Skillshort

Self-Study Preparation Pack

CA FOUNDATION

Paper 1: Accounting

Chapter-wise Detailed Notes

For January 2027 attempt (useful for May 2027 too) · ICAI BoS Study Material Aug 2024 (reprint Aug 2025) + RTP

100 marks · 3 hours | Descriptive | Q1 compulsory + any 4 of 5 | Pass: 40% paper, 50% aggregate

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This subject pack has 6 parts

1 Chapter-wise notes

2 Important topics & weightage

3 Past papers: trends & links

4 Mock tests + solutions

5 Chapter practice questions

6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

How to use these notes

These notes follow the **ICAI new-scheme syllabus order** (11 chapters). Every chapter has: definitions → explanation → tables → worked examples with full working → exam tips and common mistakes. Use them with the other files in this pack:

File	Use it for
01 Chapter Notes (this file)	First reading and concept building
02 Important Topics & Weightage	Deciding what to study first
03 Past Papers – Trend Analysis & Links	Knowing how ICAI asks; download official papers
04 Mock Tests 1–2 with Solutions	Full 3-hour practice in exam pattern
05 Chapter-wise Practice Questions	Practice after each chapter
06 Last-Week Plan & Exam Strategy	Final revision and exam-day plan

Paper at a glance

Item	Detail
Marks / time	100 marks, 3 hours (+15 minutes reading time)
Pattern	Fully descriptive. Q1 compulsory (True/False with reasons + theory + small practical); attempt any **4 of the remaining 5** questions (20 marks each)
ICAI section-wise weightage (issued 26-10-2023, applicable May 2024 onwards; ±5% deviation allowed)	I Theoretical framework **5–10%** · II Accounting process, BRS, inventories, depreciation, bills (Ch 2–6) **30–35%** · III Final accounts, NPO, incomplete records (Ch 7–9) **20–25%** · IV Partnership & LLP (Ch 10) **15–20%** · V Company accounts (Ch 11) **15–25%**
Pass rule	40% in each paper and 50% aggregate of all four papers
Applicable material	ICAI BoS Study Material (Aug 2024 edition, reprint Aug 2025 onwards) + RTP for the attempt

> **NOTE Presentation matters**
>
> ICAI gives **step marks** for working notes, correct formats and narrations. Always show working notes, write narrations for journal entries, and use proper headings ("In the books of ...", "for the year ended ...").

Chapter 1: Theoretical Framework

1.1 Meaning and scope of accounting

Accounting is the art of recording, classifying and summarising, in a significant manner and in terms of money, transactions and events which are, at least in part, of a financial character, and interpreting the results (AICPA definition). In modern terms, accounting is an **information system** that identifies, measures, records and communicates financial information to users for decision-making.

Functions (scope) of accounting

1. **Recording** – journal and subsidiary books (book-keeping).
2. **Classifying** – posting to ledger accounts.
3. **Summarising** – trial balance, Profit & Loss Account, Balance Sheet.
4. **Analysing and interpreting** – ratios, trends.
5. **Communicating** – reports to owners, lenders, government and others.
6. **Meeting legal requirements** – Companies Act, tax laws, GST.

Accounting cycle: Transaction → Source document (voucher) → Journal / subsidiary books → Ledger → Trial balance → Adjustments → Financial statements → Closing entries.

Book-keeping vs Accounting vs Accountancy	Meaning
Book-keeping	Recording and classifying – the routine, clerical part
Accounting	Book-keeping + summarising, analysing, interpreting, communicating
Accountancy	The body of knowledge (theory, standards, techniques) behind accounting

Sub-fields: financial accounting (external users), cost accounting (cost per unit, cost control), management accounting (internal decisions), social responsibility accounting, human resource accounting.

Limitations of accounting: records only monetary items; based on historical cost (ignores price-level changes); involves estimates and judgement (depreciation, provisions); can be manipulated (window dressing); does not show the real worth of the business.

> EXAM TIP **ICAI likes "Explain four functions / limitations of accounting" (4 marks). Write a heading + one-line explanation for each point.**

1.2 Accounting concepts, principles and conventions

Fundamental accounting assumptions (AS 1): going concern, consistency and accrual. If any of these is **not followed**, the fact must be **disclosed**; if they are followed, no disclosure is needed.

Concept	Meaning	Example
Business entity	Business is separate from the owner	Owner's personal electricity bill is drawings, not business expense
Money measurement	Only events that can be measured in money are recorded	Quarrel among managers is not recorded
Going concern	Business will continue for the foreseeable future	Fixed assets shown at cost less depreciation, not at sale value
Accounting period	Life of business divided into periods (usually 1 year, 1 April – 31 March)	Final accounts prepared yearly
Cost concept	Assets recorded at the price paid (historical cost)	Land bought for ₹10 lakh stays at ₹10 lakh even if market value rises
Dual aspect	Every transaction has two effects – debit and credit	Assets = Liabilities + Capital
Realisation / revenue recognition	Revenue is recognised when earned (goods delivered, service performed), not when cash is received	Credit sale in March is March's revenue
Matching	Expenses of a period are matched with the revenue of the same period	Outstanding wages added to wages of the year

Concept	Meaning	Example
Accrual	Record revenue and expense when they arise, not when cash moves	Rent due but unpaid is an expense
Objective evidence	Entries supported by vouchers and documents	Cash memo, invoice

- **Consistency:** the same method is followed year after year (e.g. same depreciation method) so results are comparable. A change is allowed only if required by law or a standard or for better presentation, and its effect must be disclosed.
- **Conservatism (prudence):** "anticipate no profit but provide for all possible losses". Closing stock at **cost or net realisable value, whichever is lower**; provision for doubtful debts.
- **Materiality:** items that would influence a user's decision must be disclosed; trivial items (e.g. a stapler) can be expensed.
- **Full disclosure:** all significant information must be disclosed in the financial statements or notes (contingent liabilities, accounting policies).

MEMORY TRICK **"C-C-M-F" – Consistency, Conservatism, Materiality, Full disclosure = the 4 conventions.**

Qualitative characteristics of financial statements (ICAI framework): **understandability, relevance, reliability, comparability** (also materiality as part of relevance, and true and fair view). Reliability needs faithful representation, substance over form, neutrality, prudence and completeness.

COMMON MISTAKE **ICAI True/False favourite – "Materiality depends only on the amount" → False. Materiality depends on amount and nature of the item, size of business, level of information and the decision-maker (Sept 2025 Q1).**

MEMORY TRICK **Entity concept = owner and business separate (capital is a liability for the business). Matching = expense with revenue. Don't mix them – ICAI has tested this swap.**

1.3 Capital and revenue expenditure and receipts

Capital expenditure	Revenue expenditure	Deferred revenue expenditure
Benefit lasts more than one year	Benefit consumed within the year	Revenue in nature, but benefit spread over a few years
Acquires or improves a fixed asset or increases earning capacity	Maintains the earning capacity	Heavy advertisement campaign for a new product
Shown in the Balance Sheet	Debited to Trading/P&L A/c	Written off over 3–5 years (under AS, now mostly expensed immediately)
Purchase of machinery, installation, legal charges for buying land	Wages, rent, repairs, depreciation	–

Tricky items:

- Wages paid for installing a new machine → **capital** (added to machinery).
- Repairs to a second-hand machine bought, **before first use** → **capital**.
- Replacement of a worn-out part (normal repair) → revenue.
- Cost of extension of building → capital; white-washing → revenue (first white-washing of a new building → capital).
- Legal expenses for a suit to protect title of property → **capital**; legal expenses for recovery of debts → revenue.
- **Capital receipt** – capital introduced, loan taken, sale of fixed asset. **Revenue receipt** – sales, commission, interest received.

Capital vs revenue receipts and profits

Point	Capital receipt	Revenue receipt
Nature	Non-recurring; from sources other than operations	Recurring; from normal operations
Examples	Capital introduced, loans raised, sale proceeds of fixed assets	Sales, fees, commission, interest, rent received

Point	Capital receipt	Revenue receipt
Treatment	Balance Sheet (liability / reduction of asset)	Credited to P&L
Profit	**Capital profit** (e.g. profit on sale of land) → capital reserve / P&L shown separately	**Revenue profit** – normal trading profit

WORKED EXAMPLE **Classify (ICAI style)**

(i) ₹25,000 spent on repairs before using a second-hand car → **capital** (makes asset usable).

(ii) Insurance claim received for stock destroyed by fire → **revenue receipt** (stock is a revenue item).

(iii) ₹2,00,000 spent on a new road to the factory → **capital**.

(iv) Legal fees ₹50,000 paid to defend a suit about the title of the factory land → **capital** (protects a capital asset).

(v) Compensation received for loss of use of a leased property → capital receipt (in substance, for loss of a source of income) VERIFY.

1.4 Contingent assets and contingent liabilities

Liability – a present obligation from past events, settlement expected to result in an outflow of resources.
Provision – a liability that can be measured only by using a substantial degree of estimation (AS 29).

Contingent liability – (a) a possible obligation arising from past events whose existence will be confirmed only by uncertain future events not wholly within the control of the entity; or (b) a present obligation not recognised because an outflow is not probable or the amount cannot be measured reliably.

Contingent asset – a possible asset from past events, existence confirmed only by uncertain future events.

Item	Recognise in books?	Disclose?
Provision (probable outflow, reliable estimate)	**Yes**	Yes
Contingent liability	**No**	Yes – in notes (unless remote)
Contingent asset	**No**	Not in financial statements (may be in the Board's report)

Examples of contingent liabilities: claims against the company not acknowledged as debt, guarantees given, bills discounted but not yet matured, disputed tax demands under appeal, uncalled liability on partly paid shares.

REMEMBER **Liability vs contingent liability (asked May 2025): a liability is a present obligation that is certain and recorded; a contingent liability is possible / uncertain and only disclosed.**

1.5 Accounting policies

Accounting policies are the specific accounting principles and the methods of applying them adopted by an enterprise in preparing and presenting financial statements (e.g., method of depreciation, valuation of inventories – FIFO/weighted average, treatment of goodwill, valuation of investments, recognition of revenue).

Selection of policies – the major considerations are **prudence, substance over form and materiality**, so that the statements show a true and fair view.

When can a policy be changed? Only if the change is required by (1) **statute**, (2) an **accounting standard**, or (3) it results in a **more appropriate presentation** of the financial statements. Disclose the change and its effect (with amount, if ascertainable).

Accounting policy vs accounting estimate: a change in the **method** of depreciation is treated as a **change in estimate** under AS 10 (revised) and applied prospectively; change from FIFO to weighted average for inventory is a **change in policy**.

EXAM TIP **Jun 2024 and May 2026 both asked "Define accounting policy; when can it be changed?" – learn the 3 conditions and 3 selection considerations word-perfect.**

1.6 Accounting as a measurement discipline – valuation principles, estimates

Accounting **measures** business events in money. Three elements of measurement: **identification** of objects/events, selection of a **standard or scale** (money), and **quantification** (valuation).

Generally accepted valuation principles (bases):

Basis	Meaning (assets)	Meaning (liabilities)
Historical cost	Cash paid / fair value of consideration at acquisition	Proceeds received in exchange for the obligation
Current cost	Cash needed to acquire the same or equivalent asset **now**	Undiscounted cash needed to settle the obligation now
Realisable (settlement) value	Cash that could be obtained now by selling the asset in an orderly disposal	Undiscounted cash expected to settle the liability in the normal course
Present value	Discounted future net cash inflows the asset will generate	Discounted future net cash outflows to settle

Accounting estimates: many items cannot be measured precisely – useful life and residual value of assets, provision for doubtful debts, NRV of inventory, warranty provisions, provision for tax. Estimates must be reasonable and revised when circumstances change; revision is **prospective** (current and future periods).

WORKED EXAMPLE **Valuation bases**

A machine bought 3 years ago for ₹10 lakh (historical cost) would cost ₹14 lakh today (current cost), could be sold for ₹6 lakh (realisable value), and will generate future cash flows whose discounted value is ₹8 lakh (present value).

1.7 Accounting standards – concepts and objectives

Accounting Standards (AS) are written policy documents issued by an expert accounting body (ICAI, through its **Accounting Standards Board – ASB**, set up in 1977) and notified by the Government, covering recognition, measurement, presentation and disclosure of transactions in financial statements.

Objectives: to harmonise diverse accounting policies, reduce alternatives, improve comparability and reliability, and help users understand financial statements.

Advantages: reduces variations in treatment; ensures disclosures beyond law; facilitates comparison between firms and over time; improves credibility.

Limitations: reduce flexibility (rigidity); choosing among alternatives is still difficult; cannot override the statute (law prevails).

Procedure for issuing an AS (ICAI): identify area → study group → exposure draft → comments from public and bodies → revised draft considered by ASB → Council of ICAI approves → for companies, notified by Central Government (in consultation with NFRA) under Section 133 of the Companies Act, 2013.

Ind AS: Indian Accounting Standards converged with **IFRS**, notified under the Companies (Indian Accounting Standards) Rules, 2015 – mandatory for listed companies and unlisted companies with net worth ≥ ₹250 crore (phased roadmap from 2016-17) and optional for others. Other companies follow AS notified under the Companies (Accounting Standards) Rules, 2021.

AS no.	Title (selected for Foundation awareness)
AS 1	Disclosure of Accounting Policies
AS 2	Valuation of Inventories
AS 3	Cash Flow Statements
AS 4	Contingencies and Events after the Balance Sheet Date
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS 9	Revenue Recognition
AS 10	Property, Plant and Equipment

AS no.	Title (selected for Foundation awareness)
AS 13	Accounting for Investments
AS 26	Intangible Assets
AS 29	Provisions, Contingent Liabilities and Contingent Assets

EXAM TIP **Jan 2026 asked "What are accounting standards? Advantages and limitations" – examiners noted students wrote generic points. Write the definition with ICAI/ASB, 3 advantages, 3 limitations.**

Chapter 2: Accounting Process

2.1 Transactions, events and vouchers

A **transaction** is an exchange of value measurable in money (sale, purchase, payment). An **event** is a happening that may or may not be a transaction (e.g., loss by fire is an event that affects accounts). Every entry must be supported by a **voucher** (cash memo, invoice, receipt, debit/credit note).

2.2 Double entry and rules of debit and credit

Every transaction has two aspects of **equal amount** – one account is debited and another credited. Developed by Luca Pacioli (1494).

Traditional (English) approach	Rule
Personal account (persons, firms, companies, banks; also representative personal – outstanding/prepaid)	Debit the **receiver**, credit the **giver**
Real account (assets – cash, machinery, goods, goodwill)	Debit **what comes in**, credit **what goes out**
Nominal account (expenses, losses, incomes, gains)	Debit all **expenses and losses**, credit all **incomes and gains**

Modern (accounting equation) approach	Increase	Decrease
Assets	Debit	Credit
Expenses / losses	Debit	Credit
Liabilities	Credit	Debit
Capital	Credit	Debit
Revenue / gains	Credit	Debit

EXAM TIP **"DEAD CLIC" – Debit: Expenses, Assets, Drawings; Credit: Liabilities, Income, Capital (for increases).**

2.3 Journal – book of original entry

Each transaction is first recorded in the **journal** in date order: Date | Particulars | L.F. | Debit ₹ | Credit ₹, followed by a **narration**.

WORKED EXAMPLE **Journal entries (selected)**

(1) Started business with cash ₹50,000 and furniture ₹20,000: Cash A/c Dr 50,000; Furniture A/c Dr 20,000; To Capital A/c 70,000.

(2) Goods sold to Mohan ₹12,000 at 10% trade discount, terms 2% cash discount if paid within 7 days: Mohan A/c Dr 10,800; To Sales A/c 10,800 (trade discount is never recorded).

(3) Mohan pays within 7 days: Cash A/c Dr 10,584; Discount Allowed A/c Dr 216; To Mohan A/c 10,800.

(4) Goods withdrawn by owner for personal use ₹3,000 (cost): Drawings A/c Dr 3,000; To Purchases A/c 3,000.

(5) Goods distributed as free samples ₹1,500: Advertisement A/c Dr 1,500; To Purchases A/c 1,500.

(6) Goods lost by fire ₹8,000, insurance claim admitted ₹6,000: Loss by Fire A/c Dr 2,000; Insurance Claim A/c Dr 6,000; To Purchases A/c 8,000.

(7) Bad debt recovered ₹900 (written off last year): Cash A/c Dr 900; To Bad Debts Recovered A/c 900.

REMEMBER **Trade discount is deducted on the invoice and not recorded; cash discount is recorded (discount allowed = expense, discount received = income).**

Subsidiary books (special journals): Cash book, Purchases book, Sales book, Purchases returns (returns outward) book, Sales returns (returns inward) book, Bills receivable book, Bills payable book, and the **Journal proper**

(opening and closing entries, adjustments, rectification, credit purchase of assets).

GST in journal entries (examiner's favourite)

When goods are bought or sold with GST, record the tax separately. Intra-state = **CGST + SGST**; inter-state = **IGST**.

```
Purchased goods ₹1,50,000 less 10% trade discount, CGST & SGST 6% each, on credit from Sonu:
  Purchases A/c                Dr  1,35,000
  Input CGST A/c               Dr      8,100
  Input SGST A/c               Dr      8,100
      To Sonu                                  1,51,200
  (Being goods purchased on credit; trade discount 10% deducted; GST @12%)
Sold goods ₹80,000 to Kiran (inter-state), IGST 18%, cash received:
  Cash A/c                     Dr     94,400
      To Sales A/c                              80,000
      To Output IGST A/c                        14,400
```

⚠ COMMON MISTAKE **Writing "CGST A/c" without "Input" on purchases, or "Output" on purchases – ICAI examiners specifically cut marks for this (Jan 2026 comments). Input = asset (credit available); Output = liability.**

REMEMBER **GST is charged on the price after trade discount. Cash discount offered for prompt payment is ignored while computing GST at invoicing (unless stated otherwise).**

2.4 Ledger – posting and balancing

The ledger is the **principal book** in which all accounts are kept. Journal entries are **posted** to the respective accounts. Each account is balanced at the end of the period:

- Debit side larger → **debit balance** (assets, expenses, drawings, debtors).
- Credit side larger → **credit balance** (liabilities, capital, incomes, creditors).
- Nominal accounts are closed by transfer to the Trading or Profit & Loss Account; real and personal accounts are carried forward (balance c/d, b/d).

Rules of posting from the journal: (1) open a separate account for each item; (2) the account debited in the journal is debited in the ledger with the **name of the other account** ("To ..." on the debit side, "By ..." on the credit side); (3) write the date, journal folio and amount; (4) balance accounts at period end – "To Balance c/d" / "By Balance b/d".

2.5 Trial balance

A **statement** (not an account) listing the debit and credit balances of all ledger accounts on a date, to check the **arithmetical accuracy** of posting.

Errors NOT revealed by a trial balance:

1. **Errors of omission** – a transaction completely omitted.
2. **Errors of commission** that affect both sides equally (e.g. wrong amount in the journal itself).
3. **Errors of principle** – capital vs revenue confusion (repair debited to Machinery A/c).
4. **Compensating errors** – one error cancels another.
5. Posting to the **wrong account on the correct side** (e.g. Ram's account instead of Rahim's).

Errors revealed: posting to the wrong side, wrong totalling or balancing, posting one side only, wrong amount in posting, omission of a balance from the trial balance.

⚠ COMMON MISTAKE **"Agreement of trial balance proves the accounts are correct" – wrong. It is only proof of arithmetical accuracy.**

Methods of preparing a trial balance: (1) **Balance method** (most common – only balances), (2) **Total (gross) method** – totals of both sides of each account, (3) **compound** method (both).

Suspense account: if the trial balance does not agree and the books must be closed, the difference is placed in a **Suspense A/c** temporarily until errors are located.

2.6 Subsidiary books (special journals)

Recording every transaction in one journal is slow. Transactions of the same nature are recorded in **subsidiary books**; totals are posted periodically.

Book	What is recorded	Posting
Purchases book	Only **credit purchases of goods** (meant for resale)	Each supplier credited; monthly total debited to Purchases A/c
Sales book	Only **credit sales of goods**	Each customer debited; total credited to Sales A/c
Purchases returns (returns outward) book	Goods returned to suppliers – supported by **debit notes**	Suppliers debited; total credited to Purchases Returns A/c
Sales returns (returns inward) book	Goods returned by customers – supported by **credit notes**	Customers credited; total debited to Sales Returns A/c
Bills receivable book	Bills received from debtors	Customers credited; total debited to B/R A/c
Bills payable book	Bills accepted in favour of creditors	Creditors debited; total credited to B/P A/c
Cash book	All cash (and bank) receipts and payments	Acts as both journal and ledger
Journal proper	Opening, closing, adjustment, rectification, transfer entries, credit purchase/sale of assets, entries not fitting elsewhere	Individual posting

Advantages of subsidiary books: division of work, saving of time, specialisation and efficiency, easy reference, better internal control and fewer errors, quick information (e.g., total credit sales).

Format of a purchases book (columns): Date | Name of supplier & particulars (items, qty × rate, less trade discount, add packing/GST) | Invoice no. | L.F. | Details ₹ | Amount ₹.

WORKED EXAMPLE **Purchases book (ICAI Sept 2025 style)**

2 Dec: from Gupta & Co.: 100 plates @ ₹150 = 15,000; 500 bowls @ ₹50 = 25,000; total 40,000; less trade discount 10% = 4,000 → 36,000; add packing ₹2 per plate + ₹1 per bowl = 200 + 500 = 700 → **₹36,700**.

8 Dec: from Ajanta & Co.: 200 boxes of spoons @ ₹50 = 10,000; 40 boxes of forks @ ₹250 = 10,000; total 20,000; less 8% = 1,600 → **₹18,400**.

Total of purchases book posted to Purchases A/c (Dr) = ₹55,100 (+ further entries). Cash purchases and purchase of assets (e.g., a computer for office) are **not** entered in the purchases book.

COMMON MISTAKE **Entering a credit purchase of furniture/machinery in the purchases book – it goes to the journal proper. Similarly, packing charges added on the invoice are part of the purchase amount.**

2.7 Cash book

The cash book is both a **book of original entry** and a **ledger account** (Cash A/c / Bank A/c). Debit = receipts, credit = payments.

Type	Columns	Note
Simple cash book	Cash only	Like a cash account
Two-column cash book	Cash + Bank (or Cash + Discount)	Contra entries marked "C"
Three-column cash book	Discount + Cash + Bank	Discount columns are **not balanced**; their totals go to Discount Allowed (Dr) and Discount Received (Cr)

Type	Columns	Note
Petty cash book	Small expenses; **imprest system** – petty cashier gets a fixed float, reimbursed periodically for the amount spent	Analytical columns: postage, stationery, travelling, sundries

Contra entry: a transaction affecting both cash and bank columns (cash deposited into bank, cash withdrawn from bank for office use) – recorded on both sides with "C" in L.F.; no ledger posting needed.

WORKED EXAMPLE Three-column cash book items

(1) Received a cheque from Raman ₹9,800 in full settlement of ₹10,000 and deposited the same day → Bank column Dr 9,800; Discount (Dr side) 200.

(2) Paid Shyam by cheque ₹4,900, discount received ₹100 → Bank column Cr 4,900; Discount (Cr side) 100.

(3) Withdrew ₹5,000 from bank for office use → Cash Dr 5,000 / Bank Cr 5,000 (contra "C").

(4) A cheque received earlier from Raman ₹9,800 is dishonoured → Bank Cr 9,800; Raman is debited ₹10,000 and the discount of ₹200 is cancelled (Discount Allowed credited).

EXAM TIP **Bank column can have a credit balance (overdraft); the cash column can never have a credit balance.**

2.8 Rectification of errors

Classification of errors:

- **Clerical errors:** errors of omission (complete or partial), commission (wrong amount, wrong account, wrong side, wrong totalling), compensating.
- **Errors of principle:** violation of accounting principles (capital ↔ revenue).

Rectification before preparing the trial balance:

- One-sided errors → corrected by a note/entry in the affected account (no journal).
- Two-sided errors → journal entry.

Rectification after the trial balance (when the difference has been put in a Suspense A/c):

- Every error is rectified by a journal entry; the one-sided part goes to **Suspense A/c**.

Rectification in the next accounting year: errors affecting nominal accounts are rectified through **Profit and Loss Adjustment A/c** (prior-period item).

WORKED EXAMPLE Rectification with Suspense A/c

The trial balance does not agree; the debit side is short by ₹540, so Suspense A/c is **debited** ₹540 to make it agree. Errors found later:

(a) Sales book overcast by ₹500 → Sales A/c Dr 500; To Suspense 500.

(b) Purchase of furniture ₹2,000 entered in Purchases book → Furniture A/c Dr 2,000; To Purchases A/c 2,000 (no suspense – both sides affected).

(c) Credit sale to Amit ₹820 posted to Amit's account as ₹280 → Amit A/c Dr 540; To Suspense 540.

(d) Discount received ₹100 not posted to Discount A/c → Suspense Dr 100; To Discount Received 100.

(e) Return inward ₹200 from Bimal posted to the debit of Bimal's account → Suspense Dr 400; To Bimal 400.

Suspense A/c: Dr – balance b/d 540, Discount received 100, Bimal 400 = 1,040. Cr – Sales 500, Amit 540 = 1,040. Suspense closes to **nil** ✔ – all errors found.

EXAM TIP **For each error, write "what was done" and "what should have been done", then the rectifying entry is just the difference. This avoids confusion with sides.**

Rectification in the next accounting year (P&L Adjustment A/c)

If errors of the previous year are found after the final accounts are closed, nominal-account corrections are made through **Profit and Loss Adjustment A/c**; real and personal accounts are corrected directly. The balance of P&L Adjustment A/c is transferred to **Capital A/c** (sole proprietor) – the examiners noted students forget this transfer (Jan 2026).

WORKED EXAMPLE **Next-year rectification**

In 2024-25 the **debit** side of the TB was short by ₹1,560, so Suspense A/c was **debited** ₹1,560 and the accounts were closed. In 2025-26 these errors were found: (a) sales book **overcast** by ₹1,000; (b) purchase of machinery ₹2,500 debited to Purchases A/c; (c) ₹280 paid to Ravi (creditor) was posted to the **credit** of his account.

(a) P&L Adjustment A/c Dr 1,000; To Suspense A/c 1,000 (last year's sales and profit were overstated).

(b) Machinery A/c Dr 2,500; To P&L Adjustment A/c 2,500 (last year's purchases overstated → profit understated).

(c) Ravi A/c Dr 560; To Suspense A/c 560 (cancel wrong credit 280 + give correct debit 280).

Suspense A/c: Dr balance b/d 1,560 = Cr 1,000 + 560 → **closes** ✔.

P&L Adjustment A/c: Cr 2,500 − Dr 1,000 = **credit ₹1,500** (net prior-period profit) → P&L Adjustment A/c Dr 1,500; To Capital A/c 1,500.

EXAM TIP **Always draw the Suspense A/c after rectification – if it does not close to nil, re-check the side of each one-sided error.**

Chapter 3: Bank Reconciliation Statement

3.1 Meaning and need

A business records its bank transactions in the **bank column of the cash book**; the bank records them in the customer's account and sends a **pass book / bank statement**. On a given date the two balances often differ. A **Bank Reconciliation Statement (BRS)** is a statement prepared to reconcile (explain) the difference and to check the accuracy of both records. It is **not an account** and no entry is posted from it.

Customer's cash book	Bank's pass book
Deposits are **debited** (bank owes us)	Deposits are **credited** (bank owes customer)
Favourable balance = **debit** balance	Favourable balance = **credit** balance
Overdraft = **credit** balance	Overdraft = **debit** balance

3.2 Causes of difference

A. Timing differences

1. Cheques **issued but not yet presented** for payment.
2. Cheques **deposited but not yet collected / credited** by the bank.

B. Items recorded by the bank but not yet in the cash book (known only on receiving the statement)

3. Bank charges, interest on overdraft, commission → debited in pass book.
4. Interest on deposits, dividends collected by bank, direct deposits (NEFT/UPI) by customers → credited in pass book.
5. Direct payments by bank under standing instructions (insurance premium, EMI, electricity bill).
6. Cheques deposited but **dishonoured**.

C. Errors – in the cash book (wrong amount, wrong side, wrong totalling) or by the bank (wrong debit/credit to our account).

3.3 Methods of preparing BRS

1. **Without amending the cash book:** start with either balance, add / subtract each item.
2. **Amended cash book method** (preferred by ICAI when items of type B are many): first correct the cash book for all items recorded only by the bank (B and cash-book errors); then prepare the BRS from the **amended balance** with only timing differences and bank errors.

Starting point: Cash book debit balance (favourable)	Effect
Cheques issued but not presented	**Add**
Interest / dividend credited by bank, direct deposits not in cash book	**Add**
Cheques deposited but not credited	**Less**
Bank charges, direct payments, dishonoured cheques not in cash book	**Less**
Result	Balance as per **pass book** (credit)

MEMORY TRICK **"Start → ask: did this item make the pass book balance higher than the cash book? If yes – add." Works for every item, every starting point.**

3.4 Worked example

WORKED EXAMPLE **BRS with amended cash book**

Bank column of the cash book of M/s Rao showed a **debit balance of ₹45,000** on 31 March 2026. On comparison with the bank statement:

(i) Cheques issued ₹12,000 not yet presented. (ii) Cheques ₹8,500 deposited but not yet credited. (iii) Bank charges ₹300 not in cash book. (iv) Interest ₹900 credited by the bank. (v) A customer deposited ₹4,000 directly. (vi) A cheque of ₹2,000 deposited earlier was dishonoured – not recorded.

Amended cash book: 45,000 − 300 + 900 + 4,000 − 2,000 = **₹47,600 (Dr)**.

BRS as on 31 March 2026: Balance as per amended cash book 47,600; add cheques issued not presented 12,000 = 59,600; less cheques deposited not credited 8,500 → **Balance as per pass book ₹51,100 (Cr)**.

Check without amendment: 45,000 + 12,000 − 8,500 − 300 + 900 + 4,000 − 2,000 = 51,100 ✔.

3.5 Overdraft situations

If the cash book shows a **credit** balance (overdraft) of, say, ₹20,000, treat it as **negative**: start with (20,000) and apply the same add/less logic; the answer will be the overdraft as per pass book (a debit balance). Write "Overdraft as per pass book" in the final line.

COMMON MISTAKE **Adding "cheques issued but not presented" when starting from an overdraft as per pass book – the logic flips. Always convert overdraft to a negative number and use the same table.**

EXAM TIP **BRS appears almost every attempt as a 5–10 mark question (May 2025 Q2b, Sept 2025 Q5a, Jan 2026 Q5a). Show the amended cash book in "T" form, then the BRS in statement form.**

Chapter 4: Inventories

4.1 Meaning and AS 2

Inventories are assets (a) held for sale in the ordinary course of business (finished goods), (b) in the process of production for such sale (work-in-progress), or (c) in the form of materials or supplies to be consumed in production or rendering of services (raw materials, stores, spares, loose tools). Inventory valuation directly affects **gross profit** and the **balance sheet** – an overstatement of closing stock overstates profit.

Inventories are valued at **cost or net realisable value (NRV), whichever is lower** – an application of conservatism.

- **Cost** = cost of purchase (price, import duties, non-refundable taxes, freight inward, less trade discounts) + cost of conversion (direct labour, production overheads – fixed overheads on normal capacity) + other costs to bring to present location and condition.
- **Excluded from cost:** abnormal wastage, storage costs (unless necessary in production), administrative overheads, **selling costs**, and recoverable taxes (e.g. GST for which ITC is available).
- **NRV** = estimated selling price – estimated costs of completion – estimated selling costs.
- **Cost formulas: FIFO** or **weighted average cost**. LIFO is **not permitted** under AS 2. Specific identification for items not ordinarily interchangeable.

WORKED EXAMPLE Lower of cost or NRV, item-wise

A: cost 20,000, NRV 25,000 → 20,000

B: cost 15,000, NRV 12,000 → 12,000

C: cost 8,000, NRV 9,500 → 8,000

Closing stock = **₹40,000** (item-by-item comparison, not total cost 43,000 vs total NRV 46,500).

WORKED EXAMPLE FIFO vs weighted average (periodic)

1 Jan opening 100 units @ ₹10; 10 Jan purchase 200 @ ₹12; 20 Jan issue 250 units; 25 Jan purchase 100 @ ₹13.

FIFO closing 150 units = 100 @ 13 + 50 @ 12 = 1,300 + 600 = **₹1,900**.

Weighted average (periodic) = total cost (1,000 + 2,400 + 1,300 = 4,700) / 400 units = ₹11.75; closing 150 × 11.75 = **₹1,762.50**.

4.2 Inventory record systems

Point	Periodic inventory system	Perpetual inventory system
How	Stock is counted physically at the end of the period	Running record of every receipt and issue (stores ledger / bin card)
Cost of goods sold	Derived: Opening + Purchases – Closing	Known continuously from issues
Losses / theft	Hidden in COGS	Revealed by comparing book and physical stock
Suited to	Small traders, low-value items	Large businesses, valuable items
Cost	Cheap	Costly – needs staff/software

Stock-taking (physical verification): count, list, value (cost or NRV), compare with records. Discrepancies → investigate (normal loss vs abnormal loss).

4.3 Techniques of measuring cost

- **Standard cost** method – if results approximate actual cost; standards reviewed regularly.
- **Retail method** (retail trade with many fast-moving items with similar margins): Cost = Sales value of inventory – normal gross margin.
- **Specific identification** – for items not ordinarily interchangeable (custom jewellery, project goods).

WORKED EXAMPLE **Retail method**

Closing inventory at selling price ₹2,00,000; average gross margin 20% on sales. Cost = 2,00,000 − 20% = **₹1,60,000**.

4.4 Valuation when stock is taken after (or before) the balance sheet date

Very frequent ICAI question (June 2024, Sept 2024, May 2025, Sept 2025). Work **back** from the date of stock-taking to 31 March.

Transaction between 31 March and stock-taking date	Adjustment to physical stock
Sales (at **cost**, i.e., sales less gross profit)	**Add** (goods left after 31 March)
Purchases	**Less** (came in after 31 March)
Sales returns (at cost)	**Less**
Purchase returns	**Add**
Goods received on consignment / not owned included in count	**Less**
Goods sent on approval, not yet approved (at cost)	**Add**
Abnormal loss after 31 March	**Add**

WORKED EXAMPLE **Stock taken on 15 April 2026**

Physical stock on 15 April 2026 at cost = ₹2,50,000. Between 1 and 15 April: sales ₹60,000 (gross profit 25% on cost); purchases ₹30,000; sales returns ₹4,000; stock includes goods worth ₹10,000 received on consignment.

Cost of sales = 60,000 × 100/125 = 48,000; cost of returns = 4,000 × 100/125 = 3,200.

Stock on 31 March = 2,50,000 + 48,000 − 30,000 − 3,200 − 10,000 = **₹2,54,800**.

COMMON MISTAKE **Adding sales at selling price. Always convert to cost: GP 25% on cost = 20% on sales.**

4.5 Valuation of inventory from given particulars (gross-profit method)

When only purchases, sales and a GP ratio are known: Closing inventory = Opening inventory + Purchases + Direct expenses − Cost of goods sold (= Sales − GP). Selling expenses are **not** part of inventory cost.

Chapter 5: Depreciation and Amortisation

5.1 Tangible vs intangible assets

Tangible assets (Property, Plant & Equipment – AS 10) have physical existence (land, buildings, machinery, vehicles). **Intangible assets** (AS 26) are identifiable non-monetary assets without physical substance (patents, copyrights, software, trademarks, licences). The systematic allocation of cost is called **depreciation** for tangible assets and **amortisation** for intangibles; for natural resources it is **depletion**.

Point	Tangible	Intangible
Existence	Physical	No physical substance
Allocation	Depreciation	Amortisation
Standard	AS 10	AS 26 (rebuttable presumption: useful life ≤ 10 years from available-for-use date)
Examples	Plant, furniture	Patent, software

Depreciation is the **systematic allocation of the depreciable amount of an asset over its useful life**. Depreciable amount = Cost – Residual value.

Causes: wear and tear by use, passage of time, obsolescence (new technology), depletion (mines, oil wells), accidents.

Objectives: matching cost with revenue, showing the true value of assets, providing funds for replacement, correct tax computation.

Point	Straight-line method (SLM)	Written-down value method (WDV)
Base	Original cost (depreciable amount)	Book value at the start of each year
Annual charge	Same every year	Decreases every year
Asset value	Can become zero	Never becomes zero
Suitable for	Assets with uniform use – furniture, leasehold	Assets with higher repairs later – plant, vehicles
Tax	–	Income-tax Act uses WDV on block of assets

SLM formula: Depreciation = (Cost – Residual value) ÷ Useful life. **Rate** = Annual depreciation ÷ Cost × 100.

WDV rate formula: r = 1 – (Residual value ÷ Cost)^(1/n).

Units of production method: Depreciation per unit = (Cost – Residual value) ÷ Total estimated units; charge = units produced × rate.

Sum-of-years'-digits: charge for a year = Depreciable amount × remaining life ÷ sum of years' digits.

WORKED EXAMPLE SLM and WDV compared

Machine bought 1 April 2023 for ₹1,00,000 + installation ₹10,000. Residual value ₹10,000, life 5 years. WDV rate 20%.

SLM: (1,10,000 – 10,000)/5 = **₹20,000 every year**.

WDV: Year 1 = 1,10,000 × 20% = 22,000 (book value 88,000); Year 2 = 17,600 (70,400); Year 3 = 14,080 (56,320).

WORKED EXAMPLE Sale of an asset and profit/loss

Machine cost ₹60,000 on 1 April 2023, SLM 10% p.a. Sold on 30 September 2025 for ₹42,000. Books closed 31 March.

Depreciation 2023-24: 6,000; 2024-25: 6,000; 2025-26 (6 months): 3,000. Total 15,000.

Book value on sale = 60,000 – 15,000 = 45,000. Sale ₹42,000 → **loss on sale ₹3,000** (debited to P&L).

Two ways of recording depreciation:

1. Charging to the asset account (Depreciation A/c Dr; To Asset A/c).

2. Creating a **provision for depreciation / accumulated depreciation** account (Depreciation A/c Dr; To Provision for Depreciation A/c) – the asset stays at original cost.

REMEMBER **Change in method of depreciation is a change in accounting estimate under AS 10 – applied prospectively (from the current year), not retrospectively.**

5.2 Factors in measuring depreciation

(1) **Cost** of the asset (purchase price + duties + non-refundable taxes + directly attributable costs – site preparation, freight, installation, professional fees; less trade discounts), (2) **useful life**, (3) **residual value**. Land usually has an unlimited life and is not depreciated.

5.3 Part disposal with WDV (frequent 8–10 mark question)

WORKED EXAMPLE **Part sale of machinery**

On 1 April 2024 Machinery A/c showed ₹4,86,000 (WDV, 10% p.a.). This includes a machine bought on 1 April 2022 for ₹1,00,000, which was sold on 1 October 2024 for ₹60,000. Books closed on 31 March.

Book value of sold machine on 1 April 2024 = 1,00,000 × 0.9 × 0.9 = **₹81,000**.

Depreciation for 6 months on it = 81,000 × 10% × 6/12 = ₹4,050 → book value on sale ₹76,950 → **loss on sale ₹16,950**.

Depreciation on the remaining machinery = (4,86,000 − 81,000) × 10% = ₹40,500. Total depreciation for 2024-25 = 4,050 + 40,500 = **₹44,550**.

Balance on 31 March 2025 = 4,05,000 − 40,500 = **₹3,64,500**.

Machinery A/c: Dr Balance b/d 4,86,000. Cr Bank 60,000; Depreciation 44,550; P&L (loss) 16,950; Balance c/d 3,64,500. Total 4,86,000 ✔.

5.4 Change in depreciation method

Under AS 10, the depreciation method must be reviewed at least at each financial year-end; a change (e.g., WDV → SLM) is a **change in accounting estimate** – applied **prospectively**: the carrying amount on the date of change is depreciated over the remaining useful life by the new method. No retrospective adjustment.

WORKED EXAMPLE **WDV to SLM**

Machine cost ₹5,00,000 on 1 April 2023, WDV @ 20%. From 1 April 2025 the company switches to SLM; remaining useful life 4 years, nil residual value.

Carrying amount on 1 April 2025 = 5,00,000 × 0.8 × 0.8 = ₹3,20,000. SLM charge from 2025-26 = 3,20,000 ÷ 4 = **₹80,000 per year**.

REMEMBER **Old textbooks (old AS 6) required retrospective recomputation. That is no longer applicable. Mention "AS 10 – prospective" in your answer.**

5.5 Amortisation of intangibles

Intangibles with a finite life are amortised on a systematic basis (usually SLM) over the best estimate of useful life; the method should reflect the pattern of economic benefits. Example: software costing ₹6,00,000 with a useful life of 3 years → ₹2,00,000 amortisation per year.

EXAM TIP **Depreciation must be charged even in a loss year – it is a charge against profit, not an appropriation (Sept 2025 T/F).**

Chapter 6: Bills of Exchange and Promissory Notes

6.1 Meaning

Bill of exchange (Section 5, Negotiable Instruments Act, 1881): an instrument in writing containing an **unconditional order**, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer.

Promissory note (Section 4): an instrument in writing (not a bank note or currency note) containing an **unconditional undertaking**, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer.

Point	Bill of exchange	Promissory note
Nature	Order to pay	Promise to pay
Parties	Three – drawer, drawee (acceptor), payee	Two – maker, payee
Acceptance	Needed	Not needed
Drawn by	Creditor	Debtor
Noting / protest on dishonour	Required for foreign bills	Not required

Parties: Drawer (creditor who draws), Drawee (debtor who accepts – then called acceptor), Payee (who receives payment – may be the drawer or a third party), Endorser / endorsee.

6.2 Term, due date and days of grace

- **Term** = period after which payment is due (e.g., 3 months after date).
- **Days of grace: 3 days** are added to the nominal due date (except bills payable on demand / at sight).
- If the due date falls on a **public holiday**, the bill is due on the **preceding** business day; if an emergency holiday is declared under the NI Act, the next working day VERIFY.

WORKED EXAMPLE Due date

Bill dated 1 January 2026, payable 3 months after date → nominal due date 1 April 2026 + 3 days of grace = **4 April 2026**. A bill dated 31 January for one month → 28 February (last day of the month) + 3 = **3 March**.

6.3 Options with the drawer (holder)

1. **Retain** till maturity and present for payment.
2. **Discount** with the bank (bank deducts discount = Bill amount × rate × unexpired period).
3. **Endorse** to a creditor.
4. **Send to bank for collection.**

Event	Drawer's books (B/R)	Drawee's books (B/P)
Bill accepted	B/R Dr; To Drawee	Drawer Dr; To B/P
Discounted	Bank Dr, Discount Dr; To B/R	–
Endorsed to creditor X	X Dr; To B/R	–
Sent for collection	Bills for Collection Dr; To B/R	–
Honoured (retained)	Bank Dr; To B/R	B/P Dr; To Bank
Dishonoured (retained)	Drawee Dr; To B/R; Drawee Dr; To Bank (noting charges)	B/P Dr; To Drawer; Noting charges Dr; To Drawer
Dishonoured (discounted)	Drawee Dr; To Bank (amount + noting)	same as above
Dishonoured (endorsed)	Drawee Dr; To X (amount + noting)	same as above
Retired under rebate	Bank Dr, Rebate Dr; To B/R	B/P Dr; To Bank, To Rebate

Event	Drawer's books (B/R)	Drawee's books (B/P)
Renewal	Cancel old: Drawee Dr; To B/R; interest: Drawee Dr; To Interest; new: B/R Dr; To Drawee	Mirror
Insolvency of acceptor	Drawee Dr; To B/R ...; later Bank (dividend) + Bad debts Dr; To Drawee	Drawer Dr; To Deficiency / Capital (on settlement)

WORKED EXAMPLE **Discounting, dishonour and renewal**

Amit drew a bill on Bina for ₹40,000 for 3 months on 1 January 2026; Bina accepted. Amit discounted it at 12% p.a. On maturity it was dishonoured; noting charges ₹200. Bina paid ₹10,200 in cash and accepted a new bill for the balance with interest at 12% p.a. for 2 months.

Discount = 40,000 × 12% × 3/12 = ₹1,200. Interest on renewal = 30,000 × 12% × 2/12 = ₹600. New bill = **₹30,600**.

Amit's journal: (1) B/R Dr 40,000; To Bina 40,000. (2) Bank Dr 38,800; Discount on Bills Dr 1,200; To B/R 40,000. (3) Bina Dr 40,200; To Bank 40,200. (4) Cash Dr 10,200; To Bina 10,200. (5) Bina Dr 600; To Interest 600. (6) B/R Dr 30,600; To Bina 30,600.

Bina's account in Amit's books: Dr 40,000 + 40,200 + 600 = 80,800; Cr 40,000 + 10,200 + 30,600 = 80,800 ✔.

6.4 Accommodation bills

Bills drawn and accepted **without any trade transaction**, only to help each other raise funds (by discounting). The proceeds are shared in an agreed ratio; **discount is shared in the same ratio**; at maturity each party remits his share to the acceptor, who honours the bill.

WORKED EXAMPLE **Accommodation bill**

For mutual accommodation, Aman drew a bill of ₹30,000 on Gagan for 3 months; Gagan accepted. Aman discounted it for ₹29,400 and sent half the proceeds (₹14,700) to Gagan. Each bears discount of ₹300. Before maturity, Aman remits ₹15,000 to Gagan, who meets the bill. Net effect: each used ₹14,700 and paid ₹15,000 – the ₹300 difference is each one's share of discount.

EXAM TIP **Bills questions (10 marks) appear in Sept 2024 and May 2025. Write entries in both books if asked, and always show the computation of due date, discount and interest.**

Chapter 7: Final Accounts of Sole Proprietors

7.1 Elements of financial statements

Element	Meaning
Asset	Resource controlled by the enterprise from past events, expected to give future economic benefits
Liability	Present obligation from past events, settlement expected to cause an outflow of resources
Equity (capital)	Residual interest in assets after deducting liabilities
Income	Increase in economic benefits (inflows / increase in assets / decrease in liabilities) other than capital contributions
Expense	Decrease in economic benefits other than distributions to owners

At the end of the year, a trader prepares (1) **Manufacturing A/c** (if he manufactures), (2) **Trading A/c** to find **gross profit**, (3) **Profit & Loss A/c** to find **net profit**, and (4) **Balance Sheet** to show the financial position on the last date.

7.2 Closing (adjustment) entries

Adjustment	Entry
Closing stock	Closing Stock A/c Dr; To Trading A/c
Outstanding expense	Expense A/c Dr; To Outstanding Expense A/c
Prepaid expense	Prepaid Expense A/c Dr; To Expense A/c
Accrued income	Accrued Income A/c Dr; To Income A/c
Income received in advance	Income A/c Dr; To Income Received in Advance A/c
Depreciation	Depreciation A/c Dr; To Asset A/c
Interest on capital	Interest on Capital A/c Dr; To Capital A/c
Interest on drawings	Drawings / Capital A/c Dr; To Interest on Drawings A/c
Transfer of expenses	Trading / P&L A/c Dr; To Expense A/cs
Transfer of net profit	P&L A/c Dr; To Capital A/c
Transfer of drawings	Capital A/c Dr; To Drawings A/c

Shows the **cost of goods manufactured (produced)**.

Debit side	Credit side
Opening work-in-progress	Closing work-in-progress
Raw materials consumed (Opening stock + Purchases − Returns − Closing stock + Carriage inward)	Sale of scrap
Direct wages, direct expenses (royalty on production, power and fuel)	**Cost of goods produced** – transferred to Trading A/c
Factory overheads – factory rent, factory lighting, depreciation of plant, repairs of factory, works manager's salary	
Debit side	Credit side
Opening stock	Sales less returns inward
Purchases less returns outward	Closing stock
Direct expenses – carriage inward, freight, wages, customs duty, dock charges, octroi, gas, fuel and power (for a trader)	Gross loss (if any)
Gross profit (transferred to P&L A/c)	

√x FORMULA **Gross profit = Net sales - Cost of goods sold. COGS = Opening stock + Net purchases + Direct expenses - Closing stock.**

- **Debit:** office and administration expenses (salaries, rent, rates and taxes, printing, postage, telephone, audit fees), selling and distribution expenses (carriage outward, advertisement, commission, bad debts, discount allowed, salesmen's salary), financial expenses (interest on loan, bank charges), depreciation, losses (loss by fire, loss on sale of assets).
- **Credit:** gross profit, discount received, commission received, rent received, interest received, bad debts recovered, profit on sale of assets.
- Balance = **net profit** (added to capital) or **net loss**.

Liabilities	Assets
Capital (opening + net profit + additional capital – drawings)	Goodwill, land and building, plant and machinery, furniture (fixed assets less depreciation)
Long-term loans	Investments
Creditors, bills payable, outstanding expenses, income received in advance, bank overdraft	Closing stock, debtors less provision, bills receivable, prepaid expenses, accrued income, cash at bank, cash in hand

7.3 Adjustments – the scoring area

Adjustment	Effect 1	Effect 2
Closing stock (given outside TB)	Credit Trading A/c	Asset side of Balance Sheet
Outstanding expenses	Add to the expense (Dr side of Trading/P&L)	Liability side
Prepaid expenses	Deduct from the expense	Asset side
Accrued income	Add to the income (Cr P&L)	Asset side
Income received in advance	Deduct from the income	Liability side
Depreciation	Debit P&L	Deduct from the asset
Bad debts (further)	Debit P&L	Deduct from debtors
Provision for doubtful debts	P&L: new bad debts + new provision – old provision	Deduct new provision from debtors (after further bad debts)
Provision for discount on debtors	Debit P&L	Deduct from debtors (after bad debts and doubtful debts provision)
Interest on capital	Debit P&L	Add to capital
Interest on drawings	Credit P&L	Deduct from capital
Goods taken by owner	Deduct from purchases	Add to drawings
Goods lost by fire (insured)	Credit Trading A/c with the full loss; debit P&L with the uninsured part	Insurance claim receivable – asset side
Manager's commission on net profit	Debit P&L	Outstanding liability

√x FORMULA Manager's commission

On net profit **before** charging commission = NP × rate / 100.

On net profit **after** charging commission = NP before commission × rate / (100 + rate).

Example: NP before commission ₹1,10,000, 10% after charging → 1,10,000 × 10/110 = **₹10,000**.

WORKED EXAMPLE **Bad debts and provision for doubtful debts**

Debtors in trial balance ₹52,000. Bad debts in TB ₹1,500. Old provision for doubtful debts ₹2,600. Adjustments: further bad debts ₹2,000; maintain provision at 5% on debtors; provision for discount 2%.

Debtors after further bad debts = 52,000 − 2,000 = 50,000. New PDD = 5% × 50,000 = 2,500. Provision for discount = 2% × (50,000 − 2,500) = 950.

P&L debit: bad debts 1,500 + 2,000 + new PDD 2,500 − old PDD 2,600 = **₹3,400**; provision for discount **₹950**.

Balance Sheet debtors: 52,000 − 2,000 − 2,500 − 950 = **₹46,550**.

WORKED EXAMPLE **Short final accounts with adjustments**

Trial balance of Sri Sen as on 31 March 2026 (₹): Capital 2,00,000 (Cr); Drawings 24,000; Opening stock 40,000; Purchases 3,10,000; Sales 4,60,000; Returns inward 10,000; Wages 30,000; Carriage inward 6,000; Salaries 36,000; Rent 18,000; Debtors 60,000; Creditors 45,000; Furniture 50,000; Cash 1,21,000 (total each side ₹7,05,000).

Adjustments: closing stock ₹55,000; outstanding salary ₹4,000; prepaid rent ₹3,000; depreciation on furniture 10%; goods ₹5,000 taken by the owner.

Trading A/c: Dr – Opening stock 40,000; Purchases 3,10,000 − 5,000 = 3,05,000; Wages 30,000; Carriage 6,000; GP 1,24,000 (balancing). Cr – Net sales 4,50,000; Closing stock 55,000. Total 5,05,000.

P&L A/c: GP 1,24,000 − Salaries 40,000 − Rent 15,000 − Depreciation 5,000 = **Net profit ₹64,000**.

Balance sheet: Capital 2,00,000 + 64,000 − Drawings (24,000 + 5,000) = 2,35,000; Creditors 45,000; Outstanding salary 4,000 → total **₹2,84,000**. Assets: Furniture 45,000; Closing stock 55,000; Debtors 60,000; Prepaid rent 3,000; Cash 1,21,000 → total **₹2,84,000**. ✔

COMMON MISTAKE **Items inside the trial balance appear once in final accounts; adjustments given outside appear twice (two effects). If closing stock is inside the trial balance (adjusted purchases), it goes only to the Balance Sheet.**

7.4 Manufacturing entity – cost per unit (ICAI "either/or" favourite)

WORKED EXAMPLE **Manufacturing account with cost per unit**

A factory produced 10,000 units in 2025-26. Opening WIP ₹20,000; closing WIP ₹30,000; raw materials consumed ₹2,40,000; direct wages ₹1,10,000; factory overheads ₹70,000; sale of scrap ₹5,000.

Cost of production = 20,000 + 2,40,000 + 1,10,000 + 70,000 − 5,000 − 30,000 = **₹4,05,000**; cost per unit = **₹40.50**.

If 9,000 units are sold and there is no opening finished stock, closing finished goods = 1,000 × 40.50 = ₹40,500 (or NRV if lower).

COMMON MISTAKE **Taking scrap sale to P&L instead of reducing factory cost, and forgetting to adjust WIP in the manufacturing account.**

Chapter 8: Financial Statements of Not-for-Profit Organisations

Clubs, charitable trusts, schools, hospitals, libraries and societies that work for the **welfare of members or society, not for profit**. Their surplus is not distributed but added to the **capital fund (general fund)**.

Final accounts of an NPO: (1) Receipts and Payments Account, (2) Income and Expenditure Account, (3) Balance Sheet.

Point	Receipts & Payments A/c	Income & Expenditure A/c
Nature	**Real account** – summary of cash book	**Nominal account** – like P&L
Items	All receipts and payments – capital and revenue, of any period	Only **revenue** items of the **current year**
Basis	Cash basis	Accrual basis
Opening balance	Starts with opening cash/bank balance	No opening balance
Closing balance	Closing cash/bank balance	**Surplus** (excess of income) or **deficit**
Sides	Debit – receipts; credit – payments	Debit – expenditure; credit – income

Profit & Loss A/c vs Income & Expenditure A/c

Point	Profit and Loss A/c	Income and Expenditure A/c
Prepared by	Trading/profit-making entities	NPOs (clubs, societies, hospitals)
Result	Net profit / net loss	**Surplus / deficit** (excess of income over expenditure)
Transfer of result	Capital A/c	**Capital (general) fund**
Trading A/c before it	Yes	Separate trading account only for activities like canteen/bar

Item	Treatment
Subscriptions	Revenue income of the year – adjust for outstanding and advance
Entrance / admission fees	Usually revenue income (small, recurring); may be capitalised if the rules say so
Life membership fees	**Capital receipt** – added to capital fund (or a Life Membership Fund)
General donation (small)	Revenue income
Specific donation (e.g. for building)	**Capital receipt** – Building Fund on liability side
Legacy (by will)	Capital receipt – added to capital fund
Sale of old newspapers / sports material	Revenue income
Sale of fixed asset	Not income; profit/loss on sale goes to I&E A/c
Endowment fund	Capital – liabilities side; income from its investments goes to the fund or I&E as per terms
Prize fund / match fund	Specific fund – expenses on the purpose are deducted from the fund; excess expense goes to I&E

WORKED EXAMPLE **Subscriptions for the year 2025-26**

Subscriptions received during the year ₹60,000 (including ₹4,000 for 2024-25 and ₹3,000 for 2026-27). Outstanding for 2025-26 on 31 March 2026: ₹5,000. Outstanding on 31 March 2025 was ₹6,000 (of which ₹4,000 received; ₹2,000 written off this year).

Income for 2025-26 = 60,000 − 4,000 − 3,000 + 5,000 = **₹58,000**.

(₹2,000 of the old dues is written off – debit I&E A/c as a loss or reduce from the capital fund, as the question requires.)

EXAM TIP **When the opening capital fund is not given, prepare an opening balance sheet – capital fund = opening assets - opening liabilities.**

8.1 Full illustration

WORKED EXAMPLE **R&P → I&E and Balance Sheet**

Green Club – Receipts & Payments A/c for 2025-26 (₹): Receipts – balance b/d (cash) 12,000; subscriptions 1,10,000 (including ₹6,000 for 2024-25 and ₹4,000 for 2026-27); entrance fees 20,000; donation for building fund 50,000; sale of old furniture 3,000 (book value 5,000); interest on investments 6,000. Payments – salaries 48,000; rent 24,000; purchase of sports equipment 30,000; electricity 9,000; investments 60,000; balance c/d 30,000.

Additional: subscription outstanding for 2025-26 ₹8,000; outstanding salary ₹4,000; accrued interest ₹1,500; equipment (opening ₹40,000) depreciated @ 10% on closing balance; **entrance fees to be capitalised 50%**. Opening subscription outstanding ₹6,000. Opening capital fund to be found.

Opening balance sheet (1 April 2025): cash 12,000 + subscription outstanding 6,000 + equipment 40,000 + furniture 5,000 = **Capital fund ₹63,000** (no liabilities given).

Subscription income = 1,10,000 − 6,000 − 4,000 + 8,000 = **₹1,08,000**.

I&E A/c (Income): subscription 1,08,000; entrance fees (50%) 10,000; interest 6,000 + 1,500 = 7,500 → total **₹1,25,500**.

Expenditure: salaries 48,000 + 4,000 = 52,000; rent 24,000; electricity 9,000; loss on sale of furniture 2,000; depreciation 10% × (40,000 + 30,000) = 7,000 → total **₹94,000**. **Surplus = ₹31,500**.

Balance sheet (31 March 2026): Liabilities – capital fund 63,000 + 31,500 + 10,000 (capitalised entrance fees) = 1,04,500; building fund 50,000; subscription in advance 4,000; outstanding salary 4,000 → **₹1,62,500**. Assets – equipment 63,000; investments 60,000; accrued interest 1,500; subscription outstanding 8,000; cash 30,000 → **₹1,62,500** ✔.

REMEMBER **Donation for a specific purpose (building fund) is capitalised as a fund; general donations of large amounts may be capitalised or treated as income as per policy; legacies are capitalised.**

EXAM TIP **ICAI asks R&P from I&E (reverse) too (Jan 2026 Q3a). Work backwards: cash items in R&P, non-cash items (depreciation, outstanding, prepaid) excluded.**

Chapter 9: Accounts from Incomplete Records

A system in which **only personal accounts and the cash book** are kept; real and nominal accounts are not maintained. Used by small traders. **Not a complete system** – trial balance cannot be prepared, and true profit cannot be found directly.

Features: no double entry for all transactions, mixing of private and business transactions, personal accounts kept, profit found by comparing capital.

Limitations: no arithmetical check, fraud and errors hard to detect, no proper valuation of assets, not acceptable to tax authorities for many cases, cannot be used by companies.

1. Prepare an **opening statement of affairs** to find opening capital (assets – liabilities).
2. Prepare a **closing statement of affairs** to find closing capital.
3. Prepare a **statement of profit or loss**:

Particulars	₹
Closing capital	xxx
Add: drawings during the year	xxx
Less: additional capital introduced	(xxx)
= Adjusted closing capital	xxx
Less: opening capital	(xxx)
Profit / (Loss) for the year	xxx
Less: interest on capital, salary to proprietor (if any adjustments)	

WORKED EXAMPLE **Profit by statement of affairs**

Opening capital ₹1,20,000. Closing assets ₹2,10,000, closing liabilities ₹50,000 → closing capital ₹1,60,000. Drawings ₹24,000. Fresh capital introduced ₹10,000.

Profit = 1,60,000 + 24,000 − 10,000 − 1,20,000 = **₹54,000**.

Point	Statement of affairs	Balance sheet
Records	Incomplete	Complete double entry
Basis	Estimates and personal knowledge	Ledger balances
Purpose	To find capital	To show financial position
Capital	Balancing figure	Taken from capital account

Missing figures are found by preparing **memorandum accounts**:

- **Total Debtors A/c** → find credit sales (balancing figure): Opening debtors + credit sales + dishonoured bills = Cash received + discount + returns + bad debts + B/R received + closing debtors.
- **Total Creditors A/c** → find credit purchases.
- **Bills Receivable / Bills Payable A/c** → bills received / accepted.
- **Cash A/c** → missing cash sales, cash purchases, drawings or opening cash.
- Then prepare the Trading and P&L A/c and Balance Sheet in the normal way. Gross profit ratio given in the question helps find missing sales or stock.

FORMULA **Sales = Cost of goods sold ÷ (1 − GP rate on sales). If GP is 25% on cost, GP on sales = 25/125 = 20%.**

9.1 Finding missing figures – the four T-accounts

Missing figure	Prepare
Credit sales	**Total Debtors A/c**: Opening debtors + Credit sales + B/R dishonoured = Cash received + Discount + Returns + Bad debts + B/R received + Closing debtors

Missing figure	Prepare
Credit purchases	**Total Creditors A/c**
Bills received/issued	Bills Receivable / Bills Payable A/c
Opening/closing cash, drawings	Cash Book summary

WORKED EXAMPLE **Credit sales from Total Debtors A/c**

Opening debtors ₹60,000; closing debtors ₹75,000; cash received from debtors ₹2,40,000; discount allowed ₹4,000; returns inward ₹6,000; bad debts ₹2,000.

Credit sales = 75,000 + 2,40,000 + 4,000 + 6,000 + 2,000 − 60,000 = **₹2,69,000**.

NOTE **ICAI syllabus excludes "preparation of accounts based on ratios" for this chapter – but the GP ratio is still used to find missing sales/purchases (as in the formula box above).**

Chapter 10: Partnership and LLP Accounts

10.1 Introduction and final accounts of partnership firms

A 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 (Section 4, Indian Partnership Act, 1932). The persons are called **partners** and together they are called a **firm**. The name under which the business is carried on is the **firm name**.

- **Essential features:** agreement (oral or written), business, sharing of profits, mutual agency (each partner is an agent of the firm and of the other partners), minimum two partners.
- **Maximum partners:** 50 (Section 464 of the Companies Act, 2013 read with Rule 10 of the Companies (Miscellaneous) Rules, 2014). An association above this limit must register as a company.
- **Liability:** unlimited, joint and several. A creditor can recover the whole debt from any one partner.
- **Registration** is optional but an unregistered firm cannot file a suit against third parties to enforce a contract (Section 69).

The written agreement among partners is called the **partnership deed**. It usually contains: name and address of firm and partners, nature of business, capital of each partner, profit-sharing ratio, interest on capital and drawings, salary or commission to partners, rules for admission, retirement and death, method of goodwill valuation, and settlement of accounts on dissolution.

Provisions of the Act when the deed is silent (Section 13)

Matter	Rule when no agreement exists
Profit-sharing ratio	Equal
Interest on capital	Not allowed
Interest on drawings	Not charged
Salary / commission to partner	Not allowed
Interest on partner's loan to firm	6% per annum (allowed even if there is a loss)
Admission of new partner	Only with consent of all existing partners

REMEMBER **Interest on capital is paid only out of profits**

Even when the deed allows interest on capital, it is an **appropriation** of profit. If the firm makes a loss, no interest on capital is given. If profit is less than the interest, the profit is shared in the ratio of interest. Interest on a partner's **loan** is a **charge** and is paid even in a loss year.

Basis	Fixed capital method	Fluctuating capital method
Accounts kept	Two accounts per partner: Capital A/c and Current A/c	Only one Capital A/c
Capital balance	Remains same unless fresh capital is introduced or withdrawn permanently	Changes every year
Adjustments (interest, salary, drawings, share of profit)	Go to Current A/c	Go to Capital A/c
Debit balance	Current A/c may show debit balance	Capital A/c rarely shows debit balance

This account is an extension of the Profit and Loss Account. It shows how the net profit is distributed among partners.

Debit side	Credit side
Interest on capital	Net profit b/d (from P&L A/c)
Partner's salary / commission	Interest on drawings
Transfer to reserve	
Share of profit to partners (balancing figure)	

Interest on drawings

- **Fixed amount drawn on the first day of every month:** interest for 6.5 months.
- **Drawn on the last day of every month:** 5.5 months.
- **Drawn in the middle of every month:** 6 months.
- **Drawn at the start of each quarter:** 7.5 months; at the end of each quarter: 4.5 months.
- **Uneven dates:** use the **product method** – multiply each drawing by months remaining till year-end, add products, and charge interest for one month on the total.

WORKED EXAMPLE **Appropriation of profit**

A and B are partners sharing 3:2. Capitals: A ₹2,00,000, B ₹1,00,000. Interest on capital 10% p.a., B gets a salary of ₹2,000 per month, A gets 5% commission on net profit after charging such commission. Net profit before these items: ₹1,26,000. Drawings: A ₹24,000, B ₹12,000; interest on drawings 6% (average 6 months).

Interest on capital: A ₹20,000, B ₹10,000 = ₹30,000. Salary B = ₹24,000.

Interest on drawings: A = 24,000 × 6% × 6/12 = ₹720; B = ₹360. Total ₹1,080.

Profit after interest and salary but including interest on drawings = 1,26,000 + 1,080 − 30,000 − 24,000 = ₹73,080.

A's commission = 73,080 × 5/105 = ₹3,480. Divisible profit = ₹69,600: A 3/5 = ₹41,760, B 2/5 = ₹27,840.

Guarantee of profit

When a partner (often a new partner) is guaranteed a minimum profit, the deficiency is borne by the guaranteeing partners in the agreed ratio (or their profit ratio if not stated). Example: C is guaranteed ₹30,000; his actual share is ₹22,000; the deficiency of ₹8,000 is borne by A and B.

Past adjustments

If interest on capital or salary was omitted in earlier years, make a single adjusting entry through the partners' capital or current accounts. Prepare a table: what was credited, what should have been credited, net effect for each partner. Only the net effect is passed.

10.2 Treatment of goodwill

Goodwill is the value of the reputation of a firm that enables it to earn more than normal profit. It is an intangible asset.

Method	Working
Average profit	Average profit × number of years' purchase
Weighted average profit	Σ(profit × weight) ÷ Σ weights × years' purchase
Super profit	(Average profit − Normal profit) × years' purchase
Annuity of super profit	Super profit × present value annuity factor
Capitalisation of average profit	(Average profit × 100 ÷ normal rate) − Net assets
Capitalisation of super profit	Super profit × 100 ÷ normal rate

FORMULA **Normal profit**

Normal profit = Capital employed × Normal rate of return ÷ 100. Capital employed = Total assets (excluding goodwill and fictitious assets) − Outside liabilities.

- **Sacrificing ratio** = Old ratio − New ratio (for partners who give up share).
- **Gaining ratio** = New ratio − Old ratio (for partners who gain).
- The gaining partner compensates the sacrificing partner for goodwill: debit gaining partner's capital, credit sacrificing partner's capital.
- Accumulated profits, reserves and revaluation results are distributed in the **old** ratio.

10.3 Admission of a partner

A new partner gets (a) a share in future profits and (b) a right in the firm's assets. He usually brings capital and a premium for goodwill.

Steps on admission

1. Calculate new ratio and sacrificing ratio.
2. Treatment of goodwill (AS 26 does not allow recording of self-generated goodwill; so premium method is preferred).
3. Revaluation of assets and liabilities through Revaluation A/c; profit or loss shared by old partners in old ratio.
4. Distribution of accumulated profits, reserves, losses among old partners in old ratio.
5. Capital brought in by the new partner; adjustment of capitals if required.

Calculating new ratio

WORKED EXAMPLE New ratio

A and B share 3:2. C is admitted for 1/5 share, which he takes from A and B in their old ratio. Remaining share = 4/5. A's new = 3/5 × 4/5 = 12/25; B = 2/5 × 4/5 = 8/25; C = 5/25. New ratio 12:8:5.

If C takes 1/5, wholly from A: A = 3/5 − 1/5 = 2/5, B = 2/5, C = 1/5 → 2:2:1.

Goodwill on admission – premium method

- Premium brought in cash: Dr Cash; Cr Premium for Goodwill A/c; then Dr Premium for Goodwill; Cr old partners (sacrificing ratio).
- New partner unable to bring premium: Dr New partner's current/capital A/c; Cr sacrificing partners.
- Existing goodwill in books is first written off among old partners in old ratio.
- **Hidden goodwill:** if the new partner's capital implies a higher total value of the firm, the difference is hidden goodwill. Total capital implied by C's capital – actual capitals of all partners (after adjustments, excluding goodwill) = goodwill.

WORKED EXAMPLE Hidden goodwill

A and B have capitals of ₹1,50,000 and ₹1,00,000 after all adjustments. C brings ₹1,00,000 for 1/4 share. Implied total capital = 1,00,000 × 4 = ₹4,00,000. Actual total = 1,50,000 + 1,00,000 + 1,00,000 = ₹3,50,000. Hidden goodwill = ₹50,000; C's share = ₹12,500 debited to C, credited to A and B in sacrificing ratio.

Revaluation Account

Debit (losses)	Credit (gains)
Decrease in value of assets	Increase in value of assets
Increase in liabilities	Decrease in liabilities
Unrecorded liabilities	Unrecorded assets
Profit transferred to old partners (balancing)	Loss transferred to old partners (balancing)

Memorandum revaluation account is used when partners want the assets to continue at old book values in the balance sheet. The first part records the changes; the second part reverses them in the new ratio.

10.4 Retirement of a partner

On retirement the outgoing partner is entitled to his capital, share of reserves, share of revaluation profit, share of goodwill, and share of profit up to the date of retirement. The remaining partners gain his share in the **gaining ratio**.

- Goodwill: Dr remaining partners (gaining ratio); Cr retiring partner (his share).
- Amount due may be paid immediately or transferred to a **Retiring Partner's Loan A/c** and paid in instalments with interest. Under Section 37, if no settlement is made, the retiring partner (or his estate) can claim either a

share of profits made after retirement attributable to his share of assets, or interest at **6% p.a.** on his share, at his option.

WORKED EXAMPLE Retirement

A, B and C share 2:2:1. B retires. Goodwill of firm ₹60,000. New ratio of A and C will be 3:2. Gaining ratio: A = 3/5 − 2/5 = 1/5; C = 2/5 − 1/5 = 1/5 → 1:1. B's share of goodwill = 60,000 × 2/5 = ₹24,000, debited ₹12,000 each to A and C.

10.5 Death of a partner

Treatment is the same as retirement except the amount goes to the **executors' account**. Additional items:

- **Profit up to date of death:** based on last year's profit (time basis) or sales basis. Dr P&L Suspense A/c; Cr deceased partner's capital.
- **Joint life policy (JLP):** the policy amount received is credited to all partners including the deceased in the profit ratio (if treated as expense), or the surrender value approach as per question.
- **Interest on capital** up to date of death if the deed allows.

EXAM TIP Profit up to date of death – sales basis

If sales up to date of death are ₹4,00,000 and last year's profit was 10% of sales, profit to date = ₹40,000. Deceased's share is credited from P&L Suspense A/c.

10.6 Dissolution of partnership firms and LLPs

Dissolution of partnership	Dissolution of firm
Change in the relationship (admission, retirement, death)	Business of the firm comes to an end
Firm continues	Firm closes
Books are not closed	All books are closed
No court involvement	May be by court order

Modes of dissolution of firm (Sections 40–44)

- **By agreement** (Section 40).
- **Compulsory dissolution** (Section 41): all but one partner insolvent, or the business becomes illegal.
- **On happening of contingencies** (Section 42): expiry of term, completion of venture, death or insolvency of a partner (subject to contract).
- **By notice** in a partnership at will (Section 43).
- **By court** (Section 44): insanity, permanent incapacity, misconduct, persistent breach, transfer of interest, perpetual losses, just and equitable ground.

1. Losses, including deficiencies of capital, are paid first out of profits, then out of capital, and lastly by partners individually in their profit-sharing ratio.
2. Assets of the firm, including sums contributed by partners to make up deficiency, are applied in this order:

- first, to pay debts of the firm to third parties;
  - next, to pay each partner rateably what is due for **advances** (loans), as distinguished from capital;
  - next, to pay each partner rateably what is due on account of capital;
  - the residue is divided among partners in profit-sharing ratio.

Realisation Account

Debit	Credit
All assets at book value (except cash, bank, fictitious assets and partner's loan to the firm)	All outside liabilities at book value
Payment of liabilities	Cash realised from sale of assets
Realisation expenses (paid by firm)	Assets taken over by partners

Debit	Credit
Profit on realisation (transferred to partners)	Loss on realisation (transferred to partners)

- **Partner's loan** is not transferred to Realisation A/c; it is paid separately after outside liabilities.
- **Fictitious assets** (P&L debit balance, deferred revenue expenditure) are written off to partners' capitals in the old ratio.
- **Reserves** are credited to partners' capitals in the old ratio.
- When a partner agrees to pay a liability: Dr Realisation; Cr partner's capital.
- When an asset is taken over by a creditor in settlement: no entry for the asset; only the balance paid in cash is recorded.

WORKED EXAMPLE Realisation

Assets (except cash) book value ₹3,00,000 realised ₹2,70,000. Creditors ₹80,000 paid ₹78,000. Expenses ₹4,000. Realisation loss = (3,00,000 + 78,000 + 4,000) − (80,000 + 2,70,000) = ₹32,000, shared in profit ratio.

Insolvency of a partner (Garner v Murray)

If a partner is insolvent and cannot pay the debit balance of his capital account, the deficiency is borne by the solvent partners. Under the **Garner v Murray** rule, (1) solvent partners bring in cash equal to their share of the **realisation loss** only, and (2) the insolvent partner's deficiency is shared by solvent partners in the ratio of their **capitals just before dissolution** (fixed capitals; or fluctuating capitals after adjusting reserves/drawings). It applies unless the partnership agreement provides otherwise; state the assumption in your answer VERIFY.

When assets are realised gradually, cash is distributed to partners in instalments. Two methods are used:

(a) Maximum possible loss method

At each instalment, assume the remaining assets will realise nothing. Compute the maximum loss, distribute it among partners in profit ratio, and pay each partner only the balance that stays positive. If a partner shows a negative balance, it is absorbed by the others in their capital ratio (Garner v Murray) or profit ratio as stated.

(b) Surplus capital (proportionate capital) method

1. Divide each partner's capital by his profit share to get **capital per unit of profit**.
2. The lowest value becomes the base. Compare and find the **surplus** capital of each partner over the base.
3. Repeat to rank partners. Cash available after paying outside liabilities and partner's loans is paid first to the partner with the highest surplus, until capitals become proportionate to profit ratio; then in profit ratio.

WORKED EXAMPLE Surplus capital method

P, Q share 3:2. Capitals P ₹90,000, Q ₹40,000.

Capital per unit of profit: P = 90,000/3 = 30,000; Q = 40,000/2 = 20,000. Base = 20,000.

Proportionate capital of P = 20,000 × 3 = ₹60,000. Surplus of P = ₹30,000.

First ₹30,000 available goes to P alone; thereafter cash is paid in 3:2.

1. Realisation expenses (or keep a provision for them).
2. Outside creditors (secured creditors from the asset concerned; preferential creditors first).
3. Partners' loans (rateably).
4. Partners' capitals – by the chosen method.

COMMON MISTAKE Do not pay capital before partner's loan

Students often pay a partner's capital along with his loan. The loan must be fully paid to all partners first.

10.7 LLP accounts – introduction and distinction

A **Limited Liability Partnership** (LLP Act, 2008) is a **body corporate** with separate legal entity and perpetual succession; partners' liability is limited to their agreed contribution. LLP accounts are prepared like partnership

accounts but the "partners' capital" is called **contribution**, and the LLP must maintain books on accrual basis and double entry, file a **Statement of Account & Solvency (Form 8)** and **Annual Return (Form 11)** with the Registrar VERIFY.

Point	Partnership firm	LLP
Law	Indian Partnership Act, 1932	LLP Act, 2008
Legal status	Not a separate legal entity	**Body corporate**, separate legal entity
Liability	Unlimited, joint and several	Limited to agreed contribution (except fraud)
Registration	Optional	Compulsory
Minimum partners	2	2 (at least 2 **designated partners**, one resident in India)
Maximum partners	50 (Companies Rules)	No limit
Audit	Not compulsory under the Act	Compulsory if turnover > ₹40 lakh or contribution > ₹25 lakh
Perpetual succession	No	Yes

EXAM TIP **ICAI now sets admission/retirement questions with an LLP (Jan 2026 Q4a, May 2026 Q3a). The accounting is the same – just use "Partners' Contribution/Capital" and mention the LLP name in headings.**

COMMON MISTAKE **Sacrificing ratio errors on admission – compute old ratio – new ratio for each old partner; gaining ratio on retirement = new – old.**

Chapter 11: Company Accounts

11.1 Introduction – shares and debentures

A **company** is an artificial person created by law, with a separate legal entity, perpetual succession and a common seal (now optional). It is governed by the **Companies Act, 2013**. Its capital is divided into small units called **shares** (Section 2(84)).

Kinds of share capital (Section 43)

Type	Meaning
Equity share capital	Ordinary shares; voting rights; residual claim; dividend not fixed. May be with differential rights (DVR) under Rule 4
Preference share capital	Preferential right to fixed dividend and to return of capital on winding up

Stages / categories of capital (as shown in the Notes to the Balance Sheet)

Category	Meaning
Authorised (nominal) capital	Maximum capital stated in the Memorandum
Issued capital	Part of authorised capital offered to the public
Subscribed capital	Part of issued capital actually applied for and allotted
Called-up capital	Part of subscribed capital called by the company
Paid-up capital	Part of called-up capital actually received
Reserve capital	Uncalled capital that can be called only on winding up (special resolution, Section 65)

Share vs debenture: a share is a part of the **ownership** capital; a debenture is an acknowledgement of **debt**. Shareholders get dividend (appropriation of profit); debenture holders get interest (charge against profit, payable even in loss). Shares cannot be issued at a discount (s.53, except sweat equity); debentures can be.

11.2 Issue, forfeiture and re-issue of shares

Shares may be issued **at par** (face value), **at a premium** (above face value) or, under very limited conditions, at a discount. **Section 53** prohibits issue of shares at a discount, except **sweat equity shares** (Section 54) and shares issued to creditors under a debt-restructuring scheme as per RBI guidelines. Shares issued at a discount in violation are void.

Securities premium (Section 52)

Premium received must be credited to the **Securities Premium A/c**. It can be used only for:

1. issuing fully paid bonus shares;
2. writing off preliminary expenses;
3. writing off expenses, commission or discount on issue of shares or debentures;
4. premium payable on redemption of preference shares or debentures;
5. buy-back of own shares or securities (Section 68).

Certain classes of companies following Ind AS face restrictions on some of these uses (Section 52(3)).

Accounting entries – issue payable in instalments

Stage	Entry
Application money received	Dr Bank; Cr Equity Share Application A/c
On allotment (transfer of application money)	Dr Share Application; Cr Share Capital (and Securities Premium if premium is in application)
Refund on rejected applications	Dr Share Application; Cr Bank
Excess application adjusted against allotment	Dr Share Application; Cr Share Allotment

Stage	Entry
Allotment due	Dr Share Allotment; Cr Share Capital; Cr Securities Premium
Allotment received	Dr Bank; Cr Share Allotment
Call due	Dr Share First Call; Cr Share Capital
Call received	Dr Bank; Cr Share First Call

- **Calls in arrears:** amount called but not paid. Interest on calls in arrears is charged as per articles (Table F allows up to 10% p.a.).
- **Calls in advance:** amount received before it is called; shown as a liability (Other current liabilities). Interest on calls in advance up to 12% p.a. under Table F.
- **Minimum subscription:** for a public issue under SEBI (ICDR) Regulations, 2018, the issue must receive at least **90%** of the issue size; otherwise all money is refunded.

Over-subscription and pro-rata allotment

When applications exceed the shares offered, the directors may reject some applications, allot fully to some, or allot pro-rata. Excess application money on pro-rata allotment is adjusted against allotment and calls; any surplus is refunded.

WORKED EXAMPLE Pro-rata allotment

A company invites 1,00,000 equity shares of ₹10 each at a premium of ₹2: ₹3 on application, ₹5 (including premium) on allotment, ₹4 on first and final call. Applications received for 1,60,000 shares. Applications for 20,000 shares rejected; the rest allotted pro-rata (1,40,000 applicants → 1,00,000 shares, i.e. 7:5).

Application money on 1,40,000 shares = ₹4,20,000; needed on 1,00,000 = ₹3,00,000. Excess = ₹1,20,000 adjusted against allotment.

Allotment due = 1,00,000 × 5 = ₹5,00,000. Cash on allotment = 5,00,000 − 1,20,000 = ₹3,80,000.

Mr X applied for 1,400 shares and got 1,000. Excess = 400 × 3 = ₹1,200. His allotment due = ₹5,000. If he fails to pay allotment, the unpaid amount = 5,000 − 1,200 = ₹3,800.

When a shareholder fails to pay allotment or call money, the directors may **forfeit** his shares after serving a notice of at least **14 days** (Table F). Forfeiture cancels his membership and the amount already paid is not refunded.

Entry on forfeiture

Dr Share Capital (called-up amount on those shares)

Dr Securities Premium (only if premium was called but **not received**)

Cr Unpaid Calls / Allotment (amount due but not paid)

Cr Share Forfeiture A/c (amount actually received)

REMEMBER Premium already received is never debited on forfeiture

If the premium has been received in cash (for example, at application or allotment), it stays in the Securities Premium A/c even after forfeiture.

Forfeited shares can be re-issued at par, premium or discount. The discount on re-issue cannot exceed the amount forfeited on those shares. After re-issue, the balance in the Share Forfeiture A/c relating to those re-issued shares is a **capital profit** and is transferred to **Capital Reserve**.

WORKED EXAMPLE **Forfeiture and re-issue**

Ravi held 500 shares of ₹10 each issued at par. He paid ₹3 on application but failed to pay ₹4 on allotment and ₹3 on first and final call. Shares forfeited.

Entry: Dr Share Capital 5,000; Cr Share Allotment 2,000; Cr Share First and Final Call 1,500; Cr Share Forfeiture 1,500.

400 of these shares re-issued at ₹8 per share fully paid. Discount = 400 × 2 = ₹800.

Entry: Dr Bank 3,200; Dr Share Forfeiture 800; Cr Share Capital 4,000.

Forfeited amount on 400 shares = 400 × 3 = 1,200. Used 800. Capital reserve = ₹400. The forfeiture on the remaining 100 shares (₹300) stays in Share Forfeiture A/c.

MEMORY TRICK **Forfeiture amount per share**

Amount forfeited per share = Amount received per share (excluding premium received). Capital reserve on re-issue = (Forfeited per share − Discount per share) × shares re-issued.

COMMON MISTAKE **Forgetting that money already received as premium is not forfeited (premium stays in Securities Premium) – only if premium was not received, Securities Premium A/c is debited on forfeiture.**

11.3 Issue of debentures

A **debenture** is an instrument acknowledging a debt by the company (Section 2(30)). Debenture holders are **creditors**, receive fixed interest whether or not there is profit, and have no voting rights. Section 71 governs issue of debentures; debentures with voting rights cannot be issued.

Basis	Types
Security	Secured, unsecured (naked)
Redemption	Redeemable, irredeemable (perpetual)
Convertibility	Fully convertible, partly convertible, non-convertible (NCD)
Records	Registered, bearer
Coupon	Fixed rate, floating rate, zero-coupon (deep discount)

Issue	Redemption	Entry on allotment
Par	Par	Dr Bank; Cr Debentures
Discount	Par	Dr Bank, Dr Discount on Issue; Cr Debentures
Premium	Par	Dr Bank; Cr Debentures, Cr Securities Premium
Par	Premium	Dr Bank, Dr Loss on Issue; Cr Debentures, Cr Premium on Redemption
Discount	Premium	Dr Bank, Dr Loss on Issue (discount + premium); Cr Debentures, Cr Premium on Redemption
Premium	Premium	Dr Bank, Dr Loss on Issue; Cr Debentures, Cr Securities Premium, Cr Premium on Redemption

- Debentures can be issued at a discount (Section 53 restricts only shares).
- Discount or loss on issue is written off over the life of the debentures, first from securities premium and then from the Statement of P&L.
- **Debentures as collateral security:** a company may issue its own debentures to a lender as additional security. Either no entry is passed (note to accounts) or Dr Debenture Suspense; Cr Debentures (both shown, one deducted from the other).
- **Debentures for consideration other than cash:** issued to vendors of assets.

Interest on debentures and TDS

Interest is a charge against profit. The company deducts TDS on debenture interest at the rate notified (check current rates under the Income-tax Act, 2025) and pays the net amount.

WORKED EXAMPLE **Writing off loss on issue**

A company issues 10,000 9% debentures of ₹100 at 5% discount, redeemable at 10% premium after 5 years. Loss on issue = 10,000 × (5 + 10) = ₹1,50,000.

Entry: Dr Bank 9,50,000; Dr Loss on Issue of Debentures 1,50,000; Cr 9% Debentures 10,00,000; Cr Premium on Redemption 1,00,000.

Loss written off equally over 5 years (₹30,000 per year) if debentures are redeemed in one lot.

11.4 Bonus issue and right issue

Bonus shares are fully paid shares issued free to existing shareholders by capitalising reserves.

Sources allowed

- Free reserves (general reserve, P&L balance);
- Securities premium account;
- Capital redemption reserve account.

Bonus shares **cannot** be issued out of **revaluation reserve**. Bonus shares cannot be issued in lieu of dividend.

Conditions (Section 63(2))

1. Authorised by the articles;
2. Recommended by the Board and approved in general meeting;
3. No default in payment of interest or principal on fixed deposits or debt securities;
4. No default in payment of statutory dues of employees (PF, gratuity, bonus);
5. Partly paid shares must be made fully paid before bonus;
6. Listed companies must also follow SEBI (ICDR) Regulations, and the bonus must be implemented within **two months** of Board approval (Regulation 295).

Entries

- Dr General Reserve / Securities Premium / CRR; Cr Bonus to Shareholders A/c.
- Dr Bonus to Shareholders A/c; Cr Equity Share Capital.
- For making partly paid shares fully paid: Dr General Reserve; Cr Bonus to Shareholders; then Dr Share Final Call; Cr Share Capital; then Dr Bonus to Shareholders; Cr Share Final Call.

WORKED EXAMPLE **Bonus issue**

Share capital ₹10,00,000 (1,00,000 shares of ₹10). The company declares a 1:4 bonus out of securities premium ₹1,00,000 and general reserve.

Bonus shares = 25,000 × ₹10 = ₹2,50,000. Use securities premium ₹1,00,000 first (capital nature), then ₹1,50,000 from general reserve.

Right issue (Section 62(1)(a))

A **rights issue** offers new shares to **existing equity shareholders** in proportion to their holdings, usually at a price below market. Shareholders may accept, **renounce** in favour of another person, or ignore. Entry: Bank Dr; To Equity Share Capital (and Securities Premium, if any).

Ex-right (theoretical) price = (MP cum-right × existing shares + issue price × new shares) ÷ (existing + new shares)

Value of a right (per existing share) = (Cum-right MP − Ex-right price) [or (Ex-right price − issue price) × new ÷ existing]

WORKED EXAMPLE **Value of right**

A company offers 1 new share for every 4 held at ₹60; market price cum-right ₹80. Ex-right price = (4 × 80 + 1 × 60) ÷ 5 = **₹76**. Value of right per existing share = 80 − 76 = **₹4** (= (76 − 60) ÷ 4 ✔).

Point	Bonus issue	Right issue
Consideration	Free – capitalisation of reserves	Paid by shareholders
Effect on funds	No cash inflow	Cash inflow
Renunciation	Not possible	Possible
Section	63	62(1)(a)

11.5 Redemption of preference shares

- No company can issue **irredeemable** preference shares. Preference shares must be redeemed within **20 years** of issue (up to 30 years for infrastructure projects, with annual redemption of at least 10% from the 21st year).
- Only **fully paid** shares can be redeemed.
- Redemption must be out of **profits available for dividend** or out of the **proceeds of a fresh issue** of shares made for the purpose.
- When redeemed out of profits, an amount equal to the nominal value must be transferred to **Capital Redemption Reserve (CRR)**.
- Premium on redemption must be provided out of profits or securities premium (companies following Ind AS: out of profits only, Section 55(2)(d)).
- CRR can be used only to issue fully paid bonus shares.

Fresh issue calculation

FORMULA **Fresh issue needed**

Fresh issue (nominal) = Nominal value of preference shares to be redeemed − Divisible profits available for redemption (keeping any minimum balance required).

If shares are issued at a premium, the premium is not counted as proceeds for capital replacement for CRR purposes (securities premium can only pay the premium on redemption).

WORKED EXAMPLE **Redemption of preference shares**

10% redeemable preference shares ₹5,00,000 to be redeemed at 10% premium. General reserve ₹3,00,000, securities premium ₹40,000. The company issues equity shares of ₹10 each at par to the extent necessary, keeping ₹1,00,000 in general reserve.

Step 1 – premium on redemption ₹50,000: ₹40,000 from securities premium and ₹10,000 from general reserve.

Step 2 – GR left = 3,00,000 − 10,000 = 2,90,000; keep ₹1,00,000, so ₹1,90,000 is available for CRR.

Step 3 – Fresh issue = 5,00,000 − 1,90,000 = ₹3,10,000 (31,000 shares). CRR = ₹1,90,000.

Always settle the premium first, then compute the fresh issue.

11.6 Redemption of debentures

Methods: (a) lump sum at the end; (b) instalments by draw of lots; (c) purchase in the open market (cancellation); (d) conversion into shares.

Sources

- Out of profits: an equal amount is transferred from P&L to **Debenture Redemption Reserve (DRR)** or general reserve.
- Out of capital: no transfer (only allowed where DRR is not required).

DRR and investment rules (Rule 18(7), Companies (Share Capital and Debentures) Rules, 2014 as amended in 2019)

Company	DRR requirement
All-India FIs, banks	Not required
Listed companies (public issue or private placement) and listed NBFCs	Not required
Unlisted companies (other than NBFCs, HFCs)	**10%** of outstanding debentures
Unlisted NBFCs and HFCs (private placement)	Not required

Investment / deposit of 15%: listed companies and other specified companies must, on or before **30 April** each year, invest or deposit at least **15%** of the debentures maturing during the year ending next 31 March in specified securities (scheduled bank deposit free from charge, central or state government securities, etc.). This amount cannot be used for anything else except redemption of debentures maturing that year.

REMEMBER **DRR is now 10%, not 25%**

Older textbooks say 25% (or 50% for some). Since the 2019 amendment, DRR is 10% for those companies that still need it. Use the current rule.

Conversion into shares

Number of shares = Amount due to debenture holders ÷ issue price of shares.

NOTE **Syllabus exclusion – ICAI Foundation excludes purchase and redemption of own debentures and the sinking fund method. Focus on redemption by lump-sum / instalments / conversion with DRR and DRI (15% investment) entries.**

WORKED EXAMPLE **DRR and DRI entries**

An unlisted company (not an NBFC/HFC/AIFI/bank) has 12% debentures ₹10,00,000 due for redemption on 31 March 2027. DRR required = 10% × 10,00,000 = ₹1,00,000. Investment (DRI) by 30 April 2026 = 15% × 10,00,000 = ₹1,50,000.

(1) Surplus in P&L Dr 1,00,000; To DRR 1,00,000. (2) DRI A/c Dr 1,50,000; To Bank 1,50,000. On redemption: (3) Bank Dr 1,50,000; To DRI 1,50,000. (4) 12% Debentures Dr 10,00,000; To Debenture holders 10,00,000. (5) Debenture holders Dr; To Bank 10,00,000. (6) DRR Dr 1,00,000; To General Reserve 1,00,000.

EXAM TIP **Company accounts carry a sure 10-mark question (Q5c/Q6a pattern). Practise: issue with pro-rata allotment + forfeiture + reissue; and redemption with fresh issue + CRR.**