STUDY MATERIAL

CSEET

FUNDAMENTALS OF ACCOUNTING

PAPER 2

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Phones :

011-45341000 / 0120-4522000

Website :

www.icsi.edu

E-mail :

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FUNDAMENTALS OF ACCOUNTING

Accounting is called the "universal language of business" because it provides a standardized method for communicating a company's financial information to various stakeholders like shareholders, regulators, customers, employees, banks and the public at large nationally as well as globally. This communication is vital for decision-making, performance evaluation, and managing a business's daily functions successfully. Therefore, in today's globalized economy, accounting knowledge is crucial for everyone to navigate the complexities of the business world and understanding the company's survival and success.

Especially all business students should have some background in accounting to understand, interpret and present the results of business. Keeping this objective in alignment, this study material is prepared to augment the basic understanding of students in the related Aspects of Accounting.

The study material has been written in lucid and simple language and conscious efforts have been made to explain the Fundamental Concepts and Principles of Accounting. The basic objective is to develop an understanding of the basic concepts and principles of accounting and apply the same in preparing the Financial Statements of entities including non-corporate entities. The study material is committed to provide a framework for understanding discipline and describing the fundamental accounting concepts and conventions of the basic accounting systems.

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CSEET

Paper 2

FUNDAMENTALS OF ACCOUNTING

SYLLABUS

Objective:

- To familiarize and develop an understanding of the basic concepts of accounting and their principles.

Level of Knowledge: Basic Knowledge

1. **Basics Concept and Principles of Accounting -** Meaning and Scope of Accounting; Accounting Concepts; Accounting Principles, Accounting Policies; Accounting as a Measurement Discipline - Valuation Principles, Accounting Estimates, Fundamental Accounting Assumptions
2. **Accounting Process –** Book Keeping, difference between book-keeping and accounting, Double entry system of accounting, Debit & Credit, Recording of Business Transactions, Journals, subsidiary books, Cash Books, Ledgers and Trial Balance; Rectification of Errors
3. **Bank Reconciliation Statement –** Meaning; Causes of difference between Bank Book Balance and Balance as per Bank Pass Book /Bank Statement; Need of Bank Reconciliation Statement; Preparation of Bank Reconciliation Statement
4. **Depreciation and Amortization –** Meaning and differences between depreciation and amortization, Methods of calculating depreciation; Accounting Treatment of Depreciation (Straight line and Diminishing Balance Method); Change in Methods of Depreciation and its Treatment
5. **Preparation of Final Accounts for Sole Proprietorship –** Preparation of Trading and Profit & Loss Account; Balance Sheet, closing and year end adjustment entries
6. **Partnership and LLP Accounts –** Meaning and Nature of Goodwill, Factors Affecting Goodwill; Methods of Valuation- Average Profit, Super Profit and Capitalization Methods; Treatment of Goodwill; Final Accounts of Partnership Firms- Admission of a Partner, Change in the Profit-Sharing Ratio among the existing partners, Retirement, Death of a Partner, Dissolution of a Partnership Firm
7. **Introduction to Company Accounts –** Issues of Shares and Debentures; Forfeiture of Shares; Re-issue of Forfeited Shares; Redemption of Preference Shares; Redemption of Debentures
8. **Accounting for Non-Profit Organizations –** Receipt and Payment Accounts; Income and Expenditure Accounts, Difference between Receipt & Payment Account and Income & Expenditure Account, Balance Sheet of Non-Profit Organization

ARRANGEMENT OF STUDY LESSONS
FUNDAMENTALS OF ACCOUNTING
PAPER 2

Sl. No.	Lesson Title
1.	Basics Concept and Principles of Accounting
2.	Accounting Process
3.	Bank Reconciliation Statement
4.	Depreciation and Amortization
5.	Preparation of Final Accounts for Sole Proprietorship
6.	Partnership and LLP Accounts
7.	Introduction to Company Accounts
8.	Accounting for Non-Profit Organizations

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Basic Concepts and Principles of Accounting

Lesson 1

KEY CONCEPTS

■ Accounting ■ Book Keeping ■ Accounting Concepts ■ Accounting Principles ■ Accounting Conventions ■ Fundamental Accounting Assumptions ■ Accounting Policies ■ Accounting Estimates ■ Accounting Standard

Learning Objectives

To understand:

Accounting is a very old concept – as old as money. A description of proper keeping of accounts is also found in 'Arthashastra" written by Kautilya. However, it has developed with the passage of time to meet the requirements and challenges of ever – growing society. The modern-day accounting concept based on double entry system was originated by Luca Pacioli in Italy. Though the act of accounting is very old, in recent times it has acquired special significance because of rapidly growing economy, cut-throat competition, expanding markets, increasing production and changes in technology.

In this lesson, we will throw light on the basic concepts of accounting, types of accounts, accounting principles, conventions, concepts & standards etc.

Lesson Outline

- Introduction to Accounting
- Historical Development of Accounting
- Meaning and Significance of Accounting
- Scope of Accounting
- Objectives of Accounting
- Bookkeeping
- Subfield of Accounting
- Users of Accounting Information
- Relationship of Accounting with other Discipline
- Limitation of Accounting
- Role of Company Secretary in Accounting and related areas
- Accounting Concepts
- Accounting Principles
- Accounting Conventions
- Fundamental Accounting Assumptions
- Financial Statements
- Components of Financial Statements
- Qualitative Characteristics of Financial Statements
- Accounting Policies
- Selection of Accounting Policies
- Changes in Accounting Policies
- Impact of Change in Accounting Policies
- Measurement
- Objects and Events to be measured in Accounting
- Dimensions of Measurement Scale
- Valuation Principles in Accounting
- Accounting Estimates
- Introduction to Accounting Standards
- Objectives of Accounting Standards
- Process of Formulation of Accounting Standards in India
- Lesson Roundup
- Test Yourself
- List of Further Readings

INTRODUCTION TO ACCOUNTING

Meaning of Accounting

Accounting is often described as the *language of business* because it communicates financial information in a structured and meaningful way. Every organisation — from a shopkeeper to a multinational company — needs to keep track of money coming in, money going out, and the value of what it owns and owes.

In essence, accounting involves:

1. **Identifying** – Spotting transactions that have a financial effect.
2. **Measuring** – Expressing them in monetary terms.
3. **Recording** – Entering them systematically in the books.
4. **Communicating** – Presenting them in financial statements so that users can make decisions.

Example: If a clothing store buys fabric for Rs. 50,000, sells garments for Rs. 80,000, and pays Rs. 10,000 in rent, accounting will record each step, calculate the profit, and present it in a profit & loss statement.

Evolution of Accounting as a Social Science

Understanding Accounting as a Social Science

When we hear the term *"social science"*, we usually think of subjects like sociology, political science, or economics. These study human behaviour in groups, societies, and institutions. Surprisingly, **accounting** also falls into this category — not because accountants are sociologists in disguise, but because accounting:

- **Shapes human decisions** – Investors decide whether to invest, governments decide how much tax to collect, and creditors decide whether to lend— all based on accounting reports.
- **Reflects society's economic activities** – The way we record and report financial transactions depends on the culture, laws, and economic systems we live in.
- **Promotes transparency and trust** – Just like rules in a game keep it fair, accounting rules ensure businesses play fair with money.

Key points:

- It's **normative** (guided by rules & standards such as IFRS, Ind AS).
- It's **empirical** (based on actual financial transactions).
- It impacts **resource allocation** in society.

HISTORICAL DEVELOPMENT OF ACCOUNTING

Ancient Civilizations:

- **Mesopotamia (circa 3500 BCE)** – Clay tablets recorded trade and taxes.
- **Egypt** – Used papyrus for recording grain storage and state revenues.
- **India** – The "Bahi-Khata" (traditional ledger) used in kingdoms.
- **Greece & Rome** – Public funds and treasury records maintained for accountability.

Middle Ages:

- **Double Entry System (1494)** formalized by *Luca Pacioli*, known as the "Father of Accounting."

Industrial Revolution (18th–19th century):

- Increased scale of business ⟶ Need for cost accounting, managerial reporting, and auditing.

20th Century:

- Rise of corporate accounting, auditing standards, stock market regulation.
- GAAP, IFRS, and accounting bodies established.

21st Century:

- Accounting integrated with **technology** (ERP, AI, blockchain).
- Focus on sustainability (Integrated Reporting, ESG reporting).
- Greater role in governance and social responsibility.

MEANING AND SIGNIFICANCE OF ACCOUNTING

Meaning of Accounting

"Accounting is the process of identifying, measuring, recording, and communicating financial information to permit informed judgments and decisions by users of the information." – *American Accounting Association*

It involves:

- **Art**: It involves judgment, skill, and creativity in presenting financial information.
- **Recording**: Chronological documentation of financial transactions.
- **Classifying**: Systematic arrangement of transactions in ledgers.
- **Summarizing**: Preparing trial balances, profit & loss accounts, and balance sheets.
- **Interpreting**: Analysing the data to aid decision-making.

Scope of Accounting

The scope of accounting has evolved significantly, expanding beyond mere bookkeeping to strategic financial management.

1. **Recording of Transactions** – The systematic process of capturing all financial transactions in the books of original entry, such as journals or cash books, to ensure a complete and chronological record.
2. **Classification and Summarization** – Organising recorded transactions into relevant categories by posting them to appropriate ledger accounts and then preparing summaries like the trial balance.
3. **Financial Reporting** – Preparing and presenting periodic financial statements, including the profit and loss account, balance sheet, and cash flow statement, to communicate the financial position and performance of the entity.
4. **Compliance with Laws and Standards** – Ensuring that the accounting process adheres to applicable legal requirements, such as the Companies Act and the Income Tax Act, as well as prescribed accounting standards (AS/Ind AS).
5. **Decision Support** – Supplying accurate and relevant financial data to assist management in planning, budgeting, performance evaluation, and strategic control.

6. **Safeguarding Assets** – Implementing proper record-keeping and internal control systems to prevent misuse, loss, or theft of the organisation's resources.
7. **Facilitating Auditing** – Maintaining clear and complete accounting records that enable auditors to verify the accuracy, completeness, and fairness of the financial statements.
8. **Assisting in Taxation** – Providing precise financial information to calculate taxable income and meet various tax obligations accurately and on time.

Significance of Accounting

1. **Decision-Making Tool for Management**

   Accounting provides managers with accurate financial data, enabling them to plan, budget, and control resources effectively. By analysing income, expenses, and cash flows, management can decide whether to launch new products, cut costs, expand operations, or enter new markets.

   Example: If a company's sales are growing but profits are declining, accounting data can help identify whether high expenses, poor pricing, or low productivity is the cause.

2. **Ensures Accountability to Shareholders and Society**

   Since shareholders are the real owners of a company, accounting ensures that they are informed about how their invested funds are being used. Transparent financial statements also reassure society that businesses are operating ethically and responsibly.

   Example: Annual reports disclose profits, dividends, CSR activities, and compliance with laws, allowing shareholders to assess management's performance.

3. **Compliance with Laws & Regulations**

   Every business must comply with statutory requirements such as the Companies Act, SEBI Listing Rules, and tax laws. Accounting ensures that books are maintained as per prescribed standards and that reports are filed on time, avoiding legal penalties.

   Example: Listed companies must prepare quarterly financial statements as per SEBI guidelines; proper accounting ensures that these reports meet regulatory standards.

4. **Facilitates Taxation and Government Planning**

   Governments rely on accounting records to assess taxes like GST, income tax, and corporate tax. Additionally, aggregated business data helps in policy formulation and economic planning.

   Example: A company's GST returns are based on its sales and purchase records; without accurate accounting, tax liability cannot be determined correctly.

5. **Performance Evaluation of Business**

   By comparing current results with past data or industry benchmarks, accounting helps evaluate efficiency, profitability, and financial health.

   Example: A hotel chain can use accounting reports to compare occupancy rates and profits of different branches, identifying which locations are performing best.

6. **Historical Record for Future References**

   Accounting creates a permanent record of all business transactions, which is useful for audits, resolving disputes, applying for loans, or strategic planning.

   Example: If a supplier disputes an old payment, the company can refer to past accounting records to prove that payment was made.

OBJECTIVES OF ACCOUNTING

1. **Recording Transactions** – Systematically documenting all financial events to maintain an accurate history.
2. **Determining Profit or Loss** – Calculating business results over a specific period through the Profit & Loss Account.
3. **Determining Financial Position** – Preparing the Balance Sheet to show assets, liabilities, and owner's equity.
4. **Providing Information to Users** – Supplying reliable data to investors, creditors, management, and regulators.
5. **Compliance with Laws** – Ensuring adherence to statutory requirements like the Companies Act, SEBI rules, and tax laws.
6. **Assisting in Decision-Making** – Helping management plan, control, and strategise using accounting reports.
7. **Safeguarding Assets** – Preventing misuse or loss of resources through proper records and internal controls.

Example: A retail store uses accounting not only to record daily sales but also to check monthly profits, plan inventory purchases, report taxes, and safeguard against theft.

BOOKKEEPING

Meaning of Bookkeeping

Bookkeeping is the **process of recording daily financial transactions** systematically in books of accounts. It is the **foundation** of accounting but not the entire accounting process.

Difference between Bookkeeping and Accounting

Basis	Bookkeeping	Accounting
Scope	Recording of transactions	Recording, classifying, summarizing, interpreting
Objective	Maintain accurate records	Provide meaningful financial information
Nature	Routine, clerical work	Analytical, interpretative
Decision-making	No role in decision-making	Assists in managerial decision-making
Stages	First stage in accounting cycle	Includes later stages like analysis and reporting
Skills Required	Basic knowledge	Professional judgment, analytical skills

SUBFIELDS OF ACCOUNTING

1. **Financial Accounting** – Preparation of financial statements for external users.
2. **Cost Accounting** – Recording, classification, and analysis of production costs.
3. **Management Accounting** – Providing internal reports to assist managerial decisions.
4. **Tax Accounting** – Preparing returns and tax planning.
5. **Auditing** – Independent examination of accounts.
6. **Forensic Accounting** – Investigating financial frauds.
7. **Environmental & Social Accounting** – Reporting on sustainability and social impact.
8. **Government Accounting** – Public sector revenue and expenditure recording.

USERS OF ACCOUNTING INFORMATION

External Users:

- Investors & Shareholders – for investment decisions.
- Creditors & Lenders – for creditworthiness assessment.
- Government – for tax and regulatory purposes.
- Public – for socio-economic information.

Internal Users:

- Management – for planning, control, and decision-making.
- Employees – for job security and performance evaluation.
- Trade Unions – for wage negotiations.

RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINES

Accounting & Mathematics

- Basic arithmetic and algebra used in calculations (totals, ratios, depreciation).
- No higher-level pure math needed, but accuracy is essential.

Accounting & Statistics

- Statistical tools used for trend analysis, forecasting, sampling in audits.

Accounting & Management

- Provides quantitative data for managerial planning, organizing, controlling.

Accounting & Law

- Must comply with Company Law, Tax Laws, SEBI regulations, etc.
- Legal framework dictates accounting disclosures.

Accounting & Economics

- Reflects and influences economic activities.
- Helps in economic policy formulation.

LIMITATIONS OF ACCOUNTING

1. **Historical Nature**

   Accounting primarily records past events and transactions. While this provides an accurate historical record, it may not reflect the current market value of assets or liabilities.

   > *Example:* A building purchased for Rs. 20 lakh in 2005 will still be shown at cost (minus depreciation) in the books, even if its current market value is Rs. 80 lakh. This can mislead stakeholders who want present-day values.

2. **Subjectivity in Estimates**

   Certain accounting entries depend on management's judgment or estimation, which may vary from one person to another. This subjectivity can affect the accuracy and comparability of accounts.

   > *Example:* Depreciation on machinery can be calculated using different methods (straight-line, written-down value). Provisions for doubtful debts also depend on the management's opinion about recoverability.

3. **Ignores Non-Monetary Factors**

   Accounting only records events measurable in monetary terms, ignoring qualitative aspects that can significantly affect a business.

   > *Example:* A company's skilled workforce, strong brand image, or high customer loyalty adds immense value but is not reflected in the balance sheet.

4. **Possibility of Manipulation**

   If management wishes, accounting data can be presented in a way that portrays a more favourable picture than reality — a practice known as *creative accounting*.

   > *Example:* A company might postpone recognising certain expenses or inflate revenue by recording sales before they are finalised to make profits look higher before a share issue.

5. **Inadequate for Inflation**

   Accounting generally follows the historical cost principle and does not automatically adjust for changes in purchasing power due to inflation. This can understate asset values and overstate profits.

   > *Example:* Inventory purchased two years ago for Rs. 50,000 may now cost Rs. 80,000 to replace, but accounts will still show the old cost unless adjusted.

6. **Static in Nature**

   Traditional accounting systems may not keep pace with rapidly changing business environments, technological advancements, or emerging financial practices.

   > *Example:* New-age digital businesses like app-based platforms may have revenue streams (e.g., cryptocurrency payments) that are not well-reflected in conventional accounting statements without updated standards.

ROLE OF A COMPANY SECRETARY IN ACCOUNTING AND RELATED AREAS

A Company Secretary (CS) plays a vital role in ensuring that the accounting function of an organisation operates within the framework of law, governance, and ethical business practices. While accountants focus on recording, analysing, and presenting financial data, the CS ensures that this information complies with statutory requirements, supports decision-making, and is communicated effectively to stakeholders. In **financial accounting**, the CS verifies that financial statements are prepared in accordance with the Companies Act, SEBI Listing Obligations and Disclosure Requirements (LODR), and applicable accounting standards like Ind AS or IFRS. For **cost accounting**, the CS works with cost accountants to ensure accurate cost reporting and, where required, facilitates statutory cost audits. In **management accounting**, the CS presents key financial information at board meetings, enabling directors to make informed strategic decisions. In the area of **tax accounting**, the CS oversees that tax returns are prepared and filed on time, ensuring compliance with Income Tax and GST laws. Similarly, during **auditing**, the CS liaises between statutory and internal auditors, addressing queries, and ensuring audit reports are submitted to the Registrar of Companies and other regulators.

As accounting has evolved, so has the role of the CS. In today's era of digital transformation and sustainability, the CS is deeply involved in **integrated reporting**, ESG disclosures, CSR reporting, and online compliance filing such as XBRL submissions. They ensure that both financial and non-financial data presented in annual reports meet statutory and stakeholder expectations. For example, if a manufacturing company is preparing its annual integrated report, the CS will coordinate with the finance team to ensure the profit figures match audited accounts, verify that environmental performance data meets ESG standards, and ensure the report is filed with the stock exchange in the correct format.

The CS also ensures that accounting output is useful to both **external users** like shareholders, lenders, and regulators, and **internal users** such as management and employees. They act as the bridge between the numbers and the people who rely on them. For instance, before a company issues new shares, the CS will ensure that the latest financial statements are accurate, approved by the board, and disclosed to the stock exchange, so potential investors can make informed decisions.

In relation to other disciplines, the CS plays a key role in integrating accounting with **law** by ensuring that disclosures comply with corporate, securities, and tax laws; with **management** by providing clear and concise financial summaries for planning and control; and with **economics** by interpreting financial results in the light of broader economic trends. A well-informed CS can even address some **limitations of accounting**, such as reducing manipulation risk by enforcing transparent disclosures, promoting fair value reporting to reflect inflation-adjusted values, and encouraging the inclusion of qualitative data like CSR impact to complement the purely monetary focus of traditional accounts.

> In essence, the CS ensures that accounting is not just a back-office record-keeping exercise, but a dynamic tool that serves governance, compliance, and strategic growth objectives.

ACCOUNTING CONCEPTS, PRINCIPLES, AND CONVENTIONS – AN OVERVIEW

Accounting is based on certain **concepts, principles, and conventions** that act like the "rules of the game." They ensure that financial statements are prepared consistently, comparably, and truthfully. Without these rules, every business could report in its own way, making it impossible to compare or rely on results.

Accounting Concepts (Basic Assumptions of Recording Transactions)

Accounting concepts are basic assumptions that guide how transactions are recorded and reported. They provide consistency and uniformity in financial reporting.

1. Business Entity Concept

- The business is regarded as separate and distinct from its owner(s).

- The owner's personal income, expenses, or property should not be mixed with the business accounts.
- This helps in knowing the true financial performance of the business itself.

> *Example:* If the owner uses Rs. 50,000 from business funds for personal needs, it is recorded as "Drawings" (reduction in owner's capital), not as a business expense.

2. Money Measurement Concept

- Only transactions that can be measured in money terms are recorded in books of accounts.
- Non-financial factors like employee skills, brand reputation, or work environment are not recorded, even though they may impact the business.

> *Example:* The company records Rs. 2,00,000 spent on staff training, but the actual knowledge/skills gained by employees are not recorded.

3. Going Concern Concept

- Assumes that the business will continue its operations indefinitely unless evidence suggests otherwise.
- Because of this assumption, assets are valued at cost less depreciation instead of liquidation (selling) value.

> *Example:* A company buys machinery for Rs. 10 lakh and depreciates it over 10 years, assuming it will keep operating during that time.

4. Accounting Period Concept

- The life of a business is continuous, but for reporting, it is divided into specific time periods (usually 1 year).
- This helps in comparing performance year by year.

> *Example:* A company prepares financial statements for 1st April 2024 to 31st March 2025, even though the business continues after that.

5. Dual Aspect Concept

- Every transaction has two aspects: one debit and one credit.
- This is the basis of the double-entry system, which ensures that the **Accounting Equation (Assets = Liabilities + Capital)** always balances.

> **Example:** Purchase of furniture worth Rs. 10,000 increases Assets (Furniture) and decreases Cash/Bank by the same amount.

6. Cost Concept

- Assets are recorded in the books at the price paid to acquire them, not at their current market value.
- This ensures objectivity and reliability.

> Example: A plot of land purchased in 2010 for Rs. 5 lakh is still shown at Rs. 5 lakh (minus depreciation, if applicable) even if its current market price is Rs. 50 lakh.

7. Realisation (Revenue Recognition) Concept

- Revenue should be recorded only when it is earned, not just when cash is received.
- Ensures profits are not overstated.

> Example: If a company sells goods on credit worth Rs. 1,00,000, the sale is recorded immediately even if the cash will be received after 2 months.

8. Matching Concept

- Expenses should be matched with the revenue of the same accounting period.
- Helps in calculating the true profit or loss.

> *Example:* If a company sells goods worth Rs. 10,00,000 in 2024, the cost of producing those goods (say Rs. 7,00,000) must also be recorded in 2024, not later.

9. Accrual Concept

- Income and expenses are recorded when they are earned or incurred, not when cash is received or paid.
- This gives a true picture of financial performance.

> Example: Rent for March payable in April is recorded as an expense in March itself.

Accounting Principles (Rules Derived from Concepts)

1. Consistency Principle

- Once a business adopts an accounting method (e.g., for depreciation or stock valuation), it should use the same method every year.
- This ensures comparability across years.

  Note: A change in method is allowed only if it makes financial statements more accurate or relevant, but it must be disclosed.

2. Conservatism (Prudence) Principle

- "Anticipate no profits, but provide for all possible losses."
- Assets and income should not be overstated, and liabilities or expenses should not be understated.

  Example: Closing stock is valued at *Cost or Market Price, whichever is lower*. If stock costs Rs. 1,00,000 but the market value has fallen to Rs. 80,000, it will be shown at Rs. 80,000.

3. Full Disclosure Principle

- All material and relevant information must be disclosed in financial statements.
- Ensures transparency and prevents misleading of stakeholders.

  Note: Disclosures are usually made in the "Notes to Accounts." For example, contingent liabilities like pending court cases must be disclosed.

4. Materiality Principle

- Only information that is significant and influences decision-making needs detailed recording and disclosure.
- Insignificant items can be grouped or written off to simplify records.

  Example: Stationery worth Rs. 500 used in a year is expensed immediately instead of being shown as an asset.

5. Objectivity Principle

The **Objectivity Principle** states that all accounting transactions should be recorded **based on verifiable and reliable evidence**, rather than personal opinion or bias of the accountant or management.

This ensures that the financial statements are:

- **Reliable** – Users can trust the information.
- **Free from personal judgment** – Minimises manipulation.
- **Comparable** – Since evidence is the same for all.

Example

1. If a company purchases machinery worth Rs. 10,00,000, the accountant records it in the books **based on the supplier's invoice and payment receipt**.
   - Evidence-based ⟶ Objective
   - Not just management's word "we bought machinery worth Rs. 10,00,000."
2. If an employee claims to have spent Rs. 5,000 for office supplies but provides **no bill**, the expense cannot be recorded. Only when the bill is submitted does the expense become valid in accounting.

Accounting Conventions

- **Conservatism** – Anticipate no profits but provide for all possible losses.
- **Consistency** – Maintain uniformity in accounting methods over time.
- **Disclosure** – Important information must be clearly stated in reports.
- **Materiality** – Ignore trivial items but disclose significant facts.

Fundamental Accounting Assumptions

As per Indian Accounting Standards (Ind AS) and Generally Accepted Accounting Principles (GAAP), there are three **fundamental accounting assumptions**:

1. **Going Concern**
   - Assumes the business will continue in the foreseeable future.
   - *Example:* Assets like plant and machinery are depreciated over several years, not valued at liquidation price.
2. **Consistency**
   - The same accounting methods are applied from one period to another to enable comparison.
   - *Example:* If a company uses straight-line depreciation, it should continue unless a change is justified.
3. **Accrual**
   - Transactions are recorded when they occur, not when cash is received or paid.
   - *Example:* Salaries payable at year-end are shown as expense even if payment is made later.

FINANCIAL STATEMENTS

Financial statements are the final outcome of accounting. They provide a summary of the financial performance and position of a business.

Components of Financial Statements

1. **Profit and Loss Account (Income Statement)** – Shows revenue, expenses, and profit/loss for a period.
2. **Balance Sheet (Statement of Financial Position)** – Shows assets, liabilities, and owner's equity at a given date.
3. **Cash Flow Statement** – Shows inflows and outflows of cash under operating, investing, and financing activities.
4. **Notes to Accounts** – Provide additional disclosures, policies, and explanations.

Qualitative Characteristics of Financial Statements

1. **Understandability**
   - Financial information should be presented in a simple, clear, and structured manner so that even users without deep accounting knowledge (like small investors or employees) can interpret it.
   - Complex data should be classified into meaningful categories.

   Example: In an **Income Statement**, revenue from the main business (say, sales of products) is shown separately from *non-operating income* (like interest earned or profit from selling machinery). This separation helps users clearly understand the *core business performance*.

2. **Relevance**
   - Information is relevant if it helps users make economic decisions, such as investing, lending, or managing resources.
   - Irrelevant or outdated information can mislead and must be avoided.

   Example: A company discloses its **contingent liabilities** (e.g., a pending court case worth Rs. 50 crore). This information is highly relevant for investors, because if the case is lost, it will affect future profits and financial stability.

3. **Reliability**
   - Information should be accurate, verifiable, unbiased, and based on documentary evidence.
   - Users must be able to trust that the figures shown are correct and not manipulated.

   Example: Inventory is valued at cost or market price (whichever is lower) and supported by **physical stock counts and purchase invoices**. This ensures the reported figure is not inflated, making it reliable for decision-making.

4. **Comparability**
   - Financial statements should be prepared in such a way that results can be compared:
     1. **Over time** (Year-to-Year comparison within the same company).
     2. **Across companies** (Industry peers).

- This requires **consistency in accounting policies** (e.g., depreciation method, stock valuation).

> **Example:** If a company uses the **Straight-Line Method (SLM)** for depreciation in 2021, it should continue in later years. This allows investors to compare profit figures across years. Similarly, when two companies in the same industry use the same depreciation method, their results can be compared fairly.

ACCOUNTING POLICIES

Accounting Policies are the **set of specific principles, bases, conventions, rules, and practices** a business adopts in preparing and presenting its financial statements. These policies guide how transactions are recognized, measured, recorded, and disclosed.

They bring **uniformity and comparability** to financial reporting, but companies may adopt **different policies** based on their size, industry, management preferences, and legal requirements.

> **Example:**
>
> - Suppose both **Company A** and **Company B** purchase machinery for Rs. 10 lakh.
> - Company A uses the **Straight-Line Method (SLM)** for depreciation, charging equal depreciation every year.
> - Company B uses the **Written Down Value (WDV)** method, charging higher depreciation in earlier years and lower in later years.
> - Both follow valid accounting methods, but the reported profits differ because of their **accounting policy choice**.
>
> This shows that **accounting policies affect how profits, assets, and liabilities are presented**.

Selection of Accounting Policies

When management selects accounting policies, they should ensure the policies present the company's accounts in a manner that is **fair, true, and useful** to stakeholders.

1. **Reflect a True and Fair View**

   - The selected policy should present a correct picture of the company's financial health and performance without manipulation or bias.
   - This helps stakeholders (investors, creditors, government, employees) make correct decisions.
   - If land purchased in 2005 for Rs. 10 lakh is now worth Rs. 2 crore, showing it at historical cost may not reflect a true and fair view. In such cases, companies may adopt **revaluation**.

   > **Example:**
   >
   > A company must decide whether to value fixed assets at **historical cost** (original purchase price) or **fair value** as per applicable regulatory standards.

2. **Follow Prudence (Conservatism)**

   - The policy should avoid overstating income or assets and must make provisions for possible losses.

- This protects users from being misled by inflated figures.

Example:

When valuing closing stock:

- If cost = Rs. 1,00,000 but market value = Rs. 80,000, the stock should be recorded at Rs.**80,000**.
- This ensures that future losses are considered in advance, but future profits are not recorded until they are actually realized.

3. Ensure Materiality

- Materiality means giving importance only to items that are significant enough to influence decisions.
- Small, insignificant items can be recorded in a simplified manner.

Example:

- A calculator worth Rs. 500 or office pen worth Rs. 50 need not be capitalized as assets. They are treated as **expenses immediately**.
- This saves time and makes records more practical, without losing accuracy for big-ticket items.

4. Promote Consistency

- Once a policy is selected, it should be followed consistently from year to year.
- Consistency ensures comparability across different accounting periods.
- A change in policy should be made only when it leads to more reliable or relevant information.

Example:

If a company adopts the **WDV method** of depreciation, it should continue in subsequent years.

- If the company switches to SLM without reason, it would distort year-to-year comparisons.
- However, if industry standards or new accounting laws require the change, it can be done but must be **fully disclosed in notes to accounts**.

5. Comply with Laws and Standards

- The accounting policy must align with statutory requirements like the **Companies Act, Income Tax Act, SEBI guidelines**, and Accounting Standards (AS / Ind AS / IFRS).
- Compliance ensures that the company is legally sound and trusted by regulators and investors.

Example:

Ind AS 16 (Property, Plant, and Equipment) provides guidelines for depreciation and asset valuation.

- If a company deviates from this, its accounts may not be legally accepted.
- Thus, policies must comply with **Ind AS / IFRS**, ensuring transparency and uniformity.

Changes in Accounting Policies

Accounting policies should generally remain consistent. However, they may be changed under the following conditions:

1. **Required by Law or Standards:** When a new law or accounting standard mandates a change.

   Example: Adoption of **Ind AS** (Indian Accounting Standards) required companies to shift from Indian GAAP.

2. **Better Presentation of Financial Statements:** When the change results in more accurate or relevant information.

   Example: A company earlier using historical cost method for investments shifts to fair value method for better reflection of market conditions.

3. **For Compliance with Industry Practice:** To align with industry norms and ensure comparability with peers.

   Example: A company in the IT sector may adopt revenue recognition policies similar to its competitors to provide better comparability for investors.

Impact of Change in Accounting Policies

- A change can affect **profit, asset values, and liabilities**.
- Companies must **disclose the nature, reason, and financial impact** of the change in the financial statements (as per AS 1 / Ind AS 8).

Example:

If a company shifts from SLM to WDV method of depreciation:

- Depreciation expense will increase in early years (lower profits).
- This must be clearly disclosed in Notes to Accounts.

MEASUREMENT

Measurement means **assigning numbers to objects, events, or attributes according to rules**, so that they can be compared, recorded, and communicated. In accounting, **measurement involves quantifying economic events and resources in monetary terms**.

Example:

- Buying machinery for Rs. 10, 00,000 ⟶ measured in terms of money.
- Providing employee training (value of knowledge gained) ⟶ cannot be measured in money, hence not recorded.

Objects and Events to be measured in Accounting

Accounting is essentially a system of **measurement** — it measures and records the **financial position** and **performance** of a business. For this purpose, two things need to be measured:

1. **Objects (Resources/Assets)**
2. **Events (Transactions/Activities)**

1. Objects (Resources / Assets to be measured)

- Objects are the **things owned or controlled by the business**, which have economic value and can be expressed in monetary terms.
- These are usually resources that will bring **future economic benefits**.
- They are listed in the **Balance Sheet** under assets.

Examples of Objects:

- **Land & Building** ⟶ Land for factory premises, office buildings.
- **Machinery & Equipment** ⟶ Machines used in production.
- **Furniture & Fixtures** ⟶ Office tables, chairs, shelves.
- **Patents, Trademarks, Copyrights** ⟶ Intangible assets providing competitive advantage.
- **Stock/Inventory** ⟶ Raw materials, work-in-progress, and finished goods.
- **Cash & Bank Balances** ⟶ most liquid form of asset.

Illustration:

- A company owns a **factory building worth Rs. 2 crore and machinery worth Rs. 1 crore.**
- Both are measured in monetary terms and appear in the Balance Sheet as **objects of measurement**.

2. Events (Transactions / Activities to be measured)

- Events are the **economic activities or financial transactions** that affect the financial position of a business.
- These are actions/events that bring a **change in the value of assets, liabilities, or income/expenses**.
- They are reflected in the **Profit & Loss Account (income statement)** or in adjustments to assets and liabilities.

Examples of Events:

- **Sales** ⟶ Selling products worth Rs. 50,000 generates revenue.
- **Purchases** ⟶ Buying raw materials worth Rs. 30,000 creates an expense or stock.
- **Rent Paid** ⟶ Monthly rent of Rs. 10,000 reduces cash and creates an expense.
- **Salaries/Wages Paid** ⟶ Rs. 1,00,000 salary expense decreases profits.
- **Depreciation** ⟶ A non-cash expense that reduces the value of machinery.
- **Tax Liability** ⟶ Income tax payable to the government.

Illustration:

- A company sells goods worth **Rs. 50,000** ⟶ This is an **event** that increases revenue.
- Paying **electricity bill of Rs. 5,000** ⟶ This is an **event** that reduces profit.

Key Difference Between Objects and Events

Basis	Objects (Assets/Resources)	Events (Transactions/Activities)
Meaning	Things the business owns/controls	Actions that affect business finances
Examples	Land, building, machinery, patents, stock	Sales, purchases, salaries, rent, depreciation
Nature	Static – they exist over time	Dynamic – they occur frequently
Shown in	Balance Sheet (Assets)	Profit & Loss A/c or adjustments

Standards and Scale of Measurement

- To measure consistently, we need a **standard unit**.
- In accounting, the standard is **money** (, $, €).
- **Scale of measurement** ensures uniformity (e.g., rupees in India, dollars in USA).

Example:

If a company owns land in India (Rs. 50 lakh) and the USA ($200,000), both are first recorded in their local currency but later converted to the reporting currency (say, INR) for financial reporting.

Dimensions of Measurement Scale

Accounting measurement is not just about money, but also about **time** and **value changes**.

Time Dimension: Transactions are recorded for a particular period (e.g., monthly, yearly).

Example: Rent for April is accounted in April, not in March.

Value Dimension: Assets and liabilities can be valued differently based on chosen principles.

Example: A building bought for Rs. 10 lakh in 2005 may be valued today at Rs. 50 lakh (market value) or kept at Rs. 10 lakh minus depreciation (historical cost).

Accounting as a Measurement Discipline

Accounting is often called a **measurement discipline** because it measures business resources, obligations, and performance in monetary terms. It provides numerical information that helps in decision-making, planning, and control.

Example:

- Assets = Rs. 50 crore, Liabilities = Rs. 30 crore ⟶ Net Worth = Rs. 20 crore.
- Profit for the year = Rs. 5 crore ⟶ This measurement helps investors assess performance.

VALUATION PRINCIPLES IN ACCOUNTING

Valuation refers to the **basis on which assets and liabilities are measured**. The main valuation principles are:

1. **Historical Cost Principle:** Assets are recorded at purchase cost.

   Example: Land purchased for Rs. 10 lakh in 2000 is still shown at Rs. 10 lakh, even if today's value is Rs. 1 crore.

2. **Fair Value Principle**: Assets and liabilities are reported at current market value.

   Example: Investments bought at Rs. 1,00,000 but currently worth Rs. 1,20,000 are shown at Rs. 1,20,000.

3. **Realizable Value Principle**: Assets are valued at the amount they can fetch if sold today.

   Example: Stock worth Rs. 5,00,000 at cost, but realizable at only Rs. 4,50,000, is valued at Rs. 4,50,000.

4. **Present Value Principle**: Liabilities are valued at the present value of future cash outflows.

   Example: Loan repayment of Rs. 1,00,000 after 2 years is discounted to present value at current interest rate.

MEASUREMENT AND VALUATION IN ACCOUNTING

1. Measurement

- Measurement means **assigning numerical values (in money terms)** to resources (assets, liabilities) and events (transactions).
- It answers the question: **"How much?"**
- Without measurement, accounts cannot be recorded or compared.

Example:

- A company buys **machinery worth Rs. 5,00,000**. Recording "Machinery = Rs. 5,00,000" is the **measurement** process.
- Similarly, if a company pays **Rs.50,000 salary**, that transaction is measured and recorded as **salary expense** = **Rs. 50,000**.

2. Valuation

- Valuation means **deciding the basis on which the measurement is made**.
- Since values change over time, accountants need to decide whether to record at **historical cost, fair value, market value, or net realizable value (NRV)**.
- It answers the question: **"On what basis is the amount measured?"**

Example (Stock/Inventory):

- Closing stock worth Rs. 1,00,000 (cost).
- NRV = Rs. 90,000.

As per **prudence principle**, stock is valued at **lower of cost or NRV** = Rs. 90,000.

Example (Machinery):

- Machinery purchased for **Rs. 5,00,000** in 2018.
- In 2024, its market value is **Rs.7,00,000**.
  - If recorded at **purchase price (historical cost)** ⟶ value in books remains Rs. 5,00,000.
  - If recorded at **revalued amount (market price)** ⟶ shown at Rs. 7,00,000.

  The difference lies in **valuation basis**.

ACCOUNTING ESTIMATES

- Not everything in accounting can be measured with **100% accuracy**.
- Some figures are uncertain and depend on **judgment, assumptions, and experience**.
- Such approximations are called **Accounting Estimates**.

Common Items Requiring Estimates:

1. **Depreciation of Assets** –
   - Useful life of machinery (10 years or 12 years) is an estimate.
   - Example: Machinery cost Rs. 5,00,000, estimated life = 10 years ⟶ Depreciation = Rs. 50,000 per year.
   - If later life is reassessed as 12 years, depreciation = Rs. 41,667 per year.
2. **Provision for Bad Debts** – Out of Rs. 10,00,000 receivables, the company estimates 5% may not be recovered ⟶ Provision = Rs. 50,000.
3. **Warranty Liabilities** –
   - A company selling electronics estimates 2% of sales may require warranty service.
   - If sales = Rs. 5,00,000 ⟶ Provision = Rs. 10,000.
4. **Obsolescence of Inventory** – Fashion retailer estimates 10% of stock may go unsold.
5. **Fair Value Estimates** – Investments in shares are shown at market value, which fluctuates daily and must be estimated at reporting date.

Common accounting estimates

1. **Depreciation of assets** – estimated useful life of machinery.
2. **Provision for doubtful debts** – estimation of how many customers may default.
3. **Warranty expenses** – estimated future cost of servicing products sold.
4. **Provisions for taxation** – estimated tax liability before final assessment.

Example:

- A company has debtors of Rs. 10,00,000. Based on past experience, it estimates that 2% may not be recoverable.
- It creates a provision of Rs. 20,000 as **bad debt expense** – this is an accounting estimate.

INTRODUCTION TO ACCOUNTING STANDARDS

- Accounting Standards (AS) are **written policy documents** issued by regulatory bodies that provide guidelines on how financial statements should be prepared and presented.
- They bring **uniformity, transparency, and comparability** in financial reporting.
- In India, Accounting Standards were initially issued by the **Institute of Chartered Accountants of India (ICAI)** and later notified by the **Ministry of Corporate Affairs (MCA)** under the Companies Act.
- For companies following IFRS-converged standards, **Indian Accounting Standards (Ind AS)** are applicable.

> **Example:**
>
> If two companies buy the same type of machinery, one may record it at historical cost and another at revalued price. Without standards, their financial statements would not be comparable. Accounting Standards remove such inconsistencies.

Objectives of Accounting Standards

1. **Uniformity in Accounting Practices**: Ensure consistency across industries and companies. Example: AS-2 prescribes how to value inventories, so all companies follow the same rule (Cost or NRV, whichever is lower).
2. **Transparency and Comparability**: Financial statements should be easily compared across years and with other companies.
3. **Reliability of Financial Statements**: Users can trust that figures are prepared without manipulation.
4. **Protection of Stakeholders**: Safeguards the interests of investors, creditors, and regulators.
5. **True and Fair View**: Ensure that statements reflect the actual performance and position of the business.

Benefits of Accounting Standards

- Brings **uniformity** in preparation of accounts.
- Increases **comparability** across industries and time.
- Provides **reliability** to investors, creditors, and other users.
- Ensures **compliance with law** and global practices.
- Facilitates **better decision-making** by management.
- Helps in **global integration** of financial reporting (especially with Ind AS/IFRS).

Limitations of Accounting Standards

- Cannot cover all possible situations – business complexities may need judgment.
- Sometimes **rigid** – reduces flexibility for unique industries.
- Implementation may involve **high cost** (system upgrades, training).
- Differences between **local laws and global standards** may create confusion.
- Too much reliance may reduce management's **professional judgment**.

Process of Formulation of Accounting Standards in India

1. **Identification of the area** – ICAI identifies an area where a standard is needed.
2. **Constitution of Study Group** – Experts study the issue and draft a proposal.
3. **Preparation of Exposure Draft** – Draft standard prepared and circulated for comments.
4. **Public Feedback** – Stakeholders, industry bodies, and regulators provide input.
5. **Finalization by ASB (Accounting Standards Board of ICAI)** – Incorporates suggestions.
6. **Approval by Council of ICAI** – Sent to **National Financial Reporting Authority (NFRA)/MCA** for notification.
7. **Implementation** – Once notified, it becomes mandatory.

List of Accounting Standards (AS) in India

(As per ICAI, for non-Ind AS entities)

1. AS 1: Disclosure of Accounting Policies
2. AS 2: Valuation of Inventories
3. AS 3: Cash Flow Statements
4. AS 4: Contingencies and Events Occurring After Balance Sheet Date
5. AS 5: Net Profit or Loss for the Period, Prior Period Items, and Changes in Accounting Policies
6. AS 6: Depreciation Accounting (withdrawn, now covered under AS 10)
7. AS 7: Construction Contracts
8. AS 9: Revenue Recognition
9. AS 10: Property, Plant, and Equipment
10. AS 11: The Effects of Changes in Foreign Exchange Rates
11. AS 12: Accounting for Government Grants
12. AS 13: Accounting for Investments
13. AS 14: Accounting for Amalgamations
14. AS 15: Employee Benefits
15. AS 16: Borrowing Costs
16. AS 17: Segment Reporting
17. AS 18: Related Party Disclosures
18. AS 19: Leases
19. AS 20: Earnings Per Share
20. AS 21: Consolidated Financial Statements
21. AS 22: Accounting for Taxes on Income

22. AS 23: Accounting for Investments in Associates
23. AS 24: Discontinuing Operations
24. AS 25: Interim Financial Reporting
25. AS 26: Intangible Assets
26. AS 27: Financial Reporting of Interests in Joint Ventures
27. AS 28: Impairment of Assets
28. AS 29: Provisions, Contingent Liabilities and Contingent Assets

List of Ind AS (Indian Accounting Standards – IFRS Converged)

- Ind AS 1: Presentation of Financial Statements
- Ind AS 2: Inventories
- Ind AS 7: Statement of Cash Flows
- Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors
- Ind AS 10: Events after the Reporting Period
- Ind AS 12: Income Taxes
- Ind AS 16: Property, Plant, and Equipment
- Ind AS 19: Employee Benefits
- Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance
- Ind AS 21: The Effects of Changes in Foreign Exchange Rates
- Ind AS 23: Borrowing Costs
- Ind AS 24: Related Party Disclosures
- Ind AS 27: Separate Financial Statements
- Ind AS 28: Investments in Associates and Joint Ventures
- Ind AS 29: Financial Reporting in Hyper inflationary Economies
- Ind AS 32: Financial Instruments – Presentation
- Ind AS 33: Earnings per Share
- Ind AS 34: Interim Financial Reporting
- Ind AS 36: Impairment of Assets
- Ind AS 37: Provisions, Contingent Liabilities, and Contingent Assets
- Ind AS 38: Intangible Assets
- Ind AS 40: Investment Property
- Ind AS 41: Agriculture
- Ind AS 101: First time adoption of Ind AS

- Ind AS 102: Share Based Payment
- Ind AS 103: Business Combination
- Ind AS 104: Insurance Contracts
- Ind AS 105: Non-Current Assets Held for Sales and Discontinued Operations
- Ind AS 106: Exploration for and Evaluation of Mineral Resources
- Ind AS 107: Financial Instruments: Disclosures
- Ind AS 108: Operating Segments
- Ind AS 109: Financial Instruments
- Ind AS 110: Consolidated Financial Statements
- Ind AS 111: Joint Arrangements
- Ind AS 112: Disclosure of Interests in Other Entities
- Ind AS 113: Fair Value Measurement
- Ind AS 114: Regulatory Deferral Accounts
- Ind AS 115: Revenue from Contracts with Customers
- Ind AS 116: Leases

LESSON ROUNDUP

- **Meaning of Accounting** – Systematic process of identifying, measuring, recording, and communicating financial transactions.
- **Evolution of Accounting as Social Science** – Developed from record-keeping in ancient times ⟶ Luca Pacioli's double entry ⟶ Corporate regulation ⟶ Today's IFRS/Ind AS + technology-driven systems.
- **Objectives of Accounting** – Recording, classifying, summarizing, reporting, compliance, decision-making, safeguarding assets.
- **Significance of Accounting** – Accountability, legal compliance, taxation, performance evaluation, decision support.
- **Limitations of Accounting** – Historical cost, subjectivity, ignores qualitative factors, risk of manipulation, static nature.
- **Accounting Concepts** – Business Entity, Money Measurement, Going Concern, Accounting Period, Dual Aspect, Cost, Realisation, Matching, Accrual.
- **Accounting Principles** – Consistency, Prudence, Full Disclosure, Materiality, Objectivity.
- **Accounting Policies** – Principles & practices selected by management (e.g., depreciation method, inventory valuation).
- **Fundamental Accounting Assumptions** – Going Concern, Consistency, Accrual.
- **Measurement & Valuation** – Assigning monetary values; choosing basis (historical cost, fair value, NRV).

- **Accounting Estimates** – Approximation in uncertain items (depreciation, provisions, warranties).
- **Accounting Standards & Ind AS** – Issued by ICAI; ensure uniformity, comparability, reliability; AS for small/medium firms, Ind AS converged with IFRS.

TEST YOURSELF

True/False Questions

1. Accounting assumes that business and owner are the same entity. (False)
2. Depreciation is an example of accounting estimate. (True)
3. Prudence principle requires recognition of all profits as soon as they are expected. (False)
4. Valuation and measurement in accounting are identical. (False)
5. Going concern assumption means business will continue in foreseeable future. (True)
6. Accounting Standards in India are issued by ICAI. (True)
7. Inventory is valued at market price only. (False – lower of cost or NRV).

Multiple Choice Questions (MCQs)

Q1. Which of the following is NOT a fundamental accounting assumption?

(a) Going Concern

(b) Consistency

(c) Matching Concept

(d) Accrual

Answer: **(c) Matching Concept**

Q2. "Stock is valued at cost or NRV, whichever is lower" is based on:

(a) Consistency principle

(b) Prudence principle

(c) Accrual concept

(d) Dual aspect concept

Answer: **(b) Prudence principle**

Q3. If the owner withdraws cash for personal use, it is recorded as:

(a) Expense

(b) Drawings

(c) Liability

(d) Asset

Answer: **(b) Drawings**

Q4. Which of the following is an accounting estimate?

(a) Cash in hand

(b) Provision for doubtful debts

(c) Purchase of land

(d) Issued capital

Answer: **(b) Provision for doubtful debts**

Q5. Which body issues Ind AS in India?

(a) MCA (Ministry of Corporate Affairs)

(b) RBI

(c) ICAI

(d) SEBI

Answer: **(a) MCA** (on recommendation of ICAI & NFRA)

Theoretical Questions

1. Define accounting. Explain its scope and objectives with examples.
2. Discuss the **evolution of accounting** from ancient to modern times.
3. Explain in detail the **Accounting Concepts** with illustrations.
4. Differentiate between **Bookkeeping and Accounting**.
5. What are **Accounting Principles**? Explain consistency, conservatism, and full disclosure.
6. Explain the term **Accounting Policies**. What factors should be considered while selecting them?
7. What do you mean by **Fundamental Accounting Assumptions**? Why are they important?
8. Discuss the significance and limitations of accounting.
9. Explain **Qualitative Characteristics of Financial Statements** with examples.
10. What is the need for **Accounting Standards**? Discuss their benefits and limitations.

Practical / Application-Based Questions

Q1. A machine is purchased for Rs. 10,00,000 with an expected life of 10 years and no residual value. Calculate depreciation under SLM. If life is later revised to 12 years, recalculate.

Ans: Rs. 1,00,000 p.a. originally; revised = Rs. 83,333 p.a.

Q2. A firm has debtors of Rs. 5,00,000. It estimates 5% will be irrecoverable. Create provision for doubtful debts.

Ans: Rs. 25,000 provision for doubtful debts.

Q3. Closing stock = Cost Rs. 2,00,000; NRV Rs. 1,80,000. Show valuation in balance sheet.

Ans: Valued at Rs. 1,80,000 (lower of cost/NRV).

Q4. Distinguish between historical cost and fair value measurement by taking the case of land purchased in 2015 for Rs. 10 lakh, with a market value of Rs. 25 lakh in 2024.

Ans: Historical cost = Rs. 10 lakh; Fair value = Rs. 25 lakh.

Q5. Identify the accounting concept or principle violated in each case:

(a) Recording owner's personal expenses as business expenses.

(b) Changing depreciation method frequently.

(c) Not disclosing contingent liability in financial statements.

Ans: (a) Business Entity, (b) Consistency, (c) Full Disclosure.

Q6. Historical Cost vs Current Cost

ABC Ltd. purchased a machine on **1st April, 2012** for Rs. 8,00,000 and spent Rs. 1,00,000 on its installation. On **31st March, 2022**, the current market price of the same machine is Rs. 22,00,000.

(a) What is the **historical cost** of the machine on March 31, 2022?

(b) What is the **current cost** of the machine on March 31, 2022?

Ans: (a) ₹9,00,000 (b) ₹22,00,000.

Q7. Realisable Value

A company purchased a machine for Rs. 7,00,000 on 1st January, 2015. On 31st March, 2022, a similar machine costs Rs. 20,00,000. However, if the company sells the machine today, it can realize only Rs. 14,00,000.

(a) At what value will the machine be shown under the **historical cost principle** on March 31, 2022?

(b) At what value will the machine be shown under the **realisable value principle** on March 31, 2022?

Ans: (a) ₹7,00,000 (b) ₹14,00,000.

Q8. Present Value (Discounting Future Cash Flows)

A machine is expected to generate **cash inflows of Rs. 1,00,000 each year for 5 years**. The appropriate discount rate is **10% p.a.** Calculate the **present value** of the machine.

(Hint: Use PV of annuity formula)

Q9. Accounting Estimates – Change in Useful Life

XYZ Ltd. purchased a machine for Rs. 10,00,000 in 2019 with an expected useful life of **10 years** and no residual value. The company uses **Straight Line Method (SLM)**. After 3 years, due to technological changes, the machine is now expected to last only **3 more years**.

Calculate **annual depreciation**:

(a) As per original estimate.

(b) As per revised estimate (from 2022 onwards).

Q10. Provision for Doubtful Debts

A company has **debtors of Rs.5,00,000** at year-end. Based on past experience, 5% of debtors are likely to turn into bad debts.

- Pass the **adjusting entry** for provision.
- Show how **net debtors** will be presented in the Balance Sheet.

Accounting Process

Lesson 2

KEY CONCEPTS

■ Accounting Process ■ Double Entry System ■ Journal ■ Ledger ■ Trial Balance ■ Rectification of Error ■ Cash Book

Learning Objectives

Accounting process involves identification and analysis of financial transactions. These transactions are recorded, classified and summarised in a systematic manner to provide useful information. Thus, accounting process starts with the recording of business transactions in monetary terms, in the primary books of accounts. For recording business transactions, it is necessary that these transactions are evidenced by proper source documents like cash memoes, purchase bills, sales bills, couterfoils of cheques issued, salary slips etc. From these source documents, transactions are recorded in the books of accounts which is the first and major step in accounting. It is the basis of accounting as entire future process would depend upon this recording of transactions. In this lesson, we will know about recording transactions in primary book journal proper and other subsidiary books, posting in ledger and then preparation of counter foils of trial balance.

Lesson Outline

- Introduction
- Accounting Process
- Double Entry System
- Meaning of Accounts
- Types of Accounts
- Real Accounts
- Personal Accounts
- Nominal Accounts
- Rules of Debit and Credit
- Journal
- Ledger
- Difference between Journal and Ledger
- Subsidiary Books
- Types of Subsidiary Books
- Purchases Book
- Sales Book
- Purchases Returns Book
- Sales Returns Book
- Bills Receivable Book
- Bills Payable Book
- Journal Proper
- Cash Book
- Petty Cash Book
- Trial Balance
- Features of Trial Balance
- Objectives of Trial Balance
- Methods of Preparing of Trial Balance
- Rectification of Errors
- Types of Error
- Lesson Round Up
- Test Yourself

INTRODUCTION

Accounting is regarded as the **systematic language of business**, and this chapter lays the foundation for understanding how financial information is generated, processed, and communicated. Every business, regardless of size or sector, engages in a wide variety of transactions – purchases, sales, expenses, and incomes – that must be accurately recorded for proper financial control. Professionals study the accounting process because it teaches the structured approach of moving from simple bookkeeping – where transactions are merely recorded – to accounting, where the same information is analyzed, classified, and summarized into useful financial statements. This ensures that decisions taken by managers, investors, creditors, and regulators are based on reliable and standardized information. Moreover, the study of concepts like the double entry system, debit and credit rules, and types of accounts (personal, real, and nominal) builds the intellectual discipline needed to trace how every transaction has two aspects and how this balance sustains the integrity of financial reporting.

Beyond the theoretical framework, this chapter also emphasizes the **practical application of accounting tools** such as journals, subsidiary books, ledgers, cash books, and trial balances. These instruments serve as checkpoints to ensure accuracy and act as the backbone of the financial system of an organization. For professionals, knowing how to post entries into ledgers, balance accounts, and rectify errors is not merely an academic exercise but a practical skill that ensures transparency, reduces the risk of fraud, and facilitates compliance with legal and regulatory requirements. Furthermore, mastering these processes enhances analytical abilities – helping professionals identify trends, prepare budgets, and support strategic decision-making. Thus, studying this chapter is not only essential for accountants but also for managers, consultants, and financial analysts who must rely on accurate financial information to guide businesses toward growth and sustainability.

ACCOUNTING PROCESS

ACCOUNTING PROCESS		
BOOK-KEEPING		ACCOUNTING

↓

DIFFERENCE BETWEEN BOTH

↓

DOUBLE ENTRY SYSTEM		
TYPES OF ACCOUNTS (Personal, Real, Nominal)		DEBIT & CREDIT

↓

RULES OF DEBIT & CREDIT

↓

RECORDING OF BUSINESS TRANSACTIONS		
JOURNALS	SUBSIDIARY BOOKS	CASH BOOKS

↓

LEDGERS

↓

TRIAL BALANCE

↓

RECTIFICATION OF ERRORS		
BEFORE TRIAL BALANCE	AFTER TRIAL BALANCE	NEXT PERIOD

DOUBLE ENTRY SYSTEM

The **Double Entry System** of accounting is the most scientific and widely used method of recording business transactions.

It is based on the principle: "Every transaction has two aspects – a giving aspect and a receiving aspect – and both should be recorded."

For example: If a business purchases goods worth 10,000 in cash,

- Goods are received (one aspect)
- Cash is paid (other aspect)

Thus, every transaction affects **at least two accounts**.

Significance

- Ensures mathematical accuracy of accounts.
- Provides complete information about financial position.
- Facilitates preparation of Trial Balance, Profit & Loss A/c, and Balance Sheet.
- Universally accepted and reliable for auditing.

MEANING OF ACCOUNT

An **Account** is a systematic record of all transactions relating to a person, asset, liability, expense, or income in summarized form.

Example:

If a firm purchases and pays for goods from **Ram**, then in *Ram's Account* all transactions relating to Ram will be recorded (both credit and debit sides).

Classification of Accounts

Accounts are broadly classified into three categories:

(A) Real Accounts

Relating to assets and properties.

- **Tangible Assets**: Cash, Furniture, Building, Machinery.
- **Intangible Assets**: Goodwill, Patents, Trademarks.

> **Rule:**
>
> Debit what comes in, Credit what goes out.

(B) Personal Accounts

Relating to persons or entities.

- **Natural Persons**: Ram, Sita, Mohan.
- **Artificial Persons**: Companies, Banks, Institutions.
- **Representative Personal Accounts**: Outstanding Salary, Prepaid Rent, Accrued Income.

> **Rule:**
>
> Debit the Receiver, Credit the Giver.

(C) Nominal Accounts

Relating to expenses, losses, incomes, and gains.

- Examples: Rent, Commission, Salary, Interest, Discount.

> **Rule:**
>
> Debit all Expenses & Losses, Credit all Incomes & Gains.

Utility of Classification & Sub-classification

- Helps in **easy identification** of accounts.
- Simplifies the **application of debit-credit rules**.
- Facilitates preparation of financial statements.
- Avoids confusion and errors in recording transactions.
- Sub-classification (Tangible/Intangible, Natural/Artificial/Representative) further improves clarity.

RULES OF DEBIT AND CREDIT

Type of Account	Debit (Dr.)	Credit (Cr.)
Real Account	What comes in	What goes out
Personal Account	Receiver	Giver
Nominal Account	All expenses & losses	All incomes & gains

JOURNAL

The **Journal** is the book of prime entry where transactions are recorded in chronological order.

Format of Journal:

Date	Particulars	L.F.	Debit	Credit

Points to Remember:

1. Identify the two accounts involved.
2. Classify the accounts into Real, Personal, or Nominal.
3. Apply debit-credit rules correctly.
4. Write narration (short explanation).
5. Record in proper date-wise sequence.
6. Record journal entries with supporting documents.

Illustrations 1

Example 1: (Started business with cash Rs.50,000).

Cash A/c (Real) – Debit (what comes in)

Capital A/c (Personal – owner treated as giver) – Credit

Example 2: Purchased goods for cash Rs.20,000.

Purchase A/c (Nominal – expense) – Debit

Cash A/c (Real – goes out) – Credit

Example 3: Paid salary Rs. 5,000.

Salary A/c (Nominal – expense) – Debit

Cash A/c (Real – goes out) – Credit

Example 4: Sold goods on credit to Ram Rs. 15,000.

Ram's A/c (Personal – receiver) – Debit

Sales A/c (Nominal – income) – Credit

PRACTICE QUESTIONS

(A) Short Answer Questions:

1. Define Double Entry System. Why is it important?
2. Differentiate between Real, Personal, and Nominal Accounts with examples.
3. Write the rules of debit and credit.
4. What are Representative Personal Accounts? Give two examples.

(B) Journalize the following transactions:

1. Commenced business with cash Rs. 1,00,000.
2. Purchased furniture for cash Rs. 15,000.

3. Paid rent Rs. 5,000.
4. Purchase of Goods Rs. 30,000.
5. Sold goods on credit to Mohan Rs. 25,000.
6. Paid commission Rs. 2,000.
7. Received cash from Mohan Rs. 10,000.

LEDGER

In accounting, business transactions are first recorded in the **Journal** in chronological order. However, to know the position of each account (e.g., how much is owed by debtors, how much cash is left, total expenses incurred), it is necessary to collect and classify all transactions account-wise.

This classification is done in the **Ledger**, which is the **principal book of accounts**. From the ledger, the **Trial Balance**, **Profit & Loss Account**, and **Balance Sheet** are prepared.

Thus, the Ledger is called the **final destination of all transactions**.

Concept of Ledger

- The Ledger is a **book of accounts** where transactions relating to a particular account are recorded under one head.
- It contains accounts of **assets, liabilities, capital, expenses, and incomes**.
- Ledger helps in determining the **net balance of each account** and the overall financial position.

Specimen of a Ledger Account

Ledger accounts are generally drawn in the **'T' format**:

Account Title

Debit Side (Dr.)			Credit Side (Cr.)		
Date	Particulars	Amount	Date	Particulars	Amount

On the **Debit side**, particulars begin with **"To"**.

On the **Credit side**, particulars begin with **"By"**.

Posting in the Ledger

Posting is the process of transferring entries from the **Journal** to their respective **Ledger Accounts**.

Steps in Posting:

1. Identify the two accounts from the Journal entry.
2. Post the **debited account** to the **debit side** of the ledger, writing the credit account's name in the particulars column.
3. Post the **credited account** to the **credit side** of the ledger, writing the debit account's name in the particulars column.
4. Use the same date and amount as in the journal.
5. Continue for all entries until all ledger accounts are completed.

Rules Regarding Posting of Entries in the Ledger

1. The account debited in the journal ⟶ Debit side of that account in the ledger with the words **"To (other account)"**.
2. The account credited in the journal ⟶ Credit side of that account in the ledger with the words **"By (other account)"**.
3. The amount entered in the journal must be the **same in ledger posting**.
4. The date of transaction should be recorded on both sides of the ledger account.
5. Each journal entry affects **two ledger accounts** (at least).

Balancing an Account

Balancing means finding the net difference between **total debits and total credits** in a ledger account.

Steps to Balance an Account:

1. Total both sides of the account.
2. Find the difference (Debit – Credit or Credit – Debit).
3. Enter the difference on the **shorter side** as **"Balance c/d"** (carried down).
4. Bring this balance forward on the **opposite side** in the next accounting period as **"Balance b/d"** (brought down).
   - If Debit > Credit ⟶ Debit Balance (Assets, Expenses).
   - If Credit > Debit ⟶ Credit Balance (Liabilities, Incomes).

Opening Accounts in the Next Year

At the beginning of a new accounting year:

- **Real Accounts (Assets)** and **Personal Accounts (Debtors, Creditors, Capital)** balances are carried forward.
- These are shown as **Balance b/d** in the next year's ledger.
- **Nominal Accounts (Incomes & Expenses)** are not carried forward; they are closed to the Profit & Loss Account at year-end.

Balance c/d and Balance b/d

- **Balance c/d (Carried Down):** The closing balance of an account at the end of the current period, entered on the **shorter side** to make both sides equal.
- **Balance b/d (Brought Down):** The same balance brought forward to the next accounting period, written on the **opposite side** of the account.

Example: If Cash A/c debit side = Rs. 70,000 and credit side = Rs. 50,000 ⟶ balance = Rs. 20,000 (Debit).

- On closing: write **Balance c/d = Rs.20,000** on Credit side.
- On reopening: write **Balance b/d = Rs. 20,000** on Debit side (next year).

Illustration 1: **Posting and Balancing**

Transactions (for the month of April):

1. Commenced business with cash Rs. 1,00,000.
2. Purchased goods for cash Rs. 30,000.
3. Paid rent Rs. 5,000.
4. Sold goods to Mohan (credit) Rs. 20,000.
5. Received cash from Mohan Rs. 12,000.

Journal Entries:

April 1.	Cash A/c	Dr.	1,00,000	
	To Capital A/c			1,00,000
April 2.	Purchases A/c	Dr.	30,000	
	To Cash A/c			30,000
April 3.	Rent A/c	Dr.	5,000	
	To Cash A/c			5,000
April 4.	Mohan A/c	Dr.	20,000	
	To Sales A/c			20,000
April 5.	Cash A/c	Dr.	12,000	
	To Mohan A/c			12,000

Ledger Accounts

Cash A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
01-Apr	To Capital A/c	1,00,000	02-Apr	By Purchases A/c	30,000
05-Apr	To Mohan A/c	12,000	03-Apr	By Rent A/c	5,000
			30-Apr	By Balance c/d	77,000
	Total	**1,12,000**		**Total**	**1,12,000**

Balance b/d on 01-May = 77,000 (Dr.)

Mohan A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
04-Apr	To Sales A/c	20,000	05-Apr	By Cash A/c	12,000
			30-Apr	By Balance c/d	8,000
	Total	20,000		Total	20,000

Balance b/d on 01-May = 8,000 (Debtor)

Rent A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
03-Apr	To Cash A/c	5,000			

(Rent will be closed to P&L at year-end)

Purchases A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
02-Apr	To Cash A/c	30,000			

(Closed to Trading A/c at year-end)

Sales A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
			04-Apr	By Mohan A/c	20,000

(Closed to Trading A/c at year-end)

Capital A/c

Dr.			Cr.		
Date	**Particulars**	**Amount (Rs.)**	**Date**	**Particulars**	**Amount (Rs.)**
30 April	To Bal C/D	1,00,000	April 1	By Cash A/c	1,00,000
		1,00,000			1,00,000

PRACTICE QUESTIONS

Theory Questions

1. Define Ledger. Why is it called the Principal Book of Accounts?
2. Explain the process of posting with rules.
3. Differentiate between Balance c/d and Balance b/d with examples.
4. Which accounts are carried forward to the next year? Why are nominal accounts not carried forward?

Practical Questions

Post the following into ledger accounts and balance them:

1. Started business with Rs. 80,000.
2. Deposited Rs. 20,000 into bank.
3. Bought goods from Sohan Rs. 25,000 on credit.
4. Sold goods for cash Rs. 15,000.
5. Paid Rs. 10,000 to Sohan.
6. Paid wages Rs. 3,000.

COMPARISON CHART: JOURNAL VS LEDGER

Basis	Journal (Book of Original Entry)	Ledger (Book of Final Entry)
Meaning	Records transactions in chronological order	Classifies transactions into accounts
Nature	Daily record of all transactions	Permanent record account-wise
Purpose	Provides raw transaction details	Provides summarized balances
Structure	Date, Particulars, Debit, Credit	Separate accounts (Dr. & Cr.)
Recording	First stage of entry	Second stage (posting from journal)
Helps in	Checking correctness of debit/credit	Preparing Trial Balance & Final Accounts
Example	Cash A/c Dr. To Capital A/c	Cash A/c and Capital A/c shown separately

SUBSIDIARY BOOKS

In large-scale businesses, recording every transaction directly in the Journal becomes cumbersome. To overcome this, transactions of similar nature are grouped and recorded in separate books known as **Subsidiary Books**. These are also called **special journals**.

They help in:

- Systematic classification of transactions.
- Easy posting to the Ledger.
- Division of work among staff.

Advantages of Subsidiary Books

1. **Division of Work** – Different clerks can maintain different books (purchases clerk, sales clerk).
2. **Time Saving** – Similar transactions are grouped together.
3. **Specialization** – Improves efficiency by allocating responsibility.
4. **Error Detection** – Easier to locate mistakes.
5. **Ledger Efficiency** – Ledger remains neat and simple.
6. **Fraud Prevention** – Division of work ensures better internal check.

Difference between Subsidiary Books and Cash Book

Basis	Subsidiary Books	Cash Book
Nature	Record of transactions of similar type (credit purchases, sales, returns, etc.)	Records only cash and bank transactions.
Types	Purchases Book, Sales Book, Returns Book, Bills Books, etc.	Cash Book only (with single, double or triple columns).
Transactions	Mostly credit transactions (except bills).	Only cash/bank receipts and payments.
Utility	Helps to divide work in large firms.	Acts as both journal and ledger for cash/bank.

TYPES OF SUBSIDIARY BOOKS

Purchases Book

- Records **credit purchases of goods** only.
- Cash purchases are recorded in the **Cash Book**.
- Non-goods purchases (e.g., machinery, furniture) on credit are recorded in the **Journal Proper**.

Specimen: Purchases Book

Date	Invoice No.	Name of Supplier	L.F.	Amount

Posting Rule:

- Debit **Purchases A/c** in Ledger.
- Credit individual **Supplier's A/c** in Ledger.

Illustration 3:

Purchased goods on credit from Ram & Co. Rs.20,000.

Entry in Purchases Book.

Solution: Purchases A/c (Dr.) Rs. 20,000; Ram & Co. A/c (Cr.) Rs. 20,000.

Sales Book

- Records **credit sales of goods** only.
- Cash sales ⟶ Cash Book.
- Sale of assets ⟶ Journal Proper.

Specimen: Sales Book (on credit)

Date	Invoice No.	Name of Customer	L.F.	Amount (Rs.)

Posting Rule:

- Debit individual **Customer's A/c**.
- Credit **Sales A/c**.

Illustration 4:

Sold goods on credit to Shyam & Co. Rs. 15,000.

Sales Book entry.

Solution: Shyam & Co. A/c (Dr.) Rs. 15,000; To Sales A/c Rs. 15,000.

Purchases Return (Return Outward) Book

- Records return of goods to suppliers.

Specimen: Purchases Return Book

Date	Debit Note No.	Supplier	L.F.	Amount (Rs.)

Posting Rule:

- Debit Supplier's A/c.
- Credit Purchases Return A/c.

Illustration 5:

Returned goods worth Rs. 5,000 to Ram & Co.

Purchases Return Book entry.

Solution: Ram & Co. A/c (Dr.) Rs. 5,000; To Purchases Return A/c Rs. 5,000.

Sales Return (Return Inward) Book

Records return of goods by customers.

Specimen: Sales Return Book

Date	Credit Note No.	Customer	L.F.	Amount (Rs.)

Posting Rule:

- Debit Sales Return A/c.
- Credit Customer's A/c.

Illustration 6:

Shyam & Co. returned goods worth Rs. 2,000.

Sales Return Book entry.

Solution: Sales Return A/c (Dr.) Rs. 2,000; To Shyam & Co. Rs. 2,000.

Bills Receivable Book

Records all **Bills Receivable** accepted by debtors.

Posting Rule:

- Debit Bills Receivable A/c with total.
- Credit individual Debtors' A/c.

Illustration 7:

Received an acceptance from Shyam for Rs. 10,000.

Bills Receivable Book entry.

Solution: Bills Receivable A/c (Dr.) Rs. 10,000; To Shyam A/c Rs. 10,000.

Bills Payable Book

Records all **Bills Payable** accepted in favor of creditors.

Posting Rule:

- Debit individual Creditor's A/c.
- Credit Bills Payable A/c.

Illustration 8:

Accepted a bill in favor of Ram for Rs. 8,000.

Bills Payable Book entry.

Solution: Ram A/c (Dr.) Rs. 8,000; To Bills Payable A/c Rs. 8,000.

Journal Proper

Transactions not covered under subsidiary books are recorded here.

Types of Entries in Journal Proper:

1. **Opening Entries** – Bringing forward balances of assets & liabilities.

   Example: Assets A/c Dr.

   To Liabilities A/c,

   To Capital A/c.

2. **Closing Entries** – Transfer of expenses and revenues to Trading & P&L A/c.

   Example: Trading A/c Dr.

   To Purchases A/c.

3. **Rectification Entries** – Correcting errors.

   Example: If Wages wrongly debited to Machinery, then

   Wages A/c Dr.

   To Machinery A/c.

4. **Adjusting Entries** – Outstanding, prepaid, depreciation.

   Example: Salary A/c Dr.

   To Salary Outstanding A/c.

5. **Entries for Dishonor of Bills** – Debtor A/c Dr.

   To Bills Receivable A/c.

Illustration 9:

Record the following in proper Subsidiary Books:

1. Purchased goods on credit from Ram & Co. Rs. 30,000.
2. Sold goods on credit to Shyam & Co. Rs. 20,000.
3. Returned goods to Ram & Co. Rs. 5,000.
4. Shyam & Co. returned goods worth Rs. 3,000.
5. Received a bill from Shyam & Co. Rs. 17,000.
6. Accepted a bill in favor of Ram & Co. Rs. 25,000.

Solution:

- Purchases Book ⟶ Rs. 30,000 (Ram & Co.)
- Sales Book ⟶ Rs. 20,000 (Shyam & Co.)

- Purchases Return Book ⟶ Rs. 5,000 (Ram & Co.)
- Sales Return Book ⟶ Rs. 3,000 (Shyam & Co.)
- Bills Receivable Book ⟶ Rs. 17,000 (Shyam & Co.)
- Bills Payable Book ⟶ Rs. 25,000 (Ram & Co.)

Journal Entries:

• Purchases A/c	Dr.	Rs. 30,000	
To Ram & Co. A/c			Rs. 30,000
• Shyam & Co. A/c	Dr.	Rs. 20,000	
To Sales A/c			Rs. 20,000
• Ram & Co. A/c	Dr.	Rs. 5,000	
To Purchases Return A/c			Rs. 5,000
• Sales Return A/c	Dr.	Rs. 3,000	
To Shyam & Co. A/c			Rs. 3,000
• Bills Receivable A/c	Dr.	Rs. 17,000	
To Shyam & Co. A/c			Rs. 17,000
• Ram & Co. A/c	Dr.	Rs. 25,000	
To Bills Payable A/c			Rs. 25,000

Cash Book – A Subsidiary and Principal Book

The **Cash Book** is a special journal maintained for recording all cash and bank transactions of a business. Unlike other subsidiary books, the Cash Book serves both as:

- **Subsidiary Book** ⟶ because it records transactions like a journal.
- **Principal Book (Ledger)** ⟶ because it also works as a Cash Account and Bank Account (hence, no need to open separate Cash A/c or Bank A/c in the ledger).

Thus, it has a **dual nature**.

Kinds of Cash Book

The cash book can be divided into the following types:

Single Column Cash Book

- Contains only one column (Cash).
- Records cash receipts on the debit side and cash payments on the credit side.
- Cash balance is always **debit** (never negative).

Specimen Format

Date	Particulars	L.F	Debit (Receipts)	Date	Particulars	L.F	Credit (Payments)

Double Column Cash Book (Cash + Bank)

- Contains **two columns**: Cash and Bank.
- Records both **cash and bank transactions**.
- Helps avoid duplication of posting.

Specimen Format

Date	Particulars	L.F	Cash (Dr)	Bank (Dr)	Date	Particulars	L.F	Cash (Cr)	Bank (Cr)

Triple Column Cash Book (Cash + Bank + Discount)

- Has **three columns** on each side: Cash, Bank, and Discount.
- Discount column is a **memorandum column** (not balanced, only totaled).

Specimen Format

Date	Particulars	L.F	Discount (Dr)	Cash (Dr)	Bank (Dr)	Date	Particulars	L.F	Discount (Cr)	Cash (Cr)	Bank (Cr)

Petty Cash Book

- Maintained for **small, routine expenses** (postage, stationery, traveling, etc.).
- Operates under **Imprest System**: a fixed sum is given to the petty cashier, and after spending, he is reimbursed.

Advantages of Petty Cash Book

1. Saves time of chief cashier.
2. Reduces clerical work.
3. Improves accuracy.
4. Provides better internal control.

Posting of Cash Book Entries

- **Single Column Cash Book** ⟶ posted to relevant accounts except Cash A/c.
- **Double Column Cash Book** ⟶ both cash and bank entries are self-contained, only contra entries (Cash ⟶ Bank, Bank ⟶ Cash) marked as "C" are not posted.
- **Discount Columns** ⟶ totals transferred to Discount Allowed A/c (Dr) and Discount Received A/c (Cr).
- **Petty Cash Book** ⟶ totals posted to respective nominal accounts.

Balancing the Cash Book

- **Cash Column** ⟶ always shows a **debit balance** (cannot be negative).
- **Bank Column** ⟶ can show debit balance (favourable balance) or credit balance (bank overdraft).
- Balancing is done like ledger accounts ⟶ "Balance c/d" at the end of the period, brought down as "Balance b/d" in the next period.

Entries for Debit and Credit Card Sales

- **Debit Card Sales** ⟶ treated like **cash sales** because money is received immediately.

Entry:

Bank A/c Dr

To Sales A/c

- **Credit Card Sales** ⟶ treated like **credit sales**, but to bank/credit card company.

  Entry:

  Bank/Credit Card Co. A/c Dr

  To Sales A/c

- Charges deducted by Card Company:

  Discount/Commission A/c Dr

  To Bank/Credit Card Co. A/c

***Illustration 10:* Single Column Cash Book**

Prepare a Cash Book from the following:

1 April: Cash in hand Rs. 10,000

2 April: Purchased goods for cash Rs. 3,000

5 April: Cash sales Rs. 4,000

10 April: Paid rent Rs. 2,000

Solution:

Cash Book (Single Column)

Date	Particulars	Receipts (Rs.)	Date	Particulars	Payments (Rs.)
Apr 1	Balance b/d	10,000	Apr 2	Purchases	3,000
Apr 5	Sales	4,000	Apr 10	Rent	2,000
			Apr 30	Balance c/d	9,000
		14,000			14,000
May 1	Balance b/d	9,000			

Illustration 11: **Enter the following transactions in Double Column Cash Book:**

1 May: Cash in hand Rs. 5,000, Bank balance Rs. 10,000

2 May: Deposited Rs. 2,000 into bank

4 May: Received cheque from Ram 3,000 and deposited in Bank on same day

6 May: Issued cheque to Shyam Rs. 4,000

Solution:

Double Column Cash Book

Date	Particulars	Cash Dr	Bank Dr	Date	Particulars	Cash Cr	Bank Cr
May 1	To Balance b/d	5,000	10,000				
May 2	To Cash (C)		2,000	May 2	By Bank (C)	2,000	
May 4	To Ram		3,000				
				May 6	By Shyam		4,000
					By Balance c/d	3,000	11,000
	Total	**5,000**	**15,000**		**Total**	**5,000**	**15,000**
Jun 1	To Balance b/d	3,000	11,000				

Illustration 12: **Triple Column Cash Book**

Transactions:

1 June: Cash in hand Rs. 8,000, Bank balance Rs. 12,000

2 June: Cash sales Rs. 6,000, after allowing discount Rs. 200

5 June: Paid to Ramesh by cheque Rs. 5,000, received discount Rs. 100

Solution:

Triple Column Cash Book

Date	Particulars	Disc Dr (Rs.)	Cash Dr (Rs.)	Bank Dr (Rs.)	Date	Particulars	Disc Cr (Rs.)	Cash Cr (Rs.)	Bank Cr (Rs.)
Jun 1	Balance b/d		8,000	12,000					
Jun 2	Sales	200	6,000						
Jun 5					Jun 5	Ramesh	100		5,000
						Balance c/d		14,000	7,000
		200	**14,000**	**12,000**			**100**	**14,000**	**12,000**
Jul 1	Balance b/d		14,000	7,000					

***Illustration 13*: Petty Cash Book (Imprest System)**

Petty cashier receives Rs. 5,000 on 1 July. Expenses during July: Postage Rs. 600, Stationery Rs. 800, Conveyance Rs. 1,000, Refreshments Rs. 700.

Solution:

Petty Cash Book

Date	Particulars	V. No	Total (Rs.)	Postage (Rs.)	Stationery (Rs.)	Conveyance (Rs.)	Refreshments (Rs.)
Jul 1	Cash Received		5,000				
Jul	Expenses		3,100	600	800	1,000	700
	Balance c/d		1,900				

TRIAL BALANCE

In the accounting cycle, after all transactions are recorded in the **Journal** and subsequently posted into the **Ledger accounts**, the next step is to check the arithmetical accuracy of these accounts. This is done by preparing a **Trial Balance**.

A **Trial Balance** is a statement prepared at a particular date, containing debit and credit balances of all ledger accounts. The main purpose is to ascertain whether the total of debits equals the total of credits.

Definition:

"A trial balance is a statement of debit and credit totals or balances extracted from ledger accounts to check the arithmetical accuracy of the books."

Objectives of Preparing a Trial Balance

1. **Check arithmetical accuracy** – Ensures total debits = total credits.
2. **Summarize ledger balances** – Provides a consolidated list of all account balances.
3. **Facilitates preparation of financial statements** – Serves as the basis for preparing Trading A/c, P&L A/c, and Balance Sheet.
4. **Helps in locating errors** – Certain types of errors can be detected when totals do not tally.
5. **Provides a snapshot** – Reflects the financial position at a glance.

Limitations of Trial Balance

- **Does not ensure complete accuracy** – Certain errors remain undetected (like compensating errors, omission, principle errors).
- **Not a final proof** – Even if debits = credits, accounts may still contain mistakes.
- **Cannot show fraud** – Manipulation may go unnoticed.
- **Only arithmetical check** – Does not check correctness of posting to correct accounts.

Methods of Preparing Trial Balance

There are **three main methods** and one **special adjusted method**:

Total Method

- Debit and credit totals of each ledger account are taken to the trial balance.
- Rarely used in practice.

Balance Method (Most widely used)

- Only balances (debit or credit) of accounts are carried to the trial balance.

Total and Balance Method

- Both debit/credit totals and balances are shown.
- Not commonly used due to redundancy.

Adjusted Trial Balance (Suspense Account)

- When the trial balance does not tally, the difference is temporarily placed in a **Suspense Account** to proceed with final accounts.
- Later adjustments are made once errors are identified.

Rules of Preparing a Trial Balance

1. List all ledger accounts in order (assets, liabilities, incomes, expenses).
2. Enter debit balances in the debit column, credit balances in the credit column.
3. Ensure the totals of both sides are equal.
4. If totals do not match, investigate errors or use suspense account temporarily.

Specimen of a Trial Balance

Trial Balance of M/s XYZ Ltd. as on 31st March, 20XX

Particulars	Debit (Rs.)	Credit (Rs.)
Cash A/c	50,000	
Purchases A/c	80,000	
Sales A/c		1,20,000
Capital A/c		60,000
Rent A/c	50,000	
Total	**1,80,000**	**1,80,000**

Illustration 14: **Balance Method**

From the following balances of M/s Raghav Traders, prepare a Trial Balance as on 31st March, 20XX:

- Cash in Hand Rs. 12,000
- Furniture Rs. 8,000
- Creditors Rs. 6,000
- Sales Rs. 50,000
- Purchases Rs. 32,000
- Capital Rs. 20,000
- Wages Rs. 4,000

Solution:

Particulars	Debit (Rs.)	Credit (Rs.)
Cash in Hand	12,000	
Furniture	8,000	
Purchases	32,000	
Wages	4,000	
Creditors		6,000
Sales		50,000
Capital		20,000
Total	56,000	76,000

Since, the total of both sides do not match, the difference (Rs. 20,000) will be placed in **Suspense A/c**.

Illustration 15: **Adjusted Trial Balance through Suspense Account**

A trial balance shows a difference of Rs. 500 carried to Suspense A/c. On rechecking:

- Sales return of Rs. 1,000 not recorded in books.
- Rent received Rs. 500 posted twice.
- Machinery purchased for Rs. 500 wrongly debited to Purchases A/c.

Solution:

Adjusting errors:

- Sales return not recorded ⟶ Debit Returns A/c Rs. 1,000, Credit Debtors A/c Rs. 1,000.
- Rent received double ⟶ Debit Rent received A/c Rs. 500, Credit Suspense A/c Rs. 500.
- Machinery wrongly posted ⟶ Debit Machinery A/c Rs. 500, Credit Purchases A/c Rs. 500.

Suspense A/c will be closed after rectification.

RECTIFICATION OF ERRORS

In accounting, transactions are first recorded in journals, then posted to ledgers, balanced, and finally a trial balance and financial statements are prepared.

During this process, **errors** may occur due to human mistakes, clerical oversight, or wrong interpretation.

The **rectification of errors** means correcting these mistakes to ensure that the financial statements reflect a true and fair view.

Illustrative Cases of Errors & Their Nature

1. **Wrong Entry**
   - Example: Purchase of furniture Rs. 10,000 entered in *Purchases A/c* instead of *Furniture A/c*.
   - **Nature:** Error of principle.
2. **Wrong Casting of Subsidiary Books**
   - Example: Total of Purchases Book Rs. 25,000 wrongly cast as Rs. 20,000.
   - **Nature:** Clerical error (error of casting).
3. **Error in Cash Book**
   - Example: Bank charges Rs. 500 omitted to be recorded in Cash Book.
   - **Nature:** Error of omission.
4. **Wrong Posting from Subsidiary Book**
   - Example: Sale to Ram Rs. 5,000 entered correctly in Sales Book, but posted to Ram's account as Rs. 500.
   - **Nature:** Error of posting.
5. **Wrong Balancing of Ledger Accounts**
   - Example: Balance of Creditor A shown as Rs. 12,000 instead of Rs. 21,000.
   - **Nature:** Error of balancing.

STAGES OF ERRORS

At the stage of recording in Journal

- Error: Machinery purchase of Rs. 10,000 recorded in Purchases A/c.
- Rectification:

Machinery A/c	Dr.	Rs. 10,000	
To Purchase A/c			Rs. 10,000

At the stage of posting in Ledger

- Error: Sale to Ram Rs. 5,000 posted to his account as Rs. 500.
- Rectification:

Ram A/c	Dr.	Rs. 4,500	
To Suspense A/c			Rs. 4,500

At the stage of balancing Ledger Accounts

- Error: Creditor balance wrongly shown.
- Rectification: Correct the balance carried forward to the next period.

At the stage of preparing Trial Balance

- Error: Credit balance of Rs. 1,000 omitted.
- Rectification: Post missing balance through Suspense A/c.

TYPES OF ERRORS

1. **Errors of Omission** – Transaction not recorded at all.

   Ex. Sale of Rs. 10,000 completely omitted.
2. **Errors of Commission** – Wrong amount or wrong account.

   Ex. Sales of Rs. 2,000 posted as Rs. 200.
3. **Errors of Principle** – Violation of accounting principles.

   Ex. Capital expenditure treated as revenue.
4. **Compensating Errors** – Two or more errors cancel each other.

   Ex. Sales overstated Rs. 1,000, Purchases overstated Rs. 1,000.

Steps to Locate Errors

1. Check trial balance totals.
2. Recheck subsidiary books.
3. Verify postings in ledgers.
4. Confirm balances are correctly carried forward.
5. Use **Suspense Account** to temporarily balance if errors not yet traced.

Rectification of Errors

Before Preparation of Trial Balance

- Directly correct the entry in books.

Illustration 16:

Purchase of Stationery Rs. 2,000 wrongly entered in Purchases A/c.

Stationery A/c	Dr.	Rs. 2,000	
To Purchases A/c			Rs. 2,000

After Trial Balance but Before Final Accounts

- Use **Suspense A/c** if trial balance does not tally.

Illustration 17:

Debit side short by Rs. 500 because Wages not posted.

Wages A/c	Dr.	Rs. 500	
To Suspense A/c			Rs. 500

After Final Accounts are Drawn (Next Accounting Period)

- Pass **rectification entries in the next year**.

Illustration 18:

Sale of goods Rs. 10,000 recorded as Rs. 1,000 in last year.

- Rectify in next year:

Debtors A/c	Dr.	Rs. 9,000	
To Profit & Loss Adjustment A/c			Rs. 9,000

Correction in the Next Accounting Period (with P&L Adjustment)

- If error affects profit, use **Profit & Loss Adjustment A/c**.

Illustration 19:

Last year's wages of Rs. 3,000 omitted.

Profit & Loss Adjustment A/c	Dr.	Rs. 3,000	
To Outstanding Wages A/c			Rs. 3,000

LESSON ROUNDUP

- Accounting cycle includes identifying, recording, classifying and summarizing of the transactions.
- Every transaction is recorded in the Journal before being posted into the ledger. It is that book of account in which transactions are recorded in a chronological order.
- Recording in the journal is done following the rules of debit and credit.
- Posting is the process of recording transactions in the ledger based on the entries in the journal.
- The main function of a ledger is to classify or sort out all the items appearing in the journal or other subsidiary books under their appropriate accounts so that at the end of the accounting period summary of each account is easily available.
- Balancing of ledger accounts involves equalization of both sides of the account by putting the difference on the side where the amount is short.
- Various subsidiary books are: purchases book; sales book; purchases returns book; sales returns book; bills receivable book; bills payable book and cash book.
- Petty Cash Book may be maintained under Imprest System of petty cash.
- General Journal or journal proper is maintained for recording those transactions for which there are no other appointment subsidiary book.
- Trial Balance is prepared after posting the entries in ledger to verify the arithmetical accuracy of entries made in the ledger

TEST YOURSELF

True / False Questions

1. Book-keeping is broader than accounting.

   False – Accounting is broader; book-keeping is just a part of it.

2. Every debit has a corresponding credit in the double-entry system.

   True

3. Real Accounts relate to persons.

   False – Real Accounts relate to assets and properties.

4. Petty cash book is maintained under imprest system.

   True

5. Trial balance ensures that accounts are completely error-free.

   False – It only ensures arithmetical accuracy, not complete error-free books.

Multiple Choice Questions (MCQs)

1. Which of the following is NOT a subsidiary book?

   a) Journal Proper

   b) Purchase Book

   c) Sales Book

   d) Trial Balance

   Answer: d) Trial Balance (It is a statement, not a subsidiary book).

2. Debit what comes in, Credit what goes out – relates to:

   a) Personal Account

   b) Real Account

   c) Nominal Account

   d) None of these

   Answer: b) Real Account

3. Suspense Account is created when:

   a) Trial balance does not tally

   b) Ledger is incomplete

   c) Petty cash book is missing

   d) None of these

   Answer: a) Trial balance does not tally

4. In double-entry system, every transaction has:
   a) One aspect
   b) Two aspects
   c) Three aspects
   d) None

   Answer: b) Two aspects

5. Which error is NOT revealed by Trial Balance?
   a) Error of Complete Omission
   b) Error of Commission
   c) Error of Casting
   d) None of the above

   Answer: a) Error of Complete Omission

Theoretical Questions

1. **Differentiate between Book-keeping and Accounting.**

   Book-keeping is the process of systematically recording financial transactions, whereas *Accounting* involves classifying, summarizing, interpreting, and reporting the financial data to stakeholders. Book-keeping is clerical, while Accounting is analytical.

2. **Explain the types of accounts with examples.**

   - **Personal Account** ⟶ Relates to persons (e.g., Ram's A/c, SBI Bank A/c).
   - **Real Account** ⟶ Relates to assets (e.g., Cash A/c, Building A/c).
   - **Nominal Account** ⟶ Relates to expenses, losses, incomes, and gains (e.g., Rent A/c, Commission Received A/c).

3. **Why is rectification of errors important?**

   It ensures accuracy of financial statements, maintains true profitability and financial position, and avoids misrepresentation to stakeholders.

Practical Questions with Solutions

Q1. Journal Entries

Record the following transactions:

1. Started business with cash Rs. 50,000
2. Purchased furniture for Rs. 10,000
3. Paid rent Rs. 2,000
4. Received commission Rs. 1,000

Solution (Journal Entries):

Date	Particulars		Debit (Rs.)	Credit (Rs.)
1	Cash A/c	Dr.	50,000	
	To Capital A/c			50,000
2	Furniture A/c	Dr.	10,000	
	To Cash A/c			10,000
3	Rent A/c	Dr.	2,000	
	To Cash A/c			2,000
4	Cash A/c	Dr.	1,000	
	To Commission A/c			1,000

Q2. Posting to Ledger & Balancing

From above Journal, prepare **Cash A/c (Ledger).**

Cash A/c

Date	Particulars	Debit (Rs.)	Credit (Rs.)
1	To Capital A/c	50,000	
2	By Furniture A/c		10,000
3	By Rent A/c		2,000
4	To Commission A/c	1,000	

Q3. Trial Balance

Prepare Trial Balance from following balances:

- Cash Rs. 39,000
- Furniture Rs. 10,000
- Capital Rs. 50,000
- Rent Rs. 2,000
- Commission Rs. 1,000

Trial Balance

Particulars	Debit (Rs.)	Credit (Rs.)
Cash A/c	39,000	

Furniture A/c	10,000	
Rent A/c	2,000	
Commission A/c		1,000
Capital A/c		50,000
Total	51,000	51,000

Q4. Rectification of Errors

Error: Rent paid Rs. 500 wrongly debited to Furniture A/c.

Rectification Entry:

Rent A/c Dr. Rs. 500

To Furniture A/c Rs. 500

Q5. Petty Cash Book (Imprest System)

Given:

- Imprest Rs. 5,000
- Expenses paid: Stationery Rs. 1,000; Postage Rs. 800; Conveyance Rs. 700; Refreshments Rs. 500

Petty Cash Book

Date	Particulars	V. No.	Amount (Rs.)
-	Stationery	-	1,000
-	Postage	-	800
-	Conveyance	-	700
-	Refreshments	-	500
Total			**3,000**

Bank Reconciliation Statement (BRS)

Lesson 3

KEY CONCEPTS

- Bank Reconciliation Statement (BRS)
- Passbook
- Cashbook

Learning Objectives

In the modern times, business operates in a financial system of the country wherein it uses the facilities and services provided by the banks. Most of the business houses conduct majority of transactions through bank account. Business enterprises record transactions with the bank in the bank columns of the cash book. Bank also maintains accounts of customers in its ledger which are supplied to customers by the bank in the form of a statement or a book called pass book. So, it becomes necessary to compare and check the transactions done with the bank and those recorded in the books of account of organisation. Bank reconciliation statement is a tool for such comparison and arriving at the causes and amount of difference between the two, if any.

This chapter provides a detailed and practical understanding of the Bank Reconciliation Statement (BRS). It begins with the basics of banking, the role of the bank passbook, and gradually builds up to explain the need, importance, and methods of preparing a BRS. Real-life examples, MCQs, and illustrative problems are included to enhance conceptual clarity and practical application.

Lesson Outline

- Introduction to Banks
- Role of Banks
- Background
- Bank Pass Book (Bank Statement)
- Bank Reconciliation Statement (BRS)
- Importance of Bank Reconciliation Statement (BRS)
- Causes of Difference between Cash Book and Pass Book
- Procedure for Reconciling the Cash Book with the Pass Book
- Methods of Bank Reconciliation
- Meaning of Adjusted Cash Book
- Practice Questions
- Lesson Roundup
- Test Yourself

INTRODUCTION TO BANKS

Banks play a very important role in today's financial world. They help people and businesses manage their money safely and efficiently. For example, individuals can keep their money in a savings account and withdraw it whenever they need it, while businesses can use current accounts to make frequent payments and receive money from customers. Banks also offer loans to people who need money for things like education, buying a house, or starting a business. In addition, banks help with everyday services like transferring money, paying bills, or receiving salaries. All these services make it easier for people to handle their finances without keeping large amounts of cash. For businesses, using a bank means better security, smoother transactions, and a clear record of all income and expenses. Overall, banks are essential for the smooth working of any economy because they help money move safely between people, businesses, and the government.

Role of Banks

- Banks help people and businesses **keep their money safe**.
- They allow easy **deposits and withdrawals** of money.
- Banks offer **different types of accounts** to suit different needs:
  - **Savings Account** – for individuals to save money and earn interest.
  - **Current Account** – for businesses to handle frequent and high-value transactions.
  - **Fixed Deposit Account** – to keep money for a fixed period and earn higher interest.
  - **Recurring Deposit Account** – to save a fixed amount at regular intervals and earn interest.
- Banks give **loans** for personal, educational, business, and housing needs.
- They help in **paying bills, receiving salaries**, and **transferring money** easily.
- Bank accounts help people and businesses keep **track of their income and spending**.
- Banks reduce the need to carry cash, making transactions **safer and more convenient**.
- They are an important part of the financial system and **support the growth of the economy**.

BACKGROUND

In any business, keeping accurate records of financial transactions is essential. One of the key areas where records must be carefully maintained is **bank-related transactions**. Businesses use a **cash book** (bank column) to record all payments into and out of their bank accounts, such as deposits, cheques issued, and withdrawals. At the same time, the **bank** keeps its own record of the same transactions in what is called a **passbook** or **bank statement**.

Ideally, the balance as per the cash book and the bank statement should be the same. However, in practice, they are **often different**. These differences can occur due to several reasons, such as:

- Cheques issued by the business not yet presented for payment.
- Cheques deposited into the bank but not yet cleared.
- Bank charges or interest not yet recorded in the business's cash book.
- Automatic payments made by the bank on behalf of the business (like EMIs or insurance premiums).
- Errors made either by the business or by the bank.

These **timing differences, omissions, or errors** can lead to confusion or even financial mismanagement if not

identified in time. Therefore, to ensure that the records in the cash book and the bank passbook are accurate and up to date, businesses prepare a **Bank Reconciliation Statement (BRS)** at regular intervals—monthly, quarterly, or as needed.

Bank Pass Book (Bank Statement)

A **Bank Pass Book** is a physical booklet or a digital statement provided by a bank to its account holders. It contains a record of all the **transactions conducted through the bank account**, such as:

- Deposits
- Withdrawals
- Cheques issued or deposited
- Bank charges
- Interest credited or debited
- Direct debits (e.g., loan payments, utility bills)

It is maintained **from the bank's point of view**, meaning:

- **Deposits** made by the customer are shown as **credits** (bank owes more to the customer).
- **Withdrawals or payments** are shown as **debits** (bank owes less).

Specimen of Bank Pass Book

Date	Particulars	Cheque No.	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
01-08-2025	Opening Balance	–	–	–	25,000
03-08-2025	Cash Deposit	–	–	5,000	30,000
05-08-2025	Cheque Issued to Supplier	234567	7,000	–	23,000
06-08-2025	Bank Charges	–	250	–	22,750
07-08-2025	Interest Credited by Bank	–	–	200	22,950
08-08-2025	Loan EMI Auto-Debit		2,000		20,950

Example to Understand Bank Pass Book Entries

Let's assume the following bank-related transactions for a business in August 2025:

- Opening balance on 01-08-2025: Rs. 25,000
- Deposited Rs. 5,000 on 03-08-2025
- Issued a cheque of Rs. 7,000 on 05-08-2025
- Bank charges Rs. 250 on 06-08-2025
- Interest of Rs. 200 credited on 07-08-2025
- Loan EMI of Rs. 2,000 auto-debited on 08-08-2025

These would appear in the pass book as shown in the specimen above, resulting in a **closing balance of Rs.20,950**.

REVIEW QUESTIONS

Fill in the blanks:

a) A **current** account is best suited for frequent business transactions.

b) A **fixed deposit** account is used to save money for a fixed period and earn higher

c) In a pass book, deposits are shown as **credits** from the bank's point of view.

d) The balance in a cash book and a pass book may differ due to timing differences such as cheques deposited but not yet **cleared**.

e) A Bank Reconciliation Statement (BRS) helps ensure that the bank's records and the **business's** records match.

WHAT IS BANK RECONCILIATION STATEMENT (BRS)?

A **Bank Reconciliation Statement** is a statement prepared to **match the bank balance shown in the Cash Book** (maintained by the business) with the **balance shown in the Pass Book or Bank Statement** (maintained by the bank).

1. **Bank Transactions Recorded by the Business**
2. **Statement from the Bank**

It helps to identify any **differences** caused due to:

- Timing differences
- Errors or omissions
- Unrecorded transactions

Importance of Bank Reconciliation Statement (BRS)

A **Bank Reconciliation Statement (BRS)** is a critical tool in accounting that ensures the cash records of a business align with the records maintained by the bank. Preparing a BRS regularly provides several important benefits that help businesses maintain accurate and reliable financial records.

1. **Detects Errors in Recording Transactions**

   One of the main reasons for preparing a BRS is to identify and correct any **errors** that may have occurred in the business's cash book or the bank's passbook. For example, a wrong amount may have been recorded, or an entry may have been posted to the wrong account. By comparing both records, such mistakes can be quickly spotted and rectified.

2. **Helps in Identifying Frauds and Unauthorized Transactions**

   Regular reconciliation helps to detect any **unauthorized or fraudulent transactions**. If the bank has processed a transaction that the business has no record of—or if a cheque has been altered or misused—it can be identified during the reconciliation process. This adds an extra layer of **security and internal control** over cash and banking operations.

3. **Ensures Accuracy of Financial Records**

   Accurate financial reporting depends on the reliability of accounting data. A BRS ensures that the

bank balance shown in the cash book is correct, and any differences are explained. This results in **accurate books of accounts**, which are essential for preparing financial statements, tax reports, and audit documentation.

4. **Keep Track of Unpresented or Uncleared Cheques**

   There are often timing differences between when a cheque is issued or deposited and when it is actually cleared by the bank. A BRS helps keep track of:

   - **Cheques issued but not yet presented for payment**
   - **Cheques deposited but not yet credited by the bank**

   Tracking these helps the business know what transactions are **still pending** and avoid confusion or double spending.

5. **Aids in Maintaining Better Internal Control Over Cash**

   Regular reconciliation allows the business to maintain **tight control over cash flow**. It helps ensure that all bank transactions are properly authorized, recorded, and monitored. This improves **accountability**, prevents losses due to mismanagement, and strengthens overall financial discipline within the organization.

Causes of Difference between Cash Book and Pass Book

A. Timing Differences

These arise due to the delay in recording transactions in either the cash book or pass book

Particular	Explanation	Example
Cheques issued but not yet presented	When cheques are issued and recorded in the cash book but have not been presented for payment in the bank.	A cheque of Rs. 10,000 issued on 28th July is recorded in the cash book but gets presented on 2nd August.
Cheques deposited but not yet cleared	When cheques are deposited and recorded in the cash book but are not yet cleared by the bank.	A cheque of Rs. 5,000 deposited on 25th July is recorded in the cash book but cleared on 30th July.
Direct deposits by customers	When customers deposit money directly into the bank, which is recorded in the pass book but not yet in the cash book.	A client transfers Rs. 15,000 directly into your bank account on 1st August. The pass book shows it, but the cash book does not until you are informed.
Bank charges debited by the bank	Bank deducts charges that are not yet recorded in the cash book.	Bank debits Rs. 500 as service charge on 31st July, visible in pass book but not recorded in the cash book.
Interest credited by bank	Bank credits interest on deposits, not yet recorded in the cash book.	Bank credits Rs. 1,200 as interest on savings on 31st July, shown in the pass book but not yet in the cash book.
Bills collected by bank on behalf of customer	Bank collects the bill amount from the drawee, records it in pass book, but customer has not yet recorded it in the cash book.	Bill of Rs. 20,000 collected by bank on 4 August, not yet entered by business.

Particular	Explanation	Example
Dishonour of a bill discounted with bank	If a bill discounted earlier with the bank is dishonoured, the bank debits the customer's account, which might not yet reflect in the cash book.	Rs. 25,000 bill dishonoured on 5 August and debited by bank.

Explanation of Some Points:

1. **Dishonour of Bill Discounted with Bank**
   - When you discount a bill with a bank, they give you immediate cash.
   - If the drawee later **fails to pay**, the **bank debits your account**.
   - This will appear in the **pass book**, but **not yet in the cash book** if not updated.
2. **Bills Collected by the Bank**
   - Sometimes, the customer gives bills to the bank for collection.
   - When the **bank collects the payment**, it credits the account in the pass book.
   - But the business might not have updated this in the **cash book** yet.

B. Transactions Not Yet Recorded in Cash Book

These arise when the bank has made an entry, but the business has not yet recorded it.

Particular	Explanation	Example
ECS debits for loan repayment or bills	Bank auto-debits for EMI or utility bills, not yet entered in cash book.	Rs. 3,000 EMI auto-debited by the bank on 5th August.
Standing instructions (e.g., insurance premium)	Bank follows standing instructions that are yet to be recorded in the cash book.	Rs. 2,500 deducted monthly for LIC premium on 3rd August.
Dividend received directly in bank	Company receives dividend which is credited by bank but not recorded in cash book.	Rs. 1,000 dividend received on shares credited by the bank on 7th August.

C. Errors

Mistakes either in the cash book or pass book that cause differences.

Particular	Explanation	Example
Error in totalling/carrying forward in cash book	Mathematical error in the cash book affecting balance.	Totalling error overstating balance by Rs. 1,000.
Wrong entry in cash book	Posting wrong amount or wrong side entry in the cash book.	Recording a cheque received of Rs. 8,000 as Rs. 6,000.
Bank's clerical error	Bank wrongly debits or credits an entry.	Bank credits another customer's deposit of Rs. 5,000 to your account.
Duplicate entry in cash book	Transaction is recorded twice in the cash book.	Same deposit of Rs. 10,000 entered twice.

PROCEDURE FOR RECONCILING THE CASH BOOK WITH THE PASS BOOK

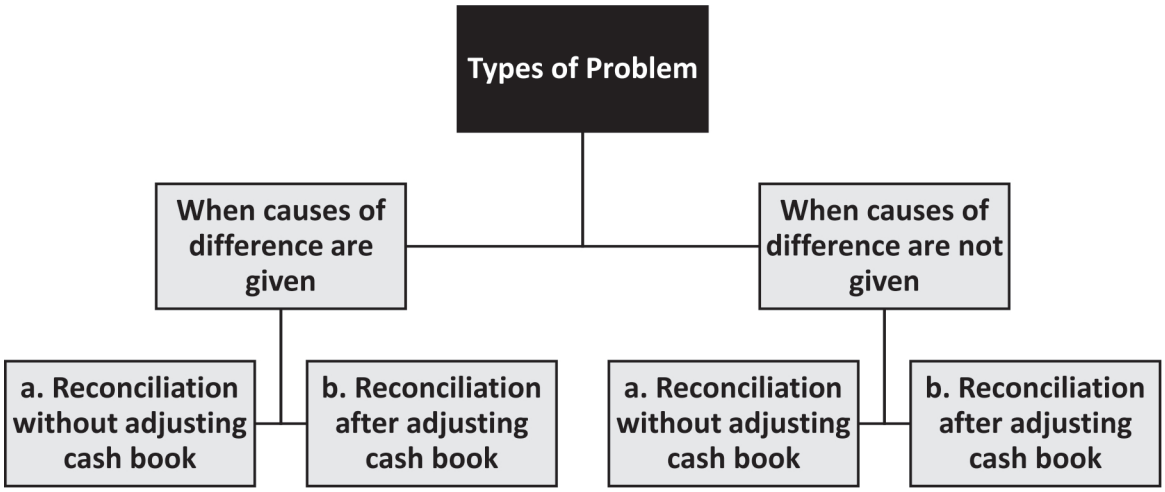
Reconciling the **Cash Book** (maintained by the business) with the **Pass Book / Bank Statement** (maintained by the bank) is a systematic process. The goal is to identify and explain the **differences** between the balances in both books, and then arrive at the **correct reconciled balance**.

Before moving ahead, remember:

- Dr. balance in the Cash Book **means the money you have in the bank (cash at bank). This is the same as a** Cr. balance in the Pass Book**.**
- Cr. balance in the Cash Book **means you have withdrawn more than you deposited (overdraft). This is the same as a** Dr. balance in the Pass Book**.**

Dr. Balance as per Cash Book	Cr. Balance as per Cash Book	Dr. Balance as per Pass Book	Cr. Balance as per Pass Book

While doing reconciliation, the following types of problems can be given



1. When Causes of Difference Are Given

If the question already lists the reasons for differences (e.g., unpresented cheques, bank charges not recorded, deposits in transit), you can **start the reconciliation** from any of the four balances:

- Dr. balance as per Cash Book (favourable balance)
- Cr. balance as per Cash Book (overdraft)
- Dr. balance as per Pass Book (overdraft)
- Cr. balance as per Pass Book (favourable balance)

How to adjust:

- If, due to the given cause, the **other book's balance is more**, **add** the amount.
- If the **other book's balance is less**, **subtract** the amount.

Example:

Suppose you start with **Dr. balance as per Cash Book = Rs. 50,000**.

- A cheque of Rs. 5,000 was deposited but not yet cleared. This means the bank hasn't credited it in the Pass Book, so the **Cr. balance in Pass Book** will be **Rs. 5,000 less**.
- Therefore, **subtract Rs. 5,000** from the Cash Book balance to arrive at the Pass Book balance.

Note:

- After adjustments, if the final figure is **positive**, it's a **Cr. balance as per the other book** (favourable).
- If the final figure is **negative**, it's a **Dr. balance as per the other book** (overdraft).

2. When causes of difference are not known

Here, we first need to **identify the causes** before preparing the BRS.

Steps:

1. Compare the **debit entries of the Cash Book** with the **credit entries of the Pass Book**, and vice versa.
2. Identify unticked (unmatched) items — these are the causes of differences.
3. Analyse how each cause affects both books.
4. Adjust starting balance as per the same "add if more / subtract if less" logic.

Example:

- Cash Book shows a deposit of Rs. 10,000, but Pass Book does not. This is a **deposit in transit** ⟶ subtract if starting from Cash Book.
- Pass Book shows bank charges of Rs. 500, but Cash Book does not. This is an **unrecorded bank charge** ⟶ subtract if starting from Cash Book.

3. Opening balance consideration

When comparing two periods (e.g., March and April), always check:

- If **opening balances** of Cash Book and Pass Book agree.
- If not, separate the unticked items into:
  1. Those relating to the **reconciliation of opening balance**.
  2. Those relating to the **reconciliation of closing balance**.

Example X Ltd. has the following entries in its **Cash Book** (bank column only) and **Pass Book** for May 2025:

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
May 1	To Balance b/d	80,000	May 15	By Richa Ltd.	20,000
May 9	To Avengers Ltd.	50,000	May 30	By Balance c/d	1,90,000

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
May 13	To Cash A/c	80,000			
Total		**2,10,000**			**2,10,000**

Pass Book

Date	Particulars	Withdrawals Rs.	Deposits	Dr./Cr. Balance	Balance Rs.
May 1	Balance b/d	–	–	Cr.	1,10,000
May 7	To Mr. A	30,000	–	Cr.	80,000
May 12	By Avengers Ltd.	–	50,000	Cr.	1,30,000
May 13	By Cash A/c	–	80,000	Cr.	2,10,000
May 23	To Richa Ltd.	20,000	–	Cr.	1,90,000
May 29	Bank Charges	2,000	–	Cr.	1,88,000

On comparing both books, it was observed that:

1. Two entries in the Pass Book — cheque paid to **Mr. A** (Rs. 30,000) and **Bank Charges** (Rs. 2,000) — do not appear in the Cash Book.
2. The difference in **closing balances** between the two books is Rs. 2,000.
3. The difference in **opening balances** between the two books is Rs. 30,000.

Therefore, the unticked items are classified as:

- **Opening Balance Difference**:

  Cheque to Mr. A – Rs. 30,000 (likely issued in the previous month and recorded in that month's BRS, but presented to the bank in April).

- **Closing Balance Difference**:

  Bank Charges – Rs. 2,000 (charged by the bank in May but not yet recorded in the company's Cash Book).

METHODS OF BANK RECONCILIATION

There are following **two methods of reconciling** the bank balances:

Bank Reconciliation Statement without Preparation of Adjusted Cash Book

In this method, we **do not alter the cash book** maintained by the business. We prepare a Bank Reconciliation Statement (BRS) directly by comparing the balance as per the Cash Book with the balance as per the Pass Book (Bank Statement) and listing all **timing differences**, **errors**, and **omissions**.

When preparing a Bank Reconciliation Statement (BRS), adjustments depend on:

- The starting balance (Cash Book or Pass Book, Dr. or Cr.)
- The nature of the reconciling item (e.g., cheque not cleared, bank charges, wrong entries, etc.)

The table below shows **whether to add or subtract** each item based on the balance you start from. The **final balance** after adjustments will be the balance as per the *other book* (on the opposite side).

Causes of Differences	Favourable Balance (Dr.) as per Cash Book	Unfavourable Balance (Cr.) as per Cash Book	Favourable Balance (Cr.) as per Pass Book	Unfavourable Balance (Dr.) as per Pass Book
Cheque deposited but not cleared	Subtract	Add	Add	Subtract
Cheque issued but not presented to bank	Add	Subtract	Subtract	Add
Cheque directly deposited in bank by a customer	Add	Subtract	Subtract	Add
Income (e.g., interest from UTI) directly received by bank	Add	Subtract	Subtract	Add
Expenses directly paid by bank on standing instructions	Subtract	Add	Add	Subtract
Bank charges levied by bank	Subtract	Add	Add	Subtract
Locker rent levied by bank	Subtract	Add	Add	Subtract
Wrong debit in the cash book	Subtract	Add	Add	Subtract
Wrong credit in the cash book	Add	Subtract	Subtract	Add
Wrong debit in the pass book	Subtract	Add	Add	Subtract
Wrong credit in the pass book	Add	Subtract	Subtract	Add
Undercasting of Dr. side of bank account in cash book	Add	Subtract	Subtract	Add
Overcasting of Dr. side of bank account in cash book	Subtract	Add	Add	Subtract
Undercasting of Cr. side of bank account in cash book	Subtract	Add	Add	Subtract
Overcasting of Cr. side of bank account in cash book	Add	Subtract	Subtract	Add
Bill receivable collected directly by bank	Add	Subtract	Subtract	Add
Interest on bank overdraft charged	Subtract	Add	Add	Subtract

Final Balance Interpretation

- **If starting from Dr. Balance (Cash Book)**
  - Positive result ⟶ Favourable balance (Cr.) as per Pass Book
  - Negative result ⟶ Unfavourable balance (Dr.) as per Pass Book

- **If starting from Cr. Balance (Cash Book)**
  - Positive result ⟶ Unfavourable balance (Dr.) as per Pass Book
  - Negative result ⟶ Favourable balance (Cr.) as per Pass Book
- **If starting from Cr. Balance (Pass Book)**
  - Positive result ⟶ Favourable balance (Dr.) as per Cash Book
  - Negative result ⟶ Unfavourable balance (Cr.) as per Cash Book
- **If starting from Dr. Balance (Pass Book)**
  - Positive result ⟶ Unfavourable balance (Cr.) as per Cash Book
  - Negative result ⟶ Favourable balance (Dr.) as per Cash Book

Example:

Balance as per Cash Book (Dr): 25,000

Prepare BRS as on 31st March:

S. No.	Particulars	Amount (Rs.)	Add / Less
1.	Cheque issued for Rs. 5,000 but not yet presented	5,000	Add
2.	Cheque deposited of Rs. 4,000 but not yet cleared	4,000	Less
3.	Bank charges Rs. 200 not entered in Cash Book	200	Less
4.	Customer directly deposited Rs. 3,000 into bank not recorded in Cash Book	3,000	Add
5.	Cash Book overcast by Rs. 1,000 (Debit Side)	1,000	Less

Solution: Bank Reconciliation Statement as on 31st March

Particulars	Amount (Rs.)
Balance as per Cash Book (Dr)	25,000
Add: Cheque issued but not presented	5,000
Add: Amount directly deposited by customer	3,000
Less: Cheque deposited but not cleared	(4,000)
Less: Bank charges not recorded	(200)
Less: Cash book overcast	(1,000)
Balance as per Pass Book	**27,800**

Bank Reconciliation Statement after Preparation of Adjusted Cash Book

Meaning of Adjusted Cash Book:

Sometimes, certain entries are **missing in the Cash Book**, such as:

- Bank charges
- Interest allowed or charged
- Direct payments by bank
- Direct deposits by customers

In such cases, we **first prepare an adjusted Cash Book**, incorporating these items, and then prepare the Bank Reconciliation Statement using the adjusted balance.

Steps to Prepare:

Step 1: Adjust Cash Book for:

- Entries not yet recorded in the cash book.

Step 2: Find **adjusted balance** from the adjusted Cash Book.

Step 3: Use that adjusted balance to prepare the BRS, reconciling with the Pass Book.

Example:

Balance as per Cash Book: Rs.30,000

Adjustments to be made:

- Bank charges Rs. 300 not entered
- Interest credited by bank Rs. 500 not entered
- Direct deposit by customer Rs. 2,000 not recorded in cash book
- Insurance premium Rs. 1,200 paid by bank not recorded

Particulars	Amount (Rs.)
Opening Balance (Dr)	30,000
Add: Interest credited	500
Add: Customer deposit	2,000
Less: Bank charges	(300)
Less: Insurance paid	(1,200)
Closing Adjusted Balance	**31,000**

Step 2: Prepare BRS using Adjusted Cash Book balance

Remaining differences:

- Cheque issued Rs. 6,000 not yet presented
- Cheque deposited Rs. 4,000 not cleared

Bank Reconciliation Statement as on 31st March

Particulars	Amount (Rs.)
Balance as per Adjusted Cash Book	31,000
Add: Cheque issued but not presented	6,000
Less: Cheque deposited but not cleared	(4,000)
Balance as per Pass Book	**33,000**

***Illustration 1*:** On **30th September 2025**, the Bank column of Mr. Kuldeep's Cash Book showed an overdraft of Rs. 10,000. However, the Bank Statement (Pass Book) for the same date reflected a **credit balance** of Rs.5,000 in his favour.

A comparison of the two records revealed the following differences:

1. A cheque worth Rs. 13,20,000 was deposited on 29th September 2025 but was credited by the bank only on 3rd October 2025.
2. A cheque payment of Rs. 20,000 was entered twice in the Cash Book by mistake.
3. On 29th September 2025, the bank credited Rs. 1,20,000 directly to Kuldeep's account (payment from a customer), but the advice reached Kuldeep only on 1st October 2025.
4. Bank charges of Rs. 1,000 had not been recorded in the Cash Book.
5. On 6th September 2025, the bank wrongly credited Rs. 20,000 to Kuldeep's account.
6. A bill of exchange worth Rs. 1,50,000, discounted with the bank, was dishonoured on 28th September 2025, but no entry was made in Kuldeep's books.
7. Cheques issued up to 30th September 2025 but not presented to the bank until after that date totalled Rs. 13,26,000.

Additional Note:

- Errors in the Pass Book are **not** to be rectified in the Cash Book.
- Adjustments made in the Cash Book are **not** repeated in the Bank Reconciliation Statement.

Required:

(a) Prepare the adjusted Cash Book (Bank column) of Kuldeep to find the corrected balance as on 30th September 2025.

(b) Prepare the Bank Reconciliation Statement on that date.

Solution

(a) Adjusted Cash Book (Bank Column only)

Date	Particulars	Amount Rs.	Date	Particulars	Amount (Rs.)
2025 Sept. 30	To Party A/c (Cheque wrongly entered twice)	20,000	2025 Sept. 30	By Balance b/d (Overdraft)	10,000

Sept. 30	To Customer A/c (Direct bank deposit)	1,20,000	Sept. 30	By Bank Charges	1,000
Sept. 30	To Balance c/d	21,000	Sept. 30	By Customer A/c (B/R dishonoured)	1,50,000
Total		**1,61,000**	**Total**		**1,61,000**

Corrected balance as per Cash Book (overdraft) = Rs. 21,000

(b) Bank Reconciliation Statement as on 30th September 2025

Particulars	Amount (Rs.)
Overdraft as per Cash Book	21,000
Add: Cheque deposited but not yet collected	13,20,000
Total	13,41,000
Less: Cheques issued but not yet presented	(13,26,000)
Less: Bank's erroneous credit on 6th September	(20,000)
Credit Balance as per Bank Statement	**5,000**

Note: If the bank corrects its error of crediting Rs. 20,000, this item will be excluded from the reconciliation. In that case: Rs. 13,41,000 – Rs. 13,26,000= Rs. (15,000)

This means the **debit balance** in the Pass Book would then be Rs. 15,000

Illustration 2:

On 30th June, 2025, the Bank Statement of **ABC** showed a favourable balance of Rs. 10,00,000. However, this balance did not match the bank column of their Cash Book.

A review of the Cash Book and the Bank Statement revealed the following points of difference:

1. A deposit of Rs. 3,00,000 made on 29th June, 2025, was credited by the bank only on 1st July, 2025.
2. As per a hire purchase agreement dated 30th March, 2025, the firm was required to pay Rs. 3,00,000 by bank order on the 10th of each month starting April 2025. No entry for these payments had been recorded in the Cash Book.
3. On 12th June, a customer paid off an account of Rs. 4,00,000 after availing a 4% cash discount. The cashier mistakenly recorded the full Rs. 4,00,000 in the bank column instead of the net amount.
4. Bank charges of Rs. 5,000 had not yet been entered in the Cash Book.
5. On 28th June, a customer directly deposited Rs. 5,00,000 into the company's bank account, but the entry was not made in the Cash Book.

6. An amount of Rs. 20,000 deposited into the bank was entered twice in the Cash Book.
7. A debit of Rs. 10,00,000 appeared in the Bank Statement for a cheque returned as "out of date." The customer later re-dated and redeposited the cheque on 5th July, 2025.

Required:

Prepare the **Bank Reconciliation Statement** for ABC as on 30th June, 2025.

Solution: Bank Reconciliation Statement as on 30th June, 2025

Particulars	Amount
Balance as per Bank Pass Book (Credit)	10,00,000
Add: Deposit made on 29 June but credited by bank on 1 July	3,00,000
Add: Hire-purchase instalments paid by bank (April–June: Rs.3,00,000 × 3) not recorded in Cash Book	9,00,000
Add: Excess credit in Cash Book due to wrong recording of discount (Rs.4,00,000 – Rs.3,84,000)	16,000
Add: Bank charges not recorded in Cash Book	5,000
Add: Cheque returned as "out of date" debited by bank but will be re-credited later	10,00,000
Add: Amount deposited but entered twice in Cash Book	20,000
Less: Direct deposit by customer not recorded in Cash Book	(5,00,000)
Balance as per Cash Book	27,41,000

Illustration 3:

The Cash Book (bank column) of X shows an overdraft of Rs. 4,062 as on 30th September 2025, whereas the Bank Statement shows a debit balance of Rs. 8,59,412. Upon examination, the following reconciling items were identified:

1. A cheque of Rs. 13,14,000 deposited on 29-09-2025 was credited by the bank on 3-10-2025.
2. Bank charges of Rs. 350 have been debited in the Bank Statement but not yet recorded in the Cash Book.
3. Cheques issued worth Rs. 4,56,000 have not been presented for payment till 30-09-2025.
4. Direct deposit by a customer of Rs. 3,000 is recorded in the Bank Statement but not in the Cash Book.

Prepare Bank Reconciliation Statement.

Solution:

Bank Reconciliation Statement

As on 30th September 2025

Particulars	Amount
Balance as per Cash Book (Overdraft)	4,062
Less: Cheques issued but not presented for payment	(4,56,000)
Less: Direct deposit by customer not recorded in Cash Book	(3,000)
Add: Cheque deposited but not yet credited by bank	13,14,000
Add: Bank charges not yet recorded in Cash Book	350
Balance as per Bank Statement (Overdraft)	8,59,412

Working Notes:

- Overdraft as per Cash Book is treated as a negative balance and added or subtracted as per reconciliation rules.
- Cheques issued but not presented increase the bank balance in the statement compared to the Cash Book.
- Cheques deposited but not credited reduce the bank balance in the statement compared to the Cash Book.
- Direct deposits by customers and bank charges are items recorded in the Bank Statement but pending in the Cash Book.

Summary

- A bank pass book is essentially a record maintained by the bank that mirrors the customer's account as it appears in the bank's own ledger.
- A **Bank Reconciliation Statement (BRS)** is a tool used to match the balance in the business's cash book with the balance shown in the bank's pass book. It lists and explains the reasons for any differences between the two balances.
- Key purposes and benefits of preparing a BRS:
- It helps identify and correct errors that might exist in either the cash book or the pass book.
- It reveals delays in the clearance of cheques or other banking transactions.
- Regular reconciliation acts as a safeguard against fraud or misappropriation, as it ensures that entries in the cash book are backed by actual deposits or withdrawals in the bank.

- It provides an accurate picture of the available bank balance at a given date.
- Reasons for differences between the two balances:
  1. **Timing differences –** when transactions appear in one book before the other.
  2. **Unrecorded transactions –** when the bank or business records an entry the other has not yet accounted for.
  3. **Errors –** mistakes in recording or posting entries in either book.
- Starting points for reconciliation:

The BRS can be prepared starting from any of the following balances:

- Debit balance as per cash book
- Credit balance as per cash book
- Debit balance as per pass book
- Credit balance as per pass book
- Methods of preparation:
  1. **Without adjusting the cash book** – prepare the statement directly from the given figures.
  2. **After adjusting the cash book** – first correct the cash book for missing or incorrect

True/False Questions

S. No.	Statement	True/False	Reasoning
1.	Cheques issued but not presented reduce the balance in the passbook.	False	They reduce the cash book balance, but the passbook balance remains unchanged until presented.
2.	Bank charges entered by the bank but not yet recorded in cash book cause a difference in balances.	True	Because they are deducted in the passbook but not yet recorded in the cash book.
3.	Interest credited by the bank increases the cash book balance.	False	It increases the passbook balance. Until entered in the cash book, the balances differ.
4.	Bank Reconciliation Statement is prepared by the bank.	False	It is prepared by the account holder to reconcile cash book and passbook.
5.	A dishonoured cheque reduces the balance in the passbook.	True	It reverses the credit earlier given, reducing the passbook balance.
6.	Errors in the cash book can cause a difference between the two balances.	True	Any error (omission, duplication, wrong amount) in the cash book will create mismatch.
7.	Direct deposits by customers appear only in the cash book until known.	False	They appear in the passbook first. Until entered in the cash book, the balances differ.
8.	BRS can be prepared only when the bank statement is received.	True	You need the bank's record (passbook/bank statement) to reconcile.

S. No.	Statement	True/False	Reasoning
9.	Overdraft as per passbook is treated as a debit balance.	True	Overdraft in passbook means debit balance (as the bank has lent you money).
10.	All differences in BRS are due to errors.	False	Timing differences (like unpresented cheques) also cause differences.
11.	Cheques deposited but not cleared increase the cash book balance.	True	They are added to cash book on deposit but not yet credited by bank.
12.	Adjusted cash book is prepared before preparing BRS when errors are found in cash book.	True	This helps in reconciling with corrected balances.
13.	If both cash book and passbook are correct and updated, BRS will show no difference.	True	BRS will tally if there are no errors or timing differences.
14.	Standing instructions for payment affect only the cash book.	False	They affect the passbook first; the cash book will show the entry later.
15.	Cheques dishonoured after reconciliation need adjustment in the next BRS.	True	The dishonour alters the previous assumption, requiring new reconciliation.

Multiple Choice Questions (MCQs)

1. **A cheque deposited but not yet cleared will have what effect in a BRS when starting from the Cash Book balance?**

   A. Added

   B. Deducted

   C. Ignored

   D. Not required to be reconciled

   Answer: B. Deducted

   Reason: Since the cheque is already recorded in the cash book but not cleared by the bank, it inflates the cash book balance. Hence, it must be deducted to reconcile.

2. **Which of the following will not cause a difference between the Cash Book and Pass Book balances?**

   A. Bank charges not recorded in Cash Book

   B. Cheques issued but not presented

   C. Direct deposit by a customer into the bank

   D. Rent expense paid in cash

   Answer: D. Rent expense paid in cash

   Reason: Cash transactions (not bank) affect neither the pass book nor the BRS process.

3. **Dishonour of a bill discounted with the bank should be treated as:**

   A. No effect on BRS

   B. Deducted when starting from Cash Book balance

C. Deducted when starting from Pass Book balance

D. Added when starting from Cash Book balance

Answer: B. Deducted when starting from Cash Book balance

Reason: Dishonoured bills increase bank liability and must be reduced from the cash book balance.

4. **When preparing BRS from the Pass Book balance, an interest credited by the bank but not recorded in Cash Book should be:**

A. Deducted

B. Added

C. Ignored

D. None of the above

Answer: A. Deducted

Reason: Since the bank has added interest but it is not yet in the cash book, it must be deducted while reconciling from pass book to cash book.

5. **An error in the cash book where Rs. 5,000 deposited is wrongly posted as Rs. 500 will lead to:**

A. No change in BRS if no amended cash book is made

B. Rs. 4,500 to be added

C. Rs. 4,500 to be deducted

D. Rs. 5,500 to be added

Answer: B. 4,500 to be added

Reason: The cash book is short by Rs. 4,500 due to an under-posting; hence, it must be added.

6. **A cheque received from a customer and entered in the cash book but not sent to the bank at all will be (if starting from cash book debit balance):**

A. Added

B. Deducted

C. Ignored

D. Error in both books

Answer: B. Deducted

Reason: Since it's recorded in the cash book but not in the bank, it overstates the cash book balance.

7. **A bank collected Rs. 10,000 on behalf of the customer which is not yet recorded in the cash book. The adjustment when starting from Cash Book is:**

A. Add Rs. 10,000

B. Deduct Rs. 10,000

C. No effect

D. Add Rs. 5,000 only

Answer: A. Add Rs. 10,000

Reason: The bank balance is more; cash book needs to be increased to match it.

8. Which of the following is not a timing difference in BRS?

A. Cheques issued but not presented

B. Direct bank charges

C. Cheques deposited but not cleared

D. None of the above

Answer: B. Direct bank charges

Reason: Bank charges are transaction differences, not timing differences. Timing differences occur when the same transaction is recorded at different times in both books.

9. Which of the following best explains the need for BRS in case of electronic fund transfers (EFT)?

A. EFT eliminates the need for BRS

B. EFT transactions are always error-free

C. Delay in recording EFTs in cash book may cause mismatch

D. EFTs are always updated in both books simultaneously

Answer: C. Delay in recording EFTs in cash book may cause mismatch

Reason: Even with automation, differences in recording time lead to mismatches requiring reconciliation.

Theoretical Questions

Q1. Explain the need and importance of preparing a Bank Reconciliation Statement.

Solution: A **Bank Reconciliation Statement (BRS)** is prepared to reconcile the difference between the **bank balance as per the Cash Book** (maintained by the business) and the **bank balance as per the Pass Book** (maintained by the bank). The need and importance are as follows:

1. **Identification of Discrepancies:** It helps identify discrepancies due to errors, omissions, or timing differences.
2. **Detection of Errors and Frauds:** It can uncover errors such as wrong postings or frauds like unauthorized withdrawals.
3. **Ensures Accuracy of Records:** Ensures the business's cash book reflects true bank transactions.
4. **Internal Control Tool:** Acts as a control mechanism to monitor how well cash and bank transactions are managed.
5. **Assists in Correct Decision Making:** Reconciled figures help stakeholders and management in correct financial analysis and planning.
6. **Timely Rectification:** Regular preparation leads to quick identification and rectification of mistakes.

Q2. Differentiate between errors and timing differences in Bank Reconciliation with suitable examples.

Solution

Basis	Errors	Timing Differences
Meaning	Mistakes or wrong entries in records	Delay in recording transactions in either book
Reason	Human or system error	Difference in date of entry in cash vs pass book

Basis	Errors	Timing Differences
Effect	Can overstate/understate balances	Causes temporary difference in balances
Examples	• Wrong amount entered in cash book • Cheque recorded twice	• Cheque issued but not presented • Cheque deposited but not credited
Rectification	Needs correction in books	Automatically resolved over time
Impact on BRS	Requires correction entries	Requires adjustment entries

Conclusion:

Both errors and timing differences cause mismatch in balances. Errors need correction, while timing differences are usually resolved in due course.

Q3. What are the different methods of preparing Bank Reconciliation Statement? Illustrate with suitable examples.

Solution: There are **two methods** of preparing a Bank Reconciliation Statement:

Method 1: Without Preparation of Adjusted Cash Book

Steps:

1. Start with balance as per Cash Book or Pass Book
2. Add/Deduct items causing differences
3. Arrive at the other book's balance

Example:

- Balance as per Cash Book: Rs. 50,000
- Cheque issued but not presented: Rs. 10,000 (Add)
- Bank charges not entered in cash book: Rs. 500 (Deduct)

Reconciled Balance as per Pass Book = Rs. 50,000 + Rs. 10,000 - Rs. 500 = Rs. 59,500

Method 2: After Preparation of Adjusted Cash Book

Steps:

1. Prepare adjusted Cash Book by entering missed items (like bank charges, interest, direct deposits).
2. Then prepare BRS starting with adjusted Cash Book balance.

Example (Adjusted Cash Book):

- Balance as per Cash Book: Rs. 50,000
- Add: Interest credited by bank: Rs. 1,000
- Less: Bank charges: Rs. 500

Adjusted Cash Book Balance = Rs. 50,500

Now prepare BRS:

- Adjusted Cash Book Balance: Rs. 50,500
- Add: Cheques issued not presented: Rs. 10,000

Reconciled Pass Book Balance = Rs. 60,500

Practical Questions

Question 1. A firm's Cash Book showed a debit bank balance of Rs. 1,00,000 as on 31st December 2025. However, upon comparing it with the bank passbook, several discrepancies were identified:

1. Cheques amounting to 14,00,000 were issued, but only Rs. 3,00,000 worth were presented for payment until 31st December.
2. Cheques totalling Rs. 11,00,000 were deposited on 28th December, 2025 but were not credited by the bank as of 31st December, 2025. Additionally, a cheque worth 5,00,000 was entered in the Cash Book on 30th December but actually deposited in the bank on 3rd January 2026.
3. A cheque received from a customer (Susan) worth Rs. 3,50,000 was deposited on 26th December and was later dishonoured, but the information was received on 2nd January 2026.
4. Bank charges of Rs. 5,000 were recorded in the bank passbook but not in the Cash Book.
5. A debtor directly deposited Rs. 4,00,000 into the firm's bank account on 20th December. However, this information was not communicated to the firm until 2nd January.
6. The bank statement showed a debit balance of Rs. 3,55,000 on 31st December.

Prepare a **Bank Reconciliation Statement** as of 31st December 2025.

Solution:

Bank Reconciliation Statement as on 31st December, 2025

(Based on Cash Book Balance)

Particulars	Amount (Rs.)
Balance as per Cash Book (Dr)	1,00,000
Add: Cheques issued but not yet presented (14,00,000 - 3,00,000)	11,00,000
Less: Cheques deposited but not yet credited	(11,00,000)
Less: Cheque deposited on 30 Dec but banked on 3 Jan	(5,00,000)
Less: Dishonour of cheque (Susan)	(3,50,000)
Less: Bank charges not recorded in Cash Book	(5,000)
Add: Direct deposit by debtor (Not recorded in Cash Book)	4,00,000
Balance as per Pass Book (Dr)	**(3,55,000)**

Question 2.

The bank balance as per the **Cash Book** of M/s XYZ on **31st March 2025** was Rs. 25,000. However, upon comparing with the bank statement, various discrepancies were discovered due to timing differences, errors, and omissions. The following items were noted:

1. A government subsidy of Rs. 10,000 was directly credited by the bank but was not recorded in the company's books.
2. On 15th March, the payment side of the Cash Book was undercast by Rs. 300.
3. On 20th March, a debit balance of Rs. 2,000 from the previous day was wrongly carried forward as a credit balance in the Cash Book.
4. A customer who was allowed a 5% discount on a payment of Rs. 2,000 paid the net amount via cheque on 24th March. However, the gross amount was recorded in the Cash Book.
5. A bill worth Rs. 5,700 was discounted on 10th March. It was recorded in the Cash Book at face value, but the bank credited only Rs. 5,600.
6. A cheque of Rs. 2,000 issued earlier was returned dishonoured by the bank as "out of date." No rectification was done in the Cash Book.
7. Insurance premium of Rs. 700 was debited by the bank through a standing instruction, which was not yet entered in the Cash Book.
8. A bill receivable for Rs. 1,600, discounted for Rs. 1,500, was dishonoured on 30th March. The intimation was received only on 1st April.
9. The bank erroneously recorded a cash deposit of Rs. 1,550 as Rs. 1,500.

Prepare the **Bank Reconciliation Statement** as on **31st March, 2025**, after correcting errors in the **Cash Book** if necessary.

Solution:

Bank Reconciliation Statement of M/s XYZ as on 31st March, 2025

Step 1: Prepare the Adjusted Cash Book

Particulars	**Amount (Rs.)**
Balance as per Cash Book (Dr.)	25,000
Add: Subsidy directly credited by bank	10,000
Cheque dishonoured not reversed	2,000
Wrong carry forward of balance (Dr. as Cr.) ⟶ Effect: Double increase ⟶ Add twice	4,000
Less: Undercasting of payment side	(300)
Discount not deducted (2,000 x 5%)	(100)
Difference in bill proceeds credited by bank	(100)
Insurance premium paid by bank	(700)
Dishonour of discounted bill	(1,600)
Adjusted Cash Book Balance (Dr.)	**38,200**

Step 2: Prepare Bank Reconciliation Statement (BRS)

Bank Reconciliation Statement of M/s XYZ as on 31st March, 2025

Particulars	Amount (Rs.)
Balance as per Adjusted Cash Book (Dr.)	38,200
Less: Cash deposit recorded less by bank (1,550 - 1,500)	(50)
Balance as per Bank Statement	38,150

Question 3:

On March 31, 2025, a business entity reviewed its bank statement and cash book records to reconcile the differences between them. The following discrepancies were noted:

1. The bank passbook shows an overdraft of Rs. 2,00,000 as on March 31, 2025.
2. Interest charged by the bank on the overdraft amounting to Rs. 30,000 was not yet recorded in the cash book.
3. The bank has paid an insurance premium of Rs. 20,000 on behalf of the business, which has not been accounted for in the firm's books.
4. Cheques amounting to Rs. 15,000 and Rs. 20,000 were issued during the last week of March but were not presented for payment by March 31.
5. A cheque of Rs. 50,000 was deposited in February, but it remains uncredited by the bank as of March 31.
6. The bank has wrongly debited Rs. 20,000 from the account.
7. Interest on investments amounting to Rs. 80,000 was collected and credited by the bank, but it is not yet recorded in the cash book.

Prepare a **Bank Reconciliation Statement** as on **31st March, 2025**, and ascertain the **balance as per the Cash Book**.

Solution:

Bank Reconciliation Statement as on 31st March, 2025

(Starting with overdraft as per Pass Book)

Particulars	Amount (Rs.)	Amount (Rs.)
Overdraft as per Pass Book (given)		2,00,000
Less: Items not yet recorded in Cash Book (i.e., deductions)		
Interest on overdraft not entered in Cash Book	(30,000)	
Insurance premium paid by bank not recorded	(20,000)	

Particulars	Amount (Rs.)	Amount (Rs.)
Cheque deposited but not yet credited by bank	(50,000)	
Amount wrongly debited by the bank	(20,000)	
	(1,20,000)	
Add: Items to be added to Cash Book (i.e., additions)		
Cheques issued but not yet presented (15,000 + 20,000)	35,000	
Interest on investment credited by bank but not recorded	80,000	
	1,15,000	
Balance as per Cash Book (Overdraft)		**1,95,000**

Question 4.

Ram's Cash Book shows a bank balance of Rs. 45,00,000 on 30th June 2025. Upon comparison with the bank passbook, the following discrepancies were observed:

1. Cheques issued to creditors amounting to Rs. 5,00,000 have not yet been presented for payment.
2. Cheques of Rs. 10,00,000 were deposited, but only Rs. 5,00,000 were collected by the bank by 30th June 2025.
3. A dividend of Rs. 50,000 and rent of Rs. 5,00,000 were directly collected by the bank but not recorded in the cash book.
4. Insurance premium paid by the bank (valid till 31st December 2025) Rs. 25,000 was omitted from the cash book.
5. The payment side of the cash book was undercast by Rs. 5,000.
6. Bank charges of Rs. 2,000 were recorded in the pass book but omitted from the cash book.
7. A bill payable of Rs. 3,00,000 was paid by the bank but not recorded in the cash book.
8. A bill receivable for Rs. 60,000 was discounted with the bank with discount Rs. 1,000. This transaction not recorded in the cash book.

You are required to:

(a) Make appropriate adjustments in the cash book.

(b) Prepare a Bank Reconciliation Statement as on 30th June 2025

Solution:

(a) Adjusted Cash Book of Ram

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance B/d	45,00,000	By Insurance Premium Paid	25,000
To Dividend Received	50,000	By Bank Charges	2,000

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Rent Received	5,00,000	By Under-casting Error	5,000
To Bills receivable	59,000	By Bill Payable Paid by Bank	3,00,000
		By Balance C/d	47,77,000
Total	51,09,000	**Total**	51,09,000

Adjusted Bank Balance (Cash Book) = Rs. 47,77,000

(b) Bank Reconciliation Statement of Ram as on 30th June 2025

Particulars	Amount (Rs.)
Balance as per Adjusted Cash Book	47,77,000
Add: Cheques issued but not presented	5,00,000
	52,77,000
Less: Cheques deposited but not yet collected	5,00,000*
Balance as per Pass Book	**47,77,000**

*Cheques deposited Rs. 10,00,000 - collected Rs. 5,00,000 = Rs. 5,00,000 not yet collected.

Question 5:

On 30th September, 2025, Shyam's bank column of the Cash Book showed an overdraft of Rs. 5,000. The bank statement as on the same date showed a credit balance of Rs. 20,000 in favour of Shyam. On examining the Cash Book and Bank Statement the following items were found:

- A cheque for Rs. 13,00,000 deposited on 29-09-2025 was credited by the bank only on 03-10-2025.
- A payment by cheque of Rs. 15,000 has been entered twice in the Cash Book.
- On 29-09-2025 the bank credited Rs. 1,20,000 received from a customer of Shyam, but advice was received by Shyam only on 01-10-2025 (so it was not in Cash Book on 30-09-2025).
- Bank charges of Rs. 2,000 had not been entered in the Cash Book.
- On 06-09-2025 the bank credited Rs. 69,000 to Shyam in error.
- A bill of exchange for Rs. 1,50,000 discounted by Shyam with the bank was dishonoured on 28-09-2025 but no entry had been made in Shyam's books.
- Cheques issued up to 30-09-2025 but not presented for payment up to that date totalled Rs. 12,73,000.

(a) Show the rectifications required in the Cash Book of Shyam to arrive at the correct balance on 30-09-2025.

(b) Prepare a Bank Reconciliation Statement as on 30-09-2025.

Solution:

(a) Rectifications in the Cash Book and corrected Cash Book balance (30-09-2025)

Balance as per Cash Book (bank column) on 30-09-2025 (Overdraft) = **(Rs. 5,000)**

Adjustments to Cash Book:

- Add: Payment by cheque entered twice (reverse duplicate) = **+ Rs. 15,000**
- Add: Bank credited collection from customer not recorded = **+ Rs. 1,20,000**
- Less: Bank charges not recorded = **– Rs. 2,000**
- Less: Dishonour of bill of exchange not recorded = **– 1,50,000**

Corrected balance as per Cash Book (30-09-2025) = **Bank Overdraft Rs. 22,000**

(b) Bank Reconciliation Statement as on 30-09-2025

Balance as per Bank Statement (30-09-2025) (credit in favour of Shyam) = **Rs. 20,000**

	Rs.
Balance as per Bank Statement (30-09-2025)	20,000
Add: Deposit in transit (cheque deposited 29-09-2025)	13,00,000
Subtotal	13,20,000
Less: Outstanding cheques	(12,73,000)
Less: Bank's erroneous credit	(69,000)
Adjusted balance (reconciled)	(22,000)

Corrected balance as per Cash Book (Overdraft) (Rs. 22,000)

Question 6:

The Pass Book of Mrs Madhu's Account No. 9458 shows an **overdraft of Rs. 30,000** as on **31 March 2025**. On examining the Pass Book the following items were found:

1. Bank credited interest of **Rs. 3,000** to her account; this has not been entered in the Cash Book.
2. On 31-Mar-2025 Mrs Madhu paid in **Rs. 20,000** (cash and cheques); cheques of **Rs. 7,000** out of this were collected by the bank only on 7-Apr-2025.
3. Out of cheques drawn by her totalling **Rs. 7,800** on 27-Mar-2025, a cheque for **Rs. 2,500** was encashed by the bank on 3-Apr-2025.
4. The bank wrongly credited her account with **Rs. 500** (this amount belonged to A/c No.8765) and wrongly debited her account with **Rs. 300** (also relating to A/c No.8765).
5. A cheque for **Rs. 1,000** was entered in the Cash Book but was omitted to be banked on 31-Mar-2025.
6. A bill for **Rs. 10,000** was retired/paid by the bank under a rebate of **Rs. 175**, but the full 10,000 was credited in the Bank column of the Cash Book.

7. A cheque for **Rs. 2,500** was deposited into the bank but omitted to be recorded in the Cash Book; the bank collected it on **31-Mar-2025**.

Prepare the **Bank Reconciliation Statement** as on **31-Mar-2025** (show reconciliation between Pass Book overdraft and Cash Book balance).

Solution:

Bank Reconciliation Statement

Particulars	Amount (Rs.)
Overdraft as per Pass Book (31-Mar-2025)	30,000
Add:	
Interest credited by bank not recorded in Cash Book	3,000
Cheque drawn encashed after date (not yet debited in Pass Book)	2,500
Bank's wrong credit/debit (net wrong credit of Pass Book) [500-300]	200
Cheque collected by bank but omitted in Cash Book	2,500
Rebate effect — Cash Book overstated	175
Total additions	8,375
Less:	
Cheques paid in but collected after date (deposits in transit)	7,000
Cheque entered in Cash Book but omitted to be banked (deposit in transit)	1,000
Total deductions	8,000
Overdraft as per Cash Book (31-Mar-2025)	**30,375**

LESSON ROUNDUP

- Bank's main business is to accept deposits and to lend money.
- Money can be deposited with a bank in Recurring Deposit types of accounts: Current Account, Savings Account form main and Fixed Deposit Account
- Pass book is a copy of the client's account in the bank's ledger.

- The balance as per bank ledger indicated in the bank pass book is called the bank balance as per pass book.
- Bank Reconciliation Statement is a statement prepared as on a particular date to reconcile the bank balance as per cash book with balance as per pass book by showing all causes of difference between the two balance.
- Overdraft means that the money withdrawn from bank account is in excess of the money deposited in the bank.
- The following are the usual causes of difference between the balances as shown by the cash book and pass book
  - Cheques issued but not presented for payment
  - Cheques deposited with the bank but not yet collected and credited by bank
  - Bank charges not entered in the cash book
  - Interest credited or debited by the bank not entered in the cash book
  - Amount collected by the bank on behalf of the customer
  - Amount paid by the bank on standing instructions of the customer
  - Dishonor of cheque(s)/bill(s)
  - Cheques received and entered in the cash book but omitted to be paid into the bank
  - Errors either in cash book or in pass book

TEST YOURSELF

Theory Questions

1. What is a bank reconciliation statement?
2. What is the significance of preparing a bank reconciliation statement?
3. What are the types of personal accounts in bank?
4. Describe the reasons why bank balance as per cash book may not agree with the bank balance as per pass book.
5. Briefly mention the steps of preparing bank reconciliation statement.

Practical Questions

1. On 31st March, 2025 the cash book of Gupta showed a debit bank balance of ₹ 4,800. Prepare a bank reconciliation statement as at that date taking into account the following additional information:
   - Cheques deposited but not yet credited by bank ₹ 3,610.
   - Cheques issued but not yet presented by payees for payment in the bank ₹ 2,050.
   - Bank charges appearing in pass book but not yet recorded in cash book ₹ 40.

– Collections made by the bank and appearing in pass book but not yet recorded in cash book ₹ 1,000.

[*Balance as per Pass Book ₹ 4,200*].

2. On 31st March, 2025 the cash book of a trader shows a bank overdraft of ₹ 1,800. A comparison of the cash book with the pass book reveals the following facts:

   – Cheques issued but not presented for payment upto 31st March, 2025 ₹ 8,500.

   – Cheques deposited with the bank on 31st March, 2025 but credited by bank on 1st April, 2025 ₹ 9,200.

   – Bank charges debited by bank, ₹ 230 and dividends collected by bank on behalf of the trader ₹ 5,000 have not been recorded in the cash book.

   – A cheque of ₹ 1,400 received from X and deposited with the bank on 26th March, 2025 was recorded as that of ₹ 400 in the cash book.

   You are required to prepare a bank reconciliation statement after passing the necessary entries in the cash book to bring its balance up-to-date. The firm closes the books on 31st March. How much will be shown in the balance sheet as bank balance/overdraft?

   (*Balance as per Pass Book ₹ 3,270; Amended cash book balance ₹ 3,970.*)

3. Following are the transactions recorded in the bank column of the Cash Book of Madhur for the month ending 31 December, 2025:

Dr. **Cash Book (Bank Columns)** *Cr.*

Date		**Particulars**	₹	**Date**		**Particulars**	₹
2025				**2025**			
Dec.				Dec.			
19	To	Cash	54,000	1	By	Balance b/d	60,000
24	”	Buddha	36,000	8	”	Ram	3,000
26	”	Chaitanya	15,000	10	”	Lakshman	600
31	”	Balance c/d	11,460	19	”	Bharat	360
				24	”	Shatrughan	52,500
			1,16,460				1,16,460

On the receipt of Bank Statement on 31st December, 2025, Madhur collected the following information:

– Credit in pass book not recorded in the cash book ₹ 300

– Interest on Government bonds collected by the bank but not entered in the cash book ₹ 1,620.

– Cheques for ₹ 1,51,000 deposited but the bank collected only ₹ 1,36,000.

– Dividend collected by the bank directly but not intimated the same to Madhuri ₹ 1,500.

- Interest on overdraft charged by the bank but not entered in the cash book ₹ 1,500.
- Cheques for ₹ 1,56,460 issued by the trader but presented to the bank for payment only ₹ 1,3,960.

Amend the Cash Book and prepare a Bank Reconciliation Statement from the above information.

4. From the following information supplied by Vikas, prepare bank reconciliation statement as on March 31, 2025.
   - Bank balance as per passbook ₹7,700.
   - Cheques issued for ₹1,75,200 were entered in cash book as ₹1,72,500. Cheques for ₹65,000 were not presented for payment till March 31, 2025.
   - A cheque of ₹8,500 paid into the bank had been debited by the bank in error.
   - Cheques received and recorded but not sent to bank for collection ₹12,400.
   - Payment received from a customer direct by the bank ₹27,300 but no entry was made in the cash book.
   - ₹44,900 was entered in the cash book as paid into bank on 30.3.2025 but was credited by the bank on 2.4.2025.
   - The bank column on payment side of the cash book had been under cast by ₹1, 000.
5. From the following particulars, ascertain the balance as would appear in the bank pass book of Mohan on 31st March, 2025. The cash book showed a credit balance of ₹82,000 on that date
   - Cheques issued, but not presented for payment by 31st March, 2025 ₹23,000
   - Cheques paid into bank, but not cleared by 31st March, 2025 ₹30,000
   - Interest charged on overdraft appeared in the pass book only ₹ 500
   - Bank charges debited by bank, but not recorded in the cash book ₹ 200
   - Interest on debentures collected by bank, but not recorded in the cash book ₹6,000
   - Bank paid insurance premium as per standing instructions, not yet recorded in the cash book ₹2,200
   - A customer paid into the firm's bank account directly ₹ 10,000
6. The following is a summary of the Cash Book of Shri Mohan Das, for the month of June 2025.

Dr.			*Cr.*
Particulars	₹	Particulars	₹
Receipts	14,690	Balance b/d	7,610
Balance c/d	5,540	Payments	12,620
	20,230		20,230

All receipts are banked and payments are made by cheques. On investigation, it is found that:

- Bank charges of ₹ 1,360 entered on the bank statement had not been entered in the cash book.
- Cheques drawn amounting to ₹ 2,670 had not been presented to the bank for payment.
- Cheques received totaling ₹ 17,620 had been entered in the cash book and paid into the bank, but had not been credited by the bank until July, 2025.
- A cheques for ₹ 1,220 had been entered as a receipt in the cash book instead of as a payment.
- A cheque for ₹ 1,250 had been debited by the bank in error.
- A cheque received for ₹ 800 had been dishonoured. No adjustments had been made in the cash book.
- All dividends receivable are credited directly to the bank account. During June, amount totaling ₹ 2,620 were credited by the bank and no entries were made in the cash book.
- A cheque drawn for ₹ 600 in favour of a creditor had been incorrectly entered in the cash book as ₹ 6,000.
- The opening balance brought forward in the cash book should have been ₹ 7,110
- The bank statement as on 30th June, 2015, showed an overdraft ₹ 17,820.

You are required to: Show the adjustments required in the cash book; and Prepare a bank reconciliation statement as on 30th June, 2015.

MULTIPLE CHOICE QUESTIONS

1. Interest on drawings is:
   a) Expenditure for the business
   b) Cost for the business
   c) Gain for the business
   d) None of the above
2. Goods given as samples should be credited to:
   a) Advertisement account
   b) Sales account
   c) Purchase account
   d) None of the above
3. Outstanding salaries are shown as:
   a) Added to Salaries while preparing P & La/c
   b) Shown in liability side of Balance sheet under current Liability
   c) (a) &(b) above
   d) None of the above
4. Income tax paid by a sole proprietor on his business income should be:
   a) Debited to trading account
   b) Debited to profit and loss account

c) Deducted from capital account in the balance sheet

d) None of the above

5. All direct & indirect expenses related to business are charged:

a) Profit and loss account

b) Trading account

c) Trading account Profit and Loss account

d) Directly to Balance sheet

6. According to Companies Act which item is not shown on Asset side of Balance sheet :

a) Investment

b) Current Loan & Advances

c) Provision

d) Lease Holds

7. Trade Payables are recorded in.....

a) Asset side of B/S

b) Liability side of B/S

c) P & L a/c

d) None of the above

8. Investment of X company profit in shares of other company PQR Pvt. ltd are recorded in.....

a) Asset side of Balance Sheet

b) Liability side of Balance Sheet

c) Profit & Loss a/c

d) Not recorded in Balance Sheet

9. Preliminary expenses are recorded in.....

a) Equity and liabilities-Liability side of B/S

b) Current liabilities- Liability side of B/S

c) Fixed assets- Asset side of B/S

d) Asset side of B/S

10. Carriage outward is charged to

a) Debit side Profit & Loss a/c

b) Debit side Trading a/c

c) Credit side of Profit & Loss a/c

d) Credit side of trading a/c

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

Depreciation and Amortization

Lesson 4

KEY CONCEPTS

■ Depreciation ■ Amortization ■ Useful Life of Assets ■ Salvage Value

Learning Objectives

To understand:

Capital expenditures results in the acquisition of fixed assets for utilisation in the process of providing goods and services to the customers. Fixed assets are utilised for a number of accounting periods. Value of fixed asset decreases with the passage of time. Moreover, the portion of asset utilised for generating revenue should be recovered during the accounting year to match the expenses of a period with the revenue of the same period. This allocation of portion of fixed assets is the concept of depreciation, which will be dealt with in detail in this lesson.

The objective of this lesson is to make students understand the meaning, causes and nature of depreciation and accounting treatment of depreciation. It will provide an understanding of the principles and methods of calculating and accounting of depreciation.

Lesson Outline

- Introduction
- Meaning of Depreciation
- Definition of Depreciation
- Characteristics of Depreciation
- Causes of Depreciation
- Objectives of Providing Depreciation
- Factors in Measurement of Depreciation
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INTRODUCTION

Meaning of Depreciation

A business enterprise acquires different types of fixed assets depending upon its requirements and financial conditions. Fixed assets have a long life and are held for use in the business for production of goods and services. Whenever an asset is used in business its value gets reduced and sooner or later the asset becomes value less. Depreciation is a permanent, continuous and gradual shrinkage in the book value of a fixed asset. It is the fall in the quality or value of a fixed asset through physical wear and tear due to use or passage of time or from any other cause. Depreciation takes place irrespective of regular repairs and maintenance. As the asset is used for business purpose, the annual loss in the value of the asset is like any other expenditure. Hence, the cost of fixed assets has to be written off over its useful economic life as a loss.

Thus, depreciation is a process of allocating the cost of a fixed asset over its estimated useful life in a rational and systematic manner.

Definition of Depreciation

The Institute of Chartered Accountants of India has defined depreciation as "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 depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined."

Depreciation Accounting has been defined by the American Institute of Certified Public Accountants as " a system of accounting which aims to distribute the cost or other basic value of tangible capital assets less salvage (if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation and not of valuation."

Characteristics of Depreciation

The following are the important characteristics of depreciation:

(i) Depreciation refers to a permanent, continuous and gradual decrease in the utility value of a fixed asset and it continues till the end of the useful life of the asset.

(ii) Depreciation is a charge against profit (i.e. revenue earned) for a particular accounting period.

(iii) Depreciation is always computed in a systematic and rational manner since it is not a sudden loss.

(iv) Depreciation is a process of allocation of expired cost and not of valuation of fixed assets.

(v) Whatever method for calculating depreciation is followed, the exact amount of depreciation can never be calculated, and it can only be estimated.

(vi) Depreciation is caused due to physical factors and functional factors.

(vii) The fundamental objectives of depreciation are - (a) to maintain the nominal capital invested in fixed assets, and (b) to allocate the expired portion of the cost of fixed assets over a number of accounting periods.

(viii) Depreciation is must, i.e. it always takes place whether the asset is carefully handled or neglected.

(ix) If the market value of a fixed asset is fluctuating, the same does not affect the amount of depreciation so made on the respective assets.

(x) Depreciation is calculated in respect of fixed assets only, i.e. plant, machinery, furniture etc.

(xi) Total depreciation cannot exceed its depreciable value or original cost where the scrap value is nil.

Causes of Depreciation

(i) *Physical Wear and Tear Resulting from Use*: Tangible fixed assets like, machinery, buildings, furniture etc. get worn out or torn out on account of friction, strain, weathering, intensity of use, chemical reaction, handling etc. This is the most important cause of charging depreciation in respect of such assets which are in constant use.

(ii) *Physical Deterioration Resulting from Atmospheric Exposure*: Number of assets deteriorates for being continually exposed nature.

(iii) *Passage of Time*: A machine also becomes potentially useless by the passage of time. It is so even if the machine is kept continuously idle.

(iv) *Depletion*: Wasting assets such as mines and quarries lose their value because they get exhausted on account of continuous extractions.

(v) *Obsolescence*: Sometimes an asset becomes useless because of technical changes within the industry, technical progress in other industries, changes in tastes and habits of consumers, changes in supply and locations of natural resources etc.

Objectives of Providing Depreciation

The objectives of providing depreciation are as follows:

(i) *To ascertain the correct profit*: When a particular asset is used for earning business income, the depreciation in the value of assets should be deducted from the income in order to calculate the correct and real profit of the business.

(ii) *To present true financial position*: In order to show the true financial position of the business in the balance sheet, it is necessary that assets must be shown at their true values after deducting reasonable depreciation. If depreciation is not provided, the assets will be overstated in the financial statements and it will be against sound business principles.

(iii) *To make provision for replacement of assets*: Since depreciation is a non-cash expense, the amount charged can be kept separately and utilised for the replacement of the fixed asset after the expiry of the useful life of the asset.

(iv) *To ascertain the proper cost of the product*: In order to ascertain the cost of production, it is necessary to charge depreciation as an item of cost of production.

(v) To maintain the capital invested in the cost of the asset intact in the business so that it can be reinvested in profit earning process.

(vi) To derive maximum tax benefit as it is allowed expense.

(vii) *To meet the legal requirements*: In the case of joint stock companies, it is necessary to charge depreciation on fixed assets before declaring dividends.

Factors in Measurement of Depreciation

The factors which affect measurement of depreciation are given below:

(i) The original cost of asset: The cost includes all cost incurred in acquiring the asset, i.e. purchase price including transportation and installation costs, if any.

(ii) The additions, if any, made to the assets during the year taking into consideration the date on which these additions were made.

(iii) The estimated useful life of the asset.

(iv) The scrap or the residual value of the asset.

(v) Obsolescence, i.e., the chance of the asset going out of fashion.

(vi) The working hours of the asset concerned.

(vii) The repairs and renewals.

(viii) The skill of the operators who handle the asset.

(ix) The legal provisions or other restrictions relating to depreciation.

ACCOUNTING CONCEPT OF DEPRECIATION

Depreciable assets are assets which

- are expected to be used for more than one accounting period;
- have a limited useful life and
- are held by the organization for use in the production or supply of goods and services.

When a fixed asset is purchased, it is recorded in the books of accounts at its original cost. But, the fixed asset is used to earn revenues for a number of accounting periods in future with the same acquisition cost until the concerned fixed asset is sold or discarded. It is therefore, necessary that a part of the acquisition cost of the fixed asset is treated or allocated as an expense in each of the accounting periods in which the asset is used. This allocation of cost in the form of an expense is known as depreciation in accounting.

Suppose, a business purchases a machinery for Rs. 10,00,000 and after using it for five years, it is sold for Rs. 2,00,000. The cost of the machinery used in the business is Rs. 8,00,000 (Rs. 10,00,000 – Rs. 2,00,000). This cost must be allocated as an expense of the business at the rate of Rs. 1,60,000 (Rs. 8,00,000 ÷ 5) is for each of five accounting periods in which the machinery has been used to earn revenues. This Rs. 1,60,000 charged as expense is called accounting concept of depreciation.

It is the cost for the services obtained from the use of the asset in the same manner as the cost of wages, rent, etc. Depreciation is the expense charged to profit and loss account before arriving at the net profit for the year. In other words, the cost of fixed asset in the form of depreciation has to be matched against the revenues of the years over which the asset is used.

Thus, in accounting, depreciation means apportionment or allocation of the cost of the fixed asset over its useful life. Its aim is to spread over and allocate or distribute the cost of the fixed asset to the years of its use and charge the depreciable cost to profit and loss account before arriving at the profits of each of the accounting periods in which the fixed asset utilized.

***Purpose of Depreciation Accounting*:** The primary purpose of depreciation accounting is cost allocation. Provision for depreciation in the profit and loss account does not involve the outflow of cash and hence funds to the extent of depreciation charged over the years will remain in the business and these funds can be easily used for replacement of asset.

SUMMARY

- Depreciation accounting is the process of allocating the cost of the tangible fixed asset less its salvage value over its serviceable life.
- Depreciation is an expense that is to be charged against the revenue whether the business makes profit or incurs loss;
- Depreciation provides funds for replacing the asset when its useful life ends. Depreciation is not a process of valuation but it is an allocation. Even if the market value of an asset increases, depreciation has to be recorded because of allocation process.

JOURNAL ENTRIES

(1) WHEN THE DEPRECIATION IS DIRECTLY CHARGED TO ASSET ACCOUNT:

Depreciation Account Dr.

To Asset Account

The asset account in this case appears at its reduced value in the balance sheet i.e.

Cost or book value	XXX
Less: Depreciation for the accounting period.	XXX

Depreciation expense is transferred to the debit of profit and loss account.

Profit and Loss Account Dr.

To Depreciation Account

(2) WHEN PROVISION FOR DEPRECIATION ACCOUNT IS OPENED:

For charging depreciation:

Depreciation Account Dr.

To Provision for Depreciation Account

For transferring depreciation expense to Profit and Loss Account:

Profit and Loss Account Dr.

To Depreciation Account

In this method, the asset account is not affected by the amount of depreciation and the value of asset appears in the ledger and the balance sheet at its original cost. The amount of depreciation written off is accumulated in provision for depreciation account.

When the asset is sold or discarded or exchanged for a new asset, the total accumulated depreciation for that asset in the provision for depreciation account is transferred to that asset account by the following journal entry.

Provision for Depreciation A/c Dr.

To Relevant Asset A/c

Thus, the balance in the provision for depreciation account always shows the accumulated depreciation on the assets which are in use or not sold out.

In the balance sheet, the asset account is shown at its original cost less balance in the provision for depreciation account.

On the assets side of the balance sheet

Relevant Asset A/c	XXX
Less: Provision for Depreciation	XXX

Alternatively, the asset account can be shown at its original cost on the assets side and provision for depreciation account can be shown on the liabilities side. But the former method is better and recommended.

REVIEW QUESTIONS

1. Depreciation is the process of allocating cost of over its estimated life.
2. _____ are some of the causes of depreciation.
3. Fixed costs are recorded in the books of accounts at value less any applicable discount.

METHODS OF PROVIDING DEPRECIATION

UNIFORM CHARGE METHODS	FIXED INSTALMENT METHOD
	ANNUITY METHOD
	DEPRECIATION FUND METHOD
	INSURANCE POLICY METHOD
DECLINING CHARGE METHODS	DIMINISHING BALANCE METHOD
	SUM OF YEARS OF DIGITS METHOD
	GROUP DEPRECIATION METHOD
OTHER METHODS	INVENTORY SYSTEM (VALUATION)
	DEPLETION METHOD
	MACHINE HOUR RATE METHOD

UNIFORM CHARGE METHODS

Depreciation is charged uniformly every year for those assets which are uniformly productive.

Fixed Instalment Method or Straight Line Method

Under this method, a fixed proportion of the original cost of the asset (less residual value) is written off each year so that asset account may be reduced to its residual value at the end of its estimated economic useful life. It is assumed that depreciation is a function of time. Depreciation is charged on a uniform basis every year till the asset is written off.

$$\text{Depreciation} = \frac{\text{Original Cost of the Fixed Assets (Including Exp require to make asset into working condition)} - \text{Estimated Scrap Value}}{\text{Life of the Assets in Number of Year}}$$

$$\text{Percentage of Depreciation} = \frac{\text{Depreciation}}{\text{Original Cost of the Fixed Assets}} \times 100$$

Note:

- Additional asset purchased during the year must be depreciated only from the date of purchase to the close of the accounting period.
- When no date of addition is mentioned, depreciation may be charged for half of the year on the assumption that addition was made in the middle of the year.
- Assets sold during the year should be depreciated from the beginning of the year till the date of sale.

ADVANTAGES	DISADVANTAGES
– *It is a simple and easy method.* – *The value of the asset can be completely written off, i.e. the value can be reduced to zero its estimated scrap value.* – *This method can be applied where asset gets depreciated because of effluxion of time like furniture, equipments, patents, leasehold etc.* – *There is no change either in the rate or amount of depreciation over the useful life of the asset.* – *The value of the asset each year in the balance sheet is reasonably fair.*	– *The assumption that the asset shall be equally useful throughout its life seems to be illogical.* – *It does not take into account the effective utilization of the asset.* – *Even though the asset is used uniformly from period to period, the total charge for the use of the asset keeps on increasing every year. This is because cost of repairs in each subsequent year rises though equal amount of depreciation is written off every year.*

Illustration 1:

A firm acquired a machinery on 1st July 2022 at a cost of Rs. 45,000 and spent Rs. 5,000 for its installation. The firm writes off depreciation at 10% per annum on the original cost every year. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

***Solution*:**

Dr. **Machinery Account** ***Cr.***

Date	Particulars	Rs.	Date	Particulars	Rs.
2022			2023		
Jul 1	To Bank	45,000	Mar.31	By Depreciation (10% on Rs. 50,000 for 9 months)	3,750
Jul 1	To Bank (Installation Expenses)	5,000	Mar.31	By Balance c/d	46,250
		50,000			50,000
2023			2024		
April 1	To Balance b/d	46,250	Mar. 31	By Depreciation (10% on Rs. 50,000)	5,000
			Mar. 31	By Balance c/d	41,250
		46,250			46,250
2024			2025		
April 1	To Balance b/d	41,250	Mar. 31	By Depreciation (10% on Rs.50,000)	5,000
				By Balance c/d	36,250
		41,250			41,250
2025					
April 1	To Balance b/d	36,250	Mar. 31		

Dr. **Depreciation Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2023			2023		
Mar. 31	To Machinery A/c	3,750	Mar.31	By Profit & Loss A/c	3,750
		3,750			3,750
2024			2024		
Mar.31	To Machinery A/c	5,000	Mar.31	By Profit & Loss A/c	5,000
		5,000			5,000
2025			2025		
Mar.31	To Machinery A/c	5,000	Mar.31	By Profit & Loss A/c	5,000
		5,000			5,000

DECLINING CHARGE METHODS

The amount of depreciation charged decreases for each subsequent year of the asset's life.

(a) When the asset becomes old and receipts decline or

(b) When it is necessary to charge depreciation according to the asset's expected earnings.

Diminishing Balance Method (Reducing Balance Method)

Under this method, depreciation is calculated at a certain percentage each year on the balance of the asset which is brought forward from the previous year. The amount of depreciation charged for each period is not fixed but it goes on decreasing gradually as the opening balance of the asset in each year will reduce. Thus, amount of depreciation becomes higher at in the earlier periods and becomes gradually lower in subsequent periods, while repairs and maintenance charges increase gradually.

Depreciation = $\mathbf{1 -} \sqrt[n]{\dfrac{\text{Net Residual Value}}{\text{Cost of Acquisition}}}$

Rate of Depreciation = 1 – n

Where, n = life of the asset in years.

DISTINCTION BETWEEN STRAIGHT LINE METHOD AND DIMINISHING BALANCE METHOD OF DEPRECIATION

Straight Line Method	Diminishing Balance Method
(i) Depreciation is charged at a fixed rate on the original cost of the asset.	(i) Depreciation is charged at a fixed rate on the original cost in the first year and on the written down value (cost-minus total depreciation) in the subsequent years.
(ii) The amount of depreciation remains the same in all the years of useful life of the asset.	(ii) The amount of depreciation goes on decreasing year after year.
(iii) The total burden on the profit and loss account is more in the later years because the repair charges increase while the amount of depreciation remains the same.	(iii) The total burden on the profit and loss account is almost same in the early years as well as is the later years because of more depreciation plus repairs cost in the beginning and less depreciation plus more repairs cost in the later years.
(iv) The book value of the asset becomes zero or equal to scrap value.	(iv) The book value never becomes zero.
(v) It is easy to calculate the rate of depreciation.	(v) It requires the use of mathematical tables.
(vi) It is suitable where repair charges are less and obsolescence is not frequent.	(vi) It is suited where repair charges are more in later years and also where there is obsolescence.

Illustration 2:

A firm acquired machinery on 1st July 2022 at a cost of Rs. 45,000 and spent Rs. 5,000 for its installation. The firm writes off depreciation at 10% per annum on diminishing balance method. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

Solution:

Dr. **Machinery Account** ***Cr.***

Date	Particulars	Rs.	Date	Particulars	Rs.
2022			2023		
Jul 1	To Bank	45,000	Mar.31	By Depreciation (10% on Rs. 50,000 for 9 months)	3,750
Jul 1	To Bank (Installation Expenses)	5,000	Mar.31	By Balance c/d	46,250
		50,000			50,000
2023			2024		
April 1	To Balance b/d	46,250	Mar. 31	By Depreciation (10% on Rs. 46,250)	4,625
			Mar. 31	By Balance c/d	41,625
		46,250			46,250
2024			2025		
April 1	To Balance b/d	41,625	Mar. 31	By Depreciation (10% on Rs. 41,625)	4,163
			Mar. 31	By Balance c/d	37,462
		41,625			41,625
2025					
April 1	To Balance b/d	37,462			

Dr. **Depreciation Account** ***Cr.***

Date	Particulars	Rs.	Date	Particulars	Rs.
2023 Mar.31	To Machinery A/c	3,750	2023 Mar.31	By Profit & Loss A/c	3,750
2024 Mar.31	To Machinery A/c	4,625	2024 Mar.31	By Profit & Loss A/c	4,625
2025 Mar.31	To Machinery A/c	4,163	2025 Mar.31	By Profit & Loss A/c	4,163

Note: The straight line method and diminishing balance method is covered in this lesson. Rest of the method is not covered in the syllabus.

CHANGE IN METHOD OF DEPRECIATION

Consistency principle of accounting requires that same accounting practices and methods should be observed and followed from year to year as otherwise the reported profit or loss will not be comparable. Hence, it is expected that the concern should consistently follow the method of depreciation which is once chosen. However, sometimes, a change in the method becomes inevitable.

According to "Accounting Standard-6 (AS-6) Depreciation Accounting", issued by the Institute of Chartered Accountants of India, when a change in the method of depreciation is made, depreciation is re-calculated in accordance with the new method from the date of asset coming into use. In brief, change in method is permitted retrospectively, that is, from the date of purchase of existing assets.

Steps for change in method of depreciation

- Calculate the value of asset by the new method on the date of change.
- Calculate the depreciation of the past period of asset by both the existing and new method.
- Find the difference between the both.
- Then the difference has to be adjusted in the current year's asset account by giving debit or credit to profit and loss account.

Illustration 3:

M Ltd. which depreciates its machinery @ 10% per annum according to diminishing balance method, had on 1st April, 2024 Rs. 4,86,000 balance in its machinery account. During the year ended 31st March, 2025, the machinery purchased on 1st April, 2022 for Rs. 60,000 was sold for Rs. 40,000 on 1st October, 2024 and a new machinery costing Rs. 70,000 was purchased and installed on the same date; installation charges being Rs. 5,000.

The company wants to change its method of depreciation from diminishing balance method to straight line method w.e.f. 1st April, 2022 and adjust the difference before 31st March, 2025, the rate of depreciation remaining the same as before.

Show the machinery account for the year ended 31st March, 2025.

Solution:

Machinery Account

Dr. *Cr.*

Date	Particulars	Rs.	Date	Particulars	Rs.
2024			2024	By Depreciation (Machinery Sold)	2430
Apr. 1	To Balance b/d	4,86,000	Oct. 1	By Bank	40,000
Oct. 1	To Bank (cost and installation charges)	75,000		By Profit and Loss A/c (loss on sale of machinery)	6,170
			2025		
			Mar. 31	By Depreciation A/c	57,750
				By Profit and Loss A/c (Additional depreciation)	5,400
				By Balance c/d	4,49,250
		5,61,000			5,61,000

Working Notes:

		Rs.
(1)	Calculation of loss on sale of machinery:	
	Cost of machinery on April 1, 2022	60,000
	Less: Depreciation for 2022-23	6,000

		54,000
	Less: Depreciation for 2023-24	5,400
		48,600
	Less: Depreciation for half year	2,430
	Book value as on 1st October, 2024	46,170
	Less: Amount realised from sale	40,000
	Loss on sale	6,170
(2)	Additional depreciation:	
	Cost of machinery on 1st April, 2022 Rs.4, 86,000 x $\frac{100}{90}$ x $\frac{100}{90}$	6,00,000
	Book value on 1st April, 2022 for machinery sold in 2024	60,000
	Book value on 1st April, 2022 on original group	5,40,000
	Depreciation for 2 years (2022-23 and 2023-24) @ 10% on Rs. 5,40,000	1,08,000
	Less: Depreciation provided for 2 years under diminishing balance method (Rs. 54,000 + Rs. 48,600)	1,02,600
	Additional depreciation due to change in the system charged to profit and loss account	5,400
(3)	Depreciation for 2024-25	
	On machinery sold	2,430
	On machinery purchased and installed	3,750
	On machinery brought from previous year (i.e. on Rs. 5,40,000 on straight line method)	54,000
	Total	60,180

CALCULATION OF PROFIT OR LOSS ON ASSETS SOLD

Assets may be sold or discarded before or on the expiry of its useful life. Then it is necessary to calculate the profit or loss, if any, on such sale. For this purpose the book value of the assets at the date of sale is to be calculated by deducting the total depreciation from the date of purchase to the date of sale from the original cost. If the sale price is more than the book value there is profit on sale of the assets and if the sale price is less than the book value, the difference will be loss on sale.

Profit or loss on sale of assets = Sale price of asset - Book value of the asset on the date of sale

Book value of the asset on the date of sale = Original cost of the asset – Total depreciation on the asset till date of sale

The following journal entries are passed to record the above transactions when the depreciation is directly credited to the asset account:

(i) On sale of assets:

Bank Dr.

To Assets Account (with the sale price)

(ii) For profit on sale of asset:

Asset Account Dr.

To Profit and Loss Account

(In case of loss the above entry is reversed.)

When Provision for Depreciation Account is maintained then the asset account appears at its cost price and the following accounting procedure is followed:

(i) Transfer of accumulated depreciation including the depreciation created at the time of sale:

Provision for Depreciation Account Dr.

To Asset Account

(ii) On sale of the asset:

Bank Dr.

To Asset Account

(iii) If the amount of accumulated depreciation and sale price put together is less than the original cost of the asset, the difference is loss on sale and transferred to profit and loss account:

Profit and Loss Account Dr.

To Asset Account

(iv) In case the accumulated depreciation and sale price put together is more than the original cost of the asset, the difference is treated as profit on sale and is credited to profit and loss account:

Asset Account Dr.

To Profit and Loss Account

When Provision for Depreciation Account is maintained on sale of asset, alternatively, it is suggested to open an `Asset Disposal Account' in such case the following accounting entries may be passed:

(i) On transfer of original cost of asset to Asset Disposal Account:

Asset Disposal Account Dr.

To Asset Account

(ii) On sale of the asset:

Bank Dr.

To Asset Disposal Account

(iii) On transfer of Provision for Depreciation Account to Asset Disposal Account:

Provision for Depreciation Account Dr.

To Asset Disposal Account

(iv) For profit on disposal of asset:

Asset Disposal Account Dr.

To Profit and Loss Account

(In case of loss the above entry is reversed.)

Illustration 4:

On 1st April, 2022, a firm purchased a machinery for Rs. 2,00,000. On 1st October in the same accounting year, additional machinery costing Rs. 1,00,000 was purchased. On 1st October, 2023, the machinery purchased on 1st April, 2022, having become obsolete, was sold off for Rs. 90,000. On 1st October, 2024, new machinery was purchased for Rs. 2,50,000 while the machinery purchased on 1st October, 2022 was sold for Rs. 85,000 on the same day.

The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year. Show machinery account and depreciation account for the period of three accounting years ending 31st March, 2025.

Solution:

Dr. **Machinery Account** ***Cr.***

Date	Particulars	Rs.	Date	Particulars	Rs.
2022			2022-23		
Apr. 1	To Bank	2,00,000	Mar.31	By Depreciation a/c	25,000
Oct. 1	To Bank	1,00,000	Mar.31	By Balance c/d	2,75,000
		3,00,000			3,00,000
2023			2023-24		
Apr. 1	To Balance b/d	2,75,000	Oct. 1	By Depreciation A/c (Machinery 1)	10,000
				By Bank Account	90,000
				By Profit & Loss A/c (Loss on Sale)	80,000
			Mar.31	By Depreciation A/c (Machinery 1 & 2)	10,000
			Mar.31	By Balance c/d	85,000
		2,75,000			2,75,000
2024-25			2024-25		
Apr. 1	To Balance b/d	85,000	Oct. 1	By Depreciation A/c	5,000
Oct. 1	To Profit & Loss (Gains) A/c	5,000		By Bank Account	85,000
	To Bank	2,50,000	Mar. 31	By Depreciation A/c	12,500
			Mar. 31	By Balance c/d	2,37,500
		3,40,000			3,40,000

Dr.			Depreciation Account		*Cr.*
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2023			2023		
Mar.31	To Provision for Depreciation A/c	25,000	Mar.31	By Profit & Loss A/c	25,000
2023			2024		
Oct. 1	To Provision for Depreciation A/c	10,000	Mar.31	By Profit & Loss A/c	20,000
2024					
Mar.31	To Provision for Depreciation A/c	10,000			
		20,000			20,000
2024					
Oct. 1	To Provision for Depreciation A/c	5,000			
2025			2025		
Mar.31	To Provision for Depreciation A/c	12,500	Mar. 31	By Profit & Loss A/c	17,500
		17,500			17,500

DEPRECIATION AND REPLACEMENT OF ASSETS

In the context of present inflationary conditions, it will be appropriate to provide for depreciation on the replacement cost instead of on the historical cost. This is because of the fact that depreciation is provided for replacing the asset. Sufficient funds will not be available for replacing an asset at the end of its serviceable life. If depreciation is provided on the basis of historical cost, there is substantial increase in the cost of the new asset to replace the old asset. But following difficulties may crop up when replacement cost system is used:

(a) Estimating replacement cost in advance is difficult.

(b) The method of charging depreciation on the basis of replacement cost is not recognized by income tax authorities.

(c) The method of charging depreciation on replacement cost during inflationary conditions is preferred but not during period of falling prices.

(d) According to the Companies Act, depreciation should be charged on the original cost of the asset and any deficiency or surplus arising due to sale of such asset should be transferred to the profit and loss account.

(e) Any new asset purchased, with few exceptions, is always of a better quality than the asset replaced.

Hence, it is difficult to calculate the cost of the asset replaced. These difficulties can be obviated by taking the following steps:

(a) The additional amount required for replacing the asset over and above the original cost of the asset may be estimated. Every year, an appropriate amount may be transferred from profit and loss account besides usual depreciation on asset to provide for additional amount required for replacement of the asset over and above the original cost of the asset. It may be debited to Profit and Loss Appropriation Account and credited to Replacement Reserve account.

(b) The Replacement Reserve Account may be credited every year with interest at the current rate on the accumulated balance standing to the credit of the account.

AMORTIZATION

Amortization is the accounting practice of spreading the cost of an intangible asset over its useful life. Intangible assets are not physical but they are still assets of value. They can include patents, trademarks, franchise agreements, copyrights, costs of issuing bonds to raise capital, and organizational costs.

Amortization is typically expensed on a straight-line basis. The same amount is expensed in each period over the asset's useful life. Assets that are expensed using the amortization method typically do not have any resale or salvage value.

Amortization of Intangible Assets

- **Purpose:** To gradually reduce the value of non-physical assets over their useful life, reflecting the cost-to-benefit spread as the asset generates revenue.
- **Examples of Intangible Assets:** Patents, trademarks, copyrights, goodwill, and software.
- **Method:** Similar to depreciation for tangible assets, the total cost of the intangible asset is divided and recorded as an expense over several years.

Illustration 5:

ABC & Co. registered a patent (intangible assets) on 1st April, 2024 developed at a cost of Rs. 12,00,000 and spent Rs. 1,00,000 towards legal and registration fees. The patent is granted for 10 years. The book are closed on 31st March every year.

Show the patent accounts and amortization accounts for the year ended 31.03.2025 & 31.03.2026.

Solution:

Useful Life : 10 Years

Residual Value : Nil

Value of Patent: 12,00,000+1,00,000 = 13,00,000

Therefore, annual amortization: Rs. 13,00,000 / 10 years = 1,30,000

Patent Accounts

Date	Particulars	Amount	Date	Particulars	Amount
01.04.2024	To Bank A/c	12,00,000	31.03.2025	By Amortization A/c	1,30,000
01.04.2024	To Bank A/c (Legal and Registration fees)	1,00,000	31.03.2025	By Bal. c/d	11,70,000
		13,00,000			13,00,000
01.04.2025	To Bal. B/d	11,70,000	31.03.2026	By Amortization A/c	1,30,000
			31.03.2026	By Bal. c/d	10,40,000
		11,70,000			11,70,000

Amortization Accounts

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
31.03.2025	To Patent A/c	1,30,000	31.03.2025	By P & L A/c	1,30,000
		1,30,000			1,30,000
31.03.2026	To Patent A/c	1,30,000	31.03.2026	By P & L A/c	1,30,000
		1,30,000			**1,30,000**

Amortization vs Depreciation: Key Differences

1. **Applicability:** Depreciation is only applicable to physical, tangible assets that are subject to having their costs allocated over their useful lives. Amortization is only applicable to intangible assets.
2. **General Philosophy:** The term depreciate means to diminish in value over time. Amortize means to gradually write off a cost over a period.
3. **Options of Methods:** Almost all intangible assets are amortized over their useful life using the straight-line method. The same amount of amortization expense is recognized each year. A company can choose from several depreciation methods. These options differentiate the amount of depreciation expense a company may recognize in a given year, yielding different net income calculations based on the option chosen.
4. **Acceleration:** A company often has the option of accelerating depreciation. More depreciation expense is recognized earlier in an asset's useful life when a company accelerates it. That asset may be used more heavily when it's newest. Amortization doesn't often use this practice. The same amount of expense is recognized whether the intangible asset is older or newer.
5. **Use of Salvage Value:** The formulas for depreciation and amortization are different because of the use of salvage value. The depreciable base of a tangible asset is reduced by its salvage value. The amortization base of an intangible asset is not. This is often because intangible assets don't have a salvage value. Use of Contra Account

LESSON ROUNDUP

- Depreciation is the process of allocation of cost of the asset to the period of its useful life. It is not the process of valuation of asset.
- Depreciation is used for recording the expired utility of a physical asset.
- Causes of depreciation are: physical wear and tear; deterioration in value of asset; disuse; depletion; obsolescence; accidents, etc.
- Depreciation is provided to: ascertain the correct profit; present correct financial position; make provision for replacement of asset; ascertain proper cost of the product; maintain uniform rate of return; attain maximum tax benefit; to meet the legal requirements, etc.
- The main factors in measurement of depreciation are: total cost of the asset; estimated useful life; estimated residual value, etc.

- The various methods of depreciation are: fixed installment method or straight line method; diminishing balance method or written down value method and other methods.
- In order to adjust depreciation for past periods due to change of method, depreciation is to be calculated for the past period of asset used both by existing as well as by the changed method and the difference is adjusted in the current year's asset account by giving debit or credit to profit and loss account.

GLOSSARY

Depreciation: Depreciation is a process of allocating the cost of a fixed asset over its estimated useful life in a rational and systematic manner.

Useful Economic Life: Useful economic life of an asset is either the period over which a depreciable asset is expected to be used by the organization or the number of production or similar units expected to be obtained from the use of the asset by the organization.

Depreciable Value: It is the cost price of the asset less scrap value or salvage value of the asset.

Salvage Value: The estimated value of an asset at the end of its useful life.

TEST YOURSELF

1. Why is correct calculation of depreciation necessary?
2. What are the methods of providing depreciation?
3. Discuss the various factors which are considered for calculating depreciation.
4. What are the various causes of depreciation on fixed assets?
5. Distinguish between straight line and diminishing balance methods of depreciation.
6. What do you mean by replacement cost? What are the difficulties faced while providing for depreciation on the basis of replacement cost? What steps may be taken to obviate these difficulties?
7. "Depreciation is a process of allocation and not of valuation". Comment.

Preparation of Final Accounts for Sole Proprietors

Lesson 5

KEY CONCEPTS

■ Proprietor- Manufacturing Account ■ Trading Account ■ Profit & Loss Account ■ Balance Sheet

Learning Objectives

To understand:

A sole trader is the sole owner and manager of the business. At the end of a accounting year the sole trader would like to know the financial results and the financial position of his business. He would be interested to know the profits or losses made by the business. For this purpose, he would prepare income statements i.e. trading and profit and loss accounts. He would also be interested in knowing the financial position of the business which will be ascertained by the preparation of balance sheet. Trading account, profit loss account and balance sheet together are called final accounts.

After recording transactions of a business for an accounting period in subsidiary books, posting to the ledger and testing their accuracy with the help of a trial balance, the last stage in the accounting process is the preparation of final accounts. In this lesson, we will learn in detail about the preparation of final accounts for a sole proprietor.

Lesson Outline

- Introduction
- Trading Account
- Profit & Loss Account
- Main Principles for preparation of Trading and Profit & Loss Account
- Difference between Trading and Profit & Loss Account
- Review Questions
- Balance Sheet
- Classification of Assets
- Classification of Liabilities
- Review Questions
- Adjustment Entries
- Closing Entries
- Manufacturing Account
- Limitations of Financial Statements
- Lesson Round Up
- Test Yourself
- List of Further Readings

INTRODUCTION

Final Accounts or Financial Statements are the end products of the financial accounting process which involves the preparation of a summary of the accounts with a view to determine:

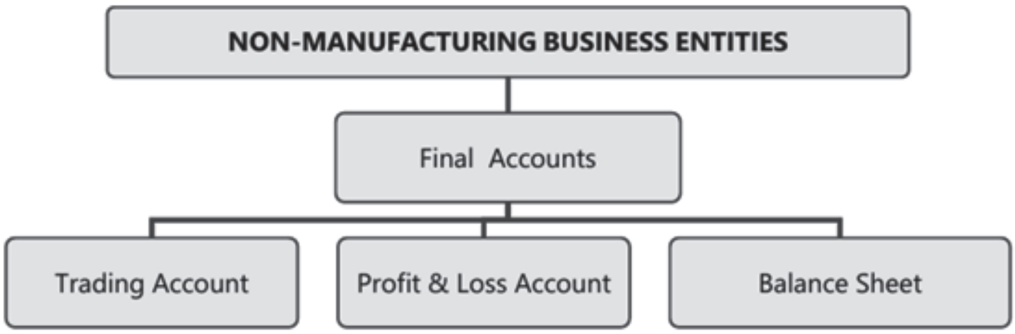
(i) net profit from the trading activities in terms of profit made or loss incurred for a given period, and

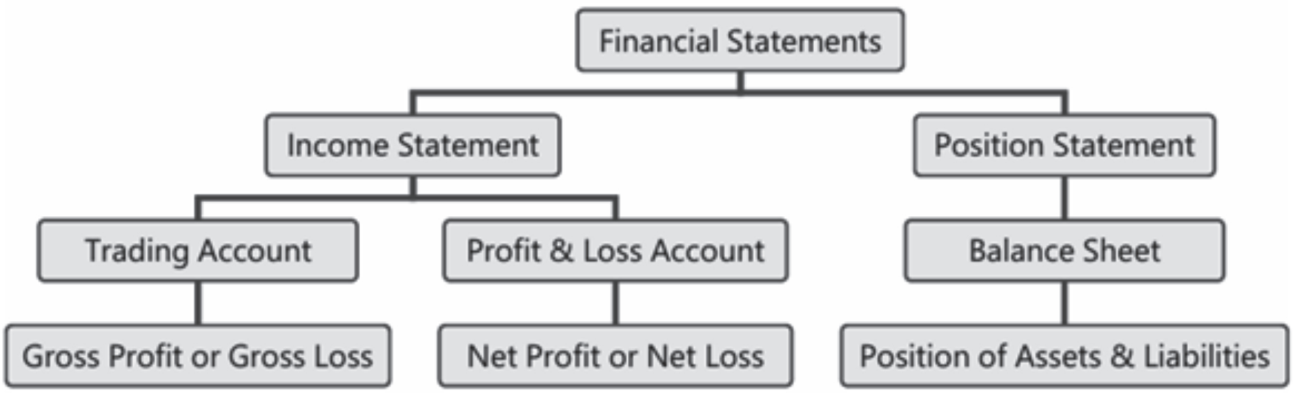
(ii) its financial position in terms of assets and liabilities as on the last date of the given period.

For the purpose of determining the profit or loss, a statement known as *Trading and Profit and Loss Account (Income Statement)* is prepared which incorporates all items of expenses and losses and all incomes and gains occurring during the accounting period.

In order to show the financial position on the last date of the accounting period, another statement known as Balance Sheet (*Position Statement*) is prepared which consists of all assets, liabilities and capital of the business. These two statements are collectively known as Final Accounts.

Final Accounts are prepared from the balances appearing in the trial balance. Debit balances of assets are transferred on the right hand side of the balance sheet while expenses and losses are debited to the Trading Account or to the Profit and Loss Account, depending upon the nature of expenditure or loss. Credit account balances like capital, liabilities, provisions and reserves are entered on the left hand side of the balance sheet while incomes and gains are credited to Trading Account or Profit and Loss Account.





Matching Principle in Accounting

The **Matching Principle** is a fundamental accounting concept that governs how and when expenses and revenues are recognized in the financial statements of a business.

Definition

The matching principle requires that **expenses incurred to earn revenue must be matched with the related revenue** in the same accounting period. This ensures that income statements reflect a true and fair view of a business's performance for that period.

How It Works

- **If a revenue is recognized in the Trading or Profit and Loss Account, all the related expenses—whether paid or still outstanding—must also be recognized in the same period.** For example, rent paid and any outstanding rent must both be included for the year.
- **Expenses incurred, but whose corresponding revenue will be earned in future periods (such as prepaid expenses), should not be recognized as expenses in the current year.** Instead, these are carried forward as assets and shown on the balance sheet; they are expensed only when the related revenue is recognized.
- **Income received in advance, but for which the service or good is to be provided later, should not be recognized as current year's income.** Such income is shown as a liability (income received in advance) in the balance sheet and recognized as revenue in the future period when the good/service is delivered.

Example Applications

1. **Outstanding Expenses:** Salaries paid and outstanding salaries are both charged to the Profit & Loss Account for the period they pertain to. Outstanding salaries are also shown as liabilities on the balance sheet.
2. **Prepaid Expenses:** If rent has been paid in advance for the next year, it is deducted from the rent expense and shown as prepaid on the balance sheet (an asset).
3. **Depreciation:** The part of a fixed asset's cost consumed to earn current year revenue is expensed (depreciation), while the remainder is shown as asset value on the balance sheet.

Exceptions

- **Abnormal losses** (such as those by fire or theft) must be expensed in the period incurred, even though these do not directly correspond to revenue generation.

Accounting Entry Patterns

- At year-end, entries are made to adjust for outstanding and prepaid items so that the expenses match the revenue for the period.
- Revenue received in advance is kept as a liability until the associated goods/services are delivered.

Importance

- The matching principle is crucial to prevent overstatement or understatement of profits and to provide a **true and fair view** of the financial results of a business for a given period.
- This principle enhances the credibility and utility of financial statements for users such as management, investors, and creditors.

"The principle that governs this concept is called the Matching Principle. This principle demands that expenses incurred to earn the revenue should be properly matched If some expense has been incurred but against it sale will take place in the next year or income will be received next year, the expense should not be debited to the current year's Profit and Loss Account but should be carried forward as an asset and shown in the Balance Sheet. It will be debited to the Profit and Loss Account only when the relevant income will also be credited.

TRADING ACCOUNT

Trading Account is the first part of income statement which is prepared to ascertain the gross profit or gross loss for a given accounting period.

Trading Account is prepared before the preparation of profit & loss account. It shows the result of trading activities relating to purchases & sales of goods & services. Trading account is prepared to calculate separately the profit from sale & purchase transactions only. The profit or loss is termed as gross profit or gross loss as various other expenses of an organsiation like administrative, selling & distribution and maintenance expenses etc. are not deducted. Only the direct expenses which are incurred to bring goods into saleable condition like freight, insurance, carriage inwards, fuel, power, royalties on production, consumption of stores etc. are taken into account to calculate gross profit/loss.

Gross Profit = Net Sales – Cost of the Goods Sold.

Gross Loss = Cost of the Goods Sold – Sales

Net Sales = Total Sales – Sales Returns (Return Inwards)

Cost of goods sold = Opening stock of goods + net purchases - closing stock of goods at the end + all direct expenses

Net Purchases = Total Purchases – Purchases Returns (Returns Outwards)

SPECIMEN OF TRADING ACCOUNT

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

Particulars	₹	*Particulars*	₹
To Opening Stock	XXX	By Sales	XXX
To Purchases	XXX	Less: Returns Inwards	XXX
Less: Returns Outwards	XXX	By Closing Stock	XXX
To Direct Expenses	XXX		
To Gross Profit (Balancing Figure)	XXX		
	XXX		XXX

- In case debit side exceeds the credit side, the balance will be gross loss and that will be shown on the credit side of Trading Account as “By Gross Loss”.
- In trading account, closing stock is shown at cost price or net realisable market value whichever is lower.
- While taking stock for the purpose of preparation of trading account, stock in hand on the last day of the accounting year should be adjusted for purchases recorded but goods not yet received, goods sold but not yet delivered and goods that may be out of business premises because of consignment, goods delivered on sale or return basis, etc.
- Gross profit or gross loss revealed by Trading Account is transferred to Profit and Loss Account.

PROFIT AND LOSS ACCOUNT

Profit and Loss Account is prepared to calculate the net profit or loss of the business for a given accounting period. The balance of Trading Account i.e. gross profit/gross loss is transferred to the Profit and Loss Account which is the starting point of the preparation of this account. Thereafter, all those expenses and losses which have not been debited already to the Trading Account are debited to the Profit and Loss Account. Other incomes and gains, if any, are credited to this account, e.g. interest earned or commission received etc. The net profit, thus arrived at is transferred to Capital Account of the proprietor/partners. Specimen of Profit & Loss Account is given on next page. Net profit increases the capital whereas net loss decreases the capital.

Net profit = Total Revenues – Total Expenses

Net Loss = Total Expenses – Total Revenues

MAIN PRINCIPLES FOR PREPARATION OF TRADING AND PROFIT & LOSS ACCOUNT

The following principles must be kept in mind while preparing Trading and Profit & Loss Account:

- Only revenue receipts i.e. sale proceeds and other incomes should be entered.
- Only revenue expenses together with losses should be taken into account.
- Profit or loss is determined by matching revenues and expenses according to the matching principle.

Application of Concept of Matching Principle

A fundamental principle which must be observed while preparing final accounts is that of 'matching cost and revenue'. It means that in final accounts, expenses and incomes for the full trading period whether they have been paid or received or not, must be included and no expenditure or income which does not pertain to the period for which final accounts are being prepared be included. The distinction between capital and revenue items is also made on the basis of this principle.

DIFFERENCE BETWEEN TRADING AND PROFIT & LOSS ACCOUNT

Trading Account	Profit and Loss Account
(i) Trading account is prepared to calculate the gross profit (loss) for a particular period.	(i) Profit and loss account is prepared to arrive at the net profit (loss)
(ii) In trading account, cost of goods sold, sales and direct expenses are accounted.	(ii) In profit and loss account, indirect expenses, such as administrative expenses, selling expenses, etc, are charged against the gross profit and other revenues.
(iii) The result of trading account i.e. gross profit (loss) is transferred to profit and loss account.	(iii) The balance in profit and loss account i.e. net profit (loss) is transferred to capital account which will be shown in the balance sheet.

SPECIMEN OF PROFIT & LOSS ACCOUNT

Profit & Loss Account for the year ended.....

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Gross Loss b/d	XXX	By Gross Profit b/d	XXX
Management expenses:		Other income:	
To Salaries (administrative)	XXX	By Discount received	XXX
To Office rent, rates and taxes	XXX	By Commission received	XXX
To Printing and stationery	XXX	By Reserve for discount on creditors	XXX
To Telephone charges	XXX	Non-trading income:	
To Postage and telegrams	XXX	By Bank interest	XXX
To Insurance	XXX	By Rent of property let-out	XXX
To Audit fees	XXX	By Dividend from shares	XXX
To Legal charges	XXX	By Interest earned on debentures	XXX
To Electricity charges	XXX	Abnormal gains:	
Maintenance expenses:		By Gains on sale of machinery	XXX
To Repairs and renewals	XXX	By Gains in sale of investment	XXX
To Depreciation on:		By Net Loss (transferred to Capital A/c) (Balancing Figure)	XXX
Office equipment	XXX		
Office furniture	XXX		
Office building	XXX		
Selling and distribution expenses:			
To Salaries (selling staff)	XXX		
To Advertisement	XXX		
To Godown rent	XXX		
To Carriage outwards	XXX		
To Bad debts	XXX		
To Provision for bad debts	XXX		

To Selling commission	XXX		
Financial expenses:			
To Bank charges	XXX		
To Interest on loans	XXX		
To Discount on bills	XXX		
To Discount allowed to customers	XXX		
Abnormal losses:			
To Loss on sale of machinery	XXX		
To Loss on sale of investment	XXX		
To Loss by fire	XXX		
To Net Profit (transferred to Capital A/c) (Balancing Figure)	XXX		
Total	XXX	Total	XXX

REVIEW QUESTION

Fill in the blanks:

(i) Trading account reveals _____ profit or _____ loss.

(ii) Profit and loss account reveals _____ profit or _____ loss.

(iii) Expenses appear on _____ side of trading and profit and loss account.

(iv) Provision for bad debts account shows _____ balance.

(v) Reserve for discount on creditors account shows _____ balance.

(vi) Carriage inwards appears in _____ account, whereas carriage outwards appears in _____ account.

Decide whether the following statements are true or false:

(i) Trade expenses account is transferred to trading account.

(ii) Capital account appears on assets side of balance sheet.

(iii) Drawings account is revenue expenditure to be shown on debit side of profit and loss account.

(iv) If trading account reveals gross loss, profit and loss account results in net profit in any case.

(v) Interest on capital and salary to proprietor are incomes and hence are shown on credit side of profit and loss account.

Tick the correct answers:

(i)	What type of account is goodwill?	Fictitious/Intangible
(ii)	What type of account is furniture?	Fixed/Current
(iii)	On which side of balance sheet is unexpired insurance shown?	Assets/Liabilities
(iv)	Which type of items appear in profit and loss account?	Revenue/Capital/Both
(v)	Is balance sheet an account or a statement?	An Account/A Statement
(vi)	Where will amount spent on stationery appear?	In Profit and Loss Account/ Balance Sheet.

BALANCE SHEET

Balance sheet is a statement which shows the financial position i.e. the balances of assets, liabilities and capital, of a business entity at a given date. It is prepared from the real accounts and personal accounts of trial balance. A debit balance in a real account or personal account represents an asset of the concern/firm. Likewise a credit balance in a personal account represents a liability. There can be some newly opened accounts as well on account of adjustment entries. The assets and liabilities are arranged in a proper way and the resultant statement is the balance sheet. On the right hand side, assets are arranged while on the left hand side, liabilities are recorded. The totals of the two sides of the balance sheet must agree because of the equation, viz. Assets = Liabilities + Capital.

If there is a difference, it means that there is some mistake. The difference, if it does occur, should be placed on the deficit side as Suspense Account to make the two sides agree apparently.

Features of Balance Sheet

- The primary objective of the preparation of balance sheet is to ascertain the financial position of a concern.
- It shows (a) the nature and value of assets, (b) the nature and value of liabilities and (c) the position of capital.
- Balance sheet is always prepared on a certain date, never for a particular period.
- Balance sheet, unlike a trading and profit and loss account, is not an account. It is a statement containing information regarding assets, liabilities and capital.

Marshalling of Balance Sheet

The arrangement of assets and liabilities in accordance with a particular order is known as marshalling of balance sheet. The items in the balance sheet are generally marshalled in two ways-

(i) Liquidity order or according to time: In liquidity order, the assets are stated in the order in which they can be easily converted into cash and the liabilities in the order in which they have to be paid off.

(ii) Permanence order or according to purpose: In permanence order, assets which are to be used permanently in the business and are not meant for sale are shown first and the assets that are liquid are shown last in order. Similarly, liabilities may also be shown according to the permanence arrangement.

Specimen of Balance Sheet in permanence order is given below. The order will be reversed in liquidity order.

SPECIMEN OF BALANCE SHEET

Balance Sheet as at...

Liabilities		₹	Assets	₹
Capital XXX			Goodwill	XXX
Add : Net profit	XXX		Land and building	XXX
Less : Drawings	XXX	XXX	Plant and machinery	XXX
Loans on mortgages		XXX	Furniture and fixtures	XXX
Outstanding expenses		XXX	Stock	XXX
Bank overdraft		XXX	Sundry debtors	XXX
Sundry creditors		XXX	Investments	XXX
Bills payable		XXX	Bills receivable	XXX
			Cash at bank	XXX
			Cash in hand	XXX
		XXXX		XXXX

REVIEW QUESTION

1. Arrange the following assets in order of their liquidity:

Furniture, Goodwill, Stock in trade, Unexpired insurance, Cash in hand, Trade debtors, Readily saleable investments, Cash at bank, Land, Buildings, Machinery, Bills receivable.

2. Arrange the following liabilities in order of permanency:

Capital, Creditors for expenses, Sundry trade creditors, Loan, Bills payable

CLASSIFICATION OF ASSETS

(i) *Fixed Assets* are those which are acquired for long use in the business itself and not for resale. For example, plant and machinery, land and buildings, furniture and fixtures, patents and trade marks are examples of fixed assets.

(ii) *Current or Floating Assets* are those that are meant to be converted into cash as soon as possible. Stock of goods, amount due from customers to whom goods have been sold on credit and balance at bank are examples of current (or floating) assets.

(iii) *Liquid Assets* are those current assets which are already in the form of cash or which can be readily converted into cash, such as Government Securities.

(iv) *Wasting Assets* are those fixed assets which have a fixed content, like coal in a coal mine; the value of the asset goes down as the contents are taken out. When the minerals have been taken out totally, the mine will become useless.

(v) *Intangible Assets* are those fixed assets which cannot be seen or touched or felt. Goodwill (the value of one's name) is an intangible asset because there is no physical form to show it. Intangible assets are not necessarily useless.

(vi) *Fictitious Assets* are valueless assets but shown as assets in the financial statements (such as useless trade marks) or expenses treated as assets (such as expenses incurred to establish a company i.e. preliminary expenses).

CLASSIFICATION OF LIABILITIES

(i) Fixed and Long-term Liabilities: Fixed liabilities are those liabilities which are payable on the termination of the business such as capital of the proprietor, whereas long-term liabilities are those which will be redeemed after a long period of time e.g. long-term loans.

(ii) Current liabilities: These are liabilities which have to be redeemed in the near future, usually within a year. Trade creditors, bank overdraft, bills payable etc. are examples of current liabilities.

(iii) Contingent liabilities: These are not actual liabilities but their becoming actual liability depends on the happening of certain events. If such events do not occur, no liability is incurred. Liability in respect of pending suit is a contingent liability because it is only if and when suit is lost that the liability will be incurred. Bills discounted with a bank are also a contingent liability because if the acceptor fails to meet the bill on due date, the firm will become liable to the bank. Such liabilities are not shown in balance sheet; usually a foot note is appended at the balance sheet for such liabilities.

REVIEW QUESTION

1. The following are the names of assets. Classify them: Leasehold premises, Accounting machines, Coal mine, Goodwill, Stock of raw materials, Motor vehicles, Cash in hand, Government securities, Copyright of book (no longer in demand),Amount due from customers, Loose tools and Cost of floating a company.

2. Classify the following assets into fixed, current and fictitious assets, mentioning sub-types, also in the case of fixed assets: Land and buildings, Furniture, Bills receivable, Cash in hand, Cash at bank, Plant and machinery, Coal mine, Loose tools, Preliminary expenses, Stock in trade, Amount due from customers, Copyright of a book no longer in demand, Stone quarries, Livestock, Motor vehicles, Government bonds and Goodwill of a firm incurring heavy losses.

DIFFERENCE BETWEEN TRIAL BALANCE AND BALANCE SHEET

Trial balance	Balance sheet
1. It is a statement of debit balances and credit balances taken from the ledger.	1. It is a statement of assets and liabilities
2. It is prepared to test the arithmetical accuracy of books of account.	2. It is prepared to ascertain the financial position of the organization on a particular date.
3. Balances of all types of accounts i.e. personal, real, and nominal accounts are shown.	3. Balances of real and personal accounts only are shown.

Trial balance	Balance sheet
4. It is usually prepared at the end of each month, three months, six months or at the end of accounting year before the preparation of trading and profit and loss account.	4. It is usually prepared at the end of the year after the preparation of trading and profit and loss account.
5. Closing stock does not appear in the trial balance.	5. Closing stock is shown on the assets side of the balance sheet.
6. It is prepared for internal use.	6. It is prepared for external use, i.e. for outside parties such as, creditors, shareholders (in case of companies), government authorities, etc.

DIFFERENCE BETWEEN PROFIT & LOSS ACCOUNT AND BALANCE SHEET

Profit & Loss Account	Balance sheet
1. Profit and loss account is an account	1. Balance sheet is a statement of assets and liabilities.
2. Profit and loss account shows the profits earned or losses incurred for the accounting period	2. Balance sheet shows financial position of the business.
3. Profit and loss account is prepared for the accounting period	3. Balance sheet is prepared as at the last day of the accounting period.
4. The accounts that are transferred to the profit and loss account are closed and cease to exist.	4. The accounts which are shown in the balance sheet do not lose their identity and become the opening balances in the next accounting period

ADJUSTMENT ENTRIES

Usually, final accounts are prepared from the balances given in the trial balance. However, at times some account balances in the trial balance do not reflect the correct 'amount' when considered in relation to accounting period. For example, payment on account of expense, say, rent, may be less or more than the actual payment that ought to have been made during the accounting period. Similar situation may arise in respect of some revenue items also, say interest on investments.

In order to ensure that the final accounts disclose the true trading results and correct balances, it is necessary that all expenses incurred whether paid or not and the whole amount of loss sustained whether ascertained or estimated should be taken into consideration. Similarly, incomes and gains whether actually received or not during the accounting period should be accounted for. All this requires adjustment entries which are used to establish correct values of account balances at the end of an accounting period. Thus, adjustment entries are those entries which are passed at the end of each accounting period for the purpose of adjusting various nominal and other accounts so that true net profit or loss is indicated in profit and loss account and the balance sheet represents a true and fair view of the financial condition of an enterprise.

The following are the usual adjustment entries which are made while preparing the final accounts.

(I) CLOSING STOCK

The unsold stock at the end of the accounting period is termed as closing stock. There can be two entries for closing stock.

(a)	Closing Stock Account	Dr.
	To Trading Account	

When this entry is passed the closing stock at the end appears in trading account and on the assets side of balance sheet. It becomes the opening stock for the next year.

(b)	Stock Account	Dr.
	To Purchases Account	

In this case, closing stock will appear in the trial balance, it means that double entry has been completed in the accounting period itself by reducing the purchases. Therefore it will appear as an asset in the balance sheet only.

(II) ACCRUED OR OUTSTANDING EXPENSES

Expenses which have been incurred during the year and whose benefit has been derived during the year but payment in respect of which has not been made are called outstanding or accrued expenses. At the end of the year, all such expenses must be brought into books, otherwise, the profit will be overstated and liability will be understated. The following journal entry is passed:

Expense Account	Dr.
To Outstanding/Accrued Expense Account	

- The outstanding expenses are shown on the debit side of the trading account or profit and loss account, as the case may be, by way of addition to the respective expenses.
- These are also shown on the liabilities side of balance sheet.
- In the beginning of the next year, a reverse entry will be passed.

EXAMPLE 1:

Salary for March, 2024 ₹ 7,000 has not been paid. The adjustment entry will be:

		₹	₹
Salary Account	Dr.	7,000	
To Outstanding Salary Account			7,000

The entry will increase the balance in salary account by ₹ 7,000 which will be transferred to the profit and loss account. Outstanding salary account is a liability which will appear in the balance sheet.

(III) UNEXPIRED OR PREPAID EXPENSES

Those expenses which have been paid in advance and whose benefit will be available in future are called unexpired or prepaid expenses e.g. insurance premium and rent paid in advance. An adjustment entry is made whereby the unexpired amount is credited to the appropriate expense account and debited to prepaid (unexpired) account as under:

Prepaid Expense Account	Dr.
To Expense Account	

- The amount of prepaid expenses is shown in the profit and loss account by way of deduction from the concerned expenses.
- These are also shown as assets in the balance sheet.
- In the beginning of the next year, a reverse entry will be passed to cancel the effect of adjusting entry.

EXAMPLE 2:

Fire insurance premium of ₹ 2,000, paid for the year ending 30th June 2024. On 31st March, 2024 insurance policy has run only for 9 months and hence only 3/4th of the premium can be said to pertain to 2023-24: 1/4th of the premium amount, i.e. ₹ 500 will be treated as an asset. Entry will be:

		₹	₹
Unexpired Insurance Premium	Dr.	500	
To Insurance Premium Account			500

Unexpired insurance premium will appear as an asset in the balance sheet and insurance premium account will be reduced by ₹ 500.

(IV) ACCRUED OR OUTSTANDING INCOME

Accrued income means income which has been earned by the business during the accounting year but which has not become due and hence has not been received. But outstanding income means any income which has become due during the accounting year but has not been so far received by the firm. Though there is a distinction between the two, for adjustment entry no such distinction is necessary, both the accrued income and outstanding income are added to the given income figure in the trial balance. The following entry is passed:

Accrued /Outstanding Income Account	Dr.
To Income Account	

- The amount of income is transferred to the credit side of profit and loss account as an addition to the respective income account.
- The accrued/outstanding income account also appears as an asset in the balance sheet.
- In the beginning of next year, a reverse entry will be passed.

EXAMPLE 3: Interest earned but not yet received, ₹ 650. The entry will be:

		₹	₹
Interest Accrued Account	Dr.	650	
To Interest Account			650

Interest accrued account will appear as an asset in balance sheet and the amount of interest account to appear on the credit side of profit and loss account will increase by ₹ 650.

(V) UNEARNED INCOME OR INCOME RECEIVED IN ADVANCE

That portion of the revenue which remains received in advance (unearned) at the end of the accounting period is known as unearned income or income received in advance. For example, subscription received in advance by a club, insurance premiums received in advance by and insurance company, rent received in advance, etc. Any income in advance is not actually earned and it rather creates an obligation. The following adjustment entry is made at the end of the accounting year;

Income Account	Dr.
To Income Received in Advance Account	

– This item is shown on the credit side of the profit and loss account by way of deduction from the income.

– It is also shown in the balance sheet on the liabilities side as 'Income received in advance'.

EXAMPLE 4: Rent for April, 2024 ₹ 8,000 received in advance

		₹	₹
Rent Received Account	Dr.	8,000	
To Rent Received in Advance Account			8,000

The balance of rent received account appearing on the credit side of profit and loss account will diminish by ₹ 8,000 and rent received in advance account will appear on liabilities side of balance sheet because service for this rent is to be rendered in the year to come.

(VI) DEPRECIATION

Depreciation is the reduction in the value of fixed assets due to a use, wear and tear or obsolescence. When an asset is used for earning purpose, it is necessary that reduction due to its use must be charged to the profit for the year in order to show correct value in the balance sheet. The following journal entry is passed for charging depreciation:

Depreciation Account	Dr.
To Fixed Asset Account	

– The amount of depreciation is debited to the profit and loss account.

– Again it is shown on the assets side of the balance sheet by way of deduction from the concerned asset.

When depreciation is given in the trial balance, it means that the asset(s) has(ve) been credited with the amount of depreciation and the necessary debit to depreciation account has been made. The only entry then would be to transfer the depreciation account to profit and loss account and no adjustment entry would be needed.

Note: There are various methods of providing depreciation, but in questions on final accounts, it is most likely asked to be calculated at a fixed percentage on opening balance of the assets. If there are additions, depreciation is provided only for that part of the year for which the new asset has been used.

EXAMPLE 5: If furniture stood at ₹ 1,00,000 on 1st April, 2023 and additional furniture was purchased for ₹15,000 on 1st October, 2023, total depreciation @5% per annum would amount to ₹ 5,375 calculated as under:

	₹
Depreciation on 1,00,000 @ 5% for full year	5,000
Depreciation on Rs. 15,000 @ 5% for 6 months i.e., from 1st October, 2023 to 31st March, 2024	375

$$\frac{₹\ 15{,}000 \times 5 \times 6}{100 \times 12}$$

		Total	5,375

Entry will be:

		₹	₹
Depreciation Account	Dr.	5,375	
To Furniture Account			5,375

Depreciation account will appear on the debit side of profit and loss account and the book value of furniture will be reduced by ₹ 5,375 in the balance sheet.

WHEN PROVISION FOR DEPRECIATION ACCOUNT IS MAINTAINED:

Depreciation Account	Dr.
To Provision for Depreciation Account	
Profit and Loss Account	Dr.
To Depreciation Account	

(VII) BAD DEBTS

Debts which cannot be recovered or become irrecoverable are called bad debts. It is a loss to the business and is brought into account by debiting bad debts account and crediting debtors' accounts who are not able to pay the amount. The adjustment entry is as follows:

Bad Debts Account	Dr.
To Sundry Debtors Account	

- The bad debts account is debited to profit and loss account.
- The debtors balance is reduced by the same amount in the balance sheet.
- When the amount of bad debts is given in the trial balance itself no adjusting entry is required. It should only be transferred to profit and loss account.

(VIII) PROVISION FOR BAD DEBTS

A firm may make a provision at the end of the accounting year for likely bad debts which may take place during the course of the next year. This is for the simple reason that if out of credit sales made during a particular year, some sales are likely to become bad in the course of the next year, the proper course would be to charge in the same accounting year with such likely bad debts in which the sales have been made. The following journal entry is passed for creating provision for bad debts:

Profit and Loss Account	Dr.
To Provision for Bad Debts Account	

- The provision for bad debts is charged to profit and loss account.
- It is also deducted from debtors in the balance sheet.
- Provision for bad debts created out of profit of the current year should be carried forward to the next period. Bad debts occurring during that period would be debited to bad debts account as usual, but total debits given to this account should be transferred to provision for bad debts account. At the end

of the next year suitable adjustment entry is passed for keeping the provision for bad debts at an appropriate amount to be carried forward.

– Sometimes the balance brought down from the previous year is so large that even after debiting the current year's bad debts and leaving the desired balance at the end of the year, a surplus is left. This surplus is transferred to the credit side of profit and loss account.

EXAMPLE 6: If debts of 2023-24, prove to be bad in 2024-25 the loss is to be treated as one for 2023-24. But on 31st March, 2024 when final accounts are be prepared, it will not be possible to know accurately, which debts will prove bad in 2024-25. Hence, only an estimate is made on the basis of past experience. If it is estimated that 6% of the debts may prove bad and on 31st March, 2024 debtors amount to ₹ 40,000, then ₹2,400 will be provided for future bad debts. The entry is:

		₹	₹
Profit and Loss Account	Dr.	2,400	
To Provision for Bad Debts Account			2,400

It will reduce the profit for 2023-24 by ₹2,400. Provision for bad debts will appear in the balance sheet as a deduction from sundry debtors on assets side although it is a separate account showing credit balance.

In the next year, the actual amount of bad debts will be debited to provision for bad debts account which will then stand reduced. On 31st March, 2024 the amount of the provision will be brought up by an appropriate debit to profit and loss account depending on the amount of sundry debtors as at that date.

(IX) PROVISION FOR DISCOUNT ON DEBTORS

This is a charge made against profits in order to provide for an expected loss in the form of discounts which are likely to be allowed to the debtors, for encouraging them to make prompt payments. In order to incorporate such provision for discount on debtors, the following journal entry is passed:

Profit and Loss Account	Dr.
To Provision for Discount on Debtors Account	

– This provision is shown on the debit side of the profit and loss account.

– It is also shown in the balance sheet by way of deduction from sundry debtors.

***Note*:** Provision for discount is always calculated on the amount of debtors left after deducting the provision for bad debts i.e. provision should be calculated on good debts. It is because no discount will be allowed on amounts which are not recovered and hence no provision for discount on such amounts is required.

For example, if 2% discount is allowed, debtors are of ₹ 10,000 and 5% provision for bad debts is required then provision for discount will be made @2% on ₹ 9,500, i.e., on ₹ 10,000 less 5% for provision for bad debts amounting to ₹ 500.

(X) RESERVE FOR DISCOUNT ON CREDITORS

A firm may like to create reserve for discount on its creditors to record discounts expected to be received from them. The adjustment entry for this purpose is as follows:

Reserve for Discount on Creditors Account	Dr.
To Profit and Loss Account	

- The reserve for discount on creditors account is credited to the profit and loss account.
- It should also be deducted from the sundry creditors in the balance sheet. Keeping with the principle of conservatism, the provision for discount on creditors is often not made in actual practice.

(XI) INTEREST ON CAPITAL

It is a normal practice to charge business with interest on the capital employed in the business. The purpose is to know whether the profits of the business are more than what could be earned from simple investments outside business. Interest charged is an expense to the business but it is a gain to proprietor. The following adjustment entries are passed:

(i) Interest on Capital Account Dr.

To Capital Account

(ii) Profit and Loss Account Dr.

To Interest on Capital Account

- Interest on capital is debited to the profit and loss account and
- It is shown on the liabilities side of the balance sheet by way of addition to the capital.

(XII) INTEREST ON DRAWINGS

As business allows interest on capital, it also charges interest on drawings made by the proprietor. This is a gain to the business and an expense for the proprietor. The following adjustment entries are made:

(i) Capital Account Dr.

To Interest on Drawings Account

(ii) Interest on Drawings Account Dr.

To Profit and Loss Account

- It is credited to the profit and loss account and
- Shown on the liabilities side of the balance sheet by way of deduction from capital.

(XIII) ACCIDENTAL LOSS OF AN ASSET

When asset is not insured:

Sometimes asset of the organization may be destroyed due to earthquake, fire or accidents. The firm has to bear the entire loss if the asset is not insured. The following entries are passed to make adjustments for loss:

(a) When loss is incurred due to accident

Accidental Loss Account	Dr.
To Asset Account	

(b) When loss is transferred to profit and loss account

Profit and Loss Account	Dr.
To Accidental Loss Account	

When asset is insured:

When the asset destroyed by accident is insured, then the firm will not have to bear the entire loss. The insurance company will pay certain amount on loss of the asset. The amount of loss will be reduced to the extent of amount recovered from the insurance company. The difference in the book value of asset on the date of accident and the amount of claim admitted by the insurance company is the loss suffered by the company. This loss will be transferred to the profit and loss account.

On admission of claim:	
Insurance Company	Dr.
To Asset Account	
On receipt of money claimed:	
Bank	Dr.
To Insurance Company	
On transfer of loss:	
Profit and Loss Account	Dr.
To Asset Account	

(XIV) ACCIDENTAL LOSS OF STOCK

Sometimes, stock in trade is lost due to fire or theft. If the firm has insured the stock, then loss can be made good fully or partly by the insurance company. The following adjustment entries are passed:

(a) If the stock is fully insured, the whole loss is fully recoverable from the insurance company. The journal entry is:

Insurance Company Account	Dr.
To Trading Account	

Insurance company account is shown on the credit side of the trading account and in the balance sheet it is treated as an asset until the amount is received.

(b) If the stock is not fully insured, the loss of stock covered by the insurance policy will be claimed from the insurance company and the rest will be treated as a loss. The journal entry in this case is:

Insurance Company Account	Dr.
Profit and Loss Account	Dr.
To Trading Account	

(c) If the stock is not insured, nothing is recoverable from insurance company and the whole loss will be borne by the firm. The journal entry is:

Profit and Loss Account	Dr.
To Trading Account	

In all cases, trading account is credited with the gross amount of stock lost.

(XV) MANAGER'S COMMISSION ON NET PROFITS

Sometimes, the manager of a business is given a commission based on a fixed percentage of the net profit of the business. The adjustment entry for such commission payable is as follows:

Profit and Loss Account	Dr.
To Commission Payable Account	

- The commission payable is shown on the debit side of the profit and loss account and on the liabilities side of the balance sheet.

Calculation of Commission: It can be calculated in following two ways.

(a) Commission as a percentage of net profits before charging such commission

$$\text{Manager's commission} = \frac{\text{Profit before commission x Rate of commission}}{100}$$

(b) Commission as percentage of net profits after charging such commission

$$\text{Manager's commission} = \frac{\text{Profit before commission x Rate of commission}}{100 + \text{Rate of commission}}$$

(XVI) GOODS DISTRIBUTED AS FREE SAMPLES

Sometimes, in order to promote the sale of goods, some of the produced goods are distributed as free samples. It may be treated like an expenditure on advertisement and the following adjustment entry is passed:

Free Samples/Advertisement Account	Dr.
To Trading/Purchases Account	

- It is shown on the credit side of the trading account or deducted from the purchases and
- It is also shown on the debit side of profit and loss account as free samples or advertisement expense.

(XVII) DRAWINGS OF GOODS BY THE PROPRIETOR FOR PERSONAL USE

If goods have been withdrawn by the proprietor for personal use and no entry has been passed during the year, the following adjustment entry should be passed:

Drawings Account	Dr.
To Purchases Account/ Trading Account	

- Goods are deducted from the purchases on the debit side of the trading account or shown on the credit side of trading account and
- They are included in proprietor's drawings which are ultimately deducted from the capital shown on the liabilities side of the balance sheet.

(XVIII) DEFERRED REVENUE EXPENDITURE

The expenditure which is incurred in one year but the benefit of which is available in a few subsequent years also is called deferred revenue expenditure. Part of such expenditure is written off each year and the rest is capitalized. The adjustment entry to write off this expenditure is as follows:

Profit and Loss Account	Dr.
To (Respective) Expense Account	

The written off amount is debited to profit and loss account and shown as a deduction from the capitalized expense in the balance sheet.

(XIX) GOODS ON SALE ON APPROVAL BASIS

Sometimes goods are sold to customers on approval basis. If consent is not received during the accounting period, it cannot be treated as sale. In such a case, the following adjustment entries are passed:

(i)	Sales Account	Dr.	
	To Debtors Account		(with sale price)
(ii)	Stock Account	Dr.	
	To Trading Account		(at cost price)

Thus, this item is shown on the credit side of trading account by way of deduction from the sales at sale price and added to the closing stock at cost price. At the same time, it is shown on the asset side as a deduction from sundry debtors at sale price and added to the closing stock at cost price.

(XX) GOODS RECEIVED BUT NOT RECORDED IN BOOKS

Often, goods may have been received but invoice has not been received or omitted to be recorded. In such a case, the following adjustment entry should be passed.

Purchases Account	Dr.
To Supplier/Creditors	

This item is shown as addition to the purchases in the trading account and added to sundry creditors on the liabilities side of the balance sheet.

(XXI) SALARY TO PROPRIETOR

If the proprietor charges salary for the work done by him, proprietor's salary account is debited and capital account is credited. If there are a number of proprietors called the partners, and salary is charged by them, salary to partners account will be debited and the respective capital accounts will be credited with the respective amounts of salary charged by them.

(XXII) GENERAL RESERVE

General Reserve is created out of the Profit and Loss Account as appropriation of net profit for strengthening the financial position of the business.

Profit and Loss Account	Dr.
To General Reserve	

- General Reserve is shown on the debit side of Profit and Loss (Appropriation) Account and
- It is shown on the liabilities side of the Balance Sheet.

(XXIII) CASH DISCOUNT

Cash discount is allowed and received for prompt payment. When cash discount is allowed to a customer, a less amount is accepted as a full payment of a debt. Similarly when cash discount is received, a less amount is paid in full discharge of a liability. Discount allowed is debited to discount allowed account, cash received is debited to cash account and the total amount is credited to debtor making the payment. Discount received is credited to discount received account, cash paid is credited to cash account and the total of the two is debited to the creditor to whom the payment is made.

(XXIV) TRADE DISCOUNT

Trade discount is a deduction from the list (or catalogue) price allowed by the manufacturers to the wholesalers or by the wholesalers to the retailers for various reasons. The rate of trade discount allowed varies considerably. From accounting point of view no entries are made either in seller's books or in the purchaser's books for such a discount. Entries for purchases and sales are made at net price i.e. after deducting trade discount from the list price.

Difference Between Cash discount and Trade discount

Cash Discount	Trade Discount
(i) It is a reduction granted by a supplier from the invoice price in consideration of immediate or prompt payment.	(i) It is a reduction granted by a supplier from the list price of goods or services on business consideration.
(ii) It is allowed to encourage the prompt payment.	(ii) It is allowed to promote sales.
(iii) It is not shown in the invoice	(iii) It is shown by way of deduction in the invoice itself.
(iv) Cash discount account is opened in the ledger.	(iv) Trade discount account is not opened in the ledger.
(v) It is allowed on payment of money	(v) It is allowed on purchase of goods
(vi) It may vary with the time period within which payment is received	(vi) It may vary with the quantity of goods purchased or amount of purchases made.

Main Principles for preparation of Final Accounts:

The list of adjustment entries given above is not exhaustive. The student may analyse each transaction and pass necessary journal entries for adjustments considering following principles:

(i) The items given in the trial balance will appear in only one of the statements i.e. the Trading Account, the Profit and Loss Account or the Balance Sheet.

(ii) The amount in respect of adjustments will appear in two of the above-mentioned statements, normally in the Balance Sheet and in the Trading Account or in the Profit and Loss Account.

The reason being that for items appearing in the trial balance, the double entry has already been completed but in respect of adjustments, the double entry has yet to be completed, hence two accounts will be affected.

CLOSING ENTRIES

In order to prepare final accounts, all nominal accounts have to be transferred to Trading and Profit and Loss Account. It is done by passing journal entries which are called closing entries as they close the nominal accounts. The entry to transfer the balance of profit and loss account itself is also one of the closing entries. Some of the closing entries are given below:

(i)	Trading Account	Dr.
	To Stock	
	To Purchases	
	To Sale Returns	
	To Carriage Inwards	
	(Transfer of various accounts to Trading Account)	
(ii)	Sales Account	Dr.
	Purchase Returns	Dr.
	Closing Stock	Dr.
	To Trading Account	
	(Transfer of sales account and purchases returns account to trading account and recording of closing stock)	
(iii)	Trading Account	Dr.
	To Profit and Loss Account	
	(Transfer of gross profit from trading account to profit and loss account)	
	or	
	Profit and Loss Account	Dr.
	To Trading Account	
	(Transfer of gross some loss from trading account to profit and loss account)	
(iv)	Profit and Loss Account	Dr.
	To Rent	
	To Salaries	
	To Sundry Expenses	
	To Depreciation	
	(Transfer of various nominal accounts to profit and loss account)	
(v)	Interest Received	Dr.
	To Profit and Loss A/c	
	(Transfer of credit balance of interest received account to profit and loss account)	
(v)	Profit and Loss Account	Dr.
	To Capital Account	
	(Transfer of net profit to capital account)	

In case of net loss, the above mentioned entry will be the reversed one.

MANUFACTURING ACCOUNT

A manufacturing concern may like to ascertain the cost of goods during the accounting period and may prepare Manufacturing Account for this purpose. Trading Account is not capable of showing the cost of goods manufactured because it deals with stock of finished goods also and because some of the expenses connected with manufacture of goods (such as depreciation and repairs of machinery and factory) are debited to the Profit and Loss Account. Manufacturing Account is debited with all expenses incurred in the factory on production of goods. This means that depreciation and repairs to plant and machinery and factory building, salary to works manager, etc. are also debited to this account. The total of such expenses plus cost of raw material used gives cost of goods manufactured during the period. This is transferred to Trading Account which deals with stock of finished goods and sales also. The remaining nominal accounts appear in Profit and Loss Account.

In fact, there is no prescribed format for the presentation of Manufacturing Account. However, a format covering various elements is given below. The Trading Account and Profit and Loss Account should be prepared in the same way as discussed earlier.

SPECIMEN OF MANUFACTURING ACCOUNT

Manufacturing Account for the year ended.....

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Work in progress (opening)	XXX	By Work in progress (closing)	XXX
To Raw material consumed:		By Sale of scrap	XXX
Opening stock Add: Purchases Less: Closing stock	XXX XXX (XXX)	By Cost of production of finished goods transferred to Trading Account	XXX
To Direct wages	XXX		
To Direct expenses	XXX		
To Factory expenses:			
Factory rent	XXX		
Plant repairs	XXX		
Indirect wages	XXX		
Depreciation on factory building	XXX		
Total	**XXX**	**Total**	**XXX**

LIMITATIONS OF FINANCIAL STATEMENTS

Financial statements are the result of the accounting process which begins with recording of transactions. Accounting process involves recording, classifying and summarizing business transactions. Financial statements are the result of the third process viz. summarizing. The financial statements are based on certain accounting concepts and conventions which cannot be said to be foolproof.

The following are the limitations of the financial statements:

(i) Financial statements are essentially interim reports and therefore, cannot be final because the final gain or loss can be computed only at the termination of the business. Financial statements only reflect the progress and position of the business at frequent intervals during its life.

(ii) Financial statements though expressed in exact monetary terms, are not absolutely final and accurate. As the balance sheet is prepared on the basis of the going concern concept, asset valuation represents neither the realizable value nor replacement costs. Further, they depend on the judgment of the management in respect of various accounting policies.

(iii) The values ascribed to the assets presented in the statements depend upon the standards of the persons dealing with them. For instance, the method of depreciation, mode of amortization of fixed assets, treatment of deferred revenue expenditure, all depend on the personal judgment of the accountant.

(iv) Financial statements take into consideration only the financial factors. They fail to bring out the significance of non-financial factors which may have considerable bearing on the operating results and financial conditions of an enterprise. For example, public image of the enterprise, the caliber of its management, efficiency and loyalty of its workers etc.

(v) It is not always possible to discover false figures in financial statements. Unscrupulous managements generally resort to 'window dressing' in the preparation of such statements.

(vi) Financial statements are prepared primarily for shareholders. Other interested parties have to generally make many adjustments before they use them profitably.

(vii) Quite often, financial statements do not disclose current worth of the business. Only historical facts are presented and the true current worth is not reflected.

(viii) Owing to the fact that financial statements are compiled on the basis of historical costs, while there is a marked decline in the value of the monetary unit and resultant rise in prices, the balance sheet loses its function as an index on current economic realities. Again, the financial statements contain both historical and current costs items, hence figures are distorted.

ILLUSTRATIONS

Illustration 1:

A business house maintains provision of 5% against bad debts and 3% for discount on debtors and a reserve for discount on creditors at 2%. On 1st April, 2023 it had the following balances:

Provision for Bad and Doubtful Debts	...	*₹ 5,000*
Provision for Discount on Debtors	...	*₹ 2,850*
Provision for Discount on Creditors	...	*₹ 4,800*

During the year 2023-24, bad debts, discount allowed to debtors and discount received from creditors amounted to ₹ 3,950, ₹ 8,800 and ₹ 9,840 respectively while for 2024-25 they amounted to ₹ 1,800, ₹ 7,000 and ₹ 6,800 respectively. Sundry Debtors were ₹ 1,20,000 on March 31, 2024 and ₹ 80,000 on March 31, 2025. Sundry Creditors on these two dates were ₹ 2,10,000 and ₹ 1,95,000 respectively.

Show provision for bad debts account, provision for discount on debtors account and reserve for discount on creditors account along with relevant portions of profit and loss account.

Solution:

Dr. **Provision for Bad Debts Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2024			2023		
March 31	To Bad Debts	3,950	April 1	By Balance b/d	5,000
March 31	To Balance c/d	6,000			
			2024		
			March 31	By Profit & Loss A/c (Balancing Figure)	4,950
		9,950			9,950
2025			2024		
March 31	To Bad Debts	1,800	April 1	By Balance b/d	6,000
March 31	By Profit & Loss A/c (Balancing Figure)	200			
March 31	To Balance c/d	4,000			
		6,000			6,000
			2025 April 1	By Balance b/d	4,000

Dr. **Provision for Discount on Debtors A/c** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2024			2023		
March 31	To Discount Allowed	8,800	April 1	By Balance b/d	2,850
March 31	To Balance c/d	3,420	2024		
			March 31	By Profit & Loss A/c (Balancing Figure)	9,370
		12,220			12,220
2025			2024		
March 31	To Discount Allowed	7,000	April 1	By Balance b/d	3,420
March 31	To Balance c/d	2,280	2025		

			March 31	By Profit & Loss A/c (Balancing Figure)	5,860
		9,280			9,280
			2025		
			April 1	By Balance b/d	2,280

Reserve for Discount on Creditors A/c

Dr. *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2023			2024		
April 1	To Balance b/d	4,800	March 31	By Discount Received	9,840
2024	To Profit & Loss A/c (Balancing Figure)		March 31	By Balance c/d	4,200
March 31		9,240			
		14,040			14,040
2024			2025		
April 1	To Balance b/d	4,200	March 31	By Discount Received	6,800
2025			March 31	By Balance c/d	3,900
March 31	To Profit & Loss A/c (Balancing Figure)	6,500			
		10,700			10,700
2025					
April 1	To Balance b/d	3,900			

Profit and Loss Account for the year ended 31st March, 2024

Dr. *Cr.*

Particulars	₹	₹	*Particulars*	₹	₹
To Bad Debts:	3,950		By Discount Received	9,840	
Add: New Provision for Bad and Doubtful Debts	6,000		Add: New Reserve for Discount on Creditors	4,200	
	9,950			14,040	
Less: Old Provision	5,000	4,950	Less: Old Reserve	4,800	9,240
To Discount Allowed	8,800				
Add: New Provision for Discount	3,420				
	12,220				
Less: Old Provision	2,850	9,370			

Profit and Loss Account for the year ended 31st March, 2025

Dr. *Cr.*

Particulars	₹	₹	*Particulars*	₹	₹
To Discount Allowed	7,000		By Old Provision for bad and doubtful debts	6,000	
Add: New Provision for Discount	2,280				
	9,280				
Less: Old Provision	3,420	5,860	Less: Bad Debts	1,800	
				4,200	
			Less: New Provision	4,000	200
			By Discount Received	6,800	
			Add: New Reserve for Discount on Creditors	3,900	
				10,700	
			Less: Old Reserve	4,200	6,500

Illustration 2:

Following is the trial balance of Amar as on 31st March, 2025:

	₹	₹
Capital Account		8,00,000
Drawing Account	60,000	
Stock (1.4.2024)	4,50,000	
Purchases	26,00,000	
Sales		31,00,000
Furniture	1,00,000	
Sundry Debtors	4,00,000	
Freight and Octroi	46,000	
Trade Expenses	5,000	
Salaries	55,000	
Rent	24,000	
Advertising Expenses	50,000	
Insurance Premium	4,000	
Commission		13,000
Discount	2,000	
Bad Debts	16,000	
Provision for Bad Debts		9,000
Creditors		2,00,000

Cash in hand	52,000	
Bank	58,000	
Goodwill (at cost)	2,00,000	
	41,22,000	41,22,000

Adjustments:

(a) *Stock on 31st March, 2025 was valued at ₹ 5,30,000.*

(b) *Salaries have been paid only for 11 months.*

(c) *Unexpired insurance included in the figure of ₹ 4,000 appearing in trial balance is ₹ 1,000.*

(d) *Commission earned but not yet received amounting to ₹ 1,220 is to be recorded in books of account.*

(e) Provision for bad debts is to be brought upto 3% of sundry debtors.

(f) Manager is to be allowed a commission of 10% of net profits after charging such commission.

(g) Furniture is depreciated @10% per annum.

(h) Only 1/4th of advertising expenses is to be written off.

Prepare trading and profit and loss account for the year ended 31st March, 2025 and balance sheet as on that date. Also show adjustments entries and closing entries.

Solution:

Mr. Amar

Trading and Profit and Loss Account
for the year ended 31st March, 2025

Dr. *Cr.*

Particulars	₹	₹	*Particulars*	₹	₹
To Stock (1.4.2024)		4,50,000	By Sales		31,00,000
To Purchases		26,00,000	By Closing Stock		5,30,000
To Freight & Octroi		46,000			
To Gross Profit transferred to P&L a/c		5,34,000			
		36,30,000			36,30,000
To Trade Expenses		5,000	By Gross Profit transferred from trading A/c		534,000
To Depreciation on Furniture		10,000			
To Salaries	55,000		Commission	13,000	
Add: Outstanding	5,000	60,000	Add: Commission earned but not received	1220	14,220
To Rent		24,000			
To Advertising Expenses	50,000				
Less: Amount C/f	37,500	12,500			
To Insurance Premium	4,000				

Less: Unexpired Insurance	1,000	3,000			
To Discount		2,000			
To Provision for Bad Debts @3% on ₹4,00,000	12,000				
Add: Bad Debts	16,000				
Less: Old provision	9,000	19,000			
To Commission payable to Manager $\frac{10}{110}$ x 412720		37,520			
To Net Profit transferred to Capital Account		3,75,200			
		5,48,220			5,48,220

Balance Sheet as on 31st March, 2025

Liabilities	₹	₹	*Assets*	₹	₹
Capital			Fixed Assets:		
Opening Balance	800,000		Goodwill		2,00,000
Add: Net profit	3,75,200		Furniture	100,000	
Less: Drawings	60,000	11,15,200	Less: Depreciation	10,000	90,000
Creditors		2,00,000	Current Assets:		
Outstanding Salary		5,000	Unexpired Insurance		1,000
Commission Payable to Managers		37,520	Unexpired advertising expenses		37,500
			Commission earned but not received		1,220
			Closing Stock		5,30,000
			Sundry Debtors	4,00,000	
			Less: Provision for bad debts	12,000	3,88,000
			Cash at bank		58,000
			Cash in hand		52,000
		13,57,720			13,57,720

Journal Book

Adjustment Entries

Particulars		₹	₹
Stock Account	Dr.	530,000	
To Trading Account			5,30,000
(Being closing stock credited to trading account)			
Salaries Account	Dr.	5,000	
To Salaries Outstanding Account			5,000
(Being the amount of salaries outstanding on 31st March, 2024)			
Unexpired Insurance	Dr.	1,000	
To Insurance Premium Account			1,000
(Being the amount of unexpired insurance premium as on 31st March, 2024)			
Commission Earned But not Received	Dr.	1,220	
To Commission Account			1,220
(Being the amount of commission earned but not received till 31st March, 2024)			
To Provision for Bad Debts Account	Dr.	16,000	
Bad Debts Account			16,000
(Transfer of bad debts to provision for bad debts)			
Profit and Loss Account	Dr.	19,000	
To Provision for Bad Debts Account			19,000
(Being credit given to provision for bad debts to make its balance 3% of ₹ 40,000)			
Profit and Loss Account	Dr.	37,520	
To Commission Payable to Manager			37,520
(Being commission payable to manager @10% of net profits remaining after charging such commission)			
Depreciation Account	Dr.	10,000	
To Furniture Account			10,000
(Being the amount of depreciation provided on furniture @10% per annum)			
Unexpired Advertising Expenses Account	Dr.	37,500	
To Advertising Expenses Account			37,500
(For advertising expenses carried forward to next year)			

Closing Entries:

Particulars		₹	₹
Trading Account	Dr.	30,96,000	
To Stock Account (1.4.2024)			4,50,000
To Purchases Account			26,00,000
To Freight & Octroi Account			46,000
(Transfer of various nominal accounts showing debit balances to trading account)			
Sales Account	Dr.	31,00,000	
To Trading Account			31,00,000
(Transfer of sales account to trading account) Note: Entry for closing stock has already been passed by way of adjustment			
Trading Account	Dr.	5,34,000	
To Profit and Loss Account			5,34,000
(Transfer of gross profit from trading account to profit and loss Account)			
Profit and Loss Account	Dr.	1,16,500	
To Trade Expenses Account			5,000
To Salaries Account			60,000
To Rent Account			24,000
To Advertising Expenses Account			12,500
To Insurance Premium Account			3,000
To Discount Account			2,000
To Depreciation Account			10,000
(Transfer of various nominal accounts showing debit balances to profit and loss account)			
Commission Account	Dr.	14,220	
To Profit and Loss Account			14,220
(Transfer of credit balance in commission account to profit and loss Account)			
Profit and Loss Account	Dr.	3,75,200	
To Capital Account			3,75,200
(Transfer of net profit to capital account)			

Note: Profit and Loss Account has already been debited in respect of provision for bad debts and commission payable to manager. Refer to adjustments entries.

Illustration 3:

Following are the balances in the ledger of Mr. Patel for the year ended 31st March, 2025:

	₹
Stock (1.4.2024):	
Raw materials	1,00,000
Semi-finished goods	50,000
Finished goods	2,60,000
Purchases:	
Raw materials	8,00,000
Finished goods	1,70,000
Carriage inwards on raw materials	30,000
Manufacturing wages	1,00,000
Salary of the supervisor	36,000
Rent of the factory	70,000
Gas and water	30,000
Return of raw materials	13,000
Fuel and coal	33,000
Factory power	1,25,000
Fire insurance	13,000
Sales returns	1,20,000
Depreciation on factory building	12,000
Stock on 31.3.2025:	
Raw materials	80,000
Semi-finished goods	1,30,000
Finished goods	2,20,000
Sales	22,00,000
Carriage outwards	35,000
Office salaries	1,50,000

Prepare manufacturing account and trading and profit and loss accounts for the year ended March, 2016.

Dr. **Manufacturing Account for the year ended 31st March, 2025** *Cr.*

Particulars	₹	₹	*Particulars*	₹	₹
To Opening stock:			By Closing stock:		
Raw materials	1,00,000		Raw materials	80,000	
Semi-finished Goods	50,000	1,50,000	Semi-finished goods	1,30,000	2,10,000
To Purchases	8,00,000		By Cost of production transferred to Trading Account		
Less : Returns	13,000	7,87,000			11,76,000
To Carriage on raw materials		30,000			
To Manufacturing wages		1,00,000			
To Factory expenses:					
Salary of supervisor	36,000				
Rent of factory	70,000				
Gas and water	30,000				
Fuel and coal	33,000				
Factory power	1,25,000				
Fire insurance	13,000				
Depreciation, on Factory Building	12,000	3,19,000			
		13,86,000			13,86,000

Dr. **Trading and Profit and Loss Account for the year ended 31st March, 2025** *Cr.*

Particulars	₹	*Particulars*		₹
To Opening stock of finished goods	2,60,000	By Sales	22,00,000	
		Less: Returns	1,20,000	20,80,000
To Cost of production transferred from Manufacturing Account	11,76,000	By Closing Stock of finished goods		2,20,000
To Purchases	1,70,000			
To Gross Profit c/d	6,94,000			
	23,00,000			23,00,000

To Carriage outwards	35,000	By Gross Profit b/d	6,94,000
To Office salaries	1,50,000		
To Net Profit transferred to Capital A/c	5,09,000		
	6,94,000		6,94,000

LESSON ROUNDUP

Introduction to Final Accounts

Final accounts are the **end products of the financial accounting process** that serve two primary purposes:

1. Determining net profit or loss from trading activities during a specific period
2. Assessing the financial position in terms of assets and liabilities as of the period's end date

These accounts are prepared from trial balance data, where debit balances (assets) transfer to the balance sheet's right side, while expenses and losses go to Trading or Profit & Loss accounts based on their nature.

Core Components of Final Accounts

Trading Account

The **Trading Account** is prepared first and focuses exclusively on:

- **Purpose**: Calculate gross profit/loss from buying and selling activities
- **Includes**: Direct expenses like freight, insurance, carriage inwards, fuel, power, and royalties
- **Excludes**: Administrative, selling, distribution, and maintenance expenses
- **Key Principle**: Only direct costs related to making goods saleable are considered

Important Rule: If debit side exceeds credit side, it results in gross loss, shown as "By Gross Loss" on the credit side.

Profit & Loss Account

This account determines the **net profit or loss** by:

- Taking gross profit from the Trading Account
- Deducting indirect expenses (administrative, selling expenses, etc.)
- Adding other revenues and incomes
- The final balance transfers to the capital account

Essential Accounting Principles

Matching Principle

A **fundamental principle** requiring that:

- Expenses and incomes for the full trading period must be included, whether paid/received or not
- No expenditure or income from outside the accounting period should be included
- This principle guides the distinction between capital and revenue items

Classification of Assets

1. **Fixed Assets**: Long-term business assets (plant, machinery, buildings, furniture)
2. **Current Assets**: Short-term assets easily convertible to cash (stock, debtors, cash)
3. **Wasting Assets**: Fixed assets with diminishing content (coal mines, oil wells)
4. **Intangible Assets**: Non-physical assets (goodwill, patents, trademarks)

Classification of Liabilities

1. **Fixed/Long-term Liabilities**: Payable on business termination or after long periods
2. **Current Liabilities**: Payable within a year (trade creditors, bank overdraft, bills payable)

Adjustment Entries

The lesson extensively covers **adjustment entries** needed at year-end to ensure accurate financial reporting:

Major Adjustments Include:

1. **Closing Stock**: Appears in balance sheet only when already in trial balance
2. **Outstanding Expenses**: Expenses incurred but not yet paid
3. **Prepaid Expenses**: Expenses paid in advance for future benefit
4. **Accrued Income**: Income earned but not yet received
5. **Income Received in Advance**: Unearned revenue received early
6. **Provision for Bad Debts**: Estimated uncollectible amounts
7. **Provision for Discount on Debtors**: Expected cash discounts
8. **Reserve for Discount on Creditors**: Expected discounts from suppliers
9. **Depreciation**: Systematic allocation of asset costs over useful life

Practical Applications

The lesson includes detailed **worked examples** showing:

- Complete preparation of Trading Account, Profit & Loss Account, and Balance Sheet
- Step-by-step adjustment entries with journal entries
- Proper classification and presentation of various items
- Calculation of provisions and reserves

Key Differences Highlighted:

Trading Account vs. Profit & Loss Account:

- Trading Account: Shows gross profit/loss from direct trading activities
- Profit & Loss Account: Shows net profit/loss after all expenses and revenues

Trial Balance vs. Balance Sheet:

- Trial Balance: Tests arithmetical accuracy of all account balances
- Balance Sheet: Shows financial position with assets and liabilities only

Cash Discount vs. Trade Discount:

- Cash Discount: Reduction for prompt payment (recorded in ledger)
- Trade Discount: Business consideration reduction (not recorded separately)

Manufacturing Account

For businesses involved in production, a **Manufacturing Account** precedes the Trading Account to calculate the cost of goods produced.

Manager's Commission

Special calculations for commission based on net profit percentages, requiring careful computation to avoid circular references.

Limitations of Financial Statements

The lesson acknowledges several limitations:

- Based on historical costs, not current values
- Relies on estimates and personal judgment
- Excludes non-financial factors
- May not reflect true economic value due to accounting conventions

This comprehensive lesson provides the foundation for understanding how sole proprietors prepare their annual financial statements, ensuring compliance with accounting principles while presenting a true and fair view of business performance and financial position.

GLOSSARY

Closing Stock: Unsold stock at the end of the accounting period

Contingent Liabilities: These liabilities depend on the happening of certain events.

Intangible Assets: Fixed assets which cannot be seen or touched.

Outstanding or Accrued Expenses: Expenses which have been incurred during the year but payment in respect of which has not been made.

Unexpired or Prepaid Expenses: Expenses which have been paid in advance and whose benefit will be available in future.

Accrued Income: Income which has been earned by the business during the accounting year but which has not become due and hence has not been received.

Income Received in Advance: The revenue which remains received in advance (unearned) at the end of the accounting period.

TEST YOURSELF

A. Multiple Choice Questions (MCQ)

1. The main purpose of a manufacturing account is to:
   a. Ascertain gross profit
   b. Ascertain cost of goods manufactured
   c. Show financial position
   d. Calculate net profit

   Answer: Ascertain cost of goods manufactured
2. Which of the following is a direct manufacturing expense?
   a. Depreciation on Plant
   b. Salary of Factory Manager
   c. Royalty based on production
   d. General Administration Expenses

   Answer: Royalty based on production
3. Manufacturing Account does NOT deal with:
   a. Raw Materials
   b. Work in Progress
   c. Finished Goods Sales
   d. Factory Overheads

   Answer: Finished Goods Sales
4. Work-in-progress at year end is:
   a. Credited to Manufacturing Account
   b. Debited to Trading Account
   c. Debited to Manufacturing Account
   d. Credited to Trading Account

   Answer: Credited to Manufacturing Account
5. The formula for Raw Material Consumed is:
   a. Purchases – Opening Inventory
   b. Raw Material Opening Inventory + Purchases – Raw Material Closing Inventory
   c. Raw Material Purchases + Closing Inventory – Raw Material Opening Inventory
   d. Raw Material Opening Inventory – Purchases – Raw Material Closing Inventory

   Answer: Raw Material Opening Inventory + Purchases – Raw Material Closing Inventory
6. Which of the following is NOT an indirect manufacturing expense?

a. Depreciation on Plant

b. Factory Rent

c. Royalty based on units produced

d. Factory Lighting

Answer: Royalty based on units produced

7. In manufacturing account, by-products are generally:

a. Ignored

b. Credited at cost price

c. Credited at net realisable value

d. Credited at selling price

Answer: Credited at net realisable value

8. If closing work-in-progress is understated, the effect is:

a. Net income is understated

b. Net income is overstated

c. No effect on income

d. Assets are overstated

Answer: Net income is understated

9. Manufacturing account is prepared only by:

a. Trading entities

b. Manufacturing entities

c. Service entities

d. Non-trading entities

Answer: Manufacturing entities

10. Overheads in a manufacturing account generally include:

a. Direct materials

b. Indirect materials, indirect wages and indirect expenses

c. Finished goods costs only

d. Direct expenses only

Answer: Indirect materials, indirect wages and indirect expenses

11. The main objective of preparing final accounts is to:

a. Record transactions

b. Ascertain profit or loss and financial position

c. Calculate depreciation

d. Maintain cash flow statement

Answer: Ascertain profit or loss and financial position

12. The Trading Account is prepared to ascertain:

1. Net Profit
2. Net Loss
3. Gross Profit or Gross Loss
4. Financial Position

Answer: Gross Profit or Gross Loss

13. In which Financial Statements, are outstanding expenses shown at the year end?

a. Income Statement
b. Liabilities side of Balance Sheet
c. Assets Side of Balance Sheet
d. Trading Account

Answer: Liabilities side of Balance Sheet

14. Expenses related to the proprietor personally are:

1. Debited to Profit & Loss Account
2. Debited to Trading Account
3. Debited to Drawings/Capital Account
4. Credited to Profit & Loss Account

Answer: Debited to Drawings/Capital Account

15. Which of the following is NOT a direct expense in Trading Account?

a. Wages
b. Carriage Inwards
c. Advertisement Expenses
d. Freight on Purchases

Answer: Advertisement Expenses

16. When Closing Inventory appears in the trial balance, it is shown:

1. Only in Trading Account
2. Only in Balance Sheet
3. Both in Trading Account and Balance Sheet
4. Not shown anywhere

Answer: Only in Balance Sheet

17. Discount received is:
    a. Debited to Profit & Loss Account
    b. Credited to Profit & Loss Account
    c. Debited to Trading Account
    d. Credited to Capital Account

    Answer: Credited to Profit & Loss Account

18. Income tax paid by sole proprietor is treated as:
    1. Business expense
    2. Personal expense debited to Capital Account
    3. Profit & Loss Account expense
    4. Current Liability

    Answer: Personal expense debited to Capital Account

19. Provision for bad & doubtful debts is:
    a. Debited to Debtors' Account
    b. Debited to Capital Account
    c. Debited to Profit & Loss Account
    d. Credited to Trading Account

    Answer: Debited to Profit & Loss Account

20. The order of liquidity in Balance Sheet means:
    1. Current assets first, fixed assets last
    2. Fixed assets first, current assets last
    3. Liabilities first, assets last
    4. Capital first, assets last

    Answer: Current assets first, fixed assets last

B.True / False Questions with Answers

1. The Trading Account shows only indirect expenses of a business for the year.

   False – Trading Account shows *direct* expenses related to purchases and bringing goods to sale.

2. Closing Stock appearing in the Trial Balance is shown only in the Balance Sheet.

   True – It is already adjusted in the books.

3. Outstanding expenses at year-end are added to the related expenses in the P&L and shown as liabilities in the Balance Sheet.

   True

4. Prepaid expenses are deducted from the related expense and shown as an asset in the Balance Sheet.

   True

5. Provision for doubtful debts is created to meet possible future bad debts.

   True

6. Drawings by the proprietor are debited to the Profit & Loss Account.

   False – They are debited to the Capital Account.

7. Goods given as free samples are treated as a selling expense.

   True – They are debited to Advertisement/Sales promotion expenses.

8. Manager's commission on net profit after charging such commission is calculated as:

   Commission = Profit before commission × Rate ÷ (100 + Rate)

   True

9. Loss from fire is always adjusted in the Trading Account.

   False – Only abnormal loss cost portion is transferred to P&L; total loss is reduced from Purchases in Trading.

10. Accrued income is an asset in the Balance Sheet.

    True

11. Income received in advance is deducted from the related income in P&L and shown as liability in the Balance Sheet.

    True

12. Depreciation is debited to P&L and reduced from the asset in the Balance Sheet.

    True

13. When goods are sold on approval basis and approval is not received before year-end, the sale is reversed for that amount.

    True

14. Provision for discount on debtors is created on the gross amount of debtors (before bad debts provision).

    False – Created on good debtors after bad debts provision.

15. Cash discount allowed is recorded in Trading Account.

    False – It is recorded in P&L as an expense.

16. Capital = Assets – Liabilities.

    True

17. The Matching Principle states that expenses should be recorded in the period in which they are paid.

    False – Expenses are recorded in the period in which the related revenue is earned, whether paid or not.

18. Purchase Returns reduce the Purchases in Trading Account.

    True

19. If the debit side of Trading A/c exceeds the credit side, it results in a Gross Loss.

    True

20. Interest on proprietor's drawings is treated as business income and credited to the P&L Account.

    True

C. Theory & Conceptual Questions (Short/Descriptive)

1. Define the Matching Principle and explain its importance in preparing final accounts.
2. Distinguish between provision and reserve with two examples each.
3. Why is closing stock sometimes shown only in the Balance Sheet and not in the Trading Account?
4. List any five examples of adjustments required before preparing the final accounts of a sole proprietor.
5. State any three limitations of financial statements.
6. Explain the difference between Capital Expenditure and Revenue Expenditure with examples related to a trading business.
7. What is the treatment of income received in advance in the final accounts?
8. The opening stock of goods appears in the trial balance — how is it treated in Trading Account and Balance Sheet?
9. Explain the double entry for goods withdrawn by the proprietor for personal use.
10. How is the provision for doubtful debts calculated and presented in final accounts?

D. Practical Questions

1. The following are the balances taken from the books of Mr. Atma Ram:

Balances on 31st March, 2025

	₹'000
Atma Ram's capital	300
Atma Ram's drawings	50
Furniture and fittings	26
Bank overdraft	42
Creditors	133
Business premises	200
Stock on 1st April, 2024	220

Debtors	186
Rent from tenants	10
Purchases	1,100
Sales	1,500
Sales returns	20
Discount-debit	16
Discount-credit	20
Taxes and insurance	20
General expenses	40
Salaries	90
Commission-debit	22
Carriage on purchases	18
Provision for bad and doubtful debts	6
Bad debts written off	8

Stock on hand on 31st March, 2025 was estimated at ₹ 200 thousand. Rent ₹ 3 thousand, is still due from the tenant. Salaries, ₹ 7.5 thousand are as yet unpaid. Write off bad debts ₹ 6 thousand and depreciate business premises by ₹ 3000 and furniture and fittings by ₹ 2660. Make a provision of 5% on debtors for bad and doubtful debts and provision of 2% for discounts. Allow interest on capital at 5 per cent and carry forward ₹ 7000 for unexpired insurance. The manager is entitled to a commission of 10% on profits remaining after charging his commission.

Prepare Trading Account, Profit and Loss Account and Balance Sheet on 31st March, 2025.

Hints: Suspense Account (difference in trial balance) = 500.

[Ans : G.P = 342 thousand, N.P. = 132.2 thousand, B/s Total = 597.92 thousand].

2. Below is the trial balance of Suresh as at 31st March, 2025.

Debit Balance	₹'000	Credit Balance	₹'000
Suresh's Current Account	150	Capital Account	5,000
Adjusted purchases	69,920	Loan from Mohan @ 9%	
Salaries	420	(taken on 1st October, 2024)	2,000
Carriage on purchases	40	Sales	72,000
Carriage on sale	50	Discount	50
Lighting	30	Sundry creditors	2,000
Rates and insurance	40		
Buildings	2,700		
Sundry debtors	800		

Furniture	600		
Cash in hand	25		
Cash at bank	150		
Stock (31st March, 2014)	6125		
	81,050		81,050

Rates have been prepaid to the extent of ₹17,500. Bad debts totaling ₹ 50,000 have to be written off. A provision for doubtful debts @ 5% on debtors is necessary. Buildings have to be depreciated at 2% and furniture @ 10%. The manager is entitled to a commission of 5% of net profits before charging such commission.

You are required to prepare the profit and loss account for the year ended 31st March, 2025 and the balance sheet as on that date.

[Hints: (a) The trial balance gives "Adjusted Purchases". It means that the opening stock has already been transferred to the Purchases Account and has thus been closed. Further, entry for closing stock has already been passed by debiting the Closing Account and crediting Purchases Account. That is why closing stock appears in the trial balance. It will now be shown in the Balance Sheet and not in the Trading Account since Purchases already stand reduced.

(b) There is a loan of Mohan @ 9% taken in October, 2024. The trial balance makes no mention of any interest being paid to him. Hence, interest @ 9% must be provided for six months i.e. from October 2024 to March 2025.]

[Ans.: G.P. = 2,040 thousand, N.P. =1212.2 thousand, Total B/S =10,216 thousand].

3. Mr. T.P.'s trial balance as on 31st March, 2025 is as under:

Debit Balance	₹'000	Credit Balance	₹'000
Land and building	2,000	Capital	8,000
Machinery	5,000	Sundry creditors	800
Furniture and fixtures	400	Discounts received	40
Opening stock	1,630	Outstanding expenses	155
Purchases	8,000	Sales	15,050
Salaries	600	Repairs and renewals	
Carriage on sales	150	provision	200
Freight on purchase	800		
Advertising	540		
Wages	1,500		
Rent	300		
Postage and stationery	150		
General expenses	320		

Loan to Santhanam @ 9% (given on 1st Oct., 2024)	500	
Prepaid insurance	20	
Sundry debtors	2,000	
Cash in hand	25	
Cash in bank	310	
	24,245	24,245

The following further information is given:

(a) Stock on 31st March, 2025 was ₹ 14,90,000.

(b) Machinery was purchased on 31st October, 2024 for ₹ 10,00,000 and was installed by own workmen. The wages for this purpose amounted to ₹ 50,000. This amount is included in wages account.

(c) Depreciation is to be written off @

3% on land and buildings;

10% on machinery; and

5% on furniture and fixtures.

(d) Provision for repairs and renewals is credited with ₹ 1,50,000 every year.

(e) A reserve of 2% is to be made on creditors for discount.

From the information given above, prepare trading account and profit and loss account for the year ended 31st March, 2025 and balance sheet as at that date.

[Hints:

(a) Prepaid insurance and outstanding expenses are given in trial balance. This means double entry in respect of these of items has been completed. Therefore, they will appear in balance sheet only.

(b) There is a provision for repairs and renewals. Actual repairs will, therefore, be debited to this account and not to the profit and loss account, the provision for repairs and renewals account will be credited with ₹ 1,50,000 by debiting profit and loss account.]

4. On 31st March 2025, the following Trial Balance was extracted from the books of Ghosh:

	Dr.(₹'000)	Cr. (₹'000)
Capital Account		9,000
Plant and Machinery	8,000	
Sales		40,700
Purchases	26,000	
Returns	600	575
Opening Stock	3,000	

Discount	35	80
Bank Charges	7.5	
Sundry debtors	4,500	
Sundry Creditors		25,00
Salaries	2,680	
Manufacturing wages	4,000	
Carriage Inwards	75	
Carriage Outwards	120	
Bad Debts Provision		52.5
Rent, Rates and Taxes	1,000	
Advertisements	200	
Cash in Hand	90	
Cash in Bank	600	
Furniture & Fittings	2,000	
	52,907.5	52,907.5

Prepare the final accounts for the year ended 31st March, 2025 and the Balance Sheet as on that date. The following adjustments are required:

(i) Clocking Stock ₹ 3,500 thousand.

(ii) (i) Depreciation on Plant and Machinery @ 15% p.a. and on furniture & Fittings @ 10% p.a. to be provided.

(iii) Bad Debts Provision to be adjusted to ₹ 50 thousand.

(iv) Interest on Capital to be allowed at 10% per annum.

(v) 15% of the profits remaining after providing interest on capital is to be carried to General Reserve.

[Ans.: G.P. = ₹ 1,1,100 thousand; N.P. = ₹ 4,114 thousand; Total of B/S =₹ 1,7,240 thousand].

5. From the following, prepare the Trading and Profit and Loss Accounts for the year ended 31st March 2025 and Balance Sheet of Niyati as at 31st March, 2025:

	₹'000
Capital	3,000
Trade Creditors	600
Bills Payable	200
General Reserve	500
Provision for Bad and Doubtful Debts	20
Profit and Loss Account, 1st April, 2024	109

Sales	11,500
Discount Allowed	95
Stocks at 1st April, 2024	1,100
Purchases	8,960
Discount Received	88
Buildings	1,000
Machinery, Plant and Furniture (Cost ₹ 2,500 thousand)	1,500
Book Debts	728
Bank Balance (Dr.)	488
Investment, 9% Government Loan at par	200
Bills Receivable	450
Salaries a Wages	660
Audit Fees	100
Office Expenses	440
Repairs and Renewals	236
Interest Paid	14
Bad Debts Recovered	5

The value of stocks on hand as at 31st March, 2025 was ₹1,360 thousand including goods costing ₹18 thousand received on 30th March, 2025 in respect of which supplier's bill had not yet been received. Goods of the cost of ₹ 30 thousand were sent to a customer on sale or approval basis. The invoice for ₹ 40 thousand was entered in the Sales Book. Provision is to be made for bad debts to the extent of ₹ 8 thousand, and for depreciation of buildings at 2% per annum: Machinery, Plant and Furniture have been depreciated at 20% of the diminishing value; Niyati, however, considers that the proper method is 8% of the original cost and wishes to adopt it with effect from 1st April, 2021.

Partnership and LLP Accounts

Lesson 6

KEY CONCEPTS

■ Partnership ■ Partner ■ Goodwill ■ Profit Sharing Ratio ■ Averate Profit ■ Super Profit ■ Capitalization of Profit

Learning Objectives

To understand:

As we know, sole proprietorship form of business organization has limited financial and managerial resources. It is also not possible to expand the business activities beyond a certain limit. So, in order to overcome these drawbacks, another form, i.e., partnership form of business has come into existence. When two or more persons come together to share profits of the business carried on by them, it is called partnership form of organization. Accounting for partnership firm is different from sole proprietorship in certain aspects as there are more than one contributor to capital who share profits and losses.

Further, there is another form partnership called limited liability partnership (LLP) wherein some or all partners (depending upon the jurisdiction) have limited liability. In an LLP, one partner is not responsibility or liable for another partner's misconduct or negligence.

Here in this lesson, we will study about partnership form of business and preparation of accounts under various situations like admission of new partner, retirement and death of partner and dissolution of partnership firm. We would also cover the concept of goodwill and valuation of goodwill for partnership firms under various situations

Lesson Outline

- Basic Concepts of Partnership
- Goodwill
- Methods of Valuation of Goodwill
- Average Profit Method
- Super Profit Method
- Capitalization Method
- Preparation of Final Accounts of Partnership
- Profit & Loss Appropriation Account
- Interest on Capital
- Interest on Drawings
- Salary or Commission payable to Partners
- Past Adjustments of Profit
- Guarantee of Profit to a Partner
- Reconstitution of Partnership
- Change in Profit Sharing Ratio
- Admission of a Partner
- Retirement of a Partner
- Death of a Partner
- Dissolution of Partnership Firm
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

BASIC CONCEPTS OF PARTNERSHIP

Partnership: Partnership is defined in Section 4 of the Indian Partnership Act, 1932 as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Partners and Firm: Persons who have entered into partnership with one another are individually known as 'partners' and collectively a 'firm'. The name under which the business is carried on is called 'firm's name'. In other words, a firm is a collection of the partners. The assets of the firm are joint property of the partners and the partners are personally liable for all liabilities of the firm.

Essential features of Partnership: The following features must exist in order to constitute a partnership -

(i) There must be an agreement and for an agreement, at least two persons are required. The agreement must be entered into by all the persons concerned. The persons must be competent to contract.

(ii) The Partnership Act does not lay down any maximum number of partners. But Section 464 read with Rule 10 of Companies Miscellaneous Rules, 2014 prohibits partnership exceeding 50 partners in a partnership firms unless its register as a company.

(iii) There must be a 'business' and for this purpose business would include any trade, profession or occupation; For example, the jobs of medical practitioners or lawyers are covered under profession and can form partnership. There can be a partnership between doctors or lawyers.

(iv) The business must be carried on for the purpose of earning profits which would be divided among the partners i.e. there must be an agreement among the partners to share the profits (including negative profits, i.e., losses) of a business.

(v) The business must be carried on by some or all of the partners for the benefit of all of them. Consequently in partnership, there is a mutual agency among the partners and in the ordinary course of business acts of one partner are considered to be the acts of the firm.

Partnership Deed: A contract for partnership need not necessarily be in writing although it is advisable to reduce it in writing to minimize the disputes among the partners. But when the contract is put in black and white, the written contract is called a partnership deed. It is a legal document signed by all the partners and mostly contains the following:

The name of the partners; name of the firm; nature of the business to be carried on by the firm; the powers of the partners; when termination is certain, the term of duration of partnership; the amount of capital to be contributed by each partner, the restrictions on working of each partner; methods of division of profits or losses; salary; commission, interest on capital etc. payable to the partners; interest on drawings to be charged on withdrawals; interest on loan payable to a partner; valuation of goodwill when there is a change in the constitution of the firm; methods of accounting and the arbitration clause, etc.

If there is no partnership deed or if there is no provision in it indicating a contrary intention, the following provisions of the Partnership Act, apply.

(i) Every partner has a right to take part in the conduct of the business of the firm and also the right of free access to all records, books and accounts of the firm.

(ii) Partners share profits and losses equally. It is so, even when partners contribute capital unequally.

(iii) Partners are not entitled to any interest on capital contributed by them nor can they claim any salary for the work done by them for the firm. In case a partnership deed provides for payment of interest on capital or salary, it is payable only if there is a profit.

(iv) On amounts advanced by a partner to the firm in excess of his agreed share of capital, the partner is entitled to receive interest on such excess at the rate of 6% per annum. Such interest is payable even if there is a loss.

(v) No interest is to be charged on drawings.

REVIEW QUESTION

1. **State whether the following statements are true or false?**
   - (i) There can be a partnership between two chartered accountants.
   - (ii) At the most, there can be fifty partners in a firm.
   - (iii) In every partnership, there must be a partnership deed.
   - (iv) Unless provided otherwise, partners are deemed to be sharing profits and losses in the ratio of their capitals.
2. **Fill in the blanks:**
   - (i) If partnership deed is silent on the profit sharing ratio; interest @_____ per annum is allowed on loans advanced by partners.
   - (ii) At the most there can be _____ partners is partnership firm.

     (1) 6% (2) 50

Difference between Partnership and Joint Venture

Partnership	Joint Venture
(i) It is not limited to a specific venture.	(i) It is limited to a specific venture.
(ii) It is a continuing profit seeking enterprise.	(ii) It is a terminable profit-seeking venture.
(iii) It is carried on under firm's name.	(iii) There is no common firm's name in joint venture.
(iv) Persons carrying on partnership business are called partners.	(iv) Parties are called co-venturers.
(v) Profit or loss is ascertained on an annual basis.	(v) Profit or loss is ascertained only after the end of the specific venture.
(vi) Partnership firms are governed by Indian Partnership Act, 1932.	(vi) There is no specific act for joint ventures.
(vii) The doctrine of implied authority is applicable to partners.	(vii) The doctrine of implied authority is not applicable to co-venturers.

Loan Account: If a partner advances to the firm a sum over and above the amount of capital required to be contributed by him under the partnership contract, the amount is credited to a loan account opened in his name. In the event of dissolution of partnership, a partner is entitled to receive the amount of loan advanced by him in priority to repayment of capital to the partners. However, if capital is insufficient to meet losses on dissolution, the amount of the loan can be used to meet losses.

Capital Accounts: There are only a few points of difference between the accounts of a partnership firm and those of a sole proprietorship concern. One difference is that in a sole proprietorship concern there is only one capital account, whereas, in the firm's ledger there are as many capital accounts as there are partners in the firm (unless some partner is not required to contribute capital at all). Amount contributed by a partner whether

in cash or in the form of some other asset or assets is credited to his capital account.

Types of Capital Account: The capital account of a partner may be either a Fixed Capital Account or a Fluctuating Capital Account.

(i) *Fixed Capital Account :* Under Fixed Capital Account method, there will be two accounts for each partner, i.e. (i) Partner's Capital Account – recording only capital of the partner and (ii) Partner's Current Account – recording the transactions relating to drawings, interest on capital, commission, salary, share of profit or loss, etc of the partner. Under this method, capital accounts are not touched at all and debits and credits for interest on capital, interest on drawings, profits, losses, drawings, etc., are made in separate accounts called current accounts or drawing accounts. Capital account is credited only when fresh (or further) capital is introduced or debited when capital is withdrawn.

If there is no addition or withdrawal of capital during the year, the capital account does not change and it remains fixed through-out the year. Sometimes, there may be current accounts as well as drawings accounts. Drawing accounts are used to record only the withdrawals made by partner; and transferred to the respective current accounts at the end of the year. Such drawings accounts are maintained when drawings are irregular and extensive to facilitate calculation of interest on drawings.

(ii) *Fluctuating Capital Account :* Just as in a sole proprietorship concern, in partnership also, profits or losses, drawings, interest on capital, interest on drawings, salary (to partners), commission, additional capital introduced, etc., may all be recorded in the capital accounts. Such capital accounts are called Fluctuating Capital Accounts because the balances of these accounts continue to fluctuate due to various debits and credits. Under this method, there is no need to maintain respective current accounts because all transactions passing through current accounts are passed through capital accounts.

DIFFERENCE BETWEEN FIXED & FLUCTUATING CAPITAL METHODS

Fixed Capital Method	Fluctuating Capital Method
(i) Two accounts of each partner are maintained, i.e. capital account and current account	(i) Only one account of each partner i.e. capital account is maintained.
(ii) Balance in capital account remains the same except when capital is introduced or capital is withdrawn.	(ii) The balance in capital account changes every year because of profits/losses, drawings, interest on capital, interest on drawings, etc.
(iii) All adjustments in respect of profit, loss, drawings, interest on capital, interest on drawings, salary, commission, etc. are made in the current account.	(iii) All adjustments in respect of profit, loss, drawings, interest on capital, interest on drawings, salary, commission, etc. are made in the capital account.
(iv) The capital account will always have a plus or credit balance while the current account may have a debit (negative) balance.	(iv) Fluctuating capital account may sometimes show a debit (negative) balance.

GOODWILL

Goodwill is the value of reputation of a business house in respect of the profits expected in future over and above the normal level of profits earned by undertakings belonging to the same class of business. In other

words, goodwill is the present value of a firm's anticipated super normal earnings. The term super normal earnings means the earnings over and above the normal rate of return earned by representative firms in the same industry. Goodwill refers to the reputation of a business enterprise acquired by it over the period of time through its successful operations and customers' satisfaction. It is an attribute of business which enables it to earn more than other firms in the industry. Goodwill is an intangible asset but not a fictitious one. The following are some of the factors that generally contribute to the value of goodwill of a firm:

- Quality of goods sold by the firm
- Location of the business unit
- Reputation of the owners of the firm
- Monopolistic nature of the business
- Risk involved in the business
- Efficiency of management
- Possibility of competition
- Government attitude
- Possession of special contracts for availability of materials
- Trends of profits, etc.

Need for valuation of goodwill

Whenever there is any change in the existing relationship of the partners, some partners may have to sacrifice their future profits and some other partners may gain. Those who are sacrificing future profit should be compensated by others who are gaining. As a result, the need for the valuation of goodwill in a firm may arise in the following circumstances:

- Where the profit sharing ratio amongst the partners is changed.
- When a new partner is admitted.
- When a partner retires or dies.
- When the business is sold, and
- When a firm is amalgamated with another firm.

METHODS OF VALUATION OF GOODWILL

One of the main factors contributing to the value of goodwill is the earning capacity of the business. Following are the usual methods of calculating the value of goodwill:

(i) Average Profit Method:

Under this method, goodwill is valued on the basis of a certain number of years' purchase of the average profits of the past few years.

Example: Suppose on 1st April, 2024 on the admission of a new partner, it is agreed that goodwill of the firm is valued at three years purchase of average profits for the last five years. Further, suppose the profits for last five years have been as follows:

	₹
For the year ended 31st March 2024	10,740
For the year ended 31st March 2023	7,900
For the year ended 31st March 2022	5,430
For the year ended 31st March 2021	400 (loss)
For the year ended 31st March 2020	8,500

Value of goodwill will be calculated as follows:

Total profits for the last 5 years = ₹ (10,740 + 7,900 + 5,430 – 400 + 8,500)

= ₹ 32,170

Average profits = ₹ $\frac{32,170}{5}$ = ₹ 6,434

Three years' purchase of the above mentioned average profit= ₹ 6,434 x 3 = ₹ 19,302

Hence, value of goodwill = ₹ 19,302

(ii) Super Profit Method

In this case the future maintainable profits of the firm are compared with the normal profits for the firm. Normal earnings of a business can be judged only in the light of normal rate of earning and the capital employed in the business. Hence, this method of valuing goodwill would require the following information:

(i) A normal rate of return for representative firms in the industry.

(ii) The fair value of capital employed.

(iii) Estimated future maintainable profits.

Note: Normal rate of earning is that rate of earning which investors in general expect on their investments in the particular type of industry. Normal rate of earning depends upon the risk attached to the investment, bank rate, market need and the period of investment.

Capital employed is the aggregate of capital and reserves less the amount of non-trading assets such as investments. The capital employed may also be ascertained by adding up the present values of trading assets and deducting all liabilities therefore. Super profit is the simple difference between future maintainable operating profit and normal profit.

There are three methods of calculating goodwill based on super profit:

(a) Purchase of super profit

As per this method, value of goodwill is obtained by multiplying super profit by a certain number of years.

Goodwill = Super profit x No. of year purchase.

(b) Annuity method

Goodwill according to the annuity method is the present value of a terminal annuity of super profit for a reasonable period during which the super profit is likely to occur. It is calculated as:

Super profit x Annuity rate.

(c) Capitalization of super profit

In this method, the value of goodwill is arrived at by capitalizing the super profit at the normal rate of return. It is calculated as:

$$\frac{\text{Super profit x 100}}{\text{Normal rate of return}}$$

Example: A firm of X, Y and Z has a total capital investment of ₹ 2,25,000. The firm earned net profit during the last four years as ₹ 35,000, ₹ 40,000, ₹ 60,000 and ₹ 50,000. The fair return on the net capital employed is 15%. Find out the value of goodwill if it is based on 3 years' purchase of the average super profits of past four years.

Solution:

	₹
Total Profits earned during four years	1,85,000
Average annual profit ₹ 1,85,000 / 4	46,250
Fair return on capital employed: 15% of ₹ 2,25,000	33,750
Super Profit: ₹ 46,250 – ₹ 33,750	12,500
Value of goodwill being 3 years' purchases of the average	
Super profit = ₹ 12,500 x 3	37,500

(iii) Capitalization Method

The capitalization of profit method values goodwill at the excess of capital that should have been employed for earning the average profit over the capital which has been actually employed. In this method, the value of whole business is found by using the formula:

$$\frac{\text{Average annual profit x 100}}{\text{Normal rate of return}}$$

From this figure, the net assets (excluding goodwill) of the firm are deducted and the resultant figure will be the goodwill.

Example: Average profit of a firm is ₹ 48,000. The rate of capitalization is 12%. Assets and liabilities of the firm are ₹ 4,00,000 and 1,70,000 respectively.

Value of goodwill be:

$$= \frac{₹48,000 \times 100}{12} - (400,000-1,70,000)$$

= ₹ 4, 00,000 – ₹ 2, 30,000

= ₹ 1, 70,000

REVIEW QUESTION

On the admission of a new partner, it is decided that goodwill of the firm be calculated at 2 years' purchase of average profits for the past three years which amounted to ₹ 8,620, ₹ 9,430 and ₹ 11,800 respectively. What is the value of goodwill?

PREPARATION OF FINAL ACCOUNTS OF PARTNERSHIP FIRM

Final accounts of a partnership firm are prepared in the usual way in which they are prepared for a sole proprietorship concern except that the profits in the partnership have to be distributed among the various partners according to the terms of the partnership contract and the amount of profit may be arrived at after making adjustments for interest on capital, interest on drawings, salaries to partners, etc. for this another account "Profit & Loss Appropriation Account" is prepared after preparing Profit & Loss Account.

PROFIT AND LOSS APPROPRIATION ACCOUNT

As against the proprietorship business, the profits of the partnership firm are divided among partners in a given ratio. The profit has to be divided among the partners in the agreed profit sharing ratio after making necessary adjustments stated in the partnership deed such as interest on capitals, interest on drawings, salaries or/commission to partners, etc. For this purpose, an additional account is prepared, known as Profit and Loss Appropriation Account in which the net profit is transferred from Profit and Loss Account and necessary adjustments are made therein before the profit is divided among the partners. Following are the adjustments to be made in the profit & loss appropriation account:-

1. Interest on Capital

Where the profit sharing ratio is different from the ratio of capitals contributed by the partners, interest on capitals may be allowed to partners and charged against the profits of the firm to make the distribution of profits equitable. Interest on capital being an appropriation of profits, should be charged only out of the profits available. In case of loss, no interest on capital is provided. Interest is mostly calculated on the capitals at the commencement of the year. Where fresh capital has been introduced during the course of the year, interest is also allowed on this additional amount for the period for which the amount has been in business. Journal entry for interest on capital will be:

Profit and Loss Appropriation Accounts	*Dr.*
To Partners Capital/Current accounts	

2. Interest on Drawings

Interest may be charged on drawings made by partners to make distribution of profit more equitable. Interest on drawings should be charged on different amounts withdrawn for different periods. Journal entry for interest on drawing will be:

Partners Capital/Current Accounts	*Dr.*
To Profit and Loss Appropriation A/c	

Note: If a partner withdraws a fixed sum at the end of each month, the interest on his drawings for the year will be equal to the interest on his total drawings for a period of 5½ months.

If a partner withdraws the fixed amount in the middle of each month, interest will be calculated on his total drawings for a period of 6 months.

If he withdraws the amount at the beginning of each month, interest will be calculated on his total drawings for the period of 6½ months.

REVIEW QUESTION

P, a partner withdraws the following sums during the year ended 31st March 2025:

On 1st May 2024	₹ 3,000
On 1st August 2024	₹ 9,000
On 1st January 2025	₹ 6,000
On 1st March 2025	₹ 4,000

Calculate interest on his drawing @ 10% p.a.

3. Salary or Commission Payable to Partners

If in a firm there are some active partners and some sleeping partners, the active partners may be allowed salary for the work. The payment of salaries is regarded as a distribution of part of the profit of the firm. Thus, the amount of profit is reduced before it is divided in the agreed profit sharing ratio. The accounting treatment is same when a partner is paid commission or bonus. Journal entry will be as follows:

Profit and Loss Appropriation A/c	*Dr.*
To Partners Capital/Current Accounts	

Commission as a % of Net Profit before charging such commission

$$= \text{Net Profit before Commission X } \frac{\text{Rate of Commission}}{100}$$

Commission as a % of Net Profit after charging such commission

$$= \text{Net Profit before Commission X } \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

A pro-forma of profit and Loss account is as follows: (It is assumed that there are two partners X & Y)

SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Profit and Loss Appropriation Account

Dr. Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital :			By Profit and Loss Account		
X's Capital/ Current A/c	XXX		(profit of the current year)		XXX
Y's Capital / Current A/c	XXX	XXX	By Interest on drawings:		
To Partners' Salary:			X's Capital /Current A/c	XXX	
X's Capital/ Current A/c	XXX		Y's Capital/Current A/c	XXX	XXX
Y's Capital / Current A/c	XXX	XXX	By Loss transferred to:		
To Partners' Commission:			X's Capital/ Current A/c	XXX	
X's Capital/ Current A/c	XXX		Y's Capital/ Current A/c	XXX	XXX
Y's Capital / Current A/c	XXX	XXX	(In case of loss)		
To Transfer to Reserve		XXX			
To Profit transferred to:					
X's Capital/ Current A/c	XXX				
Y's Capital/ Current A/c (In case of profit)	XXX	XXX			

Note: - Interest on loan is charged against profit in Profit & Loss Account only. It is not the appropriation of profits.

4. Past Adjustments of Profit

Sometimes, amounts already distributed among the partners as profits or losses for a particular year require to be readjusted after the close of accounts for the year either due to discovery of some mistakes subsequent to the closing of the books or due to revision of certain condition of the partnership contract with retrospective effect. In such a case, the revenue accounts which have already been closed off are not reopened. Amounts already debited or credited to various partners are compared with the amounts which should have been debited or credited and an entry is passed for the difference to adjust the various accounts.

5. Guarantee of Profit to a Partner

Sometimes to induce a person to become a partner, a guarantee is given to him by other partners that his share of profits will not be below a certain figure. Usually when such a guarantee is given, it is also agreed that if in a year his share of profit exceeds the minimum limit, he would have to refund the excess in repayment of amount previously credited to him in excess of his normal share of profits. When such an agreement exists, first profits should be divided as if no guarantee has been given. Then, the amount by which the actual share falls short of the guaranteed share should be credited to the partner to whom the guarantee has been given and debited to other partners in their mutual profit sharing ratio. For recoupment of excess in subsequent years, a reverse entry will be passed.

Instead of all the partners, one partner may give the guarantee to a new partner that should the share of profits to the new partner fall below a certain figure; guarantor will make up the difference. In such case, the capital account of the partner in whose favour the guarantee is given will be credited and the capital account of the guarantor partner will be debited for the excess of the guaranteed amount over the actual share of the partner

in whose favor guarantee has been given.

There can also be an arrangement that should profit due to the new partner exceed a certain figure, a particular partner, may bear the burden of such excess. It is really a guarantee to the other partners that the share of the new partner will not exceed a stipulated figure.

REVIEW QUESTION

On 1st April 2024, X's Capital Account showed a balance of ₹ 2,50,000 while Y's Capital Account showed a balance of ₹ 1,000. In 2024-25 the firm earned a profit of ₹ 15,000 before adjustment for salary to Y amounting to ₹ 30,000 for the year and interest on capital @ 10% per annum. Show how the profits would be distributed between X and Y assuming that they are equal partners.

Illustration 1:

On 1st April, 2024 P and Q started business in partnership agreeing to share profits and losses equally. P contributed ₹ 3,00,000 while Q contributed ₹ 2,00,000 by way of capital. It was agreed that interest be allowed on capital @ 6% per annum and charged on drawing @ 8% per annum. P withdrew ₹ 2,000 at the end of every month whereas Q withdrew ₹ 4,500 in the middle of every month.

Profits before the above noted adjustments for the year ended 31st March, 2025 amounted to ₹ 89,700. Show the necessary ledger accounts assuming:

(a) capital accounts are fluctuating

(b) capital accounts are fixed.

Solution:

Working Notes:

Interest on P's Capital = ₹ $\frac{3,00,00 \times 6}{100}$

= ₹ 18,000

Interest on Q's Capital = ₹ $\frac{2,00,000 \times 6}{100}$

= ₹ 12,000

Total drawing by P = ₹ 2,000 x 12

= ₹ 24,000

Total drawings by Q = ₹ 4500 x 12 = ₹ 54,000

Interests on P's drawings = ₹ 24000 x 8/100 x 5.5/12 = ₹ 880

Interest on Q's drawings = ₹ $54,000 \frac{\times 6}{12} \times \frac{8}{100}$

= ₹ 2,160

(a) When capital accounts are fluctuating:

Dr. **Profit and Loss Appropriation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Interest on Capital:		By Profit and Loss Account	89,700
P's Capital A/c	18,000	By Interest on drawings:	
Q's Capital A/c	12,000	P's Capital A/c	880
To Profit transferred to:		Q's Capital A/c	2,160
P's Capital A/c (1/2 of Profit)	31,370		
Q's Capital A/c (1/2 of Profit)	31,370		
	92,740		92,740

Dr. **P's Capital Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To P's Drawings A/c	24,000	Apr.1	By Cash A/c	3,00,000
Mar. 31	To Profits and Loss Appropriation A/c (Interest on Drawings)	880	2025 Mar. 31	By Profits and Loss Appropriation A/c (Interest on Capital)	18,000
Mar. 31	To Balance c/d	3,24,490	Mar. 31	By Profits and Loss Appropriation A/c	31,370
		3,49,370			3,49,370
			2025		
			Apr. 1	By Balance b/d	3,24,490

Dr. **Q's Capital Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To Q's Drawings A/c	54,000	Apr.1	By Cash A/c	2,00,000
Mar. 31	To Profits and Loss Appropriation A/c (Interest on Drawings)	2,160	2025 Mar. 31	By Profits and Loss Appropriation A/c (Interest on Capital)	12,000
Mar. 31	To Balance c/d	1,87,210	Mar. 31	By Profits and Loss Appropriation A/c	31,370
		2,43,370			2,43,370
			2025		
			Apr. 1	By Balance b/d	1,87,210

(b) When capital accounts are fixed:

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Interest on Capital :		By Profit and Loss Account	89,700
P's Current A/c	18,000	By Interest on drawings:	
Q's Current A/c	12,000	P's Current A/c	880
To Profit transferred to:		Q's Current A/c	2,160
P's Current A/c (1/2 of Profit)	31,370		
Q's Current A/c (1/2 of Profit)	31,370		
	92,740		92,740

P's Capital Account

Dr. *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To Balance c/d	3,00,000	Apr.1	By Cash A/c	3,00,000
			2025		
			Apr.1	By Balance b/d	3,00,000

Q's Capital Account

Dr. *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To Balance c/d	2,00,000	Apr.1	By Cash A/c	2,00,000
			2025		
			Apr.1	By Balance b/d	2,00,000

P's Current Account

Dr. *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2025		
Mar. 31	To P's Drawings A/c	24,000	Mar. 31	By Profits and Loss Appropriation A/c (Interest on Capital)	18,000
Mar. 31	To Profits and Loss Appropriation A/c (Interest on Drawings)	880	Mar. 31	By Profits and Loss Appropriation A/c	31,370
Mar. 31	To Balance c/d	24,490			
		49,370			49,370
			2025 Apr. 1	By Balance b/d	24,490

Q's Current Account

Dr.					*Cr.*
Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2025		
Mar. 31	To Q's Drawings A/c	54,000	Mar. 31	By Profits and Loss Appropriation A/c (Interest on Capital)	12,000
Mar. 31	To Profits and Loss Appropriation A/c (Interest on Drawings)	2,160	Mar. 31	By Profits and Loss Appropriation A/c	31,370
			Mar. 31	By Balance c/d	12,790
		56,160			56,160
2025					
Apr.1	To Balance b/d	12,790			

***Illustration 2**:*

On 1st April, 2024 the fined capital accounts of A, B and C stood at ₹ 30,000, ₹ 20,000 and ₹ 10,000 respectively. They shared profits and losses equally. Profit and Loss account for the year ended 31 March, 2025 revealed a net profit of ₹12, 000 which was transferred to capital accounts of the partners equally.

It was decided in April 2025 that profits should be distributed equally after allowing interests on capital @ 6% per annum with effect from 1st April, 2024. While going through the books of account for 2024-25 it was discovered that repair charges for A's personal scooter amounting to ₹ 90 had been charged to Repairs Account.

Show the journal entries necessary to adjust the current account of the partners.

Solution:

	₹	₹
Profits as already distributed		12,000
Add: Repair charges to be charged to A's Current Account		90
		12,090
Less : Interest on:		
A's Capital	1,800	
B's Capital	1,200	
C's Capital	600	3,600
Net profit after adjustment		8,490

Each partner will get ₹ $\frac{8,490}{3}$ = ₹ 2,830

Revised Distribution

	A	*B*	*C*
	₹	₹	₹
Net Profit	2,830	2,830	2,830
Interest of Capital	1,800	1,200	600
	4,630	4,030	3,430
Less : Repair charges	90	–	–
	4,540	4,030	3,430
Distribution as already made of ₹ 12,000	4000	4000	4000
Net Adjustment to be made	+540	+30	– 570

Journal Entry

Particulars		*Dr. (₹)*	*Cr. (₹)*
C's Current Account	Dr.	570	
To A's Current Account			540
To B's Current Account			30
(Adjustment effected for change on the basis of distribution of profit for 2024-25 and error located in the accounts for 2024-25)			

Illustration 3:

C and D were sharing profits in the ratio of 3:1. Profits as per books for 2024-25 amounted to ₹ 40,000. In April 2025, they agreed to change the profit sharing ratio to 5:3 with retrospective effect from 1st April, 2024. It was found that outstanding expenses of ₹ 4,000 as on 31st March, 2024 and outstanding expenses of ₹ 3,000 as on 31st March, 2025 had not been taken into account while drawing up the final accounts for 2023-24 and 2024-25. Also by mistake interest on drawings had been ignored while preparing the accounts for 2024-25 such as interest being ₹ 600 on C's drawings and ₹ 300 on D's drawings. Pass the necessary journal entries to adjust the capitals of partners.

Solution:

Working Notes:

	C		D
Old ratio	3:1 or 6	:	2
New Ratio	5	:	3

D gets 1/8 more

	C	D
	₹	₹
Old distribution of ₹ 40,000 (A)	30,000 Cr.	10,000 Cr.
New distribution of ₹ 40,000 + ₹ 600 + ₹ 300 or ₹ 40,900 in the ratio of 5 : 3	25,562.50 Cr.	15,337.50 Cr.
Interest on Drawings	600 Dr.	300 Dr.
(B)	24,962.50 (Net) Cr.	15,037.50 (Net) Cr.
Difference (A) – (B)	5,037.50 Dr.	5,037.50 Cr.

Outstanding expenses of ₹ 4,000 as on 31st March, 2024 will be debited to partners' capital accounts in the old ratio (to raise Outstanding Expenses Account) and then will be credited to partners' capital accounts in the new ratio (to write off Outstanding Expenses Account). Outstanding Expenses of ₹ 3,000 will be debited to capital accounts in the new ratio and credited to Outstanding Expenses Account. In the entry shown below, only the net effect has been recorded:

Journal Entries

Particular		Dr. (₹)	Cr. (₹)
C's Capital Account	Dr.	2,375*	
D's Capital Account	Dr.	625*	
To Outstanding Expenses Account			3,000
(Adjustment entry for outstanding expenses of ₹ 4,000 as on 31st March, 2024 and of ₹ 3,000 as on 31st March, 2025)			
C's Capital Account	Dr.	5,037.50	
To D's Capital Account			5,037.50
(Entry to adjust capital accounts on redistribution of profit for 2024-25)			

	C	*D*
* 31.3.2024 (Ratio 3 : 1)	Dr. 3,000	Dr. 1,000
1.4.2024 (Ratio 5 : 3)	Cr. 2,500	Cr. 1,500
31.3.2025 (Ratio 5 : 3)	Dr. 1,875	Dr. 1,125
	Dr. 2,375	Dr. 625

Note: If capital accounts are fixed, current accounts will be debited and credited instead of capital accounts.

Illustration 4:

With effect from 1st April, 2024, D, the manager in the firm of A,B, and C who were sharing profits and losses in the ratio of 5:3:2 respectively was admitted as a partner in the firm with 1/11th share of profit. It was agreed that should D' share of profits exceed his remuneration as the manager, A will bear the burden of such an excess. The manager D was entitled to a salary of ₹ 10,000 p.m. plus a commission of 2% of net profit remaining after charging his salary but before charging his commission.

Profit and Loss Account for the year ended 31st March, 2025 showed a profit of ₹ 22,00,000. Show how the profit will be distributed among the four partners.

Solution:

The main point is that B and C are not to suffer due to D's becoming a partner. Suppose, D is still the manager; then:

	₹
Profit as given	22,00,000
Less: Salary which D would have received	1,20,000
	20,80,000
Less: D's commission @ 2% on ₹ 20,80,000	41,600
Net profit	20,38,400

	A (5/10)	B (3/10)	C (2/10)	D (as Manager)
Distribution	10,19,200	6,11,520	4,07,680	1,61,600

Under the new arrangement D will receive 1/11th of ₹ 22,00,000 i.e., ₹ 2,00,000. It means that D will get ₹ 38,400 more than what he would have got as manager. This will be deducted from A's share. Hence, the profit of ₹ 22,00,000 will be distributed as follows:

A ₹ 9,80,800

B ₹ 6,11,520

C ₹ 4,07,680

D ₹ 2,00,000

Illustration 5:

P and S were in partnership sharing profits and losses in the ratio of 7:3 respectively. As a mark of appreciation of the services of their manager Z, they admitted him into partnership on 1st April, 2024 giving him 1/10th share of the future profits; the mutual ratio between P and S remaining unchanged. Before becoming a partner, Z was getting a salary of ₹ 4,000 per month and a commission of 5% on the net profits remaining after charging his salary and commission. It was agreed that any excess over his former remuneration to which Z as a partner becomes entitled will be provided out of P's share of profit.

The net profit for the year ended 31st March, 2025 amounted to ₹ 19,80,000. Prepare the profit and loss appropriation account for the year ended 31st March, 2025 showing the distribution of the profits of the net profits amongst the partners. Show your working notes clearly.

Solution:

In the books of P, S and Z

Profits and Loss Appropriation Account for the year ended 31st March, 2025

Dr. *Cr.*

Particulars	(₹)	*Particulars*	(₹)
To Profit transferred to		By Net profit b/d	19, 80,000
Capital Accounts:			
P	12, 30,000		
S	5, 52,000		
Z	1, 98,000		
	19, 80,000		19, 80,000

Working Notes:

	₹	₹
(1) Z's share: 1/10 of ₹ 19, 80,000		1, 98,000
Less: Z's share as manager:		
Salary: ₹ 4,000 x 12	48,000	
Commission: $\left(\frac{5}{100}\text{of Rs.19,80,000 - Rs.48,000}\right)$	92,000	1, 40,000
Excess amount chargeable to P		58,000
(2) When Z acted as manager, divisible profit of the old partner would have been (₹ 19,80,000 – ₹ 1,40,000)		18,40,000
P's share of profit would have been		
($\frac{7}{10}$ of ₹ 18,40,000)		12,88,000
S's share of profits would have been		
($\frac{3}{10}$ of ₹ 18,40,000)		5,52,000
(3) When Z becomes a partner, share of profit of each:		
P (₹ 12,88,000 – ₹ 58,000)		12,30,000
S		5, 52,000
Z		1, 98,000
		19, 80,000

Alternatively, the final distribution of profit can be arrived at as follows:

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Z's Capital A/c (1/10)	1, 98,000	By Net Profit b/d	19, 80,000
To Balance c/d	17, 82,000		
	19, 80,000		19, 80,000
To P's Capital A/c (7/10)	12, 88,000	By Balance c/d	17, 82,000
To S's Capital A/c (3/10)	5, 52,000	By P's Capital A/c	58,000
	18, 40,000		18, 40,000

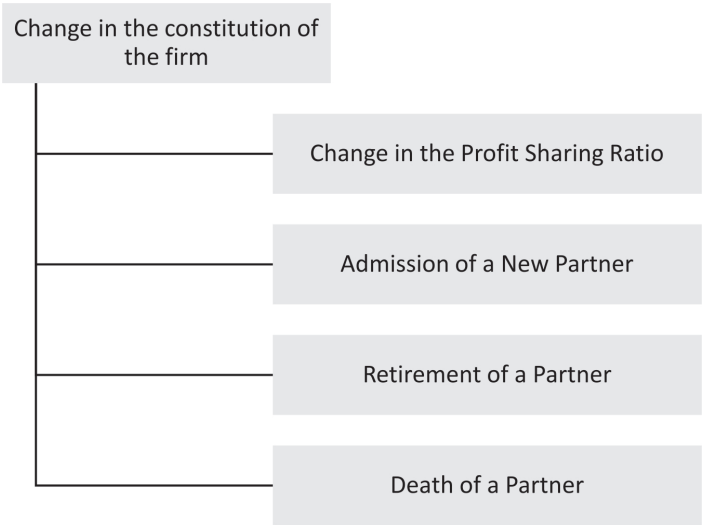
Final Distribution

	₹
P = ₹ 12,88,000 - ₹58,000	12,30,000
S =	5,52,000
Z =	1,98,000
	19,80,000

RECONSTITUTION OF PARTNERSHIP

When there is any change in the existing agreement of partnership, it is reconstitution of partnership. As a result of reconstitution, the existing agreement of partnership comes to an end and a new agreement is formed. The firm continues its business in usual manner. Some special adjustments are to be made in the accounts of partnership firm in cases of change in the constitution of the firm.

There may be changes in the constitution of the firm due to following reasons:



CHANGE IN THE PROFIT SHARING RATIO

Whenever there is a change in the profit sharing ratio of the existing partners, there arises the need for valuation of goodwill. A change in the profit sharing ratio results in gain to one partner and loss to the other. As a result, the partner who gains from the new ratio has to compensate the partner who loses. The gaining partner, in respect of share of profit, may buy his share of profits from any one or two partners, as the case may be. The partners who sell the shares may sacrifice in equal or unequal proportions. The amount of goodwill credited to partner(s) from whom the gaining partner purchases his share is always in proportion to the sacrifice made. The journal entry for this purpose is to debit the partner's capital account (one who gains) with the proportionate share of goodwill and credit the capital account or accounts of the partners (who lose) with the same amount.

Illustration 6:

On 1st April, 2024 A, B and C who were sharing profits and losses in the ratio of 5:3:2 respectively decided to become equal partners. Goodwill of the firm was valued at ₹ 4,50,000. It was also decided to appreciate the book value of land and buildings by ₹ 1,40,000. No goodwill account appeared in the books of the firm and none was opened on change in profit sharing ratio. Pass journal entries to make the necessary adjustments.

Solution:

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Land and Buildings Account	Dr.	1,40,000	
To Revaluation Account			1,40,000
(Appreciation in the value of land and buildings)			
Revaluation Account	Dr.	1,40,000	
To A's Capital Account			70,000
To B's Capital Account			42,000
To C's Capital Account			28,000
(Transfer of profit on revaluation to partners' capital accounts in old profit sharing ratio)			
B's Capital Account	Dr.	15,000	
C's Capital Account	Dr.	60,000	
To A's Capital Account			75,000
(Adjustment for goodwill on change in profit sharing ratio)			

Working Notes:

Old profit sharing ratio = $\frac{5}{10}:\frac{3}{10}:\frac{2}{10}$

New profit sharing ratio = $\frac{1}{3}:\frac{1}{3}:\frac{1}{3}$

A loses = $\frac{5}{10}-\frac{1}{3}=\frac{15-10}{30}=\frac{5}{30}$

B gains = $\frac{1}{3}-\frac{3}{10}=\frac{10-9}{30}=\frac{1}{30}$

C gains = $\frac{1}{3}-\frac{2}{10}=\frac{10-6}{30}=\frac{4}{30}$

A will be credited with $\frac{5}{30}$ of ₹ 4,50,000 or ₹ 75,000 for goodwill B will be debited with $\frac{1}{30}$ of ₹ 4,50,000 or ₹ 15,000 and

C will be debited with $\frac{4}{30}$ of ₹ 4,50,000 or ₹ 60,000

REVIEW QUESTION

On 1st April, 2024 A and B who are sharing profits and losses in the ratio of 3:2 decided to become equal partners with effect from 1st April, 2023 with the additional provision that interest on capitals will be allowed @ 7% per annum. A and B started the firm on 1st April, 2023 with a capital of ₹ 90,000 and ₹ 60,000 respectively. The profit for the year ended 31st March, 2024 amounted to ₹ 54,000. Pass the necessary adjustment entry.

ADMISSION OF A NEW PARTNER

A new partner can be admitted with the consent of all existing partners. The various reasons for admission of a new partner may be requirement of more capital, influence or managerial skill of the new partner etc.

A new partner may either purchase his share of profits from one or more of the existing partners or he may contribute to a share in the assets of the firm. In the former case, the total capital of the firm does not change; the amount brought in by the new partner is paid to the partners from whom share is purchased. In the latter case, however, the total capital of the firm is increased by the amount brought in by the new partner.

Suppose, A and B share profits and losses in the ratio of 2:1 respectively and their capitals stand at ₹ 10,000 and ₹ 5,000 respectively. If C is admitted and he buys 1/5th share from A, C will bring ₹ $15{,}000\times\frac{1}{5}=$ or ₹ 3,000 in cash which will be withdrawn by A. The new balances of the capital accounts of A, B and C will be ₹ 7,000, ₹ 5,000 and ₹ 3,000 respectively. If C contributes to the capital for 1/5th share of profits, he will bring ₹ $15{,}000\text{x}\frac{5}{4}\text{x}\frac{1}{5}=$ ₹ 3,750. Total capital of the new firm will be ₹ 18,750.

Admission of new partner results in the reconstitution of partnership firm, as a new agreement to carry on the business as a partnership firm comes into existence. When there is a change in the constitution of partnership, the profit sharing ratio of the existing partners may be revised. When a new partner is admitted, he is entitled to a share in the assets of the firm and in the future profits of the firm.

For acquiring shares in the assets of the firm partner has to	→	Contribute Capital
For acquiring right to future profits in the firm new partner has to	→	Contribute towards Goodwill of the firm

When a new partner is admitted, the amount may be contributed to the capital of the firm in the form of assets other than cash also. Journal entry will be :

Bank	*Dr.*
Any other Asset	*Dr.*
To New Partner's Capital A/c	

Example: X and Y are carrying on business in partnership. Z is admitted as a new partner who brings in ₹ 8,000 in cash and trademarks and patents valued at ₹ 2,000. The journal entry will be:

Bank	Dr.	8,000	
Patents and Trade Marks	Dr.	2,000	
To Z's Capital Account			10,000
(Capital brought in by Z in the form of cash, patents & and trade marks)			

When a new partner is admitted, a number of things have to be done. Some of the major adjustments to be made are as follows:

- Calculation of new profit sharing ratio
- Calculation of sacrificing ratio
- Transfer of accumulated profits and reserves to existing partners
- Revaluation of assets and liabilities
- Treatment of goodwill

Calculation of New Profit Sharing Ratio

Case 1: When the new profit sharing ratio is not specially mentioned but only the share given to the new partner is mentioned, the assumption is that the old partners among themselves continue to share profits in the same relative ratio in the which they were sharing profits prior to admission of the new partner. In such a case, the share given to the new partner should be deducted from 1 and then the remainder should be divided among the old partners in the old ratio. Suppose, A and B are partners sharing profits and losses in the ratio of 3:2 and they admit C as a new partner giving him 1/5 share in future profits. Then the new ratio will be calculated as follows:

C's share $= \frac{1}{5}$

Remaining share $= 1 - \frac{1}{5} = \frac{4}{5}$

A's share $= \frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$

B's share $= \frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$

C's share $= \frac{1}{5} = \frac{5}{25}$

New ratio for A, B, and C is 12: 8: 5

Case II: Sometimes the new partner purchases his share from the other partner in different proportions. Suppose, in the above example C purchases 4/25^{ths} share from A and 1/25th share from B. Then the new ratio will be calculated as follows:

$$\text{A's share} = \frac{3}{5} - \frac{4}{25} = \frac{15 - 4}{25} = \frac{11}{25}$$

$$\text{B's share} = \frac{2}{5} - \frac{1}{25} = \frac{10 - 1}{25} = \frac{9}{25}$$

$$\text{C's share} = \frac{4}{25} + \frac{1}{25} = \frac{5}{25}$$

Hence, the new ratio = 11: 9: 5.

REVIEW QUESTION

1. P and Q are equal partners. R is admitted as a new partner and he is given 1/5th share in the profit of the firm. What will be the new profit sharing ratio?
2. A & B are partners sharing profits in the ratio of 3:2. They admit C, a new partner who acquires 1/5th share from A and 4/25th share from B. Calculate new profit sharing ratio.

Calculation of Sacrificing Ratio

In partnership business when a partner is admitted into a firm, the old partners have to surrender a portion of their shares of profits in favour of the new partner. Sacrificing ratio is the difference between old profit sharing ratio and the new profit sharing ratio of the old partners. In this case, sacrifice made by the existing partners may either be in the ratio in which they were sharing profits prior to the admission or in some other ratio :

(i) Besides the old ratio of old partners, if the new ratio of the incoming partners has been given without mentioning the details of the sacrifice made by the old partners, then the presumption is that the old partners have made sacrifice in the old ratio.

(ii) Sometimes, the new ratio of all the partners and old ratio of old partners are given. In that case sacrificing ratio must be calculated by deducting the new share from the old share of the old partners.

For example, if A and B share profits in the ratio of 5:3 respectively and on admission of C the new ratio among A, B and C is agreed upon as 7:5:4 respectively, the ratio of sacrifice will be calculated as follows:

Sacrifice by A = A's old share – A's new share $= \frac{5}{8} - \frac{7}{16} = \frac{3}{16}$

Sacrifice by B = B's old share – B's new share $= \frac{3}{8} - \frac{5}{16} = \frac{1}{16}$

Hence ratio of sacrifice between A and B $= \frac{3}{16} - \frac{1}{16}$ or 3:1

Transfer of Reserves to Existing Partners

Reserves created out of profits or balance in Profit and Loss Account at the time of admission of a new partner must be transferred to the capital accounts of the old partners in the old profit sharing ratio. It is done because the new partner is not entitled to any share of the accumulated profits and similarly, he is not liable to bear any part of the past losses. So, the accumulated losses should also be transferred to the capital accounts of the old partners in the old profit sharing ratio. Transfer of reserves is done even when no new partner is admitted but the partners change their profit sharing ratio. The journal entry will be:

Reserves Account/Profit and Loss Account	Dr.
To Old Partners' Capital/Current Accounts	

Example: A and B are partners in a business sharing profits and losses in the ratio of 3:2 respectively. The Profit and Loss Account shows an undistributed profit of ₹ 5,000 and the General Reserve is ₹ 10,000. They admit a new partner 'N' with 1/4th share in the profits. The journal entry will be:

Profit and Loss A/c	Dr.	5,000	
General Reserve A/c	Dr.	10,000	
To A's Capital A/c			9,000
To B's Capital A/c			6,000

(Being the amount of Profit and Loss A/c and the General Reserve distributed among the old partners in the old profit sharing ratio.)

Revaluation of Assets and Liabilities on Admission of a Partner

A new partner is not to be benefitted by any appreciation in the values of assets of the firm or by any decrease in the values on liabilities of the firm. Similarly, he is not to bear any part of the loss that is due to decrease in the values of the assets or increase in the values of the liabilities of the firm till the date of his admission. Therefore, before a new partner is admitted, the assets and liabilities of the firm are revalued and any profit or loss resulting from such a revaluation is transferred to old partners' capital accounts in the old profit sharing ratio. For this purpose, the following entries are passed:

Revaluation Account	Dr.
To Assets (individually)	
To Liabilities (individually)	

(To record decrease in the book values of assets and increase in the book values of liabilities as agreed upon on admission of the new partner).

Assets (individually)	Dr.
Liabilities (individually)	Dr.
To Revaluation Account	

(To record increase in the book values of assets and decreases in the book value of liabilities as agreed upon on admission of the new partner).

Revaluation Account	Dr.
To Old Partners' Capital/Current Accounts (individually)	

(Transfer of profit on revaluation to old partners capital accounts in their old profit sharing ratio)

OR

Old Partners' Capital/Current Accounts (individually)	Dr.
To Revaluation Account	

(Transfer of loss on revaluation to old partners capital accounts in their old profit sharing ratio).

Sometimes, all the partners including the new partner may agree not to alter the book value of assets and liabilities even when they agree to revalue them. In order to record this, ***Memorandum Revaluation Account*** is opened. It has two parts. In the first part, the entries for revaluation of assets and liabilities are made in the usual manner. But no record of revaluation of assets and liabilities is made through the respective ledger accounts. The resultant profit or loss on revaluation in the first part is transferred to the capital accounts of old partners in the old profit sharing ratio. In order to complete the double entry, entries regarding assets and liabilities made in the first part are reversed in the second part so that the values of assets and liabilities remain unchanged. The balance in the second part is transferred to the capital accounts of all the partners including the new partner in their new profit sharing ratio. If there is a profit, the following entries are passed.

Memorandum Revaluation Account	Dr.
To Old Partners' Capital/Current Accounts (individually)	
(Profit on revaluation transferred to old partners' capital accounts in old profit sharing ratio.)	
All Partners' (including new) Capital Accounts/Current Accounts (individually)	Dr.
To Memorandum Revaluation Account	
(Transfer of Memorandum Revaluation Account to all the partners' (including the new partner's) capital accounts in the new profit sharing ratio).	

Note: If there is a loss on revaluation, the above entries will be reversed.

DIFFERENCE BETWEEN REVALUATION A/C AND MEMORANDUM REVALUATION A/C

Revaluation account	Memorandum revaluation account
(i) Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the revalued figures.	(i) Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities but they are recorded at their old figures in the new balance sheet.
(ii) Revaluation account is not divided in parts. The profit or loss goes to old partners only.	(ii) Memorandum revaluation account has two parts. The profit or loss of first part goes to old partners while the profit or loss of the second part goes to all the partners including the new partner.

Treatment of Goodwill on Admission

Whenever a new partner is admitted, he/she is generally expected to pay cash to old partners for his/her share of goodwill for the right acquires to share in profits of the firm in future. Strictly, such a payment should be made only when there are super profits but in actual practice, some premium or goodwill may have to be paid by the new partner on his admission even when the business of the firm is not unusually profitable and consequently there are no super profits. The payment is made to the old partners for the sacrifice they make on their shares of profits for future. It is not necessary that the new partner must bring cash for his share of goodwill, only adjustment may be made for goodwill. The various alternative courses for the accounting treatment of goodwill on admission of a partner are as follows:

Important Note: Concept of accounting treatment of Goodwill

1) Goodwill should be recorded in the books of account only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be treated as goodwill. For example, when a partnership firm of X and Y purchases the net assets of Z amounting to ₹ 6,00,000 for ₹ 6,50,000 in cash, the additional payment of ₹ 50,000 is a payment for goodwill in cash. It is a case of purchased goodwill (an asset) and can be recorded in the books of account of X and Y. Thus, only purchased goodwill is recorded in the books of account when the payment is made directly in cash or money's worth.

2) When no payment is made for the purchase of goodwill, it is a case of internally, generated goodwill or inherent goodwill. For instance, in the event of reconstitution of the firm as a result of admission, retirement, death or change in profit sharing ratio, goodwill of the firm is evaluated. In such cases, the value of goodwill should not be brought into books of account as it is an inherent or self generated goodwill and no money or money's worth has been paid for it. The goodwill is calculated as per any of the methods of valuation of goodwill and adjusted through the capital accounts of the partners. No goodwill account is raised in the books of accounts on reconstitution of the firm or change in the profit sharing ratio among the partners. Therefore, the internally generated or inherent goodwill is not raised in the books of account. It is adjusted through the capital accounts of the concerned partners. Always remember that in this case the goodwill raised will not be shown in the balance sheet.

(i) When the incoming partner brings in the required amount of goodwill in cash and this amount is retained in the business:

- The amount of goodwill brought in by the incoming partner along with his share of capital is credited to his capital account and
- Then this amount of goodwill is debited to the new partner's capital account and credited to the old partners' capital account in the sacrificing ratio.

Journal entries:

(a) Bank Dr.

To New Partner's Capital A/c

(Being amount of goodwill and capital brought by the new partner)

(b) New Partner's Capital A/c Dr.

To Old Partners' Capital Accounts

(Being the amount of goodwill brought in by the new partner shared by the old partners in the sacrificing ratio)

(ii) When the required amount of goodwill brought in by the new partner in cash is immediately withdrawn by the old partners

In this case the amount of goodwill is withdrawn by the partners in the sacrificing ratio and the entry for withdrawal will be:

Journal entries:

(a) Bank Dr.

To New Partner's Capital A/c

(Being amount of goodwill and capital brought by the new partner)

(b) New Partner's Capital A/c Dr.

To Old Partners' Capital Accounts

(Being the amount of goodwill brought in by the new partner is shared by the old partners in the sacrificing ratio)

(c) Old Partners' Capital Accounts Dr.

To Bank

(Being the amount of goodwill brought in by the new partner is withdrawn by the old partners in the sacrificing ratio)

(iii) Where the new partner pays amount of goodwill privately to the old partners

In this case, no entry is passed in the books of the firm. The amount to be paid to each partner should be calculated as per the profit-sacrificing ratio.

(iv) Where the partner is unable to bring anything for goodwill

In this case, the value of goodwill should not be raised in the books. Since it is inherent goodwill, it is preferable that such value of goodwill should be adjusted through partners' capital accounts. The new partner's capital is debited with his share of goodwill and the amount is credited to old partners' capital accounts in the ratio in which they make sacrifice of profits. The journal entry will be:

New Partner's Capital A/c Dr.

To Old Partners' Capital Accounts

(Being the share of new partner's goodwill credited to old partners' capital accounts in the sacrificing ratio and debiting the new partners' capital account)

(v) When the new partner brings a portion of the required amount of goodwill

In this case, the amount brought in by the new partner will be shared by the old partners in the sacrificing ratio and the portion of amount of goodwill not brought in by the new partner is adjusted through the capital accounts of partners by debiting, new partner's capital account with the amount and crediting the old partners' capital accounts in their sacrificing ratio.

(vi) When the goodwill is already appearing in the books of accounts:

When the goodwill is already appearing in the firm's books, first of all goodwill is to be written off from the books by debiting old partners' capital accounts in their profit sharing ratio and crediting goodwill account. Then new partner's capital account is debited with his difference in share of goodwill not brought in cash and this amount is credited to old partners' capital accounts in sacrificing ratio.

Journal entries:

(a) Old Partners' Capital Accounts Dr.

To Goodwill A/c

(Being goodwill written off from the books)

(b)	Bank (Cash brought in)	Dr.
	New Partner's Capital A/c (Difference not brought in cash)	Dr.
	To Old Partners' Capital Account	
	(Being the amount of goodwill brought in by the new partner is shared by the old partners in the sacrificing ratio)	

(vii) Hidden goodwill:

Sometime the value of goodwill has to be inferred from the agreement of capitals and profit sharing ratio among the partners.

(a) Suppose, A and B share profits in the ratio 2:1 and their capitals stand at ₹ 20,000 and ₹ 10,000 and they admit C who brings ₹ 14,000 and is given 1/4th share in future profits. Now C's capital should be 1/4th of the total capital.

For 1/4th share, the capital of C = ₹14000

Therefore, total capital of the firm should be = ₹ 56,000

Total capital of A, B and C= ₹20,000 + ₹10 000 + ₹14,000 = ₹44,000

Value of Goodwill= Total Estimated Capital- Actual Capital

₹ 56,000- ₹44,000 = ₹12,000

REVIEW QUESTION

X and Y are sharing profits and losses in the ratio of 7:4. They admit Z as new partner and the new profit sharing ratio is agreed upon to be X$\frac{5}{11}$, Y $\frac{3}{11}$ and Z$\frac{3}{11}$. Z brings in ₹ 20,000 by way of his share of goodwill. How will this amount be distributed between X and Y?

Adjustment Regarding Capitals of Partners

It is often agreed that after the admission of a new partner, capitals of all the partners should be in proportion to their respective shares in profit. The basis may be the amount of capital brought in by the new partner or the new partner himself may be required to bring in capital equal to his share in the firm. If the new partner's capital is given, the total capital of the firm should be ascertained on that basis. Then, the capital required for each one of the old partners should be ascertained and it should be compared with the actual balances in the accounts of the partners concerned, adjustments may then be made in cash or through current accounts to bring the balances of capital accounts of all the old partners to the desired figures. Suppose, C brings in ₹ 10,000 for 1/5th share of profits. Total capital of the firm should be ₹ 10,000 x 5 or ₹ 50,000. If A and B are to share profits as to A $\frac{1}{2}$ and B$\frac{3}{10}$, then A's capital account should show a balance of ₹ 50,000 $\times\frac{1}{2}$or ₹ 25,000 and B's capital should show a balance of ₹ 50,000 $\times\frac{3}{10}$ or ₹ 15,000. If A's capital account shows a balance of ₹ 24,000 and the capital account of B shows a balance of ₹ 16,500, A will bring in ₹ 1,000 and B will withdraw ₹ 1,500.

Alternatively, the new partner may be required to bring capital on the basis of capital of old partners. Suppose, the capital accounts A and B after all adjustments are ₹ 32,000 and ₹ 18,000 respectively and C is admitted as a new partner to whom 1/5th share of profits is given. Then

C's Share = $\frac{1}{5}$

Remaining share = $1-\frac{1}{5}=\frac{4}{5}$

Combined capital of A and B = ₹ 32,000 + ₹ 18,000 = ₹ 50,000

Total Capital =₹ $50,000 \times \frac{5}{4}$ = ₹ 62,500

C's Capital = ₹ $62,500 \times \frac{1}{5}$= ₹ 12,500

If A and B are to share profits as to A 1/2 and B 3/10, then

A's Capital = ₹ $62,500 \times \frac{1}{2}$ = ₹ 31,250

B's Capital = ₹ $62,500x\frac{3}{10}$ 62,500 = ₹ 18,750

A will withdraw ₹ 750 and B will bring in ₹ 750.

Illustration 7:

On 31st March, 2025 the following was the Balance Sheet of A and B who were equal partners:

Liabilities	₹	*Assets*		₹
Sundry Creditors	8,940	Cash in hand		950
General Reserve	10,000	Stock		32,710
A's Capital Account	35,000	Debtors	11,000	
B's Capital Account	20,000	Less: Provision for Bad Debts	220	10,780
		Furniture and Fittings		9,500
		Land and Buildings		20,000
	73,940			73,940

On 1st April 2025, C was admitted as a new partner on the following conditions:

(i) A, B and C share profits and losses in the ratio 4:3:2 respectively.

(ii) Prior to C's admission appreciation of ₹ 15,000 in the value of land and buildings would be recorded and provision for bad debts would be brought upto ₹ 820.

(iii) C would bring ₹ 20,000 in cash as his capital.

Pass journal entries to record the abovementioned transactions and show the balance sheet of firm immediately after C's admission.

Solution :

Journal Entries

Particulars		*Dr. (₹)*	*Cr.(₹)*
General Reserve	Dr.	10,000	
To A's Capital Account			5,000
To B's Capital Account			5,000
(Transfer of general reserve to old partners in old profit sharing ratio)			
Land and Building Account	Dr.	15,000	
To Revaluation Account			15,000
(Appreciation in the value of land and buildings as agreed on admission of C as a new partner).			
Revaluation Account	Dr.	600	
To Provision for Bad Debts			600
(Increase in provision for bad Debts by ₹ 600)			
Revaluation Account	Dr.	14,400	
To A's Capital Account			7,200
To B's Capital Account			7,200
(Transfer of net profit on revaluation to old Partners' capital accounts in old profits sharing ratio)			
Bank	Dr.	20,000	
To C's Capital Account			20,000
(Amount brought in by C as in his capital)			

Balance Sheet of A, B and C as on 1st April, 2025

Liabilities	₹	*Assets*		₹
Sundry Creditors	8,940	Cash		20,950
A's Capital Account	47,200	Stock		32,710
B's Capital Account	32,200	Debtors	11,000	
C's Capital Account	20,000	Less: Provision for Bad Debts	820	10,180
		Furniture and Fittings		9,500
		Land and Buildings		35,000
	1,08,340			1,08,340

Revaluation Account

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Provision for Bad Debts	600	By Land and Buildings	15,000
To A's Capital Account	7,200		
To B's Capital Account	7,200		
	15,000		15,000

Dr. **Capital Accounts** *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	*Particulars*	*A* ₹	*B* ₹	*C* ₹
To Balance c/d	47,200	32,200	20,000	By Balance b/d	35,000	20,000	
				By General Reserve	5,000	5,000	
				By Revaluation	7,200	7,200	
				By Cash			20,000
	47,200	32,200	20,000		47,200	32,200	20,000
				By Balance b/d	47,200	32,200	20,000

If the values of assets and liabilities were not to be changed, the following would have been the solution:

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
General Reserve	Dr.	10,000	
To A's Capital Account			5,000
To B's Capital Account			5,000
(Transfer of general reserve to old partners in old profit sharing ratio)			
Memorandum Revaluation Account	Dr.	14,400	
To A's Capital Account			7,200
To B's Capital Account			7,200
(Record of profit on revaluation)			
Bank	Dr.	20,000	
To C's Account			20,000
(Amount brought in by C as his capital)			
A's Capital Account	Dr.	6,400	

B's Capital Account	Dr.	4,800	
C's Capital Account	Dr.	3,200	
To Memorandum Revaluation Account			14,400

(Transfer of Memorandum Revaluation Account after C's admission to all the partners' capital accounts in the new profit sharing ratio)

Balance Sheet of A, B and C on 1st April, 2025

Liabilities	₹	*Assets*		₹
Sundry Creditors	8,940	Cash		20,950
A's Capital account	40,800	Stock		₹ 32,710
B's Capital Account	27,400	Debtors	11,000	
C's Capital Account	16,800	Less: Provision for Bad Debts	220	10,780
		Furniture and Fittings		9,500
		Land and Buildings		20,000
	93,940			93,940

Working Notes

Dr. **Memorandum Revaluation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To A's Capital Account	7,200	By A's Capital account	6,400
To B's Capital Account	7,200	By B's Capital Account	4,800
		By C's Capital Account	3,200
	14,400		14,400

Working Notes:

Dr. **Capital Accounts** *Cr.*

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Memorandum Revaluation A/c	6,400	4,800	3,200	By Balance b/d	35,000	20,000	
To Balance c/d	40,800	27,400	16,800	By General Reserve	5,000	5,000	

				By Revaluation memorandum	7,200	7,200	
				By Bank			20,000
	47,200	32,200	20,000		47,200	32,200	20,000
				By Balance b/d	40,800	27,400	16,800

Illustration 8:

On 31st March, 2025 the following was the balance sheet of P and Q who were carrying on business in partnership sharing profits and losses in the ratio of 5:3 respectively.

Liabilities	₹	*Assets*	₹
Sundry Creditors	10,900	Furniture and Fittings	15,000
Capital Accounts		Stock	48,000
P	45,000	Sundry Debtors	16,500
Q	27,000	Cash	3,400
	82,900		82,900

On 1st April, 2025 R is admitted to the firm as a new partner, the new profit sharing ratio among P, Q and R is agreed upon as 7:5:4 respectively. R brings in ₹ 24,000 as his capital. R's share of goodwill is fixed at ₹ 5,000.

Show journal entries and balance sheet immediately after R's admission in each of the following cases:

(a) R brings cash for his shares of goodwill and the old partners withdraw half of the amounts credited to their accounts for goodwill brought by R.

(b) R does not bring anything by way of his share of goodwill.

(c) R brings ₹ 3,000 as his share of goodwill and an adjustment in capital accounts is made for the balance sheet.

Solution:

Case (a):

Journal Entries

Particulars		*Dr. (₹)*	*Cr. (₹)*
Bank	Dr.	29,000	
To R's Capital Account			24,000
To Goodwill Account			5000
(Amount brought in by R as his capital))			
Goodwill Account	Dr.	5,000	
To P's Capital Account			3,750
To Q's Capital Account			1250
(Goodwill brought in by R credited to old partners in their ratio of sacrifice i.e., 3:1)			
P's Capital Account	Dr.	1,875	
Q's Capital Account	Dr.	625	
To Bank			2,500
(Half of the amount of goodwill credited to old partners withdrawn by them in cash)			

Balance Sheet of P, Q and R as on 1st April, 2025

Liabilities	₹	*Assets*	₹
Sundry Creditors	10,900	Furniture and Fittings	15,000
Capital Accounts		Stock	48,000
P	46,875	Sundry Debtors	16,500
Q	27,625	Bank	29,900
R	24,000		
	1,09,400		1,09,400

Case (b):

Journal Entry

Particulars		*Dr. (₹)*	*Cr. (₹)*
Bank Account	Dr.	24,000	
To R's Capital Account			24,000
(Capital brought in by R)			
R's Capital Account	Dr.	5,000	
To P's Capital Account			3,750
To Q's Capital Account			1,250
(Being R's share of goodwill credited to old partners' capital account in the sacrificing ratio on his admission, credit being given to old partners in their ratio of sacrifice).			

Balance Sheet of P, Q and R as on 1st April, 2025

Liabilities	₹	*Assets*	₹
Sundry Creditors	10,900	Furniture and Fittings	15,000
Capital Accounts		Stock	48,000
P	48,750	Sundry Debtors	16,500
Q	28,250	Bank	27,400
R	19,000		
	1,06,900		1,06,900

Case (c):

Particulars		*Dr. (₹)*	*Cr. (₹)*
Bank	Dr.	27,000	
To R's Capital Account			24,000
To Goodwill Account			3000
(Capital brought in by R)			
Goodwill Account	Dr.	3,000	
To P's Capital Account			2,250
To Q's Capital Account			750
(Being the amount of goodwill brought in by R credited to old partners in sacrificing ratio)			

Particulars		*Dr. (₹)*	*Cr. (₹)*
R's Capital Account	Dr.	2,000	
To P's Capital Account			1,500
To Q's Capital Account			500
(Being portion of R's share of goodwill adjusted through the capital accounts by debiting new partner's capital account and credited to old partners' capital accounts in the sacrificing ratio.)			

Balance Sheet of P, Q and R as on 1st April, 2025

Liabilities	₹	*Assets*	₹
Sundry Creditors	10,900	Furniture and Fittings	15,000
Capital Accounts		Stock	48,000
P	48,750	Sundry Debtors	16,500
Q	28,250	Bank	30,400
R	22,000		
	1,09,900		1,09,900

Illustration 9:

A and B sharing profits in proportion of three-fourth and one-fourth showed the following as their Balance Sheet as on 31st March, 2025:

Liabilities	₹	*Assets*	₹
Creditors	375,000	Cash at Bank	2,25,000
General Reserve	40,000	Bills Receivable	30,000
Capital Account:		Debtors	1,60,000

A ₹3,00,000		Stock	2,00,000
B ₹1,60,000	4,60,000	Office Furniture	10,000
		Land and Buildings	2,50,000
	8,75,000		8,75,000

They admit C into partnership on 1st April, 2025 on the following terms:

(1) That C pays ₹ 1,00,000 as his capital for a fifth share in the future profits.

(2) That goodwill of the new firm is valued at ₹ 2,00,000 and C brings his share of goodwill in cash.

(3) That a stock and furniture be reduced by 10% and a 5% provision for doubtful debts is created on debtors.

(4) That the value of land and buildings be appreciated by 20%.

(5) That the capital accounts of all the partners be re-adjusted on the basis of their profits-sharing arrangement and any additional amount be immediately withdrawn by them.

Pass the journal entries; prepare the Profit and Loss Adjustment Account (Revaluation Account), Partners' capital accounts and the opening Balance Sheet of the new firm.

Solution:

Journal Entries

Particulars		*Dr. (₹)*	*Cr. (₹)*
Profit and Loss Adjustment Account	Dr.	29,000	
To Stock			20,000
To Office Furniture			1,000
To Provision for doubtful debts			8,000
(Adjustment for writing down the values of assets)			
Land and Buildings Account	Dr.	50,000	
To Profit and Loss Adjustment Account			50,000
(Adjustment for appreciation in the value of Land and Buildings)			
General Reserve Account	Dr.	40,000	
To A's capital Account			30,000
To B's Capital Account			10,000
(Transfer of General Reserve to partners' capital accounts in the profit sharing ratio)			
Profit and Loss Adjustment Account	Dr.	21,000	
To A's Capital Account			15,750
To B's Capital Account			5,250
(Transfer of profit arising from adjustments to partners' capital accounts in their profit-sharing proportions)			

Bank	Dr.	1,40,000	
To C's Capital Account			1,40,000
(Amount brought in by C as his share capital and 1/5th share of goodwill)			
C's Capital Account	Dr.	40,000	
To A's Capital Account			30,000
To B's Capital Account			10,000
(Share of goodwill brought in by the incoming partner credited to old partners in their sacrificing ratio)			
A's Capital Account	Dr.	75,750	
To Bank			75,750
(Withdrawal of excess of capital over profit-sharing proportion)			
B's Capital Account	Dr.	85,250	
To Bank			85,250
(Withdrawal of excess of capital over his profit sharing proportion)			

Dr. **Profit and Loss Adjustment account** *Cr.*

Particulars		₹	*Particulars*	₹
To Stock		20,000	By Land and Buildings	50,000
To Office Furniture		1,000		
To Provision for Doubtful Debts		8,000		
To Transfer of Profits of Capital				
Accounts:				
A 3/4th	15,750			
B 1/4th	5,250	21,000		
		50,000		50,000

Dr. **A's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Bank	75,750	By Balance b/d	3,00,000
To Balance c/d	3,00,000	By General Reserve	30,000
		By Profit and Loss	
		Adjustment A/c	15,750
		By C's Capital A/c	30,000
	3,75,750		3,75,750
		By Balance b/d	3,00,000

Dr. **B's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Bank	85,250	By Balance b/d	1,60,000
To Balance c/d	1,00,000	By General Reserve	10,000
		By Profit and Loss Adjustment A/c	5,250
		By C's Capital A/c	10,000
	1,85,250		1,85,250
		By Balance b/d	1,00,000

C's Capital Account

Particulars	₹	*Particulars*	₹
To A's Capital A/c	30,000	By Bank	1,40,000
To B's Capital A/c	10,000		
To Balance c/d	1,00,000		
	1,40,000		1,40,000
		By Balance b/d	1,40,000

Balance Sheet of A, B and C as at 1st April, 2025

Liabilities	₹	₹	*Assets*	₹	₹
Sundry Creditors		3,75,000	Cash at Bank		2,04,000
Capital Account:			Bills Receivable		30,000
A	3,00,000		Office Furniture		9,000
B	1,00,000		Sundry Debtors	1,60,000	
C	1,00,000	5,00,000	Less: Provision for Doubtful Debts @ 5%	(8,000)	1,52,000
			Stock		1,80,000
			Land and Building		3,00,000
		8,75,000			8,75,000

Note: from the above balance sheet, it is clear that the capitals of the partners now bear the same proportions as their profit sharing arrangement.

illustration 10:

Ajay and Binoy are partners in a firm sharing profits and losses in the ratio of 2:1 respectively. On 31st March, 2025 their balance sheet stood as follows:

Liabilities	*(₹)*	*Assets*	*(₹)*
Bills payable	6,000	Cash at bank	90,000
Sundry creditors	90,000	Bills receivable	20,000
General reserve	42,000	Sundry debtors	1,00,000
Ajay's capital	2,82,000	Stock	1,60,000
Binoy's capital	2,40,000	Furniture	40,000
		Machinery	2,50,000
	6,60,000		6,60,000

On 1st April 2025, a new partner Harry is admitted into partnership on the following terms:

(i) That Harry brings in cash ₹ 60,000 as goodwill for his one-third share in future profits.

(ii) That Harry brings such an amount that his capital will be one-third of total capital of the new firm.

(iii) That the value of stock be raised to ₹ 1,68,000.

(iv) That furniture and machinery be depreciated by 5% and 10% respectively.

(v) That a provision for doubtful debts be created at 5% on sundry debtors.

(vi) That the capital accounts of the partners be re-adjusted on the basis of their profit sharing ratio through their current accounts.

Prepare the necessary ledger accounts and the opening balance sheet of the new firm.

Solution:

Dr. **Revaluation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Furniture A/c	2,000	By Stock A/c	8,000
To Machinery A/c	25,000	By Ajay's Capital A/c(2/3 loss)	16,000
To Provision for doubtful debts A/c	5,000	By Binoy's Capital A/c (1/3 loss)	8,000
	32,000		32,000

Capital Accounts

Dr. Particulars	Ajay ₹	Binoy ₹	Harry ₹	Cr. Particulars	Ajay ₹	Binoy ₹	Harry ₹
To Revaluation A/c (Loss)	16,000	8,000	--	By Balance b/d	2,82,000	2,40,000	–
To Ajay's Capital A/c (Goodwill)	–	–	40,000	By General Reserve	28,000	14,000	–
To Binoy's Capital A/c (Goodwill)	–	–	20,000	By Bank (Goodwill)	–	–	60,000
To Binoy's Current A/c	–	66,000		By Harry's Capital A/c (Goodwill)	40,000	20,000	
To Balance c/d	4,00,000	2,00,000	3,00,000	By Bank	–	–	3,00,000
				By Ajay's Current A/c	66,000		
	4,16,000	2,74,000	3,60,000		4,16,000	2,74,000	3,60,000

Balance Sheet of Ajay, Binoy and Harry as on 1st April, 2025

Liabilities	₹	Assets		₹
Bills Payable	6,000	Cash at Bank		4,50,000
Sundry Creditors	90,000	Bills Receivables	₹	20,000
Binoy's Current A/c	66,000	Sundry Debtors	1,00,000	
Ajay's Capital A/c	4,00,000	Less : Provision for		
Binoy's Capital A/c	2,00,000	Doubtful Debts	(5,000)	95,000
Harry's Capital A/c	3,00,000	Stock		1,68,000
		Furniture		38,000
		Machinery		2,25,000
		Ajay's Current Account		66,000
	10,62,000			10,62,000

Working Notes:

(i) Calculation of Harry's Capital

Total capital:

Ajay's capital: ₹ (2,82,000 + 28,000 + 40,000 – 16,000) = ₹ 3,34,000

Binoy's capital: ₹ (2,40,000 + 14,000 + 20,000 – 8,000) = ₹ 2,66,000

Total capital of Ajay and Binoy before Harry's Admission = ₹ 6,00,000

This capital is for 1-(1/3) = 2/3 share

So total capital of new firm (₹6,00,000 x 3/2) = ₹ 9,00,000

Harry's Capital = 1/3 x ₹9, 00,000 = ₹ 3,00,000

(ii) Calculation of new profit sharing ratio and capital of Ajay and Binoy:

Harry's share = 1/3

Balance = 1-(1/3) = 2/3 to be shared by Ajay and Binoy

Ajay's new share = 2/3 x 2/3 = 4/9

Binoy's new share = 2/3 x 1/3 = 2/9

New profit share ratio = 4 : 2 : 3

Ajay's capital in new firm = 4/9 x ₹9,00,000 = ₹4,00,000

Binoy's capital in new firm = 2/9 x ₹9,00,000 = ₹2,00,000

Adjustment of capitals is made through partners' current accounts

Sacrifice by Ajay = (2/3) – (4/9) = 2/9

Sacrifice by Binoy = (1/3) – (2/9) = 1/9

Sacrificing ratio = 2 : 1

So goodwill is distributed between Ajay and Binoy in the ratio of 2 : 1 respectively.

Illustration 11:

Bansal and Chandar were partners in a firm sharing profits and losses equally. Their balance sheet as on 31st March, 2025 was as follows:

Liabilities	₹	₹	*Assets*	₹
Sundry Creditors		1,26,000	Cash at Bank	14,000
General Reserve		70,000	Debtors	1,40,000
Capital Accounts:			Stock	1,68,000
Bansal	2,10,000		Furniture	28,000
Chander	1,68,000	3,78,000	Buildings	2,24,000
		5,74,000		5,74,000

Sagar was admitted as a partner and was given one-fourth share of profits on the following terms:

- *He would bring ₹ 2,10,000 in cash as his capital.*
- *His share of goodwill was valued at ₹70,000 but he was unable to bring it in cash.*
- *Stock and furniture be depreciation by 10%.*
- *A provision of 5% on debtors be created for doubtful debts.*
- *An amount of ₹14,000 included in creditors not to be treated as a liability.*

– *A provision of ₹7,000 be created against bills discounted.*

– *The buildings be treated as worth ₹2,80,000.*

It was agreed that except cash, the other assets and liabilities were to be shown at old figures in the balance sheet. Give journal entries to record the transactions and prepare Memorandum Revaluation Account and capital accounts of the partners. Also prepare the balance sheet after admission of Sagar.

Solution:

Journal Entries

Particulars		***Dr.*** ***(₹)***	***Cr.*** ***(₹)***
General Reserve Account	Dr.	70,000	
To Bansal's Capital Account			35,000
To Chander's Capital Account			35,000
(The transfer of general reserve to capital accounts of old partners in the old ratio)			
Bank	Dr.	2,10,000	
To Sagar's Capital Account			2,10,000
(The Amount brought in by Sagar as his capital)			
Sagar's Capital Account	Dr.	70,000	
To Bansal's Capital Account			35,000
To Chander's Capital Account			35,000
(Sagar's share of goodwill credited to old partners' capital accounts in the ratio of sacrifice which is 1: 1)			
Memorandum Revaluation A/c	Dr.	36,400	
To Bansal's Capital Account			18,200
To Chander's Capital Account			18,200
(Profit on revaluation credited to the old partners in the old ratio)			
Bansal's Capital Account	Dr.	13,650	
Chander's Capital Account	Dr.	13,650	
Sagar's Capital Account	Dr.	9,100	
To Memorandum Revaluation Account			36,400
(Memorandum Revaluation Account closed by debiting all the partners in the new profit sharing ratio)			

Dr. **Memorandum Revaluation Account** *Cr.*

Particulars		₹	*Particulars*		₹
To Provision for Doubtful Debts		7,000	By Buildings		56,000
To Stock		16,800	By Sundry Creditors		14,000
To Furniture		2,800			
To Provision for Bills Discounted		7,000			
To Profit transferred to :					
Bansal ½	18,200				
Chander ½	18,200	36,400			
		70,000			70,000
To Buildings		56,000	By Provision for Doubtful Debts		7,000
To Sundry Creditors		14,000	By Stock		16,800
			By Furniture		2,800
			By Provision for Bills Discounted		7,000
			By Loss transferred to:		
			Bansal (3/8)	13,650	
			Chander (3/8)	13,650	
			Sagar(1/4) or (2/8)	9,100	36,400
		70,000			70,000

Dr. **Capital Accounts** *Cr.*

Particulars	*Bansal (₹)*	*Chander (₹)*	*Sagar (₹)*	*Particulars*	*Bansal (₹)*	*Chander (₹)*	*Sagar (₹)*
To Bansal's Capital A/c	–	–	35,000	By Balance b/d	2,10,000	1,68,000	–
To Chander's Capital A/c	–	–	35,000	By General Reserve	35,000	35,000	–
To Memorandum Revaluation A/c	13,650	13,650	9,100	By Bank	–	–	2,10,000
To Balance c/d	2,84,550	2,42,550	1,30,900	By Sagar's Capital A/c	35,000	35,000	–
				By Memorandum Revaluation A/c	18,200	18,200	
	2,98,200	2,56,200	2,10,000		2,98,200	2,56,200	2,10,000
				By Balance b/d	2,84,550	2,42,550	1,30,900

Balance Sheet of Mr. Bansal, Chander and Sagar as on 31st March, 2025

Liabilities		₹	*Assets*	₹
Sundry Creditors		1,26,000	Cash at Bank	2,24,000
Capital Accounts:		6,58,000	Debtors	1,40,000
Bansal	₹ 2,84,550		Stock	1,68,000
Chander	₹ 2,42,550		Furniture	28,000
Sagar	₹ 1,30,900		Buildings	2,24,000
		7,84,000		7,84,000

RETIREMENT OF A PARTNER

According to Section 32(1) of the Indian Partnership Act, a partner may retire:

(a) with the consent of all the partners;

(b) in accordance with an express agreement by the partners;

(c) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

Generally, the business of the partnership firm may not come to an end when one of the partners retires. Other partners continue to run the business of the firm. Just as a number of adjustments have to be made on the admission of a partner, a number of similar adjustments have to be made before a partner retires. These adjustments may be as regard to reserves and undistributed profits, revaluation of assets and liabilities, profits sharing ratio, goodwill etc.

Calculation of New Profit Sharing Ratio on Retirement

Unless an intention to the contrary is expressed, the assumption should be made that on the retirement of a partner, the remaining partners continue to share profits and losses in the same relative ratio in which they were sharing profits and losses prior to retirement of the partner.

The absolute share of the remaining partners may increase but the ratio between the increased shares does not change because the increase itself is in that very ratio.

Example 1: A, B and C share profits and losses in the ratio of 7:4:3 respectively and B retires.

Now in the absence of an agreement to the contrary, A and C will continue to share profits and losses in the ratio of 7:3 respectively.

However, their absolute shares will go up. New shares will be: 7/10 and 3/10.

Previously, A and C got 7/14ths and 3/14ths of the profit respectively.

Example 2: If the remaining partners decide to distribute among themselves the share left by the retiring partner in a different ratio, the relative profit sharing ratio between the remaining partners will also change. Suppose, A and C agree that one half of B's share be added to A's share and the other half of B's share be added to C's share.

Then A's share will be $\frac{7}{14}+\left(\frac{1}{2}\times\frac{4}{14}\right)$ *or* $\frac{9}{14}$

and C's share will be $\frac{3}{14}+\left(\frac{1}{2}\times\frac{4}{14}\right)$ *or* $\frac{5}{14}$

The new ratio between A and C will be 9:5 respectively.

Calculation of Ratio of Gain (Gaining Ratio)

On retirement of a partner, the shares of profit to other partners increase. In order to find ratio in which the remaining partners have gained, old shares should be deducted from the new shares of remaining partners.

Example: If A, B and C share profits and losses in the ratio of 7:5:3 respectively and after B's retirement A and C decide to share profits and losses in the ratio of 3:2 respectively, then the ratio of gain will be calculated as follows:

A's old share = $\frac{7}{15}$

A's new share = $\frac{3}{5}$

A's gain = $\frac{3}{5}-\frac{7}{15}=\frac{9-7}{15}=\frac{2}{15}$

C's old share = $\frac{3}{15}$

C's new share = $\frac{2}{5}$

C's gain = $\frac{2}{5}-\frac{3}{15}=\frac{6-3}{15}=\frac{3}{15}$

Hence, ratio of gain between A and C is 2:3 respectively.

Treatment of Reserves and Undistributed Profits on Retirement

Before a partner retires, reserves created out of profits or balances in profit and loss account must be transferred to the capital accounts of all the partners in the ratio in which they share profits and losses at the time of retirement (old ratio). It is done so that the retiring partner may get his share of accumulated profits and may contribute his share of the loss that has not been transferred to capital accounts so far.

The journal will be:

Reserve/Profit and Loss A/c	Dr.
To All Partners' Capital Accounts	
(Reserves/balance in profit and loss account transferred to the capital accounts of all the partners in old profit sharing ratio)	

Alternative Method: Only the share of the retiring partner is credited to his capital account for his share of profit.

Reserve/Profit and Loss A/c	Dr.
To Retiring Partner's Capital A/c	
(Retiring partner's share in reserve/balance in profit and loss account transferred to the capital account of retiring partner)	

Revaluation of Assets and Liabilities on Retirement of a Partner

Before a partner retires, all the assets and liabilities of the firm are revalued as in the case of admission of a partner. Any profit or loss resulting from such revaluation is transferred to all the partners' capital accounts in their profit sharing ratio. A Revaluation Account or Profit and Loss Adjustment Account is opened which is debited for all decrease in the book values of assets and all increases in liabilities and is credited for all increases in the values of assets and all decreases in liabilities. The balance is transferred to the capital accounts of all the partners.

If adjustments have to be made for profit or loss on revaluation without altering the values of assets and liabilities, a Memorandum Revaluation Account is opened. In this case, besides the entries required for recording the profit or loss on revaluation of assets and liabilities some additional entries are necessary. These additional entries are made by reversing the original entries. The profit or loss disclosed by the original entries is transferred to all partners' capital accounts in the old ratio, but the profit or loss disclosed by the reversed entries is transferred to remaining partners' capital accounts in the new ratio. Hence, revaluation account under this method is called memorandum revaluation account.

If there is a loss on revaluation, first all the partners' capital accounts are debited and Memorandum Revaluation Account is credited with the amount of such a loss. Then after retirement has taken place, Memorandum Revaluation Account is closed by transfer of the amount to the remaining partners' capital accounts in the new profit sharing ratio.

Illustration 12:

A, B and C are partners sharing profits and losses in the ratio of 3:2:1 and on the retirement of C, the various assets and liabilities are revalued as under:

	Book Value	*Revalued Value*
	₹	₹
Plant and machinery	*35,000*	*43,000*
Sundry creditors	*10,000*	*9,000*
Stock	15,000	13,000

Pass journal entries on revaluation of these assets and liabilities.

Solution:

Journal Entries

Particulars		*Dr. (₹)*	*Cr. (₹)*
Revaluation Account	Dr.	2,000	
To Stock			2,000
(Fall in value of stock debited to revaluation account)			

Plant and machinery A/c	Dr..	8,000	
Sundry creditors	Dr.	1,000	
To Revaluation A/c			9,000
(Gain on revaluation of plant and machinery and sundry creditors credited to revaluation account)			
Revaluation Account	Dr.	7,000	
To A's Capital A/c			3,500
To B's Capital A/c			2,333
To C's Capital A/c			1,167
(Revaluation profit transferred to all partners in the old profit sharing ratio.)			

Treatment of Goodwill on Retirement

In case of retirement of a partner, goodwill is valued in the same manner in which it is valued in case of admission of a partner.

In this case, the continuing partners will gain in terms of profit sharing ratio. Hence, the continuing partners have to share the goodwill of the retiring partner in the gaining ratio. In this case, the retiring partner's capital account is credited with his share of goodwill and the continuing partners' capital accounts are debited with the amount in the gaining ratio.

Goodwill Account is not opened; only capital accounts of the partners may be debited and credited with the necessary amounts

REVIEW QUESTION

1. Mahesh, Ramesh and Dinesh were sharing profits and losses in the ratio of 3:2:1 respectively. On 31st March, 2024 Ramesh decides to retire. Mahesh agrees to purchase 1/3rd Ramesh's share while Dinesh purchases the balance of Ramesh's share. Find out the new profit sharing ratio between Mahesh and Dinesh.
2. P, Q and R, partners sharing profits and losses in the ratio of 7:4:3 respectively. On 31st March, 2024 Q retires and P and R decide to become equal partners. Goodwill of the firm is valued at ₹ 28,000. What adjustment will you make if no Goodwill Account is to be opened and none already exist. What will be the entry if Goodwill Account already appears at ₹ 21,000 and it is desired that Goodwill Account be allowed to show the same balance?

Capitals in Profit Sharing Ratio

After the retirement of a partner, the remaining partners may decide that their capitals be in their new profit sharing ratio. For this purpose, the total capital of the new firm may be fixed which will then be divided among the remaining partners in their new profit sharing ratio. Alternatively, the total of the balance of capital accounts of the remaining partners after all the adjustments in respect of retirement have been made may be considered to be the total capital of the firm which may then be reallocated to the different partners in their new profit sharing ratio. The adjustments in the capital accounts for this purpose may be made either by bringing in or payment of cash or through current accounts.

Computation of Retiring Partner's Interest in the Firm

The terms of the partnership agreement are to be observed while ascertaining the amount due to the retiring partner. Usually, following items are taken into consideration while calculating the total amount due to the retiring partner:

(a) Balance of the capital account of the retiring partner appearing in the ledger on the date of retirement;

(b) Share of undistributed reserve and profit (loss) in the firm;

(c) Share in firm's goodwill;

(d) Share in the profit and loss on the revaluation of assets and liabilities;

(e) Share of profit or loss in the current year till the date of retirement,

(f) Salary and interest on capital and drawing till the date of his retirement.

Payment of Retiring Partner's Interest

The amount due to the retiring partner can be paid as per the terms of the partnership agreement. In case the terms of the agreement are silent, the payment may be made as mutually agreed. The payment can be made by any of the following methods:

(i) ***Lump Sum Payment Method:*** If the firm has adequate funds, the amount due to the retired partner may be paid forthwith. His Capital Account will be debited and Bank will be credited.

(ii) ***Installment Payment Method:*** In order to avoid financial difficulties, a part or full payment due to the retired partner, may be deferred, In this case, the balance of his Capital Account will be transferred to his Loan Account which will be credited periodically with interest at the agreed rate on the outstanding balance and debited with payment on account until the balance is extinguished. The arrangement of installments may take the following two forms.

(a) ***Decreasing Payment Method:*** In this method, the total amount due is divided in a number of equal installments and the installment amount plus interest on the outstanding balance is paid out.

(b) ***Equal Payment Method:*** In this method, the total amount to be paid is divided in a number of equal installments in such a way that the amount after including interest on the outstanding balance is always equal.

Example: On 31st March, 2021 D retired from a partnership firm leaving ₹ 15,000 in the firm as a loan to be repaid in three annual installments of ₹ 5,000 each plus interest at 8%p.a. on outstanding balances. Show D's Loan Account

Solution:

D's Loan Account

Dr. Cr.

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2021			2021		
Mar.31	To Balance c/d	15,000	Mar.31	By D's Capital A/c	15,000
2022			2021		
Mar. 31	To Bank	6,200	Apr. 1	By Balance b/d	15,000
Mar. 31	To Balance c/d	10,000	2022		
			Mar. 31	By Interest @ 8% on ₹ 15,000	1,200
		16,200			16,200
2023			2022		
Mar. 31	To Bank	5,800	Apr.1	By Balance b/d	10,000
Mar. 31	To Balance c/d	5,000	2023		
			Mar.31	By Interest @ 8%	800
		10,800			10,800
2024			2023		
Mar. 31	To Bank	5,400	Apr.1	By Balance b/d	5,000
			2024		
			Mar. 31	By Interest @ 8% on ₹ 5,000	400
		5,400			5,400

Purchase of Retiring Partner's Share by Remaining Partners

The retiring partner's share may be purchased by the remaining partners in an agreed ratio. In such a case, retiring partner's capital account is closed by transfer to the remaining partners' capital accounts in the ratio in which they agree to purchase his share. When the remaining partners purchase the retiring partner's share, the retiring partner has to look to the remaining partners' in individual capacities for the satisfaction of his claim; the new firm as such will not be responsible.

Note: In the examination, if the question states that the remaining partners purchase the retiring partner's share but does not specify the proportion in which they purchase his share, the candidate should assume that it is done in the relative profit sharing ratio between the remaining partners; and if the new profit sharing ratio is given, the purchase should be taken to be in the ratio of gain.

Illustration 13:

On 31st March, 2024 the following was the balance sheet of A, B and C who were equal partners:

Liabilities	₹	*Assets*		₹
Sundry Creditors	89,400	Cash in hand		1,800
General Reserves	1,50,000	Cash at Bank		39,700
A's Capital Account	2,40,000	Investments		50,000
B's Capital Account	1,90,000	Debtors	2,10,000	
C's Capital Account	1,75,000	Less:		
		Provision for Bad debts	(2,200)	2,07,800
		Stock		3,70,100
		Furniture and Fittings		1,75,000
	8,44,400			8,44,400

On that date, A decided to retire due to ill health and the following adjustments were agreed upon by the partners:

- Investments be appreciated by ₹ 15,000
- *Provision for bad debts be brought upto 5% of debtors.*
- *Furniture be depreciated by 10%*
- *Stock be depreciated by ₹ 7,200*

A was paid the amount due to him by means of cheque, the bank agreed to allow the necessary overdraft. Pass journal entries to record the above mentioned transactions and show the balance sheet of the firm immediately after A's retirement.

Solution:

JOURNAL ENTRIES

Particulars		*Dr.(₹)*	*Cr.(₹)*
General Reserve	Dr.	1,50,000	
To A's Capital Account			50,000
To B's Capital Account			50,000
To C's Capital Account			50,000
(Transfer to general reserve to capital accounts)			
Investments	Dr.	15,000	
To Revaluation Account			15,000
(Increase in the value of investments)			
Revaluation Account	Dr.	33,000	
To Provision for Bad Debts			8,300
To Furniture			17,500

To Stock			7,200
(Various adjustments as agreed upon by partners)			
A's Capital Account	Dr.	6,000	
B's Capital Account	Dr.	6,000	
C's Capital Account	Dr.	6,000	
To Revaluation Account			18,000
(Transfer of loss on revaluation to partners' capital account)			
A's Capital Account	Dr.	2,84,000	
To Bank			2,84,000
(Payment of the amount due to A on his retirement)			

Balance Sheet of B and C as on 1st April, 2024

Liabilities	₹	*Assets*		₹
Bank Overdraft	2,44,300	Cash in Hand		1,800
Sundry Creditors	89,400	Investment	₹	65,000
B's Capital Account	2,34,000	Debtors	2,10,000	
C's Capital Account	2,19,000	Less:		
		Provision for Bad Debts	(10,500)	1,99,500
		Stock		3,62,900
		Furniture and Fittings		1,57,500
	7,86,700			7,86,700

Alternative Method:

If the values of assets and liabilities were not being changed, the following would have been the journal entries:

JOURNAL ENTRIES

Particulars		*Dr.(₹)*	*Cr.(₹)*
General Reserve	Dr.	1,50,000	
To A's Capital Account			50,000
To B's Capital Account			50,000
To C's Capital Account			50,000
(Transfer of general reserve to capital accounts)			

A's Capital Account	Dr.	6,000	
B's Capital Account	Dr.	6,000	
C's Capital Account	Dr.	6,000	
To Memorandum Revaluation Account			18,000
(Transfer of loss on revaluation to all the partners' capital accounts)			
A's Capital Account	Dr.	2,84,000	
To Bank			2,84,000
(Payment to A on his retirement)			
Memorandum Revaluation Account	Dr.	18,000	
To B's Capital Account			9,000
To C's Capital Account			9,000
(Transfer to memorandum revaluation account to remaining partners' capital accounts in new profit sharing ratio)			

Balance Sheet of B and C as on 1st April, 2024

Liabilities	₹	*Assets*		₹
Bank Overdraft	2,44,300	Cash in Hand		1,800
Sundry Creditors	89,400	Investments	₹	50,000
B's Capital Account	2,43,000	Debtors	2,10,000	
C's Capital Account	2,28,000	*Less:* Provision for Bad Debts	(2,200)	2,07,800
		Stock		3,70,100
		Furniture and Fittings		1,75,000
	8,04,700			8,04,700

Illustration 14:

Following is the balance sheet of A, B and C who share profits and losses in the ratio of 7:5:3 respectively.

Balance Sheet of A, B and C as on 31st March, 2024

Liabilities	₹	*Assets*	₹
Sundry Creditors	15,400	Furniture and Fittings	12,000
Capital Accounts:		Sundry Debtors	16,000
A	40,000	Stock	44,000
B	25,000	Cash at Bank	18,400
C	10,000		
	90,400		90,400

On 31st March, 2024 C retires on the condition that he be immediately paid the amount due to him after making adjustment for goodwill which is valued at ₹22,500. A and B agree to share profits and losses in the ratio of 8:7 respectively in future.

Show journal entries and balance sheet in each of the following cases:

(a) Goodwill Account is raised only with C's share of goodwill.

(b) No Goodwill account is raised but adjustments are made in the capital accounts with retiring partner's share of goodwill.

(c) A and B pay privately to C for goodwill.

Solution:

Case (i)

Journal Entries

Particulars	*Dr. (₹)*	*Cr. (₹)*
Goodwill Account Dr.	4,500	
To C's Capital Account		4,500
(Credit given to C for his share of goodwill)		
C's Capital Account Dr.	14,500	
To Bank		14,500
(Payment to C)		
A's Capital Account Dr.	1,500	
B's Capital Account Dr.	3,000	
To Goodwill Account		4,500
(Transfer of Goodwill Account to the remaining partners in the ratio of gain which turns out to be 1:2)*		

*The ratio of gain in this case has been calculated as under:

A's old share = $\frac{7}{15}$

A's new shares = $\frac{8}{15}$

A's gain = $\frac{8}{15} - \frac{7}{15} = \frac{1}{15}$

B's old share = $\frac{5}{15}$

B's new share = $\frac{7}{15}$

B's gain = $\frac{7}{15} - \frac{5}{15} = \frac{2}{15}$

Hence ratio of gain between A and B is 1:2

Balance Sheet of A and B as on 1st April, 2024

Liabilities	₹	*Assets*	₹
Sundry Creditors	15,400	Furniture and Fittings	12,000
A's Capital Account	38,500	Sundry Debtors	16,000
B's Capital Account	22,000	Stock	44,000
		Cash at Bank	3,900
	75,900		75,900

Case (ii)

Journal Entries

Particulars		*Dr. (₹)*	*Cr. (₹)*
A's Capital Account	Dr.	1,500	
B's Capital Account	Dr.	3,000	
To C's Capital Account			4,500
(Retiring partner being credited with his share of goodwill which is debited to remaining partners in the ratio of gain 1:2)			
C's Capital Account	Dr.	14,500	
To Bank			14,500
(Payment to C)			

Balance Sheet will be the same as in case (i)

Case (iii)

Journal Entries

C's Capital Account Dr.	10,000	
To Bank		10,000
(Payment to C)		

Balance Sheet of A and B as on 1st April, 2024

Liabilities	₹	*Assets*	₹
Sundry Creditors	15,400	Furniture and Fittings	12,000
A's Capital Account	40,000	Sundry Debtors	16,000
B's Capital Account	25,000	Stock	44,000
		Cash at Bank	8,400
	80,400		80,400

Illustration 15:

The balance sheet of Anil, Bashin and Chaman who were sharing profits in proportion to their capitals stood as follows on 31st March, 2024.

Liabilities	₹	*Assets*	₹	₹
Sundry Creditors	69,000	Cash in Bank		55,000
General Reserve	1,80,000	Sundry Debtors	50,000	
Capital Accounts:		Less : Provision for Bad Debts	(1,000)	49,000
Anil	2,00,000	Stock		2,60,000
Bashin	1,50,000	Plant and Machinery		1,35,000
Chaman	1,00,000	Land and Buildings		2,00,000
	6,99,000			6,99,000

Bashin retired on the above date and the following was agreed upon:

- *That the provision for bad debts be brought upto 5% on debtors.*
- *That land and buildings be appreciated by 25%.*
- *That a provision of ₹ 3,500 be made in respect of outstanding legal charges.*
- *That the goodwill of the entire firm be fixed at ₹ 1,08,000 and Bashin's share of it be adjusted into the accounts of Anil and Chaman who are going to share future profits in the ratio of 5:3 respectively.*
- *That the entire capital of the new firm be fixed at ₹ 4,80,000 and the capital accounts of the partners be made in their new profit sharing ratio; actual cash to be brought in or paid off as the need be.*

Pass journal entries, show profit and loss adjustment account and capital accounts and prepare balance sheet of Anil and Chaman.

Solution:

Journal Entries

Particulars		₹	₹
General Reserve	Dr.	1,80,000	
To Anil's Capital Account			80,000
To Bashin's Capital Account			60,000
To Chaman's Capital Account			40,000
(Transfer of general reserve to capital accounts)			
Profit and Loss Adjustment Account	Dr.	5,000	
To Provision for Bad Debts			1,500
To Outstanding Legal Expenses			3,500
(Increase in provision for bad debts and record of outstanding legal expenses)			
Land and Building	Dr.	50,000	
To Profit and Loss Adjustment Account			50,000
(Appreciation in the value of land and buildings)			

Profit and Loss Adjustment Account	Dr.	45,000	
To Anil's Capital Account			20,000
To Bashin's Capital Account			15,000
To Chaman's Capital Account			10,000
(Transfer of profit on revaluation)			
Anil's Capital Account	Dr.	19,500	
Chaman's Capital Account	Dr.	16,500	
To Bashin's Capital Account			36,000
(Bashin's share of goodwill debited to Anil and Chaman in ratio of gain which is 13:11 respectively)			
Bashin's Capital Account	Dr.	2,61,000	
To Bashin's Loan Account			2,61,000
(Transfer of Bashin's Capital Account to his Loan Account)			
Bank	Dr.	66,000	
To Anil's Capital Account			19,500
To Chaman's Capital Account			46,500
(Cash brought in by Anil and Chaman)			

Profit and Loss Adjustment Account

Dr. *Cr.*

Particulars	₹	*Particulars*	₹
To Provision for Bad Debts A/c	1,500	By Land and Buildings	50,000
To Outstanding Legal Expenses A/c	3,500		
To Anil's Capital A/c (4/9 profit)	20,000		
To Bashin's Capital A/c (3/9 profit)	15,000		
To Chaman's Capital A/c (2/9 profit)	10,000		
	50,000		50,000

Capital Accounts

Dr. *Cr.*

Particulars	*Anil* (₹)	*Bashin* (₹)	*Chaman* (₹)	*Particulars*	*Anil* (₹)	*Bashin* (₹)	*Chaman* (₹)
To Bashin's Capital A/c	19,500		16,500	By Balance b/d	2,00,000	1,50,000	1,00,000
To Bashin's Loan A/c		2,61,000		By General Reserve	80,000	60,000	40,000
To Balance c/d	3,00,000		1,80,000	By P & L Adjustment A/c	20,000	15,000	10,000
				By Anil's Capital	–	19,500	–
				By Chaman's Capital	–	16,500	
				By Bank	19,500		46,500
	3,19,500	2,61,000	1,96,500		3,19,500	2,61,000	1,96,500
				By Balance b/d	3,00,000		1,80,000

Balances Sheet of Anil and Chaman
as on 1st April, 2024

Liabilities		₹	*Assets*		₹	₹
Sundry Creditors		69,000	Cash in Bank			1,21,000
Outstanding Legal Expenses		3,500	Sundry Debtors		50,000	
Bashin's Loan Account		2,61,000	Less: Provision for Bad Debts		(2,500)	47,500
Capital Accounts:						
Anil	₹ 3,00,000		Stock			2,60,000
Chaman	₹ 1,80,000	4,80,000	Plant and Machinery			1,35,000
			Land and Buildings			2,50,000
		8,13,500				8,13,500

Working Notes:

Anil's gain in profit = $\frac{5}{8} - \frac{4}{9} = \frac{45-32}{72} = \frac{13}{72}$

Chaman's gain in profit = $\frac{3}{8} - \frac{2}{9} = \frac{27-16}{72} = \frac{11}{72}$

Ratio of Gain = 13:11

Bashin's share of goodwill = ₹$1,08,000 \times \frac{3}{9}$ or ₹36,000

Anil's will be debited with ₹ $36,000 \times \frac{13}{24}$ or ₹ 19,500 and

Chaman will be debited with ₹ $36,000 \times \frac{11}{24}$ or ₹ 16,500 for goodwill.

Illustration 16:

On 31st March, 2024 the balance sheet of M/s. Ashok, Basu, and Chauhan, who were sharing profits and losses in proportion to their capitals, stood as follows:

Liabilities		₹	*Assets*	₹
Capital Accounts:			Land and Buildings	2,00,000
Ashok	3,00,000		Machinery	2,00,000
Basu	2,00,000		Closing Stock	1,00,000
Chauhan	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, 2024, Ashok desired to retire from the firm and the remaining partners decided to carry on. They agreed on the following terms and conditions:

(i) Land and buildings be appreciated by 30%

(ii) Machinery be depreciated by 20%

(iii) Closing stock to be valued at ₹ 80,000.

(iv) Provision for bad debts be made at 5%.

(v) Old credit balances of sundry creditors amounting to ₹ 10,000 be written back.

(vi) Joint Life Policy of the partners be surrendered. Cash received was ₹ 60,000.

(vii) Goodwill of the entire firm be valued at ₹ 1,80,000 and Ashok's share of the goodwill be adjusted in the accounts Basu and Chauhan who would share the future profits equally.

(viii) The total capital of the firm was to be the same as before retirement. Individual capitals of partners were to be in their profit sharing ratio.

(ix) Amount due to Ashok was to be settled on the following basis:

50% on retirement and balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of the Partners, Loan Account of Ashok, Cash Book and Balance Sheet as on 1st April 2024 of M/s. Basu and Chauhan.

Solution:

Dr. **Revaluation Account** *Cr.*

Particulars		₹	*Particulars*	₹
To Machinery A/c		40,000	By Land and Building	60,000
To Closing Stock		20,000	By Sundry Creditors	10,000
To Provision for Bad Debts A/c		10,000	By Bank A/c (Joint Life Policy)	60,000
To Capital Accounts:				
Ashok	30,000			
Basu	20,000			
Chauhan	10,000	60,000		
		1,30,000		1,30,000

Dr. **Capital Accounts** *Cr.*

Particulars	*Basu* ₹	*Chauhan* ₹	*Particulars*	*Basu* ₹	*Chauhan* ₹
To Ashok			By Balance b/d	2,00,000	1,00,000
Capital A/c (Goodwill)	30,000	60,000	By Revaluation A/c	20,000	10,000
To Balance c/d	3,00,000	3,00,000	By Bank (Additional capital)	1,10,000	2,50,000
	3,30,000	3,60,000		3,30,000	3,60,000
			By Balance b/d	3,00,000	3,00,000

Dr. **Ashok's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Bank	2,10,000	By Balance b/d	3,00,000
To Ashok's Loan A/c	2,10,000	By Revaluation A/c	30,000
		By Chauhan's Capital A/c (Goodwill)	60,000
		By Basu's Capital A/c (Goodwill)	30,000
	4,20,000		4,20,000

Dr. **Ashok's Loan Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance c/d	2,10,000	By Ashok's Capital A/c	2,10,000
		By Balance b/d	2,10,000

Dr. **Cash Book** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	1,00,000	By A's Capital A/c	2,10,000
To Revaluation A/c		By Balance c/d	3,10,000
(J.L. Policy surrendered)	60,000		
To Basu's Capital A/c	1,10,000		
To Chauhan's Capital A/c	2,50,000		
	5,20,000		5,20,000
To Balance b/d	3,10,000		

M/s. B and C

Balance Sheet as on 1.4.2024

Liabilities	₹	₹	*Assets*		₹
Capital Accounts:			Land and Building		2,60,000
Basu	3,00,000		Machinery		1,60,000
Chauhan	3,00,000	6,00,000	Closing Stock		80,000
A's Loan		2,10,000	Sundry Debtors	2,00,000	
Sundry Creditors		1,90,000	Less: Provisions for Bad Debts	(10,000)	1,90,000
			Cash and Bank Balances		3,10,000
		10,00,000			10,00,000

Working Notes:

(1) Calculation of ratio of gain of remaining partners.

Ratio of gain = New ratio – Old ratio

Basu = 1/2 – 1/3 = 1/6

Chauhan = 1/2 – 1/6 = 2/6

Ratio of gain = 1:2.

(2) Goodwill borne by Basu and Chauhan:

Total goodwill of the firm = ₹ 1,80,000

Ashok's share = 1/2 x ₹ 1,80,000 = ₹ 90,000

Ashok's share to be borne by Basu and Chauhan in their ratio of gain.

Basu = 1/3 x ₹ 90,000 = ₹ 30,000

Chauhan = 2/3 x ₹ 90,000 = ₹ 60,000

DEATH OF A PARTNER

All the problems which arise on the retirement of a partner also arise in case of the death of a partner. However, there are a few additional points which have to be noted.

If the balance of deceased partner's capital account is not immediately paid in cash, the amount should be transferred to the deceased partner's Executors Account and not to any Loan Account.

A partner usually retires at the close of an accounting year when his capital account is credited with his share of profits for the year. But a partner's death may take place any day. Partnership deed may provide that in case of death of a partner during the accounting year, the deceased partner's capital account will be credited with his share of profits for the period for which he remained alive during the year on the basis of profits of the year preceding the year in which death takes place. Suppose, a partner C getting 1/3 share in profits died on 30 June 2024 and the profits for the year ended 31st March, 2024 have been ₹ 18,000. Then C's Capital Account will be credited with ₹ 1500 (₹ $18,000 \times \frac{3}{12} \times \frac{1}{3}$ = ₹ 1,500) for his share of profits for 3 months. Of course, some other basis may also be provided for, or the partnership deed may provide that final accounts will be prepared to ascertain profits for the part of the year.

Joint Life Policy

Partners often take out a joint life policy to provide funds for settling the claim of the deceased partner. Annual premium is paid by the firm and on the death of a partner, the amount of the policy is received by the firm from the insurance company.

It is possible to treat a joint life policy in anyone of the following three ways in the books of account.

1. When premium paid is treated as an expense

Under this method, the annual premium is treated as an expense and debited to the Profit and Loss Account. On the death of a partner, the amount of the policy received by the firm is credited to all the partners' capital accounts in the profit sharing ratio.

JOURNAL ENTRIES

(i) For payment of premium of the joint life policy

(a) Joint Life Insurance Premium A/c Dr.

To Bank

(Amount of premium paid on joint life policy)

(b) Profit and Loss A/c Dr.

To Joint Life Insurance Premium A/c.

(The amount of premium charged to Profit and Loss A/c)

(ii) For Receipt of the Policy Money

Bank Dr.

To All Partners' Capital Accounts

(The policy money distributed among all partners in the profit sharing ratio)

2. When premium paid is treated as an asset and surrender value is taken into account

Under this method, Joint Life Policy Account is debited with the amount of premium as and when paid. At the end of the year, the amount in excess of surrender value is treated as loss and transferred to Profit and Loss Account. The balance in Joint Life Policy Account is shown as an asset in the balance sheet. The amount received on maturity of policy in excess of surrender value will be net gain and divided among all the partners in their profit sharing ratio.

Journal entries

(i)	Joint Life Policy A/c	Dr.
	To Bank	
	(The premium paid on policy)	
(ii)	Profit and Loss A/c	Dr.
	To Joint Life Policy A/c	
	(The adjustment of book value with the surrender value i.e. excess of joint life policy over the surrender value)	
(iii)	Bank	Dr.
	To Joint Life Policy A/c	
	(Amount received on maturity of policy)	
(iv)	Joint Life Policy A/c	Dr.
	To All Partners' Capital Accounts	
	(The amount received minus the surrender value on that date distributed among the partners.)	

3. When premium paid is treated as an asset and life policy reserve account is maintained.

Under this method, whenever premium is paid, the amount of the premium is debited to Joint Life Policy Account. At the end of the year, Profit and Loss account is debited and Joint Life Policy Reserve Account is credited with the amount of the premium paid for the year. Then, in order to reduce the balances of Joint Life Policy Account and Joint Life Policy Reserve Account to the figure of surrender value of the policy, Joint Life Policy Reserve Account is debited and Joint Life Policy Account is credited with the difference between balance of Joint Life Policy Account and surrender value of the policy. The entries are repeated every year. On maturity of the policy, the amount received from the insurance company is credited to Joint Life Policy Account, Joint Life Policy Reserve Account is transferred to Joint Life Policy Account and the balance in Join Life Policy Account is transferred to all the partners' capital accounts in their profit sharing ratio. The amount standing to the credit of Joint Life Policy Reserve Account may alternatively be transferred directly to partners' capital accounts in their profit sharing ratio.

Journal entries

(i)	**For payment of premium of the Joint Life Policy**	
	Joint Life Policy A/c	Dr.
	To Bank	
	(The amount of premium paid on Joint Life Policy)	

(ii) For appropriation of amount equal to annual premium

Profit and Loss A/c Dr.

To Joint Life Policy Reserve A/c

(The amount transferred to Joint Life Policy Reserve Account)

(iii) For adjusting the difference between the premium paid and the increase in the surrender value

Joint Life Policy Reserve A/c Dr.

To Joint Life Policy A/c

(Excess of premium over surrender value adjusted)

(iv) For receipt of the policy money

(a) Bank Dr.

To Joint Life Policy A/c

(The amount received of joint life policy on maturity)

(b) Joint Life Policy Reserve A/c Dr.

To Joint Life Policy A/c

(The credit balance of joint life policy reserve account transferred to Joint Life Policy A/c)

(c) Joint Life Policy A/c Dr.

To All Partners' Capital Accounts

(Balance joint life policy transferred to capital accounts in the old profit sharing ratio of all the partners)

4. Individual policies on the life of each partner

If instead of one joint life policy, a number of individual policies are taken, on the death of a partner, the amount of the policy of the life of the deceased partner will be received in cash. The other policies will be shown at their respective surrender values while ascertaining the amount due to the executors of the deceased partner.

Repayment of the Amount due to Deceased Partner

On death of a partner, the amount due to his legal representatives will have to be paid. It may not be possible to pay the whole amount in a lump sum. As a rule, the payment is made according to the terms of partnership agreement. The various courses available are –

(a) Repayment in installments over a period of time and interest being paid on outstanding balances.

(b) The amount due may be treated as a loan to the firm. The firm may pay interest at an agreed rate or a share of profit of the firm.

(c) An annuity may be paid to the heirs of deceased partner.

Illustration 17:

A, B and C are partners in a firm sharing profits and losses in the ratio of 5:4:3 respectively. The firm had insured the partners' lives severally, A's life for ₹ 20,000, B's life for ₹ 16,000 and C's life for ₹ 14,000. The premiums were charged to the firm's profit and loss account. B died on 1.4.2024. The surrender values of these policies were 20% of the policy amount. Calculate B's share in policies.

Solution:

Claim on B's policy	₹ 16,000
Surrender value of A's and C's Life policies (20%)	
(₹ 4,000 + ₹2,800)	₹ 6,800
	₹ 22,800
B's Share =₹ $22,800 \times \frac{4}{12}$	₹ 7,600

Illustration 18:

A, B and C are partners sharing profits in the ratio of 2:1:1 respectively. On 30th June, 2024 their balance sheet was as follows:

Liabilities	₹	*Assets*	₹
Creditors	40,000	Goodwill	30,000
Bills Payable	20,000	Freehold Property	1,00,000
Capitals:		Joint Life Policy	20,000
A	1,00,000	Stock	55,000
B	60,000	Debtors	45,000
C	40,000	Cash	10,000
	2,60,000		2,60,000

A died on July 1, 2024. The firm had taken a joint life policy for ₹ 1,50,000, the payment for which was received on July 31, 2024. According to the partnership agreement, on retirement or death of a partner, the goodwill was to be valued at 1-1/2 times the average profit of the last four years. The profits for the last four years were ₹ 60,000, ₹ 75,000, ₹ 90,000 and ₹ 95,000 respectively. For paying the amount due to A's legal representative, B and C brought as much cash as would bring their capitals in profit-sharing ratio and the firm would have cash in hand ₹ 30,000. Calculate goodwill, prepare partners' capital accounts and the balance sheet.

Solution:

Calculation of goodwill

Average profit for four years = $\frac{60,000+75,000+90,000+95,000}{4}$ = ₹ 80,000

Goodwill at $1\frac{1}{2}$ times=80,000×$1\frac{1}{2}$	₹1,20,000
Less: Existing goodwill	₹ 30,000
Increase in the value of goodwill	₹ 90,000

Calculation of gain in joint life policy

Sum received from insurance company	1,50,000
Less: Joint life policy amount	20,000
Net gain to be distributed amongst the partners	1,30,000

Dr. **Partners' Capital Accounts** *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	*Particulars*	*A* (₹)	*B* (₹)	*C* (₹)
To Cash A/c	2,10,000	–	–	By Balance b/d	1,00,000	60,000	40,000
To A's Capital A/c	–	22,500	22,500	By B's Capital	22,500	–	–
To Balance c/d	–	1,00,000	1,00,000	By C's Capital	22,500	–	–
				By Joint Life Policy A/c	65,000	32,500	32,500
				By Cash	–	30,000	50,000
	2,10,000	1,22,500	1,22,500		2,10,000	1,22,500	1,22,500

Calculation of cash brought in by B and C:

	₹	₹
Amount payable to A's legal representatives		2.10,000
Add: Desired cash in hand		30,000
Amount required		2,40,000
Less: Amount received from Insurance company	1,50,000	
Existing balance of cash in hand	10,000	1,60,000
Shortage of cash to be brought in By B and C		80,000
B's capital after adjustment of Goodwill and Life Policy		70,000
C's capital after adjustment of Goodwill and Life Policy		50,000
Shortage of cash to be brought in		80,000
Total capital of B and C after A's death		2,00,000
Share of B being 1/2th of ₹ 2,00,000	1,00,000	
Less: Already in the business	70,000	
Cash to be introduced by B	30,000	
Share of C being 1/2 of ₹ 2,00,000	1,00,000	
Less: Already in the business	50,000	
Cash to be introduced by C	50,000	

Balance Sheet of B and C

Liabilities	₹	₹	*Assets*	₹
Creditors		40,000	Goodwill	30,000
Bills Payable		20,000	Freehold Property	1,00,000
Capitals:			Stock	55,000
B	1,00,000		Debtors	45,000
C	1,00,000	2,00,000	Cash	30,000
		2,60,000		2,60,000

Illustration 19:

On 31st March, 2024 the balance sheet of Sen, Sil and Som who shared profits and losses in the ratio of 4:3:2 respectively stood as follows:

Liabilities	₹	*Assets*	₹
Sundry Creditors	20,600	Furniture and Fittings	12,000
Joint Life Policy Reserve	6,000	Joint Life Policy (Policy for ₹ 18,500)	10,000
Capital Accounts:		Sundry Debtors	17,500
Sen	10,000	Stock	30,500
Sil	30,000	Cash at Bank	7,100
Som	10,500		
	77,100		77,100

On 30th June, 2024 Sen died. According to partnership deed, at the time of death, goodwill of the firm was to be valued at 2 years' purchase of average profits of the last three years and deceased partner's capital account was to be credited with the share of profits for the period he lived in the year of death on the basis of profit of immediately previous year.

Find out the amount due to Sen's executors on 30th June, 2024. Profits for the past three years have been as follows:

For the year ended 31st March, 2024 ₹ 36,000

For the year ended 31st March, 2023 ₹ 30,000

For the year ended 31st March, 2022 ₹ 25,800

Solution:

Total profits for the past three years = ₹ 36,000 + ₹ 30,000 + ₹ 25,800

= ₹ 91,800

2 years' purchases of average profit = ₹ $\frac{91,800}{3} \times 2$ = ₹ 61,200

Total Goodwill	= 61,200
Sen's share	$= ₹\ 61{,}200 \times \frac{4}{9} = ₹\ 27{,}200$
Sen's share of profits for 3 months on the basis of profit for the year ended 31st March, 2024	
	$= ₹\ 36{,}000 \times \frac{4}{9} \times \frac{1}{4} = ₹\ 4{,}000$
Sen's share in policy	$= ₹\ (18{,}500 + 6{,}000 - 10{,}000) \times \frac{4}{9} = ₹\ 6{,}444$
Total amount due to Sen's executors	= ₹ 10,000 + ₹ 27,200 + ₹ 4,000 + ₹ 6,444 = ₹ 47,644.

Illustration 20:

Following is the balance sheet of A, B and C as at 1st April, 2024:

Liabilities	₹	*Assets*	₹
Sundry Creditors	20,000	Goodwill	40,000
Reserve fund	32,000	Plant and Machinery	60,000
Capital Accounts:		Stock	40,000
A	1,00,000	Sundry Debtors	60,000
B	50,000	Cash at Bank	50,000
C	50,000	Cash in Hand	2,000
	2,52,000		2,52,000

C died on 30th June, 2024. Under the terms of partnership deed, the executors of a deceased partner were entitled to –

(a) Amount standing to the credit of partner's capital account;

(b) Interest on capital balance at 15% per annum;

(c) Share or goodwill on the basis of twice the average of the past three years' profit; and

(d) Share of profit from the closing of the last financial year to the date of death on the basis of the average of three completed year profits before the death.

Profits for the years ended 31st March, 2022, 2023 and 2024 were ₹ 60,000, ₹ 70,000 and ₹ 80,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up C's Capital Account to be rendered to his executors.

Solution:

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Reserve Fund	Dr.	8,000	
To C's Capital A/c			8,000
(Reserve fund transferred to capital account)			

Interest on Capital A/c	Dr.	1,875	
To C's Capital A/c			1,875
(Interest @ 15% credited to C's Capital Account)			
A's Capital A/c	Dr.	16,667	
B's Capital A/c	Dr.	8,333	
To C's Capital A/c			25,000
(Share of goodwill due to C, debited to the capital accounts of existing partners)			
Profit and Loss suspense A/c	Dr.	4,375	
To C's Capital A/c (Share of profit till 30th June, 2016 based on the average profit of the preceding three years credited to C's Capital Account)			4,375

Dr. **C's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To C's Executors	89,250	By Balance b/d	50,000
		By Reserve fund	8,000
		By Interest on Capital	1,875
		By A's Capital A/c	16,667
		By B's Capital A/c	8,333
		By Profit and Loss suspense A/c	4,375
	89,250		89,250

Working Notes

(i) *Calculation of Goodwill*

Total profit of three years = ₹ 2,10,000

Average Profit = ₹ 2,10,000 ÷ 3 = ₹ 70,000

Goodwill = ₹ 70,000 × 2 = ₹ 1,40,000

Existing Goodwill = ₹ 40,000

Goodwill to be increased by ₹ 1,00,000

C's Share = ₹ 1,00,000 ÷ 4 = ₹ 25,000

(ii) *Calculation of C's Share of Profit*

Average Profit = ₹ 70,000

C's Share for 3 months = ₹ $70{,}000 \times \frac{1}{4} \times \frac{3}{12}$ = ₹ 4,375

Dissolution of Partnership

Dissolution of a firm means that the business of the firm is put to an end, assets are disposed of, liabilities are paid off, and the accounts of all the partners are also settled. Dissolution of a firm differs from dissolution of a partnership. A partnership is dissolved on the expiry of the term or on the completion of the specified venture, death, retirement or insolvency of a partner. However if the remaining partners decide to continue to run the business, the partnership firm is not dissolved. If they do not continue, then the firm is also dissolved automatically. Thus, there is difference between dissolution of partnership and dissolution of firm which may be summarized as under:

- In case of dissolution of firm, the firm ceases to continue its business i.e. the business comes to an end. But in the case of dissolution of partnership, the business of the firm is continued.
- In dissolution of firm, the partnership among all the partners no longer exists while in case of dissolution of partnership, the partnership among all the partners does not come to an end.
- Dissolution of partnership does not necessarily mean dissolution of firm whereas dissolution of firm necessarily implies dissolution of partnership.

A firm is dissolved when:

- the partners of the firm decide to dissolve it,
- all the partners or all the partners except one become insolvent,
- the business of the firm is declared illegal,
- in case partnership at will, a partner gives notice of dissolution,
- The Court may order dissolution of the firm which may happen 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 affecting the business,
  - (d) where there is persistent disregard of partnership agreement by a partner,
  - (e) where a partner transfers his interest or share to a third person,
  - (f) where a business cannot be carried on except at a loss, and
  - (g) where a dissolution appears to the Court to be just and equitable on any other ground.

Settlement of Accounts of Partners

The Indian Partnership Act has certain provisions for the dissolution of partnership firm. According to section 48, in settling the accounts of a firm after dissolution, the following rules shall be observed subject to agreement by the partners:

(a) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits;

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

- in paying the debts of the firm to third parties;
- in paying to each partner ratably what is due to him from the firm for advances as distinguished from capital;
- in paying to each partner ratably what is due to him on account of capital; and
- the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Thus, on dissolution the assets of the firm are sold out and the proceeds are applied in the following order:

- in paying debts due to third parties.
- in paying ratably the loans advanced by partners to the firm.
- in paying to the partners the sums due to them on account of capital, and
- if there is a surplus, it has to be distributed among the partners in the profit sharing ratio. On the other hand, if there is a loss on dissolution, it has to be made up first out of past accumulated profits, then out of capitals of the partners and lastly out of contributions from private estates of the partners in the profit sharing ratio.

Important principles

- *The private property of a partner should be used to pay his private debts first and if there is any surplus it can be used to pay firms liabilities.*
- *Similarly, firm's assets should be first used to pay firm's liabilities. A partner can use his share of the surplus only to pay his private liabilities.*
- *The liability of partners is joint and several. It means that if a partner is unable to bring in his share of loss, the other partners have to make up his share of loss also.*

Accounting Treatment on Dissolution of Partnership

On dissolution, the books of accounts of the partnership firm are closed. The various steps to be followed are as follows:

1. "Realisation Account" is opened and transfer to it all the assets except cash in hand and at bank. Sundry Debtors will be transferred at gross amount.
2. Realisation Account is created with all liabilities to outsiders and provisions against assets like Provision for Bad Debts. However, accounts denoting accumulated losses or profits will not be transferred to Realisation Account.
3. Now, Realisation Account will be credited with the actual amount realised by sale of assets. If a partner takes over an asset, the capital account of that partner is debited and Realisation Account is credited with the value agreed upon.
4. Actual amount paid to the creditors of the firm is debited to Realisation Account. If a partner takes over a liability, his capital account is credited and Realisation Account is debited with the amount agreed upon.

5. Expenses during the course of dissolution are debited to Realisation Account and credited to cash.
6. Profit or loss revealed by Realisation Account is transferred to all the partners' capital accounts in their profit sharing ratio. Realisation Account is thus closed.
7. Loans advanced by partners to the firm are repaid.
8. Any reserve or accumulated profit or loss lying in the books of accounts is transferred to capital accounts in the profit sharing ratio.
9. Partners whose capital accounts may be showing a debit balance bring cash to clear their accounts.
10. Payment is made to the partners whose capital accounts are showing credit balances. This will close the books of accounts.

Difference Between Revaluation Account and Realisation Account

Revaluation Account	Realisation Account
(i) The effect of the revaluation of assets and liabilities is recorded in revaluation account.	(i) It records the sale of various assets and payment of liabilities.
(ii) Revaluation account is prepared at the time of reconstitution of the firm.	(ii) It is prepared only at the time of dissolution of the firm.
(iii) Revaluation account is prepared to find out the profit (loss) on the revaluation of assets and liabilities.	(iii) Realisation account is prepared to find out the profit (loss) on the realization of assets and settlement of liabilities.
(iv) It contains only those assets and liabilities which are revalued.	(iv) It contains generally all assets and liabilities.
(v) The balance of this account is transferred to the old partners' capital accounts.	(v) The balance of this account is transferred to the capital accounts of all partners.
(vi) Accounting entries are made on the basis of the difference between book value and revalued figures.	(vi) Accounting entries are made at the book values of assets and liabilities.
(vii) On revaluation, the accounts of assets and liabilities are not closed.	(vii) The accounts of assets and liabilities are closed on preparation of realization account.

Return of Premium on Dissolution

If a partner on his admission pays to the other partner an amount for goodwill (also known as premium) and it is agreed that the partnership would be for a fixed term, then, if the firm is dissolved before the expiry of such

a term, the partner will be entitled to a refund of a ratable amount of the premium so paid. Suppose, A and B admit C as a new partner on the condition that C pays ₹ 10,000 for goodwill and it is agreed that the partnership would be for 10 years. But if the firm is dissolved after 4 years, C will be entitled to a refund of ₹ 6,000 depending upon the circumstances.

However, such a refund cannot be claimed under the following conditions:

(i) When the firm is dissolved due to the death of a partner.

(ii) When the dissolution takes place mainly due to the misconduct of the partner making the claim, or

(iii) Where the dissolution is in pursuance of an agreement that no such refund will be made.

Insolvency of a Partner

In dissolution, if the capital account of a partner shows a debit balance, he will have to pay the amount to the firm. But if he is insolvent, he will not be able to do so; he will not be able to pay the full amount of such a debit balance. The sum which becomes irrecoverable from a partner due to his insolvency is a loss to be borne by other partners. Before the decision in Garner v. Murray case was made, such loss used to be treated as an ordinary loss and transferred to the capital accounts of the solvent partners in their relative profit sharing ratio. But decision in *Garner* v. *Murray* changed the position.

Decision in Garner Vs. Murray

According to the decision in *Garner* v. *Murray*, in case of insolvency of a partner:

(a) first, the solvent partners should bring in cash equal to their respective shares of the loss on realisation, and

(b) then, the loss due to the insolvency of a partner should be divided among the other partners in the ***ratio of capitals*** then standing.

The effect of this decision practically is that the deficiency in the capital account of the insolvent partner has to be borne by the solvent partners in the ratio of capitals standing just prior to dissolution.

Important Note:

If on the date of dissolution, a partner had no credit balance in his capital account, he will not bear any loss on account of insolvency of another partner. This is irrespective of his private wealth.

If the capitals are fixed, then the loss due to the insolvency of a partner will be borne by the solvent partners in the ratio of their capitals.

If the capitals are fluctuating, all necessary adjustments in respect of reserves or profit and loss account are first made (but the loss on realisation is not adjusted) in the capital accounts of all the partners, and then the ratio of their capitals is calculated to transfer the deficiency of the insolvent partner.

Accounting in case of Insolvency - Steps summarized

- Prepare Realisation Account in the usual manner.
- Transfer profit of loss on realisation to all the partners in profit sharing ratio.
- Prepare insolvent partner's capital account. If anything is received from his estate, it should be credited to his account.

- The debit balance of insolvent partner should be transferred to all other solvent partners in the ratio of capitals before dissolution (or in the ratio of fixed capitals if capitals are fixed).
- Then, settle claims of solvent partners.

Insolvency of All Partners

If all the partners become insolvent, creditors will not be able to get their amounts in full. All the cash available together with whatever can be received from the private estates of the partners will be paid to the creditors after the expenses of realisation have been met. In case of insolvency of all the partners, creditors should not be transferred to Realisation Account; only assets should be transferred to this account. Amount realised from assets should be credited to Realisation Account. Expenses should be debited to Realisation Account. Now the balance in Realisation Account should be transferred to the Capital Accounts in profit sharing ratio. Now Cash Account should be prepared. After recording the amounts which are received from the estates of the partners, the entire cash should be distributed among the creditors ratably. The balances in the accounts of creditors and in the capital accounts should be transferred to Deficiency Account. Thus, all the accounts will be closed.

Illustration 21:

On 31st March, 2024 the following was the balance sheet of A, B and C when the firm was dissolved:

Liabilities	₹	*Assets*	₹	₹
Capital Accounts:		Goodwill		10,000
A	30,000	Plant and achinery		20,000
B	30,000	Furniture		8,000
C	30,000	Investments		10,000
General Reserve	9,000	Stock		51,060
B's Loan	5,000	Debtors	23,600	
Mrs. A's Loan	5,000	Less: Provision for Bad Debts	(1,020)	22,580
Current Accounts		Bill Receivable		5,000
A	2,860	Cash at Bank		2,760
C	1,240	Unexpired Insurance		125
Bill Payable	10,000			
Sundry Creditors	6,530			
		B's Current Account		105
	1,29,630			1,29,630

Investments were taken over by A for ₹ 13,000 whereas bills receivable were taken over by B for ₹ 4,800, fixed assets fetched ₹ 17,000 whereas stock realised ₹ 60,000. All the debtors paid the amounts due from them. Total rebate of ₹ 110 was received on retiring all bills payable immediately. Expenses of realisation came to ₹ 1,441. Pass Journal entries to close the books of the firm and show Realisation Account, Bank Account, and the Capital Accounts of all the partners.

Solution:

Journal Entries

Particulars		*Dr. (₹)*	*Cr. (₹)*
Realisation Account	Dr.	1,27,785	
To Goodwill			10,000
To Plant and Machinery			20,000
To Furniture			8,000
To Investments			10,000
To Stock			51,060
To Debtors			23,600
To Bills Receivable			5,000
To Unexpired Insurance			125
(Transfer of assets to Realisation Account)			
Provision for Bad Debts	Dr.	1,020	
Mrs. A's Loan	Dr.	5,000	
Bills Payable	Dr.	10,000	
Sundry Creditors	Dr.	6,530	
To Realisation Account			22,550
(Transfer of liabilities to outsiders to Realisation Account) Note: Mrs. A is also an outsider			
Bank	Dr.	1,00,600	
To Realisation Account			1,00,600
(Sale proceeds of fixed assets and stock and amount received from debtors)			
A's Current Account	Dr.	13,000	
B's Current Account	Dr.	4,800	
To Realisation Account			17,800
(For investments taken over by A for ₹ 13,000 and bills receivable taken over by B for ₹4,800)			
Realisation Account	Dr.	21,420	
To Bank			21,420
(Payment made to pay off liabilities to outsiders – ₹ 5,000 to Mrs. A. ₹ 9,890 for bills payable and ₹ 6,530 to creditors)			

Realisation Account	Dr.	1,441	
To Bank			1,441
(Payment of expenses of realisation amounting ₹ 1,441)			
A's Current Account	Dr.	3,232	
B's Current Account	Dr.	3,232	
C's Current Account	Dr.	3,232	
To Realisation Account			9,696
(Transfer of loss on realisation)			
B's Loan Account	Dr.	5,000	
To Bank			5,000
(Payment of B's loan)			
General Reserve	Dr.	9,000	
To A's Current Account			3,000
To B's Current Account			3,000
To C's Current Account			3,000
(Transfer of General Reserve)			
A's Capital Account	Dr.	10,372	
B's Capital Account	Dr.	5,137	
To A's Current Account			10,372
To B's Current Account			5,137
(Transfer of debit balances of current accounts of A and B to their capital accounts)			
C's Current Account	Dr.	1,008	
To C's Capital Account			1,008
(Transfer of credit balance in C's current account to C's capital account)			
A's Capital Account	Dr.	19,628	
B's Capital Account	Dr.	24,863	
C's Capital Account	Dr.	31,008	
To Bank			75,499
(Payment to partners)			

Ledger Accounts

Dr. **Realisation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Sundry Assets:		By Provision for Bad Debts	1,020
Goodwill	10,000	By Mrs. A's Loan	5,000
Plant and Machinery	20,000	By Bills Payable	10,000
Furniture	8,000	By Sundry Creditors	6,530
Investments	10,000	By Bank	1,00,600
Stock	51,060	By A's Current Account	13,000
Debtors	23,600	(Investments)	
Bills Receivable	5,000	By B's Current Account	4,800
Unexpired Insurance	125	(B/R)	
To Bank (Liabilities)	21,420	By A's Current Account (1/3rd loss)	3,232
To Bank (Expenses)	1,441	By B's Current Account (1/3rd loss)	3,232
		By C's Current Account (1/3rd loss)	3,232
	1,50,646		1,50,646

Dr. **Bank** *Cr.*

Particulars	₹	*Particular*	₹
To Balance b/d	2,760	By Realisation (liabilities)	21,420
To Realisation A/c (Sale proceeds of assets)	1,00,600	By Realisation (expenses)	1,441
		By B's Loan Account	5,000
		By A's Capital Account	19,628
		By B's Capital Account	24,863
		By C's Capital Account	31,008
	1,03,360		1,03,360

Dr. **Partners' Current Accounts** *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	*Particulars*	*A* (₹)	*B* (₹)	*C* (₹)
To Balance b/d	–	105	–	By Balance b/d	2,860	–	1,240
To Realisation	13,000	4,800	–	By General Reserve	3,000	3,000	3,000
To Realisation (loss)	3,232	3,232	3,232	By A's Capital	10,372	–	–
To C's Capital	–	–	1,008	By B's Capital		5,137	–
	16,232	8,137	4,240		16,232	8,137	4,240

Dr. **Partners' Capital Accounts** *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	*Particulars*	*A* (₹)	*B* (₹)	*C* (₹)
To A's Current A/c	10,372	–	–	By Balance b/d	30,000	30,000	30,000
To B's Current A/c	–	5,137	–	By C's Current A/c	–	–	1,008
To bank	19,628	24,863	31,008				
	30,000	30,000	31,008		30,000	30,000	31,008

Illustration 22:

A, B and C commenced business on 1st April, 2024. They agreed to share the profits and losses in the ratio of 2: 2: 1. Their capitals were ₹ 30,000, ₹ 22,500 and ₹ 15,000 respectively. The partnership deed provided for interest on capital at 6% per annum. During 2024-25 the firm earned a profit of ₹ 20,050 (before providing for interest on capital). During the year the partners' drawings were A – ₹7,000; B – ₹ 6,250; and C – 4,000.

The relations between partners were not good. They decided to dissolve the firm on 31st March, 2025. The assets were sold which realised ₹ 75,000. There were creditors to the extent of ₹ 12,000 which were paid off at a discount of 5%. Expenses of realisation amounted to ₹ 1,200.

Prepare the necessary accounts to close the books of the firm.

Solution:

Dr. **Profit and Loss Appropriation Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2025		
Mar. 31	To Capital Accounts (interest)		Mar. 31	By Net Profit	20,050
	A 1,800				
	B 1,350				
	C 900	4,050			

	To Profit transferred to:				
	A 6,400				
	B 6,400				
	C 3,200	16,000			
		20,050			20,050

Dr. **A's Capital Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar.31	To Drawings	7,000	Apr.1	By Bank	30,000
	To Balance c/d	31,200	2025		
			Mar.31	By Profit & Loss A/c (interest)	1,800
				By Profit & Loss A/c (share of profit)	6,400
		38,200			38,200
Mar. 31	To Realisation (loss)	3,160	Mar. 31	By Balance b/d	31,200
	To Bank	28,040			
		31,200			31,200

Dr. **B's Capital Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To Drawings	6,250	Apr. 1	By Bank	22,500
	To Balance c/d	24,000	2025		
			Mar. 31	By Profit & Loss A/c (interest)	1,350
				By Profit & Loss A/c (share of profit)	6,400
		30,250			30,250
Mar. 31	To Realisation (loss)	3,160	Mar. 31	By Balance b/d	24,000
	To Bank	20,840			
		24,000			24,000

Dr. **C's Capital Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2024		
Mar. 31	To Drawings	4,000	Apr. 1	By Cash	15,000
	To Balance c/d	15,100	2025		
			Mar. 31	By Profit & Loss A/c (interest)	900
				By Profit & Loss A/c (share of profit)	3,200
		19,100			19,100
2025			2025		
Mar. 31	To Realisation (loss)	1,580	Mar. 31	By Balance b/d	15,100
	To Bank	13,520			
		15,100			15,100

Balance Sheet as at 31st March, 2025

Liabilities	₹	*Assets*	₹
Sundry Creditors	12,000	Sundry Assets	82,300
Capital Accounts:			
A 31,200			
B 24,000			
C 15,100	70,300		
	82,300		82,300

Dr. **Realisation Account** *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2025		
Mar. 31	To Sundry Assets	82,300	Mar.31	By Sundry Creditors	12,000
	To Cash (expenses)	1,200		By Cash (assets realised)	75,000
	To Cash (creditors ₹ 12,000 less 5%)	11,400		By Loss transferred to:	
				A – 3,160	
				B – 3,160	
				C – 1,580	7,900
		94,900			94,900

Cash Account

Date	*Particulars*	₹	*Date*	*Particulars*	₹
2025			2025		
Mar. 31	To Realisation A/c (assets realised)	75,000	Mar. 31	By Realisation (expenses)	1,200
				By Realisation A/c (creditors)	11,400
				By Capital Accounts:	
				A – 28,040	
				B – 20,840	
				C – 13,520	
					62,400
		75,000			75,000

Illustration 23:

On 31st March, 2024 the following was the balance sheet of A, B and C who shared profits and losses in the ratio of 2:1:1 respectively.

Liabilities	₹	*Assets*	₹
Creditors	16,000	Cash in hand	200
General Reserve	5,000	Stock	18,800
Capital Accounts:		Debtors	11,300
A	30,000	Furniture	12,500
B	20,000	Plant & Machinery	20,000
C	1,000	Goodwill	9,200
	72,000		72,000

The firm was dissolved on this date due to C's insolvency. Assets realised ₹32,000. Expenses of dissolution came to ₹ 200. C's estate paid 50% of what was due to C. Close the books of the firm assuming that the loss due to C's insolvency has been divided:

(i) in the ratio of fixed capitals.

(ii) in the ratio of fluctuating capitals.

Solution:

Case (i) Loss due to deficiency is divided in the ratio of fixed capital accounts

Dr. **Realisation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Stock	18,800	By Creditors	16,000
To Debtors	11,300	By Cash (Assets)	32,000
To Furniture	12,500	By A's Capital Account	20,000
To Plant & Machinery	20,000	By B's Capital Account	10,000
To Goodwill	9,200	By C's Capital Account	10,000
To Cash (Creditors)	16,000		
To Cash (Expenses)	200		
	88,000		88,000

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

Particulars	*A (₹)*	*B (₹)*	*C (₹)*	*Particulars*	*A (₹)*	*B (₹)*	*C (₹)*
To Realisation	20,000	10,000	10,000	By Balance b/d	30,000	20,000	1,000
To C's Capital	2,325	1,550	–	By General Reserve	2,500	1,250	1,250
To Cash A/c	30,175	19,700	–	By Cash A/c	20,000	10,000	3,875
				By A's Cap	–	–	2,325
				By B's Cap	–	–	1,550
	52,500	31,250	10,000		52,500	31,250	10,000

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

Particulars	₹	*Particulars*	₹
To Balance b/d	200	By Realisation A/c (creditors)	16,000
To Realisation A/c (assets)	32,000	By Realisation A/c (expenses)	200
To A's Capital Account	20,000	By A's Capital Account	30,175
To B's Capital Account	10,000	By B's Capital Account	19,700
To C's Capital Account	3,875		
	66,075		66,075

Note: Since, current accounts have not been specified in the question the adjustments have been made in capital accounts.

Case (ii) Loss due to deficiency is divided in the ratio of fluctuating capital accounts

Realisation Account will be the same as in the case (i)

Capital Accounts

Particulars	*A (₹)*	*B (₹)*	*C (₹)*	*Particulars*	*A (₹)*	*B (₹)*	*C (₹)*
To Realisation	20,000	10,000	10,000	By Balance b/d	30,000	20,000	1,000
To C's Capital	2,343	1,532	–	By Gen. Res.	2,500	1,250	1,250
To Cash A/c	30,157	19,718	–	By Cash A/c	20,000	10,000	3,875
				By A's Capital (26/43ths share)	–	–	2,343
				By B's Capital A/c (17/43ths share)	–	–	1,532
	52,500	31,250	10,000		52,500	31,250	10,000

Balances in A's Capital Account and B's Capital Account after adjustment for General Reserve are ₹ 32,500 and ₹ 21,250 respectively. Hence, A and B will bear the loss of ₹ 3,875 due to C's insolvency in the ratio of 32,500 : 21,250 or 26 : 17 respectively.

A's share = ₹ 3,875 × $\frac{26}{43}$ = ₹ 2,343

B's share = ₹ 3,875 × $\frac{17}{43}$ = ₹ 1,532

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

Particulars	₹	*Particulars*	₹
To Balance b/d	200	By Realisation A/c (Creditors)	16,000
To Realisation A/c (Assets)	32,000	By Realisation A/c (Expenses)	200
To A's Capital Account	20,000	By A's Capital Account	30,157
To B's Capital Account	10,000	By B's Capital Account	19,718
To C's Capital Account	3,875		
	66,075		66,075

Illustration 24:

A, B, C and D are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is the balance sheet as at March 31st, 2024.

Liabilities	₹	₹	*Assets*	₹	₹
Sundry creditors		30,000	Cash in hand		14,000
Capital accounts:			Sundry debtors	35,000	
A	70,000		Less: Provision for bad debt	(5,000)	30,000
D	30,000	1,00,000	Other assets		51,000

			Capital accounts:		
			B	20,000	
			C	15,000	35,000
		1,30,000			1,30,000

On March 31st, 2024, the firm is dissolved. The partnership agreement provides that the deficiency of an insolvent partner will be borne by the solvent partners in the ratio of capitals as they stand just before dissolution.

The following arrangements are agreed upon:

(i) A is to take over 60% of book debts at 70% and D is to take over the balance at 75%. Further, they are to be allowed ₹ 2,100 and 1,100 respectively to cover future losses.

(ii) D is to realise other assets and to pay off the creditors. He is to receive 5% gross commission on the amounts finally payable to other partners but to bear expenses of realisation. He reports the results of realisation as follows:

Other assets realize at a loss of 2% on net collection and pays of the creditors at a discount of 30%. Realisation expenses amount to ₹ 3,000 but the same is paid by the firm. B is declared insolvent and a dividend of 20% in a rupee is realised from his estate.Prepare Cash Account, Realisation Account and Capital Accounts.

Solution:

Dr. **Cash Accounts** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	14,000	By Realisation A/c (payment to creditors)	21,000
To Realisation A/c	50,000	By D's Capital A/c (expenses)	3,000
To B's Capital A/c (20% dividend)	4,000	By A's Capital A/c	44,000
To C's Capital A/c	15,000	By D's Capital A/c	15,000
	83,000		83,000

Dr. **Realisation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Debtors	35,000	By Provision for bad debts	5,000
To Other assets	51,000	By Sundry creditors	30,000
To Cash A/c (30,000 – 9,000) (payment to creditors)	21,000	By Cash A/c (realisation of other assets)	50,000
		By A's Capital A/c (debtors taken over)	12,600
		By D's Capital A/c (debtors taken over)	9,400
	1,07,000		1,07,000

Dr. **A's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Realisation A/c (debtors taken over)	12,600	By Balance b/d	70,000
To B's Capital A/c (deficiency)	11,200		
To D's Capital A/c (commission)	2,200		
To Cash A/c (final payment)	44,000		
	70,000		70,000

Dr. **B's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	20,000	By Cash A/c	4,000
		By A's Capital A/c (7/10ths deficiency)	11,200
		By D's Capital A/c (3/10ths deficiency)	4,800
	20,000		20,000

Dr. **C's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	15,000	By Cash A/c	15,000
	15,000		15,000

Dr. **D's Capital Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Realisation A/c (debtors taken over)	9,400	By Balance b/d	30,000
To Cash A/c (expenses)	3,000	By A's Capital A/c (commission)	2,200
To B's Capital A/c (deficiency)	4,800		
To Cash A/c (final payment)	15,000		
	32,200		32,200

Working Notes:

Sundry Debtors taken over by A:

₹ 35,000 x 60% x 70%	=	₹ 14,700
Less: Allowance for further loss	=	₹ 2,100
		₹ 12,600

Sundry Debtors taken over by D:		
₹ 35,000 x 40% x 75%	=	₹ 10,500
Less : Allowance for further loss	=	₹ 1,100
		₹ 9,400
D's Commission		
Gross amount payable		₹ 46,200
Commission $\frac{5}{105} \times 46,200$		₹ 2,200

Illustration 25:

Below is the Balance Sheet of C, D and E as on 31st March, 2025

Liabilities	₹		*Assets*	₹
Sundry Creditors	2,00,000		Cash	31,200
Loan	1,00,000	3,00,000	Stock	1,56,300
Capital Accounts:			Debtors	47,200
C	80,000		Furniture	95,300
D	60,000		Profit & Loss Account	1,20,000
E	10,000	1,50,000		
		4,50,000		4,50,000

The firm was dissolved due to insolvency of all the partners. Stock was sold for ₹ 1,09,000 while furniture fetched ₹ 40,000. ₹ 41,000 were received from Debtors. Expenses were ₹ 2,200. Nothing could be recovered from D and E but C's private estate showed a surplus of ₹ 6,000. Close the books of the firm.

Solution:

Dr. **Realisation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Stock	1,56,300	By Cash A/c (assets)	1,90,000
To Debtors	47,200	By C's Capital A/c	37,000
To Furniture	95,300	By D's Capital A/c	37,000
To Cash A/c (expenses)	2,200	By E's Capital A/c	37,000
	3,01,000		3,01,000

Dr. **Capital Account** Cr.

Particulars	C (₹)	D (₹)	E (₹)	Particulars	C (₹)	D (₹)	E (₹)
To Profit and Loss A/c - Transfer	40,000	40,000	40,000	By Balance b/d	80,000	60,000	10,000
To Realisation (Loss)	37,000	37,000	37,000	By Cash A/c	6,000	–	–
To Deficiency A/c	9,000	–	–	By Deficiency	–	17,000	67,000
	86,000	77,000	77,000		86,000	77,000	77,000

Dr. **Cash Account** Cr.

Particulars	₹	Particulars	₹
To Balance b/d	31,200	By Realisation A/c (expenses)	2,200
To Realisation A/c (assets)	1,90,000	By Loan A/c	75,000
To C's Capital Account	6,000	By Sundry Creditors	1,50,000
	2,27,200		2,27,200

Dr. **Loan Account** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	75,000	By Balance b/d	1,00,000
To Deficiency A/c	25,000		
	1,00,000		1,00,000

Dr. **Sundry Creditors** Cr.

Particulars	₹	Particulars	₹
To Cash A/c	1,50,000	By Balance b/d	2,00,000
To Deficiency A/c	50,000		
	2,00,000		2,00,000

Dr. **Deficiency Account** Cr.

Particulars	₹	Particulars	₹
To D's Capital Account	17,000	By Loan Account	25,000
To E's Capital Account	67,000	By Sundry Creditors	50,000
		By C's Capital	9,000
	84,000		84,000

LIMITED LIABILITY PARTNERSHIP 'LLP'

The Indian Partnership Act of 1932 provides for a general form of partnership which has inherent shortcoming of unlimited liability of all partners for business debts and legal consequences, regardless of their holding or profit-sharing ratio, as the firm is not a legal entity. General partners are also jointly and severally liable for tortuous acts of co-partners. In case of liquidation personal assets of partners can be liquidated to meet liabilities of the firm.

With the growth of the Indian economy, the role played by its entrepreneurs as well as its technical and professional manpower has been acknowledged internationally. Entrepreneurship, knowledge, risk and capital may be combined to provide a further impetus to India's economic growth. In this background, a need has been felt for a new corporate form that would provide an alternative to the traditional partnership, with unlimited personal liability on the one hand, and, the statute-based governance structure of the limited liability company on the other. This would enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.

The Government felt that with Indian professionals increasingly transacting with or representing multi-nationals in international transactions, the extent of the liability they could potentially be exposed to, is extremely high. Hence, in order to encourage Indian professionals to participate in the international business community without apprehension of being subject to excessive liability, the need for having a legal structure like the LLP is encouraged. Thus, in convergence towards global scenario, Limited Liability Partnership Act, 2008 was introduced.

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

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

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

Advantages:

(i) LLP is organized and operates on the basis of an agreement.

(ii) Enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.

(iii) Limited liability of partners as in case of corporate entities along with flexibility of a partnership without imposing detailed legal and procedural requirements;

(iv) Lower registration costs as compared to corporate entities;

(v) Audit not mandatory (subject to turnover / capital contribution benchmark)

Challenges:

(i) Public disclosure of financial statements;

(ii) No option for Equity investments;

(iii) Extensive penal provisions for non-compliance

The Limited Liability Partnerships (LLPs) in India were introduced by Limited Liability Partnership Act, 2008 which lay down the law for the formation and regulation of Limited Liability Partnerships. Later, the Ministry of Law and Justice made amendments to the Limited Liability Partnership Act, 2008 (LLP Act) through the LLP (Amendment) Act, 2021.

Minimum number of partners in case of LLP

As per the LLP Act, any individual or body corporate may be a partner in a limited liability partnership; provided that an individual shall not be capable of becoming a partner of a limited liability partnership, 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 limited liability partnership shall have at least two partners.

If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership 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 limited liability partnership incurred during that period.

Limitation of Liability of an LLP and its partners

- Under the LLP Act, 2008 an obligation of an LLP arising out of a contract or otherwise, will be solely the obligation of the LLP;
- The Liabilities of an LLP should 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 the authority to act on behalf of the LLP in doing a particular act; and
  - 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 will be unlimited for all or any of the debts or other liabilities of the LLP. However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.
- The LLP is liable if a partner of LLP is liable to any person as a result of wrongful or omission on his part in the course of business of the LLP or with his authority.

Difference Between Limited Liability Partnership And Partnership Firm

SR. NO.	BASIS	LIMITED LIABILITY PARTNERSHIP	PARTNERSHIP FIRM
1.	Governing Law	The Limited Liability Partnership Act, 2008 and various Rules made thereunder	The Indian Partnership Act, 1932 and various Rules made thereunder
2	Registration	Compulsory	Optional
3	Creation	Created by law	Created by contract
4	Separate Legal Entity	It is separate legal entity, separate from its partners\ designated partners.	It is not separate legal entity from partners. Partners are collectively referred as firm.
5	Perpetual succession	It has perpetual succession.	It does not have perpetual succession.
6	Common Seal	It denotes the signature of the Company and LLP may have its own common seal, if it besides to have one.	Not required
7	Legal Proceeding	LLP can also sue and be sued	Only registered partnership can sue.
8	Liability	Liability of partners is limited up to their capital contribution however in case a partners acts with an intension to conduct fraud, they are personally liable.	Liability of partners is unlimited
9	Transferability of interest	Rights/interest of partners are transferable as per the provisions of LLP agreement.	Transferability of Interest subject to the mutual consent of all the members.
10	Maximum number of Member	No cap of maximum number of its partners	Maximum fifty.

Winding Up of a Limited Liability Partnership (LLP)

When a Limited Liability Partnership (LLP) ceases its business and is dissolved, it undergoes a formal process known as winding up. Unlike a simple partnership, an LLP is a separate legal entity, and its winding up follows statutory procedures under the Limited Liability Partnership Act, 2008 (as amended). Winding up ensures that the LLP's affairs are properly concluded and that creditors and partners' interests are settled in an orderly manner.

1. Modes of Winding Up

An LLP may be wound up in one of two ways:

- **Voluntary Winding Up**

  Initiated by the partners themselves, typically by a special resolution when the LLP has no debts or when the partners decide to cease the business.

- **Tribunal-Ordered Winding Up**

  Commenced by an application to the National Company Law Tribunal (NCLT), on grounds including:

  – The LLP has less than two partners for more than six months.

  – The LLP is unable to pay its debts.

  – The LLP has failed to file annual accounts or returns for five consecutive financial years.

  – It is just and equitable for the LLP to be wound up.

2. Appointment of a Liquidator

Upon commencement of winding up (voluntary or tribunal-ordered), a liquidator is appointed to take control of the LLP's assets, settle its liabilities, and distribute any surplus. In a voluntary winding up, the partners typically appoint the liquidator; in a tribunal winding up, the NCLT appoints one.

3. Realization and Distribution of Assets

The liquidator's primary duties include:

1. **Realizing Assets**

   Converting the LLP's assets (tangible and intangible) into cash or marketable securities.

2. **Discharging Liabilities**

   Paying secured and unsecured creditors in accordance with the LLP Act and the LLP's deed.

3. **Partner Loans and Capital**

   After creditors are paid, the liquidator repays any loans from partners, then returns capital contributions.

4. **Surplus Distribution**

   Any remaining surplus is distributed among partners in their profit-sharing ratio. If there is a deficit, partners share it in that ratio unless the LLP deed specifies otherwise.

4. **Specific Considerations**

   - **Joint Life Policies**

     If the LLP holds a joint life insurance policy on its partners, the surrender or claim proceeds are treated as an asset of the LLP and realized by the liquidator, then distributed among partners following creditor settlement.

   - **Tax and Statutory Compliance**

     The liquidator must ensure that all tax returns and statutory filings are up to date before dissolution.

   - **Notification and Dissolution**

     Once all debts are discharged and assets distributed, the liquidator files a final account with the Registrar. The Registrar then issues a certificate of dissolution, and the LLP ceases to exist.

Winding up an LLP is a structured process that protects the interests of creditors and partners alike. By converting assets into cash, settling debts, and distributing any net balance, the LLP's affairs are brought to a lawful close. Whether initiated voluntarily by the partners or ordered by the NCLT, strict adherence to the LLP Act's provisions ensures transparency, fairness, and finality in dissolving the LLP.

LESSON ROUNDUP

- A partnership is defined by the Indian Partnership Act, 1932 as "the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all."
- Key features of a partnership: agreement among persons, existence of a business, sharing of profits (not necessarily losses), and mutual agency.
- Firms must have at least two partners; maximum 50 under the Companies (Incorporation) Rules, 2014.
- Partners have unlimited personal liability for firm debts; creditors may enforce claims against partners' personal assets.
- In absence of any agreement, partners share profits and losses equally, receive no salary, no interest on capital, and pay 6% p.a. interest on any partner's loan to the firm.
- A Partnership Deed (written or oral) may specify name of firm, capital contributions, profit-sharing ratios, interest on capital and drawings, partner remuneration, accounting methods, admission, retirement, and death procedures.
- Admission of a new partner entails revaluation of assets and liabilities (via a Revaluation or Memorandum Revaluation Account), adjustment of goodwill, transfer of reserves, and computation of new profit-sharing and sacrificing ratios.
- Goodwill valuation methods include average profit, super-profit (number-of-years purchase, annuity), and capitalization basis.
- When a partner is admitted for cash goodwill, the premium is credited to partners' capital accounts in the profit-sacrificing ratio.
- On admission, reserves and accumulated profits are transferred to old partners' capitals in their old profit-sharing ratio.
- Retirement or death of a partner also requires revaluation, goodwill adjustment in the gaining ratio, and transfer of reserves.
- Gaining ratio = new share minus old share for each continuing partner. Where no ratio is specified, continuing partners share the deceased's/retiring partner's share in their old ratio.
- On retirement, retiring partner's capital account is settled by transfer to a loan account or cash payment; any balance may be left as a loan bearing interest or profit-share.
- If assets and liabilities are not to be restated in the books on revaluation, a Memorandum Revaluation Account is used to allocate profits to old partners and losses to all partners in new ratios.
- Fluctuating capital method: all transactions (interest on capital, salary, profit, drawings) flow through each partner's capital account.
- Fixed capital method: initial capital remains unchanged; a separate current (or drawings) account records subsequent adjustments.
- Interest on capital is paid only if provided by deed; typically at a negotiated rate, calculated on opening balances adjusted for capital introductions and withdrawals.
- Interest on partner loans is allowed in absence of an agreement at 6% p.a.; where provided, the agreed rate applies.
- Interest on drawings is chargeable, calculated by product of drawings and time outstanding, then credited to the Profit & Loss Appropriation Account.

- Salary or commission to a partner must be explicitly provided; otherwise no remuneration beyond profit-share is payable.
- A right to a minimum guaranteed profit may be provided; deficiency is borne by other partners in a specified ratio or their profit-sharing ratio.
- Partners' shares may be in proportion to capital, time-weighted capital contributions, or any agreed ratio.
- On death of a partner, the firm obtains the full insured amount under a joint life policy; the policy value (less any reserve shown on the books) is distributed among all partners in their profit-sharing ratio.
- Where individual life policies are held, the deceased partner's executors receive the assured amount plus the surviving partners' policies' surrender values proportionate to the deceased's share.
- The deceased partner's executors are entitled to capital credit, share of goodwill, share of reserves, share of profit to date of death, interest on capital (if provided), profit/loss on revaluation, and joint-life policy proceeds.
- In absence of an agreement contrary, surviving partners must carry on business with the deceased's share of firm assets until final settlement, entitling the executor to profit on the use of that share or 6% p.a. interest.
- A de facto partner (by representation) may bind the firm; certain acts—e.g. sale of immovable property or litigation—require all partners' consent.
- The Limited Liability Partnership Act, 2008 creates LLPs with separate legal personality, perpetual succession, and limited partner liability to their agreed contributions.
- LLPs combine corporate-style limited liability with partnership-style internal flexibility; bodies corporate and individuals can be partners.
- LLPs require at least two designated partners (one a resident) responsible for compliance; criminal penalties apply for non-compliance.
- LLPs file an annual statement of accounts and solvency; audit is required unless exempted by turnover or capital thresholds.
- The Profit & Loss Appropriation Account appropriates net profit by providing for interest on capital, partner salaries and commissions, partners' interest on drawings, transfers to reserves, and distribution of the remainder.
- Capital accounts of partners reflect their contributions, appropriations, and drawings; closing capitals feed into the Balance Sheet.
- Goodwill and revaluation provisions are closed through the partners' capital (or current) accounts; no standalone Goodwill or Revaluation assets remain post-reconstitution.
- Changes in partner composition (admission, retirement, death) require adjusted capital statements and, where specified, reissue of capital or additional contributions to maintain agreed capital ratios.
- Partners' Current Accounts record annual appropriations for fixed capitals; they may show drawings, interest and remuneration.
- In the event of insolvency of a partner, losses caused by that insolvency may be borne by solvent partners in profit-sharing ratio or capital-ratio (Garner v. Murray principle) as agreed.

- Piecemeal distribution (on realisation of assets in instalments) uses either Maximum Loss Method or Highest Relative Capital Method to proportion distributions.
- On dissolution, assets are realised and realised funds apply first to creditors, then to loans, capital, and finally to distribute surpluses or deficits among partners.
- Winding up LLPs is governed by the LLP Act and rules; Tribunal may order winding up for insolvency, inactivity, or just-equitable grounds.
- Proper documentation (Partnership Deed, LLP agreement) prevents disputes by specifying profit-sharing, capital maintenance, retirement/death settlements, and other internal governance.

GLOSSARY

Partners: Persons who have entered into partnership with one another.

Partnership deed: The written contract of partnership.

Goodwill: Present value of a firm's anticipated super normal earnings.

Sacrificing ratio: The difference between old profit sharing ratio and the new profit sharing ratio of the old partners.

Surrender: The sum of money that an insurance company will pay to the policy holder in the Value event of voluntary termination of the policy before its maturity if the insured event occurs.

TEST YOURSELF

Theory Questions:

1. What is meant by partnership?
2. What is a partnership deed?
3. Distinguish between fluctuating and fixed capital accounts.
4. Why is interest allowed on capital?
5. Why is interest charged on drawings? How is it calculated?
6. What is goodwill? In what ways can it be treated on admission of a partner?
7. Why are adjustments in the values of assets and liabilities made on the admission of a partner?
8. What are the accounting adjustments necessary at the time of retirement of a partner?
9. What is the significance of purchase of shares of a retiring partner by the remaining partners?
10. What is dissolution of a firm? How does if differ from dissolution of a partnership?
11. When is a firm dissolved?
12. When may the Court order dissolution of a firm?
13. On dissolution of a firm, in what order are payments made to creditors and partners?
14. What is *Garner v. Murray* rule? What is its effect in case of insolvency of a partner? Will it make any difference if capital accounts of the partners are fixed or fluctuating?
15. How does insolvency of all the partners of a firm affect the creditors of the firm?

16. Explain LLP
17. What are the essential features that distinguish partnership from other business associations?
18. Under what circumstances can a minor be admitted as a partner? What limitations apply to his rights and liabilities?
19. Explain the effect of non-registration of a partnership firm under the Indian Partnership Act, 1932.
20. List and explain the key clauses that should be included in a partnership deed to avoid future disputes.
21. Describe the preparation and purpose of the Profit and Loss Appropriation Account. Which items are charged or credited here rather than in the Profit & Loss Account?
22. How is interest on capital calculated when the capital balance changes during the year? Illustrate with an example.
23. Under what conditions may partners agree to guarantee a minimum profit to one of their number? How is any deficit in that guarantee shared?
24. Outline the procedure and journal entries for the revaluation of assets and liabilities on the retirement of a partner.
25. How is goodwill adjusted in the capital accounts of remaining partners when a partner retires? Provide the formula for calculating the gaining ratio.
26. When a partner dies, what components make up the amount payable to his legal representatives?
27. Describe how separate individual life policies held by each partner are treated in the firm's books on the death of one partner.

Practical Questions:

1. 1st March, 2024 the following was the balance sheet of A and B who were carrying on business in partnership sharing profits and losses in the ratio of 3:2 respectively:

Liabilities	₹	₹	*Assets*	₹	₹
Capital Accounts			Goodwill		5,000
A	18,000		Machinery		20,000
B	14,000	32,000	Furniture		10,000
			Debtors	10,000	
General Reserve		9,000	*Less:* Provision for		
Sundry Trade Creditors		19,700	Bad Debts	(500)	9,500
Bank Overdraft		6,100	Stock		22,300
		66,800			66,800

C was admitted to the firm on this date on the following terms:

(i) C would get 1/5th share of future profits.

(ii) C would bring ₹ 3,000 by way of his share of goodwill and ₹ 15,000 as capital.

(iii) Provision for bad debts would be reduced to ₹ 350.

(iv) Capitals of the partners would be in their profit sharing ratio; A and B bringing in cash or withdrawing cash as need be.

Pass journal entries, show the important ledger accounts and prepare balance sheet as it would appear immediately after C' admission.

2. Following is the balance sheet of A and B (sharing profit and losses in the ratio of 3:2 respectively on 31st March, 2024:

Liabilities	₹	*Assets*	₹
Outstanding Expenses	11,000	Goodwill	2,00,000
Creditors	1,30,000	Plant and Machinery	1,85,000
8% Loan	2,00,000	Furniture and Fittings	67,000
Capital Accounts:		Stock	2,46,000
A	3,00,000	Debtors	9,3,500
B	2,00,000	Cash at Bank	49,500
	8,41,000		8,41,000

A retires on that date. Goodwill is valued at ₹ 2,50,000. It is also agreed that plant and machinery be depreciated by 10% and provision for bad debts amounting to ₹ 1,500 be made. A new partner named C is admitted who buys one half of A's share, B buying the remaining half share. Find out the amount brought in by C and prepare the initial balance sheet of B and C.

3. Balance Sheet C, D and E as on 31st March, 2024

Liabilities	₹	*Assets*	₹
Capital Accounts		Fixed Assets :	
C	50,000	Goodwill	25,000
D	30,000	Plant and Machinery	30,000
E	20,000	Furniture	10,000
Current Accounts		Current Assets:	
D	1,500	Investments	15,000
E	1,300	Stock	40,000
Current Liabilities		Debtors	8,000
Trade Creditors	16,250	Cash In Hand	500
Bills Payable	10,000	Current Account	900
Outstanding Expenses	350		
	1,29,400		1,29,400

C died on 31st December, 2024 by which date he had withdrawn ₹ 8,500. Partnership deed provided that in case of death of a partner, in addition to the amount standing to the credit of capital and current accounts of such a partner, the executors will also been titled to a share of the profits from the closing of the last accounting year to the date of death on the basis of the last year's profits. It also provided that goodwill of the firm in case of death of a partner should be revalued at 2 years' purchase of the average profits of the last three years. Profits for 2021-22, 2022-23, and 2023-24 were ₹ 37,500, ₹ 45,800 and ₹ 37,700 respectively.

Investments were sold for ₹ 24,000 net at the stock exchange to pay immediately to C's executors for one-third of the total amount due to them.

Find out the balance left in C's Executors Account? Calculations may be made to the nearest rupee.

(Hints**:** Profit on sale of investment will be shared by the executors also since it is due to appreciation in the value of assets within the life time of C.)

4. A, B and C were carrying on business in partnership sharing profit and losses in the ratio 3:2:1 respectively. On 31st March, 2024 balance sheet of the firm stood as follows:

Liabilities	₹	*Assets*	₹
Bills Payable	1,50,000	Cash at Bank	89,000
Sundry Creditors	1,83,400	Creditors	80,000
Capital Accounts	₹	Stock	2,34,400
A	1,50,000	Furniture	50,000
B	1,00,000	Buildings	2,30,000
C	1,00,000		
	6,83,400		6,83,400

B retired on the above mentioned date on the following terms:

(i) Buildings be appreciated by ₹ 70,000.

(ii) Provision for bad debts be made @ 5% on debtors.

(iii) Goodwill of the firm be valued @ ₹ 90,000 and adjustment in this respect be made without raising Goodwill Account.

(iv) ₹ 70,000 be paid to B immediately and the balance due to him be treated as a loan carrying interest @ 6% per annum.

Pass journal entries to record the above mentioned transactions and show the balance sheet of the firm as it would appear immediately after B's retirement.

5. A, B and C were equal partners. On 31st March, 2024 their balance sheet stood as follows:

Liabilities	₹	*Assets*	₹
Sundry Creditors	1,80,000	Cash in hand	10,000
General Reserve	60,000	Debtors	1,25,000
A's Capital Account	1,80,000	Stock	1,85,000
B's Capital Account	80,000	Furniture	1,04,000

	C's Capital Account – overdrawn	76,000
	5,00,000	5,00,000

On this date, the firm was dissolved due to C's insolvency. Only ₹ 1,17,000 could be realised from debtors while stock and furniture fetched ₹ 1,16,800 and ₹ 80,000 respectively. Expenses came to ₹ 1,800. C's estate could pay only 50% of what was due from C. Show Realisation Account and the accounts of the partners. Assume the capitals are fluctuating. Apply *Garner* v. *Murray* rule.

MULTIPLE CHOICE QUESTIONS

1. **Which of the following is NOT a feature of an ordinary partnership under the Indian Partnership Act, 1932?**

   A Mutual agency

   B. Perpetual succession

   C. Sharing of profits

   D. Agreement among partners

   Answer: B

2. **Under fixed-capital method, which account records partners' drawings?**

   A Capital Account

   B. Current Account

   C. Drawings Account

   D. Realization Account

   Answer: B

3. **In the absence of any partnership agreement, profits are shared**

   A In capital ratio

   B. Equally

   C. In proportion to drawings

   D. As agreed by any two partners

   Answer: B

4. **A partner's loan to the firm, when no rate is specified in the deed, carries interest at**

   A 6% p.a.

   B. 10% p.a.

   C. 12% p.a.

   D. Rate declared by RBI

   Answer: A

5. Interest on capital may be charged to the Profit & Loss Account when

A Provided in the deed

B. Capital is fixed

C. Drawings exceed capital

D. No partner salary is allowed

Answer: A

6. The Revaluation Account is credited with

A Increase in liabilities

B. Decrease in assets

C. Increase in assets

D. Partners' drawings

Answer: C

7. On admission of a new partner, goodwill brought in cash is credited to

A Goodwill Account

B. Realization Account

C. Old partners' Capital Accounts

D. New partner's Capital Account

Answer: C

8. When the incoming partner's share of goodwill is borne equally by two old partners, the sacrificing ratio is

A 1 : 1

B. 2 : 3

C. 3 : 2

D. 1 : 2

Answer: A

9. If A and B share profits 3 : 2 and admit C for 1/5th share, A's new share is

A 2/5

B. 3/10

C. 3/5

D. 12/25

Answer: D

10. In the event of retirement, a profit on revaluation is credited to

A Retiring partner only

B. All partners in old ratio

C. All partners in new ratio

D. Goodwill Account

Answer: B

11. A clause providing repayment of retiring partner's capital over time creates his balance as

A Current Account

B. Loan Account

C. Realization Account

D. Drawings Account

Answer: B

12. On death of a partner, share of profit to date of death is credited to

A Profit & Loss Account

B. Profit & Loss Suspense Account

C. Deceased's Capital Account

D. Deceased's Executor's Account

Answer: D

13. In a joint-life policy, when full policy proceeds exceed balance sheet surrender value, the excess is

A Credited to profit & loss Account

B. Credited to partners in profit ratio

C. Credited to retiring partner only

D. Transferred to reserve

Answer: B

14. Under fluctuating-capital method, interest on drawings is recorded by crediting

A Drawings Account

B. Profit & Loss Appropriation Account

C. Capital Account

D. Trading Account

Answer: B

15. A partner's firm accounts close on 31st December. A dies on 30th June. His share of the year's profit is normally based on

A Last year's profit

B. Three-year average

C. Sales up to date of death

D. Net capital at date of death

Answer: A

16. The minimum number of partners required to form an LLP is

A One

B. Two

C. Three

D. Fifty

Answer: B

17. Designated partners in an LLP are responsible for

A Filing annual statements

B. Sharing profits with minors

C. Auditing the firm

D. Registering new directors

Answer: A

18. In the absence of any clause on interest on drawings, interest is

A Charged at 6% p.a.

B. Not charged

C. Charged at 12% p.a.

D. Shared equally

Answer: B

19. On admission, if revaluation profit is not to appear in new Balance Sheet, it is adjusted through

A Revaluation Account only

B. Memorandum Revaluation Account

C. Capital Accounts directly

D. Goodwill Account

Answer: B

20. In the absence of partnership deed, interest on capital is

A 6% p.a.

B. 9% p.a.

C. 12% p.a.

D. Not allowed

Answer: D

21. A partner who takes over an asset on retirement is credited with the agreed value in

A Realization Account

B. Revaluation Account

C. His Capital Account

D. Goodwill Account

Answer: A

22. A retiring partner's share of reserve is transferred to his

A Capital Account

B. Current Account

C. Realization Account

D. Loan Account

Answer: A

23. Guarantees of minimum profit are borne by other partners in

A Their capital ratio

B. Profit sharing ratio

C. Fixed ratio of 1 : 1

D. Salary ratio

Answer: B

24. In case of minor admitted to partnership, minor's share of loss is borne by others in

A Profit ratio

B. Capital ratio

C. Minor bears no loss

D. Equally

Answer: A

25. The format of LLP financial statements prescribed by ICAI is mandatory for

A All LLPs

B. LLPs with turnover above threshold

C. LLPs having foreign partner

D. LLPs not required to file audit report

Answer: B

Introduction to Company Accounts

Lesson 7

Learning Objectives

To understand:

The company form of business organization is formed to overcome the limitations of partnership form of business organization. A company is an association or collection of individual real persons and/or other companies, who provide some form of capital with a common purpose or focus and an aim of gaining profits. Thus, a company can be defined as an "artificial person" created by law, with a distinct legal entity, perpetual succession and a common seal. It is not affected by the death, insanity or insolvency of an individual member.

Company accounting is different from sole proprietorship and partnership accounting. Company being a legal entity, has to maintain proper books of accounts to give a true and fair view of the state of affairs of the company. The books are kept on accrual basis and according to double entry system of accounting. The company has to prepare its balance sheet and statement of profit & loss and Cash Flow Statement (CFS) from the books of account maintained by it.

In this lesson, we will study some basic concepts of company accounts like shares, share capital, entries for issue of share, debentures, forfeiture and re- issue of shares and redemption of preference shares.

Lesson Outline

- Basic Concepts of Company Accounts
- Issue of Shares
  - For Cash
  - Under Subscription of Shares
  - Over Subscription of Shares
- Calls in Advance and Interest on Calls in Advance
- Calls in Arrears and Interest on Calls in Arrears
- Issue of shares for consideration other than cash
- Review Questions
- Forfeiture of Shares
- Re-issue of Forfeited Shares
- Forfeiture and Re-issue of Shares allotted on Pro-Rata basis in case of over subscription
- Issue of Debentures
  - For cash
  - For consideration other than Cash
  - As Collateral Security
- Redemption of Preference Shares
  - Out of the profits of the company
  - Out of the proceeds of the fresh issue
  - Out of the profits of the company and proceeds of the fresh issue
- Lesson Round Up
- Glossary
- Test Yourself
- List of Further Readings

We are not going to see a significant upside until we get a clearer sense of how companies make their money and how it is accounted for.

– Charles Pradilla

BASIC CONCEPTS OF COMPANY ACCOUNTS

The company form of business organization is a voluntary association of persons to carry on a business. Normally, it is given a legal status and is subject to certain legal regulations. It is an association of persons who generally contribute money for some common purpose. The money so contributed is the capital of the company. The persons who contribute capital are its members. The proportion of capital to which each member is entitled is called his share, therefore members of a joint stock company are known as shareholders and the capital of the company is known as share capital. The total share capital is divided into a number of units known as 'shares'. The companies are governed by the Indian Companies Act, 2013.

Meaning of Shares

Share as defined in Section 2(84) of the Companies Act, 2013 means a share in the share capital of a company and it also includes stock. A share is one unit into which the total share capital is divided. It is a fractional part of the share capital and forms the basis of ownership in the company. For example, when a company has a share capital of Rs. 5,00,000 divided into 50,000 shares of Rs. 10 each and a person who has taken 50 shares of that company is said to have a share in the share capital of the company to the tune of Rs. 500. In other words, shares are divisions of the share capital of a company. Each share forms a unit of ownership and is offered for sale so as to raise capital for the company. Face value of a share is the par Value of the share. It is also known as the Nominal value or denomination of a share.

Kinds of Share Capital

The share capital of a company limited by shares shall be of two kinds under the Companies Act 2013, namely :–

(a) *Equity share capital*: Equity share capital with reference to any company limited by shares means all share capital which is not preference share capital. Equity share capital can be

  (i) with voting rights; or

  (ii) with differential rights as to dividend or voting or any other right.

(b) *Preference share capital*: Preference share capital with reference to any company limited by shares means that part of the issued share capital of the company which carries or would carry a preferential right with respect to –

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate; and
- repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Deemed preference share capital: The capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:–

- that in respect of dividends, in addition to the preferential rights to the payment of dividend, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Types of Share Capital

(a) ***Nominal or Authorized Capital:*** It refers to that amount which is stated in the Memorandum of Association as the share capital of the company. The company is registered with this amount of capital. This is the maximum limit of capital which the company is authorized to issue and beyond which the company cannot issue shares unless the capital clause in the Memorandum is altered and the authorized capital is increased.

(b) ***Issued Capital:*** It refers to that part of the authorized capital of the company which has actually been offered to the public for subscription in cash and the shares allotted to vendors/promoters for consideration other than cash. It sets the limit of the capital available for subscription. The prescribed form of the Balance Sheet requires that under the head "Issued Capital", should be stated (i) the different classes of share capital as also the sub-classes of the preference shares, (ii) the date and terms of redemption or conversion (if any) of any redeemable preference capital, and (iii) any option on un-issued share capital.

(c) ***Subscribed Capital:*** It refers to that part of the issued capital which has actually been subscribed by the public and subsequently allotted to them by the directors of the company which are fully paid or partially paid.

(d) ***Called up Capital:*** It is that portion of the subscribed capital which the shareholders are called upon to pay on the shares allotted to them. A company does not necessarily require the full amount at once on the shares subscribed and hence calls up only such portion as it needs. The balance then remaining is known as uncalled capital.

(e) ***Paid-up Capital:*** It refers to that part of the called up capital which has actually been paid by the shareholders. This is the actual capital of the company which is included in the total of the Balance Sheet. Paid-up capital is equal to the called up capital if all the shareholders have paid the amount called up by the company.

Summary Table:	
Nominal/Authorised or Registered Capital	• Authorised by MOA to be the maximum amount of share capital of the company
Issued Capital	• **Part of the authorised or nominal capital** which the company issues for the time being for public subscription and allotment. • **Computed at the FV or NV.**
Unissued Capital	·**Portion of the authorized capital** which has **not yet been issued.**
Subscribed Capital	• **Portion of the issued capital** at face value which has been subscribed for or taken up by the subscribers of shares in the company. • Entire issued capital **may or may not be subscribed.**
Called Up Capital	• **Portion of Subscribed capital** which has been called up or demanded on shares.
Paid Up capital	• **Aggregate amount of money credited as paid-up as is equivalent to the amount received** as paid-up in respect of shares issued and also includes any amount credited as paid up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.
Uncalled Capital	• **Portion of the issued capital** which has not yet been called up by the company
Reserve Capital	• **Portion of uncalled share capital** which shall not be capable of being called up except in the event and for the purpose of being wound up. **(Sec.65)**

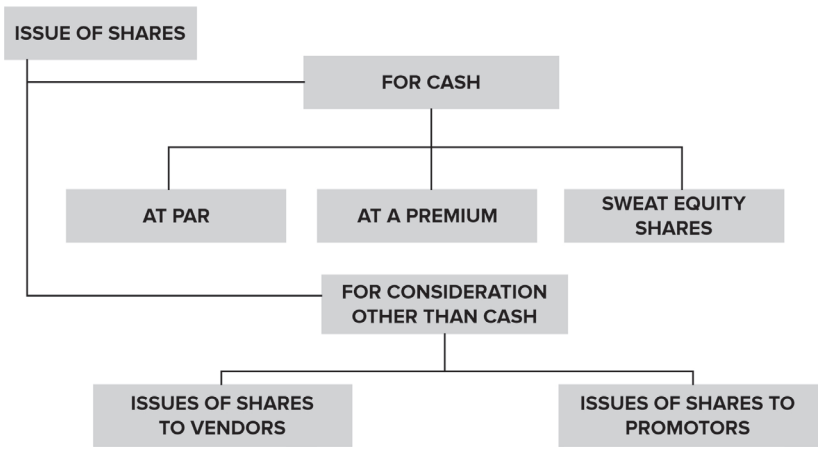
Regulatory Framework of Accounting of Company in India			
The Companies Act, 2013		**The Company Rules**	**Accounting Standards**
Chapter	IX	• The Companies (Accounts) Rules, 2014 • Companies (Declaration and Payment of Dividend) Rules, 2014 • Companies (Corporate Social Responsibility) Rules, 2014	• Common sets of **principles, standards and procedures** that define the basis of financial accounting policies and practices • AS notified under Companies (Accounting Standards) Rules, 2021) • Indian Accounting Standards (or Ind ASs) notified under Companies (Indian Accounting Standards) Rules, 2015.
Section	128-137		
Schedule	III		

ISSUE OF SHARES

When a public company desires to raise capital by issuing its shares to the public, it has to invite the public to subscribe for its shares. The invitation is made through a document called the prospectus. The person who intends to subscribe to those shares should make an application for the desired number of shares to the company. Then, the company will allot shares to the applicant.

Allotment means the appropriation of a certain number of shares to an applicant in response to his application. The company cannot allot more than the number of shares offered to the public for subscription through the prospectus. Moreover, the company cannot make allotment unless the amount stated in the prospectus as the minimum subscription has been subscribed and the sum payable on application for the stated amount has been received by the company.

If the number of shares applied for is less than the number of shares offered, the allotment can be only for the shares applied for provided minimum subscription is raised. The minimum subscription is 90% of the issued amount.



ISSUE OF SHARES FOR CASH

Issue of Shares at par

Shares are said to be issued at par when the issue price is equal to the face value or nominal value of the shares i.e. issue price is ₹ 10 and face value is also ₹ 10. When the shares are issued, the company may ask the payment of the shares either in one lump sum or in installments.

(a) When shares are issued at par and are payable in full in a lump sum:

(1)	On receipt of application money -		
	Bank	Dr.	*(With the amount received on application)*
	To Share Application and Allotment A/c		
(2)	On allotment of shares –		
	Share Application and Allotment A/c	Dr.	(With the application money received
	To Bank		excess money refunded)
	To Share Capital		(with the allotment of shares)

Note:

(i) When the capital of the company consists of shares of different classes, a separate share application account will be opened for each class of shares, i.e. equity share application account/ preference share application account etc.

(ii) Unless shares are allotted by the company, the receipt of application is simply an offer and cannot be credited to Share Capital Account.

(iii) If the company fails to raise the minimum subscription, then no shares can be allotted and the application money has to be returned to the applicants. For this, the entry will be as follows:

(iv) In actual practice, the cash transactions are not journalised but the same have to be entered in the cash book. The entry in the Cash Book will be as follows:

Dr. **Cash Book (Bank Columns)** *Cr.*

Particulars	₹	Particulars	₹
To Share Application and Allotment A/c (Received of Application money on..... shares @ ₹.....per share)	XXX	By Share Application and Allotment A/c (Refund of application money on..... shares @ ₹..... per share)	XXX

Example: A Ltd. issued 10 lakh equity shares of Rs. 10 each payable in full on application. The company received application for 10 lakh shares. Applications were accepted in full.

Journal Entries

Particulars		*Dr.*	*Cr.*
Bank	Dr.	1,00,00,000	
To Equity Share Application and Allotment A/c			1,00,00,000
(Application money on 10 lakh equity shares @ Rs. 10 per share)			
Equity Share Application and Allotment A/c	Dr.	1,00,00,000	
To Equity Share Capital A/c			1,00,00,000
(Allotment of 10 lakh equity shares of Rs. 10 each)			

(b) When shares are issued at par and the amount is payable in installments:

When shares are not payable in a lump sum, the amount can be called in a number of installments. After allotment, whenever the need arises, the directors may demand further money from the shareholders towards payment of the value of shares taken up by them. Such demands are termed as calls. The different calls are distinguished from each other by their serial numbers, i.e. first call, second call, third call and so on. The last installment is also termed the final call along with the number of the last call.

- First installment is called 'application money'
- Second installment is called 'allotment money'
- Third installment is called 'first call money' and
- The last installment is called 'second final call money'.

JOURNAL ENTRIES

(i) On receipt of application money

Bank Dr. (with the amount received on application)

To Share Application Account

(Being the application money received in respect of..... shares @ Rs. .....per share)

(ii) On allotment of shares

Share Application Account Dr. (with the amount of application money on

To Share Capital Account allotted shares)

(Being the application money on allotted shares now transferred to share capital account)

(iii) On refund of application money on rejected applications

Share Application Account Dr. (with the amount actually repaid)

To Bank

(Being application money on shares refunded)

(iv) On making the allotment money (second installment) due

Share Allotment Account Dr. (with the amount due on allotment)

To Share Capital Account

(Being the allotment money due in respect of allotment of..... shares @ Rs. ..... each)

(v) On receipt of allotment money is received the following journal entry is made

Bank Dr. (with the actual amount received as

To Share Allotment Account allotment money)

(Being the amount received on.....shares @ Rs. ..... each)

(vi) On making the first call

Share First Call Account Dr. (with the amount due on first call)

To Share Capital Account

(Being the amount due on first call @ Rs. ..... per share on.....shares)

(vii) On receipt of first call money

Bank Dr. (with the amount received on first call)

To Share First Call Account

(Being the amount received in respect of first call @ Rs. ..... per share on.....shares)

(viii) When second call is made

Share Second Call Account Dr. (with the amount due on second call)

To Share Capital Account

(Being the amount due on second call @ Rs. .... per share on.... shares)

(ix) On receipt of second call money:

Bank Dr. (With the amount actually received on second call)

To Share Second Call Account

(Being the amount received in respect of second call @ Rs. ..... per share on..... shares)

(x) When the third & final call is made:

Share Third & Final Call Account Dr. (with the amount due on final call)

To Share Capital Account

(Being the amount due on final call @ Rs. ..... per share on.....shares)

(xi) On receipt of Third & final call money:

Bank Dr. (with the amount actually received on final call)

To Share Third & Final Call Account

(Being the amount received in respect of final call @ Rs. ..... per share on..... shares)

Summary Table

Issue of Shares at Par (Issue Price = FV)

Shares issued in lump sum	Shares Issued in Instalments
(i) On receipt of application money Bank A/c Dr. To Share Application A/c **(ii) For excess share application money refunded** Share Application A/c Dr. To Bank A/c **(iii) On allotment of shares** Share Application A/c Dr. To Share Capital A/c	**(i) On receipt of application money** Bank A/c Dr. To Share Application A/c **(ii) For excess share application money refunded** Share Application A/c Dr. To Bank A/c **(iii) For share application money transferred to share capital** Share Application A/c Dr. To Share Capital A/c

	(iv) For share allotment money due Share Allotment A/c Dr. To Share Capital A/c **(v) For share allotment money received** Bank A/c Dr. To Share Allotment A/c **(vi) For share call money due** Share Call A/c Dr. To Share Capital A/c **(vii)For share call money received** Bank A/c Dr. To Share Call A/c

Issue of Shares at Premium

The shares of many successful companies which offer attractive rates of dividend on their existing capitals fetch a higher price than their face value in the market. When shares are issued at a price higher than the face value, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium. For example, if a share of Rs. 10 is issued at Rs. 12, Rs. (12 – 10) = Rs. 2 is the premium.

The premium on issue of shares must not be treated as revenue profits. On the contrary, it must be regarded as capital receipt. The Companies Act requires that when a company issues shares at a premium whether for cash or otherwise, a sum equal to the aggregate amount of the premium collected on shares must be credited to a separate account called "Securities Premium Account". There are no restrictions in the Companies Act on the issue of shares at a premium, but there are restrictions on its disposal. Under Section 52(2) of the Companies Act 2013, the Securities Premium Account may be applied by the company–

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

It is to be noted here that utilization of the amount of Securities Premium Account except in any of the modes specified above, will attract the provisions relating to the reduction of share capital of a company under the section 66 of the Companies Act 2013.

The Securities Premium Account must be shown as "Securities premium reserves" separately in the liabilities side of the balance sheet under the head "Reserves & Surplus".

The premium is usually payable with the installment due on allotment. However, some companies may charge

premium with share application money or partly with share application money and partly at the time of allotment of shares. It may be included in call money also.

JOURNAL ENTRY		
When allotment money becomes due:		
Share Allotment A/	Dr.	(with the money due on allotment including premium)
To Securities Premium A/c		(with the premium amount)
To Share Capital A/c		(with the share allotment amount)
(Being allotment money due on shares issued at premium)		

Summary Points: Issue of Shares at Premium [Section 52(2)]		
Meaning and nature	• **Share issue price > Face value** then Share issue at premium • Premium on issue of share treated as **"Capital receipt".** • Sum equal amount of premium credited to **"Securities Premium Account"**	
Restriction Note:	• No restrictions in the Companies Act on the issue of shares at a premium, but **there are restrictions on its disposal**	
Section 52(2) of the Companies Act 2013, the Securities Premium Account may be applied by the company	**I.** towards the issue of unissued shares of the company to the members of the company as fully **paid bonus shares;** **II.** **writing off the preliminary expenses** of the company; **III.** **writing off the expenses of, or the commission paid or discount allowed** on, any issue of shares or debentures of the company; **IV.** **providing for the premium payable on the redemption** of any redeemable preference shares or of any debentures of the company; or **V.** For the purchase of its own shares or other securities under **section 68.(Buy back)**	
Shown under head	Liabilities side under the head **"Reserves and Surplus"**	
Applicable section	**Section 52(2)of the Companies Act 2013**	
Security Premium vs Share premium	**Security Premium**	• It's a **broader** than Share Premium • It includes **premium on issue of shares, debentures, bonds and other financial instruments.**
	Share Premium	• It includes **premium on issue of equity share and preference shares**.
Journal Entry: ***When allotment money becomes due:*** **Share Allotment A/c** **Dr.** (with the money due on allotment including premium) **To Securities Premium A/c** (with the premium amount) **To Share Capital A/c** (with the share allotment amount)		

Example: DK & Co. Ltd. issued 5,00,00,000 Equity shares of Rs.10 each at a premium of Rs. 4 per share payable on application. The shares were all subscribed and all money due was received. Give the Journal entries to record the above transactions.

Solution:

		(Rs. In Lakhs)	(Rs. In Lakhs)
Bank A/c	Dr.	7,000	
To Share Application A/c			7,000

(Share application money on 5,00,00,000 shares @ Rs.14 per share received.)

Share Application A/c	Dr.	7,000	
To Share Capital A/c			5,000
To Securities Premium A/c			2,000

(Share application money transferred to share capital account and Securities Premium account as per Board's resolution no..... dated ...)

Example: DP & Co. Ltd. issued 5,00,00,000 Equity shares of Rs.10 each at a premium of Rs. 4 per share payable Rs. 1 per share on application, Rs.6 per share on allotment (including premium), Rs. 3 on first call and the balance on final call. The shares were all subscribed and all money due was received. Give the Journal entries and cash book to record the above transactions.

Solution:

Note:1 Journal Entries in the books of DP & Co.

	(Rs. In Lakhs)	(Rs. In Lakhs)
Equity Share Application A/c	500	
To Equity Share Capital A/c		500

(Share application money transferred to share capital account as per Board's resolution no..... dated ...)

Equity Share Allotment A/c	3000	
To Equity Share Capital A/c		1,000
To Securities Premium A/c		2,000

(Share allotment money including premium due as per Board's resolution no..... dated ...)

Equity Share First Call A/c	1,500	
To Equity Share Capital A/c		1,500

(Share first call money due as per Board's resolution no..... dated ...)

Equity Share Final Call A/c	2,000	
To Equity Share Capital A/c		2,000

(Share final call money due as per Board's resolution no..... dated ...)

Note: 2 Cash Book

In the books of DP & Co. Ltd.

Dr. **Cash Book (Rs in lacs)** *Cr.*

Particulars	Amount Rs.	Particulars	Amount Rs.
To Equity Share Application A/c	500	By Balance c/d	7,000
To Equity Share Allotment A/c	3,000		
To Equity Share 1st Call A/c	1,500		
To Equity Share Final Call A/c	2,000		
	7,000		7,000

Issue of Shares at A Discount

When shares are issued at a price lower than the face value, they are said to be issued at discount. Thus, the excess of the face value over the issue price is the amount of discount. For example, if a share of Rs. 10 is issued at Rs. 9 then Rs. (10 – 9) = Rs. 1 is the discount.

As per companies Act 2013, a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares. Any share issued by a company at a discounted price shall be void.

Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less and the companies shall also be liable to refund all the monies received with interest @12% p.a. from the date of issue of such shares to the persons to whom such shares has been issued.

REVIEW QUESTION

1. When shares are issued at a price higher than the face value, they are said to be issued at .....
2. ..... means the appropriation of a certain number of shares to an applicant in response to his application.
3. When shares are issued at a price lower than the face value, they are said to be issued at .....

Summary Points - Issue of Shares at Discount (Section-53)	
Meaning and nature	• **Share issue price < Face** value then Share issue at Discount.
A company shall not issue shares at a discount	• As per Companies Act 2013, a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares.
Legal consequences **(Prohibition on issue of shares at discount- section 53)**	• Any share issued by a company at a discounted price shall be **void.** • Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less and the companies shall also be liable to refund all the monies received with interest @12% p.a. from the date of issue of such shares to the persons to whom such shares has been issued.

RBI Act, 1934 **Banking Regulation Act,1949**	• However, company can issue shares at discount to its creditors **when its debt is converted in to shares in pursuance of any statutory resolution plan or debt restructuring scheme.**

Illustration 1:

P Ltd. was registered with an authorised capital of Rs. 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each out of which 50,000 equity shares were offered to the public for subscription. The shares were payable as under:

₹ 3 per share on application

₹ 2 per share on allotment

₹ 2 per share on 1st call

₹ 3 per share on 2nd and final call

The shares were fully subscribed for and the money was duly received.

Show the journal and cash book entries.

Solution:

In the books of P Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Equity Share Application A/c Dr.	1,50,000	
	Equity Share Allotment A/c Dr.	1,00,000	
	To Equity Share Capital A/c		2,50,000
	(Capitalization of application money @ ₹ 3 per share and allotment money due on 50,000 equity shares transferred as per Boards resolution dated.....)		
	Equity Share First Call A/c Dr.	1,00,000	
	To Equity Share Capital A/c		1,00,000
	(First call money on 50,000 equity shares @ ₹2 per share due as per Board's resolution dated.....)		
	Equity Share Second & Final Call A/c Dr.	1,50,000	
	To Equity Share Capital A/c		1,50,000
	(Second and final call money due on 50,000 Equity Shares @ Rs. 3 per share as per Board's resolution dated.....)		

Dr. **Cash Book (Bank Columns)** *Cr.*

Particulars	₹	Particulars	₹
To Equity Share Application A/c	1,50,000	By Balance c/f	5,00,000
To Equity Share Allotment A/c	1,00,000		
To Equity Share First Call A/c	1,00,000		
To Equity Share Second & Final Call A/c	1,50,000		
	5,00,000		5,00,000

Illustration 2:

Wonder Ltd. issued 10,000, 12% Preference Shares of ₹ 100 each at a premium of ₹ 10 per share payable as follows:

On Application ₹ 30

On Allotment ₹ 30 (including premium) On First Call ₹ 25

On Final Call ₹ 25

Applications were received for 12,000 shares and the directors allotted 10,000 shares and rejected applications for 2,000 shares and the money received thereon was refunded.

The allotment money was duly received while the first call money was received on 9,000 shares and the final call money on 8,000 shares.

Show the cash book and journal entries.

Solution:

In the books of Wonder Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	12% Preference Share Application A/c	Dr.	3,00,000	
	12% Preference Share Allotment A/c	Dr.	3,00,000	
	To 12% Preference Share Capital A/c			5,00,000
	To Securities Premium A/c			1,00,000
	(Capitalisation of application money @ ₹ 30 per share and allotment money due @ ₹ 30 per share shares including ₹ 10 as premium on 10,000, 12% preference as per Board's resolution dated.....)			
	12% Preference Share First Call A/c	Dr.	2,50,000	
	To 12% Preference Share Capital A/c			2,50,000

	(First call money due @ ₹ 25 per share on 10,000, 12% Preference Shares as per Board's resolution dated.....)		
	Calls-in-Arrear A/c Dr. To 12% Preference Share First Call A/c (First call money due on 1,000, 12% Pref. Shares @ ₹ 25 per share transferred to Call-in-Arrear A/c)	25,000	 25,000
	12% Preference Share Final Call A/c Dr. To 12% Preference Share Capital A/c (Final call money due @ ₹ 25 per share on 10,000, 12% Pref. shares as per Board's resolution dated...)	2,50,000	 2,50,000
	Calls-in-Arrear A/c Dr. To 12% Preference Share Final Call A/c (Final call money due on 2,000, 12% Pref. Shares @ ₹ 25 per share transferred to Calls-in-Arrear A/c)	50,000	 50,000

Dr. **Cash Book (Bank Columns)** *Cr.*

Particulars	₹	Particulars	₹
To 12% Preference Share Application and Allotment A/c (Application money on 12,000, 12% Pref. Shares @ ₹ 30 per share)	3,60,000	By 12% Preference Share Application and Allotment A/c (Refund of Application money on 2000, 12% Pref. Shares @ ₹ 30 per share)	60,000
To 12% Preference Share Application and Allotment A/c (Allotment money @ ₹ 30 per share on 10,000, 12% preference shares)	3,00,000	By Balance c/d	10,25,000
To 12% Preference Share First Call A/c (First call money @ ₹ 25 per share on 9,000, 12% Pref. Shares)	2,25,000		
To 12% Preference Share Final Call A/c (Final call money @ ₹ 25 per share on 8,000, 12% Pref. shares)	2,00,000		
	10,85,000		10,85,000

UNDER-SUBSCRIPTION OF SHARES

In actual practice, it rarely happens that the number of shares applied for is exactly equal to the number of shares offered to public for subscription. If the number of shares applied for is less than the number of shares issued the shares are said to be undersubscribed. When an issue is under-subscribed, entries are made on the basis of number of shares applied for, provided the minimum subscription is raised.

OVER-SUBSCRIPTION OF SHARES

When the number of shares applied for exceeds the number of shares issued, the shares are said to be over-subscribed. In such a situation, the directors allot shares on some reasonable basis because the company can allot only that number of shares which has been actually offered for subscription. Moreover, as per the guidelines issued by SEBI, the company cannot reject out-rightly any application for shares unless it has incomplete information or absence of signature(s) or insufficient application money and so on. In short, the following procedure is adopted:

(i) Total rejection of some applications;

(ii) Acceptance of some applications in full; and

(iii) Allotment to the remaining applicants on pro-rata basis.

The shares should be issued in tradable lot. In case of pro-rata allotment, no applicant for shares is refused and no applicant is allotted the shares in full. Each applicant receives the shares in some proportion. In such cases, the excess amount of application money (i.e. overpaid amount) is not refunded but retained and treated as a payment towards allotment money. The following journal entry is made to transfer excess application money to allotment account.

Share Application A/c	Dr.	(with the excess application money)
To Share Allotment A/c		
(Being the surplus application money transferred to share allotment account)		

Surplus money exceeding that due on allotment should be refunded to the allottees. However, the company may transfer this to Calls-in-Advance Account if:

(i) Acceptance of calls in advance is permitted by the company's Articles.

(ii) The consent of the applicant has been taken either by a separate letter or by inserting a clause in the company's prospectus.

The company can retain the calls in advance at the most so much amount as is sufficient to make the allotted shares fully paid up ultimately.

The journal entry will be as follows:

Share Application A/c	Dr.	(with the excess application money left over the amount due on application and allotment)
To Calls-in-Advance A/c		
(Being the surplus application money transferred to Calls-in-Advance Account)		

Pro Rata Allotment

Meaning:

- It means allotment of less number of shares to applicants for more number of shares on proportionate basis.

When to perform or required?

- In case of over subscription (i.e. Share applied > Shares issued (offered)

Statement showing adjustment of application money received

Category	*Shares Applied (No.)*	*Shares Allotted (No.)*	*Application Money received (Rs.)*	*Adjustment of application money received*			
				Share capital (Rs.)	*Share Allotment (Rs.)*	*Calls in Advance (Rs.)*	*Refund (Bank) (Rs.)*

Journal Entries:

Share Application A/c Dr.

To Share Capital A/c

To Share Allotment A/c

To Call in Advance A/c

To Bank A/c

CALLS-IN-ADVANCE AND INTEREST ON CALLS-IN-ADVANCE

If authorised by the articles, a company may receive from a shareholder the amount remaining unpaid on shares, even though the amount has not been called up. This is known as calls-in-advance. It is a debt of a company until the calls are made and the amount already paid is adjusted. Calls-in-advance may also arise when the number of shares allotted to a person is much smaller than the number applied for and the terms of issue permit the company to retain the amount received in excess of application and allotment money. Of course, the company can retain only so much as is required to make the allotted shares fully paid ultimately. The calls-in-advance account is ultimately closed by transfer to the relevant call accounts. It is noted that the money received on calls-in-advance does not become part of share capital. It is shown under a separate heading, namely 'calls-in-advance' on the liabilities side. No dividend is paid on calls-in-advance.

Accounting Treatment

(i) On receipt of call money in advance:

Bank A/c Dr. (with the amount of call money received in advance)

To Call-in-Advance A/c

(Being the calls received in advance)

(ii) As and when calls are made:

Calls-in-Advance A/c Dr. (with the amount adjusted on relevant call becoming due)

To Relevant Call A/c

The amount received as calls-in-advance is a debt of the company, the company is liable to pay interest on the amount of Calls-in-Advance from the date of receipt of the amount till the date when the call is due for payment. Generally the Articles of the company specify the rate at which interest is payable. If the articles do not contain such rate, Table F will be applicable & company liable to pay interest @ 12% p.a.

It is to be noted that the interest payable on Calls-in- Advance is a charge against the profits of the company. As such, Interest on Calls-in-Advance must be paid even when no profit is earned by the company.

Accounting Treatment

(i) If Interest on Calls-in-Advance is paid in cash -

Interest on Calls-in-Advance A/c Dr. (with the amount of interest paid)

To Bank A/c

(Interest on Calls-in-Advance paid @ .....% p.a. on ₹..... for..... months)

(ii) If interest on Calls-in-Advance is not paid in cash -

Interest on Calls-in-Advance A/c Dr. (with the amount of interest payable)

To Sundry Shareholders A/c

When payment is made,

Sundry shareholders A/c Dr.

To Bank A/c

(iii) At the end of the year, when interest on Calls-in-Advance is transferred to Profit and Loss A/c -

Profit and Loss A/c Dr. (with the amount of interest)

To Interest on Calls-in-Advance A/c

Note: The liability to sundry shareholders is to be treated as outstanding liability and should be shown under the head "Current Liabilities" in the balance sheet.

Summary Points- Calls-In-Advance And Interest On Calls-In-Advance	
Section 50 of Companies Act, 2013	• **Company to accept unpaid share capital, although not called up**

Section 51 of Companies Act, 2013	• **Payment of dividend in proportion to amount paid-up** • A company may, if so authorized by its articles, pay dividends in proportion to the amount paid-up on each share.
Calls in advance	• Authorized by articles of association. • **Debt of company** until calls are made an amount already paid is adjusted. • **Arises when Numbers of share allotted < shares applied for** • When calls are made, calls in advance account is ultimately closed by transfer to relevant call a/c.
Shown as	• "Calls in Advance " on liabilities side
Important note	• **Does not become part of share capital** • ***No dividend is paid on Calls in Advance.***
Interest on calls in advance **Regulation-18 of Table F of Companies Act, 2013**	• Period- from date of receipt of amount till date when call is due for payment • ***Rate of Interest-*** (a) As per AOA or (b) Subject to Max. 12% per annum as per Companies Act, 2013. [Table-F if AOA silent] • ***Charge against***- Profit of the company and must be paid.

Journal Entry:

(1) On receipt of call money in advance:

Bank	Dr.	(with the amount of call money received in advance)
To Call-in-Advance A/c		

(2) As and when calls are made:

Calls-in-Advance A/c	Dr.	(with the amount adjusted on relevant call becoming due)
To Relevant Call A/c		

(3) If Interest due on Calls-in-Advance

Interest on Calls-in-Advance A/c	Dr.	(with the amount of interest paid)
To Sundry members		

(4) On payment of Interest

Sundry Member A/c	Dr.	
To Bank A/c		

(5) At the end of the year, when interest is transferred to Profit and Loss A/c

Profit and Loss A/c	Dr.	(with the amount of interest)
To Interest on Calls-in-Advance A/c		

Note: The liability to sundry shareholders is to be treated as outstanding liability and should be shown under the head "Current Liabilities" in the balance sheet.

Example:1

GH & Co. Ltd. issued 5,000 Equity shares of Rs.10 each at par, payable Rs.2 per share on application, Rs.4 per share on allotment, Rs.4 on first call and final call. The shares were all subscribed and all money due was received. One shareholder holding 200 shares paid the call money along with the allotment money. The amount was subsequently adjusted. Give the Journal entries to record the above transactions

Solution:

		₹	₹
Bank A/c	Dr.	10,000	
To Share Application A/c			10,000
Share Application A/c	Dr.	10,000	
To Share Capital A/c			10,000
Share Allotment A/c	Dr.	20,000	
To Share Capital A/c			20,000
Bank A/c	Dr.	20,000	
To Share Allotment A/c			20,000
Bank A/c	Dr.	800	
To Calls-in-Advance A/c			800
Share 1st and Final Call A/c	Dr.	20,000	
To Share Capital A/c			20,000
Bank A/c	Dr.	19,200	
Calls-in-Advance A/c	Dr.	800	
To Share 1st and Final Call A/c			20,000

Illustration 3:

Newlook Ltd. issued, 1,00,000 Equity Shares of ₹ 10 each payable as follows:

On Application (On 1st March, 2025) ₹ 4

On Allotment (On 1st April, 2025) ₹ 1

On First Call (On 1st August, 2025) ₹ 3

On Final Call (On 1st October, 2025) ₹ 2

Application were received for 2,60,000 shares. Of these 10,000 shares were in disorder; 40,000 shares in lots of 100 shares; 1,20,000 shares in lots of exceeding 100 but less than 500 shares; 60,000 shares in lots of exceeding 500 but less than 1,000 shares and the balance in lots of exceeding 1,000 shares.

Allotment was made as follows:

Application for the 10,000 shares in disorder were rejected.

Application for 100 shares in full, i.e. 100% 40,000

Application over 100 shares but not exceeding 500 shares - 40% 48,000

Application over 500 shares but not exceeding 1,000 shares - 15% 9,000

Applications over 1,000 shares - 10% 3,000

Money received in excess on shares partially allotted was retained to the extent possible. Show the cash book and journal entries assuming that all the installments were duly received and interest was paid by the directors on calls-in-advance @ 12% per annum on 1st October, 2025.

Dr. **Cash Book (Bank Columns)** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
1.3.2025	To Equity Share Application A/c (application money @ ₹ 4 per share)	10,40,000	1.4.2025	By Equity Share Application A/c (refund of application money)	2,80,000
1.4.2025	To Equity share Allotment A/c (balance of allotment money)	40,000	1.10.2025	By Interest on Call in Advance A/c (interest @ 12% on ₹ 1,80,000 for 4 months = 7,200 and on ₹ 1,20,000 for 6 months - ₹ 7,200)	14,400
1.8.2025	To Equity Share 1st Call A/c (balance of share 1st call money)	1,20,000	1.10.2025	By Balance c/d	9,85,600
1.10.2025	To Equity Share Final A/c	80,000			
		12,80,000			12,80,000

Journal Entries

Date	Particulars	Dr. (₹)	(Cr. (₹)
1.4.2025	Equity Share Application A/c Dr.	4,00,000	
	To Equity Share Capital A/c		4,00,000
	(Being the application money on 1,00,000 shares transferred to share capital account)		
1.4.2025	Equity Share Allotment A/c Dr.	1,00,000	
	To Equity Share Capital A/c		1,00,000
	(Being the allotment money due in respect of 1,00,000 equity shares @ Re. 1 per share)		
1.4.2025	Share Application A/c Dr.	3,60,000	
	To Share Allotment A/c		60,000
	To Calls in Advance A/c		3,00,000
	(Being the transfer of surplus application money received on 60,000 shares)		

1.8.2025	Equity Share 1st Call A/c Dr. To Equity Share Capital A/c (Being the 1st call money due on 1,00,000 equity shares @ ₹ 3 per share)	3,00,000	 3,00,000
1.8.2025	Calls-in-Advance A/c Dr. To Equity Share 1st Call A/c (Being the amount transferred from calls in advance account)	1,80,000	 1,80,000
1.10.2025	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Being the final call money due on 1,00,000 equity share @ ₹ 2 per share)	2,00,000	 2,00,000
1.10.2025	Calls-in-Advance A/c Dr. To Equity Share Final Call A/c (Being the amount transferred from calls-in-advance account)	1,20,000	 1,20,000

Working Note

Statement showing the adjustment of Application Money and Calls in Advance Money

Shares applied	Shares alllotted	Amount received on applications	Amount due on applications	Balance of application money	Amount due on allotment	Amount received on allotment	Surplus to be transferred to calls-in-advance
1	2	3	4	5	6	7	8
		₹	₹	₹	₹	₹	₹
10,000	Nil	40,000	Nil	Nil	Nil	Nil	Nil
40,000	40,000	1,60,000	1,60,000	Nil	40,000	40,000	Nil
1,20,000	48,000	4,80,000	1,92,000	2,88,000	48,000	Nil	2,40,000
60,000	9,000	2,40,000	36,000	2,04,000	9,000	Nil	45,000
30,000	3,000	1,20,000	12,000	1,08,000	3,000	Nil	15,000
2,60,000	1,00,000	10,40,000	4,00,000	6,00,000	1,00,000	40,000	3,00,000

Amount to be refunded	Amount due to 1st call	Calls-in-Advance to be adjusted against 1st call	Amount payable on 1st call	Surplus remaining in calls in advance	Amount due on final call	Calls-in-advance to be adjusted against final call	Amount payable on final call
9	10	11	12	13	14	15	16
₹	₹	₹	₹	₹	₹	₹	₹
40,000	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Nil	1,20,000	Nil	1,20,000	Nil	80,000	Nil	80,000
Nil	1,44,000	1,44,000	Nil	96,000	96,000	96,000	Nil
1,50,000	27,000	27,000	Nil	18,000	18,000	18,000	Nil
90,000	9,000	9,000	Nil	6,000	6,000	6,000	Nil
2,80,000	3,00,000	1,80,000	1,20,000	1,20,000	2,00,000	1,20,000	80,000

CALLS IN ARREAR AND INTEREST ON CALLS IN ARREAR

When calls are made upon shares allotted, the shareholders holding the shares are bound to pay the call money within the date fixed for such payment. If a shareholder makes a default in sending the call money within the appointed date, the amount thus failed is called Calls-in-Arrear.

The interest on Calls-in-Arrear is recoverable according to the provisions in this regard in Articles of the company. But if the Articles are silent, Table 'F' shall be applicable which prescribes that if a sum called in respect of shares is not paid before or on the day appointed for payment, the person who failed to pay shall pay thereof from the day appointed for payment to the time of actual payment at a rate of 10% per annum. However, the directors have the right to waive the payment of interest on Calls-in-Arrear. The interest on Calls-on-Arrear Account is transferred to the Profit and Loss Account at the end of the year.

Journal Entries

(i) *When call money is in arrear:*

Calls-in-Arrear A/c Dr. (with the amount-failed by the shareholders)

To Relevant Call A/c

(ii) *On receipt of amount of Calls-in-Arrear with interest, on a subsequent date:*

Bank Dr. (with the amount received)

To Calls-in-Arrears A/c

To Interest on Calls-in-Arrear

Summary Points - Calls In Arrears	
Meaning	• Default in sending call money within appointed date by shareholder. • It is an asset account which represent the called up amount not received from some shareholders. • It is disclosed "Notes to account" – Share Capital
Interest on call in arrears	• Interest is recoverable as per AOA. • ***Period*- Form day appointed for payment** • ***Rate*- not exceeding 10% p.a. [Table-A if AOA silent]** **(*Regulation 16 of Table F of Companies Act, 2013)***
Important note	• Directors have right to waive payment of interest • **Interest is transferred to *Profit and loss a/c* at the end year**

Journal Entry:

(1) When call money is in arrear:

Calls-in-Arrear A/c Dr. (with the amount-failed by the shareholders)

To Relevant Call A/c

(2) Receipt of amount of Calls-in-Arrear on a subsequent date:

Bank Dr. (with the amount received)

To Calls-in-Arrears A/c

(3) Making due the interest on calls in arrears (with Interest due)

Sundry Members A/c Dr.

To Interest on Calls-in-Arrears A/c

(4) On receipt of Interest on calls in arrears (With Interest received)

Bank A/c Dr.

To Sundry Members A/c

(5) Transfer to P&L

Interest on calls in arrears A/c Dr.

To P&L A/c

Conceptual Explanation:

X Ltd. issued 2,000 shares of Rs. 100 each at a premium of 10% payable as follows:

On application Rs. 20 (1st April 2025). On allotment Rs. 40 (including premium) (1st June 2025). On First Call Rs.30 (1st July 2025). On Second & Final call Rs. 20 (1st Aug 2025). Applications were received for 1,800 shares and the directors made allotment in full. One shareholder to whom 40 shares were allotted paid the entire balance on his share holdings with allotment money and another share holder did not pay allotment and 1st call money on his 60 shares but which he paid with final call. Interest should be received @ 5% p.a. on calls-in-arrears and interest should be paid @ 6% p.a. on calls in Advance (as per Articles of the company). Required:

Calculated the amount of interest paid and received on calls-in-advance and calls in arrears respectively on 1st Aug. 2025.

Solution:

Interest on Calls-in-advance		**Interest on Calls-in-arrears**	
On Rs. 1200 (i.e. 40 ×Rs 30) *1/12* 6%	6	On Rs. 2400 (i.e. 60 × Rs. 40) *2/12* 5%	20
On Rs. 800 (i.e. 40 × Rs. 20) * 2/12* 6%	8	On Rs. 1800 (i.e. 60 × Rs. 30) *1/12*5%	7.5
Total Interest	**14**	**Total Interest**	**27.5**

CALLS IN ARREARS VS CALLS IN ADVANCE

Points	Call in Arrears	Calls In Advance
Meaning	Called up amount not received yet from some shareholders till the last day fixed for payment	Uncalled up amount received in advance from shareholders
Authority under AOA	No	Company may accept if AOA permits
Interest	Charged	Allowed (Charged against the profit)
Max. ROI	10% p.a.	12% p.a.
Disclosure	Share Capital Balance sheet	Current Liabilities – Other CL

Illustration 4:

On 1st January, 2025, New Ventures Ltd. issued 1,00,000 equity shares of ₹10 each payable as follows:

On application ₹ 3

On allotment ₹ 2

On 1st Call ₹ 2 (Payable after 2 months, from the date of allotment)

On Final Call ₹ 3 (Payable after 1 months from the date of 1st call)

Applications were received on 15th January, 2025 for 1,20,000 shares and allotment was made on 1st February, 2025. Applicants for 50,000 shares were allotted in full, those for 60,000 shares were allotted 50,000 shares and applications for 10,000 shares were rejected.

Balance of amount due on allotment was received on 15th February. The calls were duly made on 1st March, 2025 and 1st April, 2025 respectively. One shareholder did not pay the 1st call money on 3,000 shares which he paid with the final call together with interest at 10% p.a. Another shareholder holding 2,000 share did not pay the final call money till end of the accounting year which ended on 31st December, 2025. Show the Cash Book and Journal Entries.

Solution:

Journal Entries

Date	Particulars	Dr. (₹)	Cr.(₹)
1.2.2025	Equity Share Application A/c Dr. To Equity Share Capital A/c (Being the transfer of application money on 1,00,000 shares @ ₹ 3 per share transferred to share capital account)	3,00,000	3,00,000
1.2.2025	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being the amount due on allotment of 10,00,000 shares @ ₹ 1 per share)	2,00,000	2,00,000
1.2.2025	Equity Share Application A/c Dr. To Share Allotment A/c (Being the transfer of excess application money)	30,000	30,000
1.3.2025	Equity Share Ist Call A/c Dr. To Equity Share Capital A/c (Being the Ist call amount due on 1,00,000 shares @ ₹ 2 per share)	2,00,000	2,00,000
1.4.2025	Calls-in-Arrear A/c Dr. To Equity Share Ist Call A/c (Being the transfer of Ist call money on 3,000 equity shares @ ₹ 2 per share)	6,000	6,000
1.4.2025	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Being the final call amount due on 1,00,000 shares @ ₹ 3 per share)	3,00,000	3,00,000
1.5.2025	Calls-in-Arrear A/c Dr. To Equity Share Final Call A/c (Being the transfer of final call money on 2,000 equity shares @ ₹3 per share)	6,000	6,000
31.12.2025	Sundry Shareholders A/c Dr. To Interest on Calls-in-Arrears A/c (Being the interest due on ₹ 6,000 @ 10% for eight months)	400	400

Dr. **Cash Book (Bank Column)** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
15.1.2025	To Equity Share Application A/c (application money @ ₹ 3 per share 1,20,000 shares)	3,60,000	1.2.2025	By Equity Share Application A/c (refund of application money @ ₹ 3 per share on 10,000 shares rejected)	30,000
15.2.2025	To Equity Share Allotment A/c (balance of allotment money on ₹ 1,00,000 shares)	1,70,000	1.5.2025	By Balance c/d	9,94,050
1.4.2025	To Equity Share 1st Call A/c (1st call money on 97,000 shares)	1,94,000			
1.5.2025	To Equity Share Final A/c (final call money on 98,000 shares)	2,94,000			
1.5.2025	To Calls-in-Arrear A/c (arrears of 1st call money @ ₹ 2 per share on 3,000 shares)	6,000			
1.5.2025	To Interest on Calls- in-Arrear A/c (interest on ₹ 6,000 for one month @ 10% p.a.)	50			
		10,24,050			10,24,050

ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

A company may also issue shares for consideration other than cash to vendors who sell some assets to the company or to the promoters for their services. When shares are so issued, the Companies Act requires that the same must be clearly stated in the balance sheet and must be distinguished from the issue made for cash.

ISSUE OF SHARES TO VENDORS

A company may purchase assets from the vendors and instead of paying the vendors cash, may settle the purchase price by issuing fully paid shares of the company. This type of issue of shares to the vendors is called issue of shares for consideration other than cash.

Journal Entries

(i) When assets are acquired from the vendors -

Sundry Assets A/c (individually) Dr. (with the purchase price payable for the assets acquired)

To Vendors

(ii) When fully paid shares are issued to vendors at par -

Vendors Dr. (with the nominal value of the shares allotted)

To Share Capital A/c

(iii) When fully paid shares are issued to vendors at a premium -

Vendors Dr. (with the purchase price)

To Share Capital A/c (with the nominal value of the shares allotted)

To Securities Premium A/c (with the amount of premium)

Illustration 5:

Rocket Ltd. purchased the business of Comet Ltd. for ₹ 2,70,000 payable in fully paid shares. Rocket Ltd. allotted equity shares of ₹ 10 each fully paid in satisfaction of the claim by Comet Ltd. Show the necessary journal entries in the books of Rocket Ltd. assuming that:

(a) Such shares are issued at par,

(b) Such shares are issued at premium of 20% and

Solution:

Journal Entries

	Particulars	Dr. (₹)	Cr.(₹)
	Sundry Assets Dr.	2,70,000	
	To Comet Ltd.		2,70,000
	(Purchase of assets from Comet Ltd. as per agreement dated.....)		
(a)	If shares are issued at par	2,70,000	
	Comet Ltd. Dr.		2,70,000
	To Equity Share Capital A/c		
	(Allotment of 27,000 equity shares of ₹ 10 each to vendors as fully paid-up for consideration other than cash as per Board's resolution dated...)		
(b)	If shares are issued at a premium of 20%		
	Comet Ltd. Dr.	2,70,000	
	To Equity Share Capital A/c		2,25,000
	To Securities Premium A/c		45,000
	(Allotment of 22,500 equity shares of ₹ 10 each at a premium of ₹2 per share to vendors as fully paid-up for consideration other than cash as per Board's resolution dated.....)		

Working Notes:

1. When shares are issued at a premium of 20%

Issue price per share = ₹ 10 $\frac{20}{100}$ = ₹ 12

No. of shares to be allotted = $\frac{₹\ 2,70,000}{= ₹\ 12}$ = ₹ 22,500

ISSUE OF SHARES TO PROMOTERS

A company may allot fully paid shares to promoters or any other party for the services rendered by them by way of furnishing technical information, engineering services, plant layout, drawing and designing, etc. without payment. This type of issue of shares to promoters is called issue of shares for consideration other than cash. As the amount paid to promoters for services rendered by them is supposed to be utilised by the company over a long period of time, such expenditure should be treated as capital expenditure and debited to Goodwill Account. The accounting entry in such a case will be as follows:

Goodwill A/c	Dr.	(with the nominal value of the shares allotted.)
To Share Capital A/c		

Illustration 6:

Bright Ltd. was registered with a share capital of ₹ 10,00,000 in equity shares of ₹ 10 each. The company acquired factory building worth ₹ 1,00,000 and plant and machinery worth ₹ 80,000 from Delite Ltd. and issued 18,000 equity shares of ₹ 10 each to the vendors as fully paid-up. The directors also decided to allot 2,000 equity shares credited as full paid to the promoters for their services. Further capital was issued to the public for cash to the extent of ₹ 3,00,000 payable in full with the application. All the shares were taken up by the public and fully paid for. Show the necessary journal entries and the balance sheet.

Solution:

Journal Entries

Particulars		Dr. (₹)	Cr.(₹)
Factory Building A/c	Dr.	1,00,000	
Plant and Machinery A/c	Dr.	80,000	
To Delite Ltd.			1,80,000
(Purchase of assets from Delite Ltd. as per agreement dated.....)			
Delite Ltd.	Dr.	1,80,000	
To Equity Share Capital A/c			1,80,000
(Allotment of 18,000 equity shares of ₹ 10 each to vendors as fully paid-up for consideration other than cash as per Board's resolutions dated.....)			

Goodwill A/c	Dr.	20,000	
To Equity Share Capital A/c			20,000
(Allotment of 2,000 equity shares of ₹ 10 each to promoters as fully paid-up for consideration other than cash as per Board's Resolution dated.....)			
Bank	Dr.	3,00,000	
To Equity Share Application and Allotment A/c			3,00,000
(Application money on 30,000 equity shares ₹ 10 each per share)			
Equity Share Application and Allotment A/c	Dr.	3,00,000	
To Equity Share Capital A/c			3,00,000
(Allotment of 30,000 equity shares of ₹ 10 each as fully paid as per Board's resolution dated.....)			

Balance Sheet of Bright Ltd., as at.....

	Particulars	Note No.	Amount (₹)
I	Equity and Liabilities		
	Shareholders' Funds		
	Share Capital	1	5,00,000
	Total		5,00,000
II	Assets		
	Non-current Assets		
	Fixed Assets		
	Tangible Assets	2	1,80,000
	Intangible Assets	3	20,000
	Current Assets		
	Cash and Cash Equivalents	4	3,00,000
	Total		5,00,000

Notes:

1. Share Capital

Authorised	
1,00,000 Equity Shares of ₹ 10 each	10,00,000
Issued, Subscribed and Paid-up :	
50,000 Equity Shares of ₹ 10 each, fully paid-up	5,00,000
(Of the above shares, 20,000 equity shares have been issued to vendors and promoters for consideration other than cash)	

2.	**Tangible Assets**	
	Factory Building	1,00,000
	Plant and Machinery	80,000
		1,80,000
3.	**Intangible Assets**	
	Goodwill	20,000
4.	**Cash and Cash Equivalent**	
	Balance with Bank	3,00,000

Summary Points - Issue of Shares for Consideration other than Cash	
Meaning:	Any allotment of shares against which cash is not to be received
Cases:	1. Shares are issued to the promoters 2. Allot its shares to vendors/ creditors in lieu of cash 3. Shares are also issued/ exchanged during a business purchase or merger of the companies (Not covered in Syllabus)

Case-1 Issue of shares to Promoters	
Meaning and nature	• For furnishing technical information, egg. Services, plant layout. Drawing and designing without payment i.e. for consideration other than cash.
Treatment of exp paid to promoters	• **Treated as *"Capital expenditure"* and debited to *"Goodwill account"***

Case-2 Allot its shares to vendors/ creditors

(1) When assets are acquired from the vendors

Sundry Assets A/c	Dr.	(with the purchase price payable for the assets acquired)
To Vendors		

(2) When fully paid shares are issued to vendors at par/premium:

Vendors	Dr.	(with the purchase price)
To Share Capital A/c		(with the nominal value of the shares allotted)
To Securities Premium A/c		(with the amount of premium)

Case-3 Shares are also issued/ exchanged during a business purchase or merger of the companies		
(1) On purchase of business:		
Sundry Assets A/c	Dr.	(at agreed purchase price)
Goodwill A/c (Bal.)	Dr.	(Difference between purchase price and net assets acquired)
To Capital Reserve (Bal.)		(Difference between purchase price and net assets acquired)
To Sundry Liabilities A/c		
To Vendor A/c		
(2) On par payment to vendor:		
Vendor A/c	Dr.	
To Cash A/c		
To Bank A/c		
To Bills Payable A/c (If)		
(3) On issue of Shares		
Vendors	Dr.	(with the purchase price)
To Share Capital A/c		(with the nominal value of the shares allotted)
To Securities Premium A/c		(with the amount of premium)

Practice Question:

[1] B Ltd purchase the assets of Rs. 10,80,000 from C Ltd. The consideration was payable in fully paid equity shares of Rs. 100 each.

Required: Show the necessary journal entries in books of B Ltd. assuming that —

- Such shares are issued at par
- Such shares are issued at premium of 20%

Solution:

Case: 1 Shares are issued at Par

Sundry Assets A/c	Dr.	1080000	
To C Ltd.			1080000

[Being the purchase of assets from Y Ltd. as per agreement dated...)

C Ltd.	Dr.	1080000	
To Equity Share Capital A/c			1080000

(Being the issue of 10,800 shares at par to C Ltd. as per agreement dated...)

Case:2 Shares are issued at premium of 20%

Sundry Assets A/c	Dr.	1080000	
To C Ltd.			1080000

[Being the purchase of assets from Y Ltd. as per agreement dated...)

C Ltd.	Dr.	1080000	
To Equity Share Capital A/c			900000
To Security Premium			180000

(Being the issue of 9000 shares at par to C Ltd. i.e. 1080000/120)

[2] D Ltd. issued 2,000 shares of Rs.100 each credited as fully paid to the promoters for their services and issued 1,000 shares of Rs.100 each credited as fully paid to the underwriters for their underwriting services. Journalise these transactions.

Solution:

Goodwill A/c	Dr.	200000	
To Share Capital A/c			200000

(Being the issue of 2,000 shares of Rs.100 each at par to promoters

Underwriting Commission A/c	Dr.	100000	
To Underwriter's A/c			100000

(Being the Underwriting commission due on shares)

Underwriter's A/c	Dr.	100000	
To Share Capital A/c			100000

(Being the issue of 1,000 shares of Rs.100 each at par to Underwriters as per the Board's Resolution no..... dated.....)

FORFEITURE OF SHARES TABLE-F OF COMPANIES ACT, 2013 (REGULATIONS 28 TO 34)

If a shareholder fails to pay the allotment money and/or calls made on him, his shares are liable to be forfeited. Forfeiture of shares may be said to be the compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.

The Companies Act does not contain any specific provisions regarding forfeiture. The directors must follow certain procedure for forfeiting the shares. They have to give notice to the defaulting shareholder calling upon him to pay the amount due from him together with interest before a specified date (not being earlier than the expiry of fourteen days from the date of service of the notice). This notice must also state that if the shareholder fails to pay the amount along with interest due within the specified date, the shares will be forfeited. If the payment is not received within the specified time, the directors meet to consider the forfeiture and they can proceed to forfeit the shares. The directors must pass a resolution for forfeiting the shares at a duly constituted meeting of the Board of Directors and the defaulting shareholder should be informed about the forfeiture of his shares.

The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in the shares and ceases to be a member. The name of the shareholder is removed from the Register of Members and the amount already

paid by him is forfeited. He is not entitled in future to dividends and the rights of membership. However, the directors have the right to cancel such forfeiture before the forfeiture shares are re-issued.

Forfeited shares account is to be shown in the balance sheet by way of addition to the paid-up share capital on the 'liabilities' side, until the concerned shares are reissued.

Accounting Entries on Forfeitures of Shares

- **Issued at Par**
- **Issued at A Premium**

Forfeiture of Shares Issued at Par

JOURNAL ENTRIES

The forfeiture of shares can be recorded in two ways:

1. Where the unpaid calls have already been transferred to Calls-in-Arrear A/c and the respective call accounts have been closed:

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited i.e. no. of shares forfeited x the called up value per share.
To Shares Forfeited A/c		with the amount already paid-up by the shareholders on the shares forfeited.)
To Calls-in-Arrear A/c		(with the amount of unpaid calls.)

OR

2. Where the unpaid calls have not been transferred to Calls-in-Arrear A/c and the respective call accounts are showing balances representing unpaid amounts:

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited i.e., no. of shares forfeited x the called up value per share.)
To Shares Forfeited A/c		(with the amount already paid up by the shareholders on the shares forfeited.)
To Share Allotment A/c		(with the amount failed on allotment, if any.)
To Share First Call A/c		(with the amount failed on first call, if any.)
To Share Final Call A/c		(with the amount failed on final call, if any.)

Forfeiture of Shares Issued at a Premium

Case 1: Where shares to be forfeited were issued at a premium and the premium money remained unpaid:

In this case the credit already given to the 'Securities Premium A/c' will be cancelled at the time of forfeiture of the shares by debiting "Securities Premium A/c".

JOURNAL ENTRIES

Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited, i.e., no. of shares forfeited x called up value per share excluding premium).
Securities Premium A/c	Dr.	(with the amount of premium money remaining unpaid on shares forfeited.)
To Shares Forfeited A/c		(with the amount already paid by the shareholders on the shares forfeited.)
To Calls-in-Arrear A/c		(with the amount unpaid on calls.)
OR		
Share Capital A/c	Dr.	(with the amount of called up value of shares forfeited, i.e., no. of shares forfeited x called up value per share excluding premium.)
Securities Premium A/c	Dr.	(with the amount of premium money remaining unpaid on shares forfeited.)
To Shares Forfeited A/c		(with the amount already paid by the shareholders on the shares forfeited.)
To Share Allotment A/c		(with the amount failed on allotment, if any.)
To Share First Call A/c		(with the amount failed on first call, if any.)
To Share Final Call A/c		(with the amount failed on final call, if any.)

Case 2: Where shares to be forfeited were issued at a premium and the premium money was duly received on the shares to be forfeited: In this case Securities Premium Account is already credited at the time of making call will not be cancelled at the time of forfeiture of the shares. In such a case, the accounting entry on forfeiture will be the same as the one passed in case of shares issued at par.

RE-ISSUE OF FORFEITED SHARES

The Board of Directors can sell/ reissue or dispose of forfeited shares on such terms as it thinks fit. However, the amount receivable on re-issue of such shares together with the amount already received from the defaulting member, shall not, in any case, be less than the face value of the shares. Forfeited shares may be re-issued at par, at a premium or even at a discount.

Re-Issue of Forfeited Shares - At Par

The forfeited shares can be re-issued at par. In such a case, the entire amount standing to the credit of Shares Forfeited Account for those shares would be treated as net gain and transferred to Capital Reserve Account.

JOURNAL ENTRIES

1. On re-issue of shares:

Bank	Dr.	(with the amount received on reissue i.e. no. of shares re-issued x amount received per share.)
To Share Capital A/c		

2. On transfer of Shares Forfeited Account to Capital Reserve Account:

Shares Forfeited A/c	Dr.	(with the forfeited amount on shares re-issued.)
To Capital Reserve A/c		

Re-Issue of Forfeited Shares - At a Premium

If forfeited shares are re-issued at a premium, the amount of such premium should be credited to Securities Premium Account. In such a case also, the entire amount standing to the credit of Shares Forfeited Account would be treated as net gain and transferred to Capital Reserve Account.

JOURNAL ENTRIES

1. On re-issue of shares:

Bank	Dr.	(with the total amount received on re- issue.)
To Share Capital A/c		(with nominal value or paid-up value of shares.)
To Securities Premium A/c		(with the premium amount received.)

2. On transfer of Shares Forfeited A/c to Capital Reserve A/c:

Shares Forfeited A/c	Dr.	(with the forfeited amount on shares re-issued)
To Capital Reserve A/c		

Re-Issue of Forfeited Shares - At a Discount

If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account. Discount thus allowed on re-issue has to be debited to Shares Forfeited Account. If the discount allowed on re-issue is less than the forfeited amount, there will be a surplus left in the Shares Forfeited Account which will be treated as net gain on forfeiture. As this gain is in the nature of capital profits, it should be transferred to Capital Reserve Account. Capital Reserve Account will appear on the liabilities side of the balance sheet under the head “Reserves and Surplus”.

JOURNAL ENTRIES

1. On re-issue of shares:

Bank	Dr.	(with the amount received on re-issue.)
Shares Forfeited A/c	Dr.	(with the discount allowed on re-issue.)
To Share Capital A/c		(with the total.)

2. On transfer of balance in Shares Forfeited Account, if any, to Capital Reserve Account:

Shares Forfeited A/c	Dr.	(with the net gain, if any, on shares re-issued.)
To Capital Reserve A/c		

Important Note: *In case only a part of the forfeited shares are re-issued, only the proportionate amount representing the net gain on the shares re-issued should be transferred to Capital Reserve Account and the balance representing the amount received on forfeited shares not yet re-issued should be left in the Shares Forfeited Account itself. This amount should be shown as addition to the paid up capital on the liabilities side of the balance sheet.*

Summary Points – Reissue of Shares		
[1] Reissue		
At Par	**At Discount**	**At Premium**
Bank **Dr.** **To Share Capital A/c** (with the amount received on reissue)	**Bank** **Dr.** **Sh. FF A/c (Dis. Allowed)** **To Share Capital A/c** (with the amount received on reissue)	**Bank** **Dr.** **To Security Premium A/c** **To Share Capital A/c** (with the amount received on reissue)
[2] Transfer of Share forfeiture to Capital Reserve		
Shares Forfeited A/c **Dr.** (with the forfeited amount on shares re-issued.) **To Capital Reserve A/c** **[Refer Note:1]**		

Note: 1 Amount Transfer to Capital Reserve		
Particulars	**Defaulter -1**	**Defaulter -2**
Amount forfeited on reissue [(Total Amt Forfeited/No. of sh Forefeited) * No of sh Reissue]	***	***
Less:		
Re-issue Discount (No of sh reissue * Discount)	***	***
Profit on reissue of shares transfer to Capital Reserve	***	***

Note:1A Treatment of Transfer of balance of share forfeiture	
All Forfeited shares reissued	Cr. Balance left on sh. Forfeited A/c transfer to Capital Reserve
Few Forfeited shares reissued	Profit transfer to Capital Reserve Balance transfer to Notes to Account "Share Capital"

Note:

In a situation when only ***part of shares forfeited be re-issued****. In such a case,* ***only the respective proportionate amount which represents the net gain on shares that are re-issued shall be transferred to the Capital Reserve Account*** *and the balance which represents the amount that is received on the forfeited shares,* ***not yet re-issued, must be left in Shares Forfeited Account itself.***

Examples:[1] XD Ltd. forfeited 500 equity shares of Rs.10 each fully called up which were issued at a premium 20%. Amount payable on shares were: on application Rs.2; on allotment Rs.5; on first and final call Rs.5. Only application money was paid by the shareholders in respect of these shares. 300 shares out of the above were reissued at Rs.9 per share fully paid. Pass journal entries for the forfeiture and re-issue.

Solution:

In the books of XD Ltd.		Dr.	Cr.
Equity Share Capital A/c	Dr. (500*100)	5000	
Securities Premium A/c	Dr. (500*2)	1000	
To Equity Share Allotment A/c (500 × 5)	(or calls in Arrear A/c)		2500
To Equity Share Final Call A/c (500 × 5)			2500
To Forfeited Shares A/c (500 × 2)			1000

(Being the forfeiture of 500 equity shares of Rs.10 each fully called up for non-payment of allotment and final call money as per board resolution number. ..... Dated)

Bank A/c	Dr. (300*9)	2700	
Forfeited Share A/c	Dr. (300*1)	300	
To Equity Share Capital A/c			3000

(Being reissue of 300 forfeited shares at Rs.9 per share fully paid as per Board's resolution number ..... Dated...)

Forfeited Share A/c	Dr.	300	
To Capital Reserve A/c			300

(Being net profit on forfeiture and re-issue of 300 shares transferred to Capital Reserve)

Note:1

Profit on forfeiture (1000/500) *300	600
Less: Discount on re-issue (300 *1)	300
Net profit to be transferred to Capital Reserve	**300**

Illustration 7:

X Ltd. forfeited 1,000 equity shares of ₹ 10 each issued at par for non-payment of the first call of ₹ 2 per share and the final call of ₹ 3 per share. Give journal entry for the forfeiture.

Solution:

In the books of X Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	Equity Share Capital A/c (1,000 x ₹10)*	Dr.	10,000	
	To Shares Forfeited A/c (1,000 x ₹ 5)*			5,000
	To Calls-in-Arrear A/c (1,000 x ₹ 5)			5,000
	(Forfeiture of 1,000 equity shares for non-payment of the first call @ ₹ 2 per share and the final call @ ₹ 3 per share as per Board's resolution dated...)			
	Alternative			
	Equity Share Capital A/c (1,000 x ₹10)*	Dr.	10,000	
	To Shares Forfeited A/c (1,000 x ₹ 5)*			5,000
	To Equity Share First Call A/c			2,000
	To Equity Share Final Call A/c			3,000
	(Forfeiture of 1000 equity shares for non-payment of the first call @ ₹ 2 per share and the final call @ ₹ 3 per share as per Board's resolution dated...)			

Illustration 8:

X Ltd. forfeited 1,500 equity shares of ₹ 10 each, issued at a premium of ₹ 5 per share for non-payment of allotment money of ₹ 8 per share (including share premium ₹ 5 per share) the first call @ ₹ 2 per share and the final call @ ₹ 3 per share. Give the journal entry for the forfeiture.

Solution

In the books of X Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	Equity Share Capital A/c (1,500 x ₹10)*	Dr.	15,000	
	Securities Premium A/c (1,500 x ₹5)*	Dr.	7,500	
	To Shares Forfeited A/c (1,500 x ₹ 2)*			3,000
	To Equity Share Allotment A/c			12,000
	To Equity Share First Call A/c			3,000
	To Equity Share Final Call A/c			4,500
	(Forfeiture of 1,500 equity shares of ₹ 10 each for non- payment of allotment money @ ₹ 8 per share, including a premium @ ₹ 5 per share, first call money @ ₹ 2 per share and the final call money @ ₹ 3 per share as per Board's resolution dated...)			

Illustration 9:

X Ltd. forfeited 1,500 equity shares of ₹ 10 each issued at a premium of ₹ 5 per share payable with the allotment money, for non-payment of the first call money of ₹ 2 per share and the final call money of ₹ 3 per share. Give journal entries.

Solution:

In the books of X Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	Equity Share Capital A/c (1,500 x ₹10)*	Dr.	15,000	
	To Shares Forfeited A/c (1,500 x ₹ 5)*			7,500
	To Equity Share First Call A/c			3,000
	To Equity Share Final Call A/c			4,500
	(Forfeiture of 1,500 equity shares of ₹ 10 each for non- payment of the first call money @ ₹ 2 per share and the final call money @ ₹ 3 per share as per Board's resolution dated...)			

Note: *As the premium has already been received on these shares, Securities Premium Account will not be debited.*

Illustration 10:

Give journal entries for the forfeiture and re-issue of shares in the following cases:

(a) P Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 10 per share as fully paid-up.

(b) Q Ltd. forfeited 300 shares of ₹ 10 each, fully called up for non-payment of final call @ ₹ 4 per share. These shares were subsequently re-issued by the company @ ₹ 12 per share as fully paid-up.

(c) R Ltd. forfeited 200 shares of ₹ 10 each, ₹ 8 per share being called up on which a shareholder paid application and allotment money @ ₹ 5 per share but did not pay the first call money @ ₹ 3 per share. Of these forfeited shares, 150 shares were subsequently re-issued by the company as fully paid-up @ ₹ 8 per share.

Solution:

(a) In the books of P Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c (300 x ₹10) Dr.	3,000	
	To Shares Forfeited A/c (300 x ₹ 6)		1,800
	To Share Final Call A/c (300 x ₹ 4)		1,200
	(Forfeiture of 300 shares of ₹ 10 each for non-payment of the final call money @ ₹ 4 per share as per Board's resolution dated...)		
	Bank Dr.	3,000	
	To Share Capital A/c (300 x ₹10)		3,000
	(Re-issue of 300 forfeited shares of ₹ 10 each fully paid-up as per Board's resolution dated...)		
	Shares Forfeited A/c Dr.	1,800	
	To Capital Reserve A/c		1,800
	(Transfer of profit on re-issue of forfeited shares to Capital Reserve A/c)		

(b) In the books of Q Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c (300 x ₹10) Dr.	3,000	
	To Shares Forfeited A/c (300 x ₹ 6)		1,800
	To Share Final Call A/c (300 x ₹ 4)		1,200
	(Forfeiture of 300 shares of ₹ 10 each for non-payment of the final call money @ ₹ 4 per share as per Board's resolution dated...)		
	Bank (300 x ₹12) Dr.	3,600	
	To Share Capital A/c (300 x ₹10)		3,000
	To Securities premium A/c (300 x ₹ 2)		600
	(Re-issue of 300 forfeited shares of ₹ 10 each at a premium of ₹ 2 per share as per Board's resolution dated...)		

	Shares Forfeited A/c Dr.	1,800	
	To Capital Reserve A/c		1,800
	(Transfer of profit on re-issue of forfeited shares to Capital Reserve A/c)		

(c) In the books of R Ltd.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
	Share Capital A/c (200 x ₹8) Dr.	1,600	
	To Shares Forfeited A/c (200 x ₹ 5)		1,000
	To Share First Call A/c (200 x ₹ 3)		600
	(Forfeiture of 200 shares of ₹ 10 each, ₹ 8 being called up for non-payment of the first call money @ ₹ 3 per share as per Board's resolution dated...)		
	Bank (150 x ₹8) Dr.	1,200	
	Shares Forfeited A/c (150 x ₹2)	300	
	To Share Capital A/c (150 x ₹10)		1,500
	(Re-issue of 150 forfeited shares of ₹ 10 each fully paid-up @ ₹ 8 per share as per Board's resolution dated...)		
	Shares Forfeited A/c (1000/200 x 150 – 300 = 450) Dr.	450	
	To Capital Reserve A/c		450
	(Transfer of capital profit proportionate to forfeited shares re- issued i.e. on 150 shares to Capital Reserve A/c)		

REVIEW QUESTION

1. A company forfeited 1,000 shares of ₹ 10 each held by Mr. X for non-payment of allotment money of ₹ 4 per share. Called up value is ₹ 9 what will be total amount debited to share capital?
2. A company forfeited 2000 shares of ₹ 10 each for non-payment of final call of ₹ 2 per share. What will be the amount of share forfeiture account?

Illustration-11

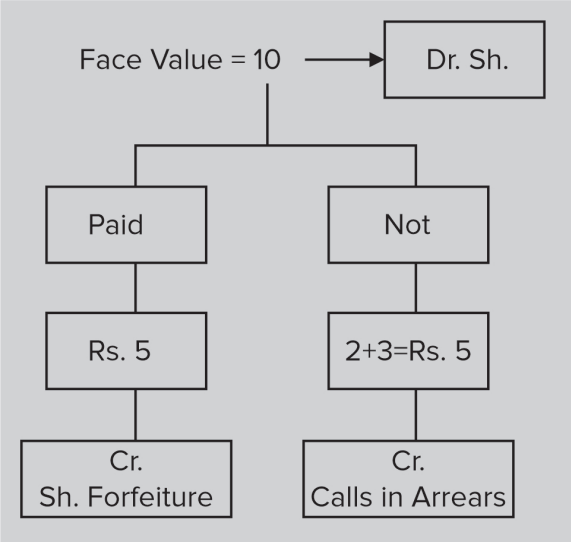
Give journal entries for the following:

1. P Ltd. forfeited 10,000 equity shares of Rs.10 each for non-payment of first call of Rs.2 and final call of Rs.3 per share. These shares were reissued at a discount of Rs.3.50 per share.
2. K Ltd. forfeited 20,000 equity shares of Rs.15 each (including Rs.5 per share as premium), for non-payment of final call of Rs.3 per share. Out of these 10,000 shares were reissued at a discount of Rs.4 per share.

3. KP Ltd. forfeited 15,000 equity shares of Rs.15 each (including Rs.5 per share as premium), for non-payment of allotment money Rs.8 (including premium money) and first & final call of Rs.5 per share. Out of these 10,000 shares were reissued at Rs.14 per share.

Solution:

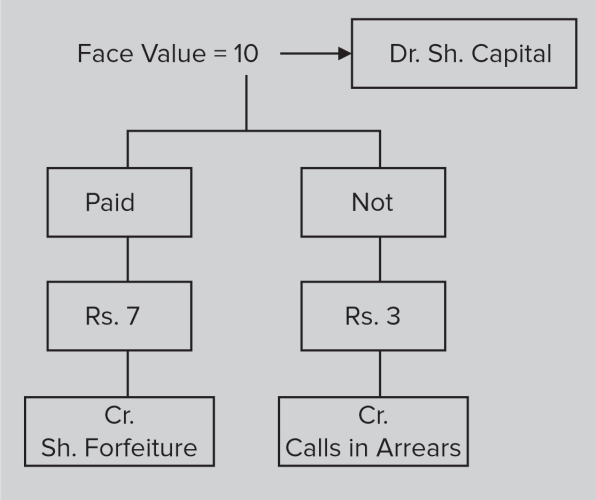
Case: 1



Journal Entries in the book of P ltd.

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
	Equity Share Capital A/c Dr.(10000*10)		1,00,000	
	To Calls in Arrear A/c (10000*5)			50,000
	To Forfeited Share A/c (10000*5)			50,000
	(Being 10,000 shares forfeited for non-payment of first and final call money)			
	Bank A/c Dr. (10000*6.50)		65,000	
	Forfeited Share A/c Dr. (10000*3.50) **[Discount]**		35,000	
	To Equity Share Capital Account (10000*10)			1,00,000
	(Being reissue of 10,000 sh. @ ₹ 6.50 each)			
	Forfeited Share A/c Dr.		15,000	
	To Capital Reserve A/c [50,000-35,000]			15,000
	(Being Balance of Forfeited share Account transferred)			

Case: 2



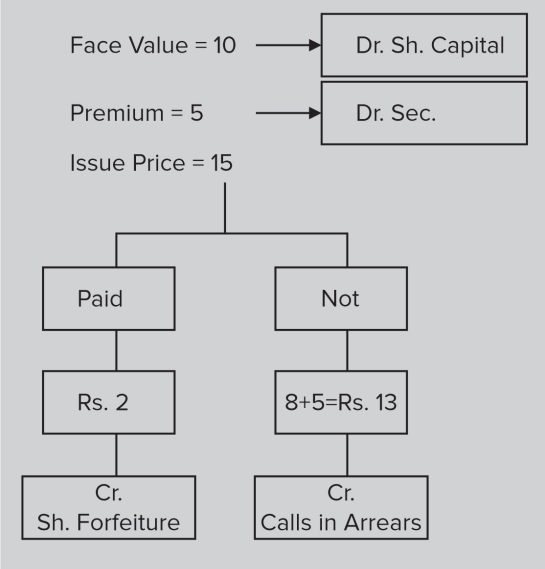
Note:

Here, **forfeited shares were issued at a premium and the premium money was duly received on the shares to be forfeited**. Hence, **accounting entry** on forfeiture will be **the same** as the one passed in case **of shares issued at par**.

Journal Entries in the book of K ltd.

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
	Equity Share Capital A/c Dr.(20000*10)		200,000	
	To Calls in Arrear A/c (20000*3)			60,000
	To Forfeited share A/c (20000*7)			140,000
	(20,000 shares forfeited for non-payment of final call money)			
	Bank A/c Dr. (10000*6)		60,000	
	Forfeited Share A/c Dr. (10000*4) **[Discount]**		40,000	
	To Equity Share Capital A/c (10000*10)			1,00,000
	(Reissue of 10,000 sh. @ ₹ 6 each)			
	Forfeited Share A/c Dr.		30,000	
	To Capital Reserve A/c			30,000
	(Being balance of Forfeited share A/c relating to 10,000 shares transferred)			
	[Forfeited Amt Per share – Discount Amt per share)* No. of shares Reissue] = [(7-4)*10000] =30,000			

Case: 3



Note:

Here, **forfeited shares were issued at a premium and the premium money was not received on the shares to be forfeited**.

Journal Entries in the book of KP ltd.

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
	Equity Share Capital A/c Dr. (15000*10)		1,50,000	
	Securities Premium A/c Dr. (15000*5)		75,000	
	To Calls in Arrear A/c (15000*13)			1,95,000
	To Forfeited share A/c (15000*2)			30,000
	(Being 15,000 shares forfeited for non-payment of allotment and first and final call money)			
	Bank A/c Dr. (10000*14)		1,40,000	
	To Security Premium A/c (10000*4)			40,000
	To Equity Share Capital A/c (10000*10)			1,00,000
	(Being reissue of 10,000 sh. @ ₹ 15 each)			
	Forfeited Share A/c Dr.		20,000	
	To Capital Reserve A/c			20,000
	(Being Balance of Forfeited share A/c transferred)			
	[Forfeited Amt Per share – Discount Amt per share)* No. of shares Reissue] = [(2-0)*10000] =20,000			

FORFEITURE AND RE-ISSUE OF SHARES ALLOTTED ON PRO-RATA BASIS IN CASE OF OVER-SUBSCRIPTION

In case, the shares of a Company are over-subscribed, it is not possible for the company to satisfy the demand of all the applicants. In such a case allotment may be made on pro-rata basis, i.e., proportionately. For example, 10,000 shares are allotted pro-rata among the applicants for 12,000 shares. In this case, the ratio between allotment of shares and application for shares will be 10,000: 12,000 or 5:6, i.e., those applying for every 6 shares will be allotted 5 shares.

If shares are allotted on pro-rata basis, the excess application money received on shares allotted will be retained by the company and adjusted subsequently against allotment money and/or call money.

If such shares are subsequently forfeited for non-payment of allotment money and/or call money, the entries will be the same, but it may involve some difficulty in calculation. In such a case, it is to be noted carefully that if there is any excess amount received along with the application and it is adjusted against the allotment money which is failed by the shareholder, such amount should be deducted from the amount due on allotment to arrive at the net amount defaulted by the shareholder.

Illustration 11:

A limited company issued a prospectus inviting applications for 2,000 shares of ₹ 10 each at a premium of ₹ 2 per share payable as follows:

On Application	--	₹ 2
On Allotment	--	₹ 5 (including premium)
On First Call	--	₹ 3
On Second and Final Call	--	₹ 2

Applications were received for 3,000 shares and allotment was made pro-rata to the applicants of 2,400 shares. Money overpaid on applications was employed on account of sum due on allotment.

Ramesh, to whom 40 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Mohan, the holder of 60 shares failed to pay the two calls and his shares were forfeited after the second and final call.

Of the shares forfeited, 80 shares were sold to Krishna credited as fully paid for ₹ 9 per share, the whole of Ramesh's share being included. Show journal and cash book entries and the Balance Sheet.

Solution:

Working Notes:

1. Ratio between allotment of shares and application for shares = 2,000: 2,400 = 5: 6,
2. Ramesh was allotted 40 shares.

   Therefore, Ramesh must have applied for 40 x 6/5 = 48 shares.
3. Ramesh must have paid excess application money on (48 - 40) = 8

   Excess applications @ ₹ 2 per share, i.e., 8 x ₹ 2 = ₹ 16 retained by the company for adjustment against allotment money.
4. Allotment money due from Ramesh on 40 shares @ ₹ 5 per share = 40 x ₹ 5 = ₹ 200.

5. As the allotment money was failed by Ramesh against which excess money paid on application was adjusted, the net amount failed by Ramesh on Allotment = ₹ (200 - 16) = ₹ 184.

6. As Mohan paid the allotment money and the excess amount paid by him along with the application had already been adjusted, pro rata allotment in this case has no significance.

7. Amount to be transferred to Capital Reserve A/c from Shares Forfeited A/c has to be determined as follows:

	₹
Amount forfeited on 40 shares held by Ramesh (48 x ₹ 2)	96
Amount forfeited on 60 shares held by Mohan (60 x ₹ 5)	300
Total amount credited to Shares Forfeited A/c	396
Less: Amount on 20 forfeited shares held by Mohan which are not yet re-issued (20 x ₹ 5)	100
	296
Less: Discount allowed @ ₹ 1 on 80 shares (80 x ₹ 1)	80
Net gain on 80 forfeited shares which are reissued to be transferred to Capital Reserve	216

Dr. **Cash Book (Bank Column)** *Cr.*

Particulars	₹	Particulars	₹
To Share application A/c (Application money on 3000 shares @ ₹ 2 per share)	6,000	By Share Application A/c (Refund of application money on 600 shares rejected @ ₹ 2 per share)	1,200
To Shares Allotment A/c (Balance of allotment money on 2,000 shares less amount failed by Ramesh)	9,016*	By Balance c/d	24,036
To Share First Call A/c (First call money on 1900 shares, i.e., 2000 shares - (40 + 60) shares @ ₹ 3 per share)	5,700		
To Shares Final call A/c (Final call money on 1900 shares, i.e., 1960 shares less 60 shares held by Mohan who failed @ ₹ 2 per share)	3,800		
To Share Capital A/c (Amount received on re-issue of 80 forfeited shares @ ₹ 9 per share)	720		
	25,236		25,236
To Balance b/d	24,036		

* (10000 – 40 x 5 + 16 – 800)

Journal Entries

Particulars		Dr. (₹)	Cr.(₹)
Share Application A/c	Dr.	4,000	
To Share Capital A/c			4,000
(Transfer of application money to share capital account as per Board's resolution dated...)			
Share Allotment A/c	Dr.	10,000	
To Share Capital A/c			6,000
To Securities Premium A/c			4,000
(Allotment of 2000 shares to the applicants for 2400 shares pro-rata and allotment money due @ ₹ 5 per share including premium of ₹ 2 per share as per Board's resolution dated...)			
Share Application A/c	Dr.	800	
To Share Allotment A/c			800
(Surplus application money adjusted towards share allotment account)			
Share First Call A/c	Dr.	6,000	
To Share Capital A/c			6,000
(First call money due on 2000 shares @ ₹ 3 per share as per Board's resolution dated...)			
Share Capital A/c	Dr.	320	
Securities Premium A/c	Dr.	80	
To Shares Forfeited A/c			96
To Share Allotment A/c			184
To Share First Call A/c			120
(Forfeiture of 40 shares held by Ramesh for non-payment of allotment of money @ ₹ 5 per share including premium @ ₹ 2 per share and first call money @ ₹ 3 per share as per Board's resolution dated...)			
Share Final Call A/c	Dr.	3,920	
To Share Capital A/c			3,920
(Share final call due on 1960 shares (i.e., 2000 shares-Ramesh's 40 shares forfeited) @ ₹ 2 per share as per Board's resolution dated...)			
Share Capital A/c	Dr.	600	
To Shares Forfeited A/c			300
To Share First Call A/c			180
To Share Final Call A/c			120
(Forfeited of 60 shares held by Mohan for non-payment of first call money @ ₹ 3 per share and final call money @ ₹ 2 per share as per Board's resolution dated...)			

Shares Forfeited A/c	Dr.	80	
To Share Capital A/c			80
(Discount allowed on re-issue of 80 forfeited share @ Rs. 1 per Board's resolution dated...)			
Shares Forfeited A/c (296 – 80)	Dr.	216	
To Capital Reserve A/c			216
(Transfer of net gain on re-issue of 80 forfeited shares to capital Reserve A/c)			

Balance Sheet of.....Ltd. as at.....

Particulars	*Note No.*	*Amount (₹)*
I. Equity and Liabilities		
Shareholders' Funds		
Share Capital	1	19,9,00
Reserves and Surplus	2	4,136
Total		24,036
II Assets		
Current Assets		
Cash and Cash Equivalents	3	24,036
Total		24,036

Notes:

1. Share Capital		
Authorised		
Issued:		
2,000 Equity Shares of ₹ 10 each		20,000
Subscribed and Paid-up :		
1,980 Equity Shares of ₹ 10 each, fully paid-up	19,800	
Add: Shares Forfeited	100	19,900
2. Reserves and Surplus		
Capital Reserve Account		216
Securities Premium Account		3,920
		4,136
4. Cash and Cash Equivalent		
Balance with Bank		24,036

Practice Questions

[1] SOS Limited issued a prospectus inviting applications for 6,000 shares of Rs.10 each at a premium of Rs.2 per share, payable as follows;

- On application Rs.2 per share;
- On allotment Rs.5 per share (including premium):
- On 1st call Rs.3 per share;
- On Second and Final Call Rs.2 per share.,

Applications were receiving for 9,000 shares and allotment was made prorate to the applicants of 7,500 shares, the remaining applicants were refused allotment. Money overpaid on applications were applied towards sums due on allotment. D to whom 100 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Z, the holder of 200 shares, failed to pay both the calls, and his shares were forfeited after the second and final call. Of the shares forfeited 200 shares were sold to C credited as fully paid up for Rs.8.50 per share, the whole of D's shares being included.

Solution:

Note: 1

Application	2
Allotment	5 (3 + 2 Premium)
First call	3
Second and final call	2
Issue Price	**12**

Note: 2 Computation of Adjustment of Pro-rata

Category	Sh Applied (No.)	Sh Allotted (No.)	Appl'n Money received (₹)	Adjustments of Application money received			
				Sh Capital (₹)	Sh Allotment (₹)	Calls in Advance (₹)	Refund Bank (₹)
1	1500	-	3000 (1500*2)	-	-	-	3000
2	7500	6000	15000 (7500*2)	12000 (6000*2)	3000	-	-
Total	9000	6000	18000 Dr.	12000 Cr.	3000 Cr.	-	3000 Cr.

Journal Entry in the books of SOS Ltd.

	Particulars	LF	Dr. (₹)	Cr. (₹)
Receipt	Bank A/c (9000 sh. *2) Dr.		18000	
	To Equity share application A/c			18000
Transfer (Pro-Rata)	Sh Application A/c Dr.		18000	
	To Sh Capital			12000
	To Sh Allotment			3000
	To Bank (Refund)			3000
	(Refer Note:2)			
Due	Eq sh Allotment A/c (6000 sh *5) Dr.		30000	
	To Eq sh Capital A/c (6000 sh.*3)			18000
	To security Premium (6000 sh *2)			12000
Receipt	Bank A/c Dr.		26550	
	Calls in Arrears A/c Dr.		450	
	To Eq Sh Allotment A/c			27000
	(6000sh*5=30000-3000 Adjusted (Note-4)=27000-450 call in arrears			
Due	Eq Sh First Call (6000 sh *3) Dr.		18000	
	To Eq Sh Capital A/c			18000
Receipt	Bank A/c Dr.		17100	
	Calls in Arrears A/c [(200+100)*3] Dr.		900	
	To Eq Sh First Call			18000
Forfeiture	Sh Capital A/c (100*8) Dr.		800	
	Security Prem. A/c (100*2) Dr.		200	
	To Sh Forfeiture A/c (Paid)			250
	To Calls in Arrears A/c (Not Paid)			750
	Paid=125*2=250			
	Not Paid= 450 (Allotment) + 300(First Call)=750			
Due	Eq Sh Second & Final Call (5900 sh *2) Dr.		11800	
	To Eq Sh Capital A/c			11800

Receipt	Bank A/c Dr.		11400	
	Calls in Arrears A/c [200*2] Dr.		400	
	To Eq Sh Second and Final Call			11800
Forfeiture	Sh Capital A/c (200*10) Dr.		2000	
	To Sh Forfeiture A/c (Paid)			1000
	To Calls in Arrears A/c (Not Paid)			1000
	Paid=200*(2+3)=1000			
	Not Paid= 200*(2+3)=1000			
Reissue	Bank A/c (200*8.5) Dr.		1700	
	Sh Forfeiture A/c (200*1.5) Dr.		300	
	To Sh Capital (200*10)			2000
Transfer to CR	Sh Forfeiture A/c Dr.		450	
	To Capital Reserve A/c (Note:5)			450

Note: 3

Sh Allotted	**Sh Applied**
6000	7500
100	(?)

Sh Applied =125

Note: 4

Application Money received on sh applied (125*2)	250
Less: Application money due on sh allotted (100*2)	(200)
Excess Money (A)	50
Allotment due on sh allotted (100*5)	500
Less: Adjustment of Excess Money (A)	(50)
Allotment money due but not received (i.e. Calls in Arrears)	450

Note: 5

	Defaulter-1	**Defaulter-2**	**Total**
Amount of FF (Amt FF/No of sh FF)*No of Sh reissue	250 [(250/100*100)]	500 [(1000/200*100)]	750
Less:			
Reissue Discount	150 (100*1.5)	150 (100*1.5)	300
Profit on Reissue	100	350	450

[2] Alpha Ltd issued a prospectus inviting applications for 2,000 shares of Rs.10 each at a premium of Rs.2 per share, payable as follows: On Application Rs. 2, On Allotment Rs. 5 (including premium) On First Call Rs. 3, On Second & Final Call Rs. 2 Applications were received for 3,000 shares and pro rata allotment was made on the applications for 2,400 shares. It was decided to utilise excess application money towards the amount due on allotment. Mohit, to whom 40 shares allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Jagat, the holder of 60 shares failed to pay the two calls and on his such failure, his shares were forfeited. Of the shares forfeited, 80 shares were sold to Rishav credited as fully paid for Rs. 9 per share, the whole of Mohit's shares being included. Required: Give Journal Entries to record the above transactions (including cash transactions)

Solution:

Note: 1

Application	2
Allotment	5 (3 + 2 Premium)
First call	3
Second and final call	2
Issue Price	**12**

Note: 2 Computation of Adjustment of Pro-rata

Category	Sh Applied (No.)	Sh Allotted (No.)	Appl'n Money received (₹)	Adjustments of Application money received			
				Sh Capital (₹)	Sh Allotment (₹)	Calls in Advance (₹)	Refund Bank (₹)
1	600	-	1200 (600*2)	-	-	-	1200
2	2400	2000	4800 (2400*2)	4000 (2000*2)	800	-	-
Total	3000	2000	4800 Dr.	4000 Cr.	800 Cr.	-	1200 Cr.

Journal Entry in the books of Alpha Ltd.

	Particulars	LF	Dr.₹	Cr.₹
Receipt	Bank A/c Dr. (3000 sh. *2)		6000	
	To Equity share application A/c			6000
Transfer (Pro-Rata)	Sh Application A/c Dr.		4800	
	To Sh Capital			4000
	To Sh Allotment			800
	To Bank (Refund)			1200
	(Refer Note:2)			

Due	Eq sh Allotment A/c Dr.(2000 sh *5)		10000	
	To Eq sh Capital A/c (2000 sh.*3)			6000
	To Security Premium (2000 sh *2)			4000
Receipt	Bank A/c Dr.		9016	
	Calls in Arrears A/c Dr. (Note:4)		184	
	To Eq Sh Allotment A/c			9200
	(2000sh*5=10000-800 Adjusted (Note-2)=9200			
Due	Eq Sh First Call Dr.(2000 sh *3)		6000	
	To Eq Sh Capital A/c			6000
Receipt	Bank A/c Dr.(1900sh *3)		5700	
	Calls in Arrears A/c Dr.[(40*3)+(60*3)]=300		300	
	To Eq Sh First Call			6000
Forfeiture	Sh Capital A/c Dr.(40*8)		320	
	Security Prem. A/c Dr.(40*2)		80	
	To Sh Forfeiture A/c (Paid)			96
	To Calls in Arrears A/c (Not Paid)			304
	Paid=48*2=96			
	Not Paid= 184 + 120 (40*3)=304			
Due	Eq Sh Second & Final Call Dr.[(2000-40 =1960 *2)		3920	
	To Eq Sh Capital A/c			3920
Receipt	Bank A/c Dr.(1900*2)		3800	
	Calls in Arrears A/c Dr.[60*2]		120	
	To Eq Sh Second and Final Call			3920
Forfeiture	Sh Capital A/c Dr.(60*10)		600	
	To Sh Forfeiture A/c (Paid)			300
	To Calls in Arrears A/c (Not Paid)			300
	Paid=60*5=300, Not Paid= 60*(3+2)=300			
Reissue	Bank A/c Dr.(80*9)		720	
	Sh Forfeiture A/c Dr. (80*1)		80	
	To Sh Capital (80*10)			800
Transfer to CR	Sh Forfeiture A/c Dr.		216	
	To Capital Reserve A/c (Note:5)			216

Note: 3

Sh Allotted	**Sh Applied**
2000	2400
40	(?)

Sh Applied =48

Note: 4

Application Money received on sh applied (48*2)	96
Less: Application money due on sh allotted (40*2)	(80)
Excess Money (A)	**16**
Allotment due on sh allotted (40*5)	200
Less: Adjustment of Excess Money (A)	(16)
Allotment money due but not received (i.e. Calls in Arrears)	**184**

Note: 5

	Mohit	**Jagat**	**Total**
Amount of FF (Amt FF/No of sh FF)*No of Sh reissue	96 [(96/40*40)]	200 [(300/60*40)]	296
Less:			
Reissue Discount	40 (40*1)	40 (40*1)	80
Profit on Reissue	**56**	**160**	**216**

[3] JK Ltd is a company with an authorized capital of Rs.10 lacs in equity shares of Rs.10 each, of which 600000 shares had been issued and fully paid on 30th June, 2024. The company proposed to make a further issue of 100000 of these Rs. 10 shares at a price of Rs.14 each the arrangements for payment being:

- Rs 2 per share payable on application, to be received by 1st July 2024.
- Allotment to be made on 10th July and a further Rs.5 per shares (including the premium) to be payable.
- The final call for the balance to be made, and the money received by 31st January 2025.

Applications were received for 355000 shares and were dealt with as follows:

- Applicants for 5000 shares received allotment in full.
- Applicants for 30000 shares received an allotment of one share for every 2 applied for, No money was returned to the applicant, the surplus on application being used to reduce the amount due on allotment.
- Applicants for 320000 shares received an allotment of one share for every four applied for, the money due on allotment was retained by the company, the excess being returned to the applicant.
- The money due on final call was received on the due date.

You are required to record these transactions in the journal of JK Limited.

Solution:

Note: 1

Application	2 (1.7.2024)
Allotment	5 (10.7.2024) [1+4 Premium]
Final call (Balance)	7 (31.1.2025)
Issue Price	**14**

Note: 2 Computation of Adjustment of Pro-rata

Cat.	Sh Applied (No.)	Sh Allotted (No.)	Appl'n Money received (₹)	Adjustments of Application money received			
				Sh Capital (₹)	Sh Allotment (₹)	Calls in Advance (₹)	Refund Bank (₹)
1	5,000	5,000	10,000 (5,000*2)	10,000 (5,000*2)	-	-	-
2 (2:1)	30,000	15,000	60,000 (30,000*2)	30,000 (15,000*2)	30,000	-	-
3 (4:1)	3,20,000	80,000	6,40,000 (3,20,000*2)	1,60,000 (80,000*2)	4,00,000 (80,000*5)	-	80,000
	3,55,000	1,00,000	7,10,000 Dr.	2,00,000 Cr.	4,30,000 Cr.	-	80,000 Cr.

Journal Entry in the books of JK Ltd.

	Particulars	LF	Dr. (₹)	Cr. (₹)
Receipt	Bank A/c (355000 sh. *2) Dr.		7,10,000	
	To Equity share application A/c			7,10,000
Transfer (Pro-Rata)	Sh Application A/c Dr.		7,10,000	
	To Sh Capital			2,00,000
	To Sh Allotment			4,30,000
	To Bank (Refund)			80,000
	(Refer Note:2)			
Due	Eq sh Allotment A/c (100000 sh *5) Dr.		5,00,000	
	To Eq sh Capital A/c (10000 sh.*1)			1,00,000
	To Security Premium A/c (100000 sh *4)			4,00,000

Receipt	Bank A/c Dr. To Eq Sh Allotment A/c (500000-430000Adjusted (Note-2)=70000		70,000	 70,000
Due	Eq Sh Final Call (100000 sh *7) Dr. To Eq Sh Capital A/c		7,00,000	 7,00,000
Receipt	Bank A/c Dr. To Eq Sh Final Call		7,00,000	 7,00,000

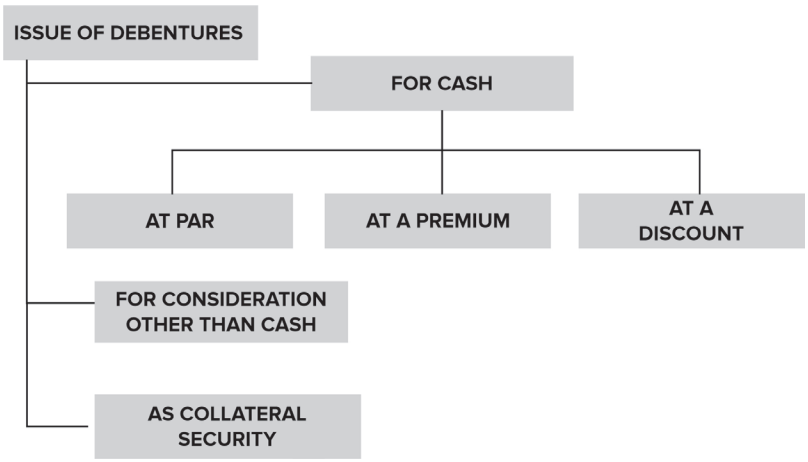
ISSUE OF DEBENTURES

Meaning of Debentures

Besides raising capital by the issue of shares, a company may supplement its capital by borrowings. Such borrowings may take the form of both short-term and long-term borrowings. Short-term borrowings by way of promissory notes, bills of exchange, bank overdrafts, cash credits, public deposits, etc., are needed by a company to provide for its working capital while long-term borrowings by way of loan on mortgage of property, term loans from financial institutions, public deposits for a long period, issue of debentures, etc., are needed by a company for financing expenditure of a capital nature. Loan capital of a company refers to the long-term borrowings of which issue of debentures is the most important and common method adopted by companies. Debentures are part of loan capital and the company is liable to pay interest thereon whether it earns profit or not.

Issue of Debentures

The procedure for issuing debentures by a company is very much similar to that of an issue of shares. Applications for debentures are invited from the public through the prospectus and the applicants are asked to pay the application money along with the applications. The company may ask for payment of the whole of the amount along with the application itself or in installments.



Issue of Debentures for Cash

When debentures are issued for cash, the amount to be collected on them may be payable in a lump sum or in installments. Where payable in installments, debenture application account is opened on receipt of applications. Then there are debenture allotment account and debenture calls account.

Issue of Debentures at Par

Debentures are said to be issued at par when the debenture-holder is required to pay an amount equal to the nominal or face value of the debentures e.g. the issue of ₹ 1,000 debenture for ₹ 1,000.

(a) If the full amount is payable along with the application:

(1) On receipt of application money:

Bank	Dr.	(with the money received on application)
To Debentures Application and Allotment A/c		

(2) On allotment:

Debenture Application and Allotment A/c	Dr.	(with the money received on debentures allotted)
To Debentures A/c		

(b) If the amount is payable in installments

1. On receipt of application money:

Bank	Dr.	(with the money received on application)
To Debentures Application A/c		

2. On Allotment:

Debenture Application A/c	Dr.	(with the application money
Debenture Allotment A/c	Dr.	(with the allotment money due on debentures)
To Debentures A/c		(with application and allotment money on debentures allotted)

3. On refund of application money:

Debenture Application A/c	Dr.	(with the excess application money
To Bank		refunded)

4. On receipt of allotment money:

Bank	Dr.	(with the money received on allotment)
To Debenture Allotment A/c		

5. On making calls:

Debenture Calls A/c	Dr.	(with the money due on respective
To Debenture A/c calls)		

6. On receipt of call money:

Bank	Dr.	(with the money received on respective
To Debenture Calls A/c		calls)

Note:

- *All cash transactions are generally passed through the Cash Book.*
- *It is customary to prefix the rate of interest payable on debentures with the debenture account.*
- *The company cannot allot more debentures than issued. The excess application money may be retained by the company against the allotment money due. But the excess application money received on debentures rejected has to be refunded to the applicants.*

Issue of Debentures at a Premium

If the debentures are issued at a price higher than the nominal value of the debentures, the debentures are said to be issued at a premium. The excess of issue price over the nominal value is regarded as the premium amount. In such a case, the Debentures Account should be credited only with the nominal value of the debentures and the premium should be credited to "Securities Premium Reserves".

Debenture Application A/c	Dr.	(with the money due on application)
Debenture Allotment A/c	Dr.	(with allotment money including premium)
To Debentures A/c		(with the nominal value of the debentures)
To Securities Premium A/c		(with the premium money)

Issue of Debentures at a Discount

If the debentures are issued at a price lower than the nominal value of the debentures, the debentures are said to be issued at a discount. The difference between the nominal value and the issue price is regarded as the discount. Such discount being a capital loss must be shown specifically as a deduction of general Reserve on the liabilities side of the balance sheet under the heading 'Reserves and Surplus'. If there are no Reserves, the discussion on issue of debentures is to be shown as a negative item under the heading

'Reserves and Surplus'. Such discount on issue of debentures may either be written off against revenue profits or capital profits of the company. When debentures are issued at a discount, the Debentures Account should be credited with the nominal value of the debentures and the discount allowed on issue of debentures, being a capital loss, should be debited to "Discount on Issue of Debentures Account".

Debenture Application A/c	Dr.	(with the money due on application)
Debenture Allotment A/c	Dr.	(with the money due on allotment)
Discount on Issue of Debentures A/c	Dr.	(with the amount of discount)
To Debentures A/c (with the total)		

Illustration 12:

X Ltd. made an issue of 10,000 12% Debentures of ₹ 100 each, payable as follows:

₹ 25 on Application

₹ 25 on Allotment

₹ 50 on First and Final Call.

Applications were received for 12,000 debentures and the directors allotted 10,000 debentures rejecting applications for 2,000 debentures. The money received on applications for 2,000 debentures rejected was duly refunded. The call was made and the moneys were duly received.

Show the necessary cash book and journal entries to record the above transactions and above the relevant items in the balance sheet of the company.

Solution:

Dr. **Cash Book (Bank Columns)** *Cr.*

Particulars	₹	Particulars	₹
To 12% Debenture Application (Application money on 12,000 12% Debenture @ ₹ 25 per debenture)	3,00,000	By 12% Debenture Application A/c (Refund of Application money on 2,000, 12% Debenture @ ₹ 25 per debenture)	50,000
To 12% Debenture Allotment (Allotment money on 10,000 12% Debenture @ ₹ 25 per debenture)	2,50,000	By Balance c/d	10,00,000
To 12% Debenture First and Final Call A/c (First and final call money on 10,000 debentures @ ₹ 50 per debenture)	5,00,000		
	10,50,000		10,50,000

In the books of X Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	12% Debenture Application A/c	Dr.	2,50,000	
	12% Debenture Allotment A/c	Dr.	2,50,000	
	To 12% Debentures A/c			5,00,000
	(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 10,000 debentures as per Boards resolution dated.....)			
	12% Debenture First and Final Call A/c	Dr.	5,00,000	
	To 12% Debentures A/c			5,00,000
	(First and final call money due on 10,000, 12% debentures @ ₹ 50 per debenture as per board's resolution dated...)			

Particulars		*Note No.*	*Amount (₹)*
I	**Equity and Liabilities**		
	Non-current Liabilities		
	Long-term Borrowings	1	10,00,000
	Total		**10,00,000**
II	**Assets**		
	Current Assets		
	Cash and Cash Equivalents	3	10,00,000
	Total		**10,00,000**

Notes:

1. Long-term Borrowings

12% Debentures 10,00,000

2. Cash and Cash Equivalent

Balance with Bank 10,00,000

Illustration 13:

B Ltd. issued 2,000, 13% Debentures of ₹ 100 each at ₹ 110 payable as follows:

On Application ₹ 25

On Allotment ₹ 35 (including premium)

On First and Final Call ₹ 50

The debentures were fully subscribed and the moneys were duly received. Prepare cash book, pass the necessary journal entries and about the relevant portions of the balance sheet of the company.

Solution:

Dr. **Cash Book (Bank Columns)** *Cr.*

Particulars	₹	Particulars	₹
To 13% Debenture Application (Application money on 2,000 debentures @ ₹ 25 per each)	50,000	By Balance c/d	2,20,000
To 13% Debenture Allotment A/c (Allotment money on 2,000 debentures @ ₹ 35 per debenture including premium of ₹10 each)	70,000		
To 13% Debenture First and Final Call A/c (First and final call money on 2,000 debentures @ ₹ 50 per debenture)	1,00,000		
	2,20,000		2,20,000

In the books of B Ltd.

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	13% Debenture Application A/c	Dr.	50,000	
	13% Debenture Allotment A/c	Dr.	70,000	
	To 13% Debentures A/c			1,00,000
	To Securities Premium A/c			20,000
	(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 2,000 debentures @ ₹ 35 including premium of ₹ 10 each as per Boards resolution dated.....)			
	13% Debenture First and Final Call A/c	Dr.	1,00,000	
	To 13% Debentures A/c			1,00,000
	(First and final call money due on 10,000, 12% debentures @ ₹ 50 per debenture as per board's resolution dated...)			

Balance Sheet of B Ltd. as at...

Particulars		*Note No.*	*Amount (₹)*
I	**Equity and Liabilities**		
	Shareholders' Funds		
	Reserves and Surplus	1	20,000
	Non-current Liabilities		
	Long-term Borrowings	2	2,00,000
	Total		**2,20,000**
II	**Assets**		
	Current Assets		
	Cash and Cash Equivalents	3	2,20,000
	Total		**2,20,000**

Notes:

1.	**Reserves and Surplus**	
	Securities Premium	20,000
2.	**Long-term Borrowings**	
	13% Secured Debentures	2,00,000
3.	**Cash and Cash Equivalents**	
	Balance with Bank	2,20,000

Illustration 14:

W Ltd. issued 2,000, 14% Debentures of ₹ 100 each at discount of 5%, the discount being adjustable on allotment. The debentures were payable as follows:

On Application - ₹ 25

On Allotment - ₹ 20

On First and Final Call - ₹ 50

The debentures were fully subscribed and the moneys were duly received. Show the cash book and journal entries and prepare the balance sheet of the company.

Solution:

In the books of W Ltd.

Dr. ***Cash Book (Book Columns Only)*** *Cr.*

Particulars	₹	Particulars	₹
To 14% Debenture Application A/c (Application money on 2,000 debentures @ ₹ 25 per each)	50,000	By Balance c/d	1,90,000
To 14% Debenture Allotment A/c (Allotment money on 2,000 debentures @ ₹ 20 each)	40,000		
To 14% Debenture First and Final Call A/c (First and final call money on 2,000 debentures @ ₹ 50 per debenture)	1,00,000		
	1,90,000		1,90,000

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
	14% Debenture Application A/c	Dr.	50,000	
	14% Debenture Allotment A/c	Dr.	40,000	
	Discount on issue of debentures A/c	Dr.	10,000	
	To 12% Debentures A/c			1,00,000
	(Being capitalization of application money @ ₹ 25 per debenture and allotment money due on 2,000 debentures @ ₹ 20 after adjusting discount of ₹ 5 each as per Boards resolution dated.....)			
	14% Debenture First and Final Call A/c	Dr.	1,00,000	
	To 13% Debentures A/c			1,00,000
	(First and final call money due on 2,000, debentures @ ₹ 50 per debenture as per board's resolution dated...)			

Balance Sheet (Relevant Items Only)

	Particulars	*Note No.*	*Amount (₹)*
I	**Equity and Liabilities**		
	Shareholders' Funds		
	Reserves and Surplus	1	(10,000)
	Non-current Liabilities		
	Long-term Borrowings	2	2,00,000
	Total		**1,90,000**
II	**Assets**		
	Current Assets		
	Cash and Cash Equivalents	3	1,90,000
	Total		**1,90,000**

Notes:

1.	**Reserves and Surplus**	
	Discount on Issue of Debentures	(10,000)
2.	Long-term Borrowings	
	13% Debentures	2,00,000
3.	**Cash and Cash Equivalents**	
	Balance with Bank	1,90,000

DEBENTURES ISSUED FOR CONSIDERATION OTHER THAN CASH

The company may allot debentures to the vendors for acquiring some assets as payment for purchase consideration. This issue of debentures to vendors is known as issue of debentures for consideration other than cash.

Journal Entries

(1) For acquisition of assets:

Sundry Assets (Individually) A/c Dr. (with the value of assets)

To Vendors (with the purchase price)

(2) (a) On allotment of debentures (at par)

Vendors Dr. (with the value of debentures)

To Debentures A/c

(b) On allotment of debentures (at premium)

Vendors A/c Dr. (with the purchase price)

To Debentures A/c (with the nominal value)

To Securities Premium A/c (with the amount of premium)

(c) On allotment of debentures (at discount)

Vendors A/c Dr. (with the amount of purchase)

Discount on Issue of Debentures A/c Dr. (with the amount of discount)

To Debentures A/c

Notes:

(i) If the value of debentures allotted is more than the agreed purchase price, the difference is debited to Goodwill Account.

(ii) Similarly, if the value of debentures allotted is less than the agreed purchase price, credited to Capital Reserve Account.

Illustration 15:

Optimist Ltd. purchased building worth Rs.1,20,000 and plant and machinery worth Rs. 1,00,000 from Depressed Ltd. for an agreed purchase consideration of Rs. 2,00,000 to be satisfied by the issue of 2,000, 12% Debentures of Rs. 100 each. Show the necessary journal entries in the books of Optimist Ltd.

Solution:

Journal

Particulars		Dr.(₹)	Cr.(₹)
Building A/c	Dr.	1,20,000	
Plant and Machinery A/c	Dr.	1,00,000	
To Depressed Ltd.			2,00,000
To Capital Reserve A/c			20,000
(Purchase of sundry assets and transfer of capital profits as per agreement with the vendor dated...)			
Depressed Ltd.	Dr.	2,00,000	
To 12% Debentures A/c			2,00,000
(Being 2,000, 12% Debentures of Rs. 100 each allotted to vendors for consideration other than cash as per Board's resolution dated...)			

[2] The XYZ Company Ltd. took over assets of Rs. 230 Lakh and liabilities of Rs. 30 Lakh of PQR Company Ltd. for the purchase consideration of Rs. 220 Lakh. The XYZ Company Ltd. paid the purchase consideration issuing debentures of Rs. 100 each at 10% premium. Give journal entries in the books of the XYZ Company Ltd.

Sol:

Sundry Assets A/c	Dr.	230	
Goodwill A/c	Dr.	20	
To Liabilities A/c			30
To PQR Company A/c			220

(Being purchase of assets and liabilities of company)

PQR Company A/c	Dr.	220	
To Debentures A/c			200
To Securities Premium A/c			20

(Being issue of debentures at 10% premium)

[3] Z Ltd. took over the assets of Rs.6,00,000 and liabilities of Rs.80,000 of C Ltd. for an agreed purchase consideration of Rs.5,40,000 to be satisfied by the issue of 10% Debentures of Rs.1,000 each.

Required: Show the necessary journal entries in the books of Z Ltd, assuming that–

Case (a) Such Debentures are issued at par;

Case (b) Such Debentures are issued at 20% premium; and

Case (c) Such Debentures are issued at 10% discount;

Solution:

Common Entry in All Cases

Sundry Assets A/c	Dr.	600000	
Goodwill A/c	Dr.	20000	
To Sundry Liabilities A/c			80000
To C Ltd. A/c			540000

(Being the purchase of assets and liabilities from C Ltd. as per agreement dated...)

Case (a) If Debentures are issued at par

C Ltd. A/c	Dr.	540000	
To 10% Debentures A/c			540000

(Being the issue of 5,400 debentures at par to C Ltd. as per Board's resolution dated....)

Case (b) If Debentures are issued at 20% premium

C Ltd. A/c	Dr.	540000	
To 10% Debentures A/c			450000
To Securities Premium A/c			90000

(Being the issue of 4,500 debentures at a premium of 20% to C Ltd. as per Board's resolution dated...)

Case (c) If Debentures are issued at 10% discount

C Ltd. A/c	Dr.	540000	
Discount on Issue of Debentures A/c	Dr.	60000	
To 10% Debentures A/c			600000

(Being the issue of 6,000 debentures at a discount of 10% to C Ltd. as per Board's resolution dated...)

DEBENTURES ISSUED AS COLLATERAL SECURITY

The term 'Collateral Security' implies additional security given for a loan. Where a company obtains a loan from a bank or insurance company, it may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid. On repayment of the loan, however, the lender is legally bound to release the debentures forthwith. But in case the loan is not repaid by the company on the due date or in the event of any other breach of agreement, the lender has the right to retain these debentures and to realise them. The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures. Such an issue of debentures is known as "Debentures issued as Collateral Security". There are two alternative ways by which debentures issued as collateral security can be dealt with:

(1) No accounting entry is required to be shown in the books of account at the time of issue of such debentures for the simple reason that the loan against which the debentures are issued as collateral security has already been credited, the debit being given to Bank. But the existence of such debentures issued as collateral security has to be mentioned by way of a note on the Balance Sheet under the specific loan account.

(2) If it is desired that such an issue of debentures as collateral security is to be recorded in the books of account, the accounting entries will be as follows:

(i) On issue of debentures as collateral security

Debentures Suspense A/c Dr. (with the nominal value of the debentures issued)

To Debentures A/c

In this case, Debentures Suspense Account will appear on the asset side of the balance sheet under the heading Miscellaneous Expenditure. Debentures Account will appear as a liability on the liabilities side of the Balance Sheet.

(ii) On repayment of the loan and release of debentures

Debentures A/c Dr. (with the nominal value of the debentures released)

To Debentures Suspense A/c

Note: The net effect of the above two entries is nil. Both the Debentures Suspense Account and the Debentures Account are cancelled on repayment of the loan. As such, this method is rarely followed in practice.

Illustration 16:

Z Ltd. secured an a long-term loan of Rs. 50,000 from the bank by issuing 600, 12% Debentures of Rs. 100 each as collateral security. Show relevant items in the Balance Sheet of the Company under both the methods.

Solution:

(First Method):

Balance Sheet (relevant items only)

Particulars	*Note No.*	*Amount (₹)*
I Equity and Liabilities		
Non-current Liabilities		
Long-term Borrowings	1	50,000

Note:

1. **Long-term Borrowings**

Long term Secured Loan	50,000
(Secured by the issue of ..... 12% Debentures of ₹ 100 each as collateral securities)	

Solution *(Second Method):*

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Debentures Suspense A/c	Dr.	60,000	
To Debentures A/c			60,000
(Issue of 600, 12% Debentures of Rs. 100 each as collateral security for a long term borrowings of Rs. 50,000 as per Board's resolution dated.....)			

Balance Sheet (relevant items only)

Particulars	*Note No.*	*Amount (₹)*
I **Equity and Liabilities**		
Non-current Liabilities		
Long-term Borrowings	1	50,000

Note:

1. **Long-term Borrowings**	₹	₹
Long term Secured Loan		50,000
(Secured by the issue of ..... 12% Debentures of ₹ 100 each as collateral securities)	60,000	
Less: 12% De Debentures Accounts	(60,000)	Nil
		50,000

ISSUE OF PREFERENCE SHARES

A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue under section 55 of the Companies Act 2013. No company limited by shares shall, can issue any preference shares which are irredeemable.

A company may issue preference shares for a period exceeding 20 years but not exceeding 30 years for infrastructure projects (Specified in Schedule VI). However, it is subject to redemption of minimum 10% of such preference shares per year from the twenty-first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Redemption of preference shares

The preference shares can be redeemed only when they are fully paid up-

- out of the profits of the company which would otherwise be available for dividend or
- out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

CAPITAL REDEMPTION RESERVE ACCOUNT

If preference shares are proposed to be redeemed out of the profits of the company, a sum equal to the nominal amount of the shares to be redeemed, shall be transferred to a reserve called the Capital Redemption Reserve Account out of the profits of the company and the provisions of this Act relating to reduction of share capital of a company shall apply as if the Capital Redemption Reserve Account were paid- up share capital of the company

The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Summary Points - Capital Redemption Reserve Account (CRR)	
When to transfer?	If preference shares are to be **redeemed out of the profits**
Amt. transfer to CRR	A sum equal to **nominal amount** of shares that are to be redeemed
Transfer to capital redemption reserve account is allowed from these profits	1. General reserve 2. Reserve fund 3. Dividend equalisation fund 4. Voluntary debenture redemption account 5. Voluntary debenture sinking fund 6. Profit and loss account.
Transfer to capital redemption reserve account is not allowed from these profits.	1. Securities premium account 2. Forfeited shares account 3. Profit prior to incorporation 4. Capital reserve 5. Development rebate reserve

Premium on Redemption of Preference Shares

(a) For the companies whose financial statements comply with the accounting standards as prescribed under section 133, *the premium payable on redemption shall be provided out of the profits of the company,* before the shares are redeemed.

(b) For redemption of any preference shares issued on or before the commencement of 2013 Act, *the premium payable on redemption shall be provided out of the profits of the company,* or out of the company's securities premium account, before such shares are redeemed.

For the companies whose financial statements need not comply with the accounting standards as prescribed under section 133, *the premium payable on redemption shall be provided out of the profits of the company,* or out of the company's securities premium account, before such shares are redeemed.

Case 1: Redemption out of the profits of the company which would otherwise be available for dividend

If the redeemable preference shares are redeemed out of the profits of the company which would otherwise be available for dividend, the "Capital Redemption Reserve Account" has to be created which will represent the redeemable preference shares in the balance sheet after the redemption. This capital redemption reserve should be equal to the amount of Preference Shares to be redeemed. The profits available for dividend have to be transferred to Capital Redemption Reserve Account.

JOURNAL ENTRIES

1. Transfer profits available for dividend to Capital Redemption Reserve Account:

General Reserve Account	Dr.	(as the case may be)
Profit and Loss Appropriation A/c	Dr.	
Dividend Equalization Account	Dr.	
To Capital Redemption Reserve A/c		(with the nominal value of the shares to be redeemed)

2. If current assets are realized to provide cash for redemption of preference shares:

Bank	Dr.	
To Respective Assets Account		(with the realized value of assets)

3. On transfer of redeemable preference share capital to be redeemed to Preference Shareholders Account:

Redeemable Preference Share Capital A/c	Dr.	(with the nominal value of the shares to be redeemed)
To Preference Shareholders A/c		

4. If preference shares are redeemed at premium:

Redeemable Preference Share Capital A/c	Dr.	
Premium on Redemption of Preference Shares A/c	Dr.	(with the amount of premium payable)
To Preference Shareholders A/c		

5. For providing premium on redemption of preference shares:

Securities Premium Account	Dr.	(with the amount of premium paid on redemption of preference shares)
or Profit and Loss A/c	Dr.	
To Premium on Redemption of Preference Shares Account		

6. On redemption of preference shares:

Preference Shareholders Account	Dr.	(with the amount paid)
To Bank		

Case 2: If the redeemable preference shares are redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption:

If the redeemable preference shares are redeemed out of the proceeds of fresh issue of shares, the new Share

Capital Account raised by fresh issue will take the place of the Redeemable Preference Share Capital Account after the redemption. Thus, in such a case, new Share Capital Account (Equity or Preference) must be equal to the redeemable preference shares redeemed.

First of all, entries for fresh issue of shares will be passed. Then, entries for redemption passed as given in previous case.

Case 3: If the redeemable preference shares are redeemed partly out of the profits of the company which would otherwise be available for dividend and partly out of the proceeds of a fresh issue of shares made for the purpose of redemption:

If the redeemable preference shares are redeemed partly out of the profits of the company which would otherwise be available for dividend and partly out of the proceeds of a fresh issue of shares equity or preference, the Capital Redemption Reserve Account and the new Share Capital Account taken together will replace the Redeemable Preference Share Capital redeemed. Thus in such a case, Redeemable Preference Share Capital redeemed = Capital Redemption Reserve Account + New Share Capital Account (Equity or Preference).

Here, all the entries shown under (1) and (2) have to be passed. But there are certain common entries which can be combined together.

Illustration 17:

Vanities Ltd. had an issue 1,000, 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 10%. These shares are to be redeemed now out of the accumulated reserves, which are more than the necessary sum required for redemption. Show the necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's Securities Premium Account.

Solution:

In the books of Vanities Ltd.

Journal Entries

Particulars		Dr.(₹)	Cr.(₹)
General Reserve Account	Dr.	1,00,000	
To Capital Redemption Reserve A/c			1,00,000
(Transfer of reserves to Capital Redemption Reserve Account on redemption of redeemable preference shares)			
12% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	10,000	
To 12% Preference Shareholders A/c			1,10,000
(Amount payable to 12% preference shareholders on redemption of 12% preference shares at a premium of 10%)			
Securities Premium A/c	Dr.	10,000	
To Premium on Redemption of Preference Share A/c			10,000
(Application of Securities Premium Account to write off premium on redemption of preference shares)			

12% Preference Shareholders A/c Dr.	1,10,000	
To Bank		1,10,000
(Amount due to 12% preference shareholders on redemption paid)		

Note: Capital Redemption Reserve Account replaces the 12% Redeemable Preference Shares Capital Account and the capital structure of the company remains unchanged.

illustration 18:

Sure and Fast Ltd. has part of its share capital in 12% redeemable preference shares of ₹ 100 each, repayable at a premium of 5%. The shares have now become due for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of ₹ 10 each at ₹ 11 each. The whole amount is received in cash and the 12% preference shares are redeemed. Show the necessary journal entries in the books of the company.

Solution:

In the books of Sure and Fast Ltd.

Journal Entries

Particulars	Dr. (₹)	Cr. (₹)
Bank Dr.	2,20,000	
To Equity Share Application and Allotment A/c		2,20,000
(Application money on 20,000 equity shares @ ₹ 11 per share including a premium of Re. 1 per share)		
Equity Share Application and Allotment A/c Dr.	2,20,000	
To Equity Share Capital A/c		2,00,000
To Securities Premium A/c		20,000
(Allotment of 20,000 equity shares ₹ 10 each issued at a premium of ₹ 1 per share as per Board's Resolution dated....)		
12% Redeemable Preference Share Capital A/c Dr.	2,00,000	
Premium on Redemption of Preference Share A/c Dr.	10,000	
To 12% Preference Shareholders A/c		2,10,000
(Amount due to 12% preference shareholders on redemption of 8% preference shares at a premium of 5%)		
Securities Premium A/c Dr.	10,000	
To Premium on Redemption of Preference Shares A/c		10,000
(Application of Securities Premium Account to write off Premium on Redemption of Preference Shares)		

12% Preference Shareholders A/c	Dr.	2,10,000	
To Bank			2,10,000
(Payment of amount due to 12% preference shareholders on redemption)			

Note: Equity Share Capital Account replaces the 12% Redeemable Preference Share Capital Account and the capital structure of the company remains unchanged.

Illustration 19:

The following is the balance sheet of Oscar India Ltd. as on 31st March 2024:

	Particulars	*Note No.*	*Amount (₹)*
I	**Equity and Liabilities**		
	Shareholders' Funds		
	Share Capital	1	5,48000
	Reserves and Surplus	2	1,65,000
	Current Liabilities		
	Trade Payable	3	1,27,000
	Total		**8,40,000**
II	**Assets**		
	Non-Current Assets		
	Fixed Assets		6,00,000
	Current Assets		
	Investment		50,000
	Inventories		1,10,000
	Cash and Cash Equivalents	4	80,000
	Total		**8,40,000**

Notes:

1.	**Share Capital**	₹	₹
	Authorised		
	Issued, subscribed and paid-up:		.....
	30,000 Equity Shares of ₹ 10 each fully paid-up		3,00,000
	2,500 Preference share of ₹ 100 each fully called-up	2,50,000	
	Less: Final Call on 100 preference shares @ ₹ 20 per share unpaid	2,000	2,48,000
			5,48,000

2.	**Reserves and Surplus**	
	Securities Premium	15,000
	Surplus	1,50,000
		1,65,000
3.	**Trade Payable**	
	Trade Creditors	1,10,000
	Outstanding Expenses	17,000
		1,27,000
4.	**Cash and Cash Equivalent**	
	Balance with Bank	80,000

On 30th June, 2024, the Board of Directors decided to redeem the preference shares at a premium of 10% and to sell the investments at its market price of ₹ 40,000. They also decided to issue sufficient number of equity shares of ₹ 10 each at a premium of Re. 1 per share, required after utilizing the profit and loss account leaving a balance of ₹ 50,000. Premium on redemption is required to be set off against securities premium account.

Repayments on redemption were made in full except to one shareholder holding 50 shares only due to his leaving India for good.

You are required to show the journal entries and the balance sheet of the company after redemption. Assumption made should be shown in the working.

Solution:

In the books of Oscar Ltd.

Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Bank	Dr.	40,000	
Profit and Loss A/c	Dr.	10,000	
To Investments			50,000
(Being the sale of investments at a loss of ₹ 10,000)			
Bank	Dr.	1,65,000	
To Share Capital A/c			1,50,000
To Securities Premium A/c			15,000
(Being the issue of required number of equity shares at a premium of 10%)			
Preference Share Capital A/c	Dr.	2,40,000	
Premium on Redemption A/c	Dr.	24,000	
To Preference Shareholders A/c			2,64,000
(Being the transfer of the amount due to preference shareholders on redemption)			

Securities Premium A/c	Dr.	24,000	
To Premium on Redemption A/c			24,000
(Being the transfer of securities premium account to write off premium on redemption of preference shares account)			
Profit and Loss A/c	Dr.	90,000	
To Capital Redemption Reserve A/c			90,000
(Being the transfer of profit used for redemption of preference shares to capital redemption reserve account)			
Preference Shareholders A/c	Dr.	2,58,500	
To Bank			2,58,500
(Being the payment to preference shareholders except to a holder of 50 shares)			

Balance Sheet of Oscar India Ltd.

(After redemption)

	Particulars	*Note No.*	*Amount (₹)*
I	**Equity and Liabilities**		
	Shareholders' Funds		
	Share Capital	1	4,58,000
	Reserves and Surplus	2	1,46,000
	Current Liabilities		
	Trade Payable	3	1,27,000
	Preference shareholders		5,500
	Total		7,36,500
II	**Assets**		
	Non-Current Assets		
	Fixed Assets		6,00,000
	Current Assets		
	Inventories		1,10,000
	Cash and Cash Equivalents	4	26,500
	Total		7,36,500

Notes:

1.	**Share Capital**	₹	₹
	Authorised		
	Issued, subscribed and paid-up:		.....

45,000 Equity Shares of ₹ 10 each fully paid-up		4,50,000
In preference share of ₹ 100 each fully called-up	10,000	
Less: Final Call @ ₹20 per share unpaid	(2,000)	8,000
		4,58,000
2. Reserves and Surplus		
Capital Redemption Reserve		90,000
Securities Premium		6,000
Surplus		50,000
		1,46,000
3. Trade Payable		
Trade Creditors		1,10,000
Outstanding Expenses		17,000
		1,27,000
4. Cash and Cash Equivalent		
Balance with Bank		26,500

Working Notes:

Calculation of required number of fresh issue of equity shares:

	₹	₹
Balance of Profit and Loss A/c		1,50,000
Less: Loss on Sale of Investment	10,000	
Balance required	50,000	(60,000)
Profit available for redemption		90,000
Amount required for redemption		2,40,000
Amount available from Profit and Loss A/c		(90,000)
New issue required 15,000 shares		1,50,000

Dr. **Bank Account** *Cr.*

Particulars	₹	Particulars	₹
To Balance b/d	80,000	By Preference Share- holders A/c	2,58,500
To Investment	40,000	By Balance b/d	26,500
To Share Capital A/c	1,50,000		
To Securities Premium A/c	15,000		
	2,85,000		2,85,000

Illustration 22

The Balance Sheet of Producers Ltd. as at 31st March, 2025 is as follows:

Particulars	*Note No.*	*Amount (₹)*
I Equity and Liabilities		
Shareholders' Funds		
Share Capital	1	3,50,000
Reserves and Surplus	2	64,000
Current Liabilities		
Trade Payable	3	72,500
Short-term provision	4	39,500
Total		**5,26,000**
II Assets		
Non-Current Assets		
Fixed Assets	5	2,80,000
Current Assets		
Short-term Investment		60,000
Inventories		1,30,500
Trade Receivables		50,550
Cash and Cash Equivalents	6	4,950
Total		**5 26,000**

Notes:

1.	Share Capital	₹
	Authorised	
	Issued, subscribed and paid-up:	.....
	40,000 Equity Shares of ₹ 10 each fully paid-up	4,00,000
	10,000 10% Preference share of ₹ 100 each	1,00,000
		5,00,000
	Issued, subscribed and paid-up:	.....
	25,000 Equity Shares of ₹ 10 each, fully paid-up	2,50,000
	10,000 10% Preference share of ₹ 100 each, fully paid-up	1,00,000
		3,50,000

2.	Reserves and Surplus	
	Securities Premium	10,000
	Surplus	54,000
		64,000
3.	Trade Payable	
	Supplies of Goods	66,000
	Outstanding Expenses	6,500
		72,500
4.	Short-term Provision	
	Provision for Income Tax	18,000
	Staff Provision Fund	21,500
		39,500
5.	Tangible Assets	
	Plant and Machinery	2,40,000
	Staff Provision Fund	40,000
		2,80,000
6.	Cash and Cash Equivalent	
	Balance with Bank	4,900
	Cash on hand	50
		4,950

In order to redeem its preference shares, the company issued 5,000 equity shares of ₹ 10 each at a premium of 10% and sold all of its investment for ₹ 70,800. Preference shares were redeemed at a premium of 10%. Show the necessary journal entries in the books of the company and prepare the balance sheet of the company immediately after redemption of preference shares.

Solution:

In the books of Producers Ltd.

Journal Entries

Particulars	Dr. (₹)	Cr.(₹)
Bank Dr.	55,000	
To Equity Share Application and Allotment Account		55,000
(Application money received on 5,000 equity shares of ₹ 10 issued at a premium of 10%)		

Equity Share Application and Allotment A/c Dr.	55,000	
To Equity Share Capital A/c		50,000
To Securities Premium A/c		5,000
(Allotment of 5000 equity shares of ₹ 10 each issued at a premium of 10% as per Board's resolution dated....)		
Profit and Loss A/c Dr.	50,000	
To Capital Redemption Reserve A/c		50,000
(Transfer of the balance of the nominal value of preference shares to be redeemed not covered by fresh issue, i.e., ₹ 1,00,000 - ₹ 50,000 on redemption to Capital Redemption Reserve A/c)		
Bank Dr.	70,800	
To Investments A/c		60,000
To Profit and Loss A/c		10,800
(Sale of Investments at a profit and transfer of profit on sale to Profit and Loss A/c)		
10% Redeemable Preference Share Capital A/c Dr.	1,00,000	
Premium on Redemption of Preference Shares A/c Dr.	10,000	
To 10% Preference Shareholders A/c		1,10,000
(Amount due to 10% preference shareholders on redemption)		
Securities Premium A/c Dr.	10,000	
To Premium on Redemption of Preference Shares A/c		10,000
(Application of securities premium to write off premium on redemption of preference shares)		
10% Preference Shareholders A/c Dr.	1,10,000	
To Bank		1,10,000
(Amount due to 10% Preference Shareholders on redemption of their shares paid)		

Balance Sheet of Producers Ltd.

(After redemption preference shares)

Particulars	*Note No.*	*Amount (₹)*
I **Equity and Liabilities**		
Shareholders' Funds		
Share Capital	1	3,00,000
Reserves and Surplus	2	69,800

	Current Liabilities			
	Trade Payable		3	72,500
	Short-term provision		4	39,500
		Total		**4,81,800**
II	**Assets**			
	Non-Current Assets			
	Fixed Assets			
	Tangible assets		5	2,80,000
	Current Assets			
	Inventories			1,30,500
	Trade Receivables			50,550
	Cash and Cash Equivalents		6	20,750
		Total		**4,81,800**

Notes:

1.	**Share Capital**	₹
	Authorised	
	Issued, subscribed and paid-up:	.....
	40,000 Equity Shares of ₹ 10 each	4,00,000
	10,000 10% Preference share of ₹ 10 each	1,00,000
		5,00,000
	Issued, subscribed and paid-up:	.....
	30,000 Equity Shares of ₹ 10 each, fully paid-up	3,00,000
2.	**Reserves and Surplus**	
	Capital Redemption Reserve	50,000
	Securities Premium	5,000
	Surplus	14,800
		69,800
3.	**Trade Payable**	
	Supplies of Goods	66,000
	Outstanding Expenses	6,500
4.	**Short-term Provision**	72,500
	Provision for Income Tax	18,000
	Staff Provision Fund	21,500
		39,500

5.	**Tangible Assets**	
	Plant and Machinery	2,40,000
	Staff Provision Fund	40,000
		2,80,000
6.	**Cash and Cash Equivalent**	
	Balance with Bank	20,700
	Cash on hand	50
		20,750

Working Notes:

(i) *Dr.* **Bank Accounts** *Cr.*

Particulars	₹	Particulars	₹
To Balance b/d	4,900	By 8% Preference Shareholders A/c	1,10,000
To Equity Share Application and Allotment A/c	55,000	By Balance c/d	20,700
To Investment A/c	60,000		
To Profit and Loss A/c	10,800		
	1,30,700		1,30,700

(ii) *Dr.* **Securities Premium A/c** *Cr.*

Particulars	₹	Particulars	₹
To Premium on Redemption of Preference Shares Account	10,000	By Balance b/d	10,000
To Balance c/d	5,000	By Equity Share Application and Allotment A/c	5,000
	15,000		15,000

(ii) *Dr.* **Profit and Loss A/c** *Cr.*

Particulars	₹	Particulars	₹
To Capital Redemption Reserve A/c	50,000	By Balance b/d	54,000
To Balance c/d	14,800	By Bank (Profit on sale of investments)	10,800
	64,800		64,800

Note: Equity Share Capital issued of ₹ 50,000 and Capital Redemption Reserve Account ₹ 50,000 jointly replace 8% Redeemable Preference Share Capital of ₹ 1,00,000. Hence, the capital structure of the company remains unchanged.

Practical Problems on Redemption of Preference Shares

[1] HAHA Ltd. had an issue of 2,000, 10% Redeemable Preference Shares of Rs. 100 each, repayable at a premium of 10%. These shares are to be redeemed out of the accumulated reserves, which are more than the necessary sum required for redemption. Show the necessary entries in the books of the company, assuming that the premium on redemption of shares has to be written off against the company's Securities Premium Reserves.

Solution:

10% Redeemable Preference Share Capital A/c	Dr.	200000	
Premium on Redemption of Preference Shares A/c	Dr.	20000	
To 12% Preference Shareholders A/c			220000
Securities Premium Reserves	Dr.	20000	
To Premium on Redemption of Preference Share A/c			20000
(Securities Premium Account to write off premium on Redemption of Preference Shares)			
10% Preference Shareholders A/c	Dr.	220000	
To Bank A/c			220000
(Amount due to 10% preference shareholders **on redemption paid)**			
General Reserve Account	Dr.	200000	
To Capital Redemption Reserve A/c			200000
(Transfer of reserves to Capital Redemption Reserve Account on Redemption of Redeemable Preference Shares)			

[2] Diamond Ltd. has part of its share capital consisting of 20,000, 12% Redeemable Preference Shares of Rs. 100 each, repayable at a premium of 5%. The shares have now become ready for redemption. It is decided that the whole amount will be redeemed out of a fresh issue of 20,000 equity shares of Rs. 10 each at Rs. 15 each. The whole amount is received in cash and the 12% preference shares are redeemed for the relevant portion. Show the necessary journal entries in the books of the company.

Solution:

Bank	Dr.	300000	
To Equity Share Application and Allotment, A/c			300000
(Application money on 20,000 equity shares @ Rs. 15 per share including a premium of Rs. 5 per share)			
Equity Share Application and Allotment A/c	Dr.	300000	
To Equity Share Capital A/c			200000
To Securities Premium Reserves A/c			100000
12% Redeemable Preference Share Capital A/c	Dr.	200000	
Premium on Redemption of Preference Share A/c	Dr.	10000	
To 12% Preference Shareholders A/c			210000
(Amount due to 12% preference shareholders on redemption of 12% preference shares at a premium of 5%)			

Securities Premium Reserves A/c	Dr.	10000	
To Premium on Redemption of Preference Shares A/c			10000
(Securities Premium Account to write off Premium on Redemption of Preference Shares)			
12% Preference Shareholders A/c	Dr.	210000	
To Bank A/c			210000
(Amount due to 12% preference shareholders on redemption paid)			

[3] X Ltd. furnishes you with the following Balance Sheet as at 31st March, 2025 : (₹ in Lakhs)

Equity shares of ₹10 each fully paid	400
12% redeemable preference shares of ₹ 100 each fully paid	200
Reserves and surplus:	
- Capital reserve	15
- Securities Premium	25
- Revenue reserves	260
Funds Employed in:	
Fixed assets less depreciation	560
Current assets	540
Less: Current liabilities	(200)

The company redeemed preference shares on 1st April 2025 at a premium of 10%. You are required to pass journal entries to record the above.

Solution:

12% Preference Share Capital A/c	200	
Premium on redemption of preference share A/c	20	
To Preference Share Holders A/c		220
Securities Premium A/c	20	
To Premium on redemption of preference share A/c		20
Preference Shareholders A/c	220	
To Bank A/c		220
Revenue reserve A/c	200	
To Capital Redemption Reserve A/c		200

[4] Find out in each case what amount shall be transferred to capital redemption reserve account:

Redeemable preference shares redeemed	Fresh issue of share capital
a. Rs. 10,00,000 at par	Rs 10,00,000 at par

b. Rs. 10,00,000 at 5% premium	Rs 800,000 at par
c. Rs. 10,00,000 at par	Rs 800,000 at 10% premium
d. Rs. 10,00,000 at 5% premium	Rs 800,000 at 10% premium

Solution:

For (a) Nil., For (b), (c) and (d) Rs. 2,00,000

[5] JP Ltd Balance Sheet as at 31st March, 2025

I. EQUITY AND LIABILITIES		
1. Shareholders' funds		
(a) Share Capital	1	350,000
(b) Reserve & Surplus	2	64,000
2. Current Liabilities		
Trade Payable	23,700	
Short-term provisions	38,500	62,200
TOTAL		**4,76,200**
II. ASSETS		
1. Non-current assets		
(a) Fixed Assets		2,25,000
I. Tangible fixed assets		60,000
(b) Non-Current Investments		
2. Current Assets		
Inventories	1,30,500	
Trade receivable	49,550	
Cash and cash equivalents	9,950	
Other current assets	1,200	1,91,200
TOTAL		**4,76,200**

Notes

1. **Share capital**

Authorized Share Capital		
40,000 equity shares of Rs. 10 each fully paid up	4,00,000	
1000, 8% preference shares of Rs. 100 each	1,00,000	
		5,00,000
Issued, Subscribed Called Up and Paid up Share Capital		

1000, 10% Preference shares of Rs. 100 each fully paid up	1,00,000	
25,000 equity shares of Rs. 10 each fully paid up	2,50,000	
		3,50,000
2. Reserve and Surplus		
Securities Premium Reserves	9,000	
Surplus Account	55,000	
		64,000

In order to redeem its preference shares, the company issued 5,000 equity shares of Rs. 10 each at a Premium of 10% and sold its investment of' 70,800. Preference shares were redeemed at a premium of 10%. Show the necessary journal entries in the books of the company.

Solution:

Bank A/c	Dr.	70800	
To Investments A/c			60000
To Surplus A/c			10800
(Sale on Investments at a profit and transfer of profit on sale to Profit and Loss A/c)			
Bank A/c	Dr.	55000	
To Equity Share Application and Allotment, A/c			55000
(Application money received on 5,000 equity shares of Rs. 10 at a premium of 10%).			
Equity Share Application and Allotment A/c	Dr.	55000	
To Equity Share Capital A/c			50000
To Securities Premium Reserves A/c			5000
(Allotment of 5000 equity shares of Rs. 10 each issued at a premium of 10% as per Board's resolution dated....)			
10% Redeemable Preference Share Capital A/c	Dr.	100000	
Premium on Redemption of Preference Shares A/c	Dr.	10000	
To 10% Preference Shareholders A/c			110000
(Amount due to 8% preference shareholders on redemption)			
Securities Premium Reserves A/c	Dr.	10000	
To Premium on Redemption of Preference Shares A/c			10000
(Application of securities premium to write off premium on redemption of preference shares)			
10% Preference Shareholders A/c	Dr.	110000	
To Bank A/c			110000
(Amount due to 10% Preference Shareholders on redemption paid)			

Surplus A/c	Dr.	50000	
To Capital Redemption Reserve A/c			50000
(Transfer of the balance amount of the nominal value preference shares to be redeemed not covered by fresh issue)			

REDEMPTION OF DEBENTURES

Section 71 (1) of the Companies Act, 2013	Section 71 (2) of the Companies Act, 2013	Section 71 (4) of the Companies Act, 2013
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.	No company can issue any debentures which carry any voting rights.	Where debentures are issued by a company, the company should create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilized by the company for any purpose other than the redemption of debentures.

CREATION OF DEBENTURE REDEMPTION RESERVE

Section 71(4) of the Companies Act, 2013, read with Rule 18(7) of the Companies (Share Capital And Debentures) Rules, 2014, requires every company issuing redeemable non-convertible debentures to create a Debenture Redemption Reserve (DRR) account of at least a certain percentage of the total outstanding value of the issued debentures (described below), out of the profits of the company available for the payment of dividend and the amount credited to such account shall only be used for the redemption of debentures. This effort is to protect the debenture holders from the possibility of the company defaulting on repayments, as DRR ensures that enough funds are available to meet the obligations of the debenture holders.

Let us assume that an unlisted company issues ₹10 crore worth of debentures in January 2022 with a maturity date of January 2032. In this case, the company has to create ₹1 crore (representing 10% of the total outstanding of the issued debentures, i.e., ₹10 crore) as DRR before the maturity date.

Adequacy of Debenture Redemption Reserve (DRR)

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:

Sr. No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (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)

Sr. No.	Debentures issued by	Adequacy of Debenture Redemption Reserve (DRR)
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 under section 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

As per Rule 18 (7) of the Companies (Share Capital and Debentures) Amendment Rules, 2019, following companies:

(a) All listed NBFCs

(b) All listed HFCs

(c) All other listed companies (other than AIFIs, Banking Companies and Other FIs); and

(d) 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.

Important Point:

- 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 referred to above.

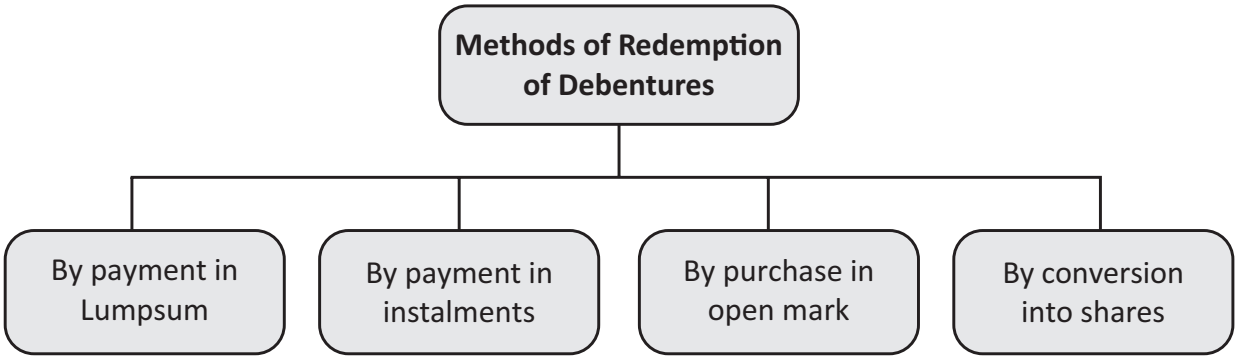
Provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15% of the amount of debentures maturing during the 31st day of March of that year.

- In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion of debenture issue.
- The amount credited to DRR shall not be utilised by the company except for the purpose of redemption of debentures.
- It should be noted that appropriation to DRR can be made any time before redemption and Investments in specified securities as mentioned above can be done before 30th April for the debentures maturing that year, however, for the sake of simplicity and ease, it is advisable to make the appropriation and investment immediately after the debentures are allotted assuming that the company has sufficient amount of profits (issued if allotment date is not given in the question). Also, in some cases, the date of allotment could be missing, in such cases the appropriation and investments should be done on the first day of that year for which ledgers accounts are to be drafted.

Journal Entries				
Date	**Particular**	**L.F.**	**Amount (Dr.)**	**Amount (Cr.)**
	(a) For setting aside the fixed amount of profit for redemption			
	Profit and Loss A/c Dr.			
	To Debenture Redemption Reserve A/c			
	(b) For investing the amount set aside for redemption			
	Debenture Redemption Reserve Investment A/c Dr.			
	To Bank A/c			
	(c) For receipt of interest on Debenture Redemption Reserve Investments			
	Bank A/c Dr.			
	To Interest on Debenture Redemption Reserve			
	Investment A/c			
	(d) For transfer of interest on Debenture Redemption Reserve Investments (DRRI)			
	Interest on Debenture Redemption Reserve Investment A/c Dr.			
	To Profit and loss A/c*			
	At the time of redemption of debentures			
	(a) For encashment of Debenture Redemption Reserve Investments			
	Bank A/c Dr.			
	To Debenture Redemption Reserve Investment A/c			

	(b) For amount due to debenture holders on redemption Debentures A/c Dr. To Debenture holders A/c **(c) For payment to debenture holders** Debenture holders A/c To Bank A/c Dr. After redemption of debentures, DRR should be transferred to general reserve DRR A/c Dr. To General Reserve			

** Considering the fact that interest is received each year through cash/bank account and it is not re-invested. In the illustrations given in the chapter, the same has been considered and hence interest on DRR investment is not credited to DRR A/c but taken to P&L A/c.*



By payment in lumpsum

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period.

By payment in Instalments

Under payment in instalments method, the payment of specified portion of debenture is made in instalments at specified intervals.

Purchase of Debentures in Open Market

Debentures sometimes are purchased in open market.

Question 1

The following balances appeared in the books of a company (unlisted company other than AIFI, Banking company, NBFC and HFC) as on December 31, 2022: 6% Mortgage 10,000 debentures of Rs. 10 each; Debenture Redemption Reserve (for redemption of debentures) Rs. 5,000; Investments in deposits with a scheduled bank,

free from any charge or lien Rs. 15,000 at interest 4% p.a. receivable on 31st December every year. Bank balance with the company is Rs. 90,000.

The Interest on debentures had been paid up to December 31, 2022.

On February 28, 2023, the investments were realised at par and the debentures were paid off at 10.1, together with accrued interest.

Write up the concerned ledger accounts (excluding bank transactions).

Solution:

6% Mortgage Debentures Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb. 28, 2023	To Debenture-holders A/c		1,00,000	Jan. 1 2023	By Balance b/d		1,00,000

Debentures Redemption Reserve Investment Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Jan. 1, 2023	To Balance b/d		15,000	Feb. 28, 2023	By Bank		15,000

Debenture Interest Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb. 28, 2023	To Bank (10,000x 10 x 6% x 2/12)		1,000	Feb. 28, 2023	By Profit & Loss A/c		1,000

Bank A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Jan 01, 2023	To Balance b/d		90,000	Feb. 28, 2023	By Debenture-holders (10,000 x 10.1)		1,01,000
Feb 28, 2023	To Interest on Debentures Redemption Investments (15,000 x 4% x 2/12)		1,00		By Debenture Interest A/c		1,000
	To Debentures Redemption Reserve investment A/c		15,000		By Balance c/d		3,100
			1,05,100				1,05,100

Debenture Redemption Reserve Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Feb 28, 2023	To General Reserve-(note)		10,000	Jan.1, 2023	By Balance b/d		5,000
				Jan.1, 2023	By Profit & Loss (b/f)		5,000
			10,000				10,000

Note: Amount to be transferred to DRR before the redemption = Rs. 10,000 [i.e. 10% of (10,000 X 10)].

Question: 2

The following balances appeared in the books of Apple Ltd (unlisted company other than AIFI, Banking company, NBFC and HFC) as on 1-4-2022:

(i) 12 % Debentures Rs. 75,000

(ii) Balance of DRR Rs. 2,500

(iii) DRR Investment Rs. 11,250 represented by 10%, 1,125 Secured Bonds of the Government of India of Rs.10 each.

Annual contribution to the DRR was made on 31st March every year. On 31-3-2023, balance at bank was Rs. 75,000 before receipt of interest. The investment were realised 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, 2023:

(1) Debentures Account

(2) DRR Account

(3) DRR Investment Account

(4) Bank Account

(5) Debenture Holders Account.

Solution:

12% Debentures Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31 2023	To Debenture-holders A/c		75,000	April 1 2022	By Balance b/d		75,000

10% Secured Bonds of Govt. (DRR Investment) A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Apr. 1, 2022	To Balance b/d		11250	Mar. 31, 2023	By Bank		11250

Bank A/c

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Apr 01, 2022	To Balance b/d		75,000	Mar 31, 2023	By Debenture-holders		82500
Mar 31, 2023	To Interest on Debentures Redemption Investments (11250 x 10%)		1125				
Mar 31, 2023	To Debentures Redemption Reserve investment A/c		11250	Mar 31, 2023	By Balance c/d		4875
			87375				87375

Debenture Redemption Reserve Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31, 2023	To General Reserve-(note)		7500	Apr.1, 2022	By Balance b/d		2,500
					By Profit & Loss		5,000
			7500				7,500

Note: *Calculation of DRR before redemption = 10% of Rs. 75,000 = 7500*

Available balance = 2500

DRR required = 7500 - 2500 = 5000.

Debenture Holder Account

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount
Mar 31, 2023	To Bank A/c		82500	Mar 31, 2023	By 12% Debenture		75000
				Mar 31, 2023	By Premium on redemption of debentures (75000 X 10%)		7500
			82500				82500

Question: 3

ABC Ltd. has issued 1,0000, 12% convertible debentures Rs. 100 each redeemable after a period of five years at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 30% of their holdings into equity shares of Rs. 10 each at a price of Rs. 20 per share and balance in cash. Debenture holders amounting Rs. 2,00,000 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 Rs. 20,000 debenture holders.

Solution:

Particulars	No. of Debentures
Debenture holders opted for conversion (200000 /100)	2000
Option for conversion	30%
Number of debentures to be converted (30% of 2000)	600
Redemption value of 600 debentures at a premium of 5% [600 x (100+5)]	63000
Equity shares of Rs. 10 each issued on conversion [Rs. 63000/ Rs. 20]	3150 shares

Calculation of cash to be paid: `

Number of debentures	2000
Less: number of debentures to be converted into equity shares	(600)
	1400

Redemption value of 1400 debentures (1400 x Rs. 105) i.e. Rs. 147000.

Question 4

The Balance Sheet of Shyam Co. Ltd. (unlisted company other than AIFI, Banking company, NBFC and HFC) as at 31st March, 2023 shown **Long term borrowings with respect to** 12% Debentures of Rs. 100000

At the Annual General Meeting, it was resolved that to repay the debentures at a premium of 5%. Give the necessary journal entries for these transactions.

Journal Entries			
Particular	**L.F.**	**Amount (Dr.)**	**Amount (Cr.)**
Profit and Loss A/c Dr. To Debenture Redemption Reserve (for DRR created 10% x 100000)		10000	 10000
Debenture Redemption Reserve Investment A/c Dr. To Bank A/c (for DRR Investment created 15% x 100000)		15000	 15000
12% Debentures A/c Dr. Premium Payable on Redemption A/c @ 5% Dr. To Debenture holders A/c (Amount payable to debentures holders)		100000 5000	 105000
Profit and loss A/c Dr. To Premium Payable on Redemption A/c (Premium payable on redemption of debentures charged to Profit & Loss A/c)		5000	 5000

Debenture Redemption Reserve A/c Dr.		10000	
To General Reserve			10000
(for DRR transferred to general reserve)			
Bank A/c Dr.		15000	
To Debenture Redemption Reserve Investment			15000
(for DRR Investment realised)			
Debenture holders A/c Dr.		105000	
To Bank A/c			105000
(Amount paid to debenture holders on redemption)			

LESSON ROUNDUP

- There are two basic types of share capital which can be issued by a company under the Companies Act, 2013 i.e. (a) preference shares and (b) equity shares.
- Preference shares are those which carry preferential rights as to the payment of dividend at a fixed rate; and the return of capital on winding up of the company.
- An equity share is one which is not a preference share. Equity shares are risk bearing shares.
- Share capital of a company can be categorized as: Nominal or Authorised Capital; Issued Capital; Subscribed Capital; Called up Capital and Paid-up Capital.
- Shares of a company may be issued at par, at a premium or at a discount.
- When shares are issued at a price higher than the face value, they are said to be issued at a premium.
- When shares are issued at a price lower than the face value, they are said to be issued at a discount. Only sweat equity shares can be issued at discount u/s 54.
- Forfeiture of shares may be said to be the compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.
- The forfeited shares may be re-issued at par, at a premium or even at a discount. If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account.
- A company limited by shares may, if authorised by its articles, issue preference shares, which are, or at the option of the company liable to be redeemed. They have to be redeemed within 20 years of the date of issue.
- Debentures may be issued at par, or at a premium, or at a discount.
- Debentures may be issued by a company for cash, for consideration other than cash, or as a collateral security.
- The issue of debentures to vendors is known as issue of debentures for consideration other than cash.
- A company may issue debentures on any specific condition as to its redemption such as: issued at par and redeemable at par, issued at a discount redeemable at par, issued at a premium and redeemable at par, issued at par and redeemable at a premium, issued at a discount, but redeemable at a premium.

- When a company issues debentures it undertakes to pay interest thereon at a fixed percentage. The payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not and the interest payable on debentures is a charge against the profits of the company.
- Discount on issue of debentures is a capital loss of the company and it is required to be shown on the liabilities side of the Balance Sheet under the heading "Redemption and Surplus" until it is written off.
- When a company issues debenture at par or at a discount which are redeemable at a premium, the premium payable on redemption of the debentures is treated as a capital loss.
- The preference shares can be redeemed out of profits or out of the proceeds of fresh issue of equity or preference shares or a combination of both. The preference shares can be redeemed at a premium also.
- If the redeemable preference shares are redeemed out of the profits of the company which would otherwise be available for dividend, the "Capital Redemption Reserve Account" has to be credited which will represent the redeemable preference shares in the balance sheet after the redemption.
- If the redeemable preference shares are redeemed out of the proceeds of a fresh issue of shares, the new Share Capital Account raised by fresh issue takes the place of the Redeemable Preference Share Capital Account after the redemption.

GLOSSARY

Shares: The total share capital is divided into a number of units known as 'shares'.

Authorized Capital: The Company is registered with this amount of capital.

Issued: That part of the authorized capital of the company which has actually been offered to

Capital: the public for subscription in cash.

Subscribed Capital: It refers to that part of the issued capital which has actually been subscribed by the public and subsequently allotted to them.

Called Up Capital: It is that portion of the subscribed capital which the shareholders are called upon to pay on the shares allotted to them.

Paid Up Capital: It refers to that part of the called up capital which has actually been paid by the shareholders.

Forfeiture: The compulsory termination of membership by way of penalty for non-payment of allotment and/or any call money.

TEST YOURSELF

Theory Questions

1. What do you mean by shares? What are the types of shares?
2. Explain types of share capital in a company.
3. Briefly describe issue of shares at a premium.
4. What do you mean by forfeited shares? Can forfeited shares be re-issued? Explain.
5. What are debentures? What are the type of debentures?
6. Explain various methods of redemption of preference shares.

Practical Questions

1. The authorised capital of a company is 1,00,000 shares of ₹ 10 each. On April 10, 2025, 50,000 shares are issued for subscription at a premium of ₹ 2 per share. The share money is payable as follows: ₹ 5 (including the premium of ₹ 2) with application, ₹ 3 on allotment; ₹ 2 on first call and ₹ 2 on second call. The subscription list closes on May 11, 2025 and directors proceed to allotment on May 18, 2025. The shares are fully subscribed and the application money (including the premium) is received in full. The allotment money is received by June 30, 2025, except as regards 500 shares. It is expected that the allotment money on these 500 shares will not be received and hence shares are forfeited. The first call and second call money is received by September 30, 2025 and December 31, 2025 respectively, barring the second call money on 200 shares which is not received hence the shares are forfeited. Show the cash book and the structure of the share capital in the balance sheet.

2. X Ltd. forfeited 100 shares of ₹ 10 each for non-payment of the final call of ₹ 2; the shares were re-issued @ ₹ 9 per share. How much was credited to shares forfeited account and what amount was transferred to capital reserve?

   [**Ans.:** ₹ 800; ₹ 700]

3. Z Ltd. forfeited 150 shares of ₹ 10, issued at a premium of ₹ 2, for non-payment of the final call of ₹ 3. Of these 100 shares were re-issued @ ₹ 11 per share. How much would be transferred to capital reserve?

   [**Ans.:** ₹ 700]

4. Redemption of 1,00,000 preference shares of ₹ 10 each was carried out by utilisation of reserves and by issue of 40,000 equity shares of ₹10 each at ₹12.5. How much should be credited to capital redemption reserve account?

   [**Ans.:** ₹ 6,00,000]

   In the above case, the redemption was carried out of reserves and out of the issue of 40,000 shares of ₹10 each @ ₹ 9.5. What is the amount of capital redemption reserve account that is required?

   [**Ans.:** ₹ 6,20,000]

5. A company having free reserves of ₹ 30,000 want to redeem rupees one lakh preference shares.

   Calculate the face value of fresh issue of shares of ₹ 10 each to be made at a premium of 10%.

   *[**Ans.:** ₹ 70,000]*

6. Bhalla and Co. Ltd. has an authorised equity capital of ₹ 20 lakhs divided into shares of ₹ 10 each. The paid-up capital was ₹ 12,50,000. Besides this, the company had 9% preference shares of ₹ 10 each for ₹ 2,50,000. Balance on other accounts were - Securities Premium ₹ 18,000; Profit and Loss Account ₹ 72,000 and General Reserve ₹ 3,40,000. Included in Sundry Assets were investments of the face value of ₹ 30,000 carried in the books at a cost of ₹ 34,000. The company decided to redeem the preference shares at 10% premium, partly by the issue of equity shares of the face value of ₹ 1,20,000 at a premium of 10%. Investments were sold at 105% of their face value. All preference shareholders were paid off except 3 holding Rs. 2,500. Give the necessary journal entries bearing in mind that the Directors wanted a minimum reduction in free reserves, while effecting the above transactions. Working should form part of your answer.

   [**Ans.:** Amount paid to preference shareholders: ₹ 2,72,250]

7. Krishna Ltd issued 10,000 12% Debentures of ₹10 each at a discount of 6%. Applications were received for 7,500 debentures. Journalise the transactions assuming all money has been received.

8. On April, 1, 2025, X Ltd. took over the Assets of Rs. 6,80,000 and Creditors of Rs. 80,000 of Y Ltd. payable 10% by Cheque and balance by issue of fully paid equity shares of Rs.100 each. Pass the necessary Journal Entries in the books of the company on April, 1, 2025 if such Shares issued at par or premium of 20%.

9. On April 1, 2020, DP Ltd. purchased a running business from Y Ltd. for Rs.10,40,000 payables as to 25% by cheque and balance by issue of equity shares Rs. 100 each at a premium of 4%. The assets and liabilities consisted of the following: Building Rs.6,00,000, Plant and Machinery Rs. 1,00,000, Inventories Rs. 2,00,000, Trade Receivables Rs. 1,80,000, Trade Payables Rs. 80,000. Pass the necessary journal entries in the books of DP Ltd on April 1, 2020.

10. On April 1, 2025, DP Ltd. purchased a running business from Y Ltd. for Rs.9,60,000 payables as to 25% by cheque and balance by issue of equity shares Rs. 100 each at a premium of 20%. The assets and liabilities consisted of the following: Building Rs.6,00,000, Plant and Machinery Rs. 1,00,000, Inventories Rs. 2,00,000, Trade Receivables Rs. 1,80,000, Trade Payables Rs. 80,000. Pass the necessary journal entries in the books of DP Ltd on April, 1,2025.

11. X Ltd. issued 2,000 shares of Rs. 10 each at par payable as under: On application Rs. 2 per share, on allotment Rs. 3 per share, on first call Rs.3per share, on second call Rs. 2 per share. Mr. X was allotted 40 Shares. Mr. X failed to pay allotment money and on his subsequent failure to pay first call, his shares were forfeited. Pass the necessary journal entry relating to the forfeiture of shares.

12. X Ltd. forfeited 40 shares of Rs. 10 each (Rs.8 called up) issued at par to Mr. X on which he has paid Rs. 2 per share. Journalise.

13. X ltd issued 2000 shares of Rs. 10 each at a premium of Rs. 4 per share payable as under: On applicationRs 3 per share (including Rs.1 premium), on allotment Rs. 4 per share (including Rs. 1 premium), On first call Rs. 4 per share (Including Rs.1 premium), on second call balance. Mr. X was allotted 40 shares and failed to pay allotment money and subsequent failure to pay first call, his shares were forfeited. Pass the necessary journal entry relating to the forfeiture of shares.

14. X Ltd. forfeited 40 shares of Rs.10 each (Rs.8 called up) issued at 40% premium (payable on final call) to Mr. X on which he had paid Rs. 2 per share. Journalise.

15. Moti Ltd. invited applications for issuing 10,00,000 Equity Shares of Rs.10 each at a premium of Rs.2 per share. The amount was payable as follows:

    - On Application Rs.5 (including Premium)
    - One Allotment Rs.4
    - On First and Final call Rs.3

    Applications for 15,00,000 shares were, received. Applications for 3,00,000 shares were rejected and pro rata allotment was made to remaining applicants. Excess application money was utilized towards sum due on allotment. Giri who has applied for 24,000 shares failed to pay the allotment and call money. His shares were forfeited. Out of the forfeited shares, 10,000 shares were reissued for Rs.8 per share fully paid up. Pass necessary Journal entries in the books of Moti Ltd.

16. The balance sheet of G Ltd as on 31.12.2024

Liabilities:	(Rs.)
Equity shares of Rs.10 each	2,00,000
Less: Calls in arrear @ Rs. 2	10,000
14% Preference Shares of Rs.100	1,00,000
Securities Premium	10,000
Investment Allowance Reserve	40,000
Development Rebate Reserve	20,000
Workmen Compensation Fund	10,000
Dividend Equalization Reserve	12,000
Profit and Loss Account	38,000
Unsecured Loans	80,000
Assets	
Non-Current Assets	4,00,000
Current Assets (including Bank balance Rs. 10,000)	1,00,000

The board of directors decided to redeem the preference shares on 1st January 2025 on the following conditions. Issue 4000 equity shares and Rs.50,000 10% debentures. Redeem preference shares at a premium of 10%. Raise necessary bank loan to provide funds for redemption and to have Rs.15,000 as balance. Admit claim of Rs.40,00 for workmen compensation. Utilise Rs.10,000 out of development rebate reserve for the purpose. Necessary journal entries assuming that holders of 100 reference shares could not be traced by the company.

17. Books of N Limited show the following balances on 31st December 2024

• 15000 present equity shares of Rs.10 each fully paid	1,50,000
• 2500 10% preference shares of Rs.100 each fully paid	2,50,000
• 500 8% redeemable pref. shares pop ups Rs.108, what is Rs.70 paid up	35,000
• General Reserve	75,000
• Profit and Loss Account	1,60,000
• Securities Premium	15,000
• Investment	1,20,000
• Cash at Bank	39,600

On 1st January 2025, the board of directors decided to redeem the preference shares at a premium of 8%. In order to pay of preference shareholders, the company also decided to sell the Investments and use companies fund and to raise the balance by issue of sufficient number of equity shares of Rs.10 each at a premium of rupee 1 per share subject to leaving a minimum bank balance of Rs.9,600 after such Redemption. Investments were sold at Rs.1,08,000. Show the necessary journal entries (without narration) to record the transactions.

18. D Ltd. secured a loan of Rs. 8,00,000 from the Axis Bank by issuing 1,000, 12% Debentures of Rs. 1000 each as collateral security. Required: How will you treat the issue of such debentures?

19. B Ltd. secured an overdraft of Rs. 80,000 from the bank by issuing 900, 12% Debentures of Rs. 100 each as collateral security. Prepare the Balance Sheet of the Company.

20. Mahi Ltd. taken a loan of Rs. 15,00,000 from the SBI by issuing 25000, 12% Debentures of Rs. 100 each as collateral security. Pass the necessary journal entries in the books of company.

21. X Ltd. decides to redeem 650, 15% preference shares of Rs.100 each at 10% premium. It has General Reserve of Rs.45,500 and securities premium of Rs.1,000. The new equity shares of Rs.10 each are to be issued at 25% premium for the purpose of redemption of pref. shares. Calculate the minimum number of equity shares to be issued by X Ltd.

MCQs

1. While issuing shares at a *premium*, the *premium amount* must be credited to:

a) General Reserve

b) Capital Redemption Reserve

c) Securities Premium A/c

d) Share Capital A/c

Answer: c

2. A company issued shares of ₹10 each at ₹12. What is the accounting term for the extra ₹2 collected?

a) Discount on shares

b) Capital reserve

c) Securities premium

d) Capital redemption reserve

Answer: c

3. On non-payment of allotment money, a company *cancels shares*. This accounting process is called:

a) Reissue of shares

b) Buy-back

c) Forfeiture of shares

d) Redemption of shares

Answer: c

4. Forfeited shares can be re-issued at a price...

a) Less than face value

b) More than face value

c) Equal to face value

d) Any of the above

Answer: d

5. When forfeited shares are reissued at a discount, the discount is debited to:

a) Share Capital A/c

b) Discount on Issue of Shares A/c

c) Forfeited Shares A/c

d) P&L Appropriation A/c

Answer: c

6. Capital Redemption Reserve (CRR) is created out of:

a) Revenue profits

b) Capital profits

c) Both (a) and (b)

d) Issue of debentures

Answer: a

7. Which reserve *cannot* be used for redemption of preference shares?

a) CRR

b) Securities Premium

c) General Reserve

d) Profit & Loss A/c

Answer: b

8. Debentures carry:

a) Ownership rights

b) Voting rights

c) Fixed interest

d) Variable dividends

Answer: c

9. Debentures issued at ₹100 face value but repayable at ₹110 are said to be issued:

a) At premium

b) At discount

c) At par

d) At premium on redemption

Answer: d

10. Premium payable on redemption of debentures is debited to:

a) General Reserve

b) Profit & Loss A/c

c) Capital Redemption Reserve

d) Share Capital A/c

Answer: b

Accounting for Non-Profit Organisation

Lesson 8

KEY CONCEPTS

■ Non-Profit Organization ■ Receipt & Payment Account ■ Income & Expenditure Accounts

Learning Objectives

To understand:

Not-for-Profit Organisations (NPO) are set up with the prime objective of providing services and not to earn profit thereby enhancing the welfare of society. Such organisations include schools, hospitals, trade unions, religious organisations, etc. The person/s or the groups of individuals who govern and manage the working of an NPO are known as trustees. NPO's main sources of income are donations, subscriptions, life membership fees, grants etc. As these organisations are not set up with profit motive, they do not prepare Trading and Profit and Loss Account. Instead, they maintain Receipt and Payments Account, Income and Expenditure Account and Balance Sheet.

From temples to youth organizations to the local chambers of commerce, nonprofit organizations make our communities more livable places. Unlike for-profit businesses that exist to generate profits for their owners, non-profit organizations exist to pursue missions that address the needs of society. Nonprofit organizations serve in a variety of sectors, such as religious, education, health, social services, commerce, amateur sports clubs, and the arts.

In this lesson we will learn some basic concepts of accounting of not for profit organisations along with illustrations and objective questions.

Lesson Outline

- Meaning of Non-Profits Organizations (NPO)
- Key Features of Non-Profit Organisations
- Books of Accounts
- Profit Seeking Organization Vs. Not for Profit Organization
- Accounting Records of Non-Profit Organisations
- Receipts and payments Accounts
- Features of Receipts and Payments Account
- Income and Expenditure Accounts
- Features of Income and Expenditure Accounts
- Balance Sheet
- Receipts and Payments Account Vs. Income and Expenditure Account
- Income and Expenditure Account vs. Profit & Loss Account
- Illustrations
- Test Yourself
- List of Further Readings

ACCOUNTING FOR NON-PROFIT ORGANISATIONS

Certain organisations are established not for the purpose of earning profits but to provide services to their members or to the community at large. The beneficiaries of these services are generally members who contribute through periodic subscriptions or other forms of support. Such organisations are commonly referred to as *Non-Trading Entities***.** Examples include gymkhanas and sports clubs, educational institutions, public hospitals, libraries, cultural associations such as the Rotary Club or Lions Club, religious institutions, and charitable trusts.

Meaning of Non-Profit Organisations

Non-Profit Organisations (NPOs) are established with the primary objective of serving society rather than generating profits. Their purpose may include promoting arts, science, commerce, sports, charity, education, research, and other activities of public interest. These organisations encompass a wide range of entities such as educational institutions, medical organisations, social and cultural clubs, religious bodies, trade unions, and charitable trusts. Notable examples include professional institutions like the Institute of Company Secretaries of India (ICSI), the Institute of Cost Accountants of India (ICMAI), and the Institute of Chartered Accountants of India (ICAI).

NPOs are generally set up as charitable institutions and function without any profit motive, focusing instead on providing services to a specific group or the public at large. Unlike trading concerns, they usually do not manufacture, purchase, or sell goods and may have minimal or no credit transactions. As a result, their accounting system is relatively simple, designed primarily to meet statutory requirements and to ensure proper control over the utilisation of funds.

The main sources of income for NPOs include subscriptions from members, donations, life membership fees, grants-in-aid, and income from investments. Funds collected are typically credited to a capital or general fund. At the end of each accounting period, NPOs prepare financial statements—including the Receipts and Payments Account, the Income and Expenditure Account, and the Balance Sheet—to determine their income, expenditure, and overall financial position.

Through their activities, NPOs contribute significantly to community development and social welfare, making them essential institutions for creating equitable, inclusive, and vibrant societies.

Key Features of Non-Profit Organisations

Governing Body	• Managed by an elected committee or trustees responsible for policy-making and administration.
No Profit Distribution	• Prohibited from paying dividends or distributing profits to members.
Purpose	• Operate without a profit motive, focusing on social, cultural, educational, or community welfare activities.
Sources of Funds	• Primarily funded through Donations, Grants, and Membership subscriptions.
Use of Funds	• All funds are applied solely towards activities that benefit society or the target community.
Membership	• Membership rights are Personal, Non-Transferable, and cannot be sold or assigned.
Accounting Principle	• Follow the Entity Concept, treating the organisation as distinct from its members.

Books of Accounts

The primary books of account maintained by a Not-for-Profit Organisation typically include a **Cash Book** (with or without an analysis column) to record all cash and bank transactions, a **Members' Register** to keep detailed records of membership and subscriptions, and a **Register of Assets** to track the acquisition, disposal, and current status of the organisation's assets.

Profit Seeking Organization Vs. Not for Profit Organization

Points	Profit Seeking Organization	Not for Profit organization
Objective	To earn profit	To provide services
Fund	Interest of owner is known as "Owner's Fund"	Interest of members is known as "Capital Fund"
Result	Profit/Loss	Surplus/Deficit
Accounting Statements	• Manufacturing Account • Trading Account • P&L Account • Balance sheet	• Receipts and Payments Account • Income and Expenditure Account (I&E Account) • Balance sheet

Treatment of Special Items

Certain revenue and expense items in non-profit organisations are of a distinct nature and require special consideration in their treatment while preparing the final accounts. Some of the more common special items are outlined below.

Treatment of Subscription	
Periodical (Yearly basis)	Revenue Receipts
Life Membership (Lump Sum)	Capital Receipts ⟶ Transfer to "Life Membership Fund" in Balance sheet.

Subscription received during Current year	***
Outstanding: • Opening (-) • Closing (+)	
Advance: • Opening (+) • Closing (-)	
Subscription Cr. To Income & Expenditure Account (I&E Account)	***

Treatment of Entrance Fees/Admission Fees	
Treat Exclusively Revenue Receipts	Cr. of I&E Account
Treat Exclusively Capital Receipts	Add to Capital Fund (Balance Sheet Liability Side)

Treatment of Donations & Legacies (D&L)	
Meaning	Donation – Donated by any person to Organization. Legacies – Donations given under will on death of donor.
General (D&L)	Revenue Receipts ⟶ Cr. Of I&E Account
Specific (D&L)	Capital Receipts ⟶ Transfer to Special Fund ● Any income related to Special Fund added to Fund ● Any REVEX is deducted from Fund ● Any CAPEX is shown under Assets Side & Equal amount transferred from Special Fund to Capital Fund.

Treatment of Sale of Old Newspapers and Periodicals	
Revenue Receipts	● Cr. of I&E Account

Treatment of Sale of Old Fixed Assets	
Capital Receipts	● Cr. To Fixed Assets & Profit/Loss on Sale will transfer to I&E Account

Treatment of Aid from Govt. and Other institutions	
General Aid	● Revenue Receipts and Cr. I&E Account
Special Aid	● Capital Receipts and Add to Capital Fund

Treatment of Consumables items consumed during year	
Introduction	● Items like stationery, Sports Materials, Medicines etc.
Treatment	● Prepare Stock Account for each consumable items and compute amount of consumables consumed during year and transfer to Dr. of I&E Account. ● Prepare Creditors Account in case of Credit purchase is missing.

Treatment of P/L from Trading Activities	
Introduction	● Trading Activities like Restaurant/Bar run by club, Chemist shop by Hospital, Book Shop by Library.
Treatment	● Prepare Separate Trading Account to ascertain P&L and transfer such Profit/Loss to I&E Account

Examples:

1. Treatment of Subscription

XYZ Sports Club has the following subscription details for 2024–25:

- Subscriptions received during the year: ₹1,50,000
- Outstanding subscriptions:
  - Opening (1 April 2024): ₹5,000
  - Closing (31 March 2025): ₹8,000
- Subscriptions received in advance:
  - Opening: ₹3,000
  - Closing: ₹2,000

Required: Calculate the amount of subscription to be credited to the Income & Expenditure Account.

Solution:

Subscriptions for I&E A/c= ₹1,50,000 - ₹5,000 + ₹8,000 + ₹3,000 - ₹2,000 =₹1,54,000

Answer: ₹1,54,000 will be credited to the Income & Expenditure Account.

2. Treatment of Life Membership Fees

ABC Cultural Club received ₹40,000 from life membership fees during the year.

Treatment:

This is a **capital receipt** and will be transferred to the **Life Membership Fund** on the liabilities side of the Balance Sheet.

3. Treatment of Entrance Fees

Case 1 – Treated as Revenue Receipt:

Entrance fees received during the year ₹12,000.

Treatment: Credit to the Income & Expenditure Account.

Case 2 – Treated as Capital Receipt:

Entrance fees received ₹12,000.

Treatment: Add to the Capital Fund on the liabilities side of the Balance Sheet.

4. Treatment of Donations & Legacies

During the year, an NPO received:

- General donation: ₹50,000
- Specific donation for a sports pavilion: ₹1,00,000.
- Interest earned on the specific donation fund: ₹5,000.
- Pavilion construction cost incurred: ₹90,000.

Solution:

- **General Donation (₹50,000):** Revenue receipt ⟶ Credit to I&E Account.
- **Specific Donation (₹1,00,000):** Capital receipt ⟶ Transfer to *Pavilion Fund*.
- **Interest on Fund (₹5,000):** Add to Pavilion Fund.
- **Construction Cost (₹90,000):**
  - Show pavilion as an asset at ₹90,000.
  - Reduce Pavilion Fund by ₹90,000.

5. Treatment of Sale of Old Newspapers and Periodicals

Sale proceeds: ₹3,000.

Treatment: Revenue receipt ⟶ Credit to I&E Account.

6. Treatment of Sale of Old Fixed Assets

Old furniture (book value ₹10,000) sold for ₹12,000.

Treatment:

- Reduce Furniture account by ₹10,000.
- Profit on sale ₹2,000 ⟶ Credit to I&E Account.

7. Treatment of Government Aid

Example:

- General grant from State Govt.: ₹25,000 ⟶ Revenue receipt ⟶ Credit to I&E Account.
- Special grant for library building: ₹50,000 ⟶ Capital receipt ⟶ Add to Capital Fund.

8. Treatment of Consumables

Example:

Sports material:

- Opening stock: ₹5,000
- Purchases: ₹25,000
- Closing stock: ₹7,000

Consumables Consumed:

₹5,000+₹25,000−₹7,000=₹23,000

Treatment: Debit ₹23,000 to I&E Account.

9. Treatment of Profit/Loss from Trading Activities

Example:

XYZ Club runs a canteen:

Particulars	Amount (₹)
Sales	80,000
Purchases	50,000
Wages	10,000
Rent	5,000

Trading Account Result:

Profit=₹80,000− (₹50,000+₹10,000+₹5,000) =₹15,000

Treatment: Transfer ₹15,000 profit to the credit side of the I&E Account.

Accounting Records of Non-Profit Organisations

Non-Profit Organisations are generally not engaged in trading or commercial activities. Their primary sources of income include member subscriptions, donations, government grants or financial assistance, and income generated from investments. As most of their transactions are conducted in cash or through banks, these organisations are legally required to maintain proper accounting records to ensure transparency and effective control over the utilisation of funds. Typically, they maintain a Cash Book to systematically record all receipts and payments, along with a Ledger that contains accounts for all incomes, expenses, assets, and liabilities. This systematic record-keeping facilitates the preparation of accurate financial statements at the end of the accounting period.

Final Accounts (Financial Statements)

At the end of each accounting period, Non-Profit Organisations are required to prepare financial statements to present a clear picture of their financial performance and position. Although these entities are not profit-oriented and therefore do not prepare a Trading Account or a Profit and Loss Account, it is essential to determine whether the income generated during the year was sufficient to meet the expenses incurred. Additionally, these statements serve to provide necessary financial information to members, donors, contributors, and regulatory authorities such as the Registrar of Societies. For this purpose, NPOs prepare their final accounts in accordance with generally accepted accounting principles. The financial statements of a Non-Profit Organisation typically comprise:

1. Receipts and Payments Account
2. Income and Expenditure Account
3. Balance Sheet

Receipts and Payments Account

The Receipts and Payments Account is prepared at the end of the accounting year based on the cash receipts and cash payments recorded in the Cash Book. It serves as a summary of all cash and bank transactions during the year, classified under appropriate heads. For example, subscriptions received from members on various dates, recorded individually on the debit side of the Cash Book, are presented in total on the receipts side of this account. Similarly, recurring expenses such as salaries, rent, and electricity charges, recorded separately on the credit side of the Cash Book, are shown as aggregated totals on the payments side.

This account presents a consolidated view of all receipts and payments—whether related to the current, previous, or future accounting periods—and includes both capital and revenue transactions. It does not record non-cash items such as depreciation. The opening balance represents cash in hand and/or cash at bank at the beginning of the year and is shown on the receipts side, while the closing balance—representing the year-end cash and bank balance—is shown on the payments side. In cases where there is a bank overdraft at year-end, it is recorded on the receipts side as the final item.

Features of Receipts and Payments Account

- It is an Account which contains all Cash and Bank transactions made by a non-profit organization during a particular financial period.
- It starts with the opening balances of Cash and Bank. All Cash Receipts both capital & revenue during the period are debited to it.
- All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
- While recording the Cash and Bank transactions all entries are made on Cash Basis.
- It is a summary of Cash Book.
- It follows Real Account.

Summary Points - Receipts and Payments Account	
Account	• Assets Account or • Real Account (***Dr. what comes in and Cr. what goes out***)
Features	• Starts with Opening Balance of Cash (In hand and at Bank) • Ends with Closing balance of Cash (In hand and at Bank) • Dr. - All Sums **received [Revenue or Capital] & [Past/Present/Future]** • Cr. - All sums **paid out [Revenue or Capital] & [Past/Present/Future]** • It does **not record Non cash item (e.g. Depreciation)**

Receipts and Payments account for the period ending on ...

Dr. *Cr.*

Receipts	Amount (₹)	Payments	Amount (₹)
To Balance b/d		**By Balance b/d (BOD)**	
• Cash		By Annual Sports Exp	
• Bank		By Salaries and Wages	
To Subscription:		By Rent, Rates and Taxes	
• For Previous Year		By Insurance	
• For Current Year		By Furniture	
• For Next Year		By Sports Equipment	
To Entrance Fees		By Books and Periodicals	
To Donation for Building		By Audit Fees	
To General Donation		By Printing and Stationery	
To Life Membership Fees		By Honorarium	
To Legacy		By Bank Charges	
To Grant from Govt.		By Postages and telegrams	
To contribution for Annual Dinner		By Water and Electricity	
To Dividend		By Conveyances and Travelling	
To Interest		By Repairs and Maintenance	
To Rent		By sundry Exp	
To Receipt on Annual sports		By Annual Dinner Exp	
To Sale of Old Mat./Magazines		By Investment	
To Sundry Receipts		**By Balance c/d**	
To Balance c/d (Bank Overdraft)		• Cash	
		• Bank	
Total		**Total**	

Example:

The receipts and payments for the DP Club for the year ended March 31, 2024 were: Entrance fees ₹ 300; Membership Fees ₹ 3,000; Donation for Club Pavilion ₹ 10,000, Foodstuff sales ₹ 1,200; Salaries and Wages ₹ 1,200 Purchase of Foodstuff ₹ 800; Construction of Club Pavilion ₹11,000; General Expenses ₹ 600; Rent and Taxes ₹ 400; Bank Charges ₹ 160. Cash in hand–April. 1st ₹ 200, March. 31st ₹ 350 Cash in Bank–April. 1st ₹ 400; March. 31st ₹ 590 You are required to prepare Receipts and Payment Account

Solution:

DP Club
Receipts and Payments Accounts for the year ended 31st March, 2024

Receipts	₹	Payments	₹
To Balance b/d (op. bal.) Cash in hand	200	By Salaries and Wages	1,200
To Cash with bank	400	By Purchase of Foodstuff	800
To Entrance Fees	300	By Club Pavilion (Expenditure on its construction)	11,000
To Membership Fees	3,000		
To Donation of A/C of Club Pavilion	10,000	By General Expenses	600
To Sales of foodstuff	1,200	By Rent and Taxes	400
		By Bank Charges	160
		By Balance c/d (closing bal) Cash in hand	350
		Cash in bank	590
Total	15,100	Total	15,100

Income and Expenditure Account

The Income and Expenditure Account is a summary of all revenue incomes and expenditures for the accounting year, prepared on the accrual basis of accounting. It is similar in form and purpose to the Profit and Loss Account of a business organisation, but is used by Non-Profit Organisations to determine their operating results. Only revenue items relating to the current period are included—expenses and losses are recorded on the expenditure side, while incomes and gains are shown on the income side. The resulting balance represents either a surplus (excess of income over expenditure) or a deficit (excess of expenditure over income), which is transferred to the Capital Fund in the Balance Sheet. ***Non-profit organizations registered under section 8 of the Companies Act, 2013 are required to prepare their Income and Expenditure account and Balance Sheet as per the Schedule III to the Companies Act, 2013.***

The preparation of this account requires adjustments to the figures in the Receipts and Payments Account, incorporating additional information such as outstanding and prepaid expenses, accrued incomes, and non-cash charges like depreciation. These adjustments ensure that the account reflects the true financial performance of the organisation for the period under consideration.

Features of Income and Expenditure Accounts

- It follows Nominal Account.
- All expenses of revenue nature for the particular period are debited to this account on accrual basis.
- Similarly, all revenue incomes related to the particular period are credited to this account on accrual basis.
- All Capital incomes and expenditures are excluded.
- Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.

- Profit on sale of asset is credited. Loss on sale of asset is debited. Annual depreciation on assets is also debited.
- If income is more than expenditure, it is called a surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
- If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Summary Points - Income and Expenditure Account	
Account	P&L **For current Accounting period** with: ● Surplus (Income > Exp.) ● Deficit (Income < Exp.) Transfer to **"Capital Fund".**
Features	● Dr. – Expenses and Losses **[Revenue] & [Current Year]** ● Cr. - Incomes **[Revenue] & [Current Year]** ● It does **record Non cash item (e.g. Depreciation)**

Dr. **Income and Expenditure account for the period ending on ...** *Cr.*

Expenditure	**Amt. ₹**	**Income**	**Amt. ₹**
To Salaries and Wages paid		**By Subscription Received**	
Add: O/S (Cl.)		Add: O/S (Cl.)	
Less: O/S (Op.)		Less: O/S (Op.)	
Add: Prepaid (Op.)		Add: Advance (Op.)	
Less: Prepaid (Cl.)		Less: Advance (Cl.)	
To Rents, Rates and Taxes		By Entrance Fees (Only Revenue)	
To Insurance Premiums		By General Donation	
To Depreciation		**By Life Membership Fees (Rev.)**	
To Books and Periodicals		By Profit from Annual Dinner	
To Audit Fees		(Contribution – Expenses)	
To Printing and Stationery		By Profit on Annual Sports	
To Honorarium		(Receipts – Expenses)	
To Bank Charges		By Profit on Sale of Provisions	
To Postages and Telegram		(Sale + Cl.st.-Purchase-Op.St.)	
To Electricity and Water		By Rent of club Hall	
To Conveyance and Travelling		By Dividend and Interest	
To Sundry Expenses		By Sundry Receipts	
To Surplus (Income > Exp.)		**By Deficit (Exp. > Income)**	
Total		Total	

Balance Sheet

The **Balance Sheet** of a Non-Profit Organisation presents a statement of assets and liabilities as on a specific date. It is prepared after the Income and Expenditure Account, incorporating the closing balances of assets and liabilities along with the updated Capital Fund. When the total value of assets exceeds total liabilities, the difference represents the **Capital Fund**, which reflects the accumulated surplus of the organisation. Proforma is given below:

Balance Sheet of ... as at....

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Fund:		**Fixed Assets:**	
Opening Balance		**Building (Op.)**	
Add: Surplus		Add: Additions	
Less: Deficit		Less: Depreciation	
Add: Entrance Fees (Capital Only)		**Furniture (Op.)**	
Add: Life M'Ship Subs'n (Cap.Only)		Add: Additions	
Add: CAPEX Tfr. From Special Fund		Less: Sale	
Prize Fund:		Less: Depreciation	
Opening Balance		**Sports Equipment**	
Add: Donation for Prize		Less: Depreciation	
Add: Income from Prize Fund Invsmt.		**Investments:**	
Less: Expenses		Prize Fund	
Building Fund:		Building Fund	
Add: Donation for Building		G-Sec.	
Add: Income from Building Fund Invt.		FD	
Less: Transfer to Capital Fund		**Current Assets:**	
Current Liabilities:		Sports Material	
Subscription received in Advance		O/S Subscriptions	
Outstanding Expense		Accrued Int/Rent	
BOD		Cash in hand	
Creditors		Cash at Bank	
Total		Total	

Example:

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, 2024:

Details	Amount (Rs.)
Match expenses paid during the year ended 31st March 2024	1,10,000
Match fund as on 01.04.2023	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

Solution:

Balance sheet as at March 31st 2024 (extract)

Liabilities	Amount (Rs.)	Assets	Amount Rs.)
Match fund	*30000*		
Add: Donation for match fund	*55000*		
Add: Proceeds from sale of tickets	*20000*		
Less: Match expenses *(Note-1)*	*(105000)*		
	Nil		

Note:1

Since the expenses incurred are more than the Match fund available ₹ 1,05,000 we are limiting the expenses to ₹ 1,05,000. The remaining expenses of ₹ 5000 (1,10,000-1,05,000) will be debited to the Income and expenditure account.

Receipts and Payments Account vs. Income and Expenditure Account

Points	Receipts & Payment Account	Income & Expenditure Account
Nature	Real Account	Nominal Account
Structure	Cash Book	Like P&L Account
Objective	To present summary of Cash	To ascertain net Results
Opening Balance	Cash or Bank balance (or BOD) in beginning of period	No opening Balance
Debit	All sums received	Expenses and Losses
Credit	All sums paid out	Income
Closing Bal.	C/F in same account of next period	Transfer to Capital Fund in Balance sheet
Non-Cash Items	Excludes	Includes
Period	Past, Present and Future	Current
Nature of items	Capital or Revenue	Only Revenue

Income and Expenditure Account vs. Profit & Loss Account

Points	Income & Expenditure Account	Profit & Loss Account
Objective	To ascertain Surplus/Deficit	To ascertain Profit/Loss
Who prepares?	Not for profit organization	Trading Intuitions
Bases	On Receipts & Payment A/C and other	Based on Trial Balance
Balance	Surplus or Deficit	Net Profit or Loss

Illustration 1:

From the following Cash Book entries of Shiva Entertainment Club, prepare Receipts and Payments Account:

Shiva Entertainment Club

Cash Book (Columnar)

Date	Receipts	LF	Bank Amount (Rs.)	Cash Amount (Rs.)	Date	Payments	L.F.	Bank Amount (Rs.)	Cash Amount (Rs.)
2025 April 1	Balance b/d		35,000	20000	2025 April 15	Insurance premium		15,000	
April 10	Subscriptions		1,20,000		May 10	Printing and stationery		10,750	
April 15	Entrance fees		13,000		May 20	Postage and courier fees			1,430
May 20	Life membership fees		12,000		June 10	Telephone expenses			2,810
June 15	Hall rent			42,000	July 15	Wages and salaries			32,000
July 23	Life membership fees		8,000		July 15	Rates and Taxes		17,000	
Aug. 12	Donation for building		60,000		July 31	Fixed Deposit		1,00,000	
Sept. 10	Subscriptions (2024-25)		30,000		Aug. 10	Printing and stationery		15,000	
Sept. 13	Subscription		1,45,000		Aug. 15	Postage and courier service			1,480

Oct. 14	Entrance fees		40,000		Sept. 8	Lighting		12,250	
Nov. 9	Subscription		35,000		Sept. 13	Telephone exp.			2,830
2026 Jan.10	Subscription (2026 -2027)		10,000		Oct. 1	Wages and salaries		20,000	12,000
Feb. 07	Subscription		25,000		Oct. 18	Printing and stationary		13,000	
					Nov. 30	Fixed Deposit		1,00,000	
Mar. 28	Interest on Fixed Deposit		18,000		Dec. 31	Wages and Salaries		32,000	
					2026 Jan. 10	Postage charges			240
					Feb. 2	Telephone expenses			2,960
					Feb. 10	Postage and Courier fees			850
					Mar. 15	Lighting		14,000	
					Mar. 27	Wages and Salaries		32,000	
					Mar. 31	Balance c/		1,70,000	5,400
			551,000	62,000				5,51,000	62,000

Solution:

Item wise Aggregation of various Receipts

Subscriptions (2025-2026)

Date	Amount (Rs.)
April 10, 2025	1,20,000
Sept. 13, 2025	1,45,000
Nov. 9, 2025	35,000
Feb. 7, 2026	25,000
Total	325,000

Subscriptions (2024-25)

Date	Amount (Rs.)
Sept. 10, 2025	30,000
Total	30,000

Subscription (2026-27)

Date	Amount (Rs.)
Jan. 10, 2026	10,000
Total	10,000

Entrance Fees

Date	Amount (Rs.)
April 15, 2025	13,000
Oct. 14, 2025	40,000
Total	53,000

Hall Rent

Date	Amount (Rs.)
June 15, 2025	42,000
Total	42,000

Life Membership fee

Date	Amount (Rs.)
May 20, 2025	12,000
July 23, 2025	8,000
Total	20,000

Donation for Buildings

Date	Amount (Rs.)
Aug. 12, 2025	60,000
Total	60,000

Interest on Fixed Deposits

Date	Amount (Rs.)
March 28, 2026	18,000
Total	18,000

Item wise Aggregation of various Payments

Insurance Premium

Date	Amount (Rs.)
April 15, 2025	15,000
Total	15,000

Printing and Stationery

Date	Amount (Rs.)
May 10, 2025	10,750
Aug. 10, 2025	15,000
Oct. 18, 2025	13,000
Total	38,750

Lighting

Date	Amount (Rs.)
Sept. 8, 2025	12,250
March 15, 2026	14,000
Total	26,250

Telephone Expenses

Date	Amount (Rs.)
June 10, 2025	2,810
Sept. 13, 2025	2,830
Feb. 2, 2026	2,960
Total	8,600

Rates and Taxes

Date	Amount (Rs.)
July 15, 2025	17,000
Total	17,000

Fixed Deposits

Date	Amount (Rs.)
July 31, 2025	1,00,000
Nov. 30, 2025	1,00,000
Total	2,00,000

Wages and Salaries

Date	Amount (Rs.)
July 15, 2025	32,000
Oct. 1, 2025	32,000
Dec. 31, 2025	32,000
March 27, 2026	32,000
Total	1,28,000

Postage and Courier Service

Date	Amount (Rs.)
May 20, 2025	1,430
Aug. 15, 2025	1,480
Jan. 10, 2026	240
Feb.10, 2026	850
Total	4,000

Shiva Entertainment Club

Dr. **Receipt and Payment Account for the year ending March 31, 2026** *Cr.*

Receipts		Amount (Rs.)	Payments	Amount (Rs.)
Cash in hand as on		20,000	Printing and Stationery	38,750
April 1, 2025			Lighting	26,250
Cash at bank as on		35,000	Rates and Taxes	17,000
April 1, 2025			Telephone charges	8,600
Subscription:			Postage and Courier	4,000
2024–25	30,000		Wages and Salaries	1,28,000
2025-26	3,25,000		Insurance Premium	15,000
2026–27	10,000	3,65,000	Investment in Fixed Deposits	2,00,000
Donation for building		60,000	Cash in hand as on 31.3.26	5,400
Entrance fees		53,000	Cash at bank as on 31.3.26	170,000
Life membership fee		20,000		
Interest on investment in Fixed Deposits		18,000		
Hall rent		42,000		
		6,13,000		6,13,000

Illustration 2:

From the following particulars relating to Sports Point, prepare a Receipt and Payment account for the year ending March 31, 2026.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
Opening cash balance		10,000	Sale of old sports materials	22,000
Opening bank balance		72,000	Donation received for pavilion	1,46,000
Subscriptions collected for:	Rs.		Rent paid	30,000
2024-25	5,000		Sports materials purchases	48,000
2025-26	76,000		Purchase of refreshments	16,000
2026-27	9,000	90,000	Expenses for maintenance of sports ground	20,000
Sale of refreshments		20,000	Salary paid	55,000
Entrance fees received		10,000	Tournament expenses	24,000
			Furniture purchased	15,000
			Office expenses	12,000
			Closing cash in hand	4,000

Solution:

Books of Sports Point

Dr. **Receipt and Payment Account for the year ending March 31, 2026** *Cr.*

Receipts		Amount (Rs.)	Payments	Amount (Rs.)
Balance b/d			Rent	30,000
Cash		10,000	Sports materials purchased	48,000
Bank		72,000	Purchase of refreshments	16,000
Subscriptions	Rs.		Maintenance expenses for Spots ground	20,000
2024-25	5,000		Salary	55,000
2025-26	76,000		Tournament expenses	24,000
2026-27	9,000	90,000	Furniture purchased	15,000
Sale of refreshments		20,000	Office expenses	12,000
Entrance fees		10,000	Balance c/d	
Sale of old sports materials		22,000	Cash	4,000
Donation for pavilion		1,46,000	Bank (balancing figure)	1,46,000
		3,70,000		3,70,000

Illustration 3:

From the following Receipts and Payments Account for the year ending March 31, 2026 of Senior Citizen Club, prepare Income and Expenditure Account for the same period:

Receipt and Payment Account for the year ending March 31, 2026

Dr. *Cr.*

Expenditure		Amount (Rs.)	Income	Amount (Rs.)
Balance c/d (Cash & Bank)		2,61,500	Purchase of furniture (1.7.25)	50,000
Subscriptions			Salaries	1,20,000
2024-25	25,000		Telephone expenses	3,000
2025-26	2,00,000		Electricity charges	16,000
2026-27	15,000	2,40,000	Postage and Stationery	11,500
Donation		20,000	Purchase of books	25,000
Hall rent		33,000	Entertainment expenses	9,000
Interest on bank deposits		14,500	Purchase of 8% government papers (1.7.25)	80,000
Entrance fees		10,000	Miscellaneous expenses	16,000
			Balance c/d:	
			Cash	3,000
			Bank	2,45,500
		5,79,000		5,79,000

The following additional information is available:

(i) Salaries outstanding – Rs. 15000;

(ii) Entertainment expenses outstanding – Rs. 5000;

(iii) Bank interest receivable – Rs. 4500;

(iv) Subscriptions accrued – Rs. 14000;

(v) 50 per cent of entrance fees is to be capitalised;

(vi) Furniture is to be depreciated at 10 per cent per annum.

Solution

Books of Senior Citizen Club

Income and Expenditure Account for the year ending 31.3.2026

Dr. *Cr.*

Expenditure		Amount (Rs.)	Income		Amount (Rs.)
Salaries	1,20,000		Subscriptions		2,14,000
Add: Outstanding	15,000	1,35,000	Donation		20,000
Telephone expenses		3,000	Entrance Fees (50% of Rs. 10,000)		5,000
Electricity charges		16,000	Bank interest	14,500	
Postage and Stationery		11,500	Add: Outstanding interest	4,500	19,000
Entertainment expenses	9,000		Interest on investment		4,800
Add: Outstanding expenses	5,000	14,000	Hall rent		33,000
Miscellaneous expenses		16,000			
Depreciation on furniture		3,750			
Surplus		96,550			
(Excess of Income over Expenditure)		2,95,800			2,95,800

Working Notes:

1. Interest on Investment (Accrued): 80,000x8% x9/12 = Rs. 4,800
2. Subscription for the year ending 31st March, 2026:

Received during 2025-26 Rs.2,00,000 + Outstanding on 31-3-2026 Rs. 14,000 = Rs. 2,14,000

Illustration 4:

From the Receipts and Payments Account given below, prepare the Income and Expenditure Account of Jaipur Club for the year ended March 31, 2026:

Receipts and Payments Account for the year ending March 31, 2026

Dr. *Cr.*

Receipts	Amount (Rs.)	Payments		Amount (Rs.)
To Balance b/d	32,000	By Salary		3,15,000
To Subscriptions	8,25,000	By Rent		18,000
To Entrance Fees	12,500	By Electricity		35,000
To Donations for Building	1,25,000	By Taxes		17,000
To Rent of hall	17,500	By Printing and Stationery		13,800
To Sale of investments	30,000	By Sundry expenses		29,200
		By Books purchased		1,75,000
		By Fixed deposit with bank (on 31.03.2026)		1,50,000
		By Balance c/d		
		Cash in hand	14,000	
		Cash at bank	2,75,000	2,89,000
	10,42,000			10,42,000

Solution:

Books of Jaipur Club

Income and Expenditure Account for the year ending March 31, 2026

Dr. *Cr.*

Expenditure	Amount (Rs.)	Income	Amount (Rs.)
To Salary	3,15,000	By Subscriptions	8,25,000
To Rent	18,000	BY Entrance fees	12,500
To Electricity	35,000	By Rent of hall	17,500
To Taxes	17,000		
To Printing & Stationery	13,800		
To Sundry Expenses	29,200		
To Surplus (excess of income over expenditure)	4,27,000		
	8,55,000		8,55,000

Illustration 5:

Following is the Receipt and Payment Account of Patel Entertainment Club for the year ending March 31, 2026

Receipt and Payment Account for the year ending March 31, 2026

Receipts		Amount (Rs.)	Payments		Amount (Rs.)
Balance b/d			Salaries		44,000
Cash	7,500		Electricity		21,000
Bank	70,000	77,500	Restaurant expenses		70,000
Member's subscriptions:			Telephone		35,000
2024-2025	12,500		Subscription for periodicals		14,500
2025-2026	1,00,000		Printing and stationery		13,000
2026-2027	10,000	1,22,500	Sports expenses		50,000
Sale of furniture - (1.4.2025) (book value: Rs. 8,000)		10,000	Secretary's honorarium		30,000
			Invest. In 8% Securities (31.3.26)		1,00,000
Sale in restaurant		1,00,000	Balance c/d:		
Sale of old periodicals and newspapers		3,200	Cash	6,500	
Hire of ground used for marriage		48,750	Bank	20,000	26,500
Donation for sports fund		25,000			
Locker Rent		17,050			
		4,04,000			4,04,000

Additional Information

1. The club had 150 members, each paying an annual subscription of Rs. 750. Subscription outstanding as on 31 March 2026 Rs.20,000.
2. Telephone bill outstanding for the year 2025-26 is Rs.2,000.
3. Locker Rent Rs.4,050 outstanding for the year 2024-25 and Rs.2,500 for 2025-26.
4. Salary outstanding for the year 2025-26 Rs.4,000.
5. Opening Stock of Printing and stationery Rs. 2,000 and closing stock of printing and stationery is Rs.3,000 for the year 2025-26.
6. On 1st April 2025 other balances were as under:

	Rs.
Furniture	1,23,000
Building	6,50,000
Sports fund	15,000

7. Depreciation to be charged on Furniture and Building @ 10% and 5% respectively. Prepare Income and Expenditure account for the year ended 31st March, 2026.

Solution:

Book of Patel Entertainment Club

Income and Expenditure Account for the year ending on March 31, 2026

Expenditure		Amount (Rs.)	Income		Amount (Rs.)
Salary	44,000		Subscriptions	1,00,000	
Add: Outstanding	4,000	48,000	*Add:* Outstanding	12,500	1,12,500
Electricity Bill		21,000	Sale of old periodicals		3,200
Telephone	35,000		Gain on sale of furniture		2,000
Add: Outstanding	2,000	37,000	Hire of ground		48,750
Subscription for periodicals		14,500	Locker rent	17,050	
Printing and Stationery	13,000		*Less:* Opening o/s	(4,050)	
Add: Opening Stock	2,000			13,000	
	15,000		*Add:* Closing o/s	2,500	15,500
Less: Closing stock	(3,000)	12,000	Sale in restaurant	1,00,000	
Secretary's honorarium		30,000	Less: Restaurant exp.	(70,000)	30,000
Sports Expenses	50,000		Deficit (Excess of Expenditure over Income)		4,550
Less: Opening Balance of sports fund	(15,000)				
	35,000				
Less: Donation for Sports	(25,000)	10,000			
Depreciation On:					
Furniture	11,500				
Building	32,500	44,000			
		2,16,500			2,16,500

Illustration 6:

From the following Receipts and Payments Account and additional information relating to Sikar Cricket Club, prepare Income and Expenditure Account for the year ended March 31, 2026:

Sikar Cricket Club

Receipts and Payments Account

Dr. *Cr.*

Receipts	**Amount (Rs.)**	**Payments**	**Amount (Rs.)**
Balance b/d (Cash in Hand)	18,000	Balance b/d (bank overdraft)	16,000
Member's subscriptions	2,50,000	Upkeep of field and pavilion	1,15,000
Member's entrance fee	15,000	Tournament expenses	40,000
Sale of old sports materials	2,500	Rates and Insurance	10,000
Hire of ground	28,000	Telephone	3,500
Subscription for tournament	60,000	Postage charges	4,000
Life membership fee	20,000	Printing and Stationery	26,000
Donations	6,00,000	Miscellaneous expenses	14,400
		Secretary's honorarium	50,000
		Grass seeds	2,600
		Investments	6,00,000
		Purchase of sports materials	68,000
		Balance c/d	44,000
	9,93,500		9,93,500

Assets at the beginning of the year were:

	Rs.
Stock of sports materials	85,000
Printing and Stationery	11,000
Subscriptions receivable	28,000

Donations and Surplus on account of tournament are to be kept in Reserve for a permanent pavilion. Subscriptions due on March 31, 2026 were Rs. 42,000. Write-off fifty per cent of sports materials and thirty per cent of printing and stationery.

Solution:

Books of Sikar Cricket Club

Income and Expenditure Account for the year ending on March 31, 2026

Dr. *Cr.*

Expenditure		**Amount (Rs.)**	**Income**		**Amount (Rs.)**
Upkeep of field and pavilion		1,15,000	Subscriptions	2,50,000	
Rates and Insurance		10,000	*Add:* Outstanding (closing)	42,000	
Telephone		3,500		2,92,000	
Postage charges		4,000	*Less:* Outstanding (opening)	28,000	2,64,000
Printing & stationery	26,000		Entrance fees		15,000
Add: Opening stock	11,000		Sale of old sports material		2,500
Available for use	37,000		Hire of grounds		28,000
Less: Closing stock	(25,900)				
Stationery consumed		11,100			
Miscellaneous expenses		14,400			
Secretary's honorarium		50,000			
Grass seeds		2,600			
Sports materials consumed:					
Opening stock	85,000				
Add: Purchases	68,000				
	1,53,000				
Less: Closing stock	(76,500)	76,500			
Surplus		22,400			
(Excess of income over expenditure)					
		3,09,500			3,09,500

Illustration 7:

During the year ended 31st March, 2026, Surya Cricket Club received subscriptions as follows:

For year ending 31st March, 2025	12,000
For year ending 31st March, 2026	6,15,000
For year ending 31st March, 2027	18,000
Total	6,45,000

There are 500 members and annual subscription is ₹ 1,500 per member. On 31st March, 2026, a sum of ₹ 15,000 was still in arrears for subscriptions for the year ended 31st March, 2025. Ascertain the amount of subscriptions that will appear on the credit side of Income and Expenditure Account for the year ended 31st March, 2026. Also show how the items would appear in the Balance Sheet as on 31st March, 2025 and the Balance Sheet as on 31st March, 2026.

Solution:

Income & Expenditure Account (An extract) of Surya Cricket Club for the year ended 31st March, 2026

Expenditure	₹	Income	₹
		By Subscription (500 members × ₹ 1,500 per member)	7,50,000

Balance Sheet of Surya Cricket Club as on 31st March, 2025 (An extract)

Liabilities	₹	Assets	₹
		Subscription Receivable (₹15,000 + ₹12,000)	27,000

Balance Sheet of Surya Cricket Club as on 31st March, 2026 (An extract)

Liabilities	₹	Assets	₹
Unearned Subscription	18,000	Outstanding Subscription of 2024-25 = ₹ 15,000 of 2025-26 = (₹ 7,50,000 – ₹ 6,15,000)	1,50,000

TEST YOURSELF

(Multiple Choice Questions):

Choose the most appropriate answer from the given options:

1. Which of the following consist in the final accounts of a non-profit organisation-
   (a) Trading and Profit and Loss Account; and Balance Sheet
   (b) Income Statement; and Statement of Financial Position
   (c) Receipts and Payments Account; and Income and Expenditure Account
   (d) Receipts and Payments Account; Income and Expenditure Account; and Balance Sheet
2. Receipts and Payments Account is a
   (a) Income Statement
   (b) Cash Book
   (c) Summary of the Cash Book
   (d) Statement of Financial Position
3. Receipts and Payments Account is prepared on
   (a) Accrual basis of accounting
   (b) Cash basis of accounting
   (c) Hybrid basis of accounting
   (d) Either (a) or (b)
4. Which of the following items are included in the Receipts and Payments Account
   (a) Only revenue nature receipts and payments relating to a particular accounting period
   (b) Only capital nature receipts and payments relating to a particular accounting period
   (c) All kinds of receipts and payments of during a particular accounting period
   (d) All kinds of receipts and payments relating to a particular accounting period
5. Income and Expenditure Account is prepared on
   (a) Cash basis (b) Accrual basis (c) Hybrid basis
   (d) Either (a) or (b)
6. Income and Expenditure Account records income and expenditure items of
   (a) Both capital and revenue nature
   (b) Only capital nature
   (c) Only revenue nature
   (d) Only revenue nature related to a particular accounting period

7. Income and Expenditure Account is equivalent to
   (a) Profit and Loss Account
   (b) Receipts and Payments Account
   (c) Balance Sheet
   (d) None of the above
8. Receipts and Payments Account is in nature of
   (a) Personal Account
   (b) Artificial Personal Account
   (c) Real Account
   (d) Nominal Account
9. Income and Expenditure Account is a
   (a) Nominal Account
   (b) Real Account
   (c) Representative Personal Account
   (d) Personal Account
10. Which of the following is not recorded in the Receipts and Payments Account
   (a) Outstanding subscription
   (b) Prepaid insurance premium
   (c) Depreciation
   (d) All the above
11. Depreciation includes in
   (a) Receipts and Payments Account
   (b) Income and Expenditure Account
   (c) Both (a) and (b)
   (d) Either (a) or (b)
12. Life membership fee is a
   (a) Revenue nature receipt
   (b) Capital nature receipt
   (c) Revenue nature expenditure
   (d) Capital nature expenditure
13. Excess of income over expenditure is also known as
   (a) Profit
   (b) Surplus

(c) Loss

(d) Deficit

14. Excess of expenditure over income is also known as

(a) Profit

(b) Loss

(c) Surplus

(d) Deficit

15. A Club is of 200 members. Subscription per member is Rs. 3000 per annum. Outstanding subscription at the beginning of the year and end of the year were Rs.18000 and Rs.28000 respectively. Amount of subscription to be shown in Receipts and Payments Account will be

(a) Rs.600000 (b) Rs.618000 (c) Rs.572000 (d) Rs. 590000

16. A Club is of 200 members. Subscription per member is Rs. 3000 per annum. Outstanding subscription at the beginning of the year and end of the year were Rs.18000 and Rs. 28000 respectively. Amount of subscription to be shown in Income and Expenditure Account will be

(a) Rs. 600000 (b) Rs.618000 (c) Rs.572000 (d) Rs. 590000

17. A Club is of 150 members. Subscription per member is Rs. 500 per month. Subscription of 8 members of whole year's was not received and subscription from 5 members has been received in advance for six months of the next year. The amount of subscription to be shown in Receipts and Payments Account will be

(a) Rs. 900000 (b) Rs.867000 (c) Rs.963000 (d) Rs. 933000

18. A Club is of 100 members. Subscription per member is Rs. 2500 per annum. Rs. 218000 are received during the year 2025-26 which includes Rs. 20000 and Rs. 15000 subscription for the years 2024-25 and 2026-27 respectively. At the end of the year 2025-26, the amount of outstanding subscription will be

(a) Rs. 32000 (b) Rs.52000 (c) Rs.35000 (d) Rs. 67000

19. A Club is of 100 members. Subscription per member is Rs. 2500 per annum. Rs. 218000 are received during the year 2025-26 which includes Rs.20000 and Rs. 15000 subscription for the years 2024-25 and 2026-27 respectively. At the end of the year 2025-26, the amount of subscription received in advance will be

(a) Rs. 20000 (b) Rs.15000 (c) Rs.35000 (d) Rs. 32000

20. An institution received Rs. 180000 as rent during the year 2025-26 which includes Rs. 36000 received in advance for the year 2026-27. Outstanding rent at the end of the years 2024-25 and 2026-27 were Rs.24000 and Rs.28000 respectively. Amount of rent to be shown in Income and Expenditure Account for the year 2025-26 will be

(a) Rs. 180000 (b) Rs.144000 (c) Rs.140000 (d) Rs. 148000

21. In a Club, subscription received for current year is Rs. 250000, Subscription of current year received in the previous year is Rs. 25000, Subscription outstanding for current year isRs.45000, Subscription received in advance in current year isRs.11000 and subscription of previous year received in current year is Rs. 35000. The amount of subscription to be shown in Receipts and Payments Account will be

(a) Rs. 250000 (b) Rs.296000 (c) Rs.274000 (d) Rs. 226000

22. In a Club, subscription received for current year Rs. 250000, Subscription of current year received in the previous year Rs. 25000, Subscription outstanding for current year Rs.45000, Subscription received in advance in current year Rs.11000 and subscription of previous year received in current year Rs. 35000. The amount of subscription to be shown in Income and Expenditure Account will be

(a) Rs. 274000 (b) Rs.226000 (c) Rs.309000 (d) Rs. 320000

23. In a Club, subscription received for current year Rs. 250000, Subscription of current year received in the previous year Rs. 25000, Subscription outstanding for current year Rs.45000, Subscription received in advance in current year Rs.11000 and subscription of previous year received in current year Rs. 35000. If the beginning of the current year the outstanding subscription is Rs.42000 then the amount of outstanding subscription at the end of the current year will be

(a) Rs. 45000 (b) Rs.87000 (c) Rs. 52000 (d) Rs. 55000

24. In a Club, subscription received for current year Rs. 250000, Subscription of current year received in the previous year Rs. 25000, Subscription outstanding for current year Rs.45000, Subscription received in advance in current year Rs.11000 and subscription of previous year received in current year Rs. 35000. At the end of the current year amount of subscription received in advance will be

(a) Rs. 11000 (b) Rs.46000 (c) Rs. 36000 (d) Rs. 60000

25. Without adjusting the items of: Outstanding subscription Rs. 5600;Outstanding rent Rs. 3500; and Prepaid insurance Rs.1500, the Income and Expenditure Account of Poova Entertainment Club shown a surplus of Rs. 67000. The amount of surplus after above adjustments will be

(a) Rs. 59400 (b) Rs.63400 (c) Rs. 70600 (d) Rs.66400

26. Which of the following is generally considered as a non profit oriented organization?

(a) Charitable organization

(b) Corporation

(c) Audit firms

(d) Insurance companies

27. Outstanding subscription for a non-profit organization is considered as a/an

(a) Expense (b) Liability (c) Equity (d) Asset

28. Non-profit organizations prepare all of the following accounts except the

(a) Receipts and payment accounts (b) Income and Expenditure accounts

(c) Balance sheet (d) Income statement

29. Expenditure greater than income of a non-profit organization give rise to a

(a) Loss (b) Profit (c) Surplus (d) Deficit

30. Rent expense of a non-profit organization paid in advance. Which of the following is the correct classification of rent?

(a) Expense (b) Liability (c) Equity (d) Asset

31. An advance receipt of subscription from a member of the non-profit organization is considered as a/an

(a) Expense (b) Liability (c) Equity (d) Asset

32. Purchase of a fixed asset by a non-profit organisation will be shown in

(a) Income and Expenditure account (b) Receipts and Payments Account

(c) Both (a) and (b) (d) Neither (a) or(b)

33. Which of the following is to be recorded in an income and expenditure account?

(a) Purchase of a fixed asset

(b) Capital expenditure incurred on a fixed asset

(c) Profit on the sale of a fixed asset

(d) Sale of a fixed asset

34. Honorarium is a kind of remuneration paid to a person who is not the employee of a non-profit organization. Which of the following statements is true about the honorarium payment?

(a) It's a revenue expenditure

(b) It's a capital expenditure

(c) It's a deferred revenue expenditure

(d) It is not recorded in the books of accounts

35. The capital of a non-profit organization is generally known as

(a) Equity

(b) Accumulated fund/ Capital fund

(c) Cash fund

(d) Financial reserve

36. In case of a non-profit organisation, life membership fee is treated as

(a) a revenue expenditure

(b) a capital expenditure

(c) a deferred revenue expenditure

(d) Either (a) or (b)

37. XYZ club has a restaurant that maintains a separate trading account for its trading activities. Which of the following is the treatment of profit or loss on restaurant trading activities?

(a) Profit or loss is directly shown in the balance sheet

(b) Profit or loss is to be presented in income and expenditure account

(c) Profit and loss is credit in income statement

(d) Profit or loss is added to accumulated fund

38. Which of the following is the accounting equation for a non-profit organization?

(a) Asset = Capital + Liabilities

(b) Capital + Liabilities = Assets

(c) Accumulated fund + Liabilities = Assets

(d) Liabilities = Asset + Accumulated fund

39. In case of a non-profit organisation rent of building is due but not yet paid is considered as a/an

(a) Asset (b) Liability (c) Income (d) None of the above

40. A non-profit organization received Rs.10,000 as the entrance fee of a new member. If 20% of the fee has to be capitalized, what is the amount of fee needs to be shown in the income and expenditure account?

(a) Rs.2000 (b) Rs.8000 (c) Rs.9000 (d) Rs.10000

41. Rs.100000 received as the annual membership subscription. Out of this, Rs.20000 is pertaining to the previous accounting period, whereas Rs.10000 is receivable at the end of the current accounting period. Calculate the amount of subscription that will be shown in the income and expenditure account for this accounting year

(a) Rs.100000 (b) Rs.90000 (c) Rs.120000 (d) Rs.80000

42. Income and expenditure accounts show

(a) Cash available to an organization

(b) Closing capital of an organization

(c) Cash available in the bank account

(d) Surplus or deficit for the current accounting period

43. The amount or property received by a non- profit organization as stated by the will of a deceased person is commonly referred to as

(a) Donation

(b) Honorarium

(c) Legacy

(d) Endowment

44. Investment in sinking fund by a non-profit organization is a/an

(a) Liability

(b) Accumulated fund

(c) Asset

(d) Equity

45. In accounting of non-profit organisations, the sale of old newspapers is generally considered as a/an

(a) Revenue expenses (b) Capital expenditure

(c) Revenue income (d) Capital receipt

ANSWERS

1 (d)	2 (c)	3 (b)	4 (c)	5 (b)	6 (d)
7 (a)	8 (c)	9 (a)	10 (d)	11 (b)	12 (b)
13 (b)	14 (d)	15 (d)	16 (a)	17 (b)	18 (d)
19 (b)	20 (d)	21 (b)	22 (d)	23 (c)	24 (a)
25 (c)	26 (a)	27 (d)	28 (d)	29 (d)	30 (d)
31 (b)	32 (b)	33 (c)	34 (a)	35 (b)	36 (b)
37 (b)	38 (c)	39 (b)	40 (b)	41 (b)	42 (d)
43 (c)	44 (c)	45 (c)			

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

CSEET
FUNDAMENTALS OF ACCOUNTING – TEST PAPER
PAPER 2

(This test paper is for practice and self-study only and not to be sent to the Institute)

Time allowed: 3 hours *Maximum Mark: 100*

Note:

1. Attempt: Q. N. 1 which is compulsory and any 5 (five) questions from Q. No. 2 to Q. No. 8.
2. **The contents and structure of this test paper is indicative only.**

Question 1

Mr. X had prepared the following trial balance form his ledger as on 31st March, 2026:

Items	Debit Balance Rs.	Credit Balance Rs.
Purchases	6,20,000	
Sales		8,30,000
Cash in hand	4,200	
Cash in Bank	24,000	
Stock of goods (opening)	1,00,000	
Mr X's Capital		5,77,200
Drawings	8,000	
Salaries	64,000	
Postage and Telephone	23,000	
Salesman's Commission	70,000	
Insurance	18,000	
Advertising	34,000	
Furniture	44,000	
Printing and Stationery	6,000	
Motor Car	96,000	
Bad Debts	4,000	
Cash Discount	8,000	
General Expenses	60,000	
Carriage inwards	20,000	

Items	Debit Balance Rs.	Credit Balance Rs.
Carriage Outward	44,000	
Wages	40,000	
Creditors		80,000
Debtors	2,00,000	
Total	14,87,200	14,87,200

You are required to prepare Trading and Profit and Loss Account for the year ended March 2026 and Balance Sheet as on that date.

Additional Information:

(i) Cost of goods in stock as on 31st March, 2026 Rs. 1,45,000.

(ii) Mr. X had withdrawn goods worth Rs. 5,000 during the year

(iii) Purchases include Purchase of furniture worth Rs. 10,000

(iv) Debtors include Rs. 5,000 bad debts

(v) Creditors include a balance of Rs. 4,000 to the credit of Mr. B in respect of which it has been decided and settled with the party to pay only Rs. 1,000

(vi) Sales of goods worth Rs. 15,000 sent to Ram & Co. on approval basis remain unsold as on March 31, 2026 the cost of goods was Rs. 10,000

(vii) Provision for bad debts is to be created at 5% on Sunday Debtors.

(viii) Depreciate Furniture by 15% and Motor Car by 20%

(ix) The Salesmen are entitled to a commission of 10% on total sales.

[20 Marks]

Question 2

a) A Company purchased machinery for Rs. 50,000 on 1st July, 2022. Another machinery costing Rs. 10,000 was purchased on 1st September, 2023. On 31st December, 2025; the machinery purchased in 2022 was sold at a loss of Rs. 5,000. The company charges depreciation at the rate of 15% on diminishing balance method. Accounts are closed on 31st March every year. Prepare Machinery Account for 4 years.

b) What is meant by 'Shares Issued at Premium? State the purposes for which Premium amount can be utilised.

[8 marks each]

Question 3

a) X Ltd. was registered with a capital of 2,30,000 in 23,000 shares of Rs. 10 each. It issued a prospectus inviting applications for 23,000 shares at 40% premium payable as follows:

On application Rs. 5 (including Rs. 1 premium)

On allotment Rs. 4 (including Rs. 1 premium)

On first call Rs. 3 (including Rs. 1 premium)

On second call Rs. 2 (including Rs. 1 premium)

Applications were received for 23,000 shares; all money was duly received. Pass the necessary journal entries.

b) ABC Ltd. issued 1,00,000 12% debenture of Rs. 100 each at a discount of 10% payable in full on application by 31st May 2025. Application were received for 1,20,000 debentures. Debentures were allotted on 9th June 2025. Excess money was refunded on the same date. Pass necessary journal entries. Also show ledger accounts.

[8 marks each]

Question 4

a) What is "Share capital"? Explain the meaning of different types of share capital. How is it shown in the Balance Sheet?

[8 marks]

b) Classify the accounts into personal, real and nominal accounts along with reasoning of classification:

i. Machinery

ii. Goodwill

iii. Unexpired insurance

iv. Outstanding wages

v. Freight

vi. Depreciation

vii. Bank

viii. Drawings

[1 x 8 = 8 marks]

Question 5

a) Record the following transaction in the journal of Mr. Amit for the month of July 2025.

Date	Details of Transaction	Amount (Rs.)
July 1	Started business with cash	90,000
July 1	Paid into bank	50,000
July 2	Goods purchased for cash	30,000
July 3	Purchase of furniture and payment by cheque	10,000
July 4	Sold goods to Ramlal	4,000
July 5	Sold goods to Mahesh	8,000
July 7	Goods purchased from Raj	14,000
July 8	Goods returned by Mahesh	2,000
July 9	Goods returned to Raj	2,000

Date	Details of Transaction	Amount (Rs.)
July 10	Cash received from Mahesh and discount allowed to him	7,520 80
July 12	Withdrew from bank for private use	2,000
July 12	Withdrew from bank for use in business	10,000
July 15	Paid Telephone rent for one year	800
July 17	Proprietor took a loan from his brother Rajan for business	2,000
July 19	Cash paid to Raj in full settlement	11,450
July 25	Received an order for goods from Mahesh	1,000

b) "Bank reconciliation statement plays an important role to removing the errors between cash book and pass book." Explain this statement.

[8 marks each]

Question 6

a) Pass the rectification journal entries with respect to following errors and prepare Suspense A/c:

i. Paid salaries to Mr. Raju have been debited to his account Rs. 5000

ii. Repairs to plant and machinery has been debited to plant and machinery account Rs. 3500

iii. Paid wages has been debited to salaries account Rs. 8000

iv. Cash received Rs. 1000 from Ram (creditors) has been credited to another creditor's accounts i.e. Shyam

v. Legal expenses Rs. 119 paid to James was debited to his personal account.

vi. A sale of Rs. 500 to Ramesh was wrongly debited to Ganesh account.

vii. Sales Day book was overcast by Rs. 100.

viii. General expenses Rs. 180 was posted in the account as Rs. 810.

[1 x 8 = 8 marks]

b) What do you understand by the term of "Forfeiture of Shares'? What will be the accounting treatment on re-issue of forfeited shares?

[8 marks]

Question 7

a) The following trial balance was prepared by a clerk appointed newly by Rao & Company. Some errors were found in the Trial Balance due to lack of experience in preparing accounts. Prepare Trial Balance by rectifying these mistakes.

Particulars	Rs. (Dr.)	Rs. (Cr.)
Opening Stock	5,000	
Capital		60,000

Particulars	Rs. (Dr.)	Rs. (Cr.)
Discount allowed		500
Discount received		700
Fixed Assets		60,000
Sales	85,000	
Purchases		45000
Purchase returns		1000
Sales returns	2,000	
Carriage inwards		600
Carriage outwards		700
Wages & Salaries	25,000	
Bills receivable	7,000	
Debtors	9,000	
Bills Payable		7000
Rent	3,000	
Interest Paid		2000
Cash	800	
Creditors	6,900	
Closing Stock	33,800	
Total	1,77,500	1,77,500

[8 marks]

b) Explain with examples the difference between Profit & Loss accounts and Income & Expenditure accounts?

[4 marks]

c) The debtors of a trader are Rs. 10,00,000 as on 31st March, 2025. It has been decided to provide 10% for doubtful debts and 2% for discount on debtors. Give adjustment journal entry for provision for doubtful debts and also discount on debtors.

[4 marks]

Question 8

a) X and Y are partners sharing profits and losses in the ratio of their effective capital. As on 1st April, 2025, they had Rs. 2,80,000 and Rs. 1,60,000 respectively in their Capital Accounts.

- X introduced a further capital of Rs. 20,000 on 1st June, 2025 and another Rs. 15,000 on 1st October 2025. On 31st January 2026, X withdrew Rs. 25,000. On 1st August, 2025, Y introduced further capital of Rs. 30,000.
- During the Financial year 2025-26, the partners drew the following amounts in anticipation of profit: X drew Rs. 5,000 at the beginning of each quarter and Y drew Rs. 1,500 per month at the end of each month beginning from April 2025.

- As per the partnership agreement, the profits were to be shared in a capital ratio.
- The interest on Capital @ 12% p.a. is allowable, and interest on drawings @ 10% p.a. is chargeable.

You are required to calculate:

(i) Profit-sharing ratio.

(ii) Interest on capital; and

(iii) Interest on drawings.

[8 marks]

b) Prepare Bank Reconciliation Statement from the following information:

i. Balance as per pass book on 31st March 2026 Rs. 12, 000

ii. Cheques issued but not presented for payment Rs. 4,000

iii. Cheques deposited but not collected Rs. 6,000

iv. Bank charges debited in pass book Rs. 1,000

[4 marks]

c) Write adjusting entries:

i. Outstanding wages Rs.1,000

ii. Prepaid Insurance Rs. 2000

iii. Rent due but not received Rs. 1,000

iv. Commission received in advance Rs. 1500

[**4 marks**]