lakhs - ₹ 2 Lakhs = ₹ 16 Lakhs.

METHODS OF DEPRECIATION

1. Methods Available:

The following methods are available for computing and allocating the depreciable amount of an asset over its useful life -

- Fixed Instalment or Straight Line Method
- Reducing Balance or Written Down Value (WDV) Method,
- Sum of Digits of Years Method
- Machine Hour Method,
- Production Units Method,
- Depletion Method,

2. Selection of method:

The choice of a method is based on the type of asset, nature of its use, and circumstances prevailing in the business.

METHOD 1: FIXED INSTALMENT OR STRAIGHT-LINE METHOD (SLM)

Meaning	➢ Under this method, an equal or constant amount of depreciation is written off from Depreciable Asset every year. ➢ Suitable for assets which generate equal utility during each year of its useful life. ➢ At the end of the useful life of the asset, the cost of the asset will be NIL or equal to its Residual Value / Scrap Value. ➢ Total Charge to P&L Account (Depreciation + Repairs & Maintenance): Unequal every year
Formula	Straight Line Depreciation $= \frac{\text{Cost of Asset Less Residual Value}}{\text{Useful Life}}$
	SLM Depreciation Rate $= \frac{\text{SLM Depreciation}}{\text{Cost of Asset}} \times 100$
Example	X Ltd purchased a Machine costing ₹ 10 Lakhs, having a useful life of 5 years Its estimated Residual Value is ₹ 1 Lakh.

METHOD 2: REDUCING BALANCE / WRITTEN DOWN VALUE (WDV) METHOD

Meaning	➢ Depreciation Amount for each year is computed by applying a fixed % on the Opening Balance of the Asset (i.e. Diminishing Balance of the Asset.) ➢ Reducing Balance refers to the Written Down Value of the Asset, i.e. value of the asset as reduced by the depreciation upto the previous year. ➢ The value of the asset will never be extinguished, as it happens in SLM Method. ➢ Depreciation Rate is computed such that at the end of the useful life of the asset, the cost of asset will be equal to its Residual Value / Scrap Value. ➢ Total Charge to P&L Account (Depreciation + Repairs & Maintenance): More or Less Equal/constant/Uniform every year
Formula	WDV Depreciation Rate = $1 - \sqrt[n]{\frac{\text{Residual.Value}}{\text{Cost.of.Asset}}}$, where n = Useful Life.
Example	X Ltd purchased a machine costing ₹ 10 Lakhs, and has ascertained its WDV rate as 10% p.a. Depreciation amounts for the first three years will be as under

Particulars	Year 1	Year 2	Year 3
Cost / Opening WDV			
(-) Depreciation			
Closing WDV			

METHOD 3: SUM OF DIGITS OF YEARS METHOD

Meaning	It is a variation of the WDV Method. Under this method, Depreciation Amount for each year is computed by applying the following formula –
Formula	Dep. = Depreciable Amt. x $\frac{\text{No.of years of balance useful life (including current year)}}{\text{Total of Digits of the Useful Life of the Asset (in years)}}$
Example	X Ltd purchased a machine costing ₹ 78 Lakhs, having a useful life of 5 years, and estimated Scrap Value ₹ 3 Lakhs. Depreciation amounts for the five years will be –

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Depreciation amount for the year					

Note: Depreciation is calculated on the Depreciable Amt, i.e. Cost less Residual Value

Example: (Sum of Digits of Years Method)
Original cost of Asset 35,00,000. Residual Value 2,00,000. Useful Life 10 Years.
Find book value of asset after 6 years and Depreciation for 7th year.

METHOD 4: MACHINE HOUR METHOD

Meaning	In this method, Depreciation is computed based on the number of Machine Hours (rather than years). Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machinery worked for. Under machine hour rate method of calculating depreciation, the life of a machine is not estimated in years but in hours. Thus depreciation is calculated after estimating the total number of hours that machine would work during its whole life
Formula	Dep. = Depreciable Amt x $\frac{\text{No.of Machine Hours during the year}}{\text{Total Machine Hours during the entire useful life}}$
Example	X Ltd purchased a machine costing ₹ 23,00,000, having a Scrap Value of ₹ 2,30,000. The machine has a useful life of 20,700 machine hours distributed as under – • Years 1 to 3: 2,500 machine hours each, • Years 4 to 6: 2,000 machine hours each, and • Years 7 to 10: 1,800 machine hours each. In this case, Depreciation Amounts will be computed as under –

METHOD 5: PRODUCTION UNITS METHOD

Meaning	Depreciation is computed based on the production / output quantity.
Formula	Dep. = Depreciable Amt x $\frac{\text{Production Quantity for the current year}}{\text{Total Estimated Production Quantity from the Machine}}$
Example	X Ltd purchased machine costing ₹25,00,000, having Scrap Value of ₹5,00,000. The machine is expected to produce 10,00,000 units of output as follows – • Years 1 & 2: 1,15,000 units each, • Years 3 to 7: 1,00,000 units each, and • Years 8 to 10: 90,000 units each. In this case, Depreciation Amounts will be computed as under –

METHOD 6: DEPLETION METHOD

Meaning	➢ Depletion means reduction or exhaustion. ➢ This method is used in the case of Mines, Quarries, Oil Well, etc. containing only a certain estimated quantity of resources / products. ➢ Natural resources include physical assets like mineral deposits, oil and gas resources and timber. These natural resources exhaust by exploitation.
Formula	Dep. = Depreciable Amt x $\frac{\text{Quantity of Mineral / Oil extracted during current year}}{\text{Total Estimated Quantity from the Mine / Quarry / Well}}$
Example	X Ltd took a quarry on lease by paying ₹ 75,00,000. As per technical estimate, total quantity mineral deposit is 1,00,000 tones. Extraction pattern is given as: • Year 1: 6,000 tones, • Years 2 to 5: 15,000 tones each, and • Years 6 & 7: 17,000 tones each. In this case, Depreciation Amounts will be computed as under –

ACCOUNTING ENTRIES FOR DEPRECIATION

Depreciation can be recorded in the books of account, under 2 approaches, which are described below -

Method	Method 1 Asset Credit Method	Method 2 Provision for Depreciation Method
Journal Entry	Depreciation A/c Dr. To Fixed Asset A/c Profit and Loss A/c Dr. To Depreciation A/c	Depreciation A/c Dr. To Provision for Depreciation A/c Profit and Loss A/c Dr. To Depreciation A/c
Provision for Depreciation A/c	There is no Provision for Depreciation Account at all.	Depreciation for each year is credited to Provision for Depreciation A/c, which shows the Accumulated Dep. on the Asset.
Effect on Asset A/c	Asset A/c is shown at Historical Cost less Depreciation. So, balance in Asset A/c is reduced year after year.	Asset is shown in the books at Original Cost. Net Book Value = Original Cost less Accumulated Depreciation thereon.

Note: The above schemes are applicable to SLM and WDV Methods. The same treatment is also applicable under –
(a) Sum of Digits, (b) Machine Hours, (c) Production Units, and (d) Depletion Methods.

Example:
Original Cost of Machinery 1,00,000. Residual Value 10,000. Useful Life: 10 Years
Method: Straight Line Method
Show Presentation in Balance Sheet as both the approaches for first 2 years.

CHANGE IN COST AND RESIDUAL VALUE / LIFE OF ASSET

CHANGE IN HISTORICAL COST

The Historical Cost of a depreciable asset may undergo subsequent changes arising as a result of increase or decrease in long term liability on account of —

(a) Exchange Rate Fluctuations,
(b) Price Adjustments,
(c) Changes in duties, or
(d) Other similar factors.

When the Historical Cost of an asset has undergone a change due to the above circumstances the depreciation on the revised unamortised depreciable amount is provided prospectively over the residual useful life of the Asset.

Example

X Ltd has an equipment purchased 2 years ago for 3,80,000. The residual value of asset was estimated to be 20,000. The total useful life of the asset when purchased was 12 years. The Company charges Straight Line Method of depreciation. Due to Price Adjustment, the cost of asset is now increased by 30,000. Calculate depreciation for the third year.

CHANGE IN ESTIMATED USEFUL LIFE & SCRAP VALUE

The useful lives & scrap values of major depreciable assets or classes of depreciable assets may be reviewed periodically. The change should be accounted for as a change in an accounting estimate. Where there is a revision of the estimated useful life or scrap value of an asset, the unamortised depreciable amount should be charged over the revised estimate.

Example

A Machine costing ₹ 11,00,000 is depreciated on straight line basis, assuming 10 years working life & 1,00,000 residual value, for 3 years. The estimate of remaining useful life after 3rd year was reassessed at 5 years with 70,000 residual value. Calculate depreciation for the 4th year.

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.
Change in method of depreciation is applied with prospective effect. Hence, depreciation is recalculated in accordance with the new method from the date method is changed.

Example
A Machine costing ₹ 10,00,000 is depreciated on straight line basis, assuming 10 years working life for 4 years. After 4^{th} year, method of straight line is changed to WDV method & depreciation rate is 12% p.a. Calculate depreciation for 5^{th} year.

REVALUATION OF DEPRECIABLE ASSETS

An enterprise should choose Either Cost model, Or Revaluation model
as its accounting policy and should apply that policy to an entire class of PPE.
If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.
Class of PPE: A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.
Examples of separate classes:
(a) Land (b) Buildings (c) Machinery (d) Ships (e) Motor Vehicles (f) Furniture & Fixtures
(g) Aircraft (h) Office Equipment
Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using Fair value at the Balance Sheet date. It may be pertinent to note that revaluation of PPE is an accounting policy choice, and not mandatory under the accounting standards or the Companies Act, 2013

<table>
<tr><td rowspan="2">First Revaluation</td><td>Upward</td><td>Use Revaluation Surplus (R/S)</td></tr>
<tr><td>Downward</td><td>Use P & L A/c</td></tr>
<tr><td>Subsequent Revaluation</td><td colspan="2">
<table>
<tr><th>Case</th><th>1st</th><th>2nd</th><th>Ist</th><th>2nd</th></tr>
<tr><td>1</td><td>↑</td><td>↑</td><td>R/S</td><td>R/S</td></tr>
<tr><td>2</td><td>↓</td><td>↓</td><td>P & L</td><td>P & L</td></tr>
<tr><td>3</td><td>↑</td><td>↓</td><td>R/S</td><td>Use R/S 1st</td></tr>
<tr><td>4</td><td>↓</td><td>↑</td><td>P & L</td><td>Use P&L 1st</td></tr>
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Example: *(ICAI Study Material)*
A machine of cost ₹ 12,00,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. At the end of third year, the machine was revalued upwards by ₹ 60,000 the remaining useful life was reassessed at 9 years.
Calculate depreciation for the fourth year.

RELATED MATTERS

CESSATION OF DEPRECIATION

Depreciation ceases to be charged
A) When asset's residual value exceeds its carrying amount
The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

B) At the earlier of:
- The date that the asset is retired from active use and is held for disposal, or
- The date that the asset is derecognized.

RETIREMENT

Asset is retired from active use & held for disposal
❖ It is to be recorded in the books at Carrying Amount or NRV, whichever is lower.
❖ Any expected loss is recognized immediately in the P&L statement.

SALE / DISPOSAL OF DEPRECIABLE ASSETS

Sale/Disposal of Depreciable Assets in dealt with in the following manner —
1. Ascertain Depreciation for the year (upto date of disposal) & charge the same for that year.
2. Determine Net Book Value" (or) Written Down Value of the Asset = Historical Cost less Depreciation till date, including depreciation upto the date of disposal.
3. Compare Net Book Value of Asset with its Disposal Value and ascertain Profit / (Loss) on disposal & thereafter transfer the Profit / (Loss) on disposal to the Profit and Loss Account.

Example:
Cost of Machine purchased on 1st January, 2018 = ₹ 75 Lakhs, Useful Life = 7 years. Estimated Residual Value = ₹ 5 Lakhs,
The Company adopts original cost method (SLM) of Depreciation. On 30th June, 2020, the Machine was sold for 53,00,000. Prepare:-
A) Machinery Account
B) Machinery Account , Provision for Depreciation Account & Asset Disposal Account

INTANGIBLE ASSETS

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Examples of intangible assets include:

(a) Streaming rights of movies / TV shows / web series on platforms like Netflix, Disney Hot Star, Amazon Prime / Sony LIV etc.
(b) Broadcasting rights of events such as the Cricket World Cup, the Indian Premier League, the Pro Kabaddi League etc.
(c) Landing rights / time slots at airports which permit aircrafts to land or take-off during a particular time frame
(d) Patents
(e) Trademarks
(f) Copyrights
(g) Distribution rights for motion pictures in theatres
(h) Customer data collected by the entities such as customer contact numbers / email IDs and spending data at stores like Pantaloons, Westside etc. could be a major intangible asset for these entities.
(i) Goodwill (purchased)
(j) Computer Software

Intangible assets comprise a major portion of the balance sheet. It may be noted that it can also be the case that intangible assets could make the entities far more valuable than the tangible assets.

Intangible assets can be recognized in the financial statements provided they meet the following conditions:

(i) The intangible asset is identifiable.
(ii) The enterprise can exercise control over such intangible asset.
(iii) It is probable that the future economic benefits attributable to the asset will flow to the enterprise; and
(iv) The cost of the intangible asset can be measured reliably.

Cost of Intangible Assets include the following:

Purchase price	XX
Add: Non-refundable taxes & duties	XX
Add: Directly attributable expenditure on making the asset ready for its intended use.*	XX
Less: Trade discount & rebates	(XX)
Cost of Asset	XX

*Example: Professional fees for legal services

Derecognition

An intangible asset should be derecognized (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as *income or expense in the statement of profit and loss*.

Difference between Tangible and Intangible Assets

These are assets that have a physical substance i.e., they can be seen and touched, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.	These are identifiable assets that do NOT have a physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
Tangible Assets have a finite life based on expected usage.	Intangible Assets have a finite life based on contractual terms. In some cases, intangible assets could also have an indefinite life e.g. purchased goodwill.
Useful life is based on expected usage, with no presumption laid down for the same.	Useful life of Intangible Assets is presumed not to exceed 10 years unless evidence exists to the contrary
Tangible Assets are depreciated over the useful life. In other words, writing off the value of tangible assets on an annual basis is known as depreciation.	Intangible Assets are amortised over the useful life. In other words, writing off the value of intangible assets on an annual basis is known as amortisation.
Examples incl. Property, Machinery, Vehicles etc.	*Examples* incl. software, streaming rights, landing rights, trademarks, patents etc.

AMORTISATION

Amortisation can be defined as 'the systematic allocation of the depreciable amount of an intangible asset over its useful life'.
Depreciable amount is the cost of an asset less its residual value.
The concept of amortisation in case of intangible assets is similar to the concept of depreciation in case of tangible assets. In other words, 'depreciation of an intangible asset' is called AMORTISATION.

Useful Life

Amortisation should commence when the asset is available for use. It is presumed that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use unless evidence exists to the contrary.
For instance, given the rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short. Similarly, intangible assets with contractual rights for a period exceeding ten years, will be amortised over such extended period rather than the presumed period of ten years.

Amortisation Method

The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used.
The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly.
If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

Jain Bros. acquired a machine on 1st July, 2021 at a cost of ₹ 14,00,000 and spent ₹ 1,00,000 on its installation. The firm writes off depreciation at 10% p.a. of the original cost every year. The books are closed on 31st December every year.
Show the Machinery Account and Depreciation Account for the year 2021 and 2022.

Question 2 *(ICAI Study Material)* Pg no._____

M/s Akash & Co. purchased machine for ₹ 10,00,000. Estimated useful life & scrap value were 10 years & ₹ 1,20,000 respectively. The machine was put to use on 1.1.2017. Show Machinery Account & Depreciation Account in their books for 2022 by using sum of years digits method.

Question 3 *(ICAI Study Material)* Pg no._____

A firm purchased on 1st January, 2020 certain machinery for ₹ 5,82,000 and spent ₹ 18,000 on its erection. On July 1, 2020 another machinery for ₹ 2,00,000 was acquired.
On 1st July, 2021 the machinery purchased on 1st January, 2020 having become obsolete was auctioned for ₹ 3,86,000 and on the same date fresh machinery was purchased at a cost of ₹ 4,00,000. Depreciation was provided for annually on 31st December at the rate of 10% p.a. on written down value. Prepare Machinery Account.

Question 4 Pg no._____

Mr. X purchased 10 trucks at ₹ 9,00,000 each on 1st April 2018. On October 1st, 2020, one of the trucks is involved in an accident and is completely destroyed and ₹ 5,40,000 is received from the insurance in full settlement. On the same date another truck is purchased by the company for the sum of ₹ 10,00,000. The company write off 20% on the original cost per annum. The company observe the calendar year as its financial year. Give the motor truck account for two year ending 31 Dec, 2021.

Question 5 *(ICAI Study Material)* Pg no._____

The Machinery Account of a factory showed a balance of ₹ 19,00,000 on 1st January, 2022. Its accounts were made up on 31st December each year and depreciation is written off at 10% p.a. under the Diminishing Balance Method. On 1st June 2022, a new machinery was acquired at a cost of ₹ 2,80,000 and installation charges incurred in erecting the machine works out to ₹ 8,920 on the same date. On 1st June, 2022 a machine which had cost ₹ 4,37,400 on 1st January 2020 was sold for ₹ 75,000. Another machine which had cost ₹ 4,37,000 on 1st January, 2021 was scrapped on the same date and it realised nothing.
Write Machinery account for the year 2022 allowing the same rate of depreciation as in the past, calculating depreciation to the nearest multiple of a Rupee.

Question 6 *(RTP Nov 2018) / (Nov 2019) / (Nov 2020) / (May 2021) & (May 2022) (Similar)* Pg no._____

M/s. Green Channel purchased a second-hand machine on 1st January, 2018 for ₹ 1,60,000. Overhauling and erection charges amounted to ₹ 40,000. Another machine was purchased for ₹ 80,000 on 1st July, 2018.
On 1st July, 2020, the machine installed on 1st January, 2018 was sold for ₹ 1,00,000. Another machine amounted to ₹ 30,000 was purchased and was installed on 30th September, 2020.
Under the existing practice the company provides depreciation @ 10% p.a. on original cost.
However, from the year 2021 it decided to adopt WDV method and to charge depreciation @ 15% p.a. You are required to prepare Machinery account for the years 2018 to 2021.

Question 7 *(ICAI Study Material)* *Pg no._____*

M/s Anshul & Co. commenced business on 1st January 2017, when they purchased plant and equipment for ₹ 7,00,000. They adopted a policy of charging depreciation at 15% per annum on diminishing balance basis and over the years, their purchases of plant have been:

Date	Amount ₹
1-1-2018	1,50,000
1-1-2021	2,00,000

On 1-1-2021 it was decided to change the method and rate of depreciation to straight line basis. On this date remaining useful life was assessed as 6 years for all the assets purchased before 1.1.2021 with no scrap value and 10 years for the asset purchased on 1.1.2021.
Prepare Plant and Equipment Account for the year ending 31st December, 2021.

Question 8 *(CA Foundation July 2021) (4 Marks)* *Pg no._____*

The balance of Machinery Account of a firm on 1st April, 2020 was ₹ 28,54,000. Out of this, a plant having book value of ₹ 2,16,000 as on 1st April, 2020 was sold on 1st July, 2020 for ₹ 82,000. On the same date a new plant was purchased for ₹ 4,58,000 and ₹ 22,000 was spent on its erection. On 1st November, 2020 a new machine was purchased for ₹ 5,60,000. Depreciation is written off @ 15% per annum under the diminishing balance method.
Calculate the depreciation for the year ended 31st March, 2021.

Question 9 *(CA Foundation Dec 2021) (5 Marks)* *Pg no._____*

On 1st January, 2019 Kohinoor Transport Company purchased a Bus for ₹ 8,00,000. On 1st July, 2020 this bus was damaged due to fire and was completely destroyed and ₹ 6,00,000 were received by a cheque from the Insurance Company in full settlement on 1st October, 2020. On 1st July, 2020 another Bus was purchased by the company for ₹ 10,00,000. The Company charges Depreciation @ 20% per annum under the WDV Method.
Calculate the amount of depreciation for the year ended 31st March, 2021 and gain or loss on the destroyed Bus.

Question 10 *(ICAI Study Material)* *Pg no._____*

On April 1, 2019 Shubra Ltd. purchased a machinery for ₹ 12,00,000. On Oct 1, 2021, a part of the machinery purchased on April 1, 2019 for ₹ 80,000 was sold for ₹ 45,000 and a new machinery at a cost of ₹ 1,58,000 was purchased and installed on the same date. The company has adopted the method of providing 10% p.a. depreciation on the written down value of the machinery.
Show necessary ledger accounts for the years ended 31st March 2020 to 2022 assuming that
(a) 'Provision for Depreciation Account' is not maintained
(b) Provision for Depreciation Account is maintained.

Question 11 *(CA Foundation June 2023) (10 Marks)* *Pg no._____*

The following balances appear in the books of Dheeraj Enterprises:

	₹
Machinery account as on 01.04.2021	12,00,000
Provision for depreciation account as on 01.04.2021	4,65,000

On 1st October, 2021 the Machinery which was purchased on 1st April, 2018 for ₹ 2,00,000 was sold for ₹ 1,10,000 and on the same date another Machinery was purchased for ₹ 4,80,000. The firm has been charging depreciation at 10% p.a. on written down value of the Machinery every year.

Prepare the Machinery account, Provision for Depreciation account and Machinery disposal account for the year ending 31st March, 2022.

Question 12 *(ICAI Study Material)* *Pg no._____*

A firm's plant and machinery account at 31st December, 2021 and the corresponding depreciation provision account, broken down by year of purchase are as follows:

Year of Purchase	Plant and Machinery at cost	Depreciation Provision
2005	2,00,000	2,00,000
2011	3,00,000	3,00,000
2012	10,00,000	9,50,000
2013	7,00,000	5,95,000
2020	5,00,000	75,000
2021	3,00,000	15,000
	30,00,000	21,35,000

Depreciation is at the rate of 10% per annum on cost. It is the Company's policy to assume that all purchases, sales or disposal of plant occurred on 30th June in the relevant year for the purpose of calculating depreciation, irrespective of the precise date on which these events occurred.

During 2022 the following transactions took place:

1. Purchase of plant and machinery amounted to ₹ 15,00,000
2. Plant that had been bought in 2011 for ₹ 1,70,000 was scrapped.
3. Plant that had been bought in 2012 for ₹ 90,000 was sold for ₹ 5,000.
4. Plant that had been bought in 2013 for ₹ 2,40,000 was sold for ₹ 15,000.

You are required to:

Calculate the provision for depreciation of plant and machinery for the year ended 31st December, 2022. It is company's policy to show any profit or loss on the sale or disposal of plant as a completely separate item in the Profit & Loss Account. You are also required to prepare the following ledger accounts during 2022.

(i) Plant and machinery at cost; (ii) Depreciation provision;
(iii) Sales or disposal of plant and machinery.

Question 13 *(ICAI Study Material)* *Pg no._____*

Kumar R&D Co. registered a patent (the patent meets the criteria of an intangible asset) on 1st July, 2021 developed at a cost of ₹ 28,00,000 and spent ₹ 2,00,000 towards legal fees and registration. The patent is granted for a period of 10 years. The books are closed on 31st December every year.

Show the Patent Account and Amortisation Account for the year 2021 and 2022.

Question 14 *(ICAI Study Material)* *Pg no._____*

Prime Streaming Co. acquired the streaming rights of a movie for ₹ 18,00,000 with the contracted duration of the streaming period being 10 years. At the beginning of the fourth year, based on the decline in viewership, Prime Streaming Co. decided to stream the movie only for the next 5 years. Calculate amortisation for the fourth year.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1. The portion of the acquisition cost of the tangible asset, yet to be allocated is known as
   (a) Written down value
   (b) Accumulated value
   (c) Realisable value

2. The main objective of providing depreciation is to
   (a) Create secret reserve
   (b) Reduce the book value of assets
   (c) Allocate cost of the assets

3. Which of the following assets does not depreciate?
   (a) Machinery and equipment
   (b) Patents
   (c) Land

4. Obsolescence of a depreciable asset may be caused by:
   I. Technological changes.
   II. Improvement in production method.
   III. Change in market demand for the product or service output.
   IV. Legal or other restrictions.
   (a) Only (I) above
   (b) Both (I) and (II) above
   (c) All (I), (II), (III) and (IV) above

5. The number of production or similar units expected to be obtained from the use of an asset by an enterprise is called as
   (a) Unit life
   (b) Useful life
   (c) Production life

6. If the equipment account has a balance of ₹ 22,50,000 and accumulated depreciation account has a balance of ₹ 14,00,000, the book value of the equipment is
   (a) 36,50,000
   (b) 8,50,000
   (c) 14,00,000

7. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is
   (a) Plant account
   (b) Revaluation Reserve
   (c) Profit & Loss account

8. Original cost = ₹ 12,60,000; Salvage value = Nil; Useful life = 6 years Depreciation for the first year under sum of years digits method will be
   (a) 3,60,000
   (b) 1,20,000
   (c) 1,80,000

9. Original cost of a machine was ₹ 25,20,000 salvage value was ₹ 1,20,000, useful life was 6 years. Annual depreciation under Straight Line Method
   (a) 4,20,000
   (b) 4,00,000
   (c) 3,00,000

10. The cost of a machine is ₹ 20,00,000. Two years later the book value is ₹ 10,00,000. The Straight-line percentage depreciation is
   (a) 50%
   (b) 33-1/3%
   (c) 25%

11. Original cost ₹13,00,000, Salvage value ₹ 40,000, Useful life 6 years. Depreciation for the first year under sum-of-years digit methods will be
   (a) 60,000
   (b) 1,20,000
   (c) 3,60,000

12. A company purchased a machinery on April 01, 2016, for ₹ 15,00,000. It is estimated that the machinery will have a useful life of 5 years after which it will have no salvage value. The depreciation charged during the year 2020-21 was
   (a) 5,00,000
   (b) 4,00,000
   (c) 3,00,000

13. A plant with original cost of ₹ 50,00,000 was revalued after 2 years resulting in credit to Revaluation Surplus account of ₹ 4,00,000. Towards the year end of 2019-20, due to COVID-19 the plant value had gone down by ₹ 5,00,000 and accordingly management decided to revalue the same. What shall be the impact of this downwards revaluation on Profit & Loss Account?
   (a) Debit of ₹ 5,00,000
   (b) Debit of ₹ 1,00,000
   (c) Credit of ₹ 5,00,000
   (d) Credit of ₹ 1,00,000

14. A machinery with original cost of ₹ 10,00,000 and Nil Salvage value acquired on 1st April 2017 with 4 years useful life was depreciated using Straight Line Method. It was decided to sell the machinery on 1st October 2020 for ₹ 1,20,000. What shall be the gain or (loss) on the sale of Machinery?
   (a) Loss of ₹ 1,30,000
   (b) Gain of ₹ 1,20,000
   (c) Loss of ₹ 5,000
   (d) Gain of ₹ 5,000

15. In respect of intangible assets, there is a presumption that the useful life of an intangible asset will not exceed
   (a) 2 years
   (b) 3 years
   (c) 10 years

16. A company developed a technology to enhance the battery life of mobile phones. The cost of development have been capitalized as an intangible asset at ₹ 5,00,000. The company

estimates the life of the technology developed to be 3 years. The company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in third year?

(a) ₹ 2,50,000
(b) ₹ 75,000
(c) ₹ 1,75,000

17. An intangible asset is an asset
(a) with no physical existence
(b) generated internally by the business
(c) cannot be sold

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following are true or false:

1) Increase in market value of a fixed asset is one of the reasons for depreciation being charged.
2) Depreciation is a cash expenditure like other normal expenses.
3) Cost of property, plant and equipment includes purchase price, refundable taxes & import duties after deducting any discount or rebate.
4) Cost of fixed asset should also include cost of opening a new facility such as inauguration costs.
5) Depreciation is charged with a constant amount under straight line method and charged with a constant percentage under diminishing balance method.
6) In case an item of Property, Plant & Equipment is revalued, whole class of assets to which that asset being revalued belongs should be revalued.
7) In case the carrying amount of an asset is decreased due to revaluation, such decrease should always be recognized in the Profit and Loss account.
8) Akash purchased a machine for ₹ 12,00,000. Estimated useful life is 10 years & scrap value is ₹ 1,00,000. Depreciation for the 1st year using sum of the years digit method shall be ₹ 2,00,000.
9) Depreciation cannot be provided in case of loss, in a financial year.
10) Providing for depreciation also helps in providing for accumulation of funds to facilitate the replacement at the end of its useful life.
11) If the equipment account has a balance of ₹ 12,50,000 and the accumulated depreciation account has a balance of ₹ 4,00,000, the written down value of same shall be ₹ 16,50,000.
12) Sum of years digit method is an example of accelerated method of charging depreciation.
13) Over the life of an asset subject to depreciation, the accelerated method will result in less Depreciation Expense in early years and more depreciation in later years of its life.
14) While depreciating Land cost, Straight line method shall give more depreciation than the written down value.
15) Provision for depreciation account is debited at the time of recording the depreciation on an asset.
16) If adequate maintenance expenditure is incurred with relation to running repairs of an asset, we need not charge any depreciation.

17) When a property, plant or equipment is sold then provision for depreciation account is debited, asset account is credited & any gain or loss is recorded to profit and loss account.
18) While calculating the depreciation as per diminishing balance method, the salvage value of the asset at the end of its life is reduced from its cost.
19) Any change in the estimated useful life of an asset should be accounted for as a change in an accounting estimate in accordance with Accounting Standards.
20) An intangible asset is a non identifiable, non monetary asset.
21) There exists difference between the written down value method and diminishing balance method of depreciation.
22) The expressions depreciation is to be charged at 10% and 10% p.a. on furniture and fittings carry the same meaning.
23) Higher depreciation will not affect cash profit of the business.
24) Land is also a depreciable asset.
25) Whenever any depreciable asset is sold during the year, depreciation is charged on it for that entire year.
26) Depreciation is a process of allocation of the cost of fixed asset.
27) Depreciable amount refers to the difference between historical cost and the market value of an asset.
28) Reducing balance method of depreciation is followed to have a uniform charge for depreciation and repairs and maintenance together.
29) Depreciation is a non-cash expense and does not result in any cash outflow. *(Nov 2018)*

Solution

1) False: It is the decrease in market value as one of the reasons for depreciation. Increase in market value may result in Revaluation.
2) False: - Depreciation is not a cash expenditure like other normal expenses as it does not result in any cash outflow.
3) False: Non refundable taxes & duties form part of the cost.
4) False: Inauguration costs shouldn't be part of cost.
5) True: SLM method results in same amount and Diminishing method involves same rate of depreciation.
6) True: Revaluation should be done for the whole class of the asset.
7) False: Any decrease in value of asset on account of revaluation should be first debited to Revaluation Reserve, if any, and then to Profit & Loss account.
8) True: Sum of years digit method depreciation is calculated as 10/55 x (12,00,000 – 1,00,000) = 2,00,000
9) False: Depreciation is a charge against profit and not an appropriation of profit. Therefore, depreciation has to be provided for, even in case of loss in a financial year.
10) True: Depreciation being non cash expense reduces the distributable profits and hence facilitates replacement of asset when required.
11) False: WDV = ₹ 12,50,000 - ₹ 4,00,000 = ₹ 8,50,000
12) True: Higher depreciation is charged in earlier years under sum of the years digit method.
13) False: It is vice versa as under diminishing balance method; higher depreciation is charged in beginning.
14) False: Land is not depreciated.
15) False: Provision for Depreciation account is credited while charging the depreciation.
16) False: Depreciation is allocation of the cost of an asset over its useful life. Regular repairs may be required during its life are expensed and depreciation has to be charged anyways.
17) True: At the time of sale of an asset, respective asset a/c is credited with provision for depreciation a/c being debited & any resulting gain or loss being charged to P&L A/c.

18) False: Under diminishing balance method, salvage value is not considered initially as it assumes that at the end of the asset's life the remaining value shall be its salvage value.
19) True: Any change in useful life of an asset is accounted for as a change in estimate.
20) False: An intangible asset is an identifiable non-monetary asset, held for use in production and supply of goods and services.
21) False: - Both are same methods. Depreciation is computed by applying a fixed rate on the diminishing balance which is known as written down value.
22) False:- They differ on the basis of time factor. 10% p.a. implies that time factor is to be considered while calculating depreciation on prorate basis whereas simply 10% implies that time factor is immaterial for calculation.
23) True: - It is a non-cash expense and therefore will not affect cash profit of the business.
24) False: - Land is not a depreciable asset since it has unlimited life.
25) False: Whenever any depreciable asset is sold during the year, depreciation is charged on it for the period it has been used in the sale year.
26) True: - It is measure of wear and tear of an asset. On charging depreciation, the cost of fixed asset is allocated during the period it is used.
27) False: - Depreciation is allocated over the estimated useful life of the assets depreciated. Depreciable amount= [Historical Cost of the Asset]- [Residual or Scrap Value]
28) True - In the early periods of useful life of fixed assets, repairs and maintenance expenses are relatively low because the asset is new. Whereas in later periods, as the asset become old, repairs and maintenance expenses increase continuously. Under written down value method, depreciation charged is high in the initial period and reduces continuously in the later periods. Thus, depreciation and repair and maintenance expenses become more or less uniform throughout the useful life of the asset.
29) True: - Depreciation is a non-cash expense and it does not result in any outflow of cash.

DIFFERENCE BETWEEN STRAIGHT LINE METHOD (SLM) & WRITTEN DOWN VALUE METHOD

S.No.	Straight Line Method (SLM)	Written Down Value (WDV)
1.	Under SLM an equal amount is written off each year throughout the working life of the depreciable asset so as to reduce the cost of the asset to nil or to its scrap value at the end.	Under WDV, a fixed percentage is charged on the diminishing balance of the asset each year so as to reduce the value of the asset to its scrap value at the end of useful life
2.	Under this method, annual depreciation charge is equal throughout the life of the asset	Under this method, depreciation charge is reduced over the years as the asset grows old
3.	Under this method, the asset can be fully depreciated	Under this method asset can never be fully depreciated.
4.	Under this method the charge for depreciation is constant while repair charges increase with the life of the asset, so the total charge throughout the life of the asset will not be uniform	Under this method, depreciation charges become high in the initial years but generally repair remains low. As the asset grows old depreciation charge reduces but repair expenses increase. Thus under this method depreciation and repairs are more or less evenly distributed throughout life of the asset.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

A machine was purchased for ₹ 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be ₹ 2,00,000 and anticipated pattern of distribution of effective hours is :

Year 1 – 3 3,000 hours per year
Year 4 - 6 2,600 hours per year
Year 7 - 10 1,800 hours per year

Determine Annual Depreciation under Machine Hour Rate Method.

Question 2 *(ICAI Study Material)* Pg no._____

A machine is purchased for ₹ 20,00,000. Its estimated useful life is 10 years with a residual value of ₹ 2,00,000. The machine is expected to produce 1,50,000 units during its life time. Expected distribution pattern of production is as follows:

Year	Production
1-3	20,000 units per year
4-7	15,000 units per year
8-10	10,000 units per year

Determine the value of depreciation for each year using production units method.

Question 3 *(ICAI Study Material)* Pg no._____

M/s Surya & Co. took lease of a quarry on 1-1-2019 for ₹ 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes. Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year	Quantity of Mineral extracted
2019	2,000 tonnes
2020	10,000 tonnes
2021	15,000 tonnes

Show the Quarry Lease Account and Depreciation Account for each year from 2019 to 2021.

Question 4 *(ICAI Study Material)* Pg no._____

Jain Bros. acquired a machine on 1st July, 2021 at a cost of ₹ 14,00,000 and spent ₹ 1,00,000 on its installation. The firm writes off depreciation at 10% p.a.. The books are closed on 31st December every year. Show the Machinery Account on diminishing balance method for the year 2021 and 2022.

Question 5 *(CA Foundation Nov 2019) (4 Marks)* Pg no._____

X purchased a machinery on 1st January 2020 for ₹ 4,80,000 and spent ₹ 20,000 on its installation. On July 1, 2020 another machinery costing ₹ 2,00,000 was purchased. On 1st July, 2021 the machinery purchased on 1st January, 2020 having become scrapped and was sold for ₹ 2,90,000 and on the same date fresh machinery was purchased for ₹ 5,00,000. Depreciation is provided annually on 31st December at the rate of 10% p.a. on written down value.
Prepare Machinery account for the years 2020 and 2021.

Question 6 *(RTP May 2018) / (ICAI Study Material)* Pg no._____

The M/s LG Transport purchased 10 trucks at ₹ 45,00,000 each on 1st April 2019. On October 1st, 2021, one of the trucks is involved in an accident and is completely destroyed and ₹ 27,00,000 is received from the insurance in full settlement. On the same date, another truck is purchased by the company for the sum of ₹ 50,00,000. The company writes off 20% on the original cost per annum. The company observe the calendar year as its financial year. You are required to prepare the motor truck account for two year ending 31 Dec, 2022

Question 7 *(RTP Nov 2021)* *Pg no._____*

The M/s Nishant Transport purchased 10 Buses at ₹ 15,00,000 each on 1st April 2017. On October 1st, 2019, one of the Buses is involved in an accident and is completely destroyed and ₹ 7,00,000 is received from the insurance in full settlement. On the same date, another truck is purchased by the company for the sum of ₹ 18,00,000. The company write off 10% on the original cost per annum. The company observe the calendar year as its financial year.
You are required to prepare the buses account for two year ending 31 Dec, 2020.

Question 8 *(CA Foundation Jan 2021) (10 Marks)* *Pg no._____*

M/s. Dayal Transport Company purchased 10 trucks @ ₹ 50,00,000 each on 1st July 2017. On 1st October, 2019, one of the trucks is involved in an accident and is completely destroyed and ₹ 35,00,000 is received from the insurance in full settlement. On the same date, another truck is purchased by the company for the sum of ₹ 60,00,000. The company writes off 20% of the original cost per annum. The company observes the calendar year as its financial year. Give the motor truck account for two years ending 31st December, 2020

Question 9 *Pg no._____*

M/s. Mohit Pharmaceuticals has imported a machine on 1st July, 2019, for Pound 2,000, paid custom duty and freight ₹ 20,000 and incurred erection charges ₹ 15,000. Another local machinery costing ₹25,000 was purchased on 1st Jan 2020. On 1st July, 2021, a portion of the imported machinery (value one-third) got out of order and was sold for ₹ 33,700. Another machinery was purchased to replace the same for ₹ 12,500. Depreciation is to be calculated at 20% p.a on cost. Show the machinery account for 2019, 2020, and 2021. Exchange rate is ₹ 80 per pound.

Question 10 *(CA Foundation June 2022) (10 Marks)* *Pg no._____*

The Machinery Account of a Factory showed a balance of ₹ 95 Lakhs on 1st April,2020. The Books of Accounts of the Factory are closed on 31st March every year. Depreciation is written off @ 10% per annum under the Diminishing Balance Method. On 1st September,2020 a new machine was acquired at a cost of ₹ 14 Lakhs and ₹ 44,600 was incurred on the same day as installation charges for erecting the machine. On 1st September,2020 a machine which had cost ₹ 21,87,000 on 1st April,2018 was sold for ₹ 3,75,000. Another machine which had cost ₹ 21,85,000 on 1st April,2019 was scrapped on 1st September,2020 and it realized nothing. Prepare Machinery Account for the year ended 31st March,2021. Allow the same rate of depreciation as in the past and calculate depreciation to the nearest multiple of a rupee. Also show all the necessary working notes.

Question 11 *Pg no._____*

A firm purchased, on 1st January, 2017, certain machinery for ₹ 19,40,000 and spent ₹ 60,000 on its erection. On 1st July in the same year additional machinery costing ₹ 10,00,000 was acquired. On 1st July, 2019 the machinery purchased on 1st January, 2017 having become obsolete was auctioned for ₹ 8,00,000 and on the same data fresh machine was purchased at a cost of ₹ 15,00,000. Depreciation was provided for annually on 31st December at the rate of 10% per annum on the original cost of the asset. In 2020 however, the firm changed this method of providing depreciation and adopted the method of writing off 20% on the written down value. Give the Machinery Account as it would stand at the end of each year from 2017 to 2021.

Question 12 *(CA Foundation May 2019) (10 Marks)/(RTP Nov 2022)/(RTP Nov 2023)* *Pg no._____*

A Firm purchased an old Machinery for ₹ 37,000 on 1st January, 2018 and spent ₹ 3,000 on its overhauling. On 1st July 2019, another machine was purchased for ₹ 10,000. On 1st July 2020, the machinery which was purchased on 1st January 2018, was sold for ₹ 28,000 and the same day a new machinery costing ₹ 25,000 was purchased. On 1st July, 2021, the machine which was purchased on 1st July, 2019 was sold for ₹ 2,000. Depreciation is charged @ 10% per annum on straight line method. The firm changed the method and adopted diminishing balance method with effect from 1st January, 2019 and the rate was increased to 15% per annum. The books are closed on 31st December every year. Prepare Machinery account for four years from 1st January, 2018.

Question 13 *(CA Foundation Dec 2022) (4 Marks)* *Pg no._____*

A purchased a machinery for ₹ 1,30,000 on 1st April, 2019 and paid ₹ 20,000 for freight & installation charges. On 1st October, 2021 another machine was purchased for 50,000 and sold old machinery for ₹ 1,00,000. The machine purchased on 1st October, 2021 was installed on 1st January, 2022.

Under existing practice, the company is charging depreciation @ 20% p.a. on the original cost. However, from 1st April, 2021 it decided to adopt WDV method and charge depreciation @15% p.a. You are required to prepare Machinery Account from 1st April, 2019 to 31st March, 2022.

Question 14 *(ICAI Study Material)* *Pg no._____*

A firm purchased second hand machinery on 1st January, 2019 for ₹ 3,00,000, subsequent to which ₹ 60,000 and ₹ 40,000 were spent on its repairs and installation, respectively. On 1st July, 2020 another machinery was purchased for ₹ 2,60,000. On 1st July, 2021, the first machinery having become outdated was auctioned for ₹ 3,20,000 and on the same date, another machinery was purchased for ₹ 2,50,000.

On 1st July, 2022, second machinery was also sold off and it fetched ₹ 2,30,000. Depreciation was provided on machinery @ 10% on the original cost annually on 31st December, under the straight line method. Prepare the following accounts in the books of the company:

(i) Machinery Account for the years ending Dec. 31, 2019 to 2022 and (ii) Machinery Disposal Account

Question 15 *(ICAI Study Material)* *Pg no._____*

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 and Depreciation Account for the period of three accounting years ending March 31, 2022.

Question 16 *Pg no._____*

S & Co. purchased a machine for ₹1,00,000 on 1.1.2019 Another machine costing ₹1,50,000 was purchased on 1.7.2020. On 31.12.2021 the machine purchased on 1.1.2019 was sold for ₹50,000. The company provides depreciation at 15% on Written Down Value Method. The company closes its accounts on 31st December every year.

Prepare – (i) Machinery Account, (ii) Machinery Disposal Account and (iii) Provision for Depreciation Account.

Question 17 *(ICAI Study Material)* Pg no._____

Amazing group had Property, Plant & Equipment (PP&E) with a book value of ₹ 35,00,000 on 31st December 2022. The balance in Revaluation Surplus on that date was ₹ 3,00,000. As part of their practice of revaluing the assets on yearly basis, another revaluation was carried out on 31st December 2022. Evaluate the impact of Revaluation if the Fair Value as a result of Revaluation done on 31st December 2022 was (a) ₹ 37,00,000 (b) ₹ 33,00,000 and (c) ₹ 31,00,000. Also, give the journal entries.

Question 18 Pg no._____

B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value. At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000. How would the above changes in estimates be made by B Ltd.?

Question 19 Pg no._____

Entity A purchased an asset on 1st January 2016 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2020, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

Question 20 *(CA Foundation Nov 2018)(4 Marks)/(RTP May 2020)/(May 2023)/(ICAI SM)* no._____

A Plant & Machinery costing ₹ 10,00,000 is depreciated on straight line assuming 10 year working life and zero residual value, for four years. At the end of fourth year, the machinery was revalued upwards by ₹ 40,000. The remaining useful life was reassessed at 8 years. Calculate depreciation for the 5th year.

Question 21 *(ICAI Study Material)* Pg no._____

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. Calculate depreciation for the fourth year.

Question 22 Pg no._____

A property costing ₹ 10,00,000 is bought in 2020. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.
The estimated residual value in 20 years' time, based on 2020 prices, is:
Case (a) ₹ 10,00,000 Case (b) ₹ 9,00,000
You are required to compute the amount of depreciation charged for the year 2020

Question 23 *(CA Foundation Nov 2020) (5 Marks)* Pg no._____

Discuss the factors taken into consideration for calculation of depreciation.

Question 24 *(CA Foundation Dec 2022) (5 Marks)* Pg no._____

"The cost of Property, Plant and Equipment comprises of any cost directly attributable to bring the asset to the location and condition necessary for it to be capable of operating in a manner intended by the enterprise". Give any five examples of such 'directly attributable costs'.

BILLS OF EXCHANGE & PROMISSORY NOTES

CH 6

"Your life today is the result of your attitude and choices in the past. Your life tomorrow will be the result of your attitudes and choices you make today."

BILL OF EXCHANGE – MEANING AND FEATURES

Meaning:

As per Sec. 5 of the Negotiable Instruments Act, 1881, a Bill of Exchange (B/E) is —

- an instrument in writing,
- containing an unconditional order,
- signed by the Maker,
- directing a certain person,
- to pay a certain sum of money only,
- to, or to the order of a certain person or to the Bearer of the instrument.

Note: When prepared by the Maker (i.e. Seller of Goods), it is called Draft. Once it is accepted by the Acceptor (i.e. Buyer of Goods), it becomes a valid Bill of Exchange.

Features of Bill of Exchange:

✓ It must be in writing.
✓ It must contain an order to pay. Order must be unconditional.
✓ It must be dated.
✓ The instrument must be to pay money only and the amount of money payable must be certain.
✓ The party must sign the instrument.
✓ It should be properly stamped.
✓ It must be accepted for payment by the party to whom order is made.
✓ Payment must be in the legal currency of the country.

Parties involved:

(a) The person who makes the order is known as the Drawer (or Maker), i.e. Seller of Goods.
(b) The person who accepts the order is known as the Acceptor/ Drawee, i.e. Buyer of Goods.
(c) The person to whom the amount is payable is known as the Payee. [Note: The Drawer and Payee may be the same person. Sometimes, the Drawer may order the payment to a third party, i.e. Payee.]

Example: Ram sold goods to Laxman on credit for 50,000 on 1st January, payable after credit period of three months. On the same date, Ram draws a B/E to be paid 3 months after date and sends the draft to Laxman for acceptance. After Laxman's acceptance, this draft becomes a valid B/E (i.e. Bills Receivable for Ram, and Bills Payable for Laxman). Ram needs to make payment to Krishna. In the following B/E, Ram is the Drawer, Laxman is the Acceptor, and Krishna is the Payee.

Format of Bill of Exchange

₹ 50,000 only		Chandigarh, 1st January 2023
Three months after date, pay to Sri. Krishna or his order, a sum of ₹ 50,000 only.		
To	Accepted	
Sri. Laxman	Signature of Laxman	Stamp
Signature of Ram		
43, Old Street, Delhi.		

PROMISSORY NOTE – DEFINITION AND FEATURES

Meaning:

As per Sec. 4 of the Negotiable Instruments Act, 1881, a Promissory Note (P/N or Pro-Note) is –

- An instrument in writing (not being a Bank Note or a Currency Note),
- Containing an unconditional undertaking,
- Signed by the Maker,
- To pay a certain sum of Money only,
- To, or to the order of a certain person.

Note: A Promissory Note cannot be made payable to Bearer.

Features of a Promissory Note:

- ✓ P/N must be in writing.
- ✓ P/N must contain an undertaking/promise to pay. Mere acknowledgement of debt is not sufficient.
- ✓ The undertaking/promise to pay should be unconditional and definite (and not vague).
- ✓ P/N should be signed by the Maker himself.
- ✓ P/N should specify the Payee in clear terms
- ✓ Sum payable must be certain.
- ✓ P/N must be duly stamped and dated.
- ✓ It does not require any acceptance

Format of Promissory Note

₹ 50,000 only		Laxman 43, Old Street, Delhi
There months after date, I promise to pay Ram/Krishna or his order, a sum of ₹ 50,000 only, for value received.		
To Ram Chandigarh	Stamp	Signature of Laxman Date: 1st January 2023

DIFFERENCE BETWEEN BILL OF EXCHANGE AND PROMISSORY NOTE

S.No.	Bill of Exchange	Promissory Note
1	A bill contains an unconditional order to pay	A promissory note contains only a promise to pay certain sum of money
2	There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange	There are 2 parties (Maker and Payee) in promissory note
3	A bill is paid by Acceptor	A promissory note is paid by maker
4	A bill is drawn by creditor	A promissory note is made by debtor
5	The drawer and payee may be same person in case of bill of exchange	In promissory note maker and payee cannot be same person
6	In a bill of exchange the liability of drawer is secondary and conditional	In a promissory note the liability of a maker is primary and absolute
7	In a bill of exchange, notice of dishonor must be given	Notice of dishonor is not required in case of promissory note
8	In case of dishonor, a bill of exchange must be noted and protested	Noting and protest is not required in case of dishonor of a promissory note.

FOREIGN BILL

An instrument which is not an Inland Instrument, is deemed to be a Foreign Instrument. Following are the examples of Foreign Bills:-

- Bill drawn in India on a person resident outside India and made payable outside India.
- Bill drawn outside India on a person resident outside India.
- Bill drawn outside India and made payable in India.
- Bill drawn outside India and made payable outside India.

MATURITY DATE FOR PROMISSORY NOTE AND BILL OF EXCHANGE

1. Maturity: Date on which Promissory Note (P/N) or Bill of Exchange (B/E) falls due
   a) When a bill is drawn after sight, the term of the bill begins to run from the date of 'sighting', i.e., when the bill is accepted.
   b) When a bill is drawn after date, the term of the bill begins to run from the date of drawing the bill.

2. Days of Grace: In calculating the maturity of a P/N or a B/E which is not payable on demand, at sight or on presentment, 3 days of grace shall be added to the date on which the instrument is expressed to be payable.
   A cheque cannot be a time instrument because the cheque is always payable on demand. Though a cheque can be postdated and which can be presented on or after such date. A cheque has validity of 90 days from its date after that it becomes void, normally termed as 'Stale Cheque' as bank will not honour it.

3. Instruments entitled to Days of Grace:
   (a) A Note or Bill payable on a specified date.
   (b) A Note or Bill payable after certain period of time / after sight
   (c) A Note or Bill payable after a certain period or after the happening of a certain event.
   (d) Where a Note or Bill is payable in installments, days of grace are allowed on each installment.

4. Meaning of "At Sight", "On Presentment" and "After Sight":
   (a) In a P/N or B/E, the expressions "at sight" and "on presentment" mean, "on demand".
   (b) In a P/N, the expression "after sight" means, after presentment for sight.
   (c) In a B/E, the expression "after sight' means, after acceptance

5. Provisions as to calculation of Maturity:

Payable after	Maturity is at –
Stated number of months – • After date, or • After sight, or • After a certain event.	• 3 days after corresponding date of month after stated number of months Example: B/E dated 30th August, is made payable 3 months after date. It matures on 3rd December. • If the month in which the period terminates has no corresponding day, period will terminate on the last day of such month. Thereafter 3 days of grace is added. Example: B/E dated 30th January is payable 1 month after date. It falls due on 3rd March.
A certain number of days – • After date, or • After sight, or • After a certain event.	• It shall be at maturity on the 3rd day after the specified day. • While calculating the date at which a P/N or B/E made payable a certain number of days after date or after sight or after a certain event is at maturity, day presentment for acceptance or sight, or of protest for non – acceptance, or on which the event happens shall be excluded. Example: B/E dated 1st November is made payable 15 days after date. The period of 15 days will be counted from 2nd November and the B/E will be at maturity on 19th November.
On a day when day of maturity is a Public Holiday.	• Public holiday includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a Public Holiday. • A P/N or B/E which matures on a public holiday shall be deemed to fall due on the preceding business day, e.g. if a B/E falls due on Sunday, it shall be deemed to be due on Saturday. • A B/E which falls due on emergency holiday shall be deemed to be due on the succeeding business day.

CHART

Bills of Exchange

- **Bill at sight** or **Bill on presented** or **Bill on Demand**
  - When demanded then needs to make payment
  - No Time Period
  - No Grace Days
- **Bill after Date**
  - Due Date considered from date of drawing of bill
- **Bill after sight**
  - From date of Acceptance of bill

Bill after Date and Bill after sight:
- Time Period Mentioned
- 3 Days of Grace Applicable

Due Date or Date of Maturity ⇒ Date of Drawing or Date of Acceptance (After Sight) + Term of Bill* + 3 Days of Grace

* Where term of bill can be specified no. of days or months

Note: If the month in which period terminates has no corresponding day, period will terminate on last day of such month.

Date of Maturity is holiday

- **Public / Gazetted holiday** → Preceding / Previous working day [26/1, 15/8, 2/10, Sundays]
- **Emergency / Sudden / Unforeseen holiday** → Succeeding / next working day

Case a) Date of Bill: 10.04.23 Term 3 months

Case b) Date of Bill: 10.04.23 Term 90 days

Case c) Date of Bill: 30.01.23 Term 1 month

Case d) Date of Bill: 30.01.23 Term 30 days

Case e) Date of Bill: 12.06.23 Term 2 months

Case f) Date of Bill: 25.09.23 Term 2 months
Due date is Emergency holiday.

ENTRIES IN THE BOOKS OF DRAWER & DRAWEE

Bills of Exchange

$A \xrightarrow{\text{Sale : 10000}} B$

B 10000
To Sales 10000

B/R 10000
To B 10000

Purchases 10000
To A 10000

A 10000
To B/P 10000

Books of DRAWER (A)

	Held Bill Till Maturity	Discounting with Bank	Endorse to Creditor	Sent to Bank for collection
1) Event	–	Bank 9800 Discount 200 To B/R 10000	Creditor/C 10000 To B/R 10000	BSFC 10000 To B/R 10000
2) Maturity a) Honour	Bank 10000 To B/R 10000	–	–	Bank 10000 To BSFC 10000
OR b) Dishonour (Noting charges 100)	B 10100 To B/R 10000 To Bank 100	B 10100 To Bank 10100	B 10100 To C 10100	B 10100 To BSFC 10000 To Bank 100

Books of DRAWEE (B)

In all 4 cases, same entries to be passed :

Honour

B/P A/c - Dr 10000
To Bank A/c 10000

Dishonour

B/P A/c - Dr 10000
Noting charges A/c - Dr 100
To A 10100

DISHONOUR OF BILL OF EXCHANGE AND PAYMENT OF NOTING CHARGES

1. Dishonour: Non-payment of Bill of Exchange on the due date is called Dishonour.
2. Noting: In case of dishonour of a B/E on the due date, the fact of dishonour, and the causes of dishonour should be ascertained and recorded on the B/E itself. Otherwise, the Acceptor may prove that B/E was not properly presented to him on the due date and hence can escape from his liability.
3. Charges: Noting Charges refers to the fees paid to a Public Official known as "Notary Public", who records the fact and causes of dishonour of B/E.
4. Accounting: Noting Charges is incurred by the person presenting the B/E on the due date, and is recoverable from the person causing the dishonour, i.e. the Acceptor.

RETIREMENT OF BILL OF EXCHANGE

1. Reason for Retirement	2. Accounting for Retirement
• Sometimes, the Acceptor of a B/E is ready to pay the amount, even before the due date. • So, the Acceptor may request the Payee, for settling the payment before due date. • This constitutes Retirement of Bill.	• Acceptor is entitled to receive certain Interest or Discount (called Rebate) for making payment before the due date. • This Rebate on Bills Retired before due date, constitutes Income of Acceptor, and Expense of Payee. • It is a consideration of premature payment.

Example ***(ICAI Study Material)***

On 1st January, 2023, A sells goods for ₹ 10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 4th March, 2023, B retires his acceptance under rebate/discount of 12% per annum. Record these transactions in the journals of A and B.

RENEWAL OF BILL OF EXCHANGE

1. Reason for Renewal	2. Accounting for Renewal
• Sometimes, the Acceptor of a B/E is unable to pay the amount on the due date. • In such case, the Acceptor may request the Drawer for an extension of time period. • This constitutes Renewal of Bill.	• Old B/E will be cancelled. So, the earlier Journal Entry relating to acceptance of Old B/E will be reversed. • New B/E will be made out. Journal Entries are passed for recording the New B/E. • Value of New B/E = Value of Old B/E + Interest, if any.

The amount of the new bill may represent any of the following:

a) Where the drawee pays nothing: Total of amount of original bill as well as the interest for the extended time period.
b) Where the drawee pays interest amount at the time of renewal: Amount of the Original bill.
c) Where the drawee makes part payment of the original bill or interest amount or both: That part of total of amount of original bill as well as the interest for the extended time period on unpaid amount.

Example

On 1st January, A sold goods to B amounting 10,000 & B accepted 3 months bill drawn by A. On maturity he was unable to meet the bill.

Case 1: He paid nothing & accepted another bill for 2 months for 10,000 with interest @12% p.a.

Case 2: He paid nothing & accepted another bill for 2 months for 10,000. However, interest @12% p.a is paid at the time of renewal of bill.

Case 3: He paid 4,000 & accepted another bill for 2 months for balance with interest @12% p.a.

Case 4: He paid 4,000 & accepted another bill for 2 months for balance. However, interest @12% p.a is paid at the time of renewal of bill.

DEALING WITH INSOLVENCY OF DRAWEE

1. Meaning: Insolvency of the Drawee means that he will be unable to pay his liabilities. This means that bills accepted by him will be dishonoured on the due date.

Books of the Drawer

(a) For dishonour of B/R	Drawee A/c Dr. To Bills Receivable A/c
(b) For recording final amount, if any, received	Cash A/c Dr. (Amt actually received) Bad Debts A/c Dr. (Balancing Figure) To Drawee Account (Total Amount due)

Books of the Drawee

(a) For dishonour of B/R	Bills Payable A/c Dr. To Drawer A/c
(b) For recording final amount, if any, paid	Drawer A/c Dr. (Total Amount due) To Cash A/c (Amt actually paid) To Deficiency A/c (Balancing Figure)

Example

A draws bill on B on 1st April, 2023 for 1,00,000 for 3 months. At maturity bill returned dishonoured & noting charges 1,000. 30 paise in rupee is recovered from B's estate. Pass entries in books of both the parties.

ACCOMODATION BILLS

1. Meaning:
   (a) Generally, B/E is drawn in support of a trade transaction, i.e. credit sales. However, B/E can also be utilized for raising finance (i.e. without a trade transaction).
   (b) When B/E is used for financing purposes, it is called as Accommodation Bill. (Note: An Accommodation Bill is referred to as "Kite".)

Example

a)

For the mutual accommodation of 'A' and 'B' on 1st April, 2023, 'A' drew a four months' bill on 'B' for ₹4,000. 'B' returned the bill after acceptance of the same date. 'A' discounts the bill from his bankers @ 6% per annum and remit 50% of the proceeds to 'B'.

On the due date A send his share in total bill to B and B paid the bill amount to the Bank.

Pass Journal entries in the books of 'A' & ' B '.

b)

Consider in Case a) that on due date 'A' is unable to send the amount due and therefore 'B' draws a bill for ₹7,000, which is duly accepted by 'A'. 'B' discounts the bill for ₹6,600 and sends ₹ 1,300 to 'A'. Before the bill is due for payment 'A' becomes insolvent. Later 25 paise in a rupee received from his estate. Pass Journal entries in the books of 'A' & ' B '.

BILLS RECEIVABLE BOOK AND BILLS PAYABLE BOOK

Bills receivable and bills payable books are journals (Day Books) to record in a chronological order the details of bills receivable and bills payable. When large number of bill transactions take place in an organization, it is convenient to maintain these books. Wherein any bill transaction takes place, the same is entered in the Day Books in the first instance. Postings to individual Debtors or Creditors accounts are made from the Day Books. Also totals of bills received or accepted are posted periodically to Bills Receivable Account and Bills Payable Account respectively.

Bills receivable book and bills payable book are very useful for following up the status of outstanding bills. When there are large number of bills and these bills fall due on different dates, some of these bills may not be honoured on maturity due to varied reasons. It is possible from these Day Books to trace the details of the outstanding bills and to identify the reasons for not honouring the bills.

Bills Receivable Book (Folio No . . .)

Date of Receipt	Voucher No.	Party from whom received	Acceptor	Date of Bill	Due Date	Place of Payment	Amount	L.F.	Mode of Disposal

Bills Payable Book (Folio No . . .)

Date of Acceptance	Drawer	Payee	Date of Bill	Due Date	Place of Payment	Amount	L.F.	Mode of Disposal

TRADE BILL VS ACCOMODATION BILL

	Trade Bill	Accommodation Bill
Purpose	It is drawn and accepted for some consideration i.e. for trade purpose.	It is drawn and accepted without any consideration.
Need	It is drawn to settle a business transaction.	It is drawn to meet the financial requirements of the drawer / drawee / both temporarily.
Legal Status	The drawer can take legal action if the bill is dishonoured.	The drawer cannot take any legal action when the bill is dishonoured.
Discounting of bill	It may, or, may not be discounted with the bank.	It is always discounted with the bank.
Discounting charges	Discounting charges are borne by the drawer.	Discounting charges are divided between the drawer and drawee in the ratio of the proceeds.

ASSIGNMENT QUESTIONS

Question 1 *Pg no._____*

Record the following transactions in the Journals of Ram and Hari:
Ram sells goods for ₹ 1,00,000 to Hari on 1st January, 2023 and on the same day draws a bill on Hari at three months for the amount. Hari accepts it and returns it to Ram, who discounts it on 4th January, 2023 with his bank at 12% per annum. The acceptance is dishonored on due date and the bank pays ₹ 250 as noting charges.

Question 2 *(ICAI Study Material)* *Pg no._____*

Vijay sold goods to Pritam on 1st September, 2023 for ₹1,06,000. Pritam immediately accepted a three months bill. On due date Pritam requested that the bill be renewed for a fresh period of two months. Vijay agrees provided interest at 9% was paid immediately in cash. To this Pritam was agreeable. The second bill was met on due date. Give Journal entries in the books of Vijay and Pritam.

Question 3 *(ICAI Study Material) / (RTP May 2022) (Similar)* *Pg no._____*

David draws two bills of exchange on 1.1.2023 for ₹ 6,000 and ₹10,000. The bills of exchange for ₹6,000 is for two months while the bill of exchange for ₹10,000 is for three months. These bills are accepted by Mr. Thomas. On 4.3.2023, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of two months. Mr. David agrees to this proposal. On 20.3.2023, Mr. Thomas retires the acceptance for ₹10,000, the interest rebate i.e. discount being ₹100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.
You are to give the journal entries in the books of Mr. David.

Question 4 *(ICAI Study Material)* *Pg no._____*

A draws upon B three Bills of Exchange of ₹ 3,000, ₹ 2,000 and ₹ 1,000 respectively. A week later his first bill was mutually cancelled, B agreeing to pay 50% of the amount in cash immediately and for the balance plus interest ₹100, he accepted a fresh Bill drawn by A. This new bill was endorsed to C who discounted the same with his bankers for ₹1,500. The second bill was discounted by A at 5%. This bill on maturity was returned dishonoured (noting charge being ₹30). The third bill was retained till maturity when it was duly met.
Give the necessary journal entries recording the above transactions in the books of A.

Question 5 *(RTP May 2023)* *Pg no._____*

Priya owed ₹5,00,000 to Pratika. On 1st October, 2022, Priya accepted a bill drawn by Pratika for the amount at 3 months. Pratika got the bill discounted with his bank for ₹4,95,000 on 3rd October, 2022. Being unable to pay the amount on due date, Priya approached Pratika for renewal of the bill. Pratika agreed on the conditions that ₹2,50,000 be paid immediately together with interest on the remaining amount at 10% per annum for 3 months and for the balance, Priya should accept a new bill at three months. These arrangements were carried out. But afterwards, Priya became insolvent and 60% of the amount could be recovered from his estate. Pass journal entries (with narration) in the books of Pratika.

Question 6 *(ICAI Study Material)/(RTP Nov 2018)/(May 2021) /(Nov 2021) (Similar)* *Pg no._____*

Prepare Journal entries for the following transactions in K. Katrak's books.

(i) Katrak's acceptance to Basu for ₹ 2,500 discharged by a cash payment of ₹ 1,000 and a new bill for the balance plus ₹ 50 for interest.

(ii) G. Gupta's acceptance for ₹ 4,000 which was endorsed by Katrak to M. Mehta was dishonoured. Mehta paid ₹ 20 noting charges. Bill withdrawn against cheque.
(iii) D. Dalal retires a bill for ₹ 2,000 drawn on him by Katrak for ₹ 10 discount.
(iv) Katrak's acceptance to Patel for ₹ 5,000 discharged by Mody's acceptance to Katrak for a similar amount

Question 7 *(ICAI Study Material)* *Pg no._____*

Journalize the following in the books of Don:

(i) Bob informs Don that Ray's acceptance for ₹ 3,000 has been dishonoured and noting charges are ₹ 40. Bob accepts ₹ 1,000 cash and the balance as bill at 3 months at interest of 10%. Don accepts from Ray his acceptance at 2 months plus interest @ 12% p.a.
(ii) James owes Don ₹ 3,200; he sends Don's own acceptance in favour of Ralph for ₹ 3,160; in full settlement.
(iii) Don meets his acceptance in favour of Singh for ₹ 4,500 by endorsing John's acceptance for ₹ 4,450 in full settlement.
(iv) Ray's acceptance in favour of Don retired one month before due date, interest is taken at the rate of 6% p.a.

Question 8 *Pg no._____*

Sunil draws a bill for ₹9,000 on Vijay on 5th April, 2023 for 3 months, which Vijay returns it to Sunil after accepting the same. Sunil gets it discounted with the bank for ₹ 8,820 on 8th April, 2023 and remits one-third amount to Vijay. On the due date Sunil fails to remit the amount due to Vijay, but he accepts a bill for ₹12,600 for three months, which Vijay discounts it for ₹ 12,330 and remits ₹ 2,220 to Sunil. Before the maturity of the renewed bill Sunil becomes insolvent and only 50% was realized from his estate on 15th October, 2023.
Pass necessary Journal entries for the above transactions in the books of Sunil & Vijay

Question 9 *(ICAI Study Material)* *Pg no._____*

On 1st July, 2023 Gorge drew a bill for ₹1,80,000 for 3 months on Harry for mutual accommodation. Harry accepted the bill of exchange. Gorge had purchased goods worth ₹1,81,000 from Jack on the same date. Gorge endorsed Harry's acceptance to Jack in full settlement. On 1st September, 2023, Jack purchased goods worth ₹1,90,000 from Harry. Jack endorsed the bill of exchange received from Gorge to Harry and paid ₹ 9,000 in full settlement of the amount due to Harry. On 1st October, 2023, Harry purchased goods worth ₹2,00,000 from Gorge. Harry paid the amount due to Gorge by cheque. Give the necessary Journal Entries in the books of Harry, Gorge and Jack.

Question 10 *(CA Foundation Nov 2020) (10 Marks)* *Pg no._____*

Suresh draws a bill for ₹15,000 on Anup on 15th April, 2023 for 3 months, which is returned by Anup to Suresh after accepting the same. Suresh gets it discounted with the bank for ₹ 14,700 on 18th April, 2023 and remits one-third amount to Anup. On the due date Suresh fails to remit the amount due to Anup, but he accepts bill of ₹ 17,500 for 3 months, which Anup discounts for ₹ 17,100 and remits ₹ 2,825 to Suresh. Before the maturity of the renewed bill Suresh becomes insolvent and only 50% was realized from his estate on 31st October,2023.
Pass necessary Journal entries for the above transactions in the books of Suresh.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1. On 1.1.2023, A draws a bill on B for ₹1,20,000 for 3 months' maturity date of the bill will be:
   (a) 1.4.2023
   (b) 3.4.2023
   (c) 4.4.2023

2. On 16.6.2023 P draws a bill on Q for ₹1,25,000 for 30 days. 19th July is a public holiday, maturity date of the bill will be:
   (a) 19th July
   (b) 18th July
   (c) 17th July

3. PQ draws a bill on XY for ₹130,000 on 1.1.2023. XY accepts the same on 4.1.2023 for period of 3 months after date. What will be the maturity date of the bill:
   (a) 4.4.2023
   (b) 3.4.2023
   (c) 7.4.2023

4. A draws a bill on B. A endorsed the bill to C. The payee of the bill will be
   (a) A
   (b) B
   (c) C

5. A bill of ₹ 120,000 was discounted by Saras with the banker for ₹1,18,800. At maturity, the bill returned dishonoured, noting charges ₹ 200. How much amount will the bank deduct from Saras's bank balance at the time of such dishonour?
   (a) ₹1,20,000
   (b) ₹1,18,800
   (c) ₹1,20,200

6. X draws a bill on Y for ₹300,000 on 1.1.2023 for 3 months after sight, date of acceptance is 6.1.2023. Maturity date of the bill will be:
   (a) 8.4.2023
   (b) 9.4.2023
   (c) 10.4.2023

7. X sold goods to Y for ₹ 5,00,000. Y paid cash ₹4,30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:
   (a) ₹ 98,000
   (b) ₹ 68,000
   (c) ₹ 68,600

8. On 1.1.2023, X draws a bill on Y for ₹ 5,00,000 for 3 months. X got the bill discounted 4.1.2023 at 12% rate. The amount of discount on bill will be:
   (a) ₹ 15,000
   (b) ₹ 16,000
   (c) ₹ 18,000

9. Mr. Jay draws a bill on Mr. John for ₹ 3,00,000 on 1.1.2023 for 3 months. On 4.2.2023, John got the bill discounted at 12% rate. The amount of discount will be:
   (a) ₹ 9,000
   (b) ₹ 6,000
   (c) ₹ 3,000

10. XZ draws a bill on YZ for ₹ 2,00,000 for 3 months on 1.1.2023. The bill is discounted with banker at a charge of ₹1,000. At maturity the bill return dishonoured. In the books of XZ, for dishonour, the bank account will be credited by:
   (a) ₹199,000
   (b) ₹ 200,000
   (c) ₹ 201,000

11. On 1.1.2023, XA draws a bill on YB for ₹ 1,00,000. At maturity YB request XA to renew the bill for 2 month at 12% p.a. interest. Amount of interest will be:
   (a) ₹ 2,000
   (b) ₹ 1,500
   (c) ₹ 1,800

12. A bill of exchange is drawn by a
   (a) Creditor
   (b) Debtor
   (c) Debenture holder

13. At the time of drawing a bill, the drawer credits
   (a) Bills Receivables A/c
   (b) Bills Payable A/c
   (c) Debtor's A/c

14. A promissory note is made by a
   (a) Seller
   (b) Purchaser
   (c) Endorsee

15. A bill of exchange contains
   (a) An unconditional order
   (b) A promise
   (c) A request to deliver the goods

16. A promissory note contains
   (a) An unconditional order
   (b) A promise
   (c) A request to deliver the goods

17. The rebate on the bill shows that
   (a) It has been endorsed
   (b) It has been paid after the date of maturity
   (c) It has been paid before the date of maturity

18. Notary Public may charge his fee from the
    (a) Holder of bill of exchange
    (b) Drawer
    (c) None

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Bills payable account is a nominal account.
2) Promise to pay is included in a bill of exchange.
3) Days of rebate are added to the due date to arrive at the maturity date.
4) Discount at the time of retirement of a Bill is a gain for the drawee.
5) Foreign bill is drawn in the country and payable outside the country.
6) Promissory note is different from that of a bill of exchange where the amount is paid by the maker in case of former and by the acceptor in the later.
7) A has drawn a bill on B. B accepts the same and endorses the bill to C
8) A bill given to a creditor is called bill payable
9) A Promissory note can be made payable to bearer
10) No cancellation entry is required when a bill is renewed.
11) A promissory note cannot be made payable to bearer.
12) Cancelling old bill and drawing new bill is called renewal of Bill or A cancellation entry is required, when a bill is renewed.
13) A bill given to a creditor is called Bills Receivable.
14) Discount at the time of retirement of a Bill is a gain for the drawer.
15) Refusal by acceptor to make payment of the bill on the maturity date is called Retirement of the bill.
16) A bill of exchange is a conditional order in writing given by a Debtor to a Creditor.
17) A Promissory Note requires acceptance.
18) At the time of the Renewal of a bill, Interest account is debited in the books of a drawee.
19) In case of bill of exchange, the drawer and the payee may not be the same person but in case of a promissory note, the maker and the payee may be the same person. *(Nov 2019)*
20) There are always 2 parties to the bills of exchange.

Solution

1) False: The bills payable account is a personal account that represents a liability.
2) False: Bill of exchange contains an order to pay the required amount and not a mere promise to pay.
3) False: 3 Days of grace are added to the due date to arrive at the maturity date.
4) True: - Discount at the time of retirement of a bill is a gain for the drawee and loss for the drawer.
5) True: When a bill is drawn in the country and is payable outside the country it is termed as a foreign bill.

6) True: In case of the promissory note, it is generally the maker who makes the payment, but in case of the bill of exchange, the person accepting the bill shall be liable to make the payment to the holder of the bill.
7) False: - A is drawer and B is the drawee. So B cannot endorse the bill to C, only A can do so.
8) True: - On giving a bill, the debtor has committed for a payment, therefore, bill given to a creditor is called Bills Payable.
9) False: - A promissory note cannot be made payable to a bearer as it is payable on the order of the person who is mentioned in it.
10) False: - On renewal of bill, entries are passed for cancellation of the old bill & recording of a new bill.
11) True: - A promissory note cannot be made payable to a bearer as it is payable on the order of the person who is mentioned in it.
12) True: - On the failure of the payment on the due date by the acceptor, a new bill is drawn on him by cancelling the old bill, which is known as renewal of bill. On renewal, the entries are passed for cancellation of old bill and recording of new bill.
13) False: - On a giving a bill, the debtor has committed for a payment; therefor, a bill given to creditor is called Bills payable.
14) False: - It is a gain for the drawee, as he receives an amount over the bill amount.
15) False: - Refusal by the acceptor to make payment of the bill on the date of maturity is called dishonour of the bill.
16) False: - Bill of exchange is an unconditional order signed by the maker, directing the debtor to pay a certain sum of money on a certain date or on the demand of the maker i.e. creditor.
17) False: - Promissory note is a written unconditional promise and it does not requires any acceptance. It is drawn and signed by the person to whom credit is granted or by the debtor.
18) True: - At the time of renewal of a bill, interest account is debited and drawer's account is credited in the books of drawee because interest becomes liability for drawee and it becomes payable to drawer.
19) False: In case of Bills of exchange, Drawer & payee may be same person when the Bill hold by drawer up to the date of Maturity. In case of promissory note, the maker and the payee cannot be the same person.
20) False: There can be more than 2 parties- namely the drawer, acceptor and the payee of the bill.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

On 1st January, 2023, Ankita sells goods for ₹5,00,000 to Bhavika and draws a bill at three months for the amount. Bhavika accepts it and returns it to Ankita. On 4th March, 2023, Bhavika retires his acceptance under rebate of 12% per annum.
Record these transactions in the journals of Ankita and Bhavika.

Question 2 *(ICAI Study Material) / (RTP May 2019) / (RTP Nov 2020)* Pg no._____

Rita owed ₹1,00,000 to Siriman. On 1st October, 2023, Rita accepted a bill drawn by Siriman for the amount at 3 months. Siriman got the bill discounted with his bank for ₹99,000 on 3rd October, 2023. Before the due date, Rita approached Siriman for renewal of the bill. Siriman agreed on the conditions that ₹50,000 be paid immediately together with interest on the remaining amount at 12% per annum for 3 months and for the balance, Rita should accept a new bill at three months. These arrangements were carried out. But afterwards, Rita became insolvent and 40% of the amount could be recovered from his estate.
Pass journal entries (with narration) in the books of Siriman.

Question 3 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2022)/(Nov 2023) (Similar)* Pg no._____

Mr. B accepted a bill for ₹ 10,000 drawn on him by Mr. A on 1st August, 2023 for 3 months. This was for the amount which B owed to A. On the same date Mr. A got the bill discounted at his bank for ₹ 9,800. On the due date, B approached A for renewal of the bill. Mr. A agreed on condition that ₹ 2,000 be paid immediately along with interest on the remaining amount at 12% p.a. for 3 months & that for the remaining balance B should accept a new bill for 3 months. These arrangements were carried through. On 31st December, 2023, B became insolvent and his estate paid 40%.
Prepare Journal Entries in the books of Mr. A

Question 4 Pg no._____

R owed ₹ 1,000 to S. On 1st October, 2022, R accepted a bill drawn by S for the amount at 3 months. S got the bill discounted with his bank for ₹ 900 on 3rd October, 2022. Before the due date, R approached S for renewal of the bill. S agreed on the conditions that ₹ 500 be paid immediately together with interest on the remaining amount at 12% per annum for 3 months and for the balance, R should accept a new bill at three months. These arrangements were carried out. But afterwards, R became insolvent and 40% of the amount could be recovered from his estate.
Pass journal entries (with narration) in the books of S.

Question 5 *(CA Foundation May 2019) (5 Marks) / (RTP May 2020)* Pg no._____

On 1st January 2023, Akshay draws two bills of exchange for ₹ 16,000 and ₹ 25,000. The bill of exchange for ₹ 16,000 is for two months while the bill of exchange for ₹ 25,000 is for three months. These bills are accepted by Vishal. On 4th March, 2023, Vishal requests Akshay to renew the first bill with interest at 15% p.a. for a period of two months. Akshay agreed to this proposal. On 25th March, 2023, Vishal retires the acceptance for ₹ 25,000, the interest rebate i.e. discount being ₹ 250. Before the due date of the renewed bill, Vishal becomes insolvent and only 50 paisa in a rupee could be recovered from his estate.
Show the Journal Entries (with narrations) in the books of Akshay.

Question 6 *(ICAI Study Material)* *Pg no._____*

Ms. Sujata receives two bills from Ms. Aruna dated 1st January 2023 for 2 months. The first bill is for 10,200 and the second bill is for ₹ 15,000. The First bill is discounted immediately with the bank for ₹ 10,000 and the second bill was endorsed in favour of Mr. Sree on 3rd January. Pass the necessary journal entries in the books of Ms. Sujata.

Question 7 *(CA Foundation June 2023) (5 Marks)* *Pg no._____*

Journalise the following transactions in the books of Karthik:

a. Karthik accepted a bill of Balu for ₹ 3,500 discharged by a cash payment of ₹ 1,500 and a new bill for the balance plus ₹ 75 for interest.
b. Gopal acceptance for ₹ 4,500 which was endorsed by Karthik to Mohan was dishonoured. Mohan paid ₹ 50 as noting charges. Bill was withdrawn against cheque.
c. Doshi retires a bill for ₹ 2,500 drawn on him by Karthik for ₹ 25 discount.
d. Karthik's acceptance to Prem for ₹ 6,500 discharged by Ashok's acceptance to Karthik for a similar amount.

Question 8 *Pg no._____*

A draws on B a bill of ₹ 45,000 on 1st June, 2023 for 3 months. B accepts the bill and sends it to A who discounted for ₹ 44,100. A immediately remits ₹ 14,700 to B. On the due date A, being unable to remit the amount due, accepts a bill for ₹ 63,000 for three months which is discounted by B for ₹ 61,650. B sends ₹ 11,100 to A. On the due date A becomes insolvent, his estate paying forty paise in the rupee.
Give the Journal Entries in the books of A and B.

Question 9 *(ICAI Study Material)* *Pg no._____*

X draws on Y a bill of exchange for ₹ 30,000 on 1st April, 2023 for 3 months. Y accepts the bill and sends it to X who gets it discounted for ₹ 28,800. 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.

Question 10 *(CA Foundation Nov 2022) (15 Marks)* *Pg no._____*

T draws on J a bill of exchange for ₹ 1,80,000 on 1st April, 2022 for 3 months. J accepts the bill and sends it to T, who gets it discounted from his banker for ₹ 1,72,800. T 'immediately remits ₹ 57,600 to J. On the due date, T, being unable to remit the amount due, accepts a bill for ₹ 2,52,000 for three months, which is discounted by J from his banker for ₹ 2,40,660. J sends ₹ 40,440 to T. Before the maturity of the bill, T becomes bankrupt and his estate paying fifty paisa in a rupee.
Give the journal entries in the books of T and J.

Question 11 *Pg no._____*

On 1st July, 2023 G drew a bill for ₹ 80,000 for 3 months on H for mutual accommodation who accepted the bill of exchange. G had purchased goods worth ₹ 81,000 from J on the same date. G endorsed H's acceptance to J in full settlement. On 1st September, 2023 J purchases goods worth ₹ 90,000 from H. J endorsed the bill of exchange received from G to H and paid ₹ 9,000 in full settlement of the amount due to H. On 1st October, 2023 H purchased goods worth ₹ 1,00,000 from G. He paid the amount due to G by cheque.
Give the necessary Journal Entries in the books of H.

Question 12 *(CA Foundation Dec 2021) (10 Marks)* *Pg no._____*

On 12th May, 2023 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, 2023 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, 2023 it was agreed between A and 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,2023 B approached A offering ₹ 12,240 for retirement of his acceptance A accepted the request.

You are required to pass journal entries of all the above transactions in the books of A.

Question 13 *(RTP May 2019) / (RTP May 2021) / (RTP May 2022) / (RTP Nov 2022)* *Pg no._____*

Write short notes on:

(i) Noting Charges. (ii) Retirement of bills of exchange.

Question 14 *(RTP Nov 2019) / (RTP Nov 2021) / (RTP Nov 2023)* *Pg no._____*

Write short note on Bills of exchange and various parties to it.

Question 15 *(RTP May 2020)/ (RTP Nov 2022) / (RTP May 2023)* *Pg no._____*

Write short note on Trade bill vs. Accommodation bill.

FINAL ACCOUNTS OF SOLE PROPRIETORS

CH 7

"Choice, not circumstances, determines your success. Success is a state of mind. If you want success, start thinking of yourself as a success."

FINANCIAL STATEMENTS

1. Financial Statements (also called General Purpose Financial Statements) consist of the following –
   (a) Statement of Performance - Profit and loss Account
   (b) Statement of Financial Position - Balance Sheet
2. Meaning: the above terms are explained below –

Item	Description
Statement of Performance	• This Statement / Account shows the result of operations, i.e. Profit or Loss of the entity for the period. • It is also called "Performance Statement" or "Income Statement" • Consists of – (i) Manufacturing Account, (ii) Trading Account, and (iii) Profit and Loss Account.
Statement of Financial Position	• This Statement (not an Account) shows the financial position, i.e. Assets and Liabilities of the entity as on a particular date. • It is also called "Position Statement" or "Balance Sheet"

Final Accounts of Sole Proprietorship

Non-Manufacturing / Trading Entities, i.e. Entities engaged in purchase and sale of goods, without involving any production process

1. Trading account
2. Profit and Loss Account
3. Balance Sheet

Manufacturing Entities i.e. Entities engaged in converting Raw Materials into Finished Goods through production process.

1. Manufacturing Account
2. Trading Account
3. Profit and Loss Account
4. Balance Sheet

TRADING ACCOUNT

The Trading Account shows the surplus of the Sale Value over the Cost of Goods Sold. This is called as Gross Profit. Since the Gross Profit is the basic indicator of business profitability, the preparation of the Trading Account assumes significance.

Trading Account of ……. For the year ended …….

Particulars	₹	Particulars	₹
To Opening Stock To Purchases (net of Returns) To Direct Expenses like Freight Inward, Octroi, Wages, etc. To Gross Profit c/d to P/L Account		By Sales (net of returns) By Closing Stock By Gross Loss c/d to P&L Account	
Total		Total	

Gross Profit = Sales - Cost of Goods Sold
Where Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses – Closing Stock
GP (%) = Gross Profit/ Sales * 100

PROFIT AND LOSS ACCOUNT

1. The Profit and Loss Account shows the net result of operations, i.e. Profit and loss during the period.
2. From the Gross Profit, the other expenses (i.e. Administrative, Selling and Distribution, Financing, Provisions, etc.) are deducted and the Net profit/Loss is arrived at.
3. The P&L Account should facilitate the user to make informed decisions. Hence, too much information loading is not warranted. Where necessary, separate supporting schedules in respect of various expenses may be added.
4. Capital Expenditure and Personal Expenditure should not be debited to this account.
5. Care should be taken to adjust expenses for prepaid / unpaid items. Incomes should also be suitably adjusted for amounts not yet received / amounts received in advance.

FORMAT OF PROFIT AND LOSS ACCOUNT

Profit and Loss Account of ……… for the year ended …………

Particulars	₹	Particulars	₹
To Gross Loss b/d (if any) To Administrative Expenses To Selling Expenses To Financing Expenses To Depreciation To Other Items, Adjustments & Provisions To Net Profit, transferred to Capital A/c		By Gross Profit b/d from Trading A/c By Other Income items By Net Loss, if any, transferred to Capital A/c	
Total		Total	

ITEMS IN PROFIT AND LOSS ACCOUNT

	Item	Examples	
1.	Administrative Expenses	• Salaries of General Office Staff, etc. • Rent, Rates and Insurance • Printing and Stationery, • Repairs & Maintenance of Office building / Furniture,	• Telephone Expenses • Books and Periodicals • Legal Expenses • Audit Fees, etc.

2.	Selling and Distribution Expenses	• Salesman Salaries • Agents Commission • Advertising and Sales Promotion, • Carriage / Freight outwards	• Bad Debts • Repairs and Maintenance of Delivery Vans, vehicles, etc.
3.	Financing Expenses	• Interest Paid on Term loans, Working Capital Loans, etc. • Discount on Bills Discounted with Bank • Discount allowed to customers. • Bank Charges	
4.	Depreciation	• Depreciation on various assets is generally shown as a separate line item in the P&L A/c.	
5.	Other Items, Adjustments & Provisions	• Provisions for Bad and Doubtful Debts, Provision for Discount Allowed to Debtors, Provisions for Repairs and Renewals, etc. • Items like Loss on Sale of Fixed Assets / Investments, Loss (net of insurance Claim) in respect of abnormally lost goods, etc.	
6.	Other Income	• Rent from Properties • Interest on Investments in Fixed Deposits • Dividend from Shares	• Profit on Sale of Fixed Assets • Sale of Old Newspapers, Junk Materials, etc. • Bad Debts Recovered

BALANCE SHEET

1. Meaning: The Balance Sheet is a statement of financial position which sets out the Assets and liabilities of an enterprise as at a certain date.

2. Features:
   (a) Assets are shown on Right Hand Side and Liabilities are shown on Left Hand Side.
   (b) It is prepared as at a particular date and not for a period. So, it is a Position Statement, and not a Performance Statement.
   (c) The Balance Sheet is not an account, its two side represent Liabilities and Assets and not the Debit and the Credit sides of an account.
   (d) The Balance Sheet represents the confirmation of the Basic Accounting Equation, i.e. Equity + Liabilities =Assets. Hence, the total of both the sides should agree.
   (e) The Ledger Account Balance of all Personal and Real Accounts will flow into the Balance Sheet.

3. Format:

Balance Sheet of ……… as at ………..

Liabilities	₹	Assets	₹
Capital Reserves & Surplus Loans Current Liabilities: Sundry Creditors Outstanding Expenses		Fixed Assets Investments Current Assets: Stock Debtors Cash at Bank, Cash in Hand	
Total		Total	

ARRANGEMENT OF ASSETS AND LIABILITIES

<table>
<tr><th></th><th>Method 1: Permanence Approach</th><th>Method 2: Liquidity Approach</th></tr>
<tr><td>Assets</td><td>Assets which are to be used in the business for a longer span of time and which are not meant for sale, are shown first. These items are followed by Current/Liquid Assets
1. Fixed Assets:
• Land and Building
• Plant & Machinery
2. Current Assets
• Stock
• Sundry Debtors
• Bills Receivable
• Other Investments
• Cash at Bank
• Cash in hand</td><td>Assets which are readily convertible into cash are shown first and which are not readily convertible are shown subsequently in the Balance Sheet

1. Current Assets
• Cash in hand
• Cash at Bank
• Other Investments
• Bills Receivable
• Sundry Debtors
• Stock
2. Fixed Assets
• Plant & Machinery
• Land and Building</td></tr>
<tr><td>Liabilities</td><td>• Capital
• Reserves & Surplus
• Loans
• Trade Creditors
• Bills Payable
One way is to first show the capital, then long-term liabilities and last of all short-term liabilities</td><td>• Bills Payable
• Trade Creditors
• Loans
• Reserves & Surplus
• Capital
The other way is to start with short-term liabilities and then show long term liabilities and last of all capital</td></tr>
</table>

Note: The Permanence Approach is generally adopted for presentation of balance sheet

Example: Following is the Trial Balance of Mr. PopatLal as on 31.03.2023.

Trial Balance on 31st March, 2023

Particulars	Debit (₹)	Credit (₹)
Opening Stock	1,00,000	
Purchases	10,00,000	
Purchase Return		50,000
Sales		18,00,000
Sales Return	1,00,000	
Carriage Inward	55,000	
Salary	1,50,000	
Office Expenses	20,000	
Selling Expenses	30,000	
Plant & Machinery	3,00,000	
Furniture	2,00,000	
Debtors	2,50,000	
Cash in Hand	40,000	
Cash at Bank	85,000	
Creditors		2,50,000
Capital		2,30,000
Total	23,30,000	23,30,000

Value of Closing Inventory on 31st March 2023 was ₹ 2,00,000

Prepare closing entries for the above items. Prepare Trading Account, Profit & Loss Account & Balance Sheet. Also Pass Opening Entry as on 01.04.2023 for the next year.

ADJUSTMENT ENTRIES IN FINAL ACCOUNTS

1. EXPENSES

	Adjustment	Journal entry	Treatment in Trading and P&L A/c	Treatment in Balance sheet
1.	Outstanding or Accrued Expenses	Expenses A/c Dr. To O/s Expenses A/c	Add to Expense on Debit side of Trading/ P&L A/c	Liability Side under "CurrentLiabilities"
2.	Prepaid Expenses	Prepaid Exp. A/c Dr. To Expenses A/c	Reduce from Expense on Debit side of Trading/ P& L A/c	Assets Side under "Current Assets"

Expenses

O/s Expenses
(Accrued but not paid)

Expense A/c - Dr.
To O/s Expense A/c

Trading and P&L A/c

To Expense xx + O/s Exp. xx xx	

B/s

Liabilities	Assets
O/s Exp. xx	

Prepaid Expenses
(Paid but not accrued)

Prepaid Expense A/c - Dr
To Expense A/c

Trading and P&L A/c

To Expense xx - Prepaid Exp (xx) xx	

B/s

Liabilities	Assets
	Prepaid Exp. xx

Note:
If O/s Expense, Prepaid Expense appearing in trial balance then effect only in balance sheet as entry has already been passed & respective expense has already been adjusted.

Example: Trial Balance

	Dr.	Cr.
Salaries	140000	
Rent	90000	

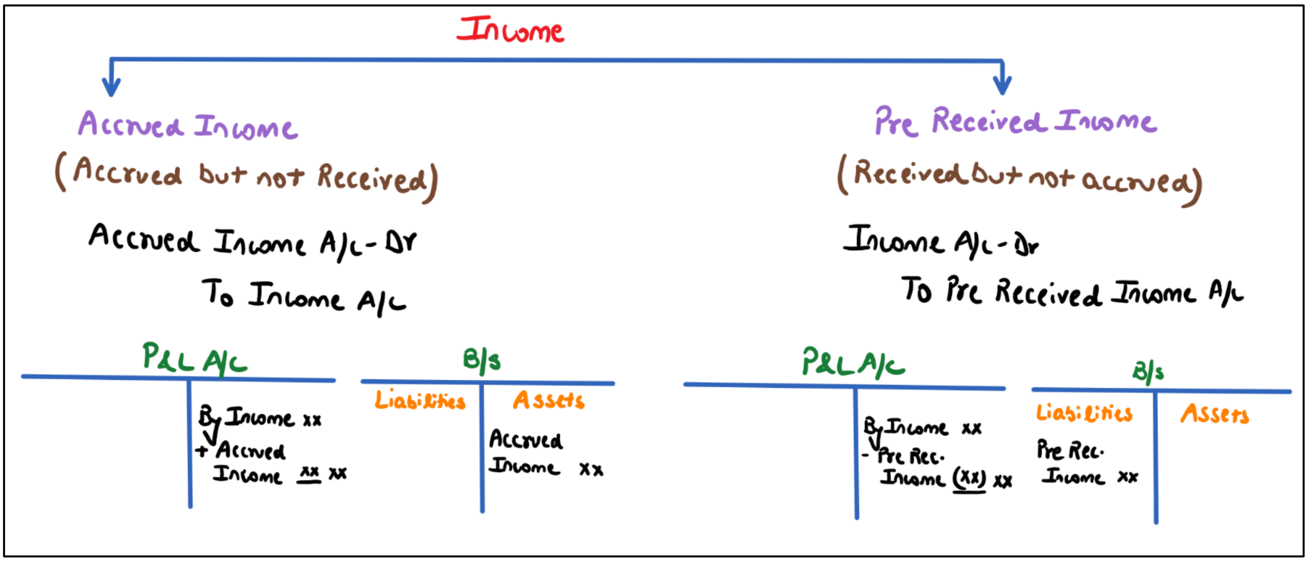
Adjustments:
1) O/s Salary 20000
2) Prepaid Rent 8000

Example: Trial Balance

	Dr.	Cr.
Salaries	140000	
Rent	90000	
O/s Salary		20000
Prepaid Rent	8000	

2. INCOMES

	Adjustment	Journal entry	Treatment in P&L A/c	Treatment in Balance sheet
1.	Accrued Income or Income receivable	Accrued Income A/cDr. To Income A/c	Add to Income Head on Credit side of P&L A/c	Assets Side under "Current Assets".
2.	Income Received in advance / Unearned Income	Income A/c Dr. To Income recd in advance	Reduce from Income Head on Credit side of P&L A/c.	Liability Side under "Current Liabilities".



Note:
If Accrued Income, Pre received income appearing in trial balance then effect only in balance sheet as entry has already been passed & respective income has already been adjusted.

Example: Trial Balance

	Dr.	Cr.
Interest on F.D.		70000
Interest on Loan given		60000

Adjustments:
1) Accrued Interest on F.D. 5000
2) Interest on loan received in advance 3000

Example: Trial Balance

	Dr.	Cr.
Interest on F.D.		70000
Int. on loan given		60000
Acc. Int. on F.D.	5000	
Prerec. Int. on loan		3000

3. CLOSING STOCK

Closing Stock

Not Appearing in Trial Balance / Given in Adjustments
(Entry to be passed)

Closing Stock A/c – Dr.
To Trading A/c
(2 Effects)

Trading A/c

	By closing Stock xx

B/s

Liabilities	Assets
	Closing Stock xx

Appearing in Trial Balance
(Entry already passed)

Closing Stock A/c – Dr.
To Purchases A/c
(1 Effect)

B/s

Liabilities	Assets
	Closing Stock xx

Example: Trial Balance

	Dr.	Cr.
Opening Stock	100000	
Purchases	1200000	
Sales		2000000

Adjustments:

Closing Stock 200000

Example: Trial Balance

	Dr.	Cr.
Purchases	1200000	
Closing Stock	200000	
Sales		2000000

4. DEPRECIATION

Depreciation

Method 1
Asset Credit Method

Depreciation A/c – Dr
To Fixed Asset A/c

P&L A/c

To Dep. xx	

B/s

Liabilities	Assets
	Fixed Ass. xx –Dep. (xx) xx

Method 2
Provision for Depreciation Method

Depreciation A/c – Dr
To Provision for Dep./Acc. Dep. A/c

P&L A/c

To Dep. xx	

B/s

Liabilities	Assets
	Fixed Ass. xx – Acc. Dep (xx) xx

Note:
If Depreciation appearing in trial balance then effect only in P&L Account

Example: Trial Balance

	Dr.	Cr.
Machinery	500000	

Adjustments:

Dep. on Machinery 10% p.a.

Example: Trial Balance

	Dr.	Cr.
Machinery	500000	
Dep. on Machinery	50000	

Example: Trial Balance

	Dr.	Cr.
Machinery	600000	
Prov. for Dep.		100000

Adjustments:

Dep. on Machinery 10% p.a. (WDV Method)

Example: Trial Balance

	Dr.	Cr.
Machinery	600000	
Prov. for Dep.		100000
Dep. on Machinery	30000	

5. ABNORMAL LOSS

1) Abnormal loss A/c - Dr
   To Trading A/c

2) Insurance claim Rec. A/c - Dr
   P&L A/c (Loss) - Dr
   To Abnormal Loss A/c

Trading A/c

	By Abnormal Loss xx

P&L A/c

To Abnormal Loss xx	

B/S

Liabilities	Assets
	Ins. claim Rec. xx

6. SALE OF GOODS ON APPROVAL OR RETURN BASIS PENDING CONFIRMATION

1) Sales A/c - Dr
   To Debtors A/c
   (At Selling Price)

2) Stock with customers A/c - Dr
   To Trading A/c
   (Lower of Cost or NRV)

Trading A/c

	By Sales xx - Approval Basis (xx) xx By Closing Stock In hand xx With customers xx xx

Balance sheet

Liabilities	Assets
	Debtors xx - Approval Basis (xx) xx Closing Stock In hand xx With customers xx xx

7. MANAGER COMMISSION

Manager Commission

1) Manager Commission A/c – Dr
To O/s Manager Commission

Before charging

Net Profit before comm. X $\frac{\text{Rate}}{100}$

After charging

Net Profit before comm. X $\frac{\text{Rate}}{100+\text{Rate}}$

Example:

Net Profit before commission 110000

Commission

a) 10% of Profits before charging commission
b) 10% of Profits after charging commission

8. BAD DEBTS AND PROVISION FOR DOUBTFUL DEBTS

If a customer fails to pay the amount due from him, the uncollectible amount is called Bad Debts. The accounting treatment is as under:

Method	Method1: General Treatment, i.e. Without having Provision for Bad & Doubtful Debts Account	Method 2: With Provision/Reserve for Bad & Doubtful Debts Account
Rule	Transfer Bad Debts as per TB, to the Debit Side of P&L A/c	• Transfer Bad Debts to Provision A/c. • Maintain provision upto desired amount
Bad Debts written off	Bad Debts A/c Dr. To Sundry Debtors (by name)	Bad Debts A/c Dr. To Sundry Debtors (by name)
Transfer of Bad Debts	Profit and Loss A/c Dr. To Bad Debts A/c	Prov. for Bad & Doubtful debts Dr. To Bad Debts A/c
Provision at year-end	There is no such requirement	Profit and Loss A/c Dr. To Prov. for Bad & Doubtful Debts
Treatment in B/sheet	Not Applicable	Closing Balance of Provision for Bad and Doubtful debts A/c is shown on Assets Side, as a reduction from Sundry Debtors

Note: Instead of the term "Provision for Bad and Doubtful Debts," Sometimes the word "Reserve for Bad debts" is used the word "Provision" is considered preferable.

Bad Debts

1) Bad debts A/c - Dr
   To Debtors A/c

2) P&L A/c - Dr
   To Bad debts

P&L A/c

To Bad debts xx	

B/s

Liabilities	Assets
	Debtors xx - Bad debts (xx) Xx

Example: Trial Balance

	Dr.	Cr.
Debtors	400000	

Adjustments:

Bad debts 10000

Example: Trial Balance

	Dr.	Cr.
Debtors	500000	
Bad debts	10000	

Adjustments:

Further Bad debts 15000

Provision for Doubtful Debts

P&L A/c - Dr
  To Provision for Doubtful debts A/c

B/s

Liabilities	Assets
	Debtors xx - PDD (xx) xx

Provision for Doubtful Debts A/c

To Bad debts	xx	By Bal b/d	xx
To Bal c/d	xx	By P&L A/c (B.f.)	xx

P&L A/c

To PDD xx	

Example:

Year 1: Debtors 500000
Create Provision for Doubtful debts @ 2%.

Year 2: Case (a)

Trial Balance

	Dr.	Cr.
Prov. for Doubtful Debts		10000
Debtors	1000000	
Bad debts	30000	

Create Provision for Doubtful Debts @ 2%.

Year 2: Case (b)

Trial Balance

	Dr.	Cr.
Prov. for Doubtful Debts		10000
Debtors	1000000	
Bad debts	30000	

Adjustments:

Further Bad debts 20000
Create Provision for Doubtful Debts @ 2%.

9. DISCOUNT ALLOWED AND PROVISION FOR DISCOUNT ON DEBTORS

The different accounting treatments in respect of discount allowed to debtors is as under

Method	Method 1: General Treatment	Method 2
Description	Without having Provision for Discount on Debtors A/c	With Provision on Discount on Debtors A/c
Rule	Transfer discount allowed as per Tb, to the debit side of P&L A/c	Transfer discount allowed as per TB to the debit side of Provision A/c. Maintain Provision up to the desired amt.
Discount Allowed	Discount allowed A/c Dr. To Sundry Debtors	Discount allowed A/c Dr. To Sundry Debtors
Tfr of Dis Allowed	Profit & Loss A/c Dr. To Discount allowed A/c	Prov. for discount on debtors Dr. To Discount allowed A/c
Creating Provision at year end	There is no such requirement	Profit and Loss A/c Dr. To Prov. for discount on debtors
Treatment in Balance sheet	Not applicable	Closing balance of provision for discount is shown on the assets side as a reduction from debtors

Note: The provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors in order to determine the provision for discount on good debtors who make their payment promptly after getting the discount.

Example:

Trial Balance

	Dr.	Cr.
Bad debts	20000	
Discount Allowed	30000	
Debtors	1000000	
Prov. for Doubtful debt		5000
Prov. for Discount		15000

Adjustments:

Create Provision for Doubtful debts @ 3%

Create Provision for Discount @ 5%

10. DISCOUNT RECEIVED & RESERVE FOR DISCOUNT ON CREDITORS

The different accounting treatment in respect of discount received from supplier is as under:-

Method	Without having Reserves for Discount on Creditors A/c	With Reserves for Discount on Creditors A/c
Rule	Transfer discount received as per TB, to the credit side of P&L A/c	Transfer Discount received as per TB, to the reserve account. Maintain reserves up to desired amount
Discount received	Sundry Creditors A/c Dr. To Discount Received	Sundry Creditors A/c Dr. To Discount Received
Tfr of Disc received	Discount Received A/c Dr. To Profit and Loss A/c	Discount Received A/c Dr. To Reserve for disc. on creditors
Creating reserves	There is no such requirement	Reserves for dis. on creditors Dr. To Profit and Loss A/c
Treatment in Balance sheet	Not applicable	Closing balance of Reserve for discount is shown on liabilities side as reduction from sundry creditors.

Note: Provision for discount on creditors is often not provided in keeping with principle of conservatism.

Example :

Trial Balance

	Dr.	Cr.
Prov. for Disc. on Creditors	15000	
Creditors		500000
Discount Received		25000

Create Provision @ 2%

11. GOODS USED OTHER THAN FOR SALE

	Situation	Journal Entry	Treatment in financial Statement
1.	Goods withdrawn for personal use	Drawings A/c Dr. To Purchases A/c	Reduce from capital in B/ sheet. Purchases reduced in Trading A/c
2.	Goods given away as charity/ donation	Donation / Charity A/c Dr. To Purchases A/c	Add to donation / charity A/c Purchases reduced in Trading A/c
3.	Goods distributed as free sample	Samples/Advertisement Dr. To Purchases A/c	Add to samples/advt. in P/L A/c Purchases reduced in Trading A/c
4.	Goods used for construction of building or machinery	Building/Machinery A/c Dr. To Purchases A/c	Add to Assets Cost in B/ sheet Purchases reduced in Trading A/c

13. OTHER MISC. ITEMS

	Adjustment	Journal entry	Treatment in P&L A/c	Treatment in Balance sheet
1.	Interest on capital	Interest on capital A/c Dr. To Capital	Show in debit side of P&L A/c	Add to capital A/c on the liabilities Side.
2.	Interest on drawings	Capital A/c Dr. To Interest on drawings	Show in credit side of P&L A/c	Reduce from capital A/c on liabilities side

SIGNIFICANCE OF MANUFACTURING ACCOUNT

1. Meaning:
   (a) The Manufacturing Account shows the total cost of manufacturing the finished products, with appropriate details and classifications of Cost.
   (b) The debits to this account consist of the cost of materials consumed, Manufacturing Wages and Expenses incurred directly or indirectly on manufacture.
   (c) This Account is relevant only for Manufacturing Entities, and is not applicable for Trading Entities.

2. Purposes:
   (a) This Account provides details of Factory Cost and facilitates reconciliation of financial Books with Cost Records
   (b) It also serves as a basis of comparison of manufacturing operations from year to year.
   (c) Separate Columns provided for Quantity and Values, will enable the entity to ascertain the cost of production per unit of the product.
   (d) It may be useful to have a column for percentage in the Manufacturing A/c showing the cost of each item as a percentage of the total.
   (e) Where the output is carried to the Trading A/c at above cost, e.g. market prices, the Manufacturing Account discloses the Profit or loss on manufacture. This will be used to fix the amount of production or profit sharing bonus when such schemes are in force.

MANUFACTURING ACCOUNT

Manufacturing Account of ....for the year ended.........

Particulars	₹	Particulars	₹
To Raw Material consumed: Opening stock of raw materials Add: Purchases of Raw Materials Less: Closing Stock of Raw Materials Net Balance = Material Consumed To Direct Manufacturing Wages To Direct Expenses, if any To Production Overheads To Opening Stock of WIP		By NRV/ Sale Value of By-Products By Closing Stock of WIP By Net Factory Cost of Production transferred to Trading A/c (Bal. Fig)	
Total		Total	

Trading Account of ....for the year ended.........

Particulars	₹	Particulars	₹
To Opening stock of finished goods To Manufacturing account – Cost of Products To Gross Profit c/d to P&L Account		By Sales By Closing stock of finished goods	
Total		Total	

ITEMS IN MANUFACTURING ACCOUNTS

Item	Explanation	Treatment
1. Material consumed	Cost of Raw Material Consumed during the period= Opening stock of Raw Material Add: Purchases of Raw Materials Less: Closing Stock of Raw Materials	Debit in Mfring Accounts
2. Direct Wages	Wages paid to workers engaged in production process, (i.e., in factory Departments) is debited to the Manufacturing Account.	Debit in Mfring Account
3. Direct Expenses	• Direct Manufacturing Expenses are costs, other than Materials and Wages, which are incurred for a specific product/ service. • Examples: (a) Royalty for use of license/ technology, (b) Hire Charges of Plant / Equipment, if based on units produced.	Debit in Mfring Account
4. Prime cost	Prime cost (or Direct Cost) = Raw Materials Consumed + Direct Wages + Direct Expenses	Sub-Total in Dr. side
5. Indirect Manufacturing Expenses	• These are called Factory Overheads/ Production Overheads/ Works Overheads/ Manufacturing Overheads etc. • It is the Total Indirect costs (Indirect Materials + Indirect Labour + Indirect Expenses) which cannot be linked directly to units produced. • Examples: Factory Rent, Depreciation on Machinery, Depreciation on Factory shed, Repair & Maintenance work, Supervisor's Salary, Consumables like Oils, Lubricants, etc.	Debit in Mfring Account
6. By-Product Revenues	• By-Product is an incidental product, arising during the production operations, having some saleable value. • Examples: Molasses is the by-product in sugar manufacturing • Net Realizable Value of By-product is credited to this account as they generally have insignificant value as compared to main product.	Credit in Mfring Account
7. Factory Cost	It is the Net Cost of Production as shown by Manufacturing A/c (Balancing figure in Manufacturing Account, and is transferred to Trading Account)	Tfd to Trading Acc

Example:

	Opening Stock	Closing Stock
Raw Material	10,000	15,000
Work in Progress	22,000	18,000
Finished Goods	34,000	24,000

Purchase of Raw Material = 2,45,000; Direct Wages = 82,000; Production Overheads = 64,000; Sales = 4,50,000

Compute:

a) Raw Material Consumed

b) Cost of Goods Manufactured

c) Cost of Goods Sold

d) Gross Profit

COMPARISON BETWEEN INCOME STATEMENT AND POSITION STATEMENT

Income Statement	Position Statement
Profit or loss is disclosed in Income Statement prepared at the close of the financial year	It exhibits assets and liabilities of the business as at the close of the financial year.
Income Statement discloses net profit of the business after adjusting from the income earned during the year, all the expenditures of the business incurred in that year.	Position statement discloses the assets and liabilities position as at a particular date
Income Statement is sub-divided into following two parts for a non-manufacturing concern: (i) Trading account; and (ii) Profit and Loss account	Apart from balance sheet, to judge financial position of the business, sometimes additional statements are also prepared like cash flow statement, value added statement etc. which is not mandatory for non-corporate entities. These are prepared for the better understanding of the financial position of the business.

ACCOUNTING TREATMENT - INCOME-TAX

	Sole Proprietorship Firms	Partnership Firms
Nature of Expenses	Income –Tax is considered as a personal expense of the proprietor	Income Tax relating to the firm is considered just like any other expense
Treatment	Income Tax is debited to capital account	Income Tax is debited to P&L A/c
Journal Entry	(a) For payment of Tax during the year: Income –Tax A/c Dr. To Cash/ Bank (b) For transfer to Capital A/c at year end: Capital A/c Dr. To Income-Tax A/c	(a) For payment of Tax during the year: Firm Income –Tax A/c Dr. To Cash/ Bank (b) For provision for tax at year end: Profit & Loss A/c Dr. To Provision for taxation

Effect on Balance sheet	Capital account is reduced to the extent of Income-Tax paid.	If Tax Amount paid > Provision for Taxation:- The difference is shown as "Receivable", i.e., Current Asset If Provision for Taxation > Tax Amount paid:- The difference is shown as " Payable", i.e. Current Liability

Note: In case of partnership firms, if the partners' Personal Income tax is paid out of the firm's resources, it should be treated as drawings and should be debited to their capital account individually.

PROVISION AND RESERVES

Particular	Provision	Reserves
Meaning	Provision is defined as "any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy."	Reserves may be defined as "portion of earning, receipts or other surplus of an enterprise appropriated by the management for a general or a specific purpose.
Relation to profit	Charge against profit	Appropriation of profit
When it can be created?	Provision (for Depreciation, other Expenses and liabilities) should be created even if there is no profit.	Reserve cannot be created unless there is a profit.
Nature	Provisions are a necessity, based on accounting principles.	Generally, reserves are optional, based on managerial discretion.
P& L A/c disclosure	Provisions are shown above the line.	Appropriation for reserve is made below the line
B/sheet disclosure	Provisions are shown as a deduction from the respective assets, on the assets side.	Reserves are shown generally on the liabilities side.

Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

Example: ***(ICAI Study Material)***

Crimpson traders Profit and Loss Account for the year ended 31st March, 2023 includes the following information:

1	Depreciation	57,500
2	Bad debts written off	21,000
3	Increase in provision for doubtful debts	18,000
4	Retained profit for the year	20,000
5	Liability for tax	4,000

State which one of the items (1) to (5) above are – (a) transfer to provisions; (b) transfer to reserves; and (c) neither related to provisions nor reserves.

LIMITATIONS OF FINANCIAL STATEMENTS

Historical Cost	Financial statements are prepared only on the basis of the money value prevailing at the time the transaction were entered into. Thus, the effect of subsequent changes in the value of money is not taken into account.
Intangible strengths and weaknesses	An organization may have a number of strengths and weaknesses which cannot be shown in the balance sheet e.g., the loyalty and calibre of its staff.
Perpetual continuity and periodical account	Financial statements ordinarily are drawn up at the end of each year but the accounting record is maintained on the assumption that the business undertaking shall continue to exist forever on the basis of going concern assumption.
Different accounting policies	It is permissible for an organization within certain limits to adopt different policies for the preparation of accounts, valuation of various assets and distribution of expenditure over different periods of account.
Management policies	Management can have different accounting policies for welfare of the staff and public at large.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no.______

The following is the Trial Balance of Mr. Wanchoo on 31st March 2023.

Trial Balance on 31st March, 2023

Particulars	Debit (₹)	Credit (₹)
Capital Account		10,00,000
Inventories as on 1st April, 2022	2,00,000	
Cash in hand	1,44,000	
Machinery Account	7,36,000	
Purchases Account	18,20,000	
Wages Account	10,00,000	
Salaries Account	10,00,000	
Discount Allowed A/c	50,000	
Discount Received A/c		30,000
Sundry Office Expenses Account	6,00,000	
Sales Account		50,00,000
Sums owing by customer (Trade receivables)	8,50,000	
Trade payables (sums owing to suppliers)		3,70,000
Total	64,00,000	64,00,000

Value of Closing Inventory on 31st March 2023 was ₹ 2,70,000

Pass closing entries for the above items. Prepare Trading Account, Profit & Loss Account & Balance Sheet.

Question 2 *(ICAI Study Material)* Pg no.______

Trial Balance for financial year ended 31st March 2023 of Deepakshi shows following details:

Particulars	Debit (₹)	Credit (₹)
Purchase & Sales	10,00,000	12,00,000
Debtors & Creditors	5,00,000	4,00,000
Opening Stock	2,00,000	
Closing Stock	3,00,000	
Other Expenses & Incomes	7,00,000	9,00,000
Fixed Assets & Long Term Liabilities	25,00,000	6,00,000
Capital		21,00,000
Total	52,00,000	52,00,000

Additional Information: Creditors balance on 1st April 2022 is ₹ 3,00,000

You are required to calculate cost of goods sold and amount paid to creditors during year.

Question 3 *(ICAI Study Material)* Pg no.______

The balance sheet of Thapar on 1st April, 2022 was as follows:

Liabilities	Amount	Assets	Amount
Trade payables	15,00,000	Plant & Machinery	30,00,000
Expenses Payable	1,50,000	Furniture & Fixture	3,00,000
Capital	50,00,000	Trade receivables	14,00,000
		Cash at Bank	6,50,000
		Inventories	13,00,000
	66,50,000		66,50,000

During 2022-23, his Profit and Loss Account revealed a net profit of ₹18,30,000. This was after allowing for the following:
(a) Rent received from property let out ₹3,00,000
(b) Depreciation on Plant and Machinery @ 10% and on Furniture and Fixtures @ 5%.
(c) A provision for Doubtful Debts @ 5% of the trade receivables as at 31st March, 2023.
But while preparing the Profit and Loss Account he had forgotten to provide for (1) outstanding expenses totaling ₹1,80,000 and (2) prepaid insurance to the extent of ₹20,000.

His current assets and liabilities on 31st March, 2023 were: Inventories ₹ 14,50,000; Trade receivables ₹ 20,00,000; Cash at Bank ₹ 10,35,000 and Trade payables ₹ 11,40,000.
During the year he withdrew ₹6,00,000 for domestic use.
Draw up his Balance Sheet at the end of the year.

Question 4 *(ICAI Study Material)* *Pg no._____*

Mr. Birla is a proprietor engaged in business of trading electronics. An excerpt from his Trading & P&L account is as follows:

Particulars	Amount	Particulars	Amount
To Cost of Goods Sold	45,00,000	By Sales	C
To Gross Profit c/d	D		
	F		F
To Rent	26,00,000	By Gross Profit b/d	D
To Office Expenses	13,00,000	By Miscellaneous Income	E
To Selling Expenses	B		
To Commission to Manager (on Net Profit before charging such commission)	2,00,000		
To Net Profit	A		
	G		60,00,000

Commission is charged at the rate of 10%.
Selling Expenses amount to 1% of total sales.
You are required to compute the missing figures.

Question 5 *(ICAI Study Material)* *Pg no._____*

Sengupta & Co. employs a team of eight workers who were paid ₹30,000 per month each in the year ending 31st March, 2022. At the start of financial year 2022-23, the company raised salaries by 10% to ₹33,000 per month each.
On October 1, 2022 the company hired two trainees at salary of ₹21,000 per month each. The work force are paid salary on the first working day of every month, one month in arrears, so that the employees receive their salary for January on the first working day of February etc.
You are required to calculate:
a) Amount of salaries which would be charged to the profit and loss for the year ended 31st March, 2023.
b) Amount actually paid as salaries during 2022-23
c) Outstanding Salaries as on 31st March, 2023.

Question 6 *(ICAI Study Material)* *Pg no._____*

Mr. Kotriwal is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March 2023 has been given below:

On 1.4.2022 he had a balance of ₹ 2,00,000 advance from customers of which ₹ 1,50,000 is related to year 2022-23 while remaining pertains to year 2023-24. During the year 2022-23 he made cash sales of ₹ 5,00,000. You are required to compute:

a) Total income for the year 2022-23.

b) Total money received during the year if the closing balance in advance from customers account is ₹ 1,70,000.

Question 7

*Pg no.*_____

From the following trial balance & additional information prepare Provision for Doubtful Debts Accounts & Provision for Discount on Debtors Account. Make balance sheet extract.

Particulars	Debit (₹)	Credit (₹)
Bad Debts	14,000	
Discount Allowed	11,000	
Provision for Doubtful Debts		10,000
Provision for Discount on Debtors		5,700
Sundry Debtors	5,15,000	

Additional Information:

1) Further Bad Debts ₹ 9,000 & Further Discount Allowed ₹ 6,000
2) Create Provision for Doubtful Debts @ 5% & Provision for Discount on Debtors @ 3%

Question 8

*Pg no.*_____

From the following balances and information, prepare Trading and Profit and Loss Account of Mr. X for the year ended 31st March, 2023 and a Balance Sheet as on that date:

	Dr. (₹)	Cr. (₹)
X's Capital Account	-	10,000
Plant and Machinery	3,600	-
Depreciation on Plant and Machinery	400	-
Repairs to Plant	520	-
Wages	3,400	-
Salaries	2,100	-
Income-tax of Mr. X	100	-
Cash in Hand and at Bank	400	-
Land and Building	14,900	-
Depreciation on Building	500	-
Purchases	25,000	-
Purchases Return	-	300
Sales	-	49,800
Bank Overdraft	-	760
Accrued Income	300	-
Salaries Outstanding	-	400
Bills Receivable	5,000	-
Provision for Bad Debts	-	1,000
Bills Payable	-	1,600
Bad Debts	200	-
Discount on Purchases	-	708
Debtors	7,000	-
Creditors	-	6,252
Opening Stock	7,400	-
	70,820	70,820

Information:-

a) Stock on 31st March, 2023 was ₹ 6,000.
b) Write off further ₹600 for Bad Debt and maintain a provision for Bad Debts at 5% on Debtors.
c) Goods costing ₹ 1,000 were sent to customer for ₹ 1,200 on 30th March, 2023 on sale or return basis. This was recorded as actual sales.
d) Received ₹ 2,000 worth of goods on 28th March, 2023 but the invoice of Purchase was not recorded in Purchases Book.
e) ₹ 240 paid as rent of the office were debited to Landlord account and were included in the list of debtors.
f) General Manager is to be given commission at 10% of net profit after charging the commission of the works manager and his own.
g) Works manager is to be given commission at 12% of net profit before charging the commission of General Manager and his own.

Question 9 *(ICAI Study Material)* *Pg no._____*

From the following particulars extracted from the books of Ganguli, Prepare Trading and Profit and Loss Account and Balance Sheet as at 31st March, 2023 after making the necessary adjustments:

Ganguli's capital account (Cr.)	5,40,500	Interest received	7,250
Stock on 1.4.2022	2,34,000	Cash with Traders Bank Ltd.	40,000
Sales	14,48,000	Discounts received	14,950
Sales return	43,000	Investments (at 5%) as on 1.4.2022	25,000
Purchases	12,15,500	Furniture as on 1-4-2022	9,000
Purchases return	29,000	Discounts allowed	37,700
Carriage inwards	93,000	General expenses	19,600
Rent	28,500	Audit fees	3,500
Salaries	46,500	Fire insurance premium	3,000
Sundry debtors	1,20,000	Travelling expenses	11,650
Sundry creditors	74,000	Postage and telegrams	4,350
Loan from Dena Bank Ltd. at 12%	1,00,000	Cash in hand	1,900
Interest paid	4,500	Deposits at 10% as on 1-4-2022 (Dr.)	1,50,000
Printing and stationery	17,000	Drawings	50,000
Advertisement	56,000		

Adjustments:

a) Value of stock as on 31st March, 2023 is ₹ 3,93,000. This includes goods returned by customers on 31st March, 2023 to the value of ₹ 15,000 for which no entry has been passed in the books.
b) Purchases include furniture purchased on 1st January, 2023 for ₹10,000.
c) Depreciation should be provided on furniture at 10% per annum.
d) The loan account from Dena bank in the books of Ganguli appears as follows:

31.3.2023 To Balance c/d	1,00,000	01.4.2022 By Balance b/d	50,000
		31.3.2023 By Bank	50,000
	1,00,000		1,00,000

e) Sundry debtors include ₹ 20,000 due from Robert & sundry creditors include ₹ 10,000 due to him.
f) Interest paid include ₹ 3,000 paid to Dena bank.

g) Interest received represents ₹ 1,000 from the sundry debtors (due to delay on their part) and the balance on investments and deposits.
h) Provide for interest payable to Dena bank and for interest receivable on investments and deposits.
i) Make provision for doubtful debts at 5% on the balance under sundry debtors. No such provision need to be made for the deposits.

Question 10 *(ICAI Study Material)* *Pg no._____*

The following is the schedule of balances as on 31.3.23 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of M/s Gavaskar & Co., at Mumbai:

Particulars	Dr.	Cr.
Cash in hand	14,000	
Cash at bank	26,000	
Sundry Debtors	8,60,000	
Stock on 1.4.2022	6,20,000	
Furniture & fixtures	2,14,000	
Office equipment	1,60,000	
Buildings	6,00,000	
Motor Car	2,00,000	
Sundry Creditors		4,30,000
Loan from Raj		3,00,000
Provision for bad debts		30,000
Purchases	14,00,000	
Purchase Returns		26,000
Sales		23,00,000
Sales Returns	42,000	
Salaries	1,10,000	
Rent for Godown	55,000	
Interest on loan from Raj	27,000	
Rates & Taxes	21,000	
Discount allowed to Debtors	24,000	
Discount received from Creditors		16,000
Freight on purchases	12,000	
Carriage Outwards	20,000	
Drawings	1,20,000	
Printing and Stationery	18,000	
Electricity Charges	22,000	
Insurance Premium	55,000	
General office expenses	30,000	
Bad Debts	20,000	
Bank charges	16,000	
Motor car expenses	36,000	
Capital A/c		16,20,000
Total	47,22,000	47,22,000

Prepare Trading and Profit and Loss Account for the year ended 31st March 2023 and the Balance Sheet as at that date after making provision for the following:

a) Depreciate: (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for ₹ 14,000 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for ₹ 40,000 has been wrongly debited to purchase; and (d) Motor car by 20%.

b) Value of stock at the close of the year was ₹ 4,40,000.
c) Two month's rent for godown is outstanding.
d) Interest on loan from Raj is payable at 12 % per annum, this loan was taken on 1.5.2022.
e) Reserve for bad debts is to be maintained at 5 percent of Sundry Debtors.
f) Insurance premium includes ₹ 40,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2022 to 30.6.23.

Question 11 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2021) (Similar)* *Pg no.______*

The following are the balances as at 31st March, 2023 extracted from the books of Mr. XYZ

	₹
Plant and Machinery	19,550
Furniture and Fittings	10,250
Bank Overdraft	80,000
Capital Account	65,000
Drawings	8,000
Purchases	1,60,000
Opening Stock	32,250
Wages	12,165
Provision for doubtful debts	3,200
Provision for Discount on Debtors	1,375
Sundry Debtors	1,20,000
Sundry Creditors	47,500
Bad Debts	1,100
Bad Debts recovered	450
Salaries	22,550
Salaries payable	2,450
Prepaid rent	300
Rent	4,300
Carriage inward	1,125
Carriage Outward	1,350
Sales	2,15,300
Advertisement Expenses	3,350
Printing and Stationery	1,250
Cash in Hand	1,450
Cash at Bank	3,125
Office Expenses	10,160
Interest paid on Loan	3,000

Additional Information:

a) Purchases include sales return of ₹ 2,575 and sales include purchases return of ₹ 1,725.
b) Goods withdrawn by Mr. XYZ for own consumption ₹ 3,500 included in purchases.
c) Wages paid in the month of April for Installation of Plant and Machinery amounting to ₹ 450 were included in wages account.
d) Free samples distributed for Publicity costing ₹ 825.
e) Create a provision for doubtful debts @ 5% and provision for discount on debtors @ 2.5%.
f) Depreciation is to be provided on Plant and Machinery @ 15% p.a. and on furniture and fittings @ 10% p.a.

g) Bank overdraft is secured against hypothecation of stock. Bank overdraft outstanding as on 31.3.2023 has been considered as 80% of real value of stock (deducting 20% as margin) and after adjusting the marginal value 80% of the same has been allowed to draw as on overdraft.

Prepare Trading and Profit Loss Account for the year ended 31st March, 2023, and a Balance Sheet as on that date. Also show the rectification entries.

Question 12 *(RTP May 2019) / (RTP Nov 2020) / (RTP Nov 2022) (Similar)* Pg no._____

The following is the Trial Balance of T on 31st March, 2023:

Particulars	Dr. (₹)	Cr. (₹)
Capital		6,00,000
Drawings	70,000	
Fixed Assets (Opening)	1,40,000	
Fixed Assets (Additions 01.10.2022)	2,00,000	
Opening Stock	60,000	
Purchases	16,00,000	
Purchases Returns		69,000
Sales		22,00,000
Sales Returns	99,000	
Debtors	2,50,000	
Creditors		2,20,000
Expenses	50,000	
Fixed Deposit with Bank	2,00,000	
Interest on Fixed Deposit		20,000
Bank Overdraft		8,000
Suspense A/c		2,000
Depreciation	14,000	
Rent (17 months upto 31.8.2023)	17,000	
Investments 12% (01.08.2022)	2,50,000	
Cash & Bank Balance	1,69,000	
Total	31,19,000	31,19,000

Stock on 31st March, 2023 was valued at ₹ 1,00,000. Depreciation is to be provided at 10% per annum on fixed assets purchased during the year. A scrutiny of the books of account revealed the following matters:

(i) ₹ 20,000 drawn from bank was debited to Drawings account, but out of this amount withdrawn ₹ 12,000 was used in the business for day-to-day expenses.

(ii) Purchase of goods worth ₹ 16,000 was not recorded in the books of account upto 31.03.2023, but the goods were included in stock.

(iii) Purchase returns of ₹ 1,000 was recorded in Sales Return Journal and the amount was correctly posted to the Party's A/c on the correct side.

(iv) Expenses include ₹ 6,000 in respect of the period after 31st March, 2023.

Give the necessary Journal Entries in respect of (i) to (iv) and prepare the Final Accounts for the year ended 31st March, 2023.

Question 13 *(ICAI Study Material)* Pg no._____

1,00,000 units were produced in a factory. Per unit material cost was ₹10 and per unit labour cost was ₹5. That apart it was agreed to pay royalty @ ₹ 3 per unit to the Japanese collaborator who supplied technology. Calculate Manufacturing Cost.

Question 14 *(ICAI Study Material)* Pg no._____

Mr. Vimal runs a factory which produces soaps. Following details were available in respect of his manufacturing activities for the year ended on 31.3.2023:

Opening Work-in-Process (10,000 units)	16,000
Closing Work-in-Process (12,000 units)	20,000
Opening inventory of Raw Materials	1,70,000
Closing inventory of Raw Materials	1,90,000
Purchases	8,20,000
Hire charges of machine @ ₹ 0.60 per unit manufactured	
Hire charges of factory	2,20,000
Direct wages-Contracted @ ₹ 0.80 per unit manufactured and @ ₹ 0.40 per unit of Closing W.I.P.	
Repairs and Maintenance	1,80,000
Units produced – 5,00,000 units	

Prepare a Manufacturing Account of Mr. Vimal for the year ended 31.3.2023.

Question 15 *(ICAI Study Material)* Pg no._____

Following are the Raw Material A/c, Creditors A/c and Manufacturing A/c provided by Ms. Shivi related to 2022-23. There are certain figures missing from these accounts.

Raw Material A/c

Particulars	Amount	Particulars	Amount
To Opening Stock A/c	1,00,000	By Raw Material Consumed	______
To Creditors A/c	______	By Closing Stock A/c	______

Creditors A/c

Particulars	Amount	Particulars	Amount
To Bank A/c	22,00,000	By Balance b/d	15,00,000
To Balance c/d	6,00,000		

Manufacturing A/c

Particulars	Amount	Particulars	Amount
To Raw Material Consumed	______	By Trading A/c	17,94,000
To Wages	3,50,000		
To Depreciation	2,00,000		
To Direct Expenses	2,44,000		

Additional Information:

1) Purchase of machinery worth ₹ 10,00,000 has been omitted. Machinery are chargeable at a depreciation rate of 10%.
2) Wages include the following
   - Paid to Factory Workers - ₹ 3,00,000
   - Paid to labour at office - ₹ 50,000
3) Direct Expenses include following:
   - Electricity charges of ₹ 80,000 of which 30% pertained to office.
   - Fuel Charges of ₹ 20,000
   - Freight Inwards of ₹ 35,000
   - Delivery charges to customers - ₹ 20,000.

You are required to prepare Revised Manufacturing A/c, Raw Material A/c & Creditors A/c.

Question 16 *(CA Foundation Dec 2021) (15 Marks)/(ICAI Study Material)(Similar)* *Pg no._____*

On 31st March, 2023 the Trial Balance of Mr. Black were as follows:

Particulars	Debit (₹)	Particulars	Credit (₹)
Stock on 1st April 2022		Sundry Creditors	1,50,000
Raw Materials	2,10,000	Bills Payable	75,000
Work in Progress	95,000	Sale of Scrap	25,000
Finished goods	1,55,000	Commission Received	4,500
Sundry Debtors	2,40,000	Provision for doubtful debts	16,500
Carriage on Purchases	15,000	Capital Account	10,00,000
Bills Receivable	1,50,000	Sales	16,72,000
Wages	1,30,000	Bank Loan	85,000
Salaries	1,00,000		
Telephone, Postage etc.	10,000		
Repairs to Office Furniture	3,500		
Cash at Bank	1,70,000		
Office Furniture	1,00,000		
Repairs to Plant	11,000		
Purchases	8,50,000		
Plant and Machinery	7,00,000		
Rent	60,000		
Lighting	13,500		
General Expenses	15,000		
	30,28,000		30,28,000

The following additional information is available:

a) Stocks on 31st March, 2023 were:
   Raw Materials ₹1,62,000 Finished goods ₹1,81,000 Work in Progress ₹ 78,000

b) Salaries and wages unpaid for March 2023 were respectively, ₹ 9,000 and ₹ 20,000

c) Machinery is to be depreciated by 10% and office furniture by 7 1/2 %

d) Provision for doubtful debts is to be maintained @ 1% of sales

e) Rent is to be charged as to 3/4 to factory and 1/4 to office.

f) Lighting is to be charged as to 2/3 to factory and 1/3 to office.

Prepare the Manufacturing Account, Trading Account, Profit and Loss Account for the year ended on 31st March 2023.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) A debit to an account may
   (a) increase expense
   (b) decrease an asset.
   (c) increase a liability.

2) Prepayment of insurance premium will appear in the Balance Sheet and in the Insurance Account respectively as:
   (a) a liability and a debit balance.
   (b) an asset and a debit balance.
   (c) an asset and a credit balance.

3) Gross profit is the difference between:
   (a) Sales and purchases
   (b) Sales and cost of sales.
   (c) Sales and total expenses.

4) Payment made to a creditor subject to cash discount will :
   (a) reduce a liability, reduce an asset and add to expenses.
   (b) reduce a liability, add to an asset, and add to revenue.
   (c) reduce an asset, reduce a liability, and add to revenue.

5) A customer returns goods already charged to him. We should:
   (a) debit his account.
   (b) credit his account.
   (c) make no entry on his account.

6) Capital is the difference between
   (a) Income and expenses
   (b) Sales and Cost of goods sold
   (c) Assets and liabilities

7) The capital of a sole trader would change as a result of:
   (a) A creditor being paid his account by cheque.
   (b) Raw materials being purchased on credit.
   (c) Wages being paid in cash.

8) A decrease in the provision for doubtful debts would result in:
   (a) An increase in liabilities.
   (b) A decrease in working capital.
   (c) An increase in net profit.

9) A Company wishes to earn a 20% profit margin on selling price. Which of the following is the profit mark up on cost, which will achieve the required profit margin?
   (a) 33%
   (b) 25%
   (c) 20%

10) If sales is ₹ 2,000 and the rate of gross profit on cost of goods sold is 25%, then the cost of goods sold will be
    (a) ₹ 2,000.
    (b) ₹ 1,500.
    (c) ₹ 1,600.

11) Sales for the year ended 31st March, 2023 amounted to ₹ 10,00,000. Sales included goods sold to Mr. A for ₹ 50,000 at a profit of 20% on cost. Such goods are still lying in the godown at the buyer's risk. Therefore, such goods should be treated as part of
    (a) Sales.
    (b) Closing Inventory.
    (c) Goods in transit.

12) If sales revenues are ₹4,00,000; cost of goods sold is ₹ 3,10,000 and expenses are ₹60,000, the gross profit is
    (a) ₹ 30,000.
    (b) ₹ 90,000.
    (c) ₹ 3,40,000.

13) Under-statement of closing work in progress in the period will
    (a) Understate cost of goods manufactured in that period.
    (b) Overstate current assets.
    (c) Understate net income in that period.
    (d) None of the three.

14) Sales is equal to
    (a) Cost of goods sold – Gross profit.
    (b) Cost of goods sold + Gross profit.
    (c) Gross profit – Cost of goods sold.
    (d) Net profit + cost of goods sold.

15) Indirect Manufacturing expenses are also called
    (a) Manufacturing overhead.
    (b) Production overhead.
    (c) Works overhead.
    (d) All the three.

16) Sale value of the by-product is credited to
    (a) Manufacturing account.
    (b) Capital account.
    (c) Overheads account.
    (d) Trading account.

17) Manufacturing account shows
    (a) Total cost of manufacturing the finished products.
    (b) It provides details of factory cost.
    (c) It facilitates reconciliation of financial books with cost records.
    (d) All the three.

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) The income statement shows either net profit or net loss for a particular period.
2) Gains from the sale or exchange of assets are not considered as the revenue of the business.
3) The salary paid in advance is not an expense because it neither reduces assets nor increases liabilities.
4) A loss is an expenditure which does not bring any benefit to the concern.
5) All liabilities which become due for payment within the year are classified as long-term liabilities.
6) The term current asset is used to designate cash and other assets or resources which are reasonably expected to be realized or sold or consumed within one year.
7) An asset gives rise to expenditure when it is acquired and to an expense when it is consumed.
8) If the balance of an account is on the debit side of the trial balance where the benefit has already expired then it is treated as an expense.
9) Sales less cost of goods sold = gross profit.
10) If the debit side of the trading account exceeds its credit side then balance is termed as gross profit.
11) The provision for bad debts is debited to Sundry Debtors Account. *(Dec 2021)*
12) The provision for discount on creditors is often not provided in keeping with the principle of conservatism. *(Dec 2022)*
13) The debts written-off as bad, if recovered subsequently are credited to debtor's account.
14) The adjustment entry in respect of income received in advance is debit Income received in advance account and credit income account.
15) Premium paid on the life policy of a proprietor is debited to profit and loss account.
16) Depreciation account appear in the trial balance is taken only to profit and loss account.
17) Personal purchases included in the purchases day book are added to the sales account in the Trading account.
18) Medicines given to the office staff by a manufacturer of medicines will be debited to salaries account.
19) Goods worth ₹ 600 taken by the proprietor for personal use should be credited to Capital Account.
20) If Closing Stock appears in the Trial Balance, the closing inventory is then not entered in Trading Account. It is shown only in the balance sheet. *(Nov 2018)*
21) By-products valued at cost or net realisable value whichever is lower.
22) The manufacturing account is prepared to ascertain the profit or loss on the goods produced.
23) If there remain unfinished goods at the beginning and at the end of the accounting period, cost of such unfinished goods is shown in the Manufacturing Account.
24) Raw Material Consumed = Opening inventory of Raw Materials + Purchases – Closing inventory of Raw Materials.
25) The Trading Account will show the quantities of finished goods, raw materials and work-in-progress.
26) Overhead is defined as the total cost of direct material, direct wages and direct expenses. *(June 2023)*
27) Manufacturing A/c is prepared by an enterprise engaged in trading activities.
28) Profit and Loss Account shows the financial position of the concern.

29) The provision for discount on debtors is calculated after deducting the provision for doubtful debts from Debtors.
30) Freight paid on purchases of goods is added to the amount of purchases.
31) The debit balance in the Profit and Loss Account is surplus.
32) Capital is all assets less fictitious assets.
33) Under the 'Liquidity approach', assets which are most liquid are presented at the bottom of the Balance Sheet.
34) Goodwill is a fictitious asset.
35) Sundry debtors are liquid assets.
36) A withdrawal of cash from the business by the proprietor should be charged to profit and loss account as an expense.
37) Stock at the end, if appears in the Trial Balance, is taken only to the Balance Sheet.
38) Inventory by-product should be valued at net realisable value where cost of any product can be separately determined.
39) All the personal & real accounts are recorded in P&L A/c.
40) Goodwill is intangible asset therefore it cannot be valued.
41) Outstanding salaries for the previous year shall be shown as liability in the current year balance sheet.
42) The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business.
43) Sale of office furniture should be credited to Profit and Loss Account.
44) The sale value of by-product is credited to Trading Account.

Solution

1) True: Profit and loss account shows either net profit or net loss for a particular period.
2) False: Gains from the sale or exchange of assets are considered as the revenue of the business. But this revenue not in the ordinary course of business so it is capital receipts.
3) True: Salary paid in advance relates to the coming accounting period. It has nothing to do with the current period. Hence it is not taken in the Profit and Loss Account as an expense. It is shown as a Current Asset in the Balance Sheet.
4) True: A loss is an expenditure of the business which does not bring any gain to the business.
5) False: All liabilities which become due for payment within one year are classified as current liabilities.
6) True: Current assets are all the assets which are expected to be realized or sold or consumed within one year.
7) True: When an asset is purchased, capital expenditure is incurred and when asset is put to use expenses are incurred in consumption.
8) True: Debit balance of accounts are treated as expenses whose benefit is already received or expired.
9) True: Gross profit is obtained by deducting cost of goods sold from sales.
10) False: If the debit side of the trading account exceeds its credit side then the balance is termed as gross loss.
11) False: Provision for bad debts is debited to Profit and Loss Account, in Balance Sheet it is shown either on liability side or deducted from the head Debtors.
12) True: According to the provision of conservatism provision is maintained for the losses to be incurred in future. Discount on creditors is an income so provision is not maintained.
13) False: It will be credited to Bad debtors Recovered Account & becomes an income

14) False: Income received in advance is reduced from the concerned income in profit and loss account. And, it is shown as a liability in the balance sheet under the head Current Liabilities.
15) False: Premium paid on the life policy of a proprietor is to be debited to capital account, as it is personal expense.
16) True: Depreciation is charge on each of the asset on a certain percentage. Depreciation is a charge to profit and loss account and should be debited to profit & loss account by crediting the respective assets. If it appears in trial balance then it is taken only to profit and loss account.
17) False: Personal purchases included in the purchases day book are deducted from the purchases account in the Trading account.
18) True: Any benefit given to the staff is debited to the salary account.
19) False: Goods taken by the proprietor for personal use should be credited to Purchase Account as less goods are left in the business for sale.
20) True: The closing stock appears in the trial balance only when it is adjusted against purchases by passing the entry (in which Closing Stock A/c is debited and Purchases A/c is credited). In this case, closing stock is not entered in Trading Account and is shown only in Balance sheet.
21) False: By-products generally have insignificant value as compared to the value of main product. Therefore, they are generally valued at net realizable value.
22) False: The objective of preparing Manufacturing Account is to determine manufacturing costs of finished goods for assessing the cost effectiveness of manufacturing activities.
23) True: Manufacturing account deals with the raw material and work in progress & their opening & closing stock are shown in Manufacturing Account
24) True: Raw Material consumed is arrived at after adjustment of opening and closing inventory of raw materials and purchases.
25) False: The Trading Account will show the quantities of finished goods manufactured and sold and the opening and closing inventory. It will not show the quantity of raw materials or work-in-progress.
26) False: Overhead is defined as total cost of indirect material, indirect wages and indirect expenses. Indirect material, wages & expenses cannot be directly linked to unit produced.
27) False: Manufacturing A/c is prepared by the entities engaged in manufacturing activities
28) False: Balance sheet shows the entire financial position of the business.
29) True: The provision for discount on debtors is calculated after deducting the provision for doubtful debts from debtors in order to determine the provision for discount on good debtors who make their payment promptly after getting the discount.
30) True: Such freight paid on the purchases of goods is included in the cost of purchase.
31) False: The Debit balance in P & L A/c is a loss because expenses are more than revenue.
32) False: Capital is all assets less (fictitious assets and outside or external liabilities.)
33) False: When assets & liabilities are arranged according to their realizability and payment preferences in such case the assets which are most liquid are presented at the top of the Balance Sheet.
34) False: Goodwill is not a fictitious asset. It is an intangible asset.
35) True: Liquid asset are those assets which are readily converted into cash and will include cash balance, bills receivable, Sundry debtors and short term investments. But it does not include prepaid expenses and inventories.
36) False: Cash withdrawal by the proprietor from his business should be treated as his drawings and not a business expense chargeable to profit and loss account. Such drawings should be deducted from the proprietor's capital.

37) True: Because it depicts that one aspect of the double entry has been completed. The closing Stock appears in the trial balance only when it is adjusted against purchases by passing the entry. In this case, closing stock is not entered in Trading Account and is shown only in Balance Sheet.
38) False: Inventory of by-product is valued at NRV where the cost of by-product cannot be separately determined as they do not involve any intentional input for production.
39) False: All the personal & real account are recorded in balance sheet
40) False: Even though Goodwill is intangible asset it can be valued in terms of money. It can be measured in terms of physical units.
41) False: It shall be disclosed as a current liability in the opening balance sheet.
42) True: The profit on sale of capital assets should not be added to revenue to ascertain profit since it has not been earned due to normal business operations.
43) False: Sale of office furniture should be credited to Furniture account since it is a capital receipt.
44) False: The sale value of the by-product is credited to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no.______*

Particulars	₹
Opening Inventory	1,00,000
Purchases	6,72,000
Carriage Inwards	30,000
Wages	50,000
Sales	11,00,000
Returns inward	1,00,000
Returns outward	72,000
Closing Inventory	2,00,000

From the above information, prepare Trading Account of M/s. ABC Traders for the year ended 31st March, 2023 and Pass necessary closing entries in the journal proper of M/s. ABC Traders

Question 2 *(ICAI Study Material)* *Pg no.______*

Mr. Mohan gives you the following trial balance and some other information:

Trial Balance as on 31st March, 2023

Particulars	Debit (₹)	Credit (₹)
Capital Account		6,50,000
Sales		9,70,000
Purchases	4,30,000	
Opening Inventory	1,10,000	
Freights Inward	40,000	
Salaries	2,10,000	
Other Administration Expenses	1,50,000	
Furniture	3,50,000	
Trade receivables and Trade payables	2,10,000	1,90,000
Returns	20,000	12,000
Discounts	19,000	9,000
Bad Debts	5,000	
Investments in Government Securities	1,00,000	
Cash in Hand and Cash at Bank	1,89,000	
Input CGST	10,000	
Input SGST	10,000	
Output CGST		8,000
Output SGST		8,000
Output IGST		6,000
Total	18,53,000	18,53,000

(i) Closing Inventory was ₹ 1,80,000; (ii) Depreciate Furniture @ 10% p.a.

Prepare Trading and Profit and Loss Account for the year ended on 31.3.2023 and Balance Sheet of Mr. Mohan as on that date.

Question 3 *(ICAI Study Material)* *Pg no.______*

Shri Mittal gives you the following Trial Balance and some other information:

Trial Balances as on 31st March, 2023

Particulars	Debit (₹)	Credit (₹)
Capital Account		8,70,000
Purchases and Sales	6,05,000	12,10,000

Opening Inventory	72,000	
Trade receivables and Trade payables	90,000	1,70,000
14% Bank Loan (loan taken at year end)		2,00,000
Overdrafts (overdraft taken at year end)		1,12,000
Salaries	2,70,000	
Advertisements	1,10,000	
Other expenses	60,000	
Returns	40,000	30,000
Furniture	4,50,000	
Building	8,90,000	
Cash in Hand	2,000	
Input CGST	9,000	
Input SGST	9,000	
Output IGST		15,000
Total	26,07,000	26,07,000

Closing Inventory on 31st March, 2023 was valued at ₹ 1,00,000. Prepare final accounts.

Question 4 *(ICAI Study Material)* Pg no._____

You are required, prepare a Trading and Profit and Loss Account for the year ending 31st March, 2023 and a Balance Sheet as on that date from the Trial Balance given below:

Particulars	Debit	Credit
Trade receivables	3,50,000	
Inventory 1st April, 2022	5,00,000	
Cash in Hand	5,60,000	
Wages	3,00,000	
Bad Debts	50,000	
Furniture and Fixtures	1,50,000	
Depreciation	1,50,000	
Salaries	2,20,000	
Purchases	12,50,000	
Plant and Machinery	15,70,000	
Capital		25,00,000
Trade payables		9,00,000
Sales		17,00,000
	51,00,000	51,00,000

On 31st March, 2023 the Inventory was valued at ₹10,00,000.

Question 5 *(ICAI Study Material)* Pg no._____

Revenue, Expenses and Gross Profit Balances of M/s ABC Traders for the year ended on 31st March 2023 were as follows:

Gross Profit ₹4,20,000, Salaries ₹1,10,000, Discount (Cr.), ₹18,000, Discount (Dr.) ₹ 19,000, Bad Debts ₹17,000, Depreciation ₹65,000, Legal Charges ₹ 25,000, Consultancy Fees ₹32,000, Audit Fees ₹ 1,000, Electricity Charges ₹17,000, Telephone, Postage and Telegrams ₹ 12,000, Stationery ₹ 27,000, Interest paid on Loans ₹70,000.

Prepare Profit and Loss Account of M/s ABC Traders for the year ended on 31st March, 2023. Show necessary closing entries in the Journal Proper of M/s. ABC Traders also.

Question 6 *(ICAI Study Material)* Pg no._____

Given below Trial Balance of M/s Dayal Bros. as on 31st March, 2023:

Particulars	Debit (₹)	Credit (₹)
Capital Account		7,00,000
Land and Building	3,00,000	
14% Term Loan		4,00,000
Loan from M/s. D & Co.		4,60,000
Trade receivables	4,20,000	
Cash in hand	20,000	
Inventories in Trade	6,00,000	
Furniture	2,00,000	
Trade payables		40,000
Advances to Suppliers	1,00,000	
Net Profit		1,00,000
Drawings	60,000	
Total	17,00,000	17,00,000

Prepare Balance Sheet as on 31st March, 2023.

Question 7 *(ICAI Study Material)* *Pg no._____*

From the given balance sheet pass the relevant opening entry

BALANCE SHEET As at 31st March, 2023

Liabilities	Amount	Assets	Amount
Mahendra & Sons	5,60,000	Cash in hand	43,000
Capital	20,00,000	Cash at Bank	2,67,500
		Trade receivables	7,49,500
		Closing Inventory	9,00,000
		Machinery and Equipment	6,00,000
	25,60,000		25,60,000

Question 8 *(ICAI Study Material)* *Pg no._____*

The Balance Sheet of Mr. PopatLal, a merchant on 31st March, 2023 stood as below:

Liabilities	Amount	Assets		Amount
Capital	2,40,000	Fixed Assets		1,25,600
Trade payables	1,64,000	Inventories		2,06,400
Bank Overdraft	1,46,000	Trade receivables	1,88,000	
		Less: Provision	(6,200)	1,81,800
		Cash		36,200
	5,50,000			5,50,000

Show opening journal entry on 1st April, 2023 in the books of Mr. PopatLal.

Question 9 *(ICAI Study Material)* *Pg no._____*

On 1st April 2022 provision for Doubtful Debts existed at ₹ 40,000. Trade receivables on 31.03.2023 were ₹ 15,00,000; bad debts totalled ₹ 1,00,000. It is required to write off the bad debts and create a provision equal to 5% of the Trade receivables' balances.
Show how you would compute the amount debited to the Profit and Loss Account.

Question 10 *(CA Foundation Nov 2019) (10 Marks)* *Pg no._____*

The balance sheet of Mittal on 1st January, 2023 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Trade payables	16,00,000	Plant & Machinery	31,00,000
Expense payable	2,50,000	Furniture & Fixture	4,00,000

Capital	51,00,000	Trade receivables	14,50,000
		Cash at bank	7,00,000
		Inventories	13,00,000
	69,50,000		69,50,000

During 2023, his profit and loss account revealed a net profit of ₹ 15,10,000. This was after allowing for the following:
a. Interest on capital @ 6% p.a.
b. Depreciation on plant and machinery @ 10% and on Furniture &Fixtures @ 5%
c. A Provision for doubtful debts @5% of the trade receivables as at 31st December 2023.
But while preparing the profit and loss account he had forgotten to provide for
(1) outstanding expenses totalling ₹ 1,85,000 and
(2) prepaid insurance to the extent of ₹ 25,000.
His current assets and liabilities on 31st December, 2023 were: Trade receivables ₹ 21,00,000; Cash at bank ₹ 5,20,000 and Trade payables ₹ 13,84,000. During the year he withdrew ₹ 6,20,000 for domestic use. Closing inventories is equal to net trade receivables at the year-end. You are required to draw up the revised Profit & Loss Account and Balance Sheet at the end of the year.

Question 11 *(CA Foundation Dec 2022) (10 Marks)* *Pg no.____*

The balance sheet of S on 1st April, 2022 was as follows:

Particulars	Amount (₹)	Particulars	Amount (₹)
Trade Payables	6,50,000	Furniture and Fixtures	6,50,000
Expenses Payable	75,000	Vehicle	2,75,000
Capital	22,00,000	Trade Receivable	11,00,000
		Cash at Bank	4,75,000
		Inventories	4,25,000
	29,25,000		29,25,000

During 2022-23, his profit and Loss Account revealed a net profit of ₹ 6,70,000. This was after allowing for the following:

a. Commission paid to selling agent ₹ 65,000.
b. Discount received from creditors ₹ 75,000.
c. Purchased a vehicle of ₹ 50,000 on 31st March, 2023.
d. Depreciation on Furniture and Fixtures @ 10% and on Vehicle @ 20%
e. A provision for doubtful debts @ 3% of the trade receivables as at 31st March, 2023

But while preparing the Profit and Loss Account he had forgotten to provide for

1) prepaid expenses ₹ 15,000 and
2) outstanding commission₹ 35,000.

His current assets and liabilities on 31st March, 2023 were: Inventories ₹ 6,50,000. Trade Receivables 13,00,000 (before provision for doubtful debts), cash at Bank 5,50,000 and Trade Payables ₹ 1,46,000. During the year he introduced further capital of ₹ 3,00,000 into the business. You are required to prepare the balance sheet as at March 31, 2023.

Question 12 *(CA Foundation Nov 2018) (5 Marks)* *Pg no.____*

Mr. Fazhil is a proprietor in business of trading. An abstract of his Trading and P&L account:

Trading and P&L A/c for the year ended 31st March, 2023

Particulars	Amount	Particulars	Amount
To Cost of Goods Sold	22,00,000	By Sales	45,00,000
To Gross Profit c/d	?		
	?		45,00,000

To Salaries paid	12,00,000	By Gross Profit b/d	?
To General Expenses	6,00,000	By Other Income	45,000
To Selling Expenses	?		
To Commission to Manager (on Net Profit before charging such commission)	1,00,000		
To Net Profit	?		
	?		?

Selling expenses amount to 1% of total Sales. You are required to compute the missing figures.

Question 13 *(CA Foundation Nov 2020) (5 Marks)* *Pg no._____*

Max & Co. employs a team of 9 workers who were paid ₹ 40,000 per month each in the year ending 31st December, 2022. At the start of 2023, the company raised salaries by 10% to ₹ 44,000 per month each. On 1st July, 2023 the company hired 2 trainees at salary of ₹ 21,000 per month each. The work force are paid salary on the first working day of every month, one month in arrears, so that the employees receive their salary for January on the first working day of February, etc.

You are required to calculate:

(a) Amount of salaries which would be charged to the profit and loss account for the year ended 31st December, 2023.

(b) Amount actually paid as salaries during 2023.

(c) Outstanding salaries as on 31st December, 2023.

Question 14 *(CA Foundation Jan 2021) (5 Marks)* *Pg no._____*

Mr. K is engaged in business of selling magazines. Several of his customers pay money in advance for subscribing his magazines. Information related to year ended 31st March, 2023 has been given below:

On 1st April, 2022 he had a balance of ₹ 3,00,000 advance from customers of which ₹ 2,25,000 is related to year 2022-23 while remaining pertains to year 2023-24- During the year 2022-23 he made cash sales of ₹ 7,50,000.

You are required to compute :

a) Total income for the year 2022-23.

b) Total money received during the year, if the closing balance as on 31st March, 2023 in Advance from Customers Account is ₹ 2,55,000.

Question 15 *(CA Foundation May 2019) (10 Marks)* *Pg no._____*

Following particulars are extracted from the books of Mr. Sandeep for the year ended 31st December, 2023.

Debit Balances:	Amount	Credit Balances:	Amount
Cash in hand	1,500	Capital	16,000
Purchase	12,000	Bank overdraft	2,000
Sales return	1,000	Sales	9,000
Salaries	2,500	Purchase return	2,000
Tax and Insurance	500	Provision for Bad debts	1,000
Bad debts	500	Creditors	2,000
Debtors	5,000	Commission	500
Investments	4,000	Bills payable	2,500
Opening stock	1,400		
Drawings	2,000		

Furniture	1,600		
Bills receivables	3,000		
	35,000		35,000

Other information:

a) Closing stock was valued at ₹ 4,500
b) Salary of ₹ 100 and Tax of ₹ 200 are outstanding whereas insurance ₹ 50 is prepaid.
c) Commission received in advance is ₹ 100.
d) Interest accrued on investment is ₹ 210
e) Interest on overdraft is unpaid ₹ 300
f) Reserve for bad debts is to be kept at ₹ 1,000
g) Depreciation on furniture is to be charged @ 10%

You are required to prepare the final accounts after making above adjustments.

Question 16

Pg no._____

Mr. Neel had prepared the following Trial Balance from his Ledger as on 31st March, 2023:

	Dr. (₹)	Cr. (₹)
Stock as on 1st April, 2022	5,00,000	-
Purchases and Returns	31,00,000	45,000
Sales and Returns	55,000	41,50,000
Cash in Hand	2,50,000	-
Cash at Bank	5,00,000	-
Trader's Capital	-	22,59,200
Rates and Taxes	50,000	-
Drawings	45,000	-
Salaries	95,000	-
Postage and Telegram	1,05,000	-
Insurance	90,000	-
Salesman Commission	78,000	-
Printing and Stationery	95,500	-
Advertisement	1,70,000	-
Furniture and Fittings	5,50,000	-
Motor Car	48,000	-
Discounts	50,000	75,000
General Expenses	65,700	-
Carriage Inward	10,000	-
Carriage Outward	22,000	-
Wages	50,000	
Sundry Debtors/Creditors	10,00,000	4,00,000
Total	69,29,200	69,29,200

You are required to prepare Trading Profit and Loss Account for the year ended on 31st March, 2023 and Balance Sheet as on that date after making the necessary adjustments.

You are provided with the following information:

a) Closing Stock as on 31st March, 2023 ₹ 1,45,000.
b) Neel had withdrawn goods worth ₹ 50,000 during the year.
c) Purchases include Purchase of furniture worth ₹ 1,00,000.
d) Debtors include ₹ 50,000 bad debts.
e) Sales include goods worth ₹ 1,50,000 sent out to NN & Co. on approval and remained unsold as on 31st March, 2023. The cost of the goods was ₹ 1,00,000.
f) Provision for Bad debts is to be created at 5% of Sundry Debtors.

g) Depreciate Furniture and Fittings by 10% and Motor Car by 20%.
h) The salesman is entitled to a commission of 10% on total sales.

Question 17 *(RTP Nov 2018) / (RTP May 2021) / (RTP May 2023) (Similar)* *Pg no._____*

The following is the Trial Balance of Hari as at 31st December, 2023:

	Dr. (₹)	Cr. (₹)
Hari's Capital Account	-	76,690
Stock 1st January, 2023	46,800	-
Sales	-	3,89,600
Returns Inwards	8,600	-
Purchases	3,21,700	-
Returns Outwards	-	5,800
Carriages Inwards	19,600	-
Rent & Taxes	4,700	-
Salaries & Wages	9,300	-
Sundry Debtors	24,000	-
Sundry Creditors	-	14,800
Bank Loan @14% p.a.	-	20,000
Bank Interest	1,100	-
Printing and Stationary Expenses	14,400	-
Bank Balance	8,000	-
Discount Earned	-	4,440
Furniture & Fittings	5,000	-
Discount Allowed	1,800	-
General Expenses	11,450	-
Insurance	1,300	-
Postage & Telegram Expenses	2,330	-
Cash Balance	380	-
Travelling Expenses	870	-
Drawings	30,000	-
	5,11,330	5,11,330

The following adjustments are to be made:

a) Included amongst the Debtors is ₹ 3,000 due from Ram and included among the Creditors ₹ 1,000 due to him.
b) Provision for Bad and Doubtful Debts be created at 5% and for Discount @ 2% on Sundry Debtors.
c) Depreciation on Furniture & Fittings @ 10% shall be written off.
d) Personal Purchases of Hari amounting to ₹ 600 had been recorded in the Purchases Day Book.
e) Interest on Bank Loan shall be provided for the whole year.
f) A quarter of the amount of Printing and Stationery Expenses is to be carried forward to the next year.
g) Credit Purchase Invoice amounting to ₹ 400 had been omitted from the Books.
h) Stock on 31.12.2023 was ₹ 78,600.

Prepare:
(i) Trading & Profit and Loss Account for the year ended 31.12.2023 and
(ii) Balance Sheet as on 31st December, 2023.

Question 18 *(CA Foundation May 2018) (20 Marks) / (RTP May 2020)/ (RTP Nov 2023)* *Pg no._____*

The following are the balances extracted from the books of Shri Raghuram as on 31.03.2023, who carries on business under the name and style of M/s Raghuram and Associates at Chennai:

	Dr. (₹)	Cr. (₹)
Capital A/c		14,11,400
Purchases	12,00,000	
Purchase Returns		18,000
Sales		15,00,000
Sales Returns	24,000	
Freight Inwards	62,000	
Carriage Outwards	8,500	
Rent of Godown	55,000	
Rates and Taxes	24,000	
Salaries	72,000	
Discount allowed	7,500	
Discount received		12,000
Drawings	20,000	
Printing and Stationery	6,000	
Insurance premium	48,000	
Electricity charges	14,000	
General expenses	11,000	
Bank charges	3,800	
Bad debts	12,200	
Repairs of Motor vehicle	13,000	
Interest on loan	4,400	
Provision for Bad-debts		10,000
Loan from Mr. Rajan		60,000
Sundry creditors		62,000
Motor vehicles	1,00,000	
Land and Buildings	5,00,000	
Office equipment	2,00,000	
Furniture and Fixtures	50,000	
Stock as on 31.03.2022	3,20,000	
Sundry debtors	2,80,000	
Cash at Bank	22,000	
Cash in Hand	16,000	
	30,73,400	30,73,400

Prepare Trading and Profit and Loss Account for the year ended 31.03.2023 and the Balance Sheet as at that date after making provision for the following:

(a) Depreciate Building by 5%, Furniture & Fixtures by 10%, Office Equipment by 15% and Motor Car by 20%.

(b) Value of stock at the close of the year was ₹ 4,10,000.

(c) One month rent for godown is outstanding.

(d) Interest on loan from Rajan is payable @ 10% per annum. This loan was taken on 01.07.2022

(e) Reserve for bad debts is to be maintained at 5% of Sundry debtors.

(f) Insurance premium includes ₹ 42,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 01.04.2022 to 30.06.2023.

Question 19 *(RTP May 2022)* Pg no._____

Mr. Bansal submitted to you the following Trial Balance, which he has not been able to agree. Rewrite Trial Balance & prepare Trading and Profit & Loss Account for year ended 31.03.2023 and a Balance Sheet as on that date after giving effect to the undermentioned adjustments:

	Dr. (₹)	Cr. (₹)
Capital	-	16,000
Opening Stock	17,500	-
Closing Stock	-	18,790
Drawings	3,305	-
Return Inward	-	550
Carriage Inward	1,240	-
Deposit with X	-	1,400
Return outward	840	-
Carriage outward	-	725
Rent Paid	800	-
Rent Outstanding	150	-
Purchases	13,000	-
Sundry Debtors	5,000	-
Sundry Creditors	-	2,200
Furniture	1,500	-
Sales	-	29,000
Wages	850	-
Cash	1,370	-
Advertisement	950	-
	46,505	68,665

Adjustments:

a) Write off ₹ 600 as Bad Debts and make Provision for doubtful debts at 5% on balance Sundry Debtors.

b) Stock valued at ₹ 2,000 was destroyed by fire on 25th March, 2023, but insurance Company admitted a claim for ₹ 1,500 only and paid the sum in April 2023.

c) Depreciation to be provided on furniture at 10% per annum.

Question 20 *(CA Foundation Nov 2019) (5 Marks)* Pg no._____

Mr. Shyamal runs a factory, which produces detergents. Following details were available in respect of his manufacturing activities for the year ended 31-03-2023.

	₹
Opening work-in-progress (9000 units)	26,000
Closing work-in-progress (14,000 units)	48,000
Opening inventory of Raw Materials	2,60,000
Closing inventory of Raw Materials	3,20,000
Purchases	8,20,000
Hire charges of Machinery @ ₹ 0.70 per unit manufactured	
Hire charges of factory	2,60,000
Direct wages-contracted @ ₹ 0.80 per unit manufactured and @ ₹ 0.40 per unit of closing W.I.P	
Repairs and maintenance	1,80,000
Units produced-5,00,000 units	

Required a Manufacturing Account of Mr. Shyamal for the year ended 31-03-2023.

Question 21 *(ICAI Study Material)* Pg no._____

Mr. Pankaj runs a factory which produces motor spares of export quality. The following details were obtained about his manufacturing expenses for the year ended on 31.3.2023.

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
Indirect Expenses	- Repairs and maintenance	2,30,000
	- Depreciation on factory shed	40,000
	- Depreciation on plant & machinery	60,000
By-product at selling price		20,000

You are required to prepare Manufacturing Account of Mr. Pankaj for the year ended on 31.3.2023.

Question 22 *(CA Foundation Nov 2020) (10 Marks)* Pg no._____

Following are the Manufacturing A/c, Creditors A/c and Raw Material A/c provided by M/s. Shivam related to financial year 2022-23. There are certain figures missing in these accounts.

Raw Material A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock A/c	1,27,000	By Raw Materials Consumed	
To Creditors A/c	-	By Closing Stock	-

Creditors A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c	23,50,000	By Balance b/d	15,70,000
To Balance c/d	6,60,000		

Manufacturing A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Raw Material A/c	-	By Trading A/c	17,44,000
To Wages	3,65,000		
To Depreciation	2,15,000		
To Direct Expenses	2,49,000		

Additional Information:

a) Purchase of machinery worth ₹ 12,00,000 on 1st April; 2022 has been omitted, Machinery is chargeable at a depreciation rate of 15%.

b) Wages include the following:

Paid to factory workers	₹ 3,15,000
Paid to labour at office	₹ 50,000

c) Direct expenses included the following:

Electricity charges	₹ 80,000 of which 25% pertained to office
Fuel charges	₹ 25,000

Freight inwards	₹ 32,000
Delivery charges to customers	₹ 22,000

You are required to prepare revised Manufacturing A/c and Raw Material A/c.

Question 23 *(ICAI Study Material)* *Pg no._____*

The following is the trial balance of Mr. Pandit for the year ended 31st March, 2023:

Particulars	Debit (₹)	Particulars	Credit (₹)
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 Doubtful Debts	2,000
Plant & Machinery	30,000	Sales	8,50,000
Investments	25,000	Bank Overdraft	23,000
Cash in Hand	20,000		
Cash at Bank	5,000		
Furniture & Fixtures	15,000		
Bills Receivable	15,000		
Sundry Debtors	40,000		
Drawings	20,000		
Salaries	20,000		
Coal and Fuel	15,000		
Factory rent & rates	20,000		
General Expenses	4,000		
Advertisement	5,000		
Sales Return	10,000		
Bad Debts	4,000		
Direct Wages (Factory)	80,000		
Power	30,000		
Interest Paid	7,000		
Discount Allowed	3,000		
Carriage Inwards	15,000		
Carriage Outwards	7,000		
Commission Paid	9,000		
	12,54,000		12,54,000

Additional Information:

a) Stock at the end of the year of Finished Goods ₹1,00,000
b) A provision for doubtful depts. at 5% on Sundry Debtors
c) Depreciation on building ₹ 1,000 and ₹ 3,000 on Machinery to be provided
d) Accrued commission of ₹ 12,500 is to be received for the year.
e) Interest has accrued on investment ₹ 15,000
f) Salary Outstanding ₹ 2,000
g) Prepaid Interest ₹ 1,500

You are required to prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31st March, 2023

Question 24 *(CA Foundation June 2022) (20 Marks)* *Pg no._____*

The following is the trial balance of Mr. B for the year ended 31st March,2023:

Particulars	Dr.	Particulars	Cr.
Opening Stock:		Sundry Creditors	1,75,000
Raw Material	5,25,000	Purchase Return	17,500
Finished Goods	2,62,500	Capital	3,50,000
Purchase of Raw Material	17,50,000	Bills Payable	84,000
Land & Building	3,50,000	Long Term Loan	7,00,000
Loose Tools	1,05,000	Provision for bad and doubtful debts	7,000
Plant and Machinery	1,05,000	Sales	29,75,000
Investments	87,500	Bank Overdraft	80,500
Cash in Hand	70,000		
Cash at Bank	17,500		
Furniture and Fixtures	52,500		
Bills Receivables	52,500		
Sundry Debtors	1,40,000		
Drawings	70,000		
Salaries	70,000		
Coal and Fuel	52,500		
Factory rent and rates	70,000		
General Expenses	14,000		
Advertisement	17,500		
Sales Return	35,000		
Bad Debts	14,000		
Direct Wages (Factory)	2,80,000		
Power	1,05,000		
Interest paid	24,500		
Discount allowed	10,500		
Carriage inwards	52,500		
Carriage outwards	24,500		
Commission paid	17,500		
Dividend paid	14,000		
	43,89,000		43,89,000

Additional Information:

a) Stock of finished goods at the end of the year was ₹ 3,50,000.
b) A provision for doubtful debts is to be created @ 5% on Sundry Debtors. Provide Depreciation on building 3,500 and Plant and Machinery 10,500.
c) Accrued commission is 43,750. Interest has accrued on investment ₹ 52,500.
d) Salary Outstanding is ₹ 7,000 and Prepaid Interest is ₹ 5,250.

You are required to prepare Manufacturing, Trading and Profit & Loss Account for the year ended 31st March,2023 and Balance Sheet as at that date.

Question 25 *(CA Foundation July 2021) (10 Marks)* *Pg no._____*

Karuna decided to start business of fashion garments under the name of M/s. Designer Wear on 1st April, 2022. She had a saving of about ₹ 10,00,000. She invested ₹ 3,00,000 out of her savings and borrowed equal amount from bank. She purchased a commercial space for ₹ 5,00,000 and further spent ₹ 1,00,000 on its renovation to make it ready business for.
Loan and interest repaid by her in the first year are as follows:

30th June, 2022	15,000 principal + 9,000 interest
30th September, 2022	15,000 principal + 8,550 interest
31st December, 2022	15,000 principal + 8100 interest
31st March, 2023	15,000 principal + 7,650 interest

In view of further capital requirement, she transferred ₹ 2,00,000 from her saving bank account to the bank account of the business. She paid security deposit of ₹ 7,000 for telephone connection. Furniture of ₹ 10,000 was purchased, All payments were made by cheque and all receipts in cash were deposited in the bank.

At the end of the year, her business showed the following results

Particulars	Amount	Particulars	Amount
Total Sales	20,00,000	Total Purchases	17,00,000
Electricity Expenses paid	40,000	Telephone Charges	50,000
Cartage Outwards	60,000	Travelling Expenses	45,000
Entertainment Expenses	5,000	Maintenance Expenses	25,000
Misc. Expenses	15,000	Electricity Expenses Payable	20,000

Other Information:

a) She withdrew ₹ 5,000 by cheque each month for her personal expenses.
b) Depreciation on building @ 5% p.a. and furniture @ 10% p.a.
c) Closing stock in hand as on 31st March, 2023: ₹ 5,50,000

Prepare Trading account, Profit and Loss Account for the year ended 31-3-2023 and Balance Sheet as on that date.

Question 26 *(CA Foundation July 2021) (5 Marks)* *Pg no._____*

PQR Limited's Profit and Loss account for the year ended 31st March, 2023 includes the following information:

(1)	Liability for Income Tax	₹ 40,000
(2)	Retained Profit	₹ 2,00,000
(3)	Proposed Dividend	₹ 20,000
(4)	Increase in Provision for Doubtful Debts	₹ 25,000
(5)	Bad Debts written off	₹ 20,000

State which one of the items above is - (a) transfer to provisions; (b) transfer to reserves; and (c) neither related to provisions nor reserves.

FINANCIAL STATEMENTS OF NOT FOR PROFIT ORGANISATIONS

CH 8

Every great dream begins with a dreamer, Always remember you have within you a Strength, the Patience, & the Passion to reach for the stars to change the world."

MEANING

NPO is a legal & accounting entity i.e. operated for the benefit of society as a whole rather than for the benefit of a sole proprietor or group of partners or group of shareholders.

FINANCIAL STATEMENTS OF NPO

I. Receipts & Payments Account

- It is a summary of cash book i.e. all the receipts (capital or revenue) are debited & similarly all the payments (capital or revenue) are credited.
- It starts with Opening Cash & Bank balance and also ends with their closing balances
- Items in this account may relate to any year.

II. Income & Expenditure Account:

- It is equivalent to Profit & Loss Account of a business enterprise.
- It is prepared by following accrual principle.
- It may include non-cash items like depreciation, etc. and it related to current year only.
- Only items of revenue nature are included.

III. Balance Sheet:

Note:
1) NPO registered under section 8 of Companies Act, 2013 are required to prepare their Income & Expenditure A/c and Balance Sheet as per Schedule III to Companies Act.
2) Until & unless question specifies, always assume that NPO referred in the question is not registered u/s 8 of Companies Act, 2013 and therefore financial statements are prepared in the normal manner.

GENERAL EXPENSE ITEMS

S.No	Particulars	Journal Entry
1.	Payment during the year	
2.	At the end of the year a) Outstanding b) Prepaid	
3.	At the beginning of the year a) Outstanding b) Prepaid	
4.	Transfer to Income & Expenditure A/c	

Computation of Amount to be transferred to Income & Expenditure A/c

Particulars	Amount
Payment during the year	xxx
Add: Outstanding expense at the end of the year	xxx
Less: Outstanding expense at the beginning of the year	(xxx)
Add: Prepaid expense at the beginning of the year	xxx
Less: Prepaid expense at the end of the year	(xxx)
Amount to be transferred to Income & Expenditure A/c	xxx

EXAMPLE

Compute the salaries for the year 2022-2023 from the following information:

Particulars	1.4.2022	31.3.2023
Outstanding salaries	7,500	10,000
Prepaid salaries	2,000	6,500
Salaries paid during 2022-2023 ₹1,50,000		

SUBSCRIPTION (INCOME)

S.No	Particulars	Journal Entry
1.	Received during the year	
2.	At the end of the year a) Outstanding/Accrued b) Pre-received/Received in Advance	
3.	At the beginning of the year a) Outstanding/Accrued b) Pre-received/Received in Advance	
4.	Transfer to Income & Expenditure A/c	

Computation of Amount to be transferred to Income & Expenditure A/c

Particulars	Amount
Subscription received during the year	xxx
Add: Outstanding subscription at the end of the year	xxx
Less: Outstanding subscription at the beginning of the year	(xxx)
Add: Pre received subscription at the beginning of the year	xxx
Less: Pre received subscription at the end of the year	(xxx)
Amount to be transferred to Income & Expenditure A/c	xxx

EXAMPLE

Particulars	1.4.2022	31.3.2023
Outstanding subscription	9,500	7,000
Advance subscription	2,800	5,200

Subscription received during 2022-2023, ₹ 1,48,900. Show relevant extracts in financial statements for the year ending 31st March, 2023.

EXAMPLE

A club has 75 members, each paying annual subscription of	1,000
Subscription received during 2022-2023	80,000
Subscription received in advance as at 31.3.2022	15,000
Subscription received in advance as at 31.3.2023	10,000
Subscription outstanding as at 31.3.2022	26,000
Subscription of 12,000 are still in arrears for the year 2021-2022	

Show relevant extracts in financial statements for the year ending 31st March, 2023.

ENTRANCE FEES / ADMISSION FEES

It's an initial amount payable at the time of seeking admission by a person who intends to become member of a club, association, etc.
Since it is payable by a member only once, it is argued that it should be treated as a capital receipt & transferred to capital fund. However when the amount is small it should be treated as income (or revenue receipt) & credited to Income & Expenditure Account. In case question is silent any treatment can be adopted by giving a suitable note.

TREATMENT

EXAMPLE

How will you deal the entrance fees while preparing the final accounts for the year ending on 31st March 2023 in each of the following alternative cases

Case (a)	During the year 2022-2023, Entrance fees received ₹ 1,00,000
Case (b)	During the year 2022-2023 entrance fees received ₹ 1,00,000. The accounting policy of club is to treat entrance fees as of revenue nature.
Case (c)	During the year 2022-2023 entrance fees received ₹ 1,00,000. The accounting policy the club is to treat entrance fees as of capital nature.
Case (d)	During the year 2022-2023 entrance fees received ₹ 1,00,000. According to accounting policy of the club, 40% of the entrance fees is to be capitalized. There was no pending membership as on 31st March, 2023.

DONATIONS

Donations are the amounts which are given to the NPO as gift by the member of the society. It is shown on the receipt side of Receipts & Payments account.

Types	Accounting Treatment
General	When the donor does not lay down any specific condition for using the amount of donation, it is called as general donation. a) <u>If Amount is Small</u>: Treated as Revenue receipts (credited to Income & Expenditure Account) b) <u>If Amount is Large</u>: Treated as Capital receipts (To be capitalized & added to Capital Fund in Balance Sheet) If nothing is clear any treatment can be adopted by giving a suitable note.
Specific	a) These donations are treated as capital receipts and thus, are transferred to a 'Special Fund Account' (e.g., building Fund) maintained for the purposes. b) Any Income relating to such 'Special Fund Account' is added to the respective fund. c) Any revenue expenditure relating to 'Special Fund Account is deducted from the respective fund. d) However, any expenditure of capital nature on account of this special fund (e.g., expenditure on the construction of building out of building fund) should be shown on the assets side of the balance sheet and an equal amount should be transferred from that special fund to the capital/general fund.

EXAMPLE

How will you deal with the following items while preparing the final accounts of a club for the year ending on March, 31, 2023

Case a)

Prizes awarded ₹ 3,000, Prize Fund as at 31.3.2022 ₹ 15,000.

Case b)

Prizes awarded ₹ 3,000, Prize fund as at 31.3.2022, ₹ 15,000, Donations for prizes received during the year 2022-2023 ₹ 4,900.

Case c)

Prizes awarded ₹ 3,000. Prizes Fund as at 31.3.2022 ₹ 15,000, Donations for prizes received during the year 2022-2023 ₹ 4,900, 10% Prize fund investments as at 31.3.2022 ₹ 15,000.

LIFE MEMBERSHIP SUBSCRIPTION & LEGACIES

Life Membership Subscription	Fees received for life membership is usually treated as capital receipt as it is of non-recurring nature & added to Capital Fund in Balance Sheet
Legacies	It is the amount which a NPO will receive as per will of a deceased person. It is shown on debit side of Receipts & Payment account. It should be capitalized being an item of non recurring nature & should be shown on the liabilities side of the Balance sheet.

SALE OF OLD NEWSPAPERS, etc.

The sale proceeds of old newspapers and periodicals are treated as Revenue Receipts and thus, are credited to the income & expenditure account.

SALE OF OLD FIXED ASSETS

The sale proceeds of old fixed assets are treated as capital receipts and thus, are credited to the respective fixed asset account. However, the profit or loss on sale of fixed assets is shown in the income & expenditure account.

CONSUMABLES

- Sometimes NPO consume some consumable item e.g. stationery, sports material, medicines, etc.
- A separate stock account is prepared for each consumable item to ascertain the amount of consumable item consumed during the year.
- In such a case, sometimes Trade Creditors account is to be prepared to ascertain the credit purchases (if missing).
- Such amount consumed is to be debited to Income & Expenditure account.

Creditors for Consumable Item A/c

Particulars	Amount	Particulars	Amount

CONSUMPTION

EXAMPLE

How will you deal with the following items while preparing the income and expenditure account for the year ending on March 31, 2023 and a balance sheet as on that date?

Particulars	As at 1.4.2022	As at 31.3.2023
Creditors for Sports Materials	2,000	1,200
Stock of Sports Materials	2,100	500

During 2022-2023, the payment made to these creditors was ₹ 10,800.

TREATMENT OF PROFIT / LOSS FROM TRADING ACTIVITIES

1. Sometimes NPO carry on trading activities e.g. restaurant/bar run by a club, chemist shop by a hospital, book shop by a library, etc.
2. In such case, separate Trading account for each of the trading activities is prepared to ascertain the Profit/Loss from each of such trading activities.
3. Such Profit/Loss is transferred to Income & Expenditure Account.

Trading Account

Particulars	Amount	Particulars	Amount

EXAMPLE

How will you deal with the following items while preparing the income and expenditure account for the year ending on March 31, 2023 and a balance sheet as on that date?

Particulars	As at 1.4.2022	As at 31.3.2023
Creditors for Bar Purchases	5,000	8,000
Bar Stock	10,000	18,000

During 2022-2023, payment for bar purchases were 35,000 and total bar receipts / collections were 42,000

EDUCATIONAL INSTITUTIONS

Educational institutions are quite different from other not-for-profit organisations in terms of sources of finance and items of expenditure.

There are 3 main sources through which amounts are collected by the educational institutions. These are:

(1) Donation from Public;

(2) Fees in the form of annual tuition fees, term fees, admission fees, laboratory fee etc., and

(3) Grants received from the Government. The Government grants are of four kinds namely Maintenance Grant, Equipment grant, Building Grant and such other grants as may be sanctioned by the Government from time to time.

Receipts & Payments Account for the period ending on ...

Receipts		₹	Payments		₹
To Balance b/d:			By Balance b/d (Bank overdraft)		xxx
Cash	xxx		By Annual Sports Expenses		xxx
Bank	xxx	xxx	By Salaries & Wages		xxx
To Subscription:			By Rent, Rates &Taxes		xxx
For previous year	xxx		By Insurance		xxx
For current year	xxx		By Furniture		xxx
For next year	xxx	xxx	By Sports Equipments		xxx
To Entrance fees		xxx	By Books & Periodicals		xxx
To Donation for Building		xxx	By Audit Fees		xxx
To General Donations		xxx	By Printing & Stationary		xxx
To Life Membership Fees		xxx	By Honorarium		xxx
To Legacy		xxx	By Bank Charges		xxx
To Gran from Govt.		xxx	By Postage & Telegrams		xxx
To Contribution for Annual Dinner		xxx	By Water & Electricity		xxx
To Dividend		xxx	By Conveyance & Travelling		xxx
To Interest		xxx	By Repairs & Maintenance		xxx
To Rent		xxx	By Sundry Expenses		xxx
To Receipt on Annual Sports		xxx	By Annual Dinner Expenses		xxx
To Sale of Old Sports Materials		xxx	By __% Investments		xxx
To Sale of Old Magazines		xxx	By Balance c/d:		xxx
To Sundry Receipts		xxx	Cash	xxx	xxx
To Balance c/d (Bank overdraft)		xxx	Bank	xxx	xxx
		XXX			XXX

Income and Expenditure Account for the year ending on ....

Expenditure		₹	Income		₹
To Salaries and Wages paid	xxx		By Subscription Received	xxx	
Add: Outstanding at the end	xxx		Add: Outstanding at the end	xxx	
Less: Prepaid at the end	xxx		Less: Advance at the end	xxx	
Add: Prepaid in the beginning	xxx		Add: Advance in the beginning	xxx	
Less: Outstanding in the beg	xxx	xxx	Less: Outstanding in beginning	xxx	xxx
To Rent, Rates and Taxes		xxx	By Entrance Fees (revenue portion)		
To Insurance Premium		xxx	By General Donations/Legacies		xxx
To Depreciation on Furniture and		xxx	By Life membership Fees (revenue		xxx
Sports equipment		xxx	portion)		xxx

To Books and Periodicals	xxx	By Annual Dinner Cont. xxx	
To Audit fees	xxx	Less Expenses xxx	
To Printing & Stationary	xxx	By Profit on Annual sports	xxx
To Honorarium	xxx	(Receipt-expenses)	
To Bank Charges	xxx	By Profit on sale of provisions (Sale	xxx
To Postage & Telegram	xxx	+ closing stock – Purchases-Opening	
To Electricity & Water	xxx	stock)	xxx
To Conveyance & Travelling	xxx	By Dividend & Interest	xxx
To Surplus i.e.,excess of income over exp.	xxx	By Deficit i.e. excess of exp. over income	xxx
	XXX		XXX

Balance Sheet of .. as at…

Liabilities	₹	₹	Assets		₹
Capital Fund:			Fixed Assets:		
Opening Balance	xxx		Building		
Add: Surplus (or Less: Deficit)	xxx		Opening Balance	xxx	
Add: Entrance Fees	xxx		Add: Additions	xxx	
(to the extent capitalized)			Less: Depreciation	xxx	xxx
Add: Life Membership subsc.	xxx		Furniture		
(to the extent capitalized)			Opening Balance	xxx	
Add: Amt. of Capital exp. tfd from			Add: Additions	xxx	
special fund (e.g. Building			Less: Assets sold	xxx	
fund)	xxx	xxx	Less Depreciation	xxx	xxx
Prize Fund:			Sports Equipment	xxx	
Opening Balance	xxx		Less Depreciation	xxx	xxx
Add: Donation for prizes	xxx				
Add: Income from Prize Fund			Investments:		xxx
Investments	xxx		Prize Fund Investments		xxx
Less: Expenses	xxx	xxx	Building Fund Investments		xxx
Building Fund:			10% Govt. Securities		xxx
Add: Donation for Building	xxx		Fixed Deposits		
Add: Income from Building					
Fund Investments	xxx		Current Assets:		xxx
Less: Transfer to Capital Fund	xxx		Sports Materials		xxx
Current Liabilities:			Outstanding Subscriptions		xxx
Subscription received in advance		xxx	Accrued Interest		xxx
Outstanding expenses		xxx	Accrued Rent		xxx
Bank overdraft		xxx	Cash in hand		xxx
Creditors		xxx	Cash at bank		
	XXX		XXX		

ASSIGNMENT QUESTIONS

Question 1 Pg no.______

A)

Elite Club (not registered under the Companies Act, 2013) has 200 members with an annual subscription of ₹ 3,600 payable by every member. An analysis of subscriptions received by the club during the accounting year ended on 31st March, 2023 revealed the following

For the year 2021-22	25,200
For the year 2022-23	6,98,400
For the year 2023-24	7,200
	7,30,800

On 31st March, 2023 it was noted that a sum of ₹ 3,600 was still in arrears for the year ended 31st March, 2022. Calculate the amount of subscriptions that will appear on the credit side of the Club's Income and Expenditure Account for the year ended 31st March, 2023. Also show how items relating to subscriptions will appear in the Balance Sheet dated 31st March, 2023

B)

From the following information of M/s. Officers Sports Club (A non-profit organization) calculate (i) the total cost of sports material consumed and (ii) Sale value of sports material during the year 2022-23

	₹
Opening balance of sports material as on 1-4-2022	56,800
Closing balance of sports material as on 31-3-2023	32,900
Sports material purchased in cash	23,500
Payment made to creditors of sports material	64,300
Creditors for sports materials	
Opening	23,200
Closing	29,400

Out of the total sports material used during the year 40% was consumed by the club and the remaining was sold at a profit of 20% of cost.

Question 2 *(RTP Nov 2018) / (RTP Nov 2020)* Pg no.______

The following information of M/s. TT Club are related for the year ended 31st March, 2023:

Balances	As on 01-04-2022	As on 31-3-2023
Stock of Sports Material	75,000	1,12,500
Amount due for Sports Material	67,500	97,500
Subscription due	11,250	16,500
Subscription received in advance	9,000	5,250

Subscription received during year ₹ 3,75,000. Payments for Sports Material during year ₹ 2,25,000

You are required to:

(A) Ascertain the amount of Subscription and Sports Material that will appear in Income & Expenditure Account for the year ended 31.03.2023 and

(B) Also show how these items would appear in the Balance Sheet as on 31.03.2023.

Question 3 Pg no.______

Noida School maintains separate building fund. As on 31.3.2022, balance of building fund was ₹ 10,00,000 and it was represented by fixed deposit (15% per annum) of ₹ 6,00,000 and current account balance of ₹ 4,00,000. During the year 2022-23, the school collected as donations towards the building fund ₹ 5,60,000 and transferred 40% of developmental fees collected ₹ 22,56,500 to building fund. Capital work progress as on 31st March, 2022 was ₹ 8,25,000 for which contractors' bill upto 75% was paid on 14.4.2022. The extension of building was finished on 31.12.2022 costing ₹ 7,25,000 for which contractors' bill was fully met. It was decided to transfer the cost of completed building (₹ 15,50,000) to the corresponding asset account.

You are required to pass journal entries to incorporate the above transactions in the books of Noida School for the year 2022-23 and show the trial balance of building fund ledger.

Question 4

Pg no._____

The relevant accounts of a Club for the year ended 31st December, 2023 were as follows:

Receipts and Payments Account

To Balance c/d		2,500	By Books purchased	1,000
To Subscriptions:			By Printing and Stationery	200
2022	600		By Salary	1,500
2023	4,300	4,900	By Advertisement	200
To Interest		500	By Electric Charge	400
To Donation for special fund		300	By Balance c/d	7,350
To Rent:				
2022	150			
2023	300	450		
To Govt. Grants		2,000		
		10,650		10,650

Income and Expenditure Account

Expenditure	₹	Income	₹
To Salary	2,800	By Interest	400
To Tent Hire	200	By Subscription	4,800
To Electric charges	400	By Rent	2,300
To Depreciation on Building	750	By Govt. Grant	2,000
To Printing and Stationery	200		
To Advertisement	150		
To Surplus	5,000		
	9,500		9,500

The club's assets as on 1st January 2023 were:
Building ₹ 15,000; Books ₹ 10,000 Furniture ₹ 4,000; Investments ₹ 10,000
Liabilities as on that date were: ₹ 50 for advertisement and ₹ 100 for salary.
You are required to prepare balance sheet of the club on 31st December, 2022 & 31st December, 2023.

Question 5

Pg no._____

Mahaveer Sports club gives following receipts & payments account for the year ended March 31, 2023:

Receipts and Payments Account

Receipts	₹	Payments	₹
To Opening cash & bank balances	5,200	By Salaries	15,000
To Subscription	34,800	By Rent and taxes	5,400
To Donations	10,000	By Electricity charges	600
To Interest on investments	1,200	By Sports goods	2,000
To Sundry receipts	300	By Library books	10,000

		By Newspapers and periodicals	1,080
		By Miscellaneous expenses	5,400
		By Closing cash & bank balances	12,020
	51,500		51,500

Liabilities	As on 31.03.2022	As on 31.03.2023
Outstanding expenses:		
Salaries	1,000	2,000
Newspapers and periodicals	400	500
Rent and taxes	600	600
Electricity charges	800	1,000
Library books	10,000	-
Sports goods	8,000	-
Furniture and fixtures	10,000	-
Subscription receivable	5,000	12,000
Investment-government securities	50,000	-
Accrued interest	600	600

Provide depreciation: Furniture & fixtures@ 10% p.a; Sports goods@ 20% p.a; Library books@ 10%p.a.

You are required to prepare Club's opening balance sheet as on 1.4.2022, income and expenditure account for the year ended on 31.3.2023 and balance sheet as on that date.

Question 6

Pg no._____

Following is Receipts & Payments Account of Mayur Club for year ended 31st Mar, 2023

Receipts	₹	Payments	₹
Opening Balance		Sports materials	3,04,500
Cash in Hand	39,100	Salaries	3,15,000
Cash at Bank	50,000	Equipment purchased on 1.10.22	60,000
Subscriptions		Bank fixed deposits on 31.3.23	1,50,000
For the year 2021-22	18,000	Rent	1,48,500
For the year 2022-23	9,63,000	Ground maintenance	22,120
For the year 2023-24	4,500	Insurance	38,400
Interest on Bank F.D. @10%	45,000	Stationery	3,450
		Sundry expenses	5,880
		Closing balance as on 31.3.2023	
		Cash in Hand	31,750
		Cash at Bank	40,000
	11,19,600		11,19,600

Following additional information is provided to you:

a. The club has 220 members. The annual subscription is ₹4,500 per member

b. Depreciation to be provided on furniture at 10% p.a. and on sports equipment at 15% p.a.

c. On 31st March, 2023, stock of sports material in hand (after members use during the year) is valued at ₹78,000 and stock of stationery at ₹3,150. Rent for 1 month is outstanding. Unexpired insurance amounts to ₹9,600.

d. On 31st March, 2022 the club had the following assets:

Furniture	2,70,000
Sports equipment	1,80,000
Bank fixed deposit	4,50,000

Stock of stationery	1,500
Stock of sports material	73,500
Unexpired insurance	8,400
Subscription in arrear	22,500

Note: There was no liability on 31.3.2022

You are required to prepare:

(i) Income and Expenditure Account; and

(ii) Balance Sheet as at 31st March, 2023.

Question 7 *(RTP Nov 2019) (Similar) / (RTP Nov 2023)* Pg no._____

From the following data, prepare an Income and Expenditure Account for the year ended 31st December, 2023, and a statement of affairs as at that date of the Amar Leela Hospital:

Receipts and Payments Account for the year ended 31 December, 2023

To Balances		By Salaries: (₹ 21,600 for 2022)	93,600
Cash	2,400	By Hospital Equipment	51,000
Bank	15,600	By Furniture purchased	18,000
To Subscriptions :		By Additions to Building	1,50,000
For 2022	15,300	By Printing & Stationery	7,200
For 2023	73,500	By Diet expenses	46,800
For 2024	7,200	By Rent & rates (₹ 900 for 2024)	6,000
To Government Grant :		By Electricity and water charges	7,200
For building	2,40,000	By Office expenses	6,000
For maintenance	60,000	By Investments	60,000
Fees from sundry patients	14,400	By Balances :	
To Donations (not to be capitalized)	24,000	Cash	4,200
To Net collections from benefit shows	18,000	Bank	20,400
	4,70,400		4,70,400

Additional Information:-

Value of building under construction as on 31.12.2023	4,20,000
Value of hospital equipment on 31.12.2023	1,53,000
Building Fund as on 1.1.2023	2,40,000
Subscriptions in arrears as on 31.12.2022	19,500
Investments in 8% Govt. securities were made on 1st July, 2023	

Question 8 - *(ICAI Study Material)* Pg no._____

Summary of receipts & payments of Bombay Medical Aid society for year ended 2023 are: Opening cash balance in hand ₹ 8,000, subscription ₹ 50,000, donation ₹ 15,000 (raised for meeting revenue expenditure), interest on investments @ 9% p.a. ₹ 9000, payments for medicine supply ₹ 30,000 Honorarium to doctor ₹10,000, salaries ₹ 28,000, sundry expenses ₹ 1,000, equipment purchase ₹ 15,000, charity show expenses ₹ 1,500, charity show collections ₹ 12,500. Additional information:

	31.12.2022	31.12.2023
Subscription due	1,500	2,200
Subscription received in advance	1,200	700

Stock of medicine	10,000	15,000
Amount due for medicine supply	9,000	13,000
Value of equipment	21,000	30,000
Value of building	50,000	48,000

You are required to prepare receipts and payments account and income and expenditure account for the year ended 31.12.2023 and balance sheet as on 31.12.2023.

Question 9 *Pg no._____*

From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account for the year ended 31st March, 2023:

Income & Expenditure Account for the year 2022-23

To Upkeep of Ground	21,000	By Subscriptions	56,640
To Printing	2,800	By Sale of Newspapers (Old)	530
To Salaries	28,000	By Lectures	8,000
To Depreciation on Ground & Building	9,000	By Entrance Fee	2,900
To Depreciation on Furniture	1,000	By Misc. Income	1,200
To Repairs	3,500		
To Surplus	3,970		
	69,270		69,270

Balance Sheet as at 31st March, 2023

Liabilities		₹	Assets	₹
Subscription in Advance (23-24)		700	Furniture	9,000
Outstanding Salary		4,200	Ground and Building	1,43,200
Sports Prize Fund :			Prize Fund Investment	43,000
Opening Balance	51,000		Cash & Bank	19,400
Add : Interest	4,500		Subscription (2022-23)	2,600
	55,500			
Less : Prizes	(6,500)	49,000		
Capital Fund :				
Opening Balance	1,56,430			
Add: Surplus	3,970			
Add : Entrance Fee	2,900	1,63,300		
		2,17,200		2,17,200

The following adjustments have been made in the above accounts:

(1) Upkeep of ground ₹ 1,500 & Printing & Stationery ₹ 510 relating to 2021-22 was paid in 2022-23.

(2) One-half of entrance fees have been capitalized.

(3) Subscription outstanding in 2021-22 was ₹ 3,100 and for 2022-23 ₹ 2,600.

(4) Subscription received in advance in 2021-22 was ₹ 1,100 and in 2022-23 for 2023-24 ₹ 700.

(5) Outstanding Salary on 31.03.2022 was ₹ 3,600.

Question 10 *Pg no._____*

Following is Income and Expenditure Account of Gama Club for year ended 31st March, 2023:

Income and Expenditure Account for the year ended 31st March, 2023

	₹		₹
To Salaries	19,500	By Subscription	68,000
To Rent	4,500	By Donation	5,000
To Printing	750		

To Insurance	500		
To Audit Fees	750		
To Games & Sports	3,500		
To Subscriptions written off	350		
To Miscellaneous Expenses	14,500		
To Loss on sale of furniture	2,500		
To Depreciation: Sports Equipment Furniture	 6,000 3,100		
To Excess of income over expenditure	17,050		
	73,000		73,000

Additional information:

	31-03-2022	31-03-2023
Subscriptions in arrears	2,600	3,700
Advance Subscriptions	1,000	1,500
Outstanding expenses Rent Salaries Audit Fee	 500 1,200 500	 800 350 750
Sports Equipment less depreciation	25,000	24,000
Furniture less depreciation	30,000	27,900
Prepaid Insurance	-	150

Book value of furniture sold is ₹ 7,000. Entrance fees capitalized ₹ 4,000. On 1st April, 2022 there was no cash in hand but Bank Overdraft was for ₹ 15,000.
On 31st March, 2023 Cash in hand amounted to ₹ 850 and the rest was Bank balance.
Prepare the Receipts and Payments Account of the Club for the year ended 31st March, 2023.

Question 11

Pg no.______

Income and Expenditure Account of City Sports Club for year ended 31st March, 2023 was as follows:

Expenditure	₹	Income	₹
To Salaries	1,20,000	By Subscriptions	1,60,000
To Printing and Stationery	6,000	By Entrance Fees	10,000
To Depreciation on Sports equipment	6,000	By Contribution for Annual dinner	20,000
To Repairs	10,000	By Profit on Annual Sports meet	20,000
To Sundry Expenses	8,000		
To Annual Dinner Expenses	30,000		
To Interest to Bank	6,000		
To Rent	12,000		
To Excess of Income over Expenditure	12,000		
	2,10,000		2,10,000

The above account had been prepared after the following adjustments:

Subscriptions outstanding on 31.03.2022	12,000
Subscriptions received in advance on 31.03.2022	9,000
Subscriptions received in advance on 31.03.2023	5,400
Subscriptions outstanding on 31.03.2023	15,000

Salaries outstanding at the beginning and at the end of the financial year were ₹ 8,000 and ₹ 10,000 respectively. Sundry expenses included prepaid insurance expenses of ₹ 1,200.
The Club owned a freehold ground valued ₹ 2,00,000. The Club has sports equipment on 01.04.2022 valued at ₹ 52,000. At the end of the year, after depreciation, the sports equipment amounted to ₹ 54,000. The Club raised a loan of ₹ 40,000 from a bank on 01.01.2022, which was unpaid till 31.03.2023. On 31.03.2023, cash in hand was ₹ 32,000.
Prepare Receipts and Payments account of the Club for the year ended 31st March, 2023 and Balance Sheet as on that date.

Question 12 *(RTP May 2019) / (RTP Nov 2021) (Similar)* *Pg no._____*

The Receipts & Payments account of Trustwell Club prepared on 31st March, 23 is as follows.

Receipts and Payments Account

Receipts		₹	Payments	₹
To Balance b/d		450	By Expenses (including payment for sports material ₹ 2,700)	6,300
To Annual income from subscription Add: Outstanding of last year received this year Less: Prepaid of last year	4,590 180 4,770 (90)	4,680	By Loss on sale of furniture (cost price ₹ 450)	180
To Other fees		1,800	By Balance c/d	90,450
To Donation for building		90,000		
		96,930		96,930

Additional information:
Trustwell club had balances as on 1.4.2022:

Furniture ₹ 1,800; investment at 5% ₹ 27,000; Sports material ₹ 6,660;

Balance as on 31.3.2023;

Subscription receivable ₹ 270; Subscription received in advance ₹ 90;
Stock of sports material ₹ 1,800.

Do you agree with above receipts and payments account? If not, prepare correct receipts and payments account and income and expenditure account for the year ended 31st March, 2023 and balance sheet as on that date.

Question 13 *(CA Foundation Jan 2021)(10 Marks)/(RTP May 2020)/(May 2023) (Sim.)* *Pg no._____*

Dr. Deku started private practice on 1st April, 2022 with ₹ 2,00,000 of his own fund and ₹ 3,00,000 borrowed at an interest of 12% per annum on the security of his life policies. His accounts for the year were kept on a cash basis & following is his summarized cash account:

	₹		₹
Own capital	2,00,000	Medicines purchased	2,45,000
Loan	3,00,000	Surgical equipments	2,50,000
Prescription fees	6,60,000	Motor car	3,20,000
Visiting fees	2,50,000	Motor car expenses	1,20,000
Fees from lectures	24,000	Wages and salaries	1,05,000
Pension received	3,00,000	Rent of clinic	60,000
		General charges	49,000
		Household expenses	1,80,000
		Household Furniture	25,000

		Expenses on daughter's marriage	2,15,000
		Interest on loan	36,000
		Balance at bank	1,10,000
		Cash in hand	19,000
	17,34,000		17,34,000

One-third of the motorcar expense may be treated as applicable to the private use of car and ₹ 30,000 of the salaries are in respect of domestic servants. The stock of medicines in hand on 31st March, 2023 was valued at ₹ 95,000. You are required to prepare his private practice income and expenditure account and capital account for the year ended 31st March, 2023. Ignore depreciation on fixed assets.

Question 14

Pg no._____

Beer Bar club was registered in a city and the accountant prepared the following Receipts and Payments Account for the year ended 31st March, 2023 and showed a deficit of ₹ 14,520.

Receipts	₹	Payments	₹
Subscriptions	62,130	Premises	30,000
Fair receipts	7,200	Honorarium to Secretary	12,000
Variety show receipt (net)	12,810	Rent	2,400
Interest	690	Rates & taxes	3,780
Bar collection	22,350	Printing & stationary	1,410
Excess cash spent	1,000	Sundry expenses	5,350
Deficit	14,520	Wages	2,520
		Fair expenses	7,170
		Bar purchases payments	17,310
		Repair	960
		New car (less proceeds of old car ₹ 9,000)	37,800
	1,20,700		1,20,700

The following additional information are:

	01.04.2022	31.03.2023
Cash in hand	450	-
Bank balances as per pass book	24,690	10,440
Cheque issued but not presented - for sundry expenses	270	90
Subscriptions due	3,600	2,940
Premises at cost	87,000	1,17,000
Accumulated depreciation on premises	56,400	-
Car at cost	36,570	46,800
Accumulated depreciation on car	30,870	-
Bar stock	2,130	2,610
Creditors for the bar purchases	1,770	1,290

Cash excess spent represent honorarium to secretary not withdrawn due to cash deficit. His annual honorarium is ₹ 12,000. Depreciation on premises & car is to be provided at 5% & 20% on WDV method.

Prepare correct Receipts & Payments Account and Income & Expenditure Account.

Question 15 *(ICAI Study Material)* Pg no.______

The following was the Receipts and Payments Account of Exe Club for the year ended March 31, 2023 *(All the figures in thousands)*

Receipts	₹	Payments	₹
Cash in hand	100	Groundsman's Fee	750
Balance at Bank as per Pass Book:		Moving Machine	1,500
Deposit Account	2,230	Rent of Ground	250
Current Account	600	Cost of Teas	250
Bank Interest	30	Fares	400
Donations and Subscriptions	2,600	Printing & Office Expenses	280
Receipts from teas	300	Repairs to Equipment	500
Contribution to fares	100	Honoraria to Secretary/Treasurer of 2021-22	400
Sale of Equipment	80	Balance at Bank as per Pass Book	
Net proceeds of Variety Entertainment	780	Deposit Account	3,090
Donation for forth coming Tournament	1,000	Current Account	150
		Cash in hand	250
	7,820		7,820

You are given the following additional information:

	April 1, 2022	March 31, 2023
Subscription due	150	100
Amount due for printing etc.	100	80
Cheques unpresented being payment for repairs	300	260
Estimated value of machinery and equipment	800	1,750
Interest not yet entered in the Pass book		20
Bonus to Groundsman outstanding		300

For the year ended March 31, 2023, the honoraria to the Secretary and Treasurer are to be increased by a total of ₹ 200. Prepare the Income and Expenditure Account and Balance Sheet for period ending 31st March, 2023.

Question 16 *(ICAI Study Material)* Pg no.______

From the following balances and particulars of Republic College prepare Income & Expenditure Account for the year ended March, 2023 and a Balance Sheet as on the date:

	Dr.	Cr.
Seminars & Conference Receipts		4,80,000
Consultancy Receipts		1,28,000
Security Deposit-Students		1,50,000
Capital fund		16,06,000
Research Fund		8,00,000
Building Fund		25,00,000
Provident Fund		5,10,000
Tuition Fee received		8,00,000
Government Grants		5,00,000
Donations		50,000
Interest & Dividends on Investments		1,85,000
Hostel Room Rent		1,75,000

Mess Receipts (Net)		2,00,000
College Stores-Sales		7,50,000
Outstanding expenses		2,25,000
Stock of-stores and Supplies	3,00,000	
Purchases-Stores & Supplies	8,00,000	
Salaries-Teaching	8,50,000	
-Research	1,20,000	
Scholarships	80,000	
Students Welfare expenses	38,000	
Repairs & Maintenance	1,12,000	
Games & Sports Expenses	50,000	
Misc. Expenses	65,000	
Research Fund Investments	8,00,000	
Other Investments	18,50,000	
Provident Fund Investment	5,10,000	
Seminar & Conference Expenses	4,50,000	
Consultancy Expenses	28,000	
Land	1,00,000	
Building	16,00,000	
Plant and Machinery	8,50,000	
Furniture and Fittings	6,00,000	
Motor Vehicle	1,80,000	
Provision for Depreciation		
Building		4,80,000
Plant & Equipment		5,10,000
Furniture & Fittings		3,36,000
Cash at Bank	6,42,000	
Library	3,60,000	
	1,03,85,000	1,03,85,000

Adjustments:

(i)	Materials & Supplies consumed (From College Stores)	
	Teaching	50,000
	Research	1,50,000
	Students Welfare	75,000
	Games or Sports	25,000
(ii)	Tuition fee receivable from Government for backward class Scholars	80,000
(iii)	Stores selling prices are fixed to give a net profit of 10% on selling price	
(iv)	Depreciation is provided on straight line basis at the following rates:	
	a. Building	5%
	b. Plant & Equipment	10%
	c. Furniture & Fixtures	10%
	d. Motor Vehicle	20%

Question 17 ***(ICAI Study Material)*** *Pg no._____*

The following is the Receipts and Payments Account of Lion Club for the year ended 31st March, 2023.

Receipts and Payments Account

Receipts	₹	Payments	₹
Opening balance		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and stationary	70,000
Subscription received	2,02,750	Postage	40,000
Entrance donation	1,00,000	Telephones and telex	52,000
Interest received	58,000	Repairs and maintenance	48,000
Sale of assets	8,000	Glass and table linen	12,000
Miscellaneous income	9,000	Crockery and cutlery	14,000
Receipts at		Garden upkeep	8,000
Coffee room	10,70,000	Membership fees	4,000
Wines and spirits	5,10,000	Insurance	5,000
Swimming pool	80,000	Electricity	28,000
Tennis court	1,02,000	Closing balance	
		Cash	8,000
		Bank	2,24,600
	21,53,600		21,53,600

The assets and liabilities as on 1.4.2022 were as follows:

Fixed assets (net)	5,00,000
Stock	3,80,000
Investment in 12% Government securities	5,00,000
Outstanding subscription	12,000
Prepaid insurance	1,000
Sundry creditors	1,12,000
Subscription received in advance	15,000
Entrance donation received pending membership	1,00,000
Gratuity fund	1,50,000

The following adjustments are to be made while drawing up the accounts:

a) Subscription received in advance as on 31st March, 2023 was ₹ 18,000.
b) Outstanding subscription as on 31st March, 2023 was ₹ 7,000.
c) Outstanding expenses are salaries ₹ 8,000 and electricity ₹ 15,000.
d) 50% of the entrance donation was to be capitalized. There was no pending membership as on 31st March, 2023.
e) The cost of assets sold net as on 1.4.2022 was ₹ 10,000.
f) Depreciation is to be provided at the rate of 10% on assets.
g) A sum of ₹ 20,000 received in October 2022 as entrance donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 3.6.2023.
h) Purchases made during the year amounted ₹ 15,00,000.
i) The value of closing stock was ₹ 2,10,000.
j) The club as a matter of policy, charges off to income and expenditure account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2023 and the Balance Sheet as on 31st March, 2023 along with necessary workings.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1. Scholarship granted to students out of specific funds provided by Government will be debited to
   a) Income and Expenditure Account.
   b) Receipts and payments Account.
   c) Funds granted for Scholarship Account.

2. In case of NPO, excess of total assets over liabilities is known as
   a) Profits.
   b) Surplus.
   c) Capital Fund.

3. General donations and legacies are credited to
   a) Receipts and Payments Account.
   b) Income and Expenditure Account.
   c) Capital Fund.

4. Interest on prize funds is
   a) Credited to Income and Expenditure Account.
   b) Credited to Receipts and Payments Account.
   c) Added to prize fund.

5. Special aids are
   a) Treated as capital receipts.
   b) Treated as revenue receipts.
   c) Both (a) and (b).

6. If there exist a specific sports fund, the expenses incurred in relation to sports activities will be taken to
   a) Income and Expenditure Account
   b) Receipt and Payment Account
   c) Sports fund

ANSWERS MCQs 1. (c) 2. (c) 3. (b) 4. (c) 5. (c) 6. (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:

1) The Receipts and payment account for a non-profit organization follows the accrual concept of accounting.
2) Both the revenue and capital nature transactions are recorded in the Income and expenditure account.
3) Sale of grass by a sports club is to be treated as sale of an asset.
4) Subscriptions outstanding for the current year are disclosed under the Fixed assets side of the Balance sheet.

5) Receipts & payments account gives the details about the expenses outstanding for year.
6) Adjustments in the form of additional information shall be adjusted in the final accounts of an Nonprofit organisation only in one place.
7) Tournament expenses incurred are more than the Tournament fund, then the excess to be shown as an asset in the closing Balance sheet.
8) For Non-profit organisation, Excess of income over expenditure in the Income and Expenditure account is termed as profit.
9) Surplus of non-profit organizations is distributed among its members.
10) Tournament fund, building fund, library fund is based on the fund based accounting.
11) Subscription fees refers to the one-time fees paid by the memberships to get admission to the benefits of the club.
12) Token payment made to a person, who voluntarily undertakes a service which would normally be paid in case of profitable organization is termed as Honorarium.
13) An Insurance company is an example of non-profit organization.
14) Part amount of entrance fees which is to be capitalized shall be disclosed in the income and expenditure account.
15) Both the income and expenditure of the current and the previous year are recorded in the Income and Expenditure account.
16) Amount received as donation by Non-profit organisation under the will of a deceased person is termed as legacy.
17) Where a Non-profit organisation has a separate trading activity, the profit/loss from the trading account shall be transferred to Income and Expenditure Account at the time of consolidation.
18) Not for profit concerns concentrate their efforts to maximize the profit earning avenues.
19) All the receipts are of revenue nature in case of Non-profit organisation.
20) There is opening balance of Income and expenditure account.
21) Receipts & Payments Account is a summary of all capital receipts & payments
22) If there appears a sports fund, the expenses incurred on sports activities will be taken to income & expenditure account
23) Receipts & Payments Account highlights total income and expenditure
24) Only revenue items are disclosed in Income & Expenditure Account
25) Net income in case of persons practicing vocation is determined by preparing profit and loss account.
26) In case a Sports Fund is kept, expenses on account of sports events should be charged to Sports Fund.
27) Laboratory & library Deposits taken from the students in case of an Educational Institution are shown on the liabilities side of the Balance Sheet.
28) Fees received for Life Membership is a revenue receipt as it is of recurring nature. *(Nov 2018)*
29) Subscriptions received for the current year shall be shown in the balance sheet as a current asset.
30) In Not for Profit (NPO) organizations, the excess of total assets over total outside liabilities is known as Capital Fund.
31) Both revenue and capital nature transactions are recorded in the Receipts and Payments Account. *(Dec 2022)*

Solution

1) False: It depicts the cash system of accounting rather than the accrual system, as the cash receipts and payments pertaining to any year are entered in the Receipts and

payments account. The principle of accrual is not followed with regard to the receipts and payments account of a non-profit organization.

2) False: The income and expenditure account records only the revenue income and expenditure. The capital transactions are being recorded in the Balance sheet.
3) False: The grass for a sports club is not a capital item, hence the sale of such grass shall be treated as a revenue receipt.
4) False: They are disclosed under the current assets of the Balance sheet as they will be received within the next year and not to be treated as non-current assets.
5) False: Receipts and payments account gives information about the expenses paid in cash for the current year, previous or the next year. It is only from the additional information we identify the outstanding expenses.
6) False: Additional information means that information which has been identified just before the preparation of the final accounts. As NPO follows the double entry system of book keeping, there shall be 2 effects for each of the additional information.
7) False: The excess of expenditure over the tournament fund shall be debited to the income and expenditure account and not taken to the closing balance sheet.
8) False: The excess of the income over the expenditure is called as Surplus and not profit for an Nonprofit organisation.
9) False: The Non-profit organisation credits the surplus earned in a year to the general/capital fund maintained by it.
10) True: It is Fund based accounting that records the fund balances in the balance sheet.
11) False: Subscription is regular fees paid by the members to keep the membership alive.
12) True: Honorarium refers to the nominal amount paid for the services with a non-commercial intent.
13) False: Insurance Company has a profit motive, hence it is not a non-profit organization.
14) False: It shall be shown in the Balance sheet- where it is to be capitalized.
15) False: It is only the current year income and expenditure which is recorded in the Income and Expenditure account as per the accrual concept.
16) True: While on the death bed, if there is any will written that the assets of a person shall be donated to any NPO- then such a donation to the NPO, is termed as LEGACY.
17) True: Where in case of the trading activities, the profit /loss from such activity to be transferred to the Income and expenditure account in case of consolidated accounts.
18) False: The Non-profit organisation has its very existence to the main base line of serving the members and the society. Profit earning shall never be its motive.
19) False: Receipts can be both of revenue as well as capital nature. Receipts of both the nature are recorded in the receipts and payments account.
20) False: It represents a nominal account and is prepared in accordance with the accrual concept, hence there can be no opening balances.
21) False- Receipts & Payments Account is a summary of all the cash or bank receipts & payments of both whether of capital or revenue nature.
22) False- Such expenses should be deducted from the sports fund and will not be taken to income & expenditure account
23) False- Receipts and payments account is a classified summary of cash receipts and payments over a certain period together with cash and bank balances at the beginning and close of the period.
24) True- Only revenue items are disclosed in Income & Expenditure Account
25) False: Net income is determined by preparing income and expenditure in case of persons practicing vocation.

26) True: Institutions sometimes keep special funds for some special purposes. In such a case the income related to such funds should be added to these funds and expenses should be deducted from such funds.
27) True: Because the laboratory and library deposits are of the nature of security deposits to be refunded to the students on their leaving the College or University.
28) False: Fees received for life membership is a capital receipt as it is of non-recurring nature. It is directly added to capital fund or general fund.
29) False: Current year subscription shall be shown in the credit side of the income & expenditure account and not in the balance sheet as it is not a capital item.
30) True: The capital fund represents the amount contributed by members through legacies, special donations entrance fee and accumulated surplus over the years
31) True: All the receipts and payments whether of revenue or capital nature are included in Receipt and Payment account.

DISTINCTION BETWEEN RECEIPTS & PAYMENT ACCOUNT AND INCOME & EXPENDITURE ACCOUNT

Not for profit organizations such as public hospitals, public educational institutions, clubs, Temples, churches etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period.

<u>The distinguishing features of both the accounts can be summarized as:</u>

Receipt and Payment Account

- It is an elementary form of account consisting of a classified summary of cash receipts and payments over a certain period together with cash balances at the beginning and close of the period.
- The receipts are entered on the left hand side and payments on the right hand side i.e. same sides as those on which they appear in cash book.
- All the receipts and payments whether of revenue or capital nature are included in this account.
- The balance of the account at the end of a period represents the difference between the amount of cash received and paid up.
- It is always in debit since it is made up of cash in hand and at bank.

Income and Expenditure Account

- It resembles a Profit and Loss Account and serves the same function in respect of a non-profit making concern as the last mentioned account does for a firm, carrying on business or trade.
- Income and Expenditure Account is drawn up in the same form as the Profit and Loss Account.
- Expenditure of revenue nature is shown on the debit side, income and gains of revenue nature are shown on the credit side.
- Income and Expenditure Account contains all the items of income and expenditure relevant to the period of account, whether received or paid out as well as that which have fallen due for recovery or payment. Capital Receipts, prepayments of income and capital expenditures, prepaid expenses are excluded.
- It does not start with any opening balance. The closing balance represents the amount by which the income exceeds the expenditure only or vice versa.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

During 2023, subscription received in cash is ₹ 42,000. It includes ₹ 1,600 for 2022 and ₹ 600 for 2024. Also ₹ 3,000 has still to be received for 2023. Calculate the amount to be credited to Income and Expenditure Account in respect of subscription.

Question 2 *(ICAI Study Material)* *Pg no._____*

During the year ended 31st March, 2023, the subscriptions received by the Jaipur Literary Society were ₹ 4,50,000. These subscriptions include ₹ 20,000 received for the year ended 31st March, 2022. On 31st March, 2023, subscriptions due but not received were ₹ 15,000. Advance subscription received for the year ending 31st March 2023 but pertaining to year 2024 amounted to ₹ 26,000. The Subscriptions received in advance for the year ending 31st March, 2022 includes ₹ 18,000 pertaining to year 2022-23.
Show the subscription account in book of the society?

Question 3 *(ICAI Study Material)* *Pg no._____*

From the following information, calculate amount of subscriptions outstanding for the year ended 31st March, 2023
A club has 350 members each paying an annual subscription of ₹ 1,050. The Receipts and Payments Account for the year showed a sum of ₹ 4,10,000 received as subscriptions.
The following additional information is provided:
Subscriptions Outstanding on 31st March, 2022 – ₹ 45,000
Subscriptions Received in Advance on 31st March, 2023 – ₹ 62,000
Subscriptions Received in Advance on 31st March, 2022 – ₹ 30,000

Question 4 *Pg no._____*

Omshanti Club has 500 members with annual fee of ₹ 1,000 per member. At the end of the accounting year, accountant noticed that 40 members have not paid annual fee and 70 members had paid fee in advance. Help the accountant to compute cash receipts of annual fee for the year.

Question 5 *(ICAI Study Material)* *Pg no._____*

During the year ended 31st March, 2023, Sachin Cricket Club received subscriptions as follows

For year ending 31st March, 2022	12,000
For year ending 31st March, 2023	6,15,000
For year ending 31st March, 2024	18,000
Total	6,45,000

There are 500 members and annual subscription is ₹ 1,500 per member. On 31st March, 2023, a sum of ₹ 15,000 was still in arrears for subscriptions for the year ended 31st March, 2022.
Ascertain the amount of subscriptions that will appear on the credit side of Income and Expenditure Account for the year ended 31st March, 2023. Also show how the items would appear in the Balance Sheet as on 31st March, 2022 and the Balance Sheet as on 31st March, 2023

Question 6 *Pg no._____*

From the following extract of Receipts and Payments Account and the additional information, you are required to calculate the Income from Subscription for the year ending March 31, 2023 and show them in the Income & Expenditure Account, and the Balance Sheet of a Club
An extract of Receipts and Payments Account for the year ended 31st March, 2023

Receipts		₹	Payments	₹
To Subscription				
2021-22	4,000			
2022-23	20,000			
2023-24	5,000	29,000		

Information:

Subscription outstanding on 31.03.2022	5,000
Subscription outstanding on 31.03.2023	4,000
Subscription received in advance on 31.03.2022 for 2022-23	5,000

Question 7 *(ICAI Study Material)* *Pg no.______*

Suppose salaries paid during 2022-23 were ₹ 23,000. The following further information is available:

Salaries unpaid on 31st March 2022	1,400
Salaries prepaid on 31st March 2022	400
Salaries unpaid on 31st March 2023	1,800
Salaries prepaid on 31st March 2023	600

Calculate the amount to be debited to Income and expenditure account in respect of salaries and also show necessary ledger accounts. (In other words, how will you disclose in financial statements of NPO?)

Question 8 *(ICAI Study Material)* *Pg no.______*

From the following information of a club show the amounts of match expenses and match fund in the appropriate Financial Statements of the club for the year ended on 31st March, 2023:

Details	Amount
Match expenses paid during the year ended 31st March 2023	1,10,000
Match fund as on 01.04.2022	30,000
Donations for Match fund (received during the year)	55,000
Proceeds from the sale of the match tickets (during the year)	20,000

Question 9 *(ICAI Study Material)* *Pg no.______*

Following is the Receipts and Payments Account of New bird Forty Club for the year ended 31st March, 2023:

Receipts & Payments Account for the year ending on 31st March, 2023

Receipts	₹	Payments	₹
To Balance b/d	2,50,000	By Salaries & Wages	1,65,000
To Subscription		By Office Expenses	35,000
2021-2022	65,000	By Sports Equipment	3,42,000
2022-2023	3,55,000	By Telephone charges	28,000
To Donations	55,000	By Electricity charges	32,000
To Entrance Fees	85,000	By Travelling & conveyance	65,000
		By Balance c/d	1,43,000
	8,10,000		8,10,000

Additional information:

(a) Outstanding Subscriptions for the year ended 31st March, 2023 – 55,000.

(b) Outstanding Salaries & Wages for the year ended on 31st March 2023 – 40,000

(c) Depreciate Sports Equipments by 25% for the year ended on 31st March 2023.

(d) Capitalize 50% of the entrance fees
Prepare Income and Expenditure Account of the club from the above particulars for the year ended on 31st March 2023.

Question 10 *(ICAI Study Material)* Pg no._____

The Sportwriters Club gives the following Receipts & Payments Account for year ended March 31, 2023:

Receipts	₹	Payments	₹
To Balance b/d	4,820	By Salaries	12,000
To Subscriptions	28,600	By Rent and electricity	7,220
To Miscellaneous income	700	By Library books	1,000
To Interest on Fixed deposit	2,000	By Magazines & newspapers	2,172
		By Sundry expenses	10,278
		By Sports equipments	1,000
		By Balance c/d	2,450
	36,120		36,120

Figures of other assets and liabilities are furnished as follows:

	31st March, 2022	31st March, 2023
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines and newspapers	226	340
Fixed Deposit (10%) with bank	20,000	20,000
Interest accrued thereon	500	500
Subscription receivable	1,263	1,575
Prepaid expenses	417	620
Furniture	9,600	
Sports equipments	7,200	
Library books	5,000	

The closing values of furniture and sports equipments are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The Club's library books are revalued at the end of every year and the value at the end of March 31, 2023 was ₹ 5,250. From the above information you are required to prepare:
(a) The Club's Balance Sheet as at March 31, 2022;
(b) The Club's Income and Expenditure Account for the year ended March 31, 2023.
(c) The Club's Closing Balance Sheet as at March 31, 2023.

Question 11 Pg no._____

The following is the Receipt and Payment Account of Park View Club in respect of the year ended 31st March, 2023.

Receipts	₹	Payments	₹
To Balance b/d	1,02,500	By Salaries	2,08,000
To Subscriptions		By Stationery	40,000
2021-22 4,500		By Rent	60,000
2022-23 2,11,000		By Telephone expenses	10,000
2023-24 7,500	2,23,000	By Investment	1,25,000
To Profit on sports meet	1,55,000	By Sundry expenses	92,500
To Income from investments	1,00,000	By Balance c/d	45,000
	5,80,500		5,80,500

Additional information:

1) There are 450 members each paying an annual subscription of ₹ 500. On 1st April, 2022 outstanding subscription was ₹ 5,000.
2) There was an outstanding telephone bill for ₹ 3,500 on 31st March, 2023.
3) Outstanding sundry expenses as on 31st March, 2022 totalled ₹ 7,000.
4) Stock of stationery: On 31st March, 2022 ₹ 5,000 On 31st March, 2023 ₹ 9,000
5) On 31st Mar, 2022 building stood in the books at ₹ 10,00,000 & was subject to depreciation@5% p.a
6) Investment on 31st March, 2022 stood at ₹ 20,00,000.
7) On 31st March, 2023, income accrued on investments purchased during year amounted to ₹ 3,750.

Prepare Income & Expenditure A/c for the year ended 31st March, 2023 & Balance Sheet as at that date.

Question 12 *(CA Foundation July 2021) (10 Marks)* Pg no.______

Summary of receipts & payments of AMA Society for year ended 31st March 2023 are as follows:

Receipts	₹	Payments	₹
Subscription Received	5,00,000	Payment for Medicine Supply	3,00,000
Donation Raised for meeting revenue expenditure	1,50,000	Honorarium to Doctors	1,00,000
Interest on Investments @ 9% p.a.	90,000	Salaries	2,80,000
Charity Show Collection	1,25,000	Sundry Expenses	10,000
		Equipment Purchase	1,50,000
		Charity Show Expenses	15,000

Additional information:

Particulars	01.04.2022	31.03.2023
Subscription due	15,000	22,000
Subscription received in advance	12,000	7,000
Stock of medicine	1,00,000	1,50,000
Amount due for medicine supply	90,000	1,30,000
Value of equipment	2,10,000	3,00,000
Value of building	5,00,000	4,80,000
Cash balance	80,000	90,000
Opening balance of Capital Fund	18,03,000	

You are required to prepare

a) Income and Expenditure Account for the year ended 31.03.2023
b) Balance sheet as on 31.03.2023.

Question 13 *(CA Foundation June 2023) (15 Marks)* Pg no.______

Following is the Receipts and Payments account of Pune Medical Aid Society for the year ended 31-12-2022.

Receipts and Payments Account for the year ended 31-12-2022

Receipts	Amount ₹	Payments	Amount ₹
To Opening cash in hand	12,000	By Medicine supply	35,000
To Subscription	65,000	By Honorarium to Doctors	15,000
To Donations	25,000	By Salaries	36,000

To Interest on Investment (10%)	10,000	By Sundry expenses.	950
To Charity show collection	16,500	By Purchase of Medical equipment	25,000
		By Charity show expenses	2,750
		By Closing Cash in hand	13,800
	1,28,500		1,28,500

The following is the additional information provided.

	01-01-2022	31-12-2022
	Amount ₹	Amount ₹
Subscription due	2,500	3,100
Subscription received in advance	1,800	1,400
Stock of medicine	12,500	17,250
Amount due for medicine supply	12,000	16,500
Value of equipment	21,500	37,200
Value of building	65,000	61,750

You are required to prepare Income and Expenditure account, and Balance sheet as on 31-12-2022.

Question 14 *(RTP May 2018) / (ICAI Study Material)* *Pg no._____*

Smith Library Society showed the following position on 31st March, 2022:

Balance Sheet as on 31st March, 2022

Liabilities	₹	Assets	₹
Capital fund	7,93,000	Electrical fittings	1,50,000
Expenses payable	7,000	Furniture	50,000
		Books	4,00,000
		Investment in securities	1,50,000
		Cash at bank	25,000
		Cash in hand	25,000
	8,00,000		8,00,000

The receipts and payment account for the year ended on 31st March, 2023 is given below:

Receipts	₹	Payments	₹
To Balance b/d		By Electric charges	7,200
Cash at bank 25,000		By Postage and stationary	5,000
Cash in hand 25,000	50,000	By Telephone charges	5,000
To Entrance fee	30,000	By Books purchased	60,000
To Membership subscription	2,00,000	By Outstanding expenses paid	7,000
To Sale proceeds of old papers	1,500	By Rent	88,000
To Hire of lecture hall	20,000	By Investment in securities	40,000
To Interest on securities.	8,000	By Salaries	66,000
		By Balance c/d	
		Cash at bank 20,000	
		Cash in hand 11,300	31,300
	3,09,500		3,09,500

You are required to prepare income and expenditure account for the year ended 31st March, 2023 and a balance sheet as at 31st, March, 2023 after making the following adjustments:

Membership subscription included ₹ 10,000 received in advance.
Provide for outstanding rent ₹ 4,000 and salaries ₹ 3,000.
Books to be depreciated @ 10% including additions. Electrical fittings and furniture are also to be depreciated at the same rate. 75% of the entrance fees is to be capitalized.
Interest on securities is to be calculated @ 5% p.a. including purchases made on 1.10.2022 for ₹ 40,000

Question 15 *(RTP May 2022) (Similar)* Pg no._____

Jodhpur Club furnishes you the Receipts and Payments Account for the year ended 31.03.2023.

Receipts	₹	Payments	₹
Cash in hand (01.04.2022)	40,000	Salary	20,000
Cash at Bank (01.04.2022)	1,00,000	Repair Expenses	5,000
Donations	50,000	Furniture	60,000
Subscriptions	1,20,000	Investments	60,000
Entrance fee	10,000	Misc. Expenses	5,000
Interest on investments	1,000	Insurance premium	2,000
Interest from banks	4,000	Billiard table & other sports items	80,000
Sale of old newspaper	1,500	Stationary expenses	1,500
Sale of drama tickets	10,500	Drama expenses	5,000
		Cash in hand (31.03.2023)	26,500
		Cash at Bank (31.03.2023)	72,000
	3,37,000		3,37,000

Additional information:

a. Subscriptions in arrear for 2022-23 ₹ 9,000 & subscription in advance for year 2023-24 ₹ 3,500.
b. ₹ 400 was the insurance premium outstanding as on 31.03.2023.
c. Miscellaneous expenses prepaid ₹ 900.
d. 50% of donation is to be capitalized.
e. Entrance fees to be treated as revenue income.
f. 8% interest has accrued on investments for five months.
g. Billiards table & other sports equipments costing ₹ 3,00,000 were purchased in financial year 2021-22 & of which ₹ 80,000 was not paid 31.03.2022. There is no charge for Depreciation to be considered.

You are required to prepare Income and Expenditure Account for the year ended 31.03.2023 and Balance Sheet of the Club as at 31.03.2023.

Question 16 *(CA Foundation Nov 2018) (10 Marks)* Pg no._____

You are provided with the followings:

Balance Sheet as on 31st March, 2022

Liabilities	₹	Assets	₹
Capital Fund	1,06,200	Building	1,50,000
Subscription received in Advance	6,000	Outstanding Subscription	3,800
Outstanding Expenses	14,000	Outstanding Locker Rent	2,400
Loan	40,000	Cash in Hand	20,000
Sundry Creditors	10,000		
	1,76,200		1,76,200

Receipts & Payments Account for the year ended on 31st March, 2023

Receipts	₹	Payments	₹
To Balance b/d		By Expenses	
Cash in Hand	20,000	For 2022 12,000	
To Subscriptions		For 2023 20,000	32,000
For 2022 2,000		By Land	40,000
For 2023 21,000		By Interest	4,000
For 2024 1,000	24,000	By Miscellaneous Expenses	4,700
To Entrance fees	38,000	By Balance c/d	
To Locker Rent	7,000	Cash in Hand	18,300
To Sale Proceeds of old newspapers	1,000		
To Miscellaneous Income	9,000		
	99,000		99,000

You are required to prepare Income & Expenditure A/c for the year ended 31st March, 2023 & Balance Sheet as at 31st March 2023 (Workings should form part of your answer).

Question 17 *(RTP May 2021)* *Pg no._____*

The following is the Receipts and payments account of Rotary Club for the year ended on 31st March, 2023.

Receipts	₹	Payments	₹
To balance b/d	8,450	By Salaries and wages	12,250
To Subscription	23,000	By Supply of refreshment	18,250
To Sale of refreshments	22,000	By Sports equipment	27,500
To Entrance fees	26,000	By Telephone Charges	2,800
To interest on investments @ 7%	4,550	By Electricity charges	15,600
		By Honorarium charges	6,500
		By balance c/d	1,100
	84,000		84,000

Additional information:

2. Following are the assets and liabilities on 31st March, 2022:
   Assets- Sports equipment- ₹ 32,000; Subscription in arrears- ₹ 7,600; Furniture- ₹ 12,480
   Liabilities- Outstanding Electricity charges- ₹ 5,400; Subscription in advance- ₹ 6,250
3. Following are the assets and liabilities on 31st March, 2023-
   Assets- Sports equipment- ₹ 50,500; Subscription in arrears- ₹ 5,200; Furniture- ₹ 11,180
   Liabilities- Outstanding Electricity charges- ₹ 3,800; Subscription in advance- ₹ 4,850
4. 50% of the entrance fees to be capitalized.
5. Interest on the investments is being received in full, and the investments have been made on 1.4.2021

You are required to prepare Income and Expenditure account and the Closing balance sheet as of 31st March 2023 in the books of Rotary Club.

Question 18 *(ICAI Study Material)* *Pg no._____*

The Receipts & Payments for the Swaraj Club for the year ended 31st March, 2023 were: Entrance Fees ₹ 300, Membership Fees ₹ 3,000, Donation for Club Pavilion ₹ 10,000, Foodstuff Sales ₹ 1,200, Salaries & wages ₹ 1,200, Purchase of Foodstuff ₹ 800, Construction of Club Pavilion ₹ 11,000, General Expenses ₹ 600, Rent & Taxes ₹ 400, Bank Charges ₹ 160.
Cash in hand–April 1st ₹ 200, March 31st ₹ 350

Cash in Bank–April 1st ₹ 400; March 31st ₹ 590
You are required to prepare Receipts & Payments A/c.

Question 19 *(CA Foundation Nov 2019) (10 Marks)* *Pg no._____*

From the following Income and Expenditure account and the Balance sheet of a club, prepare its Receipts and Payments Account and subscription account, for the year ended 31st March 2023:

Income & Expenditure Account for the year 2022-23

Particulars	₹	Particulars	₹
To Upkeep of ground	11,000	By Subscriptions	19,052
To Printing	1,100	By Sale of Newspapers (Old)	286
To Salaries	11,100	By Lectures (Fee)	1,650
To Depreciation on furniture	1,100	By Entrance Fee	2,145
To Rent	1,660	By Misc. Income	440
		By Deficit	2,387
	25,960		25,960

Balance sheet as at 31st March 2023

Liabilities		₹	Assets	₹
Subscription in advance (2023-24)		110	Subscription(outstanding) (2022-2023)	770
Prize fund:			Furniture	9,900
Opening balance	27,500		Ground and Building	51,700
Add: Interest	1,100		Prize Fund Investment	22,000
	28,600		Cash in Hand	2,530
Less: Prizes given	(2,200)	26,400		
General Fund:				
Opening balance	62,062			
Less: Deficit	(2,387)			
	59,675			
Add: Entrance Fee	715	60,390		
		86,900		86,900

The following adjustments have been made in the above accounts:

a) Upkeep of ground ₹ 660 and printing ₹ 264 relating to 2021-22 were paid in 2022-23
b) One fourth of entrance fee has been capitalized by transfer to General Fund
c) Subscription outstanding in 2021-22 was ₹ 880 and for 2022-23 ₹ 770.
d) Subscription received in advance in 2021-22 was ₹ 220 & in 2022-23 for 2023-24 was 110
e) Furniture was purchased during the year.

Question 20 *Pg no._____*

Income & Expenditure Account for year ended 31st March, 2023 of Asia Club is given below:

Expenditure	₹	Income	₹
To Salaries & wages	47,500	By Subscription	75,000
To Miscellaneous expenses	5,000	By Entrance fee	2,500
To Audit fee	2,500	By Contribution for annual day (After deducting expenses ₹ 7,500)	7,500
To Executive's honorarium	10,000		
To Sports day expenses	5,000		
To Printing & stationary	4,500		
To Interest on bank loan	1,500		

To Depreciation on sports equipment	3,000		
To Excess of income over expenditure	6,000		
	85,000		85,000

Following additional information are also available:

	31.03.2022	31.03.2023
Subscription received in advance	4,500	2,700
Subscription outstanding	6,000	7,500
Salaries outstanding	4,000	4,500
Sports equipment (After deducting depreciation)	26,000	27,000
Cash in hand on 31-3-23 was ₹ 16,000.		
The club took a 5% loan of ₹ 30,000 from a bank during 2021-22 for which interest was not paid in the financial year 2022-23.		

Prepare Receipts and Payments account of Asia Club for the year ending 31st March 2023.

Question 21 *(CA Foundation Dec 2021) (10 Marks) / (ICAI Study Material)* *Pg no._____*

The Income and Expenditure Account of the Women Club for the year ended on December 31, 2023 is as follows:

To Salaries	47,500	By Subscription	75,000
To General Expenses	5,000	By Entrance Fees	2,500
To Audit Fee	2,500	By Contribution for annual dinner	10,000
To Secretary's Honorarium	10,000	By Annual Sports Meet Receipts	7,500
To Stationery & Printing	4,500		
To Annual Dinner Expenses	15,000		
To Interest & Bank Charges	1,500		
To Depreciation	3,000		
To Surplus	6,000		
	95,000		95,000

This account had been prepared after the following adjustments:

Subscription outstanding at the end of 2022	6,000
Subscription received in Advance on 31st December, 2022	4,500
Subscription received in advance on 31st December, 2023	2,700
Subscription outstanding on 31st Dec., 2023	7,500

Salaries Outstanding at the beginning and the end of 2023 were respectively ₹ 4,000 and ₹ 4,500. General Expenses include insurance prepaid to the extent of ₹ 600. Audit fee for the year 2023 is as yet unpaid. During 2023 audit fee for 2022 was paid amounting to ₹ 2,000.
The Club owned a freehold lease of ground valued at ₹ 1,00,000. The club had sports equipment on 1st January, 2023 valued at ₹ 26,000. At the end of the year, after depreciation, this equipment amounted to ₹ 27,000. In 2022, the Club has raised a bank loan of ₹ 20,000. This was outstanding throughout 2023. On 31st December, 2023 cash in hand amounting to ₹ 16,000.
You are required to:
Prepare the Receipts and Payments Account for the year ended on December 31, 2023 and Balance Sheet as on that date.

Question 22 *(CA Foundation Dec 2022) (10 Marks)* Pg no._____

The Income and Expenditure Account of the Young Boys Club for the year 2022 is as follows:

Expenditure	Amount (₹)	Income	Amount (₹)
To Salaries	3,750	By Subscription	8,500
To General Expenses	1,500	By Entrance Fees	250
To Audit fee	250	By Contribution for Annual Dinner	1,000
To Secretary's Honorarium	1,000		
To Stationery and Printing	450	By Annual Sports meet receipts	750
To Annual Dinner expenses	1,500		
To Interest and Bank Charges	150		
To Depreciation	400		
To Surplus	1,500		
	10,500		10,500

This Account has been prepared after the following adjustments:

	Amount (₹)
Subscription outstanding on 31st December, 2021	700
Subscription received in advance on 31st December, 2021	550
Subscription received in advance on 31st December, 2022	370
Subscription outstanding on 31st December, 2022	750

Salaries outstanding at the beginning and at the end of 2022 were respectively ₹ 600 and ₹ 150. General Expense include insurance prepaid to the extent of ₹ 150. Audit fee for 2022 is still unpaid. During 2022 audit fee for 2021 was paid amounting to ₹ 200.

The club owned a freehold lease of ground valued at ₹ 20,000. The club had sports equipment on 1st January, 2022 valued at ₹ 2600. At the end of the year, after depreciation, the balance of equipment amounted to, 3,600. In 2021, the club raised a bank loan of ₹ 5,000, This was outstanding throughout 2022. On 31st December, 2022 cash in hand amounted to ₹ 1600.

You are required to prepare:

a. Receipts and Payments Account for 2022
b. Balance Sheet as on 31st December, 2022
c. Balance Sheet as on 31st December, 2021.

Question 23 Pg no._____

From the following Income & Expenditure A/c of Premium Sports Club for the year ended 31st March, 2023, prepare Receipts & Payment A/c for the year ended 31st March, 2023 and Balance Sheet as on that date:

Expenditure	₹	Income	₹
To Salaries	1,18,800	By Subscriptions	4,20,000
To Rent	2,16,000	By Entrance Fee	1,20,000
To Printing & Stationery	28,000	By Profit on sale of Sports Material	5,500
To Postage & Telephone	41,600	By Interest on 8% Government bonds	12,000
To Membership Fee	3,200	By Sale of Old Newspaper	11,600
To Electricity Charges	38,500		
To Garden Upkeep	19,300		
To Sports Material Utilized	62,800		
To Repairs & Maintenance	18,700		

To Depreciation	13,000		
To Miscellaneous Expenses	5,700		
To Surplus carried to Capital Fund	3,500		
	5,69,100		5,69,100

The following additional information is provided to you:

	Balances as on 01.04.2022	Balances as on 31.03.2023
Fixed Assets	2,40,000	-
Bank Balance	8,300	-
Stock of Sports Material	43,450	35,670
Outstanding Subscription	10,200	5,700
Subscription received in advance	2,400	4,900
8% Government Bonds	1,50,000	1,50,000
Outstanding Salaries	16,000	14,300
Outstanding Rent	21,000	15,000
Advance for Stationery	1,350	1,550
Outstanding Repairs & Maintenance	1,200	Nil
Creditors for purchase of Sports Material	3,400	4,200

a. Some of Fixed Assets were purchased on 01.10.2022 and depreciation is to be charged @ 5% p.a.
b. Sports Material worth ₹ 72,000 was purchased on credit during the year.
c. The Club became member of State Table Tennis Association on 01.01.2023 when it paid fee up to 31.12.2023.
d. 50% of Entrance Fee is to be capitalized.
e. Interest on 8% Government Bonds was received for two quarters only.
f. A Fixed Deposit of ₹ 80,000 was made on 31st March, 2023.

Question 24 *(CA Foundation Jan 2021) (10 Marks)* *Pg no._____*

From the following Income and Expenditure Account and additional information of ATK Club, prepare Receipts and Payments Accounts and Balance Sheet of the club as on 31st March, 2023. Income and Expenditure Account for the year ending 31st March, 2023

Expenditure	₹	Income	₹
To Salaries	4,80,000	By Subscription	6,80,000
To Printing and Stationery	24,000	By Entrance Fees	16,000
To Postage	2,000	By Misc. Income	1,44,000
To Telephone	6,000		
To Office expenses	48,000		
To Bank Interest	22,000		
To Audit Fees	10,000		
To Annual General Meeting Exp.	1,00,000		
To Depreciation (Sports Equipment)	28,000		
To Surplus	1,20,000		
	8,40,000		8,40,000

Additional Information:

	As on 31.03.2022	As on 31.03.2023
Outstanding subscription	64,000	72,000
Subscription received in advance	52,000	33,600
Salaries Outstanding	24,000	32,000
Audit Fees Payable	8,000	10,000
Bank Loan	1,20,000	1,20,000
Value of Sports Equipment	2,08,000	2,52,000
Value of Club Premises	7,60,000	7,60,000
Cash in Hand	?	1,14,000

Question 25

Pg no._____

Highend Club appointed a new accountant for maintaining books of account. He prepared following Receipts and Payments A/c for the year ended as on 31st March, 2023.

Receipts and Payments Account

Receipts		₹	Payments	₹
To Balance b/d		9,000	By Loss on sale of furniture (cost price ₹ 90,000)	36,000
To Annual income from subscription Add: Outstanding of last year received this year Less: Prepaid of last year	9,18,000 36,000 9,54,000 (18,000)	9,36,000	By Repair & Maintenance Expenses (including payment for sports material ₹ 54,000)	1,26,000
To Sale of Old Newspaper		36,000	By Printing & Stationery	21,000
To 5% Interest on Investments		27,000	By Telephone Expenses	45,000
To Entrance Fees		68,000	By Garden Upkeep	55,000
To Donation for building		18,00,000	By Electricity Charged	36,000
			By Balance c/d	25,57,000
		28,76,000		28,76,000

Additional information: Highend Club had following balances:

	01-04-2022	01-04-2023
Furniture	3,60,000	
Stock of Sports material	1,33,200	36,000
Subscription receivable		54,000
Subscription received in advance		18,000
Outstanding Printing & Stationery Exp.	1,500	2,500
Outstanding Electricity Charges		3,200

50% Entrance Fees is to be capitalized.

Do you agree with above Receipts and Payments Account? If not, prepare correct Receipts and Payments Account and Income and Expenditure Account for the year ended 31st March, 2023 and Balance Sheet as on that date.

Question 26

Pg no._____

The Accountant of Diana Club furnishes you the following receipts and payments account for the year ending 30th September, 2023:

Receipts	₹	Payments	₹
Opening balance:		Honoraria to secretary	9,600

Cash & Bank	16,760	Misc. expenses	3,060
Subscription	21,420	Rates and taxes	2,520
Sale of old newspapers	4,800	Ground man's wages	1,680
Entertainment fees	8,540	Printing and stationary	940
Bank interest	460	Telephone expenses	4,780
Bar receipts	14,900	Payment for bar purchases	11,540
		Repairs	640
		New car (Less sale proceeds of old car ₹ 6,000)	25,200
		Closing balance:	
		Cash and bank	6,920
	66,880		66,880

Additional information:

	01.10.2022	30.09.2023
Subscription due (not received)	2,400	1,960
Cheques issued, but not presented for payment of printing	180	60
Club premises at cost	58,000	-
Depreciation on club premises provided so far	37,600	-
Car at cost	24,380	-
Depreciation on car	20,580	-
Value of Bar stock	1,420	1,740
Amount unpaid for bar purchases	1,180	860

Depreciation is to be provided @ 5% p.a. on the written down value of the club premises and @ 15% p.a. on car for the whole year.

You are required to prepare an income and expenditure account of Diana Club for the year ending 30th September, 2023 and balance sheet as on that date

Question 27 *(CA Foundation June 2022) (10 Marks)* *Pg no._____*

The following is the Receipts and Payments Account of Mumbai Club for the year ended March 31, 2023:

Receipt and Payment Account of Mumbai Club

Receipts	Amount (₹)	Payments	Amount (₹)
Cash in hand	20,000	Ground man's Fee	75,000
Balance at Bank as per PassBook		Purchase of Equipment's	1,55,000
Saving Account	1,93,000	Rent of Ground	25,000
Current Account	60,000	Club night expenses	38,000
Bank Interest	5,000	Printing and Office Expenses	30,000
Donations and Subscriptions	2,50,000	Repairs to Equipment	50,000
Entrance fees	18,000	Honorarium to Secretary(2021-22)	40,000
Contribution to Club night	10,000	Balance at Bank as per PassBook	
Sale of Equipment	8,000	Saving Account	2,04,000
Bar Room receipts	20,000	Current Account	20,000
Proceeds from club night	78,000	Cash in hand	25,000
	6,62,000		6,62,000

You are given the following additional information (All figures are in ₹)

	01.04.22	31.03.23
Subscription due	15,000	10,000
Amount due for printing etc.	10,000	8,000
Cheques unpresented being payment for repairs	30,000	25,000
Interest not yet entered in the Passbook	-	2,000
Estimated value of machinery and equipment	80,000	1,75,000

For the year ended March 31, 2023, the honorarium to the Secretary is to be increased by a total of ₹ 20,000 and Ground man is to receive a bonus of ₹ 20,000. Prepare the Income and Expenditure Account for period ended 31st March,2023 and the Balance Sheet as at that date.

Question 28 *(CA Foundation Nov 2020) (10 Marks)* *Pg no._____*

From the following balances and particulars of AS College prepare Income & Expenditure Account for the year ended March, 2023 and a Balance Sheet as on the date:

	Dr.	Cr.
Security Deposit-Students		1,55,000
Capital fund		13,08,000
Building Fund		19,10,000
Tuition Fee received		8,10,000
Government Grants		5,01,000
Interest & Dividends on Investments		1,75,000
Hostel Room Rent		1,65,000
Mess Receipts (Net)		2,05,000
College Stores-Sales		7,60,000
Outstanding expenses		2,35,000
Stock of-stores and Supplies (opening)	3,10,000	
Purchases-Stores & Supplies	8,20,000	
Salaries-Teaching	8,75,000	
Salaries-Research	1,25,000	
Scholarships	85,000	
Students Welfare expenses	37,000	
Games & Sports Expenses	52,000	
Other Investments	12,75,000	
Land	1,50,000	
Building	15,50,000	
Plant and Machinery	8,50,000	
Furniture and Fittings	5,40,000	
Motor Vehicle	2,40,000	
Provision for Depreciation		
Building		4,90,000
Plant & Equipment		5,05,000
Furniture & Fittings		3,26,000
Cash at Bank	3,16,000	
Library	3,20,000	
	75,45,000	75,45,000

Adjustments:

(i)	Materials & Supplies consumed (From college stores) Teaching	 52,000

	Research Students Welfare Games or Sports	1,45,000 78,000 24,000
(ii)	Tuition fee receivable from Government for backward class Scholars	82,000
(iii)	Stores selling prices are fixed to give a net profit of 15% on selling price	
(iv)	Depreciation is provided on straight line basis at the following rates: a) Building b) Plant & Equipment c) Furniture & Fixtures d) Motor Vehicle	 5% 10% 10% 20%

Question 29 *(CA Foundation May 2019) (10 Marks) / (RTP Nov 2022) (Similar)* *Pg no._____*

From the following information supplied by M.B.S. Club, prepare Receipts and Payments account and Income and Expenditure Account for the year ended 31st March 2023.

	01.04.2022	31.03.2023
Outstanding subscription	1,40,000	2,00,000
Advance subscription	25,000	30,000
Outstanding salaries	15,000	18,000
Cash in Hand and at Bank	1,10,000	?
10% Investment	1,40,000	70,000
Furniture	28,000	14,000
Machinery	10,000	20,000
Sports goods	15,000	25,000

Subscription for the year amount to ₹ 3,00,000/-. Salaries paid ₹ 60,000. Face value of the Investment was ₹ 1,75,000, 50% of the Investment was sold at 80% of Face Value. Interest on investments was received ₹ 14,000. Furniture was sold for ₹ 8000 at the beginning of the year. Machinery and Sports Goods purchased and put to use at the last date of the year.

Charge depreciation @ 15% p.a. on Machinery and Sports goods and @10% p.a. on Furniture.
Following Expenses were made during the year:

Sports Expenses: ₹ 50,000
Rent: ₹ 24,000 out of which ₹ 2,000 outstanding
Misc. Expenses: ₹ 5,000

ACCOUNTS FROM INCOMPLETE RECORDS

CH 9

"You don't have to be Great to Start, but you have to Start to be Great."

MEANING OF SINGLE-ENTRY

The term "Single Entry System" is popularly used to describe the problems of accounts from incomplete records.

Very often the small sole proprietorship and partnership businesses do not maintain double entry book keeping system. Sometimes they keep record only of the cash transactions and credit transactions. Sometimes they maintain no record of many transactions. But at the end of accounting period they want to know the performance and financial position of their businesses. This creates some special problems to the accountants.

FEATURES

➢ It is an inaccurate, unscientific and unsystematic method of recording business transactions.
➢ There is generally no record of real and personal accounts and, in most of the cases; a record is kept for cash transactions and personal accounts.
➢ Cash book mixes up business and personal transactions of the owners.
➢ There is no uniformity in maintaining the records and the system may differ from firm to firm depending on the requirements and convenience of each firm.
➢ Profit under this system is only an estimate and therefore true and correct profits cannot be determined. The same is the case with the financial position in the absence of a proper balance sheet.

TYPES

Pure single entry	In this, only personal accounts are maintained with the result that no information is available in respect of cash and bank balances, sales and purchases, etc.. In view of its failure to provide even the basic information regarding cash etc., this method exists only on paper and has no practical application.
Simple single entry	In this, only: (a) personal accounts, and (b) cash book are maintained. Although these accounts are kept on the basis of double entry system, postings from cash book are made only to personal accounts and no

	other account is to be found in the ledger. Cash received from debtors or cash paid to creditors is simply noted on the bills issued or received as the case may be.
Quasi single entry	In this: (a) personal accounts, (b) cash book, and (c) some subsidiary books are maintained. The main subsidiary books kept under this system are Sales book, Purchases book and Bills book. No separate record is maintained for discounts which are entered into the personal accounts. In addition, some scattered information is also available in respect of few important items of expenses like wages, rent, rates, etc. In fact, this is the method which is generally adopted as a substitute for double entry system.

Difference between Statement of Affairs and Balance Sheet

Basis	Statement of Affairs	Balance Sheet
Source	It is prepared on the basis of transactions partly recorded under the double entry bookkeeping and partly under the single entry. Most of the assets are recorded based on the estimates, assumptions, information gathered from memory rather from the records.	It is based on transactions recorded strictly on the basis of double entry bookkeeping; each item in the balance sheet can be verified from the relevant subsidiary books, ledger and documentary evidences.
Capital	In this statement, capital is merely a balancing figure being excess of assets over liabilities. Hence assets need not be equal to liabilities.	Capital is derived from the capital account in the ledger and therefore the total of assets side will always be equal to the total of liabilities side.
Omission	Since this statement is prepared from incomplete records, it is very difficult, to identify and record those assets and liabilities, if omitted from the books.	There is no possibility of omission of any item of asset and liability since all items are properly recorded. Moreover, it is easy to locate the missing items since the balance sheet will not agree.
Basis of Valuation	The valuation of assets is generally done in an arbitrary manner; therefore, no method of valuation is disclosed	The valuation of assets is done on scientific basis, fixed assets are shown at the original costs less depreciation till date. Any change in the method of valuation is properly disclosed.
Objective	The objective of preparing this statement is to identify the capital figures in the beginning and at the end of the accounting period respectively.	The objective of preparing the balance sheet is to ascertain the financial position on a particular date.

Profitability

Final Accounts Approach

Trading and P&L A/c

Capital Approach

- Finding Opening & closing capital
- Making capital A/c or Statement of P&L

Capital A/c

Particulars	Amount	Particulars	Amount
To Share of Loss	xx	By Bal. b/d (Opening)	xx
To Drawings	xx	By cash / Bank (Additional)	xx
To Interest on Drawings	xx	By Interest on capital	xx
To Bal c/d (Closing)	xx	By Share of Profits	xx

Statement of Profit & Loss

Particulars	Amount
Capital at the end (Closing capital)	xx
Add: Drawings	xx
Add: Interest on Drawings	xx
Less: capital at the beginning (Opening capital)	(xx)
Less: Additional capital	(xx)
Less: Interest on capital	(xx)
Profit / (Loss) (+ve) (-ve)	xx

Bills of Exchange

$$A \xrightarrow{\text{Sale : 10000}} B$$

B	10000		Purchases	10000	
To Sales		10000	To A		10000
B/R	10000		A	10000	
To B		10000	To B/P		10000

Books of DRAWER (A)

	Held Bill Till Maturity	Discounting with Bank	Endorse to Creditor	Sent to Bank for Collection
1) Event	–	Bank 9800 Discount 200 To B/R 10000	Creditor/C 10000 To B/R 10000	BSFC 10000 To B/R 10000
2) Maturity a) Honour	Bank 10000 To B/R 10000	–	–	Bank 10000 To BSFC 10000
OR b) Dishonour (Noting charges 100)	B 10100 To B/R 10000 To Bank 100	B 10100 To Bank 10100	B 10100 To C 10100	B 10100 To BSFC 10000 To Bank 100

Books of DRAWEE (B)

In all 4 cases, same entries to be passed :

Honour

B/P A/c - Dr 10000
To Bank A/c 10000

Dishonour

B/P A/c - Dr 10000
Noting charges A/c - Dr 100
To A 10100

Debtors A/c

Particulars	Amount	Particulars	Amount
To Balance b/d		By Cash A/c	
To Sales (Credit)		By Bank A/c	
To Interest charged		By B/R A/c	
Dishonour of B/R:		By Discount Allowed A/c	
To B/R (Normal)		By Bad debts A/c	
To Bank (Discounted)		By Sales Return A/c	
To Creditors (Endorsed)		By Balance c/d	

Creditors A/c

Particulars	Amount	Particulars	Amount
To Purchase Return A/c		By Balance b/d	
To Cash A/c		By Purchases (Credit)	
To Bank A/c		By B/P [Dishonoured]	
To Discount Received		By Noting charges	
To B/P A/c		By Debtors A/c [Endorsed B/R Dish.]	
To B/R (Endorsed)		By Interest A/c	
To Balance c/d			

Bills Receivable (B/R) A/c

Particulars	Amount	Particulars	Amount
To Balance b/d		By Bank [Discounted	
To Debtors A/c		By Discount with Bank]	
		By Creditors (Endorsed)	
		By Bank (Payment Rec.)	
		By Debtors (Dishonour)	
		By Balance c/d	

Bills Payable (B/P) A/c

Particulars	Amount	Particulars	Amount
To Bank (Paid)		By Balance b/d	
To Creditors (Dishonour)		By Creditors	
To Balance c/d			

ASSIGNMENT QUESTIONS

TOPIC 1: CAPITAL COMPARISON / STATEMENT OF AFFAIRS METHOD

Question 1 *(ICAI Study Material)* Pg no._____

Raju does not maintain proper records of his business. However, he provides the following information:

Opening capital	10,000
Closing capital	12,500
Drawings during the year	3,000
Capital added during the year	3,750

You are required to calculate the profit or loss for the year.

Question 2 *(ICAI Study Material)* Pg no._____

Rakesh started his business on 1st of April 2022. He invested a capital of ₹ 1,00,000. On 31st March 2023, he has the following information available as per the Single-entry system maintained by him.

Cash balance (counted)	3,200
Inventory (physically verified)	34,800
Receivable from Ajay against credit sales	31,000
Machine	85,000
Payable to Vinod towards credit purchase	12,000
Loan taken from Bank	10,000
Drawings made during the year	24,000

You are required to calculate the profit or loss earned by Rakesh for the year ended 31st March 2023.

Question 3 *(ICAI Study Material)* Pg no._____

Assets and Liabilities of Mr. X as on 31-03-2022 and 31-03-2023 are as follows:

Particulars		31-03-2022	31-03-2023
Assets	Building	1,00,000	-
	Furniture	50,000	-
	Inventory	1,20,000	2,70,000
	Sundry Debtors	40,000	90,000
	Cash at Bank	70,000	85,000
	Cash in Hand	1,200	3,200
Liabilities	Loans	1,00,000	80,000
	Sundry Creditors	40,000	70,000

Decided to depreciate building by 2.5% & furniture by 10%. One Life Insurance Policy of the Proprietor was matured during the period and the amount ₹ 40,000 is retained in the business. Proprietor took @ ₹ 2,000 p.m. for meeting family expenses.

Prepare Statement of Affairs as on 31-03-2022 & 31-03-2023 and compute profit for the year ended 31-03-2023.

Question 4 Pg no._____

Assets & Liabilities of Ms. Shreya, who runs Beauty Saloon as on 31-03-2022 & 31-03-2023 are as follows

	31-03-2022	31-03-2023
Assets:		
Machinery & Tools	25,000	30,000
Furniture & Fixtures	50,000	60,000
Stock of Consumables	60,000	1,35,000
Sundry Debtors	20,000	45,000
Cash at Bank	35,000	42,500
Cash in Hand	2,150	3,750
Liabilities:		
Loans (Principal)	50,000	40,000
Sundry Creditors	20,000	35,000

Depreciation on Machinery & Tools and Furniture & Fixture to be provided on W.D.V. method @ 10% p.a. during FY 2022-23. Shreya has purchased Machinery & Tools amounting to ₹ 5,000 on 01-07-2022. She has also purchased Furniture & Fixture amounting to ₹ 10,000 on 01-01-2023.

Loan amount of ₹ 10,000 was partly paid by her on 31-03-2023. Interest on Loan to be provided @ 12 p.a. and same is unpaid as on 31-03-2023. No interest of earlier period is outstanding.

During FY 2022-23, Shreya participated in a competition and won a prize of ₹ 20,000. Same is retained by her in the business. Monthly withdrawals of Shreya were ₹ 1,000 during FY 2022-23.

Prepare Statement of Affairs and determine Profit for the FY ending as on 31-03-2023 by applying the method of the Capital Comparison.

Question 5

Pg no.______

Mr. X had ₹ 1,65,000 in the bank account on 1.1.2022 when he started his business. He closed his accounts on 31st March, 2023. His single entry books (in which he did not maintain any account for the bank) showed his position as follows:

Particulars	31.03.2022 (₹)	31.03.2023 (₹)
Cash in hand	1,100	1,650
Stock in trade	10,450	15,950
Debtors	550	1,100
Creditors	2,750	1,650

On and from 1.2.2022, he began drawings ₹ 385 per month for his personal expenses from the cash box of the business. His account with the bank had the following entries.

	Deposits (₹)	Withdrawals (₹)
01.01.2022	1,65,000	-
01.01.2022 to 31.03.2022		1,22,650
01.04.2022 to 31.03.2023	1,26,500	1,48,500

The above withdrawals included payment by cheque of ₹ 1,10,000 and ₹ 33,000 respectively during the period from 1.1.2022 to 31.3.2022 and from 1.4.2022 to 31.3.2023 respectively for the purchase of machineries for the business. The deposits after 1.1.2022 consisted wholly of sale price received from the customers by cheques.

Draw up Mr. X's statement of affairs as at 31.3.2022 and 31.3.2023 respectively and work out his profit or loss for the year ended 31.3.2023.

TOPIC 2: FINAL ACCOUNTS METHOD

Question 6 — Pg no._____

Calculate the credit sales from the below information:

Opening balance of Debtors	10,00,000
Closing balance of Debtors	6,00,000
Payments collected in cash	13,00,000
Discount allowed	30,000
Bad debts	10,000

Question 7 *(ICAI Study Material)* — Pg no._____

Calculate the bad debts from the below information:

Opening balance of Debtors	5,00,000
Closing balance of Debtors	7,00,000
Amount received in Cash	6,00,000
Discount allowed	10,000
Credit Sales	11,40,000
Bills Receivable	3,00,000
Bad Debts	??

Question 8 *(ICAI Study Material)* — Pg no._____

Calculate the credit purchases from the below information:

Opening balance of Creditors	4,00,000
Closing balance of Creditors	5,00,000
Payments made in Cash	8,50,000
Discount received	20,000

Question 9 *(ICAI Study Material)* — Pg no._____

A.Admajee keeps his books on single entry basis. The analysis of the cash book for the year ended on 31st March, 2023 is given below:

Receipts	₹	Payments	₹
Bank Balance as on 1st April, 2022	2,800	Payments to Sundry creditors	35,000
Received from Sundry Debtors	48,000	Salaries	6,500
Cash Sales	11,000	General expenses	2,500
Capital brought during year	6,000	Rent and Taxes	1,500
Interest on Investments	200	Drawings	3,600
		Cash purchases	12,000
		Balance at Bank on 31st Mar, 2023	6,400
		Cash in hand on 31st Mar, 2023	500
	68,000		68,000

Particulars of other assets and liabilities are as follows:

Particulars	01-04-2022 (Amount in ₹)	31-03-2023 (Amount in ₹)
Sundry Debtors	14,500	17,600
Sundry Creditors	5,800	7,900
Machinery	7,500	7,500

Furniture	1,200	1,200
Stock	3,900	5,700
Investments	5,000	5,000

Prepare final accounts for the year ending 31st March, 2023 after providing depreciation at 10 percent on machinery and furniture and ₹ 800 against doubtful debts.

Question 10 *(ICAI Study Material)* Pg no._____

From the following data furnished by Mr. Manoj, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2023 and a Balance Sheet as at that date.

Assets & Liabilities	As on 1st April,2022	As on 31st March,2023
Creditors	15,770	12,400
Sundry expenses outstanding	600	330
Sundry Assets	11,610	12,040
Inventory in trade	8,040	11,120
Cash in hand and at bank	6,960	8,080
Trade debtors	?	17,870
Details relating to transactions in the year:		
Cash & discount credited to debtors		64,000
Sales return		1,450
Bad debts		420
Sales (cash and credit)		71,810
Discount allowed by trade creditors		700
Purchase returns		400
Additional capital-paid into Bank		8,500
Realisations from debtors-paid into Bank		62,500
Cash purchases		1,030
Cash expenses		9,570
Paid by cheque for machinery purchased		430
Household expenses drawn from Bank		3,180
Cash paid into Bank		5,000
Cash drawn from Bank		9,240
Cash in hand on 31-3-2023		1,200
Cheques issued to trade creditors		60,270

Question 11 Pg no._____

Ms. Rashmi furnishes you with the following information relating to her business:

Particulars	1.1.2023	31.12.2023
Sundry Debtors	32,000	?
Furniture (W.D.V.)	12,000	12,700
Prepaid Expenses	1,200	1,400
Sundry Creditors	22,000	30,000
Stock	16,000	14,000
Unpaid Expenses	4,000	3,600
Cash in Hand & at Bank	2,400	1,250

Receipts and Payments during 2023:

a) Collections from debtors, after allowing discount of ₹ 3,000 (discount of 2.5%) amounted to ₹ 1,17,000

b) Collections on discounting of bills of exchange, after deduction of discount of ₹ 250 (Discounted at an average of 2%) by the bank, totalled to ₹ 12,250.
c) Creditors of ₹ 80,000 were paid ₹ 78,400 (discount of 2%) in full settlement of their dues.
d) Payment for freight inwards ₹ 6,000.
e) Amount withdrawn for personal use ₹ 14,000.
f) Payment for office furniture ₹ 2,000.
g) Investment carrying annual interest of 4% were purchased at ₹ 192 (face value ₹ 200) on 1st July, 2023 and payment made therefor.
h) Expenses including salaries paid ₹ 29,000.
i) Miscellaneous receipts ₹ 1,000.
j) Bills of exchange drawn on and accepted by customers during the year amounted to ₹ 20,000. Of these, bills of exchange of ₹ 4,000 were endorsed in favour of creditors. An endorsed bill of exchange of ₹ 800 was dishonoured.
k) Goods costing ₹ 1,800 were used as advertising materials.
l) Goods are invariably sold to show a gross profit of 33-1/3% on sales.
m) Difference in cash book, if any, is to be treated as further drawing or introduction of capital.
n) Provide at 2.5% for doubtful debts on closing debtors.

Prepare Trading and Profit & Loss A/c for the year ended 31st December, 2023 and the Balance Sheet.

Question 12

Pg no._____

A trader keeps his books of account under single entry system. On 31st March, 2022 his statement of affairs stood as follows:

Liabilities	₹	Assets	₹
Trade Creditors	5,80,000	Furniture, Fixtures & Fittings	1,00,000
Bills Payable	1,25,000	Stock	6,10,000
Outstanding Expenses	45,000	Trade Debtors	1,48,000
Capital Account	2,50,000	Bills Receivable	60,000
		Unexpired Insurance	2,000
		Cash in Hand & At Bank	80,000
	10,00,000		10,00,000

The following was the summary of Cash-book for the year ended 31st March, 2023:

Receipts	₹	Payments	₹
Cash & Bank on 1st April,22	80,000	Payments to Trade Creditors	75,07,000
Cash Sales	73,80,000	Payments for Bills payable	8,15,000
Receipts from Trade Debtors	15,10,000	Sundry Expenses paid	6,20,700
Receipts for Bills Receivable	3,40,000	Drawings	2,40,000
		Cash & Bank on 31st Mar,23	1,27,300
	93,10,000		93,10,000

Discount allowed to trade debtors &received from trade creditors amounted to ₹ 36,000 and ₹ 28,000 respectively. Bills endorsed amounted to ₹ 15,000. Annual Fire Insurance premium of ₹ 6,000 was paid every year on 1st August for the renewal of the policy. Furniture, fixtures and fittings were subject to depreciation @ 15% per annum on diminishing balances method.

You are also informed about the following balances as on 31st March, 2023:

Particulars	₹
Stock	6,50,000
Trade Debtors	1,52,000
Bills Receivable	75,000
Bills Payable	1,40,000
Outstanding Expenses	5,000

The trader maintains a steady gross profit ratio of 10% on sales.
Prepare Trading and Profit & Loss A/c for the year ended 31st March, 2023 & Balance Sheet.

Question 13

Pg no._____

'X' and 'Y' are in partnership sharing profits and losses equally. They keep their books by single entry system.
The following balances are available from their books as on 31.3.2022 and 31.3.2023

Particulars	31.03.2022 (₹)	31.03.2023 (₹)
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	60,000	?

The transactions during the year ended 31.3.2023 were the following:

Collection from Debtors	3,80,000
Payment to Creditors	2,50,000
Cash Purchases	65,000
Expenses paid	40,000
Drawings by 'X'	30,000

a. On 1.4.2022 an equipment of book value ₹ 20,000 was sold for ₹ 15,000. On 1.10.2022, some equipments were purchased.
b. Cash sales amounted to 10% of sales. Credit sales amounted to ₹ 4,50,000.
c. Credit purchases were 80% of total purchases.
d. The firm sells goods at cost plus 25%.
e. Discount allowed ₹ 5,500 during the year. Discount earned ₹ 4,800 during the year.
f. Outstanding expenses ₹ 3,000 as on 31.3.2023.
g. Capital of 'X' as on 31.3.2022 was ₹ 15,000 more than the capital of 'Y', equipments and furniture to be depreciated at 10% p.a. and building @ 2% p.a.

You are required to prepare:
(i) Trading and Profit and Loss account for the year ended 31.3.2023 and
(ii) Balance Sheet as on that date.

Question 14 *(RTP Nov 2019)*

Pg no._____

Following are the incomplete information of Moonlight Traders:

Balances	31.03.2022	31.03.2023
Land and Building	5,00,000	5,00,000
Plant and Machinery	2,20,000	3,30,000
Office equipment	1,05,000	85,000

Debtors (before charging for bad debts)	?	2,25,000
Creditors for purchases	95,000	?
Creditors for office expenses	20,000	15,000
Stock	?	65,000
Long term loan from SBI @ 12%.	1,60,000	1,00,000
Bank	25,000	?

Other Information	₹
Collection from debtors	9,25,000
Payment to creditors for purchases	5,25,000
Payment of office expenses (excluding interest on loan)	42,000
Salary paid	32,000
Selling expenses	15,000
Cash sales	2,50,000
Credit sales (80% of total sales)	
Credit purchases	5,40,000
Cash purchases (40% of total purchases)	
GP Margin at cost plus 25%	
Discount Allowed	5,500
Discount Received	4,500
Bad debts (2% of closing debtors)	
Depreciation to be provided as follows	
Land and Building	5%
Plant and Machinery	10%
Office Equipment	15%

Other adjustments:

(a) On 01.10.22 they sold machine having Book Value ₹ 40,000 (as on 31.03.2022) at a loss of ₹ 15,000. New machine was purchased on 01.01.2023.

(b) Office equipment was sold at its book value on 01.04.2022.

(c) Loan was partly repaid on 31.03.23 together with interest for the year.

Prepare Trading P & L A/c and Balance Sheet as on 31.03.2023.

Question 15 *(ICAI Study Material)* *Pg no._____*

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

Particulars	31-03-2022	31-03-2023
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 2022-23:

a) 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.

b) Cash Withdrawn from Bank ₹ 1,21,000

c) Cash payment to suppliers ₹ 77,200 for supplies and ₹ 25,000 for furniture.
d) Cheques collected from customers but dishonoured ₹ 5,700.
e) Bills accepted by customers ₹ 40,000.
f) Bills endorsed ₹ 10,000.
g) Bills discounted ₹ 20,000, discount ₹ 750.
h) Bills matured and duly collected ₹ 16,000.
i) Bills accepted ₹ 24,000.
j) Paid suppliers by cheque ₹ 3,20,000.
k) Received ₹ 20,000 on maturity of one LIC policy of the proprietor by cheque.
l) Rent received ₹ 14,000 by cheque for the premises owned by the proprietor.
m) A building was purchased on 30-11-2022 for opening a branch for ₹ 3,50,000 & some expenses were incurred on this building, details of which are not maintained.
n) 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 year ended 31-03-2023 and Balance Sheet as on that date.

TOPIC 3: FINAL ACCOUNTS METHOD: TIME LAG / CREDIT PERIOD

Question 16 *Pg no._____*

A company sold 25% of the goods on cash basis and the balance on credit basis. Debtors are allowed 2 months credit and their balance as on 31.3.2023 is ₹1,40,000. Assume that sale is uniform throughout the year. Calculate total sales for the year ended 31.3.2023.

Question 17 *(CA Inter July 2021) (10 Marks) / (ICAI Study Material) (Similar)* *Pg no._____*

Mr. Arun runs a business of readymade garments. He closes the books of accounts on 31st March. The Balance Sheet as on 31st March, 2022 was as follows:

Liabilities	₹	Assets	₹
Capital A/c	5,05,000	Furniture	50,000
Creditors	1,02,500	Closing Stock	3,50,000
		Debtors	1,25,000
		Cash in Hand	35,000
		Cash at Bank	47,500
	6,07,500		6,07,500

You are furnished with following information :
1) His sales, for the year ended 31st March, 2023 were 20% higher than the sales of previous year, out of which 20% sales was cash sales.
2) Total Sales during the year 2021-22 were ₹ 6,25,000
3) Payments for all the purchases were made by cheques only.
4) Goods were sold for cash and credit both. Credit customers pay by cheques only.

5) Deprecation on furniture is to be charged 10% p.a.
6) Mr. Arun sent to the bank the collection of the month at the last date of each month after paying salary of ₹ 2,500 to the clerk, office expenses ₹ 1,500 and personal expenses ₹ 625.

Analysis of bank pass book for the year ending 31st March, 2023 disclosed the following:

	₹
Payment to creditors	3,75,000
Payment to rent up to 31st March, 2023	20,000
Cash deposited into bank during the year	1,00,000

The following are the balances on 31st March, 2023:

	₹
Stock	2,00,000
Debtors	1,50,000
Creditors for goods	1,82,500

On the evening of 31st March, 2023, the cashier absconded with the available cash in the cash book.

You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2023 and Balance Sheet as on that date. All the working should form part of the answer.

Question 18 *(RTP May 2022) (Similar)* *Pg no.____*

The following is the Balance Sheet of Sri Dev as on 31st March, 2022:

Liabilities	₹	Assets	₹
Capital Account	2,52,500	Machinery	1,20,000
Sundry Creditors for Purchases	45,000	Furniture	20,000
		Stock	33,000
		Debtors	1,00,000
		Cash in Hand	8,000
		Cash at Bank	16,500
	2,97,500		2,97,500

Riots occurred and fire broke out on the evening of 31st March, 2023, destroying the books of account and Furniture. The cashier was grievously hurt and the cash available in the cash box was stolen.

The trader gives you the following information:

a. Sales are effected as 25% for cash and the balance on credit. His total sales for the year ended 31st March, 2023 were 20% higher than the previous year. All the sales and purchases of goods were evenly spread throughout the year (as also in the last year).

b. Terms of credit

   i. Debtors 2 Months

   ii. Creditors 1 Month

c. Stock level was maintained at ₹ 33,000 all throughout the year.

d. A steady Gross Profit rate of 25% on the turnover was maintained throughout. Creditors are paid by cheque only, except for cash purchase of ₹ 50,000.

e. His private records and the Bank Pass-book disclosed the following transactions for the year.

i. Miscellaneous Business expenses ₹ 1,57,500 (including ₹ 5,000 paid by cheque and ₹ 7,500 was outstanding as on 31st March, 2023)
ii. Repairs ₹ 3,500 (paid by cash)
iii. Addition to Machinery ₹ 60,000 (paid by cheque)
iv. Private drawings ₹ 30,000 (paid by cash)
v. Travelling expenses ₹ 18,000 (paid by cash)
vi. Introduction of additional capital by depositing into the Bank ₹ 5,000

f. Collection from debtors were all through cheques.
g. Depreciation on Machinery is to be provided @ 15% on the Closing Book Value.
h. The Cash stolen is to be charged to the Profit and Loss Account.
i. Loss of furniture is to be adjusted from the Capital Account.

Prepare Trading, Profit and Loss Account for the year ended 31st March, 2023 and a Balance Sheet as on that date. Make appropriate assumptions whenever necessary.

Question 19 Pg no._____

The following is the Balance Sheet of a concern on 31st March, 2022:

Liabilities	₹	Assets	₹
Capital	10,00,000	Fixed Assets	4,00,000
Creditors (Trade)	1,40,000	Stock	3,00,000
Profit & Loss A/c	60,000	Debtors	1,50,000
		Cash & Bank	3,50,000
	12,00,000		12,00,000

The management estimates the purchases and sales for the year ended 31st March, 2023 as under:

	Upto 28.02.23 (₹)	March 2023 (₹)
Purchases	14,10,000	1,10,000
Sales	19,20,000	2,00,000

It was decided to invest ₹ 1,00,000 in purchases of fixed assets, which are depreciated @ 10% on cost.

The time lag for payment to Trade Creditors for purchase and receipt from Sales is one month. The business earns a gross profit of 30% on turnover. The expenses against gross profit amount to 10% of the turnover. The amount of depreciation is not included in these expenses.

Draft a Balance Sheet as at 31st March, 2023 assuming that creditors are all Trade Creditors for purchases and debtors for sales and there is no other item of current assets and liabilities apart from stock and cash and bank balances. Assume that all sales and purchases are on credit basis.

Question 20 *(RTP Nov 2020)* Pg no._____

The following is the Balance Sheet of Manish and Suresh as on 1st April 2022:

Liabilities	₹	Assets	₹
Capital:		Building	1,00,000
Manish	1,50,000	Machinery	65,000
Suresh	75,000	Stock	40,000
Creditors for Goods	30,000	Debtors	50,000
Creditors for Expenses	25,000	Bank	25,000
	2,80,000		2,80,000

They give you the following additional information:

a) Sales & purchases for the year ended 31st March 2022 were ₹ 3,00,000 and ₹ 2,40,000 respectively.
b) Stock Level is maintained uniformly in value throughout all over the year.
c) Depreciation on Machinery is charged @ 10%, Depreciation on Building @ 5% in the current year.
d) Sales in the current year will increase by 43.75% in volume.
e) Rate of Gross Profit remains the same.
f) Business Expenditures are ₹ 50,000 for the year. All Expenditures are paid off in cash.
g) All sales and purchases are on credit basis and there are no cash purchases and sales.

Prepare Trading and Profit and Loss Account for the year ending 31.03.2023.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1. In case of net worth method, profit is determined by
   (a) Preparing a trading and profit and loss account.
   (b) Comparing the capital in the beginning with the capital at the end of the accounting period
   (c) Comparing the net assets in the beginning with the net assets at the end of the accounting period.

2. Single entry system can be followed by
   (a) Small firms.
   (b) Joint stock companies.
   (c) Co-operative societies.

3. Closing capital is calculated as
   (a) Opening capital +Additional capital -Drawings
   (b) Opening capital +Additional capital –Drawings + Profit.
   (c) Opening capital +Additional capital +Drawings - Profit

4. Under single entry system, only personal accounts are kept and, in some cases
   (a) Cash book is maintained
   (b) Fixed assets' accounts are maintained
   (c) Liabilities' accounts are maintained.

5. The closing capital of Mr. B as on 31.3.2023 was ₹ 4,00,000. On 1.4.2022 his capital was ₹ 3,50,000. His net profit for the year ended 31.3.2023 was ₹ 1,00,000. He introduced ₹ 30,000 as additional capital in February, 2023 Find out the amount drawn by Mr. B for his domestic expenses.
   (a) ₹ 1,00,000
   (b) ₹ 80,000
   (c) ₹ 1,20,000

5. Given information:

Opening capital:	60,000
Drawings:	5,000
Capital introduced during the period:	10,000
Closing capital:	90,000

   Profit earned during the period. ?
   (a) ₹ 20,000
   (b) ₹ 25,000
   (c) ₹ 30,000

ANSWERS MCQs

1. (b) 2. (a) 3. (b) 4. (a) 5. (b) 6. (b)

TRUE / FALSE

State with reasons whether the following are true or false:

1) A Trial Balance cannot be drawn up from books kept under Single Entry.
2) Nominal Accounts are kept under Single Entry System.
3) Single Entry System can be adopted by small firms
4) Profit under single entry system is always correct and accurate.
5) Profits computed under single entry system by different business entities are not comparable.

Solution

1) True: Since incomplete records are maintained, trial balance cannot be prepared
2) False: Under the single entry system of bookkeeping, generally cash book and personal accounts of creditors and debtors are maintained, and no other ledger is maintained.
3) True: A single entry system is the one where financial transactions are recorded as a single entry in a log and is usually used by new small businesses.
4) False: Profit under single entry system is only an estimate based on available information and correct profits cannot be determined.
5) True: Since entry system has no fixed set of principles for recording the financial transaction, different organizations maintain records as per their needs. Hence their accounts are not comparable.

HOMEWORK QUESTIONS

TOPIC 1: CAPITAL COMPARISON / STATEMENT OF AFFAIRS METHOD

Question 1

Pg no._____

Lakhan keeps his books of account by single entry system. Following is the list of his assets and liabilities in the beginning as well as at the end of the year.

Particulars	On 1st April,2022 (₹)	On 31st March,2023 (₹)
Cash in hand	1,750	1,400
Cash at bank	20,000	-
Bank Overdraft	-	1,800
Bills Receivable	15,000	25,000
Stock	93,500	98,700
Debtors	60,000	70,000
Furniture and Fittings	65,000	65,000
Creditors	45,000	31,000
Bills Payable	5,000	Nil

Lakhan introduced ₹ 10,000 as fresh capital on 1st October, 2022. He also withdrew ₹ 5,000 every month for his household expenses. During the year, there was no sale or fresh purchase of furniture and fittings. Ascertain the profit earned by Lakhan during the year ended 31st March, 2023 after depreciating furniture and fittings @ 10% per annum and creating a provision for bad debts @ 5% on debtors

Question 2 *(ICAI Study Material)*

Pg no._____

The Income Tax Officer, on assessing the income of Shri Moti for the financial years 2020-2021 and 2021-2022 feels that he has not disclosed full income. He gives you the following particulars of assets and liabilities of Shri Moti as on 1st April, 2020 and 1st April, 2022

<table>
<tr><td rowspan="7">1-4-2020</td><td rowspan="5">Assets</td><td>Cash in Hand</td><td>25,500</td></tr>
<tr><td>Inventory</td><td>56,000</td></tr>
<tr><td>Sundry Debtors</td><td>41,500</td></tr>
<tr><td>Land & Building</td><td>1,90,000</td></tr>
<tr><td>Wife's Jewellery</td><td>75,000</td></tr>
<tr><td rowspan="2">Liabilities</td><td>Owing to Moti's Brother</td><td>40,000</td></tr>
<tr><td>Sundry Creditors</td><td>35,000</td></tr>
<tr><td rowspan="8">1-4-2022</td><td rowspan="7">Assets</td><td>Cash in Hand</td><td>16,000</td></tr>
<tr><td>Inventory</td><td>91,500</td></tr>
<tr><td>Sundry Debtors</td><td>52,500</td></tr>
<tr><td>Land & Building</td><td>1,90,000</td></tr>
<tr><td>Motor Car</td><td>1,25,000</td></tr>
<tr><td>Wife's Jewellery</td><td>1,25,000</td></tr>
<tr><td>Loan to Moti's Brother</td><td>20,000</td></tr>
<tr><td>Liabilities</td><td>Sundry Creditors</td><td>55,000</td></tr>
</table>

During the two years the domestic expenditure was ₹ 4,000 p.m. The declared income of the financial years were ₹ 1,05,000 for 2020-2021 & ₹ 1,23,000 for 2021-2022 respectively. State whether the Income-tax Officer's contention is correct. Explain by giving your workings.

Question 3 *(CA Inter Nov 2022) (10 Marks)* *Pg no.____*

Ramesh had ₹ 3,30,000 in the bank account on 1st January,2021 when he started his business. He closed his accounts on 31st March, 2022. His single-entry books (in which he did not maintain any bank account for the bank) showed his position as follows:

Particulars	31.3.2021	31.3.2022
Stock	20,900	31,900
Debtors	1,100	3,200
Cash	2,200	3,300
Creditors	5,500	4,300

On and from 1st February,2021, he began drawings at ₹ 770 per month for his personal expenses from the cash box of the business. His account with the bank had the following entries:

Particular	Deposits	Withdrawals
1.1.2021 to 31.3.2021	-	2,45,300
1.4.2021 to 31.3.2022	2,53,000	2,97,000

a) The above withdrawals included payment by cheque of ₹ 2,20,000 and ₹ 66,000 during the period from 1st January, 2021 to 31st March,2021 and from 1st April,2021 to 31st March,2022 respectively for the purchase of Machines for the business.

b) The deposits after 1st January, 2021 consisted wholly of sale proceeds received from the customers by cheques.

c) One customer (Suresh) had directly deposited a cheque of ₹ 2,700 on 25th March, 2022 into bank account of Ramesh. Ramesh has no knowledge of this and this cheque is not included in the deposits for the period 1st April 2021 to 31st March 2022 given above.

You are required to draw up Ramesh's Statement of Affairs as at 31st March, 2021 and 31st March, 2022 respectively and work out his Profit or Loss for the year ended 31st March, 2021 and 31st March, 2022.

TOPIC 2: FINAL ACCOUNTS METHOD

Question 4 *(RTP May 2020)* *Pg no.____*

Balance sheet position of RukRukMaan is as follows:

	31.03.2022	31.03.2023
Furniture & fixtures	2,60,000	2,34,000
Stock	2,45,000	3,20,000
Debtors	1,25,000	?
Cash in Hand & at bank	1,10,000	?
Creditors	1,35,000	1,90,000
Bills payable	70,000	80,000
Outstanding salaries	19,000	20,000

An analysis of the cash book revealed the following:

Cash sales	16,20,000
Collection from debtors	10,58,000
Discount allowed to debtors	20,000
Cash purchases	6,15,000
Payment to creditors	9,73,000

Discount received from creditors	32,000
Payment for bills payable	4,30,000
Drawings for domestic expenses	1,20,000
Salaries paid	2,36,000
Rent paid	1,32,000
Sundry trade expenses	81,000

Depreciation is provided on furniture & fixtures @10% p.a. on diminishing balance method. RukRukMaan maintains a steady gross profit rate of 25% on sales.

You are required to prepare Trading and Profit and Loss account for the year ended 31st March, 2023 and Balance Sheet as on that date.

Question 5 *(RTP Nov 2021)* *Pg no._____*

From the following furnished by Mittalji, prepare Trading and Profit and Loss account for the year ended 31.3.2023. Also draft his Balance Sheet as at 31.3.2023.

Assets & Liabilities	As on 1st April,2022	As on 31st March,2023
Creditors	3,15,400	2,48,000
Sundry expenses outstanding	12,000	6,600
Plant & Machinery	2,32,200	2,40,800
Stock in trade	1,60,800	2,22,400
Cash in hand	59,200	24,000
Cash at bank	80,000	1,37,600
Trade debtors	3,30,600	?
Details relating to transactions in year:		
Cash and discount credited to debtors		12,80,000
Return from Debtors		29,000
Bad debts		8,400
Sales (cash and credit)		14,36,200
Discount allowed by creditors		14,000
Returns to Creditors		8,000
Capital introduced by Cheque		1,70,000
Collection from debtors (Deposited into bank after receiving cash)		12,50,000
Cash purchases		20,600
Expenses paid by cash		1,91,400
Drawings by cheque		8,600
Machinery acquired by cheque		63,600
Cash deposited into Bank		1,00,000
Cash withdrawn from Bank		1,84,800
Cash Sales		92,000
Payment to creditors by cheque		12,05,400

Note: Mittalji has not sold any machinery during the year.

Question 6 *(ICAI Study Material) / (RTP May 2021)* *Pg no._____*

Ram carried on business as retail merchant. He has not maintained regular account books. However, he always maintained ₹ 10,000 in cash and deposited the balance into the bank account. He informs you that he has sold goods at profit of 25% on sales. Following information is given to you:

Assets & Liabilities	As on 01.04.2022	As on 31.03.2023
Cash in Hand	10,000	10,000
Sundry Creditors	40,000	90,000
Cash at Bank	50,000(Cr.)	80,000(Dr.)
Sundry Debtors	1,00,000	3,50,000
Stock in Trade	2,80,000	?
Ram's Capital	3,00,000	

Analysis of his bank pass book reveals the following information:
(a) Payment to creditors ₹ 7,00,000
(b) Payment for business expenses ₹ 1,20,000
(c) Receipts from debtors ₹ 7,50,000
(d) Loan ₹ 1,00,000 taken on 1.10.2022 at 10% per annum
(e) Cash deposited in the bank ₹ 1,00,000
He informs you that he paid creditors for goods ₹ 20,000 in cash and salaries ₹ 40,000 in cash. He has drawn ₹ 80,000 in cash for personal expenses. During the year Ram had not introduced any additional capital. Surplus cash if any, to be taken as cash sales. All purchases are on credit basis.
Prepare: Trading and Profit & Loss A/c for the year ended 31.3.2023 and Balance Sheet as at 31st March, 2023.

Question 7 *(RTP May 2019) / (RTP Nov 2023) (Similar)* *Pg no._____*

From the following information in respect of Mr. X, prepare Trading and Profit and Loss Account for the year ended 31st March, 2023 and a Balance Sheet as at that date:

	Particulars	31-03-2022 (₹)	31-03-2023 (₹)
1.	**Liabilities and Assets:**		
	Stock in trade	1,60,000	1,40,000
	Debtors for sales	3,20,000	?
	Bills receivable	-	?
	Creditors for purchases	2,20,000	3,00,000
	Furniture at written down value	1,20,000	1,27,000
	Expenses outstanding	40,000	36,000
	Prepaid expenses	12,000	14,000
	Cash on hand	4,000	3,000
	Bank Balance	20,000	1,500
2.	Receipts and Payments during 2022-2023:		
	Collections from Debtors (after allowing 2-1/2% discount)		11,70,000
	Payments to Creditors (after receiving 2% discount)		7,84,000
	Proceeds of Bills receivable discounted at 2%		1,22,500
	Proprietor's drawings		1,40,000
	Purchase of furniture on 30.09.2022		20,000
	12% Government securities purchased on 1-10-22		2,00,000
	Expenses		3,50,000
	Miscellaneous Income		10,000
3.	Sales are effected so as to realize a gross profit of 50% on cost.		
4	Capital introduced during year by proprietor by cheques was omitted to be recorded in Cash Book, though bank balance of 1,500 on 31st Mar, 2023 (as shown above), is after taking same into account		
5	Purchases and Sales are made only on credit.		

6	During the year, Bills Receivable of ₹ 2,00,000 were drawn on debtors. Of these, Bills amounting to ₹ 40,000 were endorsed in favour of creditors. Out of this latter amount, a Bill for ₹ 8,000 was dishonoured by the debtor.

Question 8 (RTP Nov 2018) / (RTP May 2023) Pg no._____

The following information relates to the business of ABC Enterprises, who requests you to prepare a Trading and Profit & Loss A/c for the year ended 31stMarch,2023 and a Balance Sheet as on that date.

(a) Assets and Liabilities as on:

	01.04.2022	31.03.2023
Furniture	60,000	63,500
Stock	80,000	70,000
Sundry Debtors	1,60,000	??
Sundry Creditors	1,10,000	1,50,000
Prepaid Expenses	6,000	7,000
Outstanding Expenses	20,000	18,000
Cash in Hand & Bank Balance	12,000	26,250

(b) Cash transaction during the year:

(i) Collections from debtors, after allowing discount of ₹ 15,000 amounted to ₹ 5,85,000

(ii) Collections on discounting of bills of exchange, after deduction of discount of ₹ 1,250 by the bank, totalled to ₹ 61,250.

(iii) Creditors of ₹ 4,00,000 were paid ₹ 3,92,000 in full settlement of their dues.

(iv) Payment for freight inwards ₹ 30,000.

(v) Amount withdrawn for personal use ₹ 70,000.

(vi) Payment for office furniture ₹ 10,000.

(vii) Investment carrying annual interest of 6% were purchased at ₹ 95 (200 shares, Face value ₹ 100 each) on 1st October, 2022 and payment made thereof.

(viii) Expenses including salaries paid ₹ 95,000.

(ix) Miscellaneous receipts ₹ 5,000.

(x) Bills of exchange drawn on and accepted by customers during the year amounted to ₹ 1,00,000. Of these, bills of exchange of ₹ 20,000 were endorsed in favour of creditors. An endorsed bill of exchange of ₹ 4,000 was dishonoured.

(xi) Goods costing ₹ 9,000 were used as advertising materials.

(xii) Goods are invariably sold to show a gross profit of 20% on sales.

(xiii) Difference in cash book, if any, is to be treated as further drawing or introduction of capital by proprietor of ABC Enterprises.

(xiv) Provide at 2% for doubtful debts on closing debtors.

Question 9 (CA Inter Jan 2021) (10 Marks) Pg no._____

Mr. Prakash furnishes following information for his readymade garments business:

Receipts and Payments during 2022-23:

Receipts	Amount	Payments	Amount
Bank Balance as on 1-4-22	16,250	Payment to Sundry Creditors	3,43,000
Received from Sundry Debtors	4,81,000	Salaries	75,000
Cash sales	1,70,800	General Expenses	22,500
Capital brought in the business during the year	50,000	Rent and Taxes	11,800
Interest on Investment received	9,750	Drawings	96,000
		Cash Purchases	1,22,750

		Balance at Bank on 31-03-23	36,600
		Cash in hand on 31-03-23	20,150
	7,27,800		7,27,800

Particulars of other Assets and Liabilities are as follows:

	1st April, 2022	31st March, 2023
	(₹)	(₹)
Machinery	85,000	85,000
Furniture	24,500	24,500
Trade Debtors	1,55,000	?
Trade Creditors	60,200	?
Stock	38,600	55,700
12% Investment	85,000	85,000
Outstanding Salaries	12,000	14,000

Additional information:

a) 20% of Total sales and 20% of total purchases are in cash.

b) Of the Debtors, a sum of 7,200 should be written off as Bad debt and further a reserve for doubtful debts is to be provided @ 2%.

c) Provide depreciation @ 10% p.a. on Machinery and Furniture.

You are required to prepare Trading and Profit & Loss account for the year ended 31st March, 2023, and Balance Sheet as on that date.

Question 10 *Pg no._____*

Mr. Vivek keeps his books under single entry system. On 31st March, 2022 his Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Capital of Mr. Vivek	4,50,000	Fixed Assets	2,25,000
Creditors	8,70,000	Stock	9,15,000
Bills Payable	1,87,500	Debtors	2,22,000
Expenses Outstanding	67,500	Bills Receivable	90,000
		Prepaid Insurance	3,000
		Cash/Bank Balance	1,20,000
	15,75,000		15,75,000

(i) Following are the summary of cash and bank transactions for the year ended 31st March, 2023

Cash sales	1,10,70,000
Collection from debtors	22,65,000
Payments to creditors	1,12,60,500
Paid for bills payable	12,22,500
Sundry expenses paid	9,31,050
Drawings for domestic expenses by Mr.Vivek	3,60,000
Cash and bank balance as on 31.3.2023	1,90,950

(i) Following further details are furnished:

Gross profit on sales @ 10%	
Bills receivable from debtors during the year	6,52,500
Discount allowed to debtors	54,000
Discount received from creditors	42,000
Bills receivable endorsed to creditors	22,500

Annual fire insurance premium paid (This is paid on 1st August every year)	9,000
Depreciate fixed assets @ 10%	

(ii) Balances as on 31.3.2023 are given below:

Stock in hand	9,75,000
Debtors	2,28,000
Bills Receivable	2,10,000
Bills Payable	2,10,000
Outstanding Expenses	7,500

Prepare Trading, Profit and Loss Account for the year ended 31st March, 2023 and Balance Sheet on that date.

Question 11 *(CA Inter Nov 2019) (10 Marks)* *Pg no._____*

Archana Enterprises maintain their books of accounts under single entry system. The Balance Sheet as on 31st March, 2022 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital A/c Trade creditors Outstanding exp.	6,75,000 7,57,500 67,500	Furniture & fixtures Stock Trade debtors Prepaid insurance Cash in hand & at bank	1,50,000 9,15,000 3,12,000 3,000 1,20,000
	15,00,000		15,00,000

The following was the summary of cash and bank book for year ended 31st March, 2023:

Receipts	Amount (₹)	Payments	Amount (₹)
Cash in hand & at Bank on 1st April, 2022 Cash sales Receipts from trade debtors	1,20,000 1,10,70,000 27,75,000	Payment to trade creditors Sundry expenses paid Drawings Cash in hand & at Bank on 31st March, 2023	1,24,83,000 9,31,050 3,60,000 1,90,950
	1,39,65,000		1,39,65,000

Additional Information:

a) Discount allowed to trade debtors and received from trade creditors amounted to ₹ 54,000 and ₹ 42,500 respectively. (for the year ended 31st March, 2023)

b) Annual fire insurance premium of ₹ 9,000 was paid every year on 1st August for the renewal of the policy.

c) Furniture & fixtures were subject to depreciation @ 15% p.a. on diminishing balance method.

d) The following are the balances as on 31st March, 2023:
- Stock ₹ 9,75,000
- Trade debtors ₹ 3,43,000
- Outstanding expenses ₹ 55,200

e) Gross profit ratio of 10% on sales is maintained throughout the year.

You are required to prepare Trading and Profit & Loss account for the year ended 31st March, 2023, and Balance Sheet as on that date.

Question 12 *(CA Inter May 2022) (12 Marks)* *Pg no._____*

Stevie and Alicia are in partnership sharing profits and losses equally. They maintain their books on Single Entry System. The following balances are available from their books as on 31.3.2021 and 31.3.2022:

Particulars	31.3.2021 ₹	31.3.2022 ₹
Building	3,00,000	3,00,000
Equipment	4,80,000	5,44,000
Furniture	50,000	50,000
Debtors	?	2,00,000
Creditors	1,30,000	?
Stock	?	1,40,000
Bank loan	90,000	70,000
Cash	1,20,000	?

The transactions during the year ended 31.3.2022 were the following:

Collection from Debtors	7,60,000
Payment to Creditors	5,00,000
Expenses Paid	80,000
Drawings by Stevie	60,000
Discount allowed	11,000
Discount received	9,600

Other information:

a) On 1.4.2021, an equipment of book value ₹ 40,000 was sold for ₹ 30,000. On 1.10.2021, some more equipment were purchased.

b) Cash sales amounted to 10% of total sales.

c) Credit sales amounted to ₹ 9,00,000.

d) Credit purchases were 80% of total purchases.

e) Cash Purchases amounted to ₹ 1,30,000.

f) The firm sells goods at cost plus 25%.

g) Outstanding expenses were ₹ 6,000 as on 31.3.2022.

h) Capital of Stevie as on 31.3.2021 was ₹ 30,000 more than the capital of Alicia, equipment and furniture to be depreciated at 10% p.a. and building @ 2% p.a. (apply depreciation of new equipment for 1/2 year)

You are required to prepare:

1. Trading and Profit and Loss Account for the year ended 31.3.2022 and;
2. Balance Sheet as on that date.

Question 13 *(CA Inter May 2019) (12 Marks)* *Pg no._____*

The following balances appeared in the books of M/s Sunshine Traders:

	As on 31-03-2022 (₹)	As on 31-03-2023 (₹)
Land and Building	2,50,000	2,50,000
Plant and Machinery	1,10,000	1,65,000
Office Equipment	52,500	42,500
Sundry Debtors	77,750	1,10,250
Creditors for Purchases	47,500	?
Provision for office expenses	10,000	7,500
Stock	?	32,500
Long Term loan from ABC Bank @ 10% p.a.	62,500	50,000

Bank Capital	12,500 4,65,250	? ?

Other information was as follows:

Collection from Sundry Debtors	4,62,500
Payments to Creditors for Purchases	2,62,500
Payment of office Expenses	21,000
Salary paid	16,000
Selling Expenses paid	7,500
Total sales	6,25,000
Credit sales (80% of Total Sales)	
Credit Purchases	2,70,000
Cash Purchases (40% of Total Purchases)	
Gross Profit Margin was 25% on cost	
Discount Allowed	2,750
Discount Received	2,250
Bad debts	2,250
Depreciation to be provided as follows: Land and Building Plant and Machinery Office Equipment	 5% per annum 10% per annum 15% per annum

(a) On 01.10.2022 the firm sold machine having Book Value ₹ 20,000 (as on 31.03.2022) at a loss of ₹ 7,500. New machine was purchased on 01.01.2023.
(b) Office equipment was sold at its book value on 01.04.2022.
(c) Loan was partly repaid on 31.03.2023 together with interest for the year.

You are required to prepare:
(i) Trading and Profit & Loss account for the year ended 31st March, 2023.
(ii) Balance Sheet as on 31st March 2023.

Question 14 *(CA Inter May 2023) (10 Marks)* *Pg no._____*

Mr. Takewood keeps his books on single entry system. The following information of Mr. Takewood is given:

a) Balances as on 1st April, 2022:

Cash in Hand	₹ 4,000	Stock	₹ 35,000
Cash in Bank	₹ 28,000	Fixed Assets	₹ 20,000
Sundry Creditors	₹ 15,000	Sundry Debtors	₹ 23,000
Capital Account	₹ 95,000		

b) During the year 2022-2023 Sundry Creditors were paid ₹ 26,000 in cash and ₹ 1,55,000 by cheque and received ₹ 55,000 in cash & ₹ 1,90,000 by cheque from Sundry Debtors.
c) All Sales and Purchases were on credit.
d) Balances as on 31st March, 2023: Sundry Debtors ₹ 27,000 & Sundry Creditors ₹ 35,000
e) All expenses which are debited to profit and loss accounts were disbursed by cheques except petty expenses amounting to ₹ 7,500 paid in cash.
f) Outstanding expenses as on 31st March 2023 were ₹ 2,000,
g) Net Profit for the year was ₹ 41,000 after allowing 10% depreciation on fixed assets.
h) Closing Stock was valued at ₹ 75,000.
i) His Drawings during the year were ₹ 10,000 in cash and ₹ 14,000 by cheques.

You are required to prepare Profit and Loss Account for the year ended 31st March 2023 and Balance Sheet as at that date.

TOPIC 3: FINAL ACCOUNTS METHOD: TIME LAG / CREDIT PERIOD

Question 15 *(ICAI Study Material)* Pg no._____

A Firm sold 20% of the goods on cash basis and the balance on credit basis. Debtors are allowed 1½ month's credit and their balance as on 31.03.2023 is ₹ 1,25,000. Assume that the sale is uniform through out the year. Calculate credit sales and total sales of the company for the year ended 31.03.2023.

Question 16 *(CA Inter Dec 2021) (5 Marks)* Pg no._____

A company sold 20% of the goods on cash basis and balance on credit basis. Debtors allowed 1.5 month's credit and their balance as on 31st March, 2023 is ₹1,50,000. Assume that sale is evenly spread throughout the year. Purchase during the year ₹9,50,000. Closing stock is ₹10,000 less than the opening stock. Average stock maintained during year is ₹60,000. Direct expenses amounted to ₹35,000.
Calculate Credit sales, Total sales and Gross profit for the year ended 31st March, 2023.

Question 17 Pg no._____

The following is the Balance Sheet of retail business of Sri Srinivas as at 31st Dec, 2022:

Liabilities	₹	Assets	₹
Sri Srinivas's capital	1,00,000	Furniture	10,000
Liabilities for Goods	20,500	Stock	70,000
Rent	1,000	Debtors	25,000
		Cash in Hand	2,000
		Cash at Bank	14,500
	1,21,500		1,21,500

You are furnished with the following information:
a) Sri Srinivas sells his goods at a profit of 20% on sales.
b) Goods are sold for cash and credit. Credit customers pay by cheques only.
c) Payments for purchases are always made by cheques.
d) It is the practice of Sri Srinivas to send to bank every weekend the collections of the week after paying every week, salary of ₹ 300 to the clerk, Sundry expenses of ₹ 50 and personal expenses ₹ 100.

Analysis of the Bank Pass-Book for the 13 weeks period ending 31st March, 23 disclosed the following:

Particulars	Amount (In ₹)
Payments to creditors	75,000
Payments of rent upto 31.3.2023	4,000
Amounts deposited into the bank (include ₹ 30,000 received from debtors by cheques)	1,25,000

The following are the balances on 31st March, 2023:

Stock	40,000
Debtors	30,000
Creditors for goods	36,500

On the evening of 31st March, 2023 the Cashier absconded with the available cash in the cash box. There was no cash deposit in the week ended on that date.
You are required to prepare a statement showing the amount of cash defalcated by the Cashier and also a Profit and Loss Account for the period ended 31st March, 2023 and a Balance Sheet as on that date.

Question 18 *(CA Inter Nov 2018) (15 Marks) / (RTP Nov 2022)* *Pg no.*_____

Aman, a readymade garment trader, keeps his books under single entry system. On the closing date, i.e. on 31st March, 2022 his statement of affairs stood as follows:

Liabilities	₹	Assets	₹
Aman's capital	4,80,000	Building	3,25,000
Loan	1,50,000	Furniture	50,000
Creditors	3,10,000	Motor car	90,000
		Stock	2,00,000
		Debtors	1,70,000
		Cash in hand	20,000
		Cash at bank	85,000
	9,40,000		9,40,000

Riots occurred and a fire broke out on the evening of 31st March, 2023, destroying the books of accounts. On that day, the cashier had absconded with the available cash. You are furnished with the following information:

1. Sales for the year ended 31st March, 2023 were 20% higher than the previous year's sales, out of which, 20% sales were for cash. He always sells his goods at cost plus 25%. There were no cash purchases.
2. Collection from debtors amounted to ₹ 14,00,000, out of which ₹ 3,50,000 was received in cash.
3. Business expenses amounted to ₹ 2,00,000, of which ₹ 50,000 were outstanding on 31st March, 2023 and ₹ 60,000 paid by cheques.
4. Gross profit as per last year's audited accounts was ₹ 3,00,000.
5. Provide depreciation on building and furniture at 5% each and motor car at 20%.
6. His private records and the Bank Pass Book disclosed the following transactions for the year 2022-23:

Payment to creditors (paid by cheques)	13,75,000
Personal drawings (paid by cheques)	75,000
Repairs (paid by cash)	10,000
Travelling expenses (paid by cash)	15,000
Cash deposited in bank	7,15,000
Cash withdrawn from bank	1,20,000

7. Stock level was maintained at ₹ 3,00,000 all throughout the year.
8. The amount defalcated by the cashier is to be written off to the Profit and Loss Account.

You are required to prepare Trading and Profit and Loss A/c for the year ended 31st March, 2023 and Balance Sheet as on that date of Aman. All the workings should form part of the answer.

Question 19 *(CA Inter Nov 2020) (10 Marks)* *Pg no.*_____

M/s Rohan & Sons runs a business of Electrical goods on wholesale basis. The Balance Sheet as on 31st March, 2022 is as follows:

Liabilities	₹	Assets	₹
Capital	12,50,000	Fixed Assets	6,50,000
Trade Creditors	1,90,000	Closing stock	3,75,000
Profit & Loss A/c	1,45,000	Trade Debtors	3,65,000
		Cash & Bank	1,95,000
	15,85,000		15,85,000

Management estimates the purchase & sales for year ended 31st March, 2023 as under:

Particulars	Upto 31.01.2023 (₹)	February 2023 (₹)	March 2023 (₹)
Purchases	16,20,000	1,40,000	1,25,000
Sales	20,75,000	2,10,000	1,75,000

All Sales and Purchases are on credit basis. It was decided to invest ₹ 1,50,000 in purchase of Fixed assets, which are depreciated @ 10% on book value. A Fixed Asset of book value as on 01.04.2022; ₹ 60,000 was sold for ₹ 56,000 on 31st March, 2023.

The time lag for payment to Trade Creditors for purchases is one month and receipt, from Trade debtors for sales is two months. The business earns a gross profit of 25% on turnover. The expenses against gross profit amounts to 15% of the turnover. The amount of depreciation is not included in these expenses.

Prepare Trading & profit & Loss Account for the year ending 31st March, 2023 and draft a Balance Sheet as at 31st March, 2023 assuming that creditors are all Trade creditors for purchases and debtors are all Trade debtors for sales and there is no other current assets and liabilities apart from stock and cash and bank balances. Also, prepare Cash & Bank account and Fixed Assets account for the year ending 31st March, 2023.

Unit 1: INTRODUCTION TO PARTNERSHIP ACCOUNTS

CH 10A

"Your problem isn't the problem. Your reaction is the problem. You can do anything, but not everything."

DEFINITIONS

Partnership	Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all.
Partners	Persons who have entered into Partnership with one another are individually called Partners.
Firm	Persons who have entered into Partnership with one another are collectively called firm
Firm Name	The name under which their business is carried on is called the Firm Name

FEATURES OF PARTNERSHIP

Persons	It requires at least two persons to form a Partnership.
Agreement	An agreement is entered by all the persons concerned, setting out the terms and conditions under which the Partnership is based. When this agreement is set out in writing, it is called the "Partnership Deed".
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
Mutual Agency	The activities of the business will be carried on/managed by all or any one of them acting for all. This principle of mutuality is the essence of Partnership agreement
Sharing of Profit/loss	The Partners share the profits and losses of the business in the agreed ratio.
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.

Number of Partners:
Minimum Partners: Two
Maximum Partners: As per Section 464 of Companies Act, 2013, no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business which shall not exceed 100. Prescribed limit is 50. Thus, maximum number of members in a partnership firm are 50.

PARTNERSHIP DEED & CONTENTS

Meaning	Partnership Deed is the written agreement containing the terms and conditions under which the Partnership will sustain or exist.

Contents of Partnership Deed	❖ Name of the firm and the nature of the Partnership Business. ❖ Commencement and Tenure of the Business (e.g. Partnership at Will, etc.) ❖ Amount of Capital to be contributed by each Partner. ❖ Ratio for sharing the Profit/Loss of Partnership business. ❖ Arrangement in respects of Drawings by Partners and limits thereon. ❖ Interest to be credited on the Capital Account of Partners. ❖ Interest to be charged on Drawings of Partners ❖ Remuneration to Partners & the basis of determining such remuneration e.g. Commission as a percentage of Firm's Turnover, other conditions etc. ❖ Process of setting disputes that may arises among the Partners. ❖ Procedure for maintenance of Books of Accounts ❖ Audit of Books of Accounts ❖ Manner of valuation of Goodwill in case of admission of new partners, retirement of existing partners and death of a Partner. ❖ Procedure for settlement of Partners' claims in case of retirement/death ❖ Procedure for dissolution of Partnership
Notes	❖ When partnership deed is not registered a partnership firm is allowed to carry on business subject to certain disabilities. ❖ It is not mandatory to have a written agreement in all cases. Further, even in cases where there is a written Partnership Deed, it is not compulsory to have it registered.

DISTINCTION BETWEEN PARTNERSHIP & LIMITED LIABILITY PARTNERSHIP

BASIS	PARTNERSHIP	LIMITED LIABILITY PARTNERSHIP
Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
Registration	Optional	Compulsory
Creation	Created by an Agreement	Created by Legal process
Separate Legal Entity	No	Yes
Body Corporate	No	Yes
Name	No guidelines. The partners can have any name as per their choice	Name of LLP to contain word limited liability partners (LLP) as suffix.
Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
Number of Partners	Minimum 2 and Maximum 50	Minimum 2 but no maximum limit
Designated Partners	There is no provision for such partners under the Partnership Act, 1932.	At least two designated partners and atleast one of them shall be resident in India.
Legal compliances	All partners are responsible for all the compliances and penalties under the Act.	Only designated partners are responsible for all the compliances and penalties under this Act
Liability of Partners / Members	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.

POWERS OF PARTNERS

- ❖ Buying and selling of goods;
- ❖ Receiving payments on behalf of the firm and giving valid receipt;
- ❖ Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm;
- ❖ Borrowing money on behalf of the firm with or without pledging the inventories-in-trade;
- ❖ Engaging servants for the business of the firm.

REMUNERATION, INTEREST ON CAPITAL, LOAN, DRAWINGS, PROFIT SHARING RATIO

1. Governing Statute: The law governing Partnership in India is the Partnership Act, 1932.
2. Conditions not covered by Partnership Deed: Where any situation or circumstance is not covered by the Partnership Deed or is not adequately provided for in the Partnership Deed, the Provision of the Partnership Act, 1932 will apply.

If the Deed is silent on-	Provisions of the Partnership Act
Partners' Remuneration/ Salary/Commission	No Remuneration will be allowed.
Interest on Partners' Capital	No IOC will be allowed to any Partner.
Interest on loan given by Partner to Firm	Maximum 6% p.a. can be allowed on loan.
Interest on Partners' Drawings	No interest will be charged.
Profit Sharing Ratio	Profits and Losses will be shared equally.

PARTNER'S CAPITAL ACCOUNTS

1. Transactions: The following transactions affect the Capital Accounts of Partners-
   (a) Capital Contribution in the form of Cash/ other Asset introduced into business. (Both Initial Capital Contribution & Additional Capital Contribution, to the extent not treated as Loan, will be considered.)
   (b) Interest on Capital at the rate agreed in the Partnership Deed,
   (c) Amounts withdrawn by Partners during the period.
   (d) Interest, if any, chargeable on Drawings of partners.
   (e) Salary/ Remuneration to Partners for managing the affairs of the business,
   (f) Share of Profit / loss of the business as per agreed Profit Sharing Ratio (PSR)

2. Methods of Accounting: The transactions affecting the Partners' Capital Accounts may be accounted under any of the following methods-

Aspects	Fluctuating Capital Method	Fixed Capital Method
Ledger A/cs prepared	Partner's Capital Account.	1. Partner's Capital Account, and 2. Partner's Current Account.
Initial Capital contribution	Amount brought in or contribution is credited to Partner's Capital A/c	Amount brought in or contributed is credited to Partners' Capital A/c
Subsequent transactions	Subsequent transactions are accounted in Partner's Capital A/c	Subsequent transactions are accounted in Partner's Current A/c

FORMAT OF PARTNER'S CAPITAL ACCOUNT

Particulars	A	B	C	Particulars	A	B	C
To Cash/Bank (Withdrawal of capital, if any) To Balance c/d				By Balance b/d By Cash/ Bank/ Assets (Capital Contribution)			
Total				Total			

FORMAT OF PARTNER'S CURRENT ACCOUNT

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d To Drawings A/c To P&L A/c - Share of Loss To P&L Appropriation -Interest on Drawings To Balance c/d				By Balance b/d By P&L Appropriation -Remuneration/ Salary etc. -Interest on Capital -Share of Profit By Balance c/d			
Total				Total			

Note: If Capital Accounts are maintained on Fluctuating basis, all the above entries will be made in one single Capital Account only. There will not be any Current Account.

PROFIT & LOSS APPROPRIATION ACCOUNT

1. Purpose: Profit & Loss A/c of firm will show the profit earned or loss suffered by the firm. To distribute the Profit properly to the Partners, the Profit & Loss Appropriation A/c is used

2. Features:
   (a) It is an extension of P&L Account.
   (b) It is applicable only for Partnership Firm, and not Sole Proprietary Concerns.
   (c) It provides details of how Net Profit for the period has been distributed to the Partners.
   (d) The entries in P&L Appropriation A/c are governed by the Partnership Deed.

Note: Interest on Partners' Loan, Rent for use of Partners' premises, if any, etc. are debited to P&L A/c itself. Net Profit after charging and debiting these items, is only transferred to P&L Appropriation A/c.

3. Format:

Dr. Profit & Loss Appropriation A/c Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Interest on partner's capital A --- B --- To Partner's Salary A --- B --- To Partner's Commission/Bonus A --- B --- To Reserves (Amount transferred) To Profits transferred in PSR: A --- B ---	XX XX XX XX XX	By P&L A/c balance (Profit) By Interest on partner'sdrawings A --- B ---	XX XX
Total	XXXX	Total	XXXX

CALCULATION OF REMUNERATION / SALARY / COMMISSION TO PARTNERS

Remuneration/ Salary/ Commission to Partners, can be provided to Partners, only if the Partnership Deed so provides. The calculations are as under:-

Type of Capital	Computation
1. Remuneration/ Salary	Remuneration / Salary p.a. = Monthly Amount x No. of months
2. Commission as x % of Turnover	Commission p.a. = Sales Turnover of the Firm x Rate of Commission
3. Commission as x % of Net Profit (a) Before Commission (b) After Commission	 Net Profit before Commission x Rate of Commission /100 Net Profit before Commission x $\frac{\text{Rate of Commission}}{(100+\text{Rate of Commission})}$

Example:

Net Profit for the year before Manager's Commission amounted to ₹ 1,10,000
Calculate Manager Commission if commission rate is

a) 10% of net profit before charging manager's commission
b) 10% of net profit after charging manager's commission

INTEREST ON PARTNERS' CAPITAL

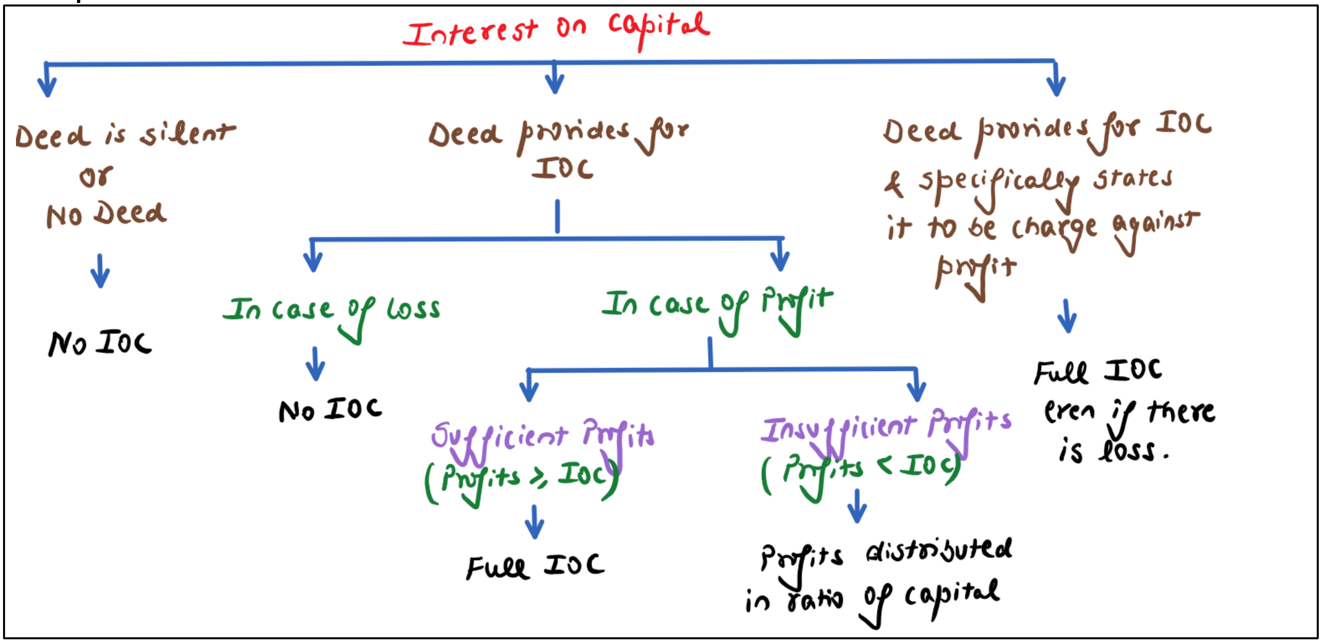
Type of Capital	Computation of Interest on Capital (IOC)
1. Opening Capital	IOC= Opening Capital x Rate of Interest
2. Additional Capital	IOC= Additional Capital x Rate of Interest x Period of use

Example:

Ramesh & Naresh are partners in a firm. Their Capitals as on 1st April of a financial year were ₹ 3,00,000 and ₹ 1,20,000 respectively. They share profits equally. On 1st July, they decided that their Capitals should be ₹ 2,00,000 each. The necessary adjustment in the capitals was made by introducing or withdrawing cash. Interest on Capital is allowed at 8% p.a.
Compute the interest on capital for both Partners for the year ending 31st March.

Interest on Capital in case of Insufficient Profits or Loss

It is an appropriation. It will be paid to the partners if provided for in the agreement but only from profits. The treatment in different situations is as under-



Example:

X and Y are Partners sharing profits and losses in the ratio of 2:3 with a capital of ₹ 2,00,000 and ₹ 1,00,000 respectively. Show the distribution of profits/losses for the year ended 31st March, in each of the following cases-

Case 1: If Partnership Deed is silent as to IOC and profits for the year is ₹ 20,000.
Case 2: If Partnership Deed provides for IOC at 6% p.a. and loss for the year is ₹ 15,000.
Case 3: If Partnership Deed provides for IOC at 6% p.a. and profits for year is ₹ 21,000.
Case 4: If Partnership Deed provides for IOC at 6% p.a. and profits for year is ₹ 15,000.

Effective Capital

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 and 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.

Example:

A and B formed a partnership with a capital contribution of ₹ 1,00,000 & ₹ 80,000 respectively on 1st January 2023. The profits were to be shared in the Capital /Effective Capital ratio. Calculate effective capital, profit sharing ratio & Interest on capital @ 6% p.a.

Date	Capital Introduced		Capital Withdrawn	
	A	B	A	B
1st April	2,00,000			
1st July		40,000	1,00,000	

INTEREST ON PARTNERS' DRAWINGS

- ❖ Drawings refers to amount withdrawn by Partners, in cash or kind, for their personal use.
- ❖ Partners are supposed to pay interest on drawings only when provided by the agreement or agreed by the partners.
- ❖ Interest on drawings is gain for the business. It is recorded on credit side of P&L Appropriation A/c.
- ❖ Partner's Drawings A/c & interest on drawings is closed by transferring to debit side of Capital or Current A/c.

Interest on Drawings

- **Dates of Drawings not given**
  - P.a. → $IOD = Drawings \times \frac{Rate}{100} \times \frac{6}{12}$
  - ~~P.a.~~ → $IOD = Drawings \times \frac{Rate}{100}$
- **Dates of Drawings given**
  - Amount of each drawing same **and** Time interval b/w 2 drawings same
    - Direct Method
    - Product Method
    - Shortcut Method (Preferable)
  - Either amount not same **or** Time interval not same
    - Direct Method
    - Product Method (Preferable)
    - Shortcut Method (X)

Short Cut Method

$$IOD = \text{Total Drawings} \times \frac{Rate}{100} \times \frac{\text{Average Time Period}^{*}}{12}$$

* Average Time Period

TTP = Total Time Period

TI = Time Interval

	Beginning $\frac{TTP+TI}{2}$	Middle $\frac{TTP}{2}$	End $\frac{TTP-TI}{2}$
A) 12 Months Period			
a) Monthly	$\frac{12+1}{2} = 6.5$	$\frac{12}{2} = 6$	$\frac{12-1}{2} = 5.5$
b) Quarterly	$\frac{12+3}{2} = 7.5$	$\frac{12}{2} = 6$	$\frac{12-3}{2} = 4.5$
A) 6 Months Period			
a) Monthly	$\frac{6+1}{2} = 3.5$	$\frac{6}{2} = 3$	$\frac{6-1}{2} = 2.5$
b) Quarterly	$\frac{6+3}{2} = 4.5$	$\frac{6}{2} = 3$	$\frac{6-3}{2} = 1.5$

Example:
Compute interest on partners' Drawings in the following situations, if interest rate is 6% p.a. (Financial year of the firm ends on 31st December)

Date of withdrawal	Feb 1	May 1	June 30	Oct 31st
Amt. withdrawn (₹)	20,000	50,000	40,000	60,000

Example:

Compute interest on partners' Drawings in the following situations, if interest rate is 10% p.a.-

- ₹ 10,000 withdrawn per month, throughout the year, at – (a) beginning of each month, (b) middle of each month, and (c) end of each month.
- Drawings during the entire year ₹ 2,50,000 (details of withdrawal not available)
- Drawings during the entire year ₹ 2,50,000, & interest is to be calculated without reference to time factor (i.e., interest on drawing at 10% and not 10% p.a.)

PAST ADJUSTMENTS IN CAPITAL ACCOUNTS OF PARTNERS

Sometimes few errors & omissions in recording of transactions or the preparation of financial statements are found after final accounts have been prepared & profits distributed among partners. These omissions and errors may be in respect of:

- Interest on capitals,
- Interest on drawings,
- Partner's salary, partner's commission or
- There may also be some changes in the provisions of partnership deed or system of accounting having impact with retrospective effect.

All these acts of omission and commission need adjustments for correction.

Now instead of altering all the old accounts, necessary adjustments can be made either;

- ❖ Through Profit and Loss Adjustment Account, or
- ❖ Directly in the Capital Accounts of the concerned partners.

<u>Journal entry for adjustment is:</u>

Gaining partner capital/current A/c Dr.

To Sacrificing Partner capital/current A/c

TABLE

	A	B	Total
Items to be Recorded			
IOC	✓	✓	✓
Salary, Commission, etc.	✓	✓	✓
Share of Profit	✓	✓	✓
IOD	(✓)	(✓)	(✓)
CR.	✓	✓	✓
Items to be Reversed			
IOC	✓	✓	✓
Salary, Commission, etc.	✓	✓	✓
Share of Profit	✓	✓	✓
IOD	(✓)	(✓)	(✓)
DR.	✓	✓	✓
Difference	✓	✓	

Example:

A, B and C are partners in a firm sharing profits and losses in the ratio of 2:3:5. Their fixed capitals were ₹ 15,00,000, ₹ 30,00,000 and ₹ 60,00,000 respectively.

Case 1: For the year 2023 interest on capital @ 10% was not provided.

Case 2: For the year 2023 interest on capital was credited to them @ 12% instead of 10%.

Pass entry to rectify the error.

GUARANTEE OF MINIMUM PROFIT TO A PARTNER

1. Meaning: Sometimes, Partners may mutually agree that certain Partner (s) has the right to have minimum amount of profit. Such profit is called Guaranteed Profit or Guaranteed Minimum Profit.

Example: Guarantee given to a partner 'X' by the other partners 'Y & Z' means in case of loss or insufficient profits 'X' will withdraw the minimum guaranteed amount.

2. Treatment:

Situation	Steps in Computation/ Treatment
(a) If Profit Share > Guaranteed Profit	Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner.
(b) If Profit Share < Guaranteed Profit	• Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner. • Compute the shortfall in Guaranteed Profit, and add that to the share of the Partner entitled to the same. • Deduct the shortfall from the Profit shares of the Other Partners, as described below

Burden of Shortfall:

Guarantee given by	Shortfall to be reduced from
(a) One of the remaining partners	That Remaining Partner's Share of Profit
(b) Remaining 2 or all Partners in agreed ratio	Two or all Partners, in agreed ratio
(c) Remaining Partners in their mutual PSR	All remaining Partners in mutual PSR

Note: If the question is silent about nature of guarantee, situation (c) given above is assumed

Example

A, B & C partners with PSR 5:3:2. Guarantee given to Partner C of amount 50,000.
Guarantee given by:

1) A and Profits for the year 3,00,000
2) A and Profits for the year 2,00,000
3) A & B (Deficiency to be shared in mutual PSR) and Profits for the year 2,00,000
4) A & B (Deficiency to be shared in 3:2) and Profits for the year 2,00,000

LIMITED LIABILITY PARTNERSHIPS (LLP Act, 2008)

DEFINITIONS

LLP	a partnership formed and registered under this Act
LLP agreement	any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights & duties of the partners and their rights and duties in relation to that limited liability partnership.
Small LLP	Means a limited liability partnership— • the contribution of which, does not exceed 25 lakh rupees or such higher amount, not exceeding 5 crore rupees, as may be prescribed; and • the turnover of which, as per Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed 40 lakh rupees or such higher amount, not exceeding 50 crore rupees, as may be prescribed

NATURE OF LIMITED LIABILITY PARTNERSHIP

1) A LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
2) A LLP shall have perpetual succession.
3) Any change in the partners of LLP shall not affect the existence, rights or liabilities of LLP

NON-APPLICABILITY OF THE INDIAN PARTNERSHIP ACT, 1932

Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to a LLP.

MINIMUM NUMBER OF PARTNERS

Any individual or body corporate may be a partner in a LLP.
Provided that an individual shall not be capable of becoming a partner of a LLP, if
a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
b) he is an undischarged insolvent; or
c) he has applied to be adjudicated as an insolvent and his application is pending

Every LLP shall have at least two partners.
If at any time the number of partners of a LLP is reduced below two and the LLP carries on business for more than six months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period

DESIGNATED PARTNERS

Section 7

Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

Provided that in case of a LLP in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

Explanation- For the purposes of this section, the term "*resident in India*" means a person who has stayed in India for a period of not less 120 days during the immediately preceding one year.

Subject to the provisions of sub-section (1),
1) if the incorporation document-
   a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
   b) states that each of the partners from time to time of LLP is to be designated partner, every such partner shall be a designated partner;
2) any partner may become a designated partner by and in accordance with the LLP agreement and a partner may cease to be a designated partner in accordance with LLP agreement.
3) An individual shall not become a designated partner in any LLP unless he has given his prior consent to act as such to the LLP in such form and manner as may be prescribed.
4) Every LLP shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.
5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed

LIABILITIES OF DESIGNATED PARTNERS

Unless expressly provided otherwise in this Act, a designated partner shall be-
a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement; and .
b) liable to all penalties imposed on the LLP for any contravention of those provisions.

LIMITATION OF LIABILITY OF AN LLP AND ITS PARTNERS

An obligation of an LLP arising out of a contract or otherwise, shall be solely the obligation of the LLP. The Liabilities of LLP shall be met out of the properties of the LLP
A partner is not personally liable, directly or indirectly, for an obligation referred to above, solely by reason of being a partner in the LLP
An LLP is not bound by anything done by a partner in dealing with a person, if: ❖ The partner does not have authority to act on behalf of LLP in doing a particular act & ❖ The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
The liability of the LLP and the partners perpetrating fraudulent dealings shall be unlimited for all or any of the debts or other liabilities of the LLP
LLP is liable if a partner of LLP is liable to any person as a result of wrongful acts or omission on his part in the course of business of the LLP or with his authority

FINANCIAL DISCLOSURES AND RETURNS

Every LLP shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to the double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.
Every LLP shall within six months of the end of each financial year prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year, in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP.
Every LLP shall file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner and accompanied by such fee as may be prescribed.
The accounts of an LLP must be audited in accordance with rules as prescribed. Provided that the Central Government may, by notification in the Official Gazette, exempt any class or classes of limited liability partnerships from the requirements of this sub-section

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2022)* Pg no._____

A and B are partners in a firm sharing profits and losses equally. On 1st April, 2020 the balance of their Capital Accounts were : A ₹ 50,000 and B ₹ 40,000. On that date the balances of their Current Accounts were: A ₹ 10,000 (credit) and B ₹ 3,000 (debit). Interest @ 5% p.a. is to be allowed on the balance of Capital Accounts as on 1.4.2020. B is to get annual salary of ₹ 3,000 which had not been withdrawn. Drawings of A and B during the year were ₹ 1,000 and ₹ 2,000 respectively.

The profit for year ended 31st March, 2021 before charging interest on capital but after charging B's salary was ₹ 70,000. It is decided to transfer 10% of divisible profit to a Reserve Account. Prepare Profit & Loss Appropriation Account for the year ended 31st March, 2021 and show Capital and Current Accounts of the Partners for the year.

Question 2 *(RTP May 2023)* Pg no._____

P, Q and R were partners in a firm sharing profits in the ratio of 1:2:2. After division of the profits for the year ended 31.03.2022 their capitals were: P ₹ 1,50,000. Q ₹ 1,80,000 and R ₹ 2,10,000. During the year they withdraw ₹ 20,000 each. The profit of the year was ₹ 60,000. The partnership deed provided that interest on capital will be allowed @ 10% p.a. While preparing the final accounts, interest on partners' capital was not allowed. You are required to pass the necessary adjustment entity for providing interest on capital.

Question 3 *(CA Foundation Dec 2021) (5 Marks)* Pg no._____

A, B and C are partners in a firm. On 1st April 2019 their fixed capital stood at ₹ 50,000, ₹ 25,000 and ₹ 25,000 respectively.

As per the provision of partnership deed:

(1) C was entitled for a salary of 5,000 p.a.

(2) All the partners were entitled to interest on capital at 5% p.a.

(3) Profits and losses were to be shared in the ratio of Capitals of the partners.

Net Profit for the year ended 31st March, 2020 of ₹ 33,000 and 31st March,2021 of ₹ 45,000 was divided equally without providing for the above adjustments.

You are required to pass an adjustment journal entry to rectify the above errors.

Question 4 Pg no._____

A and B formed a partnership with a capital contribution of ₹ 50,000 and ₹30,000 respectively on 1st January 2023. The profits were to be shared in the capital ratio. Calculate the capital ratio on the basis of following details:

	Capital Introduced		Capital Withdrawn	
	A	B	A	B
31 March	5,000	-	-	2,000
1 July	-	9,000	3,000	-
1 September	5,500	-	-	1,000
1 November	-	4,000	4,500	-

Question 5 *(ICAI Study Material)* Pg no._____

Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 % per annum. (No interest will be charged/allowed on Current Accounts).

The following are the particulars of the Capital and Drawings Accounts of the partners:

	Weak	Able	Lazy
Capital (1.1.2023)	75,000	40,000	30,000
Current Account (1.1.2023)	10,000	5,000	5,000 (Dr.)
Drawings	15,000	10,000	10,000

The draft accounts for 2023 showed a net profit of ₹ 60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

(a) Life Insurance premium of Weak amounting to ₹ 750 paid by the firm on 30th June, 2023 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, 2023 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, 2023.

Question 6 *(ICAI Study Material)* *Pg no._____*

Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2023, and becomes entitled to 1/10th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

Before becoming a partner, Ratan was getting a salary of ₹ 500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission.

It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits.

The net profit for the year ended December 31, 2023 is ₹ 1,10,000. Show the distribution of net profit amongst the partners

Question 7 *(RTP May 2021)* *Pg no._____*

Rose, Lilly and Lotus start business with capital of ₹ 2,00,000/-, ₹ 3,00,000/- and ₹4,00,000 on 1st April 2019. Lotus is entitled to a salary of ₹ 50,000 per annum. Interest is allowed on capitals at 12% p.a. and is charged on drawings at 12% per annum. Profits are to be distributed in the ratio 1:2:3 after the above-mentioned adjustments. Rose was given guarantee of minimum profit of ₹ 50,000 by Lotus. Partners drawings during the year were Rose ₹ 40,000/- Lilly ₹ 30,000/- Lotus ₹ 20,000/-.

Lotus had paid ₹ 10,000/- as tuition fees of his son on 31st March 2020, which was wrongly debited to salaries account. The profit for the year 2019-20 before allowing interest on capital and charging interest on drawings and salary paid to Lotus was ₹3,34,600/-.

Assuming the capitals to be fixed, prepare the Profit and Loss Appropriation Account and the Capital and Current Accounts relating to the partners.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) If a firm prefers Partners' Capital Accounts to be shown at the amount introduced by the partners as capital in firm then entries for salary, interest, drawings, interest on capital and drawings and profits are made in
   (a) Trading Account
   (b) Profit and Loss Account
   (c) Partners' Current Account

2) In the absence of any agreement, partners are liable to receive interest on their Loans @
   (a) 12% p.a.
   (b) 10% p.a.
   (c) 6% p.a.

3) The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as ....
   (a) Partnership.
   (b) Joint Venture.
   (c) Association of Persons.

4) In the absence of an agreement, partners are entitled to
   (a) Interest on Loan and Advances.
   (b) Commission.
   (c) Salary.

5) Partners are supposed to pay interest on drawings only when .... by the ....
   (a) Provided, Agreement.
   (b) Agreed, Partners
   (c) Both (a) & (b) above.

6) When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by
   (a) Partner who gave the guarantee
   (b) All the other partners.
   (c) Partnership firm

7) A, B and C had capitals of ₹ 50,000; ₹ 40,000 and ₹ 30,000 respectively for carrying on business in partnership. The firm's reported profit for the year was ₹ 80,000. As per provisions of the Indian Partnership Act, 1932, find out the share of each partner in the above amount after taking into account that no interest has been provided on an advance by A of ₹ 20,000, in addition to his capital contribution.
   (a) ₹ 26,267 for Partner B and C & ₹ 27,466 for partner A.
   (b) ₹ 26,667 each partner.
   (c) ₹ 33,333 for A, ₹ 26,667 for B and ₹ 20,000 for C.

8) X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and X wanted interest on capital @ 20% as his capital contributions was ₹ 1,00,000 as compared to that of Y and Z which was ₹ 75,000 and ₹ 50,000 respectively.

(a) Profits of ₹ 6,000 will be distributed equally with no interest on either Capital.
(b) X will get the interest of ₹ 20,000 and the loss of ₹ 14,000 will be shared equally.
(c) All the partners will get interest on capital and the loss of ₹ 39,000 will be shared equally.

9) X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and Y determined interest @ 24% p.a. on his loan of ₹ 80,000. There was no agreement on this point. Calculate the amount payable to X, Y and Z respectively.
(a) ₹ 2,000 to each partner.
(b) Loss of ₹ 4,400 for X and Z & Y will take home ₹ 14,800.
(c) ₹ 400 for X, ₹ 5,200 for Y and ₹ 400 for Z.

10) X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹ 6,000 and Z demanded minimum profit of ₹ 5,000 as his financial position was not good. However, there was no written agreement. Profits to be distributed to X, Y and Z will be
(a) Other partners will pay Z the minimum profit and will suffer loss equally.
(b) Other partners will pay Z the minimum profit and will suffer loss in capital ratio.
(c) ₹ 2,000 to each of the partners.

ANSWERS MCQs
1 (c) 2 (c) 3 (a) 4 (a) 5 (c) 6 (a) 7 (a) 8 (a) 9 (c) 10 (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:
1) In absence of any agreement partners share profits of the business in the ratio of their capital contribution.
2) Profit sharing ratio and capital contribution ratio need not be same.
3) Every partnership firm must register itself with Registrar of firms.
4) A partner can advance loan to the partnership firm in addition to capital contributed by him.
5) A partner can demand interest on capital even if it is not provided in the partnership deed.
6) If a partner does not take part in day to day business activities of the firm then he is not entitled to any share of profit.
7) Interest should be paid @ 6% p.a. on partners' loan even if it is not provided in the partnership deed.
8) Husband and wife can not be partners in the same firm.
9) One senior partner is Principal and other partners are his agents.
10) Partners are the agents of the firm and each other.
11) A partner who devotes more time to a business than other partners is entitled to get a salary.
12) Partners can share profits or losses in their capital ratio, when there is no agreement
13) The business of partnership firm must be carried on by all the partners.
14) When there is no partnership deed prevails, the interest on loan of a partner to be paid @ 6%. *(May 2018)*
15) Limited Liability Partnership (LLP) is governed by Indian Partnership Act, 1932. *(May 2019)*
16) A Partnership firm cannot own any Assets. *(Nov 2019)*
17) A partnership firm can acquire fixed assets in the name of the firm.

Solution

1) False: In absence of any agreement partners share profits equally and not in capital contribution ratio.
2) True: Profit sharing can be different from the that of the capital introduced by each of the partner. Not necessary that partner contributing more capital should have a higher profit sharing ratio and vice versa.
3) False: Registration of firms is not compulsory under Indian Partnership Act 1932.
4) True: Yes loan can given to the firm by the partner in addition to the capital. Where the partnership deed is absent, then the interest shall be paid at a minimum of 6% per annum. So the interest on the loan to be paid to the partner.
5) False: Interest on capital can be paid only if it is provided in the partnership deed.
6) False: Every partner need not take part in the business. Even if a partner does not take part in the business he is entitled for his share of profit.
7) True: Yes as per the provisions of the law- it is necessary that the interest on loan at 6% per annum shall be paid to the concerned partner.
8) False: Husband and wife can be partners in the same firm.
9) False: There is no senior or junior partner. Every partner is agent/principal of other partners.
10) True: Concept of agency applies to every partner and the firm as well. So each partner is a principal to and agent of every other partner and to the firm.
11) False: Unless and until the partnership deed specifically provides for the entitlement of salary, no partner can receive it.
12) False: According to the Partnership Act, 1932, when there is no agreement the partners are to share the profit and loss equally among themselves.
13) False: According to the Partnership Act, 1932, partnership can be carried on by all or any of them acting for all.
14) True: When there is no partnership deed then the provisions of the Indian Partnership Act are to be applied for settling the dispute. Interest on loan is payable @ 6% p.a. as per Indian Partnership Act
15) False: The provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership. Limited Liability (LLPs) Act, 2008 is applicable for Limited Liability Partnerships.
16) True: A partnership firm is not a distinct legal entity and therefore can't own any assets. The partners own the assets of the firm
17) False: A partnership firm cannot acquire fixed assets in its name since it is not a separate legal entity. It acquires fixed assets in the name of its partners.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no.*_____

Ram and Rahim started business with capital of ₹ 50,000 and ₹ 30,000 on 1st January, 2023. Rahim is entitled to a salary of ₹ 400 per month. Interest is allowed on capitals and is charged on drawings at 6% per annum. Profits are to be distributed equally after the above noted adjustments. During the year Ram withdrew ₹ 8,000 and Rahim withdrew ₹ 10,000. The profit for the year before allowing for the terms of the Partnership Deed came to ₹ 30,000. Assuming Fixed capitals, Prepare Profit & Loss Appropriation Account and Capital & Current Accounts of the partners

Question 2 *(ICAI Study Material)* *Pg no.*_____

A and B started business on 1st January, 2023, with capitals of ₹ 30,000 and ₹ 20,000. According to the Partnership Deed, B is entitled to a salary of ₹ 500 per month and interest is to be allowed on capitals at 6% per annum. The remaining profits are to be distributed amongst partners in the ratio of 5:3. During 2023 firm earned profit, before charging salary to B & interest on capital amounting ₹ 25,000. During year A & B withdrew ₹ 8,000 & ₹ 10,000 for domestic purposes. Pass Journal entries relating to division of Profit and Prepare P&L Appropriation A/c & Capital Accounts.

Question 3 *Pg no.*_____

On 1st April, 2020, X, Y and Z enter into partnership introducing capital of ₹80,000, ₹50,000 and ₹50,000 respectively. They agree to share Profits and Losses equally. At the end of the accounting year on 31st March, 2021, X claims that he be paid interest on his additional Capital of ₹30,000 @ 10% per annum, while Z demands salary of ₹600 per month for the extra hours devoted by him daily at the shop. The partnership deed is silent on these matters. Decide the matters with reasons.

Question 4 *(ICAI Study Material)* *Pg no.*_____

Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims:

a) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Rahim and Karim do not agree.
b) Rahim has devoted full time for running the business and demands salary at the rate of ₹ 500 p.m. But Ram and Karim do not agree.
c) Karim demands interest on loan of ₹ 2,000 advanced by him at market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ₹ 45,000 at the end of the first year of their business.

Question 5 *(ICAI Study Material)* *Pg no.*_____

X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charge on drawing at 10% p.a. X withdrew ₹40,000 pm at the end of each month and Y withdrew ₹ 120,000 at the end of each quarter. You are required to fill the missing figures in following accounts:

Profit and Loss Appropriation Account for the year ended March 31, 2023

Particulars	Amount	Particulars	Amount
To ...?	?	By Profit and Loss A/c (Net profit)	?
To Interest on Capital A/c X 160,000 Y ?	2,88,000	By Interest on Drawings A/c X ? Y ?	?
To Profit tfd to Capital A/c X (2/3) ? Y (1/3) 280,000	?		
	?		?

Partner's Capital Accounts

Particulars	X	Y	Particulars	X	Y
To ....?	?	?	By ....?	?	?
To ....?	?	?	By Salary A/c	3,60,000	Nil
To ....?	?	?	By ....?	?	?
			By ....?	?	?
	?	?		?	?

Question 6 *(RTP May 2018) / (May 2020) / (Nov 2021) / (Nov 2022) (Similar)* *Pg no._____*

A, B and C entered into partnership on 1.1.2021 to share profits and losses in the ratio of 5 : 3 : 2. A personally guaranteed that C's share of profit after charging interest on capitals at 5% p.a. would not be less than ₹ 30,000 in any year. Capitals of A, B and C were ₹ 3,20,000, ₹ 2,00,000 and ₹ 1,60,000 respectively. Profits for the year ending 31.12.2021 before providing for interest on partners capital was ₹ 1,59,000. You are required to prepare the Profit and Loss Appropriation Account

Question 7 *(ICAI Study Material)* *Pg no._____*

A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than ₹ 250,00,000. Total profits of the firm for the year ended 31st March, 2023 were ₹ 900,00,000. Calculate share of profits for each partner when:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally.

Question 8 *(ICAI Study Material)* *Pg no._____*

A and B are partners sharing profits and losses in the ratio of their effective capital.
They had ₹ 1,00,000 and ₹ 60,000 respectively in their Capital Accounts as on 1st January, 2023. A introduced a further capital of ₹ 10,000 on 1st April, 2023 and another ₹ 5,000 on 1st July, 2023. On 30th September, 2023 A withdrew ₹ 40,000.
On 1st July, 2023, 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, 2023. B drew ₹ 1,000 on 30th June, and ₹ 5,000 on 30th September, 2023.
12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2023.
Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

Question 9 *(CA Foundation Jan 2021) (5 Marks)* *Pg no._____*

Discuss the rules if there is no Partnership Agreement.

Question 10 *(CA Foundation June 2023) (5 Marks)* *Pg no._____*

X and Y were partners in a firm, sharing profit and losses in the ratio of 3: 2. They admit Z for 1/6th share in profits and guaranteed that his share of profits will not be less than 50,00,000. Total profits of the firm for the year ended 31st March, 2022 were 1,80,00,000. Calculate share of profit for each partner when:

(i) Guarantee is given by firm

(ii) Guarantee is given by X and Y equally.

Unit 2: TREATMENT OF GOODWILL

CH 10B

Whenever you get pains in your life, just think about the full form of pains. Positive attitude in negative situation.? Follow it, life will change."

1. Goodwill is the value of reputation of a Firm in respect of profits expected in future over and above the normal rate of profits earned by similar Firms in the same locality.
2. Goodwill is the benefits & advantages of good name, reputation & connections of a business firm. It is that attractive force which brings in customers & enhances the revenues of firm.
3. Extra amount over and above the saleable values of the identifiable assets that could be fetches by selling an existing firm as a going concern.

TYPES OF GOODWILL

A. Purchased Goodwill	B. Self-Generated Goodwill
1. Purchased Goodwill arises when a business is purchased, & the consideration paid therefore is more than the value of assets taken over. 2. Purchased Goodwill= Purchase Consideration Less Net Assets taken over 3. Purchased Goodwill is recorded in books of accounts & is shown in balance sheet. 4. The firm may write off purchased Goodwill over a period of time.	1. It refers to internally generated goodwill, that arises to the special advantages possessed by the Firm. 2. Internally Generated Goodwill is not recorded in the books of account, since Accounting Standard 26 issued by ICAI specifically provides so.

Situations which may involve valuation of Goodwill in case of Firms:

Following are the situations warranting Valuation of Goodwill in case of Partnership Firms-

- Change in Profit Sharing Ratio amongst the Partners,
- Admission of a new Partner,
- Retirement or Death of a Partner

METHODS OF VALUATION OF GOODWILL

METHOD 1: AVERAGE PROFITS METHOD

Average Profits Method

Simple Average

$$\text{Average Profits} = \frac{\text{Profits of 'n' years}}{\text{No. of years}}$$

Goodwill = Avg. Profits x No. of years of Purchase

Weighted Average

$$\text{Weighted Average Profits} = \frac{\text{Total weighted Profits}}{\text{Total of weights}}$$

Goodwill = Weighted Avg. Profits x No. of years of Purchase

Computation of Adjusted Profits

Profits	xx
+ Abnormal loss	xx
− Abnormal Gain	(xx)
− Omission of Expense	(xx)
+ Omission of Income	xx
± Rectification of Errors	xx / (xx)
	xx

METHOD 2: SUPER PROFITS METHOD

Super Profits Method

Goodwill = Super Profits (SP) × No. of Years of Purchase

SP = Average Profits (AP) − Normal Profits (NP)

NP = Capital Employed (CE) × Rate of Return (rr)

CE = Total Assets − Outsider Liabilities (excl. Fictitious assets & Non Trade Investments)

Example:

A firm earned Net Profits during the last three years as follows-

Year	I	II	III
Profit	₹ 24,000	₹ 20,000	₹ 22,000

The capital investment of the Firm is ₹ 60,000. A fair return on the capital having regard to the risk involved is 10%. Compute the value of Goodwill based on three years purchase of the Super Profits for the last three years.

METHOD 3: ANNUITY METHOD

Annuity Method

Goodwill = Super Profits × Annuity Factor (A.F.)

$\downarrow$

A.F. = $\sum$ PVF (r%, n)

PVF = Present value Factor

r% = Rate of Return / Discounted Rate

n = No. of years

Example:
Super Profits = 16,000
What will be the value of Goodwill if future cash flow of next 3 years are discounted at 8% rate?

METHOD 4: CAPITALISATION METHOD

Capitalisation Method

Capitalisation of Average Profits

$\downarrow$

Goodwill = Capitalised value of Business (CVB) − Capital Employed

$\downarrow$

CVB = $\dfrac{\text{Average Profits}}{r\%}$

Capitalisation of Super Profits

$\downarrow$

Goodwill = $\dfrac{\text{Super Profits}}{r\%}$

Sometimes Question specifies to apply Average Capital Employed

Average Capital Employed = $\dfrac{\text{Opening Capital Employed + Closing Capital Employed}}{2}$

TREATMENT OF GOODWILL IN CASE OF CHANGE IN PSR

Accounting Issue involved	Journal Entry
1. Writing off Goodwill existing in books	All Partner's Capital A/c (individually) Dr. (in old ratio) To Goodwill A/c
2. Adjusting Goodwill on change in PSR	Gaining Partner's Capital A/c Dr. (in Gain ratio) To Sacrificing Partners' Capital A/c (in Sacrifice Ratio)

Sacrifice	Gain
Partners whose shares in Profit have deceased as a result of change in PSR, are known as Sacrificing Partners.	Partners whose shares in profits have increased as a result of change in PSR, are known as Gaining Partners
The ratio in which Partners have agreed to reduce their profits in favour of the other Partner(s) is called Sacrifice Ratio or Sacrificing Ratio.	The ratio in which Partners have agreed to gain their profits from the other Partner (s) is called Gain Ratio or Gaining Ratio
Sacrifice Ratio = Old Ratio less New Ratio	Gain Ratio = New Ratio less Old Ratio

Example:

P, Q and R are partners sharing profits and losses in the ratio of 3:2:1. The goodwill of the firm is valued at ₹ 12,000. They have decided to change the profit-sharing ratio to 2:2:1. Pass Journal Entry for goodwill adjustment.

ASSIGNMENT QUESTIONS

Question 1 Pg no._____

The past profits of five years of a partnership firm are: ₹ 50,000; ₹ 40,000; ₹ 52,000; ₹ 48,000 and ₹ 56,000 respectively. Calculate the value of goodwill on the basis of 4 years' purchase of the average profits of the last five years.

Question 2 Pg no._____

A firm of A, B and C has a total capital investment of ₹ 4,50,000. The firm earned net profits during the last four years as: I-₹ 70,000; II-₹ 80,000; III-₹ 1,20,000 and IV- ₹ 1,00,000. The reasonable expected return is 15 per cent having regard to the risk involved. Calculate the value of goodwill based on 3 years' purchase of average super profits of the past four years.

Question 3 Pg no._____

Calculate the goodwill by annuity method of super profit from the following facts:
(a) Annual maintainable profit after tax is ₹ 65,000.
(b) Capital employed is ₹ 4,00,000.
(c) Normal rate of return is expected at 12% p.a.
(d) Present value of an annuity of ₹ 1 for five years @ 12% interest is 3.604776.

Question 4 Pg no._____

The net tangible assets of a firm are worth ₹ 4,10,000 and the average profit of last four years amounts to ₹ 60,000. Find out the value of goodwill under capitalization method if the reasonable return on capital invested is 12%.

Question 5 *(ICAI Study Material)* Pg no._____

Lee and Lawson are in equal partnership. They agreed to take Hicks as 1/4th partner. For this it was decided to find out the value of goodwill. M/s Lee & Lawson earned profits during 2020-2023 as follows:

Year	Profit	Year	Profit
2020	1,20,000	2022	1,30,000
2021	1,25,000	2023	1,50,000

On 31.12.2023 capital employed by M/s Lee and Lawson was ₹ 5,00,000. Rate of normal profit is 20%. Find out the value of goodwill following various methods. (Consider 3 years purchase)

Question 6 *(RTP Nov 2018) / (Nov 2019) / (Nov 2021) / (Nov 2023) (Similar)* Pg no._____

Vasudevan, Sunderarajan and Agrawal are in partnership sharing profit and losses at the ratio of 2:5:3. The Balance Sheet of the partnership as on 31.12.2021 was as follows:

Balance Sheet of M/s Vasudevan, Sunderarajan & Agrawal

Liabilities	₹	Assets	₹
Capital A/cs		Sundry fixed assets	5,00,000
Vasudevan	85,000	Stock	1,00,000
Sunderarajan	3,15,000	Debtors	50,000
Agrawal	2,25,000	Bank	5,000
Sundry Creditors	30,000		
	6,55,000		6,55,000

The partnership earned profit ₹ 2,00,000 in 2021 & the partners withdrew ₹ 1,50,000 during the year. Normal rate of return 30%. Find out the value of goodwill on the basis of 5 years' purchase of super profit. Calculate super profit using average capital employed

Question 7 *(ICAI Study Material)* Pg no._____

The following particulars are available in respect of the business carried on by Rathore

1.	Capital Invested	1,50,000
2.	Trading Results: 2020	Profit 40,000
	2021	Profit 36,000
	2022	Loss 6,000
	2023	Profit 50,000
3.	Market Rate of interest on investment	10%
4.	Rate of risk return on capital invested in business	2%
5.	Remuneration from alternative employment of the proprietor (if not engaged in business).	₹ 6,000 per annum

You are required to compute the value of goodwill on the basis of 5 years' purchase of super profit of the business calculated on the average profits of the last four years.

Question 8 *(ICAI Study Material)* Pg no._____

A, B and C are in partnership sharing profits and losses in the ratio of 4:3:3. They decided to change the profit sharing ratio to 7:7:6. Goodwill of the firm is valued at ₹ 20,000. Calculate the sacrifice/gain by the partners and make the necessary journal entry.

Question 9 *(ICAI Study Material)* Pg no._____

A, B, C and D are in partnership sharing profits and losses equally. They mutually agreed to change the profit sharing ratio to 3:3:2:2. Goodwill of the firm is valued at ₹ 20,000. Pass necessary journal entry.

Question 10 *(ICAI Study Material)* Pg no._____

Wise, Clever and Dull were trading in partnership sharing profits and losses 4:3:3 respectively. The accounts of the firm are made up to 31st December every year.

The partnership provided, inter alia, that:

On the death of a partner the goodwill was to be valued at three years' purchase of average profits of the three years upto the date of the death after deducting interest @ 8 per cent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year.

On 30th June, 2023, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. It was agreed for the purpose of valuation of goodwill that the fair remuneration for work done by each partner would be ₹ 15,000 per annum and that the capital employed would be ₹ 1,56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after the death of Wise.

The following were the amounts of profits of earlier years before charging interest on capital employed.

Year	Profit
2020	67,200
2021	75,600
2022	72,000
2023	62,400

Compute the value of goodwill and show the adjustment thereof in the books of the firm.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their………ratio.
   (a) Capital.
   (b) New Profit Sharing.
   (c) Sacrificing.

2) A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings ₹70,000 cash and ₹48,000 against goodwill. New profit sharing ratio between A, B and C are 7:5:4. Find the sacrificing ratio of A:B.
   (a) 3:1.
   (b) 4:7.
   (c) 5:4.

3) Following are the factors affecting goodwill except:
   (a) Nature of business.
   (b) Efficiency of management.
   (c) Location of the customers.

4) Weighted average method of calculating goodwill should be followed when:
   (a) Profits has increasing trend.
   (b) Profits has decreasing trend.
   (c) Either 'a' or 'b'.

5) In the absence of any provision in the partnership agreement, profits and losses are shared
   (a) In the ratio of capitals.
   (b) Equally.
   (c) In the ratio of loans given by them to the partnership firm

6) The profits and losses for the last 4 years are 2018-19 Losses ₹ 10,000; 2019-20 Losses ₹ 2,500; 2020-21 Profits ₹ 98,000 & 2021-22 Profits ₹ 76,000. The average capital employed in the business is ₹ 2,00,000. The rate of interest expected from capital invested is 12%. The remuneration of partners is estimated to be ₹ 1,000 per month not charged in the above losses/ profits. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.
   (a) ₹ 9,000.
   (b) ₹ 8,750.
   (c) ₹ 8,250.

7) A, B and C are partners sharing profits and losses in the ratio 3:2:1. They decide to change their profit sharing ratio to 2:2:1. To give effect to this new profit sharing ratio they decide to value the goodwill at ₹ 30,000. Pass the necessary journal entry if Goodwill not appearing in the old balance sheet and should not appear in the new balance sheet.
   (a) B's Capital Account Dr. ₹ 2,000
   C's Capital Account Dr. ₹ 1,000
   To A's Capital Account ₹ 3,000
   (b) Goodwill Account Dr. ₹ 30,000
   To A's Capital Account ₹ 15,000
   To B's Capital Account ₹ 10,000
   To C's Capital Account ₹ 5,000

(c) A's Capital Account Dr. ₹ 12,000
B's Capital Account Dr. ₹ 12,000
C's Capital Account Dr. ₹ 6,000
To Goodwill Account ₹ 30,000

8) Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in ………
   (a) Profit sharing of the partners.
   (b) Calculation of the goodwill.
   (c) Both.

ANSWERS MCQs

1 (c) 2 (a) 3 (c) 4 (c) 5 (b) 6 (b) 7 (a) 8 (b)

TRUE / FALSE

State with reasons, whether the following statements are true or false:

1) Goodwill is intangible asset therefore it cannot be valued.
2) Goodwill is valued whenever there is change in profit sharing ratio among the partners.
3) Goodwill is the value of reputation of a firm in respect of profits expected in future over and above the normal rate of profits
4) At the time of admission or retirement of a partner, goodwill can be raised in the books of accounts and shown as an asset.
5) Only simple average method can be used for valuation of goodwill.
6) Super profit means excess of actual average profit over normal profit.
7) Normal profit means profit earned by similar companies in the same industry.
8) Normal profit depends upon Normal Rate of Return and past profits.
9) At the time of admission/retirement of a partner, since goodwill cannot be raised in the books of accounts is recorded through capital accounts of the partners.
10) At the time of admission of a partner, goodwill brought in by the new partner is shared equally by old partners.

Solution

1) False: Even though Goodwill is intangible asset it can be valued in terms of money.
2) True: Goodwill has to be valued every time whenever there is a reconstitution.
3) True: Goodwill is the brand image the firm has in the market due to which it enjoys an advantageous position over the other players in the market.
4) False: At the time of admission or retirement of a partner, goodwill should not be raised in the books of account of partnership firm because no consideration in money or money worth has been paid for it.
5) False: Weighted average profit method, capitalisation method, super profits methods also can be used for valuation of Goodwill.
6) True: Super profit means excess profit that can be earned by the firm over and above the normal profit usually earned by similar firms under similar circumstances.
7) True: The rate of return is considered as an average for the industry, which is applied to the capital employed in the concerned firm.
8) False: Normal profit depends upon Normal rate of return only and not on past profits.
9) True: Generally, the goodwill at the time of admission is adjusted through the capital accounts and not shown in the books of the firm.
10) False: Goodwill brought in by new partner is shared by old partners in sacrificing ratio and not equally

HOMEWORK QUESTIONS

Question 1 Pg no._____

Shiv and Mohan are partners in a firm sharing profits and losses equally. On 31st March, 2023, the balances of their capital accounts were ₹ 3,00,000 and ₹ 2,00,000 respectively. The average profits of the firm are ₹ 1,36,000 and the rate of normal profit is 20%. On 1st April, 2023 they agreed to admit Hari as a partner for one fourth share. Hari will bring ₹ 1,00,000 as capital. Compute value of the goodwill of firm on admission of Hari, if it is to be calculated on the basis of:

a) 5 years purchase of super profit
b) Capitalization method
c) 3 years purchase of average profit.

Question 2 *(RTP Nov 2019) / (May 2020) / (Nov 2020) / (May 2022) / (Nov 2022) (Similar)* Pg no._____

J and K are partners in a firm. Their capital are J ₹ 3,00,000 and K ₹ 2,00,000. During the year ended 31st March, 2021 the firm earned a profit of ₹ 1,50,000. Assuming that the normal rate of return is 20%, calculate the value of goodwill on the firm:

(i) By Capitalization Method; and
(ii) By Super Profit Method if the goodwill is valued at 2 years' purchase of Super Profit.

Question 3 *(RTP May 2023) / (RTP May 2021)/ (RTP May 2019) (Similar)* Pg no._____

The profits and losses for the previous years are: 2019 Profit ₹ 15,000, 2020 Loss ₹ 25,500, 2021 Profit ₹ 75,000, 2022 Profit ₹ 1,12,500. The average Capital employed in the business is ₹ 3,00,000. The rate of interest expected from capital invested is 10%. The remuneration from alternative employment of the proprietor is ₹ 9,000 p.a. Calculate the value of goodwill on the basis of 3 years' purchases of Super Profits based on the average of 4 years.

Question 4 *(ICAI Study Material)* Pg no._____

A, B & C are equal partners. They wanted to change the profit sharing ratio into 4:3:2. Make the necessary journal entries. Goodwill of the firm is valued at ₹ 90,000.

Question 5 *(ICAI Study Material)* Pg no._____

Antoo, Bantoo and Chintoo were in partnership sharing profits and losses 3:4:3 respectively. The accounts of the firm are made up to 31st March every year. The partnership provided, interalia, that: On the retirement of a partner the goodwill was to be valued at three years' purchase of average profits of the past four years up to the date of the retirement after deducting interest @12%p.a. on capital employed and remuneration of ₹ 2,000 p.m.to each partner. On 1st April 2023, Antoo retired and it was agreed on his retirement to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. It was agreed that the capital employed would be ₹6,50,000. Bantoo and Chintoo were to continue the partnership, sharing profits and losses equally after the retirement of Antoo.

The following were the amounts of profits of earlier years before charging salary to partners and interest on capital employed.

Year	Profit
2019-20	2,60,000
2020-21	2,75,000
2021-22	2,65,000
2022-23	2,80,000

You are required to compute the value of goodwill & show the adjustment there of in the books of firm.

Question 6 *(CA Foundation June 2022) (5 Marks)* Pg no._____

Mr. X gives the following particulars in respect of business carried on by him:

Particulars	Amount (₹)
Capital Invested in business	9,00,000
Market rate of interest on investment	8%
Rate of risk return on capital invested in business	3%
Remuneration per annum from alternative employment of proprietor if he was not engaged in business	36,000

The business earned profits of ₹ 2,40,000, ₹ 2,16,000 and ₹ 3,00,000 in the years 2018, 2019 and 2021 respectively but made a loss of ₹ 36,000 in the year 2020.

Compute the value of Goodwill on the basis of 6 years' purchase of super profits of the business, calculated on the basis of average profit of last four years.

Question 7 *(CA Foundation Dec 2022) (5 Marks)* Pg no._____

R and S are partners in a firm with a capital of 14,00,000 and 12,00,000 respectively. During the year ended on 31st March, 2022 firm earned a profit of ₹ 6,50,000. Assuming that the normal rate of return is 20%. Calculate the amount of Goodwill of the firm by using

a. Capitalization method
b. Super Profit method, if the goodwill is valued at 6 years purchase of super profits.

Unit 3: ADMISSION OF NEW PARTNER

CH 10C

"A working ant is better than a sleeping elephant. A small progress everyday lead us to big success."

CONCEPT

New partners are admitted for the benefit of the partnership firm. New partner is admitted either for increasing the partnership capital or for strengthening the management of the firm.
Points to Note:

1) Calculation of New Ratio & Sacrificing Ratio
2) Revaluation of Assets & Liabilities
3) Treatment of Reserves
4) Treatment of Goodwill
5) Adjustment of Partners capital Accounts

Example 1

X and Y share profits in the ratio 5:3. Z is admitted for 1/4th Share in Profits. Compute New PSR and Sacrifice Ratio

Example 2

X & Y share profits in the ratio 5:3. Z is admitted for 1/5th Share in Profits, which he takes as 1/10th each from X & Y. Compute New PSR and Sacrifice Ratio.

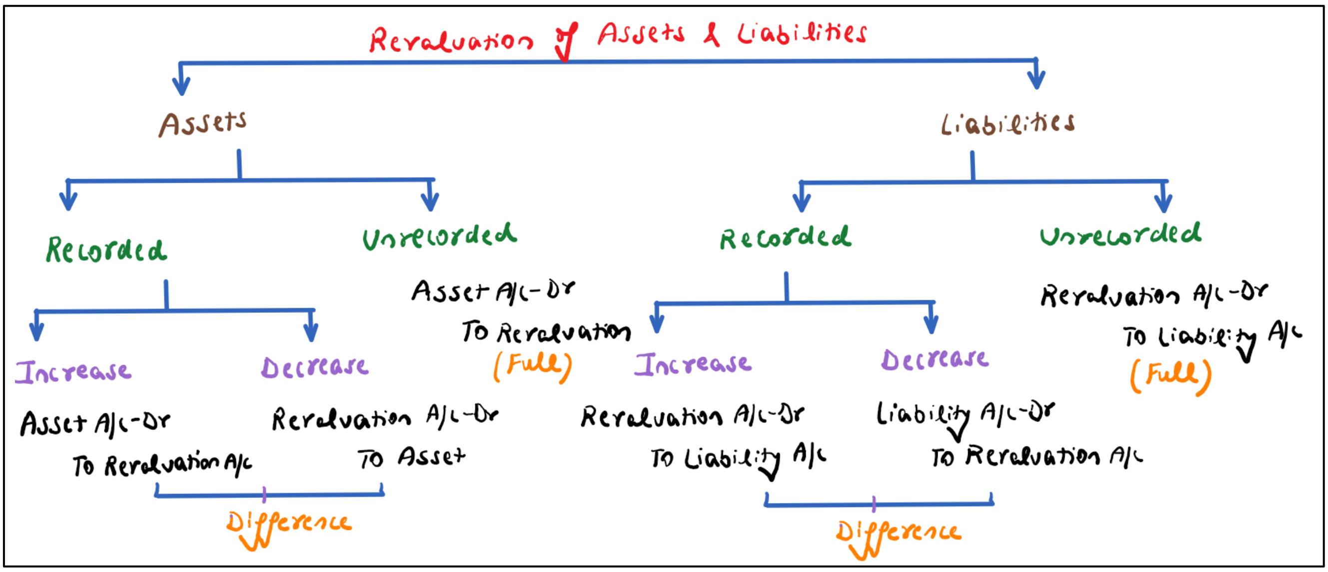
Example 3

X & Y share profits in the ratio 3:2. Z is admitted and for which X surrenders 1/5th of his share in favour of Z & Y surrenders 2/5th of his share in favour of Z. Compute New PSR and Sacrifice Ratio.

Example 4

A,B & C share profits in the ratio 3:2:5. D is admitted for 1/4th share which is contributed in the ratio of 1 : 1 : 3. Compute New PSR.

REVALUATION OF ASSETS & LIABILITIES



Revaluation A/c

Particulars	Amount	Particulars	Amount
To Asset (Decrease)		By Asset (Increase)	
To Liabilities (Increase)		By Assets unrecorded	
To Liabilities unrecorded		By Liabilities (Decrease)	
To Revaluation profit (old partners in old ratio)		By Revaluation Loss (old partners in old ratio)	

Passing the entry through Capital A/c of Partners (Preparing Memorandum Revaluation Account)

1. Find the net gain or loss on Revaluation as follows
2. Entry:

Gaining partners capital A/c (in case of profits)

To Sacrificing partners capital A/c

Sacrificing partners capital A/c (in case of losses)

To Gaining partners capital A/c

Note: When profit/loss on revaluation of assets and liabilities is adjusted through capital accounts only then the assets & liabilities appear in B/sheet of new firm at their old figures.

Difference Between Revaluation Account and Memorandum Revaluation Account

- Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets & liabilities which of course are recorded at their old figures in new balance sheet.
- Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

Example

X, Y & Z Old PSR = 5 : 3 : 2 New PSR = 2 : 3 : 5

They decided to record effect of revaluation without affecting the book values of assets & liabilities by passing single adjustment entry.

	Book value	Revaluation figures
Land & Building	1,00,000	1,50,000
Plant & Machinery	1,50,000	1,40,000
Creditors	50,000	45,000
Outstanding Expenses	45,000	60,000

TREATMENT OF RESERVES

Reserves

General Reserve (P&L A/c, etc.)

General Reserve / P&L A/c - Dr
To Partner's capital A/cs
(OLD RATIO)

Specific Reserve
[Investment Fluctuation Fund, Workmen Compensation Reserve, etc.]

If no other information given

Reserve A/c - Dr
To Partner's capital A/cs

If Ques. specifies Liability against it

Reserve > Liability

Reserve A/c - Dr
To Liability A/c
To Partner's cap. A/cs

Reserve = Liability

Reserve A/c - Dr
To Liability A/c

Reserve < Liability

Reserve A/c - Dr
Revaluation A/c - Dr
To Liability A/c

Note: Sometimes the partner may decide not to close the Reserves / P& L A/c but to record the adjustment entry.

Gaining Partners' capital A/c Dr.
  To Sacrificing Partners capital A/c

Example

X, Y & Z

Old Ratio = 5 : 3 : 2 New Ratio = 2 : 3 : 5

Workmen Compensation Reserve appearing in balance sheet ₹ 1,200.

a) If there is no other information

b) If the workmen compensation claim is ₹ 150/-

c) If the workmen compensation claim is ₹ 2,250/-

TREATMENT OF GOODWILL

Treatment of Goodwill

Old G/w (Appearing in B/S)

Old Partner's Capital A/c - Dr
  To Goodwill A/c

G/w Valued

1. Bring
   Cash/Bank/Asset A/c - Dr
     To New Partner's Cap. A/c
     To Premium for G/w
2. G/w Adjustment
   Premium for G/w A/c - Dr
   New Partner's Cap. A/c - Dr
     To Sacrificing Partners Cap. A/c
3. Withdrawal of G/w
   Sacrificing Partner's Cap. A/c - Dr
     To Cash/Bank A/c

Example:
A & B are partners with PSR of 3:2.
C is admitted into the firm for 1/5th share. His share of capital is 50,000. Goodwill of firm valued at 1,00,000. Pass entries in the following cases:

a) C brings his share of capital & goodwill
b) C brings his share of capital & 60% share of goodwill
c) C brings his share of capital only & nothing for goodwill

HIDDEN GOODWILL

Net worth (including goodwill) on the basis of capital brought by an incoming partner (Incoming partners capital A/c x Reciprocal of his share)
Less: Net worth (excluding G/w of the firm)

Where, *Net worth* is Total Assets – Outsiders' Liabilities
OR
Capital of partners including new + Reserves + P & L (Cr. Bal.) - Miscellaneous expenditure

Example
A & B having PSR 3 : 2 are partners with capitals of ₹ 30,000 & ₹ 20,000 on date of C's admission for 1/5th share who brings ₹ 40,000. Following are the balances:
P & L (Cr.) = 6,000 Reserves = 55,000 Deferred Revenue Expenditure = 1,000
Find Goodwill.

ADJUSTMENT OF CAPITAL

Example 1

A & B. Ratio = 3 : 2. C is admitted 1/4th share & brings ₹ 1,00,000 as capital. Capital of new firm is to be ₹ 4,00,000. Actual capital after all adjustments of A & B are ₹ 2,00,000 & ₹ 1,00,000. New capital will be shared in their new PSR.

Example 2

A & B = 3 : 2. Capital of A & B after adjustments are ₹ 80,000 & ₹ 60,000 respectively C is admitted who brings ₹35,000 as capital for 1/5th share of profit to be acquired equally from A & B. Capital of A & B are to be adjusted on the basis of C's capital.

Example 3

A & B = 3 : 2

Capitals of A & B after adjustments are ₹ 90,000 & ₹ 70,000. Calculate incoming partners proportionate capitals & surplus/shortage of existing capitals of old partners.

a) If C is to contribute proportionate capital for his 1/5th share

b) If C is to contribute 1/4th of the combined capitals of the existing partners.

c) If C is to contribute proportionate capital for his 1/5th share & capitals of all the partners are to be adjusted in new PSR 3:1:1

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

The following is the Balance Sheet of Yellow and Green as at 31st December, 2023:

Liabilities	₹	Assets	₹
Capital A/cs		Cash at Bank	10,000
Yellow	25,000	Sundry assets	55,000
Green	20,000		
Trade Payables	20,000		
	65,000		65,000

The partners shared profits and losses in the ratio 3:2. On the above date, Black was admitted as partner on the condition that he would pay ₹ 20,000 as Capital.

Goodwill was to be valued at 3 years' purchase of average of four years' profits which were:

Year	Profit
2020	9,000
2021	14,000
2022	12,000
2023	13,000

The new profit sharing ratio is 6:5:5. Give journal entries & balance sheet

a) If goodwill is adjusted through partners' capital accounts

b) If goodwill is brought in cash

c) If goodwill is brought in cash but withdrawn

d) If goodwill is paid privately

Question 2 *(ICAI Study Material)* *Pg no._____*

Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms' balance sheet as on 31.03.2023 was as follows:

Liabilities		₹	Assets	₹
Long term loan		2,00,000	Fixed assets	3,00,000
Current liabilities		2,50,000	Investments	50,000
Capital Accounts:			Current assets	2,00,000
Gopal	1,20,000		Loans and advances	1,00,000
Govind	80,000	2,00,000		
		6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as partner in the firm from 01.04.2023 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 & 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 31.3.2021: profit ₹ 20,000 (includes insurance claim received of ₹ 40,000).

For the year ended 31.3.2022: loss ₹ 80,000 (includes voluntary retirement compensation paid ₹1,10,000).

For the year ended 31.3.2023: profit of ₹1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2023 as follows:

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

The new profit sharing ratio after the admission of Guru was 35:25:40.
Pass journal entries on admission, show goodwill calculation & prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2023 after the admission of Guru.

Question 3 *(ICAI Study Material)* *Pg no._____*

Alpha & Beeta were partners in LLP namely Meta-Chem LLP sharing profits & losses equally.

BALANCE SHEET of Meta-Chem as on 31st March 2023

Liabilities	₹	Assets	₹
Capital Accounts:		Factory Building	4,78,000
Alpha	3,00,000	Plant & Machinery	3,41,000
Beeta	2,00,000	Office Furniture	55,850
General Reserve	1,80,000	Inventory	77,740
Workmen Compensation Fund	60,000	Trade Receivables	1,43,210
Term Loan from IDFC Bank	2,78,000	Bank	44,200
Trade Payables	1,22,000		
	11,40,000		11,40,000

They agreed to admit Gyama as partner from 1st April 2023 on the following terms:

1. He shall have one-sixth share in future profits.
2. New profit sharing ratio would be 3:2:1
3. He shall bring ₹ 2,50,000 as his capital.
4. Goodwill of the firm is valued at ₹ 3,00,000
5. Factory Building is to be appreciated by 20% and inventory is revalued at ₹ 70,000.
6. Machinery to be appreciated by 20%.and Office furniture to be revalued at ₹ 50,000
7. Of the trade receivables ₹ 3,210 are bad and 5% be provided for bad & doubtful debts.
8. There is no actual liability towards workman.

You are required to prepare:

1. Revaluation account
2. Partners' capital accounts.
3. Bank Account
4. Balance Sheet after admission.

Question 4 *(ICAI Study Material)* *Pg no._____*

A and B are in the partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their balance sheet as on 31st March, 2023 was as follows: Cash ₹1,000; trade receivables ₹25,000; Inventory ₹22,000; plant and machinery ₹4,000; trade payables ₹12,000; bank overdraft ₹15,000; A's capital ₹15,000; B's capital ₹10,000.
On 1st April, 2023, they admitted C into partnership on the following terms:

a) C to purchase one-third of the goodwill for ₹2,000 and provide ₹10,000 as capital. Goodwill not to appear in books.
b) Further profits and losses are to be shared by A, B and C equally.
c) Plant and machinery is to be reduced by 10% and ₹500 is to be provided for estimated bad debts. Inventory is to be taken at a valuation of ₹24,940.
d) By bringing in or withdrawing cash and capitals of A and B are to be made proportionate to that of C on their profit-sharing basis.

Set out entries to the above arrangement in firm's journal & give partners' capital accounts.

Question 5 ***(ICAI Study Material)*** *Pg no._____*

A and B are in partnership sharing profits and losses equally. The Balance Sheet of M/s A and B as on 31-12-23 was as follows :

Liabilities	₹	Assets	₹
Capital A/cs		Sundry Fixed assets	60,000
A	45,000	Inventories	30,000
B	45,000	Bank	20,000
Trade Payables	20,000		
	1,10,000		1,10,000

On 1-1-24 they agreed to take C as 1/3rd partner to increase the capital base to ₹ 1,35,000. C agrees to pay ₹ 60,000. Capital to be in their new profit sharing ratio. Show necessary journal entries and prepare partners' capital accounts.

Question 6 ***(ICAI Study Material)*** *Pg no._____*

Dalal, Banerji and Mallick is a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March, 2023 is as below:

Liabilities		₹	Assets	₹
Trade Payables		12,850	Land and Buildings	25,000
Outstanding liabilities		1,500	Furniture	6,500
General reserve		6,500	Inventory of goods	11,750
Capital Account :			Trade Receivables	5,500
Mr. Dalal	12,000		Cash in hand	140
Mr. Banerji	12,000		Cash at bank	960
Mr. Malick	5,000	29,000		
		49,850		49,850

Partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2023 on the following terms:

(1) Mr. Mistri shall bring 5,000 towards his capital.

(2) The value of inventory should be increased by ₹ 2,500 and Furniture should be depreciated by 10%.

(3) Reserve for bad and doubtful debts should be provided at 10% of the trade receivables.

(4) The value of land and buildings should be enhanced by 20%

(5) The value of the goodwill be fixed at ₹ 15,000.

(6) General Reserve will be transferred to the partner's Capital Accounts.

(7) The new profit sharing ratio shall be : Mr. Dalal 5/15, Mr. Banerji 5/15,Mr. Mallick 3/15 and Mr. Mistri 2/15.

The outstanding liabilities include ₹ 1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books. Prepare

(i) Revaluation Account, and

(ii) The Capital Accounts of the partners, and

(iii) Balance Sheet of the firm after admission of Mr. Mistri.

Question 7 *Pg no._____*

The following was the Balance Sheet of 'Kamal' and 'Rani', who were sharing profits and losses in the ratio of 2:1 on 31.12.2021:

Liabilities	₹	Assets	₹
Capital Account :		Plant and Machinery	24,00,000
Kamal	20,00,000	Building	18,00,000

Rani	10,00,000	Sundry debtors	6,00,000
Reserves	18,00,000	Stock	8,00,000
Sundry creditors	8,00,000	Cash	2,00,000
Bills payable	2,00,000		
	58,00,000		58,00,000

They agreed to admit 'Nisha' into the partnership on the following terms:

a) The goodwill of the firm was fixed at ₹ 2,10,000.
b) That the value of stock and plant and machinery were to be reduced by 10%.
c) That a provision of 5% was to be created for doubtful debts.
d) That the building account was to be appreciated by 20%.
e) There was an unrecorded liability of ₹ 20,000.
f) Investments worth ₹ 40,000 (Not mentioned in the Balance Sheet) were taken into account.
g) That the value of reserves, the values of liabilities and the values of assets other than cash are not to be altered.
h) 'Nisha' was to be given one-fourth share in the profit and was to bring capital equal to his share of profit after all adjustments.

Prepare Memorandum Revaluation Account, Capital account of the partners and the Balance Sheet of the newly reconstituted firm.

Question 8

Pg no._____

The Balance Sheet of Amit, Bhushan and Charan, who share profits and losses as 3 : 2 : 1 respectively, as on 01.04.2021 is as follows:

Liabilities	₹	Assets		₹
Capital Accounts :		Machinery		1,50,000
Amit	1,80,000	Furniture		1,50,000
Bhushan	1,60,000	Stock		2,10,000
Charan	1,40,000	Debtors	80,000	
Current Accounts: Bhushan	16,000	Less: Provision for Bad Debts	(4,000)	76,000
Creditors	1,20,000	Cash		20,000
		Current Account: Charan		10,000
	6,16,000			6,16,000

Dev is admitted as a partner on the above date for 1/5th share in the profit and loss. Following are agreed upon:

1) The profit and loss sharing ratio among the old partners will be equal.
2) Dev brings in ₹ 1,50,000 as capital but is unable to bring required amount of premium for goodwill.
3) The goodwill of the firm is valued at ₹ 60,000.
4) Assets and liabilities are to be valued as follows: Machinery ₹ 2,06,000 : Furniture ₹ 1,28,000 : Provision for doubtful debts @ 10% on debtors.
5) Necessary adjustments regarding goodwill and Profit / loss on revaluation are to made through the Partner's Current Accounts.
6) It is decided that the revalued figures of assets and liabilities will not appear in the Balance Sheet of the new firm.
7) Capital Accounts of the old partners in the new firm should be proportionate to the new profit and loss sharing ratio, taking Dev's Capital as base. The existing partners will not bring cash for further capital. The necessary adjustments are to be made through the partner's Current Account.

Prepare Partner's Capital & Current Account, & Balance Sheet of the new firm after admission

Question 9 *(CA Foundation Dec 2021) (10 Marks)* *Pg no._____*

A and B are partners, sharing profits and losses in the proportion of 3/4th and 1/4th As at 31st March, 2021, following is the Balance Sheet of A and B.

Balance Sheet as at 31st March 2021

Liabilities	₹	Assets	₹
Capital Accounts:		Cash in Hand	1,15,000
A 2,85,000		Cash at Bank	1,10,000
B 1,55,000	4,40,000	Debtors	1,60,000
General Reserve	60,000	Stock	2,00,000
Creditors	3,75,000	Bills Receivable	30,000
		Land & Building	2,50,000
		Office Furniture	10,000
	8,75,000		8,75,000

They agreed to take C into Partnership on 1st April, 2021 on the following terms:

(a) Goodwill is to be valued at ₹ 2,00,000. C is unable to bring cash for his share of goodwill. So, it was decided that due credit for goodwill be given to A and B for their sacrifice in favour of C through C's current account.

(b) C pays ₹ 1,40,000 as his capital for 1/5th share in the future profits.

(c) Stock and Furniture to be reduced by 10%.

(d) A provision @ 5% for doubtful debts to be created on debtors.

(e) Land and building to be appreciated by 20%.

(f) Capital Accounts of the partners be readjusted on the basis of their profit sharing arrangement and any excess or deficiency is to be transferred to their Current Accounts.

Prepare Revaluation Account and Partners Capital Accounts.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?
   (a) 35:42:17.
   (b) 35:21:24.
   (c) 49:22:29.

2) A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5 from A and 1/10 from B, new profit sharing ratio will be:
   (a) 5:6:3.
   (b) 2:4:6.
   (c) 17:11:12

3) C was admitted in a firm with 1/4th share of the profits of the firm. C contributes ₹15,000 as his capital, A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A & B, if capital should be in profit sharing ratio taking C's as base capital:
   (a) ₹27,000 and ₹16,000 for A and B respectively.
   (b) ₹27,000 and ₹18,000 for A and B respectively.
   (c) ₹32,000 and ₹21,000 for A and B respectively.

4) A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take D into partnership for 1/8th share of profits. Find the new profit sharing ratio.
   (a) 12:27:36:42.
   (b) 14:7:7:4.
   (c) 1:2:3:4.

5) A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is ₹30,000 and B's Capital is ₹15,000). They admitted C and agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?
   (a) ₹9,000.
   (b) ₹12,000.
   (c) ₹11,250.

6) A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who brings in ₹25,000 against capital and ₹10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.
   (a) ₹8,000: ₹2,000.
   (b) ₹5,000: ₹5,000.
   (c) Old partners will not get any share in the goodwill brought in by C.

7) A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring ₹25,000 against capital and ₹10,000 against goodwill. New profit sharing ratio is 1:1:1. C brought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.
   (a) Cash brought in by C will only be credited to his capital account.
   (b) Goodwill will be raised to full value in old ratio.
   (c) Goodwill will be raised to full value in new ratio.

8) X and Y are partners sharing profits in the ratio of 3: 1. They admit Z as a partner who pays ₹4,000 as Goodwill the new profit sharing ratio being 2:1: 1 among X, Y and Z respectively. The amount of goodwill will be credited to:
   (a) X and Y as ₹3,000 and ₹1,000 respectively.
   (b) X only
   (c) Y only.

9) P and Q are partners sharing Profits in the ratio of 2:1. R is admitted to the partnership with effect from 1st April on the term that he will bring ₹ 20,000 as his capital for 1/4th share and pays ₹ 9,000 for goodwill, half of which is to be withdrawn by P and Q. If profit on revaluation is ₹ 6,000 and opening capital of P is ₹ 40,000 and of Q is ₹ 30,000, find the closing balance of each capital.
   (a) ₹ 47,000: ₹ 33,500: ₹ 20,000
   (b) ₹ 50,000: ₹ 35,000: ₹ 20,000.
   (c) ₹ 40,000: ₹ 30,000: ₹ 20,000

10) Adam, Brain and Chris were equal partners of a firm with goodwill ₹ 1,20,000 shown in the balance sheet and they agreed to take Daniel as an equal partner on the term that he should bring ₹ 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ₹ 60,000 and the goodwill account is to be written off before admission. What will be the treatment for goodwill?
   a) Write off the goodwill of ₹ 1,20,000 in old ratio.
   b) Cash brought in by Daniel for goodwill will be distributed among old partners in sacrificing ratio.
   c) Both (a) & (b)

ANSWERS MCQs

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

TRUE / FALSE

State with reasons, whether the following statements are true or false:

1) A newly admitted partner does not have same rights as old partners.
2) When a new partner is admitted, old partners have to forego certain share in profits of the firm, this is called as sacrifice ratio.
3) Revaluation account is also called as Profit and Loss Adjustment Account.
4) Any appreciation in the value of an asset is credited to Revaluation account.
5) All the partners may decide not to change the values of assets and liabilities in the books of accounts.
6) New partner is entitled to have share in Reserves appearing in the balance sheet prior to his admission.
7) If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners equally.
8) New partner brings in necessary amount as his capital.
9) New partner is entitled to share in revaluation profit.
10) Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their new profit sharing ratio
11) Profit or loss on revaluation is shared among the partners in new profit sharing ratio.
12) The balance of memorandum revaluation account (second part) is transferred to the capital accounts of the partners in old profit sharing ratio.

13) When Memorandum Revaluation account is prepared, assets & liabilities in the balance sheet will appear at their old values.
14) At the time of admission or retirement of a partner, goodwill can be raised in the books of accounts and shown as an asset.
15) Any Reserve appearing in the Balance Sheet is credited to existing partners equally.
16) In case of admission of a new partner in a partnership firm, the profit/loss on revaluation account is transferred to all partners in their new profit sharing ratio. *(Nov 2020)*

Solution

1) False: All the partners have same rights at all times, unless contrary is provided in the partnership deed or agreed by the partners.
2) True: With every new partner, remaining old partners have to foregone a proportion in their share which is called as sacrifice ratio
3) True: Revaluation Account is also called as Profit and Loss Adjustment account.
4) True: Increase in Asset is an income hence credited to revaluation account.
5) True: This can be done by opening Memorandum Revaluation Account.
6) False: New partner is not entitled to have any share in the reserves of the firm prior to his admission. Such reserves are distributed to old partners in their old profit sharing ratio.
7) False: If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners in their profit sharing ratio and not equally.
8) True: Every incoming partner shall bring in some amount of capital for the firm
9) False: New partner is not entitled to profit on revaluation, it belongs to old partners in their old profit sharing ratio.
10) False: The goodwill in cash, brought in by the new partner is taken away by the old partners in the sacrificing ratio and not in the new profit sharing ratio.
11) False: Profit or loss on revaluation is shared among the partners in old profit sharing ratio.
12) False: The balance of memorandum revaluation account (second part) is transferred to the capital accounts of the partners in new profit sharing ratio.
13) True: When Memorandum Revaluation account is prepared, assets & liabilities in the balance sheet will appear at their old values.
14) False: At the time of admission or retirement of a partner, goodwill can be raised in the books of accounts and it is immediately written off. It can not remain in the books of accounts as asset in balance sheet as per accounting standard.
15) False: Any Reserve appearing in the Balance Sheet is credited to existing partners in their old profit sharing ratio and not equally.
16) False: In case of admission of new partner in a partnership firm, profit/loss on revaluation account is transferred to old partners in their old profit-sharing ratio.

HOMEWORK QUESTIONS

Question 1 *Pg no._____*

A , B and C are sharing profits and losses in the ratio of 5:3:2. Calculate the new profit sharing ratio and the sacrificing ratio in each of the following alternative cases:
Case (a) If C acquires 1/10th share from B
Case (b) If C acquired 1/10th share equally from A and B
Case (c) If C's share is increased by 1/10th share by acquiring from A.
Case (d) If C's share is increased to 3/10th by acquiring from B.
Case (e) If A, B and C decide to share future profits and losses in the ratio of 5:2:3.
Case (f) If A, B and C decide to share future profits and losses in the ratio of 2:3:5.
Case (g) If A, B and C decide to share future profits and losses in the ratio of 2:1:2.
Case (h) If A, B and C decide to share future profits and losses equally.
Case (i) If A, B and C decide that the future profit sharing ratio between B and C shall be the same as existing between A and B

Question 2 *(ICAI Study Material)* *Pg no._____*

A and B are in partnership sharing profits and losses at the ratio 3:2. They take C as a new partner. Calculate the new profit sharing ratio if –

(i) C purchases 1/10 share from A
(ii) A and B agree to sacrifice 1/10th share to C in the ratio of 2: 3
(iii) Simply gets 1/10th share of profit.

Question 3 *(ICAI Study Material)* *Pg no._____*

A and B are partners with capitals of ₹7,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings ₹ 8,000 as his share of capital. Give the necessary journal entry to record goodwill.

Question 4 *(ICAI Study Material)* *Pg no._____*

Leena and Meena were in partnership business sharing profits and losses in the ratio of 2:3 Their Balance Sheet as on 31st March, 2023 was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Building	60,000
Leena	60,000	Plant	45,000
Meena	1,40,000	Furniture	23,500
General Reserve	40,000	Debtors	38,400
Creditors	42,600	Bill Receivable	12,500
Bills Payable	17,400	Stock	42,600
		Bank	78,000
	3,00,000		3,00,000

On 1st April, 2023, they decided to admit Neena into the partnership giving her a 1/5th share in future profits. She brings in ₹ 80,000 as his share of capital. Goodwill was valued at 1,00,000 at the time of admission of Neena. The partners decided to revalue the Assets as follows: Plant ₹ 40,000, Debtors ₹ 38,000, Stock ₹ 42,000, Building ₹ 90,000, Furniture ₹ 20,000, Bills Receivable ₹ 12,000. You are required to show the following accounts in the books of the firm

(a) Profit & Loss Adjustment Account
(b) Partners' Capital Accounts
(c) Balance Sheet of the new firm.

Question 5 *(ICAI Study Material)* *Pg no._____*

A and B are partners of X LLP sharing profits and losses in 3:2 ratio between themselves. On 31st March, 2023, the balance sheet of the firm was as follows:

Balance Sheet of X LLP as at 31.3.2023

Liabilities	₹	Assets	₹
Trade payables	5,000	Plant and machinery	20,000
Capital Accounts:		Furniture & Fittings	5,000
A 37,000		Inventories	15,000
B 28,000	65,000	Trade receivables	20,000
		Cash	10,000
	70,000		70,000

X agrees to join the business on the following conditions as and from 1.4.2023:

(a) He will introduce ₹25,000 as his capital and pay ₹15,000 to the partners as premium for goodwill for 1/3rd share of the future profits of the firm.

(b) A revaluation of assets of the firm will be made by reducing the value of plant and machinery to ₹15,000, Inventory by 10%, furniture and fitting by ₹1,000 and by making a provision of bad and doubtful debts at ₹750 on trade receivables.

Prepare profit and loss adjustment account, capital accounts of partners including the incoming partner X assuming that the relative ratios of the old partners will be in equal proportion after admission.

Question 6 *(ICAI Study Material)* *Pg no._____*

The following is the Balance Sheet of Ram and Mohan, who share profits in the ratio of 3:2 as on 1st January, 2023:

Liabilities	₹	Assets	₹
Trade payables	15,000	Buildings	18,000
Ram's Capital	20,000	Plant and Machinery	15,000
Mohan's Capital	25,000	Inventories	12,000
		Trade receivables	10,000
		Bank	5,000
	60,000		60,000

On this date Shyam was admitted on the following:

1. He is to pay ₹ 25,000 as his capital and ₹ 10,000 as his share of goodwill for one fifth share in profits.
2. The new profits sharing ratio will be 5:3:2.
3. The assets are to be revalued as under:

Building	25,000
Plant and Machinery	12,000
Inventories	12,000
Trade receivables (because of doubtful debts)	9,500

4. It was found that there was a liability for ₹1,500 for goods received but not recorded in books.

Give journal entries to record the above. Also, give the Balance Sheet of the partnership firm after Shyam's admission.

Question 7 *(CA Foundation Nov 2018)(15 Marks)/(RTP May 2020)/(May 2023)(Sim.)* *Pg no._____*

Dinesh, Ramesh and Naresh is a firm sharing profits and losses in the ratio 3:2:1. Their Balance Sheet as on 31st March, 2021 is as below:

Liabilities		₹	Assets	₹
Trade Payables		22,500	Land and Buildings	37,000
Outstanding liabilities		2,200	Furniture & Fixtures	7,200
General reserve		7,800	Stock	12,600
Capital Account :			Trade Receivables	10,700
Dinesh	15,000		Cash in hand	2,800
Ramesh	15,000		Cash at bank	2,200
Naresh	10,000	40,000		
		72,500		72,500

The partners have agreed to take Suresh as a partner with effect from 1st April, 2021 on the following terms:

(1) Suresh shall bring 8,000 towards his capital.

(2) The value of stock to be increased to ₹ 14,000 and Furniture & Fixtures to be depreciated by 10%.

(3) Reserve for bad and doubtful debts should be provided at 5% of the Trade Receivables.

(4) The value of land and buildings to be increased by 5,600 and the value of the goodwill be fixed at ₹ 18,000.

(5) The new profit sharing ratio shall be divided equally among the partners

The outstanding liabilities include ₹ 700 due to Ram which has been paid by Dinesh. Necessary entries were not made in the books. Prepare

(i) Revaluation Account, and

(ii) The Capital Accounts of the partners, and

(iii) Balance Sheet of the firm after admission of Suresh

Question 8 *(ICAI Study Material) / (RTP May 2019)* *Pg no._____*

A and B are partners in a firm, sharing profits and losses in the ratio of 3:2. The Balance Sheet of A and B as on 1.1.2023 was as follows:

Liabilities		₹	Assets		₹
Trade payables		17,000	Building		26,000
Bank overdraft		9,000	Furniture		5,800
Capital Accounts:			Inventories		21,400
A	44,000		Trade receivables	35,000	
B	36,000	80,000	Less: Provision	(200)	34,800
			Investment		2,500
			Cash		15,500
		1,06,000			1,06,000

'C' was admitted to the firm on the above date on the following terms:

a) C is admitted for 1/6 share in the future profits and to introduce a capital of ₹25,000.

b) The new profit sharing ratio of A, B and C will be 3:2:1 respectively.

c) 'C' is unable to bring in cash for his share of goodwill, they decide to calculate goodwill on the basis of C's share in the profits and the capital contribution made by him to the firm.

d) Furniture is to be written down by ₹870 and Inventory to be depreciated by 5%. A provision is required for trade receivables @ 5% for bad debts. A provision would also be made for outstanding wages for ₹1,560. The value of buildings having appreciated be brought upto ₹29,200. The value of investments is increased by ₹450.

e) It is found that the trade payables included a sum of ₹1,400, which is not to be paid off.

Prepare the following:

(i) Revaluation account. (ii) Partners' capital accounts.

Question 9 *(RTP May 2021)* Pg no._____

Ramu and Mamu were partners in a firm sharing profits and losses in the ratio 3:2 Their Balance Sheet as on 31st March, 2020 was as follows:

Liabilities	₹	Assets	₹
Capital		Land & Building	1,50,000
Ramu	2,10,000	Machinery	1,80,000
Mamu	1,90,000	Furniture	44,000
General Reserve	60,000	Trade Receivables	42,800
Loan from LFC bank	25,000	Inventory	65,200
Trade Payables	21,000	Bank	24,000
	5,06,000		5,06,000

Damu was admitted as partner from 1st April, 2020 on the following terms:

1. He shall bring ₹ 1,50,000 as capital and goodwill.
2. He shall get 1/5th share in future profits, to be acquired equally from Ramu and Mamu.
3. Goodwill of the firm to be valued at ₹ 2,50,000. It was agreed that goodwill shall not appear in the books of accounts.
4. Land & Building is to be appreciated by 50% and inventory is revalued at ₹ 60,000.
5. Machinery to be depreciated by 20%. Debtors of ₹ 2,800 are to be written off as bad debts and a Reserve for doubtful debts should be created @ 5% of debtors.
6. Furniture to be reduced to ₹40,000.
7. After admission of Damu, capitals of the partners' to be adjusted in their new profit sharing ratio, taking Damu's capital as base.

You are required to prepare:

1. Revaluation account
2. Partners' capital accounts.
3. Cash and bank account.
4. Balance Sheet after admission

Question 10 *(CA Foundation Dec 2022) (10 Marks)* Pg no._____

X and Y are in partnership business sharing profits and losses in the ratio of 2:3. Their Balance Sheet as at 31st March, 2022 is as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts:		Building	60,000
X	60,000	Plant	45,000
Y	1,40,000	Furniture	23,500
General Reserve	40,000	Debtors	38,400
Creditors	42,600	Bills receivable	12,500
Bills payable	15,400	Stock	42,600
Salary payable	2,000	Bank	78,000
	3,00,000		3,00,000

On 1st April, 2022 they decided to admit Z into the partnership giving him 1/5th share in the future profits. He brings in ₹ 1,00,000 as his share of capital. Goodwill was valued at ₹ 1,20,000 at the time of admission of Z. The partners decided to revalue assets & liabilities as follows:

a. Plant ₹ 40,000, Stock ₹ 42,000, Furniture ₹ 20,000 and Bills Receivable ₹ 12,000.
b. Out of total Debtors, ₹ 2,400 is bad and 5% provision is to be provided for bad and doubtful debts.
c. Building is to be appreciated by 75%.
d. Actual liability towards salary payable is ₹ 1,200 only.

You are required to show the following accounts in the books of the firm:
1. Revaluation Account
2. Partner's Capital Accounts
3. Balance sheet of the Firm after Admission of Z.

Question 11 *Pg no._____*

The Balance Sheet of a Partnership Firm M/s AB & Co consisted of two partners A and B who were sharing Profits and Losses in the ratio of 5:3 respectively. The position as on 31-03-2021 was as follows:

Liabilities	Amount	Assets	Amount
A's Capital	4,10,000	Land & Building	3,80,000
B's Capital	3,30,000	Plant & Machinery	1,70,000
Profit & Loss A/c	1,12,000	Furniture	1,09,480
Trade Creditors	54,800	Stock	1,45,260
		Sundry Debtors	60,000
		Cash at Bank	42,060
	9,06,800		9,06,800

On the above date, C was admitted as a partner on the following terms:

a) C should get 1/5th of share of profits.

b) C brought ₹ 2,40,000 as his capital and ₹ 32,000 for his share of Goodwill.

c) Plant & Machinery would be depreciated by 15% and Land & Buildings would be appreciated by 40%.

d) A provision for doubtful debts to be created at 5% on sundry debtors.

e) An unrecorded liability of ₹ 6,000 for repairs to Buildings would be recorded in the books of accounts.

f) Immediately after C's admission, Goodwill brought by him would be adjusted among old partners. Thereafter, the capital accounts of old partners would be adjusted through the current accounts of partners in such a manner that the capital accounts of all the partners would be in their profit sharing ratio.

Prepare Revaluation A/c, Capital Accounts of the partners, New profit sharing ratio and Balance Sheet of the Firm after the admission of C.

Question 12 *(ICAI Study Material)* *Pg no._____*

The following was the balance sheet of A, B & C who were equal partners on January 1, 2023

Liabilities		₹	Assets	₹
Bills payables		3,000	Cash	1,000
Creditors		6,000	Debtors	10,000
Capital Accounts:			Stock	12,000
A	20,000		Furniture	5,000
B	15,000		Buildings	25,000
C	10,000	45,000	Bills Receivable	1,000
		54,000		54,000

They agree to take D into partnership & give him a 1/4 share in the profits on following terms:

(1) that D should bring in ₹ 6,000 for goodwill and ₹ 10,000 as capital.

(2) that one-half of the goodwill shall be withdrawn by old partners.

(3) that stock and furniture be depreciated by 10%.

(4) that a liability of ₹ 1,300 be created against bills discounted.

(5) that the building be valued at ₹ 40,000.

(6) that the values of liabilities and assets other than cash are not to be altered.

Give the necessary entries to give effect to the above arrangement; prepare revaluation account and opening balance sheet of the firm as newly constituted.

Question 13 *(ICAI Study Material)* *Pg no._____*

A and B are partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet as on 31.3.2023 is given below:

Liabilities	₹	Assets	₹
Trade payables	50,000	Freehold premises	2,00,000
Capital Accounts:		Plant	40,000
A	2,00,000	Furniture	20,000
B	1,00,000	Office equipment	25,000
		Inventories	30,000
		Trade receivables	25,000
		Bank	10,000
	3,50,000		3,50,000

On 1.4.2023 they admit C on the following terms:

(1) C will bring ₹ 50,000 as a capital and ₹ 10,000 for goodwill for 1/5 share;
(2) Provision for doubtful debts is to be made on Trade receivables @ 2%
(3) Inventory to be written down by 10%.
(4) Freehold premises is to be revalued at ₹2,40,000, plant at ₹ 35,000, furniture ₹ 25,000 and office equipment ₹ 27,500.
(5) Partners agreed that the values of the assets and liabilities remain the same and, as such, there should not be any change in their book values as a result of the above mentioned adjustments.

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

Question 14 *Pg no._____*

A and B were partners of a firm sharing profits and losses in the ratio 2:1. The Balance Sheet of the firm as at 31st March, 2021 was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts		Plant and Machinery	5,00,000
A	8,00,000	Building	9,00,000
B	4,00,000	Sundry Debtors	2,50,000
Reserves	5,25,000	Stock	3,00,000
Sundry Creditors	2,75,000	Cash	1,50,000
Bills Payable	1,00,000		
	21,00,000		21,00,000

They agreed to admit P and Q into the partnership on the following terms:

a) The firm's goodwill to be valued at 2 years' purchase of the weighted average of the profits of the last 3 years. The relevant figures are:
   Year ended 31.3.2018 - Profit ₹ 37,000
   Year ended 31.3.2019 - Profit ₹ 40,000
   Year ended 31.3.2020 - Profit ₹ 45,000
b) The value of the stock and Plant & Machinery were to be reduced by 10%.
c) Building was to be valued at ₹ 10,11,000.
d) There was an unrecorded liability of ₹ 10,000.
e) A, B, P & Q agreed to share profits and losses in the ratio 3:2:1:1.

f) The value of reserve, the values of liabilities & values of assets other than cash were not to be altered.
g) P and Q were to bring Capitals equal to their shares of profit considering B' s Capital as base after all adjustments.

You are required to prepare:
1) Memorandum Revaluation Account,
2) Partner's Capital Accounts and
3) The Balance Sheet of the newly constructed firm

Question 15 *(ICAI Study Material)* *Pg no._____*

Cu and Au were in partnership sharing profits and losses in the ratio 5:3. On 1st April 2023, they decided to admit Ag in the partnership on the following terms:

1. Ag will bring ₹ 2,00,000/- as capital for ¼ share.
2. New profit sharing ratio shall be 2:1:1 among Cu, Au and Ag.
3. Cu was entitled to salary of ₹ 2,000/- p.m., it was revised to ₹ 3,000 p.m. from 1st October 2021.
4. Interest on capital was paid at 8% p.a.
5. Capitals as on 31st March 2023 were Cu ₹ 4,00,000 Au ₹ 3,00,000, which had remained unchanged since last four years.
6. Goodwill was to be valued on the basis of 3 years purchase of average adjusted weighted average profits of past 4 years. The profits of previous four years, before charging interest on capital and salary to Cu were as follows:

Year	Profit
2019-20	2,10,000
2020-21	2,60,000
2021-22	2,10,000
2022-23	3,05,000

These profits were subject to following rectification

(b) A machine costing ₹ 40,000 purchased on 1st October 2021 was wrongly charged to revenue. The machinery was depreciated at 20% p.a. on w.d.v. method

(c) Stock on 31st March 2021 was over valued by ₹ 20,000/-

(d) There was a loss by fire amounting to ₹ 10,000/- in the year 2019-20 which was not considered in trading account but correctly debited in the P&L Acc for that year.

(e) Debtors as on 31st March 2023 included bad debts of ₹ 5,800/-

7. Ag shall bring his share of goodwill in cash.

You are required to calculate amount of goodwill Ag is supposed to bring and journal entry for the same.

Unit 4&5: RETIREMENT & DEATH OF PARTNER

CH 10D

"Everyone has two eyes. But no one has the same view. The most important quality of successful people is their willingness to change."

CONCEPT OF RETIREMENT

- Whenever a partner retires, the continuing partners gain. So they arrange for the amount to be paid to discharge the claims of the retiring partners.
- On retirement of a partner, it is required to revalue assets and liabilities just as in the case of admission of a partner. If there is revaluation profit/loss, then such profit/loss should be distributed amongst the existing partners including the retiring partner at the existing profit sharing ratio (i.e. Old PSR)
- On the retirement of a partner any undistributed profit or reserve standing at the Balance Sheet is to be credited to the Partners' Capital Accounts in the old profit sharing ratio.

Example 1

A, B & C having PSR 3 : 2 : 1 . B retires and his share is taken by A & C in 2 : 1. Find new ratio.

Example 2

P, Q & R having PSR 4 : 3 : 2 . Q retires & surrenders $1/9^{th}$ of his share in favour of P & remaining in favour of R.

Example 3

X, Y, Z having PSR 4 : 3: 2, Y retires & surrender $1/9^{th}$ from his share in favour of X & remaining in favour of Z.

Example 4

A, B and C are partners sharing profits and losses in the ratio of 1/2, 3/10 & 1/5 respectively. B retires from the firm and A&C decide to share future profits and losses in the ratio of 3:2.

Example 5

A, B and C are partners sharing profits and losses in the ratio of 25:15:9. B retires and it is decided that profit sharing ratio between A&C will be the same as existing between B and C

Example 6

A, B & C are partners sharing profits and losses in the ratio of 1/2 , 3/10 and 1/5 respectively. B retires and his share is taken by A and C in the ratio of 2:1. Then immediately W is admitted for 1/4th share of profit, half of which was gifted by A and remaining share was taken by W equally from A and C.

TREATMENT OF GOODWILL

Old goodwill

Already appearing in B/sheet

Goodwill arising at the time of retirement

Example

X, Y & Z having PSR 2 : 3 : 5. Goodwill appearing in the books ₹ 50,000. X retires & Goodwill valued at ₹ 45,000. Y & Z decided to share equally.

FINAL PAYMENT TO RETIRING PARTNER

The following adjustments are necessary in the Capital A/c:

(i) Transfer of Profit/Loss on Revaluation.

(ii) Transfer of Reserve

(iii) Transfer of Goodwill

After adjustment of the above-mentioned items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him.

Claim of the retiring partner is payable in the following forms:

- Fully in cash
- Fully transferred to loan account to be paid later with some interest on it.
- Partly in cash and partly as loan repayable later with agreed interest.
- An annuity may be paid to the retired partner for life or for agreed no. of years for the life of some dependent.

CONCEPT OF DEATH OF PARTNER

- The problems arising on the death of a partner are similar to those arising on retirement. Assets and liabilities have to be revalued and the resultant profit or loss has to be transferred to the Capital Accounts of all partners including the deceased partner. Goodwill is dealt with exactly in the way already discussed in the case of retirement.
- The only additional point is that as death may occur on any day, the representatives of the deceased partner will be entitled to the partner's share of profit from the beginning of the year to the date of death. After ascertaining the amount due to the deceased partner, it should be credited to his Executor's Account.
- If the death takes place during the accounting period, the Executor of the deceased partner is entitled to have a share of profit upto the date of death based on the profit earned in the immediately preceding year or some other agreed basis.

The balance from Capital A/c of deceased partner is transferred to the Deceased Partner's Executor A/c.

Deceased Partner's Capital A/c

Particulars	Amount	Particulars	Amount
To Drawings A/c		By Balance b/d	
To Interest on Drawing A/c		By Interest on capital	
To Goodwill A/c (Existing G/w written off)		By P&L Suspense A/c (Share of profit)	
To Undistributed losses		By Reserve A/c	
To Revaluation (Loss)		By Revaluation A/c (profit)	
To Deceased Partner's Executor A/c (Bal. Fig.)		By Gaining partner's capital A/c (Share of G/w)	

HOW TO CALCULATE OUTGOING PARTNER'S SHARE IN PROFITS EARNED FROM THE DATE OF LAST BALANCE SHEET TO THE DATE OF DEATH / RETIREMENT

Step (1):
Calculate Profits of firm from the date of last Balance sheet to the date of death/retirement.

i. Time Basis

Previous year's profits Or Avg. profits X No. of days/months from the date of last b/sheet
365 days/12 months

ii. Sales basis

Previous year's profits Or Avg. profits X Sales from the date of last b/sheet
Previous years' Sales/Average Sales of past years

Step (2)
Calculate outgoing partners share in profits.
= Step (1) X Proportion of share of outgoing partner

Accounting Treatment

I) Through P & L suspense A/c

Profit : P & L Suspense A/c Dr.
To Outgoing partner's capital A/c

Loss : Outgoing partner's capital A/c Dr.
To P & L Suspense A/c

Balance of P&L suspense A/c is transferred to the P&L Appropriation A/c at the end of accounting period.

II) Through the Capital A/c of the gaining partner
    Gaining partner's capital A/c Dr.
        To Outgoing partner's capital A/c

Example
A, B & C are 3 partners having PSR 5:3:2. C died on 30/06/2023. His share of profit is to be calculated on the basis of the previous year profit which was 2,25,000 for FY 2022-23.
Find his share of profits till death.

Example
G, M & D. PSR 3:2:1 D died on 31/5/23. Sales of previous year i.e 2022-23 were ₹ 4,00,000 & profit was ₹ 60,000. Sales from 1st April, 2023 till 31st May, 2023 is 1,00,000. Find his share of profit.

RETIREMENT / DEATH & ADMISSION

Simultaneous retirement/death and admission do not introduce any new principles of accounting.
The principles studied under admission and retirement/death are combined-the combination of the two sets of transactions.
In case there is retirement/death & simultaneous admission we need to check whether the admission is on the same date or after a subsequent period of time.

Retirement/Death & Admission on the different dates:
1) Treatment of Accumulated Profits, Revaluation of Assets & Liabilities: Adjustment of these will be between old partners in old ratio.
2) Effect of Goodwill: Separate entries will be passed since both the events are on different dates.

Retirement/Death & Admission on the same date:
1) Treatment of Accumulated Profits, Revaluation of Assets & Liabilities: Adjustment of these will be between old partners in old ratio.
2) Effect of Goodwill: Single entry will be passed since both the events are on same date.

RIGHT OF OUTGOING PARTNER TO SHARE SUBSEQUENT PROFITS / CALCULATION OF RELIEF u/s 37

Relief is allowed to outgoing partner. The same can be due to Retirement/Death.
Relief is allowed only if:

a) Outgoing partner's balance has not been fully settled
b) Firm does not allow only interest/share of profits on unsettled balance. i.e., partnership deed is silent.

❖ Relief is higher of the following

Unsettled balance X 6% p.a. X Period upto relief date

OR

$$\frac{\text{Profits earned upto relief date X Unsettled balance of outgoing partner}}{\text{Total capital of partners \& unsettled balance.}}$$

Note: Capital of partners should be calculated on the date of death/retirement after all adjustments.

Example

A, B, C having PSR 1 : 1 : 1. C retires on 31.10.2022 Capital of partners after all adjustments stood at ₹ 50,000, ₹ 75,000 & ₹ 1,20,000 respectively. A & B continued to carry on business without settling C's account. Final payment to C is made on 1.02.2023. Profits made during 3 months period amounted to ₹ 28,000. Find Relief u/s 37

JOINT LIFE POLICY

Insurance

- It's a contract between the two parties that if first party suffers any loss, the second party will make such loss good. Thus, the risk of one is assumed by the other.
- Party which transfers such risk is called insured & party which assumes such risk is called insurer.
- Insured pays the amount of premium to insurer in consideration of risk being undertaken by the insurer & in the event of mishappening, insurer provides the lump sum amount to insured in the name of claim.

Types of Insurance

1.	Life Insurance	Life insurance is a contract that offers financial compensation in case of death or disability. In this amount is received generally at the time of death or maturity whichever is earlier.
2.	General Insurance	A general insurance is a contract that offers financial compensation on any loss other than death. It insures everything apart from life. In this amount is received at the time of happening of event

Joint Life Policy (JLP)

It is an insurance policy which is taken out by the partnership firm on the lives of all the partners. The amount of policy is payable by the Insurance Company either on the death or on maturity of policy, whichever is earlier. The firm pays annual premium to the insurer against the policy. The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.

Instead of life policy taken jointly on the name of all the partners, all the partners may take individual life policies for each of them by paying the premium from the firm

ACCOUNTING TREATMENT OF JOINT LIFE POLICY

METHOD 1: PREMIUM PAID IS TREATED AS EXPENSE (ORDINARY EXPENSE METHOD)

In this case premium is treated as an expense and it is closed every year by transferring to profit and loss account.

1.	Payment of Premium	Insurance Premium A/c Dr. To Bank A/c
2.	Transfer to P&L A/c	Profit & Loss A/c Dr. To Insurance Premium

METHOD 2: PREMIUM PAID IS TREATED AS ASSET (SURRENDER VALUE METHOD)

In this case insurance premium paid is first debited to life policy account and credited to bank account. At the end of the year the amount in excess of surrender value is treated as a loss and is transferred to Profit and Loss Account.

1.	Payment of Premium	JLP A/c Dr. To Bank A/c
2.	Transfer to P&L A/c	Profit & Loss A/c Dr. To JLP (JLP A/c Balance- its Surrender Value)

METHOD 3: PREMIUM PAID IS TREATED AS ASSET & RESERVE IS MAINTAINED (RESERVE METHOD)

Under this method, premium paid is debited to policy account and credited to bank account. At the end of the year, amount equal to premium is transferred from Profit and Loss Appropriation Account to Policy Reserve Account.

After this, policy account is brought down to its surrender value by debiting the life policy reserve account with amount which exceeds the surrender value of the policy.

1.	Payment of Premium	JLP A/c Dr. To Bank A/c
2.	Creation of Reserve	Profit & Loss Appropriation A/c Dr. To JLP Reserve
3.	Amount in excess of Surrender Value	JLP Reserve A/c Dr. To JLP A/c

Note: In the balance sheet JLP will appear on the Asset side & JLP Reserve will appear on the liability side at surrender value.

Example:
A, B and C shared profits and losses in the ratio of 5:3:2. They took out a joint life Policy in 2021 for ₹1,00,000, a premium of ₹5,000 being paid annually on 1st January. The surrender value of the policy on 31st December of various years was as follows: 2021 Nil; 2022 ₹ 3,000; 2023 ₹ 6,500. Prepare ledger accounts
Case 1: Assuming Ordinary Expense Method.
Case 2: Assuming Surrender Value Method.
Case 3: Assuming Reserve Method.

DEATH OF PARTNER

JOINT LIFE POLICY [POLICY AMOUNT]

Ordinary Expense Method	Asset/Surrender Value Method	JLP & JLP Reserve Method
[JLP is not appearing in Books]	[JLP appearing in Books at Surrender value]	[Reserve Method]
* Premium charged to P&L A/c every year * Amount Received (Policy Amount) is credited to Partner's Capital A/c in PSR	* JLP shown as asset at S.V. * Amount received (net of S.V.) credited to Partner's Capital A/c	* Both maintained at S.V. * Amount Received is credited to Partner's Capital A/c in PSR

Example:

A, B and C shared profits and losses in the ratio of 3:2:1. C died on 31.03.2023

Policy Amount 1,20,000 & Surrender Value 30,000

Case 1: JLP is not appearing in the books/Ordinary Expense Method

Case 2: JLP is appearing in the books at Surrender Value

Case 3: JLP & JLP Reserve are maintained at Surrender Value

RETIREMENT OF PARTNER

JOINT LIFE POLICY [SURRENDER VALUE]

Ordinary Expense Method	Asset/Surrender Value Method	JLP & JLP Reserve Method
[JLP is not appearing in Books]	[JLP appearing in Books at Surrender value]	[Reserve Method]
Amount Received (Surrender Value) is credited to Partner's cap. A/c in PSR	No Treatment	Distribute JLP Reserve in their PSR

Example:
A, B and C shared profits and losses in the ratio of 3:2:1. C retired on 31.03.2021
Policy Amount 1,20,000 & Surrender Value 30,000
Case 1: JLP is not appearing in the books/Ordinary Expense Method
Case 2: JLP is appearing in the books at Surrender Value
Case 3: JLP & JLP Reserve are maintained at Surrender Value

DEATH OF PARTNER

Separate/Individual Life Policy

Surrender value not appearing in books
- Share in Own Policy
+
Share in Surrender value of Remaining Partner's Policy

Surrender value appearing in books
- Share in Own Policy (Remaining Balance) [ie. Policy Amount – S.V.]

Example:
A, B and C shared profits and losses in the ratio of 3:2:1. C died on 31.03.2021

	Policy Amount	Surrender Value
A	2,00,000	30,000
B	3,00,000	60,000
C	4,80,000	90,000

Case 1: Surrender Value not appearing in the books
Case 2: Surrender Value appearing in the books

RETIREMENT OF PARTNER

Separate/Individual Life Policy

Surrender value not appearing in books

Share in Surrender value of all Partner's Life Policies

Surrender value appearing in books

NO Treatment

Example:

A, B and C shared profits and losses in the ratio of 3:2:1. C retired on 31.03.2021

	Policy Amount	Surrender Value
A	2,00,000	30,000
B	3,00,000	60,000
C	4,80,000	90,000

Case 1: Surrender Value not appearing in the books

Case 2: Surrender Value appearing in the books

ASSIGNMENT QUESTIONS

Question 1 (RTP May 2018) / (RTP Nov 2020) / (RTP Nov 2022) (Similar) Pg no._____

On 31st March, 2021, the Balance Sheet of P, Q and R sharing profits and losses in proportion to their Capital stood as below:

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Building	30,000
P	20,000	Plant and Machinery	20,000
Q	30,000	Inventory of goods	12,000
R	20,000	Sundry debtors	11,000
Sundry Creditors	10,000	Cash and Bank Balances	7,000
	80,000		80,000

On 1st April, 2021, P desired to retire from firm & remaining partners decided to carry on the business. It was agreed to revalue the assets & liabilities on that date on the following basis:

(a) Land and Building be appreciated by 20%.
(b) Plant and Machinery be depreciated by 30%.
(c) Inventory of goods to be valued at ₹ 10,000.
(d) Old credit balances of Sundry creditors, ₹ 2,000 to be written back/off.
(e) Provisions for bad debts should be provided at 5%.
(f) Joint life policy of the partners surrendered and cash obtained ₹ 7,550.
(g) Goodwill of the entire firm is valued at ₹ 14,000 and P's share of the goodwill is adjusted in the A/cs of Q and R, who would share the future profits equally. No goodwill account being raised.
(h) The total capital of the firm is to be the same as before retirement. Individual capital is in their profit sharing ratio.
(i) Amount due to Mr. P is to be settled on the following basis: 50% on retirement and the balance 50% within one year.

Prepare
(a) Revaluation account,
(b) The Capital accounts of the partners,
(c) Cash account and
(d) Balance Sheet of the new firm M/s Q & R as on 1.04.2021.

Question 2 Pg no._____

A, B and C are partners sharing profits in the ratio of 4:3:1.

Balance sheet as on 31st March, 2023

Liabilities		₹	Assets		₹
Creditors		70,000	Cash in Hand		80,000
Bills Payable		30,000	Cash at bank		20,000
Workmen's Compensation Reserve		20,000	Stock		75,000
General Reserve		80,000	Debtors	1,30,000	
Capital A/cs:			Less: Provision for Doubtful Debts	5,000	1,25,000
A	2,00,000		Joint Life Policy		1,50,000
B	3,00,000		Investments		1,00,000
C	2,00,000	7,00,000	Plant and Machinery		1,20,000
			Building		2,30,000
		9,00,000			9,00,000

On the above date B retires from the firm selling his share of profit to A for ₹ 36,000 and to C for ₹ 45,000 in the ratio of 4:5. For the purpose of B's retirement it was agreed that:

a) Stock is to be appreciated by 20% and Building by 10%.
b) Joint Life Policy is surrendered to the insurance company for ₹ 70,000.
c) Provision for Doubtful Debts is increased to 10%.
d) Investments are sold for ₹ 2,30,000.
e) Claim on account of workmen's compensation is ₹ 12,000.
f) Amount due to B is to be settled on the following basis:
   50% on retirement and the balance 50% within one year.
g) The capital of the newly constituted firm is fixed at ₹ 6,00,000 to be divided among A and C in the profit sharing ratio.

Adjustment is to be made in cash, calculate the new profit sharing ratio and prepare the Revaluation Account and Partners Capital Accounts.

Question 3 *(ICAI Study Material)* Pg no._____

F, G and K were partners in LLP sharing profit and losses at the 2:2:1. K wants to retire on 31-12-2023. Given below the Balance Sheet of the partnership as well as other information:

Balance Sheet as on 31-12-2023

Liabilities	₹	Assets	₹
Capital A/cs		Sundry Fixed assets	1,50,000
F	1,20,000	Inventories	50,000
G	80,000	Bank	50,000
K	60,000	Trade Receivables (Including B/R of 20,000)	70,000
Reserve	10,000		
Trade Payables	50,000		
	3,20,000		3,20,000

F and G agree to share profits and losses at the ratio of 3:2 in future. Value of goodwill is taken to be ₹ 50,000. Sundry Fixed Assets are revalued upward by ₹ 30,000 and Inventories by ₹ 10,000. Bills Receivable dishonoured ₹ 5,000 on 31-12-2023 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.

Pass necessary journal entries, prepare capital accounts and draft the Balance Sheet of M/s F and G.

Question 4 *(ICAI Study Material)* Pg no._____

A, B & C were in partnership sharing profits in the proportions of 5:4:3. The balance sheet of the firm as on 31st March, 2023 was as under:

Liabilities		₹	Assets	₹
Capital Accounts:			Fixtures	8,200
A	1,35,930		Inventories	1,57,300
B	95,120		Trade receivables	93,500
C	61,170	2,92,220	Cash in hand	74,910
Trade payables		41,690		
		3,33,910		3,33,910

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 2023, the terms of which were as follows:

a) The profit and loss account for the year ended 31st March, 2023 which showed a net profit of ₹48,000 was to be re-opened. B was to be credited with ₹4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing was to be revised from 1st April, 2022, as 3:4:4.
b) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The fixtures were to be valued by an independent valuer. The valuations arising out of the above agreement were goodwill ₹56,800 and fixtures ₹10,980. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to retain the fixtures on the books at the revised value, & to increase the provision for doubtful debts to 6%.

Pass the journal entries necessary to give effect to the above arrangements and to draw up the capital account of the partners after carrying out all adjusting entries as stated above.

Question 5 *Pg no._____*

P, Q and R were carrying on a business in partnership, sharing profits and losses in the ratio of 5 : 3 : 2 respectively. The firm earned a profit of ₹ 3,60,000 for the accounting year ended 31st March, 2020 on which date the firm's Balance Sheet stood as follows:

Balance Sheet as at 31st March, 2020

Liabilities	₹	Assets	₹
Capital Accounts :		Freehold Land and Building	8,00,000
P	7,00,000	Machinery	3,50,000
Q	5,70,000	Furniture & Fixtures	1,02,000
R	4,30,000	Stock	2,98,800
Outstanding Expenses	4,900	Debtors	1,60,000
Creditors	79,400	Cash at Bank	73,500
	17,84,300		17,84,300

P died on 31st August, 2020. According to firm's partnership deed, in case of death of a partner:-
(a) Assets and Liabilities have to be revalued by an independent valuer.
(b) Goodwill is to be calculated at two years' purchase of average profits for the last three completed accounting years and the deceased partner's capital account is to be credited with his share of goodwill.
(c) The share of the deceased partner in the profits for the period between end of the previous accounting year and the date of death is to be calculated on the basis of the previous accounting year's profits. Post death of P, Q & R will share profit in the ratio of 3 : 2.

Profits for the accounting years 2017-2018 and 2018-2019 were as follows :-

For the year ended 31st March, 2018 2,90,000 .
For the year ended 31st March, 2019 3,40,000

Drawings by P from 1st April, 2020 to the date of his death totalled ₹ 46,000.
On revaluation, Freehold Land and Building was appreciated by ₹ 1,00,000; Machinery was depreciated by ₹ 10,000 and a Provision for Bad Debts was created @ 5% on Debtors as on 31st March, 2020. P's sole heir was given ₹ 5,00,000 immediately and the balance along with interest @ 12% per annum was paid to him on 31st March, 2021.
Prepare Revaluation Account, P's Capital Account and P's Heir Account, giving important working notes.

Question 6 ***(ICAI Study Material)*** *Pg no._____*

B and N were partners. The partnership deed provides inter alia:

(i) That the accounts be balanced on 31st December each year.

(ii) That the profits be divided as follows: B: One-half; N: One-third; and carried to Reserve Account: One-sixth

(iii) That in the event of death of a partner, his executor will be entitled to the following:
(a) the capital to his credit at the date of death; (b) his proportion of profit to date of death based on the average profits of the last three completed years; (c) his share of goodwill based on three years' purchases of the average profits for the three preceding completed years.

Trial Balance on 31st December, 2022

Particulars	Dr.	Cr.
B's Capital		90,000
N's Capital		60,000
Reserve		30,000
Bills receivable	50,000	
Investments	40,000	
Cash	1,10,000	
Trade payables		20,000
Total	2,00,000	2,00,000

The profits for the three years were 2020: ₹ 42,000; 2021: ₹ 39,000 and 2022: ₹ 45,000. N died on 1st May, 2023.

Show the calculation of N (i) Share of Profits; (ii) Share of Goodwill; (iii) Draw up N's Executors Account as would appear in the firms' ledger transferring the amount to the Loan Account

Question 7 ***(ICAI Study Material)*** *Pg no._____*

M/s X and Co. is a partnership firm with the partners A, B and C sharing profits and losses in the ratio of 3:2:5. The balance sheet of the firm as on 30th June 2023, was as under:

Balance Sheet of X and Co. as on 30.06.2023

Liabilities		₹	Assets	₹
Capital Accounts:			Land	1,00,000
A	1,04,000		Building	2,00,000
B	76,000		Plant and Machinery	3,80,000
C	1,40,000	3,20,000	Investments	22,000
Long Term Loan		4,00,000	Inventories	1,16,000
Bank Overdraft		44,000	Trade receivables	1,39,000
Trade payables		1,93,000		
		9,57,000		9,57,000

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st July, 2023. For this purpose, the following adjustments are to be made:

(a) Goodwill of the firm is to be valued at ₹2 lakhs due to the firm's locational advantage but the same will not appear as an asset in the books of the reconstituted firm.

(b) Buildings and plant and machinery are to be valued at 90% and 85% of the respective balance sheet values. Investments are to be taken over by the retiring partner at ₹25,000. Trade receivables are considered good only upto 90% of balance sheet figure. Balance be considered bad.

(c) In the reconstituted firm, the total capital will be ₹3 lakhs, which will be contributed by A, C and D in their new profit sharing ratio, which is 3:4:3.
(d) The amount due to retiring partner shall be transferred to his loan account.
Prepare Revaluation Account and Partners' Capital Accounts.

Question 8

*Pg no.*_____

P, Q and R were partners sharing profits and losses in the ratio of 2 : 2 : 1. R wants to retire from partnership on 31-3-2021 and S wants to join the partnership on the same date, to which both P & Q agreed. The Balance Sheet of the partnership firm as on 31-03-2021 and other information were as detailed below:

Balance Sheets as on 31-03-2021

Liabilities	₹	Assets	₹
Partner's Capital A/c		Fixed Assets	6,00,000
P	4,80,000	Stock in Hand	2,00,000
Q	3,20,000	Sundry Debtors	2,80,000
R	2,40,000	Cash at Bank	1,60,000
General Reserve	40,000	Cash in Hand	40,000
Sundry Creditors	2,00,000		
	12,80,000		12,80,000

P, Q and S agrees to share profits and losses in equal ratio in future. Value of goodwill is taken to be ₹ 1,80,000. Fixed Assets are revalued upwards by ₹ 1,20,000 and Stock by ₹ 40,000. A debtor from whom ₹ 20,000 was due, become insolvent. No amount will be received from him in future and same is not recorded in the books and balance sheet as above. Claim of R will be settled in full. P, Q and S agree to make their capital proportionate to their new profit sharing ratio. Balance amount receivable from / payable to partners will be paid to partners / brought in by partners immediately.
All these transactions viz., claim of R and amount receivable / payable to partners will be routed through bank only. New partners also want to maintain ₹ 3,20,000 bank balance for working capital requirement. However they don't want to show goodwill in the books of accounts
Prepare:
a) Revaluation Account
b) Capital Accounts of Partners and
c) Balance Sheet of the Firm as newly constituted.

Question 9

*Pg no.*_____

E, F and G were partners sharing Profits and Losses in the ratio of 5:3:2 respectively. On 31st March, 2021 Balance Sheet of the firm stood as follows:

Liabilities		₹	Assets	₹
Capital A/cs			Buildings	55,000
E	50,000		Furniture	25,000
F	40,000		Stock	42,000
G	28,000	1,18,000	Debtors	20,000
Creditors		33,500	Cash at Bank	11,200
Outstanding Expenses		1,700		
		1,53,200		1,53,200

On 31st March, 2021, E decided to retire and F and G decided to continue as equal partners. Other terms of retirement were as follows:

a) Building be appreciated by 20%.
b) Furniture be depreciated by 10%
c) A provision of 5% be created for bad debts on debtors.
d) Goodwill be valued at two years' purchase of profit for the latest accounting year. The firm's Profit for the year ended 31st March, 2021 was ₹25,000. No goodwill account is to be raised in the books of accounts.
e) Fresh capital be introduced by F and G to the extent of ₹10,000 and ₹35,000 respectively.
f) Out of sum payable to retiring partner E, a sum of ₹45,000 be paid immediately and the balance be transferred to his loan account bearing interest @ 12% per annum. The loan is to be paid off by 31st March, 2023.

One month after E's retirement, F and G agreed to admit E's son H as a partner with one-forth share in Profits/Losses. E agreed that the balance in his loan account be converted into H's Capital. E also agreed to forgo one month's interest on his loan.
It was also agreed that H will bring in, his share of goodwill through book adjustment, valued at the price on the date of E's retirement. No goodwill account is to be raised in the books.
Prepare Revaluation Account & Partners' Capital Accounts.

Question 10 — Pg no._____

The Balance Sheet of Amitabh, Abhishek and Amrish as at 31.12.2020 stood as follows:

Liabilities		₹	Assets		₹
Capital Accounts :			Land & Buildings		74,000
Amitabh	60,000		Investments		10,000
Abhishek	40,000		Goodwill		37,800
Amrish	40,000	1,40,000	Life Policy (at surrender value):		
Creditors		25,800	Amitabh		2,500
General Reserve		8,000	Abhishek		2,500
Investment Fluctuation Reserve		2,400	Amrish		1,000
			Stock		20,000
			Debtors	20,000	
			Less: Provision for doubtful debts	(1,600)	18,400
			Cash & bank balance		10,000
		1,76,200			1,76,200

Amrish died on 31 March, 2021, due to this reason,following adjustments were agreed upon:
(a) Land and Buildings be appreciated by 50%.
(b) Investment be valued at 6% less than the cost.
(c) All debtors (except 20% which are considered as doubtful) were good.
(d) Stock to be reduced to 94%.
(e) Goodwill to be valued at 1 year's purchase of the average profits of the past five years.
(f) Amrish's share of profit to the date of death be calculated on the basis of average profits of the three completed years immediately preceding the year of death.

The profits of the last five years are as follows:

Year	₹
2016	23,000
2017	28,000
2018	18,000
2019	16,000

2020	20,000
	1,05,000

The life policies have been shown at their surrender values representing 10% of the sum assured in each case. The annual premium of ₹1,000 is payable every year on 1st August. Prepare the Balance Sheet of the firm.

Question 11 *(ICAI Study Material)* *Pg no._____*

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 31.3.2023. Mr. Z died on 31st December, 2023. His account has to be settled under the following terms.

Balance Sheet of Om & Co. as on 31.3.2023

Liabilities		₹	Assets	₹
Capital Accounts:			Building	1,20,000
X	40,000		Computers	80,000
Y	80,000		Inventories	20,000
Z	80,000	2,00,000	Trade receivables	20,000
Trade payables		20,000	Cash at bank	50,000
Bank loan		50,000	Investments	10,000
General reserve		30,000		
		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	Profit/Loss
31.3.2023	30,000
31.3.2022	20,000
31.3.2021	(10,000) Loss

Profit for the period from 1.4.2023 to 31.12.2023 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years. During the year ending on 31.3.2023 a car costing ₹40,000 was purchased on 1.4.2022 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:

a) Calculate goodwill and Z's share in the profits of the firm for the period 1.4.2023 to 31.12.2023.

b) Prepare revaluation account assuming that other items of assets and liabilities remained the same.

c) Prepare partners' capital accounts and balance sheet of the firm Om & Co. as on 31.12.2023.

Question 12 *Pg no._____*

X, Y, Z were partners in a firm sharing Profit & Loss in ratio of 2 : 1 : 1.

The firm took a joint life policy on the lives of all the partners of assured value of ₹ 2,00,000.

The firm also took separate life policies of partners as follows:

	Assured values
X	1,50,000
Y	2,00,000
Z	3,00,000

The premium paid for separate life policies was debited to Profit & Loss A/c. Surrender value of all policies is 50%.
You are required to calculate the share of life policies which X's executors will get in even of X's death?

Question 13 *(ICAI Study Material)* *Pg no._____*

The partnership agreement of a firm consisting of three partners - A, B and C (who share profits in proportion of ½, ¼ and ¼ and whose fixed capitals are ₹10,000; ₹6,000 and ₹4,000 respectively) provides as follows:

(a) That partners be allowed interest at 10 per cent per annum on their fixed capitals, but no interest be allowed on undrawn profits or charged on drawings.
(b) That upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.
(c) That an insurance policy of ₹10,000 each to be taken in individual names of each partner, the premium is to be charged against the profit of the firm.
(d) Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals etc. calculated upon 31st December following his death.
(e) That the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.
(f) That the partnership books be closed annually on 31st December.

A died on 30th September 2023, the amount standing to the credit of his current account on 31st December, 2022 was ₹450 and from that date to the date of death he had withdrawn ₹3,000 from the business.
An unrecorded liability of ₹2,000 was discovered on 30th September, 2023. It was decided to record it and be immediately paid off.
The trading result of the firm (before charging interest on capital) had been as follows: 2020 Profit ₹9,640; 2021 Profit ₹6,720; 2022 Profit ₹7,640; 2023 Profit ₹3,670.
Assuming the surrender value of the policy to be 20 percent of the sum assured.
Prepare an account showing the amount due to A's legal representative as on 31st December, 2023.

Question 14 *(ICAI Study Material)* *Pg no._____*

a) Peter, Paul and Prince were partners sharing profits and losses in the ratio 2:1:1. It was provided in the partnership deed that in the event of retirement /death of a partner he/his legal representatives would be paid:
b) The balance in the capital Account
c) His share of goodwill of the firm valued at two years purchase of normal average profits (after charging interest on fixed capital) for the last three years to 31st December preceding the retirement or death.
d) His share of profits from the beginning of the accounting year to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous year as increased by 25%
e) Interest on fixed capital at 10% p.a. though payable to the partners will not be payable in the year of death or retirement.
f) All the asset are to be revalued on the date of retirement or death and the profit and loss be debited/ credited to the Capital Accounts in the profit sharing ratio.

Peter died on 30th September, 2022. The books of Account are closed on calendar year basis from 1st January to 31st December.

The balance in the Fixed Capital Accounts as on 1st January, 2022 were Peter ₹ 10,000, Paul ₹ 5,000 and Prince ₹ 5,000. The balance in the Current Account as on 1st January, 2022 were Peter ₹ 20,000, Paul ₹ 10,000 and Prince ₹ 7,000. Drawings of Peter till 30th September, 2022 were ₹ 10,000. The profits of the firm before charging interest on capital for the calendar years 2019, 2020 and 2021 were ₹ 1,00,000, ₹ 1,20,000 and ₹ 1,50,000 respectively.
The profits include the following abnormal items of credit:

	2019	2020	2021
Profit on sale of assets	5,000	7,000	10,000
Insurance claim received	3,000	-	12,000

The firm has taken out a Joint Life Policy for ₹1,00,000. Besides the partners had severally insured their lives for ₹ 50,000 each, the premium in respect thereof being charged to the Profit and Loss account. The surrender value of the Policies were 30% of the face/policy value. On 30th June, 2022 the firm received notice from the insurance company that the insurance premium in respect of fire policy had been undercharged to the extent of ₹ 6,000 in the year 2021 and the firm has to pay immediately. The revaluation of the assets indicates an upward revision in value of assets to the extent of ₹ 20,000.
Prepare an account showing the amount due to Peter's Legal representatives as on 30th September, 2022 along with necessary workings.

Question 15 *(CA Foundation July 2021) (10 Marks)* *Pg no.*_____

It was provided under the Partnership Agreement between Ram, Laxman and Bharat that in the event of death of a partner, the survivors would have to purchase his share in the firm on the following terms:

(a) Goodwill is to be valued at 3 year's purchase of simple average profits of last 4 completed years.
(b) Outstanding amount due to the representative of a deceased partner shall be paid in 4 equal half yearly installments commencing 6 months after the death plus interest @ 5% p.a. on the outstanding dues.

They shared profit and loss in the ratio 9:4:3.
Ram died on 30th September 2020 and Partner's Capital account balances on that date were: Ram - ₹ 21,600, Laxman - ₹ 12,800 and Bharat - ₹ 7,200. Ram's current account on 30th September, 2020 after crediting his share of profit to that date, however showed a debit balance of ₹ 1,920.
Firm profits were for the year ended
- 31st March, 2017 ₹ 70,400
- 31st March, 2018 ₹ 56,320
- 31st March, 2019 ₹ 48,160
- 31st March, 2020 ₹ 17,408

Show Ram's Capital Account and Executor's Account (of Ram) till full payment is made to Ram's Executor.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) C, D and E are partners sharing profits and losses in the proportion of 1/2, 1/3 and 1/6. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of ₹ 12,000 is divided among the partners in the ratio:
   (a) ₹ 2,000: ₹ 4,000: ₹ 6,000.
   (b) ₹ 5,000: ₹ 5,000: ₹ 2,000.
   (c) ₹ 6,000: ₹ 4,000: ₹ 2,000.

2) A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of ₹2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?
   (a) ₹ 50,000 credited to all the partners in old ratio.
   (b) ₹2,50,000 credited to all the partners in old ratio.
   (c) ₹2,00,000 credited to all the partners in old ratio.

3) A, B and C takes a Joint Life Policy, after five years, B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of ₹2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at the surrender value?
   (a) ₹ 50,000 credited to all the partners in old ratio.
   (b) ₹2,50,000 credited to all the partners in old ratio.
   (c) No treatment is required.

4) A, B and C are partners sharing profits in the ratio 2:2:1. On retirement of B, goodwill was valued as ₹ 30,000. Find the contribution of A and C to compensate B.
   (a) ₹ 20,000 and ₹ 10,000.
   (b) ₹ 8,000 and ₹ 4,000.
   (c) They will not contribute anything.

5) A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of ₹ 50,000 for A and B, for C ₹ 25,000. B declared to retire from the firm and balance in reserve on the date was ₹ 15,000. If goodwill of the firm was valued as ₹ 30,000 and profit on revaluation was ₹ 7,050 then what amount will be transferred to the loan account of B.
   (a) ₹ 70,820.
   (b) ₹ 50,820.
   (c) ₹ 25,820.

6) A, B and C are partners sharing profits and losses in the ratio of 3:2:1. C retires on a decided date and Goodwill of the firm is to be valued at ₹ 60,000. Find the amount payable to retiring partner on account of goodwill.
   (a) ₹ 30,000.
   (b) ₹ 20,000.
   (c) ₹ 10,000.

7) A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at ₹ 24,000. What will be the treatment for goodwill?
   (a) Credited to Revaluation Account at ₹ 24,000.
   (b) Adjusted through partners' capital accounts in gaining/sacrificing ratio.
   (c) Only A's capital account credited with ₹ 12,000.

8) Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A - ₹2,00,000; B - ₹3,00,000 and C - ₹2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at ₹1,40,000 and no Goodwill account being raised.
   (a) Credit Partner's Capital Account with old profit sharing ratio for ₹1,40,000.
   (b) Credit Partner's Capital Account with new profit sharing ratio for ₹1,40,000.
   (c) Credit A's Account with ₹ 40,000 and debit B's Capital Account with ₹ 10,000 and C's Capital Account with ₹ 30,000.

9) In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in
   (a) Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.
   (b) Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.
   (c) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

10) A, B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of ₹1,20,000 and in the balance sheet it is appearing at the surrender value i.e. ₹ 20,000. On the death of A, how this JLP will be shared among the partners.
   (a) ₹ 50,000: ₹ 25,000: ₹ 25,000.
   (b) ₹ 60,000: ₹ 30,000: ₹ 30,000.
   (c) ₹ 40,000: ₹ 35,000: ₹ 25,000.

11) R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022. It was decided to value the goodwill on the basis of three year's purchase of last five years average profits. If the profits are ₹ 29,600; ₹ 28,700; ₹ 28,900; ₹ 24,000 and ₹ 26,800. What will be D's share of goodwill?
   (a) ₹ 20,700.
   (b) ₹ 27,600.
   (c) ₹ 82,800.

12) R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2022 and profits for the accounting year 2021-2022 were ₹ 24,000. How much share in profits for the period 1st April 2022 to 30th June 2022 will be credited to D's Account.
   (a) ₹ 6,000.
   (b) ₹ 1,500.
   (c) ₹ 2,000.

13) Revaluation account is prepared at the time of
   (a) Admission and Retirement of a partner
   (b) Death of a partner
   (c) All of the above

14) If three partners A, B & C are sharing profits as 5:3:2, then on the death of a partner A, how much B & C will pay to A's executer on account of goodwill. Goodwill is to be calculated on the basis of 2 years purchase of last 3 years average profits. Profits for last three years are: ₹ 3,29,000; ₹ 3,46,000 and ₹ 4,05,000.
(a) ₹ 2,16,000 & ₹ 1,42,000.
(b) ₹ 2,44,000 & ₹ 2,16,000.
(c) ₹ 2,16,000 & ₹ 1,44,000.

ANSWERS MCQs

1 (c) 2 (a) 3 (c) 4 (b) 5 (a) 6 (c) 7 (b) 8 (c) 9 (c) 10 (a) 11 (a) 12 (b) 13 (c) 14 (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:

1) Business of a partnership has to be closed if any one partner retires.
2) At the time of retirement of a partner no special treatment is required for any reserves appearing in the Balance Sheet.
3) After retirement of a partner, profit sharing ratio of continuing partners remains the same.
4) If any partner wants to retire from the business, he must retire on 1st day of the accounting year.
5) Retiring partner has to forego his share of goodwill in the firm.
6) If a partner retires in between the accounting year then he is not entitled to any profit from the date of beginning of the year till his date of retirement.
7) If the firm has taken any joint life policy then it is to be surrendered at the time of retirement of a partner.
8) Any joint life policy reserve appearing in the Balance Sheet is credited to all the partners in their old profit sharing ratio.
9) No revaluation account is necessary on retirement of a partner.
10) Profit on revaluation is credited to continuing partners, retiring partner is not entitled to any profit on revaluation.
11) Business of partnership comes to an end on death of a partner. *(July 2021)*
12) Legal heir of a deceased partner automatically becomes partner in the firm.
13) A revaluation account is opened in the books of accounts on death of a partner.
14) Any reserve appearing in the balance sheet on the date of death of a partner is transferred to all partners capital account in their profit sharing ratio.
15) Legal heirs of a deceased partner are entitled to his capital account balance only.
16) It is not necessary to adjust goodwill on death of a partner.
17) On death of a partner continuing partners can agree to change their capital contribution and profit sharing ratio.
18) On death of a partner, the firm gets surrender value of the joint life policy.
19) Only legal heirs of deceased partner are entitled to amount received from joint life policy
20) If a partner retires then other partners have a gain in their profit sharing ratio.
21) The objective of taking a joint life policy by the partnership firm is to secure the lives of the existing partners of the firm.
22) At the time of retirement of a partner, firm gets policy amount from the insurance company against the Joint Life Policy taken jointly for all the partners.
23) Retiring or outgoing partner is liable for obligations incurred before and after his retirement

24) A joint venture is a partnership under the Partnership Act.
25) If individual life policies are taken in the name of partners and premium is paid from the firm, then retiring partner is entitled to surrender value of his policy only.

Solution

1) False: Business of a partnership is not closed if any one partner retires, remaining partners continue to carry on the business.
2) False: At the time of retirement of a partner all the reserves appearing in the balance sheet are transferred to all the partners in their profit sharing ratio.
3) False: After retirement of a partner, profit sharing ratio of continuing partners does not remain the same.
4) False: A partner can retire on any day as per his wish.
5) False: Retiring partner is entitled to his share of goodwill in the firm.
6) False: If a partner retires in between the accounting year then he is certainly entitled to the profit from the date of beginning of the year till his date of retirement.
7) True: The firm is eligible for the surrender value on the JLP taken on the partners at the time of their retirement.
8) True: JLP reserve is distributed to the partners in their profit sharing ratio.
9) False: Revaluation account is necessary on retirement of a partner.
10) False: Profit on revaluation is credited to all the partners in their profit sharing ratio.
11) False: Surviving partners continue to carry on the business.
12) False: Legal heirs of deceased partners are entitled to dues of the deceased partner.
13) True: To find out the actual values of the assets and liabilities, revaluation account is prepared.
14) True: Reserves belong to the partners in the same manner the capital contributed by them. Hence it is distributed to them through the capital account.
15) False: Legal heirs of a deceased partner are entitled to all the dues of deceased partner.
16) False: It is very much necessary to adjust goodwill on death of a partner.
17) True- Yes, it can be continued in the earlier share or in new share- in either case it leads to computing a new profit sharing ratio
18) False: On death of a partner the firm gets full value of sum assured of the joint life policy.
19) False: All the partners are entitled to amount received from joint life policy
20) True: If a partner retires the share of his profit or loss will be shared by other partners in their profit sharing ratio.
21) False: The object of taking a joint life policy is to reduce the financial pressure for the payment of a large sum to the legal representative of a deceased partner at the time of death of a partner.
22) False: At the time of retirement of a partner, firm gets surrender value from the insurance company against the Joint Life Policy taken jointly for all the partners.
23) False: Retiring or outgoing partner is liable for obligations incurred before his retirement
24) False- Joint Venture is only a kind of temporary trading relationship between the co-venturers to carry out a commercial venture. Therefore, it is not a partnership
25) False: If individual life policies are taken in the name of partners and premium is paid from the firm, then retiring partner is entitled to surrender value of all the partners policies.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

On 31st March, 2023, 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, 2023, 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 on the following basis:50% on retirement and the balance 50% within one year

Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2023 of M/s Rahul and Rohit.

Question 2 *(ICAI Study Material)* *Pg no._____*

Aarav, Nirav and Purav are partners in LLP sharing profits and losses in the ratio of 3:2:1 Their Balance Sheet as on 31st March 2023 was as follows:

BALANCE SHEET as on 31st March 2023

Liabilities		₹	Assets	₹
Capital Accounts:			Building	50,000
Aarav	80,000		Machinery	67,500
Nirav	50,000		Debtors	65,000
Purav	35,000	1,65,000	Stock	80,000
General Reserve		60,000	Bank	12,500
Trade Creditors		50,000		
		2,75,000		2,75,000

Purav retired from the business on 1st April 2023 on the following terms:

1. Goodwill was to be valued at 2 years purchase of average profit of past 3 years.
   31st March 2021 ₹ 41,000 31st March 2022 ₹ 50,000 31st March 2023 ₹ 55,000
2. Goodwill was not to be raised in the books of accounts.
3. Provision for Doubtful Debts to be created on debtors at 5%.
4. Machinery is to be depreciated by 10% and stock is revalued at ₹ 71,000.

5. Building to be appreciated by 20%.
6. Aarav and Nirav to bring in additional capital of ₹ 35,000 and ₹25,000 respectively.
7. Balance payable to Purav must be paid immediately.

You are required to prepare:

1. Revaluation account
2. Partners capital accounts
3. Bank Account
4. Balance Sheet after retirement.

Question 3 *(ICAI Study Material)* *Pg no._____*

Satyam Shivam & Sundaram are partners of M/s. Great Stationers sharing profits and losses in the ratio of 1:1:2. On 31st March 2023 their Balance Sheet was as under:

Liabilities		₹	Assets	₹
Capital Accounts:			Building	2,50,000
Satyam	1,95,000		Plant	1,60,000
Shivam	1,48,000		Investments	85,000
Sundaram	1,12,000	4,55,000	Stock	45,280
General Reserve		80,000	Trade Receivables	68,000
Loan from Satyam		94,000	Bank	95,720
Trade Creditors		75,000		
		7,04,000		7,04,000

On 1st April 2023 Shivam retired on the following terms:

1. Goodwill is to be revalued at ₹ 1,20,000 but the same will not appear as an asset in the books of the reconstituted firm.
2. Buildings is to be appreciated by 20% and Plant is to be depreciated by 10 %
3. Investments are to be taken over by the Satyam in full settlement of his loan
4. Provision of 5% is to be made on Trade receivables to cover doubtful debts.
5. In the reconstituted firm, the total capital will be ₹ 3,00,000/- which will be contributed by Satyam and Sundaram in their new profit sharing ratio, which is 2:3.
6. The amount due to retiring partner shall be transferred to his loan account.

Pass Journal entries & prepare Balance Sheet.

Question 4 *(CA Foundation May 2018) (10 Marks) / (RTP Nov 2023)* *Pg no._____*

A, B & C are partners sharing profits in ratio of 3:2:1. Their Balance Sheet as at 31st March, 2021

Liabilities		Amount	Assets		Amount
Capital Accounts			Building		10,00,000
A	8,00,000		Furniture		2,40,000
B	4,20,000		Office equipments		2,80,000
C	4,00,000	16,20,000	Stock		2,50,000
Sundry Creditors		3,70,000	Sundry debtors	3,00,000	
General Reserves		3,60,000	Less: Provision for Doubtful debts	(30,000)	2,70,000
			Joint life policy		1,60,000
			Cash at Bank		1,50,000
		23,50,000			23,50,000

B retired on 1st April, 2021 subject to the following conditions:

(i) Office Equipments revalued at ₹ 3,27,000.

(ii) Building revalued at ₹ 15,00,000. Furniture is written down by ₹ 40,000 and Stock is reduced to ₹ 2,00,000 .

(iii) Provision for Doubtful Debts is to be created @ 5% on Debtors.
(iv) Joint Life Policy will appear in the Balance Sheet at surrender value after B's retirement. The surrender value is ₹ 1,50,000
(v) Goodwill was to be valued at 3 years purchase of average 4 years profit which were:
2017 90,000 2018 1,40,000 2019 1,20,000 2020 1,30,000
(vi) Amount due to B is to be transferred to his Loan Account.
Prepare the Revaluation Account, Partners' Capital Accounts and the Balance Sheet immediately after B's retirement.

Question 5 *(ICAI Study Material)* Pg no._____

A and B are partners in a business sharing profit and losses as A-3/5th and B-2/5th. Their balance sheet as on 1st January, 2023 is given below:

Liabilities	₹	Assets	₹
Capital Accounts:		Plant and Machinery	20,000
A 20,000		Inventories	16,000
B 15,000	35,000	Trade receivables	15,000
Reserve Account	15,000	Balance at Bank	6,000
Trade payables	7,500	Cash in hand	500
	57,500		57,500

B retires from the business owing to illness and A takes it over. The following revaluation was made:
(1) The goodwill of the firm is valued at ₹25,000.
(2) Depreciate Plant & Machinery by 7.5% and Inventories by 15%.
(3) Doubtful debts provision is raised against trade receivables at 5% and a discount reserve against trade payables at 2%.
Required: Journalize the above transactions in the books of the firm and close the Partners' Accounts as on 1st January 2023. Give also the opening Balance Sheet of A.

Question 6 *(CA Foundation June 2022) (10 Marks)* Pg no._____

X, Y and Z are partners sharing profits and losses in the ratio of 1:2:3. Their Balance Sheet as on 31st March,2021 was as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capitals:		Building	2,50,000
X	1,75,000	Machinery	3,37,500
Y	2,50,000	Debtors	3,25,000
Z	4,00,000	Stock	4,00,000
General Reserve	3,00,000	Bank	62,500
Trade Creditors	2,50,000		
Total	13,75,000	Total	13,75,000

Z retired from business on 1st April,2021 on the following terms:

a) Building to be appreciated by 25%.
b) X and Y to bring in additional capital of ₹ 5,00,000 each.
c) Machinery to be depreciated by 10%.
d) Stock is revalued at ₹ 3,72,250.
e) Provision for Doubtful Debts to be created at 4%.
f) Goodwill was to be valued at 3 years' purchase of average profits of past 3 years. The profits of past 3 years were ₹ 2,75,000, ₹ 2,50,000 and ₹ 1,95,000 respectively.
g) Goodwill was not to be raised in the Books of Accounts.
h) Balance payable to Z was to be paid immediately.

Prepare Revaluation Account, Bank Account and Partners' Capital Accounts after giving effect to Z's retirement, Also show the valuation of Goodwill and pass a Journal Entry for adjustment of Goodwill.

Question 7 *(ICAI Study Material)* *Pg no._____*

A,B,C were in partnership sharing profits and losses in the ratio of 3:2:1. The balance sheet of the firm as on 31.3.2023 was as under:

Liabilities		₹	Assets	₹
Capital Accounts:			Fixtures	30,000
A	1,50,000		Stock	1,70,000
B	1,00,000		Sundry debtors	90,000
C	50,000	3,00,000	Cash	50,000
Sundry creditors		40,000		
		3,40,000		3,40,000

A, on account of ill-health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered as on 31.3.2023, the terms of which were as follows:

(a) The profit and loss account for the year ended 31.3.2023, which showed a net profit of ₹ 42,000 was to be re-opened. B was to be credited with ₹ 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio is to be 2:3:1 as and from 1st April 2022.

(b) Goodwill was to be valued at two years' purchase of the simple average profits of five years. Profits for these five years ending on 31st March were as under:

31.3.2019	15,000
31.3.2020	23,000
31.3.2021	25,000
31.3.2022	35,000
31.3.2023	42,000

(c) Fixtures are to be valued at ₹ 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.

(d) That the amount payable to A shall be paid by B.

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3:1 and decided to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6 %. Total capital of the firm will be ₹3 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare capital accounts of partners, cash account and balance sheet of B and C.

Question 8 *(ICAI Study Material) / (RTP Nov 2019) / (RTP Nov 2021) (Similar)* *Pg no._____*

The following is the Balance Sheet of M/s. ABC LLP as at 31st December, 2022.

Balance Sheet as at 31st December, 2022

Liabilities		₹	Assets		₹
Capital Accounts:			Machinery		5,000
A	4,100		Furniture		2,800
B	4,100		Fixture		2,100
C	4,500	12,700	Inventories		950
General Reserve		1,500	Trade receivables	4,500	
Trade payables		2,350	Less: Provision	(300)	4,200
			Cash		1,500
		16,550			16,550

C died on 3rd January, 2023 and the following agreement was to be put into effect.
(a) Assets were to be revalued: Machinery to ₹ 5,850; Furniture to ₹ 2,300; Inventory to ₹ 750.
(b) Goodwill was valued at ₹ 3,000 and was to be credited with his share, without using a Goodwill Account
(c) ₹ 1,000 was to be paid away to the executors of the dead partner on 5th January, 2023.
Required to show:
(i) The Journal Entry for Goodwill adjustment.
(ii) The Revaluation Account and Capital Accounts of the partners.
(iii) Which account would be debited and which account credited if the provision for doubtful debts in the Balance Sheet was to be found unnecessary to maintain at the death of C.

Question 9 *(CA Foundation Nov 2019) (10 Marks)* Pg no._____

Arup and Swarup were partners. The partnership deed provides inter alia:
b) That the annual accounts be balanced on 31st December each year;
c) That the profits be allocated as follows:
Arup: One-half; Swarup: One-third and Carried to reserve account: One Sixth;
d) That in the event of death of a partner, his executor will be entitled to the following:
1) The capital to his credit at the date of death;
2) His proportionate share of profit to date of death based on the average profits of the last three completed years; and
3) His Share of goodwill based on three years' purchase of the average profits for the three preceding completed years

Trial Balance as on 31st December 2020

Particulars	Debit (₹)	Credit (₹)
Arup's Capital		90,000
Swarup's Capital		60,000
Reserve		45,000
Bills receivable	50,000	
Investment	55,000	
Cash	1,10,000	
Trade payables		20,000
Total	2,15,000	2,15,000

The profits for the three year were 2018: ₹ 51,000; 2019: ₹ 39,000 and 2020. ₹ 45,000. Swarup died on 1st May 2021.
Show the calculation of Swarup (A) Share of profits; (B) Share of Goodwill; (C) Draw up Swarup's Executors Account as would appear in the firms' ledger transferring the amount to the Loan account.

Question 10 *(ICAI Study Material)* Pg no._____

The Balance Sheet of Seed, Plant and Flower as at 31st December, 2021 was as under:

Liabilities		₹	Assets	₹
Capital Accounts:			Fixed Assets	40,000
Seed	25,000		Debtors	10,000
Plant	15,000		Bills Receivable	4,000
Flower	15,000	55,000	Inventories	16,000
General Reserve		5,000	Cash at Bank	10,000
Trade payables		20,000		
		80,000		80,000

The profit sharing ratio was: Seed 5/10, Plant 3/10 and Flower 2/10. On 1st May, 2022 Plant died. It was agreed that:

(a) Goodwill should be valued at 3 years purchase of the average profits for 4 years. The profits were:
   2018 ₹ 10,000 2019 ₹ 13,000 2020 ₹ 12,000 2021 ₹ 15,000
(b) The deceased partner to be given share of profits upto the date of death on the basis of previous year.
(c) Fixed Assets were to be depreciated by 10%. A bill for ₹ 1,000 was found to be worthless. These are not to affect goodwill.
(d) A sum of ₹ 7,750 was to be paid immediately, the balance was to remain as a loan with the firm at 9% p.a. as interest.

Seed & Flower agreed to share profits & losses in future in the ratio of 3: 2. Give necessary journal entries.

Question 11 *(ICAI Study Material) / (RTP Nov 2018) / (RTP May 2022) (Similar)* Pg no.______

Dowell LLP with partners Mr. A, Mr. B and Mr. C, sharing profits and losses in the ratio of 10:6:4. The balance sheet of the firm as at 31st March, 2023 is as under:

Liabilities	₹	Assets	₹
Capitals		Land	10,000
A 80,000		Buildings	2,00,000
B 20,000		Plant and machinery	1,30,000
C 30,000	1,30,000	Furniture	43,000
Reserves (un-appropriated profit)	20,000	Investments	12,000
Long Term Debt	3,00,000	Inventories	1,30,000
Bank Overdraft	44,000	Trade receivables	1,39,000
Trade payables	1,70,000		
	6,64,000		6,64,000

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2023. For this purpose, the following adjustments are to be made:

a) Goodwill is to be valued at ₹1 lakh but the same will not appear as an asset in the books of the reconstituted firm.
b) Buildings and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at ₹15,000. Provision of 20% is to be made on Trade receivables to cover doubtful debts.
c) In the reconstituted firm, the total capital will be ₹ 2 lakhs which will be contributed by Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2:2:1.
   (i) The surplus funds, if any, will be used for repaying bank overdraft.
   (ii) The amount due to retiring partner shall be transferred to his loan account.

Required:
Prepare
(a) Revaluation account;
(b) Partners' capital accounts;
(c) Bank account; and
(d) Balance sheet of the reconstituted firm as on 1st April, 2023

Question 12 *(CA Foundation Nov 2020) (10 Marks)* Pg no.______

M/s. TB is a partnership firm with the partners A, B and C sharing profits and losses in the ratio of 3:2:5. The balance sheet of the firm as on 30th June, 2020 was as under:

Balance Sheet of M/s. TB as on 30-6-2020

Liabilities		₹	Assets	₹
Capital Accounts:			Land	1,20,000
A	1,24,000		Building	2,20,000
B	96,000		Plant and Machinery	4,00,000
C	1,60,000	3,80,000	Investments	42,000
Long Term Loan		4,20,000	Inventories	1,36,000
Bank Overdraft		64,000	Trade receivables	1,59,000
Trade payables		2,13,000		
		10,77,000		10,77,000

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st July, 2020. For this purpose, following adjustments are to be made:

(a) Goodwill of the firm is to be valued at ₹ 3 lakhs due to the firm's location advantage but the same will not appear as an asset in the books of the reconstituted firm.

(b) Building and Plant & Machinery are to be valued at 95% and 80% of the respective balance sheet values. Investments are to be taken over by the retiring partner at ₹ 46,000. Trade receivables are considered good only upto 85% of the balance sheet figure. Balance to be considered bad.

(c) In the reconstituted firm, the total capital will be ₹ 4 lakhs, which will be contributed by A, C and D in their new profit sharing ratio, which is 3:4:3.

(d) The amount due to retiring partner shall be transferred to his loan account.

You are required to prepare Revaluation Account and Partners' Capital Accounts after reconstitution, along with working notes.

Question 13 *(ICAI Study Material)* *Pg no._____*

K, L & M are partners sharing profits and losses in the ratio 5:3:2. Due to illness, L wanted to retire from the firm on 31.3.2023 and admit his son N in his place.

Liabilities		₹	Assets	₹
Capital Accounts:			Furniture	20,000
K	40,000		Trade receivables	50,000
L	60,000		Inventories	50,000
M	30,000	1,30,000	Cash and Bank balances	80,000
Reserve		50,000		
Trade payables		20,000		
		2,00,000		2,00,000

On retirement of L assets were revalued: Furniture ₹10,000 and Inventory in trade ₹30,000. 50% of the amount due to L was paid off in cash and the balance was retained in the firm as capital of N. On admission of the new partner, goodwill was valued at ₹50,000. Partners are being paid off their extra balances to make capital proportionate by keeping N's capital as base.

You are required to give:

a) Necessary journal entries;

b) Balance sheet of M/s K, M and N as on 1.4.2023;

c) Capital accounts of partners.

Question 14 *Pg no._____*

X, Y & Z were in partnership sharing profits and losses equally and following financial year for accounting. Z died on 30th September, 2020. As per the accounts drawn upto 30th

September, 2020 the capital account balances were X: 30,000 (Cr.), Y:40,000 (Cr.), Z: 50,000 (Cr.) respectively. Z's legal representative would be paid their dues on 1st April, 2021. In the meanwhile, X & Y continued the business and earned a profit of ₹ 40,000 for the half year ended 31.03.2021. Partnership deed did not contain any clause for payment of Interest on deceased partner's dues. Suggest the amount that legal heirs of the deceased partner should settle for as per Section 37 of the Partnership Act, 1932.

Question 15 *(ICAI Study Material)* *Pg no._____*

Red, White and Black shared profits and losses in the ratio of 5:3:2. They took out a joint life Policy in 2018 for ₹50,000, a premium of ₹3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil; 2019 ₹ 900; 2020 ₹ 2,000; 2021 ₹ 3,600. Black retires on 15th April, 2022.
Prepare ledger accounts assuming no Joint Life Policy Account is maintained.

Question 16 *(ICAI Study Material)* *Pg no._____*

Red, White and Black shared profits and losses in the ratio of 5: 3: 2. They took out a Joint Life Policy in 2018 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil; 2019 ₹ 900: 2020 ₹ 2,000; 2021 ₹ 3,600. Black retires on 15th April, 2022.
Prepare ledger accounts assuming Joint Life Policy Account is maintained on surrender value basis.

Question 17 *(CA Foundation July 2021) (5 Marks)* *Pg no._____*

Rama, Krishna and Raghu shared profits and losses in the ratio of 5:3:2. They took out a Joint Life Policy in 2017 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows:
2017 Nil   2018 ₹ 900   2019 ₹ 2,000   2020 ₹ 3,600
Rama retired on 15th April, 2021 and the policy was surrendered.
You are required to prepare Joint Life Policy Account from 2017 to 2021 (assuming the Policy Account is maintained at surrendered value basis)

Question 18 *(CA Foundation May 2019) (10 Marks)* *Pg no._____*

Monika, Yedhant and Zoya are in partnership, sharing profits and losses equally. Zoya died on 30th June 2021. The Balance Sheet of Firm as at 31st March 2021 stood as

Liabilities	Amount	Assets		Amount
Creditors	20,000	Land and Building		1,50,000
General Reserve	12,000	Investments		65,000
Capital Accounts:		Stock in trade		15,000
Monika	1,00,000	Trade receivables	35,000	
Yedhant	75,000	Less: Prov. for doubtful debt	(2,000)	33,000
Zoya	75,000	Cash in hand		7,000
		Cash at bank		12,000
	2,82,000			2,82,000

In order to arrive at the balance due to Zoya, it was mutually agreed that:
(i) Land and Building be valued at ₹ 1,75,000
(ii) Debtors were all good, no provision is required
(iii) Stock is valued at ₹ 13,500
(iv) Goodwill will be valued at one Year's purchase of the average profit of the past five years. Zoya's share of goodwill be adjusted in the account of Monika and Yedhant.

(v) Zoya's share of profit from 1st April 2021, to the date of death be calculated on the basis of average profit of preceding three years.

(vi) The profit of the preceding five years ended 31st March were:

2021	2020	2019	2018	2017
25,000	20,000	22,500	35,000	28,750

You are required to prepare:

(1) Revaluation account

(2) Capital accounts of the partners and

(3) Balance sheet of the Firm as at 1st July 2021.

Question 19 *(MTP Oct 2019)* *Pg no._____*

A, B and C are partners in a firm sharing profits and losses as 8:5:3. Their balance sheet as at 31st December, 2020 was as follows:

	Amount		Amount
Sundry creditors	1,50,000	Cash	40,000
General reserve	80,000	Bills receivable	50,000
Partners' loan accounts:		Sundry debtors	60,000
A	40,000	Stock	1,20,000
B	30,000	Fixed assets	2,80,000
Partners' capital accounts:			
A	1,00,000		
B	80,000		
C	70,000		
	5,50,000		5,50,000

From 1st January, 2021 they agreed to alter profit-sharing ratio as 5:6:5. It is also decided that:

(a) the fixed assets should be valued at ₹ 3,31,000;

(b) a provision of 5% on sundry debtors to be made for doubtful debts;

(c) the goodwill of the firm at this date be valued at three years' purchase of the average net profits of the last five years before charging insurance premium; and

(d) the stock be reduced to ₹ 1,12,000.

There is a joint life insurance policy for ₹ 2,00,000 for which an annual premium of ₹ 10,000 is paid, the premium being charged to profit and loss account. The surrender value of the policy on 31st December, 2020 was ₹ 78,000.

The net profits of the firm for the last five years were ₹ 14,000, ₹ 17,000, ₹ 20,000, ₹ 22,000 and ₹ 27,000. Goodwill and the surrender value of the joint life policy was not to appear in the books. Pass journal entries necessary to adjust the capital accounts of the partners and prepare the revised balance sheet.

Question 20 *(ICAI Study Material)* *Pg no._____*

A, B and C are in partnership sharing profits and losses at the ratio of 5:3:2. The balance sheet of the firm on 31.12.2022 was as follows:

Liabilities		₹	Assets	₹
Capital Accounts:			Sundry Fixed Assets	80,000
A	50,000		Inventories	50,000
B	40,000		Trade receivables	30,000
C	30,000	1,20,000	Joint Life Policy	20,000
Bank Loan		40,000	Bank	10,000
Trade payables		30,000		
		1,90,000		1,90,000

On 1.1.2023, A wants to retire, B and C agreed to continue at 2:1. Joint Life Policy was taken on 1.1.2018 for ₹ 1,00,000 and its surrender value as on 31.12.2022 was ₹ 25,000. For the purpose of A's retirement goodwill was raised for ₹ 1,00,000. Sundry Fixed Assets was revalued for ₹ 1,10,000. But B and C did not prefer to show such increase in assets in the Balance Sheet.
Also they agreed to bring necessary cash to discharge 50% of the A's claim, to make the bank balance ₹25,000 and to make their capital proportionate.
Pass necessary journal entries

Question 21 _(ICAI Study Material)_ _Pg no.______

Diya Riya & Kiya are partners of M/s. DRK Fabrics sharing profits and losses in the ratio of 2:1:2. On 31st March 2023 their Balance Sheet was as under:

Liabilities		₹	Assets	₹
Capital Accounts:			Land & Building	1,65,000
Diya	1,50,000		Furniture	75,000
Riya	1,80,000		Joint Life Policy	60,000
Kiya	70,000	4,00,000	Inventory	88,740
General Reserve		1,40,000	Trade Receivables	96,750
Trade Payables		60,000	Bank	1,14,510
		6,00,000		6,00,000

Kiya died on 30th September, 2023. The partnership deed provides as follows:

(a) That partners be allowed interest at 12% p.a. on their capitals, but no interest be charged on drawings.

(b) That upon the death of a partner, the goodwill of the firm be valued at one years' purchase of the average net profits (after charging interest on capital) for the four years to 31st March preceding the death of a partner.

The profits of the firm before charging interest on capitals were

2019-20	1,62,000	2020-21	1,99,000
2021-22	1,87,000	2022-23	1,96,000

Average capital during preceding four years may be assumed as ₹ 3,00,000

(c) Profits till the date of death to be ascertained on the basis of average profit of previous four years

(d) Upon the death of a partner, she is to be credited with her share of the profits, interest on capitals etc. calculated till the date of death

After the death of Kiya

1. ₹ 2,00,000 was received from insurance company against Joint life Policy.
2. Land & Building was appreciated by 20%, Furniture to be depreciated by 10%, inventory to be revalued at ₹ 80,000. Bad debts amounted ₹ 1760.
3. Amount payable to Kiya was paid in cash.

You are required to prepare

1. Revaluation A/c
2. Partners' Capital A/c
3. Balance Sheet as on 30th September 2023, assuming other Assets and liabilities remaining the same.

Question 22 _(CA Foundation Jan 2021) (10 Marks)_ _Pg no.______

The partnership deed of a firm consisting of 3 partners - P, Q and R (profit sharing ratio being 2:1:1) and whose fixed capitals are ₹ 30,000, ₹ 12,000 and ₹ 8,000 respectively provides as follows:

(i) The partners be allowed interest @ 8% p.a. on their fixed capitals, but no interest to be allowed on undrawn profits or charged on drawings.
(ii) That upon the death of a partner, the goodwill of the firm be valued at 2 years purchase of the average net profit (after charging interest on capital) for the 3 years to 31st December preceding the death of a partner.
(iii) That an insurance policy of ₹ 25,000 each was taken in individual names of each partner. The premium was charged against the profits of the firm. The surrender value of the policy was 20% of the sum assured.
(iv) Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals, etc. calculated upto 31st December following his death.
(v) That the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.
(vi) That the partnership books to be closed annually on 31st December.

P died on 30th September, 2020. The amount standing to the credit of his current account as on 31st December, 2019 was ₹ 5,000 and from that date to the date of death he had withdrawn₹ 30,000 from the business.
An unrecorded liability of ₹ 6,000 was discovered on 30th September, 2020 and it was decided to record it and immediately pay it off.
The trading results of the firm (before charging interest on capital) had been as follows:
2017 Profit ₹ 29,340
2018 Profit ₹ 26,470
2019 Loss ₹ 8,320
2020 Profit ₹ 13,470
You are required to prepare an account showing amount due to P's legal heir as on 31st December, 2020.
Note: Impact for unrecorded liability not to be given in earlier years.

Question 23 *(CA Foundation June 2023) (20 Marks)* *Pg no._____*

A, B and C were trading in partnership sharing profits and losses in the proportion of 4:3:3. The balances in the books of the firm as on 31st December, 2022 subject to final adjustment were as under:

	Debit	Credit
	Amount ₹	Amount ₹
Capital Accounts		
- A		2,25,000
- B		1,12,500
- C		1,35,000
Current Account		
- A	36,000	
- B	54,000	
- C	54,000	
Land and Building	1,80,000	
Furniture and Fixtures	33,750	
Stock	2,81,250	
Debtors	45,000	
Bank Account	90,000	
Profit for the year before charging interest		2,34,000
Creditors		67,500
Total	7,74,000	7,74,000

Goodwill may be recorded separately, instead of through Revaluation Account. C died on 30th June, 2022. The Partnership deed provided that:

a) Interest was credited on Capital Account of Partners as @ 12% per annum on the balance at the beginning of the year.
b) On the death of partner
   (i) Goodwill was to be valued at three years purchase of average annual profits of three years up to the death, after deducting interest on capital employed at 10%p.a. and a fair remuneration for each of the partners.
   (ii) Fixed assets were to be valued by an independent valuer and all other assets and liabilities to be taken at book value, and
c) Whenever necessary, profit or loss should be apportioned on a time basis. You ascertain that:
   (i) Profit for three years, before charging partners' interest were:

2019	₹ 2,52,000
2020	₹ 2,83,500
2021	₹ 2,70,000

   (ii) The independent valuation on the date of death revealed:

Land and Building	₹ 2,25,000
Furniture and Fixtures	₹ 22,500

   (iii) For valuation of goodwill a fair remuneration for each of the partners would be ₹ 56,250 per annum and that the capital employed in the business to be taken as ₹ 5,85,000 throughout.

It was agreed between the partners that:

a. Goodwill was not be shown as an asset of the firm as on 31st December, 2022. Therefore, adjustment for goodwill was to be made in Capital Accounts.
b. The amount due to C's Estate was to remain as loan with the firm carrying interest at 12% p.a.
c. A and B would share profits equally from the date of death of C.
d. Depreciation on revised value of assets would be ignored.

You are required to prepare:

1. Partners' Capital Account and Current Account; and
2. Balance Sheet of the firm as on 31st December, 2022.

Working should be done correct to the nearest rupee.

Unit 6: DISSOLUTION OF FIRM AND LLP

CH 10E

"Don't be pushed around by the Fears in your Mind. Be led by the Dreams in your Heart."

TOPIC 1A: DISSOLUTION

DISSOLUTION

A partnership is dissolved or comes to an end on:
- expiry of the term for which it was formed or completion of the venture for which it was entered into
- death of a partner
- insolvency of a partner.

However, the partners or remaining partners (in case of death or insolvency) may continue to do the business. In such case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved

A firm stands dissolved in the following cases:
- The partners agree that the firm should be dissolved
- All partners except one become insolvent
- The business becomes illegal
- In case of partnership at will, a partner gives notice of dissolution and
- The court orders dissolution

The court has the option to order dissolution of a firm in the following circumstances:
(a) Where a partner has become of unsound mind;
(b) Where 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; and
(g) Where it appears to be just and equitable.

SETTLEMENT OF ACCOUNTS (Section 48 of the Partnership Act)

A. Treatment of Losses: Losses including deficiencies of capital are paid,
- → first out of profits,
- → next out of capital and,
- → lastly, if necessary, by the partners individually in their PSR.

B. Application of Assets: The assets of firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:
- → paying the debts of the firm to third parties;
- → pay off loans from partners.
- → pay off capitals of partners.
- → Any surplus to be divided among the partners in their PSR.

Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund of premium or of such part as may be reasonable, if the firm is dissolved before the term has expired.

No claim in this respect will arise if:

(1) the firm is dissolved due to the death of a partner;

(2) the dissolution is mainly due to the partner's (claiming refund) own misconduct; and

(3) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit- sharing ratio.

Distinction Between Dissolution of Partnership & Dissolution of Firm

S. No.	Dissolution of Partnership	Dissolution of Partnership Firm
1	Refers to the discontinuance of the relation between the partners of firm.	Implies that entire firm ceases to exist, including the relation among all partners
2	There can be change in PSR or admission/death/retirement of a partner	Dissolution of partnership firm occurs
3	In event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.	In event of the dissolution of the firm, the business ceases to end.
4	There is no intervention by the court.	Court has inherent power to intervene. By its order, a firm can be dissolved.
5	Economic relationships among partners may remain same or change.	Economic relationship among partners comes to an end.
6	Assets and liabilities are revalued. New balance sheet is prepared	Assets are sold and realized. Liabilities are paid off.
7	Revaluation account is prepared	Realization account is prepared.
8	Assets and liabilities are revalued after winding up of the existing partnership.	Assets and liabilities are settled on winding up of a firm.
9	Books of accounts are not closed.	Books of accounts are closed.

WINDING UP OF A LIMITED LIABILITY PARTNERSHIP (LLP)

The winding up of a LLP may be either voluntary or by the Tribunal and LLP, so wound up may be dissolved.

Winding up of a LLP may be initiated by Tribunal if:

- The LLP wishes to wind up;
- The LLP has less than 2 partners for more than 6 months;
- The LLP is unable to pay its debts;
- The LLP has not acted in the interest of the sovereignty and the integrity of India;
- The LLP has failed to submit with the statements of accounts and solvency or the LLP annual returns for more than five consecutive financial years with the Registrar;
- The Tribunal thinks that it is Just and Equitable that the LLP should be wound up.

The Central Government may make rules for the provisions in relation to winding up and dissolution of LLP.

ACCOUNTING ENTRIES: BOOKS OF FIRM

1. Transfer of Assets to Realisation Account

Realisation A/c Dr. To Sundry Assets A/c

- By Name of Individual Assets
- To be transferred at *BOOK VALUE*
- Do not transfer the following.
    - Fictitious Assets
    - P & L debit balance
    - Cash & Bank balance
    - Current & Capital Account debit balance
- If any asset is having corresponding provision, then gross value to be transferred.

2. Transfer of Outsider's Liabilities to Realisation Account

Liabilities A/c Dr. To Realisation A/c

- By Name of Individual Liabilities
- To be transferred at *BOOK VALUE*
- Do not transfer the following
    - Partner's capital & current account balances
    - Reserves and surplus
    - Partner's Loan
- Any provision appearing on asset side is to be debited in this entry

3. Realisation of All Assets (whether recorded or unrecorded)

When assets are sold for cash	Cash/Bank A/c Dr. To Realisation Account
When assets are taken away by the partners	Partner's Capital A/c Dr. To Realisation Account
When assets are given away to any of the creditors towards his dues	No Entry

4. Discharge of Outsider's Liabilities (whether recorded or unrecorded)

When the liabilities are discharged in cash	Realisation Account Dr. To Cash/Bank A/c
When any of the partners agree to discharge the liability	Realisation Account Dr. To Partner's Capital A/c

5. Realisation Expenses:

When expenses are paid by the firm on its own behalf	Realisation Account Dr. To Cash/Bank A/c
When expenses are paid by a partner on firm's behalf	Realisation Account Dr. To Partner's Capital A/c
When any of the partners agree to do dissolution work for an agreed remuneration	Realisation Account Dr. To Partner's Capital A/c
When expenses are paid by a partner who has to bear such expenses	No Entry
When expenses are paid by firm on behalf of a partner who has to bear such expenses	Partner's Capital A/c Dr. To Cash/Bank A/c

6. Payment of Partner's Loan /Advance

Partner's Loan A/c Dr. To Capital A/c (Only to the extent of Dr. Balance in Capital A/c) To Cash/Bank A/c

7. Ascertainment of Profit/Loss on Realisation A/c & Transfer in Profit Sharing Ratio (PSR)

A: If Profit	B: If Loss
Realisation A/c Dr. To All Partner's Capital A/c	All Partner's Capital A/c Dr. To Realisation A/c

8. Transferring Accumulated Profits/Reserves & Losses to Partner's Capital Account in PSR

For Transfer of Accumulated Profits & Reserves
General Reserves A/c Dr. P&L A/c Dr. To All Partner's Capital A/c *Reverse entry to be passed in case of Accumulated Losses*

Realisation Account

To Sundry Assets (Individually at Book value) × Cash & Bank × Losses × Adv. to partner Current/Capital (Dr. Bal.)		By Sundry Liabilities (Outsider) (Individually at Book value) × Capital/Current A/c × Reserves & Profits × Partner's Loan A/c	
To Cash & Bank / Partner's Capital A/c (Paid value) (Taken over value) [Including unrecorded Liabilities/ Dissolution Expenses]		By Cash & Bank / Partner's Capital A/c (Realised value) (Taken over value) [Including unrecorded Assets]	
To Profit tfd. to Partner's cap. A/c (B.f.) (PSR)		By Loss tfd. to Partner's cap. A/c (B.f.) (PSR)	

NOTES:

1) Debtors & Provision for Doubtful Debts

Balance Sheet

Liabilities		Assets	
		Debtors 50000 - Provision for Doubtful debt (3000)	47000

Realisation A/c

To Debtors	50000	By Provision for Doubtful Debt	3000

2) Treat Goodwill just like any other normal asset.

Transfer Goodwill to Realisation A/c by passing entry:

Realisation A/c – Dr.

To Goodwill A/c

3) If any asset is assigned for settlement of liability

Only transfer to Realisation A/c with no further effect.

Balance Sheet

Liabilities		Assets	
Creditors	100000	Stock	80000

Realisation A/c

To Stock	80000	By Creditors	100000

4) Question is silent on payment of liabilities & realisation of assets.

For Liabilities: Full payment is made.

For Assets: Depends on nature & value of asset.

Option 1: Assume full value realised.

Option 2: Assume Nil value realised

[Eg. Goodwill, Prepaid Expenses, etc.]

TOPIC 1B: INSOLVENCY OF PARTNER

CONSEQUENCES OF INSOLVENCY OF A PARTNER

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.
2. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
3. The estate of insolvent partner is not liable for any act of firm after the date of order of adjudication
4. The firm cannot be held liable for any acts of insolvent partner after the date of order of adjudication.

LOSS ARISING FROM INSOLVENCY OF A PARTNER

When a partner is unable to pay his debt due to the firm he is said to be insolvent & share of loss is to be borne by other solvent partners as per decision: English case of Garner vs Murray
According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.
The provisions of the Indian Partnership Act are not contrary to Garner vs. Murray rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Insolvency of Partner
[GARNER vs MURRAY]

1) Deficiency / Shortage on account of insolvency of partner to be borne by remaining (other) solvent partners (having credit balance) in their last agreed capital ratio

2) Realisation loss to be brought in cash by all the solvent partners (including Dr. Balance)

Last Agreed Capital Ratio
(upto the date of dissolution of firm)

Fixed Capital	Fluctuating Capital	
Ratio of Fixed capital	Capital Balances in B/S	xx
	± Effect of Reserves, Profits & Losses	xx
		xx

Capital Ratio on Insolvency

- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of partners & capital ratio will be determined after adjusting all reserves

& accumulated profits, all drawings, all interest on capitals & on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.

- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Non Applicability of Garner vs Murray

1. When the solvent partner has a debit balance in the capital account. Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.
2. When the firm has only two partners.
3. When there is an agreement between the partners to share the deficiency in capital account of insolvent partner.
4. When all the partners of the firm are insolvent.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances don't transfer creditors (Outsider Liabilities) to Realisation A/c.
- Creditors (Outsider Liabilities) may be paid the amount available including the amount contributed by the partners in the ratio of their outstanding amount.

TOPIC 2: PIECEMEAL DISTRIBUTION

Generally, the assets sold upon dissolution of partnership are realised only in small instalments over a period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected. Usually, the first course is adopted. In order to ensure that the distribution of cash among the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made.

PIECEMEAL DISTRIBUTION
(Instalments)

Sequence of Distribution:

1) Provide for Dissolution/Realisation Expenses (Estimated)
(Actual Amount decided in last instalment)
2) Outsider Liabilities [If >1, distribute in o/s Amount ratio until they are fully paid]
3) Partner's Loan
4) Partner's capital* → Highest Relative capital Method
→ Maximum loss Method

* Capital Balances	xx
+ Reserves & Surplus	xx
- P&L A/c (Dr.)	(xx)
- Loan to Partner	(xx)
	xx

ASSIGNMENT QUESTIONS

TOPIC 1A: NORMAL DISSOLUTION

Question 1 *(ICAI Study Material)* *Pg no._____*

P, Q and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2023 is as follows:

Liabilities	₹	Assets	₹
Partners' Capitals:		Plant and Machinery	1,08,000
P	1,20,000	Fixtures	24,000
Q	48,000	Stock in trade	60,000
R	24,000	Sundry debtors	48,000
Reserve Fund	60,000	Cash in hand	60,000
Creditors	48,000		
	3,00,000		**3,00,000**

They decided to dissolve the business. The following are the amounts realized:

	₹
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realization expenses amounted to ₹ 1,500. There was an unrecorded asset of ₹ 6,000 which was taken over by Q at ₹ 4,800. A bill for ₹ 4,200 due for GST was received during the course of realization and this was also paid. Prepare:

(i) Realisation account.
(ii) Partners' capital accounts.
(iii) Cash account.

Question 2 *Pg no._____*

X, Y and Z were in partnership sharing profits and losses in the ratio of 3:2:1 respectively. They decided to dissolve the partnership firm on 31.3.2020, when the Balance Sheet of the firm appeared as under:

Balance Sheet of the firm as on 31.3.2020

Liabilities	₹	Assets	₹
Sundry Creditors	8,50,500	Plant and Machinery	15,95,700
Bank Overdraft	9,09,675	Furniture	96,975
Joint Life Policy Reserve	3,98,250	Stock	3,55,050
Loan from Mrs. X	2,25,000	Sundry Debtors	8,01,000
Capital Accounts:		Joint Life Policy	3,98,250
X	6,30,000	Commission Receivable	2,10,825
Y	3,37,500	Cash in Hand	73,125
Z	1,80,000		
	35,30,925		35,30,925

The following details are relevant for dissolution:

(i) The joint life policy was surrendered for ₹ 3,48,750.
(ii) X took over plant and machinery for ₹ 13,50,000.
(iii) X also agreed to discharge bank overdraft and loan from Mrs. X.
(iv) Furniture and stocks were divided equally between X and Y at an agreed valuation of ₹ 5,40,000.

(v) Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.
(vi) Commission receivable was received in time.
(vii) A bill discounted was subsequently returned dishonoured and proved valueless ₹ 46,125 (including ₹ 750 noting charges).
(viii) X paid the expenses of dissolution amounting to ₹ 27,000.

You are required to prepare:
(i) Realisation Account (ii) Partners' Capital Accounts and (iii) Cash Account.

Question 3 *(ICAI Study Material) / (RTP Nov 2021)* Pg no._____

P and Q were partners sharing profits equally in LLP. Their Balance Sheet as on March 31, 2023 was as follows:

Liabilities		Amount	Assets	Amount
Capitals:			Bank	30,000
P	1,00,000		Debtors	25,000
Q	50,000	1,50,000	Stock	35,000
Creditors		20,000	Furniture	40,000
Q's current account		10,000	Machinery	60,000
Reserves		15,000	P's current account	10,000
Bank overdraft		5,000		
		2,00,000		2,00,000

The firm was dissolved on the above date:
P took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realized for ₹ 30,000 and ₹ 50,000 respectively; There was an unrecorded investment which was sold for ₹ 25,000; Debtors realized 90% only and ₹ 1,245 were recovered for bad debts written off last year; There was an outstanding bill for repairs which had to be paid for ₹ 2,000.
You are required to prepare Realization Account, Partners' capital accounts (including transfer of current account balances) and Bank Account in the books of the firm.

TOPIC 1B: INSOLVENCY OF PARTNER

Question 4 *(ICAI Study Material)* Pg no._____

A, B, C and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 2023 when their balance sheet was as under:

Liabilities		₹	Assets	₹
Creditors		15,700	Bank	535
Employees Provident Fund		6,300	Debtors	15,850
Capital Accounts:			Stock	25,200
A	40,000		Prepaid Expenses	800
B	20,000	60,000	Plant & Machinery	20,000
			Patents	8,000
			C's Capital A/c	3,200
			D's Capital A/c	8,415
		82,000		82,000

Following information is given to you :-

1. One of the creditors took some of the patents whose book value was ₹ 5,000 at a valuation of ₹ 3,200. Balance of the creditors were paid at a discount of ₹ 400.
2. There was a joint life policy of ₹ 20,000 (not mentioned in the balance sheet) and this was surrendered for ₹ 4,500.

3. The remaining assets were realised at the following values:- Debtors ₹ 10,800; Stock ₹ 15,600; Plant and Machinery ₹ 12,000; and Patents at 60% of their book-values. Expenses of realisation amounted ₹ 1,500.

D became insolvent and a dividend of 25 paise in a rupee was received in respect of the firms claim against his estate. Prepare necessary ledger accounts.

Question 5 *(ICAI Study Material)* *Pg no._____*

P, Q and R were partners sharing profits and losses in the ratio of 3 : 2 : 1, no partnership salary or interest on capital being allowed. Balance sheet on 30th June, 2023 is as follows:

Liabilities	₹	Assets	₹
Fixed Capital		Fixed Assets:	
P- 20,000		Trademark	40,000
Q- 20,000		Freehold Property	8,000
R- 10,000	50,000	Plant and Equipment	12,800
Current Accounts:		Motor Vehicle	700
P- 500		Current Assets:	
Q- 9,000	9,500	Stock	3,900
Loan from P	8,000	Trade Debtors 2,000	
Trade Creditors	12,400	Less: Provision (100)	1,900
		Cash at Bank	200
		R's Current Account	400
		Profit and Loss Account	12,000
	79,900		79,900

On 1st July, 2023 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of ₹ 500 but no cash passed specifically in respect of this transaction. Sale of other assets realised the following:

	₹
Trademark	Nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

Trade Creditors were paid ₹ 11,700 in full settlement of their debts. The costs of dissolution amounted to ₹ 1,500. The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and was only able to bring 1/3 of the amount due. You are required to show:

(a) Cash and Bank Account,

(b) Realisation Account, and

(c) Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

Question 6 *(RTP May 2023)* *Pg no._____*

P, Q and R are sharing profits and losses in the ratio 5:3:2. Due to finding of frauds committed by R during the year, it was decided to dissolve the partnership on 31st March, 2022. As on 31st March, 2022 their Balance Sheet was as under:

Equity & Liabilities	Amount (₹)	Assets	Amount (₹)
Partner's Capital A/c		Plant & Machinery	6,00,000
P	4,50,000	Stock	4,27,500
Q	4,50,000	Investments	1,45,000
R	-	Debtors	2,10,000
General reserve	1,20,000	Cash	72,500

Trade creditors	2,35,000	R's Capital	75,000
Bills payable	1,00,000		
Mrs. Q's loan	1,75,000		
Total	15,30,000	Total	15,30,000

Additional information are given as under:

a) During the year R sold Investments costing of ₹ 45,000 at ₹ 56,000 and the said funds were transferred to his personal account. This transaction was not recorded in the firm's books.

b) A cheque for ₹ 30,000 was received from debtor, not recorded in the books and was misappropriated by R.

c) A Trade creditor agreed to takeover stock of the book value of ₹ 25,000 at ₹ 26,500. The rest of the Trade creditors were paid off at a discount of 2%.

d) The bills payable were settled at a discount of 2%.

e) The expenses of dissolution amounted to ₹ 15,900.

f) The other assets realized were as follows:

Plant & Machinery	5% above the book value
Stock	Rest of the stock realized at a loss of ₹ 15,000
Investments	Rest of investments were sold at a profit of ₹ 5,600
Debtors	Rest of the debtors were realized at a discount of 12%.

g) Q agreed to takeover loan of Mrs. Q of ₹ 1,75,000.

h) The realizable value of R's private assets would only be ₹ 20,000.

Applying the principles laid down in Gamer vis. Murray, prepare Realization Account, Cash Account and Partner's Capital Accounts.

Question 7

Pg no._____

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2020:

Liabilities		₹	Assets		₹
Capital Accounts			Capital Accounts		
Neptune	1,00,000		Venus	10,000	
Jupiter	60,000	1,60,000	Pluto	12,000	22,000
General Reserve		56,000	Premises		1,20,000
Capital Reserve		14,000	Furniture		40,000
Sundry Creditors		20,000	Stock		1,00,000
Mortgage Loan		80,000	Debtors		40,000
			Cash		8,000
		3,30,000			3,30,000

(i) The other assets realized as follows:

Debtors	24,000
Stock	60,000
Furniture	16,000
Premises	90,000

(ii) Expenses of dissolution amounted to ₹ 4,000.

(iii) Further creditors of ₹ 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray.

Question 8 *(ICAI Study Material)* *Pg no._____*

M/s X, Y and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as at December 31, 2023:

Liabilities	₹	Assets	₹
Capital: X 29,200		Fixed Assets	40,000
Y 10,800		Stock	25,000
Z 10,000	50,000	Book Debts 25,000	
Z's Loan	5,000	Less: Provision (5,000)	20,000
Loan from Mrs. X	10,000	Cash	1,000
Sundry Trade Creditors	25,000	Advance to Y	4,000
	90,000		90,000

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 2023 and had been received but the purchase was not recorded in books.

Fixed assets realised ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on the average. The expenses of realisation come to ₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything. Give accounts to close the books; work according to the decision in Garner vs. Murray.

Question 9 *(ICAI Study Material)* *Pg no._____*

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 2023 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors A/c	4,800	Plant & Machinery	2,500
Amal's Capital A/c	750	Furniture	500
		Debtors	1,000
		Stock	800
		Cash	200
		Bimal's drawings	550
	5,550		5,550

The assets realised as under:

Plant & Machinery	1,250
Furniture	150
Debtors	400
Stock	500

The expenses of realisation amounted to ₹ 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.
Show necessary ledger accounts to close the books of the firm.

TOPIC 2: PIECEMEAL DISTRIBUTION

Question 10 *(ICAI Study Material) / (RTP May 2019) (Similar)* *Pg no._____*

A partnership firm was dissolved on 30th June, 2023. Its Balance Sheet on the date of dissolution was as follows:

Liabilities		₹	Assets	₹
Capital Accounts			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, 2023	25,200
On 30th August, 2023	60,000
On 15th September, 2023	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.

Question 11 *Pg no._____*

Amar, Akbar and Antony are in partnership. The following is their Balance Sheet as at March 31, 2020 on which date they dissolved their partnership. They shared profit in the ratio of 5:3:2.

Liabilities	₹	Assets	₹
Creditors	80,000	Plant and machinery	60,000
Loan A/c – Amar	20,000	Premises	80,000
Capital A/cs -		Stock	60,000
Amar	1,00,000	Debtors	1,20,000
Akbar	30,000		
Antony	90,000		
	3,20,000		3,20,000

It was agreed to repay the amounts due to the partners as & when the assets were realised.

	₹
April 15, 2020	60,000
May 1, 2020	1,46,000
May 31, 2020	94,000

Prepare a statement showing how the distribution should be made under maximum loss method.

Question 12 *(ICAI Study Material)* *Pg no._____*

A, B & C are partners sharing profits & losses in ratio 5:3:2. Their capitals were 9,600, 6,000 and 8,400 respectively. After paying creditors, the liabilities and assets of the firm were:

	₹		₹
Liability for interest on loans from:		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent. Prepare statement showing distribution of cash as & when available, applying maximum possible loss procedure.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Partnership could be dissolved because of
   (a) Death of a partner.
   (b) Insolvency of a partner.
   (c) Either (a) or (b).

2) On the dissolution of partnership, profit or loss on realization of assets and liabilities should be divided among partners
   (a) In the ratio of their capitals.
   (b) In the same ratio in which they share profits.
   (c) Equally.

3) An unrecorded asset realized at the time of dissolution is credited to
   (a) Realization account.
   (b) Revaluation account.
   (c) Capital accounts.

4) A liability taken over by a partner at the time of dissolution is credited to
   (a) Profit and loss account.
   (b) Partners' capital accounts.
   (c) Realization account

5) Realization account is a
   (a) Nominal account.
   (b) Real account.
   (c) Personal account.

6) Which of the following method/methods is adopted to ensure that distribution of cash among partners is in proportion to their interest in partnership?
   (a) Maximum loss method.
   (b) Highest relative capital method.
   (c) Either (a) or (b).

ANSWERS MCQs
1 (c) 2 (b) 3 (a) 4 (b) 5 (a) 6 (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:
1) Books of accounts are closed in dissolution of partnership.
2) On the dissolution of a partnership, firstly, the assets of the firm are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders.
3) In event of the dissolution of the firm, the business ceases to end. In event of dissolution of the partnership, the partnership is reconstituted and the business discontinues.
4) Expenses of dissolution on realization of assets are credited to the Realization Account.
5) Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

Solution

1) False: Books of accounts are not closed in dissolution of partnership but are closed in case of dissolution of partnership firm.
2) True: On the dissolution of a partnership, firstly, the assets of the firm, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards, the capital contributed by partners is repaid.
3) True: In event of the dissolution of the firm, the business ceases to end. However, in event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.
4) False: Expenses of dissolution on realization of assets are debited to the Realization Account.
5) True: Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

HOMEWORK QUESTIONS

TOPIC 1A: NORMAL DISSOLUTION

Question 1 *(ICAI Study Material)* *Pg no._____*

X, Y, and Z are partners of the firm XYZ and Co., sharing Profits & Losses in the ratio of 4: 3: 2. Following is the Balance Sheet of the firm as on 31st March, 2023.

Liabilities	₹	Assets	₹
Partner's Capital:		Fixed Assets	5,00,000
X	4,00,000	Stock	3,00,000
Y	3,00,000	Debtors	5,00,000
Z	2,00,000	Cash in Hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above-said date.
Fixed assets realized ₹ 5,20,000 & book debts ₹ 4,40,000. Stocks were valued at ₹ 2,50,000 and it was taken over by partner Y. Creditors allowed discount of 5% and the expenses of realization amounted to ₹ 6,000. You are required to prepare:
(i) Realization account; (ii) Partners capital account; and (iii) Cash account.

Question 2 *(ICAI Study Material) / (RTP Nov 2020) (Similar)* *Pg no._____*

Amit, Sumit and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March, 2023 when their Balance Sheet was as under:

Liabilities	Amount	Assets		Amount
Capital Accounts:		Land & Building		1,35,000
Amit	55,200	Plant & Machinery		45,000
Sumit	55,200	Furniture-		25,500
General Reserve	61,500	Investments		15,000
Kumar's Loan A/c	15,000	Book Debts	60,000	
Loan from D	1,20,000	Less: Prov. for bad debts	(6,000)	54,000
Trade Creditors	30,000	Stock		36,000
Bills Payable	12,000	Bank		13,500
Outstanding Salary	7,500	Capital withdrawn: Kumar		32,400
	3,56,400			3,56,400

The following information is given to you:

(i) Realisation expenses amounted to ₹ 18,000 out of which ₹ 3,000 was borne by Amit.

(ii) A creditor agreed to takeover furniture of book value ₹ 12,000 at ₹ 10,800. The rest of the creditors were paid off at a discount of 6.25%.

(iii) The other assets realized as follows:

Furniture - Remaining taken over by Kumar at 90% of book value
Stock - Realised 120% of book value
Book Debts - ₹ 12,000 of debts proved bad, remaining were fully realized
Land & Building - Realised ₹ 1,65,000
Investments - Taken over by Amit at 15% discount

(iv) For half of his loan, D accepted Plant & Machinery and ₹ 7,500 cash. The remaining amount was paid at a discount of 10%.

(v) Bills payable were due on an average basis of one month after 31st March, 2023, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realisation Account, Bank Account and Partners Capital Accounts in the books of partnership firm.

Question 3 *Pg no._____*

W paid ₹ 70,000 as premium to other partners of the firm at the time of his admission to the firm, with a condition that it will not be dissolved before expiry of five years. The firm is dissolved after three years. W claims refund of premium. Explain -

(1) List the criteria for the calculation of the amount of the refund.

(2) Also explain any two conditions when no claim in this respect will arise.

TOPIC 1B: INSOLVENCY OF PARTNER

Question 4 *Pg no._____*

Kamal, Kishor, Mohan, and Sohan, were partners sharing profits and losses in the ratio of 3:3:2:2. Following was balance sheet as on 31st March, 2020 on which date firm was dissolved

Liabilities		₹	Assets		₹
Capital Accounts			Capital Accounts		
Kamal	30,000		Mohan	24,000	
Kishor	22,500	52,500	Sohan	9,000	33,000
Trade creditors		23,250	Trade debtors	24,000	
Kamal's loan		15,000	Less: Provision	(750)	23,250
			Inventories		15,000
			Cash at bank		3,000
			Furniture and fixture		6,000
			Trademarks		10,500
		90,750			90,750

The assets realised were as follows: trade debtors ₹ 16,500; inventories ₹ 12,000; furniture and fixture ₹ 1,500; trade mark ₹ 6,000; trade creditors were settled at ₹ 23,000. Also there was a joint life insurance policy for ₹ 45,000. This was surrendered for ₹ 4,500. Expenses of realisation amounted to ₹ 750. 'Mohan' was insolvent, but ₹ 5,550 were recovered from his estate. You are required to show the following accounts in the book of partnership firm:

(a) Realisation account;

(b) Cash account;

(c) Partners' capital accounts.

Question 5 *Pg no._____*

A, V, R and S are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 2020:

Liabilities		₹	Assets		₹
Sundry Creditors		6,00,000	Sundry Debtors	7,00,000	
Capital Accounts:			Less: Doubtful Debts	(1,00,000)	6,00,000
A	14,00,000		Cash in hand		2,80,000
S	6,00,000	20,00,000	Stocks		4,00,000
			Other Assets		6,20,000
			Capital Accounts:		
			V	4,00,000	
			R	3,00,000	7,00,000
		26,00,000			26,00,000

On 31st March, 2020, the firm is dissolved and the following points are agreed upon:
(a) A is to takeover sundry debtors at 80% of book value.
(b) S is to takeover the stocks at 95% of the value.
(c) R is to discharge sundry creditors.
(d) Other assets realise ₹ 6,00,000 and the expenses of realisation come to ₹ 60,000.
(e) V is found insolvent and ₹ 43,800 is realised from his estate.
Prepare Realisation Account , Partner's Capital Accounts & Cash A/c. The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray.

Question 6 *(ICAI Study Material)* Pg no._____

'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2023 their Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Capital Accounts:		Premises	50,000
Thin 80,000		Fixtures	1,25,000
Short 50,000		Plant	32,500
Fat 20,000	1,50,000	Stock	43,200
Current Accounts:		Debtors	54,780
Thin 29,700			
Short 11,300			
Fat (Dr.) (14,500)	26,500		
Sundry Creditors	84,650		
Bank Overdraft	44,330		
	3,05,480		3,05,480

'Thin' decides to retire on 30th September, 2023 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, 2023. 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 book value less 5%. Debtors realise ₹ 45,900. Realisation 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 following the rules in Garner vs. Murray:
(i) Realisation Account;
(ii) Partners' Current Accounts;
(iii) Partners' Capital Accounts showing the closing of the firm's books

Question 7 *(CA Inter Nov 2019) (15 Marks)* Pg no._____

G, S & J were partners sharing profits and losses in the ratio of 4:3:2, no partnership salary or interest on capital being allowed. Their Balance Sheet as on 31.3.2019 is as follows:

Liabilities	Amount	Assets	Amount
Partners' Fixed capital accounts		Fixed assets:	
G	24,000	Goodwill	48,000
S	24,000	Land	9,600
J	12,000	Plant & Machinery	15,360
Partners' current accounts:		Motor Car	840
G	600	Current assets:	
S	10,800	Stock	4,680
J	(480)	Trade debtors 2,400	
Loan from G	9,600	Less: Provision (120)	2,280

Trade creditors	14,880	Cash at bank	240
		Miscellaneous losses:	
		Profit & loss	14,400
	95,400		95,400

On 1st April, 2019, the partnership was dissolved. Motor car was taken over by G at a value of ₹ 600, but no cash was given specifically in respect of this transaction. Sale of other assets realized the following amounts:

Particulars	Amount
Goodwill	Nil
Land	8,400
Plant & Machinery	6,000
Stock	3,600
Trade Debtors	1,920

Trade creditors were paid ₹ 14,040 in full settlement of their debts. The cost of dissolution amounted to ₹ 1,800. The loan from G was repaid; G and S both were fully solvent and able to bring in any cash required but J was forced into bankruptcy and was only able to bring 1/2 of the amount due. You are required to prepare: (Applying Garner Vs. Murray rule.)

(i) Cash & Bank account
(ii) Realization account, and
(iii) Partners' Fixed Capital Accounts (after transferring current accounts balances)

Question 8 *(RTP Nov 2019) / (RTP Nov 2023) (Similar)* *Pg no._____*

P, Q, R and S are sharing profits and losses in the ratio 3 : 3 : 2 : 1. Frauds committed by R during the year were found out and it was decided to dissolve the partnership on 31st March, 2020 when their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capital Accounts:		Building	1,90,000
P	1,50,000	Stock	1,30,000
Q	1,50,000	Investments	50,000
R	-	Debtors	70,000
S	60,000	Cash	30,000
General reserve	40,000	R	40,000
Trade creditors	80,000		
Bills payable	30,000		
	5,10,000		5,10,000

Following information is given to you:

(i) A cheque for ₹ 7,000 received from debtor was not recorded in books and & misappropriated by R
(ii) Investments costing ₹ 8,000 were sold by R at ₹ 11,000 and the funds transferred to his personal account. This sale was omitted from the firm's books.
(iii) A creditor agreed to take over investments of the book value of ₹ 9,000 at ₹ 13,000. The rest of the creditors were paid off at a discount of 5%.
(iv) The other assets realized as follows:

	₹
Building	110% of book value
Stock	1,20,000
Investments	The rest of investments were sold at a profit of ₹ 7,000
Debtors	The rest of the debtors were realized at a discount of 10%

(v) The bills payable were settled at a discount of ₹ 500.
(vi) The expenses of dissolution amounted to ₹ 8,000.

(vii) It was found out that realization from R's private assets would only be ₹ 7,000.
Prepare Realisation Accounts, Cash Account and Partner's Capital Account.

Question 9 *(CA Inter May 2022) (15 Marks)* *Pg no._____*

Ajay, Vijay and Sanjay have been in partnership for a number of years, sharing profits and losses in the ratio 7:7:4 as a wholesale stationer running business under the name "AVS Traders". On 31st March,2021, it was found that some frauds were committed by Sanjay during the year 2020-2021. So, it was decided to dissolve the partnership business on 31st March,2021 when their Balance sheet stood as under:

Balance Sheet as at 31st March,2021

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital accounts:		Building	1,90,000
Ajay 1,80,000		Inventory	1,30,000
Vijay 1,80,000	3,60,000	Investments	50,000
General Reserve	36,000	Trade Debtors	70,000
Trade Creditors	80,000	Cash & Bank	26,000
Bills payables	30,000	Sanjay's Capital (overdrawn)	40,000
	5,06,000		5,06,000

Additional Information:

(i) Following frauds were committed by Sanjay:
1) Investments costing ₹8,000 were sold by Sanjay at ₹ 11,000 and the funds were transferred to his personal account. This sale was omitted from firm's books.
2) A cheque for ₹ 7,000 received from trade debtors was not recorded in the books and was misappropriated by Sanjay.

(ii) A trade creditor agreed to take over investments of the book value of ₹ 9,000 at ₹ 13,000. The rest of the trade creditors were paid off at a discount of 10%.

(iii) Other assets were realized as follows:

Inventory	₹ 1,20,000
Building	110% of book value
Investments	The rest of the investments were sold at a profit of ₹ 7,000
Trade Debtors	The rest of the trade debtors were realised at a discount of 10%

(iv) The Bills payables were settled at a discount of, ₹500.

(v) The expenses of dissolution amounted to ₹8,060.

(vi) It was found out, that realisation from Sanjay's private assets would be ₹ 7,000.

You are required to prepare
1. Realisation Account
2. Cash & Bank Account
3. Partners' Capital Accounts.

Question 10 *Pg no._____*

P, Q, R and S had been carrying on business in partnership sharing profits & losses in the ratio of 4:3:2:1. They decided to dissolve the partnership on the basis of following Balance Sheet as on 30th April, 2020:

Liabilities	₹	Assets	₹
Capital Accounts		Capital Accounts	
P 1,68,000		R 25,000	
Q 1,08,000	2,76,000	S 18,000	43,000
General reserve	95,000	Land & building	2,46,000

Capital reserve	25,000	Furniture & fixtures	65,000
Sundry creditors	36,000	Stock	1,00,000
Mortgage loan	1,10,000	Debtors	72,500
		Cash in hand	15,500
	5,42,000		5,42,000

(i) The other assets realized as follows:

Land & building	2,30,000
Furniture & fixtures	42,000
Stock	72,000
Debtors	65,000

(ii) Expenses of dissolution amounted to ₹ 7,800.
(iii) Further creditors of ₹ 18,000 had to be met.
(iv) R became insolvent and nothing was realized from his private estate.

Applying the principles laid down in Garner Vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account.

Question 11 *(RTP May 2022)* *Pg no._____*

The firm of M/s OM has 4 partners A, B, C & D and as on 31st March, 2021, its Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Land	50,000
A	2,00,000	Building	2,50,000
B	2,00,000	Office Equipment	1,25,000
C	1,00,000	Computers	70,000
Current Accounts:		Debtors	4,00,000
A	50,000	Stock	3,00,000
B	1,50,000	Cash at Bank	75,000
C	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c:	
Current Liabilities	70,000	D	87,400
	13,80,000		13,80,000

The partners have been sharing profits & losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 01.04.2021 on the basis of the following understanding:

a) The following assets are to be adjusted to the extent indicated with respect to the book values: Land 200%, Building 120%, Computers 70%, Debtors 95%, Stocks 90%.
b) In case of loan the lenders are to be paid at their insistence a prepayment premium of 1%.
c) D is insolvent & no amount is recoverable from him. His father C, however agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.
d) The assets are realized at the agreed (adjusted) values.

Assuming that the realization of the assets and discharge of liabilities is carried out immediately, show the Bank Account, Realization Account & the Partner's Capital Accounts (including Current Accounts).

Question 12 *(CA Inter May 2019)/ (CA Inter Dec 2021)/ (CA Inter May 2023) (5 Marks)* *Pg no._____*

State the circumstances when Garner V/s Murray rule is not applicable.

TOPIC 2: PIECEMEAL DISTRIBUTION

Question 13 *Pg no._____*

The firm of Omega was dissolved on 31.3.2020, at which date its Balance Sheet stood as:

Liabilities	₹	Assets	₹
Creditors	2,00,000	Fixed Assets	45,00,000
Bank Loan	5,00,000	Cash and Bank	2,00,000
L's Loan	10,00,000		
Capital			
L	15,00,000		
M	10,00,000		
S	5,00,000		
	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building. Realisations are:

	₹
I (including Cash & Bank)	5,00,000
II	15,00,000
III	15,00,000
IV	30,00,000
V	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. Prepare a statement showing distribution of cash with necessary workings.

Question 14 *(ICAI Study Material)* *Pg no._____*

Following is Balance Sheet of A,B,C on 31st Dec, 2022 when they decided to dissolve partnership

Liabilities	₹	Assets	₹
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
C	9,000		
	49,000		49,000

The assets realised the following sums in instalments:

	₹
I	1,000
II	3,000
III	3,900
IV	6,000
V (includes saving in expenses 100)	20,100
	34,000

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only. Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1. Show by Maximum Loss Method.

Question 15 *(CA Inter Nov 2019) (5 Marks)* *Pg no._____*

AD, BD & SD are partners sharing profits and losses in the ratio of 5:3:2. There capitals were ₹13,440, ₹8,400, ₹11,760 respectively. Liabilities and assets of the firm are as under:

Liabilities:	Amount
Trade creditors	2,800
Loan from partners	1,400
Assets of the firm:	
Patent	1,400
Furniture	2,800
Machinery	1,680
Stock	5,600

The assets realized in full in the order in which they are listed above. BD is insolvent. You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

Unit 1: INTRODUCTION TO COMPANY ACCOUNTS

CH 11A

"Failure is simply the opportunity to begin again, this time more intelligently, There are those who dream and wish and there are those who dream and work."

COMPANY - BASICS

DEFINITION : COMPANY

Companies Act, 2013	A Company mean company which is formed and incorporated under the Companies Act, 2013 or an existing company formed and registered under any of the previous company laws.
Hanay	A Company is an Artificial Person created by law, having a Separate Entity, with a Perpetual Succession and a Common Seal.

CHARACTERISTICS / FEATURES OF A COMPANY

Feature	Explanation
Artificial Person (Incorporated Association)	• A Company comes into existence by the operation of law. • By sanction of law, a Company is granted certain rights and obligations as that of a person. Thus, company is an artificial person, incorporated under law.
Separate Legal Entity	• A Company is a separate legal entity & artificial person known by its own name • A Company is distinct and separate from the members who constitute it. • A Company can contract, sue & be sued in its incorporated name & capacity.
Person, not Citizen	• A Company is not a citizen either under — (a) the Constitution of India or (b) the Citizenship Act • The Constitution provides certain fundamental rights to its citizens. A Company cannot enjoy the citizenship rights and duties as are enjoyed by natural citizens
Perpetual Succession	• A Company is an artificial person and has a separate legal entity. • Hence, death, insolvency or change of its Members does not affect the Company. • The shares of Company being transferable, members may change during the lifetime of the company. However, that does not change the status of the Company. • The Company goes on forever and continues to exist, till it is wound up and dissolved.
Common Seal	• Common Seal is the official signature of a Company. The Company's name is engraved on the Seal. • The Articles of Association may provide for the documents that require the signature of the Company, i.e. the Common Seal. Where any

	document is affixed with the Common Seal, it amounts to being signed by the Company. • Now, use of common seal has been made optional. All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company.
Ownership Vs Management	• The Board of Directors is the elected representative body of the Shareholders of the Company, and manages the affairs of the Company. • Generally, every Shareholder / Member does not participate in the day-to-day affairs of working and administration of the Company. Hence, Ownership of Company is different from that of its Management.
Right of Access	The right of the shareholders of a company to inspect its books of account, with the exception of books open for inspection under the Statute, is governed by the Articles of Association. The shareholders have a right to seek information from the directors by participating in the meetings of the company and through the periodic reports.
Limited Liability	The liability of every shareholder of a company is limited to the amount he has agreed to pay to the company on the shares allotted to him. If such shares are fully paid-up, he is subject to no further liability.
Transferability of Shares	The capital is contributed by the shareholders through the subscription of shares. Such shares are transferable by its members except in case of a private limited company, which may have certain restrictions on such transferability.
Maintenance of Books	A limited company is required by law to keep a prescribed set of account books and any failure in this regard attracts penalties.
Periodic Audit	A company has to get its accounts periodically audited through the chartered accountants appointed for the purpose by the shareholders on the recommendation of board of directors

TYPES OF COMPANIES

TYPE	EXPLANATION
Government Company	Any company in which not less than 51% of Paid-up Capital of a Company is held by the Central Government, or State Government(s), or partly by Central Government and partly by one or more state Governments and includes a company which is a subsidiary company of such a government company.
Foreign Company	Any company or body corporate incorporated outside India which – a) has a place of business in India whether by itself or through an agent physically or through electronic mode; and b) conducts any business activity in India in any other manner.
Private company	A company which by its articles,— a) restricts the right to transfer its shares; b) except in case of One Person Company, limits the number of its members to 200. This number does not include present and former employees who are also members. Moreover, ≥ 2 persons who own shares jointly are treated as single member. c) prohibits any invitation to the public to subscribe for any securities of the company. Shares of a Private Company are not listed on Stock Exchange

Public Company	A company which is not a private company and has minimum paid capital as may be prescribed; provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles. A company which is a listed public company if it gets unlisted continues to be a public company.
One Person Company	A company which has only one person as a member
Small Company	A company, other than a public company, - a) paid-up share capital of which does not exceed 4 crore rupees or such higher amount as may be prescribed which shall not be more than 10 crore rupees; or b) turnover of which as per its last profit and loss account does not exceed 40 crore rupees or such higher amount as may be prescribed which shall not be more than 100 crore rupees Provided that nothing in this clause should apply to: (A) a holding company or a subsidiary company (B) a company registered under section 8 (C) a company or body corporate governed by any special Act
Listed Company	A company which has any of its securities listed on any recognised stock exchange.
Unlisted Company	The company, whose shares are not listed on any recognised stock exchange An unlisted company can be a public company or a private company.
Unlimited Company	A company not having any limit on the liability of its members
Company limited by Shares	Company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.
Company limited by Guarantee	A company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.
Holding Company	In relation to one or more other companies, means a company of which such companies are subsidiary companies.
Subsidiary company	A company in which the holding company: a) controls the composition of the Board of Directors; or b) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies A company shall be deemed to be a subsidiary company of holding company even if there is indirect control through the subsidiary company (ies). The control over the composition of a subsidiary company's Board of Directors means exercise of some power to appoint or remove all or a majority of the directors of the subsidiary company.

MAINTENANCE OF BOOKS OF ACCOUNTS (Sec 128 of Companies Act, 2013)

Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.
Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

PREPARATION OF FINANCIAL STATEMENTS

Under Section 129 of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the notified accounting standards and shall be in the form or forms as may be provided for different class or classes of companies, as prescribed in Schedule III.
The Board of Directors of the company shall lay financial statements at every annual general meeting of a company which include:-

a) Balance Sheet as at the end of the period, and
b) Profit and Loss Account for that period.
   [Note: For a Company not carrying on business for profit, an Income and Expenditure Account shall be laid at that AGM, instead of the P & L Account.]
c) Cash flow statement for the financial year
d) Statement of changes in equity, if applicable; and
e) Any explanatory note annexed to, or forming part of, any document referred above

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

Requisites of Financial Statements It shall give a true and fair view of the state of affairs of the company as at the end of the financial year.

Provisions Applicable
(1) Specific Act is Applicable
   For instance any
   a) Insurance company
   b) Banking company or
   c) Any company engaged in generation or supply of electricity or
   d) Any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

(2) In case of all other companies
Balance Sheet as per Form set out in Part I of Schedule III and Statement of Profit and Loss as per Part II of Schedule III

Compliance with Accounting Standards

As per Section 129 of the Companies Act, it is mandatory to comply with accounting standards notified by the Central Government from time to time.

Schedule III 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.

PART I – BALANCE SHEET

Name of the Company.......................

Balance Sheet as at ....

	PARTICULARS	Note No.	Figures as at the end of current Reporting period	Figures as at the end of previous reporting period
A.	EQUITY AND LIABILITIES			
1.	Shareholder's funds			
a	Share capital			
b	Reserves and surplus			
c	Money received against share warrants			
2.	Share application money pending allotment			
3.	Non-Current Liabilities			
a	Long-term borrowings			
b	Deferred tax liabilities (Net)			
c	Other long term liabilities			
d	Long-term provisions			
4.	Current Liabilities			
a	Short-term borrowings			
b	Trade payables			
c	Other current liabilities			
d	Short-term provisions			
	TOTAL			
B.	ASSETS			
1.	Non-Current Assets			
a	PPE & Intangible Assets			
i.	Property, Plant & Equipment (PPE)			
ii.	Intangible assets			
iii.	Capital work-in-Progress			
iv.	Intangible assets under development			
b	Non-current investments			
c	Deferred tax assets (net)			
d	Long-term loans and advances			
e	Other non-current assets			
2.	Current Assets			
a	Current investments			
b	Inventories			
c	Trade receivables			
d	Cash and cash equivalents			
e	Short-term loans and advances			
f	Other current assets			
	TOTAL			

PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company.......................

Profit and loss statement for the year ended ....

	PARTICULARS	Note No.	Figures for the current Reporting period	Figures for the previous reporting period
I.	Revenue from operations			
II.	Other income			
III.	Total Revenue (I + II)			
IV.	Expenses:			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, work-in-progress and Stock-in-Trade			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total Expenses			
V.	Profit before exceptional and extraordinary items and tax (III-IV)			
VI.	Exceptional items			
VII.	Profit before extraordinary items and tax (V - VI)			
VIII.	Extraordinary Items			
IX.	Profit before tax (VII- VIII)			
X	Tax expense:			
	(1) Current tax			
	(2) Deferred tax			
XI.	Profit (Loss) for the period from continuing operations (VII-VIII)			
XII.	Profit/(loss) from discontinuing operations			
XIII.	Tax expense of discontinuing operations			
XIV.	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)			
XV	Profit (Loss) for the period (XI + XIV)			
XVI.	Earnings per equity share:			
	(1) Basic			
	(2) Diluted			

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Which of the following statement is not a feature of a Company?
   (a) Separate legal entity
   (b) Perpetual Existence
   (c) Members have unlimited liability

2) In a Government Company, the holding of the Central Government in paid-up capital should not be less than
   (a) 25%
   (b) 50 %
   (c) 51%

3) Which of the following statement is true in case of a Foreign Company?
   (a) A Company incorporated in India and has place of business outside India.
   (b) A Company incorporated outside India and has a place of business in India.
   (c) A Company incorporated in India and has a place of business in India.

4) Which of the following statements is not a feature of a private company?
   (a) Restricts the rights of members to transfer its shares.
   (b) Does not restrict on the number of its members to any limit.
   (c) Does not involve participation of public in general.

5) Under Schedule III of the Companies Act, assets and liabilities are to be disclosed based on:
   (a) Current/ non-current.
   (b) Financial /non-financial.
   (c) Owned /not-owned.

6) Schedule III of the Companies Act prescribes the format and content of
   (a) Balance sheet and statement of profit and loss
   (b) Auditors' report.
   (c) Directors' report.

7) A company is required to maintain its books of accounts at
   (a) its registered office.
   (b) its largest branch office.
   (c) Managing Director's residence.

8) Cash flow statements are not required for
   (a) Private company.
   (b) One person company.
   (c) Public company.

9) The presentation and disclosure requirements of a company are prescribed by
   (a) Schedule III.
   (b) Schedule II.
   (c) Schedule I

10) Following is an example of current assets
    (a) Inventories.
    (b) Property, Plant & Equipment.
    (c) Intangible Assets.

11) Earnings per share (EPS) is to be disclosed in which of the following section of the financial statements
    (a) Balance Sheet.
    (b) Statement of Profit and Loss.
    (c) Cash Flow Statements.

12) Following is NOT an example of a company under Companies Act, 2013
    (a) Small company.
    (b) Private company.
    (c) Large company.

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Every public company is a listed company.
2) Shares of a private company are not listed on stock exchange.
3) It is not mandatory to incorporate a company under the companies act.
4) Company is an artificial, legal person created by law.
5) Death, insolvency or change of members affects the existence of a company.
6) If the shares are fully paid-up by the shareholder, he is subject to no further liability.
7) Public limited company has restrictions on transferability of shares.
8) Financial statements of company show the financial position of the business.
9) Schedule I gives proforma of Balance Sheet.
10) Schedule III prescribes the format of Directors' Report
11) Financial statements need to be true and correct as per Companies Act.
12) According to the Companies Act, 2013, Statement of Profit & Loss of a company is prepared as per Part II of Schedule III
13) According to the Companies Act, 2013, Balance Sheet of a company is prepared as per Part II of Schedule III
14) Schedule I gives proforma of Balance Sheet.
15) "Listed company" means a company which has its securities only listed with National stock exchange.

Solution

1) False: Listed companies are those which are listed on the stock exchange. Shares of listed companies are open to general public. Every listed company is a public company but every public company is not a listed company.
2) True: Only the shares of public company are listed on stock exchange. Every listed company is a public company.

3) False: It is mandatory to incorporate a company under the Companies Act. Without such incorporation, a company cannot come into existence.
4) True: Company comes into existence through the operation of law. It is a separate entity distinct from it's members.
5) False: Company is a separate legal entity created by law. Death, insolvency or change of member does not affect it's existence.
6) True: Liability of shareholders is limited to the extent of the unpaid share capital. So, if shares are fully paid-up, he is subject to no further liability.
7) False: Shares of public company are freely transferable. Transferability of shares is restricted in a private limited company.
8) True: Financial statements give a true & fair view of the state of affairs of the company. Financial statements include profit and loss account, balance sheet, etc.
9) False: Schedule III Part I explains proforma of Balance Sheet.
10) False: Schedule III Part I explains proforma of Balance Sheet and Profit and Loss.
11) False: As per Section 128, every company shall prepare financial statement for every financial year which give a true and fair view of the state of the affairs of the company.
12) True: According to the Companies Act, 2013, Statement of Profit & Loss of a company is prepared as per Part II of Schedule III
13) False: According to the Companies Act, 2013, Balance Sheet of a company is prepared as per Part I of Schedule III
14) False: Schedule III Part I explains form of Balance Sheet.
15) False: As per Companies Act, 2013,"listed company" means a company which has any of its securities listed on any recognised stock exchange.

Unit 2: ISSUE, FORFEITURE & REISSUE OF SHARES

CH 11B

"Stop being afraid of what could go wrong and focus on what could go right"

SHARE

Meaning	Total capital of the company is divided into a number of small indivisible units of a fixed amount and each such unit is called a share. "Share" is the basic unit which the Capital of a Company is divided. Example: A company with a total Capital of ₹ 1 crore is divided into 1 Lakh units of ₹ 100 each. Each unit of ₹ 100 is called a Share of the Company.

KINDS OF SHARES RECOGNISED IN THE COMPANIES ACT, 2013

The Share Capital of a Company limited by Shares can only be of two kinds-

1. Equity Share Capital – (a) with Voting rights, or (b) with differential rights as to dividend, voting or otherwise in accordance with the prescribed Rules
2. Preference Share Capital, i.e. Priority for Dividend at Fixed Rate + Priority for repayment of Capital.

DIFFERENT TYPES OF PREFERENCE SHARE CAPITAL

1. Cumulative and Non-Cumulative Preference Shares

	Cumulative Preference Shares	Non-Cumulative Preference shares
a)	Dividend is at fixed rate/fixed amount, but keeps on accumulating until it is fully paid	Dividend is at a fixed rate/fixed amount, but does not accumulate for future years.
b)	Dividend is payable even out of future profits, if current year's profits are insufficient for that purpose.	If no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires
c)	Arrears of fixed Cumulative dividend are shown in the Balance sheet as a Contingent Liability.	There is no contingent liability

Note: Cumulative Preference shareholders will get voting rights if dividend remains in arrear for not less than 2 years.

2. Redeemable and Irredeemable Preference Shares

	Redeemable Preference Shares	Irredeemable Preference Shares
a)	These are issued on the condition that the company will repay the same after a fixed period or even at company's discretion. This repayment is called Redemption.	These are Preference shares, which are redeemable only at the time of winding up of the company.
b)	Companies can issue only this category of preference shares. Also, the redemption period shall be a maximum of 20 years. *Exception:* Infrastructure Projects	No Company limited by shares shall issue • Irredeemable Preference Shares, or • Preference Shares redeemable after the expiry of 20 years from the date of issue

3. Participating and Non-Participating Preference Shares

	Participating Preference Shares	Non-Participating Preference Shares
a)	In addition to a fixed dividend, the holders of these Shares have the right to participate in the surplus profits, if any, after the Equity Shareholders have been dividend at a stipulated rate.	Here, only a fixed rate of dividend is paid every year, without any additional rights in surplus profits.
b)	In the event of winding-up of the Company, the holders have the right to receive a pre-determined proportion of surplus, after the Equity Shareholders have been paid off towards their Capital.	In case of winding-up of the Company, the holders of these Shares are not entitled to any additional rights in the surplus on winding-up.

4. Convertible and Non-Convertible Preference Shares

	Convertible Preference Shares	Non-Convertible Preference Shares
a)	These Shares give the right to the holder to get them converted into Equity Shares at their option, and according to the terms and conditions of their issue.	There is no right to the holder, to get his holding converted into Equity Shares.
Unless otherwise stated, Preference Share are – (a) Cumulative, (b) Redeemable, (c) Non-Participating, and (d) Non-Convertible.		

PREFERENCE SHARES AND EQUITY SHARES

BASIS	PREFERENCE SHARES	EQUITY SHARES
Definition	Shares that carry a Preferential Right as to payment of (a) Dividend, and (b) Repayment of Capital.	Shares that are not Preference Shares are called Equity Shares.
Return	Fixed Rate	Based on profits available for distribution.
Dividend	Priority over Equity Dividend, i.e. paid first.	After Payment of Preference Dividend.
Repayment of Capital	Paid before repayment of Equity Capital.	Paid after entire Preference Capital is repaid.
Arrears of Dividend	Generally accumulates unless specifically said to be non-cumulative.	No accumulation of Unpaid Dividend. No Profits means no Dividend.
Redemption	Redeemable as per terms of issue and provisions of Act.	Not Redeemable till winding-up. Even in winding-up, will be repaid after Preference Shares.
Voting Rights	Generally restricted. Carries right to vote on all matters if dividend remains unpaid for the prescribed period.	Unrestricted, i.e. Holders can vote at any matters at any Meeting, or the Shares may be issued with varying voting rights.
Control/ Management	No right to take part in Management.	Equity Shareholders are the real owners, hence have a right to control the Management of Company.

DIFFERENT TYPES OF SHARE CAPITAL

ITEM	EXPLANATION
Authorised Share Capital	• It is the amount of Share Capital which can be raised by the Company. • The Authorised Share Capital is also known as the "Registered Capital" or "Nominal Capital" and is given in the Memorandum of Association. • Authorised Capital is shown in the Balance Sheet at Nominal Value (Face Value). • *Example:* Authorised Capital=10,000 Shares of ₹ 100 each, Total=₹ 10,00,000
Issued Share Capital	• It represents that part of Authorised Share Capital which has been given or issued or offered to Shareholders. • Issued Capital includes Shares issued for- (i) Cash, and (ii) Consideration other than cash, to Promoters and Others. • Issued Share Capital is shown in the Balance Sheet at Nominal Value (Face Value). • *Example:* Issued Capital= 9,000 Shares of ₹ 100, each, Total= ₹ 9,00,000 . Note: The remaining portion of Authorised Capital, which is not issued for cash or other consideration is called as Unissued Capital. It is not shown in the Balance Sheet.
Subscribed Share Capital	• Subscribed Capital is the part of Issued Capital which has been subscribed (i.e. applied for) by the public/ Shareholders, and allotted by the Company. • *Example:* Out of 9,000 Shares issued; 8,500 Shares are subscribed by public. Note: The remaining portion of Issued Capital, which is not subscribed, is not shown in the Balance Sheet.
Called up Share capital	• Companies generally receive the Issue Price of Shares in installments, e.g. Application stage, Allotment stage, First Call, Second Call, etc. • The portion of the Face Value of Shares which a Company has demanded or called from Shareholders is known as "Called-Up Capital". • The Balance portion which the Company has decided to call / demand in future is called as Uncalled Capital. • *Example:* Out of ₹ 100 per Share, the Company has called up ₹ 70 per Share. In such case, the Uncalled Capital is ₹ 30 per Share.
Paid-Up Capital	• It is that portion of called up capital which has been actually paid by shareholders. • The unpaid portion is called "Unpaid Calls" or "Calls in Arrears". • So, Paid Up Capital = Called Up Capital Less Call in Arrears. • *Example:* If out of ₹ 70 per Share Called up, only ₹ 60 has been paid by some shareholders, remaining ₹ 10 per Share constitutes Calls in Arrears.
Reserve Capital	• Company may decide by passing a resolution, that a certain portion of its Subscribed Uncalled Capital shall be called up only in the event of winding-up / liquidation of the Company. • That portion is called Reserve Capital. It is not shown in the Balance Sheet. • Reserve Capital is different from Capital reserve, Capital reserves (created out of capital profits) are part of 'Reserves and Surplus' and refer to those reserves which are not available for declaration of dividend.

DISCLOSURE REQUIREMENTS – SHARE CAPITAL OF A COMPANY

Share Capital should be disclosed in a Company's Balance Sheet as under:

Particulars	Amount
Authorised: .... Shares of ₹ ... each	
Issued:... ... Shares of ₹ ... each	
Subscribed: .... Shares of ₹ .. each (Various classes of capital should be distinguished while stating the above particulars)	
Called up & Paid Up: ... ... Shares of ₹ ... each [of the above Shares .... Shares are allotted as fully paid up for consideration other than cash, Shares are allotted as fully paid up by way of Bonus Shares] Less: Call unpaid: Add: Forfeited Shares (amount originally paid up)	

PROCEDURE FOR ISSUE OF ISSUE OF SHARES FOR CASH

(a) Public Company shall issue a Prospectus, i.e. invitation to general public, to subscribe for Shares.
(b) Prospectus shall comply with the provisions of Companies Act, and SEBI Guidelines.
(c) Private Companies do not issue Prospectus. They depend upon "Private Placement" of Shares.

(a) On the basis of Prospectus, Applications are deposited in a Scheduled Bank by the interested parties along with the amount payable at the time of application.
(b) Minimum Application Money is as specified in the Companies Act and as per SEBI Guidelines. [Note: Companies Act is applicable for all Companies, while SEBI Guidelines is applicable only for Listed Companies.]

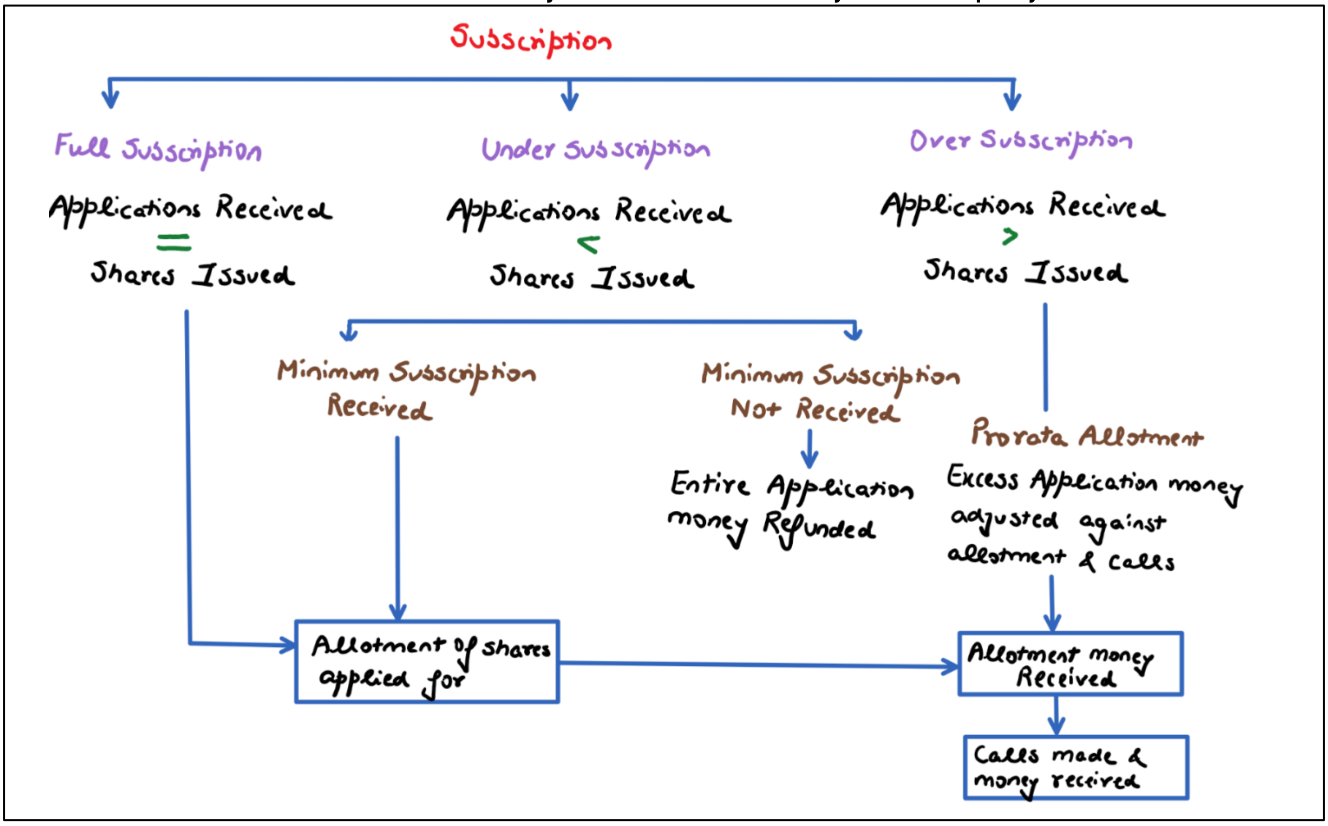
(a) After the last date for filing applications (i.e. Closing Date), the Company decides about Allotment of Shares in consultation with SEBI and Stock Exchange concerned.
(b) Allotment is the acceptance of a Company to give Shares to the Investor in response to an offer for purchase of Shares made by him for a consideration. Allotment can be done only when Minimum Subscription has been received by the Company.
(c) Successful Applicants become Shareholders of the Company and are required to pay the next installment which is known as "Allotment Money". Unsuccessful Applicants get back their money.

(a) In case of delay in refunding the excess money, the Company is liable to pay interest on the amount of refund. The Company calls up the balance amount from the Shareholders, called "Calls".
(b) Call refers to the demand for Share Money other than those by way of application and allotment.
(c) The issue price of shares is generally received by the company in instalments and these are known as:

First instalment: - Application Money   Second Instalment: - Allotment Money
Third Instalment: - First Call Money   Fourth Instalment: - Second Call Money and so on.
Last Instalment: - Final Call Money

PROVISIONS RELATING TO MINIMUM SUBSCRIPTION

1. Meaning: Minimum Subscription is the minimum amount stated in the Prospectus, which must be raised by the issue of Share Capital to start with.
2. If the Company does not receive the Minimum Subscription of 90% of the issue, the entire subscription shall be refunded to the applicants within prescribed time period (15 days of closure of issue in case of non-underwritten issue & 70 days in case of underwritten issue)
3. As per Section 39 of the Companies Act 2013, application money must be atleast *5% of the face value* of shares. However, as per SEBI Regulations, minimum application money shall not be less than *25% of the issue price.*
4. According to Section 24 of the Companies Act, 2013 matters related to issue and transfer of securities will be administered by the SEBI and not by the Company Law Board.



ISSUE OF SHARES AT PREMIUM (SEC. 52)

1. Meaning: Premium refers to the excess of the Share Issue Price over its Face Value / Par Value. A Company can issue Shares at a premium, i.e. at a price above its Face Value.
Example: If Share of Face Value ₹ 100 is issued at price of ₹ 120, there is premium of ₹ 20
2. Cash or Kind: Shares can be issued at a premium which may be received in Cash or in Kind. Sec.52 of the Act uses the words "at a premium, whether for cash or otherwise".
3. Securities Premium Account: The aggregate amount / value of the premiums received should be transferred to Securities Premium Account.
4. Application of Securities Premium: Securities Premium Account can be used only for —
   (a) Issuing Fully Paid Bonus Shares to Members.
   (b) Writing—off the Preliminary Expenses of the Company.
   (c) Writing off the — (i) Expenses Incurred, or (ii) Commission Paid, or (iii) Discount Allowed, on the Issue of Securities or Debentures of the Company.
   (d) Providing for the premium payable on redemption of Redeemable Preference Shares or Debentures of the Company.
   (e) For the purchase of own shares or other securities.

Note: Certain class of Companies as prescribed u/s 133 of Companies Act, 2013, whose financial statements comply with Accounting Standards prescribed for them, can't apply for (b) and (d) above.

5. Accounting Treatment:

(a) The amount of Premium is generally called with the amount due on allotment, sometimes with the Application Money and rarely with the Call Money.

(b) The Premium Amount is credited to the "Securities Premium Account". This Account is shown on the Liabilities Side of the Company's Balance Sheet under the heading "Reserves and Surplus".

PROVISIONS REGARDING THE ISSUE OF SHARES AT DISCOUNT (SEC. 53)

According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in case of issue of sweat equity shares (issued to employees and directors). Thus, any issue of shares at discount shall be void.

JOURNAL ENTRIES RELATING TO ISSUE OF SHARES

	TRANSACTION	JOURNAL ENTRY
1.	Receipt of Application Money	Bank A/c (Amount actually received) Dr. To Share Application A/c (Amount actually received)
2a.	Full/Under Subscription	Share Application A/c Dr. To Share Capital A/c [Shares allotted x Application Money] To Securities Premium A/c* (Share allotted x Premium / share) *(If Premium Amount is collected at the time of Application itself)
2b.	Over subscription	Share Application A/c Dr. (Amount received) To Share Capital A/c [Shares allotted x Application Money] To Securities Premium A/c* (Share allotted x Premium /share) To Share Allotment A/c (Adjusted with Allotment) To Share Calls -in -Advance A/c (Adjusted with Calls) To Bank A/c (Refund) *(If Premium Amount is collected at the time of Application itself)
3.	Allotment money due	Share Allotment A/c Dr. To Share Capital A/c [Shares allotted x Allotment money due] To Securities Premium A/c* (Share allotted x Premium / share) *(If the Premium Amount is at the time of Allotment)
4.	Receipt of Allotment	Bank A/c (Amount received) Dr. To Share Allotment A/c
5.	Call Money due	Share ... (First or Second or Final)... Call A/c Dr. To Share Capital A/c [Shares allotted x Call Money due]
6.	Receipt of Call	Bank A/c (Amount received) Dr. To Share ...... Call A/c

Note: If question specifically asks preparation of Cash Book, then all the entries relating to Cash/Bank Account are not passed in journal and to be shown in Cash Book only.

CALLS IN ARREARS

1. Meaning: Calls in Arrears is the money remaining unpaid by the shareholder on the calls raised by the Company in respect of the shares held by him.
2. Disclosure: Calls in Arrears always have a Debit Balance and are shown as a deduction from called up capital to arrive at paid up value of the Share Capital on Liabilities Side of the Balance Sheet.
3. Interest: The Company can recover interest on the amount of calls in arrears from the date it became due till the when the call is received at the rate of 10% p.a. (Table F).
4. Waiver of Interest: The Directors may also be empowered to waive the Interest on Calls in Arrears, subject to certain conditions laid down in the Articles.

CALLS IN ADVANCE

1. Meaning: Calls in Advance is the surplus money received by Company from the allottees, i.e. its Shareholders.
2. Calls in Advance: A Company, if permitted by its Articles, may accept from members either whole or part of amount remaining unpaid on any shares held by him as Calls in Advance.
3. No Voting Rights: The Member shall not be entitled to any voting rights on Calls in Advance, until the same becomes presently payable and duly appropriated. Shareholders are not entitled for any dividend on calls in advance.
4. Disclosure: Calls in Advance will always have Credit Balance and will be shown under the Liabilities Side (Other Current Liabilities). It is not added to the amount of Paid -Up Capital.
5. Interest: The Company is liable to pay interest on the amount of Calls in Advance from the date of receipt till the when the Call is due for payment, at the rate of 12% p.a. (Table F)

JOURNAL ENTRIES

	CALLS IN ARREARS	
1.	Transfer of non - receipt of Share Allotment/ Call Money	Calls in Arrears A/c Dr. To Share Allotment / Share ...... Call A/c (This Journal Entry is optional. The amount may also be left in the Share Allotment/Share .....Calls A/c)
2.	Receipt of Calls in Arrears	Bank A/c Dr. To Calls in Arrears A/c (If this account was opened)
3.	Interest on Calls in Arrears	Shareholders' A/c Dr. To Interest on Calls in Arrears A/c
4.	Receipt of Interest on Calls in Arrears	Bank A/c Dr. To Shareholders' A/c
	CALLS IN ADVANCE	
1.	Receipt of Calls in Advance	Bank A/c Dr. To Calls in Advance A/c
2.	Adjusting Calls in Advance	Calls in Advance A/c Dr. To Particular Call A/c
3.	Interest on Calls in Advance	Interest on Calls in Advance A/c Dr. To Shareholders' A/c
4.	Payment of Interest on Calls in Advance	Shareholders' A/c Dr. To Bank A/c

OVER SUBSCRIPTION & PRO RATA ALLOTMENT

Over subscription is the application money received for more than the number of shares offered to the public by a company. It usually occurs in the case of good issues and depends on many other factors like investors' confidence in the company, general economic conditions, pricing of the issue etc.

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

For example:

A company offers to the public 1,00,000 shares for subscription. The company receives applications for 1,20,000 shares. If the shares are to be allotted on pro-rata basis, applicants for 1,20,000 shares are to be allotted 1,00,000 shares, i.e., on the 1,20,000:1,00,000 or 6:5 ratio. Any applicant who has applied for 6 shares will be allotted 5 shares.

JOURNAL ENTRIES

	TRANSACTION	JOURNAL ENTRY
1.	Receipt of Application Money	Bank A/c (Amount actually received) Dr. To Share Application A/c (Amount actually received)
2	Oversubscription	Share Application A/c Dr. (Amount received) To Share Capital A/c [Shares allotted x Application Money] To Securities Premium A/c* (Share allotted x Premium /share) To Share Allotment A/c (Adjusted with Allotment) To Share Calls in Advance A/c (Adjusted with Calls) To Bank A/c (Refund) *(If Premium Amount is collected at time of Application itself)

FORFEITURE OF SHARES

1. Meaning: Forfeit = Taking away of property, on breach (non fulfilment) of a condition. Forfeiture of Shares refers to the action taken by the Company, to cancel the Shares.
2. Situation: When Shareholders fail to pay Allotment or Call Money due, the Directors may forfeit the Shares in the bonafide interests of Company & in accordance with the Articles of Association. Proper Notice should be sent to defaulting Shareholder before forfeiture.
3. Effect: When Shares are forfeited, the title of such Shareholder is extinguished, but amount paid by him till such forfeiture, is not refunded to him. The Shareholder has no further claim on the Company. The amount received is transferred to "Shares Forfeited A/c".
4. Treatment: Till Forfeited Shares are re -issued, the amount is shown as an addition to Share Capital, on the Liabilities Side of the Balance Sheet.

Note: - Forfeiture for non-payment of calls, premium, or the unpaid portion of the face value of the shares is one of the many causes for which a share may be forfeited. But fully paid-up shares may be forfeited for realization of debts of the shareholder if the Articles specially provide it.

RE-ISSUE OF FORFEITED SHARES

Shares forfeited is reissued by the Company, subject to the following considerations -

1. Sale, not Allotment: Reissue of Forfeited Shares is not an allotment, it is only a Sale. So, the Company need not file a Return of Allotment with the Registrar of Companies.

2. Auction Sale: After forfeiture, the Forfeited Shares vest in the Company in the Company, for the purpose of sale. The Company is under an obligation to dispose it off, generally by auction.
3. Price: Forfeited Shares can be reissued at any price, such that the total amount received (from Original Allottee and Subsequent Purchaser) for these Shares is not less than the amount in arrears on those Shares.
4. Loss on Reissue: Loss on Reissue shall be debited to "Forfeited Shares" A/c. Condition for Reissue: Loss on Reissue of Forfeited Shares should not exceed the Forfeited Amount, i.e. amount paid by Original Allottee, excluding premium, if any.)
5. Surplus: Surplus arising on Reissue of Forfeited Shares (i.e. Forfeited Amount > Loss on Reissue), should be transferred to Capital Reserve A/c. In case only portion of Shares are reissue, amount of profit attributable to such Re-issued Shares should only be transferred to Capital Reserve A/c.
6. Reissue at Premium: When Forfeited Shares are reissued at a price higher than its Face Value, the excess amount should be credited to Securities Premium A/c.

JOURNAL ENTRIES

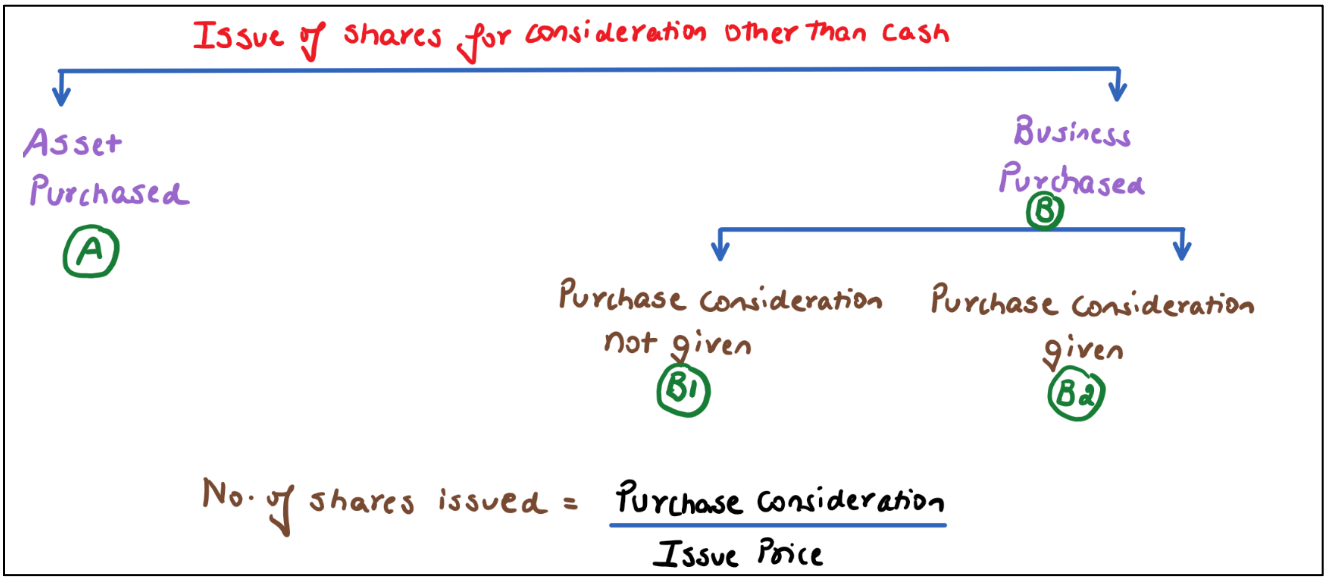
	TRANSACTION	JOURNAL ENTRY
	FORFEITURE OF SHARES	
1.	Forfeiture of Shares Issued at Par	Share Capital A/c (to the extent called) Dr. To Shares Forfeited A/c (to the extent amount received) To Calls in Arrears (to the extent amount called up & unpaid) (or alternatively Share Allotment A/c or Share ...... Call A/c)
2.	Forfeiture of Shares Issued at Premium - premium fully collected	Share Capital A/c (to the extent called - excluding Premium) Dr. To Shares Forfeited A/c (to the extent amount received) To Calls in Arrears (to the extent amount called up & unpaid) (or alternatively Share Allotment A/c or Share ...... Call A/c)
3.	Forfeiture of Shares Issued at Premium - premium not fully collected	Share Capital A/c (to the extent called excluding Premium) Dr. Securities Premium A/c (Premium amount on Shares forfeited) Dr. To Shares Forfeited A/c (to the extent amount received) To Calls in Arrears (to the extent amount called up and unpaid (or alternatively Share Allotment A/c or Share ...... Call A/c)
	Note: When Shares are originally issued at a Premium, and the Premium has been collected in full, the Securities Premium A/c should not be reversed.	
	RE -ISSUE OF SHARES FORFEITED	
1.	Re -issue of Forfeited Shares	Bank A/c (Shares Reissued x Reissue Price) Dr. Shares Forfeited A/c (to the extent discount given) Dr. To Share Capital A/c (Shares Reissued x Paid up Value)
2.	Transfer of Share Forfeited A/c Balance on Reissued Shares	Shares Forfeited A/c Dr. To Capital Reserve A/c

SHARES ISSUED FOR CONSIDERATION OTHER THAN CASH

1. Meaning: A Company can issue shares for valuable Consideration other than Cash. Shares may be issued to (a) Vendors towards payment of Purchase Consideration, (b) Promoters towards reimbursement of Preliminary Expenses incurred by them for incorporation, (c) Underwriters towards payment of Underwriting Commission, etc.
2. Disclosure: Shares issued for Consideration other than Cash shall be separately disclosed in the Balance Sheet of Company, as required by Part I of Schedule III.
   Within specified time of allotment, the company must produce before the Registrar a written contract of sale of service in respect of which shares have been allotted.

JOURNAL ENTRIES

1.	Recording Purchase of Machinery, Assets etc.	Machinery / Assets A/c (in case of assets purchased) Dr. To Liabilities A/c To Vendor's A/c (Difference if any to be tfd. to Goodwill/Capital Reserve A/c)
2.	Allotment of Shares to the Vendor	Vendor's A/c Dr. To Share Capital (Nominal Value of Shares issued) To Securities Premium (if issued at Premium)



A.

Example:

X Ltd. purchased Machinery from Y Ltd. ₹ 2,20,000. Shares Issued (Face Value ₹10 each)

a) At Par

b) At 10% Premium

B1.

Example:

X Ltd. purchased business of Y Ltd. which includes Assets ₹ 5,00,000 & Liabilities ₹ 1,40,000.
Shares Issued (Face Value ₹10 each)

a) At Par
b) At 20% Premium

B2.

Example:

X Ltd. purchased business of Y Ltd. for ₹ 3,90,000 which includes Assets ₹ 5,00,000 & Liabilities ₹ 1,40,000.
Shares Issued (Face Value ₹10 each)

a) At Par
b) At 30% Premium

ASSIGNMENT QUESTIONS

Question 1 *Pg no.____*

A company invited applications for 20,000 equity shares of ₹50 each at 10 premium payable on application ₹20, on Allotment ₹ 30 (including 10 premium), on first and final call ₹ 10. Applications are received for 20,000 shares and all the applicants are allotted the number of shares they have applied for and installment money was duly received by the company.
Case 1: Show Journal entries in the books of the company.
Case 2: Prepare cash book & journalise remaining transactions in the books of the company.

Question 2 *(RTP Nov 2018) / (RTP Nov 2019) / (RTP Nov 2021) (Similar)* *Pg no.____*

On 1st April, 2020, Pehal Ltd. issued 64,500 shares of ₹ 100 each payable as follows:
₹ 30 on application, ₹ 30 on allotment, ₹ 20 on 1st October, 2020; & ₹ 20 on 1st February, 2021.
By 20th May, 60,000 shares were applied for and all applications were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July; those on 1st call were received on 20th October.
You are required to prepare the Journal entries to record the transactions when accounts were closed on 31st March, 2021.

Question 3 *(ICAI Study Material) / (RTP May 2018) / (RTP May 2021) (Similar)* *Pg no.____*

Rashmi Limited issued at par 1,00,000 Equity shares of ₹ 10 each payable ₹ 2.50 on application; ₹ 3 on allotment; ₹ 2 on first call and balance on the final call. All the shares were fully subscribed. Mr. Nair who held 10,000 shares paid full remaining amount on first call itself. The final call which was made after 3 months from first call was fully paid except a shareholder having 1,000 shares who paid his due amount after 2 months along with interest on calls in arrears. Company also paid interest on calls in advance to Mr. Nair. Give journal entries to record these transactions.

Question 4 *(RTP May 2019) / (RTP Nov 2020) / (RTP Nov 2023) (Similar)* *Pg no.____*

Konica Limited registered with an authorised equity capital of ₹ 2,00,000 divided into 2,000 shares of ₹ 100 each, issued for subscription of 1,000 shares payable at ₹ 25 per share on application, ₹ 30 per share on allotment, ₹ 20 per share on first call and the balance as and when required. Application money on 1,000 shares was duly received and allotment was made to them. The allotment amount was received in full, but when the first call was made, one shareholder failed to pay the amount on 100 shares held by him and another shareholder with 50 shares, paid the entire amount on his shares. The company did not make any other call.
Give the necessary journal entries in the books of the company to record these transactions.

Question 5 *(ICAI Study Material)* *Pg no.____*

Pant Ltd. invited applications for 50,000 equity shares at ₹50 each, which are payable as on application ₹20, on allotment ₹10 and on first and final call ₹20. The company received applications for 60,000 shares. The directors accepted application for 50,000 shares and rejected the rest. Show Journal entries if company refunded the application money to rejected applicants and allotment money was received for 45,000 shares.

Question 6 *(ICAI Study Material)* *Pg no.____*

A company had an authorised capital of ₹10,00,000 divided into 1,00,000 equity shares of ₹10 each. It decided to issue 60,000 shares for subscription and received applications for 70,000 shares. It allotted 60,000 shares and rejected remaining applications. Upto 31-3-2023, it has demanded or called ₹9 per share. All shareholders have duly paid the amount called, except one shareholder, holding 5,000 shares who has paid only ₹7 per share. Prepare a balance sheet assuming there are no other details.

Question 7 *(ICAI Study Material)* *Pg no._____*

JHP Limited is a company with an authorised share capital of ₹1,00,00,000 in equity shares of ₹10 each, of which 6,00,000 shares had been issued and fully paid on 30th June, 2022. 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, 2022;
b) Allotment to be made on 10th July, 2022 and a further ₹ 5 per share (including the premium) to be payable;
c) The final call for the balance to be made, and the money received by 30th April, 2023.

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 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 of JHP Limited.

Question 8 *Pg no._____*

Pass Journal Entries in the following situations (each situation is independent of the other) –

1. 300 Equity Shares of ₹ 10 each, originally issued at par, fully called -up, forfeited for non-payment of Final Call of ₹ 4 each. These were re -issued as fully paid at ₹ 5 per Share.
2. 200 Equity Shares of ₹ 10 each, originally issued at par, ₹ 8 called up, forfeited for non-payment of First Call of ₹ 2 each. 150 shares were reissued at ₹ 5 per Share, ₹ 8 called up.
3. 300 Equity Shares of ₹ 10 each, originally issued at 30% premium. ₹ 8 called -up, forfeited for non-payment of First Call of ₹ 2 each. The Shareholder had already paid application and allotment money incl. premium. Subsequently 100 Shares out of these Forfeited Shares were re -issued at ₹ 6 per Share, as fully paid up.
4. 300 Equity Shares of ₹ 10 each, originally issued at 30% premium. ₹ 8 called up, forfeited for non-payment of 1st Call of ₹ 3 each and ₹ 5 on allotment (including premium).
   The Shareholder had paid application money ₹ 3 per Share. Later, 200 Shares out of these Forfeited Shares were re -issued at ₹ 12 per share, fully paid -up.
5. 360 shares forfeited of ₹ 10 each, ₹ 8 called-up, issued at a premium of ₹ 2 per share to Rakesh for non-payment of allotment money of ₹ 5 per share (including premium). Out of these, 320 shares were re-issued to Rohit at ₹ 8 for ₹ 10 per share fully paid up.

Question 9 *(RTP May 2022)* *Pg no._____*

Delta Ltd. forfeited 600 shares of ₹ 10 each issued at a premium of 10% to W for nonpayment of first and final call money of ₹ 3 (including ₹ 1 premium). At different intervals of time out of these 400 shares were re-issued to Z, credited as fully paid for ₹ 9 per share and 100 shares were re-issued to X as ₹ 10 paid up for ₹ 11 per share.

Record the journal entries for forfeiture and reissue of shares.

Question 10 *(ICAI Study Material)* *Pg no._____*

Beautiful Co. Ltd issued 30,000 equity shares of ₹10 each payable as ₹3 per share on Application, ₹5 per share (including ₹2 as premium) on Allotment and ₹4 per share on Call. All the shares were subscribed. Money due on all shares was fully received except from Ram, holding 500 shares, who failed to pay the Allotment and Call money and Shyam, holding 1,000 shares, who failed to pay the Call Money. All those 1,500 shares were forfeited. Of the shares forfeited, 1,250 shares (including whole of Ram's shares) were subsequently re-issued to Jadu as fully paid up at a discount of ₹ 2 per share.

Pass the necessary entries in the Journal of the company to record the forfeiture and re-issue of the share. Also prepare the Balance Sheet of the company.

Question 11 *(ICAI Study Material)* *Pg no._____*

Mr. Shami has applied for 1,000 shares of Company XYZ Ltd. paying application money @ ₹ 2 per share but has been allotted only 600 shares. The shares have a face value of ₹10 and a premium of ₹ 2 per share, which are payable as: on Allotment- ₹ 5 (including premium) and on final call ₹ 5.

Pass journal entry if Mr. Shami doesn't pay allotment money and final call and his shares are forfeited.

Question 12 *(ICAI Study Material)* *Pg no._____*

X Co. Ltd. was incorporated with an authorized share capital of 90,000 equity shares of ₹ 10 each. The company purchased land and buildings from Y Co. Ltd for ₹ 4,00,000 payable in fully paid-up shares of the company. The balance of the shares were issued to the public, which were fully subscribed and paid for.

You are required to pass Journal Entries and to prepare the Balance Sheet.

Question 13 *Pg no._____*

Calculate the Dividend amount

Called up Capital ₹ 10,00,000	Calls in Arrears ₹ 10,000
Calls in Advance ₹ 50,000	Dividend rate 10%

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) The excess price received over the par value of shares, should be credited to __________.
   (a) Calls-in-advance account
   (b) Share capital account
   (c) Securities premium account

2) The Securities Premium amount may be utilized by a company for __________.
   (a) Writing off any loss on sale of fixed asset
   (b) Writing off any loss of revenue nature
   (c) Writing off the expenses/discount on the issue of debentures

3) When shares are forfeited, the share capital account is debited with ________ and the share forfeiture account is credited with __________.
   (a) Paid-up capital of shares forfeited; Called up capital of shares forfeited
   (b) Called up capital of shares forfeited; Calls in arrear of shares forfeited
   (c) Called up capital of shares forfeited; Amount received on shares forfeited

4) T Ltd. proposed to issue 6,000 equity shares of ₹100 each at a premium of 40%. The minimum amount of application money to be collected per share as per the Companies Act, 2013
   (a) ₹5.00
   (b) ₹6.00
   (c) ₹7.00

5) Dividends are usually paid as a percentage of ______.
   (a) Authorized share capital
   (b) Net profit
   (c) Paid-up capital

6) As per the SEBI guidelines, on issue of shares, the application money should not be less than
   (a) 2.5% of the nominal value of shares
   (b) 2.5% of the issue price of shares
   (c) 25.0% of the issue price of shares

7) G Ltd. acquired assets worth ₹7,50,000 from H Ltd. by issue of shares of ₹100 at a premium of 25%. The number of shares to be issued by G Ltd. to settle purchase consideration = ?
   (a) 6,000 shares
   (b) 7,500 shares
   (c) 9,375 shares

8) Securities Premium is presented as a part of
   (a) Reserves & Surplus
   (b) Share Capital
   (c) Liabilities

9) Schedule III of Companies Act 2013 prescribes the format for
   (a) Financial statements
   (b) Directors' Report
   (c) Auditors' Report

10) Dividend on ____________ shares have to be paid before dividend on __________shares.
   (a) Equity, Preference
   (b) Preference, Equity
   (c) Convertible, Non-Cumulative

11) Preference shares are _____________ unless expressly stated otherwise.
   (a) Non-participating
   (b) Convertible
   (c) Interest-bearing

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:
1) Liability of a holder of shares is limited to the face value of shares acquired by them.
2) Authorised capital appears in the balance sheet at face value.
3) The rate of dividend on preference shares may vary from year to year.
4) A company may issue shares at a discount to the public in general.
5) Sweat equity shares are those which are issued to employees & directors at a discount.
6) As per Table F, rate of interest on calls in arrears is 12%.
7) As per Table F, rate of interest on calls in advance is 10%.
8) Non-participating preference shareholders enjoy voting rights. *(Dec 2021)*
9) Forfeited shares are available to the company for the purpose of resale.
10) Loss on reissue should exceed the forfeited amount.
11) When shares are forfeited, the share capital account is debited with called up capital of shares forfeited and the share forfeiture account is credited with calls in arrear of shares forfeited.
12) The amount of calls in arrear is deducted from paid up capital to arrive at Called up capital.
13) Dividends are usually paid as a percentage of Authorized share capital.
14) A company cannot issue redeemable preference shares for a period exceeding 10 years
15) Re-issue of forfeited shares is allotment of shares but not a sale. *(May 2018)/(Jan 2021)*
16) Since company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members. *(Nov 2019)*
17) In the balance sheet of X Limited, preliminary expenses amounting to ₹ 5 lakhs and securities premium account of ₹ 35 lakhs are appearing; The accountant can use the balance in securities premium account to write off preliminary expenses. *(Nov 2020)*
18) A Company is not allowed to issue shares at a discount to the public in general. *(July 2021)*
19) A person holding preference shares of a company cannot hold equity shares of the same company. *(July 2021)*
20) Interest on calls in arrears is payable by company to shareholders.

Solution

1) False: Liability of the holder of shares is limited to the issue price of shares acquired by them.
2) True: Authorised capital is the amount of capital mentioned in 'capital clause' of the 'Memorandum of Association'. Authorised capital is considered only as presentation and not considered in total of balance sheet.
3) False: Rate of preference dividend is always fixed.
4) False: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.
5) True: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors).
6) False: As per table F, rate of interest on calls in arrears is 10%.
7) False: As per Table F, rate of interest on calls in advance is 12%.
8) False: A share on which only a fixed rate of dividend is paid every year, without any accompanying additional rights in profits and in the surplus on winding-up, is called 'Non-participating Preference Shares. Non-participating preference shareholders do not enjoy voting rights.
9) True: Reissue of forfeited shares is not allotment of shares but only a sale.
10) False: Loss on re-issue should not exceed the forfeited amount.
11) False: When shares are forfeited, the share capital account is debited with called up capital of shares forfeited, and the share forfeiture account is credited with amount received towards nominal value on shares forfeited.
12) False: The amount of calls in arrear is deducted from Called up capital to arrive at Paid up capital.
13) False: Dividends are usually paid as a percentage of Paid up share capital
14) False: A company cannot issue redeemable preference shares for a period exceeding 20 years
15) False: A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale as they have already been allotted earlier.
16) True: Company has existence independent of its members. The Company goes on forever and continues to exist, till it is wound up and dissolved. As per Perpetual Existence company has existence independent of its members, it continues to be in existence despite the death, insolvency or change of members.
17) True: According to Section 52 of the Companies Act, 2013, Securities Premium Account may be used by the company to write off preliminary expenses of the company. Thus, the accountant can use the balance in securities premium account to write off the preliminary expenses amounting ₹ 5 lakhs.
18) True: According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors).
19) False: Preference share holder can hold both Equity shares and Preference shares of the company. Any person can hold both kinds of shares.
20) False: Interest on calls in arrears is payable by shareholders to company

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

A company invited applications for 10,000 equity shares of ₹50 each payable on application ₹15, on Allotment ₹ 20, on first and final call ₹15. Applications are received for 10,000 shares and all the applicants are allotted the number of shares they have applied for and installment money was duly received by the company. Show Journal entries in the books of the company.

Question 2 *(ICAI Study Material) / (RTP May 2022) (Similar)* *Pg no._____*

On 1st April, 2022, A Ltd. issued 43,000 shares of ₹ 100 each payable as follows:

₹ 20 on application; ₹ 30 on allotment;
₹ 25 on 1st October, 2022; and ₹ 25 on 1st February, 2023.

By 20th May, 40,000 shares were applied for & all applications were accepted. Allotment was made on 1st June. All sums due on allotment were received on 15th July; those on 1st call were received on 20th October. Journalize transactions when accounts were closed on 31st Mar,2023

Question 3 *(ICAI Study Material)* *Pg no._____*

On 1st October, 2023 Pioneer Equipment Limited received applications for 2,50,000 Equity Shares of ₹ 100 each to be issued at a premium of 25 per cent payable as:
On Application ₹ 25 On Allotment ₹75 (including premium)
Balance Amount on Shares as and when required.
The shares were allotted by the Company on October 20, 2023 and the allotment money was duly received on October 31, 2023. Record journal entries in the books of the company to record the transactions in connection with the issue of shares.

Question 4 *(ICAI Study Material)* *Pg no._____*

The Delhi Artware Ltd. issued 50,000 equity shares of ₹ 100 each and 1,00,000 preference shares of ₹ 100 each. The Share Capital was to be collected as under:

	Equity Shares	Preference Shares
On Application	25	20
On Allotment	20	30
First Call	30	20
Final Call	25	30

All these shares were subscribed. Final call was received on 42,000 equity shares and 88,000 preference shares. Prepare the cash book and journalise the remaining transactions in the books of the company.

Question 5 *(ICAI Study Material)* *Pg no._____*

Shreyas Ltd. did not receive the first call on 10,000 equity shares @ ₹ 3 per share which was due on 1.7.2022. This amount was received on 1.4.2023. Open Calls in arrears account and journalise the entries in the books of the company on 1.7.2022 and 1.4.2023.

Question 6 *(ICAI Study Material)* *Pg no._____*

X Ltd. invited applications for 10 lakhs shares of ₹ 100 each payable as follows:

	₹
On Application	20
On Allotment (on 1st May, 2022)	30
On First Call (on 1st Oct., 2022)	30
On Final Call (on 1st Feb., 2023)	20

All the shares were applied for and allotted. A shareholder holding 20,000 shares paid the whole of the amount due along with allotment. Journalise the transactions, assuming all sums due were received. Interest was paid to the shareholder concerned on 1st February, 2023

Question 7 *(ICAI Study Material)* *Pg no._____*

A limited Company, with an authorized capital of ₹ 20,00,000 divided into shares of ₹ 100 each, issued for subscription 10,000 shares payable at ₹ 25 per share on application, ₹ 30 per share on allotment, ₹20 per share on first call three months after allotment and the balance as and when required.
The subscription list closed on January 31, 2023 when application money on 10,000 shares was duly received and allotment was made on March 1, 2023. All amounts due were received within one month of the date they were called.
The allotment amount was received in full but, when the first call was made, one shareholder failed to pay the amount on 1,000 shares held by him and another shareholder with 500 shares paid the entire amount on his shares.
Give journal entries in the books of the Company to record these share capital transactions.

Question 8 *(CA Foundation June 2022) (15 Marks)* *Pg no._____*

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 2000 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 along with 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).

Question 9 *(CA Foundation May 2018) (10 Marks)/(RTP May 2020)/(May 2023)(Sim.)* *Pg no._____*

Piyush Limited is a company with an authorized share capital of ₹ 2,00,00,000 in equity shares of ₹ 10 each, of which 15,00,000 shares had been issued and fully paid on 30th June, 2020. The company proposed to make a further issue of 1,30,000 shares of ₹ 10 each at a price of ₹ 12 each, the arrangements for payment being:

(i) ₹ 2 per share payable on application, to be received by 1st July, 2020;
(ii) Allotment to be made on 10th July, 2020 and a further ₹ 5 per share (including the premium) to be payable;
(iii) The final call for the balance to be made, and the money received by 30th April, 2021.

Applications were received for 4,20,000 shares and were dealt with as follows:

(1) Applicants for 20,000 shares received allotment in full;
(2) Applicants for 1,00,000 shares received an allotment of one share for every two applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;
(3) Applicants for 3,00,000 shares received an allotment of one share for every five shares applied for; the money due on allotment was retained by the company, the excess being returned to applicants; and
(4) The money due on final call was received on the due date.

You are required to record these transactions (including cash items) in the journal of Piyush limited.

Question 10 *(CA Foundation Jan 2021) (15 Marks)* *Pg no._____*

A Limited is a company with' an authorised share capital of ₹ 1,00,00,000 in equity shares of ₹ 10 each, of which 6,00,000 shares had been issued and fully paid up on 31st March, 2020. The company proposes to make a further issue of 1,35,000 of these ₹ 10 shares at a price of ₹ 14 each, the arrangement of payment being:

(i) ₹ 2 per share payable on application, to be received by 31st May, 2020;

(ii) Allotment to be made on 10th June, 2020 and a further ₹ 5 per share (including the premium to be payable);

(iii) The final call for the balance to be made, and the money received by 31st December, 2020.

Applications were received for 5,60,000 shares and dealt with as follows:

(1) Applicants for 10,000 shares received allotment in full;

(2) Applicants for 50,000 shares received allotment of 1 share for every 2 applied for; no money was returned to these applicants, the surplus on application being used to reduce the amount due on allotment;

(3) Applicants for 5,00,000 shares 'received an allotment of 1 share for every 5 shares applied for; the money due on allotment was retained by the company, the excess being returned to the applicants; and

(4) The money due on final call was received on the due date.

You are required to record these transactions (including bank transactions) in the Journal Book of A Limited.

Question 11 *(ICAI Study Material)* *Pg no._____*

A Ltd forfeited 30,000 equity shares of ₹10 fully called-up, held by Mr. X for non-payment of final call @ ₹4 each. However, he paid application money @ ₹2 per share & allotment money @ ₹4 per share. These shares were originally issued at par. Give Journal Entry for forfeiture.

Question 12 *(ICAI Study Material)* *Pg no._____*

X Ltd forfeited 20,000 equity shares of ₹ 10 each, ₹ 8 called-up, for non-payment of first call money @ ₹ 2 each. Application money @ ₹ 2 per share and allotment money @ ₹ 4 per share have already been received by the company. Give Journal Entry for the forfeiture (assume that all money due is transferred to Calls-in-Arrears A/c.

Question 13 *(ICAI Study Material)* *Pg no._____*

X Ltd. forfeited 5,000 equity shares of ₹100 each fully called-up which were issued at a premium of 20%. Amount payable on shares were: on application ₹20; on allotment ₹50 (including premium) on First and Final call ₹50. Only application money was paid by the shareholders in respect of these shares. Pass Journal Entries for the forfeiture.

Question 14 *(ICAI Study Material)* *Pg no._____*

A Ltd forfeited 100 equity shares of ₹10 fully called upon. The shareholder failed to pay the first call money of ₹4 per share and the second and final Call Money of ₹4 per share. Give journal entry to show the effect of this transaction.

Question 15 *(ICAI Study Mat.)/ (RTP May 2018)/(May 2019)/(Nov 2019)/(May 2021) (Sim.)* *Pg no._____*

Mr. Long who was the holder of 2,000 preference shares of ₹ 100 each, on which ₹ 75 per share has been called up could not pay his dues on Allotment and First call each at ₹ 25 per share. The Directors forfeited the above shares and reissued 1,500 of such shares to Mr. Short at ₹ 65 per share paid-up as ₹75 per share. Give journal entries to record the above forfeiture and re-issue in the books of the company.

Question 16 *(RTP Nov 2018)* *Pg no._____*

Mr. P who was the holder of 2,500 preference shares of ₹ 100 each, on which ₹ 70 per share has been called up could not pay his dues on Allotment and First call each at ₹ 20 per share. The Directors forfeited the above shares and reissued 2,000 of such shares to Mr. Q at ₹ 60 per share paid-up as ₹ 70 per share.
You are required to prepare the Journal Entries to record the above forfeiture and re-issue in the books of the company.

Question 17 *(CA Foundation Nov 2018) (10 Marks) / (RTP May 2023)* *Pg no._____*

Give necessary journal entries for the forfeiture & reissue of shares:

(i) X Ltd. forfeited 300 shares of ₹ 10 each fully called up, held by Ramesh for non payment of allotment money of ₹ 3 per share & final call of ₹ 4 per share. He paid the application money of ₹ 3 per share. These shares were issued to Suresh for ₹ 8 per share.

(ii) X Ltd. forfeited 200 shares of ₹ 10 each (₹ 7 called up) on which Naresh had paid application and allotment money of ₹ 5 per share. Out of these 150 shares were reissued to Mahesh as fully paid for ₹ 6 per share.

Question 18 *(RTP Nov 2021)* *Pg no._____*

Mr. Samphat who was the holder of 12,000 preference shares of ₹ 100 each, on which ₹ 60 per share has been called up could not pay his dues on Allotment and First call each at ₹ 20 per share. The Directors forfeited the above shares and reissued 10,000 of such shares to Mr. Sushil at ₹ 50 per share paid-up as ₹60 per share.
You are required to prepare journal entries to record the above forfeiture and re-issue in the books of the company.

Question 19 *(ICAI Study Material)* *Pg no._____*

A holds 2,000 shares of ₹10 each on which he has paid ₹2 as application money. B holds 4,000 shares of ₹10 each on which he has paid ₹ 2 per share as application money and ₹ 3 per share as allotment money. C holds 3,000 shares of ₹10 each and has paid ₹2 on application, ₹ 3 on allotment and ₹3 for the first call. They all fail to pay their arrears on the second and final call and the directors, therefore, forfeited their shares. The shares are re-issued subsequently for ₹12 per share fully paid-up. Journalise the transactions relating to the forfeiture and re-issue.

Question 20 *(ICAI Study Material)* *Pg no._____*

B Ltd. issued 20,000 equity shares of ₹100 each at a premium of ₹20 per share payable as follows: on application ₹50; on allotment ₹50 (including premium); on final call ₹20. Applications were received for 24,000 shares. Letters of regret were issued to applicants for 4,000 shares and shares were allotted to all the other applicants. Mr. A, the holder of 150 shares, failed to pay the allotment and call money, the shares were forfeited. Show the Journal Entries and Cash Book in the books of B Ltd.

Question 21 *(CA Foundation Nov 2019) (15 Marks)* *Pg no._____*

B Limited issued 50,000 equity shares of ₹ 10 each payable as ₹ 3 per share on applications, ₹ 5 per share (including ₹ 2 as premium) on allotment and ₹ 4 per share on call. All these shares were subscribed.
Money due on all shares was fully received except from X, holding 1000 shares who failed to pay the allotment and call money and Y, holding 2000 shares, failed to pay the call money. All

these 3,000 shares were forfeited. Out of forfeited shares, 2,500 shares (including whole of X's shares) were subsequently re-issued to Z as fully paid up at a discount of ₹ 2 per share.
Pass necessary journal entries in the books of B limited. Also prepare Balance Sheet and notes to accounts of the company.

Question 22 *(CA Foundation Dec 2021) (15 Marks)* *Pg no._____*

Fashion Garments Ltd invited applications for issuing 10,000 Equity Shares of ₹ 10 each. The amount was payable as follows:

(i) On Application ₹ 1 per share
(ii) On Allotment ₹ 2 per share
(iii) On First call ₹ 3 per share
(iv) On Second and final Call ₹ 4 per share

The issue was fully subscribed. Ram to whom 100 shares were allotted, failed to pay the allotment money and his shares were forfeited immediately after the allotment. Shyam to whom 150 shares were allotted, failed to pay the first call. His shares were also forfeited after the first call. Afterwards the second and final call was made. Mohan to whom 50 shares were allotted failed to pay the second and final call. His shares were also forfeited. Al the forfeited shares were re-issued at ₹ 9 per share fully paid-up.
Pass necessary Journal entries in the books of Fashion Garments Ltd.

Question 23 *(CA Foundation Dec 2022) (15 Marks)* *Pg no._____*

PQR Limited issued 2,00,000 equity shares of, 10 each payable as ₹ 3 per share on application & ₹ 5 per share (including ₹ 2 as premium) on allotment and ₹ 4 per share on call. All these shares were subscribed. Money due on all shares was fully received except from Mr. J, holding 5,000 shares who failed to pay ·the allotment and call money and Mr. K, holding 10,000 shares, who failed to pay the call money. All these 15,000 shares were forfeited. Out of the forfeited shares, 10,000 shares (including whole of J's shares) were subsequently re-issued to Mr. L as fully paid up at a discount of ₹ 1 per share.
Pass necessary journal entries in the books of PQR Limited. Also prepare Balance Sheet and notes to accounts of the company.

Question 24 *(CA Foundation Nov 2020) (10 Marks)* *Pg no._____*

ABC Limited issued 20,000 equity shares of ₹ 10 each payable as:
₹ 2 per share on application
₹ 3 per share on allotment
₹ 4 per share on first call
₹ 1 per share on final call
All the shares were subscribed. Money due on all shares was fully received except for Mr. Bird, holding 300 shares, who failed to pay first call and final call money. All these 300 shares were forfeited. The forfeited shares of Mr. Bird were subsequently re-issued to Mr. John.as fully paid up at a discount of ₹ 2 per share.
Pass the necessary Journal Entries to record the above transactions in the books of ABC Limited.

Question 25 *(CA Foundation May 2019) (10 Marks)/(RTP May 2020)/(RTP Nov 2022)* *Pg no._____*

Bhagwati Ltd. invited applications for issuing 2,00,000 equity shares of ₹ 10 each. The amounts were payable as follows:

On application - ₹ 3 per share
On allotment - ₹ 5 per share
On first and final call - ₹ 2 per share

Applications were received for 3,00,000 shares and pro-rata allotment was made to all the applicants. Money overpaid on application was adjusted towards allotment money. B, who was allotted 3,000 shares, failed to pay the first and final call money. His shares were forfeited. Out of the forfeited shares, 2,500 shares were reissued as fully paid-up @ ₹ 6 per share. Pass necessary Journal entries to record the above transactions in the books of Bhagwati Ltd.

Question 26 *(CA Foundation July 2021) (15 Marks)* *Pg no._____*

X Limited invited applications for issuing 75,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. The total amount was payable as follows: -
₹ 9 per share (including premium) on application and allotment
- Balance on the First and Final Call

Applications for 3,00,000 equity shares were received. Applications for 2,00,000 equity shares were rejected and money refunded. Shares were allotted on pro-rata basis to the remaining applicants. The first and final call was made. The amount was duly received except on 1,500 shares applied by Mr. Raj. His shares were forfeited. The forfeited shares were re-issued at a discount of ₹ 4/- per share.
Pass necessary journal entries· for the above transactions in the books of X Limited.

Question 27 *(MTP November 2021)/(June 2023)* *Pg no._____*

Hemant applies for 2,000 shares of ₹ 10 each at a premium of ₹ 2.50 per share. He was allotted 1,000 shares. After having paid ₹ 3 per share on application, he did not pay the allotment money of ₹ 4.50 per share (including premium) and on his subsequent failure to pay the first call of ₹ 2 per share, his shares were forfeited. These shares were reissued at ₹ 8 per share, his shares were forfeited.
At the time of re-issue of forfeited shares of Mr. Hament, final call money amount all other shareholders were duly called up.
You are required to pass journal entries to record forfeiture and reissue of shares.

Question 28 *(CA Foundation June 2023) (15 Marks)* *Pg no._____*

BP Limited issued a prospectus inviting applications for 1,20,000 equity shares of ₹ 10 each at a premium of ₹ 2 per share payable as follows:

On Application - ₹ 3 per share
On Allotment - ₹ 5 per share (including premium)
On First and Final Call - ₹ 4 per share

Applications were received for 3,60,000 equity shares. Applications for 80,000 shares were rejected and the money refunded. Shares allotted to remaining applications as follows:

Category	No. of shares Applied	No. of shares Allotted
I	1,60,000	80,000
II	1,20,000	40,000

Excess money received with applications was adjusted towards sums due on Allotment and the balance amount returned to the applicants. All calls were made duly received except the final call by a shareholder belonging to Category I who has applied for 680 shares. His shares were forfeited. The forfeited shares were reissued at ₹ 13 per share fully paid-up.
Pass necessary journal entries for the above transactions in the books of BP Ltd, Open call in arrears account whenever required.

Unit 3: ISSUE OF DEBENTURES

CH 11C

"Efforts are never wasted even when they lead to disappointing results. Because they always make us more experienced.

DEBENTURES – DEFINITION AND FEATURES

DEFINITION

(a) Debenture includes Debentures Stock, Bonds and any other instrument of a Company evidencing a debt, whether constituting a charge on the assets of the Company or not.
(b) It is a document issued by a Company indicating its indebtedness.
(c) Debenture is one of the most commonly used debt instruments issued by the company to raise funds for the business. The most common method of supplementing the capital available to company is to issue debentures which may either be secured or unsecured. *(Purpose for raising of debenture by the company)*

FEATURES

(a) Debt: Debenture is a document which evidences a loan made to a Company. 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.
(b) Interest: The Company pays a fixed rate of interest on Debentures, due on specific dates. Such interest is payable, irrespective of whether the Company has earned profit or not.
(c) Maturity/Redemption: Generally, Debentures are issued for specified period of time, after which they mature & have to be redeemed by the Company by paying the money. Sometimes, they may be converted into Equity Shares, after the maturity period.
(d) Creation of Charge: Most Debentures are secured by way of a charge on the assets / part of the assets of the Company. However, they may also be unsecured Debentures.
(e) Trading: Debentures may be bought or sold through the Stock Exchange, at a price above or below the Face Value. Hence, Debentures may be traded, in the same manner as Shares.
(f) No Voting Rights: Debenture Holders are mere lenders to the Company, who are generally secured for payment. Hence they do not have any right as to voting in meetings. The Company shall not issue any Debentures carrying voting rights at any Company Meeting, whether generally or in respect of particular class of business.

DISTINGUISH – SHARES AND DEBENTURES

BASIS	SHARES	DEBENTURES
Holders	Shareholders are the Owners of the Company	Debentureholders are the Creditors of the Company.
Kinds	There are two basic kinds of Shares (a) Equity & (b) Preference Shares.	Debentures can be classified in different ways.

Voting	Shareholders generally enjoy voting rights.	Debentureholders do not have any voting rights.
Return	Dividend is paid only out of the profits of the Company.	Interest on Debentures is paid even if there are no profits.
Variation in return	Dividend on Equity Shares may vary from year to year. [But, Dividend on Pref. Shares is paid at fixed rates.]	Rate of Interest on Debentures is Fixed.
Nature of Payment	Dividend is an appropriation of Profits of the Company. Hence, it is not deductible as an "expense" for tax purposes.	Interest on debentures is a "charge" on the profits of the Company. Interest payment gives tax savings to the Company.
Disclosure	Shares are shown under "Share Capital" (under Shareholder Funds) on the Liabilities Side of the Balance Sheet.	Debentures are shown under "Long term Borrowings" (under Non-Current Liabilities) on the Liabilities Side of the Balance Sheet.
Conversion	Shares cannot be converted into debentures under any circumstances.	Debentures may be converted into Shares (partly or fully) as per the terms of issue.
Forfeiture	Shares can be Forfeited for non-payment of Allotment or Call Money	Debentures cannot be forfeited for non-payment of Call Money.
Charge on Assets	Shares do not carry any charge on Assets.	Debentures generally have a charge on the Assets of the Company.
Priority of repayment	Upon winding-up, they are paid after Debentureholders are settled.	They are paid before Shareholders, since they are the Creditors of the company.
Risk	Higher Risk than Debentureholders.	Lower Risk than Equity Shareholders.
Control	Higher degree of control over Company	Minimum / No control.

DIFFERENT KINDS / TYPES OF DEBENTURES

BASED ON PRIORITY

	First Mortgage Debentures	Second Mortgage Debentures
(a)	They are ranked first and are to be paid first in priority to other Debentures which may be issued later or subsequently by the Company.	They are issued subsequent to first Debentures and rank next in matters of repayment, i.e. they can be redeemed only after First Debentures are repaid.
(b)	These constitute first priority in repayment.	These constitute second priority in repayment.

BASED ON NEGOTIABILITY

	Bearer or Unregistered Debentures	Registered Debentures
(a)	These are payable to Bearer. Interest is paid through coupons attached to Certificate. On maturity, principal is paid to the Bearer.	These are payable to Registered Holders, i.e. whose names appear on the Certificate and are entered as a Holder in Register of Debenture Holders of the Company.

(b)	These are similar to Negotiable Instruments, and are freely transferable, by mere delivery. No transfer deed is required for transfer of such debentures	They are not easily transferable. They are transferable only as per condition endorsed in it, i.e. by way of execution of transfer deed and registration with the Company.

BASED ON PERMANENCE / REDEEMABILITY

	Redeemable Debentures	Irredeemable / Perpetual Debentures
(a)	They are issued for a specified period of time upon whose expiry, company has the right to pay back the Holders and have its properties released from charge.	It is a Debenture which contains no clause to payment, or which contains a clause that it shall not be paid back.
(b)	Payment / Redemption is made at the end of the specified period.	Payment / Redemption is only upon winding-up/liquidation of company.

BASED ON CONVERTIBILITY

	Convertible Debentures	Non Convertible Debentures
(a)	They are issued with an option that they can be converted into Shares (at par or premium), after a certain period.	They do not have any option as to convertibility.
(b)	They can be fully convertible or partly convertible. In Partly Convertible debentures, the non-convertible portion is redeemed at the expiry of certain period.	They become fully payable on maturity, as specified in the terms of issue.

BASED ON SECURITY

	Secured Debentures	Unsecured / Naked Debentures
(a)	These are secured by a charge on the assets / part of the assets of the Company.	These are issued without any security. They do not create any charge on the Company's Assets.
(b)	The Charge may either be Fixed or Floating. (See Note below.)	Holders are like ordinary Unsecured Creditors and may sue the Company for recovery.
(c)	Holders of such Debentures have lower risk.	These types of debentures are very risky from the viewpoint of Investors.

Note:
A Fixed Charge is a mortgage on specific assets, e.g. Machinery, Land and Building, etc. These assets cannot be sold without the consent of Debentureholders. The sale proceeds of these assets are utilized first for repaying Debentureholders.
A Floating Charge generally covers all assets of the Company, including future assets, e.g. Stock, Receivables, Debtors, etc.

JOURNAL ENTRIES IN RESPECT OF ISSUE OF DEBENTURES (For Cash)

Issue At	Redemption At	Journal Entry
1) PAR	PAR	Bank A/c - Dr To _% Debentures A/c
2) Premium	PAR	Bank A/c - Dr To _% Debentures A/c To Securities Premium A/c
3) Discount	PAR	Bank A/c - Dr Discount on Issue A/c - Dr To _% Debentures A/c
4) PAR	Premium	Bank A/c - Dr Loss on Issue A/c - Dr To _% Debentures A/c To Premium on Redemption A/c
5) Premium	Premium	Bank A/c - Dr Loss on Issue A/c - Dr To _% Debentures A/c To Securities Premium A/c To Premium on Redemption A/c
6) Discount	Premium	Bank A/c - Dr Loss on Issue A/c - Dr (Disc. + Loss) To _% Debentures A/c To Premium on Redemption A/c

	Transaction	Journal Entries
1.	Receipt of Application Money	Bank A/c Dr. To Debenture Application A/c
2.	Transfer of Application Money	
(a)	Issued at par, and redeemable (i) at par, or (ii) at discount	Debenture Application A/c Dr. To...% Debentures A/c
(b)	Issued at Premium, and redeemable- (i) at par, or (ii) at discount	Debenture Application A/c Dr. To...% Debentures A/c To Securities Premium A/c
(c)	Issued at Discount, and redeemable- (i) at par, or (ii) at discount	Debenture Application A/c Dr. Discount on Issue of Deb A/c Dr. To...% Debentures A/c

(d)	Issued at par, and redeemable at premium. [Note: Here, Loss on Issue of Debentures= Premium payable on Redemption only.]	Debenture Application A/c Dr. Loss on Issue of Deb. A/c Dr. To…% Debentures A/c To Premium on Redemption of deb.
(e)	Issued at Premium, redeemable at premium. [Note: Here, Loss on issue of Debentures= Premium payable on Redemption only.]	Debenture Application A/c Dr. Loss on Issue of Deb. A/c Dr. To…% Debentures A/c To Securities Premium A/c To Premium on Redemption of deb.
(f)	Issued at Discount, and redeemable at premium [Note: Here, Loss on Issue of Debentures= Discount on Issue + Premium payable on Redemption only]	Debenture Application A/c Dr. Disc./Loss on Issue of Deb. A/c Dr. To…% Debentures A/c To Premium on Redemption of deb.

Note: In the above scheme, it is assumed that entire money is collected at the time of application itself. If the moneys are collected in installments, e.g. Application, Allotment, Calls, etc. the Journal Entries are similar to that of Issue of Shares.

- *In fact, the discount on issue of debentures is considered as incremental interest expense. The true expense (net borrowing cost) for a particular accounting period is, therefore, the total interest payment plus the discount amortised.*
- *Debenture Redemption Premium Account is a personal account which represents a liability of the company in respect of premium payable on redemption.*

ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH

Just like shares, debentures can also be issued for consideration other than for cash, such as for purchase of land, machinery, etc. In this case, the following entries are passed:

(a)	Assets purchased from Vendor / business taken over, etc.	Sundry Assets A/c Dr. To Sundry Liabilities A/c, (if any) To Vendor A/c
(b)	Assets purchased from Vendor, at par / premium / discount	Vendor A/c Dr. Discount on Issue of Deb. A/c (if any) To…% Debentures A/c To Securities Premium A/c (if any)
	No. of Debentures = Purchase Consideration/Issue Price	

1) When debentures are issued at par

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value}}$$

2) When debentures are issued at premium

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value + Premium}}$$

3) When debentures are issued at discount

$$\text{No. of Debentures} = \frac{\text{Purchase Consideration}}{\text{Par Value – Discount}}$$

ACCOUNTING TREATMENT OF ISSUE OF DEBENTURES AS COLLATERAL SECURITY

1. Meaning
   (a) Collateral Security means secondary or supporting security for a loan, which can be realized by the Lender, when the original loan is not paid on due date.
   (b) Companies may Issue their Own Debentures as Collateral Security for Loan or Overdraft facility taken from Bank / other Lenders.
   (c) The holder of such debentures is entitled to interest only on the amount of loan but not on the debentures.

2. Effect:
   (a) If the Company repays the loan on the due date, the Debentures will be released, along with the main security.
   (b) If the Company is not able to repay the loan or the interest thereon, the Lender will become the Debentureholders who can exercise all the rights of a debenture holder.

2. Accounting Treatment: There are two method of showing Debentures issued as Collateral Security –

Situation	Method I	Method II
Journal Entry for Issue of Debentures as Collateral Security	No Entry. It is only a Memorandum Method	Debenture Suspense A/c Dr. To…% Debentures A/c
Disclosure in the Balance Sheet till Loan is settled	The Issue of debentures and Loan Outstanding is shown as a Note under "Long Term Borrowings"	Debenture Suspense A/c will appear on the Assets Side under 'Non Current Assets' and Debentures A/c will appear on the Liabilities Side under 'Long Term Borrowings'.
Treatment after settlement of Loan	The Note given as above will be discontinued.	The Journal Entry given above will be reversed

Note: Method 1 is much more logical from the accounting point of view. Therefore, it is advised to follow Method 1.

TREATMENT OF DISCOUNT / LOSS ON ISSUE OF DEBENTURES

1. Treatment: Discount / Loss on Issue of Debentures is capital loss and to be written-off /amortized over the period between the date of issue and date of redemption.

2. Determination of write-off amount:

Situation	Amount written off is computed as under-
Debentures redeemed at lumpsum at the end of a given period	Total Amount of Discount / Loss should be written off equally over the life of Debentures, i.e. Straight Line Method is used.
Debentures redeemed in different / unequal instalments	Total Amount of Discount / Loss should be written off in the ratio of benefit derived from Debenture Loan in any particular year, i.e. Sum of Year's Digits Method is used in the case.
Debentures are irredeemable	Total Amount of Discount / Loss should be written off gradually over a long period.

3. Journal Entry:
Profit and Loss Account Dr.
To Discount / Loss on Issue of debentures A/C

Note: The unamortized amount is shown on the Assets Side of the Balance Sheet as Non-Current /Current Asset depending upon the period for which it has to be written off.

Example:
12%, 5,000 debentures of ₹100 each issued on 01.01.2023 at 3% discount.

1) *Redemption after 5 years in lumpsum*
2) *Redemption of ₹1,00,000 at the end of each year*

ACCOUNTING TREATMENT FOR PAYMENT OF INTEREST ON DEBENTURES

1. Interest: Interest on debentures is a charge against the profits of the Company. Interest is paid at specified dates, (e.g. on half-yearly or annual basis) on the Nominal Value of Debentures.
2. Tax Deducted at Source: The Company will pay Interest to the Debentureholders after deducting the amount of tax, as specified in the Income Tax Rules. The Company is under an Obligation to deduct tax at source and deposit the deducted tax amount with the Income Tax Authorities.
3. Journal Entries:

	Transaction	Journal Entry
(a)	Interest due on Debentures after considering tax at source (TDS)	Interest on Debentures A/c Dr. To Debentureholders A/c To TDS Payable A/c
(b)	Payment of interest to Debentureholders	Debentureholders A/c Dr. To Bank A/c
(c)	Remittance Tax Deducted at Source with Government	TDS Payable A/c Dr. To Bank A/c
(d)	Transfer of Interest on Debentures to P&L A/c	Profit & Loss A/c Dr. To Interest on Debentures A/c

ASSIGNMENT QUESTIONS

Question 1 *Pg no._____*

C Ltd. is interested in issuing 10,000, 12% debentures of ₹100 each. You are required to pass necessary journal entries in each of the following situations:
Application Money ₹ 40 & balance on Allotment.
a) Issued at par and redeemable at par
b) Issued at par and redeemable at premium of 5%
c) Issued at 10% discount and redeemable at par
d) Issued at discount of 5% and redeemable at premium of 10%
e) Issued at 5% premium and redeemable at par
f) Issued at premium of 10% and redeemable at premium of 20%.

Question 2 *(ICAI Study Material)* *Pg no._____*

Simmons Ltd. issued 1,00,000, 12% Debentures of ₹100 each at par payable in full on application by 1st April, Application were received for 1,10,000 Debentures. Debentures were allotted on 7th April. Excess money refunded on the same date. You are required to pass necessary Journal Entries (including cash transactions) in the books of the company.

Question 3 *Pg no._____*

Sam Ltd. issued ₹ 70,000, 12% debentures of ₹ 100 each at a premium of 5% redeemable at 110% Show by means of journal entries how you would record the above issue.

Question 4 *(RTP May 2019)* *Pg no._____*

Suvidha Ltd. purchased machinery worth ₹ 1,98,000 from Hemant Ltd. The payment was made by issue of 12% debentures of ₹100 each. Pass the necessary journal entries for the purchase of machinery and issue of debentures when:
(i) Debentures are issued at par;
(ii) Debentures are issued at 10% discount; and
(iii) Debentures are issued at 10% premium

Question 5 *Pg no._____*

Mahesh Ltd. obtained loan from ICICI Bank of ₹ 5,00,000 on 31st March, 2023 by issuing and securing 6,000, 12% debentures of ₹ 100 each as collateral security.
Pass journal entries & show balance sheet extract as per both approaches.

Question 6 *(ICAI Study Material) / (RTP May 2018) / (RTP May 2023) (Similar)* *Pg no._____*

X Company Limited issued 10,000 14% Debentures of nominal value of ₹50,00,000 as follows:
i. To sundry persons for cash at 90% of nominal value of ₹ 25,00,000.
ii. To a vendor for purchase of fixed assets worth ₹ 10,00,000 – ₹ 12,50,000 nominal value.
iii. To the banker as collateral security for a loan of ₹ 10,00,000 – ₹ 12,50,000 nominal value.
You are required to pass necessary journal entries.

Question 7 *(ICAI Study Material)* *Pg no._____*

A Limited issued 14% Debentures of the nominal value of ₹10 each as follows:
(a) To sundry persons 1,00,000 Debentures for cash at 10% discount.
(b) To a vendor for purchase of Inventory worth ₹1,00,000, 8,000 debentures at 25% premium.
(c) To the banker as collateral security for a loan of ₹1,00,000 – ₹1,50,000 nominal value.
Pass necessary Journal Entries.

Question 8 ***(ICAI Study Material)*** *Pg no._____*

HDC Ltd. issues 2,00,000, 12% Debentures of ₹10 each at ₹9.40 on 1st January,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.

Question 9 *Pg no._____*

X Ltd. issues 1,00,000, 9% Debentures of ₹10 each at ₹9.50 on 1st January,2020. Under the terms of issue, 1/5th of the debentures are redeemable by drawings, the first redemption occurring on 31st December, 2020. Accounting year is from April to March.
Calculate the amount of discount to be written-off for each year.

Question 10 ***(ICAI Study Material)*** *Pg no._____*

A company issued 12% debentures of the face value of ₹10,00,000 at 10% discount on 1-1-2023. 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 2023.

Question 11 ***(ICAI Study Material)*** *Pg no._____*

On 1st April 2022 Sheru Ltd. issued 1,00,000 12% debentures of ₹100 each at a discount of 5%, redeemable on 31 March 2027. Issue was oversubscribed by 20,000 debentures, who were refunded their money. Interest is paid annually on 31 March. You are required to prepare:

i) Journal Entries at the time of issue of debentures.
ii) Discount on issue of Debenture Account
iii) Interest account and Debenture holder Account assuming TDS is deducted @ 10%.

Question 12 *Pg no._____*

D Ltd. issued ₹ 15,00,000, 10% debentures on 1st October, 2020 and interest is payable on 30th June and 31st December. Pass journal entries to record debenture interest for accounting years ended on 31st March, 2021 and 31st March, 2022.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Premium on redemption of debentures account appearing in the balance sheet is ______.
   (a) A nominal account - expenditure
   (b) A nominal account - income
   (c) A personal account ______.

2) Debenture interest
   (a) Is payable before the payment of any dividend on shares
   (b) Accumulates in case of losses or inadequate profits
   (c) Is payable after the payment of preference dividend but before the payment of equity dividend

3) F Ltd. purchased Machinery from G Company for book value of ₹4,00,000. The consideration was paid by issue of 10% debentures of ₹ 100 each at a premium of 25%. The debenture account was credited with ______.
   (a) ₹ 4,00,000
   (b) ₹ 5,00,000
   (c) ₹ 3,20,000

4) Which of the following is not a characteristic of Bearer Debentures?
   (a) They are treated as negotiable instruments
   (b) Their transfer requires a deed of transfer
   (c) They are transferable by mere delivery

5) When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is _________.
   (a) Credit Debentures A/c and debit Cash A/c.
   (b) Debit Debenture suspense A/c and credit Cash A/c.
   (c) Debit Debenture suspense A/c and credit Debentures A/c.

6) When debentures are redeemable at different dates, the total amount of discount on issue of debentures should be written off
   (a) Every year by applying the sum of the year's digit method
   (b) Every year by applying the straight line method
   (c) To profit and loss account in full in the year of final or last redemption

7) Debentures are issued at discount when
   (a) Market interest rate is higher than debenture interest rate
   (b) Market interest rate is lower than debenture interest rate
   (c) Market interest rate is equal to debenture interest rate

8) Interest payable on Debentures attract
   (a) Tax deducted at source
   (b) Goods and Service tax
   (c) Fringe benefit tax

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Debenture holder are the owners of the company.
2) Perpetual debentures are payable at the time of liquidation of the company. *(June 2023)*
3) Registered debentures are transferable by delivery.
4) When companies issue their own debentures as collateral security for a loan, the holder of such debenture is entitled to interest only on the amount of loan & not on the debentures
5) Debentures suspense account appears on the liability side of balance sheet. *(June 2022)*
6) If a company incurs loss, then it does not pay interest to the debenture holders.
7) At the time of liquidation, debenture holders are paid off after the shareholders.
8) Convertible debentures can be converted into equity shares.
9) Redeemable debentures are not payable during the lifetime of the company.
10) Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.
11) Debenture interest is payable after the payment of preference dividend but before the payment of equity dividend.
12) Interest on debentures is calculated on Issue Price of Debentures
13) When debentures are issued as collateral security against any loan then holder of such debentures is entitled to Interest both on the amount of the loan and on the debentures
14) Debenture holders enjoy the voting rights in the company.
15) A fixed charge generally covers all the assets of company including future one. *(Dec 2022)*

Solution

1) False: Debenture holder are the creditors of the company.
2) True: Perpetual debentures, also known as irredeemable debentures are not repayable during the life time of the company & are repayable at the time of liquidation of company
3) False: Registered debentures are not easily transferable by delivery. Bearer debentures are transferrable by delivery.
4) True: In case the company cannot repay its loan & the interest thereon on the due date, the lender becomes debenture holder & then only he is entitled to interest on debentures.
5) False: Deb. Suspense A/c appears on asset side of balance sheet under non-current asset
6) False: Even if the company incurs loss or earns profit, it has to pay interest on debentures. Debentures being debts on company & debenture holders are not concerned with profit/ loss of company, interest is to be paid at the rate fixed on it at the time of issue of debenture.
7) False: At the time of liquidation, debenture holders are paid off before shareholders on priority basis.
8) True: Convertible debentures can be converted into equity shares after a certain period of time from the date of its issue.
9) False: These debentures are repayable as per the terms of issue, for example, after 8 years from the date of issue.
10) True: Debentures can be issued for a consideration other than for cash, such as for purchasing land, machinery etc.
11) False: Debenture interest is payable before the payment of any dividend on shares.
12) False: Interest on debentures is calculated on Face Value of Debentures
13) False: When debentures are issued as collateral security against any loan then holder of such debentures is entitled to Interest only on the amount of the loan.
14) False: Debenture holders does not enjoy voting rights in company. He is only a creditor of the company.
15) False: A fixed charge is a mortgage on specific assets. A floating charge generally covers all the assets of the company including future one.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Amol Ltd. issued 40,00,000, 9% debentures of ₹ 50 each, payable on application as per term mentioned in the prospectus and redeemable at par any time after 3 years from the date of issue. Record necessary entries for issue of debentures in the books of Amol Ltd.

Question 2 *(ICAI Study Material)* *Pg no._____*

Atul Ltd. issued 1,00,00,000, 8% debenture of ₹100 each at a discount of 10% redeemable at par at the end of 10th year. Money was payable as follows:

₹ 30 on application
₹ 60 on allotment

Record necessary journal entries regarding issue of debenture.

Question 3 *(ICAI Study Material)* *Pg no._____*

Koinal Chemicals Ltd. issued 15,00,000, 10% debenture of ₹50 each at premium of 10%, payable as ₹20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in application money.

Question 4 *(ICAI Study Material)* *Pg no._____*

Modern Equipments Ltd. issued 4,00,000, 12% debentures of ₹ 100 payable as follows :

On application	₹ 30
On allotment	₹ 70

The debenture were fully subscribed and all the money was duly received. As per the terms of issue, debentures are redeemable at ₹110 per debenture. Record necessary entries regarding issue of debentures.

Question 5 *(ICAI Study Material)* *Pg no._____*

Agrotech Ltd. issued 150 lakh 9% debentures of ₹100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as: ₹50 on application and ₹ 44 on allotment.
Record necessary journal entries for issue of debentures.

Question 6 *(ICAI Study Material)* *Pg no._____*

Country Crafts Ltd. issued 1,00,000, 8% debentures of ₹ 100 each at premium of 5% payable fully on application and redeemable at premium of ₹ 10.
Pass necessary journal entries at the time of issue.

Question 7 *(ICAI Study Material)* *Pg no._____*

Koinal Chemicals Ltd. issued 20,00,000, 10% debentures of ₹50 each at premium of 10%, payable as ₹ 20 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Record necessary entries when premium money is included in allotment money.

Question 8 *(ICAI Study Material)* *Pg no._____*

Kapil Ltd. issued 50,000, 12% Debentures of ₹100 each at a premium of 10% payable in full on application by 1st March, 2023. The issue was fully subscribed and debentures were allotted on 9th March, 2023. Pass necessary Journal Entries (including cash transactions).

Question 9 *(RTP Nov 2019) / (RTP May 2021) (Similar)* Pg no._____

Pihu Ltd. issued 50,00,000, 9% debentures of ₹ 100 each at a discount of 10% redeemable at par at the end of 10th year. Money was payable as follows:
₹ 40 on application & ₹ 50 on allotment
You are required to give necessary journal entries regarding issue of debenture

Question 10 *(RTP Nov 2018) / (RTP Nov 2020)* Pg no._____

A Ltd. issued 3,50,000, 12% Debentures of ₹100 each at par payable in full on application by 1st April, Application were received for 3,85,000 Debentures. Debentures were allotted on 7th April. Excess money refunded on the same date.
You are required to prepare necessary Journal Entries (including cash transactions) in the books of the company.

Question 11 *(ICAI Study Material)* Pg no._____

X Ltd. issued 1,00,000 12% Debentures of ₹100 each at a discount of 10% payable in full on application by 31st May, 2023. Applications were received for 1,20,000 debentures. Debentures were allotted on 9th June, 2023. Excess money was refunded on the same date.
Pass necessary Journal Entries. Also show necessary ledger accounts.

Question 12 *(ICAI Study Material)* Pg no._____

X Ltd. obtains a loan from IDBI of ₹ 1,00,00,000, giving as collateral security of ₹ 1,50,00,000 (of ₹10 each), 14%, First Mortgage Debentures. Pass journal entries & show balance sheet extract as per both approaches.

Question 13 - *(ICAI Study Material)* Pg no._____

HDC Ltd issues 1,00,000, 12% Debentures of ₹100 each at ₹94 on 1st January,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.

Question 14 *(CA Foundation Nov 2018) (5 Marks)/(RTP May 2020)/(Nov 2022)(Similar)* 'g no._____

Pure Ltd. issues 1,00,000 12% debentures of ₹ 10 each at ₹ 9.40 on 1st January,2021. Under the terms of issue the debentures are redeemable at the end of 5 years from the date of issue.
Calculate the amount of discount to be written off in each of the 5 years.

Question 15 Pg no._____

X Ltd. issued 10,000 12% debentures of ₹ 100 each at a discount of 5%. These debentures are redeemable at a premium of 10 % after 5 years.
You are required to show:
a) Journal entry on issue of the debentures; and
b) The loss on issue of debentures account over the period.

Question 16 Pg no._____

A company issued 12% debentures of the face value of ₹ 2,00,000 at 10% discount on 1st January, 2020. Debenture Interest after deducting tax at source @ 10% was payable on 30th June and 31st December every year. All the debentures were to be redeemed after the expiry of 5 years period at 5% premium. Pass the necessary journal entries for the year 2020.

Question 17 *(CA Foundation May 2019) (5 Marks) / (RTP Nov 2023)* *Pg no._____*

On 1st January 2020·Ankit Ltd. issued 10% debentures of the face value of ₹ 20,00,000 at 10% discount. Debenture interest after deducting tax at source @10% was payable on 30th June and 31st December every year. All the debentures were to be redeemed after the expiry of five year period at 5% premium.
Pass necessary journal entries for the accounting year 2020.

Question 18 *(CA Foundation Nov 2020) (5 Marks)* *Pg no._____*

Y Company Limited issue 10,000 12% Debentures of the nominal value of ₹ 60,00,000 as follows:
(i) To a vendor for purchase of fixed assets worth ₹ 13,00,000 - ₹ 15,00,000 nominal value.
(ii) To sundry persons for cash at 90% of nominal value of ₹ 30,00,000.
(iii) To the banker as collateral security for a loan of ₹ 14,00,000 - ₹ 15,00,000 nominal value
You are required to pass necessary Journal Entries.

Question 19 *(RTP May 2022)* *Pg no._____*

On 1st April 2020, XY Ltd. took over assets of ₹4,50,000 and liabilities of 60,000 of Himalayan Ltd. for the purchase consideration of ₹ 4,40,000. It paid the purchase consideration by issuing 8% debenture of ₹ 100 each at 10% premium on same date. XY Ltd. issued another 3000, 8% debenture of ₹ 100 at discount of 10% redeemable at premium of 5 % after 5 years. According to the terms of the issue ₹ 30 is payable on application and the balance on the allotment on debentures. It has been decided to write off the entire loss on issue of discount in the current year itself. You are required to pass the journal entries in the books of XY Ltd. for the financial year 2020-21.

Question 20 *(RTP Nov 2021)* *Pg no._____*

Avantika Ltd. purchased machinery worth ₹9,90,000 from Avneet Ltd. The payment was made by issue of 10% debentures of ₹100 each. Pass the necessary journal entries for the purchase of machinery and issue of debentures when:
(i) Debentures are issued at par
(ii) Debentures are issued at 20 % discount and
(iii) Debentures are issued at 20% premium

Unit 4: ACCOUNTING FOR BONUS ISSUE & RIGHT ISSUE

CH 11D

"Everything is easy when you are busy...!! Nothing is easy when you are lazy...!! You are born to success..."

BONUS ISSUE

Means issue of additional shares to existing shareholders free of cost in proportion to their existing holding.

Section 63(1) A company may issue fully paid-up bonus shares to its shareholders out of—

- its free reserves;
- the securities premium account; or
- the capital redemption reserve account:

Bonus shares should not be issued out of revaluation reserves (i.e., reserves created by the revaluation of assets).

Section 63(2) provides that no company shall capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

(a) it is authorised by its articles;
(b) it has on the recommendation of Board been authorised in the general meeting of company
(c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
(d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
(e) the partly paidup shares, if any outstanding on the date of allotment, are made fully paidup.

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Section 63(3) provides that the bonus shares shall not be issued in lieu of dividend.

As per Para 39 (i) of Table F under Schedule I to the Companies Act, 2013, a company can utilize free reserves which are available for distribution of dividend, for the purpose of converting partly paid shares into fully paid up.

A Securities Premium A/c and a Capital Redemption Reserve A/c may only be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares. In other words, Securities premium A/c and capital redemption reserve cannot be applied towards payment of unpaid amount on any shares held by existing shareholders.

SEBI Regulations (Issue of Capital & Disclosure Requirements), 2018 Regulation 294- Restrictions on bonus issue
➢ An issuer shall make a bonus issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments if any, in proportion to the convertible part thereof. ➢ They shall be issued at the time of conversion of such instruments on the same terms or proportion at which the bonus shares were issued. ➢ A bonus issue shall be made only out of free reserves, securities premium account or capital redemption reserve account and built out of the genuine profits or securities premium collected in cash and reserves created by revaluation of fixed assets shall not be capitalised for this purpose. ➢ The bonus share shall not be issued in lieu of dividend

Bonus issue has following major effects:
- Share capital gets increased according to the bonus issue ratio.
- Effective Earnings per share, Book Value and other per share values stand reduced.
- Markets take the action usually as a favourable act.
- Market price gets adjusted on issue of bonus shares.
- Accumulated profits get reduced.

RIGHT ISSUE

It is an issue of rights to company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period. In a rights offering, the subscription price at which each share may be purchased is generally at a discount to the current market price.

❖ *Rights are often transferable, allowing the holder to sell them in the open market.*

❖ *The difference between cum-right and ex-right value of the share is the value of the right.*

In a situation where existing shareholder does not intend to subscribe to the rights issue of a company, he may give up his right in favour of another person for a consideration. Such giving up of rights is called renunciation of rights.

Advantages of Right Issue
➢ Right issue enables the existing shareholders to maintain their proportional holding in the company and retain their financial and governance rights. ➢ It works as a deterrent to the management, which may like to issue shares to known persons with a view to have a better control over the company's affairs. ➢ Right issue is a natural hedge against the issue expenses normally incurred by the company in relation to public issue. ➢ Right issue has an image enhancement effect, as public & shareholders view it positively ➢ The chance of success of a right issue is better than that of a general public issue and is logistically much easier to handle.
Disadvantages of Right Issue
➢ The right issue invariably leads to dilution in market value of the share of the company. ➢ The attractive price of the right issue should be objectively assessed against its true worth to ensure that you get a bargained deal.

Right issue has following major effects:
- Maintenance of existing shareholders' proportional holding in company and retain their financial and governance rights.
- Dilution in the value of share.
- Image enhancement
- Convenience in handling issue

Exceptions to the rights of existing equity shareholders

Section 62 recognises four situations under which the further shares are to be issued by a company, but they need not be offered to the existing shareholders provided the company has passed a special resolution and shares are offered accordingly.

Situation 1 To employees under a scheme of employees' stock option subject to certain specified conditions

Situation 2 To any person either for cash or for consideration other than cash, if price of such shares is determined by valuation report of registered valuer subject to certain conditions.

Situation 3 Sometimes companies borrow money through debentures / loans and give their creditor an option to buy equity shares of a company.

Situation 4 It is a special situation where the loan has been obtained from government, and government in public interest, directs the debentures/loan to be converted into equity shares.

ASSIGNMENT QUESTIONS

TOPIC 1: BONUS ISSUE

Question 1 *(ICAI Study Material)* Pg no._____

Following items appear in trial balance of Bharat Ltd (listed company) as on 31st March, 2023

40,000 Equity shares of ₹ 10 each	4,00,000
Capital Redemption Reserve	55,000
Securities Premium (collected in cash)	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Question 2 *(CA Inter July 2021) (5 Marks)* Pg no._____

Following is the extract of the Balance Sheet of K Ltd (listed company) as at 31st March, 2023

Authorized capital:	₹
3,00,000 Equity shares of ₹ 10 each	30,00,000
	30,00,000
Issued and Subscribed capital:	
2,00,000 Equity shares of ₹ 10 each, ₹ 8 paid up	16,00,000
Reserves and surplus:	
General Reserve	3,60,000
Capital Redemption Reserve	1,20,000
Securities premium (not realised in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 2023, the Company has made final call @ ₹ 2 each on 2,00,000 equity shares. The call money was received by 25th April, 2023. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.
Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue.

Question 3 Pg no._____

Following is the extract from the Balance Sheet of M/s. Hello Ltd. as at 31st March, 2023:

	₹
Authorised capital: 50,000, 10% Preference shares of ₹ 10 each 2,00,000 Equity shares of ₹ 10 each	 5,00,000 20,00,000
Issued and subscribed capital: 40,000, 10% Preference shares of ₹ 10 each fully paid 1,80,000, Equity shares of ₹ 10 each, of which ₹ 7.50 paid up	 4,00,000 13,50,000
Reserves and Surplus: General reserve Capital reserve Securities premium Profit and loss account	 2,40,000 1,50,000 30,000 3,00,000

On 1st April, 2023, the company has made a final call @ ₹ 2.50 each on 1,80,000 equity shares. The call money was received by 30th April, 2023. There after the company decided to capitalize its reserves by issuing bonus shares at the rate of one share for every three shares held. Capital reserve includes ₹ 90,000 being profit on sale of plant and machinery. Pass Journal Entries in the books of company and prepare the extract of Balance Sheet after bonus issue.

Question 4 *(ICAI Study Material)* *Pg no.*_____

The following notes pertain to Brite Ltd.'s Balance Sheet as on 31st March, 2023:

Note	Particulars	Amount (In Lacs)
Note 1	Share Capital	
	Authorised:	
	20 crore shares of ₹ 10 each	20,000
	Issued and Subscribed:	
	10 crore Equity Shares of ₹ 10 each	10,000
	2 crore 11% Cumulative Preference Shares of ₹ 10 each	2,000
	Total	12,000
	Called and paid up:	
	10 crore Equity Shares of ₹ 10 each, ₹ 8 per share called and paid up	8,000
	2 crore 11% Cum. Preference Shares of ₹ 10 each, fully called & paid up	2,000
		10,000
Note 2	Reserves and Surplus:	
	Capital Redemption Reserve	1,485
	Securities Premium (collected in cash)	2,000
	General Reserve	1,040
	Surplus i.e. credit balance of Profit & Loss Account	273
		4,798

On 2nd April 2023, the company made the final call on equity shares @ ₹ 2 per share. The entire money was received in the month of April, 2023.
On 1st June 2023, the company decided to issue to equity shareholders bonus shares at the rate of 2 shares for every 5 shares held. Pass journal entries for all the above mentioned transactions. Also prepare the notes on Share Capital and Reserves and Surplus relevant to the Balance Sheet of the company immediately after the issue of bonus shares

Question 5 *(ICAI Study Material)* *Pg no.*_____

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 2023:

Authorized capital :	
10,000 12% Preference shares of ₹ 10 each	1,00,000
1,00,000 Equity shares of ₹ 10 each	10,00,000
	11,00,000
Issued and Subscribed capital:	
8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up	7,20,000
Reserves and Surplus :	
General reserve	1,60,000
Revaluation reserve	35,000
Securities premium (collected in cash)	20,000
Profit and Loss Account	2,05,000
Secured Loan:	
12% Debentures @ ₹ 100 each	5,00,000

On 1st April, 2023 the Company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 20th April, 2023. Thereafter the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.
Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

Question 6 Pg no._____

Following items appear in the Trial Balance of X Ltd. as at 31st March 2023:

	₹
Authorised capital: 3,00,000 equity shares of ₹ 10 each	30,00,000
Issued and subscribed capital:	
80,000 Equity Shares of ₹ 10 each, ₹ 7.50 paid up	6,00,000
1,20,000 Equity Shares of ₹ 10 each	12,00,000
Capital Redemption Reserve	2,60,000
Revaluation Reserve	20,000
Securities Premium Account	1,20,000
General Reserve	2,00,000
Profit & Loss Account	1,00,000
Capital Reserve (including ₹ 50,000 being profit on sale of machinery)	1,50,000

The company decided to convert the partly paid equity shares into fully paid shares by way of bonus and to issue fully paid-up bonus shares to the holders of fully paid up shares in the same ratio.
You are required to pass journal entries assuming that there should be minimum reduction in free reserves.

TOPIC 2: RIGHT ISSUE

Question 7 *(RTP May 2019) / (ICAI Study Material)* Pg no._____

A company offers new shares of ₹ 100 each at 25% premium to existing shareholders on one for four bases. The cum-right market price of a share is ₹ 150.
Calculate the value of a right. What should be the ex-right market price of a share?

Question 8 Pg no._____

A Company having 70,000 shares of ₹ 10 each as its issued share capital and having market value of ₹ 21 issues rights shares in the ratio of 1:10 at an issue price of ₹ 10.
Pass journal entry for issue of right shares

Question 9 *(RTP May 2021)* Pg no._____

Beta Ltd. having share capital of 20,000 equity shares of 10 each decides to issue rights share at the ratio of 1 for every 8 shares held at par value.
Assuming all the share holders accepted the rights issue and all money was duly received, pass journal entry in the books of the company.

Question 10 *(ICAI Study Material)* Pg no._____

Following notes pertain to the Balance Sheet of Mars Company Limited as at 31st March 2023:

	₹
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	5,00,000
4,00,000 Equity Shares of ₹ 10 each, ₹ 8 paid up	32,00,000
Reserves & Surplus	
General Reserve	1,60,000
Capital Redemption Reserve	2,40,000
Securities Premium Account (collected in cash)	2,75,000
Revaluation Reserve	1,00,000
Profit & Loss Account	16,00,000

On 1st April, 2023, the Company has made final call @ ₹ 2 each on 4,00,000 equity shares. The call money was received by 25th April, 2023. Thereafter, on 1st May 2023 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 2023, 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 2023.

Show necessary journal entries in the books of the company for bonus issue and rights issue.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Which of the following cannot be used for issue of bonus shares as per the Companies Act?
   (a) Securities premium account
   (b) Revaluation reserve
   (c) Capital redemption reserve

2) Which of the following statements is true with regard to declaring and issuing of Bonus Shares?
   (a) Assets are transferred from the company to the shareholders.
   (b) A Bonus issue results in decrease in reserves and surplus.
   (c) A Bonus issue is same as declaration of dividends.

3) Which of the following statement is true in case of bonus issue?
   (a) Convertible debenture holders will get bonus shares in same proportion as to the existing shareholders.
   (b) Bonus shares may be issued to convertible debenture holders at the time of conversion of such debentures into shares.
   (c) Both (a) and (b).

4) Bonus issue is also known as
   (a) Scrip issue.
   (b) Capitalisation issue.
   (c) Both (a) and (b).

5) The bonus issue is not made unless
   (a) Partly paid shares are made fully paid up.
   (b) It is provided in its articles of association
   (c) Both (a) and (b).

6) Bonus issue has the following effect
   (a) Market price gets adjusted on issue of bonus shares.
   (b) Effective Earnings per share, Book Value and other per share values stand increased.
   (c) Markets generally take the action as an unfavourable act.

7) ABC Co. Ltd resolved to issue bonus shares. Which of the following is not a pre-requisite for issuance of bonus shares?
   (a) Authorization in Articles of Association.
   (b) Timely Payment of statutory dues of employees such as PF, Gratuity etc.
   (c) Sufficient balance in bank account of company.

8) In case of further issue of shares, the right to renounce the shares in favour of a third party
   (a) Must include a right exercisable by the person concerned to renounce the shares;
   (b) Should include a right exercisable by the person concerned to renounce the shares;
   (c) Is deemed to include a right exercisable by the person concerned to renounce the shares (subject to the provisions under the articles of the company).

9) A company's share's face value is ₹10, book value is ₹20, Right issue price is ₹30 and Market price is ₹40, while recording the issue of right share, the securities premium will be credited with
   (a) ₹10
   (b) ₹20
   (c) ₹30

10) A. Right shares enable existing shareholders to maintain their proportional holding in the company.
    B. Right share issue does not cause dilution in the market value of the share.
    Which of the option is correct?
    (a) A-Correct; B Correct
    (b) A – Incorrect; B Correct
    (c) A - Correct; B – Incorrect

11) Ex-Rights price can be calculated by which of these formulas?
    (a) (Cum rights value of the existing shares + Rights share issue proceeds)/ (existing number of shares + No. of right shares).
    (b) (Cum rights value of the existing shares + Rights share issue proceeds) X (existing number of shares + No. of right shares).
    (c) (Cum rights value of the existing shares - Rights share issue proceeds)/ (existing number of shares – No. of right shares).

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) Earning per share gets increased after bonus issue.
2) Issued share capital including issue of rights shares and bonus shares may be more than the Authorised capital.
3) Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.
4) Right shares are normally offered at a price more than the cum-right value of the share, causing dilution in its value post-right issue.

Solution

1) False: Earnings per share gets decreased after bonus issue.
2) False: Issued share capital including issue of rights shares and bonus shares is always less than or equal to Authorised capital.
3) True: Rights issue of shares results in decrease of market value of per share in comparison to market price before rights issue.
4) False: Right shares are normally offered at a price less than the cum-right value of the share, causing dilution in its value post-right issue.

HOMEWORK QUESTIONS

TOPIC 1: BONUS ISSUE

Question 1 *(ICAI Study Material)* *Pg no._____*

Following items appear in the trial balance of Saral Ltd. as on 31st March, 2023:

4,500 Equity shares of ₹ 100 each	4,50,000
Securities Premium (collected in cash)	40,000
Capital Redemption Reserve	70,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	45,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books of Saral Ltd.

Question 2 *(RTP May 2023)* *Pg no._____*

Following items appear in the Trial Balance of Satish Limited as on 31st March, 2023:

9,000 Equity shares of ₹ 100 each	9,00,000
Capital Reserves (including ₹ 80,000 being profit on sale of plant)	1,80,000
Securities Premium	80,000
Capital Redemption Reserve	60,000
General Reserve	2,10,000
Profit and Loss Account (Cr. Balance)	1,30,000

The company decided to issue bonus shares to equity shareholders at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books of Satish Ltd.

Question 3 *(CA Inter Nov 2019) (5 Marks)* *Pg no._____*

Following is the extract of Balance Sheet of Prem Ltd. as at 31st March, 2023:

	₹
Authorized capital:	
3,00,000 equity shares of ₹ 10 each	30,00,000
25,000,10% preference shares of ₹ 10 each	2,50,000
	32,50,000
Issued and subscribed capital:	
2,70,000 equity shares of ₹ 10 each fully paid up	27,00,000
24,000, 10% preference shares of ₹10 each fully paid up	2,40,000
	29,40,000
Reserves and surplus:	
General reserve	3,60,000
Capital redemption reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and loss account	6,00,000
	11,55,000

On 1st April, 2023, the company decided to capitalize its reserves by way of bonus at the rate of two shares for every five shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet after bonus issue.

Question 4 *(ICAI Study Material)* Pg no.______

Following is the extract of the Balance Sheet of Preet Ltd. as at 31st March, 2023

Authorised capital :	
15,000 12% Preference shares of ₹ 10 each	1,50,000
1,50,000 Equity shares of ₹ 10 each	15,00,000
	16,50,000
Issued and Subscribed capital:	
12,000 12% Preference shares of ₹ 10 each fully paid	1,20,000
1,35,000 Equity shares of ₹ 10 each, ₹ 8 paid up	10,80,000
Reserves and Surplus :	
General reserve	1,80,000
Capital Redemption reserve	60,000
Securities premium (collected in cash)	37,500
Profit and Loss Account	3,00,000

On 1st April, 2023, the Company has made final call @ ₹ 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2023. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2023 after bonus issue.

Question 5 *(ICAI Study Material) / (RTP M18/N19/N20/M21/N21/N23) (Similar)* Pg no.______

Following notes pertain to the Balance Sheet of Manoj Ltd. as at 31st March, 2023

Authorized capital:	
30,000 12% Preference shares of ₹ 10 each	3,00,000
3,00,000 Equity shares of ₹ 10 each	30,00,000
	33,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000
Reserves and Surplus :	
General reserve	3,60,000
Capital Redemption reserve	1,20,000
Securities premium (collected in cash)	75,000
Profit and Loss Account	6,00,000

On 1st April, 2023, the Company has made final call @ ₹ 2 each on 2,70,000 equity shares. The call money was received by 20th April, 2023. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of company and prepare the extract of the balance sheet as on 30th April, 2023 after bonus issue.

Question 6 *(RTP Nov 2018) / (RTP May 2019)* Pg no.______

Following is the extract of the Balance Sheet of Xeta Ltd. as at 31st March, 2023

Authorised capital :	
50,000 12% Preference shares of ₹ 10 each	5,00,000
4,00,000 Equity shares of ₹ 10 each	40,00,000
	45,00,000
Issued and Subscribed capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000

Reserves and Surplus :	
General reserve	3,60,000
Securities premium	1,00,000
Profit and Loss Account	6,00,000

On 1st April, 2023, the Company has made final call @ ₹ 2 each on 2,70,000 equity shares. The call money was received by 20th April, 2023. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held. Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2023 after bonus issue

Question 7 *(CA Inter May 2018) (5 Marks)* *Pg no._____*

Following are the balances appear in the trial balance of Arya Ltd. as at 31st March, 2023.

	Amount
Issued and Subscribed Capital:	
10,000; 10% Preference Shares of ₹ 10 each fully paid	1,00,000
1,00,000 Equity Shares of ₹ 10 each ₹ 8 paid up	8,00,000
Reserves and Surplus:	
General Reserve	2,40,000
Securities Premium (collected in cash)	25,000
Profit and Loss Account	1,20,000

On 1st April, 2023 the company has made final call @ ₹ 2 each on 1,00,000 Equity Shares. The call money was received by 15th April, 2023. Thereafter the company decided to issue bonus shares to equity shareholders at the rate of 1 share for every 5 shares held and for this purpose, it decided that there should be minimum reduction in free reserves.
Pass Journal entries.

Question 8 *(CA Inter Jan 2021) (5 Marks)* *Pg no._____*

Following items appear in the Trail Balance of Star Ltd. as on 31st March, 2023:

	₹
80,000 equity shares of ₹ 10 each, ₹ 8 paid-up	6,40,000
Capital Reserve (including ₹ 45,000 being profit on sale of Machinery)	1,10,000
Revaluation Reserve	80,000
Capital redemption reserve	75,000
Securities premium	60,000
General reserve	2,10,000
Profit and loss account (Cr. Balance)	1,00,000

On 1st April, 2023, the Company has made final call on Equity shares @ ₹ 2 per share. The entire money was received in the month of April, 2021. On 1st June, 2023, the Company decided to issue to Equity shareholders bonus shares at the rate of 2 shares for every 5 shares held and for this purpose, it was decided that there should be minimum reduction in free reserves. Pass necessary journal entries in the Books of Star Ltd.

Question 9 *(ICAI Study Material) / (RTP Nov 2022) (Similar)* *Pg no._____*

Pass Journal Entries in the following circumstances:

(i) A Limited company with subscribed capital of ₹ 5,00,000 consisting of 50,000 Equity shares of ₹ 10 each; called up capital ₹ 7.50 per share. A bonus of ₹ 1,25,000 declared out of General Reserve to be applied in making the existing shares fully paid up.

(ii) A Limited company having fully paid up capital of ₹ 50,00,000 consisting of Equity shares of ₹ 10 each, had General Reserve of ₹ 9,00,000. It was resolved to capitalize ₹ 5,00,000 out of General Reserve by issuing 50,000 fully paid bonus shares of ₹ 10 each, each shareholder to get one such share for every ten shares held by him in the company.

Question 10 *(CA Inter May 2023) (5 Marks)* **Pg no._____**

Storek Limited has a subscribed capital of ₹ 21,00,000 in Equity Share Capital consisting of 1,50,000 shares of ₹ 10 each fully paid and 1,00,000 shares of ₹ 10 each, called up capital ₹ 6 per share. On 01.04.2023 the company decides to convert the partly paid-up shares into fully paid-up shares by way of bonus issue and holders of fully paid-up shares are also allotted fully paid-up bonus share in the same ratio.

The following figures appear in trial balance of Storek Limited as on 31.03.2023:

	(₹)
Capital Redemption Reserve	80,000
Capital Reserve	1,00,000
Securities Premium	2,20,000
General Reserve	12,50,000
Surplus (credit balance in Profit & Loss Account)	2,40,000

Securities Premium Account includes a premium of ₹ 75,000 for shares issued to vendors pursuant to a scheme of absorption. It was decided that there should be minimum reduction in free reserves. You are required to pass necessary Journal Entries.

Question 11 *(RTP May 2022)* **Pg no._____**

Mobile Limited has authorized share capital of 1,00,000 equity shares @ ₹ 10 each. The company has already issued 60% of its capital for cash. Now the company wishes to issue bonus shares in the ratio 1:5 to its existing shareholders. The following is the status of Reserve and Surplus of the company:

	₹
General Reserve	₹ 1,60,000
Plant Revaluation Reserve	₹ 25,000
Securities Premium Account (Realised in cash)	₹ 60,000
Capital Redemption Reserve	₹ 80,000

Answer the following questions:

a) What is the number of Bonus shares to be issued?
b) Can company issue Bonus out of General Reserve only?
c) Give Journal Entries & also give the extracts of balance sheet after such Bonus issue.

Is it possible for the company to issue partly paid-up bonus shares?

TOPIC 2: RIGHT ISSUE

Question 12 *(RTP Nov 18/22/23) (Similar) / (RTP May 2020) / (ICAI Study Material)* **Pg no._____**

A company has decided to increase its existing share capital by making rights issue to its existing shareholders. The company is offering one new share for every two shares held by the shareholder. The market value of the share is ₹ 240 and the company is offering one share of ₹ 120 each. Calculate the value of right. What should be the ex-right market price of share?

Question 13 *(RTP May 2018) / (RTP Nov 2020) / (RTP May 2021)* **Pg no._____**

Omega company offers new shares of ₹ 100 each at 25% premium to existing shareholders on the basis one for five shares. The cum-right market price of a share is ₹ 200.

You are required to calculate the (i) Ex-right value of a share; (ii) Value of a right share?

Question 14 *(RTP Nov 2019) / (RTP Nov 2021)* **Pg no._____**

Omega company offers new shares of ₹ 100 each at 20% premium to existing shareholders on the basis of one for four shares. The cum-right market price of a share is ₹ 190.

You are required to calculate the Value of a right share.

Question 15 *(RTP May 2023)* *Pg no._____*

A company having 100,000 shares of ₹ 10 each as its issued share capital, and having a market value of ₹ 46, issues rights shares in the ratio of 1:10 at an issue price of ₹ 31.
Calculate value of right & pass necessary journal entry in the books of company.

Question 16 *(ICAI Study Material)* *Pg no._____*

A Ltd company having share capital of 25,000 equity shares of ₹ 10 each decides to issue rights share at the ratio of 1 for every 4 shares held at par value.
Assuming all the shareholders accepted the rights issue and all money was duly received, pass journal entries in the books of the company.

Question 17 *(RTP May 2022)* *Pg no._____*

a) A company offers new right shares of ₹ 100 each at 20% premium to existing shareholders on one for four shares. The cum-right market price of a share is ₹ 140. You are required to calculate (i) Ex-right value of a share; (ii) Value of a right.
b) A company having 1,00,000 shares of ₹ 10 each as its issued share capital, and having a market value of ₹ 45 issues rights shares in the ratio of 1:5 at an issue price of ₹ 25. Pass journal entry for issue of right shares.

Question 18 *(CA Inter May 2022) (5 Marks)* *Pg no._____*

Following is the extract of the Balance Sheet of Sujata Foods Limited as at 31st March,2023:

Particulars	₹
Authorised Capital	
1,00,000 12% Preference shares of ₹ 10 each	10,00,000
5,00,000 Equity shares of ₹ 10 each	50,00,000
	60,00,000
Issued and Subscribed capital	
8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up	7,20,000
Reserves and Surplus	
General Reserve	1,20,000
Capital Redemption Reserve	75,000
Securities Premium (Collected in cash)	25,000
Profit and Loss Account	2,00,000
Revaluation Reserve	80,000

On 1st April 2023, the company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 15th April,2023. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held, it also decided that there should be minimum reduction in free reserves.
On 1st June 2023, the Company issued right shares at the rate of two shares for every five shares held on that date at issue price of ₹ 12 per share. All the right shares were accepted by the existing shareholders and the money was duly received by 20th June,2023.
You are required to pass necessary journal entries in the books of the Sujata Foods Limited for bonus issue and rights issue.

Unit 5: REDEMPTION OF PREFERENCE SHARES

CH 11E

"Make schedule, Don't just stick it on your study table but work on it…"

1. Redemption of Preference Shares means repaying the Capital back to the Preference Shareholders, at an agreed amount at an agreed date.
2. The process of discharging the liability / obligation towards Preference Share Capital is called redemption. So, Redemption = Repayment of Capital during the lifetime of the Company.
3. Date of redemption is called "Maturity Date" and is usually printed on the Preference Share Certificate itself.

CONDITIONS TO BE FULFILLED FOR REDEMPTION OF PREFERENCE SHARES (SECTION 55 OF COMPANIES ACT, 2013)

<table>
<tr><td>Authorized by Articles</td><td colspan="2">The Articles of Association should contain a provision authorizing the Company to issue Redeemable Preference Shares (not exceeding 20 years from the date of issue)</td></tr>
<tr><td>Fully Paid</td><td colspan="2">Preference share Capital cannot be redeemed unless they are fully paid. If the Company has partly paid-up Preference Shares which are to be redeemed, they should be made fully paid before redeeming them.</td></tr>
<tr><td>Sourcing Redemption</td><td colspan="2">The Preference Shares can be redeemed only out of –
a) Fresh Issue: Proceeds of Fresh Issue of shares for purpose of redemption, & / or
b) Divisible Profits: Profits otherwise available for distribution as Dividend.</td></tr>
<tr><td>Capital Redemption Reserve</td><td colspan="2">If the Redemption is not sourced by Fresh Issue of Share Capital, then an amount equal to the Nominal Value of shares redeemed, to the extent not financed by fresh issue, should be transferred to Reserve called Capital Redemption Reserve (CRR).
<u>Amount to be transferred to CRR</u>
Face Value of Preference Shares to be redeemed
Less Face Value of Fresh Issue of Share Capital</td></tr>
<tr><td>Utilization of CRR</td><td colspan="2">The balance in CRR can be utilized only for the purpose of issuing Fully Paid Bonus Shares. It shall not be used for any other Purpose, e.g. distribution of dividend, etc.</td></tr>
<tr><td rowspan="2">Sourcing Premium on Redemption</td><td>Prescribed Companies & whose financial statements comply with AS (u/s 133)</td><td>Provided for out of the profits of the company before the shares are redeemed</td></tr>
<tr><td>Other Companies</td><td>Provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.</td></tr>
</table>

(i) Out of Undistributed Profits, and (b) Out of Fresh Issue of Capital.

Redemption of Preference Shares

Out of Capital (i.e. Out of Fresh Issue of Shares)	Out of Profit (i.e. Capitalization of Undistributed Profits)
(a) To raise finance for repaying the Preference Shareholders, Company can issue Equity Shares or Pref. Shares. (b) Such fresh issue can be made either at par, or at premium.	A company having surplus profits, can use these surplus funds for redemption of Preference Shares. In such a case, transfer to CRR is necessary.

Note:

1. A company may redeem its Preference Share Capital out of Capital and Profits, i.e. combination of above.
2. Redemption out of Capital means that the Company can issue either Equity Shares or Preference Shares. So, Preference Shares cannot be redeemed by fresh issue of Debentures

PURPOSE OF TRANSFER TO CRR

Retention of Capital	When Preference Shares are redeemed out of Profits, replacement / retention of Capital is ensured in an indirect manner, by transfer of profit to CRR. The amount, which would otherwise have been distributed as dividend, is now retained in the business, in the form of CRR, and this is subsequently converted into Equity Share Capital, by issuing Bonus Shares. Transfer to CRR creates non-distributed profits, and maintains the Capital Base of the Company
Protection of Outsiders Interest	The purpose of transfer to CRR is to ensure Capital Maintenance, and to protect the interests of Outsiders / Creditors of the Company. Transfer to CRR ensures that there is no reduction in "Shareholders' Funds" or Capital Base due to the redemption, and hence the interest of outsiders is not affected.

ACCOUNTING ENTRIES FOR REDEMPTION OF PREFERENCE SHARES

	Transaction	Journal Entries
1.	Calling unpaid portion of Preference Share Capital, if any	Redeemable Preference Share Final Call A/c Dr. To Redeemable Preference Share Capital A/c
2.	Receipt of Final Call Amount [Also see Note below]	Bank A/c Dr. To Redeemable Preference share final call A/c
3.	Fresh issue of Share Capital for the purpose of redemption	Bank A/c Dr. To Share Capital A/c (at Face value) To Securities Premium A/c (if at premium)
4.	Sale of Investments or Current Assets for raising funds for redemption	Bank A/c Dr. Profit and loss A/c (if sold at a loss) Dr. To Investment/ Current Assets A/c To Profit and loss A/c (if sold at profit)
5.	Transfer of preference share capital & premium on redemption (if any) to preference shareholders A/c	Redeemable Preference Share Capital A/c Dr. Premium on Redemption of Pref. Share Dr. To Preference shareholders A/c

6.	Transferring divisible profit to capital redemption reserve account	General Reserve A/c Dr. Profit and Loss A/c Dr. Other divisible profits A/c Dr. To Capital Redemption Reserve A/c (Nominal Value of PSC to be redeemed Less Nominal value of any fresh issue of share capital)
7.	Sourcing Premium payable on Redemption of Preference share	Profit and loss A/c Dr. General Reserve A/c Dr. To Premium on Redemption of Preference shares A/c
8.	Making Payment to Preference shareholders	Preference shareholders A/c Dr. To Bank A/c

Note: Non-Payment of Final Call:

1. If final Call is made on partly paid-up Preference Shares (as per Entry 1 above), but some Preference shareholders fail to pay the call amount due, those Preference Shares can be forfeited.
2. Such Forfeited Shares are generally not re-issued, since redemption of these Shares is due immediately or in the near future.

Conditions when company should issue new equity shares for redemption of pref. shares:

A company may prefer issue of new equity shares in the following situations:

(a) When the company realizes that the capital is needed permanently, and it makes more sense to issue Equity Shares in place of Redeemable Preference Shares which carry a fixed rate of dividend.
(b) When the balance of profit, which would otherwise be available for dividend, is insufficient.
(c) When the liquidity position of the company is not good enough.

Redemption of Preference shares by issue of fresh equity shares

Advantages:

(1) No cash outflow of money is required – now or later.
(2) New equity shares may be valued at a premium.
(3) Shareholders retain their equity interest.

Disadvantages:

(1) There will be dilution of future earnings;
(2) Share-holding in the company is changed.

Redemption of Preference shares by capitalization of undistributed divisible profits

Advantages:

(1) No change in the percentage of equity share-holding of the company;
(2) Surplus funds can be used.

Disadvantages:

(1) There may be a reduction in liquidity or assets may need to be sold such as investments.

Example 1: Preference Share Capital ₹ 2,00,000. New Issue 15,000 shares of 10 each.

Example 2: Preference Share Capital ₹ 2,00,000. New Issue 15,000 shares of 10 each @ 10% premium.

Example 3: Preference Share Capital ₹ 2,00,000. New Issue 30,000 shares of 10 each.

Example 4: Preference Share Capital ₹ 2,00,000. Premium on Redemption 10%.
New Issue 15,000 shares of 10 each @ 10 % premium.

Example 5: Preference Share Capital 2,500 shares of 100 each 80 paid up
New Issue 15,000 shares of 10 each.

Example 6: Preference Share Capital ₹ 4,00,000 Premium on Redemption 10%.
Free Reserves 2,60,000. Find equity shares to be issued FV= 10 each

Example 7: Preference Share Capital ₹ 65,000 Premium on Redemption 10%.
Free Reserves 48,000. P&L balance to be maintained 15,000.
Find equity shares to be issued FV= 50 each issued at a premium of 13 each.

Example 8: Preference Share Capital ₹ 2,00,000 Premium on Redemption 10%.
Existing bank balance 20,000. Investment sold for 27,500.
Minimum Bank Balance to be maintained 15,000.
Find equity shares to be issued FV= 10 each issued at 25% premium.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* Pg no._____

C Ltd. had 10,000, 10% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of ₹ 10 each at a premium of ₹ 2 per share as fully paid up.
You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 2 *(ICAI Study Material) / (RTP May 2023) (Similar)* Pg no._____

The Board of Directors of a Company decide to issue minimum number of equity shares of ₹ 9 to redeem ₹ 5,00,000 preference shares. The maximum amount of divisible profits available for redemption is ₹ 3,00,000.
Calculate the number of shares to be issued by the company to ensure that provisions of Section 55 are not violated. Also determine number of shares if company decides to issue shares in multiples of 50 only.

Question 3 *(RTP Nov 2019)* Pg no._____

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2021: Share capital: 50,000 Equity shares of ₹10 each fully paid – ₹5,00,000; 2,000 10% Redeemable preference shares of ₹100 each fully paid – ₹ 2,00,000. Reserve & Surplus: Capital reserve – ₹2,00,000; General reserve –₹ 2,00,000; Profit and Loss Account – ₹75,000.
On 1st January 2022, Board of Directors decided to redeem the preference shares at premium of 5% by utilization of reserves.
Pass Journal Entries including cash transactions in the books of company.

Question 4 *(RTP May 2019)/(May 2020)/(Nov 2023) (Similar) / (ICAI Study Material)* Pg no._____

The capital structure of a company consists of 20,000 Equity Shares of ₹ 10 each fully paid up and 1,000 8% Redeemable Preference Shares of ₹ 100 each fully paid up (issued on 1.4.2021). Undistributed reserve and surplus stood as: General Reserve ₹ 80,000; Profit and Loss Account ₹ 20,000; Investment Allowance Reserve out of which ₹ 5,000, (not free for distribution as dividend) ₹ 10,000; Securities Premium ₹ 2,000, Cash at bank amounted to ₹ 98,000.
Preference shares are to be redeemed at a Premium of 10% and for the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at par after utilizing the undistributed reserve and surplus, subject to the conditions that a sum of ₹ 20,000 shall be retained in general reserve and which should not be utilized.
Pass Journal Entries to give effect to the above arrangements.

Question 5 *(ICAI Study Material) / (RTP May 2023) (Similar)* Pg no._____

C Limited had 3,000, 12% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company had to redeem these shares at a premium of 10%. It was decided by the company to issue the following:
a) 25,000 Equity Shares of ₹ 10 each at par,
b) 1,000 14% Debentures of ₹ 100 each.
The issue was fully subscribed and all amounts were received in full. The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Question 6 *Pg no._____*

The balance sheet of A Ltd. as on 31.12.2021 is given below:

EQUITIES & LIABILITIES	₹
Shareholder's Funds	
5,000 Equity Shares (₹ 100 each fully paid-up)	5,00,000
9% Redeemable Preference Shares (₹ 10 each fully paid-up)	2,00,000
Profit & Loss Account	1,60,000
Current Liabilities	1,20,000
	9,80,000
ASSETS	**₹**
Non-Current Assets	
Property, Plant & Equipment	4,00,000
Investments	2,00,000
Current Assets	
Bank balance	10,000
Other Current Assets	3,70,000
	9,80,000

On 1.1.2022 the company:

(a) Redeemed preference shares at a premium of ₹ 2 per share.

(b) Realized investments at a value of ₹ 1,60,000.

(c) Issued at a premium of ₹ 40 per share, such number of equity shares of ₹ 100 each for the purpose of redemption as to ensure that after the compliance with requirements of the Companies Act, 2013, the credit balance in Profit & Loss A/c would be ₹ 25,000.

(d) Issued of bonus equity share at par at the rate of 1 share for every 20 shares held on 31st December, 2021.

You are required to show journal entries to record the above transactions.

Question 7 *(ICAI Study Material)* *Pg no._____*

X Ltd. gives you the following information as at 31st March, 2023:

Particulars	₹
EQUITY AND LIABILITIES	
1. Shareholders' funds	
Share capital	2,90,000
Reserves and Surplus	48,000
2. Current liabilities	
Trade Payables	56,500
TOTAL	3,94,500
ASSETS	
Non Current Assets	
Property, Plant & Equipment & Intangible Assets	
Property, Plant & Equipment	3,45,000
Non Current Investments	18,500
2. Current Assets	
Cash and cash equivalents (bank)	31,000
TOTAL	3,94,500

The share capital of the company consists of ₹ 50 each equity shares of ₹ 2,25,000 and ₹ 100 each Preference shares of ₹ 65,000 (issued on 1.4.2021). Reserves and 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 to raise the balance of funds required.
You are required to pass the necessary Journal Entries to record the above transactions.

Question 8 *(ICAI Study Material)* *Pg no._____*

The books of B Ltd. showed the following balance on 31st December, 2023:
30,000 Equity Shares of ₹ 10 each fully paid; 18,000 12% Redeemable Preference Shares of ₹ 10 each fully paid; 4,000 10% Redeemable Preference Shares of ₹ 10 each, ₹ 8 paid up (all shares issued on 1st April, 2022).
Undistributed Reserve and Surplus stood as: Profit and Loss Account ₹ 80,000; General Reserve ₹ 1,20,000; Securities Premium Account ₹ 15,000 and Capital Reserve ₹ 21,000.
Preference shares are redeemed on 1st January, 2024 at a premium of ₹ 2 per share. The whereabouts of the holders of 100 shares of ₹ 10 each fully paid are not known.
For redemption, 3,000 equity shares of ₹ 10 each are issued at 10% premium. At the same time, a bonus issue of equity share was made at par, two shares being issued for every five held on that date out of the Capital Redemption Reserve Account. However, equity shares, issued for redemption are not eligible for bonus.
Show the necessary Journal Entries to record the transactions. (Ignore date column)

Question 9 *Pg no._____*

The following is the summarized balance sheet of XYZ Ltd.

EQUITIES & LIABILITIES		₹
50,000 Equity Shares (₹ 10 each)		5,00,000
1,000 Preference Shares (₹ 100 each)	1,00,000	
Less: Calls-in-Arrear (50 X 20)	(1,000)	99,000
Securities Premium Account		20,000
Profit & Loss Account		60,000
General Reserve		70,000
Non-Current Liabilities		-
Current Liabilities		1,51,000
		9,00,000
ASSETS		**₹**
Non-Current Assets		90,000
Current Assets		8,10,000
		9,00,000

The redeemable preference shares were redeemed on the following basis:
(1) Further 4,500 equity shares were issued at a premium of 10%.
(2) Of the 50 preference shares, holders of 40 shares paid the call money before the date of redemption. Balance 10 shares were forfeited for non-payment of calls before redemption. The forfeited shares were re-issued as fully paid on receipt of ₹ 500 before redemption.
(3) Preference shares were redeemed at a premium of 10%. All payments were made except to holders of 150 shares who cannot be traced. Show journal entries.

Question 10 *(ICAI Study Material)* Pg no._____

The Balance Sheet of XYZ Ltd. as at 31st December, 2021 *inter alia* includes the following:

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 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 (Ignore date column).

Question 11 *(ICAI Study Material)* Pg no._____

With the help of details in Question 10 above and further assuming that the Preference Shareholders holding 2,000 shares fail to make the payment for the final call made under Sec 55, you are asked to pass the necessary Journal Entries assuming that the shares in default are forfeited after giving proper notice. (Ignore date column).

Question 12 *(CA Inter Nov 2022) (5 Marks)* Pg no._____

Given below are extracts of Balance Sheet of Sea Chemicals Limited as on 31st March, 2022:

Particulars	Amount in ₹
9% Redeemable Preference Share Capital	10,00,000
Calls in arears (Redeemable Preference Shares)	20,000
General Reserve	7,00,000
Securities Premium	80,000

It is provided that:

a. Preference Shares are of 100 each fully-called, due for immediate redemption at a premium of 5%.

b. Calls-in-arrears are on account of final call on 1000 shares held by four members whose whereabouts are not known.

c. Balance of General Reserve and Securities Premium to be fully utilized for the purposes of redemption and the shortfall to be made good by issue of equity shares of ₹ 10 each at par.

d. The redemption of preference shares was duly carried out.

You are required to pass the necessary journal entries (narration not required) to give effect to the above redemption.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Securities premium cannot be used to ______.
   (a) Issue bonus shares
   (b) Redeem preference shares
   (c) Write-off preliminary expenses

2) S Ltd. issued 2,000, 10% Preference shares of ₹ 100 each at par on 1.4.2021, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 Equity Shares of ₹ 100 each at a premium of 20% per share. At the time of redemption of Preference Shares, the amount to be transferred by the company to the Capital Redemption Reserve Account = ?
   (a) ₹ 50,000
   (b) ₹ 40,000
   (c) ₹ 2,00,000

3) Which of the following cannot be used for the purpose of creation of capital redemption reserve account?
   (a) Profit and loss account (credit balance)
   (b) General reserve account
   (c) Unclaimed dividend account

4) According to Section 52 of the Companies Act, 2013, the amount in the Securities Premium A/c cannot be used for the purpose of
   (a) Issue of fully paid bonus shares
   (b) Writing off losses of the company
   (c) For purchase of own securities

5) Which of the following can be utilized for redemption of preference shares?
   (a) The proceeds of fresh issue of equity shares
   (b) The proceeds of issue of debentures
   (c) The proceeds of issue of fixed deposit

6) Preference shares amounting to ₹ 2,00,000 (already issued on 1.4.2021) are redeemed at a premium of 5%, by issue of shares amounting to ₹ 1,00,000 at a premium of 10%. The amount to be transferred to capital redemption reserve = ?
   (a) ₹ 1,05,000
   (b) ₹ 1,00,000
   (c) ₹ 2,00,000

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

1) When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Reserve account by debiting the distributable profit.
2) A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing for premium on the redemption of Redeemable Preference shares of the Company.
3) The balance in forfeited shares account can be used for transfer to capital redemption reserve account.
4) Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses

Solution

1) False: When shares are redeemed by utilising distributable profit, an amount equal to the face value of shares redeemed is transferred to Capital Redemption Reserve account by debiting the distributable profit.
2) True: A company who prepares financial statements in compliance with Accounting Standards under Section 133 of the Companies Act, 2013, it cannot utilize securities premium for the purpose of providing the premium on the redemption of redeemable preference shares.
3) False: The balance in Forfeited shares account cannot be used for transfer to capital redemption reserve account.
4) True: Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Hinduja Company Ltd. had 5,000, 8% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 2 *(ICAI Study Material)* *Pg no._____*

G India Ltd. had 9,000 10% redeemable Preference Shares of ₹ 10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of ₹ 9 each fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 3 *(ICAI Study Material)* *Pg no._____*

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2023.
Share capital: 40,000 Equity shares of ₹ 10 each fully paid - ₹ 4,00,000; 1,000 10% Redeemable preference shares of ₹ 100 each fully paid – ₹ 1,00,000.
Reserve & Surplus: Capital reserve – ₹ 50,000; Securities premium – ₹ 50,000; General reserve – ₹ 75,000; Profit and Loss Account – ₹ 35,000
On 1st January 2024, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Question 4 *(RTP May 2018) / (RTP Nov 2020) (Similar) / (RTP May 2021) (Similar)* *Pg no._____*

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2021:
Share capital: 50,000 Equity shares of ₹10 each fully paid – ₹5,00,000;
1,500 10% Redeemable preference shares of ₹100 each fully paid – ₹ 1,50,000.
Reserve & Surplus: Capital reserve – ₹1,00,000; General reserve –₹ 1,00,000; Profit and Loss Account – ₹75,000.
On 1st January 2022, the Board of Directors decided to redeem the preference shares at premium of 10% by utilization of reserves. You are required to prepare necessary Journal Entries including cash transactions in the books of the company.

Question 5 *(RTP Nov 2018)* *Pg no._____*

The following are the extracts from Balance Sheet of Meera Ltd. as on 31st December, 2021.
Share capital: 60,000 Equity shares of ₹10 each fully paid – ₹ 6,00,000; 1,500 10% Redeemable preference shares of ₹ 100 each fully paid – ₹1,50,000.
Reserve & Surplus: Capital reserve – ₹ 75,000; Securities premium – ₹ 75,000; General reserve – ₹ 1,12,500; Profit & Loss A/c – ₹ 62,500.
On 1st January 2022, the Board of Directors decided to redeem the preference shares at premium of 10% by utilisation of reserve. You are required to prepare necessary Journal Entries including cash transactions in the books of the company.

Question 6 *(CA Inter May 2018) (10 Marks) / (RTP Nov 2022)* *Pg no._____*

Dheeraj Limited had 5,000, 10% Redeemable Preference Shares of ₹ 100 each, fully paid up. The company had to redeem these shares at a premium of 10%.
It was decided by the company to issue the following:
(i) 40,000 Equity Shares of ₹ 10 each at par

(ii) 2,000 12% Debentures of ₹ 100 each.

The issue was fully subscribed and all accounts were received in full. The payment was duly made. The company had sufficient profits. Show journal entries in the books of the company.

Question 7 Pg no._____

Extract of ledger balances of Kalpana Ltd. as on 31st March, 2022 includes the following:

	₹
2,000, 12% Preference shares of ₹ 100 each, fully paid	2,00,000
Surplus	40,000
Securities Premium	12,000

Under the terms of issue, the preference shares are redeemable on 31st March, 2022 at a premium of 10%. The directors desire to make a minimum fresh issue of equity shares of ₹ 10 each at a premium of 5% for redemption purpose.

You are required to ascertain the amount of fresh issue to be made and pass necessary journal entries in the books of the company.

Question 8 *(CA Inter Jan 2021) (12 Marks) / (RTP Nov 2021) (Similar)* Pg no._____

The Capital structure of a company BK Ltd. consists of 30,000 Equity Shares of ₹ 10 each fully paid up and 2,000 9% Redeemable Preference Shares of ₹ 100 each fully paid up as on 31.03.2022. The other particulars as at 31.03.2022 are as follows:

	Amount (₹)
General Reserve	1,20,000
Profit & Loss Account	60,000
Investment Allowance Reserve (not free for distribution as dividend)	15,000
Cash at Bank	1,95,000

Preference Shares are to be redeemed at a premium of 10%. For the purpose of redemption, the directors are empowered to make fresh issue of Equity Shares at per after utilizing the undistributed reserve & surplus, subject to the conditions that a sum of ₹ 40,000 shall be retained in General Reserve and which should not be utilized.

Company also sold investment of 4500 Equity Shares in G Ltd., costing ₹ 45,000 at ₹ 9 per share. Pass Journal entries to give effect to the above arrangements and also show how the relevant items will appear in the Balance Sheet as at 31.03.2022 of BK Ltd., after the redemption is carried out.

Question 9 *(CA Inter May 2019) (10 Marks)* Pg no._____

The Summarized Balance Sheet of Clean Ltd. as on 31st March, 2022 is as follows:

Particulars	₹
EQUITY AND LIABILITIES	
1. Shareholders' funds	
Share capital	5,80,000
Reserves and Surplus	96,000
2. Current liabilities	
Trade Payables	1,13,000
TOTAL	7,89,000
ASSETS	
1. Non Current Assets	
Property, Plant & Equipment & Intangible Assets	
Property, Plant & Equipment	6,90,000
Non Current Investments	37,000

2. Current Assets	
Cash and cash equivalents (bank)	62,000
TOTAL	7,89,000

The Share Capital of the company consists of ₹ 50 each Equity shares of ₹ 4,50,000 and ₹ 100 each 8% Redeemable Preference Shares of ₹ 1,30,000 (issued on 1.4.2019).

Reserves and Surplus comprises statement of profit and loss 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 ₹ 30,000.

(b) to finance part of redemption from company funds, subject to, leaving a Bank balance of ₹ 24,000.

(c) to issue minimum equity share of ₹ 50 each at a premium of ₹ 10 per share to raise the balance of funds required.

You are required to

(1) Pass Journal Entries to record the above transactions.

(2) Prepare Balance Sheet after completion of the above transactions.

Question 10 *(CA Inter Nov 2020) (12 Marks)* *Pg no._____*

The Books of Arpit Ltd. shows the following Balances as on 31st December, 2021:

	Amount (₹)
6,00,000 Equity shares of ₹ 10 each fully paid up	60,00,000
30,000, 10% Preference shares of ₹ 100 each, ₹ 80 paid up	24,00,000
Securities Premium	6,00,000
Capital Redemption Reserve	18,00,000
General Reserve	35,00,000

Under the terms of issue, the Preference Shares are redeemable on 31st March, 2022 at a premium of 10%. In order to finance the redemption, the Board of Directors decided to make a fresh issue of 1,50,000 Equity shares of ₹ 10 each at a premium of 20%, ₹ 2 being payable on application, ₹ 7 (including premium) on allotment and the balance on 1st January, 2023. The issue was fully subscribed and allotment made on 1st March, 2022. The money due on allotment was received by 20th March, 2022. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are required to pass the necessary Journal Entries and also show how the relevant items will appear in the Balance Sheet of the company after the redemption carried out on 31st March, 2022 with comparative figures of 31st December,2021.

Question 11 *(CA Inter Nov 2018) (5 Marks)* *Pg no._____*

Explain the conditions when a company should issue new equity shares for redemption of the preference shares. Also discuss the advantages and disadvantages of redemption of preference shares by issue of equity shares.

Unit 6: REDEMPTION OF DEBENTURES

CH 11F

"When you stop chasing wrong things, you give right things a chance to catch you…"

MEANING OF DEBENTURE

A debenture is an instrument issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

LEGAL PROVISIONS

- Under Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
- Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.
- Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.
- If a charge has been created on any asset or the entire assets of the company, the nature of the charge & the asset(s) charged are described therein.
- Debentures are usually redeemable i.e. either redeemed in cash or convertible after a time period. Redeemable debentures may be redeemed:
  - after a fixed number of years; or
  - any time after a certain number of years has elapsed since their issue; or
  - on giving a specified notice; or
  - by annual drawing.

DEBENTURE REDEMPTION RESERVE (DRR)

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company except for redemption of debentures.
Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.
In case of partly convertible debentures, DRR shall be created in respect of nonconvertible portion of debenture issue.

ADEQUACY OF DEBENTURE REDEMPTION RESERVE (DRR)

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below—

- the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- the limits with respect to adequacy of DRR and investment or deposits, as the case may be, shall be as under:

S.No.	Debentures Issued by	Adequacy of DRR
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures	No DRR is required
2.	Other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR will be as applicable to NBFCs registered with RBI (as per (3) below)
3.	For listed companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above):	
a.	All listed NBFCs (registered with RBI under section 45-IA of the RBI Act,) and listed HFCs (Housing Finance Companies registered with National Housing Bank) for both public as well as privately placed debentures	No DRR is required
b.	Other listed companies for both public as well as privately placed debentures	No DRR is required
4.	For unlisted companies (other than AIFIs and Banking Companies as specified in Sr. No. 1 above	
a.	All unlisted NBFCs (registered with RBI u/s 45-IA of the RBI (Amendment) Act, 1997) and unlisted HFCs (Housing Finance Companies registered with National Housing Bank) for privately placed debentures	No DRR is required
b.	Other unlisted companies	DRR shall be 10% of the value of the outstanding debentures issued

INVESTMENT OF DEBENTURE REDEMPTION RESERVE (DRR) AMOUNT

Further, as per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies are required to make DRR Investment

- All listed NBFCs
- All listed HFCs
- All other listed companies (other than AIFIs, Banking Companies and Other FIs); and
- All unlisted companies which are not NBFCs and HFCs

shall on or before the 30th day of April in each year, in respect of debentures issued, deposit or invest, as the case may be, a sum which should not be less than 15% of the amount of its debentures maturing during the year ending on the 31st day of March of next year, in any one or more of the following methods, namely:

(a) in deposits with any scheduled bank, free from charge or lien;
(b) in unencumbered securities of the Central Government or of any State Government;
(c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of Section 20 of the Indian Trusts Act, 1882;
(d) in unencumbered bonds issued by any other company which is notified under clause (f) of Section 20 of the Indian Trusts Act, 1882.

The amount deposited or invested, as the case may be, above should not be utilised for any purpose other than for the redemption of debentures maturing during the year.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no.____*

The following balances appeared in the books of Paradise Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) on 1-4-2021:

(a) 12 % Debentures ₹ 7,50,000

(b) Balance of DRR ₹ 25,000

(c) DRR Investment 1,12,500 represented by 10% 1,125 secured bonds of government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March each year. On 31-3-2022, balance at bank was ₹ 7,50,000 before receipt of interest. The investments were realized at par for redemption of debentures at a premium of 10% on the above date.

You are required to prepare the following accounts for the year ended 31st March, 2022:

(1) Debentures Account

(2) DRR Account

(3) DRR Investment Account

(4) Bank Account

(5) Debenture Holders Account

Question 2 *(ICAI Study Material)* *Pg no.____*

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2021:

6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 50,000; Investments in deposits with scheduled bank free from any charge or lien ₹ 1,50,000, at interest 4% p.a. receivable on 31st December every year.

Bank Balance with company is ₹ 9,00,000. The Interest on debentures had been paid up to December 31, 2021. On February 28, 2022, the investments were realized at par and the debentures were paid off at 101, together with accrued interest. Write up the ledger accounts concerned.

Question 3 *(ICAI Study Material) / (RTP Nov 2019 & 2021) (Similar)* *Pg no.____*

Libra Limited (a listed company) recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued 2,00,000; face value and issue price ₹ 100 per debenture.

(b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.

(c) Date of closure of subscription lists 1.5.2021, date of allotment 1.6.2021, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion ₹ 60 (Face Value ₹ 10).

(d) No. of debentures applied for 2,00,000.

(e) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022 (including cash and bank entries).

Question 4 *(ICAI Study Material)* *Pg no.____*

A company had issued 20,000, 13% debentures of ₹ 100 each on 1st April, 2021. The debentures are due for redemption on 1st July, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debentureholders to

convert 20% of their holding into equity shares (Nominal value ₹ 10) at a price of ₹ 15 per share. Debentureholders holding 2,500 debentures did not exercise the option.
Calculate no. of equity shares to be allotted to Debentureholders exercising the option to the maximum.

Question 5 *Pg no._____*

The summarised Balance Sheet of Convertible Limited (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 30th June, 2021, stood as follows:

Liabilities	₹
Share Capital: 5,00,000 equity shares of ₹ 10 each fully paid	50,00,000
General Reserve	90,00,000
Profit & Loss A/c	10,00,000
Debenture Redemption Reserve	10,00,000
13.5% Convertible Debentures, 1,00,000 Debentures of ₹ 100 each	1,00,00,000
Other loans	65,00,000
Current Liabilities and Provisions	1,25,00,000
	4,50,00,000
Assets:	
Fixed Assets (at cost less depreciation)	1,60,00,000
Debenture Redemption Reserve Investments	15,00,000
Cash and bank Balances	75,00,000
Other Current Assets	2,00,00,000
	4,50,00,000

The debentures are due for redemption on 1st July, 2021. The terms of issue of debentures provided that they were redeemable at a premium 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares at a predetermined price of ₹ 15.75 per share and the payment in cash. Assuming that:

(a) except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.
(b) the investments realize at par on sale; and
(c) all the transactions are put through, without any lag, on 1st July, 2021.

Pass necessary journal entries.

Question 6 *(ICAI Study Material) / (RTP Nov 2020 & 2022) (Similar)* *Pg no._____*

XYZ Ltd. has issued 1,000, 12% convertible debentures of ₹ 100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 opted to get their debentures converted into equity shares as per terms of the issue.
You are required to calculate the number of shares issued and cash paid for redemption of ₹ 20,000 debenture holders.

Question 7 *(ICAI Study Material)* *Pg no._____*

Case Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) provides the following information as at 31st March, 2022:

	Particulars	₹
	Equity & Liabilities	
(1)	Shareholder's Funds	
	(a) Share Capital	

	Authorized share capital:	
	45,000 equity shares of ₹ 10 each fully paid	4,50,000
	Issued and subscribed share capital:	
	30,000 equity shares of ₹ 10 each fully paid	3,00,000
	(b) Reserves and Surplus	
	Profit & Loss Account	1,62,000
	Debenture Redemption Reserve	18,000
(2)	Non-current liabilities	
	(a) Long term borrowings	
	12% Debentures	1,80,000
(3)	Current Liabilities	
	(a) Trade payables	1,72,500
	Total	8,32,500
	Assets	
(1)	Non-current assets	
	(a) Property, Plant and Equipment (Freehold property)	1,72,500
	(b) Non-current Investment: DRR Investment	27,000
(2)	Current assets	
	(a) Inventories	2,02,500
	(b) Trade receivables	1,12,500
	(c) Cash and bank balances:	
	Cash at bank	2,73,000
	Cash in hand	45,000
	Total	8,32,500

At the Annual General Meeting on 1.4.2022, it was resolved:

a) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to 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.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Which of the following statements is true?
   (a) A debenture holder is an owner of the company.
   (b) A debenture holder can get his money back only on the liquidation of the company.
   (c) A debenture issued at a discount can be redeemed at a premium.

2) Which of the following statements is false?
   (a) Debentures can be redeemed by payment in lump sum at the end of a specified period.
   (b) Debentures cannot be redeemed during the life time of the company.
   (c) Debentures can be redeemed by payments in annual instalments.

3) For debentures issued by unlisted companies (other than AIFIs, Banking companies, NBFCs and HFCs), Debentures Redemption reserve will be considered adequate if it is:
   (a) 25% of the value of debentures issued through public issue.
   (b) 10% of the value of debentures issued through public issue.
   (c) 5% of the value of debentures issued through public issue.

4) A company has issued 6% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company redeems ₹ 10,000 debentures at ₹ 96 (ex-interest) on 1st August 2021. The amount of Profit/loss on cancellation of debentures will be
   (a) Profit of ₹ 600
   (b) Profit of ₹ 400
   (c) Loss of ₹ 400

ANSWERS MCQs

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

TRUE / FALSE

State with reasons whether the following statement is true or false:

a) Amounts credited to the debenture redemption reserve may be utilised by the company for any purpose.
b) All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any Debenture Redemption Reserve (DRR).
c) Under payment in instalments method, the payment of entire debenture is made in one lot.
d) At redemption of debentures, DRR should be transferred to general reserve.

Solution

a) False: Amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose other than for redemption of debentures.
b) True: All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures need not create any DRR.
c) False: Under payment in instalments method, the payment of specified portion of debentures are made in instalments at specified intervals.
d) True: DRR is transferred to general reserve at the time of redemption of debentures.

HOMEWORK QUESTIONS

Question 1 *(RTP May 2020) / (RTP May 2021) / (RTP Nov 2023) (Similar)* Pg no._____

The following balances appeared in the books of Lakshya Ltd. as on 1-4-2021:

a) 10 % Debentures ₹ 37,50,000
b) Balance of DRR ₹ 1,25,000
c) DRR Investment 5,62,500 represented by 10% ₹ 5,625 Secured Bonds of the Government of India of ₹ 100 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2022, balance at bank was ₹ 37,50,000 before receipt of interest. Interest on Debentures had already been paid. The investment were realized at par for redemption of debentures at a premium of 10% on the above date.

Lakshya Ltd. is an unlisted company (other than AIFI, Banking company, NBFC and HFC). You are required to prepare Debenture Redemption Reserve Account, Debenture Redemption Reserve Investment Account and Bank Account in the books of Lakshya Ltd. for the year ended 31st March, 2022.

Question 2 Pg no._____

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31st, 2021,

6% Mortgage 25,000 Debentures of ₹ 100 each. Debenture Redemption Reserve (for redemption of debentures) ₹ 1,50,000.

DRR Investments ₹ 3,75,000 at 4% interest receivable on 31st December every year.

Bank Balance with the company ₹ 30,00,000.

The interest on debentures had been paid up to December 31st, 2021. On February 28th, 2022, the investments were sold at par and the debentures were paid off at ₹ 101 together with accrued interest. Write up the ledger accounts concerned.

Question 3 *(CA Inter Jan 2021) (8 Marks)* Pg no._____

During the year 2021-2022, A Limited (a listed company) made a public issue in respect of which the following information is available:

(i) No. of partly convertible debentures issued-1,00,000; face value and issue price ₹ 100 per debenture. (Whole issue was underwritten by X Ltd.)
(ii) Convertible portion per debenture -60%, date of conversion -on expiry of 6 months from the date of closing of issue.
(iii) Date of closure of subscription lists -1st May,2021, date of allotment – 1st June, 2021, rate of interest on debenture -15% p.a. payable from the date of allotment, value of equity share for the purpose of conversion – ₹ 60 (face value ₹ 10)
(iv) Underwriting Commission –2%
(v) No. of debentures applied for by public –80,000
(vi) Interest is payable on debentures half yearly on 30th September and 31st March each year.

Pass relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2022. (including cash and bank entries)

Question 4 *(CA Inter July 2021) (10 Marks)* Pg no._____

AB Limited (a listed company) recently made a public issue in respect of which the following information is available:

(i) No. of partly convertible 8% debentures issued 3,00,000; face value and issue price ₹ 100 per debenture.

(ii) Convertible portion per debenture- 60%, date of conversion- on expiry of 7 months from the date of closing of issue.
(iii) Date of closure of subscription lists 1-5-2020, date of allotment 1-6-2020, rate of interest on debenture 8% payable from the date of allotment, market value of equity share as on date of conversion ₹ 60 (Face Value ₹ 10).
(iv) Underwriting Commission 1%
(v) No. of debentures applied for 2,50,000.
(vi) Interest payable on debentures half-yearly on 30th September and 31st March.

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2021 (including cash and bank entries).

Question 5 *(CA Inter Dec 2021) (5 Marks)* Pg no._____

A Company had issued 25,000, 12% Debentures of ₹ 100 each on 1st April, 2018. The Debentures were due for redemption on 1st July, 2020. The terms of issue of Debentures provided that they will be redeemable at a premium of 5% and also conferred option to convert 20% of their holding into equity Shares (Nominal value ₹ 10 each) at a price of ₹ 20 per share. Debenture holders holding 5,000 Debentures did not exercise the option. Calculate the number of Equity shares to be allotted to the debenture holders exercising the option to the maximum.

Question 6 *(CA Inter Nov 2019) (5 Marks)* Pg no._____

A company had issued 40,000, 12% debentures of ₹100 each on 1st April, 2018. The debentures are due for redemption on 1st March, 2022. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (nominal value ₹10) at a predetermined price of ₹15 per share and the payment in cash. 50 debentures holders holding totally 5,000 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders and the amount to be paid in cash on redemption.

Question 7 *(ICAI Study Material) / (RTP May 2022) (Similar)* Pg no._____

The Balance Sheet of BEE Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2023 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
	Total		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
	Total		5,55,000

Notes to Accounts

	Particulars		₹
1.	Share Capital		
	Authorised share capital:		3,00,000
	30,000 shares of ₹ 10 each fully paid		
	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 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.

Question 8 *Pg no._____*

Mention the ways by which Redeemable Debentures may be redeemed under the Companies Act, 2013.

Question 9 *(CA Inter May 2023) (5 Marks)* *Pg no._____*

On 1st April, 2018 Improvis Limited issued ₹ 75,000, 9% Debentures of ₹ 100 each at a premium of 5%. The Debentures are redeemable at 10% premium on 31.03.2023, Investment as required by law was made in Fixed Deposit of Bank on 30.04.2022 earning interest @8% p.a.

You are required to pass Journal Entries for the year 2022-2023 related to Investment and Redemption of the Debentures.

ACCOUNTING TERMINOLOGY

CH 12

"Do not dwell in the past, Do not dream of the future, Concentrate the mind on the present moment."

Acceptance	The drawee's signed assent on bill of exchange, to the order of the drawer. This term is also used to describe a bill of exchange that has been accepted.
Accounting policies	Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.
Accrual	Recognition of revenues and costs as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments.
Accrual/ Mercantile Basis of Accounting	The method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue. The 'accrual basis of accounting' includes considerations relating to deferrals, allocations, depreciation and amortisation. This basis is also referred to as mercantile basis of accounting.
Accrued Asset	A developing but not yet enforceable claim against another person which accumulates with the passage of time or the rendering of service or otherwise. It may arise from the rendering of services (including the use of money) which at the date of accounting have been partly performed, and are not yet billable.
Accrued Expense	An expense which has been incurred in an accounting period but for which no enforceable claim has become due in that period against the enterprise. It may arise from the purchase of services (including the use of money) which at the date of accounting have been only partly performed, and are not yet billable.
Accrued Liability	A developing but not yet enforceable claim by another person which accumulates with the passage of time or the receipt of service or otherwise. It may arise from the purchase of services (including the use of money) which at the date of accounting have.
Accrued Revenue	Revenue which has been earned in an accounting period but in respect of which no enforceable claim has become due in that period by the enterprise. It may arise from the rendering of services (including the use of money) which at the date of accounting have been partly performed, and are not yet billable.
Accumulated Depletion	The total to date of the periodic depletion charges on wasting assets.
Accumulated Depreciation	The total to date of the periodic depreciation charges on depreciable assets.
Advance	Payment made on account of, but before completion of, a contract, or before acquisition of goods or receipt of services.
Amortisation	The gradual and systematic writing off of an asset or an account over an appropriate period

Amortised Value	The amortizable amount less any portion already provided by way of amortization.
Annual Report	The information provided annually by the management of an enterprise to the owners and other interested persons concerning its operations and financial position. It includes the information statutorily required, e.g., in the case of a company, the balance sheet, profit & loss statement & notes on accounts, auditor's report thereon, and the report of the Board of Directors. It also includes other information voluntarily provided e.g., value added statement, graphs, charts, etc.
Appropriation Account	An account sometimes included as a separate section of the profit and loss statement showing application of profits towards dividends, reserves, etc.
Assets	Tangible objects or intangible rights owned by an enterprise and carrying probable future benefits.
Authorised Share Capital	The number and par value, of each class of shares that an enterprise may issue in accordance with its instrument of incorporation. This is sometimes referred to as nominal share capital.
Average Cost	The cost of an item at a point of time as determined by applying an average of the cost of all items of the same nature over a period. When weightages are also applied in the computation, it is termed as weighted average cost.
Bad Debts	Debts owed to an enterprise which are considered to be irrecoverable.
Balance Sheet	A statement of the financial position of an enterprise as at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values.
Bill of Exchange	An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only, to or to the order of a certain person or to the bearer of the instrument.
Bonus Shares	Shares allotted by capitalization of the reserves or surplus of a corporate enterprise
Book Value	The amount at which an item appears in the books of account or financial statements. It does not refer to any particular basis on which the amount is determined e.g., cost, replacement value, etc.
Borrowing costs	Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.
Bond/Debenture	A formal document constituting acknowledgment of a debt by an enterprise usually given under its common seal and normally containing provisions regarding payment of interest, repayment of principal and security, if any. It is transferable in the appropriate manner.
Call	A demand pursuant to terms of issue to pay a part or whole of the balance remaining payable on shares or debentures after allotment.
Called-up Share Capital	That part of the subscribed share capital which shareholders have been required to pay.
Capital	Generally refers to the amount invested in an enterprise by its owners e.g. paid-up share capital in a corporate enterprise. It is also used to refer to the interest of owners in the assets of an enterprise.
Capital Assets	Assets, including investments not held for sale, conversion or consumption in the ordinary course of business.
Capital Commitment	Future liability for capital expenditure in respect of which contracts have been made.

Capital Employed	The finances deployed by an enterprise in its net fixed assets, investments and working capital. Capital employed in an operation may, however, exclude investments made outside that operation.
Capital Profit/ Capital Loss	Excess of the proceeds realised from the sale, transfer, or exchange of the whole or a part of a capital asset over its cost. When the result of this computation is negative, it is referred to as capital loss.
Capital Reserve	A reserve of a corporate enterprise which is not available for distribution as dividend.
Capital Work-in-progress	Expenditure on capital assets which are in the process of construction or completion.
Cash	Cash comprises cash on hand and demand deposits with banks
Cash equivalents	Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
Cash Basis of Accounting	The method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.
Cash Discount	A reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period.
Cash Profit	The net profit as increased by non-cash costs, such as depreciation, amortization, etc. When the result of the computation is negative, it is termed as cash loss.
Carrying amount	Carrying amount is the amount at which an asset is recognized in the balance sheet, net of any accumulated amortization and accumulated impairment losses thereon.
Charge	An encumbrance on an asset to secure an indebtedness or other obligations. It may be fixed or floating.
Cheque	A bill of exchange drawn upon a specified banker and not expressed to be payable otherwise than on demand.
Collateral Security	Security which is given in addition to the principal security against the same liability or obligation.
Costs of disposal	Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.
Conservatism	Conservatism states that the accountant should not anticipate any future income however they should provide for all possible losses. When there are many alternative values of an asset, an accountant should choose the method which leads to the lesser value.
Contingency	A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.
Contingent Asset	An asset the existence, ownership or value of which may be known or determined only on the occurrence or non-occurrence of one or more uncertain future events.
Contingent Liability	An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events.
Contra Account	One or two or more accounts which partially or wholly off-set another or other accounts.

Cost	The amount of expenditure incurred on or attributable to a specified article, product or activity.
Cost of Purchase	The purchase price including duties and taxes, freight inwards and other expenditure directly attributable to acquisition, less trade discounts, rebates, duty drawbacks, and subsidies in respect of such purchase.
Cost of Goods Sold	The cost of goods sold during an accounting period. In manufacturing operations, it includes (i) cost of materials; (ii) labour and factory overheads; selling and administrative expenses are normally excluded.
Conversion Cost	Cost incurred to convert raw materials or components into finished or semi-finished products. This normally includes costs which are specifically attributable to units of production, i.e., direct labour, direct expenses and subcontracted work, and production overheads as applicable in accordance with either the direct cost or absorption costing method. Production overheads exclude expenses which relate to general administration, finance, selling and distribution.
Convertible Debenture	A debenture which gives the holder a right to its conversion, wholly or partly, in shares in accordance with the terms of issue.
Cumulative Dividend	A dividend payable on cumulative preference shares which, if unpaid, accumulates as a claim against the earnings of a corporate enterprise, before any distribution is made to the other shareholders
Cumulative Preference Shares	A class of preference shares entitled to payment of cumulative dividends. Preference shares are always deemed to be cumulative, unless they are expressly made non-cumulative.
Current Assets	Cash and other assets that are expected to be converted into cash or consumed in the production of goods or rendering of services in the normal course of business.
Current Liability	Liability including loans, deposits and bank overdraft which falls due for payment in a relatively short period, normally not more than twelve months.
Deferral	Postponement of recognition of a revenue or expense after its related receipt or payment (or incurrence of a liability) to a subsequent period to which it applies. Common examples of deferrals include prepaid rent and taxes, unearned subscriptions received in advance by newspapers & magazine selling company, etc
Deficiency	The excess of liabilities over assets of an enterprise at a given date. The debit balance in the profit and loss statement.
Deficit	The debit balance in the profit and loss statement.
Depletion	A measure of exhaustion of a wasting asset represented by periodic write off of cost or other substituted value.
Depreciation	Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.
Depreciable amount	Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in financial statements, less estimated residual value.

Depreciable assets	Depreciable assets are assets which (i) are expected to be used during more than one accounting period; and (ii) have a limited useful life; and (iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.
Depreciation Method	Any method of calculating depreciation for an accounting period.
Depreciation Rate	A percentage applied to the historical cost or the substituted amount of a depreciable asset (or in case of diminishing balance method, the historical cost or the substituted amount less accumulated depreciation).
Diminishing Balance Method	A method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as written down value method.
Discount	A reduction from a list price, quoted price or invoiced price. It also refers to the price for obtaining payment on a bill before its maturity.
Dividend	A distribution to shareholders out of profits or reserves available for this purpose.
Entity Concept	The view of the relationship between the accounting entity and its owners which regards the entity as a separate person, distinct and apart from its owners.
Equity Share	A share which is not a preference share. Also sometimes called ordinary share
Exchange difference	Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.
Expenditure	Incurring a liability, disbursement of cash or transfer of property for the purpose of obtaining assets, goods or services.
Expense	A cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period.
Expired Cost	That portion of an expenditure from which no further benefit is expected. Also termed as expense.
Extraordinary items	Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.
Fair Market Value	The price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.
First In, First Out (FIFO)	Computation of the cost of items sold or consumed during a period as though they were sold or consumed in order of their acquisition.
First Charge	A charge having priority over other charges.
Fixed asset	Asset held with intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

Fixed Cost	That cost of production which by its very nature remains relatively unaffected in a defined period of time by variations in the volume of production.
Fixed Deposit	Deposit for a specified period and at specified rate of interest.
Fixed or Specific Charge	A charge which attaches to a particular asset which is identified when the charge is created, and the identity of the asset does not change during the subsistence of the charge.
Floating Charge	A general charge on some or all assets of an enterprise which are not attached to specific assets and are given as security against a debt.
Financial Instrument	A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise
Foreign currency	Foreign currency is a currency other than the reporting currency of an enterprise.
Forfeited Share	A share to which title is lost by a member for non-payment of call money or default in fulfilling any engagement between members or expulsion of members where the articles specifically provide therefor.
Free Reserve	A reserve the utilization of which is not restricted in any manner.
Functional Classification	A system of classification of expenses and revenues and the corresponding assets and liabilities to each function or activity, rather than by reference to their nature.
Fund	An account usually of the nature of a reserve or a provision which is represented by specifically earmarked assets.
Fundamental Accounting Assumptions	Basic accounting assumptions which underlie the preparation and presentation of financial statements. They are going concern, consistency & accrual. Usually, they are not specifically stated because their acceptance & use are assumed. Disclosure is necessary if they are not followed.
Gain	A monetary benefit, profit or advantage resulting from a transaction or group of transactions.
General Reserve	A revenue reserve which is not earmarked for a specific purpose.
Going Concern Assumption	An accounting assumption according to which an enterprise is viewed as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.
Goodwill	An intangible asset arising from business connections or trade name or reputation of an enterprise.
Gross Margin or Gross Profit	The excess of the proceeds of goods sold and services rendered during a period over their cost, before taking into account administration, selling, distribution and financing expenses. When the result of this computation is negative it is referred to as gross loss.
Government	Government refers to government, government agencies and similar bodies whether local, national or international.
Government grants	Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Gross book value	Gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value.
Income and Expenditure Statement	A financial statement, often prepared by non-profit making enterprises like clubs, associations etc. to present their revenues and expenses for an accounting period & to show the excess of revenues over expenses (or vice versa) for that period. It is similar to profit & loss statement & is also called revenue and expense statement.
Intangible Asset	Asset which does not have a physical identity e.g. goodwill, patents, copyright etc.
Inventories	Inventories are assets: (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services.
Investment	Expenditure on assets held to earn interest, income, profit or other benefits
Investments	Assets held not for operational purposes or for rendering services i.e. assets other than fixed assets or current assets (e.g. securities, shares, debentures, immovable properties).
Issued Share Capital	That portion of the authorized share capital which has actually been offered for subscription. This includes any bonus shares allotted by the corporate enterprise.
Joint venture	A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.
Last In, First Out (LIFO)	Computation of the cost of items sold or consumed during a period on the basis that the items last acquired were sold or consumed first.
Liability	The financial obligation of an enterprise other than owners' funds.
Lien	Right of one person to satisfy a claim against another by holding or retaining possession of that other's assets/property.
Long-term Liability	Liability which does not fall due for payment in a relatively short period, i.e., normally a period not more than twelve months.
Lease	A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
Materiality	An accounting concept according to which all relatively important and relevant items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements are disclosed in the financial statements
Mortgage	A transfer of interest in specific immovable property for the purpose of securing a loan advanced, or to be advanced, an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability. The security is redeemed when the loan is repaid or the debt discharged or the obligations performed.
Net Assets/ Shareholders' funds/ Net Worth	The excess of the book value of assets (other than fictitious assets) of an enterprise over its liabilities. This is also referred to as net worth or shareholders' funds.

Net Fixed Assets	Fixed assets less accumulated depreciation thereon up-to-date.
Net Profit/Net loss	The excess of revenue over expenses during a particular accounting period. When the result of this computation is negative, it is referred to as net loss. The net profit may be shown before or after tax.
Net realizable value	Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale
Obsolescence	Diminution in the value of an asset by reason of its becoming out-of date or less useful due to technological changes, improvement in production methods, change in market demand for the product or service output of the asset, or legal or other restrictions.
Operating Profit	The net profit arising from the normal operations and activities of an enterprise without taking account of extraneous transactions and expenses of a purely financial nature.
Paid-up Share Capital	That part of the subscribed share capital for which consideration in cash or otherwise has been received. This includes bonus shares allotted by the corporate enterprise.
Preference Share Capital	That part of the share capital of a corporate enterprise which enjoys preferential rights in respect of payments of fixed dividend and repayment of capital. Preference shares may also have full or partial participating rights in surplus profits or surplus capital.
Preliminary Expenses	Expenses relating to the formation of an enterprise. These include legal, accounting and share issue expenses incurred for formation of the enterprise.
Prepaid Expense	Payment for expense in an accounting period, the benefit for which will accrue in the subsequent accounting period(s).
Prime Cost	The total cost of direct materials, direct wages and other direct production expenses.
Prior Period Item	Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.
Profit/Loss	A general term for the excess of revenue over related cost. When the result of this computation is negative it is referred to as loss.
Profit and Loss Account	A financial statement which presents the revenues and expenses of an enterprise for an accounting period and shows the excess of revenues over expenses (or vice versa). It is also known as profit and loss account.
Promissory Note	An instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.
Provision	An amount written off or retained by way of providing for depreciation or diminution in value of assets or retained by way of providing for any known liability the amount of which cannot be determined with substantial accuracy.
Provision for Doubtful Debts	A provision made for debts considered doubtful of recovery.
Prudence	A concept of care and caution used in accounting according to which (in view of the uncertainty attached to future events) profits are not

	anticipated, but recognised only when realised, though not necessarily in cash. Under this concept, provision is made for all known liabilities and losses, even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.
Redeemable Preference Share	The preference share that is repayable either after a fixed or determinable period or at any time decided by the management (by giving due notice), under certain conditions prescribed by the instrument of incorporation or the terms of issue.
Redemption	Repayment as per given terms normally used in connection with preference shares and debentures.
Reserve	The portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability. The reserves are primarily of two types: capital reserves and revenue reserves.
Revaluation Reserve	A reserve created on the revaluation of assets or net assets of an enterprise represented by the surplus of the estimated replacement cost or estimated market values over the book values thereof.
Residual value	Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.
Revenue/ Income	Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them.
Revenue Reserve	Any reserve other than a capital reserve
Right Share	An allotment of shares on the issue of fresh capital by a corporate enterprise to which a shareholder is entitled on payment, by virtue of his holding certain shares in the enterprise in proportion to the number of shares already held by him.
Sales Turnover / Gross Turnover / Gross Sales	The aggregate amount for which sales are effected or services rendered by an enterprise. The terms gross turnover and net turnover are sometimes used to distinguish sales aggregate before & after deduction of returns and trade discounts.
Secured Loan	Loan secured wholly or partly against an asset.
Share Capital	Aggregate amount of money paid or credited as paid on the shares and/ or stocks of a corporate enterprise.
Share Discount	The excess of the face value of shares over their issue price.
Shareholders' Equity	The interest of the shareholders in net assets of a corporate enterprise. However, in case of liquidation it is represented by residual assets after meeting prior claims.
Share Issue Expenses	Costs incurred in connection with the issue and allotment of shares. These include legal and professional fees, advertising expenses, printing costs, underwriting commission, brokerage, and also expenses in connection with the issue of prospectus and allotment of shares.

Share warrants	Share warrants or options are financial instruments that give the holder the right to acquire equity shares.
Securities Premium	The excess of the issue price of shares over their face value.
Sinking Fund	A fund created for the repayment of a liability or for the replacement of an asset.
Straight Line Method	The method under which the periodic charge for depreciation is computed by dividing the depreciable amount of a depreciable asset by the estimated number of years of its useful life.
Subscribed Share Capital	That portion of the issued share capital which has actually been subscribed and allotted. This includes any bonus shares allotted by the corporate enterprise.
Substance over Form	An accounting concept according to which the substance and not merely the legal form of transactions and events governs their accounting treatment and presentation in financial statements.
Creditors / Trade Creditors / Trade payables	Amount owed by an enterprise on account of goods purchased or services received or in respect of contractual obligations. Also termed as trade creditors or account payables or Trade payables.
Sundry Debtors / Trade Debtors / Receivables	Person from whom amounts are due for goods sold or services rendered or in respect of contractual obligations. Also termed as debtors, trade debtors, account receivables, trade receivables.
Surplus	Credit balance in the profit and loss statement after providing for proposed appropriations, e.g., dividend or reserves
Trade Discount	A reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment
Unexpired Cost	That portion of an expenditure whose benefit has not yet been exhausted.
Unissued Share Capital	That portion of the authorised share capital for which shares have not been offered for subscription.
Unpaid Dividend	Dividend which has been declared by a corporate enterprise but has not been paid, or the warrant or cheque in respect whereof has not been dispatched within the prescribed period.
Useful life	Useful life is either (i) the period over which depreciable asset is expected to be used by enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise

PRACTICE QUESTIONS

TRUE / FALSE

State with reasons whether the following statement is true or false:

1. The drawer's signed assent on bill of exchange, to the order of the drawee is called an acceptance:
2. That portion of an expenditure whose benefit has been exhausted is called Unexpired Expenditure.
3. Accrual basis of accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.
4. Authorised Share capital is sometimes referred to as nominal share capital.
5. Fixed assets less interest on obligations undertaken to purchase asset less accumulated depreciation thereon up-to-date are called Net Fixed Assets.
6. The credit balance in the profit and loss statement is called a deficit.

Solution

1. False: The drawee's signed assent on bill of exchange, to the order of the drawer. This term is also used to describe a bill of exchange that has been accepted.
2. False: Unexpired Cost - That portion of an expenditure whose benefit has not yet been exhausted.
3. False: Cash Basis of Accounting is the method of recording transactions by which revenues and costs and assets and liabilities are reflected in the accounts in the period in which actual receipts or actual payments are made.
4. True: Authorised share capital is number and par value of each class of shares that an enterprise may issue in accordance with its instrument of incorporation and is sometimes referred as nominal share capital.
5. False: Net Fixed Assets - Fixed assets less accumulated depreciation thereon up-to-date.
6. False: The debit balance in the profit and loss statement is deficit.

Question 1 ***(CA Foundation Jan 2021) (4 Marks)*** *Pg no._____*

Define the following terms:

(i) Capital Commitment
(ii) Expired Cost
(iii) Floating Charge
(iv) Obsolescence

Solution

(i) Capital commitment: Future liability for capital expenditure in respect of which contracts have been made.

(ii) Expired cost: The portion of the expenditure from which no further benefit is expected. Also termed as expense.

(iii) Floating charge: A general charge on some or all assets of an enterprise which are not attached to the specific assets and are given as security against a debt.

(iv) Obsolescence: Diminution in the value of an asset by reason of its becoming out-of-date or less useful due to technological changes, improvement in production methods, change in market demand for the product or service output of the asset, legal or other restrictions.

Question 2 *(CA Foundation Dec 2021) (4 Marks)* *Pg no.*_____

Explain the followings:
(i) Accrual Basis of Accounting (ii) Amortisation (iii) Contingent Assets (iv) Contingent Liabilities

Solution

1. Accrual Basis of Accounting: The method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue.
2. Amortisation: The gradual and systematic writing off of an asset or an account over an appropriate period.
3. Contingent Asset: An asset the existence, ownership or value of which may be known or determined only on the occurrence or non-occurrence of one or more uncertain future events.
4. Contingent Liability: An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events.

Question 3 *(CA Foundation June 2023) (4 Marks)* *Pg no.*_____

Briefly explain the following terms:

a. Materiality
b. Conservatism
c. Extraordinary item
d. Floating Charge

Solution

a. Materiality refers to all relatively important and relevant items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements are disclosed in the financial statements.
b. Conservatism states that the accountant should not anticipate any future income however they should provide for all possible losses. When there are many alternative values of an asset, an accountant should choose the method which leads to the lesser value.
c. Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.
d. Floating charge is a general charge on some or all assets of an enterprise which are not attached to specific assets and are given as security against a debt.

Paper 1: ACCOUNTING (New Scheme)

S. No.	Weightage	Chapters
1	5% - 10%	Theoretical Framework • Meaning and Scope of Accounting • Accounting concepts, principles and conventions • Capital & revenue expenditure, receipts. • Contingent assets and Contingent liabilities • Accounting policies • Accounting as a measurement discipline • Accounting Standards - concepts & objectives.
2	30% - 35%	Accounting Process Journal, Ledger, Subsidiary books, Cash Book, Trial balance, Rectification of errors
3		Bank Reconciliation Statement
4		Inventories
5		Depreciation and Amortisation
6		Bills of exchange and Promissory notes
7	20% - 25%	Preparation of Final accounts of Sole Proprietors
8		Financial Statements of Not-for-Profit Organizations
9		Accounts from Incomplete Records *(Newly added from Inter)*
10	15% - 20%	Partnership and LLP Accounts • Final Accounts of partnership firms and LLPs • Treatment of Goodwill • Admission of Partner • Retirement and Death of a partner • Dissolution of Firms and LLPs *(Newly added from Inter)*
11	15% - 25%	Company Accounts • Introduction to Company Accounts • Issue of Shares, forfeiture & re-issue • Issue of Debentures • Accounting for Bonus & Right issue. *(Newly added from Inter)* • Redemption of Preference shares *(Newly added from Inter)* • Redemption of Debentures *(Newly added from Inter)*
S. No.		Chapters Deleted
1		Consignment Accounts
2		Average Due Date
3		Account Current
4		Sale of Goods on Approval or Return Basis

WEIGHTAGE IN PAST YEAR EXAMS

	MAY 18	NOV 18	MAY 19	NOV 19	NOV 20	JAN 21	JULY 21	DEC 21	JUNE 22	DEC 22	JUNE 23
Theoretical Framework	4	4	4	4	4	4	4	4	4	4	4
Accounting Process	4+10	10	4	5+10	4+5	10	5+5 +10	5+5 +5	4+5	5+10	4
Bank Reconciliation Statement	10	10	10	10	10	4	5	10	5	10	5
Inventories	-	-	5	5	10	5	5	4	5	-	5
Depreciation	-	4	10	4	5	10	4	5	10	4+5	10
Bills of Exchange	-	-	5	-	10	-	-	10	-	15	5
Final Accounts of Sole Proprietors	20	5	10	10+5	10+5	5	10+5	15	20	10	-
Not for Profit Organisation	-	10	10	10	10	10+10	10	10	10	10	15
Accounts from Incomplete Records	-	15	12	10	10	10	10	5	12	10	10
Partnership	10	15	10+5	10+ 15+5	10	5+10	10+5	5+10 +5	5+10 +15	5+10	5+20 +5
Company Accounts	10+5 +10	10+5 +5	10+5 +10	15+ 5+5	10+ 5+12	15+5 +12	15+5 +10	15+5	15+5	15+5	15+5 +5