



ACCOUNTANCY (320)

CHAPTERWISE NOTES



General Journal Entry				
Date	Particulars	L.F.	Debit	Credit
	Cash		1,000	
	Capital			1,000
	Cash		200	
	Capital			300



ACCOUNTANCY

Sl. No.	Module	Chapters (Public Examination)	Marks
1	Module 3: Financial Statements	L-16 Financial Statements: An Introduction; L-17 Financial Statements -I; L-18 Financial Statements -II; L-19 NPO: An Introduction; L-20 Financial Statements (NPOS); L-21 Accounts from Incomplete Records	20
2	Module 4: Partnership Accounts	L-23 Admission of a Partner; L-24 Retirement and Death of a Partner; L-25 Dissolution of a Partnership Firm	20
3	Module 5: Company Accounts	L-27 Issue of Shares; L-28 Forfeiture of Shares; L-29 Reissue of Forfeited Shares	20

Component	Details	Marks
Public Exam (Selected Modules - 3,4,5)	Total Chapters : 12	60
Practical Exam	NA	0
TMA	Tutor Marked Assignment	20
Final Possible Marks		80 Marks

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FINANCIAL STATEMENTS

Introduction

Financial statements are the final summary reports prepared at the end of an **accounting period**. They consist of the **Trading and Profit & Loss Account** to ascertain true profitability, and the **Balance Sheet** to present the exact financial position. Their accurate preparation requires proper classification of capital and revenue items, along with the incorporation of essential year-end **accounting adjustments**.

Meaning and Objectives of Financial Statements

Meaning: Financial statements are formal, basic annual reports through which a business enterprise communicates its financial information to its various user groups.

Objectives:

- To ascertain the true financial performance (net profit earned or net loss incurred) of the business during a specific accounting period.
- To present a true and fair view of the financial position (assets and liabilities) of the enterprise on a particular closing date.
- To provide reliable financial information to various interested users to help them make rational economic decisions.
- To judge the operational efficiency and managerial effectiveness of the business operations over the year.

Importance of Financial Statements

- They serve as a reliable indicator of the financial health and earning capacity of the business.
- They help management in future planning, budgeting, and policy-making.
- They provide a basis for credit assessment by banks and financial institutions.
- They are essential for determining the correct tax liability by government authorities.



Users of Financial Statements

- **Internal Users:** Management (for planning/operational decisions), Employees (for wage negotiations/job security), Owners (for profitability/safety of invested capital).
- **External Users:** Investors (to evaluate risk/return), Creditors/Banks (to assess repayment capacity), Government (to evaluate tax liabilities).

Capital and Revenue

- **Capital Expenditure:** Amount spent on acquiring or improving fixed assets. It benefits the business for multiple years and is shown on the Assets side of the Balance Sheet.
- **Revenue Expenditure:** Amount spent on day-to-day business operations. Its benefit expires within one year and is debited to the Trading or P&L A/c.
- **Deferred Revenue Expenditure:** A heavy revenue-natured expense whose benefit extends over several future years (e.g., massive advertising).

Difference between Capital and Revenue Expenditure:

1. **Earning Capacity:** Capital expenditure increases the earning capacity of the business, whereas revenue expenditure only maintains the existing earning capacity.
2. **Period of Benefit:** The benefit of capital expenditure extends for more than one year, while revenue expenditure's benefit expires within one year.
3. **Recording:** Capital expenditure is shown on the Assets side of the Balance Sheet. Revenue expenditure is debited to the Trading or Profit & Loss Account.

Difference between Capital and Revenue Receipts:

1. **Nature:** Capital receipts (like loans or sale of fixed assets) are non-recurring, whereas revenue receipts (like sale of goods) are recurring in nature.
2. **Recording:** Capital receipts are shown in the Balance Sheet, while revenue receipts are credited to the Trading or Profit & Loss Account.



Income Statement: Trading Account

- **Meaning:** A **Trading Account** is a nominal account prepared to determine the **Gross Profit** or **Gross Loss** incurred from direct business activities (buying and selling of goods) during an accounting year.

Need of Trading Account

- It reveals the **Gross Profit** or **Gross Loss** of the business.
- It provides valuable information about the direct cost of goods sold (**COGS**) and helps management control direct expenses.
- It helps in comparing the current year's gross profit with previous years to measure trading efficiency.

Preparation of Trading Account

- The Trading Account is prepared by transferring the balances of all direct accounts from the Trial Balance.
- **Debit Side Items:** It includes **Opening Stock**, **Purchases** (less Purchase Returns), and all **Direct Expenses** (like Wages, Carriage Inward, Freight, Custom Duty, Factory Rent, Coal, Gas, and Water).
- **Credit Side Items:** It includes **Sales** (less Sales Returns) and **Closing Stock**.

Closing Entries for Trading Account

These entries are passed at the end of the year to close the accounts relating to goods and direct expenses.

1. For transferring opening stock, purchases, and direct expenses:

Trading A/c ...Dr.

To Opening Stock A/c

To Purchases A/c

To Wages A/c (and other direct expenses)

2. For transferring sales and closing stock:

Sales A/c ...Dr.

Closing Stock A/c ...Dr.



To Trading A/c

3. For transferring Gross Profit to Profit & Loss A/c:

Trading A/c ...Dr.

To Profit & Loss A/c

(If there is a Gross Loss, the entry will be reversed).

Standard Format of Trading Account

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
Opening Stock	xxx	Sales	xxx
Purchases	xxx	Less: Sales Returns	(xxx)
Less: Purchase Returns	(xxx)	Closing stock	xxx
Direct Expenses:			
Carriage Inward	xxx		
Freight	xxx		
Wages	xxx		
Fuel & Power	xxx		
Excise Duty	xxx		
Factory Rent	xxx		
Heating & Lighting	xxx		
Factory Rent & Insurance	xxx		
Work Managers Salary	xxx		
Gross Profit transferred to Profit & Loss Account	xxx	Gross loss transferred to Profit & Loss Account	xxx
Total	xxx	Total	xxx

Income Statement: Profit and Loss Account

- **Meaning:** The **Profit and Loss Account** is a nominal account prepared immediately after the Trading Account to determine the final **Net Profit** or **Net Loss** of the business for the accounting year.

Need of Profit and Loss Account

- To ascertain the exact **Net Profit** or **Net Loss** which ultimately belongs to the owner's capital.



- To compare the current year's net profit with past years to judge overall business efficiency.
- To control indirect expenses by analyzing various administrative and selling costs.

Preparation of Profit and Loss Account

- It starts with the **Gross Profit** (on the credit side) or **Gross Loss** (on the debit side) brought down from the Trading Account.
- **Debit Side Items:** All indirect expenses such as **Office and Administrative Expenses** (Salaries, Rent, Printing), **Selling and Distribution Expenses** (Advertisement, Carriage Outward, Bad Debts), and **Financial Expenses** (Interest on Loan).
- **Credit Side Items:** All other operating and non-operating incomes like **Discount Received, Commission Received, Rent Received,** and **Interest on Investment.**

Closing Entries for Profit and Loss Account

1. For transferring indirect expenses:

Profit & Loss A/c ...Dr.

To Salaries A/c

To Rent A/c

To Advertisement A/c (etc.)

2. For transferring other incomes:

Discount Received A/c ...Dr.

Commission Received A/c ...Dr.

To Profit & Loss A/c

3. For transferring Net Profit to Capital Account:

Profit & Loss A/c ...Dr.

To Capital A/c



Standard Format of Profit and Loss Account

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
Gross loss b/d; if any	xxx	Gross Profit b/d	xxx
Salaries	xxx	Discount Received	xxx
Rent, Rates & taxes	xxx	Commission Received	xxx
Insurance Premium	xxx	Dividend Received	xxx
Advertising	xxx	Interest on Investment	xxx
Commission paid	xxx	Rent Received	xxx
Discount Allowed	xxx		
Repairs & Renewals	xxx		
Bad Debts	xxx		
Establishment charges	xxx		
Travelling Expenses	xxx		
Bank Charges	xxx		
Sales Tax/Value added Tax	xxx		
Depreciation on fixed assets	xxx		
Net Profit transferred to Capital Account	xxx	Net Loss transferred to capital account; if any	xxx
Total	xxx	Total	xxx

Difference between Gross Profit and Net Profit (Plain Text):

Gross Profit is the difference between net sales and the direct cost of goods sold. It represents trading efficiency.

Net Profit is calculated by deducting all indirect expenses from the Gross Profit and adding other incomes. It represents the overall profitability of the entire business.

Position Statement: Balance Sheet

- **Meaning:** A **Balance Sheet** is a statement prepared on a specific date (usually the last day of the accounting year) to show the exact financial position of the business, detailing its Assets, Liabilities, and Capital.

Need of Preparing Balance Sheet

- To ascertain the true **financial position** (solvency) of the business on a particular date.



- To verify the arithmetical accuracy of the accounts, as the total of Assets must always equal the total of Liabilities plus Capital.
- To provide vital information to external users like creditors and banks.

Grouping and Marshalling of Assets and Liabilities

- **Grouping:** Means putting items of a similar nature under a common heading (e.g., all machines under 'Fixed Assets').
- **Marshalling:** Refers to the arrangement of assets and liabilities in a specific, logical order. There are two methods:

1. In Order of Liquidity: Most liquid assets (Cash) are shown first, and least liquid (Goodwill) are shown last. Current liabilities are shown first, followed by long-term liabilities and Capital. (Used by sole traders).

2. In Order of Permanence: Most permanent assets (Goodwill/Land) are shown first, and most liquid (Cash) are shown last. Capital is shown first, followed by liabilities. (Used by Joint Stock Companies).

Preparation of Balance Sheet

- **Liabilities Side (Left):** Shows what the business owes to outsiders (Creditors, Bank Overdraft, Loans) and to the owner (Capital + Net Profit - Drawings).
- **Assets Side (Right):** Shows what the business owns (Cash, Debtors, Stock, Machinery, Building).

Treatment of Closing Stock:

- If Closing Stock is given **OUTSIDE** the Trial Balance, it is recorded twice: Credited to the Trading Account AND shown on the Assets side of the Balance Sheet.
- If Closing Stock is given **INSIDE** the Trial Balance, it is shown **ONLY** on the Assets side of the Balance Sheet.

Standard Format of Balance Sheet (In Order of Liquidity)

Liabilities	Amount (₹)	Assets	Amount (₹)
Bank overdraft	xxx	Cash in hand	xxx
Outstanding Expenses	xxx	Cash at bank	xxx
Bill payables	xxx	Prepaid expenses	xxx
Sundry creditors	xxx	Investments (short term)	xxx



Loans	xxx	Bill Receivables	xxx
Capital	xxx	Sundry Debtors	xxx
Add Net Profit	xxx	Closing stock	xxx
Less drawings	(xxx)	Investments	xxx
		Furniture	xxx
		Plant & Machinery	xxx
		Land & Building	xxx
		Goodwill	xxx
Total	xxx	Total	xxx

Standard Format of Balance Sheet (In Order of Permanency)

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital	xxx	Goodwill	xxx
Add: Net profit	xxx	Land & Building	xxx
Less: Drawings	(xxx)	Plant & Machinery	xxx
Loans	xxx	Furniture	xxx
Sundry creditors	xxx	Investments	xxx
Bills payable	xxx	Closing stock	xxx
Outstanding expenses	xxx	Sundry Debtors	xxx
Bank overdraft	xxx	Bills Receivables	xxx
		Investments (short term)	xxx
		Prepaid expenses	xxx
		Cash at bank	xxx
		Cash in hand	xxx
Total	xxx	Total	xxx

Accounting Adjustments

- **Meaning of Adjustments:** The process of inclusion or exclusion of certain items of income and expenditure into the books of accounts at the time of preparing financial statements is called **adjustments**.
- **Need:** They are necessary to ensure that the Income Statement shows the correct net profit or loss, and the Balance Sheet reflects the true and fair financial position of the business on an accrual basis.



Adjustments and Their Incorporation

- 1. Closing Stock:** It is the value of goods remaining unsold at the end of the accounting year.
- 2. Outstanding Expenses:** These are the expenses which are related to the current accounting period but have not yet been paid.
- 3. Prepaid Expenses:** A part of a certain expense paid during the current year that actually relates to the next accounting period.
- 4. Accrued Income (Due but not received):** It means the income earned by the business but not received in cash till the end of the accounting year.
- 5. Unearned Income / Income Received in Advance:** Sometimes income is received before it becomes actually due. Such income does not relate to the current accounting year.

Difference between Accrued Income and Unearned Income:

Accrued Income is the income that has been earned during the current year but has not been received yet. It is an asset for the business.

On the other hand, **Unearned Income** is the income that has been received in advance but not yet earned. It is a liability for the business because the service against it is still pending.

Other Adjustments

- 6. Interest on Capital:** To calculate the exact profit, the proprietor may be allowed interest on the capital invested. It is an expense for the business.
- 7. Interest on Drawings:** If the proprietor withdraws cash for personal use, the business may charge interest on it. It is a gain for the business.
- 8. Depreciation:** It is the decline in the value of fixed assets due to regular wear and tear, passage of time, or obsolescence. It is treated as a business expense.
- 9. Further Bad Debts:** These are the debts that could not be recovered and were not recorded in the Trial Balance. They are discovered only before preparing final accounts.
- 10. Provision for Bad and Doubtful Debts:** It is a suitable amount kept aside from current profits to meet the possible future loss of bad debts in the next year.



Adjustments in Preparation of Financial Statements

11. Provision for Discount on Debtors: Debtors who pay their dues on time are allowed cash discounts. A provision is created for the likely amount of discount to be allowed in the next year.

12. Manager's Commission: Sometimes, a manager is entitled to a commission on profits, calculated as a fixed percentage of the net profit.

13. Abnormal Losses: These are unforeseen losses occurring because of fire, earthquakes, or accidents. They destroy goods or fixed assets.

14. Drawings of Goods by the Proprietor: When the proprietor withdraws goods from the business for personal use, it reduces the overall purchases.

15. Goods Distributed as Free Samples: Goods distributed for sales promotion. It acts as an advertisement expense and reduces the purchases.

Treatment of Special Items:

Adjustment	Adjustment entry	Treatment in Trading and Profit & Loss A/c	Treatment in Balance Sheet
1. Closing stock	Closing stock A/c ...Dr To Trading A/c	Shown on the credit side of Trading A/c	Shown on the Assets side
2. Outstanding expenses	Expenses A/c ...Dr To Outstanding expenses A/c	Added to respective expenses on the debit side	Shown on the liabilities side
3. Prepaid expenses	Prepaid expenses A/c ...Dr To Expenses A/c	Deducted from the respective expenses on the debit side	Shown on the Assets side
4. Accrued income	Accrued income A/c ...Dr	Added to the respective income on the credit side	Shown on the Assets side



	To Income A/c		
5. Income received in advance	Income A/c ...Dr To income received in advance A/c	Deducted from the respective income on the credit side	Shown on the liabilities side
6. Interest on capital	Interest on capital A/c ...Dr To capital A/c	Shown on the debit side of P&L A/c	Shown as addition to capital on liabilities side
7. Interest on drawings	Capital A/c ...Dr To interest on drawing A/c	Shown on the credit side of P&L A/c	Shown as deduction to capital on liabilities side
8. Depreciation	Depreciation A/c ...Dr To Assets A/c	Shown on the debit side of P&L A/c	Deducted from the value of Assets
9. Further bad debts	Bad Debts A/c ...Dr To Debtors A/c	Shown on the debit side of P&L A/c	Deducted from debtors, shown on Assets side
10. Provision for bad & doubtful debts	Profit & Loss A/c ...Dr To Provision for bad and doubtful debts	Shown on the debit side of P&L A/c	Shown as deduction from debtors on Assets side
11. Provision for Discount on Debtors	Profit & Loss A/c ...Dr To Provision for Discount	Shown on the debit side of P&L A/c	Shown as deduction from debtors on Assets side
12. Commission to Manager	Profit & Loss A/c ...Dr To Manager's Commission	Shown on the debit side of P&L A/c	Shown in liability side



13. Extra Ordinary Loss (Fire)	Profit & Loss A/c ...Dr To Extra Ordinary Loss	Shown on the debit side of P&L A/c	Shown as deduction from concerned Asset on Assets side
14. Drawings of goods by Owner	Drawings A/c ...Dr To Purchases A/c	To be deducted from purchases	Shown as deduction from Capital on Liabilities side
15. Distribution of goods as free samples	Advertisement A/c ...Dr To Purchases A/c	To be deducted from purchases	Shown on debit side of P&L A/c

All Important Formulas

1. Cost of Goods Sold (COGS):

$$COGS = \text{Opening Stock} + \text{Net Purchases} + \text{Direct Expenses} - \text{Closing Stock}$$

2. Net Sales:

$$\text{Net Sales} = \text{Total Sales} - \text{Sales Returns}$$

3. Gross Profit / Gross Loss:

$$\text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods Sold}$$

$$\text{Gross Loss} = \text{Cost of Goods Sold} - \text{Net Sales}$$

4. Operating Profit:

$$\text{Operating Profit} = \text{Net Sales} - \text{Operating Cost}$$

OR

$$\text{Operating Profit} = \text{Net Sales} - (\text{Cost of goods sold} + \text{Administration and office exp.} + \text{Selling and Distribution expenses})$$

$$\text{Operating Profit} = \text{Net Profit} + \text{Non - operating exp.} - \text{Non - Operating Income}$$

5. Manager's Commission (Before charging):

$$\text{Commission} = \text{Net Profit (before commission)} \times \frac{\text{Percentage of commission}}{100}$$

6. Manager's Commission (After charging):

$$\text{Commission} = \text{Net Profit (before commission)} \times \frac{\text{Percentage of commission}}{100 + \text{Percentage of commission}}$$



IMPORTANT QUESTIONS

Q1. Explain the term 'Journal Proper'.

Answer: Journal Proper (or General Journal) is a book of original entry used to record those specific transactions which cannot be recorded in any of the special purpose subsidiary books (like Cash Book, Sales Book, etc.). In the context of financial statements, it is strictly used to pass:

1. **Closing Entries:** To transfer balances of direct/indirect expenses and incomes to the Trading and Profit & Loss A/c.
2. **Adjustment Entries:** To record unrecorded items like outstanding expenses, depreciation, etc., at the end of the year.

Q2. What is meant by 'Unearned Income'? Give its accounting treatment and Adjustment entry.

Answer: Unearned income (or Income received in advance) is the income received during the current year, but the service against it is pending, meaning it actually relates to the next accounting year.

- **Accounting Treatment:** It is deducted from the respective income on the credit side of the Profit & Loss A/c, and it is shown as a liability on the Liabilities side of the Balance Sheet.
- **Adjustment Entry:**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Income A/c ...Dr.		xxx	
	To Unearned Income (or Income Recd. in Advance) A/c			xxx
	<i>(Being income received in advance adjusted)</i>			

Q3. While preparing financial statements of a proprietor, how is 'Drawings of Goods by proprietor' recorded in the books of accounts? Also pass the necessary journal entry.

Answer: When a proprietor withdraws goods from the business for personal use, it reduces the overall stock and purchases of the business.

- **Accounting Treatment:** It is deducted from 'Purchases' on the debit side of the Trading Account. Secondly, it is deducted from 'Capital' on the Liabilities side of the Balance Sheet.
- **Journal Entry:**



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Drawings A/c ...Dr.		xxx	
	To Purchases A/c			xxx
	<i>(Being goods withdrawn by proprietor for personal use)</i>			

Q4. Distinguish between Capital Expenditure and Revenue Expenditure on the basis of (a) Earning capacity (b) Placement in financial statements.

Answer:

Basis of Difference	Capital Expenditure	Revenue Expenditure
(a) Earning Capacity	It is incurred to acquire fixed assets, which <i>increases</i> the earning capacity of the business.	It is incurred for maintenance, which only <i>maintains</i> the existing earning capacity intact.
(b) Placement	It is shown as an asset on the Assets side of the Balance Sheet.	It is shown on the debit side of either the Trading Account or the Profit & Loss Account.

Q5. What is Operating Profit? State its formula.

Answer: Operating profit is the excess of gross profit over operating expenses. It measures the profit earned from the core, day-to-day operations of the business, excluding non-operating incomes (like interest received) and non-operating expenses (like loss by fire).

Operating Profit = Net Profit + Non-operating Expenses - Non-Operating Incomes

Q6. The ledger balances extracted at the close of a trading year on 31st March, 2014 are: Opening stock ₹ 12,000; Purchases ₹ 52,000; Sales ₹ 74,000; Purchase Returns ₹ 2,000; Carriage Inward ₹ 800; Wages ₹ 4,200; Closing stock ₹ 13,500. Pass necessary closing journal entries in the journal proper.

Answer:



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2014 Mar 31	Trading A/c ...Dr.		69,000	
	To Opening Stock A/c			12,000
	To Purchases A/c			52,000
	To Wages A/c			4,200
	To Carriage Inward A/c			800
	<i>(Being transfer of debit balances to Trading A/c)</i>			
Mar 31	Sales A/c ...Dr.		74,000	
	Purchase Returns A/c ...Dr.		2,000	
	Closing Stock A/c ...Dr.		13,500	
	To Trading A/c			89,500
	<i>(Being transfer of credit items to Trading A/c)</i>			
Mar 31	Trading A/c ...Dr.		20,500	
	To Profit & Loss A/c			20,500
	<i>(Being Gross Profit transferred to P&L A/c)</i>			

Q7. On 31st Dec. 2013, stocks worth ₹ 4,00,000 were destroyed by fire. The stock was insured and the insurance company admitted the claim of ₹ 3,00,000 only. Give the necessary journal entries and show how it will be treated in the Final Accounts.

Answer:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2013 Dec 31	Loss by Fire A/c ...Dr.		4,00,000	
	To Trading A/c			4,00,000
	<i>(Being loss of stock by fire recorded)</i>			
Dec 31	Insurance Co. A/c ...Dr.		3,00,000	



	Profit & Loss A/c ...Dr.		1,00,000	
	To Loss by Fire A/c			4,00,000
	<i>(Being insurance claim admitted partially and balance transferred to P&L)</i>			

Financial Statement	Side	Presentation	Amount (₹)
Trading Account	Credit Side	By Loss by Fire A/c	4,00,000
Profit & Loss A/c	Debit Side	To Loss by fire (4,00,000) Less: Ins. Claim (3,00,000)	1,00,000
Balance Sheet	Assets Side	Claim due from Insurance Co.	3,00,000

Q8. Calculate Provision for Discount on Debtors for year ending 31st March, 2025 from the following information:

Sundry debtors as on 31st March, 2025: ₹ 45,000. Bad debts as per adjustments: ₹ 3,000. Reserve for bad debts to be made on sundry debtors @ 5%. Provision for discount on debtors to be made @ 3%.

Answer:

Step	Calculation Particulars	Amount (₹)
1.	Sundry Debtors given	45,000
2.	Less: Further Bad Debts (as per adjustments)	(3,000)
3.	Remaining Debtors	42,000
4.	Less: Reserve for Bad Debts (5% of 42,000)	(2,100)
5.	Good Debtors	39,900
6.	Provision for Discount (3% of 39,900)	1,197

Q9. The net profit of a firm amounts to ₹ 1,05,000 before charging commission. The manager of the firm is entitled to a commission of 5% on the net profit AFTER charging such commission. Calculate the Manager's Commission and show its presentation.



Answer:

Particulars	Details / Formula	Amount (₹)
Formula Used	Net Profit × [Rate / (100 + Rate)]	-
Calculation	1,05,000 × (5 / 105)	5,000
P&L A/c Presentation	Debit Side	To Manager's Commission (5,000)
Balance Sheet	Liabilities Side (Current Liabilities)	Outstanding Commission (5,000)

Q10. Calculate Cost of Goods Sold (COGS) and Gross Profit from the following information: Sales ₹ 62,500; Sales Returns ₹ 500; Opening Stock ₹ 6,400; Purchases ₹ 32,000; Direct Expenses ₹ 4,200; Closing Stock ₹ 7,200.

Answer:

Particulars	Calculation	Amount (₹)
Net Sales	62,500 - 500	62,000
Cost of Goods Sold	Opening Stock (6,400) + Purchases (32,000) + Direct Expenses (4,200) - Closing Stock (7,200)	35,400
Gross Profit	Net Sales (62,000) - COGS (35,400)	26,600

Q11. From the following Trial Balance of Ammu Bhai Trading Co., prepare Trading and Profit & Loss Account for the year ending 31st March, 2024 and Balance Sheet. Adjustments: (i) Stock as on 31st March, 2024 was ₹ 38,000 (ii) Wages outstanding were ₹ 1,500.

(Trial Balance Balances: Op Stock ₹44,000; Purchases ₹85,000; Sales ₹1,40,000; Carriage Inwards ₹3,600; Wages ₹6,000; Repairs ₹4,000; Rent ₹4,500; Trade Exp ₹6,400; Bad Debts ₹2,500; Debtors ₹42,000; Creditors ₹36,000; Land & Building ₹50,000; Capital ₹80,000; Cash at Bank ₹52,000; Bank Loan ₹44,000).

Answer:

Trading and Profit & Loss Account (For the year ended 31.03.2024)

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Opening Stock	44,000	By Sales	1,40,000



To Purchases	85,000	By Closing Stock	38,000
To Carriage Inwards	3,600		
To Wages (6,000 + 1,500 O/S)	7,500		
To Gross Profit c/d	37,900		
Total	1,78,000	Total	1,78,000
To Repairs	4,000	By Gross Profit b/d	37,900
To Rent	4,500		
To Trade Expenses	6,400		
To Bad Debts	2,500		
To Net Profit (to Capital)	20,500		
Total	37,900	Total	37,900

Balance Sheet (As on 31.03.2024)

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	36,000	Cash at Bank	52,000
Bank Loan	44,000	Sundry Debtors	42,000
Outstanding Wages	1,500	Closing Stock	38,000
Capital (80,000 + 20,500 NP)	1,00,500	Land and Building	50,000
Total	1,82,000	Total	1,82,000

Q12. From the Trial Balance of MB Garments, prepare Trading and Profit & Loss Account and Balance Sheet. Adjustments: (i) Closing Stock ₹ 10,000 (ii) Machinery to be depreciated @ 10% p.a. (iii) Salaries outstanding for March ₹ 1,200 (iv) Insurance Premium paid for one year ending 30th Sept 2024 was ₹ 300.

(Trial Balance Balances: Op Stock ₹10,790; Purchases ₹53,200; Sales ₹78,000; Carriage inward ₹2,040; Carriage outward ₹3,200; Machinery ₹60,000; Salaries ₹4,000; Insurance ₹600; Debtors ₹28,000; Creditors ₹10,000; Capital ₹80,000; Cash in Hand ₹570; Cash at Bank ₹5,600).



Answer:

Trading and Profit & Loss Account (For the year ended 31.03.2024)

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Opening Stock	10,790	By Sales	78,000
To Purchases	53,200	By Closing Stock	10,000
To Carriage Inward	2,040		
To Gross Profit c/d	21,970		
Total	88,000	Total	88,000
To Carriage Outward	3,200	By Gross Profit b/d	21,970
To Salaries (4,000 + 1,200 O/S)	5,200		
To Insurance (600 - 300 Ppd)	300		
To Dep. on Machinery (10% of 60k)	6,000		
To Net Profit (to Capital)	7,270		
Total	21,970	Total	21,970

Balance Sheet (As on 31.03.2024)

Liabilities	Amount (₹)	Assets	Amount (₹)
Sundry Creditors	10,000	Cash in hand	570
Outstanding Salaries	1,200	Cash at Bank	5,600
Capital (80,000 + 7,270 NP)	87,270	Sundry Debtors	28,000
		Prepaid Insurance	300
		Closing Stock	10,000
		Machinery (60k - 6k Dep)	54,000
Total	98,470	Total	98,470



2

NPO : AN INTRODUCTION

Introduction

Not-for-Profit Organisations (NPOs) like schools, hospitals, and clubs are established to provide services to society rather than to earn profits. Despite their non-profit nature, they engage in **financial transactions** and must prepare **financial statements** at the end of the year to ascertain their financial results.

Not-For-Profit Organisations-Meaning and Characteristics

- **Meaning: Not-for-Profit Organisations (NPOs)** are entities whose primary objective is not to make profits but to provide service to their members and the public.
- Examples of NPOs include schools, hospitals, charitable institutions, welfare societies, clubs, and public libraries.

Characteristics of Not-for-profit organisations (NPOs):

- **Service Motive:** The main objective is to provide service to members and society, not to earn a profit.
- **Source of Income:** Their major sources of income are admission fees, subscriptions, donations, and grant-in-aid (not profit from buying and selling goods).
- **Management:** They are managed by an elected group of members called the **managing committee**.
- **Accounting System:** They prepare their accounts following the exact same accounting principles used by profit-earning business organizations.
- **Financial Statements:** They generally prepare the Receipts and Payments Account, Income and Expenditure Account, and Balance Sheet.

Receipts and Payments Account-Meaning and Need

- **Meaning:** The **Receipts and Payments Account** is a summary of all cash and bank transactions prepared at the end of the accounting year based on the cash book.
- All cash receipts are recorded on its debit side, while all cash payments are shown on its credit side.



Main Features of Receipts and Payments Account:

- It is prepared at the end of the year using items taken directly from the cash book.
- It is a summary of all cash transactions of the year categorized under various specific heads.
- It records all cash transactions that occurred during the year, irrespective of whether they relate to the previous, current, or next year.
- It records cash transactions of both **revenue nature** and **capital nature**.
- It begins with an opening cash/bank balance and ends with a closing cash/bank balance.

Need for preparing Receipts and Payments Account:

- It presents most of the cash transactions of the NPO at one single place.
- Being in a summary form, it provides an idea of a large number of transactions at a quick glance.
- It gives accounting information item-wise for the entire accounting year.
- It reveals the closing cash and bank balance, which is then taken to the Balance Sheet.
- It serves the purpose of a Trial Balance and becomes the base for preparing the Income and Expenditure Account and the Balance Sheet.

Format of Receipts and Payments Account

Receipts (Dr.)	Amount (₹)	Payments (Cr.)	Amount (₹)
Balance b/d:		Purchase of Assets	xxx
Cash	xxx	Printing and stationery	xxx
Bank	xxx	Repairs and Renewal	xxx
Donations	xxx	Newspapers/Magazines	xxx
Legacies	xxx	Rent and taxes	xxx
Membership fees	xxx	Postage	xxx
Entrance fees	xxx	Investments	xxx
Subscriptions	xxx	Conveyance	xxx
Lockers Rent	xxx	Honorarium	xxx



Sale of fixed assets	xxx	Charity	xxx
Interest on investments	xxx	Insurance Premium	xxx
Miscellaneous Receipts	xxx	Upkeep of Ground	xxx
Sale of old periodicals	xxx	Telephone Charges	xxx
		Balance c/d:	
		Cash	xxx
		Bank	xxx
Total	xxx	Total	xxx

Specific Items of Receipts and Payments Account

- 1. Subscription:** A regular payment contributed annually by members. It is a main source of income shown on the receipts side.
- 2. Entrance fees or Admission fees:** The amount charged from a person at the time of their admission as a member.
- 3. Life membership fees:** A special fee charged only once in the lifetime of a member, treated as a capital receipt.
- 4. Endowment fund:** A fund that provides a permanent means of support for the organization; treated as a capital receipt.
- 5. Donation:** Amount received by way of gift. It can be a **Specific donation** (for a specific purpose like a building) or a **General donation** (not for any specific purpose).
- 6. Legacy:** The amount received by the organization as per the will of a deceased person; treated as a capital receipt.
- 7. Sale of old newspapers/periodicals and sports material:** Money realized from selling old items is shown on the receipts side.
- 8. Purchase of fixed assets:** Payments made for acquiring assets like buildings, machinery, or books are capital expenditures shown on the payment side.
- 9. Payment of honorarium:** Remuneration paid to persons who participate in the activities but are not regular employees (e.g., secretary of the club).



10. Purchase of consumable items: Regular payments for items like stationery, sports material, drugs, and medicines.

Preparation of Receipts and Payments Account (Working Steps):

1. Write the opening cash and bank balance on the debit side.
2. Enter all amounts received under relevant heads (subscriptions, donations) on the receipts (debit) side.
3. Enter all amounts paid under relevant heads (salary, rent) on the payments (credit) side.
4. Record all cash items regardless of whether they are capital/revenue or belong to the past/current/future year.
5. Balance the account by deducting total payments from total receipts to find the closing 'balance c/d'.

Receipts and Payments Account and Cash Book

Difference between Receipts and Payments Account and Cash Book:

- **Time of Preparation:** The Receipts and Payments Account is prepared at the end of the accounting year, whereas the Cash Book is prepared on a day-to-day basis.
- **Frequency of Items:** In the Receipts and Payments Account, a specific item appears only once. In the Cash Book, items appear multiple times on different dates based on their occurrence.
- **Core Purpose:** The Receipts and Payments Account serves the purpose of a Trial Balance to prepare financial statements. The Cash Book is primarily a means of maintaining a systematic daily record of cash.
- **Prepared By:** The Receipts and Payments Account is prepared exclusively by Not-for-Profit Organisations (NPOs). The Cash Book is prepared by both NPOs and profit-earning business organizations.

IMPORTANT QUESTIONS

Q1. State the meaning of Not-for-Profit organisations and give two examples.

Answer: Not-for-Profit Organisations (NPOs) are institutions established not to make profits, but to provide services to their members and the society in general. They rely on subscriptions and donations rather than trading income.

Examples: Public hospitals and sports clubs.



Q2. Explain the terms 'Honarium' and 'Legacy'.

Answer: **Honarium** is a payment made to individuals who take part in the organisation's activities but are not its regular employees (e.g., paying a guest speaker). **Legacy** is a lump-sum amount received by the NPO as per the legal will of a deceased person. It is a capital receipt.

Q3. State the main purpose of preparing a Receipts and Payments Account.

Answer: The main purpose is to provide a unified summary of all cash and bank transactions for the entire accounting year. It helps the organization track its cash flow, ascertain the closing cash balance, and serves as the base (like a Trial Balance) for preparing final financial statements.

Q4. Classify the following items into Receipts and Payments for an NPO.

(i) Purchase of Sports Material (ii) Subscriptions (iii) Honarium (iv) Entrance Fees

Answer:

- **Receipts:** Subscriptions, Entrance Fees.
- **Payments:** Purchase of Sports Material, Honarium.

Q5. From the information given below, prepare a Receipts and Payments Account for the year ending 31st December, 2013.

Opening Cash in hand: ₹ 1,650; Opening Cash at Bank: ₹ 18,250; Subscription: ₹ 15,000; Donation: ₹ 18,000; Salaries: ₹ 16,000; Rent paid: ₹ 12,000; Purchase of Books: ₹ 10,000.

Answer: Working Notes:

- **Step 1:** Add all opening balances and incoming cash on the Receipts (Debit) side. Total Receipts = 1,650 + 18,250 + 15,000 + 18,000 = ₹ **52,900**.
- **Step 2:** Add all outgoing cash on the Payments (Credit) side. Total Payments (before balance) = 16,000 + 12,000 + 10,000 = ₹ **38,000**.
- **Step 3:** Calculate the Closing Balance (Balance c/d) by deducting Payments from Receipts. Closing Balance = 52,900 - 38,000 = ₹ **14,900**.



Receipts & Payments A/c (for the year ending 31st Dec. 2013)

Receipts (Dr.)	Amount (₹)	Payments (Cr.)	Amount (₹)
Balance b/d:		Salaries	16,000
Cash in hand	1,650	Rent paid	12,000
Cash at Bank	18,250	Purchase of Books	10,000
Subscription	15,000	Balance c/d (Balancing figure)	14,900
Donation	18,000		
Total	52,900	Total	52,900



3

FINANCIAL STATEMENTS (NPOS)

Introduction

Not for Profit Organisations (NPOs) like hospitals, schools, and clubs do not engage in trading activities for profit. However, they perform financial transactions and must prepare financial statements at the end of the year to ascertain their financial position. In this chapter, we will learn how an NPO prepares its **Income and Expenditure Account** and its **Balance Sheet**.

Income and Expenditure Account: Meaning, Need and Items

- **Meaning:** It is the summary of incomes and expenditures of the organisation for a particular year, prepared at the end of the year.
- It is similar to the Profit and Loss Account of business organisations.
- In this account, only **revenue expenditure** and **revenue income** of the *current year* are taken. Amounts pertaining to the previous year or next year are not considered.
- The balance of this account represents either '**surplus**' (excess of income over expenditure) or '**deficit**' (excess of expenditure over income).

Need of preparing Income and Expenditure Account:

- Although their objective is not to earn profits, NPOs need to know the net result of their activities—whether income exceeds expenditure or vice versa.
- Preparation of this account is a legal requirement.
- It helps the organisation control its expenditures.

Relevant Items of Income:

1. **Subscription:** A periodic contribution by members of the organization.
2. **Entrance fees/Admission fees:** Received from members at the time of their admission.
3. **Donations:** Only general donations of smaller amounts and recurring nature are treated as revenue income.



4. **Sale of old items:** Sale of old newspapers, condemned books, or sports material.
5. **Interest receipt:** Interest received on surplus funds kept in fixed deposits or invested elsewhere.
6. **Grant-in-Aid:** Money received from local, state, or central governments.

Items of Revenue Expenses:

1. **Common expenses:** Salaries, wages, rent, stationery, postage, telephone, and electricity charges.
2. **Honorarium:** Amount paid to a person who looks after the functioning of the organisation but is not its employee.
3. **Depreciation:** Provided on fixed assets like furniture, building, and books.
4. **Specific event expenses:** Expenses on tournaments, fairs, etc.

Preparation of Income and Expenditure Account

The Income and Expenditure Account is prepared from the Receipts and Payments Account along with additional information.

1. Steps for Expenditure side (Debit):

- Revenue payments (like rent paid, salaries) are taken from the payment column of the Receipts and Payments A/c.
- Adjustments are made for outstanding expenses and prepaid expenses relating to both the current and previous years.
- Non-cash expenses like depreciation and bad debts are also entered here.

2. Steps for Income side (Credit):

- Revenue receipts (like subscriptions, interest) are taken from the receipt column of the Receipts and Payments A/c.
- Adjustments are made for income outstanding or received in advance relating to the current and previous years.

3. Surplus or Deficit: The difference between the two sides is worked out. If credit > debit, it is a **surplus** (written on debit side). If debit > credit, it is a **deficit** (written on credit side).



Difference between Receipts and Payments A/c and Income and Expenditure A/c:

- **Nature:** Receipts and Payments A/c is a summary of the Cash Book, while Income and Expenditure A/c is a summary of Revenue Income and Revenue Expenditure.
- **Side:** In Receipts and Payments A/c, debit shows receipts and credit shows payments. In Income and Expenditure A/c, debit shows expenses/losses and credit shows incomes/gains.
- **Balances:** Receipts and Payments A/c starts with opening cash/bank balance and ends with closing cash/bank balance. Income and Expenditure A/c has no opening balance and ends with Surplus or Deficit.
- **Items:** Receipts and Payments A/c records both capital and revenue items. Income and Expenditure A/c records only revenue items.
- **Adjustments:** Adjustments are not considered in Receipts and Payments A/c, but are necessary in Income and Expenditure A/c.

Adjustment of Items in Income and Expenditure Account

1. **Subscription Received:** Subscriptions require adjustment to ensure only the current year's amount is recorded.
 - **Formula logic:** Subscription received during the year + Outstanding for current year + Received in previous year for current year - Outstanding of previous year - Received in advance for next year.
2. **Rent Paid (or other expenses):** Expenses require adjustment to reflect only the current year's cost.
 - **Formula logic:** Rent paid in current year + Rent outstanding for current year + Rent paid in advance in previous year - Outstanding rent of previous year paid now - Advance rent paid for next year.
3. **Depreciation on Assets:** It is a non-cash item charged on fixed assets. It is debited to the Income & Expenditure A/c and deducted from the respective asset in the Balance Sheet.

Preparation of Balance Sheet

- **Meaning:** NPOs prepare a Balance Sheet at the end of the year, which is not different from that prepared by a profit organisation. It has an Assets side and a Liabilities side.
- **Objective:** To show the financial stability, strength, and soundness on the last date of the accounting year.



Important points while preparing the Balance Sheet:

- Assets from the previous year are adjusted for any sale, purchase, and depreciation during the current year.
- New assets purchased (from the payments side of Receipts & Payments A/c) are added to the Balance Sheet.
- Outstanding expenses, prepaid expenses, outstanding incomes, and advance incomes are shown in the Balance Sheet.
- Special receipts (like building fund) are not treated as income; they are shown as special funds on the liabilities side.
- **Capital Fund / General Fund:** It is taken from the opening Balance Sheet and adjusted for the current year's 'surplus' (added) or 'deficit' (deducted).

Standard Formats
Format of Income and Expenditure A/c (Extract with Adjustments)

Dr.	Expenditure	Amount (₹)	Income	Amount (₹)	Cr.
	To Rent	xxx	By Subscriptions received	xxx	
	Add: current year outstanding	xxx	Less: received for last year	(xxx)	
	Less: paid for next year	(xxx)	Less: received for next year	(xxx)	
	Add: paid last year for current year	xxx	Add: outstanding for current year	xxx	
	To Salaries	xxx	Add: received last year for current year	xxx	
	To Depreciation	xxx	By Donations	xxx	
	To Surplus (excess of income)	xxx	By Deficit (excess of expenditure)	xxx	
	Total	xxx	Total	xxx	



Format of Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Rent outstanding	xxx	Cash in hand	xxx
Salary outstanding	xxx	Cash at Bank	xxx
Subscription received in advance	xxx	Fixed Deposits	xxx
Building fund	xxx	Subscription outstanding	xxx
Capital fund / General fund	xxx	Sports material	xxx
Add: Life membership fee	xxx	Books	xxx
Add: Surplus (or Less: Deficit)	xxx	Furniture	xxx
		Building	xxx
Total	xxx	Total	xxx

Important Journal Entries Block

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Subscriptions outstanding A/c ...Dr.		xxx	
	To Subscriptions A/c			xxx
	<i>(Being subscription for current year due but not received)</i>			
	Rent A/c ...Dr.		xxx	
	To Rent outstanding A/c			xxx
	<i>(Being rent due but not paid)</i>			
	Depreciation A/c ...Dr.		xxx	
	To Asset A/c			xxx
	<i>(Being depreciation charged on asset)</i>			



IMPORTANT QUESTIONS

Q1. What term is given to the amount by which the credit side of an Income and Expenditure Account exceeds its debit side?

Answer: The amount by which the income side (credit side) exceeds the expenditure side (debit side) is termed as 'surplus'. It is added to the Capital Fund in the Balance Sheet.

Q2. On which side of the Balance Sheet will a loan item appearing on the Receipts side of the Receipt and Payment Account be shown?

Answer: A loan raised by the NPO is a liability. Therefore, it will be shown on the **Liabilities side** of the Balance Sheet at its net value (after deducting any repayments made during the year).

Q3. For what items must the Capital Fund of the previous year be adjusted in the current year's Balance Sheet?

Answer: The opening Capital Fund must be adjusted by adding the current year's **Surplus** (or deducting the **Deficit**) calculated from the Income and Expenditure Account. Life membership fees and legacy amounts may also be added to it.

Q4. Calculate the amount of subscription to be shown in the Income & Expenditure A/c for the year ending 31st Dec 2013, and prepare the Subscription Account table:

Subscription received during 2013: ₹ 15,000; Subscription outstanding as on 31.12.2013: ₹ 1,500; Subscription received in 2012 for 2013: ₹ 800; Subscription received in 2013 for 2012: ₹ 400; Subscription received in 2013 for advance 2014: ₹ 600.

Answer: Working Notes:

- **Step 1:** Total Received = 15,000
- **Step 2:** Add current year outstanding (+ 1,500) and received last year for current year (+ 800).
- **Step 3:** Deduct received for previous year (- 400) and advance for next year (- 600).
- **Calculation:** $15,000 + 1,500 + 800 - 400 - 600 = ₹ 16,300$.



Subscription Account (Ledger Format)

Dr.	Particulars	Amount (₹)	Particulars	Amount (₹)	Cr.
	To Subscription outstanding A/c (2012)	400	By Cash A/c	15,000	
	To Subscription received in advance (2014)	600	By Subscription outstanding A/c (2013)	1,500	
	To Income & Expenditure A/c (Bal. Fig.)	16,300	By Subscription received in advance (2012)	800	
	Total	17,300	Total	17,300	

Q5. From the Receipts and Payments Account of Pollution Control Awareness Society (Regtd.), prepare Income and Expenditure Account for the year ending on 31st March, 2024 and Balance Sheet as on that date:

Receipts: Balance b/d ₹ 4,800; Subscriptions ₹ 5,600; Entrance Fees ₹ 1,600; Donations ₹ 24,000; Grant from State Pollution Control Board ₹ 60,000. *(Total: ₹ 96,000)*

Payments: Honorarium of Secretary ₹ 8,000; Publicity Expenses ₹ 12,000; Expenses on Seminars ₹ 15,000; Publishing and Distribution of Literature ₹ 18,000; Office Expenses ₹ 4,000; Expenses on Motor Van ₹ 4,500; FD with Bank ₹ 30,000; Balance at Bank ₹ 4,500. *(Total: ₹ 96,000)*

Additional Information: In the beginning of the year, Furniture was of the value of ₹ 25,200 and Capital Fund ₹ 30,000.

Answer: Working Notes:

- **Step 1: Verify Opening Capital Fund:** Opening Assets = Opening Cash (4,800) + Opening Furniture (25,200) = ₹ 30,000. Opening Liabilities = Nil. Hence, Opening Capital Fund is correctly given as ₹ 30,000.
- **Step 2: Identify Capital Payments/Receipts:** 'FD with Bank' is an asset (Capital Payment). It will go to the Balance Sheet. Grants and Donations are treated as Revenue income here as they relate to the core awareness activities of the society.

Income and Expenditure Account (For the year ended 31st March, 2024)

Expenditure (Dr.)	Amount (₹)	Income (Cr.)	Amount (₹)
To Honorarium of Secretary	8,000	By Subscriptions	5,600



To Publicity Expenses	12,000	By Entrance Fees	1,600
To Expenses on Seminars	15,000	By Donations	24,000
To Publishing & Distribution	18,000	By Grant from Control Board	60,000
To Office Expenses	4,000		
To Expenses on Motor Van	4,500		
To Surplus (Excess of Income over Exp.)	29,700		
Total	91,200	Total	91,200

Balance Sheet (As on 31st March, 2024)

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Fund		Cash at Bank (Closing)	4,500
Opening Balance (30,000)		FD with Bank	30,000
Add: Surplus (29,700)	59,700	Furniture	25,200
Total	59,700	Total	59,700



4

ACCOUNTS FROM INCOMPLETE RECORDS

Introduction

Typically, businesses maintain their books using the **Double Entry System** where both aspects of a transaction are recorded. However, some small businesses do not follow strict accounting rules and record only a single aspect of certain transactions, or ignore some entirely. This unscientific method is known as the Single Entry System or **Accounts from Incomplete Records**. In this chapter, we will learn how to ascertain profit or loss from such incomplete information.

Accounts From Incomplete Records: Definition and Features

- **Meaning:** A system of bookkeeping where both aspects of a transaction are not systematically recorded is known as Accounts from Incomplete Records or Single Entry System. Sometimes, complete records may also be rendered incomplete due to unforeseen events like fire, floods, or earthquakes.
- **Definition:** Kohler defines it as "A system of book keeping in which as a rule only records of cash and of personal accounts are maintained; it is always incomplete double entry varying with the circumstances."

Features of Single Entry System:

1. **Suitability:** It is suitable only for small businesses like sole traders or partnership firms. Limited companies cannot use it due to legal provisions.
2. **Preparation of Cash Book:** A Cash Book is usually maintained, but business and private transactions are often mixed up.
3. **Preparation of Personal Accounts:** Only personal accounts (debtors and creditors) are prepared. Real and nominal accounts are avoided.
4. **No Uniformity:** The system differs from firm to firm as there are no set uniform principles.
5. **Preparation of Final Accounts:** Trading and Profit & Loss A/c cannot be prepared easily. A "Statement of Affairs" (based on estimates) is prepared instead of a proper Balance Sheet.



Uses and Limitations of Single Entry System

Uses of Single Entry System:

1. **Simple Method:** It is a very simple method of recording business transactions.
2. **Less Expensive:** It is cheaper to maintain compared to the Double Entry System.
3. **Suitable for Small Concerns:** Best suited for businesses with limited transactions and few assets/liabilities.
4. **No Specialized Knowledge:** Maintenance of records does not require deep knowledge of accounting principles.

Limitations of Single Entry System:

1. **Arithmetical Accuracy Cannot be Proved:** Since a Trial Balance cannot be prepared, the arithmetical accuracy of books cannot be tested, leaving room for undetected frauds.
2. **No Control on Assets:** Without real accounts, keeping full control over assets to avoid misappropriation is difficult.
3. **True Profits Cannot be Known:** In the absence of a proper Trading and P&L A/c, exact profit or loss cannot be ascertained.
4. **Financial Position Cannot be Judged:** The Statement of Affairs is based on physical inspection and estimates, so the exact net asset position is unknown.
5. **Comparative Study is Difficult:** Comparing the current year's financial position with the previous year is difficult due to incomplete information.

Ascertaining Profit from Incomplete Records

Since a Trading and P&L Account cannot be prepared directly, profit is ascertained using two methods:

1. **Net Worth Method (Statement of Affairs Method)**
2. **Conversion Method**

Net Worth Method or Statement of Affairs Method

- **Statement of Affairs:** It is a statement of all assets and liabilities (similar to a Balance Sheet). The difference between the total assets and total liabilities is taken as the **Capital**.



$$\text{Capital} = \text{TotalAssets} - \text{TotalLiabilities}$$

- **Ascertaining Profit:** To find the profit, we compare the capital at the end of the year with the capital at the beginning. Two adjustments must be made:
 1. **Drawings:** Must be **added** back to the closing capital.
 2. **Additional Capital Introduced:** Must be **deducted** from the closing capital.

Important Formulas Highlighted

1. $\text{Profit} = (\text{ClosingCapital} + \text{Drawings}) - (\text{AdditionalCapital} + \text{OpeningCapital})$
2. $\text{NetCreditSales} = \text{TotalSales} - \text{CashSales} - \text{SalesReturns}$
3. $\text{CostOfGoodsSold} = \text{OpeningStock} + \text{NetPurchases} + \text{DirectExpenses} - \text{ClosingStock}$

Conversion Method

Conversion method means converting the accounts from incomplete records into complete Double Entry records to find out missing figures like sales and purchases.

Steps to find missing figures:

1. **Prepare Cash and Bank Summary:** To find missing opening/closing cash balances, cash sales, cash purchases, or drawings.
2. **Prepare Total Debtors Account:** To find missing Credit Sales, opening/closing debtors, or cash received from debtors.
3. **Prepare Bills Receivable Account:** To find missing Bills Receivable received during the year.
4. **Prepare Total Creditors Account:** To find missing Credit Purchases, opening/closing creditors, or cash paid to creditors.
5. **Prepare Bills Payable Account:** To find missing Bills Payable accepted.



Standard Formats

Format of Statement of Profit or Loss (Net Worth Method)

Particulars	Amount (₹)
Capital at the end of the year	xxx
Add: Drawings made during the year	xxx
Less: Additional Capital introduced during the year	(xxx)
Adjusted Capital at the end	xxx
Less: Capital in the beginning of the year	(xxx)
Profit or Loss for the year	xxx

Format of Total Debtors Account (To find Credit Sales)

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Balance b/d (Opening Debtors)	xxx	By Cash/Bank (Received)	xxx
To Bills Receivable (Dishonoured)	xxx	By Discount Allowed	xxx
To Credit Sales (Balancing Figure)	xxx	By Sales Returns	xxx
		By Bad Debts	xxx
		By Bills Receivable (Received)	xxx
		By Balance c/d (Closing Debtors)	xxx
Total	xxx	Total	xxx

Format of Total Creditors Account (To find Credit Purchases)

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Cash/Bank A/c (Paid)	xxx	By Balance b/d (Opening Creditors)	xxx
To Discount Received	xxx	By Bills Payable (Dishonoured)	xxx
To Bills Payable (Accepted)	xxx	By Total Debtors (Endorsed B/R dis.)	xxx



To Purchases Returns	xxx	By Credit Purchases (Balancing Fig.)	xxx
To Balance c/d (Closing Creditors)	xxx		
Total	xxx	Total	xxx

IMPORTANT QUESTIONS

Q1. Define Single Entry System of accounting.

Answer: Single Entry System is a method of bookkeeping where both aspects of a transaction are not fully recorded. Usually, only the Cash Book and personal accounts are maintained, while real and nominal accounts are ignored, making it an incomplete and unscientific system.

Q2. Why is the statement of assets and liabilities prepared under Single Entry System called a 'Statement of Affairs' and not a Balance Sheet?

Answer: It is called a Statement of Affairs because the values of assets and liabilities are not extracted from proper ledger accounts (which are absent in this system). Instead, they are put down based on physical inspection, estimates, and available incomplete records.

Q3. State the formula to ascertain Profit or Loss under the Statement of Affairs Method.

Answer: $Profit = (CapitalAtTheEnd + Drawings) - (AdditionalCapitalIntroduced + CapitalInTheBeginning)$.

Q4. Ram maintains books on Single Entry System. Calculate his profit or loss for the year ended March 31, 2014, from the following data:

Capital on April 1, 2013: ₹ 60,800. Capital on March 31, 2014: ₹ 67,600. Drawings made during the year: ₹ 19,200. Additional Capital introduced: ₹ 8,000.

Answer: Working Notes:

- **Step 1:** Add Drawings to Closing Capital (67,600 + 19,200 = 86,800).
- **Step 2:** Deduct Additional Capital (86,800 – 8,000 = 78,800).
- **Step 3:** Deduct Opening Capital to find profit (78,800 – 60,800 = 18,000).



Statement of Profit or Loss (For the year ended March 31, 2014)

Particulars	Amount (₹)
Capital as on March 31, 2014 (Closing Capital)	67,600
Add: Drawings made during the year	19,200
	86,800
Less: Additional Capital introduced	(8,000)
Adjusted Capital at the end	78,800
Less: Capital as on April 1, 2013 (Opening Capital)	(60,800)
Profit made during the year	18,000

Q5. From the following information, calculate the Total Purchases made during the year by preparing a Total Creditors Account.

Creditors as on Jan 1: ₹ 800. Cash Paid to Creditors: ₹ 3,100. Purchases Returns: ₹ 100. Creditors as on Dec 31: ₹ 1,340. Cash Purchases: ₹ 1,700.

Answer: Working Notes:

- **Step 1:** Prepare Total Creditors Account to find Credit Purchases. Total Debit side $(3,100 + 100 + 1,340 = 4,540)$. Deduct opening balance $(4,540 - 800 = 3,740)$ Credit Purchases).
- **Step 2:** Calculate Total Purchases. $TotalPurchases = CashPurchases + CreditPurchases (1,700 + 3,740 = 5,440)$.

Total Creditors Account

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Cash A/c (Paid)	3,100	By Balance b/d (Opening Bal.)	800
To Purchases Returns	100	By Credit Purchases (Bal. Fig.)	3,740
To Balance c/d (Closing Bal.)	1,340		
Total	4,540	Total	4,540



5

ADMISSION OF A PARTNER

Introduction

When an **existing partnership firm** expands or needs additional capital and managerial expertise, it may admit a new partner with the consent of all existing partners. This process reconstitutes the firm under a new agreement. This chapter explores the crucial **accounting adjustments** required during admission, such as calculating new profit-sharing and sacrificing ratios, valuing and treating goodwill, revaluing assets and liabilities, and adjusting partner capitals.

Adjustments Required on Admission of a Partner

When a new partner is admitted, the firm stands reconstituted, making the following adjustments necessary:

1. Adjustment in Profit Sharing Ratio and calculation of Sacrificing Ratio.
2. Valuation and Adjustment of Goodwill.
3. Revaluation of Assets and Reassessment of Liabilities.
4. Distribution of Accumulated Profits and Reserves.
5. Adjustment of Partners' Capitals.

Profit Sharing Ratio & Sacrificing Ratio

When a new partner is admitted, he/she acquires their share of profit from the existing partners. The existing partners surrender (sacrifice) a portion of their profit share.

- **Sacrificing Ratio:** The ratio in which existing partners agree to sacrifice their share of profits in favor of the incoming partner.
- **Formula:** $\text{Sacrificing Ratio} = \text{Existing Ratio} - \text{New Ratio}$



Goodwill: Meaning and Factors Affecting It

Meaning: Goodwill is the capitalized value of the extra profit earned by an established firm due to its good name and reputation compared to a newly set up business. It is an intangible asset representing the present value of the capacity to earn future profits.

Factors Affecting Goodwill:

1. **Location:** A central location results in better sales.
2. **Nature of Business:** Stable demand or high-value products.
3. **Efficient Management:** Well-managed firms earn higher profits.
4. **Quality:** Good quality products increase reputation.
5. **Market Situation:** Monopoly conditions lead to high profits.
6. **Special Advantages:** Patents, trademarks, import licenses, etc.

Methods of Valuation of Goodwill

I. Simple Average Profit Method:

$$\text{Average Profit} = \frac{\text{Total Profit of given years}}{\text{Number of years}}$$

$$\text{Goodwill} = \text{Average Profit} \times \text{Number of years of purchase}$$

II. Weighted Average Profit Method: (Used when profits show an increasing tendency).

$$\text{Weighted Average Profit} = \frac{\text{Total product of profit}}{\text{Total of weights}}$$

$$\text{Goodwill} = \text{Weighted Average Profit} \times \text{Number of years of purchase}$$

III. Super Profit Method:

Super profit is the excess of actual profit over the normal profit expected in a similar business.

$$\text{Normal profit} = \text{Capital employed} \times \frac{\text{Normal rate of return}}{100}$$

$$\text{Super Profit} = \text{Actual Profit} - \text{Normal Profit}$$

$$\text{Goodwill} = \text{Super Profit} \times \text{Number of years of purchase}$$



IV. Capitalisation Method:

(a) Capitalisation of Average Profit:

$Capital\ Employed = Total\ Assets - Outside\ Liabilities$

$Capitalised\ Value\ of\ Profit = Average\ Profit \times \frac{100}{Normal\ Rate\ of\ Profit}$

$Goodwill = Capitalised\ Value\ of\ Profits - Capital\ Employed$

(b) Capitalisation of Super Profit:

$Goodwill = Super\ Profit \times \frac{100}{Normal\ Rate\ of\ Profit}$

Accounting Treatment of Goodwill on Admission

According to AS-10, goodwill should be recorded in books only when money is paid for it. If a new partner does not bring cash for goodwill, no goodwill account can be raised; it is adjusted through Capital accounts.

Situation	Journal Entry
1. Goodwill paid privately	No Journal Entry is made in the books of the firm.
2. New partner brings goodwill in Cash	<p>(i) For bringing cash:</p> <p>Bank A/c ...Dr.</p> <p>To Goodwill Premium A/c</p> <p>To New Partner's Capital A/c</p> <p>(ii) For transferring to existing partners:</p> <p>Goodwill Premium A/c ...Dr.</p> <p>To Existing Partner's Capital A/cs (<i>in Sacrificing Ratio</i>)</p>
3. Existing partners withdraw goodwill	<p>Existing Partner's Capital A/cs ...Dr.</p> <p>To Cash/Bank A/c</p>
4. New partner does NOT bring goodwill in Cash	<p>New Partner's Capital A/c ...Dr.</p> <p>To Existing Partner's Capital A/cs (<i>in Sacrificing Ratio</i>)</p>
5. Writing off existing Goodwill appearing in Balance Sheet	<p>Existing Partner's Capital A/cs ...Dr. (<i>in Old Ratio</i>)</p> <p>To Goodwill A/c</p>



Revaluation of Assets and Reassessment of Liabilities

A 'Revaluation Account' (or Profit & Loss Adjustment A/c) is prepared to show the true position of the firm at the time of admission. It records increases/decreases in assets and liabilities.

Standard Format of Revaluation Account

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Decrease in value of assets	xxx	By Increase in value of assets	xxx
To Increase in value of liabilities	xxx	By Decrease in value of liabilities	xxx
To Unrecorded liabilities	xxx	By Unrecorded assets	xxx
To Gain on Reval. transferred to partner's capital A/cs (old ratio)	xxx	By Loss on Reval. transferred to partner's capital A/cs (old ratio)	xxx
Total	xxx	Total	xxx

Treatment of Reserves and Accumulated Profits/Losses

Reserves and accumulated profits/losses belong to the old partners because they were created before the new partner's admission.

- **For Accumulated Profits/Reserves:**

General Reserve A/c ...Dr.

Profit & Loss A/c (Credit Balance) ...Dr.

To Old Partner's Capital A/cs (in Old Profit Sharing Ratio)

- **For Accumulated Losses:**

Old Partner's Capital A/cs ...Dr. (in Old Profit Sharing Ratio)

To Profit & Loss A/c (Debit Balance)



IMPORTANT QUESTIONS

Q1. Define Sacrificing Ratio. How is it calculated?

Answer: At the time of admission of a new partner, existing partners have to surrender some of their share of profits in favor of the new partner. The ratio in which they agree to sacrifice their share is called the sacrificing ratio. It is used to distribute the goodwill premium brought by the new partner.

Formula: **Sacrificing Ratio = Existing Ratio – New Ratio.**

Q2. As per AS-10, what is the rule regarding the recording of Goodwill in the books of accounts?

Answer: According to Accounting Standard 10 (AS-10), goodwill should be recorded in the books of accounts only when some consideration in money or money's worth has been paid for it. If a new partner does not bring their share of goodwill in cash, no goodwill account can be raised in the books. It must be adjusted through capital accounts.

Q3. Deepak and Vivek are partners sharing profit in the ratio of 3:2. They admit Ashu as a new partner for 1/5 share in profit. Calculate the new profit sharing ratio and sacrificing ratio.

Answer:

Step	Calculation	Result
1.	Let total Profit = 1	
2.	Ashu's (New Partner) share	1/5
3.	Remaining share (1 - 1/5)	4/5
4.	Deepak's new share (3/5 of 4/5)	12/25
5.	Vivek's new share (2/5 of 4/5)	8/25
6.	Ashu's share (1/5)	5/25
7.	New Ratio (Deepak : Vivek : Ashu)	12 : 8 : 5
8.	Sacrificing Ratio (Old Share - New Share) Deepak = $3/5 - 12/25 = 3/25$ Vivek = $2/5 - 8/25 = 2/25$	3 : 2



Q4. A firm earned net profits during the last 4 years as: 2003 (₹90,000), 2004 (₹1,20,000), 2005 (₹1,60,000), 2006 (₹1,80,000). Capital employed in the firm is ₹10,00,000. The normal rate of profit is 10%. Calculate the value of the goodwill on the basis of 4 years' purchase of super profit.

Answer:

Step	Calculation Details	Amount (₹)
1.	Total Profit of 4 years (90,000 + 1,20,000 + 1,60,000 + 1,80,000)	5,50,000
2.	Average Annual Profit (5,50,000 / 4)	1,37,500
3.	Normal Profit (10% of 10,00,000)	1,00,000
4.	Super Profit (Average Profit - Normal Profit) (1,37,500 - 1,00,000)	37,500
5.	Value of Goodwill (Super Profit × 4) (37,500 × 4)	1,50,000

Q5. Ashmita and Sahil are partners sharing profit in the ratio of 3:2. They admit Charu for 1/5 share. Charu brings ₹2,50,000 as capital but is unable to bring her share of goodwill in cash. The firm's goodwill is valued at ₹1,80,000. Goodwill already exists in the books at ₹80,000. Make necessary journal entries.

Answer: Working Note:

Charu's share of goodwill = ₹ 1,80,000 × 1/5 = ₹ 36,000.

Sacrificing Ratio of Ashmita and Sahil = 3:2.

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr.		2,50,000	
	To Charu's Capital A/c			2,50,000
	(Being Cash brought by Charu for her capital)			
	Ashmita's Capital A/c ...Dr. (80,000 × 3/5)		48,000	



	Sahil's Capital A/c ...Dr. (80,000 × 2/5)		32,000	
	To Goodwill A/c			80,000
	(Being existing goodwill written off in old ratio)			
	Charu's Capital A/c ...Dr.		36,000	
	To Ashmita's Capital A/c (36,000 × 3/5)			21,600
	To Sahil's Capital A/c (36,000 × 2/5)			14,400
	(Being new partner's share of goodwill adjusted in sacrificing ratio)			



6

RETIREMENT AND DEATH OF A PARTNER

Introduction

When a partner retires or dies, the existing partnership ends, and the firm is reconstituted. Preparing accurate financial statements requires calculating the new profit-sharing and gaining ratios, adjusting goodwill, revaluing assets, and distributing **accumulated reserves**. Finally, the total claim of the retiring partner or the deceased partner's legal representative is calculated and settled.

Meaning of Retirement of a Partner

When one or more partners leave the firm and the remaining partners continue to do the business of the firm, it is known as the retirement of a partner. A partner may decide to quit the partnership business due to old age, health issues, or other unavoidable reasons.

A partner can retire from a partnership business:

- (i) With the consent of all partners, or
- (ii) As per the terms of the agreement, or
- (iii) At his or her own will.

Due to retirement, the existing partnership comes to an end, the remaining partners form a new agreement, and the partnership firm is reconstituted with new terms and conditions.

Profit Sharing Ratio and Gaining Ratio

As soon as a partner retires, the profit-sharing ratio of the continuing partners gets changed. The share of the retiring partner is distributed amongst the continuing partners.

Gaining Ratio: The ratio in which the retiring partner's share is distributed amongst continuing partners is known as the gaining ratio.

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Existing Ratio}$$



Different Cases of Acquiring Share:

(i) Retiring partner's share distributed in Existing Ratio: In the absence of information, the continuing partners take the retiring partner's share in their existing profit-sharing ratio.

(ii) Retiring partner's share distributed in Specified proportions: The remaining partners purchase the share of the retiring partner in a specified ratio. The share purchased by them is added to their old share.

(iii) Retiring Partner's share is taken by one of the partners: The retiring partner's entire share is added to one specific partner's existing share; the other partners' shares remain unchanged.

Treatment of Goodwill

At the time of retirement, the retiring partner is entitled to their share of goodwill because the present goodwill is the result of the past efforts of all partners. According to AS-10, a Goodwill Account cannot be raised in the books unless money has been paid for it.

- **Adjustment Entry (When Goodwill does not appear in the books):**

The gaining partners compensate the retiring partner strictly in their gaining ratio.

Continuing Partners' Capital A/cs ...Dr. (*in Gaining Ratio*)

To Retiring Partner's Capital A/c

- **When Goodwill already appears in the Balance Sheet:**

It must be written off among *all* partners (including the retiring partner) in their *old* profit-sharing ratio before making the new adjustment.

All Partners' Capital A/cs ...Dr. (*in Old Ratio*)

To Goodwill A/c

Revaluation of Assets and Reassessment of Liabilities

A Revaluation Account is prepared to ascertain the net gain or loss on the revaluation of assets and reassessment of liabilities at the time of retirement. The final balance of this account (profit or loss) is transferred to the Capital Accounts of **all partners** (including the retiring/deceased partner) in their **old profit-sharing ratio**.



Treatment of Accumulated Reserves and Undistributed Profit

Any General Reserve, Reserve Fund, or accumulated Profit/Loss appearing in the Balance Sheet belongs to all the partners because it was earned before the reconstitution.

- **For Accumulated Reserves/Profit:**

General Reserve A/c / Profit & Loss A/c ...Dr.

To All Partners' Capital A/cs (*in Old Ratio*)

- **For Accumulated Losses:**

All Partners' Capital A/cs ...Dr. (*in Old Ratio*)

To Profit & Loss A/c

Settlement of Retiring Partner's Claim

At the time of retirement, the retiring partner's claim is settled. The various claims of a retiring partner include:

1. The balance of his/her Capital Account.
2. His/her share in the goodwill of the firm.
3. His/her share in the Revaluation Profit/Loss.
4. His/her share in General Reserve and Accumulated Profit.
5. Interest on Capital (if applicable).

The final amount is either paid in cash immediately or transferred to the **Retiring Partner's Loan Account**. If transferred to a loan account, it carries interest at 6% p.a. (as per the Indian Partnership Act, 1932) until it is completely paid.

Death of a Partner and Ascertainment of Claim

The accounting treatment in the case of a partner's death is identical to retirement. However, the deceased partner's claim is transferred to their **Executor's Account** (Legal Representative). The executor is also entitled to the deceased partner's share of profit earned from the beginning of the financial year up to the exact date of death.



Calculation of Profit up to the Date of Death:

(a) On Time Basis:

$$\text{Estimated Profit} = \text{Previous Year's Profit} \times \frac{\text{Months alive in current year}}{12} \times \text{Deceased Partner's Share}$$

(b) On Turnover (Sales) Basis:

$$\text{Estimated Profit} = \frac{\text{Previous Year's Profit}}{\text{Previous Year's Sales}} \times \text{Sales up to date of death} \times \text{Deceased Partner's Share}$$

Journal Entry for Share of Profit:

Profit & Loss Suspense A/c ...Dr.

To Deceased Partner's Capital A/c

IMPORTANT QUESTIONS

Q1. What is meant by the retirement of a partner? List the various claims of a retiring partner.

Answer: Retirement of a partner means when a partner decides to quit the partnership business due to some unavoidable reasons like old age or health issues. Due to retirement, the existing partnership comes to an end and the remaining partners form a new agreement. The various claims of a retiring partner are:

1. The balance of his/her Capital Account.
2. His/her share in the goodwill of the firm.
3. His/her share in the Revaluation Profit.
4. His/her share in General Reserve and Accumulated Profit.
5. Interest on Capital (if provided in the deed).

Q2. Tanu, Manu, and Rena are partners sharing profits and losses in the ratio of 4:3:2. Tanu retires and the remaining partners decide to take Tanu's share in the existing ratio i.e. 3:2. Calculate the new ratio of Manu and Rena and the Gaining Ratio.



Answer:

Step	Calculation Details	Manu	Rena
1.	Old Ratio (Manu and Rena)	3/9	2/9
2.	Tanu's Share (Retiring Partner)	4/9	-
3.	Gain Acquired (Tanu's share taken in 3:2)	$4/9 \times 3/5 = 12/45$	$4/9 \times 2/5 = 8/45$
4.	New Share (Old Share + Gain Acquired)	$3/9 + 12/45$	$2/9 + 8/45$
5.	Calculation using LCM (45)	$(15 + 12) / 45 = 27/45$	$(10 + 8) / 45 = 18/45$
6.	New Ratio (27 : 18 Simplified)	3	2
7.	Gaining Ratio (New Ratio - Old Ratio)	$27/45 - 15/45 = 12/45$	$18/45 - 10/45 = 8/45$
8.	Final Gaining Ratio (12 : 8 Simplified)	3	2

Q3. A, B, and C are partners in a firm sharing profits in the ratio of 3:2:1. B retired and his share was divided equally between A and C. Calculate the new profit-sharing ratio of A and C.

Answer:

Step	Calculation Details	A	C
1.	Old Ratio (A, B, C = 3:2:1)	3/6	1/6
2.	B's Share (Retiring Partner)	2/6	-
3.	Gain Acquired (B's share taken in 1:1)	$2/6 \times 1/2 = 1/6$	$2/6 \times 1/2 = 1/6$
4.	New Share (Old Share + Gain Acquired)	$3/6 + 1/6 = 4/6$	$1/6 + 1/6 = 2/6$
5.	New Profit Sharing Ratio (4 : 2 Simplified)	2	1

Q4. X, Y, and Z are partners sharing profits in the ratio of 3:2:1. Z dies on 31st May. Sales for the previous year amounted to ₹ 4,00,000 and the profit on sales was ₹ 60,000. Sales from 1st April to 31st May is ₹ 1,00,000. Calculate the deceased partner's share in the profit up to the date of death and pass the necessary journal entry.



Answer:

Particulars	Formula / Details	Amount (₹)
Previous Year's Rate of Profit	$(\text{Previous Year Profit} / \text{Previous Year Sales}) \times 100$ $(60,000 / 4,00,000) \times 100$	15%
Estimated Profit up to Date of Death	Sales up to date of death \times Rate of Profit $1,00,000 \times 15\%$	15,000
Z's Share of Profit	Estimated Profit \times Z's Share (1/6) $15,000 \times 1/6$	2,500

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Profit & Loss Suspense A/c ...Dr.		2,500	
	To Z's Capital A/c			2,500
	<i>(Being deceased partner's share of profit up to the date of death credited to his capital A/c)</i>			

Q5. P, Q, and R are partners sharing profits in the ratio of 3:2:1. Q retires. The new profit-sharing ratio of P and R will be 3:1. The goodwill of the firm is valued at ₹ 60,000. Goodwill already appears in the books at ₹ 30,000. Pass necessary journal entries for the treatment of goodwill.

Answer:

Step	Calculation Particulars	Details / Amount (₹)
1.	Write off existing Goodwill	Distributed in Old Ratio (3:2:1) $P = 15,000; Q = 10,000; R = 5,000$
2.	Q's Share of new Goodwill	$60,000 \times 2/6 = \mathbf{20,000}$
3.	Gaining Ratio of P and R	New Ratio (3:1) - Old Ratio (3/6, 1/6) $P = 3/4 - 3/6 = 3/12$



		$R = 1/4 - 1/6 = 1/12$ Gaining Ratio = 3 : 1
4.	Amount to be debited to P and R	P will pay = $20,000 \times 3/4 = 15,000$ R will pay = $20,000 \times 1/4 = 5,000$

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1.	P's Capital A/c ...Dr.		15,000	
	Q's Capital A/c ...Dr.		10,000	
	R's Capital A/c ...Dr.		5,000	
	To Goodwill A/c			30,000
	<i>(Being existing goodwill written off in the old ratio)</i>			
2.	P's Capital A/c ...Dr.		15,000	
	R's Capital A/c ...Dr.		5,000	
	To Q's Capital A/c			20,000
	<i>(Being retiring partner Q's share of goodwill adjusted through gaining partners' capital accounts in 3:1 ratio)</i>			



7

DISSOLUTION OF PARTNERSHIP FIRM

Introduction

When a **partnership firm** decides to wind up its business operations and close down completely, it is known as the dissolution of the firm. This chapter covers the accounting procedures required to close the books of accounts, dispose of assets, pay off external liabilities, and settle the final claims of the partners.

Objectives

- Understand the meaning of dissolution of a partnership firm.
- Distinguish between the dissolution of a partnership and the dissolution of a partnership firm.
- Prepare the Realization Account for the disposal of assets and payment of liabilities.
- Illustrate the treatment of unrecorded assets and liabilities.
- Prepare partners' capital accounts and the final Cash/Bank account to close the books.

Dissolution of Partnership vs. Dissolution of Partnership Firm

- **Dissolution of Partnership:** It means the termination of the old partnership agreement and the reconstitution of the firm due to admission, retirement, or death of a partner. The firm itself does not end; business operations continue under a new agreement.
- **Dissolution of Partnership Firm:** It means that the firm closes its business and comes to an end. Its affairs are wound up by selling assets, paying liabilities, and discharging partners' claims. The dissolution of a firm necessarily means the dissolution of the partnership.

Modes of Dissolution

1. **Dissolution by Agreement:** When all partners give consent or as per the terms of the agreement.
2. **Compulsory Dissolution:** When all partners (or all except one) become insolvent/unsound mind, the business becomes unlawful, all except one retire/die, expiry of the period, or completion of a specific venture.
3. **Dissolution by Notice:** In a partnership at will, if any partner gives written notice to others.



4. **Dissolution by Court:** When a partner becomes of unsound mind, permanently incapable, deliberately breaches agreements, conduct adversely affects business, transfers interest to a third party, or if the court finds it just and equitable.

Treatment of Assets and Liabilities

On the dissolution of the firm, the books of accounts are closed. A separate account called the '**Realisation Account**' is opened.

- **Transfer of Assets:** All assets (excluding Cash/Bank, fictitious assets, and debit balance of P&L A/c) are transferred to the debit side at their **book value**.
- **Transfer of Liabilities:** All external liabilities (including a partner's wife's loan) are transferred to the credit side at their **book value**. Partners' Capital and Loan accounts are NOT transferred here.
- **Sale of Assets:** Credited to Realisation A/c (By Bank/Cash A/c or By Partner's Capital A/c if taken over).
- **Payment of Liabilities:** Debited to Realisation A/c (To Bank/Cash A/c or To Partner's Capital A/c if taken over).
- **Realisation Expenses:** Debited to Realisation A/c.

Standard Format of Realisation Account

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
All Assets A/c (Book Value) <i>(Except Cash/Bank)</i>	xxx	All External Liabilities A/c <i>(Book Value)</i>	xxx
Cash/Bank A/c <i>(Payment of external liabilities)</i>	xxx	Cash/Bank A/c <i>(Amount realised on sale of various assets)</i>	xxx
Partners Capital A/c <i>(If any liability paid by partner)</i>	xxx	Partners' capital A/c <i>(If any asset is taken over)</i>	xxx
Cash/Bank A/c <i>(Expenses on realisation)</i>	xxx	Partners Capital A/c <i>(For transferring loss on realisation)</i>	xxx



Partners Capital A/c <i>(Expenses on realisation paid by a partner)</i>	xxx		
Partners Capital A/c <i>(For transferring profit on realisation)</i>	xxx		
Total	xxx	Total	xxx

Treatment of Special Items

- **Provisions against assets (e.g., Provision for Doubtful Debts, Provision for Depreciation):** Closed by crediting the Realisation Account.
- **Accumulated Reserves and Profit/Loss:** General Reserve, P&L A/c (Cr), etc., are credited to the Partners' Capital Accounts in their profit-sharing ratio. Undistributed loss (P&L Dr) and fictitious assets are debited to Partners' Capital Accounts.
- **Unrecorded Assets:** Never transferred to the debit of Realisation A/c. Amount realised from their sale is credited to Realisation A/c (By Cash/Bank).
- **Unrecorded Liabilities:** Never transferred to the credit of Realisation A/c. Amount paid to discharge them is debited to Realisation A/c (To Cash/Bank).

Partners' Capital Account and Cash/Bank Account

After transferring the profit or loss from the Realisation Account, the Capital Accounts are settled.

- If a partner's capital account shows a **debit balance**, they bring in cash (Bank A/c ...Dr. To Partner's Capital A/c).
- If a partner's capital account shows a **credit balance**, they are paid off (Partner's Capital A/c ...Dr. To Bank A/c).

Finally, a **Cash/Bank Account** is prepared. If it tallies (shows no balance), it implies that all the accounts of the dissolved firm have been closed properly.



IMPORTANT QUESTIONS

Q1. Distinguish between dissolution of partnership firm and dissolution of partnership.

Answer:

Basis of Distinction	Dissolution of Partnership	Dissolution of Partnership Firm
Meaning	It means the termination of the old partnership agreement and reconstitution of the firm.	It means the firm closes its business and comes to an end.
Business Operations	The business of the firm continues under a new agreement.	The business of the firm ceases to exist.
Settlement	Assets and liabilities are revalued, and the retiring/deceased partner's claim is settled.	Assets are sold, liabilities are paid, and the books of accounts are completely closed.

Q2. What journal entry is made when realisation expenses are agreed to be borne by the partners and paid by the firm?

Answer: When realisation expenses were agreed to be paid (borne) by the partner but were paid by the firm on their behalf:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partner's Capital A/c ...Dr.		xxx	
	To Cash/Bank A/c			xxx
	<i>(Being realisation expenses paid by the firm but borne by the partner)</i>			

Q3. Under what circumstances can the court dissolve the partnership firm?

Answer: A court may order a partnership firm to be dissolved in the following cases:

- When a partner becomes of unsound mind.
- When a partner becomes permanently incapable of performing his/her duties as a partner.
- When a partner deliberately and consistently commits a breach of agreements relating to the management of the firm.



(d) When a partner's conduct is likely to adversely affect the business of the firm.

(e) When a partner transfers his/her interest in the firm to a third party.

(f) When the court regards dissolution to be just and equitable.

Q4. Anu and Hema were partners sharing profits equally. The firm was dissolved on December 31, 2014. The Balance Sheet showed: Sundry Creditors ₹ 42,000; Bills Payable ₹ 26,000; Hema's Loan ₹ 20,000; Reserve Fund ₹ 6,000; Provision for Bad Debts ₹ 2,000; Anu's Capital ₹ 90,000; Hema's Capital ₹ 62,000. Assets were: Cash at Bank ₹ 13,000; Sundry Debtors ₹ 50,000; Stock ₹ 40,000; Bills Receivable ₹ 28,000; Machinery ₹ 60,000; Investment ₹ 30,000; Fixtures ₹ 27,000.

Assets realised: Debtors ₹ 48,000; Stock ₹ 38,000; Bills Receivable ₹ 27,000; Machinery ₹ 62,000. Investment was taken over by Hema at ₹ 36,000 and she agreed to pay creditors. Bills payable paid 3% less. Fixtures are valueless. Realisation expenses were ₹ 2,200. Prepare Realisation Account.

Answer:

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Assets transferred:		By Liabilities transferred:	
Sundry Debtors	50,000	Sundry Creditors	42,000
Stock	40,000	Bills Payable	26,000
Bills Receivable	28,000	Provision for Bad Debts	2,000
Machinery	60,000	By Bank (Assets realised):	
Investment	30,000	Sundry Debtors	48,000
Fixtures	27,000	Stock	38,000
To Hema's Capital (Creditors)	42,000	Bills Receivable	27,000
To Bank (Liabilities Paid):		Machinery	62,000
Bills Payable (26k - 3%)	25,220	By Hema's Capital (Investment)	36,000
Realisation Expenses	2,200	By Loss transferred to:	
		Anu's Capital (Half)	11,710
		Hema's Capital (Half)	11,710
Total	3,04,420	Total	3,04,420



Q5. Sumit and Anish are equal partners. They decided to dissolve the partnership on December 31, 2014. The Balance Sheet showed: Sundry Creditors ₹ 30,000; Bills Payable ₹ 30,000; Reserve Fund ₹ 7,000; Sumit's Capital ₹ 70,000; Anish's Capital ₹ 60,000. Assets were: Cash at Bank ₹ 7,000; Sundry Debtors ₹ 23,000; Stock ₹ 42,000; Furniture ₹ 35,000; Plant ₹ 40,000; Leasehold Land ₹ 50,000.

Assets realised: Leasehold land ₹ 62,000; Furniture ₹ 30,500; Stock ₹ 40,500; Plant ₹ 48,000; Sundry Debtors ₹ 22,500. Sundry Creditors were paid ₹ 29,500 in full settlement. Bills Payable paid 5% less. Expenses of realisation amounted to ₹ 2,500. Prepare Realisation Account.

Answer:

Particulars (Dr.)	Amount (₹)	Particulars (Cr.)	Amount (₹)
To Assets transferred:		By Liabilities transferred:	
Sundry Debtors	23,000	Sundry Creditors	30,000
Stock	42,000	Bills Payable	30,000
Furniture	35,000	By Bank (Assets realised):	
Plant	40,000	Leasehold Land	62,000
Leasehold Land	50,000	Furniture	30,500
To Bank (Liabilities Paid):		Stock	40,500
Sundry Creditors	29,500	Plant	48,000
Bills Payable (30k - 5%)	28,500	Sundry Debtors	22,500
Realisation Expenses	2,500		
To Profit transferred to:			
Sumit's Capital (Half)	6,500		
Anish's Capital (Half)	6,500		
Total	2,63,500	Total	2,63,500



8

ISSUE OF SHARES

Introduction

Share capital is one of the main sources of finance for a company. This chapter details the procedure a company follows to raise capital by issuing shares. It covers the accounting treatment for issuing shares for cash (at par, premium, or discount) or for consideration other than cash, and addresses complexities like over-subscription, calls-in-arrears, and calls-in-advance.

Issue of Shares for Consideration Other Than Cash

Sometimes a company issues shares to vendors instead of paying cash for the purchase of assets, or to promoters for their services.

Accounting Treatment:

- **For issue to Promoters:**

Goodwill A/c ...Dr.

To Share Capital A/c

- **For purchase of Assets from Vendors:**

1. Assets A/c ...Dr.

To Vendors A/c

2. Vendors A/c ...Dr.

To Share Capital A/c

Issue of Shares for Cash

The face value (nominal value) of a share can be collected by the company either in a lump sum or in installments (Application, Allotment, First Call, Second/Final Call).



Accounting Treatment for Installments:**1. Receipt of Application Money:**

Bank A/c ...Dr.

To Share Application A/c

2. Transfer to Capital:

Share Application A/c ...Dr.

To Share Capital A/c

3. Allotment Money Due:

Share Allotment A/c ...Dr.

To Share Capital A/c

4. Receipt of Allotment:

Bank A/c ...Dr.

To Share Allotment A/c

5. Call Money Due:

Share Call A/c ...Dr.

To Share Capital A/c

6. Receipt of Call:

Bank A/c ...Dr.

To Share Call A/c

Full, Under, and Over Subscription

1. Full Subscription: Applications received equal the shares offered.



2. Under Subscription: Applications received are less than the shares offered. Allotment proceeds if the minimum subscription is met.

3. Over Subscription: Applications received are more than the shares offered. A company cannot allot more shares than issued. It has two options:

- **Option I:** Reject excess applications and refund the money (Share Application A/c ...Dr. To Bank A/c.)
- **Option II (Pro-rata Allotment):** Partially accept applications and allot shares proportionately. Excess application money is adjusted towards the allotment (Share Application A/c ...Dr. To Share Allotment A/c). If money still remains, it is transferred to Calls-in-Advance or refunded.

Issue of Shares at Premium

When a company issues shares at a price higher than their face value, the excess amount is called "Premium." It is a capital gain and is credited to the **Securities Premium Reserve A/c**.

Utilization of Securities Premium (Section 78 of Companies Act):

1. Issuing fully-paid bonus shares.
2. Writing off preliminary expenses, discount on issue of shares/debentures, underwriting commission, or issue expenses.
3. Paying premium on redemption of preference shares or debentures.
4. Buy-back of shares.

Accounting Treatment (If demanded with Allotment):

Share Allotment A/c ...Dr.

To Share Capital A/c

To Securities Premium Reserve A/c

Issue of Shares at Discount

When the issue price is less than the face value, it is issued at a discount. Discount is a loss for the company.



Conditions (Section 79 of Companies Act):

1. One year must have elapsed since the commencement of business.
2. Shares must be of a class already issued.
3. Sanctioned by a resolution in the General Meeting and approved by the Court.
4. Discount should not exceed 10% (requires Central Government approval if > 10%).

Accounting Treatment (Adjusted with Allotment):

Share Allotment A/c ...Dr.

Discount on Issue of Shares A/c ...Dr.

To Share Capital A/c

Calls in Arrears and Calls in Advance

- **Calls in Arrears:** If a shareholder fails to pay the allotment or call money within the specified time, the unpaid amount is transferred to the Calls-in-Arrears A/c. The company can charge interest @ 5% p.a.

Entry: Calls-in-Arrears A/c ...Dr. To Share Allotment/Call A/c

- **Calls in Advance:** If a shareholder pays the uncalled amount before it is demanded, it is credited to the Calls-in-Advance A/c. It is shown as a liability in the Balance Sheet. The company pays interest @ 6% p.a. on this amount.

Entry: Bank A/c ...Dr. To Calls-in-Advance A/c

IMPORTANT QUESTIONS

Q1. What is meant by 'Shares Issued at Premium'? State the purposes for which the Premium amount can be utilized.

Answer: If a company issues its shares at a price higher than their face value, the shares are said to have been issued at a premium. The difference is a capital gain and is transferred to the Securities Premium Reserve A/c. According to Section 78 of the Companies Act, the premium amount can be utilized for:



1. Issuing fully-paid bonus shares.
2. Writing off preliminary expenses, discount on the issue of shares/debentures, or underwriting commission.
3. Paying premium on the redemption of Preference shares or Debentures.
4. Buy-back of shares.

Q2. What is meant by issue of shares at discount? State the conditions to be fulfilled for the issue of shares at a discount under the Companies Act.

Answer: When the issue price of a share is less than its nominal (face) value, it is said to be issued at a discount. It is a loss to the company. Conditions under Section 79 of the Companies Act:

1. At least one year must have elapsed from the date of commencement of business.
2. The shares must be of the same class that has already been issued.
3. The company must sanction the issue by passing a resolution in its General Meeting, and court approval must be obtained.
4. The discount should not exceed 10% of the face value (unless sanctioned by the Central Government).

Q3. Fashion Fabrics Ltd. issued 1,00,000 shares of ₹ 10 each on 1st April, 2014. The amount payable was: ₹ 2 on application, ₹ 3 on allotment, and ₹ 5 on call. Make journal entries in the books of the company.

Answer:

S. No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1.	Bank A/c ...Dr.		2,00,000	
	To Share Application A/c			2,00,000
	<i>(Being application money received @ ₹2 per share on 1,00,000 shares)</i>			
2	Share Application A/c ...Dr.		2,00,000	
	To Share Capital A/c			2,00,000
	<i>(Being share application money transferred to share capital)</i>			
3	Share Allotment A/c ...Dr.		3,00,000	



	To Share Capital A/c			3,00,000
	<i>(Being allotment money made due @ ₹3 per share)</i>			
4	Bank A/c ...Dr.		3,00,000	
	To Share Allotment A/c			3,00,000
	<i>(Being allotment money received)</i>			
5	Share First & Final Call A/c ...Dr.		5,00,000	
	To Share Capital A/c			5,00,000
	<i>(Being call money made due @ ₹5 per share)</i>			
6	Bank A/c ...Dr.		5,00,000	
	To Share First & Final Call A/c			5,00,000
	<i>(Being call money received)</i>			

Q4. Luxury Cars Ltd. issued 1,00,000 shares of ₹ 10 each at a premium of ₹ 5 per share, payable as: On application ₹ 4 (including ₹ 2 premium), On allotment ₹ 8 (including ₹ 3 premium), On call ₹ 3. Applications were received for 1,00,000 shares and allotment was made to all. Make journal entries.

Answer:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr.		4,00,000	
	To Share Application A/c			4,00,000
	<i>(Being application money received)</i>			
	Share Application A/c ...Dr.		4,00,000	
	To Share Capital A/c (1,00,000 × 2)			2,00,000
	To Securities Premium Reserve A/c (1,00,000 × 2)			2,00,000
	<i>(Being application money transferred to share capital and securities premium)</i>			
	Share Allotment A/c ...Dr.		8,00,000	
	To Share Capital A/c (1,00,000 × 5)			5,00,000
	To Securities Premium Reserve A/c (1,00,000 × 3)			3,00,000
	<i>(Being share allotment money made due)</i>			



Bank A/c ...Dr.		8,00,000	
To Share Allotment A/c			8,00,000
<i>(Being share allotment money received)</i>			
Share First & Final Call A/c ...Dr.		3,00,000	
To Share Capital A/c			3,00,000
<i>(Being share call money made due)</i>			
Bank A/c ...Dr.		3,00,000	
To Share First & Final Call A/c			3,00,000
<i>(Being share call money received)</i>			

Q5. India Software Ltd. offered 50,000 shares of ₹ 10 each to the public payable as: ₹ 2 on application, ₹ 3 on allotment, ₹ 2 on First call. All shares were applied for and allotted, but Mukesh, a shareholder holding 200 shares, paid the entire balance on allotment. Pass the entries for Allotment (receipt) and First Call (receipt) adjusting the advance.

Answer:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr.		1,51,000	
	To Share Allotment A/c (50k × 3)			1,50,000
	To Calls-in-Advance A/c (200 × 5)			1,000
	<i>(Being amount received on allotment and advance for 200 shares @ ₹5 per share)</i>			
	Bank A/c ...Dr. (49,800 × 2)		99,600	
	Calls-in-Advance A/c ...Dr. (200 × 2)		400	
	To Share First Call A/c			1,00,000
	<i>(Being First call money received on 49,800 shares and advance adjusted for 200 shares)</i>			



9

FORFEITURE OF SHARES

Introduction

When a **shareholder** fails to pay the due amount on allotment or calls, the company may cancel their membership and retain the amount already paid. This chapter covers the **legal procedure** and detailed accounting treatment for the **forfeiture of shares** issued at par, premium, or discount, including pro-rata allotment scenarios.

Meaning, Results, and Procedure of Forfeiture

When a shareholder is deprived of his/her membership due to non-payment of calls, it is known as the forfeiture of shares.

Results of Forfeiture:

- Cancellation of the membership of the defaulting shareholder.
- Reduction of the issued share capital of the company.
- The amount paid by the defaulting member towards share capital stands forfeited.

Procedure of Forfeiture:

1. The authority to forfeit shares must be given to the Board of Directors in the Articles of Association.
2. The Board must give at least **14 days' notice** to the defaulting members to pay the outstanding amount (with or without interest) before a specified date.
3. The notice must explicitly state that failure to pay will result in forfeiture.
4. If the default continues, the Board passes a resolution to forfeit the shares, and the allottee is asked to return the share certificates.

Accounting Treatment: Forfeiture of Shares Issued at Par

When shares issued at par are forfeited, the Share Capital Account is debited with the called-up amount, the Share Forfeited A/c is credited with the amount already received, and the Unpaid Calls A/c is credited with the amount due but not paid.



Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (Called-up amount)		xxx	
	To Share Forfeited A/c (Amount paid)			xxx
	To Unpaid Calls / Calls in Arrears A/c (Amount unpaid)			xxx

Forfeiture of Shares Allotted on Pro-rata Basis

In pro-rata allotments, excess application money is transferred to the Share Allotment A/c. If a shareholder defaults on allotment, the exact unpaid amount must be calculated using the following steps:

Step	Calculation Formula
1. Applied Shares	(Total Applied / Total Allotted) × Shares Allotted to Defaulter
2. Excess Applications	Applied Shares - Allotted Shares
3. Excess Money Received	Excess Applications × Money called per share on application
4. Net Unpaid on Allotment	Total Due on Allotment - Excess Application Money Adjusted

Accounting Treatment: Forfeiture of Shares Issued at Premium

There are two distinct situations when shares issued at a premium are forfeited:

(a) Premium Money has been Received Prior to Forfeiture:

If the premium has been received, the Securities Premium A/c is NOT affected. The entry is exactly the same as for shares issued at par.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (Called-up amount)		xxx	
	To Share Forfeited A/c (Capital amount paid)			xxx
	To Unpaid Calls A/c (Amount unpaid)			xxx

(b) Premium Money has NOT been Received: If the premium is due but not paid, the Securities Premium A/c must be cancelled (debited) at the time of forfeiture.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (Called-up amount)		xxx	
	Securities Premium A/c ...Dr. (Premium due but not paid)		xxx	



	To Share Forfeited A/c (<i>Amount paid excluding premium</i>)			xxx
	To Unpaid Calls A/c (<i>Amount unpaid including premium</i>)			xxx

Accounting Treatment: Forfeiture of Shares Issued at Discount

Discount on the issue of shares is a loss to the company. When such shares are forfeited, the discount originally allowed is written back (credited) to cancel it.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (<i>Called-up amount</i>)		xxx	
	To Share Forfeited A/c (<i>Amount paid</i>)			xxx
	To Discount on Issue of Shares A/c (<i>Discount allowed</i>)			xxx
	To Unpaid Calls A/c (<i>Amount unpaid</i>)			xxx

IMPORTANT QUESTIONS

Q1. State the meaning of forfeiture of shares. What are its main results?

Answer: When a shareholder fails to pay the due amount of allotment or any call on shares issued by the company, the Board of Directors may cancel their membership. This deprivation of membership due to non-payment is called forfeiture of shares. Its main results are:

1. Cancellation of the membership of the shareholder.
2. Reduction of the issued share capital of the company.
3. Forfeiture of the amount already paid by the defaulting member.

Q2. What accounting treatment is given to the Securities Premium A/c on the forfeiture of shares when the amount of premium has NOT been received?

Answer: When a share is forfeited on which the amount of premium has been made due but has not been received, the Securities Premium Account must be cancelled. Therefore, at the time of forfeiture, the Securities Premium A/c is debited with the amount of premium that was due but remained unpaid.



Q3. Alpha Ltd. issued 10,000 shares of ₹ 100 each. Ganesh, who was allotted 300 shares, failed to pay the allotment money (₹ 25), first call (₹ 20), and second/final call (₹ 30). He had only paid the application money (₹ 25). The Board forfeited these shares. Make the journal entry.

Answer:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (300 × 100)		30,000	
	To Share Forfeited A/c (300 × 25)			7,500
	To Share Allotment A/c (300 × 25)			7,500
	To Share First Call A/c (300 × 20)			6,000
	To Share Second and Final Call A/c (300 × 30)			9,000
	<i>(Being 300 shares forfeited due to non-payment of allotment and call money)</i>			

Q4. A company offered 10,000 shares of ₹ 10 each. Applications were received for 15,000 shares. Shares were allotted on a pro-rata basis. Gunakshi, holding 200 shares, failed to pay allotment (₹ 3) and first call (₹ 5). She had paid application money (₹ 2). Her shares were forfeited. Calculate her unpaid amount on allotment and pass the forfeiture entry.

Answer: Working Note Calculations:

- Shares Applied by Gunakshi:** $(15,000 / 10,000) \times 200 = 300$ shares
- Excess Applications Received:** $300 - 200 = 100$ shares
- Excess Application Money Adjusted:** $100 \text{ shares} \times ₹ 2 = ₹ 200$
- Amount Due on Allotment:** $200 \text{ shares} \times ₹ 3 = ₹ 600$
- Net Unpaid Amount on Allotment:** $₹ 600 - ₹ 200 = ₹ 400$

Journal Entry:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (200 × 10)		2,000	
	To Share Forfeited A/c (300 × 2)			600



	To Share Allotment A/c (from working note)			400
	To Share First & Final Call A/c (200 × 5)			1,000
	(Being 200 shares forfeited for non-payment of allotment and call money)			

Q5. The Latest Technology Company Ltd. offered shares of ₹ 20 each at a premium of ₹ 5 per share. Ashima failed to pay the allotment money (₹ 12 including premium) and the first and second calls (₹ 4 + ₹ 4) on 200 shares held by her. She had only paid the application money (₹ 5). Her shares were forfeited. Make the necessary journal entry.

Answer:

(Since premium was due on allotment and she failed to pay it, Securities Premium A/c will be debited).

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Capital A/c ...Dr. (200 × 20)		4,000	
	Securities Premium A/c ...Dr. (200 × 5)		1,000	
	To Share Forfeited A/c (200 × 5)			1,000
	To Share Allotment A/c (200 × 12)			2,400
	To Share First Call A/c (200 × 4)			800
	To Share Second and Final Call A/c (200 × 4)			800
	(Being forfeiture of 200 shares held by Ashima for non-payment of allotment and calls)			



10

REISSUE OF FORFEITED SHARES

Introduction

When **shares are forfeited**, the membership of the original allottee stands cancelled, and they cannot be asked to make payment for the remaining unpaid amount. The forfeited shares become the property of the company. The Board of Directors has the authority to sell these shares to **new purchasers**. This chapter deals with the rules, maximum discount limits, and the accounting treatment for the **reissue of these shares**.

Meaning and Issue Price of Reissued Shares

- **Meaning:** The sale of forfeited shares by the company to a new purchaser is called the 'reissue of shares'.
- **Procedure:** It is not a fresh issue of shares but a sale of existing shares. Therefore, neither a prospectus is issued nor is any offer made to the general public. The Board of Directors passes a resolution allotting these shares to the new purchasers. The entire amount is usually called in one single installment.
- **Issue Price:** The Board of Directors has full authority to decide the price of the reissue. These shares can be reissued at par, at a premium, or at a discount. Generally, these shares are reissued at a discount (a price less than their nominal value).

Maximum Permissible Discount on Reissue

While there is no limit on the maximum price at which shares can be reissued, the Companies Act places a strict restriction on the maximum discount that can be allowed.

Core Rule: The amount of discount allowed at the time of reissue in no case should be more than the amount already forfeited on such shares.

The maximum permissible discount is ascertained in three different situations:

1. **Shares originally issued at par:** The maximum permissible discount is exactly equal to the amount forfeited on such shares (i.e., the amount already paid by the defaulting shareholder).
2. **Shares originally issued at premium:** The amount forfeited is the amount that has been received. If the premium was already received before forfeiture, it is included in the forfeited amount. The maximum discount that can be allowed is equal to this forfeited amount.



3. **Shares originally issued at discount:** The actual amount received becomes the forfeited amount. The maximum permissible discount on reissue will be equal to the amount forfeited *plus* the amount of discount initially allowed on these shares at the time of their original issue.

Recording of Reissue of Shares

When the forfeited shares are reissued at a discount, the Bank account is debited by the amount actually received, and the Share Capital account is credited by the paid-up amount. The amount of discount allowed is debited to the **Share Forfeited Account**. This adjusts the discount allowed against the amount forfeited at the time of original forfeiture.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr. <i>(Amount actually received)</i>		xxx	
	Share Forfeited A/c ...Dr. <i>(Amount allowed as discount)</i>		xxx	
	To Share Capital A/c <i>(Paid-up amount)</i>			xxx

Transfer of Balance of Share Forfeited Account to Capital Reserve Account

If the amount of discount allowed on the reissue of shares is less than the amount forfeited on those shares, the remaining surplus in the Share Forfeited Account represents a capital gain for the company. This surplus profit must be transferred to the **Capital Reserve Account**.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Share Forfeited A/c ...Dr.		xxx	
	To Capital Reserve A/c			xxx
	<i>(Being the surplus of share forfeited account transferred to Capital Reserve)</i>			

Note: If the shares are reissued at par or at a premium, no discount is given. In such cases, the entire amount standing in the Share Forfeited Account is transferred to the Capital Reserve Account.

Reissue of a Part of the Forfeited Shares (Partial Reissue)

If a company reissues all of its forfeited shares, the entire remaining balance in the Share Forfeited Account is transferred to the Capital Reserve. However, sometimes a company reissues only a **part** of the forfeited shares.



In the case of a partial reissue, the amount forfeited on the shares that are *not yet reissued* will remain in the Share Forfeited Account (and is shown on the liabilities side of the Balance Sheet). Only the proportionate profit relating to the **reissued shares** is transferred to the Capital Reserve.

Formula for calculating the amount to be transferred to Capital Reserve:

$$\text{Capital Reserve} = \left(\frac{\text{Total Amount Forfeited}}{\text{Total Number of Shares Forfeited}} \times \text{Number of Shares Reissued} \right) - \text{Discount Allowed on Reissue}$$

IMPORTANT QUESTIONS

Q1. What do you mean by the reissue of forfeited shares? Is a company required to issue a prospectus for it?

Answer: The sale of forfeited shares by the Board of Directors to a new purchaser is called the 'reissue of shares'. Since it is a sale of existing shares that have become the property of the company (and not a fresh issue of new shares), the company is neither required to issue a prospectus nor make any offer to the general public.

Q2. State the rule regarding the maximum permissible discount that can be allowed on the reissue of forfeited shares.

Answer: The Companies Act restricts the maximum discount that can be given on the reissue of forfeited shares. The rule states that the amount of discount allowed at the time of reissue in no case should be more than the amount already forfeited on those specific shares (i.e., the amount already paid by the original defaulting shareholder).

Q3. A company forfeited 400 shares of ₹ 10 each, fully called up, on which the shareholder had paid ₹ 6 per share. The company reissued all these shares as fully paid up for ₹ 7 per share. Pass the necessary journal entries for the reissue and the transfer of profit.

Answer: Working Note Calculations:

- Total Amount Forfeited:** 400 shares × ₹ 6 = ₹ 2,400
- Discount allowed on Reissue:** 400 shares × ₹ 3 (₹ 10 Face Value - ₹ 7 Issue Price) = ₹ 1,200
- Amount transferred to Capital Reserve:** ₹ 2,400 (Forfeited) - ₹ 1,200 (Discount) = ₹ 1,200



Journal Entries:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr. (400 × 7)		2,800	
	Share Forfeited A/c ...Dr. (400 × 3)		1,200	
	To Share Capital A/c (400 × 10)			4,000
	<i>(Being 400 forfeited shares reissued at ₹7 per share as fully paid up)</i>			
	Share Forfeited A/c ...Dr.		1,200	
	To Capital Reserve A/c			1,200
	<i>(Being the surplus on reissue of shares transferred to Capital Reserve)</i>			

Q4. Y Ltd. forfeited 300 shares of ₹ 10 each on which ₹ 8 per share had been paid by the defaulting shareholder. The company reissued all these 300 shares to Mr. Z at ₹ 12 per share as fully paid up. Pass the journal entries for the reissue and the transfer of profit.

Answer: Working Note Calculations:

- Total Amount Forfeited:** 300 shares × ₹ 8 = ₹ 2,400
- Discount allowed on Reissue:** Nil (Shares are reissued at ₹ 12, which is a premium of ₹ 2).
- Amount transferred to Capital Reserve:** Since no discount was given, the entire forfeited amount of ₹ 2,400 is a capital profit and must be transferred.

Journal Entries:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr. (300 × 12)		3,600	
	To Share Capital A/c (300 × 10)			3,000
	To Securities Premium Reserve A/c (300 × 2)			600
	<i>(Being 300 forfeited shares reissued at ₹12 per share, i.e., at a premium)</i>			
	Share Forfeited A/c ...Dr.		2,400	
	To Capital Reserve A/c			2,400



	<i>(Being the entire forfeited amount on reissued shares transferred to Capital Reserve)</i>			
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Q5. XYZ Ltd. forfeited 500 shares of ₹ 100 each on which the shareholder had paid ₹ 40 per share. Out of these, 200 shares were reissued to a new purchaser at ₹ 85 per share as fully paid up. Pass the necessary journal entries for the reissue and the transfer to Capital Reserve.

Answer: Working Note Calculations:

- Total Amount Forfeited on 500 shares:** $500 \text{ shares} \times ₹ 40 = ₹ 20,000$
- Proportionate Forfeited Amount for 200 reissued shares:** $(₹ 20,000 / 500) \times 200 = ₹ 8,000$
- Discount allowed on Reissue of 200 shares:** $200 \text{ shares} \times ₹ 15 (₹ 100 - ₹ 85) = ₹ 3,000$
- Amount transferred to Capital Reserve:** ₹ 8,000 (Proportionate Forfeited) - ₹ 3,000 (Discount) = ₹ 5,000
(The remaining balance of ₹ 12,000 for the 300 unissued shares stays in the Share Forfeited A/c).

Journal Entries:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank A/c ...Dr. (200 × 85)		17,000	
	Share Forfeited A/c ...Dr. (200 × 15)		3,000	
	To Share Capital A/c (200 × 100)			20,000
	<i>(Being 200 forfeited shares reissued at ₹85 per share as fully paid up)</i>			
	Share Forfeited A/c ...Dr.		5,000	
	To Capital Reserve A/c			5,000
	<i>(Being the proportionate profit on 200 reissued shares transferred to Capital Reserve)</i>			

