Bureau's

Higher Secondary

ACCOUNTANCY

CLASS- XII

(For Commerce Students)

(Prescribed by the Council of Higher Secondary Education, Odisha)

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FOREWORD

The Odisha State Bureau of Textbook Preparation and Production, Bhubaneswar has made a pioneer attempt to publish text books for Commerce Stream with an excellent team of teachers in different subjects.

The present book **"Accountancy"- Class-XII** is meant for Higher Secondary Commerce Students. This book has been written by a team of learned academicians namely Dr. Ajoy Mohanty, Dr. Uma Chand Lal, Dr. Prafulla Kumar Parida and Dr. Ram Chandra Jena and reviewed by Prof. (Dr.) Gunanidhi Sahu. I would like to record my sincere gratitude to all them for accomplishing this venture in time. The main purpose of developing this text book is to provide a thorough exposure to the students of Commerce in this subject. The book prepared according to the new syllabus prescribed by the CHSE, Odisha shall cater to the needs of young students.

I believe that the students and teachers of commerce stream shall welcome and appreciate the book. Constructive suggestions for further improvement of the book will be highly appreciated.

Sri Umakanta Tripathy
Director
The Odisha State Bureau of Textbook
Preparation and Production,
Pustak Bhavan, Bhubaneswar

PREFACE

The book on 'Accountancy' has been written for the Twelfth (XII) class students of Commerce Stream. It has been written according to the syllabus prescribed by the Council of Higher Secondary Education (CHSE), Odisha. Keeping in view the standard and requirements of the students, the book has been written in a very simple, lucid and comprehensive manner. We do not claim that the book is an original one. We have taken the help of publications by many renewed authors. We express our gratitude to all of them.

Sufficient care has been taken to see that the students can be well-acquainted with the types of questions usually set by the CHSE, Odisha. Accordingly, large number of typical examples and illustrations have been given in each chapter. At the end of each chapter, varied type of questions such as : on multiple choice, one word, rectification of errors, filling up the blanks, one sentence, 30 words, 50 words, long questions and practical problems, have been incorporated. We are confident that the students will find this book quite useful. We have taken all possible care to see that the book is complete in every respect. Despite our best possible efforts, errors might have crept in inadvertently and there might have been some deficiencies as well. We shall highly appreciate the suggestions from the different quarters for imporvement of the book in the next edition.

We are extremely thankful to the authorities of the CHSE, Odisha and the Odisha State Bureau of Text Book Preparation and Production, Bhubaneswar for entrusting this work to us. We also express our deep sense of gratitude to Prof. (Dr.) Gunanidhi Sahu, former Director of Higher Education, Odisha, who has taken pains to go through the entire manuscript throroughly and suggested imporvements to make the publication complete and perfect as far as possible. We express our sincere thanks to staff members of the Bureau, who have taken keen interest for bringing out the publication. We also express our thanks to the Jagannath Process Pvt.Ltd. but for whose efforts, the book could not have seen the light of the day.

Board of Writers

SYLLABUS

Objectives :

- To enable the students to understand and analyze the financial Statements of Profit & Non-Profit Making Organizations.
- To help the students in understanding the concepts and applications of depreciation.
- To develop and understanding about Accounting from Incomplete Records and its application.
- To help the students in learning the process of accounting for reconstitution and dissolution of partnership firms, and
- To help students understand the concept of accounting for companies specially about issue of shares and debentures :

Course Inputs :

Unit-I Financial Statements of Sole Trade and Not for Profit Organizations :

Sole Trade form of Organizations

Meaning, objectives and importance of preparing Trading, Profit and Loss Account and Balance sheet. Preparation of Trading, Profit and Loss Account and Balance Sheet of sole trader without and with adjustments relating to closing stock, outstanding expenses, prepaid expenses, accrued income, income received in advance, depreciation and bad debts, provision for doubtful debts, provision for discount on debtor/creditor, manager's commission, goods distributed as free samples and goods taken by the owner for personal use, abnormal loss, interest on capital and drawings.

Not for profit organizations

Meaning, objectives, necessity treatment of some important items such as legacy, donations, entrance fees, life membership fees, sale of assets, sale of old news paper, subscriptions, endowment fund, honorarium, expenses relating to a specific fund. Receipts and Payments Accounts-meaning, features, differences between Receipts and Payments Account and Cash Book. Income and Expenditure Accounts-meaning, features, difference between Income and Expenditure Account and Profit and Loss Account Preparation of Income and Expenditure Account and Closing Balance Sheet.

Unit-II Accounting for Depreciation and from Incomplete Records (Single Entry System)

Depreciation :

Meaning, need, causes, objectives and characteristics of depreciation. Methods of Charging Depreciation- Simple depreciation, method and provision for depreciation method. Method of calculating depreciation Straight Line and Written down Value method.

Accounting from Incomplete Records (Single Entry System)

Meaning, charateristics and limitations of single entry system. Difference between single entry and double entry system. Difference between balance sheet and statement of affairs. Ascertainment of profit and loss by the statement of affairs method only.

Unit-III Accounting for Partnership Firm :

Meaning, Features, Partnership Deed and Provisions of Partnership Act, 1932 in the absence of partnership deed. Fixed vs Fluctuating Capital Accounts, preparation of Profit and Loss Appropriation A/c.

Goodwill- Meaning, nature and Factors affecting Goodwill. Methods of Valuation of Goodwill (Average profit, super profit method and capitalization method).

Reconstitution of partnership firm - Meaning, Circumstances Leading to Reconstitution : Change in Profit Sharing Ratio, Sacrificing Ratio, Gaining Ratio. Accounting for revaluation of assets and liabilities and distribution of reserves and accmulated profits and loss.

Admission of a Partner - Simple Problems without Adjustment of Capital

Unit-IV Accounting for Companies :

Accounting for Share Capital :

Shares and share capital : Nature and types as per Companies Act 2013.

Issue of Shares at Par, Premium and Discount, Calls in Advance, Calls in Arrear, over subscription and under subscription of shares. Accounting for Forfeiture of shares and re-issue of shares. Disclosure of share capital in companies balance sheet (Vertical Format).

Accounting for Debenture :

Issue of debentures at par, at premium and at discount and issue of debentures for consideration other than cash.

Unit-V Project Work with Viva :

Suggested Areas for Project Work :

- Collections of source documents preparation of Vouchers, recording of transactions will the help of vouchers.
- Preparation of Bank Reconciliation Statement with the given cash book and the pass book with ten to fifteen transactions.
- Comprehensive project starting with journal entries regarding any sole proprietorship business, posting them to the ledger and preparation of Trial balance. The students will then prepare Trading and Profit and Loss Account and Balance Sheet on the basis of the prepared trial balance Expenses, incomes and profit (loss), assets and liabilities are to be depicted using pie chart / bar diagram.

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CONTENTS

❖❖❖

CHAPTER-1

FINANCIAL STATEMENTS OF SOLE TRADING ORGANISATIONS

Chapter-1

Financial Statements of Sole Trading Organisations

1.0 MEANING OF FINAL ACCOUNTS

The accounts and/or statements prepared at the end of the year (accounting period) are called final accounts. The final accounts are prepared from the Trial balance. Trial balance is the last step of Book-keeping and preparation of final accounts is the first step of Accounting. Final accounts are also interchangeably called the financial statements. Final accounts are usually prepared at the end of the accounting period to convey, the stakeholders/users, the financial health and operating efficiency of the business.

Finacial statements are the summary of the accounts showing the result of operations and financial position of a business enterprise. These are the reports of incomes and expenditures of a business at the end of the year.

Traditional concept of financial statements include the Income Statement (Trading account and Profit and Loss account) and the Balance Sheet/Position Statement. The modern concept of financial statements includes Cash Flow Statement and Value Added Statement in addition to the above two traditional statements. Our study, in this chapter, is limited to only the traditional concept of financial statements, i.e., the Trading and Profit and Loss Account and Balance Sheet.

1.1. OBJECTIVES OF FINANCIAL STATEMENTS

The basic objectives of preparing financial statements are :

(a) to present a true and fair view of the operational efficiency of the business in financial terms;

(b) to present a true and fair view of the financial position of the business. Besides the above, the other objectives are:

(i) to help in the comparison of financial performance of the current year with that of the previous years,

(ii) to help in ascertaing the financial ratios for controlling the expenses and maximising/optimising revenues,

(iii) to monitor the use of debts and capital in acquisition of assets, etc.

1.2 IMPORTANCE OF FINANCIAL STATEMENTS

Financial statements are regarded as the financial barometers of a business enterprise. It measures the financial health, efficiency, soundness of the business. The various accounts are fed into the final accounts at the end of the year to make the business operations meaningful. The objective of a business is to earn profit besides the other social and cultural objectives. The importance of final accounts is to ascertain the profit, profitability and financial soundness of the business. The business enterprises are bound to prepare the final accounts annually, otherwise they will remain in dark. Final accounts are the summary of all accounts at the end of the accounting period. These are the means to communicate information to various stakeholders in the business so that they can take proper decisions. The stakeholders have diverse requirements of financial information from the business. They get better insight into the financial strengths and weaknesses of a business. The financial statements are most important for the informational needs of investors and providers of risk capital.

1.3 DISTINCTION BETWEEN CAPITAL AND REVENUE

It is essential to distinguish between capital and revenue items in order to prepare the final accounts. The revenue items form part of the Trading and Profit and Loss Account; while the capital items go to the Balance Sheet. The Going Concern Concept and Accounting Period Concept prompt the accountant to draw the distinction between capital receipts and revenue receipts; and payments as capital expenditure, revenue expenditure and deferred revenue expenditure. A failure or negligence to distinguish between the two items will falsify the entire results of accounting.

1.3.1 Capital Expenditure

It is an expenditure incurred to acquire fixed assets. Capital expenditure increases the earning capacity of business. It is necessary for the operations of any business. It normally yields benefits for more than one accounting period. A particular capital expenditure is debited to the specific asset account. For example, acquisition of land and building, plant and machinery, furniture and fixtures are all capital expenditures. Assets acquired through capital expenditures are not meant for resale and are supposed to remain in the business for a long period (more than one year) with the help of which the business is carried on. These are subject to depreciation. Depreciation is charged to Profit and Loss Account every year and is shown as a deduction from the value of the concerned asset (Capital expenditure) in the Balance Sheet. An expenditure can be treated as capital expenditure in the following situations:

1. When an expenditure results in the acquisition of an asset, for example, purchasing land and building, plant and machinery, furniture and fixtures, etc.
2. When an expenditure is incurred whose benefits will last for a long time, for example, preliminary expenses, cost of research and development, cost of acquisition of patents, trade mark, development expenditure on plantations, etc.
3. When an expenditure is incurred to put a newly purchased asset in the working condition, for example, cost of transportation, installation, registration, etc.
4. When an expenditure results in creation of extra capacity, for example, extension or addition of new rooms to an existing building.
5. When an expenditure reduces the cost of production, for example, replacement of petrol engine by a diesel engine of a passenger car, etc.

1.3.2 Revenue Expenditure

This expenditure is incurred for the the day-to-day conduct of the business. If helps in maintaining the earning capacityof the business. Revenue expenditure is recurring in nature and gives benefit to the business for a maximum period of one year. For example, manufacturing expenses, office and administrative expenses, selling and distribution expenses- all these are charged/debited to Trading and Profit and Loss Account of the year during which these are incurred. An expenditure is treated as revenue expenditure in the following situations:

1. Expenditure incurred to purchase raw materials, or finished products, for example, carriage inward, octroi duty, customs duty, etc.
2. Expenditure whose benefit will expire during the same accounting year for example, salary, rent, postage, printing and stationery, etc.
3. Expenditure for maintaing the capacity of a fixed asset, for example, repairs and maintenance, renewals, etc.
4. Expenditure incurred to defend one's right to an asset or product in the interest of the business, for example, renewal of licence.
5. All types of losses, i.e., whether stock-in-trade or any current or fixed asset, for example, loss of stock by theft or fire, loss of any asset by accident, etc.

1.3.3 Deferred Revenue Expenditure

Sometimes it is difficult to correctly demarcate between capital expenditure and revenue expenditure. Deferred Revenue Expenditure is one which is normally treated as revenue expenditure but it gives benefits to the business for more than one accounting period. For example, a heavy expenditure on advertising for launching a new product or opening a new brand, preliminary expenses, etc. are likely to give benefit for more than one accounting period. The impact of advertisement on consumers will remain for more than one accounting year. Deferred revenue expenditure is of non-recurring and special in nature and a heavy amount is spent on it. So, it may be spread over a number of years during which the benefit is received by the business. A proportionate amount of expenditure is charged to the Profit and Loss Account every year. The balance is carried forward to the subsequent years as deferred revenue expenditure and is shown on the asset side of the Balance Sheet, till it is fully written off.

1.3.4 Distinction between Capital and Revenue Expenditure

The following are the distinctions between capital and revenue expenditure :

(a) Capital expenditure improves the earning capacity of the business but revenue expenditure is incurred to maintain the earning capacity.

(b) Capital expenditure is incurred to acquire fixed assets for operation of business but revenue expenditure is incurred for day-to-day conduct of the business.

(c) Capital expenditure is non-recurring in nature but revenue expenditure is recurring in nature.

(d) Capital expenditure gives benefit for more than one accounting year but revenue expenditure normally benefits one accounting year.

(e) Capital expenditure represents unexpired cost and its benefits are taken to the future. But revenue expenditure represents expired cost and its benefits are exhausted within the year of expenditure.

(f) Capital expenditure is subject to depreciation while revenue expendure is subject to adjustment for outstanding and prepaid amounts.

(g) Capital expenditure is shown on the asset side of Balance Sheet but revenue expenditure is closed by transfer to the debit side of Trading or Profit and Loss Account.

1.3.5 Capital Receipts and Revenue Receipts.

Receipts of a business enterprise comprise of capital receipts and revenue receipts. When the receipts of a business imply an obligation to return the money, these are capital receipts. For example, capital invested in the business, long-term loans and sale proceeds of fixed assets are capital receipts. But when a receipt does not imply an obligation to return the money or is not in the form of a sale of fixed asset, it is treated as revenue receipts. For example, money received from sale of goods/merchandises, interest, commission, discount, interest on drawings, income from other sources are revenue receipts. Capital receipts are reflected in the Balance Sheet whereas the revenue receipts are transferred to Profit and Loss account.

1.3.6 Capital Profits and Revenue Profits

The profits earned by selling or revalution of old fixed assets, profits earned at the time of procuring share capital at premium on issue of shares or debentures, profit made on the reissue of forfeited shares or profits made prior to the incorporation of a company are called capital profits. Capital profits are usually shown as capital reserve on the liability side of Balance Sheet but in practice, capital profit like profit on sale of fixed assets is credited to Profit and Loss Account. For example, a machinery purchased for ₹1,00,000 is sold at ₹85,000 after two years of use at a depreciation rate of 10% on straight line method, the excess of ₹5,000 over the book value of ₹80,000 is capital profit. Capital profits are non-recurring in nature.

The profits earned during the normal course of day to day business is called revenue profits. The net result of the Trading Account and Profit and Loss Account is revenue profit. It is the profit earned by selling goods and merchandises of the business. In other words, the excess of net sales over the cost of goods sold plus indirect expenses is called revenue profit. Both gross profit and net profit come under the purview of revenue profit. Revenue profits are recurring in nature.

1.3.7 Capital Loss and Revenue Loss

The losses incurred by selling old fixed assets, revaluation of fixed assets, loss/ discount on issue of share or debentures, premium on redemption of preference shares or debentures are called capital losses. Capital losses are non recurring in nature i.e. do not occur in the ordinary course of the business. Capital losses may be treated as deferred revenue expenditure or fictitious assets which may be written off during a few years.

Revenue losses occur in the normal course of the business. These losses are incidental to the day to day business operations. Revenue losses are the excess of revenue expenditure over the revenue incomes. Loss of stock by fire, pilferage, bad debts, misappropriation of goods and embezzlement of cash are treated as revenue losses.

Illustration 1

1. State with reasons whether the following are Capital or Revenue items :

(a) Freight and insurance on new machinery.

(b) Wages paid for erection of a new machinery.

(c) ₹2,000 paid on repairing a second hand machine purchased newly.

(d) ₹8,000 paid as compensation to employees who are retrenched.

(e) ₹5,000 spent on repainting the factory.

(f) Discount allowed to debtors ₹200.

(g) Discount allowed by creditors ₹300.

(h) Legal expenses paid ₹3,000 to purchase a building.

(i) Carriage paid on goods purchased.

(j) A building costing ₹1,00,000 sold for ₹1,20,000.

(k) Plant costing ₹60,000 is sold for ₹58,000.

(l) Dividend received on shares ₹5,000.

(m) Raised a Loan of ₹5,00,000 from IDBI.

(n) Additional capital invested in the business ₹1,00,000.

(o) Misappropriation of cash by cashier ₹7,000.

(p) Bad debts written off.

(q) Bad debts previously written off now recovered.

Solution:

(a) Capital expenditure as it is incurred to make the machinery ready for use.

(b) Capital expenditure since it makes the machinery fit for use.

(c) Capital expenditure as it makes the second hand machinery ready for use.

(d) Revenue expenditure since it is neither giving extra benefit nor increasing the value of any asset.

(e) Revenue expenditure as it is incurred to maintain the asset (factory) in working order.

(f) Revenue expenditure as it is incurred in the ordinary course of the business.

(g) Revenue receipts since it is earned in the ordinary course of the business.

(h) Capital expenditure as it is spent to acquire a fixed asset which is a capital expenditure.

(i) Revenue expenditure because it is incurred in connection with the purchase of goods which is revenue expenditure.

(j) Building sold at ₹1,20,000 is a capital receipt. Profit on sale of building ₹20,000 is a capital profit.

(k) Plant sold at ₹58,000 is a capital receipt. Loss on sale of plant ₹2,000 is capital loss.

(l) Revenue receipt since it is received regularly on investment in shares.

(m) Capital receipt as the loan is raised from the bank which increases the liability of the business.

(n) Capital receipt as it increases the liability of the business to the proprietor.

(o) Revenue loss because it is incidental to the business.

(p) Revenue loss as it is incidental to the business.

(q) Revenue receipt since bad debts written off was treated as a revenue loss.

1.4 PREPARATION OF FINANCIAL STATEMENTS WITHOUT ADJUSTMENT

Financial statements are the summaries of information about the operating result and financial position of a business enterprise. Traditionally the term 'Financial Statements' is used to denote mainly two statements :

(i) Income Statement (Trading and Profit and Loss Account) which shows the financial performance of an enterprise during an accounting period;

(ii) Position Statement (Balance Sheet) which shows the financial position of the business at a particular point of time.

Now a days as per the International Financial Reporting Standard (IFRS) two more financial statements are to be prepared by the business enterprises, i.e., (a) Cash Flow Statement and (b) Value Added Statement.

The traditional financial statements are to be prepared on the basis of trial balance and additional information, if any. Financial statements are the means of conveying to management, present and potential investors, lenders, short term creditors, employees, customers, government and their various agencies, a concise picture of earning capacity and financial soundness of the business.

1.4.1 Preparation Trading Account (without adjustment)

Trading account is one of the financial statements prepared on the basis of trial balance to show the results of buying and selling of goods and services during an accounting period.

It is prepared to ascertain the Gross Profit/Gross Loss by matching the net sales with the cost of goods sold or services rendered, as the case may be.

Gross Profit = Net Sales – Cost of goods sold

Net Sales = Gross Sales – Sales Return.

Cost of Goods Sold = Net Purchases + Stock at the begining + Direct expenses on purchases – Stock at the end.

A Trading Account is prepared by passing of entries to transfer the balances of revenues and expenses accounts to it. These transferring entries so made to close the concerned nominal accounts are called "Closing Entries". A closing entry may be either simple or compound closing entry. A simple closing entry only affects two accounts, i.e., one account is debited and another account is credited with an equal amount. A compound closing entry involves several accounts which are either debited or credited to Trading account.

Relevant Items in Trading Account

The relevant items of revenue and expense appearing in the trading account are explained below:

Items on the debit side :

(i) Opening Stock - This is the amount of goods in hand at the begining of the accounting period. It has been carried forward from the closing stock of the previous year. It remains unchanged during the year and appears on the debit side of the trial balance. It appears on the debit side because it forms a part of the cost of goods sold during the current year. There is no opening stock for a new business. Opening stock consists of raw materials, work-in process and finished goods in case of a manufacturing concern while it is only one item of goods traded by the business, in case of a trading concern.

(ii) Net Purchase- It includes both cash and credit purchases of goods meant for resale or further processing or production, as the case may be, less purchase returns, if any.

(iii) Direct expenses- These expenses are incurred in order to make goods ready and fit for sale. The various direct expenses are :

(a) Wages (or wages and salaries) : When wages have been incurred on manufacturing the goods or making the goods better saleable, they become direct expenses and are debited to Trading account.

(b) Carriage/Cartage/Freight- inward : These expenses are incurred to carry the goods from the godown of the supplier to the godwon of the purchaser. If such expenes are incurred in carrying the fixed assets from supplier to purchaser, carriage/cartage should be capitalised and debited to relevant asset account.

(c) Import duty and Dockdues : When goods are imported from abroad import duty, customs duty and dock charges, etc. have to be paid. These direct expenses are debited to Trading Account.

(d) Octroi : Sometimes goods are purchased outside the municipal area (local self-government area) which are to be sold within the area of municipality. Octroi duty is to be paid on such goods by the purchaser at the octroi gate. This expense is shown on the debit side of the Trading Account.

(e) Motive Power, Coal, Gas and Water : These direct expenses are shown on the debit side of the Trading Account if Manufacturing Account is not prepared. otherwise these expenses are normally debited to the Manufacturing Account.

(f) Manufacturing expenses : Expenses incurred in manufacturing the goods in the factory such as factory rent, insurance, depreciation, lighting, are debited to Trading Account if no Manufacturing Account is prepared.

(g) Consumable stores : Expenses incurred to keep the machineries in ready working conditions are called consumable stores. It includes grease, engine oil, soap, rags, etc., are debited to Trading Account if Manufacturing Account is not prepared.

(h) Royalty : Royalty is the expense incurred for using patent right, copyright or ownership right of land to their owners. If royalty is paid on the basis of production, it is direct expense and debited to Trading Account when Manufacturing Account is not prepared. When royalty is paid on the basis of sales, it is debited to Profit and Loss Account, being an indirect expense.

(i) Packaging : Ordinary or primary packaging is one which forms part of the manufacturing expenses. It is a direct expense and debited to Trading Account, when Manufacturing Account is not prepared.

Items on the credit side :

(i) Sales : Sales mean the sale of goods purchased for resale. Sales account on the credit side of Trial Balance shows gross total sales made during the year. It includes both cash and credit sales. Goods returned by customers are called sales return or return inwards and are shown as a deduction from total sales. Gross total sales less return inwards is the net sales.

Sale of fixed assets, goods sold on consignment or on hire-purchase or on sale-or-return basis, if included in sales, are to excluded and shown separately.

(ii) **Closing stock :** It is the unsold goods at the end of the current accounting period. Closing stock is shown usually under adjustment outside the trial balance, it will be credited to the Trading Account and shown on the asset side of Balance Sheet. But when purchases are adjusted (adjusted purchases) through opening and closing stock, it will be shown on the debit column of trial balance. When closing stock is given outside the trial balance, it will be credited to the Trading Account and shown on the asset side of Balance Sheet. But when it is under the debit column of trial balance, it will appear as an asset on Balance Sheet only. Value of the closing stock is always shown at cost or market price which ever is less.

Closing Entries

Trading Account is prepared by transferring the balances of opening stock, purchases, sales, returns, direct expenses and closing stock to it through a journal entry. The journal entry made to transfer the balances of such accounts to Trading Account is called 'closing entry' The closing entry closes the balances of such accounts in the particular accounting year. The closing entries passed to give effect to such transfers are cited below:

(a) For transferring opening stock, purchases, sales return, wages, carriage inwards and all other direct expenses to Trading Account :

Trading Account Dr.
To Opening Stock A/c
To Purchases A/c
To Sales Return A/c
To Wages A/c
To Cariage Inward A/c
To All other direct expenses A/c

(b) For transferring sales, purchases returns, closing stock to Trading Account :

Sales A/c Dr.
Purchases Returns A/c Dr.
Closing Stock A/c Dr.
To Trading A/c

Sales Returns and Purchases returns A/c are respectively credited and debited in the closing entries in order to close these accounts in the ledger. But in actual practice, sales return is shown as deduction from sales on the credit side of the Trading A/c to arrive at the net sales. Similarly purchases return is shown as deduction from purchases in order to arrive at the net purchases.

(i) For transferring Gross Profit :

Trading Account Dr.

To Profit and Loss Account

(ii) For tranferring gross loss :

Profit and Loss Account Dr.

To Trading Account

Typical Proforma of a Trading Account.

Trading Account of M/s XYZ
for the year ending......

Dr. Cr.

Particulars		₹	Particulars		₹
To Opening Stock		XXX	By Sales :		
To Purchases :			Cash Sales XXX		
Cash Purchases XXX			Credit Sales XXX		
Credit Purchases XXX			Total Sales	XXX	
Total Purchases	XXX		Less :		
Less :			Sales Returns	XXX	
Purchase Retruns	XXX				XXX
Abnormal Loss	XXX		By Closing Stock		XXX
Goods for Personal use	XXX		By Gross Loss c/d to		
Goods as free sample	XXX		Profit & Loss Account		XXX
(-)	XXX	XXX			
To Wages		XXX			
To Carriage Inward		XXX			
To Other Direct expenses		XXX			
To Gross Profit c/d to P&L A/c	XXX				
		XXX			XXX

Illustration 2

From the following balances, prepare the Trading Account for the year ending on 31.12.2016: Opening stock ₹80,000, cash sales ₹2,00,000, credit sales ₹5,00,000, returns outward ₹6,000, wages and salaries ₹8,000, carriage inwards ₹3,000 cartage inward ₹1,000, cash purchases ₹1,00,000 credit purchases ₹2,50,000, returns inward ₹5,000, closing stock ₹86,000 whose market value ₹82,000.

Solution :

TRADING ACCOUNT
for the year ending 31st December, 2016

Dr. Particulars		₹	Particulars		₹ Cr.
To Opening Stock		80,000	By Sales :	₹	
To Purchases :	(₹)		Cash Sales	2,00,000	
Cash Purchases	1,00,000		Credit Sales	5,00,000	
Credit Purchase	2,50,000		Total Sales	7,00,000	
Total Purchase	3,50,000		Less		
Less Returns Outward	6,000	3,44,000	Returns Inward	5,000	6,95,000
To wages and Salaries		8,000	By Closing Stock		82,000
To Cariage Inwards		3,000			
To Cartage Inward		1,000			
To Gross profit transferred to P&L A/c		3,41,000			
		7,77,000			**7,77,000**

N.B.: Here gross profit will be transferred to the credit side of Profit and Loss Account, closing stock is to be shown on the asset side of the Balance Sheet.

Illustration 3

From the following information, prepare the Trading Account for the year ending 30th June 2016 :

Adjusted purchases ₹10,26,000, Sales ₹13,95,000, closing stock ₹87,000, freight and cartage inwards ₹7,000, wages ₹3,000, Freight outwards ₹4,000, octroi ₹1,000, clearing charges ₹8,000, Coal, gas and water ₹11,000, motive power ₹10,000.

Solution:

Trading Account
for the year ending 30th June 2016

Dr. Cr.

Particulars	₹	Particulars	₹
To Adjusted Purchase	10,26,000	By Sales	13,95,000
To Freight & Cartage Inward	7,000		
To Wages	3,000		
To Clearing charges	8,000		
To Coal, gas and water	11,000		
To Motive power	10,000		
To Octroi	1,000		
To Gross Profit transferred to P & L A/c	3,29,000		
	13,95,000		**13,95,000**

Note :

(i) Adjusted Purchases = Net purchases + Opening Stock – Closing stock

(ii) Opening and closing stock are not shown in the Trading Account separetely as opening stock has been already added to purchases and closing stock has been deducted from purchases for computing adjusted purchases.

(iii) Freight outwards are indirect expenses, hence excluded from being debited to Trading Account.

Illustration 4

From the following particulars, you are required to prepare Trading Account for the year ending 30th September 2016:

Cost of goods sold	₹7,70,000
Sales	₹11,28,000
Closing stock	₹75,000

Solution :

Trading Account
for the year ending 30th September 2016

Dr. Cr.

Particulars	₹	Particulars	₹
To Cost Goods sold	7,70,000	By Sales	11,28,000
To Gross Profit transferred to Profit and Loss Account	3,58,000		
	11,28,000		**11,28,000**

1.4.2 Preparation of Profit and Loss Account. (Without adjustment)

Profit and Loss Account is one of the income statements showing the financial performance of a business during an accounting period. The aim of preparing Profit and Loss Account is to ascertain the net profit/loss of a business for the year. There are certain items of revenues, expenses and losses of the business to be taken into consideration for preparing profit and loss account. All revenues, both operating and non-operating and all indirect expenses are taken for calculating net profit/loss. Indirect expenses are those expenses which relate to the whole business and are incurred for the purpose of making the goods available to the customers. Broadly, these expenses may be management expenses, legal expenses, financial expenses, selling and distribution expenses, extraordinary expenses, losses, etc. Profit and Loss Account is prepared by taking all the (indirect expenses and losses) nominal accounts from the trial balance.

Relevant items in Profit and Loss Account

(i) Gross profit/Loss : Gross profit or Gross Loss is the first item of the Profit and Loss Account which is brought down from Trading Account.

(ii) Salaries : Salaries paid to employees of office, sales and advertising department is an indirect expense and debited to Profit and Loss Account. When net salary is paid after deduction of income tax, employees contribution to provident fund, the gross salary is charged to Profit and Loss Account. Even the employers' contribution to provident fund is added to salary of the employees.

Both employees' own contribution and contribution of employer to provident fund will be payable to the employees at the time of their retirement. So, these two items of provident fund contribution are to be shown on the liability side of Balance Sheet.

(iii) 'Salaries and wages' / 'wages and salaries' : As salary is an indirect expense and wages are included in salary account, such wages are treated as indirect expenses. Hence, 'salaries and wages' are debited to Profit and Loss Account and 'wages and salaries' are direct expenses and debited to Trading Account.

(iv) Interest : Interest may be received or paid. Interest received being income is credited to Profit and Loss Account and interest paid being an expense is debited to Profit and Loss Account.

(v) Commission : Commission paid to effect sales is an indirect expense and debited to Profit and Loss Account. Commission received from agency services are income of the business and credited to Profit and Loss Account. When commission is paid on purchase of goods being a direct expense is debited to Trading Account.

(vi) Discount : Discount may be either credit or debit. Discount allowed is debit and discount received is credit. Discount allowed on cash sales or on collections from sundry debtors being an indirect expense is debited to Profit and Loss Account. Discount received from sundry creditors at time of early payment to them is credited to Profit and Loss Account.

(vii) Apprenticeship premium : It is the fee received from trainees on various trades by the business for providing them skill enhancement and practical oriented training facilities. This, being an income of the business, is credited to Profit and Loss Account.

(viii) Printing and stationery: Printing and stationery expenses include ink, pen, pencils, files, registers, bills, vouchers, invoices, letter pads, threads, gums, carbon papers, etc. and are debited to Profit and Loss Account.

(ix) Insurance premium : Insurance premium paid on the assets of the office, godown and warehouse, showroom are debited to Profit and Loss Account. But when insurance premium is paid on the assets of factory and production department, it is debited to Trading Account, being a direct expense.

(x) Sales Tax/Goods and Services Tax : Sales tax/Goods and services tax are paid on goods and services sold. It may appear in the trial balance either with a debit balance or with a credit balance. When it shows a debit balance, it is debited to Profit and Loss account. But when it shows a credit balance, it means that Sales Tax/Goods and Services Tax is not paid and remains outstanding. It is to be shown as a current liability in the Balance Sheet.

(xi) Income Tax : Income tax is paid to the Central Government on the profit and gains of a business. It is a personal expense of the proprietor and not debited to Profit and Loss Account. If it appears in the trial balance, it is to be deducted from capital as a drawing of the proprietor in the Balance Sheet.

(xii) Depreciation : Depreciation of fixed asset is charged to Profit and Loss account as an indirect notional expense.

(xiii) Advertisements : Advertisement charges are debited to Profit and Loss Account. When a lump sum amount is paid to an advertising agency for providing benefits for more than one year, a proportionate amount is charged to Profit and Loss Account for the current accounting period and the balance is to be transferred to Balance Sheet as an asset under the head 'Deferrded Revenue Expenditure'.

(xiv) Samples : Free samples are distributed by the business for the purpose of advertisement, hence, debited to Profit and Loss Account.

(xv) Stable Expense : Expenses incurred on rearing horses in the stable are treated as indirect expenses, hence debited to Profit and Loss Account.

(xvi) Abnormal losses : Loss on sale of fixed assets, misappropriation of cash, goods destroyed by fire not covered under insurance are treated as abnormal losses, hence, debited to Profit and Loss Account.

(xviii)Rent, Rates and Taxes : Rent may be paid either for office or for factory or for warehouse. Rates are the cess or taxes paid to the local authority. When rent, rates and taxes are paid for the factory, those are debited to Trading Account. But when such expenses are paid for the office or warehouse, these are to be debited to Profit and Loss Account. Sometimes rent is received on subletting of the building, which is an income of the business and credited to Profit and Loss Account.

(xix) Bad debts : The debtors remain uncollected for a long period are to be treated as bad as it is unrecoverable. Hence, it is an indirect expense and debited to Profit and Loss Account.

(xx) Life insurance premium :Life insurance premium is a personal expense of the proprietor. If it is paid out of the business cash, it is not to be debited to Profit and Loss Account. It is to be debited to drawings account and deducted from capital in the Balance Sheet.

(xxi) Private expenses : Any private expenses of the proprietor, if paid out of business cash, is debited to drawings account and deducted from capital in the Balance Sheet.

(xxii) Interest on capital and on drawings : Interest on capital being an expense for the business is charged at a normal rate and debited to profit and loss account. Interest on drawing is charged by the firm to the proprietor. Interest on drawing is a gain to the business and credited to Profit and Loss Account. Interest on capital is added to capital in the Balance Sheet and interest on drawings is added to drawings and shown as a deduction from capital in the Balance Sheet.

Closing Entries

The entries required to bring down the net profit/loss by transferring the indirect expenses and incomes to Profit and Loss Account, are called closing entries.

The purpose of passing closing entry is to close the indirect and direct expenses (nominal accounts) at the end of the accounting period. For a sole trade organisation, Profit and Loss Account is closed by transferring the net profit/ loss to capital account. The closing entries for indirect expenses/incomes are :

(a) To close the accounts of indirect expenses and losses-

Profit and Loss Account Dr.

To various Items of Expenses and Losses Account (individually)

(b) To close the accounts of indirect incomes and gains (other than those shown on the credit side of Trading account)-

Various Items of Gains and Incomes Account. (Individually) Dr.

To Profit and Loss Account

(c) To Close the Profit and Loss Account -

(i) For net profit

Profit and Loss Account Dr.

To Capital Account

(ii) For net Loss

Capital Account Dr.

To Profit and Loss Account.

Typical Proforma of Profit and Loss Account

Profit And Loss Account of (M/s ABC Traders)
for the year ending on (31st March 2017)....

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Gross Loss b/d	XXX	By Gross Profit b/d	XXX
To Salaries and Wages	XXX	By Interest received	XXX
To Rent, Rate and Taxes	XXX	By Commission received	XXX
To Fire Insurance Premium	XXX	By Rent from subletting	XXX
To Repairs and Maintenance	XXX	By Discount received	XXX
To Depreciation	XXX	By Apprenticeship Premium	XXX
To Audit Fees	XXX	By Dividend received	
To Bank Charges	XXX	By Recovery of bad debts	XXX
To Legal Charges	XXX	By Sale of old news papers	
To Cariage, freight outward	XXX	By Profit on sale of fixed assets	XXX
To Commission	XXX	By Interest on drawings	XXX
To Discount	XXX	By Profit on sale of short-term	
To Trade Expenses	XXX	marketable shares	XXX
To Advertisements	XXX	By Sundry receipts	XXX
To Packaging Expenses (secondary)	XXX	By Net loss transferred	
To Bad debts	XXX	to Capital Account	XXX
To Printings and Stationeries	XXX		
To Postage and telephone	XXX		
To Bonus to Staff	XXX		
To Office heating, cooling and lighting	XXX		
To Rent of showroom	XXX		
To Free samples	XXX		
To Interest on Loan	XXX		
To Charity, Donations	XXX		
To Loss on sale of fixed assets	XXX		
To Loss of goods by fire/theft	XXX		
To Employees State Insurance (ESI)	XXX		
To Employer's Contribution			
to Provident fund	XXX		
To Loss by pilferage	XXX		
To Net profit transfered			
to Capital A/c	XXX		
	XXX		XXX

Illustration-4

From the following particulars, prepare Profit and Loss Account for the year ending 31st March 2017 :

	(₹)		(₹)
Gross Profit	1,13,000	Bank charges	2,000
Discount allowed	2,000	Legal charges	9,000
Discount received	3,000	Audit fees	11,000
Salaries and wages	7,000	Entertainment expenses	7,000
Wages and salaries	5,000	Depreciation on office furniture	3,000
Carriage inward	2,000	Depreciation on office machinery	10,000
Carriage outward	4,000	Loss by Embezzlement of cash	1,000
Commission allowed	6,000	Sundry incomes	2,000
Commission received	3,000	Apprenticeship premium	11,000
Interest on loan paid	2,000	Sales of old newspapers	1,000
Interest received	5,000	Fire insurance premium	8,000
Rent paid	10,000		
Rent received	8,000		
General Expenses	1,000		
Freight outward	9,000		
Profit on Sale of fixed assets	7,000		
Loss by Fire	6,000		
Income from Investment	2,000		
Miscellaneous expenses	1,000		
Trade Expenses	3,000		
Bad debts	7,000		
Sales promotion expenses	5,000		
Loss on sale of fixed assets	2,000		
Brokerage allowed	6,000		
Repairs and maintenance	1,000		
Travelling expenses	3,000		
Office heating, cooling and lighting	5,000		
Postages and Telephone	3,000		
Packaging expenses (Primary)	2,000		
Packaging expenses (secondary)	6,000		

Solution :

Profit and Loss Account
for the year ending 31st March 2017

Dr. **Cr.**

	(₹)		(₹
To Discount allowed	2,000	By Gross Profit b/d	1,13,000
To Salaries and wages	7,000	By Apprenticeship premium	11,000
To Carriage outward	4,000	By Income from Investments	2,000
To Commission Allowed	6,000	By Profit on sale of fixed assets	7,000
To Interest on Loan paid	2,000	By Interest received	5,000
To Rent Paid	10,000	By Sundry incomes	3,000
To General Expenses	1,000	By Sale of old newspapers	1,000
To Freight Outward	9,000	By Rent received	8,000
To Loss by fire	6,000	By Discount Received	3,000
To Loss by Embezzlement of cash	1,000	By Commission Received	3,000
To Loss on sale of fixed asset	2,000		
To Miscellaneous expenses	1,000		
To Trade Expenses	3,000		
To Bad debts	7,000		
To Sales Promotion Expenses	5,000		
To Brokerage allowed	6,000		
To Repairs and maintenance	1,000		
To Travelling Expenses	3,000		
To Office heating, cooling and lighting	5,000		
To Postage and Telephone	3,000		
To Packaging (secondary)	6,000		
To Bank Charges	2,000		
To Legal Charges	9,000		
To Audit Fees	11,000		
To Entertainment Expenses	7,000		
To Depreciation :			
Office Furniture 3,000			
Office Machinery 10,000	13,000		
To Fire Insurance	8,000		
To Net Profit transferred to Capital A/c	16,000		
	1,56,000		**1,56,000**

1.4.3 Preparation of Balance Sheet (Without adjustments)

Balance Sheet is prepared after the preparation of Profit and Loss Account. It is a statement of financial position of the business on a particular date. It shows assets, external liabilities, capital, reserves and surplus. Balance Sheet is also called the "Position Statement" of a business. It is a statement of the balances of ledger accounts which are carried forward to the next year. The nominal accounts are closed by transferring to Trading Account and Profit and Loss Account. But the personal accounts and real accounts including fictitious assets accounts, not yet written off, are never closed on the last day of the accounting period. These three types of accounts are shown as a statement called Balance Sheet. A Balance Sheet is also called a statement showing the sources and applications of funds.

Features of Balance Sheet : The features of a balance sheet are stated as under -

(a) Balance Sheet is a 'statement', not an 'account'. It has two sides, i.e., assets and liabilities. It has neither debit side nor credit side, as it is not an account.

(b) Balance Sheet is prepared and presented on a particular point of time or on a particular date but not over a period of time.

(c) It is a summary of balances of those ledger accounts which have not been closed by transfer to either Trading Account or Profit and Loss Account.

(d) Balance Sheet shows the assets and liabilities in a classified manner such as current and fixed assets and liabilities on a particular point of time.

Purpose of Preparing a Balance Sheet :

The purpose of preparing a balance sheet is to -

(i) ascertain the nature and value of assets of a business on a particular date,

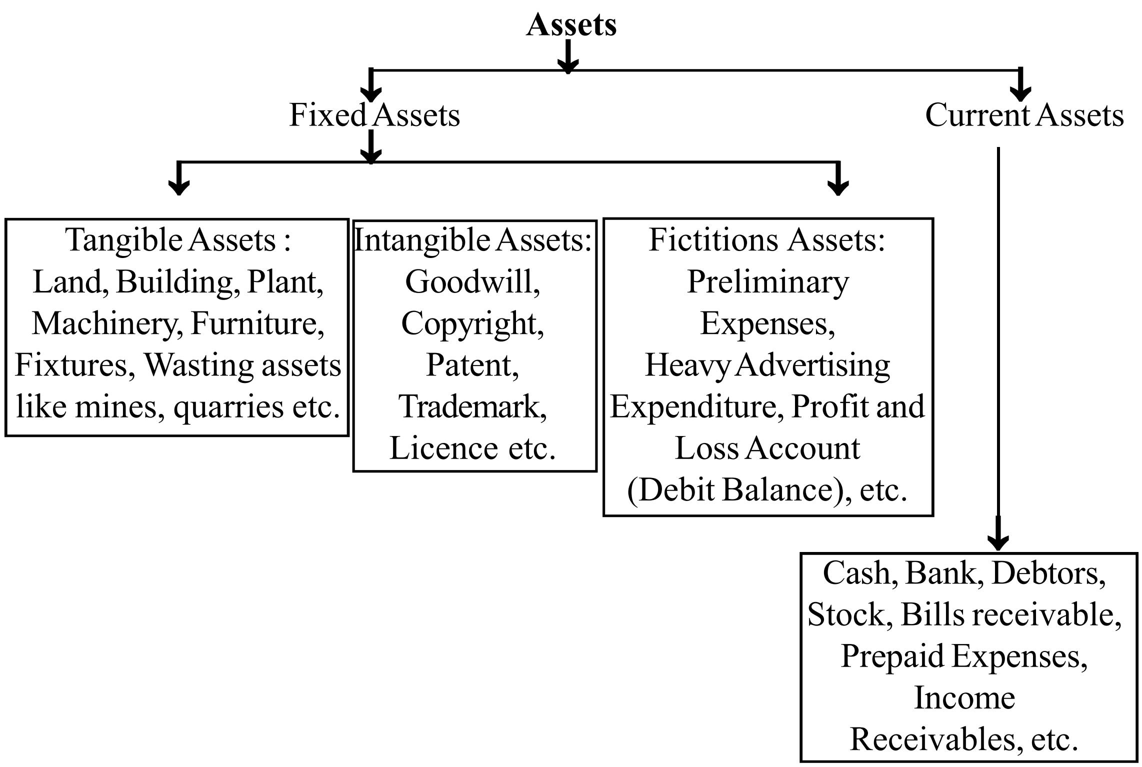
(ii) ascertain the nature and extent of liabilities of a business on the same date, and

(iii) ascertain the financial solvency of the business. If assets exceed the liabilities, the enterprise is financially sound and solvent. It can pay off the external liabilities on due date. On the other hand, if the liabilities exceed the assets, it is a situation of insolvency and the business cannot pay off the external liabilities fully.

Relevant items shown in a Balance Sheet :

Following items are generally shown in a balance sheet :

(i) Assets side - The debit balances of personal, real and fictitious assets accounts are not closed after the preparation of Trading Account and Profit and Loss, Accounts. These are to be shown as assets on 'Assets' side of the Balance Sheet. Classification of various assets shown in a Balance Sheet is given below:



Different kinds of assets are described below:

a) Fixed assets : The assets are acquired and held permanently with a view to carrying on the business. Such assets are land, building, plant, machinery, furniture, fixtures, mines, quarries, timber yards, etc. Fixed assets collectively are also known as "Block".

b) Current assets : Current assets are the assets which are likely to be converted into cash within a maximum period of one accounting year. These assets are held in the business in the form of cash or cash equivalents such as bank balances, bills receivable, debtors, stock, etc. Current assets can be realised to discharge the short term liabilities within one accounting period. Adequate current assets prove the short-term solvency of an organisation.

c) Intangible fixed assets : The assets which can neither be seen nor touched without having physical substance, are called intangible assets. The intangible assets held for use in production or supply of goods and services of a business enterprise for a long period of time, are called intangible fixed assets. Such assets are goodwill, copyright, patent, trademark, licence, etc.

d) Wasting assets : The fixed assets whose value are gradually reduced or which are physically depleted or exhausted in the course of regular use are called wasting assets. These assets are finally exhausted completely. Mines, quarries, oil wells, etc. come under this category of assets.

e) Investments : These are assets held by a business for earning income in the form of dividends, interests, rentals, capital appreciation etc. Investments may be made in Shares, Debentures, Bonds, Immovable Properties, etc. When investments are held for a short period, it is a short-term investment and treated as current asset. But when investment is held for a long period with a profit motive, it is a long term investment and treated as fixed asset.

f) Contingent assets : These assets are not in the immediate possession of the business and hence, not shown in the Balance Sheet. These assets may be acquired and possessed on the happening of an uncertain event in future. For example, claim for damages from the supplier for which the matter is subjudice in the court of law. If the judgement of the court goes in favour of the business enterprise, the claim for damages will be received in the form of a compensation in future. Such assets are shown as footnotes under the Balance Sheet.

g) Fictitious assets : Some assets are fictitious in nature and these assets are not virtual assets. These may be past accumulated losses or expenses incurred once in the life time of a business, etc. These losses and expenses are capitalised for the time being. Such assets are profit and loss account debit balance, preliminary expenses, heavy advertising expenditure, etc.

(ii) Liability Side

The credit balance of ledger accounts, i.e., personal accounts which are not closed after preparation of Trading Account and Profit and Loss Account, are called liabilities. These are shown in the 'liabilities' side of Balance Sheet. A classification of various liabilities shown in a Balance Sheet is given below:

Liabilities

- Fixed liabilities
  - Capital
- Longterm labilities
  - Long Term Loans, Debentures, etc.
- Current Labilities
  - Sundry creditors, out standing expenses, Income received in advance, Bills payable, short-term loans, Bank overdrafts, etc.

Liabilities are the claims of owners and outsiders on the assets of a business. The liabilities of a business are to be paid legally as and when they become due. The various liabilities are :

a) Fixed liabilities : The liability of the business is to pay the owner on the closure of the business. The capital invested by him may increase by the amount of profit earned or may decrease by the amount of loss suffered and the amount of drawing either in cash or in kind or in both. The liability of the business to the owner is called 'capital' which is payable only after the winding up of the business. This is why it is termed as fixed liability.

b) Long-term liabilities : A long term liability is one which is not payable within one accounting period. It is payable after more than 12 months from the date of a Balance Sheet. Long-term loan from financial institutions, debentures, etc are examples of long-term liability of a business. A long-term liability is also called non-current liability.

c) Current liabilities : A liability expected to be paid within one accounting period by the business, is called a current liability. Current liabilities are to be settled normally within 12 months from the date of Balance Sheet.Such liabilities are sundry creditors, bills payable, outstanding expenses, bank overdraft, income received in advance, etc.

d) Contingent Liability : The liability which may or may not arise in future, the occurrence of which depends on the happening of an uncertain event in future, is called a contingent liability. If the uncertain event occurs, the contingent liability becomes a liability, otherwise it is not a liability. As the contingent liability is not a real liability, it is not shown in the Balance Sheet. But it is shown as a footnote under the Balance Sheet.

Marshalling and Grouping of Assets and Liabilities

The presentation of groups of assets and liabilities in a Balance Sheet in an orderly manner is called 'marshalling and grouping' of assets and liabilities. The assets and liabilities are arranged either in order of liquidity or in order of permanence. Liquidity refers to the early convertibility of a current asset into cash and the urgency of payment of a current liability in cash or near cash. If order of liquidity is followed, Current assets are shown first followed by fixed assets and current liabilities are shown on the top of the Balance Sheet, the long-term liabilities being shown thereafter.

An example of the balance sheet arranged in order of liquidity, is given below:

Balance Sheet of ....

as on.....

Liabilities		Amount	Assets	Amount
Outstanding Expenses		XXX	Prepaid Expenses	XXX
Bills Payable		XXX	Cash in Hand	XXX
Sundry Creditors		XXX	Bills Receivable	XXX
Bank Overdraft		XXX	Debtors	XXX
Longterm Loan		XXX	Stock	XXX
Capital :			Furniture	XXX
Opening Balance	XXX		Plant & Machinery	XXX
Add / Less : Profit/Loss	XXX		Landand Building	XXX
Less : Drawings	XXX		Goodwill	XXX
	XXX	XXX		
Total		**XXX**	**Total**	**XXX**

In an order of permanence, the arrangement is reversed. The least liquid assets are shown at the top and the most liquid asset is shown at the bottom of the Balance Sheet. Goodwill is shown at the top, followed by land and buildings, plant and machinery etc, and cash is at the bottom of the Balance Sheet on the assets side. So also the least urgent liabilities for payment remain at the top of the Balance Sheet on the liability side.Capital (Owner's equity/liability) being least urgent for payment is shown at the top and current liability, outstanding expenses being most urgent for payment are shown at the bottom of the Balance Sheet on the liabilities side.

Proforma of Balance Sheet

A Balance Sheet may be presented either horizontally or vertically. The horizontal presentation of Balance Sheet is in the form of an 'account' In a sole-trading and partnership business, the Balance Sheet is presented horizontally or in the "T" shape. It has two sides, i.e., left hand side known as liabilities side and the right hand side known as assets side. Horizontal form of presentation of Balance Sheet is shown as above in page 30.

The vertical presentationof a Balance Sheet is in the form of a 'report'. Under this method of presentation, the items are presented in a "single column statement" in a meaningful sequence. The vertical presentation of Balance Sheet has been made compulsory for the company form of business under the Companies Act 2013. A model vertical form of Balance Sheet is shown below.

Vertical Form

Balance Sheet...............

	Particulars		(₹)	(₹)
A.	Sources of Funds :			
	(a) Proprietor's Funds			
	Capital in the beginning	XXX		
	Add : Net Profit	XXX		
	Less : Drawings	XXX		
	Less : Income Tax	XXX		
			XXX	
	(b) Longterm Loan		XXX	XXX
B.	Application of Funds :			
	(a) Networking Capital			
	(i) Current Assets :			
	Cash in Hand	XXX		
	Cash at Bank	XXX		
	Bills Receivable	XXX		
	Sundry Debtors	XXX		
	Stock	XXX		
	Prepaid Expenses	XXX		
	Income Receivable	XXX		
	Less: Current Liabilities		XXX	
	Accured Expenses	XXX		
	Income received in advance	XXX		
	Bank overdraft	XXX		
	Sundry Creditors	XXX		
	Bills Payable	XXX	XXX	XXX
	(b) Investments			XXX

(c) Fixed Assets :			
Goodwill	XXX		
Land and Building	XXX		
Plant and Machinery	XXX		
Patents and Trademark	XXX		
Furniture & Fittings	XXX		
			XXX

Distinction between Trial Balance and Balance Sheet

Followings are the points of distinction between Trial Balance and Balance Sheet :

Sl No.	Basis of Distinction	Trial Balance	Balance Sheet
1.	Format	It has two columns for recording debit and credit balances.	It has two columns for recording assets and liabilities.
2.	Contents	It contains real, personal and nominal accounts.	It contains only personal and real accounts.
3.	Objective	Its objective is to check the arithmetical accuracy of the recorded transactions.	Its objective is to ascertain the financial position of the business on a particular date.
4.	Compulsion	It is not compulsory to prepare.	It is compulsory to prepare.
5.	Opening stock	Opening stock is shown in Trial Balance.	Opening stock is not shown in Balance sheet.
6.	Closing stock	Generally, closing stock is not shown in Trial Balance except at the time of 'adjusted purchase'.	Closing stock is always shown on the asset side of Balance Sheet.
7.	Net Profit/Loss	It does not give information on net profit/loss.	It gives information on net profit/loss.
8.	Use by outsiders	It is of no use to outsiders.	It is of utmost use to creditors, bankers, tax authorities, etc.
9.	Order of presentation	There is no order in the presentation of items in the Trial Balance.	There must be an order in the presentationof items in Balance Sheet.

Distinction between Trading Account, Profit and Loss Account and Balance Sheet

Trading Profit and Loss Account and Balance Sheet are different from each other on the following points :

Sl. No.	Basis	Trading, Profit and Loss Account	Balance Sheet
1.	Nature	It is an account.	It is a statement.
2.	Objective	It is prepared to ascertain the financial performance (gross profit / gross loss and net profit / net loss during an accounting period.	It is prepared to ascertain the financial position on a particular date.
3.	Contents	All nominal accounts are recorded in this account.	All personal and real accounts are recorded in Balance sheet.
4.	Period	It is prepared for a particular accounting period.	This is prepared on a particular date.
5.	Balancing	It is balanced to show either profit or loss.	Balance sheet does not show any balance. Its two sides are tallied.
6.	Sides	It has two sides, i.e., debit and credit.	It has also two sides i.e., assets and liabilities.
7.	Manner of recording	All expenses are recorded on debit side and all incomes and revenues are recorded on credit side, prefixed by "To" and "By" respectively.	All real and personal accounts with debit balance are recorded on the assets side and only personal accounts with credit balances are recorded on the liabilities side without any prefix "To" and "By".

Illustrations 13

From the following Trial Balance, prepare the Trading and Profit and Loss Account of Messrs. Jaga Balia Garments for the year ending 31.03.2017 and Balance Sheet as on that date :

Particulars	(Dr.) (₹)	(Cr.) (₹)
Opening stock	55,000	--
Purchases	3,50,000	--

Sales	--	4,26,000
Purchases Return	--	2,000
Sales Return	2,000	--
Capital	--	3,00,000
Commission	--	4,000
Sundry Creditors	--	1,00,000
Bank Overdraft	--	28,000
Cash in hand	32,000	--
Sundry Debtors	1,40,000	--
Furniture	1,28,000	--
Machinery	60,000	--
Carriage on Purchases	12,000	--
Wages	7,000	--
Rent	10,000	--
Bad debts	16,000	--
Drawings	18,000	--
Stationery	6,000	--
Travelling Expenses	8,000	--
Insurance	10,000	--
Discount	3,000	2,000
Office Expenses	5,000	--
Total	**8,62,000**	**8,62,000**

Closing stock as on 31st March 2017 was valued at ₹64,000.

Solution :

Trading, Profit and Loss Account of Messers Jaga Balia Garments for the year ending 31st March 2017

Dr. Cr.

Particulars		(₹)	Particulars		(₹)
	(₹)		By Sales	4,26,000	
To Opening Stock		55,000	Less		
To Purchases	3,50,000		Sales Return	2,000	4,24,000
Less			By Closing Stock		64,000
Purchase return	2,000	3,48,000			
To Carriage on Purchases		12,000			
To Wages		7,000			
To Gross Profit c/d		66,000			
		4,88,000			4,88,000
To Rent		10,000	By Gross Profit b/d		66,000
To Bad debts		16,000	By Commission		4,000

To Stationery	6,000	By Discount	2,000
To Travelling Expenses	8,000		
To Insurance	10,000		
To Discount	3,000		
To Office Expenses	5,000		
To Net Profit transferred to Capital A/c	14,000		
	72,000		72,000

Balance Sheet of Messrs Jaga Balia Garments
as on 31 March 2017

Liabilities		Amount	Assets	Amount
Current Liabilities :			Current Assets :	
Bank Overdraft		28,000	Cash in Hand	32,000
Sundry Creditors		1,00,000	Debtors	1,40,000
Capital :			Closing Stock	64,000
Opening Balance	3,00,000		Fixed Assets :	
Add :			Funiture	1,28,000
Net Profit	14,000		Machinery	60,000
	3,14,000			
Less :				
Drawings	18,000			
		2,96,000		
		4,24,000		**4,24,000**

Illustrations 14

From the following Trial Balance of Mr Jayant, Prepare the Trading, Profit and Loss Account for the year ending 31st December 2016 and Balance Sheet as on that date :

Particulars	(Dr.) **(₹)**	(Cr.) **(₹)**
Bills Payable	--	6,600
Sundry Creditors	--	99,000
Sales	--	6,32,000
Purchases	5,27,000	--

Loan from Bank	--	50,000
Capital	--	5,54,000
Returns outward	--	5,000
Discount	3,000	2,000
Bad debts Recovered	--	4,500
Bad debts	4,000	--
Fixed Assets	4,50,000	--
Opening stock	80,000	--
Sundry Debtors	1,50,000	--
Bills Receivale	10,000	--
Investments	60,000	--
Cash in Hand	5,000	--
Returns Inward	10,000	--
Carriage	2,000	--
Drawings	19,000	--
Duty on Purchases	1,600	--
Primary Packing Charges	2,000	--
Rent	3,000	--
Insurance	3,400	--
Office Expenses	15,200	--
Interest Bank Loan	2,400	--
Delivery Van Expenses	7,000	--
Income Tax	3,000	--
Goods and Service Tax (GST)	--	5,500
Loose Tools	4,000	--
Apprentice Premium	--	3,000
Total	**13,61,600**	**13,61,600**

Closing stock was ₹90,000.

Note: (a) Goods and services Tax : Goods Services Tax (GST) is replacing the Value Added Tax (VAT) and Central and State Sales Tax Excise Duty from the Financial year 2017-18. If Goods and Services Tax is collected and paid to the Central and State Government, it is to be shown under the debit column of Trial Balance and will be debited to Profit and Loss Account as an expenses. But when GST is collected and not paid to the Government, it is a liability of the business and shown under the credit column of the Trial Balance and will be shown in the Balance Sheet as a liability. (b) Income Tax - It is a personal expenditure of the proprietor levied by the Central Govt on his personal income. If it is shown in the debit column of Trial Balance, it is treated as drawings of the proprietor and debited to his capital Account, i.e; to be deducted from his capital in the Balance Sheet.

Trading, Profit and Loss Account of Mr. Jayant
for the year ending 31st December 2016

Liabilities		Amount	Assets		Amount
To Opening Stock		80,000	By Sales	6,32,000	
To Purchases	5,27,000		Less :		
Less :			Returns		
Returns Outward	5,000	5,22,000	Inward	10,000	6,22,000
To Duty on Purchases		1,600	By Closing Stock		90,000
To Carriage		2,000			
To Primary Packing Charges		2,000			
To Gross Profit c/d		1,04,400			
		7,12,000			7,12,000
To Bad debts		4,000	By Gross Profit b/d		1,04,400
To Rent		3,000	By Discount		2,000
To Insurance		3,400	By Bad debts Recovered		4,500
To Office Expenses		15,200	By Apprentice Premium		3,000
To Discount		3,000			
to Interest on Bank Loan		2,400			
To Delivery Van Expenses		7,000			
To Net Profit transferred to Capital A/c		75,900			
		1,13,900			**1,13,900**

Balance Sheet of Mr. Jayant
as on 31st December 2016

Liabilities		Amount	Assets	Amount
Capital :			Fixed Assets :	4,50,000
Opening Balance	5,54,000		Investments :	60,000
Add : Net Profit	75,900		Current Assets :	
Less : Drawings	19,000		Cash in Hand	5,000
Less : Income Tax	3,000	6,07,900	Sundry Debtors	1,50,000
Loans :			Bills Receivable	10,000
Loan from Bank		50,000	Loose Tools	4,000
Current Liabilities :			Closing Stock	90,000
Bills payable		6,600		
Sundry Creditors		99,000		
Goods and Services Tax		5,500		
		7,69,000		**7,69,000**

Illustrations 15

From the following Trial Balance of Ruma Textiles, as on 30th September 2016, prepare Trading and Profit and Loss Account for the year ending 30th September 2016 and Balance Sheet as on that date :

Particulars	Dr. (₹)	Cr. (₹)
Capital	--	1,00,000
Opening Stock	20,000	--
Purchases	1,78,000	--
Carriage Inwards	2,500	--
Sales	--	2,28,000
Salaries	20,000	--
Commission	--	13,000
Wages	8,000	--
Interest on Investments	--	7,000
Creditors	--	28,000
Bills Payable	--	2,300
Rent and Taxes	3,800	--
Repairs	4,000	--
Telephone Charges	2,400	--
Legal Expenses	2,300	--
Cash in Hand	12,000	--
Sundry Debtors	30,000	--
Machinery	50,000	--
Investments	40,000	--
Drawings	18,000	--
Bank overdraft	--	10,000
Miscellaneous Incomes	--	2,700
	3,91,000	**3,91,000**

Closing stock was valued at ₹30,000.

Solution :

Trading and Profit and Loss Account of
Ruma Textiles for the year ending 30th September 2016

Dr. Cr.

Particulars	Amount(₹)	Particulars	Amount (₹)
To Opening Stock	20,000	By Sales	2,28,000
To Purchases	1,78,000	By Closing Stock	30,000
To Carriage Inwards	2,500		
To wages	8,000		
To Gross Profit c/d	49,500		
	2,58,000		**2,58,000**
To Salaries	20,000	By Gross Profit b/d	49,500
To Rent and Taxes	3,800	By Commission	13,000
To Repairs	4,000	By Interest on Investment	7,000
To Telephone Charges	2,400	By Miscelloneous Incomes	2,700
To Legal Expenses	2,300		
To Net Profit transferred to Capital A/c	39,700		
	72,200		**72,200**

Balance sheet of Ruma Textiles
as on 30th September 2016

Dr. Cr.

Liabilities		Amount	Assets	Amount
Bills Payable		2,300	Cash in Hand	12,000
Creditors		28,000	Sundry Debtors	30,000
Bank Overdraft		10,000	Closing Stock	30,000
Capital :			Investments	40,000
Opening balance	1,00,000		Machinery	50,000
Add : Net Profit	39,700			
Less :	1,39,700			
Drawings	18,000	1,21,700		
		1,62,000		**1,62,000**

1.5 PREPARATION OF FINANCIAL STATEMENTS WITH ADJUSTMENTS

In the previous section, we learnt about the preparation of simple final accounts without any adjustments. In the absence of any business complexities, simple final accounts can be prepared. But in fact, during the normal business operations, one will come across the complexities as the preparation of final account is based on accrual basis of accounting It is necessary to consider all the incomes and expenses relating to the year for ascertaining true profit or loss and financial position of a business. Revenue recognition concept requirs that the revenue should be recognised in the period in which the sale is deemed to have taken place. Again matching concept requires that expenses should be recognised in the same period in relation to the revenues. Expenses recognition is linked to revenue recognition during a particular accounting period.

According to accrual concept of accounting the final accounts are to be prepared by taking into account the incomes earned, not the incomes received in cash and the expenses incurred, not the expenses paid in cash. Adjustments are made in final accounts for all those items which have not been included in the trial balance. It implies that certain expenses of the current period are to be recorded which are incurred but not yet paid; and certain incomes of the current period are to be recorded which are earned but not yet received.

The rationale of adjustment in final accounts is that some receipts of incomes and payments of expenses in cash during the current year may partially relate to the previous year or to the next year. Also there may be some revenues and expenses relating to the current year which are still to be brought into the books of account. For example, outstanding expenses (expenses incurred but not paid), accrued incomes (incomes earned but not received), prepaid expenses (expenses paid but partially relate to next year), incomes received in advance (income received in the current year but partially relate to next year), non-cash items like depreciation on fixed assets, interest on capital, interest on drawings), anticipated losses (like provision for bad debts, provision for discount on debtors), anticipated gains (like reserve for discount on creditors), need adjustment in the final account to ascertain true profit/loss and the correct financial position.

1.5.1 Important Adjustments

The various adjustments made in final accounts by means of journal entries at the end of the trading period called adjustment entries. The items, which need adjustments, are :

(a) Closing Stock

(b) Outstanding expenses

(c) Prepaid expenses

(d) Accrued Income

(e) Income received in advance/Unearned income

(f) Depreciation

(g) Opening stock

(h) Interest on Capital

(i) Interest on drawings

(j) Interest on loan

(k) Bad detbts

(l) Provision for Bad and Doubtful debts

(m) Provision for Discount on Debtors

(n) Reserve for Discount on Creditors

(o) Loss by accident (Abnormal Loss)

(p) Charity in the form of goods

(q) Distribution of goods as free sample

(r) Goods taken by the owner for personal use.

(s) Manager's commission

(t) Deferred revenue expenditure

(a) Closing Stock :

Closing stock is the stock which remains unsold at the end of the current accounting period and is carried forward to the next accounting period as opening stock. Closing stock is valued at cost or market price which ever is lower as per the principle of prudence and conservatism concept. In case of manufacturing organisations, closing stock consists of finished products, work-in-progress and raw materials. While, in case of trading organisations, it is only of one type, i.e. the products that is traded in. It is ascertained only at the end of the accounting period and therefore, it is not included in trial balance and shown as an additional information below the trial balance. The following adjustment entry is passed for closing stock :

Closing Stock A/c.... Dr.

To Trading A/c

(Being closing stock transferred to Trading Account)

Closing stock is shown on credit side of Trading Account and on the asset side of the Balance Sheet as a current asset.

If closing stock is given in the trial balance, no adjusting entry is required to be passed, as it has already been taken into account for computing the amount of Adjusted purchase or cost of goods sold. Closing stock will be shown as a current asset in the Balance Sheet only and not in the Trading Account.

Illustration 16

Closing stock on 31st December 2016 amounting ₹15,000 was shown outside the Trial Balance. Pass an Adjustment entry and show how this will appear in final accounts if accounts are closed on 31st December every year.

Solution :

Adjustment Entry

Particulars		Dr. ₹	Cr. ₹
Closing Stock A/c	Dr	15,000	
To Trading A/c			15,000
(Being closing transferred to Trading A/c)			

Trading Account

for the Year ending 31.12.2016

Dr. Cr.

Particulars	₹	Particulars	₹
		By Closing Stock	₹15,000

Balance Sheet

as on 31.12.2016

Liabilities	Amount ₹	Assets	Amount ₹
		Current Assets : Closing Stock	 15,000

(b) Outstanding Expenses :

Outstanding expenses refer to those expenses which are incurred but not paid during the accounting period. The benefit of those expenses have already been derived by the business during the current accounting period. Such expenses must be taken into the books of account in order to find out the true profit/loss and show the true financial position of the business. Outstanding expenses are normally incurred for salaries, wages, rent and utility expenses like water, electricity, cess, ctc. The following adjustment entry is passed for recording outstanding expenses :

(Relevant) Expenses A/c Dr.

To Outstanding Expenses A/c

(Being outstanding expenses brought into books)

Accounting Treatment

(i)	Treatment in Trading A/c (If it is a direct expense)	Added to the relevant expenses i.e. suppose wages on the debit side.
(ii)	Treatment in P & L A/c (If it is an indirect expense)	Added to the relevant expenses like salary on the debit side.
(iii)	Treatment in Balance Sheet.	Shown on the liabilities side as a current liabilities.

If any item of outstanding expenses already appears in the Trial Balance, then adjustment entry is not required to be passed. Because these expenses have already been taken into account for recording the amounts. Such outstanding expenses will be shown on the liability side of the Balance Sheet as a current liability and it will never be shown in either Trading Account or Profit and Loss Account (Income Statement).

Illustraion 17

Rent paid for 10 months @₹5,000 during the year 2016-17. Pass an adjustment entry and show how this will appear in final accounts if books are closed on 31st March every year.

Solution :

Adjustment Entry

Particulars		Dr. (₹)	Cr. (₹)
Rent A/c	Dr	10,000	
To Outstanding Rent A/c			10,000
(Being rent not paid for two months)			

Profit and Loss Account
for the year ending 31.03.2017

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Rent A/c (Paid) 50,000 Add : Outstanding 10,000	60,000		

Balance Sheet as on 31st March 2017

Liabilities	(₹)	Assets	(₹)
Current Liabilities : Outstanding Rent	10,000		

(c) Prepaid Expenses :

Prepaid expenses refer to those expenses which have been paid in advance but the benefits are not received during the period. These are the expenses paid in advance in the current accounting period, but their benefit will be realised in the next accounting period. The unexpired (prepaid) part of these expenses will be taken over to the next accounting year in order to get the correct amount of profit of the current year and true financial position of the business. The adjustment entry to be passed for recording the prepaid expenses is as follows :

Prepaid Expenses A/c Dr

To (Relevant) Expenses A/c

(Being prepaid expenses brought into books)

Accounting Treatment

(i)	Treatment in Trading A/c (If it is a direct expense)	Deducted from the relevant Expense say wages on the debit side.
(ii)	Treatment in P & L A/c (If it is an indirect expense)	Deducted from relevant expense, i.e., Insurance on the debit side.
(iii)	Treatment in Balance Sheet	Shown on the assets side as a current asset.

If any item of prepaid expenses already appears in the Trial Balance then adjustment entry is not required to be passed. Because this expense has already been excluded from the relevant expense. Such prepaid expense will be shown as a current asset in the Balance sheet only and not in the Income Statement.

Illustration 18

Salary paid in advance for one month @ A10,000 per month in the year ending 31.12.2016. Pass an adjustment entry and show how this will appear in final accounts.

Solution :

Adjustment Entry

Particulars	Dr.	Cr.
Prepaid Salary A/c Dr. To Salary A/c	10,000	 10,000

Profit and Loss Account for the year ending 31st December 2016

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Salary 1,30,000 (Paid) Less: Prepaid <u>10,000</u>	 1,20,000		

Balance Sheet as on 31st December 2016

Liabilities	(A)	Assets	(A)
		Current Assets : Prepaid Salary	 10,000

(d) Accrued Income : The income which has been earned during the current year and is due, but has not been received in the current accounting period, is called accrued income. Income like interest on investment, rent receivable, commission, etc. are normally earned, due in a year but received in the following year. Such incomes require adjustment to get a true picture of the financial statements. The treatment of such incomes in accounting is based on the accrual concept. The adjustment entry to be passed for recording the accrued income is as follows :

Accrued Income A/c Dr.

To (Relevant) Income A/c

(Being income earned, due but not received yet)

Accounting Treatment

(i) Treatment in P & L A/c	Accrued Income is added to the relevant income on the credit side.
(ii) Treatment in Balance Sheet	Shown on the assets side as a current asset.

If accrued income appears in the trial balance, then adjustment entry is not required to be passed as these incomes have already been taken into account while recording such income. Such accrued income will be shown as a current asset in Balance sheet and not to be shown in the Income Statement.

Illustration 19

An amount of A20,000 received on account rent for the year ending 31st December 2016 @ A2,000 p.m. Pass an adjusting entry and show it in the final accounts.

Solution :

Adjustment Entry

Particulars		Dr. (A)	Cr. (A)
Accrued Rent A/c	Dr.	4,000	
To Rent receivable A/c			4,000
(Being rent earned, due but not received yet)			

Profit and Loss Account
for the year ending 31.12.2016

Dr. Cr.

Particulars	(A)	Particulars	(A)
		By Rent (Received) 20,000 Add : Accrued 4,000	24,000

Balance Sheet as on 31.12.2016

Liabilities	(A)	Assets	(A)
		Current Assets : Accrued Rent (Receivable)	4,000

(e) Income received in Advance/Unearned Income :

The income received in advance or unearned income is one which is received but not earned during the current accounting period. It is that part of the Income which has been received before the sale of goods or services rendered. The unearned income relates to the next year or any future year but has been received during the current year. The adjustment entry to be passed for recording the unearned income is:

Relevant Income A/c Dr.
To Income received in Advance A/c
or
To Unearned Income A/c
(Being Income received in advance recorded)

Accounting Treatment

(i) Treatment in P& L A/c	Deducted from the relevant Income on the credit side.
(ii) Treatment in Balance Sheet	Shown on the liabilities side as a current liability

If unearned income already appears in the Trial Balance, no adjustment entry is required as it has already been deducted from the relevant income. Such accrued income will be shown as a current liability in the Balance Sheet only and not to be shown in the Income Statement.

Illustration 20

X & Co. received a rent of A13,000 from his tenant during the year ending 31st March 2017 out of which A1000 belongs to the next year. Pass the necessary adjustment entry and show it in the Income Statement and Balance Sheet.

Solution :

Adjustment Entry

Particulars	Dr. (A)	Cr. (A)
Rent A/c Dr.		1,000
To Unearned Rent A/c		1,000
(Being unearned rent recorded)		

Profits Loss Account for the year ending 31st March 2017

Dr. Cr.

Particulars	(A)	Particulars	(A)
		By Rent Received 13,000	
		Less : Unearned 1,000	12,000

Balance Sheet as on 31st March 2017

Liabilities	(A)	Assets	(A)
Current Liabilities :			
Unearned Rent	1,000		
(OR Rent Received in Advance)			

(f) Depreciation : Depreciation is the charge against profit for the use of fixed assets in the business. The value of fixed assets decreases due to wear and tear, passage of time, obsolescence etc. Depreciation is treated as a business expense for income generation like other expenses. The adjustment entry for recording depreciation is :

Depreciation A/c Dr.
To Fixed Assets A/c
or
To Provision for Depreciation A/c
(Being depreciation provided on fixed asset)

According Treatment

(i) Treatment in P& L A/c	Shown on the debit side like any other expenses.
(ii) Treatment in the Balance Sheet	Shown on the asset side by deduction from the value of relevant fixed asset.

If depreciation already appears in the trial balance, then no adjustment entry is required to be passed as it has already been recorded and deducted from the relevant fixed asset. Only such depreciation will be shown in debit side of the Income Statement and not in the Balance sheet. When fixed assets are to be shown at their original cost in the Balance Sheet, depreciation will not be deducted from the relevant fixed asset. Provision for Depreciation Account will be opened and shown in the liability side of the Balance sheet.

Illustration 21

On 1.7.2016 a machinery was purchased at a cost of A1,00,000. Depreciation is to be charged @10% per annum. The books are closed on 31st December 2016. Pass necessary adjustment entry and show in the final accounts.

Solution :

Adjustment Entry

Particulars	Dr. A	Cr. A
Depreciation A/c Dr To Machinery A/c (Being depreciation provided on machinery)	5,000	 5,000

Profit and Loss Account
for the year ending 31st December 2016

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Depreciation	5,000		

Balance sheet as on 31st December 2016

Liabilities	(A)	Assets		(A)
		Fixed Assets :	(A)	
		Machinery	1,00,000	
		Less : Depreciation	5,000	
				95,000

(g) Opening Stock : Opening stock normally appears in trial balance and is debited to Trading Account. In some cases, opening stock appears outside the trial balance as an information and closing stock and Adjusted Purchases account appear in the trial balance simultaneously. It is implied from the situations that the opening stock is added to and closing stock is deducted from the net purchases in order to arrive at the Adjusted Purchases Account. As such opening stock appearing outside trial balance will not be taken for adjustment and it is given for the sake of information.

(h) Interest on Capital : The proprietor should charge the interest on capital to profit at a normal rate in order to arrive at the real profit. As a man of prudence, the proprietor should consider the interest on the capital invested by him in the business. Interest on capital of the proprietor is a notional expense and should be charged to profit. The adjustment entry is as follows :

Interest on Capital A/c Dr.

To Capital A/c

(Being interest on capital allowed)

Accounting Treatment

(i) Treatment in Profit and Loss Account	Debited to Profit and Loss Account as an expense of the business.
(ii) Treatment in Balance Sheet	Added to Capital as a gain to the proprietor on the liabilities side.

(i) Interest on Drawings : Sometimes the proprietor withdraws cash or goods from the business for his personal use. Such withdrawals by the proprietor is called drawings and interest on drawings is charged on the proprietor. It is treated as a notional income of the firm. The adjustment entry is as given below :

Drawings A/c Dr.

To Interest on Drawings A/c

Accounting Treatment

(i)	Treatment in Profit and Loss Account.	Credited to Profit and Loss Account as an income of the firm.
(ii)	Treatment in Balance Sheet.	Added to Drawings and deducted from Capital in the liabilities side of Balance Sheet.

Interest on drawings is calculated at a fixed rate from the date of drawings to the end of the accounting period. But practically, all the drawings are made on different dates as and when the proprietor requires money or goods for personal use. That is why, interest is calculated by taking the individual date of drawings by applying the product method. But when the date of drawings are not available for each drawings, interest on total drawings is calculated for 6 months.

(j) Interest on Loan : The proprietor borrows money for the purpose of expansion for a long period from outside persons, banks and financial institutions. Loan is a liability of the firm and the interest on such loan is an expense. Normally the interest on such loan remains unpaid at the end of the accounting period, so interest on loan remains outstanding.

Sometimes, the firm advances loans to emplolyees and other outside persons. The loan, in these cases, is an asset of the firm and any interest on such loan is treated income of the firm.

The adjustment entry for interest on loan (as liability) is as follows :

Interest on Loan A/c Dr.

To Loan A/c

(Being interest on loan provided for)

The reverse adjustment entry is passed when the firm advances loan as an asset.

Accounting Treatment

(i)	Treatment in P & L A/c	Shown on the debit side of P &L A/c (as an expense) Shown on the credit it side of P&L A/c (as an income)
(ii)	Treatment in the Balance sheet	(a) Shown in liabilities side of Balance Sheet as current liability. (b) Shown in the assets side of Balance Sheet as current asset.

Illustration 22

The proprietor S. Das charges interest @6% on his capital of A2,00,000 for the accounting year ending 31.03.2017. Make necessary accounting treatment in the books of S. Das.

Adjustment Entry

Particulars	Dr. A	Cr. A
Interest on Capital A/c Dr. To Capital A/c (Being interest on capital provided)	12,000	12,000

Profit and Loss Account
for the year ending 31.03.2017

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Interest on capital A/c	12,000		

Balance Sheet as on 31st March 2017

Liabilities	(A)	Assets	(A)
(A) Capital 2,00,000 Add : Interest on Capital 12,000	2,12,000		

Illustration 23

The capital and drawings of a soletrader Mr. A given in his trial balance are A2,00,000 and A10,000 respectively as on 31.12.2016. He decided to charge interest on drawings A600 for the accounting period ending 31.12.2017. Pass necessary adjustment entry, show them in Final Accounts.

Solution :

Adjustment entry

Particulars		Dr. A	Cr. A
Drawing A/c	Dr.	600	
To Interest n Drawings A/c			600
(Being Interest charged on drawings)			

Profit and Loss Account
of Mr. A for the year ending 31.12.2016

Dr. Cr.

Particulars	(A)	Particulars	(A)
		By Interest on Drawings A/c	600

Balance Sheet of Mr. A as on 31.12.2017

Liabilities		(A)	Assets (A)
	(A)		
Capital	2,00,000		
Less : Drawings 10,000			
Add: Interest 600			
	10,600	1,89,400	

Illustration 24

A borrowed from his wife A1,00,000 @$7^1/_2$% interest per annum at the begining of the year ending on 30th June 2017 Show the adjustment entry for the interest on drawing and treatment in final accounts.

Solution :

Adjustment entry

Particulars	Dr. A	Cr. A
Interest on Loan A/c Dr.	7,500	
To Mrs. A's Loan A/c		7,500
(Being Interest on loan provided)		

Profit and Loss Account
for the year ending 30.06.2017

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Interest on Loan	7,500		

Balance Sheet as on 30.06.2017

Liabilities		(A)	Assets	(A)
Mrs. A's Loan :	1,00,000			
Add : Interest on Loan	7,500			
		1,07,500		

Illustration 25

From the trial balance of Mr. X, a sole trader as on 30.06.2017, prepare Trading, Profit and Loss Account for the yer ending 30.06.2017 and the Balance sheet as on that date :

Trial Balance as on 30.06.2017

Particulars	Dr. A	Cr. A
Opening Stock	70,000	--
Capital	--	2,00,000
Drawings	20,000	--
Fixed Assets	4,00,000	--
Purchases and sales	7,00,000	13,00,000

Sales Return	15,000	--
Purchases Return	--	10,000
Carriage	28,000	--
Wages	50,000	--
Salaries	30,000	--
Rent	--	20,000
Insurance	3,000	--
Audit Fee	1,500	--
Debtors and creditors	80,000	1,00,000
Bills Receivable and Bills Payable	60,000	40,000
Printing & Stationary	3,000	--
Commission	--	1,000
Cash in Hand	20,000	--
Cash at Bank	3,38,000	--
Bank Loan	--	1,50,000
Interest on Bank Loan	2,500	--
	18,21,000	**18,21,000**

Additional Information :

1) Closing stock was A90,000
2) Rent received in advance A2,000
3) Commission due A200.
4) Depreciation to be provided @10% on fixed assets.
5) Interest on Bank Loan outstanding A500
6) Allow 8% interest on capital
7) Charge A2,000 as interest on drawings
8) Wages outstanding A2,000

Solution :

Trading and Profit and Loss Account of Mr. X
for the year ending 30.06.2016

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Opening Stock	70,000		
To Purchases 7,00,000		By Sales 13,00,000	
Less:			
Purchases Return <u>10,000</u>	6,90,000	Less: Sales Return <u>15,000</u>	12,85,000

			By Closing Stock		90,000
To Carriage		28,000			
To Wages	50,000				
Add : Wages					
outstanding	2,000	52,000			
To Gross Profit c/d		5,35,000			
		13,75,000			**13,75,000**
To Salaries		30,000	By Gross Profit b/d		5,35,000
To Insurance		3,000	By Commission	1,000	
To Audit fee		1,500	Add: Accrued Commission	200	1,200
To Interest Bank on Loan	2,500				
Add : Outstanding Interest	500	3,000	By Rent	20,000	
To Printing and Stationary		3,000	Less :		
To Depreciation fixed assets		40,000	Rent received in Advance	2,000	18,000
To Interest on Capital		16,000	By Interest on Drawings		2,000
To Net Profit transferred					
to Capital A/c		4,59,900			
		5,56,200			**5,56,200**

Balance Sheet of Mr. X as on 30.06.2017

Liabilities		Amount (A)	Assets		Amount (A)
Capital	2,00,000		Fixed Assets	4,00,000	
Add : Interest	16,000		Less : Depreciation	40,000	3,60,000
Net Profit	4,59,700		Closing Stock		90,000
Less :	6,75,700		Accrued Commission		200
Drawings	20,000		Bills Receivable		60,000
	6,55,700		Debtors		80,000
Interest on drawings	2,000	6,53,700	Cash at Bank		3,38,000
Bank Loan	1,50,000		Cash in Hand		20,000
Add : Interest					
outstanding	500	1,50,500			

Rent Received in Advance	2,000	2,000		
Creditors		1,00,000		
Bills Payable		40,000		
Wages outstanding		2,000		
		9,48,200		**9,48,200**

(k) Bad Debts : Finished goods are sold to the customers both in cash and on credit. The customers to whom the goods sold on credit are called debtors. Sometimes the amount due from the customers could not be recovered/realised and becomes bad. The reasons of debts being bad may be death or insolvency of the customers or any other reasons. As such, bad debt is the amount of unrealised debt due from the customers. The adjustment entry for bad debts is as follows :

Particulars		Dr. A	Cr. A
Bad debts A/c	Dr.	7,500	
To Debtors A/c			7,500
(Being bad debts provided for)			

Accounting Treatment		
(i)	Treatment in P & L A/c	Shown on the debit side as a loss
(ii)	Treatment in the Balance Sheet	Shown on the asset side of the Balance Sheet by way of deduction if bad debt is given outside the Trial Balance. If baddebt is given inside the Trial Balance, it should not be taken to Balance Sheet.

Illustration 26

Out of A50,000 total debtors, A2,000 became bad because of the insolvency of one of the debtors. Pass an adjustment entry and show how this will be treated in final accounts.

Solution :

Adjustment Entry

Particulars		Dr. A	Cr. A
Bad debts A/c	Dr.	2,000	
To Sundry Debtors A/c			2,000
(Being bad debts provided for)			

P & L A/c for the year ending 31.12.20.....

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Bad Debts	2,000		

Balance Sheet as 31.12.20....

Liabilities	Amount (A)	Assets		Amount (A)
		Sundry Debtors	50,000	
		Less :		
		Bad Debts	2,000	48,000

When bad debts appear in the trial balance, these should not be deducted from sundry debtors in the Balance Sheet. In these cases, bad debts will be debited to Profit and Loss A/c. But when bad debts are given as additional information, then only the bad debt is treated as additional/further bad debt and deducted from sundry debtors in the Balance Sheet and shown in the debit side of Profit and Loss Account.

(l) Provision for Bad and Doubtful Debts : Normally, the debtors of the trader are divided into three groups, i.e., good, doubtful and bad. A part of total debtors are good and there is certainty of their realisation, and some debtors are doubtful of their realisation and some other debtors are bad which cannot be realised. After deducting the bad debts from the total debtors, the remaing debtors could not be taken as good debtors. Therefore, a provision for bad and doubtful debts should be made on these debtors by means of a predetermined percentage/rate on the net debtors. If some of the net debtors (Total Debtors less bad debts) do not pay the dues in future, then the loss can be recovered from this provision. The adjustment entry for provision for bad and doubtful debt is as follows :

Profit and Loss A/c Dr.

To Provision for Bad Doubtful Debts A/c

(Being provision for bad and doubtful debts created)

Accounting Treatment

(i) Treatment in P & L A/c	Shown on the debit side as a separate item like any other expense/loss.
(ii) Treatment in Balance sheet	Shown on the Asset side by way of deduction from net debtors.

Illustration 27

An extract of a Trial Balance as on 31.03.2015, show sundry debtors at A52,000 and bad debts at A1,000. Besides it is revealed that after preparation of Trial Balance, a debtor owing A2,000 died and nothing could be recovered from him. It is also decided to create a provision of 5% on debtors for doubtful debts.

Pass the necessary journal entries and show the relevant ledger accounts along with final accounts.

Solution :

Particulars	L.F.	Dr. A	Cr. A
Bad Debts A/c Dr.		2,000	
To Sundry Debtors A/c			2,000
(Being the amount bad now written off)			

Profit an Loss A/c Dr.		3,000	
To Bad Debts A/c			3,000
(Being transfer of bad debts to P&L A/c)			
Profit & Loss A/c Dr.		2,500	
To Provision for Bad and doubtful debts A/c			2,500
(Being the provision created for doubtful debts on {(52,000-2000)×5%}			

Sundry Debtors A/c

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Balance b/d	1,000	By profit and loss A/c (transferred)	3,000
To Sundry Debtors A/c	2,000		
	3,000		3,000

Provision for Bad and Doubtful Debts Account

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Balance c/d	2,500	By profit and loss A/c	2,500
	2,500		2,500
		By Balance b/d	2,500

Profit and Loss Account
for the year ending 31.12.2015

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Bad Debts 1,000 Add: Further Bad Debts 2,000	3,000		
To Provision for Bad and Doubtful Debt A/c	2,500		

Balance Sheet as on 31.12.2015

Liabilities	Amount (A)	Assets		Amount (A)
		Current Assets :		
		Sundry Debtors	52,000	
		Less :		
		Further Bad Debts	2,000	
		Less :	50,000	
		Provision created	2,500	
				47,500

Illustration 28

Following balances have been extracted from the Trial Balance as on 31.12.2016 :

Particulars	Debit A	Credit A
Sundry Debtors	52,000	
Bad Debts	1,000	
Provision for Bad and Doubtful Debts		1,500

Additional Information :

(i) Additional Bad Debts A2,000

(ii) Create a provision for doubtful debts @5% on debtors.

Pass the necessary jourbal entries and prepare relevant ledger accounts and show them in final accounts.

Solution :

Journal

Particulars	L.F.	Dr. A	Cr. A
Bad Debts A/c Dr.		2,000	
To Sundry Debtors A/c			2,000
(Being the additional bad debts written off)			

Provision for Bad and Doubtful Debts A/c Dr. To Bad Debts A/c (Being the bad debts transfered to provision for Bad an Dobtful Debts A/c)		3,000	3,000
Profit and Loss A/c Dr. To Provision for Bad and Doubtful Debts A/c (Being the provision for Bad debts credited and charged to P&L A/c)		4,000	4,000

Sundry Debtors A/c

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Balance b/d	52,000	By Bad Debts A/c	2,000
		By Balance c/d	50,000
	52,000		52,000
To Balance b/d	50,000		

Bad Debts A/c

Particulars	Amount (A)	Particulars	Amount (A)
To Balance b/d	1,000	By Provision for Bad	
To Sundry Debtors A/c	2,000	and Doubtful Debts A/c (transferred)	3,000
	3,000		3,000

Provision for Bad and Doubtful Debts Account

Dr. Cr.

Particulars	Amount (A)	Particulars	Amount (A)
To Bad Debts A/c	3,000	By Balance b/d	1,500
To Balance c/d $\{(52{,}000-2000)\times\frac{5}{100}\}$	2,500	By Profit and Loss A/c	4,000
	5,500		5,500
		By Balance b/d	2,500

Profit and Loss Account
for the year ending 31.12.2016

Dr. Cr.

Particulars		(A)	Particulars	(A)
To Provisional for Bad Debts A/c:				
Bad Debts	1,000			
Add : Additional				
Bad debts	2,000			
New provision required	2,500			
$\{(5200-2000)\times \frac{5}{100}\}$				
	5,500			
Less : Existing				
provision	1,500	4,000		

Balance Sheet
as on 31.12.2016

Liabilities	(A)	Assets	(A)	(A)
		Current Assets :		
		Sundry Debtors	52,000	
		Less : Additional		
		Bad Debts	2,000	
		Less :	50,000	
		New Provision Required	2,500	47,500

(m) Provision for Discount on Debtors :

Traders usually allow cash discount to those customers who make prompt payment. At the end of a financial year, there may be some credit customers who may make payment in the next financial year. They may be allowed cash discount. Such discount should be treated as a loss for the trader only for the financial year in which sale was effected. Hence, at the end of the year, a provision for discount on debtors account wills be created. Such provision is made only on good debtors only. The adjustment entry is given as below :

Profit and Loss A/c Dr
To Provision for Discount on Debtors A/c
(Being provision for Discount on Debtors created)

Accounting Treatment

(i) Treatment in P & L A/c	Shown on the debit side as a separate item.
(ii) Treatment in the Balance Sheet	Shown on the Assets side by way of deduction from Sundry Debtors after deduction of further bad debt and new provision created.

Illustration 29

From the extracts of a Trial Balance as on 31.03.2016 as given below, you are required to pass the necessary journal entries and show the treatment in relevant accounts and in the final accounts :

Particulars	Dr. A	Cr. A
Sundry Debtors	1,06,500	
Bad Debts	2,000	
Discount	1,000	
Provision for Bad and Doubtful Debts A/c		1,500

Additional Information:

(a) Create a provision for bad and doubtful debts @5% on debtors

(b) A further bad debt of A6,500 to be written off.

(c) Create a provision on for Discount on Debtors @2% on debtors.

Solution:

Journal

Particulars	L.F.	Dr. A	Cr. A
Bad Debts A/c Dr.		6,500	
To Sundry Debtors A/c			6,500
(Being further bad debts written off)			

Provision for Bad and Doubtful Debts A/c . Dr.		8,500	
To Bad Debts A/c			8,500
(Being bad debts transferred to provision for Bad and doubtful debts A/c)			
Profit and Loss A/c Dr.		12,000	
To Provision for Bad and Doubtful Debts A/c			12,000
(Being the provision for Bad and Doubtful Debts created)			
Profit and Loss A/c Dr.		1,900	
To Provision for Discount on Debtors A/c			1,900
(Being the Provision for Discount on Debtors created) i,e., 95,000×2%=1900			

Sundry Debtors A/c

Dr. Cr.

Particulars	(A)	Particulars	(A)
To balance b/d	1,06,500	By Bad debts A/c	6,500
		By Balance c/d	1,00,000
	1,06,500		1,06,500
To balance b/d	1,00,000		

Bad Debts A/c

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Balance b/d	2,000	By Provision for Bad Debts A/c	8,500
To Sundry Debtors	6,500		
	8,500		8,500

Provision for Bad and Doubtful Debts A/c

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Bad Debts A/c	8,500	By Balance b/d	1,500
To Balance c/d (1,00,000×5%)	5,000	By Profit and Loos A/c	12,000
	13,500		13,500

Discount (Allowed) A/c

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,000	By Profit and Loss A/c	1,000
	1,000		1,000

Provision for Discount on Debtors A/c

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance c/d $\{(1,06,500-6,500-5,000)\times\frac{2}{100}\}$	1,900	By Profit and Loss A/c	1,900
	1,900		1,900
		By Balance b/d	1,900

Profit and Loss Account for the year ending 31.03.2016

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Provision for Bad and Doubtful Debts A/c				
Bad Debts	2,000			
Add : Further Bad Debts	6,500			
New Provision required	5,000			
Less	13,500			
Old Provision	1,500	12,000		

Profit & Loss A/c (continued)

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Discount	1,000		
To Provision for Discount on Debtors A/c	1,900		

Balance Sheet as on 31.03.2016

Dr. Cr.

Liabilities	(A)	Assets		(A)
		Current Assets :		
		Sundry Debtors	1,06,500	
		Less :		
		Further Bad Debt	6,500	
			1,00,000	
		Less Provision		
		for Bad Debts @5%	5,000	
		on 1,00,000.	95,000	
		Less :		
		Provision for Discount	1,900	
		on Debtors (@2% onA95,000)		93,100

(n) Reserve for Discount on Creditors : A trader also expects to receive discount from his creditors by making early payment. So he creates a provision/reserve for discount on creditors. If he pays off the creditors before the agreed date, he may receive some discount which is an income for him. The Provision for Discount on Creditors is popularly named as Reserve for Discount on Creditors as it is an income of the business. The adjustment enty is as given below :

Reserve for Discount on Creditors A/c Dr.

To Profit and Loss A/c

(Being a reserve created on Sundry Creditors)

Accounting Treatment

(i)	Treatment in P & L A/c	Shown on the credit side as a separate item of income.
(ii)	Treatment in Balance Sheet	Shown on the Liabilities side as a deduction from Sundry Creditors.

Illustration 30

On 01.01.2013, a provision for Doubtful Debts showed a credit balance of A7,200. During the year, the bad debts amounted to A5,600. The debtors on 31.12.2013 amounted to A1,92,000 and a provision of 5% for Doubtful Debts was to be maintained.

In 2014, the bad debts amounted to A2,400 and the debtors at the end of the year amounted to A80,000 on which a provision of 5% for Doubtful Debts was to to be maintained.

Make journal entries and prepare the provision for Doubtful Debts Account. Also show the items in Profit and Loss Account and Balance Sheet for the periods.

Solution :

Journal Entries

	Particulars	L.F.	Dr.	Cr.
			A	A
2013 Dec,31	Bad Debts A/c Dr.		5,600	
	To Sundry Debtors A/c			5,600
	(Being the additional bad debts written off)			
	Provision for Doubtful Debt A/c Dr.		5,600	
	To Bad Debts A/c			5,600
	(Being the transferd of Bad Debts to Provision for Doubtful Debt A/c)			
	Profit and Loss A/c Dr.		8,000	
	To Provision for Doubtful Debts A/c			8,000
	(Being the provision created and charged to P&L A/c)			

Date	Particulars		L.F.	Dr.	Cr.
2014 Dec,31	Bad Debts A/c	Dr.		2,400	
	To Sundry Debtors				2,400
	(Being debts written off)				
	Provision for Doubtful Debts A/c	Dr.		2,400	
	To Bad Debts A/c				2,400
	(Being Bad debts transferred to Provision for Doubtful Debts A/c)				
	Provision for Doubtful Debts A/c	Dr.		3,200	
	To Profit and Loss A/c				3,200
	(Being excess provision credited to P&L A/c)				

Provision for Doubtful Debts A/c

Dr. Cr

Date	Particulars	(A)	Date	Particulars	(A)
31.12.2013	To Bad Debts A/c	5,600	1.1.2013	By Balance b/d	7,200
	To Balance c/d		31.12.2013	By Profit and Loss A/c	
	(1,92,000×5%)	9,600		(Balancing figure)	8,000
		15,200			15,200
31.12.2014	To Bad Debts A/c	2,400	1.1.14	By Balance b/d	9,600
	To Profit and Loss A/c	3,200			
	(Balancing figure)				
	To Balance c/d				
	(80,000×5%)	4,000			
		9,600			9,600

Profit and Loss A/c for the year ended 31.12.13 and 31.12.14

Dr. Cr.

Particulars		(A)	Particulars	(A)
2013 :				
To Provision for Doubtful Debts A/c :				
Bad Debts	5,600			

And New provision						
required	9,600					
	15,200					
Less Old Provision	8,000	7,200				
			2014			
			By Provision for Doubtful Debts A/c			
			Old Provision	9,600		
			Less Bad Debts	2,400		
				7,200		
			Less New Provision required	4,000	3,200	

Balance Sheet as on 31.12.2013 and 31.12.2014

Dr. Cr.

Liabilities	(A)	Assets	(A)	
		2013		
		Sund Debtors	1,92,000	
		Less Provision		
		for Doubtful Debts	9,600	1,82,400
		2014		
		Sundry Debtors	80,000	
		Less		
		Provision for		
		Doubtful Debts	4,000	
				76,000

Illustration 31

Mr. A maintained reserve for Discount @4% on creditors which on 1st January 2013 was A4,000. His balances on 31.12.2013 and 2014 were as given below :

	31.12.2013	31.12.2014
	(A)	(A)
Discount Received	3,000	300
Sundry Creditors	50,000	40,000

Show the necessary ledger accounts and show how the items would appear in the final accounts of 2013 and 2014.

Solution :

Discount (Received) A/c

Dr. Cr.

Date	Particulars	(A)	Date	Particulars	(A)
31.12.2013	To Reserve for Discount on Creditors A/c	3,000	31.12.2013	By Sundry Creditors A/c	3,000
		3,000			3,000
31.12.2014	To Reserve for Discount on Creditors A/c	500	31.12.2014	By Sundry Creditors A/c	300

Reserve for Discount on Creditors A/c

Dr. Cr.

		(A)			(A)
31.12.2013	To Balance b/d	4,000	31.12.2013	By Discount Received A/c	3,000
	To Profit and Loss A/c (Balancing figure)	1,000		By Balance c/d (50,000×4%)	2,000
		5,000			5,000
31.12.2014	To Balance b/d	2,000	31.12.2014		
				By Discount Received A/c	300
				By Profit and Loss A/c (Balancing figure)	100
				By Balance c/d (40,000×4%)	1,600
		2,000			2,000

(o) Abnormal Loss (Accidental Loss) : Losses of goods and assets may occur due to accident, natural calamity, fire, theft, pilferage, leakage, spoilage, etc. The cost of such stock or asset lost is abnormal loss. The abnormal loss of stock or asset is an avoidable loss. The adjustment entries for abnormal loss of stock is as follows :

(i) When goods are lost due to accident

Loss by Accident A/c Dr.

To Trading A/c

(Being goods destroyed in accident)

(ii) If goods are not insured

Profit and Loss A/c Dr.

To Loss by Accident A/c

(Being loss of goods charged to P&L A/c

(iii) If goods are fully insured

Insurance claim A/c Dr.

To Loss by Accident A/c

(Being amount due from Insurer)

(iv) When goods are partially insured

Profit and Loss A/c Dr.

Insurance Claim A/c Dr.

To Loss by Accident A/c

(Being claim received from insurer and balance transferred P&L A/c as a loss)

Accounting Treatment

(i) Treatment in Trading A/c	The value of abnormal loss is credited
(ii) Treatment in Profit & Loss A/c	The cost of goods if not insured, all or partially uncovered is debited
(iii) Treatment in Balance Sheet	If goods are insured fully or partly, the claim amount received from the insurer is shown as Insurance claim.

When some fixed asset is lost in accident, this abnormal loss is reflected only in Profit and Loss Account and Balance Sheet. The Adjustment entries for such loss is :

Loss by Accident A/c Dr.

To Fixed Asset A/c

(Being the asset lost in accident)

Accounting Treatment

(i)	Treatment in P&L A/c	The amount of abnormal loss for the fixed asset is debited.
(ii)	Treatment in Balance sheet	The amount of such abnormal loss is deducted from the fixed asset.

Illustration 32

Goods lost in transit during the year ending 31.12.2016 of M/s T Krishna Patra & Sons worth A2,00,000. Give the adjustment entries and accounting treatment in final accounts

(a) If goods were not insured.

(b) If the goods were fully insured.

(c) If the goods were partially insured (70%).

Solution :

(a) If goods were not insured

Adjustment Entry

Date	Particulars		L.F.	Dr.(A)	Cr. (A)
31.12.2016	Loss in Transit A/c	Dr.		2,00,000	
	To Trading A/c				2,00,000
	(Being goods lost in transit)				

Trading Account of

M/s. T. Krishna Patro & Sons for the year ending 31.12.2016

Dr. Cr.

Particulars	(A)		(A)
		By Loss in Transit A/c	2,00,000

Profit and Loss A/c of M/s T. Krishna Patro & Sons

Dr. for the year ending 31.12.2016 Cr.

Particulars	(A)	Particulars	(A)
To Loss in Transit A/c	2,00,000		

(b) If goods were fully insured.

Adjustment Entry

Date	Particulars		L.F.	Dr.(A)	Cr. (A)
	Loss in Transit A/c	Dr.		2,00,000	
	To Trading A/c				2,00,000
	(Being goods lost in transit)				
	Insurance Claim A/c			2,00,000	
	To Loss in Transit A/c				2,00,000
	(Being claim accepted fully by Insuer)				

Balance sheet of M/S T. Krishna Patra & Sons
as on 31.12.2016

Liabilities	(A)	Assets	(A)
		Insurance Claim	2,00,000

(c) If goods were Partially (70%) Insured :

Adjustment Entry

Date	Particulars		L.F.	Dr. (A)	Cr. (A)
31.12.16	Loss in Transit A/c	Dr.		2,00,000	
	To Trading A/c				2,00,000
	(Being goods lost in transit)				
	Insurance Claim A/c	Dr.		1,40,000	
	To Loss in Transit A/c				1,40,000
	(Being 70% of loss claimed was accepted)				

Trading Account of M/s. T. Krishna Patro & Sons
Dr. for the year ending 31.12.2016 Cr.

Particulars	(A)		(A)
		By Loss in Transit A/c	2,00,000

Profit & Loss Account of M/s T. Krishna Patro
Dr. for the year ending 31.12.2016 Cr.

Particulars	(A)	Particulars	(A)
To Loss in Transit A/c (2,00,000-1,40,000)	60,000		

Balance Sheet of M/s T. Krishna Patro & Sons
as on 31.12.2016

Liabilities	(A)	Assets	(A)
		Insurance Claim (70% of 2,00,000)	1,40,000

(p) Charity (in the form of Goods) : Sometimes, the businessman gives some goods as charity from his stock. It is taken as an expense of the business. The adjustment entry is as follows:

Charity A/c Dr.

To Purchases A/c

(Being goods issued as charity)

Accounting Treatment

(i)	Treatment in Trading A/c	Shown as a deduction from total purchases
(ii)	Treatment Profit and Loss A/c	Shown as an expense on the debit side

(q) Distribution of goods as free samples :

The trader distributes goods as free sample for the sake of advertisement. The free samples are taken as a business expense. It reduces the stock position of the trader. The adjustment entry for distributing goods as free sample is as follows :

Advertisement A/c Dr.

or

Free samples A/c Dr.

To Purchases A/c

(Being the goods distribuded as free sample for advertisement)

Accounting Treatment

(i)	Treatment in Trading A/c	Shown as a deduction from total purchases
(ii)	Treatment Profit and Loss A/c	Shown as an expense on the debit side

(r) Goods taken by the owner for personal use :

Sometimes the trader takes away goods from the business for personal use. It is called drawing of goods by the owner / trader. The adjutment entry for this is given below

Drawings A/c Dr.
To Purchases A/c
(Being goods withdrawn for personal use)

Accounting Treatment

(i) Treatment in Trading Account	Shown as a deduction from total purchases.
(ii) Treatment in Balance sheet	Deducted from Capital Account as Drawings for Goods.

Further sometimes cash is withdrawn by the trader for paying off personal expenses.

The adjustment entries for withdrawing cash for private use is as follows :

Adjustment Entry

(i) Drawings A/c To Cash/Bank A/c (Being drawings made in cash)	Dr.
(ii) Capital A/c To Drawings A/c (Being drawings adjusted in Capital)	Dr.

Accounting Treatment

(i) Treatment in Balance Sheet	Deducted (i) from relevant Cash/Bank A/c and also (ii) from Capital Account.

If Income Tax or Life Insurance Premium is paid out of the business cash, the adjustment entries are :

Adjustment Entry

(i) Income Tax/Life Insuracne Premium A/c To Cash/Bank A/c (Being Income Tax/Life Insurance Premium Paid)	Dr.

(ii) Drawings A/c Dr.
To Income Tax/Life Insurance Premium A/c
(Being income tax / life insurance premium transfered to Drawings A/c)

(iii) Drawings A/c Dr.
To Capital A/c
(Being Capital A/c is reduced by Drawings amount)

The accounting treatment of income tax / life insurance premium paid out of the business cash is like that of the withdrawings of cash by the trader to pay off his personal expenses.

Illustration 33

From the following extracts from Trial Balance of M/s X & Co. as on 31.03.2017, you are required to give adjustment entries and also show the treatment in final accounts :

	Dr. A	Cr. A
Purchases	2,00,000	--
Advertisement	10,000	--
Charity	1,500	--

Adjustments

(i) Goods worth A2,000 distributed as free samples;

(ii) Goods worth A800 were given as charity.

Solution :

Date	Particulars		L.F.	Dr.(A)	Cr. (A)
	Advertisement A/c	Dr.		2,000	
	Charity A/c	Dr.		800	
	To Purchases A/c				2,800
	(Being goods issued as free samples and charity)				

Trading Account of M/s X & Co.

Dr. for the year ending 31.03.2017 Cr.

Particulars	(A)	Particulars	(A)
To Purchases 2,00,000 Less : Free Samples - 2,000 Charity - 800 2,800	1,97,200		

Profit and Loss Account of M/s X & Co.

Dr. for the year ending 31.03.2017 Cr.

Particulars		(A)	Particular	(A)
To Advertisement	10,000			
Add :				
Free Samples	2,000	12,000		
To Charity	1,500			
Add : Charity of goods				
	800			
		2,300		

(s) Manager's Commission :

Sometimes, the manager is allowed commission on profits earned by the trader. The commission is allowed on the basis of the service conditions and job profile. The commission is calculated as a percentage of profit either before charging such commission or after charging such commission. If commission is payable at fixed percentage on net profit before charging such commission, then :

$$\text{Manager's Commission} = \frac{\text{\% of commission}}{100} \times \text{Net profit before charging such commission}$$

If commission is payable on net profit after charging such commission, then

$$\text{Manager's Commission} = \frac{\text{\% of commission}}{(100 + \text{\% Commission})} \times \text{Net profit before charging such commission}$$

The adjustment entry for Manager's Commission is as follows :

Manager's Commission A/c Dr.

To Outstanding Commission A/c

(Being Manger's commission remains outstanding)

Accounting Treatment

(i) Treatment in P&L A/c	Shown on the debit side as a separate item of expense.
(ii) Treatment in the Balance Sheet	Shown on the liabilities side as a current liability.

(t) Deferred Revenue Expenditure :

There are some expenditures of a trader which is revenue in nature but gives benefit to the business for a long period. For example, a heavy expenditure incurred in launching a new product will give benefit to the trader for more than one year. Such a revenue expenditure is partially revenue and partially capital in nature. This revenue expenditure is of specialised in nature and called Deferred Revenue Expenditure. The adjustment entry for deferred revenue expenditure is :

Profit and Loss Account Dr

To Relevant Expense A/c

(Being a part of the relevant expense written off)

Accounting Treatment

(i)	Treatment in P&L A/c	A part of the relevant expenses say ($\frac{1}{8}$th) is written off and shown on the debit side as a revenue expense.
(ii)	Treatment in the Balance Sheet	Remaining part of the relevant expenses, (say $1-\frac{1}{8}$th) $\frac{7}{8}$th is shown as an asset under the heading Deferred Revenue Expenditure.

Illustration 34

On 31st December 2015, goods costing A5,000 were taken by the proprietor for his private use for which no record was made. Purchases were A1,00,000 and capital A2,00,000. Pass the adjusting entry and show the accounting treatment for drawings in final accounts for the year ending 31.12.2015.

Solution :

Adjustment Entry

Particulars	L.F.	Dr.(A)	Cr. (A)
Drawings A/c Dr.		5,000	
To Purchases A/c			5,000
(Being the goods withdrawn for private use)			

Trading Account for the year ending 31.12.2015

Dr. Cr.

Particulars	(A)	Particulars	(A)
To Purchases 1,00,000 Less : Goods taken for private use 5,000	95,000		

Balance Sheet as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital : Opening Balance 2,00,000 Less : Drawings for goods 5,000	1,95,000		

Illustration 35

The net profits of M/s AB & Co. for the year ending 31.03.2017 are ₹2,10,000 before charging any commission. The manager is allowed a commission of 5% on the net profits (i) before/ (ii) after charging such commission. Calculate the commission payable to the manager and also show it in Final Accounts of the year.

Solution :

(i) Manager's commission before charging such commisson.

$$\text{Commission} = \text{Net profit} \times \frac{\text{Rate of Commission}}{100}$$

$$= ₹2,10,000 \times \frac{5}{100}$$

$$= ₹10,500$$

(ii) Manager's commission after charging such commission.

$$\text{Commission} = \text{Net profit} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

$$= ₹2,10,000 \times \frac{5}{105} = \text{A}10,000$$

(i)

Profit and Loss Account
for the year ending 31.03.2017

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Manager's Commission	10,500		

Balance Sheet as on 31.03.2017

Liabilities	(₹)	Assets	(₹)
Current Liabilities : Manager's Commission Due	10,500		

(ii)

Profit and Loss Account
for the year ending 31.03.2017

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Manager's Commission	10,000		

Balance Sheet as on 31.03.2017

Liabilities	(₹)	Assets	(₹)
Current Liabilities : Manager's Commission Due	10,000		

Illustration 36

From the "following trial balance of Ajay as on 31.12.2016, prepare the final accounts :

Particulars	Dr. (₹)	Cr. (₹)
Cash in Hand	3,200	--

Cash at Bank	10,600	--
Purchases	2,62,500	--
Purchases Return	--	2,000
General Expenses	10,000	--
Insurance	3,600	--
Capital	--	3,50,000
Debtors and creditors	60,000	48,000
Sales	--	5,00,500
Sales return	4,500	--
Wages	45,200	--
Fuel and Power	5,700	--
Cariage on sales	5,100	--
Cariage Inwards	2,600	--
Stock on 01.01.2016	40,000	--
Building and Land	3,00,000	--
Machinery	1,00,000	--
Salaries	12,500	--
Trademark	35,000	--
	9,00,500	**9,00,500**

Adjustments :

(a) Closing stock amounted to ₹85,000.

(b) Salaries Outstanding ₹2,500.

(c) Insurance prepaid for the next years ₹1,200.

(d) Depreciate Building & Land by 5% and Machinery by 10%.

Solution :

Trading A/c, Profit & Loss A/c of Ajay
for the year ending 21.12.2016

Dr Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock		40,000	By Sales	5,00,500	
To Purchases	2,62,500		Less : Sales Return	<u>4,500</u>	4,96,000
Less : Returns	<u>2,000</u>	2,60,500	By Closing Stock		85,000
To wages		45,200			

To Fuel and Power		5,700		
To Carriage Inwards		2,600		
To Gross Profit c/d		2,27,000		
		5,81,000		5,81,000
To General Expenses		10,000	By Gross Profit b/d	2,27,000
To Insurance	3,600			
Less : Prepaid	1,200	2,400		
To Carriage on Sales		5,100		
To Salaries	12,500			
Add :				
Outstanding	2,500	15,000		
To Depreciation :				
On Building and Land	15,000			
On Machinery	10,000	25,000		
To Net profit transferred to Capital A/c		1,69,500		
		2,27,000		2,27,000

Balance Sheet of Ajay
as on 31.02.2016

Liabilities		(₹)	Assets		(₹)
Outstanding Salaries		2,500	Cash in Hand		3,200
Creditors		48,000	Cash at Bank		10,600
Capital :			Debtors		60,000
Opening Balance	3,50,000		Closing Stock		85,000
Add :			Prepaid Insurance		1,200
Net Profit	1,69,500		Machinery	1,00,000	
		5,19,500	Less : Depreciation	10,000	90,000
			Building & Land	3,00,000	
			Less : Depreciation	15,000	2,85,000
			Trademark		35,000
		5,70,000			**5,70,000**

Illustration 37

From the following trial balance of M/s Raj Traders, prepare Trading and Profit and Loss Account for the year ending 31.03.2017 and the Balance Sheet as on that date :

Name of Accounts	Dr.	Cr.
Opening Stock	30,000	
Purchases	2,70,000	
Sales Return	7,000	
Cariage Inward	2,000	
Plant and Machinery	1,00,000	
Furniture & Fixturess	60,000	
Freehold Property	50,000	
Cash in Hand	6,000	
Carriage Outwards	1,000	
Wages	33,000	
Salaries	20,000	
Lighting-factory	2,000	
Sundry Debtors	30,000	
Travelling Expenses	2,500	
Rent & Taxes	5,000	
Drawings	6,000	
Insurance	2,000	
Capital		1,50,000
Sales		4,00,000
Purchases Return		6,500
Sundry Creditors		40,000
Bills payble		20,000
Commission		10,000
	6,26,500	**6,26,500**

Adjustments :

(a) Stock on 31.03.2017 was valued at ₹40,00,000 (market price ₹35,000)

(b) Wages ₹2,000 were outstanding.

(c) Commission received in advance ₹3,000.

(d) Provide depreciation on plant and machinery at 5% and on furniture and fixtures at 10%.

Solution :

Trading and Profit and Loss Account of
M/s Raj Traders for the year ending 31.03.2017

Dr Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock		30,000	By Sales	4,00,000	
To Purchases	2,70,000		Less : Returns	7,000	3,93,000
Less : Returns	6,500		By Closing stock		35,000
		2,63,500			
To Wages	33,000				
Add :					
Outstanding Wages	2,000	35,000			
To Carriage Inward		2,000			
To Factory Lighting		2,000			
To Gross Profit c/d		95,500			
		4,28,000			**4,28,000**
To Salaries	20,000		By Gross profit b/d		95,500
To Travelling Expenses		2,500	By Commission	10,000	
To Carriage Outwords		1,000	Less : Received		
To Rent & Taxes		5,000	in Advance	3,000	7,000
To Insurance		2,000			
To Depreciation :					
Plant and Machinery	5,000				
Furntiture and Fixture	6,000	11,000			
To Net profit transferrred					
to Capital A/c		61,000			
		1,02,500			**1,02,500**

Balance Sheet of M/S Raj Traders
as on 31.03.2017

Liabilities		(₹)	Assets		(₹)
Outstanding wages		2,000	Cash in Hand		6,000
Bills Payable		20,000	Sundry Debtors		30,000
Sundry Creditors		40,000	Closing Stock		35,000
Commission Received in Advance		3,000	Furnitures Fixture	60,000	
Capital :			Less:Depreciation	6,000	54,000
Opening Balance	1,50,000		Plant and Machinery	1,00,000	
Add : Net Profit	61,000		Less:		
	2,11,000		Depreciation	5,000	95,000
Less :			Freehold Property		50,000
Drawings	6,000	2,05,000			
		2,70,000			**2,70,000**

Illustration 38

From the following Trial balance of Sri Ganpati Ram, prepare the final accounts for the year ending 31.12.2016 and the Balance Sheet on that date :

Trial Balance

Ledger Accounts	Dr. (₹)	Cr.(₹)
Capital	--	5,00,000
Drawing	35,000	--
Plant and Machinery	2,50,000	--
Land and Building	3,00,000	--
Patents	1,50,000	--
Purchases & Sales	7,50,000	13,00,000
Return Inward/Outward	15,000	14,000
Carriage	28,000	--
Wages	60,000	--
Salaries	40,000	--
Rent received	--	35,000
Insurance	2,500	--

Audit Fees	6,000	--
Debtors and Creditors	80,000	40,000
Printing and Stationery	9,000	
Opening Stock	1,50,000	
Cash in Hand	13,500	
	18,89,000	**18,89,000**

Adjustments :

1. Closing stock was ₹95,000.
2. Accrued Rent ₹7,500
3. Insurance paid in advance ₹500
4. Allow 10% interest on capital and charge ₹2,000 on drawings.
5. Provide 5% depreciation on plant and machinery and 10% on patents.

Solution :

Trading and Profit and Loss Account
of Sri Ganpati Ram for the year ending 31.12.2016.

Dr. Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock		1,50,000	By Sales	13,00,000	
To Purchases	7,50,000		Less: Returns Inward	15,000	12,85,000
Less : Returns	14,000		By Closing stock		95,000
		7,36,000			
To Carriage		28,000			
To Wages		60,000			
To Gross profit c/d		4,06,000			
		13,80,000			**13,80,000**
To Salaries		40,000	By Gross profit b/d		4,06,000
To Insurance	2,500		By Rent Received	35,000	
Less : Prepaid	500	2,000	Add :		
To Audit fees		6,000	Accrued Rent	7,500	42,500
To Printing and Stationery		9,000	By Interest on Drawings		2,000
To Interest on Capital		50,000			

To Depreciation :					
Plants machinery	12,500				
Patents	15,000	27,500			
To Net profit transferred					
to Capital A/c		3,16,000			
		4,50,500			**4,50,500**

Balance Sheet of Sri Ganpati Ram
as on 31.12.2016

Liabilities		(₹)	Assets		(₹)
Capital	5,00,000		Land and Building		3,00,000
Add :			Plant and Machinery	2,50,000	
Interest on Capital	50,000		Less:Depreciation	12,500	2,37,500
Net profit	3,16,000		Patents	1,50,000	
	8,66,000		Less : Depreciation	15,000	1,35,000
Less : Drawings	35,000		Closing stock		95,000
	8,31,000		Debtors		80,000
Less :			Cash in Hand		13,500
Interest			Accrued Rent		7,500
on Drawings	2,000	8,29,000	Prepaid Insurance		500
Creditors		40,000			
		8,69,000			**8,69,000**

Illustration 39

From the following Trial balance of Mr. Bohidar on 31.03.2015, prepare Trading, Profit and Loss Account for the year ending 31.03.2015 and the Balance Sheet as on that date.

Debit Balances	(₹)	Credit Balances	(₹)
Opening Stock	50,000	Purchases Return	2,000
Purchases	1,80,000	Bank Loan	20,000
Cash in Hand	300	Creditors	70,000
Bank Balances	10,000	Capital	1,68,000

Plant and Machinery	50,000	Provision for bad debts	1,000
Manufacturing wages	10,000	Sales	3,22,800
Freight Inward	2,500		
Freight Outward	3,000		
Salaries	15,000		
Furniture	30,000		
Insurance & Taxes	7,000		
General Expenses	8,000		
Debtors	90,000		
Bad debts	2,700		
Discount	1,300		
Sales Return	4,000		
Stable Expenses	3,000		
Live Stock	15,000		
Fuel & Power	2,000		
Building	1,00,000		
	5,83,800		**5,83,800**

Adjustments :

(a) Closing stock was ₹40,000.

(b) Maintain a provision for bad debts @5% on Debtors

(c) Create a reserve for discount @2% on creditors.

(d) Depreciate Plant and Machinery by 10%, Furniture by 5% and Live Stock by ₹2,000.

(e) Prepaid insurance ₹800

(f) Commission to factory manager allowed @10% on net profit before charging such commission.

Solution :

Trading and Profit and Loss Account
of Mr. Bohidar for the year ending 31.03.2015

Dr. Cr.

Particulars	(₹)	Particulars		(₹)
To Opening Stock	50,000	By Sales	3,22,800	

To Purchases	1,80,000		Less : Sales Return	4,000	3,18,800
Less: Purchases Returns	2,000	1,78,000	By Closing stock		40,000
To Manufacturing wages		10,000			
To Fuel and Power		2,000			
To Freight Inward		2,500			
To Gross Profit c/d		1,16,300			
		3,58,800			**3,58,800**
To Freight Outward		3,000	By Gross Profit b/d		1,16,300
To Salaries		15,000	By Reserve for Discount on creditors		1,400
To Insurance & Taxes	7,000				
Less :					
Prepaid Insurance	800	6,200			
To General Expenses		8,000			
To Discount		1,300			
To Stable Expenses		3,000			
To Depreciation :					
Plants & Machinery	5,000				
Furniture	1,500				
Live stock	2,000	8,500			
To Provision for Bad debts :					
Bad debts	2,700				
Add :					
New Provision Required	4,500				
	7,200				
Less: Existing Provision	1,000	6,200			
To Balance c/d (Profit before charging manager's commission)		66,500			
		1,17,700			**1,17,700**
To Factory Manager's Commission		6,650	By Balance b/d (Net profit before charging such commission)		66,500
To Net profit transferred to capital A/c		59,850			
		66,500			**65,100**

Balance Sheet of Mr. Bohidar
as on 31.03.2015

Liabilities		(₹)	Assets		(₹)
Bank Loan		20,000	Cash in Hand		300
Creditors	70,000		Bank Balances		10,000
Less :			Debtors	90,000	
Reserve for discount					
on creditors	1,400	68,600	Less : Provision		
Factory Manager's Commission			Provision for bad debts	4,500	85,500
outstanding		6,650	Closing stock		40,000
Capital :			Prepaid Insurance		800
Opening Balance	1,68,000		Furniture	30,000	
Add : Net Profit	59,850	2,27,850	Less : Depreciation	1,500	28,500
			Live stock	15,000	
			Less : Depreciation	2,000	
			Plant and Machinery	50,000	13,000
			Less : Depreciation	5,000	45,000
			Building		1,00,000
		3,23,100			**3,23,100**

Illustration 40

From the Trial Balance of M/s Purohit & Sons, prepare the final accounts for the year ending 31.03.2017 and the Balance Sheet as on that date.

Trial Balance
as on 31.03.2017

Dr. Balances	(₹)	Cr. Balances	(₹)
Opening Stock	25,000	Capital	1,60,000
Purchases	2,55,000	Return Outwards	4,000
Plant and Machinery	1,30,000	Sundry Creditors	20,900
Sundry Debtor	60,000	Sales	3,41,000
Furniture	15,000	Rent Received	4,000
Customs duty	5,000	Loan from Bank @10%	29,000
Life Insurance Premium	3,000		

Carriage Inward	1,500		
Carriage Outward	1,700		
Trade Expenses	2,000		
Return Inward	3,500		
Discount allowed	3,000		
Bank Interest	500		
Office Expenses	3,000		
Cash in Hand	5,700		
Salaries	45,000		
	5,58,900		**5,58,900**

Adjustments :

(i) Closing stock was ₹35,000

(ii) Stock of ₹5,000 was burnt by fire. It was fully insured and the insurance company admitted the claim in full.

(iii) Goods worth ₹3,000 were distributed as free samples and goods worth ₹1,000 were taken by the proprietor for personal use.

(iv) Maintain a reserve of 2% on sundry creditors.

(v) Provide a depreciation @10% on Plant and machinery.

Solution :

Trading and Profit and Loss Account of M/s Purohit and Sons
for the year ending 31.03.2017

Particulars		(₹)	Particulars		(₹)
To Opening Stock		25,000	By Sales	3,41,000	
To Purchases	2,55,000		Less :		
Less:					
Return outward	4,000		Return Inward	3,500	3,37,500
Less:	2,51,000		By Closing Stock		35,000
Lost by fire	5,000				
	2,46,000				
Less:					
Free samples	3,000				
	2,43,000				

Less:				
Drawings in goods	1,000	2,42,000		
To Customs duty		5,000		
To Carriage Inward		1,500		
To Gross Profit c/d		99,000		
		3,72,500		**3,72,500**
To Carriage Outward		1,700	By Gross Profit b/d	99,000
To Trade Expenses		2,000	By Rent Received	4,000
To Discount allowed		3,000	By Reserve for Discount	
To Bank Interest	500		on Creditors	418
Add :				
Outstanding interest	2,400			
(29,000×10% – 500)		2,900		
To Free Samples		3,000		
(or Advertisements)				
To Office expenses		3,000		
To Salaries		45,000		
To Depreciation on Plant and				
Machinery		13,000		
To Net Profit transferred				
to Capital A/c		29,818		
		1,03,418		**1,03,418**

Balance Sheet of M/s Purohit and Sons as on 31.03.2017

Liabilities		(₹)	Assets		(₹)
Sundry Creditors	20,900		Cash in Hand		5,700
Less :			Sundry Debtors		60,000
Reserve for			Closing Stock		35,000
Discount on creditors	418	20,482	Insurance Claim Admitted		5,000
10% Bank Loan	29,000		Furniture		15,000
Add :			Plant and Machinery	1,30,000	
Outstanding Interest	2,400	31,400			
Capital :			Less :		
Opening Balance	1,60,000		Depreciation	13,000	1,17,000
Add : Net Profit	29,818				
	1,89,818				

Less :				
Drawings for Life insurance Premium	3,000			
	1,86,818			
Less :				
Drawings for Goods	1,000	1,85,818		
		2,37,700		**2,37,700**

Illustration 41

Prepare final accounts from the following Trial Balance for the year ending 31.12.2016 :

Dr. Balances	(₹)	Cr. Balances	(₹)
Drawings	20,000	Provision for bad debts	8,000
Carriage Inwards	8,000	Purchases Return	4,500
Wages	7,500	Sundry Creditors	70,000
Power	2,700	Capital	2,00,000
Advertisement	25,000	Sales	3,95,500
Plant and Machinery	70,000		
Opening Stock	28,000		
Purchases	3,80,000		
Return Inward	3,500		
Cash in Hand	17,000		
Cash at Bank	15,000		
Salaries	12,500		
Prepaid Insurance	1,200		
Rent and Insurance	20,000		
Goods services Tax	6,700		
Bad debts	900		
Sundry Debtors	60,000		
	6,78,000		**6,78,000**

Adjustments :

(i) Closing stock was ₹1,00,700

(ii) Depreciate machinery by 10%.

(iii) Write off advertisement by 20%.

(iv) Further bad debts ₹2,000 and make provision for bad debts by 5%.

(v) Charge 10% manager's commission on net profit after charging such commission.

Solution :

Trading and Profit and Loss Account
for the year ending 31.12.2016

Dr. Cr.

Particulars		(₹)	Particulars		(₹)
To opening stock		28,000	By Sales	3,95,500	
To Purchases	3,80,000		Less :		
Less :			Return Inward	3,500	3,92,000
Purchases Return	4,500	3,75,500	By Closing stock		1,00,700
To Carriage Inward		8,000			
To Wages		7,500			
To Power		2,700			
To Gross Profit c/d		71,000			
		4,92,700			**4,92,700**
To Advertisement written off		5,000	By Gross Profit b/d		71,000
To Depreciation on Machinery		7,000	By Provision for Bad debts :		
To Salaries		12,500	Existing Provision	8,000	
To Rent and Insurance		20,000	Less :		
To Goods Services Tax		6,700	Bad debts 900		
To Balance c/d		22,000	Further Bad debts 2,000		
(Profit before charging			New Provision		
Manager's Commission)			{(60,000-2,000)×5%}2,900		
				5,800	2,200
		73,200			**73,200**
To Manager's Commission		2,000	By Balances b/d		22,000
$(22000\times\frac{10}{110})$					
To Net Profit transferred					
to Capital A/c		20,000			
		22,000			**22,000**

Balance Sheet as on 31,12.2016

Liabilities		(₹)	Assets		(₹)
Sundry Creditors		70,000	Cash in Hand		17,000
Capital :			Cash at Bank		15,000
Opening Balance	2,00,000		Closing Stock		1,00,700
Add : Net Profit	20,000		Prepaid Insurance		1,200
	2,20,000		Plants and Machinery	70,000	
Less : Drawings	20,000		Less : Depreciation	7,000	63,000
		2,00,000	Advertisements	25,000	
Manager's Commission		2,000	Less : Written off	5,000	20,000
			Sundry Debtors	60,000	
			Less: Further bad debts	2,000	
				58,000	
			Less : Provision Required	2,900	55,100
		2,72,000			**2,72,000**

Illustration 42

From the following Trial Balance of M/s Prabhu Traders prepare final accounts for the year ending 31.03.2017.

Dr. Balances	(₹)	Cr. Balances	(₹)
Opening Stock	30,000	Discount	3,700
Purchases	1,50,000	Apprentice Premium	6,000
Manufacturing Wages	9,000	Creditors	25,000
Fuel & Power	3,000	Interest on Loan	1,500
Salaries	10,000	Capital	1,00,000
Income Tax	2,500	Sales	2,23,800
Loan to Ambika @10% p.a.	20,000		
Furniture	8,000		
Plants and Machinery	85,000		
Debtors	32,400		
Cash	3,700		
Rent	6,400		
	3,60,000		**3,60,000**

Adjustments :

1. Closing stock was ₹38,000
2. Depreciate plant and machinery by 10% and furniture by 5%.
3. Create a reserve for discount on creditors by 5% and provision for discount on debtors by 5%.
4. Sundry debtors include ₹400 due from a customer who became insolvent.
5. Goods worth ₹3,000 were destroyed by fire and the insurance company admitted claim for ₹1,800.
6. Outstanding salaries were ₹2,000.

Solution :

Trading and Profit and Loss Account of M/s Prabhu Traders
for the year ending 31.03.2017

Dr. Cr.

Particulars		(₹)	Particulars		(₹)
To Opening stock		30,000	By Sales		2,23,800
To Purchases	1,50,000				
Less:			By Closing Stock		38,000
Goods lost by fire	3,000	1,47,000			
To Manufacturing wages		9,000			
To Fuel and Power		3,000			
To Gross Profit c/d		72,800			
		2,61,800			**2,61,800**
To Salaries	10,000		By Gorss profit b/d		72,800
Add :			By Reserve for discount		
Outstanding Salaries	2,000	12,000	on creditors.		1,250
To Depreciation :			By Apprentice Premium		6,000
Plant & Machinery	8,500		By Interest on Loan	1,500	
Furniture	400	8,900	Add : Accured Interest	500	2,000
To Bad debt		400	By Discount		3,700
To Provision for discount					
on debtors {(32,400–400)×5%)}		1,600			
To Loss by fire (A3000–A1,800)		1,200			
To Rent		6,400			
To Net Profit transferred					
to Capital A/c		55,250			
		85,750			**85,750**

Balance Sheet of M/s Prabhu Traders
as on 31,03.2017

Liabilities		(₹)	Assets			(₹)
Creditors	25,000		Cash			3,700
Less :			Debtors		32,400	
Reserve			Less :			
for discount on creditors	1,250	23,750	Bad debts	400		
			Provsion for			
			Discount	1,600	2,000	30,400
Salaries Outstanding		2,000				
Capital :			Closing Stock			38,000
Opening balance	1,00,000		Loan to Ambika			20,000
Less : Drawings			Interest on Loan Accrued			500
(for income tax)	2,500		Furniture		8,000	
	97,500		Less : Depreciation		400	7,600
Add :			Plant & Machinery		85,000	
Net Profit	55,250	1,52,750	Less : Depreciation		8,500	76,500
			Insurance claim admitted			1,800
		1,78,500				**1,78,500**

Illustration 43

Following is the Trial balance of PJ Brothers on 31.12.2016

Dr. Balances	(₹)	Cr. Balances	(₹)
Purchases (adjusted)	3,49,600	Capital	20,000
Salaries	2,100	Bills Payable	5,000
Lighting	150	Loan	10,000
Carriage on Sales	250	Sales	3,60,000
Building	13,500	Commission	250
Carriage on Purchases	200	Sundry Creditors	10,000
Rates & Taxes	200		
Sundry Debtors	4,000		
Furniture	3,000		
Cash in Hand	125		
Bills Receivable	750		
Closing stock	30,625		
Bank balance	750		
	4,05,250		**4,05,250**

Adjustments :

(i) Rates have been prepaid ₹60

(ii) During year, bad debt amounted to ₹250.

(iii) A provision of 10% is to be made on debtors.

(iv) Buildings have to be depreciated by 2% and furniture by 1%. Prepare the final accounts for the year.

Solution :

Trading and Profit and Loss Account of P.J. Brothers
for the year ending 31.12.2016

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Adjusted Purchases		3,49,600	By Sales	3,60,000
To Carriage on purchases		200		
To Gross Profit c/d		10,200		
		3,60,000		**3,60,000**
To Salaries		2,100	By Gross Profit b/d	10,200
To Lightining		150	By Commission	250
To Carriage on sales		250		
To Rates & Taxes	200			
Less : Prepaid Rates	60	140		
To Bad debt		250		
To Provision for bad debts		375		
{(4,000-250)×10%				
To Depreciation :				
Building	270			
Furnitures	30			
To Net profit transfered		300		
to Capital A/c		6,885		
		10,450		**10,450**

Balance of PJ Brothers as on 31,12.2016

Liabilities		(₹)	Assets		(₹)
Sundry Creditors		10,000	Cash in Hand		125
Bills Payable		5,000	Bank balance		750
Loan		10,000	Bills Receivable		750
Capital :	20,000		Sundry Debtors	4,000	
Net Profit	6,885	26,885	Less : Bad debts	250	
				3,750	
			Less : Provision		
			for doubtful debt	375	3,375
			Closing Stock		30,625
			Prepaid Rates		060
			Furniture	3,000	
			Less : Depreciation	30	2,970
			Buildings	13,500	
			Less: Depreciation	270	13,230
		51,885			**51,885**

1.6 Questions

1. From the alternatives given below, write the correct answer along with its serial number against each bit :

(i) Revenue expenditure is one which gives benefits for :

(a) Current year (c) Future year

(b) Previous year (d) First two years

(ii) Capital expenditure is one which gives benefits for :

(a) Current year only (c) Future years

(b) Previous year only (d) Less than one year

(iii) Heavy amount spent on advertisement of new product is :

(a) Capital expenditure (c) Revenue loss

(b) Revenue expenditure (d) Deferred revenue expenditure

(iv) Wages spent for installation of machinery is a :

(a) Capital expenditure (c) Deferred revenue expenditure

(b) Revenue expenditure (d) Capital loss

(v) Expenditure incurred in manufacturing goods is :

(a) Capital expenditure (c) Revenue expenditure

(b) Capital loss (d) Revenue loss

(vi) Trading Accounts reveals :

(a) Gross profit/Loss (c) Financial position

(b) Net profit /loss (d) Appropriation of profits

(vii) Profit and Loss Account reveals :

(a) Gross profit/loss (c) Appropriation of profits

(b) Net profit/loss (d) Financial position

(viii) Balance Sheet of a trader reveals :

(a) Balances of all ledger accounts (c) Balance of Net profit

(b) Balance of Gross profit (d) Financial Position

(ix) Closing stock appearing in the Trial Balance is transferred to :

(a) Trading Account only (c) Trading Account and Balance sheet

(b) Balance sheet only (d) Trading Account and Profit and Loss Account

(x) Income tax paid by a sole trader is shown in :

(a) Debit side of Trading A/c (c) Asset side of Balance Sheet

(b) Debit side of Profit and Loss A/c (d) Deducted from capital on the liability side of Balance Sheet

(xi) An example of intangible asset is :

(a) Machinery (c) Prepaid Expenditure

(b) Mines (d) Copyrights

(xii) Marshalling of Balance Sheet means :

(a) the arranging assets and liabilities

(b) the arranging assets only

(c) the arranging liabilities only

(d) the totalling assets and liabilities

(xiii) Direct expenses are shown in :

(a) Balance Sheet (c) Trading Account

(b) Profit and Loss Account (d) Trading Account and Balance sheet

(xiv) Indirect expenses are shown in :

(a) Balance sheet (c) Trading Account

(b) Profit and Loss Account (d) Profit and Loss A/c and Balance Sheet

(xv) One of the following, which is not shown in the Balance Sheet is :

(a) Current Liability (c) Current Asset

(b) Non-current liability (d) Contingent liability

(xvi) One of the following, which is not deducted from capital, is :

(a) Net Loss (c) Income Tax

(b) Drawings (d) Loan

(xvii) Accrued Income is a/an :

(a) Asset (c) Income

(b) Liability (d) Expense

(xviii) Income received in advance is a/an :

(a) Asset (c) Income

(b) Liability (d) Expenditure

(xix) Prepaid expense is an example of :

(a) Current Asset (c) Intangible asset

(b) Fixed Asset (d) Fictitious asset

(xx) Prepaid Insurance appearing in the Trial balance is shown in :

(a) Profit and Loss A/c only (c) Balance Sheet only

(b) Balance Sheet & Profit and Loss A/c (d) Balance Sheet and Trading A/c

(xxi) A manager's commission of 10% on net profit of ₹2,20,000 after charging such commission is :

(a) ₹22,000 (c) ₹20,200

(b) ₹20,000 (d) ₹22,020

(xxii) A manager's commission of 5% on net profit A2,10,000 before charging such commission is :

(a) ₹10,500 (c) 10,050

(b) ₹10,000 (d) 10,505

(xxiii) Closing stock is shown in final accounts at :

(a) cost price (c) cost or market price which ever is more

(b) market price (d) cost or market price which ever is less

[Answers : (i) a, (ii) c, (iii) d, (iv) a, (v) c, (vi) a, (vii) b, (viii) d, (ix) b, (x) d, (xi) d, (xii) a, (xiii) c, (xiv) b, (xv) d, (xvi) d, (xvii) a, (xviii) b, (xix) d, (xx) c, (xxi) b, (xxii) a, (xxiii) d.]

2. Answer the following questions in one word / term each :

(a) Where will you show in final accounts the prepaid Insurance if appearing in the Trial balance ?

(b) Where will you show the income received in advance in the Balance sheet ?

(c) Where will show in final accounts if the closing stock appears in Trial Balance ?

(d) Which item is an expense to the firm but income to the proprietor ?

(e) Which item is an income to the firm but expense to the proprietor ?

(f) What is the term used for income earned but not received during the current accounting period ?

(g) How do you term the expense which has been paid during the current accounting period but benefit will accrue in the sabsequent account period ?

(h) Where will you show in final accounts, if depreciation appears in the Trial Balance ?

(i) What is that amount which is due from a customer but cannot be recovered ?

Ans : (a) Balance Sheet (b) Liability side (c) Balalnce Sheet (d) Interest on capital (e) Interest on drawings (f) Accrued income (g) Prepaid expense (h) Income Statement (i) Bad debts.

3. Rectify the underlined portions of the following sentences :

(a) An expenditure, the benefit of which is consumed in the current year is <u>capital</u> expenditure.

(b) An expenditure, the benefit of which is consumed in more than one accounting period is <u>revenue</u> expenditure.

(c) Provision for discount on debtors <u>sometimes</u> shows a credit balance.

(d) Depreciation appearing in Trial balance will appear in <u>Balance Sheet</u>.

(e) Prepaid expenses appearing in Trial balance is shown on the <u>liabilities</u> side of the Balance sheet.

(f) Outstanding salary, if appears in Trial balance will be shown in the <u>Profits Loss A/c.</u>

(g) The manager's commission is <u>an income</u> for the business firm.

(h) Closing stock is always recorded at cost or market price whichever is <u>higher</u>.

(i) Depreciation is charged on <u>fictitious</u> assets only.

(j) Interest on capital is considered as an <u>expense</u> of the proprietor.

(k) Interest on capital is considered as an income of the <u>business</u>.

(l) Interest on drawing is considered as an <u>income</u> of the proprietor.

(m) Interest on drawing is considered as an income of the <u>proprietor</u>.

(n) For goods withdrawn by proprietor for personal use, purchase account is debited.

(o) For goods distributed as free samples /charity purchase account is <u>debited</u>.

(p) For abnormal loss of stock, insurance claim admitted by insurer is treated in <u>Profit and Loss Account</u>.

(q) All direct expenses are charged to <u>Profit and Loss A/c.</u>

(r) <u>Income Statement</u> depicts the financial position of the business at the end of the year.

(s) <u>Income Statement</u> is also known as the Position Statement of a business.

[Ans. : (a) Revenue (b) Capital (c) Always (d) P&L A/c (e) asset (f) Balance Sheet (g) expense (h) lower (i) fixed (j) income (k) proprietor (l) expense (m) business (n) credited (o) credited (p) Balance Sheet (q) Trading (r) Balance Sheet (s) Balance Sheet.]

4. Fill up the blanks.

(a) Bad debts is a ______ .

(b) Discount received from creditors is an ______ .

(c) An expenditure incurred in achieving economy in operation is a ______ expenditure.

(d) An amount spent on white washing a new factory is a ______ expenditure.

(e) Royalties paid on sales is charged to ______ A/c.

(f) Royalities paid on production is charged to ______ A/c.

(g) Bad debts recovered are transferred to ______ side of Profit and Loss A/c.

(h) All indirect expenses are taken to ______ A/c.

(i) All direct expenses are taken to ______ A/c.

(j) Depreciation is charged on ______ assets.

(k) If prepaid expenses are shown in the Trial Balance, it will be shown onlyin the ______ .

(l) Income received in advance is a ______ for the business firm.

(m) Manager's commission payable is shown on the ______ side of Balance Sheet.

(n) Accrued Income is an ______ for the business.

[Answer: (a) loss (b) income (c) capital (d) capital (e) Profit and Loss (f) Manufacturing (g) credit (h) Profit and Loss (i) Trading (j) Fixed (k) Balance Sheet (l) liability (m) liability (n) asset.]

5. Answer the following questions in one sentence each :

(a) What do you mean by capital expenditure ?

(b) What do you mean by revenue expenditure ?

(c) What is meant by deferred revenue expenditure ?

(d) To which account will the item 'salaries and wages' be transferred ?

(e) What is meant by marshalling of Balance Sheet ?

(f) Why is Balance Sheet also called Position Statement ?

(g) Why is the Trading and Profit and Loss Account called Income Statement ?

(h) What do you mean by adjusted purchase ?

(i) Under which circumstances closing stock is given in Trial Balance ?

(j) What do you mean by doubtful debts ?

6. Answer the following questions within thirty words each :

(a) Distinguish between revenue expenditure and capital expenditure.

(b) What is cost of goods sold ?

(c) Differentiate between Balance Sheet and Tril Balance.

(d) What are the direct expenses ?

(e) What are the two ways of arranging the items of Balance Sheet ?

(f) Differentiate between current asset and fixed asset.

(g) Distinguish between gross profit and net profit.

(h) Name five items appearing in Profit and Loss Account.

(i) Name five items appearing in Trading Account.

(j) Give two examples of fictitious asset.

(k) Give two examples of deferred revenue expenditure.

7. Answer the following questions in fifty words each :

(a) Why is it necessary to distinguish between capital expenditure and revenue expenditure ?

(b) Explain the difference between capital expenditure and capitalised expenditure.

(c) Distinguish between deferred revenue expenditure and prepaid expenditure.

(d) How will you treat 'Outstanding expenses' and 'Prepaid expenses' appearing in the Trial balance ?

(e) How is managers commission on net profit calculated while preparing final account ?

(f) How is abnormal loss treated in final accounts if :

(i) stocks are not insured (ii) fully insured and (iii) partly insured, on the presumption that insurance claim is admitted.

(g) How are accrued income and unearned income treated in final accounts if they appear is the Trial Balance ?

(h) Give adjustment entries for provision for discount on debtors.

(i) Give adjustment entry for provision for bad and doubtful debts.

(j) Define closing entries.

(k) Define adjustment entries.

8. Explain the accounting treatment of outstanding expenses, prepaid expenses, accrued income and unearned income in final accounts with imaginary figures.
9. Give the accounting treatment of goods destroyed by fire under different situations with suitable examples.
10. Show the treatment of goods used for personal use of proprietor, goods distributed as free samples and also for charity in final accounts with suitable examples.
11. What is meant by provision for doubtful debts ? How are the relevant accounts prepared and what journal entries are passed in final accounts ?
12. Is it necessary to pass two entries for every adjustment ? Explain with suitable examples.
13. Calculate gross profit from the extract of Trial Balance of Mohan for the year ending 30.09.2016 :

	₹		₹
Opening stock	15,000	Purchase return	5,000
Closing stock	25,000	Purchases	20,000
Net Sales	40,000	Direct expenses	8,000

(Ans. Gross profit ₹27,000)

14. From the ledger balances given below, prepare the Trading Account for the year ending 31.12.2015 :

	₹		₹
Opening stock	7,000	Returns outward	2,400
Purchases	21,000	Carriage Inwards	3,500
Sales	90,000	Freight & Customs duty	4,600
Returns inward	2,000	Stock on 31.12.2015	10,000

(Ans. Gross profit ₹60,300)

15. From the following Trial Balance, prepare Trading and Profit and Loss Account and Balance Sheet as on 31.12.2016 :

Dr. Balances	(₹)	Cr. Balances	(₹)
Plant & Machinery	27,000	Capital	60,000
Sundry Debtors	21,600	Bills Payable	1,400
Drawings	2,700	Sundry Creditors	2,800
Purchases	59,000	Sales	73,500
Wages	14,500		
Sundry Expenses	600		
Rent and Taxes	1,350		
Carriage Inwards	450		
Bank	4,500		
Opening stock	6,000		
	1,37,700		**1,37,700**

Closing stock as on 31.12.2016 was ₹22,400 (Ans. Gross profit ₹15,950 Net profit 14,000 B/s Total 75,500)

16. From the following Trial Balances of M/s Chahar on 31.03.2017, you are required to prepare Trading and Profit and Loss Account and Balance Sheet as on that date :

Name of the Accounts	Dr. Bal.(₹)	Cr. Bal (₹)
Opening stock	12,000	
Purchases and sales	38,000	80,000
Returns	900	600
Productive wages	6,000	
Dock and clearing charges	4,000	
Donation and charity	600	
Delivery van expenses	6,000	
Lighting	500	
Goods and Services Tax	800	

Bad debts	600	
Miscellaneous incomes		6,000
Rent from Tenants		2,000
Royalty	3,200	
Capital		40,000
Drawings	2,000	
Debtors and Creditors	6,000	8,000
Cash	3,000	
Investment	6,000	
Patents	4,000	
Machinery	43,000	
	1,36,600	**1,36,600**

Closing stock 15,000

(Ans. Gross profit 31,500, Net profit 31,000 B/s Total 77,000)

17. From the following balances, prepare Trading and Profit and Loss Account for the year ended on 31st March 2016 and Balance Sheet as on that date :

Dr. Balances	(₹)	Cr. Balances	(₹)
Insurance	750	Capital	1,52,000
Bad debts	1,250	Discount	2,980
Book debts	82,740	Loans	15,000
Plant & Machinery	31,640	Sales	2,81,500
General expenses	3,630	Provision for bad	
Drawings	6,300	and doubtful debts	4,650
Cash at Bank	13,870		
Bills Receivable	2,860		
Buildings	41,580		
Furniture	5,130		
Discount	3,960		
Bank Charges	100		
Salaries	6,420		
Purchases	1,99,080		
Opening stock	60,220		
Sales Return	1,870		

Carriage	5,170		
Rent and Taxes	7,680		
	4,74,250		**4,74,250**

Adjustments :

(a) Closing stock was ₹70,000.

(b) Create a provision for bad and doubtful debts @10% on debtors.

(c) Insurance prepaid ₹50.

(d) Rent outstanding ₹150.

(e) Interest on Loan is due @6% p.a.

(Ans. Gross Profit 86,610; Net Profit ₹61,176; B/S Total ₹2,39,596.)

18. The following balances have been extracted from the Trial balance of Bijoy. You are required to prepare Trading, Profit and Loss Account for the year ending 30th September 2016 and the Balance Sheet on that date from the given data :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Drawings	20,000	Sales	2,76,000
Bad debts	1,000	Returns outward	2,000
Sundry Debtors	80,000	Capital	2,50,000
Printing and Stationery	2,000	Bank Overdraft	12,000
Freight Inwards	4,000	Provision for bad debts	4,000
Trade Expenses	2,400	Sundry Creditors	20,000
Returns Inward	7,000	Bills Payable	5,400
Opening stock	25,000		
Purchases	1,80,000		
Rent, Rates and Taxes	5,000		
Furniture & Fixtures	20,000		
Plant and Machinery	1,00,000		
Bills Receivable	14,000		
Wages	10,000		
Cash	6,000		
Discount	2,000		
Investment	40,000		
Land and Buildings	51,000		
	5,69,400		**5,69,400**

Adjustments :

(1) Closing stock was ₹45,000.

(2) Provision for doubtful debts is to be made @5% on debtors.

(3) Depreciation charged on Furniture and Fixtures @5% p.a., Plant and Machinery @6% p.a., and on Land and Buildings @10% p.a.

(Ans.Gross profit ₹97,000; Net profit ₹72,500; Balance sheet Total ₹3,39,900.)

19. Prepare Trading, Profit and Loss Account of Mr Sujit for the year ending 31.12.2016 from the following trial balance :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Investment	23,100	Sales	2,50,000
Bed debts	3,500	Returns Outward	6,000
Discount	3,500	Creditors	10,000
Lighting and Heating	5,000	Bills Payable	20,000
Machinery	70,000	Discount	1,000
Cash	10,000	Provision for Bad Debts	4,500
Debtors	50,000	Capital	75,000
Insurance	4,000	Interest Received	5,400
General Expenses	400		
Packing (Primary)	500		
Rent & Rates	1,000		
Wages	3,000		
Salary	12,300		
Postage	600		
Returns Inward	5,000		
Purchases	1,45,000		
Opening Stock	35,000		
	3,71,900		3,71,900

Adjustments :

(1) Closing stock was ₹25,000.

(2) Wages Outstanding ₹1000.

(3) Insurance Prepaid ₹400

(4) Provide for doubtful debt @5% on debtors subject to further bad debts of ₹1,000.

(5) Depreciation on machinery 10% p.a.

(Ans. G.P. ₹86,500, N.P. ₹62,050, B/S Total ₹1,68,050)

20. From the following extracts of a Trial balance of Mr. Sajjan Kumar, prepare Trading, Profit and Loss Account for the year ending 30.06.2017 and the Balance sheet as on that date :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Opening Stock	20,000	Capital	1,06,000
Building	50,000	Sales	2,20,000
Furniture	6,000	Returns Outward	2,000
Purchases	90,000	Discount	500
Carriage Inward	2,000	Sundry Creditors	10,000
Returns Inward	7,000	Bills Payable	4,000
Plant	50,000		
Cash	6,000		
Carriage Outward	500		
Wages	33,000		
Salaries	20,000		
Lighting-factory	1,000		
Sundry Debtors	30,000		
Travelling Expenses	1,500		
Rent & Taxes	5,000		
Drawings	6,000		
General Expenses	2,000		
Insurance	12,500		
	3,42,500		3,42,500

Adjustments:

1. Provide depreciation on plant @5% and on furniture @ 10% p.a.
2. Wages outstanding ₹2,000 and Salaries outstanding ₹1,800.
3. Prepaid Insurance ₹2,00.
4. Stock on 31.06.2017 ₹28,000, its market value is ₹25,000.

(Ans. Gross Profit ₹92,000; Net Profit ₹46,300; B/S Total ₹1,64,100.)

21. Prepare Trading Account, Profit and loss Account for the year ending 31.12.2016 and the Balance Sheet on that date from the Trial Balance of Suraj given below :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Rent	1,000	Capital	46,000
Plant and Machinery	40,000	Creditors	30,000
Horses & Carts	34,000	Sales	20,000
Debtors	10,000	Bills Payable	9,250
Cash in hand	2,600		
Purchases	8,000		
Wages	1,000		
Salaries	1,000		
Repairs	950		
Stock	2,400		
Coal, gas and water	600		
Bad debt	200		
Carriage	300		
Octroi	200		
Drawings	3,000		
	1,05,250		1,05,250

Adjustment:

1. Rent paid in advances ₹120.
2. Wages due ₹300.
3. Depreciate plant and machinery @10% and horses and carts @15% p.a.
4. Interest on capital is charged @10% p.a.
5. Closing stock ₹4,100.

(Ans. Gross Profit ₹11,300; Net Loss ₹5,430; Balance sheet Total ₹81,720)

22. From the trial balance given below, prepare Trading and Profit and Loss Account for the year ending 31.03.2017 and the Balance Sheet as on that date :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Opening Stock	2,000	Capital	10,000
Machinery	4,000	Creditors	1,000
Debtors	2,400	Bills Payable	700

Drawings	1,000	Returns Outward	500
Purchases	11,500	Sales	17,400
Returns Inward	300		
Wages	4,800		
Manufacturing expenses	1,000		
Bank	1,000		
Rent	450		
Carriage	250		
Bad debt	900		
	29,600		29,600

Adjustments :

1. Closing stock was valued at ₹2,450.
2. Depreciate machinery by 8% p.a.
3. Allow interest on Capital @5% p.a.
4. Rent outstanding ₹50.

(Ans. Gross Profit ₹500; Net Loss ₹1,720; Balance sheet Total ₹9530)

23. From the following Trial balance of Rajat Traders, prepare Trading, Profit and Loss Account for the year ending 31.03.2017 and the Balance Sheet as on that date :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Adjusted Purchases	3,80,000	Sales	5,40,000
Sundry Debtors	1,40,000	Sundry Creditors	1,00,000
Returns Inward	3,600	Returns Outward	6,400
Trade Expenses	2,000	Capital	2,00,000
Production expenses	6,000	Commission	16,500
Plant and Machinery	40,000	Bills Payable	2,900
Rates and Taxes	10,000	Loan	30,000
Productive wages	44,000		
Repairs and Maintenance	14,400		
Land and Building	70,000		
Cash	19,000		
Power	14,000		
Office Salaries	11,000		
Bad debts	2,800		

Drawings	12,000		
Carriage Inward	4,600		
Carriage Outward	2,400		
Bills Receivable	15,200		
Sundry Expenses	4,800		
Closing Stock	1,00,000		
	8,95,800		8,95,800

Adjustments :

1. Salaries outstanding ₹1,000
2. Commission accrued but not received ₹3,500
3. Provide depreciation on plant & machinery @10% p.a.

   (Ans. Gross Profit ₹94,200; Net Profit ₹61,800; B/s Total ₹3,83,700.

24. Prepare Trading, Profit and Loss Account for the year ending 30.09.2016 from the extracts of a trial balance given below :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Purchases	3,33,950	Sales	4,52,160
Opening Stock	27,400	Returns Outward	1,150
Returns Inward	2,005	Creditors	12,000
Carriage Inward	7,715	Discount	110
Wages	59,840	Capital	1,00,000
Coal, gas and water	40,860		
Production expenses	6,840		
Debtors	67,900		
General Expenses	3,890		
Bad debt	1,000		
Salaries	3,305		
Rent, Rates & Taxes	2,910		
Cash	4,805		
Drawings	3,000		
	5,65,420		5,65,420

Adjustments :

1. Closing stock ₹45,820
2. Salaries outstanding ₹695.
3. Rent, Rates & Taxes paid in advance ₹910.

(Ans. Gross Profit ₹20,520; Net Profit ₹9,740; B/S ₹1,19,435.)

25. From the following Trial balance of Mr Amit, prepare Trading, Profit and Loss Account for the year ending 30th June 2017 and the Balance Sheet as on that date :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Opening stock	8,000	Sales	37,000
Purchases	20,000	Returns Outward	1,455
Returns Inward	1,350	Capital	30,000
Wages	1,000	Sundry Creditors	20,000
Carriage	500		
Salaries	1,700		
Printing and stationery	800		
Drawings	3,000		
Machinery	32,000		
Cash	105		
Sundry Debtors	20,000		
	88,455		88,455

Adjustments :

1. Wages outstanding ₹300
2. Goods destroyed by fire ₹2,000; Insurance claim was not admitted for the loss.
3. Depreciate machinery by 5% p.a.
4. Closing stock ₹18,000.

(Ans. Gross profit ₹27,305; Net profit ₹21,205; Balance sheet ₹68,505.)

26. From the following trial balance of Kamlesh, prepare final accounts for the year ending 31.03.2017 :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Plant and Machinery	52,000	Capital	75,000
Furniture	8,000	Sales	1,27,500
Sundry Debtors	10,000	Sundry Creditors	12,000

Trade Expenses	1,000	Purchases Return	1,000
Depreciation	2,000	Rent	3,200
Cash at Bank	7,500	Bills Payable	4,000
Wages and Salaries	6,000	Interest	1,000
Opening stock	23,500		
Purchases	90,800		
Discount	1,200		
Drawings	17,000		
Bills Receivable	4,000		
Bad debts	700		
	2,23,700		2,23,700

Adjustments :

1. Closing stock ₹35,000
2. Wages due ₹2,000
3. Create a reserve for discount @ 5% on creditors.
   (Ans. Gross Profit ₹41,200; Net Profit ₹41,100; Balance sheet Total ₹1,16,500.)

27. From the following trial balance taken from the books of Bimal Kumar, prepare Trading, Profit and Loss Account for the year ending 31.12.2016 and a Balance Sheet as on that date :

Dr. Balances	Amount (₹)	Cr. Balances	Amount (₹)
Opening stock	9,700	Bank overdraft	7,000
Purchases	30,250	Creditors	15,000
Bank charges	050	Capital	60,000
Freehold Premises	10,000	Sales	50,920
Fixed Deposit	3,000	Bills Payable	18,000
Furniture	4,000		
Legal Charges	200		
Insurance	600		
General Expenses	2,900		
Telephone	600		
Wages	6,300		
Factory Fuel	2,900		

Bills Receivable	5,320		
Drawings	5,000		
Rent and Taxes	3,500		
Office Expenses	600		
Sundry Debtors	66,000		
	1,59,920		1,50,920

Additional Information :

1. Closing stock was A15,750
2. Prepaid insurance A300
3. Wages due A700
4. Interest accrued on Fixed Deposits @10% p.a.

[Ans. Gross Profit A16,820; Net Profit A8,970; Balance sheet Total A1,04,670.)

28. From the following Trial balance extracted from the books of Pooja Stores, prepare the final accounts for the year ending 31.03.2017 :

Dr. Balances	Amount (A)	Cr. Balances	Amount (₹)
Cash in hand	10,500	Sales	4,30,000
Plant & Machinery	1,20,000	Capital	2,50,000
Furniture	20,000	Bills Payable	5,000
Bad debts	2,000	Discount Received	4,000
Printing	2,500	Sundry Creditors	40,000
Patents	20,000		
Income Tax	5,000		
Debtors	45,000		
Stock as on 01.04.2016	22,000		
Salary Paid	45,000		
Wages	15,000		
Carriage Inward	10,000		
Carriage Outward	9,000		
Land and Building	1,00,000		
Commission	23,000		
Purchases	2,80,000		
	7,29,000		7,29,000

Adjustments :

1. Closing stock was ₹35,000
2. Goods worth ₹15,000 were destroyed by fire but insurance company accepted a claim of ₹10,000 only.
3. Depreciate Plant and Machinery by 10%, Patents by 5% and Buildings by $7^1/_2$%.

4.Wages due ₹ 3,000

(Ans. Gross Profit ₹1,50,000; Net Profit ₹47,000; Balance sheet total ₹3,40,000.)

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CHAPTER-2

FINANCIAL STATEMENTS OF 'NOT FOR PROFIT' ORGANISATIONS

STRUCTURE

2.0 INTRODUCTION

Some organisations are set up with an objective either for making profit or for providing service to the society. Thus, from the point of view of objectives of any legal and accounting entity, one can divide the organisations into two categories such as : (a) Trading/Manufacturing or Profit making organisations, and (b) Non-trading or 'Not for Profit' making organisations. The trading organisations are the common business organisations such as sole trading units, partnership firms and corporate houses like Reliance Industries Ltd., Tata Iron and Steel Company Ltd., National Alumunium Company Ltd., Parle Agro Private Ltd., etc. The main objective of commercial organisations is to earn profit. On the other hand, non-trading or 'not for profit' making organisations primarily provide services to the society at large and also to its meambers without any objective of making profit. These organisations are mainly set up for social, religious, cultural, scientific, charitable, recreation and entertainment purposes. Social organisations are non-governmental organisations like clubs, societies and associations. The charitable organisations are like hospitals, religious organisations like temples, mosques, churches, educational and cultural organisations like schools, colleges, universities, libraries, etc. These organisations mainly render services to the society and also to its members. They carry on their activities for promoting their objectives of raising the standard of living and other socio-cultural and economic conditions of the society.

2.1 MEANING

'Not for profit' organisations are those organisations whose main objective is not to earn profit but to render services to its members and to the society at large. These organisations help in promoting art, science, culture, religion, charity, recreation, entertainment, etc. Their intention is to spend their earnings in promoting their organisational objectives. They restrict on distributing dividend to its members. The examples of some organisations are, Board of Cricket Control of India, Cricket Associations of different states, Institute of Chartered Accountants of India, Federation of Indian Chambers of Commerce and Industries, charitable educational institutions like DAV group of educational institutions, etc.

2.2 OBJECTIVES

The primary objective of 'not for profit' organisations is to render valuable services to its members and to the society. They carry out their activities without an intention to make profit. The main objectives of such organisations are :

(a) to render valuable services to its members and to the society;

(b) to work without any motive to earn profit;

(c) to promote art, culture, religion, etc;

(d) to create awareness on social evils like untouchability, child marriage, animal sacrifice, etc;

(e) to promote health and education in remote, hilly and mountaineous regions;

(f) to promote and protect socio-economic status of its members and the society;

(g) to provide entertainment facility and charity.

2.3 NECESSITY OF PREPARING FINANCIAL STATEMENTS

The 'not for profit' organisations do not exist for earning profit. They simply render services to the public. The primary sources of income of such organisations are by way of fees, donations, subscriptions, grants, etc. These incomes do not belong to any person in particular. There are chances of fraud and mismanagement of cash and other valuable assets of such organisations. An Executive Committee or Governing Body or Trust is formed by taking a group of persons as members to organise and manage the activities and funds of the organisation. An individual works as the Chairman or Director or CEO (Chief Executive Officer) or Trustee of the organisation. It becomes essential to record and maintain the books of accounts regularly and periodically.

Accounting for 'not for profit' organisations is a particular accounting system. This accounting system accumulates, communicates and interpretes the historical data useful for the purpose of ascertaining the financial position and operating results of such an organisation.Accumulating of data refers to collection, recording and summarising the historical data and finding out the operating results and financial position of the organisation, communicating the accumulated data to the stakeholders of the organisations like members, society, government, donors by preparing Income and Expenditure Account and Balance Sheet.

2.4 BOOKS OF ACCOUNTS AND ACCOUNTING PROCEDURE

As most of the transactions of 'not for profit' organisations are in cash, they normally maintain a book to record the receipts and payments of cash. It is known as Receipts and Payments Account. Besides this book, they maintain other books, such as :

(a) Members' Register: It is a record of all the members of 'not for profit' organisations. This register contains the name, address and date of admission as member in the organisation. It also records, whether a member is a Life member or Annual member.

(b) Personal Ledger : It consists of :

(i) Collection Register : It records the collection of fees, subscriptions from members, etc.

(ii) Donors' Register : It shows the amount paid by the donors - how much is received and how much is outstanding and for which purpose the amount is donated, i.e., whether it is a general donation or a specific donation.

(c) Stock Register : It keeps the record of all properties purchased, i.e., purchase of land and buildings, machineries, furniture, investments, books, consumable stores, sports materials, etc.

(d) Minutes Book : It is a record of the proceedings of the meetings of Executive Committee or Governing Body or any other body as may be named.

At the end of each accounting period, the 'not for profit' organisations prepare :

(i) Receipts and Payments Account;

(ii) Income and Expenditure Account; and

(iii) Balance Sheet

2.5 RECEIPTS AND PAYMENTS ACCOUNT

Usually, the 'not for profit' organisations prepare a Receipts and Payments Account at the end of each accounting period. It is simply a summary of Cash Book. This account is prepared on the basis of transactions recorded in the Cash Book. Each item of receipt and payment recorded chronologically in the Cash Book is summerised and totalled. The total amount of an item is recorded in the Receipts and Payments Account. For example, salary paid to the employees are recorded in the cash book on different dates of different months. Then individual salary item is totalled for the year and recorded in the payment side of the Receipts and Payments Account. Similarly, subscriptions and fees collected from members on different dates of different months are recorded in the Cash Book. The fees/suscriptions received for the year is totalled and recorded on the receipt side of Receipts and Payments Account.

2.5.1 Meaning of Receipts and Payments Account

A Receipts and Payments Account is a Real Account. It records the classified summary of transactions of a Cash Book alongwith cash and bank balances in the beginning and end of an accounting period. All receipts are recorded on the debit (receipts) side and all payments are recorded on the credit (payments) side of this account.

According to William Pickles "Receipts and Payments Account is nothing more than a summary of cash book (cash and bank transactions) over a certain period, analysed and classfied under suitable headings. It is the form of account most commonly adopted by the treasurers of societies, clubs, associations, etc. when preparing the results of the year's working."

2.5.2. Features of Receipts and Payments Account

The main features of Receipts and Payments Account are as follows :

(i) It is a Real Account and is based on the golden principle of double-entry system of book-keeping, i.e., debit what comes in and credit what goes out.

(ii) It starts with an opening balance of cash in hand and cash at bank at the beginning of the accounting period.

(iii) It ends with a closing balance of cash in hand and cash at bank at the end of the accounting period.

(iv) It is a summary of Cash Book. It represents the totals of all transactions of Cash Book under different heads.

(v) It ignores the time period of cash transactions. The receipts and payments made in the current year may relate to the previous year, current year or the next year.

(vi) The transactions are recorded in this account without any date.

(vii) All receipts are recorded on the debit side and all payments are recorded on the credit side.

(viii) It ignores the cash or bank status by summing up both cash and bank transactions as similar transactions. Contra entries are not passed for a cash and bank transaction.

(ix) It does not record non-cash items like depreciation, outstanding expenses or accuced incomes.

(x) It ignores the nature of the transactions while recording. It records all receipts and payments whether they are of revenue or capital in nature.

2.5.3. Format of Receipts and Payments Account

Receipts and Payments Account of...

Dr. for the year ending 31.12.20.... Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Balance b/d	
Cash	....	(in case of	
Bank	....	Bank overdraft)	....
To Subscriptions :		By Rent, Rates and Taxes	....

Previous year	....	By Salaries	....
Current year	....	By Printing and Stationery	....
Next year	....	By Postage and Telephone	....
To Dividend received	....	By Purchase of News	
To Interest received	....	Papers/periodicals	....
To General donations	....	By Electricity and Water	....
To Govt. grants	....	By Travelling and Conveyance	....
To Lockers rent	....	By Repairs and Maintenance	....
To Rent of club	....	By Upkeep of Lawn	....
To Rent of Hall	....	By Charity Show expenses	....
To Rent of playground	....	By Advertisement	....
To Sale of old newspaper	....	By Honorarium to	
and periodicals	....	Secretary/coach/doctors	....
To Proceeds from charity show	....	By Bar Payments	....
To Tuition fees	....	By Catering payments	....
To Sale of Assets	....	By Restaurant Expenses	....
To Bar takings receipts	....	By Entertainment	....
To Legacies	....	By Tournament Expenses	....
To Entrance fees	....	By Office Expenses	....
To Lifemembership fee	....	By Library Books	....
To Specific Donations	....	By Purchase of Land and	
To Endowment Fund receipts	....	Building, flat	
To Prize Fund		machinery, and furniture	
To Sports Fund		By Payment of Bank Loan	....
To Scholarship Fund		By Billiard Table	....
To Bank Loan		By Mowing Machine	....
To Sundry Receipts		By Balance c/d	
To Restaurant takings		Cash	
To Tournament proceeds	....	Bank	....

2.5.4 Difference between Receipts and Payments Account and Cash Book

Basis of difference	Receipt and Payments A/c	Cash Book
1. Nature	It is a ledger account.	It is a journal as well as ledger account
2. Prepared by	It is prepared by 'not for profit' organisations.	It is prepared by trading and manufacturing organisations with profit motive.
3. Manner of recording	Transactions of similar nature are recorded in summarised form and put under one head.	Transactions are recorded chronologically as and when they occur.
4. Contra Entries	It ignores contra entries.	It records contra entries for a transaction in cash and bank
5. Side	Left side is Receipt and right side is Payment.	Left side is debit and right side is credit.
6. Columns	There is only one column for recording both cash and bank transactions.	There is separate column for recording cash, bank and discount transactions.

2.6 INCOME AND EXPENDITURE ACCOUNT

The 'not for profit' organisations are interested to know the financial performance of their activities at the end of each year, like the trading organisations. While the trading organisations prepare Trading Account, Profit and Loss Account, 'not for profit organisations' prepare Income and Expenditure Account, at the end of each accounting period. They are interested to know whether their incomes are sufficient to meet the expenditures or not.

2.6.1 Meaning of Income and Expenditure Account

Income and Expenditure Account is a Nominal Account, It is a summary of revenue incomes and revenue expenditures of a 'not for profit' organisation in an accounting period. All expenses and losses of revenue nature are recorded on the debit side and all incomes and gains are recorded on the credit side.

If the credit side of the account is more than its debit side, it is known as surplus or excess of income over expenditure. But if the debit total of this account is more than its credit total, it is known as deficit or excess of expenditure over income.

Income and Expenditure Account is prepared on accrual basis and not on cash basis.That is why all the incomes earned during an accounting period are recorded in this account. The incomes earned both received and accrued are taken into account. The incomes received in advance is deducted from the total of incomes received in cash during the accounting period. Similarly, all expenses incurred in the relevant period, whether paid or not, are taken into consideration. Any prepaid expenditure is deducted from the total expenditure paid during an accounting period. The excess of income over expenditure or the excess of expenditure over income is transferred to Capital Fund, shown in the Balance Sheet.

2.6.2. Features of Income and Expenditure Account

1. It is a nominal account.
2. It is debited with all expenses and losses of revenue nature.
3. It is credited with all incomes and gains of revenue nature.
4. It is prepared on accrual basis.
5. If records only income and expenditures of the current accouting period.
6. It takes into account all outstanding expenses and accrued incomes.
7. It records both cash and non-cash items like depreciation, bad debt, expenses payable and incomes receivable for the current accounting period.
8. Its balance at the end of the accounting period is either surplus, i.e., excess of incomes over expenditures or deficit, i.e., excess of expenditures over incomes.
9. The balance either surplus or deficit is transferred to Capital Fund in the Balance Sheet.

2.6.3 Difference between Income and Expenditure Account and Receipts and Payments Account

Basis of differences	Receipts and Payments Account	Income and Expenditure Account
1. Types of Account	It is a Real account	It is a Nominal account.
2. Objective	Its objective is to provide a summary cash receipts and payments of similar transactions during an accounting period.	Its objective is to ascertain the surplus or deficit of its financial operations.
3. Form	It is a summarised form of cash book.	It is in the form of an Income statement, i.e., profit and loss account.
4. Opening Balance	It starts with opening balances of cash in hand cash and at bank.	It does not start with any opening balance.
5. Closing Balance	It ends with closing balances of cash in hand and cash at bank.	It ends with a closing balance of surplus i.e. excess of income over expenditure or deficit, i.e., excess of expenditure over income.
6. Debit	All receipts of cash-both revenue and capital are debited.	All revenue expenses/ losses are debited.
7. Credit	All payments of cash are credited.	All revenue incomes and gains are credited.
8. Cash items	It ignores non-cash items	It records non-cash items
9. Revenue/Capital	If records both revenue and capital items.	It records only revenue items.
10. Transfer	Closing balance is transfered to next year.	Closing balance is transferred to capital fund.

2.6.4 Difference between Income and Expenditure Accoutnt and Profit and Loss Account

Both the accounts one prepared for the purpose of ascertaining the results of financial operations. Both record only the revenue items. Adjustment entries are passed in both the accounts for transactions not taken care of.

Inspite of such similaries between the two, there are some differences which are discussed below :

Basis of differences	Income and Expenditure Accoutnt	Profit and Loss Account
1. Organisation	It is prepared by 'not for profit' organisation.	It is prepared by trading and commercial organisations.
2. Basis	It is prepared on the basis of data from Receipts and Payments Account.	It is prepared on the basis of data from the Trial balance.
3. Objective	Its objective is to ascertain the excess of income over expenditure or excess of expenditure over income.	Its objective is to ascertain the net profit or net loss.
4. Opening balance	It does not have any opening balance.	It starts with gross profit/loss as opening balance.
5. Transfer of closing balance	Closing balance is transferred to Capital fund.	Closing balance is transferred to Capital Account.

2.6.5 Format of Income and Expenditure Account

The typical proforma of Income and Expenditure Account is given below :

Income and Expenditure Account of ......

Dr. for the year ending 31st....... 20...... Cr.

Expenditure	(₹)	Income	(₹)
To Salaries	....	By Subscriptions	....
To Wages	....	By Entrance Fees	....
To Rent, Rates and Taxes	....	By Donations	....
To Purchase of news papers, magazines	....	To Dividend and Interest	....
To Repairs and maintenance	....	By Proceeds from Lectures	....
To Charity	....	By Income from charity show	....
To Expenses on Lectures	....	By Profit on sale of fixed Assets	....
To Upkeep of lawn	....		

To General Body Expenses	....	By Profit on sale of sports	
To Land Revenue	....	equipment / materials	....
To Entertainment Expenses	....	By Sales of Periodicals	
To Tournament Expenses	....	and Journal	....
To Printing and Stationery	....	By Visiting Fees	
To Ground Rent	....	(Received by doctors)	....
To Honorarium to CEO/		By Sale of Grass	....
Coach / Doctors	....	By Fees from Non-members	....
To Purchase of Bars	....	By Locker Rent	....
To Cost of Refreshments	....	By Income from	
To Annual function Expenses	....	Restaurants	....
To Audit Fees	....	By Receipts from	
To Help to Poor Students	....	Annual Function	....
To Conveyance and Travelling	....	By Bar Takings (Collections)	....
To Electricity and Water	....	By Income from	
To Bank Charges	....	Billiard Rooms	....
To Grass seeds		By Grants from Governments	
To Surgery and Dispensary		and Local Authority	....
To Loss from Annual Dinner		By Souvenir Advertisement	....
To Loss from sale of		By Deficit transferred to	
Fixed Assets		Capital Fund	....
To Loss on sale of sports			
Equipment / materials	....		
To Miscellaneous Expenses	....		
To Insurance Premium	....		
To Depreciation on			
Fixed Assets	....		
To Surplus transferred to			
Capital Fund	....		

2.7 TREATMENT OF SOME IMPORTANT ITEMS

1. Legacy : Legacy is the amount received from property of a deceased person as per his 'will' prior to his death. It is a type of donation received by the 'not for profit' organisations under a 'will' on the death of the donor. It appears on the receipt side of the Receipts and Payments Account. If the amount of the legacy is very small and not for any specific purpose, it is treated as 'revenue' receipt and credited to Income and Expenditure Account. On the other hand, if the amount of legacy is significantly large and for a specific purpose, it is a 'capital' receipt and credited to Capital Fund in the Balance sheet.

2. Donations : Donation is an amount received by the 'not for profit' organisations from a donor. The donor may be a member of the organisation or an outsider. The purpose of the donation may be either general or specific.

If the amount of 'General' donation is small, it is treated as a 'revenue' receipt and credited to Income and Expenditure Account. On the other hand, if the amount of general donation is significantly large, it is treated as a 'capital' receipt and credited to Capital Fund in the Balance Sheet, Whether the general donation is small or large, it depends on the nature and size of the organisation. If the question is silent on the nature of donation, it is treated as a general donation and the students should specify it under foot note.

Any donation received for a specific purpose is treated as a 'capital' receipt and is credited to that specific fund and shown on the liabilities side of the Balance Sheet. The specific funds are like Building Fund, Prize Fund, Tournament Fund, etc. Any income from the specific fund is credited to that fund and any expenditure of revenue in nature is deducted from the specific fund. Sometimes a part of the specific fund is transferred to Capital Fund in the Balance Sheet. When the amount of the specific fund is invested outside the business, a Specific Fund Investment Account is opened and shown on the assets side of the Balance Sheet.

Illustration 1

From the extracts of the Receipts and Payments Account of an Orphanage, treat the amount of donations :

Receipts and Payments Account (extracted)
for the year ending 31.03.2017

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	-----------		
To Donations for			
Building Fund	1,00,000		
To Donations	7,000		
To Legacy	70,000		

Additional Information : (1) An amount of ₹9,000 is spent on building (2) Capital Fund stood at ₹2,00,000.

Solution :

Income and Expenditure Account
for the year ending 31.03.2017

Dr. Cr.

Expenditure	(₹)	Income	(₹)
		By Donations	7,000

Balance Sheet as on 31.03.2017

Liabilities		(₹)	Assets	(₹)
Capital Fund :	2,00,000			
Add Legacy	70,000	2,70,000		
Building Fund	1,00,000			
Less :				
Building Expenses	9,000	91,000		

3. Entrance Fees : Entrance fee is received from the new members only at the time of admission into the organisation. The entrance fee received is non-recurring in nature. So it is treated as a Capital receipt and shown on the liability side of the Balance Sheet.

Some accountants are of the view that entrance fees are received regularly from the members and hence, it is recurring in nature and treated as revenue receipt and credited to Income and Expenditure Account. In the absence of any specific information, the students are advised to justify the accounting treatment by giving a foot note.

4. Life membership fees : It is a lump sum amount received once only from the members for their permanent/life membership. It is non-recurring in nature. It is a capital receipt and should be shown on the liability side of Balance Sheet either as an independent item or added to Capital Fund on the liability side of Balance Sheet.

5. Sale of Assets : Sale of old and obsolete assets like equipment, sports materials, waste papers is treated as revenue receipts and credited to Income and Expenditure Accounts. Normally the sale of old current assets are revenue in nature and credited to Income and Expenditure Account.

The sale proceeds of the fixed assets are credited to the relevant Fixed Asset Account as a capital receipt. But the profit/loss on sale of the fixed asset is credited/ debited to Income and Expenditure Account. The profit or loss sale of fixed asset is the difference between the sales proceeds and its written down value.

6. Sale of old news papers : The sale proceeds of old news papers and periodicals are treated as revenue receipts. It is a recurring source of revenue. It is credited to Income and Expenditure Account.

7. Sale of consumble stores : The 'not for proft' organisations have some consumbale items for sale during their normal course of operations. These are : sale of eatable refresments, medicines, stationeries, etc. These are treated as revenue receipts and credited to Income and Expenditure Account.

8. Subscription : Subscription is a periodical contribution of specific amount by the members to a 'not for profit' organisation. It is a regular/recurring income of the club or society. The subscriptions may be collected from the members monthly, quarterly, half-yearly or annually. It is a revenue receipt and is credited to Income and Expenditure Account.

9. Endowment Fund : Endowment Fund is a permanent fund created by the 'not for profit' organisations from receipts in the form of gifts, bequests, etc. It is a capital receipt and shown on the liability side of the Balance Sheet. It represents a permanent source of income to a 'not for profit' organisation. Any interest received from the Endowment Fund Investments is credited to Income and Expenditure Account.

10. Specific Fund : 'Not for profit' organisations create some specific funds like Tournament Fund, Prize Fund, Building Fund, Entertainment Fund, etc. Any receipt from this type of fund invested in various securities, is credited to the specific fund account while the expenses on those specific funds are debited to the fund account and the balance is shown on the liabilities side of the Balance Sheet.

When the expenses of the specific fund are more than the balance of the fund account, the difference is debited to the Income and Expenditure Account.

As and when the purpose of the specific fund is fulfilled, the balance in the specific fund is transferred to Capital Fund.

11. Honorarium : An amount paid to the invitees, guest lecturers, doctors, artists, singers for their voluntary services is called honorarium. This amount is paid to them in their honour for visiting the 'not for profit' organisation and providing service to the public. It is a revenue expenditure and is debited to Income and Expenditure Account.

12. Capital Fund : The excess of assets over the total outside liabilities is called Capital Fund of a 'not for profit' organisation. It is shown on the liabilities side of the Balance Sheet. Capital Fund is also called the General Fund. Capital Fund is increased by addition of surplus and decreased by deduction of deficit. Sometimes, the amount of special funds are transferred to this fund and some receipts are capitalised.

Capital Fund is the major source of funds of every 'not for profit' organisation. It accumulates year after year. The capital fund at the end of the year becomes the opening Capital Fund for the following year. The increase/decrease in Capital Fund is shown as below :

Opening Capital Fund at the beginning of the year	XXX
Add : Surplus (excess of income over expenditure)	XXX
Capitalised portion of Entrance Fees/Life membership Fees	XXX
Amount transferred from special fund, if any	XXX
	XXX
Less : Deficit (Excess of expenditure over income)	XXX
Closing Capital Fund	XXX

13. Government Grant : Grant from the Government is an important source of revenue for a 'not for profit' organisation. Grants from the Governemnts are received for (i) maintenance and for (ii) development. The grants for maintenance is meant for day-to-day expenses of the organisation. It is treated as a revenue income and credited to Income and Expenditure Account. The grants for development are meant for acquiring any fixed asset. The grants for development are non-recurring and are capital receipts. So it is shown on the liabilities side of the Balance Sheet as an independent item.

2.8 PREPARATIN OF INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEET

(A) The preparation of Income and Expenditure Account is followed by the preparation of Balance Sheet of a 'not for profit' organisation. The Income and Expenditure Account is prepared on the lines of Profit and Loss Account prepared by the profit-making organisations. The revenue expenses are debited and revenue incomes are credited to this account on the basis of the information from the Receipts and Payments Account. The steps in the preparation of Income and Expenditure Account are :

1. Ignore the opening balance of cash and bank.
2. Ignore all capital receipts and all capital expenditures.

3. Ascertain the revenue incomes of the current accounting period and credit them to Income and Expenditure Account. The revenue income of the current accounting period is to be calculated as follows :

Calculation of Revenue Income

Revenue receipts as per Receipts and Payments A/c		XXX
Add : Accrued Income at the end of curent year	XXX	
Income received in Advance in the previous year	XXX	XXX
		XXX
Less : Accured Income in the Previous year	XXX	
Income received in Advance at the end of the current year	XXX	XXX
Revenue Income for the current accounting period		XXX

4. Ascertain the revenue expenses of the current year and debit them to Income and Expenditure Account. The revenue expense of the current year is to be calculated as follows :

Calculation of Revenue Expenses

Revenue payments as per Receipts and Payments Account		XXX
Add: Outstanding expenses at the end of the current year	XXX	
Prepaid expenses at the end of the previous year	XXX	XXX
		XXX
Less Outstanding expenses at the beginning of the previous year	XXX	
Prepaid expenses at the end of the current year XXX	XXX	
Revenue Expense of the current accounting year		XXX

5. Ascertain the non-cash expenses such as depreciation or loss on sale of fixed assets. These non-cash expenses are to be debited to Income and Expenditure Account.

6. Ascertain profit or loss from the trading activities such as Restaurant Bar, Canteen, etc. separetely. Show them on the credit side (if profit) or on the debit

side (if loss) of Income and Expenditure Account. A Separate trading account is to be prepared for each trading activity. Debtors Account and Creditors Account are to be prepared for credit sales and credit purchases repectively.

7. Ascertain the difference between the total of credit side and total of debit side of the Income and Expenditure Account.
   (a) If the total of the credit side is more than the total of the debit side, it is surplus. The surplus is transferred and credited to 'Capital Fund'.
   (b) If the total of the debit side is more than the total of the credit side, it is deficit. The deficit is transferred and debited to 'Capital Fund'.

Illustration 2

Calculate the subscription income and show it in Income and Expenditure Account and in Balance Sheet from the data given below :

Subscription received during 2016	₹25,000	
	01.01.2016	31.12.2016
Subscription Accrued	₹5,000	₹3,000
Subscription Received in Advance	₹3,000	₹2,000

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income		(₹)
		By Subscription	25,000	
		Add : Accrued 31.12.16	3,000	
		Advance on 01.01.16	3,000	
			31,000	
		Less: Accrued on 1.1.16 (-)	5,000	
		Advance on 31.12.16 (-)	2,000	24,000

Balance Sheet as on 31.12.2016

Liabilities	(₹)	Assets	(₹)
Subscription received in Advance (Closing)	2,000	Subscription Accrued (Closing)	3,000

Illustration 3

Ascertain the Rent expenses and show it in Income and Expenditure Account and in Balance Sheet from the information given below :

	(₹)
Rent paid during the year ending 31.12.15	22,000
Rent outstanding as on 31.12.2015	5,000
Rent outstanding as on 01.01.2015	3,000
Rent prepaid as on 31.12.2015	4,000
Rent prepaid as on 01.01.2015	2,000

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income	(₹)
	(₹)			
To Rent	22,000			
Add : Outstanding (on 31.12.15)	5,000			
Prepaid (on 01.01.15)	2,000			
	29,000			
Less :				
Prepaid on 31.12.15 (-)	4,000			
Outstanding on 01.01.15 (-)	3,000	22,000		

Balance Sheet as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Rent outstanding (31.12.15)	5,000	Rent prepaid (31.12.15)	4,000

Illustration 4

From the following Receipts and Payments Account, prepare Income and Expenditure Account for the year ending 31st December 2016 :

Dr. Cr.

Receipts		(₹)	Payments		(₹)
	(₹)				
To Balance b/d			By Salary		8,000
Cash in Hand	1,000		By Insurance Premium		2,000
Cash at Bank	9,000	10,000	By Printing and Stationery		1,000
To Subscriptions			By Electricity		1,500
2015	4,000		By Furniture		12,000
2016	30,000		By Mowing Machine		18,000
2017	6,000	40,000	By Annual Drama Expenses		7,000
To Entrance Fees		4,800	By Subscription to Journals		3,000
To Sale of old New papers		300	By Investments		15,000
To Locker Rent		2,900	By Balance c/d	(₹)	
To Hire of Ground		2,000	Cash in Hand	800	
To Sale of Annual Drama Tickets		10,000	Cash at Bank	2,200	3,000
To Interest on Investments		500			
		70,500			**70,500**

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income		(₹)
To Salary	8,000	By Subscriptions		30,000
To Insurance Premium	2,000	By Entrances Fees		4,800
To Printing and Stationery	1,000	By Sale old news papers		300
To Electricity	1,500	By Locker Rent		2,900
To Subscription to Journal	3,000	By Hire of Ground		2,000
To Excess of Income				
over Expenditure	25,000	By Interest on on Investment		500
		By Profit from Annual		
		Drama :	(₹)	
		Sale of Tickets	10,000	
		Less : Expenses	7,000	3,000
	40,500			40,500

(B) After preparation of Income and Expenditure Account, a Balance Sheet has to be prepared by the 'not for profit' organisations. The Balance Sheet of these organisations is prepared on the lines of preparation of Balance Sheet of any Trading and profit-making organisations. The excess of assets over liabilities is treated as 'Capital Fund' or 'General Fund'. No members contribute to the Capital Fund of the 'not for profit' organisations. Capital Fund. is increased with capital receipts, receipts which are capitalised and surplus of the Income and Expenditure Account. If Capital Fund is not given in the beginning, it is to be ascertained by preparing the opening Balance Sheet.

Balance Sheet is prepared from the items remaining in the Receipts and Payments Account after transfer of all revenue incomes and expenses to the Income and Expenditure Account. The Balance Sheet contains only the capital items, i.e., capital expenditures and capital receipts, liabilities and Capital Fund.

Assets and liabilities are to be arranged either on the basis of 'permanence' or on the basis of 'liquidity'.

The following points should be taken into consideration at the time of preparing the Balance Sheet :

(i) Recording of Fixed Assets : The fixed assets in the opening balance sheet are to be adjusted for assets purchased, sold and depreciation charged during the year. The new fixed assets purchased shown on the credit (payment) side of Receipts and Payments Account is to be added to the balance of fixed assets of opening Balance Sheet while preparing the new balance sheet. If only asset is sold, its book value/written down value is to be deducted from the relevant asset of the previous year. The amount of depreciation is to be charged after adjustment of purchase and sale of fixed assets.

(ii) Recording of Prepaid Expenses and Accrued Incomes : The prepaid expenses and accrued incomes at the end of the accounting period are to be shown on the assets side of the closing Balance Sheet. Similarly, the prepaid expenses and accrued incomes of the previous year are taken to the assets side of the opening Balance Sheet.

(iii) Recording of Balances of cash in hand and cash at bank : The opening balance of cash in hand and cash at bank shown in the receipts and payments account, are to be transferred to the assets side of the opening Balance Sheet. Similarly, the closing balnaces of cash in hand and cash at bank shown in the receipt and payments account are transferred to the assets side of the closing Balance Sheet.

(iv) Balance of consumable items: The balances of consumable items like stationeries, sports materials, medicines, stock of bars, refreshments at the end of the accounting period are to be shown on the assets side of the closing Balance Sheet.

(v) Recording of Capital Fund : The capital fund of the opening Balance Sheet is adjusted with curent year's surplus/deficit and transfer from Special Fund Account, Capitalised portion of Entrance Fees and Life Membership Fees in the closing Balance Sheet.

(vi) Recording of Loans : The loan appearing on the liability side of the opening Balance Sheet is to be taken to the closing Balance Sheet. Any repayment of loan shown on the credit side of the Receipts and Payments Account is taken for deduction in the closing Balance Sheet. Similarly, if some additional loan is raised from the banks or other financial institutions, are added to the loan account in the closing balance sheet. The fresh loan taken during the current year is found on the credit side of Receipts and Payments Account.

(vii) Recording of Capital Receipts : The capital receipts like donations for specific purpose are shown on the liabilities side of the Balance Sheet. Similarly, Special Funds and Endowment Funds will be shown on the liabilities side of the Balance Sheet.

(viii) Recording of Entrance fees, Legacies and Life Membership Fees : When it is decided to capitalise these receipts, these are transferred to the liabilities side of the Balane Sheet.

(ix) Outstanding expenses and incomes received in advance at the end of the accounting period are shown on the liability side of the closing Balance Sheet. Similalry, prepaid expenses and accrued incomes at the end of the accounting period, are shown on the assets side of the Balance Sheet.

FORMAT OF BALANCE SHEET

BALANCE SHEET AS ON ......

Liabilities		(₹)	Assets		(₹)
Capital Fund :			Land and Building	XXX	
Opening Balance	XXX		Less Depreciation	XXX	XXX
Add : Surplus	XXX		Ground and Pavillion		XXX
Entrance Fees	XXX		Sports Equipment		XXX
(Capitalised portion)			Mowing Machine		XXX
Life membership fee	XXX		Furniture and Fixtures		XXX
(Capitalised portion)			Billiards Table		XXX
Amount Transferred			Liabrary Books		XXX
from Speecial Fund	XXX		Motor Vehicles		XXX
	XXX		Crockery and Cutlery		XXX
Less : Deficit	XXX	XXX	Investments :		
Special Fund :			Share	XXX	
Prize Fund	XXX		Debentures	XXX	
Add: Income from Prize Fund	XXX		National Savings Certificates	XXX	

	XXX		Prize Fund Investment	XXX	
Less : Prize Awarded	XXX	XXX	Building Fund Investment	XXX	XXX
Building Fund		XXX	Endowment Fund Investment		XXX
Tournament Fund		XXX	Scholarship Fund Investment		XXX
Scholarship Fund		XXX	Fixed Deposits		XXX
Endowment Fund		XXX	Current Assets :		
Loans		XXX	Sports Materials		XXX
Life Membership Fees		XXX	Stock of Refreshments		XXX
Entrance Fees		XXX	Bar Stock		XXX
(if capitalsed)			Stock of medicines		XXX
Legacy		XXX	Prepaid Expenses		XXX
Government Grants :			Accrued Incomes		XXX
For Development		XXX	Cash in Hand		XXX
For Books		XXX	Cash at Bank		XXX
For Computers		XXX			
For Pavillion		XXX			
Current Liabilities :					
Bank overdraft		XXX			
Creditors		XXX			
Outstanding Expenses		XXX			
Subscriptions received in advance		XXX			
		XXX			XXX

Illustration 5

From the following Receipts and Payments Account of Sambulpur Club for the year ending 31.12.2016, prepare Income and Expenditure Account for the year and the Balance Sheet as on that date :

Receipts and Payments Account
for the year ending 31.12.2016.

Dr. Cr.

Liabilities		(₹)	Assets	(₹)
To Balance b/d :	(₹)			
Cash in Hand	4,800		By Salaries	15,000
Cash at Bank	5,000	9,800	By Printing and Stationeries	3,000
To Subscriptions :			By Office Expenses	8,500

	(₹)		By Books		10,000
For 2015	12,500		By Newpapers		6,000
For 2016	34,500		By Rent		4,500
For 2017	5,400	52,400	By Balance c/d :		
To Rent of Hall		12,000	Cash in Hand :	18,000	
To Entrance Fees		5,000	Cash at Bank	15,200	33,200
To Sale of Old News Papers		1,000			
		1,000			
		80,200			80,200

Additional Information:

(i) On 01.01.2016, the club owned Building valued ₹2,00,000 and Furniture ₹50,000.

Solution :

Income and Expenditure Account of
Sambalpur Club for the year ending 31.12.2016

Dr. Cr.

Expenditures	(₹)	Incomes	(₹)
To Salaries	15,000	By Subscriptions	34,500
To Printing and Stationeries	3,000	By Rent of Hall	12,000
To Office Expenses	8,500	By Entrance Fees	5,000
To Newspapers	6,000	By Sale of old Newspapers	1,000
To Rent	4,500		
To Exces of Income over Expenditure (surplus transferred to Capital Fund)	15,500		
	52,500		52,500

Balance Sheet of Sambalpur Clus
as on 31st December, 2016

Liabilities		(₹)	Assets	(₹)
Subscriptions received in advance		5,400	Cash in hand	18,000
Capital Fund :			Cash at bank	15,200
Opening balance	2,72,300		Building	2,00,000
Add surplus	15,500	2,87,800	Furniture	50,000
			Library books	10,000
		2,93,200		2,93,200

Working Note :

Balance Sheet as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund	2,72,300	Cash in Hand	4,800
(Balancing figure)		Cash at Bank	5,000
		Subscription outstanding	12,500
		Furniture	50,000
		Building	2,00,000
	2,72,300		2,72,300

Illustration 6

From the following Receipts and Payments Account and additional information, prepare the Income and Expenditure Account and Balance Sheet of DAV Educational Society :

Receipts and Payments Account
for the year ending 31.12.2016

Dr. Cr.

Receipts		(₹)	Payments	(₹)
To Balance b/d		20,550	By General Expenses	4,200
To Subscriptions			By Newspapers	2,850
For 2015	2,200		By Salaries	4,600
For 2016	27,500		By Electricity	3,000
For 2017	2,500	32,200	By Investments	30,000
To Lockers Rent		3,000	(@10% per annum)	
To Sale of old Newspapers		250	By Rent	5,500
To Sale of Old Furniture		4,200	By Printing and Stationery	3,300
(Book Value ₹6,000)			By Furniture	20,000
To Interest on Investment		450	By Balance c/d	7,200
To Grants from Government		20,000		
		80,650		80,650

Additional Information :

(i) Subscription outstanding on 31.12.2016 ₹2,000

(ii) Salary outstanding on 31.12.2016 ₹1,400

(iii) Rent ₹700 has been paid in advance.

(iv) On 01.01.2016, the society had furniture worth ₹15,000.

Solution :

DAV Educational Society

Income and Expenditure Account

for the year ending 31.12.2016

Dr. Cr.

Expenditures		(₹)	Incomes		(₹)
To General Expenses		4,200	By Subscriptions	27,500	
To Newspaper		2,850	Add : Accrued	2,000	29,500
To Salaries	4,600		By Lockers Rent		3,000
Add : Outstanding	1,400	6,000	By Sale of Old Newspapers		250
To Electricity		3,000	By Interest on Investment	450	
To Rent	5,500		Add : Accrued Interest	2,550	3,000
Less : Prepaid	700	4,800	$\{(30,000 \times \frac{10}{100}) - 450\}$		
To Printing and Stationery		3,300	By Grants from Government		20,000
To Loss on sale of old furniture		1,800			
To Surplus (Excess of Income over Expenditure)		29,800			
		55,750			55,750

Balance Sheet as on 31.12.2016

Liabilities		(₹)	Assets	(₹)
Outstanding Salaries		1,400	Furniture	29,000
Subscription Received in Advance		2,500	10% Investment	30,000
Capital Fund	37,750		Accrued Interest on Investment	2,550
Add Surplus	29,800	67,550	Subrscription outstanding	2,000
			Prepaid rent	700
			Cash	7,200
		71,450		**71,450**

Working Notes :

1. Balance Sheet as on 01.01.2016 (Opening)

Liabilities	(₹)	Assets	(₹)
Capital Fund	37,750	Cash	20,500
(Balancing figure)		Subscription due	2,200
		Furniture	15,000
	37,750		**37,750**

2. Furniture A/c

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	15,000	By Bank (Sale of Furniture)	4,200
To Bank (Purchases)	20,000	By Loss on Sale of Furniture	1,800
		By Balance c/d	29,000
	35,500		**35,000**

Illustration 7

From the information of Sunshine Club Joyepre ascertain the amount of sports materials consumed during the year ending 31.12.2016 and show it in their final accounts.

Receipts and Payments Account
for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payment	(₹)
		By Sports Materials	3,500

Balance Sheet as on 01.01.2016

Liabilities	(₹)	Assets	(₹)
Creditor of on sports materials	150	Sports Materials	200

Illustration 6

From the following information of Sunshine Club, Jeypore, ascertain the amount of sports materials consumed during the year ending 31.12.2016 and show it in their final accounts :

Receipts and Payments Account
for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
		By Sports Materials	3,500

Balance Sheet as on 01.01.2016

Liabilities	(₹)	Assets	(₹)
Creditors for Sports Materials	150	Sports Materials	200

Additional information :

(a) Sports materials on hand as on 31.12.2016 was valued at ₹550.

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income	(₹)
To Consumption of sports materials :				
Opening stock	200			
Purchased in 2016	<u>3,500</u>			
Less	3,700			
Creditors paid				
for previous year	<u>150</u>			
Less				
Closing Stock				
(as on 31.12.2016)	<u>550</u>	3,000		

Balance Sheet as on 31.12.2016

Dr. Cr.

Liabilities	(₹)	Assets	(₹)
		Sports Materials	550

Illustration 7

A Club has 50 members each contributing an annual subscription of ₹250. For the year 2016, the extract of the Receipts and Payments Account of the club was as follows :

Subscriptions:	For 2015	₹850
	For 2016	₹10,000
	For 2017	₹900

Calculate the amount of subscriptions to be credited to the Income and Expenditure Account.

Solution :

Dr. Income and Expenditure Account Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions :		
		Received for 2016	₹10,000	
		Add Outstanding {(250×50) – actually received 10,000}	₹2,500	₹12,500

Illustration 8

The Receipts and Payments Account of a 'Not for Profit' organisation shows ₹44,000 as subscriptions received during the year 2016. Taking into consideration the following additional information, calculate the income from subscriptions for 2016:

	(₹)
(i) Subscriptions outstanding as on 31.12.2015	1,350
(ii) Subscriptions outstanding as on 31.12.2016	3,200
(iii) Subscriptions received in advance as on 31.12.2015	950
(iv) Subscriptions received in advance as on 31.12.2016	1,250

Solution :

Income and Expenditure Account
Dr. for the year ending on 31.12.2016 Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions :	(₹)	
		Received in 2016	44,000	
		Add : Outstanding in 2016	3,200	
		Received in advance for 2015	950	
			48,150	
		Less :		
		Outstanding for 2015	1,350	
			46,800	
		Received in advance for 2017	1,250	
				45,550

Illustration 9

From the following extract of Receipts and Payments Account and additional information given below, calculate the amount of subscription and show how they would appear in the Income and Expenditure Account for the year ending 31.12.2016 and in the Balance Sheet as on that date :

Receipts and Payments Account
for the year ending on 31.12.2016

Dr. Cr.

Receipts		(₹)	Payments	(₹)
To Subscriptions	(₹)			
For 2015	750			
For 2016	25,000			
For 2017	1,000	26,850		

Additional information :

(i) Subscriptions outstanding as on 31.12.2015 ₹1,200.

(ii) Subscriptions outstanding as on 31.12.2016 ₹4,000.

(iii) Subscriptions received in advance as on 31.12.2015 ₹1,000.

Solution :

Income and Expenditure Account
for the year ending on 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions :	₹	
		Received in 2016	25,000	
		Add :		
		Outstanding for 2016	3,550	
		Received in Advance in 2015 for 2016	1,000	29,550

Balance Sheet as on 31.12.2016

Dr. Cr.

Liabilities	(₹)	Assets	(₹)
Subscriptions Received in Advance	1,100	Subscriptions outstanding :	
		For 2015 (₹1,200-received ₹750)	550
		For 2016 (Total outstanding ₹4,000 – outstanding for 2015 ₹450)	3,550

Illustration 10

Srikrishna Dance Society has 120 members. The annual subscription for each member is ₹300. During the year ending 31.12.2016, 85 members have paid their subscriptions. Of these, 25 members have paid their annual subscriptions for 2017 in advance. You are required to show the Income from subscriptions as it would appear in the Income and Expenditure Account. Also, show the required information in the Balance Sheet of the society.

Solution :

Income and Expenditure Account of Srikrishna Dance society
for the year ending 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income	(₹)
		By Subscriptions : ₹ Received (85×₹300) 25,500 Add : Outstanding {(120×₹300) –₹25,500} <u>10,500</u>	36,000

Balance Sheet as on 31.12.2016

Dr. Cr.

Liabilities	(₹)	Assets	(₹)
Subscriptions Received in Advance (25×₹300)	7,500	Subscriptions outstanding	10,500

Illustration 11

Kishore Club, Bhubaneswar had the following assets and liabilities on 01.03.2017.

	(₹)
Cash in Hand	350
Outstanding Subscriptions	800
Books	3,000
Furniture	4,000
Bat and Balls	2,500
Prepaid rent	600
Salary Outstanding	950
Creditors for stationery	750

Calculate Capital Fund on 01.03.2017.

Solution :

Balance Sheet of Kishore Club
as on 01.03.2017

Liabilities	(₹)	Assets	(₹)
Salary Outstanding	950	Cash in Hand	350
Creditors for stationery	750	Outstanding Subscriptions	800
Capital Fund (Balancing Figure)	9,550	Prepaid Rent	600
		Books	3,000
		Bat and Ball	2,500
		Furniture	4,000
	11,250		11,250

Illustration 12

Receipts and Payments Account of Lions Club, Cuttack showed that ₹80,000 were received by way of subscriptions for the year ending 31.03.2017. The additional information were as follows :

	₹
(i) Subscriptions outstanding as on 31.03.2016	4,200
(ii) Subscriptions outstanding as on 31.03.2017	3,800
(iii) Subscriptions received in advance as on 31.03.2016	3,500
(iv) Subscriptions received in advance as on 31.03.2017	2,700

Show the above information in the Income and Expenditure Account and Balance Sheet of the Club for the year ending on 31.03.2017.

Solution :

Income and Expenditure Account of Lions Club, Cuttack
for the year ending 31.03.2017

Dr. Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions :	₹	
		Received during the year ending 31.03.17	80,000	
		Add :		
		Outstanding as on 31.3.17	3,800	
		Received in advance as on 31.03.2016:	3,500	
		Less :	87,300	
		Outstanding as on 31.3.16	4,200	
		Received in advance	83,100	
		as on 31.03.2017	2,700	80,400

Balance Sheet of Lions Club, Cuttack
as on 31.03.2017

Dr. Cr.

Liabilities	(₹)	Assets	(₹)
Subscriptions Received in Advance	2,700	Subscriptions Outstanding	3,800

Illustration 13

Receipts and Payments Account shows payment of salary ₹5,600 for the year ending 31.12.2016. The additional information are :

Salary paid include ₹550 for 2015 and ₹600 for 2017. Salary due but not paid on 31.12.2016 amounts to ₹750. Salary paid in advance as on 31.12.2015 was ₹700. Show the information in the Final Accounts for the year ending 31.12.2016.

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income	(₹)
	(₹)			
To Salary	5,600			
Add :				
Outstanding on 31.12.2016	750			
Prepaid on 31.12.2015	700			
	7,050			
Less :				
Outstanding on 31.12.2015	550			
	6,500			
Prepaid as on 31.12.2016	600			
		5,900		

Balance Sheet as on 31.12.2016

Liabilities	(₹)	Assets	(₹)
Salary Outstanding	750	Salary Prepaid	600

Illustration 14

Following is the extract of a Receipts and Payments Accounts of Vijay Club for the year ending 31.12.2016 :

Receipts and Payments Account
for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments		(₹)
		By Salary Paid		
		For 2015	800	
		For 2016	6,500	
		For 2017	300	7,600

Calculate the expenses on salary for 2016 and show it in the Income and Expenditure Account and Balance Sheet after taking into consideration the following additional information :

(a) Salary outstanding as on 31.12.2015 ₹1,000

(b) Salary outstanding as on 31.12.2016 ₹500

(c) Salary paid in advance as on 31.12.2015 ₹400

(d) Salary paid in advance as on 31.12.2016 ₹300

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income	(₹)
To Salary				
Paid for 2016	6,500			
Add : Outstanding for 2016	300			
Prepaid in 2015 for 2016	400	7,200		

Balance Sheet as on 31.12.2016

Liabilities		(₹)	Assets	(₹)
Salary outstanding :			Salary prepaid (for 2017)	300
For 2015	200			
(₹1,000 – ₹800)				
For 2016	300	500		
(Total outstanding ₹500 less outstanding for 2015 ₹200)				

Illustration 15

From the following extracts of Receipts and Payments Account and additional information for the year ending 31.12.2016, show the treatment of subscriptions in the final accounts :

Receipts and Payments Account
for the year ending 31.12.2016

Dr. Cr.

Receipts		(₹)	Payments	(₹)
To Subscriptions	(₹)			
For 2015	5,600			
For 2016	38,700			
For 2017	8,500	52,800		

Additional Information :

(i) Subscriptions outstanding on 31.12.2016 ₹4,400

(ii) Subscriptions outstanding on 31.12.2015 ₹6,900

(iii) Subscriptions received in advance on 31.12.2015 ₹2,400

Solution :

Income and Expenditure Account
for the year ending on 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions :	(₹)	
		Received in 2016 :	38,700	
		Add : Outstanding for 2016 {4,400-(6,900-5,600)}	3,100	
		Received in advance in 2015 for 2016	2,400	44,200

Balance Sheet as on 31.12.2016

Liabilities	(₹)	Assets		(₹)
Subscriptions Received in Advance		Subscriptions outstanding		
(In 2016 for 2017)	8,500	For 2015 (6,900-5,600)	1,300	
		For 2016 (4,400-1,300)	3,100	
				4,400

Illustration 16

From the following Receipts and Payments Account, prepare Income and Expenditure Account :

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Salaries	4,600
Cash in Hand	800	By Rent	1,800
Cash at Bank	1,000	By Postage and Telephones	700
To Subscriptions	9,000	By Printing and Stationery	1,200
To Sale of old newspapers	350	By Fixed Deposit	3,000
To Sale of old furniture	800	By Balance c/d	
(Book value ₹1,000)		Cash in Hand	500
To Donations	300	Cash at Bank	450
	12,250		12,250

Solution :

Income and Expenditure Accounts

Dr. Cr.

Expenditure	(₹)	Income	(₹)
To Salaries	4,600	By Subscriptions	9,000
To Rent	1,800	By Sale of old Newspapers	350
To Postage and Telephones	700		
To Printing and Stationery	1,200		
To Loss on sale of Furniture	200		
To Excess of Income			
over Expenditure (Surplus)	850		
	9,350		9,350

Note : Donations assumed to have been capitalised.

Illustration 17

From the following information, calculate the amount of subscriptions to be credited to the Income and Expenditure Account of Current Year :

Subscriptions received during the current year	₹ 9,500
Subscriptions outstanding at the end of the previous year	₹ 1,000
Subscriptions outstanding at the end of the current year	₹ 750
Subscriptions received in advance at the end of the previous year	₹ 800
Subscriptions received in advance at the end of the current year	₹ 650

Solution :

Income and Expenditure Account

Dr. Cr.

Expenditure	(₹)	Income		(₹)
		By Subscriptions	₹	
		Received during the year	9,500	
		Add : Outstanding at the end of the current year	750	
		Received in Advance at the end of the previous year	800	
			11,050	
		Less :		
		Outstanding at the end of the previous year	1000	
			10,050	
		Received in Advance at the end of the current year	650	9,400

Illustration 18

The Receipts and Payments Account shows the payment of salary ₹14,500 for the year ending 31.12.2016. The additional information below the Receipts and Payments Account are :

Salary paid includes ₹4,500 for 2015 and ₹7,000 for 2017. Salary outstanding on 31.12.2016 amounts to ₹6,000 and salary paid in advance as on 31.12.2015 was ₹5,000.

Show the salary account in the Income and Expenditure Account of 2016.

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income	(₹)
	(₹)			
To Salary	14,500			
Add : Outstanding				
as on 31.12.2016	6,000			
Prepaid on 31.12.15	5,000			
	25,500			
Less : Outstanding				
as on 31.12.15	4,500			
	21,000			
Prepaid on 31.12.16	7,000			
		14,000		

Illustration 19

From the following Receipts and Payments Account of Adishakti Club for the year ending 31.12.2015, prepare Income and Expenditure Account :

Dr. Cr.

Receipts		(₹)	Payments		(₹)
To Balance b/d			By Charity		3,000
Cash in Hand	21,070		By Rates and Taxes		750
Cash at Bank	12,650	33,720	By Match Expenses		3,000
To Donations		18,000	By Salaries		11,000
To Subscriptions		14,500	By General Expenses		1,800
To Interest on Securities		3,400	By Investment		30,000
To Sale of old Newspaper		300	By Furniture		6,000
To Entrance Fees		2,450	By Insurance Premium		1,800
To Locker Rent		2,900	By Newspapers		650
To Receipts from cricket match		7,800	By Books Purchased		12,000
			By Balance c/d		
			Cash in Hand	6,700	
			Cash at Bank	6,370	13,070
		83,070			83,070

Additional Information :

(i) Salary unpaid for 2015 ₹1,000 (2) Half of the donation is to be capitalised (3) Insurance premium paid in advance ₹300.

Solution :

Income and Expenditure Account
for the year ending 31.12.2015

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Charity		3,000	By Donations	18,000	
To Rates and Taxes		750	Less Capitalised	9,000	9,000
To Salaries	11,000		By Subscriptions		14,500
Add Unpaid	1,000	12,000	By Interest on securities		3,400
To General Expenses		1,800	By Sale of old Newspapers		300
To Insurance Premium	1,800		By Entrance Fees		2,450
Less Prepaid	300	1,500	By Locker Rent		2,900
To Newspapers		650	By Profit from cricket match :		
To Excess of Income over			Receipts	7,800	
Expenditure (surplus)		17,650	Less Expenses	3,000	
					4,800
		37,350			37,350

Illustration 20

From the Receipts and Payments Account of Ganjam Club, Berhampur, prepare the Income and Expenditure Account for the year ending 31st December 2014 and the Balance Sheet as on that date :

Receipts and Payments Account
for the year ending 31.12.2014

Dr. Cr.

Receipts	(₹)	Payments		(₹)
To Balance b/d		By Salaries		
Cash in Hand	3,600	For 2013	500	
Cash at Bank	17,000	For 2014	6,000	6,500
To Subscriptions	26,900	By Miscellaneous Expenses		1,500
To Entrance Fees	2,400	By Books		10,000
To Restaurants taking	3,800	By Restaurant Expenses		2,650
To Rent of Ground	800	By 9% Fixed Deposit		15,000
To Sale of old Newspapers	200	(on 01.01.2014)		

To Interest on Fixed Deposits	600	By Honorarium to Coach	2,500
		By Periodicals and Newspapers	1,100
		By Balance c/d	
		Cash in Hand	4,050
		Cash at Bank	12,000
	55,300		55,300

Additional Information :

(1) The club has 50 members and each paying an annual subscription of ₹600 per annum. Subscriptions received include ₹900 for 2013 and ₹1,200 for 2015.

(2) Salaries outstanding on 31.12.2014 ₹1,000.

(3) On 01.01.2014, the club owned Land and Building worth ₹1,00,000, Furniture worth ₹10,000 and Machinery worth ₹20,000.

(4) Provide a depreciation of 5% on all fixed assets except on books.

Solution :

Income and Expenditure Account of Ganjam Club
for the year ending 31.12.2014

Expenditure		(₹)	Income		(₹)
	(₹)		By Subscriptions :	(₹)	
To Salaries	6,000		Received during 2014	26,900	
Add : Outstanding			Less : Received for 2013	900	
for 2014	1,000	7,000		26,000	
To Miscellaneous Expenses		1,500	Received for 2015	1,200	
To Honorarium to coach		2,500		24,800	
To Periodicals and Newspapers		1,100	Add		
To Depreciation :	₹		outstanding for 2014	5,200	
On Land and Buildings	5,000		$\{(50 \times 600) - 24,800\}$		30,000
On Furniture	500		By Entrance Fees		2,400
			By Profit from Restaurants		
On Machinery	1,000		Takings	3,800	
To Excess of Income over		6,500	Less Expenses	2,650	1,150
Expenditure (surplus)		17,300	By Rent of Ground		800
			By Sale of old Newspapers		200
			By Interest on Fixed Deposit		
			Received	600	
			Add Accrued	750	1,350
			$\{(₹15,000 \times \frac{9}{100}) - ₹600\}$		
		35,900			35,900

Balance Sheet as on 31.12.2014

Liabilities		(₹)	Assets		(₹)
Salaries outstanding		1,000	Cash in Hand		4,050
Subscriptions received in Advance		1,200	Cash at Bank		12,000
Capital Fund :			Subscription outstanding		5,200
Opening Balance	1,51,000		Interest on FD Accrued		750
Add Surplus	17,300		9% Fixed Deposit		15,000
		1,68,300	Books		10,000
			Land and Buildings	1,00,000	
			Less Depreciation	5,000	95,000
			Machinery	20,000	
			Less Depreciation	1,000	19,000
			Furniture	10,000	
			Less Depreciation	500	9,500
		1,70,500			1,70,500

Working Note :

Balance Sheet as on 31.12.2013

Liabilities	(₹)	Assets	(₹)
Salaries outstanding	500	Land and Buildings	1,00,000
Capital Fund	1,51,000	Machinery	20,000
(Balancing figure)		Furniture	10,000
		Subscriptions Outstanding	900
		Cash in Hand	3,600
		Cash at Bank	17,000
	1,51,500		1,51,500

Illustration 21

The following is the Receipts and Payments Account of Lions Club, Bhubaneswar for the year ending 31.12.2016 :

Receipts and Payments Account
for the year ending 31.12.2016

Receipts		(₹)	Payments	(₹)
To Balance b/d			By Salaries	3,640
Cash	1970		By Charity	1,500
Bank	13,620		By Municipal Expenses	700
		15,590	By Sundry Expenses	800

To Donations	10,000	By Investment in		
To Subscriptions	22,500	Government security		20,000
To Interest on securities	3,400	By Furniture		8,000
To Sale of sports materials	250	By Insurance		1,000
To Entrance Fees	1,450	By Bar Expenses		6,000
To Locker Rent	950	By Sports Equipment		8,000
To Bar Takings	7,500	By Balance c/d		
		Cash in Hand	2,000	
		Cash at Bank	10,000	12,000
	61,640			61,640

Additional Information :

(1) Salaries not paid for 2016 ₹1,360.

(2) Insurance premium paid in advance ₹200.

(3) Subscriptions received during 2016 include subscriptions of ₹1,500 for 2017.
Prepare Income and Expenditure Account and Balance Sheet.

Solution :

Income and Expenditure Account of Ganjam Club
for the year ending 31.12.2016

Expenditure		(₹)	Income		(₹)
	(₹)		To Donations		10,000
To Salaries	3,640		By Subscriptions	22,500	
Add Unpaid	1,360	5,000	Less Received in Advance	1,500	
To Charity		1,500	(for 2017)		21,000
To Municipal Expenses		700	By Interest on securities		3,400
To Sundry Expenses		800	By Sale of sports materials		250
To Insurance	1,000		By Entrance Fees		1,450
Less Prepaid	200	800	By Locker Rent		950
To Excess of Income			By Profit from Bar :		
over expenditure (surplus)		29,750	Takings	7,500	
			Less Expenses	6,000	1,500
		38,550			38,550

Balance Sheet as on 31.12.2016

Liabilities		(₹)	Assets	(₹)
Salaries Unpaid		1,360	Cash in Hand	2,000
Subscriptions Received in Advance		1,500	Cash at Bank	10,000
Capital Fund :			Prepaid Insurance	200
Opening Balance	15,590		Investment in Government	
Add Surplus	29,750	45,340	Securities	20,000
			Sports Equipment	8,000
			Furniture	8,000
		48,200		48,200

Working Note :

(1) Balance Sheet as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund	15,590	Cash	1,970
(Balancing Figure)		Bank	13,620
	15,590		15,590

Illustration 22

From the following Receipts and Payments Account and additional information, prepare Income and Expenditure Account for the year ending 31.12.2016 and the Balance sheet as on that date :

Dr. Receipts and Payments Account for the year ending 31.12.2016 Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	11,500	By Charities	7,500
To Subscriptions	20,000	By Salaries	3,500
To Donations	2,700	By Printing	500
To Legacies	15,000	By Postages	300
To Interest on Investment	2,600	By Telephones	700
To Dividend on shares	800	By Rate and Taxes	1,300
To Sale of old Newspapers	200	By Furniture	10,000
		By Insurance	1,000
		By Investment	20,000
		By Balance c/d	8,000
	52,800		52,800

Additional Information :

(1) Donations are treated as revenue receipts.

(2) Legacies 60% is treated as capital and 40% as revenue receipt.

(3) Insurance prepaid during 2016 ₹100.

Solution :

Income and Expenditure Account
for the year ending 31.12.2016

Dr. Cr.

Income		(₹)	Expenditure	(₹)
To Charities		7,500	By Subscriptions	20,000
To Salaries		3,500	By Donations	2,700
To Printing		500	By Legacies ($\frac{40}{100}$ ×15,000)	6,000
To Postages		300	By Interest on Investment	2,600
To Telephones		700	By Dividend on Shares	800
To Rate and Taxes		1,300	By Sale of old Newspapers	200
To Insurance	1,000			
Less Prepaid	100	900		
To Excess of Income				
over Expenditure (surplus)		17,600		
		32,300		32,300

Balance Sheet
as on 31.12.2016

Liabilities		(₹)	Assets	(₹)
Legacies	15,000		Cash and Bank	8,000
Less (40% of ₹15,000)	6,000	9,000	Prepaid Insurance	100
Capital Fund :			Investment	20,000
Opening Balance	11,500		Furniture	10,000
Add Surplus	17,600	29,100		
		38,100		38,100

Working Note :

Balance Sheet
as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund (Balancing Figure)	11,500	Cash and Bank	11,500
	11,500		11,500

Illustration 23

The following is the Receipts and Payments Account of Sambalpur Dance society for the year ending 31.03.2017. Prepare the Final Accounts of the Society for the year ending 31.03.2017.

Receipts and Payments Account

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Equipment and Machinery	17,000
Cash in Hand	4,700	By Stationery	3,500
Cash at Bank	5,300	By Insurance	4,500
To Subscriptions	40,000	By Repairs	2,000
To Sale of Old Furniture	800	By Salaries	23,000
(Book value ₹1,200)		By Help to poor students	10,000
To Donations	10,000	By Audit fee	1,500
To Interest on Investments	2,800	By Advertisement	1,000
		By Balance c/d	1,000
		Cash in Hand	600
		Cash at Bank	500
	63,600		63,600

Additional Information :

(1) Subscriptions for March 2017 is outstanding ₹7,000 and for March 2016, it was due ₹9,000.

(2) Investments as on 31.03.2016 were ₹25,000 (Rate of Interest 12% p.a.)

(3) Insurance prepaid was ₹500.

(4) Depreciate Equipment and Machinery @10% p.a.

Solution :

Income and Expenditure Account of Sambalpur Dance Society
for the year ending 31.03.2017

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Stationery		3,500		(₹)	
	(₹)		By Subscriptions	40,000	
To Insurance	4,500		Add : Outstanding		
Less Prepaid	500	4,000	for March 2017	7,000	
				47,000	
To Repairs		2,000	Less Outstanding		
			for March 2016	9,000	38,000
To Salaries		23,000	By Donations		10,000
To Help to poor students		10,000	By Interest on Investments	2,800	
To Audit fee		1,500	Add Accrued Interest	200	3,000
To Advertisement		1,000	$\{(₹25,000\times\frac{12}{100})-₹2,800\}$		
To Depreciation on Equipment and Machinery (₹17,000×10%)		1,700			
To Loss on sale of old Furniture		400			
To Excess of Income over Expenditure (surplus)		3,900			
		51,000			51,000

Balance Sheet of Sambalpur Dance Society
as on 31.03.2017

Liabilities		(₹)	Assets	(₹)
Capital Fund :			Cash in Hand	600
Opening Balance :	45,200		Cash at Bank	1,500
Add Surplus	3,900	49,100	Subscriptions Accrued	7,000
			Interest on Investment Accrued	200
			Prepaid Insurance	500
			12% Investments	25,000
			Equipment and Machinery (₹17,000 – ₹1,700)	15,300
		49,100		49,100

Working Note :

Balance Sheet
as on 31.03.2016

Liabilities	(₹)	Assets	(₹)
Capital Fund (Balancing Figure)	45,200	Cash in Hand	4,700
		Cash at Bank	5,300
		Subscriptions Accrued	9,000
		Furniture	1,200
		Investments	25,000
	45,500		45,200

Illustration 24

The following is the Receipts and Payments Account of Star Club for the year ending 31.03.2016 :

Dr. Receipts and Payments Account Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	7,000	By Salaries	12,450
To Subscriptions	13,380	By Stationery	3,600
To Receipts from Canteen	14,000	By Rent and Taxes	2,400
To Sundry Incomes	450	By Telephone Charges	600
To Rent of Hall	1,120	By Investments	7,500
To Interest on Investment	4,850	By Advertisements	1,250
		By Postage	800
		By General Expenses	3,500
		By Canteen Expenses	5,000
		By Balance c/d	3,700
	40,800		40,800

Additional Information :

1. There are 50 members each paying ₹300 as annual subscription.
2. Stock of Stationery on 01.04.2015 was ₹700 and on 31.03.2016 ₹900.
3. Land and Building ₹80,000, to be depreciated @$7\frac{1}{2}$%.

You are required to prepare an Income and Expenditure Account for the year ending 31.03.2016 and the Balance Sheet as on that date.

Solution :

Income and Expenditure Account of Star Club
for the year ending 31.03.2016

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Salaries		12,450	By Subscriptions	₹13,380	
To Stationeries consumed :	₹		Add : Due for Current year (31.03.16)	₹1,620	15,000
Opening Stock	700		By Profit from Canteen		9,000
Add Purchases	3,600		By Sundry Incomes		450
	4,300		By Rent of Hall		1,120
Less Closing stock	900	3,400	By Intereston Investments		4,850
To Rent and Taxes		2,400			
To Telephone Charges		600			
To Advertisements		1,250			
To Postage		800			
To General Expenses		3,500			
To Depreciation on Land and Building (₹80,400× $\frac{15}{200}$)		6,000			
To Excess of Income over Expenditure (surplus)		20			
		30,420			30,420

Balance Sheet of Star Club
as on 31.03.2016

Liabilities		(₹)	Assets		(₹)
	₹		Cash in Hand		3,700
Capital Fund :			Subscriptions Accrued		1,620
Opening Balance	₹87,700		Stock of Stationery		900
Add Surplus	₹20	87,720	Investments		7,500
			Land and Building :		
			Opening Balance	₹80,000	
			Less Depreciation	₹ 6,000	74,000
		87,720			87,720

Working Note :

Balance Sheet of Star Club
as on 31.03.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund	87,700	Cash in Hand	7,000
(Balancing Figure)		Stock of Stationery	700
		Land and Building	80,000
	87,700		87,700

Illustration 25

From the following Receipts and Payments Account of Jogamaya Club and additional information supplied, prepare an Income and Expenditure Account for the year ending 31.12.2016 and a Balance Sheet on that date :

Receipts and Payments Account
for the year ended of 31st December, 2016

Dr. Cr.

Receipts		(₹)	Payments	(₹)
To Balance b/d			By Books	30,000
Cash in Hand		4,200	By Salaries	12,800
Cash in Bank		46,000	By General Expenses	3,500
To Subscriptions :			By Newspapers	850
2015	₹800		By 6% Fixed Deposit (on 1.7.16)	12,000
2016	₹7,500		By Hanorarium	3,000
2017	₹400	8,700	By Balance c/d	
To Donations		3,275	Cash in Hand	845
To Lockers Rent		420	Cash at Bank	1,300
To Profit from entertainment		1,380		
To Sale of grass		80		
To Interest on Fixed Deposit		240		
		64,295		64,295

Additional Information :

(a) The club has 100 members each paying an annual subscriptions of ₹120. Subscriptions outstanding on 31.12.2015 were ₹1,200.

(b) Salaries paid include ₹800 for 2017 and salaries outstanding on 31.12.2016 ₹3,000.

(c) On 01.01.2016, the club owned building ₹50,000 and furniture ₹8,000.

(d) Provide depreciation on building and furniture @10% p.a.

Solution :

Income and Expenditure Account of Jogamaya Club
for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Salaries	₹12,800		By Subscriptions	₹7,500	
Less Prepaid	₹800		Add Outstanding		
	₹12,000		(100×₹1200-₹7,500)	₹4,500	12,000
Add Unpaid	₹3,000	15,000	By Donations		3,275
To General Expenses		3,500	By Lockers Rent		420
To Newspapers		850	By Profit from entertainment		1,380
To Honorarium		3,000	By Sale of grass		80
To Depreciation :			By Interest on Fixed Deposit	₹240	
Building	₹5,000		Add Accrued	₹120	
Furniture	₹800	5,800	(₹12,000$\times\frac{6}{100}\times\frac{1}{2}$ -₹240)		
			By Excess of Expenditure over Income (Deficit)		10,635
		28,150			28,150

Balance Sheet of Jogamaya Club as on 31.12.2016

Liabilities		(₹)	Assets		(₹)
Subscriptions Received in Advance		400	Subscriptions outstanding	₹	
			For 2015 (₹1,200–₹800)	400	
Salary unpaid		3,000	For 2016	4,500	4,900
Capital Fund :			Prepaid Salary		800
Opening Balance	₹1,09,400		Cash in Hand		845
Less Deficit	₹10,635	98,765	Cash at Bank		1,300
			Accrued Interest on Fixed Deposit		120
			6% Fixed Deposit		12,000
			Books		30,000
			Building	50,000	
			Less Depreciation	5,000	45,000
			Furniture	8,000	
			Less Depreciation	800	7,200
		1,02,165			1,02,165

Working Note :

Opening Balance Sheet as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund (Balancing Figure)	1,09,400	Subscriptions Outstanding	1,200
		Cash in Hand	4,200
		Cash at Bank	46,000
		Furniture	8,000
		Building	50,000
	1,09,400		1,09,400

Illustration 26

Following is the Receipts and Payments Account of Nandighosh Club, Bolgarh for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	7,750	By Salaries	4,800
To Subscriptions :		By Books	2,000
2015 ₹1,250		By Newspapers	800
2016 ₹15,800		By Postages	250
2017 ₹1,600	18,650	By Furniture	2,000
To Sale of old furniture		By Office Expenses	1,050
(Book value ₹200)	120	By Balance c/d	16,590
To Rent of Hall	850		
To Sale of old Newspapers	120		
	27,490		27,490

Additional Information :

(a) The club has 100 members. Annual subscription per member is ₹180. ₹300 are still outstanding for 2015.

(b) Salaries outstanding for as on 31.12.2016 were ₹1,250 and salaries paid include ₹500 paid for 2015.

(c) On 31.12.2015, the club owned the following assets : Building ₹80,000 and Furniture ₹18,000. You you are required to prepare Income and Expenditure Account for the year ending 31.12.2016, and a Balance Sheet as on that date.

Solution :

Income and Expenditure Account of Nandighosh Club, Bolgarh
for the year ending 31.12.2016

Expenditure	₹	Income	₹
To Salaries ₹4,800		By Subscriptions ₹15,800	
Less Paid for 2015 ₹500		Add	
₹4,300		Outstanding ₹2,200	
Add Outstanding ₹1,250		(₹180×100 –₹15,800)	18,000
	5,550	By Rent of Hall	850
To Newspapers	800	By Sale of old Newspaper	120
To Loss on sale			
of furniture (₹200 – ₹120)	80		
To Postages	250		
To Office Expenses	1,050		
To Excess of Income over			
Expenditure (surplus)	11,240		
	18,970		18,970

Balance Sheet of Nandi Ghosh Club, Bolgarh
as on 31.12.2016

Liabilities	(₹)	Assets	(₹)
Subscriptions Received		Cash in Hand	16,590
in Advance	1,600		
Salaries Outstanding	1,250	Subscriptions Outstanding :	
Capital Fund :		For 2015 ₹300	
Opening Balance ₹1,06,800		For 2016 ₹2,200	2,500
Add Surplus ₹11,240	1,18,040	Books	2,000
		Furniture ₹18,000	
		Less Sold ₹200	
		₹17,800	
		Add Purchased ₹2,000	19,800
		Building	80,000
	1,20,890		1,20,890

Working Note :

Opening Balance Sheet of Nandighosh Club, Bolgarh as on 31.12.2015

Liabilities	(₹)	Assets		(₹)
Salaries Outstanding	500	Subscriptions outstanding		
Capital Fund		Received in 2016	₹1,250	
(Balancing Figure)	1,06,800	Still outstanding	₹300	
				1,550
		Cash in Hand		7,750
		Furniture		18,000
		Building		80,000
	1,07,300			1,07,300

Illustration 27

From the following information relating to Star Club, prepare Income and Expenditure Account for the year ending on 31.12.2016 and a Balance Sheet as on that date :

Receipts and Payments Account of Star Club
for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	5,180	By Salaries	12,500
To Subscriptions	40,500	By Rent	3,200
To Entrance Fees	2,400	By Electricity Charges	1,280
To Donations	2,540	By Books	3,600
To Life Membership Fees	3,600	By 12% Fixed Deposits	
To Interest on Fixed Deposits	1,500	(on 01.01.2016)	15,000
		By Office Expenses	2,400
		By Balance c/d	17,740
	55,720		55,720

Balance Sheet of Star Club as 31.12.2015

Liabilities	(₹)	Assets	(₹)
Salaries Outstanding	2,400	Cash in hand	5,180
Capital Fund	22,580	Books	12,000
(balancing figure)		Furniture	5,000
		Subscriptions outstanding	2,800
	24,980		24,980

Additional Information :

(a) Subscriptions outstanding as on 31.12.2016 ₹3,500.

(b) Half of donations are to be taken as income.

(c) Salaries outstanding ₹1,800.

Solution :

Income and Expenditure Account of
Star Club for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Salaries	₹12,500		By Subscriptions	₹40,500	
Add Outstanding	₹1,800		Less Received for 2015	₹2,800	
	₹14,300			₹37,700	
Less paid for 2015	₹2,400	11,900	Add Outstanding		
To Rent		3,200	for 2016	₹3,500	41,200
To Electricity charges		1,280	By Donation	₹2,540	
To Office Expenses		2,400	Less Capitalised		
To Excess of Income over			(50% of ₹2,540)	₹1,270	1,270
Expenditure (Surplus)		27,890	By Entrance Fees		2,400
			By Interest on fixed Deposit	₹1,500	
			Add Accrued	₹300	1,800
			$\{(₹15{,}000 \times \frac{12}{100} - ₹1{,}500)\}$		
		46,670			46,670

Balance Sheet of Star Club
as on 31.12.2016

Liabilities		(₹)	Assets		(₹)
Salaries Outstanding		1,800	Subscriptions outstanding		3,500
Life membership Fees		3,600	Interest on Fixed Deposit Accrued		300
Capital Fund :			Cash in hand		17,740
Opening Balance	₹22,580		12% Fixed Deposit		15,000
Add Donation			Books	₹12,000	
Capitalised	₹1,270		Add Purchased	₹3,600	15,600
Add surplus	₹27,890	51,740	Furniture		5,000
		57,140			57,140

Illustration 28

From the following Receipts and Payments Account of Sahara Club, Jaipur and additional information, prepare the Income and Expenditure Account for the year ending 31.12.2016 and a Balance Sheet as on that date :

Receipts and Payments Account of Sahara Club, Jaipur
for the year ending 31.12.2016

Dr. Cr.

Receipts		(₹)	Payments		(₹)
To Balance b/d			By Purchase of Equipment		3,200
			(on 01.07.2016)		
Cash	₹350		By Repairs		850
Bank	₹8,400		By Match Expenses		1,260
8% Fixed Deposit	₹5,000	13,750	By Salaries		5,340
To Subscriptions		15,860	By Honorarium		2,950
(including ₹950 for 2015)			By Upkeep of Lawn		560
To Donations		3,000	By Postage Stamp		250
To Entrance Fees		1,800	By Sundry Expenses		1,350
To Interest on Fixed Deposit		200	By Investment		4,000
To Sale of old Newspapers		140	By Tournament Expenses		1,240
To Sale of Equipment		350	By Balance c/d		
(Book Value ₹500)			Cash	₹800	
To Tournament Fund		2,000	Bank	₹10,240	
			8% Fixed Deposit	₹5,000	16,100
		37,100			37,100

Additional Information :

(a) Provide depreciation on equipment @10%.

(b) Stock of postage stamp on 31.12.2016 ₹80.

(c) Subscriptions outstanding for 2016 ₹2,840.

(d) Salaries outstanding for 2016 ₹1,350.

(e) Donations are to be capitalised.

Solution :

Income and Expenditure Account of
Sahara Club for the year ending 31.12.2016

Dr. Cr.

Expenditure		(₹)	Income		(₹)
To Repairs		850	By Subscriptions	₹15,860	
To Match Expenses		1,260	Loss Paid for 2015:	₹950	
To Salaries	₹5,340			₹14,910	
Add Outstanding	₹1,350	6,690	Add Outstanding in 2016	₹2,840	17,750
To Honorarium		2,950	By Entrance Fees		1,800
To Upkeep of Lawn		560	By Interest on Fixed Deposit	₹200	
To Postage	250		Add Accured Interest		
Less Stock on 31.12.16	80	170	$\{(₹5{,}000 \times \frac{8}{100}) - ₹200\}$	₹200	400
To Sundry Expenses		1,350	By Sale of old Newspapers		140
To Depreciation on Equipment		160			
$(₹3{,}200 \times \frac{10}{100} \times \frac{6}{12})$					
To Loss sale of Equipment		150			
(₹500 – ₹350)					
To Excess of Income over					
Expenditure (Surplus)		5,950			
		20,090			20,090

Balance Sheet of Sahara Club
as on 31.12.2016

Liabilities		(₹)	Assets		(₹)
Salaries Outstanding		1,350	Subscriptions Outstanding		2,840
Tournament Fund :			Stock of Postage		80
Opening Balance	₹2,000		Interest on Fixed Deposit Accrued		200
Less Expenses	₹1,240	760	Cash		860
Capital Fund :			Bank		10,240
Opening Balance	₹15,200		8% Fixed Deposit		5,000
Add Surplus	₹5,950		Investments		4,000
Add Donations	₹3,000	24,150	Equipment	₹3,200	
			Less Depreciation	₹160	3,040
		26,260			26,260

Working Note :

Opening Balance Sheet of Sahara Club
as on 31.12.2015

Liabilities	(₹)	Assets	(₹)
Capital Fund	15,200	Subscriptions Outstanding	950
(Balancing Figure)		Equipment	500
		Cash	350
		Bank	8,400
		8% Fixed Deposit	5,000
	15,200		15,200

Illustration 29

The Master Club, Bolangir submits you its Receipts and Payments Account for the year ending 31.12.2016. You are required to prepare the Income and Expenditure Account and the Balance Sheet relating to the year.

Receipts and Payments Account of Master Club, Bolangir
for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Opening Balance :		By Rent (includes ₹400 for 2017)	6,000
Cash	250	By Postage and Telephone	540
Bank	20,550	By Upkeep of ground	250
To Subscriptions		By Printing and Stationery	600
(including ₹750 for 2017)	21,250	By Travelling Expenses	150
To Lockers Rent	1,250	By Meeting Expenses	500
To Interest on 6% Bonds	1,000	By Salaries	5,400
To Donations	10,000	By Books	3,000
To Sale of Grass	50	By Donations	5,000
		By Closing Balance :	
		Cash	310
		Bank	32,600
	54,350		54,350

The Club gives also the following information :

(a) The club holds 6% Government Bonds of ₹40,000 on 01.01.2016.

(b) The Books Account stood at ₹20,000 on 01.01.2016.

(c) Half of the donations received is to be capitalised.

(d) Salaries ₹300 is still unpaid.

Solution :

Income and Expenditure Account of Master Club, Bolangir
for the year ending 31.12.2016

Dr. Cr.

Expenditure	(₹)	Income	(₹)
To Rent ₹6,000		By Subscriptions ₹21,250	
		Less For 2017 ₹750	20,500
Less Paid for 2017 ₹400	5,600	By Lockers Rent	1,250
To Postage and Telephone	540	By Interest on Bonds ₹1,000	
To Upkeep of ground	250	Add Accrued	
To Donations	5,000	(₹40,000× $\frac{6}{100}$ -₹1,000) ₹1,400	2,400
To Printing and Stationery	600	By Donations ₹10,000	
To Travelling Expenses	150	Less Capitalised ₹5,000	5,000
To Meeting Expenses	500	By Sale of grass	50
To Salaries ₹5,400			
Add Unpaid ₹300	5,700		
To Excess of Income over			
Expenditure (surplus)	10,860	$\frac{1}{2}$	
	29,200		29,200

Balance Sheet of Master Club, Bolangir
as on 31.12.2016

Liabilities	(₹)	Assets	(₹)
Subscriptions Received in Advance	750	Cash	310
Salary Unpaid	300	Bank	32,600
Capital Fund :		6% Government Bond ₹40,000	
Opening Balance ₹80,800		Add Accrued Interest ₹1,400	41,400
Add Surplus ₹10,860		Books ₹20,000	
Add $\frac{1}{2}$ of Donations Capitalised ₹5,000	96,660	Add Purchased	
		during 2016 ₹3,000	23,000
		Prepaid Rent	400
	97,710		97,710

Working Note :

Opening Balance Sheet
as on 01.01.2016

Liabilities	(₹)	Assets	(₹)
Capital Fund	80,800	Cash	250
(Balancing Figure)		Bank	20,550
		6% Government Bond	40,000
		Books	20,000
	80,800		80,800

2.9 QUESTIONS

1. From the Following alternatives given under each bit, write the correct answer along with its serial number, against each bit;

(a) One of the following which is a 'not for profit' organisation, is.
   (i) Tata Iron and Steel Company Limited.
   (ii) Birla Tyres Ltd.
   (iii) Ramakrishna Charitable Trust.
   (iv) Bharat Sanchar Nigam Limited.

(b) Receipts and Payments Account is a :
   (i) Personal Account   (iii) Cash Account
   (ii) Real Account   (iv) Nominal Account

(c) Receipts and Payments Account shows :
   (i) Capital Fund   (iii) Receipts and Payments in cash
   (ii) Surplus/Deficit   (iv) Balance of assets

(d) The Receipts and Payments Account reveals :
   (i) Net profit/loss   (iii) Balances of Assets
   (ii) Surplus/Deficit   (iv) Balance of Cash

(e) Income and Expenditure Account is prepared by
   (i) Manufacturing concerns   (iii) 'Not for profit' concerns
   (iv) Trading concerns   (v) Manufacturing and trading concerns

(f) Income and Expenditure Account is a :
   (i) Nominal Account   (iii) Real Account
   (ii) Personal Account   (iv) Representative Personal Account

(g) Income and Expenditure Account shows :
  (i) Cash in Hand and at Bank (iii) Capital Fund
  (ii) Net Profit/Loss (iv) Surplus/deficit

(h) Subscription received in advance during an accounting year is :
  (i) An asset (iii) An income
  (ii) A liability (iv) An expense

(i) Subscription outstanding at the end of an accounting year is :
  (i) An asset (iii) A liability
  (ii) An income (iv) An expense

(j) Donation received for a specific purpose is a :
  (i) Capital Receipt (iii) Capital expenditure
  (ii) Revenue Receipt (iv) Revenue expenditure

(k) Life membership fee is a/an :
  (i) Capital receipt (iii) Capital expenditure
  (ii) Revenue receipt (iv) Revenue expenditure

(l) Legacy may be treated as :
  (i) Capital receipt (iii) Capital or revenue receipt
  (ii) Revenue receipt (iv) Revenue Income

(m) Sale of old newspaper is a/an
  (i) Capital receipt (iii) Capital expenditure
  (ii) Revenue receipt (iv) Revenue expenditure

(n) Receipts and Payments Account is prepared in lieu of :
  (i) Balance sheet (iii) Income and Expenditure Account
  (ii) Profit and Loss Account (iv) Cash Book

(o) Income and Expenditure Account is the equivalent name of :
  (i) Trading Account (iii) Revaluation Account
  (ii) Profit and Loss Appropriation A/c (iv) Profit and Loss Account

(p) The day to day cash transactions are recorded in
  (i) Receipts and Payments Account (iii) Income and Expenditure Account
  (ii) Cash Book (iv) Trial Balance

(q) When sports fund is created, sports expenses are transfered to :
  (i) Receipt and Payments Account (iii) Sports Fund Investment Account
  (ii) Income and Expenditure Account (iv) Sports Fund Account

(r) Special Fund usually appears in :
  (i) Income and Expenditure Account (iii) Balance Sheet
  (ii) Receipts and Payments Account (iv) Trial Balance

(s) The difference of assets and liabilities of opening Balance Sheet is :

(i) Surplus (iii) Reserve Fund

(ii) Capital Fund (iv) Deficit

(t) Income and Expenditure Account records only :

(i) Revenue items (iii) Both Revenue and Capital items

(ii) Capital items (iv) Only revenue receipts

(u) Receipts and Payments Account records :

(i) Revenue items (iii) Both revenue and capital items

(ii) Capital items (iv) Only revenue receipts

[Ans.: (a) iii, (b) ii, (c) iii, (d) iv, (e) iii, (f) i, (g) iv, (h) ii, (i) i, (j) i, (k) i, (l) iii, (m) ii, (n) iv, (o) iv, (p) ii, (q) iv, (r) iii, (s) ii, (t) i, (u) iii.]

2. Answer the following questions in one word / term each :

(a) Name the organisation rendering service to its members and the society without any profit motive.

(b) What type of organisations are the schools, colleges, universities, libraries, sports clubs, charitable hospitals, religious societies, etc. ?

(c) What does a 'not for profit' organisation provide ?

(d) What is the principal source of income of a 'not for profit' organisation ?

(e) To which Account is the surplus/deficit transferred ?

(f) Name the fee paid by the members at the time of their admission to a club for membership.

(g) What is the term used for the lump sum amount paid by the members/well-wishers of a 'not for profit' organisation ?

(h) What is the term used for the amount received by a 'not for profit' organisation as per the will of a deceased person ?

(i) Name a register which contains the names and addresses of all members.

(j) Name the book which contains the proceedings of all meetings of the Board and Committees.

(k) On which side of the Balance Sheet is the 'outstanding subscription' shown ?

(l) What is the term used for the remuneration paid to artists/dancers/doctors, etc for their performance and service ?

(m) On which side of the Balance Sheet is the subscription received in advance shown ?

(n) What is that fund which is not to be spent but provides a permanent source of income to the 'not for profit' organisation ?

[Ans. (a) 'Not for profit', (b) 'Not for profit', (c) Service, (d) Membership fee/Subscription, (e) Capital Fund, (f) Entrance fee, (g) Donation, (h) Legacy, (i) Members register, (j) Minutes Book, (k) Asset, (l) Honorarium, (m) Liability, (n) Endowment.]

3. Correct the underlined portions of the following sentences :
   (a) Receipts and Payments Account is a Personal account.
   (b) Income and Expenditure Account is a Real account.
   (c) Legacy is a revenue receipt.
   (d) Life membership fee is a revenue receipt.
   (e) Life membership fees is a recurring receipt.
   (f) Capitalised donations are recurring items.
   (g) Any amount paid to invitees like dancers, artists, singers, doctors, etc for their performance and service is called salary.
   (h) Honoraium is a capital expenditure.

   [Ans.: (a) Real (b) Nominal (c) Capital, (d) Capital, (e) non-recurring (f) non-recurring (g) Honorarium (h) revenue]

4. Fill up the blanks of the following sentences :

(a) The opening balance of Receipts and Payments Accounts is _______.
(b) Receipts and Payments accont records revenue and _______ items.
(c) The difference between two sides of Income and Expenditure Account is ______.
(d) The excess of assets over liabilities of a 'not for profit' organisation is _______.
(e) Endowment fund yields _______ income.
(f) Life membership fee is shown on the _______ side of Balance Sheet.
(g) Payment of honorarium is treated as _______ expenditure.
(h) Endoment Fund is shown on the _______ side of the Balance Sheet.
(i) Subscriptions due but not received are shown on ______ side of Balance sheet.
(j) Subscriptions received in advance is shown on the ______ side of Balance Sheet.
(k) Income and Expenditure Account does not show any ______ balance.
(l) Income and Expenditure Account is prepared on ______ basis.
(m) Receipts and Payments Account is prepared on ______ basis.
(n) Receipt of legacy is treated as a ______ receipt.
(o) Building Fund Investment is shown on the ______ side of Balance Sheet.
(p) Non-recurring entrance fee is treated as a ______ receipt.
(q) Entrance fee collected from members every year is treated as _______ receipt.
(r) Purchase and sale of fixed assets is ascertained from ______ Account.
(s) Lump sum amount received from well-wishers is _______.
(t) Amount received under the will of a person after his death is known as _______.

[Ans.: (a) Cash in hand/at Bank, (b) Capital, (c) Surplus/deficit, (d) Capital Fund, (e) Regular, (f) Liabilities, (g) revenue, (h) Liability, (i) Assets, (j) Liabilities, (k) opening, (l) accrual, (m) cash, (vi) Capital, (o) Assets, (p) Capital, (q) revenue, (r) Receipts and Payments, (s) donations, (f) legacy]

5. Answer the following questions in one sentence each :
   (a) State the objective of a 'not for profit' organisation.
   (b) Which account gives information about cash in a 'not for profit' organisation ?
   (c) Which items are shown in Receipts and Payments Account ?
   (d) Which items are shown in Income and Expenditure Account ?
   (e) What are the sources of income of a 'not for profit' organisation ?
   (f) What is the basis of accounting in preparing Receipts and Payments Account ?
   (g) What is the basis of accounting in preparing Income and Expenditure Account ?
   (h) How is capital fund of a 'not for profit' organisation calculated ?
   (i) How will you treat specifice Fund expenditure ?
   (j) How will you treat general donation ?
   (k) How will you calculate Capital Fund if nothing is mentioned in question ?
   (l) How would you treat suscriptions due at the beginning of the year ?
   (m) How would you treat subscriptions received in advance in the current year ?
6. Answer the following questions within thirty words each :
   (a) What do you mean by 'not for profit' organisation ?
   (b) State the treatment of specific donation.
   (c) State the treatment of legacy in the final accounts of a 'not for profit' organisation.
   (d) What is an Endowment Fund ?
   (e) Give the accounting treatment of life membership fee.
   (f) Give any two important features of Receipts and Payments Account.
   (g) Give any two important features of Income and Expenditure Account.
   (h) What is Honorarium ?
   (i) What do constitute the financial statements of a 'not for profit' organisation ?
   (j) Give any two important features of a 'not for profit' organisation.
   (k) Give the treatment of sale of fixed assets at the time of preparing Income and Expenditure Account.
   (l) State the treatment of subscription outstanding at the time of preparing Income and Expenditure Account.

(m) State the treatment of subscription received in advance at the time of preparing Income and Expenditure Account.

(n) How does donation differ from subscription ?

7. Answer the following questions within fifty words each :

(a) Define Receipts and Payments Account.

(b) Define Income and Expenditure Account.

(c) State the features of a 'not for profit' organisation.

(d) What is 'legacy' ?

(e) How do you treat 'specific donations' ?

(f) Give the steps in preparing Income and Expenditure Account.

(g) How will you treat entrance fees in the final accounts of a 'not for profit' organisation ?

(h) Why is Receipts and Payments Account prepared ?

(i) Distinguish between Cash Book and Receipts and Payments Account.

(j) Distinguish between Receipts and Payments Account and Income and Expenditure Account.

(k) Distinguish between Income and Expenditure Account and Profit and Loss Account.

(l) Give any five items of Capital Receipt.

(m) Give any five items of Revenue Receipt.

(n) How does donation differ from subscription ?

8. Define 'not for profit' organisation with suitable examples. Distinguish between Receipts and Payments Account and Income and Expenditure Account.

9. Define Receipts and Payments Account. State the procedure of preparing Income and Expenditure Account.

10. What is 'not for profit' organisation ? Distinguish Receipts and Payments Account from Cash Book.

11. What is Receipts and Payments Account ? How does it differ from Income and Expenditure Account ?

12. Explain the treatment of the following items in preparing final accounts of 'not for profit' organisations :

(a) Entrance Fees	(c) Subscription	(e) Life membership fee
(b) Capital Fund	(d) Legacy	(f) Donations

13. The following is the Receipts and Payments Account of Koshal Club, Bhawanipatna for the year ending 31st March 2017 :

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Salaries	4,200
Cash in Hand ₹1,700		By Postages and Telephones	700
Cash at Bank ₹1,400	3,100	By Investments	12,000
To Sale of old Newspapers	500	By Rent	2,000
To Subscriptions	25,000	By Printing and Stationery	800
		By Furniture	6,000
		By Balance c/d	
		Cash in Hand ₹1300	
		Cash at Bank ₹1600	2,900
	28,600		28,600

Additional Information :

1. Salaries Outstanding ₹300
2. Rent prepaid ₹500
3. Subscription due ₹1,000
4. Depreciate furniture by 10%.

Prepare Income and Expenditure Account and Balance Sheet.

(Answer : Surplus ₹18,400, Opening Capital Fund ₹3,100, Balance Sheet Total ₹21,800.)

14. From the following particulars of Kandhamal Legal Services Club, prepare the final accounts for the year ending 31.12.2016 :

Receipts and Payments Account of Kandhamal Legal Service Club for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	11,000	By Salaries	4,000
To Subscriptions	25,000	By Legal Fees	2,000
To Sale of Grass	1,000	By Equipment	20,000
To Rent of Hall	1,700	By Travelling Expenses	1,400
To Donation for prizes	10,000	By Office Expenses	1,300
		By Balance c/d	20,000
	48,700		48,700

Additional Information :

1. Books as on 01.01.2016 were ₹17,000.
2. Buildings as on 01.01.2016 stood at ₹63,000.
3. Travelling expenses unpaid ₹600.
4. Depreciate equipment by $7^{1}/_{2}$%.
5. Subscription due at the end of the year ₹600.
6. Subscription received in advance during the year ₹700.

   Hint - Capitalise donation as it is for a specific purpose.

   [Answers : Surplus ₹16,800, Opening Capital Fund ₹91,000

   Balance Sheet Total ₹1,19,100.]

15. The following is the Receipts and Payments Account of Mayurbhanja Cultural Society for the year ending 31.03.2017 :

Receipts and Payments Account of Mayurbhanja
Cultural Society for the year ending 31.03.2017

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	18,000	By Salaries and wages	32,200
To Subscriptions	30,000	By Office Expenses	3,100
To Govt. Grants	12,000	By Library Books	12,300
To Rent of Hall	1,000	By Telephone Charges	3,600
To Entrance fees	7,000	By Repairs	900
		By Addition to Building	5,000
		By Balance c/d	10,900
	68,000		68,000

You are required to prepare an Income and Expenditure Account and Balance Sheet after considering the following additional information :

1. Assets on 31.3.2016 were :

   Furniture 17,000, Building ₹50,000, Library Books ₹10,700.
2. Subscriptions outstanding on 31.03.2017 were ₹1,000.
3. Provide depreciation on all fixed assets @10%.

   [Ans. Surplus 1,700, Opening capital fund ₹95,700, Balance Sheet total ₹97,400.]

16. From the following particulars, prepare Income and Expenditure Account and Balance Sheet of Utkal Sangeet Parishad, Puri :

Receipts and Payments Account of Utkal Sangeet Parishad, Puri
for the year ending 31.03.2017

Receipts	(₹)	Payments	(₹)
To Balance b/d	9,000	By Repairs	2,000
To Subscriptions	40,000	By Stationery	4,500
To Sale of old furniture	600	By Rent	3,500
(Book value ₹1,000)		By Salaries	23,000
To Donations	10,000	By Help to Poor	10,000
To Interest on Investments	1,800	By Equipment	17,000
To Locker Rent	1,200	By Advertisement	1,500
		By Balance c/d	1,100
	62,600		62,600

Additional Information :

1. Subscription on 31st March 2017 was due ₹7,000 and on 31st March 2016 was due ₹9,000.
2. Investments were ₹25,000 as on 31.03.2016.
3. Rent Prepaid ₹500.
4. Depreciate Equipment @20% p.a.

[Answer : Deficit ₹6,800, opening capital Fund ₹44,000, Balance Sheet Total ₹47,200.]
Hints - (1) Donation is Capitalised, (2) Furniture ₹1,000 and Investments ₹25,000 will appear on the Balance Sheet as on 31.03.2016.

17. From the following information of Neelachal Club, prepare Income and Expenditure Account and Balance Sheet for the year ending 31.12.2016 :

Receipts and Payments Account of Neelachal Club
Dr. for the year ending 31.12.2016 Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	22,800	By Salaries	6,600
To Subscriptions	23,375	(Including ₹440 for 2015)	
(including ₹825 for 2017)		By Rent	5,940
To Lockers Rent	1,375	By Establishment	1,100
To Interest on Securities	1,150	By Telephone Charges	275
To Donations	11,000	By Stationeries	825
		By Library Books	3,300
		By Donations	5,500
		By Balance c/d	36,160
	59,700		59,700

Additional Information :

1. On 1.1.2016, Library books was ₹40,000 and 8% Government Bonds ₹20,000.
2. 1/4 the of donations received is to be capitalised.
3. Rent outstanding on 31.12.2017 ₹60.

[Answer: Surplus ₹13,965, Opening Capital Fund ₹82,360. Balance Sheet Total ₹99,960.]

18. From the following Receipts and Payments Account of Berhampur Music Club and other information given below, prepare Income and Expenditure Account for the year ending 31.12.2016 and the Balance Sheet as on that date :

Receipts and Payments Account
for the yer ending 31.12.2016

Receipts		(₹)	Payments	(₹)
To Balance b/d		23,000	By Salaries	18,000
To Entrance fees		2,000	By Postage and Telephone	2,500
To Subscriptions :			By Rent	4,000
2015	₹7,000		By Printing and Stationery	3,500
2016	₹48,000		By Furniture (1.7.16)	20,000
2017	₹2,000	57,000	By 12% Debentures (1.4.16)	30,000
To Interest on Debentures		2,000	By Miscellaneous Expenses	5,000
To Profit on Restaurants		12,000	By Balance c/d	13,000
		96,000		96,000

Additional Information :

1. Depreciate furniture @10% p.a.
2. Rent unpaid ₹800.
3. Subscriptions outstanding ₹3.000.
4. The club had instruments worth ₹20,000 on 01.01.2016 on which depreciation to be charged @5% p.a.

[Answer : Surplus ₹31,900. Opening Capital fund ₹50,000 Balance Sheet Total ₹84,700.]

19. From the following information, calculate the amount of subscription to be credited to Income and Expenditure Account for the year ending 31.03.2017 :

Receipts and Payments Account

Dr. Cr.

Receipts	(₹)	Payments	(₹)
Subscriptions :			
For the year ending on 31.03.2016	15,000		
For the year ending on 31.03.2017	95,000		
For the year ending on 31.03.2018	10,000		

Additional Information :

1. Subscriptions outstanding on 31.03.2017 ₹18,000
2. Subscriptions outstanding on 31.03.2016 ₹15,000
3. Subscriptions received in advance on 31.03.2016 ₹5,000

[Answer : ₹1,18,000.] Hint : (₹95,000 + ₹18,000 + ₹5,000)

20. From the following information, calculate the amount to be charged to Income and Expenditure Account for the year ending 31.03.2017 :

	₹
Salaries paid during the year	40,000
Salaries outstanding as on 31.03.2017	8,000
Salaries outstanding as on 31.03.2016	6,000

[Answer : ₹42,000 (₹40,000+₹8,000 – ₹6,000)]

21. During the year 31.03.2016, rent actually paid was ₹9,000. Find out the actual expenses on rent chargable to Income and Expenditure Account for the year ending 31.03.2016 from the information given below :

	₹
Prepaid Rent on 01.04.2015	1,200
Prepaid Rent on 31.03.2016	800
Outstanding Rent on 01.04.2015	700
Outstanding Rent on 31.03.2016	1,400

[Answer : ₹10,100. (₹9,000+₹1,200+₹1,400 – ₹800 – ₹700)]

22. Show the consumption of stationery to be charged to Income and Expenditure Account from the following data for the year ending 31.03.2017 :

Stock of Stationery : On 31.03.2016 ₹7,000 and on 31.03.2017 ₹8,000.

Stationery purchased during the year ending on 31.03.2017 ₹22,000.

[Answer : ₹21,000 (₹22,000+₹7,000 – ₹8,000)]

23. Calculate the amount of stationery consumed during the year ending 31.03.2017 and to be charged to Income and Expenditure Account for the year from the information given below:

	(₹)
Amount paid for stationery during the year	3,700
Creditors for stationery on 01.04.2016	500
Creditors for stationery on 31.03.2017	650
Stock of stationery as on 01.04.2016	750
Stock of stationery as on 31.03.2017	800

[Ans.: (1) Purchase of Stationery during the year : (₹3,850. (₹3,700+₹650–₹500)

(2) Amount to be charged to Income and Expenditure Account ₹3,800. (₹3,850+₹750–₹800).]

24. From the following Receipts and Paymetns Account of Santosh Club, Prepare the Income and Expenditure Account for the year ending 31.12.2016 and the Balance Sheet as on that date :

Receipts and Payments Account of Santosh Club

for the year ending 31.12.2016

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d		By Rent	2,400
Cash in Hand	600	By Salary	1,600
Cash at bank	2,500	By Printing	1,200
To Entrance fee	490	By Postage and Telephone	2,400
To Subscriptions	18,000	By Electricity	2,100
To Donations	1,650	By Library Books	4,000
To Life Member Fees	2,500	By 8% National Savings	
To Interest on Deposits	240	Certificates (01.07.2016)	12,000
To Proceeds from Entertainment	2,320	By Balance c/d	
		Cash in Hand	500
		Cash in Bank	2,100
	28,300		28,300

Additional Information :

(a) On 31.12.2015, the club had books worth ₹20,000 and furniture worth ₹8,000. Provide depreciation on these assets @10% p.a.

(b) Subscriptions outstanding at the beginning ₹500 and at the end ₹700.

[Answer : Surplus ₹10,240. Opening Capital fund ₹31,600 Balance Sheet Total ₹44,340.]

24. Following is the Receipts and Payments Account of Peacock Club for the year ending 31.12.2016 :

Dr. Cr.

Receipts	(₹)	Payments	(₹)
To Balance b/d	1,000	By Salaries	2,300
To Subscriptions	10,000	By Rent	1,100
		By Printing	500
		By Furniture (purchased on 1.7.2016)	6,000
		By Balance c/d	
		Cash in Hand	100
		Cash at Bank	1,000
	11,000		11,000

Additional Information :

(i) Salary outstanding ₹200

(ii) Rent Prepaid ₹100

(iii) Subscriptions outstanding ₹400.

(iv) Depreciation on Furniture 10% p.a.

(v) On 31.12.2015, the Building stood at ₹20,000 and Investments were ₹40,000.

Prepare Income and Expenditure Account for the year ending 31.12.2016 and Balance Sheet as on that date.

[Answer : Surplus ₹6,100, Opening Capital Fund ₹61,000, Balance Sheet total ₹67,300)]

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CHAPTER-3

DEPRECIATION

STRUCTURE

3.1 Meaning

3.2 Causes of depreciation

3.3 Objectives / Needs for providing depreciation

3.4 Characteristics

3.5 Factors for determination of depreciation

3.6 Methods of charging depreciation

- **3.6.1 Simple depreciation method**
- **3.6.2 Provision for Deprecation method**

3.7 Methods of calculating depreciation

- **3.7.1 Straight line method**
- **3.7.2 Written Down Value method**

3.8 Questions

After going through this chapter, you will be able to know meaning, need, causes, objectives and characteristics of depreciation. You will also be able to know different methods of charging depreciation.

It is derived from latin word depretium which means decline in price. The word depreciation is related to the concept of business income. The long term assets are used in the business to generate revenue. In the process of use, the long term assets consume their economic potential. After certain period of time the assets become useless and discarded. The assets are replaced for new long term assets. The economic potential so consumed is the expired cost of the assets. Such expired cost must be recovered from the revenue of the business. Such recovery of the expired cost determines the actual profit earned by business.

3.1 MEANING

The concept of depreciation refers to allocation of the cost of fixed assets over their expected period of useful life. The main purpose of depreciation is to charge it as an expense in order to find out the cost of production. As a result, true profit/loss earned/suffered by the business can be ascertained.

The following definitions will give a clear understanding of the term depreciation :

"The measure of the exhaustion of the effective life of an asset from any cause during a period." Spicer and peggler

"A measure of the wearing out, consumption or other loss of the value of depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined." The Institute of Chartered Accountants of India.

"Depreciation is the allocation of the depreciable amount of an asset over the estimated useful life. Depreciation for the accounting period is charged to the income either directly or indirectly" International Accounting Standard Committee.

"Depreciation accounting is a system of accounting which aims to distribute the cost of tangible capital assets, less salvage value, if any over the estimated useful life of the assets in a systematic and rational manner. It is the process of allocation, not of valuation. Depreciation for the year is a portion of the total charge under such a system that is allocated to the year."

Analysis of the above definitions reveals :

(i) Depreciation is a gradual decrease in the value of the assets.

(ii) Depreciation accounting is concerned with allocation of amount to be depreciated (cost less scrap value) over the estimated useful life period of the asset.

(iii) Such depreciation amount is charged to profit and loss account.

(iv) Depreciation is a process of allocation, not valuation of fixed assets.

Depreciable asset means :

(i) Life period of the asset is more than one accounting period.

(ii) Life of the asset is limited.

(iii) Asset is used in the business.

3.2 CAUSES OF DEPRECIATION

The following are the causes of depreciation

(i) Wear and tear : Assets get worn out because of constant use, passage of time. Such thing happens with fixed assets like plant and machinery, furniture and fixtures, building, etc.

(ii) Passage of time : The value of the most of the fixed assets fall because of the passage of time, irrespective of the use. Some assets have fixed legal life like lease, patent, copyright, etc.

(iii) Exhaustion : Some assets get exhausted in the process of use. Examples are : mines, oil wells, stone quarries, etc. These assets are known as wasting assets. The value reduces with extraction or exploitation.

(iv) Obsolescence : Obsolescence is a process of becoming obsolete or out of date. Some assets are discarded though they are in existence and working condition.

For example, a new asset has hit the market with more efficiency, low running and maintenance cost, etc. Use of the old asset becomes uneconomic. Running and maintend cost will be increased. So the old asset is discarded and it is replaced by a new asset.

(v) Accident : Sometimes the value of an asset reduces to zero or very negligible amount after it meets an accident.

3.3 OBJECTIVES / NEEDS FOR PROVIDING DEPRECIATION

The following are the objectives of or need for providing depreciation.

(i) To ascertain true profit :

When we are purchasing an asset, we are paying in advance for the future expenses. For example we have purchased plant & machinery for ₹5,00,000 for business use. As a result we are saving the hiring charge or the rent of the plant & machinery until it exists and used in the business. But this will be useless after some period of time. So the cost of the plant is nothing but the advance rent or hiring charges for the entire period for which the plant is useful. This rent or hiring charges would have been charged to profit and loss account. So the cost of the plant is to be charged to the profit and loss account over the useful life period of the plant and machinery. So we are charging the depreciation as an expense to know the true profit or loss. This is an invisible expense for the subsequent years of purchase of the asset during which period no cash is paid, as it has been paid in lump sum when it was purchased.

(ii) True financial position

The balance sheet must reveal true and fair view of the financial position of the business. The asset loses its value because of depreciation for various reasons. Value of the assets will be overstated, if shown in the balance sheet without charging depreciation. So depreciation must be deducted from the asset to show true financial position of the business.

(iii) For replacement of asset :

All fixed assets become commercially unviable after a fixed period of time.

But as per going concern concept, the business continues for a long period of time. So the old discarded assets are to be replaced by new ones in order to keep the business going. The depreciation so charged is accumulated over its useful life. This amount can be used to purchase a new asset.

(iv) Computation of tax liability

Depreciation is to be charged at a specific rate prescribled by the Income Tax authorities depending upon the nature and type of assets. Profit or loss can be calculated only after changing depreciation, so that the tax can be appropriataly levied.

(v) Determination of cost of production

Depreciation is an important componet of the cost of products though it is not paid in cash every year. So calculation of depreciation is important to find out the real cost of production.

3.4 CHARACTERISTICS

(i) Depreciation is a non-cash or non-monetary expense. The businessman need not pay anything in cash for depreciation.

(ii) The term depreciation is applicable to only fixed assets.

(iii) Depreciation is a charge against profit. This implies that true profit or loss of a business cannot be accurately ascertained without charging depreciation.

(iv) Depreciation is charged on the asset whether it is used for full year or part of the year.

(v) The total amount of depreciation cannot exceed the depreciable value of the fixed asset (i.e. cost price–scrap value)

(vi) Depreciation is a process of allocation of cost.

(vii) Calculation of exact depreciation is almost impossible. It is always calculated on estimated basis.

(viii) Depreciation is continuous fall in the value of the asset till the entire cost is exhausted.

(ix) Depreciation has no link with market price of the asset. It is always charged as a percentage of the cost price of the fixed asset.

(x) Depreciation is different from maintenance. Maintenance expenses are incurred to keep the asset in usable condition.

3.5 FACTORS FOR DETERMINATION OF DEPRECIATION

Calculation of depreciation usually depends upon the three factors, such as acquisition or historical cost, expected residual value or salvage or scrap value and estimated useful life of the asset. Each one of these factors is discussed below :

1. **Historical cost** of the asset implies cost incurred on acquisition of the asset and other cost incurred to put the asset in useful condition. The other cost includes all expenses incurred till the asset is installed or put to use. These expenses include transportation charges, transit insurance charge, installation expenses, registration charges, commission paid on purchase of asset and any other expenses. Depreciation is calculated on cost of acquisition including all the above expenses. For example, a machinery is purchased at a cost of ₹2,00,000, transportation cost incurred is ₹10,000 and installation cost is ₹20,000. For the purpose of depreciation, the cost of the asset is ₹2,30,000.

2. **Estimated useful life** of the depreciable asset implies either the number of years over which the asset is expected to be used or number of units expected to be produced or number of working hours of the asset during its life period or total kilometer to run during its useful life; depending upon the nature of the asset.

3. **Number of years :** Usually the life of an asset is expressed in terms of number of calender years for which the asset can be used effectively. Methods of depreciation under this category are :

- Fixed instalment method
- Diminishing balance method
- Annuity method

- Depreciation fund method
- Insurance policy method
- Revaluation method

4. **Number of units :** Total number of units to be produced during the life time of the asset is taken as its life. Depreciation is calculated basing upon number of units produced during an accountng year. The method used is production unit method or depletion method.

   For example, the cost of the machine is five lakh rupees. Total number of units to be produced during its life time is estimated at 10,000 units. In a particular year, 500 units are produced. Depreciation will be calculated as follows :

$$\frac{\text{Cost of the asset}}{\text{No. of units to be produced during life time}} \times \text{Number of units produced during the year.}$$

$$= \frac{5,00,000}{10,000} \times 500 = 25,000 \text{ rupees}$$

5. **No. of working hours :** Total number of hours for which asset is available for use during its life period is treated as its life. Depreciation is calculated basing upon number of hours for which asset is put to use during the year. Proceduer to calculate such depreciation is machine hour rate method or working hour method. For example, the cost of the machinery is ₹5,00,000, total number of working hour during its life is estimated to be 1,00,000 hours. During a year the machine is used for 10,000 hours. The amount of deprection during the year is :

$$₹\frac{5,00,000}{1,00,000} \times 10,000 = ₹50,000.$$

6. **Expected residual value or salvage** of depreciable asset implies estimated realisable value of the asset at the end of its useful life. It is also called scrap

value or salvage. Difference between cost of the asset and its estimated scrap value is termed as depreciable cost of the asset. Such depreciable cost is allocated and recovered during the life period of the asset. Total depreciation charged during its life time must be equal to depreciable cost.

3.6 METHODS OF CHARGING DEPRECIATION

There are two methods of charging depreciation. Those are :

(i) Simple Depreciation Method or by charging depreciation to Asset Account,

(ii) Provision for Depreciation Method or by creating provision or accumulated depreciation account.

These methods are discussed below :

3.6.1 Simple Depreciation Method or Recording of Depreciation by charging to Asset Account

Under this method, the amount of depreciation is debited to Depreciation Account and credited to Asset Account every year. The Asset Account appears in the Balance sheet at written down value (i.e. original cost less depreciation till date). The Depreciation Account is closed by transferring to Profit and Loss Account like any other items of expenses.

The various journal entries which are passed under this method are summarised below:

1.	To record purchase of asset	Asset A/c Dr. To Bank A/c (Being the asset purchased)
2.	To provide depreciation	Depreciation A/c Dr. To Asset A/c (Being the depreciation provided for)
3.	To transfer depreciation to Profit and Loss Account	Profit and Loss Account Dr. To Depreciation A/c (Being transfer of depreciation account to P.L. A/c)

4.	When additional asset is purchased	Asset A/c Dr. To Bank A/c (Being the asset purchased)
5.	To record sale of asset	Bank A/c Dr. Loss on sale of asset A/c Dr. To Asset A/c (Being loss on sale of asset) or Bank A/c Dr. To Asset A/c To Profit on sale of asset A/c. (Being profit on sale of asset)
6.(a)	To transfer profit on sale of asset	Profit on sale of asset A/c Dr. To Profit and Loss A/c (Being transfer of profit on sale of asset).
(b)	To transfer loss on sale of asset	Profit and loss A/c Dr. To Loss on sale of asset A/c (Being transfer of loss on sale of asset to P/L A/c).

Tutorial Notes

1. Book value on the date of sale = Original cost of asset – Total depreciation provided till the date of sale.
2. Profit = Sale price of asset - Book value on the date of sale.
3. Loss = Book value of asset on the date of sale – selling price of the asset.
4. In case of exchange of asset, the amount at which the vendor agrees to acquire the asset is the sales price.
5. In case of destruction or damage of an asset which is insured, claim admitted by insurance company is treated as sale price.

3.6.2 Provision for Depreciation Method or Recording depreciation when a provision for Depreciation Account is maintained

Under this method, the amount of depreciation to be charged in a particular year is debited to Profit and Loss Account and credited to Provision for Depreciation Account. The asset account appears on the asset side of the Balance Sheet at its original cost throughout its life; and the Provision for Depreciation Account appears on the liabilities side of the Balance Sheet. In case of sale of asset the provison for depreciation Account (relating to the asset sold) is transferred to Asset Account. Any amount realised on sale of asset is also transferred to Asset Account. The balance, if any, in the Asset Account (either profit or loss) is transfered to Profit and Loss Account.

The following journal entries are passed under this method :

1.	For providing deprecration :	Depreciation A/c To Provision for Deprecation A/c	Dr.
2.	For transferring depreciation A/c to Profit and Loss A/c	Profit and Loss A/c To Depreciation A/c	Dr.
3.	For transferring accumulated depreciation on asset sold.	Provision for Depreciation A/c To Asset A/c	Dr.
4.	In case of profit on sale of asset	Bank A/c To Asset A/c To Profit and Loss A/c	Dr/
5.	In case of loss on sale of Asset	Bank A/c Profit and Loss A/c To Asset A/c	Dr. Dr.

Distinction between Depreciation Account and Provision for Depreciation Account

Depreciation is a gradual reduction in the value of a fixed asset. Depreciation account is opened to record such reduction in the value of the fixed assets.

Depreciation account is a direct charge against the asset. It means every year the depreciation account is debited and concerned asset account is credited. At the end of the year the depreciation account is closed by transferring to Profit and Loss account. However, when the provision for depreciation account is opened, depreciation is not a direct charge against the asset. The provision for depreciation account is not closed each year and it is closed by transferring to asset account at the time of sale of the asset. Throughout the life time of the asset, the asset is shown on the asset side of the balance sheet at its original cost and provision for depreciation is shown on the liabilities side of the balance sheet.

Depreciation Account	**Provision for Depreciation Account**
This account is a Nominal account.	This account is a provision account, always showing a credit balance till the disposal of the asset.
At the time of charging depreciation, depreciation account is debited and asset account is credited.	At the time of charging depreciation, depreciation account is debited and provision for depreciation account is credited.
At the end of the accounting year, depreciation account is closed by transferring to profit and loss account.	Provision for depreciation account has no place in profit and loss account. It is shown on the liabilities side of the balance sheet and is closed by transferring to the particular asset account, when the asset is sold.
This account shows debit balance.	This account shows credit balance.
Asset is shown at written down value in the balance sheet.	Asset is shown at original cost in the balance sheet.
Depreciation account does not appear in the balance sheet.	Provision for depreciation account is shown on the liabilities side of the balance sheet.

3.7 METHODS OF CALCULATING DEPRECIATION

There are several methods of allocating depreciation over the useful life of the asset. There are various methods to recover the depreciable cost of the asset over its useful life. However, we will discuss only Straight Line method and Written Down value method.

3.7.1 Straight line method

Under this method, a fixed percentage of the original cost of the asset is written off during each accounting period over the useful life of the asset.

The rate of depreciation is calculated as under :

$$\text{Depreciation} = \frac{\text{Cost of the asset} - \text{Residual Value}}{\text{Estimated life}}$$

For example, the cost of an asset is ₹1,10,000. Its residual value after its 10 years estimated life is ₹10,000. Amount of depreciation is :

$$\frac{₹1,10,000 - ₹10,000}{10} = ₹10,000 \text{ per annum.}$$

₹10,000 is charged as depreciation per annum for a period of 10 years. At the end of 10 years, the cost of the asset reduces to its residual value or scrap value. It is called straight line method as the amount of depreciation remains fixed or same in each year. Under this method, depreciation is generally calculated as a fixed percentage on the original cost of the asset.

Advantages : The main advantages of straight line method of depreciation are as follows :

(i) This method is very simple to calculate and easy to apply.

(ii) The same depreciation amount is charged every year. So comparison of income of different years is easy.

(iii) The value of the asset will be reduced to zero or scrap value at the end of its life time.

(iv) This method is very suitable, particularly for those assets, which have a fixed life like leasehold property, patent right, etc.

Disadvantages : If suffers from the following disadvantages :

(i) It is based on the assumption that the asset has the same utility in different accounting periods. But the efficiency of the asset reduces with the passage of time.

(ii) The repair and maintance cost of the asset increases as the asset gets older. Depreciation amount remains the same. So total charge (i.e., depreciation plus repair and maintenance cost) to profit and loss account increases year after year as the asset grows older and older.

(iii) It does not consider loss of interest on the amount invested in the business.

(iv) If does not provide liquid fund for replacement of asset on expiry of its useful life.

(v) It is difficult to calculate depreciation on subsequent addition of the asset.

(vi) This method is not recognised by the income tax department.

3.7.2 Written down value method

This is otherwise known as diminising balance method or reducing instalment method.

Under this method, depreciation is calculated at a fixed percentage on written down value of the asset.This method assumes that the efficiency of the asset goes on reducing as the asset grows older. So the amont of depreciation to be charged in different accounting periods also decreases with the passage of time. For example, the cost of an asset is ₹1,00,000 and the rate of depreciation is 10% per annum. Under written down value method, the depreciation is calculated as under :

	₹
Cost of the asset	1,00,000
less : Depreciation for 1st Year (10% of ₹1,00,000)	10,000
Written down value in the beginning of 2nd year	90,000
less : Depreciation for 2nd year (10% of ₹90,000)	9,000
Written down value in the beginning of 3rd year	81,000
less : Depreciation for 3rd year (10% of ₹81,000)	8,100
Written down value in the beginning of 4th year	72,900

As the amount of depreciation is calculated on written down value of the asset, it is known as written down value method.

Formula for calculating depreciation is as follows :

$$\text{Rate of Depreciation} = \left[1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of asset}}}\right] \times 100$$

Where n = number of year

For example cost of the asset is ₹10,00,000, residual value is ₹64,000 and life period is 3 years.

$$\text{The rate of Depreciation} = \left[1 - \sqrt[3]{\frac{64{,}000}{10{,}00{,}000}}\right] \times 100$$

$$= 60\%$$

Advantages

This method has the following advantages :

(i) The total charge (i.e., depreciation plus repair and maintenance) remains almost the same year after year. The reason is amount of depreciation is more in the initial period. It goes on reducing as the asset grows older. The repair and maintenance is less in the initial period. It goes on increasing as the asset gets older. So total charge to profit and loss remains almost uniform.

(ii) This method is logical as the asset grows older, deprciation goes on reducing.

(iii) This method is recognised by the Income Tax department.

(iv) Fresh calculation of dereciation is not required when addition is made.

(v) A major portion of the asset is recovered in its earlier life. Replacement of the asset due to technological change will not create more problem.

Disadvantages

It suffers from the following disadvantages :

(i) As the depreciation is calculated at a fixed percentage on written down value of the asset, the value of the asset cannot be zero.

(ii) It does not take into consideration the loss of interest due to investment in asset.

(iii) It does not provide liquid fund for replacement of asset at the end of its useful life.

(iv) It is very difficult to calculate the amount of depreciation.

(v) It takes a long time to write off the asset.

Distinction between straight line method and written down value method

Straight line method	Written down value method
The rate and amount of depreciation remain the same year after year throughout the life period.	The rate of depreciation remains the same, but the amount of depreciation goes on reducing year after year.
Depreciation is calcualted as a percentage on the original cost of the asset.	Depreciation is calculated as a percentage on the written down value or reducing balance or book value of the asset.
The book value of the asset becomes zero at the end of the life of the asset.	The value of the asset never comes down to zero.
As the asset grows older, the amount of repair increases. But the amount of depreciation remains the same. Hence, the total amount of repair and depreciation increases year after year. It reduces the annual profit gradually.	As the asset grows older, the amount of repair increases. But the amount of depreciation decreases. Hence, the total amount of depreciation and repair remains almost the same each year. It does not affect the profit of the subsequent years substantially.
It is suitable for the assets whose repair charges are less and possibility of obsolescence is less.	It is suitable for assets which are affected by change in technology and which require more repair with the passage of time.

Illustration 1 (Calculation of Rate of Depreciation under straight line method.)

Calculate the cost of the asset, the amount of depreciation per annum and the rate of depreciation in the following cases under straight line method :

Case	Purchase Price ₹	Expenses to be capitalised (₹)	Estimated Scrap value	Expected Life
1.	55,000	15,000	10,000	6 years
2.	45,000	27,000	12,000	5 years
3.	63,000	27,000	9,000	9 years
4.	2,00,000	30,000	20,000	15 years

Solution :

Calculation of total cost of the asset :

Total cost of an asset = purchase price + Expenses to be capitalised

Case-1 ₹55,000 + ₹15,000 = ₹70,000

Case-2 ₹45,000 + ₹27,000 = ₹72,000

Case-3 ₹63,000 + ₹27,000 = ₹90,000

Case-4 ₹2,00,000 + ₹30,000 = ₹2,30,000

Calculation of amount of depreciation per year :

$$\text{Amount of depreciation} = \frac{\text{Total cost of asset} - \text{Estimated scrap value}}{\text{Expected life in years}}$$

$$\text{Case-1} \quad \frac{₹70,000 - ₹10,000}{6} = ₹10,000$$

$$\text{Case-2} \quad \frac{₹72,000 - ₹12,000}{5} = ₹12,000$$

$$\text{Case-3} \quad \frac{₹90,000 - ₹9,000}{9} = ₹9,000$$

$$\text{Case-4} \quad \frac{₹2,30,000 - ₹20,000}{15} = ₹14,000$$

Calculation of rate of depreciation under straight line method :

Rate of depreciation under straight line method= $\dfrac{\text{Annual depreciation}}{\text{Total cost of asset}} \times 100$

Case-1 $\dfrac{₹10,000}{₹70,000} \times 100 = 14.29\%$

Case-2 $\dfrac{₹12,000}{₹72,000} \times 100 = 16.67\%$

Case-3 $\dfrac{₹9,000}{₹90,000} \times 100 = 10\%$

Case-4 $\dfrac{₹14,000}{₹2,30,000} \times 100 = 6.09\%$

Illustration 2

(Calculation of depreciation for the 1st year of purchase, when rate of depreciation is not given.)

A machine costing ₹1,80,000 was purchased. Installation expense is ₹20,000. Expected life period is 7 years. Expected residual value at the end of useful life is ₹25,000.

Calculate the amount of depreciation for the year ending 31st March 2017, if the machine is purchased on :

(i) 1st April, 2016

(ii) 1st July 2016

(iii) 30th September 2016

(iv) 1st January 2017

Solution :

Cost of the machinery =

Purchase price + Installation expense

= ₹1,80,000 + ₹20,000 = ₹2,00,000

Amount of depreciation per year :

$$\frac{\text{Total cost of machine } - \text{ Estimated scrap value}}{\text{Expected useful life}}$$

$$= \frac{₹2,00,000 - ₹25,000}{7} = ₹25,000 \text{ per annum.}$$

Amount of depreciation for the first year of purchase :

Case-(i) Asset is purchased on 01.04.2016

Amount of depreciation for 12 months = ₹25,000

Case-(ii) Asset is purchased on 1st July, 2016

Amount of depreciation for 9 months

$$₹25,000 \times \frac{9}{12} = ₹18,750$$

Case-(iii) Asset is purchased on 30th September 2016

Amount of depreciation for 6 months

$$₹25,000 \times \frac{6}{12} = ₹12,500$$

Case-(iv) Asset is purchased on 1st January 2017

Amount of depreciation for 3 months

$$₹25,000 \times \frac{3}{12} = ₹6,250$$

Illustration 3

(Calculation of depreciation for the first year of purchase when rate is given)

A machine costing ₹80,000 was purchased.

Installation expense is ₹20,000.

Rate of depreciation under straight line method is 10% p.a. Calculate depreciation for the first year ending 31st March 2017, if the machine is purchased on :

(i) 1st April 2016
(ii) 1st July 2016
(iii) 1st October 2016
(iv) 1st January 2017

Solution :

Total cost of the machine ₹80,000 + ₹20,000 = ₹1,00,000

Amount of Depreciation =

$$\text{Cost of the machine} \times \frac{\text{Rate}}{100} \times \frac{\text{Period from date of purchase to date of closing the accounts}}{12}$$

Case-(i) When date of purchase is 1st April 2016 :

Amount of depreciation for 12 months

$$= ₹1,00,000 \times \frac{10}{100} \times \frac{12}{12} = ₹10,000$$

Case-(ii)

When the date of purchase is 1st July 2016 :

Amount of depreciation for 9 months $= ₹1,00,000 \times \frac{10}{100} \times \frac{9}{12} = ₹7,500$

Case-(iii)

When date of purchase is 1st October 2016 :

Amount of depreciation for 6 months $= ₹1,00,000 \times \frac{10}{100} \times \frac{6}{12} = ₹5,000$

Case-(iv)

When date of purchase is 1st January 2017 :

Amount of depreciation for 3 months $= ₹1,00,000 \times \frac{10}{100} \times \frac{3}{12} = ₹2,500$

Illustration 4

(Calculation of profit or loss on sale of asset)

A vehicle is purchased for ₹4,00,000. Depreciation is provided @10% p.a. on straight line method. The vehicle is sold for ₹3,00,000. Calculate the profit or loss on sale of vehicle in the following cases for the year ending 31st March 2017 :

(i) The date of purchase is 1st April 2015and the date of sale is 30th June 2016.

(ii) The date of purchase is 1st July 2015 and the date of sale is 31st December 2016.

(iii) The date of purchase is 1st October 2015 and date of sale is 30th Sept 2016.

(iv) The date of purchase is 1st January 2014 and the date of sale is 31st December 2016.

Solution :

Calculation of profit or loss on sale

Particulars	**Case-(i)** ₹	**Case-(ii)** ₹	**Case-(iii)** ₹	**Case-(iv)** ₹
A. Total cost of Vehicle	4,00,000	4,00,000	4,00,000	4,00,000
B. Depreciation from the date of purchase to date of sale	50,000 (4,00,000× $\frac{10}{100}\times\frac{15}{12}$)	60,000 (4,00,000× $\frac{10}{100}\times\frac{18}{12}$)	40,000 (4,00,000× $\frac{10}{100}\times\frac{12}{12}$)	1,20,000 (4,00,000× $\frac{10}{100}\times\frac{36}{12}$)
C. Book value on the date of sale (A-B)	3,50,000	3,40,000	3,60,000	2,80,000
D. Sale price	3,00,000	3,00,000	3,00,000	3,00,000
E. Profit on sale/loss on sale (D - C)	(50,000)	(40,000)	(60,000)	20,000

Journal Entries

(i) For providing depreciation :

Depreciation Account Dr. (with amount of depreciation provided)

To Asset Account

(ii) For Transfer of depreciation to Profit and Loss Account :

Profit and Loss Account Dr.
  To Depreciation Account

(iii) For sale of the asset at a profit :

Bank Account Dr. (With the selling price)
  To Asset A/c
  To profit on sale of asset A/c (with the amounts of profit, i.e., excess realised over the book value of the asset).

(iv) For transfer of profit on sale of asset :

Profit on sale of asset Account Dr.
  To Profit and Loss Account

(v) For sale of asset at a loss :

Bank A/c Dr. (With the sale price of the asset)
Loss on sale of asset A/c Dr. (With the difference between book value and sale price of the asset.)
  To Asset A/c

(vi) For transfer of loss on sale of asset.

Profit and Loss A/c Dr. (With the amount of loss)
  To Loss on sale of asset A/c

Illustration 5

A machine is purchased on 1st April 2015 for ₹5,00,000. Depreciation is charged under straight line method @10% per annum. Pass Journal entries for the year ending 31st March 2016 and 31st March 2017.

Solution :

Journal

Date	**Particulars**	L.F.	**(Dr.) (₹)**	**(Cr.) (₹)**
1st April 2015	Machinery Account Dr.		5,00,000	
	To Bank Account			5,00,000
	(Being the machinery purchased)			

31st March 2016	Depreciation Account Dr.		50,000	
	To Machinery Account			50,000
	(Being depreciation charged)			
31st March 2016	Profit and Loss Account Dr.		50,000	
	To Depreciation Account			50,000
	(Being transfer of depreciation to Profit and Loss Account)			
31st March 2017	Depreciation Account Dr.		50,000	
	To Machinery Account			50,000
	(Being depreciation charged)			
31st March 2017	Profit and Loss Account Dr.		50,000	
	To Depreciation Account			50,000
	(Being transfer of depreciation to Profit and Loss Account)			

Working Note :

$$\text{Annual Depreciation} = ₹5,00,000 \times \frac{10}{100} = ₹50,000$$

Illustration 6

A businessman bought a machinery on 1st October 2014 at a cost of ₹2,80,000. Amount spent on installation is ₹20,000. The business man writes off depreciation @10% per annum on original cost. The books are closed on 31st March every year. Prepare Machinery account and Depreciation account for 3 years.

Solution :

In the Books of....

Machinery Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Oct 1	To Bank A/c (Purchase price)	2,80,000	2015 Mar 31	By Depreciation A/c (1)	15,000
	To Bank A/c (Installation expense)	20,000	Mar 31	By Balance c/d	2,85,000
		3,00,000			3,00,000
2015 Apr 11	To Balance b/d	2,85,000	2016 Mar 31	By Depreciation A/c (2)	30,000
			Mar 31	By Balance c/d	2,55,000
		3,00,000			2,85,000
2016 Apr 1	To Balance b/d	2,55,000	2017 Mar 31	By Depreciation A/c (2)	30,000
			Mar 31	By Balance c/d	2,25,000
		2,55,000			2,55,000

Depreciation Account

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Machinery A/c (For half year)	15,000	2015 Mar 31	By Profit and Loss A/c (Transferred)	5,000
2016 Mar 31	To Machinery A/c	30,000	2016 Mar 31	By Profit and Loss A/c (Transferred)	30,000
2017 Mar 31	To Machinery A/c	30,000	2017 Mar 31	By Profit and Loss A/c (Transferred)	30,000

Working Notes :

Calculation of Depreciation :

1. Depreciation for the year ending 31st March 2015 :

$$₹3,00,000 \times \frac{10}{100} \times \frac{6}{12} = ₹15,000$$

2. Depreciation for the year ending 31st March 2016 and 2017

$$₹3,00,000 \times \frac{10}{100} = ₹30,000$$

Illustration 7

Auto Trader purchased a machine on 1st April 2014 at a cost of ₹1,00,000. It provides depreciation @20% per annum on 31st March every year on original cost of the machine. The plant was sold for ₹60,000 on 31st December 2016.

Prepare Machinery Account from 2014-15 to 2016-17.

Solution :

In the books of Auto Traders

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Apr 1	To Bank A/c	1,00,000	2015 Mar 31	By Depreciation A/c (20% on ₹1,00,000)	20,000
			Mar 31	By Balance c/d	80,000
		1,00,000			1,00,000
2015 Apr 1	To Balance b/d	80,000	2016 Mar 31	By Depreciation A/c (20% on ₹1,00,000)	20,000
			Mar 31	By Balance c/d	60,000
		80,000			80,000
2016 Apr 1	To Balance b/d	60,000	2016 Dec 31	By Depreciation A/c (20% on ₹1,00,000 for 9 months)	15,000
Dec-31	To Profit on sale of asset A/c (profit on sale)	15,000	Dec-31	By Bank A/c (sale of machine)	60,000
		75,000			75,000

Working Note :

Calculation of profit on sale :	₹
Cost price on 1s April 2014	1,00,000
less depreciation from 01.04.14 - 31.03.15 $\left(1,00,000 \times \frac{20}{100}\right)$	20,000
Book value on 01.04.15	80,000

less Depreciation from 01.4.15 to 31.3.16 $\left(100{,}000 \times \frac{20}{100}\right)$	20,000
Book value on 01.04.16	60,000
less : Depreciation from 01.04.16 to 31.12.16 $\left(100{,}000 \times \frac{10}{100} \times \frac{9}{12}\right)$	15,000
Book value on 31.12.16	45,000
Sale proceeds	60,000
Profit on sale of machine	15,000

Illustration 8

M/s Mehta Bros purchased a machine for ₹4,00,000 on 1st April 2015. They spent ₹20,000 on its installation. Depreciation is charged @10% on original cost. The books are closed on 31st March every year. On 31st March 2017, one half of the machine is sold for ₹1,50,000. Prepare Machinery Account for 2 years.

Solution :

Machinery A/c

Date	Particulars	₹	Date	Particulars	₹
2015 April 1	To Bank A/c (Purchase of machine)	4,00,000	2016 Mar 31	By Depreciation A/c (10% on ₹4,20,000)	42,000
April 1	To Bank A/c (Installation Charges)	20,000	Mar 31	By Balance c/d	3,78,000
		4,20,000			4,20,000
2015 April 1	To Balance b/d	3,78,000	2017 Mar 31	By Depreciation A/c (10% on ₹4,20,000)	42,000
			Mar 31	By Bank A/c (Sale of Machine)	1,50,000
			Mar 31	By Profit and Loss A/c (loss sale of machine)	18,000
			Mar 31	By Balance c/d	1,68,000
		3,78,000			3,78,000
2017 April 1	To Balance b/d	1,68,000			

Working Note :

Calculation of loss on sale :	₹
Balance on 01.04.16	3,78,000
less : Depreciation for 2016-17	42,000
Book value on 31.03.17	3,36,000
Half of 3,36,000	1,68,000
Less : Selling price	1,50,000
loss on sale	18,000

Illustration 9

M/s Raman Singh purchased a machine on 1st April 2014 for ₹2,00,000. On 1st July 2015, additions were made for ₹1,00,000. On 1st October 2016 further additions were made for ₹50,000. On 31st December 2016, the machine purchased on 1st April 2014 became obsolete and sold for ₹1,40,000/-. Depreciation is charged at 10% p.a. under fixed instalment method, and the accounts are closed on 31st March every year.

Show Machinery Account for the year 2014-15 to 2016-17.

Solution :

In the Books of M/s Raman Singh

Machinery Account

Date	Particulars		Date	Particulars	₹
2014			2015		
April 1	To Bank A/c (Purchase of machine)	2,00,000	Mar 31	By Depreciation A/c (10% on ₹2,00,000 for one year)	20,000
			Mar 31	By Balance c/d	1,80,000
		2,00,000			2,00,000
2015			2016		
April 1	To Balance b/d	1,80,000	Mar 31	By Depreciation A/c 10% on ₹2,00,000 for 1 year $₹2,00,000 \times \frac{10}{100} = 20,000$ 10% on ₹1,00,000 for 9 months. $1,00,000 \times \frac{10}{100} \times \frac{9}{12} = \underline{7,500}$	27,500
July 1	To Bank A/c (purchase of new machinery)	1,00,000	Mar 31	By Balance c/d	2,52,500
		2,80,000			2,80,000

2016 April 1	To Balance b/d	2,52,500	2016 Dec 31	By Bank A/c (obsolete machinery sold)	1,40,000
Oct 1	To Bank A/c (addition of new machinery)	50,000	Dec 31	By Depreciation A/c $\left(2,00,000 \times \frac{10}{100} \times \frac{9}{12}\right)$	15,000
			Dec 31	By Profit and Loss Account (loss on sale of obsolete machinery)	5,000
			2017 Mar 31	By Depreciation A/c On ₹1,00,000, 10% p.a. for one year $₹1,00,000 \times \frac{10}{100} = ₹10,000$ 10% p.a. on 50,000 for 6 months. $₹50,000 \times \frac{10}{100} \times \frac{6}{12} = ₹2,500$	12,500
				Mar 31 By Balance c/d	1,30,000
		3,02,500			**3,02,500**
2017 Mar 31	To Balance b/d	1,30,000			

Working Note

Calculation of profit or loss on sale of machine :

	₹
cost price on 1.4.2014	2,00,000
less Depreciation for 1.4.14-31.3.15 $\left(2,00,000 \times \frac{10}{100} \times \frac{12}{12}\right)$	20,000
Book value on 1.4.15	1,80,000
less Depreciation for 1.4.15-31.3.16 $\left(2,00,000 \times \frac{10}{100}\right)$	20,000
Book value on 1.4.16	1,60,000
Less Depreciation from 1.4.16 - 31.12.16 for 9 months $\left(2,00,000 \times \frac{10}{100} \times \frac{9}{12}\right)$	15,000
Balance on 31.12.2016	1,45,000
less Selling price	1,40,000
Loss on sale of asset	5,000

Illustration 10

Somesh Dutta & Co. purchased a machinery an 1st April 2014 for ₹50,000. Depreciation is to be provided @10% p.a. according to written down value method. Prepare Journal, Machinery Account and Depreciation Account for 3 years assuming that accounts are closed on 31st March every year.

Solution :

Journal of Somesh Dutta & Co.

Date	Particulars	L.F.	Amount ₹	Amount ₹
01.04.2014	Machinery A/c Dr.		50,000	
	To Bank A/c			50,000
	(Being the purchase of machinery)			
31.03.2015	Depreciation A/c Dr.		5,000	
	To Machinery A/c			5,000
	(Being the depreciation provided)			
31.03.2015	Profit and Loss A/c Dr.		5,000	
	To Depreciation A/c			5,000
	(Being the transfer depreciation A/c to P/L A/c.)			
31.03.16	Depreciation A/c Dr.		4,500	
	To Machinery A/c			4,500
	(Being depreciation provided)			
31.03.16	Profit and Loss A/c Dr.		4,500	
	To Depreciation A/c			4,500
	(Being the transfer of depreciation A/c)			
	To P/l A/c)			
31.03.17	Depreciation A/c Dr.		4,050	
	To Machinery A/c			4,050
	(Being the depreciation provided)			
31.03.17	Profit and Loss A/c Dr.		4,050	
	To Depreciation A/c			4,050
	(Being the transfer of depreciation to P/L A/c).			

Depreciation Account

Date	Particulars	₹		Particulars	₹
31.3.15	To Machinery A/c	5,000	31.3.15	By Profit and Loss A/c (Transferred)	5,000
		5,000			5,000
31.3.16	To Machinery A.c	4,500	31.3.16	By Profit loss A/c	4,500
		4,500		(Transferred)	4,500
31.3.17	To Machinery A.c	4,050	31.3.17	By Profit and Loss A/c	4,050
		4,050		(Transferred)	4,050

Dr. Machinery Account Cr.

Date	Particulars		₹	Date	Particulars	₹
1.4.14	To Bank A/c		50,000	31.3.15	By Depreciation A/c	5,000
	(Purchase of machine)			31.3.15	By Balance c/d	45,000
			50,000			50,000
1.4.15	To Balance b/d		45,000	31.3.16	By Depreciation A/c	4,500
				31.3.16	By Balance c/d	40,500
			45,000			45,000
1.4.16	To Balance b/d		40,500	31.3.17	By Depreciation A/c	4,050
				31.3.17	By Balance c/d	36,450
			40,500			40,500
1.4.17	To Balance b/d		36,450			

Working Notes

$$\text{Depreciation for } 2014-15 = ₹50,000 \times \frac{10}{100} = ₹5,000$$

$$\text{Depreciation for } 2015-16 = ₹45,000 \times \frac{10}{100} = ₹4,500$$

$$\text{Depreciation for } 2016-17 = ₹40,500 \times \frac{10}{100} = ₹4,050$$

Illustration 11

A merchant purchased a second hand machinery for ₹80,000 on 1.4.14. He spent ₹20,000 for repair and installation. Depreciation is provided @20% p.a. according to written down value method. Pass journal entries, show Machinery Account and Depreciation Account for first three years assuming accounts are closed on 31st March each year.

Solution :

Journal of the Merchant

Date	Particulars		L.F.	Amount Dr ₹	Amount Dr ₹
1.4.14	Machinery A/c	Dr.		80,000	
	To Bank A/c				80,000
	(Being the machinery purchased)				
1.4.14	Machinery A/c	Dr.		20,000	
	To Bank A/c				20,000
	(Being the repair and installation charges paid)				
31.3.15	Depreciation A/c	Dr.		20,000	
	To Machinery A/c				20,000
	(Being depreciation provided)				
31.3.15	Profit and Loss A/c	Dr.		20,000	
	To Depreciation A/c				20,000
	(Being transfer of Depreciation to P/L A/c)				
31.3.16	Depreciation A/c	Dr.		16,000	
	To Machinery A/c				16,000
	(Being depreciation provided)				
31.3.16	Profit and Loss A/c	Dr.		16,000	
	To Depreciation A/c				16,000
	(Being transfer of depreciation to P/L A/c)				
31.3.17	Depreciation A/c	Dr.		12,800	
	To Machinery A/c				12,800
	(Being depreciation provided)				
31.3.17	Profit and Loss A/c	Dr.		12,800	
	To Depreciation A/c				12,800
	(Being transfer of Depreciation)				

Dr. Machinery Account Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
1.4.14	To Bank A/c		80,000	31.3.15	By Depreciation A/c	20,000
1.4.14	To Bank A/c (Installation and repair)		20,000	31.3.15	By Balance c/d	80,000
			1,00,000			1,00,000

1.4.15	To Balance b/d		80,000	31.3.16	By Depreciation A/c	16,000
				31.3.16	By Balance c/d	64,000
			80,000			80,000
1.4.16	To Balance b/d		64,000	31.3.17	By Depreciation	12,800
				31.3.17	By Balance c/d	51,200
			64,000			64,000
1.4.17	To Balance b/d		51,200			

Depreciation Account

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
31.3.15	To Machinery A/c		20,000	31.3.15	By Profit and Loss A/c (Transferred)	20,000
			20,000			20,000
31.3.16	To Machinery A/c		16,000	31.3.16	By Profit and Loss A/c (Transferred)	16,000
			16,000			16,000
31.3.17	To Machinery A/c		12,800	31.3.17	By Profit and Loss A/c (Transferred)	12,800
			12,500			12,500

Working Notes

Depreciation for 2014-15 :

$$₹1,00,000 \times \frac{20}{100} = ₹20,000$$

Depreciation for 2015-16 :

$$₹80,000 \times \frac{20}{100} = ₹16,000$$

Depreciation for 2016-17 :

$$₹64,000 \times \frac{20}{100} = ₹12,800$$

Note: In case of purchase of old/second hand machinery, all expenses incurred including the installation expenses are to be capitalised.

Illustration 12

X Ltd. purchased a plant on 1st July 2014 for ₹1,20,000. The plant is subject to depreciation of 10% p.a. on reducing balance method. The plant became obsolete on 31st December 2016 and sold for ₹20,000. Write up the Plant Account assuming that accounts are closed on 31st March every year.

Solution :

Dr. Plant Account Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
1.7.14	To Bank A/c		1,20,000	31.3.15	By Depreciation A/c	9,000
				31.3.15	By Balance c/d	1,11,000
			1,20,000			1,20,000
1.4.15	To Balance b/d		1,11,000	31.3.16	By Depreciation A/c	11,100
				31.3.16	By Balance c/d	99,900
			1,11,000			1,11,000
1.4.16	To Balance b/d		99,900	31.12.16	By Bank A/c (sale of absolete machinery)	20,000
				31.12.16	By Depreciation A/c	7,493
				31.12.16	By Profit and Loss A/c (loss on sale)	72,407
			99,900			99,900

Working Notes

Depreciation for 2014-15 :

$$₹1,20,000 \times \frac{10}{100} \times \frac{9}{12} = ₹9,000$$

Depreciation for 2015-16 :

$$₹1,11,000 \times \frac{10}{100} = ₹11,100$$

Depreciation for 2016-17 :

$$₹99{,}900 \times \frac{10}{100} \times \frac{9}{12} = ₹7{,}493$$

Calculation of profit/loss on sale :

	₹
Cost of the plant on 1.7.14	1,20,000
Less : Depreciation from 1.7.14-31.3.15	9,000
Cost on 1.4.15	1,11,000
Less : Depreciation from 1.4.15-31.3.16	11,100
Cost on 1.4.16	99,900
Less Depreciation from 1.4.16-31.12.16	7,493
Written down value on 31.12.16	92,407
Less : Sale Price	20,000
Loss on Sale	72,407

Illustration 13

(Provision for Depreciation Account)

Raman purchased a machinery for ₹2,00,000 on 1.4.14 and sold for ₹1,45,000 on 31.3.17. Depreciation is provided @10% p.a. on the original cost of the machinery. Pass the necessary journal entries and prepare necessary ledger accounts assuming that Provision for Depreciation Account is maintained.

Solution :

Journal

Date	Particulars	L.F.	Amount Dr ₹	Amount Dr ₹
1.4.14	Machinery A/c Dr.		2,00,000	
	To Bank A/c			2,00,000
	(Being the purchase of machinery)			
31.3.15	Depreciation A/c Dr.		20,000	
	To Provision for Depreciation A/c			20,000
	(Being provision for depreciation created)			
31.3.15	Profit and Loss A/c Dr.		20,000	
	To Depreciation A/c			20,000
	(Being transfer of depreciation to P/L A/c)			

31.3.16	Depreciation A/c Dr. To Provision for Depreciation A/c (Being the provision for made)		20,000	20,000
31.3.16	Profit and Loss A/c Dr. To Depreciation A/c (Being transfer of depreciation Account to P & L A/c)		20,000	20,000
31.3.17	Depreciation A/c Dr. To Provision for Depreciation A/c (Being provision for depreciation made)		20,000	20,000
31.3.17	Profit and Loss Account A/c Dr. To Depreciation A/c (Being transfer of depreciation to P&L A/c)		20,000	20,000
31.3.17	Bank A/c Dr. To Machinery A/c (Being sale of machinery)		1,45,000	1,45,000
31.3.17	Provision for Depreciation A/c Dr. To Machinery A/c (Being transfer of Provision for Depreciation to Machinery account on sale)		60,000	60,000
31.3.17	Machinery A/c Dr. To Profit and Loss A/c (Being profit on sale of machinery)		5,000	5,000

Dr. Machinery Account Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
01.4.14	To Bank A/c		2,00,000	31.3.15	By Balance c/d	2,00,000
01.4.15	To Balance b/d		2,00,000	31,.3.16	By Balance c/d	2,00,000
01.4.16	To Balance b/d		2,00,000	31,.3.17	By Bank A/c	1,45,000
31.3.17	To Profit and Loss A/c (profit on sale of machinery)		5,000	31.3.17	By Provision for Depreciation A/c	60,000
			2,05,000			**2,05,000**

Dr. Depreciation Account Cr.

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
31.3.15	To Provision for Depreciation A/c		20,000	31.3.15	By Profit and Loss A/c	20,000
31.3.16	To Provision for Depreciation A/c		20,000	31,.3.16	By Profit and Loss A/c	20,000
31.3.17	To Provision for Depreciation A/c		20,000	31.3.17	By Profit and Loss A/c	20,000

Provision for Depreciation Account

Date	Particulars	L.F.	Amount (₹)	Date	Particulars	Amount (₹)
31.3.15	To Balance c/d		20,000	31.3.15	By Depreciation A/c	20,000
31.3.16	To Balance c/d		40,000	01.4.15	By Balance b/d	20,000
				31.3.16	By Depreciation A/c	20,000
			40,000			40,000
31.3.17	To Machinery A/c		60,000	01.4.16	By Balance b/d	40,000
				31.3.17	By Depreciation A/c	20,000
			60,000			60,000

Working Notes :

Calculation of profit or loss on sale of machinery	₹
Cost price of Machinery on 1.4.2014	2,00,000
less : Depreciation for 3 years @ ₹20,000 p.a.	60,000
Written down value on 31.03.17	1,40,000
Sale price	1,45,000
Profit on sale	5,000

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3.8 QUESTIONS

1. From the alternatives given under each bit, write the correct answer along with its serial number against each bit :

(a) Depreciation is calculated on the basis of :

(i) Market Price.

(ii) Cost Price.

(iii) Market Price or cost price whenever is less.

(iv) On average of cost price and market price.

(b) Under straight line method of depreciation, the amount of annual depreciation :

(i) Increases every year.

(ii) decreases every year.

(iii) Increases in some years and decreases in some other years.

(iv) remains constant.

(c) Under diminishing balance method, the amount of depreciation :

(i) increases every year.

(ii) decreases every year.

(iii) remains constant.

(iv) both Increases and decreases.

(d) Depreciation is :

(i) an income.

(ii) a loss.

(iii) an asset.

(iv) a liability.

(e) Depreciation is calculated on :

(i) fixed assets.

(ii) current assets.

(iii) liquid assets.

(iv) fictitious asset.

(f) Deprecation is charged to :

(i) Trading Account.

(ii) Profit and Loss Account.

(iii) Profit and Loss Adjustment account.

(iv) Profit and Loss Appropriation account.

(g) Depreciation arises due to :

(i) fall in market price of the asset.

(ii) physical wear and tear of the asset.

(iii) fall in the value of money.

(iv) pilferage.

(h) Profit on sale of machinery should be credited to :

(i) Profit and Loss Account.

(ii) Trading Account.

(iii) Profit and Loss Appropriation Account.

(iv) Provision for Depreciation Account.

(i) The cost of the plant is ₹5,000. Depreciation is provided @10% p.a. on written down value method. The depreciation for 3rd year will be.

(i) ₹500.

(ii) ₹450.

(iii) ₹400.

(iv) ₹405.

(j) If the cost of the asset is ₹31,000 and scrap value is ₹1,000, then the amount of depreciation @10% p.a. on straight line method is :

(i) ₹3,100 p.a.

(ii) ₹3,000 p.a.

(iii) ₹2,900 p.a.

(iv) ₹3,110 p.a.

(k) One of the following assets which is assumed not to be depreciated is :

(i) plant.

(ii) machinery.

(iii) land.

(iv) mine.

(l) Depreciation is a process of :

(i) valuation of asset.

(ii) allocation of cost of asset.

(iii) amortisation of the asset.

(iv) duplication of asset.

[Ans. (a) - (ii) - Cost price

(b) - (iv) - Remain constant

(c) - (ii) - decreases every year

(d) - (ii) - a loss

(e) - (i) fixed assets

(f) - (ii) - profit and loss account

(g) - (ii) - physical wear and tear of the asset

(h) - (i) - profit and loss account

(i) - (iv) - ₹405

(j) - (ii) - ₹3,000 p.a

(k) - (iii) - land

(l) - (ii) - allocation of cost of asset]

2. Answer the following questions in one word/term each :

(a) Name the type of asset on which depreciation is calculated.

(b) Name the type of fixed asset on which depreciation is not calculated.

(c) Name the account to be debited for the amount of depreciation charged against an asset.

(d) Under which method of charging depreciation, the amount of depreciation for each year remains constant ?

(e) Name the asset against which the term 'depletion' is used.

(f) Name the term used for the amount likely to be realised on sale of fixed asset after its useful life.

(g) In which method of depreciation the value of the fixed asset becomes zero at the end of its useful life.

(h) Name the account to be debited for loss on sale of fixed asset.

(i) Name the method of depreciation in which amount depreciation reduces year after year of use.

(j) What is the amount of depreciation on the deminishing balance method on a machinery of ₹10,000 at the rate at 10% p.a. in the 3rd year of its use ?

[Ans.: (a) fixed asset (b) Land (c) Depreciation Account (d) Straight line method (e) wasting asset (f) scrap value or salvage value (g) straight line method (h) profit and loss account (i) reducing balance method (j) ₹810.]

3. Answer the following questions in one sentence each :

(i) What do you mean by depreciation ?

(ii) Write any one cause of depreciation.

(iii) On which type of asset, depreciation is chargeed ?

(iv) State any one characteristic of depreciation.

(v) Give any one difference between depreciation account and provision for depreciation account.

(vi) Give the journal entry for writing off depreciation.

(vii) Give any one difference between straight line method and written down value method of depreciation.

(viii) Which method of depreciation is approved for income tax purpose ?

(ix) What do you mean by residual value of the asset ?

(x) Explain the meaning of the term “wear and tear” in depreciation.

4. Fill up the blanks of the following sentences :

(a) The word depreciation is derived from the latin word ______.

(b) Permanent decrease in the value of the asset is known as ______ .

(c) The estimated value realised at the time of discard of fixed assets is known as ______ .

(d) Obsolescence is the technical term used as the reason of discarding ______ asset.

(e) Total cost of the fixed asset is equal to purchase price – installation expenses.

(f) Depreciation refers to ______ in the value of fixed assets.

(g) Depreciation is a ______ expense.

(h) When depreciation is charged, asset account is ______.

(i) ______ is the only asset which is usually not depreciated.

(j) Depreciation is charged on ______ assets.

[Ans. : (a) Depretium (b) depreciation (c) scrap (d) fixed (e) + (f) decrease/ reduction (g) Non cash (h) credited (i) Land (j) fixed]

5. Correct the underlined partions of the following sentences :

(a) In written down value method of depreciation, the written down value of the asset becomes zero at the end of its useful life.

(b) In straight line method of depreciation the value of the asset is never zero.

(c) Provision for depreciation account always shows Debit balance.

(d) Fixed assets are shown in the balance sheet at market price.

(e) In case of loss suffered during a financial year, depreciation cannot be provided.

(f) Profit and Loss Account is credited with the amount of depreciation.

[Ans.: (a) straight line (b) written down value (c) credit (d) cost (e) can (f) debited]

6. Answer the following questions within 30 words each :

(a) Define the term ‘depreciation’.

(b) What do you mean by salvage value of the fixed asset ?

(c) What is ‘written down value’ of asset ?

(d) Write any two differences between straight line method of depreciation and written down value method of depreciation.

(e) Why is asset shown in the balance sheet at its original cost under provision for depreciation method ?

(f) What are the causes of depreciation ?

(g) What is the need for charging depreciation ?

(h) What do you mean by reducing balance method of depreciation ? Explain with an example.

(i) Write the formula for calculation of depreciation under straight line method. Explain with an example.

7. Answer the following questions within 50 words each :

(a) Explain the merits and demerits of straight line method of depreciation.

(b) State the merit and demerits of written down value method of depreciation.

(c) Show the calculation of depreciation under reducing balance method of depreciation for 3 years with an imaginary example.

(d) State the objectives of providing depreciation.

(e) Explain the characteristics of depreciation.

(f) Which factors affect the depreciations ?

(g) Show the calculation of profit on sale of depreciable asset with an imaginary example.

(h) Distinguish between straight line method and written down value method of depreciation.

(i) Differentiate between sample depreciation method and provision for depreciation method.

8. What is depreciation ? Discuss the causes and objectives of providing depreciation.

9. Define depreciation. Discuss its characteristics.

10. Explain straight line method and written down value method of providing depreciation.

11. Give the Journal entries for charging depreciation under simple method with imaginary example. Show the treatment in the balance sheet also.

12. Write journal entries required for charging depreciation under provision for depreciation method with imaginary example. Show the treatment also in the Balance Sheet.

13. M purchased a machinery for ₹40,000. The useful life of the machinery is 10 years. The estimated scrap value is ₹4,000/- M wants to provide depreciation under straight line method. Calculate the rate of depreciation. (Ans. 9%)

14. Raman purchased a machinery on 1st April 2014 for ₹1,00,000. The estimated life of the machine is 15 years. Its scrap value after 15 years will be ₹10,000. Pass journal entries for the first three years, under straight line method assuming that the accounts are closed on 31st March, every year.

(Annual depreciation₹6,000)

15. Madan Purchased a machine on 1.4.14 for ₹1,20,000. Assuming the life of the machine at 10 years and estimated scrap value at ₹20,000, prepare the Machinery Account for the first three years under straight line method. Accounts are closed on 31st March each year.

(Balance in Machinery Account ₹90,000)

16. Mr. Kumar purchased a plant on 1.4.13 costing ₹2,00,000. The life of the plant is estimated at 15 years. The estimated scrap value after the useful life is ₹20,000. Prepare necessary ledger accounts from 2013-14 to 2016-17 under straight line method of depreciation.

(Ans. Balance of Plant Account ₹1,52,000)

17. Sanjay purchased a fixed asset on 01.01.2014 for ₹80,000. Depreciation is provided under straight line method @ 10% p.a. Accounts are closed on 31st March every year. Pass Journal entries and prepare necessary ledger accounts till 31st March 2017.

(Ans. Balance of Plant Account ₹54,000)

18. A manufacturer acquires a machine on 1.4.2014 for ₹80,000. He spent ₹2,000 on transportation and ₹18,000 on installation. The manufacturer charges depreciation @10% on original cost every year. Show the Machinery Account and Depreciation Account for 3 years. The books are closed on 31st March every year.

(Ans. Balance in Machinery Account ₹70,000)

19. Mr. Nandan purchased a second-hand machine for ₹40,000 on 1st April 2014. He spent ₹10,000 on its overhauling and installation. Depreciation is written off @10% p.a. on original cost. Prepare Machinery Account and Depreciation Account and show the balance sheet entries for first three years assuming that accounts are closed on 31st March every year.

(Balance in Machinery Account of ₹35,000)

20. Mrs. Smruti Purchased a machinery for ₹50,000 on 1st April 2013. She purchased another machinery on 31st December 2015 for ₹60,000. Rate of depreciation under straight line method is 10%. Write up Machinery Account and Depreciation Account from 2013-14 to 2016-17 assuming that accounts are closed on 31st March every year.

(Balance in Machinery Account ₹82,500)

21. On 1st January 2014, an asset was purchased for ₹64,000. If was decided to write off 10% depreciation on original cost each year. On 31st March 2017, it was sold for ₹40,200. Prepare asset account till 31st March 2017 assuming that books are closed on 31st March every year.

(loss ₹3,000)

22. Mr. Ram lal purchased a machine at a cost of ₹75,000 on 1st January 2014. He spent ₹5,500 on installation of the machine. He purchased another machine on 1st April 2015 for ₹60,000. Another machine was purchased on 1st April 2016 for ₹50,000. Show Machinery Account and Depreciation Account from 1st January 2014 to 31st March 2017 assuming that accounts are closed on 31st March every year. Depreciation is calculated @10% p.a. on original cost of the machine.

(Ans. Balance in Machinery account ₹1,55,000)

23. Mr. Jambaban purchased a second hand machine for ₹70,000 on 1st April 2014. He spent ₹20,000 on repair and installation. He purchased another machine on 1st April 2015 for ₹58,000. He spent ₹2,000 on installation of the machine. Depreciation is provided @10% p.a. on straight line method. Pass necessary journal entries, prepare necessery ledger accounts for the period 2014-15 to 2016-17 assuming that accounts are closed on 31st March every year.

[Ans. Balance in Machinery Account ₹1,11,000)

24. The cost of furniture on 1.4.2013 was ₹30,000. Depreciation is to be provided at 10% p.a. on diminishing balance method. Show the necessary ledger accounts for the first four years assuming that accounts are closed on 31st March every year.

[Ans. Depreciationon ₹3,000, ₹2,700, ₹2,430, ₹2,187]

25. Mr. Som Prasad purchased a machine for ₹3,00,000 an on 1st January 2014. It was decided that depreciation would be charged at 10% p.a. on reducing balance method. Show the Machinery Account and Depreciation Account in the books of Som Prasad from 1st January 2014 to 31st March 2017 assuming that accounts are closed on 31st March every year.

    [Ans. Balance of Machinery account ₹2,13,232]

26. The original cost of a plant an 1st April 2013 amounted to ₹4,00,000. It was decided to charge depreciation at 5% p.a. on written down value method. Show the necessary ledger accounts as these will appear from 2013-14 to 2016-17, assuming that accounts are closed on 31st March every year.

    [Ans. ₹3,25,803]

27. On 1st April 2014 a machine was bought at a cost at ₹2,82,000. Installation charges were ₹18,000. It was decided to charge depreciation @15% p.a. on dimmishing balance. Show Machinery Account and Depreciation Account for the year 2014-15 to 2016-17 assuming that accounts are closed on 31st March every year.

    [Ans. Balance in machinery account ₹1,84,237]

28. A plant was purchased for ₹5,00,000 on 1st April 2012. It was depreciated @5% p.a. on reducing balance method. It became obsolete on 31st March 2017 due to new method of production and was scrapped. The scrap realised ₹1,00,000. Show Plant Account from 2012-13 to 2016-17 assuming that accounts are closed on 31st March every year.

    [Ans. Depreciation ₹25,000, ₹23,750, ₹22,563, ₹21,434, ₹20,363, loss on sale ₹2,86,890)

29. On 1st April 2012 a firm purchased a machine worth ₹6,00,000. Show, how it will be depreciated under fixed instalment method and written down value method. Annual depreciation is 10%. Show Machinery Account, Depreciation Account and entries in the Balance Sheet for a period of 5 years, assuming that accounts are closed on 31st March every year.

    [Ans. Depreciation under written down value method : ₹60,000, ₹54,000, ₹48,600, ₹43,740, ₹39,366, Balance ₹3,54,294. Under straight line method : Depreciation each year ₹60,000, Balance ₹3,00,000]

30. On 01.4.2016 balance of Machinery Account was ₹2,00,000. On 30.09.2016 part of the machinery was sold for ₹40,000 (original cost being ₹50,000 on 01.04.2015). Machinery was depreciated @10% p.a. under diminishing balance method.

Show the Machinery Account for the year 2016-17 assuming accounts are closed on 31st March every year.

[Ans. Balance in Machinery Account ₹1,39,500, loss on sale ₹2,750]

Hints, Balance of machinery sold on 01.04.16 ₹45,000, Depreciation from 01.4.16-30.9.16 ₹2,250. Balance of other machine ₹1,55,000 on 1.4.16]

31. Amar purchased 3 Trucks @ ₹5,00,000 for each truck on 01.4.2014. On 30.09.2015 one truck was completely damaged in accident. The insurance company admit a claim of ₹2,00,000. Prepare Truck Account for 3 years ending 31st March 2017 assuming that depreciation is provided @20% p.a. on W.D.V. method.

[Ans. Truck Account blance ₹6,40,000 (loss on accident ₹1,60,000)

(Hints : original cost of Truck damaged on 01.04.14 ₹5,00,000 Depreciation from 01.04.2014 to 31.03.2015 @ 20% on ₹5,00,000 is ₹1,00,000, on ₹4,00,000 @20% p.a. for six months from 1.4.2015-30.9.15 ₹40,000)

32. A manufacturer purchased a machinery on 01.4.14 for ₹2,00,000. Additional machinery was purchased on 01.04.2015 for ₹1,00,000. On 30.9.15, the machinery purchased on 1.4.15 was sold for ₹72,000. Another machinery for ₹50,000 was purchased on the same day. Give Machinery Account for the year ending 31st March 2017 assuming that depreciation is provided @10% p.a. on reducing balance method.

(Ans. Balance ₹1,90,800, loss on sale ₹13,500)

[Hint. Machinery purchased on 1.4.15 ₹1,00,000. Depreciation for 1 year ₹10,000. depreciation from 1.4.16-30.09.16 for 6 months @10% p.a. 4,500.]

33. On 01.4.14, Raman purchased a machinery for ₹10,00,000. On 1st April 2016, a part of the machinery purchased on 1.4.14 costing ₹1,00,000 was sold for ₹75,000. The business had adopted the method of providing depreciation at

10% p.a. on the original cost of the machine. Accounts are closed on 31st March every year.

Show necessary ledger accounts from 2014-15 to 2016-17 assuming that :

(a) Provision for depreciation account is not maintained.

(b) Provision for depreciation account is maintained.

[Ans.: Whe provision for depreciation account is not maintained : Balance of Machinery Account ₹6,30,000.

When provision for depreciation account is maintained-Balance in machinery Account - ₹8,00,000.

Balance in Provision for Depreciation Account ₹2,70,000.]

34. X purchased a machinery on 1st April 2014 for ₹12,00,000. On 1st April 2015 a part of the machine purchased on 1.4.14 for ₹2,00,000 was sold for ₹1,70,000. Another machine was purchased on 1st April 2016 for ₹1,00,000. X has adopted method of providing 10% depreciation p.a on the diminishing balance of the machinery. Show necessary ledger accounts from 2014-15 to 2016-17 assuming that :

(a) Provision for depreciation account is not maintained.

(b) Provision for depreciation account is maintained.

[Ans. : - When provision for Depreciation account is not maintained :

balance in Machinery account ₹8,19,000

loss on sale of machine ₹10,000

When provision for depreciation account is maintained :

Balance in Machinery Account ₹11,00,000

Balance in Provison for Depreciation Account ₹2,71,000.]

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CHAPTER - 4

ACCOUNTING FROM INCOMPLETE RECORDS

(Single Entry System)

STRUCTURE

After going through this chapter, you will be able to understand the meaning, characteristics and limitations of single entry system of book keepaing. You will also understand the difference between :

(i) Single entry and Double entry system

(ii) Balance Sheet and Statement of Affairs.

You will also understand the method of calculation of profit and loss under statement of affairs method.

4.1 MEANING

The team "single entry system" can be defined as a system which is not exactly double entry system. In other words, incomplete accounting records are those accounting records which are not completed according do double entry principles. Many authors describe it as the single entry system. But majority of accountants describe it as incomplete records. In fact, single entry is not at all a separate system of accounting. Under this system, the principles of Double entry system are followed but in a half-hazard or incomplete manner. Therefore, it is more appropriately described as a incomplete record of keeping accounts.

For example, under this system, incomplete record may consist of :

(i) in certain cases, both the aspects of some transactions are recorded, e.g., in case of cash received from the debtor and cash paid to the creditors.

(ii) in certain other cases, only one aspect of the transaction is recorded. As for example, in case of cash purchase, cash sales, payment for expenses, purchase of fixed assets for cash, etc., only one aspect is recorded and finally, yet in some other cases,

(iii) no aspect of a transaction is recorded. For example, writting off depreciation on fixed assets is not at all recorded in the books of accounts.

Thus, a business is said to be following incomplete records or single entry system, if it is not following the complete system of double entry system of Book-keeping. The accountant Kohler has defined Single Entry System as, "A system of Book-Keeping in which as a rule only records of cash and personal accounts are maintained, it is always incomplete double entry varying with the circumstances."

4.2 CHARACTERISTICS

The following are the characterstics of the single entry system of book-keeping:

(i) Recording of personal accounts

Under this system, only personal accounts are maintained. Real accounts and Nominal accounts are ignored. For this reason, some accountants define it as a system of personal accounts only.

(ii) Maintaining of the cash-book

A cash book is maintained by the business adopting single entry system. However, the businessman mixes the personal transactions with the business transactions.

(iii) No uniformity

This system of maintaning records may vary from business to business as per their requirements, and hence, no uniform system is maintained by all the concerns following this system.

(iv) Suitability

This system is suitable only to small business units. Small sole traders and partnership firms only adopt this system. The companies and other big business houses cannot adopt the system because of legal requirements.

(v) Dependant on original vouchers

As the business records only cash transactions and personal accounts, complete information is not available. So one has to depend on original vouchers for necessary information. For example, to find out the total amount of credit purchase or credit sales, one has to depend on original invoices.

4.3 LIMITATIONS

Maintenance of incomplete records or single entry system suffers from the following limitations :

(i) Arithmetic accuracy of accounts cannot be checked : Under Double entry system of book-keeping both the debit and credit aspects of the transactions are recorded. Trial Balance is prepared to check the arithmetic accuracy of the accounts. But under single entry system, trial balance cannot be prepared. Full information is not recorded under single entry system. So chances of fraud and misappropriation is increased.

(ii) True profit of the business cannot be ascertained : True and correct profit can be ascertained from the information like purchases, sales and other expenses. But complete information regarding these items are not available under such system. Hence, Trading and Profit and Loss account cannot be prepared to ascertain the true profit earned or loss suffered by the business.

(iii) True financial position of the business cannot be ascertained : Balance Sheet records the position of assets and liabilities on a specific date. The liabilities include true profits of the business. But true profit cannot be ascertained. Correct figures of other assets and liabilities are not available. So Balance Sheet cannot be prepared to know the correct financial position of the business.

(iv) No internal check : Internal check is not possible under single entry system. So chances of fraud and misappropriation increase in comparison to Double entry system.

(v) Not recognised by law : The legal authorities like Income Tax and other Tax authorities, courts, etc., does not recognise the records under this system.

(vi) It is difficult to conduct the audit work.

(vii) Planning and decision-making of the business is difficult.

(viii) It is difficult to ascertain the worth of the business. So goodwill cannot be valued.

(ix) It is difficult to exercise control over the assets.

As it suffers from so many limitations, the system is not popular.

4.4 DIFFERENCE BETWEEN SINGLE ENTRY SYSTEM AND DOUBLE ENTRY SYSTEM

Basis of Distinction	Single entry system	Double entry system
Principles and Assumptions	It is not based upon any specific and scientific principles and assumptions.	It is based upon certain principles and assumptions.
Aspect of transaction	It does not record both the aspects of transactions normally.	It records both the aspects of the transactions scrupulously.
Accounts maintained	It usually records cash account and personal accounts.	It records all types of accounts-Personal, Real and Nominal accounts.
Trial Balance	Trial Balance cannot be prepared. Hence arithmetical accuracy of the accounts cannot be checked.	Trial Balance can be prepared as complete records of all transactions are maintained. Artihmetic accuracy of the accounts can be checked.
Calculation of true profit and loss	Trading and Profit and Loss Account cannot be prepared. Hence, only estimated profit and loss can be calculated.	True profit and loss can be determined by preparing Trading and Profit and Loss Account.
Financial position	Balance Sheet cannot be prepared as complete records of Real and Nominal accounts are not available. Only estimated financial position can be known by preparing statement of affairs.	True financial position of the business can be ascertained by preparing Balance Sheet as complete records of all accounts are available.

Adjustments	Accounts are prepared without considering the adjustments.	Final Accounts are prepared considering all type of adjustments in accounts.
Recognition	It is not recognised by Income Tax authorities, Companies Act and other government agencies.	The accounts are recognised by all the government agencies.
Businessman	Usually small business enterprises adopt this system.	This system is adopted by all types of business houses.
Manipulation of Accounts	There is scope for manipulation of accounts and possibility of frauds.	There is no scope for manipulation of accounts and frauds.
Free from doubts	The results draw from this system are not free from doubts.	The results drawn from this system are completely free from doubts.

4.5 DIFFERENCE BETWEEN BALANCE SHEET AND STATEMENT OF AFFAIRS

Both the Balance Sheet (prepared under Double-entry system) and statement of affairs (prepared under single-entry system) show the financial position of the business on a particular date. However, they differ from each other in the following ways :

Basis of Distinction	Balance Sheet	Statement of Affairs
System	It is prepared on double entry system	It is prepared under single entry system
Basis of Preparation	It is prepared under the basis of Trial balance prepared, from ledger accounts.	It is prepared on the basis of some ledger accounts and estimates.
Time of preparation	It is always prepared at the end of the year.	It is prepared either at the end of the year or beginning of the year.

Balance of capital account	Capital balance can be known from the Capital Account found in the ledger.	Balance of capital account is found out by balancing the Statement of Affairs.
Assets and Liabilities	The assets and liabilities shown in the Balance Sheet are taken from the ledger accounts.	The assets and liabilities shown in Statement of Affairs are taken by physical inspection.
Financial position	It shows the true and fair view of the financial position of the business.	It shows only estimated financial position of the business.
Omission of assets and liabilities	Omission of assets and liabilities can be traced.	omission of assets and liabilities cannot be traced.
Trial Balance	Trial Balance is prepared before preparation of Balance Sheet.	Trial balance is not prepared at all.

4.6 ASCERTAINMENT OF PROFIT OR LOSS BY STATEMENT OF AFFAIRS METHOD

The profit or loss of the business maintaining accounts under single entry system can be ascertained by :

(i) Statement of Affairs method or Net worth method or pure Single Entry System.

(ii) Conversion method or Quasi Single Entry System or Final Accounts System.

However, we will discuss only Statement of Affairs Method.

Statement of Affairs Method

Meaning : A Statement of Affairs is nothing but a balance sheet prepared under single entry system on a particular date. In other words, it is a balance sheet which shows the assets and liabilities of a business concern on a particular date. It lists assets on the right hand side and liabilities on the left hand side. Excess of assets over liabilities is assumed to be capital. It is to be noted that complete information is not available about assets and liabilities from accounting records. Some assets and liabilities are estimated. The proforma of Statement of Affairs is given below :

Statement of Affairs as on ....

Liabilities	Amount (₹)	Liabilities	Amount (₹)
Sundry Creditors	?	Cash in Hand	?
Bills Payable	?	Cash at Bank	?
Outstanding expenses	?	Sundry Debtors	?
Bank Overdraft	?	Bills Receivable	?
Income received in advance	?	Stock	?
Loans	?	Prepaid expenses	?
Capital (Balancing figure)	?	Accrued Income	?
		Fixed Assets	?

Ascertainment of profit or loss

According to this method, profit or loss made by the business can be ascertained by comparing net worth (capital) of the business on two different dates. For example, the capital of a business on 01.04.2016 is ₹2,00,000 and on 31.3.2017 is ₹3,00,000. We can tell that the business has earned a profit of is ₹1,00,000 (₹3,00,000 – ₹2,00,000) during the period.

The following steps are involved in the ascertainment of profit or loss under statement of affairs method.

- Step-1 Prepare statement of affairs at the end of the accounting period and find out closing capital.
- Step-2 Deduct additional capital introduced from the closing capital.
- Step-3 Add amount of drawings whether cash or in kind. The figure is adjusted closing capital.
- Step-4 Prepare statement of affairs in the beginning of the accounting period and find out opening capital.
- Step-5 Deduct opening capital from the adjusted closing capital (As per step 3).
- Step-6 Make adjustment for interest on capital, interest on drawings, proprietor/partner's salary, depreciation on fixed assets, provision for doubtful debts, etc.

It is to be noted that when adjustments are given in the question, prepare statement of affairs to calculate capital, record assets and liabilities before adjustments.

Format for showing profit (loss) for the period ending.......

	₹
Capital at the end of the accounting period	XXXX
Add Drawings (whether in cash or in kind)	XXXX
Less Additional capital introducted during the year	XXXX
Adjusted capital of the end of the accounting period	XXXX
Less Capital of the beginning of the accounting period	XXXX
Profit (or loss) for the accounting period	XXXX

Illustration 1

A keeps the accounts under single entry system. Prepare statement of affairs from the following information :

Particulars	1.4.2016 ₹	31.3.17 ₹
Cash in hand	5,000	6,500
Cash at Bank	13,200	18,600
Stock	15,300	12,700
Sundry Debtors	18,100	19,300
Bills Receivable	7,500	8,600
Machinery	27,500	27,500
Bills Payable	12,300	8,200
Creditors	17,300	18,600
Investments	6,000	8,000

Solution :

Statement of Affairs as on 1.4.2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Bills Payable	12,300	Cash in hand	5,000
Creditors	17,300	Cash at Bank	13,200
Capital (Balancing figure)	63,000	Stock	15,300
		Sundry Debtors	18,100
		Bills Receivable	7,500
		Investments	6,000
		Machinery	27,500
	92,600		92,600

Statement of Affairs as on 31.3.2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Bills Payable	8,200	Cash in hand	6,500
Creditors	18,600	Cash at Bank	18,600
Capital (Balancing figure)	74,400	Stock	12,700
		Sundry Debtors	19,300
		Bills Receivable	8,600
		Investments	8,000
		Machinery	27,500
	1,01,200		1,01,200

Illustration 2

Following incomplete information is available from the record maintained by Mr. X :

Particulars	1.4.2016	31.3.17
	₹	₹
Cash	12,200	14,300
Bank	18,500	21,300
Debtors	22,300	17,500

Creditors	25,200	27,000
Investment	14,000	16,000
Stock	15,600	12,700
Bank Loan	18,000	20,000
Bills Receivable	12,400	14,300

During the year, Mr. X introduced further capital ₹10,000. His drawings were ₹2,000 p.m.

From the above information, prepare a statement showing the profit or loss made by him for the year ending 31st March 2017.

Solution :

Statement of Affairs on 01.04.16

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	25,200	Cash	12,200
Bank Loan	18,000	Bank	18,500
Capital (Balancing figure)	51,800	Debitors	22,300
		Stock	15,600
		Bills Receivable	12,400
		Investments	14,000
	95,000		95,000

Statement of Affairs as on 31.03.17

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	27,000	Cash	14,300
Bank Loan	20,000	Bank	21,300
Capital (Balancing figure)	49,100	Debitors	17,500
		Stock	12,700
		Bills Receivable	14,300
		Investments	16,000
	96,100		96,100

Statement of profit of Mr. X for the year ending 31.3.2017

Particulars	Amount ₹
Capital as on 31.03.2017	49,100
Add Drawings during the year (@₹2,000 p.m. for one year)	24,000
	73,100
Less Capital introduced during the year	10,000
	63,100
Less Capital as on 01.4.16	51,800
Profit earned during the year	11,300

Illustration 3

Following information is available from Jagadamba's record who is maintaining books under single entry system :

Particulars	31.3.2016 ₹	31.3.17 ₹
Debtors	25,200	27,300
Creditors	16,800	15,400
Bills Receivable	23,300	24,500
Bills Payable	21,400	25,200
Stock	22,400	28,600
Cash	24,300	31,200
Bank overdraft	24,400	28,300
Building	52,000	52,000
Furniture	21,000	21,000

During the year Jagadamba has withdrawn ₹15,000 for personal expenses. He introduced further capital of ₹10,000 in the business.

Calculate profit after making the following adjustments :

a) Depreciate Furniture by 10%

b) Depreciate Building by 2%

c) Bad debts ₹300

Solution :

Statement of Affairs of Jagadamba as on 31.3.2016 and 31.3.2017.

Liabilities	31.3.16 ₹	31.3.17 ₹	Assets	31.3.16 ₹	31.3.17 ₹
Creditors	16,800	15,400	Cash	24,300	31,200
Bills Payable	21,400	25,200	Debtors	25,200	27,300
Bank Overdraft	24,400	28,300	Bills Receivable	23,300	24,500
Capital (Balancing			Stock	22,400	28,600
figure)	1,05,600	1,15,700	Furniture	21,000	21,000
			Building	52,000	52,000
	1,68,200	1,84,600		1,68,200	1,84,600

Statement of profit or loss for the year ending 31.3.2017

Particulars		Amount (₹)
Capital as on 31.3.2017		1,15,700
Add Drawings during the year		15,000
		1,30,700
Less Further Capital introduced		10,000
Adjusted Capital at the end		1,20,700
Less Capital as an 01.4.2016		1,05,600
Profit subject to adjustments		15,100
Less Adjustments :		
Depreciation on Furniture	2,100	
(10% on ₹21,000)		
Depreciation on Building	2,400	
(2% on ₹52,000)		
Bad debts	300	4,800
Net Profit		10,300

Illustration 4

A trader does not keep proper books of accounts. However, he provides you the following information :

	31.3.2016 ₹	31.3.17 ₹
Cash in hand	42,000	45,000
Bank overdraft	33,000	37,000
Stock-in-trade	68,000	77,000
Debtors	26,800	31,400
Equipment	50,000	50,000
Creditors	30,000	20,000
Furniture	40,000	40,000

The trader had introduced further capital of ₹30,000. He withdrew 40,000 for his personal use. Depreciation to be provided on equipment and furniture of 5% per annum. Allow interest on capital ₹2,000. Charge interest on drawings ₹500. Rent prepaid ₹500. Salary outstanding ₹1,000.

Prepare a statement showing profit or loss for the year ending 31st March 2017.

Solution :

Statement of affairs of the trader as of 31.3.2016 and 31.3.2017.

Liabilities	31.3.16 ₹	31.3.17 ₹	Assets	31.3.16 ₹	31.3.17 ₹
Bank overdraft	33,000	37,000	Cash in hand	42,000	45,000
Creditors	30,000	20,000	Stock-in-trade	68,000	77,000
Capital (Balancing figure)	1,63,800	1,86,400	Debtors	26,800	31,400
			Equipment	50,000	50,000
			Furniture	40,000	40,000
	2,26,800	2,43,400		2,26,800	2,43,400

Statement showing profit or loss for the year ended 31st March 2017

Particulars	₹	₹
Closing capital (capital on 31.3.2017)		1,86,400
Add Drawings during the year		40,000
		2,26,400
Less Additional capital introduced during the year		30,000
Adjusted closing capital		1,96,400
Less Opening capital (capital on 31.3.2016)		1,63,800
Gross Profit		32,600
Less Depreciation on equipements (5% on ₹50,000)	2,500	
Depreciation on Furniture (5% on ₹40,000)	2,000	
Interest on capital	2,000	
Outstanding salary	1,000	7,500
		25,100
Add Interest on drawings	500	
Prepaid Rent	500	1,000
Net Profit		26,100

Illustration 5

Prem commenced business on 1st April 2016 with a capital of ₹1,00,000. He Immediately purchased furniture and fixtures for ₹20,000. On 30th September 2016, he borrowed ₹50,000 from his wife @9% p.a. (Interest not yet paid) and introduced a further capital of ₹11,500. Prem withdrew @₹3,000 p.m. at the end of each month for his household expenses. on 31st March 2017, his position was as follows :

Cash-in-hand ₹28,000; Sunday debtors ₹48,000; Stock ₹68,000; Bills Receivable ₹16,000; Creditors ₹5,000; Owing for rent ₹1,500.

Furniture and fixtures are to be depreciated by 10%. Ascertain the profit or loss made by Prem during the year ended 31st March 2017.

Solution :

Statement of Affairs of Prem as on 31.3.2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	5,000	Cash in hand	28,000
Loan from Mrs. Prem	50,000	Sundry Debtors	48,000
Capital (Balancing figure)	1,25,000	Stock	68,000
		Bills Receivable	16,000
		Furniture and Fixtures	20,000
	1,80,000		**1,80,000**

Statement of Profit or loss
for the year ended 31st March 2017

Particulars	₹	₹
Capital as on 31.3.2017		1,25,000
Add Drawings during the year		
@₹3,000 p.m for 12 months		36,000
		1,61,000
Less Capital Introduced during the year		11,500
Adjusted closing capital		1,49,500
Less Capital as on 01.4.2016		1,00,000
Gross profit		49,500
Less Depreciation on furniture and fixtures	2,000	
(10% on ₹20,000)		
Outstanding Rent	1,500	
Interest on Mrs. Prem's Loan	2,250	
(@9% p.a. on ₹50,000 for 6 months, i.e., from 30.9.16 to 31.3.17)		5,750
Net Profit		**43,750**

Illustration 6

A trader does not keep proper books of accounts. However, he provides the following information to you :

Particulars	31.3.2016 ₹	31.03.17 ₹
Cash at bank	4,500	4,000
Cash in hand	300	3,000
Stock-in-trade	40,000	45,000
Debtors	12,000	20,000
Equipment	5,000	5,000
Creditors	30,000	20,000
Furniture	4,000	4,000

During the year ended 31st March 2017, the trader introduced ₹6,000, as additional capital and withdrew ₹4,000 for his personal use. Depreciation is to be provided on furniture at 10% p.a. and on equipment at 5% per annum. Prepare statement showing profit or loss made by him for the year ended 31st March 2017.

Solution :

Statement of Affairs of prem as on 31st March 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	30,000	Cash in hand	300
Capital (Balancing figure)	35,800	Cash at Bank	4,500
		Stock-in-trade	40,000
		Debtors	12,000
		Equipment	5,000
		Furniture	4,000
	65,800		**65,800**

Statement of Affairs
as on 31st March 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	20,000	Cash in hand	3,000
Capital (Balancing figure)	61,000	Cash at Bank	4,000
		Stock-in-trade	45,000
		Debtors	20,000
		Equipment	5,000
		Furniture	4,000
	81,000		**81,000**

Statement of profit or loss
for the year ending 31st March 2017

Particulars	₹	₹
Capital as on 31st March 2017		61,000
Add Drawings made during the year		4,000
		65,000
Less Further capital introduced during the year		6,000
Adjusted Capital		59,000
Less Capital on 31st March 2016		35,800
Gross Profit		23,200
Less Depreciation on Furniture	400	
(10% on ₹4,000 p.a.)		
Depreciation on Equipment	250	650
(5% on ₹5,000 p.a.)		
Net Profit		22,550

Illustration 7

Ramesh, who keeps the books under single entry, gives you the following information :

Particulars	1.4.2016 ₹	31.3.17 ₹
Debtors	24,000	28,000
Creditors	18,000	3,000

Stock-in-trade	36,000	46,000
Bills receivable	12,000	15,000
Bills payable	4,000	3,000
Furniture	16,000	16,000
Bank overdraft	8,600	6,500

Additional information :

(i) A provison for doubtful debt on debtors amounting ₹2,100 is to be created.

(ii) Furniture is to be depreciated @5% per annum.

(iii) Insurance prepaid ₹500.

(iv) Expenses outstanding ₹1,200.

(v) Drawing during the year ₹5,700

Calculate the profit of the year.

Solution :

Statement of Affairs as on 31st March 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	18,000	Debtors	24,000
Bill Payable	4,000	Stock-in-trade	36,000
Bank overdraft	8,600	Bills Receivable	12,000
Capital (Balancing figure)	57,400	Furniture	16,000
	88,000		88,000

Statement of Affairs as on 31st March 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	3,000	Debtors	28,000
Bill Payable	3,000	Stock-in-trade	46,000
Bank overdraft	6,500	Bills Receivable	15,000
Capital (Balancing figure)	92,500	Furniture	16,000
	1,05,000		1,05,000

Statement showing the profit or loss
for the year ending 31st March 2017

Particulars	Amount ₹	Amount ₹
Closing capital (Capital on 31.3.17)		92,500
Add Drawings during the year		5,700
Adjusted Capital		98,200
Less Opening Capital (on 01.4.16)		57,400
Gross Profit		40,800
Add Incomes and gains (prepaid insurance)		500
		41,300
Less Expenses and lossess :		
Provison for doubtful debts	2,100	
Depreciation on furniture	800	
(5% on ₹16,000 p.a.)		
Outstanding expenses	1,200	4,100
Net Profit		37,200

Illustration 8

Mr Joseph keeps his books under single entry system. From the following information, prepare a statement showing profit or loss for the year ended 31st March 2017 :

Particulars	1.4.2016 ₹	31.3.17 ₹
Cash	32,000	35,500
Stock	47,200	52,400
Debtors	31,400	32,000
Bank	12,000	16,000 (overdraft)
Bills Receivable	7,000	8,000
Sundry creditors	18,000	11,000
Investments	22,000	---
Furniture (30.9.2016)	--	18,000

Plant and Machinery	40,000	40,000
Bills payable	17,500	--

During the year he withdrew ₹20,000 for personal use. He introduced further capital of ₹21,000.

Adjustments :

(i) Debtors include ₹1,000 from a customer who is insolvent. The amount is irrecoverable.

(ii) Depreciate furniture by 10% p.a.

(iii) Depreciate plant and machinery by 5% p.a.

Solution :

Statement of affairs as on 01.4.2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Careditors	18,000	Cash	32,000
Bills Payable	17,500	Bank	12,000
Capital (Balancing figure)	1,56,100	Stock	47,200
		Debtors	31,400
		Bills receivable	7,000
		Investments	22,000
		Plant and machinery	40,000
	1,91,600		**1,91,600**

Statement of affairs as on 31st March 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Bank overdraft	16,000	Cash	35,500
Sundry Creditors	11,000	Stock	52,400
Capital (Balancing figure)	1,58,900	Debtors	32,000
		Bills Receivable	8,000
		Furniture	18,000
		Plant and Machinery	40,000
	1,85,900		1,85,900

Statement showing profit or loss for the year ended 31st March 2017

Particulars	₹	₹
Closing capital (capital on 31.3.2017)		1,58,900
Add Drawings during the year		20,000
		1,78,900
Less Additional Capital introduced		21,000
Adjusted Capital		1,57,900
Less Opening Capital (As on 01.4.2016)		1,56,100
Gross Profit		1,800
Less Loss and expenses :		
Bad debts	1,000	
Depreciation on Furniture	900	
(10% on ₹18,000 for six months		
₹$18,000 \times \frac{10}{100} \times \frac{6}{12}$)		
Depreciation on plant and machinery	2,000	
(5% on ₹40,000 p.a.)		3,900
Net loss		2,100

Revised Statement of Affairs (or Balance Sheet) is prepared taking the closing assets, liabilities and adjustments. Revised statement of affairs is similar to Balance Sheet.

Illustration 9

Mr. Ratan supplies you the following information, who keeps his books on single entry system :

	31.3.2016 ₹	31.3.17 ₹
Creditors	36,700	39,000
Debtors	32,200	28,400
Stock	37,300	41,300
Cash-in-hand	38,300	42,200
Bank Balance	8,200 (overdraft)	7,300
Bank Loan	--	25,000
Furniture	22,000	22,000
Motor car	52,000	52,000

9% Investment (on 1.10.16)	--	20,000
Bills receivable	27,000	22,500

During the year he withdrew ₹17,500 for personal use.

Adjustments :

(i) Depreciate furniture by 10% and motor car by 15%.

(ii) Bad debt is ₹1,500.

(iii) Prepaid insurance ₹800.

(iv) Outstanding salary ₹2,000.

Prepare a statement showing profit or loss for the year ending 31.3.17 and the revised statement of affairs on that date.

Solution :

Statement of affairs as on 31st March 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	36,700	Cash in hand	38,300
Bank overdraft	8,200	Bills receivable	27,000
Capital (Balancing figure)	1,63,900	Debtors	32,200
		Stock	37,300
		Motor Car	52,000
		Furniture	22,000
	2,08,800		2,08,800

Statement of affairs as on 31st March 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	39,000	Cash in hand	42,200
Bank Loan	25,000	Bank Balance	7,300
Capital (Balancing figure)	1,71,700	Bills receivable	22,500
		Stock	41,300
		Debtors	28,400
		9% Investments	20,000
		Motor Car	52,000
		Furniture	22,000
	2,35,700		2,35,700

Statement showing profit or loss
for the year ended 31st March 2017

Particulars	₹	₹
Closing capital (capital on 31.3.2017)		1,71,700
Add Drawings		17,500
Adjusted Capital		1,89,200
Less Opening Capital (As on 31.3.2016)		1,63,900
Gross Profit		25,300
Add Income and gains : Interest accrued $\left(\frac{9}{100}\times 20{,}000\times\frac{6}{12}\right)$	900	
Prepaid Insurance	800	1,700
Less Expenses and lossess :		27,000
Depreciation on Furniture	2,200	
(10% p.a. on ₹22,000)		
Depreciation on Motor Car	7,800	
(15% p.a. on ₹52,000)		
Bad debts	1,500	
Outstanding salary	2,000	13,500
Net Profit		13,500

Revised Statement of Affairs / Balance Sheet
as on 31st March 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Creditors		39,000	Cash in hand		42,200
Bank Loan		25,000	Bank Balance		7,300
Salary outstanding		2,000	Bills Receivable		22,500
Capital :			Debtors	28,400	
Opening Balance	1,63,900		Less Bad debts	1,500	26,900
Add Net Profit	13,500		Stock		41,300
	1,77,400		9% Investments	20,000	
Less Drawings	17,500	1,59,900	Add Interest Accrued	900	20,900

Liabilities	Amount (₹)	Liabilities		Amount (₹)
		Prepaid Insurance		800
		Motor car	₹52,000	
		Less Depreciation (15%)	₹7,800	44,200
		Furniture	₹22,000	
		Less Depreciation (10%)	₹2,200	19,800
	2,25,900			**2,25,900**

Illustration 10

Mr. Despande, a small trader who maintains his books of accounts on single entry, supplies the following information :

Particular	01.4.2016 ₹	31.3.17 ₹
Furniture	20,000	20,000
Plant and Machinery	45,000	45,000
8% Investment	25,000	25,000
Motor car (purchased on 1.10.2016)	--	50,000
Sundry Debtors	38,000	45,000
Sundry Creditors	42,000	37,000
Cash-in-hand	22,000	23,200
Cash at Bank	17,500	6,500 (overdraft)
Stock-in-trade	40,000	45,000
Building	1,20,000	1,20,000

During the year, he withdrew ₹25,000 for personal use. On 1.11.16, he introduced a further capital of ₹20,000.

Adjustments :

(i) Depreciate Furniture, Plant and Machinery and Motor Car by 10%.

(ii) Appreciate Building by 10%.

(iii) Make a provision of 5% for doubtful debts on sundry debtors.

(iv) Interest on capital ₹3,200.

(v) Prepaid rent ₹1,500.

(vi) Outstanding salary ₹1,800.

(vii) No interest on investment is received.

Prepare a statement showing profit or loss for the year ending 31st March 2017 and the revised statement of affairs as on that date.

Solution :

Statement of affairs as on 01.4.2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	42,000	Cash-in-hand	22,000
Capital (Balancing Figure)	2,85,500	Cash at Bank	17,500
		Sundry Debtors	38,000
		Stock-in-trade	40,000
		8% Investments	25,000
		Furniture	20,000
		Plant and machinery	45,000
		Building	1,20,000
	3,27,500		**3,27,500**

Statement of affairs as on 31.03.2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	37,000	Cash-in-hand	23,200
Bank overdraft	6,500	Sundry Debtors	45,000
Capital (Balancing figure)	3,29,700	Stock-in-trade	45,000
		8% Investments	25,000
		Motor car	50,000
		Furniture	20,000
		Plant and machinery	45,000
		Building	1,20,000
	3,73,200		**3,73,200**

Statement of profit or loss for the year ending 31st March 2017

Particular	₹	₹
Closing capital (As on 31.3.2017)		3,29,700
Add Drawings		25,000
		3,54,700
Less Further capital introduced		20,000
Adjusted Capital		3,34,700
Less Opening capital (As on 01.4.2016)		2,85,500
Gross Profit		49,200
Add Income and Gains :		
Appreciation in Building	12,000	
(10% on ₹1,20,000)		
Prepaid Rent	1,500	
Interest on investment (8% on ₹25,000 p.a)	2,000	15,500
		64,700
Less Expenses and Losses :		
Depreciation on furniture	2,000	
(10% on ₹20,000 p.a)		
Depreciation on plant and machinery	4,500	
(10% ₹45,000 p.a.)		
Depreciation on Motor Car	2,500	
(10% on ₹50,000 for six months)		
Provision for doubtful debts	2,250	
(5% on ₹45,000)		
Interest on Capital	3,200	
Outstanding salary	1,800	16,250
Net profit		**48,450**

Revised Statement of Affairs / Balance Sheet

As on 31st March 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Sundry Creditors		37,000	Cash-in-hand		23,200
Bank overdraft		6,500	Prepaid Rent		1,500
Outstanding salary		1,800	Sundry Debtors	45,000	
Capital :			Less : Provision for		
Opening Balance	₹2,85,500		Bad debts	2,250	42,750
Add Net profit	₹48,450		Stock-in-trade		45,000
Add Further Capital			Building	1,20,000	
introduced	₹20,000		Add Appreciation	12,000	1,32,000
Add Interest on Capital	₹3,200		8% Investments	25,000	
	₹3,57,150		Add Interest Accured	2,000	27,000
Less Drawings	25,000	3,32,150	Motor car	50,000	
			Less Depreciation	2,500	47,500
			Furniture	20,000	
			Less Depreciation	2,000	18,000
			Plant and Machinery	45,000	
			Less Depreciation	4,500	40,500
		3,77,450			**3,77,450**

4.7 QUESTIONS

1. From the alternatives given under each bit, write the correct answer along with its serial number against each bit :

(a) When adjusted closing capital is greater than opening capital, it denotes :
   (i) Profit.
   (ii) Loss.
   (iii) No profit no loss.
   (iv) Sometimes profit and sometimes loss.

(b) When adjusted closing capital is less than opening capital, it denotes :
   (i) Profit.
   (ii) Loss.

(iii) No profit no loss.
(iv) Either profit or loss.

(c) Incomplete records are generally maintained by :
(i) Company.
(ii) Government.
(iii) Sole trader.
(iv) Banks.

(d) The other name of single entry is :
(i) Incomplete records.
(ii) Complete records.
(iii) Single record.
(iv) Full records in one book

(e) Incase of networth method of single entry, profit of the business can be ascertained by :
(i) Preparing trading and profit and loss account.
(ii) Preparing statement of affairs in the beginning and end of the accounting period.
(iii) Preparing Balance Sheet in the beginning and end of the period.
(iv) adopting any convenient method.

(f) The opening capital (capital in the beginning of the accounting period) can be ascertained by preparing :
(i) Capital Account.
(ii) Opening Balance Sheet.
(iii) Opening statement of affairs.
(iv) Cash account.

(g) The capital at the end of the accounting period can be ascertained by preparing :
(i) Capital Account.
(ii) Closing Balance Sheet.
(iii) Closing Statement of Affairs.
(iv) Cash Account

(h) Adjusted closing capital is :
(i) Opening Capital – Drawings – Additional Capital.
(ii) Opening Capital – Drawings + Additional Capital.
(iii) Opening Capital + Drawings + Additional Capital.
(iv) Opening Capital + Drawings – Additional Capital.

[Answer : a (i) Profit
b (ii) Loss
c (iii) Sole trader
d (i) Incomplete records
e (ii) Preparing statement of affairs in the beginning and end of the period
f (iii) Opening statement of affairs
g (iii) Closing statement of affairs
h (iv) Opening capital + Drawings – Additional capital]

2. Answer the following questions in one word/term each :
   (i) Name the capital under single entry system which is arrived by taking capital at the end+Drawings –fresh capital introduced.
   (ii) Name the term which represents the increase in closing capital under single entry system.
   (iii) Name the term which represents the decrease in closing capital under single entry system.
   (iv) Name the system of accounting followed by the business which is not following complete system of double entry system of Book-keeping.
   (v) Under which system of Book-keeping arithmetic accuracy of the accounts cannot be checked ?
   (vi) State wheather single entry system of Book-keeping is recognised by law ?
   (vii) State wheather internal check is possible under single entry system ?
   (viii) Is it possible to find but the true financial position of the business under single entry system ?

   [Answer : (i) Adjusted closing capital
   (ii) Profit
   (iii) Loss
   (iv) Single entry system
   (v) Single entry system
   (vi) No
   (vii) No
   (viii) No]

3. Answer the following questions in one sentence each :
   (i) What do you mean by adjusted closing capital ?
   (ii) What do you mean by single entry system of Book-Keeping ?

(iii) State one difference between single entry and double entry system of Book-Keeping.

(iv) Write any one characteristic of single entry.

(v) State any one limitation of single entry system of book-keeping.

(vi) Explain one difference between Balance Sheet and Statement of Affairs.

(vii) Write the name of the methods used to ascertain the profit or loss of the business under single entry system of Book-keeping.

(viii) What do you mean by opening capital under single entry system of Book-Keeping ?

(ix) How to calculate closing capital under single entry system ?

(x) State any one reason of maintaining books of accounts under single entry system.

4. Fill up the blanks of the following sentences :

(i) In case of single entry, a ______ picture of all transactions will be available.

(ii) Under single entry system, closing capital is adjusted by adding ______ to find out the profit.

(iii) Under single entry system, closing capital is adjusted by subtracting ______ capital to find out the profit.

(iv) If Closing capital is ₹5,000, Drawings ₹500, Profit ₹1,000, then Opening capital is _______ .

(v) Closing capital is ₹15,000, Drawings ₹2,000, Opening capital ₹10,000, then profit is _______ .

(vi) Increase in adjusted closing capital represents _______.

(vii) Decrease in adjusted closing capital represents _______ .

(viii) Opening capital is ₹18,000, Drawings ₹5,000, Profit ₹12,000, then Closing capital would be _______ .

[Answer : (i) Partial
(ii) Drawings
(iii) Additional
(iv) ₹4,500
(v) ₹7,000
(vi) Profit
(vii) Loss
(viii) ₹25,000.]

5. Correct the underlined portions of the following sentences :
   (i) Single entry system is used in large business enterprises.
   (ii) Single entry system and double entry system are same.
   (iii) Closing capital ৳17,000, Drawings ৳5,000, Opening Capital ৳12,000. Profit is ৳15,000.
   (iv) Opening Capital ৳18,000. Profit ৳12,000, Drawings ৳6,000. Closing capital is ৳14,000.
   (v) Opening capital ৳27,000. Profit ৳11,000. Closing capital ৳30,000. Drawings is ৳18,000.

   [Answer : (i) small
   (ii) different
   (iii) ৳10,000
   (iv) ৳24,000
   (v) ৳8,000.]

6. Answer the following questions within 30 words each;
   (i) Define single entry system.
   (ii) What do you mean by "Statement of Affairs" ?
   (iii) What do you mean by 'Incomplete accounting records' ?
   (iv) "Arithmetic accuracy of the accounts maintained under single entry cannot be checked". explain.
   (v) Why cannot the true profit of a business be ascertained under the single entry system of keeping accounts ?
   (vi) Name the different laws of the country which have not recognised single entry system ?
   (vii) Why cannot goodwill be valued under single entry system ?
   (viii) Why is internal check not possible under single entry system ?
   (ix) Why is the single entry system not popular ?

7. Answer the following questions within 50 words each :
   (i) How can you ascertain the profit under single entry system ?
   (ii) Explain the advantages of single entry system.
   (iii) State the meaning of single entry system.

(iv) Explain the characteristics of single entry system.
(v) Explain the disadvantages of single entry system.
(vi) Explain the reasons for maintaining the single entry system.
(vii) How can opening capital be ascertained under single entry system ? Explain with example.
(viii) How can you calculate the profit under single entry system ? Explain with example.
(ix) Prepare a statement of affairs with imaginary figures and ascertain the profit.
(x) Prepare the statement of affairs with imaginary figures and ascertain the capital.

8. What do you mean by single entry system ? What are its advantages ?
9. Discuss the characteristics and limitations of single entry system.
10. Discuss, in brief with suitable example, the ascertainment of profit under net worth method.
11. Distinguish between Single entry and Double entry system.
12. Differentiate between Balance Sheet and Statement of Affairs.
13. Ascertain the opening and closing capital from the following balances :

Particulars	01.4.2016 ₹	31.3.17 ₹
Cash	12,200	15,600
Bank	4,000 (over draft)	6,300
Bills receivable	8,200	12,300
Debtors	7,500	6,300
Creditors	16,400	12,500
Stock-in-trade	8,400	10,200
Furniture	20,000	20,000
Machinery	40,000	40,000

[Ans : Opening capital ₹75,900
Closing capital ₹91,900]

14. Prepare the statement of affairs and ascertain the profit from the following information :

Particulars	01.4.2016 ₹	31.3.17 ₹
Stock	22,200	25,700
Debtors	18,300	20,200
Creditors	17,400	12,600
Cash-in-hand	22,500	28,600
Bank balance	8,200	7,300
Bills receivable	14,200	16,400
Furniture	25,000	25,000
Prepaid expenses	--	500

[Ans. Opening capital - ₹93,000
Closing capital - ₹1,10,600
Gross profit - ₹17,600
Net profit - ₹17,100]

15. Jivan keeps his books under single entry system. His position on 31st March 2016 was as follows :

Cash in hand ₹15,200, Cash at Bank ₹6,300, Sundry Debtors ₹7,600, Sundry Creditors ₹8,400, Bills receivable ₹4,200, Fixture and fittings ₹18,000.

He introduced ₹15,000 as further capital during the year. His drawings were ₹1,000 p.m.

His position on 31st March 2017 was as follows :

Cash in hand ₹16,400, Cash at Bank ₹7,200, Sundry Debtors ₹8,200, Sundry Creditors ₹7,200, Bills receivable ₹5,400, Fixture and fittings ₹18,000.

Prepare statement of affairs and statement of profit or loss for the year ending 31st March 2017.

[Ans. Opening capital ₹42,900
Closing capital ₹48,000
Profit - ₹2,100]

16. Jaydeep commenced business on 1st April 2016 with a capital of ₹50,000. He bought furniture worth ₹10,000. On 1st Octorber, 2016 he borrowed ₹20,000 from his wife at 12% p.a. (Interest not paid yet). He introduced further capital of ₹10,000. He withdrew @ ₹1,500 p.m. for household expenses. On 31st March, 2017 his position was as follows :

Cash in hand ₹12,000, Bank ₹16,700, Debtors 16,800, Creditors ₹12,500, Stock ₹32,200.

Furniture is to be depreciated by 10%. Prepare a statement showing Jaydeep's profit or loss in the business for the year ending 31st March 2017.

[Ans.: Closing capital ₹55,200
Profit - ₹11,000]

17. Mr. Raghubir who maintains his accounts under single entry system, supplies you the following information :

	31.3.2016 ₹	31.3.2017 ₹
Cash in hand	30,000	35,000
Cash at Bank	12,000	16,200
Sundry Debtors	28,000	26,400
Stock	45,000	55,200
Furniture	30,000	30,000
Sundry Creditors	38,000	28,600
Loan from Mrs. Raghubir	30,000	30,000

He withdrew ₹5,000 every month from the business to meet his private expenses. He had sold a private investment for ₹30,000 and invested the amount in the business.

Adjustments :

Interest on Mrs. Raghubir's loan @ 12% p.a. is not paid.

Depreciate furniture by 10% p.a.

[Ans. Opening capital ₹77,000
Closing capital ₹1,04,200
Profit - ₹50,600]

18. Mr. Rama keeps the books under single entry system. He supplies you the following information :

Particulars	01.4.2016 ₹	31.3.2017 ₹
Bank overdraft	10,000	12,000
Furniture	20,000	20,000
Land and Building	70,000	70,000
Investments	--	10,000
Sundry Debtors	20,000	30,000
Sundry Creditors	30,000	40,000
Stock	45,000	50,000
Motor Car (01.10.2016)	--	20,000
Cash	10,000	20,000
Plant and Machinery	40,000	40,000

During the year, he withdrew ₹10,000 for personal use. On 01.10.2016 he introduced further capital of ₹20,000 by selling his private investment.

Adjustment :

(a) Appreciate land and Building by 20%.

(b) Debtors include ₹1,000 from a customer who is insolvent and nothing can be recovered from him.

(c) Maintain reserve for bad debts at 5% on debtors.

(d) Depreciate plant and machinery at 10%, furniture at 5% and motor car at 10%.

Prepare a statement showing profit and loss for the year ending 31st March 2017 and a revised statement of affairs on that date.

[Ans. Opening capital ₹1,65,000, Closing capital ₹1,98,000,
Profit ₹38,550, Revised statement of affairs
Total ₹2,65,550.]

19. Chandraswami keeps his books under single entry system. Ascertan the profit of Chandraswami for the year ending 31st March 2017 and prepare revised statement affairs as on that date.

Particulars	31.3.2016 ₹	31.3.2017 ₹
Cash in hand	12,000	16,000
Cash at Bank	6,500	17,600
Debtors	18,000	32,000
Creditors	21,300	17,400
Bills receivable	22,500	19,600
Bills payable	17,600	18,400
Stock	45,000	55,300
Furniture	32,000	32,000
Machinery	48,000	48,000

During the year, he introduced a fresh capital of ₹26,000. He withdrew @₹3,000 p.m. for domestic expenses.

Adjustments :

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

(ii) Bad debts amounting to ₹2,000 to be written off.

(iii) Outstanding salaries ₹2,000.

(iv) Prepaid rent ₹3,000.

[Ans. Opening capital ₹1,45,100, Closing ₹1,84,700, Profit ₹43,000, Revised statement of affairs total ₹2,15,900.]

20. Amarendra, who keeps his books on single entry system, provides the following information :

Particulars	01.4.2016 ₹	31.3.2017 ₹
Cash in hand	22,000	27,800
Cash at Bank	13,200	24,300
Sundry Debtors	18,000	22,500
Sundry Creditors	27,000	22,000
Stock-in-trade	45,000	65,000
Building	1,20,000	1,20,000

Furniture	40,000	40,000
Bills receivable	27,500	28,300
Bills payable	12,000	14,000

Additional capital introduced during the year ₹20,000. He was drawing @₹2,500 p.m. for his domestic expenses.

Adjustments :

1. Depreciate furniture at 10% p.a.
2. Appreciate building by 5%.
3. Write off a bad debt of ₹2,500
4. Outstanding rent ₹2,000.
5. Prepaid salary ₹3,000.

Prepare a statement of profit for the year ending 31.3.17 and a revised statement of affairs as on that date.

[Ans.- Opening Capital ₹2,46,700, Closing Capital ₹2,91,900, Profit ₹55,700, Revised Statement of Affairs total ₹3,30,400]

21. Mr Javedkar, who maintains his accounts on single entry system, supplies the following information :

Particulars	01.4.2016 ₹	31.3.2017 ₹
Debtors	18,700	25,300
Creditors	17,200	12,300
Bills receivable	14,400	8,600
Bills payable	16,800	7,600
Cash in hand	14,400	18,600
Cash at Bank	17,600	14,400
Motor car	50,000	50,000
Furniture	30,000	30,000
Stock	42,600	70,300

He introduced a further capital of ₹30,000. He drew @₹5,000 p.m. for his personal expenses.

Adjustments :

(i) Depreciate motor car by 10% and furniture by $7^1/_2\%$.

(ii) Allow Interest on capital ₹2,500.

(iii) Interest on drawings is ₹1,600.

(iv) Outstanding Rent ₹3,200

(v) Prepaid salary ₹2,300

(vi) Create a provison for Bad debts @2% on debtors.

Prepare statement of affairs for the year ending 31.3.2016 and 31.3.2017. Show the statement of profit and loss for the year ending 31st March 2017 and revised statement of affairs as on that date.

[Ans. Opening capital ₹1,53,700, closing capital ₹1,97,300, profit ₹64,044, Revised statement of affairs total ₹2,11,744.]

22. Mr. Swapan, who keeps his books on single entry system, supplies the following information :

Particulars	01.4.2016 ₹	31.3.2017 ₹
Building	2,50,000	2,50,000
Motor car	60,000	60,000
Furniture	30,000	30,000
Cash in hand	22,000	25,000
Cash at Bank	17,000	19,300
Debtors	18,000	32,000
Creditors	22,000	17,000
Bills receivable	31,000	36,000
Bills payable	17,000	14,000
Furniture	35,000	35,000

He withdrew @₹3,000 p.m. for his domestic expenses.

Adjustments :

(i) Depreciate furniture @10% p.a., Motor car @ 20%, Building @2% p.a.

(ii) A customer became insolvent. ₹1,000 due from him was irrecoverable.

(iii) Outstanding salary ₹3,000.

(iv) Prepaid expenses ₹2,500.

(v) Interest on capital amounts to ₹3,200.

Prepare statement of profit or loss for the year ending 31st March 2017.

[Ans.:Opening capital ₹4,24,000, closing capital ₹4,56,300, profit - ₹93,500]

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CHAPTER - 5

ACCOUNTING FOR PARTNERSHIP FIRM

STRUCTURE

5.1 MEANING, DEFINITION AND FEATURES OF PARTNERSHIP

Partnership is an association of two or more persons to carry on, as co-owners, a business and to share its profits or losses. When two or more persons agree to carry on business for their mutual benefits, they are said to form a partnership. Partnership firm in India is governed by the Indian Partnership Act, 1932., According to sec-4 of the Indian Partnership Act, 1932 the term 'Partnership' is ‘‘the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.’’

ESSENTIAL CHARACTERISTICS OF PARTNERSHIP

The essential characteristics of partnership are :

1. **Two or More Persons :** There nust be at least two persons to form a partnership and all such persons must be competent to contract. According to Indian contract Act, 1872, every person except the following is competent to contract :

   (i) Minor

   (ii) Persons of unsound mind (Lunatics, idiots, etc.)

   (iii) Persons disqualified by any law to which they are subjected (insolvent, alien enemy etc.)

2. **Agreement -** Partnership comes into existence by an agreement. The agreement may be written or oral. The relation of partnership arises out of contract and not from status.

   A written agreement or deed is preferred to oral one, because it helps in resolving the disputes, if any, arising in future among partners.

3. **Lawful Business** : There must exist a lawful business. The business may be of the nature of any trade, occupation or profession.

4. **Profit-sharing :** The agreement between/among the partners must be to share profits or losses of the business. It is not essential that all the partners must

share losses also. There may be a provision in the Partnership Deed that a particular partner or partners shall not bear the losses. In the absence of a specific mention regarding profit-sharing in the Partnership Deed the partners must share the proft/loss equally as provided in the partnership Act.

5. **Good faith :** The partnership lies on the mutual trust and good faith of all the partners. Each and every partner should act honestly and fairly in the conduct of business.

6. **Implied Agency :** Each and every partner is regarded as an agent of the business. All the partners are entitled to take active part in the day to day management of the business. Every partner can bind the firm for acts undertaken by him in good faith and on behalf of the firm.

7. **No Separate Legal Entity:-** A partnership firm has no separate legal entity of its own. It is represented collectively by its partners. Persons who have entered into a partnership with one another are called partners individually, and collectively, a firm, and the name under which their business in carried on is called the firm name.

8. **Unlimited Liability :** Each and every partner is liable, jointly and severally for the amount of all the debts owed by the firm. As a rule, the liability of the partners is unlimited. If assets of the business are not sufficient to meet the obligations of the business at the time of dissolution of the firm, the private property of partners can be used to meet them.

5.2 RIGHT OF PARTNERS

1. All the partners have the right to participate in the management of the business.
2. All the partners have the right to be consulted about the affairs of the business.
3. All the partners have the right to inspect the books of accounts and have a copy of it.

4. All the partners have the right to share profits or losses with others in the agreed ratio.
5. If a partner has advanced loan, he has the right to receive interest on it at an agreed rate of interest. If rate of interest is not agreed upon, interest is paid @6% p.a.
6. In case of an emergency, a partner has the right to act according to his best judgement and be indemnified for the expenses incurred by him.
7. A partner has the right not to allow the admission of a new partner.
8. After giving proper notice, a partner has the right to retire from the firm.
9. If a partner incurs expenses on the business or he pays some money on behalf of the firm, that partner may get indemnified against these payments from the firm.

5.3 PARTNERSHIP DEED

Meaning - Partnership arises out of contractual relationship among partners. This contract or agreement may either be oral or written. But it is always advisable to have it in black and white. 'Partnership Deed' or 'Partnership Agreement' is a document which contains the terms of partnership as agreed among the partners. The deed is required to be duly stamped as per Indian Stamp Act, 1889 and duly signed by all the partners. To solve all future disputes, that may creep into the partnership, all firms should have their own partnership deed.

CONTENTS OF PARTNERSHIP DEED :

The contents of the deed may vary from firm to firm. But certain clauses are usually incorporated to ensure smooth working of the business, which are outlined below :

1. The name of the firm;
2. Name and address of all the partners;
3. The nature of business to be carried on;
4. The place of business;

5. Duration of partnership - It may be dissolved at will, if no limit has been fixed for its duration so that it can be disolved at any moment; or it may be for a fixed term, if the time of dissolution has been previously fixed by the original agreement;
6. The amount of capital investment to be made by each partner;
7. Ratio in which profits and losses are to be shared
8. The drawings, i.e., the sums the partners can withdraw during a particular period;
9. The interest to be allowed on capital and charged on drawings;
10. Interest on loan by a partner to the firm;
11. Remuneration by way of salary, commission etc.; if any, payable to the partners;
12. Method of computation and treatment of goodwill;
13. Mode of settlement of accounts in case of retirement or death of a partner;
14. Mode of settlement of accounts in case of dissolution of firm.
15. Maintenance of proper books of accounts;
16. Operating bank accounts.
17. Arbitration clause, laying down the procedure to be followed in the event of disputes.

However, the partnership deed must not contain any term which is in contravention with the provisions of the Indian Partnership Act.

5.3.1 PROVISIONS OF PARTNERSHIP ACT, 1932 IN THE ABSENCE OF PARTNERSHIP DEED

We know that drafting a deed is not compulsory, though it is advisable to have it to resolve all future disputes among partners. In the absence of a written deed, the following provisions of the Indian partnership Act shall be applicable for making accounting treatments :

1. No remuneration by way of salary or commission is payable to any partner for taking part in the conduct of business (Sec. 13(a)]

2. Profit and losses are to be shared equally [sec-13(b)]
3. No interest is allowed on capital [sec-13(c)]. If the deed provides for the payment of interest on capital, it is payable only out of available profits.
4. Interest @6% p.a. is allowed on loan or advance given to the firm by a partner. [sec 13(d)]
5. No interest is to be charged on drawings made by a partner.

5.3.2 SOME OTHER IMPORTANT PROVISIONS OF THE PARTNERSHIP ACT, 1932

(i) With the consent of all the partners, a minor may be admitted for the benefit of partnership. [sec-30]

(ii) A person may be admitted as a partner either with the consent of all the existing partners or in accordance with an express agreement among the partners. [sec-31]

(iii) A partner may retire from the firm either with the consent of all the other partners or in accoriance with an express agreement among the partners. [sec.32]

(iv) Registration of the firm is optional and not compulsory. [sec-69]

(v) Unless otherwise agreed by the partners, a firm is dissolved on the death of a partner. [sec-35]

Note: It should be noted that the above provisions of the Act are applicable when partnership deed does not have a clause to this effect.

Illustration 1

A, B and C are partners in a firm. They do not have a Partnership Deed.

(i) A, who has contributed more capital than other partners, demands interest on capital at 10% p.a. and share of profit in the capital ratio. But B and C donot agree with him.

(ii) B has devoted full time to run the business and demands a salary of ₹5,000p.m. But A & B donot agree with him.

(iii) C demands interest on the loan of ₹50,000 advanced by him, at the market rate of interest which is 12% p.a.

(iv) Net profit before taking into account any of the above claims amounted to ₹50,000 at the end of the first year of the business.

How will the disputes be settled ?

Solution :

The partners do not have a Partnership Deed. Therefore, provisions of the Indian Partnership Act, 1932 will apply to settle the disputes :

(i) Interest on capital is not payable to any partner. Therefore, A is not entitled to interest on capital.

(ii) Remuneration is not payable to any partner. Therefore, B is not entitled to any salary.

(iii) Interest on loan is payable @6% p.a., which comes to ₹3,000 and the balance of ₹47,000 to be distributed equally. Profit cannot be shared in capital ratio, as claimed by A.

5.4 PARTNERS' CAPITAL ACCOUNTS : (Fixed vs Fluctuating)

A separate Capital Account is maintained for each partner. For example, if A, B and C are three partners in a firm, there shall be three Capital Accounts, one each for A, B and C. The partners' Capital Accounts may be maintained by following any of the two methods :

(i) Fixed Capital Accounts Method

(ii) Fluctuating Capital Accounts Method

Fixed Capital Accounts Method

When capital contribution of partners are fixed, it is called fixed capital. When fixed Capital Accounts method is followed, a separate Current Account is opened for each partner in addition to the Capital Account.

Capital Account : Fixed capital means that the capital remains unaltered, i.e., fixed unless additional capital is introduced or withdrawal is made from the existing capital. Thus, if fresh capital is not introduced or capital is not withdrawn, Capital Account of a partner will continue to show the same balance year after year.

Current Account : Current Account is maintained to record transactions other than introduction and withdrawals of capital such as interest on capital, interest on drawings, salary or commission to a partner, share of profits/losses. As a result, the balance of Current Account fluctuates with every transaction with the partner.

Current Account of each partner is debited with :

(i) Drawings made by him;

(ii) Interest on drawings;

(iii) Share of loss;

(iv) Transfer of any amount to Capital Account permanently, in case of deficiency in capital balance as per new agreement, if any.

Similarly, Current Account of each partner is credited with :

(i) Interest on capital;

(ii) Salary or commission;

(iii) Share of profit; and

(iv) Transfer of any amount from Capital Account permanently, in case of excess capital balance as per new agreement, is any.

Normally, partner's Current Account has a credit balance but, if a partner has drawn more than his or her share of profits or there are losses in the business year after year, it will have a debit balance.

The balance of the partners' Capital Accounts are shown on the liabilities side of the Balance Sheet, as that much amount is due to them.

Credit balance in Current Account is shown on the liabilities side and debit balance on the asset side of the Balance Sheet.

The outline of the two accounts. maintained under the Fixed Capital Method are:-

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Particulars	A(₹)	B(₹)	C(₹)	Particulars	A (₹)	B(₹)	C(₹)
To Cash/Bank A/c (withdrawal of capital)	---	---	---	By balance b/d	---	---	---
To Balance c/d	---	---	---	By cash/Bank A/c (Additional capital)	---	---	---

PARTNER'S CURRENT ACCOUNTS

Dr. Cr.

Particulars	A(₹)	B(₹)	C(₹)	Particulars	A(₹)	B(₹)	C(₹)
To Balance b/d	---	---	---	By balance b/d	---	---	---
(in case of debit				(in case of credit			
opening balance)	---	---	---	opening balance)			
To Drawings A/c				By Interest on Capital			
To Interest on Drawings A/c	---	---	---	By Commission A/c	---	---	---
To Profit and Loss A/c	---	---	---	By Salary A/c	---	---	---
(loss)				By Profit and loss	---	---	---
To Balance c/d*				Appropriation A/c			
				(profit)			

* The balance may be on the opposite (credit) side also

FLUCTUATING CAPITAL ACCOUNTS METHOD

Under this method, only one account namely 'capital' is maintained for each partner.

All transactions of a partner (e.g., salary or commission, interest allowed on capital, drawings, interest charged on drawings, share of profit or share of loss, etc.) are recorded in the Capital Account.

As a result, balance in the Capital Account fluctuates with every transaction.

Capital Accounts having credit balances are shown on the liabilities side while Capital Accounts having debit balances are shown on the assets side of the Balance Sheet.

Fluctuating Capital Method is normally followed for maintaining Capital Accounts and therefore, in the absence of any instruction, this method should be followed for maintaining the partners' Capital Accounts.

The outline of Capital Accounts under the Fluctuating Capital Method is as follows :

PARTNERS' CAPITAL ACCOUNTS

Dr. Cr.

Particulars	A ₹	B (₹	C (₹	Particulars	A ₹	B (₹	C (₹
To Balance b/d (in case of debit balance)	---	---	---	By Balance b/d (in case of credit balance)	---	---	---
To Drawings A/c	---	---	---	By Cash/Bank A/c (Additional Capital)	---	---	---
To Interest on Drawings A/c	---	---	---	By Interest on Capital A/c	---	---	---
To Profit and Loss A/c (loss)	---	---	---	By Commission A/c	---	---	---
				By Salary A/c	---	---	---
To Balance c/d*	---	---	---	By Profit and Loss A/c (Profit)	---	---	---

* The balance may be on the opposite (credit) side also.

Difference between Capital Account and Current Account

Basis	Capital Account	Current Account
1.- Need	Capital Account is maintained in all the cases, i.e., under fixed capital account and fluctuating capital account.	Current Account is maintained only when fixed capital account method is followed.
2.- Balance of Account	When fixed capital method is followed, Capital Account will show a credit balance.	Current Account may have a credit or debit balance.
3.- Nature	In case of fixed Capital, Capital Account balance generally remains unchanged from year to year. It will change only when further capital is introduced or capital is withdrawn from business.	Current Account balance fluctuates with every transaction.
4.- Transactions	Capital Account records the amount invested by a partner in the firm.	Current Account records the transactions such as drawings, interest on capital, interest on drawings, salary, profit, ctc.

Difference between Fixed Capital Account and Fluctuating Capital Account.

Basis	Fixed Account	Fluctuating Account
1.- No. of Acconts Maintained	Two accounts are maintained for each partners, i.e., Capital Account and Current Account.	Only one account (viz, Capital Account) is maintained for each partner.

2. Frequency of change	Balance in fixed capital Account does not change except under specific circumstances.	The balance changes frequently from period to period.
3. Adjustment for drawings, etc.	All adjustments for drawings, interest on drawings, interest on capital, salary, share of profit / loss are made in Current Account.	All entries for drawings, interest on drawings, interest on capital, salary, share of profits and losses are made in Capital Account.
4. Balance	It always shows credit balance in Capital Account.	Capital Account can also show debit balance

The important question, in this connection, is whether the firm should adopt Fluctuating Capital System or Fixed Capital System. The answer is that if Partnership Deed prescribes any definite system, it should be followed. In the absence of a clear mention, partners' decision should be treated as final, However, in most of the cases, fluctuating capital system is followed.

Interest on Drawings

The amount drawn by a partner from the partnership firm to meet his personal needs is termed as drawings. As per the partnership agreement, the firm may impose restrictions on the maximum amount of withdrawals by a partner. Similarly the partnership deed may provide for charging interest on drawings at an agreed rate. In the absence of such an agreement no interest can be charged on drawings.

Interest on drawings is an income for the firm and an expense for the partner. The partner usually does not pay this interest amount to the firm in cash. This may be charged to his drawings account which may reduce his capital in case of fluctuating capital. It the capital is treated as fixed, the drawings may be charged to the partner's Current Account. Drawings may be made in cash or in the form of goods.

Accounting Treatment

(i) When drawings made by cash :

Partner's Drawings Account Dr.

To Cash A/c

(ii) When drawings made in the form of goods :

Partner's Drawings Account Dr.

To Purchases A/c

(iii) For charging interest on drawings :

Partner's Drawings / current A/c Dr.

To Interest on Drawings A/c

(iv) For transferring the interest on drawings to Profit and Loss Appropriction A/c :

Interest on Drawing A/c

To Profit and Loss Appropriation A/c

Sometimes, the (iii) and (iv) entries above are combined and only one entry is passed which is as under :

Partner's Drawings / Current A/c Dr.

To Profit and Loss Appropriation A/c

Calculation of Interest on Drawings :

Interest on Drawings is calculated with reference to the time period for which the money is withdrawn by the partner. Depending upon the different situations of drawings, interest may be calculated under various ways, which are discussed below :

(i) When date of drawings is not given :

If the date of drawings by a partner is not given and the total drawings during the period are given, the interest on drawings is calculated at the agreed rate for a period of six months on the assumption that, the drawings have been made by the partner uniformly throughout the year.

Illustration 2

During the period total drawings made by a partner is ₹9,000 and interest on drawings is to be charged at 5% p.a. Calculate the interest on drawings.

Solution :

Since no date of drawings is given, it may be assumed that the total drawings of ₹9,000 has been uniformly made throughout the total period. That is, the partner has drawn every month a sum of ₹750

Interest on Drawings - $₹9{,}000 \times \frac{5}{100} \times \frac{1}{2} = ₹225$

(ii) When dates of drawings are given :

If the dates of drawings and the amounts of drawings on these dates are specifically given, the interest on drawings may be calculated by the product method, which is explained in the following illustration :

Illustration 3

Calculate the interest on drawings of Y, a partner, for the year ending 31st December 2016, from the following data by product method, by charging interest at 6% p.a.

Date of drawings	**Amount of drawings (₹)**
1st April, 2016	5,000
1st July, 2016	4,000
1st Oct, 2016	3,000
1st Dec, 2016	6,000

Solution :

Date of drawings	Amount of drawings (₹)	Period of drawings (in months)	Product (₹)
1st April, 2016	5,000	9	45,000
1st July, 2016	4,000	6	24,000
1st Oct, 2016	3,000	3	9,000
1st Dec, 2016	6,000	1	6,000
		Sum of the products =	84,000

$$\text{Interest on Drawings} = ₹84{,}000 \times \frac{6}{100} \times \frac{1}{12} = ₹420$$

Note: Interest on sum of the products is calculated for 1 month at the given rate.

The interest calculated under the product method for 1 month may also be calculated individually for the amount and period of drawings.

Taking the above illustration, the interest on drawings may be calculated individually as follows :

Date of drawings	Amount of drawings (IN ₹)	Period of drawings (in months)	Product
1st April, 2016	5,000	9	$5{,}000 \times \frac{9}{12} \times \frac{6}{100} = 225$
1st July, 2016	4,000	6	$4{,}000 \times \frac{6}{12} \times \frac{6}{100} = 120$
1st Oct, 2016	3,000	3	$3{,}000 \times \frac{3}{12} \times \frac{6}{100} = 45$
1st Dec, 2016	6,000	1	$6{,}000 \times \frac{1}{12} \times \frac{6}{100} = 30$
			Total Interest 420

(iii) When a fixed amount is withdrawn on the first day of each month for a period of 12 months.

In this situation, interest on the total amounts withdrawn during the period is calculated at the given rate for a period of $6\frac{1}{2}$ months.

(iv) When a fixed amount is withdrawn on the last day of each month for a period of 12 months.

In this case, interest on the total amounts withdrawn during the period is calculated at the given rate for a period of $5\frac{1}{2}$ months.

Interest on Capital

If the partnership deed provides for allowing interest on capital, then only this is allowed to all the partners on their capital contributions. In the absence of such a provision, no interest on capital is allowed to any partner. This is calculated before distributing the profits to the partners. The rationale behind allowing interest on capital is to compensate the partner who subseribes capital in excess of what is required as per the profit sharing ratio.

Accounting Treatment :

The interest on capital allowed to a partner is normally not given in cash. It is credited to his capital or current account as in case of fluctuating or fixed capital method respectively.

(i) For allowing interest on capital :

Interest on capital A/c Dr.

To Partner's Capital / Current A/c

(ii) For transferring the interest on capital to profits and loss appropriation account.

Profit and Loss Appropriation A/c Dr.

To Interest on capital A/c.

Sometimes only one entry is passed instead of the above, which is :

Profit and loss Appropriation A/c Dr.

To Partner's Capital/Current A/c.

The interest on capital allowed to the partners is a charge against the profits of the firm and is income for the partners. If the same is not withdrawn in cash, this increases their capital. However, instead of treating the interest on capital as a charge against profit, it may be regarded as an appropriation of profit. In this case, interest on capital is shown on the debit side of profit and loss appropriation A/c before distributing the profits among the partners. It will be more appropriate to treat this as an appropriation of profit. It is important to note that interest on capital is allowed onlywhen the firm has earned some profits. In case of loss, no interest on capital is allowed to the partners.

Calculation of Interest on Capital

While calculating the interest on capital, the drawings and introduction of additional capital, if any, should be taken into account. Interest is calculated at the given rate with reference to the time period for which the capital has been used. If there is no withdrawal or no introduction on of additional capital during a year, the interest on capital is calculated for the whole year on the opening balance of capital. On the otherhand, if there are drawings or introduction of additional capital, the effective use of capital for the time period will be calculated separately upto and after the date of drawing or introduction of additional capital.

Illustration 4

Amiya and Binoy are partners in a firm providing capitals of ₹60,000 and ₹50,000, respectively. They are allowed interest on capital @8% p.a. Calculate the interest on capital to be allowed to them for the year ending 31st march, 2016.

Solution :

Interest on Capital to Amiya $= ₹60{,}000 \times \frac{8}{100}$

$= ₹4{,}800.$

Interest on capital to Binoy $= ₹50{,}000 \times \frac{8}{100} = ₹4{,}000$

Illustration 5

In continuation of the above illustration, if the drawings and introduction of additional capital by the partners are given as below, calculate the interest on capital allowed to them.

Amiya withdrew ₹10,000 on 1st July,2015 and Binoy introducted additional capital of ₹5,000 on 1st October, 2015.

Solution :

Amiya's capital of ₹60,000 has been used for 3 months, i.e., from 1st April, 2015 to 1st July, 2015. After drawings of ₹10,000, his capital of 50,000 has been used for next 9 months i.e., from 1st July 2015 to 31st March, 2016.

Interest on Capital to Amiya $= ₹60{,}000 \times \frac{3}{12} \times \frac{8}{100} = ₹1{,}200$

$= ₹50{,}000 \times \frac{9}{12} \times \frac{8}{100} = ₹3{,}000$

Total interest = ₹1,200 + ₹3,000 = ₹4,200

Binoy's Capital of ₹50,000 has been used for 6 months i.e., from 1st April, 2015 to 1st october, 2015. After introducing additional capital of ₹5,000 on 1st October, his capital of ₹55,000 has been used for next 6 months i.e., from 1st October, 2015 to 31st March, 2016.

$\therefore$ Interest on Capital to Binoy $= ₹50{,}000 \times \frac{6}{12} \times \frac{8}{100} = ₹2{,}000$

$$= ₹55{,}000 \times \frac{6}{12} \times \frac{8}{100} = ₹2{,}200$$

So total interest = ₹2,000 + ₹2,200 = ₹4,200.

Interest on Loan given by a Partner :

If a partner provides loan to the firm at the time of its need for additional funds, he is entitled to interest on loan amount. If there is an agreement to this effect, interest on loan is paid at the agreed rate. If there is no agreement as to the rate of interest, interest at the rate of 6% p.a. is payable to the partner as per the provisions of the partnership Act.

The partner provides the loan to the firm over and above his capital contribution. So this amount of loan is credited to the partner's loan Account which represents liability for the firm, hence, shown on the liability side of the Balance Sheet. Interest on loan may be paid in cash. Since interest on loan is an expense of the firm, it is debited to the profit and loss account of the firm for determining the profit/loss.

Accounting treatment

(i) When loan is taken :

Cash A/c Dr.

  To Partners Loan A/c

(ii) When interest on Loan becomes due :

Interest on Loan A/c Dr.

  To Partner's Loan A/c

or

(iii) When interest on Loan is paid in cash :

Interest on Loan A/c Dr.

  To Cash A/c

(iv) When interest on Loan is transferred to Profit and Loss A/c.

Profit and Loss A/c Dr.

  To Interest on Loan A/c.

Illustration 6

X and Y are partners sharing profits and losses in the ratio of 2:1. On 1st April, 2015, X gave a loan of ₹60,000 and on 1st July, 2015, Y gave a loan of ₹50,000 to the firm. Show, how profit of the firm will be distributed for the year ending 31st March, 2016, in the following cases :

(i) If the profit before interest is ₹28,350

(ii) If the profit before interest is ₹4,350

(iii) If the loss before interest is ₹7,050

Solution :

(i) **Profit and Loss Appropriation Account**

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To interest on Loan		By Profit before interest	28,500
X 3,600			
Y 2,250	5,850		
To Profit transferred to Capital A/c			
X - 15,000			
Y - 7,500	22,500		
	28,350		**28,350**

(ii)

Dr. **Profit and Loss Appropriation Account** **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To interest on Loan		By Profit before interest	4,350
X- 3,600		By loss transferred to Capital A/c	
Y- 2,250	5,850	X - 1,000	
		Y - 500	1,500
	5,850		**5,850**

(iii)

Profit and Loss Appropriation Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Loss before interest	7050	By Loss transferred	
To Interest on Loan		to Capital A/c	
X- 3,600		X - 8,600	
Y- 2,250	5,850	Y - 4,300	12,900
	12,900		**12,900**

N.B.: Since no interest rate is given, it is charged at 6% p.a. as per the provision of Partnership Act.

It should be noted that the loan given by a partner has to be kept quite distinct from his capital and in the Balance Sheet also, it should be separately shown. Therefore, interest due on loan should be credited to loan account and not to Partner's Capital Account. The justification for this is that in the case of dissolution of partnership firm, partners loans have priority in repayment over partner's capitals.

Salary, commission payable to partners :

Normally no salary or commission is payable to a partner for the work done by him, because it is his duty to work for the firm sincerely and honestly However, if he is given any extra work, may be remunerated for the same by way of salary, commission, fees, etc. For this purpose, there must be an agreement between all the partners as to who is to be entitled to salary, commission, etc. and by what amount. In the absence of this agreement, no salary or commission is payable to any partner

Salary or commission payable to a partner is regarded as an appropriation of profit and not an expense or a charge against profits. So this is debited to the profit and loss appropriation account and not to the profit and loss account. However, salary or commission payable to the manager or any other employee of the firm is regarded as an expense and hence, debited to the profit and loss account.

Calculation of Commission based on profit :

Sometimes, commission may be allowed to partners or manager of the firm, as a percentage of the profits earned by the firm. The objective behind this way of remunerating them is to make them more involved in the activities of the firm and to put their best for earning more profits so that their income can be enhanced. Commission may be calculated as a certain percentage of net profits before charging such commission or after charging such commission.

Commission on Net profit before charging commission

$$\text{Commission} = \text{Net profit before commission} \times \frac{\text{Rate of commission}}{100}$$

Commission on Net Profit after Charging Commission

$$\text{Commission} = \text{Net profit before commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

Accounting Treatment

(i) For Salaries, Commission, etc. due to a partner :

Partner's Salaries / Commission A/c Dr.

To Partner's Capital / Current A/c.

(ii) For Transfer of Salaries / Commission to Profit and Loss Appropriation A/c

Profit and Loss Appropriation A/c Dr.

To Partner's Salaries / Commission A/c.

Illustration 7

Anita and Binita share the profits of a firm in the ratio of 3:2. Anita, being an active partner, is entitled to a salary of ₹2,000 p.m. Binita is entitled to a commission of 10% on net profit before charging her commission. Profit for the year ending 31st March, 2016, before charging salary and commission is ₹55,000.

Show, how you will divide the profit between Anita and Binita.

Profit and Loss Appropriation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Salary to Anita	24,000	By Profit b/d from profit and loss A/c	55,000
To Commission to Binita	3,100		
To Net profit transferred to capital A/c			
Anita - ₹16,740			
Binita - ₹11,160	27,900		
	55,000		**55,000**

5.5 PROFIT AND LOSS APPROPRIATION ACCOUNT

Meaning :

Profit and loss Account is prepared to ascertain the net profit/loss. The profit earned by the firm is to be distributed among the partners in their profit sharing ratio. Before distribution of profits, certain adjustments like interest on drawings, salary or commission due to partners, etc. are to be accounted for. This is done by means of a 'Profit and Loss Appropriation A/c, This is merely an extension of the Profit and Loss Account. This account shows, how the profits earned by the firm have been utilised and distributed among the partners.

Accounting treatment :

(i) This account is credited with the net profits as calculated in Profit and Loss Account and interest on drawings.

(ii) It is debited with interest on capital, salary, commission payable to the partners.

(iii) It is debited with the amount transferred to General Reserve/Reserve fund, Specific Reserve, etc.

Format of Profit and Loss Appropriation Account

(i) Profit and Loss Appropriation Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Interest on Capital		By Profit and Loss A/c	
X -		(Net Profit b/d)	
Y -		By Interest on Drawings	
To Salary to Partners			
X-		X-	
Y-		Y-	
To Commission			
to Partners			
X-			
Y-			
To General/Specific			
Reserve			
To Profit transferred			
to capital A/cs			
X-			
Y-			

Illustration 8

What entries are passed to record the following transactions in the books of the firm of A and B before distributing the profits earned ?

(i) Commission of ₹5,000 payable to B.

(ii) Interest on Capital A - ₹8,000; B - ₹5,000.

(iii) Salary payable to A - ₹20,000 p.a.

(iv) Transfer to the General Reserve - ₹25,000.

Solution :

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
(i)	Profit and Loss Appropriation A/c	Dr.		5,000	
	To B's Capital A/c				5,000
	(Being the amount of commission payable to B)				
(ii)	Profit and Loss Appropriation A/c	Dr.		13,000	
	To A's Capital A/c				8,000
	To B's Capital A/c				5,000
	(Being interest on capital payable to A and B)				
(iii)	Profit and Loss Appropriation A/c	Dr.		20,000	
	To A's Capital A/c				20,000
	(Being salary payable to A)				
(iv)	Profit and Loss Appropriation A/c	Dr.		25,000	
	To General Reserve A/c				25,000
	(Being the amount transferred to general reserve.				

Note : Capital Accounts are assumed to be fluctuating.

Miscellaneous Illustrations on Division of Profits :

Illustration 9

X and Y started a partnership on 1st January 2016 by contributing capital of ₹70,000 and ₹60,000 respectively.The agreement between the partners was as follows:

(i) X and Y to get a monthly salary of ₹1,500 and ₹2,000 respectively and share the profits in the ratio of 3:2.

(ii) Interest on Capital to be allowed at 10% p.a.

(iii) Interest on Drawings to be charged at 8% p.a.

(iv) X is entitled to a commission of ₹5,000.

(v) 15% of the profits to be transferred to General Reserve.

The profit for the year ending 31st December 2015 before above mentioned adjustments was ₹1,44,000. X and Y have drawn ₹35,000 and ₹30,000 respectively during the year.

You are required to pass journal entries relating to the above appropriations. Prepare Profit and Loss Appropriation Account and Partner's Capital Accounts.

Solution :

Journal of X and Y

Date	Particulars	L.F	Dr. Amt (₹)	Cr. Amt. (₹)
2015 Dec 31	Salary A/c Dr. To X's Capital A/c To Y's Capital A/c (Being the salary due to X & Y)		42,000	 18,000 24,000
,,	Profit and Loss Appropriation A/c Dr. To Salary A/c (Being transfer of salary of X & Y to P & L App. A/c)		42,000	42,000
,,	Interest on Capital A/c Dr. To X's Capital A/c To Y's Capital A/c (Being interest on capital allowed to X & Y)		13,000	 7,000 6,000
,,	Profit and Loss Appropriation A/c Dr. To Interest on Capital A/c (Being transfer of interest on capital to P & L App. A/c.)		13,000	13,000
,,	X's Capital A/c Y's Capital A/c To Interest on Drawings A/c (Being interest on drawings charged)		1,400 1,200	 2,600
,,	Interest on Drawings A/c To Profit and Loss Appropriation A/c (Being transfer of interest on drawings to P & L App. A/c.)		2,600	2,600
,,	Commission to X's A/c To X's Capital A/c (Being commission due to X)		5,000	5,000
,,	Profit and Loss Appropriation A/c Dr. To Commission to X's A/c (Being transfer of commission to X's A/c to P&L Appr. A/c)		5,000	5,000
,,	Profit and Loss Appropriation A/c Dr. To General Reserve A/c (Being 15% of the profits transferred to General Reserve)		21,600	21,600
,,	Profit and Loss Appropriation A/c Dr. To X's Capital A/c To Y's Capital A/c (Being transfer of Net Profits to X and Y)		65,000	 39,000 26,000

Profit and Loss Appropriation A/c for the year ended 31st December 2016

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Salary X - 18,000 Y - 24,000	42,000	By Net Profit transferred from P & L A/c	1,44,000
To Interest on Capital X - 7,000 Y - 6,000	13,000	By Interest on Drawings X - 1,400 Y - 1,200	2,600
To Commission to X	5,000		
To General Reserve	21,600		
To Net Profit transferred to Capital A/cs. X - 39,000 (3/5) Y - 26,000 (2/5)	65,000		
	1,46,000		**1,46,000**

Partner's Capital Accounts

Dr. **Cr.**

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Drawings	35,000	30,000	By Cash A/c	70,000	60,000
To Interest on Drawings	1,400	1,200	By Salary	18,000	24,000
			By Interest on Capital	7,000	6,000
			By Commission	5,000	
			By Profit & Loss App. A/c	39,000	26,000
To balance c/d	1,02,600	84,800			
	1,39,000	**1,16,000**		**1,39,000**	**1,16,000**

Illustration 10

X and Y are partners in a firm. X is to get a commission of 10% of net profit before charging any commission. Y is to get a commission of 10% of net profit after charging all commissions. Net profit for the year ended 31st March, 2016 before charging any commission was ₹5,50,000.

Find the commission of X and Y, Also, show the distribution of profits.

Solution :

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2016

Dr. Cr.

Particulars	₹	Particulars	₹
To X's Commission A/c $\left(5,50,000 \times \frac{10}{100}\right)$	55,000	By Profit (before any commission)	5,50,000
To Y's Commission A/c (Note) $\left[(5,50,000 - 55,000) \times \frac{10}{100}\right]$	45,000		
To Net profit transferred to capital A/cs.			
X $\left(\frac{1}{2}\right)$ 2,25,000			
Y $\left(\frac{1}{2}\right)$ 2,25,000	4,50,000		
	5,50,000		**5,50,000**

Note - The above stated amount of Y's commission can be verified. After charging all commissions, net profit comes to 4,50,000 [i.e. 5,50,000-(55,000+45,000)]. Now, Calculate 10% of 4,50,000. It works out to 45,000 which means the amount of commission calculated by the given formula i.e., Net profit before commission × $\left(\frac{\text{Rate of commission}}{100 + \text{Rate of commission}}\right)$ is correct.

Illustration 11

X and Y are partners sharing profits and losses in the ratio of 3:1. On 1st April, 2015, their capitals were : X-₹50,000 and Y-₹30,000. During the year ended 31st March, 2016, they earned net profit of ₹74,000. The terms of partnership are :

(i) Interest on capital is to be allowed @6% p.a.

(ii) X will get commission @3% on turnover.

(iii) Y will get a salary of ₹500 per month.

(iv) Y will get commission of 5% on profits after deductions of interest, salary and commission (including his own commission)

(v) X is entitled to a rent of ₹2,000 per month for the use of his premises by the firm. It is paid to him by cheque at the end of every month.

Partner's drawings for the year were : X-₹8,000 and Y-₹6,000. Turnover for the year was ₹3,00,000. After considering the above factors, you are required to prepare Profit and Loss Appropriation Account and Capital Accounts of the Partners.

Solution :

In the Books of X and Y
PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2016

Dr. Cr.

Particulars	₹	Particulars	₹
To Interest on Capital A/cs-		By Profit and Loss A/c	50,000
X $\left(₹50,000 \times \frac{6}{100}\right) = 3,000$		- Net profit (₹74,000-Rent ₹24,000)	
Y $\left(₹30,000 \times \frac{6}{100}\right) = 1,800$	4,800		
To salary A/c (Y) ₹500×12	6,000		
To Commission A/cs :			
X- $₹3,00,000 \times \frac{2}{100} = 6,000$			
Y- (WN-1) 1,581	7,581		
To Partner's capital A/cs (Profit)			
X- $\left(\frac{3}{4}\right)$ 23,714			
Y- $\left(\frac{1}{4}\right)$ 7,905	31,619		
	50,000		**50,000**

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Date	Particulars	X (₹)	Y (₹)	Date	Particulars	X (₹)	Y (₹)
2016 March 31	To Drawings A/c	8,000	6,000	2015 April	By Balance b/d	50,000	30,000
				2016	By Interest on Capital A/c	3,000	1,800
					By Salary A/c	....	6,000
,,	To Balance c/d	74,714	41,286	March 31	By Commission A/c	6,000	1,581
					By Profit and loss Appropriation A/c (Profit)	23,714	7,905
		82,714	**47,286**			**82,714**	**47,286**

Working Notes :

1. Y's Commission :

Net profit after charging interest, salary and X's commission but before charging Y's commission.

= ₹(50,000-4,000-6,000-,6000)=₹33,200

Profit after commission	Commission	Profit before commission
100	5	105
	x	33,200

$$x = \frac{5}{105} \times ₹33{,}200 = ₹1{,}581.$$

2. Rent payable to partner for the use of his premises is a charge against profit not an oppropriation of profit Hence, it is deducted from Net profit, while preparing profit & loss appropriation A/c.

Illustration 12

A, B and C are partner in a firm. According to the partnership Deed, the partners are entitled to draw a maximum amount of ₹7,000; per month. On the 1st day of every month A, B and C draw ₹7,000; ₹6,000 and ₹5,000 respectively. Interest on capitals and interest on Drawings are fixed at 8% and 10% respectively. Profit for the year ended 31st March, 2016 was ₹7,55,000 out of which ₹2,00,000 are to be transferred to General Reserve. B and C are entitled to receive salary of ₹30,000 and ₹45,000 p.a. respectively and A is entitled to receive commission @10% on net distributable profits after charging such commission. On 1st April, 2015, the balances of their Capital Accounts were ₹5,00,000, ₹4,00,000 and ₹3,50,000 respectively. You are required to show profit and loss Appropriation Account for the year ended 31st March, 2016 and capital Accounts of Partners in the books of the firm.

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2016

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on capital :			By Profit as per Profit and loss A/c	7,55,000
A's Capital A/c ($₹5,00,000 \times \frac{8}{100}$)	40,000		By Interest on Drawing (WN-1):	
B's Capital A/c ($₹4,00,000 \times \frac{8}{100}$)	32,000		A's Capital A/c ($₹84,000 \times \frac{10}{100}$)	8,400
C's Capital ($₹3,50,000 \times \frac{8}{100}$)	28,000	1,00,000	B's Capital A/c ($₹72,000 \times \frac{10}{100}$)	7,200
To Partners' Salaries :			C's Capital A/c ($₹60,000 \times \frac{10}{100}$)	6,000
B's Capital	30,000			
C's Capital	45,000	75,000		
To General Reserve		2,00,000		
To Commission A/c (A's Capital A/c) (Working Note-3)		36,510		
To profits transferred to :				
A's Capital A/c	1,21,697			
B's Capital A/c	1,21,697			
C's Capital A/c	1,21,696	3,65,090		
		7,76,600		**7,76,600**

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Drawings A/c	84,000	72,000	60,000	By Balance b/d	5,00,000	4,00,000	3,50,000
To Interest on Drawings A/c	8,400	7,200	6,000	By Interest on Capital A/c	40,000	32,000	28,000
To Balance c/d	6,05,807	5,04,497	4,78,696	By Partners' salaries A/c	......	30,000	45,000
				By Commission A/c	36,510	......	....
				By Profit and Loss Appropriation A/c	1,21,697	1,21,697	1,21,696
	6,98,207	5,83,697	5,44,696		6,98,207	5,83,697	5,44,696

Working Notes :

1. Interest on capital and interest on drawings are @8% and 10% (and not 8% p.a. and @10% p.a.) respectively. Therefore, the time factor is ignored.
2. Unless otherwise stated in the deed, all partners are equal partners. Thus, profits of the year is divided among partners equally.
3. Commission payable to A is calculated as :
   $\frac{10}{100}\times$(₹7,55,000+₹21,600-₹1,10,000-₹75,000-₹2,00,000=₹36,510

Illustration 13

X, Y and Z were partners, sharing profits and losses in the ratio of 5:3:2, after providing for interest at 5% per annum on their capitals, which were : X-₹50,000; Y₹30,000 and Z₹20,000 and allowing Y and Z salary of ₹5,000 each per annum. During the year 2016 X has drawn ₹10,000; Y₹7,500 and Z₹1,000 in addition to their salaries. The profit during the year before charging interest on capital and partner's salaries, amounted to ₹45,000. On 1st January 2016, the balances in the Current

Accounts of the partners were - X ₹4,500 (Cr), Y ₹1,000 (Dr) and Z₹2,500 (Cr). Show the Profit and Loss Appropriation A/c, Partners' Capital and Current Accounts as on 31st December 2016.

Solution :

Profit and Loss Appropriation A/c

Dr. Cr.

Particulars	₹	Particulars	₹
To Current A/c (Interest on capital) X - 2,500 Y - 1,500 Z - 1,000	5,000	By Net Profit transferred from P&LA/c	45,000
To Current A/c (Salary) X - 5,000 Y - 5,000	10,000		
To Current A/c (Profit) X - 15,000 Y - 9,000 Z - 6,000	30,000		
	45,000		**45,000**

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Particulars	A ₹	B (₹	C (₹	Particulars	A ₹	B (₹	C (₹
To Balance c/d	50,000	30,000	20,000	By Balance b/d	50,000	30,000	20,000
	50,000	**30,000**	**20,000**		**50,000**	**30,000**	**20,000**
				By balance b/d	50,000	30,000	20,000

Illustration 14

Ajaya, Bijoy and Chita are in partnership with respective fixed capitals of ₹40,000, ₹30,000 and ₹20,000. Bijoy and Chita are entitled to annual salaries of ₹2,000 and ₹1,500 respectively payable before division of profits. Interest on capital is allowed at 5% p.a., but no interest is charged on drawings. Of the profits earned during a year, the first ₹12,000 is divided between Ajaya, Bijoy and Chita as to 50%, 30% and 20% and profit in excess of this, is shared equally. The profit for the year ended 31st Decemeber, 2016 was ₹20,100 after debiting partner's salaries but before charging interest on Capital. The drawings during the year were, Ajaya ₹8,000, Bijoy ₹7,500 and Chita ₹4,000. The balances on partners' Current Accounts on 1st January, 2016 were- Ajaya ₹3,000 (Cr.), Bijoy ₹500 (Cr.) and Chita ₹1,000 (Dr.).

Prepare Profit and Loss Appropriation Account and the partner's Current Accounts for the year 2016.

Solution :

Profit and Loss Appropriation A/c
for the year ending 31st December, 2016

Dr. Cr.

Particulars	₹	Particulars	₹
To Current A/c (Interest on capital) Ajaya - 2,000 Bijoy - 1,500 Chita - 1,000	4,500	By Net Profit before salaries ₹(20,100+2,000+1,500)	23,600
To Current A/c (Salary) Ajaya - 2,000 Bijoy - 1,500	3,500		
To Current A/c (Profit) Ajaya - 7,200 Bijoy - 4,800 Chita - 3,600	15,600		
	23,600		**23,600**

Current Accounts

Dr. Cr.

Particulars	Ajaya ₹	Bijay (₹	Chita (₹	Particulars	Ajaya ₹	Bijay (₹	Chita (₹
To Balance b/d	.....	.....	1,000	By Balance b/d	3,000	500	---
To Cash				By P/L App. A/c			
(Drawings)	8,000	7,500	4,000	Interest on capital	2,000	1,500	1,000
To Balance c/d	4,200	1,300	1,100	Salary	---	2,000	1,500
				Profit	7,200	4,800	3,600
	12,200	8,800	6,100		12,200	8,800	6,100
				By Balance b/d	4,200	1,300	1,100

Working Note : Calculation of Share of Profit

Profits after interest on capital = ₹20,100-4,500 = ₹15,600, First ₹12,000 distributed as to 50%, 30% and 20% among Ajaya, Bijoy and Chita respectively.

∴ Ajaya's share = ₹6,000, Bijoy = ₹3,600 and Chita = ₹2,400

Remaining profit = ₹15,600 - ₹12,000 = ₹3,600, which is to be shared equally (i.e., each parter gets ₹1,200)

Now total share of Ajaya= ₹6,000 + ₹1,200 = ₹7,200, that of Bijay ₹3,600+₹1,200=₹4,800 and of Chita is = ₹2,400+₹1200=₹3,600.

-o-

5.6 QUESTIONS

1. From the given alternatives, under each bit choose and write the correct answer along with its serial number against each bit:

(i) Indian Partnership Act was enacted in the year :

(a) 1956.

(b) 1961.

(c) 1932.

(d) 1912.

(ii) Current Account of a partner :

(a) will always have a credit balance.

(b) can never have a debit balance.

(c) will always have a debit balance.

(d) may have a debit balance or credit balance.

(iii) In the absence of an agreement profits and losses are divided by the partners in the ratio of :

(a) Capital.

(b) Drawing.

(c) Time devoted by each partner.

(d) Equality.

(iv) In the absence of an agreement to contrary, the partners :

(a) are entitled to 6% interest on loans to the firm, only when there are profits.

(b) are entitled to 6% interest on loans to the firm, whether there are profits or not.

(c) are not entitled to any interest on loans to the firm.

(d) are entitled to 9% interest on loans to the firm, when there are profits.

(v) Interest payable on the capitals of the partners is charged to

(a) Profit and Loss Account.

(b) Profit and Loss Adjustment Account.

(c) Realisation Account.

(d) Profit and Loss Appropriation Account.

(vi) Interest on partners drawings under Fluctuating Capital Accounts is debited to :

(a) Partner's Capital Account.

(b) Profit and Loss Account.

(c) Drawings Account.

(d) Profit and Loss Appropriation Account.

(vii) Partners Current Accounts are opened :

(a) When capital is fixed.

(b) When capital is fluctuating.

(c) always.

(d) as and when desired by partners.

(viii) Minimum number of persons required to start a partnership is

(a) Three.

(b) Two.

(c) Seven.

(d) Eleven.

(ix) Interest on partner's capital is calculated on the :

(a) capital at the beginning of the period.

(b) capital af the end of the period.

(c) capital at the end less drawings.

(d) average capital employed.

(x) Profit and Loss Appropriation Account is prepared after the preparation of :

(a) Trading Account

(b) Manufacturing Account

(c) Profit and Loss Account

(d) Balance Sheet

[Ans.: (i) c, (ii) d , (iii) d, (iv) b, (v) d, (vi) a, (vii) a, (viii) b, (ix) d, (x) c.]

2. **Answer the following questions in one word/term each :**

(i) What is the maximum number of partners for a banking business ?

(ii) In which year the Indian Partnership Act was enacted ?

(iii) Which account is opened to record the transactions of a partner with the firm when capital is fixed ?

(iv) What is the minimum number of persons required to start a partnership business ?

(v) Under which capital method, the Current Accounts of partners are maintained ?

(vi) If the partnership Deed doesnot specify the rate of interest payable on loan by a partner, at what rate will the interest be paid ?

(vii) If the partnership Deed doesnot specify the profit sharing ratio, in what ratio is the profit or loss shared by the partners ?

(viii) If the partner's Capital Accounts are fixed, where will you record the fresh capital introduced by a partner ?

Ans: (i) 10, (ii) 1932, (iii) Current Account, (iv) two, (v) Fixed Capital, (vi) 6%, (vii) Equally, (viii) Capital Account

3. **Correct the underlined portions of the following sentences.**

(i) In case of fixed capital method, the additional capital introduced by a partner is recorded in his <u>current</u> account.

(ii) The written agreement among the partners is known as partnership <u>will</u>.

(iii) In the absence of agreement, profit is divided among the partners in their <u>capital</u> ratio.

(iv) Registration of partnership is <u>compulsory</u>.

(v) At the time of admission of a partner, the <u>firm</u> is dissolved.

(vi) In the absence of partnership deed, the partners are allowed to get <u>5%</u> interest on loan given to the firm.

(vii) The liability of partners is <u>limited</u> in case of partnership business.

(viii) Interest on capital is a <u>charge</u> against profit.

[Ans. (i) Capital, (ii) partnership deed, (iii) Equal, (iv) voluntary,
(v) partnership, (vi) 6%, (vii) Unlimited, (viii) appropriation.]

4. Answer the following questions in one sentence each :

(i) Define Partnership.

(ii) Where will the drawings made by a partner be recorded if the partners' Capital Accounts are fixed ?

(iii) What is the purpose of preparing Profit and Loss Appropriation account ?

(iv) What share of profits would a "sleeping partner", who has contributed 75% of the total capital, get in the absence of a deed ?

(v) How is interest on drawings calculated, if the drawings are made on the 15th day of each month ?

(vi) Why is a Partners Current Account prepared ?

(vii) What is partnership deed ?

5. Fill up the blanks of the following sentences :

(i) In the absence of any mention in the partnership Deed, the partners share profits in ______ ratio.

(ii) The document containing the terms of an agreement of a partnership is known as partnership ______ .

(iii) Under the ______ capital method, capital at the beginning and capital at the end will be different.

(iv) In absence of agreement, ______ is not paid on capitals.

(v) Partnership Deed is a ______ agreement among partners.

(vi) When date of drawings is not given, interest for ______ months is calculated on total drawings during a period.

(vii) When drawings by partner is made in the form of goods, ______ account is credited by the firm.

(viii) Salary to a partner is a/an ______ of profit.

[Ans.- (i) equal, (ii) Deed, (iii) fluctuating, (iv) interest, (v) written, (vi) six, (vii) purchase, (viii) appropriation]

6. Answer the following questions within 30 words each :

(i) What is fixed capital ?

(ii) How do you calculate interest on drawings, if no date of drawing is given ? Explain with illustration.

(iii) What is the maximum number of partners under different situations ?

(iv) Is it essential that each partner should contribute capital ? Explain.

(v) Is it always necessary to have a written agreement ?

(vi) At what rate of interest on capital and interest on drawings is calculated in the absence of any specific agrement.

(vii) What is oral agreement ?

(viii) Can minor be admitted as a partner ?

(ix) What do you mean by a partnership firm ?

7. Answer the following questions within 50 words each :

(i) What is the objective of preparing Profit and Loss Appropriation Account ?

(ii) Give four important contents of a "Partnership Deed".

(iii) Discus the provisions of Indian Partnership Act applicable for a firm in the absence of Partnership Deed.

(iv) Mention the items that may appear on the credit side of the Capital Account of a partner when the capitals are fluctuating.

(v) List any four items appearing on the Profit and Loss Appropriation Account.

(vi) How will you compute the commission payable to a partner based on net profit ?

8. What is Partnership Deed ? Discuss its important clauses.
9. Discuss and distinguish between fixed and fluctuating capital.
10. X and Y, two partners, drew for private use ₹1,20,000 and ₹80,000 respectively. Interest is chargeable @6% p.a. on drawings. What is the total interest changeable to X and Y ?

    [Ans. X-₹3,600 and Y-₹2,400.]
11. B and C are partners in a firm. They withdraw ₹48,000 and ₹36,000 respectively during the year evenly at the middle of every month. According to the partnership agreement, interest on drawings is to be charged @10% p.a.

    Calculate interest on drawings of the partners using the appropriate formula.

    [Ans. B-₹4,400 and C-₹1,800.]
12. A and B are partners sharing profits and losses equally. A drew regularly ₹4,000 in the beginning of every month for six months ended 30th September, 2016. Calculate interest on drawings @5% p.a.

    [Ans. Interest on drawings ₹350]
13. Amit and Binit are partners sharing profits and losses equally. Amit drew regularly ₹4,000 at the end of every month for six months ended 30th September, 2016. Calculate interest on drawings @5% p.a.

    [Ans. Int. on drawings ₹250]
14. For the year ending 31st March 2016, A has withdrawn an amount of ₹13,000 on 1st December 2015. As per the deed, interest on drawings is charged at 6% p.a. upto maximum drawings of ₹10,000. Beyond this limit, interest on drawings is charged at 10% p.a. Calculate the interest on drawings payable by A.

    [Ans. Int. on drawings ₹300]
15. A and B are partners sharing profit, and loss in the ratio of 3:2 having Capital Account balances of ₹50,000 and ₹40,000 respectively on 1st April 2015. On 1st July 2015, A introduced ₹10,000 as his additional capital whereas B introduced only ₹1,000. If the interest on capital is allowed to partners @10%

p.a., calculate interest on capital assuming that the financial year closes on 31st March.

[Ans. Total int. payable A-₹5,750 and B-₹4,075]

16. Ram and Rahim are partners in a business. Their capitals at the end of the year were ₹24,000 and ₹18,000 respectively. During the year 2015-16, Ram's drawings and Rahim's drawings were ₹4,000 and ₹6,000 respectively. Profit (before changing interest on capital) during the year was ₹16,000. Calculate interest on capital @5% p.a. for the year ended 31st March, 2016.

17. The capital of A and B at the end of the year was ₹1,00,000 and ₹1,50,000 respectively. Their drawings were ₹20,000 and ₹40,000 during the year. They had shared profits of ₹60,000 in the ratio of 3:2 for the year. Interest on capital @10% has been omitted. Find out the interest on capital to be allowed to them.

18. From the following Balance Sheet of X and Y, Calculate interest on Capital @6% p.a. payable to Y for the year ended 31st March, 2016 :

Balance Sheet as on 31st March 2016

Liabilities	**₹**	**Assets**	**₹**
X's Capital A/c	50,000	Sundry Assets	1,10,000
Y's Capital A/c	40,000		
Profit & Loss Appropriation A/c 2015-16	20,000		
	1,10,000		**1,10,000**

During the year Y's drawings were ₹15,000 and profit during 2015-16 was ₹30,000. [Ans. Interest on Y's capital ₹3,000]

19. M and N are partners sharing profit and loss in the ratio of 2:3 having capital account balances of ₹50,000 and ₹60,000 on 1st April, 2015. On 1st July, 2015, A introduced ₹10,000 as his additional capital whereas B introduced only

₹5,000. If the interest on capital is allowed to partners @10% p.a., calculate interest on capital assuming that the financial year closes on 31st March.

20. A and B are partners in a firm having profit sharing ratio of 3:2 respectevely. They had advanced to the firm a sum of ₹30,000 as a loan in their profit sharing ratio on 1st october, 2015. The partnership deed is silent on the question of interest on loans from partners. Compute interest on loan payable by the firm to the partners, if the firm closes its books of accounts on 31st March. [Ans: A-₹540, B-₹360]

21. X and Y are partners sharing profit and losses in the ratio of 2:3 with capital of ₹2,00,000 and ₹3,00,000 respectively. On 1st october, 2015. X and Y advanced loans of ₹80,000 and ₹40,000 respectively to the firm. Show the distribution of profits/losses for the year ended 31st March, 2016 in each of the following alternative cases :

Case 1. If the profits before any interest for the year amounted to ₹21,000.

Case 2. If the profits before any interest for the year amounted to ₹3,000.

Case 3. If the profits before any interest for the year amounted to ₹5,000.

[Ans : Int. to X's lean ₹2,400, Int. to Y's lean ₹1,200

Case -1. Profit X ₹6,960; Y₹10, 440

Case-2. Loss X ₹240; Y₹360

Case-3. Profit X₹560; Y₹540]

22. Y has advanced a loan of ₹80,000 to the firm on 01.07.2015, without any agreement as to the rate of interest with his co-partner X. Calculate the amount of interest on loan allowable to him for the year ending 31st March,2016.

[Ans : ₹3,600]

23. A and B are partners in a firm. A has advanced a loan to the firm at the rate of 12% p.a. amounting to ₹60,000 on 1st August 2015. Calculate the amount of

interest payable to him for the year ending 31st March, 2016.

[Ans : Int on loan to A ₹4,800]

24. Arjun and Bhima are partners in a firm sharing profits and losses in the ratio of 3:2. A gets a salary of ₹2,000p.m. and B is entitled to a commission of 5% on net profits before charging his commission. Distribute a profit of ₹70,000 earned during a year before allowing salary and commission.

[Ans : A's share of profit ₹24,840, B's share ₹16,560]

[Total share of A = ₹48,840, Total share of B = ₹21,160]

25. X. Y and Z are partners sharing profits and losses equally. As per Partnership Deed, Z is entitled to a commission of 10% on the net profits after charging such commission. The net profit before charging commission is ₹2,20,000. Findout the commission payable to Z.

[Ans : commission payable to Z = ₹11,000]

26. A and B are partners in a firm. A is entitled to a salaryof ₹10,000 per month together with a commission of 10% of the net profit after partner's salaries but before charging any commission. B is entitled to a salary of ₹25,000 p.a. together with a commission of 10% of the net profit after charging all commission and partners' salaries. The net profit before providing for partners' salaries and commission for the year ended 31st March, 2016 was ₹4,20,000.

Show distribution of profit.

[Ans: A's commission ₹27,500 B's commission ₹22,500 Net profit - ₹2,25,000 A and B share ₹1,12,500 each]

27. X and Y are partners in a firm sharing the profits and losses equally. They contributed capital of ₹10,000 and ₹12,000 respectively on which they are entitled to interest at 5% p.a. A gets ₹500 p.m. as salary. If the total profits for the year before the above adjustments are ₹26,100, distribute the profit by

preparing a Profit and Loss Appropriation Account.

[Ans. X's profit ₹9,500, Y's ₹9,500]

28. A, B and C entered into a partnership providing capital of ₹50,000, ₹50,000 and ₹20,000 respectively and agreed to share the profits and losses in the ratio of 4:3:3 after allowing interest on capital @9% p.a. and charging interest on drawings @10% p.a. During the year 2015, drawings of A,B and C were ₹10,000; ₹6,000 and ₹8,000 respectively. C, being a working partner is entitled to a salary of ₹6,000 p.a. The firm earned a profit of ₹30,000 before charging or allowing interest and salary payable to partners. Prepare Profit and Loss Appropriation Account and Capital Accounts of the partners for the year.

[Ans. Share of profits A = ₹5,760; B= ₹4,320; C=₹4,320

Capital Accounts A = ₹49,760; B= ₹52,520; C= ₹3,350]

29. A and B started business with capitals of ₹1,00,000 and ₹60,000 respectively on 1st January 2016. B is allowed a salary of ₹800p.m. Interest on capital and drawings are at 6% p.a. Profits are distributed equally after making the above noted adjustments. Drawings of A and B during the year amounted to ₹16,000 and ₹20,000 respectively. Profits as per profit and loss account for the year amounted to ₹60,000.

Assuming the capitals to be fixed, prepare Profit and Loss Appropriation Account and accounts relating to partners.

[Ans : Profit A = ₹20,940, B=₹20,940. Current Account Balance, A = ₹10,460, B= ₹13,540]

30. X, Y and Z are partners in a firm with capital contribution of ₹50,000, ₹60,000 and ₹80,000 respectively. They agreed to share the profits in the ratio of 2:3:5. Partnership deed provides for allowing interest on capital @6% p.a. and charging interest an drawings @8% p.a. A is allowed a salary of ₹1,200 p.m. B is entitled

to a commission of 10% on net profits after charging his commission. Drawing during the year by X, Y and Z amounted to ₹5,000, ₹10,000 and ₹20,000 respectively. Profit during the year before the above adjustments amounted to ₹1,12,840. Prepare Profit and Loss Appropriation Account and Capital Accounts of partners.

[Ans.: Profit×=₹16,080, Y=₹24,120 and Z=₹10,200]

31. A and B are partners sharing profits and losses in the ratio of 3:2. They have contributed capitals of ₹60,000 and ₹40,000 respectively. Drawings during the year were ₹10,000 and ₹5,000 respectively by A and B. The partnership deed provides for the following adjustments :

(i) Interest on capital is allowed at 5% p.a.

(ii) Interest on drawings is charged at 6% p.a.

(iii) A is allowed a salary of ₹1,500 p.m. for managing the business.

(iv) A has assured B of earning a minimum profit of ₹60,000 for the firm. Any short fall is to be borne by him.

(v) ₹3,000 is to be credited to a Reserve Fund. Profits before the above adjustment were ₹55,000. Distribute the profit and prepare capital accounts.

[Ans.: Profit A=₹20,000, B= ₹13,780

Capital A/cs A = ₹86,370, B = ₹50,630]

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CHAPTER-6

ACCOUNTING FOR PARTNERSHIP FIRM (GOODWILL)

STRUCTURE

6.1 MEANING, NATURE AND FACTORS AFFECTING GOODWILL

Meaning : Goodwill is an intangible asset. It is the reputation of a firm which is acquired in course of time. It is neither visible nor can be dealt with like any other tangible asset. It is the value of reputation of a firm in respect of profits expected in future over and above the normal profits earned by similar firms belonging to the same industry. This excess profit over the normal profit earned by a firm is called super profit. Thus, goodwill exists only when the firm earns super profits. In this connection, it would be pertinent to go through the views expressed by certain authorities on goodwill. Lord Eldon says "Goodwill is nothing more than the probability that the old customers will resort to the old place" Similarly, Dicksee remarks :

"When a man pays for goodwill, he pays for something which places him in the position of being able to earn more than he would be able to do by his own unaided efforts."

However, if time value of money is considered, Goodwill may be defined as the present value of firm's anticipated excess earnings.

Nature of Goodwill

1. Goodwill is an intangible asset which cannot be seen, nor touched but it has a value.
2. No value is attached to goodwill of a firm which is incurring losses.
3. A price for the goodwill may be realised if the business is sold as a going concern.
4. It helps to earn higher profit. It is the capitalised value of super profits.
5. It is an attractive force which brings in customers to old place of business.
6. It is an extra value attached to a prosperous business beyond the intrinsic worth of the net assets.
7. It is usually calculated at the time of admission, retirement or death of a partner.
8. No such concrete method is laid down for its valuation.

Factors affecting Goodwill

The goodwill of a firm arises due to the following factors :

1. Nature of Business : A firm which deals with quality products having a stable demand in the market is in an advantageous position to earn more profit and therefore, is in a position to earn more and more goodwill.
2. Suitable Location : If the business is situated in a busy shopping complex or is centrally located, it acquires more goodwill.
3. Greater managerial Talent : If a firm is well managed because of expert

knowledge of the managers in their respective fields, economy arises in every field which leads to cost efficiency and ultimately results in the acquisition of more goodwill.

4. Degree of competition : If a firm enjoys monopoly over the products dealt in by it or the products are in short supply in the market, it stands to earn more profits which leads to higher value of goodwill.
5. Commitment towards customers : If a firm fulfills all its commitments towards customers like prompt supply of goods, provision of timely after-sales service, it attracts more goodwill.
6. Degree of Risk : If the risk involved in the business is less, it creates more goodwill and vice-versa.
7. Advantages of Patents : Normally, patents are necessary for the manufacture or production of certain types of articles. A firm which possesses the necessary patents will have an edge over its competitors having no such patents and hence, in a position to earn more goodwill.
8. Profit Trend : If the business is showing an upward trend in profits for years together, it has the scope for earning more goodwill.
9. Market situation : If a firm is in a business wherein, demand for the products dealt in is higher than the supply, it will lead to more turnover as well as more profit, which will increase the value of goodwill.
10. Nature of Business : If the business of a firm is of the nature where the products dealt in are in high demand, the profit will be higher. It will, thus, increase the value of goodwill.
11. Other factors : General economic conditions, political stability, Government policies, money market conditions, trade cycles, etc. are the other factors influencing the value of goodwill.

6.2 METHODS OF VALUATION OF GOODWILL

In actual practice, it is very difficult to value goodwill of a firm on any particular date. We know that the value of goodwill depends upon the earning capacity of a firm, yet no simple procedure or rule can be laid down for its valuation. However, taking the profit as the basis, goodwill may be valued by any of the three following methods :

(i) Average profit method;

(ii) Super profit method;

(iii) Capitalisation method.

(i) Average Profit method :

Under this method, usually goodwill is valued at a few years' purchase of adjusted average of past profits.

Goodwill under this method is calculated as follows :

(a) Calculate normal past business profits for each year by deducting abnormal gains and non-business incomes and adding abnormal losses and non-business expenses.

(b) Add the profits calculated as per (a) above.

(c) Calculate Average Profits as follows :

$$\text{Average Profit} = \frac{\text{Total Profits (as per (b) above)}}{\text{Number of years for which profit and loss are given}}$$

Note - Above average profit is known as Actual Average profit or average maintainable profit in future.

In actual practice, this method is used very rarely by the business firms as it is not a scientific method. The only advantage of this method is that it is a very simple method which can be easily understood and applied by everybody.

(d) Calculate Goodwill applying the formula :

Goodwill = Average Profit (as per c) above × Number of years purchase

For example, goodwill of a firm is to be valued at three years purchase of four years average profit. The firm earned in the previous four years profits of ₹17,000; ₹11,500, ₹19,000 and ₹16,500. Goodwill will be valued as follows :

$$\text{Average Profit} = \frac{₹17{,}000 + ₹11{,}500 + ₹19{,}000 + 16{,}500}{4} = ₹16{,}000$$

Goodwill = ₹16,000 × 3 = ₹48,000.

Illustration 1

Calculate the value of goodwill of a firm on the basis of three years purchase of the average profits of the last five years. The profits for the last five years are -

Year	Profit (₹)
2012	40,000
2013	47,000
2014	60,000

2015	68,000
2016	75,000

Solution :

Total profits of the given 5 years = ₹(40,000+47,000+60,000+68,000+75,000) =₹2,90,000

$$\text{Average Profits} = \frac{\text{Total Profits}}{\text{No. of years}} = \frac{₹2,90,000}{5} = ₹58,000$$

Goodwill = Average Profits × No. of years purchase

= ₹58,000×3 = ₹1,74,000

(ii) Super Profit Method :

Captial employed in a business yields a profit. Some of the enterprises earn more profit, while others in the same line of business earn less profit on the capital employed. When a similar type of business earns profit as a certain percentage of the capital employed, it is called normal return. But an investor's advantage lies in the excess of normal return on capital employed. It is only such enterprises which enjoy goodwill. The excess of actual profit over the normal profit is called super profit.

For calculating goodwill under this method, the steps are :

(a) Calculate Average Capital Employed as :

$$\frac{\text{Opening Capital Employed} + \text{Closing Capital Employed}}{2}$$

Capital Employed = Capital + Free Reserves - Fictitious Assets (if any)

OR

All Assets (other than goodwill, fictitious assets and non-trade investments) – outsiders' liabilities.

(b) Calculate actual expected profit, i.e., actual average profit.

(c) Calculate normal profit on average capital employed by applying the following formula :

$$\text{Average Capital Employed} \times \frac{\text{Normal Rate of Return}}{100}$$

Note - Normal Rate of Return refers to the rate of return normally earned by other firms in the same industry.

(d) Calculate super profit, i.e., Actual Average Profit - Normal Profit.

(e) Calculate value of goodwill as follows :

Goodwill = Super Profit × Number of years purchase

Illustration 2 (Super Profit Method)

A firm earned net profits during the last three years as follows :

Year	Profit (₹)
2014	18,500
2015	20,300
2016	22,100

The capital investment of the firm is ₹60,000. A fair return on the capital having regard to the risk involved is 10%. Calculate the value of goodwill on the basis of three years purchase of the average super profit for the last three years.

Solution :

a) Average Profit $= \dfrac{₹18,500 + ₹20,300 + ₹22,100}{3} = ₹20,300$

(b) Normal Profit $= ₹60,000 \times \dfrac{10}{100} = ₹6,000$

(c) Super Profit = Average profit - Normal profit
$= ₹20,300 - ₹6,000 = ₹14,300$

(d) Goodwill = Super profit × No. of years' purchase
$= ₹14,300 \times 3 = ₹42,900.$

Illustration 3 (Super Profit Method)

Average net profit of ABC Ltd. expected in the future is ₹54,000 per year. The average capital employed in the business is ₹3,00,000. Normal profit expected from capital investment in this class of business is 10%. The remuneration of the partners is estimated to be ₹9,000 p.a.

Find out the value of goodwill on the basis of two year's purchase of super profit.

Solution :

	₹	₹
Average annual profit	-	54,000
Less : Partners remuneration	9,000	
Normal profit on capital employed	30,000	39,000
Annual super profit		15,000

Goodwill, being two year's purchase of super profit

= ₹15,000×2=₹30,000

Difference between average Profit and Super Profit :

Basis	Average Profit	Super Profit
1. Meaning	It is average of the profits of past few years.	It is excess of average profit over normal profit.
2. Normal Rate of return	Normal rate of return is not relevant in the calculation of average profit.	Normal rate of return is considered while calculating super profit.
3. Average Capital Employed	Average Capital Employed is not taken into account in the calculation of average profit.	Average capital employed is taken into account while calculating the super profit.
4. Relevance of valuing Goodwill.	Average profit is relevant for Average profit method, Super profit method and Capitalisation method of valuing Goodwill.	Super profit is relevant for super profit method and capitalisation of super profit method of valuation of Goodwill.

(iii) Capitalisation Method :

Under this method, goodwill can be valued in two ways :

(a) Capitalisation of Average Profits; or

(b) Capitalisation of Super Profit.

(a) Capitalisation of Average Profit :

Under this method, goodwill is calculated by deducting capital employed (i.e., Net Assets as on the date of valuation) in the business from the capitalised value of average profit on the basis of Normal Rate of Return. Capitalised value of the business is ascertained by capitalising profits earned at the normal rate of profit. It is calculated as follows:

$$\frac{\text{Average Profit}}{\text{Normal Rate of Return}} \times 100$$

Net Assets = All Assets (other than goodwill, fictitious assets and non-trade investments) at their current values minus outsiders' liabilities.

If a firm earns a profit of ₹24,000 annually and firms in the same time of business normally earn 10%, the total capitalised value of the firm will be ₹2,40,000, i.e., $24{,}000 \times \frac{100}{10}$.

For calculating goodwill under this method, the steps are :

- Calculate average normal profit earned.
- Calculate capitalised value of the firm by using the above formula.
- Determine the value of Net Assets, on the date of valuation of goodwill.

  Net Assets = All Assets (other than goodwill, fictitious assets and non-trade investments) at their current values minus outsiders' liabilities.
- Goodwill = Capitalised Value- Net Assets.

  This method is suitable when the actual profits are less than the normal profit.

Illustration 4 (Capitalisation Method)

A firm earns ₹65,000 as its annual profit, the normal rate of profit being 10%. Assets of the firm are ₹7,20,000 (excluding goodwill) and liabilities are ₹2,40,000. Find the value of goodwill by Capitalisation Method.

Solution :

$$\text{Total Capitalised Value of the Firm} = \frac{\text{Average Profit}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{₹65,000}{10} \times 100 = ₹6,50,000$$

Net Assets of the Firm = Total Assets - Liabilities

= ₹7,20,000 - ₹2,40,000 = ₹4,80,000

Goodwill = Total Capitalised Value of Business - Net Assets

= ₹6,50,000 - ₹4,80,000 = ₹1,70,000.

(b) Capitalisation of Super Profit :

Under this method, goodwill is calculated by capitalisation of super profit. In other words, goodwill is ascertained by capitalising the super profit on the basis of Normal Rate of Return. For example, where average profit is ₹60,000 and normal profit is ₹48,000, the super profit will be ₹12,000 (i.e., ₹60,000-₹48,000). Assuming that the Normal Rate of Return is 10%, the goodwill will be ₹1,20,000 (i.e., ₹12,000$\times\frac{100}{10}$).

For calculating the goodwill under this method. the steps are :

(a) Calculate Capital Employed (i.e., Net Assets of the firm as on the date of valuation.

(b) Calculate Normal Profit on Capital Employed by using the following formula:

Normal Profit = Capital Employed × Normal Rate of Return/100

(c) Calculate Average Profit of past years, i.e., three to five years.

(d) Calculate Super Profit, i.e., Actual Average Profit-Normal Profit.

(e) Goodwill = Super Profit × $\frac{100}{\text{Normal Rate of Return}}$.

Illustration 5

Average profit of the firm is ₹1,50,000. Total Tangible assets in the firm are ₹15,00,000 and outside liabilities ₹4,00,000. In the same type of business, the normal rate of return is 10% of the capital employed.

Calculate the value of goodwill by capitalisation of Super Profit Method.

Solution :

Capital Employed = Total Tangible Assets - outside liabilities

= ₹15,00,000 - ₹4,00,000 = ₹11,00,000

Normal Profit = Capital Employed × Normal Rate of Return

$$= ₹11,00,000 \times \frac{10}{100} = ₹1,10,000$$

Super Profit = Average Profit - Normal Profit

= ₹1,50,000 – ₹1,10,000 = ₹40,000

$$\therefore \text{ Goodwill } = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{₹40,000}{10} \times 100 = ₹4,00,000.$$

Illustrations 6

Average net profit expected in future by U.C. Lal & Co is ₹30,000 per year. Average capital employed in the business by the firm is ₹2,00,000. Normal rate of return on capital employed in a similar business is 10%. Calculate goodwill of the firm by :

(i) Super Profit Method on the basis of two years' purchase, and

(ii) Capitalisation of Super Profit Method.

Solution :

(i) Super Profit Method :

Average Profit = ₹30,000

Normal Rate of Return - 10%

Capital Employed = ₹2,00,000

Normal profit = 10% of ₹2,00,000 = ₹20,000

Super profit = Average Profit - Normal Profit

= ₹30,000 - ₹20,000 = ₹10,000

Goodwill = Super Profit × Number of years purchase

= ₹10,000 × 2 = ₹20,000

(ii) Capitalisation of Super Profit Method :

$$\text{Goodwill} = \text{Super Profit} \times \frac{100}{\text{Normal Rate of Return}}$$

$$= ₹10{,}000 \times \frac{100}{10} = ₹1{,}00{,}000$$

6.3 Questions

1. From the given alternatives under each bit, choose and write the correct answer along with its serial number against each bit:

(i) The excess of actual profit over normal profit is called :

(a) Gross profit.

(b) Net profit.

(c) Super profit.

(d) Average profit.

(ii) Goodwill is a/an :

(a) tangible asset.

(b) fictitious asset.

(c) intangible asset.

(d) wasting asset.

(iii) Profit of last three years were ₹13,000, ₹10,000 and ₹7,000. Value of goodwill at 3 years purchase will be :

(a) ₹27,000.

(b) ₹28,000.

(c) ₹29,000.

(d) ₹30,000.

(iv) Under capitalisation of super profit method, goodwill is calculated by :

(a) Average profit × years of purchase

(b) Super profit × years of purchase

(c) Super profit divided by expected rate of return.

(d) Total of the discounted value of expected future profit.

(v) When the incoming partner pays for goodwill in cash, the amount should be debited to:

(a) goodwill account

(b) Capital account of the incoming partner.

(c) Cash.

(d) Capital account of the existing partners.

(vi) Super profit is equal to :

(a) $\frac{\text{Total profit}}{\text{No. of years}}$

(b) $\frac{\text{Average profit}}{\text{Normal rate of return}}$

(c) $\frac{\text{Weighted profits}}{\text{No. of weights}}$

(d) Average profits - Normal profits.

[Ans.: (i) c, (ii) c, (iii) d, (iv) c, (v) c, (vi) d]

2. Answer the following questions in one word/term each :

(i) What is the term used for expressing the reputation of a firm in monetary term ?

(ii) Name the asset which is intangible but not fictitious.

(iii) Name the term used for writting off of Goodwill.

(iv) Name the method of calculating goodwill, when average maintainable profit and normal profit of a firm are given.

[Ans.: (i) Goodwill, (ii) Goodwill, (iii) Amortisation (iv) Super profit method.]

3. Answer the following in one sentence each :

(i) Define Goodwill.

(ii) What is meant by number of years' purchase ?

(iii) What do you mean by super profit ?

(iv) Write two factors which affect the value of Goodwill.

(v) What is normal profit ?

(vi) What is meant by average maintainable profit ?

4. Correct the underlined portions of the following sentences :

(i) Super profit is the <u>shortage</u> of average profit over normal profit.

(ii) Three years purchase of super profit means, super profit <u>divided</u> by 3.

(iii) In case of partnership business goodwill is valued, when partnership firm is <u>dissolved</u>.

(iv) Capitalised value of average profit method for valuing goodwill is used <u>frequently</u>.

(v) For writing off the decrease in the value of goodwill, the term <u>depreciation</u> is used.

[Ans.: (i) excess, (ii) multiplied, (iii) sold/reconstituted, (iv) rarely, (v) amortisation]

5. Fill in the blanks with appropriate words :

(i) Excess of actual adjusted profit over normal profit is called ______ profit.

(ii) Negative super profit indicates that there is no _______ of business concern.

(iii) When a business is taken over by another business, the excess of purchase price over its net asset value is referred to as _______.

(iv) Goodwill is a/an _______ asset.

(v) The number of methods of valuation of goodwill is _______.

[Ans.: (i) Super, (ii) goodwill, (iii) goodwill, (iv) intangible, (v) three.]

6. Answer the following questions within **30** words each :
   (a) What do you mean by Goodwill ?
   (b) State any four factors which influence the valuation of Goodwill of a partnership firm.
   (c) Distinguish between Average Profit and Super Profit Methods of valuation of Goodwill.
   (d) Briefly explain the Average Profit method of valuation of goodwill.
   (e) Briefly explain the super profit method of valuation of goodwill.
7. Answer the following questions within **50** words each :
   (a) What are the circumstances under which valuation of goodwill is necessary in case of partnership ?
   (b) How do you calculate goodwill in Average Profit method ? Give one example.
   (c) Name the methods of valuation of goodwill.
   (d) Explain the method of calculation of goodwill under capitalisation of super profit with an example.
8. What is goodwill ? How is it valued ?
9. "Goodwill is intangible but not fictitious" Justify the statement giving examples.
10. Define goodwill. On what occasions does the need for valuation of goodwill arise ?
11. What do you mean by goodwill ? Describe the factors affecting goodwill.

12. Goodwill is to be valued at three years purchase of four years average profit. Profits of a partnership firm for last four years were :

    2013- ₹1,20,000; 2014-₹1,80,000; 2015-₹1,60,000; 2016-₹1,40,000

    [Ans. Goodwill-₹4,50,000]

13. The profits of a firm for the last five years were as follows :

Year	2012	2013	2014	2015	2016
Profit (₹)	24,000	36,000	48,000	60,000	66,000

    Calculate the value of goodwill on the basis of three years purchase of average profits. [Ans.: ₹1,40,400]

14. X and Y were partners in a firm. In order to admit Z into their firm, the need for valuation of goodwill arises. Goodwill for this purpose is to be calculated at two years purchase of the average normal profit of past three years. Profits of the last three years were:

    2014- Profit ₹5,00,000 (including profits on sale of assets ₹50,000)

    2015- Loss ₹2,00,000 (including loss by fire ₹3,00,000)

    2016- Profit ₹7,00,000 (including insurance claim received ₹1,80,000 and interest on investments ₹80,000) [Ans. ₹6,60,000]

15. A and B are partners in a firm sharing profits and losses in the ratio of 2:1. They decide to take C into partnership for 1/4th share on 1st April, 2016. For this purpose, goodwill is to be valued at four times the average annual profit of the previous four or five years whichever is higher. The profits for the goodwill purpose of the past five years are :

Year	2012	2013	2014	2015	2016
Profit (₹)	24,000	25,500	20,000	26,000	25,000

    Find the value of goodwill. [Ans.: ₹96,500]

16. Bini and Gini had a firm in which they had invested ₹5,00,000. On an average, the profits were ₹1,60,000. The usual rate of earning in the industry is 15%.

Goodwill is to be valued at four years' purchase of profits in excess of profits @15% on the money invested. Value the goodwill. [Ans. ₹3,40,000]

17. The average net profits expected in the future by ABC firm are ₹36,000 per year. The average capital employed in the business by the firm is ₹2,00,000. The rate of interest expected from capital invested in this class of business is 10%. The remuneration of partners is estimated to be ₹6,000 p.a. Find out the value of goodwill on the basis of two years purchase of super profit.

[Ans. ₹20,000]

18. A and B are partners in a firm investing capitals of ₹6,00,000 and ₹4,00,000 respectively. The normal rate of return for the same business is 15%. If the firm makes an average profit of ₹2,50,000, compute goodwill by taking it to be five years' purchase of super profits. [Ans. ₹5,00,000]

19. From the following information, calculate the value of goodwill on the basis of 3 years' purchase of the super profits :

(i) Average Capital employed in the business is ₹15,00,000.

(ii) Rate of interest expected from capital is 10%.

(iii) Net trading profits for the firm for last four years were : ₹2,70,800; ₹3,20,000; ₹2,70,500 and ₹3,05,100.

(iv) Fair remuneration to the partners for their services for the firm is ₹36,000p.a. [Ans. ₹2,56,800]

20. The following particulars are available in respect of a firm carried on by X and Y :

(i) Profit earned, 2014 ₹50,000; 2015 ₹60,000 and 2016 ₹55,000

(ii) Normal rate of profit 10%

(iii) Capital Employed ₹3,00,000.

(iv) The profit included non-recurring profits on an average basis of ₹3,000p.a. You are required to calculate goodwill as per capitalisation of super profit method.

[Ans. ₹2,20,000]

21. A firm earns profit of ₹5,00,000. Normal Rate of return in a similar type of business is 10%. The value of total assets (excluding goodwill) and total outsiders liabilities as on the date are ₹55,00,000 and ₹14,00,000 respectively Calculate value of goodwill according to capitalisation of Super Profit Method as well as capitalisation of Average Profit Method.

[Ans. Value of Goodwill- ₹9,00,000 in both cases]

22. From the following information, calculate value of goodwill of the firm by applying Capitalisation Method :

Total Capital of the firm ₹16,00,000.

Reasonable rate of return 10%.

Profit for the year ₹2,00,000. [Ans. ₹4,00,000]

23. From the following particulars, calculate value of goodwill of a firm, by applying capitalisation of Average Profit Method :

(i) Profit of last five consecutive years ending 31st March are 2012-₹59,000; 2013-₹67,000; 2014-₹39,000; 2015-₹42,000 and 2016-₹54,000.

(ii) Capitalisation rate 20%.

(iii) Net assets of the firm ₹2,00,000. [Ans. ₹61,000]

24. A business has earned average profit of ₹4,00,000 during the last few years and the normal rate of return in similar business is 10%. Find the value of goodwill by :

(i) Capitalisation of super profit method, and

(ii) Super profit method, if the goodwill is valued at 3 years purchase of super profits.

Assets of the business were ₹40,00,000 and its external liabilities ₹7,20,000.

[Ans. (i) ₹7,20,000, (ii) ₹2,16,000]

●

CHAPTER - 7

RECONSTITUTION OF PARTNERSHIP FIRM

STRUCTURE

7.1 MEANING

Partnership is created by an agreement among the partners. The agreement may be changed if all the partners so like. Any change in the existing agreement of partnership, amounts to reconstitution of a firm. As a result, the old agreement comes to an end and a new one comes into existence. In other words, reconstitution of partnership means change in relationship among the partners.

7.2 CIRCUMSTANCES LEADING TO RECONSTITUTION

The various circumstances which lead to reconstitution of partnership, are discussed below :

(i) Change in the existing profit-sharing ratio :

When partners decide to change the existing profit-sharing ratio, reconstitution is said to take place. A change in such ratio usually occurs when a partner starts putting in more effort into the business, brings in additional capital, shoulder additional responsibilities, etc.

(ii) Admission of a new partner :

When a new partner is admitted into the partnership, reconstitution is said to take place. A new partner must have a share in the further profits of the business. It is bound to change the profit-sharing ratio of the existing old partners.

(iii) Retirement of a partner :

When a partner retires, he ceases to be a partner in the firm. In such a case, reconstitution is said to take place and the share of profit which was earlier taken by the retiring partner would be shared by the continuing partners in their old profit sharing ratio unless it is otherwise agreed upon by them.

(iv) Death of a partner :

When a partner dies, reconstitution is said to take place. For example, X, Y and Z are partners in a firm sharing profits and losses equally, i.e, 1/3rd each. Z dies on September 20, 2016 leaving behind X and Y who would now to share profits and losses in the ratio of 1:1, i.e., having equal profit sharing ratio unless it is otherwise agreed upon.

(v) Insolvency of a partner :

When a partner turns insolvent, that is, his assets are insufficient to meet his liabilities, reconstitution is said to take place. For example, X, Y and Z are in partnership sharing profit in the ratio of 1:2:3. X declares himself to be insolvent and can only repay 20 paise in a rupee. As a result of this, he now cases to be a partner which leads to reconstitution of the partnership firm.

(vi) Amalgamation of two Partnership Firms :

When two or more partnership firms amalgamate, reconstitution is said to take place. For example, a partnership firm consisting of X, Y and Z sharing profits and losses equally get merged with another partnership firm consisting of A and B sharing profits and losses in the ratio of 2:1.

Amalgamation is usually preferred for better availability of capital, increased marketing opportunities, decreased costs through economies of scale, streamlined administration, spreading of risks, more effective allocation of resources, lesser competition, etc.

In all of the above cases reconstitution takes place because respective shares of the partners get re-distributed and there occurs a change in profit sharing ratio.

7.3 CHANGE IN PROFIT-SHARING RATIO

Change in the profit sharing ratio among the existing partners means reconstitution of the firm without admission of a new partner or retirement or death of a partner. A change in the profit-sharing ratio in a partnership firm means, one (or more) partner(s) acquires share of profit in the business from another partner(s). Therefore, the aggregate amount of gain by one (or more) partner(s) is equal to the aggregate amount of sacrifice made by the other partner (s). In other words if share of profit of one or more partners increases, the share of profit of other partner(s) decreases.

A change in profit sharing ratio usually takes place due to change in capital contribution, more active participation of a partner(s) in management, looking after greater responsibilities by one or more partners and similar other reasons. Goodwill is the means of compensation by which the gaining partners provide to the sacrificing partners, with a proportionate amount in scenarios where reconstitution takes place through a change in profit-sharing ratio.

Various other adjustments also take place at the time of reconstitution of a firm through a change in profit sharing ratio which are as follows :

(i) Determination of sacrifice ratio and gaining ratio.

(ii) Accounting treatment of goodwill

(iii) Accounting treatment of reserve and accumulated profits or losses, and

(iv) Revaluation of assets and reassessment of liabilities.

Sacrificing ratio

Wherever there is a change in the profit-sharing ratio, one or more of the existing partners have to surrender some of their old share in favour of one or more other partners. The ratio of surrender of the share of profit is called sacrificing ratio. It is calculated as : Sacrificing Ratio = Old Share – New Share.

The sacrificing ratio determines the compensation that has to be paid through a proportionate amount of goodwill by the gaining partners to the sacrificing partners. The gaining partners are those that acquire a greater share in profits when the reconstitution occurs. Similarly, the sacrificing partners are those that lose a proportionate share of profits during reconstitution.

Gaining ratio

The ratio in which a gain in profit-sharing ratio is made is called the gaining ratio. In other words, gaining ratio is the proportion in which a partner receives an increased share of profits than his earlier share.

As a result of change in the 'profit sharing ratio', one or more of the existing partners gains/gain some portion of other partner's share of profit. The ratio of gain of profit-sharing ratio is called gaining ratio. It is calculated as :

Gaining Ratio = New share – Old share.

The objective of calculating gaining ratio is exactly the same as above mentioned for sacrificing ratio, that is, through this ratio it may be determined what proportion of amount has to be paid by the gaining partner/partners to the sacrificing partner/ partners under circumstances of change in profit-sharing ratio.

Illustration 1

A, B, and C were in partnership sharing profits and losses in the ratio 4:3:1. The partners agreed to share future profits in the ratio 5:4:3. Calculate each partner's gain or sacrifice due to change in ratio.

Solution :

Old ratio of A, B and C = 4:3:1 and New ratio of A, B and C = 5:4:3.

Sacrificing = Old share – New share.

$$\therefore \text{For } A = \frac{4}{8} - \frac{5}{12} = \frac{12-10}{24} = \frac{2}{24} \text{ (Sacrifice)}$$

$$B = \frac{3}{8} - \frac{4}{12} = \frac{9-8}{24} = \frac{1}{24} \text{ (Sacrifice)}$$

$$C = \frac{1}{8} - \frac{3}{12} = \frac{3-6}{24} = -\frac{3}{24} \text{ (Gain)}$$

A has sacrificed $\frac{2}{24}$, B has sacrificed $\frac{1}{24}$ and C has gained $\frac{3}{24}\left(\frac{2}{4}+\frac{1}{4}\right)$.

It is important to note that sacrifices of A and B is equal to the gain of C.

Illustration 2

X, Y, and Z were partners in a firm sharing profits and losses in the ratio of 3:2:1. The partners decide to share future profits and losses in the ratio of 2:2:1. Indicate each partner's gain or sacrifice due to change in ratio.

Solution :

Old ratio of X, Y and Z = 3:2:1

New ratio of X, Y and Z = 2:2:1

Sacrifice/ Gain = Old share – New share

$\therefore$ For $X = \frac{3}{6} - \frac{2}{5} = \frac{15-12}{30} = \frac{3}{30}$ (Sacrifice)

$Y = \frac{2}{6} - \frac{2}{5} = \frac{10-12}{30} = -\frac{2}{30}$ (Gain)

$Z = \frac{1}{6} - \frac{1}{5} = \frac{5-6}{30} = -\frac{1}{30}$ (Gain)

X has sacrificed $\frac{3}{30}$; Y has gained $\frac{2}{30}$ and Z has gained $\frac{1}{30}$.

($\because$ negative sacrifice=gain)

Illustration 3

A, B, C and D are partners in a firm sharing the profits and losses in the ratio of 5:4:3:1. They agreed to share the future profits of the firm in the ratio of 4:3:4:2

respectively. Find the sacrificing and gaining ratio of the partners. Also verify that sum of sacrifice is equal to sum of gain.

Solution :

Old Ratio A:B:C:D = 5:4:3:1

	A's share	B's share	C's share	D'Share
i.e.,	5/13	4/13	3/13	1/13
Share in New Ratio	4/13	3/13	4/13	2/13

$\therefore$ A's Sacrifice = $\frac{5}{13}-\frac{4}{13}=\frac{1}{13}$, B's Sacrifice = $\frac{4}{13}-\frac{3}{13}=\frac{1}{13}$

C's Gain = $\frac{4}{13}-\frac{3}{13}=\frac{1}{13}$,

D's Gain = $\frac{2}{13}-\frac{1}{13}=\frac{1}{13}$ ($\because$ Gain = New Ratio - Old Ratio)

Verification :

Total sacrificing ratio of A and B = $\frac{1}{13}+\frac{1}{13}=\frac{2}{13}$

and total gaining ratio of C and D = $\frac{1}{13}+\frac{1}{13}=\frac{2}{13}$

Hence, Sum of sacrifice = Sum of gain.

7.4 ACCOUNTING FOR REVALUATION OF ASSETS AND LIABILITIES

Assets are revalued and the liabilities are reassessed at the time of change in profit-sharing ratio and the profit of loss arising from it, is credited or debited to the Partner's Capital Accounts in their old profit-sharing ratio. The reason for revaluation of assets and reassessment of liabilities is that any increase or decrease in the value of assets and liabilities up to the date of change in profit-sharing ratio should be shared by the partners in their old profit-sharing ratio. For revaluation of assets and reassessment of liabilities, an account entitled 'Revaluation Account' or 'Profit and Loss Adjustment Account' is opened. Increase in value of assets and decrease in liabilities is credited to this account while decrease in the value of assets and increase in liabilities is debited. Unrecorded assets, if any, are credited and unrecorded liabilities are debited. The balance in the account is gain (profit), if total of credit side is larger than the total of debit side and loss, if total of debit side is larger than the total of credit side. Gain (profit) or loss on revaluation and reassessment is credited or debited to Partner's Capital Accounts in their old profit-sharing ratio.

Specimen of Revaluation Account is given below :

Revaluation Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Assets (Individually) (Decrease in value on revaluation)		By Assets (Individually) (Increase in value)	
To Liabilities (Individually) (Increase on reassessment)		By Liabilities - (Individually) (Decrease in reassessment)	
To Partner's Capital A/cs (Individually) (profit on revaluation)		By Partner's Capital A/cs. (Individually)–(Loss on revaluation)	

Important note : When Revaluation Account is prepared, assets and liabilities appear in the Balance Sheet of the reconstituted firm at their revised values.

Accounting Entries to Record the Revaluation of Assets and Reassessment of Liabilities

1. For increase in the value of an asset	Asset A/c(Individually) Dr. To Revaluation A/c
2. For decrease in the value of an asset	Revaluation A/c Dr. To Asset A/c (Individually)
3. For increase in the amount of a liability	Revaluation A/c Dr. To Liability A/c (Individually)
4. For decrease in the amount of a liability	Liability A/c (Individually) Dr. To Revaluation A/c
5. For recording an unrecorded asset	Unrecorded Asset A/c. Dr. To Revaluation A/c
6. For recording an unrecorded liability	Revaluation A/c. Dr. To Unrecorded Liability
7. For transfer of Balance in Revaluation Account (a) If credit side exceeds debit side (Net Gain) (b) If debit side exceeds credit side (Net Loss)	(a) Revaluation A/c Dr. To Partner's Capital A/cs (Individually in old profit-sharing ratio) (b) Partner's Capital A/cs. (Individually in old profit sharing ratio) To Revaluation A/c

Illustration 4

Pass Journal entries to record the following cases relating to revaluations :

(a) Machinery of ₹70,000 brought down by 15%.
(b) Value of Stock ₹50,000 appreciated by 10%.
(c) Furniture of ₹10,000 is brought down to ₹7,000.
(d) Stock of ₹35,000 is written down to ₹30,000.
(e) Building of ₹1,00,000 is written up to ₹1,30,000.
(f) Provision for doubtful debt @5% is created on Sundry Debtors of ₹40,000.
(g) Creditors were over-estimated by ₹6,000.
(h) Interest accrued on investment ₹2,000 is to be brought into account.
(i) A claim of ₹750 for damages should be created against the firm.
(j) An old typewriter having a book value of ₹2,500 is to be written off fully.

Solution :

Date	Particulars		LF	Dr. (₹)	Cr. (₹)
(a)	Revaluation A/c	Dr.		10,500	
	To Machinery A/c				10,500
	(Being machinery brought down by 15%)				
(b)	Stock A/c	Dr.		5,000	
	To Revaluation A/c				5,000
	(Being value of stock increased by ₹5,000)				
(c)	Revaluation A/c	Dr.		3,000	
	To Furniture A/c				3,000
	(Being value of furniture decreased by ₹3,000)				
(d)	Revaluation A/c	Dr.		5,000	
	To Stock A/c				5,000
	(Being value of stock decreased by ₹5,000)				
(e)	Building A/c	Dr.		30,000	
	To Revaluation A/c				30,000
	(Being value of Building increased)				
(f)	Revaluation A/c	Dr.		2,000	
	To Provision for doubtful debt A/c				2,000
	(Being provision for doubtful debts created)				
(g)	Creditors A/c	Dr.		6,000	
	To Revaluation A/c				6,000
	(Being creditors written down)				
(h)	Accrued Interest A/c	Dr.		2,000	
	To Revaluation A/c				2,000
	(Being interest accrued on investment brought into account)				
(i)	Revaluation A/c	Dr.		750	
	To Claim for damages A/c				750
	(Being a claim for damages provided for)				
(j)	Revaluation A/c	Dr.		2,500	
	To Typewriter A/c				2,500
	(Being old typewriter written off)				

Illustration 5

X, Y and Z are partners in a firm sharing profits and losses in the ratio of 3:3:2. Their Balance Sheet as at 31st March, 2016 was :

Liabilities		₹	Assets	₹
Sundry Creditors		24,000	Cash at Bank	27,000
General Reserve		36,000	Sundry Debtors	50,000
Capital A/cs :			Stock	1,20,000
X	2,00,000		Machinery	1,59,000
Y	2,00,000		Building	2,00,000
Z	1,00,000	5,00,000	Advertisement Expenditure	
			(Deferred Revenue)	4,000
		5,60,000		5,60,000

Partners decided that with effect from 1st April, 2016 they would share profits and losses in the ratio of 4:3:2. It was agreed that :

(i) Stock to be valued at ₹1,10,000.

(ii) Machinery is to be depreciated by 10%.

(iii) A provision for doubtful debts is to be made on Sundry Debtors @5%.

(iv) Building to be appreciated by 20%.

(v) A liability for ₹3,000 included in Sundry creditors is not likely to arise.

Partners agreed that revised values of assets and liabilities are to be recorded in the books. They decided to retain the General Reserve in the books. Give necessary accounting entries.

Solution :

Journal

Date	Particulars		LF	Dr. (₹)	Cr. (₹)
	Revaluation A/c	Dr.		28,400	
2016	To Stock A/c				10,000
April 1	To Machinery A/c				15,900
	To Provision for doubtful debts A/c				2,500
	(Being decrease in the value of assets and provision for doubtful debts)				
April 1	Building A/c	Dr.		40,000	
	Sundry Creditors A/c.	Dr.		3,000	
	To Revaluation A/c.				43,000
	(Being increase in the value of building and decrease in creditors)				
April 1	Revaluation A/c	Dr.		14,600	
	To X's Capital A/c				5,475
	To Y's Capital A/c				5,475
	To Z's Capital A/c				3,650
	(Being the transfer of profit on revaluation to the Capital Accounts of partners in old profit sharing ratio(WN-1)				
April 1	X's Capital A/c $\left(₹36,000 \times \frac{5}{72}\right)$	Dr.		2,500	
	To Y's Capital A/c $\left(₹\,36,000 \times \frac{3}{72}\right)$	Dr.			1,500
	To Z's Capital A/c $\left(₹\,36,000 \times \frac{2}{72}\right)$	Dr.			1,000
	(Being the adjustment of general reserve on change in profit-sharing ratio) (W.N.-2)				
April 1	X's Capital A/c	Dr		1,500	
	Y's Capital A/c	Dr		1,500	
	Z's Capital A/c	Dr		1,500	
	To Advertisement expendture A/c				4,000
	(Being transfer of advertisement expenditure to all partners in old profit-sharing ratio.)				

Working Notes :

1. Revaluation A/c

Particulars	₹	Particulars	₹
To Stock A/c	10,000	By Building A/c	40,000
To Machinery A/c	15,900	By Sundry Creditors A/c	3,000
To Provision for Doubtful Debt A/c	2,500		
To X's Capital A/c 5,475			
To Y's Capital A/c 5,475			
To Z's Capital A/c 3,650 (Profit on revaluation)	14,600		
	43,000		43,000

2. Calculation of Sacrifies /Gain in share of Partners :

	X	Y	Z
Old Ratios	3/8	3/8	2/8
New Ratios	4/9	3/9	2/9
Difference (Gain or Sacrifies)	–5/72	3/72	2/72
	Gaining Partner	Sacrificing Partner	Sacrificing Partner

Illustration 6

X, Y and Z are partners in a firm sharing profits and losses in the ratio of 8:5:3. Their Balance Sheet as at 31st December, 2016 was as follows :

Date	Particulars	₹	Date	Particulars	₹
	Sundry Creditors	30,000		Cash	12,000
	General Reserve	16,000		Bills Receivable	10,000
	Partners' Loan A/cs			Sundry Debtors	8,000
	X 8,000			Stock	24,000
	Y 6,000	14,000		Fixed Assets	56,000
	Partners' capital A/cs:				
	X 20,000				
	Y 16,000				
	Y 14,000	50,000			
		1,10,000			1,10,000

From 1st January, 2017, they agreed to alter their profit-sharing ratio as 5:6:5. It is also decided that :

(a) The fixed assets should be valued at ₹66,200.

(b) A provision of $7\frac{1}{2}$% on sundry debtors be made for doubtful debts.

(c) The stock be reduced to ₹22,400.

They have decided to make revaluation of assets and liabilities before bringing into force the new ratio.

Pass necessary journal entries, prepare Revaluation Account and calculate gain or sacrifice of partners.

Solution :

Journal

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
2017 Jan 1.	Fixed Assets A/c Dr. To Revaluation A/c (Being value of fixed assets increased)		10,200	10,200

	Revaluation A/c Dr.		2,200	
	To Provision for doubtful debt A/c			600
	To Stock A/c			1,600
	(Being value of liability increased and asset decreased)			
	Revaluation A/c Dr.		8,000	
	To X's Capital A/c			4,000
	To Y's Capital A/c			2,500
	To Z's Capital A/c			1,500
	(Being profit on revalutation transferred to partner's capital accounts in old profit sharing ratio.)			

Revaluation Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Provision for doutful debts A/c	600	By Fixed Assets	10,200
To Stock A/c	1,600		
To X's Capital A/c 4,000			
To Y's Capital A/c 2,500			
To Z's Capital A/c 1,500	8,000		
(Profit on revaluation)			
	10,200		10,200

Working Notes :

(i) Calculation of Gain or Sacrifice of partners :

	X	Y	Z
Old Share	8/16	5/16	3/16
New Share	5/16	6/16	5/16
Difference	3/16	-1/16	-2/16
Effect	(sacrifice)	(gain)	(gain)

When assets and liabilities are to appear in the books at the old values (Memorandum Revaluation Account)

The partners may decide that the value of assets and liabilities will continue to appear in the books at the existing value. In such a case, an increase or decrease in the amount of assets and liabilities is recorded in the Memorandum Revaluation Account. This account is divided into two parts. First part is similar to the Revaluation Account and in the second part, entries are reversed. The balance of the first part (i.e., profit or loss on revaluation) is transferred to the Capital Accounts of the old partners in thier old profit sharing ratio. The balance of the second part is transferred to all the partners, including the incoming partners, in the new profit-sharing ratio. The journal entries for the same are as follows:

(i) For increase in the value of assets and decrease in the value of liabilities :

Assets A/c (individually) Dr.
Liabilitis A/c (individually) Dr.
To Memorandum Revaluatin A/c

(ii) For decrease in the value of assets and increase in the account of liabilities:

Manorandum Revaluation A/c Dr.
To Assets A/c (individually)
To Liabilities A/c (individually)

(iii) For transferring the balance of the first part of Memorandum Revaluation Account :

(If credit side exceeds debit side, i.e., in case of profit):

Memorandum Revaluation A/c Dr.
To Old partners capital A/cs
(This entry is reversed if debit side exceeds credit side, i.e., in case of loss on revaluation)

(iv) For reversing the first entry, entry (i) :

Memorandum Revaluation A/c Dr.
To Assets (individually) A/c
To Liabilities (individually) A/c

(v) For reversing the second entry, i.e., entry (ii) :

Assets (individually) A/c Dr.

Liabilities (individually) A/c Dr.

To Memorandum Revaluation A/c

(vi) For transferring the balance of the second part of the Memorandum Revaluation Account (if debit side exceeds credit side)

All Partners' Capital A/c Dr.

To Memorandam Revaluation A/c

(This entry is reversed if credit side exceeds the debit side)

It should be kept in mind that if the first part of the Memorandum Revoluation Account results in profit, the second part will result in loss and vice versa.

It may be noted that value of assets and liabilities except the cash and capital accounts, will not change and they will continue to appear at old values in the Balance Sheet of the firm after the reconstitution.

Difference between the Revaluation Account and the Memorandum Revaluation Account :

Basic	**Revaluation Account**	**Memorandum Revoluation Account**
1. Purpose	It is prepared to record the effect of revaluation of assets and liabilities when the assets and liabilities are to appear at their revised figures.	It is prepared to record the effect of revaluation of assets and liabilities which are to appear at their old figures.
2. Parts	It is not divided into two parts.	It is divided into two parts, viz, the first part to record the changes in the value of assets and liabilities and the second part to nullify the changes recorded in the first part.

3.Transfer of Balance	The balance of the Revaluation Account is transferred to the old partners' capital accounts in the old profit-sharing ratio.	The balance of first part (profit or loss) of this account is transferred to the capital A/cs of the old partners in their old profit sharing ratio. The balance (Profit or loss) of the second part is transferred to the capital A/cs. of all the partners including the new partner in the new profit sharing ratio in case of the admission of a partner and continuing partner in the case of retirement of a partner.

7.5 DISTRIBUTION OF RESERVE AND ACCUMULATED PROFITS / LOSSES

If at the time of admission of a partner, a balance in reserve and accumulated profits/losses exists in the Balance Sheet, those are transferred to old partners' Capital Accounts (or Current Accounts in case of fixed capital) in their old profit-sharing ratio. Those are transferred to the old partners' Capital Accounts because those had been set aside out of profits in the earlier periods, i.e., before the new partner was admitted. As a rule, the new partner should not be put to advantage or disadvantage on this account. Thus, the journal entry will be :

Profit and loss A/c	Dr.	
General Reserve A/c	Dr.	
Workmen's Compensation Reserve A/c	Dr.	(excess of reserve over liability)
Investments Fluctuation Reserve A/c	Dr.	(excess of reserve over the difference between book value and market value) (in old ratio)
		to old partners' capital (or current) A/cs.

(Being the reserve and profits transferred to old partners in their old ratio)

The effect of this entry is that in the new Balance Sheet, balance of the General Reserve or the Profit and Loss Account (credit) will not appear. Similarly if Profit and Loss Account (debit balance) appears on the asset side of the Balance Sheet, it is transferred to the old partners' Capital Accounts in their old profit-sharing ratio by passing the following entry :

Old partners' capital (or current) A/cs Dr.

To Profit and Loss A/c

To Deferred Revenue Expenditure A/c *

(like Advertisement Expenditure)

(Being the accumulated losses transferred to old partners capital A/cs. in their old ratio).

* It is an accumulated loss which should be borne by the old partners only.

The loss will not appear in the new Balance Sheet.

Important Note

When the partners decide to record the net effect of accumulated profits, losses or reserves without affecting their old figures single adjustment entry through Capital Accounts or Current Accounts of gaining partners and sacrificing partners should be passed. In that situation, the Accumulated profits, Losses or Reserves shall appear in the Balance Sheet of new firm at their old figures.

For example, X and Y sharing profits in the ratio of 2:1 decide to share future profits in equal proportion. Suppose, reserves appearing in the Balance Sheet amount to ₹60,000 and partners do not want to distribute that. In such a case, in the old arrangement, X is entitled to ₹40,000 and Y to ₹20,000 of such reserve. But in future, after the change in the profit-sharing ratio, each partner would be entitled to ₹30,000 of such reserves. Hence, Y must compensate X to the extent of ₹10,000. This amount is proportionate to the 1/6th share gained by him. The following jounral entry will be passed :

Y's Capital A/c	Dr	10,000	
To X's Capital A/c			10,000

(Being proportionate share of reserves adjusted between existing partners)

When partners decide not to close the reserves and undistributed Profit and Loss Account:

(i) For accumulated profits

Gaining Partner's Capital A/c Dr. [with his respective share]
To Sacrificing Partner's Capital A/c

(ii) For accumulated losses :

Sacrificing Partner's Capital A/c Dr. [with his respective share]
To Gaining Partner's Capital A/c

Illustration 7

Amit and Sumit are two partners sharing profits and losses in the ratio of 3:2. On 31.03.2016 they had ₹80,000 in general reserve and ₹40,000 in profit and loss account.

They have decided to change the profit sharing ratio to 1:1 with effect from 1.4.2016. Pass adjusting entry if :

(i) They decide not to show the accumulated profits in the Balance Sheet.

(ii) They decide to show the accumulated profits in the Balance Sheet.

Solution :

(i) The accumulated profits are to be distributed among themselves in the old ratio if they do not want to show in the Balance Sheet. The journal entry will be;

General Reserve A/c	Dr.	80,000	
Profit and loss A/c	Dr.	40,000	
To Amit's Capital A/c			72,000
To Sumit's Capital A/c			48,000

(ii) If they want to show the accumulated profits in the Balance Sheet, the following adjustment entry will be passed :

Sumit's Capital A/c	Dr.	12,000	
To Amit's Capital A/c			12,000

(Being gaining partner's capital A/c debited and sacrificing partner’s capital A/c credited)

Working Note

	Amit	Sumit
Old share	$\frac{3}{5}$	$\frac{2}{5}$
New share	$\frac{1}{2}$	$\frac{1}{2}$
Difference	$\frac{1}{10}$	$-\frac{1}{10}$
Effect	(sacrifice)	(gain)

Adjusted amount $\frac{1}{10} \times 1,20,000 = 12,000$

Students are advised to transfer the accumulated profits/reserves or accumulated losses to old partners' capital account in old profit sharing ratio, even if the question is silent on this point.

Illustration 8

A, B and C are three partners sharing profit in the ratio of 5:3:2. They decided to change the ratio to 2:2:6. On that date, they had a debit balance of ₹18,000 in Profit and Loss Account and ₹6,000 in Deferred Revenue Expenditure Account.

(a) They decide not to show the accumulated losses in the books of accounts.

(b) They decide to show the same in the books of accounts.

Solution :

(a) The accumulated losses are to be divided among themselves in their old ratio. If they do not want to show that in the books of accounts, the journal entry will be:

A's Capital A/c	Dr.	12,000	
B's Capital A/c	Dr.	7,200	
C's Capital A/c	Dr.	4,800	
To Profit and Loss A/c			18,000
To Referred Revenue Expenditure A/c			6,000

(Being accumulated losses shared by old partners in their old profit securing ratio)

(b) If they want to show the accumulated losses, necessary adjustment shall be made through capital accounts. In such a case, journal entry will be :

A's Capital A/c	Dr.	7,200	
B's Capital A/c	Dr.	2,400	
To C's Capital A/c			9,600

Working Note

	A	B	C
Old Share	5/10	3/10	2/10
New Share	2/10	2/10	6/10
Difference	3/10	1/10	- 4/10
Effect	(sacrifice)	(Sacrifice)	(gain)

Adjusted amount $\left(\frac{3}{10}\times 24000\right)=7200$, $\left(\frac{1}{10}\times 24,000\right)=2,400$, $\left(\frac{4}{10}\times 24,000\right)=9,600$.

When both Accumulated Profits and Losses Exist

When the partners decide to record the net effect of accumulated profits, losses or reserves, without disturbing the old figures, the reserves/accumulated profits or losses continue to appear at the same amount in the Balance Sheet of the reconstituted firm. In such a situation, a single adjusting entry is passed involving the capital accounts of the gaining and sacrificing partners.

Illustration 9

P, Q and R were sharing profits and losses in the ratio of 5:3:2. They decided to share future profits and losses in the ratio of 2:3:5 with effect from 1.4.2016. They also decided to record the effect of the following, without affecting their book values:

(i) General Reserve ₹24,000 (ii) Profit and Loss Account (losses) ₹12,000.

Pass necessary adjusting journal entry.

Solution:

Step-I : Calculation of Amount to be adjusted.

General Reserve	₹24,000
Less : Profit and Loss (losses)	₹12,000
	₹12,000

Amount to be adjusted $12,000 \times \frac{3}{10} = 3,600$

Step-II : Calculation of sacrifice or gaining ratio :

Particulars	P	Q	R
Partners' Old Share	5/10	3/10	2/10
Partners' New Share	2/10	3/10	5/10
Difference	3/10	NIL	-3/10
Effect	Sacrifice	No effect	Gain

Step-III : Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2016 Apri-1	R's Capital A/c Dr. To P's Capital A/c (Being adjustment of profit on change in profit sharing ratio.)		3,600	3,600

7.6 QUESTIONS

1. From the alternatives given under each bit, write the correct answer along with its serial number against each bit :

(i) The profit on revaluation of assets and liabilities are shared by :

(a) Old partners in sacrificing ratio.

(b) Old partners in old profit sharing ratio.

(c) all partners including new partner in new ratio.

(d) Old partners equally.

(ii) When assets are revalued, any increase in the value of assets is debited to :

(a) Revaluation Account.

(b) Asset Account.

(c) Profit and loss Account.

(d) Profit and loss Appropriation Account.

(iii) X and Y sharing profits in the ratio of 3:2 admit Z as a partner with $\frac{1}{6}$ th share. The new profit and loss sharing ratio is :

(a) 2:2:2

(b) 4:3:2

(c) 5:3:2

(d) 3:2:1

(iv) A and B sharing profits in the ratio of 5:3 admit C and new profit sharing ratio of A,B and C is fixed at 4:2:2. The ratio of sacrifice of A and B is:

(a) 5:3

(b) 1:2

(c) 1:1

(d) 2:1

(v) Increase in liability amounts to :

(a) Gain to old partners.

(b) Loss to old partners.

(c) Neither gain nor loss,

(d) More gain and less loss.

(vi) An old Partner's Capital Account is debited, when there is :

(a) Credit balance in Profit and Loss A/c.

(b) Debit balance in Profit and Loss A/c.

(c) General Reserve.

(d) Workmen's compersation Fund.

(vii) When new partner acquires $\frac{1}{5}$th share from X, then X's sacrifice is:

(a) $\frac{2}{5}$

(b) $\frac{1}{5}$

(c) $\frac{2}{3}$

(d) $\frac{9}{10}$

(viii) When all the partners including the incoming partner decide not to change the value of assets and liabilities, then the account which is prepared is called :

(a) Revaluation Account

(b) Profit and Loss Adjustment Account

(c) Memorandum Revaluation Account

(d) Suspense Account.

(ix) Revaluation Account is a :

(a) Real Account

(b) Nominal Account.

(c) Personal Account.

(d) Statement.

(x) The purpose of Profit and Loss Adjustment account is :

(a) to find out gross profit.

(b) to find out net profit.

(c) to know the financial position.

(d) to find out results of revaluation of assets and liabilities.

[Ans.: (i) b (ii) b (iii) d (iv) c (v) b (vi) b (vii) b (viii) c (ix) b (x) d]

2. Answer the following questions in one word / term each :

(i) To which partner's capital Account, profit or loss on revaluation is not transferred ?

(ii) What would be the result by deducting new ratio from old ratio ?

(iii) On which side of Revaluation Account, unrecorded assets are recorded ?

(iv) On which side of Revaluation Account, unrecorded liabilities are recorded ?

(v) Name at least one item which is debited to partner's capital account, even if the question is silent about that item at the time of reconstitution of the firm.

[Ans.(i) New partner (ii) sacrificing ratio (iii) credit side (iv) Debit side (v) Debit balance of profit and loss A/c.]

3. Fill up the blanks:

(i) Profit on revaluation of assets and liabilities is credited to capital accounts of old partners in ______ ratio.

(ii) Appreciation in the value of investment is ______ to the Revaluation Account.

(iii) A partner whose share is increased due to change in profit sharing ratio, is called ______ partner.

(iv) Revaluation of assets becomes necessary because present value of assets may be ______ from their book value.

(v) If all the partners decide that the assets and liabilities in the new balance sheet should be shown at the old figure after reconstitution of the firm, then ______ revaluation account should be prepared.

[Ans. (i) Old (ii) credited (iii) gaining (iv) different (v) Memorandum]

4. Correct the underlined portions of the following sentences :

(i) Unrecorded assets are shown in the Revaluation Account as <u>decrease</u> in assets.

(ii) Loss on revaluation is <u>credited</u> to old partners' capital accounts in old ratio.

(iii) The excess of new ratio over old ratio is called <u>sacrificing</u> ratio.

(iv) If provision for bad and doubtful debt is created for a reconstituted firm, the revaluation account will be <u>credited</u>.

(v) In case of change in profit sharing ratio, the gaining partner's capital account is <u>credited</u> and losing partner's capital account <u>debited</u>.

[Ans.: (i) increase (ii) debited (iii) gaining (iv) debited (v) debited and credited]

5. Answer each of the following questions in one sentence :

(i) What is reconstitution of firm ?

(ii) What is meant by revaluation of assets ?

(iii) State the ratio in which old partners share the accumulated profits or losses or reserves.

(iv) Why is 'Memorandum Revaluation Account' prepared ?

(v) What is the nature of Revaluation Account ?

(vi) On which side of Revaluation Account, unrecorded assets are recorded ?

(vii) State whether Revaluation Account is debited or credited to record the increase in the value of Building.

(viii) State whether revaluation Account is debited or credited to record the amount recovered that was earlier written off as bad debt.

(ix) State whether the partner's Capital Account is debited or credited to record the profit of revaluation account.

(x) When the General Reserve is distributed, is the partner's Capital Account debited or credited ?

6. Answer the following questions within 30 words each;

(i) What is reconstitution of partnership ?

(ii) Define Revaluation Account.

(iii) Define sacrificing ratio.

(iv) What should be the profit-sharing ratio of partners if there is no mention about it in the agreement ?

(v) What is gaining ratio and who is gaining partner ?

(vi) List any three features of Revaluation Account.

(vii) What is the necessity of revaluation of assets and reassessment of liabilities at the time of change in profit sharing ratio among the existing partners.

(viii) Give a specimen of Revaluation Account.

7. Answer the following questions within 50 words each:

   (i) Distinguish between 'Revaluation Account' and Memorandum Revaluation Account.

   (ii) Distinguish between gaining partner and sacrificing partner.

   (iii) What is Revaluation Account ? Draw Revaluation Account with imaginary items.

   (iv) What is meant by revaluation of assets and reassessment of liabilities on the reconstitution of a firm ? What purpose does it serve at the time of reconstitution of partnership ?

8. What is a ‘Revaluation Account’ ? How does it differ from a ‘Memorandum Revaluation Account’ ?

9. Explain the need for and calculation of different ratios to be calculated at the time of reconstitution of a partnership firm.

10. List the various issues that need to be taken care of when there is a change in profit sharing ratio among the existing partners. Explain any one issue with example.

11. Pass necessary journal entries relating to revaluation of assets and liabilities on the reconstitution of a firm.

12. X, Y and Z are partners sharing profits and losses in the ratio of 2:2:1. Now they decide to change the ratio to 3:2:1. Calculate gaining or sacrificing ratio of each partner.

    [Ans.: A's gain 3/30, B's sacrifice 2/30 and C's sacrifice 1/30]

13. Amit, Sumit and Ranjeet are partners sharing profits in the ratio of 5:3:2. They decided to share future profits and losses in the ratio of 2:3:5 rerpctively. You are required to calculate the sacrifice and gaining ratio of each partner.

    [Ans.: Amit sacrifices $\frac{3}{10}$ and Sumit gains $\frac{3}{10}$]

14. X, Y and Z are partners sharing profits in the ratio of 3:2:1. X gave away $\frac{1}{5}$ to Y and Y gave away $\frac{1}{10}$ to Z. Find the new ratio, gaining and sacrificing ratio.

    [Ans.: New Ratio : 9:13:8, X′s sacrifice $\frac{6}{30}$, Y's gain $\frac{3}{30}$, Z's gain $\frac{3}{30}$]

15. A, B and C share the profits of a firm in the ratio of 5:3:2. Now decided to share the profits equally. Find the sacrifice and gain of each partner.

    [Ans.: A's sacrifice $\frac{5}{30}$, B's gain $\frac{1}{30}$, C's is gain $\frac{4}{30}$]

16. A and B are sharing profits and losses equally. With effect from 1st April, 2016, they agree to share profits in the ratio of 4:3. Calculate individual partner's gain or sacrifice due to the change in ratio.

    [Ans. A gains and B sacrifices $\frac{1}{14}$th share]

17. X, Y and Z are sharing profits and losses in the ratio of 5:3:2. With effect from 1st April 2016, they decide to share future profits and losses in the ratio of 5:2:3. Calculate each partner's gain or sacrifice due to change in ratio.

    [Ans.: Z's gain $\frac{1}{10}$th share and Y's sacrifice $\frac{1}{10}$th share.]

18. Anita and Binita are partners in a firm. They have ₹60,000 in Profit and Loss A/c and ₹80,000 in general reserve on 1st April 2016. On this day, they decided to change their profit sharing ratio from 3:2 to 1:1. They also decided to distribute profits and reserves before bringing the new profit sharing ratio into force. Pass the necessary adjustment entry.

    [Ans.: Anita's Capital A/c Cr. ₹84,000 and Binita's Capital A/c Cr. ₹56,000]

19. A and B are Partners in a firm sharing profits in the ratio of 3:2. They decided to share future profits equally. On the date of change in the profit sharing ratio, Profit and Loss Account showed a debit balance of ₹60,000. Pass Journal entry for distribution of balance in Profit and loss Account immediately before change in the profit sharing ratio.

    [Ans.: Debit A's capital A/c ₹36,000 and B's capital A/c ₹24,000 and credit profit and loss A/c 60,000]

20. X and Y are partners in a firm sharing profits and losses in the ratio of 3:2. With effect from 1st April, 2016, they decided to share future profits equally. On the date of change in the profit sharing ratio, the Profits and loss Account showed a credit balance of ₹1,50,000. Record the necessary journal entry for the distribution of the balance in the Profit and Loss Account immediately before the change in the profit sharing ratio.

    [Ans.: Dr. Profit and Loss A/c by- ₹1,50,000; Cr. X's Capital A/c by ₹90,000 and Y's Capital A/c by ₹60,000]

21. A, B and C are sharing profits and losses in the ratio of 5:3:2. They decide to share future profits and losses in the ratio of 2:3:5 with effect from 1.4.2016. They also decide to record the effect of the following accumulated profits, losses and reserves without affecting their book figures by passing a single entry:

	Book Figure (₹)
General Reserve	6,000
Profit and loss A/c (credit)	24,000
Advertisement Suspense A/c	12,000

    [Ans.: Debit C and credit A by ₹5,400]

22. X and Y are partners sharing profits and losses in the ratio of 2:1. On 31st March, 2016, their Balance Sheet showed General Reserve of ₹60,000. It was decided that in future they will share profits and losses in the ratio of 3:2. Pass necessary journal entry in each of the following alternative cases:

(i) If they do not want to show General Reserve in the new Balance Sheet.

(ii) If they want to show General Reserve in the new Balance sheet.

[Ans.: (i) Dr. General Reserve A/c by ₹60,000; credit X's capital A/c by ₹40,000 and Y's capital A/c by ₹20,000.

(ii) X's sacrifice=$\frac{1}{15}$; Y's gain $\frac{1}{15}$, Debit Y's Capital A/c by ₹4,000 and credit X's Capital A/c by ₹4000)

23. X, Y and Z who presently sharing profits and losses in the ratio of 5:3:2 decide to share future profits and losses in the ratio of 2:3:5. Give the journal entry to distribute workmen's compensation reserve of ₹1,20,000 at the time of change in profit sharing ratio, when there is no claim against it.

[Ans: Debit Workmen's is Compensation Reserve A/c ₹1,20,000; Credit X's Capital A/c ₹60,000; Y's Capital A/c ₹36,000 and Z's Capital A/c-₹24,000]

24. A, B and C are partners sharing profits and losses in the ratio of 2:1:1. They decided that with effect from 1st April, 2016, A shall receive $\frac{1}{4}$th share in the profits.

On March 31, 2016, their Balance Sheet stood as follows :

Liabilities		₹	Assets	₹
Creditors		20,000	Cash	10,000
Capital A/cs :			Debtors	35,000
A	50,000		Stock	15,000
B	25,000		Land	60,000
C	25,000			
		1,00,000		
		1,20,000		1,20,000

On this date, land was valued at ₹75,000; stock at ₹30,000 and a provision of ₹2,000 on debtors is to be created.

Pass necessary journal entries in the books of the firm regarding the revaluation of assets and prepare Revaluation Account.

[Ans.: Profit on Revaluation ₹28,000]

25. A, B and C are sharing profits and losses in the ratio of 5:3:2. They decided to share future profit and losses in the ratio of 2:3:5 with effect from 1st April, 2016. They also decide to record the effect of the following revaluation without changing the book value of the assets and liabilities :

Particulars	₹	₹
Land and Building	10,00,000	11,00,000
Plant and Machinery	5,00,000	4,80,000
Trade Creditors	1,20,000	1,10,000
Outstanding expenses	1,20,000	1,50,000

Show the accounting treatment to give effect to the new arrangement.

[Ans.: Debit C's Capital A/c by ₹18,000 and credit A's Capital A/c by ₹18,000.]

26. P, Q and R are partners sharing profits and losses in the ratio of 7:5:4. Their Balance Sheet as at 31st March, 2016 stood as :

Liabilities		₹	Assets	₹
Capital A/cs :			Sundry Assets	7,00,000
P	2,10,000			
Q	1,50,000			
R	1,20,000	4,80,000		
General Reserve		65,000		
Profit and loss A/c		25,000		
Creditors		1,30,000		
		7,00,000		7,00,000

Partners decided that with effect from 1st April, 2016, they will share profit and losses in the ratio of 3:2:1. For this purpose, goodwill of the firm was valued at

₹1,50,000. The partners neither want to record the goodwill nor want to distribute the General Reserve or profits.

Pass a journal entry to record the change and prepare revised Balance Sheet.

[Ans.: Debit P's Capital A/c by ₹15,000; Q's Capital A.c by ₹5,000; credit Z's capital A/c by ₹20,000 and Total Balance Sheet - ₹7,00,000]

27. X,Y and Z are partners in a firm sharing profits and losses in the ratio of 5:4:3 respectively. Their Balance Sheet as at 31st March, 2016 was :

Liabilities		₹	Assets	₹
Sundry Creditors		40,000	Cash at Bank	40,000
outstanding Expenses		15,000	SundryDebtors	2,10,000
General Reserve		75,000	Stock	3,00,000
Capital A/cs :		1,30,000	Furniture	60,000
X	4,00,000		Plant and Machinery	4,20,000
Y	3,00,000			
Z	2,00,000	9,00,000		
		10,30,000		1,030,000

From 1st April, 2016, they agree to alter their profit sharing ratio as 4:3:2. It is also decided that :

(a) Furniture be taken at 80% of its value.

(b) Stock be appreciated by 20%.

(c) Plant and Machinery be valued at ₹4,00,000.

(d) Outstanding expenses be increased by ₹13,000.

Partners agreed that altered values are not to be recorded in the books and they also donot want to distribute General Reserve.

You are required to pass a single journal entry to give effect to the above. Also, prepare revised Balance Sheet.

[Ans.: Profit on Revaluation-₹15,000, Adjustment for Revaluation and General Reserve: Debit X's Capital A/c and credit Z' Capital A/c by ₹2,500 and Balance Sheet Total-₹10,50,000]

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CHAPTER-8

ADMISSION OF A PARTNER

STRUCTURE

8.1 MEANING OF ADMISSION OF A PARTNER

Admission of a partner is one of the modes of reconstituting the firm under which old partnership comes to an end and a new one (among all partners including incoming partner) comes into existence. Capital contribution by the new partner, his share of profits and other conditions are agreed upon. The new partner, on joining, becomes liable for the liabilities of the firm and is entitled to assets and profits of the firm. According to section 31 of the Indian Partnership Act, 1932, a person can be admitted as a new partner only with the consent of all the existing partners, unless otherwise agreed upon.

8.2 RIGHTS OF A NEW PARTNER

After admission, the new partner gets the following two main rights :

(i) Rights to share future profits of the firm and

(ii) Right to share in the assets of the firm

At the same time, he becomes liable for any liability of the business incurred after admission and any loss incurred by the firm.

The new or incoming partner receives share in future profits that is equal to the sacrifice of profit by an existing partner or partners of the firm. The new partner compensates the partner or partners who sacrifice their share in profits in his or her favour. The amount he pays for their sacrifice is called Goodwill or Premium for Goodwill.

Besides the goodwill or premium for goodwill, new partner may bring in capital to get right in the assets of the firm.

8.3 EFFECTS OF ADMISSION OF A PARTNER

The effects of admission of a new partner are :

(i) Old partnership comes to an end and new partnership comes into existence but the firm continues.

(ii) New partner becomes entitled to share future profits of the firm and the combined share of the old partners get reduced.

(iii) New partner contributes an agreed amount of capital.

(iv) New partner acquires right on the assets and also becomes liable for the liabilities of the firm.

(v) Adjustment is made in regard to accumulated profits or losses which are credited or debited to the old partners capital accounts respectively.

(vi) Assets are revalued and liabilities are reassessed. The net change is adjusted in old partners' capital accounts in their old profit sharing ratio, by opening one Profit and Loss Adjustment Account or Revaluation Account.

(vii) Goodwill of the firm is valued to be paid to sacrificing partners for their sacrified share, by the new partner.

8.4 ADJUSTMENTS REQUIRED ON THE ADMISSION OF A PARTNER

The adjustments required on admission of a partner are :

(i) Determining new profit-sharing ratio.

(ii) Valuation and adjustment of Goodwill

(iii) Adjustment of profit/loss arising from revaluation of assets and reassessment of liabilities.

(iv) Adjustment of accumulated profits, reserves and losses.

(v) Adjustment of capital (if agreed).

8.4.1 New Profit-Sharing Ratio

New partner is entitled to share future profits of the firm. In effect, there is a change in the old profit-sharing ratio. Since, new partner acquires his share from old partners, it is necessary to determine new profit-sharing ratio and also sacrificing ratio.

New profit sharing ratio is the ratio in which all partners, including new partner, share future profits and losses of the firm.

New partner may acquire his share from old partners through any of the following alternatives :

(1) In their old profit-sharing ratio; or

(2) In a particular ratio or surrendered ratio; or

(3) In a particular fraction from some or all of the partners.

Let us now discuss each of the above cases in detail.

Case 1 : **When new partner acquires his share from old partners in their old profit-sharing ratio**

In such a situation, share of the new partner is given and it is assumed that the new partner has acquired his share from old partners in their old profit sharing ratio.

Old partners, therefore, continue to share balance profits or losses in their old profit-sharing ratio. In other wards, unless otherwise agreed, profit-sharing ratio among the existing partners remains unchanged. New profit-sharing ratio among all the partners is ascertained by deducting new partner's share from 1 and then dividing the balance in old profit-sharing ratio of the old partners.

Illustration 1 (new partner's share is given)

X and Y are partners sharing profits in the ratio of 5:3. Z is admitted for 1/4th share in the profits.

Calculate new profit-sharing ratio of the partners.

Solution :

Calculation of new profit sharing ratio :

Old ratio of X and Y=5:3 or $\frac{5}{8}$ and $\frac{3}{8}$

Let the total share be 1; Z's share = $\frac{1}{4}$

$\therefore$ Remaining share of X and Y = $1-\frac{1}{4}=\frac{3}{4}$

X's new share = $\frac{3}{4}\times\frac{5}{8}=\frac{15}{32}$,

Y's new share = $\frac{3}{4}\times\frac{3}{8}=\frac{9}{32}$ and Z's share $\frac{1}{4}$ or $\frac{8}{32}$.

Hence, new profit-sharing ratio of X, Y and Z

$$=\frac{15}{32}:\frac{9}{32}:\frac{8}{32} \text{ or } 15:9:8.$$

Since only share of Z is given, it is assumed that Z has acquired his share from X and Y in their old profit-sharing ratio.

Illustration 2

P, Q and R were partners in a firm sharing profits and losses in 3:2:1 ratio. They admitted S for 10% profits. Calculate new profit-sharing ratio.

Solution :

S's share = 10% or $\frac{10}{100}$ or $\frac{1}{10}$, remaining share = $1-\frac{1}{10}=\frac{9}{10}$.

P's new share = $\frac{9}{10}\times\frac{3}{6}=\frac{27}{60}$

Q's new share = $\frac{9}{10}\times\frac{2}{6}=\frac{18}{60}$

R's new share = $\frac{9}{10}\times\frac{1}{6}=\frac{9}{60}$

$\therefore$ New profit sharing ratio of P,Q,R and S

$$=\frac{27}{60}:\frac{18}{60}:\frac{9}{60}:\frac{1}{10} \text{ or } \frac{6}{60} = 27:18:9:6 \text{ or } 9:6:3:2.$$

Case 2 :

When share of new partner and new ratio of old partners are given

In this situation, new partner's share is deducted from I and balance is divided among old partners in their new ratio. This gives new profit-sharing ratio of all the partners of the new firm.

Illustration 3

X and Y are partners. They admit Z for $\frac{1}{4}$ th share. In future, profit sharing ratio between X and Y would be 2:1. Calculate new profit-sharing ratio.

Solution :

Let the total share be = 1. Share of new partner Z is $\frac{1}{4}$.

Remaining share = $1-\frac{1}{4}=\frac{3}{4}$.

Existing partners' share being calculated by dividing remaining share in their future profit-sharing ratio (i.e., 2:1) as under :

X's new share = $\frac{2}{3}\times\frac{3}{4}=\frac{6}{12}$

Y's new share = $\frac{1}{3}\times\frac{3}{4}=\frac{3}{12}$

$\therefore$ New profit-sharing ratio of X, Y and Z = $\frac{6}{12}:\frac{3}{12}:\frac{1}{4}$ or $\frac{3}{12}$ =6:3:3 or 2:1:1.

Case 3 When new partner acquires his share from old partners in a particular ratio

New partner may acquire a part of share of profits from one partner and part of share of profits from another partner. In such a case, existing partners' profit-sharing ratio will change to the extent of share sacrificed on admission of the new partner. Existing partners' share of profits in the reconstituted firm is determined by deducting the sacrifice made from the existing share of profits.

Illustration 4

X and Y are in partnership sharing profits and losses in the ratio of 5:3. Z is admitted as a partner for $\frac{1}{5}$ th share for which he takes $\frac{1}{10}$ th from X and $\frac{1}{10}$ th from Y.

Calculate the new profit-sharing ratio of the partners.

Solution :

Calculation of future profit sharing ratio :

Old profit-sharing ratio of X and Y = 5:3

Z acquires his share $\frac{1}{10}$ th from X and $\frac{1}{10}$ th from Y.

X's share after sacrifice = $\frac{5}{8}-\frac{1}{10}=\frac{25-4}{40}=\frac{21}{40}$

Y's share after sacrifice = $\frac{3}{8}-\frac{1}{10}=\frac{15-4}{40}=\frac{11}{40}$

$\therefore$ The new profit-sharing ratio of X, Y and Z = $\frac{21}{40}:\frac{11}{40}:\frac{1}{5}$ or $\frac{8}{40}$ = 21:11:8

Illustration 5

M and N are partners sharing profits in the ratio of 5:4. They admit O for $\frac{1}{10}$ th share of profits which he acquires, in equal proportions from both. Find out the new profit-sharing ratio.

Solution :

O's share of profit in the firm is $\frac{1}{10}$, which he acquires from M and N in equal proportions.

It means, M has surrendered $\frac{1}{2}$ of $\frac{1}{10}=\frac{1}{20}$

N has surrendered $\frac{1}{2}$ of $\frac{1}{10}=\frac{1}{20}$

$\therefore$ M's share of profit in the new firm

$=\frac{5}{9}-\frac{1}{20}=\frac{100-9}{180}=\frac{91}{180}$

N's share of profit in the new firm

$$= \frac{4}{9} - \frac{1}{20} = \frac{80-9}{180} = \frac{71}{180}$$

O's share of profit in the new firm = $\frac{1}{10}$ or $\frac{18}{180}$

Hence, new profit-sharing ratio of M, N and O

$$= \frac{91}{180} : \frac{71}{180} : \frac{18}{180} = 91:71:18.$$

Case-4 When new partner acquires his share by surrender of a particular fraction of their share by the old or existing partners

In this case, shares surrendered by the old partners in favour of new partner are added up in order to arrive at the share of new partner. The share surrendered by old partners is deducted from their respective shares to determine old partners share in the reconstituted firm.

Illustration 6

P and Q were partners in a firm sharing profits and losses in the ratio of 3:2. P surrendered $\frac{1}{5}$ th of his share, and Q surrendered $\frac{2}{5}$ th of his share in favour of R, the new partner. Calculate the new profit-sharing ratio.

Solution :

P's share = $\frac{3}{5}$, P surrendered in favour of R = $\frac{3}{5} \times \frac{1}{5} = \frac{3}{25}$

So P's new share $= \frac{3}{5} - \frac{3}{25} = \frac{15-3}{25} = \frac{12}{25}$

Q's share $= \frac{2}{5}$, Q surendered in favour of R = $\frac{2}{5} \times \frac{2}{5} = \frac{4}{25}$

So Q's new share $= \frac{2}{5} - \frac{4}{25} = \frac{10-4}{25} = \frac{6}{25}$

R's share is the sum total of shares surrendered by P and Q $= \frac{3}{25} + \frac{4}{25} = \frac{7}{25}$

Now the new profit-sharing ratio of P,Q and R $= \frac{12}{25} : \frac{6}{25} : \frac{7}{25}$ or 12:6:7

Illustration 7

A and B share profits in the ratio of 5:4. They admit C as a partner. A surrenders $\frac{1}{6}$th of his share and B, $\frac{1}{3}$rd of his share in favour of C. Calculate new profit-sharing ratio.

Solution :

A's share was $\frac{5}{9}$. $\frac{1}{6}$th of A's share $= \frac{5}{9} \times \frac{1}{6} = \frac{5}{54}$

$\therefore$ A's new share was $= \frac{5}{9} - \frac{5}{54} = \frac{30-5}{54} = \frac{25}{54}$

B's old share was $\frac{4}{9}$. $\frac{1}{3}$rd of B's share $= \frac{4}{9} \times \frac{1}{3} = \frac{4}{27}$

$\therefore$ B's new share $= \frac{4}{9} - \frac{4}{27} = \frac{12-4}{27} = \frac{8}{27}$

Hence, C's share will be (sum of) $\frac{5}{54} + \frac{4}{27} = \frac{5+8}{54} = \frac{13}{54}$

Therefore, New ratio of A, B and C will be :

$\frac{25}{54} : \frac{8}{27}$ or $\frac{16}{54} : \frac{13}{54}$ or 25:16:13

Case 5

When new partner's share contributed solely by only one existing partner

Illustration 8

X and Y are partners sharing profits and losses in the ratio of 3:2. They admit Z as a new partner who gets $\frac{1}{5}$th of profit, entirely from X. Calculate new profit-sharing ratio.

Solution :

X's original share = $\frac{3}{5}$

X's sacrifice in favour Z = $\frac{1}{5}$

$\therefore$ X's new share = old share - share sacrificed

$$= \frac{3}{5} - \frac{1}{5} = \frac{2}{5}$$

Hence, new profit sharing ratio of X, Y and Z will be $\frac{2}{5}:\frac{2}{5}:\frac{1}{5}$ or 2:2:1.

Illustration 9

Ajay and Bijay are partners sharing profits in the ratio of 5:3. Chita is admitted for $\frac{3}{10}$ th share, half of which was gifted by Ajay and the remaining share was taken by Chita equally from Ajay and Bijay. Calculate new profit-sharing ratio.

Solution :

	Ajay	Bijay
(i) Their old share	$\frac{5}{8}$	$\frac{3}{8}$
(ii) Share gifted by Ajay	$\frac{3}{10} \times \frac{1}{2} = \frac{3}{20}$	--
(iii) Share acquired by Chita	$\frac{3}{20} \times \frac{1}{2} = \frac{3}{40}$	$\frac{3}{20} \times \frac{1}{2} = \frac{3}{40}$

New share of Ajay = old share - share gifted – share acquired by Chita

$$= \frac{5}{8} - \frac{3}{20} - \frac{3}{40} = \frac{25 - 6 - 3}{40} = \frac{16}{40}$$

New share of Bijay $= \frac{3}{8} - \frac{3}{40} = \frac{15 - 3}{40} = \frac{12}{40}$

New profit-sharing ratio of Ajay, Bijay and Chita $= \frac{16}{40} : \frac{12}{40} : \frac{3}{10}$ or $\frac{12}{40}$

or $= \frac{16}{40} : \frac{12}{40} : \frac{12}{40} = 4:3:3$

8.4.2 Accounting treatment of Goodwill

Accounting Standard-26 (AS-26) on 'Intangible Assets' prescribes that goodwill should be recorded in the books only when consideration in money or money's worth has been paid for it, i.e., goodwill is purchased. Thus, in case of admission or retirement/death of a partner or in case of change in the profit sharing ratio among partners, goodwill should not be raised in the books of the firm because no consideration in money or money's worth is paid for it. If any partner brings any premium over and above his capital contribution at the time of his admission, such premium should be distributed among the existing partners in their sacrificing ratio.

If goodwill is evaluated at the time of change in the constitution of the firm (by way of admission/retirement/death/change in profit-sharing ratio), goodwill should not be brought into books as it is inherent goodwill. The value of goodwill should be adjusted through partners' capital accounts.

As you know, Goodwill is an intangible asset which enables a firm to earn profit over and above the normal profit (i.e., super profit) earned by other firms in the industry. It arises due to efforts made by the old partners in the past. Therefore, at the time of admission, new partner who acquires the share in future profits from the old or existing partners, should compensate sacrificing partners by paying them an amount, termed as goodwill or premium for goodwill.

So, goodwill is a way for compensating the old partners for the sacrifice they make in favour of new partner. From the accounting point of view, there may be different situations related to treatment of goodwill and these are :

(i) Goodwill paid privately : When goodwill or premium for goodwill is paid privately (i.e., outside the business) by the new partner to the old partners, it is not recorded in the books of account of the firm and hence, no entry is passed.

(ii) Goodwill/Premium for Goodwill brought in cash by the new partner and retained in the business :

Under this situation, cash brought in by the new partner for his share of goodwill is credited to goodwill account and then the same amount is credited to old partners' capital accounts in their sacrificing ratio, debiting the goodwill account. The process is illustrated by means of the following journal entries :

1) When new partner brings his share of capital and goodwill in cash.

Cash A/c	Dr.	(with share of capital brought in)
To New Partner's Captial A/c		
To Goodwill A/c		

2) The amount of goodwill is credited to the old partners' capital accouts in sacrificing ratio.

Goodwill A/c	Dr.
To old partners' capital A/c (individually)	

Illustration 10

P and Q share profits in the ratio of 5:3. They admit R with $\frac{1}{5}$th of share in the future profits. R is required to pay ₹50,000 as capital and his share of goodwill in cash. The Goodwill of the firm is valued at ₹80,000. Record the above transactions in the books of the firm.

Solution :

Profit sharing ratio of Pand Q = 5:3 = $\frac{5}{8}:\frac{3}{8}$

R's share in the profit = $\frac{1}{5}$

$\therefore$ Remaining share = $1-\frac{1}{5}=\frac{4}{5}$

P's share = $\frac{4}{5} \times \frac{5}{8} = \frac{20}{40}$

Q's share = $\frac{4}{5} \times \frac{3}{8} = \frac{12}{40}$

Hence, profit-sharing ratio of P,Q and R

$= \frac{20}{40} : \frac{12}{40} : \frac{1}{5} = \frac{20}{40} : \frac{12}{40} : \frac{8}{40}$ or $\frac{5}{10} : \frac{3}{10} : \frac{2}{10}$

Therefore, their new profit sharing ratio

= 20:12:8 or 5:3:2

Sacrificing ratio = old ratio - new ratio

$\therefore$ P's Sacrifice $= \frac{5}{8} - \frac{5}{10} = \frac{25-20}{40} = \frac{5}{40}$

Q's sacrifice $= \frac{3}{8} - \frac{3}{10} = \frac{15-12}{40} = \frac{3}{40}$

So, sacrificing ratio of P and Q = 5:3

Total goodwill of the firm = ₹80,000

R's share of goodwill, for $\frac{1}{5}$th of profit = ₹80,000 × $\frac{1}{5}$ = ₹16,000

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Cash A/c Dr.		66,000	
	To R's Capital A/c			50,000
	To Goodwill A/c			16,000
	(Being the amount brought in by R towards his Capital and Goodwill)			
	Goodwill A/c Dr.		16,000	
	To P's Capital A/c			10,000
	To Q's Capital A/c			6,000
	(Being the amount of goodwill credited to the old partners' Capital Accounts in their sacrificing ratio)			

(iii) When the new partner brings his share of goodwill in cash which is withdrawn by the old partners either partly or fully :

In this situation, the cash paid by the new partner towards goodwill, is credited to the goodwill account and subsequently the amount in credited to the old partners' capital accounts in their sacrificing ratio debiting goodwill account. At the time of withdrawal of the same amount by the old partners, their capital accounts are debited with their individual share of withdrawal and the cash/bank account is credited.

The following journal entries need to be passed :

1. For cash paid by the new partner towards his share of goodwill.

   Cash A/c Dr.

   To Goodwill A/c

   (Being cash received from new partner towards goodwill)

2. Old partner's capital accounts are credited in their sacrificing ratio debiting goodwill A/c.

   Goodwill A/c Dr.

   To Old Partner's Capital A/cs (individually)

   (Being the goodwill credited to the old partners capital accounts in their sacrificing ratio)

3. Amount is withdrawn from the business by the old partners.

   Old Partners' Capital A/cs Dr. (Individually)

   To Cash

   (Being the amount withdrawn from business)

Illustration 11

A and B share profits of a firm in the ratio of 2:1. They admit C with $\frac{1}{4}$th share in the profit with the understanding that C will pay ₹68,000 in cash towards his share of capital and goodwill. The total goodwill of the firm is valued at ₹72,000. Pass journal enties in the books of the firm if :

(a) A and B withdraw their share of goodwill from the business fully.

(b) A and B withdraw 25% of the amount of goodwill brought in by the new partner.

Solution :

Profit-sharing ratio of A and B = 2:1. C is admitted for $\frac{1}{4}$ th share in the profits, hence, remaining share = $1-\frac{1}{4}=\frac{3}{4}$. This is to be shared by A and B in their profit sharing ratio.

$\therefore$ A's new share = $\frac{3}{4}\times\frac{2}{3}=\frac{2}{4}$

B's new share $=\frac{3}{4}\times\frac{1}{3}=\frac{1}{4}$

C's share $=\frac{1}{4}$

Hence, new profit-sharing ratio of all partners $=\frac{2}{4}:\frac{1}{4}:\frac{1}{4}$ or 2:1:1

Again sacrificing ratio of A and B = 2:1 (same as old ratio)

Total value of goodwill = ₹72,000

C's share for $\frac{1}{4}$ th profit = ₹72,000$\times\frac{1}{4}$=₹18,000.

C pays ₹68,000 for capital and goodwill. Therefore, his capital contribution would be ₹68,000 - ₹18,000 = ₹50,000.

JOURNAL

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Cash A/c Dr.		68,000	
	To C's Capital A/c			50,000
	To Goodwill A/c			18,000
	(Being the amount brought in by C towards his Capital and Goodwill)			

	Goodwill A/c Dr.		18,000	
	To A's Capital A/c			12,000
	To B's Capital A/c			6,000
	(Being the amount of goodwill credited to the old partners' Capital Accounts in their sacrificing ratio)			
(a)	A's Capital A/c Dr.		12,000	
	B's Capital A/c		6,000	
	To Cash A/c			18,000
	(Being the amount of goodwill withdrawn by A and B fully)			
(b)	A's Capital A/c Dr.		3,000	
	B's Capital A/c Dr.		1,500	
	To Cash			4,500
	(Being 25% of the amount of goodwill withdrawn from business by A and B)			

(iv) When the new partner is unable to bring his share of goodwill in cash :

When a new partner is admitted, he contributes his share of capital as agreed upon but may express his inability to pay his share of goodwill in cash. Under this situation, goodwill is treated by debiting the new partner's capital account with his share of goodwill and crediting the old partners' capital accounts with their sacrificing ratio. The following journal entries are passed :

1. Cash A/c Dr.
   To New Partner's Capital A/c
   (Being cash brought in by new partner towards his capital)
2. New Partner's Capital A/c Dr. (with his share of goodwill)
   To Old Partners' Capital A/c (in sacrificing ratio)
   (Being the new partners' share of goodwill debited to his capital account and credited to old partners' capital accounts in sacrificing ratio)

When the value of goodwill of the firm is not specifically given, the value of goodwill has to be inferred on the basis of the net worth of the firm (hidden goodwill) which is arrived at as follows :

A. Net worth (including goodwill) on the basis of capital brought in by incoming partner. (Incoming partner's capital X reciprocal of share of the incoming partner)

B. Networth (excluding goodwill) of the reconstituted firm (i.e., after taking into consideration the capital brought in by the incoming partner)

C. Value of Goodwill (A-B)

Illustration 12

A and B were partners sharing profits and losses equally having capital of ₹10,000 each. C is admitted for $\frac{1}{4}$th share in the profits of the firm and contributes ₹12,000 as his share of capital. Record the above transactions showing the treatment of goodwill.

Solution :

Working Note :

C's Capital for $\frac{1}{4}$th share = ₹12,000

So, A and B's share for $\frac{3}{4}$th profit = 12,000×3=₹36,000

But the combined capital of A and B = ₹20,000

Hence, Goodwill of the firm may be inferred at ₹36,000 – ₹20,000=₹16,000

$\therefore$ C's share in the goodwill = ₹16,000×$\frac{1}{4}$=₹4,000.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
?	Cash A/c Dr.		12,000	
	To C's Capital A/c			12,000
	(Being capital brought in by C)			
	C's Capital A/c Dr.		4,000	
	To A's Capital A/c			2,000
	To B's Capital A/c			2,000
	(Being the share of C's goodwill in the firm credited to old partners' capital accounts in sacrificing ratio)			

Illustration 13

Pass journal entries to record the following adjustments relating to revaluation of assets and liabilities :

(a) Machinery of ₹80,000 brought down by 15%.
(b) Value of stock ₹30,000 appreciated by 10%.
(c) Furniture of ₹12,000 is brought down to ₹9,000.
(d) Stock of ₹35,000 is written down to ₹28,000.
(e) Building of ₹1,00,000 is written up to ₹1,20,000.
(f) Provision for doubtful debts @5% on Sundry Debtors of ₹50,000.
(g) Creditors were over estimated by ₹5,000.
(h) Interest accrued on investments ₹2,000 is to be brought into account.
(i) A claim of ₹750 for damages should be created against the firm.
(j) An old typewriter having a book value of ₹1,500 is to be written off fully.

Solution :

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(a)	Revaluation A/c	Dr.		12,000	
	To Machinery A/c				12,000
	(Being machinery brought down by 15%)				
(b)	Stock A/c	Dr.		3,000	
	To Revaluation A/c				3,000
	(Being value of stock increased by ₹3,000)				
(c)	Revaluation A/c	Dr.		3,000	
	To Furniture A/c				3,000
	(Being value of furniture decreased by ₹3,000)				
(d)	Revaluation A/c	Dr.		7,000	
	To stock				7,000
	(Being value of stock decreased by ₹7,000)				
(e)	Building A/c	Dr.		20,000	
	To Revaluation A/c				20,000
	(Being value of building increased)				
(f)	Revaluation A/c	Dr.		2,500	
	To Provision for doubtful debts A/c				2,500
	(Being provision for doubtful debts created)				

(g)	Creditors A/c Dr. To Revaluation A/c (Being creditor written down)		5,000	 5,000
(h)	Accrued Interest A/c Dr. To Revaluation A/c (Being interest accrued on investment brought into account)		2,000	 2,000
(i)	Revaluation A/c Dr. To Claim for damages A/c (Being claim for damages created)		750	 750
(J)	Revaluation A/c Dr. To Typewriter A/c (Being old typewriter written off)		1,500	 1,500

Illustration 14

The following was the Balance sheet of X and Y on 1st April 2016 :

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry creditors	3,000	Cash in hand	4,000
Bills Payable	2,000	Sundry Debtors	12,000
Capital Accounts :		Stock	14,000
X - 40,000		Machinery	10,000
Y - 30,000	70,000	Buildings	30,000
		Furniture	5,000
	75,000		75,000

X and Y share profits and losses in the ratio of 2:1. They decided to admit Z as a new partner with $\frac{1}{4}$th share in the profits of the firm. Z paid in ₹35,000 on his share of capital. It was agreed to revalue the assets and liabilities as follows :

a) Stock to be appreciated by 10%

b) Machinery to be depreciated by 5%

c) Buildings to be written up to ₹38,000

d) Furniture is valued at ₹4,300

e) A provision for doubtful debts is to be created at $2\frac{1}{2}$% on Sundry Debtors.

f) Creditors waive out their claim by ₹500.

You are required to pass necessary journal entries and open necessary ledger accounts and show the Balance Sheet after Z's admission.

Solution :

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
?	Stock A/c	Dr.		1,400	
	Buildings A/c	Dr.		8,000	
	Creditors A/c	Dr.		500	
	To Revaluation A/c				9,900
	(Being revaluation of assets and liabilities made)				
?	Revaluation A/c	Dr		1,500	
	To Machinery A/c				500
	To Furniture A/c				700
	To Provision for doubtful debts A/c				300
	(Being assets revalued)				
	Revaluation A/c	Dr		8,400	
	To X's Capital A/c				5,600
	To Y's Capital A/c				2,800
	(Being profit on revaluation transferred to X's and Y's capital A/cs in old profit-sharing ratio)				
	Cash A/c	Dr.		35,000	
	To Z's Capital A/c				35,000
	(Being capital brought in by Z)				

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Machinery A/c	500	By Stock A/c	1,400
To Furniture A/c	700	By Buildings A/c	8,000
To Provision for doubtful debts A/c	300	By Creditors A/c	500
To X's capital A/c (profit)	5,600		
To Y's capital A/c (profit)	2,800		
	9,900		**9,900**

Partners Capital Accounts

Dr. Cr.

	X (₹)	Y (₹)	Z (₹)		X (₹)	Y (₹)	Z (₹)
				By Balance b/d	40,000	30,000	--
				By Revaluation A/c (Profit)	5,600	2,800	
				By Cash	--	--	35,000
To Balance c/d	45,600	32,800	35,000				
	45,600	32,800	35,000		45,600	32,800	35,000
				By Balance b/d	45,600	32,800	35,000

Cash Account

Dr Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	4,000		
To Z's Capital A/c	35,000		
		By Balance c/d	39,000
	39,000		39,000
To Balance b/d	39,000		

Balance Sheet of X, Y and Z as on 1st April 2016

Liabilities	Amount (₹)	Assets Amount	(₹)
Sundry Creditors	2,500	Cash in hand	39,000
Bills Payable	2,000	Sundry Debtors 12,000	
Capital A/cs.		Less provision for	
X- 45,600		doubtful debtrs 300	11,700
Y- 32,800		Stock	15,400
Z- 35,000	1,13,400	Furniture	4,300
		Machinery	9,500
		Buildings	38,000
	1,17,900		**1,17,900**

Illustration 15

The following is the Balance Sheet of A, B and C who were equal partners :

Balance Sheet of A, B and C as on 1st April 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts :		Buildings	19,500
A - 16,800		Furniture	2,400
B - 12,600		Stock	11,400
C - 6,000	35,400	Debtors	10,800
Trade creditors	6,000	Cash	900
Bills payable	3,600		
	45,000		**45,000**

They agreed to take D into partnership and give him 1/4th share in the profits, on the following terms :

(a) D should bring a capital of ₹20,000.

(b) Stock and Furniture be depreciated by 10%.

(c) A provision for doubtful debts be created at 5% on sundry debtors.

(d) A liability of ₹1,080 be created against bills discounted.

(e) The value of building be increased to ₹27,000.

(f) The assets and liabilities to appear in the new Balance Sheet at the old figures.

Prepare Memorandum Revaluation Account and the Balance Sheet after D's admission into the firm.

Solution :

Memorandum Revaluation Account

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock A/c	1,140	By Buildings A/c	7,500
To Furniture A/c	240		
To Provision for doubtful debt A/c	540		
To Reserve for bills discounted	1,080		

To Capital Accounts : A - 1,500 B - 1,500 C- 1,500	4,500		
	7,500		**7,500**
To Building A/c	7,500	By Stock A/c	1,140
		By Furniture A/c	240
		By Provision for doubtful debts	540
		By Reserve for bills discounted	1,080
		By Capital Accounts : A - 1,125 B - 1,125 C - 1,125 D - 1,125	4,500
	7,500		**7,500**

Balance Sheet of A, B, C and D as on 1st April 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts :		Buildings	19,500
A 17,175		Furniture	2,400
B 12,975		Stock	11,400
C 6,375		Debtors	10,800
D 18,875	55,400	Cash	20,900
Trade creditors	6,000		
Bills Payable	3,600		
	65,000		**65,000**

Working Note :

Balance of Capital Accounts :

A's Capital = ₹16,800+₹1,500 – ₹1,125 = ₹17,175

B's Capital = ₹12,600+₹1,500 – ₹1,125 = ₹12,975

C's Capital = ₹6,000+₹1,500 – ₹1,125 = ₹6,375

D's Capital = ₹20,000 – ₹1,125 = ₹18,875

Illustration 16

P and Q are partners sharing profits in the ratio of 3:2. R is admitted and the new profit-sharing ratio is 2:2:1. R brings in ₹20,000 as his capital and could not pay any thing towards his share of goodwill which is valued at ₹3,000. The balance sheet of P and Q as on 31.03.2016 was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts :		Cash in hand	15,000
P - 15,000		Sundry assets	45,000
Q - 15,000	30,000		
Profit and Loss A/c	10,000		
General Reserve	8,000		
Sundry Creditors	12,000		
	60,000		60,000

It was further agreed by all partners that the value of sundry assets be written down to ₹42,000 and sundry creditors be valued at ₹10,000, Pass journal entries to give effect to the above adjustments and prepare necessary ledger accounts and show the opening balance sheet of the firm after R's admission.

Solution :

Working Note :

P:Q = 3:2

P:Q:R = 2:2:1

Q's profit – sharing ratio remains intact, i.e., $\frac{2}{5}$

P's old profit sharing ratio was $\frac{3}{5}$ and new share is $\frac{2}{5}$, which means P alone has sacrificed $\frac{1}{5}$ in favour of R. Hence, he is entitled to the compensation (goodwill) from the new partner R.

Journal

Date	Particulars	L.F.	Dr. Amt. ₹	Cr. Amt. ₹
?	Cash A/c Dr.		20,000	
	To R's Capital A/c			20,000
	(Being capital brought in by R)			

R's Capital A/c Dr.		3,000	
To P's Capital A/c			3,000
(Being R's share of goodwill debited to R's capital and credited to P's capital A/c)			
Revaluation A/c Dr.		3,000	
To Sundry Assets A/c			3,000
(Being decrease in the value of assets)			
Sundry Creditors A/c Dr.		2,000	
To Revaluation A/c			2,000
(Being decrease in the value of sundry creditor)			
P's Capital A/c Dr.		600	
Q's Capital A/c Dr.		400	
To Revaluation A/c			1000
(Being loss on revaluation transferred to Capital Accounts of old partners in old profit-sharing ratio)			
Profit and Loss A/c Dr.		10,000	
To P's Capital A/c			6,000
To Q's Capital A/c			4,000
(Being the undistributed profits transferred to old partners' capital accounts in their old profit–sharing ratio)			
General Reserve A/c Dr.		8,000	
To P's Capital A/c			4,800
To Q's Capital A/c			3,200
(Being general reserve transferred to old partners' Capital Accounts in old profit-sharing ratio.)			

Ledger

Dr. Revaluation A/c Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry Assets	3,000	By Sundry Creditors	2,000
		By Loss on Revaluation transferred to	
		P's Capital	600
		Q's Capital	400
	3,000		3,000

Dr. General Reserve A/c Cr.

	Amount (₹)	Particulars	Amount (₹)
To P's Capital A/c	4,800	By Balance b/d	8,000
To Q's Capital A/c	3,200		
	8,000		**8,000**

Profit and Loss A/c

Dr. Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To P's Capital	6,000	By Balance b/d	10,000
To Q's Capital	4,000		
	10,000		**10,000**

Partners' Capital Accounts

Dr. Cr.

	P (₹)	Q (₹)	R (₹)		P (₹)	Q (₹)	R (₹)
To P's Capital	--	--	3,000	By Balance b/d	15,000	15,000	--
To Revaluation A/c	600	400	--	By Cash	--	--	20,000
To Balance c/d	28,200	21,800	17,000	By R's Capital A/c	3,000	--	--
				By P and L A/c	6,000	4,000	--
				By General Reserve A/c	4,800	3,200	--
	28,800	**22,200**	**20,000**		**28,800**	**22,200**	**20,000**
				By Balance b/d	28,200	21,800	17,000

Cash Account

Dr Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	15,000		
To R's Capital A/c	20,000	By Balance c/d	35,000
	35,000		35,000
To Balance b/d	35,000		

Balance Sheet of P, Q,R as on 1st April 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts		Cash in hand	35,000
P- 28,200		Sundry Assets	42,000
Q- 21,800			
R- 17,000	67,000		
Sundry Creditors	10,000		
	77,000		**77,000**

8.5 QUESTIONS

1. **From the alternatives given under each bit write the correct answer along with its serial number against each bit :**

(i) When the share of goodwill of a new partner is brought in cash, it is shared by :

(a) old partners in old profit – sharing ratio.

(b) old partners in sacrificing ratio.

(c) old partners in gaining ratio.

(d) all the partners in new profit – sharing ratio.

(ii) A new partner may be admitted to the partnership :

(a) without the consent of all partners.

(b) with the consent of all partners.

(c) with the consent of majority of partners.

(d) with the consent of any one partner.

(iii) At the time of admission of new partner, goodwill appearing in the books is shared among old partners in :

(a) New profit sharing ratio.

(b) Old profit sharing ratio.

(c) Sacrificing ratio.

(d) Equally.

(iv) When assets are revalued, any increase in the value of assets is debited to :

(a) Revaluation Account.

(b) Asset Account.

(c) Profit and Loss Account.

(d) Profit and Loss Appropriation Account.

(v) The profit on revaluation of assets and liabilities are shared by :

(a) old partners in sacrificing ratio.

(b) old partners equally.

(c) old partners in old profit – sharing ratio.

(d) all partners including new partner in new ratio.

(vi) A, B and C are partners in a firm. If D is to be admitted as a new partner :

(a) old parnership has to be dissolved

(b) old firm has to be dissolved.

(c) Both old partnership and firm have to be dissolved.

(d) Neither firm nor partnership need to be dissolved.

(vii) The balance of Memorandum Revaluation Account (second part) is transferred to the capital accounts of the partners in :

(a) Capital ratio

(b) Old profit sharing ratio

(c) New profit sharing ratio

(d) Equally among all partners

(viii) A and B who are partners sharing profits in the ratio of 3:1 and admit C for one –fourth share in the future profits, the profit sharing ratio will be :

(a) A 9/16; B 3/16; C 4/16

(b) A 10/16; B 2/16; C 4/16

(c) A 8/16; B 4/16; C 4/16

(d) A 6/16; B 6/16; C 4/16

(ix) A and B sharing profits in the ratio of 2:1 admit C for $\frac{1}{5}$ th share in future profits. The new profit and loss sharing ratio is :

(a) 4:2:1

(b) 5:3:7

(c) 8:4:3

(d) 5:7:3

(x) A and B sharing profits in the ratio of 5:3 admit C and new profit sharing ratio of A, B and C is fixed at 4:2:2. The ratio of sacrifice of A and B is :

(a) 5:3

(b) 1:2

(c) 1:1

(d) 2:1

(xi) X and Y who shared profits in the ratio of 3:1 respectively admit Z to one – fourth share in the future profits. Z acquired his share equally from X and Y. The new profit sharing ratio would be :

(a) 9:3:4

(b) 2:1:1

(c) 3:2:3

(d) 5:1:2

(xii) A and B are partners in a business sharing profits in the ratio of 5:3. They admit C as a partner with $\frac{1}{4}$ th share in the profits which he acquires $\frac{3}{4}$ from A and $\frac{1}{4}$ th from B. He pays ₹8,000 for his share of goodwill. A and B will be credited by:

(a) ₹5,000 and ₹3000 respectively

(b) ₹6,000 and ₹2000 respectively

(c) ₹3,000 and ₹5,000 respectively

(d) ₹4,000 each.

[Ans. i (b), ii(b), iii(b), iv(b), v(c), vi(a), vii(c), viii(a), ix(c), x(c), xi(d), xii(b)]

2. Answer the following questions in one ward or term each :

(i) By what name is the compensation, paid by a new partner to the old partners, known ?

(ii) By what name is the undistributed profit of a firm known ?

(iii) What is the name given to the excess of desired total capital of a firm over the actual combined capital of all the partner ?

(iv) On which side of Revaluation Account, unrecorded liabilities are recorded ?

(v) On which side of Revaluation Account, appreciation in building is recorded ?

(vi) In which ratio, goodwill brought in by new partner, is distributed among old partners ?

[Ans.: (i) Goodwill, (ii) General Reserve/ Profit and Loss Account credit balance, (iii) Hidden goodwill, (iv) Debit side, (v) Credit side, (vi) Sacrificing ratio]

3. Fill in the blanks with appropriate words :

(i) Share of goodwill brought in cash by the new partner in also called ____.

(ii) Reduction in provision for bad debts will be ______ to Revaluation A/c.

(iii) Profit and loss arising from revaluation of assets and liabilities is shared by _______ partners.

(iv) Old ratio is also the _______ ratio unless otherwise mentioned.

(v) _______ assets are debited to old partners' Capital Accounts at the time of admission of partners.

[Ans : (i) Premium; (ii) credited, (iii) old, (iv) sacrificing, (v) Fictitious]

4. Correct the underlined partions of the following sentences :

(i) Profits and loss adjustment account is otherwise known as <u>profit and loss appropriation</u> account.

(ii) The Employees' Provident Fund represents <u>profits</u>.

(iii) At the time of <u>retirement</u> of a partner, sacrificing ratio is calculated.

(iv) As per <u>AS-20</u> only purchased goodwill be recorded in the books of account.

(v) The sum of closing capital and opening capital divided by two is known as <u>total</u> capital employed.

(vi) Profit on revaluation of assets and liabilities is transferred to the capital of old partners in the <u>sacrificing</u> ratio.

[Ans.: (i) Revaluation, (ii) liability, (iii) admission, (iv) AS-26, (v) average, (vi) old.]

5. Answer the following questions in one sentence each :

   (i) What do you understand by admission of a partner ?

   (ii) State any one purpose of admitting a new partner into a firm.

   (iii) State any one right acquired by a newly admitted partner.

   (iv) What is sacrificing ratio ?

   (v) State the ratio in which the old partners share all the accumulated profits, reserves and losses.

   (vi) State whether Revaluation Account is debited or credited to record the increase in the value of an asset.

   (vii) List any two items that need adjustments in the books of accounts of a firm at the time of admission of a partner.

   (viii) State whether partner's Capital Account is debited or credited to record the profit on Revaluation Account.

   (ix) Under what circumstance will the premium for goodwill paid by the incoming partner, not be recorded, in the books of accounts ?

   (x) State whether at the time of admission of a partner, partnership is dissolved or partnership firm is dissolved.

6. Answer the following questions within 30 words each :

   (i) What is hidden goodwill ? How is it treated when a new partner is admitted ?

   (ii) What is the effect of Memorandum Revaluation Account on partners' capital accounts ?

   (iii) Explain the AS-26 with regard to the treatment of goodwill.

   (iv) Pass the journal entries when a new partner is unable to bring his share of goodwill in cash.

   (v) On admission of a partner, what journal entries will be passed for :

   (a) Increase in assets

   (b) Increase in liabilities

7. Answer the following questions within 50 words each :

   (i) What do you mean by Memorandum Revaluation Account ?

(ii) State any two circumstances when Revaluation Account will be debited and any two situation when Revaluation Account will be Credited.

(iii) Why is it necessary to revalue the assets and reassess the liabilities in case of the admission of a partner ?

(iv) Draw a Revaluation Account with imaginary amounts.

(v) What entry will be passed when new partner brings in goodwill in cash ? In what ratio the old partners will divide it ?

8. A and B share the profits of a firm in the ratio of 3:2. They admit C as a partner and the new profit-sharing ratio becomes 3:2:1. The goodwill of the firm is valued at 2 years purchase of the average of three years profits. The profits of the firm for the last 3 years were ₹58,000; ₹68,000 and ₹54,000. C brings his share of goodwill in cash. Journalise the above transactions.

[Ans.: Goodwill of the firm ₹1,20,000]

9. P and Q are partners sharing profits and losses in the ratio of 3:2. They admit R into partnership with $\frac{1}{4}$ th share in the profits which he acquires $\frac{1}{6}$ th from P and $\frac{1}{12}$ th from Q. The goodwill of the firm is valued at ₹72,000. R pays ₹1,00,000 as capital and pays his share of goodwill in cash. Half of the amount of goodwill is withdrawn by the old partners. Give necessary journal entries.

[Ans : P's withdrawal ₹6,000 and Q's withdrawal ₹3,000]

10. A, B and C are partners sharing profits in the ratio of 5:3:2. D is admitted with $\frac{1}{10}$ th share. Goodwill of the firm is valued at ₹60,000. D brings in ₹80,000 as his share of capital but could not pay anything for goodwill in cash. New ratio is fixed at 4:4:1:1. Pass journal entries.

[Ans : B's capital and D's capital wil be debited by ₹6,000 each and A's capital C's capital will be credited by ₹6,000 each]

11. X and Y are partners sharing profits in the ratio of 3:2. Z is admitted and the new profit sharing ratio is 2:2:1. Z brings in cash ₹20,000 as capital and ₹3,000 as goodwill. The balance sheet of X and Y is as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts : X	40,000	Sundry Assets	80,000
Y	30,000		
Reserve Fund	10,000		
	80,000		

Give journal entries and prepare the balance sheet of new firm.

12. A and B are equal partners. They decided to admit C as a partner and readjust the Balance Sheet values for this purpose. The Balance Sheet of A and B as on 31st. December, 2016 was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,000	Cash	600
Bills Payable	1,000	Debtors	1,500
Reserve Fund	400	Stock	1,400
A's Capital 1,500		Furniture	400
B's Capital 1,000	2,500	Machinery	1,000
	4,900		4,900

The following adjustments are to be made before C's admission :

(a) ₹300 were to be provided for doubtful debts.

(b) Furniture was valued at ₹250.

(c) Investments worth ₹400 not shown in the Balance Sheet were to be taken into account.

(d) C brings ₹1,000 as capital and ₹1,000 for goodwill which amount was withdrawn by A and B fully.

Give journal entries, Revaluation Account and Balance Sheet of the new firm.

[Ans.: Loss on Revaluation ₹50]

13. X, Y and Z are partners in a firm sharing profits and losses in the ratio of 2:2:1. Their Balance Sheet as on 31st March, 2017 was as follows :

Liabilities		Amount (₹)	Assets	Amount (₹)
Sundry Creditors		12,850	Land and Building	25,000
Outstanding liabilities		1,500	Furniture	6,500
General Reserve		6,500	Closing Stock	11,750
Capital Accounts :			Sundry Debtors	5,500
X	12,000		Cash in hand	140
Y	12,000		Cash at Bank	960
Z	5,000	29,000		
		49,850		49,850

P is admitted as a partner with effect from 1st April 2017 on the following terms :

a) P shall bring ₹5,000 towards his capital.

b) The value of stock be intereased by ₹2,500.

c) Provision for bad and doubtful debts should be provided at 10% of the debtors.

d) The furniture to be depreciated by 10%.

e) The value of land and building be appreciated by 20%.

f) The outstanding liabilities of ₹1,000 has been paid by X, for which no entry has been made in books.

g) General reserve will be transferred to the capital accounts of partners.

h) The new profit sharing ratio shall be 5:5:3:2 among X, Y, Z and P respectively.

Prepare Revaluation Account, Capital Accounts of partners and their new Balance Sheet.

[Ans.: Profit on revaluation ₹6,300]

14. A, B and C are partners in a firm sharing profits and losses in the ratio of 2:3:1. They decided to admit D as a partner with $\frac{1}{4}$th share in the future profits. Their Balance Sheet as on 31st March 2017 was as follows :

Liabilities	Amount (₹)	Assets Amount	(₹)
B's Capital	35,000	Furniture	10,000
C's Capital	22,000	Motor Car	20,000
		Cash at Bank	18,000
		A's Capital	9,000
	57,000		57,000

The following adjustments are to be made :

a) The motor car is taken over by B at a value of ₹25,000.

b) The furniture is revalued at ₹18,000.

c) D is to bring ₹20,000 as his capital and his share of goodwill in cash. The goodwill of the firm is valued of ₹48,000.

d) Unrecorded debtors of ₹11,000 be brought into account.

e) Expenses incurred, but not paid ₹3,000 are to be provided for. Pass journal entries and prepare Revaluation Account, Capital Accounts of Partners and the new Balance Sheet after D's admission.

15. The following is the Balance Sheet of P, Q and R as on 31.03.2017.

Liabilities		Amount (₹)	Assets Amount	(₹)
Creditors		11,000	Cash	1,500
Bills Payable		6,000	Debtors	26,500
Capital Accounts :			Stock	30,000
P	40,000		Furniture	7,500
Q	33,500		Land and Building	50,000
R	25,000	98,500		
		1,15,500		1,15,500

They share profits in the ratio of 6:5:3. On 1st April 2017, they agreed to admit S as a partner giving him $\frac{1}{10}$th share in future profits. The following arrangements were made :

a) S should bring ₹14,840 as his capital.

b) Stock be depreciated by 10% and furniture by ₹900.

c) A reserve of ₹1,300 be made for outstanding repair bill.

d) The value of land and buildings be brought upto ₹65,000.

e) S does not contribute anything for goodwill which was valued at 8,400 for the firm.

Pass necessary journal entries to record the above and prepare the new Balance Sheet.

16. The Balance Sheet of A, B and C sharing profits in the ratio of 3:2:1, is given below :

Liabilities	Amount (₹)	Assets		Amount (₹)
Trade creditors	1,60,000	Cash at Bank		40,000
Employee's Provident Fund	20,000	Debtors	2,00,000	
Contingency Reserve	1,26,000	Less provision	3,000	1,97,000
		Stock		2,03,000
A's Capital	4,00,000	Furniture		30,000
B's Capital	4,00,000	Machinery		5,30,000
C's Capital	2,00,000	Buildings		3,00,000
		Advertisement Suspense A/c		6,000
	13,06,000			13,06,000

They decided to admit D into partnership on the following terms and conditions:

a) New profit – sharing ratio will be 3:3:2:2.

b) Goodwill of the firm is valued at ₹3,00,000 and D brings his share of goodwill in cash.

c) D should bring a capital of ₹1,50,000.

d) Contingeney Reserve is no more required.

e) Provision for doubtful debts to be raised to 5% on debtors.

f) Machinery is found overvalued by ₹30,000 and Building is found undervalued by ₹67,000.

Prepare Revaluation Account, Capital Accounts of partners and the new Balance Sheet.

[Ans.: Revaluation profit ₹1,56,000]

17. The Balance Sheet of A and B who share profits and losses in the ratio of 3:2 as on 31st March 2017 was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
A's Capital	1,00,000	Goodwill	20,000
B's Capital	75,000	Plant	45,000
Creditors	70,000	Furniture and Fittings	37,500
Provident Fund	20,000	Stock	57,500
		Bills Receivable	10,000
		Debtors	55,000
		Cash	40,000
	2,65,000		2,65,000

On 1st April, 2017, C was admitted into partnership on the following terms :

a) New profit – sharing ratio will be 2:2:1.

b) C is to bring his capital of ₹50,000 in cash and to pay his share of goodwill in cash. Goodwill for this purpose, is to be valued at 2 years purchase of average of the previous 4 years profits. The profits for the past four years were ₹25,000; ₹22,500; ₹25,000 and ₹27,500.

c) Other assets are valued as under :

Plant ₹52,000; Furniture and Fittings ₹32,000; Stock ₹63,000; Debtors ₹50,000.

d) The value of assets except cash shall remain unchanged.

Give necessary journal entries and the opening Balance Sheet of the reconstituted firm.

[Ans : value of goodwill ₹50,000. Revaluaiton profit ₹2,500]

18. A and B are partners sharing profits in the ratio of 2:1. Their Balance Sheet as on 31st March 2017 is as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	44,000	Cash	17,000
Capital Accounts :		Sundry Debtors	15,000
A 30,000		Bills Receivable	4,000
B 20,000	50,000	Stock	25,000
		Furniture and Fixtures	3,000
		Land & Buildings	30,000
	94,000		94,000

C is admitted to partnership with effect from 1st April 2017 on the following terms :

a) That he brings in ₹15,000 as his capital for $\frac{1}{4}$th share and pays ₹6,000 for goodwill, half of which is to be withdrawn by A and B.

b) Provision to the extent of ₹1,500 is to be made since there is likely to be claim against the firm for damages.

c) A liability on account of unpaid electricity bill of ₹500 is to be provided for.

d) That the stock is to be reduced to ₹23,000 and furniture and fittings by ₹1,000.

e) That a 5% reserve for bad debt is to be created.

f) That value of land and buildings be appreciated by 20%.

g) An item of ₹1,200 included in creditors has to be written off.

h) That the value of assets and liabilities will not change except cash.

Prepare the necessary accounts and opening Balance Sheet the firm.

[Ans : Profit on Revaluation (1st part ₹1,450)]

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9.10 QUESTIONS

1. From the alternatives given below, choose and write the correct answer along with its serial number against each :

(i) Minimum number of shareholders in a private limited campany other than one person company is :

(a) 7 (b) 50 (c) 2 (d) 10

(ii) Minimum number of shareholders in a public limited company is :

(a) 2 (b) 7 (c) 50 (d) 20

(iii) Maximum number of shareholders in a private company is :

(a) 200 (b) 50 (c) 7 (d) No limit as to maximum number

(iv) Maximum number of shareholders in a public limited company is :

(a) No limit as to maximum number (b) 50 (c) 7 (d) 100

(v) As per the Comapnies Act, 2013, minimum amount of paid up share capital in a private limited company is :

(a) ₹5 lakh (b) ₹1 lakh (c) ₹2 lakh (d) ₹10 lakh

(vi) As per the Comapnies Act, 2013, minimum amount of paid up share capital in a public limited company is :

(a) ₹2 lakh (b) ₹5 lakh (c) ₹1 lakh (d) No such minimum amount

(vii) The equity shareholders of a company are :

(a) creditors (b) debtors (c) owners (d) customers of the company

(viii) The preference shareholders of a company have preferential right :

(a) to receive dividednd

(b) to return of capital when the company goes into liquidation

(c) both (a) and (b) above

(d) to participate in management

(ix) Preference shareholders who do not have any right to share the surplus left over after paying equity shareholders are called :

(a) Non-participating preference shareholders

(b) Non-convertible preference shareholders

(c) Non-cumulative preference shareholders

(d) Irredeemable preference shareholders

(x) Nominal share capital is :

(a) the amount of share capital issued by a company

(b) the amount of share capital subscribed by the public

(c) the amount of share capital which is actually paid by the shareholders

(d) the maximum amount of capital which a company is authorised to raise

(xi) The part of share capital which can be called up only in the event of winding up of a company is known as :

(a) authorised capital (b) called up capital

(c) reserve capital (d) uncalled capital

(xii) The minimum share application money as per Companies Act is :

(a) 5% of the nominal value of shares

(b) 10% of the nominal value of shares

(c) 25% of the nominal value of shares

(d) 5% of the issue price of shares

(xiii) As per the guidelines of Securities and Exchange Board of India, the minimum share application money is :

(a) 5% of the nominal value of shares

(b) 25% of the nominal value of shares

(c) 5% of the issue price of shares

(d) 25% of the issue price of shares

(xiv) When excess application money is to be adjusted towards allotment, the accoutn to be credited is :

(a) share applicatiion account (b) share allotment account

(c) share capital account (d) calls-in-advance account

(xv) According to Table F ot the Companies Act, 2013, the maximum amount of one call should not exceed :

(a) 5% of the nominal value of shares

(b) 25% of the nominal value of shares

(c) 10% of the nominal value of shares

(d) 25% of the issue price of shares

(xvi) When shares are allotted, one of the following accounts to be credited is :

(a) share allotment account (b) share capital account

(c) share application account (d) bank account

(xvii) Securities premium cannot be utilised for :

(a) issuing fully paid bonus shares to the members

(b) writing off the preliminary expenses of the company

(c) writing off discount on issue of debentures of the company

(d) declaration of dividend to the shareholders

(xviii) If the Articles of Association are silent, interest on calls-in-arrear in charged at a maximum rate of :

(a) 5% p.a. (b) 10% p.a. (c) 12% p.a. (d) 6% p.a.

(xix) As per the provisions of Table F of the Companies Act, 2013, interest on calls-in-advance is payable by the company at :

(a) 5% p.a. (b) 10% p.a. (c) 12% p.a. (d) 6% p.a.

(xx) Amount of calls-in-advance is :

(a) added to share capital in the Balance Sheet

(b) deducted from share capital in the Balance Sheet

(c) shown on the assets side of the Balance Sheet

(d) shown on the Equity and Liabilities side of the Balance Sheet

(xxi) A company offered 10,000 shares of ₹10 for public subscription. 8,000 shares were subscribed on which ₹8 per share was called up. Amount due on 7,000 shares was received at ₹8 per share and ₹6 per share on 1,000 shares. The paid up capital of the company is :

(a) ₹64,000 (b) ₹8,000 (c) ₹62,000 (d) ₹56,000

(xxii) On forfeiture of shares, the account to be debited is :

(a) Share forfeiture A/c (b) Capital reserve A/c

(c) Shareholders' A/c (d) Share capital A/c

(xxiii) Shares can be forfeited :

(a) for failure to pay the allotment or call money

(b) for failure to attend the shareholders' meeting

(c) for failure to repay the loan to the bank for which the shares are pledged as security

(d) for not buying the products of the company

(xxiv) On forfeiture, share capital account is debited with :

(a) the amount received on such forfeited shares

(b) the nominal value of shares forfeited

(c) the called up amount on the forfeited shares

(d) the amount not received on the shares forfeited

(xxv) The profit on reissue of forfeited shares is transferred to :

(a) General Reserve A/c (b) Capital reserve A/c

(c) Capital Redemption Reserve A/c (d) Securities Premium Reserve A/c

(xxvi) On forfeiture of shares, the share forfeiture account is credited with :

(a) the amount not received on shares forfeited

(b) the amount received on such forfeited shares

(c) the nominal value shares forfeited

(d) the called up amount on the shares forfeited

(xxvii) If a share of ₹100 issued at par is forfeited on which ₹80 has been called up and ₹60 paid, the share capital account is debited with :

(a) ₹60 (b) ₹80 (c) ₹20 (d) ₹40

(xxviii) The balance of share forfeiture account is shown in the Balance Sheet under the head :

(a) Reserves and Surplus (b) Share Capital

(c) Current Liabilities (d) Non-current Liabilities

(xxix) If a share of ₹100 issued at a premium of ₹20, is forfeited in respect of which the full amount has been called up and ₹80 (including premium) is paid, the share capital account is debited with :

(a) ₹120 (b) ₹100 (c) ₹80 (d) ₹20

(xxx) X Ltd. forfeited 100 shares of ₹10 each issued at par and fully called up, on whih ₹4 per share was paid. The minimum price which the company must charge, if all the forfeited shares are reissued as fully paid up is :

(a) ₹600 (b) ₹1,000 (c) ₹400 (d) ₹800

[Ans : (i) c, (ii) b, (iii) a, (iv) a, (v) b, (vi) b, (vii) c, (viii) c, (ix) a, (x) d, (xi) c,

(xii) a, (xiii) d, (xiv) b, (xv) d, (xvi) b, (xvii) d, (xviii) b, (xix) c, (xx) d, (xxi) c, (xxii) d, (xxiii) a , (xxiv) c, (xxv) b, (xxvi) b, (xxvii) b, (xxviii) b, (xxix) b, (xxx) a.]

2. Answer the following questions in one word/term each :

(i) Name the company which has only one person as its member.

(ii) Name the company which limits the number of its members to 200.

(iii) Which type of comapny has a minimum paid up capital of rupees five lakh or such higher paid up capital as may be prescribed ?

(iv) Which type of shares have voting rights ?

(v) Which type of shares carry preferential rights as regards payment of dividend and repayment of capital ?

(vi) What is the other name of authorised capital ?

(vii) Under which head of the Balance Sheet 'securities premium reserve accoun' is shown ?

(viii) Which balance does calls-in-arrear account show ?

(ix) What is the maximum rate of interest charged on 'calls-in-arrear' as per Table F of schedule I of the Companies Act, 2013 ?

(x) What is the maximum rate of interest paid on 'calls-in'advance' as per the Table F of schedule I of the Companies Act, 2013 ?

(xi) Under which head of the Balance Sheet, Share Forfeiture A/c' is shown ?

[Ans : (i) one person company, (ii) Private Limited company, (iii) Public Limited company, (iv) Equity shares (v) Preference shares (vi) Nominal or Registered capital (vii) Reserves and surplus, (viii) Debit, (ix) 10%, (x) 12%, (xi) current liabilities, (xii) Share Capital.]

3. Answer the following questions in one sentence each:

(i) State any one essential feature of a joint stock company.

(ii) Write any one feature of a private limited company.

(iii) Write any one essential feature of a public limited comapny.

(iv) What is a share ?

(v) What do you mean by redeemable preference shares ?

(vi) What is authorised capital of a company ?

(vii) What is subscribed capital ?

(viii) How does 'Securities premium Reserve' appear in the Balance Sheet ?

(ix) What do you mean by Over-subseription ?

(x) What is under-subscription ?

(xi) What are calls-in arrear ?

(xii) What are calls-in-advance ?

(xiii) How are calls-in-advance shown in the Balance Sheet ?

(xiv) How are calls-in-arrear shown in the Balance Sheet ?

(xv) What is the name given to the part of capital of a company which is called up only on winding up ?

(xvi) State the meaning of 'subscribed and fully paid up capital ?

(xvii) What is the maximum amount of discount which may be allowed on reissue of forfeited shares ?

(xviii) What is meant by 'Issue of shares at par' ?

(xix) Where would you transfer the balance left in the 'Share Forfeiture Account' after the reissue of such shares ?

(xx) How does 'Capital Reserve' appear in the Balance Sheet ?

4. Correct the underlined portion of the following sentences:

(i) Liability of a shareholder is limited to paid up value of the shares allotted to him.

(ii) Calls-in-advance is shown separately in the Balance Sheet under the main head 'Current Assets'.

(iii) The maximum rate of interest on calls-in-advance payable by a company is 6% p.a. as per Table F of schedule I of the Companies Act, 2013.

(iv) As per Table F of schedule I of the Companies Act, 2013, a company can charge interest @5% p.a. on calls-in-arrear.

(v) Subscribed capital refers to the maximum amount which a company is authorised to issue shares.

(vi) Shares are said to have been issued at par when an applicant has to pay a sum more than the face value of the share.

(vii) Shares are said to be under-subscribed when the number of shares applied for is more than the number of shares offered to the public for subscription.

(viii) Redeemable preference shareholders have a right to get their preference shares converted into equity shares at their option according to the terms of issue.

(ix) Authorised capital is that part of issued capital which is subscribed for by the public.

(x) Paid up capital is that part of subscribed capital. which has been called up for payment by the directors, from shareholders.

[Ans.: (i) face, (ii) Liabilities, (iii) 12%, (iv) 10%, (v) Authorised, (vi) premium, (vii) over-subscribed, (viii) convertible, (ix) subscribed, (x) called.]

5. Fill up the blanks:

(i) Maximum number of shareholders in a private limited company is _______.

(ii) Minimum number of shareholders in a public limited company is _______.

(iii) The equity shareholders are the _______of a company.

(iv) The part of share capital which can be called up only is the event of winding up of a company is known as _______capital.

(v) The minimum share application money is _______% of the issue price of shares as per the guidelines of Securities and Exchange Board of India.

(vi) When shares are allotted, share _______account is credited.

(vii) The balance of calls-in-arrear account is shown on the Equity and Liabilities side of the Balance Sheet by way of _______from called up capital under the head 'subscribed but not fully paid capital ?

(viii) The amount of calls-in-advance is a _______of the company.

(ix) Calls-in-advance is shown on the Equity and Liabilities side of the Balance Sheet under the main head 'Current Liabilities' and sub-head 'Other _______Liabilities.

(x) As per Table _______of schedule I of the Companies Act, 2013, a company may pay maximum 12% p.a. interest on calls-in-advance.

(xi) When shares are forfeited, share _______account is debited for the amount already called up on shares forfeited.

(xii) After the reissue of all the forfeited shares, the credit balance of share forfeiture acount is tranferred to capital reserve account and is shown under the head 'Shareholders' Funds' and sub-head 'Reserve and _______.

(xiii) The company cannot proceed with the allotment of shares, unless it receives _______subscription.

(xiv) If any shareholder fails to pay the allotment money or any call money within the specified period, the company may _______his shares.

(xv) According to the guidlines of SEBI, minimum subscription has been fixed at _______% of the issued amount.

[Ans.: (i) 200, (ii) 7, (iii) owners, (iv) reserve, (v) 25, (vi) capital, (vii) deduction, (viii) debt, (ix) other, (x) F, (xi) capital, (xii) surplus, (xiii) minimum, (xiv) forfeit, (xv) 90.)

6. Answer the following questions within 30 words each:

(i) Write any two features of a joint stock company.

(ii) State any two features of a private limited company.

(iii) Write any two essential features of a publci limited company.

(iv) What are the types of shares which a company can issue ?

(v) What are preference shares ?

(vi) What are equity shares ?

(vii) What is cumulative preference share ?

(viii) What do you mean by redeemable preference share ?

(ix) What is participating preference share ?

(x) What do you mean by convertible preference shares ?

(xi) What is authorised capital ?

(xii) What is subscribed capital ?

(xiii) What do you mean by 'Issued capital' ?

(xiv) What is meant by 'Reserve Capital' ?

(xv) What do you mean by 'sweat equity shares' ?

(xvi) What is meant by 'Issue of shares at a premium' ?

(xvii) Write any two purposes for which securities premium can be utilised by a company.

(xviii) What is meant by 'over-subscription' ?

(xix) What is pro rata allotment of shares ?

(xx) What is calls-in arrear ?

(xxi) What is calls-in-advance ?

(xxii) What is meant by 'Issue of shares for consideration other than cash' ?

(xxiii) What is forfeiture of shares ?

(xxiv) How are forfeited shares reissued ?

(xxv) State the steps a company can take in case of over-subscription of shares other than rejecting applications.

7. Answer the following questions within 50 words each :

(i) State any three points of distinction between private limited company and public limited company.

(ii) Write any three points of distinction between an equity share and a preference share.

(iii) Write any three points of distinction between calls-in-arrear and calls-in-advance.

(iv) What do you mean by 'private placement of shares' ?

(v) What is pro rata allotment of shares ?

(vi) What is 'Minimum subscription' ?

(vii) What is meant by 'Issue of shares for consideration other than cash' ?

(viii) State the purposes for which securities premium can be utilised.

(ix) State any six essential features of a joint stock company.

(x) Mention the alternatives while allotting shares in case of over-subscription by public.

8. Define a joint stock company. Discuss the essential features of a joint stock company.

9. What is a public limited company ? State the differences between a private limited and a public limited company.

10. What do you mean by 'share' ? Describe the different classes of shares which a company can issue.
11. What is a preference share ? Distinguish between preference share and equity share.
12. What is share capital ? Explain different classes of share capital. How are they shown in the Balance Sheet ?
13. Discuss brifely the different kinds of companies.
14. Can the shares be issued at a premium ? State the purposes for which securities premium reserve can be utilised.
15. What is over-subscription of shares ? How does a company allot shares in case of over-subscription ? Illustrate your answer.
16. What is 'calls-in-arrear' ? Explain the accounting treatment of calls-in-arrear with suitable examples.
17. What is calls-in-advance ? Discuss the accounting treatment of calls-in-advance with imaginary figures.
18. What is forfeiture of shares ? Can forfeited shares be reissued at discount ? If so, th what extent ? Where would you transfer the balance of share forfeiture account after reissue of the forfeited shares ? Explain with examples.
19. A Ltd. was incorported with an authorised capital of ₹50,00,000, divided into 5,00,000 Equity shares of ₹10 each. The company offered 1,00,000 Equity shares for public subscription. The public applied for 80,000 Equity shares and the amount due on these shares was duly received. How will you show the 'Share Capital' in the Balance Sheet of the company as per Schedule III of the Companies Act, 2013 ? Also prepare 'Notes to Accounts' for the same.

    [Ans.: Subscribed and fully paid up capital ₹8,00,000.]
20. B. Ltd. was registered with an authorised capital of ₹50,00,000 in Equity shares of ₹10 each. If offered 1,00,000 Equity shares for public subscription.

The public applied for 80,000 Equity shares and the shares were fully allotted. The Directors called up ₹8 per shares on these shares. The entire called up amount on shares was received except ₹2 per share on 1,000 shares. Prepare an extract of the Balance Sheet of B. Ltd. showing 'share capital' as per the schedule III, of Companies Act, 2013 and also prepare 'Notes to Accounts'.

[Ans: Subscribed but not fully paid up capital ₹6,38,000.]

21. AB Ltd. was formed on 1.1.2016 with an authorised capital of ₹50,00,000 divided into 5,00,000 Equity shares of ₹10 each. It offered 20% of the shares to the public for subscription. Public applied for 80,000 shares and the shares were duly allotted. All calls were made and the amount duly received except ₹2 per share on 500 shares. Show the 'share capital' is the Balance Sheet of the company as per schedule III of the Companies Act, 2013 at the end of financial year. Also prepare 'Notes to Accounts' for the same.

[Ans.: Subscribed and fully paid up capital ₹7,95,000 and Subscribed but not fully paid up capital ₹4,000.]

22. X Ltd. was incorporated on 1.6.2015 with an authorised capital of ₹50,00,000, divided into 5,00,000 Equity shares of ₹10 each. Out of these, 20,000 Equity shares were issued to the vendors as fully paid up as purchase consideration for a machine purchased and issued 80,000 Equity shares to the public for subscription, the entire issue being subscribed and duly allotted. The amounts due on these shares were received in full except ₹2 per share on 6,000 shares.

You are required to :

(a) show the 'share capital' in the Balance Sheet of X Ltd. as per schedule III of the Companies Act, 2013 as at 31st March, 2016, and (b) prepare 'Notes to Accounts' relating to share capital.

[Ans : Subscibed and fully paid up capital ₹9,40,000, and subscribed but not fully paid up capital ₹48,000.]

23. Y Ltd. was formed on 1.10.2015 with an authorised capital of ₹50,00,000, divided into 4,00,000 Equity shares of ₹10 each and 1,00,000 6% Preference shares of ₹10 each. The company issued 80,000 Equity shares and 20,000 6% preference shares for public subscription. Applications for 75,000 Equity shares and 15,000 6% preference shares were received and duly allotted by the directors. The amounts due on these shares were received in full except ₹2 per share on 500 Equity shares and ₹3 per share on 1,000 6% preference shares. Prepare an extract of the Balance Sheet of Y Ltd. as at 31st March, 2016 showing 'share capital' as per the Schedule III of the Companies Act, 2013 and also prepare 'Note to Accounts'.

    [Ans. Subscribed and fully paid up capital: Equity share capital ₹7,45,000, 6% Preference share capital ₹1,40,000 Subscribed but not fully paid up capital : Equity share capital ₹4,000, 6% Preference share capital ₹7,000.]

24. Moon Ltd. issued 20,000 Equity shares of ₹10 each, payable on application ₹3, on allotment ₹3, ₹2 on each two subsequent calls. All shares were subscribed in full and were duly allotted. All the calls were made and money realised. Show the journal entries to record the above transactions in the books of Moon Ltd.

25. Star Ltd. issued 50,000 Equity shares of ₹10 each, payable ₹3 on application, ₹2 on allotment, ₹2.50 on first call and ₹2.50 on final call. The public applied for all the shares which were subsequently allotted. All the calls were duly made and amounts were fully realised.

    Pass the journal entries, prepare the cash book and necessary ledger accounts in the books of Star Ltd.

    [Ans. Cash at Bank ₹5,00,000]

26. Skyview Ltd. offered for public subscription 30,000 Equity shares of ₹10 each and 50,000 10% preference shares of ₹10 each, payable as follows:

	For Equity Shares	For Preference shares
On application	₹3.50	₹3.00
On allotment	₹4.50	₹5.00
On first and final call	₹2.00	₹2.00

Public applied for 40,000 Equity shares and 60,000 10% preference shares. The company rejected the application for 10,000 Equity shares and 10,000 preference shares and remaining applications were accepted in full. All the calls were duly made and money was realised.

Prepare the cash book and pass journal entries in the books of Skyview Ltd.

[Ans. Cash at Bank ₹8,00,000]

27. Sunshine Ltd. offered 80,000 Equity shares of ₹10 each for public subscription on 1.5.2016, payable as follows :

On application ₹3 per share

On allotment (1.7.2016) ₹5 per share

On first and final call ₹2 per share

(one month after allotment)

Public applied for 75,000 shares and the application money was duly received by 1.6.2016. All amounts due on allotment were received by 25.7.2016 and amounts due on call were received by 25.8.2016. Journalise the transactions. The company maintains the joint account for application and allotment.

28. Sun Ltd. issued 1,00,000 Equity shares of ₹10 each at a premium of ₹2 per share payable as follows:

On application ₹3.00

On allotment ₹6.00

On first and final call ₹3.00

The issue was fully subscribed and duly allotted. The call was also made. All sums were received.

Pass journal entries if,

a) Securities premium is included with application money,

b) Securities premium is included with allotment money, and

c) Securities premium is included with call money.

29. Mind fire Ltd. was incorporated with an authorised capital of ₹50,00,000 in Equity shares of ₹100 each. The company issued 30,000 Equity shares of ₹100 each at ₹120 per share, payable on application ₹50, on allotment ₹50 (including premium of ₹10), and on call ₹20 (including premium of ₹10). All the shares were applied for and allotted. All the amounts including call money were duly received. Share issue expenses amounted to ₹5,000, which were fully written off against securities premium.

Prepare the Bank Account, pass necessary journal entries in the looks of the company and show the Balance Sheet after the issue of shares.

[Ans.: Subscribed and fully paid up capital ₹30,00,000, Reserves and Surplus ₹5,95,000 cash, Cash at Bank ₹35,95,000]

30. AB Ltd. had an authorised capital of ₹30,00,000 in Equity shares of ₹100 each. The company issued 20,000 Equity shares of ₹100 each at ₹120 per share, payable as follows :

On application	₹40
On allotment	₹60 (including premium)

and on first and final call ₹20.

All the shares were subscribed by the public and the directors made the allotment in full to all the applicants. All the amounts due on allotment and first and final call were received except the first and final call money on 5,000 Equity shares. Prepare the Cash Book and Journal of the company. Also prepare the Balance Sheet showing the items in respect of the above issue of shares,

(a) without opening Calls - in - Arrear A/c and

(b) by opening Calls-in-Arrear A/c.

[Ans.: Subscribed and fully paid up capital ₹15,00,000

Subscribed but not fully paid up capital ₹4,00,000

Reserves and Surplus ₹4,00,000

Cash at Bank ₹23,00,000.]

31. BK Ltd. was incorporated with a capital of 5,00,000 Equity shares of ₹10 each. The company issued 2,00,000 Equity shares of ₹10 each at ₹12 per share, payable as follows :

On application	₹5
On allotment	₹5 (including premium)
and on call	₹2
(three months after allotment)	

All the shares were subscribed. The allotment was made and all the amounts received except the allotment money on 2,000 shares, which was received with the call money (the amount due on call received in full) together with interest as per the provisions of Table F. Pass entries in the Cash Book and Journal.

[Ans.: Cash at Bank ₹24,00, 250.]

Note : Interest on calls-in-arrear is calculated at the maximum rate of 10%

p.a. as per Table F.

32. ABC Ltd. with authorised capital of ₹1,00,00,000 in Equity shares of ₹100 each, issued 60,000 of such shares payable as follows :

On application	₹30
On allotment	₹50 (including premium)
On first call	₹20
On final call	₹20.

All the shares were subscribed by the public. The allotment was duly made and money was received. On first call being made, Rakesh to whom 3,000 shares were allotted, paid the entire amount due on his shares. Final call is yet to be made.

Pass journal entries to record the above transactions and prepare the Balance Sheet.

[Ans.: Subscribed but not fully paid up capital ₹48,00,000

Reserves and Surplus ₹12,00,000

Other Current Liabilities ₹60,000

Cash at Bank ₹60,60,000.]

33. New India Ltd. issued 50,000 Equity shares of ₹10 each at a premium of ₹2 per share, payable as follows :

On application	₹3
On allotment	₹5 (including premium)

and the balance by two equal calls.

The due dates of the instalments were :

application on 1.10.2015

allotment on 1.11.2015

first call on 1.1.2016

final call on 1.3.2016

Interest was to be paid @12% p.a. on calls-in-advance as per the Articles of Association of the company. All the shares were fully subscribed and duly allotted, The amounts were received on the due dates. Ram, holding 5,000 shares, paid the entire amount due on his holdings with the allotment money. You are required to prepare the Cash Book and the Journal in the books of the company.

[Ans.: Cash at Bank ₹5,99,400.]

34. AB Ltd. was registered with a capital of ₹60,00,000 in Equity shares of ₹100 each. 30,000 of such Equity shares were issued for public subscription at a premium of ₹20 per share and payable as follows :

On application	₹25 per share
On allotment	₹45 per share including premium
On first call	₹20 per share and

the balance as and when required.

All the amounts were received except Mr. A, holding 3,000 shares, failed to pay the amount due on first call and Mr. B, holding 6,000 shares, paid the entire amount due on final call (not yet made) along with the first call money. Record these transactions in the Journal of the company and prepare the Balance Sheet.

[Ans .: Subscribed but not fully paid up capital ₹20,40,000

Reserves and Surplus ₹6,00,000

Other Current Liabilities ₹1,80,000

Cash at Bank ₹28,20,000.]

35. Star Ltd. invited applications for issue of 60,000 Equity shares of ₹10 each, payable as follows :

On application	₹3
On allotment	₹5
On call	₹2.

Applications were received for 50,000 shares and allotment was made in full. Akash to whom 1,000 shares were allotted, failed to pay the amount due on allotment and call. Surya, who had applied for 500 shares, failed to pay the amount due on call.

Pass the necessary journal entries to record the above transactions.

[Ans.: Total calls-in-arrear ₹8,000.]

36. XYZ Ltd. invited applications for 30,000 Equity shares of ₹100 each, payable as follows :

On application	₹40
On allotment	₹40
On call	₹20

Applications were received for 40,000 shares. The Board of Directors accepted applications for 30,000 shares and rejected the remaining applications. Excess application money was refunded. Allotment money was received in full and call money was received on 28,000 shares.

Pass journal entries.

[Ans.: Excess application money refunded ₹4,00,000

Calls-in-Arrear ₹40,000.]

37. Jay Prakash Ltd. invited applications for issue of 30,000 Equity shares of ₹100 each, payable ₹60 on application, ₹20 on allotment and ₹20 on first

and final call. Applications were received for 45,000 shares. It was decided by the Board of Directors to allot 30,000 shares on pro-rata basis and utilise the excess application money towards the amount due on allotment and the balance, if any, to be refunded.

Prepare the Cash Book and Journal in the books of the company assuming the amounts due were duly received.

[Ans. Excess application money refunded ₹3,00,000. Cash at Bank ₹30,00,000.]

38. Himalaya Ltd. invited applications for issue of 20,000 Equity shares of ₹100 each, payable ₹60 on application, ₹20 on allotment and ₹20 on first and final call. Applications were received for 30,000 shares. Directors decided to allot 20,000 shares on pro-rata basis and utilise the excess application money towards the amounts due on allotment and call. Pass journal entries in the books of Himalaya Ltd. assuming the amounts due were duly received.

[Ans.: Excess application money adjusted on allotment ₹4,00,000 and on call ₹2,00,000]

39. XY Ltd. issued 50,000 Equity shares of ₹10 each for public subscription, payable as ₹5 on application, ₹3 on allotment and ₹2 on first and final call. Applications for 80,000 shares were received. The directors allotted the shares as follows :

I. To the applicants for 20,000 shares- 20,000 shares

II. To the applicants for 50,000 shares-30,000 shares

III. To the applicants for 10,000 shares - NIL

Call was made and the amounts due were received. Pass the jounal entries for the above transactions, assuming that the excess application money on partial allotment category was adjusted towards allotment and call.

[Ans.: Excess application money adjusted towards allotment ₹90,000 and call ₹10,000. Excess application money refunded ₹50,000.]

40. Sunshine Ltd. issued 5,000 Equity shares of ₹100 each for public subscription, payable on application ₹50, on allotment ₹30 and first and final call ₹20. Applications were received for 12,500 shares. It was decided :

(i) to refuse allotment to the applicants for 2,500 shares,

(ii) to allot at 50% to Mr. X who had applied for 4,000 shares,

(iii) to allot in full to Mr. Y who had applied for 2,000 shares,

(iv) to allot balance of available shares on pro-rata basis among remaining applicants,

(v) to utilise excess application money towards allotment and call.

Pass necessary journal entries assuming that the entire amount due on allotment and call was received.

[Ans.: Excess application money adjusted towards allotment ₹90,000 and call ₹60,000.

Allotment money received ₹60,000 and call money received ₹40,000.

Excess application money refunded ₹2,25,000.]

41. Sunrise Ltd. issued 6,000 Equity shares of ₹100 each at ₹120 per share for public subscription, payable on application ₹50, on allotment (including premium) ₹50 and balance on call at the end of 3 months from the date of allotment. Application for 8,500 shares were received by 5.4.2016 and shares were allotted on 24.4.2016

at the rate of 3 shares for every 4 shares applied for and an amount of 25,000 was refunded on the same date. All the amounts due on allotment and call were received on due dates. Pass Journal entries in the books of the company.

[Ans.: Excess application money adjusted towards allotment ₹1,00,000, Allotment money received ₹2,00,000]

[Hints. : Applications for 500 shares, i.e, ₹25,000 / 50 rejected and 6,000 shares were allotted among applicants for 8,000 shares]

42. X Ltd. issued for public subscription 5,000 Equity shares of ₹100 each at par, the entire amount being payable with application. Applications received for all the shares and shares were duly allotted.

    Pass necessary journal entries in the books of the Company.

43. A Ltd. Purchased a Building for ₹12,00,000 from Biswakarma Builders. It issued Equity shares of ₹100 each as fully paid up is full satisfaction of their claim. Pass Journal entries in the books of A Ltd. in case such issue is (a) at par and (b) at a premium of 20%.

    [Hints. : (a) 12,000 Equity shares were issued.

    (b) 10,000 Equity shares were issued]

44. S Ltd. Purchased a machine from Utkal Machinary for ₹2,50,000. An amount of ₹10,000 was paid by way of cheque and for the balance fully paid up Equity shares of ₹10 each at a premium of 20% were issued.

    Journalise the transactions in the books of the Company.

    [Hint - 20,000 Equity share were issued.]

45. AB Ltd. purchased a business with the following Assets and Liabilities from XY Ltd. and issued 10,000 fully paid up Equity shares of ₹100 each in full satisfaction of their claims :

	₹
Land and Buildings	6,00,000
Plant and Machinery	2,50,000

Stock-in-trade	30,000
Sundry Debtors	70,000
Bills Receivable	50,000
Cash at Bank	2,00,000
Sundry Creditors	1,80,000
Bills Payable	25,000

Journalise the above tranasactions in the books of AB Ltd.

[Hint - Goodwill ₹5000.]

46. RK Ltd. purchased a running business, which had the following Assets and Liabilities, from BK Ltd. for ₹20,00,000, payable as ₹15,00,000 is fully paid up Equity shares of ₹100 each and balance in Account Payee cheque :

Buildings	12,00,000
Plant	8,00,000
Stock-in-trade	30,000
Sundry Debtors	70,000
Cash at Bank	1,00,000
Sundry Creditors	50,000

Pass journal entries in the books of the company

[Hint - Capital Reserve ₹1,50,000.]

47. Bharat Ltd. issued 10,000 Equites shares of ₹100 each credited as fully paid to the promoters for their services. The company also issued 1,000 Equity shares of ₹100 each credited as fully paid to the underwriters for their commission. Pass necessary journal entries.

48. AB Ltd. issued 10,000 Equity shares of ₹100 each at par, payable on application ₹30, on allotment ₹30, on first call ₹20 and on second and final call ₹20. Mr. X was allotted 100 Equity shares. Show the journal entries in respect of forfeiture of shares in each of the following cases :

a) Mr. X failed to pay the allotment money and his shares were forfeitcd.

b) Mr. X failed to pay the allotment money and on his subsequent failure to pay the first call money, his shares were forfeited.

c) Mr. X failed to pay the first call money and on his failure to pay the second and final call money, his shares were forfeited.

49. Sunflower Ltd. issued 1,00,000 Equity shares of ₹10 each, payable on application ₹4, on allotment ₹2, on first call ₹2 and on final call ₹2 per share. All the shares were applied for by the public and were duly allotted. All the amounts due were received except from a shareholder holding 1,000 shares on which only application and allotment money were received. Pass journal entries in respect of forfeiture of shares if,

a) Shares were forfeited after first call,

b) Shares were forfeited after final call.

50. A Ltd. with an authorised capital of 5,00,000 Equity share of ₹10 each, invited applications for 50,000 shares of ₹10 each for public subscription, payable on application ₹3, on alllotment ₹3, on first call ₹2 and on final call ₹2 per share. The issue was fully subscribed and shares were duly allotted. All the amounts due on shares were received except the following : Mohan, to whom 100 shares were allotted, failed to pay the amount due on allotment and calls.

Rohan, who holds 200 shares, failed to pay the money due on first and final call.

Sohan, who holds 300 shares, failed to pay the final call money.

The shares allotted to Mohan, Rohan and Sohan were forfeited by the company after the final call. Pass journal entries to record the above issue and forfeiture of shares. Also show how share capital will appear in the Balance Sheet after the forfeiture of shares. Prepare the Notes to Accounts for the same.

[Ans : Subscribed and fully paid up capital ₹4,90,100, Share Forfeiture Account ₹3,900]

51. A Ltd. invited applications for issue of 40,000 Equity shares of ₹10 each at par. The amount payable on each share was as follows :

On application ₹4

On allotment ₹4

On first and final call ₹2

Applications were received for 67,000 shares. Allotment was made as follows :

a) To applicants for 20,000 shares - full

b) To applicants for 40,000 shares - 50%

c) To applicants for 7,000 shares - NIL

₹76,000 was realised on account of allotment (excluding the amount carried from application money) and ₹78,000 was realised towards first and final call.

The directors decided to forfeit the shares of those applicants to whome full allotment was made and on which allotment money and call money were over due.

Pass necessary journal entries in the books of the company to record the above transactions.

[Hint - Number of shares forfeited 1,000]

52. XY Ltd. was registered with an authorised capital of ₹50,00,000 in ₹100 Equity shares. Of these shares, 2,000 Equity shares were issued as fully paid to a vendor for the purchase a machine and 12,000 Equity shares were subscribed for by the public and were duly allotted. The company had so far called up ₹60 per share, payable as ₹30 on application, ₹10 on allotment, ₹10 on first call and ₹10 on second call. The amounts received in respect of these shares were as follows :

on 8,000 shares - full amount called up

on 2,400 shares - ₹50 per share

on 1,000 shares - ₹40 per share

on 600 shares - ₹30 per share

The directors forfeited 1,600 shares on which less than ₹50 per share had been received.

Pass the journal entries in the books of the company and show the 'share capital' as it would appear in the Balance Sheet of the company with Notes to Accounts.

[Ans. : Subscribed and fully paid up capital ₹2,00,000, Subscribed but not fully paid up capital ₹6,00,000, Share Forfeiture A/c ₹58,000.]

53. DLC Ltd. invited applications for 80,000 Equity shares of ₹100 each at ₹120 per share, payable ₹50 on application (including premium), ₹50 on allotment and the balance on first and final call. Applications for 1,00,000 Equity shares were received. Of the amounts received on applications, ₹2,50,000 was refunded and ₹7,50,000 was applied for the amount due on allotment. All the shareholders paid the amounts due on their shares allotted with the exception of one shareholder, holding 1,000 shares, failed to pay the call amount. These shares were forfeited.

Journalise the transactions in the books of the company.

[Ans. : Share Forfeiture A/c ₹80,000]

54. A limited company issued 50,000 Equity shares of ₹10 each at ₹12 per share, payable on application ₹3, on allotment (including premium) ₹7 and on first and final call ₹2. All the shares were subscribed by the public and duly allotted by the directors. All the amounts due on the shares were received except on 1,000 shares for non-payment of allotment and call money. These shares were forfeited subsequently. Pass necessary journal entries in the books of the company.

[Ans. : Share Forfeiture A/c ₹3,000.]

55. MK Ltd. invited applications for 10,000 Equity shares of ₹100 each at a premium of ₹50 per share. The amount was payable as follows:

on application ₹50 per share (including premium of ₹20)

on allotment ₹70 per share (including premium of ₹20)

on first and final call ₹30 per share (including premium) of ₹10)

Applications for 8,000 shares were received. All the applications were accepted and shares were duly allotted. Mr. A to whom 100 shares were allotted, failed to pay the allotment money. His shares were forfeited immediatly after allotment. Afterwards, the first and final call was made.

Mr. B, the holder of 50 shares, failed to pay the call money. His shares were also forfeited.

Pass the journal entries in the books of the company.

[Ans : Share Forfeiture Account ₹7,000]

56. XYZ Ltd. issued 50,000 Equity shares of ₹10 each for public subscription at a premium of ₹2 per share, payable ₹5 on application, ₹5 (including premium) on allotment and ₹2 on first and final call. Applications were received for 60,000 shares. The directors rejected applications for 10,000 shares and remaining applications were accepted. The allotment money was received in full. But the holders of 1,000 shares failed to pay the first and final call money. These shares were forfeited and subsequently reissued at ₹8 per share as fully paid up. Pass the journal entries.

[Ans. : Capital Reserve ₹6,000.]

57. FM Ltd. issued for public subscription 10,000 Equity shares of ₹10 each at par payable as follows :

on application ₹3

on allotment ₹5

on first and final call ₹2.

All the shares were subscribed and duly allotted. All the amounts due were received except on 2,000 shares held by Mr. Z who failed to pay the call money. These shares were forfeited and subsequently 1,500 of these shares were reissued at ₹8 per share as fully paid up.

Journalise the transactions in the books of the company.

[Ans.: Capital Reserve ₹9,000, Balance of Forfeiture A/c ₹4,000.]

58. A limited company issued 2,000 Equity shares of ₹10 each to A, 4,000 Equity shares of ₹10 to B and 6,000 Equity shares of ₹10 each to C. The details of the

amount received from them were :

A paid the application money @ ₹2.50 per share.

B paid the application Money of ₹2.50 and allotment money of ₹3 per share.

C paid the application money of ₹2.50, allotment money of ₹3 and first call money of ₹2.50 per share.

They could not pay their arrears of different calls made and also the amount due on final call @₹2 per share. Directors forfeited the shares held by them. These shares were subsequently reissued for cash at 10% discount.

Pass journal entries relating to forfeiture and reissue in the books of the company.

[Ans : Capital Reserve ₹ 63,000]

59. XY Ltd. issued 50,000 Equity shares of ₹ 10 each at a premium of ₹ 6 per share. The amount was payable as follows:

On application ₹ 8 per share (including ₹ 3 premium)

On allotment balance amount.

The issue was fully subscribed. One shareholder holding 500 shares paid the full amount due on his holdings with application. Another shareholder holding 300 shares could not pay the allotment money and his shares were forfeited. Subsequently these shares were reissued for ₹ 4,800 as fully paid up. Pass journal entries.

[Ans : Allotment money received ₹ 3,93,600, Capital Reserve ₹ 1,500]

60. AB Ltd. issued 5,00,000 Equity Shares of ₹ 10 each for public subscription, payable ₹ 3 on application, ₹ 5 on allotment and the balance on first and final call. Applications were received for 15,00,000 shares and the shares were allotted on pro-rata basis. The excess application money was to be adjusted towards allotment only. A shareholder who had applied for 12,000 shares, could not pay the call money and his shares were forfeited. Subsequently, these shares were reissued at ₹ 9 per share as fully paid up. Pass journal entries for the above transactions.

[Ans. Capital Reserve ₹ 28,000]

61. BC Ltd., issued for public subscription 20,000 Equity shares of ₹ 10 each at a premium of 20%, payable as,

₹ 5 on application,

₹ 5 on on allotment (including Premium), and

₹ 2 on first and final call.

Applications for 30,000 shares were received. Applications for 6,000 shares were rejected and allotment was made on pro-rata basis among the remaining applicants. Sandeep was allotted 400 shares and he failed to pay the allotment money and call money. The directors forfeited his shares and subsequently those shares were reissued at ₹ 9 per share.

Prepare the Cash Book and pass the journal entries in the books of the company.

[Ans. : Capital Reserve ₹ 2,000]

62. Utkal Ltd. invited applications for 50,000 Equity shares of ₹ 100 each at a premium of ₹ 20 per share, payable as follows :

on application	₹ 30,
on allotment	₹ 50 (including premium),
on first call	₹ 20, and
on final call	₹ 20.

Applications were received for 1,00,000 shares and allotment was made on pro-rata basis. Excess money paid on application was utilised in respect of amounts due on allotment.

X, to whom 1,000 shares were allotted , failed to pay the allotment money and on subsequent failure to pay the first call money, his share were forfeited.

Y, to whom 2,000 shares were allotted, failed to pay the two calls and his shares were forfeited after the final call. Out of these forfeited shares, 2,000 shares (whole of X' s shares included) were reissued to Z @ ₹ 80 per share.

Prepare the Cash Book and pass the journal entries. Show how will the Share Capital be shown in the company's Balance Sheet. Also prepare the Notes to Accounts.

[Ans.: Capital Reserve ₹ 80,000, Balance in Share Forfeited A/c ₹ 60,000.]

63. A Ltd. invited applications for 10,000 Equity shares of ₹ 100 each, payable as follows :

on application	₹ 40 per share,
on allotment	₹ 40 per share, and
on first and final call	₹ 20 per share.

Applications were received for 15,000 shares and allotment was made on pro rata basis as follows :

Applicants for 8,000 shares were allotted 6,000 shares on pro-rata basis and applicants for 7,000 shares were allotted 4,000 shares on pro-rata basis.

A (an applicant of the first category), who was allotted 240 shares, failed to pay the allotment money and his shares were forfeited after allotment.

B (an applicant of the second category), who had applied for 140 shares, could not pay the first and final call money and his shares were also forfeited.

Out of the forfeited shares, 200 shares (including all forfeited shares of B) were reissued @ ₹ 80 per share fully paid up.

Journalise the above transactions in the books of the company.

[Ans :. Balance is Share Forfeited A/c ₹ 6,400, Capital Reserve ₹ 8,800.]

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CHAPTER-10

ACCOUNTING FOR COMPANIES :
ACCOUNTING FOR DEBENTURES

10.1 INTRODUCTION :

Debentures play a significant role while preparing financial planning for a company. A company requires long-term funds for its initial needs and for expansion of its activities. For this purpose, a company may borrow money by issue of debentures in addition to raising funds by issue of shares. Thus, debentures are one of the important sources of raising long-term finance for a company.

10.2 MEANING, DEFINITION AND FEATURES OF DEBENTURES

The word 'debenture' has been derived from a Latin word 'debere' which means to borrow. Debenture is a written acknowledgement of a debt by a company under its common seal. A debenture issued by a company is usually in the form of a certificate under the seal of the company. A Debenture Certificate contains terms of payment of interest at a fixed rate and the terms of repayment of the principal sum on a specified date. Debentrues normally create a charge on the assets of the company. It is usual to prefix 'Debentures' with the rate of interest. Thus, if the rate of interest is 10%, the name given will be '10% Debentures'. Debentureholders are the creditors of the company. Debentures are shown under the head 'Non-current Liabilities' and sub-head 'Long-term Borrowings' on the Equity and Liabilities side of the Balance Sheet.

According to section 2(30) of the Companies Act, 2013, "Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not."

Features or Characteristics of Debentures

The features or characteristics of a debenture are as follows :

(i) A debenture is a certificate of acknowledgement of indebtedness and as such, the inner significance of a debenture is indebtedness.

(ii) A debenture is issued under the seal of the company.

(iii) Debenture certificate contains a contract for the repayment of principal sum at a specified date. Usually, the debentures are repaid after a long period, such as ten years or twelve years. Debentureholders have priority over shareholders as to repayment in case of winding up of a company.

(iv) As per the Companies Act, 2013 no company is allowed to issue debentures having a maturity period of more than 10 years from the date of issue. But a company, engaged in infrastructure projects, can issue debentures for more than 10 years, but not exceeding 30 years.

(v) Debentures are issued with a specified rate of interest. A debentureholder receives the interest on his debentures at the specified rate mentioned in the debenture certificate. Payment of interest is made, usually after every six months, whether the company makes a profit or not.

(vi) Usually a debenture creates a floating charge on the assets of the company. This signifies that if the company is unable to repay to the debentureholders as per the terms of the issue, the debentureholders can take legal action to realise their money out of the sale proceeds of the assets of the company.

(vii) Sometimes a debenture creates a fixed charge on particular assets of the company instead of floating charge.

(viii) A debentureholder, being a creditor, has no right to vote in the meetings of the company.

10.3 TYPES OF DEBENTURES

The following types of debentures can be issued by a company :

(a) From Security point of view :

(i) Unsecured or Naked Debentures

Unsecured or Naked debentures are those debentures which are issued without any security in respect of interest or the repayment of the principal. Solvency of the company is the only security. Such debentureholders are treated as unsecured creditors at the time of liquidation of the company. Such debentures are not common these days.

(ii) Secured or Mortgage Debentures

Secured or Mortgage debentures are those debentures which are secured by a charge on the assets of the company. When such debentures are secured on specific assets of the company, these are known as 'Secured Debentures having fixed charge'. If the company is unable to repay the debenturholders on the due date, such type of debentureholders can realise their money from the assets mortgaged with them. On the other hand, when the debentures are secured on all assets of the company, these are known as 'Secured Debentures having floating charge'. Such type of debentureholders can claim their dues for repayment on priority basis before anything is paid to the unsecured creditors in the event of liquidation of the company.

(b) From Permanence point of View :

(i) Redeemable Debentures

Redeemable debentures are those debentures which are repaid by the company either in lump sum at the end of a specific period or by instalments during the life time of the company. Most of the debentures are of this type.

(ii) Irredeemable or Perpetual Debentures

Irredeemable or Perpetual debentures are those debentures which are not repayable by the company during its life time. Such debentures are to be paid only in the event of liquidation of the company, as in case of shares. As per the Companies Act, 2013, no company is allowed to issue such type of debentures.

(C) From Convertibility point of view :

(i) Convertible Debentures

Convertible debentures are those debentures which are convertible into equity shares or other securities at a stated rate of exchange either at the option of the debentureholders or at the option of the company after a specified period. When full amount of debenture is convertible into shares, such debentures are called 'Fully Convertible Debentures.' But when only a part of the amount of debenture is convertible into shares, such debentures are called 'Partly Convertible Debentures'. As per SEBI guidelines where the conversion is to be made at or after 18 months from the date of allotment but before 36 months, any conversion in part or whole shall be optional on the part of the debentureholders. Convertible debentures are very popular these days as they provide liquidity, safety, capital appreciation and assured return to the investors.

(ii) Non-Convertible Debentures

Non-convertible debentures are those debentures which cannot be converted into equity shares or other securities.

(d) From Records point of view :

(i) Bearer Debentures

Bearer debentures are those debentures which are transferable by mere delivery and the company does not keep any record of names and addresses of the debantureholders. Interest is paid at the end of the stipulated period to the bearers of such debentures. In other words, interest is paid to the holders irrespective of identity. Coupons are attached with these debutures and interest is paid to such persons who produce the coupons in the specified bank.

(ii) Registered Debentures

Registered debentures are those debentures which are registered in the name of a holder in the books of the company. Names and addresses of the holders of registered debentures are recorded in a register of the company. Such debentures are not freely transferable. The transfer of such debentures needs the execution of a proper transfer deed. Principal amount and interest on such debentures are paid to the person whose name appears is the register of the company.

(e) From Priority point of view :

(i) First Debentures

First debentures are those debentures which are repayable prior to other debentures.

(ii) Second Debentures

Second debentures are those debentures which are payable only after the redemption of the first debentures.

10.4 DISTINCTION BETWEEN SHARE AND DEBENTURE

Share and Debenture can be distinguished as follows:

Basis	Share	Debenture
1.Nature	Share is a unit of owned capital.	Debenture is a part of loan capital.
2. Owner ship	A person holding a share, is a joint owner of the company.	A person holding a debenture, is a creditor of the company.
3. Reward	Dividend is the reward for the shareholders.	Interest is the reward for the debentureholders.

4. Rate of Dividend and Interest	The rate of dividend on equity shares may change from year to year depending upon the profits and decision of the directors.	The rate of interest on debentures is fixed and interest must be paid irrespective of the fact that the company makes a profit or incurs a loss.
5. Priority of payment of reward	Payment of dividend gets no priority over payment of interest.	Payment of interest gets priority over payment of dividend.
6. Priority of repayment of principal in case of winding up	In case of winding up, the payment of share capital is made after the repayment of debentures.	In case of winding up, the repayment of debentures is made before the payment of share capital.
7. Secured by charge	Shares are not secured by any charge. Hence, shareholders bear more risk.	Debentures are generally secured and carry a charge on the assets of the company. Hence, debentureholders bear little risk.
8. Voting right	Shareholders generally enjoy voting right.	Debentureholders do not enjoy any voting right.
9. Voluntary or compulsory redemption	It is at the option of the company to return the amount of share capital by buying back its own shares.	The amount of debentures must be returned as per the terms of the issue.
10. Restriction on issue at discount	Under section 53 of the Companies Act, 2013, shares cannot be issued at a discount except sweat equity shares.	There is no restriction on the issue of debentures at a discount.
11. Mortgage	There can be no mortgage shares. Assets of the company cannot be mortgaged in favour of shareholders.	There can be mortgage debentures. Assets of the company can be mortgaged in favour of debentureholders.
12. Convertibility	Equity shares are not convertible. However, preference shares may be converted into equity shares.	Debentures may be converted into shares.

10.5 ISSUE OF DEBENTURES

Issue of debentures means issue of a certificate by the company under its seal, which is an acknowledgement of debt taken by the company. The procedure of issue of debentures is similar to that of the issue of shares. A prospectus is issued, applications are invited, applications are received with application money and letters of allotment are issued. On rejection of applications, application money in respect of rejected applications is refunded. In case of partial allotment, excess application money may be adjusted towards allotment and subsequent calls. The company may also ask for the entire amount due on debentures to be paid in one instalment on application. As per section 39 of the Companies Act, 2013, condition of minimum subscription applies on every type of securities including debentures.

Issue of debentures takes various forms which are as follows :

- Issue of Debentures for cash
- Issue of Debentures for consideration other than cash
- Issue of Debentures as collateral security

10.5.1 Issue of Debentures for Cash

Debentures are normally issued by a company for cash. The amount due on debentures may be called by the company in lump sum with application or it may also be called in instalments as in the case of shares, such as on application, on allotment and on one or more calls. Accounting entries on issue of debentures are also the same as in the case of issue of shares. The only difference is that 'Debenture A/c' will be opened instead of 'Share Capital A/c'. As mentioned earlier, it is usual to prefix the rate of interest to the debentures. Like shares, debentures may be issued either at par or at a premium or at a discount. It is to be mentioned here that there is no restriction to issue debntures at a discount.

Journal Entries: (assuming that the debentures carry 10% interest)

A. When the amount is payable in lump sum on application :

When the full amount on debentures issued, is received in one instalment, the amount should be credited to 'Debenture Application and Allotment A/c' instead of 'Debenture Application A/c'.

1. When the debentures are issued at par :

(i)

Bank A/c	Dr.	(With the amount
To 10% Debenture Application and Allotment A/c		received)
(Being the application money received)		

(ii)

10% Debenture Application		
and Allotment A/c	Dr.	(With the face value
To 10% Debentures A/c		of Debentures)
(Being transfer of application memory		
to Debentures A/c.)		

2. When the debentures are issued at a premium :

(i)

Bank A/c	Dr.	(With the amount
To 10% Debenture Application and Allotment A/c		received)
(Being the application money received)		

(ii)

10% Debenture Application		
and Allotment A/c	Dr.	(With the amount received)
To 10% Debentures A/c		(with the nominal value of debentures)
To Securities Premium Reserve A/c		(With premium amount)
(Being application money transferred to Debentures A/c and Security Premium Reserve A/c.)		

3. When the debentures are issued at a discount :

(i)

Bank A/c	Dr.	(With the amount
To 10% Debenture Application and Allotment A/c		received)
(Being the application money received)		

(ii)	10% Debenture Application and Allotment A/c	Dr.	(With the amount received)
	Discount on issue of Debentures A/c	Dr.	(With the discount on issue)
	To 10% Debentures A/c		(With the face or nominal value of Debentures.)
	(Being application money transferred to 10% Debentures and Discount on issue of Debentures A/c being debited.)		

Illustration 1

X Ltd. invited applications for issue of 10,000, 10% Debentures of 100 each at par. The full amount was payable on applicaton. All the debentures were fully subscribed and duly allotted. Pass necessary journal entries is the books of X Ltd.

Solution :

Books of X Ltd.
Journal

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. To 10% Debenture Application and Allotment A/c (Being receipt of application money on 10,000 debentures @₹100 each.)		10,00,000	10,00,000
	10% Debenture Application and Allootment A/c Dr. To 10% Debentures A/c (Being transfer of application money to 10% Debentures A/c.)		10,00,000	10,00,000

Illustration 2

Y Ltd. invited applications for 10,000, 10% Debentures of ₹100 each at a premium of ₹20 per debenture. The full amount due on debentures was payable on application. Applications were received for 12,000 debentures. Applications for 2,000 debentures were rejected and money was refunded. The remaing applications were accepted in full and duly allotted. Pass journal entries in the books of Y Ltd.

Solution :

Books of Y Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		14,40,000	
	To 10% Debenture Application and Allotment A/c			14,40,000
	(Being application money received for 12,000 debentures @₹120 each.)			
	10% Debenture Application and Allotment A/c Dr.		14,40,000	
	To 10% Debentures A/c			10,00,000
	To Securities Premium Reserve A/c			2,00,000
	To Bank A/c			2,40,000
	(Being transfer of application money to 10% Debentures A/c @₹100 and to Securities Premium Reserve A/c @₹20 each, the money on rejected applications being refunded.)			

Illustration 3

Z Ltd. invited applications for 10,000, 10% Debentures of ₹100 each at a discount of ₹10 per debenture. The full amount due on debentures was payable on application. Applications were received for 9,000 debentures. Directors accepted all the applications and debentures were duly allotted.

Pass the journal entries in the books of Z Ltd.

Solution :

Books of Z Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		8,10,000	
	To 10% Debenture Application and Allotment A/c			8,10,000
	(Being application money received on 9,000 debentures @₹90 per debenture)			

	10% Debenture Application and Allotment A/c Dr.		8,10,000	
	Discount on issue of Debentures A/c Dr.		90,000	
	To 10% Debentures A/c			9,00,000
	(Being transfer of Debenture Application money to 10% Debentures A/c and Discount on issue of Debenture A/c being debited @₹10 per debenture)			

B. When the amount is payable in instalments :

1. When Debentures are issued at par :

When debentures are issued at face value or nominal value of debentures, it is said to be issued at par. When debentures are issued at par, the following entries are recorded in the books of the company assuming that the debentures carry 10% interest :

(i) On receipt of application money -

Bank A/c To 10% Debenture Application A/c.	Dr.	(with the amount of application money received)

(ii) On transfer of application money to Debentures A/c -

10% Debenture Application A/c To 10% Debentures A/c	Dr.	(with the amount of application money on debentures allotted)

(iii) On refund of application money on rejected applications -

10% Debenture Application A/c To Bank A/c	Dr.	(With the amount refunded)

(iv) On transfer of excess application money on partially accepted applications-

10% Debenture Application A/c To 10% Debenture Allotment A/c	Dr.	(with excess application money adjusted for allotment)

(v) On allotment money becoming due-

10% Debenture Allotment A/c To 10% Debentures A/c	Dr.	(with the allotment money due)

(vi) On receipt of allotment money-

Bank A/c	Dr.	(with allotment money received)
To 10% Debenture Allotment A/c		

(vii) On first call money becoming due-

10% Debenture First Call A/c	Dr.	(with the amount due on first call)
10% Debentures A/c		

(viii) On receipt of first call money-

Bank A/c	Dr.	(With first Call money received)
To 10% Debenture First Call A/c		

(ix) On final call money becoming due-

10% Debenture Final Call A/c	Dr.	(With the amount due on final call)
To 10% Debentures A/c		

(x) On receipt of final call money-

Bank A/c	Dr.	(with the final call money received)
To 10% Debenture Final Call A/c		

Illustration 4

Rose Ltd. issued 10,000, 15% Debentures of ₹100 each at par, payable as follows:

On application ₹30, on allotment ₹30,

On first call ₹20 and on final call ₹20.

Public applied for 12,000 debentures. Applications for 9,000 debentures were accepted in full. Application for 1,600 debentures were allotted 1,000 debentures and applications for 1,400 debentures were rejected. Excess money on applications was utilised towards allotment. All amounts due were duly received. Pass journal entries in the books of the company.

Solution:

Books of Rose Ltd.
Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 15% Debenture Application A/c (Being application money for 12,000 debentures received @₹30 each.)		3,60,000	3,60,000
	15% Debenture Application A/c Dr. To 15% Debentures A/c To 15% Debenture Allotment A/c To Bank A/c (Being application money transferred to 15% Debentures A/c, 15% Debentures Allotment A/c and Money refunded to rejected applicants for 1,400 debentures.)		3,60,000	3,00,000 18,000 42,000
	15% Debenture Allotment A/c Dr. To 15% Debentures A/c (Being Allotment money due on 10,000 debentures @₹30 each.)		3,00,000	3,00,000
	Bank A/c Dr. To 15% Debenture Allotment A/c (Being balance of allotment money received i.e. ₹3,00,000-₹18,000)		2,82,000	2,82,000
	15% Debenture First Call A/c To 15% Debentures A/c (Being first call money due @20 each.)		2,00,000	2,00,000
	Bank A/c Dr. To 15% Debenture First Call A/c (Being first call money received.)		2,00,000	2,00,000
	15% Debenture Final Call A/c Dr. To 15% Debentures A/c (Being final call money due @₹20 each)		2,00,000	2,00,000
	Bank A/c Dr. To 15% Debenture Final Call A/c (Being final call money received)		2,00,000	2,00,000

Illustration 5

Sunflower Ltd. invited applications for 5,000, 12% Debenture of ₹100 each at par and payable as follows:

₹30 on application, ₹40 on allotment,

₹20 on first call and ₹10 on final call.

Public applied for all the debentures and allotment was duly made. All sums on allotment and calls were received. However, Bijay who holds 100 debentures, failed to pay the allotment money and Bimal who holds 200 debentures, paid the money due on calls in advance with allotment money. Bijay paid the arrear amount with the first call money. Journalise the above in the books of the company.

Solution:

Books of Sunflower Ltd.
Journal

Date	Particulars	LF	Dr.(₹)	Cr.(₹)
	Bank A/c Dr. To 12% Debenture Application A/c (Being application money received on 5,000 debentures @₹30 each)		1,50,000	1,50,000
	12% Debenture Application A/c Dr. To 12% Debentures A/c (Being transfer of Debenture Application money to 12% Debentures A/c on allotment)		1,50,000	1,50,000
	12% Debenture Allotment A/c Dr. To 12% Debentures A/c (Being allotment money due on 5,000 debentures @₹40each.)		2,00,000	2,00,000
	Bank A/c Dr. To 12% Debenture Allotment A/c To Calls-in-Advance A/c (Being allotment money received on 4,900 debentures @₹40 each and calls-in-advance received on 200 debentures @₹30 each.)		2,02,000	1,96,000 6,000

	12% Debenture First Call A/c Dr. To 12% Debentures A/c (Being first call due on 5,000 debentures @₹20 per debenture.)		1,00,000	 1,00,000
	Bank A/c Dr. Calls-in-Advance A/c Dr. To 12% Debenture First Call A/c To 12% Debenture Allotment A/c (Being first call money received after adjusting the advance of first call @₹20 on 200 debentures and arrear on allotment received on 100 debentures @₹40 each)		1,00,000 4,000	 1,00,000 4,000
	12% Debenture Final Call A/c Dr. To 12% Debentures A/c (Being final call due on 5,000 debentures @₹10 each.)		50,000	 50,000
	Bank A/c Dr. Calls-in-Advance A/c Dr. To 12% Debenture Final Call A/c (Being final call money received after adjusting the advance of final call @₹10 each on 200 debentures.)		48,000 2,000	 50,000

2. When Debentures are issued at Premium :

When debentures are issued at a price more than the face value or nominal value of debentures, it is said to be issued at a premium. If the face value or nominal value of debentures of a company is ₹100 and such debentures are issued at ₹120 each, the debentures are said to have been issued at a premium, the premium amount being ₹20 per debenture. The amount of premium should be credited to a separate account called 'Securities Premium Reserve A/c' since the debentures are also securities like shares. It is a capital profit for the company and is shown separately on the Equity and Liabilities side of the Balance Sheet under the sub-head 'Reserves and Surplus' and head 'Shareholders' Funds'.

Journal Entries :

(a) When premium is collected with application money :

(i)

On receipt of application money -		
Bank A/c	Dr.	(With application money including premium)
To Debenture Application A/c		

(ii)

On transfer of Debenture Application A/c to Debenture A/c -		
Debenture Application A/c	Dr.	(with application money including premium)
To Debentures A/c		(with application money excluding premium)
To Securities Premium Reserve A/c		(with the amount of premium)

(b) When premium is collected with allotment money :

(i)

On allotment money due -		
Debenture Allotment A/c	Dr.	(\with allotment money including premium)
To Debentures A/c		(with allotment money excluding premium)
To Securities Premium Reserve A/c		(with premium amount)

(ii)

On receipt of allotment money -		
Bank A/c	Dr.	(with allotment money received)
To Debenture Allotment A/c		

Illustration 6

X Ltd. invited applications for 20,000, 10% Debentures of ₹100 each at a premium of 20%, payable as ₹50 on application (including premium), ₹50 on allotment and ₹20 on first and final call. Applications were received for 30,000 debentures and allotment was made on pro-rata basis. All the money due was duly received. Pass journal entries in the books of X Ltd.

Solution :

Books of X Ltd.
Journal

Date	Particulars	LF	Dr.(₹)	Cr.(₹)
	Bank A/c Dr. To 10% Debenture Application A/c (Being application money received for 30,000 debentures @₹50 each.)		15,00,000	15,00,000
	10% Debenture Application A/c Dr. To 10% Debentures A/c To Securities Premium Reserve A/c To 10% Debenture Allotment A/c (Being transfer of application money to 10% Debentures A/c @₹30 each and Securities Premium Reserve A/c @₹20 each, and Excess money transferred to Allotment A/c)		15,00,000	6,00,000 4,00,000 5,00,000
	10% Debenture Allotment A/c Dr. To 10% Debentures A/c (Being allotment money due on 20,000 debentures @₹50each.)		10,00,000	10,00,000
	Bank A/c Dr. To 10% Debenture Allotment A/c (Being allotment money received after adjusting the excess application money.)		5,00,000	5,00,000
	10% Debenture First and Final Call A/c Dr. To 10% Debentures A/c (Being first and final call money due on 20,000 debentures @₹20 each.)		4,00,000	4,00,000
	Bank A/c Dr. To 10% Debenture First and Final Call A/c (Being first and final call money received.)		4,00,000	4,00,000

Illustration 7

A Ltd. issued 10,000, 14% Debentures of ₹100 each at 10% premium, payable as ₹50 on application, ₹40 on allotment (including premium) and balance on call.

Debentures were fully subscribed and duly allotted. All the amounts due were realised. Journalise the above transactions.

Solution :

Books of A Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 14% Debenture Application A/c (Being application money received on 10,000 debentures @₹50 each per debentures)		5,00,000	5,00,000
	14% Debenture Application A/c Dr. To 14% Debentures A/c (Being transfer of application money to 14% Debentures A/c.)		5,00,000	5,00,000
	14% Debenture Allotment A/c Dr. To 14% Debentures A/c To Securities Premium Reserve A/c (Being allotment money due @₹30 towards 14% debentures and ₹10 towards premium)		4,00,000	3,00,000 1,00,000
	Bank A/c Dr. To 14% Debenture Allotment A/c (Being allotment money received)		4,00,000	4,00,000
	14% Debenture Call A/c Dr. To 14% Debentures A/c (Being amount due on call @₹20 each on 10,000 debentures.)		2,00,000	2,00,000
	Bank A/c Dr. To 14% Debenture Call A/c (Being call money received.)		2,00,000	2,00,000

3. When Debentures are issued at discount :

When the issue price of debentures is less than the face value or nominal value, it is said that debentures are issued at discount, e.g., an issue of debentures of ₹100 each at ₹90 per debenture. There is no restriction regarding the maximum limit for discount on debentures in the Companies Act, 2013.

As per Accounting standard 26, borrowing costs and discount on issue of debentures could be amortised over loan period. Unamortised portion of such discount on issue or expenses on issue of debentures is shown on the aseets side of the Balance Sheet under the head, 'Current or Non-current Assets' depending on whether the amount will be amortised in the next 12 months or thereafter. For example, if the discount or expense on issue of debentures amounts to ₹1,00,000 and it is to be written off in 10 years, then :

₹10,000 shall be debited to Statement of Profit and Loss of the current year;

₹10,000 shall be shown under 'Other Current Assets' and, ₹80,000 shall be shown under 'Other Non-Current Assets' in the Balance Sheet.

Discount or Expense on issue of debentures is a capital loss. It should be written off within the life time of the debentures as early as possible. It can be written off against Securities Premium Reserve Account or Statement of Profit and Loss.

Discount on issue of debentures is recorded usually at the time of allotment by debiting 'Discount on issue of Debentures A/c.'

Journal Entries :

1. On allotment of debentures -

Debenture Allotment A/c	Dr.	(With allotment money)
Discount on issue of Debentures A/c	Dr.	(With discount amount)
To Debentures A/c		(With the total amount)

2. On receipt of allotment money -

Bank A/c	Dr.	(With allotment money
To Debenture Allotment A/c		received)

Illustration 8

B Ltd. issued 10,000, 15% Debentures of ₹100 each at a discount of 10%, payable as ₹30 on application, ₹40 on allotment and ₹20 on first and final call. Public applied for 12,000 debentures. Allotment was made for 10,000 debentures and the remaining applications were rejected. All the amounts due were duly received. Pass journal entries in the books of the company.

Solution:

Books of B Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 15% Debenture Application A/c (Being application money received for 12,000 debentures @₹30 per debenture.)		3,60,000	 3,60,000
	15% Debenture Application A/c Dr. To 15% Debentures A/c To Bank A/c (Being application money transferred to 15% Debentures A/c and excess money refunded.)		3,60,000	 3,00,000 60,000
	15% Debenture Allotment A/c Dr. Discount on issue of Debentures A/c Dr. To 15% Debentures A/c (Being the amount due on allotment, discount on issue being ₹1,00,000 @₹10 per debenture.)		4,00,000 1,00,000	 5,00,000
	Bank A/c Dr. To 15% Debenture Allotment A/c (Being allotment money received.)		4,00,000	 4,00,000
	15% Debenture First and Final Call A/c Dr. To 15% Debentures (Being the amount due on first and final call.)		2,00,000	 2,00,000
	Bank A/c Dr. To 15% Debenture First and Final Call A/c (Being first and final call money received.)		2,00,000	 2,00,000

Illustration 9

Moonlight Ltd. issued 5,000, 10% Debentures of ₹100 each at a discount of 10%, payable as follows :

₹30 on application,

₹40 on allotment, and

the balance on first and final call.

Applications were received for 4,000 Debentures and allotment was duly made. All sums were duly received. Expenses on issue of debentures amounted to ₹5,000. It was decided by Directors to write off $^{1}/_{5}$th of expenses on issue of debentures and discount on issue of debentures from Statement of Profit and Loss each year. Pass journal entries for the year in which debentures are issued.

Solution :

Books of Moonlight Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 10% Debenture Application A/c (Being application money received on 4,000 debentures @₹30 each.)		1,20,000	1,20,000
	10% Debenture Application A/c Dr. To 10% Debentures A/c (Being application money transferred to 10% Debentures A/c.)		1,20,000	1,20,000
	10% Debenture Allotment A/c Dr. Discount on issue of Debentures A/c Dr. To 10% Debentures A/c (Being the amount money due @₹40 per debenture on 4,000 debentures and discount on issue of debentures being @₹10 each.)		1,60,000 40,000	2,00,000

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 10% Debenture Allotment A/c (Being allotment money received.)		1,60,000	1,60,000
	10% Debenture First and Final Call A/c Dr. To 10% Debentures A/c (Being first and final call money due on 4,000 debentures @₹20 per debenture.)		80,000	80,000
	Bank A/c Dr. To 10% Debenture First and Final Call A/c (Being first and final call money received.)		80,000	80,000
	Expenses on issue of Debentures A/c Dr. To Bank A/c (Being expenses paid on issue of debentures)		5,000	5,000
	Statement of Profit and Loss A/c Dr. To Discount on issue of Debentures A/c To Expenses on issue of Debentures A/c (Being 1/5th of discount on issue of debentures and 1/5th of expenses on issue of debentures written off.)		9,000	8,000 1,000

10.5.2 Issue of Debentures for Consideration Other than Cash

Sometimes a company purchases assets from vendors or acquires a running business and instead of paying cash, the company decides to issue debentures in discharge of purchase consideration. Such an issue of debentures to vendors is known as issue of debentures for consideration other than cash. Such debentures may be issued at par or at a premium or at a discount.

Journal Entries :

(i) For Purchase of Assets -

Assets A/c (individually)	Dr.	(With the agreed value of assets)
To Vendor's A/c		(With purchase Price)

(ii) For Purchase of Business -

Assets A/c (individually)	Dr.	(with agreed value of assets)
To Liabilities (individually)		(with agreed value of liabilities)
To Vendor's A/c		(Price payable to vendor)

Notes : 1. If price payable to the vendor is more than the net assets (Assets-Liabilities) purchased, the difference is to be debited to Goodwill A/c.

2. If price payable to the vendor is less than net assets purchased, the difference is to be credited to Capital Reserve A/c.

(iii) For Issue of Debentures as consideration -

Vendor's A/c	Dr.	(with the purchase price)
Discount on issue of Debentures A/c	Dr.	(with discount on issue, if any)
To Debentures A/c		(with nominal value of debentures issued)
To Securities Premium Reserve A/c		(with premium on issue of debenture, if any.)

Illustration 10

B Ltd. purchased a Building from Mr. X at an agreed value of ₹19,20,000. It was agreed to pay the purchase price by issuing 10% Debentures of ₹100 each. Pass journal entries in the books of the company if,

(a) Debentures are issued at par,

(b) Debentures are issued at a premium of 20%, and

(c) Debentures are issued at discount of 20%.

Solution :

Books of B. Ltd.
Journal

	[redacted]	Particulars	LF	Dr. ₹	Cr. ₹
		Buildings A/c Dr. To X's A/c (Being Buildings purchased from X).		19,20,000	 19,20,000
(a)		X's A/c Dr. To 10% Debentures A/c (Being issue of 10% Debentures at par to X)		19,20,000	 19,20,000
(b)		X's A/c Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Being issue of 16,000, 10% Debentures of ₹100 each at a premium of 20%, calculated as follows : $\frac{₹19,20,000}{₹120} = 16,000$ Debentures.)		19,20,000	 16,00,000 3,20,000
(c)		X's A/c Dr. Discount on issue of Debentures A/c Dr. To 10% Debentures A/c (Being issue of 24,000, 10% Debentures of ₹100 each at 20% discount, calculated as follows : $\frac{₹19,20,000}{₹80} = 24,000$ Debentures.)		19,20,000 4,80,000	 24,00,000

Illustration 11

D Ltd. acquired assets of ₹5,45,000 and creditors of ₹50,000 from A Ltd. and issued 12% Debentures of ₹100 each at a premium of 10% as purchase consideration. Pass journal entries in the books of D Ltd.

Solution :

Working Note :

Purchase consideration = Assets - Creditors

= ₹5,45,000-₹50,000=₹4,95,000

No. of Debentures issued = $\frac{₹4,95,000}{₹110}$ = 4,500

Books of D Ltd.
Journal

Date	Particulars		LF	Dr. ₹	Cr. ₹
	Assets A/c To Creditors A/c To A Ltd. (Being acquisition of assets and creditors from A Ltd.)	Dr.		5,45,000	 50,000 4,95,000
	A Ltd. To 12% Debentures A/c To Securities Premium Reserve A/c (Being issue of 4,500, 12% Debentures of ₹100 each at 10% premium)	Dr.		4,95,000	 4,95,000 45,000

Illustration 12

P Ltd. purchased a running business having the following assets and liabilities from X and issued 50,000, 10% Debentures of ₹100 each at par in full satisfaction of his claim :

	₹
Land and Building	25,00,000
Plant and Machinery	15,00,000
Stock-in-trade	10,00,000
Sundry Debtors	5,00,000
Sundry Creditors	8,00,000

Journalise the above transactions in the books of P Ltd.

Solution :

Books of P Ltd.
Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Land and Buildings A/c Dr.		25,00,000	
	Plant and Machinery A/c Dr.		15,00,000	
	Stock-in-trade A/c Dr.		10,00,000	
	Sundry Debtors A/c Dr.		5,00,000	
	Goodwill A/c (Balancing figure) Dr.		3,00,000	
	To Sundry Creditors			8,00,000
	To X's A/c			50,00,000
	(Being purchase of assetes and liabilities from X, the excess of consideration over net assets being debited to Goodwill A/c.)			
	X's A/c Dr.		50,00,000	
	To 10% Debentures A/c			50,00,000
	(Being issue of 50,000, 10% Debentures of ₹100 each to X for purchase consideration.)			

Illustration 13

S Ltd. purchased a running business consisting of the following assets and liabilities from B Ltd. for ₹10,00,000, payable as ₹8,00,000 by issuing 12% Debentures of ₹100 each and balance in A/c Payee cheque :

	₹
Land and Buildings	6,00,000
Plant and Machinery	3,00,000
Furniture and Fixture	2,00,000
Sundry Debtors	20,000
Cash at Bank	5,000
Sundry Creditors	80,000
Bills Payable	20,000

Pass necessary journal entries in the books of S Ltd.

Solution :

Books of S Ltd.
Journal

Date	Particulars		LF	Dr. ₹	Cr. ₹
	Land and Buildings A/c	Dr.		6,00,000	
	Plant and Machinery A/c	Dr.		3,00,000	
	Furniture and Fixture A/c	Dr.		2,00,000	
	Sundry Debtors A/c	Dr.		20,000	
	Cash at Bank A/c	Dr.		5,000	
	To Sundry Creditors A/c				80,000
	To Bills Payable A/c				20,000
	To Capital Reserve A/c (Balancing figure)				25,000
	To B Ltd.				10,00,000
	(Being purchase of assets and liabilities from B Ltd., the excess of net assets over the consideration being credited to Capital Reserve A/c.)				
	B Ltd.	Dr.		10,00,000	
	To 12% Debentures A/c				8,00,000
	To Bank A/c				2,00,000
	(Being issue of 8,000, 12% Debentures of ₹100 each and balance of ₹2,00,000 paid in A/c Payee cheque to B Ltd. for purchase consideration.)				

Illustration 14

R Ltd. purchased a plant worth ₹4,80,000 from M Ltd. An amount of ₹1,00,000 was paid immediately and the balance of purchase price was discharged by issue of 4,000, 15% Debentures of ₹100 each. Pass journal entries to record the above transactions in the books of R Ltd.

Solution :

Books of R Ltd.
Journal

Date	Particulars		LF	Dr. ₹	Cr. ₹
	Plant A/c	Dr.		4,80,000	
	To M Ltd.				4,80,000
	(Being purchase of plant from M Ltd.)				

	M Ltd. Dr. To Bank A/c (Being an amount of ₹1,00,000 paid in part payment of consideration.)		1,00,000	1,00,000
	M Ltd. Dr. Discount on issue of Debentures A/c Dr. To 15% Debentures A/c (Being balance amount of ₹3,80,000 settled by issue of 4,000, 15% Debentures of ₹100 each at a discount)		3,80,000 20,000	4,00,000

Illustration 15

H Ltd. purchased a plant worth ₹2,70,000 from M Ltd. An amount of ₹50,000 was paid immediately and the balance of purchase price was discharged by issue of 10% debentures of ₹2,00,000 at a premium of ₹10%. Pass journal entries in the books of H Ltd.

Solution :

Books of H. Ltd.
Journal

Date	Particulars	LF	Dr.(₹)	Cr.(₹)
	Plant A/c Dr. To M Ltd. (Being purchase of plant from M Ltd.)		2,70,000	2,70,000
	M Ltd. Dr. To Bank A/c (Being ₹50,000 paid in part payment of purchase price.)		50,000	50,000
	M Ltd. Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Being the balance amount of ₹2,20,000 settled by issue of 10% Debentures of ₹2,00,000 at 10% premium.)		2,20,000	2,00,000 20,000

Illustration 16

A Ltd. purchased the following assets of X Ltd. for a purchase consideration of ₹48,00,000 :

Land and Buildings of ₹40,00,000 at ₹35,00,000, and

Plant and Machinery of ₹20,00,000 at ₹15,00,000.

An amount of ₹12,00,000 was paid by drawing a Promissory Note in favour of X Ltd. and the balance of consideration was discharged by issue of 10% Debentures of ₹100 each at a premium of 20%.

Record the necessary journal entries in the books of A Ltd.

Solution :

Books of A Ltd.

Journal

Date	Particulars		LF	Dr. ₹	Cr. ₹
	Land and Buildings A/c	Dr.		35,00,000	
	Plant and Machinery A/c	Dr.		15,00,000	
	To Capital Reserve A/c (Balancing figure)				2,00,000
	To X Ltd.				48,00,000
	(Being purchase of assetes from X Ltd., the excess of agreed value over the consideration being credited to Capital Reserve A/c.)				
	X Ltd.	Dr.		12,00,000	
	To Bills Payable A/c				12,00,000
	(Being promissory note of ₹12,00,000 issued for part payment of consideration to X Ltd.)				
	X Ltd.			36,00,000	
	To 10% Debentures A/c				30,00,000
	To Securities Premium Reserve A/c				6,00,000
	(Being issue of 30,000, 10% Debentures of ₹100 each at 20% premium.				
	No. of Debentures issued = $\frac{₹36,00,000}{₹120}$ = 30,000 .)				

10.5.3 Issue of Debentures as Collateral Security

A Company may take a loan from a bank or any other financial institution or any other person and may have to issue debentures as an additional or secondary security besides other principal security like property or asset of the company. Such an issue of debentures as additional security is termed as 'Issue of Debentures as collateral security'. Collateral securrity means secondary security in addition to principal security. The lenders to whom such debentures are issued as collateral security, will not be entitled to any interest on these debentures. They are only entitled to get interest on the loan advanced by them. If a default is made either in the payment of interest or in the repayment of loan, the lender will realise the amount of debt from the principal security. If the debt is not fully realised from the principal security, the lender may claim all the rights of a debentureholder. But if the company pays the loan amount with interest in full, the lender will return back the debentures to the company for cancellation.

There are two methods to deal with such type of issue of debentures in the books of the company :

1. First Method :

Under this method, no entry is passed in the books of the company at the time of issue of debentures as collateral security. But entry is passed only for taking loan. If a loan is taken from a bank, the entry will be:

Bank A/c	Dr.	(with the amount of loan)
To Bank Loan A/c		

On the equity and liabilities side of the Balance Sheet, a note is given below the loan that the loan is secured by the issue of debentures as collateral security under the sub-head "Long-term Borrowings" and head "Non-current Liabilities."

2. Second Method :

Under this method, entry is passed in the books of the company for issue of debentures as collecteral security with the entry for taking loan.

a. On taking a loan from bank -

Bank A/c	Dr.	(with the amount of loan)
To Bank Loan A/c		

b. On issue of Debentures as collateral security -

Debenture Suspense A/c	Dr.	(with the nominal value
To Debentures A/c		of Debentures issued as
		collateral security)

Debenture Suspense A/c will be shown as a deduction from Debentures A/c on the equity and liabilities side of the Balance Sheet and also a note is given below the Loan that the loan is secured by issue of debentures as collateral securities under the sub-head "Long-term Borrowings" and head "Non-Current Liabilities".

Illustration 17

A Ltd. had ₹20,00,000, 10% Debentures outstanding on 1st April, 2015. During the year 2015-16, the company took a loan of ₹5,00,000 from bank for which the company issued ₹6,00,000, 10% Debentures as collateral security.

Pass journal entries, if any. Show how the Debentures and Bank Loan will appear in the Balance Sheet of A Ltd. as at 31st March, 2016.

Solution :

(a) First Method :

Books of A Ltd.

(i) No entry for issue of Debentures as collecteral security.

(ii) On taking the Bank Loan-

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		5,00,000	
	To Bank Loan A/c			5,00,000
	(Being loan of ₹5,00,000 taken from bank and ₹6,00,000, 10% Debentures issued as collateral security.)			

Extract of Balance Sheet as at 31st March, 2016

Particulars	Note No.	31st March, 2016 (₹)	31st March, 2015 (₹)
I. EQUITY AND LIABILITIES : Non-Current Liabilities : Long-term Borrowings	1	25,00,000	20,00,000

Notes to Accounts :

		₹
I.	Long-term Borrowings :	
	10% Debentures (In addition, Debentures of ₹6,00,000 have been issued as collateral security)	20,00,000
	Bank Loan (on collateral security of 10% Debentures of ₹6,00,000)	5,00,000
		25,00,000

(b) Second Method :

Books of A Ltd.

Journal

Date	Particulars		LF	Dr. ₹	Cr. ₹
	Bank A/c	Dr.		5,00,000	
	To Bank Loan A/c				5,00,000
	(Being Loan of ₹5,00,000 taken from bank and ₹6,00,000,10% Debentures issued as collateral security.)				
	10% Debenture Suspense A/c	Dr.		6,00,000	
	To 10% Debentures A/c				6,00,000
	(Being issue of 10% Debentures of ₹6,00,000 as collateral security to secure a loan of ₹5,00,000 from bank.)				

Extract of Balance Sheet
as at 31st March, 2016

Particulars	Note No.	31st March, 2016 (₹)	31st March, 2015 (₹)
I. EQUITY AND LIABILITIES : Non-Current Liabilities : Long-term Borrowings	1	25,00,000	20,00,000

Notes to Accounts :

	Particulars		₹
I.	Long-term Borrowings :		
	10% Debentures	₹26,00,000	
	Less 10% Debenture Suspense A/c	₹6,00,000	20,00,000
	Bank Loan (on collateral security of 10% Debentures of ₹6,00,000)		5,00,000
			25,00,000

Illustration 18

Bright Ltd. issued 5,000,12% Debentues of ₹100 each at a premium of 10% on 1.10.2015. On the same date, the company purchased fixed assets of the value of ₹5,00,000 and took over current liabilities of ₹60,000 and issued 12% Debentures at a premium of 10% to the vendor. It also took a loan from bank for ₹2,00,000 and issued 12% Debentures as collateral security on the same date.

Journalise the transactions in the books of Bright Ltd. and prepare the extract of the Balance Sheet as at 31st March, 2016. Ignore interest.

Solution :

Books of Bright Ltd.
Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
2015 Oct. 1	Bank A/c Dr.		5,50,000	
	To 12% Debentures A/c			5,00,000
	To Securities Premium Reserve A/c			50,000
	(Being 5,000, 12% Debentures of ₹100 each issued at a premium of 10%)			
Oct. 1	Fixed Assets A/c Dr.		5,00,000	
	To Current Liabilities A/c			60,000
	To Vendor's A/c			4,40,000
	(Being purchase of fixed assets and take over of current liabilities)			

Oct. 1	Vendor's A/c Dr. To 12% Debentures A/c To Securities Premium A/c (Being issue of 4,000 debentures of ₹100 each at 10% premium, No. of debentures issued $= \frac{₹4,40,000}{₹110} = 4{,}000$.)		4,40,000	 4,00,000 40,000
Oct. 1	Bank A/c Dr. To Bank Loan A/c (Being loan taken from bank by issuing 12% Debentures as collateral security.)		2,00,000	 2,00,000
Oct. 1	12% Debentures Suspense A/c Dr. To 12% Debentures A/c (Being issue of 12% Debentures as collateral security)		2,00,000	 2,00,000

Extract of Balance Sheet
as at 31st March, 2016

	Particulars	Note No.	31st March, 2016 (₹)	31st March, 2015 (₹)
I.	EQUITY AND LIABILITIES :			
	Shareholders' Funds :			
	Reserve and surplus	1	90,000	
	Non-current Liabilities :			
	Long-term Borrowings	2	11,00,000	
	Current Liabilities		60,000	
II.	Assets :			
	Non-current Assets :			
	Fixed Assets		2,50,000	
	Current Assets :			
	Cash and Cash Equivalents	3	7,50,000	

Notes to Accounts :

	Particulars		₹
1.	Reserves and Surplus :		
	Securities Premium Reserve A/c		90,000
2.	Long term Borrowings :		
	12% Debentures	₹ 11,00,000	
	Less 12% Debenture Suspense A/c	₹ 2,00,000	
		₹ 9,00,000	
	Bank Loan	₹ 2,00,000	11,00,000
	(on collateral security of 12%		
	Debenture of ₹2,00,000)		
3.	Cash and Cash Equivalents :		
	Cash at Bank		7,50,000

10.6 ISSUE OF DEBENTURES CONSIDERING THE TERMS AND CONDITIONS OF REDEMPTION

A company may issue debentures on different terms. These terms may not only relate to issue but also to redemption, i.e., repayment of the amount of debentures to the debentureholders. As discussed earlier, there are three possible terms of issue, i.e., at par, at premium and at discount.Debentures may be redeemed either at par or at premium according to the terms determined at the time of issue. Debentures generally are not redeemed at discount although a company may redeem its debentures by purchasing them at a discount in the open market. Thus, considering the terms and conditions of redemption of debentures, the following situations are commonly found in practice:

a. Debentures issued at par and redeemable (repayable) at par,

b. Debentures issued at discount but redeemable at par,

c. Debentures issued at premium but redeemable at par,

d. Debentures issued at par but redeemable at premium,

e. Debenutres issued at discount but redeemable at premium,

f. Debentures isued at premium and redeemable at premium.

The journal entries passed at the time of issue and redemption of debentures in all the above cases are as follows :

a. Debentures issued at par and redeemable at par :

(i) On issue of Debentures -

Bank A/c	Dr.	(With money received on application)
To Debenture Application and Allotment A/c		
(Being application money received on issue of debentures)		

Debenture Application and Allotment A/c	Dr.	(With nominal value of debentures issued)
To Debentures A/c		
(Being transfer of application money to Debentures A/c)		

(ii) On redemption of Debentures -

Debentures A/c	Dr.	(with nominal value of debentures redeemed)
To Debentureholders A/c		
(Being amount due to debentureholders on redemption)		

Debentureholders A/c	Dr.	(with nominal value of debentures redeemed)
To Bank A/c		
(Being amount paid to debentureholders.)		

b. Debentures issued at discount but redeemable at par :

(i) On issue of Debentures -

Bank A/c	Dr.	(with money received on
To Debenture Applicaton and Allotment A/c		application)
(Being application money received on issue of debentures)		

Debenture Application and Allotment A/c	Dr.	(with amount received on application)
Discount on issue of Debentures A/c	Dr.	(with the discount amount on issue)
To Debentures A/c		(with nominal value of debentures issued)
(Being transfer of application money to Debentures A/c, discount issue of debentures debited for discount)		

(ii) On redemption of Debentures -

Debentures A/c	Dr.	(with nominal value of debentures redeemed.)
To Debentureholders A/c		
(Being amount due to debentureholders on redemption.)		

Debentureholders A/c	Dr.	(with nominal value of debentures redeemed)
To Bank A/c		
(Being amount paid to debentureholders)		

'Discount on issue of Debentures' is a capital loss and will be written off during the life time of the debentures by debiting 'Securities Premium Reserve A/c' or 'Statement of Profit and Loss.' The amount not written off or unamortised portion of discount on issue of debentures will be shown on assets side of the Balance Sheet, under the head 'Current/Non-current Assets' depending on the fact that whether the amount will be amortised is the next 12 months or thereafter, and sub-head 'other current/Non-current Assets'

C. Debentures issued at premium but redeemable at par :

(i) On issue of Debentures -

Bank A/c	Dr.	(with amount received on issue of debentures)
To Debenture Application and Allotment A/c		
(Being money received on application)		

Debenture Application and Allotment A/c	Dr.	(with application money received)
To Debentures A/c		(with nominal value of debenuture issued)
To Securities Premium Reserve A/c		(with the premium amount on issue)
(Being transfer of application money to Debentures A/c and Securities Premium Reserve A/c.)		

(ii) On redemption of Debentures -

Debentures A/c	Dr.	(with nominal value of debentures redeemed)
To Debentureholders A/c		
(Being the amount due to debentureholders on redemption)		

Debentureholders A/c	Dr.	(with nominal value of debentures redeemed)
To Bank A/c		
(Being amount paid to debentureholders)		

'Securities Premium Reserve' is a capital profit and to be shown on the equity and liabilities side of the Balance Sheet under the head 'Shareholders' Funds and sub-head 'Reserves and Surplus'.

d. Debentures issued at par but redeemable at premium :

When debentures are redeemable at a premium, it is a capital loss for the company. Though such premium amount will be paid at the time of redemption, the company records such premium at the time of issue of debentures by debiting 'Loss on issue of Debenture A/c' considering the convention of conservatism. Such loss is written off from Securities Premium Reserve or from Statement of Profit and Loss gradually every year during the life time of the debentures. The balance of 'Loss on issue of Debentures A/c' is shown on the assets side of the Balance Sheet under the head 'Current/Non-current Assets' and sub-head 'Other current/Non-current Assets'. 'Premium on redemption of Debentures' is a personal account and shows a credit balance. It is a liablity of the company and shown under the head 'Non-current Liabilities' and sub-head 'Other Long-term Liabilities' on the equity and liabilities side of the Balance Sheet till the debentures are redeemed. At the time of redemption, this account is debited and closed.

(i) On issue of Debentures-

Bank A/c	Dr.	(with amount received on application)
To Debenture Application and Allotment A/c		
(Being application money received on issue of debentures)		

Debenture Application and Allotment A/c	Dr.	(with the amount of application money received)
Loss on issue of Debentures A/c	Dr.	(with the premium payable on redemption)
To Debentures A/c		(with nominal value of debentures issued)
To Premium on Redemeption of Debentures A/c		(with the premium payable on redemption)
(Being application money transferred to Debentures A/c, loss on issue of debentures debited for premium on redemptin of debentures)		

(ii) On Redemption of Debentures -

Debentures A/c	Dr.	(with the nominal value of debentures redeemed)
Premium on Redemption of Debentures A/c	Dr.	(with premium payable on on redemption)
To Debentureholders A/c		(with total amount payable on redemption)
(Being the amount due to debentureholders on redemption at premium.)		

Debentureholders A/c	Dr.	(with the amount payable to
To Bank A/c		to debentureholders)
(Being the amount paid to debentureholders)		

e. Debentures issued at discount but redeemable at Premium :

In such case, both the amount of discount allowed on issue and premium payable on redemption of debentures are capital loss and the total amount is to be debited to 'Loss on issue of Debentures A/c'. Such Loss on issue of Debentures A/c is shown on the assets side of the Balance Sheet under the head 'Current/Non-current Assets' and sub-head 'Other current/Non-Current Assets' till it is written off.

(i) On issue of Debentures -

Bank A/c	Dr.	(with amount received on application)
To Debenture Application and Allotment A/c		
(Being application money received on issue of debentures)		

Debenture Application and Allotment A/c	Dr.	(with application money received)
Loss on issue of Debentures A/c	Dr.	(with the total amount of discount allowed on issue and premium payable on redemption)
To Debentures A/c		(with the nominal value of debentures issued)
To Premium on Redemption of Debentures A/c		(with premium payable on redemption)
(Being transfer of application money to Debentures A/c and debiting loss on issue of debentures A/c for both discount on issue and premium payable on redemption)		

(ii) On redemption of Debentures -

Debentures A/c	Dr.	(with the nominal value of debentures redeemed)
Premium on Redemption of Debentures A/c	Dr.	(with premium payable on redemption)
To Debentureholders A/c		(with the amount payable on redemption)
(Being amount due to debentureholders, debiting Debentures A/c and Premium on Redemption of Debentures A/c.)		

Debentureholders A/c	Dr.	(with the amount payable to on redemption)
To Bank A/c		
(Being the amount paid to debentureholders)		

f. Debentures issued at premium and redeemable at Premium :

(i) On issue of Debentures -

Bank A/c	Dr.	(with the amount received on application)
To Debenture Application and Allotment A/c		
(Being application money received on issue of debentures)		

Debenture Application and Allotment A/c	Dr.	(with application money received)
Loss on issue of Debentures A/c	Dr.	(with premium payable on redemption)
To Debentures A/c		(with the nominal value of debentures issued)
To Securities Premium Reserve A/c		(with premium on issue)
To Premium on Redemption of Debentures A/c		(with premium payable on redemption)
(Being transfer of application money to Debentures A/c, Loss on issue of Debentures A/c debited for premium payable)		

(ii) On redemption of Debentures -

Debentures A/c	Dr.	(with the nominal value of debentures redeemed)
Premium on Redemption of Debentures A/c	Dr.	(with premium payable on redemption)
To Debentureholders A/c		(with total amount payable on redemption of debentures)
(Being amount due to debentureholders on redemption of debentures.)		

Debentureholders A/c	Dr.	(With the amount due to debentureholders)
To Bank A/c		
(Being the amount paid to debentureholders on redemption of debentures.)		

Securities Premium Reserve A/c will appear on the equity and liabilities side of the Balance Sheet under the head 'Shareholders' Funds' and sub-head 'Reserves and Surplus' and Premium on Redemption of Debentures A/c will be shown under the head 'Non-current Liabilities' and sub-head 'Other Long-term Liabilities'. Loss on issue of Debentures A/c will appear on the assets side of the Balance Sheet under the head 'Current/Non-current Assets' and sub-head 'Other Current/Non-current Assets' till it is written off by debiting Securities Premium Reserve A/c or Statement of Profit and Loss.

Illustration 19

Pass journal entries for the issue of debentures in the following situations:

(a) Issued 5,000, 10% Debentures of ₹100 each at par and also redeemable at par.

(b) Issued 5,000, 10% Debentures of ₹100 each at a discount of 5% but redeemabale at par.

(c) Issued 5,000, 10% Debentures of ₹100 each at a premium of 10% but redeemable at par.

(d) Issued 5,000, 10% Debentures of ₹100 each at par but redeembale at 10% premium.

(e) Issued 5,000, 10% Debentures of ₹100 each at a discount of 5% but redeemable at a premium of 10%.

(f) Issued 5,000, 10% Debentures of ₹100 each at a premium of 10% and redeemable at a premium of 20%.

Solution :

(a) Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 10% Debentures Application and Allotment A/c (Being application money received on issue of 10% Debentures)		5,00,000	 5,00,000
	10% Debenture Application and Allotment A/c Dr. To 10% Debentures A/c (Being Transfer of application money to 10% Debentures A/c, debentures issued at par)		5,00,000	 5,00,000

(b) Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 10% Debenture Application and Allotment A/c (Being application money received)		4,75,000	 4,75,000
	10% Debenture Application and Allotment A/c Dr. Discount on issue of Debentures A/c Dr. To 10% Debentures A/c (Being Transfer of application money to 10% Debentures A/c, issued at a discount of 10%)		4,75,000 25,000	 5,00,000

(c) Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 10% Debenture Application and Allotment A/c (Being application money received on issue of 5,000, 10% Debentures @₹110 each.)		5,50,000	 5,50,000
	10% Debenture Application and Allotment A/c Dr. To 10% Debentures A/c To Securities Premium Reserve A/c (Being application money transferred to 10% Debenture A/c, issued at a premium of 10%)		5,50,000	 5,00,000 50,000

(d) Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		5,00,000	
	To 10% Debenture Application and Allotment A/c			5,00,000
	(Being application money received on issue of 10% Debentures ₹100 each)			
	10% Debenture Application and Allotment A/c Dr.		5,00,000	
	Loss on issue of Debentures A/c Dr.		50,000	
	To 10% Debentures A/c			5,00,000
	To Premium on Redemption of Debentures A/c			50,000
	(Being transfer of application money to 10% Debentures A/c, issued at par but redeemable at a premium of 10%)			

(e) Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		4,75,000	
	To 10% Debentures Application and Allotment A/c			4,75,000
	(Being application money received on 5,000 10% Debentures @₹95 each))			
	10% Debenture Application and Allotment A/c Dr.		4,75,000	
	Loss on issue of Debentures A/c		75,000	
	To 10% Debentures A/c			5,00,000
	To Premium on Redemption of Debentures A/c			50,000
	(Being Transfer of application money to 10% Debentures A/c, issued at a discount of 5% but redeemable at premium of 10%)			

Note : Loss on issue of Debentures A/c has been debited by ₹75,000, i.e., total of discount on issue ₹25,000 and premium on redemption ₹50,000.

(f)

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr.		5,50,000	
	To 10% Debenture Application and Allotment A/c			5,50,000
	(Being application money received on 5,000, 10% Debentures @₹110 each.)			

	10% Debenture Application and Allotment A/c Dr. Loss on issue of Debentures A/c Dr. To 10% Debentures A/c To Securities Premium Reserve A/c To Premium on Redemption of Debenture A/c (Being transfer of application money to 10% Debentures A/c, issued at premium of 10% but redeemable at a premium of 20%)		5,50,000 1,00,000	 5,00,000 50,000 1,00,000

Illustration 20

Laxmi Ltd. issued 10,000, 14% Debentures of ₹100 each at a discount of 5% but redeemable at a premium of 10%. The amount was payable as follows :

On application 60 per debenture and the balance on allotment.

Public applied for all the debentures. Debentures were duly allotted and the amounts due were realised. Pass necessary journal entries for issue of debentures.

Solution :

Books of Laxmi Ltd.

Journal

Date	Particulars	LF	Dr. ₹	Cr. ₹
	Bank A/c Dr. To 14% Debenture Application A/c (Being application money received on 10,000 14% Debentures @₹60 per debenture)		6,00,000	 6,00,000
	14% Debenture Application A/c Dr. To 14% Debentures A/c (Being Transfer of application money to 14% Debentures A/c)		6,00,000	 6,00,000
	14% Debenture Allotment A/c Dr. Loss on issue of Debentures A/c Dr. To 14% Debentures A/c To Premium on Redemption of Debentures A/c (Being allotment money due @₹35 each on 10,000 debentures issued at 5% discount and redeemable at 10% premium, loss on issue of debentures account debited for total of discount on issue ₹50,000 and premium on redemption ₹1,00,000.)		3,50,000 1,50,000	 4,00,000 1,00,000
	Bank A/c Dr. To 14% Debenture Allotment A/c (Being allotment money received)		3,50,000	 3,50,000

10.7 QUESTIONS

1. From the given alternatives, choose and write the correct answer along with its serial number against each bit :

(i) Debentureholders are :

(a) Debtors of the company

(b) Creditors of the company

(c) Customers of the company

(d) Owners of the company

(ii) Debentureholders are entitled to :

(a) Dividend at a fixed rate

(b) Voting rights in the meetings of the company

(c) Share in the profits of the company

(d) Interest at a fixed rate

(iii) Unamortised portion of 'Discount on issue of Debentures' appears:

(a) On the Assets side of the Balance Sheet

(b) On the Equity and Liabilities side of the Balance Sheet

(c) In the Statement of Profit and Loss as expense.

(d) In the Statement of Profit and Loss as income.

(iv) Total amount of 'Discount on issue of Debentures' is written off :

(a) In the year of redemption of debentures

(b) During the life time of the debentures

(c) Within 3 years of the issue of debentures

(d) In the year of issue of debentures

(v) On the issue of debentures for consideration other than cash, the account credited is :

(a) Vendor's A/c (b) Debtors A/c

(c) Debentures A/c (d) Creditors A/c

(vi) On issue of debentures as collateral security, the account debited is :

(a) Debentures A/c (b) Bank Loan A/c

(c) Debentures Suspense A/c (d) Debentureholders A/c

(vii) Premium on redemption of Debentures A/c is :

(a) Personal Account (b) Real Account

(c) Nominal Account (d) Intangible Real Account

(viii) On issue of debentures to vendors, the account debited is :

(a) Vendor's A/c (b) Debtors A/c

(c) Creditors A/c (d) Debentures A/c

(ix) Securities Premium Reserve A/c is shown on the Equity and Liabilities side of Balance Sheet under :

(a) Share Capital (b) Reserves and Surplus

(c) Non-current Liabilities (d) Current Liabilities

(x) Discount on issue of debentures is written off against :

(a) General Reserve (b) Capital Reserve

(c) Securities Premium Reserve (d) Share Capital

[Ans.: (i) b, (ii) d, (iii) a, (iv) b, (v) c, (vi) c, (vii) a, (viii) a, (ix) b, (x) c]

2. Answer the following questions in one word/term each :

(i) Is the amount raised by a company by issue of debentures a loan or capital ?

(ii) Name the debentures which are issued without any security.

(iii) Name the debentures which are repayable only at the time of liquidation of the company.

(iv) Which type of debentures are secured on assets of the company ?

(v) If a company issues 10% Debentures, State the rate of interest at which the company pays interest to the debentureholders.

(vi) When debentures are issued for consideration other than cash, state the account to be credited.

(vii) Which account is debited on issue of debentures for purchase of an asset ?

(viii) Besides Securities Premium Reserve Account, State the account to be credited on issue of debentures at a premium.

(ix) On which side of the Balance Sheet, the unamortised portion of the 'Discount on issue of Debentures' is shown ?

(x) On which side of the Balance Sheet, 'Securities Premium Reserve A/c' appears ?

[Ans: (i) Loan, (ii) Unsecured or Naked Debenture, (iii) Irredeemable Debenture, (iv) Secured or Mortgage Debenture, (v) 10%, (vi) Debentures A/c, (vii) Vendor's A/c, (viii) Debentures A/c, (ix) Assets side, (x) Equity and Liabilities side.]

3. Answer the following questions in one sentence each :

(i) What is a debenture ?

(ii) What is meant by 'Secured or Mortgage Debenture' ?

(iii) What is unsecured debenture ?

(iv) What is 'Bearer Debenture' ?

(v) What is 'Redeemable Debenture' ?
(vi) What do you mean by 'Irredeemable Debenture' ?
(vii) What is meant by 'Convertible Debenture' ?
(viii) What do you mean by 'Issue of Debenture for consideration other than cash' ?
(ix) State any one point of distinction between shareholders and debentureholders.
(x) Are debentures less risky than shares ?
(xi) Is there any restriction regarding issue of debentures at a discount ?
(xii) What do you mean by 'Issue of Debentures at par' ?

4. Correct the underlined portions of the following sentences :

(i) Debentureholders are the owners of the company.
(ii) A debentureholder is entitled to dividend at a fixed rate.
(iii) Unsecured debentures are transferable by mere delivery.
(iv) Discount on issue of debentures is shown on the Equity and Liabilities side of the Balance Sheet.
(v) Convertible debentures are those debentures which can be normally converted into cash.
(vi) Debentures are shown under the head 'Current Liabilities' on the Equity and Liabilities side of the Balance Sheet.
(vii) Mortgage debentures are those which are not given any security and holders of such debentures are treated as unsecured creditors at the time of liquidation of the company.
(viii) On issue of debentures at a price less than their nominal value, the debentures are said to have been issued at a premium.
(ix) Securities Premium Reserve A/c is shown on the Assets side of the Balance Sheet.
(x) On issue of debentures as a collateral security, Debenture suspense A/c is credited.

[Ans. (i) creditors, (ii) interest, (iii) Bearer, (iv) Assets, (v) Shares, (vi) Non-current, (vii) Unsecured or Naked, (viii) discount, (ix) Equity and Liabilities (x) Debentures.]

5. Fill up the blanks :

(i) A debentureholder is entitled to interest at a _______ rate.
(ii) Debentureholders are the _______ of the company.
(iii) Debenture is an acknowledgement of a _______ by a company under its common seal.
(iv) Debentures are shown under the head _______ liabilities on the Equity and Liabilities side of the Balance Sheet.
(v) No company is allowed to issue debentures having a maturity period of more than _______ years other than a company engaged in infrastructure projects.
(vi) _______ debentures are secured by a charge on the assets of the company.

(vii) When the issue price of debenture is equal to its nominal value, debentures are said to be issued at _______.

(viii) When the issue price of debentures is more than the nominal value, debentures are said to be issued at a _______.

(ix) Unamortised portion of discount on issue of debentures is shown on the _______ side of the Balance Sheet.

(x) When debentures are issued at par to vendors, _______ A/c is credited.

(xi) If the price payable to the vendors is less than the net assets purchased, the difference is to be credited to _______ reserve A/c.

(xii) If the price payable to the vendors is more than the net assets purchased, the difference is to be debited to _______ A/c.

(xiii) Securities Premium Reserve A/c is a _______ profit.

(xiv) On issue of debentures as a collateral security, _______ account is credited.

(xv) On issue of debentures as a collateral security, Debenture _______ A/c is debited.

[Ans.: (i) fixed, (ii) creditors, (iii) debt, (iv) Non-current, (v) ten, (vi) Secured or Mortgage, (vii) par, (viii) premium, (ix) Assets, (x) Debentures, (xi) Capital, (xii) Goodwill, (xiii) Capital, (xiv) Debentures, (xv) Suspense.]

6. Answer the following questions within 30 words each :

(i) State any two characteristics of debenture.

(ii) What do you mean by 'Secured Debenture' ?

(iii) What is 'Bearer Deabenture' ?

(iv) What is meant by 'Redeemable Debenture' ?

(v) What is meant by 'Issue of Debentures for consideration other than cash' ?

(vi) What do you mean by 'Issue of Debentures as collateral security' ?

(vii) Give any two points of distinction between a share and a debenture.

(viii) What is meant by issue of debentures at a premium ?

(ix) Why would an investor prefer to invest in the debentures of a company rather than in its shares ?

(x) What do you mean by 'Debentures issued at par but redeemable at premium' ?

7. Answer the following questions within 50 words each :

(i) What is a Debenture ?

(ii) State any three characteristics of Debenture.

(iii) Write a short note on 'Convertible Debentures'.

(iv) What do you mean by 'Issue of Debentures for consideration other than cash' ?

(v) What is meant by 'Issue of Debentures as collateral security' ?

(vi) State any three points of distinction between a share and a debenture.

(vii) Write the differences between 'Premium on issue of Debentures' and 'Premium on Redemption of Debentures'.

(viii) Explain brifly the meaning of 'Issue of Debentures at par, at discount and at premium with imaginary examples.

8. What is debenture ? Describe briefly different types of debentures.
9. What do you mean by 'Issue of Debentures at par, at discount and at premium' ? Explain with the help of accounting entries in each case with imaginary figures.
10. What is meant by 'Issue of Debentures for consideration other than cash' ? Discuss with the help of journal entries with imaginary figures.
11. What do you mean by 'Issue of Debentures as collateral security' ? Explain with accounting entries taking imaginary examples.
12. A Ltd. invited applications for issue of 5,000, 14% Debentures of ₹100 each at par. The full amount due on debentures was payable on application. All the debenutres were fully subscribed and duly allotted. Make journal entries in the books of A Ltd.
13. B Ltd. issued 5,000, 14% Debentures of ₹100 each at a premium of 10% for public subscription. The full amount due on debentures was payable on application. Applications were received for 7,000 Debentures. Applications for 2,000 Debentures were rejected and money refunded. The remaining applications were accepted and Debentures were duly allotted.

    Pass necessary journal entries in the books of B Ltd.
14. C Ltd. invited applications for 5,000, 14% Debentures of ₹100 each at a discount of 5%. The entire amount due on debentures was payable on application. Applications were received for 4,500 Debentures. The company accepted all the applications and Debentures were duly allotted. Show the journal entries in the books of C Ltd.
15. Apple Ltd. issued 20,000, 12% Debentures of ₹100 each for public subscription and payable as follows :

    On application ₹40, on allotment ₹50 and

    On first and final call ₹10

    Applications for 25,000 Debentures were received. The Directors accepted the applications for 16,000 Debentures in full. Applications for 8,000 Debenutres were allotted 4,000 Debentures and the remaining applications for 1,000 Debentures were rejected. Excess money on application was utilised for allotment. Pass journal entries in the books of Apple

Ltd. assuming that all the amonts due on Debentures were duly received.

16. Sunshine Ltd. invited applications for 15,000, 10% Debentures of ₹100 each at par and payable as follows :

    On application ₹30 , on allotment ₹30,

    On first call ₹20 and on final call ₹20. Debentures were fully subscribed. All the applications were accepted and Debentures were duly allotted. The amounts due on allotment and calls were received except from Sonu who was allotted 200 Debentures and failed to pay the allotment money. But Romi who was allotted 100 Debentures, paid the money due on calls in advance with the allotment money. However, Sonu paid the arrear amount with the first call money. Record the above transactions in the books of Sumshine Ltd.

17. A Ltd. invited applications for 50,000, 12% Debentures of ₹100 each at a premium of 10%, payable as ₹40 on application, ₹50 on allotment (including premium) and ₹20 on first and final call. Applications were received for 60,000 Debentures and allotment was made on pro-rata basis. All the amounts due were duly received.

    Pass journal entries in the books of A Ltd.

18. RK Ltd. issued 20,000, 14% Debentures of ₹100 each at 10% discount for public subscription, payable as ₹40 on application, ₹30 on allotment and ₹20 on first and final call. Public applied for 25,000 Debentures. Allotment was made for 20,000 Debentures rejecting the remaining applications for 5,000 Debentures. The amounts due on allotment and call were duly received. Pass journal entries.

19. MK Ltd. issued 10,000, 12% Debentures of ₹200 each at a discount of 10% for public subscription, payable as ₹80 on application, ₹60 on allotment, and the balance on first and final call. Applications were received for 8,000 Debentures and allotment was made in full. All the amounts due were duly received. Expenses on issue of debentures amounted to ₹10,000. It was decided by the company to write off $^{1}/_{10}$th of 'Expenses on issue of Debentures A/c' and 'Discount on issue of Debentures A/c' from Statement of Profit and Loss each year. Pass journal entries in the books of MK Ltd.

20. H Ltd. purchased a machine from Mr. B at an agreed value of ₹9,90,000. It was agreed to pay the purchase consideration by issuing 12% Debentures of ₹100 each. Pass journal entries in the books of H Ltd.,

    if (a) Debentures were issued at par,

    (b) Debentures were issued at a premium of 10% and

    (c) Debentures were issued at a discount of 10%.

21. S Ltd. acquired the assets at an agreed value of ₹10,20,000 and creditors of ₹60,000 from B Ltd. and issued 10% Debentures of ₹100 each at a premium of 20% as purchase

price. Pass journal entries in the books of S Ltd.

22. Sky Ltd. purchased a running business with the following assets and liabilities from Moon Ltd. and issued 20,000, 12% Debentures of ₹100 each in full satisfaction of its claim :

₹	
Land and Buildings	12,50,000
Plant and Machinery	3,60,000
Stock-in-trade	75,000
Sundry Debtors	2,75,000
Sundry Creditors	50,000

Journalise the above transactions in the books of Sky Ltd.

23. Sun Ltd. purchased a running business having the following assets and liabilities from Mr. X for ₹15,40,000, payable as ₹15,00,000 by issuing 10% Debentures of ₹100 each and balance in Account Payee Cheque :

₹	
Land and Building	7,20,000
Plant and Machinery	6,75,000
Furniture and Fixture	55,000
Sundry Debtors	60,000
Cash at Bank	1,50,000
Sundry Creditors	60,000
Bills Payable	50,000

Pass journal entries in the books of Sun Ltd.

24. A Ltd. purchased a Machine worth ₹5,00,000 from Mr. B. An amount of ₹1,40,000 was paid immediately and the balance of purchase consideration was discharged by issue of ₹4,00,000, 14% Debentures. Pass journal entries in the books of A Ltd.

25. B Ltd. purchased a machine valued ₹4,50,000 from Mr. X. An amount of ₹30,000 was paid immediately by accepting a bill of exchange and the remaining amount was discharged by issue of ₹4,00,000, 12% Debentures.

Journalise the transactions in the books of B Ltd.

26. PK Ltd. purchased the following assets of SK Ltd. for a purchase consideration of ₹48,50,000 :

Land and Buildings of ₹35,00,000 at ₹38,00,000

Plant and Machinery of ₹15,00,000 at ₹10,00,000

and Furniture and Fixture of ₹2,50,000 at ₹2,00,000.

An amount of ₹4,50,000 was paid by drawing a promissory note in favour of SK Ltd. and the balance of purchase consideration was discharged by issue of 15% Debentures of ₹100 each at a premium of 10%.

27. Laxmi Ltd. had ₹50,00,000, 12% Debentures outstanding on 1st April, 2015. During the year 2015-16, the company took a loan of ₹10,00,000 from bank for which the company issued ₹12,00,000, 12% Debentures as collateral security.

    Pass journal entries, if any. Show how the Debentures and Bank Loan will appear in the Balance Sheet of Laxmi Ltd. as at 31st March, 2016.

28. White Ltd. issued 10,000, 10% Debentures of ₹100 each at a premium of 20% on 1.12.2015. On the same date, the company purchased a machine valued ₹8,00,000 and took over sundry creditor of ₹80,000 and issued 10% Debentures at a premium of 20% to the vendor. It also took a loan from bank for ₹5,00,000 and issued 10% Debentures for the same amount at par as collateral security in favour of the bank. Pass journal entries in the books of White Ltd. and prepare the extract of the Balance Sheet of the company as at 31st March, 2016. Ignore interest.

29. Pass journal entries for the issue of debentures in the following situations:

(a) Issued 10,000, 15% Debentures of ₹100 each at par and also redeemable at par.

(b) Issued 10,000, 15% Debentures of ₹100 each at a discount of 10% but redeemable at par.

(c) Issued 10,000, 15% Debentures of ₹100 each at a premium of 20% but redeemable at par.

(d) Issued 10,000, 15% Debentures of ₹100 each at par but redeemable at a premium of 10%.

(e) Issued 10,000, 15% Debentures of ₹100 each at a discount of 10% but redeemable at a premium of 10%.

(f) Issued 10,000, 15% Debentures of ₹100 each at a premium of 10% and redeemable at a premium of 20%.

30. Saraswati Ltd. issued 1,000, 10% Debentures of ₹1,000 each at a discount of 10% but redeemable at a premium of 10%. The amount was payable as follows :

    On application ₹550 per debenture and the balance on allotment.

    Public applied for all debentures. Debentures were duly allotted and the amounts due were realised.

    Pass necessary journal entries for the issue of debentures in the books of Saraswati Ltd.

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