FINANCIAL ACCOUNTING

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BASICS OF FINANCIAL ACCOUNING

1.0 INTRODUCTION TO FINANCIAL ACCOUNTING

Accounting is a social science. The nature of accounting information has been dictated from time immemorial by the needs of the users of the day. The history of accounting reflects the pattern of social developments and the forces which necessitate the changes in accounting system from time to time.

Over the years accountancy has made tremendous progress in the field of commerce and industry. Accounting can be described as being concerned with measurement and management. Measurement of recording transactions and management with the use of data for making decisions are the two fundamental aspects.

Accounting function is vital for every entity of the society whether individuals, house wives, business entity, nonprofit making organisations like municipalities, panchyats, clubs, etc. All are required to maintain accounts.

Accounting is commonly referred to as the "language of the business" as it is effectively employed to communicate the financial performance of business to various interested parties or stakeholders. It is concerned with the measurement and communicating financial data.

Financial Accounting is based on double entry system of accounting which comprises of

(i) recording of business transactions in the books of prime entry,

(ii) posting into respective ledger accounts,

(iii) striking balance, and

(iv) preparing the performance statement (profit and loss statement) and position statement (balance sheet).

Financial Accounting is concerned with the collection, recording, classification and presentation of financial data to serve the purposes of the management, shareholders and stakeholders, such as, creditors, bankers, Government, etc.

The nature and purpose of accounting

The basic aim of accounting in a business entity is to provide financial information for making decisions on its activities. Managers of an economic entity at various levels require analysed financial information for planning and programming, for controlling expenditure, for ascertaining the extent of profitability or otherwise of a department – even of each production item for undertaking new jobs, etc.

Financial information in tabular forms and with graphs and charts are also required by the outsiders, namely, bankers, financial institutions, creditors, investors, government agencies and even by the labour unions and the general public who have some interest in the particular business concern.

Definition of Accounting

A widely accepted definition of accounting has been provided by the American Accounting Association. According to this definition accounting is the process of identifying, measuring and communicating information to permit judgement and decisions by the users of accounts. This definition implies that –

(1) there should be users of accounts who need relevant information,

(2) the information should enable the users to make judgement and decisions, and

(3) transactions and events are measured and the data are processed and then communicated to the users through accounting.

Objectives of Accounting

The basic objectives of accounting are to provide financial information to the managers, owners and the stakeholders i.e. the parties who are interested in an organisation. To attain such objectives various financial statements are prepared.

The users of financial statements may be broadly classified in the following groups –

(a) *The investor* – This group includes both existing and potential owners of shares in companies. They are broadly interested in the performance of the entity and the dividend declared by such entity. They also measure the social and economic policies of the company to decide whether they will remain associated with such entity.

(b) *The lender* – This group includes both secured and unsecured lenders. Such creditors may be financing long term or short term loans. The financial statements are analysed to determine an organisation's ability as to

(i) pay the interest on due date,

(ii) the growth and stability of the organisation,

(iii) capability of repaying the loan as agreed upon, and.

(iv) the book value of assets offered as security by the organisation.

(c) *The customers and suppliers* – While customers are interested in the ability of the organisation to provide goods/services, the suppliers are interested in the capability of the organisation to pay their dues as and when due.

(d) *The government* – This group includes various taxation authorities viz. Income tax, Excise department, Sales tax department etc. and also various other government authorities for statistical purposes and for framing various economic and planning policies.

(e) *The employee group* – The employees are concerned with the capability of an organisation to pay their present emoluments and future retirement benefits. Moreover, financial statements help them to asses job security.

(f) *The analyst* – Advisors to the management, investors, employees or public at large collect various data from financial statements to advise their clients.

(g) *The Management* – Financial statements provide required information to different levels of management to assist them in making decisions at each appropriate level.

1.1 SUBDIVISION OF ACCOUNTING

Generally, accounting is subdivided as follows :

a) Book-keeping

b) Measuring working results and capital of the economic entity and reporting.

a) Book-Keeping : Book-keeping is the art and science of recording transactions of a business enterprise or an organisation carrying out non-business activities in a systematic and appropriate manner to measure the working results and capital at periodical interval depending upon needs of an entity.

(b) Measuring working results and capital of the economic entity and reporting : The most important aspect of accounting records is to measure the working results and the capital of the economic entity and interpreting and reporting of results.

1.2 CONCEPTS AND CONVENTIONS IN ACCOUNTING

Basic concepts:

Accounting principles are built on a foundation of a few basic concepts. These concepts are so basic that most accountants do not consciously think of them; they are regarded as being self-evident. Non-accountants will not find these concepts to be self-evident. Some accounting theorists argue that certain of the present concepts are wrong and should be changed. But in order to understand accounting, as it now exists, one must understand what the underlying concepts currently are. The different aspects are :—

1. Business Entity Concept
2. Money Measurement Concept
3. Cost Concept
4. Going Concern Concept
5. Dual-aspect Concept
6. Realisation Concept
7. Accrual Concept
8. Accounting Period Concept

1. Business Entity Concept:

The business is treated as a distinct (and separate) entity from the individuals who own it and accordingly accountants record transactions. For example, if the owner of a shop withdraws Rs. 10,000 for personal use, from the business entity point of view, the entity has less cash though it belongs to the owners. Therefore, this amount is shown as a reduction in owner's capital, which in view of business entity concept appears as a liability in the balance sheet of the business. Without such a distinction the affairs of the shop will be mixed with the personal affairs of the owner. For a company the distinction is easier as legally the company is a distinct entity from the persons who own it. Therefore, an entity is a business organisation or activity in relation to which accounting reports are compiled. It may include universities, voluntary organisations, government and non-business units. What we have stated above is just a superficial discussion of the concept, though the central point has been brought out clearly. But we have to go at least a little deeper because out of this basic concept, a large number of very important sub-concepts emerge, dealing with ownership equities, without which we cannot understand properly many of the modern accounting practices.

Pure Accounting Viewpoint : We will start from the fundamental accounting equation, that is:

Debit = Credit (i)
And, Assets = Liabilities (ii)
And, Assets = Internal Liabilities + External Liabilities (iii)
And finally, Assets = Capital + Liabilities; or A = C + L (iv)

2. Money Measurement Concept:

A record is made only of the information that can be expressed in monetary terms for accounting purposes. The advantage of doing this is that money provides common denominators by means of which variety of facts can be expressed as numbers that can be added and subtracted. This enables addition and subtraction of varied items since money provides the common denominator. An event even though important like the loyalty of the workers will not be recorded unless it can be expressed in monetary terms. The changing price level also creates difficulties in the monetary value.

If we look at financial accounting purely from the point of view of Fundamental Accounting Equation:

Assets = Capital + Liabilities,

then it would be evident that it had virtually no option but to adopt monetary values of assets and liabilities and capital to apply the equation in day-to-day business affairs. This concept is basically concerned with the problem of measuring items of the accounting equation. Such items may be plant and machinery (assets), liability for loan taken – all these are object of some kind of the other. Other items represent events (transactions) such as expenses and income. Basically, double entry system is additive (say, when finding the aggregate of assets) or subtractive (say when total liabilities are deducted from total assets to find capital, or deducting expenses from income to estimate profit). But only the "like" can be added with the "like" and the "like" can be deducted from the "like", when the word "like" means that the items involved are expressed in the same unit. But in real-world affairs, physical assets may have to be expressed in several ways, like numbers of units, weight, volume, etc. Likewise wages may have to be expressed in man-hours or simply in hours. Apart from ensuring feasibility of making addition and subtraction, which is inherent in the accounting equation, the sign of equality (actually the sign of "identity") needs use of the same units in describing such items. In accounting the description is finally expressed quantitatively in terms of money. In modern business it is essential link to accounting to a market system in an exchange economy a valuable source of quantitative data. Since goods and service are generally exchanged in terms of money, a monetary measurement of economics data can be assumed to be useful in decision-making, particularly for that decision relating to wealth and the production of goods and services.

3. Cost Concept :

The cost concept and the money measurement concept go hand in hand. Transactions are recorded in the books at the price paid that is the cost. This avoids an arbitrary value being placed on the asset and all subsequent accounting is in relation to the cost. Therefore, the recording of the assets is at cost figures and this may not reflect the current market value especially in the case of the older assets. The value of an asset in the accounting records does not remain at the original cost because it is diminished systematically by virtue of its use called expired cost and then shown at its depreciated value e.g. an asset of Rs. 1,00,000 is depreciated at 10%. Therefore, closing value will be Rs. 90,000 in the Balance Sheet. An expired cost is an expenditure of money, the economic value of which has been made use of during a particular year (or lost without accruing any benefit to the entity, like machinery destroyed by flood). Every cost has to be recovered from the market through sales, otherwise, the entity will suffer loss, that is, lose its capital. Depreciation, looked at from this viewpoint, is nothing but gradual recovery of cost incurred, that is, money paid at a time during a particular year for acquiring a fixed asset, during the subsequent years (during which the asset is assumed to remain serviceable) on some estimated basis, by treating the expired cost pertaining to a particular year, calculated on some approved and selected estimated basis, by including such expired cost, called an expense, in the cost of production of that particular accounting year. Linking annual depreciation with the expected service life of a fixed asset does not endow any scientific logic on any estimated basis of depreciation. In accounting, depreciation is nothing more and nothing less than a process of allocation of some specific costs (cost of acquiring fixed assets) on some generally accepted (may or may not be legally approved) estimated basis. An expired cost is not a money measure of the wear and tear obsolescence (passage of time) etc. of any fixed assets. It is just a reasonable basis for recovery of cost of fixed asset in a gradual manner. Money value of wear and tear would need engineering analysis, which is not the domain of financial accounting.

In essence, in a little more technical sense, cost represents the exchange price agreed upon by the buyer and the seller in a relatively free economy. Cost has been the most common valuation concept in the traditional accounting structure.

Therefore, cost is the exchange price of goods and services at the time they are acquired. So, cost is also the economic sacrifice expressed in monetary terms required to obtain a specific asset or a group of assets. Very often cost is not represented by a single exchange price, but it includes many sacrifices of economic resources necessary to obtain the asset in the form, location and time in which it can be useful to the operating activities of the firm.

4. Going Concern Concept :

Accounting assumes that the business will exist indefinitely into future and accordingly transactions are recorded. If however, there is evidence that the firm will be liquidated then market value of the assets and liabilities will be ascertained and necessary accounting considered. In other cases where the business is an on-going activity resale value of assets is irrelevant. The whole accounting is done based on this assumption.

The present concept as well as the earlier Business Entity concept belongs to the category of "Environmental Postulates of Accounting". It is important to know the precise meaning of this expression, for which purpose we have to know what an accounting postulate is and what is environmental in accounting. In order to avoid a lengthy discussion, we may summarise, by stating that postulates are basic assumption or fundamental propositions concerning the economic, political and sociological environment in which accounting must operate. Thus, it is clear that certain economic, political and sociological events do affect the thinking and actions of accountants and we must also clearly understand that every such event does not affect accounting concepts and practice. The basic criteria for any such postulates are:

(1) They must be relevant to the development of accounting logic, that is, they must serve as a foundation for the logical derivation of further propositions; and

(2) They must be accepted as valid by the participants in the discussion as either being true or providing a useful starting point as an assumption in the development of accounting logic.

5. Dual Aspect Concept :

The economic resources of an entity are assets and the acquisition of an asset must be on account of : –

(a) some other assets being sold ; or

(b) the creation of an obligation to pay ; or

(c) there has been a profit owed to proprietor ; or

(d) the owner has contributed.

On the other hand, an increase in liability is on account of an increase in asset or a loss. Therefore, at any time –

Assets = Liabilities + Capital
Capital = Assets – Liabilities

The owner's share is what is left after paying outsiders. This is the accounting equation. Every transaction has dual impact and accounting systems record both the aspects and are called the double entry system. e.g. X starts a business with a capital of Rs.20,000. There are two aspects of the transaction. On the one hand the business has assets of Rs. 20,000 while on the other hand it has to pay the proprietor Rs. 20,000, therefore: –

Capital (Equities) = Assets (Cash)

Rs. 20,000 = Rs. 20,000

What has been stated above is an oversimplified version of the concept and its application, since this is the form of the concept with which we are familiar as beginners. But we have to go a little deeper in order to have a more meaningful understanding of the concept because it is the bedrock on which double entry book keeping has built its gigantic edifice and is still flourishing as a very important discipline all over the world. There must be something deeper than what has been stated above which caught the imagination of an Italian priest and mathematician and prompted him to codify if not invent the double-entry system in 1495 which explained logically and systematically what happens in the economic world, in terms of money when goods are manufactured and sold at the market place through financial transactions. This could be applied to sale of services equally logically, and systematically. In course of time it also exposed other related concepts, especially the first two concepts already discussed, namely the Business Entity concept and the Money Measurement concept.

6. Realisation Concept :

The realisation concept indicates the amount of revenue that should be considered from a given transaction. Realization refers to inflows of cash or claims to cash. It states that the amount recognized as revenue is the amount that is reasonably certain to be realised. Sometimes there is scope for difference of judgement as to how to ascertain "reasonably certain". A situation arises when a company makes a credit sale and expects that the customer will pay their bill. Experience shows that not all customers pay their bill. In measuring the revenue for a period, the amount of credit sales that will not be realised should be reduced by the estimated amount of credit sales that will never be realised i.e. by estimated amount of bad debts. Example: If a company makes a credit sale of Rs 100,000 during a period and experience indicates that 2% of credit sales will become bad debt, the amount of revenue for the period is Rs 98,000 and not Rs 100,000. It does not anticipate events and stops the business from inflating their profits by recording sales and incomes likely to accrue. Unless money has been realised as cash or legal obligation to pay on sale, profit or income is considered e.g. M places an order with N for supply of certain goods yet to be manufactured. On receipt of order N purchases raw materials, employs workers, produces goods and delivers to M. M makes payment on receipt of goods. In this case the sale is not at the time of receipt of order but at the time when goods are delivered to M.

7. Accrual Concept :

Profit arises only out of business operation when there is an increase in the owner's share of the business and not due to his contribution to the business. Any increase in owner's equity is called revenue and any reduction in it termed as a loan. In fact, it is the direct outcome of Realisation Concept (already discussed) and the Accounting Period concept (to be discussed). In a way, realisation concept has been split up into two parts, namely, production of economic goods or rendering of economic services, and realisation of due revenue. Any uncertainty about any of the two elements beyond what is considered uncontrollable will not permit the accountant to treat the money value or cash equivalent of the sale price to be considered as realised income. Another very vital element is involved in between, that is, a third one, namely acquiring legal right to claim the price of the goods delivered or fees for services rendered. Acquiring the legal right to claim the consideration for goods/services is called accrual of revenue, which usually precedes collection. However, in case of cash transactions, under the accrual method P/L A/c and Balance Sheet are prepared on the accrual basis, in the absence of any uncertainty about collection. This does not mean that collection has been given less importance than economic value adding and the right to claim the purchase consideration. With uncertainty about collection, it is meaningless and dangerous to take income into account as having been realised. In fact, ability to pay, is considered by the supplier of goods and services before one decides to sell his products or render his services to another. Then after the deal is finalised, goods have been delivered or services rendered and legal right to claim the purchase consideration has been acquired, collection is taken up as a specialised process to ensure return of capital and earning of profit. The other pressure comes from the Accounting Period convention. Production is a continuous process. True profit is cash profit during the entire lifetime of an enterprise. Then and then only we know total money collected and spent by it during its lifetime. But the way our culture has bound us up with annual profit, annual income and other periodic results, we have divided the entire life-span of our organisation into several chapters, each chapter being an accounting period or an accounting year. A year consists of 12 months. This is very significant, because each period being equal in terms of time frame, it facilitates comparison of performances. Because of this Cost Accountants divide a year in 13 months, each period consisting of 4 weeks. The process of dividing the life span of a company into time–chapters which is an artificial man-made process, though production follows a continuous flow, gives rise to certain accounting problems. For example, at the time of closing of period/annual accounts, production and sale might have been completed, local right to claim the sales value have been acquired, but payment has not yet come through.

8. Accounting Period Concept :

The accounting reports measure activities for a specified interval of time called the accounting period, which is usually one year and therefore termed as annual reports. Interim reports in between may be compiled especially for internal users. Except for those ventures which are predetermined to end on the completion of a specific task or a specific time-frame, every enterprise, profit-oriented or not, desires to enjoy perpetual existence as a going (running) concern, making profits, grow and distribute profits judiciously. This calls for recognition and measurement of incomes and expenses and to match them to ascertain profit. But, the concept of profit is time-related. Hence, the question: profit for what length of time? Theoretically, the most correct reply would be the entire life–time of an enterprise. That means no measurement of income until an enterprise is wound up. But human beings inherently, desire to know, periodic performances mainly for the purpose of comparison, which would not be possible, different firms wind up after different lengths of time. Moreover, from the practical point of view, some firms may not close down during a number of successive generations. Hence no income tax for ages, too. Let us not extend the list of such fanciful but important (academically) possibilities. Thus, out of practical considerations, businessmen, sided by accountants, divide the life span of an entity into a number of chapters of equal duration, usually a twelve-month period. Thus one phase of activities of an enterprise is deemed to have passed – one chapter is closed. Such a 12-month chapter is called accounting period. And financial accountants prepare a P/L A/c. for that period to estimate its operating result, that is, profit or loss and the financial position as at the end of the period in terms of assets, liabilities (external) and owners' equity (internal liability).

Conventions:

The term "accounting conventions" refer to the customs or traditions, which are used as a guide in the preparation of meaningful financial records in the form of the income statement (Profit and Loss Account) and the position statement (Balance Sheet).

These are as follows.

1. Conservatism :

Financial statements are drawn on a conservatism basis where better evidence is required of losses. This is necessary as Management and ownership are in different hands and a cut is needed on management to show overoptimistic, favourable performance results. For example, inventories are valued at the cost or market price whichever is lower. Revenues are recognised when they are certain but expenses as soon as they are reasonably possible e.g. it encourages the accountant to create provisions for bad and doubtful debts.

Since inception, it has come to mean the following:

a) delay in recognition of income;

b) expedite recognition of income;

Note : This obviously affects the reliability of the process of matching cost against revenue.

c) if in doubt, understate assets and income;

d) if in doubt, overstate liabilities and expenses.

Note : (c) and (d) above violate the postulates of consistency and therefore comparability.

It may result in creation of Secret Reserves if overdone, which vitiates reliabilities of financial statement as the opposite operation, namely, window-dressing. To day's accountants condemn both the practices. The driving-force behind conservatism is: it is better to be wrong on the minus side than on the plus side of financial statements. This is pessimism and not sceptics. An accountant should be sceptic and not a pessimist; the former can be convinced by sound logic while the latter can be made to change her/his mindset. Moreover, there is no standard by which the degree of conservatism may be standardised. Hence, it becomes highly subjective and may even go to the length of seriously affecting the doctrine
of disclosure.

2. Consistency :

This concept states that once the organisation has decided on a method, it should use the same method subsequently unless there is a valid reason for a change of method. If frequent changes are made it is not possible to carry out comparisons on an inter-period or inter-firm basis. If a change is necessary it has to be highlighted. e.g. if depreciation is charged on diminishing balance method, it should be done year after year.

It is an accounting postulate since it develops the growth of the subject of accountancy with only a few constraints. By this standard, it is difficult to call conservatism an accounting postulate since it acts as constraints in many cases, as we have seen above. The basic prerequisite of the postulate of consistency is that the same accounting procedure, treatments, approaches, techniques, tools, concepts and principles should be applied from year to year within the firm; and also to the extent it is possible to ensure the same in all other organisations. But there are difficulties in having uniform principles and concepts and tools and procedures
to be used by all the firm within a country, if not globally, mainly because of the following reasons:

a) Local custom, economic, social and political environments may differ from place to place.

b) The different nature of business of different kinds and size.

c) Presence of valid alternatives, accepted by law and standard – setting bodies consistency serves two purposes, one directly and the other indirectly. Directly, it facilitates comparison, which is a vital tool for complex decision-making. Indirectly, when used over a considerable length of time it reduces risks surrounding operating enterprises.

3. Matching :

When an event affects both revenues and expenses, the effect on each period should be recognised in the same accounting period. This leads to matching concepts. The matching concepts is applied by first determining the items that constitute revenues for the period and their amounts in accordance with the conservatism concepts and than matching costs to these revenues. Thus both the aspects of an event are recorded in terms of revenue and expense in the same accounting period.

4. Disclosure :

Apart from legal requirements all significant information should be disclosed. The matching concept states that all significant information should be disclosed and all insignificant information should be disregarded. However, there are no definite rules to separate the two. For recording purposes also only significant events are recorded in detail taking into consideration the cost of detailed record keeping.

5. Materiality :

The accountant should attach importance to material details and ignore insignificant details. The question what constitutes a material detail is left to the discretion of the accountant. An item is material if there is reason to believe that knowledge of it would influence the decision

of the informed investor. This has already been referred to above in connection with Disclosure. In addition to what has already been discussed, the reader is to note the following points:

a) Materiality of information
b) Materiality of amount
c) Materiality of procedure
d) Materiality of nature

Materiality of Information : Misdescription of assets, liabilities, receipts and expenditures. Likewise, wrong classification between Capital and Revenue would also come under this category.

Materiality of Amount : This is a highly relative term. A fraud or an error of Rs. 5,000 may be material in a small organisation while not so in a large organisation. Which is why, the Companies Act 1956 and MAOCARO, 1988 have indicated at different places as to the degree (relatively) of tolerance. For example, an item of expense should be shown separately if it constitutes a certain percentage of the total expenses for the period.

Materiality of Procedure : Every accountant knows that some procedures are superior to others for certain purposes. For example, the various methods of depreciation, treating liability for gratuity on Cash Basis and on Actuarial Basis, etc.

Materiality of Nature : Some items are material by nature regardless of the amount involved and any other factor. A small error in such items will be considered as material always. For example, Director's Fees, Audit Fees, amount due from directors etc.

1.3 GOLDEN RULE OF ACCOUNTING

Duality concept provides that every transaction has two sides to it – (1) the debit and (2) the credit. In other words every financial transaction involves the simultaneous receiving and giving the value.

For the purpose of making accounting entries, it is necessary to understand the nature of account. Accounting transactions involves recording of assets, debtors, expenses and capital, creditors and incomes. Incomes and expenses are known as Nominal Accounts, Assets and Capital are known as Real Accounts. In between these two groups, personal accounts like debtors and creditors are also recorded in financial books.

The Golden Rule of accounting provides how the duality aspect of transactions is to be recorded in the books of accounts. These rules are –

Nature of Account	***Rule***
Nominal Account	*Debit* all expenses and losses *Credit* all incomes and profits
Real Account	*Debit* what comes in and *Credit* what goes out
Personal Account	*Debit* the receiver and *Credit* the giver.

The above rules are explained in the following transactions.

Illustration 1 :

During the month of January 2001, ABC Ltd. has made the following transactions –

Item No.	*Date*	*Transactions*
1.	January 1	Issued 10,000 shares of Rs. 10 each in cash
2.	2	Purchased machinery costing Rs. 50,000 from Y Ltd.
3.	3	Purchased raw materials from Z Ltd. worth Rs. 10,000
4.	15	Paid wages in cash Rs. 15,000
5.	17	Sold goods to PQR Ltd. for Rs. 25,000
6.	18	Paid cash to Y Ltd. Rs. 20,000
7.	19	Received from PQR Ltd. Rs. 20,000

Analysis of Transactions

Item No. 1 : ABC Ltd. received cash from its shareholders. Cash is an asset, a real account. Cash is given by shareholders. Cash comes in — Cash A/c is debited and shareholders giving the cash is debited.

Item No. 2 : Machinery is a real account and it comes in, Y Ltd. gives the machinery. Therefore, Machinery A/c is debited and Y's Ltd. A/c is credited.

Item No. 3 : Purchasing of goods is an expense. It is a nominal A/c and therefore should be debited, Z Ltd. gives the goods, therefore, Z Ltd. A/c should be credited.

Item No. 4 : Wages is an expense, a nominal account, therefore, it should be debited. Cash a real account which goes out and it should be credited.

Item No. 5 : Sale of goods resulted in an income, hence, credited. PQR Ltd. received the goods hence PQR Ltd. A/c should be debited.

Item No. 6 : Y Ltd. is a personal account who receives the cash and thus Y Ltd. is debited; cash a real account which goes out and is therefore credited.

Item No. 7 : Cash comes in. Cash is a real A/c hence debited. PQR Ltd. gives the cash, hence it is credited.

The entries relating to above transactions are given below :

Item no.	*Accounts involved*	*Nature of A/c*	*Dr.(Rs.)*	*Cr.(Rs.)*
1.	Cash	Real	1,00,000	
	Shareholders	Personal A/c		1,00.000
2.	Machinery	Real	50,000	
	Y Ltd.	Personal		50,000
3.	Purchases	Nominal	10,000	
	Z Ltd.	Personal		10,000
4.	Wages	Nominal	15,000	
	Cash	Real		15,000
5.	PQR Ltd.	Personal	25,000	
	Sales	Nominal		25,000
6.	Y Ltd.	Personal	20,000	
	Cash	Real		20,000
7.	Cash	Real	20,000	
	PQR Ltd.	Personal		20,000

1.4 ACCOUNTING RECORDS

Accounting Records are maintained on the dual concept basis which states that –

Assets = Liabilities + Capital.

The above terms mean :–

i) **Asset** is a resource used to derive income in the future.

Assets are mainly classified as tangible or intangible. Tangible assets are those assets which can be physically seen, such as land, building, plant, cash etc. Intangible assets are those assets which cannot be physically seen e.g. goodwill, patent, copy right, etc. Again, assets can be classified as fixed and current assets. Fixed Assets are those assets which are held for a longer period of use e.g. land, building, plant, goodwill, copyright, etc. Current Assets are those assets which are held for a shorter period, generally not exceeding one year, such as cash, debtors, stock, short term investments etc.

ii) **Liability** is an amount owed by a business or organisation, e.g. creditors, loans received, bank overdraft, etc. Capital is the amount owed by the proprietor, partners or shareholders of a business or organisation.

Thus the equation states that Assets are created by owing money to the owners of the business (Capital) and other persons who owed money from the business (Liabilities).

The equation is explained by the following illustration.

Illustration 1 :

On 31st March 2001 Mr. PQR resigned from his employment. On that date he receives from his employer Rs. 15,000. On 1st April 2001, he started a business with Rs. 15,000. On 2nd April he opened a Bank A/c by depositing Rs. 10,000 ; on 6th April he purchased 100 units of L at Rs. 10,000. He paid Rs. 5,000 in cash and agreed to pay balance amount after one month.. On 7th April he sold 60 units of L for cash and 30 units of L on 2 months credit term. Selling price per unit Rs. 120.

April 1 Cash introduced in business Rs. 15,000
Cash Rs. 15,000 = Proprietor's Capital A/c 15,000
Asset (cash) = Capital + Liabilities
15,000 = 15,000 + 0

April 2 : Opened Bank A/c by depositing Rs. 10,000
Cash (15,000 – 10,000) + Bank (10,000) = Capital (15,000)
Asset (Cash + Bank) 15,000 = Capital (15,000) + Liability (0)
15,000 = 15,000 + 0

April 6 : Goods purchased for Rs. 10,000 paid Rs. 5,000 in cash; by the transaction as on that his stock of goods amounted to Rs. 10,000. As he paid cash Rs. 5,000, cash balance was nil and liability for goods purchased was Rs. 5,000

Asset	=	Liabilities + Capital
Cash (0) + Bank (10,000) + Stock (10,000)	=	Capital (15,000) + Liability (5,000)
20,000	=	20,000

April 7 : He sold 60 units of L for cash @ Rs. 120. He therefore received Rs. 7,200 in cash and 30 units of L for credit @ 120, therefore Rs. 3,600 becomes amount receivable. He thus withdrew 90 units of L costing Rs. 9,000 which he sold at Rs. 10,800 (Rs. 7,200 + Rs. 3,600). He therefore earned an income of Rs. 1,800 which would increase his capital. The above transactions would affect the following Accounts :

Assets = Cash (0 + 7,200), Bank (10,000), Debtors 3,600 Stock (10,000 – 9,000)
Asset = Cash 7,200 + Bank 10,000 + Debtor 3,600 + Stock 1,000 = 21,800
Capital (15,000 + 1,800) = 16,800
Liability (Creditors) = 5,000
Total Assets (21,800) = Capital (16,800) + Liability (5,000)

1.5 BOOKS OF ACCOUNT

Journal :

The word *journal* means a diary or a day book. In older days all monetary transactions were recorded in chronological order in the journal book based on golden rule of accounting. The entries in journal in our **earlier illustration** would have been as follows :

Journal

Date	*Particulars*	*Dr. (Rs.)*	*Cr. (Rs.)*
April 1	Cash	15,000	
	To PQR's Capital A/c		15,000
April 2	Bank	10,000	
	To Cash		10,000
April 6	Goods/stock	10,000	
	To Cash		5,000
	To Creditors		5,000
April 7	Cash	7,200	
	Debtors	3,600	
	To Goods/Stock		9,000
	To Capital A/c		1,800

However in modern accounting systems the journal is mainly divided into three parts –

1. The General Journal.
2. Sales and Purchase Day Books or Journals
3. Sales Return and Purchase Return Books or Journals.

1. The *General Journal* is used for recording —

(a) Opening Entries

(b) Closing Entries, and

(c) Transaction of a special nature

In the general journal the following columns are normally provided.

Date	*Particulars*	*LF*	*Debit(Rs.)*	*Credit(Rs.)*

At the foot of each entry the narration is given which shows the nature of and where necessary the authority for the entry passed.

The amount shown in the debit column of the journal entered on the debit side of the ledger and the amount shown in the credit column of the journal are entered on the credit side of the ledger.

2. *Sales and Purchase Day Books or Journals.*

Each credit sale (i.e other than cash sales) are entered in the Sales Day Book or Journal with such details as are required e.g. date, name, invoice no., amount, discount allowed etc. At periodical intervals say, monthly, quarterly, half yearly or yearly additions of all entries in the Sales Day Book are made. The personal account of buyers are posted to the debit side of each buyer's account and the total amount of sale for the respective period is credited to sales following the golden rules to debit the receiver and credit what goes out.

In case of credit purchase (i.e., other than cash purchase) purchases made by an enterprise are similarly recorded and posted to the credit of the suppliers' account in the ledger (Personal A/c. credit the giver) and Purchase A/c is debited (Debit what comes in).

3. *Sales Returns and Purchase Returns Day Books or Journals*

These books or journals record sales and purchase returns. When goods already sold are returned by the buyer, they are recorded in Sales Return Day Book. Similarly when good purchased are returned to the buyer they are recorded in Purchase Return Day Book.

These journals occupy the converse position to the Day Books or Journals. Thus in case of Sales Return Day Book, Sales or Return Inward A/c. is debited and the Personal A/c. is credited. Similarly, when purchases are returned Purchase A/c is credited & Personal A/c is debited.

Ledger

Ledger is defined as a "Book which contains in a summarised and classified form of permanent record of all transactions. Ledger is called the principal book of account as final information pertaining to financial position of a business emerges from this book. The form of an account in the ledger is given below :

Dr. **Title of the Account** **Cr.**

Date	*Particulars*	*JF*	*Amount Rs.*	*Date*	*Particulars*	*JF*	*Amount Rs.*

Every account has a debit side and a credit side; Journal Folio or J.F. indicates the number of the page of the journal where the other affected account appears.

Sometimes ledger is also maintained in a " running account format" as follows –

Title of the Account

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

Posting of Entries

Consider the following Journal Entry :

Date	*Particulars*		*L.F.*	*Rs.(Dr.)*	*Rs.(Cr.)*
2003					
May 18	Purchases A/c	Dr.		5,000	
	To Bank A/c				5,000
	(Being goods purchased).				

The above journal entry when posted to the ledger accounts would appear as follows:

Dr. **Purchases Account** **Cr.**

Date (2003)	*Particulars*	*JF*	*Amount Rs.*	*Date (2003)*	*Particulars*	*JF*	*Amount Rs.*
May 18	To Bank A/c		5,000				

[The debit side of the Purchase A/c is greater. To maintain symmetry the balance is carried down (c/d) at the end of the month to the credit side and brought down again at the beginning of the following month i.e., June 1st to the debit side. Thus it can be seen that the Purchase A/c has a debit balance.]

Dr. **Bank Account** **Cr.**

Date (2003)	*Particulars*	*JF*	*Amount Rs.*	*Date (2003)*	*Particulars*	*JF*	*Amount Rs.*
				May 18	By Purchases		5,000

Subdivision of the Journal

Where the number of transactions are many it would be time consuming and cumbersome if each and every transaction were to be entered in a single Journal. Usually firms maintain subsidiary books to record transactions. These books are

1. Cash Book (to record cash and bank transactions)
2. Petty Cash Book (to record cash payments involving small amounts)
3. Sales Book (to record credit sales)
4. Purchase Book (to record credit purchases)
5. Sales Return Book (to record return from customers)
6. Purchase Returns Book (to record return to suppliers)
7. Bills Receivable Book (to record acceptances received)
8. Bills Payable Book (to record acceptances given)
9. Journal Proper (to record transactions which cannot be entered in any of the above specialised Journals)

1. Cash Book

All transactions relating to each cash are recorded in the cash book, and on the basis of such a record ledger accounts are prepared. The different types of cash book are :

1. Simple Cash Book containing Cash Column only
2. Two Column Cash Book containing both Cash Column and Bank Column
3. Three Column Cash Book containing Cash, Bank and Discount columns.

(1) Simple Cash Book

The simple cash book is maintained strictly for cash transactions, a bank book being maintained separately for bank transactions. The form of a simple cash book is like that of any other account and is as follows:

Dr.	Receipts				Payments		Cr.
Date	*Particulars*	*LF*	*Amount*	*Date*	*Particulars*	*LF*	*Amount*

(2) Two Column Cash Book

Unlike the simple cash book the Two Column Cash Book combines both bank and cash transactions for the sake of convenience due to the ever increasing bank transactions. The ruling of this book is –

Dr.	Receipts					Payments			Cr.
Date	*Particulars*	*LF*	*Cash*	*Bank*	*Date*	*Particulars*	*LF*	*Cash*	*Bank*

The cash book is so ruled that the debit column of cash and bank are placed alongside each other likewise with the credit column of cash and bank. The bank column contains details of payment made by cheques and money received and paid into the bank A/c.

In the folio columns the letter "C" is used whenever cash is being paid into the bank or there is a receipt from the bank, "C" means contra item and described transaction affecting only cash and bank accounts.

Illustration 2 :

Enter the following transactions in a two column cash book :

1997

Jan 1	Balances brought dawn – bank Rs. 5,000 and cash Rs. 450
3	Withdrew Rs. 2,000 from bank
5	Bought goods for Rs.1,500 paying by cheque
8	Purchased stationery by cash Rs.50
11	Paid electricity bill Rs.100 by cheque
15	Sold goods for Rs.2,000 and received cheque
20	Paid into bank Rs.150

Two Column Cash Book

Dr.	**Receipts**					**Payments**			**Cr.**
Date (1997)	*Particulars*	*LF*	*Cash Rs.*	*Bank Rs.*	*Date (1997)*	*Particulars*	*LF*	*Cash Rs.*	*Bank Rs.*
Jan 1	To Balance b/d		450	5,000	Jan 3	By Cash	C		2,000
Jan 3	To Bank	C	2,000		Jan 5	by Purchases			1,500
Jan 15	To Sales			2,000	Jan 8	By Stationery		50	
Jan 20	To Cash	C		150	Jan 11	By Electricity			100
					Jan 20	By Bank	C	150	
					Jan 31	By Balance		2,250	3,550
			2,450	7,150				2,450	7,150
Feb 1	To Balance b/d	2250	3,550						

Payments can easily be identified as either cash or bank payments. If a payment is made directly from bank account e.g., by a standing order it appears in the bank account column. Payments of cash are entered in the cash column. When an amount is received by cheque it should be recorded directly in the bank column. The banking on any cash is a separate transaction.

(3) Three Column Cash Book

The three column cash book has the cash and bank discount column. Cash discount is an incentive given to customers to pay before the date specified. It encourages early payment and when given to a customer is a loss and when received from a supplier is a gain. Since this discount arises only when cash is received or paid it is recorded in the cash book, discount allowed on the debit side and discount received on the credit side of the cash book. The discount columns are totalled and not balanced. The form of a three column cash book is illustrated with the following example:

Illustration 3 :

2003

May 1		Balances Brought down – bank Rs. 3080, cash Rs. 709
	2	Paid wages in cash Rs. 218
	4	Received Rs. 177 cash from Kiran after allowing him a discount of Rs. 13.
	6	Paid Ravi Rs.188 after deducting discount of Rs. 12 by cheque.
	8	Received cheque for Rs. 485 from Ali after allowing him a discount of 3%.
	10	Received cash from Joshi of Rs. 145.5 a discount 3% being deducted.

Date (2003)	*Particulars*	*LF*	*Disc. Allowed*	*Cash Rs.*	*Bank Rs.*	*Date (2003)*	*Particulars*	*LF*	*Disc. Recd.*	*Cash Rs.*	*Bank Rs.*
May 1	To Balance b/d			709	3080	May 2	By Wages			218	
May 4	To Kiran		13	177		May 6	By Ravi		12		188
May 8	To Ali		15		485						
May 10	To Joshi		4.50	145.50	.	May 11	By Balance c/d			813.50	3377
			32.50	1031.50	3565				12	1031.50	3565
May 11	To Balance b/d			813.50	3377						

The total of the debit discount column i.e., discount allowed is transferred to the discount allowed account in the ledger. Similarly, discount received (credit discount column) is transferred to the discount received account in the ledger.

Petty Cash Book

In any business there will be numerous small cash payments. It would be advantageous if these payments could be kept separate from the main cash book. This separate book is called **Petty Cash Book**.

Advantages of maintaining a Petty Cash Book are :–

(i) It saves the time of the General Cashier.

(ii) As the record of Petty Cash is checked by the cashier periodically, so the mistake is rectified immediately.

(iii) Under Imprest System, the Petty Cashier is not allowed to keep idle cash with him.

(iv) The chance of misappropriation is less.

(v) It trains the staff to handle money with responsibility.

(vi) It reduces the work load of general Cashier and the volume of General Cash Book becomes small.

The Imprest System

In this system the cashier gives the petty cashier a fixed amount of cash to meet his needs for the ensuing period. At the end of the period the cashier ascertains the amount spent by the petty cashier and reimburses the same to him. The petty cash in hand will then be equal to the original amount at the beginning of the period.

Amount given by cashier at the beginning	Rs.	200
Expenses during the period	Rs.	142
Petty cash in hand	Rs.	58
Reimbursement from cashier	Rs.	142
Petty cash at the end of the period	Rs.	200

Illustration 4 :

2003	
July 1	The cashier of a firm gives Rs. 200 as imprest to the petty cashier.
	Payments of petty cash during July are :
2	Postage stamps purchased Rs. 10
3	Pencils bought Rs. 3
4	Busfare Rs. 3
5	Cleaning charges Rs. 15
6	Wages to coolie for shifting furniture Rs. 15
9	Taxi fare paid Rs. 10
10	Refreshments bought for customers for Rs. 17
14	Telegram charges Rs. 7
15	Stationery bought Rs. 9
17	Repair of chair Rs. 12
18	Battery for clock purchased Rs. 6
21	Stamps bought Rs.8
23	Spare keys made for manager's cabin Rs.5
24	Busfare Rs. 2
26	Casual labour Rs. 9
27	Carbon paper Rs.5
29	Newspaper (special edition) Rs. 3
30	Busfare Rs. 3

Write up the petty cash book, cash book and the necessary ledger accounts.

Dr. **Petty Cash Book** **Cr.**

Receipt			*Payment*								
Date (2003)	*Particulars*	*Amt. Rs.*	*Date (2003)*	*Particulars*	*Total Rs.*	*Pos- -tage*	*Stati- -nery*	*Trave- -lling*	*Clea -ning*	*Other expns.*	
July 1	To Cash Book	200									
			Jul 2	By Postage	10	10					
			3	By Stationary	3		3				
			4	By Travelling	3			3			
			5	By Cleaning	15				15		
			6	Other Expns.	15					15	Wages. to coolie
			9	By Travelling	10			10			
			10	By other Expns.	17					17	Refreshment
			14	By Postage	7	7					
			15	By Stationery	9		9				
			17	By other Expns.	12					12	Repair of chair
			18	By other Expns.	6					6	battery
			21	By Postage	8	8					
			23	By Other Expns.	5					5	Spare Key
			24	By Travelling	2			2			
			26	By Other Expns.	9					9	Casual labour
			27	By Stationery	5		5				
			29	By Other Expns.	3					3	Newspaper (spl. edition)
			30	By Travelling	3			3			
					142	25	17	18	15	67	
			31	By Balance b/d	58						
					200						
Aug 1	To Balance b/d	58									
Aug 1	To Cash	142									

Dr. **Cash Book** **Cr.**

Date (2003)	*Particulars*	*LF*	*Cash Rs.*	*Bank Rs.*	*Date (2003)*	*Particulars*	*LF*	*Cash Rs.*	*Bank Rs.*
					July 1	By Petty Cash		200	

GENERAL LEDGER

Dr. Travelling Account Cr.

Date (2003)	*Particulars*	*Amount Rs.*	*Date (2003)*	*Particulars*	*Amount Rs.*
July 31	To Petty Cash	18			

Dr. Printing & Stationery Account Cr.

Date (2003)	*Particulars*	*Amount Rs.*	*Date (2003)*	*Particulars*	*Amount Rs.*
July 31	To Petty Cash	17			

Dr. Postage & Telegram Account Cr.

Date (2003)	*Particulars*	*Amount Rs.*	*Date (2003)*	*Particulars*	*Amount Rs.*
July 31	To Petty Cash	25			

Similarly there will be Clearing Expenses and Other Expenses Accounts.

3. Sales Book

The sales book records all credit sales of goods of business, cash sales are recorded in cash book. The form of a sales book can be explained with the following example :

Transactions of Beauty Ltd.

2003

June 1 Sold to P Ltd. 25 jars of cream @ Rs. 37 and 200 packets of powder @ Rs. 9.50 each less T.D. @ 10%.

2 Sold old books to B Ltd. on credit Rs. 750

4 Sold to S stores 35 packets of powder @ Rs. 9.50 for cash.

7 Sold to A departmental stores 310 packets of powder @ Rs. 9.50 and 40 jars of cream @ Rs. 36 each less T.D. @ 10%.

Sales Book

Date (2003)	*Particulars*	*LF*	*Invoice No.*	*Amount Rs.*	*Amount Rs.*
Jun 1	P. Ltd.				
	– 25 jars of cream @ Rs. 37			925.00	
	– 200 packets of powder @ Rs. 9.50			1,900.00	
				2,825.00	
	Less : T.D. @ 10%			282.50	2,542.50
Jun 7	A Departmental Stores				
	– 40 jars of cream @ Rs. 36			1,440.00	
	– 310 packets of powder @ Rs. 9.50			2,945.00	
				4,385.00	
	Less : T.D. @ 10%			438.50	3,946.50
					6,489.00

Note. Cash sales and sale of the old books (asset) in cash are not entered in the sales book. Trade discount is allowed where a customer purchases goods above a certain quantity or amount. Only the net amount i.e., after deduction of trade discount is considered. No entry is made in the ledger accounts.

Dr. Sales Account Cr.

Date (2003)	*Particulars*	*Amount Rs.*	*Date (2003)*	*Particulars*	*Amount Rs.*
June 01	To Balance c/d	6821.50	04	By Cash	332.50
			07	By Sales as per sales book	6489.00
		6821.50			6821.50

Difference between Trade discount and Cash discount

Cash Discount	*Trade Discount*
When payment is made earlier than the stipulated date.	It is normally allowed on purchases.
Cash discounts allowed/ received are accounted for in the ledger.	Trade discount is not entered in ledger.
It is not deducted from the invoice.	The amount of trade discount is deducted from the invoice.

4. Purchase Book

The purchase book records all credit purchases of goods of business, cash purchases and credit purchases of assets are not entered in this book. The form of a purchase book can be explained with the following illustration.

Illustration 5 :

Transaction of M/s Sporting Ltd.

2003	
July 1	Purchased from Indian Sports Co. on credit 75 cricket bats at Rs. 100 each 90 footballs at Rs. 80 each less trade discount at 10%.
July 3	Purchased from Gripwell Co. 45 hockey sticks at Rs. 85 each for cash.
July 7	Purchased vacuum cleaner for office use from M/a Spic & Span on credit Rs. 3050
July 8	Purchased on credit from Wicket Pvt. Ltd. 40 Cricket bats at Rs. 105 each 70 footballs at Rs. 82 each less trade discount at 10%
July 9	Purchased from Green & Co. 15 Hockey sticks at Rs. 75 each on credit.

Purchase Book

Date (2003)	*Particulars*	*LF*	*Amount Rs.*	*Amount Rs.*
July 1	Indian Sports Co. 75 Cricket bats @ Rs. 100 each		7,500.00	
	90 Footballs @ Rs. 80 each		7,200.00	
			14,700.00	
	Less : Trade Discount 10 %		1,470.00	13,230.00
July 8	Wicket Pvt. Ltd. 40 Cricket bats @ Rs. 105 each		4,200.00	
	70 Footballs @ Rs. 82 each		5,740.00	
			9,940.00	
	Less : Trade Discount 10%		994.00	8,946.00
July 9	Green and Company 15 Hockey Sticks @ Rs. 75 each			1,125.00
	Total			23,301.00

Cash purchases of goods and purchase of assets (i.e., vacuum cleaner) are not entered in the purchase book. From the purchase book a purchase account is prepared.

Note. The Purchase account records the cash purchases also.

Dr. **Purchase Account** **Cr.**

Date (Jul '03)	*Particulars*	*JF*	*Amount Rs.*	*Date (Jul, '03)*	*Particular*	*JF*	*Amount Rs.*
3	To Cash		3825.00	Oct 9	By Balance c/d		27126.00
9	To Purchases as per purchase book		23301.00				
			27126.00				27126.00

Dr. **Purchase Ledger** **Cr.**

Date (Jul '03)	*Particulars*	*Amount Rs.*	*Date (Jul, '03)*	*Particular*	*Amount Rs.*
			1	By Purchases A/c Wicket Pvt. Ltd.	8946.00
			8	By Purchases A/c	23,301.00

5. Sales Return Book

The sales return book is also known as Returns Inward Book.

Where customers frequently return the goods sold to them it would be convenient to record the returns in a separate book called the Sales Return Book. Where goods are returned by customers a document known as credit note will be sent to them, showing the amount of allowance given in respect of the returns. The term credit note takes its name from the fact that the customer's account will be credited with the amount of the allowance, so as to show the reduction in the amount owed by him. The Sales Return Book is illustrated below with assumed figures :

Sales Returns Book

Date (July 2003)	*Particulars*	*JF*	*Amt. Rs.*	*Amt. Rs.*
5	Indian Glassware Co.			
	20 Glass Cups @ Rs. 8		160.00	
	Less : Trade Discount @ 10@		16.00	144.00
27	Hindustan Dept. Stores			
	15 Coffee Cups @ Rs. 10		150.00	
	Less : Trade Discount @ 10%		15.00	135.0C
	Total			279.00

The form of credit note is illustrated below :

Indian Glassware Co.
15, N.S.C. Road
Chennai - 600 052

To,

Bric - A - Brac Co. Ltd.
19, Lal Street,
Delhi - 110 103

Credit Note No. 8/83

	Per unit Rs.		Rs.
20 Glass Cups	8.00		160.00
Less : Trade discount 10%			16.00
		Total	144.00

The total of the Sales Return Book is transferred to the sales returns account.

Dr. Sales Return Account Cr.

Date (2003)	*Particulars*	*JF*	*Rs. P*	*Date (2003)*	*Particulars*	*JF*	*Rs. P*
Jul 31	To Sales returns as per sales return book		279.00	Jul 31	By Balance c/d		279.00
			279.00				279.00
Aug 1	To Balance b/d		279.00				

Dr. Indian Glassware Co. Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
Jul 5	To Balance c/d		144.00	Jul 5	By Sales Returns		144.00
			144.00				144.00
				Jul 6	By Balance b/d		144.00

Dr. Hindustan Departmental Store Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
Jul 27	To Balance c/d		135.00		By Sales Returns		135.00
			135.00				135.00
				Jul 28	By Balance b/d		135.00

6. Purchases Returns Book

When goods are returned to suppliers these are recorded in the Purchases Returns or Returns Outward Book. A debit note is sent to the supplier stating the amount of allowance to which the firm returning the goods is entitled. The term Debit Note stems from the fact that as the liabilities to the supplier is accordingly reduced and his personal account must be debited to record this. The Return Outward book is illustrated below.

Returns Outward Book

Date	*Particulars*	*JF*	*Rs.*	*Rs.*
May 15	Travel Luggage Co.			
	2 40" Suitcases @ Rs. 500		1,000.00	
	Less : Trade discount @ 10%		100.00	900.00
May 26	Bags & Bags Co			
	One 24" travel bag			200.00
			Total	1,100.00

The total of the Returns Outward Book is transferred to the Returns Outwards account.

Dr. Return Outward Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
May 31	To Balance c/d		1,100.00	May 31	By Returns		1,100.00
					Less : Outwards as per		
			.		Returns Outwards Book		.
			1,100.00				1,100.00
				June 1	By Balance b/d		1,100.00

Dr. Travel Luggage Co. Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
May 15	To Returns Outward		900.00	May 15	By Balance c/d		900.00
			900.00				900.00
May 16	To Balance c/d		900.00				

Dr. Bags & Bags Co. Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
May 26	To Returns Outward		200.00	May 26	By Balance c/d		200.00
			200.00				200.00
May 27	To Balance b/d		200.00				

7. Bills Receivable Books

When the number of bills or promissory notes received is large, instead of journalising each receipt of bills, which would be cumbersome, a register to record all receipts of bill is maintained. Every month this register are totalled. Receipts of cash in respect of bills will be recorded in the cash book. Only the endorsement of bills in favour of other parties or dishonour will be journalised. The Bill Receivable Book can be illustrated with the following example :

Illustration

X received the following bills :

Sept 5 Drew on A a bill of exchange at 3 months which was accepted and returned by him on 5th Sept. 2002. The amount being Rs. 1,500.

Sept 20 Drew on C a bill of exchange for Rs. 2,500 at 2 months which was accepted on the same day. The bill was payable at Union Bank of India.

Bills Receivable Book

Sr. No.	*From whom received*	*Acceptor*	*Date of bill*	*Term*	*Date of maturity*	*Amount*	*How disposed of*
1	A	A	Sept 5	3 mths	Dec. 8	1,500	
2	C	C	Sept 20	2 mths	Nov 23	2,500	
						4,000	

The total of the Bills Receivable is transferred to the Bills Receivable A/c.

Dr. Bills Receivable Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
1996							
Sep 30	To Sundries as per Bills Receivable Book		4,000.00				

Dr. A's Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
				2002			
				Sep 5	By Bills Receivable A/c		1,500.00

8. The Bills Payable Book

The Bills Payable Book recording the acceptances given can be illustrated with the following example.

Illustration 7 :

M accepted the following bills.

2002
Aug 13 Accepted P's bill for Rs. 3,000 due in one month.
Aug 17 Accepted Q's bill for Rs. 5,000 due in two months payable at Canara Bank

Bills Payable Book

Sr. No.	*Date of issue*	*To whom given*	*Term*	*Date of maturity*	*Where maturity*	*Amount Rs.*	*Remarks*
1	Aug 13	P	1 mth	Sep 16	—	3,000	
2	Aug 17	Q	2 mth	Nov 20	Canara Bank	5,000	
						8,000	

Dr. Bills Payable Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
				2002			
				Aug 31	By Sundries as per Bills Payable Book		8,000.00

Dr. P's Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
2002							
Aug 13	To Bills Payable A/c		3,000.00				

Dr. Q's Account Cr.

Date	*Particulars*	*JF*	*Rs. P*	*Date*	*Particulars*	*JF*	*Rs. P*
2002							
Aug 17	To Bills Payable A/c		5,000.00				

9. Journal Proper

All transactions which do not find place in the subsidiary books find place in the journal proper. Opening entries, closing entries, adjustment entries, rectification entries etc. appear in the journal proper. [All these entries are explained in detail in subsequent Study Notes].

e.g. Purchase of fixed asset on credit :

Asset A/c Dr.
To Creditor's A/c

e.g. Drawings made by the proprietor

a) Cash drawn

Drawings A/c Dr.
To Bank/Cash A/c

---

b) Goods withdrawn at sale or purchase price for personal use :

Drawings A/c Dr.
To Purchase/Sale A/c

1.6 TRIAL BALANCE

In the double entry system every entry has its corresponding credit and debit. It follows, that at any given point of time, the posting from Journal, day books and cash book to the ledger is completed, the debit balances standing in all the ledgers including the cash book will equal the credit balances. At the end of the financial period (or at some other date) these balances are extracted and a schedule is prepared in journal form is called a Trial Balance. Thus the total of debit balances appearing in the Trial Balance must agree with the total of credit balances of appearing in the Trial Balance.

The next stage after posting accounts to the ledger is the preparation of a Trial Balance. The debit and credit balances of accounts are entered in this statement. The total of the debit and the total of the credit side must agree. An agreement indicates reasonable accuracy of the accounting work.

The trial balance helps in ascertaining arithmetical accuracy of the ledger accounts, location of errors and in the preparation of financial statements.

Objects of preparing Trial Balance :

1. It forms the very basis on which final accounts are prepared.
2. It helps in knowing the balance on any particular account in the ledger.
3. It is used as a test of arithmetical accuracy.

However, a Trial Balance is not a conclusive proof of absolute accuracy of the accounts. It does not indicate the absence of an error. Thus, a non-tallied Trial Balance indicates the presence of book-keeping errors.

Errors disclosed by the Trial Balance :

A Trial Balance will not agree on account of the following errors :

(i) Wrong posting of entries i.e. A debit entry of Rs. 1,000 for purchase of furniture wrongly posted as Rs. 100 in the account.

(ii) Omission of posting of debit or credit e.g. A debit entry of Rs. 1,000 for purchase of furniture is not posted at all.

(iii) Duplication of posting e.g. when debit entry of Rs. 1000 for purchase of furniture has been posted twice in the account.

(iv) Wrong side of posting e.g. when debit entry is posted on the credit side or credit entry is posted on the debit side, e.g. when a debit entry of Rs. 1000 is posted on the credit side, i.e. when debit entry of Rs. 1000 is posted on the credit side and *vice versa*.

(v) Errors in casting the totals of debit or credit side of the Trial Balance.

(vi) Wrong transfer of balances in the Trial Balance.

(vii) Omission of entering the balance of account in the Trial Balance.

(viii) Balance of cash book omitted to be recorded in the Trial Balance.

(ix) Wrong balancing of account.

(x) Errors in the total or posting or entries of subsidiary book.

(xi) Wrong carry forward of balance in the various books, i.e. day books, cash book, etc.

Errors not disclosed by Trial Balance

The following errors do not affect the agreement of the Trial Balance :

(i) Errors or omission ; omission to record any transaction

(ii) Posting of wrong amount both debit and credit side of the account

(iii) Error made in posting of debit or credit entry is compensated by an identical error of equal amount. These errors are known as compensating errors.

(iv) Errors made in posting a transaction on the correct side of wrong account.

(v) Recording a transaction twice erroneously. These are known as errors of duplication.

(vi) Errors of principle – when the accounting principle is disregarded e.g. a capital item as revenue item and *vice versa*, i.e. purchase of furniture posted to Purchases Account.

Methods of locating errors in Trial Balance :

The following are some of the ways of detecting errors in the Trial Balance –

(i) When digits are wrongly interchanged — it causes the error to occur in multiples of 9. Therefore the difference is a multiple of 9, there are good chances of error occurring in transposition of digits, i.e. when 97 is recorded as 79.

(ii) When the difference is an even number divide by 2 and check whether such an amount is wrongly entered on the wrong side of debit or credit.

(iii) If the difference is a multiple of 10 or 100 or 1000, then there are chances of the error occurring in the totalling.

(iv) Ensure that all the balances of ledger accounts have been considered in the Trial Balance.

(v) Ensure that there is no omission of recording the balances from the subsidiary books or cash book.

(vi) Check all the postings and totals.

If the difference still persists, it should be transferred temporarily to Suspense Account and on locating the errors at a future date, the Suspense Account can be closed.

The format of a trial balance is as follows :

Trial Balance

Ledger Accounts	*Debit* *Rs.*	*Credit* *Rs.*

Where the debit and the credit totals of the trial balance do not agree it is an indication that one or more errors have been made. (These errors are discussed in detail in). The trial balance is the stepping stone for the preparation of financial statements.

Illustration 1:

From the following particulars prepare a Trial Balance as on 30th September 2001 :

Stock 1st October 2000 Rs. 1,380, Debtors Rs. 2,960, Creditors Rs. 1,580, Capital Account 1st Oct. 2000 Rs. 4,100, Drawings Rs. 1,200, Bills Receivable Rs. 770, Bad Debt written off Rs. 190, Provision for Bad and Doubtful Debts Rs. 160, Bills Payable Rs. 470, Wages & Salaries Rs. 1,920, Purchases Rs. 6,580, Sales Rs. 10,670, Bank Rs. 580, Cash Rs. 40, Rent, Rates & Insurance Rs. 330, Sales Returns Rs. 410, Purchases Returns Rs. 280, Fixtures & Fittings Rs. 550, General Expenses Rs. 200, Discounts allowed Rs. 520, Discounts Recd. Rs. 370.

Trial Balance as on 30th Sept. 2001

	Dr. *(Rs.)*	*Cr.* *(Rs.)*
Stock 1st Oct. 2000	1,380	
Debtors and Creditors	2,960	1,580
Capital Account 1st Oct.2000		4,100
Drawings	1,200	
Bills Receivable	770	
Bad Debt written off	190	
Provision for Bad & Doubtful Debts		160
Bills Payable		470
Wages and Salaries	1,920	
Purchases & Sales	6,580	10,670
Bank	580	
Cash	40	
Rent, Rates & Insurance	330	
Sales & Purchases Returns	410	280
Fixtures & Fittings	550	
General Expenses	200	
Discounts	520	370
	17,630	17,630

Illustration 2 : Journalise the following transactions and post them to Ledger and balance the accounts. Also prepare a Trial Balance as on 30th April 2003.

2003.

April	1	Ravi started business with Rs. 15,000 of which Rs. 4,000 were borrowed at 15% p.a. from Shri Sashi.
	2	Purchased goods worth Rs. 4,000 from Anant at 2% trade discount.
	3	Cash sales to Madan Rs. 1,200.
	6	Credit sales to Salvi Rs. 2,000 less trade discount 2%.
	9	Pard cash Rs. 1,950 to Anant and received discount of Rs. 10
	12	Received Rs. 1,950 from Salvi in full settlement of his dues.
	14	Returned goods of the price of Rs. 100 to Anant.
	16	Paid into bank Rs. 5,000.
	18	Issued a cheque for Rs. 1,000 to Anant on account.
	19	Purchased goods of Rs. 2,000 from Anant.
	22	Sold foods costing Rs. 1,000 at 25% profit to Ratan.
	22	Received commission Rs. 800 from S & Co.
	24	Received a cheque for Rs. 395 from Ratan & he was allowed discount Rs. 5.

25 Ratan returned goods of Rs. 50.

30 Paid Interest on loan Rs. 50 to Sashi.

30 Paid Salaries Rs. 2,000 out of which Rs. 1,200 paid by cheque.

30 Paid into Bank Rs. 500.

30 Paid Office Rent by cheque Rs. 300.

Solution : **JOURNAL**

Date **(2003)**	*Particulars*		*L.F.*	*Dr. (Rs.)*	*Cr. (Rs.)*
Apr 1	Cash A/c	Dr.		15,000	
	To Capital A/c				11,000
	To Sashi's Loan A/c				4,000
	(Cash brought into business and loan taken from Sashi @ 15% to start the business)				
Apr 1	Purchases A/c	Dr.		3,920	
	To Anant's A/c				3,920
	(Credit purchases from Anant)				
Apr 3	Cash A/c	Dr.		1,200	
	To Sales A/c				1,200
	(Cash sales)				
Apr 6	Salvi's A/c	Dr.		1,960	
	To Sales A/c				1,960
	(Credit Sales to Salvi)				
Apr 9	Anant's A/c	Dr.		1,960	
	To Cash A/c				1,950
	To Discount A/c				10
	(Paid cash to & received discount from Anant.)				
Apr 12	Cash A/c	Dr.		1,950	
	Discount A/c	Dr.		10	
	To Salvi's A/c				1,960
	(Received cash from & allowed discount to Salvi)				
Apr 14	Anant's A/c	Dr.		98	
	To Returns Outwards A/c				98
	(Returned goods to Anant)				
Apr 16	Bank A/c	Dr.		5,000	
	To Cash A/c				5,000
	(Paid cash into Bank)				

Apr 18	Anant A/c	Dr.	1,000	
	To Bank A/c			1,000
	(Issued a cheque to Anant)			
Apr 19	Purchase A/c	Dr.	2,000	
	To Anant A/c			2,000
	(Credit purchases from Anant)			
Apr 22	Ratan's A/c	Dr.	1,250	
	To Sales A/c			1,250
	(Credit sales to Ratan)			
Apr 22	Cash A/c	Dr.	800	
	To Commission A/c			800
	(Received commission)			
Apr 24	Cash A/c	Dr.	395	
	Discount A/c	Dr.	5	
	To Ratan's A/c			400
	(Received a cheque from & allowed discount to Ratan)			
Apr 25	Returns Inwards A/c	Dr.	50	
	To Ratam's A/c			50
	(Received goods returned by Ratan)			
Apr 30	Interest A/c	Dr.	50	
	To Cash A/c			50
	(Paid interest for April 1993, to Sashi on loan taken from him)			
Apr 30	Salaries A/c	Dr.	2,000	
	To Cash A/c			800
	To Bank A/c			1,200
	(Paid salary Rs. 800 in cash and Rs. 1,200 by cheque)			
Apr 30	Bank A/c	Dr.	500	
	To Cash A/c			500
	(Paid cash into bank)			
Apr 30	Rent A/c	Dr.	300	
	To Bank A/c			300
	(Issued a cheque for office rent for April, 1993)			

LEDGER

Dr. **Cash Account** **Cr.**

Date 2003	Particulars	Amount Rs.	Date 2003	Particulars	Amount Rs.
Apr 1	To Capital A/c	11,000	Apr 9	By Anant's A/c	1,950
Apr 1	To Sashi's Loan A/c	4,000	Apr 16	By Bank A/c	5,000
Apr 3	To Sales A/c	1,200	Apr 30	By Interest A/c	50
Apr 12	To Salvi's A/c	1,950	Apr 30	By Salaries A/c	800
Apr 22	To Commission A/c	800	Apr 30	By Bank A/c	500
Apr 24	To Ratan's A/c	395	Apr 30	By Balance c/d	11,045
		19,345			19,345
May 1	To Balance b/d	11,045			

Dr. **Bank A/c** **Cr.**

Date 2003	Particulars	Amount Rs.	Date 2003	Particulars	Amount Rs.
Apr 16	To Cash A/c	5,000	Apr 18	By Anant's A/c	1,000
Apr 30	To Cash A/c	500	Apr 30	By Salaries A/c	1,200
			Apr 30	By Rent A/c	300
			Apr 30	By Balance c/d	3,000
		5,500			5,500
May 1	To Balance b/d	3,000			

Dr. **Salaries A/c** **Cr.**

Date 2003	Particulars	Amount Rs.	Date 2003	Particulars	Amount Rs.
Apr 30	To Cash A/c	800	Apr 30	By Balance c/d	2,000
Apr 30	To Bank A/c	1,200			
		2,000			2,000
May 1	To Balance b/d	2,000			

Dr. **Rent A/c** **Cr.**

Date 2003	Particulars	Amount Rs.	Date 2003	Particulars	Amount Rs.
Apr 30	To Bank A/c	300	Apr 30	By Balance c/d	300
		300			300
May 1	To Balance b/d	300			

Dr. — Commission A/c — Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 30	To Balance c/d	800	Apr 22	By Cash A/c	800
		800			800
			May 1	By Balance b/d	800

Dr. — Interest A/c — Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 30	To Cash A/c	50	Apr 30	By Balance c/d	50
		50			50
May 1	To Balance b/d	50			

Dr. — Discount A/c — Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 12	To Salvi's A/c	10	Apr 9	By Anant	10
Apr 24	To Ratan's A/c	5	Apr 30	By Balance c/d	5
		15			15
May 1	To Balance b/d	5			

Dr. — Capital A/c — Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 30	To Balance c/d	11,000	Apr 1	By Cash A/c	11,000
		11,000			11,000
			May 1	By Balance b/d	11,000

Dr. — Sashi's Loan A/c — Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 30	To Balance c/d	4,000	Apr 1	By Cash A/c	4,000
		4,000			4,000
			May 1	By Balance b/d	4,000

Dr. Salvi's A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 6	To Sales A/c	1,960	Apr 12	By Cash A/c	1,950
			Apr 12	By Discount A/c	10
		1,960			1,960

Dr. Anant's A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 9	To Cash A/c	1,950	Apr 2	By Purchases A/c	3,920
Apr 9	To Discount A/c	10	Apr 19	By Purchases A/c	2,000
Apr 14	To Returns Outwards A/c	98			
Apr 18	To Bank A/c	1,000			
Apr 30	To Balance c/d	2,862			
		5,920			5,920
			May 1	By Balance b/d	2,862

Dr. Ratan's A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 22	To Sales A/c	1,250	Apr 24	By Cash A/c	395
			Apr 24	By Discount A/c	5
			Apr 25	By Returns Inwards A/c	50
			Apr 30	By Balance c/d	800
		1,250			1,250
May 1	To Balance b/d	800			

Dr. Purchases A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 2	To Anant	3,920			
Apr 19	To Anant	2,000	Apr 30	By Balance c/d	5,920
		5,920			5,920
May 1	To Balance b/d	5,920			

Dr. Sales A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
			Apr 3	By Cash A/c	1,200
			Apr 6	By Salvi A/c	1,960
Apr 30	To Balance c/d	4,410	Apr 22	By Ratan A/c	1,250
		4,410			4,410
			May 1	By Balance b/d	4,410

Dr. Returns Outward A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 30	To Balance c/d	98	Apr 14	By Anant	98
		98			98
			May 1	By Balance b.d	98

Dr. Returns Inwards A/c Cr.

Date 2003	*Particulars*	*Amount Rs.*	*Date 2003*	*Particulars*	*Amount Rs.*
Apr 25	To Ratan's A/c	50	Apr 30	By Balance c/d	50
		50			50
May 1	To Balance b/d	50			

TRIAL BALANCE *as on 30th April, 2003.*

	Dr. *(Rs.)*	**Cr.** *(Rs.)*
Cash A/c	11,045	
Bank A/c	3,000	
Salaries A/c	2,000	
Rent A/c	300	
Commission A/c		800
Interest A/c	50	
Discount A/c	5	
Capital A/c		11,000
Sashi's Loan A/c		4,000
Creditor (Anant)		2,862
Debtor (Ratan)	800	
Purchases A/c	5,920	
Sales A/c		4,410
Returns Outwards A/c		98
Returns Inwards A/c	50	
	23,170	23,170

Illustration 3 :

Enter the following transactions in the subsidiary books and post them into ledger and prepare a Trial Balance.

2002		*Rs.*
1 Dec.	Mr. X started a business	1,00,000
5 Dec.	Purchased furniture from Vikram Furniture for	20,000
7 Dec.	Purchased goods for cash	15,000
10 Dec.	Purchased goods from AB & Co. for Rs. 30,000. Trade Discount 20%	
12 Dec.	Opened a bank account by depositing	25,000
14 Dec.	Sold goods for cash	15,000
15 Dec.	Purchased Stationery for Rs. 1,000 from Sayyed Stationery Mart	
18 Dec.	Sold goods to Yusuf	5,000
20 Dec.	Goods returned by Yusuf	400
21 Dec.	Payment to AB & Co. by cheque	5,000
22 Dec.	Purchased goods on Credit from Ramesh & Co. for	20,000
23 Dec.	Returned goods to Ramesh & Co. worth	2,000
23 Dec.	Paid Electricity Bill for	400
29 Dec.	Cash Sale for	5,000
30 Dec.	Withdraw Rs. 2,000 for private use from Bank.	

Solution :

Dr. **Cash Book** (with Bank Column) Dr.

Date 2002	*Particulars*	*Cash Rs.*	*Bank Rs.*	*Date 2002*	*Particulars*	*Cash Rs.*	*Bank Rs.*
Dec 1	To Capital	1,00,000		Dec 1	By Purcahse A/c (cash)	15,000	
Dec 12	To Cash A/c (Opening A/c)		25,000	Dec 12	By Bank A/c	25,000	
Dec 14	To Sales	15,000		Dec 21	By AB & Co.		5,000
Dec 29	To Sales	5,000		Dec 23	By Electricity	400	
				Dec 30	By Drawing A/c		2,000
				Dec 31	By Balance c/d	79,600	18,000
		1,20,000	25,000			1,20,000	25,000
2003							
Jan 1	To Balance b/d	79,600	18,000				

Purchase Day Book

Date (2002)	*Particulars*	*L.F.*		*Rs.*
Dec 10	AB & Co.		30,000	
	Less: Trade Discount		6,000	24,000
Dec 22	Ramesh & Co.			20,000
	Purchases A/c	**Dr.**		44,000

Sales Day Book

Date (2002)	*Particulars*	*L.F.*	*Rs.*
Dec 18	Yusuf		5,000
	Sales A/c	**Cr.**	5,000

Purchase Return Book

Date (2002)	*Particulars*	*L.F.*	*Rs.*
Dec 23	Ramesh & Co.		2,000
	Purchase Return A/c	**Cr.**	2,000

Sales Return Book

Date (2002)	*Particulars*	*L.F.*	*Rs.*
Dec 20	Yusuf		400
	Sales Return A/c	**Dr.**	400

Journal Proper

Date (2002)	*Particulars*	*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
Dec 5	Furniture A/c	Dr.	20,000	
	To Vikram Furniture A/c	Cr.		20,000
	(Being furniture purchased on credit)			
Dec 13	Stationery A/c	Dr.	1,000	
	To Sayyed Stationary Mart	Cr.		1,000
	(Being purchase of stationery)			

LEDGER of X

Dr. Capital Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec 31	To Balance c/d	1,00,000	Dec 1	By Cash A/c	1,00,000
		1,00,000			1,00,000
			2003		
			Jan 1	By Balance b/d	1,00,000

Dr. Furniture Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec 5	To Vikram Furniture A/c	20,000	Dec 31	By Balance c/d	20,000
		20,000			20,000
2003					
Jan 1	To Balance b/d	20,000			

Dr. Vikram Furniture Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec 31	To Balance c/d	20,000	Dec 5	By Furniture A/c	20,000
		20,000			20,000
			2003		
			Jan 1	By Balance b/d	20,000

Dr. Purchases Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 9	To Cash A/c	15,000			
Dec. 31	To Purchase day book	44,000	Dec. 31	By Balance c/d	59,000
		59,000			59,000
2003					
Jan 1	By Balance b/d	59,000			

Dr. **Sales Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
			Dec. 14	By Cash A/c	15,000
			Dec. 29	By Cash A/c	5,000
Dec. 31	To Balance c/d	25,000	Dec. 31	By Sales Day Book	5,000
		25,000			25,000
			2003		
			Jan 1	To Balance b/fd	25,000

Dr. **Stationery Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 15	To Sayyed Stationery Mart	1,000	Dec. 31	By Balance c/d	1,000
		1,000			1,000
2003					
Jan. 1	By Balance b/d	1,000			

Dr. **Sayyed Stationery Mart** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 31	To Balance c/d	1,000	Dec. 15	By Stationery A/c	1,000
		1,000			1,000
			2003		
			Jan. 1	By Balance b/d	1,000

Dr. **Electricity Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 23	To Cash	400	Dec. 31	By Balance c/d	400
		400			400
2003					
Jan. 1	To Balance b/d	400			

Dr. **Drawings Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 30	To Bank	2,000	Dec. 31	By Balance c/d	2,000
		2,000			2,000
2003					
Jan. 1	To Balance b/d	2,000			

Dr. Purchases Return Account Cr

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 31	To Balance c/d	2,000	Dec. 31	By Purchase Returns	2,000
		2,000			2,000
			2003		
			Jan 1	By Balance b/d	2,000

Dr. Sales Return Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 31	To Sales Return Book	400	Dec. 31	By Balance c/d	400
		400			400
2003					
Jan 1	To Balance b/d	400			

Dr. A B & Co. Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 21	To Bank A/c	5,000	Dec. 10	By Purchases A/c	24,000
Dec. 31	To Balance c/d	19,000			
		24,000			24,000
			2003		
			Jan. 1	By Balance b/d	19,000

Dr. Ramesh & Co. Account Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 23	To Purchases Returns A/c	2,000	Dec. 22	By Purchases A/c	20,000
Dec. 31	To Balance c/d	18,000			
		20,000			20,000
			2003		
			Jan. 1	By Balance b/d	18,000

Dr. **Yusuf Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
2002			2002		
Dec. 18	To Sales A/c	5,000	Dec. 20	By Sales Return	400
			Dec. 31	By Balance c/d	4,600
		5,000			5,000
2003					
Jan. 1	To Balance b/d	4,600			

TRIAL BALANCE of X *as on 31th December, 2002.*

	Dr. *(Rs.)*	**Cr.** *(Rs.)*
Capital Account		1,00,000
Furniture Account	20,000	
Vikram Furniture Account		20,000
Purchases Account	59,000	
Sales Account		25,000
Stationery Account	1,000	
Sayyed Stationery Mart		1,000
Electricity Account	400	
Drawings Account	2,000	
Purchases Return Account		2,000
Sales Return Account	400	
AB & Co. Account		19,000
Ramesh & Co. Account		18,000
Yusuf Account	4,600	
Cash Account	79,600	
Bank Account	18,000	
Total	1,85,000	1,85,000

1.7 SPECIMEN QUESTIONS WITH ANSWERS

Question 1 :

The following details were available from the books of Robin Singh in respect of Petty Cash Account for the year 2002-2003 :

		Rs.
Opening Balance		10.20
Total sums debited to Petty Cash Account		1,112.80
	Rs.	
Postage	220.30	
Stationery	334.65	
Conveyance	167.30	
Tea	90.35	
Coolly and cartage	134.80	
Miscellaneous expenses	125.60	1,073.00

Expenses have not been charged to the respective accounts.

Pass necessary entries at the time of finalisation and show the Petty Cash Account in the ledger.

Answer :

Particulars		*Dr.(Rs).*	*Cr.(Rs.)*
Sundries :			
Postage A/c	Dr.	220.30	
Stationery A/c	Dr.	334.65	
Conveyance A/c	Dr.	167.30	
Tea A/c	Dr.	90.35	
Coolly & Cartage A/c	Dr.	134.80	
Miscellaneous Expenses A/c	Dr.	125.60	
To Petty Cash	Cr.		1,073.00
(Being petty expenses during the year as per Summary from Petty Book)			

LEDGER

Dr.		Petty Cash Account			Cr.
	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Balance b/d	10.20	By	Postage	220.30
”	Cash (Total)	1,112.80	”	Stationery	334.65
			”	Conveyance	167.30
			”	Tea	90.35
			”	Coolly & Cartage	134.80
			”	Miscellaneous expenses	125.60
			”	Balance	50.00
		1,123.00			1,123.00

Question 2 :

Samson furnishes you with his statement of affairs *(in Rs.)* as on 30th Nov., 2000 and 1999 :

	30.11.2000	30.11.1999
Assets owned :		
Fixed assets : Cost	8,00,000	7,00,000
Less : Depreciation provision	3,50,000	3,00,000
	4,50,000	4,00,000
Inventory at cost	40,000	60,000
Customers dues	6,10,000	5,40,000
Bank	50,000	—
	11,50,000	10,00,000
Less : Liabilities owned :		
Creditors	2,00,000	3,00,000
Bank	—	75,000
Loan from Goliath	2,00,000	—
	4,00,000	3,75,000
Net worth	7,50,000	6,25,000

His revenue statement for the year ended 30th November, 2000 was as under :

	Rs.	*Rs.*	*Rs.*
Sales			
39,00,000			
Less :	Cost of Sales :		
Opening stock		60,000	
Purchases		34,90,000	
		35,50,000	
Less : Closing stock		40,000	35,10,000
Gross margin			3,90,000

Less : Expenses			1,00,000	
Interest to :	Bank	16,000		
	Goliath	24,000	40,000	1,40,000
Cash profit				2,50,000
Less : Depreciation				50,000
Net profit				2,00,000

Samson asks you to show his ledger accounts for the year ended 30th November, 2000.

Answer :

Samson's ledger for the year ended 30th November, 2000. *(Figures in* Rs.*)*

			Dr.	*Cr.*		*Balance*
		Fixed Assets				
Dec 01, 1999	To	Balance b/d	7,00,000		Dr.	7,00,000
	To	Bank	*1,00,000		Dr.	8,00,000
Nov 30, 2000	By	Balance c/d		8,00,000		
			8,00,000	8,00,000		
		Provision for depreciation				
Dec 01, 1999	By	Balance b/d		3,00,000	Cr.	3,00,000
Nov. 30, 2000	By	Depreciation	*	50,000	Cr.	3,50,000
"	To	Balance c/d	3,50,000			
			3,50,000	3,50,000		
		Depreciation				
Nov. 30, 2000	To	Provision for Deprn.	50,000		Dr.	50,000
"	By	Profit & Loss A/c		50,000		
			50,000	50,000		
		Inventory				
Dec. 01, 1999	To	Balance b/d	60,000		Dr.	60,000
	By	Trading A/c		60,000		Nil
Nov. 30, 2000	To	Trading A/c	40,000		Dr.	40,000
"	By	Balance c/d		40,000		Nil
			1,00,000	1,00,000		
		Customers				
Dec. 01, 1999	To	Balance b/d	5,40,000		Dr.	5,40,000
	To	Sales	39,00,000		Dr.	44,40,000
	By	Bank	*	38,30,000	Dr.	6,10,000
Nov. 30, 2000	By	Balance c/d		6,10,000		
			44,40,000	44,40,000		
		Suppliers				
Dec. 01, 1999	By	Balance c/d		3,00,000	Cr.	3,00,000
	By	Purchases		34,90,000	Cr.	37,90,000
	To	Bank	*35,90,000		Cr.	2,00,000
Nov. 30, 2000	To	Balance c/d	2,00,000			
			37,90,000	37,90,000		

	Goliath's loan					
	By	Bank	*	2,00,000	Cr.	2,00,000
Nov. 30, 2000	To	Balance c/d	2,00,000			
			2,00,000	2,00,000		
	Sales A/c					
	By	Customers		39,00,000	Cr.	39,00,000
Nov. 30, 2000	To	Trading A/c	39,00,000			
			39,00,000	39,00,000		
	Purchases A/c					
	To	Suppliers	34,90,000		Dr.	34,90,000
Nov. 30, 2000	To	Trading A/c		34,90,000		
			34,90,000	34,90,000		
	Expenses A/c					
	To	Bank	1,00,000		Dr.	1,00,000
Nov. 30, 2000	By	Profit & Loss A/c		1,00,000		
			1,00,000	1,00,000		
	Interest A/c					
	To	Bank - Bank	*16,000		Dr.	16,000
	To	Bank - Goliath	24,000		Dr.	40,000
Nov. 30, 2000	By	Profit & Loss A/c		40,000		
			40,000	40,000		
	Capital A/c					
Dec. 01, 1999	By	Balance b/d		6,25,000	Cr.	6,25,000
	By	Net Profit		2,00,000	Cr.	8,25,000
	To	Drawings - Bank	*75,000		Cr.	7,50,000
Nov. 30, 2000	To	Balance c/d	7,50,000			
			8,25,000	8,25,000		
	Bank A/c					
Dec. 01, 1999	By	Balance b/d		75,000	Cr.	75,000
	By	Fixed Assets		1,00,000	Cr.	1,75,000
	To	Customers	38,30,000		Dr.	36,55,000
	By	Suppliers		35,90,000	Dr.	65,000
	To	Goliath's Loan A/c	2,00,000		Dr.	2,65,000
	By	Expenses		1,00,000	Dr.	1,65,000
	By	Interest - Bank		16,000	Dr.	1,49,000
	By	Interest - Goliath		24,000	Dr.	1,25,000
	By	Capital - Drawings		75,000	Dr.	50,000
Nov. 30, 2000	By	Balance c/d		50,000		
			40,30,000	40,30,000		
	Trading A/c					
	To	Opening stock	60,000		Dr.	60,000
	By	Closing stock		40,000	Dr.	20,000
	To	Purchases	34,90,000		Dr.	35,10,000
	By	Sales		39,00,000	Cr.	3,90,000
	To	P & L A/c – Gross Profit	3,90,000			
			39,40,000	39,40,000		

Profit & Loss A/c

By	Trading A/c - Gross Profit		3,90,000	Cr.	3,90,000
To	Expenses	1,00,000		Cr.	2,90,000
To	Interest to bank	16,000		Cr.	2,74,000
To	Interest to Goliath	24,000		Cr.	2,50,000
To	Depreciation	50,000		Cr.	2,00,000
	Capital A/c	2,00,000			
		3,90,000	3,90,000		

* Balancing figures

1.8 SELF-EXAMINATION QUESTIONS

1. State the nature and purpose of accounting.
2. Indicate briefly the concepts and conventions in accounting.
3. State the Golden Rules of Accounting with examples.
4. What is a Journal ? Indicate the different types of Journals or Subsidiary Books.
5. What is a Ledger ? Draw two alternative types of Ledgers.
5. What is a Petty Cash Book ? State the advantages of Petty Cash Book.
6. What is a Trial Balance ? What errors are not detected by Trial Balance ?
7. From the following particulars prepare Journal, Ledger accounts and trial balance of "P" as on 30th June 2002 –

2002 June

1 Started business with cash Rs. 10,000.

7 Paid rent by cheque Rs. 550, purchased furniture Rs. 420, sold goods for cash Rs. 3,500.

15 Purchased goods on credit from A Rs. 6,000, Sold goods on credit Rs. 10,000.

21 Deposited cash into bank Rs. 500. Received from B Rs. 6,000 & paid to A Rs. 600.

23 Returned goods to A Rs. 500 and Returns from B Rs. 600.

27 Received bill from B Rs. 1,000 accepted bill of A Rs. 1,500.

FINAL ACCOUNTS

Page No.

2.0 ELEMENTS OF FINANCIAL STATEMENTS

The elements which are directly related to the measurement of financial position are assets, liabilities and equity. The elements which are directly related to the measurement of profit are income and expenses.

Asset : An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

Liability : A liability is a present obligation of the enterprise arising from past events the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

There is a distinction between a present obligation and future commitment. A decision by the management of an enterprise to acquire assets in future does not of itself give the rise to a present obligation.

Equity : In a corporate enterprise equity is classified in the Balance Sheet as Share Capital and Reserve and Surplus. Normally Equity is shown at its paid up value.

Income and Expenses : Income is increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decrease of liability that result in increase of equity. Whereas expenses are decreases in economic benefits during the accounting period in the form of' outflows or depletion of assets or increases in liabilities that result in decrease in equity other than those relating to distribution to equity participants.

Measurement of elements of financial statements

Measurement is the process of determining the monitary amounts at which the elements of the financial statement are to be recognised and carried in the Balance Sheet and Income Statement. A number of different measurements are employed to define degrees in financial statements. They are as follows:

a) Historical cost

b) Current cost

c) Realistic value

d) Present value.

The commonly adopted basis is historical cost.

Concept of Capital

The financial concept of capital is adopted by most enterprises in preparing their financial statements. Capital is synonymous with the net assets or equity of the enterprise under a financial concept such as invested money or invested purchasing power.

Fundamental accounting assumptions

Certain fundamental accounting assumptions underlie preparation and presentation of financial statements. They are stated as follows:

(a) **Going Concern :** The enterprise is normally viewed as a going concern i.e. as continuing its operation for unforeseeable future.

(b) **Consistency:** Application of same set of accounting policies over the years in preparation of financial statements is assumed.

(c) **Accrual :** Revenues and costs are recognized in the year to which they are related and not as paid or received.

Disclosure of Accounting Policies

Students should refer from any recommended Text Book:

(a) International Accounting Standards

(b) Indian Accounting Standards

Final Accounts

2.1 CAPITAL AND REVENUE EXPENDITURE

Capital expenditure is the expenditure incurred for acquisition of assets the benefits of which are enjoyed over the years. The benefits of revenue expenditures are exhausted in the year of incurrence

Thus it is seen that utilisation of business capital is made for two distinct purposes:

1) Expenses yielding benefits over the years termed – capital expenditure.
2) Expenditures yielding benefits during the current accounting year – termed as revenue expenditure

Where the benefits of a revenue expenditure are extended beyond the accounting year of incurrence it is called a differed revenue expenditure.

Suppose a company incurred an expenditure of Rs. 100000 for advertisement before marketing of a new product. If the whole amount is charged in the current year, the profit of the company would not reflect a true picture as the benefits are likely to spread over three to four years. So 1/3 or 1/4 of the expenditure will be charged to current P/L Account and the balance should be carried forward for remaining years. This will be shown on the assets side of the balance sheet as deferred revenue expenditure.

Difference between Capital and Revenue Expenditure

	Capital Expenditure	*Revenue Expenditure*
1.	It is incurred for acquiring fixed assets in use and for increasing earning capacity of the business.	It is incurred to run the business but does not increase the capacity of the business.
2.	Benefits of such expenditure extend to years beyond which it is incurred.	Usually the benefit is consumed in the period in which it is incurred
3.	It is shown in the Balance Sheet.	It is taken to the Trading / P&L A/c of the concern.

Illustration 1 :

An old building which originally costs stands in the book is at Rs. 3, 00,000 is pulled down and a new one is erected in its place. Rs. 1,500 worth of material out of the old building is sold and Rs. 5,000 worth is used in new building. In addition to this Rs.5.50 lakhs is spent under a contract for its construction, Rs. 2.25 lakhs had been set aside by firm for the depreciation on the old building and is now appropriated. What addition to the Building Account will legitimately arise out of the rebuilding ?

Solution :

Book value of old building		3,00,000
Less: Provision for Deprn.	2,25,000	
Sale of old Materials	1,500	
Old Material used in new building	5 000	2,31,500
		68,500

The cost of new building should be shown as Rs.5,50,000 + 68, 500 = Rs. 6,18,500

Illustration 2 :

An agricultural land was purchased for a mill was Rs. 1,00,000. Rs. 1 0 000 was paid for land revenue.

Solution :

Cost of land amounting to Rs. 1 00 000 will be treated as Capital Expenditure and Land revenue of Rs. 10 000 will be treated as Revenue Expenditure.

Illustration 3 :

Rs. 50,000 was spent on advertising for the introduction of a new product in the market, the benefit of the market which will be divided for four years.

Solution :

Rs. 50,000 spent on advertising is to be treated as deferred revenue expenditure considering the benefit attributable for four years to come Rs. 12,500 is to be written off every year.

Illustration 4 :

Rs. 10,000 spent as lawyer's fee to defend a suit claiming that the firm’s factory site belonged to the plaintiff. The suit was not successful.

Solution :

Rs. 10,000 incurred for defending the title to the firm’s assets is a revenue expenditure. If, however any expenditure incurred for rectifying the title is a capital expenditure.

2.2 OPENING, CLOSING AND ADJUSTMENT ENTRIES

Opening Entries

At the end of each accounting period a firm closes its books of accounts opens new hooks at the beginning of each accounting period. The first entry in the journal is to record the closing balance of various assets and liabilities at the end of the previous year or the opening balances in the beginning of the new year. The balance sheet prepared at the end of each year records these balances. It is from these balances that the first entry is passed which is known as the "Opening Entry" e.g.

Balance Sheet as on 31st March, 1994

Liabilities		Assets	
Capital	44,200	Plant & Machinery	50,000
Sundry Creditors	25,000	S. Debtors	7,500
		Closing stock	5,000
		Cash at bank	6,000
		Cash in hand	700
	69,200		69,200

Journal

Dt.	*Particulars*		*Dr.*	*Cr.*
1994 Ap.1	Cash in hand	Dr.	700	
	Cash at bank	Dr	6000	
	Stock A/c	Dr	5000	
	S. Debtors A/c	Dr	7500	
	Plant & Machinery A/c	Dr	50000	
	To S. Creditors			25000
	To Capital			44200
	(Balances brought forward)			

The above entries will then be posted to the ledger accounts as follows :–

Dr. Cash account Cr.

Date	*Particulars*	*Cash*	*Bank*	*Date*	*Particulars*	*Cash*	*Bank*
1994							
Apr. 1	To Balance b/d	700	6000				

Dr. Stock account

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
1994					
Apr 1	To Balance b/d	5000			

Dr.		Sundry Debtors account			Cr.
Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
Apr 1	To Balance b/d	7500			

Dr.		Plant & Machinery account			Cr.
Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
Apr. 1	To Balance b/d	50000			

Dr.		Sundry Creditors account			Cr.
Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
Apr. 1				By Balance b/d	25000

Dr.		Capital account			Cr.
Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
Apr. 1				By Balance b/d	44200

Closing Entries

In respect of Trading A/c:

Particulars		*Dr.*	*Cr.*
Trading A/c	Dr		
To Stock (Opening) A/c			
To Purchases A/c			
To Factory fuel & power A/c			
To Factory rent & rates A/c			
To Freight on purchases A/c etc.			
(Purchases are net purchases i.e. purchases less purchases returns)			
Sales A/c	Dr		
Stock (closing) A/c	Dr		
To Trading A/c			
(Sales are net sales i.e. sales less sales returns.)			
Trading A/c	Dr		
To P & L A/c L A/c			
(for transfer of gross profit)			

Final Accounts

In respect of Profit & Loss A/c :	
Items of expenses etc.	
P & L A/c	Dr
To Salaries A/c	
To Rent A/c	
To Interest A/c	
Items of gain :	
Interest received A/c	Dr.
Miscellaneous income A/c	Dr
To P & L A/c	
(The above entries will close all nominal accounts.)	
P & L A/c	Dr
To Capital A/c	
(transfer of net profit)	
Capital A/c	Dr.
To P& L A/c	
(transfer of net loss)	

Adjustment Entries

Adjustment means putting things in order. Adjustment entries are entries made for putting everything in order. The examples are :

i) Accrued/outstanding expenses and prepaid expenses

ii) Accrued Income and Income received in advance

iii) Depreciation

iv) Bad Debts, Provision for bad and doubtful debts, Provision for discount on debtors;

v) Commission on profits

vi) Income tax, Advance Income-tax, Income-tax deducted at source, Provident Fund, Employees' State Insurance contributions.

2.3 RECTIFICATION ENTRIES

Errors may be divided into two types :–

i) Errors not affecting the trial balance.

ii) Errors affecting the trial balance.

Errors not affecting the trial balance may be further divided into the following :–

a) Omission of an entry in the subsidiary book.

b) Wrong entry made in the subsidiary book.

c) Errors of principle.

d) Posting an amount in the wrong account but on the correct side

e) Entry made in the wrong subsidiary book.

f) Compensating errors.

Omission of an entry in the subsidiary book

Here a transaction is completely omitted to be recorded in the books of accounts .

e.g. a credit sales to A for Rs. 2000 was omitted to be recorded in the sales book.

Particulars		*Dr.*	*Cr.*
A's A/c	Dr	2000	
To Sales A/c			2000
(Rectification entry passed for omission of credit sales to A being omitted to be recorded in the sales book)			

Wrong entry made in the Subsidiary Book

e.g. Credit purchases from Q for Rs. 3000 has been wrongly entered in the purchases book as Rs. 3300.

Purchases book has an excess debit of Rs. 300 and Q's account has an excess credit for the same amount

Therefore, the rectifying entry will be

Particulars		*Dr.*	*Cr.*
Q's A/c	Dr.	300	
To Purchases A/c			300

Errors of principles

These arise when a revenue expenditure is treated as a capital expenditure or *vice versa* e.g. Furniture purchased from X for Rs. 4000 was entered in the Purchase Book.

Final Accounts

Particulars		*Dr.*	*Cr.*
Wrong entry			
Purchase A/c	Dr.	4000	
To X's A/c			4000
Correct entry			
Furniture A/c	Dr.	4000	
To X's A/c			4000
Rectifying Entry			
Furniture A/c	Dr.	4000	
To Purchase A/c			4000

Purchase A/c has been debited wrongly, therefore it has been credited [rectifying entry] in order to cancel the debit. However, X's Account has been credited correctly. As furniture A/c has to be debited in the first place it is done through the rectifying entry.

Posting an amount in the wrong A/c but on the correct side

e.g. Credit sales to Ramanthan for Rs. 1500 has been posted to Ramamurthy's A/c

Particulars		*Dr.*	*Cr.*
Wrong entry			
Ramamurthy's A/c	Dr.	1500	
To Sales A/c			1500
Correct entry			
Ramanathan A/c	Dr	1500	
To Sales A/c			1500
Rectifying entry			
Ramanathan A/c	Dr.	1500	
To Ramamurthy A/c			1500

Entry made in the wrong Subsidiary Book

e.g. Credit sales to Y Rs. 2500 was wrongly entered in the Purchases Book.

Particulars		*Dr.*	*Cr.*
Wrong entry			
Purchase A/c	Dr.	2500	
To Y's A/c			2500
Correct entry			
Y's A/c	Dr.	2500	
To Sales A/c			2500
Rectifying Entry			
Y's A/c	Dr.	5000	
To Purchase A/c			2500
To Sales A/c			2500

Compensating Errors

If the effect of one error is multiplied by the effect of some other errors the trial balance will agree, e. g. an amount of Rs.25 received by M is not credited to his A/c and the total of the sales books is overcast by Rs. 25. The omission of credit to M's A/c is offset by the increased credit to the Sales A/c and hence the Trial Balance will agree.

Errors affecting the Trial Balance

As already discussed these errors are :

a) Omission to post to the ledger from the subsidiary book.

b) Posting the wrong amount in the ledger.

c) Posting an amount to the wrong side.

d) Wrong casting of the subsidiary book.

e) Posting wrong amount lo the wrong side.

f) Posting a wrong amount to a wrong account

g) Posting a wrong amount to the wrong side of a wrong account.

Omission of posting from a subsidiary book

Goods returned to D Rs. 300 entered in the Purchases Returns Book omitted to he posted to D's A/c. D's A/c has not been debited. Therefore his A/c should be debited with Rs. 300.

Posting the wrong amount in the ledger

Credit sales to Z for Rs. 120 was correctly entered in the sales book but posted to Z's A/c as Rs. 102. Z's A/ c is debited short by Rs. 18(120-120). Therefore debit his A/c with Rs. 18.

Posting an amount to the wrong side

Credit purchases from U for Rs. 500 was correctly entered in the purchases book but wrongly debited to U's A/c has to be credited with Rs. 1000.

U 's A/c is wrongly debited with Rs. 500. To Cancel this debit of Rs. 500 a credit of Rs. 500 must be given. Another credit of Rs . 500 must be given to incorporate the correct entry. Therefore a total credit of Rs. 1,000 has been given.

Wrong casting of the subsidiary book

Sales book has been totaled as Rs. 4000 the correct being Rs. 4400. Sales A/c has short credit of Rs. 400. Therefore credit sales A/c by Rs. 400.

Posting wrong amount to wrong side

Sold goods to K for Rs. 136 entered in the sales book correctly but credited to K’s a/c for Rs. 163.

K's A/c has to be debited with Rs. 299. K’s A/c has been credited wrongly for Rs. 163. To cancel this credit a debit of Rs. 163 is given. Further a debit of Rs. 136 has to be given the accommodate the correct entry. Therefore a total debit of Rs. 299 (163 + 136) has to be given.

Posting a wrong amount to the wrong account

Credit purchases from Akila for Rs. 155 was posted to the credit Akila for Rs. 165.

Debit Akila's A/c with Rs. 165.

Credit Akila's A/c with Rs. 155.

Akila's A/c has bean wrongly credited therefore it should be debited to cancel the credit. Akila's A/c has not been credited.

So credit her A/c now with the correct amount Rs. 155.

Posting the wrong amount to the wrong side of a wrong account

A credit sales to W for Rs. 153 was credited to V's A/c for Rs. 135.

Debit V's A/c with Rs. 135.

Credit W's A/c with Rs.153.

V's A/c has been credited wrongly, so his A/c is debited to cancel the wrong credit. W's A/c should have been debited in the first place.

Therefore, his A/c is now debited with Rs. 153, being the correct amount.

Illustration 5 :

Correct the following entries.

a) Sale or goods Rs.1200 to Mr. Kumar has been entered in the sales book as Rs. 1100.

b) Machinery purchased for Rs. 11500 from XYZ Co. Ltd has been entered in the Purchases book.

c) Payment of the proprietor's personal expenses Rs. 450 has been debited to the General Expenses A/c.

d) The Returns Inwards book has been overcast by Rs. 150.

e) Discount allowed to M/s ABC Rs. 35 has not been entered in the cash book but the full amount (including discount) has been credited to M/s ABC

f) Sale of old typewriter Rs. 275 has been passed through the sales book.

Solution :

Journal Entries

	Particulars		*Dr.*	*Cr.*
a)	Kumar's A/c	Dr	100	
	To Sales A/c			100
	(Rectifying entry passed for short credit-sales A/c and short debit to Kumar's A/c)			
b)	Plant & Machinery A/c	Dr	11500	
	To Purchases A/c			11500
	(Rectifying entry passed to correct machinery purchased charged to Purchases A/c)			
c)	Drawing A/c	Dr	450	
	To General Expense A/c			450
	(Rectifying entry passed to correct drawings charged to Gen. Exp. A/c)			
d)	Credit Returns Inwards A/c by Rs. 150.			
e)	Debit Discount allowed A/c Rs. 35.			
	(As the amount has not been entered in the cash book there is a short debit in the Discount Allowed A/c. Therefore the additional debit)			
f)	Sales A/c	Dr	275	
	To Office Equipment A/c			275
	(Rectifying entry passed to correct sale of old typewriter erroneously credited to Sales A/c instead of Office Equipment A/c)			

Suspense Account

The difference in the Trial Balance may be put in an account known as the Suspense Account, where the error causing difference cannot be located immediately and the books of accounts have to be closed. Suspense account is an account to which the difference in the trial balance has been put temporarily. If the debit side is short this account is debited and if the credit side is short it will be credited. However the opening of a suspense account does not mean that the errors need not be found out.

All errors affecting the trial balance (these were discussed earlier) are corrected through the suspense account as these are one-sided errors. Previously one sided errors have been corrected by making a correcting entry in the account concerned without making an entry in any other account. Double entry will be complete where a suspense account is opened with a difference in the trial balance.

Illustration 6 :

Correct the following errors –

i) Without opening a Suspense Account, and

ii) Opening a Suspense Account

a) The Purchases Returns Book has been totalled Rs. 80 short.

b) Goods returned by M/s Amar & Sons Rs. 150 have not been recorded anywhere.

c) Goods bought from M/s Devi Bros Rs. 250 have been posted to their debit as Rs. 205.

d) Discount received from Hi-Fi Bros Rs. 25 has not been entered in the discount column of the cash book.

e) A sale to Mr. Dubey Rs. 450 was wrongly credited to his account.

Solution :

	Particulars		Dr.	Cr.
i) Without opening a Suspense Account :				
a)	Credit Purchases Returns A/c with Rs. 80.			
b)	Sales Returns A/c	Dr	150	
	To M/s Amar & Sons A/c			150
	(Entry passed for goods returned as it was omitted from the Sales Returns Book)			
c)	Credit M/s Devi Bros with Rs. 455.			
	M/s Devi Bros have been debited Rs. 205 instead of being credited.			
	(Therefore a credit of Rs. 205 is given to remove the wrong debit and a further credit of Rs. 250 is given to record the correct credit.)			

d) Credit Discount Received A/c Rs. 25.

(There is a short credit in the Discount Received A/c by Rs. 25. Hence an additional credit is given to the account.)

e) Debit Mr. Dubey's A/c with Rs. 900.

(Mr. Dubey's A/c has been credited with Rs. 450 instead of being debited. This account is now debited with Rs. 900 to remove the wrong credit and given the correct debit.)

ii) Opening a Suspense Account

a)	Suspense A/c	Dr	80	
	To Purchase Returns A/c			80
	(Correction arising from undercasting of Purchases Returns Book)			
b)	Sales Returns A/c	Dr	150	
	To M/s Amar & Sons A/c			150
	(Recording an entry omitted earlier)			
c)	Suspense A/c	Dr	455	
	To M/S Devi Bros A/c			455
	(Correction of entry by which M/s Devi Bros were debited Rs. 205 instead of being credited with Rs. 250)			
d)	Suspense A/c	Dr	25	
	To Discount Received A/c			25
e)	Mr. Dubey's A/c	Dr	900	
	To Suspense A/c			900
	(Correction of entry by which Mr. Dubey’s A/c was credited with Rs. 450 instead of being debited)			

Effect of errors and their rectification on profit or loss :

Certain errors affect the profit or loss of the firm. If the error is in the nominal account the profit and loss account will be affected but if it is in a personal or real account there will be no change on the profit or loss. Rectification of an error in a nominal account will change the figure of profit or loss previously arrived at.

Illustration 7 :

The Trial Balance of M/s Soles & Soles extracted on 31st March, 1997 was Rs. 1595 short on the debit side. A suspense account is opened to tally the trial balance. On examination of the books of accounts the fallowing errors were noticed :

a) Credit Purchases from M/s Toepuf Rs. 200 was posted as Rs. 20 in the ledger.

b) Miser the landlord was debited Rs. 250 for payment of rent.

c) Cash purchase of Rs.125 was not posted to the ledger.

d) Discount allowed column in the cash book was posted to Gen. Exps are Rs.20.

e) Payment made to Insole & Sons Rs.1500 was posted to their credit Rs.150.

f) Received Rs.250 from Tom but posted to Thompson's A/c.

g) Credit sale of Rs.750 to Shoes & Socks Ltd entered in the Returns Outwards Book.

Pass necessary rectifying entries. Prepare the Suspense A/c and show the effect of the rectifying entries on the profit of business.

Solution :

S.No.	*Particulars*	*LF*	*Dr(Rs)*	*Cr.(Rs.)*
a)	Suspense A/c	Dr	180	
	To M/s Toepuf A/c			180
	(rectification of posting of wrong amount)			
b)	Rent A/c	Dr	250	
	To Miser's A/c			250
	(rectification of payment of rent posted to Miser's (landlord) A/c)			
c)	Purchases A/c	Dr	125	
	To Suspense A/c			125
	(cash purchases not posted rectified)			
d)	Discount allowed A/c	Dr	20	
	To Gen. Expense A/c			20
	(posting of discount allowed to Gen Exp. rectified)			
e)	Insole & Sons A/c	Dr	1650	
	To Suspense A/c			1650
	(rectification of posting wrong amount i.e.Rs. 150 instead of Rs. 1500 to the credit side instead of the debit side)			

f)	Thompson's A/c	Dr	250	
	To Tom's A/c			250
	(receipt from Tom posted to Thompson rectified)			
g)	Returns Outwards A/c	Dr	750	
	To Sales A/c			750
	(Credit sales recorded in Returns Outwards Book rectified)			

Dr. Suspense Account Cr.

Dt.	*Particulars*	*Rs*	*Dt.*	*Particulars*	*Rs*
	To Difference in Trial Balance	1595		By Purchases	125
	To M/s Toepuf	180		By Insole & Sons	1650
		1775			1775

Effect of rectifying entries on profit

a) No effect

b) Profit reduced by Rs. 250

c) Profit reduced by Rs. 125

d) No effect

e) No effect

f) No effect

g) No effect

Rectification in the next trading period:

In order to ascertain the profit or loss of each period separately errors should be rectified in such a manner that the current year's income, expenses or loss are not affected.

An error committed in 2001-02 is rectified in 2002-03. By rectifying Sales A/c would mean that it is treated as an income of 2002-03 when it actually pertains to 2001-02. Therefore the proper thing to do should be to open a separate account called the Profit & Loss Adjustment account and pass all debits and credits in respect of nominal accounts for errors committed in the previous period through this account. The balance of this account is transferred lo the Capital A/c.

Only when rectification is carried out in the next trading period and if it pertains to the nominal accounts alone this procedure be adopted. Rectification in the current period is made in the usual manner.

Illustration 8 :

On 31st March, 2003, the Trial Balance of Mr. Good did not agree. The difference was transferred to a Suspense Account. In May 2003, the errors of March 1997 were discovered. They are:

1) The Returns Outwards Book was overcast by Rs. 700.
2) Purchase of furniture Rs. 2000 was passed through the Purchases Book.
3) Wages to workmen for installation of machinery Rs.1250 was charged to Wages A/c.
4) Payment of rent of Mr. Goods house Rs. 750 was charged to Rent A/c.
5) Goods returned by a customer amounted to Rs. 950 were taken into stock but no entry was made in the book.
6) Sale of goods worth Rs. 1700 has been passed through Purchases book. The Customer's A/c has been however debited correctly.
7) Sale of Rs. 2250 to M/s Wye Ltd was credited to their A/c.
8) Sales Book total while being carried forward to the next page was written as Rs. 219431 instead Rs. 291341.
9) A sale of Rs. 760 has been posted to the credit of the customer's Mr. Zed A/c as Rs. 670.
10) A cheque for Rs. 1500 received from M/s Sky Bros was dishonoured and posted to the debit of Allowances A/c.

Give journal entries to rectify the above errors without affecting the current year's Profit and Loss Adjustment A/c

Prepare the Profit & Loss Adjustment A/c.

Solution :

	Particulars		*Dr.*	*Cr.*
1)	P & L Adjustment A/c	Dr	700	
	To Suspense A/c			700
2)	Furniture A/c	Dr	2000	
	To P & L Adjustment A/c			2000
3)	Machinery are	Dr	1250	
	To P & L Adjustment A/c			1250

4)	Drawings A/c	Dr	750	
	To P & L Adjustment A/c			750
5)	P&L Adjustment A/c	Dr.	950	
	To Customer's A/c			950
6)	Suspense A/c	Dr	3400	
	P&L Adjustment A/c			3400
7)	M/s Wye Ltd. A/c	Dr	4500	
	To Suspense A/c			4500
8)	Suspense A/c	Dr	71910	
	To P&L Adjustment A/c			71910
9)	Suspense A/c	Dr	1430	
	To Mr. Z's A/c			1430
10)	M/s Sky Bros. A/c	Dr	1500	
	To P&L Adjustment A/c			1500
	P&L Adjustment A/c	Dr	79160	
	To Capital A/c			79160

Dr. **Profit And Loss Adjustment Account** **Cr.**

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
	To Suspense A/c	700		By Furniture	2000
	" Customer's A/c	950		" Machinery	1250
	" Capital A/c (Bal. fig)	79160		" Drawings	750
	"			" Suspense	3400
				" Suspense	71910
				" M/s Sky Bros.	1500
		80810			80810

Illustration 9 :

The books of accounts of B. Quick for the year ending 31st March, 2003 were closed with a difference in books carried forward. The following errors were detected subsequently:

(i) Goods Rs. 125 returned to Mita Bros. were recorded in the Returns Inward Book as Rs. 251 and from there it was posted to the debit of Mita Bros. Account.

(ii) A credit sale of Rs. 760 was wrongly posted as Rs. 670 to the customers account in the Sales Ledger.

(iii) Closing Stock was overstated by Rs. 5,000 being casting error in the schedule of inventory.

(iv) Paid acceptance to Bala Ram for Rs. 7,600 was posted to the debit of Sita Ram as Rs. 6,700.

(v) Goods purchased from A & Co. Rs. 3,250 entered in the Sales Day Book for Rs. 3,520.

(vi) Rs. 1,500 being the total of the discount column on the credit side of the Cash Book was not posted. Pass rectification entries in the next year.

Solution :

In the books of B. Quick

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	Particulars		*LF*	*Dr.(Rs.)*	*Cr.(Rs.)*
i)	Suspense A/c (251×2)	Dr.		502	
	To Mita Bros. (251 – 125)				126
	To Profit & Loss Adjustment A/c				376
	(Being the amount of purchase return to Mita Bros. Rs. 125 wrongly recorded in return inward book as Rs. 251 and posted to the debit of Mita Bros. A/c — now rectified)				
ii)	Sundry Debtors A/c	Dr.		90	
	To Suspense account (760 – 670)				90
	(Being credit sale of Rs. 760 wrongly posted to the customers account as Rs. 670 — now rectified).				
iii)	Suspense A/c	Dr.		5,000	
	To P&L adjustment A/c				5,000
	(Being Closing Stock amount was wrongly overcast — now rectified).				

iv)	Bala Ram's A/c	Dr.	7,600	
	To Sita Ram's A/c			6,700
	To Suspense A/c			900
	(Being acceptance paid to Bala Ram Rs. 7,600 wrongly posted to the debit of Sita Ram as Rs. 6,700 — now rectified).			
v)	Profit & Loss Adjustment A/c	Dr.	6,770	
	To M/s A. & Co. A/c			6,770
	(Being goods purchased from A & Co. Rs. 3,250 entered wrongly in Sales Day Book as Rs. 3,520 — now rectified).			
vi)	Suspense A/c	Dr.	1,500	
	To Profit & Loss Adjustment account			1,500
	(Being the amount of discount column on the Credit side of Cash Book was not posted — now rectified).			

Illustration 10 :

Following mistakes occurred in a computerised accounting system :–

(a) Payment of Rs. 10,000 to a party by cheque was recorded through the receipt column of the bank account;

(b) Receipt of Rs. 25,000 from a customer was entered through the payment column of the bank account;

(c) Purchase invoice of Rs. 51,000 was entered through the sales journal as Rs. 15,000;

(d) Sales bill of Rs. 46,000 was entered through the purchase journal as Rs. 64,000;

(e) Returns inwards of Rs. 6,000 was entered through the purchase journal as Rs. 60,000;

(f) Returns outwards of Rs. 5,000 was entered through the sales journal as Rs. 500.

What will be the changes in final accounts on rectification of the above mistakes? Pass the rectification entries and pinpoint the changes.

Solution :

Rectification and effects

a)	Sundry Debtors	Dr.	20,000	
	To Bank Account			20,000
	Effect : Liability to suppliers-reduced by Rs. 20,000; Bank balance-reduced by Rs. 20,000;			
	(No impact on Profit/loss)			

b)	Bank Account	Dr.	50,000	
	To Sundry Creditors Account			25,000
	To Sundry Debtors Account			25,000

(assuming the supplier party wrongly debited)

Effects : Dues from customers-reduced by Rs. 25,000;
Bank balance -increased by Rs. 50,000
Dues to supplier party-increased by Rs. 25,000; No impact on Profit/loss.

c)	Purchases Account	Dr.	51,000	
	Sales Account		15,000	
	To Party Account			51,000
	To Sundry Account			15,000

Effect : Liabilities to suppliers-increased by Rs. 51,000;
Purchases-increased by Rs.51,000;
Sundry debtors-reduced by Rs. 15,000
Sales reduced by Rs. 15,000
Profit reduced by Rs. 66,000

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d)	Sundry Creditors Account	Dr.	64,000	
	Sundry Debtors Account	Dr.	46,000	
	To Purchases Account			64,000
	To Sales Account			46,000

Effect : Personal account of the party reduced by Rs. 64,000;
Sales-increased by Rs. 46,000;
Sundry debtors-increased by Rs. 46,000;
Profit-increased by Rs. 1,10,000

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e)	Returns Inwards Account	Dr.	6,000	
	Sundry creditors Account	Dr.	60,000	
	To Sundry Debtors Account			6,000
	To Purchases Account			60,000

Effect : Amount due to supplier party-reduced by Rs. 60,000;
Purchase-reduced by Rs. 6,000;
Sundry debtors-reduced by Rs. 6,000;
Profit-goes up by Rs. 54,000.

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f)	Returns Outwards Account	Dr.	5,000	
	Sales Account	Dr.	500	
	To Sundry Debtors Account			500
	To Sundry Creditors account			5,000

Effect : Amount due from supplier party- reduced by Rs. 5,000; Purchase returns-increased by Rs. 5,000; Sales-reduced by Rs. 500; Sundry debtors-reduced by Rs. 500; Profit-goes up by Rs. 4,500.

Illustration 11 :

The trial balance of M/s Ganguly & Co. as at 31.03.2003 did not agree. In order to close the books the accountant transferred the difference to the Suspense A/c newly opened and carried forward the difference to the next period for necessary adjustments. Later, the following errors, arising in 2002-03 were detected —

(a) Sales Day book was overcast by Rs. 100 in January, 2003.

(b) Furniture purchased for Rs. 2,500 cash was posted to the purchase account in the Ledger.

(c) Credit Sale of Rs. 97 was posted to the credit of the Customer's Account as Rs. 79.

(d) Rs. 50 allowed as Cash discount to a Trade Debtor was not debited to the Discount Account.

(e) An item of purchase of Rs. 162 was recorded in the Purchase Day Book as Rs. 62 and posted to the debit of the Supplier's Account as Rs. 26. Show the necessary journal entries to rectify these errors and show Suspense Account; and Profit and Loss Adjustment Account and state the ultimate effect of these correcting entries in the books for 2003-04.

Solution :

In the books of M/s GANGULY & CO.

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Date (2003)	*Particulars*	*L/F*	*Dr. (Rs.)*	*Cr.(Rs.)*
April 1				
a)	Profit & Loss Adjustment A/c Dr.		100	
	To Suspense A/c			100
	(Being Sales day book overcast by Rs. 100, now rectified)			

b)	Furniture A/c	Dr.	2,500	
	To Profit & Loss Adjustment A/c			2,500
	(Being furniture purchased has been posted to the purchase A/c, now rectified)			
c)	Customers A/c	Dr.	176	
	To Suspense A/c			176
	(Being credit sale of Rs.97 wrongly posted to the credit of Customer's A/c, as Rs. 79)			
d)	Profit & Loss Adjustment A/c	Dr.	50	
	To Suspense A/c			50
	(Being discount allowed not posted to discount allowed A/c, now rectified)			
e)	Profit & Loss Adjustment A/c	Dr.	100	
	Suspense A/c	Dr.	88	
	To Supplier A/c			188
	(Being purchase of Rs. 162 entered in the purchase book as Rs. 62 but posted to the debit of supplier A/c as Rs. 26, now rectified)			

Dr. Suspense Account Cr.

Date	Particulars	L/F	Amount	Date	Particulars	L/F	Amount
	To Balance b/f (Bal. Fig.)		238		By Profit & Loss Adj. A/c		100
	To Supplier A/c		88		By Customer A/c		176
					By Profit & Loss Adj. A/c		50
			326				326

Dr. Profit & Loss Adjustment Account Cr.

Date	Particulars	L/F	Amount	Date	Particulars	L/F	Amount
	To Supplier's A/c		100		By Furniture A/c		2,500
	To Suspense A/c		100				
	To Suspense A/c		50				
	To Partner's Capital A/c		2,250				.
			2,500				2,500

2.4 ADJUSTED TRIAL BALANCE

A Trial Balance should be prepared before the adjusting entries are recorded in order to ensure that the debits are equal to the credits. In addition another Trial Balance prepared after recording the adjusting entries. This Trial Balance is called an Adjusted Trial Balance which provides a convenient source of information for the preparation of final accounts.

Illustration 12 :

From the following details prepare an Adjusted Trial Balance after passing the necessary adjustment entries :

	Rs.		*Rs.*
Purchase	65,000	Sundry Creditors	35,000
Carriage Inward	1,000	Plant and Machinery	10,000
Wages	6,000	Buildings	5,000
Salaries	10,000	Furniture	3,000
Rent, rates and taxes	1,800	Bills Receivable	10,000
Insurance	1,500	Sundry Debtors	40,000
interest paid	1,000	Capital	66,000
Sales	95,000	Sundry Expenses	5,000
Cash and Bank	21,500	Opening stock	21,000
Bills Payable	5,800		

Notes –

1. Salaries and wages due to be paid Rs. 2,000 and Rs. 1,500 respectively.
2. Insurance was paid to the extent of Rs. 300 advance.
3. A sum of Rs. 500 to be written off as bad debt out of' sundry debtors and a provision of 5% to be created for doubtful debts.
4. Sundry expenses include Rs. 2 000 spent for the personal purpose of the proprietor
5. Sales for the period include Rs. 500 worth of goods (cost price) taken by the proprietor for personal consumption. He has also taken goods worth Rs. I 000 (cost price) for personal consumption which has not been recorded in the I books
6. Depreciation to be provided as follows :–

Plant and Machinery	10%
Building	5%
Furniture	10%

7. Closing Stock Rs. 20,000

Solution :

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Particulars	*L.F.*	*Dr.*	*Cr.*
Salaries A/c	Dr.	2.000	
To Outstanding Salaries A/c			2 000
(Outstanding salaries adjusted)			

Wages A/c	Dr.	1 500	
To Outstanding Wages A/c			1,500
(Outstanding wages adjusted)			
Drawings A/c	Dr.	2 000	
To Sundry Expenses A/c			2 000
(Sundry Exp. A/c now adjusted)			
Sales A/c	Dr.	500	
To Sundry Debtors A/c			500
(Goods taken by the proprietor for personal consumption and included in sales now cancelled)			
Drawings A/c	Dr.	1 500	
To Purchase A/c			1 500
(Goods taken by the proprietor at cost price for personal consumption)			
Prepaid Insurance A/c	Dr.	300	
To Insurance A/c			300
(Insurance premium paid in advance adjusted)			
Bad Debts A/c	Dr.	500	
To Sundry Debtors A/c			500
(Amount written off as bad debt)			
Bad Debts A/c	Dr	1950	
(5% on (40000-500-500)			
To Provision for Bad Debts a/e			1950
(Provision for Bad Debts created @ 5% on Debtors)			
Depreciation A/c	Dr	1550	
To Plant & Machinery			1000
To Buildings			250
To Furniture			300
(Depreciation provided on various assets)			
Closing Stock A/c	Dr	20000	
To Purchases			20000
(Closing stock adjusted to purchases)			

Note: Since here provisions for Doubtful Debts is to be created before preparing final accounts Bad Debts A/c has been debited instead of P & L A/c.

Trial Balance as at ....

	Dr *Rs.*	*Cr* *Rs.*
Purchases (65000 - 1500 - 20000)	43500	
Carriage Inward	1000	
Wages (6000 +1000)	7000	
Salaries (10000 +2000)	12000	
Rent, Rates &Taxes	1800	
Interest (1500 - 300)	1200	
Interest Paid	1000	
Sales (95000 - 500)		94500
Cash & Bank	21500	
Bills Payable		5800
Sundry Creditors		35000
Plant & Machinery (10000 - 1000)	9000	
Buildings (5000 - 250)	4750	
Furniture (3000 - 300)	2700	
Bills Receivable	10000	
Sundry Debtors (40000 – 500 - 500)	39000	
Capital		66000
Sundry Expenses (5000 – 2000)	3000	
Opening Stock	21000	
Outstanding Salaries		2000
Outstanding Wages		1000
Drawings (2000 +1500)	3500	
Prepaid Insurance	300	
Bad-Debts (500 +1950)	2450	
Provision for Bad Debts		1950
Depreciation	1550	
Closing Stock	20000	.
	206250	206250

Balance Sheet

The Balance Sheet is a statement which sets out the Assets and Liabilities as on a certain date. It is prepared with a view to measure the true financial position at a particular point of time. The Balance Sheet has the following form.

Final Accounts

Balance Sheet as on ....

Liabilities	*Amount*	*Assets*	*Amount*
Sundry on Trade		Cash in hand	
Creditors		[including petty cash]	
Bills payable		Cash at hank	
Loans		Loans (Dr)	
Mortgage		Closing Stock	
Reserve or Reserve Fund		Investments	
Capital		Furniture & Fittings	
Add: Interest on capital		Loose Tools	
Add: New profit		Plant & Machinery	
Less: Drawings		Land & Buildings	
Less: Interest on Drawings		Freehold & leasehold Land	
Less: Net Loss		Business Premises	
Less: Income tax		Patents & Trade Marks	
		Goodwill	

A **Balance Sheet** has the following characteristics :

a) It is prepared at a particular date and not for a period.

b) it is prepared only after preparation of the Trading and Profit & Loss A/c. Without the Profit & Loss A/c it will not give the financial position of the firm adequately.

c) Capital is equal to the difference of assets and liabilities. Therefore the two sides of the balance sheet must have the same totals otherwise it is an indication of the presence of errors.

d) It is not an account but only a statement of assets and liabilities..

e) The balance sheet shows the financial position of a business at going concern concept.

Difference between a Trial Balance and a Balance Sheet

Trial Balance	*Balance Sheet*
The purpose of a trial balance is to establish the arithmetical accuracy of the books of accounts.	The Balance Sheet aims at reflecting the financial position of the business.
No information about profits can be obtained from the trial balance.	Information about profit can be obtained from the balance sheet.
It may be possible to dispense with the preparation of the trial balance though its preparation is desirable.	To complete the accounting process the balance must be essentially be prepared.

All accounts personal, real and trial balance be written up.	Only personal and real accounts find place in the balance sheet.
Normally Trial balances are prepared monthly.	Balance sheet is prepared at the end of the trading period.
A trial balance can be prepared with or without adjustment. A trial balance incorporating adjustments is known as the adjusted trial balance.	A Balance sheet cannot to be prepared without making adhustments and without taking into account all events and transactions for the year.
Closing stock does not appear in the trial balance however it may appear where an adjusted trial balance is prepared.	Closing stock appears at the balance sheet.

Assets & Liabilities Arrangement

Assets may be grouped as follows :–

In order of Liquidity	*In order of Performance*
Cash in hand	Goodwill
Cash at bank	Patents
Investments	Land & Buildings
Sundry Debtors	Machinery
Stock of finished goods	Furniture
Stock of raw materials.	Stock of partly finished
goods. Stock of partly finished goods	Stock of raw materials
Furniture	Stock of finished goods.
Machinery	Sundry Debtors
Land and Buildings	Investment
Patents	Cash at bank
Goodwill	Cash in hand

Liquidity : Liquidity means the case with which assets may be converted into cash. Assets which are most difficult in this respect are written last.

Permanence : Assets which are to be used permanently in the business and are meant to be sold are written first.

Liabilities : Liability may be shown according to the urgency with which payment has to be made. Short term liabilities such as bills payable, and sundry creditors for supply of goods may be shown first, then long term liabilities and lastly capital. Another way is to show capital, long term liabilities and last short term liabilities.

Assets and Liabilities-Classification :–

Assets may be classified as –

a) Fixed Assets
   i) Tangible fixed assets.
   ii) Intangible fixed assets.
   iii) Investments (longterm)

b) Current Assets

Fixed Assets : Fixed asset is an asset acquired for continuing use within the business with a view to earning income or making profits from its use either directly or indirectly. A fixed asset is not acquired for sale to a customer.

A tangible fixed asset is a physical asset, i.e. One that has real solid existence, e.g. Plant & Machinery.

An intangible fixed asset is an asset which does not have a physical existence, e.g. Goodwill.

An investment might also be a fixed asset, investment purchased with a view to holding them for more than a year are classified as fixed assets.

Current Assets : Current assets are either items owned by the business with the intention of their resale or cash including cash at bank deposited by the business. These assets are "Current" in the sense that they are continuously flowing.

Other current Assets are :–

Short term investment. This includes short term trade investment.

Prepayments :

These are amounts which are already paid by the business for benefits which have not yet been consumed.

Trade Debtors :

These are debtors to the business for supply of goods to them.

Liabilities :

These are debts of the business that must be paid within one year. They are –

i) Loans payable within a year.
ii) Bank Overdraft.
iii) Trade creditors for supply of goods.
iv) Bills of exchange.
v) Outstanding payments.
vi) Interest on loans due and accrued but not paid.

Long term liabilities:

Long term liability is a debt which is not payable within one year.

Owners equity or capital.

The amount owing to the proprietors as capital is shown separately.

Illustration 13 :

The following Trial Balances as on 31st May. 2000 and 31st May, 2001 are furnished to you by Ashar and Sons:

	31st May, 2001		31st May, 2000	
	Dr.	**Cr.**	**Dr.**	**Cr.**
	Rs.	*Rs.*	*Rs.*	*Rs.*
Fixed capitals:				
Ashar	—	6,00,000	—	7,00,000
Bismilla	—	4,00,000	—	2,00,000
Cawasji	—	2,00,000		
Current accounts:				
Ashar	—	10,000	5,000	—
Bismilla	—	60,000	—	40,000
Cawasji	10,000	—	—	—
Customers dues	11,00,000	—	9,00,000	
Suppliers	—	80,000	—	1,50,000
Fixed assets (cost)	3,00,000	—	2,00,000	—
Provision for depreciation	—	1,30,000	—	90,000
Stock	65,000	—	1,05,000	—
Cash	10,000	—	10,000	—
Bank	20,000	—	—	30,000
Prepaid expenses	20,000	—	15,000	—
Outstanding expenses	—	45,000	—	25,000
	15,25,000	15,25,000	12,35,000	12,35,000

You are asked to interpret the above trial balances.

Solution :

Working Note.

For interpretation of the Trial Balances it should be redrafted in the following format to find out the changes occurred in the two financial years i.e. 1999-2000 and 2000-2001.

Final Accounts

Items		*As at 31.5.2001*	*As at 31.5.2000*	*Changes Dr*	*Cr*
Liabilities :					
Capital A/c	— Ashar	6,00,000	7,00,000		
Capital A/c	— Bismilla	4,00,000	2,00,000	1,00,000	2,00,000
Capital A/c	— Cawasji	2,00,000			2,00,000
					15,000
Current A/c	— Ashar	10,000	5,000		20,000
Current A/c	— Bismilla	60,000	40,000		
Suppliers		80,000	1,50,000	70,000	
Outstanding Expenses		45,000	25,000		20,000
Provision for Depreciation		1,30,000	90,000		40,000
		15,25,000	12,10,000	1,70,000	4,95,000
Assets :					
Fixed Assets		3,00,000	2,00,000	1,00,000	
Customers		11,00,000	9,00,000	2,00,000	
Current A/c	— Cawasji	10,000		10,000	
Stock		65,000	1,05,000		40,000
Cash		10,000	10,000		
Bank		20,000	(30,000)	50,000	
Prepaid Expenses		20,000	15,000	5,000	
		15,25,000	12,00,000	3,65,000	40,000

Interpretation of Trial Balance :

1. The trial balances of both the years are prepared after preparation of Profit and Loss Account. The net profits or losses, if any, are adjusted to the current account of the partners.
2. Cawasji was admitted as partner during the financial year 2000-2001. The treatment of goodwill, if any, had not been shown in the accounts. However, it appears from the movement of fixed capital accounts that Ashar had sacrificed his share of profit in the business which was acquired by both Bismilla and Cawasji which had the effect of bringing in cash by them and withdrawal of cash by Ashar. The capital accounts being in the nature of fixed capital, normally no profit and /or drawings have been transacted through these accounts. However, in the absence of any information as to goodwill of the firm and profit sharing ratios of the partners, it is not possible to state about the movement of funds.
3. The changes in the current accounts of the partners is due to transactions relating to sharing of profits according to profit sharing ratios and credits on account of interest in capital in the one hand and correspondingly the drawings and debit of interest on drawings (if any) on the other hand. However, the debit of Rs. 10,000 in the new partner Caswaji may be on account of adjustment of goodwill which might have been debited to maintain a current account balance of Rs. 2,00,000 as may be agreed by the partners. In absence of relevant information the exact position could not be ascertained.

4. The net current assets of the firm and changes therein during the financial year is stated below :

	As at 31.5.2001	*As at 31.5.2000*	*Changes Increase*	*Decrease*
Stock	65,000	1,05,000	—	40,000
Customers	11,00,000	9,00,000	2,00,000	—
Cash	10,000	10,000	—	—
Bank	20,000	—	20,000	—
Prepaid expenses	20,000	15,000	5,000	—
Total current assets (A)	12,15,000	10,30,000	2,25,000	40,000
Less :				
Current liabilities—				
Suppliers	80,000	1,50,000	—	70,000
Expenses	45,000	25,000	20,000	—
Bank overdraft	—	30,000	—	30,000
Total current liabilities (B)	1,25,000	2,05,000	20,000	1,00,000
Net current assets (A)- (B)	10,90,000	8,25,000		2,65,000

The above statement reveals :–

(a) There is overall increase in the net current assets by Rs. 2,65,000.

(b) Current assets to current liabilities ratios

For the year 2000-2001 — Rs. 9.72 to Re. 1
For the year 1999-2000 — Rs. 5.02 to Re. 1

which shows an improvement of Rs. 4.70 to Re. 1

The changes in the ratios are due to :

	Rs.	*Rs.*
Increase in debtors A/c	2,00,000	
Increase in bank balance	20,000	
Decrease in suppliers A/c	70,000	
Decrease in bank A/c	30,000	
Decrease in Prepaid Expenses	5,000	3,25,000
Less:		
Decrease in stock	40,000	
Increase in liability for expenses	20,000	60,000
		2,65,000

Increases in bank balances, repayment of bank overdraft and reduction in stock are signs of good and positive sound position of firm's/company's trading activities. However, there is no change in the cash balance. It is assumed that cash balance represents petty cash.

In the absence of sales and purchase figures, the changes in debtors by Rs. 2,00,000 and reduction in creditors by Rs. 70,000 could not be properly explained.

Prepaid expenses have gone by up by Rs. 5,000 which may be considered as normal.

Outstanding expenses have gone up by Rs. 20,000. However, the firm possesses a cash and bank balances of Rs. 30,000 which is sufficient to repay them on due dates of payment.

5. Cost of fixed assets has gone up by Rs. 1,00,000; similarly accumulated depreciation by Rs. 40,000. No information has been provided for any sale or discard of any fixed assets. In the absence of such information exact outflow of fund in this regard could not be ascertained.

Illustration 14 :

From the following transactions pass journal entries and show ledger accounts in the Books of S. Banerjee and prepare a Trial Balance.

Started business with cash Rs. 1,50,000, Goods worth Rs. 80,000, Office Equipment Rs. 70,000 and his private car worth Rs. 1,20,000 which will henceforth be used solely for business purpose.

Bought furniture worth Rs. 40,000 of which those worth Rs. 10,000 are for office use and the balance for stock. Purchased 3 motor cars worth Rs. 1,50,000 each from Ganguly & Co. for stock.

Purchased 2 motor cars worth Rs. 80,000 each from Ganguly & Co. for business use.

Purchased for cash 1 motor car worth Rs. 70,000 for private use.

Returned motor cars worth Rs. 1,50,000 from stock and that worth Rs. 80,000 for business use to Ganguly & Co.

Sold office equipment for Rs. 40,000

Sold one of the motor cars for stock for Rs. 2,00,000; paid landlord Rs. 12,000 for rent. One-third of the premises is occupied by the proprietor for his own residence.

Sold the third car for Rs. 3,50,000.

Solution :

In the books of Mr. S. Banerjee

			Dr. *(Rs.)*	Cr. *(Rs.)*
a)	Cash A/c	Dr.	150000	
	Stock A/c	Dr.	80000	
	Office Equipment A/c	Dr.	70000	
	Motor car Q/c	Dr.	120000	
	To capital A/c			420000
	(Sundry Assets introduced as Capital to start business)			
b)	Furniture A/c	Dr.	10000	
	Purchase A/c	Dr.	30000	
	To cash A/			40000
	(Purchase of furniture worth Rs. 40000 out of which Rs.10000 for office decoration and Rs. 30000 for stock)			
c)	Purchase A/c	Dr.	450000	
	To Ganguli & Co.			450000
	(Purchased 3 motor cars for stock purpose)			
d)	Motor Car A/c	Dr	160000	
	To Ganguli & Co.			160000
	(Purchased 2 motor cars for office use)			
e)	Drawings A/c	Dr.	70000	
	To Cash A/c			70000
	(Bought 1 office car for private use)			
f)	Ganguli & Co.	Dr.	230000	
	To Return outward A/c			150000
	To Motor car A/c			80000
	(Motor car worth Rs. 150000 from stock and Rs.80000 from business use returned to Ganguli & Co.)			
g)	Cash A/c	Dr.	40000	
	To Office Equipment A/c			40000
	(Office equipment worth Rs. 40000 sold)			
h)	Cash A/c	Dr.	200000	
	To Sales A/c			200000
	(Being one motor car from stock sold)			

i)	Rent A/c	Dr.	8000	
	Drawings A/c	Dr.	4000	
	To Cash A/c			12000
	(Rent paid to landlord, 1/3 of the premises occupied by the proprietor for personal residence)			
j)	Cash A/c	Dr.	350000	
	To Sales A/c			350000
	(Sold the third car for cash)			

Dr. Cash Account Cr.

Particulars	Rs.	Particulars	Rs.
To Capital	1,50,000	By Furniture	10,000
To Office Equipment	40,000	By Purchase	30,000
To Sales	2,00,000	By Drawing	70,000
To Sales	3,50,000	By Rent	8,000
		By Drawings	4,000
		By Balance c/d	6,18,000
	7,40,000		7,40,000

Dr. Stock Account Cr.

Particulars	Rs.	Particulars	Rs.
To Capital	80000	By Balance c/d	80000

Dr. Office Equipment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Capital	70000	By Cash A/c	40000
		By Balance c/d	30000
	70000		70000

Dr. Motor Car A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Capital	120000	By Ganguli & Co.	80000
" Ganguli & Co.	160000	" Balance c/d	200000
	280000		280000

Dr. Furniture A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Cash	10000	By Balance c/d	10000

Dr. Purchase A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Cash	30000	By Balance c/d	480000
To Ganguli & Co.	450000		
	480000		480000

Dr. Return Outward A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance c/d	150000	By Ganguli & Co.	150000

Dr. Ganguli & Co. A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Return Outward	150000	By Purchase	450000
To Motor Car	80000	By Motor Car	160000
To Balance c/d	380000		
	610000		610000

Dr. Drawings A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Cash	70000	By Balance c/d	74000
To Cash	4000		.
	74000		74000

Dr. Sales A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
		By Cash	200000
To Balance c/d	550000	By Cash	350000
	550000		550000

Final Accounts

Dr. **Rent A/c** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Cash	8000	By Balance c/d	8000

Dr. **Capital A/c** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance c/d	420000	By Cash	150000
To Stock	80000		
To Office Equipment	70000	By Motor Car	120000
	420000		420000

Trial Balance

	Dr. *Rs.*	Cr. *Rs.*
Cash	618000	
Stock	80000	
Office Equipment	30000	
Motor Car	200000	
Furniture	10000	
Purchase	480000	
Ganguli & Co.		380000
Drawings	74000	
Return outward		150000
Sales		550000
Rent	8000	
Capital		420000
	1500000	1500000

2.5 DEPRECIATION

Depreciation is the diminution in the value of assets due to use, wear and tear and efflux of time. It is an estimated charge against profit for use of fixed assets. The provision for depreciation is to create funds for replacement of assets. It may either be written off against asset accounts or it may be Depreciation Provision Account keeping Asset Account
at cost. There are various method of depreciation, such as,–

1) **Straight-line method or Fixed instalment method -** This is simple and most widely used method. An equal portion of the cost of the asset is allocated to each period of use.
2) Diminishing/reducing value method

3) Annuity method
4) Insurance Policy
5) Revaluation
6) Unit charging system.
    i) Production unit.
    ii) Time unit
7) Machine Hour Rate.
8) Sum of the digits method.

The entry for depreciation will be :–

Depreciation A/c	Dr.
To Respective Asset A/c	

The most commonly methods of depreciation are –

1) Straight line method and
2) Reducing / Diminishing value method.

For depreciation, Students are advised to go thorough

i) International Accounting Standard - 4, and
ii) Indian Accounting Standard - 6 for a thorough knowledge on the subject.

Methods of Calculating Depreciation

There are a number of methods of calculating depreciation on the original cost or on the replacement cost of the assets. Each method adopts one or more of the following principles —

(a) depreciation is a function of time;
(b) depreciation is a function of use;
(c) depreciation is a function of time and use;
(d) depreciation is a function of time and maintenance; and
(e) depreciation is a function of time and interest.

Whatever method is applied in the accounts, it must be suitable to the circumstances prevailing in the organisation. The different methods are discussed as follows :

(1) **Straight line method :** This is the method of providing for depreciation by means of periodic charges over the assumed or anticipated life of the asset.

Example :

If, C = Cost of the asset depreciated = Rs. 10,000.
R = Residual value of the asset = Rs. 500.
n = Life of the asset = 4 years.

Then,

D = Proportion of cost of asset depreciated under this method

$$= \frac{C - R}{n \times C} = \frac{10{,}000 - 500}{4 \times 10{,}000} = 0.2375 \text{ or } 23.75\%$$

So, amount of depreciation is 23.75% of Rs. 10,000 = Rs. 2,375 each year.

Proof :

Year	Cost and balance b/d *Rs.*	Depreciation *Rs.*	Balance c/f *Rs.*
1	10,000	2,375	7,625
2	7,625	2,375	5,250
3	5,250	2,375	2,875
4	2,875	2,375	500

(Depreciation has been calculated to the nearest Rupee.)

Thus, by using this method an equal amount of depreciation is charged during each period, irrespective of its use. This method is simple and is usefully applied to all types of fixed assets, particularly in connection with patents, leasehold and similar assets having definite life. Its use in cost accounts affords a better comparative costs for its uniform charge. However, the total cost of depreciation and repair and maintenance costs of assets increase progressively.

(2) **Reducing balance method :** This is the method of providing for depreciation by means of periodic charges calculated as a constant proportion of the balance of the asset after deducting the amounts previously provided. This is also called written down value method.

Example :

Assuming the same data as before,

D = Proportion of reducing balance of cost of asset depreciated in each period.

$$= 1 - \sqrt[n]{\frac{R}{C}} = 1 - \sqrt[4]{\frac{500}{10{,}000}}$$

= 1– 0.4729

= 0.5271 *or* 52.71%

(if the residual value is nil, assume R =1)

Proof :

Year	Cost and balance b/d *Rs.*	Depreciation @ 52.71 % *Rs.*	Balance c/f *Rs.*
1	10,000	5,271	4,729
2	4,729	2,493	2,236
3	2,236	1,179	1,057
4	1,057	557	500

Because of its simplicity, this method is popular and is extensively used for taxation purposes. It is observed that a heavier depreciation is borne in the earlier years when repairs are lighter, and that the increasing repair cost is counterbalanced, in later years, by the reduced annual charge for depreciation. The use of this method for costing purposes is justifiable only if its effect is to provide a uniform charge for the services of the asset throughout its life; otherwise, the cost of production in subsequent years appears to decrease, although they are produced under identical conditions.

(3) **Production unit method :** This is the method of providing for depreciation by means of a fixed rate per unit of production calculated by dividing the value of the asset by the estimated number of units to be produced during its life.

Example :

Assuming C and R to have the same value as before

and N_U = Estimated units to be produced during its life = 38,000 units.

Then, D = Depreciation per unit

$$= \frac{C-R}{N_U} = \frac{10{,}000-500}{38{,}000} = \frac{9{,}500}{38{,}000}$$

= Re. 0.25 per unit.

Thus, if 4,000 units are produced in a certain period, Rs. 1,000 will be charged as depreciation.

This method gives emphasis on usage and ignores time factor. The depreciation charge is high in periods of abnormal activity and low when machines are idle. This method is suitable for wasting assets such as mines and quarries. If estimated production during the life can be determined, this method satisfies the costing requirement that the cost of an asset should be evenly spread over the work done by it. However, the main disadvantage of this method is that a separate record of output of each of the assets has to be maintained and this method cannot be applied were output are of different types.

(4) **Production hour method :** This is the method of providing for depreciation by means of a fixed rate per hour of production calculated by dividing the value of the asset by the estimated number of hours of its life.

Example :

Assuming C and R to have the same value, and

N_H = Estimated number of working hours of its life = 19,000 hrs.

Then, D = Depreciation per hour

$$= \frac{C-R}{N_H} = \frac{10{,}000-500}{19{,}000} = \text{Re. } 0.50 \text{ per hour}$$

Thus, for a work of 1,000 hours in a certain period, depreciation charge will be :

Rs. 1,000 × Re. 0.50 = Rs. 500.

This method is usefully applied in cases of costly automatic machines having a limited but definite working life. This method is similar to production unit method. However, under this method, there is no need for all the units to be produced to be one type or even similar to one another as the charge is based upon the time involved in their production, and not on their number.

(5) **Annuity method :** This is the method of providing for depreciation by means of periodic charges, each of which is a constant proportion of the aggregate of the cost of the asset depreciated and interest at a given rate per period on the written down value of the asset at the beginning of each period.

Example :

If C = Rs. 10,000; n = 4 years; r = rate of interest 4% per annum;

a_n = present value of an annuity certain of 1 per year.

$$= \frac{1-\frac{1}{(1+r)^n}}{r}$$

Then, D = amount of periodic depreciation charge under this method

$$\frac{C}{a_n} = \frac{C \times r}{1-\frac{1}{(1+r)^n}} = \frac{10{,}000 \times 0.04}{1-\frac{1}{(1.04)^4}} = \frac{400}{1-\frac{1}{1.169859}}$$

= Rs. 2,755

Proof :

Year	Cost and balance b/f *Rs.*	Interest @ 4% (nearest rupee) *Rs.*	Total *Rs.*	Annual provision *Rs.*	Balance c/f *Rs.*
1	10,000	400	10,400	2,755	7,645
2	7,645	306	7.951	2,755	5,196
3	5,196	208	5,404	2,755	2,649
4	2,649	106	2,755	2,755	Nil

The amount of depreciation is heavy in this method and is intended to cover the cost of opportunity lost by not investing the capital elsewhere.

This method is based on the concept that money invested in an asset earns interest. This method is suitably used for the redemption of leases over a fairly long period. It is a scientific method where investment funds outside a business is not required.

(6) **Revaluation method :** This is the method of providing for depreciation by means of periodic charges each of which is equivalent to the difference between the values assigned to the asset at the beginning and the end of the period.

Example :

If, C = Cost of the asset = Rs. 10,000 ;

V = Value of asset at the end of one year = Rs. 7,000

Then, D = Amount of depreciation under this method = C – V = 10,000 – 7,000 = Rs. 3,000.

This method is commonly used for depreciation of loose tools, livestock, patents, patterns, etc., which depreciate rapidly. This method is also used for use of assets in contracts.

(7) **Sum of the digits method :** This is the method of providing for depreciation by means of differing periodic rates which is computed by taking a reduced proportion of the sum of an arithmetical progression in respect of the years of life of the asset, multiplied by the cost, less residual value, of the asset.

Example :

If, C = cost of asset = Rs.10,000; R = residual value = Rs. 400 ; n = 4yrs.

Then, S = sum of years = 1 + 2 + 3 + 4 = 10

Then, depreciation charge :

		Rs.
In year 1	4/10 of Rs. 9,600	3,840
year 2	3/10 of Rs. 9,600	2,880
year 3	2/10 of Rs. 9,600	1,920
year 4	1/10 of Rs. 9,600	960

This method is suitable for depreciation of motor vehicle and other assets which drop in value immediately after purchase. Thus the advantage of this method is that it takes into account of such drop in value of new asset and makes the decision to sell and repurchase before the estimated time an easier one.

The following should be noted for depreciation of the following types of fixed assets :–

(a) *Goodwill :*No depreciation arises unless the firm's profits are decreasing. Prudent firms try to write off goodwill over a number of years.

(b) *Freehold Land :* In this case also no depreciation arises. Amounts written off should be shown separately.

(c) *Loose tools, Jigs and Patterns :* Depreciation should be calculated on revaluation method.

(d) *Patents, Trade Marks, etc :*There is a maximum legal life of such assets but the commercial life may be shorter. The asset should be depreciated by straight line method so that it is written off within the legal or commercial life whichever is shorter.

(e) *Mines, Oil wells, Quarries, etc. :* Depreciation should be charged on depletion method.

Illustration 15 :

A company purchased a machine for Rs. 20,000 and paid cost of installation Rs. 1,000. At the date of purchase, the life of the machine was estimated at 15 years and hence it was decided to create a depreciation fund to be invested in Government Securities to provide for replacement of the machine.

Before expiration of the estimated life it was decided to dismantle the machine and replace it with a modern one. The cost of dismantling was Rs. 200 and the cost of purchase and installation of new machine was Rs. 23,000. Parts of the old machine estimated to be worth Rs. 500, were retained and the remainder sold as scrap for Rs. 750.

At the date of dismantling the old machine, the depreciation fund stood in the books at Rs. 16,500 and was represented by Government Securities costing the same amount. These securities were sold for Rs. 15,600.

You are required to write up the ledger accounts concerned.

Solution :

Dr. **Machinery A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Cash A/c		By	Cash A/c Scrap Sale	750
	Cost of Machine	20,000		Depreciation fund A/c – tfd..	15,400
	Installation	1,000		Profit & Loss A/c – Loss	4,350
To	Cash A/c			Balance c/d	23,500
	Cost of new Machine	23,000		— for old machine Part – 500	
				— for new machine 23,000	
		44,000			44,000

Dr. **Depreciation Fund A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Cash A/c – Cost of dismantling	200	By	Balance b/d	16,500
	Depreciation Fund				
	Investment A/c – transferred	900			
	Machinery A/c (Balancing figure)	15,400			
		16,500			16,500

Dr. **Depreciation Fund A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Balance b/d	16,500	By	Cash A/c	
				— Sale of securities	15,600
				— Depreciation Fund A/c	
				– Loss tfd..	900
		16,500			16,500

Working to find out loss on dismantling the old machine.

Cost of old machine			Rs. 21,000
Less :	Parts retained from Old machine	500	
	Sale of Scrap	750	1,250
			19,750
Less :	Amount available from the balance of Depreciation Fund A/c		15,400
	Loss		4,350

Illustration 16 :

A firm is willing to change the system of providing for depreciation from Diminishing Balance Method to Straight Line Method with retrospective effect from 1st April, 1995. On 1st April, 1997, Machinery Account in the Ledger had a debit balance of Rs. 5,67,000. The rate of depreciations would, however, remain unchanged. Necessary adjustments for depreciations due to change in method should be made in the year 1997-98. Rate of Depreciation 10% p.a.

You are further informed that new machinery were purchased on 1st October, 1997 at a cost of Rs. 60,000.

Show the Machinery Account from 1995-96 to 1997-98.

Solution :

Cost of Machinery on 1st April, 1995

$$Rs.\ 5{,}67{,}000 \times \frac{100}{90} \times \frac{100}{90} = \text{Rs. } 7{,}00{,}000\ .$$

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

Particulars	*Rs.*	*Particulars*	*Rs.*
1.4.95–31.3.96			
To Balance	7,00,000	By Depreciation (on	
		Rs. 7,00,000 @ 10%)	70,000
		Balance c/d	6,30,000
	7,00,000		7,00,000
1.4.96 – 31.3.97			
To Balance b/d.	6,30,000	By Depreciation (on	
		Rs. 6,30,000 @ 10%)	63,000
		By Balance c/d.	5,67,000
	6,30,000		6,30,000
1.4.97– 31.3.98			
To Balance b/d.	5,67,000	By Depreciation	
		(due to change in Method)	7,000
1.10.97 To Bank (Addition)	60,000	By Depreciation :	
		(i) On Rs. 7,00,000	
		@ 10% p.a.	70,000
		(ii) On 60,000 for 6 months	
		@ 10% p.a.	3,000
		By Balance c/d	5,47,000
	6,27,000		6,27,000

Depreciation provided on reducing system :

1995-96	Rs.	70,000
1996-97	Rs.	63,000
	Rs.	1,33,000

Depreciation to be provided on Straight Line Method :

1995-96	Rs.	70,000
1996-97	Rs.	70,000
	Rs.	1,40,000
Deprn. short to be provided for (Rs. 1,40,000 – Rs. 1,33,000)	Rs.	7,000

Illustration 17 :

Depreciation has been charged for the years 1998 to 2001 at 10% on reducing balance method on opening balance of each item of plant and machinery in use. The balance of Plant and Machinery Account on 31st December, 2001 was Rs. 54,000. There were no sales during these years but purchases were Rs. 16,800 on September, 1998 and Rs. 11,400 in December, 2000.

The management decided that depreciation should be charged at 20% on the same method but calculated on the closing balance of each year with retrospective effective from 1998.

You are required to pass Journal Entry for giving effect to the revised basis at the end of 2001, and prepare Plant and Machinery Account and Revised Plant and Machinery Account for all the years.

Solution :

The balance of Plant and Machinery Account as on January, 1998 is not given. This balance is to be ascertained by working reverse way from 2001.

Dr. **Plant and Machinery Account** **Cr.**

Date		*Particulars*	*Rs.*	*Date*		*Particulars*	*Rs.*
1998				*1998*			
1-Jan	To	Balance b/d	48,000	31-Dec	By	Depreciation (1/9 of Rs. 60,000 – Rs. 16,800) = 43,200	4,800
	To	Bank A/c	16,800		By	Balance c/d	60,000
			64,800				64,800

1999				*1999*			
1-Jan	To	Balance b/d	60,000	31-Dec	By	Depreciation (1/9 of Rs. 54,000)	6,000
					By	Balance c/d	54,000
			60,000				60,000
2000				*2000*			
1-Jan	To	Balance b/d	54,000	31-Dec	By	Depreciation (1/9 of 48,600 = (Rs. 60,000 – Rs. 11,400)	5,400
Dec	To	Bank A/c	11,400		By	Balance c/d	60,000
			65,400				65,400
2001				*2001*			
1-Jan	To	Balance b/d	60,000	31-Dec	By	Depreciation (1/9 of Rs. 54,000)	6,000
					By	Balance c/d	54,000
			60,000				60,000

When deprn. is calculated on the revised basis, the Plant and Machinery Account will be as under :

Dr. **Revised Plant and Machinery** **Cr.**

Date		*Particulars*	*Rs.*	*Date*		*Particulars*	*Rs.*
1998				*1998*			
1-Jan	To	Balance b/d	48,000	31-Dec	By	Deprn. (20% on 64,800)	12,960
1-Sep	To	Bank A/c	16,800		By	Balance	51,840
			64,800				64,800
1999				*1999*			
1-Jan	To	Balance b/d	51,840	31-Dec	By	Deprn. (20% on 51,840)	10,368
					By	Balance c/d	41,472
			51,840				51,840
2000				*2000*			
1-Jan	To	Balance b/d	41,472	31-Dec	By	Deprn. (20% on 52,872)	10,574
Dec	To	Bank A/c	11,400		By	Balance c/d	42,298
			52,872				52,872
2001				*2001*			
1-Jan	To	Balance b/d	42,298	31-Dec	By	Deprn. (20% on 42,298)	8,460
					By	Balance c/d	33,838
			42,298				42,298

The resultant impact on P & L A/c of Rs. 20,162 to be disclosed in notes on Accounts.

	Deprn. @ 10%	**Residual value**	**Deprn.@20%**	**Residual value**
	Rs.	*Rs.*	*Rs.*	*Rs.*
31-Dec-01	6,000	54,000	8,460	33,838
31-Dec-00	5,400	60,000	10,574	42,298
31-Dec-00		65,400		
31-Dec-99	6,000	54,000	10,368	41,472
31-Dec-98	4,800	60,000	12,960	51,840
31-Sep-98		64,800		
01-Jan-98		48,000		
	22,200		42,362	
	Difference	*Rs.*	20,162	

Journal Entry

31-Dec-01	Depreciation A/c	Dr.	2,460	
	Prior period Adj. A/c	Dr.	17,702	
	(Deprn. for previous years)			
	To Plant & Machinery A/c			20,162
	(Being arrear provision of depreciation chargeable at the revised rate of 20% and charged @ 10% for the years 1998 to 2000 and (Rs.33,902 – Rs.16,200) for the year 2001 (Rs. 8,460 – Rs. 6,000) already charged)			

Illustration 18 :

(a) What are the different methods of providing depreciation ? Is it necessary to provide depreciation ? If yes, then what are the reasons ?

(b) XYZ Limited purchased on 1st January, 1990 second hand plant for Rs.90,000 and immediately spent Rs.60,000 in overhauling it. On 1st July 1990 additional machinery at a cost of Rs.75,000 was purchased. On 1st July 1992 the plant purchased on 1st January 1990 became obsolete and was sold for Rs.30,000. On that date new machinery was purchased at a cost of Rs.1,80,000.

Depreciation was provided annually on 31st December at 10% per annum on the original cost of asset. In 1993 however the company changed this method for depreciation and adopted the method of writing off 15% on the diminishing value. Show the Plant & Machinery Account as it would appear in the books of the company for the year 1990 to 1995.

Solution (a) :

There are various methods of providing depreciation, these are —

i) Straight Line Method or Fixed Installment Method.

ii) Diminishing/Reducing value Method.

iii) Annuity Method.

iv) Insurance Policy Method.

v) Revaluation Method.

vi) Unit Charging System Method.

vii) Machine Hour Rate Method.

Yes, it is necessary to provide depreciation on fixed assets the lives of which are extinguished gradually owing to wear and tear, efflux of time, etc.

The capital expenditure incurred on acquisition of fixed asset is not charged as such in the revenue account in the concern in any year. Since the concern is utilising the asset for its business purpose, the revenue account for a year should share reasonably chargeable proportionate cost thereof. Depreciation is that reasonable charge on the profit and it is not appropriation of the profit. The Companies Act also stipulates that depreciation should be provided. If depreciation is not provided by a concern the true and fair picture of the working results will be vitiated and the Auditor will have to make a comment on that in his report.

Solution (b) :

Books of XYZ Ltd.

Plant & Machinery Account

1990			*1990*		
Jan. 1	To Bank A/c	90,000	Dec.31	By Depreciation	18,750
	" Bank A/c- overhauling	60,000		" Balance c/d	2,06,250
July 1	" Bank A/c	75,000			
		2,25,000			2,25,000
1991			*1991*		
			Dec. 31	By Depreciation	22,500
Jan. 1	To Balance c/d	2,06,250	Dec. 31	" Balance c/d	1,83,750
		2,06,250			2,06,250
1992			*1992*		
Jan.1	To Balance b/d	1,83,750	July 1	By Bank A/c - Sale proceeds plant purchased on 1.1.90	30,000
July 1	" Bank A/c	1,80,000	Dec.31	" Depreciation A/c	24,000
				" Profit & Loss A/c	82,500
				" Balance c/d	2,27,250
		3,63,750			3,63,750

1993			*1993*		
July 1	To Bank c/d	2,27,250	Dec.31	By Depreciation A/c	34,089
		.		" Balance c/d	1,93,161
		2,27,250			2,27,250
1994			*1994*		
Jan.1	To Balance b/d	1,93,161	Dec. 31	By Depreciation A/c	28,974
				" Balance c/d	1,64,187
		1,93,161			1,93,161
1995			*1995*		
Jan.1	To Balance b/d	1,64,187	Dec.31	By Depreciation	24,628
				" Balance c/d	1,39,559
		1,64,187			1,64,187

Working Notes : —

(1) Depreciation for the year 1990 (Rs. 18,750) :

			Rs.
On cost of Plant :	90,000 @ 10% for full year		9,000
	60,000@ 10% for full year		6,000
	75,000 @ 10% for 1/2 of year		3,750
			18,750

(2) Depreciation for the year 1992 :

On plant sold	1,50,000 @ 10% for 1/2 of year		7,500
On plant purchased	75,000 for full year		7,500
On plant purchased	1,80,000 for 1/2 year		9,000
			24,000

(3) Loss on sale of plant (Rs. 82,500) :

Cost of plant	90,000		
Add : Overhauling	60,000	1,50,000	
Less : Depreciation -			
For the year 1990	15,000		
For the year 1991	15,000		
For the year 1992(1/2)	7,500	37,500	1,12,500
Less : Amount realised on Sale		30,000	
			82,500

NOTE : Regarding the change in the method of calculating depreciation reference may be made to AS - 6.

Illustration 19 :

On 1.1.93 Machinery was purchased by X for Rs. 50,000. On 1.7.94 additions were made to the extent of Rs. 10,000. On 1.4.95 further additions of Rs. 6,400 were made on 30th June 1996. Machinery original value of which was Rs. 8,000 on 1.1.93 was sold for Rs. 6,000. Depreciation is charged at 105 p.a. on original cost.

Show the Machinery Account for the years 1993 to 1996 in the books of X who closes his books on 31st December every year.

Solution :

In the Books of X

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

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.93	To Bank A/c-Purchase	50,000	31.12.93	By Depreciation A/c	5,000
		.		By Balance c/d	45,000
		50,000			50,000
1.1.94	To Balance b/d	45,000	31.12.94	By Depreciation A/c	5,500
1.7.94	To Bank-Purchase	10,000		By Balance c/d	49,500
		55,000			55,000
1.1.95	To Balance b/d	49,500	31.12.95	By Depreciation A/c	6,480
1.4.95	To Bank-Purchase	6,400		By Balance c/d	49,420
		55,900			55,900
1.1.96	To Balance b/d	49,420	30.6.96	By Bank A/c (Sale)	6,000
30.6.96	To P/L A/c-Profit on Sale	800	31.12.96	By Depreciation A/c	6,240
		.		By Balance c/d	37,980
		50,220			50,220
1.1.97	To Balance b/d	37,980			

Working Notes :

		Rs.	Rs.
1.	Annual depreciation —		
a.	For 1993		
	Depreciation @ 10% on Rs. 50,000		5,000
b	For 1994		
	1st Machine @ 10% on Rs. 50,000	5,000	
	2nd Machine @ 10% on Rs.10,000 for 6 mths	500	5,500
c.	For 1995		
	1st Machine @ 10% on Rs. 50,000	5,000	
	2nd Machine @ 10% on Rs. 10,000	1,000	
	3rd Machine @ 10% on Rs. 6,400 for		
	9 months 6,400×10/100×9/12	480	6,480
d.	1st M/c @ 10% on (50,000 – 8,000) = Rs.42,000 =	4,200	
	2nd Machine @10% on Rs. 10,000 =	1,000	
	3rd Machine @ 10% on 6,400 =	640	
	On selling Machine at Rs. 8,000 for 6 mths.		
	Rs. 8,000×10/100×1/2 =	400	6,240

2. Profit or loss on sale —

Original cost of Machine as on 1.1.93	8,000	
Less : Deprn. @ 10% for 3×1/2 years	2,800	
Value as on Selling date i.e. 30.6.96	5,200	
Sales Value	6,000	
So Profit on Sale (6,000 – 5.200)		800

2.6 PROVISIONS AND RESERVES

Reserves or Reserve Funds mean amounts set aside out of profits (as ascertained by the Profit and Loss Account) or other surpluses which are not meant to cover any liability, contingency, commitment or depreciation in the value of assets.

Capital Reserves :

These reserves are not available for distribution among shareholders as dividend in the case of companies. They are built out of capital profits as against ordinary trading or revenue profits. In case of a limited company, the following are capital profits :–

(a) Profits prior to incorporation;

(b) Premium on issue of shares or debentures;

(c) Profits on redemption of debentures;

(d) Amount utilised out of profits to redeem redeemable preference share;

(e) Profit on forfeiture of shares;

(f) Profits on sale of fixed assets over the original cost; and

(g) Profit on revaluation of fixed assets or liabilities.

Secret Reserves :

Secret Reserves are reserves which are not known to the members of the company. When secret reserves exit, the financial position of the company is better than what appears from the balance sheet. In some businesses, for example banks, the existence of secret reserves is necessary. Such businesses, depending upon public confidence, cannot afford to show a loss in any trading period. Secret reserves enable them to show a profit even when there is a loss. Secret reserves are created by the simple method of showing profit at a figure much lower than the actual.

Illustration 20 :

A company maintains its Reserve for discounts on Sundry Creditors @ 4%. On Ist April, 1995 Reserve for discounts on Sundry Creditors stood in the books for Rs. 9,500. On 31st March, 1996 and 31st March, 1997 Sundry Creditors (before adjustment of Discount received) amounted to Rs. 1,30,000 and Rs. 1,80,000 respectively.

Discounts received		*Rs.*
	1995-96	4,500
	1996-97	12,000

Show the Reserved for Discount on Sundry Creditors Account for 1995-96 and 1996-97.

Solution :

Dr. **Reserve for Discount A/c on Sundry Creditors** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
01.4.95 To Balance b/d	9,500	31.3.96 By Discount Received	4,500
31.3.96 To Profit & Loss A/c		31.3.96 By Balance c/d (4% on	
— transferred	20	Rs. 1,25,500)	5,020
	9,520		9,520
01.4.96 To Balance b/d	5,020	31.3.97 By Discount Received	12,000
31.3.97 To Profit & Loss A/c — trfd.	13,700	31.3.97 By Balance c/d	6,720
	18,720		18,720

Illustration 21 :

R. Sing, a trader makes provision for doubtful debts at the end of each year against specific debtors. On 31st March, 1997 the following debtors' balances were considered doubtful and provided for B Rs. 3,000, C Rs. 800, D Rs. 500.

Following are the particulars for the year ended 31st March, 1998 :

(i) Bad Debts 00, S - Rs. 1,200, N - Rs. 1,000;

(iii) Bad Debts considered doubtful at the end of the year : G - Rs. 1,600, H - Rs. 1,800, K - Rs. 2,000.

Debts considered doubtful at the commencement of the year were either realised or written off as Bad Debts.

Write up the Bad Debts A/c and Provision for Doubtful Debts A/c for the year ended 31st March, 1998.

Solution :

R Singh

Dr. Bad Debts Account Cr.

Particulars		Particulars	Rs.
31.3.98		31.3.98	
To Sundry Debtors		By Provisions for	
(2,400+500+500)	3,400	Bad Debts A/c	3,400
	3,400		3,400

Dr. Provision For Bad Debts Account Cr.

Particulars	Rs.	Particulars	Rs.
31.3.98		1.4.97	
To Bad Debts A/c	3,400	By Balance b/f (3,000+800+500)	4,300
To Balance (1,600+1,800+2,000)	5,400	31.3.98	
		By Bad & Doubtful Recovery A/c (1,400+1,200+1,000)	3,600
		By Profit & Loss A/c	900
	8,800		8,800

Note : Amount realised against bad debts previously written off should be credited to Provision for Bad & Doubtful Debts A/c.

Illustration 22 :

(a) The following is the agewise analysis of customers dues not yet written off as bad as at the end of each of the 3 years ended 31st March, 2000:

	Outstanding for			
	Over 3 years	*Over 2 years upto 3 years*	*Over 1 year upto 2 years*	*Less than one year*
	Rs.	*Rs.*	*Rs.*	*Rs.*
31-3-1998	40,000	1,00,000	2,00,000	10,00,000
31-3-1999	50,000	1,20,000	2,25,000	12,00,000
31-3-2000	60,000	1,50,000	2,70,000	15,00,000

(b) The business carried forward a "provision" for doubtful debts and a "reserve" for doubtful debts at the end of each year with reference to year end debtors :

Debts due	*Provision*	*Reserve*
Over 3 years	100%	Nil
Over 2 years less than 3 years	75%	25%
Over 1 year less than 2 years	50%	10%
Less than 1 year	4%	6%

(c) The actual bad debts written off before arriving at the figures of debtors in (a) above during the year were :

	Rs.
1997-1998	50,000
1998-1999	75,000
1999-2000	1,00,000

You are asked to show for each of the 3 years ended 31-3-2000 accounts relating to

(i) bad debts,

(ii) provision for doubtful debts,

(iii) reserve for doubtful debts.

You are informed that the balance on 31-3-1997 in "provision" for doubtful debts account is Rs. 60,000 and in "reserve" for doubtful debts account is Rs. 1,00,000.

Show your working.

Solution :

Working

	31.3.97	**31-3-98**	**31-3-99**	**31-3-2000**
	Rs.	*Rs.*	*Rs.*	*Rs.*
Bad debts written off.	?	50000	75000	100000
Provision for doubtful debts :	60,000			
at 100%		40,000	50,000	60,000
at 75%		75,000	90,000	1,12,500
at 50%		1,00,000	1,12,500	1,35,000
at 4%		40,000	48,000	60,000
Closing balance.	60,000	2,55,000	3,00,500	3,67,500
Reserve for doubtful debts:	1,00,000			
at 25%		25,000	30,000	37,500
at 10%		20,000	22,500	27,000
at 6%		60,000	72,000	90,000
		1,05,000	1,24,500	1,24,500

Bad Debts A/c.

		Dr.	**Cr.**	**Balance**	
1997-98		*Rs.*	*Rs.*	*Rs.*	
Mar. 31	To Customers A/c.	50,000		50,000	Dr.
	By Provision for bad debts	.	50,000	Nil.	
		50,000	50,000		
1998-99					
Mar. 31	To Customers A/c	75,000		75,000	Dr.
	By Provision for bad debts.	.	75,000	Nil	
		75,000	75,000		
1999-2000					
Mar. 31	To Customers A/c	1,00,000		1,00,000	
	By Provisions for bad debts.	.	1,00,000	Nil.	
		1,00,000	1,00,000		

Provision for Doubtful Debts

1997-98		**Dr.**	**Cr.**	**Balance**	
		Rs.	*Rs.*	*Rs.*	
Apr. 1	By Balance b/fd		60,000	60,000	Cr.
Mar. 31	To Bad Debts.	50,000		10,000	”
	By Profit and loss A/c.		2,45,000	2,55,000	”
	To Balance c/fd	2,55,000	.		
		3,05,000	3,05,000		
1998-99					
Apr. 1	By Balance b/fd		2,55,000	2,55,000	Cr.
Mar. 31	To Bad debts	75,000		1,80,000	”
	By Profit and loss A/c.		1,20,500	3,00,500	”
	To Balance c/fd.	3,00,500	.		
		3,75,500	3,75,500		
1999-2000.					
Apr. 1	By Balance b/fd		3,00,500	3,00,500	Cr.
Mar. 31	To Bad debts	1,00,000		2,00,500	”
	By Profit and loss A/c		1,67,000	3,67,500	”
	To Balance c/fd.	3,67,500	.		
		4,67500	4,67,500		

Reserve for doubtful debts

1997-98			**Dr.**	**Cr.**	**Balance**	
			Rs.	*Rs.*	*Rs.*	
Apr. 1	By	Balance b/fd		1,00,000	1,00,000	Cr.
Mar. 31	”	Profit and loss appropriation		5,000	1,05,000	”
	To	Balance c/fd	1,05,000			
			1,05,000	1,05,000		
1998-99						
Apr. 1	By	Balance b/fd		1,05,000	1,05,000	Cr.
Mar. 31	”	Profit and Loss appropriation		19,500	1,24,500	”
	To	Balance c/fd.	1,24,500	.		
			1,24,500	1,24,500		
1999-2000						
Apr.1	By	Balance b/fd		1,24,500	1,24,500	Cr.
Mar. 31	”	Profit and loss appropriation.		30,000	1,54,500	”
	To	Balance c/fd.	1,54,500	.		
			154,500	1,54,500		

2.7 SPECIMEN QUESTION WITH ANSWERS

Question 1 :

S. Ltd. keeps no running stock records but a physical inventory of stock is made at the end of each quarter and evaluated at cost. The company's year ends on 31st March, 1997 and draft accounts have been prepared to that date. The stock inventory taken on 31st March, 1997 was accidentally destroyed before the items had been evaluated, the closing stock figure used in the draft accounts being that shown by the inventory taken on 31st December, 1996. The gross margin earned by company is 25% of cost. During your audit you discovered the following :

(a) The cost of the stock on 31st December, 1996 as shown by the inventory was Rs. 40,525.

(b) On 31st December, 1996 stock sheets showed the following discrepancies:

- (i) A page total of Rs. 5,059 had been carried to the summary as Rs. 5,509.
- (ii) The total of a page had been undercast by Rs. 98.
- (iii) 100 items which had cost Rs. 5 each had been taken at 25 paise each.

(c) Invoice for purchases entered in the Purchases Book during the month of January, February and March, 1997 totalled Rs. 38,560. Of this total Rs. 2,800 related to goods received on or prior to 31st December, 1996. Invoices entered in April,
1997 relating to goods received in March, 1997 totalled Rs. 3,700.

(d) Sales invoiced to customers in January, February and March, 1997 totalled Rs. 51,073. Of this total Rs. 3,824 related to goods despatched on or before 31st December, 1996. Goods despatched to customers before 31st March, 1997 but invoiced in April, 1997 totalled Rs. 5,241.

(e) During the final quarter to the company's year, credit notes at invoiced value of Rs. 1,280 had been issued to customers in respect of goods returned during that period.

You are required to prepare a statement showing the amount of the stock at cost as on 31st March, 1997.

Answer :

Statement showing the amount of Physical Stock at Cost as on 31st March, 1997.

a) Adjusted Stock as on 31.12.96		*Rs.*
Stock at cost as on 31.12.96.		40,525
Add :	Cost of 100 items wrongly undercast by Rs. 4.75 (5.00 – 0.25) each 100×4.75	475
	Under cast in total of a page by Rs. 98	98
		41,098
Less :	Errors in carry forward of a page total by Rs. 450 (Rs. 5509 – Rs. 5059) – overcast	450
		40,648
b) Adjusted cost of sales as on 31.3.97.		
Sales from 1.1.97 to 31.3.97		51,073
Add :	Goods despatched before 31.3.97 but invoice raised in April, 97	5,241
		56,314
Less :	Goods despatched before 31.12.96 included in sales of Rs. 51,073	3,824
		52,490
Less :	Credit Note issued to customers for sales return during final quarter i.e. January to March, '97	1,280
		51,210
Less :	Gross margin @ 25% on cost i.e., 20% on sale Rs. 51,210	10,242
		40,968
c) Adjusted Purchase as on 31.3.97.		
Purchase from 01.01.97 to 31.3.97		38,560
Add :	Goods purchased before 31.3.97 but recorded in April, '97	3,700
		42,260
Less :	Goods received before 31.12.96 included in purchase of Rs. 38,560	2,800
		39,460

d) Stock (Physical) as on 31.3.97

Adjusted Stock as on 31.12.96 — (a)		40,648
Add :	Adjusted purchase as on 31.3.97 — (c)	39,460
		80,108
Less :	Adjusted cost of sales as on 31.3.97 — (b)	40,968
	Physical stock balance as on 31.3.97 at Cost	39,140

Question 2 :

The Balance in Profit & Loss Account as per Balance Sheet as at 31st March, 1997 is Rs. 32,600, whereas the balance on Balance Sheet as at 31st March, 1998 is Rs. 38,100. The following facts are ascertained :

(i) Rs. 8,500 depreciation has been charged ;

(ii) Provision for dividend Rs. 15,000 has been made ;

(iii) Rs. 4,500 has been transferred to General Reserve ;

(iv) Rs. 1,000 Dividend (gross) has been credited ;

(v) Rs. 2,300 Loss on Sale and Fixed Assets has been debited ;

(vi) Indirect Expenses debited amount to Rs. 30,500 in total.

Find out Gross Profit, Trading Profit and Net Profit.

Answer :

Profit & Loss Account (Includes)

Dr.				Cr.
To Indirect expenses	30,500	By	Gross Profit. (3)	65,300
To Trading Profit c/d (2)	34,800			
	65,300			65,300
To Loss on sale of Fixed Assets	2,300	By	Trading Profit b/d (2)	34,800
To Depreciation	8,500	By	Dividend (Gross)	1,000
To Net Profit c/d (1)	25,000			
	35,800			35,800
To Provision for dividend	15,000	By	Balance b/d	32,600
To General Reserve	4,500	By	Net Profit c/d. (1)	25,000
To Balance c/d	38,100			
	57,600			57,600

Note : The missing figures marked 1, 2 and 3 have been found out in the same order.

Question 3 :

P.K. commenced business in a retail shop on 1st July, 1997 in premises for which he paid a rent of Rs. 320 per month. The only records he kept, apart from his bank statements, were files of paid invoices and unpaid invoices for goods purchased, together with a notebook in which he recorded a few sales on credit to special customers who paid him by cheques. Cash received from cash sale was paid into the till out which he paid certain amounts, of which he kept a rough record, and he made weekly bankings out of the balance in the till. He paid all suppliers for goods purchased by cheque.

An analysis of the bank statements for the six months ended 31st December, 1997 was as follows :

	Rs.		*Rs.*
Capital paid in	6,400	Shop fixtures and fittings	3,200
Loan (interest free)	3,200	Household furniture	2,880
Suppliers cheque for goods returned	448	Suppliers (for purchases)	15,744
Special customers	480	Rent	1,600
Total of weekly cash bankings	19,088	Rates	480
		Insurance on stocks	320
		Electricity	288
		Balance on 31st December, 1997	5,104
	29,616		29,616

P.K. estimates that the total amounts paid out of the till before making the weekly bankings for the six months were :

Drawings - Rs. 3,200, Wages - Rs. 2,240 and Sundry shop expenses - Rs. 1,280.

You ascertain that as on 31st December, 1997 :–

(i) Stocks, correctly taken at cost, were Rs. 2,752.

(ii) The balance in the till was Rs. 416, including a post dated cheque for Rs. 200, cashed for a customer.

(iii) Cheques for Rs. 272 from special credit customers paid into the bank have not been cleared. One for Rs. 112 was cleared on 3rd January, 1998 and the other for Rs. 160 was returned dishonoured and the customer could not be traced. This sum is considered as bad. Other special customers owned Rs. 384.

(iv) The following cheques had been issued but had not been presented—rent for December Rs. 320 and lighting charges Rs. 240.

(v) The cash paid into the bank included Rs. 480 from a sale of surplus shop fittings. There was no profit or loss on this transaction.

(vi) Suppliers' unpaid invoices amounted to Rs. 3,584 and there was Rs. 64 owing for electricity.

You are required to prepare the Balance Sheet as at 31st December, 1997 and the Trading and Profit and Loss Account for the half-year ended on that date.

Answer :

Trading and Profit & Loss Account *for the half year ended 31st December, 1997*

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Purchases	19,328		By sales —		
Less : Returns	448	18,880	Cash sales	25,744	
			Sales to Spl. customers	1,136	26,880
" Wages		2,240	By Closing Stock		2,752
" Gross Profit c/d		8,512			
		29,632			29,632
		Rs.			*Rs.*
To Shop Expenses		1,280	By Gross Profit b/d		8,512
" Rent (1600+320)		1,920			
" Rates		480			
" Insurance		320			
" Electricity (Rs.288+64)		352			
" Reserve for Bad debts		160			
" Lighting charges		240			
" Net Profit transferred to Capital A/c		3,760			
		8,512			8,512

Balance Sheet *as at 31st December, 1997*

Liabilities		*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Creditors for expenses—Electricity			64	Cash in hand		416
Trade Creditors			3,584	Cash at Bank		4,816
Loan Account			3,200	Sundry Debtors	384	
Capital Account —				Less : Reserve for B.D.	160	224
Amount deposited		6,400				
Add : Profit		3,760				
		10,160		Stock		2,752
Less : Drawings				Shop, fixture and fittings	3,200	
(Household				Less : Sold	480	2,720
furniture	2,880					
Cash drawing	3,200	6,080	4,080			
			10,928			10,928

Working Notes :

1) Cash Sales :

		Rs.
Total of weekly cash bankings		19,088
Add : Payments made out of till -		
Drawings	3,200	
Wages	2,240	
Shop expenses	1,280	6,720
Balance on hand		416
		26,224
Less : Sale of surplus shop fittings included in weekly bankings		480
		25,744

2) Sales to special customers :

	Rs.
Cheques received from special customers and banked	480
Add : Chqs. recd. from sp. customers paid in but not collected	272
Amount due from special customers	384
	1,136

3) Purchases :

	Rs.
Payment to suppliers (for purchases)	15,744
Add : unpaid invoices	3,584
	19,328

4) Bank balance as per Cash Book :

Balance as per Pass Book		5,104
Add : Cheques paid in but not credited		272
		5,376
Less : Cheques issued but not yet presented for payment		
Rent	320	
Lighting	240	560
Bank balance as per Cash Book		4,816

Since the cheque in the till is a postdated cheque, it is not considered and is treated as cash.

5) The cheque for Rs. 160 received from special customers which was dishonoured subsequently can not be considered as bad debts during the current accounting period. Assuming that P.K. had the knowledge of the cheque being dishonoured at the time of preparing the accounts, provision for bad debts is made so that during the next accounting period, this can be written off against the Reserve.

Question 4 :

The Profit and Loss Account of Sampat for the year ended 31st March, 1998 showed a Net Profit of Rs. 2,500 after taking into account the closing Stock of Rs. 4,720.

On a scrutiny of the books the following information could be obtained :

(i) Purchases of the year included Rs. 500 spent on acquisition of a ceiling fan for his shop.

(ii) Sampat has taken goods valued at Rs. 1,800 for his personal use without making entry in the books.

(iii) Invoices for goods amounting to Rs. 4,000 have been entered on 29th March, 1998 but such goods were not included in stock.

(iv) Sale of goods amounting to Rs. 700 sold and delivered in March, 1998 had been entered in April,1998 sales.

(v) Rs. 500 had been included in closing stock in respect of goods purchased and invoiced on 28th March, 1998 but included in purchase for April, 1998.

You are required to ascertain the correct amount of Closing Stock as on 31st March, 1998 and the adjusted Net Profit for the year ended on that date.

Answer :

In the Books of Sampat :

(i) Calculation of stock as on 31st March, 1998 :

	Rs.
Stock as already given	4,720
Add : Purchases not included	4,000
	8,720

(ii)

Dr. **Profit & Loss Adjustment Account** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Suppliers A/c	500	By	Profit (as already calculated)	2,500
”	Net Profit (Balancing figure)	9,000	”	Drawing	1,800
			”	Furniture & fittings (Ceiling Fan)	500
			”	Closing Stock (Goods in Transit)	4,000
			”	Customers A/c	700
		9,500			9,500

Question 5 :

Mr. Clarence starts a business on 1.1.98 with Rs. 10,000 and purchases furniture and equipments for Rs. 1,000 and starts a Current Account with the balance.

He employs one salesman for Rs. 100 p.m. payable in the first week of the month following. He also rents a house at Rs. 70 p.m. payable in the last week of the month concerned.

He cannot stand paper work and he does not maintain any books of account, whatsoever. He prepares challans which are handed over on payment. All purchases are paid for by bearer or crossed cheques from Current Account. All collections are deposited intact in Current Account.

Rs. 500 p.m. is transferred to a Saving Account wherefrom other expenses and drawings @ Rs. 250 p.m. are made.

He keeps petty cash box from which direct charges on purchase as carriage, etc. are met and periodically it is reimbursed from Current Account.

On 31.12.98 the following balances are there : Stock Rs. 5,000; Current Account Rs. 7,000; Saving Account Rs. 300; Petty Cash Box Rs. 20; Cash Rs. 500 collected and to be deposited, already entered in pay-in-slips; Challans in hand Rs. 1,000.

It is found that Rs. 10 has been credited as interest in Savings Account. A challan showing Rs. 50 is not recoverable. Prepare Profit and Loss Account for the year and Balance Sheet as on 31.12.98 taking the following points into consideration :

(a) Depreciation @10% p.a. on Furniture and Fixture is to be provided.

(b) 10% Reserve for Bad Debt is to be created.

Answer :

Dr. **Profit and Loss Account** *for the year ended 31st December, 1998* **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Salary (1,100+100)	1,200	By	Gross Profit	10,520
”	Rent	840	”	Bank Interest	10
”	Petty Expenses	770			
”	Depreciation	100			
”	Bad Debts	50			
”	Provn. for Bad Debts on Rs. 950	95			
”	Net Profit	7,475			
		10,530			10,530

Final Accounts

Balance Sheet *as at 31st December, 1998*

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Outstanding Salary		100	Furniture & Equipments	1,000	
Capital	10,000		*Less :* Depreciation	100	900
Add : Profit for the year	7,475		Closing Stock		5,000
	17,475		Debtors	950	
Less : Drawings	3,000	14,475	*Less :* Provision for B. Debts	95	855
			Cash at Banks :		
			Current Account	7,000	
			Savings Account	300	7,300
			Cash in Hand :		
			Petty Cash	20	
			Cash (for depositing)	500	520
		14,575			14,575

Working Note :

1) Statement for finding out Gross profit (From Current Account and allied items)

Initial Deposit (Capital)	9,000	Closing Balance in Current Account	7,000
Gross Profit b/d	10,520	Last day's cash sales & credit collection	500
		Closing Stock	5,000
		Challans in hand (gross)	1,000
		Petty Cash Balance	20
		Transfers to Savings A/c (Rs.500×12)	6,000
	19,520		19,520

The Petty Expenses from Savings Accounts are found from an analysis of Savings Account

Dr. **Savings Account** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Total Deposits into Savings A/c (Rs.500×12)	6,000	By	Rent Paid (Rs.70×12)	840
			”	Salary paid (Rs.100×11)	1,100
”	Bank Interest	10	”	Drawings (Rs.250×12)	3,000
			”	Petty Exp. (Balancing figure)	770
			”	Closing Balance	300
		6,010			6,010

Question 6 :

From the following details of a partnership firm prepare Manufacturing, Trading and Profit and Loss Account and P/L Appropriation Account for the year ending 31st March, 1998, and a Balance Sheet as on 31st March, 1998.

	Dr.	*Cr.*
Opening Stock :	*Rs.*	*Rs.*
Raw Material	60,000	
Work-in-Progress	5,000	
Finished Goods	20,000	
Purchases :		
Raw Material	2,10,000	
Finished Goods	10,000	
Cash	2,000	
Factory Rent	12,000	
Office Rent, Rate and Taxes	3,000	
Factory Salary	18,000	
Office Salary	12,000	
Debtors and Creditors	78,000	56,000
Sales		3,30,000
Selling Expenses	8,000	
Interest on Loan paid	4,000	
Discount Allowed	3,000	
Discount Received		1,100
Capital and Partnership Salary (drawn) :		
Sita	6,000	68,000
Gita	3,000	30,000
Loan		50,000
Wages	30,000	
Interest on Partner's Capital (drawn) :		
Sita	500	
Gita	600	
Machinery	45,000	
Furniture	5,000	
	5,35,100	5,35,100

(a) Provide 10% depreciation on Machinery and Furniture.

(b) Loan carries 10% interest and the amount is brought forward from earlier year.

(c) Provide 6% interest on Partners' Capital.

(d) Closing Stocks are :

	Rs.
Materials	50,000
Work-in-Progress	10,000
Finished Goods	35,000

(e) Salary Outstanding as on 31st March, 1998 :

Factory	2,000	
Office		1,000

(f) Sita and Gita share profits and losses as 3:2 after charging salary @ Rs. 500 and Rs. 250 p.m. to Sita and Gita respectively.

(g) Outstanding Factory Rent Rs. 1,000.

Answer :

Dr. **Manufacturing Account** *for the year ended 31st March, 1998* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*	*Rs.*
To	Opening Stock :			By	Closing Stock :		
	Raw Materials	60,000			Raw Materials	50,000	
	Work-in-progress	5,000	65,000		Work-in-progress	10,000	60,000
To	Purchases — Raw Materials		2,10,000				
To	Wages		30,000	By	Cost of Production transferred		2,82,500
To	Factory Expenses and charges :						
	Factory Salary (18,000+2,000)		20,000				
	Factory Rent (12,000+1,000)		13,000				
	Deprn. on Machinery (10%)		4,500				
			3,42,500				3,42,500

Dr. **Trading Account** *for year ended 31st March, 1998* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*	*Rs.*
To	Opening stock of Finished Goods		20,000	By	Sales		3,30,000
To	Purchase of Finished Goods		10,000	By	Closing Stock of Finished Goods		35,000
To	Cost of Prod.-b/d from Mfg. A/c		2,82,500				
To	Balance – Gross Profit c/d		52,500				
			3,65,000				3,65,000

Dr. **Profit and Loss Account** *for the year ended 31st March, 1998* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*	*Rs.*
To	Office Salaries (12,000+1,000)		13,000	By	Balance b/d-Gross Profit		52,500
To	Office Rent, Rates and Taxes		3,000	By	Discount Received		1,100
To	Selling Expenses		8,000				
To	Discount Allowed		3,000				
To	Interest on loan : 10% of Rs.50,000		5,000				
To	Depreciation on Furniture 10%		500				
To	Balance-Net Profit c/d		21,100				
			53,600				53,600

Dr. **Profit & Loss Appropriation Account** *for the year ended 31st March, 1998* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*	*Rs.*
To	Interest of Capital :			By	Balance b/d - Net Profit		21,100
	Sita	4,080					
	Gita	1,800	5,880				
To	Partner's Salary :						
	Sita	6,000					
	Gita	3,000	9,000				
To	Share of Profit :						
	Sita (3)	3,732					
	Gita (2)	2,488	6,220				
			21,100				21,100

Balance Sheet *as at 31st March, 1998*

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
Capital Accounts :			Machinery	45,000	
Sita :	68,000		*Less :* Depreciation	4,500	40,500
Add : Salary	6,000		Furniture	5,000	
Interest on Capital	4,080		*Less :* Depreciation	500	4,500
Share of Profit	3,732		Stock :		
		81,812	Finished Goods		35,000
Less : Drawings (6000+500)	6,500	75,312	Raw Materials		50,000
Gita :	30,000		Work-in-Progress		10,000
Add : Salary	3,000		Debtors		78,000
Interest on Capital	1,800		Cash		2,000
Share of profit	2,488				
	37,288				
Less : Drawings (3000+600)	3,600	33,688			

Loan		50,000		
Sundry Creditors		56,000		
Liabilities for Expenses :				
Salaries	3,000			
Interest on Loan (5000–4000)	1,000			
Factory Rent	1,000	5,000		
		2,20,000		2,20,000

Question 7 :

Arvind operates a warehouse selling wall papers direct to the public on a strictly cash basis. On Ist April 1999, a serious fire at his premises destroyed or damaged all his stock and most of his accounting and stock records. He has asked you to calculate the cost of stocks so that he can make an insurance claim. He has also asked you to establish whether he has trading profitability in the period from 1st October 1998 to the date of fire, so that he can decide whether to start trading again in this line.

You obtain the following information in connection with his trading activities:

(1) Arvind obtains supplies of wall papers from two companies only Tee Ltd. and Dee Ltd. Both the companies supply Arvind with goods at recommended retail price(R.R.P.) less 331/3%. A cash discount of 10% is given on this net price for payment within two weeks, which Arvind always takes.

(2) Both suppliers give an extra bulk rebate based on the value of goods purchased over the winter months from Ist October to 31st March. The rebate from Tee Ltd. amount to 5% R.R.P. for goods purchased excluding the first Rs. 25,000 in the winter months. Dee Ltd. gives a rebate of 8% on R.R.P. for goods purchased excluding the first Rs. 37,500 in those months.

(3) The bulk rebate for the six months to 31st March 1999 was received in April 1999 and amounted to Rs. 4,100 in respect of purchases from Tee Ltd. and Rs. 3,800 in respect of purchases from Dee Ltd.

(4) Arvind sells all goods at a price which gives a gross profit equal to 25% of the cost of goods, before deducting either the cash discount or the bulk rebate.

(5) General expenses paid out of cash sales prior to banking are estimated at the following monthly amounts :–

	Rs.
Wages & salaries	1,470
Motor expenses	218
Sundry expenses	105
Drawings by Arvind	150

(6) Information obtained from paid cheques and bank statements showed bank deposits from sale of Rs. 1,62,362, general overheads of Rs. 27,452 and two quarterly rent payments of Rs. 1,500 each.

(7) Fixtures which cost Rs. 8,000 and vehicles which cost Rs. 7,600 are to be depreciated at the rate of 15% and 25 % per annum respectively.

(8) In January 1999 Arvind used wall paper which cost before deducting either the bulk rebate or the cash discount Rs. 180 in decorating his own house.

(9) The stock held by Arvind on 30th September 1998 had a cost before deduction of any rebates or discounts of Rs. 56,807.

You are required to :–

(a) calculate the cost before deduction of any rebate or discounts of Arvind's stock on 31.3.99.

(b) prepare a trading and profit and loss account for the six months to 31.3.1999.

Answer :

In the books of ARVIND

Dr. Trading and profit and loss account for the period ended 31.03.99 Cr.

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Opening stock		56,807	By Sales (W.N.1)		1,74,020
To Purchases		1,28,000	By Goods taken by proprietor		180
To Gross profit (20% on sales)		34,804	By Closing stock (bal. fig.)		45,411
		2,19,611			2,19,611
To Wages & salaries (1,470×6)		8,820	By Gross profit b/d		34,804
To Motor expenses (218×6)		1,308	By Discount received (1,28,000×10%)		12,800
To Sundry expenses (105×6)		630	By Bulk rebate		
To General overhead		27,452	Tee Ltd.	4,100	
To Rent (1,500×2)		3,000	Dee Ltd.	3,800	7,900
To Depreciation					
Fixtures	600				
Vehicles	950	1,550			
To Net Profit c/d		12,744			
		55,504			55,504

Working Notes : Calculation of purchases —

	Tee Ltd.	**Dee Ltd.**
	Rs.	*Rs.*
Bulk rebate	4,100	3,800
Rebate rate (on M.R.P.)	5%	8%
Bulk purchase	82,000	47,500
Basic purchase	25,000	37,500
Total purchase	1,07,000	85,000

	Rs.
Total purchases at R.R.P.—	1,92,000
Less : Trade discount (1/3)	64,000
Purchase cost	1,28,000
Cash Sales —	
Amount deposited in the bank	1,62,362
Wages & salaries	8,820
Motor car expenses	1,308
Sundry expenses	630
Drawings	900
	1,74,020

Question 8 :

On 30th November 1999 the balance sheet of Colourful & Co., a firm, is as under :–

		Rs.		*Rs.*
Creditors		60,000	Cash/bank	50,000
Reserves		40,000	Customers	40,00,000
Capitals:			Inventories	2,50,000
Green	12,00,000		Fixed assets WDV	2,00,000
Yellow	12,00,000		Investments at cost	
Blue Ltd.	25,00,000	49,00,000	(market value Rs.15,00,000)	5,00,000
		50,00,000		50,00,000

Green, Yellow and Blue Ltd. shared profit and losses in the ratio of 1:1:2.

On 1st December 1999 Green and Yellow retired and Blue Ltd. continued the business.

Blue Ltd. paid Rs. 18,00,000 to Green and Rs. 18,00,000 to Yellow in full and final discharge of their claim in the partnership. This amount was brought in by Blue Ltd. for the purpose of payment to the retiring partners. None of the asset and liabilities are to be revalued.

You are asked to :

(a) pass accounting entries in relation to the above in the books of the business unit.

(b) prepare the balance sheet of the business unit after the above transactions are recorded.

Answer :

Entries in the books of the Business Unit

Date	Particulars		Dr. *(Rs.)*	Cr. *(Rs.)*
Dec. 1	Bank A/c	Dr.	36,00,000	
1999	To Blue Ltd.'s Capital A/c			36,00,000
	(Being capital brought in by Blue Ltd. for payment to Green and Yellow.)			
	Green's Capital A/c	Dr.	18,00,000	
	Yellow's Capital A/c	Dr.	18,00,000	
	To Bank A/c			36,00,000
	(Being capitals paid off on retirement.)			
	Blue Ltd.'s Capital A/c	Dr.	12,00,000	
	To Green's Capital A/c			6,00,000
	To Yellow's Capital A/c			6,00,000
	(Being purchase by Blue Ltd. of shares of goodwill, unrecorded increase in value of assets and reserves from Green and Yellow on their retirement.)			

Balance sheet of Business Unit after retirement of Green and Yellow *(Rs.'000)*

Liabilities			*Assets*		
Net worth being excess of assets over liabilities comprising of			Fixed assets W.D.V.		200
Blue Ltd.'s capital contribution	4900		Investment at cost		500
			(Market value Rs. 15,00,000)		
Reserves	40	4940	Current assets		
Current liabilities :			Inventories	250	
Creditors		60	Customers dues	4000	
			Cash/bank	50	4300
		5000			5000

Question 9 :

Ashoka Ltd. was incorporated on l. l. 1999 with an authorised capital of Rs. 25 crores. The subscribers to the memorandum and articles of association subscribed for 1000 equity shares of Rs. 10 each. The promoters and well wishers subscribed and paid for Rs. 4,99,000 equity shares of Rs. 10 each. The company took over running business of Magadha Bros. and allotted 15,00,000 equity shares of Rs. 10 each at par. The company made a public issue of 80,00,000 equity shares of Rs. 10 each at par, Rs. 5 being payable on application, Rs. 3 on allotment and Rs. 2 on call. Application monies were receivable by 28.2.1999, allotment was made on 31.3.1999, allotment moneys were due by 30.4.99, first call was made on 31.5.1999; first call was due by 30.6.1999.

Public applied for in full. Allotment monies were received from all members except holders of 500 shares. Call monies were received from all members except holders of 800 shares (including those who had not paid allotment monies).

Alter due notice, the 800 shares were forfeited on 30.9.1999. They were reissued on 31.10.1999 at Rs. 11 per share.

Your are asked to:

(a) record all the above transactions through the journal of Ashoka Ltd.

(b) show the presentation in the balance sheet as on 30.11.1999 of the company.

Answer :

JOURNAL ENTRIES *(in Rs. '000)*

Particulars		*Dr.*	*Cr.*
Bank A/c	Dr.	10	
To Equity Share Capital A/c			10
(Being cheques received from the subscribers to the memorandum and articles of association in respect of 1000 equity shares no. 1 to 1000 agreed to be taken by them)			
Bank A/c	Dr.	4990	
To Equity Share Capital A/c			4990
(Being application money received from promoters and well wishers)			
Equity Share Application A/c	Dr.	4990	
To Equity Shares Capital A/c			4990
(Being allotment at par of 499000 equity shares vide board resolution dtd. ....)			

	Business Purchases A/c	Dr.	15000	
	To Equity Share Capital A/c			15000
	(Being allotment at par of 15,00,000 equity shares to Magadha Bros. on take over to their business vide board resolution dtd. ....)			
Feb. 28	Bank A/c	Dr.	40000	
	To Equity Share Application A/c			40000
	(Being application monies at Rs. 5 per share received from applicants for 80,00,000 equity shares as per details in the application and allotment register.)			
Mar. 31	Equity Share Aplication A/c	Dr.	40000	
	Equity Share Allotment A/c	Dr.	24000	
	To Equity Share Capital A/c			64000
	(Being allotment of 80,00,000 equity shares and recording of allotment money due at Rs. 3 per share vide board resolution dtd. 31.03.1999)			
Apr. 30	Bank A/c	Dr.	23998.5	
	To Equity Share Allotment A/c			23998.5
	(Being allotment moneys received from members except those owning 1500 shares)			
May 31	Equity Share First Call A/c	Dr.	16000	
	To Equity Share Capital A/c			16000
	(Being first call at Rs. 2 per share made from members holding 80,00,000 equity shares vide board resolution dtd. May, 31, 1999)			
Sept. 30	Equity Share Capital A/c	Dr.	8.0	
	To Equity Share Allotment A/c			1.5
	To Equity Share First call A/c			1.6
	To Forfeited Shares A/c			4.9
	(Being forfeiture of 800 shares for nonpayment of allotment & call monies as per details given : 500 shares for nonpayment of allotment, call 300 shares for nonpayment of call vide res. dtd. 30.9.99)			

Oct. 31	Bank A/c	Dr.	8.8	
	Forfeited Shares A/c	Dr.	4.9	
	To Equity Share Capital A/c			8.0
	To Capital Reserve A/c			5.7
	(Being allotment on reissue of 800 equity shares no. ... on receipt of Rs. 11 per share, vide board resolution dated dt.31.10. 1999)			

Extracts from Balance Sheet as at 30.11.1999 *(Rs. in crores)*

Share Capital :		
Authorised	25.00	
Issued and subscribed :		
For cash : 85,00,000 equity shares of Rs. 10 each fully paid	8.50	
For consideration other than cash :		
15,00,000 equity shares of Rs. 10 each fully paid on purchase of business	1.50	10.00
Reserves and surplus :		
Capital reserve (Rs. 5,700)		0.00

Question 10 :

King, Queen and Jack are sharing profits and losses in the ratio of 3 : 2 : 1. They are also entitled to interest on loan at 10% p.a., but not interest on capital.

The partners decided to dissolve the firm on 31.03.2000. Balance Sheet was drawn up to 31.12.1999 which is reproduced below :

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital of King	1,68,000	Building	2,10,000
Queen	1,15,500	Furniture	35,000
King's loan	77,000	Motor cycle	1,40,000
Sundry creditors	2,80,000	Stock	1,92,500
Bank overdraft	1,05,000	Sundry debtors	1,40,000
		Jack's Capital A/c	28,000
	7,45,500		7,45,500

Between the balance sheet date and the date of dissolution purchases amounted to Rs. 1,05,000 and sales Rs. 1,57,500. In addition to payments made to creditors, a sum of Rs. 42,000 and Rs. 21,000 were paid on account of salaries and general expenses.

Each partner withdrew Rs. 2,800 per month. On 31.03.2000 debtors, creditors and stock amounted to Rs. 2,10,000, Rs. 2,45,000 and Rs. 1,57,500 respectively.

In course of proceedings the partners decided to transfer the entire business to a private limited company with all assets, liabilities and partners loan for a consideration of Rs. 3,15,000. Dissolution expenses amounted to Rs. 9,800 was borne by King.

You are advised to present the Balance Sheet as at 31.03.2000 along with necessary ledger accounts of the firm viz. KQJ & Co.

Answer :

Dr. Sundry Debtors A/c Cr.

	Particulars	*Rs.*		*Particulars*	*Rs..*
To	Balance b/d	1,40,000	By	Bank	87,500
	Sales	1,57,500		(balancing figure)	
				Balance c/d	2,10,000
		2,97,500			2,97,500

Dr. Sundry Creditors A/c Cr.

	Particulars	*Rs.*		*Particulars*	*Rs..*
To	Bank	1,40,000	By	Balance	2,80,000
	(balancing figure)				
	Balance c/d	2,45,000		Purchase	1,05,000
		3,85,000			3,85,000

Dr. Bank A/c Cr.

	Particulars	*Rs.*		*Particulars*	*Rs..*
To	Sundry Debtors	87,500	By	Balance b/d	1,05,000
	Balance c/d	2,45,700		Sundry Creditors	1,40,000
				Salaries	42,000
				General expense	21,000
				Drawings	25,200
		3,33,200			3,33,200

Dr. Profit and Loss A/c Cr.

	Particulars	*Rs.*		*Particulars*	*Rs..*
To	Opening Stock	1,92,500	By	Sales	1,57,500
	Purchases	1,05,000		Closing stock	1,57,50C
	Salaries	42,000		Balance c/d	45,500
	General expenses	21,000			
		3,60,000			3,60,50C

Final Accounts

To	Balance c/d	45,500	By	Net loss :	
	Interest on loan	1,925		King	23,712
				Queen	15,808
				Jack	7,905
		47,425			47,425

Note : Profit on realisation		*Rs.*
Total consideration		3,15,000
Less : Net assets	1,35,888	
	91,292	
	2,27,180	
	– 44,305	1,82,875
		1,32,125
Less : Realisation expenses		9,800
		1,22,325

Dr. Partners' Capital Accounts Cr.

	King *Rs.*	*Queen* *Rs.*	*Jack* *Rs.*		*King* *Rs.*	*Queen* *Rs.*	*Jack* *Rs.*
To Balance c/d	—	—	28,000	By Balance b/d	1,68,000	1,15,000	—
Profit & Loss A/c (share of loss)	23,712	15,808	7,904	Balance c/d	—	—	44,305
Drawings	8,400	8,400	8,400				
Balance c/d	1,35,888	91,292	—				
	1,68,000	1,15,500	44,305		1,68,000	1,15,000	44,305

KQJ & Co.

Balance Sheet *as at 31-03-2000*

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital A/cs :			Building	2,10,000
King	1,35,888		Furniture	35,000
Queen	91,292	2,27,180	Motorcycle	1,40,000
Sundry Creditors		2,45,000	Stock-in-trade	1,57,500
Bank overdraft		2,45,700	Sundry Debtors	2,10,000
King's loan A/c	77,000		Capital A/c :	
Add : Interest on loan	1,925	78,925	Jack	44,305
		7,96,805		7,96,805

Question 11 :

From the information supplied below by Vinay Ventures, prepare Profit and Loss Account for the year ended 31-12-1999 and a Balance Sheet as on the date:

	1-1-1999	31-12-1999
Sundry Fixed Assets	1,80,000	2,00,000
Stock-in-hand	1,40,000	1,90,000
Cash in hand	82,000	48,000
Cash at Bank	22,000	80,000
Sundry Debtors	?	2,60,000
Sundry Creditors	1,20,000	98,000
Outstanding Expenses	10,000	6,000

During the year the following transactions took place:

		Rs.
(1)	Collection from Debtors and discount allowed to them	24,50,000
(2)	Return Inward	60,000
(3)	Bad Debts	10,000
(4)	Sales (cash and credit)	30,00,000
(5)	Return outward	30,000
(6)	Paid to suppliers by cheque	23,62,000
(7)	Collection from debtors and deposited into the bank	24,30,000
(8)	Cash Purchases	1,00,000
(9)	Salaries and wages paid by cheque	1,80,000
(10)	Miscellaneous cash expenses	50,000
(11)	Drawings in cash	94,000
(12)	Assets purchased by cheque	20,000
(13)	Cash withdrawals from bank	2,10,000
(14)	Cash sales deposited into bank	?
(15)	Discount received	40,000

Answer :

In the Books of Vinay Ventures Limited.

Trading and Profit and Loss Account for the period ended on 31.12.1999

	Particulars	*Amount*	*Amount*		*Particulars*	*Amount*	Amount
To	Opening stock.		1,40,000	By	Sales		
”	Purchases :				Cash	4,00,000	
	Cash	1,00,000			Credit	26,00,000	
	Credit	24,10,000				30,00,000	
		25,10,000			Less : Return		
	Less : Return				Inwards	60,000	29,40,000
	outward.	30,000	24,80,000	By	Closing stock.		1,90,000
”	Salary & Wages.		1,80,000				
”	Misc. expenses.		46,000	By	discount received		40,000
	(50000 + 6000 - 10000)						
”	Discount allowed.		20,000				
”	Bad debt.		10,000				
”	Net Profit transferred to Capital A/c.		2,94,000				.
			31,70,000				31,70,000

Balance Sheet as on 31.12.1999

Liabilities	*Amount*	*Amount*	*Assets*	*Amount*	*Amount*
Capital Account :			Sundry assets		2,00,000
Opening balance.	4,74,000		(180000+20000)		
Add: Net Profit	2,94,000		Stock in trade		1,90,000
	7,68,000		Sundry debtors		2,60,000
Less : Drawings.	94,000	6,74,000	Cash at Bank		80,000
Sundry creditors		98,000	Cash in hand		48,000
Outstanding expenses		6,000			.
		7,78,000			7,78,000

Opening Balance Sheet

Liabilities	*Amount*	*Amount*	*Assets*	*Amount*	Amount
Sundry Creditors		1,20,000	Sundry Assets		1,80,000
Outstanding expenses		10,000	Sundry debtors		1,80,000
Capital Account (balancing			Stock in trade		1,40,000
figure)		4,74,000	Rent		22,000
			Cash in hand		82,000
		6,04,000			6,04,000

Sundry Debtors Account

	Particulars	*Amount*		*Particulars.*	Amount
To	Balance b/d. balancing figure	1,80,000	By	Bank	24,30,000
			By	Discount allowed	20,000
To	Credit sales.	26,00,000	By	Return inward	60,000
			By	Bad debt	10,000
			By	Balance b/d	2,60,000
		27,80,000			2 7,80,000

Sundry Creditors Account

	Particulars	*Amount*		*Particulars.*	Amount
To	Bank	23,62,000	By	Balance b/d	1,20,000
”	Discount	40,000	By	Credit purchases (balancing fig)	24,10,000
”	Returns	30,000			
”	Balance c/d.	98,000			.
		25,30,000			25,30,000

Cash & Bank Account

	Particulars	*Amount*	*Amount*		*Particulars*	*Amount*	*Amount*
To	Balance b/d.	82,000	22,000	By	Sundry creditors		23,62,000
To	Sundry Debtors		24,30,000	By	Purchases	1,00,000	
To	Cash sales (balancing figure)		4,00,000	By	Salary & Wages		1,80,000
				By	Misc. exp.	50,000	
To	Bank.	2,10,000		By	Drawings	94,000	
				By	Cash.		2,10,000
				By	Fixed Assets.		20,000
				By	Balance B/D.	48,000	80,000
		2,92,000	28,52,000			2,92,000	28,52,000

Question 12 :

Jamnadas furnishes you with the following trial balance as on 31st May, 2001:

	Dr. *Rs.*	Cr. *Rs.*
Stock on 31.5.2000 (at cost)	35,000	—
Depreciation	5,000	—
Provision for depreciation	—	40,000
Fixed assets (at cost)	50,000	—
Profit/loss on sale of fixed assets	8,000	—
Investments at cost	1,25,000	—
Profit/loss on sale of investments	—	80,000
Sale (at 20% gross profit margin)	—	8,00,000

Purchases	7,50,000	—
Balances in customers' accounts	1,00,000	20,000
Balances in suppliers' accounts	5,000	60,000
Expenses	42,000	—
Discount	18,000	12,000
Commission	50,000	80,000
Amounts due to principals	—	8,000
Amounts due from consignees	75,000	—
Deposits with consignors	1,00,000	—
Deposits from consignees	—	1,50,000
Cash	7,000	—
Income on investments	—	5,000
Interest on deposits:		
with consignors	—	12,000
from consignees	18,000	—
Prepaid/outstanding expenses:		
as on 31.5.2000	7,000	13,000
as on 31.5.2001	9,000	6,000
Fixed deposits with bank	2,00,000	—
Interest on bank fixed deposit	—	20,000
Drawing/Capital	60,000	3,00,000
Bank	—	58,000
	Rs. 16,64,000	16,64,000

You find that the cost of fixed assets sold was Rs. 30,000, the accumulated depreciation up to the date of sale was Rs. 9,000.

Jamnadas asks you to :

(a) Show the following ledger accounts for the year ended 31st May, 2001:

- (i) provision for depreciation
- (ii) expenses
- (iii) trading account
- (iv) profit and loss account
- (v) capital account

(b) Prepare the balance sheet as on 31st May, 2001.

Answer (a) :

In the Ledger book of JAMNADAS

Dr. **Provision for Depreciation A/c** **Cr.**

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
31.5.01	To Assets sold A/c	9,000	1.6.00	By Balance b/d	44,000
31.5.01	To Balance c/f	40,000	31.5.01	By Depreciation A/c	5,000
		49,000			49,000

Opening balance is the balancing figure

Dr. **Expenses A/c** **Cr.**

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
1.6.00	To Prepaid A/c	7,000	1.6.00	By Outstanding liabilities A/c	13,000
"	To Cash/Bank A/c	45,000	31.5.01	By Prepaid A/c	9,000
31.5.01	By Outstanding liability A/c	6,000	31.5.01	By Profit & Loss A/c	36,000
		58,000			58,000

Cash/Bank A/c is the balancing figure.

JAMNADAS

Dr. **Trading Account** *for the year ended 31st May 2001* **Cr.**

P.Y.	*Particulars*	*Amount (Rs.)*	*P.Y.*	*Particulars*	*Amount (Rs.)*
	To Opening stock	35,000		By Sales	8,00,000
	To Purchases	7,50,000			
	To Gross profit Transferred to P & L A/c	1,60,000		By Closing stock	1,45,000
		9,45,000			9,45,000

Dr. **Profit & Loss Account** *for the year ended 31st May 2001* **Cr.**

P.Y.	*Particulars*	*Amount (Rs.)*	*P.Y.*	*Particulars*	*Amount (Rs.)*
	To Expenses	36,000		By Gross Profit b/d	1,60,000
	To Discount	18,000		By Discount	12,000
	To Interest	18,000		By Commission	80,000
	To Loss on sale of fixed assets	8,000		By Interest	
	To Commission	50,000		(i) On deposit	12,000
				(ii) From bank	20,000
	To Depreciation	5,000		By Income form investment	5,000
	To Net profit transferred to Capital A/c	2,34,000		By Profit on sale of investment	80,000
		3,69,000			3,69,000

Dr.		Capital A/c				Cr.
Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*		*Amount (Rs.)*
31.5.00	To Drawings A/c	60,000	1-6-00	By Balance		3,00,000
31.5.01	To Balance c/d	4,74,000	31.5.01	By Profit & Loss A/c		2,34,000
		5,34,000				5,34,000

Answer (b) :

Jamandas

Balance Sheet ***as at 31st May 2001***

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital A/c					
Balance as per last A/c		3,00,000	Fixed Assets :		
Add : Profit for the year		2,34,000	At cost		
		5,34,000	As per last A/c	80,000	
Less : Drawings		60,000	*Less :* Cost of assets sold	30,000	50,000
		4,74,000	*Less :* Depreciation		
			As per last A/c	44,000	
			Less : For assets sold	9,000	
					35,000
Bank overdraft		58,000	*Add :* For the year	5,000	40,000
Advances from consignees		1,50,000			10,000
Sundry Creditors		94,000	Investments (At cost)		1,25,000
For goods	60,000		Current Assets		
For expenses	6,000		Stock (At cost)	1,45,000	
For others -			Cash-in-hand	7,000	
Principals	8,000		Fixed deposit with bank	2,00,000	
Customers	20,000		— Customers	1,00,000	4,52,000
		94,000	Loans & Advances		
			Amount due from		
			Consignees	75,000	
			Suppliers	5,000	80,000
			Deposit with consignors		1,00,000
			Prepaid expenses		9,000
		7,76,000			7,76,000

Question 13 :

Vijay Stores submits you with the following information:

		2001 *(Rs.)*	2000 *(Rs.)*
(a)	Assets as on 31st May		
	Cash	4,000	5,000
	Dues from customers	60,000	50,000
	Prepaid expenses	5,000	3,000
	Stock at cost	40,000	35,000
	Bank balance (as per pass book)	15,000	20,000
	Fixed assets (cost as on 1.6.1996)	75,000	75,000
(b)	Liabilities as on 31st May		
	Suppliers of goods	37,000	43,000
	Loan from Desouza	—	25,000
	Outstanding expenses	3,000	2,000
(c)	On checking the bank pass book, you find that:		
	(i) cheques received from customers on or before 31st May, but realised after 31st May, were	55,000	45,000
	(ii) cheques issued by 31st May, but presented for payment to the bank after 31st May, were	23,000	27,000

(d) During the year ended 31st May, you find that:

		2000-2001 *Rs.*	*1999-2000* *Rs.*
(i)	cash withdrawn from bank amounted to	1,50,000	1,35,000
	of which cash taken for personal use was	1,00,000	90,000
(ii)	cash deposited in bank out of collection from customers — cash sales	60,000	55,000
(iii)	cash & cheques deposited in bank— collections from credit customers	4,50,000	4,00,000
(iv)	cheques issued to suppliers amounted to	3,00,000	2.80.000
(v)	cheques issued for expenses	25,000	30,000
(vi)	discount allowed to customers	7,000	6,000
(vii)	discount allowed by suppliers	8,000	5,000
(viii)	cost of goods taken for personal use from stock	6,000	4,000

(e) The cost of fixed assets was to be written off over 10-year period under straight line method.

(f) Vijay Stores donated to Gujarat Earthquake Relief Fund by cheque Rs. 26,000.

(g) Payment made to Desouza out of personal funds was Rs. 29,500 against Rs. 4,500 similarly paid in 1999-2000.

Vijay Stores asks you to prepare:

Either,

(i) Statement of affairs as on 31st May, 2000 -2001, and

(ii) Statement of profit or loss during the year ended 31st May, 2001.

Or,

(iii) Trading and profit and loss account for the year ended 31st May, 2001, and

(iv) Balance sheet as on 31st May, 2001

Show your working.

Answer :

Working Notes.

1. Computation of Depreciation.

Cost of Fixed Asset	Rs. 75,000
Date of purchase	1.6.1996
Depreciation Method	Straight line
Useful Life	10 years
Rate of Depreciation	10%
Amount of Depreciation	Rs. 7,500
Accumulated Depreciation upto 31.5.2000 = (Rs. 7500)×4 =	Rs. 30,000
Deprn. for the F.Y.2000-20001	Rs. 7,500
Accumulated Deprn. upto 31.5.2001	Rs. 37,500

2. Bank Reconciliation Statement

	For the year ended	
	31.5.2001	*31.5.2000*
Balance as per Pass Book	15,000	20,000
Add: Cheques deposited but not credited by bank	55,000	45,000
	70,000	65,000
Less : Cheques issued but not presented for payment	23,000	27,000
Balance as per Book	47,000	38,000

Alternative (i) :

Vijay Stores

Statement of Affairs as on 31st May 2001

	Current Year		Previous Year	
	Rs.	*Rs.*	*Rs.*	*Rs.*
Assets owned :				
Cash		4,000		5,000
Bank		47,000		38,000
Debtors		60,000		50,000
Prepaid Expenses		5,000		3,000
Stock at cost		40,000		35,000
Fixed Assets —				
At cost	75,000		75,000	
Less: Accumulated Deprn.	37,500	37,500	30,000	45,000
Total (A)		1,93,500		1,76,000
Less : Liabilities owed – Loan from De Souza		—		25,000
Creditors				
for goods	37,000		43,000	
for Expenses	3,000	40,000	2,000	45,000
Total (B)		40,000		70,000
Capital (A) – (B)		1,53,500		1,06,000

(b) Statement of Profit/Loss for the year ended 31.05.2001

Capital at the end of the year			Rs. 1,53,500
Add: Drawings during the year			
	Cheque	1,00,000	
	Goods	6,000	1,06,000
			2,59,500
Less:	Business Liabilities paid out of personal funds :		
	Loan from Desouza	25,000	
	Interest thereon	4,500	29,500
			2,30,000
Deduct: Capital at the			
	commencement of the year		1,06,000
Profit earned during the year			1,24,000

Alternative (ii) :

Working Note No. 1 :

Cash and Bank Abstract.

	Particulars	*Cash*	*Bank*		*Particulars*	*Cash*	*Bank*
To	Opening Balance	5,000	38,000	By	Drawings	—	1,00,000
To	Bank (contra)	50,000		By	Cash (contra)		50,000
To	Cash sales	60,000		By	Bank (contra)	60,000	
To	Cash (contra)		60,000	By	Creditors		3,00,000
To	Debtors		4,50,000	By	Expenses	51,000	25,000
				By	Donation	—	26,000
				By	Closing balance	4,000	47,000
		1,15,000	5,48,000			1,15,000	5,48,000

Working Note No. 2 :

Dr. **Expenses A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Prepaid A/c	3,000	By	Outstanding expenses	2,000
To	Cash	51,000	By	Closing Prepaid	5,000
To	Bank	25,000	By	Profit & Loss A/c	75,000
To	Outstanding expenses	3,000			
		82,000			82,000

Working Note No. 3 :

Dr. **Sundry Debtors A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Balance	50,000	By	Bank	4,50,000
To	Sales	4,67,000	By	Discount	7,000
			By	Closing balance	60,000
		5,17,000			5,17,000

Working Note No. 4 :

Dr. **Sundry Creditors A/c** **Cr.**

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Bank	3,00,000	By	Opening balance	43,000
To	Discount Recd.	8,000	By	Purchase A/c	3,02,000
To	Balance (Closing)	37,000			
		3,45,000			3,45,000

Alternative (iii) :

Vijay Stores

Trading and Profit & Loss A/c *for the year ended 31st May 2001*

	Particulars	*Rs.*		*Particulars*		*Rs.*
To	Opening Stock	35,000	By	Sales		
To	Purchases	3,02,000		Cash	60,000	
To	Gross Profit c/d	2,36,000		Credit	4,67,000	5,27,000
			By	Capital A/c – cost of goods withdrawn		6,000
			By	Closing stock		40,000
		5,73,000				5,73,000
To	Expenses	75,000	By	Gross Profit b/d		2,36,000
To	Discount	7,000	By	Discount earned		8,000
To	Interest	4,500				
To	Depreciation	7,500				
To	Donation	26,000				
To	Net profit for the year transferred to Capital A/c	1,24,000				
		2,44,000				2,44,000

Alternative (iv) :

Vijay Stores

Balance Sheet *as at 31st May 2001*

Capital & Liabilities	*Rs.*	*Rs.*	*Property & Assets*	*Rs.*	*Rs.*
Capital A/c			Fixed Assets		
As per last A/c		1,06,000	As cost	75,000	
Add : 1) Amt. introduced		29,500	*Less :* Deprn. to date	37,500	37,500
2) Net profit		1,24,000	Stock		40,000
		2,59,500			
Less : Drawings			Sundry debtors		60,000
Cheque	1,00,000		Prepaid expenses		5,000
Goods	6,000	1,06,000	Cash-in-hand		4,000
		1,53,500	Cash-at-bank		47,000
Sundry Creditors					
For goods	37,000				
For expenses	3,000	40,000			.
		1,93,500			1,93,500

Question 14 :

Bhola submits the following trial balance as on 31st May, 2001:

	Dr.*(Rs.)*	Cr. *(Rs.)*
Capital: Opening	—	3,00,000
Drawings	60,000	—
Fixed assets—WDV— Opening	70,000	—
Fixed assets — purchased during the year	50,000	—
Stock on Ist June, 2000	30,000	—
Purchase	8,00,000	—
Purchase returns	—	35,000
Sales	—	9,00,000
Sales returns	50,000	—
Customers dues	1.25,000	—
Creditors for :		
Fixed assets purchased	—	10,000
Goods purchased	—	1,00,000
Expenses	25,000	—
Fixed deposit with bank	1,00,000	—
Interest on bank fixed deposit	—	10,000
Cash	—	4,000
Bank balance in current account	50,000	—
Suspense (difference in trial balance)	—	1,000
	Rs. 13,60,000	13,60,000

Bhola informs you that:

(a) Stock on 31.5.2001 is worth Rs.60,000 at sales price and Rs.50,000 at cost price.

(b) Depreciation of Rs. 9,000 is to be provided for the year.

Bhola asks you to check up his books and pass necessary entries to correct the mistakes (if any).

On your checking you find that :–

(i) A sum of Rs. 10,000 drawn from the bank on 1.1.2001 was debited to drawings account in full although Rs. 6,000 out of the said withdrawal was used in the business for meeting day to day expenses and payment, which were also entered in the cash book..

(ii) Purchases of goods worth Rs. 8,000 made on 28th May, 2001 was not recorded in the books; although the sale thereof on 30th May, 2001 at Rs. 9,000 was properly recorded.

(iii) Purchase returns of Rs. 500 was recorded through sales returns journal. However the posting to the Party's account in the ledger was for the correct amount and on the correct side.

(iv) Expenses paid include Rs. 3,000 in respect of period after 31st May, 2001.

Bhola wants you to prepare his final accounts for the year ended 31st May. 2001.

Answer :

Note : Entries passed in the books in respect of Item Nos. (i) and (iii)

Re: ***Item No. (i)***

Cash	Dr.	10,000	
To Bank			10,000
Drawings	Dr.	10,000	
Expenses	Dr.	6,000	
To Cash			16,000

Thus there was a negative cash balance of Rs. 6,000

Re: ***Item No. (iii)***

In this case purchase returns were passed through sales return. The effect of this was instead of crediting the Purchase Returns the same was debited to Sales Return. In the result there was a difference of Rs. 1000 which was shown in the trial balance under the head Suspense A/c.

Rectification Entries to be passed

Re: **Item No. (1)**			
Cash	Dr.	6000	
To Drawings			6000
(Being rectification of debit given on 01-01-2001 to Drawings A/c as it is overstated by Rs. 6000, actual drawing being Rs. 4000)			
Re: **Item No. 2**			
Purchase	Dr.	8000	
To Suppliers			8000
(Being the passed to record the purchase on 28.5.2001)			
Re: **Item No. 3**			
Suspense	Dr.	1000	
To Purchase Returns			500
To Sales Returns			500
(Being rectification of Purchase Return wrongly entered in the Sales Return Day Book)			
Re: Item **No. 4**			
Prepaid Expenses	Dr.	3000	
To Expenses			3000
(Being prepaid expenses wrongly debited to expenses A/c)			

Working Note No. 2 : Effect of Entries in the Final A/cs

		As per Trial Balance		*Adjustment*		*Adjusted figures*	
1.	Drawings	Dr	Rs.10,000	Cr	6,000	Dr	4,000
2.	Cash	Cr	4,000	Dr	6,000	Dr	2,000
3.	Purchase	Dr	8,00,000	Dr	8,000	Dr	8,08,000
4.	Suppliers	Cr	1,00,000	Cr	8,000	Cr	1,08,000
5.	Purchase Returns	Cr	35,000	Cr	500	Cr	35,500
6.	Sales Returns	Dr	50,000	Cr	500	Dr	49,500
7.	Suspense	Cr	1,000	Dr	1,000		—
8.	Expenses	Dr	25,000	Cr	3,000	Dr	22,000
9.	Prepaid Expenses	Dr	—	Dr	3,000	Dr	3,000

Bhola

Trading and Profit & Loss Account *for the year ended 31.05.2001*

To	Opening Stock		30,000	By	Sales	9,00,000	
To	Purchase	8,08,000			*Less:* Returns	49,500	8,50,500
	Less: Returns	35,500	7,72,500	By	Closing Stock		50,000
To	Gross Profit c/d		98,000				
	Total		9,00,500		Total		9,00,500
To	Expenses		22,000	By	Gross Profit b/d		98,000
To	Depreciation		9,000	By	Interest on Bank Deposit		10,000
To	Net Profit transferred to Capital A/c		77,000				
			1,08,000				1,08,000

BHOLA

Balance Sheet *as at 31st May, 2001*

Sundry Creditors		1,18,000	Cash		2,000
For Goods	1,08,000		Bank-Current A/c		50,000
For Others	10,000		Fixed Deposit with Bank		1,00,000
	1,18,000		Stock (At Cost)		50,000
			Sundry Debtors		1,25,000
			Prepaid Expenses		3,000
Capital		3,23,000	Fixed Assets :		
As per Last A/c	3,00,000		Opening WDV	70,000	
Add : Profit for the year	77,000		Addition during the year	50,000	
	3,77,000			1,20,000	
Less: Drawings	54,000		*Less: Depreciation*	9,000	1,11,000
	3,23,000				
Total		4,41,000	Total		4,41,000

Question 15 :

On 31st March, 2001 James owned

(i) a shop which had cost him Rs. 40,000;

(ii) furniture and fittings whose cost was Rs. 30,000 and on which depreciation of Rs. 28,000 was provided over the last 28 years;

(iii) a delivery van which had cost him Rs. 150,000 on which depreciation of Rs. 120,000 was provided over the last 8 years;

(iv) An inventory which cost him Rs. 13,000 and which was expected to be sold for Rs. 15,000.

As on that date :

(a) his customers owed him Rs. 40,000;

(b) his unpaid suppliers for goods amounted to Rs. 15,000;

(c) he had given advance of Rs. 8,000 to his suppliers against orders to be executed after March 31, 2001;

(d) he had received advance of Rs. 11,000 from his customers against orders to be executed after March 31, 2001;

(e) expenses already paid for the period after March, 2001 were –

 (i) insurance for the year to end on 31st January, 2002 at Rs. 600 per month,

 (ii) subscription to periodicals for the year to end on June 30, 2001 at Rs. 30 per month;

(f) expenses incurred during the year ended March 31, 2001 but not yet paid amounted to Rs. 2,000;

(g) he had Rs. 1,300 in his cash box; fixed deposit of Rs. 100,000 with Union Bank of India carrying interest at 10% per annum payable on 31st December and 31st March every year; the bank owed him Rs. 3,000 in his business cash credit account. The cash credit account had drawing power of 80% of the amount of fixed deposit;

(h) during the year ended March 31, 2001 James had withdrawn Rs. 48,000 for personal use and had earned a net profit of Rs. 63,390.

James asks you to –

(i) prepare the balance sheet as at March 31, 2001

(ii) open his accounts for the year starting on April, 2001.

Answer :

i) **James**

Balance sheet as at March 31, 2001

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.	Rs.
Sundry creditors for :			Cash and bank balances :			
Goods	15,000		Cash		1,300	
Services	2,000		Balance with union			
		17,000	Bank of India in			
			Cash credit A/c		3,000	
			Fixed deposit A/c		1,00,000	
Advance from customers		11,000				1,04,300
Capital :						
Opening balance	2,00,000		Customer's dues			40,000
Net profit	63,390		Advance to suppliers of :			
	2,63,390		Goods			8,000
Less : Drawings	48,000		Prepaid expenses : :			
		2,15,390	Insurance (600 × 10)	6,000		
			Periodicals (30 × 3)	90		
					6,090	6,090
			Inventory at cost			13,000
			Delivery van cost		1,50,000	
			Less : Provision for depreciation		1,20,000	30,000
			Furniture and fittings at cost		30,000	
			Less : Provision for depreciation		28,000	
						2,000
			Shop at cost			40,000
		243,390				2,43,390

ii) **James** Ledger for 2001-2002

Sundry creditors for goods

Date	Rs.	Date		Rs.
		1-4-2001	Opening balance	15,000

Sundry creditors for services

Date	Rs.	Date		Rs.
		1-4-2001	Opening balance	2,000

Advance from customers

Date		Rs.	Date		Rs.
			1-4-2001	Opening balance	11,000

Capital

Date		Rs.	Date		Rs.
			1-4-2001	Opening balance	215,390

Cash

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	1,300			

Union Bank of India – Cash Credit A/c

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	3,000			

Fixed deposit with Union Bank of India

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	100,000			

Customer's A/c

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	40,000			

Advance to suppliers of Goods

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	8,000			

Advance to suppliers of services of Insurance & Periodicals

Date		Rs.	Date		Rs.
1-4-2001	Opening balance				
	Insurance	6,000			
	Periodicals	90			

Inventory

Date		Rs.	Date		Rs.
1-4-2001	Opening balance	13,000			

Delivery van

Date		*Rs.*	*Date*		*Rs.*
1-4-2001	Opening balance	1,50,000			

Furniture and Fittings

Date		*Rs.*	*Date*		*Rs.*
1-4-2001	Opening balance	30,000			

Shop

Date		*Rs.*	*Date*		*Rs.*
1-4-2001	Opening balance	40,000			

Provision for depreciation on Delivery van

Date		*Rs.*	*Date*		*Rs.*
			1-4-2001	Opening balance	1,20,000

Furniture and fittings

Date		*Rs.*	*Date*		*Rs.*
			1-4-2001	Opening balance	28,000

Question 16 :

Mr. Reddy, a retired Government Officer who started business as Stationery Merchant in Pune on 1st April 1994, gives you the following balances relating to the year ending 31st March, 2002. He also acts as a selling agent of Mr. Sharma and for this he is given a commission at the rate of 10% on sales.

Trial Balance as at 31.03.2002

	Debit Balance Rs.		Credit Balance Rs.
Opening stock	80,000	Sales	7,65,000
Sundry debtors	1,75,000	Capital	1,90,000
Furniture and fittings	36,000	Purchase return	2,000
Bills receivable	40,000	Discount received	2,000
Purchases	5,20,000	Sundry creditors	73,640
Wages	5,000	Consignor's	
Salaries	25,000	balance (01.04.01)	30,000
Sales return	3,000		
Printing and advertising	12,000		
Postage	4,500		

Discount allowed	2,500		
Building rent	9,600		
Insurance	1,040		
Other trade expenses	10,000		
Cash sent to consignor	75,000		
Suspense account	3,000		
Drawings	15,000		
Cash in hand	10,000		
Balance with scheduled			
bank in current account	11,000		
In fixed deposit account	25,000		
	10,62,640		10,62,640

Additional information :

(1) Stock on 31.03.2002 valued at cost Rs. 64,000.

(2) Business is carried on in a rented house. The ground floor, 50% of the accommodation, is used for business. Mr. Reddy lives with his family on the first floor.

(3) The effect of advertising is expected to last for coming year also and as such half of printing and advertising is to be carried forward.

(4) Provide depreciation on furniture and fittings @ 10% p.a.

(5) A cheque of Rs. 5,000 received from a customer was returned dishonoured by bank but the same has not been recorded in the books. The customer has become insolvent and 60% is expected to be realized from his estate.

(6) Furniture appearing in the books on 01.04.01 at Rs. 6,000 was disposed off on 30.09.01 at Rs. 3,500 in part exchange for a new furniture costing Rs. 5,000. A net invoice for Rs. 1,500 was passed through purchase day book.

(7) Sales include Rs. 75,000 for goods sold in cash on behalf of Mr. Sharma. Trade expenses also include Rs. 4,000 as expenses in connection with this sale.

(8) Suspense account represents money advanced to Sales Manager who was sent to Delhi in August 2001, for sales promotion. On returning to Pune, he submitted a statement disclosing that Rs. 1,200 was incurred for travelling, Rs. 500 for legal expenses and Rs. 900 for miscellaneous expenses. The balance lying with him is yet to be refunded.

(9) Insurance premium covers a period of one month advance.

(10) Opening stock has been valued at 20% below cost but final accounts should be prepared by taking stock at cost.

Prepare Mr. Reddy's Trading and Profit and Loss Account for the year ended 31st March 2002 and a Balance Sheet as on that date after taking into consideration the above mentioned information.

Answer :

Workings Notes.

(1) Valuation of opening stock 80000 × 100/80 = Rs.100000

(2) Net invoice of furniture Rs.(5000 – 3500) i.e 1500 passed through purchase day book.

		Rs.
(3)	Cheque dishonoured by customer	5,000
	Less: 60% expected realiastion from estate	3,000
	Provision for bad & doubtful debt	2,000
(4)	Book value of furniture on 1.04.01 -	6,000
	Less: Depreciation from 1.04.01 to 30.09.01	300
	W.D.V as on 30.09.01	5,700
	Less: Sale value of furniture	3,500
	Loss on sale of furniture	2,200
(5)	Depreciation on furniture	
	Furniture & fittings as per Trial Balance as 31-03-02	36,000
	Less: Book value of furniture sold on 30.09.01	6,000
	Value of old furniture & fittings	30,000
	Depreciation on old furniture @ 10% of Rs.30000	3,000
	Depreciation on furniture sold for 6 months @ 10% on Rs.6000	300
	Depreciation on new furniture for 6 months @ 10% on Rs.5000	250
		3,550
(6)	Insurance for 13 months	1,040
	Prepaid Rent = 1040/13	80
(7)	Advanced to sales manager shown as suspense account	3,000
	Less: Expense Sheet submitted	
	Travelling	1,200
	Legal expenses	500
	Misc. expenses	900
		2,600
	Balance suspense A/c as on 31-03-02	400

(8) **Consignors Account**

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
To Cash sent	75,000	By Balance b/d	30,000
To Expenses	4,000	By Consignment sales	75,000
To Commission	7,500		
To Balance c/d	18,500		
	105,000		105,000

In the Books of Mr.Reddy

Trading and Profit and Loss account for the year ended 31-03-02

Particulars	*Amount (Rs)*	*Amount (Rs)*	*Amount (Rs)*	*Particulars*	*Amount (Rs)*	*Amount (Rs)*	*Amount (Rs)*
To Opening stock				By Sales			
(Note 1)			100,000			765,000	
To Purchases		520,000		*Less* : Returns	3,000		
Less: Purchase				On behalf of			
of furniture				consignor			
(Note 2)	1,500				75,000	78,000	687,000
Less: Returns	2,000	3,500	516,500	By Closing stock			64,000
To Wages			5,000				
To Gross profit c/d			129,500				
			751,000				751,000
To Salaries			25,000	By Gross profit			
To Printing & Adv.		12,000		b/d			129,500
Less: Pre-paid		6,000	6,000	By Discount			2,000
To Postage			4,500	By Comm.			
To Disc. Allowed			2,500	receivable on			
To Trade Expenses		10,000		Consignment			7,500
Less: Expns. for							
Consignment		4,000	6,000				
To Provn for bad &							
doubtful debts							
(Note 3)			2,000				
To Loss on sale of							
furniture (Note 4)			2,200				
To Depn. on furniture							
(Note 5)			3,550				
To Rent		9,600					
Less: Drawings		4,800	4,800				
To Insurance		1,040					
Less: Prepaid							
(Note 6)		80	960				
To Travelling &							
Conveyance			1,200				
To Legal Expenses			500				
To Misc. Expenses			900				
To Net profit trfd. to							
Capital A/c			78,890				
			139,000				139,000

Balance Sheet *as at 31-03-02*

Liabilities	*Amount (Rs.)*	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*	*Amount (Rs.)*
Capital A/c opening bal.	190,000		Furniture & Fittings (old)	36,000	
Add:Understatement			Less: Furniture sold	6,000	
of Net Profit in last yr			Less: Deprn. @ 10%	3,000	
dur to undervaluation	20,000			27,000	
Closing stock	210,000		Add: New furniture purchased	5,000	
Add:Profit for the year	78,890			32,000	
	288,890		Less: Deprn. For 6 mths @ 10%	250	31,750
Less:Drawings			Sundry debtors	175,000	
Cash 15,000			Add: Cheque dishonoured	5,000	
Rent 4,800	19,800	269,090	Less:Pro.for bad debt	2,000	178,000
			Bills Recivables		40,000
Sundry Creditors		73,640	Closing Stock		64,000
			Cash at Bank	11,000	
Consignors Balance			Less: Cheque dishonoured	5,000	6,000
(Note 8)		18,500	Fixed Deposit		25,000
			Cash in hand		10,000
			Prepaid Expenses		
			Printing & Advt.	6,000	
			Insurance	80	6,080
			Sales Managers		
			Suspenses A/c (Note 7)		400
		361,230			361,230

Question 17 :

The following is the Trial Balance extracted from the Books of Halder & Co. as at 31.12.96. You are asked to prepare the Trading A/c and Profit & Loss A/c for the year ended on 31st December, 1996 and a Balance Sheet as at that date taking into consideration the following :

(a) Closing Stock has been valued at Rs. 38,000.

(b) Outstanding Wages Rs. 200.

(c) Prepaid Rates and Taxes Rs. 25

(d) Depreciate Buildings @ 2.5%, Machinery @ 5% and Loose Tools @ 25% p.a.

(e) Adjust the provision for doubtful Debts @ 5% on Debtors and make a provision for discount on Debtors @ 5%.

(f) Make a Provision for Discount on Creditors @ 5%.

(g) Allow 5% p.a. interest on capital and charge 4% p.a. interest on Drawings.

(h) Interest on Investment received in advance Rs. 20.

(i) Misc. Receipts accrued due but not received Rs. 10.

Trial Balance as at 31st December, 1996

	Dr. Amt. *Rs.*	Cr. Amt. *Rs.*
Capital A/c of Mr. Halder	—	16,000
Drawings A/c	600	—
Building	25,000	—
Machinery	8,000	—
Furniture and Fittings	2,000	—
Goodwill	8,000	—
Stock (01.01.96)	5,500	—
Purchases	28,600	—
Carriage Inward	300	—
Sales	—	59,800
Returns	250	135
Carriage outward	100	—
Wages	4,300	—
Motive Power	230	—
Salaries	1,300	—
Rent, Rates & Taxes	340	—
Apprenticeship Premium (for the year)	—	200
Insurance	50	—
Advertisement	500	—
Printings and Stationery	45	—
Bad Debt	100	—
Discounts	130	160
Miscellaneous Receipts	—	300
Investments	3,000	—
Sundry Debtors	2,000	—
Sundry Creditors	—	5,000
Loose Tools	1,000	—
Loan	—	7,400
Interest on Loan	370	—
Interest on Investments	—	150
Provision for Doubtful Debts	—	140
Bank Overdraft	—	2,500
Cash in hand	70	—
TOTAL	91,785	91,785

Answer :

HALDER & CO.

Dr. **Trading Account for the year ended on 31st December, 1996** Cr.

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Stock		5,500	By Sales	59,800	
To Purchase	28,600		*Less :* Return	250	59,550
Less : Return	135	28,465			
To Carriage Inward		300	By Stock (closing)		38,000
To Wages	4,300				
Add : Outstanding	200	4,500			
To Motive Power		230			
To Profit & Loss A/c					
(Gross Profit transferred)		58,555			
		97,550		97,550	

Halder & Co.

Dr. **Profit & Loss Account for the year ended on 31st December, 1996** **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Carriage Outward		100	By Trading A/c		
To Salaries		1,300	— Gross Profit		58,555
To Rent, Rates & Taxes	340		By Apprenticeship Premium A/c		200
Less : Prepaid	25	315	By Discount received		160
To Insurance		50	By Misc. Receipts	300	
To Advertisement		500	*Add :*	10	310
To Printing & Stationery		45	By Interest on		
To Bad Debt		100	Investment	150	
To Discount (allowed)		130	*Less :* Received in		
To Interest on Loan		370	advance	20	130
To Depreciation :			By Provision for Doubtful Debts :		
Building @ 231%	625		Old Provision	140	
Machinery @ 5%	400		*Less :* New Provision		
Loose Tools @ 25%	250	1,275	@ 5% on Rs.2000	100	40
To Provision for Discount @ 5%			By Provision for		
on Debtors on (2000–100)		95	discount on Creditors		250
To Interest on Capital @ 5%		800	By Interest on drawings @ 4%		
To Capital A/c		54,577	(for 6 months on average)		12
		59,657			59,657

Balance Sheet as at 31st December, 1996

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital A/c :			Building	25,000	
Opening balance	16,000		*Less :* Depreciation @ 2.5%	625	24,375
Add : Net Profit	54,577				
Add : Interest on Capital	800		Machinery	8,000	
	71,377		*Less :* Depreciation @ 5%	400	7,600
Less : Drawings	600		Furniture & Fittings		2,000
	70,777		Loose Tools	1,000	
Less : Interest on			*Less :* Depreciation @ 25%	250	750
Drawings	12	70,765	Goodwill		8,000
Loan A/c		7,400	Investment		3,000
Sundry Creditors	5,000		Stock (closing)		38,000
Less : Provision for			Sundry Debtors	2,000	
discount @ 5%	250	4,750	*Less :* Provision for		
Bank Overdraft		2,500	doubtful Debts	100	
Outstanding Wages		200	@ 5%	1,900	
Interest received in advance		20	*Less :* Prov. for discount	95	1,805
			Cash in hand		70
			Accrued Misc. Receipts		10
			Prepaid Rates and Taxes		25
		85,635			85,635

Question 18 :

Prepare the final accounts from the following information :

Mr. T. Dutta is the proprietor of a large business of Silk Piece Goods. The following Trial Balance is prepared from his books as on 31.03.97.

Debit Balance	*Rs.*	*Credit Balance*	*Rs.*
Land & Building	40,000	Sales	4,68,100
Purchases	3,26,700	Income from investment	990
Return Inward	2,500	12% Bank Loan	
Travelling Expenses	6,900	secured on Fixed Assets	40,000
Printing & Stationery	1,600	(no movements during	
Cash at Bank	30,795	the year)	
Discount Allowed	1,800	Capital A/c	80,000
Misc. Expenses	18,620	Sundry Creditors	63,100
Sundry Debtors	64,000	Bills Payable	2,600
Postage	800	Returns Outward	3,700
Furniture	8,000	Discount Received	1,200

Cash in hand	5,900	
Motor Car	16,000	
Investment	12,000	
Drawings	10,000	
Bills Receivable	4,800	
Stock (1.4.96)	63,680	
Interest on Bank Loan	3,000	
Salaries (Including an advance of Rs. 1, 500)	22,000	
Carriage Inwards	3,000	
Establishment Expenses	1,595	
Advertisement	16,000	
	6,59,690	6,59,690

a) Stock as on 31.03.97 was Rs. 1,20,000,

b) Sundry Debtors include a sum of Rs. 3,000 due from Mr. B. and Sundry Creditors include a sum of Rs. 4,000 due to Mr. B.

c) The Reserve for Doubtful Debts is to be maintained @ 10% on Sundry Debtors and Reserve for Discount on Debtors and Discount on Creditors are to be created @ 5%.

d) Bills Receivable include dishonoured bill for Rs. 600.

e) Stock worth Rs. 10,000 was destroyed by Fire in respect of which the Insurance Company admits a claim for only Rs. 7, 500.

f) The Manager of Mr. T. Dutta is entitled to a Commission of 10% of Net Profit calculated after charging such Commission.

g) 3/4th of the advertisement expenses are to be carried forward.

h) 2.5% of the Net Profit is to be transferred to Reserve Fund.

i) Depreciation is to be charged on --

(i) Land & Building @ 2.5 %;

(ii) Furniture @ 10% ; and

(iii) Motor Car @ 20%

Answer :

In the books of Mr. T. Dutta

Dr. **Trading Account for the year ended 31.03.1997** **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Opening Stock		63,680	By Sales	4,68,100	
To Purchases	3,26,700		*Less :* Returns	2,500	4,65,600
Less : Returns	3,700		By Closing Stock		1,20,000
		3,23,000			
To Carriage Inwards		3,000	By Stock Destroyed on fire		10,000
To Gross Profit (transferred to Profit & Loss A/c)		2,05,920			.
		5,95,600			5,95,600

In the books of Mr. T. Dutta

Dr. **Profit & Loss A/c for the year ended 31.03.1997** **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Travelling Expenses		6,900	By Gross Profit (Transferred		
To Printing & Stationary		1,600	from Trading A/c)		2,05,920
To Discount allowed		1,800	By Income on Investment		990
To Misc. Expenses		18,620	By Discount Received		1,200
To Postage		800	By Discount on		
To Interest on Bank Loan	3,000		Creditors (New)		3,005
Add : Due [(40,000×12%)-3000]	1,800	4,800	(63,100 - 3,000 = 60,100 x 5/100)		
To Salaries 22,000					
Less : Advance	1,500	20,500			
To Establishment Expenses		1,595			
To Advertisement	16,000				
Less : Transferred to					
Balance Sheet	12,000	4,000			
To Loss on Stock					
destroyed [10,000 - 7,500]		2,500			
To Provision for Doubtful					
Debts (New) [64,000 - 3,000					
= 61,000+600=61,600×10/100]		6,160			
To Provision for Discount on					
Debtors (New) [61,600 - 6,160					
= 55,440 x 5/100]		2,772			

To Depreciation :			
Land & Building – 5%	1,000		
Furniture – 10%	800		
Motor Car – 20%	3,200		
To Commission (due)	12,188		
To Reserve Fund	3,352		
To Net Profit (to be added with Capital A/c)	1,18,528		.
	2,11,115		2,11,115

Question 19 :

The following is the Trial Balance of Mr. Nayan Bhattacharjee as on 31.12.98. Prepare a Trading & Profit & Loss account for the year 1998 and the Balance Sheet as on 31.12.98 from it.

Particulars	*(Dr.) Rs.*	*(Cr.) Rs.*
Purchase (Adjusted)	1,60,000	
Opening Stock	20,000	
Salary less Provident Fund	15,400	
Rent @ 500 p.m.	5,000	
P. F. remittance incl. proprietor's contribution @ 50%	1,200	
Machinery	45,000	
Wages	15,000	
Furniture & Fittings	40,000	
Electricity	4,000	
Trade Expenses	1,550	
Debtors	25,500	
Interest on Loan	400	
Commission	200	
10% Bank Loan		10,000
Creditors		15,000
Building	30,000	
Capital		1,00,000
Drawings	5,000	
Closing Stock	20,000	
Prepaid Wages	2,000	
Cash at Bank	14,000	
Sales		2,72,250
Suspense A/c		7,000
	4,04,250	4,04,250

Adjustments :

1. Wages include Rs. 1,000 paid for machinery erection charge.
2. Goods costing Rs. 5,000 were destroyed by fire and insurance claim was received for Rs. 4,000.
3. Sundry Debtors include Rs. 500 proved to be bad and provide @ 10% as Reserve for Bad Debt.
4. Goods costing Rs. 5,000 were sent to a customer on "sale on approval" basis on 31.12.98. These were recorded as sales. The rate of gross profit was 1/6th of sale.
5. Two cheques of Rs. 1,000 and Rs. 1,200 were deposited into bank on 29.12.98 but not cleared by the bank till 31.12.98.
6. Goods withdrawn by the proprietor for personal use but no entry was passed Rs. 2,500.
7. Discount allowed amounting to Rs. 3,500 had been posted to the debit of Sundry Debtors.
8. Sales had been overcast on the credit side by Rs. 2,000.
9. Cash withdrawn from bank Rs. 4,000 had been entered in the bank column of the cash book.
10. Provide depreciation @ 10% p.a. on all fixed assets.

Answer :

IN THE BOOKS OF NAYAN BHATTACHARJEE

Dr. Trading Account and Profit & Loss Account *for the year ended 31.12.98* Cr.

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Opening Stock		20,000	By Sales		2,72,250
To Purchase 1,60,000			*Less :* Sale on App. basis		6,000
Less : Drawings	2,500	1,57,500			2,66,250
To Wages	15,000				
Less : Erection Charge	1,000	14,000	*Less :* Over Cost		4,000
2,62,250					
To Gross Profit c/d		80,750	By Stock destroyed by Fire		5,000
			By Cost of Goods not approved		5,000
		2,72,250			2,72,250
To Salary A/c	15,400		By Gross Profit b/d		80,750
Add : P.F. Deduc. (50% of Rs.600)	600	16,000			
To Rent A/c 5,000					
Add : Outstanding	1,000	6,000			

To Contribution to P.F. (50% of Rs.1,200)		600		
To Electric Charge		4,000		
To Trade Expenses		1,550		
To Interest on loan	400			
Add : Outstanding	100	500		
To Commission		200		
To Loss by Fire		1,000		
To Prov. for Bad Debt		1,200		
To Bad debt		500		
To Deprn. On :				
Machinery	4,600			
Building	3,000			
Furniture	4,000	11,600		
To Capital A/c (N.P. transferred)		37,600		.
		80,750		80,750

Balance Sheet as at 31.12.98

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital	1,00,000		Machinery	45,000	
Add : Net Profit	37,600		*Add* : Erection Charges	1,000	
	1,37,600			46,000	
Less : Drawings (5,000+2,500)	7,500	1,30,100	*Less* : Depreciation @10%	4,600	41,400
10% Bank Loan		10,000	Building	30,000	
Outstanding Rent		1,000	*Less* : Depreciation @10%	3,000	27,000
Outstanding Interest on Bank Loan		100	Furniture	40,000	
Creditors		15,000	*Less* : Depreciation @10%	4,000	36,000
			Closing Stock (20,000 + 5,000)		25,000
			Prepaid Wages		2,000
			Cash at bank	14,000	
			Less : Withdrawal	4,000	10,000
			Debtors	25,500	
			Less : Unapproved Sales	6,000	
			19,500		
			Less : Bad Debt	500	
			19,000		
			Less : wrong debit	7,000	
			12,000		
			Less : P.B.D. @10%	1,200	10,800
			Insurance Claim		4,000
		1,56,200			1,56,200

Working Notes :

1. **For Adjustment No. 4 :**

   Goods are not actually sold when sent for approval unless these are approved on & before the closing date (here 31.12.98) the selling price of the goods (here cost + 1/6th of sale or 1/5th of cost = 5,000 + 1/5 × 5,000 = Rs. 6,000) should be deducted from a Sale and Debtors.

   b. Added with closing stock

2. **For adjustment No. 5 :**

   Two cheques of Rs. 1,000 and Rs.1,200 were deposited but not cleared by Bank has not affected as per balance of Cash Book.

3. **For Adjustment No. 7, 8 & 9 :**

   Sundry debtors have credited by Rs. 7,000 to rectify wrong debit of discount ofRs. 3,500. Cash at bank has been reduced by Rs. 4,000 for omission of posting of withdrawal. Sales have been decreased by Rs. 4,000 due to overcasting.

Dr. **Suspense Account** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Sundry Debtors (Rs.3,500 × 2)	7,000	By Balance b/d	7,000
To Bank A/c (Cash Withdrawal)	4,000	By Sales A/c (Over Costing)	4,000
	11,000		11,000

4. In absence of any information regarding date of Bank Loan taken, Interest on Loan is Calculated for 6 months. So interest on Loan should be 10% of Rs.10,000 $\times ^1/_2$ = 500.

Question 20 :

Mr. Salil Ghosh closes his Books on 31st December every year. The following matters are to be taken into consideration while preparing final accounts for the year ended 31.12.98 :

(i) Goods costing Rs. 3,000 were taken by the proprietors for his personal use.

(ii) Goods costing Rs. 3,500 were destroyed by fire, but Insurance Company admitted a claim for Rs. 3,000 only.

(iii) Rs. 1,200 was paid for Insurance premium on 1.9.98 for the year ended 31.8.99.

(iv) Sales for the period included Rs. 1,500 worth of goods (at cost price) also taken by the proprietor for personal consumption.

Answer :

In the Books of SALIL GHOSH

JOURNAL ENTRIES

Date	*Particulars*	*L.F.*	*Rs.*	*Rs.*
1.	Drawings A/c	Dr.	3,000	
	To Purchase A/c			3,000
	(Being goods taken by proprietor for personal consumption)			
2.	Stock Destroyed by Fire A/c	Dr.	3,500	
	To Trading A/c			3,500
	(Being lost price of goods destroyed by fire)			
	Admitted Insurance Claim A/c	Dr.	3,000	
	P/L A/c	Dr.	500	
	To Stock Destroyed by fire			3,500
	(Being amount recoverable from Insurance Co. and balanced being charged to P/L Account)			
3.	Prepaid Insurance Premium A/c	Dr.	800	
	To Insurance Premium A/c (8/12×1,200)			800
	(Being prepaid Insurance premium adjusted)			
4.	Drawings A/c	Dr.	1,500	
	To Purchase A/c			1,500
	(Being goods taken by proprietor for his personal consumption)			

Question 21 :

The following is the schedule of balances as on 31.03.98 extracted from the books of Kalidas Gupta :

	Dr.*(Rs.)*	Cr.*(Rs.)*
Cash in Hand	2,800	
Cash at flank	5,200	
Sundry Debtors	172,000	
Stock as on 01.04.97	124,000	
Furniture & Fixture	42,800	
Office Equipment	32,2 00	
Building	120,000	
Motor Car	40,000	

Sundry Creditors		86,000
Loan from Mr. Goel		60,000
Reserve for Bad Debt		6,000
Purchases	280,000	
Sales		460,000
Purchase Returns		5,200
Sales Returns	8,400	
Salaries	22,000	
Motor Car Expenses	7,200	
Rent for Godown	11,000	
Interest on Loan from Mr. Goel	5,400	
Rent & Taxes	4,200	
Discount Allowed	4,800	
Discount Received		3,200
Freight	2,400	
Carriage Outward	4,000	
Drawings	24,000	
Printing & Stationary	3,600	
Electric Charges	4,400	
Insurance Premium	11,000	
General Expenses	6,000	
Bad Debt	4,000	
Bank Charges	3,200	
Capital		324,000
	944,400	944,400

Prepare Trading and Profit & Loss Account for the year ended 31.03.98 and the Balance Sheet as on that date after making provision for the following —

1. Depreciation :
   - (a) Building used for business by 5%
   - (b) Furniture and Fitting by 10% – one steel table purchased during the year for Rs. 2,800 was sold for the same price but the sale proceeds were wrongly credited to Sales Account.
   - (c) Office Equipment by 15% – A type writer purchased during the year for Rs. 8,000 has been wrongly debited to Purchase Account.
   - (d) Motor Car by 20% .
2. Value of stock at the close of the year Rs. 88,000.
3. One month's Rent for godown is outstanding.
4. One month's salary is outstanding.

5. Interest on loan from Mr. Goel is 12% per annum. This loan was taken on 01.05,97.
6. Reserve for bad debt to be maintained at 5% on Sundry Debtors.
7. Insurance premium includes Rs. 8,000 paid towards proprietor's Life Insurance Policy and the balance of the insurance charges cover the period from 01.04.97 to 01.07.98.
8. Half of the building is used for residential purposes of Kalidas Gupta.

Answer :

Trading Account *for the year ended 31.03.1998*

To	Opening Stock		124000	By	Sales	460000	
"	Purchases	280000			*Less :* Sale		
	Less : Purchase of				of fitting	2800	
	Office Equipment	8000				457200	
	Less : Returns	5200	266800		*Less :* Returns	8400	448800
"	Freight		2400				
"	Gross Profit c/d		143600	"	Closing Stock		88000
			536800				536800

Profit and Loss Account for the ended 31.03.98

To	Salaries	22000		By	Gross Profit c/d	143600	
	Add : Outstanding	2000	24000	"	Discount Received	3200	
"	Rent for godown	11000					
	Add : Outstanding	1000	12000				
"	Interest on Loan	5400					
	Add : Outstanding	1200	6600				
"	Rates & Taxes		4200				
"	Discount Allowed		4800				
"	Carriage Outward		4000				
"	Printing & Stationery		3600				
"	Electric Charges		4400				
"	Insurance Premium	11000					
	Less : Premium on						
	own life policies	8000					
		3000					
Less : Prepaid 3/15 x 3000		600	2400				
" General Office Expenses			6000				
Res. for bad debt (5%)		8600					
	Add: Bad debts	4000					
		12600					
	Less: Existing Res.	6000	6600				

“	Bank Charges		3200	
“	Motor Car Expenses		7200	
“	Depreciation —			
	Building	3000		
	Furniture	4000		
	Office Equipment	6000		
	Motor Car	8000	21000	
“	Net Profit transferred to Balance Sheet		36800	.
			146800	146800

Balance Sheet of Kalidas Gupta
as at 31.03.98

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital A/c Balance	324000		Building	120000	
Add : Net Profit	36800		*Less :* Depreciation	6000	114000
	360800				
			Furniture & Fittings	42800	
Less : Drawings	35000	325800	*Less :* Sales	2800	
(24000 + 8000 + 3000)				40000	
Loan from Mr. Goel		60000	*Less :* Depreciation	4000	36000
Interest accrued		1200	Office Equipment	32000	
			Add : Purchase	8000	
			Less : Depreciation	6000	34000
			Motor Car	40000	
			Less : Depreciation	8000	32000
Current Liabilities :			Current Assets :		
Sundry Creditors	86000		Stock in Trade		88000
Outstanding Expenses —			Sundry Debtors	172000	
Salaries	2000		*Less :* Res. for B/Debt	8600	163400
Godown	1000	89000	Cash at Bank		5200
			Cash in hand		2800
			Prepaid Insurance		600
		476000			476000

Working : —

Drawings as per Trial Balance	24000
Add : Insurance Policy on own life	8000
	32000
Add : Depreciation of Building used for own life	3000
	35000

2.8 SELF-EXAMINATION QUESTIONS

1. Define Capital Expenditure, Revenue Expenditure and Deferred Revenue Expenditure.
2. Explain the basic principles in allocating expenditure between capital and revenue.
3. Distinguish, giving examples, between Trial Balance and Balance Sheet.

4. Pass entries to adjust the following :

   a) Salary paid Rs. 15,000; opening and closing outstanding salaries are Rs. 1,000 and Rs. 3,000 respectively.
   b) Consumption of materials at cost not recorded.
   c) Provide 5% on sundry debtors and 2% Reserve for discount allowable, closing balance of Sundry Debtors Rs. 60,000, from which Rs. 2,000 is to be written off.

5. A Company prepared its financial statement for the year ended 31st March, 1994, after transferring the difference in Trial Balance to a Suspense Account which was carried to the Balance Sheet.

In the next year the following errors were discovered relating to the year 1993-94 :

   (a) Wages included Rs. 8,000 towards installation of a new plant on 1st April 1993. The company charges depreciation on plant and machinery @ 15% p.a.
   (b) A cheque of Rs. 10,800 was paid to a creditor who allowed 10% cash discount but the payment was wrongly posted to purchase account Rs.1,080 only without any other entry.
   (c) Sundry Debtors include Rs. 1,500 which proved irrecoverable but was not written off. A Reserve for Bad Debt was created only on closing debtors.
   (d) A Bills receivable amount Rs. 6,000 was discounted for Rs. 5,800, but the proceeds was posted to Sales Account as Rs. 580 and no other entry was made in this respect.

Give the appropriate Journal entries to rectify the above errors.

6. **(a)** What is depreciation? What are causes of depreciation?

   (b) Bajaj & Co. close their account on 31st March every year. They purchased the machineries as follows :

      (i) Purchased the machineries costing Rs. 1,20,000 on 1.7.90.
      (ii) On 1.1.91, some machines were purchased costing Rs. 1,20,000.
      (iii) On 1.10.91, again purchased some machinery costing Rs. 20.000.

(iv) On 1.1.92, purchased a new machine for Rs. 60,000.

(v) One machine costing Rs. 40,000 which was purchased on 1.7.90, was sold for Rs. 12,000 on 1.4.92.

(vi) They charge depreciation @ 331/3 % on the written-down value method.

(vii) They have the practice to charge depreciation for the full year even if the machinery is used for a part of the year.

Prepare Machinery A/c in the Books of Bajaj & Co. for the three years — 1990-91, 1991-92, 1992-93.

[Ans. : Balance on 31.3.91 Rs. 1.6L ; 31.3.92 Rs. 1.6L and 31.3.93 Rs. 0.94815L]

7. A Ltd. provides for doubtful debts @ 5% and for discount on debtors @ 2%. From the following details you are required to show the journal entries in the books of A Ltd.

Debtors as on 31.12.94 were Rs. 25,600 including bad debts of Rs. 600. Debts written off during the year excluding this Rs. 600 amounted to Rs. 1,330. Discount allowed during the year was Rs. 400. Provision for doubtful debts and that for discount on 1.1.94 were Rs. 2,740 and Rs. 380 respectively.

[Ans. : Provision for doubtful debts Rs. 440 ; Prov. for discount on debtors Rs. 475]

8. The financial year of Mr. X ends on 31st March 1995 but the stock on hand was physically verified only on 7th April 1995. You are required to ascertain the value of closing stock (at cost) as on 31st March 1995 from the following information :–

(a) The stock (valued at cost) as verified on 7th April 1995 was Rs. 1,54,000.

(b) Sales have been entered in the Sales day book only after the despatch of goods and sales return only on receipt of the goods.

(c) Purchases have been entered in the Purchase day book on receipt of the purchase invoice irrespective of the date of receipt of the goods.

(d) Sales as per sales day book for the period 1st April 1995 to 7th April 1995 (before the actual verification) amounted to Rs. 68,800 of which goods of a sale value of Rs. 12,000 had not been delivered at the time of verification.

(e) Purchases as per Purchase day book for the period 1st April 1995 to 7th April 1995 (before the actual verification) amounted to Rs. 58,000 of which goods for purchases of Rs. 15,000 had not been received at the date of verification and goods for purchases of Rs. 20,000 had been received prior to 31st March 1995.

(f) In respect of goods costing Rs. 50,000 received prior to 31st March 1995, invoices had not been received up to the date of verification of stocks.

(g) The gross profit is 25% on sales.

[Ans. : Value of Closing Stock on 31.3.1995 Rs. 1,03,600]

9. **(a)** The net income of Mr. A. K. Bose for the year ended 31st December, 1994 under cash basis was Rs. 10,875. From the following particulars, pass Journal entries, to convert his income from cash basis to accrual basis and ascertain his income under accrual basis :

	1-1-1994 *(Rs.)*	31-12-94 *(Rs.)*
Accrued fees	350	450
Fees received in advance	100	50
Expenses outstanding	200	150
Prepaid expenses	100	175

[Ans. : Income under Accrual basis Rs. 11,150]

(b) A manager is entitled to a commission at a certain percentage of net profit (such commission to be charged in arriving at the net profit).

The commission is to be allowed on the following rates :—

First Rs. 10,000 of the net profit			Nil
Next Rs. 20,000	"	"	@ 10%
Next Rs. 30,000	"	"	@ 15%
Next Rs. 60,000	"	"	@ 20%
Balance	"	"	@ 30%

The net profit before charging the manager's commission is Rs. 1,45,000. Compute the amount of manager's commission.

[Ans. : Manager's commission Rs. 18,500 + Rs, 1,500 = Rs. 20,000]

10. Discuss how the following items shall be treated in the Final Accounts :–

(a) Wages for extension of buildings;

(b) Carriage on new machinery;

(c) Preliminary expenses;

(d) Interest paid on capital during constructions;

(e) Advertisement expenditure in special advertisement drive.

11. The following is the Balance Sheet of the retail business of Mr. Padamsi as on 31.12.1995 :

Liabilities	*Rs.*	*Assets*	*Rs.*
Mr. Padamsi's Capital Account	1,25,000	Furniture & Fittings	25,000
Creditors for goods	30,000	Stock	75,000
Outstanding expenses (rent)	1,000	Sundry Debtors	20,000
		Cash at bank	35,000
		Cash in hand	1,000
	1,56,000		1,56,000

You are furnished with the following information :–

(1) Mr. Padamsi always sells his goods at a profit of 25% on sales.

(2) Goods are sold for cash and credit. Credit customers pay by cheque only.

(3) Payments for purchases are always made by cheque.

(4) It is Mr. Padmasi's practice to bank his takings at the end of every week after paying the weekly expenses, viz., salaries to clerk Rs. 250, sundry expenses Rs. 50, and personal expenses Rs. 100.

Analysis the bank pass book for the period ended 31.3.1996 disclosed the following :

Payments to creditors	*Rs.* 75,000
Payment of rent	4,000

Amount remitted to the bank Rs. 1,35,000 (including cheques for Rs. 10,000 received from customers to whom the goods were sold on credit).

The following are the balances as on 31.3.1996 :

Stock	*Rs.* 32,500
Creditors for goods	32,500
Sundry Debtors	30,000

In the evening of 31.3.1996, the cashier absconded with the available cash in the cash box. You are required to prepare a statement, showing the amount of cash defalcated by the cashier, and also a profit and Loss Account for the year ended 31.3.1996.

[Ans. : Cash defalcated by the cashier Rs. 10,800 ; Net Profit Rs. 22,300 ; Balance Sheet total Rs. 1,78,500 and Cash sales Rs. 1,40,000]

ACCOUNTING FOR NON-PROFIT ORGANISATIONS

3.0 INTRODUCTION

Some organisations like clubs, hospitals, educational institutions are established not for making profit but for the purpose of providing services to members and beneficiaries. Receipts and Payments A/c Income and Expenditure A/c and Balance Sheet form part of their final accounts.

3.1 TREATMENT OF CERTAIN ITEMS

1) **Entrance Fees :** Such fees are received by non profit seeking organisations at the time of admitting new members. For the incoming member it is a one time payment. Entrance Fees can be capitalised or charged to Income Expenditure A/c as per rules of the organization.

2) **Donations :** Donation can be utilised for meeting capital or revenue expenses. When received for a special purpose, the amount of donation is credited to a special fund, which may be invested in specific securities. Interest, Dividend, etc. received from such investments are credited to Fund A/c expenses for performing the purpose of Fund is charged to Fund A/c.

3) **Life membership subscriptions:** This can be treated in the following ways in the Accounts :–

   i) The entire amount is transferred to a special Account on death of the member and it is transferred to the Accumulated Fund.

   ii) An amount equal to normal yearly membership subscription is charged to Income and Expenditure A/c and the Balance is carried forward until exhausted. In case of death of a member the unexhausted portion is charged to Accumulated Fund on the date of death.

   iii) An amount calculated according to age and average life of the member may annually be transferred to the credit of Income and Expenditure A/c

4) **Subscription :** This is one of the main sources or Income and has to be accounted for on accrual basis. The amount of subscription chargeable to Income and Expenditure A/c can be determined by opening a Subscription A/c in the following way :

Dr. **Subscription A/c** **Cr.**

Particulars	*Explanation*	*Particulars*	*Explanation*
To Balance b/d	*Subscription A/c Opening balance of accrued subscription*	**By balance b/d**	*Opening Balance of advance subscription*
To Income and Expenditure A/c	*Balancing figure*	**By Bank A/c**	*Total receipts during the year*
To Balance c/d	*Closing balance of advance subscription*	**By Balance c/d**	*Closing balance of accrued subscription*

5) **Sale of News papers & used sports materials:**

   Sale proceeds are credited to Income & Expenditure A/c

6) **Sale of Assets:** Sale proceeds are debited in Receipts & Payments A/c and the Profit/Loss on sale is taken to Income/Expenditure A/c.

Illustration 1:

A summary of Receipts and Payments Account of Calcutta Club for the year ended 31.03.97 is given below :

Receipts	*Rs.*	*Rs.*	*Payments*	*Rs.*
Cash in hand (1.4.96)		4,740	Wages	13,380
Subscription :				
1995-96=	700		Restaurant Purchase	50,400
1996-97=	28,620		Rent	7,500
1997-98=	400		Rates	2,200
		29,720	Secretary's Salary	3,120
Entrance Fees		3,200	Lighting & Other Services	7,700
Restaurant Receipts		56,800	Competition Prizes	4,000
Tournament Receipts		13,640	Printing & Stationary	6,000
Due to Secretary for			Fixed Deposits	8,000
Petty Expenses		80	Balance in hand and at Bank	5,880
		1,08,180		1,08,180

On April 1,1996, the Club's Assets were : Furniture and Equipment Rs. 48,000; Restaurant Stocks Rs. 2,600; stock of Prizes Rs. 800; Rs. 5,200 was owing for supplies to the Restaurant.

On March 31,1997 the Restaurant Stocks were Rs. 3,000 and Prizes in hand were Rs. 5,600 while the Club owed Rs. 5,600 for Restaurant supplies.

It was also found that member's subscriptions unpaid at March 31,1997 amounted to Rs. 1,000.

Rent was paid upto June 30,1997. Prepare an account showing the Profit or Loss made on the Restaurant and a General Income and Expenditure account for the year ended 31.03.97 together with a Balance Sheet at that date, after writing 10% off the Furniture and Equipment.

Solution :

In the books of CALCUTTA CLUB

Dr. **Restaurant Trading for the year ended 31.3.1997** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Opening Stock	2,600	By Restaurant Receipts	56,800
To Purchase	50,800	By Closing Stock	3,000
To Profit (transferred to			
Income & Exp. A/c)	6,400		
	59,800		59,800

Dr. Income & Expenditure Account for the year ended 31.3.97 Cr.

Expenditure	*Rs.*	*Income*	*Rs.*
To Wages - Outdoor Staff	13,380	By Member's Subscription	29,620
To Rent	5,000	By Games competition receipts	13,640
To Rates	2,200	By Restaurant Profit	6,400
To Secretary's Salary	3,120		
To Lighting, cleaning and Sanitary services	7,700		
To Competition Prizes	4,300		
To Printing, Postage and Sundries	6,000		
To Depreciation on Furniture & Equipment 10%	4,800		
To Excess of Income over Expenditure	3,160		
	49,660		49,660

Balance Sheet as at 31.3.1997

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital Fund :			Furniture & Equipment	48,000	
Opening Balance	50,390		*Less:* 10% Depreciation	4,800	43,200
Add : Entrance Fees	3,200		Restaurant Stock		3,000
Add : Excess of Income			Prizes in hand		500
over Expenditure	3,160	56,750	Fixed Deposit with Bank		8,000
Subscription Received in advance		400	Cash in hand and at Bank		5,880
Creditors for Restaurant supply		5,600	Prepaid Rent (April to June,1997)		1,250
Due to Secretary		80	Subscription Outstanding		1,000
		62,830			62,830

Illustration 2 :

From the following balances in the books and other details of Dancing Club, prepare Trading Account and Income and Expenditure Account for the year and a Balance Sheet as at 31.03.2002:

	Rs.
Bar Collections	21,250
Restaurant collections	14,360
Furniture on 31.03.2001	15,000
Tennis Accessories on 31.03.2001	5,500
Tennis Receipts	7,620
Furniture Purchased	500
Subscription	25,730
Interest	480
Capital Fund Balance as on 31.03.2001	17,720
Stock in Bar on 31.03.2001	1,560

Stock in Restaurant on 31.03.2001	510
Rent and Rates	6,700
Purchases for Bar	14,365
Purchases for Restaurant	11,735
China, Cutlery, Linen on 31.03.2001	2,400
Electric Charges	1,720
Establishments :	
Bar	4,960
Restaurant	3,540
General	4,260
Outstanding Subscription on 31.03.2002	3,650
Creditors on 31.03.2002	5,000
Purchase of China, Cutlery, Linen	1,200
Cash and Bank balances on 31.03.2002	10,560
Investments	4,000

Stock in Bar on 31.03.2002 — Rs. 4,000; Stock in Restaurant on 31.03.2002 — Rs. 1,230. Provide depreciation on opening balances; Furniture @ 20% (50% to be charged to Bar and Restaurant on collection basis); Tennis Accessories 20%; China, Cutlery, Linen 20% (to be charged on collection basis).

Solution :

DANCING CLUB

Trading Account **for the year ended *31st March, 2002***

Particulars	*Bar*	*Restaurant*	*Particulars*	*Bar*	*Restaurant*
To Opening Stock	1,560	510	By Collection	21,250	14,360
To Purchases	14,365	11,735	By Closing Stock	4,000	1,230
To Establishment	4,960	3,540	By Income & Expenditure A/c		
To Depreciation :			– deficit transferred		1,083
on furniture	900	600			
on Cutlery, Linen, etc.	432	288			
To Income & Expenditure A/c					
– Surplus transferred	3,033				
	25,250	16,673		25,250	16,673

Notes : Depreciate furniture by 20% (i.e., Rs. 3,000) out of which 50% of Rs. 3,000 distributed and the ratio of 3 : 2 as rounded off on 21,250 : 14,360. Depreciate China, Cutlery & Linen by 20% (i.e., Rs. 720) and distributed as 3 : 2 as above.

Income & Expenditure Account for the year ended *31st March, 2002*

Expenditure	*Rs.*	*Rs.*	*Income*	*Rs.*	*Rs.*
To Establishment		4,260	By Subscription		25,730
To Rent & Rates		6,700	By Tennis Receipts		7,620
To Electric Charges		1,720	By Interest		480
To Depreciation :			By Profit on Trading :		
Furniture	1500		Bar	3033	
Tennis Accessories	1100	2,600	*Less:* Loss in Restaurant		
To Excess of Income over			Section	1083	1,950
Expenditure A/c					
– Surplus transferred		20,500			
		35,780			35,780

Notes : 50% of depreciation on furniture (i.e., of Rs. 3,000). Ledger balance after adjustment with outstanding subscription.

Balance Sheet as at *31st March, 2002*

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital Fund :			Furniture	15,000	
Balance on 1.4.2001	17720		*Less:* Depreciation	3,000	
Add: Excess of Income over Expenditure	20,500	38,220		12000	
Creditors		5,000	*Add:* during the year	500	12,500
			Tennis Accessories	5500	
			Less: Deprn.	1100	4,400
			China, Cutlery, Linen	2400	
			Add: During the year	1200	
				3600	
			Less: Depreciation	720	2,880
			Investments		4,000
			Stock in Bar		4,000
			Stock in Restaurant		1,230
			Outstanding Subscription		3,650
			Cash & Bank Balances		10,560
		43,220			43,220

3.2 SPECIMEN QUESTIONS WITH ANSWERS

Question 1:

The following is the Receipt and Payment Account of Jayshree Sangha Club in respect of the year to 31.12.98.

Receipt	*Rs.*	*Payment*	*Rs.*
1.1.98		*31.12.98*	
To Balance b/d	25,000	By Salaries	24,000
31.12.98		By Stationery	5,000
To Subscription :		By Rates	12,000
1997	800	By Telephone Charges	2,000
1998	40,000	By Investment	40,000
1999	1,500	By Sundry Expenses	9,000
To Sales of Newspaper	1,200	By Balance c/d	9,500
To Dividend on Investment	25,000		
To Donation	8,000		
	1,01,500		1,01,500

Additional information available :

(a) There are 500 members each paying as annual subscription of Rs. 100 ; Rs. 1,000 being in arrear for 1997 at the beginning of 1998.

(b) Stock of stationery on 31. Dec. 1997 was Rs. 2000 and on 31st Dec. 1998 Rs. 1500

(c) At 31st Dec. 1998, the rates were prepaid to the following 31st March, the yearly charges being Rs. 12,000. A Quarter's charge for telephone is outstanding for Rs. 500. Sundry Expenses outstanding on 31st Dec. 1997 was Rs. 1200.

(d) At 31st Dec. 1997 the Building stood in the book at Rs. 1,50,000 on which depreciation is to be provided at 5% per annum. Investment on 31.12.1997 were Rs. 3,50,000.

Prepare an Income & Expenditure Account for the year ended 31st Dec. 1998 and a Balance Sheet as on that date.

Answer :

In the books of Jayshree Sangh Club

Dr. **Income and Expenditure Account** ***for the year ended31.12.98*** **Cr.**

Expenditure	Rs.	Rs.	Income	Rs.	Rs.
To Salary		24,000	By Subscription	40,000	
To Stationery used :			*Add :* Outstanding	10,000	50,000
– Opening stock	20,000				
Add : Purchase	5,000		By Sale of newspaper		1,200
	7,000				
Less : Closing Stock	1,500	5,500	By Dividend on Investment		25,000
To Rates	12,000		By Donation		8,000
Less : Prepaid (3/12×12,000)	3,000	9,000			
To Telephone Charge	2,000				
Add : Outstanding	500	2,500			
To Sundry Exp.	9,000				
Less : Outstanding for '97	1,200	7,800			
To Deprn. on Building		7,500			
To Surplus (Excess of Income over					
Expenditure transfer to Capital Fund)		27,900			.
		84,200			84,200

Jayshree Sangha Club

Balance Sheet as at 31.12.98

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital	5,26,800		Building	1,50,000	
Add : Surplus	27,900	5,54,700	*Less :* Deprn. @ 5%	7,500	1,42,500
Subscription received in advance		1,500	Investment	3,50,000	
			Add : Purchase	40,000	3,90,000
Outstanding Telephone Charge		500	Stock of stationery		1,500
			ACCRUED SUBSCRIPTION :		
			1997	200	
			1998	10.000	10,200
			Prepaid Rates		3,000
			Cash		9,500
		5,56,700			5,56,700

Working Notes :–

1. **Analysis of Subscriptions :**

(a)	For 1997	*Rs.*
	Total Amount due on 31.12.97	1,000
	Less : Received in 1998 on A/c	800
		200
(b)	For 1998	
	Annual subscription times 500 × Rs. 100	. 50,000
	Less : Received in 1998 on Account	40,000
	outstanding on 31.12.98	10,000
(c)	For 1999	
	Received in advance	1,500

2. Opening Capital on 31.12.97 or 1.1.98

Balance Sheet as on 1.1.98

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital (Balancing figure)	5,26,800	Cash	25,000
Outstanding Sundry Expenses	1,200	Outstanding Subscription	1,000
		Stock of Stationery	2,000
		Building	1,50,000
		Investment	3,50,000
	5,28,000		5,28,000

Question 2:

On 31st March, 1999 Writers Club, a cultural association had the following assets and liabilities:

	Rs.		*Rs.*
Trust fund	5,00,000	Cash	3,000
Accumulated surplus in		Canara Bank:	
income and expenditure A/c	1,05,000	Savings A/c	7,000
Membership fee received in		Fixed deposit	2,00,000
advance for 1999-2000	10,000	Investments in:	
Outstanding expenses	10,000	Government securities	3,00,000
		Fixed assets	95,000
		Membership fee receivable	15,000
		Prepaid expenses	5,000
	6,25,000		6,25,000

The following is the receipt and payment account for the year ended 31st March, 2000:

		Rs.			Rs.
Opening balance:			Administrative expenses		1,25,000
Cash	3,000		Programme expenses including		
Savings with			cost of printing souvenir		2,75,000
Canara Bank	7,000		Fixed deposits with Canara Bank		1,25,000
		10,000	Fixed assets purchased		80,000
Membership fee received			Investments in ICICI Bond		3,00,000
up to 31/3/1999	14,000		Closing balance:		
for 1999-2000	1,50,000		Cash	2,700	
for 2000-2001	16,000		Savings with		
		1,80,000	Canara Bank	5,000	
Sale of tickets - programme		25,000			7,700
Advertisements in program					
souvenir		5,00,000			
Fixed deposits with					
Canara Bank		75,000			
Interest on bank A/c:					
Savings	700				
Fixed deposit	22,000				
		22,700			
Amount received on maturity of					
government security inclusive of					
interest Rs. 8,000 (cost Rs. 80,000)		1,00,000			
		9,12,700			9,12,700

The club informs you that :

(i) membership fee for 1999-2000 due is Rs. 25,000; it includes Rs. 1,000 due from the member who has not yet paid also for 1998-99; provision for irrecoverable membership is to be made in respect of this member.

(ii) Income receivable on 31-3-2000 on ICICI bond is Rs. 30,000 and on government securities is Rs. 24,000.

(iii) Prepaid expenses on 31-3-2000 amount to Rs. 7,000.

(iv) Outstanding expenses on 31-3-2000 amount to Rs. 8,000.

(v) Depreciation provision is to be Rs. 12,500.

(vi) Programme is an annual feature.

The club asks you to prepare

(a) Income and expenditure account for the year ended 31st March, 2000.

(b) Balance sheet as at 31st March, 2000.

Answer :

WRITERS CLUB :

Income and Expenditure A/c for the year ended 31st March, 2000.

	Expenditure	*Rs.*		*Income*	*Rs.*
To	Administration expenses		By	Membership fee (Working 1)	1,85,000
	(Working 3)	1,21,000	”	Interest Income :	
”	Depreciation.	12,500		(Working 4)	84,700
”	Provision for doubtful		”	Surplus from programme	
	memberships			(Working 7)	2,50,000
	(Working 2)	2,000	”	Profit on disposal of	
”	Surplus for the year	3,96,200		government securities	
				(Working 6)	12,000
		5,31,700			5,31,700

Writers Club

Balance Sheet as at 31st March, 2000

Liabilities :		*Rs.*	*Assets :*		*Rs.*
Trust Fund :			Cash		2,700
As per last balance sheet.		5,00,000	Canara Bank :		
Income and expenditure A/c –			Savings	5,000	
As per last balance Sheet	1,05,000		Fixed deposit		
Surplus for the year	3,96,200		(Working 8)	2,50,000	2,55,000
		5,01,200	Investments in :		
Membership fee received			Government Securities		
in advance		16,000	(Working 5)	2,20,000	
Outstanding expenses		8,000	ICICI Ltd. Bonds	3,00,000	
					5,20,000
			Interest income receivable on :-		
			Government securities		
			(Working 4)	24,000	
			ICICI Ltd. bonds	30,000	
					54,000

		Membership fees due for		
		1998-99	1,000	
		1999-2000	25,000	
			26,000	
		Less: Provision for		
		doubtful dues	2,000	24,000
		Prepaid expenses		7,000
		Fixed assets : (Working 9)		1,62,500
	10,25,200			10,25,200

Working :

1) Membership Fees

	Rs.			Rs.
Opening receivable.	15,000	Opening receipt in advance		10,000
Income & expenditure A/c.		Bank for 1998-99	14,000	
(balancing figure)	1,85,000	1999-2000	1,50,000	
Closing receipt in advance	16,000	2000-2001	16,000	1,80,000
		Closing receivable for :		
		1998-99	1,000	
		1999-2000	25,000	26,000
	2,16,000			2,16,000

2) **Provision for Doubtful Recovery**

	Rs.
1998-99	1,000
1999-2000	1,000
Closing balance	2,000

3) **Expenses A/c**

	Rs.		Rs.
Opening prepaid	5,000	Opening outstanding	10,000
Bank	1,25,000	Income & expenditure A/c	
Closing outstanding	8,000	(balancing figure)	1,21,000
		Closing prepaid.	7,000
	1,38,000		1,38,000

4) **Interest income :**

	Rs.	*Rs.*	*Rs.*
Bank accounts :			
Savings		700	
Fixed deposit		22,000	22,700
Investments :			
Government securities :			
received	8,000		
receivable	24,000	32,000	
ICICI Ltd. Bond :			
Receivable		30,000	62,000
			84,700
5) Investments in government securities :			
Opening cost			3,00,000
Less : Realised			80,000
Closing cost			2,20,000
6) Profit on disposal of government securities :			
Amount received		1,00,000	
Less : Interest		8,000	92,000
Cost			80,000
Profit			12,000
7) Surplus from programme :			
Advertisements in souvenir			5,00,000
Sale of tickets			25,000
			5,25,000
Less : Programme expenses.			2,75,000
			2,50,000
8) Fixed deposit with Canara Bank			
Opening balance		2,00,000	
Add : Fresh deposit		1,25,000	
		3,25,000	
Less : Maturity		75,000	
Closing balance			2,50,000
9) Fixed assets :			
Opening balance		95,000	
Purchases		80,000	1,75,000
Less : Depreciation.			12,500
			1,62,500

Question 3 :

Paresh runs a circulating library and his accounts are in a mess. One Bank Account has been used for both the business as well as his personal transactions. After looking into his records you gather the following information :

(1) Payments for Magazines for the year ended 31st March, 2002 – Rs. 9,700.

(2) Payment of Delivery Peon's Wages for the year ended 31st March, 2002 – Rs. 2,200.

(3) Payment of other expenses for the year ended 31st March, 2002 – Rs. 3,080.

(4) Subscription collected – Rs. 21,695.

(5) He has taken Rs. 500 per month in cash from the subscription collection to pay to his wife for their household and personal expenses, depositing the balance of the collections into the Bank.

(6) During the year he bought a second hand car (not used for the business) from a friend for Rs. 4,000. However, as the friend owed him Rs. 250 for subscription, the matter was settled by a cheque for the difference.

(7) An assurance policy on his life matured during the year and realised Rs. 7,000.

(8) Paresh issued a cheque for Rs. 1,200 to a friend as loan. The friend is repaying by instalments in cash, and owes Rs. 500 on 1st March, 2002.

(9) Magazine subscription for the year amounting to Rs. 400 had to be written off by Paresh as irrecoverable.

(10) Other personal payments by cheques total Rs. 2,350.

(11) The cash collected includes Rs. 600 in respect of magazine subscription written off as irrecoverable in a previous year.

(12) Paresh runs the business from his flat for which a rent of Rs. 90 per month is included in the payments for other expenses Rs. 3,080. The living accommodation may be regarded as two-thirds of the whole.

(13) The following balances may be accepted as correct :

	31st March	
	2001 *(Rs.)*	2002 *(Rs.)*
Cash in Hand	115	70
Bank Balance	4,720	5,880
Subscription receivable (Debtors) considered good	1,830	2,105
Creditors for purchase of Magazine	900	840
Stock of Magazine, at cost	2,450	830

You are required to prepare :–

(a) A Cash and Bank Account for the year;

(b) Paresh (Proprietor's) Account for the year;

(c) An income and Expenditure Account of the circulating Library for the year ended 31st March, 2002; and

(d) A Balance Sheet of the Business as at 31st March, 2002.

Show your workings.

Answer :

In the Books of Paresh

Dr. **Cash and Bank Account** **Cr.**

Receipts	*Cash*	*Bank*	*Payments*	*Cash*	*Bank*
2002, April 1					
To Balance b/d	115	4720	By Creditors (Magazine)		9700
To Subscription	6000	15095	By Other Expenses		2000
To Subscription w/o in previous year now recovered	600		By Rent of Premises		1080
			By Wages (Cash bal. figure)	1345	855
To Capital A/c (Proprietor's Policy money)		7000	By Drawing (Monthly)	6000	
			By Drawings (Car)		3750
To Drawings (Refund of loan)	700		By Drawings (for Loan to friend)		1200
			By Drawings (Personal payments)		2350
			By Balance c/d	70	5880
	7415	26815		7415	26815

* *Out of Rent Rs.1080, share of Paresh is Rs.720.*

Dr. **Paresh (Proprietor's) Account** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Drawings	13570	By Balance b/d	8,215
To Balance c/d	8045	By Bank (Policy money)	7,000
		By Income and Expenditure A/c	6,400
	21615		21615

Dr. **Mr. Paresh Income and Expenditure Account** for the year ended *31st March, 2002* **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*
To Stock of magazine		2450	By Subscription	22,020
To Purchase (magazine)		9640	By Subscription recovered for previous yr.	600
To Delivery Peon's Wages		2200	By Stock of Magazine	830
To Other Expenses		2000		
To Rent	1080			
Less: Proprietor's Rent	720	360		
To Bad debts (Subscription W/O)		400		
To Excess of Income over Expenditure – transfer to Capital A/c		6400		
		23,450		23,450

Balance Sheet of Paresh as at *31st March, 2002*

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*
Trade Creditors (Re. Magazine)		840	Cash in hand	70
Capital			Cash at Bank	5880
Opening	8215		Sundry Debtors – Subscription	
Add: Additions	7000		receivable (considered good)	2105
Excess of Income over Expenditure	6400		Stock of Magazine	830
Less: Drawings	(13570)	8045		
		8885		8885

Balance Sheet of Paresh *as at 31st March, 2001*

Liabilities	*Rs.*	*Assets*	*Rs.*
Creditors (Re- Magazines)	900	Cash at Bank	4720
Capital (Balance Figure)	8215	Cash in Hand	115
		Subscription Receivable	1830
		Stock	2450
	9115		9115

Working Notes :

Dr. Drawings Account Cr.

	Particulars	*Rs.*		*Particulars*	*Rs.*
To	Cash (Monthly Exp.)	6000	By	Capital A/c (Transfer)	13570
To	Bank (Loan to friend)	1200	By	Cash (Refund)	700
To	Bank (Car)	3750			
To	Bank (Personal Payment)	2350			
To	Other Expenses (Rent)	720			
To	Subscriptions (Car)	250			
		14270			14270

Dr. Debtors (Re-Subscriptions) Account Cr.

	Particulars	*Rs.*		*Particulars*	*Rs.*	*Rs.*
To	Balance b/d	1830	By	Cash	6000	
To	Subscriptions A/c (bal. fig.)	22020	By	Bank	15095	21095
			By	Bad Debts		
				(Subscriptions – W/O)		400
			By	Drawings (Re. Car)		250
			By	Balance c/d		2105
		23850				23850

Question 4 :

From the following details prepare **Balance Sheet of Ever Green Club** as at 31.3.2003 :

	Rs.		*Rs.*
Furniture (before Depreciation)	8,000	Printers' Bill Outstanding	1,000
Depreciation on Furniture written of	800	Allowances Outstanding	800
Building Fund	30,000	Capital Grants	10,000
Income of Building Fund	2,000	Entrance Fees (50% to be Funded)	4,000
Fixed Deposits	20,000	Legacies Received (to be Funded)	8,000
Opening Balance of General Fund	10,000	Prize Fund	10,000
Excess of Income over Expenditure	20,000	Income of Prize Fund	1,000
Capital Fund (Opening Balance)	60,000	Expenses of Prize Fund	800
Cost of Swimming Pool	40,000	Investment of Prize Fund	10,000
Equipments	20,000	Balance in Current Account	10,000
Investment of General Fund	36,000	Cash in Hand	800
Subscription Outstanding	10,000		

Answer :

Dr. **Balance Sheet of Evergreen Club** *as at 31.3.03* **Cr.**

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Funds :			**Fixed Assets :**		
Capital Fund :			Swimming Pool		40,000
Balance	60,000		Equipments		20,000
Add : Capital Grants	10,000		Furniture	8,000	
Legacies	8,000		*Less :* Deprn.	800	7,200
Entrance Fees (50%)	2,000	80,000	**Investments :**		
General Fund :			General		36,000
Balance	10,000		Prize Fund		10,000
Add : Excess of Income			**Receivables :**		
Over Expenditure	20,000	30,000	Subscription outstanding		10,000
Building Fund :			**Cash & Bank Balances :**		
Balance	30,000		Fixed Deposit		20,000
Add : Income	2,000	32,000	Current Account		10,000
Prize Fund :			Cash		800
Balance	10,000				
Add : Income	1,000				
	(800)	10,200			
Current Liabilities :					
Allowances outstanding		800			
Printers' Bill outstanding		1,000			
		1,54,000			1,54,000

Question 5 :

Surya Trust runs a charitable hospital and a dispensary and for the year ended 31.3.98, the following balances were extracted from its books :

		Dr. *(Rs.)*	**Cr.** *(Rs.)*
Capital Fund			18,00,000
Donation received in the year			12,00,000
Fees received from patients			6,00,000
Recovery for amenities — rent etc.			5,50,000
Recovery for food supplies			2,80,000
Surgical equipments		9,10,000	
Buildings, theatres etc.		6,40,000	
Consumption of –			
Medicines	2,40,000		
Foodstuffs	1,80,000		
Chemicals etc.	60,000	4,80,000	
Closing Stock of :			
Medicines etc.	40,000		
Foodstuffs	8,000		
Chemicals etc.	2,000	50,000	
Sales of Medicines (dispensary)			6,20,000
Opening Stock of Medicines (dispensary)		1,10,000	
Purchases of medicines (dispensary)		6,00,000	
Salaries :			
Administrative staff	60,000		
Doctors, nurses, etc.	3,00,000		
Assistants at dispensary	30,000	3,90,000	
Electricity and power charges etc.			
Hospital	2,10,000		
Dispensary	4,000	2,14,000	
Furniture, fittings and equipments		1,60,000	
Ambulance		60,000	
Postage, telephone charges etc. less recovery		52,000	
Subscription to medical journals		42,000	
Ambulance maintenance charges less recoveries			1,600
Consumption of linen, bedsheets, etc.		1,80,000	
Fixed Deposit (made on 10.8.96 for 3 yrs. at @ 11%p.a. interest)		10,00,000	
Cash in hand		12,100	
Cash at Bank		70,500	
Sundry Debtors (dispensary)		1,21,000	
Sundry Creditors (dispensary)			82,000
Remuneration to trustees, trust office expenses etc.		42,000	
		51,33,600	51,33,600

Additional information :

(i) The dispensary supplies medicines to Hospital on requisitions and delivery notes ; for which no adjustment has been made in the books. Cost of such supplies in the year was Rs. 1,20,000.

(ii) Stock of medicines at close at dispensary was Rs. 80,000 ;

(iii) Donations were received towards the corpus of the trust ;

(iv) Stock of medicines on 31st March, 1998 at the Hospital included Rs. 8,000 worth of medicines belonging to patients ; this has not been considered in arriving of the figure of consumption of medicines ;

(v) One of the well-wishers donated Surgery Equipment, whose market value was Rs. 80,000 on 15th August, 1997 ;

(vi) The Hospital is to receive a grant of 25% of the amount spent on treatment of poor patients from the local branch of the Red Cross Society. Such expenditure in the year was Rs. 1 lakh.

(vii) Out of the fees recovered from the patients, 10% is to given to specialists as retained.

(viii) Depreciations on assets, on closing balances, is to be provided on :

Surgical Equipments	20%
Buildings	5%
Furniture and fittings	10%
Ambulance	30%

Prepare the Income and Expenditure Account of the dispensary, Trust and the Hospital for the year ended 31st March, 1998 and statement of affairs of the Trust as at that date.

Answer :

SURYA TRUST

Dr. **Income & Expenditure Account** for the *year ended 31st March, 1998* **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Opening stock	1,10,000	By Sales	6,20,000
To Purchases	6,00,000	By Issues to Hospital	1,20,000
To Gross Profit	1,10,000	By Closing stock	80,000
	8,20,000		8,20,000
To Salaries	30,000	By Gross Profit	1,10,000
To Electric charges	4,000		
To Net Profit tfd. to General Trust Income & Expenditure A/c	76,000		
	1,10,000		1,10,000

Dr. **General Trust A/c** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Deficit in Hospital A/c	2,67,400	By Profit from Dispensary	76,000
To Postage, Telephone charges, etc	52,000	By Interest due on	
		Fixed Deposit	1,10,000
To Trustees & Remuneration expns., etc.	42,000	By Net Deficit for the year	1,75,400
	3,61,400		3,61,400

Dr. **Hospital A/c** **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*
To Consumption of :			By Fees recovered from patients	6,00,000
Medicines	3,68,000		By Recovery for room rent etc.	5,50,000
Food stuffs	1,80,000		By Recovery from Food supplied	2,80,000
Chemicals etc.	60,000	6,08,000	By Ambulance receipts (Net)	1,600
			By Grants receivable from Red Cross	25,000
To Salaries to :				
Doctors, Nurses etc.	3,00,000			
Administrative Staff	60,000	3,60,000		
To Returns due to specialists		60,000		
To Electricity & Power charges		2,10,000		
To Subscription to Medical Journals		42,000		
To Consumption of linen				
bed sheets, etc.		1,80,000		
To Depreciation of : —				
Surgical equipments @ 20%				
on Rs. 9,90,000	1,98,000			
Building @ 5%	32,000			
Furniture & fits. @ 10%	16,000		By Excess of Expenditure	
Ambulance @ 30%	18,000	2,64,000	over Income	2,67,400
		17,24,000		17,24,000

STATEMENT OF AFFAIRS *as at 31.3.98* *(figures in Rs. '000)*

Liabilities			*Assets*		
Capital Fund :			Cash in hand		12.1
As on 1.7.97	1800		*Cash at Bank :*		
Add : Donation received	1200		On Current A/c	70.5	
Add : Market value of			On Fixed Deposit	1000.0	1070.5
gift of Equipment	80	3080	Interest accrued on F. D.		110
Less : Deficit for the year		175.4	Sundry Debtors		121
		2904.6	Grant due from Red Cross		25

Sundry Creditors :			Stocks of goods –		
– For Medicine supplied	82		Medicines (Dispensary)		80
– For retainer due			*Hospital :*		
to specialists	60	142	Medicines	32	
			Food	8	
			Chemicals	2	42
			Surgical Equipments :		
			(as on 1.4.97)	910	
			Gift received	80	
				990	
			Less : Depreciation	198	792
			Building, Theatre etc :		
			as on 1.4.97	640	
			Less : Depreciation	32	608
			Furniture & Fittings etc. :		
			as on 1.4.97	160	
			Less : Depreciation	16	144
			Ambulance :		
			as on 1.4.97	60	
		.	*Less :* Depreciation	18	42.0
		3046.6			3046.6

3.3 SELF-EXAMINATION QUESTIONS

1. Distinguish, giving examples, between Receipts and Payment Account and Income and Expenditure Accounts.

2. Do you consider the following to be Capital or Revenue item ? Give reasons.

(i) A motor car, whose book value is Rs. 10,000 and was sold for Rs. 15,000, thus making a gain of Rs. 5,000.

(ii) Legal expenses incurred in raising a debenture loan.

(iii) Rs. 15,000 was paid as compensation to a discharged employee.

(iv) The removal of stock from old works to new works costed Rs. 5,000.

3. The Secretary of the Systematic Club has prepared the following draft Balance Sheet of the club as at 30.9.1995 :

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Account :		**Fixtures & Fittings :**	
Balance as on 30.9.95	14,300	As on 30.09.95	10,600
Less : Loss for the year	2,100	*Less :* Depreciation for the year	1,000
	12,200		9,600
Subscription in advance	600	Stock	3,200
Creditors	2,400	Debtors	1,400
		Balance at bank	950
		Cash in hand	50
	15,200		15,200

You ascertain the following :–

(1) The amount of loss was only a balancing figure as the books had been kept on a single entry basis.

(2) The balance at bank was that shown by the bank statement at the close of the business on 30.9.95.

(3) The following amounts had been paid into bank on 30.09.95 but had not been credited by the bank :

(i) Two cheques of Rs. 50 each had been cashed for a member - one had since been duly honoured but the other head been returned marked "refer to drawer" and, on being approached, the member repaid Rs. 50 in cash;

(ii) A member's subscription of Rs. 80 for the year 1995-96.

(4) The following cheques had been drawn in September but has not been presented until October :

(i) Rs. 480 for bar supplies which had been delivered but had not been included in stock;

(ii) Rs. 350 for additional typewriter received on October 2;

(iii) Rs. 100 as bonus of the professional included under the creditors;

(iv) Rs. 140 for fuel which had been included in the stock figure but not in the creditors and this cheque was dated October 1.

You are required to prepare :–

(a) a bank reconciliation statement as on 30.9.95, and

(b) a revised Balance Sheet as on the date to give effect to the consequential adjustments, assuming that otherwise the items in the draft Balance sheet were correct.

COMPANY ACCOUNTS

Page No.

4.0 INTRODUCTION TO COMPANY ACCOUNTS

4.1 CONCEPT OF SHARE CAPITAL

Money required by a company to commence and carry on its operations is raised by issuing shares and debentures. Although there are other sources of raising funds (like acceptance of public deposits, taking bank loans, etc.), issue of shares is the bulk of fund requirement by a company.

The term 'Share Capital of a company' can be used in the following concepts :–

1. **Authorised Capital:** This presents the value of shares with which a company is registered.
2. **Issued Capital :** This means the portion of authorised capital that is being offered for public subscription.
3. **Subscribed Capital:** This presents that portion of issued Capital that is being taken up by public.
4. **Called up Capital:** This represents that part of subscribed capital that the directors have decided to call up from the subscriber to satisfy the monetary needs of the company.
5. **Paid up Capital :** That portion of called up capital that is being actually paid in cash by the shareholders.

Types of Shares

A company can issue two types of shares :–

1. Preference shares :

Preference shares carry a fixed rate of dividend which is to be paid before distribution of Equity Dividend. At the time of winding up of the company the claim of preference shares towards repayment of capital has to be satisfied before satisfying claim of Equity Shareholders. Preference share holders can neither get the Notice of A.G.M nor they are able to take part in deliberation of the meeting except when their dividend has remained unpaid for a specified number of years.

Preference shares can be cumulative or noncumulative. In the first case the unpaid preference dividend accumulates over the years and has to be paid in later years when there is adequate profit. This condition does not exists in case of noncumulative preference shares.

Under the Companies (Amendment) Act, 1988 , preference shares issued by a company has to be redeemed within 10 years from the date of issue.

2. Equity shares:

Equity shares are those which are not preference shares. They do not carry any specific rate of dividend; i.e. the rate of dividend can vary over the years depending on the sufficiency of profit. They are allowed to get notice and attend the A.G.M. of the company.

Books of Account of a Company

According to Section 209 of the Companies Act, 1956 :

— Every Company shall keep at its registered Office proper books of account with respect to :

(a) all sums of money received and expended by the Company and the matters in respect of which the receipt and expenditure take place;

(b) all sales and purchases of goods by the Company;

(c) the Assets and Liabilities of the Company;

(d) in the case of a Company pertaining to any class of Companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of materials or labour or to other items of cost as may be prescribed, if such class of Companies is required by the Central Government to include such particulars, in the books of account.

Provided that all or any of the books of account aforesaid may be kept at such other place in India as the Board of Directors may decide and the company shall, within 7 days of the decision, file with the Registrar a Notice
in writing giving the full address of that other place.

— If proper books of account relating to the transactions effected at the branch office are kept at that Office and proper summarised returns, made up to date at intervals of not more than 3 months are sent by the branch office or the other place as decided upon.

— Proper books of account shall not be deemed to be kept with respect to the matters specified therein :

(a) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the Company or branch office, as the case may be and to explain its transactions.

(b) if such books are not kept on accrual basis and according to the double entry system of accounting.

— The books of account and other papers shall be open to inspection by any director during business hours.

— The books of account of every Company relating to a period of not less than 8 years immediately preceding the current year together with the vouchers shall be preserved in good order.

4.2 ISSUE OF SHARES

Issue of shares involves the following steps :

1. Issue of prospectus including people to take up shares
2. Receiving applications along with application money.
3. Allotment of shares
4. Making calls on shares as decided by the Board of Directors.
5. Issue and despatch of share certificate.

Journal Entries for issue of Shares

Particulars	*Dr.*	*(reason)*	*Cr.*
1) on receipt of application money :			
Bank A/c	Dr.		
To Share Application A/c *[No. of shares applied '×' Rate]*			
2) on allotment of shares:			
Share Application A/c *[No. of shares applied '×' Rate]*	Dr.		
To Share capital A/c			
3) For rejection of some applications:			
Share Application A/c	Dr.		
To Share Capital A/c *[No. of shares rejected '×' Rate]*			

Note: Shares can be issued at premium which may be receivable either at the time of application or allotment; the Journal Entries then will be :

a) When Premium is receivable along with application :			
i) Bank A/c *[Total receipt including premium]*	Dr.		
To Share Application			
ii) Share Application A/c *[No. of shares issued '×' Rate]*	Dr.		
To Share Capital *[No. of shares issued '×' Rate towards face value]*			
To Share Premium *[premium / share '×' No. of shares issued]*			
b) When premium is receivable at the time of allotment.			
i) Share Allotment A/c	Dr.		
To Share Capital			
To Share Premium.			
ii) Bank A/c	Dr.		
To Share Allotment			

5) Making and Receipt of Calls : The Balance due towards face value of shares after receiving application and allotment money can be recovered by making as many calls as the directors decide. The entries should be :

1) For Call Money due:

Share Call A/c *[No. of shares Issued '[No. of shares issued '×' Rate]' Rate.]* Dr.
To Share Capital.

2) For Call money received

Bank A/c Dr.
To Share Call A/c

6) Treatment of calls-in-arrear : The terms denotes failure on part of some shareholders to make payment of any call due on the shares taken up by him. The following entry should be passed in every case of such default.

Call-in-arrear A/c *[No. of defaulted shares '×' Rate]* Dr.
To (Respective) Call A/c.

In case shares are not forfeited the Total balance of call-in-arrear A/c should be deducted from Share Capital A/c in the Balance Sheet.

Treatment of call-in-advance

When some shareholders make excess payment in respect of any instalment due on his shares the excess amount may be retained by the company and adjusted against subsequent calls. The Journal Entries would be :

	Particulars	*Dr.*	*(reason)*	*Cr.*
1)	Share Call (1) *[No. of shares Issued '[No. of shares applied '×' Rate]' Amount due on call/share]*	Dr.		
	To Share Capital (original call made).			
2)	Bank A/c Dr. (Total receipt)			
	To Share Call (1) A/c *[No. of shares '[No. of shares '×' Due on call/per share]*			
	To Calls-in-advance *[Excess amount received]*			
3)	Share Call (2) A/c	Dr.		
	[No. of shares issued '*[No. of shares applied '×' Rate]*' Amount due on call /per share]			
	To Share Capital			
4)	Bank A/c (Balance)	Dr.		
	Calls-in-advance A/c *[Excess amount received on prior call]*			Dr.
	To share call (2) A/c *[No. of shares issued '×' amount due/per Share.]*			

Unadjusted calls in advance should be shown on Liability side of Balance Sheet.

Issue of shares at a discount

For issuing shares at discount the following conditions are to be satisfied : (u/s 79 of Companies Act)

1) Discount should be given on such classes of shares already issued by the Company.
2) The decision to issue shares at discount will be taken by passing a resolution at the A.G.M.
3) The company must be at least one year of age.
4) Without approval of CLB the maximum rate of discount must not exceed 10% of face value.
5) Sanction of CLB to such discounted issue must be obtained within two months after such issue or within two months after such issue or within such extended period as may be granted by the CLB.

JOURNAL ENTRY

Share Allotment A/c	Dr.
Discount on Issue of Share A/c	Dr.
To Share Capital	

Note : The above entry assumes the adjustment of discount at the time of allotment.

Illustration 1 :

Bat and Ball Ltd. issued 50,000 Equity Shares of Rs. 100 each. These were payable as to Rs. 20 on Application, Rs. 30 on Allotment and the balance will be paid as and when called for by Directors. Applications were received for 70,000 shares. The Directors made the allotment as follows :

To applicants of 30,000 shares — Full allotment

To applicants of 30,000 shares — 20,000 shares

To applicants of 10,000 shares — Application money refunded

Give journal entries for the above assuming all the money due on allotment has been received and no call has been made.

Solution :

Particulars		*Dr.(Rs.)*	*Cr.(Rs.)*
Bank Account	Dr.	14,00,000	
To Share Application A/c			14,00,000
(Being Application money received on 70,000 shares @ Rs. 20 per share)			
Share Application A/c	Dr.	10,00,000	
To Share Capital A/c			10,00,000
(Being Application money transferred to Share Capital Account as per Board's Resolution Dated..........)			
Share Application A/c	Dr.	2,00,000	
To Bank Account			2,00,000
(Being the application money on 10,000 shares @ Rs. 20 per Share refunded as Shares were not allotted as per Board's Resolution No. Dated..........)			
Share Allotment Account	Dr.	15,00,000	
To Share Capital Account			15,00,000
(Being the Capital Account money due on 50,000 shares @ Rs.30 per share as per Board's Resolution dated..........)			
Share Application Account	Dr.	2,00,000	
To Share Allotment A/c			2,00,000
(Being surplus Application money on 10,000 shares transferred to Share Allotment A/c as per Board's Resolution dated..........)			
Bank A/c	Dr.	13,00,000	
To Share Allotment A/c			13,00,000
(Being the receipt of the amount due on allotment Rs. 15,00,000 – 2,00,000)			

4.3 FORFEITURE AND REISSUE OF SHARES

Forfeiture of shares :

The shares allotted to a subscriber who has defaulted in paying any call due on his shares can be forfeited by decision of the Board of Directors if empowered by the articles of the company after giving due notice to the defaulting shareholders. This power of Board of Directors has to be applied bonafide and in the interest of the company.

Journal Entries for Forfeiture

Share Capital A/c Dr.
[No. of share forfeited '×' Amount called up per share]
To Calls in Arrear *[total amount of dues not collected on forfeited shares]*
To Share Forfeiture A/c *[amount collected on forfeited shares]*

If forfeited shares are issued at a premium and such premium is not received then the entry should be :

Share Capital A/c Dr.
Share Premium A/c Dr.
To Calls-in-arrear A/c
To Share Forfeiture A/c

Re-Issue of forfeiture A/c – accounting entries.

1)

Bank A/c Dr. (Amount actually received)
Share Forfeiture A/c Dr. (Discount on Reissue)
To Share Capital A/c (Face value of share)

---

2) If balance of Share Forfeiture A/c exceeds discount on Reissue, the Balance should be treated as a Capital profit which is computed on follows :–

Amount forfeited × No. of shares reissued - Discount on No. of forfeited shares reissued. × no. of shares.

The Journal Entry will be :

1) Share Forfeited A/c Dr.
To Capital Reserve

Note:

The forfeited amount on unissued shares will be shown in Balance Sheet as an addition to share capital.

Prorata Allotment

In case of over subscription the company can either reject the excess applications or make proportionate allotment to all applicants. The second case is called prorata allotment. The excess money received on application is adjusted against subsequent calls :

Entries

Share Application A/c	Dr.
To Subsequent Calls A/c	

Illustration 2 :

Kamnasib Ltd. issued 400000 equity shares of Rs. 10 each at a premium of Rs. 20 per share. The amounts were receivable as follows :

On	Capital	Premium	Total
	Rs.	*Rs.*	*Rs.*
Application	1	9	10
Allotment	2	8	10
Final call	7	3	10
	10	20	30

All members except Mr. Unfortunate paid the amounts due to allotment and call. Mr. Unfortunate who was allotted 300 shares failed to pay call money. His shares were forfeited after due compliance with law.

These shares were reissued to Hopeful at a price of Rs. 25 per share.

You are asked to pass the journal entries on :–

(a) Forfeiture

(b) Reissue

Also show the presentation in balance sheet before and after forfeiture and after reissue.

Solution :

			Dr. Rs.	Cr. Rs.
1)	Equity Share Capital (at Rs. 10/-).	Dr.	3,000	
	Share Premium (at Rs. 3)	Dr.	900	
	To Share Final Call (at Rs. 10)			3,000
	To Forfeited Shares A/c.			900
	(Being forfeiture of 300 shares numbered... to... held by Unfortunate for non payment of final call of Rs. 10, the amount received on capital account on application (Rs. 1) and allotment (Rs.2) being credited to Forfeited Shares A/c vide Board Resolution dt.)			
2)	Bank.	Dr.	7,500	
	Forfeited Shares	Dr.	900	
	To Equity Share Capital			3,000
	” Share Premium			900
	” Capital Reserve			4,500
	(Being reissue at Rs. 25 per share of 300 Equity Shares numbered to Hopeful vide board resolution dt....)			

Extract from Balance Sheet *(before forfeiture)*

	Rs.	Rs.
Equity Share Capital		
Issued : For cash		
400000 Equity Shares of Rs. 10 each fully Called up.		40,00,000
Less : Calls-in-arrear		2,100
		39,97,900
Reserves and Surplus :		
Share Premium.	80,00,000	
Less : Calls in-arrear	900	79,99,100

Extract from balance sheet *(after forfeiture)*

	Rs.	Rs.
Equity Share Capital :		
Issued : For Cash.		
399700 Equity Shares of Rs. 10 each fully paid		39,97,000
Add : Forfeited shares.		900
		39,97,900

Reserve and surplus :

Share Premium.		
As per last Balance Sheet.		79,99,100
	Rs.	*Rs.*

Extract from balance sheet *(after reissue)*

Equity Share Capital :

Issued : For cash.		
400000 Equity Shares of Rs. 10 each fully paid.		40,00,000
Reserve and surplus :		
Capital Reserve :		
Profit on reissue of forfeited equity shares.		4,500
Share Premium :		
As per last balance sheet.	7999100	
Add : Received on reissue of forfeited shares.	900	80,00,000
		80,04,500

Illustration 3 :

ABC Limited offered for public subscription 2,000 Equity shares of Rs. 100 each at a premium of Rs. 20 per share on the following terms :

(a) Applications money to be paid before 30th June, 2000; Rs. 40 per share..

(b) Allotment money to be paid before 20th September, 2000; Rs. 50 per share including Rs. 20 premium.

(c) First and final call money to be paid before 31st December, 2000; Rs. 30 per share.

Applications for 4,000 shares were received, the Company decided to :

(i) Allot in full 200 shares to 4 applicants who had applied for the same.

(ii) Reject the application for 1,400 shares applied for by persons suspected to be agents of a rival company

(iii) Allot the balance number of shares proportionately, to the remaining applicants, and to apply the excess money paid towards the allotment money dues.

Ravi who had applied for 100 shares and who was allotted all the shares applied for could not pay allotment money. Ruby who was allotted 60 shares on the proportion basis could not pay the final call. After due notices all such shares were forfeited and reissued at a discount of 20% of the face value of the share of Mr. Reddy.

Pass the necessary journal entries to record the above transactions in the books of the Company.

Solution :

Working Notes :

1. Issue of 2,000 equity shares of Rs. 100 each at Rs. 20 premium.

   For application of Rs. 40

   Amount received = 4000 × Rs. 40 = Rs. 1,60,000

Application	*Allotment*
200	200
1,400	Rejected
2,400 (4:3)	1,800
4,000	2,000

2. **For Allotment :**

   Refund of application = 1,400 × Rs. 40 = Rs. 56,000
   Excess application amount = 600 × Rs. 40 = Rs. 24,000
   Amount due = 2,000 × Rs. 50 = Rs. 1,00,000

   Amount received :

	Rs.
Amount due	1,00,000
Less : Already received	24,000
	76,000
Less : Calls in arrears (Ravi) (100×50)	5,000
Amount received	71,000

3. **For first and final call : (Rs. 30)**

   Amount due = 2,000 × 30 = Rs. 60,000

   Amount received

Amount due	60,000
Less :Calls in arrears :	
Ravi (100×30)	3,000
Ruby (60×30)	1,800
Amount received	55,200

In the books **ABC Ltd.**

JOURNAL

	Particulars		Dr. *(Rs.)*	Cr. *(Rs.)*
1.	Cash/Bank A/c	Dr.	1,60,000	
	To Share Application A/c			1,60,000
	(Being application money received)			
2.	Share Application A/c	Dr.	1,60,000	
	To Equity Share Capital A/c			80,000
	To Cash/Bank A/c			56,000
	To Share Allotment A/c			24,000
	(Being application money received transferred to various latter A/c as per Board Resolution No. ..., dated ...)			
3.	Share Allotment A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			60,000
	To Security Premium A/c			40,000
	(Being allotment of shares as per Board Resolution No. ..... dated ....)			
4.	Cash/Bank A/c	Dr.	71,000	
	Calls in-arrear A/c	Dr.	5,000	
	To Share Allotment A/c			76,000
	(Being amount received on allotment and calls in arrear on allotment of shares)			
5.	First and Final Call A/c	Dr.	60,000	
	To Equity Share Capital A/c			60,000
	(Being first and final call made as per Board Resolution No. ..... dated .....)			
6.	Cash/Bank A/c	Dr.	55,200	
	Calls in-arrear A/c	Dr.	4,800	
	To First and final call A/c			60,000
	(Being amount received and calls in arrears on first and final call)			

7.	Equity Share Capital A/c	Dr.	16,000	
	To Calls in arrears A/c			9,800
	To Share Forfeiture A/c			6,200
	(Being entry for forfeiture of 160 shares as per Board Resolution No..... dated ...)			
8.	Cash/Bank A/c	Dr.	12,800	
	Share Forfeiture A/c	Dr.	3,200	
	To Equity share capital A/c			16,000
	(Being forfeited shares reissued at a discount of Rs.20 as per Board's Resolution No. Dated....)			
9.	Share Forfeiture A/c	Dr.	3,000	
	To Capital Reserve A/c			3,000
	(Being profit on reissue transferred to Capital Reserve account)			

Illustration 4 :

The following particulars are given for the books and records of M/s Arati Ltd. relating to issue and forfeiture of shares and payable as follows :

on application Rs. 3 per share
on allotment Rs. 5 per share (including premium)
on first and final call Rs. 4 per share

	No. of shares allotted	*No. of shares applied for*
Category I	20,000	30,000
Category II	10,000	10,000
Category III	Nil	5,000 (Money refunded)

The book value of each share is Rs. 10. Allotment were made prorata in Category I. Mr. Malay Das who applied for 450 shares in Category I failed to pay allotment and call money and his shares were forfeited by directors. Subsequently 200 forfeited shares were reissued to Mr. Badal as fully paid for Rs. 9 per share.

Show the Journal Entries and Cash Book to record the above transactions. Also prepare the Balance Sheet.

Solution :

In the books of Arati Ltd..

Journal Entries

Date	*Particulars*		*Rs.*	*Rs.*
1.	Equity Share Application A/c	Dr.	1,20,000	
	To Equity Share Capital A/c			90,000
	To Equity Share Allotment A/c			30,000
	(Being Application money on 30,000 equity share were transferred and excess 10,000 application money were adjusted with Allotment as per Board Resolution No...... & Dated.....)			
2.	Equity Share Allotment A/c	Dr.	1,50,000	
	To Equity Share Capital A/c			90,000
	To Share Premium A/c			60,000
	(Being Allotment money due on 30,000 equity share of Rs. 5 each including Rs. 2 as premium as per Board Resolution No.... Dated.....)			
3.	Equity Share 1st Call & Final Call A/c	Dr.	1,20,000	
	To Equity Share Capital A/c			1,20,000
	(Being Call money due on 30,000 Equity Share @ Rs. 4 per share as per Board Resolution No..... Dated.....)			
4.	Equity Share Capital A/c	Dr.	3,000	
	Share Premium A/c	Dr.	600	
	To Share Forfeiture A/c			1,350
	To Share Allotment A/c			1,050
	To Share First & Final Call A/c			1,200
	(Being 450 Equity shares were forfeited after nonpayment of Allotment and call money as per Board Resolution No..... Dated.....)			
5.	Forfeited Share A/c	Dr.	200	
	To Equity Share Capital A/c			200
	(Being Discount on Reissue were adjusted)			
6.	Forfeited Share A/c	Dr.	700	
	To Capital Reserve A/c			700
	(Being Profit on reissue were transferred)			

Dr. **CASH BOOK (BANK COLUMN)** **Cr.**

Particulars	*L.F.*	*Rs.*	*Particulars*	*L.F.*	*Rs.*
To Equity Share Application A/c (45,000 share @ Rs.3 each)		1,35,000	By Equity Share Application (Excess appl. on 5,000 share refunded)		15,000
To Equity Sh. Allotment A/c (Note No.1)		1,18,950	By Balance c/d		3,59,550
To Equity Share 1st & Final Call A/c (29,700 share @ 4 each)		1,18.800			
To Equity Share Capital A/c		1,800			
		3,74,550			3,74,550
To Balance B/d		3,59,550			

ARATI LTD..

Balance Sheet as on .....

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		**Current Asset**	
Issued and paid up Capital		Cash at Bank	3,59,550
29,00- Equity share @ Rs. 10 each	2,99,000		
Reserve & Surplus			
Share Premium (60,000–600)	59,400		
Capital Reserve	700		
Share Forfeiture A/c (1,350–900)	450		
	3,59,550		3,59,550

Working Notes :

1. **Amount Received on Allotment :**

	Rs.
Amount due on Allotment 30,000 Share @ 5 each	1,50,000
Less : Amount already adjusted	30,000
	1,20,000
Less : Non Receipt of Allotment	1,050
	1,18,950

2. **Non Receipt of Allotment :**

Amount due on 300 shares (2/3×450) @ 5 each	1,500
Less : Amount paid in excess on Application (150×3)	450
	1,050

3. **Capital Reserve :**

Amount Credited from 200 shares (1,350/300×200)	900
Less : Amount utilised (200×1)	200
	700

Note : Balance amount in Share Forfeiture A/c i.e. (1,350–900) = Rs. 450 kept for further reissue of Balance 100 Equity Shares.

4.4 ISSUE OF BONUS SHARES

Companies with substantial reserve may decide to capitalise a part or whole of such reserves by issuing fully paid up, instead of paying dividend to its share holders.

Sources of Bonus Issue

1. For fully paid up Bonus Shares :
   - (a) P/L Account,
   - (b) General Reserve,
   - (c) Capital Redemption Reserve,
   - (d) Share Premium A/c,
   - (e) Other free reserves.
2. For partly paid up bonus shares :
   - (a) P/L A/c,
   - (b) General Reserve,
   - (c) Other free Reserves.

Note :

1) Revaluation Reserve is not available for issue of Bonus Shares.

2) Share Premium and Capital Redemption Reserves are not available for issuing partly paid up Bonus shares.

JOURNAL ENTRIES.

For fully paid up Bonus Share issue

1) Reserve A/c Dr.
    To Bonus to Shareholders
    (Declaration of Bonus as per share holders Resolution No........dated......)

2) Bonus to Shareholders A/c Dr.
    To Equity Share Capital
    (Issue of .....(no.) of Bonus shares as per Share Holder Resolution No......dated.....)

For issuing partly paid up Bonus shares

a) Share ....CallA/c Dr.
    To Share Capital
    (Call money due on ....shares @ Rs......)

b) Reserves A/c Dr.
To Bonus to Shareholder A/c
(Declaration of Bonus as per Share holder resolutions no....dated..)

c) Bonus to Shareholders A/c Dr.
To Share Call A/c
(Utilisation of Reserves for making partly paid up shares into fully paid up)>

Procedure for Issue of Bonus share:

Students are advised to refer to the SEBI Guidelines issued from time to time in this respect. Behind bonus issue

1. Reflection of true earning rate to share holders funds.
2. Avoidance of monetary outflow involved in distribution of dividend.
3. Improvement of company reputation in the market.

Redemption of Preference shares:

One should refer to Section 80 of Companies Act in this respect which is reproduced below:

1. Only fully paid up shares can be redeemed.
2. Such redemption should be affected either out of the funds obtained from fresh issue of shares or out of the nonspecific reserves of the company.
3. Premium (if any) on redemption shall be paid out of companies past profit or Share Premium A/c.
4. Where such redemption is affected otherwise than out of the proceeds of the fresh issue an amount equal to the nominal value of the shares so redeemed will be transferred termed "Capital Redemption Reserve".

JOURNAL ENTRIES.

1. Preference Share Capital A/c Dr.
[Face value of shares to be redeemed]
Premium on Redemption A/c Dr.
To Preference Shareholders A/c
(Amount due on Redemption as well as premium thereon transferred to preference share holders A/c)

2 Bank A/c Dr.
To Share Capital
(Fresh issue made on finance Redemption).

Note:

1. This entry should be made only when fresh shares are issued.
2. Premium or discount on such issue shall be adjusted in the manner mentioned earlier while discussing issue of shares.
3. Bank A/c Dr.

   To Assets A/c

   (Sale of Assets to finance redemption)

Note: Any profit or loss on such sale should be adjusted in P/L A/c

4. Reserve A/c Dr.

   To Capital Redemption Reserve

   [Face value of shares redeemed – Face Value of new issue]

   (Provision of Sec. 80 of Companies Act)

5) Preference Shareholders A/c Dr.

   To Bank

   (payment made to preference share holders)

Note : In case some of shareholders could not be found amount due to them should be shown on liability in the Balance Sheet.

6) Reserve A/c Dr.

   To Premium of Redemption A/c

   [Premium on redemption adjusted]

Illustration 5 :

The Bharat Steel Co. whose issued share capital on 31st March, 1994, consisted of 6,000 8% redeemable preference shares of Rs. 100 each fully paid and 20,000 equity shares of Rs. 100 each,Rs. 80 paid up, decided to redeem preference shares at a premium of Rs. 10 per share. The Co.'s Balance Sheet as at 31st March, 1994, showed a General Reserve of Rs. 9,00,000 and a Capital Reserve of Rs. 85,000. The redemption was effected partly out of profits and partly out of the proceeds of a new issue of 3,000 7.5% cumulative preference shares of Rs. 100 each at a premium of Rs. 25 per share. The premium payable on redemption met out of the premium received on the new issue. On 1st July, 1994 the company at its General Meeting resovled that all the capital reserves be applied in the following manner :

(a) The declaration of bonus at the rate of Rs. 20 per share on equity shares for the purpose of making the said shares fully paid; and

(b) The issue of bonus shares to the equity shareholders in the ratio of 1 share for every four shares held.

You are required to pass necessary journal entries.

Solution :

Books of Bharat Steel Co. Ltd.

JOURNAL

Date	Particulars		Dr. *(Rs.)*	Cr. *(Rs.)*
31.3.94	8% Preference Share Capital A/c	Dr.	6,00,000	
	To Preference Shareholders A/c			6,00,000
	(Redemption of 6,000 shares due)			
31.3.94	Premium on Redemption A/c	Dr.	60,000	
	To preference Shareholders A/c			60,000
	(Premium due on redemption)			
31.3.94	Bank A/c	Dr.	3,75,000	
	To 7.5% Preference Share Capital A/c			3,00,000
	To Share Premium A/c			75,000
	(Issue of Preference shares at 25% premium)			
31.3.94	General Reserve A/c	Dr.	3,00,000	
	To Capital Redemption Reserve A/c			3,00,000
	(Provision of s. 80 of Companies Act met)			
31.3.94	Preference Shareholders A/c	Dr.	6,60,000	
	To Bank A/c			6,60,000
	(Payments to Preference Shareholders)			
31.3.94	Share Premium A/c	Dr.	60,000	
	To Premium on Redemption A/c			60,000
	(Transfer entry)			
1.7.94	Equity Share Final Call A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Call made on 20,000 shares @ Rs. 20 per share)			
1.7.94	General Reserve A/c	Dr.	4,00,000	
	To Bonus Dividend A/c			4,00,000
	(Bonus issued @ Rs. 20 per share)			
1.7.94	Bonus Dividend A/c	Dr.	4,00,000	
	To Equity Share Final Call A/c			4,00,000
	(Issue of Bonus Share by conversion of partly paid up shares into fully paid up.)			

1.7.94	Capital Redemption Reserve A/c	Dr.	3,00,000	
	Share Premium A/c	Dr.	15,000	
	Capital Reserve A/c	Dr.	85,000	
	General Reserve A/c	Dr.	1,00,000	
	To Bonus Dividend A/c			5,00,000
	(Declaration of bonus as per Shareholders Resolution No......dated.....)			
1.7.94	Bonus Dividend A/c	Dr.	5,00,000	
	To Equity Share Capital A/c			5,00,000
	(Issue of 5,000 Equity shares as bonus)			

Illustration 6 :

The following is the Balance Sheet of TOM Ltd. as at 31.03.1997 :–

TOM Ltd.

Balance Sheet *as at 31st March, 1997*

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Share Capital –			Fixed Assets		
Authorised 5000 10% Redeemable			Gross Block	1,50,000	
Preference Share of			*Less :* Depreciations	50,000	
Rs. 10 each	50,000				1,00,000
45,000 Equity Shares			Investments		50,000
of Rs. 10 each	4,50,000		Current Assets, Loans and		
		5,00,000	Advances :		
Issued, Subscribed and			Inventory	12,500	
paid-up Capital			Debtors	12,500	
5000 10% Redeemable			Cash and Bank Balances	25,000	
Preference Shares of					50,000
Rs. 10 each	50,000				
5000 Equity Shares of			Misc. Expenditure to the		
Rs. 10 each	50,000	1,00,000	extent not written off		10,000
Reserves and surplus					
General Reserve	60,000				
Share Premium	35,000				
Profit & Loss A/c	9,250				
		1,04,250			
Current Liabilities and					
Provisions					
Sundry Creditors		5,750			
		2,10,000			2,10,000

For the year ended 31.3.1998, the company made a net profit of Rs. 7,500 after providing Rs. 10,000 depreciation and writing off the miscellaneous expenditure of Rs. 10,000.

The following additional information is available with regard to company's operation :–

(i) The preference dividend for the year ended 31.3.1998 was paid before 31.3.1998.

(ii) The company redeemed the preference shares at a premium of 10%.

(iii) To meet the cash requirements of redemption, the company sold a portion of the investments, so as to leave a minimum balance of Rs. 15,000 after such redemption.

(iv) Except cash and bank balances other current assets and current liabilities as on 31.3.1998 was the same as on 31.3.1997.

(v) The company issued bonus shares in the ratio of one share for every equity share held as on 31.3.1998.

(vi) Investments were sold at 90% of cost on 31.3.1998.

You are required to :

(a) prepare necessary Journal Entries to record redemptions and issue of bonus shares;

(b) prepare the Cash and Bank Account;

(c) prepare the Balance Sheet as at 31.3.1998 incorporating the above transactions.

Solution :

JOURNAL ENTRIES in the Books of TOM LTD.

		Dr. (Rs.)	Cr.(Rs.)
10% Redeemable Preference Capital A/c	Dr.	50,000	
Premium on Redemption of Preference Shares	Dr.	5,000	
To Preference Shareholders			55,000
(Being amount payable to Pref. shareholder on redemption).			
General Reserve A/c	Dr.	50,000	
To Capital Redemption Reserve			50,000
(Being transfer to the Latter A/c on redemption of shares)			
Bank A/c.	Dr.	22,500	
Profit & Loss A/c	Dr.	2,500	
To Investments			25,000
(Being amount realised on sale of Investments and loss thereon adjusted)			

Preference Shareholders A/c	Dr.	55,000	
To Bank			55,000
(Being payment made to Preference Shareholders)			
Share Premium A/c	Dr.	5,000	
To Premium on Redemption of Preference Shares			5,000
(Being amount of Premium payable on redemption of Preference shares)			
Capital Redemption Reserve A/c	Dr.	50,000	
To Bonus to Shareholders			50,000
(Amount adjusted for issuing bonus shares in ratio of 1 : 1)			
Bonus to Shareholders A/c.	Dr.	50,000	
To Equity Share Capital			50,000
(Balance of former account transferred to Latter)			

Dr. **Cash and Bank Account** **Cr.**

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*
To Balance B/F.		25,000	By Preference Dividend	5,000
To Cash from operations			By Preference Shareholders	55,000
Profit	7,500			
Add : Deprn.	10,000		Balance C/f.	15,000
Add : Misc. Expenditure	10,000	27,500		
To Investments		22,500		
		75,000		75,000

Working Notes :

Sale of Investments :	
Cost of Investments	25,000
Less : Cash received	22,500
Loss on sale of Investment	2,500
Total Investment	50,000
Less : Cost of Investment sold	25,000
Cost of Investment in hand	25,000
Market value 90% of 25000	22,500

Balance Sheet of Tom Ltd. *as at 31st March, 1998*
(After Redemption)

Liabilities		*Rs.*	*Assets*		*Rs.*
Share Capital			**Fixed Assets :**		
Authorised Capital :		5,00,000	Gross Block	1,50,000	
Issued, Subscribed & Paid up :			Less : Depreciation :		
10,000 Equity Shares of Rs. 10/- each fully paid (5000, Shares have been allotted as Bonus Shares for Capitalising Capital Redemption Reserve)		1,00,000	As per last A/c	50,000	
			For the year	10,000	90,000
			Investments : (Market value Rs. 22,500)		25,000
Reserve & Surplus :			**Current Assets, Loans & Advances :**		
General Reserve	10,000		Inventory	12,500	
Share Premium A/c	30,000		Debtors	12,500	
Profit & Loss A/c	9,250	49,250	Cash & Bank Balance	15,000	40,000
Current Liabilities & Provisions :					
Sundry Creditors		5,750			
		1,55,000			1,55,000

Working Notes :

Profit & Loss A/c –		
Balance as per last A/c		9,250
Add : Profit for the year		7,500
		16,750
Less : Pref. dividend	5,000	
Sale of Investment	2,500	7,500
		9,250

4.5 UNDERWRITING

Underwriting in the context of a company means undertaking a responsibility or giving a guarantee that the shares or debentures offered to the public will be subscribed for. There are firms which undertake this sort of work and are very useful to companies which want to raise funds by the issue price of the whole of the shares or debentures underwritten. A company cannot pay commission on issue of shares unless it is provided for in its Articles. Commission cannot be paid to any person on shares or debentures which are not offered to the public for subscription [sec. 76(4A)].

The law limits the commission on issue of share to 5% for shared and 2 1/2% for debentures. This has to be disclosed in the prospectus.

Sub-underwriters :

These are underwriters who work under other underwriters. For subscriptions procured by them, the underwriter gets a small commission called **overall commission**.

Brokerage :

It is merely the act of procuring subscriptions for shares or debentures without undertaking any responsibility.

Marked Applications:

Underwriters issue application forms stamped with their name for shares and debentures to the public.

Underwriting commission :

The entry for underwriting commission is :

Underwriting commission on Issue of Shares A/c	Dr.
To Underwriter A/c	

The underwriter can also take part responsibility. In such a case his liability will have to be calculated accordingly.

Illustration 7 :

Dale Ltd. has Authorised Capital of Rs. 8,00,000. The company issues 20,000 equity shares of Rs. 10 each at a premium of Rs. 5 per share payable as :

On application — Rs. 6 (including premium Rs. 3)

On allotment — Rs. 5 (including balance of premium)

Balance in two calls.

Applications were received for 35,000 shares. The applicants were divided in the following groups :

Group A — Applying for 5,000 shares allotted fully.

Group B — Applying for 20,000 shares are made prorata allotment for 15,00(shares.

Group C — Applying for total 10,000 shares are refunded.

Directors while making allotment adjust the excess amount received on application against allotment money due. When second and final calls were made, shareholders holding 500 shares failed to pay the final call money. The directors forfeited these shares. All the forfeited shares were reissued at Rs. 9 per share.

It is agreed that brokerage @ 3% and underwriting commission @ 3% will be paid for this issue. Claims of brokers and underwriters are satisfied by issuing to them additional equity shares of Rs. 10 each at a premium of Rs. 5 per share (without any cash payment).

Show Journal Entries and the Balance Sheet of the company in the books of the company.

Solution :

In the books of Dale Limited

Particulars	Dr. *(Rs.)*	Cr. *(Rs.)*
Bank Account	2,10,000	
To Equity Share Application Account		2,10,000
(application money recd. on 35000 shares @ Rs.6 share)		
Equity Share Application Account	60,000	
To Bank Account		60,000
(being application money on 10,000 shares refunded)		
Equity share Application Account	1,20,000	
To Equity Share Capital A/c		60,000
To Security Share Premium A/c		60,000
(being application money on 20000 shares transferred to share premium and share capital)		
Equity Share Application A/c	30,000	
To Equity Share Allotment A/c		30,000
(Excess application money received on application transferred to share allotment account as per board's resolution No........ Dated.......)		
Equity Share Allotment A/c	1,00,000	
To Equity Share Capital A/c		60,000
To Security Premium A/c		40,000
(Amount due on allotment A/c @ Rs. 5 per share including a premium of Rs. 2 as per board's resolution No. .... Dated.......)		
Bank Account	70,000	
To Equity Share Allotment A/c		70,000
(being balance of allotment money recd. in full)		

Equity Share First Call A/c	40,000	
To Equity Share Capital A/c		40,000
(being call money due on 20000 shares @ Rs.2 /share)		
Bank Account	40,000	
To Equity Share First Call A/c		40,000
(being first call money recd.)		
Equity Share Final Call A/c	40,000	
To Equity Share Capital A/c.		40,000
(being call money due on 20000 shares @ Rs. 2/share)		
Bank Account	39,000	
To Equity Share Final Call A/c.		39,000
(being call money on 19500 share received)		
Equity Share Capital Account	5,000	
To Equity Share Final Call A/c.		1,000
To share forfeiture account		4,000
(being 500 shares forfeited)		
Bank Account	4,500	
Share Forfeiture Sccount	500	
To Equity Share Capital Account		5,000
(being 500 shares reissued @Rs. 9/share)		
Share Forfeiture A/c	3,500	
To Capital Reserve A/c		3,500
(being profit on forfeiture transferred to capital reserve)		
Brokerage Account	6,000	
Commission Account	6,000	
To Equity Share Capital A/c.		8,000
To Security Premium Account		4,000
(Commission and Brokerage paid)		

Balance Sheet of Dale Ltd.

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		**Fixed Assets**	
Authorised (80000 share of Rs. 10 each)	8,00,000	**Investments**	
Issued, subscribed and paid		**Current Assets, Loans & Advances**	
20800 equity shares of Rs. 10 each		*Current Assets*	
(800 shares issued for		Bank balance	3,03,500
consideration other than cash)	2,08,000	Miscellaneous Expenditure	
Reserves & Surplus		Brokerage on issue of shares	6,000
Security premium	1,04,000	Commission on issue of shares	6,000
Capital reserves	3,500		
	3,15,500		3,15,500

4.6 DEBENTURE — ISSUE AND REDEMPTION

A debenture may be defined as an acknowledgment (mostly under seal of the company) of a debt or loan raised by the company. Just as the share capital of a company is divided in a large number of a parts, each part being called a share, the loan may be divided into a number of parts called Debentures. They enable a company to raise a loan easily by enabling investors to buy as many debentures as they want.

Debenture is a creditorship security. Company has to pay interest to debenture holders at the agreed rate. It is usual to prefix "Debentures" with annual rate of interest.

Distinction between Debentures and Shares.

	Debentures	*Shares*
i) Security	It is a creditorship Security	It is an ownership security
ii) Return	A debenture holder is certain of return on his investment and of interest payments.	No certainty of dividend payment.
iii) Order of repayment on winding up.	They are paid first	They are finally paid.
iv) Issue at a discount	No legal conditions	Legal conditions have to be satisfied.
v) Mortgage	There can be mortgage Debentures	There cannot be mortgage shares.
vi) Convertibility	Can be converted into shares at the option of the debenture holder.	Cannot be converted into debentures.

CLASSES OF DEBENTURES

Convertible Debentures

Redeemable	Mortgaged	Registered	First	Convertible
Irredeemable	Naked	Bearer	Second	Non-convertible

Issue of Debentures :

The company issues the prospectus inviting applications along with a sum of money called Application money.After scrutiny, the Board of Directors make allotment.

Entries :

1) When applications are received :		
	Bank A/c	Dr.
	To Debenture Application A/c	
2)	Debenture Application A/c	Dr.
	To Debenture A/c	
3) Rejection to applications:		
	Debenture Application A/c	Dr.
	To Debenture Allotment A/c	
4) Surplus allotment money:		
	Debenture Application A/c	Dr.
	To Debenture Allotment A/c	
5) Amount due on allotment of debentures:		
	Debenture Allotment A/c	Dr.
	To Debentures A/c	

Like shares debentures may be issued at par, at a premium or at a discount. But the law does not lay down any maximum limit for discount on issue of debentures. The sanction of the CLB is also not needed. If a company issues debentures on the condition that they would be redeemed at a premium, this additional liability should be recorded in a separate account called "Premium on Redemption of Debentures A/c" and should be shown along with the liability "Debentures" on the liabilities side of the Balance Sheet.

Entries:

i) When debentures are issued at par and are also redeemed at par:

Bank A/c	Dr.
To Debenture A/c	

ii) When debentures are issued at a discount, but redeemable at par;

Bank A/c	Dr.
Discount of Issue of Debentures A/c	Dr.
To Debenture A/c	

iii) When debentures are issued at a premium and redeemable at par:

Bank A/c	Dr.
To Debenture A/c	
To Premium on Issue of Debentures A/c	

iv) When debentures are issued at par and redeemable at a premium :

Bank A/c	Dr.
Loss of Issue of Debentures A/c	Dr.
To Debenture A/c	
To Premium on Redemption of debentures A/c	

v) When debentures are issued at a discount and redeemable at a premium:

Bank A/c	Dr.
Discount on Issue of Debentures A/c	Dr.
Loss on issue of Debentures A/c	Dr.
To Debentures A/c	
To Premium on Issue of Debentures A/c	

vi) Expenses, Discount, and loss on Issue of debentures are transferred to an account called Cost of Issue of debentures A/c and shown as "Miscellaneous Expenditure" in the Balance Sheet.

vii) Premium on Issue of debentures is transferred to Capital Reserve A/c.

Redemption of Debentures:

Debentures are invariably redeemable. Debentures may be redeemed

(i) In one lot,

(ii) In instalments or drawing by lots,

(iii) By purchase of debentures in the open market.

Cancellation of debentures may take place in one of two ways :–

(i) Immediate cancellation i.e. immediately after purchase in the open market, and

(ii) Cancellation after holding them for some time as "own debentures". After cancellation the debentures cannot be resold as they stand redeemed.

Entries:

---

1) When the debentures are redeemed at par:

i)	Debentures A/c	Dr.
	To Sundry Debentureholders A/c	
ii)	Sundry debenturesholders A/c	Dr.
	To Bank A/c	

2) When the debentures are redeemed at a premium :

i)	Debentures A/c	Dr.
	Premium on Redemption A/c	Dr.
	To Sundry Debentureholders A/c	
ii)	Sundry Debentureholders A/c	Dr.
	To Bank A/c	

When the debentures are redeemed by cancelling them immediately after their purchase in the open market, redemption will be recorded as follows –

---

1) When purchase prices is equal to the face value of debentures :

	Debentures A/c	Dr.
	To Bank A/c	

2) When purchase price is higher than the face value of debentures:

i)	Debentures A/c	Dr.
	Loss on Redemption of Debentures A/c	Dr.
	To bank A/c	
ii)	Share Premium A/c	Dr.
	or	
	Profit & Loss A/c	Dr.
	To Loss on Redemption of Debentures A/c	

3) When purchase price is lower than the face value of the debentures:

i)	Debenture A/c	Dr.
	To Bank A/c	
	To Profit on Redemption of Debentures A/c	
ii)	Profit on Redemption of Debentures A/c	Dr.
	To Capital Reserve A/c	

A company may buy its own debentures, hold them as investments for some time and then redeem them by cancellation. Entries will be as follows:

When own debentures are purchased as investments:

	Own Debentures A/c	Dr.
	To Bank A/c	
When "own debentures" held as investments are cancelled:		
1) When purchase price is equal to the face value of debentures:		
	Debentures A/c	Dr.
	To Own Debentures A/c	
2) When purchase price is higher than the face value of debentures:		
i)	Debentures A/c	Dr.
	Loss of Redemption of own debentures A/c	Dr.
	To Own Debentures A/c	
ii)	Share premium A/c	Dr.
	or	
	Profit & Loss A/c	Dr.
	To Loss on Cancellation of Own Debentures A/c	
3) When purchase price is lower than the face value of debentures:		
i)	Debentures A/c	Dr.
	To Own Debentures A/c	
	To profit on cancellation of own debentures A/c	
ii)	Profit on Cancellation of Own Debenture A/c	Dr.
	To Capital Reserve A/c	

Sinking Fund method:

Under this method the amount is invested in first class securities which when allowed to accumulate with compound interest produce the amount required to redeem the debentures on the due date. This method of providing for funds is known as Sinking fund method. Accounting entries for making the provision for the redemption of debentures are as follows:

First year on 31st December (date of closing) :

1.	Profit & Loss Appropriation A/c	Dr.
	To Sinking Fund A/c	
	(for setting aside the amount which is calculated after consulting the sinking fund tables).	
2.	Sinking Fund Investment A/c	Dr.
	To Bank A/c	
	(for investing the amount set aside)	

For second and subsequent years :

1. Bank A/c Dr.
   To Interest on Sinking Fund Investment A/c
   (for receiving interest on the investment made in the past years)

2. Interest on Sinking Fund Investment A/c Dr.
   To Sinking Fund A/c
   (for transferring interest to Sinking Fund)

For Last Year

1. Bank A/c Dr.
   To Interest on Sinking Fund Investment A/c
   (for receiving interest on the investment made in the past years)

2. Profit and Loss Appropriation A/c Dr.
   To Sinking Fund A/c
   (for setting aside the amount)

3. Interest on Sinking Fund Investment A/c Dr.
   To Sinking Fund A/c
   (for transferring Interest Account to Sinking Fund)

It may be noted that in the final year the amount appropriated from the profits of the company and the amount received as interest on sinking fund investment are not invested as the amount would be needed on the following day for the redemption of debenture.

Concept of Cum and Ex-interest

The word "Cum" means "inclusive" and "Ex" means exclusive. When debentures are quoted on "cum-interest" basis it means that the quotation in addition to covering the cost also includes accrued interest upto the date of purchase/sale.

In case of Ex-interest quotation only cost element is covered.

Redemption of Debentures by purchase in open market purchase for immediate cancellation. The company at its will can purchase own debentures for market and cancel them. The Accounting Entries will be :

---

i) **For purchase of debentures** (Quoted price × No. of debenture purchased) – Accrued interest.

Debenture Redemption A/c	Dr.	(Cost)
Debenture Interest A/c	Dr.	(Accrued Interest)
To Bank A/c Total payment.		

b) When debentures are purchased (Ex-interest)

Debenture redemption A/c Dr.

(Quoted price × No. of Debentures purchased)

Debenture Interest A/c Dr.

(Accrued Interest)

To Bank *(Total payment)*

c) Sale of Sinking Fund Investment

Bank A/c Dr.

To S.F. Investment A/c

Note: Profit/Loss on sale will be adjusted in Sinking Fund A/c.

d) For cancellation :

Debentures A/c Dr.

(Face value of Debenture Redeemed)

To Debenture Redemption A/c

Any balance in Debenture Redemption A/c will be adjusted against Sinking Fund A/c.

Purchase of Debentures in open market as Investment

Sometimes a company purchases its debentures and hold them as investment. The accounting entries are stated as follows:

---

1. When debentures are purchased

1. At cum Interest

Own Debenture Investment A/c Dr.

(Quoted price – Accrued debentures purchased)

Debenture Interest A/c Dr. (Accrued Interest)

To Bank A/c

b. At Exinterest:

Own Debenture Investment A/c Dr. (Quoted price Accrued debentures purchased)

Debenture Interest A/c Dr. (Accrued interest)

To Bank

c. For sale of Sinking Fund Investment

Bank A/c Dr.

To Sinking Fund Investment A/c

Any Profit & Loss will be adjusted in Sinking Fund A/c

4. For Cancellation:

Debentures A/c Dr.*[Face value]*

To Own Debenture investment A/c [Cost}

To Profit/Loss on Cancellation will be charged to Sinking Fund A/c

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Illustration 8 :

You are required to set out the Journal Entries relating to the issue of the following Debentures in the books of X Ltd :

(a) 8%, 120 Rs. 1,000 Debentures are issued at 5% discount and are repayable at par.

(b) Another 7%, 150 Rs. 1000 Debentures are issued at 5% discount and repayable at 10% premium.

(c) Further 80, 9% Rs. 1,000 Debentures are issued at 5% premium.

(d) In addition another 400, 8% Rs. 100 Debentures are issued at collateral security against a loan of Rs. 40,000.

Solution :

JOURNAL

			Dr.(Rs.)	*Cr.(Rs.)*
(i)	Bank Account	Dr.	1,14,000	
	Debenture Discount A/c.	Dr.	6,000	
	To 8% Debentures A/c.			1,20,000
	(Issue of 8%, 120 Rs. 1,000 Debentures of 5% discount and repayable at par as per Board's resolution dated...)			
(ii)	Bank Account	Dr.	1,42,500	
	Loss on issue	Dr.	22,500	
	To 7% Debentures			1,50,000
	To Premium on Redemption			15,000
	(Issue of 7%, 150 Rs. 1,000 Debentures at a Discount of 5% and repayable at 10% premium as per Boards' Resolution dated .....)			
(iii)	Bank Account	Dr.	84,000	
	To 9% Debenture			80,000
	To Debentures Premium			4,000
	(Issue of 9%, 80 Rs. 1,000 Debentures at 5% premium as per Boards' Resolution dated ....)			
(iv)	Debenture Suspense *(or)* (8% Collateral Debentures)	Dr.	40,000	
	To 8% Debentures			40,000
	(Issue of 400, 8% Debentures of Rs. 100 each as collateral security to against Rs. 40,000/- loan as per agreement and Board's Resolution dated....)			

Notes :

1. Discount Account may also be termed as Loss on Issue Account. But loss on issue is better used in second case as it indicates loss due to discount and also loss arising as a result of the term to pay premium on redemption.
2. Collateral Debenture will be shown in Asset side or by way of deductions from Debentures. In the alternative, no entry may be passed and a note to that effect in the Balance Sheet will serve the purpose.

Illustration 9 :

The Summarised Balance Sheet of Nipa Ltd. on March 31, 1997 was as follows :

Liabilities	*Amount*	*Assets*	*Amount*
Share capital:		Fixed assets at cost less : depreciation	4,12,000
6% Redeemable preference		Goodwill	2,00,000
shares of Rs. 10 each	2,00,000	Stock	4,50,000
Equity shares of Rs. 10 each	4,00,000	Sundry Debtors	2,15,000
Profit & loss A/c	2,50,000	Discount on Debentures	12,000
5% Debentures	3,00,000		
Bank Loan	50,000		
Sundry Creditors	89,000		
	12,89,000		12,89,000

Wanting to redeem the Preference Shares and the Debentures the company offered to the Redeemable Preference Shareholders and the Debenture holders the option to convert their holding into Equity Shares to be issued at a premium of Rs. 2.50 per share. Half of the Preference Shareholders and one-third of the Debenture holders agreed to do this. The company issued 30000 Equity Share at Rs. 12.50 to the public for cash and with the funds available paid off the bank loan and redeemed the remaining redeemable Preference Shares and Debentures.

Journalise the transaction and show how the balance sheet will appear after the transactions have been completed.

Solution :

Date	*Particulars*	*LF*	*Dr. (Rs.)*	*Cr.(Rs.)*
31st March, 1997				
i)	6% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
	To Equity Share Capital (8000×Rs.10)			80,000
	To Share Premium A/c (8000×Rs. 2.50)			20,000
	(Being 50% of Redeemable Preference Shares converted into Equity Shares @ 10 each with Premium, Rs. 2.50 each.)			

ii)	5% Debentures A/c	Dr.	1,00,000	
	To Equity Share Capital A/c (8000×Rs.10)			80,000
	To Share Premium A/c (8000×Rs.2.50)			20,000
	(Being 1/3rd Debenture converted into Equity Share @ Rs. 10 each with Premium of Rs. 2.50 each.)			
iii)	Bank A/c (30,000 × Rs. 12.50)	Dr.	3,75,000	
	To Equity Share Capital A/c (30,000×Rs. 2.50)			3,00,000
	To Share Premium A/c (30,000×Rs. 2.50)			75,000
	(Being 30,000 Equity Shares @ Rs. 10 with Premium Rs. 2.50 each issued for Cash as per Board Resolution No. .... Dt. ....)			
iv)	6% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
	5% Debentures A/c	Dr.	2,00,000	
	To Preference Share Holders A/c			1,00,000
	To Debenture Holders A/c			2,00,000
	(Being the balance amount of Redeemable Preference Share and Debentures redeemable.)			
v)	Preference Share Holders A/c	Dr.	1,00,000	
	Debenture Holders A/c	Dr.	2,00,000	
	Bank Loan A/c	Dr.	50,000	
	To Bank A/c			3,50,000
	(Being the amount paid to Share Holders and Debenture Holders in full and Bank Loan repaid.)			
vi)	Share Premium A/c	Dr.	12,000	
	To Discount on debenture A/c			12,000
	(Being the amount of discount on debenture is written off after utilising the amount of Share Premium A/c.)			

NIPA Limited.
Balance Sheet *as at 31.03.1997*

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital :		Goodwill	2,00,00
Equity Shares @ Rs. each	8,60,000	Fixed Assets at cost	
Reserve & Surplus :		*Less :* Depreciation	4,12,000
Profit & Loss A/c	2,50,000	**Current Assets :**	
Share Premium A/c	1,03,000	Stock	4,50,000
Current Liabilities & Provisions :		Sundry Debtors	2,15,000
Sundry Creditors	89,000	Cash at Bank	25,000
	13,02,000		13,02,00

Illustration 10 :

The following balances appeared in the books of Royco Ltd. on 1.4.2001 :

(a) Debenture Redemption Fund Rs. 60,000 represented by investments of an equal amount (nominal value Rs. 75,000).

(b) The 12% debentures stood at Rs. 90,000.

The company sold required amount of investments at 90% for redemption of Rs. 30,000 Debentures at a premium of 20% on the above date.

Show the :

(i) 12% Debenture Account;

(ii) Debenture Redemption Fund Account;

(iii) Debenture Redemption Fund Investments Accounts;

(iv) Debenture-holders account

Solution :

In the books of the Royco. Ltd.

Dr. 12% Debentures A/c Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
1/4/01	To Deb. holders A/c	30,000	1/4/01	By Balance b/d	90,000
31/3/02	To Balance c/d	60,000			
		90,000			90,000

Dr. Debenture Redemption Fund A/c Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
31/3/02	To Premium on redemption of debenture A/c	6,000	1/4/01	By Balance b/d	60,000
,,	To General Reserve	30,000	1/4/01	By Debenture Redemption Fund investment A/c	4,000
,,	To Balance c/d	28,000			
		64,000			64,000

Dr. Debenture Redemption Fund Investment A/c Cr.

Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
1/4/2001	To Balance b/d	60,000	1/4/01	By Bank A/c	36,000
,,	To Debenture Redemption Fund A/c	4,000	31/3/02	By Balance c/d	28,000
		64,000			64,000
1/4/02	To Balance b/d	28,000			

Dr.		Debentureholders' A/c			Cr.
Date	*Particulars*	*Rs.*	*Date*	*Particulars*	*Rs.*
1/4/01	To Bank	36,000	31/3/02	By 12% Debentures A/c	30,000
			,,	By Premium on Redm. of Debenture A/c	6,000
		36,000			36,000

Notes :

1. Debentures of Rs. 30000 is to be redeemed at a premium of 20%. Therefore, the amount payable to the debentureholders is Rs. 30000 x 120% = Rs. 36000 . To get Rs. 36000 investments worth Rs. 40000 is to be sold at 90% = Rs. 40000

2.

Sale proceeds from investments	36,000
Less: Cost of investment sold (60,000 / 75,000) × 40,000	32,000
Profit on sale of investments	4,000

Illustration 11 :

You are requested to pass the Journal Entries to the issue of the following debentures in the books of Damodar Valley Corporation.

(i) 2000, 5% Debentures of Rs. 100 each at a premium of Rs. 10 per debenture, redeemable at par.

(ii) 1000, 8% debentures Rs. 150 each at a discount of Rs. 20 per debenture.

(iii) 2000, 12 % Debentures of Rs. 200 each at par, redeemable at a premium of 10%.

(iv) 1500, 11% Debentures of Rs. 250 each at a discount of 10% redeemable at a premium of 10%.

Solution :

In the books of DVC

Journal Entries

	Particulars		*Rs.*	*Rs.*
1.	Bank A/c	Dr.	2,20,000	
	To 5% Debentures A/c			2,00,000
	To Premium on issue of Debentures A/c			20,000
	(Being issue of 2000 debentures of Rs. 100 each at premium, redeemable at per)			
2.	Bank A/c	Dr.	1,30,000	
	Discount on issue of Debentures A/c	Dr.	20,000	
	To 8% Debenture A/c			1,50,000
	(Being issue of 1000 debentures of Rs.150 each at a discount but redeemable at per)			

3.	Bank A/c	Dr.	4,00,000	
	Loss on issue of Debentures A/c	Dr.	40,000	
	To 12% Debenture A/c			4,00,000
	To Premium of redemption of debentures A/c			40,000
	(Being issue of 2000, 12% debentures of Rs. 200 each redeemable at a premium of Rs. 10%)			
4.	Bank A/c	Dr.	3,37,500	
	Loss on issue of Debentures A/c	Dr.	75,000	
	To 11% Debenture A/c			3,75,000
	To Premium on redemption of debentures A/c			37,500
	(Being issue of 2000 12% Debentures at a discount 5% and repayable at a premium of 10% as per board resolution No. ....Dated.........)			

Illustration 12 :

ABC Limited issued 4000 10% debentures of Rs.100 each at par in January1988 redeemable at par on December 1997. Interest was payable on debentures on 30th June and 31st December in each year. For redemption, the company has set up Sinking Fund by appropriating a sum of Rs .32,000 and the amount was invested. As per the terms of the Issue the company is empowered to purchase its own debentures in the market and to keep them available for reissue. On December 1996 the following balances were extracted from the company's book :

Sinking Fund Investments in Govt. Securities at cost

(a)	Sinking Fund Investments in Govt. Securities at cost	Rs. 3,27,520
(b)	10% debenture Stock	4,00,000
(c)	Sinking Fund Account	3,72,000

The transactions during the year ended 31st December '97 included the following —

January 1 :	Government securities at par value of Rs.32,000 were purchased for Rs. 31,680.
February 1 :	120 own debentures were purchased cum-interest at a cost of Rs. 11,760.
September 1 :	Government securities worth Rs. 12,000 were disposed of at Rs.11,800 ex-interest.
September 1 :	120 own debentures were purchased ex-interest for Rs.11,800 with the proceeds of investment sold.
December 22 :	The balance of the Sinking fund investment sold cum-interest at 99% .

The debenture stock was redeemed and cancelled in accordance with thee terms of issue.

Appropriate for the year from the Profit & Loss Account to Sinking Fund to the extent of amount actually required for redemption.

You are required to prepare the following accounts in the books of the company for the year ended 31st December, 1997 (workings should form part of your Answer) :

(a) Sinking Fund Account.

(b) Sinking Fund Investment Account.

Solution :

ABC Limited

10% Sinking Fund Investment Account (Government Securities)

Date	*Particulars*	*Nominal*	*Interest*	*Cost*	*Date*	*Particulars*	*Nominal*	*Interest*	*Cost*
1997					1997				
Jan.1	To Bal b/d	327520	—	327520	Jun30	By Bank	—	17,976	—
Jan.1	To Bank	32000	—	31680	Sept.1	By Bank	12000	200	11800
Dec.31	Sinking Fund A/c		34838		Sept.1	By Sinking			
	(Transfer)					Fund A/c(Loss)			200
					Dec.22	By Bank	347520	16662	327383
					Dec. 31	By Sinking			
						F. A/c (loss)			19817
		359520	34838	359200			359520	34838	359200

10% Sinking Fund Investment Account (Own Debentures)

Date	*Particulars*	*Nominal*	*Interest*	*Cost*	*Date*	*Particulars*	*Nominal*	*Interest*	*Cost*
1997					1997				
Feb.1	To Bank	12000	100	11660	Jun30	By Debenture			
						Interest A/c	—	600	—
Sept.1	To Bank	12000	200	11800	Dec.31	By Deb. Int A/c	—	1200	—
Dec.31	Sinking Fund A/c	—	1500	540	Dec.31	By 10% Debenture			
	(Transfer)					Stock A/c	24000		24000
		24000	1800	24000			24000	1800	24000

Sinking Fund Account

Date	Particulars	Amount	Date	Particulars	Amount
1997			1997		
Sept.1	To Sinking Fund Inv. A/c (Gross on sale of Govt. Sec.)	200	Jan. 1	By Balance b/d	3,72,000
Dec. 31	To Sinking Fund Inv. A/c (Loss on sale of Govt. Sec.)	19,817	Dec.31	By Sinking Fund Inv. A/c (Int. on Govt. Securities)	34,838
			Dec.31	By Sinking Fund Inv. A/c — (Own Debentures)	
				— Interest	1,500
Dec. 31	To General Reserve	4,00,000		— Profit on cancellation	540
			Dec. 31	By Profit & Loss A/c- (Apprn. for redemption)	11,139
		4,20,017			4,20,017

10% Debenture Stock Account

Date	Particulars	Amount	Date	Particulars	Amount
1997			*1997*		
Dec. 31	To Sinking Fund Inv. A/c (Own debenture cancellation)	24,000	Jan.1	By Balance b/d	4,00,000
Dec. 31	To Bank	3,76,000			
		4,00,000			4,00,000

Working Notes —

1. Interest : 3,47,520 x 10/100 x 175/365 = 16,661,90 (= 16662 say)
2. It is assumed in respect of Government Securities
   (a) Rate of interest is 10%
   (b) Interest is payable on 30th June and 31st December every year
   (c) Face value of Securities as on 31st December, 1996 is taken at Rs. 3,27,520.

4.7 PROFIT OR LOSS PRIOR TO INCORPORATION

Business is very often taken over by a company from a date earlier than the date of its incorporation or date of commencement of business. The profit of the company up to the date of its incorporation/commencement of business, cannot be treated as Trading Profit of the company. Thus, the profit arising to the company from the date of purchase, up to the date of incorporation/commencement of business is known as pre-incorporation profit. This pre-incorporation profit being considered as capital profit is transferred to Capital Reserve or adjusted with Goodwill. When a business is taken over and working continued, usually same set of books is used and ultimately, the total profit for the year is divided between pre and post incorporation periods. At times, this division is made on some estimation.

The usual practice is to prepare the profit and loss account only at the end of the year and then to allocate the profits between the two periods in the following manner :

(a) Gross profit and expenses connected with sales to be apportioned according to the ratio of sales for the two periods.

(b) Salaries, rent, interest etc. should be apportioned on the basis of ratio of time before incorporation and after.

(c) Expenses solely incurred for the company on and after its incorporation e.g. preliminary expenses, directors' fees, etc. should be charged wholly to the post-incorporation period.

Illustration 13 :

The Sai Deep Ltd. was incorporated on 1st August 1996, to take over the running business of Krishna Bros. with effect from 1st April 1996. The company received the certificate for commencement of business on 1st October 1996. The following P&L A/c was prepared for the year ended 31.3.1997.

Profit and Loss Account *for the year ended 31.03.1997*

	Particulars	*Amt. (Rs.)*		*Particulars*	*Amt. (Rs.)*
To	Office Salaries	21,000	By	Gross Profit b/d	80,000
To	Partners Salaries	6,000	By	Share Transfer Fee	1,000
To	Advertisement	4,400			
To	Printing & Stationery	1,500			
To	Travelling expenses	4,000			
To	Office Rent	9,600			
To	Electricity Charges	900			
To	Auditors Charges	600			
To	Directors Charges	1,000			
To	Bad Debts	1,200			
To	Commission on Sales	4,000			
To	Preliminary Expenses	700			
To	Debenture Interest	1,600			
To	Interest on Capital	1,800			
To	Depreciation	2,100			
To	Net Profit	20,600			
		81,000			81,000

Additional information :

(1) Total Sales for the year, which amounted to Rs. 8,00,000 arose evenly up to the date of certificate of commencement, whereafter they recorded an increase of 2/3 during the year. Gross profit was at an uniform rate of 10% of selling price throughout the year and a commission of 0.5% was paid on sales.

(2) Office Rent was paid @ Rs. 8,400 p.a. up to 30th September 1996, and thereafter it was paid @ Rs. 10,800 p.a.

(3) Travelling Expenses include Rs. 1,600 towards sales promotion

(4) Bad Debts written off –

(a) A debt of Rs. 400 taken over from the vendor.

(b) A debt of Rs. 800 in respect of goods sold in September 1996

Depreciation includes Rs. 600 for assets acquired in the post-incorporation period.

Show the "pre" and "post" incorporation results and also state how the results of pre- and post-incorporation is dealt with.

Solutrion :

M/S SAIDEEP LIMITED.

Dr. **Profit and Loss account** *for the year ended 31.3.96* **Cr.**

Expenses	*Basis*	*Pre*	*Post*	*Income*	*Basis*	*Pre*	*Post*
To Office salary	Time	7,000	14,000	By Gross Profit	Sales	20,000	60,000
To Partners' salary	Actual	6,000	–	By Share trans. fee	Actual	–	1,000
To Advertisement	Sales	1,100	3,300	By Bal. transferred			
To Printing & Stationery	Time	500	1,000	to Goodwill A/c		2,800	–
To Sales promotion	Sales	400	1,200				
To Travelling exp.	Time	800	1,600				
To Office rent	Time	2,800	6,800				
To Electricity chgs.	Time	300	600				
To Director's fees	Actual	–	1,000				
To Auditors's fees	Time	200	400				
To Bad debts	Time	400	800				
To Commission on sales	Sales	1,000	3,000				
To Preliminary Exp.	Actual	–	700				
To Debenture int.	Actual	–	1,600				
To Int. on Capital	Actual	1,800	–				
To Depreciation	Time	500	1,600				
To Bal. b/d		–	23,400				
		22,800	61,000			22,800	61,000

Working Notes :

1. **Pre-incorporation loss –** It has been transferred to Goodwill A/c.
2. **Sales ratio —**

Pre - incorporation Post- incorporation

Apr.	*May*	*June*	*July*	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan*	*Feb*	*Mar*
1	1	1	1	1	1	$1^2/_3$	$1^2/_3$	$1^2/_3$	$1^2/_3$	$1^2/_3$	$1^2/_3$

Pre-incorporation sales = 4. Post incorporation sales = 12;
Hence, Sales ratio = 4:12 i.e. 1:3
Let average sales of first six months be Rs. 3 per month —
So, average sales of remaining six months (Rs. 3 + 2/3 of Rs. 3, i.e., Rs. 3+2 = Rs. 5 p.m.
Sales ratio = 12 : 36
4 months = Rs. 3 per month = A × 3 = 12
8 months = Rs. 3 per month = i.e. 2 × 3 = 6 @ Rs. 5 p.m. = i.e. , 6 × 5 = 30 that is 30 + 6 = 36
12 : 36 = 1 : 3

3. **Allocation of office rent —**

	Pre-incorporation	Post-incorporation	
April to July	8,400 × 4 ÷ 12 = 2,800	10,800 × 6 ÷ 12 =	5,400 Oct. to Mar.
Aug. to March		8,400 × 2 ÷ 12 =	1,400 Aug. to Sept.
Aug. to Mar			6,800

4. **Allocation of depreciation —**

	Pre-inc.	Post-inc.
On post inc. assets	—	600
Bal. Rs. 1,500 on time ratio 4 : 12	500	1,000

4.8 SPECIAL POINTS IN RESPECT OF CERTAIN ITEMS

1. Income-tax : For provisions relating to advance tax, provision for income-tax refer any recommended Text Book.The following is an example –

Illustration 14 :

Trial Balance of Soma Ltd. as on 31st March, 1997 [extract]

Name of Account	Dr.(Rs.)	Cr.(Rs.)
Advance income tax for 1995-96	2,20,000	
Advance income tax for 1996-97	2,30,000	
Provision for income tax 1995-96		2,00,000

Adjustments :

(i) The income tax assessment for 1995-96 completed during the year showed gross tax demand of Rs. 2,40,000 but no effect has been given for this in the account.

(ii) Provision for income tax is to be made for Rs. 2,10,000 for 1996-97.

Show Journal Entries and relevant extract in the Final Account.

Solution :

Journal Entries of soma Limited.

Date(1997)	*Particulars*		*Dr.(Rs.)*	*Cr.(Rs.)*
31.3	Profit & Loss A/c	Dr.	2,10,000	
	To Provision for Income-tax A/c			2,10,000
	(Being the amount of provision for Income-tax for the year 1996 - 97 charged to P/L Account)			
31.3	Profit & Loss Appropriation A/c	Dr.	40,000	
	To Provision for Income-tax A/c			40,000
	(Being the amount of less provision for Income-tax for 1995-96 charged to P/L A/c of this year 1996-97)			
31.3	Provision for Income-tax A/c	Dr.	2,20,000	
	To Advance Income-tax A/c			2,20,000
	(Being the amount of advance income-tax for earlier year 1995-96 adjusted with provision for tax.)			

Dr. Profit & Loss Account for the year ended 31.3.97 (Extract) Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
To Provision for Tax (1996–97)	2,10,000	By Gross Profit b/d	?
To Net Profit c/d	?		
To Provision for Tax			
(*Less:* Provision for 1995-96)	40,000	By Balance b/d	?
		By Net Profit during the year	?

SOMA Limited
Balance Sheet *as on 31.03.1997 (Extract)*

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital	?	**Fixed Assets**	?
Reserves & Surplus	?	**Current Assets, Loan and Advances**	?
Current Liabilities & Provisions		**Current Assets**	?
Provision for Tax		**Loans & Advances**	
1995 - 96	20,000	Advance Income Tax for 1996-97	2,30,000
1996 - 97	2,10,000		
	?		?

2. Sundry Debtors : Sundry debtors should be segregated agewise, namely, debts outstanding for a period exceeding six months, and other debts.

In regard to Sundry Debtors particulars to be given separately of –

(a) debts considered good and in respect of which the company is fully secured :

(b) debts considered good for which the company holds no security other than the debtor's personal security; and

(c) debts considered doubtful or bad.

3. **Bank Balances :** Bank balances should be shown as follows –

(a) Bank balance with Scheduled Banks, and

(b) Bank balance with others.

For detail, Students are required to refer **Schedule VI of Part I** of the Companies Act, 1956 relating to the Form of Balance Sheet.

4.9 COMPANY FINAL ACCOUNTS

Illustration 15 :

From the following particulars furnished by Printex Ltd., prepare the Balance Sheet as at 31st March, 2002 as required by Part I, Schedule VI of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary :

		Debit *(Rs.)*	Credit *(Rs.)*
Equity Capital (face value of Rs. 100)			10,00,000
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
Calls in Arrears		1,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Stock :			
Finished	2,00,000		
Raw Materials	50,000	2,50,000	
Sundry Creditors (for goods and expenses)			2,00,000
Loans (unsecured)			1,21,000
Preliminary expenses		13,300	
Cash at Bank		2,47,000	
Cash Balance		30,000	
Profit & Loss Account			1,00,000
Proposed Dividend			60,000
Advances		42,700	
Sundry Debtors		2,00,000	
Provision for Taxation			68,000
		19,09,000	19,09,000

The following additional information is also provided :–

(a) Miscellaneous expenses included Rs. 5,000 audit fees and Rs. 700 for out of pocket expenses paid to the auditors.

(b) 2000 Equity Shares were issued for consideration other than cash.

(c) Debtors of Rs. 52,000 are due for more than six months.

(d) The Cost of Assets :

Building	Rs. 4,00,000
Plant and Machinery	Rs. 7,00,000
Furniture	Rs. 62,500

(e) The balance of Rs. 1,50,000 in the loan account with State Finance Corporation is inclusive of Rs. 7,500 for interest accrued but not due. The Loan is secured by hypothecation of the Plant & Machinery.

(f) Balance at Bank includes Rs. 2,000 with Simplex Bank Ltd., which is not a scheduled Bank.

(g) Bills Receivable for Rs. 2,75,000 maturing on 30th June, 2002 have been discounted.

(h) The company had contract for the erection of machinery at Rs. 2,50,000 which still incomplete.

Solution :

PRINTEX LTD.

Balance Sheet as at 31st March, 2002 (drawn as per Part-I Schedule - VI)
(Section 211 of the Companies Act)

Liabilities	*As at 31.3.2002*		*Assets*	*As at 31.03.2002*	
Share Capital		*Rs.*	**Fixed Assets**		*Rs.*
Authorised			Land		2,00,000
Equity Shares of Rs. ...... each			Building	4,00,000	
Issued and Subscribed 10,000			*Less:* Depreciation	50,000	3,50,000
Equity Shares of Rs. 100			Plant & Machinery	7,00,000	
each fully called up	1000000		*Less:* Depreciation	1,75,000	5,25,000
(of the above, 200 equity			Furniture	62,500	
share of Rs. 100 each have			*Less:* Depreciation	12,500	50,000
been issued for			Investment		Nil
consideration other			**Current Assets, Loans**		
than cash)			**& Advances**		
Less: Calls in arrear	1000	9,99,000	***A. Current Assets***		
Reserves & Surplus			Stock of Finished Goods	2,00,000	
General Reserve		2,10,000	Raw Material	50,000	2,50,000
Profit & Loss A/c		1,00,000	Sundry Debtors		2,00,000
Secured Loans			a) debts outstanding for a		
Loan from State Financial			period exceeding 6 months	52,000	
Corporation (secured by			b) Other debts		
hypothecation of			*Less:* Provisions	1,48,000	
Plant & Machinery)		1,42,500	i. Cash Balance on hand		30,000
Unsecured Loans			ii. Bank Balances		
Unsecured Loans		1,21,000	with scheduled bank	2,45,000	
Current Liabilities and Provisions			with others	2,000	2,47,000
A. Current Liabilities			***B. Loans & Advances***		
Sundry Creditors for goods			Advances		42,700
and Expenses		2,00,000	Miscellaneous Expenditure		

Interest Accrued but not due (S.F.C)	7,500	(to the extent not written off or adjusted)	13,300
B. Provisions :			
Provision for Taxation	68,000		
Proposed Dividend	60,000		
	19,08,000		19,08,000

Contingent Liability : Estimated amount of contract remaining to be executed on Capital Account and not provided for Rs. 1,50,000

Notes: Bills receivable —

1. Maturing on 30th June, 2002 amounting to Rs. 2,75,000 discounted.
2. Miscellaneous Expenditure included :

Audit fees	Rs. 5,000
Expenses (Out of Pocket)	Rs. 700
	Rs. 5,700

3. The information required to be given under any of the items or sub-items, if it cannot be conveniently included in the Balance Sheet itself, shall be furnished in separate schedule to be annexed to and to form part of the Balance Sheet, specially in case of Balance Sheet drawn vertically.

Illustration 16 :

The following balances and particulars are extracted from the books of Pant Co. Pvt. Ltd. for the year ended 31st December 1994 :

	Rs.
Share Capital : Authorised, issued & fully paid up (50,000 equity shares)	5,00,000
General Reserve (as at 1.1.94)	1,50,000
Furniture (including addition of Rs. 5,000)	35,000
Office equipments (as at 1.4.94)	22,000
Motor car (purchased on 30.12.94)	30,000
Sundry debtors (unsecured)	8,50,000
Advance to staff	10,000
Cash in hand	2,000
Balance with Bank of India (including fixed deposits of Rs. 1,00,000)	1,40,000
Loans from Directors	2,00,000
Liability for expenses and goods	2,67,000
Provision for tax (as on 1.1.94)	1,00,000

Profit & Loss A/c (as on 1.1.94)	3,000
Closing stock (20,000 metres)	3,00,000
Advance Tax paid	1,90,000
Depreciation written off up to 31.12.94 (Furniture : Rs.5,000, Office eqpt : Rs.2,000)	7,000
Opening Stock (10,000 metres)	1,50,000
Legal charges including Rs. 3,000 paid to auditors for tax representation	10,000
Salaries to staff	50,000
Miscellaneous expenses (including Rs. 4,000 for tour within India, Rs.36,000 for foreign tour)	2,00,000
Purchase of cloth (2.10 lakh metres)	30,39,000
Audit fees	4,000
Interest on fixed deposit with bank	5,000
Sales (2 lakhs metres) (including export sales of Rs. 10 lakhs)	35,00,000

Further information :

(a) Rate of depreciation – Furniture 10%, Office equipment 15% and Motor car 20%

(b) M.D. is entitled to commission @ 10% of net profits after providing such commission subject to maximum of Rs. 36,000 p.a.

(c) Debtors include Rs. 1,50,000 outstanding of more than 6 months. Out of this Rs. 20,000 is considered doubtful for which provision is to be made in the accounts.

(d) Tax liability for 1994 is estimated at Rs. 2,00,000 for which provision is to be made.

(e) Transfer to General Reserve Rs. 50,000 out of net profits and proposed dividend is @ 6% on equity shares.

Prepare the Balance Sheet, and Profit & Loss Account for the year ended 31st December, 1994, in accordance with the requirements of Companies Act, 1956.

Solution :

PANT CO. (P) LTD.

Balance Sheet as at 31.03.94

Liabilities	*Rs*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Share Capital :			**Fixed Assets :**		
Authorised, issued, subscribed &			Furniture	30,000	
fully paid up (50,000 Equity shares		5,00,000	Addition during year	5,000	
Rs. 10 fully paid up)				35,000	
Reserves and Surplus :			*Less :* Depreciation	5,000	30,000
			Office equipment	22,000	
General Reserve	1,50,000		*Less :* Depreciation	2,000	20,000
Add : Appropriations during			Motor Car		30,000
the year	50,000	2,00,000	Investments :		Nil
Profit and Loss A/c		23,000	**Current Assets,Loans/Advances:**		
			Stock in trade		3,00,000
Secured Loan :			S/D due for more		
Unsecured Loan :			than 6 months	1,50,000	
Loan from Directors		2,00,000	— Others	7,00,000	
Current Liabilities & Provisions :				8,50,000	
Liab. for goods and expenses	2,67,000		*Less :* Prov. for B/D	20,000	8,30,000
Remuneration to M.D.	32,000	2,99,000	Cash in hand	2,000	
Provision for taxation (net of			Cash at bank	40,000	
advance tax)	1,10,000		Fixed Deposit	1,00,000	1,42,000
Proposed dividend	30,000	1,40,000	Advances to staff		10,000
		13,62,000			13,62,000

Pant Co. (P) Ltd.

Trading and Profit and Loss Account for the year ended 31.03.1994

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
To Opening stock		1,50,000	By Sales :		
To Purchases		30,39,000	– Domestic	25,00,000	
To Travelling expenses :			– Export	10,00,000	
– Within India	4,000				35,00,000
– Outside India	36,000	40,000	By Closing stock		3,00,000
To Paid to Auditors			By Interest on fixed deposit		5,000
– Audit fees	4,000				
– Tax representation fees	3,000	7,000			

To	Legal charges	7,000			
To	Salaries to staff	50,000			
To	Provision for bad debts	20,000			
To	Misc. expenses	1,60,000			
To	M. D.'s remuneration	32,000			
To	Provision for taxation	2,00,000			
To	Net profit c/d	1,00,000			
		38,05,000			38,05,000
To	Proposed dividend	30,000	By	Balance b/d (previous year)	3,000
To	General Reserve	50,000	By	Net Profit b.d	1,00,000
To	Balance cd	23,000			
		1,03,000			1,03,000

(a) Computation of M.D's Remuneration :

Net profit after taxation provision	Rs.
As per profit and loss A/c	1,32,000
Add : Provision for taxation	2,00,000
Add : Provision for bad debt	20,000
	3,52,000

M.D.'s Remuneration = 3,52,000 × (10/110) = Rs. 32,000

(b) According to Companies Act where during any financial year any addition has been made to an asset, the depreciation on such asset will be calculated on a prorata basis from the date of such addition. As the Motor Car has been acquired on the last day of the Accounting year no depreciation on the same is chargeable.

Illustration 17 :

The Trial Balance of T.V. Ltd. (having authorised capital of Rs. 8,00,000) was at 31.12.96 as under :

Particulars	*Dr.* (Rs.)	*Cr.* (Rs.)
Share Capital (Share of Rs. 100 each fully paid)		5,00,000
Share Premium Account		50,000
Land and Building (Cost Rs. 3,00,000)	2,50,000	
Plant and Machinery (Cost Rs. 4,00,000)	3,00,000	
Live Stock	20,000	
Gross Profit Earned during 1996		1,30,000
General Reserve		2,00,000
6% Debentures (Issued on 1st January 1989 secured by mortgage on land and redeemable on 31.12.98)		1,00,000
Sundry Debtors and Creditors	60,000	30,000

Stocks as at 31.12.96 (At cost or market value whichever is lower)	50,000	
Salaries	19,000	
Directors' fees	10,000	
General Expenses	15,000	
Cash at Bank	6,400	
Cash in hand	600	
Bills Receivables	20,000	
Discount on issue on debentures	4,000	
Profit and Loss b/f		10,000
Investment (4% Government Securities, Face value Rs. 1,00,000 purchased on 1.1.96)	95,000	
Investments in Eq. Shares (10,000 shares @ Rs.25 per share, Rs. 20 paid up)	1,70,000	
	10,20,000	10,20,000

Further information :

(1) Of the shares allotted 2,000 shares worth Rs. 2,00,000 were allotted as fully paid to vendor from whom a running business was acquired.

(2) Of the Debtors Rs. 10,000 were outstanding but are considered good except a debt of Rs. 5,000 doubtful to be provided.

(3) A provision of Rs. 25,000 is to be made for Income Tax.

(4) The Market Value of Government Securities on the date of the Balance Sheet was Rs. 93,000 and that of equity shares was Rs. 1,60,000.

(5) Auditor's fee Rs. 3,000 should be provided for. Included in General Expenses is six months Insurance Rs. 1,500 paid for the year to end on 30th June 1997.

(6) Interest on Debentures issued and on Investment in Government Securities should be taken into account.

(7) Depreciation is to be provided for @ 6% Original cost of Machinery and 2 % on the Original Cost of land and building.

(8) Provide for a dividend of 5% on shares.

Prepare Profit and Loss A/c, Profit and Loss Adjustment A/c and the Balance Sheet as on 31st December, 1996.

Solution :

T.V. LTD.

Dr. **Profit and Loss Account** *for the year ended 31.3.96* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*
To	Salaries		19,000	By	Gross profit b/d	1,30,000
To	Directors's fees		10,000	By	Interest on Govt. securities	4,000
To	General expenses	15,000				
	Less: Prepaid insurance (6mts.)	750	14,250			
To	Provision for doubtful debt		5,000			
To	Interest on debentures @ 6%		6,000			
To	Depreciation on assets (Note)		30,000			
To	Audit fees		3,000			
To	Net Profit c/d		46,750			
			1,34,000			1,34,000

Dr. **Profit & Loss Adjustment A/c** *for the year ended 31.3.96* **Cr.**

	Particulars	*Rs.*	*Rs.*		*Particulars*	*Rs.*
To	Provision for tax		25,000	By	Balance b/d	10,000
To	Proposed dividend		25,000	By	Net profit during the year	46,750
To	Balance c/d transferred to B/S		6,750			
			56,750			56,750

Balance Sheet *as at 31.12.96*

Assets	*Rs.*	*Liabilities*	*Rs.*	*Rs.*
Authorised Capital :		**Fixed Assets :** (W.D.V.)		
8,000 equity shares @ Rs. 100 each	8,00,000	Land and Building (cost Rs.3,00,000)		2,44,000
Issued, Subscribed & paid up Capital :		Plant and Machinery (cost Rs.4,00,000)		2,76,000
5,000 Eq. sh. @ Rs.100 each, fully paid	5,00,000	Live stock		20,000
Reserves and Surplus :		**Investments :**		
General Reserve	2,00,000	Investments 4% Govt. securities		
Profit & Loss (Cr.)	6,750	(face value Rs. 1,00,000)		95,000
Share premium	50,000	Investment in shares		1,70,000
Secured Loans :		**Current Assets, Loans & Advances :**		
6% Debenture (mortgage on land)	1,00,000	*Current Assets :*		
Unsecured Loans :	Nil	Stock-in-trade		50,000
Current Liabilities and Provisions :		Debt. more than 6 months	10,000	
Sundry Creditors	30,000	Others	50,000	
Interest on debenture	6,000		60,000	
Auditor's fees	3,000	*Less :* Prov. for B/D	5,000	55,000

Proposed dividend	25,000	Cash in hand	600
Provision for tax	25,000	Cash at bank	6,400
		Bills receivables	20,000
		Loans and Advances :	
		Interest on Government securities	4,000
		Prepaid insurance	750
		Miscellaneous Expenditure :	
		Discount on debenture	4,000
	9,45,750		9,45,750

Notes :

- * Depreciation on assets : Plant & Machinery = 6% on 4,00,000 = Rs. 24,000 ; Land & Building. – 2% on 3,00,000 = Rs. 6,000
- * Market value of investment has not been considered.

Illustration 18 :

The Balance Sheet of PQR Ltd. as at 31st March, 1998 is given below :

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital Authorised :		Fixed Assets :	
30,000 Eq. Sh. of Rs. 10 each	3,00,000	Freehold Property	1,15,000
Issued and Subscribed :		Current Assets, Loans and Advances :	
20,000 Eq. Sh. of Rs. 10 each fully paid	2,00,000	Stock in Trade	1,35,000
Reserve and Surplus :		Sundry Debtors	75,000
Profit and Loss Account	1,20,000	Cash and Bank Balances	
Secured Loan :		Cash in Hand	30,000
12% Debentures	1,20,000	Cash at Bank	2,20,000
Current Liabilities and Provisions :			
Sundry Creditors	1,15,000		
Proposed Dividend	20,000		
	5,75,000		5,75,000

At the Annual General Meeting it was resolved :

(i) To pay the proposed Dividend of 10% in cash.

(ii) To issue one Bonus share for every four shares held.

(iii) To give existing shareholders the option to purchase one Rs. 10 share at Rs. 15 for every four shares held prior to bonus distribution, this option being taken up by all the shareholders.

(iv) To repay the debentures at a premium of 3 per cent.

Give the necessary journal entries and the company's Balance Sheet after the completion of all these transactions.

Solution :

Journal of PQR Ltd.

Particulars		*Dr.(Rs.)*	*Cr.(Rs.)*
Bank Account	Dr.	75,000	
To Equity Shareholders Account			75,000
(Application money received on 5,000 Shares @ Rs. 15 per share to be issued as rights shares in the ratio of 1:4)			
Equity Shareholders Account	Dr.	75,000	
To Equity Share Capital A/c			50,000
To Share Premium Account			25,000
(Share application money on 5,000 Shares @ Rs. 10 per share transferred to Share Capital Account and Rs. 5 per share to Share Premium Account, vide Board's Resolution dated.......)			
Proposed Dividend A/c	Dr.	20,000	
To Bank A/c			20,000
(Proposed dividend paid to existing shareholders @ 10%)			
Share Premium A/c	Dr.	25,000	
Profit and Loss A/c	Dr.	25,000	
To Bonus to Shareholders A/c			50,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1 : 4 vide General Body's Resolution dated......)			
Bonus to Shareholders A/c	Dr.	50,000	
To Equity Share Capital A/c			50,000
(Issue of bonus shares in the ratio of 1 for 4 vide Board's Resolution dated......)			
12% Debentures A/c	Dr.	1,20,000	
Premium Payable on Redemption A/c	Dr.	3,600	
To Debentureholders A/c			1,23,600
(Amount payable to Debentureholders on redemption, at a premium of 3%, transferred to Debentures holders A/c)			

Profit and Loss A/c	Dr.	3,600	
To Premium Payable on Redemption			3,600
(Premium payable on redemption charged to Profit & Loss A/c)			
Debentureholders A/c	Dr.	1,23,600	
To Bank			1,23,600
(Amount paid to Debenture holders)			

Balance Sheet of PQR Limited as on .....*(After completion of transactions) :*

Liabilities	*Rs.*	*Assets*	*Rs.*
Shares Capital :		Fixed Assets :	
Authorised, Issued & Subscribed :		Property	1,15,000
30,000 Shares of Rs. 10 each fully paid	3,00,000	Investments	—
(5,000 Shares of Rs.10 each fully paid issued as bonus shares out of share premium and P & L A/c)		Current Assets :	
Reserve & Surplus :		Stock in trade	1,35,000
Profit & Loss A/c	91,400	Sundry Debtors	75,000
Secured Loans	—	Cash at Bank	1,51,400
Unsecured Loans	—	Cash in hand	30,000
Current Liabilities & Provisions :			
Sundry Creditors	1,15,000		
	5,06,400		5,06,400

Note :

The number of bonus shares issued has been calculated on the basis of issued capital before rights issue, i.e., 20,000 shares (and not 25,000 shares after rights issue).

Illustration 19 :

The following is the trial balance on 31st March 1999 of Ramesh Ltd.:

	Dr. *(Rs.)*	Cr. *(Rs.)*
Equity capital: Equity shares of Rs. 10 each fully paid		5,00,000
Reserves and surplus: 31.3.1998		15,00,000
Bank overdraft (secured against working capital)		4,00,000
Deposits from directors		6,00,000
Suppliers A/c	2,50,000	9,00,000
Customers A/c	28,00,000	75,000
Stock on 31.3.1998	25,000	
Expenses paid	3,00,000	

Prepaid expenses 31.3.1998	4,000	
Outstanding expenses 31.3.1998		14,000
Purchases and sales	130,00,000	135,00,000
Returns in and out	1,56,000	1,46,000
Fixed assets: 31.3.1998:		
Cost	14,50,000	
Provision for depreciation		4,50,000
Interest on loans and overdraft	1,00,000	
	180,85,000	180,85,000

On 31st March 1999 value of stock was Rs. 75,000; prepaid expenses were Rs. 16,000 and outstanding expenses were Rs. 6,000. Depreciation is to be provided on fixed assets at 15% on reducing balance method.

Ramesh Ltd. asks you to prepare :–

(a) revenue statement for the year ended 313.99.

(b) balance sheet as at 31.3.99.

Solution :

Working Notes : ***1.***

Dr. Expenses A/c Cr.

Particulars	*Rs.*	*Particulars*	*Rs.*
Opening prepaid	4,000	Opening outstanding	14,000
Expenses paid	3,00,000	Expenses to profit and loss A/c	2,80,000
Closing outstanding	6,000	Closing prepaid	16,000
	3,10,000		3,10,000

2. Depreciation

	Rs.
Cost	14,50,000
Less : Provision for depreciation	4,50,000
Opening written down value	10,00,000
Depreciation thereon at 15%	1,50,000

3. Sales

Gross	1,35,00,000
Less : Returns inwards	1,56,000
	1,33,44,000

4. Purchases

Gross	1,30,00,000
Less : Returns outwards	1,46,000
	1,28,54,000

5. Cost of sales

Opening stock	25,000
Net purchases	1,28,54,000
	1,28,79,000
Less : Closing stock	75,000
	1,28,04,000

6. Reserves and surplus

As per last balance sheet	15,00,000
Add : Surplus during the year	10,000
	15,10,000

	Rs.	*Rs.*	*Rs.*
Fixed assets :			
Cost		14,50,000	
Less : Accumulated deprn. up to last year	4,50,000		
for this year	1,50,000	6,00,000	8,50,000
Current assets :			
Inventory at cost	75,000		
Customers sued – considered good	28,00,000		
Advance to suppliers	2,50,000		
Prepaid expenses	16,000	31,41,000	
Less : Current liabilities –			
Creditors for goods	9,00,000		
Outstanding expenses	6,000		
Amounts due to customers	75,000	9,81,000	21,60,000
			30,10,000

Note : *In the absence of information :–*

i) corresponding figures of last financial statement are not furnished

ii) all information required to be disclosed under Company Law has not been disclosed.

Revenue statement *for the year ended 31. 3. 1999*

Particulars	*Rs.*	*Rs.*
Sales		1,33,44,000
Less : Cost of sales		1,28,04,000
		5,40,000
Less : Expenses	2,80,000	
Interest	1,00,000	
Depreciation	1,50,000	5,30,000
		10,000

Balance Sheet *as at 31.3.1999*

Particulars	*Rs.*	*Rs.*
Sources of funds :–		
Shareholders' funds :		
Share capital :		
Issued : 50000 equity shares of Rs. 10 each	5,00,000	
	15,10,000	20,10,000
Loan funds :		
Secured : from bank – against working capital	4,00,000	
Unsecured : from directors	6,00,000	10,00,000
		30,10,000

4.10 SPECIMEN QUESTIONS WITH ANSWERS

Question 1:

D Ltd. has authorised capital of Rs. 4,00,000. The company issues 20,000 equity shares of Rs. 10 each at a premium of Rs. 5 per share payable as :

On application — Rs. 6 (including premium Rs. 3)
On allotment — Rs. 5 (including balance of premium)
Balance in two calls.

Applications were received for 35,000 shares. The applicants were divided in the following groups :

Group A — Applying for 5,000 shares allotted fully.
Group B — Applying for 20,000 shares are made prorata allotment for 15,000 shares.
Group C — Applying for total 10,000 shares are refunded.

Directors while making allotment adjust the excess amount received on application against allotment money due. When second and final calls were made shareholders holding 500 shares failed to pay the final call money. The directors forfeited these shares. All the forfeited shares were reissued at Rs. 9 per share. It is agreed that brokerage @ 3% and underwriting commission @ 3% will be paid for this issue. Claims of brokers and underwriters are satisfied by issuing to them additional equity shares of Rs. 10 each at a premium of Rs. 5 per share (without any cash payment).

Show Journal Entries and the Balance Sheet of the company in the books of the company.

Answer :

In the books of D Ltd.

JOURNAL ENTRIES

Date	*Particulars*	*L.F.*	*Rs.(Dr.)*	*Rs.(Cr.)*
	Bank Account	Dr.	2,10,000	
	To Equity Share Capital Account			2,10,000
	(being the application money received on 35,000 shares @ Rs. 6 per share)			
	Equity Share Application Account	Dr.	60,000	
	To Bank Account			60,000
	(being the application on 10,000 shares refunded)			
	Equity Share Application Account	Dr.	1,20,000	
	To Equity Share Capital			60,000
	To Equity Share premium			60,000
	(being the application money on 20,000 shares transferred to share premium and share capital)			
	Equity Share Application Account	Dr.	30,000	
	To Equity Share Allotment Account			30,000
	(being excess of application money adjusted against allotment money due)			
	Equity Share allotment account	Dr.	1,00,000	
	To Equity Share Capital Account			60,000
	To Share Premium Account			40,000
	(being the amount due on allotment @ Rs. 5 per share including a premium of Rs. 2 as per board's resolution no. ..... dated....)			
	Bank Account	Dr.	70,000	
	To Equity Share Allotment Account			70,000
	(being balance of allotment money received in full for 14,000 shares)			
	Equity Share First Call Account	Dr.	40,000	
	To Equity Share Capital Account			40,000
	(being the call money due on 20,000 shares @ Rs. 2 per share)			

Bank Account	Dr.	40,0000	
To Equity Share First Call Account			40,000
(being the first call money received)			
Equity Share Final Call Account	Dr.	40,000	
To Equity Share Capital Account			40,000
(being the call money due on 20,000 shares @ Rs. 2 per share)			
Bank Account	Dr.	39,000	
To Equity Share Final Call Account			39,000
(being the call money on 19,500 shares received)			
Equity Share Capital Account	Dr.	5,000	
To Equity Share Final Call Account			1,000
To Share Forfeiture Account			4,000
(being 500 shares forfeited)			
Bank Account	Dr.	4,500	
Share Forfeiture Account	Dr.	500	
To Equity Share Capital Account			5,000
(being 500 shares reissued @ Rs. 9 per share)			
Share Forfeiture Account	Dr.	3,500	
To Capital Reserve Account			3,500
(being profit on forfeiture transferred to capital reserve account)			
Brokerage Account	Dr.	6,000	
Commission Agent	Dr.	6,000	
To Equity Share Capital Account			8,000
To Share Premium Account			4,000
(being brokerage and commission paid)			

Balance Sheet of D Ltd.

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital –		Fixed Assets –	
Authorised Capital :			
40,000 shares on Rs. 10 each	4,00,000	Investments :	
Issued, Subscribed and Paid-up Capital		Current Assets, Loans and Advances :	
20,800 Equity Shares of Rs. 10 each		Bank	3,03,500
(800 shares issued for consideration			
other than cash)	2,08,000	Miscellaneous expenditure :	
Reserve & Surplus :		Brokerage on issue of shares	6,000
Capital Reserve	3,500		
Share Premium	1,04,000	Commission on issue of shares	6,000
	3,15,500		3,15,500

Question 2 :

Sun Ltd. issued 20,000 Equity Shares of Rs. 10 each payable as follows :

On Application	Rs. 5	(including Rs. 2 as premium)
On Allotment	Rs. 5	
On Call	Rs. 2	

Applications were received for 36,000 Shares of which the application money on 6,000 Shares were refunded and allotment was made to the rest of the applicants on pro-rata basis. All the money due on Shares was received in full with the exception of allotment money on 200 Shares and Call Money on 500 Shares (including those on which allotment money was due). These 500 Shares were forfeited by the Company. Subsequently, 400 of these shares of which 200 were those Shares on which allotment money was not paid, were reissued at Rs. 7 per Share.

Show the Journal entries (including the Cash transactions) relating to the forfeiture and reissue of the Shares.

Answer :

In the books of Sun Ltd.

JOURNAL

(All figures are in Rs.)

	Particulars		*L/F*	*Dr.*	*Cr.*
i)	Bank A/c	Dr.		1,80,000	
	To Share Application A/c (36,000×5)				1,80,000
	(Being application money received)				
ii)	Share Application A/c	Dr.		30,000	
	To Bank (6000×5)				30,000
	(Being application money refunded)				
iii)	Share application A/c	Dr.		1,50,000	
	To Equity Share Capital				60,000
	To Equity Share Premium A/c				40,000
	To Equity Share Allotment A/c				50,000
	(Being application money transferred to Capital A/c and Premium A/c after adjusting excess application money with allotment as per Bond Resolution No. ...... dt. ......)				
iv)	Share Allotment A/c	Dr.		1,00,000	
	To Equity Share Capital A/c (20,000×5)				1,00,000
	(Being allotment money due for 20,000 equity shares as per Bond Resolution No. ...... dt. ......)				
v)	Bank A/c	Dr.		49,500	
	Call in Arrear A/c	Dr.		500	
	To Equity Share Allotment A/c				50,000
	(Being allotment money received except 200 shares)				
vi)	Share Call Money A/c	Dr.		40,000	
	To Equity Share Capital A/c (20,000×2)				40,000
	(Being Call money due as per Board's Resolution No. ...... dt. ......)				
vii)	Bank A/c	Dr.		39,000	
	Call in Arrear A/c	Dr.		1,000	
	To Share Call Money				40,000
	(Being Call money received except 500 Shares)				

viii)	Equity Share Capital A/c	Dr.	5,000	
	To Call in Arrear A/c			1,500
	To Share Forfeiture A/c (1100 + 2400)			3,500
	(Being 500 Non payment shares forfeited as per Board's Resolution No. ...... dt. ......)			
ix)	Bank A/c (400×7)	Dr.	2,800	
	Share Forfeiture A/c	Dr.	1,200	
	To Share Capital A/c			4,000
	(Being 400 Forfeiture shares revised @ Rs. 7 per share as per Board's Resolution No. ...... dt. ......)			
x)	Share Forfeiture A/c	Dr.	1,500	
	To Capital Reserve A/c			1,500
	(Being Profit on revised transferred to Capital Reserve as per Board's Resolution No. ...... dt. ......)			

Working Note :

1) Due on allotment money for 200 shares.

Shares applied for = 200 x 30,000 / 20,000 = 300 Shares.

Application Money Received Rs. 1,500

Excess Money received in application = (300 – 200)×5 = 500

Due for allotment .... Rs..200×5 = 1,000

Less : Excess Received (-500)

Allotment money failed to pay (200×2.50) 500

Out of application money Rs.1500. Amount of Premium is Rs.400 for 200 Shares allotted and Balance 1100 for application and Partly allotment.

2) Profit on Reissue 400 shares.

For 200 Share forfeiture amount = Rs. 1,100

Now For 300 Share forfeiture amount = Rs. 2,400

For 200 Share forfeiture amount is = 2,400 x 200 /300 = 1,600

Profit on Reissue = (2700 – 1200) = 1,500

Balance of Forfeiture A/c will be = (3500 – 2700) = Rs. 800.

Question 3 :

The following Ledger balances are extracted from the books of QR Ltd. as on 30.9.98 :

	Rs.
9% Debenture issued @ Rs. 95	9,50,000
Debenture Redemption Reserve Fund A/c	9,37,000
Discount on issue of Debentures	26,000
Investment against Debenture Redemption Reserve Fund	9,37,000

Following further information is given :

(a) Investments include debentures of the face value of Rs. 2,00,000 purchased on 1.8.98
@ Rs. 99.

(b) Interest on debentures is payable on 30th June and 31st December.

(c) All debentures are redeemable at par on 31st December.

(d) Income from outside investments of Redemption Fund from 30.9.98 to 31.12.98 is Rs. 45,000

Show ledger accounts assuming that the above transactions have been carried out and all outside investments were sold at a gain of 10% over cost.

Solution :

Dr. Debenture Redemption Fund Investment Account Cr.

	Particulars	*Rs.*		*Particulars*	*Rs.*
1998			1998		
Oct.1st	To Balance	9,37,000	Oct 1st	By (own Debenture Inv. A/c) (Transfer to separate A/c)	1,98,000
Dec 31st	To Sinking Fund (Profit on Sales)	73,900	Dec 31st	By Bank	8,12,900
		10,10,900			10,10,900

Dr. Debenture Redemption Fund (Own Debentures) Investment A/c Cr.

Particulars	Rs.	Particulars	Rs.
1998 Oct 1st		1998 Dec. 31st	
To D.R.F. Investment A/c (Transfer)	1,98,000	By 9% Debenture A/c	2,00,000
" D.R.R.F. (Profit on cancellation)	2,000		
	2,00,000		2,00,000

Dr. Debenture Redemption Reserve Fund Cr.

Particulars	Rs.	Particulars	Rs.
1998 Dec. 31st		1998 Oct. 1st	
To Discount on issue of Debentures	26,000	By Balance b/d	9,37,000
" Capital Reserve (Profit on cancellation of Debentures)	2,000	Dec 31st	
		By Debenture A/c (on Rs. 2,00,000 for 5 months)	7,500
" General Reserve	10,37,400		
		" Int. on D.R.F. Investment A/c	45,000
		" D.R.R.F (Own Deb. Inv. A/c)	2,000
		" D.R.F.I. (Profit on Sales)	73,900
	10,65,400		10,65,400

Dr. Discount on Issue of Debentures Cr.

Particulars	Rs.	Particulars	Rs.
Dec. 31st 1998 To Balance B/D	26,000	Dec. 31st 1998 By D.R.F.	26,000
	26,000		26,000

Dr. 9% Debentures A/c Cr.

Particulars	Rs.	Particulars	Rs.
To DRF (own Debentures Inv. A/c)	2,00,000	By Balance b/d	9,50,000
" Bank	7,50,000		
	9,50,000		9,50,000

Question 4 :

Rajesh Ltd. furnishes you with the following balance sheet as at 31st March, 2001:

		(Rs. in crores)
Sources of Funds:		
Share Capital		
Authorised		
Issued	100	
10% Redeemable preference shares of Rs.100 each fully paid	75	
Equity shares of Rs. 10 each fully paid	25	100
Reserve and surplus		
Capital reserves	15	
Share premium	25	
Revenue reserves	260	300
		400
Funds employed in:		
Fixed assets (cost)	100	
Less Provision for depreciation	100	Nil
Investment (at cost)		
(Market value Rs. 400 crores)		100
Current assets	340	
Less Current liabilities	40	300
		400

The company redeemed preference shares on 1st April, 2001. It also bought back 50 lakh equity shares of Rs.10 each at Rs. 50 per share. The payments for the above were made out of the huge bank balances, which appeared as part of current assets.

You are asked to :

(i) Pass journal entries to record the above and

(ii) prepare balance sheet.

Answer (i) :

Note: As regards redemption of redeemable preference shares and buy back of shares, section 80 of the Companies Act is on redemption of redeemable preference share and Section 77A, introduced by the Companies (Amendment) Act, 1999 is on buy back of shares. While section 80 provides that redemption of redeemable preference shares can be made either out of proceeds of fresh issue or out of profits available for distribution. Section 77A provides that buy back of shares can be made –

(a) out of free reserves or

(b) security premium A/c or

(c) out of proceeds of fresh issue of capital.

However, section 80 provides that premium on redemption can be provided either out of profits or out of security premium account.

In the given problem the company redeemed the preference shares at par, but buy-back of equity shares at a premium. The company bought back 50 lakh equity shares @ Rs. 50 per share which is equal to security premium account. It is, therefore, presumed that the buy back of shares have been made out of security premium account and redemption of preference shares out of profit available for dividend. There can be other presumptions too, like both redemption of redeemable preference shares and buy back of shares have been made out of profit or out of free reserves as the case may be.

SEBI Guidelines and Rules framed by Company Law Board further requires that in case of buy back of shares, the company must open an escrow account by depositing the requisite amount to a designated bank or by giving guarantee of payment during the book building procedure and also open a separate designated account with its bankers for payment of shareholders.

Journal Entries

(Rs. in lakhs)

Re. Redeemable Preference Shares :

10% Redeemable Preference shares A/c	Dr.	75	
To Redeemable Preference Shareholders A/c			75
(Being the amount transferred to latter A/c as per Board resolution dated ......)			
Redeemable Preference Shareholders A/c	Dr.	75	
To Bank			75
(Being the payment made to redeemable Preference shareholders)			
Revenue Reserve A/c	Dr.	75	
To Capital Redemption Reserve Account			75
(Being the amount transferred from Revenue Reserve as per Board Resolution dated ......in terms of s.80 of the Companies Act, 1956)			

Re. Buy Back of Equity Shares:

Escrow Bank A/c	Dr.	5	
To Bank A/c			5
(Being amount transferred to Escrow Bank A/c opened as per Board Resolution dated ...... and for buy back of equity shares along with authorisation of payment to be made by merchant bankers for payment.)			
Equity Share Capital A/c	Dr.	5	
Premium on buy back of Equity Shares	Dr.	20	
To Shareholders A/c			25
(Being the amount of equity share capital bought back at premium of Rs. 40 per share as per special resolution dated ..... passed on extra ordinary General Meeting held on ....)			
Bank A/c for Buy-back of shares	Dr.	25	
To Escrow Bank A/c			5
To Bank A/c			20
(Being the amount transferred from latter accounts to former A/c as per Board Resolution dated .....)			
Shareholders A/c	Dr.	25	
To Bank A/c for buy back of shares			25
(Being the payment made to equity shareholders on buy back of shares as per special resolution passed on extra ordinary General Meeting dated ...... held on...........)			
Security Premium A/c	Dr.	5	
To Capital Redemption Reserve			5
(Being the transfer of security premium account to Capital Redemption Reserve A/c for the purpose of buy-back of 50 lakhs equity shares of Rs. 10 each.)			
General Reserve A/c	Dr.	20	
To Premium on buy back of equity shares			20
(Being the premium on buy back of equity shares transferred to General Reserve Account)			

Note :

Section 77A, unlike section 80 is silent about treatment of Premium on buy-back of equity shares. No authoritative pronouncement is made available. One school of thought is that the premium may be adjusted against security premium account while other school of thought that it may be adjusted against revenue reserve or may be treated as Deferred Revenue Expenditure account. Accordingly the entry may be passed.

Answer (ii):

Rajesh Ltd.
Balance Sheet as on 1.4.2001

		Schedule	(Rs. in crores)	
(Rs. in crores)				
I. **Sources of Funds :**				
Shareholders Funds			300	
(a)	Capital	1	20	
(b)	Reserves & Surplus	2	280	
	Total			300
II. **Application of Funds :**				
Fixed Assets				
	Gross Block		100	
	Less : Depreciation		100	—
Investments (Market value Rs. 400 crores)			100	
Current Assets		240		
Less : Current liabilities		40	200	
	Total			300

Schedules :

Schedule 1:

Share capital —

Authorised		
Share Capital –		
Authorised		?
Issued, Subscribed and Paid up		20
7,50,000, 10% Redeemable Preference shares of Rs. 100 each fully paid redeemed at par as per terms and conditions of issue on 1.4.2001	—	
20,00,000 (P.Y. 25,00,000) Equity shares of Rs. 10 each fully called and paid up	20	
	20	

Schedule 2 :

(1) Capital Reserve (As per last A/c)		15
(2) Capital Redemption Reserve –		
Transferred from Security Premium	5	
Transferred from Revenue Reserve	75	8C
(3) Security Premium A/c—		
As per last A/c	25	
Less : Transferred to Capital Redemption Reserve on account of Buy Back of Equity Shares	5	20
(4) Revenue Reserve —		
As per last A/c	260	
Less: Premium on Buy-back of Equity Shares	20	
		240
Less: Transferred to Capital Redemption Reserve on redemption of Redeemable Preference Shares	75	165
		280

Question 5 :

On 1st December, 1999 Mehul Ltd. was incorporated with authorised capital of Rs. 1 core. On 30th November, 2000 the following is its Trial Balance :

	Dr. *Rs.*	Cr. *Rs.*
Equity share capital (fully paid up shares of Rs. 10 each of which 1,00,000 shares are issued for consideration other than cash Rs. 10,00,000)		25,00,000
Capital reserve		2,00,000
Fixed assets — cost	8,00,000	
Purchases (net)	60,00,000	
Sales (net)		75,00,000
Expenses	4,00,000	
Depreciation	1,00,000	
Provision for depreciation		1,00,000
Bank — current account — scheduled bank	2,00,000	
Interim dividend	3,00,000	
Liability for interim dividend		1,80,000
Creditors for goods		10,00,000
Creditors for expenses		20,000
Prepaid expenses	50,000	
Advance from customers		1,00,000

Advance to suppliers	1,50,000	
Customers dues	32,00,000	
Tax payment	4,00,000	.
	1,16,00,000	1,16,00,000

On 30th November, 2000, the cost of unsold stock is Rs. 3,50,000. Customers dues are unsecured but considered good and are due for less than six months. Provide for taxation at 35%. Directors have proposed final dividend of Rs. 2,00,000 and appropriation to general reserve of Rs. 2,50,000.

Prepare the final accounts.

Answer :

Mehul Ltd Revenue statement for the year ended 30th November, 2000

	Rs.	Rs.
Sales		
75,00,000		
Cost of sales :		
Purchases	60,00,000	
Less : Inventory-year end	3,50,000	
	56,50,000	
Expenses	4,00,000	
Depreciation	1,00,000	61,50,000
Profit before tax		13,50,000
Provision for tax @ 35%		4,72,000
Profit after tax		8,77,500
Less :	Appropriation to :	
General reserve	2,50,000	
Interim dividend	3,00,000	
Proposed dividend	2,00,000	7,50,000
Balance carried forward		1,27,500

Mehul Ltd.

Balance Sheet as at 30th November 2,000

	Schedule	Rs.	Rs.
Sources of funds :			
Shareholder's fund :			
Share Capital	A		25,00,000
Reserves and surplus :			
Capital reserve		2,00,000	
General reserve		2,50,000	
Surplus		1,27,500	5,77,500
			30,77,500

Funds employed in :				
Fixed assets : Cost			8,00,000	
Less : Provision for depreciation			1,00,000	7,00,000
Current assets :				
Inventory at cost			3,50,000	
Dues from customers-unsecured but considered good for less than 6 mths			32,00,000	
Balance with scheduled bank in current account			2,00,000	
Advances recoverable in cash or in kind (50,000 + 1,50,000)			2,00,000	
Tax payment pending assessment			4,00,000	
			43,50,000	
Less : Current liabilities and provisions				
Creditors for goods		10,00,000		
Creditors for expenses		20,000		
Advances from customers		1,00,000		
Interim dividend		1,80,000		
		13,00,000		
Provision for taxation	4,72,500			
Proposed dividend	2,00,000			
		6,72,000	19,72,500	23,77,500
				30,77,500

Schedule attached to balance sheet as at 30th November, 2000.

Schedule A : Schedule Capital :	Rs.
Authorised :	
10,00,000 equity shares of Rs. 10 each	1,00,00,000
Issued :	
2,50,000 equity shares of Rs. 10 each fully paid – including 1,00,000 equity shares of Rs. 10 each issued for consideration other than cash.	25,00,000

Question 6 :

On 30th November, 2001 the following was the balance sheet of XY and Co. a partnership firm where X Ltd. and Y Ltd. were partners sharing profits and losses in the ratio of 3 : 2 after payment of interest on fixed capitals at 12% per annum :

	Rs.	Rs.
	(in crores)	
Fixed assets : Cost	60	
Less : Accumulated depreciation	40	20
Investments at cost in equity shares of :		
A Ltd. (market value Rs. 80 Cr.)	30	
B Ltd. (market value of Rs. 70 Cr.)	25	55
Current assets	140	
Less : Current liabilities	65	75
		150
Financed by :		
Loan from Zed Ltd. carrying interest at 15% p.a.		40
Reserves		30
Current accounts of partners :		
X Ltd.	3	
Y Ltd.	2	5
Capital accounts of partner(s)		
X Ltd.	40	
Y Ltd.	35	75
		150

On 1st December, 2001 they decided to admit Z Ltd. as a partner. The following terms were agreed upon :

(i) Zed Ltd.'s loan is to be converted into fixed capital.

(ii) The goodwill of the firm is considered to be worth Rs. 50 crores; however the necessary adjustment should be recorded through fixed capital accounts of the partners.

(iii) The fixed assets are considered to be worth Rs. 50 crores. However they are to continue to appear in the books at the present cost of Rs. 60 crores and the present accumulated provision for depreciation of Rs. 40 crores. The necessary adjustment is to be done through fixed capital accounts.

(iv) There is no change in the valuations of current assets and current liabilities.

(v) Reserves are to continue to appear at the balance sheet figures. However necessary adjustment is to be done through fixed capital accounts.

(vi) The investments in A Ltd. are to be taken over by X Ltd. at Rs. 70 crores. The investments in B Ltd. are to be taken over by Y Ltd. at Rs. 60 crores.

(vii) X Ltd., Y Ltd. and Z Ltd. are to bring in such amounts as fixed capital as would enable combined balance of Rs. 120 crores in the fixed capital accounts carried forward in revised profit sharing ratio.

(viii) Interest at 1% per month is to be calculated on the fixed capitals and credited to partner's current accounts.

(ix) 10% of annual profit (after considering interest on fixed capitals) is to be credited to reserves.

(x) The balance 90% of annual profit is to be shared by X Ltd., Y Ltd. and Z Ltd. in the ratio of 5:3:2. The same is to be credited to current accounts.

(xi) Drawings of the partners during the year are to be within the upper ceiling of credit to current accounts. The same is to be credited to current accounts.

You are asked to pass necessary accounting entries through the journal of the firm on the morning of December 1, 2001 and prepare the balance sheet before any other transaction takes place on December 1, 2001. The balance sheet should also show the comparative position before admission of Zed Ltd.

Answer :

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(Rs. in Crores)

DateE. No.		*Particulars*		*Dr.*	*Cr.*
2001					
Dec.	1	Zed Ltd. Loan	Dr.	40	
		To Zed Ltd. – Capital			40
		(Being transfer of loan balance into fixed capital on admission of Zed Ltd. as a partner)			
	2	Zed Ltd. – Capital	Dr.	10	
		To X Ltd. – Capital			5
		To Y Ltd. – Capital			5
		(Being 1/5th share of goodwill purchased by incoming partner Zed Ltd. from the old partners X Ltd. and Y Ltd.)			
	3	Zed Ltd. Capital	Dr.	6	
		To X Ltd.– Capital			3
		To Y Ltd. – Capital			3
		(Being the purchase of 20% share of latent increase in the value of fixed assets by Zed Ltd. from X Ltd. and Y Ltd. on admission as a partner)			

4	Zed Ltd. – Capital	Dr.	6	
	To X Ltd. – Capital			3
	To Y Ltd. – Capital			3
	(Being 20% share in existing reserves purchased by incoming partner Zed Ltd. from X Ltd. and Y Ltd.)			
5	X Ltd. – Capital	Dr.	70	
	To Investment in A Ltd.			30
	To Realisation A/c			40
	(Being investments in A Ltd. taken over by X Ltd.)			
6	Y Ltd. – Capital	Dr.	60	
	To Investments in B Ltd.			25
	To Profit on take over			35
	(Being investments in B Ltd. taken over Y Ltd.)			
7	Realisation A/c	Dr.	75	
	To Capital A/cs			
	X Ltd.			45
	Y Ltd.			30
	(Being profit on take over of investments credited to partners' capitals in old profit sharing ratio.)			
8	Bank A/c (Current asset)	Dr.	60	
	To Fixed capitals :			
	X Ltd.			34
	Y Ltd.			20
	Z Ltd.			6
	(Being fixed capital introduced by the three partners in pursuance of clause of partnership deed dated Dec. 1, 2001)			

Working Notes :

(A) Change in Partners' Profit Sharing Ratio on admission of Z Ltd. :

	Old Ratio	New Ratio	Change
X Ltd.	3/5	5/10	(–) 1/10
Y Ltd.	2/5	3/10	(–) 1/10
Z Ltd.	–	2/10	+ 2/10
	1	1	0

(B) Adjustment in Fixed Capital of Partners on account of goodwill :

(Rs. in Crores)

	X Ltd.	Y Ltd.	Z Ltd.
Goodwill raised	Rs. 30 (CR)	Rs. 20 (CR)	–
Goodwill w/off	Rs. 25 (DR)	Rs. 15 (DR)	10 (DR)
Net effect	5 (CR)	5 (CR)	10 (DR)

(C) Adjustment in Fixed Capital due to revaluation of Fixed Assets :

(Rs. in Crores)

	X Ltd.	Y Ltd.	Z Ltd.
Fixed Assets revalued at Rs. 50000 instead of Rs. 20000 (book value)			
Difference Rs. 30000.	18	12	–
Written Back to book value of 20000	15	9	6
	3(CR)	3 (CR)	6 (DR)

(D) Adjustment on A/c of Reserves due to admission of Z Ltd.:

	X Ltd.	Y Ltd.	Z Ltd.
Reserves as per old Ratio	18	12	–
Reversal as per new Ratio	15	9	6
	3 (CR)	3 (CR)	6 (CR)

(E) Adjustment on A/c of takeover of Investment :

(Rs. in Crore)

Profit on sale of Investment in A Ltd. (Rs. 70 – 30) =	40
Profit on sale of Investment in B Ltd. (Rs. 60 – 25) =	35
	75

This profit will be allocated amongst the erstwhile partners i.e. X Ltd. and Y Ltd. in their old profit sharing ratio i.e. 3 : 2, Rs. 45 and Rs. 30.

(F) Net effect of changes :

(Rs. in Crores)

	X Ltd. DR	X Ltd. CR	Y Ltd. DR	Y Ltd. Cr	Z Ltd. DR	Z Ltd. CR
Goodwill		5		5	10	
Fixed Assets		3		3	6	
Reserve		3		3	6	
Sale of investment	70	45	60	30	–	–
	70	56	60	41	22	
Capital before changes		40		35		40
Capital after changes		26		16		18
Capital as per partnership deed		60		36		24
Amount to be brought in		34		20		6

XY and Co.

Balance sheet as on the morning of 1st Dec. 2001

(in crores)	After admission Rs.	After admission Rs.	Before admission Rs.	Before admission Rs.
Fixed assets :				
Cost	60		60	
Less : Accumulated depreciation	40		40	
		20		20
Investment at cost in equity shares of :				
A Ltd.	–		30	
B Ltd.	–		25	
		–		55
Current assets :				
Bank	60		–	
Other	140		140	
	200		140	
Less : Current liabilities	65		65	
		135		75
		155		150
Financed by :				
Borrowing :				
Loan from Zed Ltd.		Nil		40

Owners' funds				
Reserves		30		30
Current accounts :				
X Ltd.	3		3	
Y Ltd.	2		2	
		5		5
Fixed capitals :				
X Ltd.	60		40	
Y Ltd.	36		35	
Zed Ltd.	24		–	
		120		75
		155		150

Question 7 :

X Co. Ltd. was registered with an authorised Capital of Rs. 10.00.000 divided into shares of Rs. 10 each, of which 40,000 shares had been issued and fully paid.

The following is the Trial Balance extracted on 31st march 2002 :

	Dr. *Rs.*	Cr. *Rs.*
Stock (1.4.2004)	1,86,420	
Returns	12,680	9,850
Sundry manufacturing expenses	19,240	
18% Bank Loan (secured)		50,000
Office salaries and Expenses	17,870	
Directors' Remuneration	26,250	
Freehold premises	1,64,210	
Furniture	5,000	
Debtors and Creditors	1,05,400	62,220
Cash at Bank	96,860	
Profit and Loss Account on 1.4.2001		38,640
Share Capital		4,00,000
Purchases and sales	7,18,210	11,69,900
Manufacturing Wages	1,09,740	
Carriage Inwards	4,910	
Interest on bank loan	4,500	
Auditors' Fees	8,600	
Preliminary Expenses	6,000	
Plant and machinery	1,28,400	
Loose Tools	12,500	
Cash in hand	19,530	
Advance payment of Tax	84,290	
	17,30,610	17,30,610

You are required to prepare Profit and Loss Account for the year ended 31st March 2002 and a Balance Sheet as at that date after taking into consideration the following adjustments :

(i) On 31st March 2002, outstanding manufacturing wages and outstanding office salaries stood at Rs. 1,890 and Rs. 1,200 respectively. On the same date stock was valued at Rs. 1,24,840 and loose tools at Rs. 10,000.

(ii) Provide for interest on bank loan for 6 months.

(iii) Depreciation on plant and machinery is to be provided @ 15% while on office furniture it is to be @ 10%.

(iv) Write-off one-third of balance of preliminary expenditure.

(v) Make a provision for income tax @ 50%.

(vi) The directors recommended dividend @ 15% for the year ending 31st March 2002 after a transfer of 5% of the profits to general reserve.

Answer :

In the books of X Co. Ltd.

Dr. Profit and Loss A/c ***for the year ended 31.3.2002*** **Cr.**

Particulars		*Rs.*	*Particulars*		*Rs.*
Opening Stock		1,86,420	By Sales	11,69,900	
Purchase	7,18,210		*Less:* Return	12,680	11,57,220
Less : Returns	9,850	7,08,360			
Wages	1,09,740		By Closing Stock		1,24,840
Add : Outstanding wages	1,890	1,11,630			
Sundry Mfg. expenses		19,240			
Carriage inward		4,910			
Gross Profit c/d		2,51,500			
		12,82,060			12,82,060
Int. on Bank loan	4,500		By Gross Profit b/d		2,51,500
Add : Outstanding	4,500	9,000			
Office salaries & expenses	17,870				
Add : Outstanding	1,200	19,070			
Auditors' Fees		8,600			
Directors' remuneration		26,250			
Provisions for depreciation					
Plant and Machinery	19,260				
Furniture	500				
Loose tools	2,500	22,260			
Preliminary expenses		2,000			
Income Tax		82,160			
Net Profit c/d		82,160			
		2,51,500			2,51,500

Directors' Fees (15% of 400000)	60000	By Balance b/d	38640
General Reserve (5% of 82160)	4108	By Net profit b/d	82160
Balance c/d	56692		
	1,20,800		1,20,800

Balance Sheet of X Co. Ltd *as at 31.3.2002*

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Share Capital			**Fixed Assets**		
Authorised, issued, subscribed and Paid up:			Freehold Premises		1,64,210
40000 Eq. Shares			Plant and Machinery	1,28,400	
Rs.10 each, fully paid up		4,00,000	*Less:* Provision for deprn.	19,260	1,09,140
			Furniture		5000
Reserves and Surplus			*Less:* Provision for deprn.	500	4,500
General Reserve		4,108			
Profit and Loss Account		56,692	**Investments**		NIL
Secured loans			**Current Assets, loans and Advances**		
18% Bank loan		50,000	Current Assets		
			Loose Tools		10,000
Unsecured loans		Nil	Stock-in-Trade		1,24,840
			Debtors		
Current Liabilities and Provisions			Outstanding for		
Current Liabilities			More than 6 months	?	
Creditors		62,220	Others	?	1,05,400
Manufacturing Wages		1,890			
Office Salaries		1,200	Cash at Bank		96,860
Interest on Bank loan		4,500	Cash in hand		19,530
Provisions			**Loans and Advances**		
Provision for Taxation		82,160	Advance payment of		84,290
Proposed Dividend		60,000	Income tax		
			Miscellaneous Expenditure		
			Preliminary Exp.(Rs.6000 – 2000)		4,000
		7,22,770			7,22,770

Question 8 :

The Balance Sheet of X & Y Ltd. as on 31st December, 1999 is given below :

Liabilities		*Rs.*	*Assets*	*Rs.*
Share Capital			**Fixed Assets**	
a) Authorised :			Land & Building	2,00,000
50,000 Eq. Sh. @ Rs. 10 each		5,00,000	**Current Assets, Loans & Advances**	
b) Issued & Paid up Capital :			Stock in Trade	2,00,000
40,000 Eq. Sh. of Rs. 10 each		4,00,000	Sundry Debtors	60,000
Reserve & Surplus			Cash and Bank Balance	2,40,000
Reserve	20,000			
Profit & Loss A/c		1,30,000		
Secured Loan				
7% Debenture		1,00,000		
Current Liabilities & Provisions				
Sundry Creditors		50,000		
		7,00,000		7,00,000

At the Annual General Meeting it is resolved :–

(i) to pay a dividend of 15% .

(ii) to issue one bonus share for every five shares held.

(iii) to give existing shareholders the option to purchase one of Rs. 10 share at Rs. 14 for every five shares held prior to the Bonus distribution.

Pass the appropriate Journal Entries to record the above transactions and also draw up Balance Sheet. 10+10

Answer :

IN THE BOOKS OF X & Y LTD.

JOURNAL ENTRIES

DateParticulars	*L.F.*		*Rs.*	*Rs.*
Profit & Loss Appropriation A/c		Dr.	60,000	
To Equity Dividend A/c				60,000
(Being a dividend @15% declared as per share holder's resolution No....... Dated......)				
Equity Dividend A/c		Dr.	60,000	
To Bank A/c				60,000
(Being equity dividend paid off)				

P/L A/c	Dr.	70,000	
Reserve A/c	Dr.	10,000	
To Bonus Dividend A/c			80,000
(Being bonus declared as per member's Resolution Dated......)			
Bonus Dividend A/c	Dr.	80,000	
To Equity Share Capital A/c			80,000
(Being Bonus utilized for the issue of 8,000 Equity Shares of Rs. 10 each distributed in the ratio of one share for every 5 share held)			
Bank A/c	Dr.	1,12,000	
To Equity Share Capital A/c			80,000
To Share Premium A/c			32,000
(Being amount received on issue of 8,000 Equity Share @ Rs. 10 each at a premium Rs. 4 per share as per members Resolution Dated......)			

Dr. **X&Y Ltd.** **Cr.**

Balance Steet *as at 31.12.99*

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		Fixed Assets :	
a. Authorised :		Land & Building	2,00,000
50,000 Equity Shares @ Rs. 10 each	5,00,000	Current Assets :	
		Stock in Trade	2,00,000
		Sundry Debtors	60,000
b. Issued & Paid up Capital :			
48,000 Equity Share @ Rs. 10 each	4,80,000	Cash & Bank Balance	1,80,000
Reserve & Surplus :		(2,40,000 – 60,000)	
Reserve (20,000 – 10,000)	10,000		
P/L A/c (1,30,000 – 60,000 – 70,000)	Nil		
Secured Loan :			
7% Debentures	1,00,000		
Current Liabilities :			
Sundry Creditors	50,000		
	6,40,000		6,40,000

Working Notes :

1. **Amount required for Dividend**
   - (a) Cash Dividend = 15% of Subscribed Capital = Rs. 60,000
   - (b) Bonus Dividend = 1/5 × 40,000 × 10 = Rs. 80,000
2. **Utilization of Profits/Reserve**
   - (a) Cash Dividend should be declared out of P/l A/c
   - (b) Bonus Dividend should be declared out of – :
     - i. Rs. 70,000 from P/L A/c
     - ii. Rs. 10,000 for Reserve A/c.

Question 9 :

The Balance Sheet of Sayan Ltd. as on 31.12.98 is given below :

Liabilities	*Rs.*	*Assets*	*Rs.*
12% Pref. sh. of Rs.100 each, fully paid up	6,50,000	Sundry Assets	8,50,000
30,000 eq. sh. of Rs.5 each fully paid	1,50,000	Investment	3,75,000
General Reserve	1,60,000	Sundry Debtors	47,500
Profit & Loss Account	3,00,000	Bills Receivable	60,000
10% Debenture	1,00,000	Cash at Bank	67,500
Sundry Creditors	40,000		
	14,00,000		14,00,000

The preference shares are to be redeemed on 1st January 1999 at a premium of 7.5% . In order to facilitate redemption of the company has decided —

- (i) To sell the investment for Rs. 3,60,000.
- (ii) To finance part of the Company's fund and to issue sufficient Equity shares at a premium of Re. 1 per share to raise the balance of funds required.
- (iii) Minimum bank balance to be retained at Rs. 5,127.
- (iv) The investments were sold, the equity shares were fully subscribed and all payments were made except to holders of 50 shares who could not be traced.

Give the necessary entries and the new Balance Sheet as on 1.1.1999.

Answer :

In the Book of Sayan Ltd.

Journal Entries

Particulars	*L.F.*	*Rs.*	*Rs.*
Bank A/c	Dr.	3,60,000	
P/L A/c	Dr.	15,000	
To Investment A/c			3,75,000
(Being investment sold and transferred the loss on sale to P/L A/c)			
12% Pref. Share Capital A/c	Dr.	6,50,000	
Premium on Redemption of Pref. Share	Dr.	48,750	
To 12% Pref. Share Holder A/c			6,98,750
(Being amount payable on Redemption of 6,500, 12% Pref. Share with a premium of 7 &$^{1}/_{2}$%)			
Bank A/c	Dr.	2,71,002	
To Equity Share Capital A/c			2,25,835
To Share Premium A/c			45,167
(Being 45,767 equity share of Rs.5 each were issued at a premium of Rs. 1 per share as per Board resolution No........... Dated.........)			
12% Pref. Shareholder A/c	Dr.	6,93,375	
To Bank			6,93,375
(Being amount due to preference share holders paid off expect to the holders of 50 shares)			
General Reserve A/c	Dr.	1,60,000	
P/L A/c	Dr.	2,64,165	
To Capital Redemption of Pref. Share			4,24,165
(Being necessary amounts transferred out of profit and Reserve for Capital Redemption)			
Share Premium A/c	Dr.	45,167	
P/L A/c	Dr.	3,583	
To Premium on Redemption of Pref. Share			48,750
(Being premium payable on redemption were adjusted)			

SAYAN LTD.

Balance Sheet *as on 1.1.99*

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		Sundry Assets	8,50,000
Issued and Subscribed		**Current Assets**	
75,167 Equity Share of Rs. each	3,75,835	Sundry Debtors	47,500
RESERVE AND SURPLUS		Bills Receivable	60,000
P/L A/c	17,252	Cash at Bank	5,127
(3,00,000 – 2,64,165 – 15,000 – 3,583)			
Capital Redemption Reserve	4,24,165		
Secured Loan			
10% Debenture	1,00,000		
Current Liabilities			
Sundry Creditors	40,000		
12% Red. Pref. Share Holder	5,375		.
	9,62,627		9,62,627

Working Notes :

1) Cash to be raised through issue of Equity Share.

Dr. **Bank Account** **Cr.**

Particulars	*Rs.*	*Particulars*	*Rs.*
To Balance b/d	67,500	By Preference Shareholder A/c	6,93,375
To Investment	3,60,000	(6,98,750 – 50/6,500 × 6,98,750)	
To Eq. Sh. Holder A/c (Balancing Figure)	2,71,002	By Balance c/f	5,127
	6,98,502		6,98,502

2). Equity Shares of Rs.5 each to be issued to a Premium of Re.1 per share. So No. of Equity Shares to be issued = Rs.2,71,002/6 = 45,167

3). Arrangement of funds :

Payable on Redemption	*New Issue*	*Reserve & Surplus*	
Preference Share	Equity Share Capital	Amount Required	
Capital = Rs. 6,50,000	45,167 × 5 = 2,25,835	6,50,000–2,25,835 = Rs.4,24,165	
Premium on Redemption	Share Premium	General Reserve	1,60,000
@7 & $^{1}/_{2}$% = Rs.48,750	47,167 × 1 = 45,167	P/L A/c	2,64,165
			4,24,165
		P/L A/c = Rs.3,583	

Question 10 :

Ram and Shyam are partners of Ram Shyam & Co. sharing profits and losses in the ratio of 3: 2. Sita and Gita are partners of Sita Gita & Co. sharing profits and losses in the ratio of 5 :3.

The balance sheets of the two firms as on 31st May, 2001 was as under:

	Ram Shyam & Co. *Rs.*	Sita Gita & Co. *Rs.*
Capitals:		
Ram	5,00,000	—
Shyam	3,00,000	—
Sita	—	6,00,000
Gita	—	4,00,000
Loan from Sita Gita & Co.	2,00,000	—
	Rs. 10,00,000	10,00,000
Fixed assets:		
Cost	4,00,000	5,00,000
Less: Depreciation to date	3,00,000	4,00,000
	1,00,000	1,00,000
Loan to Ram Shyam & Co.	—	2,00,000
Current assets	21,00,000	7,50,000
Less: Current liabilities	12,00,000	50,000
	9,00,000	7,00,000
	Rs.10,00,000	10,00,000

Kuber Ltd. was incorporated on 1st April, 2001 with an authorised capital of Rs. I crore. The subscribers to the memorandum and articles of association took up 3,00,000 equity shares of Rs. 10 each and paid for same on formation of the company. Formation expenses amounted to Rs. 1,00,000 and were paid off.

Kuber Ltd. decided to take over the net assets of Ram Shyam & Co. at a valuation of Rs. 12,50,000 and the net assets of Sita Gita & Co. at a valuation of Rs. 14,00,000. Equity shares of Rs. 10 each were allotted at par in discharge of the consideration on Ist June, 2001.

The directors of Kuber Ltd. decided to revalue only the fixed assets taken over at Rs. 2,50,000 in respect of Ram Shyam & Co. and Rs. 3,00,000 in respect of Sita Gita & Co.

The directors of Kuber Ltd. ask you to show the ledger accounts in respect of the above transactions and extract the trial balance.

Answer :

In the books of Kuber Ltd.

Dr. **Bank A/c** **Cr.**

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1.4.01	To Equity share capital	30,00,000	1.4.01	By Formation exp	1,00,000
			30.6.01	By Balance	29,00,000
		30,00,000			30,00,000

Dr. **Equity Share Capital A/c** **Cr.**

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
			1.4.01	By Bank	30,00,000
		56,50,000	1.6.01	By Business Purchase A/c	26,50,000
30.6.01	To Balance	56,50,000			56,50,000

Dr. **Ram Shyam A/c** **Cr.**

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1.6.01	To Current liabilities	12,00,000	1.6.01	By Fixed assets	2,50,000
		2,00,000		By Current assets	21,00,000
	To Business purchase A/c	9,50,000			.
		23,50,000			23,50,000

Dr. **Sita Gita & Co. A/c** **Cr.**

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
		50,000	1.6.01	By Fixed assets	3,00,000
”	To Business purchase	12,00,000	”	By Loan	2,00,000
		.	”	By Current assets	7,50,000
		12,50,000			12,50,000

Dr. **Business Purchase A/c** **Cr.**

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1.6.01	To Equity Capital A/c	26,50,000	1.6.01	By Ram Shyam & Co.	9,50,000
			”	By Sita Gita & Co.	12,00,000
		.	”	By Goodwill	5,00,000
		26,50,000			26,50,000

Dr. Fixed Assets A/c Cr.

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
1.6.01	To Ram Shyam & Co.	2,50,000	1.6.01	By Balance	5,50,000
	To Sita Gita & Co.	3,00,000			.
		5,50,000			5,50,000

Dr. Current Assets A/c Cr.

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
1.6.01	To Ram Shyam & Co.	21,00,000	30.6.01	By Balance	28,50,000
	To Sita Gita & Co.	7,50,000			.
		28,50,000			28,50,000

Dr. Current Liabilities A/c Cr.

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
30.6.01	To Balance	12,50,000	1.6.01	By Ram Shyam & Co.	12,00,000
		.		By Sita Gita & Co.	50,000
		12,50,000			12,50,000

Dr. Goodwill A/c Cr.

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
1.6.01	To Business Purchase	5,00,000	30.6.01	By Balance	5,00,000
		5,00,000			5,00,000

Dr. Formation Exps. A/c Cr.

Date	*Particulars*	*Amount (Rs.)*	*Date*	*Particulars*	*Amount (Rs.)*
1.6.01	To Bank	1,00,000	30.6.01	By Balance	1,00,000

Trial Balance *for the period 1.4.01 to 30.6.01*

	Dr. *(Rs.)*	Cr. *(Rs.)*
Bank	29,00,000	
Equity Share Capital	—	56,50,000
Formation Expenses	1,00,000	—
Fixed Assets	5,50,000	—
Current Assets	28,50,000	—
Goodwill	5,00,000	—
Current Liabilities		12,50,000
	69,00,000	69,00,000

4.11 SELF-EXAMINATION QUESTIONS

1. Distinguish between a company and a partnership firm.

2. What are the guidelines issued by SEBI regarding Issue of Bonus and Right Shares?

3. Discuss provisions of Companies Act regarding premium of redemption of preference shares.

4. A Public Co. Ltd. invited applications for the issue of 2,00,000 equity shares of Rs. 10 each at a premium of Re. 1 per share. The shares were payable as under :

   Rs. 2 with application;
   Rs. 4 on allotment (including premium);
   Rs. 3 on 1st call; and
   Rs. 2 on final call.

   The applications were received for 2,60,000 shares. The company decided to reject 40,000 share applications and allotted the rest proportionately. All the calls were made and an applicant holding 6,000 shares could not pay the dues on final. Consequently these shares were forfeited and subsequently re-issued @ Rs. 9 per share.

   Pass journal entries relating to the issue of the shares and also show the Bank Account in the books of the company.

5. Fairgrowth Ltd. had 6% Rs. 1,00,000 debentures. It had not created any Sinking fund. Debenture interest date is 31st December. On 1.4.95, it purchased Rs. 10,000 own debentures for immediate cancellation @96. On 1.12.95 it purchased Rs. 6,000 such debentures @94 exinterest which were also for cancellation.

   Show the ledger accounts in the books of Fairgrowth Ltd. Ignore Income Tax.

6. Growquick Ltd. was incorporated on 1st May 1994 and was entitled to commence business on 1st June 1994. It had acquired a running business as from 1st January 1994. The profit & loss account for 1994 was as under :

		Dr. (Rs.)		*Cr (Rs.)*
To	Salaries	40,000	ByGross profit	2,00,000
To	General expenses	10,000		
To	Carriage	15,000		
To	Advertising	20,000		
To	Debenture interest	6,000		
To	Director's fees	5,000		
To	Audit fees	4,000		
To	Depreciation	20,000		
To	Interest to vendor (up to 30th June '94)	10,000		
To	Net profit	70,000		
		2,00,000		2,00,000

Ascertain the profit prior to incorporation. Sales up to 1st May 1994 were Rs. 2,00,000 and after 1st May 1994, Rs. 8,00,000.

7. JALAJOGA Ltd. was incorporated as private limited company on 31.8.1995 to take over a business as a going concern as from 1.1.1995. Vendors would get 75% of the profits earned prior to 31.8.95. Trading and profit and Loss Accounts for the year ended 31.12.95 were as under :

(Figures in Rs.)

To	Materials consumed	1,80,000	By Sales	2,60,000
„	Manufacturing wages	48,000	By Closing stock	40,000
„	Manufacturing expenses	12,200		
„	Carriage inwards	7,000		
„	Gross profit C/d	52,800		
		3,00,000		3,00,000
To	Salaries & establishment	15,000	By Gross profit b/d	52,800
„	Office expenses	6,000		
„	Director's fees	1,800		
„	Bad debts	2,300		
„	Debenture interest	1,150		
„	Commission & discount	8,000		
„	Carriage outwards	1,600		
„	Depreciation	10,200		
„	Net profit for the year	6,750		
		52,800		52,800

Sales for March & April are 1.5 times the average monthly sales. Sales for Sept. & Oct. are twice the average monthly sales. Bad debts of Rs. 1,100 were written off in June. Prepare a statement showing pre-incorporation profits. Also indicate the disposal of such profits.

8. The following balances and particulars are extracted from the books of Pant Co. Pvt. Ltd. for the year ended 31st December 1994 :

	Rs.
Share Capital : Authorised, issued & fully paid up (50,000 equity shares)	5,00,000
General Reserve (as at 1.1. 94)	1,50,000
Furniture (including addition of Rs. 5,000)	35,000
Office equipments (as at 1.1.94)	22,000
Motor car (purchased on 30.12.94)	30,000
Sundry debtors (unsecured)	8,50,000
Advance to staff	10,000
Cash in hand	2,000
Balance with Bank of India (including fixed deposits of Rs. 1,00,000)	1,40,000
Loans from Directors	2,00,000
Liability for expenses and goods	2,67,000
Provision for tax (as on 1.1.94)	1,00,000
Profit & Loss A/c (as on 1/1/94)	3,000
Closing stock (20,000 metres)	3,00,000
Advance Tax paid	1,90,000
Depreciation written off up to 31.12.94 (Furniture : Rs.5,000, Office equipment : Rs. 2,000)	7,000
Opening Stock (10,000 metres)	1,50,000
Legal charges including Rs. 3,000 paid to auditors for tax representation	10,000
Salaries to staff	50,000
Miscellaneous expenses (including Rs. 4,000 for tour within India, Rs. 36,000 for foreign tour)	2,00,000
Purchase of cloth (2.10 lakh metres)	30,39,000
Audit fees	4,000
Interest on fixed deposit with bank	5,000
Sales (2 lakh metres) (including export sales of Rs. 10 lakhs)	35,00,000

Further information :

(a) Rate of depreciation – Furniture 10%, Office equipment 15% and Motor car 20%.

(b) M.D. is entitled to commission @ 10% of net profits after providing such commission subject to maximum of Rs. 36,000 p.a.

(c) Debtors include Rs. 1,50,000 outstanding for more than 6 months. Out of this Rs. 20,000 is considered doubtful for which provision is to be made in the accounts.

(d) Tax liability for 1994 is estimated at Rs. 2,00,000 for which provision is to be made.

(e) Transfer to General Reserve Rs. 50,000 out of net profits and proposed dividend is @ 6 % on equity shares.

Prepare the Balance Sheet, and Profit & Loss Account for the year ended 31st December 1994, in accordance with the requirements of Companies Act, 1956.

[Ans. : Net profit Rs. 1,00,000 ; Balance Sheet total Rs. 13,62,000]

9. Mr. Sharma, proprietor of a large business of textiles and readymade goods maintained a provision for doubtful debts @ 10%, a provision for discount @ 4% on debtors and a reserve for discount @ 4%, on creditors which on 1st December, 1999 amounted to Rs. 4,800, Rs. 1,600 and Rs. 1,280 respectively. His balances on 30th November 2000, 2001 and 2002 were as follows :

	30th November 2000 *(Rs.)*	30th November 2001 *(Rs.)*	30th November 2002 *(Rs.)*
Bad debts written off	4,760	960	3,840
Sundry debtors	32,000	9,600	48,000
Discount allowed	960	320	1,280
Sundry creditors	48,000	32,000	64,000
Discount received	960	160	1,120

You are asked to prepare the necessary accounts in the ledger; also show how the items would appear in the final accounts of each of the three years.

10. The Balance Sheet of M/s RAMAN Ltd. as at 31st December, 2001, inter alia includes the following :–

	Rs.
50,000 8% preference shares of Rs. 100 each, Rs. 70 paid up	35,00,000
1,00,000 equity shares of Rs. 100 each, fully paid up	1,00,00,000
Securities premium	5,00,000
Capital redemption reserve	25,00,000
General reserve	45,00,000

The Board decided to redeem the entire preference share capital at a premium of 5% on 31.03.2002. In order to finance the redemption, the Company makes a right issue of 50,000 equity shares of Rs. 100 each at Rs. 110 per share, Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on January 1, 2003. The issue was fully subscribed and allotment made on March 1, 2002. The monies due on allotment were received by March 30, 2002.

The preference shares were redeemed after fulfilling the necessary conditions of section 80 of the Companies Act, 1956. The Company decided to make the minimum utilisation of general reserve.

Show the journal entries in the books of the Company and prepare the relevant extracts from the Balance Sheet as on March 31, 2002 with the corresponding figures as on 31st Dec., 2001.

ACCOUNTING PRINCIPLES AND ACCOUNTING STANDARDS

5.1 ACCOUNTING PRINCIPLES, CONCEPTS AND CONVENTIONS

Introduction and Definition:

The business house employs the scarce economic resources – material, labour, building, equipment and different types of services, which have to be financed. The work is done through joint stock companies where groups of individuals work together for some common goals. The groups of people need information about the amounts and usage of resources, the means of financing them and the results of operating activities and may be broadly termed internal users. External users (such as lenders, creditors, shareholders, employee, public, etc) need similar information for the performance evaluation of the company. A systematic record of the events of the business leading to a presentation of a complete financial picture is known as accounting. Information requirements of external users are served through financial statements. These are balance sheet and profit and loss account for the period along with schedules and notes on account. Non-profit organisations need to know the details of income and expenditure. Therefore, accounting is similar in profit as well as non-profit organisations.

Accounting is aptly termed as the language of business. The American Institute of Certified Public Accountants have defined "Accounting is the art of recording, classifying and summarising in significant manner and in terms of money transactions and events which are, in part, at least of a financial character and interpreting the results thereof. " Affairs of a business unit are communicated to outsiders, owners, lenders and managers through accounting information, which has to be suitably recorded, classified, summarised and presented. In order to convey a uniform meaning to all people as far as possible and to make it meaningful, it is necessary that it should be based on certain uniform scientifically laid down standards. These standards are termed as accounting principles. These accounting principles/guidelines are to establish standards for sound accounting practices and procedures in reporting the financial status and periodic performance of a business. These principles are classified in two categories:

(1) Accounting concepts; and

(2) Accounting convention.

The best way to understand the underlying principles, concepts and conventions is to acquire genuine insight into the general body of accounting theory comprising the generally accepted accounting principles/standards whether they are as per law or on the strength of standard guidelines issued by authoritative accounting bodies like the ICWAI, ICAI etc. or on the basis of local custom. Students will find it profitable to study those principles/ concepts, which are still at research level. For this purpose, the students are advised to be abrest of the latest developments in the fields of accounting theory, to the extent possible, by going through at least some of the available literature on the subject like the Management Accountant issued by the ICWAI and the Chartered Accountant issued by the ICAI. As regards accounting theory, the students are advised to go through at least some above average textbooks, such as Accounting Theory by E. S. Hendriksen. The origin of double entry during 15th century can be taken as the starting point for a study of the development of the accounting theory. The basic accounting principles developed during the 19th century and early 20th century. According to Prof Hendriksen "The main influence on accounting theory during the period 1800 to 1930 can be classified as follows:

(1) The textbook presentation of bookkeeping and the development of newer methods of teaching accounting;

(2) The Industrial revolution with its influence on cost accounting and accounting for depreciation;

(3) Government regulations of business;

(4) The taxation of business;

(5) The development of the corporation and growth of industrial and financial giants through managers; and

(6) The influence of economic theory.

It is beyond the scope of these Study Notes to deal with accounting theory in detail. However, a very brief outline of the subject is given below only to kindle interest among the students to take up a detailed study of the subject as suggested above.

Theoretically, the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference for the evaluation and development of sound accounting practices. According to Hendriksen probably the most relevant definition of accounting theory is that it represents the coherent set of hypothetical, conceptual and pragmatic principles. Hence Accounting Theory, should provide the following:

a) A general frame of reference by which accounting practices can be evaluated.

b) Guidance for the development of new practices and procedures.

However, a single general theory of accounting though highly desirable, yet accounting as a logical and empirical (social) science is still in too primitive a stage for such a development. The best that can be accomplished at this stage is a set of theories (models) and sub-theories that may be complementary or competing. By definition, each theory consists of a set of statements or propositions connected by rules of logic or inferential reasoning. In any event, we should always bear in mind that all theories are subject to modification or abandonment with the development of new information or new theories that permit better predictions. To avoid confusion now and later on, it is necessary to classify accounting theories. There are several ways in which it can be done. Here again we are handicapped by the limited scope to discuss this point elaborately. So we give below a short classification of accounting theories according to predictive levels, because predictability is one of the main features of any theory, including accounting theory. The three main levels of accounting theory are as follows:

1. Theories that attempt to explain accounting practices and predict how accountants would react to certain situations or how they would report specific events. These theories relate to the structure of the data collection process and financial reporting. Which is why they are called syntactical theories (syntax in literature means the correct *Arrangement of* words in sentences). Examples of this kind of theories are:

a) Valuation of Fixed Assets of a going concern at historical cost less depreciation.

b) Valuation of current assets at cost or market price whichever is lower, barring a few exceptions.

c) Whether raw materials issued to production should be valued at cost or market price or at standard cost. Again, within the cost price bases whether it should be FIFO or LIFO or Weighted Average Cost.

d) While valuing Goodwill, the assets of the Vendor company should preferably be valued at replacement cost.

Theories concentrate on the relationship between a phenomenon (object or event) and the term or symbol representing it. These can be referred to as interpretational theories. This is the reason why these theories are called semantical theory (in literature semantics mean study of meanings). Particular care must be taken to assure that the interpretations of concepts by the accountants are the same interpretations made by the users of accounting reports. For example, the word "Profit" means something else in economics. This confusion is mainly due to the fact that particularly by borrowing from economics, accountants have long attempted to find a correspondence between accounting (money) measurements and economic or physical concepts or real-world phenomena. This search has been necessary in order to give some meaning to accounting theory and practice. Without interpretational support no accounting structure can be meaningful and useful. Examples are:

Method of assets valuation, methods of profit estimation, etc. These are all artificial concepts peculiar to accounting. Hence, for the users to financial reports/information, they should be interpreted in a specific manner. But, on many occasions real difficulty will arise. For example, the word "value" has no specific interpretations, as we see later on. The word cash/bank balances does not need any interpretation. But terms like deferred revenue expenditure, intangible assets, fictitious assets etc. need clear accounting interpretation in a standard manner, to the extent now possible.

Behavioural (Pragmatic) Theories : These theories emphasise the behavioural or decision-oriented effects of accounting information/reports/statements. The most commonly used dictionary meaning of the word "pragmatic" is "practical". This kind of accounting theories is called "practical" because to whom the periodic financial statement (Balance Sheet and the Profit and Loss Account) are sent, use them for the most practical use, that is, taking decisions on the basis of such financial statements. In this category the focus is on the relevance of information being communicated to decision-makers and the "behaviour" of different individuals or groups as a result of the presentation of accounting information. The literal meaning of the word "behaviour" is the manner in which an individual (or a group) reacts. In the present context, behaviour would mean how an individual (or a group) reacts on receiving and studying communicated accounting information for example individual; reaction on seeing the bottom line (net profit) as compared to the last year. Likewise, reaction on examining the financial condition is revealed by the Balance Sheet. Finally, helping the user of the financial statements to decide whether he would like to hold on the shares or dispose them of. Of course, before taking a final decision, the user may need much more and complex information like Ratio Analysis, Fundamental Analysis. Fundamental Analysis, studies with Technical Analysis (methods employed to study and forecast trends in stock exchange operations).

This category of accounting theories is still in its infancy. The issue is rendered more complicated because our knowledge of human psychology, which differs from person to person, is imprecise, incomplete, controversial and highly subjective in many cases. In spite of all these practical handicaps researchers are busy acquiring more dependable insight into the human psychology, both individual and group. The result is the emergence of new concepts like Human Information Processing, Agency Theory, etc. The basic contention of Human Information Processing is that individuals have been found to be limited in their ability to process information in a complex setting. To overcome the complexity, they will mostly attempt to simplify the information and reduce the uncertainty, as they perceive it.

Basic concepts:

Accounting principles are built on a foundation of a few basic concepts. These concepts are so basic that most accountants do not consciously think of them; they are regarded as being self-evident. Non-accountants will not find these concepts to be self-evident. Some accounting theorists argue that certain of the present concepts are wrong and should be changed. But in order to understand accounting, as it now exists, one must understand what the underlying concepts currently are. The different aspects are :—

1. Business Entity Concept
2. Money Measurement Concept
3. Cost Concept
4. Going Concern Concept
5. Dual-aspect Concept
6. Realisation Concept
7. Accrual Concept
8. Accounting Period Concept

1. BUSINESS ENTITY CONCEPT:

The business is treated as a distinct entity from the individuals who own it and accordingly accountants record transactions. For example, if the owner of a shop withdraws Rs. 10,000 for personal use, from the business entity point of view, the entity has less cash though it belongs to the owners. Therefore, this amount is shown as a reduction in owner's capital, which in view of business entity concept appears as a liability in the balance sheet of the business. Without such a distinction the affairs of the shop will be mixed with the personal affairs of the owner. For a company the distinction is easier as legally the company is a distinct entity from the persons who own it. Therefore, an entity is a business organisation or activity in relation to which accounting reports are compiled. It may include universities, voluntary organisations, government and non-business units. What we have stated above is just a superficial discussion of the concept, though the central point has been brought out clearly. But we have to go at least a little deeper because out of this basic concept, a large number of very important sub-concepts emerge, dealing with ownership equities, without which we cannot understand properly many of the modern accounting practices. Constrained by the limited scope of Study Notes to deal exhaustively with a particular concept, the discussion that follows in this regard will touch upon the basic outlines of the sub concepts related to the Business Entity Concept.

But before we take up the specific sub-concepts, let us turn to the factors, which compelled the emergence of the basic concept of Business Entity.

There are two ways in which we may look at it. Namely, the pure accounting angle and the legal viewpoint. Let us consider the pure accounting viewpoint first.

Pure Accounting Viewpoint : We will start from the fundamental accounting equation, that is:

Debit = Credit	(i)
And, Assets=Liabilities	(ii)
And, Assets = Internal Liabilities + External Liabilities	(iii)
And finally, Assets = Capital + Liabilities; or A = C + L	(iv)

The above equation/s epitomises the logic of the double-entry system of bookkeeping. There was internally no difficulty in recording all financial transactions, except the entry for introduction of capital by the owner. The matter was further compounded by the fact that an owner may be owning a number of business enterprises besides his personal financial affairs. Practical accounting is organisation-specific, meaning that accounting entries are passed with reference to a particular business (or non-business) organisation (enterprise). From the non-accounting point of view when an owner introduces capital into a particular business, it seems "as if" the owner is giving money to himself. Double-entry system, cannot record such a nondual transaction. It can record a financial transaction when one distinct person gives money to another distinct person. Accountants cannot afford to ignore to record introduction of capital by the owner, since in reality the business is receiving money from "somebody". Hence they were compelled to invent another person who was receiving money from the owner as capital. It was logical to assume the business itself, as the much needed "invented" person. There is no difficulty in debiting the Cash/Bank, which is coming in. But to credit Whom? After the business came to be considered as separate from the owner, his name was made secondary to the new status "Capital". This is the accounting angle. Now let us turn to the legal Angle.

Legal Angle:

When the Industrial Revolution became a grand reality nearly 250 years ago, formation of company type of business Organisation became an inevitable event, to raise huge capitals, which is possible only with a large number of co-owners, need to finance production on hitherto unknown scales of production. Prior to the centre-stage appearance of the companies, partnership was the predominant form of doing large-scale (by the then the standard) business form. But partnership was risky affair for the partners with unlimited liability.

It was risky, for the unsecured creditors due to dissolution of partnership on any change in the ownership, particularly due to the death of a partner/s. Company type of business would have failed to win the confidence of a large number of investors of large amounts as capital as well as the unsecured creditors now with bigger stakes due to much larger scales of operations, if those two characteristic features of partnership had persisted. Hence the emergence of the concepts of limited liability and perpetual succession. But these two concepts could not be put into practice until the business was endowed with an entity, that is, existence independently of and separate from its owners. This is the main point about legal recognition of the separateness of business as an entity from that of its owners. But this was no surprise to the accounting community since they had already realised the significance of (his concept under the inevitable compulsion of the rigour of double entry system of book-keeping for recording capital contributed by the owner/s.

Now let us turn to the important intimate relationship between the Entity Concept and the Equity Concept.

Entity and Equities:

An entity means an Organisation, whether a company or not, big or small or profit oriented or not, having a separate existence (entity) from the owner. Equity means any right, claim or interest in an asset (in accounting, as it could relate to things other than assets in the other departments of life) recognised as valid under any law based on impartial justice.

Note : The separate existence may be recognised under law as well as in accounting only.

In order to have close touch with real-world affairs, we shall henceforth discuss the present issue with regard to a big company unless otherwise stated specifically. From the description of what constitutes the concept of "equity". As stated above, there is no bar to admitting that all the items on the liabilities side of a Balance Sheet can be described as items of equity, which can be broadly classified as follows:

a) Shareholders' equity comprising different kinds of Shares plus all kinds of Reserves plus all kinds of Retained Earnings less Expenditure/s to the extent not written off, such as Preliminary Expenses, Deferred Revenue Expenditure, etc.

   Note : In India at present there can be only, two kinds of shares, namely Equity and Preference Shares. As regards share Capital, Preference Shareholders' claim is restricted to the paid up amount only.

b) Long-term creditors/lenders

c) Current Liabilities.

Note : The claim of any category of creditors, whether long-term or current is restricted to the amount of credit legally admitted at the point of time when it is materialised.

Equities are treated differently for a going-concern from a company, which is going, or gone into liquidation. A going-concern is one, which has not contemplated going into liquidation even in the remotest future at the time of preparing its latest financial statements, consisting primarily of the Balance Sheet and the P/L A/c. The main point of difference is that the residue of money received from sale of the business less all liabilities are due for return to the Equity Shareholders, while liabilities and Preference shareholders are paid off only, the legally prior-committed amount. In liquidation, the Equity Shareholders may get less than their book-value of claims. The equities can be looked at from different angles, depending on how the equity holders, mainly the shareholders, look at the business entity's assets. At present, however, the ways in which the employees, the community as well as the rest of the society at large, meaning the country as a whole, look at the Organisation. This has given rise to the modern concept of Social Accounting; this is, however, outside the scope of the present Study Notes. The ways in which the different kinds of equity-holders view their claims on the assets of the entity and their relative strengths among themselves determine a lot of accounting and social issues. In accounting, these factors are responsible for the format and the other aspects of what is known as the "Design of Accounts", Disclosure and Transparency of Accounts, etc. But an accountant today will have to consider every aspect of traditional accounting from the formal angle of the "structure" of the Fundamental Accounting Equation, which has already been referred to. From such an angle, certain theories of equity have been evolved. We are now going to discuss some major theories as briefly as possible.

Proprietary Theory:

Here the owner/s is the focal point of all the activities of the entity. He is concerned with his claim on the entity's assets. As a result, the fundamental accounting equation is changed from Assets = Liabilities + Capital [Capital because it includes share capital + all Reserves + all Retained Earnings – Fictitious Assets] to Capital = Assets – Liabilities. As a result of rearranging the fundamental equation in this fashion, the emphasis on Capital is heightened.

Entity Theory:

Here equal importance is given to all equity holders, whether owner or lender or creditor. As a result, the fundamental equation, Assets = Liabilities + Capital (Capital because it includes share capital + all Reserves + all Retained Earnings–Fictitious Assets) to Capital = Assets – Liabilities is either retained as it is or to focus attention on the equity holders as a whole; it may be written as: Liabilities + Capital = Assets.

Enterprise Theory:

Here the shift is from Entity to Enterprise because it is intended to include among equity holders not only those who have directly provided funds to the enterprise, but also employees, community and the state who have provided with intangible resources like human resource (by employees) co-operation (by the community) and infrastructure (by the State). Hence, the fundamental equation is viewed from two angles as shown below Tangible Form: Liabilities + Capital = Assets

Intangible Form: Liabilities (legal + contractual) + Liabilities (non-contractual but social, comprising Employees, community members and the state).

Note : At the present moment the Entity Theory is the leading most theory for companies and the point of view of the Proprietary Theory may still be used in the context of Sole-tradership and Partnership firms. The Enterprise theory is the accounting equation form of Social Accounting, which is yet to have Universal application.

Residual Equity Theory:

In this approach, the Equity Shareholders are shown separately from other equity holders like lenders. Creditors and preference shareholders, because changes in the values of assets will not affect the legal and contractual claims of those equity holders who are not equity shareholders. The fact that the equity shareholders are entitled to the residue of assets after meeting the claims of lenders, creditors and preference shareholders is highlighted by altering the fundamental equation into:

Assets – Specific Equities = Residual Equities.

Note: Specific Equities include creditors, lenders and preference shareholders.

This theory, therefore, stands halfway between proprietary Theory and Entity Theory.

Fund Theory:

This theory calls for a very critical analysis of the concept involved since it tends to violate, though conceptually only, the separateness of the owner/s entity (existence) from that of the business. It does not affect the mechanical aspect of double entry book-keeping, which will be carried out in the same manner, regardless of the equity theory, which a specific entity is following, in so far as what is to be debited and credit different situations which give rise to financial transactions. The focus on the separateness of entities is withdrawn as repositioned on the operational and activity aspects of an Organisation. This new area under focus is called the "Fund" which is nothing but a conglomeration of assets and related obligations and restrictions denoting specific economic (hence financial also in most of the cases) operation/activity undertaken by the Organisation. This Fund theory is, therefore, based on the modified equation:

Assets = Restrictions on the use of Assets

Assets represent prospective services to the Fund, that is a specific operational unit, say, Governmental expenditure on Education. Liabilities represent restrictions against specific or general assets of the fund, that is the invested capital, say, Government's allocation of money for expenditure on education, must be maintained unless specific authority has been obtained, which means that money allocated for expenditure on education must be spent only, on education. However, in very special cases some exceptions are allowed. This is primarily meant for ensuring strict adherence to planned expenditure on specific areas of activities, for various reasons, such as, social, political, economic, ethical, etc. This automatically gets involved with rigid rules of accounting and administrative accountability on the part of those who have been authorised to dispose of fund-specific assets. Naturally, therefore, this theory is found extremely suitable and useful for social organisations, political and charitable organisations, including educational institution, social welfare institutions, political parties, clubs, charitable trusts and the like. Since a Government is concerned with all the above activities, it goes without saying that by and large, Government Accounting is Fund Theory-oriented.

Commander Theory:

Fairly recently some experts have criticised the Proprietary, Entity and related theories on the ground that none puts emphasis on the correct economic aspect of an entity. On the contrary undue emphasis is put on the legal and/ or accounting feature of a personified entity to the exclusion of people who carry out economic, managerial accounting and social functions on behalf of an artificially created person devoid of any human characteristics of its own. Undue emphasis is also put on ownership that is equity and today the question of ownership is vague and complicated and difficult to understand logically. Ownership is a legal matter, but "Control" is intrinsically an economic hence human agency-related. Those who control are commanders. There are different kinds of commanders. For that matter, shareholders as well as members of the management team are commanders since they can take decisions about the source and application of fund as well as exercise specific control functions. Command guide commanders. Commander communicates with commander.

Commander reports to commanders. Hence, finally the Balance sheet should be construed as reporting of one-group commanders (the management) to the group of commanders (the owners). Management is entrusted with initiating action pertaining to source and application of funds. The owners are authorised to appoint, remove and guide the management, rather, allocate responsibility to management and the exercise control on the management by demanding accountability reports in the form of Balance Sheet and the P/L A/c, though they (the owner) do not enjoy day-to-day control right. On the other hand, the management enjoys the right to exercise day to day control but not ownership-related control, such as, adoption of accounts, appointment or reappointment of auditors are directors and declaring dividends in the advice of management (basically a staff and not an executive function). To project this view point in the correct perspective, the fundamental equation is expressed as:

Liabilities = Assets-to signify – Source of Funds = Application of Funds.

In other words: Most economically and judiciously controlled raising of funds = Most economically and judiciously controlled application of funds.

Note : A parallel economics theory known as Agency Theory is fast approaching the Centre stage in the theory and practice of management of economics organisations and related accounting aspects. Though this theory is outside the scope of the study Notes, yet it would be useful to note its basics theme which claim that the management will first take care of its personal aspect/s out of self-interest and maximisation of shareholder's funds entrusted to it for enlargement through profit maximum will assume a position of secondary importance to it (the management). This theory is still now well founded. But the fact remains that human psychology, whether operation through an individual or a group, has yet been established on sound logical and scientific foundation. Hence the psychological aspects of human behaviour will continue to be a debatable issue at least for quite some time into the foreseeable future.

2. MONEY MEASUREMENT CONCEPT:

A record is made only of the information that can be expressed in monetary terms for accounting purposes. The advantage of doing this is that money provides common denominators by means of which variety of facts can be expressed as numbers that can be added and subtracted. This enables addition and subtraction of varied items since money provides the common denominator. An event even though important like the loyalty of the workers will not be recorded unless it can be expressed in monetary terms. The changing price level also creates difficulties in the monetary value.

If we look at financial accounting purely from the point of view of Fundamental Accounting Equation:

Assets = Capital + Liabilities.

Then it would be evident that it had virtually no option but to adopt monetary values of assets and liabilities and capital to apply the equation day-to-day business affairs. This concept is basically concerned with the problem of measuring items of the accounting equation. Such items may be, plant and machinery (an assets), liability for loan taken – all these are object of some kind of the other. Other items represent events (transaction) such as expenses and income. Basically, double entry system is additive (say, when finding the aggregate of assets) or subtractive (say when total liabilities are deducted from total assets to find capital, or deducting expenses from income to estimate profit). But only the "like" can be added with the "like" and the "like" can be deducted from the "like", when the word "like" means that the items involved are expressed in the same unit. But in real-world affairs, physical assets may have to be expressed in several ways, like numbers of units, weight, volume, etc. Likewise wages may have to be expressed in man-hours or simply in hours. Apart from ensuring feasibility of making addition and subtraction, which is in inherent in the accounting equation, the sign of equality (actually the sign of "identity") needs use of the same units in describing such items. In accounting the description is finally expressed quantitatively in terms of money. In modern business it is essential link to accounting to a market system in an exchange economy a valuable source of quantitative data. Since goods and service are generally exchanged in terms of money, a monetary measurement of economics data can be assumed to be useful in decision-making, particularly for that decision relating to wealth and the production of goods and services.

At first you may wonder, how items other than assets, liabilities and capital, such as expense and income may appear in the fundamental accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

Well, during the year/period, transaction relating to expense and income usually referred to as "nominal accounts" are recorded until they are summarised at the end of the year (in the form of a Balance Sheet, as the P/L A/c only provide details of periodic profit or loss). The following illustration will clarify this, assuming a profit - earning year.

Accounting Equation as at the beginning of the year:

$$\text{Assets}_1 = \text{Liabilities}_1 + \text{Capital}_1$$

Recording of expenses and income during the year:

$$\text{Assets}_1 + \text{Expenses} = \text{Liabilities}_1 + \text{Income} + \text{Capital}_1$$

Arriving at profit at the end of the year:

$$\text{Assets}_2 = \text{Liabilities}_2 + \text{Capital}_2 + (\text{Income}–\text{Expenses} = \text{Profit})$$

From equation (3) above, we now get:

$$\text{Assets}_1 = \text{Liabilities}_1 + \text{Capital}_1 + \text{Profit} = \text{Liabilities}_1 + \text{Capital}_1$$

Notes:

a) At the end of the year : $Capital_1 + Profit = Capital_2$

b) Every transaction of expenses or income is related to either flow of an assets or the incurring of a liabilities or change in the capital. As a result, at the end of the year, we get :

$$\text{Assets}_1 + \text{liabilities (net) assumed during the year} = \text{Liabilities}_2$$

In fact, $Capital_2$

= $Capital_1$ + Profit + Net change in capital due to capital related transactions during the year, like issue/ redeeming of ownership capital.

Hence the Final Accounting equation as at the of the year would be:

$$Assets_2 = Liabilities_2 + Capital_2$$

Valuation, strictly speaking is barter-oriented. But the barter system has the following practical drawbacks:

a) Every person having a surplus item to exchange has to look for another person who has a surplus to exchange for the surplus of the former, which may be quite difficult on most of the occasions.

b) Barter of perishable goods is a constant source of worry and anxiety to the holder of such goods.

c) Carrying bulky goods would cause as much problem of carrying livestock.

d) The subtlety of barter value of services to be bartered poses real difficulties.

e) The combinations of a large number of barter able items would create a lot of computational problems. For example, if 'n' number of items are to be bartered, the possible combinations would be nc_2. However. The emergence of money as a medium of exchange as well as a temporary 'abode of purchasing power' (that is, its storage value) solved all the above problems. But, at the same time, the process of measurement itself became as undependable affair due to fluctuation in the value of money itself, which has been used as a unit of measurement. This becomes a gigantic problem when prices fluctuate violently as in hyperinflation. However, researches are at work to find out practical ways and means to combat this problem. Current Purchasing Power Accounting (CPPA) and Current Cost Accounting and the like are some such attempts. In certain cases they have succeeded in tackling the problem, but their overall track record is far from "satisfactory". Money measurement imposes a severe limitation on the scope of accounting report; as it excludes non-monetary facts like quality of the product, labour strike, rift between production and sales manager, management calibre, economic climate, etc. However, researchers are still busy in finding out a more acceptable and successful approach to the problem. The criteria of a good measurement system should possess at least the following attributes :

   a) ***Objectivity:***

   This means that the same items measured by different competent persons should produce the same value, subject to some conditions. Objectivity enhances the verifiability of the value of an item measured.

   b) ***Uncertainty:***

   One of the most important uses of current financial data is to estimate the future as correctly as possible. Such predictability is an important aspect of any decision making process. Hence, it is most desirable that the predicted future value on the basis of present value, mainly, should not be distorted by any measurement related disturbing factor.

c) ***Freedom from bias:***

Bias is another name in accounting measurement for palpable subjectivity. This becomes a really difficult problem to solve if such bias is inherent in the measurement process. Statistically, it can be measured by measuring standard deviations of observed data with reference to some "true" or "near true" value. For example replacing historical cost by current cost may go a long way towards removing or controlling bias, but that would be at the expense of verifiability, in the presence of violent price fluctuation. Sooner or later, we will have to find out a better solution.

Note :

1. For decision making sometimes non-monetary information may be acutely needed. Hence, this may be provided along with monetary value, disregarding the principle of double entry accounting.
2. The emergence and rapid development of Management Accounting has greatly facilitated decision-making by appropriately co-relating monetary data to non-monetary data.

3. COST CONCEPT

Transactions are recorded in the books at the price paid that is the cost. This avoids an arbitrary value being placed on the asset and all subsequent accounting is in relation to the cost. Therefore, the recording of the assets is at cost figures and this may not reflect the current market value especially in the case of the older assets. The value of an asset in the accounting records does not remain at the original cost because it is diminished systematically by virtue of its use called expired cost and then shown at its depreciated value e.g. an asset of Rs. 1,00,000 is depreciated at 10%. Therefore, closing value will be Rs. 90,000 in the Balance Sheet. An expired cost is an expenditure of money, the economic value of which has been made use of during a particular year (or lost without accruing any benefit to the entity, like machinery destroyed by flood). Every cost has to be recovered from the market through sales, otherwise, the entity will suffer loss, that is, lose its capital. Depreciation, looked at from this view-point, is nothing but gradual recovery of cost incurred, that is, money paid at a time during a particular year for acquiring a fixed asset, during the subsequent years (during which the asset is assumed to remain serviceable) on some estimated basis, by treating the expired cost pertaining to a particular year, calculated on some approved and selected estimated basis, by including such expired cost, called an expense, in the cost of production of that particular accounting year. Linking annual depreciation with the expected service life of a fixed asset does not endow any scientific logic on any estimated basis of depreciation. In accounting, depreciation is nothing more and nothing less than a process of allocation of some specific costs (cost of acquiring fixed assets) on some generally accepted (may or may not be legally approved) estimated basis. An expired cost is not a money measure of the wear and tear obsolescence (passage of time) etc. of any fixed assets. It is just a reasonable basis for recovery of cost of fixed asset in a gradual manner. Money value of wear and tear would need engineering analysis, which is not the domain of financial accounting.

In essence, in a little more technical sense, cost represents the exchange price agreed upon by the buyer and the seller in a relatively free economy. Cost has been the most common valuation concept in the traditional accounting structure.

Therefore, Cost is the exchange price of goods and services at the time they are acquired. So, cost is also the economic sacrifice expressed in monetary terms required to obtain a specific asset or a group of assets. Very often cost is not represented by a single exchange price, but it includes many sacrifices of economic resources necessary to obtain the asset in the form, location and time in which it can be useful to the operating activities of the firm. Thus, all of these sacrifices should be included in the concept of cost valuation. For example, the cost of a plant or machinery should include: original exchange price, import duty, transportation charges. handling charges, erecting and installation charges, etc. depending upon the circumstances of each particular case, until the plant becomes satisfactorily operational. It is also assumed that cost represents the value of the asset to the firm at the time of acquisition, but this cannot be proved, since all factors of the enterprise are used jointly (and preferably in desirable co-ordination) improving the cash available, by realised profit or surplus. To be more specific, we pay exchange prices separately for acquiring different types of assets. But, for a manufacturing enterprise, it is no use simply acquiring assets after another unless they are properly utilised in harmony to the product, which the enterprise wants to be sold at a realised profit. Hence, from the point of view of utility, it becomes very difficult to value each of those assets individually. It is because of the teamwork of a group of mutually useful assets, for example, when a team playing well, it is very difficult to assess the contribution even of a so-called mediocre player, to the team performance. It follows from cost based accounting that if nothing is paid in acquiring an item, the same will not be normally recorded as an asset. Thus a favourable business location, which becomes of increasing importance as time goes on, a good reputation with its customers (goodwill) will not be recorded as an assets in the accounts of the company although they have monetarily value. One of main disadvantages of historical cost valuation is that the value of the asset to the firm may change over time, after long period of time it may have no significance whatever as a measure of the quantity of resource available to the enterprise. Historical cost valuation is also disadvantageous because it fails to the permit the recognition of gain and losses in which they may actually occur (this point will become more clear when the concept of matching cost against revenue will be discussed later on). Also because of change over time, costs of assets acquired in different time period cannot be added together in the Balance Sheet to provide interpretable sums.

Discounting Future Costs:

Most non-monetary assets represent goods or service acquired in advance. There are many reasons for which such advance acquisitions are made. For example, it is less costly (because of trade discount on bulk purchase or before anticipated price rises). In those cases, the equivalent cost of the assets-linked service at the time of actual use may be the most relevant valuation concept. In this context, the present value of these service (the asset) is the discounted value of costs. However, no discounting, that is, recognising the time value of money, would be necessary where the service will be available in the near future, as in the case of prepaid expenses temporarily assetised (in the "current asset" category), at the end of year when the cost was yet to expire. But, in other cases, the cost price (since bought at a cheaper rate in advance) may be less than the amount that would have been required if the service had been acquired when needed. In part, this difference is due to the interest factor, and in part to other factors (like inflation). At this stage, we need not go further into the detail of the cost concept. However, being aware of the impact of the time value of money, up to understand properly the related literature, since tremendous amount of research work is going on in this regard to make decision-making more relevant in the face of fast-changing scenario.

4. GOING CONCERN CONCEPT

Accounting assumes that the business will exist indefinitely into future and accordingly transactions are recorded. If however, there is evidence that the firm will be liquidated then market value of the assets and liabilities will be ascertained and necessary accounting considered. In other cases where the business is an on-going activity resale value of assets is irrelevant. The whole accounting is done based on this assumption.

The present concept as well as the earlier Business Entity concept belongs to the category of "Environmental Postulates of Accounting". It is important to know the precise meaning of this expression, for which purpose we have to know what an accounting postulate is and what is environmental in accounting. In order to avoid a lengthy discussion, we may summarise, by stating that postulates are basic assumption or fundamental propositions concerning the economic, political and sociological environment in which accounting must operate. Thus, it is clear that certain economic, political and sociological events do affect the thinking and actions of accountants and we must also clearly understand that every such event does not affect accounting concepts and practice. The basic criteria for any such postulates are:

(1) They must be relevant to the development of accounting logic, that is, they must serve as a foundation for the logical derivation of further prepositions; and

(2) They, must be accepted as valid by the participants in the discussion as either being true or providing a useful starting point as an assumption in the development of accounting logic.

It is not necessary, that the postulates be true or even realistic. For example, the assumption in economics of a perfectly competitive society has never been true, but it has provided useful insights into the working of the economic system. On the other hand, an assumption of a monopolistic society leads to different conclusions that may also be useful in an evaluation of the economy. The assumptions that provide the greatest degree of prediction may be more useful than those that are most realistic. The environmental of accounting has a direct bearing on the objectives and on the logical derivation principles and rules. You may recall that accounting environment comprises economic, political and sociological factors. But not all aspects of society are relevant to accounting, some are clearly, irrelevant. Others are only indirectly relevant, and many social, political and economic are directly relevant. What may be relevant during one period of time may be irrelevant during another and vice versa. For example, the development of the railways and the proximity of a factory to a railway may have been much more important to some enterprises before the construction of high-speed highways. Even a few decades ago pollution, ecology etc. had no bearing on accounting. But today they have become compulsive forces on current thinking on accounting. The objective of stating environment postulates (those which are directly or indirectly influenced by the accounting "milieu" – environment) is to point out what aspects of a society are relevant to accounting and to decide which of conflicting situations or of several institutions are more significant for providing a framework for broad generalisation. Most statements of environmental postulates include in assumption that exchanges in the economy take place in markets and that market prices leave significant implications for accounting. However, there is no agreement regarding which prices are relevant. These differences arise because of different objectives of different authors of accounting postulates based on accounting environment.

Going concern or Continuity Concept:

In addition to the "accounting entity concept", a further observation made regarding the nature of the relevant accounting entity is that most economic units are organised to operate over an indefinite period of time. Therefore, it is frequently argued that it is a logical step to recognise that the entity should be viewed as remaining in operation indefinitely under normal circumstances – this is the traditional going concern postulate. But, we must know that all accountants do not agree to this. This postulate includes among the classification of imperatives (compulsory practices), apparently, because accounting practice does not generally, recognise this assumption throughout the entire accounting process. However, so far as we are concerned we should follow this postulate. If there is evidence that it will not continue in existence long enough (for instance, where there are large and persistent losses or where it appears that the enterprise cannot continue at a profitable level) general accounting principles would not apply and the accountant has the professional responsibility of informing through proper channel the users/readers accordingly. The reason for including the continuity postulate is generally to support the benefit theory of valuation (like the opportunity of spreading the cost of fixed assets over a number of years, uniformity in accounting to ensure more meaningful comparisons because of the opportunity to adopt accrual basis of accounting, etc.) or in some cases to support the use of historical costs as opposed to liquidation values. Another interesting view is offered by some researchers who do not accept the usual meaning of the going concern postulates by stating that a going concern is an enterprise that adopts itself by the sale of its assets in the ordinary course of business, that is in orderly liquidation as opposed to forced liquidation. This assumption thus supports the proposition regarding the relevance of current cash equivalents. Some experts assume an expected life span of the entity without necessarily assuming that it will be indefinite. Logically, this would include an expected life of zero (i.e., in finding liquidation situation). Another expert holds the view that the continuity concept is not an assumption, but a condition–one that is at least to a large extent a verifiable attribute of the business system. He contends that it is a "status quo" assumption that is really an extension of the measurement process. But the opponents of this view argue that the status quo assumptions are falsifiable and misleading. They propose that rather than making continuity an assumption, it should be a prediction. They further argue that the going concern concept does not automatically justify valuation on historical costs since there may we believe that postulates should basically be predictive to help make future prediction. Hence there is no need to interpret the going concern concept either as a status quo concept or as a justification for valuation on historical costs or even the benefit concept of accounting (as already explained). However it is relevant postulates, leading to the presentation of accounting information regarding resources and commitments and operational activity (such as sales of goods and services over several years), on the ground that such information may aid in the prediction of future operational activity. Continuity assumes some connection between the past and the future, although not necessarily that the future will be repetition of the past. In the case of discontinuity, such as a forced liquidation, the usual accounting procedures would not apply, and the accountant should disclose the nature of the discontinuity and then its resources would be reported at their liquidation value. Such circumstances are uncommon.

This concept will come out in bolder relief in our subsequent discussion of the concept of matching cost against revenue.

5. Dual Aspect Concept

The economic resources of an entity are assets and the acquisition of an asset must be on account of : –

(a) Some other assets being sold: or (b) the creation of an obligation to pay; or (c) there has been a profit owed to proprietor; or (d) The owner has contributed.

On the other hand, an increase in liability is on account of an increase in asset or a loss. Therefore, at any time –

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$
$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

The owner's share is what is left after paying outsiders. This is the accounting equation. Every transaction has dual impact and accounting systems record both the aspects and are called the double entry system. e.g. X starts a business with a capital of Rs.20,000. There are two aspects of the transaction. On the one hand the business has assets of Rs. 20,000 while on the other hand it has to pay the proprietor Rs. 20,000, therefore: –

$$\text{Capital (Equities)} = \text{Assets (Cash)}$$
$$\text{Rs. } 20{,}000 = \text{Rs. } 20{,}000$$

What has been stated above is an oversimplified version of the concept and its application, since this is the form of the concept with which we are familiar as beginners. But we have to go a little deeper in order to have a more meaningful understanding of the concept because it is the bedrock on which double entry book keeping has built its gigantic edifice and is still flourishing as a very important discipline all over the world. There must be something deeper than what has been stated above which caught the imagination of an Italian priest and mathematician and prompted him to codify if not invent the double-entry system in 1495 which explained logically and systematically what happens in the economic world, in terms of money when goods are manufactured and sold at the market place through financial transactions. This could be applied to sale of services equally logically, and systematically. In course of time it also exposed other related concepts, especially the first two concepts already discussed, namely the Business Entity concept and the Money Measurement concept. The two basic economic phenomena which constitute the foundation of the Dual Aspect Concept are as follows:

No financial/commercial/transaction as distinct from gifts is unilateral. In a financial transaction, each party receives as well as gives up things, which have economic value, of matching amount when a deal is finalised. Otherwise, why should one knowingly, pay in value (money value) more than that one perceives to be the value (in money) of what one receives in exchange? Hence, when one receives something of an agreed money value one's resources go up by that amount only to be reduced by the same amount, which is the agreed money value of what one gives up. This is now being interpreted as an event in which each party, to a financial transaction is affected in equal amount on two accounts, one account represents the money value of what the person receives while the other account represents the money value of what the person has to give up in exchange. If money or its equivalent is perceived to flow in when it comes in and flows out when it goes out then
"coming in" and "going out" would represent opposite directions, but of equal money-value, otherwise the transaction would not have materialised. Which is why today's accountants explain that when a transaction (financial) takes place, each party is affected equally on two fronts, that is, two accounts, but in opposite conceptual directions. But, how to equate
"going out" and "coming in" ? This can be solved if we look at each asset as a property, (wealth) as well as a claim on such property. Hence, the value of the property has got to be equal to the value of the claim on it, both in monetary terms, of course. If a property holds some reasonable promise of yielding some financial benefit in future, then every claim should be holding a prospective "threat" to give up something. This concept can be very elegantly and precise but forth if we describe a claim as a liability and a property as an asset.

Hence : Property = Claims on property. (i)
Or, Asset = Liability. (ii)

Now, a liability is internal if the owner of the business has claim over an asset, This has to be distinguished from a claim in favour of a person other than the owner. Hence owner's claim is called the capital and others' claims as liabilities.

Hence, we get, Assets =Internal Liabilities + External Liability. (iii)
Or, Assets = Capital+ Liability. (iv)

We have already explained how from the opening Balance Sheet for a year, that is opening Accounting Equation; Assets = Capital + Liability_1 is changed into Assets_2 =Capital + Liability_2 as at the end of the year, that is closing Balance Sheet. We have explained, how the various financial transactions entered into during the year, keep altering the initial equation for every transaction, caused by receipts and payments of money, goods, and services, unwiring expenses and earning income in our discussion of Money Measurement Concept.

Note : The notation of summation "S" has been omitted and the present discussion has been restricted to one "Asset" one" Liability" and one Capital for the sake of simplicity.

For a better understanding of the Dual Aspect Concept the following points should be borne in mind:

(a) The liabilities side of a Balance Sheet represents all the providers of the business fund, whether obtained from the owner/s or others. Hence this side represents the "Sources of Funds". Similarly, as assets are obtained by utilising fund, the Asset side represents the "Application of Funds".

(b) We are familiar with the "golden rule of accounting/Book keeping". This rule requires us first to classify accounts into Real, Nominal and Personal categories, and then apply the conventional rules as to which account is to be debited while which account is to be credited with for each transaction. There is nothing wrong with this system. But it does not very clearly highlight that for, whatever having a money value, we have to give up something of equal money value to the other party to the financial transaction.

In order to clearly associate this process of equality of opposite direction-oriented giving up and receiving of goods/services, we may consider a new approach which is known as the "Input-Output Concept" of equality of each financial transaction's two constituents of giving and receiving. According to this concept, the giving up and receiving of what constitutes the two components must belong to any one of the following categories:

i) Goods of all kinds ranging form nails to ships;

ii) Services of all kinds ranging from those rendered by sweepers to what are rendered by the world's topmost scientist.

iii) Facilities of all kinds which are akin to services but differ from the later in the sense that they do not include the exertion of an individual's physical or intellectual energy. Examples of facilities are – letting out of land, building, plant and machinery, equipment, etc.

iv) Money itself, for example, a banker' main business is lending out and getting back the let out money.

v) A promise to pay some definite person a definite amount on or by definite date. Such promise may be oral or by conduct or in black and white. To illustrate let us take the case of sale of goods on credit. From the seller's point of view, he/she parts with goods of agreed monetary value. But, what does he/she concurrently get in exchange therefore so as to establish the universal applicability of the double- entry principle of bookkeeping? He/she immediately gets a promise from the buyer
to pay him/her in future.

Hence strictly and academically speaking, the seller would pass the following entry :–

Promise to Receive money from :

Mr./Mrs……..A/c (Receipt of something)………..Dr.

To Sale of Goods A/c.

(giving up of something)

The language of bookkeeping has an inherent tendency to get as much symbolic as possible. As a result, in actual practice, instead of receiving a promise to get money in future from Mr./Ms. "so and so". Mere Mr./Ms. so and so's A/c is considered sufficient for getting a debit entry likewise, suffice it to write merely Sales A/c instead of Sale of Goods A/c. According to the same logic, when eventually the debtor pays up, the seller receives cash and gives up the promise received earlier. Hence Cash/Bank A/c. is debited while Mr./Ms. So and so, A/c is credited. The same logic will also hold good from the point of view of the buyer on credit. First, he receives goods which is indicated by Purchase A/c.(in fact Purchase of Goods A/c) and gives up a" Promise to pay to Mr./Mrs. So and So", for which merely Mr./Mrs. So and So's A/c. is credited. When he/she meets his/her past commitment, what comes in is the promise to pay given earlier and what goes out is Cash/Bank A/c. It may be observed that, in every case what goes out or comes in belongs to one of the five above referred to categories of things.

To sum up every transaction recorded in the accounts effects at least two items. There cannot be a transaction, which will result in only a single change in the accounts.

Note : The P/L A/c is something not directly connected with the fundamental accounting equation. It is a convenient and informative means by which accumulated periodic expenses are matched against periodic incomes to estimate the outcome of carrying out normal business activities during the said period, to find out if as a result thereof capital has undergone an increase or a decrease.

6. Realisation Concept

The realisation concept indicates the amount of revenue that should be considered from a given transaction. Realization refers to inflows of cash or claims to cash. It states that the amount recognized as revenue is the amount that is reasonably certain to be realised. Sometimes there is scope for difference of judgement as to how to ascertain" reasonably certain". A situation arises when a company makes a credit sale and expects that the customer will pay their bill. Experience shows that not all customers pay their bill. In measuring the revenue for a period, the amount of credit sales that will not be realised should be reduced by the estimated amount of credit sales that will never be realised i.e. by estimated amount of bad debts. Example: If a company makes a credit sale of Rs 100,000 during a period and experience indicates that 2% of credit sales will become bad debt, the amount of revenue for the period is Rs 98,000 and not Rs 100,000. It does not anticipate events and stops the business from inflating their profits by recording sales and incomes likely to accrue. Unless money has been realised as cash or legal obligation to pay on sale, profit or income is considered. e.g. M places an order with N for supply of certain goods yet to be manufactured.

On receipt of order N purchases raw materials, employs workers, produces goods and delivers to M. M makes payment on receipt of goods. In this case the sales is not at the time of receipt of order but at the time when goods are delivered to M.

The modern concept of Revenue Income is that it is the product of an enterprise or services rendered by it which has been measured by an exchange value or cash equivalent. This definition does not solve the problem of deciding the point/s in time when we should measure record and report the revenue. According to Economics, value added is a continuous process. In very simple terms Value added = Sale value of a product – the cost of raw materials and other goods (components) bought from outsiders (suppliers). This involves acquisition and assembling raw materials and changing them from or processed by the application of labour and fixed assets. Revenue reporting entails not only the acknowledgement that an entity has produced economic value in the form of goods or services, but also the measurement of that value. The product or services can be measured best by the money or money equivalent expected to be received for the products/services at some time in the future. It is the uncertainty of this expected receipt and the search for variable measurements that have led accountants to the adoption of specific rules for the timing of revenue. Sprouse and Moonitz stated that revenue should be identified with the period during which the major economic activities necessary to the creation and disposition of goods and services have been accomplished, provided objective measurements of the results of those activities are available. These two conditions, namely, accomplishment of major economic activity and objectivity of measurement, are fulfilled at different stages of activity in different cases, sometimes as late as time of delivery of product or rendering of services, in other cases at an earlier point of time.

An alternative to the reporting of revenue at the time of accomplishment of the major economic activity is the critical event (or crucial event) concept of revenue reporting. In most cases, the value added by the enterprise (reported as net income, that is, net profit) is jointly associated with the entire process of planning, producing, providing the goods or services for customers and the final collection of cash, and, in some cases, the providing of services (such as repairs under warranties), beyond the collection process. Because of the jointness of this value added over time, it is impossible to make a logical allocation to the several processes. Therefore, an expedient method is to report the value added by the enterprise at a single point in time. The critical event concept suggests that the most appropriate moment of time is when the most critical decision is made or when the most difficult task is performed. This could be at the point when the contract is signed, the time when the services are performed, when cash is collected (as in the hybrid system of accounting, under which professional men like doctors and lawyers keep accounts on "accrual" basis for expenses but incomes like professional fees are recorded on "cash" basis) or at some other time.

The Reporting of Revenue During Production:

The traditional accrual basis of accounting recognises revenue as earned if there is a simultaneous increase in the claim against the customer or client. This is the general practice with services. The product of the enterprise emerges as the services are provided. The amount of the claim is usually determined by prior agreement (contract), or often by established trade practices, even though the client or tenant may not be required to make payment until at later date or at least until a determinable amount of service has been provided. Examples are: rent, interest, commission, personal services rendered on a time basis. In each of these cases the basic criteria for revenue reporting are met. The services are usually performed on a time basis and the performing of services may be crucial. The amount of the revenue has been established by prior contract/agreement. In addition a valid claim arises against the customer, client or tenant even though the amount is not billed and payment
is not required until a later date.

Long-term contracts:

The generally accepted practice in this case is based on pragmatic grounds and supported by theory. An individual or a firm would usually object to publication of financial statements showing no income for a year during which the organisation had spent considerable efforts in obtaining partial completion of a contract (as in contractual jobs) that would have permitted a reasonable profit with a fair degree of certainty. If contracts are completed at irregular intervals, the reporting of profit only when the contracts are completed could result in hardship or injustice to the shareholders who wish to see their interests before the completion
of major contracts because of lack of information. The annual P/L might have less meaning also from either a managerial or a financial point of view. The most important consideration is that the total price of the contract is determined in advance or is determinable. Uncertainty regarding the selling price is minimised and uncertainty regarding collection is usually not very great, if any Government is the contractee and other renowned private sector companies. Two areas of uncertainty remain, however: (1) At any particular point, it may be difficult to determine the sale price of the product produced to date, (2) The total costs of the project may be difficult to estimate with accuracy. If the total costs of completion differ from the estimated costs, the net profit of each period will have been affected. Uncertainty, however, should not be cause for the failure to report revenue when the value increase can be measured. Reasonable estimates based on contract prices and expert judgement regarding costs may provide better information regarding the progress of the firm than on insisting on the narrow realisation concept. The actual treatment can be found in any textbook on Cost Accountancy. For example, if the progress of the contracted job is neither 100 per cent nor nearing completion, accountants usually taken into the P/L A/c of the concerned year, the following amount :

$$\text{Book profit} \times 2/3 \times \text{Cash received} / \text{Value of work certified}$$

The above amount is conservative and at the time report progress to external users, without bookishly following the age-old criteria for the realisation concept, though two uncertainties still persist.

The discussion of the topic would be incomplete without a reference to Accounting Standard – 9 (AS–9) issued by the Chartered Accountants of India (ICAI), which is titled:

Revenue Recognition: The following is an extract from AS–9 :

"11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled :

(i) the seller of the goods has transferred to buyer the property in the goods for a price or all significant risks and reward of ownership have been transferred to the buyer and the seller retains no effective control of goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

12. In a transaction involving the rendering of services, performance should be measure either under the transaction involving the rendering of services, performance should be measured either under the complete service contract method or the proportionate completion method, whichever related the revenue to the work accomplished.

Such performance should be regarded as having been achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

13. Revenue arising from the use by other of enterprise resources yielding interest, royalties and dividend, should only be recognised on the following basis :

i) Interest : On a time proportional basis taking into account the amount outstanding and the rate applicable.

ii) Royalties: On an accrual basis in accordance with the term of the relevant agreement.

iii) Dividends from Investment in share: When the owner's right to receive payment is established.

Disclosure:

In addition to the disclosures required by AS–1 on Disclosure of Accounting Policies, an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.".

7. Accrual Concept

Profit arises only out of business operation when there is an increase in the owner's share of the business and not due to his contribution to the business. Any increase in owner's equity is called revenue and any reduction in it termed as a loan. In fact, it is the direct outcome of Realisation Concept (already discussed) and the Accounting Period concept (to be discussed). In a way, realisation concept has been split up into two parts, namely, production of economic goods or rendering of economic services, and realisation of due revenue. Any uncertainty about any of the two elements beyond what is considered uncontrollable will not permit the accountant to treat the money value or cash equivalent of the sale price to be considered as realised income. Another very vital element is involved in between, that is, a third one, namely acquiring legal right to claim the price of the goods delivered or fees for services rendered. Acquiring the legal right to claim the consideration for goods/services is called accrual of revenue, which usually precedes collection. However, in case of cash transactions, under the accrual method P/L A/c and Balance Sheet are prepared on the accrual basis, in the absence of any uncertainty about collection. This does not mean that collection has been given less importance than economic value adding and the right to claim the purchase consideration. With uncertainty about collection, it is meaningless and dangerous to take income into account as having been realised. In fact, ability to pay, is considered by the supplier of goods and services before one decides to sell his products or render his services to another. Then after the deal is finalised, goods have been delivered or services rendered and legal right to claim the purchase consideration has been acquired, collection is taken up as a specialised process to ensure return of capital and earning of profit. The other pressure comes from the Accounting Period convention. Production is a continuous process. True profit is cash profit during the entire lifetime of an enterprise. Then and then only we know total money collected and spent by it during its lifetime. But the way our culture has bound us up with annual profit, annual income and other periodic results, we have divided the entire life-span of our organisation into several chapters, each chapter being an accounting period or an accounting year. A year consists of 12 months. This is very significant, because each period being equal in terms of time frame, it facilitates comparison of performances. Because of this Cost Accountants divide a year in 13 months, each period consisting of 4 weeks. The process of dividing the life span of a company into time – chapters which is an artificial man-made process, though production follows a continuous flow, gives rise to certain accounting problems. For example, at the time of closing of period/annual accounts, production and sale might have been completed, local right to claim the sales value have been acquired, but payment has not yet come through.

Yet, the sale will be included in the year of sale, though collection of dues has not yet taken place. However there is no material uncertainty about collection. Ascertaining revenue for a specific period automatically invites the question of matching cost against such revenue to estimate periodic profit. But modern experts have brought out certain inconsistencies and arbitrariness in such matching process. The most glaring example is charging depreciation to revenue. Despite a number of alternative treatments none is fully satisfactory logically. The only way to rationalise depreciation is a generally accepted principle of allocating costs of fixed assets for ultimate recovery through sales. Despite some shortcomings, accrual concept has become one of the fundamental assumptions of accounting mainly as a measure of periodic performance, which facilitates comparisons. According to the ICAI, this assumption is so basic that it need not be disclosed in the accounting policy of the enterprise, unless there has been deliberate departure. For example, logically speaking provision for gratuity should be made on accrual basis. But that would require actuarial valuation, which every organisation may not be able to afford. As a result, in India at least charging gratuity
on cash basis has been an accepted accounting practice. Similarly, we have already referred

to the hybrid system of accounting followed by some professional persons who prepare P/L A/c with expenses on accrual basis but revenue only on Cash basis due to social and professional reasons. The system that is based on accrual concept is called the mercantile system. Section 209(3)(b) of the Companies Act, 1956 requires that books of account shall not be deemed to be kept if they are not kept on accrual basis and according to the double entry book-keeping in respect of a company. Thus the financial statements except cash flow statement are to be prepared on accrual basis.

8. Accounting Period Concept

The accounting reports measure activities for a specified interval of time called the accounting period, which is usually one year and therefore termed as annual reports. Interim reports in between may be compiled especially for internal users. Except for those ventures which are predetermined to end on the completion of a specific task or a specific time-frame, every enterprise, profit-oriented or not, desires to enjoy perpetual existence as a going (running concern), making profits, grow and distribute profits judiciously. This calls for recognition and measurement of incomes and expenses and to match them to ascertain profit. But, the concept of profit is time-related. Hence, the question: profit for what length of time? Theoretically, the most correct reply would be the entire life – time of an enterprise. That means no measurement of income until an enterprise is wound up. But human beings inherently, desire to know, periodic performances mainly for the purpose of comparison, which would not be possible, different firms wind up after different lengths of time. Moreover, from the practical point of view, some firms may not close down during a number of successive generations. Hence no income tax for ages, too. Let us not extend the list of such fanciful but important (academically) possibilities. Thus, out of practical considerations, businessmen, sided by accountants, divide the life span of an entity into a number of chapters of equal duration, usually a twelve-month period. Thus one phase of activities of an enterprise is deemed to have passed – one chapter is closed. Such a 12-month chapter is called accounting period. And financial accountants prepare a P/L A/c. for that period to estimate its operating result, that is, profit or loss and the financial position as at the end of the period in terms of assets, liabilities (external) and owners' equity (internal liability).

This gives rise to a number of problems. Some of the major problems are discussed below:

a) *Cash Basis or Accrual Basis* – This question has already been discussed and we are convinced about the superiority of the accrual basis over cash basis, barring a few exceptions, like the preparation of hybrid accounts (already discussed) – by some professional persons.

b) *Matching cost against Revenue* – Sometimes it gives rise to allocation-related problems. For example, if substantial (but not unusually high) expenditure has been spent on advertisement in the last week of the accounting year, should not some part at least be carried over to the next year where it will get the benefit of the expenditure? Will it be correct to treat the whole of the expenditure as revenue expense (expired cost) for the year of payment and matched against the revenue for the year?

c) *Capital-Revenue Conflict* – We define a Fixed (Capital) Asset as one which is acquired/ not for immediate resale and it would give us benefits beyond the year of expenditure, that is, for over 12 months? We are so intimately concerned with a 12 month period, almost constantly, that an asset having an expected life-span of five years, is almost intuitively, treated as a fixed asset. But if we prepare a five–year P/L A/c., then the entire cost of the asset would be treated as the cost of one accounting period, though of 5 – year duration.

d) *Road Blocks to Company* – Besides estimating fairly and properly periodic profit/loss and period-end financial condition, another important use of annual closing of accounts is to facilitate comparison within the firm and outside the firm. Fixed Accounting Periods ensure comparability of equal time frames, but the accounting policies may differ from year to year and/or from firm to firm. This reduces the usefulness of periodic performance results. Hence uniformly of time-span of each business chapter should be supported by uniformity of accounting policies. If not so done prime facie, necessary adjustments should be made to facilitate comparability. Despite the above constraints, dedicated, experienced and enterprising accountants have succeeded in producing meaningful and useful financial information, without any respite, since a large number of accountants are engaged in a constant research work to improve upon existing concepts/practices, developing new ones to meet new challenges and to give more useful information. Accounting period assessment of income, expense, asset and liabilities can be compared with education, which is a continuous Process. To assess it we should consider the entire life span of an individual. But we artificially divide it into several man-made phases like: school leaving examination, undergraduate and post graduate examinations and doctoral assessment, etc.

Conventions:

The term "accounting conventions" refer to the customs or traditions, which are used as a guide in the preparation of meaningful financial records in the form of the income statement (profit and Loss Account) and the position statement (Balance Sheet).

These are as follows.

1. Conservatism

Financial statements are drawn on a conservatism basis where better evidence is required of losses. This is necessary as Management and ownership are in different hands and a cut is needed on management to show over-optimistic, favourable performance results. For example, inventories are valued at the cost or market price whichever is lower. Revenues are recognised when they are certain but expenses as soon as they are reasonably possible e.g. it encourages the accountant to create provisions for bad and doubtful debts.

Since inception, it has come to mean the following:

a) delay recognition of income;

b) Expedite recognition of income;

Note : This obviously affects the reliability of the process of matching cost against revenue.

c) if in doubt, understate assets and income;

d) If in doubt, overstate liabilities and expenses

Note : (c) and (d) above violate the postulates of consistency and therefore comparability.

It may result in creation of Secret Reserves if overdone, which vitiates reliabilities of financial statement as the opposite operation, namely, window-dressing. To day's accountants condemn both the practices. The driving-force behind conservatism is: it is better to be wrong on the minus side than on the plus side of financial statements. This is pessimism and not sceptics. An accountant should be sceptic and not a pessimist; the former can be convinced by sound logic while the latter can be made to change her/his mindset. Moreover, there is no standard by which the degree of conservatism may be standardised. Hence, it becomes highly subjective and may even go to the length of seriously affecting the doctrine of disclosure.

At best, conservatism was and still is a very crude way to take financial guard against a world of uncertainty in which a business operates. But today's accountant is quite well comparatively to assess risks. In fact, he is, in many cases, more competent than the user of financial statements. But subjectively cannot be fully avoided in assessing risks. Basically, in the present context, there are two kinds of risks, namely, (i) not happening what has been reported (statistically, the: "alpha risk") and (ii) happening of what has not been reported (statistically, the "beta risk"). Decades ago, accountant felt that for rejection of what might be true is more than what is untrue for favourable items. And vice versa for unfavourable items. Today accountants have realised that a true accountant should not indulge in such a practice what she/he should actually do is: to strike a realistic balance between the two kinds of risk – and provide information for a proper evaluation of the risk whenever possible; to be done by the user and not by herself/himself, even though he may be better equipped to do normally.

According to some experts, the only occasion which conservatism may be justified is when the accountant has to report on some thing which itself is highly subjective, enigmatic and elusive, like goodwill. Then the opposing camp would immediately question. Why bother to bring into accounting such capricious items?

2. Consistency :

This concept states that once the organisation has decided on a method, it should use the same method subsequently unless there is a valid reason for a change of method. If frequent changes are made it is not possible to carry out comparisons on an inter- period or inter - firm basis. If a change is necessary it has to be highlighted. e.g. if depreciation is charged on diminishing balance method, it should be done year after year.

It is an accounting postulate since it develops the growth of the subject of accountancy with only a few constraints. By this standard, it is difficult to call conservatism an accounting postulate since it acts as constraints in many cases, as we have seen above. The basic prerequisite of the postulate of consistency is that the same accounting procedure, treatments, approaches, techniques, tools, concepts and principles should be applied from year to year within the firm; and also to the extent it is possible to ensure the same in all other organisations. But there are difficulties in having uniform principles and concepts and tools and procedures to be used by all the firm within a country, if not globally, mainly because of the following reasons:

a) local custom, economic, social and political environments may differ from place to place.

b) The different nature of business of different kinds and size.

c) Presence of valid alternatives, accepted by law and standard – setting bodies consistency serves two purposes, one directly and the other indirectly. Directly, it facilitates comparison, which is a vital tool for complex decision-making. Indirectly, when used over a considerable length of time it reduces risks surrounding operating enterprises.

Only in the following cases, change in existing practice should be permitted:

(a) when law or standards set by competent bodies require a change to be introduced, or

(b) when the change is to ensure better accounting system.

The importance of maintaining consistency is so acute today that the ICAI has treated this as a fundamental accounting assumption; its compliance need not be disclosed. Only deviation from it has to be fully disclosed. After many deliberations, standard-setting bodies, local, regional and international have failed to prescribe compliance with the same concepts and procedures and have been compelled to prescribe alternatives. Hence, this is not standardisation, critically speaking, it is harmonising, that is, reducing the areas of applicability and the number of alternatives.

3. Matching :

When an event affects both revenues and expenses, the effect on each period should be recognised in the same accounting period. This leads to matching concepts. The matching concepts is applied by first determining the items that constitute revenues for the period and their amounts in accordance with the conservatism concepts and than matching costs to these revenues. Thus both the aspects of an event are recorded in terms of revenue and expense in the same accounting period.

Theoretically it is an elegant postulate. But, in the practical field, it has number of limitations. The following are the main reasons why this convention fails in so many situations:

a) The persisting fetish of adherence to the doctrine of conservatism and its frequent over application.

b) Dispute and difficulty in arriving at a consensus as regards timing for recognising expense and revenue,

c) Dispute and differences as to the clear-cut distinction between capital and revenue,

d) Extreme crudity and law of minimum of logic in allocating a number of costs over a number of years.

e) Changes in Accounting Policies with prospective and retrospective effects,

f) Delay in recognising incomes but hurry in recognising expense.

g) Matching presupposes an association between expenses and revenues. `It necessarily does not follow that all expenses result in revenues. But, it is true that no revenue can be generated without incurring expenses. These basic factors have made it very difficult to find some logical association between expenses and revenues. Any failure to detect such association is bound to introduce arbitrariness in the matching process, because the businessman has to recover money invested by him from sale proceeds. However, this has been mitigated to some extent by classifying costs between product costs and period costs. Direct costs are reported as soon as goods and services are consumed. But they are matched against revenue only when sales take place either in the year of production or afterwards. This match gives rise to conceptual problems. On the other hand, period costs are charged to revenue of the year in which they have been incurred. The logic here is also no sound enough.

h) Taking revenue for the year does usually matching and then expenses incurred for earning such revenues are identified and matched with it. The alternative procedure of identifying expenses for the period and then matching them with the revenue they have produced, has hardly been tried. We come across it in Contract Cost Accounting where the amount of realised profit is estimated on the basis of degree of work done (cost incurred) and certified by the contractee.

This is also not a very sound principle, according to some experts.

4. Disclosure

Apart from legal requirements all significant information should be disclosed. The matching concept states that all significant information should be disclosed and all insignificant information should be disregarded. However, there are no definite rules to separate the two. For recording purposes also only significant events are recorded in detail taking into consideration the cost of detailed record keeping.

The society directly through legislation and indirectly through regulatory bodies cast a duty on the accounting profession to ensure that all financial statements and related books of account and documents are scrupulously correct and that it must ensure that proper disclosure has been made of all material facts. Hence, disclosure leads us to the following basic questions:

a) how to ensure proper adequate disclosure?

b) what is a material fact?

If we study the provisions of the Companies Act,1956 relating to the preparation of financial statements (Part I, II and III of schedule VI of the Act, specially) along with MAOCARO, 1988, we will realise that the emphasis is one or more disclosure of material facts. Disclosure, therefore, has the following constituents:

a) Break-up details where totals have been reported *prima facie*.

b) Description of each item should be conventional, unless otherwise explained. For example, depreciation should be described as depreciation and not by any unfamiliar description.

c) Disclosure, explanations and remarks should be unambiguous. For example, bad debts should be described as bad debts and not in any clever way to reduce the impact of the expression: Bad Debts

d) The basis of computation. For example, the basis on which different categories of closing stocks has been valued.

e) Disclosure of Accounting Policy. An Accounting Policy of an organisation deals with the alternative accounting practices and concepts and principles which the particular organisation has selected from among prescribed alternatives. Hence, any change in the Accounting Policy and its impact on the accounts should be properly disclosed. For example, if a company changes its depreciation policy from the SLM to the Reducing Balance Method. The ICAI has attached great importance to it. Hence, ASI deals with Accounting Policy and its disclosure.

f) Some unusual and prior period items should be shown clearly and separately so that current year's operation result is not impaired.

Material Fact : A fact is material in the context of accounting if a person had known the actual fact and not what has been disclosed would have most probably made a different decision. For example, due to several factors, like estimating, every financial statement set is bound to have some degree to Secret Reserve, and Window Dressing. But, when the amount involved exceeds a certain limit, the situation becomes grave, and then the auditor is expected to report upon such secret reserves and window–dressings. Materiality, however, is a relative term. Some are material by nature, others by relative importance.

5. Materiality :

The accountant should attach importance to material details and ignore insignificant details. The question what constitutes a material detail is left to the discretion of the accountant. An item is material if there is reason to believe that knowledge of it would influence the decision of the informed investor. This has already been referred to above in connection with Disclosure. In addition to what has already been discussed, the reader is to note the following points:

a) Materiality of information
b) Materiality of amount
c) Materiality of procedure
d) Materiality of nature

Materiality of Information : Misdescription of assets, liabilities, receipts and expenditures. Likewise, wrong classification between Capital and Revenue would also come under this category.

Materiality of Amount : This is a highly relative term. A fraud or an error of Rs. 5,000 may be material in a small organisation while not so in a large organisation. Which is why, the Companies Act 1956 and MAOCARO, 1988 have indicated at different places as to the degree (relatively) of tolerance. For example, an item of expense should be shown separately if it constitutes a certain percentage of the total expenses for the period.

Materiality of Procedure : Every accountant knows that some procedures are superior to others for certain purposes. For example, the various methods of depreciation, treating liability for gratuity on Cash Basis and on Actuarial Basis, etc.

Materiality of Nature : Some items are material by nature regardless of the amount involved and any other factor. A small error in such items will be considered as material always. For example, Director's Fees, Audit Fees, amount due from directors etc.

5.2 ACCOUNTING STANDARDS – INTERNATIONAL, US GAAP AND NATIONAL

INTERNATIONAL ACCOUNTING STANDARDS

The International Accounting Standard Committee (IASC) came into existence on June 29 1973 when sixteen accounting bodies from nine nations (designated as founder members) signed the agreement and constitution for its formation with headquarters at London.

The objective of the committee is "to formulate and publish in the public interest standards to be observed in the presentation of audited financial statements and to promote their worldwide acceptance and observance". This would facilitate flow and communication of financial information and in turn investment. The committee has so far laid down standards regarding the following areas:

IAS NO.	Title
IAS 1	Presentation of Financial Statements (Revised 1997)
IAS 2	Inventories (Revised 1993)
IAS 4	Depreciation Accounting (Reformatted)
IAS 5	Information to be disclosed in financial statements
IAS 7	Cash Flow Statement (Revised 1992)
IAS 8	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies (Revised 1993)
IAS 9	Research & Development Cost
IAS 10	Events after the Balance Sheet Date (Revised 1999)
IAS 11	Construction Contracts (Revised 1993)
IAS 12	Income Taxes (Revised 1996)
IAS 13	Presentation of Current Assets and Liabilities
IAS 14	Segment Reporting (Revised 1997)
IAS 15	Information reflecting the effects of changes in prices
IAS 16	Property, Plant & Equipment (Revised 1998)
IAS 17	Leases (Revised 1997)
IAS 18	Revenue (Revised 1993)
IAS 19	Employee Benefits (Revised 1998)
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance (Reformatted 1994)
IAS 21	The Effects of Changes in Foreign Exchange Rates (Revised 1993)
IAS 22	Business Combinations (Revised 1998)
IAS 23	Borrowing Costs (Revised 1993)
IAS 24	Related Party Disclosures (Reformatted 1994)
IAS 25	Accounting for Investments
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated Financial Statements and Accounting for Investments in Subsidiaries (Reformatted 1994)
IAS 28	Accounting for Investments in Associates (Revised 1998)
IAS 29	Financial Reporting in Hyperinflationary Economics (Reformatted 1994)
IAS 31	Financial reporting of Interests in Joint Ventures (Revised 1998)
IAS 32	Financial Instruments: Disclosure and Presentation (Revised 1998)
IAS 33	Earning per share (1997)
IAS 34	Interim Financial Reporting (1998)
IAS 35	Discontinuing Operations (1998)
IAS 36	Impairment of Assets (1998)
IAS 37	Provisions, Contingent Liabilities and Contingent Assets (1998)
IAS 38	Intangible Assets (1998)
IAS 39	Financial Instruments; Recognition and Measurement (1998)
IAS 40	Investment property
IAS 41	Agriculture

The International Accounting Standards Committee (IASC) announced in January 1975, the following standards regarding disclosure of fundamental accounting assumptions and policies. Fundamental Accounting Assumptions refer to those accounting standards whose acceptance and use are assumed in the preparation of financial statements.

The fundamental accounting assumptions enumerated by the International Accounting Standards Committee are as follows :

Going concern,
Consistency,
Accrual.

If any of the above accounting assumption is not followed it should be disclosed with reasons. The assumptions already explained are applicable.

International accounting standards are being used as national standards in some developing countries. These standards are also forming the basis of research for national standards.

IASC is permitting alternatives in many areas of reporting practice, but the Board of the IASC believes that the time is ripe to reduce the alternatives. As a step in this direction, the Board set up a Special Steering Committee in March 1987 to find ways of reducing or eliminating alternatives. If all the countries follow the policy as being followed in UK, and some other countries that departures from the international standards be disclosed in the financial statement, international accounting standards will be harmonised throughout the world and the real purpose of developing IAS will be achieved.

The IAASC Board has set up a Standing Interpretation Committee (SIC) to consider on a timely basis accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance. The SIC reviews accounting issues within the context of existing International Accounting Standards and IASC framework. SIC have issued 17 interpretations on various issues such a consistency on different cost formulas for inventories, Introduction to Euro, Primary basis of accounting, alternative methods, etc.

Problem Area: However, there is a problem area. International accounting standards do not have any statutory authority so they do not acquire a compulsiveness associated with legislation. They do not impose any legal obligations on companies preparing financial statements for presentation to the shareholders.

Important IAS are discussed in the Appendix.

US GAAP

During the past 50 years the contribution of the United States to accounting theory has been tremendous. Different committees, associations and institutes have based upon researches conducted, made pronouncements from time to time to develop and improve the principles which are commonly known as Generally Accepted Accounting Principles (GAAP) in the United States. These include broad concepts, guidelines, conventions, rules and procedure at any given time. An underlying structure of concepts, techniques and conventions provides a basis for accounting practice. Three major measurement conventions are realisation, matching and stable monetary unit. The accrual basis is the heart of accounting whereby revenues are recognized as earned and expenses as incurred rather than as related cash is received or disbursed.

Every business enterprise in USA prepares its financial statements in accordance with the GAAP. The GAAP are guidelines for specific accounting issues, which are to be followed for the preparation of financial statements. These financial statements are audited by the auditors who certify that the financial statements have been prepared in accordance with GAAP.

US GAAP are more prescriptive and detailed than accounting standards in other countries. The volume and complexity of different standards under GAAP is very large as indicated below:

Statements of the Financial Accounting Standard Board (FASB) – 138 Nos.

FASB Interpretations – 44 Nos.

FASB Statement of Financial Accounting concepts – 7 Nos.

FASB Technical Bulletins – about 100 Nos.

Opinions of the Accounting Principle Board

Research Bulletins of the American Institute of Certified Public Accountants (AICPA) – 51 Nos.

AICPA Industry Audit and Accounting Guidelines.

AICPA Statement of position

AICPA Accounting Interpretations – 30 Nos.

Financial Statements as per US GAAP comprised of income statement, balance sheet, earning per share statement, and statement of shareholders' equity and cash flow statement. These statements are prepared on consolidated basis for a parent company. Comparative information is provided in the balance sheet for preceding two financial periods and in the income statement, cash flow statement and statement of shareholders' equity for one preceding financial period.

The balance sheet prepared showing separate classifications of current assets and current liabilities is commonly referred to as classified balance sheet. An enterprise preparing a classified balance sheet shall segregate current assets and current liabilities separately from other assets and liabilities. The current classification applies to those assets, which will be realized in cash, sold or consumed within one year (or operating cycle, if longer) and those liabilities that will be discharged by use of current assets or the creating of other current liabilities within one year (or operating cycle, if longer).

To sum US GAAP requires presenting fairly the results of operation for the period or period under report. Cost of sales and expenses should be appropriately matched against the periodic sales and revenue.

The students are advised to have recourse to the text and study them.

The Standards at the National Level

The Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India are both members of International Accounting Standards Committee. On 22nd April 1977, the Council of The Institute of Chartered Accountants of India established an Accounting Standards Board (ASB). The main function of this Board is to formulate standards with due consideration of the prevalent laws, customs, and business environment.

The ASB has already announced the following standards.

AS No.	Title
AS–1	Disclosure of Accounting Policies
AS–2	Valuation of Inventories, (Revised –Mandatory)
AS–3	Cash Flow Statement
AS– 4	Contingencies and Events Occurring After the Balance Date (Revised –Mandatory) AS–
5	Net Profit or Loss for the Period, Prior Period and extraordinary Items and Changes in Accounting Policies (Revised –Mandatory)
AS–6	Depreciation Accounting (Revised)
AS–7	Accounting for Construction Contracts
AS–8	Accounting for Research and Development
AS–9	Revenue Recognition
AS–10	Accounting for Fixed Assets
AS–11	Accounting for the Effects of Changes in Foreign Exchange Rates
AS–12	Accounting for Government Grants (Mandatory)
AS–13	Accounting for Investments
AS–14	Accounting for Amalgamations (Mandatory)
AS–15	Accounting for Retirement Benefits in the Financial Statements of Employers
AS–16	Borrowing Costs (Mandatory)
AS–17	Segmental Reporting
AS–18	Related Party Disclosures
AS–19	Leases
AS–20	Earnings Per Share (Mandatory)
AS–21	Consolidated Financial Statements
AS–22	Accounting for Taxes on Income
AS 23	Accounting for Investments in Associates in consolidated Financial Statements.

The accounting standards which have been made mandatory are indicated above in the table.

Compliance with Accounting Standards:

A new sub–section 3A to Section 211 of the Companies Act. 1956 was inserted in 1999. This sub-section requires that every profit and loss account and Balance sheet shall comply with accounting standards. Accounting Standards mean the standards issued by the Institute of Chartered Accountants of India (ICAI) and prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards (NACAS) constituted under Section 210(a)(1) of the Companies Act, 1956. Until the Central Government prescribes accounting standards under this section, accounting standards issued by the ICAI shall be deemed to be the accounting standards.

NACAS shall consist of the following 12 members:

- A chairman, who shall be a person of eminence well versed in accountancy, finance, business administration, business law, economics or similar discipline;
- One member each nominated by the Institute of Chartered Accountants of India, Institute of Cost & Works Accountants of India and Institute of Company Secretaries of India;
- One representative of the Central Government to be nominated by it;
- One representative of the Reserve Bank of India to be nominated by it;
- One representative of the Comptroller and Auditor General of India to be nominated by him;
- A person whole holds, or has held the office e of Professor in accountancy, finance or business management in any University or deemed university;
- The chairman of the Central Board of Direct Taxes, constituted under Central Board of Revenue Act, 1963 or his nominee;
- Two members to represent the chambers of commerce and industry to be nominated by the Central Government;
- One representative of the Securities Exchange Board to be nominated by it.

Deviation from accounting standards :

Section 211(3B) of the Companies Act, 1956 requires that in case the profit and loss account and balance sheet of company do not comply the requirements of the accounting standards, disclosure should be made stating: –

a) Deviation from the accounting standards;

b) Reasons for such deviations; and

c) The financial effect, if any, due to such deviations.

It is beyond the scope the Study Notes to include the texts of all such above standards. The students are advised to have recourse to the texts and study them (both International Accounting Standards and National Accounting standards). Some of the standards are discussed in brief as under :–

AS 1 : Disclosure of Accounting Policies

The prominent feature of Accounting Standard AS 1 announced by the ASB, regarding disclosure is as follows:

(1) Fundamental *Accounting Assumptions :*

Certain fundamental accounting assumptions undertake the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed.

Fundamental accounting assumptions are:

going concern
consistency
accrual.

If any assumption is not followed the fact should be disclosed.

(2) *Accounting Policies :*

Accounting policies refer to the specific accounting principles and the methods of applying those principles by enterprises in the compilation and presentation of financial statements. There is not exhaustive list of policies applicable under all circumstances. The varying circumstances under which enterprises operate necessitate the choice of appropriate principles and require considerable expertise of management.

The following are the areas in which a choice with regard to policy is made by the enterprise:

Method of depreciation, depletion and amortisation
Treatment of expenditure, during the construction
Conversion or translation of foreign currency items,
Valuation of inventories
Treatment of goodwill
Valuation of investments
Treatment of retirement benefits
Recognition of profit on long-term contracts
Valuation of fixed assets
Treatment of contingent liabilities.
This list is not exhaustive.

The objective of the accounting policies is to present a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended on that date.

The major considerations while selecting accounting policies are: –

Prudence
substance over form, and
materiality.

To ensure proper understanding of financial statements, all significant accounting policies adopted in the preparation should be disclosed.

The disclosure of the significant accounting policies as such should form a part of the financial statements and the significant accounting policies should normally be disclosed at one place.

Any change in the accounting policy which has material effect in the current period or which will have a reasonable effect in future should be disclosed. In case a change in the current period policy is there the measurable impact should be disclosed on the item concerned. Where the impact is not quantifiable wholly or partially, the fact should be indicated.

The effort of the ASB will therefore definitely improve the financial information presented in the country.

AS 2 : Valuation of Inventories

AS 2 HAS BEEN REVISED AND IS MANDATORY IN NATURE. This is effective for the period commencing on or after 1.4.99. As per AS2 inventories should be valued at the lower of cost and net realisable value. The cost of inventories should comprise of all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The allocation of fixed production overhead in the cost of conversion is to be based on the normal capacity. The following costs are to be excluded from the cost of inventories and recognized as expense in the period of incurrence: -

a) Abnormal amounts of waste material, labour or other production costs;

b) storage costs unless those costs are necessary in the production process prior to a further production stage;

  a) Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

  b) Selling and distribution costs.

The cost of inventories should be determined by using FIFO or weighted average formulae. The accounting policy adopted in measuring inventories, cost formula used and total carrying amount of inventories and its classification appropriate to the enterprise shall be disclosed.

AS 3 : Cash Flow Statements

This standard provides that an enterprise should present Cash Flow Statement for each period for which financial statements are presented. The cash flow statement should report cash flows during the period classified by operating, investing and financing activities on a net basis. It should also disclose the components of cash and cash equivalents and should present a reconciliation of amounts in its cash flow statements with equivalent items reported in the balance sheet.

AS 4 : Contingencies and Events occurring after the Balance Sheet date (Revised)

This revised standard comes into effect for the accounting period commencing on or after 1.4.1995 and is mandatory in nature. The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if future events will confirm that after taking into accountancy related probable recovery, as asset has been impaired or a liability has been incurred as at the balance sheet date; and a reasonable estimate of amount of loss can be made. The existence of a contingent loss should be disclosed in the financial statements. Contingent gains should not be recognized in the financial statements.

The following information should be provided in the financial statements:

a) the nature of the contingency cover;

b) the uncertainties which may affect the future outcome; and

c) an estimate of the financial effect or a statement that such an estimate cannot be made.

AS 5 : Net Profit or Loss for the period, prior periods and extraordinary items and changes in accounting policies (Revised)

This Standard has been revised and is mandatory in nature. This standard deals with classification and disclosure of extraordinary and prior period items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and disclosures to be made in the financial statements regarding changes in accounting policies.

AS 6 : Depreciation Accounting (Revised)

This standard requires that the depreciable amount of a depreciable asset should be allocated on a systematic basis to accounting period during the useful life of the asset. The following information regarding depreciation should be disclosed in the financial statements:

a) the historical cost of each depreciable assets;

b) total depreciation for the period for each class of assets;

c) the related accumulated depreciation;

d) depreciation rates or the useful lives of the assets; and

e) effect of change in depreciation policy.

AS 7 : Accounting For Construction Contracts

This statement deals with accounting for construction contracts in the financial statement of the enterprise. Various aspects of AS 7 have been discussed in Study Note 4.

According to the standard, financial statement should disclose :–

(a) the amount of construction work-in-progress;

(b) progress payments received and advances and retentions on account of contracts included in construction work-in-progress; and

(c) the amount receivable in respect of income accrued under cost-plus contracts not included in construction work-in-progress.

If both the percentage of completion method and the completed contract method are simultaneously used by the contract, the amount of contract work described in (i) above should be analysed to disclose separately the amount attributable to contracts accounted for under each method. If accounting policy in this regard is changed, the effect of the change and its amount is to be disclosed in the financial statement.

AS 8 : Research and Development

This standard deals with accounting treatment of research and development. This standard does not apply to:

a) Research and development activities conducted for other under a contract;

b) Exploration for oil, gas and mineral deposits;

c) Research and development activities at the construction stage.

The cost of research and development includes the following: :

a) Salaries, wages and other related cost of personnel;

b) costs of materials and services consumed;

c) Depreciation of building, equipment and facilities to the extent they are used for research and development;

d) An appropriate amortisation of cost of building equipment, etc, exclusively used for the project;

e) A reasonable allocation of overhead;

f) Other costs such as amortisation of patents and licences and charges paid to outside bodies for research.

Amount of research and development cost should be charged as an expense of the period in which they are incurred except where such costs may be deferred if criteria are satisfied:

1) the product or process is clearly defined and the costs attributable to future periods or process can be separately identified.

2) technical feasibility of the production or process has been demonstrated;

3) intention to provide and market or use the product or process;

4) there is a reasonable indication that current and future development costs to be incurred on the project together with expected production selling and administration cost is likely to be more than covered by related future revenue.

5) adequate resources exist or are reasonably expected to be available to complete project and market the product or process.

The total of research and development costs including the amortised portion of deferred costs charged as expense should be disclosed in the profit and loss account of the period. Deferred research and development expenditure should be separately disclosed in the balance sheet under the head Misc. Expenditure.

AS 9 : Revenue Recognition

This standard deals with bases for recognition of revenue in the profit and loss account for revenue arising in the course or ordinary activities of the enterprise from a) the sale of goods; b) the rendering of services; and c) use by others of enterprise resources yielding interest royalties and dividends. It does not apply to following aspects of revenue recognition involving special consideration:

a) Revenue arising from construction contracts;

b) Revenue arising from hire purchase, lease agreements;

c) Revenue arising from Govt grants and other similar subsidies;

d) Revenue of insurance companies arising from revenue contracts.

This also does not apply to :

(a) Realised and unrealised gains in relation to fixed assets;

(b) realised and unrealised gains in relation to current assets;

(c) realised and unrealised gains due to fluctuations in foreign currency;

(d) realised gains resulting from the discharge of an obligation at less than its carrying amount; and

(e) unrealised gains resulting from the restatement of the carrying amount of an obligation.

Various aspect of accounting revenue has been discussed earlier under principles of account and Accounting Standard on Disclosure Policy.

Appendix to the Standard lists various illustrations of revenue recognition and the same may be studied.

Other Accounting standards are AS 10 for Fixed Assets, As 11 Accounting for the effect of changes in Foreign Exchange rates; AS 12 Accounting for Government grants, etc. numbering up to AS 23. The various aspect of AS 14 and AS 23 relating to amalgamation/ consolidation of financial statement have been discussed under relevant study note.

5.3 QUESTIONS

1. Explain each of the following concepts/conventions:

   Money Measurement Concept

   Business Entity Concept

   Going Concern Concept

   Realisation Concept

   Materiality Concept

2. Distinguish briefly cash basis and accrual basis of accounting. Also discuss the provisions of Companies Act relating to accrual basis of accounting.
3. Discuss the requirement of good design of account.
4. Write a note on Principle of Disclosure.
5. Discuss conventions regarding financial statement and limitations of financial statement.
6. Explain the difference between concepts and conventions.

BANKING, ELECTRICITY, INSURANCE AND CONSEQUENTIAL LOSS

6.1 ACCOUNTING OF BANKING COMPANIES

Definition of Banking:

Section 5(h) of the Banking Companies Act defines banking as "The accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise". Till 1949 there was no special legislation to regulate banking companies but since that year the provisions of Banking Regulation Act and Companies Act, 1956 applies to corporation entities carrying on banking business including the nationalised banks. Section 6 of the Act lays down that in addition to the usual business, the following business may also be carried on by a banking company —

(a) acting as agents for any Government or local authority or any other person or persons,

(b) carrying on and transacting every kind of guarantee and indemnity business, and

(c) undertaking and executing trusts.

Other types of business are prohibited for a banking company. No banking company can directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it or engage in any trade or buy or sell or barter goods for others otherwise than in connection with bills of exchange. Immovable property, except that required for its own use, however acquired, must be disposed of within seven years from the date of acquisition.

Non-banking Assets:

A bank cannot acquire certain assets but it can always lend against the security of such assets. This means that sometimes, in case of failure on the part of the loanee to repay the loans, the bank may have to take possession of such assets. In that case, the assets will be shown in the balance sheet as "non-banking assets". These must be disposed of within seven years. Income from or profit on sale and loss on sale of such assets has to be separately shown in Profit and Loss Account of the bank.

It may be noted that should the bank lend against such assets as are allowed to be held by a bank, say, government security, it can continue to hold them if the loanee fails to meet his obligations. Such assets cannot be treated as non-banking assets.

Management:

The Act has been recently amended by the Banking Regulation (Amendment) Ordinance, 1994 w.e.f.. 31st January, 1994. Provision has been made for the appointment of a whole time or part-time Chairman for a banking company in place of only a whole time Chairman earlier. However, where a chairman is appointed on a part time basis, the management of the whole of the affairs of the banking company shall be entrusted to a Managing Director.

The Reserve Bank of India has the power to order the removal of a director or the chairman.

Minimum Share Capital and Reserve:

Section 11 lays down the following as the minimum limit of paid-up capital & reserves :

(a) Banking companies incorporated outside India :-

If it has places of business in Bombay or Calcutta Rs. 20 lakhs

If the places of business are elsewhere Rs.15 lakhs

Further every year 20% of the profits earned in India must be added to the sums specified above.

The sum must be kept deposited with the Reserved Bank either in cash or in the form of unencumbered securities.

(b) Banking companies incorporated in India :-

(i)	If the places of business are in more than one State and if any places of business are in Bombay or Calcutta.	Rs. 10 lakhs
(ii)	If the places of business are in more than one State but none of the places of business are in Bombay or Calcutta	Rs.5 lakhs
(iii)	If the places of business are only in one State, none of the places of business being in Bombay or Calcutta	Rs. 10 lakhs for the principal place *plus* Rs.10,000 for each additional place of business in the same district and Rs. 25,000 for a place of business outside the district. The total need not exceed Rs. 5 lakhs, or Rs. 50,000 in case there is only one place of business.

(But companies which commence business after the commencement of the Banking (Companies) Amendment Act of 1962, a minimum of rupees five lakhs is required)

(iv)	If the places of business are only in one State and if the place of business are also in Bombay, or Calcutta.	Rs. 5 lakhs *plus*. for each place of business situated outside Bombay), and Calcutta. The total need not exceed Rs.10 lakhs.

Banking companies carrying on business in India must see to it that :–

(a) the subscribed capital is not less than half the authorised capital;

(b) the paid up capital is not less than half the subscribed capital ; and

(c) the capital of the company consists only of ordinary or equity shares and such preference shares as may have been issued before July 1, 1964.

A shareholder cannot exercise more than ten percent of the total voting rights of the company. This was increased from 1% to 10% by Banking Regulation Amendment Ordinance, 1994 w.e.f 31st January, 1994. A chairman, managing director or chief executive of a banking company must declare his full holdings in the capital of the company. Underwriting commission or brokerage or discount on shares issued by a banking company cannot exceed 2.5 % of the paid up value of the shares. A charge on unpaid capital cannot be created. No dividend can be declared unless expenses not represented by tangible assets have been completely written off. The limits as to share capital given above were fixed a long time back. These limits have been found to be quite inadequate. In order to strengthen the capital base of the banks, the Reserve Bank on the recommendations of the Narasimhan Committee introduced in April, 1992 risk weighted asset ratio system. According to the system, paid-up capital and reserves of a bank (after writing off bad debts) should form an adequate percentage of the assets of the bank, their investment, loans and advances. All these items have been assigned weights according to the prescribed risk. Ratio so computed is known as *capital adequacy ratio*. All banks operating in India should have 8% latest by, March, 1996.

Moreover, the Reserve Bank has now finally, decided to allow private banks to be set up after almost 20 years of nationalisation of banks. Such a private bank shall be registered as a public limited company under the Companies Act, 1956 and shall have a minimum paid up capital of Rs. 100 crores.

Floating Charge:

Section 14 A lays down that a banking company shall not create a floating charge on the undertaking or any property of the company or any part thereof except upon a certificate from the Reserve Bank that such a charge is not detrimental to the interests of the depositors of the company. A floating charge created without such a certificate in invalid. A charge on uncalled capital is invalid.

Restrictions on Dividend :

According to Section 15, a banking company cannot pay dividends unless all of its capitalised expenses (including preliminary expenses, share selling commission, brokerage, amount of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

But a banking company need not -

(a) write off depreciation in the value of its investments in approved securities in any case where such depreciation has not actually been capitalised or otherwise accounted for as a loss;

(b) write off depreciation in the value of its investments in shares, debentures, or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor;

(c) write off bad debts in any case where adequate provision for such debts has been made to the satisfaction of the auditors of the banking company.

Statutory Reserve:

Section 17 of the Act lays down that at least 20% of the profits prior to declaration of dividend must be transferred to the Reserve Fund. It is only with the permission of the Reserve Bank that a bank can stop such transfer. The Reserve Fund thus built up should be shown separately from other reserves.

Cash Reserves (Section 18):

A scheduled bank (i.e. a bank included in the schedule maintained by the Reserve Bank of India) has to maintain with the Reserve Bank a balance equal to 3% of its time liabilities (i.e. deposits received for fixed terms) as well as of its demand liabilities. The Reserve Bank has the power to increase the percentage to 20% by a notification in the office gazette. Every non-scheduled bank is also required to maintain in India by way of cash reserve with itself or in any current account opened with the Reserve Bank of India or State Bank of India or partly in cash with itself and partly in such accounts a sum equivalent to at least 3% of the total of its time and demand liabilities in India.

Statutory Liquidity Ratio (SLR):

Over and above the cash reserve, every banking company is required to maintain in India in cash, gold and unencumbered securities, an amount which shall not be less than 25 percent of its time and demand liabilities in India. This is known as "Statutory Liquidity Ratio" or SLR. The Reserve Bank has the power to increase this ratio up to 40 percent. It now stands at 33.75% w.e.f. September 17,1994. The Reserve Bank has decided to gradually reduce it to 25% over a three years period.

Restrictions on Loans and Advance:

After the amendment of the law in 1968, a bank cannot: (i) grant loans or advances on the security, of its own shares, and (ii) grant or agree to grant a loan or advance to or on behalf of (a) any of its directors (b) any firm in which any of its directors is interested as partner, manager or guarantor; (c) any company of which any of its director is a director, manager, employee or guarantor or in which he holds substantial interest, or (d) any individual in respect of whom any of its directors is a partner or guarantor.

Note: (ii) (c) does not apply to subsidiaries of the banking company, registered under section 25 of the Companies Act or a government company.

Subsidiary Companies:

A banking company is allowed to form subsidiary companies only for the purpose of (a) undertaking and executing trusts, (b) the undertaking of the administration of estates as executors, trustee or otherwise, (c) the providing of safe deposit vaults; and (d) such other purposes as are incidental to the business of banking with the permission of the Reserve Bank.

Control:

The Reserve Bank of India is now authorised to exercise general supervision on the working of banks and to conduct investigation into the affairs of any bank. The Reserve Bank may order a bank not to accept further deposits. Every bank has to obtain a license from the Reserve Bank and permission to open a branch.

Accounting Record In The Books Of Bank:

In the book of bank, accounting record is made according to Slip System. Following books are mostly used in Bank accounting :

(1) General Cash Book;

(2) Sectional Cash Book,

(3) Customer's Receipts Book;

(4) Counter Payment Books;

(5) Cash Balance Books;

(6) Bills Payable Register;

(7) Bills Discounting Register;

(8) Transfer Journal;

(9) General Ledger;

(10) Current Account Ledger;

(11) Saving Account Ledger;

(12) Fixed Deposits Ledger;

(13) Investment Ledger;

(14) Loan Ledger;

(15) Safe Deposits Vault Register;

(16) Bills Register;

(17) Securities Register.

Slip System :

Double entry system of Book-Keeping is adopted in a bank. For accounting *Slip System* is very popular in banks. Records in accounting books are made only on the basis of slips. When a person deposits amount in a bank, he has to fill in pay-in-slip. The concerned officer signs on its counterfoil and returns it back to the person concerned. The portion of pay-in-slip which is retained by the officer is sent to the cashier. Cashier makes record in the cash book in its basis. From cashier this slip is sent to ledger-keeper. There customer's account is credited on the basis of this slip. Ledger-keeper sends this slip to the clerk who makes entries in the Pass Book. This method is also adopted for transferring the amount from one account to another. Slip system of accounting is also called *Unit Media of Posting*.

Final Accounts of Banking Companies - Preparation of Profit and Loss Account

The Profit & Loss Account of a banking company has to be prepared in Form B of Schedule III, attached to the Banking Regulation Act. As stated earlier the form has been revised w.e.f. 1st April, 1992 and the Profit & Loss Account of a banking company for the year ending March 31,1991, and onwards has to be prepared in the prescribed new form as given below:

FORM 'B'

THIRD SCHEDULE

FORM OF PROFIT AND LOSS ACCOUNT

Profit & Loss Account for the year ended 31st March, 19...

		Schedule No.	*Current year*	*Previous year*
I.	INCOME:			
	Interest Earned	13	—	—
	Other Income	14	—	—
	TOTAL		—	—
II.	EXPENDITURE:			
	Interest Expended	15	—	—
	Operating Expenses	16	—	—
	Provision and Contingencies		—	—
	TOTAL		—	—
III.	PROFIT/LOSS:			
	Net Profit / (Loss) for the year		—	—
	TOTAL		—	—
IV	APPROPRIATIONS:			
	Transfer to Statutory Reserves		—	—
	Transfer to other Reserves		—	—
	Transfer to Govt./Proposed Dividend			— —
	Balance carried over to Balance Sheet			— —
	TOTAL		—	—

Notes :–

(a) Total income includes income of foreign branches at Rs.____

(b) Total expenditure includes expenditure of foreign branches at Rs. ______

(c) Surplus/Deficit of foreign branches at Rs. ______

Schedules to be annexed with Profit and Loss Account

SCHEDULE 13 : INTEREST EARNED

		Current year	Previous year
I.	Interest Discount on Advances/Bills	—	—
II.	Income on Investments	—	—
III.	Interest on balances with RBI and other inter-bank funds	—	—
IV	Others		— —
	TOTAL	—	—

SCHEDULE 14 : OTHER INCOME

I.	Commission, Exchange, Brokerage	—	—
II.	Profit on sale of investments	—	—
	Less: Loss on sale of Investments	—	—
III.	Profit on revaluation of Investments	—	—
	Less: Loss on Revaluation of Investments	—	—
IV.	Profit on Sale of Land/Building and other Assets	—	—
	Less: Loss on sale of land, Bldg. & other Assets	—	—
V.	Profit on Exchange transactions	—	—
	Less: Loss on Exchange transactions	—	—
VI.	Income earned by way of dividends etc. from subsidiaries/companies and/or joint ventures/ abroad/in India	—	—
VII.	Misc. Income	—	—
	TOTAL	—	—

Note: Under Item II to V loss figures may be shown in brackets.

SCHEDULE 15 : INTEREST EXPENDED

I.	Interest on Deposits	—	—
II.	Interest on RBI/Inter-bank Borrowings	—	—
III.	Others		— —
	TOTAL	—	—

SCHEDULE 16 : OPERATING EXPENSES

I.	Payments to and Provisions for Employees	—	—
II.	Rent, Taxes and Lighting	—	—
III.	Printing and Stationery	—	—
IV	Advertisement and Publicity	—	—
V	Depreciation on Bank's Property	—	—
VI.	Directors' Fees, Allowances & Expenses	—	—
VII.	Auditors' Fees and Expenses (Including Branch Auditors)	—	—
VIII.	Law Charges	—	—
IX.	Postages, Telegrams, Telephones etc.	—	—
X.	Repairs and Maintenance	—	—
XI.	Insurance	—	—
XII.	Other Expenditure	—	—
	TOTAL	—	—

Note: Corresponding figures for the immediately preceding financial year should be shown in separate columns.

COMMENTS ON PROFIT AND LOSS ACCOUNT ITEMS:

(A) Interest Earned (Schedule 13)

I. Interest/Discount on Advances/Bills: Includes interest and discount on all types of loans and advances like cash credit, demand, loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted, (including those rediscounted), overdue interest and also interest subsidy, if any, relating to such advances/bills.

II. Income on Investments: Includes all income derived from the investment portfolio by way of interest and dividend.

III. Interest on Balances with Reserve Bank of India and other Inter-bank Funds: Includes interest on balance with Reserve Bank and other banks, call loans, money market placement, etc.

IV. Others: Includes any other interest/discount income not included in the above heads.

(B) Other Income (Schedule 14):

I. Commission, Exchange and Brokerage: Includes all remuneration on services such as collections, commission/exchange on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission on Government Business, commission on other permitted agency, business including consultancy and other services, brokerage, etc. on securities. It does not include foreign exchange income.

II. Profit on Sale of investments; Less:- Loss on Sale of Investments ;

III. Profit on Revaluation of Investments; Less: Loss on Revaluation of Investments;

IV. Profit on Sale of Land, Buildings and Other Assets; Less : Loss on sale of land, buildings and other assets. Includes profit/loss on sale of securities, land and buildings, motor vehicle, gold, silver etc. Only, the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The Net Profit/ Loss on revaluation of assets may also be shown under this item

V. Profit on Exchange transactions; Less : Loss on Exchange Transactions: Includes profit / loss on dealing in foreign exchange, all income carried by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.

VI. Income earned by way of dividends etc. from subsidiaries, companies, joint ventures abroad/in India.

VII . Miscellaneous Income : Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance etc. and any other miscellaneous income. In case any item under this head exceeds one percentage of the total income, particulars may be given in the notes.

(C) Interest Expended (Schedule 15):

I. Interest on Deposits: Includes interest paid on all types of deposits including deposits from banks and other institutions.

II. Interest on RBI/Inter-Bank borrowings: Includes discount/interest on all borrowings and refinance from Reserve Bank of India and other banks.

III Others: Includes discount/interest on all borrowings/refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.

(D) Operating Expenses (Schedule 16):

I. Payments to and Provisions for employee: Includes staff salaries/wages, allowances, bonus, other staff benefits like provident fund, pension, gratuity, liveries to staff, leave fare concessions, staff welfare, medical allowance to staff etc.

II. **Rent, Taxes and Lighting:** Including rent paid by the banks on building and other municipal and other taxes paid (excluding income tax and interest tax) electricity and other similar charges and levies. House rent allowance and other similar payments to staff should appear under the head "Payments to and Provisions for Employees."

III. **Printing & Stationery:** Includes books and forms and stationery used by the bank and other printing charges which are not incurred by way of publicity expenditure,

IV. **Advertisement and Publicity:** Includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges of publicity matter.

V. **Depreciation on Bank's Property:** Includes depreciation on bank's own property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, leasehold properties, non-banking assets, etc.

VI. **Directors Fees, Allowances and Expenses:** Includes sitting fees and all other items of expenditure incurred on behalf of directors. The daily allowance, hotel charges, conveyance charges, etc. which though in the nature of reimbursement of expenses incurred may be included under this head. Similar expenses of Local Committee members may also be included under this head.

VII. **Auditors' Fees & Expenses (including branch auditors' fee and expenses):** Includes the fee paid to the statutory auditors and branch auditors for professional services rendered and all expenses for performing their duties, even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by banks themselves for internal inspection and audits and other services, the expenses incurred in that context including fees may not be included under this head but shown under 'other expenditure'.

VIII. **Law Charges:** All legal expenses and reimbursement of expenses incurred in connection with legal services are to be included here.

IX. **Postage, Telegrams, Telephones, etc. :** Includes insurance charges on bank's property, their maintenance charges, etc.

X. **Repairs and maintenance:** Includes insurance charges on bank's property, their maintenance charges etc.

XI. **Insurance:** Includes insurance charges on bank's property, insurance premium paid to Deposit Insurance & Credit Guarantee Corporation (DICGC) etc. to the extent they are not recovered from the concerned parties.

XII. **Other Expenditure:** All expenses other than those not included in any of the other heads, like license fees, donations, subscriptions to papers, periodicals, entertainment expenses, travel expenses. etc. may be included under this head. In case any particular item under this head exceeds one percentage of the total income particulars may be given in the notes.

(E) Provisions and Contingencies : (Form B)

Includes any provision made for bad and doubtful debts, provisions for taxation, provisions for diminution in the value of investments. transfers to contingencies and other similar items.

PREPARATION OF BALANCE SHEET:

The Balance Sheet of a banking company has to be prepared in Form A of Schedule III attached to the Banking Regulation Act. The form of balance sheet, as stated earlier, has been revised w.e.f. April 1, 1991. The Balance Sheet of a banking company has to be prepared in the prescribed new form for the year ending 31st March, 1992 and onwards as given below:

THE THIRD SCHEDULE: FORM 'A'

FORM OF BALANCE SHEET

Balance Sheet as on 31st March .....

	Schedule	*Current year Rs.*	*Previous year Rs.*
CAPITAL & LIABILITIES			
Capital	1		
Reserves and Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
TOTAL			
ASSETS			
Cash and Balance with RBI	6		
Balance with banks & Money at Call & Short Notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
TOTAL			
Contingent Liabilities			
Bills for Collection	12		

The following schedules are required to be furnished with the Balance Sheet.

SCHEDULE 1 : CAPITAL

		Rs.
I.	NATIONALISED BANKS:	—
	Capital (Fully owned by Central Government)	—
	(a) FOR BANKS INCORPORATED OUTSIDE INDIA:	—
	(i) Capital (the amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)	—
	(ii) Amount of Deposit kept with RBI under Section 11(2) of the Banking Regulation Act, 1949.	—
	TOTAL	—
III.	FOR OTHER BANKS:	—
	Authorised Capital (shares of Rs each)	—
	Issued Capital (shares of Rs each)	—
	Subscribed Capital (shares of Rs each)	—
	Called up Capital (shares of Rs. each)	—
	Less: Calls unpaid	—
	Add: Forfeited Shares	

SCHEDULE 2 : RESERVES AND SURPLUS

		Rs.	Rs.
I.	**Statutory Reserves:**	—	—
	Opening Balance	—	—
	Additions during the year	—	—
	Deductions during the year	—	—
II.	**Capital Reserves:**	—	—
	Opening Balance	—	—
	Additions during the year	—	—
	Deductions during the year	—	—
III.	**Share Premium**	—	—
	Opening Balance	—	—
	Additions during the year	—	—
	Deductions during the year	—	—
IV.	**Revenue and Other Reserves**	—	—
	Opening Balance	—	—
	Additions during the year	—	—
	Deductions during the year	—	—
V.	**Balance in Profit & Loss Account:**	—	—
	TOTAL (I + II + III + IV + V)		

SCHEDULE 3: DEPOSITS

				Rs.	Rs.
A.	I.	Demand Deposits		—	—
		(i)	From Banks	—	—
		(ii)	From Others	—	—
	II.	Savings Bank Deposits		—	—
	III.	Term Deposits:		—	—
		(i)	From Banks	—	—
		(ii)	From Others	—	—
	TOTAL (I, II & III)			—	—
B.		(i)	Deposits of Branches in India	—	—
		(ii)	Deposits of Branches Outside India	—	—
	TOTAL				

SCHEDULE 4: BORROWINGS

			Rs.	Rs.
I.	Borrowings in India.		—	—
	(i)	Reserve Bank of India	—	—
	(ii)	Other Banks	—	—
	(iii)	Other Institutions and Agencies	—	—
II.	Borrowings Outside India		—	—
	TOTAL (I and II)		—	—
Secured Borrowing in 1, II above			—	—

SCHEDULE 5 : OTHER LIABILITIES & PROVISIONS

		Rs.	Rs.
I.	Bills Payable	—	—
II.	Inter-office Adjustments (net)	—	—
III.	Interest Accrued	—	—
IV	Other (including Provisions)	—	—
	TOTAL	—	—

SCHEDULE 6 : CASH AND BALANCE WITH RBI

		Rs.	*Rs.*
I.	Cash in Hand (including foreign currency notes)	—	—
II.	Balances with RBI in:	—	—
	(i) In Current Account	—	—
	(ii) In Other Accounts	—	—
	TOTAL (I & II)	—	—

SCHEDULE 7 : BALANCE WITH BANKS & MONEY AT CALL AND SHORT NOTICE

		Rs.	*Rs.*
I.	In India	—	—
	(i) Balance with Banks	—	—
	(a) in Current Accounts	—	—
	(b) in Other Deposit Accounts	—	—
	(ii) Money at Call & Short Notice	—	—
	(a) With Banks	—	—
	(b) With other Institutions	—	—
	TOTAL (I & 11)	—	—
II.	Outside India	—	—
	(i) In Current Accounts	—	—
	(ii) In other Deposit Accounts	—	—
	(iii) Money at Call and Short Notice	—	—
	Grant Total (I & II)		

SCHEDULE 8 : INVESTMENTS

		Rs.	*Rs.*
I.	Investments in India in Rs.	—	—
	(i) Govt. Securities	—	—
	(ii) Other Approved Securities	—	—
	(iii) Shares	—	—
	(iv) Debentures and Bonds	—	—
	(v) Subsidiaries and/or Joint Ventures	—	—
	Other (to be specified)	—	—
II.	Investments outside India in	—	—
	(i) Govt. Securities (incl. local authorities)	—	—
	(ii) Subsidiaries and/or Joint Ventures abroad	—	—
	(iii) Other Investment (to be specified)	—	—
	TOTAL	—	—
	GRAND TOTAL	—	—

SCHEDULE 9: ADVANCES

				Rs.	*Rs.*
A.	(i)	Bills Discounted and Purchased		—	—
	(ii)	Cash Credits, Overdrafts and Loans repayable on Demand		—	—
	(iii)	Term Loans		—	—
	TOTAL			—	—
B.	(i)	Secured by Tangible Assets		—	—
	(ii)	Covered by Bank/Govt. Guarantees		—	—
	(iii)	Unsecured		—	—
	TOTAL			—	—
C.	I.	Advances in India:		—	—
		(i)	Priority Sectors	—	—
		(ii)	Public Sector	—	—
		(iii)	Banks	—	—
		(iv)	Others	—	—
		TOTAL		—	—
	II.	Advances Outside India:			
		(i)	Due from Banks	—	—
		(ii)	Due from Others:	—	—
			(a) Bills purchased and discounted	—	—
			(b) Syndicated Loans	—	—
			(c) Others	—	—
		TOTAL		—	—
	GRAND TOTAL (C. I and C. II)				

SCHEDULE 10: FIXED ASSETS

			Rs.	*Rs.*
I.	Premises:			
		At cost as on 31st March of the preceding year	—	—
		Additions during the year	—	—
		Deductions during the year	—	—
		Depreciation to date	—	—
II.	Other Fixed Assets (incl. Furniture & Fixture):			
		At cost as on 31st March of the preceding year	—	—
		Additions during the year	—	—
		Deductions during the year	—	—
		Depreciation to date	—	—
	TOTAL (I & II)		—	—

SCHEDULE 11 : OTHER ASSETS

		Rs.	*Rs.*
I.	Inter-office Adjustments (net)	—	—
II.	Interest Accrued	—	—
III.	Tax paid in Advance/Tax Deducted at Source	—	—
IV	Stationery and Stamps	—	—
V	Non-banking Assets acquired in satisfaction of claims	—	—
VI	Others (in case there is any unadjusted balance of loss. The same may be shown under this item with appropriate footnote).	—	—
TOTAL		—	—

SCHEDULE 12 : CONTINGENT LIABILITIES

		Rs.	*Rs.*
I.	Claims against the Bank not acknowledged as debts	—	—
II.	Liability for part paid Investments	—	—
III.	Liability on account of outstanding forward exchange contracts	—	—
IV.	Guarantees given on behalf of constituents	—	—
	(i) In India	—	—
	(ii) Outside India	—	—
V.	Acceptances, Endorsements and other Obligations	—	—
VI.	Other items for which the bank is contingently liable	—	—
TOTAL		—	—

COMMENTS ON BALANCE SHEET ITEMS :

1. Capital (Schedule 1)

(I) Nationalised Banks:

(a) Capital (fully owned by Central Government): The capital owned by Central Government as on the date balance sheet including contribution from Government, if any, for participating in World Bank Projects should be shown.

(b) Banking Companies incorporated outside India :

(i) The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head.

(ii) The amount of deposit kept with RBI, under sub-section 2 of section II of the Banking Regulation Act. 1949 should also be shown.

(II) Other Banks (Indian)

Authorised, Issued, Subscribed, Called-up Capital should be given separately. Calls-in-arrears will be deducted from Called up capital while the paid-up value of forfeited shares should be added thus arriving at the paid-up capital. Where necessary, items which can be combined should be shown under one head for instance 'Issued and Subscribed Capital'.

Note: The changes in the above items, if any, during the year, say, fresh contribution made by Government, fresh issue of capital, capitalisation of reserves, etc. may be explained in the notes.

2. Reserves & Surplus (Schedule 2)

I. Statutory Reserves: Reserves created in terms of Section 17 or any other section of Banking Regulation Act must be separately disclosed.

II. Capital Reserves: The expression 'Capital Reserves' shall not include any amount regarded as free for distribution through the Profit & Loss Account. Surplus on revaluation should be treated Reserve. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is not a revaluation reserve.

III. Share Premium: Premium on issue of share capital may be shown separately under this head.

IV. Revenue and Other Reserves : The expression 'Revenue Reserve' shall mean any reserve other than capital reserve. This items will include all reserves, other than those separately classified. The expression 'reserve' shall not include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.

V. Balance of Profit: Includes Balance of Profit after appropriations. In case of loss the balance may be shown as a deduction.

Note : Movement in various categories of reserves should be shown as indicated in the schedule.

3. Deposits (Schedule3):

A. I. Demand Deposits :

(i) From Banks:

(ii) From Others: Includes all bank deposits repayable on demand. Includes all demand deposits of the non-bank sectors. Credit balance in overdrafts, cash credit account, deposits, payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificates of deposits, etc. are to be included under this category.

A. II. Savings Bank Deposits :

Includes all savings bank deposits (including inoperative savings bank accounts),

A. III. Term Deposits

(a) From Banks: Includes all types of bank deposits repayable after a specified term.

(b) From Others: Includes all types of deposits of the non - bank sector repayable after a specified term. Fixed deposits, cumulative and recurring deposits, cash certificates, certificates of deposits, annuity deposits, deposits mobilised under various schemes, ordinary staff deposits, foreign currency non-resident deposits accounts, etc. are to be included under this category.

B. (I) Deposits of Branches in India, and

(II) Deposits of Branches outside India :

The total of these two items will agree with the total deposits.

Notes: A. Interest payable on deposits which is accrued but not due should not be included but shown under other liabilities.

B. Matured time deposits and cash certificates, etc. should be treated as demand deposits.

C. Deposits under special schemes should be included under term deposits if they are not payable on demand. When such deposits have matured for payment they should be shown under demand deposits.

D. Deposits from banks will include deposits from the banking system in India. Cooperative banks, foreign banks which may or may not have a presence in India.

4. Borrowings (Schedule 4)

I. Borrowings in India:

(a) Reserve Bank of India: Includes borrowings / refinance obtained from Reserve Bank of India.

(b) Other Banks:- Includes borrowings / refinance obtained from commercial banks (including cooperative banks).

(c) Other Institutions and Agencies:- Includes borrowing / refinance obtained from Industrial Development bank of India, Export-Import bank of India, national Bank for Agriculture and Rural Development and other institutions, agencies (including liability against participation certificates, if any).

II. Borrowings outside India:

Includes borrowings of India branches abroad as well as borrowing of foreign branches.

Secured borrowing included above. This item will be shown separately Includes secured borrowings / refinance in India and outside India.

Notes:(i) The total of I & II will agree with the total borrowings shown in the Balance Sheet.

(ii) Inter-office transactions should not be shown as borrowings.

(iii) Funds raise by, foreign branches by way of certificate of deposits, bonds etc. should be classified depending upon documentation, as "deposits" "borrowings",

(iv) Refinance obtained by banks from Reserve Bank of India and various Institutions are being brought under the head 'borrowings'. Hence, advances will be shown at the gross amount on the assets side.

5. Other Liabilities & Provisions (Schedule 5):

I. Bill Payable :

The bank provide the facility of remitting funds from one place to another by means of bank drafts, telegraphic transfer, circular notes, pay orders etc. The person intending to remit the money has to deposit the money with the bank and get a pay order or bank draft in exchange for the money deposited. Alternatively, he may request the bank for making a telegraphic transfer from his account to the account of the person to whom he wants to remit the money. The paying bank is reimbursed by the bank who issues such draft or instructions. The banks also issues travellers and gift cheques for carrying or remitting money. If any such drafts, cheques etc. remain uncashed on the day of preparation of final accounts, they are shown under the heading "Bills Payable" in the balance sheet.

A. Inter Office (or Branch) Adjustments (Net): This item represents the difference on account of incomplete recording of transactions between one branch and another branch or between one branch and the head office. It may have a debit or a credit balance. In case of a credit balance, it should be shown under this head. It may be noted that only net portion is to be shown of inter office account, inland as well as foreign.

B. **Interest Accrued:** Includes interest accrued but not due on deposits and borrowings.

C. **Others (Including Provisions):** Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source, etc.), surplus in aggregate in provisions for bad debts provision account, surplus in aggregate in provisions for depreciation in securities, contingency funds which are not disclosed as reserves but are actually in the nature of reserves, proposed dividend / transfer to Government, other liabilities which are not disclosed under any of the major heads such unclaimed dividend provisions and funds kept for specific purposes, unexpired discount, outstanding charges like rent, conveyance, etc. Certain types of deposits like staff security deposits, margin deposits, etc. where the repayment is not free, should also be included under this head.

Notes:(i) For arriving at the net balance of inter-office adjustments all connected inter office account should be aggregated and the net balance only will be shown, representing mostly, items in transit and unadjusted items.

(ii) The interest accruing on all deposits, whether the payment is due or not, should be treated as liability.

(iii) It is proposed to show only pure deposits under this head 'deposits' and hence all surplus provisions for bad and doubtful debts contingency funds, Secret reserves, etc. which are not netted off against the relative assets, should be brought under the head 'Other (including provision)'.

6. Cash and Balance with the Reserve Bank of India (Schedule 6):

I. Cash in hand (including foreign currency notes);

II. Balance with RBI

(a) in current account,

(b) in other accounts.

Includes cash in hand including foreign currency notes and also of foreign branches in the case of banks having such branches.

7. Balances with Banks and Money at Call and Short Notice (Schedule 7):

I. In India:

a. Balance with Banks :

(a) Current Accounts.

(b) In other Deposit Accounts : including all balances with banks in India (including cooperative banks). Balances in current account and deposit accounts should be shown separately.

b. Money at call and short notice:

(i) *With Banks;*

(ii) *With Other Institutions.* This item mainly represents the loans given by one bank to another for a short period. Call loans are repayable at any time the banker recalls them while short notice advances are repayable within a short notice of (say) 24 hours. The maximum notice period is usually of two weeks.

This includes deposits repayable within 15 days or less than 15 days notice lent in the inter-bank call money market.

II. Outside India:

(i) Current Accounts and

(ii) Deposits Accounts: Includes balances held by foreign branches and balance held by Indian Branches of the banks outside India. Balance held with foreign branch and by other branches of the bank should not be shown under this head but should be included in inter-branch account. The amounts held in 'current account' should be shown separately.

(iii) Money at Call and Short Notice: Includes deposits usually classified in foreign currencies as money at call and short notice.

8. Investments (Schedule 8):

1. Investments in India in

(i) Government Securities : Includes Central and State Government securities and government treasury bills. These securities should be shown at the book value. However, the difference between the book value and market value should be given in the notes to the balance sheet.

(ii) Other Approved Securities : Securities other than Government Securities which according to the Banking Regulation Act, 1949 are treated as approved securities, should be included here.

(iii) Shares: Investments in shares of companies and corporations not included in item (ii) above should be included here.

(iv) Debentures and Bonds: Investments in debentures and bonds of companies and corporations not included in items (ii) should be included here

(v) Investments in Subsidiaries/Joint Ventures: Investments in Subsidiaries/Joint Ventures (including RRBs) should be included here.

(vi) Others: Includes residual investment, if any, like gold, commercial paper and other instruments in the nature of share/debentures/bonds.

II. Investments outside India -

(i) Government Securities (including local authorities) : All foreign Government securities including securities issued by local authorities may be classified under this head.

(ii) Subsidiaries and /or joint ventures abroad: All investments made in the share capital of subsidiaries floated outside India and/or joint ventures abroad should be classified under this head.

(iii) Others: All other investments outside India may be shown under this head.

9. Advances (Schedule 9):

A.

(i) Bills discounted and purchased. The banks also give advances to their customers by discounting their bills. Net amount after deducting the amount of discount is credited to the account of customer. The bank may discount the bills with or without any security from the debtor in addition to one or more persons already liable on the bill.

(ii) Cash Credits, Overdrafts and Loans repayable on demand:

Cash Credits. A cash credit is an arrangement by which a banker allows his customer to borrow money up to a certain limit. Cash credit arrangements are usually made against the security of commodities hypothecated or pledged with the bank.

In case of a cash credit facility the borrower need not borrow at once the whole of the amount he is likely to require, but draw such amounts as and when required. He can put back any surplus amount which he may find with him for the time being. Interest on cash credit has to be paid on the amount actually drawn at any time and not on the full amount of credit allowed overdrafts. The customer may be allowed to overdraw his current account with or without security if he requires temporary accommodation. This arrangement like cash credit is advantageous from the customer's point of view as he is required to pay interest on the actual amount used by him.

Loans. A loan is a kind of advance made with or without security. In case of loan the bank makes a lump sum payment to the borrower or credits his deposit account with the money advanced. Repayments may be made in instalments or at the expiry of a certain period. The customer has to pay interest on the total advance whether he withdraws the money from his account (credited with the loan). A loan once repaid in full or in part cannot be drawn again by the borrower unless the banker sanctions a fresh loan.

(iii) ***Terms Loans :*** A loan may be in the form of a demand loan. Demand loan is payable on demand. It is usually for a short period not exceeding a year, while the term loan is given for a fixed term usually exceeding a year.

In classification under section 'A' all outstanding in India as well as outside less provisions made, will be classified under three heads indicated above and both secured and unsecured advances will be included under these heads. Term loans should be mentioned including overdue instalments.

B.

(i) **Secured by Tangible Assets:** All advances or part of advances which are secured by tangible assets may be shown here. The item will include advances in India and outside India.

(ii) **Covered by Bank/Government Guarantee:** Advances in India to the extent they are covered by guarantees of Indian and foreign governments and Indian and foreign banks and DICGC and ECGC are to be included.

(iii) **Unsecured:** All advances not classified under (i) and (ii) will be included here. Total of 'A' should tally with total of 'B'.

C.

1. **Advances in India (Priority Sectors; Public Sector; Banks and Others):** Advances should be broadly classified into 'Advances in India' and 'Advances outside India'. Advances in India will be further classified on the sectorial basis as indicated. Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank are to be classified under the head 'Priority Sectors'. Such advances should be excluded from item (ii) i.e. advances to public sector. Advances to Central and State Governments and other Government undertakings including Government Companies and Corporation which are, according to the statutes, to be treated as public sector companies are to be included in the category "Public Sector". All advances to the banking sector including cooperative bank will come under the head "Banks". All the remaining advances will be included under the head "Others" and typically this category will include non-priority advances to the private, joint and cooperative sectors.

Notes:(i) The gross amount of advances including refinance and rediscounts but excluding provision made to the satisfaction of auditors should be shown as advances.

(ii) Term loans will be loans not repayable on demand.

(iii) Consortium advances would be shown net of share from other participating banks/institutions.

10. Fixed Assets (Schedule 10):

I. Premises:

(i) At cost as on 31 March of the preceding year

(ii) Additions during the year,

(iii) Deductions during the year,

(iv) Depreciation to date.

Premises wholly or partly, owned by the banking company for the purpose of business including residential premises should be shown against 'Premises'. In the case of premises and other fixed assets, the previous balance, additions thereto and deductions there from during the year as also the total depreciation written off should be shown. Where sums have been written off on reduction of capital or revaluation of assets, every balance sheet after the first balance sheet subsequent to the reduction should show the revised figures for a period of five years with the date and amount of revision made.

II. Other Fixed Assets (including Furniture and Fixtures):

(i) At cost on 31st March of the preceding year;

(ii) Additions during the year ;

(iii) Deductions during the year ;

(iv) Depreciation to date.

Motor vehicle and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.

11. Other Assets (Schedule 11): They, include the following –

I. Inter/Office Adjustments (Net):

The inter-office adjustments balance, if in debit. should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here. For arriving at the net balance of inter-office accounts should be aggregated and the net balance, if in debit, only should be shown representing mostly items in transit and unadjusted items.

II. Interest Accrued:

Interest accrued but not due on investment and advances and interest due but not collected on investments will be the main components of this item. As banks normally debit the borrowers' account with interest due on the balance sheet date, usually there may not be any amount of interest due on advance. Only such interest as can be realised in the ordinary course should be shown under this head.

III. Tax paid in advance/deducted at source:

The amount of tax deducted at source on securities, advance tax paid etc. to the extent that these items are not set off against relative tax provisions should be shown under this head.

IV. *Stationery and Stamps :*

Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc. which are shown as quasi-asset to be written off over a period of time should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account as these items are for internal use.

V. *Non-banking assets acquired in satisfaction of claims:*

Immovable properties/ tangible assets acquired in satisfaction of claims are to be shown under this head.

VI. *Others:*

This will include items like claims which have not been met, for instance, clearing items, debit items representing addition to assets or reduction in liabilities which have not been adjusted for technical reasons, want of particulars, etc. advances given to staff by a bank as employer and not as a bank, etc. Items which are in the nature of expenses are pending adjustments should be provided for and the provision netted against this item so that only realisable value is shown under this head, Accrued income other than interest may also be included here.

12. Contingent Liabilities (Schedule 12):

I. Claims against the bank not acknowledged as debts.

II. Liability for partly paid investments: Liabilities on partly paid shares, debentures, etc. will be included in this head.

III. Liability on account of outstanding forward exchange contracts.

IV. Guarantees given on behalf of constituents (i) in India (ii) Outside India.

V. Acceptances, endorsements and other obligations: This item will include letters of credit and bill accepted by the bank on behalf of customers. In such cases the bank takes upon itself the responsibility for payment. In order to keep a proper record of such liability the bank maintains a customers acceptances, endorsements and guarantee register. All obligations undertaken by the bank as a result of guarantees. endorsements, acceptances etc. are recorded here. At the end of the accounting year, if some of these obligations remain undisbursed, they are to be shown as contingent liabilities under this head.

VI. Other items for which the Bank is contingently liable: Arrears of cumulative dividends, bills rediscounted under writing contracts, estimated amounts of contracts remaining to be executed on capital account and not provided for, etc. are to be included here.

Bills for Collection:

A banking company receives a large number of bills of exchange for collection purposes. In order to keep a systematic record of such bills it maintains a book called "Bills for Collection Register". On receipt of a bill for collection the entry is made in this register. On collection of the bill of exchange, besides making a note of this fact in the bills for collection register, the following accounting entry is also passed by the banker :

Cash Account	Dr.	—	
(With the amount of bill collected)			
To Customer's Account			—
(With the amount of Bill collected less commission charges)			
To Commission Account			—

At the end of the accounting period, the amount of bills yet to be collected is ascertained from the bills for collection register. The total amount of such bills is shown here.

Compulsory Deposits: In case certain persons are required to make compulsory deposits with a bank as per income tax, excise rules etc. these deposits have been received by the concerned bank on behalf of the concerned authority. They may be included in the category of Demand Deposits and shown in the Balance Sheet accordingly.

NOTES AND INSTRUCTION FOR COMPILATION

General Instructions:

1. The formats of balance sheet and profit & loss account cover all items likely to appear in these statements. In case a bank does not have any particular item to report, it may be omitted from the formats.
2. Corresponding comparative figures for the previous year are to be disclosed as indicated in the formats. The words 'current year' and 'previous year' used in the formats are only, to indicate the order of presentation and may not appear in the account.
3. Figures should be rounded off to the nearest thousand rupees. Thus, a sum of Rs. 19,75,921.20 will appear in the balance as Rs. 19.76.
4. Unless otherwise indicated, the term 'bank/s' in these statements will include banking companies, nationalised banks, State Bank of India, Associate banks and all the institutions including cooperatives carrying on the business of banking whether or not incorporated or operating in India. The Hindi version of the Balance Sheet will be a part of the annual report.

Accounting Policies for Banking Sector:

On recommendations of the Ghosh Committee, the Reserve Bank of India has issued a directive to all scheduled commercial banks to disclose the Accounting Policies adopted by them in the financial statements for the year ending 31st March,
1991, and later. A specimen form in which accounting policies may be disclosed in the financial statements is given below:

Principal Accounting Policies:

(1) General: The accompanying financial statements have been prepared on the historical cost basis and conform to the statutory provisions and practices prevailing in the country.

(2) Transaction involving foreign exchange : (a) Monetary assets and liabilities have been translated at the exchange rates prevailing at the close of the year. Non-Monetary assets have been carried in the books at the historical cost. (b) Income expenditure items in respect of Indian Branches have been translated at the exchange rates ruling on the date of transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year. (c) Profit or loss on pending forward contracts has been accounted for.

(3) Investments: (a) Investments in Government and other approved securities in India are valued at the lower of cost or market value. (b) Investments in subsidiary companies and associate companies (i.e. companies in which the bank hold at least 35% of the share capital) have been accounted for on the historical cost basis.

(4) Advances: (a) Provisions for doubtful advances have been made to the satisfaction of the auditors : (i) in respect of identified advances, based on a periodic reviews of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the export credit and guarantee corporation and similar statutory bodies ; (ii) in respect of general advances as percentage of total advances taking into account guidelines issued by the Government of India and the Reserve Bank of India. (b) Provisions in respect of doubtful advances have been deducted from advances to the extent necessary and the excess has been included under "other liabilities and provisions". (c) Provisions have been made on a gross basis. Tax relief which will be available when the advance is written off will be accounted for in the year for write off.

(5) Fixed Assets: (a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for at the values determined on the basis of such revaluation made by professional valuers. Profit arising on revaluation has been credited to Capital Reserve. (b) Depreciation has been provided for on the straight line/diminishing balance method. (c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent on revaluation is transferred annually from the Capital Reserve to the General Reserve/ Profit and Loss Account.

(6) Staff Benefits made Provisions for gratuity/pension benefits to staff has been on an accrual/ cash basis and bonus to staff as per statutory requirement have been made. Separate funds for gratuity/pension have been created.

(7) Net Profit

(a) The net profit disclosed in the profit and loss account is after:

(i) Provisions for taxes and (income, wealth tax) on income in accordance with statutory requirements.

(ii) Provisions for doubtful advances.

(iii) Adjustments to the value of "current" investments in Government and other approved securities in India valued at lower of cost or market value.

(iv) Transfers to contingency.

(v) Other usual or necessary provision.

(b) Contingency funds have been grouped in the balance sheet under the head "Other Liabilities and Provisions".

Accounting Treatment:

Accounting treatment of some specific items in the Profit & Loss Account and Balance Sheet is being explained as follows :

1. *Income Recognition:*

The banks have been recently advised by the Reserve bank of India that they should identify the non-performing assets and ensure that interest on such non performing assets (NPA) is not recognised as income and taken to the profit and loss account w.e.f financial year 1992-93. The term non performing assets means a credit facility in respect of which the interest/instalment remains 'past due' for a period of two quarters i.e. six months. An amount under any of the credit facilities is to be treated as 'past due', when it has remained outstanding for thirty days beyond the due date. Moreover, if one of the accounts under the new norms is an NPA, all the accounts of the borrowers (other than loans with a liability of less than Rs.25,000) will be treated as NPAs.

2. *Bad Debts and Provisions for Doubtful Debts:*

The business of a banking depends on public confidence. In order to ensure that this confidence is not impaired, the banks till recently were given a special privilege permitting them not to show in their published account bad debts and provisions for doubtful debts. They could show income after making deductions for such losses. In the Profit and Loss account the income from 'interest and discount' was usually shown after meeting such losses. In the Balance Sheet, the amount of advances was shown after deducting bad and doubtful debts.

However, with effect from April 1,1991 this practice has under gone a change. The amount of bad-debts and provision for bad debts has to be charged under the heading "Provisions & Contingencies" in the Profit & Loss Account. In the Balance Sheet, the advances are shown after deducting the both. bad debts and provision for bad debts. It may be noted that the banks collect from their branches information regarding bad and doubtful debts also. The Schedule of Advance to be filled in by the branches contains a separate column regarding doubtful debts in respect of bills purchased and discounted, cash credits and overdrafts, and unsecured loans. However, while consolidating the Schedule of Advances at the Head Office level for Balance Sheet purposes the advances are shown net of any bad or doubtful debts.

Any surplus provision for doubtful debts has not to the deducted from advances but to be shown under the heading other liabilities and provisions in the Balance Sheet.

As per recent directive of the Reserve Bank, provision for doubtful debts has to be created on the various advances on the following basis:

(i) **Standard Assets:** These include advances which are not non-performing assets. No provision is required for such advances.

(ii) **Sub-Standard Assets:** These are advances which have been classified as non performing assets and are outstanding for a period not exceeding two years. A provision of 10% is required for such advances.

(iii) **Doubtful assets:** These are advances which remain classified as non performing assets for more than two years. A provision for doubtful debts against such advances has to be created as follows:

(a) First year: Unsecured portion + 20% of secured portion

(b) Second and Third year: Unsecured Portion + 30% of secured portion

(iv) **Loss Assets:** These include advances which are fully and or substantially non recoverable and the security value in respect of them is negligible. 100% provision is required for such assets.

(v) Assets for which borrowers liability is less than Rs. 25,000: 5% of the aggregate liability has to be provided as a general provision.

Illustration 1:

Compute the amount of provision for doubtful debts from the following details of advances of National Bank Ltd. *(Rs in lakhs)*

1.	Total Loans and Advances	50
2.	Fully secured advances without any default by the borrowers	30
3.	Advances overdue for 15 months	10
4.	Advances overdue for more than 30 months (secured by mortgage of plant worth Rs. 3 lakhs)	5
5.	Non-recoverable unsecured advances	3
6.	Small advances not exceeding Rs.25,000 to each borrower	2

Solution:

Computation of Provision for Doubtful Debts

SI. No.	Category of advances	Amount (Rs. Lakhs)	Prov. %	for Doubtful Debts (Rs.)
1.	Standard Assets	30	–	–
2.	Sub-Standard Assets	10	10	1,00,000
3.	Doubtful Assets [Unsecured Rs. 2.00 Secured Rs. 3.00]	5	Unsecured Portion + 30% of secured portion	2,90,000
4.	Loss Assets	3	100	3,00,000
5.	Small Advances	2	5	10,000
		50		7,00,000

3. *Provisions for Taxation:*

Its treatment till recently was on the pattern of bad and doubtful debts. The amount of Provision for Taxation was quietly deducted from Interest and Discount Income. In the Balance Sheet, the amount was merged with "Current and Contingencies Account" on the Liabilities side. However, with effect from 1.4.1991, the above practice has undergone a change. In the revised formats, effective from 1.4.1991, the item has to be shown as under :

The amount of Provision for Taxation has to be charged to the Profit & Loss Account under the heading "Provision & Contingencies" in the Balance Sheet, it will be shown under the heading "Other Liabilities & Provisions", on the Liabilities side.

It will be useful here to know the provisions of the Income Tax Act regarding treatment of Provision for Doubtful Debts while creating provision for Taxation. Section 36(I)(VII) (a) of the Income Tax Act, 1961, permits banking companies to make adequate provisions form their current profits to provide for risk in relation to their rural advances. The amount of deduction in respect of Bad & Doubtful Debts for the assessment year 1995-96 onwards is as follows:

(i) 5 per cent of the total income of the banking company before making such deduction; or

(ii) 4 per cent of aggregate average rural advances made by the banking company. Tutorial Note. In the absence of any specific details about the rural advances, the students may create Provision for Taxation on Net Profits left after charging Provision for Doubtful Debts

4. *Rebate on Bill Discounted:*

This refer to unexpired discount. A banking company charges discount in advance for the full period of the bill of exchange or promissory note discounted with it. The accounting entry made is as follows:

Bill Discounted and Purchased A/c Dr.
To Customer's A/c
To Discount A/c

Customer's account is credited with the net amount remaining after deducting the amount of discount. The amount credited to the discount account represents the earning of the bank. However, it may be possible that the bills discounted may mature after the close of the financial year. It will not be appropriate to the credit of the profit and loss account that part of the discount charged which relates to the next year. An accounting entry is, therefore, passed for unearned discount in the following manner :

Discount A/c Dr.
To Rebate on Bill Discounted
(with the amount of unearned discount relating to the next period)

Rebate on bills discounted, if already appears in the trial balance is taken to the balance sheet on the "liabilities side". However, if adjustment has to be done after preparation of the trial balance in respect of rebate on bills discounted, the amount of such rebate (i.e. the unearned discount) will be deducted from the total discount in the profit and loss account and will also appear in the balance sheet.

5. *Interest on Doubtful Debts*

Interest earned by a banking company on doubtful debts can be treated in any of the following ways in the account of a banking company

(a) **Interest Suspense Method.** The interest earned may be credited to Interest Suspense Account opened for this purpose.

(b) **Cash Method.** No entry is passed for such interest till it is actually received.

(c) **Accrual Method.** Interest Account may be credited with the full amount of interest due on doubtful debts and simultaneously an adequate provision for bad and doubtful debts may be created.

It may not be noted, as discussed earlier, that the doubtful debts come within the category of non-performing assets and therefore interest income on such doubtful advances should not be recognized and taken to the profit and loss account. The method (b) is therefore best under the present circumstances.

Illustration 2:

Following are the balance sheets of A Bank Ltd. for the year ended on 31st March, 1999 and 31st March, 1998:

	1999 (Rs.)	*1998 (Rs.)*
Interest on Loans	1,00,000	80,000
Interest on Cash Credit	2,00,000	70,000
Interest on Overdraft	50,000	30,000
Commission Received	5,000	2,000
Rent	40,000	30,000
Interest on Fixed Deposit	3,00,000	2,50,000
Discount on Bills Discounted	1,00,000	90,000
Law Charges	30,000	2,000
Brokerage received	30,000	28,000
Interest on Saving Bank Deposit	80,000	70,000
Insurance	18,000	16,000
Printing and Stationery	4,000	3,000
Auditor's Fees	2,000	2,000
Directors` Fees	4,000	3,000
Rebate on Bills Discounted	40,000	29,000
Salaries	50,000	49,000
Postage expenses	1,000	1,000
Interest on Investment	7,00,000	6,00,000
Interest on balance with RBI	10,000	8,000

Prepare Profit and Loss Account of A Ltd. from the above particulars.

Solution: *(000s omitted)*

PROFIT AND LOSS ACCOUNTS OF A BANK LTD. for the year ended 31st March, 1999

		Schedule *No.*	Year ended 31.3.99 (Current year) *Rs.*	Year ended 31.3.98 (Previous year) *Rs.*
I.	INCOME			
	Interest earned	13	1210.00	849.00
	Other Income	14	35.00	30.00
	TOTAL		1245.00	879.00
II.	EXPENDITURE			
	Interest expended	15	380.00	320.00
	Operating expenses	16	149.00	106.00
	Provision and Contingencies		—	—
	TOTAL		529.00	426.00

III. PROFIT/LOSS		
Net Profit/Loss for the year	716.00[1]	453.00[2]
Profit/Loss (-) brought forward	—	—
TOTAL	716.00	453.00
IV. APPROPRIATIONS		
Transfer to statutory reserves	143.20[3]	90.60[4]
Transfer to other reserves	—	—
Transfer to govt./proposed dividend	—	—
Balance carried over to Balance Sheet	572.80	362.40
TOTAL	716.00	453.00

1. Rs. 1245 – 529 = Rs. 716.00
2. Rs. 879 – 426 = Rs. 453;
3. 716 × 20/100 = Rs.143.20;
4. 453 × 20/100 = Rs. 90.60

SCHEDULE 13 - INTEREST EARNED

	Year ended 31.3.99 (Current Year) *Rs. '000*	Year ended 31.3.99 (Previous Year) *Rs. '000*
I. Interest/Discount on advertisement	410[1]	241[2]
II. Income on investments	700	600
III. Interest on balance with Reserve Bank of India and other inter- bank funds	100	8
IV. Others	–	–
TOTAL	1210	849

1 (Rs. 1,00,000 + 2,00,000 + 50,000 + 1,00,000) - 40,000 = Rs. 4,50,000 - 40,000 = Rs. 4,10,000

2 (Rs. 80,000 + 70,000 + 30,000 + 90,000) - 29,000 = Rs. 2,70,000 - 29,000 = Rs. 2,41,000.

SCHEDULE 14 - OTHER INCOME

		Year ended 31.3.99 (Current Year) *Rs. '000*	Year ended 31.3.99 (Previous Year) *Rs. '000*
I.	Commission, exchange and brokerage	35[1]	30[2]
	(a) Profit on sale of investment		
	Less: Loss on sale of investment	—	—
	(b) Profit on revaluation of investment		
	Less: Loss of revaluation of investment	—	—
	(c) Profit on sale of land, buildings		
	Less: Loss on sale of land, buildings and other assets	—	—
	(d) Profit on exchange transactions	—	—
	Less: Loss on exchange transaction	—	—
	(e) Income earned by way of dividends etc. , from subsidiaries/ companies and/or joint ventures abroad/ in India.	—	—
	VII. Miscellaneous Income	—	—
	TOTAL	35	30

1 Commission Rs. 5,000 + Brokerage Rs. 30,000 = Rs. 35,000 or 35 thousand;

2 Commission Rs. 2,000 + Brokerage Rs. 28,000 = Rs. 30,000 or 30 thousand.

SCHEDULE 15 - INTEREST EXPENDED

		Year ended 31.3.99 (Current Year) *Rs. '000*	Year ended 31.3.99 (Previous Year) *Rs. '000*
I.	Interest on deposits	380[1]	320[2]
II.	Interest on RBI/Inter-bank borrowings	—	—
III.	Others	—	—
	TOTAL	380	320

1 Rs. 3,00,000 + 80,000 = Rs. 3,80,000 or 380 thousand;

2 Rs. 2,50,000 + 70,000 = Rs. 3,20,000 or 320 thousand.

SCHEDULE 16 - OPERATION EXPENSES

		Year ended 31.3.99 (Current Year) *Rs. '000*	Year ended 31.3.99 (Previous Year) *Rs. '000*
I.	Payment to and provision for employees	50	49
II.	Rent, taxes and lighting	40	30
III.	Printing and stationary	4	3
IV.	Advertisement and publicity	—	—
V.	Depreciation on bank's property	-—	—
	(a) Directors fees, allowance and expenses	4	3
	(b) Auditors' fees and expenses (including branch Auditors' fees and expenses).	2	2
VIII.	Law charges	30	2
IX.	Postage, telegrams, telephones, etc.	1	1
X.	Repair and maintenance	—	—
XI.	Insurance	18	16
XII.	Other expenditure	—	—
	TOTAL	149	106

Illustration 3:

From the following particulars prepare the balance sheet of Progressive Bank Ltd., as on 31st March,1991:

Particulars	*Dr. (Rs.)*	*Cr. (Rs.)*
Share Capital	—	10,00,000
Reserve Fund	—	16,00,000
Fixed Deposit	—	40,00,000
Savings bank deposits	—	60,00,000
Current Accounts	—	2,20,00,000
Money at call and short notice in India	2,00,000	
Bills discounted and purchased in India	9,00,000	
Investments at cost :		
Central & State Govt.		
— securities	1,00,00,000	
— debentures	4,00,000	
— bullion	24,00,000	
Reserve for buildings	—	10,00,000
Premises at cost	1,00,00,000	

Addition to premises	20,00,000	
Depreciation fund on premises		80,00,000
Cash with Reserve Bank of India	34,00,000	
Cash with State Bank of India	12,00,000	
Unclaimed dividend	—	24,000
Unexpired discount	—	50,000
Loans, advances, overdraft and cash credits in India	1,00,00,000	
Branch adjustment	57,94,000	
Silver	2,00,000	
Advance payment of tax	1,10,000	
Interest accrued on investments	2,60,000	
Non-banking assets acquired	70,000	
Borrowings from banks in India	—	2,50,000
Bills payable	—	20,00,000
Profit & Loss account including Rs.2, 10,000 for the year	—	4,10,000
Dividend fluctuation fund	—	6,00,000
Total	4,69,34,000	4,69,34,000

The bank had bills for collection for its constituents Rs.3,00,000 and acceptances Rs.4,00,000. There was a claims of Rs.2,00.000 against the bank but not acknowledged as debt. The liabilities for bills rediscounted was Rs.32.000. Liability for forward exchange contract was Rs.20,00,000. The directors decided to reserve Rs.2,000 for unexpired discounts and transfer reserve for building to depreciation fund.

PROGRESSIVE BANK LIMITED

Balance Sheet as on 31st March, 1991 *'000 omitted*

	Schedule	*Rs.*
Capital and Liabilities Capital	1	1,000
Reserve and Surplus	2	2,608
Deposits	3	32,000
Borrowings	4	250
Other Liabilities and Provisions	5	11,076
Total		46,934
Assets Cash and Balance with RBI	6	3,400
Balance with Banks and money at call and short notice	7	1,400
Investments	8	12,800
Advances	9	10,900
Fixed Assets	10	12,000
Other Assets	11	6,434
		46,934
Contingent Liabilities	12	2,632
Bills for collection		300

SCHEDULE 1 – CAPITAL

	Issued, Subscribed and Paid up	Rs. 1,000

SCHEDULE 2 – RESERVE AND SURPLUS

(i)	Statutory Reserve	Rs. 1,600
	Addition during the year	42
(ii)	Revenue and other Reserves : Dividend Equalisation Fund	600
(iii)	Profit and Loss A/c (368 - 2)	366
	Total	2,608

SCHEDULE 3 – DEPOSITS

(i)	Demand Deposits	Rs. 22,000
(ii)	Saving Bank Deposits	6,000
(iii)	Term Deposits	4,000
	Total	32,000

SCHEDULE 4 – BORROWINGS

	Borrowings in India	Rs. 250

SCHEDULE 5 – OTHER LIABILITIES AND PROVISIONS

	Bills payable	Rs. 2,000
	Unexpired Discount	52
	Unclaimed Dividends	24
	Depreciation Fund	9,000
	Total	11,076

SCHEDULE 6 – CASH AND BALANCES WITH RBI

	Balance with RBI	Rs. 3,400

SCHEDULE 7 – BALANCE WITH BANKS AND MONEY AT CALL AND SHORT NOTICE

(i)	Balance with SBI	Rs. 1,200
(ii)	Money at Call and Short Notice	200
	Total	1,400

SCHEDULE 8 – INVESTMENTS

(i)	Central and State Government Securities	Rs. 10,000
(ii)	Debentures	400
(iii)	Bullion	2,400
	Total	12,800

SCHEDULE 9 – ADVANCES

(i)	Bills purchased and discounted	Rs. 900
(ii)	Loans', cash credit, advances and overdrafts	10,000
	Total	10,900

SCHEDULE 10 – FIXED ASSETS

(i)	Premises at cost	Rs. 10,000
	Addition during the year	2,000
	Total	12,000

SCHEDULE 11 – OTHER ASSETS

(i)	Branch Adjustment	Rs. 5,794
(ii)	Silver	200
(iii)	Advance Payment of Tax	110
(iv)	Interest accrued on Investments	260
(v)	Non-Banking assets	70
	Total	6,434

SCHEDULE 12 – CONTINGENT LIABILITIES

(i)	Claims against the bank acknowledge as debt	Rs. 200
(ii)	Liability on Bills Discounted	32
(iii)	Liability for forward exchange contract	2,000
(iv)	Acceptances, Endorsements and other Obligations	400
	Total	2,632

6.2 ELECTRICITY COMPANY ACCOUNTS

The Indian Electricity Act, 1910 and the Electricity (Supply) Act of 1948 consist of the special legislations governing electricity companies. Electricity is a basic infrastructure industry which is of great importance to the public.

Accounting Provisions :

(a) *Depreciation :* The straight line method of depreciation is to be followed and the Central Government has been given the power to prescribe, by notification, the life of various types of assets. No depreciation is to be written off when the asset is useless due to obsolescence, superfluousness or has been written down, value of the discarded asset is to be carried to Discarded Asset Account. On sale of such asset the sale proceeds are credited to the account and any profit or loss is charged to contingencies reserve.

(b) *Reasonable Return* : The law defines the reasonable return in following terms in order to avoid electricity undertakings from earning too high a profit.

(c) A yield at the standard rate, which is the Reserve Bank rate plus two per cent on the capital base.

(d) Income derived from investments except investments made against Contingencies Reserve.

(e) An amount equal to 1/2 per cent on loans advanced by the Electricity Board ;

(f) An amount equal to 1/2 per cent on the balance of Development Reserve ; and

(g) An amount equal to 1/2 percent received on Debentures.

(h) An amount equal to 1/2 percent on amounts approved from approved institutions.

Capital Base means : (a) the original cost of fixed assets available for use and necessary for the purpose of the undertakings less contribution, if any, made by the consumers for construction of service lines and also amounts written off; (b) the cost of intangible assets; (c) the original cost of works in progress; (d) the amount of investments made compulsorily against Contingencies Reserve; and (e) the monthly average of the stores, materials, supplies and cash and bank balances held at the end of each month,

Less :

(i) the amounts written off or set aside on account depreciation of fixed assets and amounts written off in respect of intangible assets in the books of the undertaking;

(ii) loans advanced by the Board

(iii) debentures ;

(iv) security deposits of consumers held in cash ;

(v) the amount standing to the credit of the Tariff and Dividends Control Reserve;

(vi) the amount set apart for the Development Reserve ; and

(vii) the amount carried forward in the accounts of the licensee for distribution to consumers.

Clear Profit :

Clear Profit means the difference between the total income and the total expenditure plus specific appropriations. The Act defines the three terms - income, expenditure and appropriations. The provisions are set out below for ready undertakings in the form of an amount :-

Banking, Electricity, Insurance and Consequential Loss

Expenditure	*Rs.*	*Income*	*Rs.*
Cost of generation and purchase of energy		Gross receipts from sale of energy	
Cost of distribution and sale of energy			
Rent Rates and taxes (excluding taxes on income or profits)		Less discount applicable to sale	
Interest on loans advanced by the Board		Rental of meters and other apparatus hired to consumers	
Interest on debentures			
Interest on security deposits Bad debts		Sale and repair of lamps and Apparatus	
Auditor's fees		Rent, less outgoings not otherwise provided for transfer fee.	
Management expenses			
Depreciation			
Other expenses admissible under the Indian Income-tax Act and arising from ancillary or incidental to the business of electricity supply		Interest from investments, fixed and call deposits and bank balances.	
Contribution to Provident Fund, staff pension, gratuity and apprentice and other training schemes		Other receipts liable for tax Indian Income tax and arising from and ancillary or incidental to the business of electricity	
Business of electricity supply			
Bonus paid to the employees of the undertaking in accordance with the decision of labour tribunal or the State Government			
Balance of Profit c/d			
Appropriations		Balance of profit b/f	
Previous losses			
All taxes on income and profits Instalments in respect of intangible assets and expenses regarding issue of capital			
Contribution to Contingencies reserve			
Arrears of depreciation			
Development reserve			
Other appropriations permitted by the State Govt.			
Balance. being clear Profit			

Disposal of Surplus :

Should the clear profit exceed the reasonable return, the surplus has to be disposed of as under–

(a) One-third of the surplus not exceeding 5% of the reasonable return will be at the disposal of the undertaking ;

(b) of the balance, one-half will be transferred to "Tariffs and Dividends Control Reserve", and

(c) the balance will be distributed among consumers by way of reduction of rates or by way of special rebate.

Any electricity undertaking must so adjust rates that the amount of clear profit in any year does not exceed the reasonable return by more than 20% of the reasonable return,

Tariffs and Dividends Control Reserve:

This can be utilized when ever the clear profit is less than the reasonable return. The balance in the Reserve must be handed over to the purchaser of the undertakings, if it changes hands.

Contingencies Reserve :

A sum equal to not less than 1/4% and not more than 1/2% of the original cost of fixed assets must be transferred from the revenue account to Contingencies Reserves until it equals 5% of the original cost of fixed assets. The amount of the reserve must be kept invested in trust securities. The reserve can be utilised with the approval of the State Government for the following purposes :-

(a) to meet expenses or loss of profits arising out of accidents, strikes or circumstances beyond the control of the management ;

(b) to meet expenses of replacement or removal of plant or works other than the expenses necessary for normal maintenance or renewal , and

(c) to pay compensation payable under law for which no other provision has been made.

Any loss or profit on sale of fixed asset has to be transferred to Contingencies Reserve.

Development Reserve :

An amount equal to income-tax and super tax (calculated at current rates) which would have been paid but for the development rebate allowed by income-tax authorities on installation of new plant and machinery has to be transferred to the Development Reserve Account.

If, in any accounting year, the clear profit excluding the special appropriation together with the accumulations, if any, in the Tariff and Dividends Control Reserve less the amount to the credited to Development Reserve falls short of the reasonable return, the sum to be appropriated to the Development Reserve in respect of such accounting year may be reduced
by the amount of the shortfall. Appropriations to the Development Reserve may be made over a period of 5 years. Development Reserve can be invested only in the business of electricity supply of the undertaking. On a transfer of the undertaking, the reserve should be transferred to the purchaser.

General Reserve:

Section 67 lays down that after interest and depreciation have been provided, a contribution to general reserve shall be made at the rate of not exceeding 1/2% of the original cost of the fixed assets until the total of such reserve comes to 8% of the original cost of the assets. This applied only to the Electricity Boards though there is nothing to stop electricity companies from building up reserves.

2. Final Accounts

The final accounts of an electricity company are made every year up to 31st March and submitted to the State Government in the forms prescribed in Annexures IV and V of the Indian Electricity Rules, 1956. These forms are given below:

These forms are slightly different from the usual manner in which final accounts are prepared under Double Account System. A comparative chart is given below:

Double Account System	Electricity Companies
(i) Capital A/c	(i) Statement of share and loan Capital.
(ii) Revenue A/c	(ii) Statement of Capital expenditure
(iii) Net Revenue A/c	(iii) Statement of Operating revenue
(iv) General B/Sheet	(iv) Statement of Operating expenses
	(v) Statement of Net Revenue & Appropriation A/c
	(vi) General B/Sheet.

The student should particularly note Statements No. III. IV, X and XI. Statement No. III and IV together constitute Revenue Account.

Note : It should be noted that though the Companies Act permits preparation of the final accounts in the forms prescribed by the Electricity (Supply) Act, electricity companies usually present their final accounts to their shareholders in the form laid down by Schedule VI to the Companies Act. This is because the forms under the Companies Act are much more compact than those under the Electricity Supply Act. Returns to State Governments, however, must be in the forms laid down by the Electricity (Supply) Act. They are specified in the form of annexures stated below:

Summary of Technical and Financial Particulars for the year....

Statement of share and loan capital for the year ended 31st March, 19....

Statement of loan raised and redeemed for the year ended 31st March, 19

Statement of loan and other capital for the year ended 3 1st March, 19....

Statement of capital expenditure for the year ended 31st March, 19....

Statement showing the written down cost of fixed assets retained on account of obsolescence, inadequacy, superfluity, etc.

Statement of operating revenue for the year ended 31st March, 19....

Statement of operating expenses for the year ended 31st March, 19....

Statement of provision for depreciation for the year ended 31st March, 19....

Statement of contingencies reserve for the year ended 31st March, 19....

Statement of development reserve account for the year ended 31st March, 19....

Statement of tariffs and dividends control reserve account for the year ended 31st March. 19....

Statement of consumers' rebate reserve account for the year ended 31st March, 19....

Statement of special appropriation permitted by, state govt.

Statement of net revenue and appropriation account for the year ended 31st March, 19....

General Balance sheet as on 31st December, 19…

3. Double Accounting System:

The final accounts of public utility concerns, such as electricity companies, railways, water supplies, gas companies etc. are prepared following the double account system. Double Account System is a method of presenting the final accounts where a firm prepares two Balance Sheets instead of one. The chief features of the Double Account System are as follows:-

1. The ordinary balance sheet is split in two parts: Capital account : This records all receipt and expenditure on capital accounts. It shows the sources from which the fixed capital has been raised and the purposes for which it has been utilised. The purpose of this account is to give the general public full and complete information about raising and utilization of fixed capital. One part contains fixed assets and fixed liabilities. It is called "Receipt and Expenditure on Capital Account". On each side there are three columns for amount - one column to show figures up to the beginning of the year, the second column to show expenditure (assets) or receipts (liabilities) during the year and the third column to show total. The other part (called General

Balance Sheet) contains other assets and liabilities and the balance of the Receipts and Expenditure on Capital Account. In case of electricity companies, however, the total of the expenditure as per Capital Account is shown on the assets side and the total of receipts is shown on the liabilities side.

2. A Revenue Account is prepared which is like the ordinary Profit and Loss Account. Also, a Net Revenue Account is prepared which is like the ordinary Profit and Loss Appropriation Account. The exceptions are as follow: -
   (a) Interest in all cases is debited or credited to Net Revenue Account and not to Revenue Account. In case of Railways, rent on leased land, etc., is also debited to Net Revenue Account.
   (b) Depreciation is debited to Revenue Account and credited to Depreciation Reserve. Depreciation Fixed A/c appears on the liability side of the General Balance Sheet. The amount standing to the credit of depreciation fund is invested in securities outside the business. The depreciation fund and the corresponding depreciation fund investments are shown in the general balance sheet. The fixed assets are shown at cost in the capital account. For the sake of convenience of the readers, we are giving below the prescribed form of important accounts/statements in a concise and summarized manner:

ANNEXURE V

[Sec Section II and Rule 26(3)]

Electric Licence, 19……. Date of Commencement of Licence....

Name of undertaking……. Year of operation……

No. I

STATEMENT OF SHARE AND LOAN CAPITAL
for the year ended 31st March, 19...
(Applicable to Licensees other than Local Authority Licensees)

1 *Description of Capital*	*2* *Balance at the beginning of the year*	*3* *Receipts during the year*	*4* *Redeemed during the year*	*5* *Balance at the end of the year*	*6* *Remarks*
A. Share Capital Authorized	…	…	…	…	…
Issued	…	…	…	…	…
Subscribed	…	…	…	…	…
Called up capital	…	…	…	…	…
Less: Calls-in-arrears	…	…	…	…	…
Total paid up capital	…	…	…	…	…

B . Capital Reserve					
Share Forfeited a/c	...	...	...	...	...
Share Premium	...	...	...	...	...
Other Items	...	...	...	...	...
	...	...	...	...	...
(a) Loan Capital :					
Loan from State Electricity Board	...	...	...	...	...
Debentures	...	...	...	...	...
Unsecured Loans	...	...	...	...	...
Total Loan Capital	...	...	...	...	...
(b) Other Capital :					
Contributions from consumers including local authorities	...	...	...	...	...
Total Capital raised and Appropriated					
(A + B + C + D)	...	...	...	...	...

No. II Statement of Capital Expenditure for the year ended 31 March 19...

Particulars	*Balance at the Beginning of the year* Rs.	*Additions during the year* Rs.	*Retirements during the year vide Col. 3 statement IIA* Rs.	*Balance at the end of the year* Rs.	*Rem arks -*
A. Intangible Assets					
(a) Hydraulic Power Plant					
(b) Steam Power Plant					
(c) Internal Combustion Power Plant					
E. Transmission Plant (High or Extra High voltage)					
F. Distribution Plant-High Voltage					
G. Distribution Plant-Medium and low voltage					
(a) Public Lighting					
(b) General Equipment					
Total Capital Assets in use.					

The details of assets under each head of Capital Expenditure are as given below:

A. *Intangible Assets:*

1. Preliminary and Promotional Expenses.
2. Cost of Licence.
3. Other expenses, e.g. expenses incidental to conversion from D.C. to A.C. change of frequency, etc.

B. *Hydraulic Power Plant:*

1. Land and Rights.
2. Buildings and Civil engineering works containing generating and equipment.
3. Hydraulic works forming part of a hydroelectric system including :
   (i) dams, spillways, weirs, canals, reinforced concrete flumes and siphons.
   (ii) reinforced concrete pipelines and surge tanks, steel pipe lines, sluice gates, steel surge tanks, hydraulic control valves and other hydraulic works.
4. Water wheels, generators and ancillary equipment including plant foundations.
5. Switchgear including cable connections.

6, Miscellaneous power plant equipment.

7. Other civil works (to be specified)

C. *Steam Power Plant:*

1. Land and Rights.
2. Building and civil engineering works containing generating plant and equipment.
3. Boiler plant and equipment including plant foundations.
4. Engines, Turbines, Generators and ancillary equipment including plant foundations.
5. Water-cooling system comprising cooling towers and circulating water system.
6. Switchgear including cable connections.
7. Miscellaneous power plant and equipment.
8. Other civil works (to be specified)

D. *International Power Plant*

1. Land & Rights.
   (a) Buildings and civil engineering works containing generating plant and equipment.
   (b) Engines, Turbines, Generators and ancillary equipment including plant foundations.

(c) Water-cooling system comprising cooling towers and circulating water system.

(d) Switchgear including cable connections.

6. Miscellaneous power plant and equipment.
7. Other civil works (to be specified)

E. *Transmission Plant (High or Extra High Voltage)*

1. Land and Rights
2. Building and Structures including civil engineering works containing transmission plant and equipment.
3. Substation transformers. transformer kiosks, substation equipment and other fixed apparatus including plant foundations :

(i) transformers including foundations having rating of 100 kilo volt amperes and over.

(ii) other.

4. Switchgear including cable connection.
5. Tower, Poles, Fixtures, overhead conductors and devices

(i) Lines on steel or reinforced concrete supporters operating at normal voltage
higher than 13,2 kilovolts.

(ii) Other lines on steel or reinforced concrete supports.

(iii) Lines on wood supports.

6. (a) Underground cables and devices including joint boxes and disconnecting boxes.

(b) Cable duct system.

F. *Distribution Plant (High Voltage):*

1. Land and Rights
2. Building and Structures including civil engineering works containing transmission plant and equipment.
3. Substation transformers, transformer kiosks, substation equipment and other fixed apparatus including plant foundations :

(i) transformers including foundations having rating of 100 kilo volt amperes and over.

(ii) other.

4. Switchgear including cable connection.
5. Tower, Poles, Fixtures, Overhead conductors and devices

a. Lines on steel or reinforced concrete supporters operating at normal voltage higher than 13.2 kilovolts.

b. Other lines on steel or reinforced concrete supports.

c. Lines on wood supports.

6. (a) Underground cables and devices including joint boxes and disconnecting boxes.
   (b) Cable duct system.
7. Service lines.
8. Metering equipment.

G. *Distribution Plant (medium and Lower Voltage)*

1. Land and Rights
2. Building and Structures including civil engineering works containing transmission plant and equipment.
3. Substation transformers, transformer kiosks, substation equipment and other fixed apparatus including plant foundations :
   (i) transformers including foundations having rating of 100 kilo volt amperes and over.
   (ii) other.
4. Switchgear including cable connection.
5. Tower, Poles, Fixtures, Overhead conductors and devices
   (i) Lines on steel or reinforced concrete supporters operating, at normal voltage
   higher than 13.2 kilovolts.
   (ii) Other lines on steel or reinforced concrete supports.
   (iii) Lines on wood supports.
6. (a) Underground cables and devices including joint boxes and disconnecting boxes.
   (b) Cable duct system.
7. Service lines.
8. Metering equipment.

H. *Public Lighting Street and signal lighting systems :*

I. General Equipment (Not allocated to other sub-head)
   1. Land and Rights
   2. Building and Structures.
   3. Office Furniture and equipment.
   4. Transportation equipment.
   5. Laboratory and meter testing equipment.
   6. Workshop plant and equipment.
   7. Tools and work equipment.
   8. Communication equipment.
   9. Miscellaneous equipment.

No. IIA Statement showing the Written-down Cost of Fixed Assets retired on account of Obsolescence, Inadequacy, Superfluity, etc.

Particulars of Assets	*Written down cost of asset at the begi-ning of the year*	*Written down cost of assets retired during the year*	*Written down cost of assets sold sold during the year*	*Amount realised during the year*	*Excess of sale proceeds over written down cost transferred in Contin-gencies Reserve A/c vide Col. 4 of statement VI*
	Rs.	*Rs.*	*Rs*	*Rs.*	*Rs.*
1	*2*	*3*	*4*	*5*	*6*

No. III Statement of Operating Revenue for the year ended 31st March, 19....

Particulars of revenue	*Corresponding Amount for the previous year of account Rs.*	*Amount for the year of account Rs.*	*Remarks*
1	*2*	*3*	*4*
A. Net Revenue by the sale of Electricity for Cash and Credit:			
1. Domestic and residential			
(a) Lights and fans.			
(b) Heating and small power			
2. Commercial			
(a) Lights and fans.			
(b) Heating and small powers.			
3 Industrial :			
(a) Low and Medium Voltage.			
(b) High Voltage.			
4. Public Lighting			
5. Public Water-works and Sewage pumping.			

6. Irrigation.
7. Traction.
8. Supplies in bulk to distributing licensees

   Total Revenue by sale of electricity

B. Miscellaneous Revenue from consumers

1. Rent from
   (a) Meters.
   (b) Electric motors, fittings, appliances and other apparatus hired to consumers.
2. Service connection fees.
3. Public Lighting Maintenance.

   Total Miscellaneous Revenue from consumers

C. Other Revenues:

1. Sale of Stores.
2. Repair of lamps and apparatus.
3. Commission for collection of electricity duty.
4. Other miscellaneous items (to be specified).

   Total other revenue

   Total Operating Revenues

   Deduct

   Total Operating Expenses as per Statement IV

   Net Surplus or deficit carried to the Net Revenue and Appropriation A/c Statement X.

NO. IV Statement of Operating Expenses for the year ended 31st March,19...

Particulars of Expenses	*Corresponding amount for the previous year of account (Rs.)*	*Amount for the year of account (Rs.)*	*Remarks*
1	*2*	*3*	*4*
A. Hydraulic Power Generation			
(a) Operation			
(b) Maintenance			
(c) Depreciation			
Total Hydraulic Power Generation Exps.			
B. Steam Power Generation:			
(a) Operation			
(b) Maintenance			
(c) Depreciation			
Total Steam Power Generation Exps.			

C.	International Combustion Power Generation
	(a) Operation
	(b) Maintenance
	(c) Depreciation
	Total Internal Combustion Power Generation Expenses
D.	Power Purchased Total Production Expn. (A+B+C+D)
E.	Transmission(High or Extra Voltage)
	(a) Operation and maintenance
	(b) Deprecation on Transmission Plant and equipment (from statement V)
	Total Transmission Exps
F.	Distribution (High Voltage):
	(a) Operation and maintenance
	(b) Deprecation on Transmission Plant and equipment (from statement V)
	Total Distribution (H.V) Expenses
G.	Distribution (Medium & Low Voltage):
	(a) Operation and maintenance
	(b) Deprecation on Transmission Plant and equipment (from statement V)
	Total Distribution (M. and LV Exps)
H.	Public Lighting:
	(a) Operation and maintenance
	(b) Deprecation on Transmission Plant and equipment (from statement V)
	Total Public Lighting Expenses
(a)	Servicing, Meter Reading. Billing
	Connecting, Accounting, Sales Promotion, etc.
	Proportionate salaries, allowances, etc.
	Meter reading and inspection
J.	Rates and Taxes
K.	General Establishment Charges
	Total General Establishment charges
L.	Other Charges Total Other Charges
M.	Management Expenses
	Total Operating Expenses Transferred to Statement III

Statement X

Statement of Net Revenue and Appropriation Account for the year ended 31 March 19...

Figures for last year Rs.	*Particulars*	*Amount Rs.*	*Figures for last year Rs.*	*Particulars*	*Amount Rs.*
1.	To Balance of loss brought forward from last account		1.	By Balance profit brought forward from last account	
2.	To net operating deficit as per Statement III.		2.	By Net Operating surplus As per statement III	
3.	To appropriations (applicable to local authority licensee only)		3.	By interest on securities and investments.	
	(a) Interest on loan capital		4.	By Other receipts	
	(b) Instalment of redemption of loan capital, as per col.8 of Statement I-A(l)			(non operating), e.g. rents (less out goings not otherwise provided).	
4.	To Taxes on income and profit pd.		5.	By Balance or loss carried	
5.	To Instalment written down in respect of tangible assets.				
6.	To instalment of contribution towards arrears of depreciation, as per Statement V Column 6.				
7.	To Contribution towards contingencies Reserve as per Statement VI Columns 3.				
	(a) To Appropriation towards development reserve as per statement VII columns 4 or 8 or 4 plus 8.				
9.	To Appropriation to Tariffs and dividends Control Reserve, as per Statement VII column 3.				
	(b) To Appropriation to Consumers Rebate Reserve, as per Statement VIII column 4.				
	(c)To Other special appropriation permitted by the State Govt., as per Column 3 of Statement IX.				

(d) To Appropriation towards interest paid and accrued and dividends paid /payable.
(a) Interest on debentures.
(b) Interest on other secured loans.
(c) Interest on unsecured loans, advances, deposits, bank overdrafts etc.
(d) Dividends on preference share capital.
(c) Dividends on ordinary share capital.
To Balance of profit carried over.

General Balance Sheet as on 31 March,19.....

Figures for last year Rs.	*Particulars*	*Amount Rs.*	*Figures for last year Rs.*	*Particular*	*Amount Rs.*
1	Capital Reserve appropriated vide statement I or I-A		1.	Capital amount expended on Works in use Statement II.	
	Reserve and Surplus			Less : Accumulated provision for depreciation Statement V	
2.	Non Statutory Reserve.				
3.	Contingencies Reserve Fund as per Statement VI.			Net Block	
4.	Tariffs and Dividends Control Reserve as per Statement VII.		2.	Balance of written down cost of obsolete. inadequate etc.	
5 .	Consumers' Rebate Reserve as per statement VIII.			Current Assets:	
6.	Special appropriations (as permitted by the State Govt.) reserve as per Statement IX.		3.	Capital work-in-progress.	
			4.	Stores and materials in hand :	
7.	Balance of Net Reserve and Appropriations Accounts as per Statement X.			(a) Fuel-Coal and/or oil etc. at cost.	
	Current Liabilities and Provisions			(b) General Stores at or below cost,	
8.	Balance due on construction of Plant Machinery etc.		5.	Debtors for amount paid in advance on account of contracts,	
9.	Creditors on open accounts (as per schedule attached		6.	Sundry debtors for electricity supplied.	
10.	Consumers' security deposits				

11.	Accounts payable (to be specified)	7.	Other debtors (as per schedule attached)
12.	Temporary accommodations, bank overdraft	8.	Accounts receivable (to be specified)
		9.	Investments in statutory securities at cost :
			(a) Contingencies Reserve Fund Investment (Market value on cl. date)
			(b) Depreciation Reserve Fund Investment (Market value on cl. date)
			(c) Other Investments (Market value on cl. date)

Illustration 4:

The following balances are extracted from the Books of Account of Vidut Electric Supply Company Ltd., for the year ended 31st March, 1999:

Debit Balances

	Rs.
Licence	9,000
Land (addition during the year Rs. I 0,000)	2,10,000
Building	12,18,000
Plant and Machinery	2,04,000
Transformer substation	83,70,000
Mains-overhead and underground (additions during the year Rs. 17,70,000)	2,84,25,000
Meter House Service Connection (additions during the),ear Rs.2,25,000)	32,10,000
Furniture and Fixture (additions during the year Rs.21,000)	3,30,000
Motor Lorries (additions during the year Rs. 50,000)	3,15,000
Investments of Contingency Reserves (in Government Securities)	4,80,000
Purchase of Energy	62,25,000
Salaries and Wages	12,00.000

Repairs and Maintenance:		
Building	22,500	
Plant & Machinery	7,500	
Transformers	90,000	
Mains and Services	5,10,000	
Lorries	18,000	6,48,000
Establishment Expenses		19,95,000
Rent, Rates and Taxes		76,500
Conveyance and Traveling		60,000
Audit Fees		22,500
General Expenses		1,50,000
Electricity Duty		10,50,000
Directors: Fees and Allowances		25,500
Interest on Fixed Loans		3,52,500
Interest on Consumers 'Security' Deposits		1,20,000
Current Assets		33,00,000
Work-in-progress		19,20,000
Sundry Debtors		40,50,000
Cash and Bank Balances		21,00,000
Loans and Advances		10,50,000
Total		6,71,16,000

Credit Balances

Share Capital	*Rs.*
Equity Shares of Rs. 10 each	75,00.000
3,00,000 7 percent Preference share of Rs. 10 each	30,00,000
Reserve for Rebate to Consumers	2,11,500
Contingency Reserve	4,80,000
Tariff and Dividend Control Reserve	2,10,000
Development Reserve	9,18,000
Accumulated Depreciation	2,40,00,000
Balance of Net Revenue Account brought forward from previous year	22,500
Loan from State Government (secured by charge on Fixed Assets)	49,50,000
Loan from State Electricity Board	5,70,000
Sundry Creditors	25,74.000
Consumers' Security Deposits	48,00,000
Unclaimed Dividends	2,25,000

Sale of Energy	1,74,75,000
Rental of metres	1,05,000
Maintenance of Public Lamps	22,500
Hire on Machinery and Goods	37,500
Interest on bank accounts	15,000
Total	6,71,16,000

The following adjustments have to be made

(1)	Depreciation for the year	17,25,000
(2)	Provision for taxation	22,80,000
(3)	Transfer to Contingency Reserve	2,25,000
(4)	Transfer to Development Reserve	1,20,000

The amount of reasonable return may be presumed to be Rs. 11,94,000.

You are required to prepare Capital Account, Net Revenue Account and General Balance Sheet of the Vidvut Electric Supply, Company Ltd., in the prescribed form.

STATEMENT No. I

Statement of Share and Loan Capital for the year ended 31st March ,1999

1 Description of Capitol	*2* Balance at the beginning of the year-	*3* Receipts during the year	*4* Redeemed during the year	*5* Balance at the end of the year-	*6* Remarks
A. Share Capital Authorised	...	...	...	...	
Issued	...	...	...	...	
Subscribed Capital					
7,50,000 Equity Shares of Rs. 10 each	75,00,000	....	...	75,00,000	
3,00,000 7% Preference Shares of Rs. 10 each	30,00,000	...	...	30,00,000	
	1,05,00,000			1,05,00,000	
B. Capital Reserve					
C. Loan Capital Loan from State Govt.	49,50,000	...	...	49,50,000	
State Electricity, Board	5,70,000	...	...	5,70,000	
	55,20,000	...	...	55,20,000	

Other Capital Total Capital raised and Appropriated (A+B+C+D)	1, 60,20,000	…	…	1,60,20,000

STATEMENT No. II
Statement of Capital Expenditure for the year ended 31 March 1999

	1 *Particulars*	2 *Balance at the Beginning of the year*	3 *Addition during the year*	4 *Retirements during the year vide col. 3 statement IIA*	5 *Balance at the end of the year*	6 *Remarks*
A.	Intangible Assets					
	Licence	9,000	–	–	9,000	
B.	Hydraulic power plant –		–	–	–	
C.	Steam Power Plant					
D.	Internal Combustion Power Plant					
E.	Transmission Plant:					
	Land	2,00,000	10,000	–	2,10,000	
	Buildings	12,18,000	–	–	12,18,000	
	Machinery	2,04.000	–	–	2,04,000	
F.	Distribution Plant					
	High Voltage	–	–	–	–	
G.	Distribution Plant Medium and low voltage Mains	2,66,55,000	17,70,000	–	2,84,25,000	
	Transformers	83,70,000	–	–	83,70.000	
	Meter–House–Services Connection	29,85,000	2,25,000	–	32,10,000	
H.	Public Lighting	–	–	–	–	
I.	General Equipment					
	Furniture &Fixtures	3,09,000	21,000	–	3,30,000	
	Motor	2,65,000	50,000	–	3,15,000	
	Total Capital Assets in use	4,02,15,000	20,76,000	–	4,22,91,000	

Note : In the absence of separate details regarding assets under different heads, they have been shown under headings clubbed together.

STATEMENT No. III

Statement of Operating Revenue for the year ended 31st March, 1999

Particulars of revenue	*Corresponding amount for the previous year of account*	*Amount for the year of account*	*Remarks*
1	*2*	*3*	*4*
	Rs.	*Rs.*	
(a) Net Revenue by Sale of Electricity for Cash and Credit			
1. Domestic and residential:			
2. Commercial:			
3. Industrial:			
4. Public Lighting:			
5. Public Water-works & Sewage pumping:	1,74,75,000		
6. Irrigation:			
7. Traction:			
8. Supplies in bulk:			
B. Miscellaneous Revenue from Consumers:			
Rental of Meters	1,05,000		
Maintenance of public lamps	22,500		
C. Other Revenues:			
Hire on machinery and goods	37,500		
Total Operating Revenues	1,76,40,000		
Deduct:			
Total Operating Expenses as per Statement IV	1,31,77,500		
Net Surplus carried to Net. Revenue and Appropriation A/c	44,62,500		

STATEMENT NO. IV

Statement of Operating Expenses for the year ended 31st March, 1999

	Particulars of Expenses 1	*Corresponding amount for the previous year of account* 2 Rs.	*Amount for the year of account* 3 Rs.	*Remarks* 4
A.	Hydraulic Power Generation	–	–	–
B.	Steam Power Generation	–	–	–
C.	Internal Combustion Power Generation	–	–	–
D.	Power Purchased Total Production		62 25.000	
	(A+B + C+D)		62,25,000	
E.	Transmission (High or Extra	–	–	–
	High Voltage)	–	–	–
F.	Distribution (High Voltage) –	–	–	–
G.	Distribution (Medium and Low	–		–
	Voltage) Salaries and Wages	–	12,00,000	–
	Repairs and Maintenance	–	6,48,000	–
	Total Distribution costs	–	18,48,000	–
H.	Public Lighting	–	–	–
I.	Consumers Servicing, Meter Reading,			
	tilling Connecting, Accounting	–	–	–
J.	Rates and Taxes	–	–	–
K.	General Establishment Charges			
	Establishment charges	–	19,95,000	–
	Rent, Rates and Taxes	–	76,500	–
	Conveyance and Traveling	–	60,000	–
	Audit Fees	–	22,500	–
	General Expenses	–	1,50,000	–
	Electricity Duty		10,50,000	
	Total General Establishment Charges		33,54,000	
L.	Other Charges Depreciation		17,25,000	–
M.	Management Expenses			
	Directors fees	–	25,500	–
	Total Operating Expenses			
	Transferred to Statement III		1,31,77,500	

STATEMENT - X
Statement of Net Revenue and Appropriation Account for the year ended 31 March 1999

Figures for last year Rs.	*Particulars*	*Amount Rs.*	*Figures for last year Rs.*	*Particulars*	*Amount Rs.*
	To Appropriation to Tariff and Dividend control reserve	63,150		By Balance of profit brought forward from last account.	22,500
	To Provision for Taxation	22,80,000		By Balance brought from Revenue A/c	44,62,500
	To Appropriation to Development Reserve	1,20,000		By Interest on Bank A/c	15,000
	To Appropriation to consumers Rebate Reserve	63,150			
	To Interest on Security Deposits	1,20,000			
	To Interest on Fixed Loans	3,52,500			
	To Appropriation to Contingency Reserve	2,25,000			
	To Balance of profit carried over	12,76,200			
		45,00,000			45,00,000

General Balance Sheet as on 31st March, 19......

Figures for last year Rs.	*Particular*	*Amount Rs.*	*Figures for last year Rs.*	*Particulars*	*Amount Rs.*
1,60,20,000	Capital Reserve and appropriated vide Statement No 1	1,60,20,000	4,02,15,000	Capital amount expended on Works in use- Statement It.	4,22,91,000
	Reserve and Surplus:			Less: Accumulated provision	
4,80,000	Contingency Reserve	7,05,000	2,40,00,000	for depreciation	2,57,25,000
			1,62,15,000	Net Block	1,65,66,000
2,10,000	'Tariffs and Dividends Control Reserve	2,73,150		Balance of written down cost of obsolete.. inadequate etc.	
2,11,500	Consumers' Rebate Reserve	2,74,650		Current Assets:	
	Development				

9,18,000	Reserve	10,38,000	Capital WIP	19,20,000
22,500	Net Revenue Account	12,76,200	Sundry Debtors	40,50,000
	Current Liabilities and Provisions :		Investment of Contingencies Reserve. (Market Value)	4,80,000
	Sundry Creditors	25,74,000		
	Consumers Security Deposit	48,00,000	Cash & Bank Balances	21,00,000
	Unclaimed Dividends	2,25,000	Loans and Advances	10,50,000
	Provision for Taxation	22,80,000	Other Current Assets	33,00,000
		2,94,66,000		2,94,66,000

Working Note:

	Rs.
Profit after interest or clear profit	13,80,000
Reasonable Return	11,94,000
Surplus	1,86,000
1/3 of surplus, i.e. Rs.62,000 subject to 5% of Reasonable Return is to remain at the disposal of the undertaking	59,700
Balance	1,26,300
1/2 of the balance to Tariff and Dividend Control	63,150
Balance available for benefit of consumers	63,150

Replacement of Asset:

Ordinarily, the amount standing in books against an asset is written off when the asset is replaced by another. The amount spent on the new asset is capitalised. Under the Double Account System, however, the practice is different, Firstly, the account of the asset which is replaced is not affected at all. An appropriate amount out of the new expenditure is charged to revenue or written off and the balance is capitalised. Secondly, the amount to be written off is the amount which would have been spent had the asset been acquired now. Suppose, a railway station built in 1990 at a cost of Rs.3,00,000 is replaced, in 1996, by a new station costing Rs. 16,00,000, Suppose further that between 1990 and 1996, prices of materials have risen to 2.50%, that labour rates have trebled and that the proportion of materials and labour in the old station is 4.6.

The amount to be written off will be arrived at as under

Total cost of the old station		3,00,000
Proportion of Materials	3,00,000 × 4/10 or	1,20,000
Proportion of Labour	3,00,000 × 6/10 or	1,80,000

Had the station been built in 1996,		
Materials would have cost, and	1,20,000 x 250/100	3,00,000
Labour would have cost	1,80,000 x 3	5,40,000
Total		8,40,000

Out of Rs. 16,00,0000 spent in 1996, Rs. 8,40,000 would be written off and Rs.7,60,000.i.e. (16,00,000 – 8,40,000) would be capitalised. The total amount capitalised is Rs. 10,60,000 i.e. Rs. 3,00,000 + Rs. 7,60,000.

The entries to be made are as follows —

1. Debit Replacement Account with the amount to be written off, Debit Works Account (new) with the amount to be capitalised and Credit Bank with the amount actually spent.
2. If any old materials have been used in the new construction : Debit Works Account Credit Replacement Account
3. If any old materials have been sold.

   Debit Bank

   Credit Replacement Account.

The logic behind the treatment outlined above is firstly, that additional amount should be capitalised only if there is additional capacity and, secondly, that, when an old asset is replaced, the amount lost is the asset present value rather than its historical cost.

Illustration 5:

The Hindustan Gas Company rebuilt and reequipped part of their works at a cost of Rs. 5,00,000. The part of the old works thus superseded cost Rs. 3,00,000. The capacity of the new works is double the capacity of the old works. Rs.20.000 is realised by the sale of old materials, and old materials worth Rs. 10,000 are used in the construction of the new works and included in the total cost of Rs. 5,00,000 mentioned above, The costs of labour and materials are 25% higher now than when the old works were built. Journalise the entries.

Solution:

Journal

Particulars		*Dr* *Rs*	*Cr* *Rs*
Replacement Account	Dr.	3,75,000	
New Works Account	Dr.	1,15,000	
To Bank			4,90,000
Being the amount written off (Rs. 3,00,000 + 25%) and the amount capitalised out of the Rs. 4,90,000 spent on reconstruction in cash i.e.,5,00,000 - 10,000)			

New Works Account	Dr.	10,000	
To Replacement Account			10,000
(Being the materials used in the new works)			
Bank	Dr.	20,000	
To Replacement Account			20,000
Being the amount realised by the sale of old materials.			

6.3 ACCOUNTS OF INSURANCE COMPANIES

In order to provide some coverage for the risk exposure of the business especially from fire a businessman takes an insurance policy. Usually two types of losses are covered under the policy.

(i) loss of stock, plant, buildings etc. and

(ii) loss of profits due to dislocation of the business.

Loss of Stock

A fire insurance policy compensates the insured for any loss that he may suffer on account of loss of stock due to fire inconsideration of a certain amount being paid as premium. The value of stock lost on account of fire can be determined by finding out the value of stock on the date of fire less the value of the salvaged stock.

The value of stock can also be ascertained by compiling a Memorandum Trading Account wherein balancing figure will be value of stock.

Factors determining amount of claim.

(i) *Rate of Gross profit:* The rate of gross profit is determined on the basis of the performance of the business during the preceding 3-4 years. Abnormal factors during the same period are eliminated. If gross profit percent reflects a definite trend weighted average method is employed for finding the average gross profit.

(ii) *Average clause:* The insurance company in order to discourage under-insurance limits its liability to the proportion of the actual amount of loss which the insured amount bears to the actual value of the property e.g.. stock work Rs. 1,00,000 is insured only for Rs.80,000 and if the loss amount to Rs.10,000, the claim will be

= Amount of Loss × (Amount of Policy ÷ Actual value of stock)

= 20,000 × (80,000 ÷ 1,00,000) = Rs.16,000

The average clause is applicable only if it is proved that the loss sustained by the insured is less than the sum insured. However, when the loss is more than the sum insured, the insured can recover the whole amount in spite of the average clause.

Illustration 6:

Kamal Fair Price Shop suffered loss of stock due to fire on August 20,1997. From the following particulars calculate claim to be made by the shop:

1.	Stock on December 31,1995 (including stock purchased during the year at Rs.8,000 valued at Rs.4,000 because of poor selling price)	1,00,000
2.	Wages paid - 1996 (including wages paid for the construction of a showroom for which worker of the factory worked, Rs, 2,000. Manufacturing wages Rs. 1,500 were outstanding)	3,01,000
3.	Freight inwards - 1996	5,000
4.	Purchases - 1996 (including purchases of furniture of Rs. 1500 wrongly passed through invoice book)	1,20,000
5.	Sales - 1996 (including sale of 1/4 of the stock at Rs. 1000. which had a poor selling line and which was valued at Rs.4000 on Dec. 31,1995)	2,46,000
6.	Stock on December 31,1996 (including remaining stock which had a poor selling line at the same value)	42,000
7.	Purchases - up to August 20,1997	1,42,800
8.	Sales - up to August 20,1997 (including sale of the 1/3 remaining stock which had a poor selling line at Rs.800).	1,42,900

The remaining stock which had a poor selling line, was considered, at 80 % of the original cost for the purpose of claim. The salvage was Rs. 47,400. The shop had taken the policy of Rs. 40,000. There was an average clause in the policy.

Solution :

Statement of Normal Gross Profit for 1996

Sales (exceeding poor line sale of Rs. 1000)		Rs. 2,45,000
Less: Cost of goods sold (other than of poor line)		
Opening Stock (excluding poor line)	96,000	
Purchases (excluding furniture of Rs. 1500)	1,18,500	
Wages (paid Rs.30000 plus outstanding Rs, 1500		
Less: for showroom construction Rs.2000)	29,500	
Freight	5,000	
	2,49,000	
Less: Closing Stock (excluding Rs. 3000 of poor line)	39,000	2,10,000
Gross Profit (G.R)		35,000
G.P. Ratio to sales (35,000/2,45,000) = 1/7		

Statement of Unsold Stock on August 20, 1997 (date of Fire)

Stock as at 1 January, 1997 (excluding of poor line	39,000	
Add: Purchase to date of fire	1,42,800	
Cost of goods available for sale (excluding of poor line)		1,81,800
Less: Cost of sales (or normal selling line) up to fire date;		
Sales (excluding Rs.800 of poor line)	1,42,100	
Less: 1/7 being gross profit:	20,300	1,21,800
Stock of normal selling line at fire date		60,000
Add: Admissible value of poor line stock i.e.80% of the original		
cost of Rs.4000 remaining unsold up to date of fire)		3,200
		63,200
Less: Salvage		47,400
Stock Lost by fire		15,800

Amount of claim having regard to average clause :

Lost Stock × (Policy Amount ÷ Stock at fire date)

= 15,800 × (40,000 ÷ 63,200) = Rs. 10,000

6.4 LOSS OF PROFITS OR CONSEQUENTIAL LOSS

Fire results not only in loss of property but also loss of profits to the business on account of its dislocation. Such a loss can be got covered by taking a loss of profits policy..

Amount of Policy

Considerable care should be exercised in determining the amount for which a loss policy should be taken. The policy should adequate to cover the likely amount of loss, which the insured may suffer on account of dislocation of the business. The policy specifics both the period as well as the amount it covers. While determining the amount of policy the insured should take into account not only the amount of net profit, he earns but also the amount of standing or fixed charges which have been charged against the revenue for determining the amount of net profit. Of course, he may not get such incomes covered by the insurance policy which will not be affected by dislocation of his business on account of fire. e.g. income from investments, rent from the property let out etc.

Computation of Claim:

Loss of profit occurs because of loss of sales on account of dislocation of the business. Moreover, the insured may have to incur certain additional expenses to mitigate the amount of loss. There may also be certain savings in expenses of the business because of its being closed down for some period. All these have to be taken into account while calculating the amount of insurance claim. This has been explained below:

1. *Short sales:* The term *short sales* refers to the loss of sales on account of fire resulting in dislocation of business. This is the difference between the "standard turnover" and the "actual turnover" during the period of fire.

   Computation of short sales requires the understanding of the following terms

   (a) *Standard turnover:* The term *standard turnover* refers to the turnover for the period corresponding with the indemnity period during the preceding accounting year adjusted in view of the trends noticed during the accounting year in which the fire occurred.

   (b) *Indemnity Period:* The term *indemnity period* refers to the period beginning with the occurrence of the damage and ending not later than 12 months there after during which the results of the business shall be affected in consequence of the damage. This period is selected by the insured himself. It is not necessary for the policy to cover the entire indemnity period. Of course, it is essential that on the date of fire leading to partial or complete closure of the business activity the policy must be in force.

Illustration 7:

Fire occurs on 1st March, 1999 resulting in dislocation of the business activities for a period of 3 months. During the same period the sales in the last year amounted to Rs.10000. However, during the current year beginning with 1st January 1999, the sales were showing an increasing trend of 10%. The actual sales during the period of dislocation amounted to Rs. 4000. Calculate the short sales.

Solution:

Computation of short sales	*Rs.*
Standard turnover (Rs.10,000 + Rs.1,000)	11,.000
Less: Actual sales during the period of dislocation	4,000
Short sales	7,000

2· Rate of gross profit: The term gross profit has got a different meaning than that in which it is commonly understood. It is ascertained as follows:

   Net Profit + Insured Standing Charges × 100 / Turnover

   All the figures relating to net profit, insured standing charges and turnover relate to the last period.

   In case of net loss the rate of gross profit will be determined as follows

   Insured standing charged - Net loss × 100 / Turnover

   If all the standing charges are not insured, the amount of net loss will have to be reduced as follows:

   Net loss × Insured standing charges/All standing charges

3. *Loss due to short sales:* The loss due to sales is calculated by applying the rate of gross profit to short sales. For example, if the short sales are Rs.7000 and the rate of gross profit 20% the loss of profit on account of short sales amounts to Rs.1400 i.e. Rs.7000 × 20/100

4. *Increased cost of working:* The insured may have to incur certain, additional expenses to keep the business running during the indemnity period. Such increased working expenses will be allowed subject to the limit which is lower of the two figures calculated as follows.

   (a) (Net Profit + Insured Standing Charges) × Increased cost of working ÷ Net Profit + All Standing Charges

   (b) Short sales avoided through increased cost of working × Rate of gross profit

5. *Saving in expenses:* Any saving in expenses will have to be deducted from the amount calculated as explained above.

6. *Average clause :* Finally the amount calculated will be proportionally reduced if the sum insured under the policy is less than the amount for which the policy should have been taken.

The amount for which the policy should have been taken is determined by applying the rate of gross profit to the turnover for 12 months immediately preceding the date of fire. Such turnover may have to be adjusted keeping in view, the trend of sales in the accounting year in which the fire occurs.

Illustration 8 :

Short sales	20,000
Increased working expenses	1,000
Rate of gross profit	20%
Saving in expenses	200
Sales during 12 months immediately preceding the fire	1,00,000
Amount of policy	15,000

The sales are showing an increasing trend of 10% since the commencement the accounting year.

Calculate the amount of claim to be admitted by the insurance company.

Solution:

Loss of profit due to short sales : (20,000 × 20/100)	4,000
Increased working expenses	1,000
	5,000
Less: Saving in expenses	200
Claims for loss of profit and increased working expenses	4,800
However, the above claim will be subject to the average clause Amount for which the policy should have been taken : (1,10,000 x 20 / 100)	22,000
Amount for which the policy has been taken	15,000

Amount of claim to be admitted by the insurance company

= (Amount of claim × Amount of policy) ÷ Amount for which the policy should have been taken

= 4,800 × 15,000/22,000 = Rs. 3,273

Illustration 9:

A fire occurred in the premises of a businessman on 31st January, 1997, which destroyed most of the building. However, stock worth Rs. 5,940 was salvaged. The company insurance policy covers the following:

Stock	Rs. 9,00,000
Building	Rs. 12,00,000
Loss of Profit (including standing charges)	Rs. 3,75,000
Period of indemnity - six months	

The summarised Profit & Loss Account for the year ended 31st December,1996

Turnover		30,00,000
Closing Stock		7,87,500
		37,87,500
Opening Stock	6,18,750	
Purchases	27,18,750	
Standing Charges	2,51,250	
Variable Expenses	1,20,000	37,08,750
		78,750

The transactions for the month of January, 1997 were as under:

Turnover	1,50,000
Payments to Creditors	1,60,020
Trade Creditors: Balance as on 1/1/1997	2,26,000
Trade Creditors Balance as on 31/1/1997	2,30,980

The company's business was disrupted until 30/4/1997, during which period the reduction in turnover amounted to Rs. 2,70,000 as compared with the turnover of same period corresponding in the previous year.

Building was worth Rs.15,00,000 on the date of fire and three quarters of its value was lost by fire. You are required to submit the claim for insurance for loss of stock, loss of building and loss of profit.

Solution:

(1) *Claim for loss of stock*

Memorandum Trading Account for the month ending 31st January, 1997

To	Opening stock	7,87,500	By	Sales	1,50,000
To	Purchases I Note 4 (ii)	1,65,000	By	Closing stock	
To	Gross Profit @15%	22,500		(balancing figure)	8,25,000
		9,75,000			9,75,000

Closing stock as on 31st January, 1987	8,25,000
Less : Stock Salvaged	5,940
Claim for stock	8,19,060

(2) *Claim for loss of profit*

Short sales	2,70,000
Gross Profit Ratio [Note (iii)]	11%
Gross Profit on Short Sales	29,700

(3) Claim for loss of Building:

Loss of Building, 3/4 of Rs 15,00,000 = 11,25,000

This building is insured for Rs.12,00,000 only

Hence, the claim will be subject to the average

clause presuming that the policy contains such a clause.

(3) Amount of claim = (Amount of Loss × Sum Assured)/Value of the Property

= 11,25,000 × (12,00,000 ÷ 15,00,000) = Rs.9,00,000

(4) Total Claim (8,19,060 + 29,700 + 9,00,000) = Rs.17,48,760

Working Notes:

Rate of Gross Profit for the year ending 31st December l 996

(i) **Trading Account for the Year ending 31st December 1996**

To	Opening Stock	6,18,750	By	Sales	30,00,000
To	Purchases	27,18,750	By	Closing stock	7,87,500
To	Gross Profit	4,50,000			
		37,87,500			37,87,500

Rate of Gross Profit comes to 15% (i.e. Rs. 4,50,000 / 30,00,000)

(ii) **Total Creditors Account**

1987	To Bank	1,60,020	1987	By Balance	2,26,000
Jan. 31	To Balance c/d	2,30,980	Jan.1	By Purchases	
		–		(balancing figure)	1,65,000
		3,91,000			3,91,000

(iii) Calculation of Gross Profit Ratio for Loss of Profit:

Sales for 1986		30,00,000
Net Profit + Insured standing charges		
Net Profit	78,750	
Standing Charges (assumed all insured)	2,51,250	3,30,000
Rate of gross profit (3,30,000 / 30,00,000)	11%	

6.5 QUESTIONS WITH SKELETON ANSWERS

1. Write short notes on the following : -
   (b) Non-Performing assets.
   (c) Classification of Advances in the case of a banking company.
   (d) Sub system of Posting.
2. The following are the ledger balances of X Bank Limited owning its premises. You are required to prepare Profit and Loss Account and Balance Sheet as on 31st March. 1992 as per the banking regulation Act. Also append the usual Auditors certificate to Profit and Loss Account and the Balance Sheet.

	(Rs. in '000)
Share Capital 20000000 of Rs.1000 each 100 paid up	20,00,000
Bad debts written off	1,28,710
Reserve Fund Investments	10,00,000
General Expenses	1,82,420
Current Account	2,02,44,220
Interest paid	1,60,520
Profit and Loss Account balance b/f	2,29,340
Acceptances for customers	15,42,820
Discount	2,43,760
Endorsements and Guarantees	74,020
Commission	44,240
Cash	2,26,540
Interest received	5,32,260
Cash with Reserve Bank	20,12,100
Endorsements and Guarantees per contra	74,020
Owing by foreign correspondents	2,00,440
Customers' Liabilities for acceptances	15,42,820
Short Loans	64,82,060
Loans and advances to customers	1,54,56,700
Investments	98,82.540
Bills discounted	62,28,240
Non-banking assets (estimated liabilities value Rs. 1,95,000)	2,10,000

Note: Reserve Rs.643,80,000 for rebate on bills discounted. The Profit and Loss Account balance in the balance left on that account after the payments of interim dividend of Rs. 20,00,00,000.

[Value of premises Rs. 200,79,00,000, Net Profit 26,92,30.000 ; Total of Balance Sheet Rs. 38,82.63,00,000]

3. Fire occurred in the premises of AB&C Company on 1st September, 1990 and stock of the value of Rs. 1,01,000 was salvaged and the business books and records were saved. The following information was obtained: -

Purchases for the year ended 31st March, 1990	6,80,000
Sales for the year ended 31st March, 1990	11,00.000
Purchases from 31st March to 1st September, 19990	2,50,000
Sales from 31st March to 1st September, 1990	3,60,000
Stock on 3 1st March, 1989	3,00,000
Stock on 3 1st March, 1990	3,40,000

Further information is that stock on 31st March, 1990 was overvalued by, Rs. 20,000. Calculate the amount of the claim to be presented to the Insurance Company, in respect of the loss. In April, 1990 selling price was lowered by 10% (Gross Profit to Sales Ratio 4,40,000 x 100 / I 1,00,000 = 40% 1989-90

Expected Gross Profit ratio 30 x 100 / 90 = 33 -1/3% 1990 -91

As New Selling Price = 100 - 10 = 90

Gross Profit = 40 - 10 = 30

Stock on 1st September 1990	Rs. 3,30,000
Less: Stock Salvaged	1,01,010
Claim for insurance	2,29,000

4. The Bharat Fisheries Limited insure their fleet of boats with Marine Insurance for Rs.20,00,000 through an official Broker. Premium is charged at the rate 8% and brokerage at 5%, discount is allowed at the rate of 10%.

During the period of the cover, as a result of collision of one of the company's vessels Hero is damaged and the damage is assessed at an agreed amount of Rs. 20,000. Another vessel Pawan strikes against a submerged rock and is totally wrecked. The amount of loss is assessed at Rs. 70,000 without considering salvage value. Salvage Rs.5,000 is retained by the Shipping Company. Book value of Pawan is Rs. 80,000.

The Broker collects the amounts due from the Insurance and make over the collections, less their collection commission @ 1% to the shipping company. All payments are duly made and received. Write up the Journal entries and show the transactions in the company's books.

Insurance Premium Gross 8% of Rs. 20,00,000				Rs. 1,60,000
Less:	10% of discount calculated on			
	Gross	1,60,000		
Less:	5% brokerage	8,000		
		1,52,000	@ 10%	15,200
				1,44,800

Journal Entries

Insurance Premium	Dr	1,44,800	
To Broker			1,44,800
Broker	Dr	1,44,800	
To Bank			1,44,800
Broker	Dr	20,000	
To Repairs to Hero			20,000
Broker	Dr	65,000	
Salvage	Dr	5,000	
Marine Loss	Dr	10,000	
To Pawan			80,000
Commission	Dr	850	
To Broker			850
Bank	Dr	84,150	
To Broker			84,150
(20,000 + 65,000 – 850)			

5. T Electricity Company earned a profit of Rs.16,90,000 during the year ended March 31,1990, after debenture interest at 7-1/2% on Rs.5,00.000 with the help of the figures given below. Show the disposal of the profits. Assume the bank rate to be 5%.

Original cost of fixed assets	2,00,00,000
Formation and other expenses	10,00.000
Monthly average of fixed assets 50.00,000	
Reserve Fund (represented by 4% Govt. securities)	20,00,000
Contingencies Reserves Investments	5,00,000
Loan from Electricity Board	30,00,000
Total depreciation written off to date	40,00,000
Tariffs & Dividends Control Reserve	1,00,000
Security Deposits received from customers	4,00,000

[Rs. 1,23,437 due to customers]

6. The premises of a company were partly destroyed by fire which took place on 1st March, 1992 and as a result of which the business was disorganized from 1st March to 31st July, 1992. Accounts are closed on 31st December every year. The company is insured under a loss of Profits Policy for Rs.7,50,000. The period of indemnity specified in the policy is 6 months. From the following information you are required to compute the amount of claim under the loss of Profits Policy.

	Rs.
Turnover for 1991	40,00,000
Net profits for the year 1991	2,40,000
Insured standing charged	4,80,000
Uninsured standing charges	80,000
Turnover during the period dislocation i.e. from 1/3/1992 to 31/7/1992	80, 000
Standard turnover for the same period in the preceding year i.e. 1/3/91 to 31/7/91	20,00,000
Annual Turnover for the year immediately preceding the fire i.e. 1/3/91 to 29/2/92	44,00,000
Increased cost working	1,50,000
Savings in insured standing charges	30,000
Reduction in turnover avoided through increased working cost	4,00,000

Owing to reasons acceptable to the insurer the, "special circumstances clause" stipulates for –

(a) Increase of turnover (standard and annual) by, 10% and

(b) Increase of rate of gross profit by 2%.

[Gross Profit Ratio = 20% Amount of claim = Rs. 2,55,680]

7. The premises of Sulav Enterprise, a proprietary concern, were damaged by fire on 12th February, 1998. As a result, some trading stock was totally destroyed, and, in addition, stock costing Rs. 96,000 was partly damaged. The insurance company agreed to reduce the value of the damaged stock by Rs. 52,800. On 31st December, 1997, the stock-in-trade of the concern was valued at Rs. 4,12,000. Subsequently the following purchases were made :

	Rs.
8th January, 1998	1,09,920
21st January, 1998	72,000
27th January, 1998	5,360
14th February, 1998	42,400
20th February, 1998	2,24,000
8th March, 1998	1,37,600

Additional information for the three months ended on 31st March, 1998 are given below.

(a) 50 per cent of the damaged goods were sold before 31st March, 1998 at a profit of 15%.

(b) With the exception of the damaged goods, the firm has earned a gross profit of 30% of the cost of goods sold.

(c) The sales during the three months ended 31st March, 1998, were Rs. 6,54,360.

(d) The undamaged stock at 31st March, 1998, was valued at Rs. 2,03,280.

(e) The firm has an insurance cover for loss and damage to stock by fire.

Prepare a statement of insurance claim.