FINANCIAL ACCOUNTING

B.Com – I Semester

Paper Code : BCO11MJD

PONDICHERRY UNIVERSITY

(A Central University)

CENTRE FOR DISTANCE & ONLINE EDUCATION

R.V. Nagar, Kalapet, Puducherry – 605 014

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Course Writer

Dr. V. Umasri
Asst. Professor, CDOE,
Pondicherry University

Dr. Ezhil Vembu
Guest Faculty, CDOE,
Pondicherry University

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FINANCIAL ACCOUNTING

Course Objective

To enable the students to understand basic accounting principles and apply them to record transactions and prepare financial statements.

Unit I – Fundamentals of Accounting

Meaning and Scope of Accounting – Need for Accounting – Development of Accounting – Nature and Objectives – Book-keeping and Accounting – Double Entry System – Accounting Principles – Accounting Concepts and Conventions – Accounting Standards – International Accounting Standards.

Unit II – Subsidiary books and Principal books

Preparation of Purchases book, Sales book, Purchases returns book, Sales returns book, Bills Receivable book, Bills Payable book and Journal book - Ledger book – Cash book – Single column, Double column and Three column cash book – Petty cash book – Imprest system - Trial Balance

Unit III – Final Accounts

Trading Account – Profit and Loss Account – Balance Sheet – Adjustments: Closing Stock, Depreciation (SLM and WDV methods) Bad Debts and Provision for Bad Debts, Outstanding and Prepaid Expenses, Accrued and Advance Income.

Unit IV – Partnership Account

Admission – Retirement – Death of a Partner – Dissolution – Insolvency of a Partner.

Unit V – Joint Venture and Royalty: Joint Venture:

Meaning and features – Difference between joint venture and partnership accounts – Co-ventures and their roles – Methods – Preparation – Calculation and settlement Royalty Accounts: Meaning and characteristics – Terms used in royal account - Accounting treatment in the books of lessor and lessee.

References:

1. Maheshwari, S. N., & Maheshwari, S. K. (2023). *Financial accounting* (7th ed.). Vikas Publishing House.Noida, UP, India.
2. Jain, S. P., & Narang, K. L. (2023). *Financial accounting* (Revised ed.). Kalyani Publishers.

Course Outcomes: After completion of the course, learners will be able to:

CO1: Get knowledge of basic accounting concepts and principles.

CO2: Understand the techniques of recording the business transactions in the books of accounts.

CO3: Analyse and prepare the final accounts with necessary adjustments.

CO4:.Acquire knowledge about single entry system

CO5: Familiarize with the various methods of depreciation as per AS 6.

COs/POs	PO1	PO2	PO3	PO4	PO5
CO1	✓				
CO2		✓			
CO3			✓		
CO4				✓	✓
CO5					✓

TABLE OF CONTENTS			
UNIT	**LESSON**	**TITLE**	**PAGE NO.**
I	1	Fundamentals of Accounting	1
II	2	Subsidiary books and Principal books	27
III	3	Final Accounts	73
IV	4	Partnership Account	117
V	5	Joint Venture and Royalty	193

UNIT – I

Fundamentals of Accounting

Learning objectives

After Learning this Chapter the students will be able to:-

- **Understand the Concept and Need for Accounting:** Define accounting, explain its scope, trace its historical development, and articulate why structured financial record-keeping is essential for modern business entities.
- **Distinguish Book-keeping from Accounting:** Analyze the fundamental differences between book-keeping and accounting in terms of scope, function, skill requirements, and analytical role.
- **Master the Double Entry System:** Explain the core principles of the double-entry system of bookkeeping, including the dual aspect rule ($Assets = Liabilities + Equity$) and how financial transactions are recorded.
- **Apply Accounting Principles, Concepts, and Conventions:** Identify and apply basic accounting concepts (such as Business Entity, Going Concern, Money Measurement, and Accrual) and conventions (such as Consistency, Conservatism, and Materiality) to financial transactions.
- **Understand the Accounting Standards Framework:** Explain the role, importance, and necessity of standardized financial reporting, and distinguish between domestic accounting standards and International Financial Reporting Standards (IFRS / IAS).

1.1 Introduction to Accounting

Accounting is well-known as "language of business" because it is most important discipline of commerce and business. Daily business activities involves enormous number of transactions e.g. purchase of raw material, production activities, labour expenditure, sales transactions etc.. Managing the business activities are very tough task if there is no proper accounting systems followed, because measuring profitability is the ultimate goal of business. . Accounting helps to achieve the business goals and providing

various financial information to the management for taking various decision making.

Accounting is an art of recording and classifying the monetary effects of business transactions and events of an enterprise for the purpose of analyzing and finally reporting the result to a variety of interested parties. The accounting system is termed as financial accounting because most of the transactions are in financial nature. Financial accounting is very important for all the stakeholders such as shareholders, creditors, debenture-holders, employees, regulatory bodies, etc... Accounting is also addressing as monitoring system of various aspects of the business activities. .

1.2 Meaning and Definition of Accounting

Financial Accounting is defined as the science and art of recording and classifying business transactions and making significant summaries for the determination of year-end profit or loss and their effect on owner's capital, assets and liabilities.

"The American Institute of certified Public Accountants has defined financial accounting as "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof". Financial accounting is thus concerned with the compilation and communication of financial information."

Accounting Principles Board (APB):

"Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."

The APB definition highlights the service role of accounting in supplying reliable financial information to various stakeholders.

Essential Features of Accounting

The following characteristics describe the nature of accounting:

- It is a systematic process involving several sequential steps.
- It records only transactions that can be expressed in monetary terms.
- It follows universally accepted accounting principles and standards.

- It summarizes financial information through financial statements.
- It interprets accounting information for effective decision-making.
- It serves both internal and external users.
- It ensures transparency, accountability, and financial discipline.

1.3 Objectives of Accounting

The primary objective of accounting is to provide useful financial information to interested parties. However, accounting serves several specific objectives, which are discussed below:

- **Maintaining Systematic Records:** One of the most important objectives of accounting is to maintain a complete and systematic record of all financial transactions. Proper records reduce the possibility of errors and ensure that financial information is available whenever required.
- **Determining Profit or Loss:** Accounting enables a business to ascertain whether it has earned a profit or incurred a loss during a particular accounting period. This is achieved through the preparation of the Profit and Loss Account.
- **Determining Financial Position:** Accounting provides information regarding the financial position of a business through the preparation of the Balance Sheet. The Balance Sheet presents the assets, liabilities, and owner's equity at a specific date.
- **Assisting Management in Decision-Making:** Management requires timely and reliable financial information for planning, controlling, budgeting, pricing, and investment decisions. Accounting provides such information in a structured manner.
- **Facilitating Legal Compliance:** Business organizations are legally required to maintain books of accounts and prepare financial statements according to applicable laws and accounting standards.
- **Safeguarding Business Assets:** Business Assets are protected due to keeping proper records and accounting provides information about the date of acquisition, utilization, depreciation, and disposal. Regular accounting also helps detect fraud and misappropriation.
- **Providing Information to Stakeholders:** Accounting supplies relevant financial information to shareholders, investors, creditors, employees, government agencies, suppliers, customers, and financial institutions.

- **Assisting Future Planning**: Historical accounting information provides a basis for forecasting future sales, estimating costs, preparing budgets, and formulating long-term business strategies.

1.4 Scope of Accounting

The scope of accounting has expanded significantly over the years. In earlier times, accounting was primarily concerned with recording financial transactions and preparing accounts. However, the growth of industrialization, globalization, technological advancement, and complex business operations has broadened its scope considerably. Today, accounting is not merely a bookkeeping activity but an integrated information system that supports planning, controlling, decision-making, and performance evaluation.

The scope of accounting includes all activities related to the collection, recording, classification, summarization, analysis, interpretation, and communication of financial information. It also covers specialized branches such as financial accounting, cost accounting, management accounting, tax accounting, and auditing.

1.4.1 Financial Accounting

Financial accounting is the branch of accounting concerned with recording business transactions and preparing financial statements for external users. The primary objective of financial accounting is to provide reliable information regarding the financial performance and financial position of an organization. It follows Generally Accepted Accounting Principles (GAAP), Accounting Standards (AS), Indian Accounting Standards (Ind AS), and International Financial Reporting Standards (IFRS).

The major financial statements prepared under financial accounting include:

- Trading Account
- Profit and Loss Account
- Balance Sheet
- Cash Flow Statement
- Statement of Changes in Equity

Financial accounting serves investors, shareholders, creditors, banks, government agencies, suppliers, and the general public.

1.4.2 Cost Accounting

Cost accounting deals with the determination, analysis, and control of costs incurred in producing goods or services. It provides detailed information regarding the cost of materials, labour, overheads, and production processes. Managers use cost accounting information to reduce unnecessary expenses, improve efficiency, fix selling prices, and maximize profits.

Objectives of Cost Accounting

- Determination of product cost
- Cost control
- Cost reduction
- Profit planning
- Inventory valuation
- Performance evaluation

Example:

If a company manufactures chairs, cost accounting determines the cost of wood, labour, electricity, transportation, and factory overheads involved in producing one chair.

1.4.3 Management Accounting

Management accounting provides financial and non-financial information to managers for planning and decision-making. Unlike financial accounting, management accounting is not restricted by legal requirements. It focuses on future-oriented information such as budgets, forecasts, performance reports, and investment analysis.

Functions of Management Accounting

- Planning business operations
- Budget preparation
- Decision-making
- Performance evaluation
- Cost control
- Financial forecasting
- Risk analysis

1.4.4 Tax Accounting

Tax accounting is mainly focused on the determination of taxable income, tax filing preparation, exemptions and strictly adhere the provisions of Income tax Act. Every business units must calculate their tax liabilities and meet statutory payment deadlines. Every business organizations' must follow the terms and conditions of Income Tax legislation, Goods and Services Tax (GST) mandates, customs levies, and related regulatory frameworks.

1.4.5 Auditing

Auditing refers to the independent examination of accounting records and financial statements to verify their accuracy and fairness. Auditors ensure that financial statements present a true and fair view of the financial position of the business.

Objectives of Auditing

- Verification of accounting records
- Detection of fraud and errors
- Evaluation of internal controls
- Increasing stakeholder confidence
- Ensuring legal compliance

1.4.6 Accounting Information System (AIS)

Modern accounting relies heavily on computerized accounting systems. Accounting Information Systems integrate accounting with information technology to process financial data quickly and accurately.

Examples:

- Tally Prime
- SAP ERP
- Oracle Financials
- QuickBooks
- Zoho Books

Advantages:

- Faster processing
- Reduced errors
- Better security

- Instant report generation
- Efficient data storage

1.5 Need and Importance of Accounting

Accounting is essential for every business organization because financial transactions occur daily. Proper accounting enables organizations to record, analyze, and communicate financial information efficiently.

The importance of accounting are as follows.

1. **Maintaining Systematic Records**
   Businesses perform hundreds or thousands of transactions every day. Without accounting, these transactions cannot be remembered accurately. Accounting provides a permanent and systematic record of every financial transaction.

2. **Determination of Profit or Loss**
   One of the principal objectives of accounting is to determine whether the business has earned profit or incurred loss. The Profit and Loss Account summarizes revenues and expenses during a particular accounting period. Managers use this information to evaluate business performance.

3. **Determining Financial Position**
   The Balance Sheet prepared through accounting provides information about:
   - Assets
   - Liabilities
   - Owner's Equity
     It enables users to understand the financial strength of the organization.

4. **Assistance in Decision-Making**
   Accounting information helps to take managerial decisions. Reliable accounting information reduces uncertainty in decision-making.
   Examples include:
   - Expansion of business
   - Purchase of machinery
   - Investment decisions
   - Pricing decisions
   - Borrowing funds

5. **Legal Compliance**

   Every business is legally required to maintain books of accounts under various laws. Accounting helps businesses comply with:

   - Companies Act
   - Income Tax Act
   - GST Act
   - Banking regulations
   - Corporate reporting requirements

6. **Assisting Investors and Creditors**

   - Investors use accounting information before investing their money.
   - Banks examine financial statements before sanctioning loans.
   - Creditors analyze accounting information before supplying goods on credit.

7. **Facilitating Comparison**

   Accounting follows uniform principles and standards.

   This enables comparison:

   - Between different accounting periods
   - Between different companies
   - Between actual and budgeted performance

   Comparative analysis helps identify strengths and weaknesses.

8. **Detection and Prevention of Fraud**

   A sound accounting system includes internal controls and documentation.

   This helps detect:

   - Misappropriation of cash
   - Fake purchases
   - Manipulation of accounts
   - Inventory shortages
   - Unauthorized payments

9. **Assisting Government**

   Government authorities require accounting information for:

   - Tax assessment

- Economic planning
- Statistical analysis
- Regulatory compliance
- National income estimation

10. Supporting Economic Development

Reliable accounting information promotes transparency and accountability.

It encourages:

- Domestic investment
- Foreign investment
- Efficient allocation of resources
- Economic growth

1.6 Development of Accounting

Accounting has evolved continuously in response to changing business needs. Accounting is as old as money itself. In India, Chanakya in his Arthashastra has emphasized the existence and need of proper accounting and auditing.

The modern system of accounting owes its origin to Pacioli who lived in Italy in the 18th Century. In those early days the business organizations and transactions were not so complex due to their being small and easily manageable by the proprietor himself. Things have changed fast during the last seventy years. The advent of industrial revolution has resulted in large scale production, cut-throat competition and widening of the market. This has also reduced the effectiveness of personal supervision resulting in the decentralization of authority and responsibility. Today there is a greater need for co-ordination and control. Old technique of management by intuition is no longer considered dependable in the situation in which the modern firm operates.

Accounting today, therefore, cannot be the same as it used to be about half a century back. It has also grown in importance and change in its structure with the evolution of complex and giant industrial organizations. In the early stages accounting developed as a result of the needs of the business firms to keep track of their relationship with outsiders, listing of their assets and liabilities.

In recent years changes in technology have also brought a remarkable change in the field of accounting. The whole concept of accounting has

changed. It systematically writes the economic history of the organization. It provides information that can be drawn upon by those responsible for decisions affecting the organisations's future. This history is written mostly in quantitative terms. It consists partly of files of data, partly of reports summarizing various portions of these data, and partly of the plan established by management to guide its operations.

Introduction of Double Entry System

In 1494, **"Luca Pacioli",** Italian mathematician published in his famous book "Summa de Arithmetica, Geometria, Proportioni et Proportionalita" about the Double Entry System of Book keeping. He established the principle of dual effect on each and every transaction. Hence, he called as "**Father of Accounting**".

Industrial Revolution

Due to the "Industrial Revolution" the huge manufacturing sectors were created and involves more complex business activities. Hence, it extends the development of the following aspects:

- Cost Accounting
- Management Accounting
- Budgetary Control
- Standard Costing
- Financial Analysis

Modern Accounting

Modern accounting is globally standardized and the below mentioned computerized technology are highly used for business:

- Enterprise Resource Planning (ERP)
- Cloud Accounting
- Artificial Intelligence
- Big Data Analytics
- Blockchain Technology

To foster global consistency in financial reporting, international bodies established International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). In alignment with this global effort, India instituted Indian Accounting Standards (Ind AS), which are substantially harmonized with IFRS guidelines.

1.7 Nature of Accounting

The nature of accounting involves the basic features and importance in an organization. Accounting is not only maintaining books of accounts but also it helps for decision making which involves systematic practice that provides significant financial information. With help of Accounting, the business administrations can prepare budgets, cost controlling, appraising the performance, and provide financial data to all stakeholders.

Accounting Characteristics:

1. **Accounting provides historical financial information to stakeholders**: The historical financial information helps to take management decision making within the organisation and also it facilitate the other stakeholders such as investors, lenders, regulatory bodies, staff etc..
2. **Nature of both Arts and Science:** Accounting adopts proper systems and techniques to provide and presenting the data and also it operates as a science by following to established standards, structured concepts, and uniform governing principles.
3. **Measuring Monetary Measurement:** Accounting records only quantitative transactions in terms of money or money's worth.
4. **Accounting is Historical in Nature**: Most accounting records relate to transactions that have already occurred. However, historical information is valuable for forecasting future performance, preparing budgets, and making strategic decisions.
5. **Accounting Provides Quantitative Information**: Accounting presents financial information in numerical terms, enabling users to measure performance, compare results, and evaluate financial position objectively.
6. **Accounting Ensures Accountability**: Accounting establishes responsibility by maintaining detailed records of assets, liabilities, revenues, and expenses. It enables management to account for the proper use of organizational resources.
7. **Accounting Supports Decision-Making**: Accounting information assists managers in making decisions regarding investment, financing, production, pricing, expansion, and cost control.

1.8 Bookkeeping and Accounting

Meaning of Bookkeeping

Bookkeeping is the process of recording day-to-day financial transactions in a systematic and chronological order. It forms the foundation of the accounting process. Bookkeepers maintain books such as:

- Journal
- Ledger
- Cash Book
- Purchase Book
- Sales Book

The primary objective of bookkeeping is to maintain complete and accurate records of financial transactions.

Meaning of Accounting

Accounting begins where bookkeeping ends. It includes recording, classifying, summarizing, analyzing, interpreting, and communicating financial information to users. Accounting converts bookkeeping records into meaningful financial statements and reports that facilitate decision-making.

Differences between Bookkeeping and Accounting			
Sl. No.	**Basis**	**Bookkeeping**	**Accounting**
1	Meaning	Recording of financial transactions	Recording, summarizing, analyzing, interpreting, and reporting
2	Objective	Maintain records	Provide financial information for decisions
3	Nature	Clerical activity	Analytical and managerial activity
4	Scope	Limited	Comprehensive
5	Decision-making	Not involved	Supports management decisions
6	Financial Statements	Not prepared	Prepared and interpreted
7	Skill Required	Basic accounting knowledge	Professional accounting knowledge

Relationship between Bookkeeping and Accounting

Bookkeeping and accounting are complementary activities. Bookkeeping provides the raw financial data, while accounting transforms that data into useful information. Without accurate bookkeeping, reliable accounting is not possible.

There are two types of bookkeeping i.e. Single entry and Double entry system of bookkeeping.

Single Entry system of Bookkeeping

- Under this system both debit and credit aspects of transaction are not recorded.
- Only Personal accounts & cash book are opened.
- Under this system balance sheet is not prepared.
- It is improper system of bookkeeping.

1.9 Double Entry system of Bookkeeping

The double entry system of bookkeeping is based on the fact that every transaction has two aspects, which therefore affects two ledger accounts. Every transaction involves a debit* entry in one account and a credit** entry in another account. Each and Every debit aspect has its equal and corresponding credit aspect and vise versa. Therefore, every transaction affects at least two accounts. This system ensures that the accounting equation remains balanced: **Assets = Capital + Liabilities.** The Double Entry System was formally documented by **Luca Pacioli** in 1494 and is widely used throughout the world.

- Based on principle of duel aspect of each transaction.
- For correct presentation both of them should be recorded.
- Requires maintenance of records of assets, liabilities, revenues and expenditure.
- Impact of each transaction can be seen or measured.
- Total assets are equal to total equities.

Accountants often use **T-accounts** to visualize the debit and credit effects on the accounts› balances.

*To debit an account means to enter an amount on the left side of the account.

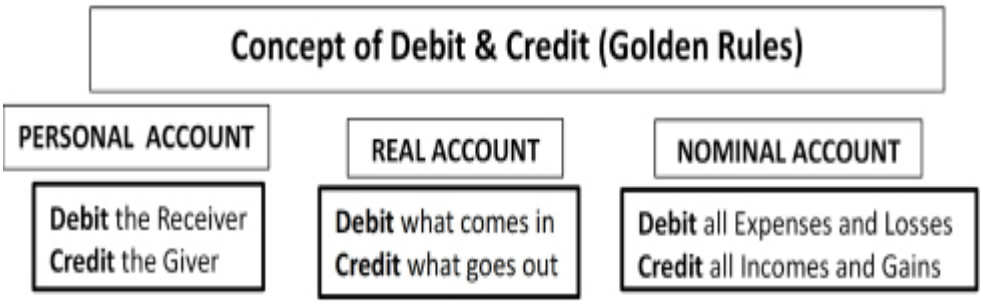
Account Type	Rule for Debit (Dr.)	Rule for Credit (Cr.)
Personal Account	Debit the Receiver	Credit the Giver
Real Account	Debit what comes in	Credit what goes out
Nominal Account	Debit all expenses and losses	Credit all incomes and gains

**To credit an account means to enter an amount on the right side of an account.

Features of Double Entry System

- Every transaction has two aspects.
- One account is debited, and another account is credited.
- Total debit is always equal to total credit.
- It provides complete financial information.
- It facilitates the preparation of financial statements.
- It helps detect errors through the Trial Balance.

The Golden Rules of Accounting are the basic rules used to determine which account to debit and which to credit in double-entry bookkeeping.



Personal Accounts

Rule:

- Debit the Receiver
- Credit the Giver

Example:

Goods sold to Mr. Kumar on credit ₹10,000

- Mr. Kumar A/c – Debit ₹10,000
- Sales A/c – Credit ₹10,000

Real Accounts

Rule:

- Debit What Comes In
- Credit What Goes Out

Example:

Purchased furniture for cash ₹25,000

- Furniture A/c – Debit ₹25,000
- Cash A/c – Credit ₹25,000

Nominal Accounts

Rule:

- Debit All Expenses and Losses
- Credit All Incomes and Gains

Example:

Salary paid ₹20,000

- Salary A/c – Debit ₹20,000
- Cash A/c – Credit ₹20,000

Practical Illustration:

The transactions follows:

- Furniture purchased for cash
- Goods purchased on credit from Raj & Co.
- Goods sold for cash
- Salaries Paid
- Electricity charges paid

Accounting Treatment

Transaction	Debit	Credit
Furniture purchased	Furniture A/c	Cash A/c
Goods purchased on credit	Purchases A/c	Ravi & Co. A/c
Cash sales	Cash A/c	Sales A/c
Salary paid	Salary A/c	Cash A/c
Electricity paid	Electricity Expense A/c	Cash A/c

The above example clearly shows that each every transaction affects at least two accounts under the Double Entry System.

Advantages of Double Entry System

- Complete recording of transactions
- Preparation of Trial Balance
- Detection of errors
- Accurate calculation of profit or loss
- Determination of financial position
- Better financial control
- Acceptance by law and accounting standards
- Reliable information for decision-making

Limitations

- Requires trained personnel
- Time-consuming for very small businesses
- Errors of principle cannot always be detected by the Trial Balance
- Costly to maintain for micro-enterprises

1.10 Accounting Principles

Accounting principles are the basic rules and guidelines followed while recording and reporting financial transactions. These principles ensure uniformity, consistency, reliability, and comparability in accounting practices. Accounting principles provide a common framework for preparing financial statements so that users can understand and compare financial information across different organizations.

Major Accounting Principles

- **Business Entity Principle:** The business and its owner are treated as separate legal and accounting entities. Personal transactions of the owner are not recorded in the business books.
- **Going Concern Principle:** Accounting assumes that the business will continue operating for the foreseeable future. This assumption affects asset valuation and depreciation.
- **Historical Cost Principle:** Assets are recorded at their original purchase cost rather than their current market value.
- **Revenue Recognition Principle:** Revenue is recognized when it is earned, irrespective of when cash is received.

- **Matching Principle:** Expenses are recognized in the same accounting period as the revenues they help generate. This ensures accurate determination of profit.
- **Full Disclosure Principle:** All significant financial information that may influence users' decisions should be disclosed in the financial statements and accompanying notes.
- **Objectivity Principle:** Accounting information should be based on objective evidence such as invoices, receipts, contracts, and vouchers.

1.11 Accounting Concepts and Conventions

Meaning of Accounting Concepts

Accounting concepts are the fundamental assumptions and ideas that guide the recording and reporting of financial transactions.

1. **Business Entity**: The business and its owner(s) are two separate existence entity. Any private and personal incomes and expenses of the owner(s) should not be treated as the incomes and expenses of the business. ***Economic Entity*** - company keeps its activity separate from its owners and other businesses. **Example:** Insurance premiums for the owner's house should be excluded from the expense of the business.
2. **Money Measurement**: All transactions of the business are recorded in terms of money and it provides a common unit of measurement. **Example:** Market conditions, technological changes and the efficiency of management would not be disclosed in the accounts.
3. **Going Concern Concept:** The business will continue in operational existence for the foreseeable future. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so. **Example**: Possible losses form the closure of business will not be anticipated in the accounts.
4. **Business Entity**: The business and its owner(s) are two separate existence entity. Any private and personal incomes and expenses of the owner(s) should not be treated as the incomes and expenses of the business. ***Economic Entity*** - company keeps its activity separate from its owners and other businesses. **Example:** Insurance premiums for the owner's house should be excluded from the expense of the business.

5. **Money Measurement**: All transactions of the business are recorded in terms of money and it provides a common unit of measurement. **Example:** Market conditions, technological changes and the efficiency of management would not be disclosed in the accounts.
6. **Going Concern Concept:** The business will continue in operational existence for the foreseeable future. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so. **Example**: Possible losses form the closure of business will not be anticipated in the accounts.
7. **The Realization concept**: This concept holds to the view that profit can only be taken into account when realization has occurred. Generally, sales revenue arising from the sale of goods is recognized when the goods are delivered to the customers. ***Revenue Recognition*** – generally occurs (1)when realized or realizable and (2) when earned. **Example**: Profit is earned when goods or services are provided to customers. Thus it is incorrect to record profit when order is received, or when the customer pays for the goods.
8. **Periodicity:** The life of an entity is divided into short economic time periods on which reporting statements are fashioned. ***Periodicity*** – company can divide its economic activities into time periods. **Example:** Based on this assumption assets are classified into current and fixed Assets**.** Current assets have benefits within **t**welve months period and fixed assets have benefits beyond 12 months.
9. **Dual Aspect**: Transaction has two fold effect: Debit &Credit. Each and every debit aspect has equal and corresponding credit aspect and vise versa. ***Accounting Equation***: Assets = Capital + Liability

Accounting Conventions

1. **Materiality:** Financial statement should separately disclose significant items for they would influence decisions of users. Accounting does not serve a useful purpose if the effort of recording a transaction in a certain way is not worthwhile. In other words do not waste your time in the elaborate recording of trivial items. **Example:** A stock of stationery worth Rs.10 should be treated as an expense when it was bought.

2. **Accounting for Conservatism**: The accountant should always be on the side of safety. The prudence concept means that normally he will take the figure which will understate rather than overstate the profit. Provision is made for all known liabilities. Conservatism means anticipate the expected future losses. **Example:** Provision for doubtful debts should be deducted from debtors in balance sheet.
3. **Consistency:** When a firm has once fixed a method for the accounting treatment of an item, it will enter all similar items that follow in exactly the same way. Frequent changes in the accounting methods would lead to misleading profits calculated from the accounting records. **Example:** Depreciation method of certain fixed assets once adopted should be used in the following years.
4. **Disclosure:** The financial statements of a firm must include all information necessary for the formation of valid decisions by the users. Any information that might be relevant to an investor or creditor should be disclosed, either in the body of the financial statements or in the notes attached thereto. **Example:** Method of Issue of stock (FIFO/LIFO/Weighted average), Method of Depreciation (SLM/WDV) Method of Valuation of Goodwill etc..

1.12 Accounting Standards

Meaning of Accounting Standards

Accounting Standards are written statements issued by recognized professional accounting bodies to guide the recognition, measurement, presentation, and disclosure of financial transactions in financial statements. They establish a common framework for preparing financial reports so that users receive information that is reliable, consistent, and comparable.

Different organizations may record similar transactions in different ways if no standards exist. Accounting Standards reduce these differences by prescribing uniform accounting practices. They also enhance transparency and improve the credibility of financial statements.

In India, Accounting Standards (AS) are issued by the **Institute of Chartered Accountants of India (ICAI)** and notified by the Central Government under the Companies Act. Certain companies are also required to follow **Indian Accounting Standards (Ind AS)**, which are substantially converged with IFRS.

The primary objectives:

- Uniformity in accounting practices.
- Reliability of financial statements
- Helping to compare with the similar organizations.
- Ensuring transparency and accountability
- Reducing discrepancies in financial reporting.
- Protecting the interest of all stakeholders of the organization.

Advantages of Accounting Standards

- It helps to follow the uniformity in the accounting principles.
- It helps to compare the financial statement analysis within the organisations id different period of time (compare the current year statement with the previous year statement) and with other organisations..
- It builds the trust and create market credibility to the investors.
- It provides clear picture of financial statements.
- It simplifies the process of external auditing.
- It helps to follow ethical practices and good corporate governance.

Limitations of Accounting Standards

- They cannot address every possible business situation.
- Frequent revisions may require additional training and system changes.
- Compliance may increase costs, particularly for smaller organizations.
- Professional judgment is still required when applying standards.

Indian Accounting Standards (Ind AS)

Indian Accounting Standards formulated under the supervision of the Accounting Standards Board (ASB), with the aim of harmonizing with the Global Accounting practices. The Accounting Standards Board (ASB) was constituted in April 1977, by the Institute of Chartered Accountants of India (ICAI).

Some important standards of Indian AS standards mentioned below:

- **Ind AS 1** – Presentation of Financial Statements
- **Ind AS 2** – Inventories
- **Ind AS 7** – Statement of Cash Flows

- **Ind AS 8 –** Accounting Policies, Changes in Accounting Estimates and Errors
- **Ind AS 12 –** Income Taxes
- **Ind AS 16** – Property, Plant and Equipment
- **Ind AS 18 –** Revenue
- **Ind AS 19 –** Employee Benefits
- **Ind AS 34 –** Interim Financial Reporting

1.13 International Accounting Standards (IAS) and IFRS

A Committee known as International Accounting Standards Committee (IASC) was formed on 29th of June, 1973 with headquarters at London. The committee was issued Global accounting principles between 1973 and 2001. The objects of IASC are "to formulate and publish in the public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. Accounting standards issued by the IASC prior to 2001, of which many of the standards were revised, amended, or withdrawn.

International Financial Reporting Standards (IFRS)

The International Accounting Standards Committee (IASC) was replaced by the International Accounting Standards Board (IASB) in April 2001. This IASB board adopted the existing International Accounting standards. In addition to that the IASB board issued subsequent standards are called as International Financial Reporting Standards (IFRS).

IFRS highlights:

- Transparency
- Comparability
- Reliability
- Relevance
- High-quality financial reporting

Many countries either adopt IFRS directly or align their national standards with it.

General Presentation & Disclosure

- IAS 1 — Presentation of Financial Statements
- IAS 7 — Statement of Cash Flows

- IAS 8 — Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 — Events after the reporting period
- IAS 21 — The Effects of Changes in Foreign Exchange Rates
- IAS 24 — Related Party Disclosures
- IAS 33 — Earnings Per Share (EPS)
- IAS 34 — Interim Financial Reporting

Assets & Valuations

- IAS 2 — Inventories
- IAS 16 — Property, Plant and Equipment (PPE)
- IAS 20 — Accounting for Government Grants and Disclosure of Government Assistance
- IAS 23 — Borrowing Costs
- IAS 36 — Impairment of Assets
- IAS 38 — Intangible Assets
- IAS 40 — Investment Property
- IAS 41 — Agriculture

Liabilities, Taxes, and Employee Benefits

- IAS 12 — Income Taxes
- IAS 19 — Employee Benefits
- IAS 37 — Provisions, Contingent Liabilities and Contingent Assets

Notable Superseded/Withdrawn IAS Standards

Several IAS standards were replaced as new IFRS rules were introduced over time:

- IAS 11 (Construction Contracts) & IAS 18 (Revenue): Superseded by IFRS 15 (Revenue from Contracts with Customers).
- IAS 17 (Leases): Superseded by IFRS 16 (Leases).
- IAS 39 (Financial Instruments: Recognition & Measurement): Largely superseded by IFRS 9 (Financial Instruments).

Objectives of IAS/IFRS

- To develop a single set of high-quality global accounting standards.
- To improve the comparability of financial statements across countries.

- To enable global trade and investment.
- To build the confidence of investor by way of apparent reporting.
- To upkeep of MNCs operating in different countries.

Advantages of IAS/IFRS

- Enhances the credibility of financial statements.
- Facilitates access to global capital markets.
- Simplifies financial reporting for multinational corporations.
- Improves transparency and disclosure.
- Enables investors to compare companies across countries.
- Encourages efficient allocation of financial resources.

Key Comparison Table

Sl. No.	Feature	IAS (International Accounting Standards)	IFRS (International Financial Reporting Standards)	Ind AS (Indian Accounting Standards)
1	**Origin / Era**	Developed from 1973 to 2001	Developed from 2001 to present	Phased rollout starting in 2015
2	**Issuing Body**	International Accounting Standards Committee (IASC)	International Accounting Standards Board (IASB)	Ministry of Corporate Affairs (MCA) / ICAI
3	**Geographic Scope**	Global (legacy)	Global (140+ countries)	Applicable only within India
4	**Relationship**	The predecessor set of international standards	The current global framework (includes active IAS standards)	A modified version of IFRS tailored to Indian laws
5	**Flexibility / Adaptations**	Standardized international rules	Uniform, non-localized global principles	Contains India-specific adaptations (*carve-outs/ ins*)

Chapter Summary:

Accounting is the language of business and provides systematic financial information for decision-making. It involves identifying, recording, classifying, summarizing, analyzing, and communicating financial transactions. The scope of accounting includes financial accounting, cost accounting, management accounting, tax accounting, and auditing. Bookkeeping forms the foundation of accounting by recording transactions, while accounting interprets and reports financial information.

The Double Entry System ensures that every transaction has equal debit and credit effects, maintaining the balance of the accounting equation. Accounting principles, concepts, and conventions provide a theoretical framework for consistent financial reporting. Accounting Standards, Ind AS, IAS, and IFRS promote uniformity, transparency, and comparability in financial statements, enabling businesses to operate effectively in both domestic and international environments.

Multiple Choice Questions (MCQs)

1. Accounting is known as the:
   (a) Language of Business ✓
   (b) Language of Law
   (c) Language of Economics
   (d) Language of Science
2. Who is known as the Father of Accounting?
   (a) Adam Smith
   (b) Luca Pacioli ✓
   (c) Karl Marx
   (d) Peter Drucker
3. The Double Entry System is based on:
   (a) One aspect
   (b) Two aspects ✓
   (c) Three aspects
   (d) Four aspects
4. Which branch of accounting helps management in planning and decision-making?
   (a) Financial Accounting

(b) Cost Accounting

(c) Management Accounting ✓

(d) Tax Accounting

5. The Going Concern Concept assumes that:

(a) The business will close soon

(b) The business will continue operating ✓

(c) The business has no liabilities

(d) The business has no assets

Short-Answer Questions

1. Define accounting.
2. Explain the scope of accounting.
3. State the objectives of accounting.
4. Differentiate bookkeeping and accounting.
5. What is the Double Entry System?
6. Explain the Business Entity Concept.
7. What is the Going Concern Concept?
8. Define Accounting Standards.
9. What are Ind AS?
10. State any four advantages of IFRS.

Long-Answer Questions

1. Explain the meaning, scope, and objectives of accounting.
2. Discuss the development and nature of accounting.
3. Differentiate bookkeeping and accounting with suitable examples.
4. Explain the Double Entry System and its advantages.
5. Discuss the major accounting principles.
6. Explain the accounting concepts and conventions with examples.
7. Describe the objectives and advantages of Accounting Standards.
8. Explain IAS, IFRS, and Ind AS.
9. Discuss the role of accounting in managerial decision-making.
10. Explain the need and importance of accounting in modern business.
11.

Notes

UNIT – II

Subsidiary Books and Principal Books

Learning Objectives:

After learning this chapter the students will be able to:-

- **Master Subsidiary Books:** Learn how to record daily transactions in specialized journals, including the Purchases, Sales, Purchase Returns, Sales Returns, Bills Receivable, and Bills Payable books.
- **Maintain Cash & Petty Cash Books:** Prepare single, double, and three-column cash books, and manage a petty cash book using the imprest system.
- **Post to the Ledger:** Transfer transaction entries from subsidiary books and the general journal into the main ledger (principal book) to determine account balances.
- **Prepare a Trial Balance:** Draft a trial balance from ledger accounts to verify the mathematical accuracy of the double-entry bookkeeping system

2.1 Introduction

Every day, a large number of business transactions will be carried out by every business organisations. All the transactions will have to be first entered in the Journal book (Primary book) and then posted to the Ledger. Recording of all the transactions in one Journal book will involve more clerical work and inconvenient in a big business houses. Hence, the Journal book is subdivided into eight different subsidiary books. Each book is exclusively for recording a particular kind of transactions.

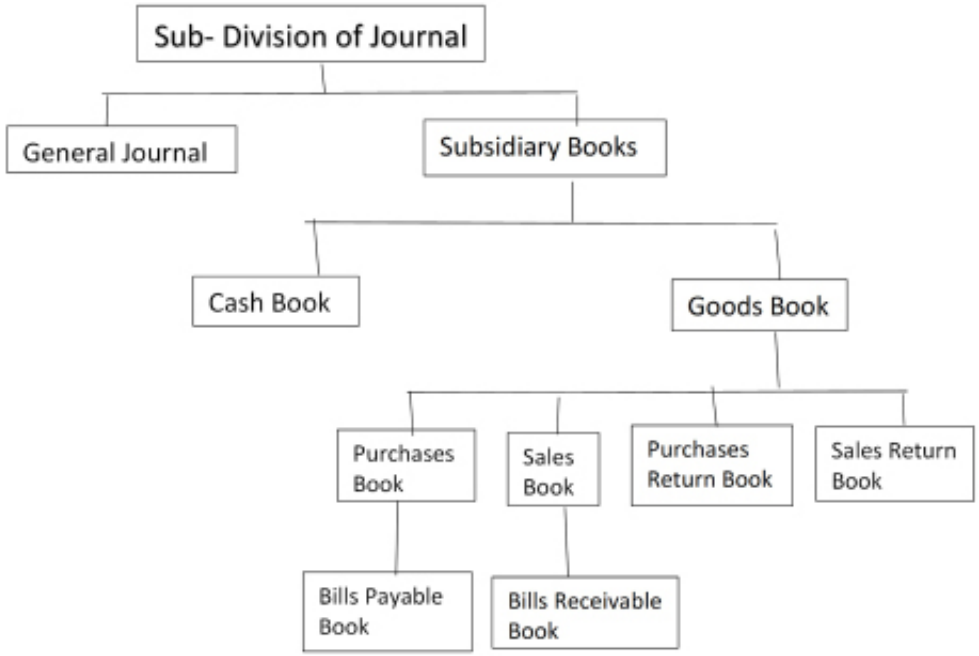
2.2 Advantages of Subsidiary Books

- **Convenience:** Sub-division of the Journal into subsidiary books will make the recording work easy and quick.
- **Division of Labour:** sub division of Journal helps in division of labour since different persons can write different Journals.
- **Classified information:** Each subsidiary books provides information relating to a particular aspect of the business. For

example, a Purchase book shows information about the total credit purchases made by the organisation. Thus, the classified form of subsidiary books provides information quickly to the organisation.

- **Quick Checking:** The transactions are grouped in a particular manner in the subsidiary book. Hence, the errors can be identified and corrected quickly.
- **Quick Preparation of Trial Balance:** Ledger posting becomes easier, facilitating the preparation of the Trial Balance.
- **Better Internal Control:** The system supports verification and accountability among accounting personnel.
- **Easy Location of Transactions:** Transactions are classified into different books, making retrieval simple.
- **Reduced Workload:** The accounting process becomes more manageable, especially in large organizations.

2.3 Classification Of Subsidiary Books



2.4 Purchases Book

The Purchases Book is meant for recording credit purchases of goods. This book records only purchase of goods which are meant for resale. Purchase of any other items (assets) on credit will not be entered in this book, but it will be entered in the General Journal book. Similarly, cash purchases will be entered in the cash book only. For example, the following transactions are **not** recorded in the Purchases Book:

- Cash purchases
- Purchase of furniture
- Purchase of machinery
- Purchase of buildings
- Purchase of office equipment

These transactions are recorded in the Cash Book or Journal Proper because they do not involve credit purchases of goods for resale.

Features:

- Records only credit purchases.
- Includes only goods purchased for resale.
- Cash purchases are excluded.
- Purchases of assets are excluded.
- Entries are recorded chronologically.
- Supplier accounts are later posted to the ledger.

The Purchases book has columns for date of Purchase, name of the party etc. Ledger folio, Invoice number and the amount of purchase. The posting to the personal accounts from the purchases book is done daily, whereas the total in the purchases book is posted to the debit of the purchases account in the ledger only at the end of a period.

Specimen Table:

Date	Invoice No.	Supplier's Name and Details	L.F.	Amount (₹)

Explanation of Columns

- **Date:** Date of purchase.
- **Supplier's Name:** Name of the seller.
- **Invoice Number:** Invoice reference.
- **Details:** Description of goods.
- **L.F. (Ledger Folio):** Ledger page reference.
- **Amount:** Total amount of purchase.

Example

ABC Traders purchased the following goods on credit:

Year 2025

January 1 Purchased from Ram & Co. on credit:

50 Heater Rods @ ₹10

30 Philips Bulbs @ ₹20

January 3 Purchased from Rahim & Co. on credit:

40 Heater Rods @ ₹10

20 ECE Bulbs @ ₹20

January 10 Purchased from Rajesh & Co. on credit

20 Electric Elements @ ₹30

50 Electric Switches @ ₹200

Purchases Book					
Date	**Invoice No.**	**Supplier**	**L.F.**	**Amount (₹)**	**Amount (₹)**
2025		Ram & Co:			
Jan-01		50 Heater Rods @ ₹10	3	500	
		30 Philips Bulbs @ ₹20		600	1,100
Jan-03		Rahim & Co:			
		40 Heater Rods @ ₹10	5	400	
		20 ECE Bulbs @ ₹20		400	800
Jan-10		Rajesh & Co.:			
		20 Electric Elements @ ₹30	8	600	
		50 Electric Switches @ ₹200		10,000	10,600
Jan-31		**Purchases A/c Dr.**			**12,500**

Ledger Posting Purchases A/c					
Date	**Particulars**	**Amount (₹)**	**Date**	**Particulars**	**Amount (₹)**
Jan-31	To Sundries	12,500			
Ram & Co. A/c					
			Jan-01	By Purchases A/c	1,100
Rahim & Co. A/c					
			Jan-03	By Purchases A/c	800
Rajesh & Co. A/c					
			Jan-10	By Purchases A/c	10,600

2.5 Sales Book

Sales book or Sales day book is meant for recording credit sales of goods only. Only credit sales of goods are entered in this book. Cash sales are shown in the cash book and other than sale of goods (sale of assets) is to be recorded in the General Journal or Journal Proper, example the following transactions are **not** recorded in the sales day book:

- Cash sales
- Sale of furniture
- Sale of machinery
- Sale of land
- Sale of office equipment

Features of Sales Book

- Records only credit sales.
- Includes goods sold for resale.
- Excludes cash sales.
- Excludes sale of assets.
- Helps monitor customer balances.
- Facilitates preparation of Debtors' Ledger.

Specimen Table:

Date	Invoice No.	Customers' Name and Details	L.F.	Amount (₹)

Example

ABC Traders sold goods on credit as follows:

- January 4: Sold goods to Ramesh ₹18,000
- January 7: Sold goods to Vinod ₹22,000
- January 11: Sold goods to Priya ₹16,000

Sales Book					
Date	**Invoice No.**	**Supplier**	**L.F.**	**Amount (₹)**	**Amount (₹)**
Jan 4		Ramesh			18,000
Jan 7		Vinod			22,000
Jan 11		Priya			16,000
Total		**Sales A/c**			**56,000**

Ledger Posting Sales A/c					
Date	**Particulars**	**Amount (₹)**	**Date**	**Particulars**	**Amount (₹)**
			Jan-31	**By Sundries**	**56,000**
Ram & Co. A/c					
Jan-04	To Sales A/c	18,000			
Rahim & Co. A/c					
Jan-07	To Sales A/c	22,000			
Rajesh & Co. A/c					
Jan-11	To Sales A/c	16,000			

Difference between Purchases Book and Sales Book

Sl. No.	Basis	Purchases Book	Sales Book
1	Purpose	Only Recording credit Purchases	Only Recording credit Sales
2	Nature	Inward transactions	Outward transactions
3	Total Posted To	Ledger - Debit side of Purchases A/c	Ledger - Credit side of Sales A/c
4	Personal Accounts	Creditors credited	Debtors debited
5	Maintained By	Buyer	Seller

2.6 Purchases Returns Book (Returns Outward Book)

Meaning

The Purchases Returns Book is also otherwise called as Return outwards, and it is meant for recording return of goods purchased on credit. Returns may occur because the goods are damaged, defective, of inferior quality, not as ordered, or supplied in excess of the quantity required. The goods purchased for cash and returned, are not recorded in this book. On receipt of cash for the returns, the entry is to be recorded through the Cash Book only because they involve a cash transaction. The Purchases Returns Book helps businesses maintain an accurate record of goods returned to suppliers and also it will reduce the credit amount.

Debit Note: When the goods are returned to the supplier, a Debit Note is sent to him indicating that his account has been debited with the amount mentioned in the Debit Note.

Objectives of the Return Outwards:

- To maintain a separate record of goods returned to suppliers.
- To reduce the balance payable to creditors.
- To avoid recording return transactions in the Journal Proper.
- To simplify posting to the ledger.
- To facilitate the preparation of financial statements.

Features

- Records only credit purchase returns.
- Entries are made in chronological order.

- Based on the debit note sent to the supplier.
- The total amount of Purchases return book is to be posted in the credit side of purchases returns account in the ledger book. And also the individual suppliers account will be debited in the ledger book

Specimen Format

Date	Debit Note No	Name of Supplier	L.F.	Amount (₹)

Illustration

ABC Traders returned goods to suppliers as follows:

- April 5 – Returned goods to Kumar & Co. – ₹5,000
- April 9 – Returned goods to Ravi Traders – ₹2,500
- April 14 – Returned goods to Suresh Enterprises – ₹3,000

Purchases Returns Book

Date	Supplier	Amount (₹)
Apr. 5	Kumar & Co.	5,000
Apr. 9	Ravi Traders	2,500
Apr.14	Suresh Enterprises	3,000
	Total	**10,500**

Ledger Posting					
Purchases Returns (Returns Outwards) A/c					
Date	**Particulars**	**Amount (₹)**	**Date**	**Particulars**	**Amount (₹)**
			Jan-31	**By Sundries**	**10,500**
Kumar & Co. A/c					
Apr-05	To Purchases Return A/c	5,000			

Ravi Traders A/c					
Apr. 9	To Purchases Return A/c	2,500			
Suresh Enterprises A/c					
Apr. 14	To Purchases Return A/c	3,000			

2.7 Sales Returns Book (Returns Inward Book)

The Sales Returns Book is also otherwise called as **Returns Inward Book**. This book is meant for recording return of goods by the customers to whom the goods have been sold on credit. Customers may return goods because they are damaged, defective, not according to specifications, or delivered in excess quantity. Only **credit sales returns** are recorded in this book.

Credit Note: When the goods are returned by the customers, a Credit Note is sent to them by indicating that their amount has been credited with the amount mentioned in the Credit Note.

Objectives

- To maintain separate records of goods returned by customers.
- To reduce the amount receivable from debtors.
- To simplify accounting work.
- To facilitate posting to the ledger.
- To determine the actual value of net sales.

Features

- Records only credit sales returns.
- Based on credit notes issued to customers.
- Entries are chronological.
- Total is debited to the Sales Returns Account.
- Individual customer accounts are credited.

Specimen Format

Sales Returns Book (Returns Inward Book)					
Date	**Credit Note No.**	**Customer Name**	**Details**	**L.F.**	**Amount (₹)**

Illustration

ABC Traders received the following returns:

- April 10 – Ramesh returned goods– ₹5,000
- April 14 – Vinod returned goods – ₹4,000
- April 18 – Goods returned by Priya – ₹1,500

Sales Returns Book/Return Inwards Book			
Date	**Credit Note**	**Customer**	**Amount (₹)**
Apr. 10		Ramesh	5,000
Apr.14		Vinod	4,000
Apr.18		Priya	1,500
Total			**10,500**

Ledger Posting					
Sales Returns/ Return Inwards A/c					
Date	**Particulars**	**Amount (₹)**	**Date**	**Particulars**	**Amount (₹)**
Apr. 31	To Sundries	10,500			
Ramesh A/c					
			Jan-10	By Sales Return A/c	5,000
Vinod A/c					
			Jan-18	By Sales Return A/	4,000
Priya A/c					
			Jan-10	By Sales Return A/	1,500

Difference between Purchases Returns Book and Sales Returns Book			
Sl. No.	**Basis**	**Purchases Returns Book**	**Sales Returns Book**
1	Records	Goods returned to suppliers	Goods returned by customers
2	Also Called	Returns Outward Book	Returns Inward Book
3	Affects	Creditors	Debtors
4	Main Account	Returns Outwards A/c	Return inwards A/c
5	Personal Account	Supplier debited	Customer credited

2.8 Bills Receivable Book

A **Bill Receivable** is a promissory note accepted by a debtor for payable amount on a future date. When a business receives such a bill from its customer, it is recorded in the **Bills Receivable Book**. This book contains all bills accepted by customers and helps track the due dates and amounts receivable.

Objectives

- To maintain records of all bills receivable.
- To monitor maturity dates.
- To simplify ledger posting.
- To improve debt collection.

Features

- Records only bills received.
- Maintains maturity details.
- Total posted to Bills Receivable Account.
- Individual debtor accounts are credited.

Specimen Format

Bills Receivable Book								
Date of Receipt	**From Whom Received (Drawee)**	**Drawer**	**Bill No.**	**Date of Bill**	**Term/ Tenor**	**Due Date**	**Amount (₹)**	**How Disposed Of**

Illustration

Record the following transactions in the Bills Receivable Book of *M/s ABC Traders* for the month of October 2024:

1. Oct 05, 2024: Received a 3-month bill from Ramesh & Co. for ₹15,000, accepted on Oct 03, 2024 (Bill No. 101).
2. Oct 12, 2024: Received a 2-month bill from Suresh Bros. for ₹22,000, accepted on Oct 10, 2024 (Bill No. 102).
3. Oct 20, 2024: Drawn a 1-month bill on Priya Electronics for ₹8,000, accepted by them today (Bill No. 103).

Solution:

Bills Receivable Book								
Date of Receipt	**From Whom Received (Drawee)**	**Drawer**	**BillNo.**	**Date of Bill**	**Term/ Tenor**	**Due Date**	**Amount (₹)**	**How Disposed of**
2024 Oct-05	Ramesh & Co.	Self	101	Oct-03	3Months	Jan.06, 2025	15,000	Retained
Oct-12	Suresh Bros.	Self	102	Oct-10	2 Months	Dec.13, 2024	Discounted	
Oct-20	Priya Electronics	Self	103	Oct-20	1 Month	Nov.23, 2024	Retained	
Oct-31	Total transferred to B/R A/c						45,000	

Note on Due Date Calculation: Standard practice adds 3 days of grace to the tenor:

- Oct 03 + 3 months + 3 days grace = Jan 06, 2025
- Oct 10 + 2 months + 3 days grace = Dec 13, 2024
- Oct 20 + 1 month + 3 days grace = Nov 23, 2024

2.9 Bills Payable Book

Meaning

When a business accepts a bill drawn by its supplier promising payment on a future date, it becomes a **Bill Payable**. Bills accepted by the business are recorded in the **Bills Payable Book**.

Objectives

- To maintain records of bills payable.
- To monitor payment obligations.
- To simplify accounting.
- To improve financial planning.

Features

- Records only accepted bills.
- Shows maturity dates.
- Individual creditor accounts are debited.
- Bills Payable Account is credited.

Specimen Format

Bills Payable Book								
Date of Acceptance	**Drawer (To Whom Given)**	**Payee**	**Bill No.**	**Where Payable**	**Term / Tenor**	**Due Date**	**Amount (₹)**	**How Disposed Of**

Illustration

Record the following transactions in the **Bills Payable Book** of *M/s Apex Traders* for the month of November 2024:

1. **Nov 04, 2024:** Accepted a 2-month bill drawn by **Mehta & Sons** for ₹18,000, payable at SBI (Bill No. 201).
2. **Nov 12, 2024:** Accepted a 3-month bill drawn by **Global Traders** for ₹25,000, payable at Punjab National Bank (Bill No. 202).
3. **Nov 22, 2024:** Accepted a 1-month bill drawn by **Anand Suppliers** for ₹10,000, payable at SBI (Bill No. 203).

Solution:

Bills Payable Book								
Date of Acceptance	**Drawer (To Whom Given)**	**Payee**	**Bill No.**	**Where Payable**	**Term / Tenor**	**Due Date**	**Amount (₹)**	**How Disposed of**
2024 Nov-04	Mehta & Sons	Mehta & Sons	201	SBI	2 Months	Jan 07, 2025	18,000	Paid on maturity

Nov-12	Global Traders	Global Traders	202	PNB	3 Months	Feb 15, 2025	Pending	
Nov-22	Anand Suppliers	Anand Suppliers	203	SBI	1 Month	Dec 25, 2024	Paid on maturity	
Nov-30	Total transferred to B/P A/c						53,000	

Due Date Calculation (Including 3 Days of Grace):

- Nov 04 + 2 months + 3 days grace = **Jan 07, 2025**
- Nov 12 + 3 months + 3 days grace = **Feb 15, 2025**
- Nov 22 + 1 month + 3 days grace = **Dec 25, 2024**

Difference between Bills Receivable and Bills Payable			
Sl. No.	**Basis**	**Bills Receivable**	**Bills Payable**
1	Nature	Asset	Liability
2	Received From	Debtors	Creditors
3	Amount	Receivable	Payable
4	Main Account	Bills Receivable A/c	Bills Payable A/c
5	Personal Account	Debtor credited	Creditor debited

2.10 Journal Proper/General Journal (Journal Book)

Meaning:

Journal is a primary set of book in which daily transactions will be recorded. "Jour" is a Latin word which means daily, hence it is termed as Journal. The Journal records all business transactions in the order in which they occur. Journal may, therefore, be defined as the book of original entry containing a chronological record of the transactions from which posting to the Ledger is made. The process of recording transaction in a Journal is termed as "Journalising".

According to Cropper "A journal is a book employ to classify or sort out transactions in a form convenient for their subsequent entry in the ledger".

Necessity of Journal

- Convenient recording of transaction
- Maintaining and preserving the identity of transaction

- Ascertaining the true nature of transaction
- Maintaining permanent record of information

Functions of Journal

- To analyze each transaction into debit and credit so as to enable their posting in the ledger
- To arrange transaction, chronological i.e in order of date.

Advantages of Journal

- Show all necessary information relating to a transaction
- Provide the explanation of the transaction
- Date wise record of all the transaction can be obtained
- Help in locating and preventing the errors

Limitations of Journal

- Recording all the transaction in a journal requires:
  - writing down name of account involved
  - individual posting of each account debited and credited
- Does not provide information on prompt basis
- Does not facilitate the internal check system since the journal can be handled only by one person
- Journal become bulky and voluminous

Journal Entries

Transactions Recorded:

- **Opening entries:** When a new set of books is started. The old accounts have to be brought forward in the beginning of the year from last year's books. The opening entry is meant for recording these transactions. The entries are made from the balance sheet of the last year.
- **Closing Entries:** At the end of accounting year, the nominal accounts are closed by transferring them to trading account or profit and loss account. The entries passed for this purpose are termed as 'Closing Entries'.
- **Adjustment Entries:** At the end of the accounting year, adjustment entries are to be passed for outstanding/prepaid expenses, accrued/ outstanding income etc. Entries for all these adjustment are passed to the General Journal.

- **Rectification Entries:** Rectification entries are passed for rectifying the errors which might have been committed in the books of account.
- **Purchases of Fixed Assets:** The entries for purchases of fixed assets such as plant & machinery, furniture, etc., on credit are also passed in this Journal.

Journal Format (Specimen):

Journal of [Name of the Business / Company]

Date	Particulars	L.F.	Amount (Dr.) (₹)	Amount (Cr.) (₹)
2024 Jan-01	**Account to be Debited** ... Dr. **To Account to be Credited** *(Brief explanation/narration of the transaction)*			

Illustration:1 Prepare Journal entries in the books of **Mr. Ram** for the following transactions:

- April 1, 2023: Cash Purchases ₹20,000.
- April 9, 2023: Sold goods to Rama at the list price of ₹60,000 at a trade discount of 10%.
- April 11, 2023: Bought goods from Vinod worth ₹30,000 at a 10% trade discount.
- April 18, 2023: Returned goods to Vinod at the list price of ₹2,000.
- April 22, 2023: Paid cash to Vinod ₹24,000 in full settlement.
- April 25, 2023: Rama returned goods of list price ₹10,000.
- April 28, 2023: Rama paid ₹43,000 in full settlement of his account.

2 Journal Entries

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
2023 Apr 1	Purchases A/c … Dr..		20,000	
	To Ca sh A/c			20,000
	(Being goods purchased for cash)			

Apr-09	Rama's A/c ... Dr.		54,000	
	To Sales A/c			54,000
	(Being goods sold to Rama at 10% trade discount: ₹60,000 - ₹6,000)			
Apr-11	Purchases A/c ... Dr.		27,000	
	To Vinod's A/c			27,000
	(Being goods purchased at 10% trade discount: ₹30,000 - ₹3,000)			
Apr-18	Vinod's A/c ... Dr.			
	To Purchase Returns A/c			
	(Being goods returned at net price: ₹2,000 - 10% = ₹1,800)		1,800	1,800
Apr-22	Vinod's A/c ... Dr.		25,200	
	To Cash A/c			24000
	To Discount Received A/c			1,200
	(Being cash paid to Vinod in full settlement of ₹25,200 due)			
Apr-25	Sales Returns A/c ... Dr.		9,000	
	To Rama's A/c			9,000
	(Being goods returned by Rama at net price: ₹10,000 - 10% = ₹9,000)			
Apr-28	Cash A/c ... Dr.		43,000	
	Discount Allowed A/c ... Dr.		2,000	
	To Rama's A/c			45,000
	(Being full settlement received from Rama for ₹45,000 due)			

Working Notes:

1. **Trade Discount:** Trade discounts are deducted directly from the list price and **are not recorded** separately in the books of accounts.
   - **Apr 9 (Sales):** ₹60,000 - (10% X ₹60,000) = ₹54,000

- **Apr 11 (Purchases):** ₹30,000 - (10% X ₹30,000) = ₹27,000
- **Apr 18 (Purchase Return):** List price ₹2,000 minus 10% trade discount = ₹1,800
- **Apr 25 (Sales Return):** List price ₹10,000 minus 10% trade discount = ₹9,000

2. **Settlement Accounts:**

- **Vinod's Account:** Total Purchases (₹27,000) - Returns (₹1,800) = **₹25,200 due**. Paid ₹24,000 - Discount Received = **₹1,200**.
- **Rama's Account:** Total Sales (₹54,000) - Returns (₹9,000) = **₹45,000 due**. Received ₹43,000 - Discount Allowed = **₹2,000**.

Illustratin 2: Prepare Journal entries for the following transactions in the books of Mr. Rahim

- **April 1:** Opened a Bank Account by depositing ₹50,000.
- **April 15:** Cash withdrawn ₹5,000 for personal use.
- **April 29:** Bank charged interest of ₹500.

Date	Particulars	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
Apr-01	**Bank A/c** ... Dr.		50,000	
	To **Cash A/c**			50,000
	(Being bank account opened with cash)			
Apr-15	**Drawings A/c** ... Dr.		5,000	
	To **Cash A/c**			5,000
	(Being cash withdrawn for personal use)			
Apr-29	**Bank Charges A/c** ... Dr.		500	
	To **Bank A/c**			500
	(Being bank charges debited by the bank)			

Illustration 3: Transactions for *Alex Enterprises* during January:

1. **Jan 1:** Alex started business with cash ₹1,00,000.
2. **Jan 5:** Purchased furniture for cash ₹15,000.

3. **Jan 10:** Purchased goods on credit from *Rohan Stores* for ₹20,000.
4. **Jan 15:** Sold goods for cash ₹12,000.
5. **Jan 28:** Paid rent by cash ₹5,000.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
Jan-01	Cash A/c		100000	
	To Capital A/c			100000
	(Being business started with cash)			
Jan-05	Furniture A/c		15000	
	To Cash A/c			15000
	(Being furniture purchased for cash)			
Jan-10	Purchases A/c		20000	
	To Rohan Stores A/c			20000
	(Being goods purchased on credit)			
Jan-15	Cash A/c		12000	
	To Sales A/c			12000
	(Being goods sold for cash)			
Jan-28	Rent A/c		5000	
	To Cash A/c			5000
	(Being rent paid in cash)			

2.11 Ledger

Meaning of Ledger

Ledger is the book of Main entry and it contains various accounts i.e personal account, real account and nominal account in which all the transactions recorded in the journal and subsidiary books are classified and posted into individual accounts. Every account—such as cash, purchases, sales, debtors, creditors, expenses, incomes, assets, and liabilities—is maintained separately in the ledger.

The ledger is often called the **"King of Books"** because it contains all the accounts required to prepare the Trial Balance and financial statements. While journals record transactions in chronological order, the ledger

records them according to their nature, making it easier to determine the balance of each account.

Definition

A ledger is a book that contains all the accounts of a business and records transactions relating to each account separately.

Objectives of Maintaining a Ledger

The main objectives of maintaining a ledger are:

1. To classify transactions account-wise.
2. To determine the balance of each account.
3. To provide information for preparing the Trial Balance.
4. To facilitate the preparation of financial statements.
5. To help management monitor individual accounts.
6. To provide a permanent record of financial transactions.

Features of a Ledger

- Contains all accounts of a business.
- Transactions are posted from journals and subsidiary books.
- Shows debit and credit balances.
- Helps determine financial position.
- Forms the basis for preparing financial statements.

Format of a Ledger Account

Dr. **Cr.**

Ledger Accounts							
Date	**Particulars**	**J.F.**	**Debit (₹)**	**Date**	**Particulars**	**J.F.**	**Credit (₹)**

Posting from Subsidiary Books to the Ledger

Transactions recorded in subsidiary books are periodically transferred to the ledger.

Posting from Purchases Book

- Individual suppliers are credited.
- Purchases Account is debited with the total.

Posting from Sales Book

- Individual customers are debited.
- Sales Account is credited with the total.

Posting from Purchases Returns Book

- Supplier accounts are debited.
- Purchases Returns Account is credited.

Posting from Sales Returns Book

- Customer accounts are credited.
- Sales Returns Account is debited.

Posting from Cash Book

All the Cash and bank transactions are posted to the respective ledger accounts.

Balancing of Ledger Accounts

Balancing means determining the difference between the debit and credit sides of an account at the end of an accounting period.

Steps in Balancing

1. Total both debit and credit sides.
2. Find the difference.
3. Record the difference on the smaller side.
4. Carry forward the balance to the next accounting period.

Types of Balances

Debit Balance

Occurs when the debit side exceeds the credit side.

Examples:

- Cash Account
- Furniture Account
- Machinery Account
- Debtors Account

Credit Balance

Occurs when the credit side exceeds the debit side.

Examples:

- Capital Account
- Creditors Account
- Sales Account
- Bank Loan Account

Advantages of the Ledger

- Classifies transactions systematically.
- Provides balances of all accounts.
- Facilitates Trial Balance preparation.
- Helps locate accounting errors.
- Supports preparation of final accounts.
- Provides useful information for decision-making.

Illustration 1

From the following transactions of **Mr. Sharma**, you are required to write up his Journal, post the entries in the Ledger accounts and balance the accounts at the end of the month and prepare a Trial Balance.

2025 Jan –

1 Sharma commenced business with Furniture Rs. 1,000 Stock Rs. 6,000 and cash Rs. 3,000.

2 Purchased from Sriram Rs. 6,000.

4 Sold goods for cash Rs. 3,000

5 Returned goods to Sriram Rs. 700

7 Purchased goods for cash Rs.3,000

8 Sold goods to Raju Rs. 4,000

11 Raju returned goods Rs. 600

13 Paid cash to Sriram Rs. 2,060 and he allowed us discount Rs. 40 15 Sold goods to Balaram Rs. 2,600

17 Received cash from Raju Rs. 1,080 and allowed him discount Rs. 20

18 Purchased stationery Rs. 300

19 Received cash from Balaram Rs. 1,600

21 Sold old furniture for cash Rs. 100

23 Paid commission Rs. 100

25 Sharma withdrew cash Rs. 1,000

27 Paid salary Rs.900 and office rent Rs. 300

30 Postage stamps purchased Rs. 50

31 Received cash from Balaram Rs. 1,000

Solution:	**Journal Entries in the books of Mr. Sharma**			
Date	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
Jan. 1	Furniture A/c Dr. Stock A/c Dr. Cash A/c Dr. To Capital A/c (Being the assets brought in as capital)		 1,000 6,000 3,000	 10,000
2	Purchases A/c Dr. To Sriram's A/c (Being the goods purchased on credit)		6,000	6,000
4	Cash A/c Dr. To Sales A/c (Being the goods sold for cash)		3,000	3,000
5	Sriram's A/c Dr. To Purchase Returns A/c (Being the goods returned to Sriram)		700	700
7	Purchases A/c Dr. To Cash A/c (Being the goods purchased for cash)		3,000	3,000
9	Raju's A/c Dr. To Cash A/c (Being the goods sold on credit to Raju)		4,000	4,000
11	Sales Returns A/c Dr. To Raju's A/c (Being the goods returned by Raju)		600	600
13	Sriram's A/c Dr. To Cash A/c To Discount received A/c (Being the cash paid to Sriram and discount allowed to us)		2,100	 2,060 40

15	Balaram's A/c Dr. To Sales A/c (Being the goods sold on credit to Balaram)		2,600	2,600
17	Cash A/c Dr. Discount allowed A/c Dr. To Raju's A/c (Being the entry for cash received from Raju and discount allowed to him)		1,080 20	1,100
18	Stationery A/c Dr. To Cash A/c (Being the stationery purchased)		300	300
19	Cash A/c Dr. To Balaram's A/c (Being the cash received from Balaram)		1,600	1,600
21	Cash A/c Dr. To Furniture A/c (Being the sale of furniture)		100	100
23	Commission A/c Dr. To Cash A/c (Being the commission paid)		100	100
25	Drawings A/c Dr. To Cash A/c (Being the drawings made by the proprietor)		1,000	1,000
27	Salary A/c Dr. Rent A/c Dr. To Cash A/c (Being the salary and rent paid)		900 300	1,200
30	Postage A/c Dr. To Cash A/c (Being the purchase of postage stamps)		50	50
31	Cash A/c Dr. To Balaram's A/c (Being the cash received from Balaram)		1,000	1,000

LEDGER ACCOUNTS

DEBTORS LEDGER

Dr. ***Raju's Account*** ***Cr.***

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025				2025			
Jan-09	To Sales A/c		4,000	Jan-11	By Sales Returns A/c		600
				Jan-17	By Cash A/c		1080
					By Discount allowed A/c		20
				Jan-31	By Balance c/d		2,300
			4,000				4,000
Feb-01	**To Balance b/d**		**2,300**				

Dr. ***Balaram's Account*** ***Cr.***

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025				2025			
Jan-15	To Sales A/c		2,600	Jan-01	By Cash A/c		1,600
				Jan-31	By Cash A/c		1,000
			2,600				2,600

Dr. ***Sriram's Account*** **Cr.**

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025				2025			
Jan-05	To Purchases Returns A/c		700	Jan-02	By Purchase A/c		6,000
Jan	To Cash A/c		2,060				
13	To Discount received A/c		40				
31	To Balance c/d		3,200				
			6,000				6,000
				Feb-01	**By Balance b/d**		**3,200**

GENERAL LEDGER

Dr. **Furniture Account** ***Cr.***

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025				2025			
Jan-01	To Capital A/c		1,000	Jan-21	By Cash A/c		100
				Jan-31	By Balance b/d		900
			1,000				1,000
Feb-01	**To Balance b/d**		**900**				

Dr. ***Stock Account*** ***Cr.***

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025 Jan-01	To Capital A/c		6,000	2025			
				Jan-31	By Balance c/d		6,000
			6,000				6,000
Feb-01	**To Balance b/d**		**6,000**				

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

Date	Particulars	JF	Amount ₹	Date	Particulars	JF	Amount ₹
2025 Jan-01	To Capital A/c		3,000	2025 Jan-07	By Purchases A/c		3,000
4	To SalesA/c		3,000	18	By Sriram's A/c		2,060
17	To Raju's A/c		1,080	23	By Stationery A/c		300
19	To Balaram's A/c		1,600	25	By Commission A/c		100
21	To Furniture A/c		100	25	By Drawings A/c		1,000
31	To Balaram's A/c		1,000	27	By Salary A/c		900
				30	By Rent A/c		300
				31	By Postage A/c		50
				31	By Balance c/d		2,070
			9,780				9,780
Feb-01	**To Balance b/d**		**2,070**				

Dr.			*Capital Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025				2025			
Jan-31	To Balance c/d		10,000	Jan-01	By Furniture A/c		1,000
					By Stock A/c		6,000
					By Cash A/c		3,000
			10,000				10,000
				Feb01	**By Balance b/d**		**10,000**

Dr.			*Purchases Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025	To Sriram's A/c		6,000	2025			
Jan-02	To Cash A/c		3,000	Jan-07	By Balance c/d		9,000
			9,000				9,000
Feb-01	**To Balance b/d**		**9,000**				

Dr.			*Sales Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount**	**Date**	**Particulars**	**JF**	**Amount**
2025				2025			
Jan-31	To Balance c/d		9,600	Jan-04	By Cash A/c		3,000
				" 9	By Raju's A/c		4,000
				" 15	By Balaram's A/c		2,600
			9,600				9,600
				Feb-01	**By Balance b/d**		**9,600**

Dr.			*Purchases Returns Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025				2025			
Jan-01	To Balance c/d		700	Jan-01	By Sriram's A/c		700
			700				700
				Feb-01	**By Balance b/d**		**700**

Dr.			*Sales Returns Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025				2025			
Jan 11	To Raju's A/c		600	Jan 31	By Balance c/d		600
			600				600
Feb-01	**To Balance b/d**		**600**				

Dr.			*Discount Allowed Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025 Jan-17	To Raju's A/c		20	2025 Jan-31	By Balance c/d		20
Feb-01	**To Balance b/d**		**20**				20

Dr.			*Discount Received Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025 Jan-31	To Balance c/d		40	2025 Jan-13	By Sriram's A/c		40
			40	**Feb-01**	**By Balance b/d**		**40**

Dr.			*Stationery Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025 Jan-18	To Cash A/c		300	2025 Jan-31	By Balance c/d		
			300				300
Feb-01	**To Balance b/d**		**300**				

Dr.			*Commission Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025				2025			
Jan-23	To Cash A/c		100	Jan-31	By Balance c/d		100
			100				100
Feb-01	**To Balance b/d**		**100**				

Dr.			*Drawings Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025 Jan-25	To Cash A/c		1,000	2025 Jan-31	By Balance c/d		1,000
			1,000				1,000

Dr.			*Salary Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025	To Cash A/c		900	2025	By Balance c/d		900
Jan-25			900	Jan-31			900
Feb-01	To Balance b/d		900				

Dr.			**Rent Account**				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025	To Cash A/c		300	2025	By Balance c/d		300
Jan-27			300	Jan-31			300
Feb-01	To Balance b/d		300				

Dr.			*Postage Account*				*Cr.*
Date	**Particulars**	**JF**	**Amount ₹**	**Date**	**Particulars**	**JF**	**Amount ₹**
2025	To Cash A/c		50	2025	By Balance c/d		50
Jan-30			50	Jan-31			50
Feb-01	To Balance b/d		50				

2.12 Cash Book

Cash book is meant for recording all cash transactions. It is a very important because the number of cash transactions is quite large in every business. The cash book is different from other Subsidiary Books because it has two sides i.e. Receipts and Payments. Hence, no further posting from the cash book is required.

Characteristic of Cash Book:

- It has two sides i.e. Receipts and Payments.
- It is maintaining bank transactions.

- It plays the both the role of Journal and a ledger.
- It shows each and every month cash and bank balances.
- It helps to avoid errors and frauds

Types of Cash Book

1. Simple Cash Book
2. Two-column Cash Book
3. Three-column Cash Book
4. Petty Cash Book.

2.13 Simple Cash Book

Meaning

A **Simple Cash Book** records only cash transactions. It contains one amount column on each side for cash. This type of cash book is suitable for small businesses where transactions involve only cash and no bank or discount columns are required.

Format

Single Column Cash Book					
Receipts (Debit Side)			**Payments (Credit Side)**		
Date	**Particulars**	**Cash (₹)**	**Date**	**Particulars**	**Cash (₹)**

Illustration

2025 Jan.1 – Mr. Raja started business and brought cash ₹100,000 as xapital

Jan 3 – Goods purchased for cash ₹25,000

Jan 8 – Goods sold for cash ₹30,000

Jan 10 – Rent paid ₹7,000

Single Column Cash Book									
Date	**Receipts**	**R.No.**	**L.F**	**Cash (₹)**	**Date**	**Payments**	**V.No.**	**L.F**	**Cash (₹)**
2025 Jan.1	To Capital A/c			1,00,000	2025 Jan 3	By Purchases A/c			25,000

Jan-08	To Sales A/c			30,000	Jan-10	By Rent A/c			7,000
					Jan-31	By Balance c/d			98,000
				1,30,000					**1,30,000**
Feb-01	To Balance b/d			**98,000**					

Advantages

- Simple to maintain.
- Suitable for small businesses.
- Easy preparation.
- Shows cash balance at any time.

2.14 Two Column Cash Book

This types of cash book has two columns: Cash column and Discount Column on either side of the cash book. Cash column is meant for recording cash receipts and payment while discount column is meant for recording discount allowed and discount received. If there are bank transactions, they can be entered in a separate bank account opened in the ledger and not in the cash book.

Cash received and discount allowed are entered on the debit side of the cash book and the cash paid and discount received are entered on the credit side of the cash book. Currency, cheques, drafts, postal orders and money orders received are treated as receipt of cash only, and entered on the debit side of the cash book in the cash column. However, if any party directly pays into our bank account it is treated as two transactions: i.e. receipt of cash from the party and deposit of the same into bank. Similarly, any payment by cheque it is also treated as two transactions i.e. withdrawal of cash from bank and payment of cash on account.

Difference between Trade Discount and Cash Discount:

- Trade discount is a deduction granted by a suppler from the list price of the goods due to large quantity of sales or business tradition. While cash discount is allowed by the creditor to the debtor for either buying in cash or for making payment before the stipulated period.

- Trade discount is allowed on sale of goods while cash discount is allowed on payment of money.
- Trade discount is not recorded in the books of account. The goods are recorded on the net price. While cash discount is shown in the books of account.
- Trade discount may vary with the quantity of goods purchased while cash discount may vary with the time period.

Format of Two Column Cash Book:

Two Column Cash Book									
Date	**Receipts**	**L.F**	**Discount**	**Cash (₹)**	**Date**	**Payments**	**L.F**	**Discount**	**Cash (₹)**

Illustration: Record the following transactions in the two column cash book:

2025 Jan.01 – Cash balance Rs.10,000

Jan 06– Goods purchased from Mukesh ₹6,000

Jan 8 – Goods sold to Mahesh ₹8,000

Jan 10 – Cash received from Mahesh 7,800 for full settlement

Jan 20 – Cash paid to Mukesh 5,800 for full settlement.

Two Column Cash Book									
Date	**Receipts**	**L.F**	**Discount**	**Cash (₹)**	**Date**	**Payments**	**L.F**	**Discount**	**Cash (₹)**
2025 Jan.1	To Balance b/d			10,000	2025 Jan 20	By Mukesh A/c		200	5,800
Jan-10	To Mahesh A/c		200	7,800	Jan-31	By Balance c/d			12,000
				17,800					**17,800**
Feb-01	To Balance b/d			**12,000**					

2.15 Three Column Cash Book

This type of cash book contains the following three columns on each side:

- Cash column for cash receipts and payments.
- Discount column for discount received and discount allowed
- Bank column for money deposited and money withdrawn from the bank.

The specimen for three column cash book:

Illustration: Record the following transactions in the two column cash book:

2025 Jan.01 – Opening balance: Cash ₹3,000 and Bank ₹4,000

Jan 04– Rent paid by cheque ₹2,000

Jan 06– Received on account of cash sales ₹3,000

Jan 08 – Paid to Mehta Bros. by cheque ₹2,000 and earned ₹200 as cash discount.

Jan 10 - Cheque received from Suresh 2,000 and allowed him ₹100 as cash discount.

Jan 12 – Cash sales ₹20,000

Jan 20 – Cash Purchases ₹15,000

Jan 31 – Salaries paid ₹5,000

Solution:

Three Column Cash Book											
Date	**Receipts**	**LF**	**Discount**	**Cash ₹**	**Bank ₹**	**Date**	**Payments**	**LF**	**Discount**	**Cash ₹**	**Bank ₹**
2025 Jan 01	To Balance b/d			3,000	4,000	**2025** Jan 06	By Rent A/c				2,000
Jan 06	To Sales A/c			3,000		Jan 08	By Metha A/c		200		2,000
Jan 10	To Suresh A/c		100		**2000**	Jan 20	By Purch.A/c			15,000	
Jan 12	To Suresh A/c			20,000		Jan 31	By Salaries A/c			5,000	
						Jan 31	By Balance b/d			6,000	2,000
			100	**26,000**	**6,000**	-	-	-	**200**	**26,000**	**6,000**
Feb 01	To Balance b/d			6,000	2,000						

Contra Entry: Three columnar cash book contains columns both for cash and bank transactions. An accounting transactions involves two accounts and there may be a transaction where both cash account and bank account are involved. Cash is withdrawn from bank, in the cash book debit side cash column will be entered the amount as "To Bank A/c" and the amount will be entered in the bank column credit side as "By Cash A/c". Such an accounting entry which is rtrecorded on both the debit and credit sides of the cash book is known as a "**Contra Entry".** No ledger posting is required for Contra Entry, the word **"C"** is put in the ledger folio column on both the sides of the Cash Book.

2.16 Petty Cash Book

Meaning

All petty expenditures are recorded in the Petty cash book. The business originations have to meet a lot of petty expenditures every day and it involves huge transactions. In case all these transactions are recorded in the Main Cash Book, their recording will be inconvenient and also time consuming. Hence, the petty cash book is usually maintained on the basis of Impress System. According to this system, a fixed amount is advanced to the Petty Cashier at the beginning of the period by the Chief Cashier. He submits his accounts at the end of the period and the amount spent by him during the period.

Format of a Petty Cash BooK							
Date	**Particulars**	**Voucher No.**	**Total Amount (₹)**	**Postage**	**Stationery**	**Conveyance**	**Miscella-neous**

Illustration: Prepare Petty Cash Book from the following transactions:

2025 Jan.01 – A cheque issued to the petty cashier as advance ₹200

Jan 04 – Paid for carriage ₹60

Jan 08 –. Postage – ₹50

Jan 10 – Stationery – ₹30

Jan 15 - Bus Fare – ₹15

Jan 20 – Tea Expenses – ₹40

Jan 31 – Courier Charges – ₹75

Petty Cash Book (Imprest system)

Amount Received ₹	Date	Particulars	Total (₹)	Carriage	Postage	Stationery	Conveyance	Sundry Exp.
300	2025 Jan 01	To Bank A/c						
	Jan 04	By Petrol	60	60				
	Jan 08	By Postage	50		50			
	Jan 10	By Stationery	30			30		
	Jan 15	By Bus Fare	15				15	
	Jan 20	By Tea	40					40
	Jan 31	By Courier	75		75	-	-	-
			240	**60**	**125**	**30**	**15**	**40**
		By Bal. c/d	**60**					
300			**300**					
60	Feb 01	**To Bal. b/d**						

2.17 Trial Balance

Definition

"A Trial Balance is a statement showing the balances of all ledger accounts on a particular date to test the mathematical accuracy of the accounting records".

Objectives of Preparing a Trial Balance

- To verify the arithmetic accuracy of ledger postings.
- To detect certain types of errors.
- To prepare financial statements.
- To summarize ledger balances.
- To provide a basis for preparing the Trading Account, Profit and Loss Account, and Balance Sheet.

The items of the trial balance can be classified under four broad categories which are mentioned below:

- All Expenses and Losses – appear in the **Debit side** of the Trial balance.
- All Incomes and Gains - appear in the **Credit side** of the trial balance
- Assets - appear in the **Debit side** of the trial balance
- Capital and Liabilities - appear in the **Credit side** of the trial balance

Specimen Trial Balance			
Account Name	**Ledger Folio**	**Debit (₹)**	**Credit (₹)**
Cash		xxx	
Purchases		xxx	
Furniture		xxx	
Sales			xxx
Capital			xxx
Creditors			xxx
Total		xxxx	xxxx

Advantages of Trial Balance

- Verifies the arithmetic accuracy of accounts.
- Facilitates preparation of final accounts.
- Helps locate certain accounting errors.
- Provides a summary of ledger balances.
- Saves time during auditing.
- Assists management in reviewing financial records.

Limitations of Trial Balance

A Trial Balance cannot detect all types of errors.

It does **not** reveal:

- Errors of omission.
- Errors of commission where debit and credit are equal.
- Errors of principle.
- Compensating errors.

- Errors of original entry when both debit and credit are incorrect by the same amount.

Therefore, agreement of the Trial Balance does not guarantee that the books are completely free from errors.

Trial Balance is explicit the following Errors:

- One-sided posting.
- Wrong totalling of ledger accounts.
- Wrong side posting of an account.
- Errors in carrying forward balances.

Trial Balance is not explicit the following Errors:

- Complete omission of a transaction.
- Recording both debit and credit with the same incorrect amount.
- Errors of principle.
- Compensating errors.
- Posting to the wrong account with the correct amount.

Practical Illustration

ABC Traders has the following ledger balances on 31 March:

Account	Amount (₹)
Cash	25,000 Dr.
Purchases	60,000 Dr.
Bank	15,000 Dr.
Furniture	20,000 Dr.
Sales	80,000 Cr.
Capital	25,000 Cr.
Creditors	15,000 Cr.

Trial Balance			
Account Name	**LF**	**Debit (₹)**	**Credit (₹)**
Cash		25,000	-
Purchases		60,000	-
Bank		15,000	

Furniture		20,000	-
Sales		-	80,000
Capital		-	25,000
Creditors		-	15,000
Total		**1,20,000**	**1,20,000**

These balances are entered into the Trial Balance. The total of the debit column should equal the total of the credit column, confirming the arithmetic accuracy of the ledger postings.

2.18 Chapter Summary

Subsidiary books are maintained to record transactions of a similar nature efficiently and systematically. They include the Purchases Book, Sales Book, Purchases Returns Book, Sales Returns Book, Bills Receivable Book, Bills Payable Book, Cash Book, and Journal Proper. These books simplify recording, facilitate division of work, and improve internal control. Transactions from subsidiary books are posted to the **Ledger**, which serves as the principal book of accounts. The **Cash Book** records cash and bank transactions and may be maintained as a single, double, or three-column cash book. Minor expenses are recorded in the **Petty Cash Book**, often maintained under the **Imprest System** for better control. Finally, ledger balances are summarized in a **Trial Balance**, which helps verify the arithmetic accuracy of the books and provides the foundation for preparing financial statements.

2.19 Multiple Choice Questions (MCQs)

1. Subsidiary books are also known as:
   (a) Books of Original Entry ✓
   (b) Final Accounts
   (c) Ledger Books
   (d) Cash Records
2. Credit purchases of goods are recorded in:
   (a) Sales Book
   (b) Purchases Book ✓
   (c) Journal Proper
   (d) Cash Book

3. The Ledger is known as the:
   (a) Principal Book ✓
   (b) Subsidiary Book
   (c) Cash Book
   (d) Journal Book
4. Which cash book contains cash, bank, and discount columns?
   (a) Single Column
   (b) Double Column
   (c) Three Column ✓
   (d) Petty Cash Book
5. The Imprest System is associated with:
   (a) Purchases Book
   (b) Sales Book
   (c) Petty Cash Book ✓
   (d) Ledger

Short-Answer Questions

1. What are subsidiary books?
2. Explain the purpose of the Purchases Book.
3. Distinguish between Sales Book and Sales Returns Book.
4. What is Journal Proper?
5. Define a Ledger.
6. Explain contra entries.
7. What is a Three-Column Cash Book?
8. What is the Imprest System?
9. Define a Trial Balance.
10. State any four limitations of a Trial Balance.

Long-Answer Questions

1. Explain the objectives and advantages of maintaining subsidiary books.
2. Describe the preparation and posting of the Purchases Book and Sales Book.

3. Explain the preparation of the Purchases Returns Book and Sales Returns Book.
4. Discuss the Bills Receivable Book and Bills Payable Book with suitable examples.
5. Explain the Ledger and the process of posting from subsidiary books.
6. Describe the preparation of Single, Double, and Three-Column Cash Books with illustrations.
7. Explain the preparation and advantages of the Petty Cash Book under the Imprest System.
8. What is a Trial Balance? Explain its methods of preparation, advantages, and limitations.
9. Distinguish between subsidiary books and principal books.
10. Explain the importance of the Trial Balance in the accounting process.

Exercise Problems:

1. Purchases Book

Enter the following transactions in the Purchases Book of M/s Modern Furniture Traders for the month of April 2026:

- **Apr 02:** Purchased from M/s Royal Wood Co. on credit (Invoice No. 101):
  - 20 Wooden Chairs @ ₹1,500 each
  - 5 Dining Tables @ ₹8,000 each
  - *Trade Discount: 10%*
- **Apr 10:** Purchased from M/s Steel Kraft Ltd. on credit (Invoice No. 240):
  - 10 Steel Almirahs @ ₹12,000 each
  - 15 Office Tables @ ₹4,000 each
  - *Trade Discount: 5%*
- **Apr 15:** Purchased computer printer for office use from Tech Supplies Co. on credit for ₹15,000 (Invoice No. 882).
- **Apr 22:** Purchased 5 Sofa Sets @ ₹25,000 each for cash from Comfort Seating Pvt. Ltd.

2. Sales Book

Record the following transactions in the Sales Book of M/s Alpha Electronics for the month of May 2026:

- **May 03:** Sold to M/s Premier Retailers on credit (Invoice No. 401):
  - 12 LED TVs @ ₹22,000 each
  - 8 Refrigerators @ ₹18,000 each
  - *Trade Discount: 10%*
- **May 11:** Sold to M/s City Dealers for cash (Invoice No. 402):
  - 5 Washing Machines @ ₹15,000 each
- **May 18:** Sold to M/s Apex Enterprises on credit (Invoice No. 403):
  - 15 Microwave Ovens @ ₹6,000 each
  - 10 Air Conditioners @ ₹35,000 each
  - *Trade Discount: 5%*
- **May 25:** Sold old office furniture on credit to Mr. Sharma for ₹8,000 (Invoice No. 404).

3. Purchases Returns Book

From the following details, prepare the Purchases Returns Book (Return Outwards Book) of M/s Zenith Cloth Store for June 2026:

- **Jun 08:** Returned to M/s Silk Fabrics Ltd. (Debit Note No. 12):
  - 5 Sarees @ ₹2,000 each (Inferior quality)
  - *Less: Trade discount received at time of purchase @ 10%*
- **Jun 17:** Returned to M/s Cotton Traders (Debit Note No. 13):
  - 20 meters Suiting @ ₹300 per meter (Damaged in transit)
- **Jun 25:** Returned 2 office chairs to Furnish Mart for cash ₹3,000 (Debit Note No. 14).

4. Sales Returns Book

Prepare the Sales Returns Book (Return Inwards Book) of M/s National Garments for July 2026:

- **Jul 05:** Goods returned by M/s Smart Wear (Credit Note No. 81):
  - 10 Shirts @ ₹800 each
  - *Less: Trade discount allowed @ 5%*
- **Jul 14:** Goods returned by M/s Fashion Point (Credit Note No. 82):
  - 5 Jackets @ ₹2,500 each (Not according to specifications)

- **Jul 20:** Returned goods to supplier M/s Style Mills amounting to ₹4,000.

5. Bills Receivable Book

Draw up the Bills Receivable Book of M/s Sterling Traders from the following particulars for August 2026:

- **Aug 04:** Received a 3-month acceptance from Ramesh & Co. dated Aug 02 for ₹25,000, payable at SBI Main Branch.
- **Aug 12:** Received a 2-month bill from Suresh Traders accepted on Aug 10 for ₹18,000, payable at PNB.
- **Aug 22:** Drew a bill for ₹30,000 on Vijay Enterprises payable 60 days after date, accepted on Aug 24, payable at Canara Bank.

6. Bills Payable Book

Prepare the Bills Payable Book of M/s Lotus Enterprise from the following details for September 2026:

- **Sep 03:** Accepted a 2-month bill drawn by M/s Global Suppliers for ₹40,000, payable at HDFC Bank.
- **Sep 15:** Accepted a 3-month bill drawn by M/s Universal Traders for ₹15,000, payable at ICICI Bank.
- **Sep 28:** Accepted a 30-day bill drawn by M/s Apex Mills for ₹22,000, payable at Axis Bank.

7. Journal Book

Journalize the following transactions in the books of M/s Apex Traders for January 2026:

- **Jan 01:** Started business with cash ₹2,000,000 and goods worth ₹50,000.
- **Jan 05:** Opened a bank account with HDFC Bank by depositing ₹1,20,000.
- **Jan 09:** Purchased machinery from HMT Ltd. for ₹80,000; paid installation charges ₹5,000 in cash.
- **Jan 14:** Sold goods to Rohan worth ₹40,000 at a trade discount of 10%.
- **Jan 20:** Received ₹35,500 from Rohan in full settlement of his account.
- **Jan 25:** Goods worth ₹3,000 distributed as free samples and goods worth ₹2,000 withdrawn by proprietor for personal use.

- **Jan 31:** Paid salaries ₹12,000 and rent unpaid ₹4,000.

8. Ledger Book

From the following transactions, prepare the **Purchases Account**, **Sales Account**, and **Rahul's Account** in the Ledger of M/s Crown Stores for February 2026:

- **Feb 01:** Purchased goods from Rahul on credit for ₹30,000.
- **Feb 06:** Sold goods to Rahul on credit for ₹18,000.
- **Feb 12:** Returned goods to Rahul worth ₹4,000.
- **Feb 18:** Received goods returned by Rahul worth ₹2,000.
- **Feb 24:** Paid cash to Rahul ₹25,000.
- **Feb 28:** Received cash from Rahul ₹15,000.

9. Single Column Cash Book

Prepare a Single Column Cash Book from the following transactions of Mr. Kapoor for March 2026:

- **Mar 01:** Cash in hand ₹45,000.
- **Mar 04:** Purchased goods for cash ₹12,000.
- **Mar 08:** Sold goods for cash ₹28,000.
- **Mar 13:** Received from Sunita ₹9,500.
- **Mar 17:** Paid to General Suppliers ₹14,000.
- **Mar 22:** Paid electricity bill ₹2,200.
- **Mar 27:** Purchased stationery for office use ₹800.
- **Mar 31:** Paid salaries ₹8,000.

10. Double Column Cash Book (Cash & Discount Columns)

Enter the following transactions in a Two-Column Cash Book (Cash and Discount) of M/s Green Line Traders for October 2026:

- **Oct 01:** Cash balance in hand ₹38,000.
- **Oct 05:** Received cash from Amit ₹14,700 and allowed him a discount of ₹300.
- **Oct 10:** Paid cash to Bharat ₹8,800 who allowed us a discount of ₹200.
- **Oct 16:** Cash sales ₹21,000.
- **Oct 21:** Paid to Devendra ₹11,500 in full settlement of his account of ₹12,000.

- **Oct 27:** Received from Chetan ₹9,800 in full settlement of his debt of ₹10,000.
- **Oct 31:** Paid office rent ₹5,000.

11. Three Column Cash Book (Cash, Bank & Discount Columns)

Prepare a Three Column Cash Book (Cash, Bank, and Discount columns) of M/s Vibrant Enterprises for November 2026:

- **Nov 01:** Cash in hand ₹15,000; Bank balance (overdraft) ₹6,000.
- **Nov 04:** Cheque received from Priya for ₹19,400; discount allowed to her ₹600.
- **Nov 07:** Deposited Priya's cheque into bank.
- **Nov 11:** Paid to supplier M/s Mehta Bros. by cheque ₹14,200 in full settlement of ₹14,500.
- **Nov 16:** Cash withdrawn from bank for office use ₹5,000.
- **Nov 20:** Sold goods to Vikrant for cash ₹12,000 and deposited ₹8,000 directly into bank.
- **Nov 25:** Priya's cheque dishonoured by bank; bank charges incurred ₹100.
- **Nov 30:** Paid rent by cheque ₹4,000 and cash salaries ₹6,000.

12. Petty Cash Book (Imprest System)

Prepare an Analytical Petty Cash Book under the Imprest System for December 2026 from the following information (Imprest Amount = ₹5,000):

- **Dec 01:** Received cash from main cashier towards imprest ₹5,000.
- **Dec 03:** Paid taxi fare for manager ₹350.
- **Dec 05:** Paid postage stamps ₹180.
- **Dec 08:** Purchased courier envelopes & registers ₹240.
- **Dec 12:** Paid cartage on purchases ₹150.
- **Dec 15:** Paid bus fare to peon ₹60.
- **Dec 19:** Paid for refreshment to clients ₹280.
- **Dec 23:** Paid telegram charges ₹120.
- **Dec 27:** Purchased speed post covers ₹200.
- **Dec 30:** Paid repair charges on office typewriter ₹450.
- **Dec 31:** Reimbursed total expenses from main cashier to restore imprest.

13. Trial Balance

From the following ledger balances extracted from the books of M/s Pinnacle Solutions as of March 31, 2026, prepare a Trial Balance:

Account Title	Amount (₹)
Capital	2,50,000
Drawings	18,000
Opening Stock (01-04-2025)	45,000
Machinery	1,80,000
Purchases	2,10,000
Sales	3,80,000
Purchases Returns	5,000
Sales Returns	8,000
Sundry Debtors	65,000
Sundry Creditors	42,000
Bank Overdraft	25,000
Wages	24,000
Salaries	36,000
Commission Received	6,000
Rent & Rates	12,000
Cash in Hand	10,000
Discount Allowed	3,000
Discount Received	3,000

Notes

UNIT – III

Final Accounts

3.1 Learning Objectives:

After studying this unit the students will be able to:

- **Prepare the Trading Account:** Calculate gross profit or loss by accurately accounting for direct expenses, purchases, sales, and closing stock.
- **Construct the Profit & Loss Account:** Determine net profit or loss by recording indirect expenses, operating costs, and revenue items.
- **Draft the Balance Sheet:** Present the financial position of a business by properly classifying assets, liabilities, and owner's equity.
- **Process Year-End Adjustments:** Account for accruals, prepayments, depreciation (Straight Line and Written Down Value methods), bad debts, and provisions to ensure revenues and expenses match the correct accounting period.

3.2 Introduction to Financial Statements

At the close of every accounting period, a business entity must synthesize its transactional data into structured financial summaries. These summaries are collectively called **Final Accounts**.

Final accounts serve two main purposes:

- **Performance Evaluation:** Determining whether operational activities resulted in a profit or loss.
- **Position Assessment:** Displaying the economic resources owned (assets) and the obligations owed (liabilities) on a specific date.

The cycle begins with raw transaction entries, moves to ledger accounts, synthesizes into a **Trial Balance**, and culminates in the preparation of three primary statements:

1. **Trading Account**
2. **Profit & Loss Account**
3. **Balance Sheet**

Popularly, the Trading and Profit & Loss Account and the Balance Sheet are together called the ***final accounts***. The trading and profit & loss account is prepared to show the financial results of a business, may be in the form of profit or loss during an ***accounting period*** or year. Balance sheet is prepared to show the financial position or conditions of business in terms of position of ***assets and liabilities*** of a business as on a particular date.

3.2 Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods. End result of trading account is ***gross profit*** or gross loss. Following are format for Trading Account. The primary purpose of the **Trading Account** is to calculate the **Gross Profit** or **Gross Loss** generated directly from buying, manufacturing, and selling goods or core services.

Core Components

- **Opening Stock:** The inventory remaining from the prior accounting period available at the start of the current period.
- **Purchases & Purchase Returns:** Total inventory acquired for resale, less any goods returned to suppliers due to defects or excess delivery.
- **Direct Expenses:** Costs directly tied to bringing inventory into a saleable condition or location. Examples include factory wages, carriage inward, freight, customs duty, and factory power.
- **Sales & Sales Returns:** Total gross revenue earned from selling goods, minus returns from customers.
- **Closing Stock:** Inventory remaining unsold at the end of the current period

Trading Account of Mr. X for the Year ending ----------			
Dr. (Debit)	**Amount ₹**	**Cr. (Credit)**	**Amount ₹**
To Opening Stock	XXX	**By Sales**	XXX
To Purchases	XXX	*Less: Sales Returns*	(XXX)
Less: Purchase Returns	(XXX)	**By Closing Stock**	XXX

To Direct Expenses:		**By Gross Loss** *(transferred to P&L)*	XXX
Wages	XXX		
Freight & Carriage Inward	XXX		
Manufacturing Expenses/ Packing charges/Octroi Duty	XXX		
Import Duty / Custom Duty/ Clearing charges/Dock dues	XXX		
Power (factory)			
To Gross Profit *(transferred to P&L)*	XXX		
Total	**XXXX**	**Total**	**XXXX**

3.3 Profit and Loss Account

The **Profit & Loss (P&L) Account** takes the Gross Profit (or Gross Loss) from the Trading Account and incorporates all indirect costs and secondary revenues to establish the final **Net Profit** or **Net Loss**. If the debit side of Profit and Loss a/c exceeds the Gross profit, the result will be **Net profit**. The Gross profit or credit side of the Profit and Loss Ac exceeds the debit side of P & L A/c is called **Net Loss**.

Categorization of Indirect Items

1. **Indirect Expenses (Debited)**
   - **Administrative & Office Expenses:** Management salaries, office rent, utility bills, legal fees, stationery, and printing.
   - **Selling & Distribution Expenses:** Advertising costs, sales commission, carriage outward, showroom rent, and delivery vehicle maintenance.
   - **Financial Expenses:** Bank charges, loan interest, and discount allowed to customers.
   - **Non-Cash & Extraordinary Expenses:** Depreciation of fixed assets, bad debt write-offs, and provisions for doubtful accounts.
2. **Indirect Incomes (Credited)**
   - **Operating Incomes:** Discounts received from suppliers and commissions earned.

- **Non-Operating Incomes:** Interest received on investments, rental income from spare property, dividend income, and profit on sale of assets.

Specimen of Profit and Loss Account			
Expenses & Losses	**Amount ₹**	**Incomes & Gains**	**Amount ₹**
To Gross Loss *(b/f from Trading A/c)*	XX	By Gross Profit *(b/f from Trading A/c)*	XX
To Selling & Distribution Expenses:		**By Other Operating Incomes:**	
Salaries & Wages	XX	Rent Received	XX
Rent, Rates & Taxes	XX	Commission Received	XX
Printing & Stationery	XX	Discount Received	XX
Postage & Telegrams	XX	Interest Received	XX
Insurance	XX	Dividend Received	XX
Repairs & Maintenance	XX		
Advertising & Marketing	XX	**Non-Operating Incomes:**	
Carriage Outwards	XX	Profit on Sale of Assets	XX
Bad Debts	XX	Interest on Investments	XX
Provision for Bad Debts	XX	Miscellaneous Income	XX
Discount Allowed	XX		
Depreciation on Fixed Assets	XX		
To Non-Operating Expenses:			
Interest on Loans/ Capital	XX		
Loss on Sale of Assets	XX		
Bank Charges	XX		
Net Profit *(transferred to Capital)*	**XX**	**Net Loss** *(transferred to Capital)*	**XX**
Total	**XXX**	**Total**	**XXX**

3.4 The Balance Sheet

Balance sheet is prepared by taking up all personal accounts and real accounts (assets and properties) together with the net result obtained from profit and loss account. On the left hand side of the statement, the liabilities and capital are shown. On the right hand side, all the assets are shown. Balance sheet is not an account but it is a statement prepared from the ledger balances. Balance sheet is defined as 'a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date'. The preparation of Balance Sheet is based on **Accounting Equation i.e.** Assets = Capital + Liabilities

Asset Classifications

- **Fixed / Non-Current Assets:** Long-term assets acquired for operational use rather than resale (e.g., Property, Plant, and Equipment).
- **Current Assets:** Cash and assets expected to be converted into cash within one operating cycle (e.g., Cash at Bank, Sundry Debtors, Closing Stock, and Prepaid Expenses).

Liability & Equity Classifications

- **Capital (Owner's Equity):** Net ownership claim after adjusting for capital contributions, net income, and drawings.
- **Non-Current Liabilities:** Obligations maturing beyond one year (e.g., term loans, mortgages).
- **Current Liabilities:** Short-term obligations due within one year (e.g., Trade Creditors, Bills Payable, Accrued Expenses).

Specimen of Balance Sheet of Mr. X as on 31st December/March -------			
Liabilities & Capital	**Amount ₹**	**Assets**	**Amount ₹**
Capital & Owner's Equity:		**Fixed / Non-Current Assets:**	
Opening Capital	XX	Land & Buildings	XX
Add: Net Profit / *Less:* Net Loss	XX	Plant & Machinery	XX
Add: Additional Capital	XX	Furniture & Fixtures	XX

Less: Drawings	(XX)	Vehicles	XX
Reserves & Surplus:		Patents & Trademarks	XX
General Reserve	XX	**Investments:**	
Retained Earnings	XX	Long-term Investments	XX
Non-Current Liabilities:		**Current Assets:**	
Long-term Loans / Mortgage	XX	Closing Stock / Inventory	XX
Debentures / Bonds Payable	XX	Sundry Debtors / Accounts Receivable	XX
Current Liabilities:		*Less:* Provision for Bad Debts	(XX)
Sundry Creditors / Accounts Payable	XX	Bills Receivable	XX
Bills Payable	XX	Prepaid Expenses	XX
Outstanding Expenses	XX	Accrued Income	XX
Short-term Bank Loans / Overdraft	XX	Cash at Bank	XX
Income Received in Advance	XX	Cash in Hand	XX
Total	**XXX**	**Total**	**XXX**

Year-End Accounting Adjustments

Financial reporting relies on the **Accrual Concept** and the **Matching Principle**:

- **Accrual Concept:** Revenues and expenses are recognized when earned or incurred, regardless of cash flow timing.
- **Matching Principle:** Expenses incurred to generate revenue must be matched against that revenue in the same period.

Essential Rules for Adjustment Entries

1. **Trial Balance Items:** Any value stated inside the Trial Balance has already received a double-entry posting. It appears **once** in the Final Accounts.

2. **Adjustment Items:** Information provided outside the Trial Balance represents unrecorded events. It must be posted **twice** (one Debit, one Credit).

3.5 Adjustment Entries

Meaning and Need if Adjustment Entries:

Transactions omitted relate to the current year must be entered in books. If a transaction entered is not related to the current year, fully or partly, that portion of income or expense must be excluded. This process is made through adjustment entries in the books of accounts. If we ignore to make the necessary adjustments, the trading, profit & loss accounts do not show the true profit or loss and in consequence balance sheet fails to depict true financial position of the business. This situation defeats the very purpose of final accounts. Hence, adjustment entries play an important role in presenting correct picture of accounts.

Accounting Treatment:

Trading and Profit and Loss and Balance sheet, together, are called as final accounts. Item appearing in the trial balance appears only once in final accounts, either on the debit or credit. Any adjustment entry requires two postings, debit and credit for the same amount. Important point is students should do the posting (debit and credit) in the concerned accounts, simultaneously.

3.5.1 Closing Stock:

Every concern prepares a list of unsold goods at the end of the period and puts value against it. It is to be remembered that stock is valued at cost or market price, whichever is less.

Accounting Treatment:

- The Closing ***Stock appears below the Trial Balance as an adjustment entry:*** The Closing Stock must be shown in the credit side of Trading and also it will be shown in the Assets side of Balance Sheet under the head of Current Assets.

For example, if the value of stock at the end of the period is Rs. 30,000 and is shown below the trial balance, then the following adjusting entry will be passed:

Closing Stock A/c … Dr. 30,000

To Trading Account 30,000

The two-fold effect of this entry will be:

(i) Stock will have a debit balance. Being a real account, it will be shown on the assets side of the Balance Sheet.

(ii) Closing stock will be shown on the credit side of the Trading Account

Trading Account for the year ending…..			
Particulars	**Amount**	**Particulars**	**Amount**
		By Closing Stock	**30,000**
Balance Sheet as on …….			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets: Closing Stock	**30,000**

3.5.2 Outstanding Expenses:

There are certain expenses, which have been incurred but not paid. These expenses are called outstanding expenses.

Accounting Treatment:

- ***If the outstanding expenses appears below the Trial Balance as an adjustment entry:*** The outstanding expenses must be added to the respective expenses appear in the **debit side of Trading and P&L A/c** and also it will be shown in the **Liabilities side of Balance Sheet** under the head of Current Liability.
- ***If the outstanding expenses appears in the Trial balance itself:*** The outstanding expenses must be shown in the Liabilities side of Balance sheet only.

For example, salary to the clerk Rs. 10,000 is due for the month of December. Books are closed at the end of December. In order to bring this transaction into accounts, the following adjustment entry will be passed:

Salary Account …..Dr. Rs. 10,000

To Outstanding Salary A/c. Rs. 10,000

The two fold effect of this entry will be:

(i) Outstanding salary will be added to salary, if any, on the debit side of Profit & Loss Account.

(ii) Outstanding Salary Account, being personal and having credit balance, will be shown on the liabilities side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount**	**Particulars**	**Amount**
To Salary A/c xxxxx Add: **Outstanding Salary A/c 10,000**	**10,000**		
Balance Sheet as on …….			
Liabilities	**Amount**	**Assets**	**Amount**
Current Liabilities: **Outstanding Salary**	**10,000**		

3.5.3 Prepaid or Unexpired Expenses:

Those expenses which have been paid, in full, but their utility or benefit has not expired during the accounting period are called prepaid or unexpired expenses.

Accounting Treatment:

- ***If the Prepaid expenses appears below the Trial Balance as an adjustment entry:*** The prepaid expenses must be deducted from the respective expenses appear in the **debit side of P&L A/c** and also it will be shown in the **Assets side of Balance Sheet** under the head of Current Assets.
- ***If the Prepaid expenses appears in the Trial balance itself:*** The prepaid expenses must be shown in the Assets side of Balance sheet only.

For example, Annual Insurance premium Rs. 12,000 is paid on 1st July, where accounting year closes on 31st December. Rs. 6000 will be insurance paid in advance. To bring this into account, the following adjusting entry will be passed:

Prepaid Insurance Premium Account…..Dr. Rs. 6,000

To Insurance Premium Rs. 6,000

The double effect of this adjusting entry will be:

(i) Prepaid insurance will be deducted from the insurance premium on the debit side of the Profit & Loss Account.

(ii) Prepaid insurance, being personal account and having debit balance, will be shown on the assets side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Insurance A/c 12,000 Less: **Prepaid Insurance A/c** **6,000**	**6,000**		
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
		Current Assets: **Prepaid Insurance A/c**	**6,000**

3.5.4 Accrued Income:

Income earned but not received during the accounting period is called accrued Income.

Accounting Treatment:

- ***If the Accrued Income appears below the Trial Balance as an adjustment entry:*** The accrued income must be added to the respective income appear in the **credit side of P&L A/c** and also it will be added to the respective investment account shown in the **Assets side of Balance Sheet**.
- ***If the Accrued Income appears in the Trial balance itself:*** The accrued income must be shown in the Assets side of Balance sheet only.

Example: the interest on investments shown in the trial balance is Rs. 19,500. The adjustment may run like this. Interest @10% is due on investments of Rs. 10,000 for 6 months, though accrued, has not been yet been received. This interest Rs. 500 will be accrued income. In order to bring this into account, the following adjusting entry will be passed:

Accrued Interest on Investments Account …..Dr. Rs. 500

To Interest on Investment Account Rs. 500

The two fold effect of this entry will be:

(i) Interest on Investment account (accrued interest) will be added to the interest account on the credit side of the profit & loss account.

(ii) Accrued interest will be added to the Investment a/c on the assets side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
		By Interest on Investment A/c 19,500 **Add: Accrued Interest A/c** 500	**20,000**
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
		Investment A/c 10,000 **Add: Accrued Interest A/c** **500**	**10,500**

3.5.5 Unearned Income or Income Received in Advance:

During the year, the amount received in advance as income but rendering service will be in the following year is called as Income received in advance or Unearned Income. It is to be treated as liability for rendering service.

Accounting Treatment:

- ***If the Unearned Income appears below the Trial Balance as an adjustment entry:*** The unearned income must be deducted from the respective income appear in the **credit side of P&L A/c** and also it will be shown in the **Liabilities side of Balance Sheet** under the head of Current Assets.
- ***If the Unearned Income appears in the Trial balance itself:*** **The unearned income must** be shown in the **Liabilities** side of Balance sheet only.

2.1.1 ***Example:*** Suppose a landlord collects rent for one quarter, in advance, and closes his account on 30th June each year. Suppose, a tenant has occupied a house on 1st June and pays Rs. 1,800 as rent for 3 months. The landlord must not treat the whole of the rent received as income for the current year. Two months' rent pertains to the next year and should be credited to the Profit and Loss Account of next year. This will ensure that the income for the current year is not overstated. The required entry is:

Rent Account ….Dr. **Rs. 1,200**

To Rent Received in Advance Account **Rs. 1,200**

The double effect of this adjusting entry will be:

(i) Rent Received in advance account will be deducted from the Rent received account on the credit side of the Profit & Loss Account.

(ii) Rent Received in advance account is a liability and having credit balance, will be shown on the Liabilities side of the Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
		By Rent A/c 1,800 **Add: Rent Received in Advance A/c** **1,200**	**600**
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
Current Liabilities: **Rent Received in Advance A/c**	**1,200**		

3.5.6 Depreciation:

The value of fixed assets goes on reducing year by year because of wear, tear and efflux of time. This reduction in the value of assets should be treated as a loss or expense, to be considered before profit or loss is ascertained. The value to be shown in the Balance Sheet must also be reduced.

***Needs to provide depreciation*:**

- To ascertain the true profit during a year, it is desirable to charge depreciation.
- To ascertain the true value of assets, depreciation should be charged. Without calculating the correct value of assets, we cannot ascertain the true financial position of a company.
- Instead of withdrawal of overstated profit, it is desirable to make provisions to buy new assets to replace old asset. The accumulated value of depreciation provides additional working capital.

- Depreciation helps in ascertaining uniform profit in each accounting year.
- Depreciation allows to take the advantage of tax benefit.

Depreciation can be calculated by using various methods, among that the below mentioned method is most popular:

(a) Straight Line Method and

(b) Written Down Value Method.

(a) **Straight Line Method**:

It is otherwise called Fixed Percentage on Original Cost Method or Fixed Installment Method. Under this method, a suitable percentage of original cost is written off the asset annually.

$$\text{Depreciation} = \frac{\text{Cost of Assets- Scrap Value of Assets}}{\text{Estimated Life of Assets}}$$

Example: if an asset costs is Rs. 100,000/- and depreciation rate is 10% per annum then the amount of depreciation is Rs. 10,000 will be provided every year if scrap value of the asset at the end of its estimate life of 10 years is considered to be nil. To ascertain annual depreciation, the following formula may be remembered:

$$\frac{1,00,000 - 0}{10 \text{ Years}} = 10,000$$

(b) Written Down Value Method:

According to the Diminishing Balance Method, depreciation is charged at a fixed percentage on the book value of the asset. As the book value reduces every year, it is also known as the Reducing Balance Method or Written-down Value Method. Since the book value reduces every year, hence the amount of depreciation also reduces every year. Under this method, the value of the asset never reduces to zero.

Formulae are as follows: ***Amount of depreciation = (Book Value x Rate of Depreciation) / 100***

$$\text{Depreciation Rate} = 100\left(1 - n\sqrt{\frac{S}{C}}\right) \quad \text{where } n = \text{number of years}$$

S = Salvage value

C = Cost of asset

Accounting Treatment:

- ***If the Depreciation appears below the Trial Balance as an adjustment entry:*** The depreciation is to be treated as an expenses hence, it must be shown in the **debit side of P&L A/c** and also it is to be deducted from the respective account in the **Assets side of Balance Sheet**.
- ***If the Depreciation appears in the Trial balance itself:*** The depreciation must be shown in the debit side of P&L A/c only.

Example: Depreciation is usually computed on the basis of the life of the assets. Suppose, a machine costs Rs. 1,00,000 and has a life of 5 years. Then, each year 1/5th of the cost, i.e., Rs. 20,000 should be treated as an expense; only the remaining amount is to be shown in the balance sheet. The entry is:

Depreciation Account …Dr. 20,000

To Machinery Account 20,000

The double effect of this adjusting entry will be:

(i) Depreciation is debited to the Profit & Loss Account.

(ii) Depreciation is to be deducted from the respective Assets Account in the Assets side of Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Depreciation on Machinery A/c	**20,000**		
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
		Machinery A/c 1,00,000 **Less: Depreciation A/c 20,000**	**80,000**

3.5.7 Interest on Capital

The proprietor may wish to ascertain his profit, after considering the interest for the amount invested in the firm.

Accounting Treatment:

- ***If the Interest on Capital appears below the Trial Balance as an adjustment entry:*** The Interest on Capital is to be treated as an

expenses hence, it must be shown in the **debit side of P&L A/c** and also it is to be added to the Capital Account in the **Liabilities side of Balance Sheet**.

- ***If the Interest on Capital appears in the Trial balance itself:*** The Interest on Capital must be shown in the debit side of P&L A/c only.

Suppose, the capital is Rs. 2,00,000 and the rate of interest is 5%. Then, the interest will be Rs. 10,000. It will be treated like other expenses and debited to the Profit and Loss Account; the amount will also be credited to the Capital Account.

The entry is:

Interest on Capital Account …Dr. 10,000

To Capital Account 10,000

The double effect of this adjusting entry will be:

(i) Interest on Capital is debited to the Profit & Loss Account.

(ii) Interest on Capital is to be added to the Capital Account in the Liabilities side of Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Interest on Capital A/c	**10,000**		
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
Capital 2,00,000 **Add: Interest on capital** **10,000**	**2,10,000**		

3.5.8 Interest on Drawings:

The proprietor may also realize that when he draws money for private use, the firm loses interest as funds for business are reduced. Therefore, the proprietor's capital may be debited with the interest on the money drawn by him. Interest will depend on the amount and the date of withdrawal concerned.

Accounting Treatment:

- ***If the Interest on Drawings appears below the Trial Balance as an adjustment entry:*** The Interest on Drawings is to be treated as an

income to the business hence, it must be shown in the **Credit of P&L A/c** and also it is to be deducted from the Capital Account in the **Liabilities side of Balance Sheet**.

- ***If the Interest on Drawings appears in the Trial balance itself:*** The Interest on Drawings must be shown in the **Credit side** of P & L A/c only.

In absence of information about the date of drawings, it should be assumed that the drawings were made, evenly, throughout the year; therefore, interest should be charged for six months on the full amount. Suppose, capital is Rs. 2,00,000 and the total drawings are Rs. 10,000. The rate of interest is 6% on the drawings. So, interest @ 6% for six months on drawings Rs. 10,000 will be Rs. 300.

The entry to be passed is:

Interest on Drawings ...Dr. Rs. 300

To Profit & Loss Account Rs. 300

The double effect of this adjusting entry will be:

(i) Interest on drawings is credited to the Profit & Loss Account.

(ii) Interest on drawings is to be deducted from the Capital Account in the Liabilities side of Balance Sheet.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
		By Interest on Drawings A/c	**300**
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
Capital 2,00,000 **Less: Drawing 10,0 00** **Less: Interest on drawings 300**	**1,89,700**		

3.5.9 Bad Debts:

An unrecovered debt is called as Bad Debt and it occur, when there are credit sales. The following journal entry should, therefore, be passed in the event of a debt becoming bad.

Bad Debts A/c Dr.

To Debtor's Personal A/c

Accounting Treatment:

- ***If the Bad Debts appears below the Trial Balance as an adjustment entry:*** The Bad Debts is to be treated as loss to the business hence, it must be shown in the **Debit of P&L A/c** and also it is to be deducted from Debtors Account in the **Assets side of Balance Sheet**.
- ***If the Bad Debts appears in the Trial balance itself:*** The Bad debts must be shown in the Debit side of P & L A/c only.

e.g. Kalyan & Co. has been running its cloth business. At the end of Dec. 2008, the firm's books of accounts show the debtors at Rs. 4,00,000. Out of those debtors, Rs. 20,000 have been recognized as bad debts.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Bad Debts A/c	**20,000**		
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
		Debtors A/c 4,00,000 **Less: Bad Debts A/c** **20,000**	**3,80,000**

3.5.10 Provision for Bad and Doubtful Debts:

Prudent accounting principle is to make provision for expected losses. All credit sales would not be realized in the year in which the sales are made. A firm, therefore, makes provision at the end of the accounting year, for likely bad debts, which may happen during the course of the next year.

The following journal entry is passed for creating a provision for Bad debts and Doubtful Debts.

Profit & Loss A/c Dr.

To Provision for Bad and Doubtful Debts

The provision for bad and doubtful debts is charged to the Profit & Loss Account and is to be deducted from debtors in the Balance Sheet.

Accounting Treatment:

- ***If the Provision for Bad and Doubtful Debts appears below the Trial Balance as an adjustment entry:*** The Provision for Bad and Doubtful Debts is to be treated as loss to the business hence, it must

be shown in the **Debit of P&L A/c** and also it is to be deducted from Debtors Account in the **Assets side of Balance Sheet**.

- ***If the Provision for Bad and Doubtful Debts appears in the Trial balance itself:*** The Provision for Bad and Doubtful Debts is given in the trial balance then it is treated as old provision and it must be either shown in the credit side of P&L A/c or deducted from Bad Debts in the Debit side of P & L A/c only.

Calculation of Provision for Bad and Doubtful Debts:

Normally, problem states the % of Provision for Bad and Doubtful Debts. On which amount of debtors, this % of Provision for Bad and Doubtful Debts is to be calculated?

Provision for Bad and Doubtful Debts is to be calculated on that amount of debtors, after deducting bad debts written off given in the adjustments.

Profit and Loss Account for the year ending…..			
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Provision for Bad and Doubtful Debts A/c (New Provision)			
Balance Sheet as on …….			
Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
		Debtors A/c **Less: Provision for Bad and Doubtful Debts**	

3.6 Comprehensive Adjustment Summary Matrix

This master reference table summarizes the dual impact of every major adjustment across financial statements:

Sl. No.	Adjustment Item	Primary Accounting Impact (Trading / P&L)	Secondary Accounting Impact (Balance Sheet)
1	**Closing Stock**	Credited to **Trading A/c**	Shown under **Current Assets**

2	**Depreciation (SLM or WDV)**	Debited to **P&L A/c**	Deducted from the respective **Fixed Asset**
3	**Further Bad Debts**	Debited to **P&L A/c**	Deducted from **Sundry Debtors**
4	**New Provision for Bad Debts**	Debited to **P&L A/c** *(via formula)*	Deducted from **Sundry Debtors**
5	**Outstanding Expenses**	Added to the respective expense in **Trading/P&L**	Shown under **Current Liabilities**
6	**Prepaid Expenses**	Deducted from the respective expense in **Trading/P&L**	Shown under **Current Assets**
7	**Accrued Income**	Added to the respective income in **P&L**	Shown under **Current Assets**
8	**Income Received in Advance**	Deducted from the respective income in **P&L**	

Illustration:1 From the following Trial Balance of **M/s Sharma Traders** as on March 31, 2025, prepare the **Trading Account**, **Profit and Loss Account** for the year ended March 31, 2025, and the **Balance Sheet** as on that date:

Trial Balance as on March 31, 2025		
Particulars	**Debit (₹)**	**Credit (₹)**
Capital	—	1,00,000
Drawings	10,000	—
Purchases & Sales	75,000	1,50,000
Returns (Inward & Outward)	2,000	1,000
Opening Stock	20,000	—
Carriage Inward	3,000	—
Wages	12,000	—
Salaries	18,000	—
Rent & Rates	6,000	—

Discount Allowed & Received	1,200	800
Sundry Debtors & Creditors	40,000	25,000
Machinery	60,000	—
Cash in Hand	29,600	—
Total	**2,76,800**	**2,76,800**

Adjustments:

1. **Closing Stock** as on March 31, 2025, is valued at ₹25,000.
2. **Outstanding Wages** amount to ₹2,000.
3. **Prepaid Rent** amounts to ₹1,000.
4. Depreciate **Machinery** at 10% per annum.
5. Create a **Provision for Bad Debts** at 5% on Sundry Debtors.

Solution:

Trading and Profit and Loss Account For the year ended March 31, 2025					
Particulars	**Amount (₹)**	**Amount (₹)**	**Particulars**	**Amount (₹)**	**Amount (₹)**
To Opening Stock		20,000	By Sales	1,50,000	
To Purchases	75,000		*Less:* Returns Inward	–2,000	1,48,000
Less: Returns Outward	–1,000	74,000	By Closing Stock		25,000
To Carriage Inward		3,000			
To Wages	12,000				
Add: Outstanding Wages	2,000	14,000			
To Gross Profit c/d *(Balancing figure)*		**62,000**			
Total		**1,73,000**	**Total**		**1,73,000**

To Salaries		18,000	By Gross Profit b/d		62,000
To Rent & Rates	6,000		By Discount Received		800
Less: Prepaid Rent	–1,000	5,000			
To Discount Allowed		1,200			
To Depreciation on Machinery (10% of ₹60,000)		6,000			
To Provision for Bad Debts (5% of ₹40,000)		2,000			
To Net Profit *(Transferred to Capital)*		**30,600**			
Total		**62,800**	**Total**		**62,800**

Balance Sheet as on March 31, 2025

Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**	**Amount (₹)**
Capital	1,00,000		Fixed Assets:		
Add: Net Profit	30,600		Machinery	60,000	
	1,30,600		*Less:* Depreciation	–6,000	54,000
Less: Drawings	–10,000	1,20,600			
			Current Assets:		
Current Liabilities:			Sundry Debtors	40,000	
Sundry Creditors		25,000	*Less:* Provision for Bad Debts	–2,000	38,000
Outstanding Wages		2,000	Closing Stock		25,000
			Prepaid Rent		1,000
			Cash in Hand		29,600
Total		**1,47,600**	**Total**		**1,47,600**

Illustration- 2: From the following Trial Balance of **Mr. Rajan** as at 31st December 2025, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st December 2025 and a Balance Sheet as at the date, after making necessary adjustments. Also give journal entries for adjustments.

TRIAL BALANCE		
Name of the Account	**Debit Rs.**	**Credit Rs.**
Mr. Shyam's Capital Account		80,000
Mr. Shyam's Drawings Account	6,000	
Plant and Machinery (balance on 1st Jan. 1993)	20,000	
Plant and Machinery (additions on 1st July 1993)	5,000	
Stock on 1st January 1993	15,000	
Purchases	82,000	
Returns Inwards	2,000	
Sundry Debtors	20,600	
Furniture and Fixtures	5,000	
Freight and Duty	2,000	
Carriage outwards	500	
Rent, Rates and Taxes	4,600	
Printing and Stationery	800	
Trade Expenses	400	
Sundry Creditors		10,000
Sales		1,20,000
Returns outwards		1,000
Postage and Telegrams	800	
Provision for Doubtful Debts		400
Discounts		800
Rent of premises sub-let for year to 30th June 1994		1,200
Insurance Charges	700	
Salaries and Wages	21,300	
Cash in Hand	6,200	
Cash at Bank	20,500	
	2,13,400	**2,13,400**

Adjustments

1) Stock on 31st December 2025 was valued at Rs.14,600.
2) Write off Rs.600 as bad debts.
3) The provision for Doubtful Debts is to be maintained at 5 % on Sundry Debtors.
4) Create a Provision for Discounts on Debtors and on Creditors at 2 %.
5) Provide for depreciation on Furniture and Fixture at 5 % p.a and on Plant and Machinery at 20 % p.a.
6) Insurance Prepaid was Rs.100.
7) A fire occurred on 25th December,2025 in the godown and stock of the value of Rs.5,000 was destroyed. It was fully insured and the Insurance Company admitted the claim in full.

Journal Entries			
2025 Dec 31	Bad Debts a/c Dr. To Sundry Debtors (The amount written off as bad debts)	Rs. 600	**Rs.** 600
Dec 31	Provision for doubtful Debts a/c Dr. To Bad Debts a/c (The transfer of bad debts to the provision for doubtful Debts)	600	600
Dec 31	Profit and Loss A/c Dr. To provision for doubtful Debts A/c (The amount required to make up the provision up to Rs.1,000 @ 5% on 20,000 as under:) Provision required 1,000 Add: Bad Debts 600 1,600 Less: Existing Provision 400 1,200	1,200	1,200
Dec 31	Profit and Loss a/c Dr. To Provision for Discount on Debtors a/c (The amount required as provision for discount on debtors at 2% on 19,000)	380	380
Dec 31	Reserve for Discount on Creditors a/c Dr. To Profit and Loss a/c (The amount expected to be earned as discount on creditors 2% on 10,000)	200	200

Dec 31	Depreciation a/c Dr. To Plant & Machinery a/c To Furniture and fixtures a/c (The amount written off as depreciation is as follows:) Machinery:20% on 20.000 4,000 20% on 5,000 for 6 months 500 4,500 Furniture.: 5 % on Rs. 5,000 Rs. 250	4,750	4,500 250
Dec 31	Insurance Prepaid a/c Dr. To Insurance a/c (The Insurance Premium paid in advance)	100	100
Dec 31	Insurance Co. a/c Dr. To Trading a/c (Being the value of stock destroyed by fire will be recovered from the Insurance co.,)	5,000	5,000
Dec 31	Rent Received a/c Dr. To Rent Received in Advance Account (The rent for premises sublet from 1st Jan. 1974 to 30th June 1974 already received in Advance)	600	600

Books of Mr. Rajan

Trading and Profit and Loss Account for the year ended 31st December 1993

Trading and Profit and Loss Account for the year ended 31st December 2025

	₹	₹		₹	₹
To Stock	82,000	15,000	By Sales	1,20,000	1,18,000
To Purchases	1,000		Less: Returns	2,000	14,600
Less: Returns		81,000	By Closing Stock		
To Freight & Duty		2,000	By Insurance Co.		
To Gross Profit			(Good destroyed)		5,000
Transferred to P & L A/c		39,600			
		1,37,600			**1,37,600**
To Salaries & Wages		21,300	By G. P Transferred		
To Rent , Rates & Taxes		4,600	From Trading A/c		39,600
To Printing & Stationery		800	By Discounts		800
To Trade Expenses		400	By Reserve for discounts on creditors		
To Postage & Telegrams		800	By Rent received		200
To Carriage outwards		500	Less : Received in advance	1,200	
To Insurance Charges	700			600	600
Less: Prepaid Insurance	100	600			

To Depreciation:					
Plant &Machinery Furniture & Fixtures	4,500 250	4,750			
To Provision for Doubtful debts Required Add : Bad debts Less : Existing Provisions	1,000 600 1,600 400	1,200			
To Provision for Discount on Debtors To Net Profit		380 5,870			
		41,200			**41,200**

Balance Sheet of Mr. Rajan as on 31st December 2025					
Liabilities		**₹**	**Assets**		**₹**
Sundry creditors Less: Reserve for discounts Rent Received in Advance Capital on 1st Jan. 1993 Add: Profit Less : Drawings	10,000 200 80,000 5,870 85,870 6,000	9,800 600 79,870	Current Assets: Cash in hand Cash at Bank Sundry Debtors Less: Provision for Doubtful Debts Less: Provision of Discounts Stock Insurance Period Insurance Company's A/c Fixed Assets : Plant & Machinery 1st Jan. 1993 Add: Additions Less: Depreciation Furniture & Fixture Less: Depredation	 20,000 1,000 19,000 380 20,000 5.000 25,000 4,500 5000 250	6,200 20,500 18,620 14,600 100 5,000 20,500 4,750
Total		**90,270**	**Total**		**90,270**

Illustration 3

From the following balance extracted from the books of M/s. Ram & Co. and the subjoined information you are required to prepare the Trading and Profit and Loss Account for the year ended on 31st December, 2025 and also the Balance Sheet as on that date:-

Trial Balance		
Particulars	**Debit ₹**	**Credit ₹**
Stock on January 1, 1994	60,500	
Purchases and Sales	90,300	1,37,200
Returns	2,200	1,300
Capital Account		30,000
Drawing Account	4,500	
Land and Buildings	30,000	
Furniture and Fittings	8,000	
Sundry Debtors and Creditors	25,000	45,000
Cash in hand	3,500	
Investments	10,000	
Interest		500
Commission		3,000
Total Direct Expenditure	7,500	
Postage, Stationery and Phones	2,500	
Fire Insurance Premium	2,000	
Salaries	11,000	
Bank Overdraft		40,000
Total	**2,57,000**	**2,57,000**

Adjustment Entries:

(a) Closing Stock on 31st December,2025 was valued at Rs.65,000. Goods worth Rs.500 are reported to have been taken away by the proprietor for his personal use at home during 2025.

(b) Interest on investments Rs.500 is yet to be received while Rs.1,000 of the commission received is yet to be earned in 2025.

(c) Rs.500 of the fire insurance premium paid is in respect of the quarter ending 31st March, 2025.

(d) Salaries Rs.1,000 for December 1994 and Bank Overdraft interest estimated at Rs.2,000 have to be recorded as outstanding charges.

(e) Depreciation is to be provided on Land and Buildings @ 5% and on Furniture and Fittings @ 10%.

(f) Provision for doubtful debts @ 5% on Sundry Debtors.

Solution

TRADING & PROFIT & LOSS ACCOUNT OF M/S. Ram & CO					
for the year ending 31st December, 2025					
Dr.			**Cr.**		
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		60,500	By Sales	1,37,000	
To Purchases	90,300		Less: Returns	2,200	1,35,000
Less: Purchases Returns 1300			By Closing Stock		65,000
Less: Goods for personal use	1,800	89,500			
To Direct Expenses		7,500			
To Gross Profit c/d		43,500			
		2,00,000			**2,00,000**
To Salaries Add : Outstanding	11,000 1,000	12,000	By Gross Profit b/d		43,500
To Fire Insurance Premium Less : Prepaid	2,000 500	1,500	By Commission Less: Received in Advance	3,000 1,000	2,000
To Postage, Stationery & Phones		2,500	By Interest Add : Accrued	500 500	1,000
To Interest outstanding (For Bank overdraft)		2,000			
To Reserve for doubtful Debts on Debtors @ 5%		1,250			
To Dep. on Land & Buildings Furniture & Fittings	1,500 800	2,300			
To Net Profit transferred to Capital Account		24,950			
		46,500			**46,500**

Balance Sheet of M/s. Ram & CO as on 31st December, 2025					
Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Creditors		45,000	Cash in Hand		3,500
Outstanding Salaries Outstanding Interest on overdraft	1,000 2,000	3,000	Sundry Debtors Less: Provisions for doubtful debts	25,000 1,250	23,750
Bank Overdraft		40,000	Investments Add : Interest Accrued on Investments	10,000 500	10,500
Commission received in advance		1,000			
Capital Account Add : Net Profit	30,000 24,950	49,950	Stock		65,000
			Insurance (prepaid)		500
Less : Drawings 4,500 Less: Goods for Personal use 500	54,950 5,000		Land & Buildings Less: depreciation	30,000 1,500	28,500
			Furniture & Fittings Less: Depreciation	8,000 800	7,200
		1,38,950			**1,38,950**

Illustration 4

The following are the balances abstracted from the books of **Mr. Mani**: Balances as on 31st December, 2025.

Capital	30,000
Drawings	5,000
Furniture and Fittings	2,600
Bank Overdraft	4,200
Creditors	13,300
Business Premises	20,000
Stock on 1st January, 1992	22,000
Debtors	18,600
Rent from Tenants	1,000
Purchases	1,10,000
Sales	1,50,000
Sales Returns	2,000

Discounts - Debit	1,600
Discounts - Credit	2,000
Taxes and Insurance	2,000
General Expenses	4,000
Salaries	9,000
Commission-Debit	2,200
Carnage on Purchases	1,800
Provision for Bad & Doubtful Debts	600
Bad Debts written off	800

Stock on hand on 31st December,2025 was estimated at Rs.20,000. Rent Rs.300, is still due from the tenant. Salaries, Rs.750, are as yet unpaid. Write off Bad Debts Rs.600 and depreciate Business Premises by Rs.300 and Furniture and Fittings by Rs.266. Make a provision of 5 per cent on Debtors for Bad and Doubtful Debts and provision of 2% for Discounts. Allow interest on Capital at 5 percent and carry forwardRs.700 for unexpired insurance. The manager is entitled to a commission of 10% on profits remaining after charging his commission. Prepare Trading Account, Profit and Loss Account and Balance Sheet as on 31st December, 2025.

Solution

In questions where a regular Trial Balance is not given, it is better to first prepare it in order to locate any difference that there may be. Hence:-

Trial Balance of Mr. Mani as at December 31, 2025			
Debit Balances	**₹**	**Credit Balances**	**₹**
Drawings	5,000	Capital	30,000
Furniture & Fittings	2,600	Bank Overdraft	4,200
Business Premises	20,000	Creditors	13,300
Stock, 1st Jan, 1992	22,000	Rent from Tenants	1,000
Debtors	18,000	Sales	1,50,000
Purchases	1,10,600	Discounts	2,000
Sales Returns	2,000	Provision for Doubtful Debts	600
Discounts	1,600		2,01,100
Taxes and Insurance	2,000	**Suspense**	**500**
General Expenses	4,000	**(Difference in Trial balance)**	

Salaries	9,000		
Commission	2,200		
Carriage	1,800		
Bad Debts	800		
	2,01,600		**2,01,600**

Note: The total of the credit side is Rs.2,01,100, while it is Rs.2,01,600 for the debit side. Hence Rs.500 has been credited to the Suspense Account.

Trading and Profit and Loss Account of Mr.Mani for the year ended 31st December, 2025					
	₹	₹		₹	₹
To Opening Stock		22,000	By Sales:	1.50,000	
To Purchases		1,10,000	Less: Returns	2,000	1,48,000
To Carriage		1,800	By Closing Stock		20,000
To Gross Profit c/d		34,200			
		1,68.000			**1,68,000**
To Salaries Paid	9,000		By Gross Profit b/d		34,200
To General Expenses		4,000	By Rent Received	1,000	
To Commission		2,200	Add Due	300	1,300
To Taxes Insurance: Paid	2,000				
Less Prepaid	700	1,300			
To Discounts		1,600			
To Depreciation:					
Business premises	300				
Furniture & Fittings	266	566			
To Provision for Bad & Doubtful Debts	900				
Required Add Bad Debts	1,400*				
	2,300				

Less Existing Provision	600	1,700			
To Provision for Discounts•		1,500			
To Interest on Capital		342			
To Commission payable to Manager**		1,322			
To Net Profit to Capital A/c		13,220			
		37,500			**37,500**

Balance Sheet of Mr. Mani as on December 31, 2025					
Liabilities	**₹**	**₹**	**Assets**	**₹**	**₹**
Capital Account:			Fixed Assets:		
Balance on 1st Jan. 2025	30,000		Business Premises	20,000	
Add Interest	1,500		Less Depredation	300	19,700
Add net Profit	13,220		Furniture and Fittings	2,600	
	44,720		Less Depreciation	266	2,334
Less: Drawings	5,000	39,720	Current Assets:		
Bank Overdraft		4,200	Sundry Debtors	18,000	
Creditors		13,300	Less Provision for Bad and Doubtful Debts	900	
Liability for:				17,100	
Salaries	750		Less: Provision for Discounts	342	16,758
Commission	1,322	2,072	Stock		20,000
Suspense Account		500	Due from Tenant		300
			Prepaid Insurance		700
		59,792			**59,792**

Note: *Rs.600 has to be written off as bad debts. This increases total bad debts to Rs.1,400. It reduces sundry debtors to Rs.18,000. 5% of this is Rs.900. Deducting this amount from sundry debtors, Rs.17,100 is left. The Provision for Discount will be 2% of this figure.

** Before providing for the commission, the profit is Rs.14,542 (deduct all expenses from the incomes). The manager's commission will be 10/110 of this, because if net profit of the commission is 100, commission will be 10, making a total of 110.

Illustration 5

Below is the Trial Balance of Mr. Mohan as at December 31, 2025

Debit Balances	₹	Credit Balances	₹
Mohan's Current Account	1,500	Capital Account	50,000
Adjusted Purchases	6,99,200	Loan from Ravi @ 9% (taken on 1st Jan. 1993)	20,000
Salaries	4,200	Sales	7,20,000
Carriage on Purchases	400	Discount	500
on Sales	500	Sundry Creditors	20,000
Lighting	300		
Rates and Insurance	400		
Buildings	27,000		
Furniture	6,000		
Sundry Debtors	8,000		
Cash on hand	250		
Cash at Bank	1,500		
Stock (31st December, 1994)	61,250		
	8,10,500		8,10,500

Rates have been prepaid to the extent of Rs.175. Bad debts totaling Rs.500 have to be written off. A provision for doubtful debts @ 5% on debtors is necessary. Buildings have to be depreciated at 2% and Furniture @ 10%. The manager is entitled to a commission of 5% of net profits before charging such commission.

Solution

Note

(1) The Trial Balance gives "Adjusted purchases". It means that the opening stock has already been transferred to the Purchases Account and has thus been closed. Further entry for closing stock

has already been passed by debiting the Closing Stock Account and Crediting Purchases Account. That is why closing stock appears inside the Trial Balance: It will now be shown in the Balance Sheet and not in the Trading Account since purchases already stand reduced.

(2) There is a loan of Ravi @ 9% taken in 1993. The trial balance makes no mention of any interest being paid to him. Hence, interest 9% must be provided for the whole year.

Trading and Profit and Loss Account of Mohan for the year ended December 31, 2025			
Dr.			**Cr.**
	₹		**₹**
To Adjusted Purchases	6,99,200	By Sales	7,20,000
To Carriage on Purchases	400		
To Gross profit c/d	20,400		
	7,20,000		**7,20,000**
To Salaries	4,200	By Gross Profit b/d	20,400
To Carriage on Sales	500	By Discount	500
To Lighting	300		
To Rates & Insurance : Paid 400 Less Prepaid 175	225		
To Bad debts	500		
To Provision for Doubtful Debts (5% of Rs.7,500)	375		
To Depreciation Building (2%) 540 Furniture 600	1,140		
To Interest on Ravi's Loan	1,800		
To Commission payable to Manager (5% of Rs.11,860*)	593		
To Net Profit to Mohan's Current A/c	11,267		
	20,900		**20,900**

Note: *₹ 20,900 less ₹ 9,040 (the total of all expenses so far). Manager is entitled to 5% of this figure.

Balance Sheet of Mohan as at December 31, 2025					
Liabilities	**₹**	**₹**	**Assets**	**₹**	**₹**
Loan from Ravi: Add Interest Due	20,000 1,800	21,800	Fixed Assets:		
			Building: Less Depreciation	27,000 540	26,460
Sundry Creditors		20,000			
Commission Payable		593	Furniture: Less Depreciation	6,000 600	5,400
Capital Account		50,000			
Current Account Net Profit: Less: Debit Balance	11,267 1,500	9,767	Current Assets:		
			Cash on hand		250
			Cash at Bank		1,500
			Sundry Debtors Less:Doubtful Debts	7,500 375	7,125
			Stock		61,250
			Prepaid Rates		175
		1,02,160			**1,02,160**

Illustration 6: From the following Trial Balance of M/s Apex Enterprises as on March 31, 2025, prepare the Trading Account, Profit and Loss Account for the year ended March 31, 2025, and the Balance Sheet as on that date:

Trial Balance as on March 31, 2025		
Particulars	**Debit (₹)**	**Credit (₹)**
Capital	—	2,00,000
Drawings	15,000	—
Plant & Machinery	1,20,000	—
Furniture & Fixtures	20,000	—
Purchases & Sales	1,40,000	2,60,000
Returns (Inward & Outward)	4,000	2,000
Opening Stock	35,000	—
Wages	18,000	—
Salaries	24,000	—
Carriage Inward	2,500	—
Carriage Outward	1,500	—
Insurance Premium	3,000	—
Sundry Debtors & Creditors	52,000	30,000

Provision for Doubtful Debts	—	2,000
Cash at Bank	28,000	—
Commission Received	—	1,000
Total	**4,38,000**	**4,38,000**

Adjustments:

1. **Closing Stock** as on March 31, 2025, was valued at ₹40,000.
2. Write off **Further Bad Debts** of ₹2,000 and maintain a **Provision for Doubtful Debts** at 5% on remaining debtors.
3. Charge **Depreciation** on Plant & Machinery at 10% p.a. and Furniture at 5% p.a.
4. **Unexpired Insurance** (Prepaid Insurance) amounts to ₹600.
5. Provide **Interest on Capital** at 6% p.a.
6. The Manager is entitled to a **Commission** of 10% on Net Profit *after* charging such commission.

Solution:

Trading and Profit and Loss Account For the year ended March 31, 2025					
Particulars	**Amount (₹)**	**Amount (₹)**	**Particulars**	**Amount (₹)**	**Amount (₹)**
To Opening Stock		35,000	By Sales	2,60,000	
To Purchases	1,40,000		*Less:* Returns Inward	–4,000	2,56,000
Less: Returns Outward	–2,000	1,38,000	By Closing Stock		40,000
To Wages		18,000			
To Carriage Inward		2,500			
To Gross Profit c/d *(Balancing figure)*		**1,02,500**			
Total		**2,96,000**	**Total**		**2,96,000**
To Salaries		24,000	By Gross Profit b/d		1,02,500
To Carriage Outward		1,500	By Commission Received		1,000

To Insurance Premium	3,000				
Less: Prepaid Insurance	–600	2,400			
To Bad Debts (Further)	2,000				
Add: New Provision *(5% of ₹50,000)*	2,500				
	4,500				
Less: Old Provision	–2,000	2,500			
To Depreciation:					
Plant & Machinery (10%)	12,000				
- Furniture (5%)	1,000	13,000			
To Interest on Capital (6% of ₹2,00,000)		12,000			
To Manager's Commission *(Note 1)*		**4,373**			
To Net Profit *(Transferred to Capital)*		**39,357**			
Total		**1,03,500**	**Total**		**1,03,500**

Note 1 (Manager's Commission Calculation):

Profit before commission = 1,03,500 - (24,000 + 1,500 + 2,400 + 2,500 + 13,000 + 12,000) = ₹43,730. Commission = 43,730 X (10/110) = **₹4,373**.

Balance Sheet as on March 31, 2025					
Liabilities	**Amount (₹)**	**Amount (₹)**	**Assets**	**Amount (₹)**	**Amount (₹)**
Capital	2,00,000		**Fixed Assets:**		
Add: Interest on Capital	12,000		Plant & Machinery	1,20,000	
Add: Net Profit	39,357		*Less:* Depreciation	–12,000	1,08,000

	2,51,357		Furniture & Fixtures	20,000	
Less: Drawings	–15,000	2,36,357	*Less:* Depreciation	–1,000	19,000
Current Liabilities:			**Current Assets:**		
Sundry Creditors		30,000	Sundry Debtors	52,000	
Outstanding Manager's Commission		4,373	*Less:* Further Bad Debts	–2,000	
				50,000	
			Less: New Provision (5%)	–2,500	47,500
			Closing Stock		40,000
			Prepaid Insurance		600
			Cash at Bank		28,000
Total		**2,70,730**	**Total**		**2,70,730**

3.7 Chapter Summary:

Final Accounts are prepared at the end of a financial year to assess a business's overall profitability and financial standing. They consist of the Trading Account, which calculates Gross Profit by matching sales against direct costs; the Profit & Loss Account, which calculates Net Profit by factoring in operational expenses and indirect revenues; and the Balance Sheet, a statement outlining total assets, liabilities, and capital. Essential year-end adjustments—such as valuing closing stock, applying depreciation (via SLM or WDV), providing for bad debts, and accounting for outstanding, prepaid, accrued, or advance items—ensure that revenues and expenses are accurately aligned with the period in which they occurred, providing a true and fair view of the business.

3.8.1 Multiple Choice Questions (MCQs)

Q1. Carriage Inward is shown in which account?

(a) Debit side of Profit and Loss Account

(b) Debit side of Trading Account

(c) Credit side of Trading Account

(d) Assets side of Balance Sheet

Q2. Excess of net sales over cost of goods sold is called:

(a) Net Profit

(b) Gross Profit

(c) Operating Profit

(d) Capital Profit

Q3. Which of the following is an indirect expense?

(a) Factory Lighting

(b) Freight Inward

(c) Audit Fees

(d) Custom Duty

Q4. Sales Returns are deducted from:

(a) Gross Sales

(b) Purchases

(c) Opening Stock

(d) Closing Stock

Q5. A Balance Sheet shows:

(a) Profit or Loss of a company for a period

(b) Financial position of a business as on a specific date

(c) Cash flows during the year

(d) Total sales and purchases made

Q6. Outstanding expenses are shown as a/an:

(a) Asset

(b) Liability

(c) Income

(d) Expense in Trading Account only

Q7. Prepaid Rent is classified as a:

(a) Fixed Asset

(b) Current Asset

(c) Fictitious Asset

(d) Current Liability

Q8. If Closing Stock is given *inside* the Trial Balance, where will it appear in the final accounts?

(a) Trading Account only

(b) Balance Sheet only

(c) Both Trading Account and Balance Sheet

(d) Profit and Loss Account

Q9. Given: Opening Stock = ₹10,000, Purchases = ₹50,000, Direct Expenses = ₹5,000, Closing Stock = ₹15,000. What is the Cost of Goods Sold (COGS)?

(a) ₹50,000

(b) ₹65,000

(c) ₹55,000

(d) ₹70,000

Q10. Sundry Debtors are ₹50,000. Further bad debts to be written off = ₹2,000. Provision for doubtful debts is to be created at 5%. What is the amount of provision?

(a) ₹2,500

(b) ₹2,400

(c) ₹2,300

(d) ₹2,600

Answers & Explanations

1. **(b) Debit side of Trading Account**

   Explanation: Carriage Inward is a direct expense incurred to bring goods into the warehouse/factory.

2. **(b) Gross Profit**

   Explanation: Gross Profit = Net Sales - Cost of Goods Sold.

3. **(c) Audit Fees**

   Explanation: Audit fees relate to general administration, making it an indirect expense recorded in the Profit & Loss Account.

4. **(a) Gross Sales**

   Explanation: Sales returns are subtracted from gross sales to calculate net sales.

5. **(b) Financial position of a business as on a specific date**

   Explanation: A Balance Sheet is a snapshot statement displaying assets, liabilities, and equity at a particular point in time.

6. **(b) Liability**

   Explanation: Outstanding expenses represent an obligation to pay for services already received, making them current liabilities.

7. **(b) Current Asset**

   Explanation: Prepaid expenses represent future benefits already paid for, classified as current assets.

8. **(b) Balance Sheet only**

   Explanation: Items inside the Trial Balance have already undergone double-entry adjustments. Thus, closing stock inside the trial balance is already adjusted in Purchases and appears only on the Asset side of the Balance Sheet.

9. **(a) ₹50,000**

   Explanation: COGS = 10,000 + 50,000 + 5,000 - 15,000 = ₹50,000.

10. **(b) ₹2,400**

    Explanation: Provision is calculated on net debtors after bad debts: (50,000 - 2,000) X 5% = 48,000 X 0.05 = ₹2,400

3.8.2. Short Answer Questions:

1. What are Final Accounts?
2. What is the main objective of preparing a Trading Account?
3. What is the difference between Gross Profit and Net Profit?
4. What is a Balance Sheet?
5. What are Direct Expenses? Give two examples.
6. What are Indirect Expenses? Give two examples.
7. How is Cost of Goods Sold (COGS) calculated?
8. Why are adjustments necessary while preparing Final Accounts?
9. Where does Closing Stock appear in the Final Accounts?
10. How are Outstanding Expenses treated in Final Accounts?
11. How is Prepaid Expense treated in Final Accounts?
12. What is Provision for Bad and Doubtful Debts?
13. Differentiate between Trial Balance and Balance Sheet.

3.8.3. Exercise Problems:

1. From the following Trial Balance of M/s Sunrise Enterprises as on March 31, 2025, prepare the Trading Account, Profit and Loss Account for the year ended March 31, 2025, and the Balance Sheet as on that date:

Trial Balance as on March 31, 2025		
Particulars	**Debit (₹)**	**Credit (₹)**
Capital	—	80,000
Drawings	8,000	—
Plant & Machinery	50,000	—
Purchases & Sales	60,000	1,20,000
Returns (Inward & Outward)	3,000	1,500
Opening Stock	15,000	—
Carriage Inward	2,000	—
Wages	10,000	—
Salaries	12,000	—
Rent & Taxes	4,000	—
Sundry Debtors & Creditors	30,000	20,000
Cash in Hand	17,500	—
Total	**2,11,500**	**2,11,500**

Adjustments:

a) Closing stock as on March 31, 2025, was valued at ₹18,000.

b) Wages outstanding amount to ₹1,500.

c) Prepaid Rent amounts to ₹500.

d) Depreciate Plant & Machinery at 10% p.a.

e) Create a Provision for Bad and Doubtful Debts at 5% on Sundry Debtors.

Check Your Answers:

- **Gross Profit:** ₹49,000
- **Net Profit:** ₹28,500
- **Balance Sheet Total:** ₹1,22,000

2. From the following Trial Balance of M/s Standard Traders as on March 31, 2025, prepare the Trading Account, Profit and Loss Account, and Balance Sheet:

Trial Balance as on March 31, 2025		
Particulars	**Debit (₹)**	**Credit (₹)**
Capital	—	1,50,000
Drawings	12,000	—
Land & Buildings	1,00,000	—
Furniture & Fixtures	15,000	—
Purchases & Sales	1,10,000	2,10,000
Sales Returns & Purchase Returns	5,000	2,000
Opening Stock	25,000	—
Freight & Freight Inward	3,500	—
Manufacturing Wages	16,000	—
Office Salaries	20,000	—
Insurance Premium	2,400	—
Sundry Debtors & Creditors	45,000	28,000
Provision for Bad Debts (Old)	—	1,500
Bank Balance	37,600	—
Discount Allowed & Received	1,000	1,000
Total	**3,92,500**	**3,92,500**

Adjustments:

1. Stock on March 31, 2025, was valued at cost ₹30,000 (Market Value ₹32,000).
2. Write off ₹1,000 as further bad debts and maintain a provision of 5% on remaining debtors.
3. Charge depreciation on Land & Buildings at 5% p.a. and Furniture at 10% p.a.
4. Unexpired insurance premium amounts to ₹400.
5. Outstanding salaries amount to ₹2,000.

Check Your Answers:

- **Gross Profit:** ₹82,500
- **Net Profit:** ₹49,800
- **Balance Sheet Total:** ₹2,17,800

3. The following is the Trial Balance of M/s Regal Enterprises as on March 31, 2025:

Trial Balance as on March 31, 2025		
Particulars	**Debit (₹)**	**Credit (₹)**
Capital Account	—	2,50,000
Drawings	20,000	—
Plant & Machinery	1,50,000	—
Patents & Trademarks	30,000	—
Opening Stock	40,000	—
Purchases & Sales	1,80,000	3,20,000
Returns Inward & Outward	6,000	4,000
Direct Factory Expenses	8,000	—
Wages	22,000	—
Office Salaries	32,000	—
Commission Received	—	2,000
Sundry Debtors & Creditors	64,000	35,000
Provision for Bad Debts	—	3,000
Cash at Bank	42,000	—
Advertisement Expenses	10,000	—
Total	**6,04,000**	**6,04,000**

Adjustments:

1. Closing Stock as on March 31, 2025, is ₹45,000.
2. Goods costing ₹5,000 were destroyed by fire. The Insurance Company admitted a claim for ₹3,500 only.
3. Write off ₹4,000 as further bad debts and maintain a provision of 5% for doubtful debts on debtors.
4. Provide Interest on Capital at 6% p.a.
5. Depreciate Plant & Machinery by 10% and write off 20% of Patents & Trademarks.
6. The manager is entitled to a commission of 10% on Net Profit *after* charging such commission.

Check Your Answers:

- **Gross Profit:** ₹1,08,000
- **Net Profit (before manager's commission):** ₹36,500
- **Manager's Commission:** ₹3,318
- **Net Profit (transferred to capital):** ₹33,182
- **Balance Sheet Total:** ₹3,36,500

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UNIT – IV

Partnership Accounts

Learning Objectives

After studying this chapter, students will be able to:

- Understand the meaning and effects of admission, retirement and death of a partner.
- Calculate and adjust goodwill, revaluation of assets and liabilities, and reserves.
- Prepare necessary journal entries, capital accounts and balance sheet on admission, retirement and death.
- Account for dissolution of partnership firm under different situations.
- Apply the rules relating to insolvency of a partner (including Garner vs. Murray rule).
- Solve practical problems involving all the above adjustments.

4.1 Introduction to Partnership Accounts

One of the most popular company organizational structures is the partnership, which is especially appropriate for small and medium-sized businesses. A partnership firm is created when two or more people pool their financial resources, expertise, knowledge, and experience to operate a legal business with the goal of making money. A partnership allows the owners to divide duties, risks, and rewards in accordance with mutually agreed agreements, in contrast to a sole proprietorship, in which the company is owned and run by a single person.

The Indian Partnership Act, 1932, which outlines the rights, obligations, and liabilities of partners, governs partnerships in India. Mutual trust, confidence, and good faith—often referred to as the principle of ultimate good faith—are the cornerstones of a partnership. In matters pertaining to the firm's operations, each partner serves as both an agent for the other partners and a principle for their own activities.

A company's structure frequently changes as it expands. A partner may pass away, a current partner may retire for personal reasons, or a

new partner may be accepted to contribute more funds or managerial experience. The partners may choose to dissolve the company under specific conditions, or the settlement of accounts may be impacted by a partner's insolvency. Each of these occurrences modifies the partners' financial relationship and necessitates proper accounting treatment to guaranty accuracy and fairness.

Partnership accounting deals with the recording and reporting of financial transactions arising from such changes in the constitution of the partnership. It ensures that profits, losses, assets, liabilities, reserves, goodwill, and capital balances are adjusted equitably among the partners in accordance with the partnership deed or, in its absence, the provisions of the Indian Partnership Act, 1932.

4.1.1 Definition of Partnership

Section 4 of the **Indian Partnership Act, 1932** defines partnership as:

"Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

This definition highlights the essential elements of a partnership: an agreement between persons, the objective of earning and sharing profits, and the principle of mutual agency.

4.1.2 Essential Features of a Partnership

The following are the essential features of a partnership:

1. Association of Two or More Persons

A minimum of two individuals who consent to engage in legal business together must form a partnership. The Companies Act of 2013's provisions and any applicable regulations control the maximum number of partne₹

2. Agreement

Only an agreement between the partners can create a partnership. Although a written partnership deed is highly advised to prevent future disagreements, the agreement may be made verbally or in writing.

3. Lawful Business

The partnership must be formed to carry on a lawful business. Any agreement to conduct an illegal activity cannot create a valid partnership. To conduct a legitimate business, the partnership must be established. A

legitimate partnership cannot be formed by any agreement to engage in unlawful action.

4. Profit-Sharing

The partners decide to divide the company's gains and losses according to a set percentage. Profits and losses are distributed evenly in the absence of an agreement.

5. Mutual Agency

The most distinguishing characteristic of a partnership is mutual agency. Each partner serves as both an agent and a principal. All of the other partners are bound by the actions of one partner carried out within the parameters of the business.

6. Unlimited Liability

Partners have limitless liability. The partners' personal assets may be utilized to pay off the firm's debts if its assets are not enough to cover its responsibilities.

7. Mutual Trust and Good Faith

Honesty and trust between partners are the cornerstones of a partnership. It is expected of each partner to provide all pertinent facts and behave in the firm's best interests.

4.1.3 Need for Partnership Accounting

Partnership accounting is necessary to:

- Keep track of each partner's capital contribution.
- Calculate the company's profit or loss.
- Divide gains and losses in accordance with the profit-sharing ratio that was decided upon.
- Take draws, commission, salary, and capital interest into account.
- Document modifications to the partnership's charter, including admissions, retirements, and deaths.
- Make financial statement preparation easier.
- Make sure the accounts are settled fairly and transparently.

Contents of Partnership Deed

1. Names and addresses of the firm and partners.
2. Nature of the business.
3. Date of commencement of partnership.

4. Duration of partnership.
5. Amount of capital contributed or to be contributed by each partner
6. Amount of drawings allowed by the firm to each partner.
7. Rules regarding operation of bank accounts.
8. Interest on partners capital and drawings.
9. Ratio in which profits and losses are to be shared.
10. Interest on loan by the partners to the firm.
11. Salaries, commission, etc. if payable to partners.
12. Methods of keeping accounts and audit.
13. Rights, duties and liabilities of the partners.
14. Accounting treatment in case of admission, retirement, death etc of a partner.
15. Mode of settlement of accounts on dissolution of the firm.
16. Method of settling disputes amongst the partners.

In case the Partnership Deed is silent on certain matters, the relevant provisions of the Partnership Act shall be applicable. Following are the provisions of the Partnership Act, which have a direct bearing on the accounting treatment of certain items, in case the Deed is silent on these utters.

1. Partners share profits or losses equally.
2. No interest is charged on partners' capital.
3. No interest is charged by the firm on partners' drawings.
4. No partner is entitled to salary or commission.
5. 6% interest is charged on partners' loan.

4.1.4 Overview of Changes in the Constitution of a Partnership Firm

A partnership firm may undergo changes during its existence. These changes include:

Throughout its existence, a partnership firm may experience modifications. Among these modifications are:

- **Admission of a Partner**: All partners must agree for a new partner to join the current firm.
- **Retirement of a Partner:** A current partner leaves the company on their own volition.

- **Death of a Partner:** When a partner passes away, their share is settled with their executor or legal hei₹
- **Firm Dissolution**: The business is wound up, assets are realized, obligations are paid off, and the partners split the remaining amount.
- **Insolvency of a Partner**: When a partner is unable to make the required contributions, they will receive special accounting treatment throughout the dissolution.

These events require careful accounting adjustments to protect the interests of all partners and ensure that the financial records accurately reflect the new position of the firm.

4.2 Admission of a Partner

4.2.1 Introduction

Businesses operate in a dynamic environment where organizational structure modifications are frequently required due to expansion, diversification, and heightened competition. The addition of a new partner is one of the most frequent developments in a partnership firm. In order to accomplish future expansion, current partners may need more funding, specialized knowledge, managerial skills, or commercial contacts. In these circumstances, the firm admits a new partner.

The partnership firm's constitution is altered with the admission of a new partner. The rights and interests of the current partners are impacted when the new partner receives a portion of the company's future earnings. As a result, a number of accounting modifications are required to guaranty that the interests of both current and new partners are adequately safeguarded.

Determining the new profit-sharing ratio, figuring out the sacrifice ratio, evaluating goodwill, revaluing assets and liabilities, allocating accrued reserves and profits, and modifying the capital accounts of the partners are some of these adjustments. A fair presentation of the company's financial situation and an equitable contribution from the new partner for the benefits obtained are guarantyd by proper accounting treatment.

Definition

The procedure by which a new individual is accepted into an established partnership firm with the approval of all current partners, so

gaining a portion of the company's future profits, is known as "admission of a partner."

4.2.2 Meaning of Admission of a Partner

The process of adding a new individual to an already-existing partnership company is known as admission of a partner. The new partner gains the rights and obligations of a partnership and becomes a co-owner of the company. Unless the partnership agreement specifies differently, the admission is typically made with the unanimous assent of all current partners.

In exchange for a portion of the company's future revenues, the new partner typically offers money and, if relevant, goodwill. According to the terms of the Indian Partnership Act, 1932, the new partner is jointly accountable for the firm's debts and shares its earnings and losses starting on the date of admission.

Admission of a partner does not dissolve the business; instead, it results in a **reconstitution of the partnership firm**, with the business continuing under a revised partnership arrangement.

Example

As partners, Mr. Arun and Mr. Bala split profits evenly. They choose to accept Ms. Chitra as a new partner because their wholesale business is expanding so quickly. Ms. Chitra agrees to share a quarter of the future profits, provides money, and offers invaluable marketing expertise. Before she may become a partner, the admission necessitates a number of accounting changes and a new profit-sharing structure.

4.2.3 Objectives of Admitting a New Partner

The admission of a new partner is generally undertaken to strengthen the business and improve its long-term prospects. The major objectives are discussed below.

1. To Raise Additional Capital

A growing company frequently needs more money for modernization, expansion, or raising working capital. The company can raise more money without using outside borrowing by accepting a new partner.

2. To Expand Business Operations

Establishing additional branches, breaking into untapped markets, or launching new product lines are all examples of business expansion. The firm can carry out such expansion more successfully with the addition of a new partner

3. To Acquire Managerial Expertise

A new partner may have technological expertise, professional credentials, or specialized managerial abilities that support effective business management..

4. To Obtain Business Experience

Experienced workers frequently contribute important industry expertise, strategic planning skills, and business insights that enhance the company's performance.

5. To Reduce the Workload of Existing Partners

The obligations of current partners grow along with corporate activity. A more effective division of labor and duties is made possible by the admission of a new partner.

6. To Strengthen Financial Stability

The firm's creditworthiness and financial strength are increased by more capital and better managerial skills.

7. To Improve Business Reputation

A well-known businessperson or seasoned professional joining the partnership could improve the company's standing among clients, vendors, lenders, and investors.

8. To Ensure Business Continuity

The business's long-term viability and continuity are enhanced by the addition of a younger or more experienced partner.

4.2.4 Reasons for Admission of a Partner

The reasons for admitting a partner explain the practical factors that led to such admission, even though the objectives and reasons are closely related.

The common reasons include:

The need for more money.

- An increase in commercial activity.
- Expanding into new goods and services.

- Professional or technical experience is required.
- An increase in managerial effectiveness.
- Exchanging business risks.
- Better use of available resources.
- Future succession planning.
- Adherence to key business requirements or contractual obligations.

Each of these reasons contributes to the growth and sustainability of the partnership firm.

4.2.5 Important Accounting Adjustments on Admission

All partners' rights and responsibilities are impacted by a partner's admittance. In order to maintain equity among all partners, the firm's finances should be changed prior to the admission of the new partner.

The following accounting adjustments are commonly required:

1. Calculation of the new profit-sharing ratio.
2. Determination of the sacrificing ratio.
3. Valuation and adjustment of goodwill.
4. Revaluation of assets and liabilities.
5. Distribution of accumulated profits, reserves, and losses.
6. Adjustment of partners' capital accounts.
7. Recording the capital contribution of the new partner.
8. Preparation of the revised Balance Sheet.

These adjustments ensure that the incoming partner neither benefits unfairly from past profits nor bears the burden of past losses.

Appropriation of capital

In a proprietary organization, the entire profit belongs to the proprietor alone, but in a partnership it has to be shared among all partners. So the profit shown by the profit and loss account is to be apportioned among partners according to the terms of partnership deed, or in case it is silent, according to the provisions of the Act.

Sometimes the Deed may provide salary to a partner, who is managing the firm, interest on partner' capital and interest on partners'1 drawings. These items are to adjusted and the remaining profits are to be appropriated

among the partners. In this context, a Profit and Loss (Appropriation) Account is prepared to appropriate profits among partners.

Format of Profit and Loss (Appropriation) Account

Particulars	₹	₹	Particulars	₹	₹
To Salary to partners			By Profit & Loss a/c (Net profit)		---- ---
	X— Y—	-------	By Interest on drawings X----- Y-----		---- ---
To Interest on capital	X— Y—	------			
To Reserve fund					
To Capital account	X- Y-	--------			
(Profits transferred)		-------			

Fixed and Fluctuating Capital

Capital accounts of partners are maintained either under fixed capital system or under fluctuating capital system. Under fixed capital system, a capital account and a current account is opened for each partner. A partner's original contribution is shown in his fixed capital account and all other entries like his share of profit, salary, drawings, interest on capital and interest on drawings are shown in his current account whereas in fluctuating capital system a partner's original contribution as well as other items are shown in his capital account. Here there is only one capital account for each partner**.**

Illustration:**1**

On January 1, 2023, X, Y, Z entered into a partnership contributing ₹3,00,000, ₹2,00,000 and ₹1,00,000 respectively and sharing the profits in the ratio 2:2:1. X and Y are entitled to an annual salary of ₹30,000 and ₹15,000 respectively. 5% interest on capital is to be allowed. Interest on drawings is to be charged at 6%. The drawings of X, Y and Z are ₹1500, ₹1000, ₹500 per month respectively drawn at the end of every month. Profits for the year ended 2023, before the above adjustment were ₹1,50,000.

Show how the profit is distributed and also prepare the capital accounts (a) if they are fluctuating (b) if they are fixed.

Solution

Profit and Loss (Appropriation) Account (Fig.in rupees)

Particulars	₹	₹	Particulars	₹	₹
To Partner's Salary			By Net Profit		1,50,000
	X 30,000 Y 15,000	45,000	By Interest on drawings	X 495 Y 330 Z 165	990
To Interest on Capital	X 15,000 Y 10,000 Z 5,000	30,000			
To Capital account	X 30,396 Y 30,396 Z 15,198	75,990			
		1,50,990			1,50,990

Capital Accounts (If the capitals are fluctuating)

Date	Particulars	X	Y	X	Date	Particulars	X	Y	X
2023	To Drawings	18000	12000	6000	2023				
2023 Dec. 31	To Interest on drawings	495	330	165	Jan. 1 Dec. 31	By Bank By Salary By Interest On Capital By P & L (App) A/c	3,00,000 2,00,000 15,000 30,396	2,00,000 15,000 10,000 30,396	1,00,000 5,000 15,198
			3,56,901	2,43066	1,14,033					
			3,75,396	**2,55,396**	**1,20,198**			**3,75,396**	**2,55,396**	**1,20,198**

Capital Accounts (If the capitals are fixed)

Fixed Capital Accounts

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2023 Dec.31	To Balance c/d	3,00,000	2,00,000	1,00,000	2023 Jan.1	By Bank	3,00,000	2,00,000	1,00,000
		3,00,000	**2,00,000**	**1,00,000**			**3,00,000**	**2,00,000**	**1,00,000**

Current Accounts (Also known as Drawings Account)

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2023	To Drawings	18,000	12,000	6,000	2023	By Salary	30,000	15,000	———
Dec.31	To Interest on drawings	495	330	165	Dec.31	By Interest on Capital	15,000	10,000	5,000
	To Balance c/d	56,901	43,066	14,033		By P & L (App) A/c	30,396	30,396	15,198
							75,396	**55,396**	**20,198**
		75,396	55,396	20,198	2024 Jan.1	By Balance b/d	75,396	55,396	20,198

Note:

Calculation of interest on drawings:

If drawings are made at regular intervals and that too in fixed amounts, then interest on drawings can be calculated on the basis of average period. The calculation of average period depends whether they are made at the beginning of the month or at the end of the month. Suppose, fixed amounts are drawn at the beginning of the month, then the average period is calculated as follows:

= (Total periods in months + 1)/2

On the other hand, if fixed amounts are drawn at the end of the month the average period is calculated as follows:

= (Total periods in month- 1)/2

In the above problem, fixed amounts are drawn at the end of every month. So interest on drawings is calculated as below:

Average Period = 12-1/2 = 5.5 months

Interest on X's drawings =1500*5.5*6/100 = ₹495

Interest on Y's drawings =1000*5.5*6/100 = ₹330

Interest on Z's drawings = 600*5.5*6/100 = ₹165

Admission of a partners:

Case 1

The new partner is given his share of profit and the remaining share of profit is presumed to be divided between the old partners in the old profit sharing ratios.

X and Y are partners sharing profits and losses in the ration of 3:2. They admit 'Z' to the partnership for 1/3 of profits. Calculate the new profit sharing ratio and sacrificing ratio.

Solution

'Z' is given 1/3 profit.

Therefore remaining share of profits= 1 – 1/3 = 2/3

2/3 of profits are to be shared between X and Y in the old profit sharing ratio.

Therefore,

X's share = 2/3*3/5 = 2/5

Y's share = 2/3*2/5 = 4/15

Z's share = 1/3

Therefore,

New profit sharing ratio X:Y:Z: 2/5 : 4/15 :1/3

= 6:4:5

Profit ratio between X and Y remains the same. So sacrificing ratio of X and Y is nothing but the old profit sharing ratio.

Case 2(a)

A and B are partners sharing profits and losses in the ratio of 5:3. C is admitted to the partnership and he acquires 3/16 share of profit from A and 1/16 share of profit from B. Calculate new profit sharing ratios among all partners and the sacrificing ratios between old partners.

A's new share of profit =5/8-3/16

= 10–3/16

= 7/16

B's new share of profit=3/8-1/16

= 6–1/16

= 5/16

C's new share of profit =3/16+1/16

= 3+1/16

= 4/16

New profit sharing ratios = A:B:C

= 7:5:4

Sacrificing ratios between A and B

A gives up (sacrifices) 3/16 share

B gives up (sacrifices) 1/16 share

Therefore

Sacrificing ratio = 3:1

Case 2(b)

M and N are partners sharing profits and losses in the ratio of 3:1. They admit '0' for 1/5 share in profits which he acquires equally from M and N. Calculate new profit sharing ratio and sacrificing ratio.

O gets 1/5 share.

(i.e.) ½ of 1/5 = 1/10 he gets it from M and N each.

Therefore ,

M's new share = ¾–1/10

=15–2/20

=13/20

N's new share =1/4-1/10

=5–2/20

=3/20

O's share=1/5 or 4/20

Therefore

New profit sharing ratio = M:N:O = 13:3:4

As the old partner give up their share to new partners equally, the sacrificing rarrio between M and N is 1:1.

Case 2(c)

P and Q are partners sharing profits and losses in the ratio of 3:2. They admit R for 1/5 share of profit which he acquires wholly from 'P'. Calculate the new profit sharing ratio and sacrificing ratio.

P's new share =3/5 –1/5

=2/5

Q's new share=2/5 (No change)

R's share=1/5

New profit sharing ratio = 2:2:1

Here, P, alone gives his 1/5 share to R. So sacrificing ratio for P is 1/5.

Calculation and Treatment of goodwill

Goodwill is an intangible asset. The ability of a business to earn excess profit is due to its reputation. This reputation expressed in monetary terms is goodwill. A number of factors are responsible for good reputation like location, product, management, etc.

Goodwill is valued usually at the time of sale of business. But in the following cases also goodwill is valued.

1. When profit sharing ratios among existing partners is changed
2. Admission of a partner
3. Death or retirement of a partner
4. Amalgamation of two firms.

Following are the methods of valuing goodwill:

1. Average profits method
2. Super profits method
3. Capitalization method

I. Average Profits Method

In this method, goodwill is valued by multiplying the average profits of last few years by an agreed number.

Goodwill = Average Profits * No. of Years' Purchase.

Example 1: compute the value of goodwill on the basis of three years' purchase of the average profits of last 4 years. The profits of the last 4 years are:

2013 - ₹80,000

2014 - ₹90,000

2015 - ₹82000

2016 - ₹86,000

Solution:

Average profits of last years

80,000+90,000+82,000+86,000/4

3,38,000/4= ₹84,500

Value of goodwill = ₹84,000* 3 = ₹2,53,500

Another variation of average profit method is weighted average method. Here weights are assigned to each year's profit and the weighted average profits is calculated. Here goodwill is

Goodwill = weighted laverage profit* No. of years purchase

Example 2

Compute the goodwill of a firm on the basis of 3 years' purchase of weighted profits of last four years (assign weights 1, 2, 3 and 4 serially to the profits).

Profits of last 4 years are:

2013-₹40,000

2014-₹45,000

2015-₹50,000

2016-₹55,000

Solution

Year	Annual Profits	Weights	Product
2013	40,000	1	40,000
2014	45,000	2	90,000
2015	50,000	3	1,50,000
2016	55,000	4	2,20,000
		10	5,00,000

Weighted average profit = Total product / Total weight

= 5,00,000 / 10 = ₹50,000

Value of goodwill = Wt. average profit X No. of year purchase

= 50,000 X 3 = ₹1,50,000

J. Super Profits Method

Super profits are profits earned in excess of normal profits.

Goodwill under this Method = Super Profit X No. of Years' Purchase

Normal profit = Capital employed X normal rate of return

Example 3

From the following information, calculate goodwill using super profits method.

a) Capital employed in the business ₹6,00,000

b) Normal rate of return 10%

c) Profits for the last 3 years were

₹75,000; ₹80,000; ₹85,000

d) Goodwill is 4years purchase of super profit

Average profits = 75,000 + 80,000 + 85,000 /3

= 2,40,000/3 = ₹80,000

Normal profits = Capital employed x normal rate of return

= 6,00,000 x 10/100 = ₹60,000

Super profit = ₹80,000 – ₹60,000 = ₹20,000

Goodwill = ₹20,000 x 4 = ₹80,000

Capitalization Method

Under this method goodwill is the difference between capitalized value of average profits at normal rate of return and actual capital employed.

Example

Solution

From the following, calculate goodwill

a) Normal rate of return 10%

b) Average profits for last 3 years

₹75,000; ₹80,000; ₹85,000

c) Total assets ₹7,00,000 and total liabilities ₹2,00,000

Solution

Average profits = 75,000 + 80,000 + 85,000 3/3

= ₹80,000

Capitalized value of average profits

= average profit x 100 / Normal rate of return

= 80,000 x 100/10

= ₹8,00,000

Capital employed = Total tangible asset – Total liabilities

= ₹7,00,000 – ₹2,00,000

= ₹5,00,000

Goodwill = Capitalized value of average profit at normal rate of return capital employed

= ₹ 8,00,000 ₹5,00,000

= ₹ 3,00,000

Treatment of Goodwill

When a new partner is admitted into a firm , the old give up a part of their share of profits in favour of the new partner. Also the new partner is going to enjoy the goodwill of the firm which was built up by the old partners. So the old partners have to be compensated either by payment of money by the new partner or by way of extra credits in their capital accounts.

There are three ways by which goodwill is dealt with when a new partner is admitted. They are

1. Premium Method
2. Revaluation Method
3. Memorandum Revaluation Method

1. Premium Method

Under this method, the new partner brings his share of goodwill in cash as premium. The amount of goodwill is credited to the old partners in their **profit-sacrificing ratios**.

Journal Entries in the Books of the Firm

1. When the New Partner Brings Goodwill in Cash

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c Dr.		****	
	To Goodwill A/c			****

2. **When Goodwill is Distributed Among the Old Partners**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Goodwill A/c Dr.		****	
	To Old Partner's Capital A/c			****
	To Old Partner's Capital A/c			****

	(Being goodwill brought in by the new partner credited to the old partners in their profit-sacrificing ratios)			

3. When the Old Partners Withdraw Their Share of Goodwill

If the old partners are allowed to withdraw the whole or part of their share of goodwill:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Old Partner's Capital A/c Dr.		****	
	Old Partner's Capital A/c Dr.		****	
	To Cash/Bank A/c			****
	(Being the amount of goodwill withdrawn by the old partners)			

Example

X and Y are partners in a business, sharing profits and losses @ 3:1. They admit Z for 1/5 share. Z bring 1 s. 10,000 as his capital and ₹8,000 as goodwill. Pass Journal entry to record the transactions.

(a) When goodwill amount is returned in the business

(b) When the entire amount of goodwill is withdrawn

(c) When 50% of the goodwill is withdrawn

Solution:

□ X = ₹8,000 × 3/4 = **₹6,000**

□ Y = ₹8,000 × 1/4 = **₹2,000**

(a) When the Goodwill Amount is Retained in the Business

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c Dr.		18,000	
	To Z's Capital A/c			10,000
	To Goodwill A/c			8,000
	(Being ₹10,000 brought in by Z as capital and ₹8,000 as goodwill)			
	Goodwill A/c Dr.		8,000	

	To X's Capital A/c			6,000
	To Y's Capital A/c			2,000
	(Being goodwill brought in by Z credited to X and Y in their sacrificing ratio of 3:1)			

(b) When the Entire Goodwill Amount is Withdrawn

The first **two entries remain the same** as above. In addition:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	X's Capital A/c Dr.		6,000	
	Y's Capital A/c Dr.		2,000	
	To Cash/Bank A/c			8,000
	(Being the entire amount of goodwill credited to the old partners withdrawn)			

(c) When 50% of the Goodwill is Withdrawn

50% of goodwill = ₹8,000 × 50% = **₹4,000**

X's share = ₹6,000 × 50% = **₹3,000**

Y's share = ₹2,000 × 50% = **₹1,000**

The first two entries remain the same as in (a). The additional withdrawal entry is:

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	X's Capital A/c Dr.		3,000	
	Y's Capital A/c Dr.		1,000	
	To Cash/Bank A/c			4,000
	(Being 50% of the goodwill credited to the old partners withdrawn)			

Revaluation Method

When the incoming partner is not in a position to pay in cash for goodwill, then goodwill is raised in the books, by crediting the old partners' capital account in their old profit sharing ratio. There are two possibilities here

1. No goodwill account appears in the books in the books at the time of admission
2. When there is goodwill account at the time of admission

1. **No goodwill account appears in the books at the time of admission**

In such a case goodwill is to be brought into books at its agreed value by debiting the goodwill account and crediting the capital the capital accounts of old partner in their old profit sharing ratio. Here the goodwill account will appear in the balance sheet. The following jpurnal entry is passed.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Goodwill A/c Dr.		****	
	To Old Partner's Capital A/c			****
	To Old Partner's Capital A/c			****
	(Being goodwill raised in the books at its agreed value by crediting the old partners' capital accounts in their old profit-sharing ratio)			

Example

X and Y are partners sharing profits and losses in the ratio of 3:1. They admit 'Z' for 1/5 share. 'Z' brings in ₹20,000 for his capital, but is not in a position to bring cash for goodwill. The value of goodwill is agreed at ₹12,000. No goodwill account appears in the books. Pass necessary entries.

1. For Capital Brought in by Z

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c Dr.		20,000	
	To Z's Capital A/c			20,000
	(Being the amount brought in by Z as his capital)			

2. For Raising Goodwill in the Books

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Goodwill A/c Dr.		12,000	

	To X's Capital A/c			8,000
	To Y's Capital A/c			4,000
	(Being goodwill account raised in the books at its agreed value by crediting the old partners' capital accounts in their old profit-sharing ratio)			

2. When there is goodwill account at the time of admission

When Goodwill Already Appears in the Books

When a new partner is admitted and a **Goodwill Account already appears in the books of the firm**, the adjustment for goodwill in the old partners' capital accounts is made only for the **difference between the agreed value of goodwill and the existing book value of goodwill.**

If the **agreed value of goodwill is higher than the existing book value**, the Goodwill Account is increased by the difference. The increase is credited to the **old partners' capital accounts in their old profit-sharing ratio**.

If the **agreed value of goodwill is lower than the existing book value**, the excess amount of goodwill appearing in the books is written off by debiting the **old partners' capital accounts in their old profit-sharing ratio.**

Example

X and Y are partners of a fime sharing profits and losses in in the ratio of 3:2. They admit Z for 1/5 share in profits. Z brings in ₹20,000 as his capital. The value of goodwill is estimated at ₹20,000. Give journal entries under the following circumstances.

1. When there is no goodwill appearing in the books of the firm
2. When the goodwill account appears at ₹10,000 in the books of the firm
3. When the goodwill account appears at ₹30,000 in the books of the firm

Solution:

For the goodwill adjustment:

- X's share = ₹20,000 × 3/5 = **₹12,000**
- Y's share = ₹20,000 × 2/5 = **₹8,000**

1. When there is No Goodwill Appearing in the Books

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c	Dr.		20,000	
	To Z's Capital A/c				20,000
	(Being capital introduced by Z)				
	Goodwill A/c	Dr.		20,000	
	To X's Capital A/c				12,000
	To Y's Capital A/c				8,000
	(Being goodwill raised at its agreed value and credited to old partners in their old profit-sharing ratio of 3:2)				

2. When Goodwill Appears at ₹10,000 in the Books

Agreed value = ₹20,000

Existing goodwill = ₹10,000

Increase in goodwill = ₹20,000 – ₹10,000 = ₹10,000

This increase is credited to X and Y in the ratio 3:2:

- X = ₹10,000 × 3/5 = **₹6,000**
- Y = ₹10,000 × 2/5 = **₹4,000**

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c	Dr.		20,000	
	To Z's Capital A/c				20,000
	(Being capital introduced by Z)				
	Goodwill A/c	Dr.		10,000	
	To X's Capital A/c				6,000
	To Y's Capital A/c				4,000
	(Being goodwill increased to its agreed value and the increase credited to old partners in their old profit-sharing ratio)				

Note: Existing goodwill ₹10,000 + increase ₹10,000 = agreed goodwill ₹20,000.

3. When Goodwill Appears at ₹30,000 in the Books

Agreed value = ₹20,000

Existing goodwill = ₹30,000

Excess goodwill = ₹30,000 – ₹20,000 = ₹10,000

The excess is written off by debiting X and Y's Capital Accounts in their old ratio of 3:2:

- X = ₹10,000 × 3/5 = **₹6,000**
- Y = ₹10,000 × 2/5 = **₹4,000**

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c	Dr.		20,000	
	To Z's Capital A/c				20,000
	(Being capital introduced by Z)				
	X's Capital A/c	Dr.		6,000	
	Y's Capital A/c	Dr.		4,000	
	To Goodwill A/c				10,000
	(Being excess goodwill written off to bring the Goodwill Account down to its agreed value, debiting old partners in their old profit-sharing ratio)				

Memorandum Revaluation Method

If all partners decide not to show the goodwill account in the books, then they can write back the same by passing the following entry.

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	All Partners' Capital A/cs	Dr.		****	
	To Goodwill A/c				****
	(Being the Goodwill Account written back by debiting the capital accounts of all partners, including the new partner, in their new profit-sharing ratio)				

Example

A and B are partners sharing profits and losses in the ratio of 5:4. They admit "C" and the new profit sharing ratio is 4:3:2. 'C' brings ₹20,000 as his capital. The value of goodwill is estimated at ₹36,000. Give necessary entries in the books of the firm on C's admission assuming that the partners do not want goodwill to appear in the books.

Solution:

Working

Old ratio of A and B = 5 : 4

New ratio of A, B and C = 4 : 3 : 2

Goodwill = ₹36,000

1. *Goodwill credited to old partners in old ratio*

   A's share = ₹36,000 × 5/9 = **₹20,000**

   B's share = ₹36,000 × 4/9 = **₹16,000**

2. *Goodwill written back in new ratio*

   A's share = ₹36,000 × 4/9 = **₹16,000**

   B's share = ₹36,000 × 3/9 = **₹12,000**

   C's share = ₹36,000 × 2/9 = **₹8,000**

Therefore, the net adjustment is:

- A: ₹20,000 – ₹16,000 = **₹4,000 credit**
- B: ₹16,000 – ₹12,000 = **₹4,000 credit**
- C: ₹8,000 debit

1. **For Capital Brought in by C**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c Dr.		20,000	
	To C's Capital A/c			20,000
	(Being capital introduced by C)			

2. *For Raising Goodwill*

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Goodwill A/c Dr.		36,000	
	To A's Capital A/c			20,000
	To B's Capital A/c			16,000
	(Being goodwill raised at its agreed value and credited to old partners in their old profit-sharing ratio of 5:4)			

3. ***For Writing Back Goodwill***

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	A's Capital A/c Dr.		16,000	
	B's Capital A/c Dr.		12,000	
	C's Capital A/c Dr.		8,000	
	To Goodwill A/c			36,000
	(Being goodwill written back by debiting all partners' capital accounts in their new profit-sharing ratio of 4:3:2)			

Revaluation of Assets and Liabilities

At the time of admission of a partner into a partnership firm the assets and liabilities of the firm is revalued. The logic behind this exercise is to see that the new partner is not gaining due to understated assets and overstated liabilities or losing due to overstated assets and understated liabilities.

A revaluation (also Known as Profit and Loss Adjustment Account) is opened and necessary entries are passed to bring the assets and liabilities to its real value at the time of admission. Then the profit or loss arising out of revaluation of assets and liabilities is transferred to the capital accounts of the old partners in their profit sharing ratios.

1. For Increase in the Value of Assets

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Asset A/c Dr.		****	
	To Revaluation A/c			****
	(Being the increase in the value of assets recorded)			

2. For Decrease in the Value of Assets

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Revaluation A/c Dr.		****	
	To Asset A/c			****
	(Being the decrease in the value of assets recorded)			

3. For Increase in the Value of Liabilities

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Revaluation A/c Dr.		****	
	To Liability A/c			****
	(Being the increase in the value of liabilities recorded)			

4. For Decrease in the Value of Liabilities

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Liability A/c Dr.		****	
	To Revaluation A/c			****
	(Being the decrease in the value of liabilities recorded)			

5. For Transfer of Profit on Revaluation

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Revaluation A/c Dr.		****	
	To Old Partners' Capital A/cs			****
	(Being profit on revaluation transferred to old partners' capital accounts in their old profit-sharing ratio)			

6. For Transfer of Loss on Revaluation

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Old Partners' Capital A/cs Dr.		****	
	To Revaluation A/c			****
	(Being loss on revaluation transferred to old partners' capital accounts in their old profit-sharing ratio)			

Problem: Goodwill Premium in cash, revaluation and reserves

A and B share profits in the ratio 3 : 2. Their Balance Sheet on 31 March 2026 was:

Balance Sheet of A and B as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	60,000	Cash	10,000
Capital – B	40,000	Debtors	30,000
General Reserve	10,000	Stock	20,000
Creditors	30,000	Plant	40,000
		Building	40,000
Total	**1,40,000**	**Total**	**1,40,000**

C is admitted for **1/5th share** on these terms:

(1) C brings ₹40,000 as capital and ₹10,000 as premium for goodwill, both in cash.

(2) Building is to be appreciated by ₹10,000 and Plant is to be depreciated by ₹4,000.

(3) A provision for doubtful debts of ₹2,000 is to be created.

(4) General Reserve is to be distributed among old partners.

Pass journal entries, prepare Revaluation A/c, Partners' Capital A/c and the new Balance Sheet.

Solution

Working notes

- New share of C = 1/5. Remaining 4/5 is shared by A and B in 3 : 2 → A = 3/5 × 4/5 = **12/25**, B = 2/5 × 4/5 = **8/25**, C = 5/25.
- Sacrificing ratio: A = 3/5 − 12/25 = 3/25; B = 2/5 − 8/25 = 2/25 → **3 : 2**.
- Premium ₹10,000 → A ₹6,000, B ₹4,000.
- Net revaluation = 10,000 − 4,000 − 2,000 = **₹4,000 profit** → A (3/5) ₹2,400, B (2/5) ₹1,600.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Apr 1	Bank A/c ... Dr.	50,000	
	To C's Capital A/c		40,000
	To Premium for Goodwill A/c		10,000
	(Being capital and premium brought in by C)		

2026 Apr 1	Premium for Goodwill A/c ... Dr.	10,000	
	To A's Capital A/c		6,000
	To B's Capital A/c		4,000
	(Being premium shared by sacrificing partners in 3 : 2)		
2026 Apr 1	General Reserve A/c ... Dr.	10,000	
	To A's Capital A/c		6,000
	To B's Capital A/c		4,000
	(Being General Reserve distributed in old ratio 3 : 2)		
2026 Apr 1	Building A/c ... Dr.	10,000	
	To Revaluation A/c		10,000
	(Being building appreciated)		
2026 Apr 1	Revaluation A/c ... Dr.	6,000	
	To Plant A/c		4,000
	To Provision for Doubtful Debts A/c		2,000
	(Being plant depreciated and provision created)		
2026 Apr 1	Revaluation A/c ... Dr.	4,000	
	To A's Capital A/c		2,400
	To B's Capital A/c		1,600
	(Being profit on revaluation transferred to old partners)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Plant	4,000	By Building	10,000
To Provision for Doubtful Debts	2,000		
To Profit transferred to: A's Capital	2,400		
To B's Capital	1,600		
Total	**10,000**	**Total**	**10,000**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To Balance c/d	74,400	49,600	40,000	By Balance b/d	60,000	40,000	

				By Bank			40,000
				By Premium for Goodwill	6,000	4,000	
				By General Reserve	6,000	4,000	
				By Revaluation (profit)	2,400	1,600	
Total	**74,400**	**49,600**	**40,000**	**Total**	**74,400**	**49,600**	**40,000**

Balance Sheet of A, B and C after admission (1 April 2026)

Liabilities	₹	Assets	₹
Capital – A	74,400	Cash (10,000 + 50,000)	60,000
Capital – B	49,600	Debtors (30,000 – 2,000)	28,000
Capital – C	40,000	Stock	20,000
Creditors	30,000	Plant (40,000 – 4,000)	36,000
		Building (40,000 + 10,000)	50,000
Total	**1,94,000**	**Total**	**1,94,000**

Problem

Goodwill not brought in cash

X and Y share profits 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet of X and Y as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – X	50,000	Cash	15,000
Capital – Y	30,000	Debtors	25,000
Creditors	25,000	Stock	30,000
		Furniture	15,000
		Machinery	20,000
Total	**1,05,000**	**Total**	**1,05,000**

Z is admitted for **1/4th share** and brings ₹30,000 as capital. Goodwill of the firm is valued at ₹24,000, but **Z cannot bring his share of goodwill in cash**, so it is to be adjusted through his capital account. Stock is to be

increased by ₹6,000, Furniture reduced by ₹3,000, and outstanding rent of ₹1,500 is to be recorded. Remaining 3/4th is shared by X and Y in their old ratio.

Show journal, Revaluation A/c, Capital A/c and the new Balance Sheet.

Solution

Working notes

- New ratio: Z = 1/4; X = 3/4 × 2/3 = 1/2; Y = 3/4 × 1/3 = 1/4 → **2 : 1 : 1**.
- Sacrificing: X = 2/3 − 1/2 = 1/6; Y = 1/3 − 1/4 = 1/12 → **2 : 1**.
- Z's share of goodwill = 24,000 × 1/4 = ₹6,000 → credited to X ₹4,000 and Y ₹2,000; debited to Z's capital.
- Revaluation: gain 6,000 − loss (3,000 + 1,500) = **₹1,500 profit** → X ₹1,000, Y ₹500 (old ratio 2 : 1).

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Apr 1	Bank A/c ... Dr.	30,000	
	To Z's Capital A/c		30,000
	(Being capital brought in by Z)		
2026 Apr 1	Z's Capital A/c ... Dr.	6,000	
	To X's Capital A/c		4,000
	To Y's Capital A/c		2,000
	(Being Z's share of goodwill adjusted; shared in sacrificing ratio 2 : 1)		
2026 Apr 1	Stock A/c ... Dr.	6,000	
	To Revaluation A/c		6,000
	(Being stock appreciated)		
2026 Apr 1	Revaluation A/c ... Dr.	4,500	
	To Furniture A/c		3,000
	To Outstanding Rent A/c		1,500
	(Being furniture reduced and outstanding rent recorded)		
2026 Apr 1	Revaluation A/c ... Dr.	1,500	
	To X's Capital A/c		1,000
	To Y's Capital A/c		500
	(Being revaluation profit shared in old ratio)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Furniture	3,000	By Stock	6,000
To Outstanding Rent	1,500		
To Profit: X's Capital	1,000		
To Profit: Y's Capital	500		
Total	**6,000**	**Total**	**6,000**

Partners' Capital Accounts

Dr. Particulars	X	Y	Z	Cr. Particulars	X	Y	Z
To Goodwill (Z's share)			6,000	By Balance b/d	50,000	30,000	
To Balance c/d	55,000	32,500	24,000	By Bank			30,000
				By Goodwill	4,000	2,000	
				By Revaluation (profit)	1,000	500	
Total	**55,000**	**32,500**	**30,000**	**Total**	**55,000**	**32,500**	**30,000**

Balance Sheet of X, Y and Z after admission

Liabilities	₹	Assets	₹
Capital – X	55,000	Cash (15,000 + 30,000)	45,000
Capital – Y	32,500	Debtors	25,000
Capital – Z	24,000	Stock (30,000 + 6,000)	36,000
Creditors	25,000	Furniture (15,000 – 3,000)	12,000
Outstanding Rent	1,500	Machinery	20,000
Total	**1,38,000**	**Total**	**1,38,000**

Problem

Existing goodwill and capital adjustment

A and B share profits equally. Balance Sheet on 31 March 2026:

Balance Sheet of A and B as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	50,000	Cash	8,000
Capital – B	30,000	Debtors	30,000
General Reserve	12,000	Stock	32,000
Creditors	28,000	Machinery	40,000
		Goodwill	10,000
Total	**1,20,000**	**Total**	**1,20,000**

C is admitted for **1/3rd share** (new ratio equal). He brings ₹40,000 as capital and his share of goodwill in cash; goodwill of the firm is valued at ₹30,000. Machinery is appreciated by ₹6,000. **The capitals of A and B are to be adjusted in proportion to C's capital** by paying off or bringing in cash.

Solution

Working notes

- Goodwill in books (₹10,000) is written off in old ratio: A ₹5,000, B ₹5,000.
- Sacrificing: A = 1/2 − 1/3 = 1/6; B = 1/6 → 1 : 1. C's goodwill = 30,000 × 1/3 = ₹10,000 → A ₹5,000, B ₹5,000.
- Revaluation profit ₹6,000 → A ₹3,000, B ₹3,000. Reserve ₹12,000 → A ₹6,000, B ₹6,000.
- Total capital of the firm = 40,000 × 3 = ₹1,20,000 → each partner ₹40,000.
- A's capital before adjustment = 50,000 − 5,000 + 5,000 + 6,000 + 3,000 = ₹59,000 → **withdraws ₹19,000**. B's = 30,000 − 5,000 + 5,000 + 6,000 + 3,000 = ₹39,000 → **brings ₹1,000**.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Apr 1	Bank A/c ... Dr.	50,000	
	To C's Capital A/c		40,000
	To Premium for Goodwill A/c		10,000
	(Being capital and goodwill brought in by C)		

2026 Apr 1	Premium for Goodwill A/c ... Dr.	10,000	
	To A's Capital A/c		5,000
	To B's Capital A/c		5,000
	(Being premium shared in sacrificing ratio 1 : 1)		
2026 Apr 1	A's Capital A/c ... Dr.	5,000	
	B's Capital A/c ... Dr.	5,000	
	To Goodwill A/c		10,000
	(Being existing goodwill written off in old ratio)		
2026 Apr 1	General Reserve A/c ... Dr.	12,000	
	To A's Capital A/c		6,000
	To B's Capital A/c		6,000
	(Being reserve distributed in old ratio)		
2026 Apr 1	Machinery A/c ... Dr.	6,000	
	To Revaluation A/c		6,000
	(Being machinery appreciated)		
2026 Apr 1	Revaluation A/c ... Dr.	6,000	
	To A's Capital A/c		3,000
	To B's Capital A/c		3,000
	(Being revaluation profit transferred)		
2026 Apr 1	A's Capital A/c ... Dr.	19,000	
	To Bank A/c		19,000
	(Being excess capital withdrawn by A)		
2026 Apr 1	Bank A/c ... Dr.	1,000	
	To B's Capital A/c		1,000
	(Being additional capital brought in by B)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Profit: A's Capital	3,000	By Machinery	6,000
To Profit: B's Capital	3,000		
Total	**6,000**	**Total**	**6,000**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To Goodwill (written off)	5,000	5,000		By Balance b/d	50,000	30,000	
To Bank (withdrawn)	19,000			By Bank		1,000	40,000
To Balance c/d	40,000	40,000	40,000	By Premium for Goodwill	5,000	5,000	
				By General Reserve	6,000	6,000	
				By Revaluation (profit)	3,000	3,000	
Total	**64,000**	**45,000**	**40,000**	**Total**	**64,000**	**45,000**	**40,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	8,000	By A's Capital	19,000
To C's Capital and Premium	50,000	By Balance c/d	40,000
To B's Capital	1,000		
Total	**59,000**	**Total**	**59,000**

Balance Sheet of A, B and C after admission

Liabilities	₹	Assets	₹
Capital – A	40,000	Cash	40,000
Capital – B	40,000	Debtors	30,000
Capital – C	40,000	Stock	32,000
Creditors	28,000	Machinery (40,000 + 6,000)	46,000
Total	**1,48,000**	**Total**	**1,48,000**

Retirement of a Partner

A partnership firm may continue for many years, and during its existence one or more partners may withdraw from the business. Such withdrawal may occur because of old age, ill health, personal reasons, or a desire to pursue another profession. When a partner voluntarily leaves the firm and the remaining partners continue the business, the event is known as **retirement of a partner**.

Retirement results in a **reconstitution of the partnership firm** because the profit-sharing relationship among the partners changes. Therefore, several accounting adjustments become necessary to ensure that the retiring partner receives the amount rightfully due.

Meaning

Retirement of a partner means the withdrawal of an existing partner from the partnership firm while the business continues with the remaining partners.

Definition

Retirement of a Partner is the voluntary withdrawal of a partner from an existing partnership firm, resulting in a reconstitution of the partnership among the continuing partners.

Need for Retirement Accounting

Accounting treatment is required on retirement to:

- determine the amount payable to the retiring partner,
- adjust goodwill,
- revalue assets and liabilities,
- distribute reserves and accumulated profits,
- calculate the gaining ratio of continuing partners,
- settle the retiring partner's capital account, and
- prepare the revised balance sheet.

Rights of the Retiring Partner

A retiring partner is generally entitled to:

- balance in capital account,
- share of goodwill,
- share of reserves and accumulated profits,
- share of revaluation profit or loss,
- interest on capital up to the date of retirement (if agreed), and
- share of profit up to the date of retirement.

Important Accounting Adjustments

Meaning

Retirement means withdrawal of an existing partner while the firm continues.

Key Terms

- Gaining Ratio
- Settlement of Capital
- Revaluation
- Goodwill Adjustment

Illustration

A, B, and C share profits 3:2:1. C retires. A and B agree to share profits equally.

Old shares: A = 3/6, B = 2/6

New shares: A = 1/2 = 3/6, B = 1/2 = 3/6

Gain of A = 0

Gain of B = 1/6

Gaining Ratio = 0:1 = B alone gains.

Illustration: GOODWILL on retirement:

- Retiring partner RECEIVES compensation for goodwill
- Remaining (gaining) partners PAY in GAINING RATIO

Amount due to Retiring Partner:

Particulars	Amount
Opening Capital	****
Add: Share in reserves	****
Share in goodwill	****
Share in revaluation profit	****
Less: Share in revaluation loss	****
Drawings	****
Total Amount Due	****

Problem 1 —

Question:

Anand, Babu and Chitra share profits 4:3:3. Chitra retires. After Chitra's retirement, Anand and Babu share profits in ratio 3:2. Find the Gaining Ratio.

Given:

- Old Ratio: Anand = 4/10, Babu = 3/10, Chitra = 3/10
- New Ratio (after retirement): Anand = 3/5, Babu = 2/5

Step 1 — Convert new ratio to same denominator:

Anand new = 3/5 = 6/10

Babu new = 2/5 = 4/10

Step 2 — Gaining Ratio = New Ratio MINUS Old Ratio:

Anand gains = 6/10 minus 4/10 = 2/10

Babu gains = 4/10 minus 3/10 = 1/10

Step 3 — Gaining Ratio:

Anand : Babu = 2 : 1

Verification:

Total gained = 2/10 + 1/10 = 3/10 = Chitra's old share.

Final Answer:

Gaining Ratio = Anand : Babu = 2 : 1

Explanation:

When Chitra leaves, her share is taken over by Anand and Babu. The GAINING RATIO tells us HOW MUCH each of them took from Chitra. Anand took 2/10 of Chitra's share and Babu took 1/10. So the gaining ratio is 2:1. This ratio is important because it determines who pays how much goodwill to the retiring partner.

Problem 2 — Basic (Goodwill on Retirement)

Question:

Deepa, Ela and Faru share profits 5:3:2. Faru retires. Deepa and Ela take Faru's share in equal proportion. Firm's goodwill = ₹60,000. Pass the journal entry for goodwill.

Given:

- Old Ratio: Deepa = 5/10, Ela = 3/10, Faru = 2/10
- Faru retires, Deepa and Ela gain equally
- Total goodwill = ₹60,000

Step 1 — Faru's share of goodwill:

Faru retires with 2/10 share

His goodwill = ₹60,000 × 2/10 = ₹12,000

Step 2 — Gaining Ratio:

Faru's share = 2/10 = taken equally by Deepa and Ela

Each gains = 1/10

Gaining Ratio = Deepa : Ela = 1 : 1

Step 3 — Who pays how much:

Deepa pays = 12,000 × 1/2 = ₹6,000

Ela pays = 12,000 × 1/2 = ₹6,000

Step 4 — Journal Entry:

Particulars		Debit	Credit
Deepa's Capital A/c	Dr	6,000	
Ela's Capital A/c	Dr	6,000	
To Faru's Capital A/c			12,000

Final Answer: Faru receives ₹12,000 as goodwill compensation. Deepa pays ₹6,000 and Ela pays ₹6,000.

Problem 3 —Amount Due to Retiring Partner

Question:

Ganesh, Hari and Indra share profits in ratio 2:2:1.

Indra retires on 31st December 2024.

On that date:

Indra's Capital balance = ₹30,000

Indra's share in General Reserve = ₹5,000

Indra's share in Revaluation Profit = ₹3,000

Indra's share of Goodwill = ₹8,000

Indra's Drawings = ₹2,000

Calculate TOTAL AMOUNT DUE to Indra.

Given:

- Capital = ₹30,000
- General Reserve share = ₹5,000
- Revaluation Profit share = ₹3,000
- Goodwill share = ₹8,000
- Drawings = ₹2,000 (this must be deducted)

Step 1 — List what Indra GETS (Additions):

Particulars	Amount ₹	Amount ₹
Capital		30,000
Add: General Reserve	5,000	
Revaluation Profit	3,000	
Goodwill	8,000	16,000
Total (before deductions)		46,000
Less: Drawings		2,000
Total Amount Due		**44,000**

Final Answer: Total amount due to Indra on retirement = ₹44,000

Problem 4 —Settlement of Retirement Dues

Question:

Janaki retires from her firm. Total amount due to Janaki = ₹75,000. The firm pays her ₹25,000 immediately in cash. The remaining amount is transferred to her Loan Account. Pass Journal Entries for settlement.

Given:

- Total due = ₹75,000
- Cash paid immediately = ₹25,000
- Balance to Loan Account = 75,000 - 25,000 = ₹50,000

Step 1 — Transfer amount due to Janaki's Capital Account:

(All calculations already done in Capital Account, so we just settle it now)

Step 2 — Journal Entry for immediate payment:

Particulars		Debit	Credit
Janaki's Capital A/c	Dr	25,000	
To Cash / Bank A/c			25,000

Step 3 — Journal Entry for balance to Loan Account:

Particulars		Debit	Credit
Janaki's Capital A/c	Dr	50,000	
To Janaki's Loan A/c			50,000

Final Answer:

Cash paid = ₹25,000

Janaki's Loan Account created = ₹50,000 (firm owes this to Janaki)

Problem: Existing Goodwill, workmen's compensation reserve

P, Q and R share profits 3 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – P	60,000	Cash	25,000
Capital – Q	40,000	Debtors	35,000
Capital – R	30,000	Stock	30,000
Workmen's Compensation Reserve	9,000	Furniture	20,000
Creditors	21,000	Plant	38,000
		Goodwill	12,000
Total	**1,60,000**	**Total**	**1,60,000**

R retires on 31 March 2026. Terms: (i) Goodwill of the firm is valued at ₹36,000; (ii) Plant is depreciated by ₹8,000 and Furniture is appreciated by ₹2,000; (iii) A claim for workmen's compensation is estimated at ₹3,000; (iv) P and Q will share future profits 3 : 2; (v) R is paid ₹15,000 immediately and the balance is transferred to his loan account.

Solution

Working notes

- Existing goodwill ₹12,000 is written off in the old ratio 3 : 2 : 1 → P ₹6,000, Q ₹4,000, R ₹2,000.
- Gaining ratio: P = 3/5 − 3/6 = 3/30; Q = 2/5 − 2/6 = 2/30 → **3 : 2**. R's share of new goodwill = 36,000 × 1/6 = ₹6,000 → P ₹3,600, Q ₹2,400.
- Revaluation loss = 8,000 − 2,000 = ₹6,000 → P ₹3,000, Q ₹2,000, R ₹1,000.
- Workmen's Compensation Reserve ₹9,000: ₹3,000 remains as liability for the claim, the excess ₹6,000 goes to partners in old ratio → P ₹3,000, Q ₹2,000, R ₹1,000.
- Amount due to R = 30,000 − 2,000 + 6,000 − 1,000 + 1,000 = **₹34,000** → ₹15,000 cash + ₹19,000 loan.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	P's Capital A/c ... Dr.	6,000	
	Q's Capital A/c ... Dr.	4,000	
	R's Capital A/c ... Dr.	2,000	
	To Goodwill A/c		12,000
	(Being existing goodwill written off in old ratio)		
2026 Mar 31	P's Capital A/c ... Dr.	3,600	
	Q's Capital A/c ... Dr.	2,400	
	To R's Capital A/c		6,000
	(Being R's share of goodwill adjusted in gaining ratio 3 : 2)		
2026 Mar 31	Furniture A/c ... Dr.	2,000	
	To Revaluation A/c		2,000
	(Being furniture appreciated)		
2026 Mar 31	Revaluation A/c ... Dr.	8,000	
	To Plant A/c		8,000
	(Being plant depreciated)		
2026 Mar 31	P's Capital A/c ... Dr.	3,000	
	Q's Capital A/c ... Dr.	2,000	
	R's Capital A/c ... Dr.	1,000	
	To Revaluation A/c		6,000
	(Being revaluation loss shared in old ratio)		
2026 Mar 31	Workmen's Compensation Reserve A/c ... Dr.	9,000	
	To Workmen's Compensation Claim A/c		3,000
	To P's Capital A/c		3,000
	To Q's Capital A/c		2,000
	To R's Capital A/c		1,000
	(Being reserve applied to claim and balance distributed in old ratio)		
2026 Mar 31	R's Capital A/c ... Dr.	34,000	
	To Bank A/c		15,000
	To R's Loan A/c		19,000
	(Being amount due to R settled)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Plant	8,000	By Furniture	2,000
		By Loss: P's Capital	3,000
		By Loss: Q's Capital	2,000
		By Loss: R's Capital	1,000
Total	**8,000**	**Total**	**8,000**

Partners' Capital Accounts

Dr. Particulars	P	Q	R	Cr. Particulars	P	Q	R
To Goodwill (written off)	6,000	4,000	2,000	By Balance b/d	60,000	40,000	30,000
To Goodwill (R's share)	3,600	2,400		By Workmen's Comp. Reserve	3,000	2,000	1,000
To Revaluation (loss)	3,000	2,000	1,000	By Goodwill			6,000
To Bank			15,000				
To R's Loan			19,000				
To Balance c/d	50,400	33,600					
Total	**63,000**	**42,000**	**37,000**	**Total**	**63,000**	**42,000**	**37,000**

Balance Sheet of P and Q after R's retirement

Liabilities	₹	Assets	₹
Capital – P	50,400	Cash (25,000 – 15,000)	10,000
Capital – Q	33,600	Debtors	35,000
R's Loan	19,000	Stock	30,000
Workmen's Compensation Claim	3,000	Furniture (20,000 + 2,000)	22,000
Creditors	21,000	Plant (38,000 – 8,000)	30,000
Total	**1,27,000**	**Total**	**1,27,000**

Problem 3 – Share of profit up to date of retirement

X, Y and Z share profits 2 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – X	70,000	Cash	40,000
Capital – Y	60,000	Debtors	40,000
Capital – Z	40,000	Stock	45,000
Reserve Fund	15,000	Machinery	50,000
Creditors	25,000	Land	35,000
Total	**2,10,000**	**Total**	**2,10,000**

Z retires on **30 September 2026**. X and Y will share future profits equally. Terms: (i) Goodwill is valued at 2 years' purchase of average profit of the last three years (₹30,000, ₹40,000, ₹50,000); (ii) Land is appreciated by ₹20,000 and Machinery depreciated by ₹5,000; (iii) Z is entitled to his share of profit up to the date of retirement on the basis of last year's profit (₹50,000); (iv) Z is paid ₹30,000 in cash and the balance is transferred to his loan account. Books of account are not closed on the date of retirement.

Solution

Working notes

- Average profit = (30,000 + 40,000 + 50,000) ÷ 3 = ₹40,000. Goodwill = 40,000 × 2 = **₹80,000**.
- Gaining ratio: X = 1/2 − 2/5 = 1/10; Y = 1/2 − 2/5 = 1/10 → **1 : 1**. Z's goodwill share = 80,000 × 1/5 = ₹16,000 → X ₹8,000, Y ₹8,000.
- Revaluation profit = 20,000 − 5,000 = ₹15,000 → X ₹6,000, Y ₹6,000, Z ₹3,000.
- Z's share of profit = 50,000 × 6/12 × 1/5 = **₹5,000** (debited to Profit & Loss Suspense A/c).
- Amount due to Z = 40,000 + 3,000 + 3,000 + 16,000 + 5,000 = **₹67,000** → ₹30,000 cash + ₹37,000 loan.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Sep 30	X's Capital A/c ... Dr.	8,000	
	Y's Capital A/c ... Dr.	8,000	
	To Z's Capital A/c		16,000
	(Being Z's share of goodwill adjusted in gaining ratio 1 : 1)		

2026 Sep 30	Land A/c ... Dr.	20,000	
	To Revaluation A/c		20,000
	(Being land appreciated)		
2026 Sep 30	Revaluation A/c ... Dr.	5,000	
	To Machinery A/c		5,000
	(Being machinery depreciated)		
2026 Sep 30	Revaluation A/c ... Dr.	15,000	
	To X's Capital A/c		6,000
	To Y's Capital A/c		6,000
	To Z's Capital A/c		3,000
	(Being revaluation profit shared in old ratio)		
2026 Sep 30	Reserve Fund A/c ... Dr.	15,000	
	To X's Capital A/c		6,000
	To Y's Capital A/c		6,000
	To Z's Capital A/c		3,000
	(Being reserve distributed in old ratio)		
2026 Sep 30	Profit & Loss Suspense A/c ... Dr.	5,000	
	To Z's Capital A/c		5,000
	(Being Z's share of profit up to retirement credited)		
2026 Sep 30	Z's Capital A/c ... Dr.	67,000	
	To Bank A/c		30,000
	To Z's Loan A/c		37,000
	(Being amount due to Z settled)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Machinery	5,000	By Land	20,000
To Profit: X's Capital	6,000		
To Profit: Y's Capital	6,000		
To Profit: Z's Capital	3,000		
Total	**20,000**	**Total**	**20,000**

Partners' Capital Accounts

Dr. Particulars	X	Y	Z	Cr. Particulars	X	Y	Z
To Goodwill	8,000	8,000		By Balance b/d	70,000	60,000	40,000
To Bank			30,000	By Reserve Fund	6,000	6,000	3,000
To Z's Loan			37,000	By Revaluation (profit)	6,000	6,000	3,000
To Balance c/d	74,000	64,000		By Goodwill			16,000
				By P&L Suspense (profit share)			5,000
Total	**82,000**	**72,000**	**67,000**	**Total**	**82,000**	**72,000**	**67,000**

Balance Sheet of X and Y after Z's retirement

Liabilities	₹	Assets	₹
Capital – X	74,000	Cash (40,000 – 30,000)	10,000
Capital – Y	64,000	Debtors	40,000
Z's Loan	37,000	Stock	45,000
Creditors	25,000	Machinery (50,000 – 5,000)	45,000
		Land (35,000 + 20,000)	55,000
		Profit & Loss Suspense A/c	5,000
Total	**2,00,000**	**Total**	**2,00,000**

Death of a Partner

12.5 Dissolution of Partnership Firm

Business Scenario

Mr. Arun, Mr. Bala, and Mr. Chitra are partners in a restaurant business. Due to continuous losses and personal commitments, they decide to close the business permanently. The assets are sold, liabilities are paid, and the remaining amount is distributed among the partne₹This process is known as dissolution of the partnership firm.

Introduction

A partnership firm may come to an end because of mutual agreement, expiry of the partnership period, completion of a specific venture, death or insolvency of a partner, or by order of a court. When the business is

discontinued and the partnership relationship among all partners is terminated, the firm is said to be dissolved.

Dissolution is an important stage in partnership accounting because all assets and liabilities must be settled and the final amount payable to each partner must be determined accurately.

Meaning of Dissolution

Dissolution of Partnership Firm means the complete closure of the business and termination of the partnership relationship among all partners.

Definition

Dissolution of a partnership firm is the process by which the business of the firm is wound up, its assets are realized, liabilities are paid, and the remaining balance is distributed among the partners.

Difference between Dissolution of Partnership and Dissolution of Firm

Basis	Dissolution of Partnership	Dissolution of Firm
Meaning	Change in relationship among partners	Complete closure of business
Business	Continues	Discontinues
Accounts	Reconstitution accounts prepared	Realisation accounts prepared
Partners	At least one partner continues	All partner relationships end

Need for Dissolution Accounting

Dissolution accounting is necessary to:

- realize assets,
- pay liabilities,
- determine profit or loss on realization,
- settle partners' capital accounts,
- distribute remaining cash, and
- close the books of the firm.

Causes of Dissolution

The firm may be dissolved due to:

- mutual agreement among partners,
- expiry of the partnership period,

- completion of a specific venture,
- death of a partner,
- insolvency of a partner,
- business becoming unlawful,
- persistent losses, or
- court order.

Death is Similar to Retirement — Key Difference:

Retirement	Death
Partner leaves by choice	Partner leaves due to death
Partner handles it himself	Legal heir (executor) handles it
No profit up to date needed usually	Profit up to DATE OF DEATH calculated
No JLP usually	Joint Life Policy (JLP) may exist

Problem – Death on the balance sheet date

A, B and C share profits 3 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	60,000	Cash	30,000
Capital – B	50,000	Debtors	40,000
Capital – C	40,000	Stock	45,000
General Reserve	18,000	Machinery	55,000
Creditors	32,000	Furniture	30,000
Total	**2,00,000**	**Total**	**2,00,000**

C died on 31 March 2026. A and B will continue in the ratio 3 : 2. Goodwill is valued at ₹30,000. Stock is to be appreciated by ₹8,000 and Machinery is to be depreciated by ₹5,000. ₹20,000 is paid immediately to C's executors and the balance is left as a loan.

Solution

Working notes

- Old shares 3/6, 2/6, 1/6; new 3/5, 2/5. Gaining: A = 3/5 − 1/2 = 1/10; B = 2/5 − 1/3 = 1/15 → **3 : 2**.

- C's share of goodwill = 30,000 × 1/6 = ₹5,000 → A ₹3,000, B ₹2,000.
- Revaluation profit = 8,000 − 5,000 = ₹3,000 → A ₹1,500, B ₹1,000, C ₹500.
- Amount due to executors = 40,000 + 5,000 + 500 + 3,000 = **₹48,500**.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	A's Capital A/c ... Dr.	3,000	
	B's Capital A/c ... Dr.	2,000	
	To C's Capital A/c		5,000
	(Being C's share of goodwill adjusted in gaining ratio 3 : 2)		
2026 Mar 31	Stock A/c ... Dr.	8,000	
	To Revaluation A/c		8,000
	(Being stock appreciated)		
2026 Mar 31	Revaluation A/c ... Dr.	5,000	
	To Machinery A/c		5,000
	(Being machinery depreciated)		
2026 Mar 31	Revaluation A/c ... Dr.	3,000	
	To A's Capital A/c		1,500
	To B's Capital A/c		1,000
	To C's Capital A/c		500
	(Being revaluation profit shared in old ratio)		
2026 Mar 31	General Reserve A/c ... Dr.	18,000	
	To A's Capital A/c		9,000
	To B's Capital A/c		6,000
	To C's Capital A/c		3,000
	(Being reserve distributed in old ratio)		
2026 Mar 31	C's Capital A/c ... Dr.	48,500	
	To C's Executors A/c		48,500
	(Being amount due to C transferred to executors)		
2026 Mar 31	C's Executors A/c ... Dr.	48,500	
	To Bank A/c		20,000
	To C's Executors' Loan A/c		28,500
	(Being part paid and balance kept as loan)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Machinery	5,000	By Stock	8,000
To Profit: A's Capital	1,500		
To Profit: B's Capital	1,000		
To Profit: C's Capital	500		
Total	**8,000**	**Total**	**8,000**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To Goodwill	3,000	2,000		By Balance b/d	60,000	50,000	40,000
To C's Executors			48,500	By General Reserve	9,000	6,000	3,000
To Balance c/d	67,500	55,000		By Revaluation (profit)	1,500	1,000	500
				By Goodwill			5,000
Total	**70,500**	**57,000**	**48,500**	**Total**	**70,500**	**57,000**	**48,500**

C's Executors Account

Dr. Particulars	₹	Cr. Particulars	₹
To Bank	20,000	By C's Capital	48,500
To Balance c/d (loan)	28,500		
Total	**48,500**	**Total**	**48,500**

Balance Sheet of A and B after C's death

Liabilities	₹	Assets	₹
Capital – A	67,500	Cash (30,000 – 20,000)	10,000
Capital – B	55,000	Debtors	40,000
C's Executors' Loan	28,500	Stock (45,000 + 8,000)	53,000
Creditors	32,000	Machinery (55,000 – 5,000)	50,000
		Furniture	30,000
Total	**1,83,000**	**Total**	**1,83,000**

Problem: Death during the year with insurance policy, profit and interest

P, Q and R share profits 5 : 3 : 2. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – P	80,000	Cash	30,000
Capital – Q	50,000	Debtors	50,000
Capital – R	40,000	Stock	45,000
General Reserve	10,000	Building	60,000
Creditors	30,000	Furniture	25,000
Total	**2,10,000**	**Total**	**2,10,000**

R died on **30 September 2026**. P and Q will share future profits 3 : 2. Terms: (i) Goodwill of the firm is valued at ₹50,000; (ii) Building is appreciated by ₹10,000 and Furniture is depreciated by ₹4,000; (iii) R's share of profit up to the date of death is to be calculated on the basis of last year's profit of ₹60,000; (iv) Interest on R's capital is to be allowed at 5% p.a. up to the date of death; (v) A joint life policy of ₹30,000 was taken on the partners (premiums were charged to P&L), and the amount was received on R's death; (vi) ₹40,000 is paid to R's executors immediately and the balance is transferred to their loan account.

Solution

Working notes

- Gaining ratio: P = 3/5 − 5/10 = 1/10; Q = 2/5 − 3/10 = 1/10 → **1 : 1**. R's goodwill = 50,000 × 2/10 = ₹10,000 → P ₹5,000, Q ₹5,000.
- Share of profit = 60,000 × 6/12 × 2/10 = **₹6,000**. Interest on capital = 40,000 × 5% × 6/12 = **₹1,000**. Both are debited to P&L Suspense A/c: ₹7,000.
- Joint life policy ₹30,000 is shared in old ratio 5 : 3 : 2 → P ₹15,000, Q ₹9,000, R ₹6,000.
- Revaluation profit = 10,000 − 4,000 = ₹6,000 → P ₹3,000, Q ₹1,800, R ₹1,200.
- Reserve ₹10,000 → P ₹5,000, Q ₹3,000, R ₹2,000.
- Amount due to executors = 40,000 + 10,000 + 1,200 + 2,000 + 6,000 + 7,000 = **₹66,200**.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Sep 30	Bank A/c ... Dr.	30,000	
	To P's Capital A/c		15,000
	To Q's Capital A/c		9,000
	To R's Capital A/c		6,000
	(Being joint life policy money received and shared in old ratio)		
2026 Sep 30	P's Capital A/c ... Dr.	5,000	
	Q's Capital A/c ... Dr.	5,000	
	To R's Capital A/c		10,000
	(Being R's share of goodwill adjusted in gaining ratio 1 : 1)		
2026 Sep 30	Building A/c ... Dr.	10,000	
	To Revaluation A/c		10,000
	(Being building appreciated)		
2026 Sep 30	Revaluation A/c ... Dr.	4,000	
	To Furniture A/c		4,000
	(Being furniture depreciated)		
2026 Sep 30	Revaluation A/c ... Dr.	6,000	
	To P's Capital A/c		3,000
	To Q's Capital A/c		1,800
	To R's Capital A/c		1,200
	(Being revaluation profit shared in old ratio)		
2026 Sep 30	General Reserve A/c ... Dr.	10,000	
	To P's Capital A/c		5,000
	To Q's Capital A/c		3,000
	To R's Capital A/c		2,000
	(Being reserve distributed in old ratio)		
2026 Sep 30	Profit & Loss Suspense A/c ... Dr.	7,000	
	To R's Capital A/c		7,000
	(Being R's share of profit (6,000) and interest on capital (1,000) credited)		

2026 Sep 30	R's Capital A/c ... Dr.	66,200	
	To R's Executors A/c		66,200
	(Being amount due to R transferred to executors)		
2026 Sep 30	R's Executors A/c ... Dr.	66,200	
	To Bank A/c		40,000
	To R's Executors' Loan A/c		26,200
	(Being part paid and balance transferred to loan)		

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Furniture	4,000	By Building	10,000
To Profit: P's Capital	3,000		
To Profit: Q's Capital	1,800		
To Profit: R's Capital	1,200		
Total	**10,000**	**Total**	**10,000**

Partners' Capital Accounts

Dr. Particulars	P	Q	R	Cr. Particulars	P	Q	R
To Goodwill	5,000	5,000		By Balance b/d	80,000	50,000	40,000
To R's Executors			66,200	By Bank (Joint Life Policy)	15,000	9,000	6,000
To Balance c/d	98,000	58,800		By General Reserve	5,000	3,000	2,000
				By Revaluation (profit)	3,000	1,800	1,200
				By P&L Suspense (profit + interest)			7,000
				By Goodwill			10,000
Total	**1,03,000**	**63,800**	**66,200**	**Total**	**1,03,000**	**63,800**	**66,200**

R's Executors Account

Dr. Particulars	₹	Cr. Particulars	₹
To Bank	40,000	By R's Capital	66,200
To Balance c/d (loan)	26,200		
Total	**66,200**	**Total**	**66,200**

Balance Sheet of P and Q after R's death

Liabilities	₹	Assets	₹
Capital – P	98,000	Cash (30,000 + 30,000 – 40,000)	20,000
Capital – Q	58,800	Debtors	50,000
R's Executors' Loan	26,200	Stock	45,000
Creditors	30,000	Building (60,000 + 10,000)	70,000
		Furniture (25,000 – 4,000)	21,000
		Profit & Loss Suspense A/c	7,000
Total	**2,13,000**	**Total**	**2,13,000**

Dissolution of a Firm

Dissolution means the firm **completely closes down**. All assets are sold, all debts are paid, and whatever remains is given back to partners.

Think of it like this:

- A shop closes for good
- Everything in the shop is sold
- All bills and loans are paid
- Whatever money remains goes back to the owners

Realisation Account — The Most Important Account on Dissolution

Problem: Basic dissolution with discount on creditors

A and B share profits 3 : 2. They decide to dissolve the firm on 31 March 2026. Balance Sheet:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	60,000	Cash	5,000
Capital – B	40,000	Debtors	35,000

General Reserve	15,000	Stock	40,000
Creditors	30,000	Furniture	25,000
Bills Payable	10,000	Machinery	50,000

Assets realised: Debtors ₹30,000, Stock ₹35,000, Furniture ₹20,000, Machinery ₹45,000. Creditors were paid ₹28,000 in full settlement and Bills Payable were paid in full. Realisation expenses of ₹2,000 were paid.

Solution

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	Realisation A/c ... Dr.	1,50,000	
	To Debtors A/c		35,000
	To Stock A/c		40,000
	To Furniture A/c		25,000
	To Machinery A/c		50,000
	(Being assets transferred to Realisation A/c)		
2026 Mar 31	Creditors A/c ... Dr.	30,000	
	Bills Payable A/c ... Dr.	10,000	
	To Realisation A/c		40,000
	(Being liabilities transferred to Realisation A/c)		
2026 Mar 31	Bank A/c ... Dr.	1,30,000	
	To Realisation A/c		1,30,000
	(Being assets realised in cash)		
2026 Mar 31	Realisation A/c ... Dr.	38,000	
	To Bank A/c		38,000
	(Being creditors (28,000) and bills payable (10,000) paid)		
2026 Mar 31	Realisation A/c ... Dr.	2,000	
	To Bank A/c		2,000
	(Being realisation expenses paid)		
2026 Mar 31	General Reserve A/c ... Dr.	15,000	
	To A's Capital A/c		9,000
	To B's Capital A/c		6,000
	(Being reserve transferred to partners in 3 : 2)		

2026 Mar 31	A's Capital A/c ... Dr.	12,000	
	B's Capital A/c ... Dr.	8,000	
	To Realisation A/c		20,000
	(Being loss on realisation shared in 3 : 2)		
2026 Mar 31	A's Capital A/c ... Dr.	57,000	
	B's Capital A/c ... Dr.	38,000	
	To Bank A/c		95,000
	(Being final payment made to partners)		

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	35,000	By Creditors	30,000
To Stock	40,000	By Bills Payable	10,000
To Furniture	25,000	By Bank (assets realised)	1,30,000
To Machinery	50,000	By Loss: A's Capital	12,000
To Bank (creditors 28,000 + bills payable 10,000)	38,000	By Loss: B's Capital	8,000
To Bank (expenses)	2,000		
Total	**1,90,000**	**Total**	**1,90,000**

Partners' Capital Accounts

Dr. Particulars	A	B	Cr. Particulars	A	B
To Realisation (loss)	12,000	8,000	By Balance b/d	60,000	40,000
To Bank	57,000	38,000	By General Reserve	9,000	6,000
Total	**69,000**	**46,000**	**Total**	**69,000**	**46,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	5,000	By Realisation (creditors, bills payable)	38,000
To Realisation (assets realised)	1,30,000	By Realisation (expenses)	2,000

		By A's Capital	57,000
		By B's Capital	38,000
Total	**1,35,000**	**Total**	**1,35,000**

Problem – Assets taken over, unrecorded asset, partner's loan and expenses paid by partner

X and Y share profits 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – X	50,000	Cash	8,000
Capital – Y	30,000	Debtors	28,000
X's Loan	20,000	Stock	40,000
Creditors	24,000	Investments	12,000
Bank Loan	16,000	Furniture	22,000
		Plant	30,000
Total	**1,40,000**	**Total**	**1,40,000**

The firm is dissolved. (i) Debtors realised ₹25,000; Stock sold at 10% loss; Plant sold for ₹32,000. (ii) Investments were taken over by X at ₹11,000 and Furniture by Y at ₹20,000. (iii) A computer, not recorded in the books, was sold for ₹3,000. (iv) Bank loan was repaid; creditors accepted ₹22,000 in full settlement. (v) Realisation expenses of ₹3,000 were paid by Y. Pay X's loan after outside liabilities.

Solution

Working notes

- Stock realised = 40,000 − 10% = ₹36,000.
- Cash from sales = 25,000 + 36,000 + 32,000 + 3,000 (computer) = **₹96,000**.
- Realisation loss = ₹6,000 → X ₹4,000, Y ₹2,000. Investments taken by X and furniture taken by Y are credited to Realisation and debited to their capitals.
- Cash available = 8,000 + 96,000 = ₹1,04,000. Payments: bank loan 16,000 + creditors 22,000 + X's loan 20,000; balance goes to partners.

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	28,000	By Creditors	24,000
To Stock	40,000	By Bank Loan	16,000
To Investments	12,000	By Bank (assets realised)	96,000
To Furniture	22,000	By X's Capital (investments taken)	11,000
To Plant	30,000	By Y's Capital (furniture taken)	20,000
To Bank (bank loan)	16,000	By Loss: X's Capital	4,000
To Bank (creditors)	22,000	By Loss: Y's Capital	2,000
To Y's Capital (expenses paid)	3,000		
Total	**1,73,000**	**Total**	**1,73,000**

Partners' Capital Accounts

Dr. Particulars	X	Y	Cr. Particulars	X	Y
To Realisation (loss)	4,000	2,000	By Balance b/d	50,000	30,000
To Realisation (assets taken)	11,000	20,000	By Realisation (expenses paid)		3,000
To Bank	35,000	11,000			
Total	**50,000**	**33,000**	**Total**	**50,000**	**33,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	8,000	By Realisation (bank loan and creditors)	38,000
To Realisation (assets realised)	96,000	By X's Loan	20,000
		By X's Capital	35,000
		By Y's Capital	11,000
Total	**1,04,000**	**Total**	**1,04,000**

Problem – Three partners with reserve, P&L debit balance and unrecorded items

A, B and C share profits 3 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	60,000	Cash	12,000
Capital – B	40,000	Debtors	38,000
Capital – C	20,000	Stock	42,000
General Reserve	18,000	Plant	50,000
Creditors	26,000	Building	20,000
Bills Payable	10,000	Profit & Loss A/c (Dr.)	12,000
Total	**1,74,000**	**Total**	**1,74,000**

The firm is dissolved. Realised: Debtors ₹34,000, Stock ₹40,000, Plant ₹45,000, Building ₹25,000. Loose tools not in the books were sold for ₹4,000. Creditors were paid ₹24,000 in full settlement; Bills Payable in full. An outstanding repair bill of ₹2,000 (not recorded) was settled for ₹1,500. Realisation expenses were ₹3,000.

Solution

Working notes

- Reserve (₹18,000) is credited and P&L debit balance (₹12,000) is debited to partners in 3 : 2 : 1 — **not** through Realisation A/c.
- Reserve: A ₹9,000, B ₹6,000, C ₹3,000. P&L loss: A ₹6,000, B ₹4,000, C ₹2,000.
- Cash realised = 34,000 + 40,000 + 45,000 + 25,000 + 4,000 = **₹1,48,000**. Realisation loss = ₹4,500 → A ₹2,250, B ₹1,500, C ₹750.

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	38,000	By Creditors	26,000
To Stock	42,000	By Bills Payable	10,000
To Plant	50,000	By Bank (assets realised)	1,48,000
To Building	20,000	By Loss: A's Capital	2,250
To Bank (bills payable)	10,000	By Loss: B's Capital	1,500
To Bank (creditors)	24,000	By Loss: C's Capital	750
To Bank (outstanding repairs)	1,500		
To Bank (expenses)	3,000		
Total	**1,88,500**	**Total**	**1,88,500**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To P&L A/c (Dr. balance)	6,000	4,000	2,000	By Balance b/d	60,000	40,000	20,000
To Realisation (loss)	2,250	1,500	750	By General Reserve	9,000	6,000	3,000
To Bank	60,750	40,500	20,250				
Total	**69,000**	**46,000**	**23,000**	**Total**	**69,000**	**46,000**	**23,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	12,000	By Realisation (liabilities and expenses paid)	38,500
To Realisation (assets realised)	1,48,000	By A's Capital	60,750
		By B's Capital	40,500
		By C's Capital	20,250
Total	**1,60,000**	**Total**	**1,60,000**

Insolvency of a Partner

Insolvency means a partner cannot pay his share of loss. When a firm dissolves and there is a big loss, sometimes a partner's share of loss is MORE than his capital. This means his capital account shows a negative (debit) balance. He owes money to the firm but cannot pay because he has no money left.

Example to Understand:

- Ram's capital = ₹5,000
- His share of loss = ₹8,000
- After bearing loss: 5,000 - 8,000 = MINUS ₹3,000

Ram OWES the firm ₹3,000 but has no money. He is Insolvent.

Garner vs Murray Rule — The Famous Rule:

This rule was decided in a court case in England in 1904 (Garner vs Murray). In Simple Words: "When a partner is insolvent and cannot pay

his deficiency, the solvent (those who have money) partners must pay this deficiency from their own capitals. But they pay in the ratio of their capitals — not in their profit sharing ratio."

Capital Ratio = Compare the capitals of solvent partners only.

Why capital ratio and NOT profit sharing ratio?

Because the law says the deficiency of an insolvent partner is not a loss of the firm. It is a personal debt that the insolvent partner owes to others. Solvent partners bear it in proportion to what they have (their capital) — not in proportion to how they share profits.

Problem 1 — Identifying the Insolvent Partner

Question:

On dissolution, the Realisation Account shows a LOSS of ₹24,000.

Partners share profits equally.

Capitals before dissolution:

Arun = ₹15,000

Banu = ₹9,000

Charu = ₹6,000

After sharing the loss, identify who is insolvent.

Given:

- Loss = ₹24,000
- Shared equally (1/3 each)
- Arun capital ₹15,000
- Banu capital ₹9,000
- Charu capital ₹6,000

Step 1 — Each partner's share of loss:

Each partner bears = 24,000 ÷ 3 = ₹8,000

Step 2 — Capital after bearing loss:

Arun = 15,000 - 8,000 = ₹7,000 (Credit — Solvent)

Banu = 9,000 - 8,000 = ₹1,000 (Credit — Solvent)

Charu = 6,000 - 8,000 = - ₹2,000 (Debit — Insolvent)

Final Answer:

Charu is insolvent with a deficiency of ₹2,000.

Arun has ₹7,000 credit balance.

Banu has ₹1,000 credit balance.

Now we apply GARNER vs MURRAY RULE.

Explanation:

When a partner's capital is less than her share of loss, her capital account goes into negative (debit balance). She cannot contribute from her personal assets because she is insolvent. This negative balance is called deficiency. The remaining solvent partners must now absorb this deficiency.

Problem: Partner Insolvent, nothing recovered

A, B and C share profits equally. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	60,000	Cash	5,000
Capital – B	40,000	Debtors	35,000
Capital – C	10,000	Stock	40,000
Creditors	30,000	Plant	30,000
		Building	30,000
Total	**1,40,000**	**Total**	**1,40,000**

The firm is dissolved and C is insolvent (nothing can be recovered from his estate). Assets realised: Debtors ₹30,000, Stock ₹32,000, Plant ₹20,000, Building ₹22,000. Creditors were paid in full and realisation expenses were ₹5,000.

Solution

Working notes

- Book value of assets (except cash) = ₹1,35,000; realised = ₹1,04,000 → loss ₹31,000. Add expenses ₹5,000 → total loss **₹36,000** → ₹12,000 each.
- C's capital = 10,000 – 12,000 = **₹2,000 debit** (deficiency). C is insolvent.

- Capital ratio of A and B (before dissolution) = 60,000 : 40,000 = **3 : 2**. A bears ₹1,200; B bears ₹800.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	A's Capital A/c ... Dr.	1,200	
	B's Capital A/c ... Dr.	800	
	To C's Capital A/c		2,000
	(Being deficiency of insolvent partner C borne by A and B in capital ratio 3 : 2)		

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	35,000	By Creditors	30,000
To Stock	40,000	By Bank (assets realised)	1,04,000
To Plant	30,000	By Loss: A's Capital	12,000
To Building	30,000	By Loss: B's Capital	12,000
To Bank (creditors)	30,000	By Loss: C's Capital	12,000
To Bank (expenses)	5,000		
Total	**1,70,000**	**Total**	**1,70,000**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To Realisation (loss)	12,000	12,000	12,000	By Balance b/d	60,000	40,000	10,000
To C's Capital (deficiency)	1,200	800		By A's and B's Capital (deficiency)			2,000
To Bank	46,800	27,200					
Total	**60,000**	**40,000**	**12,000**	**Total**	**60,000**	**40,000**	**12,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	5,000	By Realisation (creditors and expenses)	35,000
To Realisation (assets realised)	1,04,000	By A's Capital	46,800
		By B's Capital	27,200
Total	**1,09,000**	**Total**	**1,09,000**

Problem – Partner insolvent, part amount recovered from his estate

A, B and C share profits 3 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – A	54,000	Cash	4,000
Capital – B	36,000	Debtors	36,000
Capital – C	2,000	Stock	40,000
General Reserve	12,000	Furniture	20,000
Creditors	36,000	Machinery	40,000
Total	**1,40,000**	**Total**	**1,40,000**

The firm is dissolved. Realised: Debtors ₹28,000, Stock ₹32,000, Furniture ₹12,000, Machinery ₹28,000. Creditors were paid in full; expenses were ₹6,000. C is insolvent and **50 paise in the rupee** is received from his estate on his deficiency.

Solution

Working notes

- Cash realised = 28,000 + 32,000 + 12,000 + 28,000 = ₹1,00,000. Loss on assets = ₹36,000; expenses ₹6,000 → total loss **₹42,000** → A ₹21,000, B ₹14,000, C ₹7,000.
- C's capital = 2,000 + 2,000 (reserve) − 7,000 = **₹3,000 debit**. Estate pays 50% = ₹1,500. Remaining deficiency = ₹1,500.
- Capital ratio of A and B before dissolution = 54,000 : 36,000 = **3 : 2** → A ₹900, B ₹600.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	Bank A/c ... Dr.	1,500	
	To C's Capital A/c		1,500
	(Being 50 paise in the rupee received from C's estate)		
2026 Mar 31	A's Capital A/c ... Dr.	900	
	B's Capital A/c ... Dr.	600	
	To C's Capital A/c		1,500
	(Being balance of C's deficiency borne by A and B in capital ratio 3 : 2)		

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	36,000	By Creditors	36,000
To Stock	40,000	By Bank (assets realised)	1,00,000
To Furniture	20,000	By Loss: A's Capital	21,000
To Machinery	40,000	By Loss: B's Capital	14,000
To Bank (creditors)	36,000	By Loss: C's Capital	7,000
To Bank (expenses)	6,000		
Total	**1,78,000**	**Total**	**1,78,000**

Partners' Capital Accounts

Dr. Particulars	A	B	C	Cr. Particulars	A	B	C
To Realisation (loss)	21,000	14,000	7,000	By Balance b/d	54,000	36,000	2,000
To C's Capital (deficiency)	900	600		By General Reserve	6,000	4,000	2,000
To Bank	38,100	25,400		By Bank (from C's estate)			1,500
				By A's and B's Capital (deficiency)			1,500
Total	**60,000**	**40,000**	**7,000**	**Total**	**60,000**	**40,000**	**7,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	4,000	By Realisation (creditors and expenses)	42,000
To Realisation (assets realised)	1,00,000	By A's Capital	38,100
To C's Capital (estate)	1,500	By B's Capital	25,400
Total	**1,05,500**	**Total**	**1,05,500**

Problem 3 – insolvent partner with partner's loan and assets taken over (Garner Vs. Murray)

X, Y and Z share profits 2 : 2 : 1. Balance Sheet on 31 March 2026:

Balance Sheet as on 31 March 2026

Liabilities	₹	Assets	₹
Capital – X	56,000	Cash	6,000
Capital – Y	36,000	Debtors	44,000
Capital – Z	1,000	Stock	50,000
General Reserve	10,000	Plant	40,000
Y's Loan	15,000	Investments	20,000
Creditors	42,000		
Total	**1,60,000**	**Total**	**1,60,000**

The firm is dissolved. Realised: Debtors ₹40,000, Stock ₹42,000, Plant ₹30,000. Investments were taken over by X at ₹18,000. Creditors were paid in full and expenses were ₹6,000. Z is insolvent and nothing is recovered from his estate. Y's loan is to be repaid.

Solution

Working notes

- Cash realised = 40,000 + 42,000 + 30,000 = ₹1,12,000. Loss = Debtors 4,000 + Stock 8,000 + Plant 10,000 + Investments 2,000 = ₹24,000; add expenses ₹6,000 → **₹30,000** → X ₹12,000, Y ₹12,000, Z ₹6,000.

- Capital before dissolution (after reserve): X = 56,000 + 4,000 = ₹60,000; Y = 36,000 + 4,000 = ₹40,000; Z = 1,000 + 2,000 = ₹3,000. **Capital ratio X : Y = 3 : 2.**
- Z's deficiency = 6,000 (loss) − 3,000 = **₹3,000** → X ₹1,800, Y ₹1,200.
- Cash = 6,000 + 1,12,000 = 1,18,000. Pay creditors 42,000, expenses 6,000 and Y's loan 15,000 → ₹55,000 to X and Y.

Journal Entries

Date	Particulars	Debit (₹)	Credit (₹)
2026 Mar 31	X's Capital A/c ... Dr.	1,800	
	Y's Capital A/c ... Dr.	1,200	
	To Z's Capital A/c		3,000
	(Being Z's deficiency borne by X and Y in capital ratio 3 : 2)		

Realisation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Debtors	44,000	By Creditors	42,000
To Stock	50,000	By Bank (assets realised)	1,12,000
To Plant	40,000	By X's Capital (investments taken)	18,000
To Investments	20,000	By Loss: X's Capital	12,000
To Bank (creditors)	42,000	By Loss: Y's Capital	12,000
To Bank (expenses)	6,000	By Loss: Z's Capital	6,000
Total	**2,02,000**	**Total**	**2,02,000**

Partners' Capital Accounts

Dr. Particulars	X	Y	Z	Cr. Particulars	X	Y	Z
To Realisation (investments)	18,000			By Balance b/d	56,000	36,000	1,000
To Realisation (loss)	12,000	12,000	6,000	By General Reserve	4,000	4,000	2,000

To Z's Capital (deficiency)	1,800	1,200		By X's and Y's Capital (deficiency)			3,000
To Bank	28,200	26,800					
Total	**60,000**	**40,000**	**6,000**	**Total**	**60,000**	**40,000**	**6,000**

Bank Account

Dr. Particulars	₹	Cr. Particulars	₹
To Balance b/d	6,000	By Realisation (creditors and expenses)	48,000
To Realisation (assets realised)	1,12,000	By Y's Loan	15,000
		By X's Capital	28,200
		By Y's Capital	26,800
Total	**1,18,000**	**Total**	**1,18,000**

Multiple Choice Questions (MCQ)

1. When a new partner is admitted, the ratio in which old partners give up their share is called:
   (a) Gaining Ratio
   (b) New Ratio
   (c) Sacrificing Ratio
   (d) Capital Ratio
2. The formula for Sacrificing Ratio is:
   (a) New Ratio minus Old Ratio
   (b) Old Ratio minus New Ratio
   (c) Old Ratio plus New Ratio
   (d) New Ratio divided by Old Ratio

   Correct Answer: (b) Old Ratio minus New Ratio
3. On admission of a new partner, the General Reserve existing in the books is distributed to:
   (a) All partners including new partner in new ratio
   (b) Old partners only in old ratio
   (c) New partner only
   (d) All partners equally

4. When a partner retires, the ratio in which remaining partners gain his share is called:

(a) Sacrificing Ratio

(b) Gaining Ratio

(c) New Ratio

(d) Capital Ratio

5. Gaining Ratio is calculated as:

(a) Old Ratio minus New Ratio

(b) New Ratio plus Old Ratio

(c) New Ratio minus Old Ratio

(d) Old Ratio divided by New Ratio

6. On retirement of a partner, goodwill is credited to:

(a) Gaining partners' capital accounts

(b) Retiring partner's capital account

(c) All partners' capital accounts equally

(d) Revaluation Account

7. When a partner dies, the total amount due to him is transferred to:

(a) His Capital Account

(b) Realisation Account

(c) Executor's Account

(d) General Reserve

Correct Answer: (c) Executor's Account

8. Profit from the beginning of the accounting year to the date of death is calculated on time basis using:

(a) Current year's actual profit

(b) Previous year's profit as base

(c) Average of last five years

(d) Estimated profit by management

Correct Answer: (b) Previous year's profit as base

9. The account opened as a temporary account to record profit up to date of death is:

(a) Revaluation Account

(b) Realisation Account

(c) Profit and Loss Suspense Account

(d) Executor's Account

Correct Answer: (c) Profit and Loss Suspense Account

10. Joint Life Policy (JLP) is taken by the firm for:

(a) Insuring the firm's assets

(b) Insuring the joint lives of all partners

(c) Insuring debtors

(d) Covering business losses

Correct Answer: (b) Insuring the joint lives of all partners

11. The account prepared to record sale of assets and payment of liabilities on dissolution is called:

(a) Revaluation Account

(b) Realisation Account

(c) Capital Account

(d) General Reserve Account

Correct Answer: (b) Realisation Account

12. Which of the following is NOT transferred to the Realisation Account?

(a) Furniture

(b) Stock

(c) Cash and Bank balance

(d) Machinery

Correct Answer: (c) Cash and Bank balance

13. When assets realised are MORE than their book value, it results in:

(a) Loss on Realisation

(b) Profit on Realisation

(c) No effect on Realisation Account

(d) Increase in liability

Correct Answer: (b) Profit on Realisation

14. Profit on Realisation is shared among partners in:

(a) Capital ratio

(b) Equal ratio always

(c) Profit sharing ratio

(d) Gaining ratio

Correct Answer: (c) Profit sharing ratio

15. Dissolution of partnership is different from dissolution of firm because:

(a) In dissolution of partnership, the firm also closes

(b) In dissolution of partnership, the firm continues with changed constitution

(c) In dissolution of partnership, all assets are sold

(d) There is no difference between the two

Correct Answer: (b) In dissolution of partnership, the firm continues with changed constitution

16. Realisation Account is a:

(a) Personal Account

(b) Real Account

(c) Nominal Account

(d) Suspense Account

Correct Answer: (c) Nominal Account

17. A partner is said to be insolvent when his Capital Account shows:

(a) Credit balance after dissolution

(b) Debit balance after dissolution (cannot pay)

(c) Zero balance

(d) Balance equal to others

Correct Answer: (b) Debit balance after dissolution (cannot pay)

18. The amount that an insolvent partner owes to the firm but cannot pay is called:

(a) Short Working

(b) Deficiency

(c) Surplus

(d) Reserve

Correct Answer: (b) Deficiency

19. Garner vs Murray Rule was established in:

(a) India in 1932

(b) England in 1904

(c) India in 1956

(d) England in 1892

Correct Answer: (b) England in 1904

20. After applying Garner vs Murray Rule, the insolvent partner's Capital Account balance becomes:

(a) A large credit balance

(b) An even larger debit balance

(c) Zero (nil)

(d) Equal to other partners

Correct Answer: (c) Zero (nil)

Part B — Short Answer Questions

1. What is Sacrificing Ratio? Give the formula with an example.
2. What is Revaluation Account? State the rules for preparing it on admission.
3. Why are accumulated profits distributed to old partners before admitting a new partner?
4. What is goodwill? State any two methods of valuing goodwill.
5. What is Gaining Ratio? How is it different from Sacrificing Ratio?
6. What are the modes of settling the amount due to a retiring partner?
7. State the items that are added and deducted to calculate the amount due to a retiring partner.
8. How is profit up to date of death calculated on Time Basis and Sales Basis?
9. What is Realisation Account? State the items on each side.
10. State the order of payment on dissolution under Section 48 of Indian Partnership Act 1932.
11. State the Garner **vs Murray Rule clearly.**

Detailed Answer Questions

1. Explain in detail all the accounting adjustments required when a new partner is admitted into a partnership firm. Give the journal entries for each adjustment.
2. Explain the accounting treatment on Retirement of a Partner with journal entries for each adjustment.
3. Explain the Garner vs Murra**y Rule with its application and exceptions.**

Practical Problem 1 — Admission (Basic)

Question:

Arjun and Bala share profits in ratio 3:2.

They admit Chandan for 1/5 share.

Balance Sheet as on 31st March 2024:

Liabilities	Rs.	Assets	Rs.
Arjun's Capital	50,000	Furniture	20,000
Bala's Capital	30,000	Stock	25,000
General Reserve	10,000	Debtors	20,000
Creditors	10,000	Cash	35,000
Total	1,00,000	Total	1,00,000

Terms of admission:

(i) Goodwill of firm = Rs. 20,000. Chandan brings his share of goodwill in cash.

(ii) Furniture to be depreciated by Rs. 2,000.

(iii) Chandan brings Rs. 15,000 as capital.

Pass all journal entries.

Practical Problem 2— Retirement Basic

Question:

Nila, Ola and Pari share profits 3:2:1.

Pari retires. Nila and Ola share future profits equally.

Pari's Capital = Rs. 30,000

General Reserve = Rs. 18,000

Goodwill of firm = Rs. 36,000

Revaluation Profit = Rs. 6,000

Pari paid fully by cheque.

Calculate amount due to Pari and pass settlement entry.

Practical Problem 4 — Retirement

Question:

Rajan, Seema and Tarun share profits 4:3:3.

Seema retires on 1st January 2024.

Rajan and Tarun share future profits in ratio 3:2.

Balance Sheet as on 31st December 2023:

Liabilities	Rs.	Assets	Rs.
Rajan Capital	70,000	Building	60,000
Seema Capital	50,000	Plant	40,000
Tarun Capital	40,000	Stock	30,000
General Reserve	20,000	Debtors	25,000
Creditors	15,000	Cash	40,000
Total	1,95,000	Total	1,95,000

Terms:

(i) Goodwill = Rs. 50,000. No goodwill to appear in books.

(ii) Building appreciated by Rs. 20,000. Plant depreciated by Rs. 5,000.

(iii) Seema paid Rs. 30,000 immediately. Balance in Loan Account.

Prepare all accounts.

Practical Problem 7 — Dissolution (Basic)

Question:

Deepa and Elan are partners sharing profits 2:1.

They dissolve their firm on 31st December 2024.

Balance Sheet:

Liabilities	Rs.	Assets	Rs.
Deepa Capital	40,000	Machinery	25,000
Elan Capital	25,000	Stock	20,000
Creditors	10,000	Debtors	15,000
		Cash	15,000
Total	75,000	Total	75,000

On dissolution:

Machinery sold Rs. 28,000 | Stock sold Rs. 18,000 | Debtors realised Rs. 13,000

Creditors paid in full | Expenses Rs. 2,000

Prepare Realisation Account, Capital Accounts and Cash Account.

S.No	Topic	Formula	Purpose
1	Admission	Sacrificing Ratio = Old Ratio minus New Ratio	To distribute goodwill to old partners
2	Admission	New ratio verified: all shares must add to 1	To check correctness of calculation
3	Admission	Goodwill = Average Profit × Years of Purchase	Average Profit Method
4	Admission	Super Profit = Avg Profit minus Normal Profit	For Super Profit Method
5	Admission	Normal Profit = Capital × Normal Rate / 100	Part of Super Profit calculation
6	Admission	Goodwill = Super Profit × Years of Purchase	Super Profit Method
7	Retirement	Gaining Ratio = New Ratio minus Old Ratio	To charge goodwill from gaining partners
8	Retirement	Total due = Capital + Reserves + Goodwill + Reval Profit minus Losses minus Drawings	Amount payable to retiring partner
9	Retirement	Verification: Total of Gaining Ratio = Retiring partner's old share	Checking Gaining Ratio
10	Death	Profit (Time) = Last profit × Share × Months/12	Profit up to date of death
11	Death	Profit (Sales) = Last profit × (Sales to death / Total sales) × Share	Sales basis profit
12	Death	Total due = Capital + Reserves + Goodwill + JLP share + Profit to death	Executor's entitlement
13	Dissolution	Loss = Book value of assets minus Cash realised	Loss on realisation
14	Dissolution	Profit = Cash realised minus Book value of assets	Profit on realisation

15	Dissolution	Order: Creditors → Partner Loans → Capitals → Surplus	Payment sequence
16	Insolvency	Deficiency = Debit balance in capital (insolvent partner)	Amount borne by solvent partners
17	Insolvency	Capital Ratio = Capitals of SOLVENT partners only	Garner vs Murray ratio
18	Insolvency	Each solvent partner's burden = Deficiency × His capital / Total solvent capitals	Amount each bears

Complete Quick Summary Table

Point	Admission	Retirement	Death	Dissolution	Insolvency
Event	New partner joins	Partner leaves	Partner dies	Firm closes	Partner cannot pay loss
Key ratio	Sacrificing Ratio	Gaining Ratio	Gaining Ratio	Profit Sharing Ratio	Capital Ratio
Formula	Old minus New	New minus Old	New minus Old	Profit sharing	Last agreed capitals of solvent partners
Goodwill	New partner PAYS old partners	Gaining partners PAY retiring partner	Gaining partners PAY deceased's estate	Realisation Account	Not applicable
Revaluation	OLD partners in OLD ratio	ALL partners in OLD ratio	ALL partners in OLD ratio	ALL partners in PSR	Part of dissolution
Reserves	OLD partners in OLD ratio	ALL partners in OLD ratio	ALL partners in OLD ratio	ALL partners in PSR	Part of dissolution
Special item	Capital may need adjustment	Loan Account if not paid	Profit up to death + JLP	Realisation Account	Garner vs Murray
Transfer to	New Partner's Capital	Loan Account or Cash	Executor's Account	Cash Account (final)	Solvent partners' capitals

Notes

Legal provision	Section 31 — consent needed	Section 32 — three ways	No specific section	Section 40 to 44	Garner vs Murray 1904
Firm continues?	YES	YES	YES (if deed allows)	NO	NO (dissolution)

UNIT – V

Joint Venture and Royalty Accounts

Learning Objectives

By the end of this part, you should be able to:

- **Understand** the meaning, nature, features and objectives of a Joint Venture and royalty.
- Distinguish a Joint Venture from a Partnership.
- **Identify** the different methods of maintaining Joint Venture accounts and royalty accounts.
- **Calculate and distribute** profit or loss among co-venturers according to the agreed ratio.
- **Prepare** necessary journal entries and ledger accounts under different Joint Venture methods.
- **Prepare** Royalty Account, Short Workings Account and Minimum Rent Account where applicable.

Introduction

5.1 Meaning

A Joint Venture is an agreement between two or more persons (called co-venturers) to carry out a specific business transaction or project jointly, sharing the profits and losses in an agreed ratio, and the venture automatically comes to an end once that specific transaction or project is completed.

In simple words: think of two traders who come together *only* to buy and sell one particular consignment of goods — say, importing and selling a batch of machinery — and once that job is done and profits/losses are shared, they go their separate ways. That is a Joint Venture.

5.2 Features of Joint Venture

1. **Formed for a specific purpose** – It is undertaken for a particular venture (e.g., a construction contract, a consignment of goods, an underwriting of shares) and not for a continuing, general business.

2. **Temporary in nature** – It automatically dissolves once the venture is completed; there is no continuing relationship beyond that.
3. **No separate legal entity/firm name is necessary** – Unlike a partnership, a joint venture does not need to be registered as a firm, and no firm name is compulsory.
4. **Co-venturers, not partners** – The persons involved are called **co-venturers**, and their relationship exists only for that venture.
5. **Profit-sharing ratio is agreed** – Just like a partnership, profits and losses are shared in an agreed ratio; in the absence of an agreement, they are shared **equally**.
6. **No need for continuous capital investment** – Co-venturers may contribute cash, goods, or simply their skill/effort (e.g., one co-venturer may only manage the venture without contributing capital, in return for a commission).
7. **Books of account may or may not be maintained separately** – Depending on the method chosen (explained in A.4 below), the co-venturers may or may not open a full separate set of books.
8. **Persons involved need not be existing partners or have any other business relationship** – A joint venture can be between individuals, firms, or companies for that one specific deal.

5.3 Difference between Joint Venture and Partnership

This is one of the most frequently asked comparison questions in exams. Study this table carefully.

Basis	Joint Venture	Partnership
Governing Act	Not governed by the Indian Partnership Act, 1932 (though the general principles of agency/ contract apply)	Governed by the Indian Partnership Act, 1932
Duration	Temporary — ends once the specific venture is completed	Continuous — carries on until dissolved by agreement
Scope of Business	Confined to one specific transaction/venture	Carries on a continuing/ general business
Name of the entity	No firm name is necessary	Usually operates under a firm name

Persons involved	Called **co-venturers**	Called **partners**
Relationship after completion	Ends automatically after the venture is completed	Continues until formally dissolved
Minimum/ Maximum members	No statutory limit prescribed	Maximum of 50 partners (as per Companies (Miscellaneous) Rules, applicable via the Partnership Act read with Companies Act provisions)
Implied Agency	A co-venturer is an implied agent only for the purposes of that venture	A partner is an implied agent of the firm for all its general business
Maintenance of separate books	Not compulsory — may or may not maintain separate books	Compulsory to maintain proper books of account for the ongoing firm
Sharing of profit if no agreement	Equally, in the absence of an agreement	Equally, in the absence of an agreement (same principle)

Venture = "One-time project partnership." Partnership = "Ongoing business relationship."

5.4 Co-Venturers and Their Roles

Co-venturers can play different roles in a joint venture, and their role decides how their transactions are recorded:

1. **Active Co-venturer** – actually manages the day-to-day operations of the venture (buying, selling, handling goods), and is usually entitled to extra remuneration for this effort, called **commission**.
2. **Sleeping/Dormant Co-venturer** – only contributes capital or goods, but does not take part in the actual management of the venture.
3. **Managing Co-venturer** – a co-venturer specifically entrusted with keeping accounts and managing the venture on behalf of all co-venturers, particularly relevant under Method 3 (Memorandum Joint Venture Account Method) discussed below.

Each co-venturer contributes something — cash, goods, or personal effort — towards the venture, and is entitled to a share of the eventual profit (or must bear a share of any loss) as per the agreed ratio.

5.5 Methods of Maintaining Joint Venture Accounts

There are **three commonly used methods**, and it's essential to know when each is used.

Method 1: When a Separate Set of Books is Maintained

This is used when the venture is **large** and it is convenient to open a completely separate set of books just for the venture. Two accounts are opened:

- **Joint Bank Account** – a bank account opened jointly by co-venturers for the venture, into which all co-venturers deposit their contributions and from which venture expenses/purchases are paid.
- **Joint Venture Account** – records all the venture's transactions (purchases, expenses, sales, commission, profit/loss).
- Each co-venturer also has a personal **Capital Account** in these joint books.

Method 2: When Each Co-venturer Keeps Records of Their OWN Transactions Only (No Separate Set of Books)

Here, each co-venturer maintains, in their own individual books, two accounts:

- A **Joint Venture Account** (personal record of their own share of the venture's transactions)
- A **Co-venturer's Personal Account** (recording amounts due to/from the other co-venturer(s))

Since each co-venturer knows only about their own transactions initially, they must exchange information (via a statement called an **Account Sales** or a memorandum) to compute the venture's total profit or loss, which is then shared in the agreed ratio.

Method 3: Memorandum Joint Venture Account Method

This is the **most commonly used and most frequently examined method**, especially when no separate set of books is opened, but the co-venturers want to see the combined result of the whole venture in one

place, while each still records only their own transactions in their own personal books.

Under this method, TWO sets of accounts are prepared:

1. A **Memorandum Joint Venture Account** — prepared **jointly**, purely as a memorandum (i.e., not part of the double-entry system of any individual co-venturer's books) — simply to find out the **total profit or loss** of the venture.
2. In **each co-venturer's own books**, a personal account titled **"Joint Venture with [Other Co-venturer's Name]"** is maintained. This records that specific co-venturer's own transactions relating to the venture, and is eventually **closed by transferring their share of profit/loss** (computed from the Memorandum account) to this account, following which the final settlement is worked out.

Joint ventures must be distinguished from joint ownership. If two brothers purchase a building jointly, without any idea of earning an income from it, it will be a case of joint ownership. In the case of joint ventures, the earning of profit is an essential point; the profit or loss will be shared by the co-venturers.

5.6 Accounting Record

Maintenance of account books usually rests with the magnitude of the operations. If it is on a large scale, a separate set of books is opened, otherwise each party records the accounts in his existing books.

1. Separate Books

These books are totally distinct from those already kept by each coventurer, if any. The important accounts incorporated under it are (a) Joint Bank A/c, (b) Personal Account of each Coventurer, and (c) Joint Venture A/c.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	**Cash contributed by each venturer is pooled together and placed in a 'Joint Bank A/c' with a banker.**			
	Joint Bank A/c Dr.		****	
	To A's Capital / Personal A/c			****
	(Being cash contributed by A)			

(2)	**On making purchases for joint venture operations**			
	Joint Venture A/c Dr.		****	
	To Joint Bank A/c			****
	(Being goods purchased for cash)			
	Joint Venture A/c Dr.		****	
	To Creditors A/c			****
	(Being goods purchased on credit)			
(3)	**On incurring expenses for the operations**			
	Joint Venture A/c Dr.		****	
	To Joint Bank A/c (for cash)			****
	To Expense Creditors (for outstanding amounts)			****
	To A's Capital / Personal A/c			****
	(Being expenses paid by A on behalf of the venture)			
(4)	**On Sale of the goods or completion of the job**			
	Joint Bank A/c Dr.		****	
	Customers' A/c Dr.		****	
	Venture's personal A/c Dr.		****	
	To Joint Venture A/c			****
	(Being goods sold on credit)			
(5)	**On allocation of the Venture result (say a profit)**			
	Joint Venture A/c Dr.		****	
	To A's Capital / Personal A/c			****
	To B's Capital / Personal A/c			****
	(Being profit on joint venture shared equally between A and B)			

Reverse this entry on loss to close off the Joint Venture Account.

On realization from the debtors or payment to the creditors, the usual entries are passed by debiting or crediting the Joint Bank A/c. The Joint Bank balance should be now just sufficient to balance off the Venturers' Personal Accounts. With the settlement of these accounts the separate books will automatically be closed off.

2. In the individual books of each venturer, a Joint Venture Investment Account is opened which is debited with the contribution made (cash, materials or expertise) and the share of profit earned. For realizations and losses incurred the Account stands credited. Just before the final settlement, the balance standing in the Joint Venture Investment Account in each venturer's books should tally (though on opposite side) with that of his personal account in the separate (common) Books. Accordingly, with the receipt (or payment) of the final amount, the Joint Venture Investment Accounts in the individual books of the Venturers close down along with the various accounts in the separate books.

Illustration 1: [Separate Joint Venture Books]

X and Y enter into a joint venture to construct a tube-well for Z and Co. The contract price is ₹ 2,00,000. The venturers open a joint bank account and deposit ₹ 65,000 each. The contractee company pays an earnest money of ₹ 25,000 of which ₹15,000 is deposited in the bank and the balance kept by X for the distribution of wages. The expenses incurred in constructing the well are:

Particulars	₹
Iron bars and cement etc.	80,000
Other sundry materials	10,000
Other sundry materials	10,000
Remuneration to supervisors and other construction expenses	7,000

All the expenses are met out of the 'Joint bank A/c' except ₹ 12,000 and ₹3,000 paid personally by X and Y respectively in the distribution of wages. On completion of the tube-well, the residual items of ₹2,000 are disposed off and realized by Y.

Finding the Z and Co. unsatisfied with the constructed tube-well, the contractors agree to a reduction of 10% in the contract price. Accordingly, the company pays off the balance due.

The co-venturers close the joint venture books after equally dividing the result of the venture.

Show the Ledger Accounts in the

(1) Separate Joint Venture Books, and

(2) Joint Venture Investment Accounts in the books of X and Y.

Solution

Separate Joint Venture Books

Joint Bank Account

Particulars	₹	₹	Particulars	₹	₹
To Coventurers:			By Joint Venture A/c		
X	65,000	1.30,000	Iron and Cement	80,000	
Y	65,000		Sundry materials	10,000	
			Wages (55,000-15,000)	40,000	
To Contractee (advance)		15,000	Supervisory charges etc.	7,000	1,37,000
To Contractee (residue)		1,55,000	By Coventurers:		
			X	82,000	
			Y	81,000	1,63,000
		3,00,000			**3,00,000**

Joint Venture Account

Particulars	₹	₹	Particulars	₹
To Joint Bank :			By Contractee (Z & Co.,) (₹ 2 lakhs less 10%)	1,80,000
Iron and Cement	80,000			
Sundry materials	10,000	1,37,000	By Conventurer : Y Realization of residual materials	2,000
Wages	40,000			
Supervisory charges etc.	7,000			
To Coventurers:				
X	12,000			
Y	3,000	15,000		
To Profit to Coventureres :				
X	15,000			
Y	15,000	30,000		
		1,82,000		**1,82,000**

Coventurers' Account

Particulars	X	Y	Total	Particulars	X	Y	Total
To Contractee (Adv)	10000	-	10000	By Joint Bank	65000	65000	130000
To Joint Venture (residue realized)	-	2000	2000	By Joint Venture (wages)	12000	3000	15000
To Joint Bank (final settlement)	82000	81000	163000	By Joint Venture : Profit	15000	15000	30000
	92000	**83000**	**175000**		**92000**	**83000**	**175000**

Coventurer X's Books

Joint Venture Investment Account (with Y)

Particulars	₹	Particulars	₹
To Cash (Initial contribution	65,000	By Cash (advance for wage)	10,000
To Cash (payment of wages)	12,000	By Cash (final settlement)	82,000
To P & L a/c (profit)	15,000		
	92,000		**92,000**

Coventurer Y's Books

Joint Venture Investment Account (with X)

Particulars	₹	Particulars	₹
To Cash (Initial contribution	65,000	By Cash (advance for wage)	2,000
To Cash (payment of wages)	3,000	By Cash (final settlement)	81,000
To P & L a/c (profit venture)	15,000		
	83,000		**83,000**

Examinees may note that reference of Joint Bank is a sufficient indication of the existence of Separate (Joint Venture) Books even if the examination problem is silent thereto.

We shall first consider the record to be made in the books of the various parties. Each party opens a joint venture account and the accounts of other parties. Suppose P and Q enter into a joint venture. Then P will open a joint venture account and also an account of Q. Similarly, Q will open, in his books, a joint venture account and the account of P. The following entries are made:

Sl. No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1	**Expenditure incurred on account of joint venture (paid in cash)**			
	Joint Venture A/c Dr.		****	
	To Cash A/c			****
	Expenditure incurred on account of joint venture (goods used from own stock)			
	Joint Venture A/c Dr.		****	
	To Goods A/c			****

2	**Expenditure incurred by the other party**				
	Joint Venture A/c	Dr.		****	
	To Other Party's A/c				****
3	**Advance received from the other party (in the form of a bill of exchange)**				
	Bills Receivable A/c	Dr.		****	
	To Other Party's A/c				****
4	**Advance given to the other party (in the form of a promissory note)**				
	Other Party's A/c	Dr.		****	
	To Bills Payable A/c				****
5(a)	**Bill receivable discounted**				
	Cash A/c	Dr.		****	
	Discount A/c	Dr.		****	
	To Bills Receivable A/c				****
5(b)	**Discount transferred to the Joint Venture Account**				
	Joint Venture A/c	Dr.		****	
	To Discount A/c				****
5(c)	**Bill payable issued to the other party and discounted by that party**				
	Joint Venture A/c	Dr.		****	
	To Other Party's A/c				****
6(a)	**Money received on account of joint venture**				
	Bank A/c	Dr.		****	
	To Joint Venture A/c				****
6(b)	**Money received by the other party on account of joint venture**				
	Other Party's A/c	Dr.		****	
	To Joint Venture A/c				****
7(a)	**Special commission receivable on account of joint venture**				
	Joint Venture A/c	Dr.		****	
	To Commission A/c				****
7(b)	**Commission payable to the other party** (for purchases or sales)				
	Joint Venture A/c	Dr.		****	
	To Other Party's A/c				****

8(a)	**Unsold goods taken over by self**			
	Purchases A/c Dr.		****	
	To Joint Venture A/c			****
8(b)	**Unsold goods taken over by the other party**			
	Other Party's A/c Dr.		****	
	To Joint Venture A/c			****
9	**Profit/loss on joint venture distributed in the agreed proportion**			
	Joint Venture A/c Dr.		****	
	To Other Party's A/c			****
	To Profit and Loss A/c			****
	(In case of loss, this entry is reversed)			

Illustration 2: Arun and Ashok enter into a joint venture sharing profits 3/5ths and 2/5ths. Arun is to purchase timber in Madhya Pradesh and forward it to Ashok in Delhi. Arun purchased timber worth ₹10,000 and paid ₹1,000 as expenses. Ashok received the consignment ands immediately accepted Arun's draft for ₹8.000. Arun got it discounted for ₹7,850. Ashok disposed off the timber for ₹16,000. He had to spend ₹350 for fire insurance and ₹300 for rent. Under the agreement he is entitled to a commission of 5 percent on sales.

Give journal entries and ledger accounts in the books of both the parties.

Solution Arun's Journal

Particulars		₹	₹
Joint Venture Account	Dr.	10,000	
To Bank Account (Amount spent on timber forwarded to Ashok)			10,000
Joint Venture Account	Dr.	1,000	
To Bank Account (Expenses incurred on timber sent to Ashok)			1,000
Bills Receivable Account To Ashok (Acceptance received from Ashok as an advance)	Dr.	8,000	8,000

Bank Account Dr. Discount Account To Bills Receivable A/c (Ashok's acceptance discounted for ₹7,850)		7,850 150	8,000
Joint Venture Account Dr. To Discount Account (Discount on Ashok's acceptance transferred to Joint Venture Account)		150	150
Ashok Account Dr. To Joint Venture Account (Sales effected by Ashok)		16,000	16,000
Joint Venture Account Dr. To Ashok Account (Expenses incurred by Ashok on Joint Venture)		650	650
Joint Venture Account Dr. To Ashok Account (Commission due to Ashok on sales)		800	800
Joint Venture Account Dr. To Profit and Loss Account To Ashok (Profit on Joint Venture. ₹3,400; 3/5ths to self and 2/5ths to Ashok)		3,400	2,040 1,360

Arun's Ledger: Joint Venture Account

Particulars	₹	Particulars	₹
To Bank a/c		By Ashok-Sale proceeds	16,000
Timber Purchased	10,000		
To Bank a/c Expenses	1,000		
To Discount a/c	150		
To Ashok-expenses	650		
To Ashok-commission	800		
To Profit to:			
Ashok (2/5) 1,360			
P&L a/c (3/5) 2,040	3,400		
	16,000		**16,000**

Bills Receivable Account

Particulars	₹	Particulars	₹
To Ashok a/c	8,000	By Bank a/c	7,850
		By Discount a/c	150
	8,000		**8,000**

Discount Account

Particulars	₹	Particulars	₹
To Bills receivable a/c	150	By Joint venture a/c transfer	150
	150		**150**

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	3,150	By Joint Venture a/c Timber	10,000
To Bills receivable a/c	7,850	By Joint Venture a/c Expenses	1,000
	11,000		**11,000**

Ashok Account

Particulars	₹	Particulars	₹
To Joint Venture a/c (Sale)	16,000	By Bills Receivable a/c	8,000
		By Joint Venture a/c	
		Expenses	650
		Commission	800
		Profit (2/5)	1,360
		By Balance c/d	5,190
	16,000		**16,000**
To Balance b/d	5,190		

Profit & Loss Account

Particulars	₹	Particulars	₹
		By Joint venture a/c	2,040

Journal Books of Ashok

Particulars		₹	₹
Joint Venture Account	Dr.	11,000	
To Arun a/c			11,000
(Arun spent ₹ 10,000 on timber & ₹1,000 as expenses)			
Arun Account	Dr.	8,000	
To Bills Payable a/c			8,000
(Acceptance sent to Arun as advance)			
Joint Venture account	Dr.	150	
To Arun a/c			150
(Discount ₹ 150 paid by Arun			
Joint Venture Account	Dr	650	
To Bank Account			650
(Rent ₹300 and insurance ₹350 paid)			
Bank Account	Dr.	16,000	
To Joint Venture Account			16,000
(Sales effected on account of Joint Venture)			
Joint Venture Account	Dr.	800	
To Commission Account			800
(5% commission on ₹ 16,000)			
Joint Venture Account	Dr.	3,400	
To Profit and Loss Account			1,360
To Arun a/c			2,040
(Profit on joint venture, ₹3,400 divided as 2/5ths to self and 3/5ths to Arun)			
Bills Payable Account	Dr.	8,000	
To Bank Account			8,000
(Acceptance of Arun met)			

Ledger - Joint Venture Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Arun-Timber and expenses	11,000	By Bank a/c sale proceeds	16,000
To Bank a/c expenses	650		
To Commission a/c	800		
To Arun-Discount	150		
To Profit to: Arun (3/5)	2,040		
P & L a/c (2/5)	1,360		
	16,000		**16,000**

Arun Account

Particulars	₹	Particulars	₹
To Bills Payable a/c	8,000	By Joint venture a/c	11,000
To Balance c/d	5,190	By Joint venture a/c -	
		Discount	150
		Profit	2,040
	13,190		**13,190**
		By Balance b/d	5,190

Illustration 3:

Varma and Sanon entered into a joint venture to carry out the interior decoration of a pavilion at the 1981 Trade Fair at New Delhi. Varma provided the necessary capital of ₹30,000 which he handed over to Sanon and for which he was to be allowed interest at 20% p.a. Sanon was to personally supervise the work and make the necessary arrangements for which he was allowed remuneration at ₹3,000 per month; he would be liable for any penalty for delay to the extent of 50%. The contract provided for a payment of ₹1,00,000 with a clause stating that for every week's or part of week's delay ₹10,000 would be deducted. According to the terms agreed upon, the work was to be completed by 31st October 1981. The work commenced on 1st Sept. and was completed on the 7th November actually. The following payments were made:

Particulars	₹
Expenses in connection with obtaining the contract	5,000
Workmen	6,000
Art work	20,000
Entertainment	2,000

The contractee paid the amount due to Sanon and the two co-venturers settled the accounts between themselves on the 7th November, 1981.

Prepare the Memorandum Joint Venture Account and the account that each party would have in respect of the joint venture.

Solution

Memorandum Joint Venture Account

Particulars	₹	Particulars	₹
To Expenses-obtaining the Contract	5,000	By Amount paid by the Contractee	90,000
– Workmen's wages	6,000		
– Art work	20,000		
– Entertainment	2,000		
To Remuneration for Sanon for 2 months and 7 days 6,700			
Less pena1ty(1/2) 5,000	1,700		
To Interest to Varma for 68 days on ₹30,000 at 20%	1,118		
To Profit-Varma	27,091		
Sanon	27,091		
	90,000		**90,000**

Books of Varma: Sanon in Joint Venture Account

Particulars	₹	Particulars	₹
To Cash-amount remitted	30,000	By Cash - received from Sanon	58,209
To interest due	1,118		
To P & L share of profit	27,091		
	58,209		**58,209**

Books of Sanon Varma in Joint Venture Account

Particulars	₹	Particulars	₹
To Cash-expenses on		By Cash-received from	
obtaining the contract	5,000	Varma	30,000
– Wages	6,000	By Cash-received from	
– Art-work	20,000	the contractee	90,000
– Entertainment	2,000		
To P & L a/c net remuneration	1,700		
To P & L a/c Share of profit	27,091		
To Cash-remitted to Varma	58,209		
	1,20,000		**1,20,000**

Part B: Royalty Accounts

5.7 Meaning of Royalty

Royalty is a periodic payment made by one party (called the **Lessee**) to another party (called the **Lessor** or **Landlord**) for the **right to use an asset** owned by the Lessor — typically the right to extract minerals from a mine, use a patent, use a copyright, or use a trademark/brand name.

In simple words: think of a mining company that does not own the land but pays the landowner a fee **based on how much coal/ore it actually extracts**. That periodic fee is Royalty.

Definition: When a person uses someone else's property or invention to earn money, he pays a regular amount to the owner. This regular payment is called Royalty.

5.8 Characteristics of Royalty

1. **Payment for use of a right/asset** – Royalty is paid for the right to use something owned by another person — a mine, patent, copyright, or trademark — not for buying that asset outright.
2. **Based on output or sales** – Royalty is usually calculated on the basis of the **quantity of output produced/extracted** (e.g., per tonne of coal mined) or the **value of sales/turnover** (e.g., a percentage of sales, common for patents/copyrights/books).
3. **Periodic in nature** – It is a recurring payment made at regular intervals (usually annually), not a one-time payment.

4. **Treated as a business expense for the lessee** – Since it relates to production/output, royalty on production is normally treated as a **manufacturing expense** (debited to Trading/Manufacturing Account) in the books of the lessee; royalty based on sales is treated as a **selling expense**.
5. **Distinguishes from Rent** – Rent is a fixed periodic payment for the use of a fixed asset (like a building), irrespective of usage. Royalty, in contrast, varies with output/sales — though a **Minimum Rent** clause (explained below) ensures the lessor gets at least a guaranteed minimum amount even if actual output is low.

5.9 Key Terms Used in Royalty Accounts

This is the **most important section** for exam purposes — you must know each term precisely.

1. **Lessor (or Landlord)**

   The person/party who owns the asset (mine, patent, copyright) and grants the right to another party to use it, in return for royalty.

2. **Lessee**

   The person/party who is granted the right to use the asset and who pays royalty to the lessor.

3. **Royalty**

   The periodic amount payable by the lessee to the lessor, calculated on the basis of output produced or sales made, as per the agreement (called the "Royalty Agreement" or "Lease Deed").

4. **Minimum Rent (also called Dead Rent or Fixed Rent)**

   This is the **minimum guaranteed amount** that the lessor will receive from the lessee in any given period, **irrespective of the actual output or sales**. This clause protects the lessor from receiving very little or nothing in years when production is low (e.g., in the early years of a mine, or during a market slump).

   - If **actual royalty (based on output/sales) is more than Minimum Rent** → the Lessee pays the **actual royalty** amount (the higher of the two).
   - If **actual royalty is less than Minimum Rent** → the Lessee must still pay the **Minimum Rent** (the guaranteed minimum), and the difference is called **Short-workings**.

5. **Short-workings**

   Short-workings = Minimum Rent − Actual Royalty (calculated only when Actual Royalty is LESS than Minimum Rent)

   This represents the excess amount the lessee has had to pay over and above the actual royalty earned/due, purely because of the Minimum Rent guarantee.

6. **Right of Recoupment of Short-workings**

   Most royalty agreements allow the lessee to **recover (recoup) short-workings paid in earlier years**, out of any **surplus** (see below) arising in later years — but usually only within a specified time limit (called the "fixed period" or "recoupable period," e.g., the right to recoup short-workings must be exercised within the next 2 or 3 years, after which the right lapses).

7. **Surplus (or Excess of Royalty over Minimum Rent)**

   Surplus = Actual Royalty − Minimum Rent (calculated only when Actual Royalty is MORE than Minimum Rent)

   This surplus amount is available for the lessee to **recoup (recover)** any short-workings of earlier years, subject to the time-limit condition in the agreement.

8. **Irrecoverable Short-workings**

   If the time limit for recoupment expires and any short-workings still remain un-recouped, such short-workings become **irrecoverable** and must be **written off** — transferred as a loss to the Profit & Loss Account of the lessee.

9. **Strike or Lock-out Clause**

   If work is stopped due to a strike or lock-out for a substantial period, many agreements provide for a **reduction in the Minimum Rent** for that period — sometimes reduced in proportion to the period of stoppage, or the Minimum Rent may even be waived off for that period, as specified in the agreement.

10. **Sub-lease**

    Sometimes the lessee, having taken the right from the lessor, further grants a portion of that right to a third party — this is called a **sub-lease**, and the original lessee (now also a sub-lessor) receives royalty from the sub-lessee, in addition to paying royalty to the original lessor.

5.10 Accounting Treatment in the Books of the LESSEE

The Lessee needs to open the following accounts:

1. **Royalty Account** – records the actual royalty earned/accrued each year (based on output/sales), and is closed by transfer to Trading/ P&L Account or Profit & Loss Account (depending on whether it's a production or sales royalty).
2. **Short-workings Account** – records the short-workings arising each year, and later shows recoupment (if any) or write-off.
3. **Landlord's (Lessor's) Account** – records the actual amount payable/ paid to the landlord each year (which is always the HIGHER of Actual Royalty or Minimum Rent).

Journal Entries in the Books of the Lessee or Tenant

Particulars	L.F.	Debit (₹)	Credit (₹)
1. For Royalty payable: **A. When there are no Shortworkings**			
Royalty A/c Dr.		****	
To Landlord A/c			****
B. When there are Shortworkings **(i) When Minimum Rent Account is not maintained**			
Royalty A/c Dr.		****	
Shortworkings A/c Dr.		****	
To Landlord A/c			****
(ii) When Minimum Rent Account is maintained **For Minimum Rent:**			
Minimum Rent A/c Dr.		****	
To Landlord A/c			****
For Actual Royalty and Shortworkings:			
Royalty A/c Dr.		****	
Shortworkings A/c Dr.		****	
To Minimum Rent A/c			****

2. For Payment of Cash **A. When there is no Recoupment of Shortworkings**			
Landlord A/c Dr.		****	
To Cash/Bank A/c			****
B. When there is Recoupment of Shortworkings			
Landlord A/c Dr.		****	
To Cash/Bank A/c			****
To Shortworkings A/c *(Being payment made to the landlord and the amount of shortworkings recouped.)*			****
3. For Transferring Royalty at the End of the Year			
Production A/c / (OR) Profit and Loss A/c Dr.		****	
To Royalty A/c			****
4. When Shortworkings are Written Off			
Profit and Loss A/c Dr.		****	
To Shortworkings A/c *(Being shortworkings written off to Profit and Loss Account.)*			****

Journal Entries in the Books of the Lessor OR Landlord

Particulars	L.F.	Debit (₹)	Credit (₹)
1. For Royalty Receivable: **A. When there are No Shortworkings**			
Tenant A/c Dr.		****	
To Royalty Receivable A/c			****
B. When there are Shortworkings			
Tenant A/c Dr.		****	
Shortworkings A/c Dr.		****	
To Royalty Receivable A/c			****
2. For Receiving Cash **A. When there is No Recoupment of Shortworkings**			

Cash/Bank A/c	Dr.		****	
To Tenant A/c				****
B. When there is Recoupment of Shortworkings				
Cash/Bank A/c *(Actual Cash Received)*	Dr.		****	
Shortworkings A/c *(Recoupment Made)*	Dr.		****	
To Tenant A/c				****
3. For Transferring Royalty Receivable A. When there is No Recoupment of Shortworkings				
Royalty Receivable A/c	Dr.		****	
To Profit and Loss A/c				****
B. When there are Shortworkings				
Royalty Receivable A/c	Dr.		****	
Shortworkings A/c	Dr.		****	
To Profit and Loss A/c				****

Illustration 4:

ABC Coal Limited a colliery on 1st January 2017 at a minimum rent of ₹32,000, merging into a royalty of ₹1 per tonne, with a stipulation to recoup shortworkings over the first 3 years of the lease. The output for the first four years of the lease was 18,000, 28,000, 44,000 and 38,000 tonnes respectively. Draft a necessary journal entries in the books of the company.

Solution:

Step 1 — Analytical Table

Year	Output (Tonnes)	Royalty @₹1	Min Rent (₹)	Amount Paid (₹)	Analytical Short Working (₹)	Recoupment	Shortworking lapse Written Off	Payment to Landlord
2017	18,000	18,000	32,000	32,000	14,000	----	----	32,000
2018	28,000	28,000	32,000	32,000	4,000	----	----	32,000
2019	44,000	44,000	32,000	44,000	----	12,000	6,000	32,000
2020	38,000	38,000	32,000	38,000	----	4,000	----	38,000

Step 2 — Working Notes (Explanation Year by Year)

Year 2017:

Royalty = 18,000 × ₹ 1 = ₹ 18,000

Minimum Rent = ₹ 32,000

Royalty < Minimum Rent → Pay Minimum Rent

Short Working = 32,000 − 18,000 = **₹ 14,000**

Year 2018:

Royalty = 28,000 × ₹ 1 = ₹ 28,000

Minimum Rent = ₹ 32,000

Royalty < Minimum Rent → Pay Minimum Rent

Short Working = 32,000 − 28,000 = **₹ 4,000**

Cumulative Short Working = 14,000 + 4,000 = ₹ 18,000

Year 2019:

Royalty = 44,000 × ₹ 1 = ₹ 44,000

Minimum Rent = ₹ 32,000

Royalty > Minimum Rent → Pay Actual Royalty

Excess = 44,000 − 32,000 = ₹ 12,000

Important Note — Fixed Recoupment:

Recoupment allowed only in FIRST 3 YEARS (2017, 2018, 2019).

Year 2019 is the **Last** Year for recoupment.

Recoup from Year 2017 SW = ₹ 14,000 — recoupable in 2017, 2018, 2019

Recoup from Year 2018 SW = ₹ 4,000 — recoupable in 2017, 2018, 2019

Total SW available = ₹ 18,000

Excess available for recoupment = ₹ 12,000

Recoup ₹ 12,000 from Year 2017 SW first.

Remaining Year 2017 SW = 14,000 − 12,000 = **₹ 2,000** (irrecoverable — last year was 2019)

Total excess in Year 2019 = ₹ 12,000

Total SW to recoup = Year 2017 SW ₹ 14,000 + Year 2018 SW ₹ 4,000 = ₹ 18,000

But only ₹ 12,000 excess available.

Total irrecoverable = ₹ 2,000 + ₹ 4,000 = **₹ 6,000**

Total recouped = ₹ 12,000

Year **2020:**

Royalty = 38,000 × ₹ 1 = ₹ 38,000

Minimum Rent = ₹ 32,000

Royalty > Minimum Rent → Pay Actual Royalty

Excess = ₹ 6,000

Journal Entries in the Books of ABC Coal Limited

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
31.12.2017	Royalty A/c Dr Short Working A/c Dr To Landlord's Account (Being royalty for 2017 at ₹1 per tonne on 18,000 tonnes)		18,000 14,000	 32,000
	Landlord's A/c Dr To Cash / Bank A/c (Being minimum rent for Year 2017 paid to landlord)		32,000	 32,000
	Profit and Loss A/c Dr To Royalty A/c (Being royalty for 2017 transferred to Profit and Loss Account)		18,000	 18,000
31.12.2018	Royalty A/c Dr Short Working A/c Dr To Landlord's A/c (Being royalty for 2018 at ₹1 per tonne on 28,000 tonnes)		28,000 4,000	 32,000
	Landlord's A/c Dr To Cash / Bank A/c (Being minimum rent for Year 2018 paid to landlord)		32,000	 32,000
	Profit and Loss A/c Dr To Royalty A/c (Being royalty for 2018 transferred to Profit and Loss Account)		28,000	 28,000

31.12.2019	Royalty A/c Dr To Short Working A/c To Landlord's A/c (Being royalty for 2019 at ₹1 per tonne on 44,000 tonnes)		44,000	 12,000 32,000
	Landlord's A/c Dr To Cash / Bank A/c (Being minimum rent for Year 2019 paid to landlord)		32,000	 32,000
	Profit and Loss A/c Dr To Royalty A/c (Being royalty for 2019 transferred to Profit and Loss Account)		44,000	 44,000
	Profit and Loss A/c Dr To Short Working A/c (Being irrecoverable short working of ₹6,000 written off to Profit and Loss Account as the fixed recoupment period of 3 years has expired at end of Year 2019)		6,000	 6,000
31.12.2020	Royalty A/c Dr To Landlord's A/c (Being royalty for 2020 at ₹1 per tonne on 38,000 tonnes)		38,000	 38,000
	Landlord's A/c Dr To Cash / Bank A/c (Being actual royalty for Year 2020 paid to landlord)		38,000	 38,000
	Profit and Loss A/c Dr To Royalty A/c (Being royalty for 2020 transferred to Profit and Loss Account)		38,000	 38,000

Illustration 5:

Mr. Mithran had patented a electric pressure cooker and gave KVS Mart, the right to manufacture and sell under a license for seven years. The stipulated terms were as follows:

(a) A royalty of ₹5 to be paid on each piece.

(b) A minimum rent of ₹50,000 per annum.

(c) The right to deduct in two following years any excess of the minimum over the calculated royalties in any year.

The number of pieces sold was:

Year	No. of pieces
2014	9,000
2015	9,600
2016	10,800
2017	12,000

Give Ledger Accounts as they would appear in the books of KVS Mart to record these transactions.

Solution:

Analytical Table

Year	Pieces Sold	Royalty (₹)	Minimum Rent (₹)	Short-workings (₹)	Recouped (₹)	Short-workings lapsed (₹)	Amount Payable to Mithran (₹)
2014	9,000	45,000	50,000	5,000	–	–	50,000
2015	9,600	48,000	50,000	2,000	–	–	50,000
2016	10,800	54,000	50,000	–	4,000	1,000	50,000
2017	12,000	60,000	50,000	–	2,000	–	58,000

In the Books of KVS Mart

Royalties Account

Date	Particulars	₹	Date	Particulars	₹
2014	To Mithran's A/c	45,000	2014	By P&L A/c	45,000
2015	To Mithran's A/c	48,000	2015	By P&L A/c	48,000
2016	To Mithran's A/c To Shortworkings A/c	50,000 4,000 **54,000**	2016	By P&L A/c	54,000 **54,000**
2017	To Mithran's A/c To Shortworkings A/c	58,000 2,000 **60,000**	2017	By P&L A/c	60,000 **60,000**

Shortworkings Account

Date	Particulars	₹	Date	Particulars	₹
2014	To Mithran's A/c	5,000	2014	By Balance c/d	5,000
2015	To Balance b/d To Mithran's A/c	5,000 2,000	2015	By Balance c/d	7,000
2016	To Balance b/d	7,000	2016	By Royalties A/c By P&L A/c By Balance c/d	4,000 1,000 2,000
		7,000			**7,000**
2017	To Balance b/d	2,000		By Royalties A/c	2,000

Mithran's Account

Date	Particulars	₹	Date	Particulars	₹
2014	To Bank A/c	50,000	2014	By Royalties A/c By Shortworkings A/c	45,000 5,000
		50,000			**50,000**
2015	To Bank A/c	50,000	2015	By Royalties A/c By Shortworkings A/c	48,000 2,000
		50,000			**50,000**
2016	To Bank A/c	50,000	2016	By Royalties A/c	50,000
2017	To Bank A/c	58,000	2017	By Royalties A/c	50,000

Production Account

Date	Particulars	₹	Date	Particulars	₹
2014	To Royalties A/c	45,000			
2015	To Royalties A/c	48,000			
2016	To Royalties A/c	54,000			
2017	To Royalties A/c	60,000			

Illustration 6:

A TV Company took a lease of a coalfield for a period of 25 years, from 1st Januuary 2018, on a royalty of ₹ 1 per tonne of coal raised, with a minimum rent of ₹20,000 and the power to recoup the shortworkings during the first three years of the lease. The annual raising were as follows:

Year	Output (Tonnes)
2018	12,000
2019	18,000
2020	12,000
2021	15,000

Prepare Shortworkings Account.

Solution:

Shortworkings Account

Date	Particulars	₹	Date	Particulars	₹
2018	To Landlord A/c	8,000	2018	By Balance c/d	8,000
2019	To Balance b/d	8,000	2019	By Balance c/d	10,000
	To Landlord A/c	2,000	2020		**10,000**
		10,000		By Landlord A/c	4,000
2020	To Balance b/d	10,000			6,000
		10,000			**10,000**

Multiple Choice Questions:

1. A Joint Venture is a:
   (a) Permanent business arrangement between two persons
   (b) Temporary business arrangement for a specific purpose
   (c) Business arrangement governed by Partnership Act 1932
   (d) Business arrangement with unlimited duration

   Correct Answer: (b) Temporary business arrangement for a specific purpose
2. The persons who participate in a joint venture are called:
   (a) Partners
   (b) Directors
   (c) Co-venturers
   (d) Shareholders

   Correct Answer: (c) Co-venturers
3. The Memorandum Joint Venture Account is:
   (a) Part of double entry system
   (b) A personal account
   (c) Only a working paper to find profit or loss

(d) Maintained in lessor's books

Correct Answer: (c) Only a working paper to find profit or loss

4. Royalty is paid by the:
   (a) Lessor to the Lessee
   (b) Lessee to the Lessor
   (c) Government to the Lessee
   (d) Landlord to the Government

   Correct Answer: (b) Lessee to the Lessor
5. Minimum Rent is also known as:
   (a) Short Working
   (b) Dead Rent or Fixed Rent
   (c) Recoupment
   (d) Royalty Reserve

   Correct Answer: (b) Dead Rent or Fixed Rent
6. Short Working arises when:
   (a) Actual Royalty is MORE than Minimum Rent
   (b) Actual Royalty is EQUAL to Minimum Rent
   (c) Actual Royalty is LESS than Minimum Rent
   (d) Minimum Rent is zero

   Correct Answer: (c) Actual Royalty is LESS than Minimum Rent
7. Irrecoverable Short Working is treated as:
   (a) Asset in the balance sheet
   (b) Income of the lessee
   (c) Loss written off to Profit and Loss Account of the lessee
   (d) Liability of the lessor

   Correct Answer: (c) Loss written off to Profit and Loss Account of the lessee

Short Answer Questions

1. **What is royalty?**
2. **What is minimum rent?**
3. **Write a note on shortworking.**
4. **What is recoupment of shortworking?**
5. **Who is lessor and lessee?**

6. What is Consignment?
7. What is Proforma invoice?
8. What do you mean by Account Sales?
9. Define Joint Venture.
10. How do you differentiate consignment from sales?
11. How does consignment differ from joint venture?

Long Answer Questions:

1. **Explain in detail of a joint venture.**
2. **Differentiate between partnership and joint venture.**
3. **Explain the terms used in royalty accounts.**

Practical Problems:

Problem 1

A and B enter into a Joint speculation and purchase an old house with extensive grounds for .₹8,000, each .contributing ₹4,000. For an agreed fee of ₹500 A is to manage the disposal of the property. Sale of internal fittings, windows etc. amounted to ₹1,700. A pays ₹300 for demolishing the house, materials of which realises ₹200. Sundry expenses paid by A were ₹100 and the whole of the land is eventually sold for ₹9,000. A and B share the net profits equally, A paying B his share by cheque.

Record these transactions in A's Journal and show Joint Venture A/c and B's A/c in his ledger.

Problem 2

A and B were participants in a joint venture, sharing profits and losses in the proportion of 10:9 respectively. Each party maintains a complete record in his own books. A supplies goods to the value of-₹25,000 and incurs an expenditure of ₹500 on them: and B supplies goods to the extent of ₹21,000 and his expenses thereon amounted to ₹1,000. A sells all the goods for ₹70,000 for which he is entitled to receive a commission at 5 per cent. Accounts are settled by bank draft. Give journal entries and prepare necessary accounts in the books of both the parties.

Problem 3

X and Y entered into a joint venture of underwriting the subscription at par of the entire share capital of Copper Mines Limited consisting of

10,000 shares of ₹10 each and to pay all expenses upto allotment. They were to share profits in the ratio of 3:2 respectively. The consideration in return for the guarantee was 1,200 other shares of ₹10 each fully paid to be issued to them.

X provides the funds for Registration Fee ₹1,200, Advertising ₹1,100 and Printing and Stationery ₹950. Y contributed towards payment of Office Rent ₹300, Legal Charges ₹ 1,550 and Staff Salaries ₹900.

The prospectus was issued and the applications fell short of the full issue by 1,500 shares. X took these over on joint account and paid for the same in full. They received 1,200 fully paid shares as underwriting commission. They sold their entire holding at ₹12 per share. The proceeds were received by X for 1,500 shares and by Y for 1,200 shares.

Write up the necessary accounts in the books of both the parties showing the final adjustment.

Problem 4

Ramesh and Suresh entered into a joint venture to purchase and sell hosiery goods. Profit and losses were to be shared equally. Ramesh financed the venture and Suresh undertook the sales on a commission of 5% on the sale proceeds. Ramesh purchased goods to the value of ₹50,000 less 5% trade discount, paid freight ₹1,500 and advanced ₹1,200 to Suresh to meet expenses. Suresh expended for carriage ₹300, rent ₹450, advertisement ₹200 and sundries ₹150. Sales made by Suresh amounted to ₹67,500. It was agreed that Ramesh would receive ₹2,500 as interest.

Remaining unsold goods costing ₹2,500 were retained by Suresh and those were charged to him at a price to show the same rate of gross profit (without charging any expenditure) as that made on the total sales (excluding those goods taken).

Give journal entries in the books of Ramesh and Suresh and also prepare the necessary ledger accounts in their books.

Problem 5

X and Y entered into a joint venture for purchase and sale of some household items. They agreed to share profits and losses in the ratio of their respective contributions. X contributed ₹10,000 in cash and Y ₹13,000. The whole amount was placed in a Joint Bank Account. Goods were purchased by X for ₹10,000 and expenses paid by Y amounted to ₹2,000. They also purchased goods for ₹15,000 through the Joint Bank Account.

The expenses on purchase and sale of the articles amounted to ₹6,000. (including those met by Y). Goods costing ₹20,000 were sold for ₹45,000 and the balance was lost due to fire. Prepare Joint Venture Account, Joint Bank Account and the Venturers' Accounts closing the venture.

Problem 6: M Ltd. (Lessee) obtained a copyright from an author N (Lessor) to publish a book. Royalty is payable @ ₹5 per copy sold; Minimum Rent is ₹40,000 per annum. Short-workings can be recouped only within the year immediately following the year in which they arise; after that, they lapse and must be written off.

Copies sold:

- Year 1: 5,000 copies
- Year 2: 6,000 copies
- Year 3: 9,000 copies
- Year 4: 10,000 copies

Answer: Total Royalty: ₹1,50,000, Total shortworking: ₹25,000, shortworkings recouped: ₹5,000, shortworkings written off: ₹20,000, Total cash paid to N: ₹1,70,000, Shortworkings for Year 1: ₹15,000 – lapsed, Shortworkings for Year 2: ₹10,000 - ₹5,000 recopued and ₹5,000 lapsed.

Question

Landlord Mani grants a licence to Durai to mine granite.

Terms: Royalty = ₹ 4 per tonne, Minimum Rent is ₹ 16,000 per year

Short workings recoverable within 2 years.

Output: Year 1 = 2,000, Year 2 = 3,500, Year 3 = 5,000, Year 4 = 6,000 tonnes

Prepare in BOTH Mani's (Lessor's) and Durai's (Lessee's) books:

(a) Royalty Account and Short Working Account (Lessee)

(b) Royalties Receivable Account and Short Working Suspense Account (Lessor)