**SUBJECT : Book-keeping and Basic Accounting**

**SUBJECT CODE : BBA N 104**

**FACULTY : Dr. Yamini Negi**

**Academic Session : 2018-21**

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| **INSTRUCTIONS FOR STUDENTS:**  The students are requested to read the relevant notes thoroughly before coming to the Institute. Surprise test and quiz would be conducted in the class based on these notes and internal marks would be given accordingly. Attending classes with prior reading of the lecture notes would help you to understand the concepts and context of the classroom teaching. |

**SYLLABUS:**

**BBA- I Semester**

**BBA N 104 : Book- Keeping and Basic Accounting**

**Unit I**

Meaning of book keeping, Process of book keeping and accounting, Basic terminology of accounting, subsidiary books or accounts, Difference between accounting and book keepin. Importance and limitations of accounting, various users of accounting information, accounting principles, conventions and concepts.

**Unit II**

Accounting equation, Dual aspect of accounting, types of accounting rules of debit and credit, preparation of journal and cash book including banking transaction, ledger and trial balance.

**Unit III**

Rectification of errors, Preparation of bank reconciliation statement, Bills of Exchange and promissory notes.

**Unit IV**

Valuation of stocks, accounting treatment of depreciation. Reserve and provision, Preparation of final accounts along with adjustment entries.

**Unit V**

Issue of shares and debentures, Issue of bonus shares and right issue, Redemption of preference shares and debentures.

**Text Book:**

J.R.Monga: Financial Accounting

**Suggested Readings for Reference:**

Singal R. S: Book-Keeping and Basic Accounting.

Agarwal B.D: Advanced Accounting.

Gupta R.L & Radhaswamy: Fundamentals of Accounting.

**LECTURE 1**

**After reading this unit, you will be able to:**

• Explain meaning of book-keeping, accountancy and accounting.

• Explain accounting concepts and different principles of financial accounting

• Explicate the importance and scope of financial accounting

• Understand various users of accounting information.

• Identify limitations of Financial Accounting

• Handle self-assessment test.

**MEANING OF ACCOUNTING:**

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

**Attributes of Accounting:**

The above definition of accounting brings out the following attributes of accounting:

1. **Economic Events:** It is the “happening of consequence” to a business entity and can be divided into two parts:
2. **Internal Events:** It is an economic event that occurs entirely within business. Example: Supply of raw materials from stores department to manufacturing department.
3. **External Events:** It is a transaction which involves the transfer or exchange of something for value between two or more persons. Example: Sale of shoes by Bata and company to its customers.
4. **Identifying:** Accounting records only those transactions and events which are of financial character, therefore it is necessary to identify the recordable transactions. If an event cannot be expressed in terms of money, then it is not considered for recording. Example: manager’s honesty cannot be expressed in terms of money, hence not recorded in books.
5. **Recording:** It is concerned with recording of identified events and transactions in the book of original entry i.e. in journal
6. **Classifying:** It is concerned with classification of the recorded transactions of the basis of their nature at one place. Book containing several separate accounts is called ledger.
7. **Summarizing:** This involves presenting the classified data in an understandable manner, useful for internal as well as external users. This involves preparation of trial balance and final accounts (trading account, profit and loss account and balance sheet).
8. **Analyzing and interpreting:** The recorded and classified data is analyzed and interpreted in a manner so that the end users such as creditors, bankers, managers, proprietors etc, can make a meaningful judgment about the financial condition and profitability of the company.
9. **Communicating:** It involves presenting the analyzed data in the form of financial reports or statements, to the end users of the financial information i.e. insiders and outsiders like officers, staff members, shareholders, creditors, government, etc.

**FUNCTIONS OF ACCOUNTING:** Accounting process involves following functions:

**(1)** **To keep systematic record of the financial activities:** The first important function of accounting is to keep a systematic record of the financial transactions of the business. In accounting only those business transactions are recorded which can be expressed in terms of money. Business transactions are properly recorded, classified into appropriate accounts and summarized into financial statements.

**(2) To protect the properties of the business:** Another important function of accounting is to protect the properties of the business by maintaining proper records and providing up-to-date information to the management. Thus, accounting records are called the eyes and ears of the business.

**(3)** **To communicate the financial results:** Accounting communicates the financial results and other valuable financial information to the various interested groups such as officers, creditors, employees, government, consumers.

**(4) To prevent and detect errors and frauds:** The most important function of accounting is that it helps in detecting errors and frauds, if any take place by maintaining proper records.

**ADVANTAGES OF ACCOUNTING:** The main advantages of accounting are:

**(1)** **Helpful in taking managerial decisions:** Accounting provides operating and financial performance of the business which is needed by management for taking planning and controlling decisions.

**(2) Facilitates comparative study:** A systematic record enables a businessman to compare one year’s results with those of other years and locate significant factors leading to the change, if any.

**(3)** **Facilitates control:** Accounting records enable a business concern to keep a good control over various activities and properties.

**(4)** **Information about debtors and creditors:** Accounting records disclose the amounts due to a business and the persons from whom the amounts are due.

**(5)** **Helpful in assessment of tax liability:** A systematic accounting record helps in assessing the tax liability. The tax requirements can be satisfied and tax liability can be calculated easily with the help of accounting records.

**(6)** **Facilitates sale of business:** if someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.

**LECTURE- 2**

**LIMITATIONS OF ACCOUNTING:**

1. **Based on accounting concepts and conventions:** The results disclosed by financial statements are not realistic as they are based on various accounting concepts and conventions. For instance, fixed assets are shown at their historical cost and not at their market price.
2. **Accounting may lead to window dressing:** The management of the business may present the financial statements to suit their own requirement by showing more profit or less profit than the actual value. This is done by window dressing, i.e. showing the items as per the convenience of the management. For example, closing stock may be over or under valued than the true value.
3. **Accounting ignores the effect of changes in price level:** Accounting statements are prepared at historical cost. Assetsare shown in the books of account at the original cost. Thus, assets do not disclose true and fair view and balance sheet does not reflect about true financial position of the entity.
4. **Accounting ignores the qualitative elements:** Accounting is concerned with quantitative elements only; qualitative elements like quality of management and labor force are ignored.
5. **Based on Unrealistic information:** Actual profit of the business can be known only when the business is shut down and closing stock is valued at realizable value. **For example**, assets are recorded at historical cost and accounts are prepared on going concern basis, which provide unrealistic financial information.

**MEANING OF BOOK-KEEPING:**

“Book-keeping is the art of recording the financial transactions of a business, in terms of money, in a set of books accurately and systematically in order to obtain necessary information.”

**Book-keeping is concerned with:**

1. Identifying financial transactions and events.
2. Measuring them in terms of money.
3. Recording the financial transactions and events in journal book
4. Classifying recorded transaction and events i.e. posting them into ledger accounts.

**MEANING OF ACCOUNTANCY:**

Accounting refers to a systematic knowledge of accounting concerned with the principles and techniques. It explains how to deal with various aspects of accounting. It educates as why and how to maintain the books of accounts and how to summarize the accounting information and communicate it to the various users.

**According to Kohler, “Accountancy refers to the entire body of the theory and practice of accounting.”**

**DIFFERENCE BETWEEN BOOK-KEEPING AND ACCOUNTING:**

**Difference between book-keeping and accounting:**

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| **S.No** | **Basis of Difference** | **Book-Keeping** | **Accounting** |
| 1 | Nature | It is concerned with identifying financial transactions; measuring them in monetary terms; recording and classifying them. | It is concerned with summarizing the recorded transactions, interpreting them and communicating the results. |
| 2 | Objective | It is to maintain systematic records of financial transactions. | It aims at ascertaining business income and financial position by maintaining records of business transactions. |
| 3 | Function | It is to record business transactions. So its scope is limited. | It is the recording, classifying, summarizing, interpreting business transactions and communicating the results. Thus its scope is wide. |
| 4 | Basis | Vouchers and other supporting documents are necessary as evidence to record the business transactions. | Book-keeping work as the basis for accounting information. |
| 5 | Level of knowledge | It is enough to have elementary knowledge of accounting to do book-keeping. | For accounting, advanced and in-depth knowledge and understanding is required. |
| 6 | Relation | Book-keeping is the first step of accounting. | Accounting begins where book-keeping ends. |

**LECTURE – 3**

**BASIC TERMINOLOGY OF ACCOUNTING: (Day 3)**

It is necessary to understand the basic accounting terms which are used in the business. These terms are a part of standard accounting terminology:

1. **Assets:** Assets are the property or legal rights owned by an individual or business to which money value can be attached. **According to Finny, “Assets are future economic benefits, the rights, which are owned or controlled by an organization or individual”.**

**Assets can be classified as follows:**

**(a) Tangible assets:** Tangible items are those which can be touched and their physical presence can be noted/felt e.g. furniture, machine etc.

**(b) Intangible assets:** Intangible rights are those rights which one possesses but cannot see e.g. patent rights, copyrights, goodwill etc.

**(c) Fixed Assets:** Fixed assets are those assets which are purchased for the purpose of operating the business and not for resale. Example: land and building, machinery and furniture.

**(d) Current Assets:** Current assets are those assets of a business which are kept for short-term with a purpose to convert them into cash or for resale. Example: bank, debtors, unsold goods.

1. **Liabilities:** Liabilities means the amount which the business owes to outsiders, except the proprietor. **According to Finny and Miller, “Liabilities are debts, they are amounts owed to creditors”.** Liabilities can be classified as under:

**(a) Long-term Liabilities:** These are those liabilities which are payable after a long-term (after 12 months). Example: long-term loans, debentures.

**(b) Current liabilities:** These are liabilities which are payable in the near future (within a year). Example: creditors, bank overdraft, bills payable, outstanding expenses.

1. **Capital:** It is the amount invested in an enterprise by its owners e.g. paid up share capital in a corporate enterprise. It also refers to the interest of owners in the assets of an enterprise. It is the claim against the assets of the business. Any amount contributed by the owner towards the business unit is a liability for the business enterprise. This liability is also termed as capital which may be brought in the form of cash or assets by the owner.
2. **Expense:** Costs incurred by a business in the process of earning revenue are called expenses. In general, expenses are measured by the cost of assets consumed or services used during the accounting period. The common items of expenses are: Depreciation, Rent, Wages, Salaries, Interest, Cost of Heating, Light and water and Telephone, etc.
3. **Income:** The difference between revenue and expense is called income. For example, goods costing Rs.25000 are sold for Rs.35000, the cost of goods sold, i.e. Rs.25000 is expense, the sale of goods, and i.e. Rs.35000 is revenue and the difference. i.e. Rs.10000 is income. In other words, we can state that

**Income = Revenue - Expense.**

1. **Expenditure:** Expenditure is the amount spent or liability incurred for the value received. Expenditure is a payment for a benefit received. Expenditure may be categorized into:

**(a) Capital Expenditure:** Capital expenditure is the amount spent in purchasing assets which will give benefits over a number of accounting periods. Capital expenditure is that expenditure incurred to acquire fixed assets or its improvement.

**(b) Revenue expenditure:** Revenue expenditure is the amount spent to purchase goods and services that are consumed during the accounting period. Revenue expenditure does not increase the earning capacity but it maintains the earning capacity in the current year. These expenses are shown on the debit side of the profit and loss account.

1. **Revenue:** Revenue means the amount, which as a result of operations, i.e. sale of goods or services, is added to the capital. Revenue is the inflow of assets, which results in an increase in the owner’s equity. Other items of revenue common to many businesses are: Commission, Interest, Dividends, Royalties, and Rent received, etc. Revenue is also called Income.
2. **Debtor:** Persons who are to pay for goods sold or services rendered or in respect of contractual obligations. It is also termed as debtor, trade debtor, and accounts receivable. Example: when goods are sold to a person on credit that person is called debtor.
3. **Creditor:** Creditors are persons who have to be paid by an enterprise an amount for providing goods and services on credit. Example: Mohan is a creditor of a firm when goods are purchased on credit from him.

**(10)Goods:** Goods are the items forming part of the stock-in-trade of an enterprise, which are purchased or manufactured with a purpose of selling. Example: Enterprise dealing in home appliances such as T.V, fridge, Air conditioner, etc is goods.

**(11)Cost:** It is the amount of expenditure incurred on or attributable to a specified article, product or activity.

**(12)Gain:** Gain is a profit that arises from transactions which are incidental to business such as sale of investments or fixed assets at more than their book values. Gain may be operating gain or non-operating gain.

**(13) Purchase:** This term is used for goods to be dealt-in i.e. goods are purchased for resale or for producing the finished products which are meant for sale. Goods purchased may be Cash Purchases or Credit Purchases. Thus, Purchase of goods is the sum of cash purchases and credit purchases.

**(14) Sale:** Sales are total revenues from goods or services provided to customers. Sales may be in cash or in credit.

**(15) Transaction:** It is an event which involves exchange of some value between two or more entities. It can be purchase of stationery, receipt of money, payment to a supplier, incurring expenses, etc. It can be a cash transaction or a credit transaction.

**(16) Profit:** It is the excess of revenue of a business over its costs. It may be gross profit and net profit. Gross profit is the difference between sales revenue and the proceeds of goods sold and/or services provided over its direct cost of the goods sold. Net profit is the profit made after allowing for all types of expenses. There may be a net loss if the-expenses exceed the revenue.

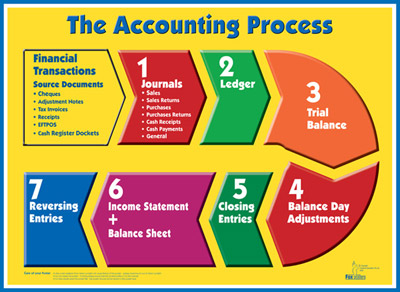
**(17)Drawings**: It is the amount of money or the value of goods which the proprietor takes for his personal use. Drawing reduces the investment of the owners.

**(18) Voucher:** Voucher is an evidence of a business transaction. Examples of voucher are: cash memo, invoice or bill.

**(19) Book Value:** This is the amount at which an item appears in the books of accounts of financial statements.

**LECTURE- 4**

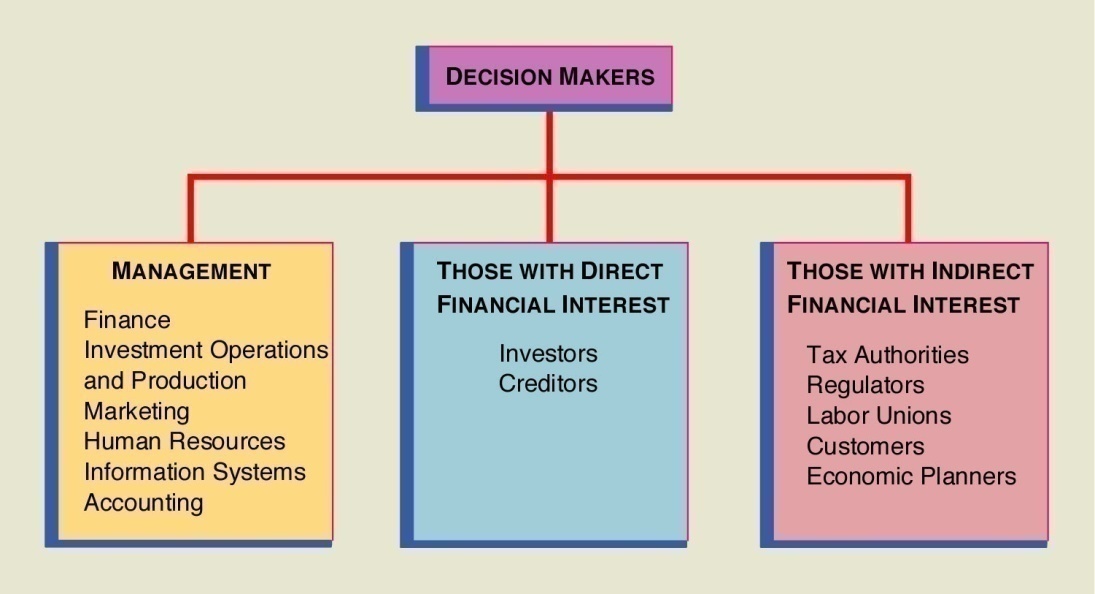
**ACCOUNTING PROCESS:**

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The accounting process is a series of activities that begins with a transaction and ends with the closing of the books. Because this process is repeated each reporting period, it is referred to as the accounting cycle and includes these major steps:

1. Identify the transaction or other recognizable event.
2. Prepare the transaction's [source document](http://www.netmba.com/accounting/fin/process/source/) such as a purchase order or invoice.
3. Analyze and classify the transaction. This step involves quantifying the transaction in monetary terms (e.g. dollars and cents), identifying the accounts that are affected and whether those accounts are to be debited or credited.
4. Record the transaction by making entries in the appropriate journal, such as the sales journal, purchase journal, cash receipt or disbursement journal, or the general. Such entries are made in chronological order.
5. Post general journal entries to the [ledger accounts](http://www.netmba.com/accounting/fin/process/ledger/).
6. Prepare the [trial balance](http://www.netmba.com/accounting/fin/process/trial/) to make sure that debits equal credits. The trial balance is a listing of all of the ledger accounts, with debits in the left column and credits in the right column. At this point no adjusting entries have been made. The actual sum of each column is not meaningful; what is important is that the sums be equal. Note that while out-of-balance columns indicate a recording error, balanced columns do not guarantee that there are no errors. For example, not recording a transaction or recording it in the wrong account would not cause an imbalance.
7. Correct any discrepancies in the trial balance. If the columns are not in balance, look for math errors, posting errors, and recording errors. Posting errors include:
   * posting of the wrong amount,
   * omitting a posting,
   * posting in the wrong column, or
   * Posting more than once.
8. Prepare [adjusting entries](http://www.netmba.com/accounting/fin/process/adjusting/) to record accrued, deferred, and estimated amounts.
9. Post adjusting entries to the ledger accounts.
10. Prepare the adjusted trial balance. This step is similar to the preparation of the unadjusted trial balance, but this time the adjusting entries are included. Correct any errors that may be found.
11. Prepare the [financial statements](http://www.netmba.com/accounting/fin/process/statements/).
    * Income statement: prepared from the revenue, expenses, gains, and losses.
    * Balance sheet: prepared from the assets, liabilities, and equity accounts.
    * Statement of retained earnings: prepared from net income and dividend information.
    * Cash flow statement: derived from the other financial statements using either the direct or indirect method.
12. Prepare [closing journal entries](http://www.netmba.com/accounting/fin/process/closing/) that close temporary accounts such as revenues, expenses, gains, and losses. These accounts are closed to a temporary income summary account, from which the balance is transferred to the retained earnings account (capital). Any dividend or withdrawal accounts also are closed to capital.
13. Post closing entries to the ledger accounts.
14. Prepare the after-closing trial balance to make sure that debits equal credits. At this point, only the permanent accounts appear since the temporary ones have been closed. Correct any errors.
15. Prepare [reversing journal entries](http://www.netmba.com/accounting/fin/process/reversing/) (optional). Reversing journal entries often are used when there has been an accrual or deferral that was recorded as an adjusting entry on the last day of the accounting period. By reversing the adjusting entry, one avoids double counting the amount when the transaction occurs in the next period. A reversing journal entry is recorded on the first day of the new period.

**VARIOUS USERS OF ACCOUNTING INFORMATION:**

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Accounting is an information system which identifies records and communicated this information to the interest users in the form of financial statements. These financial reports are transferred to the users in two forms-internal and external. Internal financial reports are used by an individual who runs, manages and operates the daily activities of inside area of an organization. Manager, supervisor, financial director are the most featured examples of internal users. External financial reports are used by individuals and organizations who want financial accounting information. External users are not the part of management of the company.

1. **Creditors:** Creditors are generally focused on those information which are related to the borrower before making a large loan such as the Bank will want information about the borrower to repay the loan, the amount of assets and liabilities of the borrower, evidence of income, tax policies and so on.
2. **Investors:** Investors generally provide money to individual or organization to start a business. Before investing money investors generally want to know whether they should invest or not or if they would invest to start a business now then how much return they will get from their investment.
3. **Government Regulatory agencies:** Government regulatory agencies like State government agencies and security and exchange commission want financial accounting information which is related to the investors, business organizations or any individuals. These regulatory agencies want the information to know that whether the business organizations are following the business rules and regulation or not or whether the investors are able to invest or make decisions or not.
4. **Taxing Authority:** Taxing authority wants financial accounting information relating to the tax policies, tax laws, amount of payable tax, etc from the individual or organization. Taxing authority wants financial accounting information to know that the business organizations are following tax rules or not and their ability to pay income tax because income tax is based on the financial accounting reports.
5. **Suppliers and Customers:** Customers also want to know about company on issues like warranty, product development, etc. Suppliers want to know about company’s future goals so that they can serve best material in coming days.
6. **Employers and labor unions:** Employers use accounting information for their own benefit. Accounting information helps the employee to ensure their future benefit from the company like pension, health provision, retirement benefit, etc. Labor union wants accounting information to know their future salary.

**LECTURE- 5**

**ACCOUNTING CONCEPTS:**

In order to maintain uniformity and consistency in preparing and maintaining books of accounts, certain rules or principles have been evolved. These rules/principles are classified as concepts and conventions. These are foundations of preparing and maintaining accounting records.

“Accounting concepts refers to the basic assumptions and rules and principles which work as the basis of recording of business transactions and preparing accounts. The various accounting concepts are:

**(1)Business Entity Concept:** This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense. This concept helps in ascertaining the profit of the business as only the business expenses and revenues are recorded.

**(2) Money Measurement Concept:** According to this concept, only those business transactions which can be expressed in terms of money are recorded in the books of accounts. Another aspect of this concept is that the records of the transaction are to be kept not in physical units but in the monetary units. Example: Sale of goods Rs. 2, 00,000 can be expressed in terms of money; hence they are recorded in the books of accounts.

**(3) Going concern concept:** This concept states that a business firm will continue to carry on its activities for an indefinite period of time. This is an important assumption of accounting, as it provides a basis for showing the value of assets in the balance sheet. Example: a company purchases a plant and machinery of Rs.100000 and its life span is 10 years. According to this concept every year some amount will be shown as expenses and the balance amount as an asset. In the absence of this concept, the cost of a fixed asset will be treated as an expense in the year of its purchase.

**(4) Accounting Period Concept:** All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc. It helps in predicting the future prospects of the business.

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| Year that begins from 1st of January and ends on 31st of December, is known as Calendar Year. The year that begins from 1st of April and ends on 31st of March of the following year, is known as financial year. |

**NOTES:**

**ACCOUNTING PRINCIPLES:**

1. **Accounting Cost Concept:** Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them. The cost concept is also known as historical cost concept. This method helps in calculating depreciation on fixed assets.
2. **Dual Aspect Concept:** Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. The implication of dual aspect concept is that every transaction has an equal impact on assets and liabilities in such a way that total assets are always equal to total liabilities. The duality concept is commonly expressed in terms of an accounting equation:

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| **ASSETS = CAPITAL + LIABILITIES** |

(3) **Revenue Recognition Concept:** According to the Revenue Recognition concept, revenue is considered to have been realized when a transaction has been entered into and the obligation to receive the amount has been established. Recognizing revenue and receipt of an amount are two separate aspects. **Example:** suppose an enterprise has received an advance in February 2009 for the sale to be made in May 2009, revenue shall be recognized in May 2009, upon sale having been made because the legal obligation to receive the amount has been established in May 2009. Generally revenue is recognized at the point of sale or while rendering service.

**(4) Matching Concept:** According to the matching concept, cost incurred to earn the revenue should be recognized as expense in the period when revenue is recognized as earned. Under this concept the expenses for an accounting period are matched against related revenues. The matching concept operates as follows:

1. When an item of revenue is recognized as income, i.e. is entered in the profit and loss account, all expenses incurred should also be recognized as expenses.
2. If an expense is incurred against which the revenue will be earned in the next period, the amount is carried to the next period and then next year be treated as an expense.
3. If an amount of revenue is received during the year but against it service is to be rendered or goods are to be sold in the next year, the amount received must be treated as revenue in the next year after the services have been rendered or the goods have been sold.

**(5) The Accrual Concept:** According to the Accrual concept, a transaction is recorded at the time when it takes place and not when the settlement takes place. Under this concept, profit is regarded as earned at the time the goods or services are sold to a customer, i.e. the legal title is passed to the customer, who has an obligation to pay for them. Similarly, expense is regarded as spent when the goods or services are purchased and an obligation to pay for them has been assumed. **Example:** a firm sells goods for Rs. 55,000 on 25th March 2011 and the payment is not received until 10th April 2011, the amount is due and payable to the firm on the date of sale i.e. 25th March 2011. It must be included in the revenue for the year ending 31st March 2011.

**LECTURE-6**

**ACCOUNTING CONVENTIONS:**

**(1) Principle of materiality:** According to this principle, only the material or important facts should be recorded through the financial statements. All other unimportant or less important information should either be totally ignored or recorded as footnotes or merged with important items. Examples: if the value of remaining pencils, carbon paper, are not shown in the balance sheet at the end of the accounting year, it will not affect the balance sheet.

**(2) Principle of consistency:** In order to enable the management to compare the results of one year with those of other years or with those of other organizations in the same field, it is necessary to prepare the financial statements on some uniform rules and assumptions. They should not be subject to frequent changes. This is known as ‘principle of consistency’. Examples: If one year one method of depreciation is followed but in next year an altogether different method is adopted, the results shown by the two financial statements will not be useful for comparison because they are based on different conventions.

**(3) Principle of conservatism or prudence:** According to this principle, the anticipated losses should be recorded in the books of accounts, but all unrealized gains should be ignored. In other words, the accountant follows the policy of ‘playing safe’ as per principle of conservatism. Accordingly, provision must be made for all known liabilities despite the uncertainty in their amount. Principle of conservatism is normally followed in the following cases:

(a) Provision for bad and doubtful debt is made in anticipation of bad debts.

(b) Closing stock is valued at cost price or market price whichever is less.

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| **STUDY NOTES:** |

**EXERCISE:**

Q1: What is accounting? What are its objectives and limitations?

Q2: Distinguish between book-keeping and accounting.

Q3: Explain the convention of consistency with example

Q2: Explain the accounting convention of conservatism with example.

Q4: Explain the convention of materiality

Q5: Explain the accounting convention of full disclosure with example.

Q6: Give your decision in the following situations:

(i) A business has unsold stock at the end of year. The cost price is Rs.200000 and the market price is Rs 250000. At which price the unsold stock is recorded?

(ii) What will be your decision if the cost price in the above case is Rs.210000?

(iii) A businessman anticipates that it may not be possible to collect Rs.50000 from one of his debtors. will he record this transaction in books of account and at what value?

**LECTURE-7**

**ACCOUNTING EQUATION:**

According to dual aspect concept, every transaction affects the business in two ways by the same amount. Suppose, a businessman starts business with Rs. 2, 00,000. In the books of accounts, Rs. 200000 will be recorded as an asset and an equivalent amount will be shown as liability against the owner. This mathematical expression is known as accounting equation. Every transaction has its effect on the accounting equation in such a manner that both sides remain equal.

The recording of business transaction in books of accounts is based on a fundamental equation called accounting equation. This equation expresses the equality of assets on one side and the claims of outsiders and owners or proprietors on the other side. In the mathematical form,

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| **ASSETS= CAPITAL + IABILITIES** |

**Effect of business transactions on accounting equation**

These transactions increase or decrease the assets, liabilities, or capital. Every business has some assets. For example, Sunil started business with cash Rs.3, 00,000 as Capital. In this transaction, asset in the form of cash

is created for the business. Hence,

**Cash (Asset) = Capital (Equity)**

Rs.3, 00,000 = Rs.3, 00,000

Sunil purchased Machinery for Rs.40, 000 and Furniture for Rs.20, 000. Thus, the position of the assets and capital is as:

**Cash + Machinery + Furniture = Capital**

2, 40,000 + 40,000 + 20,000 = 3, 00,000

Increase or decrease in capital will result in the corresponding increase or decrease in assets. For example Sunil withdrew cash for personal use Rs.5,000. Thus, the position of the assets and capital is as under:

**Cash + Machinery + Furniture = Capital**

2,40,000 + 40,000 + 20,000 = 3,00,000

[–5,000] + 0 + 0 = [–5,000]

2,35,000 + 40,000 + 20,000 = 2,95,000

Business enterprise borrows money in the form of loan from outsiders to carry on its activities. In other words, every business concern owes money from outsiders. Money borrowed from outsiders is called as liability. For

example, Rs.1,50,000 borrowed from Shipra. Thus, the position of the assets and capital is as under:

**Cash + Machinery + Furniture = Liabilities + Capital**

2,35,000 + 40,000 + 20,000 = 0 + 2,95,000

+1,50,000 + 0 + 0 = 1,50,000 + 0

3,85,000 + 40,000 + 20,000 = 1,50,000 + 2,95,000

Expenses and Revenue also affect the accounting equation. Their effect is always on the capital account. Business concern has to meet some expenses in its normal course of operations such as payment of salary, rent, insurance premium, postage, wages, repairs etc. Payment of these expenses reduces the cash. These expenses reduce the net income of the business. All the income is the income of proprietor, which is added in the capital account, so all these expenses are deducted from the capital account. Similarly, business concern receives some revenues during normal course of operations, such as rent received, commission received, etc. Revenue is added to the cash balance as it is received in terms of cash. Revenue increases the net income of the business and hence, it is added to the capital account. Now, the accounting equation is represented by

|  |
| --- |
| **ASSETS = LIABILITIES + CAPITAL**  + Revenue (cash) = + Revenue  - Expenses (cash) = - Expenses |

**RULES FOR ACCOUNTING EQUATIONS:**

**(1)CAPITAL**: When capital is increased, it is credited (+) and when some part of the capital is withdrawn, i.e. drawings are made, it is debited (-).

**(2) Interest on capital:** It is an expense for the business, and thus, profit is reduced by the amount and since interest on capital is an income for the owner it is added to capital.

**(3) Interest on drawings:** Drawings is a profit for the business therefore added to profit and thus, capital, since it is a loss/expense for the owner, thus, it is deduced from capital

**(4) Revenue:** Capital is increased by the amount of revenue.

**(5) Expense**: Capital is decreased by the amount of expenses.

**(6) Outsider’s equity:** When liabilities are increased, outsider’s equities are credited (+) and when liabilities are decreased, outsider’s liabilities are debited (-).

**(7) Assets:** If there is an increase in assets, the increase is debited (+) in the asset account. If there is decrease in assets, the decrease is credited (-) in the asset account.

**(8) Effect of outstanding expenses:** Increase in liabilities and decrease in capital

**(9) Accrued income:** Increase in asset and increase in capital

**(10) Income received in advance:** Increase in asset (as cash) and increase in liabilities.

**Effect of transactions on the accounting equation**

You have learnt that assets, liabilities and capital are the three basic elements of every business transaction, and their relationship is expressed in the form of accounting equation which always remains equal. At any point of time, there can be a change in the individual asset, liability or capital, but the two side of the accounting equation always remain equal. Let us verify this fact by taking up some transactions and see how these transactions affect the accounting equation:

1. Namita started business with cash Rs.3,50,000 introduced as capital. Thus the equation is as:

**Assets = Liabilities + Capital**

3,50,000 = 0 + 3,50,000

This transaction shows that Rs.3, 50,000 have been introduced by Namita in terms of cash, which is the capital for the business concern. Hence on one hand, the asset [cash] has been created to the extent of Rs.3, 50,000.

2. She purchased goods for cash Rs. 90,000. Thus the accounting equation is as:

**Assets = Liabilities + Capital**

**Cash + Goods**

**Old equation** 3, 50,000 = 0 + 3, 50,000

**Effect of** **Transaction** –90,000 + 90,000 = 0 + 0

**New equation** 2, 60,000 + 90,000 = 0 + 3, 50,000

Goods purchased is an asset and cash paid is also an asset. Hence in this transaction, there is an increase in one asset [Goods] and decrease in the other asset [cash]. There is no change in capital and liabilities. i.e. the other side of the accounting equation.

3. She purchased goods from Mohit for Rs.60, 000 on credit. Thus, the equation is as:

**Assets = Liabilities + Capital**

**Cash + Goods**

**Old equation** 2,60,000 + 90,000 = 0 + 3,50,000

**Effect of Transaction** 0 + 60,000 = 60,000 + 0

**New equation** 2,60,000 + 1,50,000 = 60,000 + 3,50,000

In this transaction goods have been purchased on credit from Mohit , hence there is an increase in the assets [goods] by Rs.60,000 and also an increase in the liabilities by Rs.60,000 as the business concern now owes money to Mohit.

4. She sold goods to Anish for Rs.40,000 (Cost Rs.25,000) and received Cash Rs.10,000 and balance after one month. Thus the accounting equation is as:

**Assets = Liabilities + Capital**

**Cash + Goods + Debtors**

**Old equation** 2,60,000 + 1,50,000 + 0 = 60,000 + 3,50,000

**Effect of transaction** 10,000 + [–25,000] + 30,000 = 0 + 15,000

**New equation** 2,70,000 + 1,25,000 + 30,000 = 60,000 + 3,65,000

In this transaction goods have been sold on credit and some on cash to Anish, so there is a decrease in the assets [goods] by Rs.25,000, and increase in the assets (Anish} by Rs.30,000 and [Cash] by Rs.10,000. In this process the proprietor has gain an amount of Rs.15,000 which is added to his capital.

5. She paid salaries to employees for Rs.16,000.

Assets = Liabilities + Capital

Cash + Goods + Debtors

Old equation 2,70,000 + 1,25,000 + 30,000 = 60,000 + 3,65,000

Effect of transaction [-16,000] + 0 + 0 = 0 + [–16,000]

New equation 2,54,000 + 1,25,000 + 30,000 = 60,000 + 3,49,000

In this transaction, salaries paid to employees are expenses for the business concern. Salaries are paid in terms of cash, hence cash as an asset is reduced by Rs.16, 000 and as all expenses reduce the capital, so capital is also reduced by Rs. 16,000.

|  |
| --- |
| **STUDY NOTES:** |

**LECTURE - 8**

**ILLUSTRATION 1:**

1. Hemant started business with cash Rs. 3,00,000
2. Purchased goods for cash Rs. 80,000
3. Sold goods (costing Rs. 30,000) for Rs. 45,000
4. Purchased goods from Monika Rs. 70,000
5. Salary paid Rs. 7,000
6. Commission Received Rs. 5,000
7. Paid cash to Monika in full settlement Rs. 69,000
8. Goods sold to Rahul (costing Rs. 20,000) for Rs. 25,000

Solution:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| S.no | Transaction | Assets  Cash + Goods + Debtors | =  Total | Equity  Liabilities + capital | Total |
| 1 | Started business with cash | 3,00,000 + 0 + 0 | 3,00,000 | 0 + 3,00,000 | 3,00,000 |
| 2 | Purchased goods for cash  New Equation | [-80,000] + 80,000 + 0  2,20,000 + 80,000 + 0 | 3,00,000 | 0 + 0  0 + 3,00,000 | 3,00,000 |
| 3 | Sold goods for cash  New Equation | 45,000 +[-30,000] + 0  2,65,000 + 50,000 + 0 | 3,15,000 | 0 + 15,000  0 + 3,15,000 | 3,15,000 |
| 4 | Purchased goods from Monika  New Equation | 0 + 70,000 + 0  2,65,000 + 1,20,000 + 0 | 3,85,000 | 70,000 + 0  70,000 + 3,15,000 | 3,85,000 |
| 5 | Salary paid  New Equation | [-7,000] + 0 + 0  2,58,000 + 1,20,000 + 0 | 3,78,000 | 0 + [-7,000]  70,000 + 3,08,000 | 3,78,000 |
| 6 | Commission Received  New Equation | 5,000 + 0 + 0  2,63,000 + 1,20,000+ 0 | 3,83,000 | 1. + 5,000   7,0000 + 3,13,000 | 3,83,000 |
| 7 | Paid Cash to Monika in full settlement  New Equation | [-69000] + 0 + 0  1,94,000 + 1,20,000 + 0 | 3,14,000 | [-70,000] + 1,000  0 + 3,14,000 | 3,14,000 |
| 8 | Goods sold to Rahul  New Equation | 1. + [-20,000] + 25,000   1,94,000 + 1,00,000+ 25,000 | 3,19,000 | 1. + 3,19,000   0 + 3,19,000 | 3,19,000 |

**Exercise Questions:**

**Q1: Prepare accounting equation on the basis of the following :**

(i) Anup started business with cash Rs.250,000

(ii) Purchased goods for cash Rs.35000

(iii) Purchased office furniture for cash Rs.12000

(iv) Paid rent Rs.7000

(v) Sold goods (costing Rs.30000) for Rs.50000 for cash

Q**2: Show the accounting equation on the basis of the following transactions:**

(i) Manu started business

Cash 600000

Goods 100000

(ii) Purchased office machine for cash 90000

(iii) Sold goods (costing Rs 60000) for credit to Asha

(iv) Purchased building for cash 130000

(v) Cash received from Ashu 80000

(vi) Purchased goods on credit to M/S Ashok Trader for 70000

(vii) Salaries paid 6000

(viii) Insurance prepaid 10000

(ix) cash paid to M/s Ashok traders in full settlement 68000

Q3: Show the accounting equation on the basis of the following transactions:

(i) Building purchased for Rs.600000

(ii) Goods sold on credit to M/s Reema Trader Rs.110000

(iii) Salary paid to Rs.100000

(iv) Withdrew cash for personal use Rs.6000

(v) Cash receipts from debtors M/s Ankit Bros Rs.22000

**LECTURE - 9**

**TYPES OF ACCOUNTING:**

Accounting is the art of analyzing and interpreting data. It may not be apparent to some but every business and every individual uses accounting in some form. An individual may knowingly or unknowingly use accounting when he evaluates his financial information and relays the results to others. Accounting is an indispensable tool in any business, may it be small or multi-national.

The term "accounting" covers many different types of accounting on the basis of the group or groups served. The following are the types of accounting.

**1. Private or Industrial Accounting**: This type of accounting refers to accounting activity that is limited only to a single firm. A private accountant provides his skills and services to a single employer and receives salary on an employer-employee basis. The term private is applied to the accountant and the accounting service he renders. The term is used when an employer-employee type of relationship exists even though the employer is some case is a public corporation.

**2. Public Accounting**: Public accounting refers to the accounting service offered by a public accountant to the general public. When a practitioner-client relationship exists, the accountant is referred to as a public accountant. Public accounting is considered to be more professional than private accounting. Both certified and non certified public accountants can provide public accounting services. Certified accountants can be single practitioners or by partnership ranging in size from two to hundreds of members. The scope of these accounting firms can include local, national and international clientele.

**3. Governmental Accounting**: Governmental accounting refers to accounting for a branch or unit of government at any level, may it be federal, state, or local. Governmental accounting is very similar to conventional accounting methods. Both the governmental and conventional accounting methods use the double-entry system of accounting and journals and ledgers. The object of government accounting units is to give service rather than make profits. Since profit motive cannot be used as a measure of efficiency in government units, other control measures must be developed. To enhance control, special funds accounting is used. Governmental units can use the services of both private and public accountant just as any business entity.

**4. Fiduciary Accounting:** Fiduciary accounting lies in the notion of trust. This type of accounting is done by a trustee, administrator, executor, or anyone in a position of trust. His work is to keep the records and prepares the reports. This may be authorized by or under the jurisdiction of a court of law. The fiduciary accountant should seek out and control all property subject to the estate or trust. The concept of proprietorship that is common in the usual types of accounting is non-existent or greatly modified in fiduciary accounting.

**5. National Income Accounting:** National income accounting uses the economic or social concept in establishing accounting rather than the usual business entity concept. The national income accounting is responsible in providing the public an estimate of the nation's annual purchasing power. The GNP or the gross national product is a related term, which refers to the total market value of all the goods and services produced by a country within a given period of time, usually a calendar year.

**BASES OF ACCOUNTING:**

One of the most significant functions of accounting is to make us know true and fair amount of profit earned by the business entity in a particular period. This Profit or income figure can be ascertained by following:

(i) Cash Basis of accounting, or

(ii) Accrual Basis of accounting.

**I. Cash Basis of accounting**

This is a system in which accounting entries are recorded only when cash is received or paid. Revenue is recognized only on receipt of cash. Similarly, expenses are recorded as incurred when they are paid. The difference between the total revenues and total expenses represents profit or loss of an enterprise for a particular accounting period. Outstanding and prepaid expenses and income received in advance or accrued incomes are not considered. Outstanding Expenses are those expenses which have become due during the accounting period but which have yet not been paid off. Prepaid Expenses are those expenses which have been paid in advance. Accrued Income means income which has been earned by the business during the accounting period but has not yet become due and therefore has not yet been received. Income received in advance means income which has been received by the business before being earned. Costs incurred during a particular period should be set out against the revenue of the period to ascertain profit or loss.

**Advantages:** The advantages of adoption cash basis of accounting are:

1. It is very simple as no adjustment entries are required.
2. It appears more objective as very few estimates and personal judgments are required.
3. It is more suitable to those entities which have most of the transactions on cash basis.

**Disadvantages:** The disadvantages of adopting cash basis of accounting are:

1. It does not give a true and fair view of profit and loss and the financial position of the business unit as it ignores outstanding and prepaid expenses.
2. It does not follow the matching concept of accounting.

**II. Accrual Basis of accounting**

Revenue and expense are taken into consideration for the purpose of income determination on the basis of accounting period to which they relate. The accrual basis makes a distinction between actual receipts of cash and the right to receive cash for revenues and the actual payment of cash and the legal obligation to pay expenses. It means the income accrued in the current year becomes the income of the current year whether the cash for that item is received in the current year or it was received in the previous year or it will be received in the next year. The same is true of expense items. Expense item is recorded if it becomes payable in the current year whether it is paid in the current year or it was paid in the previous year or it will be paid in the next year. For example, credit sales are included in the total sales of the period irrespective of the fact when cash on account is received. Similarly, in case the firm has taken benefit of a certain service, but has not paid within that period, the expense will relate to the period in which the service has been utilized and not the period in which the payment for it is made.

**Advantages:**

1. It is based on all business transactions of the year and discloses correct profit or loss.
2. This method is used in all types of business units.
3. It is more scientific and rational in application.

**Disadvantages:**

1. It is not simple one and requires the use of estimates and personal judgment.
2. It fails to disclose the actual cash flows.

**DIFFERENCE BETWEEN ACCRUAL BASIS OF ACCOUNTING AND CASH BASIS OF ACCOUNTING: (Lecture 10)**

|  |  |  |
| --- | --- | --- |
| BASIS OF DIFFERENCE | ACCRUAL BASIS OF ACCOUNTING | CASH BASIS OF ACCOUNTING |
| 1. Prepaid, outstanding and received in advance items | There may be outstanding expense, prepaid expenses, accrued income and income received in advance in the balance sheet. | There is no outstanding expense, prepaid expenses, accrued income and income received in advance in the balance sheet. |
| 1. Effect on income of prepaid expenses and accrued income | Income statement will show relatively higher income if there are items of prepaid expenses and accrued income. | Income statement will show relatively lower income if there are items of prepaid expenses and accrued income. |
| 1. Effect of outstanding expenses and unearned income. | Income statement will show a lower income if there are items of outstanding expenses and unearned income. | Income statement will show a higher income if there are items of outstanding expenses and unearned income. |
| 1. Legal Position | Companies Act 1956 recognizes this basis of accounting. | Companies Act 1956 does not recognize this basis of accounting. |
| 1. Option regarding valuation of inventories & methods of depreciation | The business unit has the option to value the inventories at cost of market, whichever is less of depreciation. | No such option is available in regard to inventory valuation and method of depreciation. |
| 1. Reliable. | It is a reliable basis of accounting as it records all cash as well as credit transactions. It ascertains true profit or loss. | It is not a reliable basis of accounting as only cash transactions are recorded. It fails to ascertain true profit or loss. |
| 1. Users. | A business unit with a profit motive ascertains its profit or loss as per accrual basis. | Professional people, small ventures of temporary nature, some Not-for-profit organizations ascertain their profit or loss as per cash basis. |

**Double Entry Mechanism**

Double Entry Mechanism entails recording of transactions keeping in mind the debit and credit aspect of the transaction. To record every transaction, one account is debited and the other is credited. This is based on the

principle ‘every debit has a credit’. The Double entry Book-Keeping seeks to record every transaction in money or money’s worth in its dual aspect.

**The advantages of double entry mechanism are :**

1. **Systematic Record:** It records, classifies, and synthesizes the business transaction in a systematic manner. It provides reliable information for sound decision making. It meets the needs of users of accounting information.
2. **Complete Record:** It maintains complete record of a business transaction. It records both the aspects of the transaction with narration.
3. **Accurate records:** By Preparing a Summarized Statement of Account the arithmetical accuracy of the records can be checked. l Operational Results: By preparing Income statement (Profit and Loss Account) the business can know profit or loss due to its operations during an accounting period.
4. **Financial position:** By preparing Position Statement (Balance Sheet) the business can know what it owns and what it owes to others. What are its assets and what are its Liabilities and Capital.
5. **Possibility of Fraud:** Possibility of Frauds is minimized as complete information is recorded under this system.

**NOTES:**

**UNIT-II (LECTURE – 10)**

**JOURNAL**

**Meaning:**

Journal is a book of accounts in which all day to day business transactions are recorded in a chronological order i.e. in the order of their occurrence. Transactions when recorded in a Journal are known as entries. It is the book

in which transactions are recorded for the first time. Journal is also known as ‘Book of Original Record’ or ‘Book of Primary Entry’. Business transactions of financial nature are classified into various categories of accounts such as assets, liabilities, capital, revenue and expenses. These are debited or credited according to the rules of debit and credit, applicable to the specific accounts. Every business transaction affects two accounts. Applying the principle of double entry one account is debited and the other account is credited. Every transaction can be recorded in journal. This process of recording transactions in the journal is’ known as ‘Journalizing’.

**Format of Journal**

Every page of Journal has the following format. It is a columnar book. Each column is given a name written on its top. Format of journal is given below:

**Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **DATE** | **PARTICULARS** | **LEDGER FOLIO** | **Dr. Amount (Rs)** | **Cr. Amount (Rs)** |
| **(1)** | **(2)** | **(3)** | **(4)** | **(5)** |

**1. Date**

In this column, we record the date of the transactions with its month and accounting year. We write year only once at the top and need not repeat it with every date.

**2. Particulars**

The accounts affected by a transaction i.e the accounts which have to be debited or credited are recorded in this column. It is recorded in the following way:

1. In the first line, the account which has to be debited is written and then the short form of Debit i.e. Dr. is written against that account’s name in the extreme right of the same column.
2. In the second line after leaving some space from the left of the entry in the first line, the account which has to be credited is written starting with preposition ‘To’ Then in the third line, Narration for that entry which explains the transaction, the affected accounts of which are entered, is written within Brackets. Narration should be short, complete and clear. After every journal entry, horizontal line is drawn in the particulars column to separate one entry from the other.

**Example :** Rent paid in cash on 1st April, 2011

**Date Particulars**

2006 Rent A/c.............................. Dr

April 1 To Cash A/c...............

(Rent paid in cash)

**3. Ledger Folio**

The transaction entered in a Journal is posted to the various related accounts in the ‘ledger’ (which is explained in another lesson). In ledger-folio column we enter the page-number where the account pertaining to the entry is opened and posting from the Journal is made.

**4. Dr. Amount**

In this column, the amount to be debited is written against the same line in which the debited account is written.

**5. Cr. Amount**

In this column, the amount to be credited. is written against the same line in which the credited account is written.

**JOURNAL**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| DATE | PARTICULARS | L.F. | Dr. Amount (Rs.) | Cr. Amount (Rs.) |
| 2006  April 1 | Rent A/c……………… Dr  To Cash A/c  (Being Rent paid in Cash) |  | 4000 | 4000 |

6. At the end of each page, both the Dr. and Cr. columns are totaled up. The total of both these columns should be equal as the same amount is entered in the debit as well as in the credit columns. The totals are carried forward to the next page with the words ‘total carried forward (c/f) and then at the top of the next page in Particulars column, we write totals brought forward (b/f) and the amount of totals is written in the respective amount columns.

|  |
| --- |
| **STUDY NOTES:** |

**LECTURE - 11**

**PROCESS OF JOURNALISING:**

**Preparation of a Journal requires following steps to be followed:**

1. **Identify the Accounts:** First of all, the affected accounts of an accounting transaction are identified. For example, if the transaction of “goods worth Rs.10000 are purchased for Cash”, then ‘Purchases’ A/c and ‘Cash’ A/c are the two affected accounts.
2. **Recognize the type of Accounts:** Next we determine the type of the affected accounts e.g. in the above case, ‘Purchases A/c and Cash A/c are both asset accounts.
3. **Apply the Rules of Debit and Credit:** Then the rules of ‘debit’ and ‘credit’ are applied to the affected accounts.

**ILLUSTRATION:**

Enter the following transactions in the Journal of Bhagwat and sons.

**2006 Amount (Rs)**

January 1 Tarun started business with cash 1,00,000

January 2 Goods purchased for cash 20,000

January 4 Machinery Purchased from Vibhu 30,000

January 6 Rent paid in cash 10,000

January 8 Goods purchased on credit from Anil 25,000

January 10 Goods sold for cash 40,000

January 15 Goods sold on credit to Gurmeet 30,000

January 18 Salaries paid. 12,000

January 20 Cash withdrawn for personal use 5,000

**SOLUTION:**

**JOURNAL OF TARUN:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **DATE** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 2006  January 1 | Cash A/c Dr.  To Tarun Capital A/c  (Being Capital brought in by tarun) |  | 1,00,000 | 1,00,000 |
| January 2 | Purchase A/c Dr.  To Cash A/c  (Being goods purchased for cash) |  | 20,000 | 20,000 |
| January 4 | Machinery A/c Dr.  To Vibhu’s A/c  (Being machinery purchased from Vibhu on credit) |  | 30,000 | 30,000 |
| January 6 | Rent A/c Dr.  To Cash A/c  (Being Rent paid) |  | 10,000 | 10,000 |
| January 8 | Purchases A/c Dr.  To Anil’s A/c  (Being Capital brought in by tarun) |  | 25,000 | 25,000 |
| January 10 | Cash A/c Dr.  To Sales A/c  (Being goods sold for cash) |  | 40,000 | 40,000 |
| January 15 | Gurmeet’s A/c Dr.  To Sales A/c  (Being goods sold on credit to Gurmeet) |  | 30,000 | 30,000 |
| January 18 | Salaries A/c Dr.  To Cash A/c  (Being salaries paid) |  | 12,000 | 12,000 |
| January 20 | Drawings A/c Dr.  To Cash A/c  (Being cash withdrawn by the owner for personal use) |  | 5,000 | 5,000 |

|  |
| --- |
| **STUDY NOTES:** |

**LECTURE -12**

**COMPOUND AND ADJUSTING ENTRIES:**

There can be entries that affect more than two accounts; such entries are called compound or combined entries. A simple journal entry contains only one debit and one credit. But if an entry contains more than one debit or credit or both, that entry is known as a compound journal entry. Actually, a compound journal entry is a combination of two or more simple journal entries.

**Thus, a compound journal entry can be made in the following three ways:**

1. By debiting one account and crediting more than one account.
2. By debiting more than one account and crediting one account.
3. By debiting more than one account and also crediting more than one account.

**Two simple journal entries are as:**

**Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **DATE** | **PARTICULARS** | **L.F.** | **Dr. Amount (Rs.)** | **Cr. Amount (Rs.)** |
| 2006  November 30 | Salary A/c Dr. Dr.  To Cash A/c  (Being salary paid in cash) |  | 6,000 | 6,000 |
| November 30 | Rent A/c Dr.  To Cash A/c  (Being Rent paid in cash) |  | 12,000 | 12,000 |

The above two simple entries have been converted into compound Journal entry as under:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **DATE** | **PARTICULARS** | **L.F.** | **Dr. Amount (Rs.)** | **Cr. Amount (Rs.)** |
| 2006  November 30 | Salary A/c Dr.  Rent A/c Dr. Dr.  To Cash A/c  (Being salary and rent paid in cash) |  | 6,000  12,000 | 18,000 |

|  |
| --- |
| **STUDY NOTES:** |

**ADJUSTING ENTRIES:**

Following are the items for which adjustment is required:

**1. Outstanding Expenses:**

An expense for the current accounting period should be debited (as increase in expense is to be debited). It is immaterial whether it is paid in that accounting period or not. In case the same expense is not paid during the

year, it becomes outstanding for that particular year. It is the liability of the business for that year and, thus, expense outstanding account will be credited, because liabilities are credited for increase.

**For example**, if salaries are outstanding for Rs.5,000 for December 2006 then the entry will be made as follows:

Salaries A/c Dr. 5,000

To Salaries outstanding A/c 5,000

(Salaries remaining unpaid for the

month of December)

**2. Prepaid Expenses:**

This is an expense relating to the next year that has been paid in advance during the current year. Thus, in such a case, this amount should not be treated as an expense for this year. It should be treated as an asset in the current year as the services will be received only in the next year (but the payment has been made in this year). As an increase in asset is debited, so prepaid expense account will also be debited.

**for example**, Insurance is prepaid for 2007 in 2006 for Rs.3,000 then entry will be made as follows:

Prepaid Insurance A/c Dr. 3,000

To Insurance Premium A/c 3,000

(insurance paid in advance)

**3.Accrued Income:**

In case, income has been earned but it has not been received till now, it is an accrued income. Accrued Income is an asset, as there will be an increase in the asset, it will be debited.

**For example,** Rent (receivable) is outstanding for the month of November Rs.4,000. The entry in such a case will be:

Accrued Rent A/c Dr. 4,000

To Rent A/c 4,000

(Being Rent due but not yet

received for the period)

|  |
| --- |
| **STUDY NOTES:** |

**LECTURE - 13**

**4. Income received in advance:**

Whenever Income is received in advance during the current year i.e. it is received for the next year, it should not be included in the current year’s income. As this income pertains to the next year, it cannot be treated as income in the current year, so it becomes a liability. As there is an increase in the liability, it should be credited.

**For example,** if Rent is received in advance for the period January and February 2007 in December 2006, Rs.9,000. Then the entry will be

Rent A/c Dr. 9,000

To Rent Received in Advance A/c 9,000

(Rent received in advance

for January and February in the month of December 2006)

**5. Depreciation:**

Depreciation means decline in the value of an asset due to its wear and tear. It is an expense for the business. Increase in expenses and losses are debited, so depreciation is also to be debited. The value of the asset will also be reduced because of depreciation. As decrease in assets is credited, so the same asset account will be credited.

**For example**, Depreciation on furniture Rs.3,000 is charged for the year, Journal entry will be :

Depreciation A/c Dr. 3,000

To Furniture A/c 3,000

(Depreciation charged on furniture)

**6. Interest on capital:**

Business may allow interest to its proprietor on his/her capital. It is an expense for the business. As the expense is debited for the increase, interest on capital will be debited. The other account involved here is capital account. As Capital is increasing, it will be credited with the amount of interest on capital.

**For example**, Interest allowed on capital is Rs.2,500. Thus, the journal entry will be

Interest on Capital A/c Dr. 2,500

To Capital A/c 2,500

(Interest on Capital is allowed)

**7.Drawings**

When the proprietor withdraws some money from the business for his personal or domestic use, it is known as Drawings. Drawings reduce the amount of Capital. As decrease in Capital is debited, drawings will also be debited. As Cash will be decreased as an asset, it will be credited.

**For example**, Cash withdrawn by the proprietor for his personal use is Rs.4,000. So the journal entry will be :

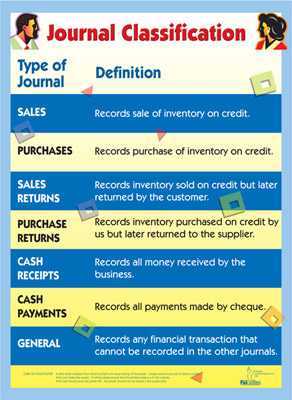
Drawings A/c Dr. 4000

To Cash A/c 4000

**LECTURE – 14**

**CLASSIFICATION OF JOURNAL:**

Journal is a book in which transactions are recorded in chronological order/ date wise, therefore it will be practically difficult to record if the number of transactions is large. To take the benefit of division of labour, journal should be divided into number of journals. Journal can be classified into various special journals and Journal proper. Special journals are also known as special purpose books. Classification of Journal can be explained with the help of the following chart:



1. **Special Journals:** Special journals are those journals which are meant for recording all the

transactions of a repetitive nature of a particular type. For example, all cash related transactions may be recorded in one book; all credit purchases in another book and so on. These are:

**(i) Cash Journal/Cash Book:**

Cash Journal or Cash Book is meant for recording all cash transactions i.e. all cash-receipts and all cash payments of the ‘business. This book helps us to know the balance of Cash in hand at any point of time. It is of two types:

(a) **Simple Cash Book:** It records only receipts and payments of cash. It is like an ordinary Cash Account.

(b) **Bank Column Cash Book:** This type of Cash Book contains one more column on each side for the Bank transactions. This Book provides additional information about the Bank transactions.

**(ii) Purchases Journal/Purchases Book:**

This journal is meant for recording all credit purchases of goods only as Cash purchases of goods are recorded in the Cash Book. In this journal, purchases of other things like machinery, typewriter, stationery, etc. are not recorded. Goods means articles meant for trading or the articles in which the business deals

**(ii) Purchases Journal/Purchases Book:**

This journal is meant for recording all credit purchases of goods only as Cash purchases of goods are recorded in the Cash Book. In this journal, purchases of other things like machinery, typewriter, stationery, etc. are not recorded. Goods means articles meant for trading or the articles in which the business deals.

**(iii) Sales Journal/Sales Book:**

This journal is meant for recording all credit sales of goods made by the firm. Cash Sales are recorded in the Cash Book and not in the Sales Book. Credit Sale of items other than the goods dealt in like sale of old furniture,

machinery, etc. are not entered in the Sales Journal.

**(iv) Purchase Returns or Returns Outward Journal:**

Whenever, the goods are not as per the specifications, the buyer may return these goods to the supplier. These returns are entered in a book known as Purchase Returns Book. It is also known as Returns Outward Journal Book.

**(v) Sale Returns or Returns Inward Journal:**

Sometimes, when the goods are sold to the customer and they are not satisfied with the goods, they may return these goods to the businessman. Such returns are known as Sales Returns. Just like Purchase Returns, they are also recorded in a separate Book which is known as Sales Returns or Returns Inward Journal/Book.

**(vi) Bill Receivables Journal/Book:**

When goods are sold on credit and the date and period of payment is agreed upon between the seller and the buyer, this is duly signed by both the parties. This written document is called a Bill of exchange. For the seller it is a bill receivable and for the buyer it is a bill payable. Bills Receivable Journal/ Book and Bills Payable journal Book are two journals prepared by a businessman. For example: Pranaya sells goods to Gunakshi on credit for

Rs 5000 payable after three months. A document is prepared containing these facts and is duly signed by Pranaya and Gunakshi. For Pranaya it is a Bills Receivable and she will record this transaction in Bill Receivable

Book. For Gunakshi it is a Bill Payable and she will record the transaction in her Bill Payable Book.

**(vii) Bill Payable Journal:**

This is a journal in which record of those bills is kept on which the firm has given its acceptance for making payments on later dates.

**LECTURE – 15**

**II. Journal Proper:**

This journal is meant for recording all such transactions for which no special journal has been maintained in the business. Therefore, in this journal, all such transactions are recorded which do not occur frequently and for these transactions no special journal is required. For example, if Machinery is purchased on credit, it will be recorded in the journal proper, because in the Cash Book, we will record only cash purchases of machinery. Similarly, many other transactions, which do not find their place in the special journals, will be recorded in the **General Journal such as:**

(i) Outstanding expenses – Salaries outstanding, Rent outstanding, etc.

(ii) Prepaid expenses – Prepaid Rent, Salaries paid in advance

(iii) Income received in advance – Rent received in advance, interest received in advance, etc.

(iv) Accrued Incomes – Commission yet to be received, interest yet to be received.

(v) Interest on Capital

(vi) Depreciation

(vii) Credit Purchase and Credit Sale of fixed Assets – Machinery, Furniture.

(viii) Bad debts.

(ix) Goods taken by the proprietor for personal use.

**EXERCISE QUESTIONS:**

**Q1:** **Enter the follwoing transactions in Journal 2011:**

January 1 Sushil & Co. started business with cash 1, 00,000

” 2 Paid into Bank 60000

” 4 Purhcased Machinery and paid by cheque 30,000

” 6 Bought goods from Naresh 20,000

” 14 Paid salaries 5,000

” 15 Sold goods to Rajesh Kuamr 15,000

” 17 Paid for Sundry Expenses 8,500

” 18 Cash deposited into Bank 20,000

” 19 Received Rent 6,000

” 22 Paid Naresh by cheque in full settlement of his A/c 19,750

” 24 Withdrawn cash for personal use 8,000

” 26 Salary paid in advance to Surjeet 2,500

” 28 Rajesh made the payment on A/c 10,000

” 30 Cash Sales for the month 16,500

Q2: The following are the transactions of Kumar Swami for the month of January. Journalize these transactions.

2011:

January 1 Capital paid into Bank 3,00,000

” 1 Bought Stationery for cash 400

” 2 Bought Goods for cash 25,000

” 3 Bought Postage Stamps

” 5 Sold Goods for Cash 10,000

” 6 Bought Office Furniture from Mahendra Bros. 40,000

” 11 Sold goods to Jacob 12,000

” 12 Received cheque from Jacob 12,000

” 14 Paid Mahendra Bros. by cheque 40,000

11 Sold goods to Jacob 12,000

” 12 Received cheque from Jacob 12,000

” 14 Paid Mahendra Bros. by cheque 40,000

” 16 Sold goods to Ramesh & Co 5,000

” 20 Bought from S. Seth & Bros 15,000

” 23 Bought Goods for cash from S.Narain & Co 22,000

” 24 Sold Good to P.Prakash 17,000

” 26 Ramesh & Co. Paid on account 2,500

” 28 Paid S.Seth & Bros. by cheque in full settlement 14,800

” 31 Paid Salaries 2,800

” 31 Rent is due to S. Sharma but not yet paid 2,000

**NOTES:**

**LECTURE -16**

**LEDGER:**

Each transaction affects two accounts. In each account transactions related to that account are recorded. For example, sale of goods taking place number of times in a year will be put under one Account i.e. Sales Account. All the accounts identified on the basis of transactions recorded in different

journals/books such as Cash Book, Purchase Book, Sales Book etc. will be opened and maintained in a separate book called Ledger. So a ledger is a book of account; in which all types of accounts relating to assets, liabilities, capital, expenses and revenues are maintained. It is a complete set of accounts of a business enterprise.

**Features of ledger:**

1. Ledger is an account book that contains various accounts to which various business transactions of a business enterprise are posted.
2. It is a book of final entry because the transactions that are first entered in the journal or special purpose Books are finally posted in the ledger. It is also called the Principal Book of Accounts.
3. In the ledger all types of accounts relating to assets, liabilities, capital, revenue and expenses are maintained.
4. It is a permanent record of business transactions classified into relevant accounts.
5. It is the ‘reference book of accounting system and is used to classify and summarize transactions to facilitate the preparation of financial statements.

**Format of a ledger sheet**

The format of a ledger sheet is as follows:

**Title of an account:**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Date | **Particulars** | **JF** | **Amount (Rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  |  |  |  |  |

**Importance of Ledger**

Ledger is an important book of Account. It contains all the accounts in which all the business transactions of a business enterprise are classified. At the end of the accounting period, each account will contain the entire information of all the transactions relating to it. Following are the advantages

of ledger:

(a) **Knowledge of Business results:**

Ledger provides detailed information about revenues and expenses at one place. While finding out business results the revenue and expenses are matched with each other.

(b) **Knowledge of book value of assets:**

Ledger records every asset separately. Hence, you can get the information about the Book value of any asset whenever you need.

**(c) Useful for management:**

The information given in different ledger accounts will help the management in preparing budgets. It also helps the management in keeping the check on the performance of business it is managing.

(d) **Knowledge of Financial Position:**

Ledger provides information about assets and liabilities of the business. From this we can judge the financial position and health of the business.

(e) **Instant Information:**

The business always needs to know what it owes to others and what the others owe to it. The ledger accounts provide this information at a glance through the account receivables and payables.

**Types of Ledger**

In large scale business organisations, the number of accounts may run into hundreds. It is not always possible for a businessman to accommodate all these accounts in one ledger. They, therefore, maintain more than one ledger.

**1. Assets Ledger:** It contains accounts relating to assets only e.g. Machinery accounts, Building account, Furniture account, etc.

**2. Liabilities Ledger:** It contains the accounts of various liabilities e.g. Capital (Owner or partner), Loan‘account, Bank overdraft, etc.

**3. Revenue Ledger:** It contains the revenue accounts e.g.. Sales account, Commission earned account, Rent received account, interest received account, etc.

**4. Expenses Ledger:** It contains the various accounts of expenses incurred, e.g. Wages account, Rent paid account, Electricity charges account, etc.

**5. Debtors Ledger:** It contains the accounts of the individual trade debtors of the business. Individuals, firms and institutions to whom goods and services are sold on credit by business become the ‘trade

debtors’ of the business.

**6. Creditors Ledger:** It contains the accounts of the individual trade Creditors of the business. Individuals, firms and institutions from whom a business purchases goods and services on credit are called ‘trade creditors’ of the business.

**7. General Ledger:** It contains all those accounts which are not covered under any of the above types of ledger. For example Landlord A/c, Prepaid insurance A/c etc.

**LECTURE - 17**

**POSTING OF JOURNAL PROPER INTO LEDGER**

The purpose of opening an account in the ledger is to bring all related items of this account which might have been recorded in different books of accounts on different dates at one place. The process involved in this exercise is called posting in the ledger. This procedure is adopted for each account.

To take the items from the journal to the relevant account in the ledger is called posting of journal

**Following procedure is followed for posting of journal to ledger:**

1. Identify both the accounts ‘debit’ and credit of the journal entry. Open the two accounts in the ledger.

2. Post the item in the first account by writing date in the date column, name of the account to be credited in the particulars column and the amount in the amount column of the ‘debit’ side of the account.

3. Write the page number of the journal from which the item is taken to the ledger in Folio column and write the page number of the ledger from which account is written in L.F. column of the journal.

4. Now take the second Account and give the similar treatment. Write the date in the ‘date’ column, name of the account in the ‘amount’ column of the account on its credit side in the ledger.

5. Write page number of journal in the ‘folio’ column of the ledger and page number of the ledger in the ‘L/F’ of column of the journal.

**ILLUSTRATION:**

Journalise the following transactions and post them in ledger for January 2006:

1 jan Commenced business with Cash Rs. 50,000

3 jan paid into bank Rs. 25,000

5 jan Purchased furniture for cash Rs. 5,000

8 jan purchased goods and paid by cheque Rs. 15,000

8 jan Paid for carriage Rs.500

14 jan purchased goods from K. Murthy Rs. 35,000

18 jan Cash sales Rs. 32,000

20 jan Sold goods to Ashok on credit Rs. 28,000

25 jan Paid cash to K. Murthy in full settlement Rs. 34,200

28 jan Cash received from Ashok Rs. 20,000

31 jan paid rent for the month Rs. 2,000

31 jan Withdrew from bank for private use Rs. 2,500

**Answer:**

**Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Date | Particulars | LF | Dr. Amount (Rs.) | Cr. Amount (Rs.) |
| 2006  Jan1 | Cash A/c Dr.  To Capital A/c  (Being commenced business with cash) |  | 50,000 | 50,000 |
| Jan 3 | Bank A/c Dr.  To Cash A/c  (Being cash paid in the bank) |  | 25,000 | 25,000 |
| Jan 5 | Furniture A/c Dr.  To Cash A/c  (Being purchased furniture for cash) |  | 5000 | 5000 |
| Jan 8 | Purchases A/c Dr.  To Bank A/c  (Being purchased goods and paid by cheque) |  | 15000 | 15000 |
| Jan 8 | Carriage A/c Dr.  To Cash A/c  (Being cash paid for carriage charges) |  | 500 | 500 |
| Jan 14 | Purchases A/c Dr.  To K.Murthy A/c  (Being goods purchases on credit) |  | 35000 | 35000 |
| Jan 18 | Cash A/c Dr.  To Sales A/c  (Being goods sold for cash) |  | 32000 | 32000 |
| Jan 20 | Ashok A/c Dr.  To Sales A/c  (Being goods sold to ashok on credit) |  | 28000 | 28000 |
| Jan25 | K Murthy A/c Dr.  To Discount A/c  To Cash A/c  (Being cash paid to K.Murthi and discount allowed by him) |  | 35000 | 800  34200 |
| Jan 28 | Cash A/c Dr.  To Ashok A/c  (Being cash received from ashok) |  | 20000 | 20000 |
| Jan 31 | Rent A/c Dr.  To Cash A/c  (Being cash paid for rent) |  | 2000 | 2000 |
| Jan 31 | Drawings A/c Dr.  To Bank A/c  (Being cash withdrawn from bank for domestic use) |  | 2500 | 2500 |

**Ledger:**

**Cash A/c**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 1  Jan 18  Jan 28 | To Capital A/c  To Sales A/c  To Ashok A/c |  | 50000  32000  20000 | 2006  Jan 3  Jan5  Jan8  Jan25  Jan31 | By bank A/c  By furniture A/c  By carriage  By K. Murthy  By Rent A/c |  | 25000  5000  500  34200  2000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  | 2006  Jan 1 | By Cash A/c |  | 50000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 2 | Cash A/c |  | 25000 | 2006  Jan3 1  Jan 8 | By Drawings A/c  By purchases A/c |  | 2500  15000 |

**Dr. Furniture A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 2 | To Cash A/c |  | 5000 |  |  |  |  |

**Dr. Purchases A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 8  Jan 14 | To Bank A/c  To K. Murthy A/c |  | 15000  35000 |  |  |  |  |

**Dr. Carriage A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 8 | To Cash A/c |  | 500 |  |  |  |  |

**Dr. K. Murthy A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 25  Jan 25 | To Cash A/c  To Discount A/c |  | 34000  800 | 2006  Jan 14 | By Purchases A/c |  | 35000 |

**Dr. Sales A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  | 2006  Jan 18  Jan 20 | By Cash A/c  By Ashok A/c |  | 32000  28000 |

**Dr. Ashok A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 20 | To Sales A/c |  | 28000 | 2006  Jan 28 | By Cash A/c |  | 20000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 3 | To cash A/c |  | 2000 |  |  |  |  |

**Dr. Drawings A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 18 | To Bank A/c |  | 2500 |  |  |  |  |

**LECTURE - 19**

**BALANCING OF AN ACCOUNT:**

Balancing of an account is the difference between the total of debits and total of credits of an account. If debit side total is more than the credit side, the account shows a debit balance. Similarly, the balance will be credit if the credit side total of an account is more than the debit side total. This process of ascertaining and writing the balance of each account in the ledger is called balancing of an account.

An account has two sides: debit and credit. Items by which this account is debited are entered on its debit side with their amounts and items by which this account is credited are entered on its credit side with their amounts so all items related to an account are shown at one place in the ledger. But It is important to know the net effect of this account i.e. the balance between its debit amount and credit

amount. The following steps are to be followed in Balancing the Ledger Account:

1. Total up the two sides of an Account on a rough sheet. l Determine the difference between the two sides. If the credit side is more than the debit side, the balance calculated is a credit balance. Put the difference on the ‘Shorter side’ of the account such that the totals of the two sides of the account are equal.
2. l If the difference amount is written on debit side (i.e., if credit. side is bigger) then write as “Balance c/d” (c/d stands for carried down). If difference is written on the credit side (i.e., if debit side is bigger) then write it as “Balance c/d.
3. Finally at the end of the year all the ledger accounts are closed by taking out the balance of each account. The Balance then should be brought down or carried forward to the next period. If the difference was put on credit side as “Balance c/d” it should now be written on the debit side of the account as “Balance b/d” (b/d stands for brought down) and vice-a-versa. Thus debit balance will automatically be brought down on the debit side and a credit balance on the credit side.

**Balancing of different types of Accounts**

**Assets:** All asset accounts are balanced. These accounts always have a debit balance.

**Liabilities:** All Liability accounts are balanced. All these accounts have a credit balance.

**Capital:** This account is always balanced and usually has a credit balance.

**Expense and Revenue:** These Accounts are not balanced but are simply totaled up. The debit total of Expense/Loss will show the expense/Loss. In the same manner, credit total of Revenue/ Income will show increase in income. At the time of preparing the Trial Balance, the totals of these are taken to the Trial Balance.

The Balance of Assets, Liabilities and Capital Accounts will be shown in Balance Sheet whereas total of Expense/Loss and Revenue/Income will be taken to the Trading and Profit and Loss Account. These Accounts are, thus, closed. If two sides of an Account (usually Assets, Liabilities and Capital) are equal

there will be no balance. The Account is then simply closed by totaling up of the two sides of the account.

**BALANCING THE ACCOUNTS IN ABOVE ILLUSTRATION:**

**Dr. CASH A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 1  Jan 18  Jan 28 | To Capital A/c  To Sales A/c  To Ashok A/c |  | 50000  32000  20000 | 2006  Jan 3  Jan5  Jan8  Jan25  Jan31  Jan31 | By bank A/c  By furniture A/c  By carriage  By K. Murthy  By Rent A/c  By Balance c/d |  | 25000  5000  500  34200  2000  35300 |
| Feb 1 | To balance b/d |  | 102000 |  |  |  | 102000 |
| 35300 |  |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 31 | To balance c/d |  | 50000 | 2006  Jan 1 | By Cash A/c |  | 50000 |
|  |  |  | 50000 | Feb 1 | By balance b/d |  | 50000 |
|  | 50000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 2 | Cash A/c |  | 25000 | 2006  Jan3 1  Jan 8  Jan 31 | By Drawings A/c  By purchases A/c  By balance c/d |  | 2500  15000  7500 |
| Feb 1 | To balance b/d |  | 25000 |  |  |  | 25000 |
| 7500 |  |

**Dr. Furniture A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 2 | To Cash A/c |  | 5000 | Jan 31 | By balance c/d |  | 5000 |
| Feb1 | To balance b/d |  | 5000 |  |  |  | 5000 |
| 5000 |  |

**Dr. Purchases A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 8  Jan 14 | To Bank A/c  To K. Murthy A/c |  | 15000  35000 | Jan31 | By Trading A/c |  | 50000 |
|  |  |  | 50000 |  |  |  | 50000 |

**Dr. Carriage A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 8 | To Cash A/c |  | 500 | Jan31 | By trading A/c |  | 500 |
|  |  |  | 500 |  |  |  | 500 |

**Dr. K. Murthy A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 25  Jan 25 | To Cash A/c  To Discount A/c |  | 34200  800 | 2006  Jan 14 | By Purchases A/c |  | 35000 |
|  |  |  | 35000 |  |  |  | 35000 |

**Dr. Sales A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| Jan 31 | To trading A/c |  | 60000 | 2006  Jan 18  Jan 20 | By Cash A/c  By Ashok A/c |  | 32000  28000 |
|  |  |  | 60000 |  |  |  | 60000 |

**Dr. Ashok A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 20 | To Sales A/c |  | 28000 | 2006  Jan28  Jan31 | By Cash A/c  By balance c/d |  | 20000  8000 |
| Feb 1 | To balance b/d |  | 28000 |  |  |  | 28000 |
| 8000 |  |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 3 | To cash A/c |  | 2000 | Jan31 | By profit and loss A/c |  | 2000 |
|  |  |  | 2000 |  |  |  | 2000 |

**Dr. Drawing A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2006  Jan 18 | To Bank A/c |  | 2500 | Jan31 | By balance c/d |  | 2500 |
|  |  |  | 2500 |  |  |  | 2500 |

**NOTES:**

**EXERCISE QUESTIONS:**

Q1: What is ledger? Why is ledger prepared?

Q2: Why is ledger known as the primary book or the principal -book of accounts? Can profit of the business and its financial position be known without maintaining ledger?

Q3: Enumerate the various types of ledgers which may be maintained by a business.

Q4: What is the rule for posting the debit account from the journal into the ledger account?

Q5: What is rule for positing the credit item of the journal into the ledger accounts?

Q6: What are the advantages of maintaining a ledger?

Q7: What is meant by balancing of an account? Explain the various steps taken while balancing accounts.

Q8: Following are the transactions of Dhani Ram and Sons for the month of July 2011. Make journal entries, post them into ledger and balance the account.

2011

July 1 commenced business with cash 60,000

” 2 Paid into bank 40,000

” 5 Purchased furniture for cash 5000

” 7 Purchased Goods and paid for them by cheque 20000

” 10 Sold Goods to Lata Gupta for cash 12000

” 12 Sold Goods to Mahavir on credit 24000

” 18 Purchased Goods from Harish 30000

” 19 Withdrew cash for domestic use 2500

” 20 Received a cheque from Mahavir on account 18900 and allowed him discount 100

” 27 Paid to Harish cash on account 16800 and Discount allowed by him 200

” 31 Paid salary by cheque 1800 and Paid cash for telephone bill 600

**NOTES:**

**LECTURE - 20**

**CASH BOOK:**

Cash Book is a Book in which all cash receipts and cash payments are recorded. It is also one of the books of original entry. It starts with the cash or bank balance at the beginning of the period. In case of new business, there is no cash balance to start with. It is prepared by all organisations. When a cash book is maintained, cash transactions are not recorded in the Journal, and no cash or bank account is required to be maintained in the ledger as Cash Book serves the purpose of Cash Account.

**Cash Book: Types and Preparation**: Cash Books may be of the following Types:

1. Simple Cash Book
2. Bank Column Cash Book
3. Petty Cash Book
4. **Simple Cash Book:** A Simple Cash Book records only cash receipts and cash payments. It has

two sides, namely debit and credit. Cash receipts are recorded on the debit side i.e. left hand side and cash payments are recorded on the credit side i.e. right hand side. In this book there is only one amount column on its debit side and on the credit side. The format of a Simple Cash Book is as under:

**Format of a simple cash book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  |  |  |  |  |

Column-wise explanation is as follows:

1. **Date:** In this column Year, Month and Date of transactions are recorded in chronological order.
2. **Particulars:** In this column, the name of the account in respect of which cash has been received or payment has been made is written. Account pertaining to the receipts of cash is recorded on the debit side and those pertaining to cash payments on the credit side.
3. **Ledger Folio:** In this column, it records the page number of the ledger book on which relevant account is prepared.
4. **Amount:** In this column, it records the amount received on debit side and cash paid on its credit side.

**Preparation of Simple Cash Book:** Cash Book is in a way, a cash account with debit and credit side and Cash account is an asset account, so the rule followed is Increase in assets to be debited and Decrease in asset is to be credited. This implies that Cash Book is a book where all the receipts in terms of cash are recorded on the debit side of the Cash Book and all the payments in terms of cash are recorded on its credit side.

On the debit side in the particulars column, the name of the account, for which cash is received, is recorded. Similarly, on the credit side, the name of account for which cash is paid, is recorded. In the amount column the actual cash paid or received is recorded. At the end of the month, cash book

is balanced. The cash book is balanced in the same manner an account is balanced in the ledger. The total of the debit side of the cash book is compared with the total of the credit side and the difference if any is entered on the credit side of the cash book under the particulars column as balance c/d. In case of Simple Cash Book, the total of debit side is always more than the total of the credit side, since the payment can never exceed the available cash. The difference is written in the amount column and total of the both sides of the cash book becomes equal. The closing balance of the credit side becomes the opening balance for the next period and is written as Balance b/d on the Debit side of the Cash Book for the following period.

Recording of cash transactions in the Simple Cash Book and its balancing is illustrated with the help of the following illustration:

**Illustration 1**

Enter the following transactions in the cash book of M/s. Rohan Traders:

2011

December 01 Cash in Hand 27,500

December 05 Cash received from Nitu 12,000

December 08 Insurance Premium paid 2,000

December 10 Furniture purchased 6,000

December 14 Sold Goods for cash 16,500

December 18 Purchased Goods from Naman for cash 26,000

December 22 Cash paid to Rohini 3,200

December 25 Sold Goods to Kanika for cash 18,700

December 28 Cash Deposited into Bank 5,000

December 30 Rent paid 4,000

December 31 Salary paid 7,000

**Books of M/s. Rohan Traders Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Dec01  Dec05  Dec14  Dec25 | To balance b/d  To Nitu  To sales  To sales |  | 27,500  12,000  16,500  18,700 | 2011  Dec08  Dec10  Dec18  Dec22  Dec28  Dec30  Dec31  Dec31 | By Insurance premium  By furniture  By purchases  By rohini  By bank  By rent  By salary  By balance c/d |  | 2,000  6,000  26,000  3,200  5,000  4,000  7,000  21,500 |
| .  Jan01 | To balance b/d |  | 74,700 |  |  |  | 74,700 |
| 21,500 |  |

**llustration 2**

Prepare Cash Book for the month of April 2011 from the following particulars:

April 01 Cash in hand 17,600

April 03 Purchased Goods for cash from Rena 7,500

April 06 Sold Goods to Rohan 6,000

April 10 Wages paid in cash 500

April 15 Cash paid to Neena 3,500

April 17 Cash Sales 10,000

April 19 Commission paid 700

April 21 Cash received from Teena 1,500

April 25 Furniture Purchased for cash 1,700

April 28 Rent paid 3,000

April 30 Paid Electricity bill in cash 1,300

**Dr. CASH A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr 01  Apr 17  Apr 21 | To balance c/d  To sales  To Teena |  | 17600  10000  1500 | 2011  Apr03  Apr10  Apr15  Apr19  Apr25  Apr28  Apr30  Apr30 | By purchases  By wages  By Neena  By Commission  By furniture  By rent  By electricity bill  By balance c/d |  | 7500  500  3500  700  1700  3000  1300  10900 |
| May 01 | To balance b/d |  | 29100 |  |  |  | 29100 |
| 10900 |  |

**Posting of Cash Book in the Ledger:**  Cash receipts are shown on debit side of Cash Book and the cash payments are shown on the credit side of Cash Book. Account appearing on the debit side of the Cash Book is posted on the credit side in the relevant ledger. Similarly, account appearing on the credit side of Cash Book is posted on the debit side of the relevant ledger. Cash Book in itself is a Cash account, so no separate cash account will be maintained in the ledger. For the posting of various cash book entries in the ledger, refer illustration No. 2.

**Dr. Sales A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  | 2011  apr 1 | By Cash A/c |  | 10000 |

**Dr. Teena A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
|  |  |  |  | 2011  Apr21 | By Cash A/c |  | 1500 |

**Dr. Purchases A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr03 | To cash |  | 7500 |  |  |  |  |

**Dr. Wages A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr10 | To cash |  | 500 |  |  |  |  |

**Dr. Neena’s A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr10 | To Cash |  | 3500 |  |  |  |  |

**Dr. Commission A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr 19 | To cash |  | 700 |  |  |  |  |

**Dr. Furniture A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr25 | To cash |  | 1700 |  |  |  |  |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr28 | To cash |  | 3000 |  |  |  |  |

**Dr. Electricity Bills A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Apr30 | To cash |  | 1300 |  |  |  |  |

**NOTES:**

**LECTURE – 21:**

**BANK COLUMN CASH BOOK:**

When the number of bank transactions is large in an organization, it is necessary to have a separate book to record bank transactions. Instead of having a separate book to record bank transactions a column is added on each side of the Simple Cash Book. This type of cash book is known as Bank column Cash Book. All payments into bank are recorded on the debit side and all withdrawals/payments through the bank are recorded on the credit side of the cash book. The format of a Bank column cash Book is as under:

**Format of a Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
|  |  |  |  |  |  |  |  |  |  |

**Preparation of Bank column cash book:**

In Bank column Cash Book, the cash transactions are recorded in a similar manner as are recorded in the Simple cash book. The difference is that Bank column cash book records transactions relating to Bank also. There are some special business transactions which need special treatment in the Bank

Column of the Cash Book:

(i) Opening balance

(ii) Receipt of cheques

(iii) Contra entries

(iv) Endorsement of cheque

(v) Bank charges

**(i) Opening Balance**

The opening cash and bank balances are recorded on the debit side of the cash book. Sometimes a businessman withdraws excess amount from the bank (from his bank account) and the closing bank balance of a month is a credit balance. This balance amount is called ‘Bank overdraft’. It is written

on the credit side of the bank column of the cash book as opening balance. **For example**, if a business firm has Rs.12, 000 as cash in hand and Rs.15, 000 as overdraft (credit balance) in the bank, it will be recorded as under:

**Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
|  | To balance b/d |  | 12000 |  |  | By balance b/d |  |  | 15000 |

**(ii) Receipt of Cheques:**

All cash receipts are entered in the cash column and cheques received in the bank column of Cash Book. If the cheques deposited in bank on the same date, it is entered on the debit side of bank column of the cash book. If the cheques received from customer are not deposited in the bank on same day, they are included in cash and written on the debit side in the cash column of cash book. For example: On May 2, 2006 a cheque received from Tarun for Rs.7,000 and deposited on same date.

**Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
| 2006  May 2 | To tarun |  | 7000 |  |  |  |  |  |  |

**(iii) Contra entries:** When there is a transaction that relates to both cash and bank, this will be written on one side of Bank Column and on other side of Cash Column, Such transactions are known as ‘Contra entries’. In case cash is withdrawn from bank for office use, it is entered on the credit side of bank column and also in the debit side of cash column of the cash Book. In case cash is deposited in the bank, the amount is recorded on the debit side of bank column and on the credit side of cash column of the cash book. The letter ‘C’ is written in the LF column on both sides against these entries. These entries are not to be posted into ledger. For example: On May 15, 2006 Cash withdrawn from bank for office use is Rs.2, 000. In this case the transaction recorded is as under:

**Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
| 2006  May 15 | To Bank | C | 2000 |  | May15 | By cash | C |  | 2000 |

**NOTES:**

**(iv) Endorsement of Cheque:** When cheque received from customer is given to some other party i.e.

endorsed, on receipt, it is recorded on the debit side of cash column. On endorsement of cheque, the amount is recorded on the credit side of the cash column of Cash Book. For example, on May 22, 2006 a cheque of Rs.8,000 is received from M/s J.P Traders. On May 27,2006 it was endorsed in favour of M/s Kapila Traders. In this case the transaction recorded is as under:

**Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
| 2006  May 22 | To J.P. Traders (cheque) |  | 8000 |  | May27 | By Kapila Traders (cheque) |  |  | 8000 |

**(v) Bank Charges:** If bank charges any interest, outstation cheque collection charges etc. are entered on the credit side of the Bank column of the Cash Book. Similarly, if bank gives interest, collects commission etc., these will be recorded on the debit side on the Bank column Cash Book.

**LECTURE - 22**

**ILLUSTRATION:**

Record the following transactions in the Bank column Cash Book of M/s Time Zone for the month of January 2011:

January 01 Bank Balance 32,500

01 Cash Balance 12,300

03 Purchased Goods by cheque 5,300

08 Goods Sold for cash 9,500

10 Purchased Typewriter by Cheque 5,400

15 Sold Goods and received Cheque 7,900 (deposited on the same day)

17 Purchased Stationery by Cheque 1,000

20 Cash deposited into bank 10,000

22 Paid Cartage 500

24 Cheque given to Mudit 7,000

28 Rent paid by Cheque 3,000

30 Paid Salary 3,500

**Bank Column Cash Book**

**Dr. Cr.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Cash(Rs) | Bank (Rs) | Date | Particulars | L.F. | Cash (rs) | Bank (rs) |
| 2011  Jan1  Jan8  Jan15  Jan20 | To Balance b/d  To sales  To sales  To cash | c | 12300  9500 | 32500  7900  10000 | Jan3  Jan10  Jan17  Jan20  Jan22  Jan24  Jan28  Jan30  Jan31 | By purchases  By typewriter  By stationery  By bank  By cartage  By mudit  By rent  By salary  By balance c/d | C | 10000  500  3500  7800 | 5300  5400  1000  7000  3000  28700 |
| Feb1 | To balance b/d |  | 21800 | 50400 |  |  |  | 21800 | 50400 |
| 7800 | 28700 |  |  |

**NOTES:**

**EXERCISE QUESTIONS:**

Q1: Enter the following transactions in the Simple Cash Book of M/s Golden Traders For April 2011:

April 1 Started Business with Cash 30,000

’’ 2 Goods Purchased for Cash 10,000

’’ 3 Furniture Purchased 1,000

’’ 6 Goods Sold for Cash 7,000

’’ 9 Cartage paid 200

’’ 10 Postage 100

’’ 12 Cash Sales 3,000

’’ 14 Cash withdrawn for Personal use 2,000

’’ 18 Deposited into Bank 10,000

’’ 22 Goods purchased for Cash 13,000

’’ 25 Wages paid 500

’’ 27 Rent paid 3,000

’’ 28 Cash Sales 2,000

’’ 30 Commission received 500

Q2: From the following transactions prepare Simple Cash Book for March 2011:

March 01 Cash in hand 32,500

’’ 08 Cash paid to Rohan 8,000

’’ 12 Goods Purchased 3,000

’’ 15 Cash received from Tanaya 2,000

’’ 18 Cash Sales 4,000

’’ 22 Paid wages 4,000

’’ 25 Salary paid 3,000

’’ 28 Cash paid to Manish 3,500

’’ 31 Rent paid 2,500

**UNIT-III (LECTURE – 23)**

**TRIAL BALANCE:**

All the transaction are first entered in the Journal and Special purpose books like cash book, purchases book, sales book, etc. . From these books items are posted in the ledger in their respective accounts. Finally, at the end of the accounting year these accounts are balanced. To check the accuracy of

posting in the ledger a statement is prepared with two columns i.e. debit column and credit column which contain debit balances of accounts and credit balances of accounts respectively. Total of the two columns are if equal, it means the ledger posting is arithmetically correct. This statement is called Trial Balance.

**Trial Balance may be defined as a statement which contains balances of all ledger accounts on a particular date.** Trial Balance consists of a debit column with all debit balances of accounts and credit column with all credit balances of accounts. The totals of these columns if tally it is presumed that ledger has been maintained correctly. However, Trial Balance proves only the arithmetical accuracy of posting in the ledger.

**Objectives of Preparing a Trial Balance**

Following are the objectives of preparing Trial Balance:

**(i) To check arithmetical accuracy:**

Arithmetical accuracy in ledger posting means writing correct amount, in the correct account and on its correct side while posting transactions from various original books of accounts, such as Cash Book, Purchases Book, Sales Book, etc. It also means not only the correct balance of ledger account but also the totals of the special purpose Books.

**(ii) To help in preparing Financial Statements:**

The ultimate objective of the accounting is to prepare financial statements i.e. Trading and Profit and Loss Account, and Balance sheet of a business enterprise at the end of an accounting year. These

statements contain balances of various ledger accounts. As Trial Balance contains balances of all ledger accounts, in financial statements the balances of ledger accounts are carried from the Trial balance for proper analysis.

**(iii) Helps in locating errors:**

If total of two columns of the trial balance agrees it is a proof of arithmetical accuracy in the ledger posting. However, if the totals of the two columns do not tally it indicates that there is some mistake

in the ledger accounts. This prompts the accountant to find out the errors.

**(iv) Helps in comparison:**

Comparison of ledger account balances of one year with the corresponding balances with the previous year helps the management taking some important decisions. This is possible by using the Trial Balances of the two years.

**(v) Helps in making adjustments:**

While making financial statements adjustments regarding closing stock, prepaid expenses, outstanding expenses etc are to be made. Trial balance helps in identifying the items requiring adjustments in preparing the financial statements. Trial Balance is generally prepared at the end of the year. However

it can be prepared at any time during the accounting year to check the accuracy of the posting.

**PREPARATION OF TRIAL BALANCE**

Trial Balance is not an account. It is only a list or schedule of balances of ledger accounts including cash and bank balances. It is prepared on a particular date. The accounts having a debit balance are entered in the debit amount column and credit balance accounts are entered in the credit amount column. The totals of the two sides of the accounts may also be used to prepare trial balance. The sum of each column should be equal. The standard format of a trial balance is given below:

**Trial Balance of………………..**

**As at…………… (closing date)**

|  |  |  |  |
| --- | --- | --- | --- |
| Name of the Account | LF | Dr. Balance (Rs) | Cr. Balance (Rs.) |
|  |  |  |  |

The name of the business firm is written on the top of the statement with Trial Balance. Under this we write the date on which Trial Balance is prepared. Trial Balance has three columns: Name of the Ledger Account, Debit Amount and Credit Amount. In the ledger account column we write the name of the account. In the Debit amount column we write the amount of debit balance of the account (or the total of the debit side of the account). Similarly in the credit amount column we write the amount of credit balance of the account (or the total of the credit side of the account.

**Steps to prepare Trial Balance:**

(i) At first ascertain the balance account wise of all the ledger accounts.

(ii) Write the name of the ledger account in the ledger account column.

(iii) Write against the name of the ledger account, the balance amount/total amount, debit balance/total in the debit column; and credit balance/ total in the credit column.

(iv) Add the debit balance/total amount column and credit balance/total amount column.

**There are three methods of preparing Trial Balance**

(i) Balance Method

(ii) Total Method

(ii) Balance Totals Method

**(i) Balance Method**

In this Balance method, the balance of each account (which may be debit balance or credit balance) is extracted and written against each account; we write debit balance in the debit column and credit balance in the credit column.

**(ii) Total Method**

In this method the total of both sides of every account in the ledger is written against the name of the respective account without balancing them in the form of debit and credit balances respectively.

**(iii) Balance totals Method**

Trial Balance is prepared by combining the first and second methods. However, in practice the trial balance is prepared with debit and credit balances of various accounts in the ledger. Normally balance method is used.

**LECTURE - 24**

**ILLUSTRATION:**

From the following ledger accounts of a trader closed as on 31st January, 2011, prepare Trial Balance:

**Dr. CAPITAL A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31 | To balance c/d |  | 100000 | 2011  Jan  Feb 1 | By bank A/c  By balance b/d |  | 100000 |
| 100000 | 100000 |
|  | 100000 |

**Dr. Sales A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31 | To balance transferred to Trading A/c |  | 70000 | 2011  Jan 8  Jan15 | By bank A/c  By vikram’s A/c |  | 70000  46000 |
| 70000 | 70000 |

**Dr. Purchases A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 05  Jan 14 | To Pranaya’s A/c  To Bank A/c |  | 40000  55000 | 2011  Jan31  Jan31 | By Stock A/c  By Balance transferred to Trading A/c |  | 15000  80000 |
| 95000 | 95000 |

**Dr. Vikram’s A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan15  Feb1 | To sales A/c  To balance b/d |  | 46000 | 2011  Jan31 | By balance c/d |  | 46000 |
| 46000 | 46000 |
| 46000 |  |

**Dr. Pranaya’s A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31 | To Balance c/d |  | 40000 | 2011  Jan31  Feb1 | By purchases A/c  By balance b/d |  | 40000 |
| 40000 | 40000 |
|  | 40000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 31 | To Balance transferred to P&L A/c |  | 1500 | 2011  Jan31 | By Bank A/c |  | 1500 |
| 1500 | 1500 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 31 | To Capital A/c  To sales A/c  To rent received |  | 100000  24000  1500 | 2011  Jan31 | By Purchases A/c  By commission A/c  By Drawings A/c  By balance c/d |  | 55000  18000  2200  66700 |
| 125500 | 125500 |

**Dr. Commission A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 20 | To Bank A/c |  | 1800 | 2011  Jan31 | By balance transferred to P&L A/c |  | 1800 |
| 1800 | 1800 |

**Dr. Stock A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31  Feb 1 | To Purchases A/c  To balance b/d |  | 15000 | 2011  Jan31 | By balance c/d |  | 15000 |
| 15000 | 15000 |
| 15000 |  |

**Dr. Drawings A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31  Feb 1 | To bank A/c  To balance b/d |  | 2000 | 2011  Jan31 | By balance c/d |  | 2000 |
| 2000 | 2000 |
| 2000 |  |

**SOLUTION:**

**TRIAL BALANCE**

|  |  |  |
| --- | --- | --- |
| **Name of the Ledger Account** | **Dr. Amount (Rs.)** | **Cr. Amount (Rs.)** |
| Capital  Sales  Purchases  Vikram  Pranaya  Commission  Rent Received  Drawings  Closing Stock  Cash at Bank | 80000  46000  1800  2000  15000  66700 | 100000  70000  40000  1500 |
| **Total** | **211500** | **211500** |

**NOTES:**

**LECTURE - 25**

**Trial Balance and Errors:**

If the sum of the two columns of Trial Balance is equal i.e. the Trial Balance is in agreement, it means that the accounting entries have been arithmetically correct and correctly posted in the ledger. If the

Totals do not tally it means there are some errors in recording and/or in posting in the ledger of the business transactions. The reasons due to which the totals of the two columns of Trial balance may not agree and can be listed as follows:

1. The totals of the Special Purpose Books like Sales Book, Purchases Book, etc are not totaled correctly or there is some mistake in the posting of these totals in their respective accounts in the ledger.
2. The items from different Special Purpose Books and Journal may be posted to the wrong side of the account or a wrong amount is posted or posted to the wrong account.

(iii) The balancing of an account is not done correctly.

1. There may be mistake in carrying balance from the ledger account to the Trial Balance.

If the trial balance is in agreement, the business transactions have been correctly recorded or posted into ledger. However, the agreement of Trial Balance is not a conclusive proof of the correctness of recording and posting of business transactions. There can be errors and the sum of each column of the Trial Balance may still be equal. If the debits are matched by credits though there are mistakes in recording and posting the Trial balance will still agree. For example, if goods have been purchased from Surender, and if not entered in the Purchases Book, this error will not affect the agreement of the

Trial Balance.

**Trial Balance and Suspense A/c:**

Now suppose the Trial Balance does not agree i.e. there is a difference of some amount in the totals of the two columns of the Trial Balance. A different account i.e. Suspense Account is opened with the difference in amount put in this account. This will result in agreement of Trial Balance. The suspense account with the amount of difference will be put on the lesser side of the Trial Balance. For example

total of the debit column exceeds the total of the credit column by Rs.500. This amount of Rs 500 will be written on the credit column against Suspense Account to make the Trial Balance tally. The suspense A/c is however a temporary arrangement to make the Trial Balance agree. This account will remain till the error or errors are rectified, this account will disappear as soon as the error or errors are rectified.

**ILLUSTRATION:**

**Dr. CASH A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan1  Jan10 | To Capital A/c  To sales A/c |  | 75000  25000 | 2011  Jan10  Jan15  Jan31  Jan31 | By Furniture A/c  By Purchases A/c  By rent A/c  By telephone expenses A/c  By balance c/d |  | 15000  25000  2000  1000  57000 |
| 100000 | 100000 |

**Dr. CAPITAL A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (Rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan31 | To Balance c/d |  | 75000 | 2011  Jan 1  Feb 1 | By Amount as per cash book  By balance c/d |  | 75000 |
| 75000 | 75000 |
|  | 75000 |

**Dr. SALES A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 31 | To Trading A/c |  | 25000 | 2011  Jan10 | By Amount as per cash book |  | 25000 |
| 25000 | 25000 |

**Dr. Purchases A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 15 | To Amount as per cash book |  | 25000 | 2011  Jan31 | By Trading A/c |  | 25000 |
| 25000 | 25000 |

**Dr. Furniture A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 10 | To amount as per cash book |  | 15000 | 2011  Jan31 | By balance c/d |  | 15000 |
| 15000 | 15000 |

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 31 | To Amount as per cash book |  | 200 | 2011  Jan31 | By profit and loss A/c |  | 200 |
| 200 | 200 |

**Dr. Telephone Charges A/c Cr.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | **Particulars** | **JF** | **Amount (rs)** | **Date** | **Particulars** | **JF** | **Amount (Rs)** |
| 2011  Jan 31 | To amount as per cash book |  | 1000 | 2011  Jan31 | By profit and loss A/c |  | 1000 |
| 1000 | 1000 |

**SOLUTION:**

**TRIAL BALANCE AS ON 31ST JAN. 2011**

|  |  |  |
| --- | --- | --- |
| **Name of the Ledger Account** | **Dr. Amount (Rs.)** | **Cr. Amount (Rs.)** |
| Capital  Sales  Purchases  Furniture  Rent  Telephone charges  Cash in hand  Suspense | 25000  15000  200  1000  57000  1800 | 75000  25000 |
| **Total** | **100000** | **100000** |

**NOTES:**

**EXERCISE QUESTIONS:**

Q 1: State the meaning of Trial Balance.

Q 2. Explain in brief the objective of preparing Trial Balance.

Q 3. Why the totals of two sides of Trial Balance do is equal? Explain.

Q 4. ‘Agreement of Trial Balance is not the conclusive proof of the accuracy of accounts’. Comment.

Q 5. What is Suspense A/c? What is its role in preparing Trial Balance?

Q 6. Explain the steps that are taken to prepare a Trial Balance.

Q 7: List the various reasons because of which the totals of two columns of Trial Balance do not tally.

Q 8: Prepare Trial Balance of M/s multiplying enterprise as on 31st December, 2011:

|  |  |  |  |
| --- | --- | --- | --- |
| **ACCOUNTS** | **BALANCES(RS)** | **ACCOUNTS** | **BALANCES(RS)** |
| Cash in hand  Cash at bank  Capital  Drawings  Purchases  Sales  Machine  furniture | 2500  14500  70000  9000  60000  82000  35000  12000 | Debtors  Creditors  Opening stock  Wages  Rent  Salary  Bills payable | 18200  16600  8700  6700  5000  8400  11400 |

**NOTES:**

**LECTURE – 26**

**BANK RECONCILIATION STATEMENT:**

Business concern maintains the cash book for recording cash and bank transactions. The Cash book serves the purpose of both the cash account and the bank account. It shows the balance of both at the end of a period. Bank also Bank also maintains an account for each customer in its book. All deposits by the customer are recorded on the credit side of his/her account and all withdrawals are recorded on the debit side of his/her account. A copy of this account is regularly sent to the customer by the bank. This is called ‘Pass Book’ or Bank statement. It is usual to tally the firm’s bank transactions as recorded by the bank with the cash book. But sometimes the bank balances as shown by the cash book and that shown by the pass book/bank statement do not match. If the balance shown by the pass book is different from the balance shown by bank column of cash book, the business firm will identify the causes for such difference. It becomes necessary to reconcile them. To reconcile the balances of Cash Book and Pass Book a statement is prepared. This statement is called the ‘Bank Reconciliation Statement.

**NEED FOR PREPARING BANK RECONCILIATION STATEMENT:**

It is neither compulsory to prepare Bank Reconciliation Statement nor a date is fixed on which it is to be prepared. It is prepared from time to time to check that all transactions relating to bank are properly recorded by the

Businessman in the bank column of the cash book and by the bank in its ledger account. Thus, it is prepared to reconcile the bank balances shown by the cash book and by the bank statement. It helps in detecting, if there is any error in recording the transactions and ascertaining the correct bank balance on a particular date.

**REASONS FOR DIFFERENCE:**

When a businessman compares the Bank balance of its cash book with the balance shown by the bank pass book, there is often a difference. As the time period of posting the transactions in the bank column of cash book does not correspond with the time period of posting in the bank pass book of the firm, the difference arises. The reasons for difference in balance of the cash book and pass book are as under:

1. **Cheques issued by the firm but not yet presented for payment:** When cheques are issued by the firm, these are immediately entered on the credit side of the bank column of the cash book. Sometimes, receiving person may present these cheques to the bank for payment on some later date. The bank will debit the firm’s account when these cheques are presented for payment. There is a time period between the issue of cheque and being presented in the bank for payment. This may cause difference to the balance of cash book and pass book.
2. **Cheques deposited into bank but not yet collected:** When cheques are deposited into bank, the firm immediately enters it on the debit side of the bank column of cash book. It increases the bank balance as per the cash book. But, the bank credits the firm’s account after these cheques are actually realized. A few days are taken in clearing of local cheques and in case of outstation cheques few more days are taken. This may cause the difference between cash book and pass book balance.
3. **Amount directly deposited in the bank account:** Sometimes, the debtors or the customers deposit the money directly into firm’s bank account, but the firm gets the information only when it receives the bank statement. In this case, the bank credits the firm’s account with the amount received but the same amount is not recorded in the cash book. As a result the balance in the cash book will be less than the balance shown in the Pass book.
4. **Bank Charges:** The bank charge in the form of fees or commission is charged from time to time for various services provided from the customers’ account without the intimation to the firm. The firm records these charges after receiving the bank intimation or statement. Example of such deductions is : Interest on overdraft balance, credit cards’ fees, outstation cheques, collection charges, etc. As a result, the balance of the cash book will be more than the balance of the pass book.
5. **Interest and dividend received by the bank:** Sometimes, the interest on debentures or dividends on shares held by the account holder is directly deposited by the company through Electronic Clearing System (ECS). But the firm does not get the information till it receives the bank statement. As a consequence, the firm enters it in its cash book on a date later than the date it is recorded by the bank. As a result, the balance as per cash book and pass book will differ.
6. **Direct payments made by the bank on behalf of the customers:** Sometimes, bank makes certain payments on behalf of the customer as per standing instructions. Telephone bills, rent, insurance premium, taxes, etc are some of the expenses. These expenses are directly paid by the bank and debited to the firm’s account immediately after their payment. But the firm will record the same on receiving information from the bank in the form of Pass Book or bank statement. As a result, the balance of the pass book is less than that of the balance shown in the bank column of the cash book.
7. **Dishonour of Cheques/Bill discounted:** If a cheque deposited by the firm or bill receivable discounted with the bank is dishonoured, the same is debited to firm’s account by the bank. But the firm records the same when it receives the information from the bank. As a result, the balance as per cash book and that of pass book will differ.
8. **Errors committed in recording transactions by the firm:** There may be certain errors from firm’s side, e.g., omission or wrong recording of transactions relating to cheques deposited, cheques issued and wrong balancing etc. In this case, there would be a difference between the balances as per Cash Book and as per Pass Book.
9. **Errors committed in recording transactions by the Bank:** Sometimes, bank may also commit errors, e.g., omission or wrong recording of transactions relating to cheques deposited etc. As a result, the balance of the bank pass book and cash book will not agree.

**LECTURE – 27**

**PREPARATION OF BANK RECONCILIATION STATEMENT:**

To reconcile the bank balance as shown in the pass book with the balance shown by the cash book, Bank Reconciliation Statement is prepared. After identifying the reasons of difference, the Bank Reconciliation statement is prepared without making change in the cash book balance. We may have the following different situations with regard to balances while preparing the Bank Reconciliation statement. These are:

**1. Favorable balances**

(a) Debit balance as per cash book is given and the balance as per pass book is to be ascertained.

(b) Credit balance as per pass book is given and the balance as per cash book is to be ascertained.

**2. Unfavorable balance/overdraft balance**

(a) Credit balance as per cash book (i.e. overdraft) is given and the balance as per pass book is to be ascertained.

(b) Debit balance as per pass book (i.e. overdraft) is given and the balance as per cash book is to be ascertained.

**The following steps are taken to prepare the bank reconciliation statement:**

(i) **Favorable balances:** When debit balance as per cash book or credit balance as per pass book is given

(a) Take balance as a starting point say Balance as per Cash Book.

(b) Add all transactions that have resulted in increasing the balance of the pass book.

(c) Deduct all transactions that have resulted in decreasing the balance of pass book.

(d) Extract the net balance shown by the statement which should be the same as shown in the pass book.

In case balance as per pass book is taken as starting point all transactions that have resulted in increasing the balance of the Cash book will be added and all transactions that have resulted in decreasing the balance of Cash

book will be deducted. Now extract the net balance shown by the statement which should be the same as per the Cash book..

**NOTES:**

**Illustration 1**

From the following particulars of M/s Ananaya Industries, prepare bank reconciliation statement as on December 31, 2011:

1. Bank balance as per cash book Rs.32, 500

2. Cheques deposited into bank but not credited up to December 31, 2011 Rs.8, 900.

3. Cheques issued but not presented for payment Rs. 12,500.

4. Bank credited Rs.5, 000 for receiving dividend through Electronic Clearing System.

5. Bank charges debited by Bank Rs.400.

**SOLUTION:**

**BANK RECONCILIATION STATEMENT OF M/S ANANAYA INDUSTRIES AS ON 31ST DECEMBER 2011:**

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **PLUS (AMOUNT IN RS)** | **MINUS (AMOUNT IN RS)** |
| 1. Balance as per cash book | 32,500 |  |
| 1. Cheques deposited but not credited by the bank |  | 8,900 |
| 1. Cheques issued but not presented for payment | 12,500 |  |
| 1. Dividend received through ECS | 5,000 |  |
| 1. Bank charges debited by bank |  | 400 |
| Balance as per pass book |  | 40,700 |
| **Total** | **50,000** | **50,000** |

**Illustration 2**

Take the figures given in illustration number 1. Prepare bank reconciliation statement taking balance as per pass book i.e. Rs.40, 700 as the starting point.

**BANK RECONCILIATION STATEMENT OF M/S ANANAYA INDUSTRIES AS ON 31ST DECEMBER 2011:**

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **PLUS (AMOUNT IN RS)** | **MINUS (AMOUNT IN RS)** |
| 1. Balance as per pass book | 40,700 |  |
| 1. Cheques deposited but not credited by the bank | 8,900 |  |
| 1. Cheques issued but not presented for payment |  | 12,500 |
| 1. Dividend received through ECS |  | 5,000 |
| 1. Bank charges debited by bank | 400 |  |
| Balance as per cash book |  | 32,500 |
| **Total** | **50,000** | **50,000** |

**LECTURE – 28**

**Illustration 3**

From the following particulars of Reema Traders, prepare a bank reconciliation statement on June 30, 2011:

1. Balance as per the cash book Rs.35, 750

2. Rs.250 charges for Credit card fee is debited by bank, which is not recorded in cash book.

3. Cheques for Rs.7, 550 are deposited in the bank but not yet collected by the Bank.

4. There was also a debit in the pass book of Rs.3, 500 in respect of a discounted bill dishonoured.

**SOLUTION:**

**BANK RECONCILIATION STATEMENT OF M/S Reema Traders as on June 30, 2011:**

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **PLUS (AMOUNT IN RS)** | **MINUS (AMOUNT IN RS)** |
| 1. Balance as per Cash book | 35,750 |  |
| 1. Cheques deposited but not credited by the bank |  | 7,550 |
| 1. Credit card fee charges debited by the bank |  | 250 |
| 1. Discounted bill dishonoured recorded only in pass book |  | 3,500 |
| 1. Balance as per pass book |  | 24,450 |
| **Total** | **35,750** | **35,750** |

**UNFAVOURABLE BALANCE/OVERDRAFT BALANCE:**

Sometimes a businessman withdraws excess amount from the bank account and the closing bank balance of a month is a debit balance. This balance amount is called ‘overdraft balance’ as per Pass Book. This is shown in

the cash book as a credit balance.

**Credit balance as per cash book/Debit balance as per Pass Book.**

Overdraft balance is to be shown in the minus column of statement as the starting point. The other steps shall remain same. The following illustration helps to understand dealing with the unfavourable balance as per cash book and pass book.

**Illustration**

On December 31, 2011, the cash book of the M/s. Mona Plastics shows the credit balance Rs.6,500. Cheques amounting to Rs.3,500 deposited into bank but were not collected by the bank. Firm issued cheques of Rs. 1,000

which were not presented for payment. There was a debit in the pass book of Rs.200 for interest and Rs.400 for bank charges. Prepare Bank Reconciliation Statement.

**SOLUTION:**

**BANK RECONCILIATION STATEMENT OF M/S Mona Plastics as on December 31, 2011:**

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **PLUS (AMOUNT IN RS)** | **MINUS (AMOUNT IN RS)** |
| 1. Overdraft as per cash book |  | 6,500 |
| 1. Cheques issued but not presented for payment | 1,000 |  |
| 1. Cheques deposited but not credited by the bank |  | 3,500 |
| 1. Bank charges and interest charged |  | 600 |
| 1. Overdraft balance as per bank pass book | 9,600 |  |
| **Total** | **10,600** | **10,600** |

**Illustration**

Prepare Bank Reconciliation Statement of M/s Ashima Travels, from the following information:

1. Bank overdraft as per Cash Book on 31st July, 2006 Rs.45,000
2. Cheques issued but not presented for payment Rs.17,500

(c)Cheques deposited but not yet collected by the bank Rs.9, 600

(d)Interest on investment collected by the bank Rs.2, 300

(e)Bank charges Rs.350 debited by the bank not yet entered in the cash book.

**Solution:**

**BANK RECONCILIATION STATEMENT OF M/S Ashima Travels as on July 2011:**

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **PLUS (AMOUNT IN RS)** | **MINUS (AMOUNT IN RS)** |
| 1. Overdraft as per cash book |  | 45,000 |
| 1. Cheques issued but not presented for payment | 17,500 |  |
| 1. Cheques deposited but not credited by the bank |  | 9,600 |
| 1. Interest on investment collected by the bank |  | 2,300 |
| 1. Bank charges | 350 |  |
| Overdraft balance as per bank pass book | 39,050 |  |
| **Total** | **56,900** | **56,900** |

**EXERCISE QUESTIONS:**

Q1: From the following particulars, prepare Bank Reconciliation statement as on December 31, 2011.

(i) Balance as per Cash Book Rs.4,200

(ii) Cheques issued but not presented for payment Rs.2, 000

(iii) Cheques deposited but not collected Rs.3, 000

(iv) Bank charges debited by the bank Rs.250.

Q2:. Prepare Bank Reconciliation statement as on March 31, 2011. On this date the passbook of M/s Noopur Industries showed a balance of Rs.27, 500.

(a) Cheques of Rs.14, 000 directly deposited by a customer.

(b) Cheques for Rs.13, 500 were issued during the month of March but of these cheques for Rs.1,500 were not presented by the end of March.

(c) The bank collected Rs.2, 500 as dividend on shares.

(d) Cheques of Rs.17500 were paid into bank but of Rs 8500 were realized in the month of April.

Q3:. On April 1, 2011, Rohan had an overdraft of Rs.16, 000 as shown bythe cash book. Cheques amounting to Rs.6, 000 had been paid by him but not collected by the bank till date. He issued cheques of Rs.8, 000 which were not presented to the bank for payment. There was a debit in his passbook of Rs.500 for interest and Rs.200 for bank charges and a cheque of Rs.5000 was paid into bank but the same was debited twice in the cash book. Prepare Bank Reconciliation Statement.

Q4:. Overdraft shown by the passbook of M/s.Mohit trader is Rs.40, 000. Prepare Bank Reconciliation statement on December 31, 2011.

(a) Bank charges debited as per pass book Rs.1, 000

(b) Received a payment directly from customer Rs.7,000

(c) Cheques wrongly recorded in debit side of cash book Rs.4, 000

(d) Cheques issued but not presented for payment Rs.9,800

(e) Cheques deposited with the bank but not collected Rs. 12,500

(f) Insurance premium paid by the bank Rs.3, 500

**NOTES:**

**LECTURE – 29**

**Rectification of Accounting Errors**

Owners of the businesses and other interested parties are interested in finding out the true profit and correct financial position of his business at the close of the trading period. Accounts are considered to be authentic proof of true financial position of a concern. But in spite of best efforts there are certain transactions which are omitted to be recorded or entered wrongly in the books. Such errors affect the final accounts.

Accountants prepare trial balance to check the correctness of accounts. If total of debit balances does not agree with the total of credit balances, it is a clear-cut indication that certain errors have been committed while recording the transactions in the books of original entry or subsidiary books. We also know that all types of errors are not revealed by trial balance as some of the errors do not affect the total of trial balance. So these cannot be located with the help of trial balance. An accountant should invest his energy to locate both types of errors and rectify them before preparing trading, profit and loss account and balance sheet. Because if these are prepared before rectification these will not give us the correct result and profit and loss disclosed by them, shall not be the actual profit or loss.

All errors accounting errors can be classified as follows:

**Errors**

Errors of Principle

Clerical Errors

Errors of Omission

Errros of Commission

Compensating Errors

**1. Errors of Principle**

When a transaction is recorded against the fundamental principles of accounting, it is an error of principle. For example, if revenue expenditure is treated as capital expenditure or vice versa.

**2. Clerical Errors**

These errors can again be sub-divided as follows:

(i) Errors of omission

When a transaction is either wholly or partially not recorded in the books, it is an error of omission. It may be with regard to omission to enter a transaction in the books of original entry or with regard to omission to post a transaction from the books of original entry to the account concerned in the ledger.

(ii) Errors of commission

When an entry is incorrectly recorded either wholly or partially-incorrect posting, calculation, casting or balancing. Some of the errors of commission affect the trial balance whereas others do not. Errors affecting the trial balance can be revealed by preparing a trial balance.

(iii) Compensating errors

Sometimes an error is counter-balanced by another error in such a way that it is not disclosed by the trial balance. Such errors are called compensating errors.

From the point of view of rectification of the errors, these can be divided into two groups:

(i) Errors affecting one account only, and

(ii) Errors affecting two or more accounts.

**Errors affecting one account**

Errors which affect can be:

(a) Casting errors;

(b) error of posting;

(c) carry forward;

(d) balancing; and

(e) omission from trial balance.

Such errors should, first of all, be located and rectified. These are rectified either with the help of journal entry or by giving an explanatory note in the account concerned.

**Rectification**

**Stages of correction of accounting errors**

All types of errors in accounts can be rectified at two stages:

(i) before the preparation of the final accounts; and

(ii) after the preparation of final accounts.

**Errors rectified within the accounting period**

The proper method of correction of an error is to pass journal entry in such a way that it corrects the mistake that has been committed and also gives effect to the entry that should have been passed. But while errors are being rectified before the preparation of final accounts, in certain cases the correction can't be done with the help of journal entry because the errors have been such. Normally, the procedure of rectification, if being done, before the preparation of final accounts is as follows:

**Correction of errors affecting one side of one account** Such errors do not let the trial balance agree as they effect only one side of one account so these can't be corrected with the help of journal entry, if correction is required before the preparation of final accounts. So required amount is put on debit or credit side of the concerned account, as the case maybe. For example:

(i) Sales book under cast by Rs. 500 in the month of January. The error is only in sales account, in order to correct the sales account, we should record on the credit side of sales account 'By under casting of. sales book for the month of January Rs. 500".I'Explanation:As sales book was under cast by Rs. 500, it means all accounts other than sales account are correct, only credit balance of sales account is less by Rs. 500. So Rs. 500 have been credited in sales account.

(ii) Discount allowed to Marshall Rs. 50, not posted to discount account. It means that the amount of Rs. 50 which should have been debited in discount account has not been debited, so the debit side of discount account has been reduced by the same amount. We should debit Rs. 50 in discount account now, which was omitted previously and the discount account shall be corrected.

(iii) Goods sold to X wrongly debited in sales account.

This error is affecting only sales account as the amount which should have been posted on the credit side has been wrongly placed on debit side of the same account.

For rectifying it, we should put double the amount of transaction on the credit side of sales account by writing "By sales to X wrongly debited previously."

(iv) Amount of Rs. 500 paid to Y, not debited to his personal account. This error of affecting the personal account of Y only and its debit side is less by Rs. 500 because of omission to post the amount paid. We shall now write on its debit side. "To cash (omitted to be posted) Rs. 500.

**Correction of errors affecting two sides of two or more accounts**

As these errors affect two or more accounts, rectification of such errors, if being done before the preparation of final accounts can often be done with the help of a journal entry. While correcting these errors the amount is debited in one account/accounts whereas similar amount is credited to some other account/ accounts.

**Correction of errors in next accounting period**

As stated earlier, that it is advisable to locate and rectify the errors before preparing the final accounts for the year. But in certain cases when after considerable search, the accountant fails to locate the errors and he is in a hurry to prepare the final accounts, of the business for filing the return for sales tax or income tax purposes, he transfers the amount of difference of trial balance to a newly opened 'Suspense Account'. In the next accounting period, as and when the errors are located these are corrected with reference to suspense account. When all the errors are discovered and rectified the suspense account shall be closed automatically. We should not forget here that only those errors which affect the totals of trial balance can be corrected with the help of suspense account. Those errors which do not affect the trial balance can't be corrected with the help of suspense account. For example, if it is found that debit total of trial balance was less by Rs. 500 for the reason that Wilson's account was not debited with Rs. 500, the following rectifying entry is required to be passed.

**LECTURE – 30**

**Difference in trial balance**

Trial balance is affected by only errors which are rectified with the help of the suspense account. Therefore, in order to calculate the difference in suspense account a table will be prepared. If the suspense account is debited in' the rectification entry the amount will be put on the debit side of the table. On the other hand, if the suspense account is credited, the amount will be put on the credit side of the table. In the end, the balance is calculated and is reversed in the suspense account. If the credit side exceeds, the difference would be put on the debit side of the suspense account.

**Effect of Errors of Final Accounts**

**1. Errors effecting profit and loss account**

It is important to note the effect that an en-or shall have on net profit of the firm. One point to remember here is that only those accounts which are transferred to trading and profit and loss account at the time of preparation of final accounts effect the net profit. It means that only mistakes in nominal accounts and goods account will affect the net profit. Error in these accounts will either increase or decrease the net profit.

**How the errors or their rectification effect the profit-following rules are helpful in understanding it:**

(I) If because of an error a nominal account has been given some debit the profit will decrease or losses will increase, and when it is rectified the profits will increase and the losses will decrease. For example, machinery is overhauled for Rs. 10,000 but the amount debited to machinery repairs account -this error will reduce the profit. In rectifying entry the amount shall be transferred to machinery account from machinery repairs account, and it will increase the profits.

(ii) If because of an error the amount is omitted from recording on the debit side of a nominal account-it results in increase of profits or decrease in losses. The rectification of this error shall have reverse effect, which means the profit will be reduced and losses will be increased. For example, rent paid to landlord but the amount has been debited to personal account of landlord-it will increase the profit as the expense on rent is reduced. When the error is rectified, we will post the necessary amount in rent account which will increase the expenditure on rent and so profits will be reduced.

(iii) Profit will increase or losses will decrease if a nominal account is wrongly credited. With the rectification of this error, the profits will decrease and losses will increase. For example, investments were sold and the amount was credited to sales account. This error will increase profits (or reduce losses) when the same error is rectified the amount shall be transferred from sales account to investments account due to which sales will be reduced which will result in decrease in profits (or increase in losses).

(iv) Profit will decrease or losses will increase if an account is omitted from posting in the credit side of a nominal or goods account. When the same will be rectified it will increase the profit or reduce the losses.

For example, commission received is omitted to be posted to the credit of commission account. This error will decrease profits (or increase losses) as an income is not credited to profit and loss account. When the error will be rectified, it will have reverse effect on profit and loss as an additional income will be credited to profit and loss account so the profit will increase (or the losses will decrease).

If due to any error the profit or losses are affected, it will have its effect on capital account also because profits are credited and losses are debited in the capital account and so the capital shall also increase or decrease. As capital is shown on the liabilities side of balance sheet so any error in nominal account will affect balance sheet as well. So we can say that an error in nominal account or goods account effects profit and loss account as well as balance sheet.

**2. Errors effecting balance sheet only**

If an error is committed in a real or personal account, it will affect assets, liabilities, debtors or creditors of the firm and as a result it will have its impact on balance sheet alone. because these items are shown in balance sheet only and balance sheet is prepared after the profit and loss account has been prepared. So if there is any error in cash account, bank account, asset or liability account it will affect only balance sheet.

**NOTES:**

**LECTURE 31**

**Illustration 1**

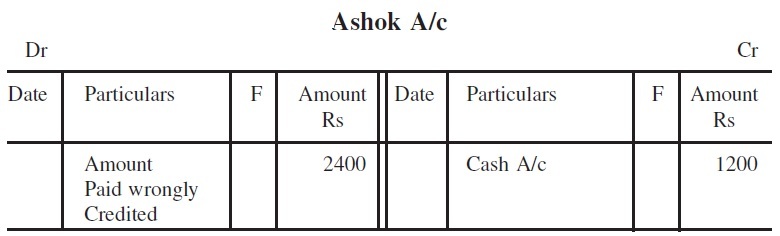
A sum of Rs 1200 paid to Ashok has been wrongly credited to his account.

**Solution: Accounts affected**

Ashok A/c is affected because his account has been credited instead of being debited.

**Rectification**

In this case Ashok A/c is to be debited to nullify the effect of its being wrongly credited at the same time it is to be debited for cash payment. Rectification is done as under:



**Illustration 2**

Purchase of furniture of Rs 5000 was entered in the Purchases Book.

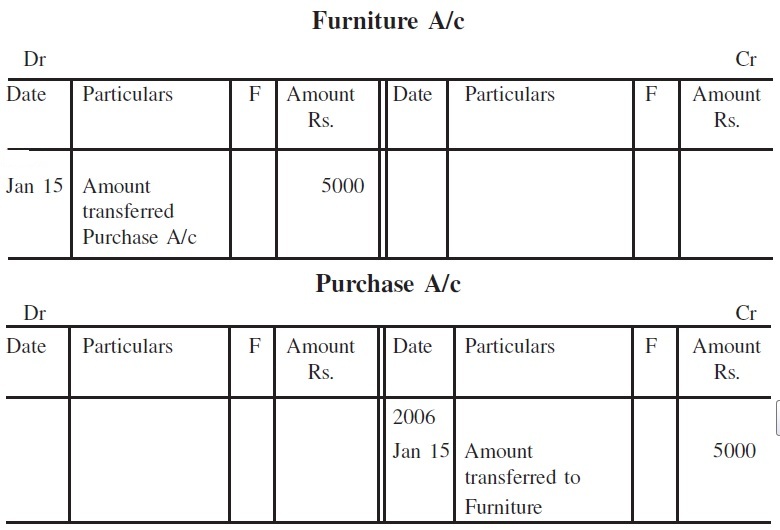
**Solution**

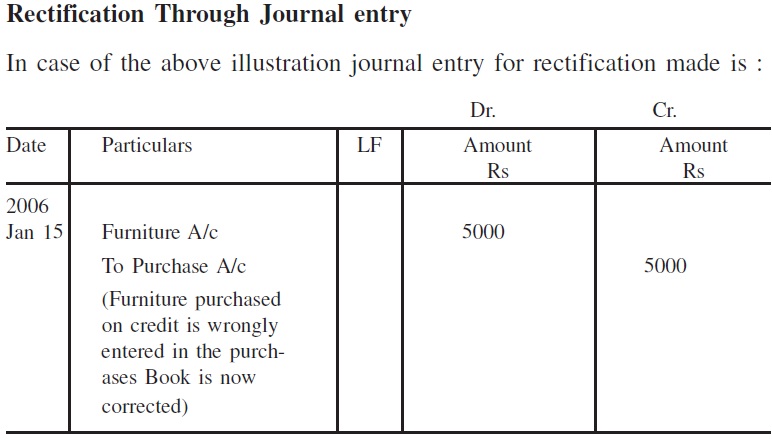
**Accounts affected**

Furniture Account and Purchases account have been affected. Furniture Account has been omitted to be debited while Purchases account is wrongly credited.

**Rectification**

In this case Purchases account is credited to nullify as it is wrongly credited as furniture account is debited in it was to be debited but was omitted.





**Self Practice**

**Question 1**

Following are some accounting errors. Rectify them by making journal entries:

(i) Sales for Rs.20000 made to Malvika was not entered in the Sales Book.

(ii) Salary of Rs.7500 paid to Accountant Raman was debited to his personal account.

(iii) Old furniture sold for Rs.2800 was entered in the Sales Book.

(iv) Carriage paid Rs.500 on purchase of a Machine was debited to Carriage A/c.

(v) Cash Rs.50000 paid to the creditor Atulya Ghosh was debited to Praful Ghosh’s A/c.

**Question 2**

Following are some accounting errors. Rectify them by making journal entries:

(i) Purchases Book has been overcast by Rs.200

(ii) Goods purchased from Manohar of Rs.2500 has been posted to the debit of his account.

(iii) Cash of Rs.4500 paid to Munish was credited to Manish.

(iv) Discount Rs.100 allowed to Anthony was not debited to discount account.

(v) Purchase of goods from Mohit for Rs2500 was entered in the Sales Book; however Mohit’s Account was correctly credited.

(vi) Cash received from Anil a debtor Rs3200 was correctly entered in the Cash Book but was omitted to be posted to his account.

(vii) Sales Book was overcast by Rs1500.

(viii) Cash of Rs4000 paid to Hanif was credited to Rafique A/c as Rs1400.

(ix) The total of Purchase Returns Book of Rs3150 was carried forward as Rs1530.

(x) Namita was paid cash Rs6500 but Sumita was debited by Rs6000.

**Question 3**

The Book keeper of a firm found that his trial balance did not agree. Its credit total exceeded the debit total by Rs.2850. He placed the amount in Suspense A/c and subsequently found the following errors. Rectify.

(i) A credit item of Rs.3490 has been debited to his personal Account as Rs.4390.

(ii) A sum of Rs.2650 written off as depreciation on machine has not been posted to Depreciation A/c.

(iii) Goods of Rs.5300 sold were returned by the customer and were taken into stock before closing the books but were not entered in the books.

(iv) Rs.4800 due from Lakhan Pal which had been written off as bad debt in a previous year was unexpected recorded and had been posted to the personal account of Lakhan Pal.

(v) Sales Book is undercast by Rs.1500.

(vi) Rs.4000 withdrawn for domestic use by the proprietor was debited to General Expenses A/c.

(vii) Machine Purchased from Machine Mart for Rs.18000 were entered in the Purchases Book.

(viii) Cash paid Rs.1200 to Lakshman was credited to Ram as Rs.2100.

**UNIT-IV (LECTURE 32)**

**FINAL ACCOUNTS:**

**Financial statements are the statements that are prepared at the end of the accounting period, which is generally one year. These include income statement i.e. Trading and Profit & Loss account and position statement i.e. Balance Sheet.**

**Objectives of financial statements:**

Financial statements are prepared to ascertain the profits earned or losses incurred by a business concern during a specified period and also to ascertain its financial position at the end of that specified period. Financial statements are generally of two types:

(a) Income statement which comprises of Trading Account and Profit & Loss Account, and

(b) Position Statement i.e., the Balance Sheet.

**Following are the objectives of preparing financial statements: -**

1. **Ascertaining the results of business operations:** Every businessman wants to know the results of the business operations of his enterprise during a particular period in terms of profits earned or losses incurred. Income statement serves this purpose.
2. **Ascertaining the financial position:** financial statements show the financial position of the business concern on a particular date which is generally the last date of the accounting period. Position statement i.e. Balance Sheet is prepared for this purpose.
3. **Source of information:** Financial statements constitute an important source of information regarding finance of a business unit which helps the finance manager to plan the financial activities of the business and making proper utilization of the funds.
4. **Helps in managerial decision making:** The Manager can make comparative study of the profitability of the concern by comparing the results of the current year with the results of the previous years and make his/her managerial decisions accordingly.
5. **An index of solvency of the concern:** Financial statements also show the short term as well as long term solvency of the concern. This helps the business enterprise in borrowing money from bank and other financial institutions and/or buying goods on credit.

**NOTES:**

**Capital Expenditure and Revenue Expenditure, Capital Receipts and Revenue Receipts**

The preparation of Trading Account and Profit and Loss Account requires the knowledge of revenue expenditure, revenue receipts and capital expenditure and capital receipts. The knowledge shall facilitate the classification of revenue items and put them in the Trading account and Profit and Loss Account on one hand and prepare Balance Sheet based on capital items (expenditure as well as receipts) on the other hand.

**Capital Expenditure** refers to the expenditure incurred for acquiring fixed assets or assets which increase the earning capacity of the business. The benefits of capital expenditure to the firm extend to number of years. Examples of capital expenditure are expenditure incurred for acquiring a fixed asset such as building, plant and machinery etc.

**Revenue expenditure**, on the other hand, is an expenditure incurred in the course of normal business transactions of a concern and its benefits are availed of during the same accounting year. Salaries, carriage etc. are examples of revenue expenditure.

There is another category of expenditure called **deferred revenue expenditure**. These are the expenses incurred during one accounting year but are applicable wholly or in part in future periods. These expenditures are otherwise of a revenue nature. Example of deferred revenue expenditure is heavy expenditure on advertisement say for introducing a new product in the market, expenditure incurred on research and development, etc.

**Capital and Revenue Receipts**

**Capital receipts** are receipts which do not arise out of normal course of business. Examples of such receipts are sale of fixed assets, and raising of loans etc. Such receipts are not treated as income of the enterprise.

**Revenue receipts** are receipts which arise during the normal course of business, Sale of goods, rent from tenants, dividend received, etc. are some of the examples of revenue receipts. They are the items of incomes of the

business entity.

**LECTURE – 33**

**TRADING ACCOUNT**

Income statement consists of Trading and Profit and Loss Account. A business firm either purchases goods from others and sells them or manufactures and sells them to earn profit. This is known as trading activities. A statement is prepared to know the results in terms of profit or loss of these activities. This statement is called Trading Account. Trading Account is prepared to ascertain the results of the trading activities of the business enterprise. It shows whether the selling of goods purchased or manufactured has earned profit or incurred loss for the business unit. Cost of goods sold is subtracted from the net sales of the business of that accounting year. In case the total sales value exceeds the cost of goods sold, the difference is called Gross Profit. On the other hand, if the cost of goods sold exceeds the total net sales, the difference is Gross Loss. All accounts related to cost of goods sold such as opening stock, net purchases i.e. purchase less returns outward, direct expenses such as wages, carriage inward etc. and closing stock with net sales (i.e. Sales minus Sales returns) are taken to the Trading Account. Then this account is balanced. Credit balance shows the gross Profit and debit balance shows the gross loss.

**The cost of goods is calculated as follows:**

**Cost of goods sold = opening stock + net purchases + all direct expenses – closing stock**

**Gross Profit = net sales – cost of goods sold.**

**Illustration 1**

Calculate the cost of goods sold from the following information:

Opening stock Rs 10000

Closing stock Rs 8000

Purchases Rs 80000

Carriage on purchases Rs 2000

Wages Rs 6600

**Solution:**

Cost of goods sold = opening stock + purchases + direct expenses (carriage on purchases + wages) – closing stock

= Rs. [10000 + 80000 + 8600 (i.e. 2000 + 6600) – 8000]

= Rs. 90600

**Format of Trading Account**

**Trading Account**

**for the year ending …………..**

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Opening Stock  Purchases  Less: purchase returns  Direct expenses:  Carriage inward  Freight  Wages  Fuel and power  Excise duty  Factory rent  Heating and lighting  Factory rent & insurance  Work managers salary  Gross profit transferred to profit and loss account |  | Sales  Less: sales returns  Closing stock  Gross loss transferred to profit and loss account. |  |

**PROFIT & LOSS ACCOUNT**

Trading account is prepared to ascertain the Gross profit or Gross loss of the trading activities of the business. But these are not the final results of business operations of an enterprise. Apart from direct expenses, there are indirect expenses also. These may be divided into office and administrative expenses, selling and distribution expenses, financial expenses, depreciation and maintenance charges etc. Similarly, there can be income from sources other than sales revenue. These may be interest on investments, discount received from creditors, commission received, etc. Another account is prepared in which all indirect expenses and revenues from sources other than sales are written. This account when balanced shows profit (or loss). This account is termed as Profit and Loss Account. The profit shown by this account is called ‘net profit’ and if it shows loss it is known as ‘net loss’.

**Format of Profit and Loss Account**

Profit and Loss A/c of M/s ................…..

for the year ended ...............

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Gross loss b/d  Salaries  Rent, rates and taxes  Insurance premium  Advertising  Commission paid  Discount allowed  Repairs and renewals  Bad debts  Establishment charges  Travelling expenses  Bank charges  Sales tax/value added tax  Depreciation on fixed assets  Net profit transferred to capital account |  | Gross profit b/d  Discount received  Commission received  Dividend received  Interest on investment  Rent received  Net loss transferred to capital account |  |

**LECTURE – 34**

**Position Statement/Balance Sheet:**

Position Statement or Balance Sheet is another basis of financial statement. Balance Sheet is a statement prepared on a particular date, generally at the end of accounting year to ascertain the financial position of the entity. It consists of assets on the one hand and liabilities on the other. Financial position of a business is the list of assets owned by the business and the claims of various parties against these assets. The statement prepared to show the financial position is termed as Balance Sheet

**In the words of Francis R Steal, “Balance Sheet is a screen picture of the financial position of a going business at a certain moment.”**

**In the words of Freeman, “A Balance Sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date.”**

**ILLUSTRATION 1:**

From the following information of M/s Nand lal and bros. for the year ending 31st March 2011, prepare trading and profit and loss A/c for the year ended 31st march 2011:

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Rs.** | **Particulars** | **Rs.** |
| Stock 01.04.2010  Purchases-cash  Purchases-credit  Freight inward  Wages  Carriage on sales  Telephone charges  Electricity expenses  Office rent paid  Salaries  Depreciation | 5800  42000  18000  1800  4500  800  1600  1200  6000  8000  1400 | Sales  Return inward  Interest on investment  Discount received  Closing stock | 72000  2000  1500  1200  7200 |

**SOLUTION:**

**Books of M/s Nand Lal & Bros.**

**Trading A/c**

**for the year ended 31st March, 2011**

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Stock (01.04.2010)  **Purchases**  Cash 42000  Credit 18000  Freight inward  Wages  Gross profit transferred to profit and loss A/c | 5800  60000  1800  4500  5100 | Sales 72000  Less: return inward 2000  Closing stock | 70000  7200 |
| 77200 | 77200 |

**Profit and Loss A/c**

**For the year ending 31st march 2011**

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Carriage on sale  Telephone charges  Electricity expenses  Office rent  Salaries depreciation | 800  1600  1200  6000  8000  1400 | Gross profit transferred from trading A/c  Interest on investment  Discount received  Net loss transferred to capital A/c | 5100  1500  1200  11200 |
| 19000 | 19000 |

**ILLUSTRATION 2:**

From the following trial balance of M/s Vikram Brothers prepare trading and profit and loss account for the year ended 31st march 2011 and balance sheet as on that date:

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Dr. Rs.** | **Particulars** | **Cr. Rs.** |
| Cash in hand  Motor car  Drawings  Legal charges  Plant and machinery  Investments  Opening stock  Sales returns  Salaries  Discount allowed  Carriage inward  Wages  Postage  Debtors  Interest  Insurance premium  purchases | 500  25000  48000  1500  60000  40000  35000  2500  12000  600  1800  21000  400  60000  1500  1200  80000 | Capital  Discount received  Sales  Creditors  Interest on investment  Purchases return  Bills payable | 70000  2000  230000  46000  5200  3800  34000 |
|  | 391000 |  | 391000 |

**Closing stock as on 31.03.2011 Rs. 28000**

**Ans: Trading A/c**

**For the year ending 31st march 2011**

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Opening stock  Purchases 80000  Less: purchase return 3800  Wages  Carriage inward  Gross profit transferred to profit and loss A/c | 35000  76200  21000  1800  121500 | Sales 230000  Less: sales returns 2500  Closing stock | 227500  28000 |
| 255500 | 255500 |

**Profit and loss A/c**

**For the year ending 31st march 2011**

**Dr.**  **Cr.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount (Rs)** | **Particulars** | **Amount (Rs)** |
| Salaries  Insurance premium  Discount allowed  Postage  Interest  Legal charges  Net profit transferred to capital A/c | 12000  1200  600  400  1500  1500  111500 | Gross profit transferred from trading A/c  Discount received  Interest on investments | 121500  2000  5200 |
| 128700 | 128700 |

**Balance Sheet**

**As on 31st march 2011**

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **Amount (Rs)** | **Assets** | **Amount (Rs)** |
| Bills payable  Capital 70000  Add: net profit 111500  Less: drawings 48000  Creditors | 34000  133500  46000 | Cash in hand  Debtors  Closing stock  Investments  Motor car  Plant and machinery | 500  60000  28000  40000  25000  60000 |
| 213500 | 213500 |

**LECTURE - 35**

**ILLUSTRATION 3:**

Following is the trial balance extracted from the books of jasmine enterprises as on 31st march 2011. Prepare trading and profit and loss account from the information given in trial balance for the year ending 31st march, 2011. Also prepare the balance sheet as on that date.

|  |  |  |
| --- | --- | --- |
| **PARTICULARS** | **DR. AMOUNT(RS)** | **CR. AMOUNT (RS)** |
| Stock (01.04.2010)  Purchases and sales  Return inwards and return outwards  Debtors and creditors  Bills receivable and bills payable  Commission paid  Audit fees  Building  Furniture  Salaries  Telephone charges  Insurance  Discount allowed  Octroi  Wages  Freight inward  Bad debts  Depreciation  Bank loan  Cash in hand and at bank  Capital  Drawing  machinery | 18500  78500  2200  16500  14000  2000  1800  65000  12000  14000  4200  2100  1000  1200  16000  2400  600  4200  25000  16500  30000 | 154200  2500  18000  21000  32000  100000 |
| **Total** | **327700** | **327700** |

**ADJUSTMENTS AND THEIR INCORPORATION**

The number and nature of adjustments differ from organisation to organisation. It depends upon the volume and nature of activities in the organisation, However, certain adjustments are common in all types of organisations. Moreover, while making adjustments you will have to follow the general principle of double entry i.e. the amount is to be debited to one account and credited to another account. Thus in the finanacial statements the item to be adjusted should appear at two places one representing the debit and the other representing the credit.

**Some of the items of adjustment and its accounting treatment in financial statements. These are as under:**

1. Closing Stock

2. Outstanding Expenses.

3. Prepaid Expenses

4. Accrued Income.

5. Income received in advance

6. Interest on Capital

7. Interests on Drawings

8. Depreciation.

9. Further Bad Debts.

10. Provision for Bad and Doubtful Debts.

**1. Closing Stock:** Closing Stock is the stock of goods remaining unsold at the end of the accounting year. Ordinarily this does not appear in the Trial Balance. Hence, this needs to be incorporated in financial statements. This appears on the credit side of the Trading Account as well as Assets side of the Balance Sheet.

**The adjustment entry will be:**

Closing Stock A/c Dr

To Trading A/c

(Closing stock transferred to trading A/c)

The effect of the adjustment entry on financial statements is as under:

**Trading A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
|  |  |  | Closing Stock | ……… |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
|  |  |  | Closing Stock | ……… |

**2. Outstanding Expenses:** Expense which is related to the current accounting period but not yet paid

is known as Outstanding Expense. Suppose the accounts are closed on 31st December every year. Salary for the month of December is due but not paid. It is an example of salary outstanding. Similarly, there are some other items like Rent outstanding, Wages outstanding etc. In case of Salaries Outstanding following adjustment entry will be made:

Salary A/c Dr.

To Salary Outstanding A/c

(Salary outstanding for the month of December)

**In financial statements it will be recorded as:**

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Salaries  Add: salary outstanding |  |  |  |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Salary outstanding | …….. |  |  |  |

**3. Prepaid expenses:**  A part of a certain expense paid may relate to the next accounting period. Such expenses are called prepaid expense or expenses paid in advance. For example, insurance premium paid in the current year may be for the year ending, the date of which falls in the next year. The part of

insurance premium which relates to next accounting year is the insurance premium paid in advance is deducted from the amount paid and is shown as an item of asset. Similarly, such items may be rent prepaid, tax prepaid etc.

**Adjustment entry for prepaid Insurance Premium**

Prepaid Insurance Premium A/c Dr

To Insurance Premium A/c

(Insurance premium paid in advance)

**In financial statements, it is recorded as:**

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Insurance Premium  Less: Prepaid Insurance premium |  |  |  |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
|  |  |  | Prepaid Insurance |  |

**LECTURE - 36**

**4. Accrued income (Due but not received)**

Accrued income means income earned but not received till the end of the accounting year. For example, interest on securities or dividends on shares, which has become due but may be received on a date falling in the next year. Such income does not appear in the trial balance but should be duly

accounted for in the year, because such income has accrued. Adjustment entry for the transaction : suppose Rent receivable as it has become due but is not yet received

Rent Receivable (accrued) A/c Dr

To Rent Received A/c

(Amount of rent due but not received)

**In financial statements, it will be recorded as;**

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
|  |  |  | Rent Received  Add: Rent Accrued |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
|  |  |  | Rent Accrued |  |

**5. Unearned income/income Received in Advance**

When income is received before it becomes actually due it is called “unearned income” or “income received in advance”. Since this income does not relate to the accounting year, it should be deducted from the relevant head of income in the Profit & Loss A/c. It is a liability and hence is shown in the liability side of the Balance Sheet. Example of such income is rent that has been received for the months of January and February of the coming accounting year. Adjustment entry for the same is

Rent Received A/c Dr

To Rent Received in Advance A/c

(Rent received in advance)

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
|  |  |  | Rent Received  Less: Rent received in advance |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Rent Received in advance |  |  |  |  |

**OTHER ADJUSTMENTS**

**6. Interest on capital**

As per business entity concept capital of the proprietor is a liability for the business. Like other loans interest can be paid on capital also. In case it is decided to allow interest on capital, adjustment entry will be as follows:

Interest on Capital A/c Dr

To Capital A/c

(Interest allowed on capital)

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Interest on Capital |  |  |  |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Capital  Add: Interest on capital |  |  |  |  |

**7. Interest on drawings**

Interest may also be charged on money withdrawn by the proprietor for household use. Following journal entry is made.

Capital A/c Dr

To Interest on Drawings A/c

(Interest on Drawings charged)

In financial statements, it will be shown as:.

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
|  |  |  | Interest on Drawings |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Capital  Less: Interest on drawings |  |  |  |  |

**8. Depreciation**

The value of fixed assets such as Plant and Machinery, Furniture and Fixtures, Land & Building, Motor Vehicles etc. goes on reducing year after year due to wear and tear, obsolescence or for any other reason. As the fixed assets are used for earning revenue the amount by which the value of a fixed asset decreases is an item of expense, similar to other expenses. This is called depreciation. It should be charged to the Profit and loss Account. The value of such assets should also be shown in the Balance Sheet at the reduced value by the amount of depreciation. The adjustment entry for depreciation will be

Depreciation A/c Dr

To Asset ( by name ) Account

**It will be shown in the Profit and Loss A/c and Balance sheet as under:**

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Depreciation on Plant & machinery |  |  |  |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
|  |  |  | Plant & machinery  Less: Depreciation |  |

**9. Further bad debts**

When the goods are sold on credit basis some of the debtors partly pay the due amount or do not pay at all. If this amount cannot be recovered it is called bad debts and is a loss to the firm. This is entered on the debit side

of the Profit & loss A/c. But then there may be amount of bad debt which was not recorded in the books of accounts and hence did not appear in the Trial Balance. But the same was discovered before preparing the financial statements. It is called further bad-debts. Following adjustment entry is made for the same :

Bad Debts A/c Dr

To Debtors A/c

(Further bad debts recorded)

**In Profit and Loss A/c and Balance sheet it is shown as under:**

**Profit & Loss A/c**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Bad Debts  Add: further bad debts |  |  |  |  |

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
|  |  |  | Sundry Debtors  Less: further bad debts |  |

**LECTURE – 37**

**Illustration 1**

From the following Trial Balance of M.B. Garments as on 31st December, 2011, prepare Trading A/c and Profit & Loss A/c for the year ended 31st December, 2006 and Balance Sheet as on that date:

|  |  |  |
| --- | --- | --- |
| Name of the Account | Dr. Amount (Rs) | Cr. Amount (Rs) |
| Capital  Cash in hand  Cash at bank  Purchases  Sales  Wages  Power  Carriage inward  Carriage outward  Stock (01.01.2006)  Land & building  Machinery  Salaries  Insurance  Sundry debtors  Sundry creditors | 570  5600  43200  10400  4730  2040  3200  5660  40000  20000  4000  600  28000 | 80000  78000  10000 |
|  | 168000 | 168000 |

Following adjustments are to be accounted for:

1. Stock on 31.12.2011 Rs. 10000
2. Machinery to be depreciated @ 10% p.a. and building to be depreciated @ 2% p.a
3. Salaries for the month of December outstanding were Rs. 1200
4. Insurance premium was paid for one year ending 30th june 2012.

prepare trading and profit and loss account and balance sheet.

**Trading A/c**

**For the year ended 31st Dec 2011**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Stock  Purchase  Wages  Power  Carriage inward  Gross profit transferred to profit and loss A/c | 5660  43200  10400  4730  2040  21970 |  | Sales  Closing stock | 78000  10000 |
|  | 88000 |  |  | 88000 |

**Profit and loss A/c**

**For the year ended 31st Dec 2011**

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount |  | Particulars | Amount (Rs) |
| Carriage outward  Salaries 4000  Add: salary outstanding 1200  Insurance 600  Less: prepaid insurance 300  Depreciation on machinery  Depreciation on land and building  Net profit transferred to capital account | 3200  5200  300  2000  800  10470 |  | Gross profit transferred from trading A/c | 21970 |
|  | 21970 |  |  | 21970 |

**Balance Sheet as at 31st Dec, 2011**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Salary outstanding  Sundry creditors  Capital 80000  Add: net profit 10470 | 1200  10000  90470 |  | Cash in hand  Cash at bank  Sundry debtors  Closing stock  Prepaid insurance  Land & building 40000  Less: depreciation (800)  Machinery 20000  Less: depreciation (2000) | 570  5600  28000  10000  300  39200  18000 |
|  | 101670 |  |  | 101670 |

**NOTES:**

**LECTURE – 38**

**Illustration 2:**

From the following Trial Balance of Mustafa & Co., prepare Trading and Profit and loss A/c for the year ending on 31st Dec. 2011 and Balance Sheet as on that date.

|  |  |  |  |
| --- | --- | --- | --- |
| Name of the Account | Dr. Amount (Rs) | Name of the account | Cr. Amount |
| Land and building  Plant and machinery  Bills receivable  Stock on 01.01.2011  Purchases  Wages  Coal, gas and coke  Salaries  Rent  Cash at bank  Sundry debtors  Repairs  Bad debts  Sales returns  Furniture and fixture  Interest on loan | 60000  40000  8000  40000  51000  20000  5800  5000  2800  25000  45000  1800  5500  2000  4000  600 | Capital  Sundry creditors  Sales  Reserve for bad and doubtful debts  Loan (12% p.a)  Commission received | 150000  30000  120000  4500  10000  2000 |
|  | 316500 |  | 316500 |

**Solution:**

Trading and profit and loss A/c of M/s Mustafa & Co. for the year ended on 31.12.2011

**Dr. Cr.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Particulars | Amount (Rs) |  | Particulars | Amount (Rs) |
| Opening stock  Purchases  Wages 20000  Add: outstanding 1000  Coal, gas and coke  Gross profit c/d | 40000  51000  21000  5800  30200 |  | Sales 120000  Less: sales returns 2000  Closing stock | 118000  30000 |
| Salaries  Rent 2800  Add: outstanding 500  Repairs  Bad debts 5500  Add: new reserve 2250  Less: old reserve 4500  Interest on loan 600  Add: interest  Outstanding 600  Depreciation on plant  Depreciation on furniture  Net profit transferred to capital A/c | 148000 |  | Gross profit b/d  Commission received  Add: accrued | 148000 |
| 5000  3300  1800  3250  1200  2000  400  16250 | 30200  2000  1000 |
|  | 33200 |  |  | 33200 |

**Balance Sheet as at 31st Dec, 2011**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liabilities | Amount (Rs) |  | Assets | Amount (Rs) |
| Sundry creditors  Loan  Interest outstanding  **Outstanding expenses:**  Wages 1000  Rent 500  Capital 150000  Add: net profit 16250 | 30000  10000  600  1500  166250 |  | Cash in bank  Bill receivables  Sundry debtors 45000  Less: reserve 2250  Closing stock  Furniture & fixture 4000  Less: depreciation 400  Plant 40000  Less: depreciation 2000  Land & building  Commission accrued | 25000  8000  42750  30000  3600  38000  60000  1000 |
|  | 208350 |  |  | 208350 |

**NOTES:**

**UNIT-V**

**COMPANY- MEANING AND CHARACTERISTICS: (LECTURE 39)**

A company is a voluntary association of individuals formed to carry on business to earn profits or for non profit purposes. These persons contribute towards the capital by buying its shares in which it is divided. A company is an association of individuals incorporated as a company possessing a common capital i.e. share capital contributed by the members comprising it for the purpose of employing it in some business to earn profit.

**Characteristics of a Company:** Following are the main characteristics of a company:

1. **Artificial legal person:** A company is an artificial person as it is created by law. It has almost all the rights and powers of a natural person. It can enter into contract. It can sue in its own name and can be sued.
2. **Incorporated body:** A company must be registered under Companies Act. By virtue of this, it is vested with corporate personality. It has an identity of its own. Although the capital is contributed by its members called shareholders yet the property purchased out of the capital belongs to the company and not to its shareholders.
3. **Capital divisible into shares:** The capital of the company is divided into shares. A share is an indivisible unit of capital. The face value of a share is generally of a small denomination which may be of Rs 10, Rs 25 or Rs 100.
4. **Transferability of shares:** The shares of the company are easily transferable. The shares can be bought and sold in the stock market.
5. **Perpetual existence:** A company has an independent and separate existence distinct from its share

Holders. Changes in its membership due to death, insolvency etc. does not affect its existence and its continuity.

1. **Limited liability:** The liability of the shareholders of a company is limited to the extent of face value of shares held by them. No shareholder can be called upon to pay more than the face value of the shares held by them. At the most the shareholders may be asked to pay the unpaid value of shares.
2. **Representative management:** The number of shareholders is so large and scattered that they cannot manage the affairs of the company collectively. Therefore they elect some persons among themselves to manage and administer the company. These elected representatives of shareholders are individually called the ‘directors’ of the company and collectively the Board of Directors.

**TYPES OF COMPANIES:** Companies can be classified under the following heads:

1. On the basis of formation.

2. On the basis of liability.

3. On the basis of ownership.

1. On the basis of formation.

1. **On the basis of formation companies can be categorised as:**
2. **Statutory Company:** A company formed by a Special Act of parliament or state legislature is called a Statutory Company. Reserve Bank of India, Industrial Financial Corporation of India, Life Insurance Corporation of India, Delhi State Finance Corporation is some of its examples.
3. **Registered Company:** A company formed and registered under the Companies Act, 1956 or earlier Companies Acts is called a Registered Company. The working of such companies is regulated by the provisions of the Companies Act.
4. **On the basis of liability:** On the basis of liability, companies can be categorised as:
5. **Company limited by shares:** The liability of the member of such company is limited to the face value of its shares.
6. **Company limited by guarantee:** The liability of each member of such company is limited to the extent of guarantee undertaken by the member. It may arise in the event of its being wound up.
7. **Unlimited Company:** The Company not having any limit on the liability of its members is called an unlimited company. Liability in such a case extends to the personal property of its shareholders. Such companies do not use the word ‘limited’ at the end of their name.
8. **Company under section 25:** A company created under section-25 is to promote art, culture and societal aims. Such companies need not use the term limited at the end of their name. Punjab, Haryana, Delhi chambers of commerce, etc. are the examples of such companies.
9. **On the basis of ownership:** On the basis of ownership, companies can be categorised as:
10. **Private Company:** A private company is one which by its Articles of Association:

(i) restricts the right of members to transfer its shares;

(ii) Limits the number of its members to fifty (excluding its past and present employees);

(iii)Prohibits any invitation to the public to subscribe to its shares, debentures.

(iv) The minimum paid up value of the company is one lakh rupees (Rs 100000).

The minimum number of shareholders in such a company is two and the company is to add the words ‘private limited’ at the end of its name. Private companies do not involve participation of public in general.

**(b) Public Company:** A company which is not a private company is a public company. Its Articles of association does not contain the above mentioned restrictions. Main features of a public company are:

(i) The minimum number of members is seven.

(ii) There is no restriction on the maximum number of members.

(iii) It can invite public for subscription to its shares.

(iv) Its shares are freely transferable.

(v) It has to add the word ‘Limited’ at the end of its name.

(vi) Its minimum paid up capital is five lakhs rupees (Rs 500,000).

**(c) Government Company:** A Government company is one in which not less than 51% of its paid up capital is held by (1) Central Government or (2) State Government, or (3) partly by Central Government and partly by State Government. Example of a Government company is Hindustan Machine Tools Limited, (HMT) State Trading Corporation (STC). Minerals as metals training corporation (MMTC).

**(d) Foreign company:** A foreign company is one which is incorporated outside India but has a place of business in India, for example Philips, L.G, etc. standard materials. (e) Holding company and Subsidiary company A holding company is a company which controls another company (called subsidiary company) either by acquiring more than half of the equity shares of another company or by controlling the composition of Board of Directors of another company or by controlling a holding company which controls

another company. (f) Listed company and unlisted company A company is required to file an application with stock exchange for listing of its securities on a stock exchange. When it qualifies for the admission and continuance of the said securities upon the list of the stock exchange, it is known as listed company. A company whose securities do not appear on the list of the stock exchange is called unlisted company.

**LECTURE – 40**

**SHARES-MEANING AND ITS KINDS**

A joint stock company divides its capital into units of equal denomination. Each unit is called a share. These units i.e. shares are offered for sale to raise capital. This is termed as issuing shares. A person who buys share/ shares of the company is called a shareholder and by acquiring share or shares in the company he/she becomes one of the owners of the company Thus, a share is an indivisible unit of capital. It expresses the proprietary relationship between the company and the shareholder. The denominated value of a share is its face value. The total capital of a company is divided into number of shares.

**Kinds of shares**

According to the Companies Act, a company can issue the following types of Shares:

(i) Preference shares (ii) Equity shares

**(i) Preference shares**

A preference share is one which carries following preferential rights over other type of shares called equity shares in regard to the following:

1. Payment of dividend
2. Repayment of capital at the time of winding up of the company.

**(ii) Equity shares**

All shares which are not preference shares are equity shares. Holders of these shares receive dividend out of the profits of the company after the payment of dividend has been made to the preference shareholders.

Equity shareholders have the right to elect directors of the company. Equity shares are the permanent source of capital

**SHARE CAPITAL–MEANING AND ITS TYPES**

A joint stock company estimates its future capital requirements. The amount of the capital is mentioned in the capital clause of the Memorandum of Association registered with the Registrar of the Companies. Total capital is divided into a number of small indivisible units of fixed amount and each such unit is called a share. A share is nothing but a share in the capital of the company. As the total capital of the company is divided into shares, the capital of the company is called share capital. Share capital of the company is divided into following categories:

1. **Nominal/Authorised/Registered capital:** It refers to the maximum amount of share capital which a company is authorised to issue as per its Memorandum of Association.
2. **Issued Capital:** Issued capital is that part of the authorised capital which the company offers to public that may include vendors, for subscription or purchase. A company may issue its entire authorised capital or may issue it in parts from time to time as per the needs of the company. It means and includes the nominal value of shares issued by the company for (a) cash, and (b)consideration other than cash to (i) promoters of a company, and (ii) others.
3. **Subscribed capital:** It is that part of issued capital which is taken up or subscribed by those who are offered for subscription. Company may receive application for equal to, more than or less than shares issued. This capital can be equal to or less than the issued capital. The portion of nominal value of the issued share capital which is actually paid (or subscribed) by the shareholders forms part of the subscribed capital.
4. **Called up Capital:** It is that part of the issued/subscribed capital which is called up by company to pay on the allotted shares and is to be paid by the shareholders. The portion of the issue price of the shares which a company has demanded or called from shareholders is known as called up capital.
5. **Uncalled Capital:** Uncalled Capital is that portion of the issued/subscribed capital that is not called up by the company on the shares allotted.
6. **Paid up Capital:** It is the portion of called up capital which is paid by the shareholders, to calculate the paid up capital, the amount of instalments in arrears is deducted from the called up capital.
7. **Unpaid Capital:** That part of the called up capital which is called but is not paid by the shareholders is called unpaid capital. I.e. calls-in-arrears.
8. **Reserve Capital:** Company may keep some part of its share capital uncalled and kept in reserve to be called only in case of need at the time of its winding up. This is known as Reserve capital. For this, a special resolution will have to be passed by the company. Thus it is that portion of the uncalled capital which a company has decided to call only in case of liquidation of the company.

**LECTURE - 41**

**PROCEDURE OF ISSUE OF SHARES**

Face value of a share is the par value of the share. It is also known as the Nominal value or denomination of a share. To issue shares a company follows a definite procedure which is controlled and regulated by the

Companies Act and Securities Exchange Board of India (SEBI). There are different ways of issue of shares which may be:

(A) For consideration other than cash

(B) For cash

**(A) Issue of shares for consideration other than cash:**  Sometimes shares are issued to the promoters of the company in lieu of the services provided by them during the incorporation of the company. The issue price of these shares is normally debited to ‘Goodwill A/c’ and journal entry is made as follows:

Goodwill A/c Dr

To Share Capital A/c

In case a company does not have sufficient funds for the purchase of fixed assets or for payment to creditors it may offer and allot its shares to vendors/ creditors in lieu of cash. Any allotment of shares against which cash is not to be received is called ‘issue of shares for consideration other than cash’. For example building is purchased and payment is made by issuing shares. In case of purchase of assets like building, machinery, stock of materials, etc. the following journal entry is made:

1. Assets A/c Dr

To Vendors/Creditors A/c

(Assets purchased)

2. Vendors/Creditors A/c Dr

To Share Capital A/c

(Issue of shares of Rs…….each fully paid up)

**(B) Issue of Shares for cash:** In general, shares are issued for cash. The company may call the share money either in one instalment or in two or more instalments. But company always collects this money through its bankers.

**(i) Receipt of share money in one instalment:**

The company may receive the share money in one instalment along with application. In this case the following journal entries are made in the books of the company:

**1. on Receipt of Application Money**

Bank A/c Dr

To Share Application A/c

(Application money received on ….shares of Rs…each)

**2. On transferring the Application Money**

Share Application A/c Dr

To Share Capital A/c

(Application money transferred to share capital A/c)

**(ii) Share money received in two or more instalments:** Instead of receiving payment in one instalment i.e. at the time of application the company collects it in two or more instalments. The first, instalment which the applicants have to pay along with the applications for shares is known as application money. On the allotment of shares the allottees are required to pay the second instalment which is termed as allotment money. If the company decides to call the share money in more than two instalments the other instalment is/are termed as call money (i.e. first-call, second call or final call). In the above case the transactions are recorded in journal as given below:

**(a) On receipt of application money**

(i) Bank A/c Dr

To Share Application A/c

(Receipt of share application money for …. Shares @ Rs.. per share)

**(b) On allotment of shares**

After receiving the application for shares within the prescribed time, the Board of Directors of the company proceeds to allot shares. On allotment of shares the application money is transferred to Share Capital A/c. For this the following journal entry is made:

Share Application A/c Dr

To Share Capital A/c

(Share application for …. Shares @ Rs… per share transferred to share capital A/c)

**Allotment Money becoming due and received**

On the allotment of shares the amount receivable on the next instalment i.e. on allotment becomes due. The following entry is made for recording the amount due:

**(i) Allotment money becoming due:**

Share Allotment A/c Dr

To Share Capital A/c

(Share allotment money due on …. shares @Rs ... per share)

**(ii) Receipt of allotment money:** On the receipt of share allotment money the following journal entry is made:

Bank A/c Dr

To Share Allotment A/c.

(Receipt of the amount due on allotment of … shares)

**LECTURE – 42**

**Calls on shares:**

After the receipt of application and allotment money the money that remains unpaid can be called up by the company as and when required. Thus a call is a demand made by the company asking the shareholders to remit the called up amount on shares allotted to them. The company may demand the remaining money in more than two instalments. The amount called after the allotment is known as call money. There may be one or more calls, depending on the funds requirements of the company. When only one call is made Call Money is due:

Share First and Final Call A/c Dr

To Share Capital A/c.

(Call money due on …. share @ Rs … per share).

**Receipt of call money**

The following journal entry is made for receipt of call money:

Bank A/c Dr

To Share First & Final call A/c

(call money due on … shares @ Rs ... per share received)

**Illustration 1**

Fashion Fabrics Ltd. issued 100000 shares of Rs. 10 each on 1st April, 2006.

The amount payable on these shares was as under:

Rs 2 per share on application.

Rs 3 per share on allotment.

Rs 5 per share on call.

Make journal entries and prepare relevant accounts in the books of company.

**FASHION FABRICS LTD:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being Application money received @ Rs.2 per share) |  | 200000 | 200000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  (Being Share application money for 100000 shares transferred to share capital account) |  | 200000 | 200000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  (Being allotment money made due on 100000 shares @ Rs 3/- per share) |  | 300000 | 300000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  (Being allotment money received on 100000 shares @ Rs. 3 per share) |  | 300000 | 300000 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being Call money on 100000 shares @ Rs. 5 per share made due) |  | 500000 | 500000 |
| 6 | Bank A/c Dr.  To Share first & final call A/c  (Being call money received on 100000 shares @ Rs. 5 per share) |  | 500000 | 500000 |

**FULL, UNDER AND OVER SUBSCRIPTION:**

A company decides to issue number of shares to raise capital. It invites public to buy these shares. Now there may be three situations:

**I. Full Subscription**

Company may receive applications equal to the number of shares company has offered to people. It is called full subscription. In case of full subscription the journal entries will be made as follows:

**(a) On receipt of application money**

Bank A/c Dr

To Share Application A/c

(Application money received for ......... shares)

**(b) On allotment of shares**

Share Application A/c Dr

To Share Capital A/c

(Application money of shares transferred to capital A/c on their allotment)

II**. The company does not receive application equal to the number of shares offered for subscription, there may be two situations:**

(i) Under subscription

(ii) Over subscription

**(i) Under subscription**

The issue is said to have been under subscribed when the company receives applications for less number of shares than offered to the public for subscription. In this case company is not to face any problem regarding allotment since every applicant will be allotted all the shares applied for. But the company can proceed with allotment provided the subscription for shares is at least equal to the minimum required number of shares termed as minimum subscription.

**(ii) Over Subscription**

When company receives applications for more number of shares than the number of shares offered to the public for subscription it is a case of over subscription. A company cannot allot more shares than what it has offered. In case of over subscription, company has the following option:

**Option I**

(i) **Rejection of Excess Applications and Money Returned**: The Company may reject the applications for shares in excess of the shares offered for issue and a letter of rejection is sent to such applicants. In this

case the application money received from these applicants is refunded to them in full. The journal entry made is as follows:

Share Application A/c Dr

To Bank A/c

(Application money on … shares refunded to the applicants)

**(ii) Excess application money adjusted towards sums due on allotment.** Journal entry made is :

Shares Application A/c Dr

To Share Allotment A/c

(Excess application money adjusted towards sums due on allotment)

If the application money received on partially accepted applications is more than the amount required for adjustment towards allotment money, the excess money is refunded. However, if the Articles of the company so authorise, the directors may retain the excess money as calls in advance to be adjusted against the call/calls falling due later on and the following entry is made:

Share Application A/c Dr

To Call-in-advance A/c

(The adjustment of excess share application money retained as call-in advance in respect of ... shares).

**NOTES:**

**Option II (LECTURE 43)**

**Partial acceptance of Applications.**

In some cases the company accepts the applications for subscription partially. It means that the company does not allot the full number of shares applied for. For example if an applicant has applied for 5000 shares and is allotted only 2000 shares, then the applications is said to have been partially accepted. The company may evolve some formula of accepting applications partially or making proportionate allotment/ the Pro-rata allotment which means that the applicants are allotted shares proportionately. In such a case the company adjusts the excess share money received on application towards share allotment money due on partially accepted applications. The journal entry recording the adjustment of application money towards share

allotment money, is as under :

Share Application A/c Dr

To Share Allotment A/c

(Share application money transferred to Share Allotment Account in respect of ... shares).

**Illustration 2**

The Full Health Care Ltd has offered to public for subscription 20000 shares of Rs 100 each payable as Rs 30 per share on application, Rs 30 per share on allotment and the balance on call. Applications were received for 30000 shares. Applications for 5000 shares were rejected all together and application money was returned. Remaining applicants were allotted the offered shares. Their excess application money was adjusted towards some due on allotment. Calls were made and duly received. Make journal entries in the Books of the company.

**FULL HEALTH CARE LTD:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being Application money received for 30000 shares@ Rs.30 per share) |  | 900000 | 900000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  To Bank A/c  To Share Allotment A/c  (Being application money of 20000 shares transferred to share capital A/c on their allotment. That of 5000 shares returned and of 5000 shares adjusted towards sum due on allotment) |  | 900000 | 600000  150000  150000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  (Being allotment money due |  | 600000 | 600000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  (Being allotment money received |  | 450000 | 450000 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being Call money due |  | 800000 | 800000 |
| 6 | Bank A/c Dr.  To Share first & final call A/c  (Being call money received ) |  | 800000 | 800000 |

**ISSUE OF SHARES AT PREMIUM**

A company can issue its shares at their face value. When company issues its shares at their face value, the shares are said to have been issued at par. Company can also issue its shares at more than or less than its face value i.e., at ‘Premium’ or at ‘Discount’ respectively. When shares are issued at premium or at discount an accounting treatment different from shares issued at par is required.

**Issue of shares at premium**

If a company issues its shares at a price more than its face value, the shares are said to have been issued at Premium. The difference between the issue price and face value or nominal value is called ‘Premium’. If a share of Rs 10 is issued at Rs 12, it is said to have been issued at a premium of Rs 2 per share. The money received as premium is transferred to Securities Premium A/c. A company issues its shares at premium only when its financial position is very sound. It is a capital gain to the company. The Premium money may be demanded by the company with application, allotment or with calls.

**Accounting Treatment of premium on Issue of Shares**

Following is the accounting treatment of Premium on issue of shares:

(**a) Securities premium collected with share Application money:**

If the Securities premium is collected on application and the company has taken decision about the allotment of shares, the following journal entry is made:

Share Application A/c. Dr

To Securities Premium A/c

(The amount of Securities premium received on application of the allotted shares is transferred to Securities Premium A/c)

**(b) Premium collected with Allotment money or Calls.**

If the company decides to demand the premium with share Allotment or/and share call money, the journal entry made is:

Share Allotment A/c Dr

Or/and

Share Call A/c Dr

To Securities Premium A/c

(Adjustment of share premium due on……shares @Rs…….per share.)

**NOTES:**

**LECTURE - 44**

**Illustration 3**

Luxuary Cars Ltd. issued 100000 shares of Rs 10 each at a premium of Rs 5 per share, payable as:

On application Rs. 4 (including Rs 2 premium) per share

On allotment Rs 8 (including Rs 3 premium) per share

On call Rs. 3 per share

Applications were received for 100000 shares and allotment was made to all.

Make journal entries.

**BOOKS OF LUXURY CARS LTD:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being Amount received for 100000 shares) |  | 400000 | 400000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  To Securities Premium A/c  (Being application money transferred to share capital A/c and securities Premium A/c) |  | 400000 | 200000  200000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  (Being allotment money due |  | 600000 | 600000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  (Being allotment money received |  | 450000 | 450000 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being Call money due |  | 800000 | 800000 |
| 6 | Bank A/c Dr.  To Share first & final call A/c  (Being call money received ) |  | 800000 | 800000 |

**ISSUE OF SHARES AT DISCOUNT**

When the issue price of share is less than the face value, shares are said to have been issued at discount. For example if a company issues its shares of Rs 100 each at Rs. 90 each, the shares are said to be issued at discount. The amount of discount is Rs 10 per share (i.e. Rs 100 – Rs 90). Discount on shares is a loss to the company. Section 79 of Companies Act 1956 has laid down certain conditions subject to which a company can issue its shares at a discount. These conditions are as follows:

(i) At least one year must have elapsed from the date of commencement of business;

(ii) Such shares are of the same class as had already been issued;

(iii) The company has sanctioned such issue by passing a resolution in its General meeting and the approval of the court is obtained.

(iv) Discount should not be more than 10% of the face value of the share and if the company wants to give discount more than 10%, it will have to obtain the sanction of the Central Government.

**Accounting Treatment of Shares Issued at Discount**

The amount of discount is generally adjusted towards share allotment money and the following journal entry is made:

Share Allotment A/c Dr

Discount on issue of shares A/c Dr

To Share Capital A/c

(Allotment money due on….shares @Rs ……per share after allowing discount @Rs ……….per share)

**Illustration 4**

Sri Krishna Agro Chemical Ltd. was registered with a capital of Rs 5000000 divided into 50000 shares of Rs 100 each. It issued 10000 shares at discount of Rs 10 per share, payable as :

Rs 40 per share on application

Rs 30 per share on allotment

Rs 20 per share on call.

Company received applications for 15000 shares. Applicants for 12000 shares were allotted 10000 shares and applications for the remaining shares were sent letters of regret and their application money was returned. Call was made. Allotment and call money was duly received. Make journal entries in the books of the company.

**Sri Krishna Agro Chemicals Ltd**

**Journal entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being application money received for 15000 shares @ Rs. 40 per share) |  | 600000 | 600000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  (Being application money of 10000 shares transferred to share capital A/c on their allotment) |  | 400000 | 400000 |
| 3 | Share Application A/c Dr.  To Share allotment A/c  To Bank A/c  (Being application money of 3000 shares returned and of 2000 shares adjusted towards sum due on allotment) |  | 200000 | 80000  120000 |
| 4 | Shares allotment A/c Dr.  Share discount A/c Dr.  To Share allotment A/c  (Being allotment money received |  | 300000  100000 | 400000 |
| 5 | Bank A/c Dr.  To Share Allotment A/c  (Being allotment money received) |  | 220000 | 220000 |
| 6 | Share First & Final Call A/c Dr.  To Share Capital A/c  (Being call money received ) |  | 200000 | 200000 |
| 7 | Bank A/c Dr.  To Share First & Final Call A/c |  | 200000 | 200000 |

**LECTURE – 45**

**CALLS IN ADVANCE AND CALLS IN ARREARS**

If a shareholder pays any amount to company before it is demanded, it is called Call-in-Advance. This amount is put in a separate account known as Calls-in-Advance A/c. This amount is not shown as capital of the company, till such time the company makes a demand from all the shareholders. Call-in-Advance A/c is shown on the liabilities side of the Balance Sheet. For example if a company issued shares of Rs 10 on which

it has already called Rs 5. Against the uncalled portion of Rs 5 per share the company makes a call Rs 3 per share, the entry for call money due will be made only for Rs 3 per share. Now suppose a shareholder pays Rs 5 per share including the uncalled amount of Rs 2 per share along with the call money, it means he has paid Rs 2 per share in advance, which will be credited to calls in Advance A/c. The company is required to pay interest on this amount @ 6% till the date of its appropriation.

**Accounting treatment for calls-in-advance**

Bank A/c Dr

To Calls-in-Advance A/c

(Calls in advance received on…….shares @ Rs …….per share)

**Appropriation of calls-in-Advance A/c say in the final call:** Journal entry will be:

Calls-in-Advance A/c Dr

To Share Final call A/c

(Calls in advance amount adjusted)

**For interest given on Calls-in-Advance:** Journal entry will be

Interest on calls-in-Advance A/c Dr

To Bank A/c

(Interest paid on the amount of Call-in-Advance)

**Illustration 5**

India Software Ltd. offered 50000 shares of Rs 10 each to the public payable as:

Rs 2 on application

Rs 3 on allotment

Rs 2 on First call and the balance as and when required.

All the shares were applied for and duly allotted but Mukesh a shareholder holding 200 shares paid the entire balance on allotment. Make necessary journal entries.

**India Software Ltd.**

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being application money received for 50000 shares @ Rs. 2 per share) |  | 100000 | 100000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  To Securities Premium A/c  (Being Share application money transferred to share capital A/c on allotment) |  | 100000 | 100000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  (Being share allotment money made due on 50000 shares @ Rs. 3 per share) |  | 150000 | 150000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  To Calls-in-advance A/c  (Being amount received on allotment @ Rs. 3 per share and advance for 200 shares @ Rs. 5 per share) |  | 151000 | 150000  1000 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being share first call money due on 50000 shares @ Rs. 2 per share) |  | 100000 | 100000 |
| 6 | Bank A/c Dr.  Call-in-advance A/c Dr.  To Share first call A/c  (Being first call money is received on 49800 shares and on 200 shares call in advance is adjusted) |  | 99600  400 | 100000 |

**LECTURE – 46**

**Calls in arrears**

When the company sends notice to the shareholders to pay allotment and /or call money, it has to be paid by them within the specified time period. If it is not paid by any one or more of the shareholders, the unpaid amount becomes arrears due from them. Such arrears are transferred to an account termed as Calls-in-Arrears A/c. The company is authorised to charge interest on calls-in-Arrears @ 5% p.a. for the intervening period. (The period between date of non-receipt of the due amount and the date of actual receipt of the due amount).

**Accounting Treatment to record calls-in-arrears:**

Calls-in-Arrears A/c Dr

To Share Allotment/Call A/c

(Share allotment/ Call money not received on …. shares)

**When the unpaid balance is received later on the following journal entry is made:**

Bank A/c Dr

To Calls in Arrears A/c

(Amount due on allotment/ call remaining unpaid now received on…… shares.)

The company may charge interest on the amount of calls in arrears at a given rate from the date of amount due till it is paid journal entry will be:

Bank A/c Dr

To Interest on calls in arrears A/c

**Illustration 6**

ABC Ltd issued 20000 shares of Rs 10 each payable as Rs 2 per share on application, Rs 5 (including premium of Rs 2 per share) on allotment, Rs 3 per share on first call and the balance on Final Call. All the money was received except the first call money on 400 shares; which was received later on with final call. Make necessary journal entries.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being application money received for 20000 shares @ Rs. 2 per share) |  | 40000 | 40000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  (Being application money of 20000 shares transferred to share capital A/c on allotment) |  | 40000 | 40000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  To Securities Premium A/c  (Being share allotment money made due with premium @ Rs. 5 per share on 20000 shares) |  | 100000 | 60000  40000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  (Being share allotment money received) |  | 100000 | 100000 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being share first call money due on 20000 shares @ Rs. 3 per share) |  | 60000 | 60000 |
| 6 | Bank A/c Dr.  Call-in-arrears A/c Dr.  To Share first call A/c  (Being first call money is received on 19600 shares @ Rs. 3 per share) |  | 58800  1200 | 60000 |
| 7 | Share Final Call A/c Dr.  To Share Capital A/c  (final call money due on 20000 shares @ Rs. 2 per share) |  | 40000 | 40000 |
| 8 | Bank A/c Dr.  To Share Final Call A/c  To Calls-in-Arrears A/c  (Final call money received on 20000 shares @ Rs. 2 per share along with arrears of first call on 400 shares) |  | 41200 | 40000  1200 |

**NOTES:**

**EXERCISE QUESTIONS**

1. What is meant by over subscription of shares? What accounting treatment is given to the amount over subscribed?
2. What is ‘Shares Issued at Premium? State the purposes for which Premium amount can be utilised.
3. What is meant by issue of shares at discount? State the conditions to be fulfilled for the issue of shares at discount under the Companies Act.
4. Explain in brief the terms: (i) Calls-in Arrears. (ii) Calls-in Advance
5. **Make journal entries:**
6. XY Limited whose share capital is divided into 20,000 equity shares of Rs. 10 each issued 6,000 shares to the public. The entire money is payable along with the application. All the shares were subscribed and application money was received.
7. A Limited issued 10,000 equity shares of Rs. 100 each, payable Rs 25 per share on application, Rs 25 per share on allotment, and Rs. 25 on each of the two subsequent calls. All the money was duly received.
8. X Ltd., issued 10,000 shares of Rs. 10 each at Rs.15 payable Rs. 3 on application, Rs. 8 on allotment (including the premium of Rs. 5) and Rs. 4 on call. All the shares are subscribed, allotted and paid for at due dates.

6. (a) Akshay Ltd. made an issue of 20,000 shares of Rs.10 each payable as follows :

Rs. 2 on application, Rs. 2 on allotment, Rs. 3 on first call and the balance on second call. The first call is made and all members pay, including a member holding 800 shares, who pays for the balance due in full. Later the final call is made and is fully met. Give journal entries.

(b) Nirmal Ltd. with an authorised capital of Rs.10, 00,000, in shares of Rs. 10 each, issued 50,000 of such shares, payable Rs.2 per share on application, Rs. 3 on allotment, Rs.2.50 per share three months later, and duly received. But when the call of Rs.2.50 was made a shareholder holding 200 shares failed to pay the call money while another shareholder holding 400 shares paid the entire Balance. Give journal entries.

**NOTES:**

**LECTURE - 47**

**FORFEITURE OF SHARES - MEANING AND PROCEDURE**

If a shareholder fails to pay the due amount of allotment or any call on shares issued by the company, the Board of directors may decide to cancel his/her membership of the company. With the cancellation, the defaulting shareholder also loses the amount paid by him/her on such shares. Thus, when a shareholder is deprived of his/her membership due to non payment of calls, it is known as forfeiture of shares.

**Procedure of forfeiture of shares**

The authority to forfeit shares is given to the Board of Directors in Articles of Association of the company. The Board of Directors has to give at least fourteen days notice to the defaulting members calling upon them to pay outstanding amount with or without interest as the case may be before the specified date. The notice must also state that if the shareholders fail to remit the amount mentioned therein within the stipulated period, their shares will be forfeited. If they still fail to pay the amount within the specified period of time, the Board of Directors of the company may decide to forfeit such shares by passing a resolution. The decision regarding the forfeiture of shares should be communicated to the concerned allottees and should be asked to return the allotment letters and share certificates of the forfeited shares to the company.

**ACCOUNTING TREATMENT**

Shares can be issued at par, at discount and at premium. Accounting treatment for forfeiture of shares in these three situations can be explained as under:

**1. Forfeiture of shares issued at Par**

When shares issued at par are forfeited the accounting treatment will be as follows:

(i) Debit Share Capital Account with amount called up (whether received or not) per share up to the time of forfeiture.

(ii) Credit Share Forfeited A/c. with the amount received up to the time of forfeiture.

(iii) Credit ‘Unpaid Calls A/c’ with the amount due on forfeited shares. This cancels the effect of debit to such calls which take place when the amount is made due. The journal entry is:

Share capital A/c Dr

(Amount called up)

To share forfeited A/c

(Amount paid)

To unpaid calls A/c

(Amount called but not paid)

**Note: (i) Amount called up = No. of shares × called up per share**

**(ii) Amount paid = No. of shares × Amount paid per share**

**(iii) Amount called but not paid = No. of shares × Amount called but not paid per share**

**Illustration 1**

X, a shareholder, holding 100 shares of Rs 10 each has paid application money of Rs 2 per share and allotment money of Rs 3 per share, but has failed to pay the first call of Rs 2 per share and second call of Rs 3 per share. His shares were forfeited. Make the journal entry to record the forfeiture of shares.

**Journal Entry**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c (100\*10) Dr.  To Share Forfeited A/c (100\*5)  To share First Call A/c (100\*2)  To Share Second and Final Call A/c (100\*3)  (Forfeiture of 100 shares) |  | 1000 | 500  200  300 |

**Illustration 2**

Alpha Ltd. issued 10000 shares of Rs 100 each payable as:

Rs 25 on application.

Rs 25 on allotment

Rs 20 on First call and

Rs 30 on second and final call.

9000 shares were applied for and allotted. All the payments were received with the exception of allotment money, first call and second and final call money on 300 shares allotted to Ganesh. The Board of Directors decided to forfeit these shares. Make journal entry to record transaction relating to forfeiture of shares.

**Journal Entry**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c (300\*100) Dr.  To Share Forfeited A/c (300\*25)  To share allotment A/c (300\*25)  To Share First Call A/c (300\*20)  To share second call A/c (300\*30)  (300 shares of Rs. 100 each forfeited due to non payment of allotment money and calls money) |  | 30000 | 7500  7500  6000  9000 |

**NOTES:**

**Forfeiture of Shares**

**Forfeiture of shares allotted on pro-rata basis.**

Shares Company has offered for subscription. This is called allotment of shares on pro-rata basis. In case of

pro-rata allotment the excess money received on applications is transferred to Share Allotment A/c from Share Application A/c. In case a shareholder fails to make payment on allotment and call money of shares held by him/her, the unpaid amount will be calculated as under:

(i) Number of shares applied for allotment

= (Total No. of shares applied\* shares allotted to defaulter)/Total shares allotted

(ii) Number of shares applied for (as per step) – number of shares allotted = Excess applications received.

(iii) Excess application money received = Excess number of applied shares × money called per share on

application.

(iv) Amount unpaid on allotment = Amount due on allotment – excess application money adjusted towards allotment

**Illustration 3**

A company has offered for subscription to the public 10000 shares of Rs 10 each. It has received applications for 15000 shares. Company has decided to allot shares on prorata basis. Gunakshi holding 200 shares failed to pay allotment money and first call money. Her shares were forfeited: Amount payable was as under :

Rs 2 per share on application.

Rs 3 per share on allotment.

Rs 5 per share on call.

Make journal entries and prepare relevant account in the books of the company.

**Solution**

**Working notes :**

Number of shares applied = (Total No. of shares applied × shares alloted to Gunakshi)/Total No. of shares allotted

= 15000/10000 × 200 = 300

Excess applications received = 300 – 200 = 100

Excess applications amount received = 100 × 2 = Rs 200

Amount Due on allotment = 200 × 3 = Rs 600

Excess application money adjusted = Rs 200

Net unpaid amount on allotment = Rs 600 – Rs 200 = Rs 400

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Share Application A/c  (Being application money received for 15000 shares @ Rs. 2 per share) |  | 30000 | 30000 |
| 2 | Share Application A/c Dr.  To Share Capital A/c  To Share allotment A/c  (Being application money of 10000 shares transferred to share capital A/c on allotment and application money for 500 shares transferred to share allotment A/c) |  | 30000 | 20000  10000 |
| 3 | Share Allotment A/c Dr.  To Share capital A/c  (Being share allotment money due on 10000 shares @ Rs. 3 per share) |  | 30000 | 30000 |
| 4 | Bank A/c Dr.  To Share allotment A/c  (Being share allotment money received on 9800 shares) |  | 19600 | 19600 |
| 5 | Share first & final call A/c Dr.  To Share Capital A/c  (Being share first call money due on 10000 shares @ Rs. 5 per share) |  | 50000 | 50000 |
| 6 | Bank A/c Dr.  To Share first & final call A/c  (Being call money received on 9800 shares @ Rs 5 per share) |  | 49000 | 49000 |
| 7 | Share Capital A/c Dr.  To Share Forfeited A/c  To Share allotment A/c  To Share First & final Call A/c  (200 shares forfeited for non payment of allotment & call money |  | 2000 | 600  400  1000 |

**LECTURE-48**

**FORFEITURE OF SHARES ISSUED AT PREMIUM AND AT DISCOUNT**

**Forfeiture of shares issued at premium**

In case shares are issued at premium and thereafter forfeited there can be two situations:

1. Premium on shares has been received prior to the forfeiture.
2. Amount of premium on shares has not been received and it still stands credited to the Securities Premium A/c.

**1. Premium money has been received prior to the forfeiture**

If the amount of premium on shares forfeited has been received by the company prior to the forfeiture, securities Premium A/c will not get affected. In this case the journal entry of forfeiture of shares will be similar to the entry made as if the shares had been issued at par. The journal entry will be :

Share Capital A/c … Dr

To Share forfeited A/c

To Unpaid Calls A/c./Calls in arrears A/c

(Forfeiture of share issued at premium)

**Illustration 4**

M.B. Software Ltd. issued Rs 500000 capital divided into equity shares of Rs 10 each. The shares were issued at a premium of Rs 4 per share and were payable as: Rs 3 per share on application, Rs 7 (including premium)

per share on allotment and the balance on call. All the shares applied for and were duly allotted. All the money was duly received except on 500 shares on which the call money was not received. Company decided to forfeit these shares. Make journal entry to record the forfeiture of 500 shares.

**Journal Entry**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c Dr.  To Share Forfeited A/c  To Share First & final Call A/c  (Forfeiture of 500 shares of Rs. 10 each due to non payment of call money of Rs. 4 per share) |  | 5000 | 3000  2000 |

**2. Premium on shares has not been received and stands credited to Securities Premium A/c as due but not paid.**

When a share is forfeited on which the amount of premium has been made due but has not been received, either wholly or partially, the Securities Premium A/c will be cancelled. At the time of making due, Securities

Premium A/c will be credited. The journal entry will be as follows:

Share Capital A/c Dr

Securities Premium A/c Dr

To Share Forfeited A/c

To Unpaid call A/c.

(Forfeiture of shares originally issued at premium due to non payment of dues).

**Illustration 5**

The Latest Technology Company Ltd. offered to public for subscription of 50,000 shares of Rs. 20 each at a premium of Rs. 5 per share. The amount was payable as under:

On application Rs. 5 per share

On allotment Rs. 12 per share (Including premium of Rs 5 per share)

On first call Rs. 4 per share

On Second and Final call Rs. 4 per share

Applications were received for all the shares. Allotment was made to all the applicants in full. Ashima failed to pay allotment and call money on 200 shares held by her. Reshma was allotted 300 shares. She did not pay

the call money. Their shares were forfeited. Make necessary journal entry for the forfeiture only

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c (200\*20) Dr.  Securities Premium A/c (200\*5)  To Share forfeited A/c (200\*5)  To Share allotment A/c (200\*12)  To Share first Call A/c (200\*4)  To Share second and final call A/c (200\*4)  (Being Forfeiture of 200 shares held by Ashima who did not pay allotment and call money) |  | 4000  1000 | 2400  800  800 |
| 2 | Share Capital A/c (200\*20) Dr.  To Share forfeited A/c  To Share first call A/c  To Share Second call A/c  (Forfeiture of 300 shares held by Reshma) |  | 6000 | 3600  1200  1200 |

**Forfeiture of shares issued at discount**

Discount on issue of shares is a loss to the company. When shares issued at a discount are forfeited for non payment of dues, the discount allowed on such shares is written back. At the time of issue of shares, Discount on issue of Shares A/c is debited and when forfeited, this account is credited to cancel the discount allowed on such shares. In this case the following journal entry is made:

Share Capital A/c Dr.

To Share Forfeited A/c

To Discount on Issue of Shares A/c

To Unpaid call A/c

(Forfeiture of shares originally issued at discount for non payment of dues).

**Illustration 6**

The Evergrowing Ltd. invited applications for 20000 shares of Rs. 50 each at a discount of 10% payable as follows:

On application Rs. 10 per share

On allotment Rs. 20 per share

On call Rs. 15 per share

Whole of the issue was subscribed and paid for except the calls money on 200 shares which were forfeited by the company. Make journal entry for forfeiture of shares.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c (200\*50) Dr.  To Share forfeited A/c (200\*30)  To Discount on issue of shares A/c (200\*5)  To Share first & final Call A/c (200\*15)  (Being Forfeiture of 200 shares of Rs. 50 issued at discount of 10% on non payment of call money) |  | 10000 | 6000  1000  3000 |

**NOTES:**

**EXERCISE QUESTIONS**

Q1. State the meaning of forfeiture of shares. When can shares be forfeited?

Q2. What accounting treatment is given to Securities Premium A/c on forfeiture of shares when:

(i) Amount of premium has been received

(ii) Amount of premium has not been received on such forfeited shares.

Q3. X Ltd. forfeited 500 shares of Rs. 100 each on which final call of Rs. 30 per share has not been received. Other calls have been duly received. Make journal entry to record the forfeiture of shares.

Q4. All Time Entertainment Ltd. issued 50000 shares of Rs. 10 each at a premium of Rs. 4 per share payable as Rs. 3 per share on application Rs. 7 (including premium) on allotment and the balance on call. Akbar who was allotted 300 shares failed to pay the allotment amount and on his subsequent failure to pay the call money his shares were forfeited. Make the journal entry for the forfeiture of 300 shares.

Q5. Exe Ltd issued 10000 shares of Rs. 50 per share issued at a discount of Rs. 5 per share payable as Rs.10 per share on application, Rs. 20 per share on allotment and the balance on call. All money was duly received except of 400 shares on which allotment and call money was not received. These shares were forfeited. Make journal entries in the books of the company and prepare ledger accounts also.

Q6. The Multi Media Ltd. invited applications for issuing 50000 shares of Rs 100 each at a premium of Rs 20 per share. The amount was payable as follows:

On Application Rs 30 per share

On Allotment Rs 60 per share (including premium)

On First and Final call Rs 30 per share

Applications were received for 1 lakh shares. Applications for 20000 shares were totally rejected and money was returned. Remaining applicants were allotted on prorata basis. Sukhbhinder who was allotted 400 shares did not pay the allotment money. On his subsequent failure to pay the call money, his shares were forfeited. Rajender who had applied for 400 shares failed to pay the call money. Make journal entries in the books of the company and prepare necessary ledger accounts.

**LECTURE – 49**

**ISSUE OF DEBENTURES - DEBENTURE AND ITS TYPES**

A Debenture is a unit of loan amount. When a company intends to raise the loan amount from the public it issues debentures. A person holding debenture or debentures is called a debenture holder. A debenture is a document issued under the seal of the company. It is an acknowledgment of the loan received by the company equal to the nominal value of the debenture. It bears the date of redemption and rate and mode of payment

of interest. A debenture holder is the creditor of the company.

**Types of debentures:** Debenture can be classified as under:

**1. From security point of view**

**(i) Secured or Mortgage debentures:** These are the debentures that are secured by a charge on the assets of the company. These are also called mortgage debentures. The holders of secured debentures have the right to recover their principal amount with the unpaid amount of interest on such debentures out of the assets mortgaged by the company. In India, debentures must be secured. Secured debentures can be of two types:

**(a) First mortgage debentures:** The holders of such debentures have a first claim on the assets charged.

**(b) Second mortgage debentures:** The holders of such debentures have a second claim on the assets charged.

**(ii) Unsecured debentures:** Debentures which do not carry any security with regard to the principal amount or unpaid interest are called unsecured debentures. These are called simple debentures.

**2. On the basis of redemption**

**(i) Redeemable debentures:** These are the debentures which are issued for a fixed period. The principal amount of such debentures is paid off to the debenture holders on the expiry of such period. These can be redeemed by annual drawings or by purchasing from the open market.

**(ii) Non-redeemable debentures:** These are the debentures which are not redeemed in the life time of the company. Such debentures are paid back only when the company goes into liquidation.

**3. On the basis of Records**

**(i) Registered debentures:** These are the debentures that are registered with the company. The amount of such debentures is payable only to those debenture holders whose name appears in the register of the company.

**(ii) Bearer debentures:** These are the debentures which are not recorded in a register of the company. Such debentures are transferrable merely by delivery. Holder of these debentures is entitled to get the interest.

**4. On the basis of convertibility**

**(i) Convertible debentures:** These are the debentures that can be converted into shares of the company on the expiry of predecided period. The term and conditions of conversion are generally announced at the time of issue of debentures.

**(ii) Non-convertible debentures:** The debenture holders of such debentures cannot convert their debentures into shares of the company

**5. On the basis of priority**

**(i) First debentures:** These debentures are redeemed before other debentures.

**(ii) Second debentures:** These debentures are redeemed after the redemption of first debentures.

**ISSUE OF DEBENTURES**

By issuing debentures means issue of a certificate by the company under its seal which is an acknowledgment of debt taken by the company. The procedure of issue of debentures by a company is similar to that of the issue of shares. A Prospectus is issued, applications are invited, and letters of allotment are issued. On rejection of applications, application money is refunded. In case of partial allotment, excess application money may be

adjusted towards subsequent calls. Issue of Debenture takes various forms which are as under :

1. Debentures issued for cash

2. Debentures issued for consideration other than cash

3. Debentures issued as collateral security.

Further, debentures may be issued

(i) at par, (ii) at premium, and (iii) at discount

**Accounting treatment of issue of debentures for cash**

**1. Debentures issued for cash at par:** Following journal entries will be made:

**(i) Application money is received**

Bank A/c Dr

To Debentures Application A/c

(Application money received for Debentures)

**(ii) Transfer of debentures application money to debentures account on their allotment**

Debentures Application A/c Dr

To Debentures A/c

(Application money transferred to debenture account on allotment)

**(iii) Money due on allotment**

Debentures Allotment A/c Dr

To Debentures A/c

(Allotment money made due)

**(iv) Money due on allotment is received**

Bank A/c Dr

To Debentures Allotment A/c

(Receipt of Debenture allotment money)

**(v) First and final call is made**

Debentures First and Final call A/c Dr

To Debentures A/c

(First and Final call money made due on ............... debentures)

**(vi) Debentures First and Final call money is received**

Bank A/c Dr

To Debentures First and Final call A/c

(Receipt of Amount due on call)

**Note : Two calls i.e. first call and second call may be made Journal entries will be made on the lines made for first and final call.**

**Illustration 1**

Shining India Ltd. issued 5000 8% Debentures of Rs 100 each payable as follows

Rs 20 on Application

Rs 30 on Allotment

Rs. 50 on First and Final call

All the debentures were applied for and allotted. All the calls were duly received. Make necessary journal entries in the books of the company

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Debenture Application A/c  (Being application money received for 5000 debentures) |  | 100000 | 100000 |
| 2 | Debentures Application A/c Dr.  To 8% Debentures A/c  (Being application money transferred to Debentures A/c on allotment) |  | 100000 | 100000 |
| 3 | Share Allotment A/c Dr.  To 8% Debentures A/c  (Being allotment money due on 5000 debentures @ Rs 30 per debenture) |  | 150000 | 150000 |
| 4 | Bank A/c Dr.  To Debenture allotment A/c  (Being allotment money received) |  | 150000 | 150000 |
| 5 | Debenture first & final call A/c Dr.  To 8% debenture A/c  (Being Debenture first and final call money due @ Rs. 50 per debenture) |  | 250000 | 250000 |
| 6 | Bank A/c Dr.  To Debenture First & final call A/c  (Being Receipt of debentures first and final call money) |  | 250000 | 250000 |

**LECTURE – 50**

**Over subscription**

Company if receives applications for number of debentures that exceed the number of debentures offered for subscription, it is called over subscription. There can be following treatment of the excess application money

received :

(a) The total amount of excess number of applications is refunded in case the applications are totally rejected.

(b) The amount of excess application money is totally adjusted towards amount due on allotment and calls

— in case partial allotment is made,

— the excess amount is adjusted towards sums due on allotment and

rest of the amount is refunded.

**Journal entries in the above cases will be as follows:**

**For refund of money if the applications are rejected**

Debentures Application A/c Dr

To Bank A/c

(Refund of money on rejected applications)

**For adjustment of excess application money adjusted towards sum due on allotment**

Debentures Application A/c Dr

To Debentures Allotment A/c

(Excess application money adjusted)

**Illustration 2**

ABC Ltd issued 5000 10% Debentures of Rs 100 each payable as Rs 40 on application and Rs 60 on allotment. Applications were received for 6000 debentures. Applicants for 500 debentures were sent letter of regret and

money was returned. Allotment was made proportionately to the remaining applicants. Over subscription was applied to the amount due on allotment. All money was duly received. Make journal entries for the above transactions in the books of the company.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Debenture Application A/c  (Being application money received for 6000 debentures @ Rs. 40 per debenture) |  | 240000 | 240000 |
| 2 | Debenture Application A/c Dr.  To 10% Debentures A/c  To Bank A/c  To Debentures Allotment A/c  (Being application money of 5000 debentures transferred to debenture A/c on their allotment of 5000 debentures returned and balance of 500 adjusted towards allotment) |  | 240000 | 200000  20000  20000 |
| 3 | Debentures Allotment A/c Dr.  To 10% Debentures A/c  (Being allotment money due on 5000 debentures @ Rs. 60 per debenture) |  | 300000 | 300000 |
| 4 | Bank A/c Dr.  To Debenture allotment A/c  (Being allotment money received) |  | 280000 | 280000 |

**ISSUE OF DEBENTURES AT PREMIUM AND AT DISCOUNT**

Debentures are said to be issued at premium when these are issued at a value which is more than their nominal value. For example, a debenture of Rs 100 is issued at Rs 110. This excess amount of Rs 10 is the amount of premium. The premium on the issue of debentures is credited to the Securities Premium A/c as per section 78 of the Companies Act, 1956. Journal entry will be as follows:

Debentures Allotment A/c Dr

To Debentures Account

To Securities Premium A/c

(Amount due on allotment alongwith premium of Rs ....)

**NOTES:**

**Illustration 3**

A company has issued 5000 10% Debentures of Rs 100 each at a premium of 20% payable as Rs 60 on application Rs 60 on allotment (including premium). All the debentures were subscribed for and money was duly received. Make journal entries.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Bank A/c Dr.  To Debenture Application A/c  (Being application money received ) |  | 300000 | 300000 |
| 2 | Debenture Application A/c Dr.  To 10% Debentures A/c  (Being application money transferred to Debenture A/c) |  | 300000 | 300000 |
| 3 | Share Allotment A/c Dr.  To 10% Debentures A/c  To Securities Premium A/c  (Being amount due on allotment along with premium) |  | 300000 | 200000  100000 |
| 4 | Bank A/c Dr.  To Debenture allotment A/c  (Being allotment money received) |  | 300000 | 300000 |

**Issue of Debentures at Discount**

When debentures are issued at less than their nominal value they are said to be issued at discount. For example, debenture of Rs 100 each is issued at Rs 90 per debenture. Companies Act, 1956 has not laid down any

conditions for the issue of debentures at a discount as have been laid down in case of issue of shares at discount. However, there should be provision for issue of such debentures in the Articles of Association of the Company. Journal entry for issue of debentures at discount (at the time of allotment)

Debentures Allotment A/c Dr

Discount on issue of debentures A/c Dr

To Debentures A/c

(Allotment money due. The amount of discount is @ Rs .... per debenture)

**NOTES:**

**LECTURE – 51**

**Issue of Debentures for consideration other than cash**

When a company purchases some assets and issues debentures as a payment for the purchase, to the vendors it is known as issue of debentures for consideration other than cash. Debentures can be issued to vendors at par,

at premium and at discount Accounting Treatment :

**1. Purchase of Assets**

Sundry Assets A/c Dr

(Individually)

To Vendors A/c

(Purchase of assets)

**2. Allotment of debentures**

**(i) At par**

Vendors' A/c Dr

To Debentures A/c

(issue of debentures at par to vendors)

**(ii) At discount**

Vendors' A/c Dr

Debentures Discount A/c Dr

To Debentures A/c

(Issue of debentures to vendors at a discount of Rs ... per debenture)

**(iii) At premium**

Vendors’ A/c Dr

To Debentures A/c

To Securities Premium A/c

(issue of debentures to vendors at a premium of Rs .... per debenture)

**NOTES:**

**Illustration 5**

M.B. Electronics Ltd. purchased machinery for Rs 198000 and issued 9% debentures of Rs 100 each to the vendors. Make journal entries if the debentures were issued

(a) at par

(b) at a premium of Rs 10

(c) at a discount of Rs 10

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Machinery A/c Dr.  To Vendors A/c  (Being machine purchased) |  | 198000 | 198000 |
| 2 | Vendors A/c Dr.  To 9% Debentures A/c  (Being 1980 debentures of Rs. 10 each issued to vendors) |  | 198000 | 198000 |
| 3 | Vendors A/c Dr.  To 9% Debentures A/c  To Securities Premium A/c  (Being amount due on allotment along with premium) |  | 198000 | 180000  18000 |

**LECTURE – 52**

**DISCOUNT ON ISSUE OF DEBENTURES AND LOSS ON ISSUE OF DEBENTURES**

In case company issues debentures on discount the total amount of discount is not charged to profit and Loss Account of the company in the accounting year in which this discount is allowed. The amount of such discount is very heavy and to the company gets benefit from the loan by issuing debentures over a number of years. Hence some part of the amount of discount is written off every year. Generally it is written off prior to the redemption

of these debentures. As the amount of discount on issue of debentures is treated as a capital loss, it is shown on the asset side of the balance sheet of the company under the head “Miscellaneous Expenditure” until and by the amount it is not written off. The amount of debenture discount can be written off in two ways:

**1. All debentures are to be redeemed after a fixed period.**

When the debentures are to be redeemed after a fixed period, the amount of discount will be distributed equally within the number of years spreaded between the issue of debentures and their redemption. The

amount of discount on issue of debentures to be written off each year is calculated as

**Amount of discount to be written off annually = Total amount of Discount/Number of years**

**2. Debentures are redeemed in installments**

Debentures may also be redeemed in installments but over a fixed period. In that case the amount of debenture discount will be written off each year in proportion to the amount of debentures redeemed.

**NOTES:**

**LECTURE 53**

**REISSUE OF FORFEITED SHARES- REISSUE – MEANING AND ISSUE PRICE OF SHARES**

Shares are forfeited because only a part of the due amount of such shares is received and the balance remains unpaid. On forfeiture the membership of the original allottees is cancelled. He/she cannot be asked to make payment of the remaining amount. Such shares become the property of the company. Therefore company may sell these shares. Such sale of shares is called ‘reissue of shares’. Thus reissue of shares means issue of forfeited shares.

Once the Board of directors has forfeited the shares, the defaulting share holder is asked to return the share certificate which is cancelled thereafter. The board of directors passes a resolution allotting the forfeited shares to the new purchaser/purchasers of such shares. In case of reissue of shares neither a prospectus is issued nor is any offer otherwise made to the general public. Though the amount of such shares may be called in more than one installment but usually the entire amount is called in one installment i.e. lump sum.

The maximum permissible discount at the time of reissue of forfeited shares is ascertained in different situations in the following manner:

**(i) Shares originally issued at par:** When the shares are originally issued at par, the maximum permissible discount for reissue of shares is equal to the amount forfeited on such shares.

**(ii) Shares originally issued at premium :** In case of shares originally issued at premium, there can be two situations : (a) premium has not been received on the forfeited shares, and (b) premium has been received on such shares. The amount forfeited is the amount that has been received including the amount of premium if it has been received and the maximum discount that can be allowed on reissue of such shares is the amount so forfeited.

**(iii) Shares originally issued at discount:** In this case the actual amount received becomes the forfeited amount. But the maximum permissible discount on reissue of shares will be equal to the amount forfeited plus the amount of discount initially allowed on these shares at the time of their original issue.

**LECTURE - 54**

**RECORDING OF REISSUE OF SHARES**

**Reissue of forfeited shares at a discount:** When the shares forfeited are reissued at discount, Bank account is debited by the amount received and Share capital account is credited by the paid up amount. The amount of Discount allowed is debited to Share Forfeited Account. This is for adjusting the amount of discount so allowed from the amount forfeited at the time of forfeiture. The journal entry for the above will be as follows:

Bank A/c (the amount received on reissue) Dr.

Share Forfeited A/c (the amount allowed as discount) Dr.

To Share Capital A/c (paid up amount)

The amount of discount allowed on reissue of shares at the most can be equal to the forfeited amount on such shares. In that case the share forfeited account after reissue will show a zero balance. But in case, this amount of discount is less than the amount forfeited, the remaining forfeited amount will be profit for the company. This profit is a capital gain to the company and is transferred to Capital Reserve account. Journal entry of the same will be as follows:

Share Forfeited A/c Dr

To Capital Reserve A/c

(Transfer of surplus share forfeited amount to capital reserve A/c)

If all the forfeited shares are reissued, the Share Forfeited A/c will show a zero balance because whole of the amount of this account after adjusting the amount of discount allowed on reissue will be transferred to capital Reserve account. But in case, only a part of the forfeited shares are reissued and others remain cancelled, the amount forfeited on forfeited shares not reissued will remain in the Shares Forfeited Account. For adjustment of forfeited amount on share reissued will be calculated as :

**Amount to be adjusted = Total Forfeited amount/Total No. of shares forfeited\*Number of shares reissued**

**LECTURE – 55**

**ACCOUNTING TREATMENT OF REISSUE OF FORFEITED SHARES**

**There can be four situations of reissue of forfeited shares. These are:**

(i) Reissue of forfeited shares at discount originally issued at par

(ii) Reissue of shares at par or at premium, originally issued at par

(iii) Reissue of forfeited shares at par, at discount and at premium originally issued at premium.

(iv) Reissue of forfeited shares at par, at discount and at premium, originally issued at discount.

**Accounting treatment in each of the above cases is discussed hereafter:**

1. Reissue of forfeited shares issued at discount, originally issued at par In this case the maximum discount that can be given on reissue of forfeited shares is the amount that has been received on these shares and is debited

to share forfeited account.

**Illustration 1**

X Company Ltd. forfeited 200 shares of Rs 10 each, fully called up on which Rs. 7 have been received and final call of Rs. 3 per share remains unpaid. These shares were later on reissued for Rs. 8 per share fully paid up. Make journal entry for recording the forfeiture and reissue of shares.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c Dr.  To Shares Forfeited A/c  To shares Final Call A/c  (Being Forfeiture of 200 shares of Rs. 10 each due to nonpayment of final call of Rs. 3 per share) |  | 2000 | 1400  600 |
| 2 | Bank A/c Dr.  Shares Forfeited A/c  To Share capital A/c  (Being Reissue of 200 forfeited shares of Rs. 10 each for Rs. 8 per share as fully paid up) |  | 1600  400 | 2000 |
| 3 | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being the balance amount in share forfeited A/c transferred to capital reserve A/c) |  | 1000 | 1000 |

**LECTURE – 56**

**2. Reissue of forfeited shares at premium and at par, originally issued at par**

In this case the whole of the amount that has been credited to Shares Forfeited A/c is transferred to Capital Reserve A/c on the reissue of such shares.

**Illustration 2**

Y Ltd. forfeited 400 shares of Rs. 20 each on which Rs 15 per share have been received and balance remains due but not paid. These shares were reissued

(a) at the rate of Rs 20 per share i.e. at par

(b) at the rate of Rs. 24 per share i.e. at premium

Make necessary journal entries for reissue of the shares

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| Case (a) | Bank A/c Dr.  To Shares capital A/c  (Being reissue of 400 share at the rat of Rs. 20 per share) |  | 8000 | 8000 |
|  | Shares forfeited A/c Dr.  To Capital Reserve  (Being balance amount of share forfeited A/c is transferred to capital reserve A/c) |  | 6000 | 6000 |
| Case (b) | Bank A/c Dr.  To Share Capital A/c  To Securities Premium A/c  (Being Reissue of forfeited shares at premium) |  | 9600 | 8000  1600 |
|  | Share Forfeited A/c Dr.  To Capital Reserve  (Balance amount of shares forfeited A/c is transferred to capital reserve A/c) |  | 6000 | 6000 |

**NOTES:**

**3. Reissue of forfeited shares at par, at discount and at premium, originally issued at premium:**

If the shares were originally issued at premium, it is not necessary that their reissue after forfeiture is to be at premium. Such shares can be reissued at par, at discount or at premium.

If such shares are reissued at premium the premium received should be credited to Securities Premium A/c. Journal entry will be

Bank A/c Dr

(Number of shares × amount received per share)

To Share Capital A/c

(Number of shares × amount paid up per share)

To Securities Premium A/c

(Number of shares × amount of premium per share)

If such shares are reissued at par the amount that has been received and has been credited to share forfeited A/c will be credited to capital reserve A/c. If such shares are reissued at discount, the amount of discount allowed will be adjusted towards the amount credited to share forfeited A/c the balance amount of Share Forfeited A/c will be transferred to Capital Reserve A/c

**Illustration 3**

AZ Ltd. forfeited 200 shares of Rs 10 each originally issued at a premium of Rs 4 per share, the holder of which paid Rs 3 per share on application but did not pay the allotment money of Rs 7 per share (including premium)

and call of Rs. 4 per share. Make necessary journal entries for the forfeiture and for reissue of these shares if:

1. Reissued at Rs 10 per share i.e. at par
2. II. Reissued at Rs 8 per share i.e. at discount
3. Reissued at Rs 12 per share i.e. at premium

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c (200\*10) Dr.  Securities Premium A/c (200\*4)  To Shares Forfeited A/c (200\*3)  To shares allotment A/c (200\*7)  To Share First & Final call A/c (200\*4)  (Being Forfeiture of 200 shares for non-payment of dues) |  | 2000  800 | 600  1400  800 |
| CaseI | Bank A/c Dr.  To Share capital A/c  (Being Reissue of 200 forfeited shares reissued at par) |  | 2000 | 2000 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being the balance amount in share forfeited A/c transferred to capital reserve A/c) |  | 600 | 600 |
| Case II | Bank A/c Dr.  Share forfeited A/c Dr.  To Share capital A/c  (Being Reissue of 200 forfeited shares reissued at discount) |  | 1600  4000 | 2000 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being the balance amount in share forfeited A/c transferred to capital reserve A/c) |  | 200 | 200 |
| Case III | Bank A/c Dr.  To Share capital A/c  To Securities Premium A/c  (Being 200 forfeited shares reissued at premium) |  | 2400 | 2000  400 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being the balance amount in share forfeited A/c transferred to capital reserve A/c) |  | 600 | 600 |

**LECTURE 57**

**4. Reissue of forfeited shares at par, premium and discount, originally issued at discount.**

When the forfeited shares originally issued at discount are reissued, the discount allowed at the time of original issue of such shares which was written back at the time of their forfeiture is again allowed. Thus on forfeiture shares Discount A/c is credited by the amount of discount allowed at the time of issue because its effect is to be cancelled out when shares were forfeited. When the same shares are reissued, discount on issue of shares A/c is again debited by the original amount of discount.

**Illustration 4**

India infrastructure Ltd. has issued its shares of Rs. 20 each at a discount of Rs 2 per share. Mahima holding 100 shares did not pay final call of Rs 5 per share. Her shares were forfeited. Later on the company reissued 100 shares of these forfeited shares at (I) Rs. 15 per share (II) Rs. 20 per share, and (III) Rs. 25 per share. Make journal entries for the forfeiture and reissue of the shares in the books

of company.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c Dr.  To Shares Forfeited A/c  To Discount on issue of shares A/c  To Share First & Final call A/c  (Being Forfeiture of 200 shares issued at discount for non-payment of final call) |  | 2000 | 1300  200  500 |
| CaseI | Bank A/c Dr.  Discount on issue of shares A/c Dr.  Shares Forfeited A/c Dr.  To Share capital A/c  (Being 100 shares reissued at Rs. 15 per share) |  | 1500  200  300 | 2000 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being balance in share forfeited A/c of 100 shares reissued transferred to capital reserve A/c) |  | 1000 | 1000 |
| Case II | Bank A/c Dr.  To Share capital A/c  (Being 100 shares reissued at Rs. 20 per share) |  | 2000 | 2000 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being balance in shares forfeited A/c transferred to Capital Reserve A/c) |  | 1300 | 1300 |
| Case III | Bank A/c Dr.  Discount on issue of share A/c  To Share capital A/c  To Securities Premium A/c  (Being Reissue of discounted shares at Rs. 25 per share) |  | 2500  200 | 2000  700 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being the balance amount in share forfeited A/c transferred to capital reserve A/c) |  | 1300 | 1300 |

**LECTURE - 58**

**Reissue of a part of the forfeited shares**

Sometimes all the forfeited shares are not reissued but a part of them are reissued.

**Illustration 5**

A company forfeited 400 shares of Rs 50 each on which only application money of Rs 10 per share and Rs 20 on allotment were received. Final call of the Rs 20 per share is not received. 300 of these shares are reissued at

Rs 40 per share. Make journal entries for forfeiture and Reissue of shares.

**Journal Entries**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **S.NO** | **PARTICULARS** | **L.F.** | **Dr. AMOUNT (Rs)** | **Cr. Amount (Rs)** |
| 1 | Share Capital A/c Dr.  To Shares Forfeited A/c  To Share First & Final call A/c  (Being 400 shares forfeited for non-payment of call) |  | 2000 | 1200  800 |
|  | Bank A/c Dr.  Shares Forfeited A/c Dr.  To Share capital A/c  (Being 300 of the forfeited shares are reissued) |  | 1200  300 | 1500 |
|  | Shares forfeited A/c Dr.  To Capital Reserve A/c  (Being balance of forfeited A/c of 300 shares transferred to capital reserve A/c) |  | 600 | 600 |

**NOTES:**

**Exercise QUESTIONS**

1. Give the meaning of ‘reissue of shares’.

2. What is the maximum permissible discount at the time of reissue of forfeited shares when the forfeited shares originally issued are (a) at par (b) at premium (c) at discount?

3. What amount is transferred to Capital Reserve A/c after reissue of forfeited shares? Why is this account transferred to capital reserve A/c?

4. Make journal entries for forfeiture and reissue of shares in the following cases:

(a) The directors of X Ltd. forfeited 400 shares of Rs 10 each fully called up on which Rs 2400 have been received. 300 of these shares were reissued upon payment of Rs. 2500

(b) Real Estate Developers Ltd. forfeited 500 shares of Rs. 10 each held by Amarjeet Singh which were issued at a premium of Rs. 3 per share to be paid along with allotment money. He paid only application money of Rs 3 per share. 200 of these shares were reissued at Rs. 10 per shares

(c) Royal Enterprises Ltd. forfeited 200 shares of Rs. 10 each issued at a discount of 10%, on which only Rs.4 per share have been paid. Out of these 100 shares have been reissued at Rs 7 per share.

5. Make journal entries

(a) P Ltd. issued 400 shares of Rs. 10 each to Suresh on which he has paid Rs. 3 per share on application but failed to pay allotment money of Rs 3 per share and first call money of Rs 2 per share. His shares were forfeited before making the fianl call. These shares were later on reissued at Rs 8 per share fully paid up.

(b) A company issued 10000 shares of Rs 100 each at a premium of Rs 20 per share, payable as Rs 20 on application, Rs 60 including premium on allotment, Rs 20 each on two calls. Final call was not made. Pinky holding 200 shares did not pay allotment money and on her nonpayment of first call, her shares were forfeited by the board of the directors of the company. 150 of these shares were reissued at Rs 120 per share fully paid up.