Chapter – 1

ACCOUNTING - CONCEPTS

Objectives :

After reading this unit we should be able to :

- Understand the definition, Objectives, functions and branches of Accounting.
- Know the users of accounting information and the accounting information system.
- Have an understanding on the advantages and limitations of accounting in addition to the principles of accounting and accounting standards.

Structure :

1.1 INTRODUCTION

All individuals and institutions depend on one another to satisfy their needs. To serve this purpose, they engage in exchange, which materializes into financial transactions (i.e., transactions carried out in terms of money). Business entities buy and sell goods, borrow and invest money, pay salaries to employees and incur expenses on rent and electricity, purchase land and buildings, etc. To be able to mange finances efficiently, it becomes necessary to keep track of these cash inflows and outflows.

In the past, when transactions were limited and businesses were small, everybody relied on their memory. As businesses grew in size, the entrepreneurs had to rely on something more than their memory to keep track of their business transacted during the year. They had to keep a proper and systematic account of the amount invested, the amount gained or lost in a year, how much they owed and how much others owed to them. Thus, accounting came into being as an aid to the entrepreneur.

1.1.2. Definition:

The American Institute of Certified Public Accountants defines accountancy as follows:

Accounting is the are of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character and interpreting the results thereof.

The above definition contains five essential characteristics of accounting. They are:

(a) Identification of financial events

(b) Recording of transactions

(c) Classification of information

(d) Summarizing the information

(e) Communication of information.

1.2 HISTORY OF ACOUNTING

The art of Book – keeping existed even in ancient days before the dawn of the Double Entry Book – keeping method.

Financial and numerical records are found in nearly even civilization with a commercial background. Records of commercial contracts were found in the realm of Babylon. Accounts for both farms and estates were kept in Greece and Rome.

The Greeks and Romans had well – developed record keeping systems, especially for government affairs. The Emperor Augusts is said to have instituted a Government budget in A. D. 5. Some what later, inspectors from the Central Government in Rome were sent out to examine the accounts of provincial Governors. During the Middle Ages, Accounting and most other elements of learning and trade languished. With the emergence of a Barter Economy, the financial transaction that are the life blood of accounting tended to disappear. Only the church and strong monarchs maintained the earlier systems of record keeping and control. The revival of Italian Commerce in the 13^{th} and 14^{th} centuries created a need for Book – keeping. The first Double Entry systems of Book – keeping evolved during this period. There are extant sets of Double Entry records prepared in Genoa in 1340. The earliest systematic description of the Double Entry procedure was provided by Luca De Barge Piccolo in 1494. This method is known as the Italian method. It was translated into English and published in London in 1543.

Avail's treatise dealt with all the attributes of a Double Entry. It still serves as the basis for the far more complex accounting system of today. A further improvement in Book – keeping can be attributed to the industrial revolution.

1.3 BOOK – KEEPING AND ACCOUNTING

Book – keeping is the subject which is to be studies by the students of Commerce and by book – keepers and accountants. A study of this subject requires more practice and less of reading. A student of Accountancy should know the theoretical as well as the practical aspects of the subject.

First**:** Book – Keeping involves the chronological recording of financial transactions stage is called Book – Keeping and the second stage is Accounting.

1. **Book – keeping** in a set of books in a systematic manner.
2. **Accounting:** Accounting is concerned with the maintenance of accounts giving stress to the design of the system of records, the preparation reports based on the recorded data and the interpretation of the reports.

1.3.1 Distinction between Book – Keeping and Accounting

Point of difference	Book – Keeping	Accounting
1. Meaning	Book – keeping is the art of recording business transactions in the book of original entry and posting them into ledger.	Accounting is the recording, classifying and summarising, the business transactions which are in terms of money and interpreting the results thereof.
2. Responsible of a person	The person who does the task of Book – keeping is known as "Book – keeper".	The person who summarises and interprets the account is known as "Accountant".
3. Nature of work	Much of the work of a book – keepers is of a routine and clerical work.	The work of an accountant is comprehensive, analytical and skilful.
4. Scope	The scope of Book – keeping is limited to the entries of original records.	It scope is wide as it includes the work of Book – keeping.
5. Dependence	Its work is independent.	Its work depends on the work of Book – keeping
6. Sequence of work	Book – keeping comes first and accounting comes next.	Accountant's work starts where Book – keeping.
7. Working	In it the work of journalising, posting into ledger, totaling and balancing of accounts are done.	In it the work of checking the accuracy of the accounts.
8. Special knowledge and ability	It does not require to possess any technical special knowledge.	It requires to have a special knowledge of accounting and experience.
9. Time of recording transactions	In it transactions are recorded on the same day when they take place.	The work of accounting is done at the end of the trading period.

1.3.2 Meaning of Accounting:

Book – keeping is an art of keeping accounts in regular and systematic fashion. It is also termed as accountancy or accounting. Now-a-days the sphere of business has become very vast. Every trader wants to sell his commodities at a price higher than their cost and thus wants to earn profit. In business, all transactions are not necessarily made in cash but through credit also. So, it is said that 'Credit is the soul of business'. Every businessman has limited memory and as such he cannot remember all the transactions. To know the correct financial position of the enterprise, it becomes imperative for the businessman to record all the transactions in the book is called 'Book – keeping' or 'Accounting'.

1.3.3 Definition of Accounting:

Accounting may be defined as the science as well as the art of recording financial transactions under appropriate accounts.

According to Smith and Ashburne, "Accounting is a science of recording and classifying the business transactions and events, primarily of a financial character and the art of making significant summaries, analysis and interpretations of these transactions and events and communicating the results to persons who must make decisions or from judgements."

According to the American Institute of Certified Public Accountants, "Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money transactions and evens which in part, at least of a financial character, and interpreting the result thereof.

Accounting can, therefore, be defined as:

Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof.

1.3.4 Objectives of Accounting:

The objects of accounting are manifold. These are enumerated below:

(i) **To keep systematic record:** The main object of accounting is to keep the record of day to day transactions in a systematic manner. At first the transactions are recorded in the journal in chronological order and then from the journal transactions are posted to the Ledger and from the Ledger. Trial balance and final Accounts are prepared.

(ii) **To find out the true profit / loss:** Profit is the main provocation to keep the businessman and around the business. Hence, he is always interested to find out the true profit or loss during a given period.

(iii) **To know the financial position on a particular date:** One can know at a glance the financial position or soundness of a business on a particular date if accounts are maintained properly.

(iv) **To communicate the information to the interested parties:** The object of accounting is to provide information to the interested parties i.e., owner, manager, creditors, Government etc. at regular intervals through Financial statements.

(v) **To help in planning and controlling various business activities:** Accounting supplies information to the manager at right time which helps him to plan the further course of action and to control the business resources by comparing the actual results with that of the pre – determined standards.

(vi) **To meet Legal requirement:** Law compels the businessman to submit various statements such as sales tax return, income tax return, stock position etc. A business will be able to supply all those statements only if there is a proper accounting system.

1.3.5 Branches of Accounting:

To fulfil the various objectives, various branches of accounting have developed. The chief amongst these are the following:

(i) **Financial Accounting:** It is one of the branch of accounting, the object of which is to ascertain the profit or loss made during a period and to state the financial position (Balance Sheet) of the business at the end of the period.

(ii) **Cost Accounting:** It is one of the branch of accounting, the object of which is to ascertain the cost incurred for, carrying out the various activities and to enable management to exercise cost control.

(iii) **Management Accounting:** It is also one of the branch of accounting, the object of which is to supply necessary information at appropriate time to the management to enable it to take decisions and effect control.

1.4. FUNCTIONS OF ACCOUNTING

The main functions of accounting can be given as follows:

(i) It keeps a systematic and permanent record of all financial transactions of the business.

(ii) It keeps a record of income and expenses in such a manner so that net results of the business can be quickly known for any period.

(iii) It keeps a record of assets and liabilities in such a way that financial position of the business can be readily had at any point of time.

(iv) It protects the property of the business by designing such a system of accounting which may be helpful to achieve this purpose.

(v) It keeps a tract of all changes in the value of assets and liabilities.

(vi) It keeps a control on expenses in order to minimise the same.

(vii) It communicate the results of the business to the various categories of persons as owners, investors, creditors, employees, management, Government etc.

(viii) It provides information for meeting various legal requirement as income – tax returns, returns for sales tax etc.

(ix) It helps in making decisions concerning the acquisition use and preservation of scarce resources.

(x) It helps in devising remedial measures for the deviation of the actual performance from the planned performance.

1.5 USERS OF ACCOUNTING INFORMATION

Accounting provides information to groups of people who are directly or indirectly interested in the performance and the financial position of a business enterprise. The accounting information helps them to understand the present position of the enterprise to compare its present and past performance as well as its performance with similar enterprises. The main sources of information for external users are annual, half – yearly and quarterly reports.

The various users of accounting information are internal and external users. External users comprise of creditors, investors, government and consumers while the internal users consist of the employees and management. The purpose for which they need accounting information is discussed below.

1. **Creditors:** Creditors may be short – term or long – term lenders. They have to be paid at some agreed date in the future for providing goods and services on credit to the enterprise. The creditors are interested in the financial stability of a business before granting loans. This is because they have to assess whether the enterprise would be able to pay them back, and also the probability of a delay in payment.
2. **Investors:** Investors of an enterprise include the existing as well as future shareholders (owners). Since the shareholders are concerned with the dividends (income) that they would receive from their share in the enterprise, they are interested in knowing how well the company would perform in the future. The profit and loss account as well as the balance sheet contain all the accounting information that the investors need.
3. **Government:** The government's task of levying taxes and regulation of industries is facilitated if accounting information is presented in a uniform manner. The different departments of the government collect information on business activities such as levels of sales activity, profits, investment, dividend policy, and so on. This information is needed for framing various policies by the government.
4. **Consumers:** Consumers and the public at large are interested in the accounting information in order to appraise the efficiency of the enterprise. The public might also be interested in the social role that the enterprise plays in different sectors of the economy. For example, they may want to know the level of industrial pollution from a particular type of activity carried on by the business enterprise.
5. **Management:** Accounting keeps the management informed of the various activities of an enterprise. It helps the managers to plan, control and evaluate the operations of the business. They also need such information for making various decisions. However, the type of accounting information needed by managers may vary with the size of the enterprise. For example, a manufacturing unit producing a number of products in small quantities may need accounting information about the profitability of each product. On the other hand, a large company operating through a number of branches would need information about the profitability of each of its branches.

6. **Employees:** Employees of a business enterprise are interested in better salaries, bonus and other benefits, which in turn depend on the earnings of an enterprise. Hence, they need accounting information to know how safe their interests are in that organization. For example, the employees of an enterprise would be interested in knowing whether the enterprise is likely to survive and also if it is capable of paying increased salaries and benefits.

1.5.1 Types of Accounting information:

Accounting is the primary source of generating information about the day – to – day working and future planning of an organization. Most of the recording functions performed in recent times are computerized. This has been made possible due to the advancement in the field of information technology. Accounting performs the main function of communicating financial information to various groups of users to enable them to make economic decisions. Accounting reduces the mass of data into reports and statements. To simplify this process, accounting is divided into financial, cost and management accounting.

1. **Financial Accounting:** Financial Accounting deals with recording and analysis of business transactions that take place during an accounting period. This is required to prepare financial statements, which are crucial for achieving organizational success and financial soundness. This form of accounting relates to the past period.
2. **Cost Accounting:** Cost Accounting is concerned with the ascertainment of the cost of various products and services as well as cost control. This includes collecting, processing and presenting financial and quantitative data to ascertain the cost.

However, for decision – making purposes, management accounting is more useful. It provides the necessary information (qualitative and quantitative) to the management for discharging their functions. This information is required to assist the management in taking decision about the operations of a business. Management accounting draws all information from financial accounting. It also develops information that is futuristic in character and relevant for decision making.

1.5.2 Accounting as an information system:

In the earlier times, the accounting work was totally manual and the accounting department used to take a long time in processing transactions and producing accounting reports. The modern system of computers has eliminated the redundancy and reduced the number of people involved in the processing of accounting information. There is automatic processing of transactions from electronic vouchers to the ledger. The accounting information system is divided into the following sub – systems:

a. **Cash system:** This system is concerned with the actual receipt and payment of cash as well as electronic fund transfer. Electronic fund transfer is made possible by using credit cards or e – banking.

b. **Sales and accounts receivable system:** This system deals with maintaining the 'Sales' ledger for credit sales and the 'receivables' ledger. This generates reports about collections made from debtors and the amount due from them.

c. **Accounts payable system:** This system deals with the 'credit purchase' any 'payments' ledger. It generates reports about the performance of suppliers and payments due to creditors.

d. **Inventory system:** This system is concerned with the recording of various items purchased and issued specifying the details of price, quantity and date. It provides the inventory position of the organization.

e. **Payroll accounting system:** This system deals with payment of wages and salaries to employees. It provides information about basic pay, dearness allowance and deductions made from salary and wages on account of provident funds, loans, taxes, etc. It also provides information on wage bills, overtime payment and payment on account of leave encashment, etc.

f. **Fixed assets accounting system:** This system includes information about purchase and sale of fixed assets. It is generated in the form of reports about the cost of depreciation and book value of different assets.

g. **Costing system:** this system is concerned with the ascertainment of cost of goods manufactured. The necessary information for the ascertainment of cost of raw material, labour, etc. is obtained from other systems.

h. **Budget system:** This system is concerned with the preparation of budget for the financial year and comparison of the current budget with the actual performance.

1.6. ADVANTAGES OF ACCOUNTING

Following are the advantages of accounting:

1. **Facilitates preparation of final accounts:** Accounting helps in maintaining systematic records. This helps to establish the net result of a transaction during a period and state the financial position of a business at a particular date. All this enables the accountant to prepare the trading and profit and loss account for a particular accounting period.
2. **Used as evidence in courts:** There are certain claims that are made against the firm and for the firm, in relation to outsiders. These claims can be confirmed by producing the systematic records as evidence in courts.
3. **Facilitates comparison:** Accounting enables the comparison of a business during a particular year with those of earlier years, and with similar other businesses. It also helps in taking corrective measures to improve the performance of a business.
4. **Replaces memory:** It is not possible to remember all the transactions that take place during a period. They are, therefore, recorded promptly in the books so that information is available when required.

5. **Helpful to management:** Accounting provides information to the management, which can be useful for making rational decisions such as being able to identify reasons for the profits earned or losses suffered. This helps in taking necessary steps to increase profits further or to prevent losses. The recording of various assets enables the management to exercise proper control over them in terms of the position of bank balance, inventories, money owed by customers, etc.
6. **Helpful in tax settlement:** Properly maintained accounts provide necessary information to the tax authorities, which levy customs duty, excise duty, sales and income taxes on the business. The tax authorities could be convinced about the taxable income or actual sales, as the case may be, with the help of written records. Hence, it helps in settling the tax liability of the business since the accounts reveal the profits earned or losses suffered.

1.7 LIMITATIONS OF ACCOUNTING

In spite of various advantages, accounting has the following limitations:

1. **Ignores qualitative aspect:** In accounting, only those transactions and events are recorded that are financial in nature or expressed in terms of a monetary unit. Non – monetary items that may be significant are not recorded. Hence, accounting does not give information on qualitative matters such as usefulness or efficiency of a particular transaction.
2. **Ignores price level changes:** Accounting information is expressed in monetary terms and its is assumed that the value of money remains stable over time. However, this does not happen. The change in prices, in many cases, is not accounted for and hence the accounting information does not show the true financial results. For example, assets like land and building remain undervalued in such cases.
3. **Personal judgement:** Financial statements are influenced by the personal judgement of the accountant. The financial statements may no longer be objective due to this reason.
4. **Inexact information:** Financial statements may not reflect the realistic position of an enterprise as some of the information is based on estimates, which may not be accurate at all times. For instance, a company may value its stocks at a higher price than the actual market price.

1.8. ACCOUNTING PRINCIPLES

The dictionary meaning of the term ‘Principle’ is a “fundamental truth implying uniformity of a acceptance everywhere.” However, when applied to accounting, it gives different meanings in different contexts. It is rarely used a fundamental accounting truth. Accounting principle is a guiding influence or an accepted rule of action or conduct. In other words accounting principles are those rules of action or conduct which are adopted by the accountants universally in recording accounting transactions. Different professional bodies like Australian Society of Accountants, The Institute of Chartered Accountants in

Australia, The Institute of Chartered Accountants in England and Wales, The American Institute of Certified Public Accountants etc. have made recommendations on accounting principles in the recent years.

Accounting principles have been developed over the years from experience, reason, usage and necessity. They are judged on their general acceptability rather than universal acceptability to the users of financial statements. Hence, they are called as generally accepted accounting principles. Accounting principles can be broadly classified into two categories:

A. Accounting Concepts
B. Accounting Conventions.

1.8.1 Accounting Concepts:

Concepts refer to the assumptions upon which accounting is based. The widely accepted and used concepts are discussed below:

(i) **Money measurement concept:** According to this concept, accounting records only those facts and events which can be expressed in monetary terms. Accounting does not record the facts which can not be expressed in terms of money so non – monetary business transactions like efficiency of the worker, bad working conditions for the workers, lack of canteen facilities etc., are not recorded in the books of accounts.

(ii) **Business entity concept:** According to this concept the accountant should assume that business is a person and its owner is another person. He should consider the business separate from its owner. If such distinction is not maintained the private affairs of the owner will be mixed with the affairs of the business and true profit or loss of the business can not be determined. Though in the eyes of law sole – trading and partnership business has no legal entity and only the company type of business has legal entity, the accountant should assume all types of business separate from its owner while doing accounting work.

(iii) **Cost concept:** This concept says that the value of assets should be recorded at the price at which they are acquired. The market value of the assets is not taken into consideration. The market price of assets may fluctuate from time to time. This is not considered while assets are recorded in the financial statements. However, in the Balance Sheet assets are recorded at cost price less usual depreciation. This concept is not applicable to record the value of closing stock in the Balance Sheet. The cost price or market price of closing stock whichever is less is taken into consideration.

(iv) **Going concern concept:** This concept is connected with the cost concept. Unless the going concern concept is taken into mind the cost concept bears little meaning. According to this concept the accountant should assume that the business will continue for ever and there is no end to it. Keeping this assumption in mind he will record the transactions in the books of account. The central idea of going concern concept is that as the business will not be liquidated in near future the account should not bother to know the sale – value of assets. The real worth of the assets can be known only when the business will be sold. For this reason all the assets except closing stock are recorded at their cost price and not at the market price. As closing stock of a year is to be sold in the next year its market price in taken into consideration.

(v) **Dual aspect concept:** A business collects funds from the proprietor and also know outside parties. It invest those funds by purchasing various assets such as land, building, machinery etc. Thus, the fund it collects must be equal to its investment.

This can be put in the form of a formula:

Owned fund + Borrowed fund = Total investment

Or

Capital + Liabilities = Assets

This concept says that at anytime capital plus liabilities must be equal to the total assets of the firm.

(vi) **Accrual concept or matching concept:** According to this concept the profit or loss of a business is found out lay matching the expenses and losses of the business during a period with the incomes and gains earned in that period. Here expenses means expenses incurred and paid in cash + expenses incurred but due. Similarly income means incomes earned and received + incomes earned but accrued.

(vii) **Accounting period concept:** The period at the end of which the profitability of business is determined, called 'Accounting Period'. Generally twelve months is taken to measure the profit or loss of a business. This twelve months may be a calendar years, or a financial year or any year like Ramnabmi to Ramnabami, Kalipuja to kalipuja etc.

Twelve months is taken to measure the profitability of a business as any twelve months cover all the seasons of a year. Further, for income tax purposes it is necessary to know the annual business income of the assessee.

(viii) **Verifiable objective concept:** This concept says that only those transactions are recorded in the books of account which have documentary evidences. Without documentary proof a transaction cannot be placed in the books of account. The examples of such documentary evidences are, invoices, salary register, wage bill, mustard roll, vouchers etc. On the basis of these documents the books of accounts is audited by auditors.

1.8.2 Accounting Conventions:

Conventions mean customs or traditions which are useful as a guide to the preparation and presentation of accounts. This include:

(a) Convention of conservatism.

(b) Convention of materiality.

(c) Convention of consistency.

(d) Convention of disclosure.

- **(a) Convention of conservatism:** This is the policy of playing safe. It takes into consideration all prospective losses but leaves all prospective profits. Valuation of stock is done at market price or cost price whichever is less. Making the provision for doubtful debts and discount on or debtors in anticipation of actual bad debts and discount is an example of this conversion. The main aim of published accounts is to convey and to conceal the information.
- **(b) Convention of materiality:** This convention says that while recording transactions, a distinction should be made between material and immaterial matters. Insignificant and minor items may be merged with some other items, For example there is no point in having separate accounts for all expenses (e.g., various items of stationery) of a business, small expenses of like nature may be combined under one general heading.
- **(c) Convention of consistency:** The usefulness of accounting data increases manifold when it is comparable – within the business over a number of years, and outside the business with other organisations carrying on a similar business. This requires that accounting practices and methods should remain consistent over time.
- **(d) Convention of disclosure:** Accounting records are meant for use. They must be prepared honestly, and scrupulously and no material which should be disclosed, most be withheld, otherwise, they will be incomplete and unreliable and there will be a creditability gap, full disclosure of all material facts has become particularly important in case of joint stock company in which there is separation between management and ownership. The companies Act, 1956 has taken sufficient precautions in this regard. This is in keeping with the latest trend of treating financial statements as a means of conveying and not canceling information.

1.9. ACCOUNTING STANDARDS

Accountancy is considered to be the language of business. There are certain norms in accounting that have to be observed by the accountants. These norms become accounting standards when a professional body makes them mandatory for recording and reporting purposes.

According to Kohler, accounting standards can be defined as : 'Accounting standards are codes of conduct imposed by customs, law or professional bodies for the benefit of public accountants and accountants generally'.

Accounting standards provide a structured framework for the preparation of financial statements. They help in standardizing the diverse accounting practices followed for many aspects of accounting.

In view of the growth of international trade and multinational corporations, the need for standardization at the international level was felt. With a view to harmonizing varying accounting policies and practices, an International Accounting Standards Committee (IASC) was formed and entrusted with the responsibility of formulating international standards. Since 1973, IASC has issued twenty – seven international accounting standards to date. Another professional body, the International Federation of Accountants of India' (a professional accountancy body of India) established an Accounting Standards Board (ASB). Its main function was to formulate accounting standards to be issued under the authority or council of the institute. ASB gives adequate representation to all interested parties, and consists of the members of council and representatives of Banks, Company Law Board, Central Board of Direct Taxes and Controller and Auditor General of India. The main function of ASB is to formulate accounting standards. It gives due consideration to the international accounting standards issued by IASC, and tries to integrate the conditions and practices in India. It also reviews the accounting standards at periodic intervals.

1.9.1 Objectives:

Accounting standards play an important role in the field of accounting. Accounting reports prepared in accordance with the accounting standards are more reliable, uniform and consistent. The objectives of accounting standards are listed as follows.

1. **To provide direction:** Accounting standards are required to enable correct decision making for maintaining accounting records. In addition, standards provide guidance for action.
2. **To provide uniformity:** Another objective of accounting standards is to provide universality to accounting procedures.
3. **To improve comparability and understandability:** Accounting standards increase comparability, creditability and understandability of financial statements.

1.9.2 International Accounting Standards (IAS) :

Keeping in view the importance of uniform accounting standards, policies and procedures 16 accounting bodies from nine nations formed the International Accounting Standard Committee (IASC) on June 29, 1973 with its headquarters at London. Since 1983, IASC ‘s members have included all the professional accounting bodies that are members of the International Federation of Accountant (IFAC). As of January, 1996 there where 118 member bodies in 85 countries. Both the Institute of chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (ICWAI) are the members of IASC.

The responsibility of IASC is to improve the quality and soundness of financial reporting in member countries all over the world. Its other responsibility is to keep the member bodies informed of the latest developments and standards by issuing exposure drafts from time to time. Looking to the objectives and aims of IASC, accountancy bodies from different countries have joined IASC to enable them to have up to date information on international accounting matters and to take guidance from these in laying down their own standards.

Objectives of IASC :

(a) Formulate and publish accounting standards to be observed in the presentation of financial statements and to promote their world wide acceptance and observance; and

(b) Work for the improvement and harmonisation of regulations accounting standards and procedures relating to the presentation of financial statements.

Standards framed by Committee so far :

The committee has so far laid down standards regarding the following matters.

IAS – 1	Disclosure of accounting policies
IAS – 2	Valuation and presentation of inventories
IAS - 3	consolidated financial statements
IAS – 4	Depreciation Accounting
IAS – 5	Information to be disclosed in financial statements
IAS – 6	Accounting responses to changing prices
IAS – 7	Statement of changes in financial position
IAS – 8	Unusual and prior period items and changes in accounting policies.
IAS – 9	Accounting for research and developmental activities
IAS –10	Contingencies and events occurring after balance sheet date
IAS – 11	Accounting for construction contracts
IAS – 12	Accounting for taxes on income
IAS – 13	Presentation of current assets and current liabilities
IAS – 14	Reporting of financial information by segments
IAS – 15	Information reflecting the effects of changing prices
IAS – 16	Accounting for property, plant and equipment
IAS – 17	Accounting for lease
IAS – 18	Revenue recognition
IAS – 19	Accounting for retirement benefits in the financial statements of Employees
IAS – 20	Accounting for government grants and disclosure of government assistance
IAS – 21	Accounting for effects of changes in foreign exchange rates
IAS – 22	Accounting for business combinations
IAS – 23	Capitalisation of borrowing costs
IAS – 24	Related party disclosures
IAS – 25	Accounting for investments
IAS – 26	Accounting and reporting of retirement benefit plans
IAS – 27	Consolidated financial statements and accounting for investment in subsidiaries
IAS – 28	Accounting for investment in associates

IAS – 29	Financial reporting in hyper – inflationary economies
IAS – 30	Disclosure in the financial statement of banks and similar financial institution
IAS – 31	Financial reporting of interest in joint ventures
IAS – 32	Financial instruments : disclosure and presentation
IAS – 33	Earnings per share
IAS – 34	Interim financial reporting
IAS – 35	Discontinuing operations
IAS – 36	Impairment of assets
IAS – 37	Provisions, contingent liabilities and contingent assets
IAS – 38	Intangible assets
IAS – 39	Financial instruments; recognition and measurement
IAS – 40	Investment property

1.9.3 Accounting Standards Board :

Accounting Standards Board (ASB) has been set up in India by the Council of the Institute of Chartered Accountants of India with a view to form Indian Accounting Standards. The Council was set up in April, 1977. While formulating the standards, the board attempts to harmonise the diverse accounting policies and practices in India and also takes into account the applicable laws, customs, usages and business environment in the country. While formulating the Accounting standards, ASB will give due consideration to Standards issued by IASC (International Accounting Standard Committee) and try to integrate them to the extent possible in the light of the conditions and practices prevailing in India.

To issue accounting standards authority lies with the Council, ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements. ASB will issue guidance notes on Accounting Standards and give classification on issue arising therefrom ASB will also review the Accounting Standards at periodical intervals.

So far, the Accounting Standards Board (ASB) has issued the following 18 accounting standards.

No.	Title	Applicability on or after
AS – 1	Disclosure of Accounting Policies	1-4-1991
AS – 2	Valuation of inventories	1-4-1999
AS – 3	Changes in Financial Position	Recommendatory
AS – 4	Contingencies and Events occurring after the	

	Balance Sheet date	1-4-1995
AS – 5	Prior period and Extraordinary Items and Changes in Accounting Policies	1-4-1996
AS – 6	Depreciation Accounting	1-4-1995
As – 7	Accounting for Construction Contracts	1-4-1991
AS – 8	Accounting for Research and Development	1-4-1991
AS – 9	Revenue Recognition	1-4-1991
AS – 10	Accounting for Fixed Assets	1-4-1991
AS – 11	Accounting for the Effects of changes in Foreign Exchange Rates	1-4-1995
AS – 12	Accounting for Government Grants	1-4-1994
AS – 13	Accounting for Investments	1-4-1995
AS – 14	Accounting for Amalgamations	1-4-1994
AS – 15	Accounting for Retirement Benefits in the Financial Statements of Employers	1-4-1995
AS – 16	Borrowing Costs	1-4-2000
AS – 17	Segment Reporting	1-4-2001
AS – 18	Related Party Disclosures	1-4-2001

1.10.1 QUESTIONS

A. Short Answer Questions

1. Define Accounting.
2. What are various branches of Accounting?
3. What are accounting concepts?
4. What are accounting conventions?
5. What are accounting standards?
6. Explain the significance of the following accounting concepts.
   (a) Dual Aspect Concept
   (b) Business entity concept
   (c) Going concern concept
   (d) Cost Concept
   (e) Accrual Concept.

B. Essay Questions

1. What is Book-keeping? Distinguish between Book-keeping and Accounting.
2. Explain the functions of Accounting.
3. Explain how accounting is useful to various users.
4. Explain the advantages and limitations of Accounting.
5. What do you mean by Accounting Principles? Explain the features of Accounting Principles.
6. What are the main Accounting Concepts? Narrate them briefly.
7. What are the Accounting Conventions? Explain them in brief
8. `Materiality is a Relative Term' Comment
9. `Business has Indefinite Life' Explain this in the light of Going Concern Concept.

1.11.1 SUGGESTED BOOKS

1. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
2. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
3. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advaned Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
4. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
5. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 2

DOUBLE ENTRY SYSTEM

Objectives :

After studying this unit we should be able to :

- Understand the meaning of Double Entry system of book keeping
- Know the advantages of double entry system
- Distinguish between Double Entry System and Single Entry System
- Understand accounting equation and Classification of Accounts

Structure :

2.1. INTRODUCTION

The double entry system of book – keeping is the only scientific system of recording business transactions. A business transactions involves exchange of value for value, or interchange of money or money's worth. When A sells goods worth Rs.500 to B, he exchanges goods for money. A gets money and parts with goods. Similarly when Ram employs a typist and pays him Rs.200 at the end of a month, this transaction involves, from his point of view, exchange of money for the services of the typist; he gives Rs.200 and receives services. It will thus be seen that every business transaction involves receiving something having value and giving of something which has value. The double entry system records both the aspects of a transaction – the giving aspect and the receiving aspect. In technical language, it can be said that every transaction affects two account and, therefore, its record must be made in both the accounts. This is the principle of double entry system of book – keeping.

2.2. PRINCIPLES OF DOUBLE ENTRY SYSTEM

Double Entry System is the system under which each transaction is regarded to have two fold aspects and both the aspects are recorded to obtain complete record of dealings. Double entry system of book – keeping adheres to the rule, without any exception, that for each transactions the debit amount (S) must equal the credit amount (S). Every business transaction affects two accounts at one and the same time. As such we debit one account and credit another account with the same amount which represents the benefit given by one account and the same benefit is received by another account. Thus, "For every debit, there is an equivalent credit and for every credit there is an equivalent debit". So, "Every business transaction has a double aspect".

2.3. ADVANTAGES OF DOUBLE ENTRY SYSTEM

Double Entry System of Book – keeping has the following advantages:

(i) As both aspects – debit and credit of a transactions are recorded, it enables to keep a complete record of all business transactions.

(ii) The transactions are recorded in the most scientific and systematic manner so that the books provide the most reliable information. This enables the trader to control the business most efficiently and effectively.

(iii) Since each debit has a corresponding credit, total debit must be equal to total credit, so arithmetical accuracy can be checked by preparing a statement called "Trial Balance" as debits must equal credit.

(iv) It enables the trader to compare the figures of sales, purchases, opening and closing stocks and other expenses of one period with the similar items of the preceding period or periods and thus see how the business stands today in comparison to what it was yesterday, last month or year. The causes of fluctuations in profit or loss may also be traced.

(v) There is a complete record of Nominal accounts and this enables the trader to prepare Trading and Profit & Loss Account to find out Gross Profit or Loss and Net Profit or Loss.

(vi) With the help of Real and Personal accounts, the financial position of the business can be ascertained with accuracy, on any particular day. This is done by preparing a statement called "Balance Sheet".

(vii) Chances of frauds and errors are minimised because of its duality and equality principles.

(viii) It is easily accepted by Tax authorities, Shareholders, Partners, Public, Financiers, etc.

2.4. SINGLE ENTRY SYSTEM

Single Entry System may be defined as any system which is not exactly the Double Entry System. In other words, Single Entry System consists of (I) Double entry in resect of certain transactions such as cash received from debtors, cash paid to creditors, etc., (ii) Single entry in respect of certain transactions such as cash purchases, cash sales, expenses made, fixed assets purchased, etc., (iii) No entry in respect of certain transactions such as depreciation, bad debts, etc. Thus, a business is said to use the single entry system if it does not follow the principles of double entry system of book – keeping. Kohler defines single entry system as, "A system of book – keeping in which as a rule, only records of cash and of personal accounts are maintained, only records of cash and of personal accounts are maintained, it is always incomplete double entry varying with the circumstances."

2.4.1 Features:

The salient features of the Single Entry System can be put as follows:

(i) Maintenance of Personal Accounts: Usually, personal accounts are maintained under this system while real and nominal accounts are avoided. On account of this reason, some accountants define it as a system where only personal accounts are maintained.

(ii) Maintenance of Cash book: A cash book which usually mixes up both personal transactions and business transactions is maintained.

(iii) Dependence on original vouchers: In order to collect the necessary information, one has to depend on original vouchers. For example, the figure of credit purchases may not be readily available. It may have to be found out on the basis of original invoices received from the suppliers. Similarly, the total figure of sales at the end of a particular period may have to be found out on the basis of the invoices which have been issued by the business from time to time.

(iv) **No uniformity:** The system may differ from firm to firm as per their individual requirements and conveniences.

(v) **Suitability:** The system is suitable in the case of small, proprietary or partnership concerns. Limited companies cannot adopt this system on account of legal requirements.

2.5. KEY WORDS IN BOOK – KEEPING

1. **Account:** An account denotes a summarised record of transactions pertaining to one person, one kind of asset, or one class of income or loss.
2. **Assets:** Properties of every description owned by a person will be called 'assets'. For example, Land and Building, Plant and Machinery, Cash Balance, Bank Balance etc.
3. **Bad debts:** Debts which are irrecoverable and written off from Debtors a/c as a loss are termed as "Bad Debts".
4. **Casting:** Casting means the totaling of the books of accounts. Casting has to be done of the ledger accounts and also of a Journal.
5. **Creditor:** A creditor is a person to whom we owe some – thing. He is the person to whom we have to pay.

   Trade Creditor: He is a person to whom the business owes money for goods purchased on credit.
6. **Capital:** The dictionary meaning of the term 'Capital' is Wealth. Capital is the total amount invested in business. The Capital of a business is the claim of the owner to the business / professions.

   In the accounting sense, Capital is the excess of assets over liabilities.

   The equation will be : Capital = Assets – Liabilities.
7. **Credit:** It means an entry on the credit side of an account.

   On account:

   It means purchase or sale of goods or asset on credit and receipt or payment of money in part settlement of an account.

8. **Carried forward:** Its abbreviation 'c/f indicates that the total amount at the foot of that page has been carried forward to the next page.
9. **Debtor:** Debtors is a person who owes something. He is the person who has to pay to the other person.
10. **Drawings:** Drawing is the total amount withdrawn by a trader from his business for meeting personal expenses. Trader becomes a debtor of business by the amount withdrawn by him from business for private purpose. The drawing may be in cash or in kind.
11. **Discount:** It is an allowance or a concession allowed by the receiver of benefit to the giver of benefit. It is normally allowed to the customers, debtors, retailers etc. the discount may be classified as:
    (i) **Cash Discount:** It is an allowance made by the receiver of cash to the giver of cash who pays it. It is usually allowed by the creditor to his debtor for immediate or a prompt payment of amount due. Cash discount may be allowed in addition to Trade Discount.
    (ii) **Trade Discount:** It is an allowance or deduction made by a manufacturer of wholesaler to a retailer or purchaser off the catalogue price or invoice price. Such allowance is usually made to the traders engaged in the same Class of trade who have to resell the goods. The main intention of allowing the discount is to allow some margin of profit to the retailer when the goods are resold by him at a price mentioned in the catalogue. The trade discount enable him to have a margin of profit after meeting all necessary expenses.
12. **Debit:** It means an entry on the debit side of an account.
13. **Debt:** The amount due from a debtor to the business is called a debt.
14. **Doubtful debt:** A debt whose recovery is doubtful.
15. **Entry:** The term entry refers to the recording of a transaction in the books of accounts. It is the prime record of a transaction in the books called journal or any other subsidiary journal. Though the term refers to entering of a transaction first time, i.e., in the journal or subsidiary journal, it is also made applicable to posting of journal entry to the ledger and is called as Ledger posting. A journal entry may be entered in the form of a combined entry.
16. **Expenses:** The efforts made by business to obtain revenues are termed as expenses. It is the amount spent on manufacturing and selling of goods and services.
17. **Folio:** It means the page number of the book of original entry or of the ledger. By writing folio i.e., page number, one can easily find out on what page the original entry is made and on what page the entry is made in the main book.

18. **Fictitious assets:** These are the value less assets. They are intangible. They cannot be sold.
19. **Fixed Assets:** These are the assets which are purchased to equip business.
20. **Goods:** Commodities in which a trader deals are called 'goods'.
21. **Insolvent:** A person is said to be insolvent when his liabilities are more than his assets.
22. **Insolvency:** When the liabilities of a firm are greater than its assets, it is referred to as insolvency indicating the inability of a business to meet all its liabilities. Such a business firm is said to be insolvent.
23. **Intangible Assets:** These are the assets which have no physical existence. They may have money value.
24. **Journal:** Journal is a book of accounts in which business transactions are first recorded. It is a book of prime entry or first entry.
25. **Liabilities:** Debts owed by a person are called liabilities. Liabilities represent the total amount payable to creditors. Debts arise because, goods may be purchased out but payment may not be made at the time of purchasing the goods. Therefore, the total amount payable to creditors will be the liabilities. Taxes payable to the Government are also liabilities. Similarly, expenses unpaid are also liabilities.
26. **Narration:** It is a brief explanation or description on to a journal entry. It is a given on the line just below the journal entry within the brackets.
27. **Posting:** Transactions entered in the original books of entry are also to be recorded in the ledger. An act of recording the transactions in the ledger on the basis of the entry made in the original book is called 'Posting'.
28. **Purchases:** The goods bought for resale or manufacture and resale are called purchases. Purchases may be classified as:
    - **(i) Cash Purchases:** When goods are purchased and payment is made immediately or on the spot, the purchases are said to be 'Cash Purchases'.
    - **(ii) Credit Purchases:** When goods are purchased and payment is postponed to some future agreed data, the purchases are said to be 'Credit Purchases'.
29. **Revenue:** Revenue represents the accomplishment of the enterprise. Until the company has been successful in selling its products, no revenue is realised. Revenue is the amount that adds to the capital.
30. **Sales:** The goods sold by a business for cash or on credit are called sales. The sales may be classified as:

i) **Cash Sales:** When the goods are sold and payment is received immediately or on the spot, the sales are said to be 'Cash Sales'.

ii) **Credit Sales:** When goods are sold and it is agreed to receive the payment on some other future date, the sales are said to be 'Credit Sales'.

31. **Solvent:** A person is said to be solvent when his assets are equal to or more than his liabilities.
32. **Stock:** Goods unsold lying with a business on any given date are called stock. Stock at the beginning of any given period is called opening stock. Unsold goods at the end of any given period are called closing stock.
33. **Transaction:** A transaction is an exchange of money or money's worth between two parties. It is a dealing between two or more persons. It involves transfer of goods and services for money and money's worth between two or more person and parties. e.g. Purchases and sales of goods, for cash or on credit, cash payments, purchase and sale of assets, payment of salaries and wages etc.
34. **Tangible assets:** These are the assets which have physical existence and which can be sold.
35. **Trade Debtor:** He is a person who owes money to the business for goods supplied to him on credit.

2.6. ACCOUNTING EQUATION

The whole of financial accounting (i.e., recording of transactions) is based on the 'Accounting Equation'. This can be stated to be that for a business to run it needs resources. These resources have to be supplied to the business by someone. The resources possessed by the business are known as 'Assets'. To begin with, these resources are supplied by the owner of the business. The total amount supplied by the owner of the business is known as 'Capital or Owner's equity'. If the proprietor is the only one who supplies resources, i.e., assets, the following equation would hold true:

CAPITAL = ASSETS

Normally however some of the assets of the business are provided by someone other than owner. The indebtedness of the business for these resource is known as 'Liabilities'. Thus because of legal distinction between the claims of creditors (outside liabilities) and those of owners (ownership liabilities or owner's equity or capital), the equation can now be expressed as:

CAPITAL + LIABILITIES = ASSETS

The two sides of the equation are always equal. On right – hand side are the resources is known as 'Liabilities'. On Left – hand side are the sources from which these resources were obtained. This equation is also known as 'Basic Accounting Equation' or 'Balance Sheet Equation'.

Loss affects both the side of the accounting equation. It reduces the capital in one side of the accounting equation. In the other side of the equation it reduces the asset i.e., cash.

The two sides of the equation are always equal. On the right – hand side are the resources possessed by the business. On the left – hand side are the sources from which these resources were obtained. So, the two sides will always be equal, no matter how many transactions are entered into. The actual assets, capital and liabilities may change, but the equality of assets (Property and rights in property) with that of liabilities (amounts owing to outsiders) and capital (amount owning to the proprietor) will always hold true under all circumstances.

2.6.1 Advantages of Accounting Equation:

The advantages of Accounting Equation are:

(i) Accounting equation shows the sources of funds and its application. Sources are two fold – own fund (comes from the owner), and borrowed funds (borrowing from banks and other financial institution, creditors). The funds so collected are invested on various assets such as land, building, Plant etc.

(ii) It shows owner's equity, Liabilities, and Assets. So, if two things are given the other can be found out by applying the equation.

(iii) Accounting equation reveals the success or failure of a business. If owner's equity decreases it implies failure. In the reverse case there is success.

(iv) It shows the impact of each transaction on owner's equity, Liability and Asset.

(v) Accounting equation, if presented in detail – item wise, helps to calculate various ratios such as Capital to total assets, owner's equity to total assets, Liabilities to total assets, current assets to fixed assets etc. These ratios help a lot in taking important decisions affecting a business.

The Accounting equation deals with increases and decreases in assets, liabilities, and capital. The increases and decreases in capital take place through:

1. Income and benefits which result in capital, and

2. Expenses and losses which result in decrease in capital.

To show the effect of incomes and benefits, and expenses and losses on capital, the Accounting Equation may be expanded as follows:

Assets = Liabilities + (Capital + Income – Expenses)

This above equation is called an ‘Expanded Accounting Equation’ or ‘Financial or Operating Equation’.

2.6.2 Accounting Transactions:

An account, as we understand it, is a ledger account opened in the ledger on separate pages. An account may be defined as a systematic and summarised record of transactions pertaining to one person, one property or one head of expense/ loss or gain. An account is given a suitable heading which may be of the person, property or an expense or a gain. An account is always divided into two sides. The left hand side is known as the Debit side and the right hand side is known as the Credit Side.

As stated earlier, every Account is dividend into two parts. These parts are shown by drawing a vertical line in the middle of the Account. The left – hand side is called the Debit side and the right – hand is called the credit side. To debit an account means to enter the transaction on the debit side and to credit an account means to enter the transaction on the credit side of a ledger account.

Mr. Kashinathan ’s a/c

Dr. (Left Hand side) (Right Hand side) Cr.

Date	Particulars	J. F.	Amount		Date	Particulars	J. F.	Amount	
			Rs.	Rs.				Rs.	Rs.

Every business requires the following three conditions to be fulfilled:

1. A businessman has to deal with a large number of persons.
2. He carries on business activities with the help of goods, furniture, building and various other assets.

3. He has to incur certain expenses while carrying on his business e.g. rent, salaries, postage, travelling expenses, rates and taxes etc. He receives has income from certain sources such as interest, commission, discount etc.

Hence, in order to keep a complete record of his business transactions he has to keep the accounts of persons or firms with whom he deals. He has to keep a record of his assets and properties and the expenses, income, losses and gains.

2.7. CLASSIFICATION OF ACCOUNTS

The ledger accounts may be classified as under:

1. Personal Accounts
2. Impersonal Accounts.
    a) Real or Property Accounts
    b) Nominal or Fictitious Accounts

    Thus, Accounts may be of three kinds:

    i) Personal Accounts

    ii) Real Accounts

    iii) Nominal Accounts.

1. **Personal Accounts:** These are the accounts of individuals, firms, limited companies, local authorities, associations with whom the businessman deals. A separate account is maintained for every person or firm or company. These accounts may be of creditors, debtors, bankers etc. For recording transactions, these accounts are treated as "Personal Accounts".
2. **Impersonal Accounts:** These are the accounts which relate to other than persons. These are again divided into further two types, viz.:
    a) Real Accounts: These are the accounts of properties, assets or possessions of the businessman. These accounts represent the belongings of the businessman. A separate account is maintained for each class of property or asset. Real accounts may assume the following two forms:

    (i) Tangible real accounts: These accounts consists of assets and properties which can be seen, touched, felt, measured, purchased and sold.

    (ii) Intangible real accounts: These accounts consists of assets and properties which cannot be seen, touched, felt but they are capable of measurement in terms of money.

b) **Nominal Accounts:** These are the accounts of expenses or losses and gains or incomes. These accounts are called fictitious accounts as they do not represent any tangible asset. They exist only in name and cannot be sent or touched. A separate account is maintained for each head of expense or loss or gain or income. For example, interest account, commission account, discount account, postage and telegrams account, rent account, salaries account etc. These accounts cannot be seen, touched and hence they are unreal.

2.7.1 Rules of Debit and Credit:

Under Double Entry System of accounting, both the aspects of the transaction are recorded. The two aspects involve, receiving of values and giving of values of each transaction. The two aspects are distinguished in terms of Debit and Credit. 'Dr.' stands for debit and 'Cr.' Stands for credit. Every account is capable of receiving and giving values. It is debited when it receives benefit and it is credited when it gives benefit. Hence, the rule is:

"Debit the Account that receives the benefit and Credit the Account that gives the benefit".

Every transaction affects at least two accounts. When one account receives the benefit of certain value, another account gives the benefit of the same value. Hence the rule is:

" Every debit must have a corresponding credit and every credit must have corresponding debit".

While recording business transactions, the accounts are either to be debited or credited. Therefore, a book – keeper must be fully aware of the rules of debiting and crediting different types of accounts.

1. **Personal Accounts:**

   "DEBIT THE RECEIVER AND CREDIT THE GIVER"

   For Example:

   a) If cash is paid in Bank, debit the Bank Account as the bank is the receiver of the benefit.

   b) If cash is received from Bombay Port Trust, credit the Bombay Port Trust Account as it is the giver of the benefit.

2. **Real Accounts:**

   ‘”DEBIT WHAT COMES IN AND CREDIT WHAT GOES OUT”

   For Example:

   a) When machinery is purchased, debit the Machinery Account as it comes in the business.
   b) When goods are sold out, credit the Goods Account as the goods are going out.

3. **Nominal Accounts:**

   “DEBIT EXPENSES AND LOSSES AND CREDIT GAINS OR INCOMES”

   For Example:

   a) If rent is paid, debit Rent Accounts as it is an expense.
   b) If a Bad Debt occurs, debit the Bad Debt Account as it is a loss.
   c) If commission is received, credit the Commission Account as it is a gain.

2.7.8. ACCOUNTING PROCESS

In order to accomplish its main objective of communicating information to the users, accounting performs the following functions.

(a) Recording: It is concerned with the recording of financial transactions in an orderly manner, soon after their occurrence in the proper books of account.

(b) Classifying: It is concerned with the systematic analysis of the recorded data so as to accumulate the transactions of similar type at one place. This function is performed by maintaining the ledger in which different accounts are opened to which related transactions are posted.

(c) Summarising: It is concerned with the preparation and presentation of the classified data in a manner useful to the users. This function involves the preparation of financial statements such as Income Statement, Balance Sheet, Statement of Changes in Financial Position. Statement of Cash Flow, Statement of Value Added.

(d) Interpreting: Now a days, the aforesaid three functions are performed by electronic data processing devices and the accountant has to concentrate mainly on the interpretation aspects of accounting. The accountants should interpret the statements in a manner useful to the users, so as to enable the users to make reasoned decisions out of alternative courses of action. The accountant should explain not only what has happened but also (a) Why it happened, and (b) what is likely to happen under specified conditions.

2.7.9. Accounting Cycle:

An accounting cycle is a complete sequence beginning with the recording of the transactions and ending with the preparation of the final accounts.

1. **Journal:** Record the transactions and events in the Journal.
2. **Ledger Posting:** Transfer the transactions (recorded in the journal), in the respective accounts opened in the Ledger.
3. **Balancing the accounts:** Ascertain the difference between the total of debit amount column and the total of credit amount column of a ledger account.
4. **Trial Balance:** Prepare a list showing the balances of each and every account to verify whether the sum of the debit balances is equal to the sum of the credit balances.
5. **Trading, Profit and Loss Account:** Prepare Trading and profit & Loss Account to ascertain the profit or loss for the accounting period.
6. **Balance Sheet:** Prepare the Balance Sheet to ascertain the financial position as the end of a accounting period.

2.8 QUESTIONS

A. Short Answer Questions

1. What is Double Entry of System of Accounting?
2. What is Single Entry System?
3. What is Accounting Equation?
4. What are personal accounts?
5. What are real accounts?
6. What are nominal accounts?
7. What is Accounting cycle?

B. Eassay Questions

1. What is Double Entry system? Distinguish between Double Entry and Single Entry System.
2. How do you classify accounts? Explain the rules of debit and credit.
3. Define Double Entry System of book-keeping? What are its advantages?

4. Mention the rules for recording business transactions under accounting equation approach
5. Give an example of business transactions affecting only : (a) Assets (b) Liabilities (c) Capital
6. ``Accounting equation holds goods under all circumstances.'' Elaborate giving at least five examples.
7. What is the effect of revenue earned and expenses incurred on the accounting equation?
8. Explain the accounting process.

2.9 SUGGESTED BOOKS

1. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
2. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
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Chapter - 3

JOURNAL – LEDGER

Objectives :

After studying this unit we may be able to :

- Understand the meaning of Journal, Ledger and Trial balance
- Pass Journal entries and post them into ledger.
- Prepare the Trial balance

Structure :

3.1 INTRODUCTION

The Double Entry system of Book – keeping provides a basic framework for analysis of business transactions. If the accounting process is to generate valuable information, the transactions which have taken place during the accounting period must be recorded in a systematic manner. The business transactions are recorded in financial books or books of accounts.

3.1.1 Accounting Cycle and Books of Accounts:

The process of accounting cycle consists of the following steps:

(i) Analysis of transactions from source documents

(ii) Journalising the transactions.

(iii) Ledger Posting

(iv) Balancing of each ledger account.

(v) Preparation of a Trial Balance.

(vi) Recording of adjustment entries.

(vii) Posting of adjustment entries.

(viii) Recording of closing entries.

(ix) Preparation of financial statements.

3.2 JOURNAL

'Journal' is derived from the French work, "Jour" which means a day. Journal therefore, means a 'daily record'.

According to a Dictionary For Accountant written by Eric L. Kohler "A 'Journal' is the book of original entry in which are recorded transactions not provided for in specialised journals".

A Journal is a book of "Original entry" or "Primary entry". It is a book of daily record. First of all the business transactions are recorded in the "Journal" and subsequently they are posted in the ledger. In modern times, a journal is divided into various books known as "Subsidiary Books". To study "Book – Keeping" one must learn first how to journalise the transactions. To journalise the transactions means to record the two – fold effects of a transaction in terms of debit and credit. This has to be done by observing the rules of debit and credit.

3.2.1 Features of a Journal:

1. It is a book of prime, original or first entry.
2. It records transactions in a systematic manner.
3. It analyses the transactions into their debits and credits.
4. It is a gateway to the ledger.

3.2.2 Utility of Journal:

A Journal is needed for the following reasons:

1. It contains a record of various transactions that take place every day.
2. It provides a complete record of transactions as both the aspects of transactions are recorded at one place.
3. Since narration of a transaction is written in the journal, there is no need to give an explanation in the ledger.
4. It facilities cross checking of transactions.

5. Since transactions are recorded in the Journal, there is no need to post the transactions to the ledger immediately.
6. From the legal point of view also a Journal becomes necessary. Courts recognise the journal as an evidence in approving or disapproving claims.
7. It helps to locate and prevent errors.

3.2.3 Ruling of Journal:

1. **Date Column:** In this column, the date of the transaction is written. The year is also written in the beginning of the page. Therefore, it is not necessary to write the year for each transaction as it is common for all the transactions. Generally, this column is divided into two parts namely for writing the month and the date of the transaction.
2. **Particulars of Column:** The 'Particulars Column' is the most important column. Before the details are written in this column, the book-keeper decides as to what accounts are affected and which account is to be debited and which account is to be credited. The account to be debited is written on the first line just near the date column. On the same line, the word "Dr" is written against the account to be debited. After that, on the second line the account to be credited is written. The name of this account should be preceded by the word "To" and while writing on the second line a little space should be left from the date column. It must be noted that the work "Cr" need not be written against the account to be credited as it is clear that if the account on the first line is shown debited the corresponding account on the next line stands credited.
3. On the third line, a brief description of the transaction is written which is known as "narration".
4. **Voucher Number:** In this column, serial number of the source document is written.
5. **Ledger Folio:** While recording the transactions nothing has to be written in this column. The journal entries are required to be posted to the debit and credit of accounts in the ledger. At that time, the page number of the ledger on which the two accounts appear are entered in this column. Usually, these page numbers are written in red ink in order to distinguish them from the amounts entered in amount columns.
6. **Debit Amount Column:** In this column, the amount of transaction is written against the work "Dr" in particulars column on that line.
7. **Credit Amount Column:** In this column, the amount of transaction is written against the name of the account credited on that line.

8. In the particulars column an explanation or narration is to be given below the credit item. Such a narration should be written in between the date line and the folio line. It should not cross these two lines on either side.
9. A thin line should be drawn between each transaction across the page from the date column to the folio column immediately below the journal entry. Some space should be left after each such line so as to distinguish one entry from another.
10. At the end of each page of a journal the debit and credit amount columns are totaled up and the total of the debit and credit amount columns must be equal, as the amount debited and amount credited are equal for every transaction. These totals are carried forward to the next page.

Notes:

In case the journal runs over several pages, the first page is totaled and the totals are carried over to the next page at the top as "Totals brought forward". This is repeated for subsequent pages. The amount of debit column must agree with the amount of credit column. Totals of amount column are never posted in the ledger.

3.2.4 Points to be remembered while passing Journal entries:

1. While writing the name of a person or real account or nominal account, the word "Account" should be added after the name of the account.
2. After journalising the transaction, the two columns should be totaled. The total of the debit column should be equal to the total of the credit column. The purpose is to check arithmetical accuracy.
3. When two or more transactions of the same nature occur, a combined entry may be passed.
4. The term, 'Purchase Account' should be used when goods are purchased. The term 'Sales Account' should be used when goods are sold out. Goods returned to suppliers are called Returns outwards or Purchase Returns. Goods returned by customers are called returns Inward or Sales Returns.
5. When it is not clearly stated in the problem whether the transaction is on a cash basis, it should be considered on a cash basis when the name of the party is not given. When the name of the party is given, and there is no mention of cash paid / received, it should be considered as a credit transaction.

6. Whenever expenses are paid in cash, the Expense Account concerned should be debited and the Cash Account credited, the Person's Account should not be debited.
7. Whenever income is received in cash, the Income Account concerned should be credited and a Cash Account debited. The Person's Account should not be credited.
8. When goods are purchased for cash from a party, the accounts affected will be:
   (i) Purchase Account,
   (ii) Cash Account.
9. When goods are sold for cash to a party, the accounts affected will be:
   (i) Cash Account and
   (ii) Sales Account.
10. When goods are purchased on credit, the accounts affected will be:

   (i) Purchase Account and
   (ii) Party's Account.
11. When goods are sold on credit, the accounts affected will be:
   (i) Sales Account and
   (ii) Party's Account.
12. When assets are purchased from a party on credit, the Asset Account should be debited. The Purchase Account should not be debited.
13. When assets are sold to a party, the Sales Account is not affected. The Asset Account concerned is affected.
14. Whenever any amount is paid for repairing any asset, the Asset Account is not affected. The account affected will be the Repairs Account and the Cash Account.
15. For the purpose of recording transactions it should be assumed that a proprietor is different from the business. A proprietor has a separate status. Therefore, if anything is given by the proprietor to the business, the proprietor becomes a creditor of the business, and if anything is taken by the proprietor from the business, the proprietor becomes a debtor of the business.
16. The payment of any personal expenses of the proprietor, such as an insurance premium, a medical bill, income tax, a club bill, amounts to drawings. The entry is made in the Drawings Account.
17. Any expenses incurred on the purchase of an asset affect the Asset Account and Cash Account.

Illu.1 : Journalise the following transactions:

2006

Jan 1 Commenced business with a capital of Rs.4,50,000

4 Opened current account with SBI Rs.1,50,000

7 Purchased furniture for Rs.50,000 through cheque.

10 Cash purchases Rs.15,000

12 Goods distributed by way of Free Samples Rs.5,000

15 Goods purchased from X Rs.20,000

20 Paid to X in full settlement Rs.19,000

24 Commission received Rs.2,500

Solution :

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2006 Jan 1	Cash a/c To Capital a/c (For business started with cash)	Dr.		4,50,000	 4,50,000
4	SBI Current a/c To Cash a/c (For opening Current Account with SBI)	Dr.		1,50,000	 1,50,000
7	Furniture a/c To Bank a/c (Furniture purchased by cheque)	Dr.		50,000	 50,000
10	Purchases a/c To Cash a/c (Goods purchased for cash)	Dr.		15,000	 15,000
12	Free Samples a/c To Purchases a/c (Being goods given for free samples)	Dr.		5,000	 5,000
15	Purchases a/c To X a/c (Goods purchased from X on credit basis)	Dr.		20,000	 20,000
20	X a/c To Cash a/c To Discount a/c (Cash paid to X in full settlement)	Dr.		20,000	 19,000 1,000
24.	Cash a/c To Commission Received a/c	Dr.		2,500	 2,500

	(For commission received)				

Illu.2 Journalise the following transaction in the books of Mr. Rahul:

2006		**Rs.**
March 1	**Started business with cash**	**10,000**
2	**Purchased furniture and payment by cheque**	**2,000**
3	**Withdrew from bank for private use**	**500**
4	**Cash paid to Lal in full settlement of his account (6,000)**	**5,940**
5	**Paid for stationery Rs.200 and salaries Rs.2,000**	

Solution :

Journal Entries in the books of Rahul

Date	Particulars		L.F.	Debit	Credit
2006				Rs.	Rs.
Mar.1	Cash a/c To Capital a/c (Being business started)	Dr.		10,000	 10,000
2	Furniture a/c To Bank a/c (Being the purchase of furniture)	Dr.		2,000	 2,000
3	Drawings a/c To Bank a/c (Being withdrew from bank)	Dr.		500	 500
4	Lal's a/c To Cash a/c To Discount a/c (Being full settlement of account)	Dr.		6,000	 5,940 60
5.	Stationery a/c Salaries a/c To cash a/c (Being expenses paid)	Dr. Dr.		200 2,000	 2,200

Illu.3 : Journalise the following transactions:

2006

April 1st Bought machinery for Rs.2,40,000 for cash from Ram.

April 2nd **Installed the above machine, charges paid being Rs.3,100.**

April 3rd **Withdrew cash from bank Rs.5,000 for office use.**

April 5th **Paid salaries to staff Rs.1,700**

April 7th **Sold goods to Shyam Rs.7,500.**

April 8th **Shyam paid cash Rs.3,000 for partial settlement.**

Solution :

Journal Entries

Date	Particulars		L.F	Debit	Credit
2006				**Rs.**	**Rs.**
Ap.1	Machinery a/c To Cash a/c (Being the purchase of machinery)	Dr.		2,40,000	 2,40,000
Ap.2	Machinery a/c To Cash a/c (Being the installation charges paid)	Dr.		3,100	 3,100
Ap.3	Cash a/c To Bank a/c (Being the cash withdrawn from Bank)	Dr.		5,000	 5,000
Ap.5	Salaries a/c To Cash a/c (Being the salaries paid)	Dr.		1,700	 1,700
Ap.7	Syam a/c To Sales a/c (Being the goods sold on credit)	Dr.		7,500	 7,500
Ap.8	Cash a/c To Syam a/c (Being the partial amount received)	Dr.		3,000	 3,000

Illu.4 : Journalise the following transactions in the books of Kapil:

2006		**Rs.**
June1	**Started business with cash**	**45,000**
2	**Cash paid into bank**	**25,000**
3	**Purchase of furniture and payments by cheque**	**5,000**
4	**Goods purchased for cash**	**15,000**
5	**Sold goods for cash**	**8,500**
8	**Sold goods on credit to Arvind**	**4,000**
10	**Goods purchased on credit from Amritlal**	**7,000**

12	**Goods returned to Amritlal**	**1,000**
15	**Goods returned by Arvind**	**200**
18	**Cash received from Arvind**	**3,760**
	Discount allowed to Arvind	**40**
21	**Withdrew from bank for private use**	**1,000**
22	**Withdrew from bank for use in the business**	**5,000**
25	**Paid telephone bill**	**400**
28	**Cash paid to Amritlal in full settlement of his account**	**5,940**
29	**Stationery purchased**	**200**
30	**Rent paid**	**1,000**
30	**Salaries paid**	**2,500**

Solution :

Journal

2006 June				**Rs.**	**Rs.**
(1)	Cash a/c To Capital a/c (Being business started)	Dr.		45,000	45,000
(2)	Bank a/c To Cash a/c (Being cash deposited into Bank)	Dr.		25,000	25,000
(3)	Furniture a/c To Bank a/c (Being furniture purchased by cheque)	Dr.		5,000	5,000
(4)	Purchases a/c To Cash a/c (Being goods purchased for cash)	Dr.		15,000	15,000
(5)	Cash a/c To Sales a/c (Being goods sold for cash)	Dr.		8,500	8,500
(8)	Aravind a/c To Sales a/c	Dr.		4,000	4,000

	(Being goods sold on credit to Aravind)				
(10)	Purchases a/c To Amritlal a/c (Being goods purchased on credit from Amritlal)	Dr.		7,000	7,000
(12)	Amritlal a/c To Purchases return a/c (Being goods returned to Amritlal)	Dr.		1,000	1,000
(15)	Sales Returns a/c To Aravind a/c (Being goods returned by Aravind)	Dr.		200	200
(18)	Cash a/c Discount a/c To Arvind a/c (Being cash received from Aravind)	Dr.		3,760 40	3,800
(21)	Drawings a/c To Bank a/c (Being amount drawn from banks for private use)	Dr.		1,000	1,000
(22)	Cash a/c To Bank a/c (Being cash withdrawn from Bank a/c)	Dr.		5,000	5,000
(25)	Telephone a/c To Cash a/c (Being telephone bill paid)	Dr.		400	400
(28)	Amritlal a/c To Cash a/c To Discount a/c (Being cash paid to Amritlal)	Dr.		6,000	5,940 60
(29)	Stationery a/c To Cash a/c (Being stationery purchased)	Dr.		200	200
(30)	Rent a/c Salaries a/c To Cash a/c (Being Rent and Salaries Paid)	Dr.		1,000 2,500	3,500

Illu.5 : Journalise the following transactions in the books of a Trader:

1-4-2004:

a) **Cash in hand: Rs.8,000; Cash at Bank : Rs.25,600; Stock of goods : Rs.20,000; Buildings: Rs.14,000; Debtors : Rs.8,100; Creditors :Rs.18,300; Mrs. Loan : Rs.10,000.**

b) **Purchased goods worth Rs.5,000 less 20% trade discount and 5% cash discount.**

c) **Rs.2,646 received from Vijay and allowed him discount Rs.54.**

d) Rs.5,292 paid to Anand and discount allowed by him Rs.108.

e) Paid for: Charity Rs.100; postage Rs.200; Stationery Rs.250.

Solution :

Books of Trader

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1-4-04					
a)	Cash in hand a/c Cash at bank a/c Stock of goods a/c Buildings a/c Debtors a/c To Creditors a/c To Mrs. Loan a/c To Capital a/c (Being assets and liabilities of previous year bought into books)	Dr. Dr. Dr. Dr. Dr.		8,000 25,600 20,000 14,000 8,100	 18,300 10,000 47,400
b)	Purchases a/c To Cash a/c To Discount Received a/c (Being goods purchased in cash and discount received)	Dr.		4,000	 3,800 200
c)	Cash a/c Discount allowed a/c To Vijay a/c (Being cash received from Vijay and discount allowed to him)	Dr. Dr.		2,646 54	 2,700
d)	Anand a/c To Cash a/c To Discount received a/c (Being paid cash and discount received)	Dr.		5,400	 5,292 108
e)	Charity a/c Postage a/c Stationery a/c To Cash a/c (Being expenses paid in cash)	Dr. Dr. Dr.		100 200 250	 550

Illu.6 : Journalise the following transactions:

2006

January 1 Purchased goods for cash 5,000

3	**Sold goods for cash**	**8,000**
4	**Purchased goods from Bose**	**2,000**
6	**Sold goods to Kavitha**	**3,000**
9	**Cash paid to Bose**	**1,600**
11	**Received cash from Kavitha**	**2,500**
13	**Sold goods to Bose for cash**	**1,800**
14	**Purchased goods from Kavitha for cash**	**1,800**
19	**Paid rent**	**400**
20	**Received interest**	**200**
22	**Received Commission**	**100**
24	**Goods returned to Bose**	**200**
25	**Goods returned by Kavitha**	**150**
29	**Purchased furniture from Mr. Ramu and Co.**	**1,500**
31	**Paid Salary**	**1,800**

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
2006				Rs.	Rs.
Jan.1	Purchases a/c To Cash a/c (Being goods purchased on cash)	Dr.		5,000	 5,000
3	Cash a/c To Sales a/c (Being goods sold for cash)	Dr.		8,000	 8,000
4	Purchases a/c To Bose a/c (Being goods purchased from Bose)	Dr.		2,000	 2,000
6	Kavita a/c To Sales a/c (Being goods sold on credit to Kavita)	Dr.		3,000	 3,000
9	Bose a/c To Cash a/c (Being cash paid to Bose)	Dr.		1,600	 1,600
11	Cash a/c To Kavitha a/c (Being cash received from Kavita)	Dr.		2,500	 2,500
13	Cash a/c To Sales a/c	Dr.		1,800	 1,800

	(Being goods sold for cash)				
14	Purchases a/c To Cash a/c (Being goods purchased for cash)	Dr,		1,200	 1,200
19	Rent a/c To Cash a/c (Being rent paid)	Dr.		400	 400
20	Cash a/c To Interest a/c (Being Interest received)	Dr.		200	 200
22	Cash a/c To Commission a/c (Being commission received)	Dr.		100	 100
24	Bose a/c To Purchase returns a/c (Being goods returned to Bose)	Dr.		200	 200
25	Sales returns a/c To Kavita a/c (Being goods returned by Kavita)	Dr.		150	 150
29	Furniture a/c To Ramu & Co. a/c (Being furniture purchased)	Dr.		1,500	 1,500
31	Salary a/c To cash a/c (Being salary paid)	Dr.		1,800	 1,800

Composite Entries:

Sometimes two or more transactions of the same nature may take place on the same date. Instead of making a separate entry for each such transaction it is proper to combine them and give a combined entry. Such entry of recording a number of transactions is them and give a combined entry. Such entry of recording a number of transactions is termed as **Compound Journal Entry.** In case of compound entry the total of all debits should be equal to the total of all credits. The compound entry may be recorded in any of the following three ways.

i. One account may be **debited,** while several other accounts may be **credited.**

ii. One account may be **credited,** while several other accounts may be **debited.**

iii. Several accounts may be **debited** and several accounts may also be **credited.**

Illu .7: Journalise the following transactions.

a. Rao starts business with Rs.10,000 cash and a building worth Rs.50,000

b. Purchased goods worth Rs.20,000 out of which goods worth Rs.12,000 was on credit from Shyam.

c. **Sold goods on credit worth Rs.16,000 to Ram.**

d. **Received Rs.15,600 from Ram in full settlement of his account.**

e. **Paid Rs.11,800 to Shyam in full settlement of Rs.12,000 due to him.**

f. **Paid wages Rs.500 and salaries Rs.2,000**

Solution :

Journal Entries

S.No.	Particulars		LF	Debit (Rs.)	Credit (Rs.)
a.	Cash a/c Building a/c To Capital a/c (Being business started with cash and building)	Dr.		10,000 50,000	 60,000
b.	Purchases a/c To Cash a/c To Shyam a/c (Being goods bought for cash and on credit)	Dr.		20,000	 8,000 12,000
c.	Ram a/c To sales a/c (Being goods sold on credit)	Dr.		16,000	 16,000
d.	Cash a/c Discount allowed a/c To Ram a/c (Being cash received and discount allowed)	Dr. Dr.		15,600 400	 16,000
e.	Shyam a/c To Cash a/c To Discount received a/c (Being cash paid and discount received)	Dr.		12,000	 11,800 200
f.	Wages a/c Salaries a/c To Cash a/c (Being expenses paid in cash)	Dr. Dr.		500 2,000	 2,500

3.3 LEDGER

3.3.1 Meaning f a Ledger:

A Ledger is the principal book of accounts. A Journal is meant for passing the entries of business transactions. It facilitates posting of transactions to respective ledger accounts. All the entries made in the journal must be posted into the Ledger. The Ledger is a book containing many ledger accounts. The term ‘Ledger’ is derived from the Dutch work ‘Legger’ which means to lie. Ledger therefore, means a book where the various accounts lie. The definition of ‘ledger’ as given in the Encyclo – paedia is as under:

“A group of accounts is known as a Ledger. The general Ledger is the main book of accounts; it contains an account for each asset, liability, proprietorship, revenue and expense account. The Ledger contains the same information as the journal. However, in the journal each transaction is completely recorded as a unit. The entire effect of a transaction is completely recorded in one place in the Journal. Periodically the same information is posted to the Ledger where it is accumulated according to individual items. The Ledger where it is accumulated includes all the basic accounts needed for the preparation of the financial statements”. The number of ledger accounts depends upon the number of transactions.

A businessman cannot get information about the business transactions from the Journal. For example, the amount receivable from debtors, the amount payable to creditors, total payments on any head of expenditure etc. In order to get information about the above, a ledger has to be maintained. While transferring the transactions from the Journal to the Ledger, the transactions are classified. For each person, head of income, head of expenditure, asset, etc. separate accounts are opened in the Ledger book.

In conclusion, the ledger helps to achieve the following results:

a) All personal accounts would show how much money is payable to creditors and receivable from debtors.
b) The real accounts would show the value of assets and properties.
c) The nominal accounts would show the sources of income and the amount spent on various heads of expenses.

Features of a Ledger.

1. It is a derived or secondary record
2. It is a book of final entry
3. It is a king of books of accounts.

Nature of a Ledger:

A Ledger is a bound book. It contains many pages which are called folios. These pages are consecutively numbered. For each account a separate page is kept. Every ledger has an index. It is generally an alphabetic index. One page is allotted for each alphabet. All the accounts commencing with that particular alphabet are indicated on that particular page only. The page number on which that particular account appears is shown against the account in the Index. This facilitates immediate reference.

3.3.2 Standard Form of Ledger Account:

Each ledger account is divided into two sides, having columns of varying sizes. The left had side is known as "Dr" side and the right hand side is known as "Cr" side of a Ledger account. The columns "Date", "Particulars", "J. F", "Amount" appear on both the sides of a ledger account. A specimen "T" form of a ledger account is as follows:

Date	Particulars	J. F.	Amt. Rs.	Date	Particulars	J. F.	Amt. Rs.
Year Month	To Name of Account credited			Year Month	By Name of Account Debited		

Running Balance form of Ledger Account:

An alternative form of a ledger which is generally adopted by commercial banks and some other business houses, is the running balance form. The entire ledger is divided into six columns viz.

1. Date;
2. Particulars;
3. Folio;
4. Dr. Amount;
5. Cr. Amount; and
6. Balance.

The specimen form is as under:

Name of Account

Dr. **Cr.**

Date	Particulars	Folio	Dr. Amount Rs.	Cr. Amount Rs.	Balance Rs.

Explanation:

1. Date column is used to show the date of the transaction.
2. Particulars column is used to write the names of the accounts debited or credited.
3. Folio column is used to show the page number of the journal on which the transaction is recorded.
4. Dr. Amount column shows the amount of the account debited.
5. Cr. Amount shows the amount of the account credited.
6. Balance column shows the new balance each time.

3.4 LEDGER POSTING

After the transaction has been analysed into its debit and credit elements in a journal, each such debit or credit element must be transferred to the respective ledger accounts. The process of transfer of entries from Journal to Ledger account is called "Posting" or "Ledger Posting".

Posting may be made immediately after the entry has been passed or any convenient time.

3,.4.1. Importance of Posting:

Posting is very important as it furnishes the results of all the transactions relating to a particular person or service. After posting one can understand the position of an account at a glance.

The Posting Process:

1. **Date Column:** Write date of the transaction as recorded in the journal.
2. **Particulars Column:**

   On Debit Side : Write Name of the Credited Account in the Journal entry after the Word "To".

   On Credit Side : Write name of the 'Debited Account in the Journal entry after the Word "By".
3. **J. F. Column:** Write page number of the journal from where the entry is posted.
4. **Amount Column:** Write the amount in the debit column of the journal on the debit side and the amount in the credit column of the journal, on the credit side.

3,4.2 Points to be noted while preparing ledger accounts:

1. A separate account is opened in the ledger for every account entered in the journal.
2. All the transactions relating to a particular account should be recorded in the account already opened. No new account of the same name should be opened in the ledger.
3. The name of the account should be recorded in bold letters at the centre of each account.
4. The word "Dr" should be written at the left hand top corner of each account. The work "Cr" should be written at the right hand to corner of each account.
5. Journal entries should be posted to the ledger in order of dates.
6. Every entry on the debit side of an account should begin with the word, "To". Every entry on the credit side of an account should begin with the word "by".
7. The account which is debited in the Journal should be posted on the debit side of the respective account. The account which is credited in the journal should be posted to the credit side of the respective account.
8. While posting on the debit side of a ledger account, the account credited in the journal should be written on the debit side in the particulars column and while posting on the credit side of a ledger account, the account debited in the Journal should be written on the credit side of a ledger account in the particulars column.
9. The page number of the Journal from where posting is made should be entered in the J. F. column against the entry.
10. Every ledger account should be balanced periodically as required by the business concern.

3.4.3 Balancing an Account:

At the end of a certain period, the accounts are balanced. The following steps should be taken in balancing an account:

1. Make a total of both the sides of a ledger account. This may be done on a rough sheet.
2. Compute the difference between the totals of both the sides.
3. Put the difference on the lighter side of an account, by writing against it in "Particular" column as "By Balance c/d" or "To Balance c/d" as the case may be. If the debit side is heavier the difference will appear on the credit side as "By Balance c/d" and if the credit side is heavier, the difference will appear on the debit side of an account as, "To Balance c/d".
4. Make the total of both sides. The total of the debit side will now agree with the total of the credit side of an account. While making the totals, it should be remembered that totals of both the sides should appear against each other on the same line.
5. Draw a single line before making the totals.
6. Draw a double line across the amount column after the totals are made.

7. Bring down the balance on the opposite side of the account. That means, "To Balance c/d" is brought down on the credit side below the totals in the particular columns as "By Balance b/d" and "By Balance c/d", is brought down on the debit side of the account in the "particulars" column below the total as, "To Balance b/d".

3.4.4 Process of Balancing Ledger Accounts:

After balancing, some of the ledger accounts show debit balances and some of them show credit balances. If the total of the debit side of an account is heavier than the total of the credit side of that account, it is said to have a debit balance. And if the total of the debit side of that account is less than the total of the credit side, such an account is said to have a credit balance. A debit balance of a personal account means a debtor. A debit balance of a real account means an asset or property and a debit balance of a nominal account means an asset or property and a debit balance of a nominal account means expense or loss. A credit balance of a personal account or real account means a liability. A credit balance of a nominal account represents income or gain.

Nominal accounts are balanced at the end of the year. Their balances are not carried down to next year / next period. They are directly transferred to the Profit and Loss Account.

3.4.5 Balancing of Goods Account:

If all the goods purchased are sold out, that means no stock remained unsold, the balance of the Goods Account will show either a profit or loss. A debit balance on Goods Account means a loss and credit balance on Goods Account means a profit.

If all the goods purchased are not sold out fully, that means there is a stock of goods remaining unsold at the end of the year, the amount of such stock should be placed on the credit side of a Goods Account and it should then be balanced. A credit balance on a Goods Account represents a profit.

3.4.6 Why Balancing of Ledger Accounts?

The purpose of balancing ledger accounts vary according to the types of accounts.

1. **Personal Accounts:** These accounts are balanced for finding out whether a person is a debtor or a creditor. A debit balance on a personal account indicates that the person is our

debtor. A credit balance on a personal account indicates that the person is our creditor. A zero balance on personal account indicates that the account has been closed. It means the person is neither debtor nor creditor of the firm. At the end of the year the total debtors and total creditors are ascertained by balancing personal accounts.

2. **Real Accounts:**
   a) **Cash Account:** The purpose is to find out cash at hand. Cash Account will always have a debit balance or no balance. It can never have a credit balance. But Bank Account may have a credit balance.
   b) **Goods Account:** The purpose is to be find out total sales, total purchases, total returns etc. In the case of Goods Account like Sales Account, Purchase Returns Account, there is a credit balance. Purchase Account and Sales Returns Account will have a debit balance.
   c) **Other Real Accounts:** The purpose is to find out the value of each property on a particular date.

   Real Accounts will generally have a debit balance. The debit balance shows the value of property in possession, a credit balance shows profit on disposal of property.

3. **Nominal Accounts:** The purpose is to find out the total amount spent on each type of expenditure, and the total amount of income earned from various sources.

   A debit balance in a Nominal Account signifies a loss or an expense. A credit balance in a Nominal Account signifies an income or a gain. A zero balance in the account shows that income or gain is equal to expense or loss.

3.4.7 Distinction between Books of Journal and Ledger:

Books of Journal and Ledger can be distinguished as follows:

Basis of Distinction	**Books of Journal**	**Ledger**
1. State of Recording	Recording of entries in these books is the first stage.	Recording of entries in the ledger is the second stage.
2. Net effect of various	These books do not help to	A ledger helps to know the

transactions	know the net effect of the various transactions affecting a particular account.	net effect of the various transactions affecting a particular account.
3. Format	In the journal, there is one column for particulars and two columns for amounts – one for debit and an other for credit. Special journals (except Cash Book) have only one column of amount.	In the ledger, there are two equally divided sides having identical columns. The left side is known as debit and the right side is known as credit.
4. Balancing	In the books of Journal (except Cash Book) balancing is not done.	In the ledger, all the accounts (except nominal accounts) are balanced.
5. Next stage of accounting process	From the books of Journal, entries are transferred to the ledger.	From the ledger, first the trial balance is drawn and then financial statements are prepared.
6. Name of the process of recording entries	The process of recording entries in these books is called "Journalising".	The process of recording entries in the ledger is called 'posting'.

Illu 8: Enter the following transactions of Krishna's a/c and bring down the balance.

		Rs.
2005		
Jan 1	Sold goods to Krishna	1,000
3	Purchased goods from Krishna	1,400
10	Paid cash to Krishna	1,200
15	Sold goods to Krishna	400
25	Received cash from Krishna	2,400

Solution :

Krishna 's A/c

Dr. **Cr.**

Date	Particulars	L.F	Amount Rs.	Date	Particulars	L. F	Amount Rs.

2005 Jan 1	To Sales		1,000	200 Jan 3	By Purchases		1,400
10	To Cash		1,200	25	By Cash		2,400
15	To Sales		400				
31	To Balance c/d		1,200				
			3,800				**3,800**
				Feb 1	By Balance b/d		1,200

3.5 TRIAL BALANCE

After posting the transactions to respective ledger accounts they are balanced and then a Trial Balance is drawn. A Trial Balance is a statement which shows the list of accounts showing debit balances and list of accounts showing credit balances. If double entry principles are strictly followed the total of all the debit balances must agree with the total of all the credit balance. The Trial Balance is prepared as under:

Trial Balance as on…….

Debit balance	**Amount Rs.**	**Credit balance**	**Amount Rs.**
All real accounts	XX	All accounts of incomes & gains	XX
All accounts of expenses & losses	XX	All personal accounts showing credit balances	XX
All personal accounts showing debit balances	XX		
Total Rs.	**XX**	Total Rs.	**XX**

Illu.9 : Journalise the following transactions in a journal, post them to the ledger accounts and prepare trail balance.

2005		**Rs.**
June 1	**Sailaja invested in the business Rs.6,000 cash goods worth Rs.3,000 and a building worth Rs.12,000**	
2	**Borrowed from Bank**	**8,000**
3	**Purchased goods for cash**	**5,000**
4	**Sold goods on credit to Ramya**	**3,000**

5	**Cash received from Ramya**	**1,000**
6	**Purchased goods on credit basis from Jalaja**	**6,000**
9	**Sold goods on credit to Jalaja**	**3,000**
10	**Paid Salaries**	**1,500**
16	**Paid Office rent**	**350**
17	**Received Commission**	**175**
19	**Paid salary to salesmen**	**110**
20	**Paid Commission**	**50**
25	**Paid on account of Jalaja**	**2,200**
26	**Received from Ramya**	**690**
27	**Repaid loan to Bank**	**3,400**
28	**Sold buildings for cash**	**3,900**
29	**Received on account from Ramya**	**1,400**
30	**Paid Carriage for Jalaja**	**220**

Solution :

Journal Entries

Date	**Particulars**		**L.F.**	**Debit**	**Credit**
2005				**Rs.**	**Rs.**
June 1	Cash a/c Goods a/c Buildings a/c To Capital a/c (Being cash, goods and buildings brought in the business)	Dr. Dr. Dr.		6,000 3,000 12,000	 21,000
2	Cash a/c To Bank's loan a/c (Being loan taken from bank)	Dr.		8,000	 8,000
3	Goods a/c To Cash a/c (Being goods purchased for cash)	Dr.		5,000	 5,000
4	Ramya a/c To Goods a/c (Being goods sold on credit)	Dr.		3,000	 3,000
5	Cash a/c To Ramya a/c (Being cash received from Ramya)	Dr.		1,000	 1,000
6	Goods a/c To Jalaja a/c	Dr.		6,000	 6,000

	(Being goods bought on credit)				
9	Jalaja's a/c To Goods a/c (Being goods sold on credit)	Dr.		3,000	 3,000
10	Salaries a/c To cash a/c (Being the payment of salaries)	Dr.		1,500	 1,500
16	Office rent a/c To Cash a/c (Being Office rent paid)	Dr.		350	 350
17	Cash a/c To Commission a/c (Being commission received)	Dr.		175	 175
19	Salaries a/c To Cash a/c (Being salaries paid)	Dr.		110	 110
20	Commission a/c To Cash a/c (Being commission paid)	Dr.		50	 50
25	Jalaja's a/c To Cash a/c (Being cash paid on account of Jalaja)	Dr.		2,200	 2,200
26	Cash a/c To Ramya a/c (Being cash received on account from Ramya)	Dr.		690	 690
27	Bank loan a/c To Cash a/c (Being the repayment of loan)	Dr.		3,400	 3,400
28	Cash a/c To Buildings a/c (Being buildings sold for cash)	Dr.		3,900	 3,900
29	Cash a/c To Ramya a/c (Being cash received on account from Ramya)	Dr.		1,400	 1,400
30	Jalaja's a/c To Cash a/c (Being carriage paid for Jalaja)	Dr.		220	 220

Ledger Accounts

Cash account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
June	To Capital a/c	6,000	June	By Purchases a/c	5,000

1			3		
2	To Bank loan a/c	8,000	15	By Salaries	1,500
5	To Ramya's a/c	1,000	16	By Office rent a/c	350
17	To Commission	175	19	By Salaries a/c	110
26	To Ramya a/c	690	20	By Commission a/c	50
28	To Buildings a/c	3,900	27	By Jalaja's a/c	2,200
29	To Ramya's a/c	1,400	27	By Bank loan's a/c	3,400
			30	Bv Jalaja a/c	220
			30	By Balance c/d	8,335
		21,165			**21,165**
July 1	To Balance b/d	8,335			

Purchases account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
1	To Capital a/c	3,000	June 4	By Ramya a/c	3,000
3	To Cash a/c	5,000	9	By Jalaja's a/c	3,000
5	To Jalaja a/c	6,000		By Balance c/d	8,000
		14,000			**14,000**
July 1	To Balance b/d	8,000			

Sales account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
	To Balance c/d	6,000	June 4	By Ramya a/c	3,000
			9	By Jalaja	3,000
		6,000			**6,000**
			July 1	By Balance b/d	6,000

Office rent account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
June 16	To Cash a/c	350	June 30	By Balance c/d	350
		350			**350**

Commission account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.

2005			**2005**		
June 20	To Cash a/c	50	June 17	By Cash	175
30	To Balance c/d	125			
		175			**175**
			July 1	By Balance b/d	125

Ramya's account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
June 4	To purchases a/c	3,000	June 5	By Cash a/c	1,000
30	To Balance c/d	90	26	By Cash a/c	690
			29	By Cash a/c	1,400
		3,090			**3,090**
			July 1	By Balance b/d	90

Jalaja's account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
June 9	To Purchases a/c	3,000	6	By goods a/c	6000
25	To Cash a/c	2,200			
30	To Cash a/c	220			
30	To Balance c/d	580			
		6,000			**6,000**
			July 1	By Balance b/d	580

Salaries account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		
June 15	To Cash a/c	1,500	June 30	By Balance c/d	1,610
19	To Cash a/c	110			
		1,610			**1,610**
July 1	To Balance b/d	1,610			

Capital account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2005			**2005**		

June 30	To Balance c/d	21,000	June 1	By Cash a/c	6,000
				By Goods a/c	3,000
				By Buildings a/c	12,000
		21,000			**21,000**
			July 1	By Balance b/d	**21,000**

Buildings account

Dr. Cr.

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2005			**2005**		
June 1	To Capital a/c	12,000		By Cash a/c	3,900
			June 30	By Balance c/d	8,100
		12,000			**12,000**
July 1	To balance b/d	8,100			

Bank Loan account

Dr. Cr.

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2005			**2005**		
June 27	To Cash a/c	3,400	June 2	By Cash a/c	8,000
June 30	To Balance c/d	4,600			
		8,000			**8,000**
				By Balance b/d	4,600

Trial balance as on 30th June, 2005

Debit Balances	**Rs.**	**Credit Balances**	**Rs.**
Cash a/c	8,335	Sales a/c	6,000
Purchases a/c	8,000	Commission a/c	125
Office Rent a/c	350	Sundry Creditors a/c	
		Ramya	580
		Jalaja	90

Salaries a/c	1,610	Capital a/c	21,000
Buildings a/c	8,100	Bank loan a/c	4,600
Sundry Debtors : Ramya Jalaja	 3,000 3,000		
	32,395		**32,395**

3.6 QUESTIONS

A. Short Answer Questions :

1. What is Journal
2. What is a compound entry?
3. What is a Ledger?
4. What is a Trial Balance?
5. Give a format of a journal and briefly explain its contents
6. Enumerate any five utilities of ledger

B. Eassy Type Questions :

1. Explain the procedure of posting
2. Explain the procedure for balancing a ledger account
3. Explain the methods of preparing a trial balance.
4. Distinguish between Journal and Ledger.

3.7 EXERCISES

1. Journalise the following transactions.

2006		**Rs.**
August 1	Shri Rajan invested to business	20,000
2	Opened an account with the bank of India by depositing cash	10,000
3	Purchased goods for cash	500
4	Purchased machinery for cash	800
5	Cash purchases of goods	300
6	Cash sales	900
15	Withdraw cash for personal use	200

16	Purchased goods from Preetam & Sons on credit	600
25	Received cash on account from Ramanand	350
26	Paid cash to Minakshi Bros	250
29	Paid rent	125
30	Received Commission	175
30	M/s Ram & Sons returned goods	100

2. Journalise the following transactions in the books of Sudhir Kumar

2006		**Rs.**
Jan.1	Sudhir commenced business with cash	40,000
3	Purchased goods for cash	500
5	Sold goods for cash	300
6	Purchased one motor car for cash	15,000
9	Sold machinery for cash	9,000
11	Purchased a building on credit from Narendra	20,000
15	Sold furniture on credit to Randhir Kapoor	9,500
17	Paid Cartage	110
22	Received Commission	50
27	Cash Sales	1,200
29	Cash Purchases	600
30	Received on account from Ahmed	350
31	Paid cash to Sunit kumar on account	190

3. Pass Journal entries of the following transactions in the books of Rajesh.

2006		**Rs.**
July 1	Rajesh commenced business with cash	16,000
3	He bought goods as his capital in beginning	4,000
7	Sold goods to Dinesh on credit	6,500
8	Purchased a horse for cash	3,100
17	Ramesh's a/c which is over due is closed as the amount is not recoverable	700

20	Goods burnt by fire	390
21	Received cash on account from Dinesh	3,300
25	Goods distributed as free samples	325

4. Journalise the following transactions in the books of Ram. Post them in the ledger and balance the various accounts opened in the ledger.

2006		**Rs.**
April 2	Ram started his business with cash	70,000
3	Deposited into bank	50,000
4	Purchased goods for cash from Mr. X	5,000
5	Bought goods on credit from Mr. Y	6,000
6	Returned goods to Y	1,000
10	Sold goods for cash for to Mr .A.	6,000
15	Sold goods to Mr. B	6,000
16	Mr. B Returned goods	1,000
17	Drew from bank for personal use	5,000
25	Paid to Mr. Y in full settlement by cheque	4,800
26	Received a cheque from Mr. B in full settlement	4,900
27	Drew cash from bank for office use	10,000
30	Drew cash for personal purposes	5,000
30	Paid salaries to staff	5,000
30	Issued a cheque for Rs.3,000 in favour of Sri Devi a landlady towards rent for April	
30	Withdrew goods for private use	1,000

5. Journalise the following transactions in the books of Mr. X Post them in the ledger and balance the various accounts opened in the ledger also prepare Trial balance.

2006		**Rs.**
April 1	Mr. X Commenced business with cash	80,000
4	Purchased furniture	22,000
5	Bought goods for cash from Mr. Y	24,000
8	Purchased goods from Mr. Z	40,000

12	Sold goods on credit to Mr.A	10,400
16	Received from Mr.A on account	4,800
20	Sold goods for cash to Mr. B	5,200
21	Paid to Mr. Z on account	12,000
27	Withdrew cash for personal use	500
28	Brought in further capital	10,000
29	Paid to Mr. Z on account	16,000
30	Paid to General expenses	250
30	Paid Rent	520
30	Paid Salaries to employees	12,000

3.8 SUGGESTED BOOKS

1. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
2. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
3. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
4. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
5. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 4

SUBSIDIAY BOOKS

Objectives :

After going to this unit we should be able to

- Know about various types of subsidiary books
- Prepare various types of subsidiary books

Structure :

4.1. INTRODUCTION

In earlier times, businessmen used only one Journal for recording all the business transactions. Since the volume of business was small, and the number of transactions very few, "Journal" as a book of accounts was convenient. But with the growth of business, the number of transactions increased manifold and the need was felt to have a better method of recording business transactions. If all these business transactions were recorded in one and the same Journal, the journal would be bulky and cumbersome. It would be very difficult to make a ready reference to such a Journal. Moreover, it is impossible for many clerks to work on the same Journal at one and the same time. Under such circumstances, it becomes necessary to divide the whole Journal into several subsidiary Journals so that work can be assigned to many at one and the same time. In each separate journal, one particular class of business transactions is recorded. That means the purchase Journal may be maintained to record credit purchases of goods and a Cash Book for recording cash transactions. Instead of recording all the transactions in one and the same journal, they are recorded in separate journals meant for the purpose.

Therefore, in order to meet the requirements of modern business, the original journal is divided into the following:

1. Purchase Book
2. Sales Book
3. Purchase Return Book (Return Outward Book)
4. Sales Return Book (Return Inward Book)
5. Cash Book
6. Bills Receivable Book
7. Bills Payable Book
8. Journal Proper

The chart given below indicates the different types of subsidiary books or journals and the category of business transactions recorded in them:

Subsidiary Books (Sub- Division of Journal)

Subsidiary Book / Subsidiary Journal	**Category of Business Transactions Recorded**
1. Purchase Book	Credit Purchases of goods only.
2. Sales Book	Credit Sales of goods only.
3. Purchase Return Book (Return Outward Book)	All return of goods purchased by us from suppliers i.e. Return Outwards.
4. Sales Return Book (Return Inward Book)	All return of goods sold by us to customers i.e. Return Inwards.
5. Cash Book	All cash and Bank transactions.
6. Bills Receivable Book	All Bills received by us.
7. Bills Payable Books	All bills accepted by us.
8. Journal Proper	All such transactions which cannot be entered in the above seven books. (Recorded in the form of journal entries)

4.2 ADVANTAGES OF SUBSIDIARY BOOKS

The advantages of using Special Journals are as under:

(a) **Facilitates division of work:** The accounting work can be divided among many persons.

(b) **Permits the installation of internal check system:** The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of error/ fraud may be avoided.

(c) **Permits the use of specialised skill:** The accounting work requiring specialised skill may be assigned to a person possessing the required skill. With the use of a specialised skill, prompt, economical and more accurate supply of accounting information may be obtained.

(d) **Time and labour saving in journalising and posting:** For instance, when Sales Book is kept, the name of Sales Account will not be required to be written down in the journal as many times as the sales transactions and at the same time, Sales Account will not be required to be posted again and again since only a periodic total of Sales Book is posted to the Sales Account.

4.3 PURCHASE BOOK

This book is maintained mainly to record purchase in business. But here care must be exercised before entering the purchase transactions in this book. Only credit purchases are to be recorded in this book. Credit purchases means the purchase of goods without making payment on the spot. Such purchases are known as credit purchases. Purchases of goods on credit in which the trader deals is recorded in this journal. For example, if a Cloth Merchant has purchased cloth on a credit basis, that will be recorded in the Purchase Book. But if he has purchased furniture on credit, it will not appear in the Purchase Book since it is a purchase of an asset.

The entries in the purchases book are made on the basis of invoices received from the suppliers with the amounts net of trade discount / quantity discount. Trade discount is a reduction granted by a supplier from the list price of goods or services on business considerations (such as quantity bought, trade practice, etc.) other than for prompt payment.

Formate of Purchase Book:

Date	Particulars	L.F.	Inward Invoice No,	Details	Amount Rs.	Amount Rs.

4.3.1 Explanation of Columns:

1. **Date:** Date of purchases is written in this column.
2. **Particulars:** In this column, the names of the suppliers are entered. There is no need to write the address of the supplier since it appears, on the Invoice itself.
3. **L. F.:** Page number of the "Ledger", on which the account of the supplier appears, is entered in this column.
4. **Inward Invoice No:** All inward invoices are filed properly, and the consecutive number of the Invoice is shown in this column.
5. **Details:** The value of goods purchased and amount of trade discount are written.
6. **Amount:** The net amount of purchases is entered in this column. Only the amount after deducting trade discount is recorded here.

4.3.2 INVOICE:

Specimen of an Inward Invoice

INVOICE

No.786 / 90
Date: 19th Feb, 2006

Reliance Co. Ltd.
40, Jawaharlal Nehru Road
Mumbai – 700016.

Customer Name Ram & Sons
R.P. Road
Hyderabad

Date	Description	Rate	Amount	Total (Rs)	Remarks

E & O. E.

The invoice is the basis of writing a Purchase Book. Transactions are recorded in the Purchase Book from the Invoices received from the suppliers. Hence it is necessary to know about Invoices.

An invoice is a statement sent by the Seller to the buyer giving a full description of the goods supplied.

All the invoices received are property arranged and consecutively numbered. They are filed in a proper file and then the purchase transactions are recorded in the Purchase Book.

When the trader receives such an invoice, he has to verify whether the goods are received as per the details given in the invoice in regard to quantity, quality etc. He also checks whether the calculations are made correctly. If the invoice is found to be correct in all respects it is given a serial number and after an entry is made in the purchase book, it is filed. All such invoices received are called Inward invoices.

4.3.3 Trade Discount:

Trade Discount is a reduction made in the catalogue price of an article to enable the retailer to earn a profit. Generally, it is recorded in the Purchase Book and Sales Book but it does not enter in the ledger accounts. In the ledger, only net amount of purchase and sale are entered.

Illu 1: Enter the following in the Purchase Book also post them into ledger.

2006		Rs.
Aug 10	Bought goods from Murali Mohan	5,000
Aug 15	Bought goods from Ranga Rao	4,000
Aug 20	Purchased goods from Gopal	8,000
Aug 25	Purchased goods from Harikrishna for cash	10,000
Aug 31	Purchased goods from Kavitha	6,000

Solution :

Purchases Book

Date	Particulars	Invoice No.	L. F.	Amount Rs.
2006				
Aug 10	Murali Mohan			5,000
15	Rama Rao			4,000
20	Gopal			8,000

31	Kavitha			6,000
Aug 31	Purchases a/c Dr.			**23,000**

Note:

1. Purchases Book deals only with credit purchases. As such purchase of goods from Hari Krishna for cash is not entered in this book.

4.4 SALES BOOK

A separate book is maintained to record all credit sales. The manner of recording sales in this Book is the same as in the case of the Purchase Book. The book is also known as the Sales Day Book or Sales Journal. The rulings of this book and other principles are almost identical with those of the Purchase Book.

Before entering the transactions in the Sales Book, it should be seen that the transaction satisfies the below mentioned two conditions:

1. It is a sale of articles on credit basis.
2. It is a sale of articles in which a businessman deals.

Sales of goods on a cash basis or the sale of an asset on a Cash / Credit basis cannot be entered in the Sales Book. Supposing a merchant dealing in radios, sells radios on credit, that will be entered in the sales book. But if he sells a Typewriter that being the sale of an asset on credit, will not be entered in the Sales Book:

4.4.1 Procedure for Writing – up the Sales Day Book

When goods are sold on credit, an outward invoice is prepared for every credit sale and are checked as to quality, quantity and price of the goods before thy are dispatched to the customers. The duplicate copy of the invoice remains with the firm and the original copy is sent to the customer. Sales Day Book is written – up on the basis of duplicate outward invoice.

INVOICE

No. P. 29

Date: 9th June 1991

Jeenath Co. Ltd.

31, Jawaharlal Nehru Road

Hyderabad.

Customer' Name Allwin Co. Ltd.

Hyderabad

Qty.	Description	Rate	Amount	Total (Rs)	Remarks
E & O. E.					

The invoice contains the following details:

(i) The names and addresses of both the parties to the contract.

(ii) An exact description of the goods, including the quantity, rate and total value of the goods sold.

(iii) The terms and conditions of sales (on the overleaf).

E & O. E. means Errors and Omissions Excepted. The market reserves the right to correct any error in the invoice.

The ruling of the Sales Day Book is given below:

Sales Day Book

Date	Particulars	Outward Invoice No.	L. F.	Debit Rs.	Credit Rs.

(i) In the "Date" column, the date on which invoice is prepared is entered.

(ii) In the "Particulars" column, the names of the customers are recorded. A brief description of each of article sold are also written in this column.

(iii) In the “Outward Invoice No.” column, the serial no. of Outward Invoice is written.

(iv) In the “L. F.” column, the page no. of the Debtors’ account in the Debtors’ Ledger is written.

(v) In the “Details” column, the value of the goods sold and amount of trade discount is written.

(vi) In the “Total” column the actual amount receivable from debtors is written.

Illu.2 : Enter the following transactions in Sales Books of Narayana

2006 February

		Rs.
2.	**Credit sales to Sravan**	**8,000**
7.	**Goods sold to Hari on credit**	**9,000**
12.	**Sold goods to Rajesh**	**6,000**
16.	**Goods returned by Rajesh**	**800**
20.	**Credit sales to Kishore**	**7,000**
24.	**Credit Sales to Siva**	**12,000**
27.	**Sold goods to Sankar**	**13,000**

Solution :

Sales Book

Date	Customer Name	L.F.	Invoice No.	Amount
Feb 2	Sravan			8,000
7	Hari			9,000
12	Rajesh			6,000
20	Kishore			7,000
24	Siva			12,000
27	Sankar			13,000
Sales Book Total				**55,000**

4.4.2 Sales book with Sales Tax Column:

It is the duty of the seller to realise sales tax from customers and deposit it to the Government. Sales tax is calculated at a fixed percentage on the net price of the goods, i.e., after trade discount. Generally a separate column is provided in the Sales Day Book for Sales tax. Periodically, the total of sales tax column is credited to Sales Tax Account. When actual payment is made to the Government, the Sales Tax Account is debited and Cash / Bank

Account is credited and any Balance of Sales Tax Account at the end of the year is shown in the Balance Sheet as a liability.

4,4.3 Purchases Returns Book:

It may be necessary to return some goods that the firm has bought on credit for a variety of reasons such as defective or excess quantity of goods supplied, etc. All return of goods are recorded primarily in the Purchases Returns Book.

When a firm returns some goods to its supplier, it prepares a "Debit Note" and sends it along with the goods returned. The supplier, in turn, will prepare a "Credit Note". The original copy of the credit note will be sent tot the firm. Entries in the Purchases Returns Book are made on the basis of original "Credit Note" received from the supplier. On receipt, all credit notes should be numbered consecutively and should be filed properly for future reference.

The specimen of the Purchase Returns Book is given below:

Purchases Returns Book

Date	Particulars	Credit Note No.	L. F.	Rs.	Remarks

Illu.3 : M/s Naval Handicrafts Emporium, Madras returned the following goods to different parties. Prepare purchase returns book.

2006	
June 10	Kalanjali, Hyderabad (Debit Note No. 6) 30 Wooden Toy Elephants at Rs.15 per toy Trade discount 20%
22	Bharathi Arts works, Madhurai (Debit Note No. 7) 40 toys each toy at Rs.12, Trade discount 10%
29	Modern Cultural Palace, Tanjavoor (Debit Note No. 8) 10 Tanjavoor plates at Rs.80. Trade discount 20%.

Solution :

Purchases Returns Book

Date	Particulars	Invoice No.	L. F.	Debit Note	Amount Rs.
2006					
Nov 10	Kalanjali, Hyderabad			6	360
Nov 22	Bharati Arts Works, Madhurai			7	432
Nov 29	Modern cultural Palace, Tanjavur			8	640
Nov 30	Total				**1,432**

4.4.4 Sales Returns Book:

Goods may be returned by the customers for a variety of reasons such as wrong quantity and/ or quality. All goods returned by the customers are primarily recorded in this book.

When goods are returned by the customer, a "Credit Note" is made out in his name. A Credit Note is prepared in duplicate. The original being sent to the customer for his information and record. The duplicate is preserved in the file for future reference. Duplicate credit Note provides information for recording in the Sales Returns Book.

The specimen ruling of the Sales Returns Book is given below:

Sales Returns Book

Date	Particulars	Credit Note No.	L. F.	Rs.	Remarks

Illu.4 :: M/s Utility Garments Corporation, Tirupathi received the returns goods from various customers. Prepare sales returns account.

2006	
Feb 10	**Return of goods from Nityanandam & Sons 25 Tea shirts at Rs. 100 per each shirt. Trade discount 10%, Credit Note No. 8**
19	**Return of goods from M/s. Nataraj & Co. 20 Pants at Rs.250 per pant. Trade discount 10% Credit Note No. 10**

Solution :

Sales Returns Book

Date	Particulars	L. F.	Credit Note No.	Amount Rs.
1998				
Feb 10	M/s Nityanandam & Sons		8	2,250-00
Feb 19	M/s Sumitra & Sons		9	5,400-00
Feb 24	M/s Nataraj & Company		10	4,500-00
Feb 28	Total			**12,150-00**

Illu.5 : Enter the following transactions in suitable subsidiary books:

Jan		*Rs.*
1	**Purchased goods from Rekaha**	**7,500**
4	**Sold goods to Midhun**	**8,000**
5	**Returned goods to Rekha**	**500**
6	**Sridevi bought goods from us**	**4,000**
8	**Received goods returned by Midhun**	**400**
10	**Rajesh sold goods to us**	**4,000**
15	**Sold goods to Kishore**	**3,000**
16	**Returned goods to Rajesh**	**600**
20	**Kishore returns goods**	**500**

(Andhra University, March 2005)

Solution :

Purchase Book

Date	*Particulars*	*L.F. No.*	*Invoice No.*	*Amount Rs.*
Jan 1	Rekha			7,500
10	Rajesh			4,000
	Total			**11,500**

Sales Book

Date	*Particulars*	*L.F. No.*	*Invoice No.*	*Amount Rs.*
Jan 4	Midhun			8,000
6	Sridevi			4,000

15	Kishore			3,000
	Total			**15,000**

Purchase Returns Book

Date	*Particulars*	*L.F. No.*	*Invoice No.*	*Amount Rs.*
Jan 5	Rekha			500
16	Rajesh			600
	Total			**1,100**

Sales Returns Book

Date	*Particulars*	*L.F. No.*	*Invoice No.*	*Amount Rs.*
Jan 8	Midhun			400
20	Kishore			500
	Total			**900**

4.4.5 Bills Receivable Book:

For large organisations, where numerous bills of exchanges are drawn on debtors, it is advantageous to enter them primarily in the Bills Receivable Book.

Bills Receivable Book

Bill No.	**Date Recd.**	**From whom Recd.**	**Drawer**	**Acceptor**	**Date of Bill**	**Term**	**Due Date**	**L. F.**	**Rs.**
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)

(1) Bill No. – In this column, the serial number of the bill is entered.

(2) Date Received – This column is used for entering actual date on which the bill is received.

(3) From Whom Received – This column records the name of the debtor from whom the bill is received.

(4) Drawer – This column records the name of the drawer of the bill.

(5) Acceptor – This column records the name of the acceptor.

(6) Date of the bill – This column records the actual date of drawing of the bill.

(7) Term – This column is used for entering the period of the bill, e.g., 60 days, 3 months, etc.

(8) Due Date – This column records the date on which the bill is payable.

(9) L. F. – The page no. of Debtors' Ledger is entered here.

(10) Amount – This records the value of the bill.

4.4.6 Bills Payable Book:

Where numerous bills payable are accepted, drawn by the creditors, it is advantageous to enter then primarily in the Bills Payable Book.

Bills Payable Book

Bill No.	Date Accepted	To whom given	Drawer	Date of Bill	Term	Due Date	L. F.	Rs.
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

(1) Bill No. – This column, records the serial no. of bills accepted.
(2) Date Accepted – This column records the actual date of acceptance of the bill.
(3) To Whom given – This column records the name of the person to whom the bill is given.
(4) Drawer – This column records the name of the drawer of the bill.
(5) Date of Bill – This column records the actual date of drawing of the bill.
(6) Term – This column is used for entering the period of the bill, e.g., 60 days, 3 months, etc.
(7) Due Date – This column records the date on which the bill is payable
(8) L. F. – Page no. of Creditors' Ledger is entered here.
(9) Amount – This records the value of the bills payable.

4.5 JOURNAL PROPER

Journal Proper is used for making the original record of those transactions which do not find a place in any of the aforesaid books of original entry.

Entries recorded in the Journal Proper may be classified as follows:

(1) Opening entries; (2) Closing entries; (3) Transfer entries; (4) rectification of Errors entries; (5) Adjustment entries; (6) Credit Purchase of assets; (7) Credit sale of worn – out or obsolete assets, (8) Credit purchase of Stationery etc. The specimen ruling of the Journal Proper is given below:

Journal Proper

Date	Particulars	L. F.	Rs.	Rs.
(1)	(2)	(3)	(4)	(5)

(1) Date – This column records the date of transaction.

(2) Particulars – This column records the name of the accounts debited or credited. The account debited is written first, adjacent to the line of date and the account credited is written below with the prefix "To". In this column, the narration is also recorded.

(3) L. F. – This column records the page no. of ledger in which this account has been posted.

(4) Dr. Column – It records the debit amount.

(5) Cr. Column – it records the Credit amount.

(1) Opening Entries:

Opening entries are used at the beginning of the financial year to open the books by recording the assets, liabilities and capital, appearing in the Balance Sheet of the previous year. The rule to be applied is:

Assets Account Dr.
To Liabilities Account
To Capital Account.

(2) Closing Entries:

Closing entries are used at the end of accounting year for closing off accounts relating to expenses and revenues. These accounts are closed of by transferring their balances to the Trading and Profit and loss Accounts. Since records must not be made in the ledger without journal entries, closing entries are passed in the Journal Proper first and then posted to the ledger.

(3) Transfer Entries:

Transfer entries are passed in the Journal Proper for transferring an item, entered in one account, to another account.

(4) Rectification of Errors:

Mistake which has been made in passing an entry should be corrected by passing another entry in the Journal Proper and the practice of erasures should not be tolerated.

(5) Adjustment Entries:

Before preparation of Final Accounts, certain adjustment is required in respect of outstanding expenses, prepaid expenses, provision for doubtful debts, etc. Entries made for such adjustment is called Adjustment Entries and is done in the Journal Proper.

Illu.6 : Pass adjustment entries for the following:

i) Wages outstanding Rs.500.

ii) Interest on Capital Rs.720.

iii) Goods destroyed by fire accident Rs.7,000 out of which insurance company admits the claim for Rs.5,200.

Solution :

Journal Entries

Date	Particulars		L.F	Debit	Credit
				Rs.	Rs.
1	Wages a/c To Outstanding Wages a/c (Being the adjustment of outstanding wages)	Dr.		500	 500
2.	Interest on Capital a/c To Capital a/c (Being the interest on capital calculated)	Dr.		720	 720
3.	Insurance claim a/c Profit and Loss a/c To Abnormal loss a/c (Being the insurance claim admitted and the balance transfer to P & L account)	Dr.		5,200 1,800	 7,000

4.6. QUESTIONS

A. Short Answer Questions

1. What are the advantages of subsidiary books of accounts?
2. What is a purchase book? What conditions are to be satisfied before a transaction is recorded in the book?
3. Explain the nature and use of a sales book.
4. What is Invoice?

5. What is a Debit note? What is the use of a Debit Note?
6. What is a Credit Note? What is the use of a Credit Note?
7. Differences between debit note and credit note.
8. What is journal proper?
9. What kind of entries are passed in a journal proper?

B. Essay Questions

1. Explain various types of subsidiary books.
2. What is a subsidiary book? Why are they to be maintained?
3. Prepare purchases book and sales book with hypothetical figures.
4. Explain sales returns book and purchase returns book with proforma

4.6 EXERCISES

1. Record the following transactions in the purchases book and post them in the ledger.

2006		Rs.
July 1	Bought goods from Arvind & Co. for	500
3	Sunder & Co. invoiced goods to us	700
4	Purchased one typewriter for office use from Godrej Ltd.	1,100
6	Dinanath sold goods to us (Rs.500 less 5% trade discount)	475
7	Cash purchases	300

[Ans.: Purchases Book Total Rs.1,675]

2. Enter the following transactions in the sales book and post them to ledger accounts.

2006		Rs.
July 1	Sold two sarees to Hemamalini @ Rs.150 Less 5/% Trade Discount	
2	Supplied one saree to Sharmila	175
3	Babita purchased one saree from us	200

4	Cash sales	100
8	Invoiced 4 Sarees to Jayasree	500
9	Sold old Typewriter	375
10	Sold blouse pieces to Pramila	125

[Ans.: Sales Book Total Rs.1,285.00]

3. Enter the following transactions in proper subsidiary books.

2006 April 1	Purchased goods from Anand for Rs.800 less 20% Trade Discount
2	Purchased goods from Baskar for Rs.700 less 20% Trade Discount
4	Returned Anand goods worth Rs.100
5	Returned Baskar goods worth Rs.80
8	Sold godos to Chandar for Rs.500 less 10% Trade Discount
11	Chandar returned us goods worth Rs.100
16	Sold goods to David for Rs.300 less 10% Trade Discount
19	David returned us goods worth Rs.50
21	Bought goods from Easwar for Rs.300
22	Sold goods to Farook for Rs.150
25	Bought goods from Gopal for Rs.150 less 20% Trade Discount
28	Returned goods worth Rs.50 to Gopal

[Ans.: Purchases Book Total Rs.1,620; Sales Book total Rs.870; Purchases returns Book Rs.184.00 Sales Returns Book Rs.135.50]

4. Enter the following transactions in the Sales day book and post them into the ledger.

2006 March 1	Sold to Zankar Stores 5 T.V. sets @ Rs.8,000 each, less 10% Trade discount
10	Sold to S.K. Electronics 2 T.V. sets @ Rs.900 each, less 10% Trade Discount
23	Sold to Ameeta Kelkar and Co. 1 colour T.V. set for Rs.15,000 less 10%

	Trade Discount
	All sales are subject to 10% sales tax.

[Ans.: Sales Day Book Total Rs.72,270]

5. Record the following transactions in Journal Proper.

2006		Rs.
Jan.1	Purchase of typewriter on credit from Kantha Rao & Company	6,500
Jan.8	Sale of building to Kumar & Sons on credit	2,75,000
Jan.12	Bad debts due from Suresh who became insolvent	300
Jan.19	Purchase of furniture on credit from Gangadhar for personal use	2,500
Jan.28	Purchase of goods from Achari for cash for household purpose	300
Jan.30	Receipt of cash Rs.1,000 from Ramesh was posted to the account of Suresh	

4.8 SUGGESTED BOOKS

1. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
2. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
3. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
4. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
5. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 5

CASH BOOK

Objectives :

After studying this unit we should be able to

- Features of cash book and the advantages in the preparation of cash book
- Know the types of cash book
- Prepare different types of cash books
- Understand the meaning and need for petty cash book and how to prepare it.

Structure :

5.1 INTRODUCTION

The Cash Book is a sub – division of the book of original entry recording transactions involving receipts or payments of Cash.

All Cash transactions are first entered in the Cash Book and then posted from Cash Book into the ledger. Cash Book is maintained in the form of a ledger with narration. Practically, the Cash Book is a substitute for Cash Account in the ledger.

Cash Book is not only a book of original entry but also a ledger account for cash transactions. Therefore, cash account is not maintained in ledger book and for preparing trial balance (which records balances of ledger accounts) balance of cash account is recorded from cash book. Therefore, it is said that cash book is a subsidiary as well as a principal book. Cash book represents in effect cash account in ledger books; therefore, rules discussed in last chapter for preparing cash account shall be applicable. To recapitulate, cash account records all cash receipts on debit side and all cash payments on credit side of the account.

5.1.1 Features:

1. Only Cash transactions are recorded in the Cash Book.
2. It performs the functions of both journal and the ledger at the same time.
3. All cash receipts are recorded in the debit side and all cash payments are recorded in the credit side.
4. It records only one aspect of a transaction, i.e., Cash.
5. All cash transactions are recorded chronologically in the Cash Book.
6. The Cash Book, recording only cash transactions, can never show a credit balance.

5.1.2 Necessity of Maintaining Cash Book:

The necessity of maintaining cash book are discussed below:

(i) If every cash transactions are recorded in the journal, a tremendous amount of work will be involved in debiting or crediting cash account every time cash received or paid. If the cash book is maintained, the botheration of posting every item or receipt or payment of cash individually to cash account in the Ledger is avoided.

(ii) Cash Book is maintained because it gives the balance of cash – in – hand.

5.2. TYPES OF CASH BOOK

The various types of Cash Book from the point of view of uses may be as follows:

Cash Book can be of several kinds:

(i) **Single Column Cash Book –** For recording cash transactions only.

(ii) **Cash Book with Cash and Bank Columns –** For recording cash and bank transactions.

(iii) **Cash Book with Cash, Bank and Discount Columns –** For recording cash and bank transactions involving loss or gain on account of discount.

5.3 SINGLE COLUMN CASH BOOK

Single column Cash Book or Simple Cash Book is a such a Cash Book appears like an ordinary account, with one amounts column on each side. The left – hand side records receipts of cash and the right – hand side the payments. The difference between the left hand side or debit side and right hand side or credit side represents the balance i.e., amount of cash in hand and the balance must be a debit one. This cash book records only cash transactions and for bank transactions, a separate Bank Account is opened in the ledger where all transactions relating to “Cheques” are recorded.

Specimen of Single Column Cash Book

Dr. **Cr.**

Receipts				Payments			
Date	Particulars	L. F.	Amount Rs.	Date	Particulars	L. F.	Amount Rs.

1. **Date:** The date column in the Cash Book enables a chronological record of each transaction. In this column year, month and actual date of transaction is recorded.
2. **Particulars:** The column for particulars is left for writing the heads of account to be credited and debited and also for providing the appropriate narration or explanation of the transaction recorded.
3. **Voucher No.:** The document in support of a transaction is called voucher. There are two types of Vouchers: (1) Receipts Voucher, and (2) Payments Voucher. Generally, voucher has a serial number and this number is written in this column.
4. **Ledger folio (L. F.) :** The column for ledger folio is for indexing. A folio is a page mark. The folio in which the accounts, named in the Cash Book, are maintained in the ledger are marked in this column. This enables to locate the respective page or pages in the ledger easily.
5. **Amount:** The money value of the transaction is written in this column.

5.3.1 Balancing of the Single – Column Cash Book:

The cash book is balanced just like any other ledger account. As mentioned earlier, the cash book always shows debit balance since the cash payments can never exceed the amount of cash receipts. After closing the cash book, the balance is shown on the debit side. The difference is written on the credit side as 'By Balance c/d', and, then, on the debit side the balance is written as 'To balance b/d'. This becomes the opening balance for the next period.

Illu.1 : Prepare a cash book from the following information.

2006		Rs.
Jan.1	Balance of cash	7,000
Jan.10	Bought goods for cash	2,500
Jan.11	Bought goods on credit from Z	3,000
Jan.15	Sold goods for cash	4,700
Jan.17	Paid salary	1,000
Jan.18	Withdrew for personal use	500

Solution :

Cash book for the month of January

Date	Particulars	L.F	Rs.	Date	Particulars	L.F.	Rs.
2006 Jan.1	To Balance b/d		7,000	2006 Jan.10	By Purchases		2,500
Jan.15	To Sales		4,700	Jan.17	By Salary		1,000
				Ja.18	By Drawings		500
				Jan.31	By balance c/d		7,700
			11,700				**11,700**
Feb.1	To Balance b/d		7,700				

5.4 DOUBLE COLUMN CASH BOOK

If along with columns for amounts to record cash receipt and cash payment another column for discount is added on cash side, it is called a Double Column "Cash Book".

Cash receipts are entered in Debit side and cash payments in credit side like the single Column Cash Book.

The Double Column Cash Book has two columns on both the sides of the cash book. This cash book can have two columns on both the sides as under:

(a) Cash and Discount Columns, (b) Cash and Bank Columns, (c) Bank and Discount columns.

However, of the three types of Double Column Cash Book, the most common cash book used is with cash and discount columns.

When a firm makes payment at an earlier date it avails cash discount. So discount received is accompanied with the payment of cash. Discount received (nominal a/c) is a gain to the firm. So whenever cash discount is received it is to be recorded on the credit side of the Cash Book under discount column. Similarly, when a customer pays at an earlier date the firm allows Cash discount. So cash discount allowed is accompanied with the receipt of Cash. Discount allowed (nominal a/c) being a loss is to be recorded on the debit side of the cash book under discount column.

Specimen of Double Column Cash Book

Dr. **Cr.**

Receipts					**Payments**				
Date	**Particulars**	**L. F.**	**Discount (Rs.)**	**Cash (Rs.)**	**Date**	**Particulars**	**L. F.**	**Discount (Rs.)**	**Cash (Rs.)**

5.4.1 Cash Book with Cash and Discount Column:

In order to record cash discount allowed or received, one additional column for "discount" is provided on both the sides of the Cash Book.

1. **Cash Discount :** It is a discount allowed to customers as an inducement to make the payment immediately. Cash discount is closely related to cash receipt and cash payment. When cash is received, discount is allowed and when it is paid discount is received. Cash discount allowed is a loss to a businessman while cash discount received is a gain to him.
2. **Trade Discount :** It is an allowance made by a wholesaler to a retailer in order to enable the retailer to sell the articles at list prices and earn a reasonable margin of profit. The

amount of trade discount is deducted from the invoice, therefore, it has no connection as to the receipt and payment of cash. Hence, trade discount does not appear in the books of accounts.

5.4.2 Difference between Cash Discount and Trade Discount:

1. A trade discount is offered by the trader to a buyer as a reduction in the catalogue or invoice price of the goods sold. However, a cash discount is a reduction in the amount due from a debtor.
2. While a trade discount is offered by the manufacturer or wholesaler to a retailer, a Cash discount is offered by a creditor to a debtor.
3. The purpose of offering the trade discount by the manufacturer or a wholesaler to a retailer is to enable him to sell the goods at the invoice price and to have a margin of profit. The purpose of offering a cash discount is to induce the debtor to make an early payment.
4. A Trade discount is offered unconditionally whereas a cash discount is offered only on payment of the amount.
5. A Trade discount does not figure in the books of both the parties whereas a cash discount is accounted for either as a gain or as a loss.
6. The rate at which a trade discount is offered varies from trade to trade and one commodity to another. However, a cash discount is offered almost at the same rate in all kinds of trade, but the cash discount rate may vary depending on the period of credit.
7. A trade discount is usually predetermined whereas a cash discount is not pre-determined.

Illu.2 : Prepare two column cash book of Sri Raj for the following transactions.

2006		Rs.
Mar 1	Cash in hand	3,000
Mar 6	Cash purchases	2,000
10	Wages paid	40
11	Cash sales	6,000
12	Cash received from Suresh	1,980

	Discount allowed	20
19	Cash paid to Munna	2,470
	Discount received	30
27	Cash paid to Radha	400
28	Bought goods for cash	2,070

Solution:

Date	Particulars	LF	Discount	Amount Rs.	Date	Particulars	LF	Discount	Amount Rs.
2006					2006				
Mar 1	To Balance b/d			3,000	Mar 6	By Purchases			2,000
Mar 11	To Sales			6,000	Mar 10	By Wages			40
Mar 12	To Suresh		20	1,980	Mar 19	By Munnu		30	2,470
					Mar 27	By Radha			400
					Mar 28	By Purchases			2,070
					Mar 31	By Balance c/d			1,000
			20	**10,980**				**30**	**10,980**
Apr 1	To Balance b/d			4,000					

Illu.3 : Prepare a Cash book with Bank and Discount columns from the following transactions.

2006		Rs.
June 1	Balance at bank	8,820
1	Cash in hand	510
2	Cash Sales	5,500
3	Paid in to Bank	5,000
4	Stationery purchased	200
10	Paid Ramesh by cheque	180
	Discount received	20
11	Gave a cheque for cash purchases	1, 000
12	Withdrawn cash for personal use	400
15	Received from Ranga, a cheque for Rs.1,920 in full settlement of account for	2,000
16	Draw from bank	500

20	Paid wages by cheque	200
30	Bank charges as per pass book	50

Solution:

Date	Particulars	LF	Discount	Bank	Date	Particulars	LF	Discount	Bank
2006					2006				
June 1	To Balance b/d			8,820	June 4	By Stationery a/c			200
June 1	To Cash a/c			510	June 10	By Ramesh a/c		20	180
2	To Sales a/c			5,500	11	By Purchases a/c			1,000
3	To cash a/c			5,000	12	By Drawings a/c			400
15	To Ranga a/c		80	1,920	16	By Cash a/c			500
					20	By Wages a/c			200
					30	By Bank charges a/c			50
					30	By Balance c/d			19,220
			80	**21,750**				**20**	**21,750**
July 1	To Balance b/d			19,220					

5.5 THREE COLUMN CASH BOOK

A three – column cash book is prepared when there are a large number of cash and bank transactions. It has three columns on each side, namely, a cash column for cash received and cash paid, a bank column for money discount received and discount allowed.

Specimen of Three Column Cash Book

Date	Receipts	LF	Discount Rs.	Cash Rs.	Bank Rs.	Date	Payments	LF	Discount Rs.	Cash Rs.	Bank Rs.

5.5.1 Balancing the Three – column Cash Book :

The cash and bank columns are balanced separately like other columns. Cash account always shows a debit balance. The bank account may show a debit or a credit balance. A credit balance shows a bank overdraft i.e., an excess amount drawn from the bank. The discount columns are not totaled in this cash book.

5.5.2 Special Points of a Three – column Cash book :

Following are some of the special points to be kept in mind while preparing a three – column cash book.

1. **Opening Balance:** The cash column of a cash book always shows a debit balance. It is written as 'balance brought down' on the debit side. But the opening balance of a bank column may be a debit or credit. If it is a debit balance, it will be shown on the debit side of the bank account while if a credit balance is given, it implies an overdraft and is shown on the credit side as 'By Balance b/d'.
2. **Contra Entries:** Contra entries means such entries that are made on both the sides of the cash book. When cash or a cheque is paid into the bank, the cash balance in the office will be reduced and the bank balance will be increased. In such a case, the Bank account is to be debited and the cash account is to be credited. Since in three column cash book, both cash and Bank accounts are included the amount will be written in a bank column on the receipt side and also in the cash column on the payment side of the cash book.

   The transactions affecting the Cash Account and Bank Account (either Cash Account or Bank Account debited or credited) are recorded on both the sides of the Cash Book. As the Triple Column Cash Book consists of Cash Account and Bank Account. Ledger posting of such transactions is completed by recording them on both the sides of the Cash Book. Entries passed to record such transactions in the Triple Column Cash Book are regarded as contra entries. Letter "C" is written in the "L. F." column of the Cash Book in order to identify such entries.

3. **Treatment of cheques received:** Cheques received may be treated in the following two ways.
   (i) A cheque received by a business may be sent to the bank on the same day for collection. In such a case it will be shown on the debit side of the bank column as soon as it is received.
   (ii) A cheque received by the business may be sent to the bank at a later date. In such a case, it is shown on the debit side of the cash account when it is received.

When the cehque is sent for collection to the bank, it is shown on both sides of the cash book.

4. **Endorsement of cehques received:** A cheque received by a business may not be sent for collection to the bank but may be endorsed and transferred in favour of a creditor of the business. The cheque received will be taken as a receipt of cash. The cheque endorsed will be taken as payment of cash.

5. **Dishonour of cheques :** The term 'dishonour of a cheque' refers to non – payment of a cheque while being presented for collection. The party from whom the cheque received is debited while the account of the bank is credited.

6. **Bank Charges :** A bank usually charges some amount for the services provided to its customers. Such a charge will be recorded on the credit side of the cash book under the bank column.

7. **Interest allowed bank :** Interest allowed by the bank increases the bank balance. The amount is recorded on the debit side of the cash book in the bank column.

8. **Amount withdrawn for person use :** Amount withdrawn from the bank for personal use is shown on the credit side of bank column in the cash book.

5.5.3 Posting from Cash Book:

The posting of the debit and credit sides of cash books is done as follows:

1. **Posting of debit side of cash book :** All the receipts appearing on the debit side are posted to the credit side of the respective ledger accounts. All entries relating to discounts are posted to the credit side of the respective personal accounts in the ledger. The total of discounts allowed on the debit side is posted to the debit of the discount allowed account in the ledger.
2. **Posting of credit side of cash book :** All the payments appearing on the credit side are posted to the debit side of the respective ledger accounts. All entries relating to the discount received column are posted to the debit side of the respective personal accounts. The total of discount received is posted to the credit of the discount
3. received account in the ledger.

Illu.4 : Enter the following transactions in three columns Cash Book.

1995 March

1. **Cash at Office Rs.600 and Bank balance Rs.3,000**
2. **Received a cheque for Rs.500 from Balu in full settlement of Rs.525**
4. **Drawn from Bank for office use Rs.800**
7. **Balu's cheque returned dishonored**

Solution :

Cash book with Cash, Bank and Discount columns

Date	Particulars	L.F.	D.A.	Cash	Bank	Date	Particulars	L.F	D.R	Cash	Bank
2006			Rs.	Rs.	Rs.	2006		`	Rs.	Rs.	Rs.
Ma.1	To Balance b/d			600	3,000	Ma.4	By Cash				800
2	To Balu		25		500	Ma.7	By Balu		25		500
4	To Bank	C		800		31	By Balance c/d			1,400	2,200
			25	1,4000	3,500				25	1,400	3,500
Ap.1	To Balance b/d			1,400	2,200						

Illu.5 : Prepare a triple column cash book with bank, cash and discount columns from the following transactions:

2006		Rs.
June 1	Cash balance Rs.5,000 and bank balance Rs.2,000	10,000
5	Cash received from sale of goods	2,000
6	Paid into bank	1,000
7	Paid Anil by cheque	800

Solution :

Three Column Cash Book

Date	Particulars	L.F.	Discount	Cash	Bank	Date	Particulars	L.F.	Discount	Cash	Bank
2006			Rs.	Rs.	Rs.	2006			Rs.	Rs.	Rs.
June 1	To Balance b/d			5,000	2,000	June 6	By Bank			1,000	
5	To Sales			2,000		7	By Anil				800

6	To Cash	(c)			1,000	7	By Balance c/d			6,000	2,200
				7,000	**3,000**					**7,000**	**3,000**
8	To Balance b/d			6,000	2,200						

Illu.6 : Prepare a Three column cash book from the following:

2006		Rs.
Jan.1.	Cash balance	15,000
	Bank balance	50,000
2.	Cash sales	40,000
5.	Furniture purchased and issued cheque	8,000
6.	Rent paid by the cheque	5,000
7.	Cash deposited on the bank	40,000
8.	Received interest on Investments	4,000
9.	Paid Salaries	5,000
10.	Received from Vishnu discount allowed	500
12.	Received cheque from Anjaneyulu and deposited in the bank	8,000
13.	Anjaneyulu cheque dishonoured	8,000
14.	Goods purchased from Gopi for cash	6,000
18.	For office use cash withdrawn from Bank	12,000
20.	Cheque issued to Raja	5,800
	Discount Received	200
24.	Cash withdrawn for personal use	4,000

SOLUTION :

Dr. **Cash Book** Cr.

Date	Receipts	L.F.	Dis. Allowed	Cash	Bank	Date	Payments	L.F	Dis Allowed	Cash	Bank
2006 Jan.1	To Balance b/d			15,000	50,000	2006	By Furniture				8,000
Jan.2	To Sales			40,000		Jan. 6	By Rent				5,000
Jan.7	To Cash	C			40,000	Jan. 7	By Bank	C		40,000	
Jan.8	To Interest on Investments				4,000	Jan.9	By Salaries			5,000	
Jan.10	To Vishnu		500	15,000		Jan.13	By Anjaneyulu				8,000
Jan.12	To Anjaneyulu				8,000	Jan.14	By Purchased			6,000	
Jan.18	To Bank			12,000		Jan.18	By Cash	C			12,000
						Jan.20	By Raja		200		5,800
						Jan.24	By Drawings				4,000
						Jan.31	By Balance c/d			31,000	59,200
			500	**82,000**	**1,02,000**				**200**	**82,000**	**1,02,000**
2006 February	To Balance b/d			31,000	59,200						

Illu.7 : Enter the following transactions in three columnar cash book:

2006		Rs.
Dec 1	Cash in hand	14,000
	Balance at bank	10,000
3	Cash sales	6,000
5	Paid into bank	7,000
7	Received a cheque from Suresh	2,000
9	Paid into bank Suresh 's cheque	2,000
10	Paid to Amar by cheque Rs.980 in full settlement of his account	1,000
	Withdrew from bank for office use	5,000
12	Goods purchased from Naveen	3,000
13	Purchase of furniture	3,000
14	Received a cheque from John for Rs.10,000 and paid into the bank on the same day	
17	Paid commission to Ram	500
18	John 's cheque was dishonoured	
20	Drew a cheque for Rs.800 for personal use	
24	Paid salaries	2,000

Solution :

Triple Column Cash book

Date	Particulars	L. F.	Cash Rs.	Bank Rs.	Discount allowed Rs.	Date	Particulars
2006						2006	
Dec 1	To Balance b/d		14,000	10,000		Dec 5	By Bank a/c
Dec 3	To Sales a/c		6,000			9	By Bank a/c
5	To Cash a/c	(C)		7,000		10	By Amar a/c
7	To Suresh a/c		2,000			11	By Cash a/c
9	To Cash a/c	(C)		2,000		13	By Furnish a/c
11	To Bank a/c	(C)	5,000			17	By Commission a/c
14	To John a/c			10,000		18	By John a/c
						20	By Drawings a/c
						24	By Salaries a/c
						31	By Balance c/d
			27,000	**29,000**			
2007 Jan 1	To Balance b/d		15,500	9,720			

Illu.8 : Enter the following transactions in the three column cash book of Raghunath.

2006	
March 1	**Cash at Office Rs.600**
	Bank balance (Cr.) Rs.3,000
2	**Cash Sales Rs.2,000**
3	**Deposited into bank Rs.2,000**
5	**Narayana settled his account of Rs.530 by giving a cheque for Rs.500**
8	**Purchased from Narendra goods worth rs.1,000 at 5% trade discount and paid half the amount by cheque and the balance by cash**
15	**Narayana's cheque returned dishonoured**
20	**Drew from bank Rs.300 for office use and Rs.200 as drawings**
25	**Paid Office rent Rs.200**
27	**Bank charges as per pass book Rs.10**
29	**Paid salaries by cheque Rs.500**
30	**Received from Satyam cash Rs.500, Cheque Rs.1,000 and allowed him a discount of Rs.50**
31	**Paid to Ramachandra Rs.475 in full settlement of his account Rs.500**

Solution :

Three Column Cash book of Raghunath

Date	Particulars	L.F.	Discount	Cash	Bank	Date	Particulars	L.F.	Discount	Cash	Bank
2006			Rs.	Rs.	Rs.	2006			Rs.	Rs.	Rs.
Mar.1	To Balance b/d			600		Mar.1	By Balance b/d				3,000
Mar.2	To Sales			2,000		Mar.3	By Bank	©		2,000	
Mar.3	To Cash	©			2,000	Mar.8	By Purchases			475	475
Mar.5	To Narayana		30		500	Mar.15	By Narayana		30		500
Mar.20	To Bank	C		300		Mar.20	By Cash	C			300
Mar.30	To Satyam		50	500	1,000	Mar.25	By Office rent			200	
Mar.31	To Balance c/d				1,485	Mar.27	By Bank charges				10
						Mar.29	By Salaries				500
						Mar.31	By Ramachandra		25	475	
						Mar.31	By balance c/d			250	
			80	3,400	4,985				55	3,400	4,985
Ap.1	To Balance b/d			250		Ap.1	By Balance b/d				1,485

5.6 PETTY CASH BOOK

Petty cash is the amount of cash an organization keeps in notes or coins on its premises to pay small items of expenses. In every business there are a number of small payments in cash such as conveyance, cartage, entertainment of the customers, etc. These are generally repetitive in nature. If all these petty expenses are recorded in the cash book along with other payments, the cashier will be over burdened and the cash book overloaded. To avoid this, a separate book called a 'petty cash book' is maintained to record all such payments. A person called the 'petty cashier' is appointed to record all such small payments. The sum of money given to the petty cashier for making small payments is called 'Petty cash'. It is usually kept in an imprest account.

5.6.1 Types of Petty Cash Books:

Following are the two types of petty cash books:

a) Simple Petty Cash Book,

b) Columnar Petty Cash Book.

a) Simple Petty Cash Book: A Simple Petty Cash Book is identical with a Cash Book. It has two sides viz., a receipt side and a payment side like a Cash Book. This type of Petty Cash Book is less useful. Therefore, many traders do not use this type of Petty Cash Book.

A simple Petty Cash Book is written on the lines of a Cash Book. There is only one amount column for recording all petty cash payments. There is no separate column for recording all classes of petty cash payments.

1. The "Amount Received" column is used for recording the amount received from the Cashier by the petty cashier.
2. The "Cash Book Folio" column is used for recording the page number of the cash book where the payment of the petty cashier is made by the cashier.
3. The "Date" column which is common to both the "Receipt" and "payment" side is used for writing the date of the receipt of an amount by the petty cashier on the "receipt" side and the date of payment on the "Payment" side.
4. Similarly, the "Particulars" column which is common to both the sides is used for recording the particulars of Receipts and Payments.
5. The "Voucher Number" column is used for recording the Number of the Voucher obtained by the petty cashier while making the payment.

6. The “Ledger Folio” column is used for writing the page number of the ledger on which the particular ledger account is maintained.
7. The “Amount Paid” column is used for recording the amount paid for a particular class of expenditure.

b) **The Columnar petty Cash Book (Analytical Petty Cash Book) :** This type of Cash Book has two sides. The left hand side is used for recording receipts of Cash or Cheque from the Chief Cashier. This part is very small as compared to the right hand side of the petty cash book. The right hand side is meant for recording payment. The payment side is ruled in suitable columns. A separate column is provided for recording a particular item of expenditure, i.e., Postage, Stationery, Travelling, Advertisement etc. In addition to it, a separate column for ledger is also provided for recording payment made on account of personal accounts or impersonal accounts. Payment made on a personal or impersonal account is entered in the Ledger Column and posted item wise in the respective ledger account.

When the amount is received from Chief Cashier, it is entered on the receipt side of the Petty Cash Book and when payments are made, they are first entered in the total column of the Petty Cash Book and then transferred in the respective column of expenditure. At the end of a certain period, the expenditure columns are totaled. The Petty cashier prepares a statement stating the summary of expenses paid and submits it to the Chief Cashier for incorporation in the main Cash Book.

5.6.2 Maintenance of Petty Cash Book :

The money which is received by the Petty cashier from the chief cashier is recorded on the left hand side under the column “Receipts”. Payments are recorded on the right hand side. For each type of expenses separate column is opened. Each cash payment is recorded under the appropriate head of expenses. As payments are analysed and recorded under appropriate columns, Petty Cash Book with separate heads for each expense is known as “Analytical Petty Cash Book”.

5.6.3 Important Advantages of Petty Cash Book :

The important advantages of a petty cash book are given below:

(i) It relieves the main cash book of numerous transactions involving petty sums.

(ii) Posting involves lesser labour and time.

(iii) Reduces work load of chief cashier.

(iv) Effective control can be exercised over small payments because each payment has to be supported by vouchers.

5.6.4 Imprest System of Petty Cash Book :

The most popular system of Petty Cash Book is the Imprest System. Under this system, the chief cashier advances a certain amount to the Petty Cashier at the beginning of a fixed period e.g. a month or a fortnight or a week. This advance given to the petty cashier for meeting small expenses is called "Float". The amount of float is fixed in such a way that the amount is enough to meet the petty expenses for a certain period. At the end of a certain period, the petty cashier submits the account to the Chief Cashier. On receiving the account from the petty cashier, the chief cashier scrutinises it, and sends an amount equal to the actual amount spent for meeting petty expenses of the next period. As such the petty cashier begins the next period with the fixed amount of float.

5.6.5 Advantages of the Imprest System :

The Imprest System has got many advantages over the other system. The Advantages are given below:

1. The record of Petty Cash is checked periodically. Therefore, mistakes, if any, in recording the transactions can be rectified immediately.
2. The Petty Cashier is not allowed to have idle cash in hand. If it is found that the float is more than adequate, it will be immediately reduced.
3. Chances of cash being misused by the petty cashier are reduced.
4. The regular check of the petty cash book creates a sense of responsibility in the petty cashier.
5. The main cashier is relieved from the botheration of petty disbursements.

Owning to the above three advantages, the Imprest System has become very popular in modern business houses.

Illu.9 :Enter the following transactions in Analytical petty cash book and balance the same:

2006		Rs.
June 1	Received for petty cash payments	1,000
2	Paid for postage	80
5	Paid for stationery	50

8	**Paid for advertisement**	**100**
12	**Paid for wages**	**40**
16	**Paid for carriage**	**30**
20	**Paid for conveyance**	**44**
25	**Paid for travelling expenses**	**160**
27	**Paid for postage**	**100**
28	**Wages paid**	**20**
29	**Paid for telegrams**	**40**
30	**Paid for postage**	**6**

SOLUTION:

Petty Cash Book

Receipts	Date	Particulars	V. No	L.F	Total payments	Analysis of Payments			
						Postage & Telegram	Carriage & Cartage	Stationery	Wage
	2006 Jan								
1,000	1	To Cash Received							
	2	By Postage			80	80			
	5	By Stationery			50			50	
	8	By Advertisement			100				
	12	By Wages			40				
	16	By Carriage			30		30		
	20	By Conveyance			44				
	25	By Travelling Expenses			160				
	27	By Postage			100	100			
	28	By Wages			20				
	30	By Telegrams			40	40			
	30	By Postage			6	6			
		Total			**670**	**226**	**30**	**50**	
	30	By Balance c/d			330				
1,000					**1,000**				
330	Feb.1	To Balance b/d							

Illu.10 : From the following particulars prepare Petty Cash Book on imprest system:

1-6-2006 : Received for petty cash payments: Rs.1,000.

		Rs.
2.	**Paid for postage**	**80**
5.	**Paid for stationery**	**50**
8.	**Paid for advertisement**	**100**
12.	**Paid for wages**	**40**

16.	**Paid for carriage**	**30**
18.	**Paid for conveyance**	**44**
20.	**Travelling expenses**	**160**
25.	**Postage**	**100**
27.	**Wages to office cleaner**	**20**
28.	**Telegrams**	**40**
30.	**Sent registered notice to landlord**	**06**

Solution :

Petty Cash book

Amount Received Rs.	CBF No.	Date	Particulars	Voucher No.	Total Payments Rs.	Analy: Postage & Telegram Rs.	Printing & Stationery Rs.	Tr Ex
1,000		2006 June 1	To Cash					
		2	By Postage		80	80		
		5	By Stationery		50		50	
		8	By Advertisement		100			
		12	By Wages		40			
		16	By Carriage		30			
		18	By Conveyance		44			
		20	By Travelling expenses		160			
		25	By Postage		100	100		
		27	By Wages to office cleaner		20			
		28	By Telegram		40	40		
		30	By Sent registered notice to landlord		6	6		
					670	**226**	**50**	
		30	By Balance c/d		330			
1,000					**1,000**			
330		July 1	To Balance b/d					
670		July 1	To Cash received					

5.7 QUESTIONS

I. Short Answer Questions

1. What is cash book?
2. What are the types of cash book?
3. What is contra entry?
4. What is a petty cash book? Explain its nature.

II. Eassy type Questions

1. Define Cash Book. Is it a subsidiary book or principal book of accounts? Give reasons
2. What is Three column cash book? How do you prepare it?
3. What purpose does an analytical petty cash book serve?
4. Explain the `Imprest System of Petty Cash Book?

5.8 EXERCISES

1. Enter the following transactions in a simple cash book.

2006		Rs.
Jan.1	Cash in hand	5,000
3	Received from Teji	500
6	Received from Nandu	370
8	Paid to Mahesh on account	750
10	Made cash purchases	1,500
17	Sold goods to Sathe for cash	350
20	Paid into Bank	1,000
22	Purchased furniture for office use	300
25	Received for interest on debentures	75
27	Paid electricity charges	25
29	Paid rent	150
31	Paid salaries to staff	570

[Ans.: Cash balance Rs.2,000]

2. Prepare two column cash book (with cash and discount column) of Bharvanji

2006		Rs.
Feb.1	Opening cash balance	2,700
2	Received Rs.980 from Raghav and cash discount allowed to him	20
3	Paid Rs.880 to Ambedkar in settlement of his account for Rs.900	
4	Cash sales	1,700
5	Cash purchases	2,250

6	Paid Rs.675 to Raj and discount allowed by him Rs.25	
10	Deposited Rs.400 in Janatha Bank	
14	Received Rs.1,560 through cheque from Samant after allowing him cash discount of Rs.40. The cheque was deposited in Bank on the same day	
18	Issued a cheque of Rs.135 towards advertisement expenses	
22	Received Rs.1,150 through cheque from Ramesh after allowing him discount of Rs.50. The cheque was immediately deposited in the bank.	
25	Bhavanji withdrew Rs.1,000 for personal expenses through cheque	
29	Cash sales Rs.1,800	
29	Deposited cash in Bank in excess of Rs.500	

[Ans.: Cash Balance Rs.500; Discount (Dr.) Rs.110; (Cr.) Rs.45]

3. Enter the following transactions of the Premier Trading Company's cash book with three columns discount, cash and bank and balance the accounts as on 31st December, 2005.

Dec. 2005	
1	Cash in hand Rs.4, 000.
1	Bank Rs.1, 000 (Cr.)
3	Receives a cheque from A Rs.290 and allowed him discount of Rs.40.
7	A's cheque deposited in to bank.
10	Withdrew from bank for office use Rs.800.
12	Paid B/p by cheque Rs.600.
15	B/R from Ram Rs.2, 500; discounted it, crediting with bank Rs.2, 400.
20	Issued a cheque for petty cash Rs.100.
25	Paid to Gupta by Cheque Rs.920; discount received Rs.30.
28	Made cash sales Rs.900

[Ans.: Cash Balance Rs.5,700; Bank Balance Rs.730; Discount (Dr.) Rs.140;

(Cr.) Rs.30

4. Prepare a three column cash book for the month of March 2006 from the following transactions:

March 2006

1	Cash in hand Rs.55,000 and cash at bank Rs.35,000
2	Bought goods by cheque Rs.10,000
3	Paid trade expenses Rs.1,000
4	Received a cheque from Naresh for Rs.30,000 and deposited into bank on the same day.
5	Paid Rs.2,000 to kumar by cheque in full settlement of Rs.2,100
6	Sold goods to Vijay Rs.5,000
10	Naresh ‘s cheque dishonoured.
12	Received cheque from Vijay for Rs.5,000.
14	Withdrew from bank for personal use Rs.5,000
20	Withdrew from bank for office use Rs.6,000
24	Cash sales Rs.10,000
25	Paid into bank Rs.15,000
26	Received a cheque from Rakesh for Rs.5,900 in full settlement of an amount of Rs.6,000.
31	An insolvent debtors pays 50% of Rs.8,000 due from him.

[Ans.: Cash Balance Rs.59,000; Bank Balance Rs.37,900; Discount (Dr.) Rs.100; (Cr.) Rs.100]

5. Write out an analytical petty cash book maintained on imprest system from the following transactions:

2004

January 1 Issued a Cheque of Rs.200 to the Petty Cashier

2	Paid electricity expenses	6.50
3	Paid Trunk call charges	5.00
4	Paid for refreshments	10.00
6	Paid for Cartage	2.50
8	Paid for Printing	7.50
10	Purchased typing papers and ribbon	9.00
14	Paid for stationery	12.00
17	Paid railway freight	11.00
19	Postal charges	6.00

24	Paid for Auto charges	24.00
26	Paid taxi hire to the Sales Manager	40.00
28	Tea and Tip to peon	3.00
31	Paid krishna against his account	30.00

[Ans.: Cash Balance Rs.33.50]

6. Enter the following transactions in petty cash book.

2006		Rs. Ps.
March 1	Amount received from Cashier	100.00
2	Purchased typing paper	4.00
8	Office cleaning	3.00
10	Postage	10.00
14	Cartage	12.00
18	Postage	8.00
22	Stationery	9.00
25	Ink	4.00
31	Telegram	10.00

[Ans.: Cash balance Rs.40]

5.9 SUGGESTED BOOKS

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5. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
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Chapter – 10

Trial Balance

Objectives :

After thorough study of this chapter, we should be able to

- Meaning and objectives of trial balance
- Understand the methods in the preparation of trial balance.

Structure :

10.1 Introduction

10.2. Preparation of Trial balance

10.3. Methods are used the Preparation of Trial balance

10.4. Questions

10.5 Exercises

10.6 Suggested Readings

10.1 INTRODUCTION

An important aspect of the double entry accounting system is that for each transaction there is an equal amount of debit and credit in two or more accounts. Therefore, the total of all the entries on the debit side of the account must be equal to the total of all the entries on the credit side of the accounts. For this purpose, a statement known as a trial balance showing the balances of various accounts is prepared. The trial balance is usually prepared just before the preparation of final accounts (profit and loss account and balance sheet) in order to check the arithmetical accuracy of the transaction recorded into the ledger accounts.

According to J.R. Batliboi ``Trial balance is a statement prepared with the debit and credit balances of accounts to test the arithmetical accuracy of books.''

10.1.1 Objectives

The following are the objectives of preparing a trial balance.

1. **To ascertain the arithmetical accuracy of ledger accounts :** Trial balance helps in ascertaining the arithmetical accuracy of the accounting entries. It indicates that equal debit and credit amounts have been recorded in the ledger accounts and the balances have been calculated correctly.
2. **To help in locating errors :** When the total of trial balance does not tally, it indicates that some errors have been committed. On the basis steps can be taken to locate the errors committed in the preparation of trial balance.
3. **To help in the preparation of final accounts :** Trial balance contains the list of all the ledger accounts. This helps in the preparation of final accounts. All revenue and expenses accounts appear in the trial balance, which are transferred to the trading and profit and loss accounts. All assets, liabilities, and capital accounts are transferred to the balance sheet. Together, they constitute the final accounts.

10.2 PREPARATION OF TRIAL BALANCE

The final accounts are prepared with the help of trial balance, which shows all the ledger balances at the end of accounting period. Generally, the trial balance is given and there is no difficulty in identifying the items of income expenses, assets and liabilities. However, sometimes the trial balance is not correctly given. In such a case, it has to be prepared. T can be easily ascertained whether a particular account has a debit balance or a credit balance. The problem arises when a list of balances is given but it is not indicated whether the account has a debit or a credit balance. Under these circumstances, the nature of each balance has to be ascertained before the preparation of trial balance. The rules of debit and credit help in the preparation of trial balance. A few guidelines, which help in the preparation of trial balance are as follows.

(i) All accounts of expenses and losses have debit balance.

(ii) All accounts of income and gains have a credit balance.

(iii) All accounts of liabilities have a credit balance

(iv) The capital account usually has a credit balance.

The format of a trial balance is as shown.

Trial Balance

S.No.	Name of the Account	Debit balances Rs.	Credit Balances Rs.

The first column is the serial number, the second column is the title or the name of the account and the third and fourth columns are the debit and credit columns respectively, representing the balance of each account.

10.3 METHODS ARE USED IN THE PREPARATION OF TRIAL BALANCE :

The following two methods are used in the preparation of trial balance.

1. Balance Method
2. Total Amounts Method

10.3.1 Balance Method :

Under this method, all the accounts showing debit balances in the ledger accounts are put on the debit side of the trial balance and the accounts showing credit balances are put on the credit side of the trial balance. After this, the debit and credit columns of the trial balance are totalled. The total of two the sides must be equal.

10.3.2 Total amounts method :

Under this method, the total of debits and credits, instead of the balances of each account, are shown in the trial balance. A trial balance by this method, can be prepared immediately after the completion of posting from the books of original entry to the ledger.

Illu.1 : Prepare the Trial Balance from the following:

	Rs.
Purchases	**82,800**
Buildings	**30,000**
Wages	**68,000**

Fuel	**2,000**
Creditors	**18,000**
Bills payable	**700**
Discount received	**100**
Sales	**1,93,000**
Insurance	**1,300**
Income Tax	**3,700**
Opening stock	**18,000**
Commission paid	**300**
Debtors	**19,000**
Bad debts	**800**
Salaries	**25,000**
Printing and stationary	**7,600**
Postage and Telegrams	**3,400**
Bills receivable	**6,900**
Cash at bank	**13,000**
Capital	**70,000**

Solution :

Trial Balance

Debit Balances	Rs.	Credit Balances	Rs.
Purchases	82,800	Creditors	18,000
Buildings	30,000	Bills payable	700
Wages	68,000	Discount received	100
Fuel	2,000	Sales	1,93,000
Insurance	1,300	Capital	70,000
Income tax	3,700		
Opening stock	18,000		
Commission paid	300		
Debtors	19,000		
Bad debts	800		
Salaries	25,000		
Printing and Stationery	7,600		
Postage and Telegrams	3,400		
Bills Receivable	6,900		
Cash at Bank	13,000		
	2,81,800		**2,81,800**

Illu.2 : From the following particulars prepare Trial Balance:

	Rs.		Rs.
Capital	**60,000**	**Repairs**	**500**
Drawings	**6,000**	**Bad debts**	**1,000**
Purchases	**25,000**	**Discount allowed**	**1,000**
Debtors	**4,000**	**Commission received**	**4,000**
Creditors	**3,000**	**Insurance**	**1,000**
Bills payable	**2,000**	**General expenses**	**2,000**
Sales	**50,000**	**Depreciation**	**3,000**
Carriage inwards	**1,000**	**Furniture**	**10,000**
Carriage outwards	**2,000**	**Land and buildings**	**32,000**
Wages	**5,000**	**Bills receivable**	**3,000**
Salaries	**10,000**	**Fixed deposit with SBI**	**6,000**
Advertisement	**1,000**	**Opening stock**	**4,000**
Power	**1,000**		
Postage	**500**		

Solution :

Trial Balance as on….

Particulars	Rs.	Rs.
Capital		60,000
Drawings	6,000	
Purchases	25,000	
Debtors	4,000	
Creditors		3,000
Bills payable		2,000
Sales		50,000
Carriage inwards	1,000	
Carriage outwards	2,000	
Wages	5,000	
Salaries	10,000	
Advertisement	1,000	
Power	1,000	
Postage	500	
Repairs	500	
Bad debtors	1,000	
Discount allowed	1,000	

Commission received		4,000
Insurance	1,000	
General expenses	2,000	
Depreciation	3,000	
Furniture	10,000	
Land and buildings	32,000	
Bills Receivable	3,000	
Fixed deposit with SBI	6,000	
Opening stock	4,000	
	1,19,000	**1,19,000**

Illu.3 : The following are the balances extracted from the books of Ramu on 31-12-2006. Prepare Trial Balance.

	Rs.
Capital	**30,000**
Drawings	**5,000**
Furniture	**2,600**
Bank Overdraft	**4,200**
Creditors	**11,000**
Premises	**20,000**
Stock	**22,000**
Debtors	**18,000**
Rent (Cr.)	**1,000**
Discount (Dr.)	**1,600**
Discount (Cr.)	**2,000**
Purchases	**1,10,000**
Sales	**1,50,000**
Returns inwards	**2,000**
Wages	**2,000**
Salaries	**9,000**
General expenses	**4,000**
Commission	**2,200**
Carriage	**1,800**
Reserve for bad and doubtful debts	**2,000**

Solution :

Trial Balance as on 31-12-2006

Debit balances	Rs.	Credit balances	Rs.
Drawings	5,000	Capital	30,000
Furniture	2,600	Bank Overdraft	4,200
Premises	20,000	Creditors	11,000
Stock	22,000	Rent	1,000
Debtors	18,000	Discount	2,000
Purchases	1,10,000	Sales	1,50,000
Return inwards	2,000	Reserve for bad and doubtful debts	2,000
Wages	2,000		
Salaries	9,000		
General expenses	4,000		
Commission	2,200		
Carriage	1,800		
Discount	1,600		
	2,00,200		**2,00,200**

10.4 QUESTIONS

1. What is Trial balance?
2. What are the advantages in the preparation of Trial Balance?
3. What are various methods in the preparation of trial balance?
4. ``Trial balance is a statement prepared with the debit and credit balances of accounts to test the arithmetical accuracy of books.'' Discuss

10.5. EXERCISES

1. From the information given below, prepare a Gross Trial Balance as on 31st December, 2006

Account	**Debit Rs.**	**Credit Rs.**
Capital a/c		25,000
Drawings a/c of Proprietor	5,000	
Purchases a/c	85,000	
Sales a/c		1,80,000
Purchase Returns a/c		2,000

Sales returns a/c	1,500	
Commission a/c	700	200
Interest a/c	300	
Office Expenses a/c	7,500	
Sundry debtors a/c	1,35,000	1,12,700
Sundry Creditors a/c	50,000	1,25,000
Cash a/c	2,00,000	25,000
Bank a/c	85,000	1,00,000

[Ans.: Trial balance Total Rs.5,70,000]

2. Prepare Trial balance from the following balances extracted from the books of accounts of Jayashree Traders as on 31st March, 2006

	Rs.		**Rs.**
Capital	1,50,000	Goodwill	1,00,000
Sundry Debtors	35,000	Office Expenses	10,000
Sundry Creditors	42,000	Outstanding expenses	15,000
Machinery	21,000	Interest received	3,200
Furniture	19,000	Cash balance	1,800
Sales	2,00,000		
Purchases	1,16,000		
Opening stock (1-4-2005)	1,07,400		

[Ans.: Trail balance Total Rs.4,10,200]

3. From the following balances given below extracted from the books of Randhir, prepare a Trial balance as on 31st December, 2006

	Rs.		**Rs.**
Cash in hand	200	Rent and Rates	2,000
Cash at Bank	2,500	Purchase returns	200
Capital account	50,000	Sales returns	300
Drawings	5,000	Plant and Machinery	15,000
Sales	35,000	Loan (taken)	20,000
Purchases	30,000	Furniture	5,000
Sundry Debtors	32,000	Opening stock	7,500
Sundry Creditors	15,000	Travelling expenses	7,000

Discount allowed	500	Carriage outward	10,000
Commission received	1,000		
Wages	3,000		
Salaries	1,200		

[Ans.: Trial balance Total Rs.1,21,200]

10.6. SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 13

FINAL ACCOUNTS WITH ADJUSTMENTS

Objectives :

After going through this unit, we should be able to

- Know the reasons for adjustments in final accounts
- Understand various types of adjustments and their adjustment in practice
- Prepare the final accounts after taking the adjustment into account.

Structure :

13.1 NEED FOR ADJUSTMENTS IN FINAL ACCOUNTS

After ascertaining the arithmetical accuracy of the books of accounts by preparing a Trial balance, a trader has to ascertain the results of his business activities and the financial position of the organisation. For this purpose he has to prepare a Trading and profit and loss account and a balance sheet. Final accounts (i.e., the Trading and profit and loss account and balance sheet) are prepared on the basis of a trial balance. But the trial balance is not the complete tool for the purpose of preparation of final accounts. The trial balance contains only those items, which have been recorded in the books of accounts. It does not consider the items such as expenses payable, income receivable, expenses paid in advance and income received in advance, non cash items such as depreciation on asset, interest on capital, interest on drawings, anticipated loses such as reserve for bad debts, reserve for discount on debtors etc.

Unless these items are considered and given effect, the final accounts cannot disclose a true and fair view of the organisation. Hence, necessary adjustments about the above items should be made.

13.1.2. Meaning of Adjustments :

Adjustments in final accounts mean bringing into accounts the items which have not been included in the trial balance It means bringing into account the expenses incurred but not paid, income earned but not actually received, depreciation on assets, interest on capital, interest on drawings, reserve for bad debts, reserve for discount on debtors and anticipated gains like reserve for discount on creditors.

13.1.3. Adjustment Entries :

Various adjustments in Trading and profit and loss account and Balance sheet are made by means of journal entries. Journal entries passed for adjustments at the end of the year are called adjustment entries. All the adjustment entries are passed in the journal proper.

13.2 ADJUSTMENTS IN FINAL ACCOUNTS :

The following are usual items of adjustments which require adjustments while preparing Trading and Profit and Loss Account and Balance Sheet.

1. Outstanding expenses
2. Prepaid expenses
3. Outstanding income
4. Income received in advance
5. Depreciation on assets
6. Treatment of bad debt, provision for doubtful debts and provision for discount
7. Provision for bad debts
8. Provision for discount on debtors
9. Provision for discount on creditors
10. Interest on Drawings
11. Interest on capital
12. Closing Stock

13.2. Outstanding Expenses :

Expenses which are incurred during the year but not paid, are called ``outstanding or unpaid expenses''. Such unpaid expenses must be considered, otherwise the profit will be overstated. Outstanding expenses must be duly accounted for because the parties who have given services have claim against the business and hence these become the liabilities at the end of the year.

For example, office rent due for the month of December is not paid in the same month, it will be outstanding rent for the month of December. Office rent outstanding is a liability and must be shown in the Balance sheet and the amount due for Office rent will be transferred to the Profit and Loss account. Next year, when this due amount will be paid off, office rent outstanding account will be debited and cash account credited.

13.3.1 Prepaid Expenses :

When an expenses is paid in advance, and the benefit of the amount paid will be available in the next year, it is called prepaid expenses. Such expenses are shown in the Balance Sheet as an asset. Such expenses are paid during the year but not incurred..

13.3.2. Outstanding Income :

The income which is earned but not yet received in cash during the year is called as an outstanding income. Such incomes, which are earned in the current year should be credited to the Profit and Loss Account and as the amount is yet to be received, it will be transferred to the Balance Sheet on the assets side. For example, the commission earned in the month of December, 2005, but received as yet, will be outstanding incomes for the year ending 31st December, 2005. The original amount of commission shown in the Trial balance will be increased by the amount of commission receivable. Next year, when the amount due on commission will be received, it will be credited by debiting the cash account.

13.3.3. Income received in Advance :

Sometimes, a trader receives the amount of income in advance before rendering the full service. Such incomes should not be transferred to the credit side of the profit and loss account. The portion of such income is deducted from the income concerned and it is treated as liability. For example, during the year ended 31st March, 2006, the total amount received as Rent is

Rs.650, out of which Rs.50 are related to the next months of April, 2006. In this case, Rent for the year ended 31st march, 2006 will be only (Rs.650 – 50) = Rs.600 and Rs.50 will be shown in the Balance Sheet as liability. Next year, rent received in advance account will be transferred to Rent (received account).

13.3.4. Depreciation :

The assets become useless after some time by continuous usage. Every fixed asset has a definite period of utility to the business. The value of an asset goes on decreasing year by year. Such a loss in value is known as depreciation. It is an invisible loss, but must be shown in the profit and loss account each year as long as the asset is in use. And the asset must be shown in the Balance sheet at its reduced value. Generally, the depreciation is charged on the basis of the life of the asset. One thing should be noted that, depreciation is charged only on fixed assets, and not on floating assets, because floating assets are not held by the business for a long time.

13.3.5. Bad debts :

A businessman has to sell goods on credit also in order to increase sales. In credit sales, goods are delivered to the customers immediately and cash is received from the debtors after a certain period. Hence, there is a risk of loss due to bad debt. It is likely that some customers may not pay their dues for one or the other reason. Thus, the debt due from customers becomes bad for recovery. Bad debt is the irrecoverable debt from customers. Bad debt is a loss to business. It reduces profits. It is a nominal account. Hence, it is placed on debit side of Profit and Loss account.

Sundry Debtors : It represents the total debt due from various parties on account of sale of goods on credit.

Provision for Doubtful debts : The term `doubtful debts' suggests that the debt may be recovered or may not be recovered. It is rather doubtful about recovery of such debt. Under such a circumstances, it cannot be considered as bad. At the same time, it cannot be considered good for recovery. If all such debtors are treated as good and shown in the balance sheet, it will amount to showing the assets at a higher value. The profit and loss account also will not show true position. The profit will be overstated. On other hand, if all such debts are shown as bad the profit will be understated and the balance sheet will not show true position as the debtors will be understated. Hence, it is necessary to show the position which is very close to the correct position. This can be done by providing for doubtful debts. The amount of doubtful debt provision is estimated on the basis of past experience. A certain percentage of debt is treated as doubtful and accordingly provided for while preparing financial statement. The amount thus provided for is called ``Provision for doubtful debts''. There is a distinction between provision for doubtful debts and reserve for doubtful debts. A provision is interpreted as the amount retained by way of providing for a known liability. The amount of such provision cannot be determined with substantial accuracy. The term `reserve is interpreted as, the amount retained for known liability which is in excess of the necessary amount. The amount which is in excess of the required amount is referred to as a `reserve;. However, for the purpose of accounting the above distinction is ignored as the distinction does not materially affect accounting treatment.

13.3.6 Provision for Discount on Debtors :

In business, a proprietor may be required to allow discount to debtors if they pay their dues before the due dates. The discount allowed would be a loss to business and it is in connection with the debtors created during the year. Hence, it is quite advisable to make a provision for such discount by charging the profit and loss account. Such a provision is called as ``Provision for discount on debtors.''

13.3.7. Bad debts recovery :

After writing off bad debts, it is quite likely that some debtors may pay their dues which have been written off as bad. The amount received from debtor against such bad debts written off is called as `Bad debts Recovery'' The amount received is credited to Bad debts Recovery Account.

11.3.8. Reserve or provision for discount on Creditors :

As the trader allows a cash discount to his debtors he may also receive a cash discount from him creditors if he makes the payment during the stipulated period. As such, the trader may receive the cash discount from his creditors which can be estimated. Thus, the cash discount likely to be received from creditors is estimated and a provision is made for discount on creditors. Such a provision is called as `Provision or Reserve for Discount on Creditors.''.

A Discount received from creditors is a gain, and it is transferred to the credit of the Profit and Los Account. A reserve for discount on creditors is created by debiting such a Reserve Account and crediting the profit and loss account. The debit balance of Reserve for discount on creditors is shown in the Balance Sheet by subtracting it from sundry creditors.

The actual amount of discount received is credited to the Discount Received Account and debited to the Creditors personal account. At the end of the year, the total amount of Discount received is transferred to the credit side of Reserve for Discount on Creditors Accounts . Then, a new estimate is made regarding the Discount receivable from Sundry Creditors by crediting the Profit and Loss Account.

11.3.9. Interest on Drawings :

Drawings denotes the money withdrawn by the proprietor from the business for his personal use. It is usual practice to charge interest on drawings in case interest is allowed to the proprietor on his capital. In case of a partnership firm, interest on drawings will be charged on the drawings made by each partner.

Computation of Interest on drawings : There is a difference between the method of computation of interest on capital and interest on drawings. In most cases interest on capital is charged on the opening balance in the capital account. However, in case of additional capital introduced during the year by the proprietor, interest may be charged from the date of introducing additional capital till the end of the accounting period. Since the interest is to be charged on the amount withdrawn by the proprietor from the date on which he withdrew the amount from the business till the end of the accounting period, it requires computation of interest on each with

13.3.10. Closing Stock :

Stock remaining unsold at the end of the accounting year is called ``Closing stock''. Closing stock has to be taken into account while preparing final accounts. Unless it is taken into account Trading and profit and loss account and balance sheet will not disclose a true and fair view of the state of affairs of the business concern. Closing stock is credited to Trading Account and shown in the Balance Sheet on the Assets side.

Illu.1 : From following Trial Balance of Swaroop, prepare Trading and Loss account for the year ended 31st March 2006 and a Balance sheet as on that date.

Debit Balances	***Rs.***	***Credit Balances***	***Rs.***
Stock	**45,000**	**Capital**	**75,000**

Plant and machinery	75,000	Sales	4,20,750
Purchases	2,25,000	Sundry Creditors	15,000
Trade expenses	10,000	Bad debts provision	200
Carriage inwards	2,500	Bills payable	2,000
Carriage outwards	1,500		
Factory rent	1,500		
Discount	350		
Insurance	700		
Sundry debtors	60,000		
Office rent	3,000		
Stationery	600		
Salaries	17,800		
Advertising	15,000		
Bills receivable	6,000		
Drawing	6,000		
Wages	20,000		
Furniture	7,500		
Coal and gas	1,000		
Cash in hand	2,000		
Cash at Bank	12,500		
	5,12,950		5,12,950

Adjustments :

a. **Closing stock amounted to Rs. 35,000**
b. **Depreciate Machinery by 10% and Furniture by 5%**
c. **Raise the Bad debts provision to 5% on Debtors**
d. **Outstanding Factory rent Rs.300 and Office rent Rs. 600**
e. **Insurance prepaid Rs.100.**

Solution :

Trading Profit & Loss Account of

Dr. Swaroop for the year ending 31.3.2006 Cr.

To Opening Stock		45,000	By Sales	4,20,750
To Purchase		2,25,000	By Closing Stock	35,000
To Wages		20,000		
To Coal and Gas		1,000		
To Carriage Inwards		2,500		
To Factory Rent	1,500			
Add outstanding	300	1,800		
To Gross profit c/d		1,60,450		
		4,55,750		**4,55,750**
To Salaries		17,800	By Gross profit b/d	1,60,450
To Advertising		15,000		
To Stationary		600		
To Office Rent	3,000			
Add outstanding	600	3,600		
To Insurance	700			
Less Prepaid	100	600		
To Discount		350		
To Carriage outwards		1,500		
To Trade expenses		10,000		
To Depreciation				
Machinery	7,500			
Furniture	375	7,875		
To Provision for Bad Debts		2,800		
To Net Profit transferred to capital		1,00,325		
		1,60,450		**1,60,450**

Balance sheet of Swaroop as on 31-3-2006

Liabilities		***Rs.***	***Assets***		***Rs.***
Sundry creditors		15,000	Cash in Hand		2,000
Bills payable		2,000	Cash at Bana		12,500
Outstanding			Bills receivable		6,000
Factory rent	300		Debtors	60,000	
Office rent	600	900	Less P.B.D.	3,000	57,000
Capital	75,000		Closing Stock		35,000
Add Net Profit	1,00,325		Plant & Machinery	75,000	
	1,75,325		Less Deprecia	7,500	67,500
Less Drawings	6,000	1,69,325	Furniture	7,500	
			Less Deprecia.	375	7,125
			Prepaid Insurance		100

	1,87,225		**1,87,225**

Existing Rs. 200+ New Rs. 2,800= Rs.3,000.

Illu.2 : From following Trial Balance, prepare Trading, Profit and Loss account for the year ended 31-12-2006 and the Balance Sheet as on that date:

Debit Balances	***Rs.***	***Credit Balances***	***Rs.***
Chandra Sekhar's drawing	**4,500**	**Chandra Sekhar's Capital**	**24,000**
Purchases	**20,000**	**Sales**	**30,500**
Returns inwards	**1,500**	**Discounts**	**1,900**
Opening Stock	**8,000**	**Sundry Creditors**	**10,000**
Salary	**4,200**	**Bills payable**	**2,500**
Wages	**1,200**		
Rent	**350**		
Bad debts	**400**		
Discounts	**700**		
Sundry debtors	**14,000**		
Cash in hand	**260**		
Cash at Bank	**5,940**		
Insurance	**400**		
Trade expenses	**300**		
Printing	**150**		
Furniture	**2,000**		
Machinery	**5,000**		
	68,900		**68,900**

Adjustments :

a. **Closing Stock Rs. 7,000**
b. **Insurance pre – paid Rs. 60**
c. **Outstanding salary Rs. 200 and wages Rs. 200**

d. **Make provision for doubtful debts at 5% on Sundry debtors**

e. **Calculate interest on capital at 5% p.a.**

f. **Depreciate Machinery at 5% and Furniture at 10%**

g. **Reserve for discount on creditors at 1%.**

Solution :

Dr. Trading and Profit and Loss Account as on 31-12-2006 Cr.

	Rs.	Rs.		Rs.	Rs.
To Opening Stock		8,000	By Sales	30,500	
To Purchases		20,000	Less Returns	1,500	29,000
To Wages	1,200		By Closing Stock		7,000
Add Outstanding	200	1,400			
To Gross Profit c/d		6,600			
		36,000			**36,000**
To Salary	4,200		By Gross profit b/d		6,600
Add outstanding	200	4,400	By Discounts		1,900
To Rent		350	By Discount reserve on Creditors		100
To Bad debts		400	By Net loss – transfer to capital		390
To Discount		700			
To Insurance	400				
Less pre-paid	60	340			
To Trade expenses		300			
To Printing		150			
To Provision for Doubtful debts		700			
To Interest on Capital		1,200			
To Depreciation c/d					
Machinery 5%		250			
Furniture 10%		200			
		8,990			**8,990**

Balance Sheet as on 31-12-2006

Liabilities		***Rs.***	***Assets***		***Rs.***
Bills payable		2,500	Cash in Hand		260
Sundry Creditors	10,000		Cash at bank		5,940
Less Discount reserve	100	9,900	Sundry Debtors	14,000	
Outstanding salary		200	Less provision	700	13,300
Wages		200	Closing Stock		7,000
Capital	24,000		Furniture	2,000	

Add Interest	1,200		Less Depreciation	200	1,800
Less Net Loss	25,200 390		Machinery	5,000	
Less Drawings	24,810 4,500	20,310	Less Depreciation	250	4,750
			Prepaid Insurance		60
		33,110			**33,110**

Illu.3 : From the following Trial Balance of Ravi prepare final accounts for the year ending 31-3-2006.

	Rs.		**Rs.**
Drawings	**4,500**	**Capital**	**24,000**
Purchases	**20,000**	**Sales**	**30,500**
Returns inwards	**1,500**	**Discounts**	**1,900**
Stock (1-4-2005)	**8,000**	**Creditors**	**10,000**
Salary	**4,200**	**Bills payable**	**2,500**
Wages	**1,200**		
Rent	**350**		
Bad debts	**400**		
Discounts	**700**		
Debtors	**14,000**		
Cash	**6,200**		
Insurance	**300**		
Printing	**150**		
Furniture	**2,000**		
Machinery	**5,000**		
	68,900		**68,900**

Adjustments:

a) **Closing Stock : Rs.7,000**

b) **Prepaid insurance : Rs.60**

c) **Outstanding salary: Rs.500; wages Rs.200**

d) **Make a provision for doubtful debts at 5% on debtors.**

e) **Calculate interest on capital at 5% and on drawings at 6%.**

f) Depreciate machinery at 5% and furniture at 10%.

Solution :

Trading and Profit and loss a/c of for the year ending 31-3-2006

Dr.			Cr.
	Rs.		**Rs.**
To Opening stock	8,000	By Sales 30,500	
To Purchases	20,000	**Less:** Sales returns 1,500	29,000
To Wages 1,200		By Closing stock	7,000
Add: O/s 200	1,400		
To Gross Profit (transferred to Profit & Loss a/c)	6,600		
	36,000		**36,000**
To Salary 4,200		By Gross profit	6,600
Add: O/s 500	4,700	By Discount	1,900
To Rent	350	By Interest on drawings (45,000 x 6%)	270
To Bad debts	400	By Net Loss (transferred to Capital a/c)	520
To Discount	700		
To Insurance 400			
Less: Prepaid 60	340		
To Trade expenses	300		
To Printing	150		
To Provision for doubtful debts (1,400 x 5%)	700		
To Interest on Capital (24,000 x 5%)	1,200		
To Depreciation on			
- Machinery	250		
- Furniture	200		
	9,290		**9,290**

Balance Sheet of Ravi as on 31-3-2006

Liabilities		**Rs.**	**Assets**		**Rs.**
Creditors		10,000	Cash		6,200
Bills payable		2,500	Debtors	14,000	
Capital	24,000		**Less:** Provision for bad debts	700	13,300
Less: Drawings	4,500		Prepaid Insurance		60
	19,500		Closing Stock		7,000
Less: Net loss	520		Furniture	2,000	
	18,980		**Less:** Depreciation	200	1,800
Add: Interest on			Machinery	5,000	

Capital	1,200				
Less: Interest on drawings	270	19,910	**Less:** Depreciation	250	4,750
Outstanding salary		500			
Outstanding wages		200			
		33,110			**33,110**

Illu.4 : The following Trial Balance is extracted from the books of merchant on 31-12-2006:

	Rs.	**Rs.**
Capital		**12,500**
Furniture	**640**	
Vehicles	**6,250**	
Buildings	**7,500**	
Bad debts	**125**	
Provision for bad debts		**200**
Debtors and creditors	**3,800**	**2,500**
Stock on 1-1-2006	**3,460**	
Purchases and sales	**5,475**	**15,450**
Bank overdraft		**2,850**
Returns	**200**	**125**
Advertising	**568**	
Commission		**375**
Cash	**650**	
Insurance	**1,250**	
General expenses	**782**	
Salaries	**3,300**	
	34,000	**34,000**

Adjustments:

a) **Stock on 31-12-2006 was Rs.3,250.**
b) **Depreciate buildings by 5%, Furniture by 10% and Vehicles by 20%.**
c) **Outstanding interest Rs.85, Salaries 300 and taxes Rs.120.**
d) **Prepare insurance is Rs.100.**

e) **1/3 of the commission received is in respect of work to be done next year.**

f) **Write off further bad debts Rs.100 and provision for bad debts is to be made equal to 5% on debtors.**

Prepare final accounts for the year ending 31-12-2006.

Solution :

Trading and Profit & Loss a/c
for the year ending 31-12-2006

Dr. **Cr.**

	Rs.		Rs.
To Opening stock	3,460	By Sales 15,450	
To Purchase 5,475		**Less:** Sales Returns 200	15,250
Less: Purchase Returns 125	5,350	By Closing stock	3,250
To Gross profit	9,690		
	18,500		**18,500**
To Advertising	568	By Gross Profit	9,690
To Insurance 1,200		By Commission 375	
Less: prepaid 100	1,150	**Less:** Received Earlier 125	250
To General expenses	782	By Provision for bad debts (3,800 – 100 = 3,700 x 5/100 = 185 – 200)	15
To Salaries 3,300			
Add: Outstanding 300	3,600		
To Outstanding interest	85		
To Bad debts (100 + 125)	225		
To Depreciation			
Buildings	375		
Furniture	64		
Vehicles	1,250		
To Net Profit	1,736		
	9,955		**9,955**

Balance Sheet as on 31-12-2006

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital 12,500		**Current Assets:**	
Add: Net profit 1,736	14,236	Cash	650
Current Liabilities:		Debtors 3,800	
Bank overdraft	2,850	**Less:** Bad debts 100	
Outstanding interest	85	3,700	

Outstanding Salaries	300	**Less:** Provision for Bad debts 185	3,515
Outstanding taxes	120	Prepaid insurance	100
Creditors	2,500	Closing Stock	3,250
Commission received	125	**Fixed Assets:**	
		Furniture 640	
		Less: Depreciation 64	576
		Vehicles 6,250	
		Less: Depreciation 1,250	5,000
		Buildings 7,500	
		Less: Depreciation 375	7,125
	20,216		**20,216**

Illu.5 : From the following Trial Balance of Shri Goyal, prepare Trading and Profit & Loss a/c for the year ending 31st December, 2006 and Balance Sheet As on that date:

Trial Balance as on 31st December, 2006

Debit Balance	***Rs.***	***Credit Balance***	***Rs.***
Adjusted purchases	**3,49,600**	**Sales**	**3,70,000**
Wages	**10,450**	**Capital**	**34,250**
National insurance	**150**	**Discount received**	**300**
Carriage inwards	**200**	**Commission received**	**10,000**
Carriage outwards	**250**	**Dividends received**	**150**
Lighting	**300**		
Rates and insurance	**250**		
Stock at 31-12-06	**30,625**		
Cash in Hand and at Bank	**875**		
Plant and machinery	**15,000**		
Discount allowed	**3,000**		
Furniture	**4,000**		
	4,14,700		**4,14,700**

Adjustments:

i) **Depreciate plant and machinery @ 15% and furniture 10%.**
ii) **Goods worth Rs.2, 000 given to his son at cost by Shri Goyal.**
iii) **Manager Commission 20% of profit after charging commission.**

Solution :

Trading and Profit & Loss a/c of Mr. Goyal

Dr. For the year ending 31-12-2006 Cr.

Particulars		*Amount Rs.*	*Particulars*		*Amount Rs.*
To Adjusted purchases	3,49,600		By Sales		3,70,000
Less: Goods given to son	2,000	3,47,600			
To Wages		10,450			
To Carriage inwards		200			
To Gross profit (transferred to P&L a/c)		11,750			
		3,70,000			**3,70,000**
To Lighting		300	By Gross profit		11,750
To Rates and insurance		250	By Dividends received		150
To National insurance		150	By Commission received		10,000
To Carriage outwards		250	By Discount received		300
To Discount allowed		3,000			
To Depreciation on P&M					
(15,000 X 15 / 100)		2,250			
To Depreciation on Furniture					
(4,000 X 10 / 100)		400			
To Manager's commission					
(15,600 X 20 / 120)		2,600			
To Net profit transferred to Capital a/c		13,000			
		22,200			**22,200**

Balance Sheet of Mr. Goyal as on 31-12-2006

Liabilities		*Amount Rs.*	*Assets*		*Amount Rs.*
Capital	34,250		Plant and Machinery	15,000	
Add: Net profit	13,000		Less: Depreciation	2,250	12,750
	47,250		Furniture	4,000	
Less: Drawings	2,000	45,250	Less: Depreciation	400	3,600
O/s Manager's commission		2,600	Stock		30,625
			Cash in Hand		875
		47,850			**47,850**

Illu.6 : From the Trial Balance of Aditya as on 31st December 2006, prepare a Trading and Profit and Loss a/c for the year ended December 2006 and a Balance Sheet as on that date:

Particulars	Dr. Rs.	Cr. Rs.
Purchases	1,80,000	
Opening stock	10,000	
Salaries	5,400	
Bonus to employees	1,200	
Rent @ 250 per month	2,750	
Machinery	29,000	
Wages	3,000	
Furniture and fittings	5,000	
Electricity	550	
Trade expenses	1,500	
Debtors	10,500	
Interest on loan	900	
Building	30,000	
Commission	200	
Sales		2,05,000
Loan @ 10%		10,000
Creditors		15,000
Capital		55,000
Drawings	5,000	
	2,85,000	2,85,000

The following adjustments need to be considered:

(i) Closing Stock on 31st December amounted Rs.12,000

(ii) Purchases include the cost of moped for Rs.5,000

(iii) Wages include Rs.1,000 paid for erection charge.

(iv) Sundry Debtors include Rs.500 which had become bad and a provision of 10% need to be maintained on doubtful debts.

(v) Electricity outstanding Rs.50 and

(vi) Provide 10% depreciation on Building.

Solution :

Trading and Profit and Loss a/c
for the year ended 31st December, 2006

Particulars	Rs.	Rs.	Particulars	Rs.
To Opening Stock		10,000	By Sales	2,05,000
To Purchases	1,80,000		By Closing stock	12,000
Less : Cost of Moped	5,000	1,75,000		
To Wages	3,000			
Less : Erection charges	1,000	2,000		
To Gross Profit c/d		30,000		
		2,17,000		2,17,000
To Salaries		5,400	By Gross profit b/d	30,000
To Bonus to employees		1,200		
To Rent	2,750			
Add : outstanding	250	3,000		
To Electricity	550			
Add : Outstanding	50	600		
To Trade expenses		1,500		
To Interest on loan	900			
Add : Outstanding	100	1,000		
To Commission		200		
To Bad debts		500		
To Provision for bad and doubtful debts		1,000		
To Depreciation on Building		3,000		
To Net Profit transferred to capital a/c		12,600		
		30,000		30,000

Balance Sheet as on 31st December, 2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		15,000	Debtors	10,500	
10% Loan	10,000		Less : Bad debts	500	
Add : Outstanding	100	10,100		10,000	
Outstanding rent		250	Less : Provision for doubtful debts	1,000	9,000
Outstanding electricity		50	Closing stock		12,000
Capital	55,000		Machinery	29,000	
Add : Net Profit	12,600		Add : Erection charges	1,000	30,000
	67,600		Furniture & Fittings		5,000
Less : Drawings	5,000	62,600	Buildings	30,000	
			Less : Depreciation	3,000	27,000
			Moped		5,000

		88,000			88,000

Illu.7 : From the following Trial Balance of Rahul, prepare Trading, profit and Loss Account for the year ending 31st March, 2006 and Balance Sheet as on that date.

	Debit Rs.	Credit Rs.
Factory Rent	4,000	
Bills receivable	5,300	
Bills payable	-	4,200
Insurance	1,200	
Furniture	10,000	
Machinery	28,000	
Office Rent	2,000	
Manufacturing Wages	21,500	
Provisions for doubtful debts		1,000
Manufacturing expenses	1,500	
General expenses	5,400	
Capital		60,000
Drawings	7,200	
Stock on 1st April, 2005	20,500	
Purchases	68,000	
Carriage inwards	1,500	
Sales		1,40,500
Sundry Debtors	23,500	
Sundry Creditors		14,300
Cash in hand	500	
Cash at Bank	2,200	
Carriage outwards	1,700	
Salaries	16,000	
	2.20,000	2,20,000

Adjustments :

i. **Write off bad debts Rs.500 and maintain the provision for doubtful debts at 5% on Sundry debtors.**

ii. **Stock on 31st March, 2006 Rs.27,000**

iii. **Unexpired Insurance Rs.300**

iv. **Depreciate Machinery by 5% and furniture by 10%**

v. **On 24th December, 2004 a fire broke out and destroyed the stock of the value of Rs.10,000 and the insurance company has admitted the claim to the extent of Rs.6,000**

Solution :

Trading and Profit and Loss a/c
for the year ended 31st March, 2006

	Rs.	Rs.		Rs.
To Opening stock		20,500	By Sales	1,40,500
To Purchases		68,000	By Loss due to goods destroyed by fire	10,000
To Manufacturing wages		21,500	By Closing stock	27,000
To Manufacturing expenses		1,500		
To Carriage inwards		1,500		
To Factory rent		4,000		
To Gross Profit c/d		60,500		
		1,77,500		1,77,500
To Insurance	1,200		By Gross profit b/d	60,500
Less : Prepaid	300	900		
To Office rent		2,000		
To General expenses		5,400		
To Carriage outwards		1,700		
To Salaries		16,000		
To Bad debts		500		
To Provision for doubtful debts		150		
To Loss of stock destroyed by fire		4,000		
To Depreciation on				
Machinery	1,400			
Furniture	1,000	2,400		
To Net profit transferred to capital a/c		27,450		
		60,500		60,500

Balance Sheet of Rahul as on 31st March, 2006

	Rs.	Rs.		Rs.	Rs.
Sundry Creditors		14,300	Cash in hand		500
Capital	60,000		Cash at Bank		2,200
Add : Net profit	27,450		Bills receivable		5,300
	87,450		Sundry Debtors	23,500	
Less : Drawings	7,200	80,250	Less : Bad debts	500	
				23,000	
Bills payable		4,200	Less : Provision for doubtful debts	1,150	21,850
			Closing stock		27,000
			Insurance claim		6,000
			Prepaid insurance		300
			Machinery	28,000	
			Less : Depreciation	1,400	26,600
			Furniture	10,000	
			Less : Depreciation	1,000	9,000
		98,750			98,750

Illu.8 : Prepare Trading account, Profit & Loss account and balance Sheet from the following data of M/s. Anil & Co. as on 31st March, 2006 :

Particulars	**Debit Rs.**	**Particulars**	**Credit Rs.**
Drawings	**5,000**	**Capital**	**40,000**
Debtors	**10,900**	**Creditors**	**6,000**
Wages	**6,000**	**Sales**	**40,000**
Purchases	**25,000**	**Purchase returns**	**2,000**
Rent	**1,000**	**Provision for bad debts**	**2,000**
Commission	**2,000**	**Interest**	**750**
Advertising	**1,000**		
Bad debts	**1,000**		
Machinery	**10,000**		
Furniture	**10,000**		
Tools	**5,000**		
Insurance	**1,000**		
Carriage outwards	**1,000**		
Investment	**10,000**		

Salary	**1,750**		
	90,750		**90,750**

Additional information:

a) **Provide 10% depreciation on furniture and 5% depreciation on machinery.**

b) **Wages includes Rs.1,000 paid for installation of machinery.**

c) **Closing stock Rs.30,000.**

d) **Create 5% provision for doubtful debts.**

e) **Goods given as free samples Rs.500.**

Solution :

Trading and Profit & Loss a/c of M/s Anil & Co.
for the year ending 31st March, 2006

Particulars	Rs.	Rs.	Particulars		Rs.
To Opening Stock		-	By Sales		40,000
To Purchases	25,000		By Closing stock		30,000
Less : returns	2,000	23,000	By Advertising		500
To Wages	6,000				
Less : Installation charges	1,000	5,000			
To Gross profit c/d		42,500			
		70,500			70,500
To Salary		1,750	By Gross profit b/d		42,500
To Rent		1,000	By Interest		750
To Commission		2,000	By Provision for bad debts	2,000	
To Advertising	1,000		Less : 5% Provision for doubtful debts	545	1,455
Add : Free Sample	500	1,500			
To Bad debts		1,100			
To Insurance		1,000			
To Carriage outwards		1,000			
To Depreciation on					
Furniture	1,000				
Machinery	550	1,550			
To Net profit (transferred to capital a/c)		33,805			
		44,705			44,705

Balance Sheet of M/s Anil & Co. as on 31-3-2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	40,000		Debtors	10,900	
Add : Net profit	33,805		Less : Reserve for bad debts	545	10,355
	73,805		Machinery	11,000	
:Less : Drawings	5,000	68,805	Less : Depreciation	550	10,450
Creditors		6,000	Furniture	10,000	
			Less : Depreciation	1,000	9,000
			Tools		5,000
			Investments		10,000
			Closing stock		30,000
		74,805			**74,805**

Illu. 9 : From the following Trial balance of Mr. Samsan, prepare the final accounts for the year ended 31-3-2006.

Debit balances	**Rs.**	**Credit balances**	**Rs.**
Land and buildings	**50,000**	**Returns**	**2,500**
Purchases	**1,10,000**	**Discount**	**1,200**
Stock	**40,000**	**Sales**	**2,05,000**
Returns	**1,500**	**Capital**	**1,15,000**
Wages	**10,000**	**Loan from Vijay**	**15,000**
Salaries	**9,000**	**Commission**	**1,500**
Office expenses	**2,400**	**Sundry Creditors**	**25,000**
Carriage	**1,200**	**Bills payable**	**2,350**
Carriage outwards	**2,000**		
Discount	**750**		
Bad debts	**1,200**		
Insurance	**1,500**		
Machinery	**50,000**		
Furniture	**10,000**		
Bills receivable	**20,000**		
Sundry debtors	**40,000**		
Cash in hand	**1,500**		
Cash at bank	**4,500**		
Office equipment	**12,000**		

	3,67,550		**3,67,550**

Adjustments :

(a) **Closing stock Rs.60,000**

(b) **Outstanding wages Rs.2,000, rent Rs.3,000**

(c) **Depreciation on land and buildings at 5%, machinery at 10%, Office equipment by 10%**

(d) **Bad debts reserve 21/2% on sundry debtors.**

(e) **Prepaid insurance Rs.200**

(f) **Provide interest on capital at 5%**

(g) **Loan from Vijay was taken on 1-1-2006 at 8% interest.**

Solution :

Trading and Profit & Loss a/c of Mr. Samsan for the year ending 31-3-2006

Particulars	Rs.	Rs.	Particulars		Rs.
To Opening Stock		40,000	By Sales	2,05,000	
To Purchases	1,10,000		Less : Returns	1,500	2,03,500
Less : Returns	2,500	1,07,500	By Closing stock		60,000
To Wages	10,000				
Add : Outstanding wages	2,000	12,000			
To Carriage		1,200			
To Gross profit c/d		1,02,800			
		2,63,500			2,63,500
To Salaries		9,000	By Gross Profit b/d		1,02,800
To Office expenses		2,400	By Discount		1,200
To Carriage outwards		2,000	By Commission		1,500
To Discount		750			
To Bad debts		1,200			
To Insurance	1,500				
Less : Prepaid insurance	200	1,300			
To Depreciation on					
Land and buildings		2,500			
Machinery		5,000			
Office equipment		1,200			
To reserve for bad debts		1,000			
To Outstanding rent		3,000			
To Interest on capital		5,750			

To Interest on Vijay loan (for 3 months)		300			
To Net profit (transferred to balance sheet)		70,100			
		1,05,500			1,05,500

Balance Sheet of Mr. Samsan as on 31-3-2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	1,15,000		Land and Buildings	50,000	
Add : Interest	5,750		Less : Depreciation	2,500	47,500
Add : Net profit	70,100	1,90,850	Machinery	50,000	
Loan from Vijay	15,000		Less : Depreciation	5,000	45,000
Add : Outstanding interest	300	15,300	Furniture		10,000
Sundry Creditors		25,000	Bills receivable		20,000
Bills payable		2,350	Sundry debtors	40,000	
Outstanding wages		2,000	Less : Reserve for bad debts	1,000	39,000
Outstanding rent		3,000	Cash in hand		1,500
			Cash at bank		4,500
			Office equipment	12,000	
			Less : Depreciation	1,200	10,800
			Closing stock		60,000
			Prepaid Insurance		200
		2,38,500			2,38,500

Illu.10 : Prepare Trading and profit and Loss account and Balance Sheet of Rajesh as on 31-3-2006 from the following Trial balance and adjourning information:

	Rs.	Rs.
Cash in hand	**540**	
Cash at Bank	**12,630**	
Purchases	**1,40,675**	
Sales		**2,58,780**
Returns	**2,680**	**1,500**
Wages	**20,480**	
Fuel and power	**4,730**	
Carriage on sales	**3,200**	
Carriage on purchase	**2,040**	
Stock (1st April, 2005)	**25,760**	

Buildings	**50,000**	
Machinery	**20,000**	
Patents	**7,500**	
Salaries	**15,000**	
General expenses	**13,000**	
Insurance	**600**	
Drawings	**15,245**	
Capital		**82,000**
Sundry debtors and creditors	**14,500**	**6,300**
	3,48,580	**3,48,580**

Additional Information:

(a) **Stock on hand on 31-3-2006 was Rs.26,800.**

(b) **Machinery is to be depreciated @ 10% and patents @ 20%**

(c) **Salaries amounting to Rs.1,500 stand unpaid.**

(d) **Prepaid insurance Rs.170.**

(e) **A provision of bad and doubtful debts be created to the extent of 5% on debtors.**

Solution :

Trading, Profit & Loss a/c of Mr. Ganguli
for the year ending 31-3-2006

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		25,760	By Sales	2,58,780	
To Purchases	1,40,675		Less : Returns	2,680	2,56,100
Less : Returns	1,500	1,39,175	By Closing stock		26,800
To Wages		20,480			
To Fuel and power		4,730			
To Carriage inward		2,040			
To Gross profit c/d		90,715			
		2,82,900			2,82,900
To Salaries	15,000		By Gross profit b/d		90,715
Add : Outstanding	1,500	16,500			
To Carriage on sales		3,200			
To General expenses		13,000			
To Insurance	600				
Less : Prepaid	170	430			

To Depreciation :					
Machinery		2,000			
Patents		1,500			
To Provision for bad debts		725			
To Net profit (transferred to Balance Sheet)		53,360			
		90,715			90,715

Balance Sheet of Mr. Ganguli as on 31-3-2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		6,300	Cash in hand		540
Outstanding salaries		1,500	Cash at bank		12,630
Capital	82,000		Closing stock		26,800
Add : Net profit	53,360		Debtors	14,500	
	1,35,360		Less : Provision	725	13,775
Less : Drawings	15,245	1,20,115	Prepaid insurance		170
			Buildings		50,000
			Machinery	20,000	
			Less : Depreciation	2,000	18,000
			Patents	7,500	
			Less : Depreciation	1,500	6,000
		1,27,915			1,27,915

Illu.11 : From the following Trial balance of Venkata Krishna as at 31st March, 2004. Prepare trading and profit and loss account for the year ended 31st March, 2004 and a Balance Sheet as on that date.

Debit balances	**Rs.**	**Credit balances**	**Rs.**
Stock	**45,000**	**Capital**	**75,000**
Plant and Machinery	**75,000**	**Sales**	**4,20,750**
Purchases	**2,25,000**	**Sundry Creditors**	**15,000**
Trade charges	**10,000**	**Bad debts provision**	**200**
Carriage inwards	**2,500**	**Bills payable**	**2,000**
Carriage outwards	**1,500**		
Factory rent	**1,500**		
Discount	**350**		
Insurance	**700**		
Sundry debtors	**60,000**		
Office rent	**3,000**		

Printing and Stationery	**600**		
General expenses	**2,800**		
Advertising	**15,000**		
Bills receivable	**6,000**		
Drawings	**6,000**		
Salaries	**15,000**		
Wages	**20,000**		
Furniture	**7,500**		
Coal and Gas	**1,000**		
Cash in hand	**2,000**		
Cash at bank	**12,500**		
	5,12,950		**5,12,950**

Adjustments :

1. **Closing stock amounted to Rs.35,000**
2. **Depreciate machinery 10% and furniture by 2%**
3. **Raise the bad debts provision to 5% on debtors**
4. **Outstanding factory rent Rs.300 and office rent Rs.600**
5. **Insurance prepaid Rs.100**

Solution :

Trading and Profit & Loss account of Venkata Krishna Reddy
for the year ending 31-3-2004

Particulars	Rs.	Rs.	Particulars	Rs.
To Opening stock		45,000	By Sales	4,20,750
To Purchases		2,25,000	By Closing stock	35,000
To Wages		20,000		
To Coal and Gas		1,000		
To Carriage inwards		2,500		
To Factory rent	1,500			
Add : Outstanding	300	1,800		
To Gross profit c/d		1,60,450		
		4,55,750		4,55,750
To Salaries		15,000	By Gross profit b/d	1,60,450
To Advertising		15,000		
To General expenses		2,800		
To Printing & Stationery		600		

To Office rent	3,000			
Add : Outstanding	600	3,600		
To Insurance	700			
Less : Prepaid	100	600		
To Discount		350		
To Carriage outwards		1,500		
To Trading expenses		10,000		
To Depreciation				
Machinery	7,500			
Furniture	375	7,875		
To Provision for bad debts		2,800		
To Net profit (transferred to balance sheet)		1,00,325		
		1,60,450		1,60,450

Balance Sheet of Venkata Krishna as on 31-3-2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		15,000	Cash in hand		2,000
Bills payable		2,000	Cash at bank		12,500
Outstanding factory rent		300	Bills receivable		6,000
Outstanding office rent		600	Debtors	60,000	
Capital	75,000		Less : Reserve for bad & doubtful debts	3,000	57,000
Add : Net Profit	1,00,325		Closing stock		35,000
	1,75,325		Plant & Machinery	75,000	
Less : Drawings	6,000	1,69,325	Less : Depreciation	7,500	67,500
			Furniture	7,500	
			Less : Depreciation	375	7,125
			Prepaid insurance		100
		1,87,225			1,87,225

13.3 QUESTIONS

1. Explain the need for adjustments in final accounts
2. Give five journal entries for adjustments in final accounts
3. How do you treat the following in final accounts?
   (a) Outstanding expenses
   (b) Prepaid expenses
   (c) Outstanding income
   (d) Income received in advance

(e) Depreciation on assets

(f) Treatment of bad debt, provision for doubtful debts and provision for discount

(g) Provision for bad debts

(h) Provision for discount on debtors

(i) Provision for discount on creditors

(j) Interest on Drawings

(k) Interest on capital

(l) Closing Stock

13.4 EXERCISES

1. From the following Trial Balance of M/s Ram & Sons, prepare trading and profit and loss account for the year ending on 31st December, 2006 and the balance sheet as on that date.

Particulars	Dr. Rs.	Cr. Rs.
Purchase	21,750	
Discount allowed	1,300	
Wages	6,500	
Salaries	2,000	
Sales		35,000
Travelling Expenses	400	
Commission	425	
Carriage Inward	275	
Administration Expenses	105	
Trade Expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors	4,250	
Capital		13,000
Creditors / Cash	7,045	2,100
	50,100	**50,100**

Stock on 31st December, 2006 was Rs.6,000. Depreciate buildings by 20%, create a provision for bad debts at 10% on debtors. Provide for outstanding wages Rs.475, salaries Rs.500 and goods used by the proprietor Rs.500.

[Ans.: Gross profit Rs.12,500, Net Profit Rs.5,495, Balance Sheet Total Rs.21,070]

2. From the following ledger balances prepare Trading and profit and Loss Account for the year ended 30th September, 2006 and a Balance Sheet as on that date.

Particulars	**Rs.**	**Particulars**	**Rs.**
Rama's Capital a/c	1,19,400	Cash	530
Rama's drawings a/c	10,550	Repairs & Renewals	3,370
Bills Receivable	9,500	Bank	18,970
Plant and Machinery	28,800	Interest and Discount (Dr.)	5,870
Sundry debtors (including Madan's dishonoured bill Rs.1,000)	62,000	Bad Debts	3,620
Loan a/c (Cr.) at 6%	20,000	Sundry Creditors	39,630
Wages (Manufacturing)	40,970	Fixtures & Fittings	8,970
Returns Inwards	2,780		
Purchases	2,56,590		
Sales	3,56,430		
Commission received	5,640		
Rent and Taxes	5,620		
Stock on 1st October, 2006	89,680		
Salaries	11,000		
Travelling Expenses	1,880		
Insurance (including Rs.300 p.a. paid up 31st March 2006)	400		

Stock in hand on 30th September, 2006 was Rs.1,28,960. Write off half of Madan's dishonoured bill. Depreciate Plant and Machinery by 5% and Fixtures and Fittings by 10%.

[Ans.: Gross Profit Rs.95,370; Net Profit Rs.66,563 and Balance Sheet Total Rs.2,55,043].

3. From the following Trial Balance of Mr. A, Prepare Trading and Profit & Loss Account for the year ending 31st December, 2006 and a Balance Sheet as on that date :

Debit Balances	**Rs.**	**Credit Balances**	**Rs.**
Drawings	5,275	Capital	59,700
Bills Receivable	4,750	Loan at 8% on (1-1-88)	10,000
Machinery	14,400	Commission received	2,820
Debtors (including X for Dishnoured Bill of Rs.1,000)	30,000	Creditors	29,815
Wages	20,485	Sales	1,78,215
Returns inwards	2,390		
Purchases	1,28,295		
Rent	2,810		
Stock (1-1-06)	44,840		
Salaries	5,500		
Travelling Expenses	945		
Insurance	200		
Cash	9,750		
Repairs	1,685		
Interest on Loan	500		
Discount Allowed	2,435		
Bad Debts	1,810		
Furniture	4,480		
	2,80,550		**2,80,550**

The following adjustments are to be made:

(i) Stock in the shop on 31st December, 2006 was Rs.64,480.

(ii) Half the amount of X's bill is irrecoverable.

(iii) Create a provision of 5% on other debtors.

(iv) Wages include Rs.600 for erection of new machinery.

(v) Depreciate Machinery by 5% and Furniture by 10%.

(vi) Commission include Rs.300 being Commission received in advance.]

[Ans.: Gross profit Rs.47,285, Net Profit Rs.30,472, Balance Sheet Total Rs.1,25,312].

4. The following are the balances of Messers Gupta & Co. as on June, 2006.

Debit Balances	**Rs.**	**Credit Balances**	**Rs.**
Cash in hand	540	Sales a/c	98,780
Cash at Bank	2,630	Returns outward	500
Purchases a/c	40,675	Capital Account	62,000
Returns Inwards	680	Sundry creditors	6,300
Wages Account	8,480	Rent	9,000
Fuel & power	4,730		
Carriage on Sales	3,200		
Carriage on Purchases	2,040		
Stock (1-7-06)	5,760		
Building a/c	32,000		
Freehold Land	10,000		
Machinery	20,000		
Patents	7,500		
Salaries	15,000		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
Sundry debtors	14,500		
	1,76,580		**1,76,580**

Prepare Trading and Profit & Loss a/c and a Balance Sheet as on 30th June, 2006 after taking into account the following adjustments:

(i) Stock on hand as on 30th June, 2006 is Rs.6,800.

(ii) Machinery is to be depreciated at 10% and Patents at 20%.

(iii) Salaries for the month of June, 2006 amounting to Rs.1,500 were unpaid.

(iv) Insurance, includes a premium of Rs.170 on a policy expiring on 31st December, 2006.

(v) Further Bad Debts are Rs.725.

(vi) Rent Receivable Rs.1,000.

[Ans.: Gross profit Rs.43,715, Net profit Rs.26,275, Balance Sheet Total Rs.90,830].

5. The following is the Trial Balance of Amrit Raj as on 31st December, 2006:

Particulars	Dr. Rs.	Cr. Rs.
Capital		25,000
Building	30,000	
Furniture	2,640	
Scooter	4,000	
Returns inward and outward	2,300	
Stock on 1st January, 2006	8,000	
Purchases and sales	33,800	56,040
Bad debts	400	
Carriage Inward	600	
General Expenses	1,200	
Bad Debts Provision		700
Bank Loan		5,000
Interest on Bank Loan	300	
Commission		900
Insurance and Taxes	2,000	
Scooter Expenses	2,600	
Salaries	4,400	
Cash in hand	2,000	
Debtors and Creditors	3,000	8,000

You are required to prepare the final accounts for the year ending 31st December, 2006 taking into account the following adjustments:

(a) Closing Stock on 31-12-06 was valued at Rs.4,340.

(b) Insurance is prepaid to the extent of Rs.200 and carriage inward is unpaid Rs.100.

(c) Salaries have been paid for 11 months.

(d) Bank Loan has been taken at 10% p.a. interest.

(e) Depreciate building by 5% and Scooter by 15%.

(f) Write off Rs.200 as further bad debts and increase bad debts provision by 5% on book debts.

(g) Scooter is used for business as well as for private purposes equally.

[Ans.: Gross Profit Rs.17,180, Net Profit Rs.6,640, Balance Sheet Total Rs.43,740]

6. From the following Trial Balance of C.C. Lakadwala as at 31st March, 2006, you are required to prepare the Trading and Profit and Loss Account for the year ended 31st March, 2006 and Balance Sheet as at that date :

Debit Balances	**Rs.**	**Credit Balances**	**Rs.**
Stock	45,000	Capital	75,000
Purchases	2,25,000	Sales	4,20,750
Plant & Machinery	75,000	Sundry Creditors	15,000
Trade charges	10,000	Bad debts provision	200
Carriage Inwards	2,500	Bills Payable	2,000
Carriage outwards	1,500		
Factory Rent	1,500		
Discount	350		
Insurance	700		
Sundry Debtors	60,000		
Office Rent	3,000		
Printing and Stationery	600		
General Expenses	2,800		
Advertising	15,000		
Bills Receivable	3,000		

Drawings	6,000		
Salaries	18,000		
Manufacturing wages	20,000		
Furniture and Fixtures	7,500		
Coal, gas and Water	1,000		
Cash in hand	2,000		
Cash at Bank	12,500		
	5,12,950		**5,12,950**

The following adjustments are to be taken into consideration:

(a) Closing stock amounted to Rs.35,000

(b) Plant and Machinery and Furniture to be depreciated by 5% and 10% respectively.

(c) Bad debts provision to be raised to 21% on debtors.

(d) Provided for outstanding liabilities for Factory Rent Rs.300 and Office Rent Rs.600.

(e) Insurance include Rs.100 in respect of 2006-07.

[Ans.: Gross Profit Rs.1,56,700, Net Profit Rs.91,100, Total of Balance Sheet Rs.1,78,000].

13.5 SUGGESTED BOOKS

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3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
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6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 11

Trading, Profit & Loss Account

Objectives :

After study of this unit we should be able to

- Understand the meaning of financial statements
- Know how to prepare trading and profit and loss account

Structure :

11.1 INTRODUCTION

It has been explained in a preceding Chapter that the accuracy of the books of accounts is determined by means of preparing a Trial balance. Having determined the accuracy of the books of accounts every businessman is interested in knowing about two more facts. They are : (I) Whether he has earned a profit or suffered a loss during the period covered by the Trial balance? (ii) Where does he stand now? In other words, what is his financial position?

The determination of the Profit or Loss is done by Preparing a Trading and Profit and Loss Account (or an Income Statement). While the financial position is judged by means of preparing a balance sheet of the business. The two financial statements together (i.e., Incomes Statement and the Balance sheet) are termed as Final Accounts. As term indicates, Final Accounts means accounts which are prepared at the final stage to give the financial position of the business.

Trading and Profit and Loss Account :

The Trading and Profit and Loss Account is a final summary of such accounts which affect the profit or loss position of the business. In other words, the accounts contain the items of Income and Expenses relating to a particular period. The account is prepared in two parts (I) Trading Account, and (ii) Profit and Loss account.

11.2 TRADING ACCOUNT

Trading Account gives the overall result of trading i.e., purchasing and selling of goods. In other words, it explains whether purchasing of goods and selling them has proved to be profitable for the business or not. It takes into account on the one hand the cost of goods sold and on the other the value for which they have been sold away. In case the sales value is higher than the cost of goods sold, there will be a profit, while in a reverse case, there will be a loss. The profit disclosed by the Trading Account is termed as gross Profit. Similarly the loss disclosed by the Trading Account is termed as Gross Loss.

11.2.1 Opening and Closing Stocks :

All goods purchased have been sold away by the trader. However, it does not normally happen. At the end of the accounting year, a trader may be left with certain unsold goods. Such stock of goods with a trader unsold at the end of the accounting period is termed as closing stock. Such a stock will become the opening stock for the next period. While calculating the amount of profit or loss on account of trading, a trader will have to take such Opening and closing Stocks into consideration.

11.2.2. Expenses on Purchases etc.

We have presumed that the trader has not incurred any expenses for purchase of goods and bringing them to his shop for sale. However, a trader has to incur various types of expenses for purchasing of goods as well as for bringing them to his shop for sale. Such expenses may include brokerage or commission paid to agents for purchase of goods, cartage or carriage charges for bringing the goods to the trader’s shop, wages paid to coolies for transportation of goods etc. All such expenses increase the cost of the goods sold and hence they have also to be included in the cost of purchasing the goods. In other words, cost of goods sold will be calculated as follows.

Cost of Goods sold = Opening Stock + Net purchases + Expenses on Purchasing Of goods – Closing stock

Cost of goods sold calculated above will then the compared with the net sales to find out the amount of profit or loss made by the business.

11.2.3 Equation for Preparing Trading Account :

The following equation can be derived for preparing Trading Account.

Gross Profit	Sales – Cost of goods sold
Cost of goods sold	Opening stock + Purchases + Direct expenses – Closing Stock
Therefore Gross Profit =	Sales – (Opening stock + Purchases + Direct expenses – closing stock)
Gross Profit	(Sales + Closing stock) – (Opening stock + Purchases + Direct expenses)

The term `Direct expenses' include those expenses which have been incurred in purchasing the goods, bringing them to the business premises and making them fit for sale. Examples of such expenses are carriage charges, octroi, import duty, expenses for seasoning the goods etc.

The Trading Account can be prepared in the following form on the basis of equation given above.

Trading Account

For the year ending ….

Dr. **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening Stock	X x x	By Sales Less Returns	X x x
To Purchases less returns	X x x	By Closing stock	X x x
To Direct expenses	X x x	By Gross Loss *	X x x
To Gross Profit *	X x x		
	X x x		X x x

- Only one figure will be appear

11.2.4 Important points regarding Trading Account

1. **Stock :** The term `stock' includes goods lying unsold on a particular date. The stock may be of two types. (I) Opening stock (ii) Closing stock.

   The term `Opening stock' means goods lying unsold with the businessman in the beginning of the accounting year. This is shown on the debit side of the Trading account.

   The term `Closing stock' includes goods lying unsold with the business at the end of the accounting year. It should be noted that stock at the end of the accounting year is taken after the books of accounts have been closed. The amount of closing stock is shown on the credit side of the Trading Account as an asset in the Balance Sheet. This has been explained later. The closing stock at the end of the accounting period will become the Opening stock the next year. The opening stock is therefore shown on the debit side of the Trial balance.

Valuation of Closing Stock : The closing stock is valued on the basis of `` cost or market price whichever is less' principle. It is therefore, very necessary that the cost of the goods lying unsold should be carefully determined. The market value of such goods will also be found out on the Balance Sheet date. The closing stock will be valued at the lower of the two values. This valuation is done because of the accounting convention of `conservatism' according to which expected losses are to be taken into account while not expected profits.

2. **Purchases :** The term `Purchases' includes both cash and credit purchase of goods. The term``goods'' as already explained in an earlier chapter means items purchased for resale. Assets purchased for permanent use in the business such as purpose of plant, furniture etc., are not included in the purchases of goods. Similarly, purchase of article such as stationery meant for using in the business will also not be included in the item of purchases. In case , a proprietor has himself used certain goods for his personal purposes., the value of such goods at cost will be deducted from the purchases and included in the drawings of the proprietor. Similarly, in case certain goods are given by way of free samples etc., the value of such goods should be charged to advertisement account and deducted from purchases. The amount of purchases will be the net purchases made by the proprietor. The term `net purchases' means total purchases of goods made by the businessman less the goods that he has returned back to the suppliers. In other words, purchases will be taken to the Trading Account after deducting purchases returns and goods as drawing from the gross purchases made during the accounting period.

3. **Sales :** The term `Sales' includes both cash and credit sales. Gross sales will be shown in the inner column of the Trading account out of which sales returns will be deducted. The net sales will then be shown in the outer column of the Trading Account. Proper care should be taken in records sale of those goods which have been sold at the end of the financial year but have not yet been delivered. The sale value of such goods should be included in the sales, but care should be taken that they are not included in the closing stock at the end of the accounting period. Sales of assets like plant and machinery, land and buildings or similar other articles which were purchased for using in the business, and not for sale, should not be included in the figure of `sales' to be taken to the Trading Account.
4. **Wages :** The amount of wages is taken as a direct expenses and, therefore, is debited to the Trading Account. Difficulty arises in those cases when the Trial balance includes a single amount for wages and salaries. In such a case, the amount is taken to the Trading Account.. However, if the Trial balance shows salaries and wages, the amount is taken to the Profit and Loss Account. In actual practice such difficulties do not arise because the businessman knows for which purpose he has incurred the expenditure by way of wages or salaries. However, in an examination problem, it will be useful for the students to follow the principle given above i.e., `Wages ad salaries' to be charged to trading account while `salaries and wages' to be charged to the profit and loss account. Wages paid for purchases of an asset for long term use in the business e.g., wages paid for plant and machinery or wages paid for construction of a building should not be charged to the Wages Account. They should be charged to the concerned Asset account.
5. **Customs and Import Duty :** In case the goods have been imported from outside the country, customs and import duty may have to be paid. The amount of such duty should be charged to the Trading Account.
6. **Freight, Carriage and Cartage :** Freight, carriage and Cartage are taken as direct expenses incurred on purchasing of the goods. They are, therefore, taken to the debit side of the Trading Account. The terms ``Freight in'' ``Cartage in'' and ``Cartage in'' have also the same meaning. However, ``Cartage out.'', ``Freight Out'' and ``Carriage out'' are taken to be the expenses incurred on selling the goods. They are, therefore, charged to the Profit and Loss account. The term ``inward'' is also used for the term ``IN''. Similarly the term ``outward'' is also used for the term ``out''. In other words ``Carriage'' or ``Carriage inward'' or ``Carriage in'' are used as synonymous terms. Similarly carriage out or ``Carriage outward'' are also the synonymous terms. The same is true for other expenses like Freight or Cartage.

7. **Royalty :** Royalty is the amount paid to the owner for using his rights. For example, the royalty is paid by a ``Lessee', of a coal mine to its owner for taking out the coal from the coal mine. Similarly, royalty is paid to the owner of a patent for using his right. It is generally taken as a direct expenses and, therefore, is charged to the Trading Account. However, where royalty is based on sales, for example in case of the book publishing trade, it may be charged to profit and loss account.
8. **Gas, Electricity, Water, Fuel etc.** : All these expenses are direct expenses and, therefore, they are charged to the Trading Account.
9. **Packing Materials :** Packing Materials used for packing the goods purchased for bringing them to the shop or convert them into a saleable state are direct expenses and, therefore, they are charged to the Trading Account. However, packing expenses incurred for making the product look attractive or packing expenses incurred after the product has been sold away are charged to the Profit and Loss account.

11.2.5 Closing Entries :

Closing entries are entries passed at the end of the accounting year to close different accounts. These entries are passed to close the accounts relating to incomes, expenses, gains and losses. In other words, these entries are passed to close the different accounts which pertain to Trading and Profit and Loss account. The accounts relating to assets and liabilities are not closed but they are carried forward to the next year. Hence, no closing entries are to be passed regarding these accounts which relate to the Balance sheet.

The principle of passing a closing entry is very simple. In case an account shows a debit balance, it has to be credited in order to close it. For example, if the purchases account is to be closed, the purchases account will have to be credited so that it may be closed because it has a debt balance. The Trading Account will have to be debited.

The closing entries are passed in the Journal Proper. The different closing entries to be passed by the Accountant for preparing a Trading Account are being explained below.

11.2.6 Importance of the Trading Account :

Trading Account provides the following information to a businessman regarding business.

1. Gross profit disclosed by the Trading Account tells him the upper limit within which he should keep the operating expenses of the business besides saving something for himself.

The cost of purchasing and the price at which he can sell the goods are governed largely by market factors over which he has no control. He can control only his operating expenses.

2. He can calculate his Gross profit ratio and compare his performance year after year. A fall in the Gross Profit Ratio means increase in the cost of purchasing the goods or decrease in the selling price of the goods or both. In order to maintain at least same figure of gross profit in absolute terms, he will have to push up the sales or make all out efforts to obtain goods at cheaper prices. Thus, he can prevent at least fall in the figure of his gross profit if can not bring any increase in it.
3. Comparison of stock figures of one period from another will help him in preventing unnecessary lock up of funds in inventories.
4. In case of new products, the businessman can easily fix up the selling price of the products by adding to the cost of purchases, the percentage gross profit that he would like to maintain.

Illu.1 : From the following information take the appropriate items relating to trading account and prepare trading account for the year ending 31-12-2002.

	Rs.
Stock 1-1- 2002	**2,000**
Purchases	**7,000**
Productive wages	**1,500**
Freight	**750**
Marine Insurance	**250**
Customs duty	**400**
Salaries	**1,500**
Power	**120**
Carriage inwards	**75**
Carriage outwards	**100**
Sales	**15,000**
Packing material	**200**
Sales returns	**400**
Purchase returns	**300**
Office lighting	**250**
Office rent	**1,200**
Stock 31-12-2002	**3,000**

Solution :

Trading a/c for the year ended 31-12-2002

	Rs.	Rs.		Rs.	Rs.
To Opening stock		2,000	By Sales	15,000	
To Purchases	7,000		Less : Returns	500	14,600
Less : Returns	300	6,700	By Closing stock		3,000
To Freight		750			
To Marine insurance		250			
To Customs duty		400			
To Carriage inwards		75			
To Power		120			
To Productive wages		1,500			
To Packing materials		200			
To Gross profit c/d		5,605			
		17,600			**17,600**
			To Gross profit b/d		5,605

Illu.2 :The following information is taken from in the books of Srinivas. Prepare Trading account for the year ended 31-12-2003 and write closing entries.

	Rs.		**Rs.**
Opening stock	**5,000**	**Sales returns**	**400**
Sales a/c	**20,000**	**Manufacturing expenses**	**100**
Purchase returns	**200**	**Octroi**	**500**
Carriage inwards	**300**	**Fuel**	**700**
Wages a/c	**4,000**	**Purchases a/c**	**8,000**
Closing stock (31-3-2003)	**2,000**		

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
2003				**Rs.**	**Rs.**
Mar.1	Trading a/c To Opening stock a/c To Purchases a/c To Wages a/c To Carriage inwards a/c To Manufacturing expenses a/c To Octori a/c To Fuel a/c (Being the transfer of accounts to trading account)	Dr.		18,600	 5,000 8,000 4,000 300 100 500 700
	Purchase returns a/c To Purchases a/c (Being the transfer of returns to purchases a/c)	Dr.		200	 200
	Sales a/c Closing stock a/c To Trading a/c (Being the transfer of accounts to trading account)	Dr. Dr.		20,000 2,000	 22,000
	Sales a/c To Sales returns a/c (Being the transfer of returns to sales a/c)	Dr.		400	 400

Trading a/c of Srinivas for the year ended 31-3-2003

	Rs.	Rs.		Rs.	Rs.
To Opening stock		5,000	By Sales	20,000	
To Purchases	8,000		Less : Returns	400	19,600
Less : Returns	200	7,800	By Closing stock		2,000
To Wages		4,000			
To Carriage inwards		300			
To Manufacturing expenses		100			
To Octroi		500			
To Fuel		700			

To Gross profit c/d		3,200			
		21,600			**21,600**
			By Gross profit b/d		3,200

Illu.3 : From the following information prepare the trading account of Sankar for the year ended 31-12-2002.

2002		**Rs.**
Jan 1	**Raw material**	**24,000**
	Work – in – progress	**10,000**
	Finished goods	**2,42,000**
Dec 31	**Purchases**	**3,56,000**
	Purchase returns	**12,500**
	Manufacturing wages	**1,82,000**
	Factory rent	**16,500**
	Coal, water	**8,500**
	Sales	**6,57,000**
	Carriage	**24,000**
	Customs duty	**15,000**
	Raw materials	**32,000**
	Work – in – progress	**12,000**
	Finished goods	**3,08,000**

Solution :

Trading a/c of Sankar for the year ended 31-12-2002

	Rs.	**Rs.**		**Rs.**	**Rs.**
To Opening stock			By Sales		6,57,000
Raw materials	24,000		By Closing stock		
Work-in-progress	10,000		Raw materials	32,000	
Finished goods	2,42,000	2,76,000	Work-in-progress	12,000	
To Purchases	3,56,000		Finished goods	3,08,000	3,52,000
Less : Returns	12,500	3,43,500			
To Wages		1,82,000			

To Factory rent		16,500			
To Coal water		8,500			
To Carriage		24,000			
To Customs duty		15,000			
To Gross profit c/d		1,43,500			
		10,09,000			**10,09,000**
			By Gross profit b/d		1,43,500

Illu.4 : Following are the balances extracted from the books of M/s Hero Motors Company as on 31st March 2003. You are required to prepare the Manufacturing Account and Trading Account for the year ended on that date:

	Rs.		**Rs.**
Raw Materials (Opening stock)	**50,000**	**Repairs to Machinery**	**3,750**
Work – in – progress (opening stock)	**37,500**	**Royalty**	**2,500**
Finished goods (opening stock)	**45,000**	**Purchases returns**	**1,250**
Raw material purchases	**1,25,000**	**Sales returns**	**2,500**
Finished goods purchases	**50,000**	**Factory insurance**	**3,750**
Productive wages	**75,000**	**Factory rent**	**46,250**
Coal and fuel	**12,500**	**Stock on 31st March 2003**	
Sales	**3,95,000**	**Raw materials**	**37,500**
Carriage inwards	**2,500**	**Work – in – progress**	**45,000**
Railway freight	**1,250**	**Finished goods**	**25,000**

Solution :

Manufacturing a/c of Hero Motors Co. for the year ended 31-3-2003

	Rs.	Rs.		Rs.	Rs.
To Opening stock		2,000	By Closing stock		
Raw materials	50,000		Raw materials	37,500	
Work-in-progress	37,500	87,500	Work-in-progress	45,000	82,500
To Purchases	1,25,000		By Manufacturing cost transferred to trading a/c		2,76,250
Less : returns	1,250	1,23,750			
To Productive wages		75,000			
To Coal & fuel		12,500			
To Carriage inwards		2,500			
To Railway freight		1,250			
To Repairs to machinery		3,750			
To Royalty		2,500			
To Factory insurance		3,750			
To Factory rent		46,250			
		3,58,750			**3,58,750**

Trading a/c for the year ended 31-3-2003

	Rs.		Rs.	Rs.
To Opening stock of finished goods	45,000	By Sales	3,95,000	
To Manufacturing cost transferred from Manufacturing a/c	2,76,250	Less : Returns	2,500	3,92,500
To Purchase of finished goods	50,000	By Closing stock of finished goods		25,000

To Gross profit transferred to profit & Loss a/c	46,250			
	4,17,500			4,17,500

11.3 PROFIT AND LOSS ACCOUNT

The Trading Account simply tells about the gross profit or loss made by a businessman on purchasing and selling of goods. It does not take into account the other operating expenses incurred by him during the course of running the business. All such expenses are charged to the Profit and Loss account. Besides this, a businessman may have other sources of income. For example, he may receive rent from some of his business properties. He may have invested surplus funds of the business in some securities. He might be getting interest or dividends from such investments. In order to ascertain the true profit or loss which the business has made during a particular period, it is necessary that all such expenses and incomes should be considered. Profit and loss Account considers all such expenses and incomes and gives the net profit made or loss suffered by a business during a particular period. It is generally prepared in the following form.

Profit and Loss Account

For the year ending ….

Dr. **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Gross Loss b/d *	X x x	By Gross Profit b/d*	X x x
To Salaries	X x x	By Discount received	X x x
To Rent	X x x	By Net loss transferred to Capital a/c	X x x
To Commission	X x x		
To Advertisements	X x x		
To Bad debts	X x x		
To Discount	X x x		
To Net profit transferred to Capital Account	X x x		

- Only one figure will appear

11.3.1 Important points regarding Profit and Loss Account :

1. **Gross profit or Gross Loss:** The figure of gross profit or gross loss is brought down from the Trading Account. Of course, there will be only one figure i.e., either of gross profit or gross loss.
2. **Salaries :** Salaries payable to the employees for the services rendered by them in running the business being of indirect nature are charged to the profit and loss account. In case of a partnership firm, salaries may be allowed to the partners. Such salaries will also be charged to the Profit and Loss Account.
3. **Salaries less Tax :** In case of employees earning salaries beyond a certain limit, the employer has to deduct at source income tax from the salaries of such employees. In such a case, the amount of gross salaries should be charged to the Profit and Loss Account, while the tax deducted by the employer will be shown as a liability in the balance sheet of the business till it is deposited with the Tax Authorities.
4. **Interest :** Interest on loans whether short term or long term is an expenses of an indirect nature and, therefore, is charged tot he Profit and Loss Account. However, interest on loans advanced by a firm to third parties is an item of income and therefore, will be credited to the Profit and Loss account.
5. **Commission :** Commission may be both an item of income as well as an item of expense. Commission on business brought by agents is an item of expenses while commission earned by the business for giving business to others is an item of income. Commission to agents is, therefore, debited to the Profit and Loss account while commission received is credited to the Profit and Loss account.
6. **Trade expenses :** Trade expenses are expenses of a miscellaneous nature. They are of small amounts and varied in nature and, therefore, it is not considered worthwhile to open separate accounts for each of such types of expenses. The term `` Sundry Expenses'', ``Miscellaneous Expenses'' or ``Petty Expenses'' have also the same meaning. They are charged to the Profit and Loss Account.
7. **Printing and Stationery :** This item of expenses includes expenses on printing of bills, invoices, registers, files, letter heads, ink, pencil, paper and other items of stationery etc. It is of an indirect nature and, therefore, charged to the Profit and Loss Account.

8. **Advertisement :** Advertisement expenses are incurred for attracting the customers to the shop and therefore, they are taken as selling expenses. They are debited to the Profit and Loss Account. However, advertisements expenses incurred for purchasing of goods should be charged to the Trading account, while advertisement expenses incurred for purchase of a capital asset (e.g. cost of insertion in a newspaper for purchase of car) should be taken as capital expenditure and debited to the concerned asset account. Similarly, advertisements expenditure incurred for sale of a capital asset should be deducted out of the sale proceeds of the asset concerned.
9. **Bad debts :** Bad debts denotes the amount lost from debtors to whom the goods were sold on credit. It is a loss, and therefore, should be debited to the Profit and Loss account.
10. **Depreciation :** Depreciation denotes decrease in the value of an asset due to wear and tear, lapse of time, obsolescence, exhaustion and accident. For example, a motor car purchased gets depreciated on account of its constant use. A property purchased on lease for Rs.12,000 for 12 years will depreciate at the rate of Rs.1,000 per year. On account of new inventions old assets become obsolete and they have to be replaced. Mines, etc., get exhausted after the minerals are completely taken out of them. An asset may meet an accident and may lose its value. It is necessary that depreciation on account of all these factors is charged to the Profit and Loss account to ascertain the true profit or loss made by the business.

In case the total of the credit side of the Profit and Loss Account is greater than the debit side of the Profit and Loss account, the difference is termed as Net profit. In a reverse case, it will be termed as Net Loss. The amount of Net profit or Net loss shown by the Profit and Loss account will be transferred to capital account in case of sole proprietary form. In case of a partnership firm, the amount of net profit or net loss will be transferred to the partners' `capital accounts in the agreed ratio. In the absence of any agreement, the partners will share profits and losses equally.

11.3.2 Importance of Profit and Loss Account :

The profit and loss account provides information regarding the following manner.

1. It provides information about the net profit or net loss earned or suffered by the business during a particular period. Thus, it is an index of the profitability or otherwise of the business.

2. The profit figure disclosed by the profit and loss account for a particular period can be compared with that of the other period. Thus, it helps in ascertaining whether the business is being run efficiently or not.
3. An analysis of the various expenses included in the Profit and Loss Account and their comparison with the expenses of the previous period or periods helps in taking steps for effective control of the various expenses.
4. Allocation of profit among the different periods or setting aside a part of the profit for future contingencies can be done. Moreover, on the basis of profit figures of the current and the previous period estimates about the profit in the year to come can be made. These projections will help the business in planning the future courses of action.

Illu.5 : From the following ledger balances prepare Trading, Profit and Loss account for the year ending 31-12-2000.

	Debit Rs.	Credit Rs.
Opening Stock (1-1-2000)	2,000	
Purchases	18,000	
Sales		21,000
Wages	300	
Carriage inwards	100	
Carriage outwards	150	
Sales returns	2,000	
Purchase returns		1,000
Salaries	2,400	
Rent	600	
Discount	50	
General expenses	500	
Commission		1,800

Closing stock as on 31-12-2000 for Rs.9,000.

Solution :

Trading, Profit & Loss a/c for the year ended 31-12-2000

	Rs.	Rs.		Rs.	Rs.
To Opening stock		2,000	By Sales	21,000	
To Purchases	18,000		Less : Returns	2,000	19,000
Less : Returns	1,000	17,000	By Closing stock		9,000
To Wages		300			
To Carriage inwards		100			
To Gross profit c/d		8,600			
		28,000			**28,000**
To Salaries		2,400	By Gross Profit b/d		8,600
To Rent		600	By Commission		1,800
To General expenses		500			
To Discount		50			
To Carriage outwards		150			
To Net profit (transferred to capital account)		6,700			
		10,400			**10,400**

Illu.6 : From the following Trial Balance of Ramamohan Rao as on 31-12-2003. Prepare Trading, Profit and Loss Account.

	Rs.		Rs.
Opening stock	**12,600**	**Sales**	**26,000**
Salaries, wages	**2,000**	**Purchase returns**	**200**
Carriage	**200**	**Discount received**	**300**
Sales returns	**500**	**Capital**	**8,000**
Trading expenses	**550**	**Creditors**	**900**
Rent	**250**	**Loan**	**2,000**
Plant	**2,500**		
Plant repairs	**450**		

Cash in hand	**300**		
Cash at bank	**1,000**		
Debtors	**5,150**		
Income tax	**600**		
Drawings	**900**		
Commission on purchases	**400**		
Purchases	**10,000**		
	37,400		**37,400**

Closing stock value as on 31-12-2003 Rs.3,000.

Solution :

Trading, Profit & Loss a/c of Rammohan Rao for the year ended 31-12-2003

	Rs.	Rs.		Rs.	Rs.
To Opening stock		12,600	By Sales	26,000	
To Purchases	10,000		Less : Returns	500	25,500
Less : Returns	200	9,800	By closing stock		3,000
To Carriage		200			
To Commission on purchases		400			
To Gross profit c/d		5,500			
		28,500			**28,500**
			By Gross profit b/d		5,500
To Salaries, wages		2,000	By Discount received		300
To Rent		250			
To Trading expenses		550			
To Plant repairs		450			
To Net profit (transferred to capital a/c)		2,550			
		5,800			**5,800**

Note :

1. Income tax and drawings are personal expenses and hence they are not to be shown in profit and loss a/c.
2. Drawings are to be deducted from capital on the liability side of the Balance Sheet.

Illu.7 :From the following trial balance prepare trading and profit and loss account for the year ended March 31st 2004.

	Debit Rs.	Credit Rs.
Capital		7,610
Cash in hand	30	
Purchases	8,990	
Sales		11,060
Cash in bank	885	
Fixtures and Fittings	225	
Freehold premises	1,500	
Lighting and heating	65	
Bills Receivable	825	
Returns inwards	30	
Salaries	1,075	
Creditors		1,950
Debtors	5,700	
Stock at January 1st, 1997	3,000	
Printing	225	
Bills Payable		1,875
Rates, Taxes and Insurance	190	
Discounts received		445
Discounts allowed	200	
	22,940	22,940

Closing stock on 31st March 2004 was valued at Rs.1,800.

Solution :

Trading, Profit & Loss a/c for the year ended 31-3-2004

	Rs.		Rs.	Rs.
To Opening stock	2,000	By Sales	11,060	
To Purchases	8,990	Less : returns	30	11,030
To Gross profit c/d	840	By closing stock		1,800
	12,830			**12,830**
To Salaries	1,075	By Gross profit		840
To Light, Heat	65	By Discount		445
To Printing	225	By Net loss – transferred to capital a/c		470
To Rates, taxes, insurance	190			
To Discount allowed	200			
	1,755			**1,755**

11.5 QUESTIONS

1. What are financial statements?
2. What is a trading account?
3. What do you meant by direct expenses?
4. Distinguish between capital and revenue expenditure
5. Distinguish between capital and revenue income
6. What is Profit & Loss account?
7. Explain the important points to be followed in the preparation of trading and profit & loss account.

11.6 EXERCISES

1. From the following information, prepare the final accounts for the year ending 31-3-06.

	Rs.		Rs.
Cash in hand	7,000	Furniture	2,500
Building	4,000	Capital	60,000
Drawings	4,000	Wages	8,000
Creditors	33,000	Debtors	30,000
Bad debts	1,000	Misc. Expenses	700
Postage & Telegram	400	Insurance	2,200
Printing	1,500	Discount received	1,000
Discount allowed	2,000	Rent & Rates	4,500
Carriage	3,000	Stock	18,000
Returns outward	2,300	Returns inward	1,500
Purchases	70,000	Sales	1,00,000
Outstanding expenses	1,000	Bills Payable	4,000

Stock on 31-3-06 Rs.26,000.

[Ans.: Gross Profit Rs.27,800, Net Profit Rs.16,500]

2. From the following information, prepare the final accounts for the year 2006.

Dr. Balances	Rs.	Cr. Balances	Rs.
Cash at Bank	7,000	Sundry Creditors	30,000
Sundry Debtors	60,000	Discount	1,000
Plant & Machinery	50,000	Returns	4,000
Cash in hand	1,000	Sales	1,50,000
Advertising	6,000	Capital	56,000
Rent, Rates & Taxes	5,000		
Bank Charges	500		
Discount	2,000		
Stock	20,000		
Returns	5,000		
Purchases	70,000		

Stock as on 31-12-1996 Rs.31,000.

[Ans.: Gross Profit Rs.81,000, Net profit Rs.63,000]

3. From the following information, prepare the final accounts for the year 2006:

Dr. Balances	Rs.	Cr. Balances	Rs.
Furniture	15,000	Bills payable	20,000
Carriage	9,000	Sales	2,20,000
Bad Debts	5,000	Returns	7,000
Manufacturing Expenses	7,000	Creditors	50,000
Bills receivable	12,000	Capital	1,89,000
Rent	10,000		
Stock	45,000		
Repairs	8,000		
Salaries	30,000		
Cash at Bank	10,000		
Cash in hand	5,000		
Wages	40,000		
Returns	10,000		
Purchases	1,10,000		
Debtors	70,000		
Plant & Machinery	80,000		
Drawings	20,000		

Stock as on 31-12-2006 Rs.51,000

[Ans.: Gross Profit Rs.57,000, Net profit Rs.4,000]

11.7 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune

4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers

5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005

6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006

7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005

8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 12

Balance Sheet

Objectives :

After study of this unit we should be able to

- Understand the meaning of balance sheet
- Know the methods in the preparation of balance sheet

Structure :

12.1 Introduction

12.2 Arrangement of Assets and Liabilities

12.3 Important points regarding to Balance Sheet

12.4 Questions

12.5 Exercises

12.6 Suggested Readings

12.1 INTRODUCTION

Having prepared the Trading and profit and loss account, a businessman will like to know the financial position of his business. For this purpose, he prepares a statement of his assets and liabilities as on a particular date. Such a statement is termed as ``Balance Sheet''. Thus, Balance Sheet is not an account but only a statement containing the assets and liabilities of a business on a particular date. It is, as a matter of fact, a classified summary of the various remaining accounts after accounts relating to Incomes and Expenses have been closed off by Transfer to Manufacturing, Trading and Profit and Loss account.

Balance sheet has two sides. On the left hand side, the liabilities of the business are shown while on the right had side the assets of the business appear. These two terms have been explained later in the chapter.

It will be useful here to quote definitions of the Balance Sheet given by some prominent writers. According to Palmer, ``The Balance sheet is a statement at a given date showing on one side the trader's property and possessions and on the other hand his liabilities.'' According to Freeman, ``A Balance Sheet is an itemised list of the asset, liabilities and proprietorship of a business of an individual at a certain date. The definition given by the American Institute of Certified Public Accountants makes the meaning of Balance Sheet more clear. According to it, Balance Sheet is ``a list of balance in the assets and liability accounts. The list depicts the position of assets and liabilities of a specific business at a specific point of time.

12.2 ARRANGEMENT OF ASSETS AND LIABILITIES

There is no prescribed form of Balance Sheet for a sole proprietary and partnership concern. However, the assets and liabilities may be shown in any of the following order.

1. Liquidity Order
2. Permanency Order

1. **Liquidity Order :** In case a concern adopts liquidity order, the assets which are more readily convertible into cash come first and those which cannot be so readily converted come next and so on. Similarly, those liabilities which are payable first come first, and those payable later on come next and so on. A proforma of Balance Sheet according to liquidity order is given below.

Balance Sheet as on…..

Liabilities	**Rs.**	**Assets**	**Rs.**
Bank overdraft	X x x	Cash in hand	X x x
Outstanding expenses	X x x	Cash at bank	X x x x
Bills payable	X x x	Prepaid expenses	X x x
Sundry Creditors	X x x	Bills receivable	X x x
Long term loans	X x x	Sundry Debtors	X x x
Capital	X x x	Closing stock	X x x
		Furniture	X x x
		Plant and Machinery	X x x
		Buildings	X x x
		Land	X x x
		Goodwill	X x x
	X x x		**X x x**

2. **Permanency order :** In case of permanency order, assets which are more permanent come first, less permanent come next and so on. Similarly, liabilities which are more parmanent come first, less permanent come next and son. In other words, an asset will be sold in the last or a liability which will be paid the last come first and that order is followed both for all assets and liabilities In case a Balance Sheet is to be prepared according to permanency order, arrangement of assets and liabilities will be reversed than what has been shown above in case of liquidity order. Arrangement of assets according to any of these orders is also termed as `Marshalling of Assets and Liabilities.

12.3 IMPORTANT POINTS REGARDING BALANCE SHEET

1. **Liabilities :** The term `Liabilities' denote claims against the assets of a firm whether those of owners of the business or of the creditors. As a matter of fact, the term `Equity is more appropriate than the term liabilities. This is supported by the definition given by American Accounting Association. According to this association, liabilities are `Claims' of the creditors against the enterprise arising out of past activities that are to be satisfied by the disbursement or utilisation of corporate resources. While the term `equity' stands both for owners equity (owners claims) as well as the outsiders equity (outsiders claims). However, for the sake of convenience, we are using the term `Liabilities' for purpose of this book.

   Liabilities can be classified in two categories.

   1. Current Liabilities and
   2. Long term or Fixed Liabilities.

   (i) Current Liabilities : The term `Current liabilities' is used for such liabilities which are payable within a year from the date of the Balance Sheet either out of current assets or by creation of new current liabilities. The broad categories of current liabilities are as follows.

   (a) Accounts payable i.e., bills payable and trade creditors

   (b) Outstanding expenses i.e., expenses for which services have been received by the business but for which payment has not been made.

   (c) Bank overdraft

   (d) Short-term loans, i.e., loan from Bank which are payable within one year from the date of the Balance Sheet.

(e) Advance payments received by the business for the services to be rendered or goods to be supplied in future.

(ii) Fixed Liabilities : All liabilities other than current liabilities come within this category. In other words, these are liabilities which do not become due for payment in one year and which do not require current assets for their payment.

2. **Assets :** The term ``Assets'' denotes the resources required by the business from the funds made available either by the owners of the business or others. It thus includes all rights of properties which a business owns Cash, investments, bills receivable, debtors, stock of raw materials, work in progress and finished goods, land, buildings, machinery, trade marks, patents, rights etc., are some examples of assets. Assets may be classified into the following categories.

   (a) Current assets : Current assets are those assets which are acquired with the intention of converting them into cash during the normal business operations of the company. According to Grady, ``the term Current assets used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realised in cash or sold during the normal operating cycle of the business. Thus the term current assets include cash and bank balances, stocks of raw materials, work-in-progress and finished goods, debtors, bills receivable, short-term investments, prepaid expenses etc.

   (b) Liquid Assets : Liquid assets are those assets which are immediately convertible into cash without much loss. Liquid assets are a part of current assets. In computing liquid assets, stocks of raw materials, work-in-progress and finished goods and prepaid expenses are excluded while all other current assets are taken.

   (c) Fixed Assets : Fixed Assets are those assets which are acquired for relatively long periods for carrying on the business of the enterprise. They are not meant for resale. Land and buildings, machinery, furniture are some of the examples of Fixed assets. Sometimes, the words Block Capital is also used for them.

   (d) Intangible assets : Intangible assets are those assets which cannot be seen and touched. Goodwill, patents, trade marks etc., are some examples of intangible assets.

   (e) Fictitious Assets : These are assets not represented by tangible possession or property. Examples of such assets are : formation expenses incurred for establishing a business such as, registration charges paid to the registrar of a joint stock company for getting a company incorporated, discount on issue of shares, debit balance in the profit and loss account when shown on the assets side in case of a joint stock company etc.

Ilu.1 : From the following balances prepare Trial Balance as on 31-12-2003. Prepare Trading and Profit and Loss Account for the above year ended and Balance Sheet as on that date.

	Rs.		Rs.
Rajakumar 's capital	**15,000**	**Opening stock (1-1-2003)**	**15,000**
Drawings	**3,000**	**Purchases**	**60,000**
Furniture, Fittings	**500**	**Sales**	**80,000**
Typewriters	**1,000**	**Purchase returns**	**500**
Cycles	**250**	**Sales returns**	**1,000**
Debtors	**15,000**	**Carriage inwards**	**750**
Creditors	**13,500**	**Carriage outwards**	**1,250**
Rent	**2,500**	**Rates, Taxes**	**600**
Salaries	**3,600**	**Cash in hand**	**2,425**
Discount allowed	**425**	**General expenses**	**1,800**

Closing stock on 31-12-2003 Rs.11,000.

Solution :

Trial balance of Raj Kumar as on 31-12-2003

	Rs.		Rs.
Drawings	3,000	Capital	15,000
Furniture, fittings	500	Creditors	13,500
Typewriters	1,000	Sales	80,000
Cycle	250	Purchase returns	500
Debtors	15,000		
Rent	2,400		
Salaries	3,600		
Discount allowed	425		
General expenses	1,800		

Opening stock (1-1-2003)	15,000		
Purchases	60,000		
Sales returns	1,000		
Carriage inwards	750		
Carriage outwards	1,250		
Rates, taxes	600		
Cash in hand	2,425		
	1,09,000		**1,09,000**

Trading, Profit & Loss a/c of Raj Kumar for the year ended 31-12-003

	Rs.	Rs.		Rs.	Rs.
To Opening stock		15,000	By Sales	80,000	
To Purchases	60,000		Less : returns	1,000	79,000
Less : Returns	500	59,500	By Closing Stock		11,000
To Carriage inwards		750			
To Gross profit c/d		14,750			
		90,000			**90,000**
To Salaries		3,600	By Gross profit b/d		14,750
To Rent		2,400			
To Discount allowed		425			
To General expenses		1,800			
To Carriage outwards		1,250			
To Rates, taxes		600			
To Net profit transferred to capital a/c		4,675			
		14,750			**14,750**

Balance Sheet of Raj Kumar as on 31-12-2003

	Rs.	Rs.		Rs.	Rs.
Creditors		13,500	Cash in hand		2,425

Capital	15,000		Debtors		15,000
Add : Net profit	4,675		Stock		11,000
	19,675		Furniture, Fittings		500
Less : Drawings	3,000	16,675	Typewriters		1,000
			Cycle		250
		30,175			**30,175**

Illu.2 : From the following trail balance of Rao and Bors. Preparing Trading and Profit and Loss account for the year ended 31st , 2002 and Balance Sheet as on that date.

Trial Balance of Rao & Bros. As on 31-12-2002

	Debit Rs.		Credit Rs.
Debtors	**12,000**	**Creditors**	**7,900**
Drawings	**2,900**	**Capital**	**30,000**
Rent, Taxes	**250**	**Sales**	**14,290**
Trade expenses	**670**	**Purchases returns**	**280**
Purchases	**8,640**	**Discount received**	**240**
Sales returns	**190**		
Carriage inwards	**250**		
Wages	**2,920**		
Salaries	**1,200**		
Stock (1-1-2002)	**3,100**		
Discount allowed	**180**		
Bad debts	**200**		
Plant, Machinery	**2,510**		
Furniture, Fittings	**1,800**		
Cash in hand	**500**		
Cash at Bank	**15,400**		
	52,710		**52,710**

Closing stock as on 31-12-2002 Rs.14,220.

Solution :

Trading and Profit & Loss a/c of Rao & Bros. ,

for the year ended 31-3-2004

	Rs.	Rs.		Rs.	Rs.
To Opening stock		3,100	By Sales	14,290	
To Purchases	8,640		Less : Returns	190	14,100
Less : Returns	280	8,360	By Closing stock		14,220
To Wages		2,920			
To Carriage inwards		250			
To Gross profit c/d		13,690			
		28,320			**28,320**
To Salaries		1,200	By Gross profit b/d		13,690
To Rent, Taxes		250	By Discount received		240
To Trade expenses		670			
To Discount allowed		180			
To Bad debts		200			
To Net profit (transferred to capital a/c)		11,430			
		13,930			**13,930**

Balance Sheet of Rao & Bros. as on 31-12-2004

Liabilities	**Rs.**	**Rs.**	**Assets**		**Rs.**
Creditors		7,900	Cash in hand		500
Capital	30,000		Cash at bank		15,400
Add : Net profit	11,430		Debtors		12,000
	41,430		Closing stock		14,220
Less : Drawings	2,900	38,530	Furniture, Fittings		1,800
			Plant, Machinery		2,510
		46,430			**46,430**

Illu.3 : From the following Trial Balance prepare Trading and profit and Loss account for the year ended 31st March, 2004 and balance sheet as on that date.

	Rs.		Rs.
Machinery	30,000	Capital	1,00,000
Stock (1-4-2003)	16,000	Sales	2,03,600
Wages	50,000	Creditors	12,500
Carriage	500	Purchase returns	2,000
Salaries	5,000	Discount received	250
Factory rent	2,400	Bills payable	8,500
Repairs	400		
Fuel, power	2,500		
Furniture	5,500		
Buildings	40,000		
Debtors	20,000		
Purchases	1,22,000		
Sales returns	3,600		
Drawings	2,000		
Discount allowed	750		
Office expenses	1,000		
Manufacturing expenses	600		
Bills receivable	5,000		
Cash in hand	2,400		
Cash at Bank	15,400		
Office rent	1,800		
	3,26,850		3,26,850

Closing stock as on 31-3-2004 Rs.20,000.

Solution

Trading, Profit & Loss a/c

for the year ended 31-3-2004

	Rs.	Rs.		Rs.	Rs.

To Opening stock		16,000	By Sales	2,03,600	
To Purchases	1,22,000		Less : Returns	3,600	2,00,000
Less : Returns	2,000	1,20,000	By Closing stock		20,000
To Carriage inwards		500			
To Fuel, Power		2,500			
To Wages		50,000			
To Factory rent		2,400			
To Manufacturing expenses		600			
To Gross profit c/d		28,000			
		2,20,000			**2,20,000**
To Salaries		5,000	By Gross profit b/d		28,000
To Repairs		400	By Discount allowed		250
To Discount allowed		750			
To Office expenses		1,000			
To Office rent		1,800			
To Net Profit (transferred to capital a/c)		19,300			
		28,250			**28,250**

Balance Sheet as on 31st March, 2004

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**
Creditors		12,500	Cash in hand	2,400
Bills payable		8,500	Cash at Bank	15,400
Capital	1,00,000		Bills receivable	5,000
Add : Net profit	19,300		Debtors	20,000
	1,19,300		Closing stock	20,000
Less : Drawings	2,000	1,17,300	Furniture	5,500
			Machinery	30,000
			Buildings	40,000

		1,38,300		1,38,300

Illu.4 : From the following trial balance of M/s Jairaj & Co. prepare Trading and profit and Loss Account for the year ending 31st March 2004 and Balance Sheet as on that date.

	Debit Rs.	Credit Rs.
Stock (1-4-2003)	20,000	-
Purchases	80,000	-
Sales	-	1,15,000
Returns inward	15,000	-
Returns outward	-	10,000
Carriage inwards	7,000	-
Carriage outwards	8,000	-
Wages	10,000	-
Salaries	12,000	-
Rent	7,000	-
Drawings	10,000	-
Capital	-	69,000
Interest Received	-	7,000
Investments	30,000	
Cash	5,000	-
Bank	8,000	-
Debtors	12,000	-
Creditors	-	15,000
Bills Payable	-	5,000
Commission Received	-	3,000
	2,24,000	2,24,000

Closing stock on March 31, 2004 was valued at Rs.19,000.

Solution :

Trading, Profit & Loss a/c Jai raj & Co.

for the year ended 31-3-2004

	Rs.	Rs.		Rs.	Rs.
To Opening stock		20,000	By Sales	1,15,000	
To Purchases	80,000		Less : Returns	15,000	1,00,000
Less : Returns	10,000	70,000	By Closing Stock		19,000
To Wages		10,000			
To Carriage inward		7,000			
To Gross profit c/d		12,000			
		1,19,000			**1,19,000**
To Salaries		12,000	By Gross profit b/d		12,000
To Carriage outwards		8,000	By Interest received		7,000
To Rent		7,000	By Commission received		3,000
			By Net Loss (transferred to capital a/c)		5,000
		27,000			**27,000**

Balance Sheet of Jai Raj & Co. as on 31st March, 2004

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**
Creditors		15,000	Cash	5,000
Bills payable		5,000	Bank	8,000
Capital	69,000		Debtors	12,000
Less : Drawings	10,000		Stock	19,000
	59,000		Investments	30,000
Less : Net Loss	5,000	54,000		
		74,000		**74,000**

12.4 QUESTIONS

1. What is a Balance Sheet?
2. What is Marshalling?
3. Explain the important points to be considered in the preparation of the balance sheet.
4. Give the proforma of trading and profit and loss account with hypothetical figures
5. Prepare a Balance sheet of an organisation with hypothetical figures.

12.5 EXERCISES

1. From the following information, prepare the final accounts for the year 2006.

Dr. Balances	**Rs.**	**Cr. Balances**	**Rs.**
Returns	15,000	Capital	1,41,000
Cash in hand	2,000	Returns	10,000
Bills Receivable	20,000	Bank overdraft	20,000
Purchases	1,50,000	Bills Payable	30,000
Bad debts	5,000	Sales	3,40,000
Income Tax	2,000	Commission	9,000
Bank Charges	1,000		
Salaries	35,000		
Insurance	5,000		
Rent & Rates	12,000		
Carriage	8,000		
Wages	70,000		
Power	10,000		
Stock	50,000		
Furniture	15,000		
Machinery	70,000		
Building	80,000		

Stock as on 31-12-2006 Rs.61,000.

[Ans.: Gross Profit Rs.1,08,000, Net Profit Rs.59,000, Balance Sheet Total Rs.2,48,000]

2. From the following information, prepare the final accounts for the year 2006.

Dr. Balances	Rs.	Cr. Balances	Rs.
Cash at Bank	5,000	Capital	60,000
Bills Receivable	9,000	Bills Payable	7,000
Salaries	11,500	Creditors	30,000
General Charges	3,000	Sales	2,20,000
Taxes & Insurance	4,000	Returns	4,000
Cash in hand	2,000	Commission	5,000
Interest	5,000		
Advertising	9,000		
Returns	5,000		
Purchases	1,20,000		
Stock	40,000		
Debtors	50,000		
Bad debts	2,500		
Furniture	10,000		
Building	50,000		

Stock as on 31-12-96 Rs.21,000.

[Ans.: Gross Profit Rs.80,000, Net Profit Rs.50,000, Balance Sheet Total Rs.1,47,000]

12.6 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 6

BANK RECONCILIATION STATEMENT

Objectives :

After studying this unit we may be able to :

- Know the meaning of Bank Reconciliation Statement
- Understand the need for preparing Bank Reconciliation Statement
- Analyse the reasons for differences between the cash book balance and pass book balance.
- Prepare the bank reconciliation statement in different circumstances.

Structure :

6.1. INTRODUCTION

This is a statement prepared so as to agree the bank balance as shown by the Pass Book with the Bank balance as shown by the Bank Column of the Cash Book. This statement is usually copied into the Cash Book at the end of a certain period. Generally, this statement is prepared monthly in order to verify the accuracy of the banking transactions made by a trader with his Bank. These transactions are recorded by the bank in the Pass Book. Bank opens a separate account of each depositor in its ledger. All the banking transactions are recorded in the respective ledger account in the books of the Bank. Similarly the banking transactions are recorded by a trader in the bank column of the Cash Book or in a separate Bank Account in the

Ledger. That means every transaction with a bank is recorded in the Cash book, as well as in the Pass Book. For example, if a trader has deposited Rs.5,000 in the Bank, it will be recorded by the trader in the bank column appearing on the receipt side of the Cash Book or a Bank Account opened in the ledger will be debited. In the books of the Bank, credit will be given to customer's account i.e., a credit entry will be made in the Pass Book. That means a Bank Account in the books of a trader is debited, and a customer's account in the Pass Book will be credited with the same amount. As such, theoretically, both the balances must agree. But in practice, this does not happen. Bank balance as shown by Bank column of the Cash Book does not tally with the balance as shown by Pass Book on a particular date. Therefore, it is necessary to find out the causes of difference between the two balances. Hence, the statement explaining the causes of disagreement between the two balances is drawn up.

6.2 NEED OF BANK RECONCILIATION STATEMENT

The following are the necessary for preparing Bank Reconciliation Statement.

1. It helps to understand the actual bank balance position.
2. It facilitates detection of any mistakes in the Cash Book and in the Pass Book.
3. It helps to prevent frauds in recording the banking transactions.
4. It explains any delay in collection of cheques.

6.3 REASONS OF DISAGREEMENT BETWEEN CASH BOOK AND PASS BOOK

The following are the reasons of disagreement between the Cash Book Bank balance and the Pass Book Bank Balance :

1. **Cheques issued but not presented for payment :** A business man issues cheques to his creditors in settlement of their accounts. The cheques issued are recorded in the bank column appearing on the payment side of the Cash Book immediately on the date of issue, but the Bank does not make a debit entry in the Pass Book. Entry in the Pass Book is made on presentation of the cheques by the creditors for payment. If creditors have not presented the cheques for payment, the Bank will not make an entry in the Pass Book. Therefore, if we compare the Cash Book with the

Pass Book, we will find that entry for issue of cheques appears in the Cash Book, and therefore, there will be a difference between the two balances.

2. **Cheques deposited in the Bank but not Collected :** Cheques are received from customers from time to time in settlement of the account. The cheques received are sent to the bank for collection and the entry is made in the bank column on the receipt side of the Cash Book. But its corresponding entry does not appear in the Pass Book, as the Bank does not give credit immediately. Credit is given only after collecting the amount of the cheques. Therefore, the bank balance as shown by the Cash Book does not agree with the balance as shown by the Pass Book.

3. **Cheques received and entered in the Cash Book, but not deposited into bank for collection :** Cheques received from customers may be entered in the Bank column of the cash Bank but the proprietor may forget to deposit the same into bank for collection. No entry is made by the bank in the Pass Book. In such a case the two balances will not agree.

4. **Cheques deposited into bank for collection but not entered in the Cash book :** Some times the customer might have received a cheque from the party and deposited the same into his bank for collection. But he might have failed to enter the cheque in the Cash Book. The cheque might have been entered by the bank in the Pass Book and customer's ledger as it has been collected. In this case, the two balances will not tally.

5. **Direct Payment into the Customer's Bank a/c by other parties but not recorded in the Cash Book:** Sometimes a third party may deposit money in the Bank a/c of the customer directly but the intimation of the same may not be received by the customer. As a result corresponding entry of the same may not be made in the Cash Book. As such these two balances will not agree.

6. **Interest allowed and credited by the Bank :** The Bank allows interest on a customer's deposit account and gives credit in the Pass Book. The entry in the Cash Book is made after receiving intimation from the bank. If a reconciliation statement is prepared before the receipt of such an intimation, there will be no corresponding entry in the Cash Book on its receipt side. Hence, a difference will arise between the two balances.

7. **Collection of dividend by the Bank:** A businessman earns income. He may instruct the Bank to collect the amount of dividend on his shares. The Bank makes a credit entry in the Pass Book immediately after collection. But it may not be entered in the Cash book immediately unless an intimation to that effect is received from the Bank. Therefore, there will be disagreement between the two balances.

8. **Interest charged or Bank charges or commission debited in the Pass Book :** May not appear in the Cash Book due to lack of intimation from the Bank. Therefore, the balance as shown by the Pass Book will not agree with the balance as shown by the Cash Book.

9. **Standing Instructions :** A businessman may give standing instructions to the Bank for payment of insurance premium, short rent, electricity charges etc. On making payment, the Bank passes a debit entry in the Pass book, thereby reducing the customer 's balance. The intimation of the same may not be received by the businessman. Therefore, it may not be recorded in the Cash Book. This will result in disagreement between the said balances.

10. **Dishonour of Cheques :** When the cheques deposited in the Bank are dishonoured, the Bank a debit entry in the Pass Book. The corresponding entry is passed in the Cash Book on receiving advise from the Bank. If a Bank Reconciliation Statement is prepared during this period, a difference will arise between the said two balances.

11. **Errors :** The balance as shown by the Cash Book will not agree with the balance as shown by the Pass Book, if certain errors are committed either by the accountant of a businessman or by the Bank clerk in recording the transactions.

6.4. PROCEDURE OF PREPARATION OF BANK RECONCILIATION STATEMENT

The following procedure is to be followed in the preparation of bank reconciliation statement.

1. **Selection of a date:** Select the date on which the Bank Reconciliation Statement is to be prepared. Preferably select the last date of the month on which the balances as per Cash Book and Pass Book are known easily.

2. **Comparison of entries :** Compare the Cash Book debit column entries with the credit side of the Pass Book, and credit column entries with the respective entries in the Pass Book on debit side. Majority of the items will tally.

3. **Classification of unticked items :** Examine the unticked items and list them. Classify them according to their characteristics and headings. The unticked items are the discrepancies.

4. **Selection of the base :** Select any balance as a base i.e. the starting point. The base may be either Cash Book balance or Pass Book balance whichever is given.

5. Apply the rule of addition and subtraction.

6. Draw the bank reconciliation statement.

A. When the Balance as per Cash Book is given :

Add : 1. Cheques issued but not presented for payment.

5. Interest and dividend collected by the Bank but not recorded in the Cash Book.
6. Direct deposit made by a customer in the Bank account.
7. Interest on a deposit allowed by the Bank but not recorded in the Cash Book.

Less 1. Cheques deposited in the Bank but not realised.

2. Commission charged by the bank, the entry of which does not appear in the Cash Book.
3. Bank charges debited in the Pass Book but not entered in the Cash Book.
4. Insurance premium paid by the Bank but not entered in the Cash book owing to lack of intimation.
5. Dishonour of cheques or dishonour of Bills Recivable discounted debited in the Pass Book but not entered in the Cash Book.

B. When the Balance as per pass book is given :

Add : 1. Cheques deposited in the Bank but not collected.

2. Bank Charges, commission, interest charged, debited in the pass book but not entered in the Cash Book.
3. Insurance Premium paid by the bank and debited in the Pass Book but which does not appear in the cash book.
4. Dishonour of cheques or dishonour of Bills Receivable discounted debited in the Pass book but not recorded in the Cash Book.

Less : 1. Cheques issued but not presented for payment.
2. Interest and dividedn collected by the Bank but not recorded in the Cash Book.
3. Direct deposit by a customer in the Bank account, not recorded in the Cash Book.
4. Interest on a Bank deposit allowed by the Bank but not recorded in the Cash Book.

6.4.1 Some points to be considered in the preparation of Bank Reconciliation Statement:

1. Cash Book refers to the Bank column of the Cash book.
2. Pass Book refers to the Customer 's a/c in the books of the Bank.
3. The phrases "Balance in Bank". "Some Balance" in "Cash Book". "Favourable Balance", mean debit balance in the Cash Book and Credit balance in the Pass Book.
4. The Phrases, "Bank Overdraft", "Unfavourable Balance" means the Credit balance in the Cash Book and the Debit balance in the Pass Book.

6.4.2 Specimen Form :

The following form is usually used for preparation of a Bank Reconciliation Statement :

Bank Reconciliation Statement as on -------

	Rs.	Rs.
Bank Balance as per Cash Book		-----
Add: i) ……………….	….	
ii) …………….	….	
iii) ……………	….	
Less: i) …………….	….	
ii) ……………	….	
iii) …………..	….	
Bank Balance as per Pass Book	**….**	**….**

Illu.1 : Prepare a Bank Reconciliation Statement from the following particulars

(i) Bank balance (credit) as per cash book on 31-12-2006 Rs.10,000

(ii) A cheque Rs.500 received from a customer was entered in the bank column of the cash book in December, 2006, but the same was omitted to be paid into bank.

(iii) A wrong debit of Rs.200 appears in the pass book

Solution :

Bank Reconciliation Statement as on 31-12-2006

	Particulars	Rs.	Rs.
	Balance as per cash book		10,000
Add :	Cash received from customer and omitted to send into bank	500	
	Wrong debit in the pass book only	200	700
	Balance as per pass book		**10,700**

Illu.2 : Prepare Bank Reconciliation statement of Ravichandra as on 31-3-2006 from the following particulars:

a. Balance as per Cash book in 31st March 2006 Rs. 25,000

b. Cheques Rs. 4,000 were deposited for collection but only Rs. 2,000 cheques were collected before 31-3-2006.

c. Cheques Rs. 2,500 were issued on 25th March 2006 Out of which, cheques Rs. 1,500 were cashed upto 31-3-2006.

d. A wrong debit Rs. 100 appears in the Passbook.

e. Bank charges Rs. 25 appears in the Pass book but not in Cash book.

f. Interest on investments collected and credited only in Pass book Rs. 400 but not entered in Cash book.

g. A cheque for Rs. 150 received from a customer was entered in the cash book, was omitted to be paid into bank.

Solution :

Bank Reconciliation Statement on 31-3-2006

	Particulars	Rs.	Rs.
	Balance as per Cash Book		25,000
Add :	Cheques issued but not presented for payment in the Bank	1,000	
	Interest on investment collected and credited by Bank but not entered in cash book	400	1,400
			26,400
Less :	Cheques deposited but not yet collected	2,000	
	Wrong debit in the pass book	100	
	Bank charges not entered in cash book	25	
	Cheque entered in cash book but was not sent to bank	150	2,275
	Balance as per Pass Book		**24,125**

Illu.3 : Prepare a bank Reconciliation Statement from the following particulars on 31-3-2003:

- **i) Debit balance as per bank column of cash book Rs.25,000**
- **ii) Cheques issued to creditors but not yet presented to bank for payment Rs.6,000.**
- **iii) Dividend received by the bank, but not entered in the cash book Rs.500.**
- **iv) Cheques deposited into bank for collection but not yet collected up to this date Rs.8,000.**
- **v) Bank charges Rs.200**
- **vi) A cheque deposited into bank was dishonoured but no intimation was received Rs.2,000**
- **vii) Bank collected interest on investments and the same was not intimated Rs.150.**

Solution :

Bank Reconciliation Statement as on 31-3-2003

	Particulars	Rs.	Rs.
	Debit balance as per cash book		25,000
Add :	Cheques issued but not presented	6,000	
	Dividend received by bank	500	
	Bank collected interest on investments	150	6,650

			31,650
Less :	Cheques deposited but not collected	8,000	
	Bank charges	200	
	Dishonoured cheques	2,000	10,200
	Credit balance as per pass book		21,450

Illu.4 : Prepare Bank Reconciliation Statement from the following

(a) Bank balance as per pass book Rs.10,000

(b) Interest on Investments collected by bank Rs.500

(c) Bank has paid Rs.300 towards insurance premium and was not entered in cash book.

(d) Cheque received, entered in cash book but not sent to Bank for collection Rs.500

(e) A wrong debit of Rs.400 is appearing in pass book.

Solution :

Bank Reconciliation Statement

	Particulars	Rs.	Rs.
	Balance as per Pass Book		10,000
Add :	Insurance premium debited in the pass book only	300	
	Cheque received was not sent to bank for collection	500	
	Wrong debit entered in the pass book	400	1,200
			11,200
Less :	Interest on Investments credited in the pass book		500
			10,700

Illu.5 : From the following particulars, ascertain the bank balance as per cash book of Swami as at 31st March 2006.

a. Credit balance as per passbook as on 31-3-06 Rs.2,500.

b. Bank charges of Rs.60 had not been entered in the cash book.

c. Out of the cheques Rs.3, 500 paid into the bank, a cheque of Rs.1, 000 was not yet credited by the banker.

d. Out of the cheques issued for Rs.4, 500, cheques of Rs.3, 800 only were presented for payment.

e. **A dividend of Rs.400 was collected by the banker directly but not entered in the cash book.**

f. **A cheque of Rs.600 had been dishonored prior 31-3-03 but no entry was made in the cash book.**

Solution :

Bank Reconciliation Statement of Mr. Swamy as on 31-3-2006

Particulars	*Amount Rs.*	*Amount Rs.*
Credit balance as per Passbook		2,500
Add: Bank charges has not been entered in the cash book	60	
Cheques paid into bank but not credited by the banker	1,000	
Dishonored cheque not entered in cash book	600	1,660
		4,160
Less: Cheques issued but not presented for payment	700	
Dividends collected by bank not entered in cash bquook	400	1,100
Balance as per Cash Book		**3,060**

Illu.6 : On 31st March, 2006 Pass Book of Kiran showed a credit balance of Rs.37,400 in Account No. 1 which did not agree with his cash book. On scrutiny, the following discrepancies were located:

(i) Three cheques totaling Rs.15,200 were deposited into his account, of which only those for Rs.9,800 were credited before 31st March .

(ii) Kiran has issued two cheques of Rs.1,200 and Rs.1,400. Only the first cheque was presented for payment before 31st March.

(iii) The banker paid electricity bill of Rs.750; telephone bill of Rs.900 as per the standing instructions of Kiran.

(iv) Pass book shows entries of Rs.50 towards charges and Rs.75 towards interest.

(v) A cheque issued for Rs.300 against a/c No.1 has wrongly entered in A/c 2 by the banker.

(vi) The pass book has no entry for the cheque of Ram prasad for Rs.270 as it has been dishonoured.

(vii) Payments side bank column has been under cost by Rs.20.

Prepare a Bank Reconciliation Statement as on 31st March 2006.

Solution :

Bank Reconciliation Statement of Kiran as on 31st March, 2006

	Particulars	Rs.	Rs.
	Balance as per Pass Book		37,400
Add :	Cheques deposited but not credited in the pass book	5,400	
	Electricity bill and telephone bill paid by bank entered in the pass book only	1,650	
	Bank charges debited in the pass book only	50	
	Payments side of the cash book undercaste	20	7,120
			44,520
Less :	Cheques issued but not presented for payment	1,400	
	Interest credited in the pass book only	75	
	Cheques issued but not entered in the pass book	300	
	Dishonoured cheques not entered in the pass book	270	2,045
	Balance as per cash book		**42,475**

Illu.7 : From the following particulars, ascertain the pass book balance of Phani Kumar as on 31-12-2006:

(a) Bank Overdraft as per Cash Book Rs.16,340.

(b) Interest on Overdraft debited in pass book Rs.1,000

(c) Bank charges debited in pass book only Rs.60.

(d) Cheques issued but not cashed up to 31-12-2006 Rs.1,500.

(e) Interest on investments recorded in Pass book only Rs.1,000.

(f) Cheque paid into Bank but not cleared before 31-12-2006 Rs.2,500.

Solution :

Bank Reconciliation Statement on 31-3-2006

	Particulars	Rs.	Rs.
	Overdraft balance as per Cash Book		16,340
Add :	i. Interest on overdraft debited only in pass book ii. Bank charges debited only in pass book iii. Cheque paid upto bank but not cleared	1,000 60 2,500	3,560
Less :	i. Cheques issued but not cashed upto 31-12-04 ii. Interest on investment credited in pass book	1,500 1,000	2,500
	Overdraft balance as per pass book		**17,400**

Illu.8 : From following particulars that appear in the Bank Pass Book of Randal as on 31st December 2006, prepare a bank Reconciliation statement and find out the balance.

		Rs.
(a)	**Overdraft as per cash book on 31-12-2006**	**10,540**
(b)	**Interest on overdraft for six months**	**240**
(c)	**Interest on investments collected by bank**	**300**
(d)	**Bank charges for the December 2006**	**60**
(e)	**Cheques drawn (issued) but not cashed by the customers prior to December 2006**	**2,500**
(f)	**Cheques paid into the bank, but not collected before 31st December 2006**	**4,200**
(g)	**A Bill receivable for Rs.1000 (discounted with the bank in November) was dishonoured on December 31st.**	**13,000**

Solution :

Bank Reconciliation statement of Randal & Sons as on 31-12-2006

	Rs.	Rs.
Overdraft as per cash book		10,540
Add (b) Interest on over draft	240	
(d) Bank charges entered in pass book	60	
(f) Cheques sent for collection not cleared	4,200	
(g) Dishonoured bills receivable entered in pass book	1,000	5,500
		16,040
Less (c) Interest on investments collected by the Bank	300	
(e) Cheques issued but not presented for payment	2,500	2,800
Over draft as per pass book		**13,240**

Illu.9 : On 1st July 2006, the Pass Book of Anvesh showed an overdraft of Rs.7,540. On scrutiny with cash book, the following discrepancies were found:

i) Rs.3,200 worth cheques deposited are not credited by the banker.

ii) Pass book shows an interest of Rs.57 on overdraft.

iii) Rs.1,500 worth of cheques issued are still not presented for payment.

Prepare Bank Reconciliation statement.

Solution :

Bank Reconciliation Statement of Anvesh as on 1st July, 2006

	Particulars	Rs	Rs.
	Overdraft as per pass Book		7,540
Add :	Cheques issued but not presented for payment		1,500
			9,040
Less :	Cheques deposited but not credited by the bank	3,200	
	Interest on overdraft debited in the pass book	57	3,257
	Overdraft as per cash book		5,783

Illu.10 : On 31-12-2006 the pass books of Prabhu showed a debit balance of Rs.41,000. Prepare a bank reconciliation statement with the following information:

a) Cheques amounting to Rs.15,600 were drawn on 27-1-2006 out of which cheques for Rs.11,000 were cashed up to 31-1-2006.

b) A wrong debit of Rs.800 has been given by the Bank in pass book.

c) A cheque for Rs.200 was credited only in the pass book.

d) Cheques accounting to Rs.21,000 were deposited for collection. But cheques for Rs.7,400 has been credited in the pass book on 5-2-2002.

e) A cheque for Rs.1,000 returned dishonoured and were debited in pass book only.

f) Interest and bank charges Rs.100 were not recorded in cash book.

g) A cheque of Rs.500 debited in the cash book omitted to be banked.

h) A wrong credit has been given by the banker for Rs.500 in the pass book.

Solution :

Bank Reconciliation statement of Prabhu as on 31-12-2006

Particulars	**Rs.**	**Rs.**
Overdraft balance as per Pass Book		41,000
Add: Cheques issued but not presented for payment		

	(Rs.15,600 – 11,000)	4,600	
	Cheque credited only in pass book	200	
	Wrong credit given only in pass book	500	5,300
			46,300
Less:	Wrong debit given in pass book	800	
	Cheques deposited but not yet collected	7,400	
	Cheque returned dishonoured debited in pass book only	1,000	
	Interest and bank charges entered in pass book only	100	
	Cheque debited in cash book but omitted to be sent to bank	500	9,800
Overdraft balance as per Cash Book			**36,500**

Illu.11 : From the following particulars, prepare a Bank reconciliation statement of Mr. Sastry.

a) **Overdraft as per pass book on Marc 31, 2004 was Rs.12,900.**

b) **Cheque issued before that date but presented for payment after that date amounted to Rs.1,200**

c) **Cheques paid into the bank but not cleared and credited before 31-3-2004 amounted to Rs.3,200.**

d) **Interest on overdraft amounting to Rs.175 debited only in the pass book.**

e) **Interest on investments Rs.700 was collected by the bank and credited in the pass book but not entered in the cash book.**

f) **Rs.950 in respect of a dishonoured cheque entered in the pass book but not in the cash book.**

Solution :

Bank Reconciliation statement as on 31-3-2004

Particulars		Rs.	Rs.
Overdraft balance as per Pass Book			12,900
Add:	1) Cheques issued but not presented for payment	1,200	
	2) Interest on Investment	700	1,900
			14,800
Less:	1) Cheques deposited but not yet cleared	3,200	
	2) Interest on overdraft	175	
	3) Dishonoured cheque entered only in pass book	950	4,325
Overdraft as per Cash Book			**10,475**

Illu.12 : On 31st January, 2006 the pass book showed debit balance of Rs.12,300. Prepare a Bank Reconciliation Statement with the following information.

(i) Cheques amounting to Rs.4,680 were drawn on 25th January, 2006 out of which cheques for Rs.3,300 were cashed up to 31st January, 2006

(ii) A wrong debit of Rs.240 has been given by bank in pass book

(iii) A cheque for Rs.60 was credited in Pass Book but was not recorded in Cash Book.

(iv) Cheques amounting to Rs.6,300 were deposited for collection. But cheques for Rs.2,220 have been credited in Pass Book at 5th February, 2006.

(v) A cheque for Rs.300 returned dishonoured and was debited in Pass Book.

(vi) Interest and bank charges amounted to Rs.30 were not accounted in Cash book.

(vii) A cheque received, entered in Cash Book but not sent to Bank for collection Rs.150.

Solution :

Bank Reconciliation Statement as on 31st January, 2006

	Particulars	Rs.	Rs.
	Overdraft balance as per pass book		12,300
Add :	Cheques issued but not presented for payment	1,380	
	Cheques credited in the pass book but not recorded in the Cash book	60	1,440
			13,740
Less :	Wrong debit given by bank in pass book	240	
	Cheques deposited for collection but not entered in the pass book	2,220	
	Cheque dishonoured but not entered in the cash book	300	
	Interest and bank charges debited in the pass book only	30	
	Cheque received entered in the cash book but not sent to bank for collection	150	2,940
			10,800

Illu.13 : From the following particulars of Murali Traders, prepare a Bank Reconciliation statement as on 31st July, 2004.

(a) Overdraft as per pass book on 31st July, 2004 Rs.42,100

(b) Cheques issued for Rs.7,500 and Rs.3,500 respectively on 25th July were encashed on 4th August.

(c) Cheques deposited on 30th July but not credited Rs.5,000

(d) A cheque for Rs.2,000 received from a customer was entered in the bank column of the cash book on 29th July but not sent to bank for collection till 3rd August.

(e) Electricity bill of Rs.150, paid by the Bank as per standing instructions on 20th July was not entered in the cash book.

(f) A credit for interest Rs.50 and a debit for bank charges Rs.10 appear in pass book only.

(g) Debit side of the bank column of the cash is over caste by mistake Rs.1,000

Solution :

Bank Reconciliation Statement on 31-7-2004

	Particulars	Rs.	Rs.
	Overdraft as per pass book		42,100
Add :	(a) Cheques issued, but not presented for payment (Rs,7,500 + 3,500) (b) Interest not entered in Cash Book	11,000 50	11,050
Less :	(a) Cheques presented, but not collected (b) Cheque not sent to bank for collection (c) Electricity bill paid by bank, not entered in cash book (d) Bank charges not appeared in cash book (e) Wrong totalling of cash book	5,000 2,000 150 10 1,000	8,160
	Overdraft as per Cash book		44,990

6.5 QUESTIONS

A. Short Answer Questions

1. Why is a Bank Reconciliation Statement?
2. Why is a Bank Reconciliation Statement Prepared?
3. What is pass book?

B. Essay Questions

1. What is a Bank Reconciliation Statement How is it prepared?
2. Give reasons for the difference between the Balance as per Cash Book and that as per Pass Book on a Particular day.

3. What are the usual reasons for disagreement between the Cash Book Balance and the Pass Book balance?

4. Explain the procedure in the preparation of Bank Reconciliation Statement.

6.6 EXERCISES

1. From the following particulars ascertain the balance that would appear in the pass book of Mr. Rajalingam as on 31st December, 2000.
   i. The cash book showed a credit balance of rs.18,500
   ii. Out of the cheques worth Rs.30,000 issued prior to this data, it was found that the bank had paid only cheque worth Rs.14,500.
   iii. There was also a credit in passbook for an amount by our customer direct into the Bank Rs.11,610.
   iv. The bank had also collected the bill for Rs.8,200 which fell due on 31-12-2000.
   v. Rs.950 in respect of a cheque paid in but dishonoured appear in the pass book only.
   vi. Cheques paid in before 31-12-2000 amounted to Rs.23,000 but the bank had collected and credit cheque worth Rs.9,000.
   vii. Interest on investment collected by Bank and credited in the pass book amounts to Rs.95.
   viii. There was an entry on the debit side in the pass book for bank charges Rs.25.

   [Ans.: Bank Balance as per Pass Book Rs.1,930]

2. The bank balance of Venkatachalam as per his Bank Pass Book on 30th September, 2003 was Rs.6,300 (credit balance). On comparing the Pass Book with the Cash Book, the following details were made known.
   a. Cheques received from Joseph Rs.420 and Chander for Rs.310 were entered in Pass Book on 3rd October, 2003, though deposited by venkatachalam on 30th September, 2003.
   b. Cheques issued on 28th September, 2003 by Venkatachalam to Raj, Reddy and Rao for Rs.430, Rs.350, Rs.570 respectively were entered in the Pass Book on 3rd, 4th and 6th October, 2003 respectively.

c. The Pass Book showed a credit for Rs.1,000 representing a direct payment made by a customer of Venkatachalam, which was not recorded in Cash Book up to 30th September, 2003.

d. A Bill payable for Rs.500 was duly paid off by the Bank on 30th September, 2003 according to the standing instructions of Venkatachalam but this was not entered in Cash Book.

e. Bank Charges of Rs.150 were debited in Pass Book.

f. An amount of Rs.300 interest on investments was collected by the Bank and credited in Pass Book only.

Prepare Bank Reconciliation Statement as on 30th September, 2003 and show the Bank balance as per Cash Book.

[Ans: Bank Balance as per Cash Book Rs.5,030]

3. From the following particulars, ascertain the bank balance of Mr.Ramesh as per the bank pass book on 31-12-2002.
   a. Bank overdraft as per cash book on 31-12-2002 was Rs.6,000.
   b. Interest on overdraft for six months ending 31-12-02 Rs.200 is debited in the pass book.
   c. Cheques issued but not cashed before 31-12-02 amounted to Rs.1,500.
   d. Cheques deposited into bank but not cleared and credited before 31-12-02 amounted to Rs.2,500.
   e. Interest on Investments collected by bank and posted in the pass book amounted to Rs.1,800.
   f. Bills receivable which was discounted with the bank in November, 02 was dishonoured on 31-12-02 and bank had debited Rs.1,050 including Rs.50 for bank charges.
   g. The bank column of cash book receipts side was overcast by Rs.1,000 in December, 2002.
   h. Bank had wrongly debited Mr. Ramnath for Rs.500 on 10-12-02 on account of dishonour of cheque pertaining to Mr. Ramgopal but rectified the said mistake on 30-12-02.

   [Ans.: Overdraft balance as per pass book Rs.7,450]

4. Prepare the bank reconciliation statement as on 30-6-03 from the following particulars.
   (i) Debit balance as per pass book on 30-6-03 Rs.15,000

(ii) A cheque for Rs.200 was deposited on 25-6-03 but was not recorded in cash book.

(iii) Cheques of Rs.17,000 were issued but, of these Rs.10,000 worth were presented before 30-6-03.

(iv) Cheques received on 20-6-03 Rs.2,000 were not sent to bank but noted in cash book.

(v) Cheques worth Rs.10,000 were sent to bank for collection. Of these Rs.2,000 were credited on 8-7-03 and Rs.1,000 credited on 10-7-03. Remaining cheques were credit before 30-6-03.

(vi) Bank paid Rs.300 on behalf of customer to Trade Association. This was not recorded in cash book.

(vii) Interest on overdraft Rs.800 was not entered in cash book.

(viii) Bank expenses Rs.40 were recorded twice in cash book and another bank charge for Rs.35 was not recorded in the cash book.

(ix) Cash book credit side bank column was undercost by Rs.1,000.

[Ans.: Overdraft balance as per Cash Book Rs.15,105]

5. From the following particulars prepare Bank Reconciliation Statement as on 31-3-2002.

(i) Credit balance as per Cash book Rs.1,500

(ii) Interest charged by the bank Rs.50.

(iii) Out of cheques paid into the bank Rs.2,500, only cheques for Rs.1,875 were cleared and credited by bank.

(iv) Two cheques of Rs.750 and Rs.1,500 were issued but out of them only one cheque of Rs.750 was presented for payment up to 31st March.

(v) Dividend of Rs.450 were collected by bank but were not appearing in cash book.

[Ans.: Overdraft balance as per Pass Book Rs.225]

6. The Cash Book (Bank Columns) and the Pass Book of Umasankar are given below. Prepare Bank Reconciliation Statement as on 31st December, 2005.

Cash Book (Bank Column)

Dr. **Cr.**

		Rs.			Rs.
2005			2005		
Dec 24	To Balance b/d	360	Dec 29	By Mahesh	15
Dec 27	To Prasad	60	Dec 29	By Ganesh	145
Dec 28	To Giridhar	120	Dec 29	By Viswanath	35
Dec 28	To Sankar	42	Dec 31	By Balance c/d	387
		582			**582**
Jan 1	To Balance b/d	387			

Bank Pass Book

Dr. **Cr.**

		Rs.			Rs.
2005			2005		
Dec 31	To Ganesh	145	Dec 25	By Balance b/d	360
Dec 31	To Balance c/d	400	Dec 28	By Prasad	60
			Dec 29	By Giridhar	120
			Dec 31	By Interest	5
		545			**545**
			2006 Jan 1	By Balance b/d	400

6.7 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005

5. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advaned Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
6. Prasad, G., Uttama Durga Devi., A., **Financial Accounting, Part – I,** Jai bharath Publishers, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter - 7

BILLS OF EXCHANGE

Objectives :

After going through this unit, we should be able to

- Define bills of exchange
- Understand the features of bill and advantages of a bills of exchange
- Differentiate the bills of exchange with a promissory note
- Understand the accounting procedure followed in bills of exchange
- Have an idea about the discounting of a bill, endorsement and dishonour of a bill.
- In addition to the procedure followed in case of insolvency of the acceptor
- Know the meaning of accommodation bills and the procedure followed in accommodation bills.

Structure :

7.1 INTRODUCTION

In modern times a large proportion of sales takes place on credit. A buyer of goods agrees to pay for the purchases after a fixed period of time from the date of the transaction. The interval of time between the completion of sale and the purchase of goods have to be filled up with some formal arrangement between the buyer and seller. This is done by means of a 'bill of exchange'. It is a piece of paper that entitles a person to a sum of money and is freely transferable.

A bill of exchange is a written acknowledgement of debit given by the buyer to the seller. It states the sum due at time of payment as well as the date and place of payment.

7.1.1 Definition:

According to Section 5 of the Negotiable Instruments Act, a bill of exchange is defined as follows: 'An instrument in writing, containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a central person or to the bearer of the instrument.'

This definition implies that a bill of exchange is a written order directing a person to pay a certain sum of money to the bearer of the instrument or to a specified person on his / her order. It is drawn by the seller who directs the buyer to pay the money to the person specified in the instrument.

7.1.2 Features of Bills of Exchange:

The features of a bill of exchange are as follows:

(a) It must be in writing.

(b) It must contain an express order to pay.

(c) The express order must be to p

(d) ay a definite amount of money.

(e) It must be signed by a drawer (Seller).

(f) The amount mentioned in the bill must be payable either on demand or at a determined time in the future.

7.2 IMPORTANT TERMS TO BE USED IN BILLS OF EXCHANGE

There are certain relevant terms used in a bill transaction. They are discussed below.

7.2 1. Parties to a bill of Exchange:

There are initially two parties involved in a bill of exchange, namely, a drawer and a drawee. Subsequently, a payee gets added in a majority of cases.

(a) Drawer: A seller of goods or the creditor is known as the drawer. The drawer makes a draws a bill on the buyer.

(b) Drawee or acceptor: A buyer or debtors who owes money to the seller is known as the drawee. The bill is drawn on the drawee.

(c) Payee: A person to whom the payment is to be made. Payment may be received either by the drawer itself or a third party.

7.2.2 Bills receivable and bills payable:

Bills are divided into two categories. They are as follows:

(a) Bills Receivable: The amounts owed to a business by its debtors are referred to as bills receivable. A bill of exchange is regarded as 'bills payable' for a person who is entitled to receive payment on it.

(b) Bills payable: The amounts owed by a business to creditors are referred to as bills payable. A bill of exchange is regarded as 'bills payable' for a person who is liable to pay on it.

The same bill is a bill receivable to one party and a bill payable to the other.

7.2.3 Due date and days of grace:

The date on which the payment of the bill is due is called the due date. While calculating the due date of the bill, three additional days are allowed, which get added from the date of maturity to the original date of maturity of the bill. These additional days are called the days of grace. However, if the day after adding the days of grace is a public holiday, the payment is made on the next day.

7.2.4 Term of a Bill:

This refers to the duration for which the bill is held by the Drawer. The term of a bill is a minimum of three months.

7.2.5 Bill at sight:

When the bill of exchange is payable at a given time after it is presented to the drawee for his / her knowledge, it is referred to as a bill at sight. The presentation of a bill for acceptance is necessary in order to fix the date of maturity.

7.2.6 Bill after date:

This refers to a bill of exchange being payable after a fixed number of days such as 30 days after date.

7.2.7 ADVANTAGES:

The following are the advantages of a bill of exchange.

1. **Facilitates purchase and sale of goods on credit:** A bill of exchange serves as a written proof of the purchase and sale of goods.
2. **Helps in transfer of money:** Money can be transferred easily from one place to another without any risk as a bill of exchange is a negotiable instrument.
3. **Serves as a source of finance:** The creditors need not wait till the due date of the payment of bill. The bill can be discounted from a bank and payment can be received immediately.
4. **Serves as evidence:** A bill of exchange is a legal evidence of indebtedness. It is a written proof of payment to the seller of goods.
5. **Helps in planning :** A bill of exchange contains in writing the terms and conditions such as the amount required to be paid, date of payment, interest to be paid (if any), place of payment, etc. Therefore, the creditor knows the time when he / she would receive the money, while the debtor is aware of the date by which he /she has to pay the money.

7.3. PROMISSORY NOTE

A bill of exchange resembles another negotiable instrument, namely, a promissory note. However, there is a distinction between the two. Sometimes, the buyer gives to the seller a promise in writing to pay him / her a certain sum of money either on demand or at a fixed future date. Such a promise is signed by the buyer and handed over to the seller. It is called a promissory note. According to Section 4 of the Negotiable Instruments Act, a promissory note is defined as:

7.3.1 FEATURES:

The definition of a promissory note reveals the following features:

1. **Writing:** A promissory note should be in writing. However, there is no particular from of words (as shown in the specimen) necessary for the validity of a promissory note, provided the requirements of law are complied with.
2. **Promise to pay:** A mere acknowledgement of debt is not considered the only feature of a promissory note. Similarly, a mere receipt for money is also not considered a promissory note. There must be an express undertaking to pay the amount.
3. **Promise to pay to be unconditional:** The promise to pay must not depend upon the occurrence of some uncertain event. If an instrument contains a conditional promise to pay, it is not considered a promissory note.
4. **Sum payable to be certain:** The sum of money promised to be payable must be certain and definite.
5. **Signed by the maker:** The signature may be on any part of the instrument and need not necessarily be at the bottom.

7.3.2 Differences between a Bill of Exchange and Promissory Note:

Basis	Bill of Exchange	Promissory Note
1. Promise and order	This is an order for making the payment.	This is a promise to make the payment.
2. Number of parties	There are three parties involved; the drawer, the drawee and the payee.	There are two parties involved; the drawer and the drawee.
3. Acceptance	It must be accepted by the person who is liable to pay.	It required no acceptance as it signed by the person who is liable to pay.
4. Nature of liability	The liability of the drawer of a bill of exchange is secondary and conditional. This implies that the liability of a drawer arises only when the acceptor fails to pay.	The liability of the maker is primary and absolute.
5. Notice of dishonour	In case of dishonour of a bill of exchange, notice of dishonour must be given by the holder to all parties.	In case of dishonour of a promissory note, no notice is necessary to be given to the maker.

7.4. BILL TRANSACTIONS

With the help of the basic terms used for a bill of exchange, the different major aspects of bill transactions and their accounting treatments are discussed below. The different aspects include the following transactions:

(a) Drawing, acceptance and payment of a bill. Under this, there are three options available:
   (i) Retaining the bill till the date of maturity
   (ii) Getting the bill discounted from the bank
   (iii) Endorsing/ transferring of the bill to the creditor

(b) Retiring of a bill under rebate
(c) Dishonour of a bill
(d) Renewal of a bill

7.5. DRAWING, ACCEPTANCE AND PAYMENT OF BILLS OF EXCHANGE

The accounting entries are the same for a bill of exchange and a promissory note. When a bill is written, it is referred to as 'drawing' of a bill. The person who draws the bill is the creditor and the person to whom it is given is the debtor. The creditor is known as the drawer and the debtor in writing, he /she becomes the acceptor of the bill. The bill is called a 'bills receivable' for the creditor and a 'bills payable' for the debtor. The person to whom the payment is to be made is called the payee. The bill is said to have been discharged when the acceptor of the bill makes the actual payment due on the bill on the maturity date. The journal entries for recording the transactions of credit sale, credit purchase of goods as well as the drawing, acceptance and payment of bills are discussed. The entries are made in the books of the drawer and the drawee.

7.5.1 Books of the Drawer:

The following entries are made in the books of the drawee.

1. **Credit sale of goods :** In case of goods sold on credit the entries would be as follows:

Credit Sale of Goods

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Debtor's Account To Sales Account (Goods sold on credit)			

2. **Drawing of bill :** No entry is required when a bill is drawn since the drawer simply writes the bill and does not send it to the drawee.

3. **Receipt of the bill duly accepted:** In case the bill is duly accepted, the entries are as follows:

Receipt of the Bill Duly Accepted

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bill Receivable Account To Debtors Account (Receipt of the bill duly accepted)			

4. **Deposit of the bill with the bank for collection:** In such a case, the sender of a bill opens a new account called 'Bills Sent for Collection Account'. This account is debited when the bill is sent for collection and credited when the intimation of actual collection is received from the bank. The purchaser authorizes the bank to collect the payment of the bill on the due date without delay. However, it is different from discounting of a bill. When a bill is discounted, the account of the customer is credited immediately whereas in case of a bill sent for collection, the account of the customer is credited when the amount is actually collected by the bank. In case the bill is sent to the bank for collection instead of retaining it for payment, the entries would be as follows:

Bill Sent for Collection

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bill Sent for collection To Bills Receivable Account (Bill sent to the bank for collection)			

5. **Receipt of payment on maturity:** In case the bill is retained by the drawer till the date of maturity, the entries would be as follows:

Receipt of payment of maturity

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Cash Account To Bills Receivable Account (Payment received on the bill)			

In case the bill is sent to the bank for collection, the amount realized on it through the bank is recorded as follows:

Bill Collected by Bank

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bank Account To Bill sent for Collection (Bill collected by the bank)			

7.5.2 Books of the Drawee:

The following entries are made in the books of the drawee.

1. **Credit Purchase of goods:** In case the goods are purchased by the buyer, the drawees account would show the following journal entries:

Credit Purchase of Goods

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Purchases Account To Creditor's Account (Goods purchased on credit)			

2. **Acceptance of the bill:** In case the bill is accepted, the journal entries in the books of the acceptor would be as follows:

Acceptance of the Bill

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Creditors 's Account To Bills Payable Account (Acceptance given on the bill)			

3. **Payment of the bill on maturity:** When the bill is paid on the date of maturity, it is the bills payable account that will be debited and not the account of the creditor. This is because there is no creditors account in the books of the acceptor after he /she has given acceptance. Further, the bill might have been endorsed to some other person and not necessarily to the drawer.

Payment of the Bill on Maturity

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills payable Account To Cash Account			

	(Bills paid on the due date)			

As mentioned earlier, the drawer of the bill of exchange has the following options:

a. To retain the bill till the date of maturity.

b. To get the bill discounted from the bank.

c. To endorse / transfer the bill to his / her creditor.

4. **Retaining the bill till the date of maturtity:** In this case the following entries are recorded:

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Debtor 's Account To Sales Account (Sales of goods on credit)			
	Bills Receivable Account To Debtor 's Account (Receipt of the bill duly accepted)			
	Bank Account To Bills Receivable Account (Receipt of payment on maturity)			

5. **Getting the bill discounted from the bank or discounting of a bill:** If the holder of a bill of exchange (holding a bill of a longer duration) wishes to obtain cash before maturity, he /she sells it to the bank. The purchaser (in this case the bank) deducts a certain amount as discount from the face value of the bill and pays the balance to the holder. This is known as 'discounting of a bill'. The discount that is deducted is a loss to the person who sells the bill and a gain to the person who purchases it. This is because the purchaser of the bill, after discounting the same, has to wait for realizing the money till the bill becomes due. Hence, the discount, which is the difference between the face value of the bill that the purchaser recovers and the value that he /she has paid to the seller, is a gain. The entries for discounting of a bill are as follows:

   (a) Books of the drawer: Cash is received or treated as deposited in the bank account while the bills receivable is given up and represents a loss. Also, the amount of the bank discount is debited as an expense.

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Cash Account Discount Account To Bills receivable Account			

(b) Books of the drawee: The acceptor is not affected by the discounting of a bill and hence, so there is no treatment in the books. The drawee 's liability remains the same at the time of maturity.

Illu.1 : On 1st June 2006 Ramesh sold goods to Mahesh for Rs.5,000 and drew a bill on Mahesh for 3 months. Mahesh accepted the bill and returned it to Ramesh who discounted it with his bank at 10% p.a. Mahesh met his acceptance on the due date. Pass the journal entries in the books of Ramesh.

Solution :

Journal Entries in the books of Ramesh

Date	Particulars		L.F.	Debit	Credit
2006				Rs.	Rs.
June 1	Mahesh a/c To Sales a/c (Being goods sold to Mahesh)	Dr.		5,000	 5,000
	Bills receivable a/c To Mahesh a/c (Being bill received for 3 months)	Dr.		5,000	 5,000
	Cash a/c Discount a/c To Bills receivable a/c (Being bill discounted in the bank)	Dr. Dr.		4,875 125	 5,000

7.6 ENDORSEMENT OF A BILL

There are times when the drawer of a bill does not keep the bill with himself/ herself until the date of maturity. Instead, the drawer transfers the bill to another person to whom he/ she owes a similar amount. This is referred to as negotiability of the bill. It implies that the holder can transfer the title in the bill. This is done by making one's own signature at the back of the bill along with the party to whom it is being transferred. This is referred to as the endorsement of a bill. Hence, endorsement refers to writing on an instrument the name of a person other than the maker on the face or back of a negotiable instrument or on a slip of paper. This implies that the title of the document can be transferred from one person to another through endorsement and delivery. Hence, a bill of exchange is a negotiable instrument. The person who endorses the bill is known as the 'endorser' and the person to whom the bill is endorsed is known as the 'endorsee'. After endorsement, the bill is payable to the endorsee instead of the original holder.

The Journal entries made in the books of the drawer, acceptor and the endorsee are as follows:

(a) Books of the Drawer: Once the drawer has received the bill duly accepted from the acceptor, the bill may be endorsed in favour of a creditor. In this case, the creditor's account will be debited while the bills receivable account will be credited.

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Endorsee/ Creditor's Account To Bills receivable Account (Being the bills receivable endorsed)			

(b) Books of the acceptor: The endorsement of a bill by the drawer does not change the position of the acceptor and, therefore, does not require any accounting treatment in the books. The acceptor is liable to pay the bill on maturity to anyone who presents the bill.

(c) Books of the endorsee: The endorsee is the creditor or drawer of the bill, who receives a qualified discharge of his/ her debt bill from the debtor. The journal entries recorded in the books of the endorsee are as follows:

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Receivable Account To Endorser / Debtors a/c (Bills received on endorsement)			

7.6.1 Effects of Endorsement:

After a bill has been endorsed and delivered to the endorsee it becomes payable to him / her instead of the original holder. The endorsee may again endorse it in favour of another person. This process may continue till the date of maturity. Endorsement provides a mechanism for settling business payments.

7.7 RETIRING OF A BILL UNDER REBATE

When the drawee makes payment of the bill before its due date, it is referred to us retiring of the bill. The person holding the bill usually allows some discount, which is called a rebate. The rebate is calculated for the period for which the payment is being made before maturity. The rebate is a gain to the party making the payment and an expense to the party receiving the payment. It is calculated at a certain rate per annum on the unexpired period of the bill.

The journal entries for retiring of a bill are as follows:

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Cash Account Rebate Account To Bills Receivable Account (Bills retired and rebate given brought into account)			

Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Payable Account To Cash Account To Rebate Account (Bills retired before the due date and rebate received)			

7.8 DISHONOUR OF A BILL

In Case a bill of exchange is not paid on the date of its maturity, it is said to have been dishonoured. It includes the failure to accept a bill of exchange (dishonour by non – acceptance) or to fail to pay a bill of exchange (dishonour by non – payment). The holder of the bill has to serve a notice to all other parties whose name appears on the bill. When the holder fails to serve the notice on the parties, he /she losses the right to sue them for the amount thereof.

A bill becomes valueless upon dishonour and the parties stand in a position where they were before the bill was drawn. The holder may sue either the endorser or any previous parties. The expenses incurred by the holder can be recovered from the acceptor. In this context, noting of a bill assumes significance.

7.8.1 Noting of a Bill:

When a bill of exchange is dishonoured, it is necessary to get the 'fact' of dishonour noted. If the acceptor can prove that the bill was not properly presented for payment, he /she may escape liability. The bill is given to a public official appointed by the court to deal with dishonur of bills known as 'notary public'. For this service, the notary public charges fees called notary charges from the holder of the bill. These charges may be recovered from the party responsible for the dishonour. The advantage of noting is that the evidence of dishonour is noted.

In case of a dishonour, the party that gave the bill has to be debited since it becomes liable to pay the amount. If the bill is held by the drawer till the date of maturity, the bills receivable account is credited. If the bill was discounted from the bank or endorsed to a creditor, the bank or the creditor's account will be credited accordingly. The journal entries for the above cases are discussed below.

7.8.2 Non – payment of the bill held till maturity:

In case the bill is held by the drawer till the date of maturity, the journal entries are as follows:

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Drawee 's Account To Bills Receivable Account (For bill dishonoured)			
	Drawee 's Account To Cash Account (For noting charges paid on drawee 's behalf)			

Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Payable Account To Drawer 's Account (For bill dishonoured)			
	Noting Charges Account To Drawer 's Account (For noting charges payable to the drawer)			

7.8.3 Non – payment of a bill discounted from the bank :

When the bill is discounted from the bank and is dishonured, the bank will recover the amount of the bill from the person who got the bill discounted. In case the noting charges are also paid by the bank, the bank, will also recover the same.

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Drawee 's Account To Bank Account (With the original amount of the bill and noting charges paid by the bank)			

Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Payable Account Noting Charges Account To Drawer's Account (With the original amount of the bill and noting charges payable)			

7.8.4 Non – payment of Endorsed bill :

The relationship between the endorser and endorsee is similar to that between the drawee the drawer. Therefore, the endorsed bill that is dishonoured brings back the parties into their original relationship as one between the acceptor and the drawer. This is done by revising the accounting entries passed at the time of endorsement. The journal entries for the drawer, drawee and the endorsee are as follows:

In the books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Drawee 's Account To Endorsee 's Account (Bills receivable dishonured)			

The following entries are passed with the original amount of the bill plus noting charges paid by the endorsee.

In the Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Payable Account			

	Noting Charges Account To Drawer's Account (Bill dishonoured and noting charges paid)			

In the Books of the Endorsee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Endorser 's Account To Bills Receivable Account To Cash Account (Bills receivable dishonour and charges paid in cash)			

Illu.2 : Pradeep draws a bill upon Prakash for Rs.1,500 payable after 4 months. After securing acceptance, Pradeep gets it discounted with his Bank at 9% p.a. On the due date the bill is dishonoured and noting charges amounted to Rs.10. Pass journal entries in the books of Pradeep.

Solution :

In the books of Pradeep

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
1.	Bills Receivable a/c To Prakash a/c (Being 4 months bill drawn)	Dr.		1,500	 1,500
2.	Bank a/c Discount a/c To Bills Receivable a/c (Being the bill discounted with bank)	Dr. Dr.		1,455 45	 1,500
3.	Prakash a/c To Bank a/c (Being the amount paid to bank on dishonour with noting charges)	Dr.		1,510	 1,510

Illu.3 : On 1st March 2002, 'A' purchased goods from 'B' worth Rs. 20,000 on credit and accepted a bill payable after 3 months. 'B' endorsed the bill in favour of 'C' on 4th March. On 15th March 'A' accepted another bill of Rs. 10,000 drawn by 'B' in support of his credit purchases from 'B'. The bill was payable after one month. The first bill was dishonoured and 'C' paid noting charges of Rs. 100. The second bill was duly met on maturity date. Show A's account in B's books.

Solution :

In the Books of B

Dr. **A's Account** **Cr.**

1-3-2002		1-3-2002	
To Sales	20,000	By Bills Receivable	20,000
15-3-2002		15-3-2002	
To Sales	10,000	By Bills Receivable	10,000
4-6-2002		4-6-2002	
To C	20,100	By balance c/d	20,100
	50,100		**50,100**
5-6-2002 To Balance b/d	20,100		

7.9 RENEWAL OF A BILL

There are times when the acceptor of a bill faces financial difficulties and is not in a position to meet the commitment to repay the bill on the due date. In this case, the acceptor approaches the drawer of the bill with a request to cancel the original bill and draw on him/ her a fresh bill. The acceptor, then, agrees to pay interest for the new period. If the interest is paid in cash, then the new bill is for the original amount otherwise the interest is also included in the new bill. The journal entries for renewal of a bill are as follows:

(a) Entry on the Calculation of the Bill :

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Acceptor 's Account To Bills Receivable Account (Original bill dishonoured)			

Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Bills Payable Account To Drawer's Account (Bills payable dishonoured)			

(b) Entry for Interest for the New Period :

Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Acceptor 's Account To Interest Account (Interest charged for the extended period of the bill brought into account)			

This entry is relevant only when the bill has not been paid in cash.

Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
	Interest Account To Drawer 's Account (Amount of interest due)			

This entry is required when the interest has not been paid in cash.

(c) Entry for the New Bill Including the Amount of Interest

In the Books of the Drawer

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
i)	Bills Receivable Account To Acceptor 's Account (New bill received)			
ii)	Cash Account To Acceptor 's Account (Being interest received in cash)			

In the Books of the Drawee

Date	Particulars	L. F.	Debit Amount Rs.	Credit Amount Rs.
i)	Drawer 's Account To Bills Payable Account (New bill issued)			
ii)	Drawer 's Account To Cash Account (Being interest paid in cash)			

Illu.4 : X purchases goods from Y for Rs.15,000 on 1-1-2004. Y draws a bill on X for Rs.15,000 for 4 months, which is accepted by X. Y discounts the same for Rs.14,900. On maturity X fails to honour the bill and requests Y to draw a new bill

for 3 months for the original amount plus interest at 10% p.a. Y agrees the proposal. Write necessary entries in the books of both the parties.

Solution :

Journal Entries in the books of X (Drawee)

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1-1-04	Purchase a/c To Y a/c (Goods purchased on credit basis)	Dr.		15,000	 15,000
1-1-04	Y a/c To Bills payable a/c (Being acceptance given for 4 months)	Dr.		15,000	 15,000
4-4-04	Bills payable a/c To Y a/c (Being bill dishonoured)	Dr.		15,000	 15,000
4-4-04	Y a/c Interest a/c To Bills payable a/c (Being acceptance given to Y payable after 3 months with interest)	Dr. Dr.		15,000 375	 15,375
7-4-04	Bills Payable a/c To Cash a/c (Being bill paid on the due date)	Dr.		15,375	 15,375

Journal Entries in the books of Y (Drawer)

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1-1-04	X a/c To Sales a/c (Goods sold on credit basis)	Dr.		15,000	 15,000
1-1-04	Bills Receivable a/c To X a/c (Being bill drawn on X)	Dr.		15,000	 15,000
1-1-04	Bank a/c Discount a/c To Bills Receivable a/c (Being bill discounted with bank)	Dr. Dr.		14,900 100	 15,000
4-4-04	X a/c To Bank a/c (Being bill dishonour and Y paid	Dr.		15,000	 15,000

	the bill to bank)				
4-4-04	Bills receivable a/c To X a/c To Interest a/c (Being new bill drawn on X with interest)	Dr.		15,375	 15,000 375
7-4-04	Cash a/c To Bills Receivable a/c (New honour on the due date)	Dr.		15,375	 15,375

Illu.5 : Phani draws a bill on Pani for Rs.12,000 payable after 4 months. After securing Pani's acceptance, Phani gets it discounted with his bank @ 9% p.a. On the due date the bill is dishonoured. Noting charges amounted to Rs.30. Pass journal entries in the books of Phani and Pani.

Solution :

Journal Entries in the books of Phani

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Bills receivable a/c To Pani a/c (being an acceptance received from Pani for 4 months)	Dr.		12,000	 12,000
	Bank a/c Discount a/c To Bills receivable a/c (Being the bill discounted @ 9%)	Dr. Dr.		11,640 360	 12,000
	Pani a/c To Bank a/c (Being bill dishonoured by pani noting charges paid)	Dr.		12,030	 12,030

Journal Entries in the books of Pani

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Phani a/c To Bills payable a/c (Being acceptance given to Phani)	Dr.		12,000	 12,000
	Bills payable a/c Noting charges a/c To Phani a/c (Being bill dishonoured on the due date and noting charges paid)	Dr. Dr.		12,000 30	 12,030

7.10 INSOLVENCY OF THE ACCEPTER

Insolvency refers to an acceptor 's inability to pay. Sometimes, the bill of exchange is dishonoured because of bankruptcy of the drawee or the acceptor. This implies that he /she will not be in a position to meet the liability. Generally, some partial payment is received from the estate of the insolvent person, which is in the form of a number of paisas in the rupee of the amount remaining unpaid. The amount remaining unpaid by the acceptor is debited to the 'bad debts' account is the books of the drawer. In the books of the drawee, it is credited to the deficiency account.

Illu6. : Vikas draws a 3 months bill on Vishal for Rs.4, 000 on 1-4-03. Vishal accepts the bill and sends it to Vikas, who discounted it with the bank for Rs.3, 940. Vikas sends ¼ of the amount i.e. Rs.985 to Vishal. On the due date, vikas could not send his amount to vishal and accepts a bill for Rs.4, 500 for 3 months, which is discounted by Vishal for Rs.4, 440. Vishal sends Rs.330 to Vikas. Before the due date of the second bill, Vikas becomes insolvent and 25paise in a rupee were received from his estate.

Give Journal entries in the books of both the parties.

Solution :

Entries in the Books of Vikas

Date	*Particulars*		*L.F. No*	*Debit Rs,*	*Credit Rs,.*
1-4-03	Bills receivable a/c To Vishal a/c (Being bill acceptance received)	Dr.		4,000	 4,000
1-4-03	Cash a/c Discount a/c To Bills receivable a/c (Being bill discounted)	Dr. Dr.		3,940 60	 4,000
4-7-03	Vishal a/c To Cash a/c To Discount a/c (Being ¼ proceeds send to vishal)	Dr.		1,000	 985 15
4-7-03	Vishal a/c To Bills payable a/c (Being bill acceptance given)	Dr.		4,500	 4,500
4-7-03	- No Entry-				
4-7-03	Cash a/c Discount a/c To Vishal a/c (Being ¾ proceeds received after	Dr. Dr,		330 45	 375

	deducting first bill amount)				
7-10-03	Bills payable a/c To Vishal a/c (Being second bill dishonored)	Dr.		4,500	‘ 4,.500
7-10-03	Vishal a/c To Cash a/c To Deficit a/c (Being first and last dividend 25% paid to Vishal)	Dr.		3,330	832.50 2,497.50
	- No Entry -				

Entries in the Books of Vishal

Date	***Particulars***		***L.F. No***	***Amount Rs.***	***Amount Rs.***
1-4-03	Vikas a/c To Bills payable a/c (Being bill acceptance given)	Dr.		4,000	4,000
	- No Entry -				
1-4-03	Cash a/c Discount a/c To Vikas a/c (Being ¼ proceeds received from Vikas)	Dr. Dr.		3,940 60	4,000
4-7-03	Bills receivable a/c To Vikas a/c (Being bill acceptance received)	Dr.		4,500	4,500
4-7-03	Cash a/c Discount a/c To Bills receivable a/c (Being bill discounted with bank)	Dr. Dr.		4,440 60	4,500
4-7-03	Bills payable a/c To Cash a/c (Being first bill honored)	Dr.		4,000	4,000
4-7-03	Vikas a/c To Cash a/c To Discount a/c (Being ¾ proceeds given to vikas after receiving the first bill amount)	Dr.		375	330 45
7-10-03	Vikas a/c To Bank a/c (Being second bill dishonored)	Dr.		4,500	4,500
7-10-03	Cash a/c Bad debts a/c To Vikas a/c (Being first and last dividend 25% received from vikas)	Dr. Dr.		832.50 2,497.50	3,330

Illu.7 : A sold goods to the value of Rs.2,000 to B, taking a bill at 3 months dated 1-10-2000. On 4th October A discounted the bill at 10% per annum with his

bankers. At maturity the bill was dishonoured and noting charges amounted to Rs.25. B paid Rs.500 and expenses of Rs.25 and gave a another bill at 3 months for Rs.1,500 and interest at 10% per annum. Before maturity B became bankrupt and at maturity, his creditors were paid at 50 paise in the rupee. Make the journal entries in the books of A for recording the above transactions.

Solution :

Journal entries in the books of A

Date	Particulars		L.F.	Debit	Credit
2000				Rs.	Rs.
Oct.1	B's a/c To Sales a/c (Being goods sold to B)	Dr.		2,000	 2,000
Oct.4	Bank a/c Discount a/c To Bills receivable a/c (Being bill discounted in the bank @ 10% p.a. for 3 months)	Dr. Dr.		1,950 50	 2,000
2001 Jan.1	B's a/c To Bank a/c (Being bill dishonoured including noting charges)	Dr.		2,025	 2,025
Jan.4	Cash a/c To B's a/c (Being partial amount and noting charges paid)	Dr.		525	 525
Jan.4	B's a/c To Interest a/c (Being interest on balance @ 10% p.a. for three months)	Dr.		37.50	 37.50
	Bills receivable a/c To B's a/c (Being new bill received for three months including interest)	Dr.		1,537.50	 1,537.50
Ap.7	B's a/c To Bills receivable a/c (Being bill dishonoured due to bankrupt)	Dr.		1,537.50	 1,537.50
	Bank a/c Bad debts a/c To B's a/c (Being 50% realised due to bankrupt)	Dr. Dr.		768.75 768.75	 1,537.50

7.11 ACCOMMODATION BILLS

There are two types of bills. They are : (1) Trade Bills (2) Accommodation Bills.

7.14.1 Trade Bills :

Trade Bills originate from genuine trade transactions. These bills are used for the consideration. The buyer gives acceptance to the bills in lieu of the goods purchased by him. So, in the bills the words ``Value received'' are embodied meaning thereby that the acceptor of the bill had actually received the goods equal to the value of the bill. As such, trade bills are accepted for certain consideration.

7.14.2 Accommodation Bills :

Sometimes, a bill is drawn and accepted without any consideration having passed form the drawer to the acceptor. Such type of bill is drawn just to oblige a friend for lending one's name so as to enable another to type of bill is termed as `Accommodation Bill.' For example, Ram approaches Shyam to borrow Rs.2,000 from him. At present, Shyam does not have sufficient funds to help Ram. However, Shyam agrees to help Ram in another way. This help is rendered by accepting a bill drawn on him by Ram. Ram gets the bill discounted with a bank. On date of maturity Ram returns the money to Shyam who meets the bill. Accommodation bill, therefore, means a bill which is drawn, accepted or endorsed without receiving value in exchange for it, but simply to oblige a party and assist him in obtaining money by negotiating it.

Thus, the accommodation bills are those which are drawn to enable one or both the parties to temporarily raise funds by getting the bills discounted at a bank.

7.11.3 Types of Accommodation Bills :

The accommodation bills are of three types. They are given below.

1. It is drawn for the accommodation of drawer only
2. It is drawn for the accommodation of drawer and drawee both.
3. Both parties draw on each other for their own accommodation.

1. **When it is drawn for the accommodation of drawer only :** When one person needs money and for this purpose he asks his friend money to lend former but wishes to help him, he can allow the persons, in need of funds to draw a bill on him. The friend, thus approached accordingly, gives his acceptance to the bill drawn on

him. The person needing money gets the bill discounted from his bank and uses the money of the bill for the period of the bill. On the date of maturity of the bill, the drawer makes remittance of the amount of the bill ot drawer who makes payment to the bank accordingly.

2. **When it is drawn for the accommodation of both parties i.e., drawer and drawee :** Sometimes, both the parties i.e., the drawer and drawee need money. In such cases, the drew on each other for some amounts. Both et the bills discounted from their banker and on the date of maturity each meets his own bill. Need not add that discounting charges in respect of a bill are brone by the aprty concerned.
3. **When both the drawer and the drawee share of the amount of each other's bill :** A bill is usually drawn by the party, without any consideration, and the other party accepts it. The drawer gets the bill discounted, the money so received is shared by both the drawer and the drawee in proportion agreed upon by them. On due date, the drawer sends his share of money to the drawee who meets the bill. Here, we should also keep in mind that they also share the discounting charges of the bill in the same proportion in which they share the proceeds of bill.

7.11.4 Distinction between Trade Bills and Accommodation Bills

Basis of Distinction	Trade Bills	Accommodation Bills
1. Purpose	This bill is drawn for trade purpose	This bill is drawn for mutual help for a temporary period
2. Consideration	This is drawn for a consideration	This is drawn without consideration
3. Proof of debt	This is a proof of debt	This is not a proof of debt but this is drawn for each others financial help
4. Discounting	If it is discounted with the bank the proceeds remain with the bank.	The proceeds of this bill are shared between the drawer and drawee in an agreed ratio.
5. Recovery	The amount of this bill can be recovered through court	The amount of this bill cannot be recovered through court.

7.11.5 Accounting Treatment :

Record of the accommodation bills in books of account does not present any special problem. Entries area made in the usual manner. The only point to remember is that a party bears the discount in the proportion in which it shares the proceeds. If both parties share the proceeds equally, each will have to bear the discount equally, If one party gets two thirds of the proceeds, it will have to bear two-thirds of the discount.

Illu.8 : Prasad draws a bill for Rs.10,000 on Ransa for mutual accommodation. He discounts the same for Rs.9,900 and remits ½ share to Ranga. Before due date Ranga draws a bill on Prasad for Rs. 20,000 and discount the same for Rs. 19,800. He honours the first bill and remits Rs. 4,900 to Prasad. Before due date of second bill Prasad becomes insolvent and Ranga receives a final dividend of 50 paise in the rupee.. Prepare necessary Ledger accounts in the Books of both the parties.

Solution :

Ledger in the Books of Prasad

Dr **Ranga Account** **Cr.**

To Bank	4,950		By Bills Receivable		10,000
To Discount	50	5,000	By Bank	4,900	
To Bills payable		20,000	By Discount	100	5,000
To Bank	5,000		By Bills payable		20,000
To Realisation a/c	5,000	10,000			
		35,000			**35,000**

Illu.9 : For the mutual accommodation of Ramu and Shyam, Ramu draws a bill on Shyam for Rs.6,000, Shyam accepts the bill and returns it to Ramu who discounts the same with his banker and receives Rs.5,850. The proceeds are shared between Ramu and Shyam in the ratio of 2 : 1. On the due date, Ramu remits his proportion to Shyam who meets the bill. Pass journal entries in the books of Ramu and Shyam.

Solution :

Books of Ramu

Journal

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
i)	Bills Receivable a/c To Shyam a/c (Being bill drawn on Shyam)	Dr.		6,000	 6,000
ii)	Bank a/c Discount a/c To Bills Receivable a/c (Being bill discounted in Bank)	Dr. Dr.		5,850 150	 6,000
iii)	Shyam a/c To Bank a/c To Discount a/c (Being 1/3rd share of proceeds sent to meet the bill)	Dr.		2,000	 1,950 50
iv)	Shyam a/c To Cash a/c (Being cash paid to Shyam to meet the bill)	Dr.		4,000	 4,000

Books of Shyam

Journal

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
i)	Ramu a/c To Bills Payable a/c (Being bill accepted)	Dr.		6,000	 6,000
ii)	Cash a/c Discount a/c To Ramu a/c (Being cash from proceeds of bill received)	Dr. Dr.		1,950 50	 2,000
iii)	Cash a/c To Ramu a/c (Being cash received from Ram to meet the bill)	Dr.		4,000	 4,000
iv)	Bills payable a/c To Cash a/c (Being bill met on maturity)	Dr.		6,000	 6,000

Illu.10 : Sameer the mutual accommodation, draws a bill for Rs.6,000 on Jagdish. Sameer discounts the bill for Rs.5,850 and remits Rs.1,950 to Jagdish. On the due date Sameer is unable to remit his dues to enable Jagadish to meet the bill. Sameer, however, accepts a bill for Rs.7,500 which is discounted by Jagadish for Rs.7,050. Jagadish sends Rs.350 to Sameer. Sameer becomes insolvent and a dividend of 80 paise in the rupee is recovered from his estate. Pass journal entries and show the account of Jagadish in Sameer's books.

Solution :

Journal Entries in the books of Sameer

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
1,	Bills receivable a/c To Jagadish a/c (Being the bill accepted by Jagadish)	Dr.		6,000	 6,000
2.	Bank a/c Discount a/c To Bills receivable a/c (Being the bill discounted)	Dr.		5,850 150	 6,000
3.	Jagadish a/c To Bank a/c To Discount a/c (Being the remittance of 1/3 of the proceeds of the bill the proportionate charges for discount)	Dr.		2,000	 1,950 50
4.	Jagadish a/c To Bills payable a/c (Being the acceptance given to Jagadish)	Dr.		7,500	 7,500
5.	Bank a/c Discount a/c To Jagadish a/c (Being the amount received form Jagadish on discounting the bill and the proportionate charges for discount)	Dr. Dr.		350 278	 628
6.	Bills payable a/c To Jagadish a/c (Being the bill dishonoured due to insolvency)	Dr.		7,500	 7,500
7.	Jagadish a/c To Bank a/c	Dr.		4,628	 3,702

	To Profit & Loss a/c (Being a dividend of 80 paise in the rupee of the amount due paid)				926

The amount of discount credited to Jagadish is calculated as follows :

Rs.4,000 due to Jagadish on first bill

Rs.350 received from Jagadish on the second bill

Rs.4,350 Total amount due to Jagadish

Proportionate charges for discount Rs.450 x 4,350/7,050 = Rs.278

Dr. Jagadish a/c Cr.

Particulars	Rs.,	Particulars	Rs.
To Bank a/c	1,950	By Bills receivable a/c	6,000
To Discount a/c	50	By Bank a/c	350
To Bills payable a/c	7,500	By Discount a/c	278
To Bank a/c	3,702	By Bills payable a/c	7,500
To Profit and Loss a/c	926		
	14,128		14,128

Illu.11 : Yashwant for mutual accommodation of himself and Jayanth draws upon the latter, a bill at 3 months date for Rs.800., The bill is discounted in the bank at 5% and half the proceeds are remitted to Jayanth. Jayanth at the same draws a bill upon Yashwant for Rs.400 payable after 3 months. The Bill is discounted at 6% by Jayanth, who remits half the proceeds to Yashwant. Jayanth becomes bankrupt and 25 paise in the rupee is received in full settlement. Pass journal entries in the books of Yashwanth and Jayanth.

Solution :

In the books of Yashwant			In the books of Jayanth		
	Rs.	Rs.		Rs.	Rs.
Bills receivable a/c Dr. To Jayanth a/c (Being 3 months bill drawn)	800	800	Yashwant a/c Dr. To Bills payable a/c (Being 3 months bill accepted)	800	800
Bank a/c Dr. Discount a/c Dr. To Bills receivable a/c	790 10	800	Bank a/c Dr. Discount a/c Dr. To Yashwant a/c (Being half of the proceeds of the bill received)	395 5	400
Jayanth a/c Dr.	400		Bills receivable a/c Dr.	400	

To Bank a/c To Discount a/c (Being half of the proceeds of the bill remitted)		395 5	To Yashwant a/c (Being 3 months bill drawn)		400
Jayanth a/c Dr. To Bills payable (Being 3 months bill drawn)	400	400	Bank a/c Dr. Discount a/c Dr. To Bills receivable a/c (Being the bill discounted)	394 6	400
Bank a/c Discount a/ To Jayanth a/c (Being half of the proceeds of discounted bill received)	197 3	200	Yashwant a/c Dr. To Bank a/c To Discount a/c (Being half of the proceeds of the bill remitted)	200	197 3
Bills payable a/c Dr. To Bank a/c (Being the bill met on maturity)	400	400	Bills payable a/c Dr. To Yashwant a/c (Being the bill dishonoured)	800	800
Jayanth a/c Dr. To Bank a/c (Being the amount paid to bank on dishonoured)	800	800	Yashwant a/c Dr. To Bank a/c To Deficiency a/c (Being 25 paise in a rupee paid from the estate)	600	150 450
Bank a/c Dr. Bad debts a/c Dr. To Jayanth a/c (Being 25 paise in a rupee received from the estate of Jayanth and the balance transferred to bad debts a/c)	150 450	600			

Illu.12 : Lalitha, for mutual accommodation draws a bill for Rs.3,000 on Amitha. Lalitha discounted the bill for Rs.2,925 and remits 975 to Amitha. On the due date Lalitha is unable to remit her dues to Amitha to enable her to meet the bill. She however, accepts a bill for Rs.3,750 which Amritha discounts for Rs.3,525. Amitha sends Rs.175 to Lalithaa. Lalitha becomes insolvent and a dividend of 80 paise in the rupee is received from her estate.

Pass Journal entries and show the account of Amitha in the books of Lalitha.

Solution :

Journal Entries in the books of Lalitha

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Bills Receivable a/c To Amitha a/c (Being the bill drawn for mutual accommodation)	Dr.		3,000	3,000
	Bank a/c Discount a/c	Dr. Dr.		2,925 75	

	To Bills receivable a/c (Being the bill discounted)				3,000
	Amitha a/c To Bank a/c To Discount a/c (Being 1/3 of the proceeds sent)	Dr.		1,000	 975 25
	Amitha a/c To Bills payable a/c (Being the bill is accepted for mutual accommodation)	Dr.		3,750	 3,750
	Bank a/c Discount a/c To Amitha a/c (Being the cash received and discount is debited for the 2nd bill)	Dr. Dr.		175 75	 250
	Bills payable a/c To Amitha a/c (Being the bill is dishonoured due to insolvency)	Dr.		3,750	 3,750
	Amitha a/c To Bank a/c To Deficiency a/c (Being final dividend 80 paise in a rupee was paid in full settlement)	Dr.		1,500	 1,200 300

Amitha a/c

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Bank a/c	975	By Bills receivable a/c	3,000
To Discount a/d	25	By Bank a/c	175
To Bills payable a/c	3,750	By Discount a/c	75
		By Bank a/c (80%)	1,200
		By Deficiency a/c (20%)	300
	4,750		**4,750**

Journal Entries in the books of Amitha

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Lalitha a/c To Bills payable a/c (Being the acceptance given to Lalitha)	Dr.		3,000	 3,000
	Bank a/c Discount a/c To Lalitha a/c	Dr. Dr.		975 25	 1,000

	(Being cash received from Lalitha)				
	Bills payable a/c To Bank a/c (Being bill paid on the due date)	Dr.		3,000	 3,000
	Bills receivable a/c To Lalitha a/c (Being on acceptance received from Lalitha)	Dr.		3,750	 3,750
	Bank a/c Discount a/c To Bills receivable a/c (Being the bill of lalitha discounted)	Dr. Dr.		3,625 125	 3,750
	Lalitha a/c To bank a/c To Discount a/c (Being share amount of Rahim sent after deducting his share of first bill)	Dr.		250	 175 75
	Lalitha a/c To Bank a/c (Being the bill dishonoured by Lalitha on the due date)	Dr.		3,750	 3,750
	Bank a/c Discount a/c To Lalitha a/c (Being 80 paise a rupee received from lalitha as full and final settlement)	Dr. Dr.		1,200 300	 1,500

Lalitha account

Dr. **Cr.**

	Rs.		**Rs.**
To Bills receivable a/c	3,000	By Bank a/c	975
To Bank a/c	175	By Discount a/c	25
To Discount a/c	75	By Bills receivable a/c	3,750
To Bank a/c	1,200		
To Bad debts a/c	300		
	4,750		**4,750**

	Rs.
Amount due regarding first bill	2,000
Amount sent on second bill	175
Total share of Rahim in second bill	**2,175**

Total discount = Rs.3,750 – Rs.3,625 = Rs.125

Share in discount Rahim = Rs.125 x 2,175 / 3,625 = Rs.75.

Illu.13 : Ram and Shyam for mutual accommodation drew bills on each for Rs.1,000 for 3 months. Each bill was discounted at 6%. On the due date, Shyam paid his acceptance. Ram could not pay his acceptance on the due date. Ram paid Rs.400 to Shyam on the due date and accepted another bill for Rs.610 for two months including interest. This bill was ment on the due date. Pass necessary journal entries in the books of Ram.

Solution :

Journal entries in the books of Ram

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Bills receivable a/c To Shyam a/c (Being acceptance received from Shyam for three months)	Dr.		1,000	 1,000
	Shyam a/c To Bills payable a/c (Being an acceptance given to Shyam for three months)	Dr.		1,000	 1,000
	Bank a/c Discount a/c To Bills receivable a/c (Being Shyam';s acceptance discounted with bank at 6%)	Dr. Dr.		985 15	 1,000
	Bills payable a/c To Shyam a/c (Being our acceptance dishonoured on the due date)	Dr.		1,000	 1,000
	Shyam a/c To Cash a/c (Being cash paid to Shyam)	Dr.		400	 400
	Shyam a/c Interest a/c To Bills payable a/c (Being an acceptance given to Shyam for the due amount with interest for 2 months)	Dr. Dr.		600 10	 610
	Bills payable a/c To Bank a/c (Being our acceptances duly met on the due date)	Dr.		610	 610

7.12 QUESTIONS

A. Short Answer Questions

1. What is Bills of Exchange?
2. What is a Promissory Note?
3. What are days of grace?
4. What is discounting of a bill?
5. What is dishonour of a Bill?
6. What are noting charges?
7. What is endorsement?
8. What is meant by retiring bill under rebate?
9. What is renewal of a bill?
10. What are accommodation bills?

B. Eassay Question

1. What is a bill of exchange? What are its advantages?
2. Distinguish between the following.
   (a) Bill of Exchange and Promissory Note
   (b) Trade Bill and Accommodation Bill

3. What entries are made in the books of the parties when the acceptor of a bill becomes insolvent?
4. What is an Accommodation Bill? How does it differ from the Trade Bill?
5. Give Journal Entries.
   (a) When a Bill is drawn and accepted
   (b) When a Bill is endorsed
   (c) When a Bill is encashed
   (d) When a Bill is discounted
   (e) When a Bill is dishonoured

7.13 EXERCISES

1. On January 1st, 2005 Ram Prasad sold goods for Rs.200 to Krishna Prasad and drawn the bill with three months. Krishna Prasad accepted the bill. The bill was honoured on the due date. Pass Journal entries in the books of Ram Prasad and Krishna Prasad.

2. Venkat draws a bill for Rs.5,000 on Vivek on 1st January, 2005 for four months. On maturity Vivek failed to honour the bill. Pass the necessary entries in the books of Venkat, if he had retained the bill till maturity.

3. Mohan sold goods to Sundar for Rs.300 on January 1st, 2001 and drawn the bill for four months. Mohan discounted the bill in the Bank at 6% on March 1st since he requires money. The bill was honoured on the due date. Pass journal entries in the books of Mohan and Sundar.

4. On 1st January, 2005 Ravi sold goods to Suri for Rs.1,500 and drawn the bill for two months. The bill was accepted. Ravi purchased goods for Rs.1,500 from Chandra and endorsed the bill to Chandra towards the debt due to him. The bill was dishonoured on the due date. Write Journal Entries in the books of Ravi, Suri and Chandra. Assume that the drawer paid the bill on behalf of the acceptor.

5. On 1-1-2005 Murthy sold goods to Raju for Rs.1,000 on credit. He has drawn the bill for 3 months and Raju accepted the bill. On 1-3-2005 Raju could not pay the amount on the bill and requested for renewal.

   How do you write Journal entries in the books of Murthy and Raju in the following circumstances of Renewal of the bill.

   a. Raju paid Rs.500 and requested for renewing the bill for 2 months along with the interest at 6%.
   b. Raju could not pay any amount and asked renewal of the bill for two months along with the interest 6%.
   c. Raju accepted to pay Rs.90 towards interest and requested to draw the bill with 2 months on principal amount.
   d. Accepted to pay Rs.590 immediately (Rs.90 towards interest) and for the remaining balance the bill is to be drawn with 2 months.

e. Agreed to pay Rs.250 in cash immediately and agreed to endorse a bill receivable for Rs.250 and accept a bill for remaining amount at 6% interest with 2 months due date.

6. Ram draws a bill on Rahim for Rs.2,000 payable after two months on 1-9-2004 and got the latters acceptance. The bill is discounted with the bank at 6%. On the due date the bill is dishonured. Noting charges Rs.10. Rahim accepted a new bill for Rs.2,025 payable after one month. Rahim became bankrupt on the due date. Prepare journal entries in the books of Ram.

7. Latika for the mutual accommodation draws a bill for Rs.3,000 on Sumitha. Latika discounted the bill for Rs.2,925 and remits Rs.975 to Sumitha. On the due date, Latika is unable to remit her dues to Sumitha to meet the bill. She however, accepts a bill for Rs.3,750 which Sumitha discounts for Rs.3,525. Sumitha sends Rs.175 to Latika. Latika becomes insolvent and a dividend of 80 paise in the rupee is received from her estate. Pass Journal Entries and show the account of Sumitha in the books of Latika.

8. X, for mutual accommodation of himself and Y, drawn upon the latter a bill of exchange for three months on 1st January, 2006 for Rs.1,800 Y accepts the bill and sends it to X. X discounts the bill at the rate of 6% p.a. and hands over half the proceeds to Y. Y draws a bill on the same date for three months for Rs.900 on X. X accepts the bill. Y discounts the bill at 6%p.a., and hand over half the proceeds to X. Y becomes insolvent on 31st March, 2006 and fails to meet his acceptance on maturity. On 30th June, 2006, a first and final dividend of 25 Paise per rupee paid in settlement.

   Write the Journal entries in X's books and draw up Y's account in X's books.

7.14 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005

6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advaned Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 9

RECTIFICATION OF ERRORS

Objectives :

After studying this unit, we should be able to

- Understand the need for rectification of errors in accounts
- Classify the errors
- Find out location of errors which do not effect the agreement of the trial balance and errors which effect the agreement of trail balance.
- Understand the meaning and need for opening a suspense account.

Structure :

9.1 INTRODUCTION

Trial Balance is prepared to check the arithmetical accuracy or correctness of recording in journal, posting to ledger and balancing of ledger accounts. In case trial balance agrees, it is assumed that recording, posting and balancing has been done correctly or accurately. However, if it does not tally, efforts are made to locate errors in accounting records. Moreover, trial balance is not conclusive proof of accuracy of records. Even when the trial balance agrees, some errors may remain in accounting records. For example, non-recording of credit sale transaction in Sales Book will not affect the agreement of trial balance because both (i.e., debit as well as credit) aspects of the sale transaction are not recorded in this case. Errors, whether affecting trial balance or not affecting trial balance, are to be corrected. Procedure followed to remedy the errors committed and set right accounting records is called rectification of errors.

9.2 CLASSIFICATION OF ERRORS :

Keeping in view the nature of errors, all the errors can be classified into the following four categories.

1. Error of Omission
2. Error of Commission
3. Error of Principle
4. Compensating Errors

9.2.1 Error of Omission :

This error arises wen a transaction is completely or partially omitted to be recorded in the books of accounts. Error of Omission may be classified as under.

(a) Error of Complete Omission : This Error arises when any transaction is not recorded in the books of original entry at all. This error does not affect the trial balance. For example, (1) Goods purchased on credit from Ram not recorded in the purchases book. (2) Goods sold on credit to Shyam not recorded in the Sales Book

(b) Errors of Partial Omission : An error of omission other than an error of complete omission is called an error of partial omission. This error affects the trial balance. The examples of errors of partial omission include the following. (1) Transaction correctly recorded in the books of original entry (other than Journal Proper) but not posed in the ledger at all. (2) Omission in carrying forward the total from one page to the other. (3) Omission to balance an account.

9.2.2 . Error of Commission :

This error arises due to wrong recording, wrong casting, wrong carrying forward wrong posting etc. Error of commission may be classified as follows.

1. **Errors of Recording :** This error arises when any transaction is incorrectly recorded in the books of original entry. This error does not affect the trial balance. For example : (1) Goods of Rs.500 purchased on credit from Ram are recorded in the purchases book for Rs.5,500. (2) Goods of Rs.5,000 purchased on credit from Ram are recorded in the Sales Book.
2. **Error of Casting :** This error arises when a mistake is committed in totaling. This error affects the trial balance. For example : (1) Purchases book is totalled as Rs.1,000 instead of Rs.100. (2) Sales book is totalled as Rs.500 instead of Rs.5,000.
3. **Error in carrying forward :** This error arises when a mistake is committed in carrying forward a total of one page on the next page. This error effects the trial balance. For example, (1) Total of purchases book is carried forward as Rs.1,000 instead of Rs.100 (2) Total of Sales book is carried forward as Rs.100 instead of Rs.1,000.
4. **Errors of Posting :** This error arises when information recorded in the books of original entry are incorrectly entered in the ledger. This error may or may not affect the trial balance.

9.2.3. Errors of Principle :

This error arises when the transaction is recorded ignoring the distinction between the capital item and revenue item. In other words, the error involves an incorrect the allocation of expenditure or receipt between Capital and Revenue. The correct allocation between capital and revenue is of paramount importance because any incorrect allocation would disturb the final results as disclosed by the Financial Statements. The error does not effect the Trial balance.

9.2.4. Compensating Errors :

These errors arise when two or more errors are committed in such a way that net effect of these errors on the debits and credits of accounts involved is nulifiled. These errors do not affect the agreement of the trial balance but may or may not affects the figure of net profit.

9.3 LOCATION OF ERRORS

Location of errors of principle, errors of compensating nature and errors of omission is slightly difficult because of the fact that such errors do not affect the agreement of the Trial balance and, therefore, their location may be considerably delayed. However, location of errors of commission is comparatively easier because they affect the agreement of the Trial Balance. Thus, the errors can be classified into two categories from point of view of locating them.

1. Errors which do not affect the agreement of the trial balance. These are also called two side errors.
2. Errors which affect the agreement of the trial balance. These are also called one sided errors.

9.3.1 Errors which do not effect the agreement of the Trial Balance :

Although, the totals of the Trial balance are equal, some mistakes may remain undetected. The agreement of a Trial balance is not affected in spite of the following errors.

1. **Complete Omission of a Transaction :** If any particular transaction is not recorded at all, it would not affect the agreement of a trial balance. For example Rs.200 are paid to P. If this transaction is not entered in the Cash Book, it will not be posted to P's Account in the ledger and therefore, there will be no difference in the Trial balance. Such types of errors are not disclosed by a Trial Balance.
2. **Recording of wrong amounts on both sides :** If wrong amounts of the transaction are entered on both the sides of ledger accounts, it would not be disclosed by the Trial balance. For example, goods worth Rs.570 are purchased from Ajay Trading Company, but in the purchase book as well as in the Ledger Accounts of Ajay Trading Company, the amount was written as Rs.750 instead of Rs.570. In this case the trial balance will tally.
3. **Posting to wrong heads of accounts :** If Posting from the journal to the ledger is made to the wrong account, this error will not be disclosed by the Trial balance. Such errors make no difference so far as the agreement of the Trial balance is concerned. For example, furniture is purchased for Rs.1,200. By mistake if it is posted to the debit side of the Machinery Account, instead of Furniture account, the trial balance will not be affected because of one account (i.e., the Machinery Account) is debited and another account (i.e., the Cash account) is credited by the same amount. Therefore, the total of the credit side will agree with the total of the debit side.

4. **Compensating Errors :** When one mistake nulifies the wrong effect of another, it is called a compensating error,. They are two or more in number and they balance each other. The trial balance fails to disclose them. These errors are generally arithmetical errors. For example, the debit side of the Siva's account is overcast by Rs.100 at the same time, the credit side of Rahim's account is also overcast by Rs.100. Similarly, if the debit side of the Postage Account is under cast by Rs.25 and the credit side of the interest account is also under cast by Rs.25 both the errors will compensate each other and there will be no effect on the agreement of the Trial balance.
5. **A wrong entry in the Original record :** Such an error occurs when a transaction has been wrongly entered in a subsidiary book. For example credit sale of Rs.145 to Ramesh and Co. has been entered in the Sales Book as Rs.154 will be posted to the Sales Account as well as to Ramesh and Co. Account will not affect the Trial balance.

11.3.2. Errors which effect the agreement of the Trial Balance :

The agreement of the Trial balance may be affected by one or more of the following types of mistakes.

1. **Partial Omission of a Transaction :** If the transaction is recorded in the journal but by mistake is not posted in the ledger, the Trial balance will not agree. For example, cash is received from Sohan Rs.200. This is entered properly in the Cash Book, but it is not posted to the credit side of Sohan's account in the ledger. As a result the credit column of the Trial balance will fall short by Rs.200.
2. **Posting of the wrong amount :** If the posting is made of a wrong amount from journal to ledger, the trial balance will disagree. For example, goods are purchased from X worth Rs.180. This transaction was entered correctly in the purchases book, but while posting the amount written on the credit side of X's account was Rs.118 instead of Rs.180. The total of the credit column of a trial balance will be less than the total of the debit column on the Trial balance by Rs.62.
3. **Posting on the wrong side of an account :** When the transaction is posted to the wrong side of an account in the ledger, it causes disagreement in the Trial Balance. Suppose, cash of Rs.150 is received as interest. This was entered in the cash book correctly but it was debited to the interest account instead of crediting that account. The result will be that the credit column of the Trial balance will be added short by Rs.300.

4. **Wrong totalling or balancing :** If any account in the ledger is wrongly totalled up or wrongly balanced, the Trial balance will not tally. Suppose, the total of the debit side of Mohan's account is Rs.1,500 and that of the credit side is Rs.1,700. Mohan's account should show a credit balance of Rs.200. But fi it is wrongly written as Rs.300 in the credit column of the Trial balance, the credit side will be heavier by Rs.100.

9.4. SUSPENSE ACCOUNT

A suspense account is an account in which the amount of difference in the trail balance is put till such time that errors are located and rectified The difference in the trial balance is transferred on the credit side of the Suspense Account (if the debit side of the trial balance exceeds the credit side) or on the debit side of the suspense account (if the credit side of the trial balance exceeds the debit side)

9.4.1 Effect on Profit :

Errors committed in a year may affect the profit of that year. This happens when the error relates to such accounts which are taken into account while computing gross or net profit of the business. In other words, if the errors relate to such accounts which find their place in the Trading account or the profit and loss account, the error will effect the profit of the business. For example errors involving Purchases Account, Sales Account, Expense Account, Income Account will all affect the profit of the business. In case on account of errors such accounts are either not debited or unnecessarily credited, this will result in increase in profit of the business.

Illu.1 :The following errors were detected in the books of Rama and Co. pass necessary entries to rectify them:

a. **Sale of old furniture Rs. 150 treated as sale of goods.**
b. **Rs. 500 received from Mohan was credited to Sohan.**
c. **Goods purchased from Mohan remained unrecorded Rs. 1,000.**
d. **A return of Rs.100 from Mukesh was debited to his account.**
e. **A return of Rs. 90 to Shyam posted as Rs. 9 to his account.**
f. **Rent of proprietor's residence Rs. 600 was debited to rent account.**
g. **A payment of Rs. 215 to Gopal was posted to his credit as Rs. 125.**
h. **Total of bills receivable Rs. 1,500 left unposted.**

SOLUTION :

Rectification Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Sales a/c To Furniture a/c (Being the error of principle rectified)	Dr.		150	150
(b)	Sohan a/c To Mohan a/c (Being the wrong credit to Sohan rectified)	Dr.		500	500
(C)	Purchases a/c To Mohan a/c (Being the unrecorded purchase, rectified)	Dr.		1000	1000
(d)	Suspense a/c To Mukesh a/c (Being the wrong credit to Mukesh rectified)	Dr.		200	200
(e)	Shayam a/c To Suspense a/c (Being the wrong amount debited is rectified)	Dr.		81	81
(f)	Drawings a/c To Rent a/c (Being rent paid for residence is debited to drawings a/c)	Dr.		600	600
(g)	Gopal a/c To Suspense a/c (Being the posting wrong amount on wrong side is rectified)	Dr.		340	340
(h)	Bills Receivable a/c To Suspense a/c (Being the omission Posting, now rectified)	Dr.		1,500	1,500

Illu.2 : Rectify the following errors and prepare suspense account:

a) **Goods purchased from Mani for Rs.300 passed through sales book.**

b) **Received a bill from Arun for Rs.500 passed through bills payable book.**

c) **An item of Rs.150 relating to prepaid rent has omitted to be brought forward.**

d) **Rs.500 paid to Hari were debited to Giri account.**

e) **Sales day book was overcast by Rs.200.**

f) Goods sold to Krishna for Rs.430 has been credited as Rs.340.

g) Salaries paid Rs.890 posted to salaries account as Rs.980.

Solution :

Rectification of Errors

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
a)	Purchases a/c Sales a/c To Mani a/c (Being wrong entry in sales book instead of purchases book is rectified)	Dr. Dr.		300 300	 600
b)	Bills Receivable a/c Bills Payable a/c To Arun a/c (Being wrong entry in Bills payable book instead of Bills receivable book is rectified)	Dr. Dr.		500 500	 1,000
c)	Prepaid rent a/c To Suspense a/c (Being prepaid rent omitted to be brought forward is rectified)	Dr.		150	 150
d)	Hari a/c To Giri a/c (Being wrong debit given to Giri A/c is rectified)	Dr.		500	 500
e)	Sales a/c To Suspense a/c (Being over cash in sales a/c is rectified)	Dr.		200	 200
f)	Krishna a/c To Suspense a/c (430 + 340) (Being wrong credit given to Krishna is rectified)	Dr.		770	 770
g)	Suspense a/c To Salaries a/c (being over debit given to Salaries a/c is rectified)	Dr.		90	 90

Suspense A/c

Dr.			Cr.
	Rs.		**Rs.**
To Balance b/d (B/ F)	1,030	By Prepaid rent a/c	150
To Salary a/c	90	By Sales a/c	200
		By Krishna a/c	770
	1,120		**1,120**

Illu.3 : From the following particulars Rectify the errors and show the suspense account:

a) Rs.220 the total of the sales returns book has been posted to the credit of the purchase returns account.

b) Goods of the value of Rs.2,100 purchased from Ramu were recorded through sales book.

c) Rs.1,000 being purchases returns were posted to the debt of purchases account.

d) Rs.2,740 paid for repairs to Motor car was debited to Motor car account as Rs.1,740.

e) A sale of Rs.347 to kishore was entered in the sales book as Rs.437, and Kishore account was debited Rs.743.

f) Rs.5,400 received from Rajesh was posted to the debit of his account.

Solution :

Rectification of Errors

Date	**Particulars**		**L.F.**	**Debit Rs.**	**Credit Rs.**
a)	Purchase Return a/c Sales Return a/c To suspense a/c (For transferring the amount to sales returns a/c)	Dr. Dr.		220 220	 440
b)	Purchase a/c Sales a/c To Ramu a/c (For sales a/c cancelled and purchase a/c increase)	Dr. Dr.		2,100 2,100	 4,200
c)	Suspense a/c To Purchase a/c To Purchase Returns a/c (Being correction of overcast of purchase)	Dr.		2,000	 1,000 1,000
d)	Repairs a/c	Dr.		2,740	

	To Motor Car a/c To Suspense a/c (For cancel the motor car and transfer the expenses to repair a/c)				1,740 1,000
e)	Sales a/c Suspense a/c To Kishore a/c (Being correct the mistake in sales book and kishore book)	Dr. Dr.		90 396	 486
f)	Suspense a/c To Rajesh a/c (Being correct the mistake in Rajesh book)	Dr.		10,800	 10,800

Suspense a/c

Dr. **Cr.**

	Rs.		**Rs.**
To Purchase a/c	1,000	By Purchase returns a/c	220
To Purchase returns a/c	1,000	By Sales returns a/c	220
To Kishore a/c	396	By Repairs a/c	1,000
To Rajesh a/c	10,800	By Difference in Trial Balance (B / F)	11,756
	13,196		**13,196**

Illu.4 :Rectify the following errors by using Suspense account:

i. Goods sold to Rama Rs.1, 000 were not posted to his account.

ii. Purchase book was overcast by Rs.400.

iii. Sales book was under cast by Rs.53.

iv. Purchase returns book was under cast by Rs.16.

v. Cash received from Govind Rs.111 was posted to his account as Rs.1, 111.

vi. Cash paid to Raghu Rs.770 was posted to his account as RS.170.

vii. Payment of Rs.140 rent debited to landlord account.

viii. Payment of Rs.1, 000 to A posted to his credit as Rs.100.

ix. A credit sale of Rs.500 was entered in the returns outward book.

x. A cash purchase of Rs.105 was not posted in the ledger.

xi. Rs.150 paid to Dinesh posted to Dhir.

xii. A credit purchase of Rs.300 from Y posted as Rs.30 in the ledger.

Solution :

Rectification Entries

Sl. No.	*Particulars*		*L.F. No*	*Debit Rs.*	*Credit Rs.*
i)	Rama a/c To Suspense a/c (Being goods sold to Rama not entered in his account is now rectified)	Dr.		1,000	1,000
ii)	Suspense a/c To Purchases a/c (Being purchases book over – cast is now rectified)	Dr.		400	400
iii)	Suspense a/c To Sales a/c (Being sales book under cast is now rectified)	Dr.		53	53
iv)	Suspense a/c To Purchase returns a/c (Being purchase returns book under cast is now rectified)	Dr.		16	16
v)	Govind a/c To Suspense a/c (Being wrong amount credited in Govind a/c is now rectified)	Dr.		1,000	1,000
vi)	Raghu a/c To Suspense a/c (Being Raghu a/c shortly debited is now rectified)	Dr.		600	600
vii)	Rent a/c To Land lord a/c (Being rent paid wrongly debited to landlord a/c is now rectified)	Dr.		140	140
Viii)	A a/c To Suspense a/c (Being payment to A wrongly credited to his a/c is now rectified)	Dr.		1,100	1,100
ix)	Returns outwards a/c To Sales a/c (Being credit sale wrongly entered in returns book is now rectified)	Dr.		500	500
x)	Purchases a/c To Suspense a/c (Being cash purchases not recorded in ledger is now rectified)	Dr.		105	105
xi)	Dinesh a/c To Dhir a/c	Dr.		150	150

	(Being amount paid to Dinesh posted to Dhir a/c is now rectified)				
xii)	Suspense a/c To Y a/c (Being credit purchase from Y Rs.300 posted in ledger (Y a/c) as Rs.30 is now rectified)	Dr.		270	 270

Illu.5 : Rectify the following errors:

i) Cash book payments side overcast by Rs.120.

ii) Rs.3,500 withdrawn by proprietor for personal use debited to General expenses account.

iii) Rs.4,000 received from Shyam is debited to his account.

Solution :

Journal Entries

Date	Particulars		L.F	Debit	Credit
				Rs.	Rs.
1	Cash a/c To Suspense a/c (Being the entry to rectify the excess credit in cash a/c)	Dr.		120	 120
2.	Drawings a/c To General expenses a/c (Being the entry to rectify the wrong debit given to general expenses a/c)	Dr.		3,500	 3,500
3.	Suspense a/c To Syam a/c (Being the entry to rectify the wrong debit instead of credit)	Dr.		8,000	 8,000

Illu.6 : Rectify the following errors discovered before preparation of Trial Balance.

(a) Rs.750 discount allowed by Creditor has been debited to discount account

(b) The total sales of book has been over casted by Rs.1,000

(c) Rs.1,000 spent for repairs of Building has been posted to Buildings Account.

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
1.	Suspense a/c To Discount a/c (Being the entry to rectify the wrong debit instead of credit)	Dr.		1,500	1,500
2.	Sales a/c To Suspense a/c (Being the entry to rectify the excess credit)	Dr.		1,000	1,000
3.	Repairs a/c To Buildings a/c (Being the entry to rectify wrong debit given to buildings a/c)	Dr.		1,000	1,000

Illu.7 : Following errors were detected after preparation of Trial Balance and taken the difference to a Suspense Account. Give the journal entries to rectify them.

(i) A sum of Rs.350 received from Arun, a debtor was debited to his account,

(ii) Goods purchased for personal use of proprietor were debited to purchases account Rs.1,000

(iii) Discount allowed Rs.75 was credited to discount receivable.

(iv) A Credit sale of Rs.450 to Chitra was debited to Mitra.

(v) A purchase of goods for Rs.750 from Aravind was debited to his account.

(vi) An Office Almirah purchased for Rs.750 was debited to repairs account.

(vii) Sales book overcast by Rs.100

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
(i)	Suspense a/c To Arun a/c (Being the entry to rectify wrong debit instead of Credit)	Dr.		700	700
(ii)	Drawings a/c To Purchases a/c (Being the entry to rectify wrong debit	Dr.		1,000	1,000

	given to purchases a/c)				
(iii)	Discount a/c To Suspense a/c (Being the entry to rectify wrong credit instead of debit)	Dr.		150	150
(iv)	Chitra a/c To Mitra a/c (Being the credit sale to Chitra wrongly debited to Mitra a/c)	Dr.		450	450
(v)	Suspense a/c To Aravind a/c (Being the entry to rectify wrong debit instead of credit)	Dr.		1,500	1,500
(vi)	Office equipment a/c To Repairs a/c (Being the entry to rectify wrong debit given to repairs a/c)	Dr.		750	750
(vii)	Sales a/c To Suspense a/c (Being the entry to rectify excess credit in sales a/c)	Dr.		100	100

Illu.8 : Rectify the following errors, prepare Suspense account and find out opening balance of Suspense account::

a. **A cheque for Rs. 220 received from a tenant for rent has been entered in cash book, but not posted to rent account.**
b. **The total purchase returns books is under cast by Rs. 500.**
c. **The Bills receivable books is overcast by Rs. 1,500.**
d. **Rs. 95 received for commission is not posted to commission account.**
e. **Cash Rs. 350 paid to Krishna has been posted to Hari account.**
f. **The account of Rama Rao, a debtor for Rs. 160 had been written off as bad, had been posted to only Rama Rao account.**

Solution :

Journal

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Suspense a/c To Rent a/c (Being non-posting to Rent a/c, now	Dr.		220	220

	rectified)				
(b)	Suspense a/c To Purchase Returns a/c (Being under cast of purchase returns book, now rectified)	Dr.		500	 500
(c)	Suspense a/c To Bills Receivable a/c (Being overcast of Bills receivable book now rectified)	Dr.		1,500	 1,500
(d)	Suspense a/c To Commission a/c (Being non-posting of commission received, now rectified)	Dr.		95	 95
(e)	Suspense a/c To Hari a/c (Being wrong posting to Hari a/c instead of krishna a/c, now rectified)	Dr.		350	 350
(f)	Bad debts a/c To Suspense a/c (Being omission of posting, now rectified)	Dr.		160	 160

Dr. Suspense Account Cr.

To Rent a/c	220	By Balance b/d (Bal. fig)	2,155
To Purchase Returns a/c	500	By Bad debts a/c	160
To Bills Receivable a/c	1,500		
To Commission a/c	95		
	2,315		**2,315**

Illu.9 :The following were identified during 2004:

(a) Sales day book was overcast by Rs.200.

(b) A sale of Rs.100 to X was wrongly debited to Y account.

(c) General expenses Rs.36 was posted in the account as Rs.160.

(d) A bill receivable for Rs.310 was written in bills payable book. The bill was given by p.

(e) Legal expenses Rs.238 paid to James was debited to his Personal Account.

(f) Cash received from C. Das was debited to G. Das Rs.300.

(g) While carrying forward the total of one page of purchase book to the next, the amount of Rs.2,470 was written as Rs.2,650.

Pass necessary entries for the rectification of above errors and show suspense account.

Solution :

Journal Proper

Date	Particulars		L.F.	Debit	Credit
				Rs.	Rs.
	Sales a/c To Suspense a/c (Being the overcasting of sales book, now rectified)	Dr.		200	 200
	X a/c To Y a/c (Being the wrong debit given to Y now rectified)	Dr.		100	 100
	Suspense a/c To General expenses a/c (being the posting of excess amount now rectified)	Dr.		124	 124
	Bills receivable a/c Bills payable a/c To P's a/c (Being the posting of wrong account, now rectified)	Dr. Dr.		310 310	 620
	Legal expenses a/c To James a/c (Being the wrong debit given, now rectified)	Dr.		238	 238
	Suspense a/c To C. Das a/c To G. Das a/c (Being the wrong posting of G. Das a/c now rectified)	Dr.		600	 300 300
	Suspense a/c To purchases a/c (Being the wrong amount carry forward to next page, now rectified)	Dr.		180	 180

Suspense a/c

Dr. **Cr.**

	Rs.		Rs.
To General expenses a/c	124	By Sales a/c	200
To C. Das a/c	300		
To G. Das a/c	300		
To Purchases a/c	180	By Balance c/d	704
	904		**904**

Illu.10 Rectify the following errors and find out the effect of the errors on net profit.

(a) Purchases of Rs.6,000 from Raman passed through Sales Book.

(b) Bills received from Ramu for Rs.10,000 passed through bills payable book.

(c) An item of Rs.3,000 relating to prepaid rent was omitted to be brought forward from last year.

(d) Rs.10,000 paid to Menan B, against our acceptance was debited Menan N.

(e) Received Rs.4,000 from Ajit (whose account for Rs.6,000 was written off earlier) and posted to the credit of Amrit.

(f) Sales to Murthy for Rs.14,000 passed through Sales book twice.

Solution :

Journal Entries

Date	Particulars		L.F.	Debit	Credit
				Rs.	**Rs.**
(a)	Profit & Loss a/c 1 To Raman a/c (Being the	Dr.		12,000	 12,000
(b)	Bills receivable a/c Bills payable a/c To Ramu a/c (Being ..	Dr. Dr.		10,000 10,000	 20,000
(c)	Prepaid Rent a/c To Profit & Loss a/c (Being	Dr.		3,000	 3,000
(d)	Menan, B. a/c To Menan, N a/c (Being	Dr.		10,000	 10,000
(e)	Amrit a/c To Profit & Loss a/c (Being	Dr.		4,000	 4,000
(f)	Profit & Loss a/c To Murthy a/c (Being rectification	Dr.		14,000	 14,000

Dr. Profit & Loss account Cr.

Particulars	Rs.	Particulars	Rs.
To Raman a/c	12,000	By Prepaid rent a/c	3,000
To Murthy a/c	14,000	By Amrit a/c	4,000
		By Profit & Loss a/c (Loss)	19,000
	26,000		**26,000**

9.5 QUESTIONS

1. How do you classify errors?
2. What is error of commission?
3. What is error of omission?
4. What is error of principle?
5. What are compensating errors?
6. Explain various types of errors of omission and commission.
7. Give two examples for errors of principle.
8. What is suspense account?
9. What are the effects of errors on the profit of an organisation?

9.6 EXERCISES

1. Rectify the following errors
   a. Purchase book is overcast by Rs.700
   b. Sales book has been undercast by Rs.300
   c. Purchase returns book has been overcast by Rs.400
   d. Sales returns book has been undercast by Rs.200

2. Rectify the following errors without opening a suspense account.
   a. A sale to Baba for Rs.261 has been entered in Sales Book as Rs.216.
   b. The total of the Discount column on the debit side of the Cash book is short added by Rs.50
   c. A typewriter purchased for Rs.3,000 has been entered in the purchase book
   d. An old machine sold for Rs.800 was entered in the sales book
   e. Goods worth Rs.1,500 sold to Ramlal has been entered in the purchase book'

3. Show how you will rectify the following errors.
   a. A Credit sale of Rs.450 to Banker was debited to Bundel
   b. A purchase of goods for Rs.750 from Sen was debited to his account.
   c. An office Almirah purchased for Rs.750 was debited to Repairs Account.
   d. A sum of Rs.350 received from a debtor was debited to his account.

e. Purchases of goods for the consumption of the proprietor were debited to Purchases account Rs.1,000
f. Discount allowed Rs.75 was credited to Discount receivable account.

4. The Trial balance of Mr. Chandra did not agree and the difference was temporarily put to Suspense account. Later on the following errors were located. Pass the entries to rectify them.
   1. The total of debit side of an Expense Account has been cast in excess by Rs.50
   2. The sales account has been totalled short by Rs.100
   3. One item of purchase of Rs.25 has been posted from the Day Book to ledger as Rs.250
   4. The Sale return of Rs.100 from a party has not been posted to that account, though the party's account has been credited.
   5. A cheque of Rs.500 issued to the Suppliers account (shown under Sundry Creditors) towards his dues has been wrongly debited to the Purchase book.
   6. A credit sale of Rs.50 has been credited to the Sales and also credited to Sundry Debtors account.
5. A book keeper having failed to agree the Trial balance, opened a Suspense account and transferred the difference Rs.1,709 to the credit of Suspense Account. The following errors were later discovered. Give journal entries and show the suspense account.
   1. Sales book was undercast by Rs.2,000
   2. Purchase of Machinery for Rs.3,000 was passed through the Purchases book
   3. Goods sold to Raj for Rs.45 was posted to his account as Rs.54
   4. Purchase returns book was overcast by Rs.200
   5. The Total of the sales book page 10 was carried forward as Rs.1,222 instead of Rs.1,122.

   [Suspense Account total Rs.2,009]
   6. The following errors were discovered in the books of a Slack on 31st December, 2006. The difference in the Trial balance had been entered in a Suspense account and on correction of the errors the Suspense Account was eliminated.
      1. The total of the purchase Day book had been under cast by Rs.100
      2. The discount column on the debit side of the cash book had been posted to the credit of Discount received account Rs.20

3. Rs.76 for repairs to Motor Van had been taken to the Motor Van a/c
4. A cheque received from Quick Rs.39 had been debited in the Cash Book, but the double entry had not been completed.
5. The returns outward book had been overcast by Rs.50

[Ans.: Suspense Account Total Rs.190; Net Profit Rs.4,320]

9.7 SUGGESTED BOOKS

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6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 8

METHODS OF DEPRECIATION

Objectives:

After studying this lesson you should be able to

1. Define depreciation and understand the related concepts
2. Understand the causes of depreciation and basic features of depreciation
3. The objectives of providing depreciation
4. Understand different methods of depreciation

Structure:

8.1 INTRODUCTION :

Depreciation is an important item in financial accounting that appears on debit side of profit and loss account and on assets side (after deducting from respective assets) of the balance sheet. There are specific objectives and causes for providing depreciation. We cannot imagine financial statements without depreciation. However, there are different methods of charging depreciation. In this lesson, we discuss these methods of depreciation along with their accounting treatment.

8.2 DEPRECIATION – DEFINITION AND MEANING :

The following are the important definitions of depreciation.

"Depreciation is the permanent and continuing diminution in the quality, quantity or value of an asset." **- PICKLES**

"Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period." **- SPICER AND PLEGLER**

"Depreciation is that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally put out of use by him. Provision against this loss of capital is an integral cost of conducting business during the effective commercial life of the asset and is not dependent upon the amount of profit earned."

The Institute of Chartered Accountants of England and Wales

From the above definitions, it can be said that depreciation is a part of the cost of fixed asset, which has expired due to its usage or lapse of time or both. In other words, depreciation is a reduction in the book value of fixed assets. However, it does not apply to land as its value generally increases y passage of time.

8.3 DEPRECIATION AND OTHER RELATED CONCEPTS :

Depreciation is used synonymously with depletion, obsolescence, amortization and dilapidation. But these are different terms with slight variations.

8.3.1 Depreciation and depletion: Depletion implies removal of an available or irreplaceable natural resource such as extracting coal from a coal mine or out of an oil well. But, depreciation refers to a reduction in the value of fixed assets arising from their wear and tear.

8.3.2 Depreciation and obsolescence: Obsolescence is a decrease in usefulness of an asset due to outdated technology or fashion. This is also one of the causes of depreciation.

8.3.3 Depreciation and amortization: Writing down of certain value on intangible assets such as goodwill, copyright, patents etc., is called amortization. But depreciation is charged on fixed assets.

8.3.4 Depreciation and dilapidation: Dilapidation refers to damage done to a building or other property during tenancy. When a property is given for lease, the lessor can ask the lessee to handover the property after the agreed period in as good condition as it was at the time of leased out. The cost of putting the asset in good condition is dilapidation cost. After adding this, the asset will be charged for depreciation.

8.4 CAUSES OF DEPRECIATION :

The main causes of depreciation are as follows:

8.4.1 Wear and tear: Assets gets worn or torn out on account of constant use. This wear and tear is an important cause of depreciation in the case of tangible fixed assets such as plant and machinery, furniture, and fixtures etc.

8.4.2 Efflux of time: Assets like lease hold properties, patents or copyrights have definite life period. On the expiry of life they cease to exist. In case of other assets they have no definite life, their life is to be estimated.

8.4.3 Obsolescence: Some assets are discarded before they are worn out because of changed conditions or technology. For example, an old machine, which is still working, may have to be replaced by a new machine because of the later being more advanced, efficient and economical. Such a loss on account of new inventions or changed fashions is known as loss on account of obsolescence.

8.4.4 Accidents: An asset may meet an accident and that accidental loss may be permanent but is not continuing and gradual.

Of the above causes, the first two factors are considered as relevant to depreciation. The next two factors are considered only when they occur and they do not happen to all assets.

8.5 FEATURES OF DEPRECIATION :

Depreciation has the following basic features.

8.5.1 Charge on fixed assets: Depreciation is charged only on fixed assets. The term is not used in the case of wasting and fictitious assets such as depletion of natural resources and amortization of goodwill etc. Similarly, loss in value of current assets is taken care by valuing them for balance sheet purposes at cost or market price whichever is less.

8.5.2 Charge on profits: Depreciation is a charge against profits. It means that true profit of the business cannot be ascertained without charging depreciation.

8.5.3 Reduction in book value: By charging depreciation, the book value of fixed assets continues to reduce. In case of land, the market value usually goes up as time passes.

8.5.4 Permanent, **gradual and continuous**: The depreciation in the form of reduction in the book value of as asset is permanent, gradual and continuous until it reaches to its scrap value. When once the book value is reduced, it is not possible to restore it to its original cost.

8.5.5 Different from maintenance: Depreciation is different from maintenance. Maintenance expenses are incurred to keep the asset in good condition. However, a good conditioned asset should also reach a state of scrap. Of course, good maintenance delays the scrap stage but cannot prevent it.

8.5.6 Not visible: Like other expenses, depreciation is not visible.

8.6 OBJECTIVES OF PROVIDING DEPRECIATION :

Depreciation is provided keeping in view the following objectives.

8.6.1 Ascertainment of true profits: To ascertain true profits, depreciation on assets has to be charged undoubtedly. The amount paid for an asset is like payment in advance for expenses. For example, if a building is purchased for Rs. 50 lakhs for business purposes, the effect of such a purchase will be saving in the cost of rent in the future. After certain period, the building may become useless. The cost of the building is, therefore, nothing but paying rent in advance for certain period. If the rent had been paid, it would have been charged as an expense for determination of the true profits.

8.6.2 Presentation of true financial position: Another objective of providing depreciation is to show the fixed assets in the balance sheet at their proper value. Because of various reasons, as explained above, fixed assets lose their value. Therefore, they must be shown in the balance sheet after deducting depreciation. Otherwise, the balance sheet fails to show the true financial position.

8.6.3 Replacement of assets: Depreciation is also provided to retain funds from profits for replacement of assets. The amounts debited in the profit and loss account are retained in the business and used for replacement of assets after their life term.

8.7 FACTORS AFFECTING THE AMOUNT OF DEPREICAITON :

The following three factors affect the amount of depreciation to be charged and transferred to profit and loss account.

8.7.1 Original cost of the asset: The cost of the asset mainly includes the invoice price of the asset. Any trade discount given by the seller should be deducted. Further, all costs incurred (erection charges) to bring the asset to a usable condition. However, financial charges such as the interest on money borrowed for the purchase of the asset should not be included.

8.7.2 Estimated scrap or residual value: Scrap or residual value is the estimated value of the asset at the end of its life period. In determining the scrap val8ue, the cost to be incurred in the disposal or removing of the asset should be deducted out of the total realizable value.

8.7.3 Estimated effective or commercial life: When an asset is not capable of producing goods at a reasonable cost, it is the end of its life. The life of the asset may be calculated in terms of years, months, hours, and units of output or other operating measures such as kilometers in case of motor vehicle.

Depreciation on asset is provided every year on the book value of the asset up to its scrap value i.e. through out its useful life period.

8.8 METHODS OF DEPRECIATION :

There are various methods of charging depreciation depending on the nature of the asset, policy of the company, different methods are followed. Let us discuss about them in detail.

8.8.1 Straight-line method: This is also known as fixed installment method. According to this method, depreciation is charged evenly every year through out the effective life of the asset. The amount of depreciation is calculated as follows:

Depreciation = Original cost of the asset – Estimated scrap value/ Number of years of expected life.

Depreciation may also be expressed as a percentage. For example, if an asset has been purchased for Rs. 1,00,000 and it will have a scrap value of Rs.10,000 at the end of its useful life of 10 years, the amount of depreciation to be charged every year over the effective life of the asset will be computed as follows:

Depreciation = 1,00,000 – 10,000/10 = 9,000 or 9%

The entry for depreciation is as follows:

Depreciation A/c Dr

To Asset A/c

Alternatively, provision for depreciation can be created, then the entry will be as follows:

Depreciation A/c Dr

To Provision for depreciation A/c

In this case, the asset account will continue to appear at the original cost and the total amount of depreciation provided so far will be apparent from the provision for depreciation account. In the balance sheet the amount of the provision for depreciation will be deducted from the cost of the asset and only the balance is shown in the outer column.

Merits of straight-line method:

This method has the following merits.

1. It is very simple to understand and easy to calculate.
2. Asset can be depreciated up to the estimated scrap value or zero value.
3. Amount of depreciation can be known easily.
4. Same amount of depreciation is debited to profit and loss account every year, so there is same effect on profit and loss account every year.

Demerits:

1. This method does not take into account the effective utilization o f the asset. The same amount of depreciation is charged every year irrespective of the use of the asset. BY passage of time, work efficiency of the asset decreases and repair expenses increase. Therefore, charging depreciation equally through out the life period of the asset is not reasonable.
2. It would not take into account the interest on capital invested on the asset.
3. In some cases, assets are used in the business even after their book values become zero.

Illu.1: Show machinery account under straight-line method for three years from the following information given to you.

i) Machinery cost	**Rs. 2,00,000**
ii) Estimated value of life	**3 years**
iii) Rate of depreciation	**331/3%**
iv) Scrap value	**Rs. 20,000**

Solution:

Machinery Account

Dr. **Cr.**

	Rs.		Rs.
1st Year		1st Year	
To Cash	2,00,000	By Depreciation	60,000
		By Balance c/d	1,40,000
	2,00,000		**2,00,000**
2nd Year		2nd Year	
To Balance b/d	1,40,000	By Depreciation	60,000
		By Balance c/d	80,000
	1,40,000		**1,40,000**
3rd Year		3rd Year	
To Balance b/d	80,000	By Depreciation	60,000
		By Balance c/d	20,000
	80,000		**80,000**

	Rs.
Machinery cost	2,00,000
Less: Scrap value	20,000
3 years Depreciation	**1,80,000**
Each year depreciation (331/3%)	60,000

Illu. 2: ABC Company acquired a machine on 1st July 2002 at a cost of Rs. 1,40,000 and spent Rs.10, 000 on its installation. The company writes off depreciation at 10% of the original cost every year. The books are closed pm 31st December every year. Show the Machinery Account and Depreciation Account for three years.

Solution:

Machinery Account

Dr. **Cr.**

	Rs.		Rs.
2002 July 1		2002 Dec. 31	
To Bank	1,40,000	By Depreciation	7,500
To Bank – Installation expenses	10,000	By Balance c/d	1,42,500
	1,50,000		**1,50,000**
2003 Jan 1		2003 Dec.31	
To Balance b/d	1,42,500	By Depreciation	15,000
		By Balance c/d	1,27,500
	1,42,500		**1,42,500**
2004 Jan 1		2004 Dec.31	
To Balance b/d	1,27,500	By Depreciation	15,000
		By Balance c/d	1,12,500
	1,27,500		**1,27,500**
2005 Jan 1 To Balance b/d	1,12,250		

Depreciation Account

Dr. **Cr.**

	Rs.		Rs.
2002 Dec 31		2002 Dec 31	
To Machinery a/c	7,500	By Profit & Loss a/c	7,500
2003 Dec 31		2003 Dec 31	
To Machinery a/c	15,000	By Profit & Loss a/c	15,000
2004 Dec 31		2004 Dec 31	
To Machinery a/c	15,000	By Profit & Loss a/c	15,000

8.8.2 Diminishing balance method: Under this method, depreciation is charged at a fixed rate on the book value of the asset or the reducing balance every year. The amount of depreciation goes on decreasing every year. It is also called as written down value method. For example, if the cost of an asset is Rs. 1,00,000, and the rate of depreciation is 10%, the amount of depreciation to be charged in the first year will be Rs. 10,000, second year Rs.9, 000 (1,00,000-10,000@10%), third year Rs. 8,100 (90,000-9000 @10%) and so on.

Merits: This method has the following merits.

1. Like straight-line method, calculation of depreciation under this method is also easy.
2. Under this method, the depreciation in the initial years is high and goes on decreasing in the subsequent years. As the repair charges increase while the usage of asset goes on, the depreciation charges come down and compensates.
3. The Income-tax Act accepts this method.

Demerits:

1. Under this method, the value of asset can never be zero.
2. Ascertainment of proper rate of depreciation is a difficult task.
3. Like straight-line method, this method also does not have provision for interest on capital invested on the asset.

Illu. 3: On 1st July 2000, X & Co. Purchased a machinery for Rs.70, 000. It spent Rs. 8,000 on its installation. Prepare the machinery account for the first four years under diminishing balance method. Depreciation is written off at 10% per annum.

Solution:

Machinery Account

Dr. **Cr.**

	Rs.		**Rs.**
1st July 2000		31st December 2001	
To Bank	78,000	By Depreciation	3,900
		By Balance c/d	74,100
	78,000		**78,000**
1st January 2001		31st December 2001	
To Balance b/d	74,100	By Depreciation	7,410
		By Balance c/d	66,690
	74,100		**74,100**
1st January 2002		31st December 2002	
To Balance b/d	66,690	By Depreciation	6,669
		By Balance b/d	60,021

	66,690		**66,690**
1st January 2003		31st December 2003	
To Balance b/d	60,021	By Depreciation	6,002
		By Balance b/d	54,019
	60,021		**60,021**
1st January 2004 To Balance b/d	54,019		

Illu. 4: On 1st July 2001 Govind purchased machinery for Rs. 60,000. Depreciation is to be provided for at 10% on diminishing balance each year. On 31st October 2003 1/4th of machinery was sold for Rs. 6,000 as they became useless. On the same date he purchased new machinery for Rs. 20,000. Prepare machinery account from 2001 to 2004. Accounts are closed every year on 31st December.

Solution:

Machinery Account

Dr. **Cr.**

	Rs.		**Rs.**
1st July 2001		31st December 2001	
To Bank	60,000	By Depreciation	3,000
		By Balance c/d	57,000
	60,000		**60,000**
1st January 2002		31st December 2002	
To Balance b/d	57,000	By Depreciation	5,700
		By Balance c/d	51,300
	57,000		**57,000**
1st January 2003		31st December 2003	
To Balance b/d	51,300	By Depreciation	1,069
31st October 2003			
To Bank	20,000	By Bank	6,000
		By Profit & Loss a/c	5,756
		By Depreciation	4,181

		By Balance c/d	54,294
	71,300		**71,300**
1st January 2004		31st December 2004	
To Balance b/d	54,294	By Depreciation	5,429
		By Balance c/d	48,865
	54,294		**54,294**
1st January 2005 To Balance b/d	48,865		

Working Notes:

	Rs.
Loss on Machinery sold :	
1/4th machinery value on 1-7-2001 6,000 x ¼	15,000
Less: 6 months depreciation in 2001	750
	14,250
Less: Depreciation	1,425
	12,825
Less : Depreciation up to 31-10-2003 (10 months)	1,069
Value of the machinery on the date of sale	**11,756**
Less: Sale price	6,000
Loss	**5,756**

	Rs.
Depreciation on 31st December 2003 :	
Machinery account balance on 1st January 2003	51,300
Less: Value of machinery sold (on 1-1-2003)	12,825
	38,475
Depreciation @ 10% = 38,475 x 10/100	3,848
Add : Depreciation on 20,000 for two months (new machinery)	333

	4,181

8.8.3 Annuity Method: The above-discussed two methods have not taken into consideration the interest on asset investment. This method considers interest aspect. Under this method, the depreciation is charged taking not only the cost of the asset but also interest thereon at an accepted rate. The amount of interest is calculated on the book value of the asset, in the beginning of each year. The amount of depreciation is uniform and is determined on the basis of annuity table. Every year, depreciation is debited to profit and loss account as usual and interest is credited to profit and loss account.

Illu. 5: A lease is purchased on 1st January 2000 for 5 years at a cost of Rs.1, 00,000. It is proposed to depreciate the lease by annuity method charging 5 per cent interest. Show the Lease Account for five years and also the relevant entries in the Profit and Loss Account. The annuity table shows that the annual amount necessary to write off Re.1 at 5% per annum is Re.0.230975.

Solution:

To write off Rs. 1,00,000 it requires to write of Rs. 23,097.50ps i.e.(0.230975x1,00,000) every year.

Lease Account

Dr. **Cr.**

		Rs.			**Rs.**
2000			2000		
Jan 1	To Bank	1,00,000	Dec 31	By Depreciation	23,097-50
Dec 31	To Interest	5,000	Dec 31	By Balance c/d	81,902-50
		1,05,000			**1,05,000**
2001			2001		
Jan 1	To Balance b/d	81,902-50	Dec 31	By Depreciation	23,097-50
Dec 31	To Interest	4,095-10	Dec 31	By Balance c/d	62,900-10
		85,997-60			**85,997-60**
2002			2002		

Jan 1	To Balance b/d	62,900-10	Dec 31	By Depreciation	23,097-50
Dec 31	To Interest	3,145-00	Dec 31	By Balance c/d	21,997-50
		66,045-10			**66,045-10**
2003			2003		
Jan 1	To Balance b/d	42,947-60	Dec 31	By Depreciation	23,097-50
Dec 31	To Interest	2,147-40	Dec 31	By Balance c/d	21,997-50
		45,095-00			**45,095-00**
2004			2004		
Jan 1	To Balance b/d	21,997-50	Dec 31	By Depreciation	23,097-50
Dec 31	To Interest	1,100-00			
		23,097-50			**23,097-50**

Profit and Loss Account

Dr. **Cr.**

		Rs.			Rs.
2000			2000		
Dec 31	To Depreciation	23,097-50	Dec 31	By Interest	5,000-00
2001			2001		
Dec 31	To Depreciation	23,097-50	Dec 31	By Interest	4,095-10
2002			2002		
Dec 31	To Depreciation	23,097-50	Dec 31	By Interest	3,145-00
2003			2003		
Dec 31	To Depreciation	23,097-50	Dec 31	By Interest	2,147-40
2004			2004		
Dec 31	To Depreciation	23,097-50	Dec 31	By Interest	1,100-00

8.8.4 Sinking fund method: This method is also called as depreciation fund method. In the above three methods, the amount of depreciation charged from the profit and loss account continues to remain in the business. But under this method, this amount is invested in some securities carrying a particular rate of interest. The amount received on account of interest from these securities is also invested from time to time together with the annual amount charged by way of depreciation. At the end of the useful life of the asset, when replacement is required, the securities are sold and the new asset is purchased. The method has the advantage of providing a separate sum for replacement of the asset. But, charging of same amount of depreciation every year is a burden on profit and loss.

Illu. 6: On 1st January 2001 a trader purchased a three-year lease of premises for Rs.30, 000 and it was decided to make provision for replacement of the lease by means of a depreciation fund. The expected rate of interest on the investment was 5% per annum. The sinking fund table shows that 0.3172ps. at 5% per annum will in three years accumulate Re.1. Show the Depreciation Fund Account.

Solution:

Each year investment to make Re.1 after 3 years 0.3172ps

Each year investment to make Rs. 30,000 after 3 years 30,000x0.3172=9,516

Depreciation Fund Account

Dr. **Cr.**

	Rs.		**Rs.**
31-12-2001		31-12-2001	
To Balance c/d	9,516-00	By Profit & Loss a/c	9,516-00
	9,516-00		**9,516-00**
31-12-2002		31-12-2002	
By Balance c/d	19,507-80	By Balance b/d	9,516-00
		31-12-2002	
		By Bank (Interest)	475-80
		By Profit & Loss a/c	9,516-00
	19,507-80		**19,507-80**
31-12-2003		1-1-2003	
By Premises a/c	30,000-00	By Bank (Interest)	19,507-80
		31-12-2003	
		By Bank (Interest)	972-20

		By Profit & Loss a/c	9,516-00
	30,000-00		**30,000-00**

Illu. 7: A company purchased a four years' Lease on January 1, 2001 for Rs.20, 150. It is decided to provide for the replacement of the lease at the end of four years by setting up a Depreciation Fund. It is expected that investments will fetch interest at 4%. Sinking Fund table shows to provide the requisite sum at 4% at the end of four years, an investment of Rs.4, 745.02 is required. Investments are made to the nearest rupee.

On December31 2004, the investments are sold for Rs.14, 830. On 1st January 2005, the same lease is renewed for a further period of 4 years by payment of Rs.22, 000. Show the important ledger accounts to record the above.

Solution:

Lease Account

Dr. **Cr.**

	Rs.		**Rs.**
1-1-2001		31-12-2001	
To Bank	20,150	By Balance c/d	20,150
	20,150		**20,150**
1-1-2002		31-12-2002	
To Balance b/d	20,150	By Balance c/d	20,150
	20,150		**20,150**
1-1-2003		31-12-2003	
To Balance b/d	20,150	By Balance c/d	20,I50
	20,150		**20,150**
1-1-2004		31-12-2004	
To Balance b/d	20,150	By Balance c/d	20,150
	20,150		**20,150**

Depreciation Fund Account

Dr. **Cr.**

	Rs.		Rs.
31-12-2001		31-12-2001	
To Balance c/d	4,745-02	By Profit & Loss a/c	4,745-02
	4,745-02		**4,745-02**
31-12-2002		1-1-2002	
To Balance c/d	9,679-84	By Balance b/d	4,745-02
		31-12-2002	
		By Bank (interest)	189-50
		By Profit & Loss a/c	4,745-02
	9,679-84		**9,679-84**
31-12-2003		1-1-2003	
To Balance c/d	14,812-06	By Balance b/d	9,679-84
		31-12-2003	
		By Bank (Interest)	387-20
		By Profit & Loss a/c	4,705-20
	14,812-06		**14,812-06**
31-12-2004		1-1-2004	
To Lease a/c	20,150-00	By Balance b/d	14,812-06
To Profit & Loss a/c	17-56	31-12-2004	
		By Bank (Interest)	592-48
		By Profit & Loss a/c	4,745-02
		By Depreciation fund investment a/c – Profit	18-00
	20,167-56		**20,167-56**

Depreciation Fund Investment Account

Dr. **Cr.**

	Rs.		Rs.
31-12-2001		31-12-2001	
To Bank	4,745-00	By Balance c/d	4,745-00

	4,745-00		**4,745-00**
1-1-2002		31-12-2002	
To Balance b/d	4,745-00	By Balance c/d	9,680-00
31-12-2002			
To Bank	4,935-00		
	9,680-00		**9,680-00**
1-1-2003		31-12-2003	
To Balance b/d	9,680-00	By Balance c/d	14,812-00
31-12-2003			
To Bank	5,132-00		
	14,812-00		**14,812-00**
1-1-2004		31-12-2004	
To Balance b/d	14,812-00	By Bank	14,830-00
31-12-2004			
To Depreciation Fund a/c	18-00		
	14,830-00		**14,830-00**

Lease (New) Account

Dr. **Cr.**

	Rs.		Rs.
1-1-2004	22,000		

8.8.5 Insurance Policy method: This method is almost similar to that of the sinking fund method. In the sinking fund method investments are purchased, but in insurance policy method, an insurance policy for the required sum is taken out. Every year premium is paid. The premium will be the annual depreciation and will be debited every year to the Profit and Loss Account and credited to depreciation reserve account. At the end of the given period, the insurance company will pay the agreed amount with which new asset can be purchased.

Illu. 8: A company purchased a lease for 3 years for Rs.30, 000 on 1st January 2002 and decided to provide for its replacement by means of an insurance policy for Rs.30,

000. The annual premium is Rs.9, 500. On 1st January 2005 the lease is renewed for a further period of 3 years for Rs.30, 000. Show the necessary ledger accounts.

Solution:

Lease Account

Dr. **Cr.**

	Rs.		**Rs.**
1-1-2002		31-12-2002	
To Bank	30,000	By Balance c/d	30,000
	30,000		**30,000**
1-1-2003		31-12-2003	
To Balance b/d	30,000	By Balance c/d	30,000
	30,000		**30,000**
1-1-2004		31-12-2004	
To Balance b/d	30,000	By Depreciation Reserve	30,000
	30,000		**30,000**

Depreciation Reserve Account

Dr. **Cr.**

	Rs.		**Rs.**
31-12-2002		31-12-2002	
To Balance c/d	9,500	By Profit & Loss a/c	9,500
	9,500		**9,500**
31-12-2003		1-1-2003	
To Balance c/d	19,000	By Balance b/d	9,500
		31-12-2003	
		By Profit & Loss a/c	9,500
	19,000		**19,000**
31-12-2004		1-1-2004	
To Lease Account	30,000	By Balance b/d	19,000
		31-12-2004	

		By Profit & Loss a/c	9,500
		By Depreciation Insurance policy a/c	1,500
	30,000		**30,000**

Depreciation Insurance Policy Account

Dr. **Cr.**

	Rs.		**Rs.**
1-1-2002		31-12-2002	
To Bank – Premium	9,500	By Balance c/d	9,500
	9,500		**9,500**
1-1-2003		31-12-2003	
To Balance b/d	9,500	By Balance c/d	19,000
To Bank – Premium	9,500		
	19,000		**19,000**
1-1-2004		31-12-2004	
To Balance b/d	19,000	By Bank	30,000
To Bank – Premium	9,500		
31-12-2004			
To Profit – transferred to Depreciation Reserve a/c	1,500		
	30,000		**30,000**

Lease (New) Account

Dr. **Cr.**

	Rs.		**Rs.**
1-1-2005			
To Bank	30,000		

8.9 SUMMARY :

Depreciation is a fall in the quality or value of an asset due to wear and tear and other reasons. The concept depreciation is different from depletion, obsolescence, amortization and dilapidation. Depreciation is a charge on fixed assets and on profits. It reduces the book value of assets gradually and continuously. The main objective of providing depreciation is ascertainment of true profits. Further, to present true financial position and to replace the expired or life completed assets are also other objectives of depreciation. The amount of depreciation is affected by original cost of the asset, its scrap value and its estimated effective life. There are various methods of depreciation. Among these, straight-line method and diminishing balance method are prominent. Both these methods have certain merits and demerits. A similarity of these two methods is that they have ignored interest concept. Annuity method of depreciation takes interest into consideration. Sinking fund method converts the depreciation amount into investments and makes the asset replacement easy. Similar to sinking fund method an insurance policy is taken under insurance policy method.

8.10 TECHNICAL TERMS :

Depreciation-------- It is the permanent and continuing diminution in the quality, quantity or value of an asset.

Depletion----------- It implies removal of an available natural resource.

Obsolescence------ It is a decrease in usefulness of an asset due to outdated technology or fashion.

Amortization-------- It is writing down of certain value on intangible assets.

Dilapidation-------- It is a damage done to a building or other property during tenancy.

8.11 QUESTIONS :

A. Very short questions:

1. Define depreciation.
2. Distinguish between depreciation and obsolescence.
3. Distinguish between depreciation and amortization.
4. What are the causes of depreciation?

B. Short questions:

1. What is depreciation? What are its basic features?
2. What are the objectives in providing depreciation?
3. What factors affect the amount of depreciation

C. Essay question:

1. What is the importance of depreciation in financial accounting? Explain various methods of depreciation.

8.12 EXERCISES :

1. On 1st January 2000 Kiran Kumar purchased a machinery costing Rs. 40,000 and spent Rs.5, 000 on its erection. The estimated effective life of the machinery is 10 years with scrap value of Rs. 5,000. Calculate depreciation on the straight-line method and show Machinery Account for the first three years.
   (Ans: Balance of Machinery Account Rs.33, 000)

2. On 1st April 2001, ABC Ltd. Purchased a machinery for Rs.3, 00,000 and incurred Rs. 21,000 towards freight and insurance, Rs. 3,000 towards carriage inward and Rs.6, 000 towards installation charges. It has been estimated that the machinery will have a scrap value of Rs. 30,000 at the end of the useful life, which is four years.
   Show the Machinery Account for the first four financial years ending 31st March each year according to the straight-line method
   (Ans: Depreciation per year Rs.75, 000)

3. On 1st January 2002 a company purchased a machine costing Rs. 1,00,000. Its working life is 10 years. It has been decided to depreciate it at the rate of 121/2% on the diminishing balance method. Show the Machinery Account for first four years.
   (Ans: Balance of Machine Account on 1st January2006 Rs.66, 992.19).

4. A boiler was purchased from abroad for Rs.10, 000. Shipping and forwarding charges were Rs.2, 000. Import duty Rs.7, 000 and expenses of installation amounted to Rs.1, 000. Calculate depreciation for the first three years at 10% on diminishing balance method.
   (Ans.: Boiler Account after 3 years Rs.14, 580)

5. An educational institution purchased a lease of land for Rs.10, 00,000 that was to run for five years. It was decided to raise a sinking fund to accumulate this amount at the end of the lease. The rate of interest is 5%.

A reference to depreciation fund table shows that the annual amount of Re.0.180975 amount to Re.1 after 5 years. Write up the necessary accounts for all the years.

8.13 SUGGESTED READINGS :

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Chapter - 14

ACCOUNTS FROM INCOMPLETE RECORD SYSTEM

Objectives:

To make acquaintance with

- Single Entry System
- Statement of affairs method
- Conversion of Single entry into double entry system

Structure:

14.1 INTRODUCTION

This system is also known as Single Entry System. There is no proper definition for single entry system of Book-Keeping. Any system, which doesn't follow the principles of double entry system is called single entry system. Under double entry system every transaction is recorded in two-fold aspect.

Under the single entry system cash account and personal accounts of Debtors, Creditors are kept. Nominal and real accounts are not maintained. It is, therefore, found that cash transactions are recorded with double aspect. The cash or personal transactions with real or nominal accounts should be recorded with only one aspect. Transactions between two nominal accounts or between two real accounts or between real and nominal accounts are not at all recorded under single entry system. Therefore, single entry system is a mixture of double entry, single entry and no entry.

14.2. DEFINITION

Carter: " Single entry is a method or a variety of methods employed for recording of transactions, which ignores the two-fold aspect, and consequently fails to provide the businessman with the information necessary for him to be able to ascertain the position."

14.3 .FEATURES OF SINGLE ENTRY SYSTEM

14.3.1. Incomplete system: This is an incomplete system due to the partial recording of transactions in the books of accounts. Tax authorities don't accept this method for the computation of tax.

14.3.2 Limited use: Sole trader and partnership who have a few transactions use this method. The company form of organisation cannot use this method for recording the transactions.

14.3.3 Only personal accounts are prepared: Cash book and personal accounts are only prepared under this method. Real and Nominal accounts are not prepared.

14.3.4 Improper maintenance of cash book: Under this system, cash and credit transactions are recorded in the cash book. Sometimes private transactions of the businessman are also recorded in the cash book.

14.3.5 Estimated profit only: The ascertained profit under this method is only an estimate but not real.

14.3.6 True financial position: Balance sheet is not prepared under this method. Hence it is difficult to know the true financial position of the firm.

14.4 . DISTINCTION BETWEEN SINGLE ENTRY AND DOUBLE ENTRY SYSTEM

Points of difference	Single entry system	Double entry system
1. Recording	Double entry principle is not	For each debit there will be an

	followed to record each and every transaction.	opposite credit and vice-versa.
2. Ledger accounts	Ledger accounts are not prepared in a systematic manner.	Ledger accounts are prepared in a systematic manner.
3. Cash book	Transactions are recorded in a diary. Cash book is not maintained in a proper form.	Cash book is maintained.
4. Trail balance	Trial balance is not prepared.	Trial balance is prepared before the preparation of final accounts.
5. Profit determination	Profit or loss for a period is ascertained by comparing the closing capital with the opening capital.	By preparing the profit and loss account profit for a period is ascertained.
6. Balance sheet	To know the financial position statement of affairs is prepared.	Balance sheet is prepared to know the financial position.
7. Acceptability	Income tax authorities are not accepting the system.	All authorities are legally accepting the system.
8. Usefulness	Small traders are using the system.	All types of traders are using the system.

14.5.ADVANTAGES OF SINGLE ENTRY SYSTEM

14.5.1. Easy system: It is the system useful for those who have no knowledge in accounting.

14.5.2. Low Cost: Cash book and some ledger books are sufficient to record the transactions. Staff required to maintain these books is also very limited. Hence maintenance of accounts is economical.

14.5.3. Secrecy: It is a very easy system to record the business transactions. If the proprietor maintains the business accounts the secrecy of the business is more.

14.5.4 Useful for small firms: This method is suitable to the small business firms due to less maintenance cost. This method is mostly suited to the firms where the cash transactions and personal accounts are more.

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14.5.5. Economy of time: Due to the limited transactions less time is required to maintain the account books.

14.6. DISADVANTAGES OF SINGLE ENTRY SYSTEM

1. **Incomplete :** All the transactions are not recorded in the books of accounts under this system. Hence it is treated as incomplete system.

2. **Unscientific:** There are no rules and regulations to record the transactions of the business. So it is not the scientific method.

3. **No trial balance:** Complete records are not maintained under this system. Trial balance can not be prepared due to the non-availability of complete books of accounts.

4. **Balance sheet cannot be prepared:** Due to non maintenance of real accounts balance sheet cannot be prepared.

5. **Trading and profit and loss account cannot be prepared:** As the nominal accounts are not prepared it is not possible to prepare the trading and profit and loss account at the end of the year.

6. **Difficulty in preparing the financial statements:** It is very difficult to ascertain the profit or loss because profit and loss account is not prepared. It is also difficult to find the financial position of the firm due to non preparation of balance sheet.

7. **Not acceptable by law:** Companies are not permitted to prepare their accounts under the single entry system.

8. **Frauds cannot be detected:** Under this system frauds cannot be detected easily.

9. **Not efficient:** Due to the incomplete recording of transactions business cannot be maintained efficiently.

10. **Arithmetical accuracy:** Transactions are not recorded under the double entry system, which fails in verifying the arithmetical accuracy of the accounting.

14.7 PREPARATION OF ACCOUNTS

Preparation of final accounts becomes difficult if the books are maintained under this system. It is mainly due to the partial recording of transactions. To ascertain correct profit we have to find missing information.

14.7.1 Steps to be taken before starting the accounting process:

1. After verification of cash book balance with physical cash, cash balance is taken.
2. Amounts due by debtors and due to the creditors are taken from the balances of debtors and creditors respectively.
3. Unsold stock are to be counted or weighed and valued.
4. Valuation of assets like building, furniture, machinery etc. is to be done.
5. Values of bill receivable whose dates have not yet expired and those of bills payable are to be ascertained.

6. Amounts of outstanding expenses and incomes, incomes received in advance etc., are to be ascertained.

14.8. PROFIT ASCERTAINING METHODS

Generally two methods are adopted to ascertain the profit under this system.

1. **Statement of affairs method:** This method is also known as network method. Under this method, profit can be ascertained by comparing the closing capital with opening capital. This method is suitable when the available information is too limited.

2. **Conversion method:** Debtors and creditors ledgers are usually maintained along with the cash book. Even though the records are incomplete, they provide sufficient information for the preparation of trading and profit account. After working out the missing information by applying the conversion method, the final accounts are prepared.

14.8.1 Steps used to ascertain profit under statement of affairs method:

1. Find the opening capital by preparing opening statement of affairs.
2. Find the closing capital by preparing closing statement of affairs.
3. Drawings made by the proprietor during the year should be added to the closing capital.
4. From the closing capital deduct the additional capital introduced during the year. The ascertained figure is known as adjusted capital.
5. Deduct opening capital from the adjusted capital. The difference is known as either profit or loss.

14.8.2 Proforma of Statement of affairs:

Statement of affairs is nothing but the balance sheet. Liabilities should be recorded on the left hand side and assets on the right hand side. Opening statement of affairs is prepared with the help of opening assets and liabilities. Closing statement of affairs is prepared with the help of closing assets and liabilities.

Opening statement of affairs is prepared to know the opening capital. Closing statement of affairs is prepared know the closing capital.

Statement of Affairs as on ……………

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	xxx	Cash in hand	xxx
Bills payable	xxx	Cash at Bank	xxx
Outstanding Expenses	xxx	Bills Receivable	xxx
Bank Overdraft	xxx	Sundry Debtors	xxx
Capital	xxx	Stock-in-trade	xxx
(Balancing figure)		Prepaid expenses	xxx
		Fixed assets	xxx
	xxx		xxx

14.8.3. Proforma for the Statement of Profit

Profit & Loss Statement for the year ended …………

	Rs.	Rs.
Closing Capital		xxx
Add: Drawings	xxx	
Interest on Drawings	xxx	xxx
		xxx
Less: Interest on Capital	xxx	
Additional capital	xxx	xxx
Adjusted captial		**xxx**
Less: Opening capital	xxx	xxx
Net profit/loss		xxx

Illus.1:

Find out the profit from the following data:

Capital at the beginning of the year Rs.40,000

Drawings during the year Rs.5,000

Capital at the end of the year Rs.45,000

Capital introduced during the year Rs.2,500

Solution:

	Rs.
Capital at the end	45,000
Add: Drawings	5,000
	50,000
Less: Additional capital	2,500
Adjusted capital	47,500
Less: Opening capital	40,000
Profit during the year	7,500

Illus 2:

What will be the capital of the proprietor at the beginning of the year from the following:

Profit made during the year Rs.2,500

Capital at the end of the year Rs.8,000

Capital introduced during the year Rs.2,000

Drawings Rs.1,200

Solution:

	Rs.
Capital at the end	8,000
Add: Drawings	1,200
	9,200
Less: Additional capital	2,000
Adjusted capital	7,200
Less: Profit	2,500
Capital at the beginning	4,700

Illus 3:

Calculate the missing figure:

Capital at the end Rs.20,400

Capital introduced Rs.5,000

Drawings Rs.3,000

Loss Rs.2,000

Capital in the beginning Rs.?

Solution:

	Rs.	Rs.
Capital at the end		20,400
Add: Drawings	3,000	
Loss	2,000	5,000
		25,400
Less: Additional capital		5,000
Adjusted capital (or) Capital at the beginning		20,400

Illus 4:

Choudary keeps his books by single entry system. On 1.04.2005 his financial position was as follows:

	Rs.		Rs.
Cash in hand	**1,250**	**Cash at bank**	**2,000**
Stock	**7,500**	**Fixtures**	**50**
Sundry debtors	**9,800**	**Plant**	**5,100**
Creditors	**9,000**	**Drawings**	**5,900**

On 31.03.2006 his financial position was a follows:

	Rs.		Rs.
Creditors	**7,500**	**Plant**	**18,100**
Fixtures	**320**	**Debtors**	**13,300**
Stock-in trade	**14,000**	**Cash**	**1,150**
Bank overdraft	**3,600**		

You are required to prepare a statement of profit or loss and closing statement of affairs.

Solution:

Statement of Affairs as on 01-04-2005

Liabilities	Rs.	Assets	Rs.
Creditors	9,000	Cash	1,250
Capital (B.F.)	32,900	Bank	2,000
		Debtors	9,800
		Stock	7,500
		Fixtures	350
		Plant	15,100
		Drawings	5,900
	41,900		**41,900**

Statement of Affairs as on 31-03-2006

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Bank overdraft		3,600	Cash		1,150
Creditors		7,500	Debtors		13,300
Capital		35,770	Stock		14,000
			Fixtures	350	
			Less: Depreciation	30	320
			(350-320)		
			Plant	15,100	
			Add: Addition	3,000	18,100
		46,870			**46,870**

Profit and loss Statement for the year ended 31-03-2006

	Rs.	Rs.
Closing capital		35,770
Less: Opening capital		32,900
Net Profit		2,870

Illus 5:

Kiran keeps his books on single entry method and gives you the following information. His capital on 31-3-2005 was Rs.22,440 and on 1-4-2004 Rs.23,040. He gave a loan of Rs.4,200 to his brother Karthik on private account and withdrew Rs.360 per month for personal purposes. The rent of his residential flat @ Rs.120 per month and electric charges Rs.12 per month were paid from the business account. He sold his 7% Government Bond of Rs.2,400 at 3% premium and put that money in business. Ascertain his profit for 2004 -'05.

Solution:

Profit and loss statement for the year ended 31-3-2005

	Rs.	Rs.
Capital on 31-3-2005		
Add: Drawings during the year:		22,440
Loan to brother	4,200	
Drawings (360 X 12)	4,320	
House rent (120 X 12)	1,440	
Electricity (12 X 12)	144	10,104
		32,544
Less: Capital introduced:		
Sale of 7% Govt. Bonds (2,400 X 103/100)		2,472
Adjusted capital		30,072
Less: Capital on 1-4-2004		23,040
Profit		7,032

Illus 6:

Anil and Sunil are equal partners who have contributed capitals also equally. They maintained books under single entry system and their positions on 1-1-2003 and 31-12-2003 shown below:

Name of the account	On 1-1-2003 Rs.	On 31-12-2003 Rs.
Sundry debtors	6,000	9,000
Sundry creditors	7,000	6,000
Plant and machinery	8,000	10,000
Unexpired expenses	90	150

Outstanding expenses	250	300
Stock	5,000	7,500
Furniture and fittings	3,500	4,500
Cash at bank	1,000	2,400
Insurance policy premium paid	500	

You are required to ascertain the profit or loss made by partners during the year 2003 and prepare a detailed statement of affairs as on 31-12-2003 after taking into consideration the following provisions.

a. Insurance policy matured during the year for Rs.800
b. Plant and Machinery and furniture and fittings are to be depreciated at 10% and 6% per annum respectively.
c. A provision for doubtful debts is to be created at 2½%.
d. Interest on capital at 5% per annum to be provided.

During the year 2003 partners withdrew from the business at Rs.1,000 each

Solution:

Statement of Affairs as on 1-1-2003

Liabilities	Rs.	Assets	Rs.
Creditors	7,000	Bank	1,000
Outstanding expenses	250	Debtors	6,000
Capital	16,340	Stock	5,000
		Plant & Machinery	8,000
		Furniture & Fittings	3,500
		Unexpired expenses	90
	23,590		23,590

Statement of Affairs as on 31-12-2003

Liabilities	Rs.	Assets	Rs.	Rs.
Creditors	6,000	Cash at Bank		2,400
Outstanding	300	Debtors	9,000	
expenses	25,885	Less: Reserve Bad debts	225	
Capital				8,775

		Stock		7,500
		Plant & Machinery	8,000	
		Add: Addition	2,000	
			10,000	
		Less: Depreciation (800 + 100)	900	
				9,100
		Furniture	3,500	
		Add: Addition	1,000	
			4,500	
		Less Depreciation (210 + 30)	240	
				4,260
		Unexpired expenses		150
	32,185			32,185

Profit and Loss Statement for the year ended 31-12-2003

	Rs.	Rs.
Closing capital		25,885
Add: Drawings:		
Anil	1,000	
Sunil	1,000	2,000
		27,885
Less: Interest on capital (16,340 X 5/100)		817
Adjusted capital		26,268
Less: Opening capital		16,340
Net profit		9928

Revised Statement of Affairs for the year ended 31-12-2003

Liabilities		Rs.	Assets		Rs.
Creditors		6,000	Bank		2,400
Outstanding			Debtors	9,000	

Expenses		300	Less: Reserve for Bad		
Capital accounts:			Debts	225	
Anil	12,942				8,775
Sunil	12,943		Stock		7,500
		25,885	Unexpired expenses		150
			Plant & machinery	8,000	
			Add: Additions	2,000	
				10,000	
			Less: Depreciation	900	
					9,100
			Furniture	3,500	
			Add: Additions	1,000	
			Less: Depreciation	4,500	
				240	
					4,260
		32,185			32,185

Dr. **Capital Accounts** **Cr.**

	Anil Rs.	Sunil Rs.		Anil Rs.	Sunil Rs.
To Drawings a/c	1,000	1,000	By Balance b/d	8,170	8,170
To Balance c/d	12,942	12,943	By Profit	4,964	4,964
			By Additional Capital	400	400
			By Interest on capital	408	409
	13,942	13,943		13,942	13,943
			By Balance b/d	12,942	12,943

Notes:

1. Insurance Premium: Whenever the Insurance Premium paid the Journal entry is:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Insurance a/c Dr. To Bank		500	 500

This Insurance Premium was already adjusted to closing balance of bank. Hence the other aspect of the Insurance need not be recorded.

2. A policy was matured and Rs.800 was received by the Proprietor. The transaction was recorded in the firm's books. Hence, it is treated as additional capital.

14.9. CONVERSION OF SINGLE ENTRY INTO DOUBLE ENTRY

Conversion method is used to know the correct profit and financial position of a firm. Under this method profit is calculated by preparing the profit and loss account and financial position is ascertained by preparing Balance Sheet. Certain information may be missing at the time of preparing Final accounts. The preparation of the following ledger accounts help to get the missing information, which in turn helps the preparation of Final accounts of the business firm.

14.9.1 Bills receivable account:

This account always shows debit balance. Hence opening bills receivable is shown on the debit side and closing bills receivable is shown on the credit side of the account. Whenever the bills are received, the transaction amount should be recorded on the debit side of the bills receivable account (To Debtors a/c). Whenever the bills are honoured, the transaction amount should be recorded on the credit side of the bills receivable account (By Cash a/c).

If the bills receivable amount increases by any transaction, it should be recorded on the debit side of the bills receivable account. If any transaction reduces the bills receivable amount that may have place on the credit side of bills receivable account. The following is the proforma of bills receivable account

Dr. **Bills Receivable Account** **Cr.**

	Rs.		Rs.
To Balance b/d	xxx	By Cash a/c	xxx
To Debtors a/c	xxx	By Balance c/d	xxx
	xxx		xxx

After preparing the bills receivable account if the balancing figure is available on the debit side, the missing information may be either opening balance of bills receivable or the bills receivable from debtors. If the balancing figure is available on the credit side of bills receivable account it may be cash received from bills or closing balance of bills receivable.

14.9.2 Debtors account:

Debtors account always shows debit balance. Hence the opening balance of the debtors appears on the debit side and closing balance on the credit side of the debtors account. The transactions which increases the debtors value should be recorded on the debit side. The transactions which decrease the debtors value should appear on the credit side. Generally the debtors may increase due to credit sales. The debtors may decrease due to the sales returns, bad debts, whenever the bills are received, discount and when cash is received from debtors.

Dr. **Debtors Account** **Cr.**

	Rs.		Rs.
To Balance b/d	xxx	By Sales returns	xxx
” Credit sales	xxx	” Bad debts	xxx
		” Bills Receivable a/c	xxx
		” Discount allowed	xxx
		” Cash a/c	xxx
		” Balance c/d	xxx
	xxx		xxx

After preparing this account, the balancing figure may be either from debit side or credit side. If it is on the debit side, it may be opening balance of debtors or credit sales. If it is on the credit side, it may be cash received from debtors or sales returns or bad debts or discount, which reduces the debtors balance or closing balance of debtors.

14.9.3 Bills payable:

This account shows the credit balance. Hence opening balance of bills payable appears on credit side and closing balance on debit side. The transactions which increases the bills payable amount should have place on the credit side and which reduces should have place on the debit side. Transactions that increase the bills payable amount is bills accepted during the year. Transactions that reduce the bills payable amount is bills payable honoured.

Dr. Bills Payable Account Cr.

	Rs.		Rs.
To Cash a/c	xxx	By Balance b/d	xxx
To Balance c/d	xxx	By Creditors a/c	xxx
	xxx		xxx

If the balancing figure is available on the credit side of the account, it may be the opening balance of bills payable or bills accepted during the year. If the balancing figure is available on the debit side, it may be cash received from bills payable or the closing balance of the bills payable.

14.9.4 Creditors account:

It always shows credit balance. So, opening balance of the creditors is recorded on the credit side and closing balance on the debit side of the account. The transactions which increase the creditors value should have posting on the credit side and the transactions which decrease the creditors value are recorded on the debit side. Transactions which increase the creditors value is credit purchases and transactions which decrease the creditors value is purchase returns, bills payable, discount received, cash paid to creditors etc.

Dr. Creditors Account Cr.

	Rs.		Rs.
To Purchase returns	xxx	By Balance b/d	xxx
" Bills payable a/c	xxx	" Credit purchases	xxx

” Discount received ” Cash a/c ” Balance c/d	xxx xxx xxx xxx		 xxx

If the balancing figure is available on the credit side, it may be either opening balance or credit purchases. If the balancing figure is available on the debit side, it may be purchase returns, bills payable, discount received, cash paid to creditors or closing balance of the creditors.

14.9.5 If the opening capital is missing:

Prepare opening statement of affairs with the help of opening assets and liabilities. The difference between opening assets and opening liabilities is known as opening capital (assets-liabilities = capital).

14.9.6 Cash book:

Cash book always shows debit balance. Therefore opening cash balance should have place on the debit side and closing cash balance on the credit side. All cash receipts should be recorded on the debit side and payments on the credit side.

If the balancing figure is on the debit side, it may be opening balance of cash or any cash receipt. If the balancing figure is on the credit side, it should be either cash payment or closing balance of cash.

14.10. Distinction between statement of affairs and balance sheet

Statement of affairs	Balance Sheet
1. It is prepared on the basis of some ledger accounts and estimates.	1. It is prepared on the basis of ledger accounts.
2. It shows only the estimated financial position.	2. It shows the true financial position.
3. Omission of an asset or liability can not be easily traced.	3. If the balance sheet is not equal, omission of an asset or liability can be easily traced.
4. The balancing figure is known as capital.	4. Capital account balance is taken from ledger.

Illus 7:

From the following information supplied by Suresh, who keeps his books on single entry, you are required to prepare Bills payable account and calculate total purchases.

	Rs.
Opening Balance of Bills payable	**5,000**
Opening Balance of creditors	**6,000**
Closing Balance of Bills payable	**9,000**
Closing Balance of creditors	**4,000**
Bills payable discharged during the year	**8,900**
Cash paid to creditors during the year	**30,200**
Return outwards	**1,200**
Cash purchases	**25,800**

Solution:

Dr. Bills payable a/c Cr.

	Rs.		Rs.
To Bank	8,900	By Balance b/d	5,000
To Balance c/d	9,000	By Creditors a/c	12,900
		(Balancing figure)	
	17,900		17,900

Dr. Creditors a/c Cr.

	Rs.		Rs.
To Bank	30,200	By Balance b/d	6,000
To Returns outwards	1,200	By Credit purchases	42,300
To Bills payable a/c	12,900	(Balancing figure)	
To Balance c/d	4,000		
	48,300		48,300

Calculation of Total Purchases:

	Rs.
Cash Purchases	25,800
Add: Credit Purchases	42,300
Total Purchases	68,100

Illus 8: From the following figures prepare Total Debtors and Total Creditors Accounts.

	Rs.
Opening balance of Sundry debtors	**48,500**
Opening balance of Sundry creditors	**36,900**
Credit Purchases	**11,520**
Credit sales	**26,400**
Payments to creditors	**20,120**
Receipts from debtors	**48,675**
Discount allowed	**1,250**
Discount received	**825**
Bills payable accepted	**12,000**
Bills receivable received	**10,000**
Bills receivable dishonoured	**4,000**
Goods returned by debtors	**1,800**
Goods returned to creditors	**1,440**
Bad debts	**625**

Solution:

Dr. Total Debtors a/c Cr.

	Rs.		Rs.
To Balance b/d	48,500	By Cash a/c	48,675
To Credit sales	26,400	By Discount allowed	1,250
To Bills Receivable dishonoured	4,000	By Bills Receivable a/c	10,000
		By Sales returns	1,800
		By Bad debts	625
		By Balance c/d (Bal.fig)	16,550

	78,900		78,900

Dr. **Total Creditors a/c** Cr.

	Rs.		Rs.
To Cash a/c	20,120	By Balance b/d	36,900
To Discount received	825	By Purchases	11,520
To Bills payable a/c	12,000		
To Purchase returns	1,440		
To Balance c/d	14,035		
(Balancing figure)			
	48,420		48,420

Illus 9:

You are given: (a) The balance sheet of Aravind on 1st April, 2004

(b) The cash transactions for the year ended March 31, 2005

(c) A summary of the remaining transactions.

(a)	Rs.		Rs.
Bank overdraft	**500**	**Cash in hand**	**70**
Sundry creditors	**3,600**	**Bills receivable**	**2,500**
Bills payable	**1,600**	**Sundry debtors**	**3,900**
Capital	**20,000**	**Stock of goods**	**7,530**
		Plant & Machinery	**4,700**
		Land & Buildings	**7,000**
	25,700		**25,700**

(b)	Rs.			Rs.
To Balance b/f	**70**	**By Overdraft**		**500**
To Receipts from Drs	**29,000**	**By Salaries**		**4,900**
To Bills Receivable	**10,000**	**By Wages**		**1,580**
To Cash sales	**3,700**	**By Bills payable**		**14,300**
		By Payments to Creditors		**14,700**

		By Office expenses		**800**
		By Drawings		**4,500**
		By Investments at par (6% G.P. Notes on 1st Oct., 2004)		**1,000**
		By Balance on 31st March, 2005	**40**	
		Cash	**450**	**490**
	42,770	**Bank**		**42,770**

(c)	**Sales (Credit)**	**40,700**
	Discount to customers	**200**
	Purchases	**30,000**
	Discount received	**100**
	Bills receivable received	**10,900**
	Bills payable issued	**15,000**
	Stock of goods on March 31, 2005	**5,300**

Provide for doubtful debts at 5% on debtors. Provide depreciation on Plant and Machinery at 5% and on Land and Buildings at 2½%.

Prepare the Trading and Profit and Loss Account and the Balance Sheet.

Solution:

Dr. Total Debtors a/c Cr.

	Rs.		Rs.
To Balance b/d	3,900	By Cash a/c	29,000
To Credit sales	40,700	By Discount allowed	200
		By Bills Receivable a/c	10,900
		By Balance c/d (Balancing figure)	4,500
	44,600		44,600

Dr. Total Creditors a/c Cr.

	Rs.		Rs.
To Cash a/c	14,700	By Balance b/d	3,600
To Bills payable a/c	15,000	By Purchases	30,000

To Discount received	100		
To Balance c/d	3,800		
(Balancing figure)			
	33,600		33,600

Dr. Bills Receivable a/c Cr.

	Rs.		Rs.
To Balance b/d	2,500	By Cash a/c	10,000
To Debtors a/c	10,900	By Balance c/d	3,400
		(Balancing figure)	
	13,400		13,400

Dr. Bills Payable a/c Cr.

	Rs.		Rs.
To Cash a/c	14,300	By Balance b/d	1,600
To Balance c/d	2,300	By Creditors a/c	15,000
	16,600		16,600

Dr. Trading and Profit & Loss a/c for the year ended 31-3-2005 Cr.

	Rs.		Rs.
To Opening stock	7,530	By Sales (40,700 + 3,700)	44,400
To Purchases	30,000	By Closing stock	5,300
To Wages	1,580		
To Gross Profit c/d	10,590		
	49,700		49,700
To Salaries	4,900	By Gross profit	10,590
" Office expenses	800	" Discount received	100
" Discount allowed	200	" Interest receivable	30
" Reserve for Bad debts	225		
" Depreciation on Land & Buildings	175		
" Depreciation on Plant &			

Machinery	235		
” Net profit transfer to Capital a/c	4,185		
	10,720		10,720

Balance sheet as on 31-3-2005

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Bills payable		2,300	Cash		40
Sundry creditors		3,800	Bank		450
Capital	20,000		Investments	1,000	
Add: Net profit	4,185		Add: Interest receivable	30	
					1,030
	24,185		Bills receivable		3,400
Less: Drawings	4,500		Debtors	4,500	
		19,670	Less: Reserve for Bad debts	225	
					4,275
			Closing stock		5,300
			Land & Buildings	7,000	
			Less: Depreciation	175	
					6,825
			Plant & Machinery	4,700	
			Less: Depreciation	235	
					4,465
		25,785			25,785

Illus 10:

Mr. Kunal keeps his books on Single entry system. From the following, prepare Trading and Profit and Loss A/c for the year ending 31-12-2002 together with Balance Sheet is on that date. Cash book shows the following:

	Rs.
Interest paid	**100**
Personal withdrawals	**2,000**

Salaries	**8,500**
Other expenses	**7,900**
Payment to creditors	**15,000**
Bank balance 31-12-2002	**2,425**
Cash in hand 31-12-2002	**75**
Received from debtors	**25,000**
Cash sales	**15,000**

Further details available are:

	As on 1-1-2002 Rs.	**As on 31-12-2002 Rs.**
Stock in hand	**9,000**	**10,220**
Creditors	**8,000**	**5,500**
Debtors	**22,000**	**30,000**
Furniture	**1,000**	**1,000**
Buildings	**15,000**	**15,000**
Bank overdraft	**4,000**	

Provide 5% interest on Mr. Kunal's Capital balance as on 1-1-2002. Provide Rs.1,500 for doubtful debts, 5% depreciation on all fixed assets.

Solution:

Statement of affairs as on 1-1-2002

	Rs.		**Rs.**
Bank overdraft	4,000	Debtors	22,000
Creditors	8,000	Closing stock	9,000
Capital	35,000	Furniture	1,000
(Balancing figure)		Buildings	15,000
	47,000		47,000

Dr. **Debtors a/c** **Cr.**

	Rs.		**Rs.**
To Balance b/d	22,000	By cash a/c	25,000
To Credit sales	33,000	By Balance c/d	30,000
(Balancing figure)			
	55,000		55,000

Dr. Creditors a/c Cr.

	Rs.		Rs.
To Cash a/c	15,000	By Balance b/d	8,000
To Balance c/d	5,500	By Credit purchases	12,500
		(Balancing figure)	
	20,500		20,500

Dr. Cash a/c Cr.

	Rs.		Rs.
To Debtors a/c	25,000	By Interest paid	100
To Sales a/c	15,000	By Drawings	2,000
		By Salaries	8,500
		By Other expenses	7,900
		By Payments to creditors	15,000
		By Bank	6,425
		(balancing figure)	
		By Balance c/d	75
	40,000		40,000

Dr. Bank a/c Cr.

	Rs.		Rs.
To Cash a/c	6,425	By Balance b/d	4,000
(balancing figure)		By Balance c/d	2,425
	6,425		6,425

Dr. Trading and Profit & Loss a/c for the year ended 31-12-2002 Cr.

	Rs.		Rs.
To Opening stock	9,000	By Sales	
To Purchases	12,500	(33,000 + 15,000)	48,000
To Gross Profit c/d	36,720	By Closing stock	10,220
	58,220		58,220
To Salaries	8,500	By Gross profit b/d	36,720
” Other expenses	7,900		

” Reserve for Bad debts	1,500		
” Depreciation on Buildings	750		
” Depreciation on Furniture	50		
” Interest paid	100		
” Interest on capital	1,750		
” Net profit transfer to	16,170		
Capital a/c	36,720		36,720

Balance sheet as on 31-12-2002

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		5,500	Cash in hand		75
Capital	35,000		Cash at Bank		2,425
Add: Interest	1,750		Debtors	30,000	
Add: Net profit	16,170		Less: Reserve for Bad		
	52,920		debts	1,500	
Less: Drawings	2,000				28,500
		50,920	Closing stock		10,220
			Buildings	15,000	
			Less: Depreciation	750	
					14,250
			Furniture	1,000	
			Less: Depreciation	50	
					950
		56,420			56,420

Note: Bank Account opening balance shows overdraft. Hence opening balance was recorded on the credit side of the bank a/c. Bank closing balance is favourable balance. So the balance should be recorded on the credit side of the Bank a/c. The balancing figure in the cash a/c is treated as cash deposited in the bank.

Illus 11:

Sarath keeps his books by single entry. His records consist of cash book, day book and a personal ledger. No discounts are received or allowed. The following statement shows the assets and liabilities as on 30th June 2004 and 2005.

	30th June 2004 Rs.	30th June 2005 Rs.
Stock	**6,184**	**7,040**
Furniture	**660**	**700**
Debtors	**2,092**	**1,852**
Cash	**674**	**246**
Creditors	**1,016**	**962**
Expenses accrued	**144**	**124**

The cash book has been lost but the proprietor is able to find out from the records that his drawings have amounted to Rs.1,300 and that the furniture etc. at 30th June 2005 included a small safe bought during the year at a cost of Rs.140. Purchases of goods amounted to Rs.11,862 and sales to Rs.14,664 and before arriving at the amount of debtors as on 30th June 2005, Rs.84 has been written off as bad.

Draw up trading and P & L account, cash account, debtors account, creditors account and expenses account and also balance sheet that would appear on June 30, 2005

Solution:

Statement of Affairs as on 30-6-2004

	Rs.		Rs.
Creditors	1,016	Cash	674
Expenses accrued	144	Debtors	2,092
Capital	8,450	Stock	6,184
(Balancing figure)		Furniture	660
	9,610		9,610

Dr. Total Debtors a/c Cr.

	Rs.		Rs.
To Balance b/d	2,092	By Bad debts	84
		By Cash a/c	156
		(Balancing figure)	
		By Balance c/d	1,852
	2,092		2,092

Dr. Total Creditors a/c Cr.

	Rs.		Rs.
To Cash a/c	54	By Balance b/d	1,016
(Balancing figure)			
To Balance c/d	962		
	1,016		1,016

Dr. Cash a/c Cr.

	Rs.		Rs.
To Balance b/d	674	By Purchases	11,862
To Sales	14,664	By Creditors a/c	54
To Debtors a/c	156	By Drawings	1,300
		By Furniture	140
		By Expenses	1,892
		(balancing figure)	
		By Balance c/d	246
	15,494		15,494

Dr. Furniture a/c Cr.

	Rs.		Rs.
To Balance b/d	660	By Balance c/d	700
To Cash a/c	140	By Depreciation	100
		(balancing figure)	
	800		800

Dr. Expenses a/c Cr.

	Rs.		Rs.
To Cash a/c	1,892	By Balance b/d	144
To Balance c/d	124	By Profit & Loss a/c	1,872
		(balancing figure)	
	2,016		2,016

Note: If opening and closing outstanding expenses are given we have to prepare expenses a/c. Then the balance of this account is to be transferred to Profit and Loss a/c.

Dr. Trading and Profit & Loss a/c for the year ended 30-6-2005 Cr.

	Rs.		Rs.
To Opening stock	6,184	By Sales	14,664
To Purchases	11,862	By Closing stock	7,040
To Gross Profit c/d	3,658		21,704
	21,704		
To Expenses	1,872	By Gross profit c/d	3,658
To Bad debts	84		
To Depreciation on furniture	100		
To N.P. transferred to capital	1,602		
	3,658		**3,658**

Balance sheet as on 30-6-2005

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Creditors		962	Cash		246
Accrued		124	Debtors		1,852
expenses	8,450		Closing stock		7,040
Capital	1,602		Furniture	660	
Add: Net profit	10,052		Add: Additions	140	
	1,300	8,752		800	
Less: Drawings			Less: Depreciation	100	700
		9,838			**9,838**

Note: When furniture opening and closing balances are given along with the additions in the adjustments, we have to prepare Furniture a/c. The Balancing figure of such account is the depreciation to be provided on furniture.

14. 11. QUESTIONS

1. What is Single Entry System? What are the advantages and limitations?
2. Distinguish between single entry system and Double entry system?
3. Explain the method of converting single entry system into double entry system?
4. Distinguish between statement of affairs and balance sheet?

14.12. EXERCISES

1. From the following particulars calculate the profit.

	Rs.
Capital as on 31-12-2005	90,000
Capital as on 1-1-2005	80,000
Capital introduced during the year	5,000
Drawings during the year 2005	3,000

(Ans: Profit Rs.8,000)

2. Find out the profit from the following data:

	Rs.
Capital at the beginning of the year	60,000
Drawings during the year	7,500
Capital at the end of the year	67,500
Additional capital introduced during the year	3,750

(Ans: Profit Rs.11,250)

3. Find out the profit from the following data:

	Rs.
Capital at the beginning of the year	75,000
Drawings during the year	6,000
Capital at the end of the year	24,000
Additional capital introduced during the year	9,000

(Ans: Rs.48,000)

4.. Calculate the missing figure:

	Rs.
Capital at the end	18,200
Capital introduced	4,700
Drawings	2,800
Loss	1,400
Capital in the beginning	?

(Ans: Capital at the beginning Rs.17,000)

5. Calculate profit earned by a trader from the following particulars. The trader follows single entry system:

	1-1-2004 Rs.	31-12-2005 Rs.
Creditors	1,50,000	1,60,000
B.P.	40,000	30,000
Plant	1,00,000	1,50,000
Machinery	3,00,000	2,80,000
Stock	1,00,000	1,10,000
Debtors	1,60,000	1,50,000
Cash	10,000	15,000

Provide depreciation on fixed assets at 5% and on stock at 10% and bad debts on debtors at 10%.

(Ans: Opening capital Rs.4,70,000; Closing capital Rs.4,58,500; Net loss Rs.11,500)

6. Sekhar maintains his books of accounts under single entry system. Prepare a statement showing the profit earned by Sekhar in the year 2003 from the following:

	31-12-2002 Rs.	31-12-2003 Rs.
Stock	19,600	75,600
Creditors	31,000	14,500
Debtors	85,000	1,42,000
Premises	90,000	90,000
Furniture	11,000	11,500
Cash at Bank	9,300	8,600
Drawings	4,700	7,200
Additional capital introduced		3,500

(Ans: Capital at the beginning Rs.1,88,600; Capital at the end Rs.3,13,200; Net profit Rs.1,28,300)

7. From the following details available from the books of a merchant, you are required to ascertain the result for the year ending 31st October, 2005:

Balances as on 1-11-2004 were as under:

Cash in hand Rs.200; Cash at Bank Rs.1,800; Stock in Trade Rs.6,000; Accounts receivable Rs.11,200; Trade fixtures Rs.2,800; Machinery Rs.18,000; Accounts payable Rs.6,000; and Loan from a friend Rs.4,000.

Position on 31-10-2005:

Cash in hand Rs.500; Cash at Bank Rs.2,500; Stock in Trade Rs.5,000; Accounts receivable Rs.12,000; Trade fixtures Rs.2,800; Machinery Rs.17,200; Accounts payable Rs.4,000.

During the year he had introduced Rs.5,000 as additional capital and had withdrawn at the rate of Rs.500 per month for domestic purposes. He states that interest on loan from the friend was unpaid which was Rs.120. A provision for doubtful debts is needed at 10%.

(Ans: Opening capital Rs.30,000; Closing capital Rs.34,680; Profit during the year Rs.5,680)

8. Sanjay keeps his books by the single entry method. His position on 31st March, 2004 was as follows:

Cash in hand Rs.200; Cash at Bank Rs.25,500; Debtors Rs.18,400; Stock on hand Rs.28,600; Furniture Rs.5,000; Creditors Rs.18,700; Expenses outstanding Rs.2,000.

On 1st October, 2004 Sanjay introduced Rs.10,000 as further capital and withdrew on the same date Rs.7,000. Out of which he spent Rs.5,000 on the purchase of machine for the business. On 31st March 2005 his position was as follows:

Cash in hand Rs.2,100; Cash at Bank Rs.27,500; Stock Rs.31,500; Debtors Rs.24,200; Furniture Rs.6,000; Creditors Rs.25,200 and prepaid insurance Rs.200.

Find out the Profit or Loss made by Sanjay after providing depreciation on machine at 10% and on furniture 20%.

(Ans: Opening capital Rs.57,000; Closing capital Rs.69,850; Net profit Rs.4,850)

9. Manoj who keeps his books of account under single entry system gives you below some of the balances as per his records as on 1st January, 2005 and 31st December, 2005.

	January 1, 2005 Rs.	December 31, 2005 Rs.
Cash and bank balance	4,500	4,100
Sundry debtors	?	37,800
Sundry creditors	19,600	21,700
Stock in trade	11,000	13,400
Furniture and fixtures	16,000	?
Salaries and expenses outstanding	4,100	5,300

He also informs you that he always sells goods at a profit of 25% on sales. The cash book summary for 1995 showed the following items:

Receipts	Rs.	Payments	Rs.
To Balance b/d	4,500	By Payments to sundry creditors	57,000
” Cash sales	15,000	” Cash purchases	6,000
” Received from debtors	76,000	” Salaries and other expenses	20,300
” Miscellaneous receipts	900	” Purchase of furniture	3,000
		” Drawings	6,000
		” Balance c/d	4,100

	96,400		96,400

Discounts allowed to debtors were Rs.1,000

Discounts received from creditors were Rs.900

Depreciation on furniture was @ 10%.

Prepare Manoj's Trading and Profit and Loss Account for the year ended 31st December 2005 and a Balance Sheet as on 31st December, 2005

(Ans: Gross Profit Rs.21,200; Net Loss Rs.1,250; Balance Sheet Rs.72,500)

10. Madhu who keeps his books under single entry, supplies you the following information for the year ended 31st December, 2002. Prepare Trading and Profit and Loss Account and Balance Sheet. On 1-1-2002 he had a cash balance of Rs.10,000.

Other Assets and Liabilities	1-1-2002 Rs.	31-12-2002 Rs.
Debtors	36,000	50,000
Stock	19,600	26,400
Furniture at cost	2,000	3,000
Creditors	12,000	9,000

His transactions during 2002:	Rs.
Receipts from Debtors	1,21,600
Payments to creditors	88,000
Salaries	24,000
Rent and Taxes	3,000
Other expenses	3,600
Drawings	6,000
Additional Capital	4,000
Cash sales	3,000
Cash purchases	10,000
Discount received	1,400
Discount allowed	600
Sales returns	2,000
Purchase returns	1,600

(Ans: Gross Profit Rs.50,400; Net Profit Rs.10,800; Balance Sheet Rs.82,400)

11. Amit did not keep proper books of account. However, he gives you the following information relating to 2004:

Assets and Liabilities	1st Jan.2004 Rs.	31st Dec. 2004 Rs.
Cash at bank	1,000	1,800
Stock	20,000	19,500
Sundry Debtors	15,000	16,000
Machinery	40,000	
Sundry Creditors	20,000	18,500

Summary of cash transactions:

Receipts	Rs.	Payments	Rs.
Opening balance	1,000	Payments to creditors	35,000
Received from Debtors	76,500	Wages	15,100
Cash sales	8,200	Salaries & expenses	11,600
Sale of old newspapers	200	Buildings purchased	20,000
Loan from Mrs. Amit	6,000	Drawings	8,400
(9% on 1 October 2004)		Closing balance	1,800
	91,900		91,900

During the year Rs.600 had to be written off as bad. Machinery is to be depreciated by 15% p.a. Expenses owing are Rs.800.

Prepare Amit's Trading and Profit and Loss A/c and Balance Sheet relating to 2004.

(Ans: Gross Profit Rs.37,200; Net Profit Rs.18,265; Balance Sheet Rs.91,300)

12. Mr.Sharma maintains his books under single entry system. Prepare Trading and Profit & Loss A/c for the year ended 31st December 2002 and a Balance Sheet as on that date:

The particulars of his Cash Book are as follows:

	Rs.
Received from Debtors	60,000

Cash sales	5,000
Paid to creditors	25,000
Business expenses	8,000
Wages	15,000
Drawings	3,000
Cash purchases	2,600

Particulars of his other assets and liabilities are as follows:

Assets and Liabilities	1-1-2002 Rs.	31-12-2002 Rs.
Debtors	53,000	88,000
Creditors	15,000	19,500
Bank balance	(Cr.) 7,400	(Dr.) 40,000
Stock	17,000	19,000
Plant & Machinery	20,000	20,000
Furniture	1,400	1,400

Write off depreciation on Plant & Machinery at 10% and on furniture at 5%. Allow interest on capital at 6% p.a.

13. From the information given below, prepare Trading and Profit & Loss account for the year ending 30th June 2005 and a Balance Sheet as on that date:

	Balance as on 1-7-2004 Rs.	Balance as on 30-6-2005 Rs.
Debtors	4,000	3,750
Creditors	1,500	1,200
Rent payable	25	15
Cash	375	1,625
Stock	3,750	4,000
Plant	2,500	3,000

Cash transactions:

Receipts: Cash sales Rs.250; Debtors Rs.17,750.

Payments: Purchase of Plant Rs.500; Rent Rs.310; Cash purchases Rs.500; Payment to the creditors Rs.7,800; Salaries Rs.5,000; Wages Rs.1,500; Electricity Rs.500.

Bad debts already written off Rs.50; Depreciation on Plant is to be provided for @ 10% p.a.

(Ans: Gross Profit Rs.8,550; Net Profit Rs.1,785; Balance Sheet Rs.12,100)

14. Supraja commenced business as a cloth merchant on 1st January, 2004 with a capital of Rs.10,000. On the same day she purchased furniture for Rs.3,000. From the following particulars obtained from her books kept by single entry, you are asked to prepare Trading and Profit and Loss account for the year ending 31st December, 2004.

	Rs.
Sales (inclusive of cash sales Rs.7,000)	17,000
Purchases (inclusive of cash purchase Rs.4,000)	15,000
Supraja's drawings	1,200
Staff salaries	2,000
Bad debts written off	500
Business expenses	700

Supraja took cloth worth Rs.500 from the shop for her own purpose and paid Rs.200 to her son but it was not recorded in the books. On 31st December, 2004 her Sundry debtors amounted to Rs.5,200 and Sundry creditors Rs.3,600. Stock on hand on that date was Rs.6,500.

(Ans: Gross Profit Rs.9,000; Net Profit Rs.5,800; Balance Sheet Rs.17,700)

14.13 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.

2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
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6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advaned Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 15

PARTNERSHIP ACCOUNTS

Objectives:

This lesson tells

- About the partnership business
- Accounting treatment of Partnership Business

Structure:

15.1. INTRODUCTION

An agreement between two or more persons is known as Partnership. Partnership firm may be formed with the contribution of capital, skill and administrative ability. There is an agreement between the partners to share profits and losses of the business.

15.2 DEFINITION

Sec.4 of Partnership Act, 1932 defined Partnership as "The relation between persons, who have agreed to share the profits of the business carried on by all or anyone of them acting for all".

The members in a firm are individually called as partners and collectively known as firm.

15.3. ESSENTIALS OF PARTNERSHIP

1. **Agreement between partners:** Partnership arises due to the agreement between partners. The agreement may be oral or in written.

2. **Existence of lawful business:** The partners should establish lawful business. If business established by the partners is unlawful, it should not be treated as a partnership business.
3. **Number of partners:** The minimum number to start a partnership is two. The Partnership Act does not say anything about the maximum number of partners. However, Sec.11 of the Companies Act fixes the maximum number at 10 for partnership carrying on banking business. If it is carrying on any other type of business, the maximum number is 20.
4. **Registration of firm**: Registration is not compulsory to the partnership firm. If it is not registered, firm suffers from a number of disabilities.
5. **Profit sharing:** Profits and losses of the firm should be shared according to the agreement. In the absence of agreement, all the partners should share the profits and losses equally.
6. **Partners' Liability**: The liability of partners is unlimited, joint and several.
7. **Non-transferability of interest:** Without obtaining the prior permission from the remaining partners, the partners are not allowed to transfer their share.
8. **Mutual agency:** The partnership firm may be carried on by all or anyone of them acting for all. Hence, the partners are liable for the acts of the others.

15.4 PARTNERSHIP DEED

Partnership is the result of agreement. It is the agreement, which sets out the terms of the business by the partners. It must be in writing or by words of mouth. To avoid future disputes it is desirable to have the partnership agreement in written. In the absence of the agreement, the partnership deed mentioned in the Partnership Act came into force. A partnership deed has the following contents:

a. Name of the firm
b. Nature of the partnership business
c. Capital brought by the partners.
d. Profit & loss sharing ratio.
e. Interest on capital allowed to the partners.
f. Interest charged on the drawings.

g. Amount of withdrawals from the firm by each partner.
h. Amount of allowances and salaries payable to the working partners.
i. Commencement and duration of partnership.
j. Valuation of goodwill at the time of retirement or death of a partner.
k. Keeping and preparation of proper books of accounts by the firm.
l. Appointment of the auditor to the firm and the procedure to be followed for auditing the accounts of the firm.
m. Whether the capital accounts are fixed or fluctuating.
n. Rights and duties of the partners.
o. About the settlement of disputes among the partners.
p. Procedure to be adopted for the payment of retiring partners or to the legal heirs of the deceased partners.

15.5 RULES APPLICABLE IN THE ABSENCE OF AN AGREEMENT

In the absence of an agreement the following rules are applicable.

a. The partners shall share the profits and losses equally.
b. If the partner provides the loan to the firm, he is entitled to receive interest at the rate of 6% p.a.
c. The firm will charge no interest on drawings.
d. If any partner is participating in the daily activities of business, he is not entitled to get salary or commission.
e. No partner is entitled to get interest on capital.

15.6 IMPLIED AUTHORITY OF A PARTNER

The authority of the partners to bind the firm is known as implied authority. Every partner within the scope of his implied authority may bind the firm by the following acts:

a. Buying and selling goods.
b. Receiving payments of the debts due to the firm and issuing receipts for the same.
c. Drawing cheques and endorsing bills of exchange and promissory notes in the name of the firm.
d. Engaging servants to perform the business of the firm.
e. Borrowing money for the purpose of business on the credit of the firm.

The implied authority of a partner does not extend the following acts:

a. Submitting the business dispute to arbitration.
b. Opening bank account on behalf of the firm in his own name.

c. Admission of a liability in a suit or a proceeding against the firm.
d. Acquisition of immovable property of the firm.
e. Transfer of immovable property of the firm.
f. Entering partnership on behalf of the firm.
g. Withdrawal of suit or proceeding file on behalf of the firm.
h. Compromising any claim or a portion of claim by the firm.

Sec.20 lays down that the implied authority of any partner may be extended or restricted by an agreement between all partners.

15.7. SPECIAL ASPECTS OF PARTNERSHIP ACCOUNTS

The partner may contribute his capital in the form of cash or stock. On behalf of the partners, the firm maintains the capital account of each partner. The contribution of capital by the partners should be credited to the partners' capital accounts. The amounts paid by the firm to the partners should be credited to the capital accounts. Generally the amounts paid by the firm to the partners are salary, commission, bonus, interest on capital etc. The amount of drawings and interest on drawings etc., is debited to the capital accounts.

For bringing capital by the partners to the firm:

a. Capital brought in cash

Date	Particulars	L.F.	Debit	Credit
	Casha/c Dr.		xxx	
	To partners' capital a/c			xxx
	(Being capital brought)			

b. Capital brought in cash and other assets

Date	Particulars	L.F.	Debit	Credit
	Casha/c Dr.		xxx	
	Machinery a/c Dr.		xxx	
	Stock a/c Dr.		xxx	
	Furniture a/c Dr.		xxx	
	To partners' capital a/c			xxx
	(Being capital brought)			

15.8 MAINTENANCE OF PARTNERSHIP ACCOUNTS

15.8.1. Capital Accounts:

Partners' capital accounts are maintained under two methods. They are:
1. Fixed capital method and 2. Fluctuating capital method.

1. Fixed capital method:

a. Preparation of capital account:

Whatever the capital contributed by the partners should remain fixed in the capital accounts. Whenever the additional capital is introduced, that entry should also be recorded in the capital account. The other transactions related to the partners' capital accounts should be recorded in the partners' current accounts.

Dr. **Capital a/c** **Cr.**

	Rs.		Rs.
To Balance c/d	xxx	By Cash/assets a/c (initial investment)	xxx
		By Cash/assets (Additional capital)	xxx
	xxx		xxx

b. Preparation of current account:

In the current account, we should record the entries related to the share of profit, interest on capital, salary, commission, etc. have place on the credit side. Drawings, interest on drawings, share of loss etc. should be recorded on the debit side. The difference between the debit and credit amounts is known as closing balance of the current account. The closing balance may be either debit or credit. If it is debit balance, it should be represented on the assets side of the balance sheet. If it is credit balance, it should be represented on the liabilities side of the balance sheet.

Dr. **Current a/c** **Cr.**

	Rs.		Rs.
To Drawings (cash/goods)	xxx	By Interest on capital	xxx
To Interest on drawings	xxx	By Salary	xxx
To Share of loss	xxx	By Commission	xxx

To Balance c/d*	xxx	By Share in profit	xxx
	___	By Balance b/d *	xxx
	xxx		xxx

***Only one figure is available.**

2. Fluctuating capital method:

There is no need to open current account separately under this method. All the transactions should have place only in the capital accounts. Under this method, the balance of capital accounts may change year by year.

Dr. **Capital a/c** **Cr.**

	Rs.		Rs.
To Drawings (cash/goods)	xxx	By Balance b/d	xxx
To Interest on drawings	xxx	By Interest on capital	xxx
To Share of loss	xxx	By Salary	xxx
To Balance c/d*	xxx	By Commission	xxx
	___	By Share in profit	xxx
	xxx		xxx
		By Balance b/d	xxx

15.8.2 Profit and loss appropriation account:

The net profit is transferred to the capital accounts of the proprietor in case of sole traders concern. In case of partnership, it is transferred to profit and loss appropriation account. After transferring, from the profit and loss account, the following items should be deducted. Those items are interest on capital, partners' salaries and interest on drawings. These items are not charged against trading profit. The proforma of profit and loss appropriation account is given below:

Profit and loss Appropriation Account

Date	Particulars	Rs.	Rs.	Date	Particulars	Rs.	Rs.
	To Interest on capital:				By Balance b/d		xxx
	X capital a/c	xxx			By Interest on drawings:		
	Y capital a/c	xxx	xxx		X capital a/c	xxx	
	To Salaries:				Y capital a/c	xxx	xxx
	X capital a/c	xxx			By Capital Accounts:		
	Y capital a/c	xxx	xxx		X capital a/c	xxx	
	To Commission:				Y capital a/c	xxx	xxx
	X capital a/c	xxx					
	Y capital a/c	xxx	xxx				
	To Capital Accounts:						
	X capital a/c	xxx					
	Y capital a/c	xxx	xxx				
			xxxx				xxxx

15.8.3 Drawings:

If the partners withdrew the amount from the business cash, it is known as drawings. Such an amount is debited to each partner's drawings account. The amount of drawings taken by the partners may vary from time to time. Sometimes, the partners may withdraw same amount in every month. The following entries are necessary for partners' drawings.

Date	Particulars	L.F.	Debit	Credit
	For cash withdrawals:			
	Partners drawings a/c	Dr.	xxx	
	To Cash a/c			Xxx
	(Being drawings made)			
	Transfer entry:			
	Partners capital/current a/c	Dr.	xxx	
	To Partners drawings a/c			xxx
	(Being transfer entry made)			

15.8.4 Interest on capital:

No partner is entitled to get the interest on his capital. He will get the interest on capital if it was mentioned in the partnership deed. Interest on capital is always calculated on the opening balance of the capital. The interest on capital is calculated with reference to the time factor. The following entries are to be recorded for interest on capital.

Date	Particulars	L.F.	Debit	Credit
	Interest on capital a/c	Dr.	xxx	
	To Partners capital/current a/c			xxx
	(Being interest credited to capital a/c)			
	P & L appropriation a/c	Dr.		
	To Interest on capital a/c		xxx	
	(Being the transfer of interest on capital)			xxx

15.8.5 Interest on drawings:

While calculating the interest on drawings the following rules shall be followed:

Interest on drawings shall be charged from the partners whenever it was mentioned in the partnership deed.

1. Interest on drawings is to be calculated as per the date of the withdrawal made by partners. If the dates of withdrawals are not mentioned, the interest will be charged at the given rate for 6 months on the whole amount.
2. Whenever the partners withdraw equal amounts at the beginning of each month the interest on the whole amount will be charged for 6 ½ months.
3. Whenever the partners withdraw equal amounts at the end of each month the interest on the whole amount will be charged for 5 ½ months.
4. When the drawings are made at different dates, interest on drawings as per given rate may be calculated by products method. The formula for that is

   $$\text{Interest on drawings} = \text{Total of products} \times \frac{\text{Rate of interest}}{100} \times \frac{1}{12}$$

Date	Particulars	L.F.	Debit	Credit
	Partners drawings a/c	Dr.	xxx	
	To Interest on drawings a/c			xxx
	(Being interest on drawings)			
	Interest on drawings a/c	Dr.	xxx	
	To P & L appropriation a/c			xxx
	(Being interest on drawings transferred)			

15.8.6. Salaries allowed to partners:

The active partners may receive an extra remuneration, which is called salary. It should be definitely mentioned in the deed. This amount should be credited to the capital amounts. The following journal entry is necessary

Date	Particulars	L.F.	Debit	Credit
	Partners salaries a/c Dr.		xxx	
	To Partners capital/current a/c			xxx
	(Being salary paid)			

15.8.7 Partners loan:

If the partner advances an amount to the firm, partner's loan account is opened. Even though the rate of interest is not mentioned in the partnership deed, the partner is entitled to get 6% interest p.a.

15.8.8 Losses:

Profits and losses should be distributed according to the agreement. There may be possibility to have separate ratio for profits as well as losses. If the profits and losses sharing ratio is not mentioned in the deed, they should be distributed equally.

In case of profits, the share of profit should be credited to the capital accounts and in case of loss the share is debited to the capital accounts and credited to profit and loss account.

Date	Particulars		L.F.	Debit	Credit
	In case of profit:				
	P & L appropriation a/c	Dr.		xxx	
	To Partners capital/current a/c				xxx
	(Being transfer of profit)				
	In case of loss:				
	Partners capital/current a/c	Dr.		xxx	
	To P & L appropriation a/c				xxx
	(Being transfer of loss)				

Illus 1:

X, Y, Z are partners sharing profits and losses in the ratio of 5:3:2. They are maintaining capital accounts under fixed and fluctuating capital system.

Their capitals on 1-1-1991 were Rs.5,000; Rs.3,000; Rs.1,000. Y received a salary of Rs.75 p.m. and Z received a salary of Rs.600 p.a. Interest on Capital is at 6%. Rs.3,900 profit was earned on 31-12-1991 before charging interest on Capital and after charging salary. Drawings of the partners were Rs.600; Rs.500; Rs.400 respectively. Prepare partners capital accounts and current accounts.

Solution:

A. Fixed capital system:

Dr. Profit & Loss Appropriation Accounts Cr.

		Rs.		Rs.
To Capital a/c (Interest on Capital):			By Balance b/d	3,900
X	300			
Y	180			
Z	60			
		540		
To Capital a/c (Profit):				
X	1,680			
Y	1,008			
Z	672	3,360		

		3,900		3,900

Dr. **Capital Accounts** Cr.

Date	Particulars	X Rs.	Y Rs.	Z Rs.	Date	Particulars	X Rs.	Y Rs.	Z Rs.
1991 Dec. 31	To Drawings	600	500	400	1991 Jan.1	By Balance b/d	5,000	3,000	1,000
	To Balance c/d	6,380	4,588	1,933	Dec.31	By Salaries	---	900	600
						By P & L app. a/c (interest on capital)	300	180	60
						By P & L app. a/c (profit)	1,680	1,008	672
		6,980	5,088	2,333			6,980	5,088	2,333
					1992 Jan.1	By Balance b/d	6,380	4,588	1,933

B. Fluctuating capital system:

Dr. **Profit & Loss Appropriation Accounts** **Cr.**

		Rs.		Rs.
To Current a/c (Interest on Capital):			By Balance b/d	3,900
X	300			
Y	180			
Z	60			
		540		
To Current a/c (Profit):				
X	1,680			
Y	1,008			
Z	672	3,360		
		3,900		3,900

Dr. **Current Accounts** **Cr.**

Date	Particulars	X Rs.	Y Rs.	Z Rs.	Date	Particulars	X Rs.	Y Rs.	Z Rs.
1991					1991				
Dec.	To Drawings	600	500	400	Jan.1	By Salaries	-	900	600
31	To Balance c/d	1,380	1,588	932		By P & L a/c	300	180	60
						By P & L Adjustment a/c	1,680	1,008	672
		1,980	2,088	1,333			1,980	2,088	1,333
						By Balance b/d	1,380	1,588	932

Dr. **Capital Accounts** **Cr.**

Date	Particulars	X Rs.	Y Rs.	Z Rs.	Date	Particulars	X Rs.	Y Rs.	Z Rs.
1991					1991				
Dec. 31	To Balance c/d	5,000	3,000	1,000	Jan.1	By Balance b/d	5,000	3,000	1,000
		5,000	3,000	1,000			5,000	3,000	1,000
						By Balance b/d	5,000	3,000	1,000

15.9. FINAL ACCOUNTS

Just like in the sole trading concerns at the end of the year, the partnership firm should also prepare the final accounts. The profit or loss earned by the partnership firm should be credited or debited to their capital accounts. Separate capital accounts are maintained to each partner in the books of accounts. After adjusting profits or losses, interest on capital, drawings, interest on drawings, salaries and commission, the final capital accounts balances should be shown on the liabilities side of the balance sheet.

Illus 2:

From the following Trial Balance given as on 31-3-1999. Prepare Trading and Profit and Loss account and Balance Sheet as on that date.

Trail Balance

Dr.	Rs.	Cr.	Rs.
X's Drawings	**12,000**	**X's Capital**	**60,000**
Y,s Drawings	**10,000**	**Y's Capital**	**40,000**

Sundry Debtors	**45,000**	**Sundry Creditors**	**45,000**
Plant, Machinery	**50,000**	**Bills payable**	**10,000**
Fixtures, Fittings	**10,000**	**Purchase returns**	**1,000**
Opening stock	**30,000**	**Sales**	**1,15,000**
Cash in hand	**350**		
Cash at bank	**10,000**		
Purchases	**55,000**		
Wages	**16,000**		
Salaries	**12,000**		
Insurance	**350**		
Sales returns	**1,200**		
Carriage	**400**		
Commission	**850**		
Rent, Taxes	**5,500**		
Discount	**200**		
Trade expenses	**600**		
Bad debts	**250**		
Bills receivable	**10,000**		
Sundry Expenses	**1,800**		
	2,71,500		**2,71,500**

Partners sharing profits and losses equally.

a) Closing stock Rs.45,000

b) Provide Interest on Capital @ 6% p.a.

c) Y supervises the business and he gets a salary of Rs.600 p.a.

d) Outstanding expenses: Wages Rs.1,200, Salaries Rs.500.

e) Depreciate Plant by 5% and provide 5% for Bad and doubtful debts.

Solution:

Trading and Profit & Loss Account of X and Y for the year ending 31-3-1999

Dr. **Cr.**

	Rs.	**Rs.**		**Rs.**	**Rs.**
To Opening Stock		30,000	By Sales	1,15,500	
To Purchases	55,000		Less: Sales returns	1,200	
Less: Purchase returns	1,000	54,000			1,14,300

			By Closing Stock		45,000
To Wages	16,000				
Add: Outstanding wages	1,200	17,200			
To Carriage expenses		400			
To Trading Expenses		600			
To Gross Profit c/d		57,100			
		1,59,300			1,59,300
To Salaries	12,000		By Gross Profit b/d		57,100
Add: Outstanding salaries	500	12,500			
		350			
To Insurance		850			
To Commission		5,500			
To Rent, Taxes		200			
To Discount		1,800			
To Sundry Expenses	250				
To Bad Debts	2,250	2,500			
Add: Further bad debts					
To Depreciation on Plant and Machinery		2,500			
		30,900			
To Net Profit		57,100			57,100

Profit & Loss Appropriation Account of X, Y for the year ended 31-3-1999

Dr. **Cr.**

		Rs.		Rs.
To Y's Salary		7,200	By Net Profit	30,900
To Interest on Capital				
X	3,600			
Y	2,400	6,000		
To X's Capital (1/2)	8,850			
To Y's Capital (1/2)	8,850	17,700		
		30,900		30,900

Balance sheet as on 31-3-1999

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		45,000	Cash in hand		350
Bills payable		10,000	Cash at bank		10,000
Outstanding expenses			Debtors	45,000	
Wages	1,200		Less: Reserve for Bad	2,250	
Salaries	500	1,700	debts		42,750
					10,000
Capital Accounts:			Bills receivable		45,000
X's Capital	60,000		Closing stock		10,000
Add: Interest on Capital	3,600		Fixtures, Fittings	50,000	
Add: Net Profit (1/2)	8,850		Plant, Machinery	2,500	47,500
	72,450		Less: Depreciation		
Less: Drawings	12,000	60,450			
Y's Capital	40,000				
Add: Interest on Capital	2,400				
Add: Net Profit (1/2)	8,850				
Add: Salary	7,200				
	58,450				
Less: Drawings	10,000	48,450			
		1,65,600			1,65,600

15.10 QUESTIONS

1. Define partnership? What are the essentials of a partnership?
2. What is a partnership deed? Mention the important clauses in it.
3. What do you understand by fixed and fluctuating capitals of partnership?

15.11.EXERCISES

1. X and Y are sharing profits and losses equally. 'Z' is admitted for 1/4th share in future profits. What will be their new profit sharing ratio?
   (Ans: 3:3:2)

2. X and Y were partners sharing profits in the ratio of 3:2. ‘Z’ was admitted with 1/5th share in profits. Calculate the new profit sharing ration. What will be the new ratio if ‘Z’ takes 1/4th share in profits?

   (Ans: (a) 12:8:5; (b) 9:6:5)

3. X and Y are partners, sharing profits in the ratio of 5:3. Z is admitted and is given 1/4th share in the profits. What will be the new profit sharing ratio of X, Y and Z?

   (Ans: 15:9:8)

4. Ravi and Kiran are sharing profits and losses in the ratio of 5/8 : 3/8. They admit Rahul on 3/7th share in the firm, which he takes 2/7th from Ravi and 1/7th from Kiran. Calculate new profit sharing ratio of Ravi, Kiran and Rahul.

   (Ans: 19:13:24)

5. Bhavya and Kavya share profits in the ratio of 5:3. They admit Sravya as a partner. Their new profit sharing ratio is 7:5:4. Calculate the sacrificing ratio.

   (Ans: Sacrificing ratio 3:1)

6. Tom and Tim are partners sharing profits and losses in 3:2 ratio. They admit Jim as a partner who has to contribute Rs.5,000 as his capital and premium for goodwill for the 1/5th share. He being unable to bring any cash for capital, requested Tom to grant Rs.3,000 as loan and Tim Rs.2,000 as loan. Since he couldn’t bring his share of goodwill also, it was raised in the books at Rs.15,000. Tom and Tim had capitals of Rs.18,000 and Rs.12,000 respectively. Pass necessary journal entries in the books of the firm and show the balance sheet of the new firm, assuming that the firm’s total capital is in the profit sharing ratio, partners either bringing in or taking out.

   (Ans: Cash withdrawn by Tom Rs.10,200; Cash withdrawn by Tim Rs.6,800;
   Cash brought by Jim Rs.2,000; Balance sheet total Rs.50,000; Other Assets
   balance Rs.35,000)

7. A and B are partners in a firm sharing profits in the ratio 3:2 with capitals of Rs.12,000 and Rs.5,400 respectively. They advised ‘X’ as a partner with Rs.7,500 for 1/3rd share in the profits of the firm. Adjust the capitals of the partners according to the profit sharing ratio and show the amount of each partner. (No entries are required)

(Ans: Capital accounts: A Rs.9,000; B Rs.6,000)

8. M is admitted for 1/5th share in a firm and he is required to bring his share of goodwill. The goodwill is to be determined on the basis of 3 years purchase price of the average profits of the business for the last five years. Particulars of profit were

1997	Rs.20,000 (Profit)
1998	Rs.10,000 (Loss)
1999	Rs.20,000 (Profit)
2000	Rs.25,000 (Profit)
2001	Rs.30,000 (Profit)

Ascertain the amount of goodwill to be brought in by M

(Ans: Rs.51,000)

9. Squeeze and Wriggle share profits in the ratio of 2:1. As on 30th June, 2005 their books showed the following balances. You are required to prepare Trading and Profit & Loss Account for the year ending 30th June, 2005 and their Balance Sheet as on that date:

	Rs.		Rs.
Squeeze's capital	40,000	Buildings	36,870
Squeeze's Drawings	2,125	Interest a/c (Dr.)	1,060
Wriggle's capital	30,000	Advertising	1,075
Wriggle's Drawings	1,500	General charges	2,670
Office salaries	4,965	Discount (Cr.)	200
Plant and machinery	32,100	Reserve for bad debts	625
Purchases	80,155	Taxes and Insurance	1,235
Purchase returns	1,070	Furniture	1,000
Sales	1,43,035	Repairs	1,245
Sale returns	800	Manufacturing expenses	1,175
Wages	25,785	Bad debts	555
Opening stock:		Sundry debtors	15,710
Raw materials	8,995	Sundry creditors	4,300

Finished goods	10,000	Bills receivable	4,465
Cash in hand	815		
Cash at bank	5,680		
Donation to cyclone relief fund	500		
Loss on mortgage	21,250		

Adjustments:

(a) Closing stock:

Raw materials Rs.13,000

Finished goods Rs.23,000

(b) Partners are entitled to interest on capital at 6% per annum

(c) Write off depreciation on plant and machinery at 10%, on buildings at 5% and on furniture at 10%.

(d) Bad debts reserve is to be raised to Rs.1,000

(e) Rs.800 for wages and Rs.1,000 for salaries are outstanding.

(Ans: Gross profit Rs.52,395; Net profit Rs.28,562; Balance Sheet Rs.1,26,487)

15.12 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 16

ADMISSION OF A PARTNER

Objectives:

The lesson gives information about the:

1. Admission of the partner
2. Accounting treatment in the books of the firm at the time of admission

Structure:

16.1 Introduction

16.2 Accounting Treatment

16.2.1. Capital brought by the new partner

16.2.2. Goodwill treatment

16.2.3. Revaluation of Assets and Liabilities

16.2.4. Distribution of undistributed profits to the old partners

16.2.5. Adjustment of partners capital accounts

16.2.6. Calculation of new profit sharing ratio and sacrificing ratio

16.3 Questions

16.4 Exercises

16.5 Suggested Readings

16.1 INTRODUCTION:

Whenever a partner is admitted in the partnership firm, the firm has to close the books of accounts in the middle of the year. The admission of a partner may be due to the following reasons. It may be due to the requirement of additional capital or because of technological or managerial reasons. The admission of a partner requires the following adjustments in the books of the firm:

1. Capital brought by the new partner
2. Goodwill treatment
3. Revaluation of assets and liabilities
4. Distribution of undistributed profits to the old partners

5. Adjustment of partners capital accounts
6. Calculation of new profit sharing ratio

16.2 ACCOUNTING TREATMENT :

16.2.1 Capital brought by the new partner: When a partner is admitted into the partnership firm, he has to bring capital into the firm. The capital may be brought in the form of cash or assets. The following journal entries are required for the capital brought by the new partner:

Date	Particulars		L.F.	Debit	Credit
	If capital is in the form of cash:				
	Cash a/c	Dr.		xxx	
	To New partner's capital a/c				xxx
	(Being capital brought)				
	If it is in the form of different assets:				
	Machinery a/c	Dr.		xxx	
	Furniture a/c	Dr.		xxx	
	Buildings a/c etc.	Dr.		xxx	
	To New partner's capital a/c				xxx
	(Being capital brought)				

16.2.2 Goodwill treatment: Goodwill is the amount paid by the new partner to the old partners to get his share of profit in the new firm. Hence the goodwill amount is owned by old partners. It should be distributed among the old partners according to their sacrificing ratio. Sacrificing ratio is nothing but the difference between the old profit sharing ratio and the new profit sharing ratio. Goodwill value is calculated under four methods. They are: 1) Average profit method 2) Super profits method 3) Capitalisation method. The following procedure is adopted to record the goodwill in the books of the firm at the time of admitting a partner.

16.2.2.1 Average Profit Method: Under this method goodwill is calculated on the basis of the average profits of the previous year multiplied by the number of years purchase.

$$\text{Average profit} = \frac{\text{Profit of the last years}}{\text{No. of years}}$$

Goodwill = Average profit X No. of years purchase

16.2.2.2 Super profits method: The difference between the actual or average profit and the normal profit is known as super profit. Calculate the actual or average profit. Then calculate normal profits on capital employed.

$$\text{Normal profit} = \frac{\text{Capital employed X Normal Rate}}{100}$$

Goodwill = Super profits X No of years purchase

16.2.2.3 Capitalisation method: Under this method the goodwill is valued in two methods. 1. Capitalisation of average profits and 2. Capitalisation of super profits.

a. **Capitalisation of Average Profits:** Calculate average profit for the past specified period and second calculate the value of the business. Value of Business = Average profit /Normal rate of return X100. Calculate the capital employed by deducting the outsiders liabilities from the total assets (other than goodwill). Net assets = Total assets (excluding fictitious assets)- Outsiders liabilities. Now goodwill can be arrived by deducting net assets from the value of business.

b. Capitalisation of Super Profits: By capitalising super profits goodwill can be calculated under this method.

16.2.2.4 Accounting Treatment of Goodwill: The new partner can bring goodwill in four ways. The accounting treatment for goodwill is:

a. When the goodwill is brought in the form of cash and retained in the business:

Whenever the new partner brings the goodwill in the form of cash the accounting treatment is:

Date	Particulars	L.F.	Debit	Credit
	For bringing the goodwill in cash:			
	Cash a/c Dr.		xxx	
	To Goodwill a/c			xxx
	(Being goodwill brought)			

	For distributing the goodwill to the old partners:			
	Goodwill a/c Dr.		xxx	
	To Old partner's capital a/c			xxx
	(Being goodwill distributed)			

Illus 3: ABC share profits and losses in the ratio of 5:3:2. They admit Das a Partner by giving him 1/5 share in future profits. He brings Rs.20,000 as his share of Goodwill. Old partners retain their share of goodwill in the firm. Draft Journal Entries.

Solution:

Date	Particulars	L.F.	Debit	Credit
	For bringing the goodwill in cash:			
	Cash a/c Dr.		20,000	
	To Goodwill a/c			20,000
	(Being goodwill brought)			
	For distributing the goodwill to the old			
	partners:		20,000	
	Goodwill a/c Dr.			10,000
	To A capital a/c			6,000
	To B capital a/c			4,000
	To C capital a/c			
	(Being goodwill distributed)			

b. When the goodwill is brought in the form of cash and withdrawn by the partners partially or as a whole:

Whenever the new partner brings the goodwill in the form of cash and if the shared goodwill amount is withdrawn partially or wholly by the old partners the accounting treatment is:

Date	Particulars	L.F.	Debit	Credit
	For bringing the goodwill in cash:			
	Cash a/c Dr.		xxx	
	To Goodwill a/c			xxx
	(Being goodwill brought)			
	For distributing the goodwill to the old partners:		xxx	
	Goodwill a/c Dr.			xxx
	To Old partners' capital a/c			
	(Being goodwill distributed)			
	For withdrawing the shared amount partially or as a whole by the old partners':		xxx	
	Old partners' capital a/cs Dr.			xxx
	To cash a/c			
	(Being cash withdrawn by the partners)			

Illus 4: ABC share profits and losses in the ratio of 5:3:2. They admit Das a Partner by giving him 1/5 share in future profits. He brings Rs.20,000 as his share of Goodwill and also brings Rs.50,000 as his capital. Old partners withdrew their share of goodwill. Draft Journal Entries.

Solution:

Date	Particulars	Debit Rs.	Credit Rs.
	Cash a/c Dr.	50,000	
	To D's Capital a/c		50,000
	(Being Capital introduced)		
	Cash a/c Dr.	20,000	
	To Goodwill a/c		20,000
	(Being goodwill brought)		
	Goodwill a/c Dr.	20,000	
	To A's Capital a/c		20,000
	To B's Capital a/c		
	To C's Capital a/c		
	(Being goodwill distributed)		
	A's Capital a/c Dr.	10,000	
	B's Capital a/c Dr.	6,000	
	C's Capital a/c Dr.	4,000	
	To Cash a/c		20,000
	(Being the goodwill withdrawn by the old partners)		

c. **If the goodwill raised in the firm's books:**

If there is an agreement between new and old partners' to raise the goodwill in the firm's books the accounting treatment is:

Date	Particulars	L.F.	Debit	Credit
	For raising the goodwill in the books of the firm:		xxx	
	Goodwill a/c			xxx
	Dr.			
	To Old partners' capital a/c			
	(Being goodwill raised)			

In this case the goodwill amount appears on the assets side of the new balance sheet.

Illus 5: ABC share profits and losses in the ratio of 5:3:2. They admit Das a Partner by giving him 1/5 share in future profits. They agreed to raise the goodwill Rs.20,000 in the books of the firm. Draft Journal Entries.

Solution:

Date	Particulars	Debit Rs.	Credit Rs.
	Goodwill a/c Dr.	20,000	
	To A's Capital a/c		10,000
	To B's Capital a/c		6,000
	To C's Capital a/c		4,000
	(Being goodwill distributed)		

d. If the goodwill raised and then written off in the firm's books:

If the goodwill is raised and then written of in the firm's books at the time of admission of a partner the accounting treatment is:

Date	Particulars	L.F.	Debit	Credit
	For raising the goodwill in the books of the firm:		xxx	
	Goodwill a/c Dr.			xxx
	To Old partners' capital a/c			
	(Being goodwill raised in the books according to the old profit sharing ratio)			
	If the raised goodwill written off:		xxx	
	Old partners' capital a/c Dr.		xxx	
	New partner capital a/c Dr.			Xxx
	To Goodwill a/c			
	(Being raised goodwill written off according to the new profit sharing ratio)			

Illus 6:

ABC share profits and losses in the ratio of 5:3:2. They admit Das a Partner. The new profit sharing ratio is 2:1:1:1. They agreed to raise the goodwill Rs.20,000 in the books of the firm and it should be written off from the books of accounts. Draft Journal Entries.

SOLUTION:

Date	Particulars	L.F.	Debit	Credit
	For raising the goodwill in the books of the firm:			
	Goodwill a/c Dr.		20,000	
	To A capital a/c			10,000
	To B capital a/c			6,000
	To C capital a/c			4,000
	(Being goodwill raised in the books according to the old profit sharing ratio)			

	If the raised goodwill written off:			
	A capital a/c Dr.		8,000	
	B capital a/c Dr.		4,000	
	C capital a/c Dr.		4,000	
	Das capital a/c Dr.		4,000	
	To Goodwill a/c			20,000
	(Being raised goodwill written off according to the new profit sharing ratio)			

e. **When agreement made privately:**

When the amount of goodwill is paid privately by the new partner to the old partners no journal entry is required in the firms books of accounts. This is due to their private agreement, which is not related to the firm.

16.2.2 Revaluation of Assets and Liabilities: The new partner requests the old partners to re-value the assets and liabilities of the old firm. At the time of revaluation of assets and liabilities the related entries should be recorded in the "Profit and Loss Adjustment a/c; or Revaluation a/c". Losses are recorded on the debit side and profits on the credit side of the revaluation account.

Whenever the assets are reduced and liabilities are increased the loss arise, may shown on the debit side of the revaluation a/c. If the assets are increased and liabilities are decreased the profit arise, may shown on the credit side of the revaluation a/c. The difference in the revaluation account may be either profit or loss on revaluation, which should be distributed to the old partners.

Dr. **Revaluation account** **Cr.**

		Rs.		Rs.	Rs.
To Decrease of Assets:			**By Increase of Assets:**		
Land & Buildings	xxx		Investments	xxx	
Plant & Machinery	xxx		Type writer etc.	xxx	
Furniture & fittings	xxx				xxx
Stock etc.	xxx		**By Decrease in Liabilities:**		xxx

		xxx			
To Increase in Liabilities:					
Sundry creditors	xxx				
New liabilities etc.	xxx	xxx			
To A capital a/c*	xxx				
To B capital a/c*	xxx	xxx			
		xxx			xxx

*** In case of revaluation loss reverse the above entry**

16.2.3 Distribution of undistributed profits to the old partners: The past profits which are not distributed are known as undistributed profits. These profits are to be distributed to the old partners. If the general reserve, or profit and loss account appears on the liabilities side of the given balance sheet, then we may conclude that the firm has undistributed profits. These amounts should be distributed to the old partners according to the profit sharing ratio. The journal entry for that is:

Date	Particulars	L.F.	Debit	Credit
	General Reserve a/c or P & L a/c Dr.		xxx	
	To Old partners' capital a/c			Xxx
	(Being undistributed profit distributed)			

16.2.4 Adjustment of partners capital accounts: If there is an agreement among the partners on the adjustment of capital accounts, these accounts are to be adjusted on the basis of new partner capital amount. After the adjustment, if the old partners' capital accounts have more balance the amount is going to be withdrawn by the old partners. If the old partners' capital accounts have less balance the partners may bring cash for adjustment of capital.

Date	Particulars	L.F.	Debit	Credit
	If the capital accounts have more balance:			
	Old partners' capital a/cs Dr.		xxx	
	To Cash a/c			xxx
	(Being excess cash withdrawn)			
	If the capital accounts have less balance:			
	Cash a/c Dr.		xxx	
	To Old partners' capital a/cs			xxx
	(Being cash brought)			

16.2.5 Calculation of new profit sharing ratio and sacrificing ratio:

16.6 New profit sharing ratio: Whenever the new partner is admitted into the firm, the future profit sharing ratio may change. The calculation of future profit sharing ratio related to the partners is known as new profit sharing ratio.

16.7 Sacrificing ratio: Sacrificing ratio is nothing but the difference between the old ratio and the new ratio. Generally sacrificing ratio is used for the distribution of goodwill. Sacrificing ratio should be calculated only for old partners.

First Model:

Illus 7:

X, Y and Z are sharing profits and losses in the ratio of 4 : 3 : 3. They admitted A into partnership for 1/5th share. What will be the new profit sharing ratio and sacrificing ratio?

Solution:

a. New profit sharing ratio:

Total profits of the new firm assumed as 1. In that A's share = 1/5th .

Remaining share = 1 – 1/5th = 4/5th

X's new share = Remaining share X His old share

= 4/5th X 4/10 = 16/50

Y's new share = Remaining share X His old share

= $4/5^{th}$ X 3/10 = 12/50

Z's new share = Remaining share X His old share

= $4/5^{th}$ X 3/10 = 12/50

A's share = $1/5^{th}$ or 10/50

∴New profit sharing ratio = 16 : 12 : 12 : 10 (or) 8 : 6 : 6 : 5

b. Sacrificing ratio:

Sacrificing ratio of X = Old share – New share = 4/10 – 8/25 = 4/50

Sacrificing ratio of Y = Old share – New share = 3/10 – 6/25 = 3/50

Sacrificing ratio of Z = Old share – New share = 3/10 – 6/25 = 3/50

∴ Sacrificing ratio = 4 : 3 : 3

Second Model:

Illus.8:

A and B share profits and losses in the ratio of 7 : 5. C is admitted as a partner and A surrendered $1/7^{th}$ of his share and B $1/3^{rd}$ of his share in favour of C. Find out the new ratio.

Solution:

A's new share = Old share – Surrendered share = 7/12 – 1/7 = 37/84

B's new share = Old share – Surrendered share = 5/12 – 1/3 = 1/12 or 7/84

C's share = 1/7 + 1/3 = 10/21 or 40/84

∴New profit sharing ratio = 37 : 7 : 40

Illus 9:

X,Y are partners in the firm. They share profits and losses in the ratio of 5:3. Their positions on 31-3-2002 was as under.

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		**Plant, Machinery**	**40,000**
X	**40,000**	**Stock**	**40,000**
Y	**30,000**	**Debtors**	**30,000**

Creditors	**15,000**	**Bills receivable**	**10,000**
Bank Overdraft	**42,500**	**Cash at bank**	**7,500**
	1,27,500		**1,27,500**

They want to join Z as a partner:

a. **Z will get ¼ share**

b. **Z will bring Rs.40,000 as capital**

c. **Z also brings Rs.4,000 as premium which will retain in the business.**

d. **Depreciate plant by 10%.**

e. **Provide 5% Reserve for Bad debts on Debtors**

f. **Increase stock by 10%.**

Prepare Journal Entries and also prepare Balance Sheet.

SOLUTION:

Journal Entries

Date	Particulars		Debit Rs.	Credit Rs.
	Bank a/c	Dr.	44,000	
	To Z's Capital a/c			40,000
	To Goodwill a/c			4,000
	(Being the goodwill brought by new partner)			
	Goodwill a/c	Dr.	4,000	
	To X's Capital a/c			2,500
	To Y's Capital a/c			1,500
	(Being the distribution of goodwill to Old partners in old sharing ratio)			
	Profit & Loss Adjustment a/c	Dr.	5,500	
	To Plant a/c			4,000
	To Reserve for Bad debts a/c			1,500
	(Being the reduction value of Plant and the provision for Bad debts)			

	Stock a/c Dr.	4,000	
	To Profit & Loss Adjustment a/c		4,000
	(Being the increasing the value of Closing stock)		
	X's Capital a/c Dr.	937.50	
	Y's Capital a/c Dr.	562.50	
	To Profit & Loss Adjustment a/c		1,500
	(Being the distribution of Revaluation Loss)		

Dr. Profit & Loss Adjustment a/c Cr.

	Rs.		Rs.
To Plant a/c	4,000.00	By Stock	4,000.00
To Reserve for Bad debts	1,500.00	By X's Capital a/c	937.50
		By Y's Capital a/c	562.50
	5,500.00		5,500.00

Dr. Capital Accounts Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To P & L				By Balance			
Adjustment	937.50	562.50	40,000.00	b/d	40,000.00	30,000.00	---
a/c	41,562.50	33,937.50	---	By Goodwill	2,500.00	1,500.00	---
To Balance	42,500.00	31,500.00	40,000.00	By Bank	---	---	40,000.00
c/d					42,500.00	31,500.00	40,000.00
				By Balance			
				b/d	41,562.50	30,937.50	40,000.00

Dr. Bank a/c Cr.

	Rs.		Rs.
To Balance c/d	7,500	By Balance c/d	51,500
To Z's Capital a/c	40,000		
To Goodwill a/c	4,000		
	51,500		51,500
To Balance b/d	51,500		

Dr. Goodwill a/c Cr.

	Rs.		Rs.
To X's Capital a/c	2,500	By Bank a/c	4,000
To Y's Capital a/c	1,500		
	4,000		4,000

Balance Sheet of X, Y, Z as on 31-12-2002

Liabilities	Rs.	Assets	Rs.	Rs.
Creditors	15,000.00	Cash at Bank		51,500.00
Bank Overdraft	42,500.00	Stock		44,000.00
Capital a/cs:		Debtors	30,000	
X	41,562.50	Less: Reserve	1,500	
Y	30,937.50			28,500.00
Z	40,000.00	Bills receivable		10,000.00
		Plant		36,000.00
	1,70,000.00			1,70,000.00

Illus.10:

A and B are partners in a firm sharing profits and losses as 5:3. The position of the firm as on 31st March, 2002 is as follows:

Capital & Liabilities	**Rs.**	**Assets**	**Rs.**
Capital:		**Plant**	**40,000**
A	**30,000**	**Stock**	**30,000**
B	**20,000**	**Debtors**	**20,000**
Sundry creditors	**15,000**	**Bills Receivable**	**10,000**
Bank overdraft	**42,500**	**Cash at Bank**	**7,500**
	1,07,500		**1,07,500**

C now joins them on condition that he will share ¾ of future profits, the balance of profits being shared by A and B as 5:3. He introduces Rs.40,000 by way of capital in cash and pay off the overdraft. He also pays Rs.4,000 by way of premium for goodwill of the

business and this amount is to remain in the business. The partners agree to depreciate plant by 10% and raise a reserve against Sundry debtors by 5%.

You are asked to journalise the entries in the books of the firm and show the resultant Balance Sheet. How will the partners share future profits?

SOLUTION :

Calculation of future Profit Sharing Ratio:

Total profits of the new firm = 1

C's share = ¾

Remaining share = 1 - ¾ = ¼

A's new share = Old share X Remaining share

= 5/8 x ¼ = 5/32

B's new share = 3/8 x ¼ = 3/32

C's share = ¾ = 24/32

New profit sharing ratio = 5 : 3 : 24

Journal entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Cash Dr. To C's Capital a/c (Being capital brought)		40,000	 40,000
	Cash a/c Dr. To Goodwill a/c (Being goodwill brought)		4,000	 4,000
	Goodwill a/c Dr. To A's Capital a/c To B's Capital a/c (Being goodwill transferred to old partners)		4,000	 2,500 1,500
	Cash a/c Dr. To C's Capital a/c (Being cash brought by C)		42,500	 42,500

	Bank Overdraft a/c Dr. To Cash a/c (Being bank overdraft paid)		42,500	 42,500
	Revaluation a/c Dr. To Plant a/c (Being plant depreciated)		4,000	 4,000
	Revaluation a/c Dr. Reserve for Bad debts (Being revalued loss distributed)		1,000	 1,000
	A's Capital a/c Dr. B's Capital a/c Dr. To Revaluation a/c (Being revalued loss distributed)		3,125 1,875	 5,000

Dr. Revaluation a/c Cr.

	Rs.		Rs.	Rs.
To Plant a/c	4,000	By A's Capital a/c	3,125	
To Reserve for Bad debts	1,000	By B's Capital a/c	1,875	5,000
	5,000			5,000

Dr. Capital Accounts Cr.

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To Revaluation	3,125	1,875	---	By Balance b/d	30,000	20,000	---
To Balance c/d	29,375	19,625	82,500	By Cash a/c	---	---	40,000
				By Goodwill a/c	2,500	1,500	---
				By Cash a/c	---	---	42,500
	32,500	21,500	82,500		32,500	21,500	82,500
				By Balance b/d	29,375	19,625	82,500

Dr. **Cash a/c** Cr.

	Rs.		Rs.
To C's Capital a/c	40,000	By Bank overdraft	42,500
To Goodwill a/c	4,000	By Balance c/d	44,000
To C's Capital a/c	42,500		
	86,500		86,500
To Balance b/d	44,000		

Balance Sheet of A, B, C as on 1-4-2002

Liabilities	Rs.	Assets	Rs.	Rs.
A's Capital	29,375	Plant & Machinery		36,000
B's Capital	19,625	Stock		30,000
C's Capital	82,500	Sundry Debtors	20,000	
Sundry Creditors	15,000	Less: Reserve for bad	1,000	19,000
		debts		10,000
		Bills receivable		7,500
		Cash at Bank		44,000
	1,46,500	Cash in hand		1,46,500

Illus. 11:

The following is the Balance Sheet of J, K and L sharing profits and losses in the proportion of 6 : 5 : 3 respectively:

	Rs.		Rs.
Creditors	**18,900**	**Cash**	**1,890**
Bills payable	**6,300**	**Debtors**	**26,460**
General Reserve	**10,500**	**Stock**	**29,400**
J's Capital	**35,400**	**Furniture**	**7,350**
K's Capital	**29,850**	**Land and Buildings**	**45,150**
L's Capital	**14,550**	**Goodwill**	**5,250**
	1,15,500		**1,15,500**

They agreed to take A into partnership and give him 1/8th share on the following terms:

a. **The furniture to be depreciated by Rs.920**
b. **The stock to be depreciated by 10%.**
c. **That a provision of Rs.1,320 be made for outstanding repair bills.**
d. **That the value of the land and buildings be brought up to Rs.59,850**
e. **That the value of Goodwill be brought upto Rs.14,070.**
f. **That A should bring in 14,700 as his capital**
g. **That after making the above adjustments, the capital amounts of the old partners be adjusted in the proportion of A's capital to his share in the business.**

Pass necessary journal entries and prepare the Balance Sheet of New Firm.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Cash Dr. To A's Capital a/c (Being capital brought)		14,700	 14,700
	Goodwill a/c Dr. To J's Capital a/c To K's Capital a/c To L's Capital a/c (Being goodwill raised the books)		8,820	 3,780 3,150 1,890
	Revaluation a/c Dr. To Furniture a/c To Stock a/c To Provision for Repair bills a/c (Being assets & liabilities revalued)		5,180	 920 2,940 1,320
	Land & Buildings a/c Dr. To Revaluation a/c (Being revaluation of assets)		14,700	 14,700
	Revaluation a/c Dr.		9,520	

	To J's Capital a/c			4,080
	To K's Capital a/c			3,400
	To L's Capital a/c			2,040
	(Being revalued profits distributed)			
	General Reserve a/c Dr.		10,500	
	To J's Capital a/c			4,500
	To K's Capital a/c			3,750
	To L's Capital a/c			2,250
	(Being undistributed profits distributed)			
	J's Capital a/c Dr.		3,660	
	K's Capital a/c Dr.		3,400	
	To J's Current a/c			3,660
	To K's Current a/c			3,400
	(Being capital adjusted)			
	L's Current a/c Dr.		1,320	
	To L's Capital a/c			1,320
	(Being capital adjusted)			

Dr. Revaluation a/c Cr.

		Rs.		Rs.
To Furniture a/c		920	By Land & Buildings	14,700
" Stock a/c		2,940		
" Provision for Repairs bills		1,320		
" J's Capital a/c	4,080			
" K's Capital a/c	3,400			
" L's Capital a/c	2,040	9,520		
		14,700		14,700

Dr. **Capital Accounts** **Cr.**

Particulars	J Rs.	K Rs.	L Rs.	A Rs.	Particulars	J Rs.	K Rs.	L Rs.	A Rs.
To Current a/c	3,660	3,400		---	By Balance b/d	35,400	29,850	14,550	14,700
To Balance c/d	44,100	36,750	22,050	14,700	By Cash a/c	3,780	3,150	1,890	
					By Goodwill	4,080	3,400	2,040	
					By Revaluation	4,500	3,750	2,250	
					By General Reserve			1,320	
	47,760	40,150	22,050	14,700		47,760	40,150	22,050	14,700
					By Current a/c	44,100	36,750	22,050	14,700
					By Balance b/d				

Dr. **Cash a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	1,890	By Balance c/d	16,590
To J's Capital a/c	14,700		
	16,590		16,590
To Balance b/d	16,590		

Dr. **Goodwill a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	5,250	By Balance c/d	14,070
To J's Capital a/c	3,780		
To K's Capital a/c	3,150		
To L's Capital a/c	1,890		
	14,070		14,070
To Balance b/d	14,070		

Calculation of New Profit Sharing Ratio:

Total profits of the new firm	=	1
A's capital	=	1/8
Remaining share	=	1 – 1/8 = 7/8
J's new share	=	7/8 X 6/14 = 42/112
K's new share	=	7/8 X 5/14 = 35/112
L's new share	=	7/8 X 3/14 = 21/112
A's share	=	1/8 = 14/112
New profit sharing ratio	=	42 : 35 : 21 : 14
	=	6 : 5 : 3 : 2

Capital Adjustments: (on the basis of New Partner A)

A's share	2 – 14,700 Capital
J For	6 - ?
	6/2 X 14,700 = 44,100
K For	5 - ?
	5/2 X 14,700 = 36,750
L For	3 - ?
	3/2 X 14,700 = 22,050

Balance Sheet of J, K & L as on ………..

Liabilities	Rs.	Assets	Rs.
Creditors	18,900	Cash a/c	16,590
Bills payable	6,300	Debtors	26,460
J's Capital	44,100	Stock	26,460
K's Capital	36,750	Furniture	6,430
L's Capital	22,050	Land & Buildings	59,850
A's Capital	14,700	Goodwill	14,070
Provision for Repairs Bills	1,320	L's current a/c	1,320
J's current a/c	3,660		
K's current a/c	3,400		
	1,51,180		1,51,180

Illus.12:

R and S partners in a business share profits and losses in the ratio of 3 : 1. Their Balance sheet as on 31-12-2001 was as under:

	Rs.	Rs.		Rs.
Creditors		37,500	Bank	22,500
General Reserve		4,000	Bills receivable	3,000
Capitals:			Debtors	16,000
R	30,000		Stock	20,000
S	16,000	46,000	Furniture	1,000
			Buildings	25,000
		87,500		87,500

On 1-1-2002, they admit T on the following terms:

a. **That T pays Rs.10,000 as his capital for 1/5 share of profits**
b. **That goodwill account be raised to Rs.20,000.**
c. **That stock and furniture be reduced by 10% and provision of 5% be made for doubtful debts.**
d. **That the value of Buildings be appreciated by 20%**
e. **That the capital accounts of all the partners be readjusted on the basis of their profit sharing arrangements and any additional amount to be credited to their current accounts.**

Prepare Revaluation account and capital accounts and the opening Balance Sheet of the firm.

SOLUTION:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Cash Dr. To T's Capital a/c (Being capital brought)		10,000	 10,000

	Goodwill a/c Dr.		20,000	
	To R's Capital a/c			15,000
	To S's Capital a/c			5,000
	(Being goodwill raised the books)			
	Revaluation a/c Dr.		2,900	
	To Stock a/c			2,000
	To Furniture a/c			100
	To Provision for Bad debts a/c			800
	(Being assets revalued)			
	Buildings a/c Dr.		5,000	
	To Revaluation a/c			5,000
	(Being asset revalued)			
	Revaluation a/c Dr.		2,100	
	To R's Capital a/c			1,575
	To S's Capital a/c			525
	(Being revalued profits distributed)			
	General Reserve a/c Dr.		4,000	
	To R's Capital a/c			3,000
	To S's Capital a/c			1,000
	(Being undistributed profits distributed)			
	R's Capital a/c Dr.		19,575	
	S's Capital a/c Dr.		12,525	
	To R's Current a/c			19,575
	To S's Current a/c			12,525
	(Being capital adjusted)			

Dr. Revaluation a/c Cr.

		Rs.		Rs.
To Stock a/c		2,000	By Buildings	5,000
" Furniture		100		
" Reserve for Bad debts		800		
" R's Capital a/c	1,575			
" S's Capital a/c	525	2,100		
		5,000		5,000

Dr. Capital Accounts Cr.

Particulars	R Rs.	S Rs.	T Rs.	Particulars	R Rs.	S Rs.	T Rs.
To Current a/c	19,575	12,525		By Balance b/d	30,000	16,000	
To Balance c/d	30,000	10,000	10,000	By Cash a/c			10,000
				By Goodwill a/c	15,000	5,000	
				By Revaluation	1,575	525	
				By General Reserve	3,000	1,000	
	49,575	22,525	22,050		47,760	22,525	10,000
				By Balance b/d	30,000	10,000	10,000

Calculation of New Profit Sharing Ratio:

Total profits of the new firm = 1

T's share = 1/5

Remaining share = 1 – 1/5 = 4/5

R's new share = 4/5 X 3/4 = 12/20

S's new share = 4/5 X 1/4 = 4/20

T's share = 1/5 = 4/20

New profit sharing ratio = 12 : 4 : 4

= 3 : 1 : 1

Calculation of capital adjustments:

T's share 1 – 10,000

R For 3 - ?

	3/1 X 10,000 = 30,000
T's share	1 – 10,000
S For	1 - ?
	1/1 X 10,000 = 10,000

Balance Sheet of R, S & T as on 1-1-2002

Liabilities	Rs.	Assets	Rs.	Rs.
Creditors	37,500	Bank		22,500
R's Capital	30,000	Bills receivable		3,000
S's Capital	10,000	Debtors	16,000	
T's Capital	10,000	Less: Reserve for Bad debts	800	15,200
R's current a/c	19,575	Stock		18,000
S's current a/c	12,525	Furniture		900
		Buildings		30,000
		Cash		10,000
		Goodwill		20,000
	1,19,600			1,19,600

Illus.13 :

A and B are partners in a firm sharing profits and losses in the ratio of 4 : 3. Their Balance Sheet was as follows on 1st April 2002:

Balance Sheet

		Rs.		Rs.
Capitals:			**Goodwill**	**10,000**
A	**21,000**		**Plant & machinery**	**15,000**
B	**14,000**	**35,000**	**Patents**	**5,000**
General Reserve		**14,000**	**Sundry debtors**	**12,000**
Profit and Loss a/c		**7,000**	**Stock**	**18,000**
Sundry creditors		**14,000**	**Cash**	**10,000**
		70,000		**70,000**

C is admitted as partner on the above date on the following terms:

a. He is to be given 2/9th share in profits

b. He cannot bring his share of goodwill. The total goodwill of the firm is valued at Rs.24,000.

c. The assets are to be revalued as under:

Plant and machinery at 20% less than book value at Rs.4,000 stock at 16,500

d. A provision for doubtful debts is to be made at 5% of Sundry debtors

e. A liability of Rs.1,000 is not likely to arise. The firm has to pay an amount of Rs.1,900 as compensation to a worker.

f. C has to contribute sufficient cash to make his capital 2/9th of the total capital of the firm.

g. The capitals of the other partners are to be adjusted in the profit sharing proportions. Any difference being withdrawn or brought in cash.

Give Revaluation account, Capital accounts and Balance Sheet of the new firm.

SOLUTION :

Dr. **Revaluation a/c** **Cr.**

	Rs.			**Rs.**
To Machinery a/c	3,000	By Creditors		1,000
” Patents	1,000	” A's capital a/c	4,000	
” Stock	1,500	” B's capital a/c	3,000	7,000
” Reserve for Bad debts	600			
” Workers Compensation fund	1,900			
	8,000			8,000

Note: Calculation of C's goodwill:

Total firm's goodwill = 24,000

In that C's goodwill = 24,000 X 2/9 = 5,333

Dr. **Capital Accounts** **Cr.**

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To Revaluation	4,000	3,000		By Balance b/d	21,000	14,000	---
To Cash a/c	999	---	10,000	" Goodwill a/c	3,047	2,286	---
To Balance c/d	31,048	23,286		" General Reserve	8,000	6,000	---
				" P & L a/c	4,000	3,000	---
				" Cash a/c			15,524
				" Cash a/c	3,000	1,000	
	36,047	26,286	15,524		36,047	26,826	15,524
				By Balance b/d	31,048	23,286	15,524

Dr. **Cash a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	10,000	By A's capital a/c	999
To C's capital a/c	15,524	By Balance c/d	25,525
To B's capital a/c	1,000		
	26,524		26,524
To Balance b/d	25,525		

Calculation of New Profit Sharing Ratio:

Total profits of the new firm	=	1
C's share	=	2/9
Remaining share	=	1 – 2/9 = 7/9
A's new share	=	7/9 X 4/7 = 28/63
B's new share	=	7/9 X 3/7 = 21/63
C's share	=	2/9 = 14/63
New profit sharing ratio	=	28 : 21 : 14
	=	4 : 3 : 2

Calculation of C's capital:

	Rs.
A's capital a/c. Credit total	36,047
Less: A's capital a/c Debit total	4,000
	32,047
B's capital a/c Net balance (26,826 – 1,000)	25,286
Less: B's Capital a/c Debit total	3,000
B's capital a/c Net balance	22,286

At the time of calculating Net profit sharing ratio, remaining share = 7/9. That 7/9 should be distributed to A & B

7/9 value of capital = 54,333 (32,047 + 22,286)

2/9 value of capital = ?

= 2/7 X 54,333 = 15,524

Dr. **Goodwill a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	10,000	By Balance c/d	15,333
" A's capital a/c	3,047		
" B's capital a/c	2,286		
	15,333		15,333
To Balance b/d	15,333		

Calculation of Capital Adjustments: (on the basis of New Partner C's capital)

Calculation of future Profit Sharing Ratio:

C share 2 – 15,524

A For 4 - ?

4/2 X 15,524 = 31,048

C share 2 – 15,524

B For 3 - ?

3/2 X 15,524 = 23,286

Balance Sheet of A, B & C as on 1-4-2002

Liabilities	Rs.	Assets	Rs.	Rs.
A's Capital	31,048	Plant & Machinery		12,000
B's Capital	23,286	Patents		4,000
C's Capital	15,524	Debtors	12,000	
Sundry Creditors	13,000	Less: Reserve for Bad	600	11,400
Workers compensation fund	1,900	debts		16,500
		Stock		25,525
		Cash a/c		15,333
	84,758	Goodwill		84,758

Illus.14:

On 1st January, 2000, Abhinav and Bhairav who were in partnership sharing 7/12 and 5/12 respectively, take in Vaishnav giving him 1/6 share. Abhinav and Bhairav were to share future profits in the ratio of 13/24 and 7/24.

Over and above his capital, Vaishnav brings in Rs.96,000 as his goodwill for the 1/6th share. The cash brought in by Vaishnav as his capital and his goodwill in credit to one separate account in his personal name. On 31st December, 2000, the Trial Balance of the firm stood as follows.

	Rs.		Rs.
Machinery	**6,00,000**	**Abhinav's capital**	**3,36,000**
Furniture	**40,000**	**Bhairav's capital**	**2,40,000**
Stock	**1,20,000**	**Vaishnav's personal**	**2,24,000**
Abhinav's Drawings	**32,000**	**account**	**48,000**
Bhairav's Drawings	**52,000**	**Creditors**	**2,32,000**
Vaishnav's Drawings	**8,000**	**Current Year's Profit**	
Cash on hand	**28,000**		
	10,80,000		**10,80,000**

Interest on drawings is to be ignored but interest on capital accounts is to be allowed at 5% per annum after the necessary adjustments therein consequent on Vaishnav's admission.

Prepare the Balance Sheet of the firm as on December 31st 2000.

SOLUTION:

Sharing of goodwill:

In this problem we have difference in old profit sharing ratio and new profit sharing ratio. Hence the goodwill should be distributed according to the sacrificing ratio.

Calculation of Sacrificing Ratio:

Sacrificing ratio = Old ratio – New ratio

Abhinav's sacrificing ratio = $\frac{7}{12} - \frac{13}{24} = \frac{14-13}{24} = \frac{1}{24}$

Bhairav's sacrificing ratio = $\frac{5}{12} - \frac{7}{24} = \frac{10-7}{24} = \frac{3}{24}$

Sacrificing ratio = 1 : 3

Goodwill amount = 96,000

Abhinav's share in goodwill = 96,000 X ¼ = 24,000

Bhairav's share in goodwill = 96,000 X ¾ = 72,000

Calculation of Interest on Capital:

Abhinav's capital	= 3,36,000 + 24,000	= 3,60,000
Bhairav's capital	= 2,40,000 + 72,000	= 3,12,000
Vaishnav's capital	= 2,24,000 - 96,000	= 1,28,000
Interest on Abhinav's capital	= 3,60,000 X 5/100	= 18,000
Interest on Bhairav's capital	= 3,12,000 X 5/100	= 15,600
Interest on Vaishnav's capital	= 1,28,000 X 5/100	= 6,400
Total Interest		40,000

Distribution of current year Net profit:

Current year total profit	2,32,000
Less: Interest on capital	42,000
Current year Net profit	1,92,000

Abhinav's share	= 1,92,000 X 13/24	= 1,04,000
Bhairav's share	= 1,92,000 X 7/24	= 56,000
Vaishnav's share	= 1,92,000 X 4/24	= 32,000

Dr. **Capital Accounts** **Cr.**

Particulars	Abhinav Rs.	Bhairav Rs.	Vaishnav Rs.	Particulars	Abhinav Rs.	Bhairav Rs.	Vaishnav Rs.
To Abhinav capital a/c			24,000	By Balance b/d	3,36,000	2,40,000	2,24,000
To Bhairav capital a/c			72,000	" Vaishnav's capital a/c	24,000	72,000	
To Drawings	32,000	52,000	8,000	" Interest on capital	18,000	15,600	6,400
To Balance c/d	4,50,000	3,31,600	1,58,400	" Current year P & L adj.a/c	1,04,000	56,000	32,000
	4,82,000	3,83,600	2,62,400		4,82,000	3,83,600	2,62,400
				By Balance b/d	4,50,000	3,31,600	1,58,400

Balance Sheet of Abhinav, Bhairav & Vaishnav as on 31-12-2000

Liabilities	Rs.	Assets	Rs.
Creditors	48,000	Cash on hand	28,000
Abhinav's Capital	4,50,000	Machinery	6,00,000
Bhairav's Capital	3,31,600	Furniture	40,000
Vaishnav's Capital	1,58,400	Stock	1,20,000
		Debtors	2,00,000
	9,88,000		9,88,000

Illus.15:

The following is the Balance Sheet of Anita, Sunita who share profits in the ratio of 3 : 2.

Liabilities	Rs.	Assets	Rs.
Anita's capital	**10,000**	**Debtors**	**11,000**
Sunita's capital	**8,000**	**Buildings**	**8,000**
Creditors	**12,000**	**Plant**	**10,000**
General Reserve	**16,000**	**Stock**	**12,000**
Workmen's compensation fund	**4,000**	**Cash**	**9,000**
	50,000		**50,000**

They agreed to admit Vinita on the following terms:

a. **The value of buildings to be increased to Rs.18,000.**

b. **The value of stock to be increased to Rs.16,000.**

c. **The liability on workmen's compensation fund was determined at Rs.2,000.**

d. **Vinita contributes Rs.10,000 in cash towards goodwill.**

e. **Vinita has to bring further cash as would make her capital equal to 20% of the combined capital of Anita and Sunita after all adjustments.**

Show the necessary ledger accounts in the books of the frim and prepare new balance sheet after Vinita's admission

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Cash Dr. To Vinta's Capital a/c (Being capital brought)		12,000	 12,000
	Cash a/c Dr. To Goodwill a/c (Being goodwill brought)		10,000	 10,000
	Buildings a/c Dr. Stock a/c Dr. Workmen's compensation a/c Dr. To Revaluation a/c (Being assets and liabilities revalued)		10,000 4,000 2,000	 16,000
	Revaluation a/c Dr. To Anita's Capital a/c To Sunita's Capital a/c (Being profit on revaluation distributed)		16,000	 9,600 6,400
	General Reserve a/c Dr. To Anita's Capital a/c To Sunita's Capital a/c (Being undistributed profits distributed)		16,000	 9,600 6,400

	Workmen's compensation a/c Dr.		2,000	
	To Cash a/c			2,000
	(Being liability paid)			

Dr. **Revaluation a/c** **Cr.**

		Rs.		Rs.
To Anita's Capital a/c	9,600		By Buildings	10,000
" Sunita's Capital a/c	6,400		By Stock	4,000
		16,000	By Workmen's compensation	2,000
		16,000		16,000

Dr. **Capital Accounts** **Cr.**

Particulars	Anita Rs.	Sunita Rs.	Vinita Rs.	Particulars	Anita Rs.	Sunita Rs.	Vinita Rs.
To Balance c/d	35,200	24,800	12,000	By Balance b/d	10,000	8,000	
				By Goodwill a/c By	6,000	4,000	
				Revaluation a/c	9,600	6,400	
				By General			
				Reserve a/c	9,600	6,400	
				By Cash a/c	---	---	12,000
	35,200	24,800	12,000		35,200	24,800	12,000
				By Balance b/d	35,200	24,800	12,000

Calculation of Vinita's Capital: **Rs.**

Anita's Capital	35,200
Sunita's Capital	24,800
Combined adjusted capital of Anita and Sunita	60,000

Vinita's capital = 60,000 X 20/100 = 12,000

Dr. **Cash a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	9,000	By Workmen's compensation	2,000
To Vinita's capital a/c	12,000	By Balance c/d	29,000
To Goodwill a/c	10,000		
	31,000		31,000
To Balance b/d	29,000		

Balance Sheet of Anita, Sunita & Vinita as on …….

Liabilities	**Rs.**	**Assets**	**Rs.**
Anita's Capital	35,200	Debtors	11,000
Sunita's Capital	24,800	Buildings	18,000
Vinita's Capital	12,000	Plant	10,000
Creditors	12,000	Stock	16,000
		Cash	29,000
	84,000		84,000

16.3 QUESTIONS:

1. What are the adjustments acquire in the books of the firm when a new partner is admitted?
2. Define goodwill? State the methods of valuation of goodwill.
3. Explain the accounting treatment of goodwill in partnership business?

16.4 EXERCISES

1. The Balance Sheet of X and Y as on 31st December 2004 is set below. They share profits and losses in the ratio of 2:1.

Liabilities	Rs.	Assets	Rs.
X's Capital	40,000	Freehold property	20,000
Y's Capital	30,000	Furniture	6,000
General reserve	24,000	Stock	12,000
Creditors	16,000	Debtors	60,000
		Cash	12,000
	1,10,000		1,10,000

They agree to admit Z into the firm subjected to the following terms and conditions:

(a) Z will bring in Rs.12,000 as capital and Rs.9,000 as premium for goodwill for 1/4th share.

(b) Depreciation is to be provided on furniture at 5%.

(c) Stock is to be revalued at Rs.10,500.

Prepare ledger accounts and Balance Sheet of the new firm.

(Ans: Revaluation loss Rs.1,800; Capital accounts: X Rs.60,800; Y Rs.40,400; Z Rs.12,000; Balance Sheet Rs.1,29,200)

2. A and B are partners in a firm sharing profits and losses in the ratio of 3:1. The Balance Sheet of the firm as on 31-12-2005 was as follows:

Balance Sheet

	Rs.		Rs.	Rs.
Creditors	9,000	Cash		5,000
Workmen compensation fund	6,000	Bills receivable		12,500
General reserve	10,500	Debtors	20,000	
Capital: A	30,000	Less provision	2,500	17,500
B	24,500	Stock		20,000
		Investments		25,000
	80,000			80,000

On the above data C is admitted for 2/5 share and the following adjustments are made:

(a) Accrued income not appearing in the books Rs.500

(b) Market value of the investments is Rs.22,500

(c) Claim on account of workmen compensation is estimated at Rs.750.

(d) X, an old customer who account was written off as bad, has promised to pay Rs.350 in full settlement of his debt.

(e) C is required to bring Rs.40,000 as capital and Rs.10,000 as goodwill.

You are required to prepare Revaluation account, Partners Capital account and the Balance Sheet of the new firm.

(Ans: Revaluation loss Rs.2,000; Capital accounts: A Rs.47,813; B Rs.30,437; C Rs.40,000; Balance Sheet total Rs.1,28,000)

3. A and B are partners sharing profits in the ratio of 3:2. C is admitted and the new profit sharing ratio is 2:2:1. C brings in cash Rs.8,000 for capital and Rs.2,000 for goodwill. The balance sheet of A and B is as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts: A	8,000	Goodwill	2,500
B	8,000	Other Assets	17,500
Reserve account	4,000		
	20,000		20,000

Partners decide that goodwill accounts should appear in the new firm's books at Rs.6,000. Give journal entries and prepare Balance sheet of the new firm.

(Ans: Capital accounts: A Rs.15,900; B Rs.9,600; C Rs.8,000; Balance Sheet total Rs.33,500)

4. The following was the balance sheet of A, B and C who share profits and losses in the proportions of 6/14, 5/14, 3/14 respectively.

Liabilities	Rs.	Assets	Rs.
Creditors	28,350	Land and Buildings	72,550
Bills payable	9,900	Furniture	11,500
Reserve	7,000	Stock	45,000
Capitals: A	60,000	Debtors	40,000
B	52,000	Cash at bank	13,200
C	25,000		
	1,82,250		1,82,250

They agreed to take D into partnership and give him 1/8 share of profits on the following terms:

(a) That D brings in Rs.24,000 as his capital

(b) That furniture be written down by Rs.1,400 and stock be depreciated by Rs.2,800.

(c) That a reserve of Rs.700 be made for outstanding repairs bills.

(d) That the value of Land and Buildings be appreciated by Rs.9,800

(e) That goodwill be created at Rs.16,800

(f) That the capitals A, B and C be adjusted on the basis of D's capital by opening the necessary current accounts.

Prepare Revaluation account, Capital and Current accounts and also the Balance Sheet of the new firm.

(Ans: Revaluation Profit Rs.4,900; Capital accounts: A Rs.72,000; B Rs.60,000; C Rs.36,000; D Rs.24,000; Current Accounts: A Rs. 300; B Rs.2,250; C Debit Balance Rs.4,850; Balance Sheet total Rs.2,33,500)

5. The Balance sheet of Ram and Shyam as on 31-12-2005 is given below who share profits and losses in the ratio of 2:1.

Liabilities	Rs.	Assets	Rs.
Ram's Capital	45,000	Furniture	20,000
Shyam's Capital	25,000	Freehold property	6,000
General reserve	24,000	Stock	12,000
Creditors	16,000	Debtors	60,000
		Cash	12,000
	1,10,000		1,10,000

They agreed to admit Karan into the firm subject to the following conditions:

(a) Karan will bring Rs.21,000 of which Rs.9,000 will be treated as his share of goodwill to be retained in the business.

(b) 50% of the general reserve is to remain as provision for doubtful debts.

(c) Depreciation is to be provided on furniture @5%.

(d) Closing stock is to be valued at Rs.10,500.

(e) Karan is entitled to one fifth share of the profits.

Give journal entries to give effect to these arrangements and prepare the Balance Sheet of the new firm.

(Ans: Revaluation loss Rs.1,800; Capital accounts: Ram Rs.57,800; Shyam Rs.31,400; Karan Rs.12,000; Balance Sheet total Rs.1,17,200)

6. The following is the balance sheet of Partnership firm of Surjit and Baljit on 31-12-2004. They share profits and losses as to 3:2

	Rs.	Rs.		Rs.
Creditors		31,000	Cash in hand	2,500
Capital Accounts:			Debtors	22,500
Surjit	17,500		Stock	10,250
Baljit	17,500	35,000	Furniture	750
			Machinery	17,500
			Buildings	12,500
		66,000		66,000

They admit Mr.Prabujit into partnership on 1-1-2005, the terms being that he has to pay Rs.2,500 as his share of goodwill, the amount to be retained in the business and that he shall bring in cash Rs.7,500 as capital for a fourth share in the future profits. The new profit sharing ratio shall be 2:1:1.

For the purpose of Prabujit's admission, the following revaluation were made:

Buildings to be taken at Rs.15,000; Machinery and Furniture to be reduced by 10% and a Provision of 5% to be made for doubtful debts, Stock to be taken at Rs.12,500.

The excess of capital accounts of Surjit and Baljit over their due proportion of the sharing of profits in the new firm is to be transferred to their respective loan accounts.

Prepare necessary accounts and balance sheet of the new firm.

(Ans: Revaluation Profit Rs.1,800; Capital accounts: Surjit Rs.19,560; Baljit Rs.19,720; Prabujit Rs.7,500; Balance Sheet total Rs.77,800)

7. The following was the balance sheet of A, B and C who share profits and losses in the proportions of 6/14, 5/14, 3/14 respectively.

Liabilities	Rs.	Rs.	Assets	Rs.
Creditors		18,900	Land and Buildings	50,400
Bills payable		6,300	Furniture	7,350
Reserve		7,000	Stock	29,400
Capitals: A	39,900		Debtors	26,460
B	33,600		Cash at bank	8,890
C	16,800	90,300		
		1,22,500		1,22,500

They agreed to take D into partnership and give him 1/8 share of profits on the following terms:

a) That D brings in Rs.16,000 as his capital
b) That furniture be written down by Rs.920 and stock be depreciated by 10%.
c) That provision of Rs.1,320 be made for outstanding repairs bills.
d) That the value of Land and Buildings be written upto Rs.65,100
e) That the value of goodwill be fixed at Rs.8,820
f) That the capita
g) Is A, B and C be adjusted on the basis of D's capital by opening the necessary current accounts.

Show the accounts giving effect to these arrangements as also the Balance Sheet of the new firm.

(Ans: Revaluation Profit Rs.9,520; Capital accounts: A Rs.48,000; B Rs.40,000; C Rs.24,000; D Rs.16,000; Current Accounts: A Rs.2,760; B Rs.2,650; C Rs.1,770; Balance Sheet total Rs.1,59,930)

8. Srikanth and Sasikanth are equal partners and their Balance Sheet as on 31-3-2005 is as follows:

Liabilities	Rs.	Rs.	Assets	Rs.
Sundry Creditors		15,000	Stock in trade	10,500
Bank overdraft		4,500	Sundry Debtors	18,300
Capital Accounts:			Furniture & fittings	750
Srikanth	6,300		Cash in hand	150
Sasikanth	4,800	11,100	Investments	900
		30,600		30,600

Partners have agreed to admit Ramakanth into partnership. It is agreed (as between Srikanth and Sasikanth only) to make the following adjustments in the above balance sheet.

(a) To write off Bad debts of Rs.4,500
(b) To bring down the value of Furniture & Fittings to Rs.300
(c) To depreciate the stock in trade by 15%
(d) To write off investments by 25% and
(e) To create Goodwill for Rs.3,000

Ramakanth then introduces Rs.3,000 as his share of capital to which amount the capital amounts of other partners be adjusted. Write journal entries and prepare the opening balance sheet of the new firm after the admission of Ramakanth.

(Ans: Revaluation loss Rs.6,750; Capital accounts: Srikanth Rs.4,425; Sasikanth Rs.2,925; Ramakanth Rs.3,000; Balance Sheet total Rs.29,850)

9. The Balance Sheet of Usha and Uma on 31-12-2001 was as under:

Liabilities	Rs.	Assets	Rs.
Creditors	10,000	Cash	5,000
Loan from SFC	20,000	Debtors	10,000
Capital: Usha	30,000	Stock	20,000
Uma	25,000	Plant	50,000
	85,000		85,000

On 1-1-2002 Rama was admitted on to partnership with the following terms and conditions:

(a) The new profit and loss sharing ratio among Usha, Uma and Rama would be 5:3:2.

(b) Rama bring Rs.20,000 as capital to her 2/10th share profits. She also brings Rs.5,000 towards goodwill.

(c) Plant was revalued at Rs.55,000 and Stock at Rs.18,000.

(d) Usha and Uma should also maintain Capitals proportionate to their share on future profits after the all above adjustments.

Write the necessary Journal entries and show the balance sheet after admission.

(Ans: Revaluation Profit Rs.3,000; Capital accounts: Usha Rs.50,000; Uma Rs.30,000; Rama Rs.20,000; Balance Sheet total Rs.1,30,000)

Note: (Uma sacrifices her future profit sharing ratio. Hence the goodwill brought by the new partner belongs to Uma only)

16.5 SUGGESTED BOOKS

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6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
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Chapter – 17

PARTNERSHIP RETIREMENT, DEATH AND DISSOLUTION

Objectives:

This lesson explores about:

- Retirement of a partner
- Accounting treatment when the partner retires from the firm
- Death of a partner
- Accounting treatment when the partner deceased
- Dissolution of the partnership
- Accounting treatment when the firm dissolved

Structure:

A. Retirement:

17.1. Introduction

17.2. Accounting procedure for retirement of a partner

17.2.1. Treatment of goodwill

17.2.2. Revaluation of assets and liabilities

17.2.3. Distribution of undistributed profits

17.2.4. Calculation of new profit sharing ratio and gaining ratio

17. 2.5 Payment to the retiring partner and its mode of payment

B. Death of a Partner:

17.3. Settlement of Executor's loan account

17.4. Calculation of share of profits

17.5. Payment of loan by installment

17.6 Joint life policy

C. Dissolution of Partnership:

A. RETIREMENT

17.1 INTRODUCTION :

A partner may retire due to ill health or for some personal reasons. The remaining partners may continue the business. The retired partner will be paid the due amount immediately. If the firm doesn't have sufficient cash to pay the due amount, it should be transferred to his loan account. The loan amount receives interest at an agreed rate.

The retiring partner's claim amount includes his capital plus his share of goodwill in the firm plus his share in the accumulated profits of the firm, less drawings, less his share of accumulated loss, plus/minus his share in the profit or loss on the revaluation of assets and liabilities of the firm.

17.2 ACCOUNTING PROCEDURE FOR RETIREMENT OF A PARTNER :

The share of the retiring partner will be taken over by the continuing partners on his retirement. Hence, new profit sharing ratio of continuing partners should be calculated. The continuing partners may change their future profit sharing ratio. At the time of retirement focus should be lighted on the following points:

1. Treatment of goodwill
2. Revaluation of assets and liabilities
3. Distribution of undistributed profits
4. Calculation of new profit sharing ratio and gaining ratio

5. Payment to the retiring partner and its mode of payment

17.2.1 Treatment of goodwill:

If the partner retires from the firm, he is entitled to get his share in the firm's goodwill. Hence at the time of retirement, every firm should value its goodwill. In this value the retiring partner's share of goodwill will be worked out. The accounting treatment depends on the appearance of goodwill in the books. There are two possibilities for this: a) When goodwill doesn't appear in the books and b) When goodwill appears in the books.

a) When goodwill doesn't appear in the books:

i) When the goodwill is raised at its full value and goodwill account is also maintained

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Goodwill a/c	Dr.		xxx	
	To All partners' capital a/cs				xxx
	(Being full value of the goodwill raised)				
	(in old ratio)				

ii) When full value of goodwill is raised and then written off:

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Goodwill a/c	Dr.		xxx	
	To All partners' capital a/cs				xxx
	(Being full value of the goodwill raised)				
	(in the old ratio)				
	Continuing partners' capital a/cs	Dr.		xxx	
	To Goodwill a/c				xxx
	(Being goodwill written off)				
	(in the new ratio)				

iii) When retiring partner's share of goodwill is raised and goodwill a/c is maintained:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Goodwill a/c (only retiring partner's share) Dr.		xxx	
	To Retiring partner's capital a/c			xxx
	(Being goodwill credited)			

iv) When retiring partner's share of goodwill is raised and then written off:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Goodwill a/c (only retiring partner's share) Dr.		xxx	
	To Retiring partner's capital a/c			xxx
	(Being goodwill credited)			
	Continuing partners' capital a/cs Dr.		xxx	
	To Goodwill a/c			xxx
	(Being goodwill written off)			
	(Sacrificing ratio)			

v) When retiring partner's share of goodwill is to be given to him without raising or recording:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Continuing partner's capital a/c Dr.		xxx	
	To Retiring partner's capital a/c			xxx
	(Being goodwill adjusted)			
	(in sacrificing ratio)			

b) When goodwill appears in the books

i) If the goodwill appears at correct value: No entry is required

ii) If the goodwill appears at less than full value

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Goodwill a/c Dr.		xxx	
	To All partners' capital a/cs			xxx

	(Being goodwill adjusted) **Note: Difference between full value and book value**			

iii) If goodwill appears at more than full value

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	All partners' capital a/cs Dr.		xxx	
	To Goodwill a/c			xxx
	(Being goodwill adjusted) **Note: Difference between book value and full value**			

Note: The process for the valuation of goodwill is followed as in admission

17.2.2 Revaluation of assets and liabilities:

The firm's assets and liabilities should be revalued on the date of retirement of a partner. To record the revaluation of assets and liabilities "Revaluation account" is to be opened. The process we follow as in the case of admission should be followed here also. The profit or loss on the revaluation is to be transferred to all partners.

17.2.3 Distribution of undistributed profits:

Undistributed profits if any should appear on the liabilities side of the given balance sheet. The total amounts of undistributed profits are credited to all partners' capital accounts according to old profit sharing ratio.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Profit & Loss a/c Dr.		xxx	
	General Reserve a/c Dr.		xxx	
	To Old partners' capital a/cs			xxx

	(Being undistributed profits distributed) (in old ratio) **Note: P & L a/c, General Reserve a/c should not appear in the new balance sheet**			

Alternatively only the retiring partner's share may be transferred to his capital account if the others continue at the same profit sharing ratio.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Profit & Loss a/c Dr. General Reserve a/c Dr. To Retiring partner's capital a/c (only retiring partner's share) (Being undistributed profits distributed) **Note: The remaining balances of P & L a/c and General Reserve a/c should appear in the new balance sheet**		xxx xxx	 xxx

Note: If accumulated losses are there, reverse the above process

17.2.4 Calculation of new profit sharing ratio and gaining ratio:

New profit sharing ratio is also calculated in the case of retirement or death of partners. Whenever the partner retires, the remaining partners gain some portion of the retiring partner's share. Hence, in the retirement gaining ratio is calculated. Gaining ratio is calculated only for the remaining partners.

Gaining ratio = New ratio – Old ratio

Illus.1:

A, B and C are sharing profits and losses in the ratio of 5 : 3 : 2. B retired from the firm. Find out the new ratio and the gaining ratio.

Solution:

New Ratio = A - 5/7; C – 2/7

Old Ratio = A – 5/10; C – 2/10

Gaining Ratio A = $\frac{5}{7} - \frac{5}{10} = \frac{15}{70}$; C = $\frac{2}{7} - \frac{2}{10} = \frac{6}{70}$

Gaining Ratio of A and C = 15 : 6 (or) 5 : 2

Illus.2:

R, S and T are partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1. R retired from the firm and he sold his share for Rs.6,000. S and T purchased this for Rs.4,800 and Rs.1,200 respectively. Find out the new profit sharing ratio.

Solution:

Share of S and T in the purchase of R's share – Rs.4,800; Rs.1,200 (or) 4 : 1

S's New profit sharing ratio = $\frac{2}{5} + (\frac{2}{5} \times \frac{4}{5}) = \frac{2}{5} + \frac{8}{25} = \frac{18}{25}$

T's New profit sharing ratio = $\frac{1}{5} + (\frac{2}{5} \times \frac{1}{5}) = \frac{1}{5} + \frac{2}{25} = \frac{7}{25}$

S and T's new profit sharing ratio = $\frac{18}{25} : \frac{7}{25}$ (or) 18 : 7

17.2.5 Payment to the retiring partner and its mode of payment:

The retiring partner's due amount may be paid in any one of the following ways:

1. **Immediate cash payment:** If the cash is available the due amount to the retiring partner should be paid immediately.
2. **Payment in installments:** If sufficient cash is not available the retiring partner's due amount is transferred to his loan account. It is paid in installments as per agreement along with interest. Agreed interest rate is applicable on the outstanding balance. If the interest rate is not mentioned 6% p.a. is to be charged.
3. **Annuity method:** Under this method, the retiring partner gets fixed annual payment as long as he lives. This payment may be in lieu of his capital or in addition to it. This payment is

known as annuity. The amount due to the outgoing partner is transferred to the credit of annuity account.

Illus.3:

Ram and Shyam are partners sharing profits and losses equally. On 31-12-2002 their Balance Sheet was as under:

Balance Sheet

	Rs.		Rs.
Sundry Creditors	39,800	Freehold premises	26,800
Ram's Capital	45,000	Machinery	42,000
Shyam's Capital	36,000	Stock	12,000
		Sundry debtors	38,000
		Bank balance	2,800
	1,20,800		1,20,800

It is agreed that Ram will retire from 31-12-2002 and that Shyam will take over the business on the following terms:

a. **Goodwill of the firm to be valued at Rs.11,000.**
b. **Stock to be taken at worth Rs.10,000**
c. **A provision for doubtful debts to be created at 2%.**
d. **Ram on his retirement is to be paid as follows:**

1) **Rs.30,000 as loan taken by business at 10% per annum interest**
2) **Balance by way of Bill payable for six months.**

Show journal entries to record the above and also the Balance Sheet of Shyam after Ram's retirement.

Solution:

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Revaluation a/c Dr.		2,000	
	To Stock a/c			2,000
	(Being asset revalued)			

	Revaluation a/c Dr.		760	
	To Reserve for Bad debts			760
	(Being Reserve for Bad debts provided)			
	Ram's Capital a/c Dr.		1,380	
	Shyam's Capital a/c Dr.		1,380	
	To Revaluation a/c			2,760
	(Being revaluation loss distributed)			
	Shyam's Capital a/c		5,500	
	To Ram's Capital a/c			5,500
	(Being Ram's goodwill distributed)			
	Ram's Capital a/c Dr.		49,120	
	To Bank a/c			30,000
	To Bills payable a/c			19,120
	(Being balance transferred)			
	Bank a/c Dr.		30,000	
	To 10% Loan a/c			30,000
	(Being 10% Loan transferred)			

Dr. **Revaluation a/c** **Cr.**

	Rs.			Rs.
To Stock a/c	2,000	By Ram's Capital a/c	1,380	
To Reserve for Bad debts	760	By Shyam's Capital a/c	1,380	2,760
	2,760			2,760

Dr. **Capital Accounts** **Cr.**

Particulars	Ram Rs.	Shyam Rs.	Particulars	Ram Rs.	Shyam Rs.

To Revaluation a/c	1,380	1,380	By Balance b/d	45,000	36,000
To Ram's Capital a/c	30,000	5,500	By Shyam's Capital a/c	5,500	
To Bank a/c	19,120				
To Bills payable a/c	______	29,120		______	______
To Balance c/d	50,500	36,000		_	36,000
			By Balance b/d	50,500	29,120

Dr. 10% Loan a/c Cr.

	Rs.		Rs.
To Balance c/d	30,000	By Bank a/c	30,000
	30,000		30,000
		By Balance b/d	30,000

Dr. Bills payable a/c Cr.

	Rs.		Rs.
To Balance c/d	19,120	By Ram's Capital a/c	19,120
	19,120		19,120
		By Balance b/d	19,120

Dr. Bank a/c Cr.

	Rs.		Rs.
To Balance b/d	2,800	By Ram's Capital a/c	30,000
To 10% Loan a/c	30,000	By Balance c/d	2,800
	32,800		32,800
To Balance b/d	2,800		

Balance Sheet of Shyam as on 1-1-2003

Liabilities	Rs.	Assets	Rs.	Rs.
Sundry Creditors	39,800	Freehold premises		26,000
Bills payable a/c	19,120	Machinery		42,000
10% Loan a/c	30,000	Stock		10,000

Shyam's Capital	29,120	Sundry Debtors	38,000	
		Less: Reserve for bad	760	37,240
		debts		2,800
	1,18,040	Bank balance		1,18,040

Illus.4:

The Balance Sheet of X, Y, Z sharing profits in proportion to their capital was as follows as on 31st December 2002:

Liabilities		Rs.	Assets	Rs.	Rs.
Sundry Creditors		27,600	Cash in Bank		22,000
Capital accounts:		30,000	Sundry Debtors	20,000	
X	90,000	29,120	Less: Reserve for bad	400	19,600
Y	60,000		debts		32,000
Z	30,000	1,80,000	Stock		34,000
			Machinery		1,00,000
		2,07,600	Buildings		2,07,600

Y retires and the following adjustments of the assets and liabilities have been agreed upon before the ascertainment of the amount payable by the firm to Y.

a. **Insurance charged to profit and loss account includes unexpired insurance Rs.300**
b. **Provision for bad debts to be raised to 5%.**
c. **Land and Buildings to be appreciated by 20%.**
d. **A bill of repairs for Rs.5,300 is due as on 31st December 2002.**
e. **Goodwill of the firm is fixed at Rs.43,200 and Y's share of the same to be adjusted into the accounts of X and Z who are going to share in future in the proportion of ¾ and ¼ respectively without raising a goodwill account.**
f. **The entire capital of the firm as newly constituted is fixed at Rs.1,12,000 between X and Z in proportion of ¾ and ¼ either withdrawing or contribution in cash by the continuing partners as the case may be.**
g. **The amount due to Y is to be treated as his loan account.**

Show the capital accounts of all partners and also prepare the Balance Sheet of X and Z.

Solution:

Dr. Revaluation a/c Cr.

		Rs.		Rs.
To Reserve for Bad debts		6,000	By Unexpired Insurance	300
" Outstanding repairs bill		5,300	" Buildings	20,000
" X's Capital a/c	7,200			
" Y's Capital a/c	4,800			
" Z's Capital a/c	2,400	14,400		
		20,300		20,300

Dr. Capital Accounts Cr.

Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.
To Y's Capital a/c	10,800	---	3,600	By Balance b/d	90,000	60,000	30,000
" Y's Loan a/c	---	79,200	---	" X's Capital a/c	---	10,800	---
" Cash at Bank	2,400	---	800	" Z's Capital a/c	---	3,600	---
" Balance c/d	84,000	---	28,000	" Revaluation a/c	7,200	4,800	2,400
	97,200	79,200	32,400		97,200	79,200	32,400
				By Balance b/d	84,000		28,000

Calculation of Gaining Ratio:

Gaining Ratio = New Ratio – Old Ratio

X Gaining Ratio = $\frac{3}{4} - \frac{3}{6} = \frac{9-6}{12} = \frac{3}{12}$

Z Gaining Ratio = $\frac{1}{4} - \frac{1}{6} = \frac{3-2}{12} = \frac{1}{12}$

Gaining ratio = 3 : 1

Dr. Y's Loan a/c Cr.

	Rs.		Rs.
To Balance c/d	79,200	By Y Capital a/c	79,200
	79,200		79,200

		By Balance b/d	79,200

Calculation of Capitals in the New Firm:

Total Capital in the New firm	1,12000
In that X's share	1,12,000 X ¾ = 84,000
In that Z's share	1,12,000 X ¼ = 28,000

Dr. **Bank a/c** **Cr.**

	Rs.		Rs.
To Balance b/d	22,000	By X's Capital a/c	2,400
		By Z's Capital a/c	800
		By Balance c/d	18,800
	22,000		22,000
To Balance b/d	18,800		

Balance Sheet of X and Z as on 1-1-2003

Liabilities	Rs.	Assets	Rs.	Rs.
Sundry Creditors	27,600	Cash at bank		18,800
Outstanding repairs	5,300	Sundry Debtors	20,000	
Y's Loan a/c	79,200	Less: Reserve for bad	1,000	19,000
X's Capital a/c	84,000	debts Stock		32,000
Z's Capital a/c	28,000	Machinery		34,000
		Buildings		1,20,000
		Prepaid Insurance		300
	2,24,100			2,24,100

Illus.5:

Raj, Gopal and Chari were sharing profits and losses in the ratio of 5 : 4 : 3.Their Balance Sheet as on 31st March, 2005 was as follows:

Liabilities		Rs.	Assets	Rs.
Creditors		**20,845**	**Goodwill**	**20,000**

Capitals:			Furniture	4,100
Raj	67,965		Closing Stock	78,650
Gopal	47,560		Debtors	46,750
Chari	30,585	1,46,110	Cash at Bank	17,455
		1,66,955		1,66,955

On the above date, Raj gave notice that he wished to retire. The partners agreed for the following adjustments.

a. **The Profit and loss account for the year ended 31st March, 2005, which showed a net profit of Rs.24,000 was to be reopened.**

b. **Gopal was to be paid bonus Rs.2,000**

c. **Raj, Gopal and Chari decided to share profits and losses in the ratio of 3: 4: 4, as from 1st April, 2004.**

d. **Goodwill was valued at Rs.28,400 and furniture at Rs.5,490**

e. **Gopal and Chari agreed to share profits and losses in the ratio of 4 : 3, to increase the reserve for Doubtful debts to 6% and to write off goodwill.**

Give journal entries for the above arrangements and prepare the Balance Sheet of Gopal and Chari.

Solution:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Raj's Capital a/c Dr.		10,000	
	Gopal's Capital a/c Dr.		8,000	
	Chari's Capital a/c Dr.		6,000	
	To Revaluation a/c			24,000
	(Being Profit and Loss adjustment a/c reopened)			
	Revaluation a/c Dr.		2,000	
	To Gopal's Capital a/c			2,000
	(Being Bonus paid to Gopal)			
	Revaluation a/c Dr.		22,000	
	To Raj's Capital a/c			6,000
	To Gopal's Capital a/c			8,000

	To Chari's Capital a/c (Being reopened P & L appropriation a/c closed)			8,000
	Goodwill a/c Dr. To Raj's Capital a/c To Gopal's Capital a/c To Chari's Capital a/c (Being increase in the value of goodwill distributed in the ratio of 3 : 4 : 4)		8,400	 2,290 3,055 3,055
	Gopal's Capital a/c Dr. Chari's Capital a/c Dr. To Goodwill a/c (Being goodwill cancelled)		16,229 12,171	 28,400
	Revaluation a/c Dr. To Reserve for Bad debts (Being Reserve for Bad debts provided)		2,805	 2,805
	Furniture a/c Dr. To Revaluation a/c (Being asset revalued)		1,390	 1,390
	Gopal's Capital a/c Dr. Chari's Capital a/c Dr. To Revaluation a/c (Being loss on revaluation distributed)		809 606	 1,415
	Raj's Capital a/c Dr. To Raj's loan a/c (Being balance in Raj's capital transferred to Raj's loan a/c)		66,255	 66,255

Dr. **Revaluation a/c** **Cr.**

		Rs.		Rs.
To Gopal's capital a/c		2,000	By Raj's Capital a/c	10,000
To Gopal's capital a/c	8,000		By Gopal's capital a/c	8,000
To Chari's capital a/c	8,000	22,000	By Chari's capital a/c	6,000
		24,000		24,000

Dr. **Revaluation a/c** **Cr.**

	Rs.			Rs.
To Reserve for bad debts	2,805	By Furniture		1,390
		By Raj's Capital a/c	385	
		By Gopal's capital a/c	515	
		By Chari's capital a/c	515	1,415
	2,805			2,805

Dr. **Capital Accounts** **Cr.**

Particulars	Raj Rs.	Gopal Rs.	Chari Rs.	Particulars	Raj Rs.	Gopal Rs.	Chari Rs.
To Revaluation	10,000	8,000	6,000	By Balance b/d	67,965	47,560	30,585
a/c	63,965	49,560	32,585	By Revaluation a/c	---	2,000	---
To Balance c/d				By Revaluation a/c	6,000	3,000	8,000
	73,965	57,560	38,585		73,965	57,560	38,585
	---	16,229	12,171	By Balance b/d	63,965	49,560	32,585
To Goodwill a/c	---	809	606	By Goodwill a/c	2,290	3,055	3,055
To Revaluation	66,255	---	---				
a/c	---	35,577	22,863				
To Raj's loan	66,255	52,615	35,640		66,255	52,615	35,640
To Balance b/d				By Balance b/d	---	35,577	22,863

Balance Sheet of Gopal and Chari as on 31-3-2005

Liabilities		Rs.	Assets	Rs.	Rs.
Creditors		20,845	Furniture		5,490
Raj's Loan a/c		66,255	Closing Stock		78,650
Capital a/cs:			Debtors	46,750	

Gopal	35,577		Less: Reserve for bad	2,805	43,945
Chari	22,863	58,440	debts		17,455
		1,45,540	Cash at bank		1,45,540

Note: Goodwill amount should also be transferred to revaluation accounts.

Illus.6:

Ramesh, Nagesh and Suresh were equal partners. Suresh retires on 31st March, 2001. The Balance Sheet of the firm as on 1st April, 2000 as follows:

Liabilities		Rs.	Assets	Rs.	Rs.
Creditors		12,900	Cash in hand		1,000
Investment			Cash at bank		4,000
Fluctuation		1,200	Debtors	10,000	
fund			Less: Provision for B.D	800	9,200
Partner's	30,000		Stock		10,000
Capital:	20,000		Investment (cost)		5,000
Ramesh	20,000	70,000	Land & Buildings		36,000
Nagesh			Goodwill		18,900
Suresh		84,100			84,100

In order to arrive at the balance due to Mr.Suresh it was mutually agreed that,

- a. **Land and buildings to be valued at Rs.50,000**
- b. **Investment fluctuation fund be brought to Rs.500**
- c. **Debtors being all good; no reserve is required.**
- d. **Stock be taken at Rs.9,400**
- e. **Goodwill be valued at one year's purchase of the average profits of the last five years.**
- f. **Suresh's share of profit to the date of retirement be calculated on the basis of average profits of the proceeding three years. The profits for the last five years were as follows: 1996 – Rs.11,500; 1997 – Rs.14,000; 1998- Rs.9,000; 1999 – Rs.8,000; 2000 – Rs.10,000.**

Prepare Revaluation a/c, Partner's Capital Accounts and Balance Sheet of the new firm.

Solution:

Dr. **Revaluation a/c** **Cr.**

		Rs.		Rs.
To Stock a/c		600	By Land & Buildings	14,000
To Ramesh's capital a/c	4,967		By Investment fluctuation fund	700
To Nagesh's capital a/c	4,967		By reserve for Bad debts	800
To Suresh's capital a/c	4,966	14,900		
		15,500		15,500

Calculation of Goodwill:

Profits for 5 years	Rs.
1996	11,500
1997	14,000
1998	9,000
1999	8,000
2000	10,000
Total profits for 5 years	52,500

Average Profit = 52,500/5 = 10,500

Suresh's share of goodwill = 10,500 X 1/3 = 3,500

Ramesh's share of goodwill = 3,500 X 1/2 = 1,750

Nagesh's share of goodwill = 3,500 X 1/2 = 1,750

Calculation of Suresh share of Profit upto 31-3-2001

Average Profits for 3 the last years	Rs.
2000	10,000
1999	8,000
1998	9,000
Total profits for 3 years	27,000

Average profit = 27,000/3 = 9,000

For 12 months - Profit 9,000

For 3 months - ? 9,000 X 3/12 = 2,250

Profit earned by the firm during 3 months = Rs.2,250

Suresh share in that profit = 2,250 X 1/3 = Rs. 750

Dr. Capital Accounts Cr.

Particulars	Ramesh Rs.	Nagesh Rs.	Suresh Rs.	Particulars	Ramesh Rs.	Nagesh Rs.	Suresh Rs.
To Suresh's capital a/c	1,750	1,750	---	By Balance b/d	30,000	20,000	20,000
" Suresh's loan a/c	---	---	29,216	By Revaluation a/c	4,967	4,967	4,966
" Balance c/d	33,217	23,217		By Ramesh's Capital a/c	---	---	1,750
				By Nagesh's Capital a/c	---	---	1,750
				By P & L a/c	---	---	750
	34,967	24,967	29,216		34,967	24,967	29,416
				By Balance b/d	33,217	23,217	

Dr. Suresh Loan a/c Cr.

	Rs.		Rs.
To Balance c/d	29,216	By Suresh's capital a/c	29,216
	29,216		29,216
		By Balance b/d	29,216

Balance Sheet of Ramesh and Nagesh as on 1-4-2001

Liabilities	Rs.	Assets	Rs.
Creditors	12,900	Cash in hand	1,000
Suresh's Loan a/c	29,216	Cash at bank	4,000
Investment Fluctuation		Debtors	10,000
Fund	500	Stock	9,400

Ramesh capital a/c	33,217	Investments	5,000
Nagesh capital a/c	23,217	Land & Buildings	50,000
		Goodwill	18,900
		Profit and Loss suspense a/c	750
	99,050		**99,050**

B. DEATH OF A PARTNER

The partnership may dissolve due to the death of a partner. The remaining partners may continue the business by purchasing the deceased partner's share. In case of death of a partner, books of accounts of the firm are maintained in the same way as in the case of retirement of a partner with one exception. In case of retirement, the retired partner's due amount should be paid immediately or transferred to his loan account. But in the case of death, the due amount of the deceased should be transferred to his executor's loan account.

17.3 SETTLEMENT OF EXECUTOR'S LOAN ACCOUNT :

The deceased capital account should be credited with the following items:

a. Capital balance available in his capital a/c
b. Share of his goodwill
c. Interest on his capital
d. Share of his Profit/Loss on the revaluation of assets and liabilities
e. His share of reserve fund
f. Share of profit upto the date of his death
g. Share in additional profit and
h. Share in joint life policy.

The amounts due by the deceased partner are debited to his capital account. They are:

1. Drawings
2. Interest on drawings
3. Loss on revaluation of assets and liabilities
4. Business laws
5. Laws on revaluation of goodwill

The net balance in the deceased capital account is transferred to the executor's loan account. The executors are paid the due amount according to the negotiations between the firm and the executors.

17.4 CALCULATION OF SHARE OF PROFITS :

Upto the date of death of partner, the firm should decide the current year's profits on the basis of the last years' profits. The deceased share of profit for the current year should be calculated on time basis and on turn-over basis.

17.5 PAYMENT OF LOAN BY INSTALLMENT :

The total amount due to the deceased partner is not paid in a lump-sum. The amount is paid in installments to the legal heirs of the deceased partner. This process helps the firm to avoid the withdrawal of big sum at a time. Withdrawals of big sum at a time sometimes lead to losses also. Interest on the outstanding amount is paid, till the account is cleared.

Illus.7:

A, B and C sharing profits and losses in the proportion of 5 : 3 : 2 respectively had the following position as on 31-12-1997.

Liabilities	Rs.	Assets	Rs.	Rs.
Capitals:		**Freehold premises**		**6,000**
A	**12,000**	**Plant**		**2,950**
B	**9,000**	**Furniture**		**750**
C	**6,000**	**Motor lorry**		**850**
Creditors	**15,000**	**Stock**		**12,500**
Bills payable	**1,950**	**Debtors**	**19,500**	
		Less: RDD	**1,000**	**18,500**
		Bills receivable		**1,150**
		Bank		**1,250**
	43,950			**43,950**

C dies on 1-4-98, In order to arrive at the amount payable to C's executors' following was agreed:

1. **Value of goodwill to be arrive on basis of twice the average of last three years' profits. The profits were Rs.17,500;Rs.15,600 and Rs.17,000 for 1995,1996 and 1997 respectively.**
2. **C's share in profit upto date of his death was to be based on previous year's profit.**
3. **Interest on capitals to be allowed at 5% p.a.**
4. **The assets were to be valued as under :**

Freehold premises Rs.7,000; Plant Rs.2,800; Furniture Rs.700; Motor lorry Rs.800; stock at a discount of 10% and Reserve for doubtful debts to be increased by Rs.500. Prepare C's capital a/c and show balance sheet of A and B.

Solution :

Dr. **Revaluation a/c** **Cr.**

	Rs.			Rs.
To Plant a/c	150	By Freehold premises		1,000
To Furniture a/c	50	By A's capital a/c	500	
To Motor Lorry a/c	50	By B's capital a/c	300	
To Stock a/c	1,250	By C's capital	200	
To Reserve for Bad debts	500			1,000
	2,000			**2,000**

Calculation of Goodwill:

Average Profit for 3 years = $\frac{17,500 + 15,600 + 17,000}{3} = \frac{50,100}{3} = 16,700$

Goodwill = Average Profit X 2 years purchase

= 16,700 X 2 = 33,400

C's share of goodwill = 33,400 X 2/10 = 6,680

Calculation of Profit upto 1-4-1998

(Based on previous year profit)

For 12 months - 17,000

For 3 months - ? 17,000 X 3/12 = 4,250

Estimated profit for 3 months = 4,250

C's share of profit = 4,250 X 2/10 = 850

Calculation of Interest on Capital:

Opening capital of C = 6,000

On that Interest on 3 months = $6{,}000 \times \frac{5}{100} \times \frac{3}{12} = 75$

Dr. Capital Accounts Cr.

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To Revaluation	500	300	200	By Balance b/d	12,000	9,000	6,000
To Goodwill a/c (5:3)	4,175	2,505	---	By P & L suspense a/c	---	---	850
C's creditors loan a/c	---	---	13,405	By Interest on capital			75
To Balance c/d	7,325	6,195	---	By Goodwill	---	---	6,680
	12,000	**9,000**	**13,605**		**12,000**	**9,000**	**13,605**
				By Balance b/d	7,325	6,195	---

Balance Sheet of A and B as on 1-4-1998

Liabilities	Rs.	Assets		Rs.
Creditors	15,000	Freehold premises		7,000
Bills payable	1,950	Plant		2,800
C's executors loan a/c	13,405	Furniture		700
A's capital a/c	7,325	Motor Lorry		800
B's capital a/c	6,195	Stock		11,250
		Debtors	18,500	
		Less: Reserve for Bad debts	500	18,000
		Bills receivable		1,150
		Profit and Loss suspense a/c		1,250
		Prepaid Interest on capital		850
				75
	43,875			**43,875**

17.6 JOINT LIFE POLICY RESERVE :

Firms usually takes life policy on the lives of its partners to insure against the risk of dislocation of the business due to the death of one of its partners. The problem arises as to payment of the balance due to the deceased partner to his widow or legal representative. If firm pays to legal representative of the deceased partner out of the sale proceeds of an asset or cash, which will again put the business in difficulty. Therefore, the firm takes life policies on the lives of the partners.

17.6.1 Types of Policies: Policies can be of two types:

1. **Joint Life Policy:** Joint Life policy is one life policy on the lives of all the partners. In this case, the amount of the policy is paid to the firm, if only one partner dies.
2. **Separate Life Policies:** These can be separate life policies on the lives of each partner. In this case, if any partner dies, the amount of the policy of that individual is paid in full.

17.6.2. Accounting Treatment of Joint Life Policy: The premium paid by the firm on such Joint Life Policy may be treated in accounts in any one of the following three ways.

1. When premium paid is treated as business expense and charged to Profit and Loss account.
2. When premium paid is treated as an asset which is shown in the Balance Sheet as its present value.
3. When premium paid is treated as an asset which is represented by a reserve called Joint Life Policy Reserve.

Illus.8:

A and B who shared profits in the ratio of 3 : 2 took a joint life policy on May 1, 2002 for Rs.30,000. The annual premium was Rs.1,300. The surrender value of the policy was 2002 – Nil; 2003 - Rs.400; 2004 – Rs.900 and 2005 – Rs.1,450. B died on September 15, 2005 and the amount of the policy was received on 31-12-2005. The books are closed on 31st December each year.

Give journal entries assuming that –

a. **When premium paid is written off to Profit and Loss a/c each year.**
b. **When premium is treated as an asset.**

c. When premium is treated as an asset and reserve is maintained.

Solution:

1. When premium paid is written off to Profit and Loss a/c each year.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2002 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	 1,300
Dec.31	Profit and Loss a/c Dr. To Joint Life Policy Premium a/c (Being premium debited to P & L a/c)		1,300	 1,300
2005 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	 1,300
Dec.31	Life Insurance Corporation a/c Dr. To Joint Life Policy a/c (Being maturity of claim on account of Joint Life Policy due to B's death)		30,000	 30,000
Dec.31	Profit & Loss a/c Dr. To Joint Life Policy Premium a/c (Being premium debited to P & L a/c)		1,300	 1,300
Dec.31	Bank a/c Dr. To Life Insurance Corporation a/c (Being amount received against the policy on B's death)		30,000	 30,000
Dec.31	Joint Life Policy a/c Dr. To A's Capital a/c To B's Capital a/c (Being joint life policy amount transferred to capital accounts of the partners in the ratio 3:2)		30,000	 18,000 12,000

Note: Similar entries like 2002 will be repeated for 2003 and 2004

2. When premium is treated as an asset.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2002 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	1,300
Dec.31	Profit and Loss a/c Dr. To Joint Life Policy Premium a/c (Being the amount written off to make the Joint Life Policy a/c zero)		1,300	1,300
2003 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	1,300
Dec.31	Profit & Loss a/c Dr. To Joint Life Policy Premium a/c (Being the amount written off to make the Joint Life Policy a/c Rs.400)		900	900
2004 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	1,300
Dec.31	Profit & Loss a/c Dr. To Joint Life Policy Premium a/c (Being the amount written off to make the Joint Life Policy a/c to Rs.900)		800	800
2005 May 1	Joint Life Policy Premium a/c Dr. To Bank a/c (Being joint life policy premium paid)		1,300	1,300
Sep.30	Life Insurance Corporation a/c Dr. To Joint Life Policy a/c (Being maturity of claim on account of Joint Life Policy due to B's death)		30,000	30,000

Dec.31	Bank a/c Dr.		30,000	
	To Life Insurance Corporation a/c			30,000
	(Being amount received due to B’s death)			
Dec.31	Joint Life Policy a/c Dr.		27,800	16,680
	To A’s Capital a/c			11,120
	To B’s Capital a/c			
	(Being joint life policy amount transferred to capital accounts of two partners in the ratio 3:2)			

Note: It is not necessary to bring the policy account to the surrender value in 2005 as the Policy has become due for payment.

Dr. Joint Life Policy Account Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
May 1	To Bank a/c	1,300	Dec.31	By P & L a/c	1,300
		1,300			1,300
2003			2003		
May 1	To Bank a/c***	1,300	Dec.31	By P & L a/c	900
				By Balance c/d	400
		1,300			1,300
2004			2004		
Jan.1	To Balance b/d	400	Dec.31	By P & L a/c	800
May 1	To Bank a/c	1,300		By Balance c/d	900
		1,700			1,700
2005			2005		
Jan.1	To Balance b/d	900	Dec.31	By Life Insurance	
May 1	To Bank a/c	1,300		Corporation a/c	30,000
Dec.31	To Profit transferred to				
	A 3/5 16,680				
	B 2/5 11,120	27,800			

		30,000			30,000

3. When premium is treated as an asset and reserve is maintained.

Dr. **Joint Life Policy Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
May 1	To Bank a/c	1,300	Dec.31	By Joint Life Policy Reserve	1,300
		1,300			1,300
2003			2003		
May 1	To Bank a/c	1,300	Dec.31	By JLP Reserve a/c	900
				By Balance c/d	400
		1,300			1,300
2004			2004		
Jan.1	To Balance b/d	400	Dec.31	By JLP Reserve a/c	800
May 1	To Bank a/c	1,300		By Balance c/d	900
		1,700			1,700
2005			2005		
Jan.1	To Balance b/d	900	Dec.31	By Life Insurance	
May 1	To Bank a/c	1,300		Corporation a/c	30,000
Dec.31	To Profit transferred to			By JLP Reserve	900
	A 3/5 17,220				
	B 2/5 11,480	28,700			
		30,900			30,900

Dr. **Joint Life Policy Reserve Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
Dec. 1	To Joint Life Policy a/c	1,300	Dec.31	By P & L Appropriation a/c	1,300
		1,300			1,300
2003			2003		
Dec. 1	To Joint Life Policy a/c	900	Dec.31	By P & L Appropriation a/c	1,300

	To Balance c/d	400			
		1,300			1,300
2004			2004		
Dec. 1	To Joint Life Policy a/c	800	Dec.31	By Balance b/d	400
	To Balance c/d	900		By P & L Appropriation a/c	1,300
		1,700			1,700
2005			2005		
Dec.31	To Joint Life Policy a/c	900	Dec.31	By Balance b/d	900
		900			900

C. DISSOLUTION OF PARTNERSHIP

17.7 INTRODUCTION :

The discontinuation of partnership firm is known as dissolution. According to 1932 Partnership Act, the dissolution may be either for partnership or a firm.

17.7.1. Dissolution of partnership: If the relationship between the partners changes, the firm may continue its business under the same name, if the partners so decide. The partnership may be deemed to dissolve in anyone of the following situations:

1. Expiry of the period of partnership
2. Completion of the venture
3. Admission of a partner
4. Retirement of a partner
5. Death of a partner
6. Insolvency of a partner

In all the above mentioned causes, the old partnership comes to an end but the business may be carried in the same name. If the profit sharing ratio of the existing partners change, the old partnership is dissolved and a new one comes into existence.

17.7.2. Dissolution of a firm:

If the firm is completely closed, then the dissolution of a firm may happen. All the assets of the firm are disposed off and all the liabilities are discharged. Therefore, the dissolution of the firm, the partnership is automatically dissolved.

In addition to the dissolution of a partnership, there is also the dissolution of the firm under the following situations:

1. When all the partners agree that the firm be dissolved
2. When all the partners except one are insolvent
3. When the business becomes insolvent
4. When anyone of the partner gives notice of dissolution
5. When the court gives the order for dissolution

17.8. METHODS OF DISSOLUTION :

17.8.1. Dissolution by agreement: A partnership can be dissolved with the consent of all partners**.**

17.8.2. Compulsory dissolution: The firm may be dissolved under the following situations**:**

a. When all the partners except one become insolvent
b. When the carried business is unlawful.
c. When the business of the firm is opposed to public policy.
d. When the firm’s business becomes illegal due to same legal provision.

17.8.3. Contingent dissolution: In the absence of agreement, if the firm dissolve it may be called as contingent dissolution**.**

a. On the death of a partner
b. If the firm is for a fixed period, it is automatically dissolved on the expiry of that period.
c. If the partner resigns from the firm
d. When the firm is established for a particular work, after the completion of that work the firm is automatically dissolved

17.8.4. Dissolution by notice: The firm can be dissolved at any time when a partner gives a written notice to all the partners of the firm. The firm will be dissolved from the date mentioned in the notice. If the date is not mentioned in the notice, it will be dissolved from the date of receipt of notice. The served dissolution notice cannot be withdrawn without the consent of all the partners**.**

17.8.5. Dissolution through Court: Court may dissolve the partnership firm on any of the following grounds**:**

a. When the partner has become insane

b. When a partner, other than the partner filing a suit, has become permanently incapable of performing his duties as a partner.

c. When a partner, other than the partner who has filed the suit is guilty of misconduct, which may affect the carrying of the business. For example, if he is jailed for moral misconduct

d. When a partner, other than the partner filing a suit, willfully and persistently commits breach of agreement relating to the management of the affairs of the firm.

e. When a partner transfers all his share to a third party, then the other partners can move to the court of law for the dissolution of the firm.

f. When the firm is showing continuous losses for the last few years.

g. If there is a permanent dispute among the partners, the firm has to be dissolved as the partnership is based on mutual faith.

17.9 SETTLEMENT OF ACCOUNTS :

The partnership business comes to an end at the dissolution of partnership. In case of dissolution all the assets of the firm are realised and all the liabilities of the business are paid. If the liabilities of the business are more than the assets, the deficit will be contributed from the partners' private sources.

17.10 ACCOUNTING TREATMENT :

On dissolution of a firm, all assets are to be realised and the liabilities are to be paid off. A "Realisation Account" is opened for this purpose. The realisation account should have the following process.

17.10.1 Transfer of assets to realisation account: Except cash and bank accounts, all assets appear on the assets side of the balance sheet, should be transferred to the debit side of the realisation account. On the assets side of the balance sheet the accumulated losses are also available. These balances should not be transferred to realisation account. The book values of the assets are to be transferred to the realisation account.

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Realisation a/c	Dr.		xxx	
	To Stock				xxx
	To Sundry Debtors a/c				xxx
	To Plant, Machinery a/c				xxx
	To Land and Buildings etc.				xxx
	(Being transfer of assets to realisation acount)				

If the reserves or provisions made on assets, there gross values are to be transferred to Realisation account on the credit side

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Reserve for Doubtful Debts a/c	Dr.		xxx	
	Provision for Discount a/c	Dr.		xxx	
	Provision for Depreciation a/c	Dr.		xxx	
	To Realisation a/c				xxx
	(Being the transfer of provisions)				

17.10.2 Transfer of liabilities:

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Sundry creditors a/c	Dr.		xxx	
	Bills payable a/c	Dr.		xxx	
	Bank overdraft a/c	Dr.		xxx	
	Outstanding expenses a/c etc.	Dr.		xxx	
	To Realisation a/c				xxx
	(Being transfer of liabilities)				

17.10.3 Sale of assets: If the assets are sold for cash

Date	Particulars	L.F	Debit	Credit

			Rs.	Rs.
	Cash/Bank a/c Dr. To Realisation a/c (Being assets sold for cash)		xxx	 xxx

a. If the assets are taken over by partners

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Partners capital/current a/c Dr. To Realisation a/c (Being assets taken over)		xxx	 xxx

b. When the assets taken by the creditors

If the creditor accepts the payment partly in cash and partly as asset, only cash payment is recorded. This is due to the transfer of creditors due amount on the credit side of the realisation account. The assets taken over by the creditors appear on the debit side of the realisation account.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Realisation a/c Dr. To Cash/Bank a/c (Being the settlement of liabilities)		xxx	 xxx

17.10.4 Payment of liabilities:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	a. Payment of liabilities in cash: Realisation a/c Dr. To Cash/Bank a/c (Being liabilities paid) **b. Taken over by partner:** Realisation a/c Dr.		 xxx xxx	 xxx

	To Partners capital/current a/c (Being liabilities taken over)			xxx

17.10.5 Realisation expenses:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	a. Payment in cash:			
	Realisation a/c Dr.		xxx	
	To Cash/Bank a/c			xxx
	(Being realisation expenses paid)			
	b. Expenses paid by partners:			
	Realisation a/c Dr.		xxx	
	To Partners capital/current a/c			xxx
	(Being expenses paid by partners)			
	c. The firm paid back the expenses to the partners:			
	Partners capital/current a/c Dr.		xxx	
	To Cash/Bank a/c			xxx
	(Being expenses paid back to partners)			

17.10.6 Closing of the Realisation account:

The realisation profit or loss will be shown by closing the realisation account. If the debit side is more than the credit side, the difference is loss and vice-versa the difference is profit. The profit or loss in the realisation account will be transferred to partners' capital account in their profit sharing ratio.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	a. Distributing the realisation profit:			
	Realisation a/c Dr.		xxx	
	To Partners capital/current a/c			xxx

	(separately) (Being realisation profit distributed) **b. Loss on realisation:** Reverse the above entry			

17.10.7 Payment of partners' loan:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Partners loan a/c Dr. To Cash/Bank a/c (Being loan paid)		xxx	 xxx

17.10.8 Distribution of accumulated profit:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	a. When reserve fund, credit balance of P & L a/c distributed: Reserve fund/ P & L a/c Dr. To Partners' capital a/c (separately) (Being the accumulated profits distributed) **b. Distribution of accumulated losses:** Reverse the above entry		 xxx	 xxx

17.10.9 Closing the current accounts:

Whenever the capital accounts are maintained under Fixed capital system, the current account balances are to be transferred to their respective capital accounts with the help of the following journal entries.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	If the current account shows credit balance:			

	Partners' current a/cs (separately) Dr.		xxx	
	To Partners' capital a/cs (separately)			xxx
	(Being transfer of balance)			
	If the current account shows debit balance:			
	Reverse the above entry			

17.10.10 For closing partners' capital accounts:

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Capital account showing debit balance:			
	Cash/Bank Dr.		xxx	
	To Partners' capital a/cs			xxx
	(Being due amount brought by the partners)			
	Capital account showing credit balance:			
	Reverse the above entry			

17.10.11 Assets and liabilities not shown in the books:

Assets and liabilities, which are not recorded in the books should be transferred to realisation account. If such assets are sold or liabilities are paid, the following entries are to be made.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	When the assets are sold:			
	Cash/Bank Dr.		xxx	
	To Realisation a/c			xxx
	(Being assets sold)			
	If these assets are taken by the partners:			
	Partners' Capital a/c Dr.		xxx	
	To Realisation a/c			xxx
	(Being assets taken by partners)			

	If the liabilities are taken: Realisation a/c Dr. To Cash/Bank a/c (Being liabilities paid)		xxx	xxx

17.11. LEDGER ACCOUNTS :

At the time of preparing ledger accounts prepare realisation , outsiders' liabilities, current , capital and cash/bank accounts.

The balance in the realisation account should be transferred to the partners' capital accounts. The balance in the outsiders' liabilities should be transferred to the bank account. The current account balances will be transferred to capital accounts. The capital account balances will be transferred to the bank account. Finally the bank account automatically gets closed.

17.11.1 Proforma of Realisation Account:

Dr. **Realisation Account** **Cr.**

	Rs.		Rs.
To Assets (Individual assets)	xxx	By Liabilities (Individual liabilities)	xxx
To Bank (Payment of liabilities)	xxx	By Bank (Realisation of assets)	xxx
To Partners' capital a/cs (Liabilities taken by the partner)	xxx	By Partners' Capital a/cs (Assets taken by the partner)	xxx
To Bank (Payment of Realisation expenses)	xxx	By Partners' Capital a/cs* (Loss)	xxx
To Partners Capital a/cs* (profit)	xxx		
	xxx		xxx

* Only one be there

Illus.1:

The following was the balance sheet of A, B and C on 31st March, 2000

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	30,000	Cash	2,500
Loan on Mortgage of		Debtors	30,000
Freehold property	4,000	Stock in Trade	23,100
A's Capital	25,000	Furniture	5,000
B's Capital	15,000	Freehold property	10,000
A's Current Account	1,000	B's Current	4,900
B's Current Account	500	Account	
	75,500		75,500

They shared profits and losses in the proportion of 6: 4: 6. It was decided to dissolve the partnership on the date of the Balance Sheet. The assets realised are as under:

	Rs.
Freehold property	5,000
Furniture	1,000
Stock in Trade	10,000
Debtors	10,000

The expenses of realisation amounted to Rs.2,000. The Sundry Creditors agreed to take 75 paise in the rupee in full satisfaction.

It was ascertained that B had incurred a heavy loss in speculation business he was carrying on, on his own and he had become insolvent. A dividend of 50 P. in the rupee was received from the Court Receiver.

Write up the realisation account, capital and current accounts of the partners and the cash account.

Solution:

Dr. **Realisation a/c** **Cr.**

	Rs.	Rs.		Rs.	Rs.
To Debtors		30,000	By Sundry creditors		30,000
To Stock in trade		23,100	By Loan on mortgage		
To Furniture		5,000	of freehold property		4,000
To Freehold property		10,000	By Bank a/c:		
To Bank a/c:			Freehold property	5,000	
Sundry creditors	22,500		Furniture	1,000	
Freehold property loan	4,000	26,500	Stock in trade	10,000	
To Bank (expenses)		2,000	Debtors	10,000	26,000
			By A current a/c	13,725	
			By B current a/c	9,150	
			By C current a/c	13,725	36,600
		96,600			**96,600**

Dr. **Current Accounts** **Cr.**

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To Balance b/d		4,990		By Balance b/d	1,000		500
To Realisation	13,725	9,150	13,725	By Bank a/c	13,725	7,025	13,725
To B's Current a/c	4,391		2,634	(loss brought by the partner)			
				By A's current a/c		4,360	
				By B's current a/c		2,634	
				By Capital a/cs	3,321		2,134
	18,116	**14,050**	**16,359**		**18,116**	**14,050**	**16,359**

Note: Total cash due by B Rs.4,900 + 9,150 = Rs.14,050

In that 50% = $14,050 \times \frac{50}{100}$ = Rs.7,025

Note:

Deficiency in B account = Debit total of current a/c = Rs.14,050

Less: 50% Dividend = Rs.7,025

Deficiency of B = Rs.7,025

That deficiency should be shared by A & C (Solvent partner) in their capital ratio

Capital ratio of A & C = 25 : 15 = 5 : 3

A's share in B's deficiency = $7{,}025 \times \frac{5}{8}$ = Rs.4,391

C's share in B's deficiency = $7{,}025 \times \frac{3}{8}$ = Rs.2,634

Dr. Capital a/c Cr.

Particulars	A Rs.	C Rs.	Particulars	A Rs.	C Rs.
To Current a/c	3,391	2,134	By Balance b/d	25,000	15,000
To Cash a/c	21,609				
	25,000	15,000		25,000	15,000
To Balance b/d	25,000	15,000			

Dr. Cash a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	2,500	By Realisation a/c	26,500
To Realisation a/c	26,000	By Realisation a/c	2,000
To A Current a/c	13,725	By A capital a/c	21,609
To B Current a/c	7,025	By B capital a/c	12,866
To C Current a/c	13,725		
	62,975		62,975

17.12 INSOLVENCY OF PARTNERS :

If at the time of dissolution, a partner owes a sum of money to the firm, he has to pay is to the firm. But if he is insolvent, he will not be able to do so, at least not fully. The sum which is irrecoverable from an insolvent partner is, therefore a loss. The question arises whether this loss is like the ordinary loss to be shared by the solvent partners in the profit sharing ratio or whether it is an extraordinary loss. Before the decision in Garner Vs. Murray was made, such a loss was treated as an ordinary loss.

17.12.1. Garner Vs. Murray Case: In the famous historic Garner Vs. Murray case the issue of settlement of partners' claims was resolved in a situation wherein the partners maintain their capital accounts under Fluctuating Capital Method and an insolvent partner was unable to make good the loss in his capital accounts**.**

17.12.2. Details of this case are: Garner, Murray and Wilkens were in a partnership under an agreement that capital was to be contributed by them in unequal shares whereas profit was to be divided equally. On the dissolution of the partnership, after payment of creditors and of advances made by two of the partners, there was a deficiency of assets to the extent of £ 635. In addition to that Wilken's Capital account was overdrawn by £ 263, which he was unable to pay**.**

There was thus total deficiency of £ 898. It was claimed that this deficiency of £ 898 was to be borne by Garner and Murray in profit sharing ratio, i.e., 1 : 1. Mr. Justice Joyee gave the historic verdict that each of the three partners was liable to make good his share of realisation loss of £ 635 and thereafter the available assets should be applied rateably in repaying each partner what was due to him on account of capital. Since one of the assets, i.e., debit balance of Wilken's Capital Account, was value less, the remaining assets would be applied in paying Garner and Murray, rateably what was due to them in respect of capital with the result that Wilken's deficiency was born by them in proportion of capital.

17.12.3. Consequences of Garner Vs. Murray Case: If a partner's capital account shows a debit balance on the dissolution of the firm, he is to pay the debit balance to the firm, then his deficiency which he is not able to bring will be borne by the other solvent partners in accordance with the decision in Garner Vs. Murray**.**

In this case it was ruled that in absence of any agreement to the contrary, the deficiency on the insolvent partner's capital account must be borne by other solvent partners in proportion to their capitals which stood before the dissolution of the firm. The effect of his ruling is to make a distinction between an ordinary loss due to trading or realisation of assets and loss on account of insolvency of a partner. The loss on account of the insolvency of a partner is a capital loss and as such should be borne by other solvent partners in proportion to their capitals.

Second clause in the ruling is that the solvent partners should bring in cash equal to their share of loss on realisation. This ruling has been given to bring the capital accounts of the solvent partners to the figures they stood before transferring the loss on realisation.

Therefore, the implications of the above case are two.

1. Solvent partners to bring cash equal to their respective share of loss on realisation. However, in practice, only entries are made and no cash is brought actually; notional adjustment is sufficient.
2. Deficiency on the capital account of the insolvent partners to be shard by solvent partners in their capital ratio.

   The practical effect of this is that the loss due to the insolvency of a partner has to be borne by the solvent partners in the ratio of their capitals standing just prior to dissolution.

17.12.4. Fixed and Fluctuating Capitals: The partners are free to have their fixed or fluctuating capitals in the firm. If they are maintaining capitals at fixed amounts then all adjustments regarding their share profits, interest on capitals, drawings, interest on drawings, salary etc., are done through current accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals**.**

But if capitals are not fixed and all transactions relating to drawings, profits, interest etc., are passed through capital accounts, then the Balance Sheet of the business shall not exhibit Current Accounts of the Partners and capitals ratio will be determined after adjusting all the reserves and accumulated profits, all drawings, all interest on capitals and drawings to the date of dissolution but before adjusting profit and loss on Realisation Account.

Thus in case of insolvency of a partner, the following procedure is to be followed.

a. First prepare a Realisation a/c and transfer its profit or loss to the capital accounts of all the partners in the profit sharing ratio.
b. If anything is received from the estate of the insolvent partner, it should be credited to his capital account.
c. The balance (debit) in the capital account of the insolvent partner should be transferred to the capital accounts of solvent partner in the ratio of capitals as they stand just before dissolution for in the ratio of fixed capitals, if capitals are fixed.
d. The solvent partners will then draw out cash according to their claims.

Illus.2:

M, N and O sharing profits in 1/2, 1/3 and 1/6 respectively decided to dissolve the firm from 1-1-2001 when their Balance Sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	40,000	Land and buildings	57,000
Bills payable	7,000	Stock	50,000
M's Loan	10,000	Sundry Debtors	50,000
M's Capital	90,000	Bank	3,000
N's Capital	10,000	N's Current Account O's	2,000
O's Capital	10,000	Current Account	5,000
M's Current Account	1,500	P & L a/c	1,500
	1,68,500		1,68,500

Land and Buildings were sold for Rs.40,000 and stock and debtors realised Rs.30,000 and Rs42,000 respectively. Goodwill was sold for Rs.600.The expenses of realisation came to Rs.1,200 .Z is insolvent and dividend of 50 paise in the rupee is received from his estate.

Pass journal entries to close the books of the firm applying the ruling in Garner Vs. Murray.

Solution:

Dr. Realisation a/c Cr.

	Rs.	Rs.		Rs.	Rs.

To Land & Buildings		57,000	By Creditors		40,000
To Stock		50,000	By Bills payable		7,000
To Sundry Debtors		50,000	By Bank a/c:		
To Bank a/c			Land & Buildings	40,000	
(expenses)		1,200	Stock	30,000	
To Bank a/c:			Debtors	42,000	
Creditors	40,000		Goodwill	600	1,12,600
Bills payable	7,000	47,000			
			By M current a/c	22,800	
			By N current a/c	15,200	
			By O current a/c	7,600	45,600
		2,05,200			**2,05,200**

Dr. **Current a/c** **Cr.**

Particulars	M Rs.	N Rs.	O Rs.	Particulars	M Rs.	N Rs.	O Rs.
To Balance b/d		2,000	5,000	By Balance b/d	1,500		
To Realisation a/c	22,800	15,200	7,600	By Bank a/c	22,800	15,200	6,425
To P & L a/c	750	500	250	(loss brought by			
To O's Current a/c (9 : 1)	5,783	642		the partner)			5,783
				By M's current a/c			642
				By N's current a/c	5,033	3,142	
	29,333	18,342	12,850	By Capital a/c	29,333	18,342	12,850

Dr. **Capital a/c** **Cr.**

Particulars	M Rs.	N Rs.	O Rs.	Particulars	M Rs.	N Rs.	O Rs.

To Current a/c	5,033	3,142		By Balance b/d	90,000	10,000	10,000
To Cash a/c	84,967	6,858	10,000				
	90,000	10,000	10,000		90,000	10,000	10,000

Dr. M's Loan a/c Cr.

	Rs.		Rs.
To cash a/c	10,000	By Balance c/d	10,000
	10,000		10,000

Dr. Cash & Bank a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	3,000	By Realisation a/c	47,000
To Realisation a/c	1,12,600	By Realisation a/c	1,200
To M's Current a/c	22,800	By M's capital a/c	84,967
To N's Current a/c	15,200	By N's capital a/c	6,858
To O's Current a/c	6,425	By O's capital a/c	10,000
		By M's loan a/c	10,000
	1,60,025		1,60,025

Illus.3:

A, B and C were partners sharing profits in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31-12-1999 was as follows when they decided to dissolve:

Liabilities	Rs.	Assets	Rs.	Rs.
Sundry Creditors	**13,000**	**Bank**		**1,000**
Loan from A	**7,500**	**Debtors**	**6,000**	
A's Capital	**10,000**	**Less: RBD**	**500**	**5,500**
B's Capital	**5,000**	**Stock**		**9,000**
C's Capital	**1,000**	**Plant**		**15,000**
Reserve	**6,000**	**P & L a/c**		**12,000**
	42,500			**42,500**

The assets realised : Sundry debtors Rs.4,500; Plant Rs.10,000. Stock was taken over by A at Rs.6,000; Sundry creditors were paid off at Rs.9,500 in full settlement and realisation

expenses were Rs.500. C was insolvent and could contribute only Rs.250. Prepare necessary accounts as per Garner Vs. Murray decision.

Solution:

Dr. Realisation a/c Cr.

	Rs.		Rs.	Rs.
To Sundry Debtors	6,000	By Sundry Creditors		13,000
To Stock	9,000	By Reserve for		
To Plant	15,000	doubtful debts		500
To Bank a/c:		By Bank a/c:		
Creditors	9,500	Debtors	4,500	
To Bank a/c		Plant	10,000	14,500
(expenses)	500	By A's capital a/c		6,000
		By A's capital a/c By	3,000	
		B's capital a/c	2,000	
		By C's capital a/c	1,000	6,000
	40,000			40,000

Dr. A's Loan a/c Cr.

	Rs.		Rs.
To Bank a/c	7,500	By Balance c/d	7,500
	7,500		7,500

Dr. Capital a/c Cr.

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.

To Profit & loss a/c	6,000	4,000	2,000	By Balance b/d	10,000	5,000	1,000
To Realisation a/c	3.000	2,000	1,000	By Reserve a/c	3,000	2,000	1,000
To Realisation a/c	6,000			By Bank a/c	3,000	2,000	250
To C's capital a/c	525	225		By A's capital a/c			525
To Bank a/c	475	2,775		By B's capital a/c			225
	16,000	9,000	3,000		16,000	9,000	3,000

Dr. **Cash & Bank a/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,000	By Realisation a/c	9,500
To Realisation a/c	14,500	By Realisation a/c	500
To A's capital a/c	3,000	By A's capital a/c	475
To B's capital a/c	2,000	By B's capital a/c	2,775
To C's capital a/c	250	By A's loan a/c	7,500
	20,750		20,750

Calculation of capital ratio:

A's capital = 10,000 + 3,000 – 6,000 = 7,000

B's capital = 5,000 + 2,000 – 4,000 = 3,000

Capital ratio of A and B = 7 : 3.

Illus.4:

The following is the Balance Sheet of Sidharth and Rohanth as on 31-12-2004.

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Sundry creditors		**76,000**	**Cash at bank**		**23,000**
Loan from			**Stock in Trade**		**12,000**
Sidharth's wife		**20,000**	**Sundry debtors**	**40,000**	
Loan from Rohanth		**30,000**	**Less : provision**	**2,000**	**38,000**
Reserve fund		**10,000**	**Furniture**		**8,000**
Capitals:			**Plant**		**56,000**
Sidharth	**20,000**		**Investments**		**20,000**
Rohanth	**16,000**	**36,000**	**P & L Account**		**15,000**
		1,72,000			**1,72,000**

The firm was dissolved on 31-12-2004. Particulars were:

a. **Sidharth took over investments at a value of Rs.16,000 and agreed to pay the loan to his wife.**
b. **Realisation – Stock Rs.10,000; Debtors Rs.37,000; Furniture Rs.9,000; Plant – Rs.50,000.**
c. **Realisation expenses Rs.2,200.**
d. **The Sundry creditors were paid off less 2½ % discount. Sidharth and Rohanth share profits and losses in the ratio of 3 : 2. Show realisation, bank and partners capital accounts. No entries are necessary.**

Solution:

Dr. Realisation a/c Cr.

	Rs.		Rs.	Rs.
To Stock in trade	12,000	By Sundry Creditors		76,000
To Sundry Debtors	40,000	By Reserve for		
To Furniture	8,000	Doubtful debts		2,000
To Plant	56,000	By Mrs. Sidharth Loan		20,000
To Investments	20,000	By Sidharth capital a/c		16,000
To Sidharth capital a/c	20,000	By Bank a/c:		
To Bank a/c (expenses)	2,200	Stock	10,000	
To Bank a/c:		Debtors	37,000	
Sundry Creditors		Furniture	9,000	
(76,000 –1,900)	74,100	Plant	50,000	1,06,000
		By Sidharth capital a/c	7,380	
		By Rohanth capital a/c	4,920	12,300
	2,32,000			2,32,000

Dr. Rohanth Loan a/c Cr.

	Rs.		Rs.
To Cash a/c	30,000	By Balance b/d	30,000
	30,000		30,000

Dr. Capital a/c Cr.

Particulars	Sidharth Rs.	Rohanth Rs.	Particulars	Sidharth Rs.	Rohanth Rs.
To Profit & loss a/c	9,000	6,000	By Balance b/d	20,000	16,000
To Realisation a/c	16,000		By Reserve fund	6,000	4,000
To Realisation a/c	7,380	4,920	By Realisation a/c	20,000	
To Cash a/c	13,620	9,080			
	46,000	20,000		46,000	20,000

Dr. Cash a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	23,000	By Realisation a/c	2,200
To Realisation a/c	1,06,000	By Realisation a/c	74,100
		By Sidharth's capital a/c	13,620
		By Rohanth' s capital a/c	9,080
		By Rohanth's loan a/c	30,000
	1,29,000		1,29,000

Illus.5:

A and B were in partnership and agreed to dissolve. The assets realised Rs.80,000. The liabilities were as follows. Sundry creditors Rs.45,000; Loan from A Rs.20,000; A's Capital Rs.10,000; B's Capital Rs.15,000. They share profits and losses in proportions A 3/4th and B 2/5th.

Show by means of ledger accounts how the cash realised should be distributed.

Solution:

Balance Sheet

	Rs.	Rs.		Rs.
Sundry Creditors		45,000	Sundry Assets (B.F.)	90,000
Loan from A		20,000		
Capitals:				
A	10,000			
B	15,000	25,000		
		90,000		90,000

Dr. **Realisation a/c** **Cr.**

	Rs.		Rs.	Rs.
To Sundry Debtors	90,000	By Creditors		45,000
To Cash a/c:	45,000	By Cash a/c:		80,000
		By A capital a/c	6,000	
		By B capital a/c	4,000	10,000
	1,35,000			1,35,000

Dr. **Loan from A a/c** **Cr.**

	Rs.		Rs.
To Cash a/c	20,000	By Balance b/d	20,000
	20,000		20,000

Dr. **Capital a/cs** **Cr.**

Particulars	A Rs.	B Rs.	Particulars	A Rs.	B Rs.
To Realisation a/c	6,000	4,000	By Balance b/d	10,000	15,000
To Cash a/c	4,000	11,000			
	10,000	15,000		10,000	15,000

Dr. **Cash a/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Realisation	80,000	By Realisation	45,000
		By A’s loan a/c	20,000
		By A’s capital a/c	4,000
		By B’ s capital a/c	11,000
	80,000		80,000

17.13 . WHEN ALL PARTNERS ARE INSOLVENT :

When the partners are insolvent and are not able to bring the amount due from them then the creditors of the firm cannot be paid in full. In such case, the creditors of the firm will be paid all the cash available, together with whatever can be received from the private properties of the partners, after the expenses of realisation are made. The capital accounts will be closed according to Garner Vs. Murray's rule.

Alternatively, creditors will not be transferred to realisation account but their separate accounts may be prepared. If this is done, unpaid amount of creditors is transferred to the deficiency account or unpaid account to which account are also transferred the balances of partners capital accounts. The deficiency account shall be automatically closed and the books of a firm should also be closed.

Illus.6:

The following is the balance sheet of M, N and O as on 31-12-2003:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	**80,000**	**Cash**	**2,000**
M's loan	**20,000**	**Stock**	**48,000**
Capitals:		**Debtors**	**40,000**
M	**10,000**	**Furniture**	**6,000**
N	**6,000**	**O's Capital (Dr.)**	**20,000**
	1,16,000		**1,16,000**

Due to inability to pay creditors the firm was dissolved. N and O cannot pay anything. M can contribute only Rs.3,000 from his private estate. Stock realised Rs.30,000, debtors realise Rs.32,000 and furniture was sold for Rs.2,000. Realisation expenses amounted to Rs.6,000. Prepare necessary accounts to close the books of the firm.

Solution:

Dr. Realisation a/c Cr.

	Rs.			Rs.
To Stock	48,000	By Cash		
To Debtors	40,000	Stock	30,000	
To Furniture	6,000	Debtors	32,000	
To Cash – Expenses	6,000	Furniture	2,000	64,000
		By Loss on Realisation		
		M's Capital a/c	12,000	

		N's Capital a/c	12,000	
		O's Capital a/c	12,000	36,000
	1,00,000			1,00,000

Dr. Cash a/c Cr.

	Rs.		Rs.
To Balance b/d	2,000	By Realisation a/c	6,000
To Realisation a/c	64,000	By Creditors	63,000
To M's Capital a/c	3,000		
	69,000		69,000

Dr. Creditors a/c Cr.

	Rs.		Rs.
To Cash	63,000	By Balance b/d	80,000
To Deficiency a/c	17,000		
	80,000		80,000

Dr. Capital a/c Cr.

Particulars	M Rs.	N Rs.	O Rs.	Particulars	M Rs.	N Rs.	O Rs.
To Balance b/d			20,000	By Balance b/d	10,000	6,000	
To Realisation a/c-loss	12,000	12,000	12,000	By Deficiency		6,000	32,000
To Deficiency a/c	21,000			By M	20,000		
				By Cash	3,000		
	33,000	12,000	32,000		33,000	12,000	32,000

Dr. Deficiency a/c Cr.

	Rs.		Rs.
To N's Capital a/c	6,000	By Creditors a/c	17,000
To O's Capital a/c	32,000	By M's Capital a/c	21,000
	38,000		38,000

Note: Since the firm was unable to pay debts M's loan was transferred to M's Capital a/c.

17.14. QUESTIONS :

1. Discuss the different modes, in which goodwill is treated in the books of accounts in case of retirement of a partner.
2. How will you calculate the amount payable to retiring partner?
3. Mention the different ways in which the amount due to the retiring partner is paid to him.
4. Explain in detail the adjustment of accounts on the death of a partner
5. Generally partners' undertake joint life policy. Explain why?
6. Explain the dissolution of partnership and partnership firm.
7. What is insolvency? Explain Garner Vs. Murray case.
8. Bring out the salient features of the decision of Garner Vs. Murray case

17.15 EXERCISES :

Retirement and Death:

1. Ram, Laxman and Bharat are partners in a firm sharing profits equally. Their Balance sheet stood as follows on 1-1-2004.

Balance sheet as on 1-1-2004

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	10,000	Land & Buildings	60,000
Bills payable	20,000	Plant & Machinery	40,000
Reserve fund	30,000	Stock	30,000
Capital: Ram	40,000	Debtors	20,000
Laxman	50,000	Cash	10,000
Bharat	60,000	Bank balance	50,000
	2,10,000		2,10,000

Ram contemplate to retire. Partners agree for the following:

(a) Fixed assets be appreciated by 10%
(b) Stock be reduced to Rs.25,000
(c) Provision on debtors at 10%
(d) A goodwill a/c be raised in the books for Rs.30,000.
(e) To pay half of the amount due to retiring partner and to transfer the rest to a Loan a/c.

Show the necessary ledger accounts and the Balance sheet of Laxman and Bharat.

(Ans: Revaluation Profit Rs.3,000; Laxman Capital a/c Rs.71,000; Bharat Capital Rs.81,000; Ram loan a/c Rs.30,500; Balance Sheet total Rs.2,12,500)

2. Sruthi, Kranthi & Santhi carrying on business in partnership were sharing in 3:2:1 ratio. On 31-3-2004 the following is their position.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		13,590	Plant & Machinery	15,000	
Reserve fund		4,200	Less: Depreciation	4,000	11,000
Capital:			Debtors		8,000
Sruthi	15,000		Cash		5,900
Kranthi	10,000		Buildings	17,200	
Santhi	10,000	35,000	Less: Depreciation	1,000	16,200
			Stock		11,690
		52,790			52,790

Show the balance sheet, after Kranthi's retirement on 30-6-2004, on the following terms:

(a) Buildings to be appreciated by Rs.7,000

(b) Provisions for doubtful debts to be made at 5%.

(c) Goodwill of the firm to be valued at Rs.9,000 for his retirement.

(d) Rs.5,000 to be paid to Kranthi and the balance taken as loan @ 10%.

(e) Average profits for last 3 years were Rs.6,000 p.a.

(Ans: Revaluation Profit Rs.6,600; Capital Accounts: Sruthi Rs.24,900; Santhi Rs.13,300; Kranthi loan a/c Rs.13,100; Balance Sheet total Rs.64,890)

3. Given the balance sheet of Ritu and Nitu on 30th June 2005 and the terms of retirement of Nitu, show the journal entries to record her retirement and the Balance sheet of Ritu after Nitu's retirement:

Balance sheet of Ritu and Nitu

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	79,600	Freehold premises	52,000
Capitals:		Machinery	84,000
Ritu	90,000	Stock	24,000

Nitu	72,000	Sundry Debtors	76,000
		Bank balance	5,600
	2,41,600		2,41,600

On Nitu's retirement, Ritu agreed to take over the business on the following terms:

(a) Goodwill of the firm is to be valued at Rs.22,000

(b) Stock to be valued at Rs.20,000

(c) A reserve for doubtful debts to be carried at 2 per cent.

(d) Nitu to be paid out as to Rs.40,000 of the amount found to be due to him by a loan taken at 10% and as to the balance by a bill of exchange payable after 9 months.

(Ans: Revaluation Loss Rs.5,520; Nitu loan a/c Rs.80,240; Ritu Capital a/c Rs.76,240; Balance Sheet total Rs.2,36,080)

4. Sravan and Navin are partners sharing profits 3/6 & 3/6, balance being reserved. Their balance sheet was as follows on 31-3-2005

	Rs.		Rs.
Sravan's Capital	40,000	Fixed assets	60,000
Navin's Capital	30,000	Sundry Debtors	20,400
Reserve	20,000	Bills receivable	15,600
Sundry Creditors	15,600	Stock	8,800
Outstanding expenses	2,400	Cash	3,200
	1,08,000		1,08,000

Sravan retired on 31-3-2005. He is entitled for goodwill which is valued at Rs.36,200. It was agreed that fixed assets had to be appreciated by 10%, Debtors Rs.400 to be written off, Provision for doubtful debts to be maintained at 3%, Rs.1,000 to be written off from bills, and outstanding expenses to be reduced by Rs.90. Show the necessary accounts for the adjustment and the balance sheet of Navin.

(Ans: Revaluation Profit Rs.4,090; Sravan's loan a/c Rs.52,045; Navin's Capital a/c Rs.60,145; Balance Sheet total Rs.1,30,100)

5. X, Y and Z are partners sharing profits equally. Their Balance Sheet at 31st December 2005 is as follows:

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	16,000	Cash at bank		16,000
Capital Accounts:		Bills receivable		12,000
X	48,000	Sundry Debtors	80,000	
Y	72,000	Less: Reserve for bad debts	4,000	76,000
Z	30,000	Stock		72,000
Reserve	24,000	Fixtures		14,000
	1,90,000			1,90,000

Y retires on that date and the following adjustments are to be made for the purpose:

(a) Goodwill of the firm is valued at Rs.48,000

(b) Fixtures to be depreciated by 5%.

(c) Stock to be appreciated by 10%

(d) Reserve for bad debts to be increased by Rs.1,000

Draw up profit and loss adjustment account, capital accounts of the partners and opening balance sheet of the continuing partners.

(Ans: Revaluation Profit Rs.5,500; Capital Accounts X Rs.73,833; Z Rs.55,834; Y Loan a/c Rs.97,833; Balance Sheet total Rs.2,43,500)

6. A, B and C have been partners in a firm. On 31-12-2004 their Balance Sheet was as follows:

Liabilities	Rs.	Assets		Rs.
Creditors	8,000	Bank balance		5,000
Reserve fund	6,000	Plant & Machinery		20,000
Capitals:		Furniture		4,000
A	15,000	Debtors	25,000	
B	15,000	Less: Reserve for bad debts	2,000	23,000
C	15,000	Goodwill		6,000
		Patents		1,000
	59,000			59,000

A retired on the above date and the following adjustments were agreed upon:

(a) The reserve for bad debts was to be reduced to Rs.500.

(b) Patents were worthless

(c) Value of furniture should be increased to Rs.5,000

(d) Goodwill should be written off from the books

(e) Necessary cash should be brought in by B and C to pay off 'A'.

Show necessary accounts and the new Balance Sheet.

(Ans: Revaluation loss Rs.4,500; Capital Accounts B Rs.23,250; C Rs.23,250; Payment to A Rs.15,500; Balance Sheet total Rs.54,500)

7. A, B and C were partners sharing profits in proportions of 1/2, 1/3 and 1/6 respectively. The balance sheet of the firm on 31st December 2005 was as follows:

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		19,000	Cash at bank		2,500
Bills payable		5,000	Debtors	16,000	
Reserve fund		12,000	Less: Reserve	500	15,500
Capital:	40,000		Stock		25,000
A	30,000		Motor can		8,000
B	25,000	95,000	Plant & Machinery		35,000
C			Buildings		45,000
		1,31,000			1,31,000

B retires on that date subject to the following adjustments:

(a) The goodwill of the firm to be valued at Rs.18,000

(b) Plant to be depreciated by 10% and motor van by 15%.

(c) Stock to be appreciated by 20% and buildings by 10%

(d) The reserve for doubtful debts to be increased to Rs.1,950.

Show the necessary accounts in the books of firm and the balance sheet after B's retirement.

(Ans: Revaluation Profit Rs.2,850; Capital Accounts A Rs.55,600; C Rs.30,200; B loan a/c Rs.40,400; Balance Sheet total Rs.1,51,850)

8. P, Q and R are partners sharing profits and losses in the ratio of 5:3:2. Their Balance sheet as on 31-12-2004 is as follows:

Liabilities	Rs.	Assets	Rs.
P	50,000	Machinery	80,000
Q	30,000	Stock	24,000
R	20,000	Debtors	16,600

Reserve	8,000	Cash	9,800
P & L a/c	10,000	Prepaid insurance	200
Creditors	12,600		
	1,30,600		1,30,600

On 1-4-2005 Q retired. His share of goodwill is valued on that date at Rs.8,000 and share of Q in profits to the date of retirement is Rs.2,000.

It was decided to revalue Machinery at Rs.76,000 and stock Rs.22,000, write off bad debts Rs.600 and create provision for doubtful debts at 5%. Partners decided to take retiring partner's share equally. Goodwill is to be written off. Partners bring cash required for payment to Q equally.

Show necessary ledger accounts and treatment of goodwill in the books of partners.

(Ans: Revaluation loss Rs.7,400; Capital Accounts P Rs.72,890; R Rs.39,710; Payment to Q Rs.43,180; Balance Sheet total Rs.1,25,200)

Note: Assumed for Q's payment cash was brought equally by P & R.

Dissolution:

9. X,Y and Z are partners sharing profits and losses in the proportion of 5:3:2. They decide to dissolve the partnership from 1-1-1999 when the Balance Sheet is as noted below:

Liabilities		Rs.	Assets	Rs.
Sundry		1,82,000	Cash at Bank	18,000
Creditors			Sundry Debtors	1,52,000
Capital	3,30,000		Stock-in-trade	60,000
Accounts	1,30,000		Fixtures and fittings	10,000
X		4,60,000	Plant & Machinery	2,90,000
Y			Land & Buildings	80,000
			Capital Account Z	32,000
		6,42,000		6,42,000

The assets realise Land and Buildings Rs.1,00,000, Plant and Machinery Rs.2,50,000, Sundry Debtors Rs.1,21,000, Stock Rs.47,000, Fixtures and fittings Rs.9,200, Expenses of Dissolution Rs.3,600

Close the books of the firm

(Ans: Realisation loss Rs.68,400; Capital Accounts X Rs.2,95,800; Y Rs.1,09,480; Z (Dr.) Rs.45,680; Cash a/c total Rs.5,90,880)

10. A, B and C sharing profits in the ratio of 3:2:1 agreed upon the dissolution of the firm. A was appointed to realise the assets and pay off the liabilities for which he was entitled to a remuneration of Rs.1,000. The Balance Sheet of the firm on 31-3-2005 which is the date of dissolution is as follows:

Balance Sheet

	Rs.			Rs.
Capitals:		Machinery		40,500
A	50,000	Stock		7,500
B	20,000	Investments		20,000
Creditors	18,500	Debtors	9,300	
General Reserve	6,00	Less: Provision	600	8,700
		C's Capital		11,500
		Cash		6,300
	94,500			94,500

The Investments are taken over by A for Rs.18,000. B takes over the stock and debtors for Rs.13,650. Machinery is sold for Rs.55,000.

Prepare Ledger accounts to close the Books of the firm.

(Ans: Realisation Profit Rs.8,950; Capital Accounts A Rs.40,475; B Rs.11,333; C (Dr.) Rs.9,008; Cash a/c total Rs.70,308)

11. The position of a firm on 31-12-2004 was as under:

Liabilities		Rs.	Assets		Rs.

Reserve		5,000	Bank		5,000
Creditors		10,000	Debtors	10,000	
Bills payable		5,000	Less: Reserve	1,000	9,000
Capitals: A	10,000		Stock		17,000
B	5,000	15,000	Furniture		4,000
		35,000			35,000

On the above date the partners decided to dissolve. The Assets realised Rs.25,000 and creditors were paid Rs.9,000 in full settlement. Expenses of realisation came to Rs.1,000. Prepare realisation account.

(Ans: Realisation loss Rs.5,000)

12. The partnership of P,Q, R who are sharing profits and losses in the proportion of 4/9, 2/9 and 1/3 is dissolved on 31-3-2004. Their Balance Sheet on 1-3-2004 was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	4,500	Cash at Bank	3,750
Bills payable	2,050	Bills receivable	2,800
P's loan	2,000	Investments	12,000
Capitals: P	34,000	Debtors	15,500
Q	23,000	Stock	9,700
R	1,500	Furniture	1,850
Reserve fund	6,300	Buildings	30,000
Profit & Loss a/c	2,250		
	75,600		75,600

Assets realised – Investments 15% less; Bill receivable and debtors Rs.14,100; Stock 25% less; Furniture Rs.1,025, Buildings Rs.17,500.

The cost of realisation was Rs.300. R becomes insolvent and he pays only Rs.512 to the firm. Prepare necessary accounts to close the books.

(Ans: Realisation loss Rs.22,050; When fixed capitals are maintained bank account total Rs.69,062; When fluctuating capital accounts are maintained bank account total Rs.69,062*; Capital accounts balances under fixed capital system: P Rs.36,316; Q Rs.23,896; R Rs.2,488; Capital account balances under fluctuating capital system: P Rs.36,300; Q Rs.23,912; R Rs.2,488)

13. Sravan and Pavan were in partnership. Their Balance Sheet as on 31st December., 2001 showed the following state of affairs:

Liabilities	Rs.	Assets	Rs.
Creditors	5,000	Cash	1,500
Sravan – Capital A/c	3,500	Debtors	4,700
Current A/c	300	Stock	2,300
Pavan – Capital A/c	2,750	Furniture	50
		Pavan – Current A/c	1,000
		Property	2,000
	11,550		11,550

The partners shared profits and losses in the ratio of 9:7. It was decided to dissolve the partnership as on the date of the balance sheet. Property realised Rs.1,500. Bad debts and discounts amounted to Rs.500. Stock realised Rs.2,500. Furniture was taken over by Pavan at mutually agreed price of Rs.25. Creditors allowed a discount of Rs.105.

Give the journal entries and show cash account and partners' capital accounts.

(Ans: Capital Accounts: Sravan Rs.3,395; Pavan Rs.1,450; Cash a/c total Rs.9,700)

14. The following is the balance sheet of X, Y and Z as on 31-12-2003:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	80,000	Cash	2,000
X's loan	20,000	Stock	48,000
Capitals:		Debtors	40,000
X	10,000	Furniture	6,000

Y	6,000	Z's Capital (Dr.)	20,000
	1,16,000		1,16,000

Due to inability to pay creditors the firm was dissolved. Y and Z cannot pay anything. X can contribute only Rs.3,000 from his private estate. Stock realised Rs.30,000, debtors realise Rs.32,000 and furniture was sold for Rs.2,000. Realisation expenses amounted to Rs.6,000. Prepare necessary accounts to close the books of the firm.

(Ans: Realisation loss Rs.36,000; Cash a/c total Rs.69,000; Deficiency a/c total Rs.38,000)

15. The following is the balance sheet of M and N as on 31st December, 2001.

Liabilities	Rs.	Rs.	Assets	Rs.
Sundry Creditors		16,000	Cash at bank	1,000
Capital Account:			Sundry assets	95,000
M	40,000			
N	40,000	80,000		
		96,000		96,000

On this date they agreed to sell their business to XY Co. Ltd. The company took over all the assets except cash at bank for Rs.1,00,000. The purchase price was paid but issue of 7,000 shares of Rs.10 each at a premium of Rs.2 per share fully paid up and the balance in cash. Creditors were paid by the firm Rs.15,000 in settlement of their claims. Prepare realisation account in the books of M and N and pass necessary journal entries in the books of XY Co. Ltd.

(Ans: Realisation Profit Rs.15,000; Balance Sheet Total Rs.95,000)

17.16 SUGGESTED BOOKS

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2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
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6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 18

ISSUE OF SHARES

Objectives:

To acquire knowledge about

- A company
- Kinds of companies
- Different kinds of shares
- Issuing of Shares
- Accounting procedures in issue of shares

Structure:

18.1. INTRODUCTION

18.1.1. Meaning of a company:

A joint stock company is an artificial person, created by law. It has a fixed capital. Capital is divided into transferable shares. It has perpetual succession and common seal. The company has a separate legal entity. It must be compulsorily registered. The capital of a company is divided into small units called shares. Any one who holds or buys share in a company is called shareholder.

18.2. DEFINITION OF A COMPANY

According to Section 3(1)(i) of Indian Companies Act,1956 ,"Company means a company formed and registered under the Companies Act or an existing company formed and registered under any previous, Indian Companies Act".

18.3. CHARACTERISTICS OR FEATURES OF A COMPANY

a. **Incorporation:** A company comes into existence only after registration under the Companies Act.
b. **Artificial legal person:** A company is a corporate body. It is an artificial body created by law.
c. **Distant legal entity:** A company is regarded as a separate entity from its members.
d. **Common seal:** A company is not a natural person. It cannot sign documents. So the common seal is used as a substitute for signature.
e. **Perpetuity:** A company has perpetual or continuous existence.
f. **Limited liability:** The liability of a shareholder is limited. If a shareholder pays the face value of the shares in full to the company, he need not pay even a single paisa.
g. **Number of members:** In a public limited company, the minimum number of members is seven and there is no limit to maximum number. In case of Private limited company, minimum is two and maximum is fifty.
h. **Separation of ownership and management:** A company is owned by the shareholders. It is managed by a separate body called 'Board of Directors'.

i. **Rigidity of objects:** The scope of the business of a company cannot be charged. It cannot do any business which is not included in the 'Objects Clause' of its Memorandum of Association.

j. **Transferability of shares:** Shares can be easily transferred from one person to another. A shareholder can sell hi shares easily and quickly whenever he wants money.

k. **Financial Resources:** A company can secure large capital compared to sole trader or partnership.

l. **Statutory regulations:** A company is governed by the Companies Act. It has to follow the various provisions of the Act.

18.4. VARIOUS KINDS OF COMPANIES

There are three main classes of Joint Stock Companies.

1. **Chartered Companies:** These are the companies formed by the grant of a Royal Charter. They are prevalent in England. This kind of companies are not there in India. Ex. British East India Company.
2. **Statutory Companies:** These are the companies formed by the enactment of special Act of Parliament or State Assembly. The Reserve Bank of India, the State Bank of India, Life Insurance Corporation of India etc., are the examples of Statutory companies.
3. **Registered Companies:** These are the companies formed and registered under the Companies Act, 1956. This is the common way of forming companies. Ex. Tata Iron and Steel Co., HMT Ltd. etc.

   The registered companies are further classified into four groups:

   a) **Companies limited by shares:** In these companies the liability of the members is limited to the extent of the value of shares held by them.

   b) **Companies limited by Guarantee:** In these companies the members liability is not only upto the face value of the shares but also extended to the amount guaranteed by them.

   c) **Unlimited companies:** In these companies the liability of the members is unlimited. The members are fully liable for all the debts of the company.

   d) **Government Companies:** In these companies the government share is more than 51%. Further a registered company may be a Private Limited Company or a Public Limited Company.

18.5 THE SHARE

The capital of a company is divided into units of small denominations. Each such unit into which the capital of the company is divided, is called a share. For Eg: in one company the total capital of Rs.10,00,000 is divided into 1,00,000 units of Rs.10 each. Thus each unit of Rs.10 is called a share of Rs.10 each. The company is said to have 1,00,000 shares of Rs.10 each. Thus share means a part of companies capital divided in Rs.10, Rs.50, Rs.100 each.

18.5.1 Types of Shares:

A company can issue two types of shares. They are (1) Equity shares and (2) Preference shares. Equity shareholders are the owners of the business. They have the right to vote and hence they elect Board of Director of their choice. The dividend on equity shares is not fixed. It will be changing according to the amount of profit available for distribution in the firm of dividends. The equity shareholders will not be paid back during the lifetime of the company. In case of winding up of the equity shareholders are paid back only after all other claimants are paid the amount due to them.

18.5.1 Features of Equity Shares:

The features of Equity Shares are:

1. Dividend is payable on these shares only after payment of dividend on preference shares.
2. At the time of liquidation, equity capital is returnable only after repayment of preference capital.
3. These shares are always non-cumulative.
4. Dividend is not a fixed amount.
5. Equity shareholders are entitled to vote on all resolutions.

18.5.2. Preference Shares:

Preference shares are those shares, which enjoy preferential rights both with respect to dividend and with respect to repayments of capital either during the lifetime or on winding up of the company. They will have the first change on the distributable amount of net profits.

18. 5.3 Kinds of preference shares:

The preference shares may be of the following types.

a. **Cumulative Preference Shares:** The dividend payable on these shares goes on accumulating till it is fully paid off. A cumulative preference shareholder has a right to claim the fixed dividend of the current year out of future profit. Company is bound to pay dividend only if it has sufficient profits available for distribution.

b. **Non-cumulative Preference Shares:** In the case of non-cumulative preference shares, the dividend shall be payable only out of the profits of the current year. If it is not paid in a particular year, it is lost and the arrears of dividend cannot be carried forward. In other words, the unpaid dividends cannot accumulate.

c. **Participating Preference Shares:** Participating preference shares are not only entitled to a fixed rate of dividend, but also to a share in the surplus profits which remain after the claims of the equity shareholders have been met.

d. **Non-participating Preference Shares:** Non-participating preference shares entitled to only a fixed rate of dividend. They do not share in the surplus which belong to the equity share holders.

e. **Convertible Preference Shares:** The holders of these shares have a right to convert them into equity shares within a certain period of time.

f. **Non-convertible Preference Shares:** The preference shares without a right of conversion into equity shares are known as non-convertible preference shares.

g. **Redeemable Preference Shares:** These are the shares to be repayable after certain specified period by the company.

h. **Non-Redeemable Preference Shares:** Non-redeemable preference shares constitute permanent capital of the company. These shares cannot be refunded before the winding up of the company.

18. 6. CATEGORIES OF SHARE CAPITAL

18.6.1. Authorised capital:

The company is authorised to raise the capital to the maximum extent of this capital. A company can not issue shares for more than this amount. This amount is stated in Memorandum of Association of the company. This capital is also known as Nominal or Registered capital.

18.6.2. Issued capital:

It is the part of authorised capital. The company has issued to the public for cash or for consideration other than cash. For example, Shares to vendors or promoters.

The part of the capital which is not issued by the company is called unissued capital. This capital can be issued later or when needed.

18.6.3. Subscribed capital:

It is that part of the issued capital, which is actually subscribed by the public known as subscribed capital. A company can allot only that number of shares which are issued. If the applications for the purchase of shares issued are not received in full, such unissued part of capital is called unsubscribed capital.

18.6.4. Called-up capital:

The shares, which are offered to the public for subscription is known as called-up capital.

18.6.5. Paid-up capital:

The part of called-up capital, which is actually paid by the shareholders is known as paid-up capital. If the called-up amount is paid in full by the shareholders, the paid-up and called-up capital would be the same.

If the shareholders fail to make the payment of their due amounts till the last date, such part is known as calls-in-arrears. A few shareholders make the payment of calls in advance. That advance received amount is known as calls-in-advance.

18.6.7. Reserve capital:

By passing a special resolution, a portion of uncalled amount shall not be called up by the company except in case of winding up or liquidation. This is known as reserve capital. This can be shown in the balance sheet of a company by way of a note.

18.6.8 Working capital:

This is the capital used in purchasing fixed assets for long-term. The balance of cash is used for running the business. This later part of the capital is called working capital (or) the capital which is going to be used to transact the business is working capital.

18.7 PROCEDURE FOR ISSUING SHARES

The procedure for the issue of shares of the company involves the following steps:

1) Issue of Prospectus
2) Receipt of Applications for Shares
3) Allotment of Shares to applicants
4) Issue of Share certificate
5) Receipt of call money

18.7.1 Issue of Prospectus

At the time of issue of debentures or shares to the public, the company issues prospectus. Normally favourable and strong points of the company are pressed upon to attract the investors.

18.7.2 Receipt of Applications for Shares

In response to the invitation given through the prospectus, applications on prescribed form for purchase of shares are received through a scheduled bank at least 4 days after the issue of prospectus. The filled application forms are deposited with the Company's bankers along with the application money. The applications received directly in company's office are also sent to the company's Bankers along with the required application fee.

18.7.3. Allotment of Shares to applicants

Allotment of shares means distribution of shares amongst the applicants. After the closure of subscription list the bankers would forward all applications to the company. The Board of Directors then make the allotment of shares. All the applications are properly scrutinised and classified in different groups. Normally applications for small number of shares are rejected. The shares have to be allotted within 60 days of the issue of prospectus, subject to the following restrictions:

a. The company making the issue has to follow the provisions of the Companies Act, 1956, as well as guidelines of the Securities and Exchange Board of India (SEBI)
b. No allotment may be made of any shares of the company offered to the public for subscription unless the minimum subscription which is 90% of the issued capital has been received.
c. *Minimum Subscription* (Section 69) is the minimum amount, which in the opinion of the directors must be raised in cash by the issue of shares for providing:
    1) the purchase price of any property acquired or to be acquired;
    2) the preliminary expenses payable by the company and any commission payable in connection with the issue of shares;
    3) the repayment of money borrowed for the aforesaid expenditure;
    4) the working capital and
    5) any other expenditure stating the nature and purpose thereof and the estimated amount in each case.
d. The amount payable on application shall not be less than 5% of the nominal amount (face value) of the share.
e. All money received from applicants of shares shall be deposited in a scheduled bank and shall be kept till certificate of commencement of business is obtained by the company.
f. As per the latest amendment in Companies Act a company can remain open the issue for the maximum period of 30 days. If the amount of minimum subscription is not received in these 30 days then the company will refund the amount to applicants within

next 30 days. If the company delays in the refund then the directors and officers of the company will be liable to pay interest @ 15% p.a. for delayed period.

g. A company cannot issue more number of shares than those mentioned in the prospectus.
h. Shares issued for consideration other than cash be separately mentioned in the Balance Sheet.

18.7.4. Despatch of Allotment letters:

Letters of allotment are sent to successful applicants. The number of shares allotted are mentioned in the letter and the allotment money is demanded (if whole amount is not received with applications) to be paid upto a specified date. The agreement for the purchase of shares is deemed to be completed as soon as the allotment letters are issued.

18.7.5. Filing Allotment Return to Registrar:

After the allotment of shares is over the company is required to file a return to the Registrar of companies within 30 days from the date of allotment or extended date by the Registrar. It is the information of allotment furnished by the company to the Registrar in which a declaration is given that all legal formalities were followed by the company in this connection.

The unsuccessful applicants are issued letters to regret together with refund of application money.

18.7.6 Issue of Share certificate

After allotment of shares, a contract comes into being between the company and the allottees. Then all transactions relating to the shares are regulated by the terms and conditions of issue of the shares as well as by the provisions of Articles of Association. The allottees are issued necessary share certificates. The procedure for the issue is the same whether shares are issued at par, at premium or at discount.

18.7.7 Receipt of call money

In case the full amount of shares is not called with application and allotment, the balance may be called in one or more installments. Such installments after allotment are known as "Calls on shares". The following points are mentioned in the articles of association of the company in this connection:

(1) The right to demand the balance of amount on shares issued lies with the directors. They may pass a resolution in directors meeting for the amount to be called and the place of deposit.
(2) The amount called on a call shall not exceed 25% of the nominal value of shares.

(3) Each shareholder shall be informed at least 14 days before the last day of the call.

(4) There shall be a gap of at least one month between two consecutive calls.

(5) The rate of interest to be charged by the company on calls in arrears or interest to be allowed by it on calls in advance shall be mentioned in its articles of association. If the company adopts Table-A of companies act the rate of interest on call in arrears is 5% per annum and on calls in advance 6% per annum.

18.7.8 Register of Members:

Every company is required to keep a register to maintain complete particular for each member.

18.7.9 Index of Member:

Every company having 50 or more members shall maintain a list of members in the form of an index.

18.7.10 Books of Accounts:

Under the companies act every company has to maintain books of accounts compulsorily on double entry system.

18.7.11. Preliminary Expenses:

All such expenses incurred in connection with the formation of the company are called preliminary expenses or promotion expenses or formation or organisation expenses. The following are the examples of such expenses:

(1) Expenses incurred in getting prepared the legal documents;

(2) The fee for filling of necessary documents with the register, registration fee, duty payable on authorised capital;

(3) Expenses for printing of prospectus and advertisement;

(4) Printing charges of application forms and other necessary forms;

(5) Expenses for company's seal;

(6) Commission on first issue of shares and debentures

Preliminary expenses are of capital nature to be shown in company's balance sheet as fictitious asset.

18.8. ISSUE OF SHARES

A company can issue its shares in two types: 1) for cash, and 2) for consideration other than cash. These shares may be issued at par or at premium or at discount. Issue price may be payable either in lump sum along with application, or in installments at different stages, it means, partly on application, partly on allotment and the balance on call or calls.

18.9. ACCOUNTING ENTRIES FOR ISSUE OF SHARES

18.9.1 Issue of Shares at Par:

Date	Particulars	Debit Rs.	Credit Rs.
	On receipt of application money:		
	Bank a/c Dr.	xxx	
	To Share application a/c		xxx
	For transfer of application money to share capital a/c:		
	Share application a/c Dr.	xxx	
	To Share capital a/c		xxx
	For adjustment of excess application money towards allotment:		
	Share application a/c Dr.	xxx	
	To Share allotment a/c		xxx
	For refund of excess application money:		
	Share application a/c Dr.	xxx	
	To Bank a/c		xxx
	For the allotment of money due:		
	Share allotment a/c Dr.	xxx	
	To Share capital a/c		xxx
	On receipt of allotment money:		
	Bank a/c Dr.	xxx	
	To Share allotment a/c		xxx
	On making the first call:		
	Share first call a/c Dr.	xxx	
	To Share capital a/c		xxx
	On receipt of first call money:		
	Bank a/c Dr.	xxx	
	To Share first call a/c		xxx
	On making the Second and Final call:		
	Share second and final call a/c Dr.	xxx	
	To Share capital a/c		xxx
	On receipt of second and final call money:		

	Bank a/c Dr.	xxx	
	To Share second and final call a/c		xxx

Illus.1:

Aptech Ltd. offered to the public 50,000 equity shares of Rs.10 each, payment as follows:

Rs.2.50 on application;

Rs.3.50 on allotment;

Rs.2.00 on first call and

Rs.2.00 on second and final call.

The company received applications for 50,000 shares which it duly allotted. Both the calls were made and duly received.

Pass the Journal entries in the books of the company and show how the share capital will appear in the Balance Sheet.

Solution:

Journal Entries in the Books of Aptech Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank a/c (50,000 x Rs.2.50) Dr. To Equity share application a/c (Being share application money received on 50,000 shares @ Rs.2.50 per share)		1,25,000	 1,25,000
	Equity share application a/c Dr. To Equity share capital a/c (Being share application money transferred to Equity share capital a/c)		1,25,000	 1,25,000
	Equity share allotment a/c Dr. To Equity share capital a/c (Being share allotment money due on 50,000 equity shares @ Rs.3.50 per share)		1,75,000	 1,75,000
	Bank a/c Dr. To Equity share allotment a/c (Being share allotment money received)		1,75,000	 1,75,000
	Equity share first call a/c Dr. To Equity share capital a/c		1,00,000	 1,00,000

	(Being share first call money due on 50,000 shares @ Rs.2 per share)			
	Bank a/c Dr. To Equity share first call a/c (Being Equity share first call money received)		1,00,000	 1,00,000
	Equity share second and final call a/c Dr. To Equity share capital a/c (Being Equity share final call money due on 50,000 shares @ Rs.2 per share)		1,00,000	 1,00,000
	Bank a/c Dr. To Equity share second and final call a/c (Being Equity share final call money received)		1,00,000	 1,00,000

Balance Sheet of Aptech Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
Share capital: Authorised: Issued, subscribed, called up & paid up : 50,000 shares @ Rs.10 each	 5,00,000 5,00,000	Cash at bank	5,00,000 5,00,000

18.9.2 Issue of Shares at a Premium:

A. Use of Amount of Premium:

Amount called on shares in the form of premium is credited in Share Premium Account. According to Section 78 of the Companies Act, 1956, the amount of premium may be used for the following purposes:

a. to issue fully paid bonus shares to the members;
b. to write off preliminary expenses of the company;
c. to write off the expenses or the commission paid or discount allowed on the issue of shares or debentures of the company;
d. to provide premium on redemption of preference shares or premium on redemption of debentures of the company.

Share premium cannot be used for the purpose of dividends. The use of Share Premium for the purpose other than mentioned above shall mean reduction of share capital.

B. Accounting for Share Premium:

The premium on issue of shares is a capital receipt. As such it shall be credited to a separate account called "Share Premium Account". Premium may be called with share application or allotment. The share application or allotment account is debited with the amount of premium and Share Premium account is credited with the amount of premium only. Generally amount of premium is due with allotment.

C. Share Premium to be shown in the Balance Sheet:

"Share Premium Account" is to be shown on the liabilities side of the Balance Sheet under the heading "Reserves and Surpluses".

Date	Particulars		Debit Rs.	Credit Rs.
	When premium is received with application money:			
	Bank a/c	Dr.	xxx	
	To Share application a/c			xxx
	To Share premium a/c			
	When the premium is payable with allotment money:			
	Share allotment a/c	Dr.	xxx	
	To Share Capital a/c			xxx
	To Share premium a/c			xxx

Illus.2:

X Y Z Co. Ltd. issued 1,00,000 equity shares of Rs.10 each at a premium of Rs.5 per share payable as follows :

On application	**Rs.2**
On allotment	**Rs.8 (including premium)**
On First call	**Rs.3**
On Final call	**Rs.2**

All the shares offered were subscribed for by the public and cash duly received. Pass journal entries to record the above issue of shares and prepare balance sheet.

Solution:

Journal Entries of XYZ Company Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c (1,00,000 x 2) Dr.		2,00,000	
	To Equity share application a/c			2,00,000
	(Being share application money received on 1,00,000 shares @ Rs.2 per share)			
	Equity share application a/c (1,00,000 x 2) Dr.		2,00,000	
	To Equity share capital a/c			2,00,000
	(Being share application money transferred to Equity share capital a/c)			
	Equity share allotment a/c(1,00,000 x 2) Dr.		8,00,000	
	To Equity share capital a/c (1,00,000 x 3)			3,00,000
	To Share premium a/c (1,00,000 x 5)			5,00,000
	(Being share allotment money due on 1,00,000 equity shares @ Rs.3 per share on capital a/c and Rs.5 per share on share premium a/c)			
	Bank a/c Dr.		8,00,000	
	To Equity share allotment a/c			8,00,000
	(Being share allotment money received)			
	Equity share first call a/c Dr.		3,00,000	
	To Equity share capital a/c			3,00,000
	(Being share first call money due on 1,00,000 equity shares @ Rs.3 per share)			
	Bank a/c Dr.		3,00,000	
	To Equity share first call a/c			3,00,000
	(Being Equity share first call money received)			
	Equity share second and final call a/c Dr.		2,00,000	
	To Equity share capital a/c			2,00,000
	(Being Equity share final call money due on 1,00,000 equity shares @ Rs.2 per share)			
	Bank a/c Dr.		2,00,000	
	To Equity share second and final call a/c			2,00,000

	(Being Equity share final call money received)			

Balance Sheet of XYZ Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
1. Share capital:		**Current Assets:**	15,00,000
Authorised:		Cash at bank	
Issued, subscribed, called up & paid up :			
1,00,000 equity shares @ Rs.10 per share	10,00,000		
2. Reserves & Surplus:			
Share premium	5,00,000		
	15,00,000		15,00,000

18.9.3 Over-subscription of Shares

Shares are said to be over-subscribed when the number of shares applied for is more than the shares offered for the issue. It happens in case of public issue of reputed and popular companies. The board of directors may make the allotment of shares as under in case of over-subscription.

a. Pro-rata or proportional allotment to all the applicants. For example, 2000 shares are issued for which applications for the purchase of 6000 shares are received. If all the applicants are made pro-rata allotment, it means 200 shares will be allotted for every 600 shares applied or two shares for every 6 shares applied. Excess money received is not refunded but retained and adjusted towards sums due for allotment.
b. Some of the applications may be rejected fully while remaining applicants be allotted shares in full. In such case, the application money to non-allottees is refunded along with a letter of regret.

Illus.3:

A company issued Rs.5,00,000 new capital divided into Rs.10 shares at premium of Rs.4 per share, payable as under:

On Application Rs.1 per share; on allotment Rs.4 per share and Rs.2 premium; on final payment Rs.5 per share and Rs.2 premium.

Over-payments on application were to be applied towards sums due on allotment. Where no allotment was made money was to be returned in full. The issue

was over-subscribed to the extent of 13,000 shares. Applicants for 12,000 shares were allotted only 1,000 and applicants for 2,000 were sent letters of regret. All money due on allotment and final call was duly received. Make the necessary entries in company's books.

Solution:

Journal entries in the books of a Company

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c (63,000 x 1) Dr.		63,000	
	To Equity share application a/c			63,000
	(Being equity share application money received on 63,000 shares @ Rs.1 per share)			
	Equity share application a/c (63,000 x 1) Dr.		63,000	
	To Equity share capital a/c (50,000 x 1)			50,000
	To Equity share allotment a/c (1,000 x 6)			6,000
	To Equity share first call a/c (1,000 x 5)			5,000
	To Bank a/c (2,000 x 1)			2,000
	(Being the amount received on share application transferred to share capital a/c and the excess application money transferred to share allotment, share call account and the balance amount returned)			
	Equity share allotment a/c (50,000 x 6) Dr.		3,00,000	
	To Equity share capital a/c (50,000 x 4)			2,00,000
	To Equity share premium a/c (50,000 x 2)			1,00,000
	(Being Equity share allotment money due on 50,000 shares @ Rs.4 per share and premium @ Rs.2 per share)			
	Bank a/c Dr.		2,94,000	
	To Equity share allotment a/c			2,94,000
	(Being Equity share allotment money received on 50,000 shares i.e. Rs.3,00,000-6,000 = Rs.2,94,000)			

	Equity share first &n final call a/c (50,000 x 7) Dr.		3,50,000	
	To Equity share capital a/c (50,000 x 5)			2,50,000
	To Equity share premium a/c (50,000 x 2)			1,00,000
	(Being Equity share final call money due on 50,000 shares @ Rs.5 per share and premium @ Rs.2 per share)			
	Bank a/c Dr.		3,45,000	3,45,000
	To Equity share first & final call a/c			
	(Being equity share first and final call money received on 50,000 shares i.e. Rs.3,50,000 – 5,000 = Rs.3,45,000)			

No. of shares issued Rs.5,00,000 / 10 =	50,000 shares	
Oversubscribed shares =	13,000 shares	
Application money received on =	63,000 shares	@ Rs.1 = 63,000
2,000 applications were returned back i.e. 2,000 shares x Rs.1 =		2,000
Balance application money received		61,000
Actual application money for 50,000 shares @ Rs.1 =		50,000
Excess application money received		11,000
Less: Adjustment towards allotment money for 1,000 shares x Rs.6		6,000
Balance amount adjusted towards first & final call money		5,000

18.9.4 Under subscription

Shares are said to be under-subscribed when the number of shares applied for is less than the number of shares offered. Foe example, in case a company has offered 10,000 shares to public but the public applied for 9,000 shares only, it is case of under-subscription. In such a case, it must be ensured whether the company has received the minimum subscription after which allotments will be made to all the applicants. No adjustment is needed in such a case.

Illus.4:

Sruthi Ltd., invited application for 5,00,000 Equity shares of Rs.10 each payable as follows.

With application Rs.2; on allotment Rs.3; on first call Rs.2.50; on second and final call Rs.2.50.

Applications totalled 4,70,000 share were received. The Board of Directors accepted all the applications. Both the calls were made. You are required to pass necessary Journal Entries in the books of Sruthi Ltd.

Solution:

Journal of Anusha Co. Ltd.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c (4,70,000 x 2) Dr. To Equity share application a/c (Being application money received on 4,70,000 shares @ Rs.2 per share)		9,40,000	 9,40,000
	Equity share application a/c Dr. To Equity share capital a/c (Being share application money transferred to share capital a/c)		9,40,000	 9,40,000
	Equity share allotment a/c Dr. To Equity share capital a/c (Being share allotment amount due on 4,70,000 shares @ Rs.3 per share)		14,10,000	 14,10,000
	Bank a/c Dr. To Equity share allotment a/c (Being the allotment money received)		14,10,000	 14,10,000
	Equity share first call a/c Dr. To Equity share capital a/c (Being shares first call money due on 4,70,000 shares @ Rs.2.50 each)		11,75,000	 11,75,000
	Bank a/c Dr. To Equity share first & final call a/c (Being the first call money received)		11,75,000	 11,75,000

	Equity share final call a/c Dr.		11,75,000	
	To Equity share capital a/c			11,75,000
	(Being the final call money due on 4,70,000 shares @ Rs.2.50 each)			
	Bank a/c Dr.		11,75,000	
	To Equity share final call a/c			11,75,000
	(Being the final call money received)			

Note: The students are advised to prepare the following ledger accounts also

1. Bank a/c
2. Equity share capital a/c and
3. Opening Balance Sheet of Sruthi ltd.

18.9.5 Issue of Shares at a Discount:

A. Conditions for issue of shares at discount:

According to Section 70 of Companies Act, 1956 a company may issue its shares at discount only if the following conditions are fulfilled:

a. The share must belong to a class already issued;
b. The issue must be authorized by an ordinary resolution of the company;
c. The sanction of the Company Law Board must be obtained;
d. The resolution must specify the maximum rate of discount at which the shares are to be issued. No resolution shall be sanctioned by the Company Law Board if the maximum rate of discount specified in the resolution exceeds 10% unless it is of the opinion that a higher percentage of discount may be allowed in the special circumstance of the case;
e. At least one year must have elapsed since the date on which the company was entitled to commence business and
f. The issue must be made within two months from the date receiving the sanction of the Company Law Board or within such extended time as the Company Law Board may allow.

B. To write off discount on issue of shares:

Discount on issue of shares is a capital loss of the company. It may be written off either out of capital profits of the company or out of the profits prior to incorporation. In case there is no Capital Reserve or capital profit in a company, the discount on issue of shares may be written off out of Profit & Loss Account. Discount on issue of shares is a fictitious asset to be shown on Assets side of the balance sheet till it is written off.

Date	Particulars		Debit Rs.	Credit Rs.
	When the shares are issued at discount at the time of allotment:			
	Share allotment a/c	Dr.	xxx	
	Discount on issue of shares a/c	Dr.	xxx	xxx
	To Share capital a/c			

Illus.5:

M Ltd., invited applications for 50,000 shares of Rs.10 each at a discount of 6% payable as follows:

On application Rs.2.50; on allotment Rs.3.40 and on First and final call Rs.3.50

The applications received were for 45,000 shares and all of these were accepted. All money due was received.

Pass necessary entries in the journal of the company. Also show how the transactions would appear in Balance Sheet of the company.

Solution:

Journal Entries in the Books of M Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c (45,000 x Rs.2.50)	Dr.		1,12,500	
	To Equity share application a/c				1,12,500
	(Being share application money received)				
	Equity share application a/c (45,000 x Rs.2.50)	Dr.		1,12,500	
	To Equity share capital a/c				1,12,500
	(Being share application money on 45,000 shares @ Rs.2.50 per share transferred to capital a/c)				
	Equity share allotment a/c (45,000 x Rs.3.40)	Dr.		1,53,000	
	Discount on issue of shares a/c (45,000 x Rs.0.60)			27,000	
	To Equity share capital a/c (45,000 x Rs.4)				1,80,000
	(Being Equity share allotment money due on 45,000 shares @ Rs.3.40 per share and discount @ Rs.0.60 per share)				
	Bank a/c	Dr.		1,53,000	

	To Equity share allotment a/c (Being share allotment money received)			1,53,000
	Equity share first & final call a/c Dr. To Equity share capital a/c (Being Equity share final call money due on 45,000 shares @ Rs.3.50 per share)		1,57,500	1,57,500
	Bank a/c Dr. To Equity share first & final call a/c (Being share first and final call money received)		1,57,500	1,57,500

Balance Sheet of M Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
Share capital:		**Current Assets:**	
Authorised:		Cash at bank	4,23,000
Issued:		Discount on issue of Shares	27,000
50,000 shares @ Rs.10 each	5,00,000		
Subscribed:			
45,000 shares @ Rs.10 each	4,50,000		
Called up & paid up :			
45,000 shares @ Rs.10 each	4,50,000		
	4,50,000		4,50,000

18.9.6 Calls in Arrears and Calls in Advances:

A. Calls in Arrear:

It often happens that some shareholders fail to pay the amount due on allotment and/or calls on the shares held by them. The total of unpaid amount on account of one or more installments is called Calls in Arrear or Unpaid calls.

(i) Interest on Calls in Arrear:

The directors may charge interest on calls in arrear at a stipulated rate mentioned in the articles of association of the Company. If the company adopts Table-A of Companies Act, 1956 (which is a model of articles of association), interest at the rate not exceeding 5% per annum shall be charged for the period from the date fixed for payment to the date of actual payment. The directors may waive the application of this rule at their discretion.

(ii) Accounting for Calls in Arrear:

It is not mandatory to maintain a separate account for calls in arrear. The debit balance of allotment and/or call accounts will be shown in the Balance Sheet not as an asset but by way of deduction from the called-up capital.

B. Calls in Advance:

A shareholder may sometimes pay a part or whole of the amount not yet called up on his shares in order to save himself of the trouble of paying several calls on various dates. Any amount received from a shareholder in excess of the amount due is called "Calls-in-Advance". The following entry is to be passed:

Bank a/c Dr. (With the amount received
To Calls in Advance a/c in advance)
(Amount received on ….. shares @ Rs……
per share in anticipation of future calls)

Note: No dividend is payable by the company on calls-in-advance as it is not a part of Share Capital. As such "Calls in Advance" is shown under the 'Current Liabilities' on liabilities side of the Balance Sheet.

(i) Interest on Calls in Advance:

Interest on calls in advance may be allowed by the company at a specified rate mentioned in the articles of association of the company. If the company adopts 'Table-A' of Companies Act, 1956, interest at the rate of 6% per annum may be allowed to the shareholders.

(ii) Adjustment of Calls in Advance:

The amount received in respect of future calls shall be adjusted when the call received in advance is made due.

Date	Particulars		Debit Rs.	Credit Rs.
	For calls in arrears:			
	Calls in arrears a/c	Dr.	xxx	
	To Share call a/c			xxx
	When call money is received in advance:			
	Bank a/c	Dr.	xxx	
	To Share call a/c			xxx

	To Calls in advance a/c		xxx
	When calls in advance amount is adjusted Against the subsequent calls: Calls in advance a/c Dr. To Share call a/c	xxx	xxx
	For receipt of Interest on calls in arrears: Bank a/c Dr. To Interest on calls in arrears a/c	xxx	xxx
	For payment of interest on calls in advance: Interest on calls in advance a/c Dr. To Bank a/c	xxx	xxx

Illus.6:

Sarada & Co. Ltd., invited application for 5,000 equity shares of Rs.100 each payable Rs.25 on application, Rs.50 on allotment and the balance on 1st and final call. The issue was fully subscribed and all the money was duly received except 1st call on 250 shares. Record the above transactions in the books of the company and show its balance sheet.

Solution:

Journal Entries in the books of Sarada & Co. Ltd.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank a/c Dr. To Equity share application a/c (Being share application money received on 2,500 equity shares @ Rs.25 each)		1,25,000	1,25,000
	Equity share application a/c Dr. To Equity share capital a/c (Being share application amount transferred to share capital a/c)		1,25,000	1,25,000
	Equity share allotment a/c Dr. To Equity share capital a/c (Being share allotment amount due on 5,000 shares @ Rs.50 each)		2,50,000	2,50,000
	Bank a/c Dr.		2,50,000	

	To Equity share allotment a/c			2,50,000
	(Being share allotment amount received)			
	Equity share first & final call a/c Dr.		1,25,000	
	To Equity share capital a/c			1,25,000
	(Being first and final call amount due on 5,000 shares @ Rs.25 each)			
	Bank a/c (4,750 x 25) Dr.		1,18,750	
	Calls in Arrears a/c (250 x 25) Dr.		6,250	
	To Equity share first & final call a/c (5,000 x 25)			1,25,000
	(Being share first and final call amount received on 4,750 shares)			

Balance Sheet of Singh & Co. Ltd., as on ……..

Liabilities		Rs.	Assets	Rs.
Share capital:			**Current Assets:**	
Authorised:			Cash at bank	4,93,750
Issued, Subscribed:				
5,000 shares @ Rs.100		5,00,000		
each				
Called up & paid up :	5,00,000			
5,000 shares @ Rs.100	6,250	4,93,750		
each		4,93,750		4,93,750
Less: Calls in arrears				

Illus.7:

Anusha Co. Ltd., issued equity shares of Rs.25 each payable Rs.10 on application, Rs.5 on allotment and the balance on first and final call. Another person Karunya, a holder of 150 shares made the full payment at the time of application.

Pass necessary journal entries and prepare the balance sheet of the company.

Solution:

Journal of Anusha Co. Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c	Dr.		1,02,200	
	To Equity share application a/c (10,000 x10)				1,00,000
	To Calls in Advance a/c (150 x 15)				2,250
	(Being share application amount received on 10,000 shares @ Rs.10 each and full payment received on 150 shares)				
	Equity share application a/c (10,000 x 10)	Dr.		1,00,000	
	To Equity share capital a/c				1,00,000
	(Being share application amount transferred to equity share capital a/c)				
	Equity share allotment a/c	Dr.		50,000	
	To Equity share capital a/c				50,000
	(Being share allotment amount due on 10,000 shares @ Rs.5 each)				
	Bank a/c (9,850 x 5)	Dr.		49,250	
	Calls in Advance a/c (150 x 5)	Dr.		750	
	To Equity share allotment a/c				50,000
	(Being share allotment money received on 9,850 shares and allotment money on 150 shares received in advance adjusted)				
	Equity share first & final call a/c	Dr.		1,00,000	
	To Equity share capital a/c				1,00,000
	(Being shares first and final call money due on 10,000 shares @ Rs.10 each)				
	Bank a/c (9,750 x 10)	Dr.		97,500	
	Calls in Advance a/c (150 x 10)	Dr.		1,500	
	Calls in Arrears a/c (100 x 10)	Dr.		1,000	

	To Equity share first & final call a/c (Being share first call amount on 9,750 shares received, on 150 shares received in advance adjusted and on 100 shares not received)			1,00,000

Balance Sheet of Anusha Ltd., as on ……..

Liabilities		Rs.	Assets	Rs.
Share capital:			**Current Assets:**	
Authorised:			Cash at bank	2,49,000
Issued, Subscribed:				
10,000 shares @ Rs.25 each		2,50,000		
Called up & paid up :	2,50,000			
10,000 shares @ Rs.25 each	1,000	2,49,000		
Less: Calls in arrears		2,49,000		2,49,000

18.9.7 Forfeiture of Shares:

When a shareholder fails to pay one or more installments (viz,. allotment and/or call or calls) due on the shares held by him, the company has the authority to forfeit such shares. Forfeiture of shares means the cancellation of allotment to defaulting shareholders and to treat the amount already received in such shares as forfeited. In this case a shareholder ceases to be a member of the company.

A. Procedure for forfeiture of shares:

There is no specific procedure laid down in Indian Companies Act in respect of forfeiture of shares. The right of forfeiture should be contained in the articles of association of the company for non-payment of installment or installments. If procedure for forfeiture of shares has not been laid down in the articles of the company, the provision of Table-A' shall apply. Accordingly, (1) the Board of Directors shall serve a notice to the defaulting shareholder to make the payment of such calls in arrear with interest, if any, on a further date (not being earlier than the expiry of 14 days from the date of serving notice); (2) it shall be stated therein that in the event of non-payment upto the specified date, his shares shall be liable for forfeiture.

Despite the receipt of such notice, if the shareholder fails to make payment of his dues, by stipulated date, his shares be forfeited by passing a resolution by the Board of Directors to this effect and the member be informed accordingly.

The forfeiture of shares under the provisions of the articles may be made only for non-payment of installments and not for any other reasons. In case the shares are forfeited for non-payment of business debts, the forfeiture shall be treated as illegal and invalid.

The articles may provide that even after forfeiture of shares the member may remain liable for payment of his arrears. It is not treated as suitable in practice and therefore, the companies generally reissue the shares forfeited immediately so that the past member's liability is automatically finished.

Date	Particulars		Debit Rs.	Credit Rs.
	Forfeiture of shares issued at par:			
	Share capital a/c	Dr.	xxx	
	To Forfeited shares a/c			xxx
	To Various calls a/c			xxx
	Forfeiture of shares issued at premium and the premium amount not paid by shareholders:			
	Share capital a/c	Dr.	xxx	
	Share Premium a/c	Dr.	xxx	
	To Forfeited shares a/c			xxx
	To Various calls a/c			xxx
	Forfeiture of shares issued at discount:			
	Share capital a/c	Dr.	xxx	
	To Forfeited shares a/c			xxx
	To Discount on issue of shares a/c			xxx
	To Various calls a/c			xxx

Illus.8:

Yashwant Limited had offered 50,000 equity shares of Rs.10 each to public for subscription, payable as follows.

Rs.1 on application

Rs.2 on allotment

Rs.3 on first call

Rs.4 on second and final call

All the calls were made and duly received except from A holding 200 shares who failed to pay both the calls and B holding 500 shares who failed to pay the final call.

Pass journal entry on the forfeiture of shares of both A and B.

Solution:

Journal of Yashwant

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Equity share capital a/c (200 x 10) Dr.		2,000	
	To Equity share first call a/c (200 x 3)			600
	To Equity share second & final call a/c (200 x 4)			800
	To Forfeited shares a/c (200 x 3)			600
	(Being forfeiture of 200 shares of A for non-payment of first call money of Rs.3 per share and final call of Rs.4 per share)			
	Equity share capital a/c (500 x 10) Dr.		5,000	
	To Equity share second & final call a/c (500 x 4)			2,000
	To Forfeited shares a/c (500 x 6)			3,000
	(Being forfeiture of 500 shares of B for non-payment of second and final call of Rs.4 per share)			

Illus.9:

Pass Journal entries for the forfeiture of shares in the following cases:

a. **A holds 200 shares of Rs.10 each in X Ltd., payable Rs.3 on application, Rs.4 (including share premium of Rs.1) on allotment, Rs.2 on first call and Rs.2 on second and final call. The company forfeits A's share for non-payment of first call**

b. **B is a holder of 300 shares in the above company. His shares are forfeited for non-payment of allotment and first call money.**

Solution:

Journal Entries

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Equity share capital a/c (200 x 8)	Dr.		1,600	
	Share Premium a/c (200 x 1)	Dr.		200	400
	To Equity share first call a/c (200 x 2)				1,400
	To Forfeited shares a/c (200 x 7)				
	(Being forfeiture of 200 shares of A for non-payment of first call money)				
	Equity share capital a/c (300 x 8)	Dr.		2,400	
	Equity share premium a/c (300 x 1)	Dr.		300	
	To Equity share allotment a/c (300 x 4)				1,200
	To Equity share first call a/c (300 x 2)				600
	To Forfeited shares a/c (300 x 3)				900
	(Being forfeiture of 300 shares of B for non-payment of Allotment & first call money)				

18.9.8 Re-issue of Forfeited shares:

The forfeited shares become the property of the company. A company can reissue the forfeited shares in accordance with the provisions contained in the articles of the company as and when it is convenient. These shares may be reissued at par, at premium or at discount. The provisions of Section 79 (For issue of shares at discount) do not apply on reissue of forfeited shares at discount. But the maximum amount of discount which may be allowed on reissue is as under:

Case	Maximum permissible discount
1. When shares were originally issued at par or at premium	1. the amount credited for forfeited shares
2. When shares were originally	2. amount credited to forfeited shares account

issued at discount	plus the amount of original discount.

Date	Particulars		Debit Rs.	Credit Rs.
	On re-issue of forfeited shares:			
	Bank a/c	Dr.	xxx	
	To Forfeited shares a/c			xxx
	To Share capital a/c			xxx
	If the re-issue is at par:			
	Bank a/c	Dr.	xxx	
	To Share capital a/c			xxx
	If the re-issue is at premium:			
	Bank a/c	Dr.	xxx	
	To Share capital a/c			xxx
	To Share premium a/c			xxx
	If the re-issue is at discount:			
	Bank a/c	Dr.	xxx	
	Discount on issue of shares a/c	Dr.	xxx	
	Forfeited shares a/c	Dr.	xxx	
	To Share capital a/c			xxx
	To record the transfer of profit on Forfeited shares:			
	Forfeited shares a/c	Dr.	xxx	
	To Capital Reserve a/c			xxx

Illus.10:

The directors of A Co. Ltd. decided to forfeit the following shares:

200 shares issued to X on which he paid Rs.3 on application but failed to pay Rs.5 (including premium of Rs.2) and the first and final call of Rs.4

These shares were re-issued to Y at a discount of 10%. Journalise.

Solution:

Journal Entries in the books of A Company Limited

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Equity share capital a/c (200 x 10)	Dr.		2,000	
	Share Premium a/c (200 x 2)	Dr.		400	
	To Equity share allotment a/c (200 x 5)				1,000
	To Share first & final call a/c (200 x 4)				800
	To Forfeited shares a/c (200 x 3)				600
	(Being 200 shares of Rs.10 each issued at a premium of Rs.2 per share forfeited for non-payment of allotment, first and final call money)				
	Bank a/c (200 x 9)	Dr.		1,800	
	Forfeited shares a/c	Dr.		200	
	To Equity share capital a/c				2,000
	(Being re-issue of forfeited shares @ a discount of 10% i.e. Rs.9 per share)				
	Forfeited shares a/c	Dr.		400	
	To Capital reserve a/c				400
	(Being the balance of Shares forfeited a/c transferred to Capital reserve a/c)				

Working Notes: Amount transferred to Capital reserve a/c:

		Rs.
Amount received on 200 forfeited shares	(200 x 3)	600
Less: Discount allowed on reissue (10-9 =1)	(200 x 1)	200
Amount transferred to Capital reserve		400

Illus.11:

X Ltd., forfeited 10 shares of Rs.10 each (Rs.6 called up) issued at a discount of 10% to Nirupama on which she had paid Rs.2 per share. Out of these 8 shares were re-issued to Mina as Rs.8 called up at Rs.6 per share. Give journal entries.

Solution:

Journal Entries in the books of X Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Equity share capital a/c (10 x 6) Dr.		60	
	To Discount on issue of shares a/c (10 x 1)			10
	To Share call a/c (10 x 3)			30
	To Forfeited shares a/c (10 x 2)			20
	(Being forfeiture of 10 shares of Rs.10 each issued at a discount of 10% for non-payment of share call of Rs.3)			
	Bank a/c (8 x 6) Dr.		48	
	Discount on issue of Shares a/c (8 x 1) Dr.		8	
	Forfeited shares a/c Dr.		8	
	To Equity share capital a/c (8 x 8)			64
	(Being 8 shares re-issued out of 10 shares forfeited at Rs.8, Rs.6 called up)			
	Forfeited shares a/c Dr.		8	
	To Capital reserve a/c			8
	(Being the balance left in forfeited shares a/c transferred to Capital reserve a/c)			

Illus.12:

Rahul was holding 30 shares of Rs.10 each X Ltd., issued at 10 % discount. He paid Rs.2 on application but could not pay the allotment money of Rs.3 and his shares were forfeited. Make journal entry in the books of the company.

Solution:

Journal Entries in the books of X Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Equity share capital a/c (30 x 6) Dr.		180	
	To Share allotment a/c (30 x 3)			90
	To Discount on issue of shares a/c (30 x 1)			30
	To Forfeited shares a/c (30 x 2)			60
	(Being forfeiture of 30 shares of Rs.10 each issued at 10% discount for non-payment of allotment money)			

Working Notes:

Face value of share = Rs.10

Discount given on each share = 10%

$10 \times \frac{10}{100} = \text{Rs.}1$

Discount on 1 share = Rs.1

Discount on 30 shares = 30 x Rs.1 = Rs.30

18.9.9 Issue of Shares for consideration other than Cash:

a. Issue to vendors for the purchase of assets:

Date	Particulars	Debit Rs.	Credit Rs.
	On Purchasing the Assets:		
	Sundry asset a/c Dr.	xxx	
	To Vendor a/c		xxx
	For issue of shares to Vendor:		
	Vendors a/c Dr.	xxx	
	To Share capital a/c		xxx
	To Share premium a/c (if any)		xxx
	Issue of Promoters for Service rendered:		
	Goodwill a/c Dr.	xxx	
	To Share premium a/c		xxx
	(With the nominal value of shares allotted)		

Illus.13:

Sarath Co. Ltd. was formed with an authorised capital of Rs.20,00,000 divided into 2,00,000 shares of Rs.10 each. It acquired machinery costing Rs.3,00,000 and other assets costing Rs.7,00,000 from Mr. Bhaskar. In consideration Rs.5,00,000 paid

in cash and the balance in shares at a premium of Rs.2.50 per share. The company further issued to the public 1,00,000 shares payable Rs.4 on application, Rs.5.50 (including premium Rs.2.50) on allotment and the balance of first and final call.

The purchase consideration was fully satisfied. Shareholders holding 1,000 shares failed to pay the final call and after due notice they were forfeited and re-issued at a price of Rs.6 per share. The preliminary expenses Rs.45,000 were paid by the company.

Journalise the above transactions and show the balance sheet.

Solution:

Journal Entries in the books of Sarath Co. Ltd.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Machinery a/c Dr. Other Assets a/c Dr. To Bhaskar a/c (Being the machinery and other assets purchased from Bhaskar)		3,00,000 7,00,000	 10,00,000
	Bhaskar a/c Dr. To Bank a/c To Equity share capital a/c (40,000 x 10) To Equity share premium a/c (40,000 x 2.50) (Being the consideration of Rs.5,00,000 paid in cash and the balance on shares at a premium of Rs.2.50 per share) (Rs.10,00,000 –5,00,000 =5,00,000) $\frac{5,00,000}{12.50}$ = 40,000 shares		10,00,000	 5,00,000 4,00,000 1,00,000
	Bank a/c Dr. To Equity share application a/c (Being the application money received on 1,00,000 shares @ Rs.4 per share)		4,00,000	 4,00,000
	Equity share application a/c Dr. To Equity Share capital a/c (Being the application money received on 1,00,000 shares @ Rs.4 per share)		4,00,000	 4,00,000

	Equity share allotment a/c (1,00,000 x 5.50) Dr. To Equity Share capital a/c (1,00,000 x 3) To Equity share premium a/c (1,00,000 x 2.50) (Being Equity share allotment money due on 1,00,000 shares @ Rs.5.50 per share including a premium of Rs.2.50)		5,50,000	 3,00,000 2,50,000
	Bank a/c Dr. To Equity share allotment (Being the Equity share allotment money received)		5,50,000	 5,50,000
	Equity share first and final call a/c Dr. To Equity Share capital a/c (Being the first and final call money due on 1,00,000 equity shares @ Rs.3 per share)		3,00,000	 3,00,000
	Bank a/c Dr. To Equity shares first and final call a/c (Being Equity share first and final call money received on 99,000 shares)		2,97,000	 2,97,000
	Equity share capital a/c (1,000 x 10) Dr. To Equity share first & final call a/c (1,000 x 3) To Shares forfeited a/c (1,000 x 7) (Being forfeiture of 1,000 shares for non-payment and first & final call money)		10,000	 3,000 7,000
	Bank a/c (1,000 x 6) Dr. Forfeited shares a/c Dr. To Equity share capital a/c (Being the re-issue of 1,000 forfeited shares @ Rs.6 per share)		6,000 4,000	 10,000
	Forfeited shares a/c Dr. To Capital Reserve a/c (Being the balance in forfeited shares a/c transferred to capital reserve a/c)		3,000	 3,000
	Preliminary expenses a/c Dr. To Bank a/c (Being preliminary expenses paid)		45,000	 45,000

Working Notes:

			Rs.
1.	Amount due on first and final call	1,00,000 X 3	3,00,000
	Less: Calls in arrears	1,000 X 3	3,000
	Cash received on first and final call	99,000 @ Rs.3	2,97,000
2.	Money received on 1,000 forfeited shares	(1,000 X 7)	7,000
	Less: Discount allowed on the re-issue of shares (10 - 6 = 4)	(1,000 X 4)	4,000
	Amount transferred to Capital Reserve		3,000

Ledger Accounts in the Books of Sarath Co. Ltd.

Dr. Bank a/c Cr.

	Rs.		Rs.
To Equity Share Application a/c	4,00,000	By Mr. Bhaskar a/c	5,00,000
To Equity Share Allotment a/c	5,50,000	By Preliminary Expenses a/c	45,000
To Equity Share final call a/c	2,97,000	By Balance c/d	7,08,000
To Equity Share capital a/c	6,000		
	12,53,000		12,53,000
To Balance b/d	7,08,000		

Balance Sheet of a Sarath Co. Ltd. as on ……..

Liabilities	Rs.	Assets	Rs.
I. Share Capital:		**I. Fixed Assets:**	
Authorised:2,00,000 shares of Rs.10 each	20,00,000	Machinery	3,00,000
		Other Assets	7,00,000
Issued, Subscribed and paid up:		**II. Current Assets:**	
		Cash at bank	7,08,000
(1,00,000 + 40,000) 1,40,000 shares of Rs.10 each	14,00,000	**III. Miscellaneous Expenditure:**	
II. Reserves & Surplus			
Share Premium (1,00,000 +2,50,000)	3,50,000	Preliminary expenses	45,000
Capital reserve	3,000		
	17,53,000		17,53,000

18. 9.10 Issue of Bonus Shares:

A. When bonus is utilised for making partly paid shares into fully paid shares:

Date	Particulars		Debit Rs.	Credit Rs.
	When bonus is declared:			
	Profit & Loss a/c	Dr.	xxx	
	General Reserve a/c	Dr.	xxx	
	To Bonus to shareholders a/c			xxx
	When share call amount due:			
	Share final call a/c	Dr.	xxx	
	To Share capital a/c			xxx
	When bonus is utilised for the purpose:			
	Bonus to shareholders a/c	Dr.	xxx	
	To Share final call a/c			xxx

B. When bonus is utilised for issuing free fully paid shares:

Date	Particulars		Debit Rs.	Credit Rs.
	When bonus is declared:			
	Profit & Loss a/c	Dr.	xxx	
	Other Reserves a/c	Dr.	xxx	
	To Bonus to shareholders a/c			xxx
	For issue of bonus shares:			
	Bonus to shareholders a/c	Dr.	xxx	
	To Share capital a/c			xxx

Illus.14:

The Balance Sheet of A Co. Ltd. On 31st December 2005 is as follows:

	Rs.		Rs.
Share Capital:		**Sundry Assets**	**4,75,000**
2,000 shares of Rs.100 each	**2,00,000**		
	50,000		
Share Premium	**1,00,000**		

Reserve Fund	**80,000**		
P & L Account	**45,000**		
Creditors	**4,75,000**		**4,75,000**

The company decided to issue bonus shares at the rate of three shares for every four shares held and decided, for this purpose, to utilize share premium Rs.60,000 out of reserve and the balance out of P & L a/c. Give Journal entries.

Solution:

Working Notes: No. of Bonus Shares issued:

For every 4 shares in A Co. Ltd. …… 3 Bonus shares will be issued

For 2,000 shares in A Co. Ltd. …… ? = 2,000 X ¾ = 1,500 shares

= 1,500 Bonus shares @ Rs.100 each = Rs.1,50,000

Journal Entries in the Books of A Co. Ltd.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Share Premium a/c Dr.		50,000	
	Reserve Fund a/c Dr.		60,000	
	Profit & Loss a/c (1,50,000 – (50,000 + 60,000)) Dr.		40,000	
	To Bonus shareholders a/c			1,50,000
	(Being Bonus shares to be issued)			
	Bonus to shareholders a/c Dr.		1,50,000	
	To Share capital a/c			1,50,000
	(Being Bonus shares issued for every 4 shares held in A Co. Ltd.)			

Illus.15

A limited company has resolved to utilize Rs.5,00,000 out of its reserve fund in declaration of a bonus to the shareholders. The bonus, however is to be applied to the extent of Rs.2,00,000 in payment of final call of Rs.40 per share on 5,000 Equity shares of Rs.100 each and to the extent of Rs.3,00,000 in the issue of 3,000 fully paid Equity Shares of Rs.100 each to the existing shareholders. Give the journal entries necessary to give effect of the above resolution.

Solution:

Journal Entries in the Books of a Limited Company

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Reserve Fund a/c Dr.		5,00,000	
	To Bonus shareholders a/c			5,00,000
	(Being the reserve fund amount to be capitalized transferred to Bonus to shareholders a/c)			
	Equity share final call a/c Dr.		2,00,000	
	To Equity share capital a/c			2,00,000
	(Being the final call amount due on 5,000 equity shares @ Rs.40 per share)			
	Bonus to shareholders a/c Dr.		2,00,000	
	To Equity share final a/c			2,00,000
	(Being the amount of bonus utilized towards the payment of final call)			
	Bonus to shareholders a/c Dr.		3,00,000	
	To Equity share capital a/c			3,00,000
	(Being the issue of 3,000 fully paid bonus shares of Rs.100 each.)			

Illus.16:

M/s Karthik Company Limited, having an authorised capital of 5,00,000 equity shares of Rs.10 each, issued 4,00,000 shares to the public for subscription. The amounts payable are as follows:

Rs.3 per share on application, Rs.5 (including premium) on allotment, Rs.2 on first call and Rs.2 on second call. The company received applications for 6,00,000 shares. Hence, the directors made allotment as follows:

a. **Applicants for 2,50,000 shares were allotted Rs.2,50,000 shares**
b. **Applicants for 1,60,000 shares were allotted Rs.1,00,000 shares**
c. **Applicants for 1,20,000 shares were allotted Rs.40,000 shares**
d. **Applicants for 50,000 shares were allotted Rs.10,000 shares**
e. **Applicants for 20,000 shares were allotted Nil shares**

Excess amount received with application was adjusted towards the remaining instalments. The amounts on the calls were received in full.

Pass necessary Journal entries for the above transactions and also show Balance Sheet.

Solution:

Journal entries in the books of a Company

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c (6,00,000 x 3) Dr.		18,00,000	
	To Equity share application a/c			18,00,000
	(Being equity share application money received on 6,00,000 shares @ Rs.3 per share)			
	Equity share application a/c (6,00,000 x 3) Dr.		18,00,000	
	To Equity share capital a/c (4,00,000 x 3)			12,00,000
	To Equity share allotment a/c (1,80,000 x 3)			5,40,000
	To Bank a/c (20,000 x 3)			60,000
	(Being application money on 4,00,000 shares transferred to share capital, 1,80,000 shares money transferred to Equity share allotment and 20,000 shares money returned back)			
	Equity share allotment a/c (4,00,000 x 5) Dr.		20,00,000	
	To Equity share capital a/c (4,00,000 x 3)			12,00,000
	To Equity share premium a/c (4,00,000 x 2)			8,00,000
	(Being the allotment money due on 4,00,000 shares @ Rs.5 per share including a premium)			
	Bank a/c Dr.		14,60,000	
	To Equity share allotment a/c			14,60,000
	(Being Equity share allotment money received) Rs.20,00,000-5,40,000 = Rs.14,60,000)			
	Equity share first call a/c Dr.		8,00,000	
	To Equity share capital a/c			8,00,000
	(Being Equity share first call money due on 4,00,000 shares @ Rs.2 per share)			
	Bank a/c (4,00,000) Dr.		8,00,000	
	To Equity share first call a/c			8,00,000
	(Being the equity shares first call money received)			

	Equity share second & final call a/c Dr.		8,00,000	
	To Equity share capital a/c			8,00,000
	(Being share second & final call money due on 4,00,000 shares @ Rs.2 per share)			
	Bank a/c (4,00,000 X 2) Dr.		8,00,000	
	To Equity share second & final call a/c			8,00,000
	(Being final call money received)			

Balance Sheet of Karthik Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
Share capital:		**Current Assets:**	
Authorised:		Cash at bank	48,00,000
5,00,000 equity shares @ Rs.10 each	50,00,000		
Issued, subscribed, called up & paid up :	40,00,000		
4,00,000 shares @ Rs.10 each			
Reserves and surplus:	8,00,000		
Equity share premium	48,00,000		48,00,000

Note: The students are advised to prepare the following ledger accounts also.

1. Equity share capital a/c = Rs.40,00,000
2. Equity share premium a/c = Rs.8,00,000
3. Bank a/c = Rs.48,00,000

Illus.17:

Giri Company Ltd. was registered with 20 lakh equity shares of Rs.10 each. The company offered 10 lakh shares for subscription at a premium of Rs.50 per share payable Rs.30 on application (Rs.25 for premium) Rs.28 on allotment (Rs.25 for premium) and the balance Rs.2 on call.

All the shares were subscribed and paid for except Suri who failed to pay the call money on his 500 shares which were later forfeited and reissued to Mahesh at the same amount offered to public; who paid the money.

Write necessary Journal entries and prepare the Balance Sheet.

Solution:

Journal Entries in the books of Giri Company Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c Dr.		3,00,00,000	
	To Equity share application a/c (10,00,000 x 30)			3,00,00,000
	(Being the application money received on 10 lakh shares @ Rs.30 per share)			
	Equity share application a/c Dr.		3,00,00,000	
	To Equity Share capital a/c (10,00,000 x 5)			50,00,000
	To Equity share premium a/c (10,00,000 x 25)			2,50,00,000
	(Being the share application money on 10 lakhs shares @ Rs.5 transferred to share capital a/c and Rs.25 per share transferred to Equity share premium a/c)			
	Equity share allotment a/c (10,00,000 x 28) Dr.		3,00,00,000	
	To Equity Share capital a/c (10,00,000 x 3)			30,00,000
	To Equity share premium a/c (10,00,000 x 25)			2,50,00,000
	(Being Equity share allotment money due on 10 lakhs shares @ Rs.28 per share including a premium of Rs.25 per share)			
	Bank a/c Dr.		2,80,00,000	
	To Equity share allotment a/c (10,00,000 x 28)			2,80,00,000
	(Being Equity share allotment money received)			
	Equity share first and final call a/c (10,00,000 x 2) Dr.		20,00,000	
	To Equity Share capital a/c			20,00,000
	(Being equity share final call money due on 10 lakhs shares @ Rs.2 per share)			
	Bank a/c Dr.		19,99,000	
	To Equity shares final call a/c			19,99,000
	(Being Equity share final call money received on 9,99,500 shares @ Rs.2 per share (10,00,000 –500)			

	Equity share capital a/c (500 x 10) Dr.		5,000	
	Equity share premium a/c (500 x 50) Dr.		25,000	
	To Share first call a/c (500 x 2)			1,000
	To Forfeited shares a/c (500 x 58)			29,000
	(Being forfeiture of 500 shares for the non-payment of first and final call money)			
	Bank a/c (500 x 60) Dr.		30,000	
	To Equity share capital a/c (500 x 10)			5,000
	To Equity share premium a/c (500 x 50)			25,000
	(Being the reissue of forfeited shares at the same amount)			
	Forfeited shares a/c Dr.		29,000	
	To Capital Reserves a/c			29,000
	(Being the balance of shares forfeited a/c transferred to capital reserve a/c)			

Working Notes: Calculation of Amount transferred to Capital Reserve A/c:

Amount received on 500 forfeited shares (500 x 58) = Rs.29,000

Ledger Accounts

Dr. **Bank a/c** **Cr.**

	Rs.		Rs.
To Equity Share Application a/c	3,00,00,000	By Balance c/d	6,00,29,000
To Equity Share Allotment a/c	2,80,00,000		
To Equity Share final call a/c	19,99,000		
To Equity Share capital a/c	5,000		
To Equity Share premium a/c	25,000		
	6,00,29,000		6,00,29,000
To Balance b/d	6,00,29,000		

Dr. **Equity Share Capital a/c** **Cr.**

	Rs.		Rs.
To Balance c/d	1,00,00,000	By Equity Share Application a/c	50,00,000
		By Equity Share Allotment a/c	30,00,000
		By Equity Share final call a/c	20,00,000
			1,00,00,000
	1,00,00,000	By Balance b/d	1,00,00,000

Dr. Equity Share Premium a/c Cr.

	Rs.		Rs.
To Balance c/d	5,00,00,000	By Equity Share Application a/c	2,50,00,000
		By Equity Share Allotment a/c	2,50,00,000
			5,00,00,000
	5,00,00,000	By Balance b/d	5,00,00,000

Dr. Capital Reserve a/c Cr.

	Rs.		Rs.
To Balance c/d	29,000	By Forfeited shares a/c	29,000
			29,000
	29,000	By Balance b/d	29,000

Balance Sheet of Giri Co. Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
Authorised Capital:		Current Assets:	
2,00,00,000 shares @ Rs.10 each	2,00,00,000	Cash at bank	6,00,29,000
Subscribed Capital:			
10,00,000 shares @ Rs.10 each	1,00,00,000		
Equity share premium	5,00,00,000		
Capital Reserve a/c	29,000		
	6,00,29,000		6,00,29,000

Illus.18:

Jhansi CO. Ltd. has an issued capital of 20,000 equity shares of Rs.100 each which was fully called-up and paid-up with the exception of some amounts from the following three shareholders.

Srikanth holds 400 shares on which he paid only application money of Rs.25 per share.

Bhargav holds 200 shares on which he paid Rs.25 on application and Rs.30 on allotment of each share.

Deepak holds 100 shares on which he paid Rs.25 on application, Rs.30 on allotment and Rs.20 on first call respectively on each share.

All the three failed to pay their arrears as well as final call of Rs.25 on each share. In due course, their shares were forfeited and reissued to Tarakaram for Rs.80 per share. Give necessary Journal entries in the books of Jhansi Company.

Solution:

Working Notes:

		Application money paid Rs.	Allotment money paid Rs.	First call money paid Rs.	Final call money paid Rs.
Srikanth holds	400 shares	25	-	-	-
Bhargav holds	200 shares	25	30	-	-
Deepak holds	100 shares	25	30	20	-
Total shares	**700**	**75**	**60**	**20**	**Nil**

			Rs.	Rs.
a	Application money received	20,000 shares @ Rs.25		5,00,000
b	Allotment money due:	20,000 shares @ Rs.30	6,00,000	
	Less: Calls in arrears (Srikanth)	400 shares @ Rs.30	12,000	5,88,000
c	First call money received:			
	First call money due	20,000 shares @ Rs.20	4,00,000	
	Less: Calls in arrears	600 shares @ Rs.20	12,000	
	(Srikanth + Bhargav)			3,88,000
	First call money received***			
d	Second and Final call money received:			
	Final call money due	20,000 shares @ Rs.25	5,00,000	
	Less: Calls in arrears:	700 shares @ Rs.25	17,500	
	(Srikanth + Bhargav + Deepak)			4,82,500
	Final call money received***			

Journal Entries in the books of Jhansi Company Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c Dr.		5,00,000	
	To Equity share application a/c			5,00,000
	(Being the application money received on 20,000 equity shares @ Rs.25 each)			
	Equity share application a/c Dr.		5,00,000	
	To Equity Share capital a/c			5,00,000
	(Being Equity share application money transferred to Equity share capital a/c)			
	Equity share allotment a/c Dr.		6,00,000	
	To Equity Share capital a/c			6,00,000
	(Being Equity share allotment money due on 20,000 shares @ Rs.30 each)			
	Bank a/c Dr.		5,88,000	
	To Equity share allotment a/c			5,88,000
	(Being Equity share allotment money received with an exception of 400 shares)			
	Equity share first call a/c Dr.		4,00,000	
	To Equity Share capital a/c			4,00,000
	(Being equity share first call money due on 20,000 shares @ Rs.20 each)			
	Bank a/c Dr.		3,88,000	
	To Equity shares first call a/c			3,88,000
	(Being Equity share first call money received with an exception of 600 shares)			
	Equity share second & final call a/c Dr.		5,00,000	
	To Equity Share capital a/c			5,00,000
	(Being equity share second call money due on 20,000 shares @ Rs.25 each)			
	Bank a/c Dr.		4,82,500	
	To Equity share second and final call a/c			4,82,500
	(Being Equity share second call money received with an exception of 700 shares)			

	Equity share capital a/c (700 x 10) Dr.		70,000	
	To Equity share allotment a/c (400 x 30)			12,000
	To Equity share first call a/c (600 x 20)			12,000
	To Equity share second & final call a/c (700 x 25)			17,500
	To Forfeited shares a/c (700 x 25)			28,500
	(Being 700 shares forfeited for non-payment of allotment, first, second & final call amounts)			
	Bank a/c (700 x 80) Dr.		56,000	
	Forfeited shares a/c (700 x 20) Dr.		14,000	
	To Equity share capital a/c (700 x 100)			70,000
	(Being the reissue of 700 forfeited shares @ Rs.80 per share)			
	Forfeited shares a/c Dr.		14,500	
	To Capital Reserve a/c			14,500
	(Being the balance of shares forfeited a/c transferred to capital reserve a/c)			

1. Amount transferred to Capital Reserve a/c: **Rs.**

Amount received on 700 forfeited shares

28,500

Less: Discount allowed on re-issue of shares (100 – 80=20) 700 x 20 14,000

Capital Reserve 14,500

2. Forfeited shares amount:

		Rs.
a. Srikanth	400 x Rs.25	10,000
b. Bhargav (25 + 30)	200 x Rs.55	11,000
c. Deepak (25 + 30 + 20)	100 x Rs.75	7,500
		28,500

Illus.19:

Meenakshi and Co. Ltd. issued 2,000 shares of Rs.10 each at a premium of Rs.2 per share. The share amount is to be received as follows:

On application Rs.2

On allotment Rs.5 (including premium)

On first call Rs.3

On second call Rs.2

Applications were received for 3,000 shares. The total shares were allotted to the applications of 2,400 shares pro-rata. Raju to whom 40 shares were allotted did not pay the allotment money. His shares were forfeited after first call. Mohan to whom 60 shares were allotted did not pay the calls. His shares were also forfeited after the second call. Then 80 of such shares were reissued at Rs.9 per share to Mr. Rao. These shares included the shares of Raju. Show Journal, Cash book entries and Balance Sheet.

Solution:

Journal Entries in the books of Meenakshi Company Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c (3,000 x 2) Dr.		6,000	
	To Equity share application a/c			6,000
	(Being the application money received on 3,000 shares @ Rs.2 per share)			
	Equity share application a/c Dr.		5,200	
	To Equity Share capital a/c (2,000 x 2)			4,000
	To Bank a/c (600 x 2) *			1,200
	(Being the transfer of application money on 20,000 shares @ Rs.2 per share to share capital a/c and refunded application money to the applicants of 600 shares @ Rs.2 per share)			
	Equity share allotment a/c (2,000 x 5) Dr.		10,000	
	To Equity Share capital a/c (2,000 x 3)			6,000
	To Equity Share premium a/c (2,000 x 2)			4,000
	(Being the allotment money due on 2,000 shares @ Rs.5 per share including the premium of Rs.2 per share)			
	Bank a/c ** Dr.		9,016	
	Equity share application a/c Dr.		800	
	To Equity share allotment			9,816
	(Being receipt of allotment money and surplus money on application adjusted to share allotment a/c)			

	Equity share first call a/c Dr.		6,000	
	To Equity Share capital a/c			6,000
	(Being the first call money due on 2,000 shares @ Rs.3 per share)			
	Bank a/c Dr.		5,700	
	To Equity shares first call a/c			5,700
	(Being the receipt of first call money on 1,900 shares @ Rs.3 per share)			
	Equity share capital a/c (40 x 8) Dr.		320	
	Equity share premium a/c (40 x 2)		80	
	To Equity share allotment a/c			184
	To Equity share first call a/c			120
	To Forfeited shares a/c			96
	(Being forfeiture of 40 shares held by Raju for non-payment of allotment money & first call money)			
	Equity share final call a/c Dr.		3,920	
	To Equity Share capital a/c			3,920
	(Being final call money due on 1,960 shares @ Rs.2 per share)			
	Bank a/c Dr.		3,800	
	To Equity share final call a/c			3,800
	(Being the receipt of final call money on 1,900 shares @ Rs.2 per share)			
	Equity share capital a/c (60 x 10) Dr.		600	
	To Equity share first call a/c (60 x 3)			180
	To Equity share final call a/c (60 x 2)			120
	To Forfeited shares a/c (60 x 5)			300
	(Being forfeiture of 60 shares held by Mohan			
	for non-payment of first call @ Rs.3 and final			28,500
	call @ Rs.2 per share)			
	Bank a/c (80 x 9) Dr.		720	
	Forfeited shares a/c Dr.		80	
	To Equity share capital a/c (700 x 100)			800
	(Being 80 shares out of 100 forfeited shares re-issued @ Rs.9 at a discount of Rs.1 per share)			

	Forfeited shares a/c Dr.		216	
	To Capital Reserve a/c			216
	(Being profit on re-issue of 80 shares transferred to capital reserve a/c leaving a balance of Rs.100 in the shares forfeited a/c)			

Dr. **Bank a/c** **Cr.**

	Rs.		Rs.
To Equity Share Application a/c	6,000	By Equity share	
To Equity Share Allotment a/c	9,016	application a/c	1,200
To Equity Share first call a/c	5,700	By Balance c/d	24,036
To Equity Share final call a/c	3,800		
To Equity Share capital a/c (800 x 9)	720		
	25,236		25,326
To Balance b/d	24,036		

Dr. **Forfeited shares a/c** **Cr.**

	Rs.		Rs.
To Equity Share capital a/c	80	By Equity Share capital a/c	96
To Capital Reserve a/c	216	Equity Share capital a/c	300
To Balance c/d	100		
	396		396
		By Balance b/d	100

Balance Sheet of Meenakshi Co. Ltd., as on ……..

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Current Assets:**	
Authorised		Cash at bank	24,036
…… shares @ Rs.10 each	---		
Issued : 2,000 shares of Rs.10 each	20,000		
Subscribed: 1980 shares of Rs.10 each fully paid up	19,800		
Share premium a/c (4,000 – 80)	3,920		
Forfeited shares	100		
Capital reserve	216		

	24,036		24,036

Working Notes:

* Since total number of shares offered to public were only 2,000, the allotment in no case should exceed 2,000 shares. This allotment has been made to those who applied for 2,400 shares, others apply for 600 shares were not allotted any shares. Hence the refund amount is Rs.1,200 i.e. 600 shares @ Rs.2 per share.

** **Calculation of the amount received on allotment:**

			Rs.
Total amount due on allotment of 2,000 shares @ Rs.5			10,000
Less: Excess application money of 400 shares adjusted on allotment (400 x 2 = 800)			800
			9,200
Less: Amount not received on 40 shares of Raju:			
Allotment due on 40 shares of Raju = 40 shares @ Rs.5		200	
Less: Advance money received from Raju on application adjusted towards allotment:			
Amount received on application: 48 shares @ Rs.2	96		
Amount adjusted on application : 40shares @ Rs.2	80	16	184
Amount received on allotment			9,016

Shares applied by Raju:

If allotted 2,000 shares … applied 2,400

If Raju allotted 40 shares … applied ? = $\frac{2,400}{2,000}$ X 40 = 49 shares

= Shares applied by Raju = 48; Shares allotted to Raju = 40

Calculation of amount transferred to Capital Reserve:

		Rs.
Balance in forfeited shares account		396
Less: Discount allowed on re-issued	80	
Less: Amount to be retained in respect of 20 shares not yet re-issued i.e. (20 x 5)	100	
		180

Amount to be transferred to Capital Reserve		216

Illus.20:

A company issued 50,000 equity shares of Rs.10 each as par on the following terms of payment.

On application Rs.3

On allotment Rs.4

On first call Rs.2

On second & final call Rs.1

Applications were received for 60,000 shares. Allotments were made on the following basis.

a) To applications for 10,000 shares in full

b) To applications for 20,000 shares – 15,000 shares

c) To applications for 30,000 shares – 25,000 shares

All excess amounts paid on application to be adjusted against amounts due on allotment.

The shares were fully called and paid except amounts of allotment, first and second calls not paid by those who allotted 2,000 shares out of the group applying for 20,000 shares. All the shares on which calls were not paid were forfeited by the Board of Directors.

1,000 forfeited shares were reissued as fully paid on receipt of Rs.8 per share.

Show the Journal entries and also show how share capital, capital reserve and forfeited shares amount appear in the balance sheet.

Solution:

Journal Entries in the books of Meenakshi Company Limited

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Bank a/c Dr.		1,80,000	
	To Equity share application a/c			1,80,000
	(Being the application money received on 60,000 shares @ Rs.3 per share)			

Equity share application a/c Dr.	1,80,000	
To Equity Share capital a/c		1,50,000
To Equity Share allotment a/c		30,000
(Being the application money on 50,000 shares @ Rs.3 transferred to Equity share capital a/c and the balance amount transferred to Equity share allotment a/c)		
Equity share allotment a/c Dr.	2,00,000	
To Equity Share capital a/c		2,00,000
(Being Equity share allotment money due on 50,000 shares @ Rs.4 per share)		
Bank a/c * Dr.	1,64,000	
To Equity share allotment		1,64,000
(Being the Equity share allotment money received with an exception of 2,000 shares)		
Equity share first call a/c Dr.	1,00,000	
To Equity Share capital a/c		1,00,000
(Being the first call money due on 50,000 shares @ Rs.2 per share)		
Bank a/c (48,000 x 2) Dr.	96,000	
To Equity shares first call a/c		96,000
(Being the receipt of first call money on 48,000 shares @ Rs.2 per share) (i.e. 50,000 – 2,000 = 48,000)		
Equity share second & final call a/c Dr.	50,000	
To Equity Share capital a/c		50,000
(Being Equity final call money due on 50,000 shares @ Rs.1 per share)		
Bank a/c (48,000 x 1) Dr.	48,000	
To Equity share second & final call a/c		48,000
(Being second & final call money received with an exception of 2,000 shares) (i.e. 50,000 – 2,000 = 48,000)		

	Equity share capital a/c (2,000 x 10) Dr.		20,000	
	To Equity share allotment a/c *			6,000
	To Equity share first call a/c (2,000 x 2)			4,000
	To Equity share final call a/c (2,000 x 1)			2,000
	To Forfeited shares a/c			8,000
	(Being forfeiture of 2,000 shares held for the non -payment of allotment, first call and final call amount)			
	Bank a/c (1,000 x 8) Dr.		8,000	
	Forfeited shares a/c Dr.		2,000	
	To Equity share capital a/c (1,000 x 10)			10,000
	(Being the re-issue of 1,000 forfeited shares @ Rs.8 per share)			
	Forfeited shares a/c * Dr.		2,000	
	To Capital Reserve a/c			2,000
	(Being the balance of share forfeited a/c transferred to capital reserve a/c)			

Working Notes:

For 20,000 shares applied, 15,000 shares were allotted. i.e. For 4 shares applied, 3 shares were allotted.

When shares allotted were 3 ….. Shares applied for were 4

When shares allotted were 2,000 ….. Shares applied for were ?

= 4/3 X 2,000 = 8,000/3 = 2,667 approximately

		Rs.
Application money received on 2,667 shares were =	2,667 @ Rs.3	8,001
Rounded off to		8,000
Application money on 2,000 shares applied:	2,000 shares @ Rs.3	6,000
This excess money is adjusted towards share allotment		2,000
Allotment money due on 2,000 shares:		8,000
Less: Application money already adjusted towards allotment	(2,000 X 4)	2,000
Amount not received on allotment		6,000
Allotment money due on 50,000 shares @ Rs.4		2,00,000

Amount not received on allotment	6,000
Amount received on allotment	1,94,000
Less: Excess application money transferred to share allotment	30,000
Amount received on allotment*	1,64,000

Amount transferred to Capital Reserve a/c:		
Balance amount of 2,000 shares forfeited		8,000
1,000 shares were re-issued and amount to be utilised from Share forfeited a/c for re-issue of 1,000		4,000
shares	(8,000 X 1/2)	2,000
Less: Amount utilised for re-issue of forfeited shares		2,000
Capital Reserve:		

Dr. Bank a/c Cr.

	Rs.		Rs.
To Equity Share Application a/c	1,80,000	By Balance c/d	4,96,000
To Equity Share Allotment a/c	1,64,000		
To Equity Share first call a/c	96,000		
To Equity Share final call a/c	48,000		
To Equity Share capital a/c	8,000		
	4,96,000		4,96,000
To Balance b/d	4,96,000		

Dr. Equity share capital a/c Cr.

	Rs.		Rs.
To Equity Share Allotment a/c	6,000	By Equity Share Application a/c	1,50,000
To Equity Share first call a/c	4,000	By Equity Share Allotment a/c	2,00,000
To Equity Share final call a/c	2,000	By Equity Share first call a/c	1,00,000
To Forfeited shares a/c	8,000	By Equity Share second & final call a/c	50,000
To Balance c/d	4,90,000	By Bank a/c	8,000
		By Forfeited shares a/c	2,000
	5,10,000		5,10,000
		By Balance b/d	4,90,000

Dr. Forfeited shares a/c Cr.

	Rs.		Rs.
To Equity Share capital a/c	2,000	By Equity Share capital a/c	8,000
To Capital Reserve a/c	2,000	Equity Share capital a/c	
To Balance c/d	4,000		
	8,000		8,000
		By Balance b/d	4,000

Balance Sheet of a Company as on ……..

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Current Assets:**	
Authorised, Issued, Subscribed		Cash at bank	4,96,000
And paid up:			
(50,000 –1,000) 49,000 shares @			
Rs.10 per share	4,90,000		
Reserves & Surplus			
Capital reserve	2,000		
Forfeited shares	4,000		
	4,96,000		4,96,000

Illus.21:

Himani Co. Ltd. offered to the public 20,000 equity shares of Rs.100 each at a premium of Rs.10 per share. The payment was to be as follows:

On application	**Rs.20**
On allotment	**Rs.40 (including premium)**
On first call	**Rs.25**
On second & final call	**Rs.25**

Applications received total for 35,000 shares; applications for 10,000 shares were rejected; those totaling 15,000 shares were allotted 10,000 shares and the remaining applications were accepted in full. The directors made both the calls. One shareholder holding 500 shares failed to pay the two calls as a consequence his shares were forfeited. 200 of these shares were re-issued as fully paid @ Rs.80 per share.

Expenses of the issue came to Rs.15,000

Prepare the cash book, and the journal on the basis of information given above.

Solution:

Dr. **Cash Book** **Cr.**

	Rs.		Rs.
To Equity Share Application a/c	7,00,000	By Equity share application a/c	2,00,000
To Equity Share Allotment a/c*	7,00,000	By Issue expenses	10,000
To Equity Share first call a/c	4,87,500	By Balance c/d	21,81,000
To Equity Share second & final call a/c	4,87,500		
To Equity Share capital a/c	16,000		
	23,91,000		23,91,000
To Balance b/d	21,81,000		

Working Notes:

Equity share allotment money received:

	Rs.
Allotment money due = 20,000 shares @ Rs.40 each (including a premium of Rs.10 per share)	8,00,000
Less: Excess Application money received on 5,000 Shares @ Rs.20 each	1,00,000
Allotment money received	7,00,000

Journal Entries in the books of Himani Co. Ltd.

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Equity share application a/c (25,000 x 20) Dr.		5,00,000	
	To Equity Share capital a/c (20,000 x 20)			4,00,000
	To Equity Share allotment a/c (5,000 x 20)			1,00,000
	(Being application money on 20,000 shares transferred to Equity share capital a/c and the amount on 5,000 shares transferred to Equity share allotment a/c)			

	Equity share allotment a/c (20,000 x 40) Dr.		8,00,000	
	To Equity Share capital a/c (20,000 x 30)			6,00,000
	To Equity Share premium a/c (20,000 x 10)			2,00,000
	(Being Equity share allotment money due on 20,000 shares @ Rs.40 per share including a premium of Rs.10 per share)			
	Equity share first call a/c (20,000 x 25) Dr.		5,00,000	
	To Equity Share capital a/c			5,00,000
	(Being the first call money due on 20,000 shares @ Rs.25 per share)			
	Equity share capital a/c (500 x 100) Dr.		50,000	
	To Equity share first call a/c (500 x 25)			12,500
	To Equity share second & final call a/c (500 x 25)			12,500
	To Forfeited shares a/c			25,000
	(Being forfeiture of 500 shares for the non-payment of first and second call money)			
	Forfeited shares a/c Dr.		4,000	
	To Share capital a/c			4,000
	(Being the discount allowed on re-issue of 200 forfeited shares @ Rs.20 per share)			
	Forfeited shares a/c Dr.		6,000	
	To Capital Reserve a/c			6,000
	(Being the balance of forfeited shares a/c transferred to capital reserve a/c)			

Working Notes:

Amount transferred to Capital Reserve a/c:

500 forfeited shares amount …. Rs.25,000

200 forfeited shares amount …. ?

$$= \frac{200}{500} \times 25,000 = \text{Rs.}10,000$$

	Rs.
Amount on 200 forfeited shares	10,000
Less: Discount allowed on re-issue (200 x 20)	4,000
Balance transferred to Capital Reserve	6,000

18.10. QUESTIONS

1. Define a company? Explain the features of a company.
2. Explain different kinds of share capital.
3. Discuss the provisions relating to the issue and allotment of shares as per the Companies Act,1956.
4. What is forfeiture of shares? Explain the provisions relating to re-issue of forfeited shares.

18.11. EXERCISES

1. Samsun Ltd., made an issue of 10,000 equity shares of Rs.100 each, payable Rs.20 on application, Rs.40 on call. All the shares are subscribed and amounts duly received. Pass journal entries to give effect to these.

2. The authorised capital of a company is 1,00,000 shares of Rs.10 each. On April 10, 2005 it issued 50,000 shares to the public at par. All the shares were subscribed. The company called Rs.2 on application, Rs.3 on allotment and Rs.2 on first call. Presuming that all moneys are received. Show these items in the balance sheet.

3. A Limited Company was incorporated with a capital of Rs.4,00,000 consisting of 20,000 equity shares of Rs.10 each and 10,000 preference shares of Rs.20 each. It offered to the public 10,000 equity 5,000 preference shares payable as follows:

	Equity shares Rs.	Preference shares Rs.
On application	2	4
On allotment	3	6
On first call	2	4
On second and final call	3	6

The company received applications for just 10,000 Equity and 5,000 Preference shares. The shares were duly allotted and all money duly received.
Show how the above transactions would appear in journal.

4. Crane Ltd. offered 2,00,000 equity shares of Rs.10 each at a premium of 40% payable as follows:
Rs. 4 (including 50% of premium) on application
Rs. 4 (including the balance premium) on allotment

Rs. 5 on first and final call.

The company received applications for 2,00,000 shares which it duly allotted. All the moneys including premium were received on due date.

Pass the Journal entries.

5. Mr. Kiran holds 100 shares of Rs.20 each on which he has paid Rs.2 as application money and Rs.4 as allotment. Vamsi holds 200 shares of Rs.20 each on which he has paid Rs.2 on application, Rs.4 on allotment and Rs.6 as first call. They all fail to pay the final call of Rs.8. The directors forfeit their shares and reissued them at Rs.18. Journalise the transactions to record the forfeiture and reissue.

6. Sandhya Ltd. allotted shares of Rs.10 each to Mrs. Jeevika who paid Rs.2 per share on application, Rs.3 per share on allotment but failed to pay Rs.5 per share on the call. Consequently her shares were forfeited and reissued to Mrs. Chandra at Rs.8 per share. Give journal entries relating to forfeiture and reissue in the books of Sandhya Ltd.

7. Rajesh Tyres Ltd., issued equity shares of Rs.10 each payable 25% on application, 50% on allotment an d25% on call. All the 1 lakh were subscribed and paid for except Mehta who failed to pay the call money on his 300 shares, which were later forfeited and reissued to Ganesh @ Rs.8 per share. Pass necessary journal entries for forfeiture & resissue and prepare the Balance Sheet of the company

   (Ans: Balance Sheet total Rs.10,01,650)

8. Visala Company Ltd., having an authorized capital of Rs.2,00,00,000 in shares of Rs.10 each, invited applications for 10,00,000 share payable as follows:

   On application Rs.2.50; on allotment Rs.3.50; on first call Rs.2 and second & final call Rs.2

   The company received applications for 9,00,000 shares. All the applications were accepted. All moneys due as stated above were received with exception of the second & final call on 2,000 shares; these were forfeited and reissued as fully paid @ Rs.9 per share.

   Write the necessary journal entries in the books of the company also show the balance sheet of the company.

   (Ans: Amount transferred to Capital reserve Rs.14,000; Balance Sheet total Rs.90,14,000)

9. A Ltd. invited applications for 10,000 shares of Rs.100 each at a discount of 6% payable as follows:

On application	Rs.25
On allotment	Rs.34

On first and final call Rs.35

The applications received were for 9,000 shares and all of these were accepted. All moneys due were received except the first and final call on 100 shares, which were forfeited. 50 shares were reissued @ Rs.90 fully paid. Assuming that all requirements of the Law were compiled with, pass entries in the cash book and journal of the company. Also show how the transactions will be reflected in the company's balance sheet.

(Ans: Amount transferred to capital reserve Rs.2,750; Cash book balance Rs.8,47,000; Balance Sheet total Rs.9,00,700)

10. Manoj & Co. made an offer of 1,00,000 equity shares of Rs.10 each payable as follows:

On application Rs.2; on allotment Rs.3; on first call Rs.2.50; and on second call Rs.2.50

Applications were received for 1,60,000 shares and allotments were made on pro rata to the applicants of 1,20,000 shares, the remaining applications being rejected and money refunded. Application money paid in excess by the allottees was adjusted with the money due on allotment.

Ravi the holder of 200 shares failed to pay the allotment money and on his failure to pay the first call, his shares were forfeited. Sohan another shareholder to whom 500 shares were allotted, failed to pay the first and second call amount and his shares were also forfeited after making the second call.

Out of the forfeited shares 600 shares were reissued to Ranjit as fully paid on payment of Rs.9 per share. Record the above transactions in the journal of Manoj & Co.

(Ans: Amount transferred to capital reserve Rs.1,800)

11. Keerthi Co. Limited issued 60,000 equity shares of Rs.10 each at a premium of Rs.2.50 per share payable on application. The amount payable on allotment was fixed at Rs.4 per share and an equivalent sum was due on a call to be made.

Total applications received were for 1,00,000 shares and after consulting Stock Exchange, the following scheme of allotments was decided upon.

Category	A	B	C
Grouping of Shares	1 –100	101 – 500	Over 500
No. of applications received	1,200	175	5
No. of shares applied for	70,000	35,000	5,000

No. of shares allotted	42,000	14,000	4,000

It was decided that the excess amount received on applications would be utilized in payment of allotment money and surplus, if any, would be refunded to the applicants.

All the dues were received except a shareholder belonging to category A who had applied for 100 shares defaulted in payment of Allotment money. His shares were forfeited.

Show the necessary journal entries in the books of the company to record the above transactions.

(Ans: Amount transferred to capital reserve Rs.300)

12. Nikhita Ltd. acquired land costing Rs.2,00,000 and in payment allotted 20,000 equity shares of Rs.10 each as fully paid. Further the company issued 80,000 equity shares to the public payable as follows:

    On application Rs.3; on allotment Rs.3 and on first and final call Rs.4

    The public applied for all the shares which were allotted. All moneys were received except the call on 400 shares. After due notice these shares were forfeited and Reissued for Rs.9 each as fully paid. Write necessary Journal entries and prepare Balance Sheet.

    (Ans: Amount transferred to capital reserve Rs.2,000; Balance Sheet Total Rs.10,02,000)

13. Sahiti Co. Ltd., has the following items in the Balance Sheet.
    a. 1,00,000 Equity shares of Rs.50 each, Rs.40 paid up.
    b. General reserve Rs.11,00,000
    c. Share premium Rs.5,00,000
    d. Capital reserve Rs.7,00,000

    The company decided:

    5. To capitalize its general reserve
    6. To convert the existing shares into fully paid up
    7. To issue 20,000 bonus shares of Rs.50 each at a premium of Rs.10 per share out of share premium and capital reserve.

    Pass Journal entries.

14. The extracts are given from the draft balance sheet of Zinda Ltd. as on 31st December, 2002:

	Rs.
Authorised capital:	
20,000 equity shares of Rs.10 each	2,00,000
Issued and subscribed capital:	
7,000 equity shares of Rs.10 each fully paid up	70,000
Reserve fund	36,000
Profit and Loss account	29,000

The Board of Directors pass a resolution to capitalize a part of existing reserves and profits by issuing bonus shares. One bonus share is being issued for every 4 equity shares held at present. For this purpose, Rs.10,000 are to be provided out of Reserve fund and the balance out of Profit and Loss account.

18.22 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.

Chapter – 19

ISSUE OF DEBENTURES

Objectives:

The objectives of learning the lesson is :

- To know about the debentures
- Issue of debentures
- Accounting treatment of debentures at the time of issue

Structure:

19.1 INTRODUCTION :

There are two types of capital of a company: (1) Share Capital and (2) Loan Capital. Share capital includes equity shares and preference shares. Loan Capital includes debenture and long-term loan. According to Section 2(12) of Indian Companies Act, 1956, the bonds are also included in debentures.

A debenture is a written acknowledgement of debt by a company under its common seal, generally secured by floating charge on company's assets. Interest is paid to debenture holders at a fixed rate at regular intervals. Company retains the amount of debentures as and when its requirement is over or after a specified period, this is known as "redemption of debentures".

The term debenture is derived from the Latin word "debere" which means "to owe a debt". A debenture may be defined as document issued by the company as an evidence of debt. It is the acknowledgement or the company's indebtedness to its holders.

19.2 FEATURES OR CHARACTERISTICS OF DEBENTURES :

The following are the features of debentures.

19.2.1 Debenture-holders are entitled to periodical payment of interest at an agreed rate.

19.2.2 They are also entitled to redemption of their capital as per the agreed terms.

19.2.3 They have no voting rights.

19.2.4 Usually debentures are secured by charge on or mortgage of the assets of the company.

19.2.5 Debenture holders have the right to use the company for any unpaid dues.

19.2.6 They can enforce the security by sale in case of default.

19.2.7 They can apply for winding up of the company to safeguard their interests.

19.3 TYPES OF DEBENTURES :

A company may issue various kinds of debentures with different rights are given below:

19.3.1 On the basis of ownership:

(a) Registered Debentures: The debentures which are transferable only by transfer deed. Names, addresses and particulars of the debentures possessed by them are entered in the register of debenture holders. Interest is paid to one whose name appears in the register of debenture holders on the due date of interest.

(b) Bearer Debentures: Debentures which are transferred by mere delivery and the company does not keep the record of debenture holders' names, addresses etc. Payment of interest is made on production of coupons attached with the debenture certificate.

19.3.2 On the basis of Redemption:

(a) Redeemable Debentures: The debentures which are redeemed or the payment of which is made during the life time of company, generally after specified period of time.

(b) Irredeemable Debentures: In this case the issuing company does not fix any date by which they should be redeemed and the debenture holders cannot demand payment so long as it is a going concern. Usually such debentures are payable after a long period of time (not pre decided) or on winding up of the company.

19.3.3 On the basis of conversion:

(a) Convertible Debentures: The holders of such debentures are given the option to convert the debentures into share or new debentures after a specified time. Those, which are fully convertible are called "Fully Convertible Debentures" or simply FCDS'. Those, which are partly convertible are called "Partly Convertible Debentures" or simply PCDS'.

According to SEBI's guidelines the debentures must be converted within 36 months of issue.

(b) Non-Convertible Debentures: The holders of such debentures have no right to convert them into shares or new debentures. These are called NCDS'. If NCDS' are issued by the company and later on company wishes to convert the debentures then it would be an option to debenture holders.

19.3.4 On the basis of Security:

(a) Secured or Mortgage Debentures: The debentures which are secured either on a particular asset or on general assets of the company. When a particular asset is put or pledged is known as fixed charge and when no specific asset is put called floating charge.

(b) Unsecured or Naked Debentures: The debentures which are not secured . In other words, no assets are pledged by the company to the debenture holders. Companies of very good standing are able to issue such debentures.

19.3.5 On the basis of interest rate: There was restriction of the Government on the rate of interest upto 31-7-1991, now company is free to decide rate of interest on debentures. On the basis of interest rate the debentures may be:

(a) Fixed rate of interest: The rate of interest on the debenture is generally fixed and remains same upto redemption. Market rate of interest does not effect the interest rate of debentures.

(b) Zero interest Debentures: The debentures on which no interest is paid by the company's called zero interest debentures. Such debentures are either issued at heavy discount or such debentures converted into equity shares offered at low rate i.e., below market price.

19.4 ISSUE OF DEBENTURES :

According to Section 292 of Indian Companies Act, 1956 the Board of Directors have the power to raise the capital by issue of debentures. But if total value of debentures issued so far and offered is more than by the aggregate amount of paid up share capital and free reserves then the directors have to take permission of the shareholders in their meeting (Section 293).

Section 78 and 79 of Companies Act (rules related to premium and discount respectively) will not be applied on issue of debentures. In other words, there will be no restriction on issue of debentures at premium or discount.

If the debentures are issued at discount then such discount will be a capital loss and company has to write off such capital loss from any capital profits or revenue profits during the life time of debentures. Till the discount is not written off fully, it will be appeared in the Balance Sheet on assets side under the head "Miscellaneous Expenditure". At the time of redemption of debentures, there should not be any balance in "Discount on issue of debentures account".

According for issue of debentures for cash is the same as the accounting for issue of shares with one change, i.e., the word 'shares' shall be replaced by 'debentures' and 'shares capital' by 'debentures'. The terms used for the issued of shares will be changed as follows at the time of issue of debentures:

Terms of issue of Shares	**Terms of issue of Debentures**
1. Share Application/Allotment/ I call/ II call …..etc.	Debenture Application/Allotment/ I call/ II call …..etc.
2. Share Capital	Debentures
3. Discount on issue of Shares	Discount on issue of Debentures

Note: There is no difference between the premium on issue of shares and debentures. Both are now known as "Securities Premium".

Illus. 1: Make necessary entries in the books of Sona Ltd., in following cases:

(a) 5,000, 13% Debentures of Rs.100 each were issued. The whole amount is payable on application. The issue was fully subscribed for and was fully paid up.

(b) 5,000, 13% Debentures of Rs.100 each were issued at a premium of Rs.10 per debenture, payable as : Rs.25 on application; Rs.35 on allotment (including premium) and the balance on call. A holder of 100 debentures did not pay the allotment and call money. Rest of the amount was duly received.

(c) 5,000, 13% Debentures of Rs.1000 each were issued at Rs.950 per debenture, payable as: Rs.300 on application, Rs.500 on allotment and the balance on call. Sohan, holding 10 debentures, did not pay the call money and Mohan, holding 200 debentures, paid the whole amount due along with the allotment money.

Solution :

Journal of Sona Ltd.

Date	Particulars	L. F.	Rs.	Rs.
(a)	Bank a/c Dr.		5,00,000	
	To Debenture Application a/c			5,00,000
	(Being application money received)			
	Debenture Application a/c Dr.		5,00,000	
	To 13% Debentures a/c			5,00,000
	(Being application money transferred on allotment)			
(b)	Bank a/c Dr.		1,25,000	
	To Debenture Application a/c			1,25,000
	(Being application money received)			
	Debenture Application a/c Dr.		1,25,000	
	To 13% Debentures a/c			1,25,000
	(Being application money transferred on allotment)			
	Debenture Allotment a/c Dr.		1,75,000	
	To 13% Debentures a/c			1,25,000
	To Securities Premium a/c			50,000
	(Being allotment money due on 5,000			

	debentures @ Rs.35 including premium)			
	Bank a/c Dr. To Debenture Allotment a/c (Being allotment money received on 4,900 debentures)		1,71,500	 1,71,500
	Debenture call a/c Dr. To 13% Debentures a/c (Being call money due @ Rs.50 per debenture)		2,50,000	 2,50,000
	Bank a/c Dr. To Debenture call a/c (Being call money received on 4,900 debentures)		2,45,000	 2,45,000
(c)	Bank a/c Dr. To Debenture Application a/c (Being application money received)		1,50,000	 1,50,000
	Debenture Application a/c Dr. To 13% Debentures a/c (Being application money transferred on allotment)		1,50,000	 1,50,000
	Debenture Allotment a/c Dr. Discount on issue of debentures a/c Dr. To 13% Debentures a/c (Being allotment money due on 500 debentures and discount @ Rs.50)		2,50,000 25,000	 2,75,000
	Bank a/c Dr. To Debenture Allotment a/c To Debentures calls in advance a/c (Being allotment money received and the amount of calls in advance on 200 debentures)		2,80,000	 2,50,000 30,000
	Debenture call a/c Dr. To 13% Debentures a/c		75,000	 75,000

	(Being call money due on 500 debentures @ Rs.150 each)			
	Bank a/c Dr. Debenture call in advance a/c Dr. To Debenture call a/c (Being call money advance adjusted and the balance received, except 10 debentures)		43,500 30,000	 73,500

19.5 ISSUE OF DEBENTURES FOR CONSIDERATION OTHER THAN CASH :

When debentures are allotted by the company to the vendor of business to discharge the purchase consideration or to the vendor of asset to discharge the value of assets are called "Issue of debentures for consideration other than cash". The accounting entries are as follows:

			Rs.	**Rs.**
(a)	On Purchase of Assets or business: Assets a/c Dr. To Vendor a/c (Being assets purchased)		 xxx	 xxx
	Sundry assets a/c (individually) Dr. To Sundry liabilities a/c (individually) To Vendors a/c (purchase consideration) (Being assets and liabilities acquired)		xxx	 xxx xxx
(b)	Issue of debentures to discharge vendors balance: Vendor a/c Dr. To Debentures a/c (Being debentures issued)		 xxx	 xxx

Note: The debentures may be issued at par, premium or discount. In case debentures are issued at premium, then the "Securities premium account" will be credited and the "Discount on issue of debentures account" will be debited if it is issued at discount.

Illus.2: Rahul Ltd., acquired machine of Rs.6,60,000 from Madhu Ltd. Rahul Ltd., discharged the consideration by issuing 12% debentures of Rs.100 each at a premium of 10%. Give journal entries in the books of Rahul Ltd.

Solution:

Journal of Rahul Ltd.

Date	Particulars	L. F.	Rs.	Rs.
	Machinery a/c Dr. To Madhu Ltd. (Being asset purchased)		6,60,000	 6,60,000
	Madhu Ltd. a/c Dr. To Debentures a/c To Debenture premium a/c (Being debentures issued at 10% premium)		6,60,000	 6,00,000 60,000

Note: No. of debentures = 6,60,000/110 = 6,000

19.6 ISSUE OF DEBENTURES AS COLLATERAL SECURITY :

A collateral security is an additional or secondary but contingent security for the performance of an obligation. Sometimes, a company deposits its debentures as additional security to secure loan from the bank. Hence, the debentures are deposited to provide security for the loan taken to the lender. Generally, there will be no entry on issue of debentures as collateral security. In such a case, the loan would appear as a liability, the debentures issued will be shown only within brackets below the particulars of the loan to indicate the facts that they have been issued only as a security and the amount would not be shown in the outer column. A memorandum of such an issue would also be kept in the debentures ledger. They carry no interest. After repayment of loan, debentures deposited are returned to the company and are cancelled by the company.

Alternatively, a debenture suspense account may be debited with the amount of debentures issued as additional security and the amount is credited to the debentures account. The reverse entry may be passed on payment of loan. If company is interested to pass journal entry on issue the following entries are passed.

			Rs.	Rs.
(a)	Issue of debentures as collateral security: Debenture suspense a/c Dr. To Debentures a/c (Being ….Debenture of Rs……each issued as collateral security against a loan of Rs….)		5,00,000	 5,00,000
(b)	On repayment of loan: Debentures a/c Dr. To Debentures suspense a/c (Being debentures issued as collateral security withdrawn)		5,00,000	 5,00,000

Note: Debenture suspense a/c will be shown in the balance sheet on the assets side, debentures a/c will be shown on the liabilities side along with other debentures.

Illus.3: Bajaj Ltd., took loan on 5-1-2006 from UTI of Rs.50,00,000 and alloted Rs.60,00,000, 15% debentures as collateral security.

Solution:

These will be appeared in the Balance Sheet as follows:

Liabilities	Rs.	Assets	Rs.
Secured Loan: Loan from UTI (issued Rs.60,00,000,15% debentures as collateral security)	 50,00,000	 Bank	 50,00,000

Alternatively:

If accounting entries are passed, the entries will be:

Journal

Date	Particulars	L.F.	Rs.	Rs.
	Bank a/c Dr. To UTI Loan a/c (Being loan taken from UTI)		50,00,000	 50,00,000
	Debentures suspense a/c Dr.		60,00,000	

	To 15% Debentures a/c (Being issue of 15% debentures as collateral security)			60,00,000

Balance Sheet of Bajaj Ltd as on 31st March, 2006

Liabilities	Rs.	Assets	Rs.
15% Debentures (issued as Collateral Security)	60,00,000	Debenture Suspense account (issued as collateral security)	60,00,000
UTI Loan	50,00,000	Bank	50,00,000
	110,00,000		**110,00,000**

Illus.4: X Ltd., issued 2,000,14 debentures of Rs.100 each to the public at a discount of 10%. The company also took a loan of Rs.4,00,000 from the Central Bank and deposited 5,000, 14% debentures with the bank as a collateral security. How will you deal with the issues of debentures in the books of the company and show them in Balance Sheet?

Solution:

When no entry is to pass for the debentures issued as collateral security:

Date	Particulars	L.F.	Rs.	Rs.
(a)	Bank a/c Dr. Discount on issue of Debentures a/c Dr. To 14% Debentures a/c (Being 2,000, 14% debentures issued at a discount of 10%)		1,80,000 20,000	 2,00,000
(b)	Bank a/c Dr. To Bank Loan a/c (Being loan of Rs.4 lakhs taken from bank against collateral security of 5,000 14% debentures of Rs.100 each)		4,00,000	 4,00,000

Note: (a) When debentures are issued on lump sum payment then the debentures are issued directly without putting the amount in "Debenture application account".

(b) No entry is passed for the issue of debentures as collateral security.

Above will be shown in the balance sheet as follows:

Balance Sheet of XLtd as on …………

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital **Secured Loans:** 14%, 2,000 debentures of Rs.100 each **Bank Loans:** (5,000, 14% Debentures of Rs.100 each deposited as collateral security)	………. 2,00,000 4,00,000	Cash at bank Discount on issue of Debentures	5,80,000 20,000
	6,00,000		**6,00,000**

When accounting entry is to pass for the debentures issued as Collateral Security:

Date	**Particulars**	**L.F.**	**Rs.**	**Rs.**
(c)	Debenture Suspense a/c Dr. To 14% Debentures a/c (Being 5,000, 14% debentures of Rs.100 each deposited as collateral security to secure the bank loan of Rs.4 lakhs)		5,00,000	 5,00,000

Balance Sheet of X Ltd as on …………

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital **Secured Loans:** 14%, 2,000 debentures of Rs.100 each	………. 2,00,000	Cash at bank Debenture suspense account Discount on issue of	5,80,000 5,00,000 20,000

14%, 5,000 debentures of Rs.100 each issued as collateral security **Bank Loans:** (5,000, 14% Debentures of Rs.100 each deposited as collateral security)	5,00,000 4,00,000	Debentures	
	11,00,000		**11,00,000**

19.7 ISSUE OF DEBENTURE ACCORDING TO THE CONDITION OF REDEMPTION :

Generally company declares on issue of debentures regarding the redemption of debentures. The debentures may be redeemed either at par or at premium. When the debentures are to be redeemed at a premium(declared on issue) then the premium payable on redemption will be a capital loss and it is known by the company at the time of issue of such debentures. The accounting entries in different situations are as follows:

Date	Particulars	L.F.	Rs.	Rs.
(a)	**Debentures issued at par and to be redeemed at premium**: (i)On receipt of application: Bank a/c Dr. To Debenture application a/c (Being application money received)		 At par value	 At par value
(b)	(ii) On allotment of debentures: Debenture application a/c Dr. Loss on issue of debentures a/c Dr. To Debentures a/c To Premium on redemption of debentures a/c (Being debentures allotted and provided for premium)		 Amount received Premium on redemption	 At par Premium on redemption

Debentures issued at discount and redeemable at premium

Date	Particulars	L.F.	Rs.	Rs.
(a)	On receipt of application: Bank a/c Dr. To Debenture application a/c (Being debentures application received) On allotment: Debenture application a/c Dr. Discount on issue of debentures a/c Dr. Loss on issue of Debentures a/c Dr. To Debentures a/c To Premium on redemption of Deb.a/c (Being debentures allotted at discount and provided for premium on redemption)		Amount received Amount received Discount provided Premium payable on redemption	Amount received Par value Premium payable on redemption

Note: The "Loss on Issue of Debentures a/c" and "Discount on issue of Debentures a/c" are capital losses and appears in the balance sheet on assets side. However, it is a fictitious assets which must be written off as soon as possible. The losses can be written off from any capital profit including securities premium or revenue profit. The entry for writing off of the losses will as follows:

Date	Particulars	L.F.	Rs.	Rs.
	Capital Reserve/ Revenue profits a/c Dr. To Loss on issue of Debentures a/c To Discount on issue of Debentures a/c			

It is to be noted that writing off of above losses is not a legal necessity. However, sound financial principles require that such losses should be written off at earlier but in any case before the redemption of debentures. In other words, "till the above losses are not written off completely, the redemption procedure cannot be started".

Illus.5 Journalise the following transactions in the books of the company:

(a) Debenture issued at Rs.1000 and redeemable at Rs.1100;

(b) Debenture issued at Rs.1100 and redeemable at Rs.1050/1100/1150;

(c) Debenture issued at Rs.950 and redeemable at Rs.1100.

Note: Face value of each debenture is Rs.1000

Solution:

Date	Particulars	L.F.	Rs.	Rs.
(a)	Bank a/c Dr. To Debenture application a/c (Being debenture application money received)		1,000	 1,000
	Debenture application a/c Dr. Loss on issue of debentures a/c Dr. To Debentures a/c To Premium on redemption of debentures a/c (Being debenture allotted and provided premium on redemption)		1,000 100	 1,000 100
(b)	Bank a/c Dr. To Debenture application a/c (Being application money received)		1,100	 1,100
	Debenture application a/c Dr. Loss on issue of debenture a/c Dr. To Debenture a/c To Debenture premium a/c To Premium on redemption of debentures a/c (Being debenture allotted at premium and provided premium on redemption)		1,100 50/100/150	 1,000 100 50/100/150
	Debenture premium a/c Dr. To Loss on issue of debentures a/c (Being loss on issue written off)		50/100/150*	 50/100/150*
(c)	Bank a/c Dr.		950	

	To Debenture application a/c (Being application money received)			950
	Debenture application a/c Dr. Discount on issue of debentures a/c Dr. Loss on issue of debentures a/c Dr. To Debentures a/c To Premium on redemption of debentures a/c (Being debentures allotted at discount and provided Premium on redemption)		950 50 100	 1,000 100

* When "loss on issue" is Rs.50, then it will completely be written off from "securities premium" and there will be balance of Rs.50 in the "Securities Premium a/c". In second condition whole "loss on issue" will be set off from "Securities Premium a/c" and there will be no balance but in the third situation only Rs.100 of "loss on issue" will be written off and balance of Rs.50 will be shown in the Balance Sheet at assets side as "Miscellaneous Expenditure" and must be written off during the life time of debentures.

19.8 WRITING OFF DISOCUNT AND ISSUE OF DEBENTURES :

When debentures are issued at discount, it is prudent to write off the loss during the life of debentures. When the directors of the company decide to write it off, it can be done in two ways:

First method:

Under this method the total discount is spread over the life of debentures equally. Thus, if debentures are issued for 15 years, the total discount is divided by 15 and the amount so arrived at is taken to the profit and loss account every year for 15 years. This method is suitable only in one respect, that is, it spreads the burden of discount equally over the years. Thus it is good only when debentures are redeemed at the expiry of the period.

Second method:

If the debentures are redeemed every year by serving a notice and by drawing a lot, the first method fails in as much as the burden of discount is not in the proportion of benefit received out of money collected by issuing debentures. Under these circumstances the second method is adopted. Under this method the discount is written off in the proportion of debentures outstanding during the year.

Illus.6: Mahindra Ltd. issued 10,000 14% debentures of Rs.100 each at a discount of 12%. How much discount on issue of debentures be written off each year, if (a) Debentures are issued for 5 years; or (b) Rs.2,00,000 debentures are redeemable annually.

Solution:

(a) If debentures are issued for five years:

The discount on issue of debentures Rs.1,20,000 (12% of Rs.10,00,000) will be written off in five equal installments of Rs.24,000 (1,20,000/5) each. This amount will be transferred every year to Profit and Loss Account till written off fully.

(b) When debentures are redeemable in five equal installments:

Year	**Unpaid amount Rs.**	**Ratio to unpaid amount**	**Amount of Discount to be written off Rs.**
1	10,00,000	5	1,20,000 x 5/15 = 40,000
2	8,00,000	4	1,20,000 x 4/15 = 32,000
3	6,00,000	3	1,20,000 x 3/15 = 24,000
4	4,00,000	2	1,20,000 x 2/15 = 16,000
5	2,00,000	1	1,20,000 x 1/15 = 8,000
			Total = 1,20,000

Illus.7: On 1st January, 2000 a company issued debentures of the face value of Rs.1,00,000 at a discount of 6%. The debentures were payable by annual drawings of Rs.2,00,000 made on 31st December each year. Discount on issue of debentures be written off in the ratio of debentures outstanding each year. Show discount on Issue of debentures account for first three years.

Solution:

Computation of amount of discount to be written off every year:

Year	Amount used Rs.	Ratio	Amount to be written off Rs.
2000	10,00,000	5	60,000 x 5/15 = 20,000
2001	8,00,000	4	60,000 x 4/15 = 16,000
2002	6,00,000	3	60,000 x 3/15 = 12,000
2003	4,00,000	2	60,000 x 2/15 = 8,000
2004	2,00,000	1	60,000 x 1/15 = 4,000
			Total = 1,20,000

Discount on Issue of Debentures Account

		Rs.			Rs.
2000			2000		
Jan.1	To Debentures a/c	60,000	Dec.31	By P & L a/c	20,000
			Dec.31	By Balance c/d	40,000
		60,000			60,000
2001			2000		
Jan.1	To Balance b/d	40,000	Dec.31	By P & L a/c	16,000
			Dec.31	By Balance c/d	24,000
		40,000			40,000
2002			2000		

Jan.1	To Balance b/d	24,000	Dec.31	By P & L a/c	12,000
			Dec.31	By Balance c/d	12,000
		24,000			24,000

Illus.8: Kedar Company Ltd. issued debentures of Rs.6,00,000 on 1st July, 2002 at a discount of 5%. The debentures are repayable in three equal instalments of Rs.2,00,000 each on 30th June every year. Calculate the amount of discount to be written off at the end of each year, assuming that the books are closed on 31st March every year.

Solution:

Calculation of Amount of Discount to be written off

Year 31st March	Amount used (Rs.)	Months for which amount is used	Total product	Ratio	Amount to be written off
2002	6,00,000	9 months	54,00,000	9	1,250 x 9 = 11,250
2003	6,00,000	3 months	18,00,000	9	1,250 x 9 = 11,250
	4,00,000	9 months	36,00,000		
2004	4,00,000	3 months	12,00,000	5	1,250 x 5 = 6,250
	2,00,000	9 months	18,00,000		
2005	2,00,000	3 months	6,00,000	1	1,250 x 1 = 1,250
			Total	24	30,000

Note: Total Discount = Rs.30,000/24 = Rs.1,250

Amount to be written off in proportion of outstanding amount of debentures at the end of every year after given the weightage to the period for which it was outstanding.

Accordingly Rs.11,250; Rs.11,250; Rs.6,250 and Rs.1,250 has been written off at the end of 31st March, 2002, 2003, 2004, 2005 respectively.

19.9 INTEREST ON DEBENTURES :

As discussed earlier the debenture is a loan capital. So, the company has to pay the interest on debentures by pre-decided rate. Debenture interest is the cost of using funds borrowed by the company. Therefore, the amount of debenture interest is charged to profit and loss account. The company has to keep in mind the following important rules at the time of payment of interest:-

(1) The interest is always payable on face value of debentures not on issue price.

(2) The interest will be paid on due dates only but, if the debentures are redeemed then it will be redeemed after paying the interest upto the date of redemption.

(3) One who is registered holder on the due date of interest will get the interest.

Example: 12%, Rs.100 Debentures are issued at Rs.80 per debenture by a company. The interest is payable on 30th June and 31st December every year. Mr. Ramesh purchased 500 debentures from Mr. Shyam on 30th November. In this example:

a. Company will always pay the interest on Rs.100
b. Company will pay the interest on 30th June and 31st December only
c. One who is register holder of security on the due date of interest will get interest. Ramesh acquired the debentures on 30th November and the interest will be due on 31st December then he will get the interest of last 6 months (from 1st July). Although Shyam held the debentures for 4 months but he will not receive any amount of interest.

19.9.1 Other important points of interest on debenture:

a. The interest is a charge on the profit of the company therefore, the company has to pay the interest whether there is profit or not.
b. According to Schedule VI, Part A of Companies Act, 1956, the debenture interest should be shown separately in the Profit and Loss Account. It should not be merged with general interest.
c. The company has to deduct the income tax from the amount of interest by the rate prescribed under the Income-Tax Act and such deducted amount must be deposited with the Central Government by the 7th of next month. This will be deposited in the name of the recipient of interest or debenture holder. The debenture holder will adjust this amount with the personal income tax or may get refund from the Government. Such amount deducted by the company is termed as “Tax deducted at source”.

The following journal entries will be passed by the company related to debenture interest:

(i) On due date of interest	Debenture Interest a/c Dr. To Debenture-holders a/c	Gross amount of Interest

	(Debenture interest due)	
(ii) On Payment	Debenture-holders a/c Dr. To Bank a/c To Tax deducted at source (Being debenture interest paid and tax is deducted at source)	Gross interest Net payment Income Tax
(iii) Tax deposited with Government	Tax deducted at Source a/c Dr. To Bank a/c (Being tax deducted, deposited)	Income Tax
(iv) Transfer of Interest	Profit & Loss a/c Dr. To Debenture Interest a/c (Being debenture interest transferred)	Gross Interest

Note: (i) When the tax is not to be deducted at source then in above (ii) entry, the gross interest will be paid to the debenture holders and (iii) entry will not be passed.

	Debenture Interest a/c Dr. To bank a/c (Being debenture interest paid)	By total interest amount

Illus.9: On 1st January, 2004 Sahiti Ltd. issued 5,000 12%debentures of Rs.100 each at a discount of 5% payable in full on application on or before 1st Feb., 2002. Interest on the debentures would be paid on 30th June and 31st December every year. In response to these, public subscribed for 5,000 debentures. On the same date Sahiti Ltd. borrowed Rs.1,50,000 from the Bank of Rajasthan Ltd. and deposited debentures of Rs.3,00,000 as collateral security.

Pass necessary Journal entries regarding the issue of debentures, raising of bank loan and payment of debenture interest for 2004. Also show the item of debentures in the Balance Sheet of the Company on 31st December, 2004.

SOLUTION :

Journal of Sahiti Ltd.

Date	Particulars	L.F.	Rs.	Rs.
2004 Date of Receipt	Bank a/c Dr. To Debenture Application a/c (Being application money @ Rs.95 per debenture received for the purchase of 5,000, 12% debentures of Rs.100 each)		4,75,000	4,75,000
Date of allotment	Debenture Application a/c Dr. Discount on Issue of Debentures a/c Dr. To 12% Debentures a/c (Being transfer of application money to 12% Debentures a/c, on allotment)		4,75,000 25,000	5,00,000
Date of receipt	Bank a/c Dr. To Bank Loan a/c (Being Rs.1,50,000 borrowed from the Bank of Rajasthan Ltd. and deposited debentures of the nominal value of Rs.3 lakhs as collateral security)		1,50,000	1,50,000
June 30	Debenture Interest a/c Dr. To Bank a/c (Interest paid on 5,000 debentures for 5 months)		25,000	25,000
Dec.31	Debenture Interest a/c Dr. To Bank a/c (Interest paid on 5,000 debentures for 6 months)		30,000	30,000
Closing entry	P & L a/c Dr. To Debenture Interest a/c (Being balance transferred)		55,000	55,000

Balance Sheet as at 31st December, 2004

	Rs.		Rs.
Secured Loans:		**Miscellaneous Expenditure:**	
5,000, 12% Debentures of Rs.100 each	5,00,000	Discount on Issue of Debentures	25,000
Bank Loan (Debentures of the nominal value of Rs.3,00,000 deposited as collateral security)	1,50,000		

19.10 QUESTIONS :

1. What are Debentures? Explain their features.
2. State the provisions relating to the issue of debentures.
3. How do you treat issue of debentures at discount from accounting point of view?
4. Explain the accounting treatment of debentures issued at discount.
5. Explain the accounting treatment of Issue of debentures as collateral security.

19.11 EXERCISES :

1. B Ltd. made the following issues of debentures:
   a. For cash, 6,000, 7% Debentures of Rs.100 each at 5% premium.
   b. To a creditor, from whom machinery worth Rs.1,00,000 was purchased: 1,100, 7% Debentures of Rs.100 each.

   Record the above transactions in the Journal of the company.

2. A company issued 1,000, 14% debentures of Rs.100 each at Rs.95 payable – Rs.30 on application, Rs.50 on allotment and the balance of cal. Anand holding 50 debentures did not pay the money. Rest of the amount was duly received in time. Prepare 14% Debentures Account in the books of the company.

   (Ans: Total of 14% Debentures a/c Rs.1,00,000)

3. The Rajasthan Timber Ltd. issued on 1st January, 2005 - 10,000, 14% Debentures of Rs.100 each at rs.95. The debenture money is payable as: Rs.50 on application and the balance on

allotment. Applications for 15,000 debentures along with the deposits required were received. Allotment was made proportionately. Over-subscription being applied in payment on the balance due on allotment. Allotments were made on 15th January. Interest was payable on 30th June and 31st December each year, the first payment being due for the period from 1st February to 30th June, 2005. Pass necessary Journal entries in the books of the company.

(Ans: Cash on allotment 2,00,000; Interest Rs.61,250)

4. On 1st January, 2004, the Sasikant Ltd. issued Rs.20,00,000, 12% Debentures of Rs.1,000 each as under:
   a. 950 Debentures at a premium of 20% on cash
   b. 400 Debentures to a Vendor who sold Land & Buildings costing Rs.4,40,000
   c. 600 Debentures to Rajasthan Bank Ltd. for a loan of Rs.4,00,000 as a collateral security

   Interest on Debentures is payable on 30th June and 31st December @ 12% per annum. Journalise the above transactions for the year 2004 and show the Bank Loan in the Balance Sheet of the company when no entry is passed in the books of the company for debentures deposited as a collateral security.

   (Ans: a. Bank Rs.13,24,000, b. Discount on Issue of Debenture Rs.10,000; Debentures Interest Rs.84,000 + Rs.84,000; Interest on bank Loan Rs.48,000)

5. Manasa Ltd. issued 200, 15% Debentures of Rs.100 each. Give Journal entries in each of the following cases in the books of the company:
   a. Issued at Rs.93, repayable at Rs.100
   b. Issued at Rs.94, repayable at Rs.106
   c. Issued at Rs.100, repayable at Rs.110
   d. Issued at Rs.110, repayable at Rs.110

6. On 1st January, 2003 Rajsekhar Ltd. issued 1,000, 14% Debentures of Rs.200 each at a discount of 6%. The debentures were repayable by annual installments of Rs.40,000 each, from 31st December, 2003 each year. The directors decided to write off discount on issue over the period of debentures in such a way as to charge each year with an amount proportionate to debentures outstanding in that year. Show the Discount on Issue of Debentures Account for three years in the Ledger of Rajsekhar Ltd.

(Ans: Discount to be w/o Rs.4,000; Rs.3,200; Rs.2,400 in 2003, 2004, 2005 respectively)

19.12 SUGGESTED BOOKS

1. Agarwala, A.N., Amitabha Mukherjee, Mohammed Hanif, **Principles and Practice of Accountancy,** Kitab Mahal Agencies, New Delhi.
2. Basu & Das, **Practical in Accountancy, Volume – one,** Rabindra Library, Calcutta
3. Chopde, L.N., & Choudhari, D.H., **Accountancy,** Sheth Publishers, Pune
4. Jain, S.P., Narang, K.L., **Accoutancy, Part - I,** Kalyani Publishers
5. Maheswari, S.N., Maheswari, S.K., **Advanced Accountancy (Vol.I)**, Vikas Publishing House Pvt. Ltd., New Delhi, 2005
6. Pillai, R.S.N., Bagavathi, Uma, S., **Fundamentals of Advanced Accounting (Vol.I)** S. Chand & Company Ltd., New Delhi, 2006
7. Shukla, M.C., Grewal, T.S., Gupta, S.C., **Advanced Accounts (Volume I)** S. Chand & Company Limited, New Delhi, 2005
8. Tulsian, P.c., **Accountancy** Tata McGraw-Hill Publishing Company Limited, New Delhi.