

INTERMEDIATE : PAPER -

5

SYLLABUS - 2016

FINANCIAL ACCOUNTING

INTERMEDIATE

STUDY NOTES



The Institute of Cost Accountants of India
CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

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The Institute of Cost Accountants of India (ICAI)

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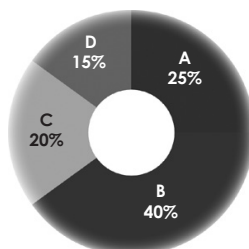
Syllabus - 2016

Paper 5: Financial Accounting (FAC)

Syllabus Structure

The syllabus comprises the following topics and study weightage

| | | |
|---|--|-----|
| A | Accounting Basics | 25% |
| B | Preparation of Financial Statements | 40% |
| C | Self Balancing Ledger, Royalties, Hire Purchase & Installment System, Branch & Departmental Accounts | 20% |
| D | Accounting in Computerised Environment and Accounting Standards | 15% |



ASSESSMENT STRATEGY

There will be written examination paper of three hours

OBJECTIVES

To gain understanding and to provide working knowledge of accounting concepts, detailed procedures and documentation involved in financial accounting system.

Learning Aims

The syllabus aims to test the student's ability to:

- Understand the framework of accounting systems and the Generally Accepted Accounting Principles
- Prepare necessary financial statements related to different business entities
- Construct financial statements for understandability and relevance of stakeholders

Skill set required

Level B: Requiring the skill levels of knowledge, comprehension, application and analysis.

| | |
|--|------------|
| Sec-A : Accounting – Basics | 25% |
| 1. Fundamentals of Accounting | |
| 2. Accounting for Special Transactions | |
| Sec-B : Preparation of Financial Statements | 40% |
| 3. Preparation of Final Accounts of Profit Oriented organizations, Non-Profit Organizations and from Incomplete Records. | |
| 4. Partnership Accounts | |
| Sec-C : Self Balancing Ledgers, Royalties, Hire Purchase & Installment System, Branch & Departmental Accounts | 20% |
| 5. Self-Balancing Ledgers | |
| 6. Royalties, Hire-Purchase and Installment System | |
| 7. Branch and Departmental Accounts | |
| Sec-D : Accounting in Computerised Environment and Accounting Standards | 15% |
| 8. Overview of Computerised Accounting | |
| 9. Accounting Standards (Specified only) | |

Section A : Accounting – Basics [25 Marks]

1. Fundamentals of Accounting:

Accounting - Meaning, Scope and Significance of Accounting - Accounting Principles, Concepts and Conventions - Capital and Revenue Transactions – Depreciation - Rectification of Errors.

2. Accounting for Special Transactions

Bills of Exchange - Consignment - Joint Venture - Insurance Claims (Loss of Stock and Loss of Profit).

Section B : Preparation of Financial Statements [40 Marks]

3. Preparation of Final Accounts of Profit Oriented organizations, Non-Profit Organizations and from Incomplete Records

- (i) Preparation of Financial statements of Profit Oriented organizations: P&L Account, Balance Sheet.
- (ii) Preparation of Financial Statements of Non-Profit making organizations: Preparation of Receipts & Payments Account, Income& Expenditure account and Balance Sheet.
- (iii) Preparation of Financial Statements from incomplete records (Single entry)

4. Partnership Accounts

Admission, Retirement, Death, Treatment of Joint Life Policy ,Dissolution of partnership firms including piece meal distribution, Amalgamation of partnership firms, Conversion of partnership firm into a company and sale of partnership firm to a company

Section C: Self Balancing Ledgers, Royalties, Hire Purchase & Installment System, Branch & Departmental Accounts [20 Marks]

- 5. Self-Balancing Ledgers
- 6. Royalty Accounts, Hire Purchase and Installment System.
- 7. Branch and Departmental Accounts.

Section D: Accounting in Computerized Environment and Accounting Standards [15 marks]

- 8. Computerized Accounting System – Features, Significance, Grouping of Accounts, Ledger hierarchy, Accounting Packages and their selection criteria
- 9. Accounting Standards (AS-1, AS-2, AS-6, AS-7, AS-9, AS-10)

Content

Study Note 1 : Fundamentals of Accounting

| | | |
|-----|--|----|
| 1.1 | Basics | 1 |
| 1.2 | Generally Accepted Accounting Principles | 11 |
| 1.3 | Concepts and Conventions | 11 |
| 1.4 | Capital & Revenue Transactions | 26 |
| 1.5 | Accounting for Depreciation | 57 |
| 1.6 | Rectification of Errors | 70 |

Study Note 2 : Accounting for Special Transactions

| | | |
|-----|--|-----|
| 2.1 | Bills of Exchange | 93 |
| 2.2 | Consignment Accounting | 110 |
| 2.3 | Joint Venture Accounts | 130 |
| 2.4 | Insurance Claim (Loss of Stock and Loss of Profit) | 143 |

Study Note 3 : Preparation of Financial Statements of Profit Oriented Organizations

| | | |
|-----|-------------------------------------|-----|
| 3.1 | Introduction | 161 |
| 3.2 | Preparation of Financial Statements | 161 |
| 3.3 | Bad Debts | 185 |

Study Note 4 : Preparation of Financial Statements of Not-for Profit Organizations

| | | |
|-----|--|-----|
| 4.1 | Preparation of Financial Statements of Not-for Profit Organization | 197 |
|-----|--|-----|

Study Note 5 : Preparation of Financial Statements from Incomplete Records

| | | |
|-----|---|-----|
| 5.1 | Preparation of Financial Statements from Incomplete Records | 231 |
|-----|---|-----|

Study Note 6 : Partnership

| | | |
|-----|-----------------------------------|-----|
| 6.1 | Admission of Partner | 251 |
| 6.2 | Retirement of Partner | 277 |
| 6.3 | Death of Partner | 301 |
| 6.4 | Dissolution of a Partnership Firm | 304 |
| 6.5 | Insolvency of a Partner | 312 |

| | | |
|-----|---|-----|
| 6.6 | Amalgamation of Firms and Conversion to a Company | 334 |
| 6.7 | Conversion or Sale of a Partnership Firm to a Company | 348 |

Study Note 7 : Self Balancing Ledger

| | | |
|-----|-----------------------|-----|
| 7.1 | Self Balancing Ledger | 359 |
|-----|-----------------------|-----|

Study Note 8 : Royalties

| | | |
|-----|-----------|-----|
| 8.1 | Royalties | 375 |
|-----|-----------|-----|

Study Note 9 : Hire-Purchase and Installment System

| | | |
|-----|--------------------------------------|-----|
| 9.1 | Hire-Purchase and Installment System | 391 |
|-----|--------------------------------------|-----|

Study Note 10 : Branch and Departmental Accounts

| | | |
|------|-----------------------|-----|
| 10.1 | Branch Accounts | 419 |
| 10.2 | Departmental Accounts | 457 |

Study Note 11 : Computerised Accounting System

| | | |
|------|--------------------------------|-----|
| 11.1 | Computerised Accounting System | 487 |
|------|--------------------------------|-----|

Study Note 12 : Accounting Standards

| | | |
|------|---|-----|
| 12.1 | AS – 1: Disclosure of Accounting Policies | 492 |
| 12.2 | AS – 2: Valuation of Inventories | 495 |
| 12.3 | AS – 6: Depreciation Accounting | 503 |
| 12.4 | AS – 7: Construction Contracts | 505 |
| 12.5 | AS – 9: Revenue Recognition | 513 |
| 12.6 | AS – 10: Accounting for Fixed Assets | 517 |

Study Note - 1

FUNDAMENTALS OF ACCOUNTING



This Study Note includes

- 1.1 Basics
- 1.2 Generally Accepted Accounting Principles
- 1.3 Accounting Concepts and Conventions
- 1.4 Capital & Revenue Transactions
- 1.5 Accounting for Depreciation
- 1.6 Rectification of Errors

1.1 BASICS

Business is an economic activity undertaken with the motive of earning profits and to maximize the wealth for the owners. Business cannot run in isolation. Largely, the business activity is carried out by people coming together with a purpose to serve a common cause. This team is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, body corporate etc. The rules of business are based on general principles of trade, social values, and statutory framework encompassing national or international boundaries. While these variables could be different for different businesses, different countries etc., the basic purpose is to add value to a product or service to satisfy customer demand.

The business activities require resources (which are limited & have multiple uses) primarily in terms of material, labour, machineries, factories and other services. The success of business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure that the businessman tracks the use of these resources. The resources are not free and thus one must be careful to keep an eye on cost of acquiring them as well.

As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in course of business. Two basic questions would have to be answered:

- (a) What is the result of business operations? This will be answered by finding out whether it has made profit or loss.
- (b) What is the position of the resources acquired and used for business purpose? How are these resources financed? Where the funds come from?

The answers to these questions are to be found continuously and the best way to find them is to record all the business activities. Recording of business activities has to be done in a scientific manner so that they reveal correct outcome. The science of book-keeping and accounting provides an effective solution. It is a branch of social science. This study material aims at giving a platform to the students to understand basic principles and concepts, which can be applied to accurately measure performance of business. After studying the various chapters included herein, the student should be able to apply the principles, rules, conventions and practices to different business situations like trading, manufacturing or service.

Over years, the art and science of accounting has evolved together with progress of trade and commerce at national and global levels. Professional accounting bodies have been doing intensive research to come up with accounting rules that will be applicable. Modern business is certainly more complex and continuous updating of these rules is required. Every stakeholder of the business is interested in a particular facet of information about the business. The art and science of accounting helps to put together these requirements of information as per universally accepted principles and also to interpret the results. It is interesting to note that each one of us has an accountant hidden in us. We do see our parents keep track of monthly expenses. We make a distinction between payment done for monthly grocery and that for buying a house or a car. We understand that while grocery is a monthly expense and buying a house is like creating a resource that has indefinite future use. The most common accounting record that each one of us knows is our bank passbook or a bank statement, which

the bank maintains for us. It tracks each rupee that we deposit or withdraw from our account. When we go to supermarket to buy something, the cashier at the counter will record things we buy and give us a 'bill' or 'cash memo'. These are source documents prepared for the transaction between the supermarket and us. While these are simple examples, there could be more complex business activities. A good working knowledge of keeping records is therefore necessary. Professional accounting bodies all over the world have been functioning with the objective of providing this body of knowledge. These institutions are engaged in imparting training in the field of accounting. Let us start with some basic definitions, concepts, conventions and practices used in development of this art as well as science.

Definitions

In order to understand the subject matter with clarity, let us study some of the definitions which depict the scope, content and purpose of Accounting. The field of accounting is generally sub-divided into:

- (a) Book-keeping
- (b) Financial Accounting
- (c) Cost Accounting and
- (d) Management Accounting

Let us understand each of these concepts.

(a) Book-keeping

The most common definition of book-keeping as given by J. R. Batliboi is "Book-keeping is an art of recording business transactions in a set of books."

As can be seen, it is basically a record keeping function. One must understand that not all dealings are, however, recorded. Only transactions expressed in terms of money will find place in books of accounts. These are the transactions which will ultimately result in transfer of economic value from one person to the other. Book-keeping is a continuous activity, the records being maintained as transactions are entered into. This being a routine and repetitive work, in today's world, it is taken over by the computer systems. Many accounting packages are available to suit different business organizations.

It is also referred to as a set of primary records. These records form the basis for accounting. It is an art because, the record is to be kept in such a manner that it will facilitate further processing and reporting of financial information which will be useful to all stakeholders of the business.

(b) Financial Accounting

It is commonly termed as Accounting. The American Institute of Certified Public Accountants defines Accounting as "an art of recoding, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character, and interpreting the results thereof."

The first step in the cycle of accounting is to identify transactions that will find place in books of accounts. Transactions having financial impact only are to be recorded. E.g. if a businessman negotiates with the customer regarding supply of products, this will not be recorded. The negotiation is a deal which will potentially create a transaction and will have exchange of money or money's worth. But unless this transaction is finally entered into, it will not be recorded in the books of accounts.

Secondly, the recording of the business transactions is done based on the Golden Rules of accounting (which are explained later) in a systematic manner. Transaction of similar nature are grouped together and recorded accordingly. e.g. Sales Transactions, Purchase Transactions, Cash Transactions etc. One has to interpret the transaction and then apply the relevant Golden Rule to make a correct entry thereof.

Thirdly, as the transactions increase in number, it will be difficult to understand the combined effect of the same by referring to individual records. Hence, the art of accounting also involves the step of summarizing them. With the aid of computers, this task is simplified in today's accounting world. The summarization will help users of the business information to understand and interpret business results.

Lastly, the accounting process provides the users with statements which will describe what has happened to the business. Remember the two basic questions we talked about, one to know whether business has made profit or loss and the other to know the position of resources that are used by the business.

It can be noted that although accounting is often referred to as an art, it is a science also. This is because it is based on universally applicable set of rules. However, it is not a pure science as there is a possibility of different interpretation.



(c) Cost Accounting

According to the Chartered Institute of Management Accountants (CIMA), Cost Accountancy is defined as "application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability as well as the presentation of information for the purpose of managerial decision-making."

It is a branch of accounting dealing with the classification, recording, allocation, summarization and reporting of current and prospective costs and analyzing their behaviours. Cost Accounting is frequently used to facilitate internal decision making and provides tools with which management can appraise performance and control costs of doing business. It primarily involves relating the costs to the different products produced and sold or services rendered by the business. While Financial Accounting deals with business transactions at a broader level, Cost Accounting aims at further breaking it up to the last possible level to indentify costs with products and services. It uses the same Financial Accounting documents and records. Modern computerized accounting packages like ERP systems provide for processing Financial as well as Cost Accounting records simultaneously.

This branch of accounting deals with the process of ascertainment of costs. The concept of cost is always applied with reference to a context. Knowledge of cost concepts and their application provide a very sound platform for decision making. Cost Accounting aims at equipping management with information that can be used for control on business activities.

(d) Management Accounting

Management Accounting is concerned with the use of Financial and Cost Accounting information to managers within organizations, to provide them with the basis in making informed business decisions that would allow them to be better equipped in their management and control functions. Unlike Financial Accounting information (which, for public companies, is public information), Management Accounting information is used within an organization (typically for decision-making) and is usually confidential and its access available only to a selected few.

According to the Chartered Institute of Management Accountants (CIMA), Management Accounting is "the process of identification, measurement, accumulation, analysis, preparation, interpretation and communication of information used by management to plan, evaluate and control within an entity and to assure appropriate use of and accountability for its resources. Management Accounting also comprises the preparation of financial reports for non management groups such as shareholders, creditors, regulatory authorities and tax authorities".

Basically, Management Accounting aims to facilitate management in formulating strategies, planning and constructing business activities, making decisions, optimal use of resources, and safeguarding assets of business.

These branches of accounting have evolved over years of research and are basically synchronized with the requirements of business organizations and all entities associated with them. We will now see what are they and how accounting satisfies various needs of different stakeholders.

Difference between Book-keeping and Accountancy:

The Significant difference between Book-keeping and Accountancy are:

| Sl No. | Points of difference | Book Keeping | Accountancy |
|--------|---------------------------|--|---|
| 1. | Meaning | Book-keeping is considered as end. | Accountancy is considered as beginning. |
| 2. | Functions | The primary stage of accounting function is called Book-keeping. | The overall accounting functions are guided by accountancy. |
| 3 | Depends | Book-keeping can provide the base of Accounting. | Accountancy depends on Book-keeping for its complete functions. |
| 4. | Data | The necessary data about financial performances and financial positions are taken from Book-keeping. | Accountancy can take its decisions, prepare reports and statements from the data taken from Book-keeping. |
| 5. | Recording of Transactions | Financial transactions are recorded on the basis of accounting principles, concepts and conventions. | Accountancy does not take any principles, concepts and conventions from Book-keeping. |

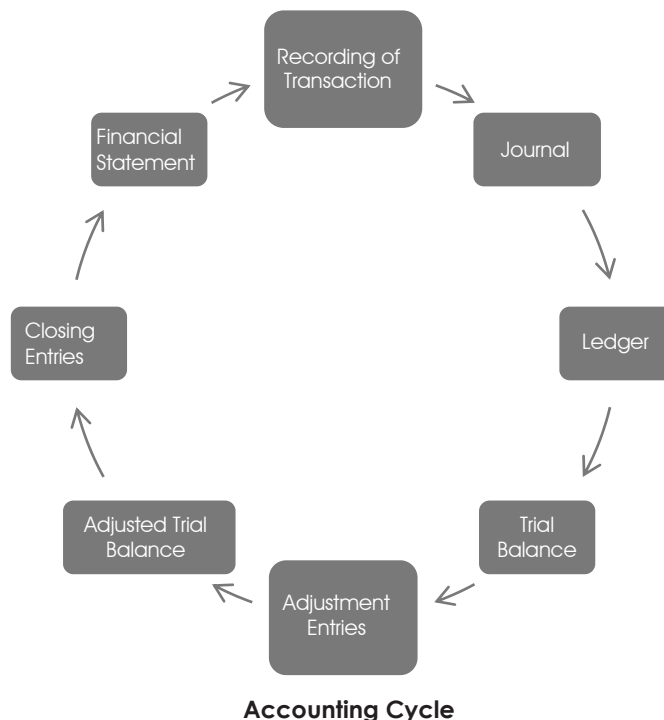
Difference between Management Accounting and Financial Accounting:

The significant difference between Management Accounting and Financial Accounting are:

| Management Accounting | Financial Accounting |
|--|---|
| 1. Management Accounting is primarily based on the data available from Financial Accounting. | 1. Financial Accounting is based on the monetary transactions of the enterprise. |
| 2. It provides necessary information to the management to assist them in the process of planning, controlling, performance evaluation and decision making. | 2. Its main focus is on recording and classifying monetary transactions in the books of accounts and preparation of financial statements at the end of every accounting period. |
| 3. Reports prepared in Management Accounting are meant for management and as per management requirement. | 3. Reports as per Financial Accounting are meant for the management as well as for shareholders and creditors of the concern. |
| 4. Reports may contain both subjective and objective figures. | 4. Reports should always be supported by relevant figures and it emphasizes on the objectivity of data. |
| 5. Reports are not subject to statutory audit. | 5. Reports are always subject to statutory audit. |
| 6. It evaluates the sectional as well as the entire performance of the business. | 6. It ascertains, evaluates and exhibits the financial strength of the whole business. |

Accounting Cycle

When complete sequence of accounting procedure is done which happens frequently and repeated in same directions during an accounting period, the same is called an accounting cycle.



Steps/Phases of Accounting Cycle

The steps or phases of accounting cycle can be developed as under:

- (a) **Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book.
- (b) **Journal:** The transactions are recorded in Journal chronologically.

- (c) **Ledger:** All journals are posted into ledger chronologically and in a classified manner.
- (d) **Trial Balance:** After taking all the ledger account's closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements.
- (e) **Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.
- (f) **Adjusted Trial Balance:** An adjusted Trail Balance may also be prepared.
- (g) **Closing Entries:** All the nominal accounts are to be closed by the transferring to Trading Account and Profit and Loss Account.

Financial Statements: Financial statement can now be easily prepared which will exhibit the true financial position and operating results.

Objectives of Accounting

The main objective of Accounting is to provide financial information to stakeholders. This financial information is normally given via financial statements, which are prepared on the basis of Generally Accepted Accounting Principles (GAAP). There are various accounting standards developed by professional accounting bodies all over the world. In India, these are governed by The Institute of Chartered Accountants of India, (ICAI). In the US, the American Institute of Certified Public Accountants (AICPA) is responsible to lay down the standards. The Financial Accounting Standards Board (FASB) is the body that sets up the International Accounting Standards. These standards basically deal with accounting treatment of business transactions and disclosing the same in financial statements.

The following objectives of accounting will explain the width of the application of this knowledge stream:

- (a) To ascertain the amount of profit or loss made by the business i.e. to compare the income earned versus the expenses incurred and the net result thereof.
- (b) To know the financial position of the business i.e. to assess what the business owns and what it owes.
- (c) To provide a record for compliance with statutes and laws applicable.
- (d) To enable the readers to assess progress made by the business over a period of time.
- (e) To disclose information needed by different stakeholders.

Let us now see which are different stakeholders of the business and what do they seek from the accounting information. This is shown in the following table.

| Stakeholder | Interest in business | Accounting Information |
|---|--|---|
| Owners / Investors / existing and potential | Profits or losses | Financial statements, Cost Accounting records, Management Accounting reports |
| Lenders | Assessment of capability of the business to pay interest and principal of money lent. Basically, they monitor the solvency of business | Financial statement and analysis thereof, reports forming part of accounts, valuation of assets given as security |
| Customers and suppliers | Stability and growth of the business | Financial and Cash flow statements to assess ability of the business to offer better business terms and ability to supply the products and services |
| Government | Whether the business is complying with various legal requirements | Accounting documents such as vouchers, extracts of books, information of purchase, sales, employee obligations etc. and financial statements |
| Employees and trade unions | Growth and profitability | Financial statements for negotiating pay packages |
| Competitors | Performance and possible tie-ups in the era of mergers and acquisitions | Accounting information to find out possible synergies |

Users of Accounting Information

Accounting provides information both to internal users and the external users. The internal users are all the organizational participants at all levels of management (i.e. top, middle and lower). Generally top level management requires information for planning, middle level management which requires information for controlling the operations. For internal use, the information is usually provided in the form of reports, for instance Cash Budget Reports, Production Reports, Idle Time Reports, Feedback Reports, whether to retain or replace an equipment decision reports, project appraisal report, and the like.

There are also the external users (e.g. Banks, Creditors). They do not have direct access to all the records of an enterprise, they have to rely on financial statements as the source of information. External users are basically, interested in the solvency and profitability of an enterprise.

Types of Accounting Information

Accounting information may be categorized in number of ways on the basis of purpose of accounting information, on the basis of measurement criteria and so on. The various types of accounting information are given below:

I. Accounting information relating to financial transactions and events.

(a) Financial Position- Information about financial position is primarily provided in a Balance Sheet. The financial position of an enterprise is affected by different factors, like -

- (i) Information about the economic resources controlled by the enterprise and its capacity in the past to alter these resources is useful in predicting the ability of the enterprise to generate cash and cash equivalents in the future.
- (ii) Information about financial structure is useful in predicting future borrowing needs and how future profits and cash flows will be distributed among those with an interest in the enterprise; it is also useful in predicting how successful the enterprise is likely to be in raising further finance.
- (iii) Information about liquidity and solvency is useful in predicting the ability of the enterprise to meet its financial commitments as they fall due. Liquidity refers to the availability of cash in the near future to meet financial commitments over this period. Solvency refers to the availability of cash over the longer term to meet financial commitments as they fall due.

(b) Financial Performance- Information about financial performance is primarily provided in a Statement of Profit and Loss which is also known as Income Statement.

Information about the performance of an enterprise and its profitability, is required in order to assess potential changes taking place in the economic resources that it is likely to control in the future. Information about variability of performance is also important in this regard. Information about performance is necessary in predicting the capacity to generate cash flows from its available resource. It is an important input in forming judgments about the effectiveness of an enterprise to utilize resources.

(c) Cash Flows—Information about cash flows is provided in the financial statements by means of a cash flow statement.

Information concerning cash flows is useful in providing the users with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash and cash equivalent.

These information may be classified as follows:

- (i) on the basis of Historical Cost,
- (ii) on the basis of Current Cost,
- (iii) on the basis of Realizable Value,
- (iv) on the basis of Present Value

II. Accounting information relating to cost of a product, operation or function.

III. Accounting information relating to planning and controlling the activities of an enterprise for internal reporting.



This information may further be classified as follows:

- (i) Information relating to Finance Area
- (ii) Information relating to Production Area
- (iii) Information relating to Marketing Area
- (iv) Information relating to Personnel Area
- (v) Information relating to Other Areas (such as Research & Development).

IV. Accounting information relating to Social Effects of business decisions.

V. Accounting information relating to Environment and Ecology.

VI. Accounting information relating to Human Resources.

Basic Accounting Terms

In order to understand the subject matter clearly, one must grasp the following common expressions always used in business accounting. The aim here is to enable the student to understand with these often used concepts before we embark on accounting procedures and rules. You may note that these terms can be applied to any business activity with the same connotation.

- (i) **Transaction:** It means an event or a business activity which involves exchange of money or money's worth between parties. The event can be measured in terms of money and changes the financial position of a person e.g. purchase of goods would involve receiving material and making payment or creating an obligation to pay to the supplier at a future date. Transaction could be a cash transaction or credit transaction. When the parties settle the transaction immediately by making payment in cash or by cheque, it is called a cash transaction. In credit transaction, the payment is settled at a future date as per agreement between the parties.
- (ii) **Goods/Services :** These are tangible article or commodity in which a business deals. These articles or commodities are either bought and sold or produced and sold. At times, what may be classified as 'goods' to one business firm may not be 'goods' to the other firm. e.g. for a machine manufacturing company, the machines are 'goods' as they are frequently made and sold. But for the buying firm, it is not 'goods' as the intention is to use it as a long term resource and not sell it. Services are intangible in nature which are rendered with or without the object of earning profits.
- (iii) **Profit:** The excess of Revenue Income over expense is called profit. It could be calculated for each transaction or for business as a whole.
- (iv) **Loss:** The excess of expense over income is called loss. It could be calculated for each transaction or for business as a whole.
- (v) **Asset:** Asset is a resource owned by the business with the purpose of using it for generating future profits. Assets can be Tangible and Intangible. Tangible Assets are the Capital assets which have some physical existence. They can, therefore, be seen, touched and felt, e.g. Plant and Machinery, Furniture and Fittings, Land and Buildings, Books, Computers, Vehicles, etc. The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as Intangible Assets. They cannot be seen or felt although they help to generate revenue in future, e.g. Goodwill, Patents, Trade-marks, Copyrights, Brand Equity, Designs, Intellectual Property, etc.

Assets can also be classified into Current Assets and Non-Current Assets.

Current Assets – An asset shall be classified as Current when it satisfies any of the following :

- (a) It is expected to be realised in, or is intended for sale or consumption in the Company's normal Operating Cycle,
- (b) It is held primarily for the purpose of being traded ,
- (c) It is due to be realised within 12 months after the Reporting Date, or
- (d) It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a Liability for at least 12 months after the Reporting Date.

Non-Current Assets – All other Assets shall be classified as Non-Current Assets. e.g. Machinery held for long term etc.

- (vi) **Liability:** It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties. E.g. when goods are bought on credit, the firm will create an obligation to pay to the supplier the price of goods on an agreed future date or when a loan is taken from bank, an obligation to pay interest and principal amount is created. Depending upon the period of holding, these obligations could be further classified into Long Term or non-current liabilities and Short Term or current liabilities.

Current Liabilities – A liability shall be classified as Current when it satisfies any of the following :

- (a) It is expected to be settled in the Company's normal Operating Cycle,
- (b) It is held primarily for the purpose of being traded,
- (c) It is due to be settled within 12 months after the Reporting Date, or
- (d) The Company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that could, at the option of the counterparty, result in its settlement by the issue of Equity Instruments do not affect its classification)

Non-Current Liabilities – All other Liabilities shall be classified as Non-Current Liabilities. E.g. Loan taken for 5 years, Debentures issued etc.

- (vii) **Internal Liability :** These represent proprietor's equity, i.e. all those amount which are entitled to the proprietor, e.g., Capital, Reserves, Undistributed Profits, etc.

- (viii) **Working Capital :** In order to maintain flows of revenue from operation, every firm needs certain amount of current assets. For example, cash is required either to pay for expenses or to meet obligation for service received or goods purchased, etc. by a firm. On identical reason, inventories are required to provide the link between production and sale. Similarly, Accounts Receivable generate when goods are sold on credit. Cash, Bank, Debtors, Bills Receivable, Closing Stock, Prepayments etc. represent current assets of firm. The whole of these current assets form the working capital of a firm which is termed as Gross Working Capital.

Gross Working Capital = Total Current Assets

= Long term internal liabilities plus long term debts plus the current liabilities minus the amount blocked in the fixed assets.

There is another concept of working capital. Working capital is the excess of current assets over current liabilities. That is the amount of current assets that remain in a firm if all its current liabilities are paid. This concept of working capital is known as Net Working Capital which is a more realistic concept.

Working Capital (Net) = Current Assets – Currents Liabilities.

- (ix) **Contingent Liability :** It represents a potential obligation that could be created depending on the outcome of an event. E.g. if supplier of the business files a legal suit, it will not be treated as a liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that it is treated as a contingent liability. Please note that contingent liability is not recorded in books of account, but disclosed by way of a note to the financial statements.
- (x) **Capital :** It is amount invested in the business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business activity. From business point of view, capital of owners is a liability which is to be settled only in the event of closure or transfer of the business. Hence, it is not classified as a normal liability. For corporate bodies, capital is normally represented as share capital.
- (xi) **Drawings :** It represents an amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use. e.g. if the life insurance premium of proprietor or a partner of business is paid from the business cash, it is called drawings. Drawings will result in reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.
- (xii) **Net worth :** It represents excess of total assets over total liabilities of the business. Technically, this amount is available to be distributed to owners in the event of closure of the business after payment of all liabilities.



That is why it is also termed as Owner's Equity. A profit making business will result in increase in the owner's equity whereas losses will reduce it.

- (xiii) **Non-current Investments** : Non-current Investments are investments which are held beyond the current period as to sale or disposal. e. g. Fixed Deposit for 5 years.
- (xiv) **Current Investments** : Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made. e. g. 11 months Commercial Paper.
- (xv) **Debtor** : The sum total or aggregate of the amounts which the customer owe to the business for purchasing goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Receivable, or Book-Debts or Debtors. In other words, Debtors are those persons from whom a business has to recover money on account of goods sold or service rendered on credit. These debtors may again be classified as under:
 - (i) Good debts : The debts which are sure to be realized are called good debts.
 - (ii) Doubtful Debts : The debts which may or may not be realized are called doubtful debts.
 - (iii) Bad debts : The debts which cannot be realized at all are called bad debts.

It must be remembered that while ascertaining the debtors balance at the end of the period certain adjustments may have to be made e.g. Bad Debts, Discount Allowed, Returns Inwards, etc.

- (xvi) **Creditor** : A creditor is a person to whom the business owes money or money's worth. e.g. money payable to supplier of goods or provider of service. Creditors are generally classified as Current Liabilities.
- (xvii) **Capital Expenditure**: This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from. e. g. amount paid to buy a computer for office use is a capital expenditure. At times expenditure may be incurred for enhancing the production capacity of the machine. This also will be a capital expenditure. Capital expenditure forms part of the Balance Sheet.
- (xviii) **Revenue expenditure**: This represents expenditure incurred to earn revenue of the current period. The benefits of revenue expenses get exhausted in the year of the incurrence. e.g. repairs, insurance, salary & wages to employees, travel etc. The revenue expenditure results in reduction in profit or surplus. It forms part of the Income Statement.
- (xix) **Balance Sheet**: It is the statement of financial position of the business entity on a particular date. It lists all assets, liabilities and capital. It is important to note that this statement exhibits the state of affairs of the business as on a particular date only. It describes what the business owns and what the business owes to outsiders (this denotes liabilities) and to the owners (this denotes capital). It is prepared after incorporating the resulting profit/losses of Income Statement.
- (xx) **Profit and Loss Account or Income Statement**: This account shows the revenue earned by the business and the expenses incurred by the business to earn that revenue. This is prepared usually for a particular accounting period, which could be a month, quarter, a half year or a year. The net result of the Profit and Loss Account will show profit earned or loss suffered by the business entity.
- (xxi) **Trade Discount**: It is the discount usually allowed by the wholesaler to the retailer computed on the list price or invoice price. e.g. the list price of a TV set could be ₹ 15000. The wholesaler may allow 20% discount thereof to the retailer. This means the retailer will get it for ₹ 12000 and is expected to sale it to final customer at the list price. Thus the trade discount enables the retailer to make profit by selling at the list price. Trade discount is not recorded in the books of accounts. The transactions are recorded at net values only. In above example, the transaction will be recorded at ₹ 12000 only.
- (xxii) **Cash Discount**: This is allowed to encourage prompt payment by the debtor. This has to be recorded in the books of accounts. This is calculated after deducting the trade discount. e.g. if list price is ₹ 15000 on which a trade discount of 20% and cash discount of 2% apply, then first trade discount of ₹ 3000 (20% of ₹ 15000) will be deducted and the cash discount of 2% will be calculated on ₹ 12000 (₹15000 – ₹ 3000). Hence the cash discount will be ₹ 240/- (2% of ₹ 12000) and net payment will be ₹ 11,760 (₹12,000 - ₹ 240)

Let us see if we can apply these in the following illustrations.

Illustration 1.

Fill in the blanks:

- (a) The cash discount is allowed by _____ to the _____.
- (b) Profit means excess of _____ over _____.
- (c) Debtor is a person who _____ to others.
- (d) In a credit transaction, the buyer is given a _____ facility.
- (e) The fixed asset is generally held for _____.
- (f) The current liabilities are obligations to be settled in _____ period.
- (g) The withdrawal of money by the owner of business is called _____.
- (h) The amount invested by owners into business is called _____.
- (i) Transaction means exchange of money or money's worth for _____.
- (j) The net result of an income statement is _____ or _____.
- (k) The _____ shows financial position of the business as on a particular date.
- (l) The _____ discount is never entered in the books of accounts.
- (m) Vehicles represent _____ expenditure while repairs to vehicle would mean _____ expenditure.
- (n) Net worth is excess of _____ over _____.

Solution:

- (a) creditor, debtor
- (b) income, expenditure
- (c) Owes
- (d) Credit
- (e) Longer period
- (f) Short
- (g) Drawings
- (h) Capital
- (i) Value
- (j) Profit, loss
- (k) Balance sheet
- (l) Trade
- (m) Capital, revenue
- (n) Total assets, total liabilities

Illustration 2.

Give one word or a term used to describe the following:-

- (a) An exchange of benefit for value
- (b) A transaction without immediate cash settlement.
- (c) Commodities in which a business deals.



- (d) Excess of expenditure over income.
- (e) Things of value owned by business to earn future profits.
- (f) Amount owed by business to others.
- (g) An obligation which may or may not materialise.
- (h) An allowance by a creditor to debtor for prompt payment.
- (i) Assets like brand value, copy rights, goodwill.

Solution:

(a) Transaction, (b) Credit transaction, (c) Goods, (d) Loss, (e) Assets, (f) Liability, (g) Contingent Liability, (h) Cash Discount, (i) Intangible Asset.

1.2 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP). These are the common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

GAAP is to be followed by companies so that investors have a optimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP cover such aspects like revenue recognition, balance sheet item classification and outstanding share measurements.

1.3 ACCOUNTING CONCEPTS AND CONVENTIONS

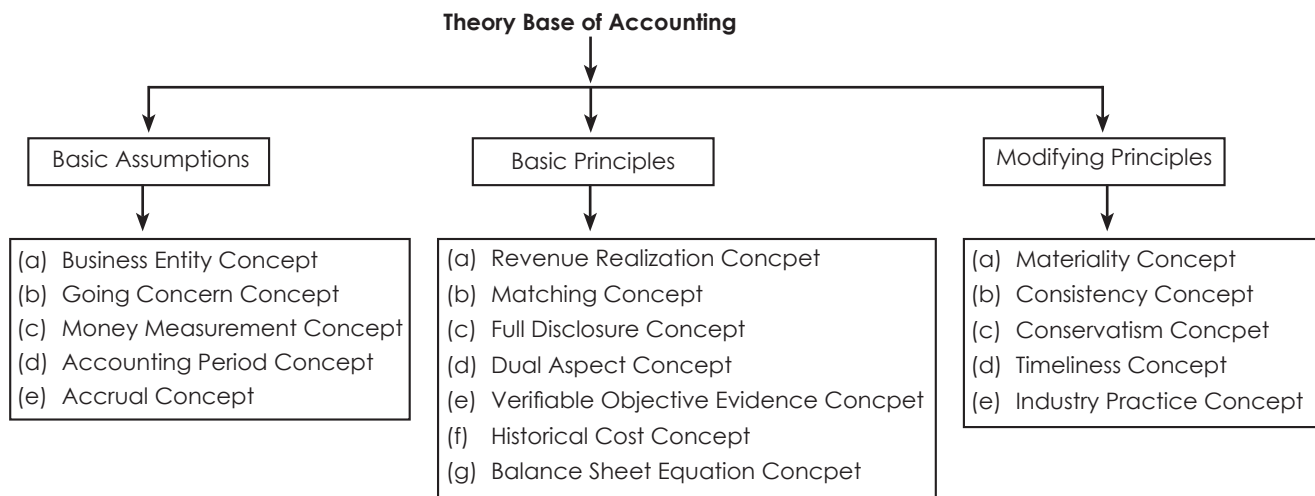
As seen earlier, the accounting information is published in the form of financial statements. The three basic financial statements are

- (i) The Profit & Loss Account that shows net business result i.e. profit or loss for a certain periods.
- (ii) The Balance Sheet that exhibits the financial strength of the business as on a particular dates.
- (iii) The Cash Flow Statement that describes the movement of cash from one date to the other.

As these statements are meant to be used by different stakeholders, it is necessary that the information contained therein is based on definite principles, concrete concepts and well accepted convention.

Accounting principles are basic guidelines that provide standards for scientific accounting practices and procedures. They guide as to how the transactions are to be recorded and reported. They assure uniformity and understandability. Accounting concepts lay down the foundation for accounting principles. They are ideas essentially at mental level and are self-evident. These concepts ensure recording of financial facts on sound bases and logical considerations. Accounting conventions are methods or procedures that are widely accepted. When transactions are recorded or interpreted, they follow the conventions. Many times, however, the terms-principles, concepts and conventions are used interchangeably.

Professional Accounting Bodies have published statements of these concepts. Over years, many of these concepts are being challenged as outlived. Yet, no major deviations have been made as yet. Path breaking ideas have emerged and the accounting standards of modern days do require companies to record and report transactions which may not be necessarily based on concepts that are in vogue for long. It is essential to study accounting from the basic levels and understand these concepts in entirety.



A. BASIC ASSUMPTIONS

(a) Business Entity Concept

As per this concept, the business is treated as distinct and separate from the individuals who own or manage it. When recording business transactions, the important question is how will it affect the business entity? How they affect the persons who own it or run it or otherwise associated with it is irrelevant. Application of this concept enables recording of transactions of the business entity with its owners or managers or other stakeholders. For example, if the owner pays his personal expenses from business cash, this transaction can be recorded in the books of business entity. This transaction will take the cash out of business and also reduce the obligation of the business towards the owner.

At times it is difficult to separate owners from the business. Consider an individual, who runs a small retail outlet. In the eyes of law, there is no distinction made between financial affairs of the outlet with that of the individual. The creditors of the retail outlet can sue the individual and collect his claim from personal resources of the individual. However, in accounting, the records are kept as distinct for the retail outlet and the individual respectively. For certain forms of business entities, such as limited companies this distinction is easier. The limited companies are separate legal persons in the eyes of law as well.

The entity concept requires that all the transactions are to be viewed, interpreted and recorded from 'business entity' point of view. An accountant steps into the shoes of the business entity and decides to account for the transactions. The owner's capital is the obligation of business and it has to be paid back to the owner in the event of business closure. Also, the profit earned by the business will belong to the owner and hence is treated as owner's equity.

(b) Going Concern Concept

The basic principles of this concept is that business is assumed to exist for an indefinite period and is not established with the objective of closing it down. So unless there is good evidence to the contrary, the accountant assumes that a business entity is a 'going concern' - that it will continue to operate as usual for a longer period of time. It will keep getting money from its customers, pay its creditors, buy and sell goods, use assets to earn profits in future. If this assumption is not considered, one will have to constantly value the worth of the assets and resource. This is not practicable. This concept enables the accountant to carry forward the values of assets and liabilities from one accounting period to the other without asking the question about usefulness and worth of the assets and recoverability of the receivables.

The going concern concept forms a sound basis for preparation of a Balance Sheet.

(c) Money Measurement Concept

A business transaction will always be recorded if it can be expressed in terms of money. The advantage of this concept is that different types of transactions could be recorded as homogenous entries with money as common denominator. A business may own ₹ 3 Lacs cash, 1500 kg of raw material, 10 vehicles, 3 computers etc. Unless each of these is expressed in terms of money, we cannot find out the assets owned by the business. When expressed in the common measure of money, transactions could be added or subtracted to find out

the combined effect. In the above example, we could add values of different assets to find the total assets owned.

The application of this concept has a limitation. When transactions are recorded in terms of money, we only consider the absolute value of the money. The real value of the money may fluctuate from time to time due to inflation, exchange rate changes, etc. This fact is not considered when recording the transaction.

(d) The Accounting Period Concept

We have seen that as per the going-concern concept the business entity is assumed to have an indefinite life. Now if we were to assess whether the business has made profit or loss, should we wait until this indefinite period is over? Would it mean that we will not be able to assess the business performance on an ongoing basis? Does it deprive all stakeholders the right to the accounting information? Would it mean that the business will not pay income tax as no income will be computed?

To circumvent this problem, the business entity is supposed to be paused after a certain time interval. This time interval is called an accounting period. This period is usually one year, which could be a calendar year i.e. 1st January to 31st December or it could be a fiscal year in India as 1st April to 31st March. The business organizations have the freedom to choose their own accounting year. For certain organizations, reporting of financial information in public domain are compulsory. In India, listed companies must report their quarterly unaudited financial results and yearly audited financial statements. For internal control purpose, many organizations prepare monthly financial statements. The modern computerized accounting systems enable the companies to prepare real-time online financials at the click of button.

Businesses are living, continuous organisms. The splitting of the continuous stream of business events into time periods is thus somewhat arbitrary. There is no significant change just because one accounting period ends and a new one begins. This results into the most difficult problem of accounting of how to measure the net income for an accounting period. One has to be careful in recognizing revenue and expenses for a particular accounting period. Subsequent section on accounting procedures will explain how one goes about it in practice.

(e) The Accrual Concept

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

When goods are sold on credit as per normally accepted trade practices, the business gets the legal right to claim the money from the customer. Acquiring such right to claim the consideration for sale of goods or services is called accrual of revenue. The actual collection of money from customer could be at a later date.

Similarly, when the business procures goods or services with the agreement that the payment will be made at a future date, it does not mean that the expense effect should not be recognized. Because an obligation to pay for goods or services is created upon the procurement thereof, the expense effect also must be recognized.

Today's accounting systems based on accrual concept are called as Accrual System or Mercantile System of Accounting.

B. BASIC PRINCIPLES

(a) The Revenue Realisation Concept

While the conservatism concept states whether or not revenue should be recognized, the concept of realisation talks about what revenue should be recognized. It says amount should be recognized only to the tune of which it is certainly realizable. Thus, mere getting an order from the customer won't make it eligible to recognize as revenue. The reasonable certainty of realizing the money will come only when the goods ordered are actually supplied to the customer and he is billed. This concept ensures that income unearned or unrealized will not be considered as revenue and the firms will not inflate profits.

Consider that a store sales goods for ₹ 25 lacs during a month on credit. The experience and past data shows that generally 2% of the amount is not realized. The revenue to be recognized will be ₹ 24.50 lacs. Although conceptually the revenue to be recognized at this value, in practice the doubtful amount of ₹ 50 thousand (2% of ₹ 25 lacs) is often considered as expense.

(b) The Matching Concept

As we have seen the sale of goods has two effects: (i) a revenue effect, which results in increase in owner's equity by the sales value of the transaction and (ii) an expense effect, which reduces owner's equity by the cost of goods sold, as the goods go out of the business. The net effect of these two effects will reflect either profit or loss. In order to correctly arrive at the net result, both these aspects must be recognized during the same accounting period. One cannot recognize only the revenue effect thereby inflating the profit or only the expense effect which will deflate the profit. Both the effects must be recognized in the same accounting period. This is the principle of matching concept.

To generalize, when a given event has two effects – one on revenue and the other on expense, both must be recognized in the same accounting period.

(c) Full Disclosure Concept

As per this concept, all significant information must be disclosed. Accounting data should properly be clarified, summarized, aggregated and explained for the purpose of presenting the financial statements which are useful for the users of accounting information. Practically, this principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm. This principle is going to be popular day by day as per Companies Act, 1956 major provisions for disclosure of essential information about accounting data and as such, concealment of material information, at present, is not very easy. Thus, full disclosure must be made for such material information which are useful to the users of accounting information.

(d) Dual Aspect Concept

The assets represent economic resources of the business, whereas the claims of various parties on business are called obligations. The obligations could be towards owners (called as owner's equity) and towards parties other than the owners (called as liabilities).

When a business transaction happens, it will involve use of one or the other resource of the business to create or settle one or more obligations. e.g. consider Mr. Suresh starts a business with the investment of ₹ 25 lacs. Here, the business has got a resource of cash worth ₹ 25 lacs (which is its asset), but at the same time it has created an obligation of business towards Mr. Suresh that in the event of business closure, the money will be paid back to him. This could be shown as:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

In other words,

Cash brought in by Mr. Suresh (₹ 25 lacs) = Liability of business towards Mr. Suresh (₹ 25 lacs)

We know that liability of the business could be towards owners and parties other than owners, this equation could be re-written as:

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

$$\text{Cash ₹ 25,00,000} = \text{Liabilities ₹ nil} + \text{Mr. Suresh's equity ₹ 25,00,000}$$

This is the fundamental accounting equation shown as formal expression of the dual aspect concept. This powerful concept recognizes that every business transaction has dual impact on the financial position. Accounting systems are set up to simultaneously record both these aspects of every transaction; that is why it is called as Double-entry system of accounting. In its present form the double entry system of accounting owes its existence to an Italian expert Mr. Luca Pacioli in the year 1495.

Continuing with our example of Mr. Suresh, now let us consider he borrows ₹ 15 lacs from bank. The dual aspect of this transaction-on one hand the business cash will increase by ₹ 15 lacs and a liability towards the bank will be created for ₹ 15 lacs.

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

$$\text{Cash ₹ 40,00,000} = \text{Liabilities ₹ 15,00,000} + \text{Mr. Suresh's equity ₹ 25,00,000}$$



The student must note that the dual aspect concept entails recognition of the two effects of each transaction. These effects are of equal amount and reverse in nature. How to decide these two aspects?

The golden rules of accounting are used to arrive at this decision. After recording both aspects of the transaction, the basic accounting equation will always balance or be equal.

The above concepts find the application in preparation of the Balance Sheet which is the statement of assets and liabilities as on a particular date. We will now see some more concepts that are important for preparation of Profit and Loss Account or Income Statement.

(e) Verifiable Objective Evidence Concept

Under this principle, accounting data must be verified. In other words, documentary evidence of transactions must be made which are capable of verification by an independent respect. In the absence of such verification, the data which will be available will neither be reliable nor be dependable, i.e., these should be biased data. Verifiability and objectivity express dependability, reliability and trustworthiness that are very useful for the purpose of displaying the accounting data and information to the users.

(f) Historical Cost Concept

Business transactions are always recorded at the actual cost at which they are actually undertaken. The basic advantage is that it avoids an arbitrary value being attached to the transactions. Whenever an asset is bought, it is recorded at its actual cost and the same is used as the basis for all subsequent accounting purposes such as charging depreciation on the use of asset, e.g. if a production equipment is bought for ₹ 1.50 crores, the asset will be shown at the same value in all future periods when disclosing the original cost. It will obviously be reduced by the amount of depreciation, which will be calculated with reference to the actual cost. The actual value of the equipment may rise or fall subsequent to the purchase, but that is considered irrelevant for accounting purpose as per the historical cost concept.

The limitation of this concept is that the Balance Sheet does not show the market value of the assets owned by the business and accordingly the owner's equity will not reflect the real value. However, on an ongoing basis, the assets are shown at their historical costs as reduced by depreciation.

(g) Balance Sheet Equation Concept

Under this principle, all which has been received by us must be equal to that has been given by us and needless to say that receipts are clarified as debits and giving is clarified as credits. The basic equation, appears as :-

$$\text{Debit} = \text{Credit}$$

Naturally every debit must have a corresponding credit and vice-e-versa. So, we can write the above in the following form –

$$\text{Expenses} + \text{Losses} + \text{Assets} = \text{Revenues} + \text{Gains} + \text{Liabilities}$$

And if expenses and losses, and incomes and gains are set off, the equation takes the following form –

$$\text{Asset} = \text{Liabilities}$$

or, $\text{Asset} = \text{Equity} + \text{External Liabilities}$

i.e., the Accounting Equation.

C. MODIFYING PRINCIPLES

(a) The Concept of Materiality

This is more of a convention than a concept. It proposes that while accounting for various transactions, only those which may have material effect on profitability or financial status of the business should have special consideration for reporting. This does not mean that the accountant should exclude some transactions from recording, e.g. even ₹ 20 worth conveyance paid must be recorded as expense. What this convention claims is to attach importance to material details and insignificant details should be ignored while deciding certain accounting treatment. The concept of materiality is subjective and an accountant will have to decide on merit of each case. Generally, the effect is said to be material, if the knowledge of an event would influence the decision of an informed stakeholder.

The materiality could be related to information, amount, procedure and nature. Error in description of an asset or wrong classification between capital and revenue would lead to materiality of information. Say, If postal stamps of ₹ 500 remain unused at the end of accounting period, the same may not be considered for recognizing as inventory on account of materiality of amount. Certain accounting treatments depend upon procedures laid down by accounting standards. Some transactions are by nature material irrespective of the amount involved. e.g. audit fees, loan to directors.

(b) The Concept of Consistency

This concept advocates that once an organization decides to adopt a particular method of revenue or expense recognition in line with the other concepts, the same should be consistently applied year after year, unless there is a valid reason for change in the method. Lack of consistency would result in the financial information becoming non-comparable between the different accounting periods. The insistence of this concept would result in avoidance of window dressing the results by choosing the accounting method by convenience and thereby either inflating or understating net income.

Consider an example. An asset of ₹ 10 lacs is purchased by a business. It is estimated to have useful life of 5 years. It will follow that the asset will be depreciated over a period of 5 years at the rate of ₹ 2 lacs every year. The estimate of useful life and the rate of depreciation cannot be changed from one period to the other without a valid reason. Suppose the firm applies the same depreciation rate for the first three years and due to change in technology the asset becomes obsolete, the whole of the remaining amount could be expensed out in the fourth year.

However, it may be difficult to be consistent if the business entities have two factories in different countries which have different statutory requirement for accounting treatment.

(c) The Prudence Concept

Accountants who prepare financial statements of the business, like other human being, would like to give a favourable report on how well the business has performed during an accounting period. However, prudent reporting based on skepticism builds confidence in the results and in the long run best serves all the divergent interests of users of financial statements. This philosophy of prudence leads to the conservatism concept.

The concept underlines the prudence of under-stating than over-stating the net income of an entity for a period and the net assets as on a particular date. This is because business is done in situations of uncertainty. For years, this concept was meant to "anticipate no profits but recognize all losses". This can be stated as

- (i) Delay in recognizing income unless one is reasonably sure
- (ii) Immediately recognize expenses when reasonably sure

This, of course, does not mean to overdo and create window dressing in reporting. e.g. if the business has sold ₹ 20 Lacs worth goods on the last day of accounting period and also received a cheque for the same, one cannot argue that the revenue should not be recognized as it is not certain whether the cheque will be cleared by the bank. One cannot stretch the conservatism concept too much. But at the same time, if the business has to receive ₹ 5 lacs from a customer to whom goods were sold quite some time ago and no payments are forthcoming, then while determining the net income for the period, the accountant must judge the likelihood of the recoverability of this money and the prudence will prevail to make a provision for this amount as doubtful debtors.

Let us take another example. A business had purchased goods for ₹ 10 lacs before the end of an accounting period. If sold at the usual selling price, the goods would fetch the price of ₹ 12.50 lacs. Due to innovative product introduced by the competition, the goods are likely to be sold for ₹ 9 lacs only. At what value should the goods be shown in the balance sheet? Would it be at ₹ 10 lacs being the actual cost of buying? Or would it be at ₹ 9 lacs? Here, the conservatism principle will come in play. The stock of goods will be valued at ₹ 9 lacs, being the lower of cost or net realisable value, as per AS-2.

(d) Timeliness Concept

Under this principle, every transaction must be recorded in proper time. Normally, when the transaction is made, the same must be recorded in the proper books of accounts. In short, transaction should be recorded date-wise in the books. Delay in recording such transaction may lead to manipulation, misplacement of



vouchers, misappropriation etc. of cash and goods. This principle is followed particularly while verifying day to day cash balance. Principle of timeliness is also followed by banks, i.e. every bank verifies the cash balance with their cash book and within the day, the same must be completed.

(e) Industry Practice

As there are different types of industries, each industry has its own characteristics and features. There may be seasonal industries also. Every industry follows the principles and assumption of accounting to perform their own activities. Some of them follow the principles, concepts and conventions in a modified way. The accounting practice which has always prevailed in the industry is followed by it. e.g Electric supply companies, Insurance companies maintain their accounts in a specific manner. Insurance companies prepare Revenue Account just to ascertain the profit/loss of the company and not Profit and Loss Account. Similarly, non trading organizations prepare Income and Expenditure Account to find out Surplus or Deficit.

Conclusion

The above paragraphs bring out essentially broad concepts and conventions that lay down principles to be followed for accounting of business transaction. While going through the different topics, students are advised to keep track of concepts applicable for various accounting treatment. One would have by now understood the importance of these concepts in preparation of basic financial statements. More clarity will emerge as one explores the ocean of different business transactions arising out of complex business situations. The legal and professional requirements also have their say in deciding the accounting treatment. Let us see if you can apply these concepts in the following illustrations.

Exercise:

Recognise the accounting concept in the following:

- (1) The business will run for an indefinite period.
- (2) The business is distinct and separate from its owners.
- (3) The transactions are recorded at their original cost.
- (4) The transactions recorded are those that can be expressed in money terms.
- (5) Revenues will be recognized only if there is reasonable certainty that it will be paid for.
- (6) Accounting treatment once decided should be followed period after period.
- (7) Every transaction has two effects to be recorded in books of accounts.
- (8) Transactions are recorded even if an obligation is created and actual cash is not involved.
- (9) Stock of goods is valued at lower of its cost and realizable value.
- (10) Effects of an event must be recognized in the same accounting period.

Events and Transactions:

Event is a transaction or change recognized on the financial statements of an accounting entity. Accounting events can be either external or internal. An external event would occur with an outside party, such as the purchase or sales of a good. An internal event would involve changes in the accounting entity's records, such as adjusting an account on the financial statements.

An accounting event is any financial event that would impact the account balances of a company's financial statements. Every time the company uses or receives cash, or adjusts an entry in its accounting records, an accounting event has occurred.

Transactions vs. Events

Transaction is exchange of an asset with consideration of money value while event is anything in general purpose which occur at specific time and particular place. All transactions are events but all events are not transactions. This is because in order events to be called transaction an event must involve exchange of values.

Voucher:

It is a written instrument that serves to confirm or witness (vouch) for some fact such as a transaction. Commonly, a voucher is a document that shows goods have bought or services have been rendered, authorizes payment, and indicates the ledger account(s) in which these transactions have to be recorded.

Types of Voucher - Normally the following types of vouchers are used. i.e.:

- (i) Receipt Voucher
- (ii) Payment Voucher
- (iii) Non-Cash or Transfer Voucher
- (iv) Supporting Voucher

(i) Receipt Voucher

Receipt voucher is used to record cash or bank receipt. Receipt vouchers are of two types. i.e.

- (a) Cash receipt voucher – it denotes receipt of cash
- (b) Bank receipt voucher – it indicates receipt of cheque or demand draft

(ii) Payment Voucher

Payment voucher is used to record a payment of cash or cheque. Payment vouchers are of two types. i.e.

- (a) Cash Payment voucher – it denotes payment of cash
- (b) Bank Payment voucher – it indicates payment by cheque or demand draft.

(iii) Non Cash Or Transfer Voucher

These vouchers are used for non-cash transactions as documentary evidence. e.g., Goods sent on credit.

(iv) Supporting Vouchers

These vouchers are the documentary evidence of transactions that have happened.

Source Documents

Vouchers are the documentary evidence of the transactions so happened. Source documents are the basis on which transactions are recorded in subsidiary books i.e. source documents are the evidence and proof of transactions.

| Name of the Book | Source document |
|--------------------------|---|
| (a) Cash Book | Cash Memos, Cash Receipts and issue vouchers |
| (b) Purchase Books | Inward invoice received from the creditors of goods |
| (c) Sales Book | Outward Invoice issued to Debtors |
| (d) Return Inward Book | Credit Note issued to Debtors and Debit Notes received from Debtors |
| (e) Returns Outward Book | Debit Note issued to creditors and Credit Note received from creditors. |

The Concept of “Account”, “Debit” and “Credit”:

One must get conversant with these terms before embarking to learn actual record-keeping based on the rules.

An 'Account' is defined as a summarised record of transactions related to a person or a thing. e.g. when the business deals with customers and suppliers, each of the customers and supplier will be a separate account. We must know that each one of us is identified as a separate account by the bank when we open an account with them. The account is also related to things – both tangible and intangible.

e.g. land, building, equipment, brand value, trademarks etc. are some of the things. When a business transaction happens, one has to identify the 'account' that will be affected by it and then apply the rules to decide the accounting treatment.



Typically, an account is expressed as a statement in form of English letter 'T'. It has two sides. The left hand side is called as "Debit" side and the right hand side is called as "Credit" side. The debit is connoted as 'Dr' and the credit by 'Cr'. The convention is to write the Dr and Cr labels on both sides as shown below. Please see the following example:

| Dr. | Cash Account | Cr. |
|------------|--------------|-------------|
| Debit side | | Credit side |

Each side of the account will show effects, so that one can easily take totals of both sides and find out the difference between the two. Such difference in the two sides of an account is called 'balance'. If the total of debit side is more than the credit side, the balance is called as 'debit balance' and if the total of credit side is more than the debit side, the balance is called as 'credit balance'. If the debit and credit side are equal, the account will show 'nil balance'.

The balances are to be computed at the end of an accounting period. These balances are then considered for preparation of income statement and balance sheet. Let us see the example:

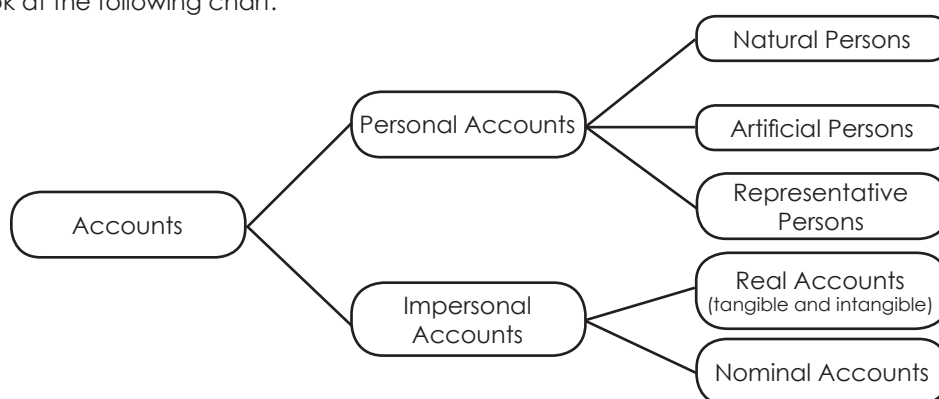
| Dr. | Cash Account | | Cr. |
|----------------------------|-----------------|--------------------------|-----------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| Cash brought into business | 1,00,000 | Paid for goods purchased | 50,000 |
| Received for goods sold | 25,000 | Paid for rent | 15,000 |
| | | Balance at the end | 60,000 |
| | 1,25,000 | | 1,25,000 |

It can be seen from the above example that the debit side of cash account shows the receipt of cash into the business and the credit side reflects the cash that has gone out of the business. What is the meaning of the balance at the end? Well, it shows that cash balance available in the business.

Types of Accounts:

We have seen that an account may be related to a person or a thing – tangible or intangible. While doing business transactions (that may be large in number and complex in nature), one may come across numerous accounts that are affected. How does one decide about accounting treatment for each of them? If common rules are to be applied to similar type of accounts, there must be a way to classify the account on the basis of their common characteristics.

Please take look at the following chart.



Let us see what each type of account means.

(1) Personal Account : As the name suggests these are accounts related to persons.

- (a) These persons could be natural persons like Suresh's A/c, Anil's A/c, Rani's A/c etc.
- (b) The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships etc. Accordingly, we could have Videocon Industries A/c, Infosys Technologies A/c, Charitable Trust A/c, Ali and Sons trading A/c, ABC Bank A/c, etc.

(c) There could be representative personal accounts as well. Although the individual identity of persons related to these is known, the convention is to reflect them as collective accounts. e.g. when salary is payable to employees, we know how much is payable to each of them, but collectively the account is called as 'Salary Payable A/c'. Similar examples are rent payable, Insurance prepaid, commission pre-received etc. The students should be careful to have clarity on this type and the chances of error are more here.

(2) Real Accounts : These are accounts related to assets or properties or possessions. Depending on their physical existence or otherwise, they are further classified as follows:

(a) Tangible Real Account – Assets that have physical existence and can be seen, and touched. e.g. Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.

(b) Intangible Real Account – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them. e.g. Goodwill A/c, Trade mark A/c, Patents & Copy Rights A/c, Intellectual Property Rights A/c and the like.

(3) Nominal Account : These accounts are related to expenses or losses and incomes or gains e.g. Salary and Wages A/c, Rent of Rates A/c, Travelling Expenses A/c, Commission received A/c, Loss by fire A/c etc.

The Accounting Process:

There are two approaches for deciding when to write on the debit side of an account and when to write on the credit side of an account:

- A. American Approach/ Modern Approach
- B. British Approach/ Traditional Approach/Double Entry System

A. American approach : In order to understand the rules of debit and credit according to this approach transactions are divided into five categories.

| | | |
|------------------------|-------------------------|-----|
| For Assets | Increase in Assets | Dr. |
| | Decrease in Assets | Cr. |
| For Liabilities | Decrease in Liabilities | Dr. |
| | Increase in Liabilities | Cr. |
| For Capital | Decrease in Capital | Dr. |
| | Increase in Capital | Cr. |
| For Incomes | Decrease in Income | Dr. |
| | Increase in Income | Cr. |
| For Expense | Increase in Expense | Dr. |
| | Decrease in Expense | Cr. |

Illustration 4.

Ascertain the debit and credit from the following particulars under Modern Approach.

- (i) Started business with capital.
- (ii) Bought goods for cash.
- (iii) Sold goods for cash.
- (iv) Paid salary.
- (v) Received Interest on Investment.
- (vi) Bought goods on credit from Mr. Y
- (vii) Paid Rent out of Personal cash

Solution:

| | Effect of Transaction | Account | To be debited/Credited |
|-----|-----------------------|--------------|------------------------|
| (a) | Increase in Cash | Cash A/c | Debit |
| | Increase in Capital | Capital A/c | Credit |
| (b) | Increase in Stock | Purchase A/c | Debit |
| | Decrease in Cash | Cash A/c | Credit |
| (c) | Increase in Cash | Cash A/c | Debit |
| | Decrease in Stock | Sale A/c | Credit |
| (d) | Increase in Expense | Salary A/c | Debit |
| | Decrease in Cash | Cash A/c | Credit |
| (e) | Increase in Cash | Cash A/c | Debit |
| | Increase in Income | Interest A/c | Credit |
| (f) | Increase in Stock | Purchase A/c | Debit |
| | Increase in Liability | Y A/c | Credit |
| (g) | Increase in Expense | Rent A/c | Debit |
| | Increase in Capital | Capital A/c | Credit |

B. British Approach or Double Entry System :

When one identifies the account that is getting affected by a transaction and type of that account, the next step is to apply the rules to decide whether the accounting treatment is to debit or credit that account. The Golden Rules will guide us whether the account is to be debited or credited.

There is one rule for each basic type of account i.e. personal, real and nominal. These rules are shown in the following chart.

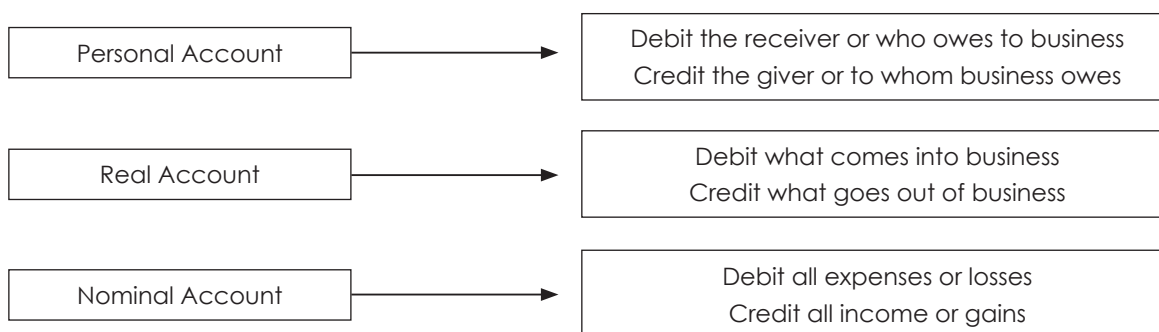


Illustration 5.

Ascertain the Debit Credit under British Approach or Double Entry System. Take Previous illustration

Solution:

| | Step-I | Step-II | Step-III | Step-IV |
|-----|--------------------------|------------------|----------------------|-----------------|
| (a) | Cash A/c Capital A/c | Real Personal | Comes in Giver | Debit Credit |
| (b) | Purchase A/c Cash A/c | Nominal Real | Expenses Goes out | Debit Credit |

| | | | | |
|------------|--------------------------|------------------|----------------------|-----------------|
| (c) | Cash A/c Sales A/c | Real Nominal | Comes in Incomes | Debit Credit |
| (d) | Salary A/c Cash A/c | Nominal Real | Expenses Goes out | Debit Credit |
| (e) | Cash A/c Interest A/c | Real Nominal | Comes in Incomes | Debit Credit |
| (f) | Purchase A/c Y' A/c | Nominal Personal | Expenses Giver | Debit Credit |
| (g) | Rent A/c Capital A/c | Nominal Personal | Expenses Giver | Debit Credit |

Accounting Equations:

The whole Financial Accounting depends on Accounting Equation which is also known as Balance Sheet Equation. The basic Accounting Equation is:

| |
|--|
| Assets = Liabilities + Owner's equity |
|--|

or $A = L + P$
 or $P = A - L$
 or $L = A - P$

} Where A = Assets, L = Liabilities, P = Capital

While trying to do this correlation, please note that incomes or gains will increase owner's equity an expenses or losses will reduce it.

Students are advised to go through the following illustration to understand this equation properly.

Illustration 6.

Prepare an Accounting Equation from the following transactions in the books of Mr. X for January, 2013:

- 1 Invested Capital in the firm ₹ 20,000
- 2 Purchased goods on credit from Das & Co. for ₹ 2,000
- 4 Bought plant for cash ₹ 8,000
- 8 Purchased goods for cash ₹ 4,000
- 12 Sold goods for cash (cost ₹ 4,000 + Profit ₹ 2,000) ₹ 6,000.
- 18 Paid to Das & Co. in cash ₹ 1,000
- 22 Received from B. Banerjee ₹ 300 (being a debtor)
- 25 Paid salary ₹ 6,000
- 30 Received interest ₹ 5,000
- 31 Paid wages ₹ 3,000

Solution:

Effect of transaction on Assets, Liabilities and Capital

| Date | Transaction | Assets = | Liabilities + | Capital |
|--------------------|---|------------------|----------------|---------------|
| January, 2013 1 | Invested Capital in the firm, ₹ 20,000 | 20,000 | - | 20,000 |
| 2 | Purchased goods on credit from Das & Co. ₹ 2,000 | +2,000 | +2,000 | - |
| | Revised Equation | 22,000 = | 2,000 + | 20,000 |
| 4 | Bought Plant for cash ₹ 8,000 | +8,000 -8,000 | - | - |
| | Revised Equation | 22,000 = | 2,000 + | 20,000 |
| 8 | Purchased goods for cash ₹ 4,000 | +4,000 -4,000 | - | - |
| | Revised Equation | 22,000 = | 2,000 + | 20,000 |
| 12 | Sold Goods for cash (Cost ₹ 4,000 + Profit ₹ 2,000) | +6,000 -4,000 | | +2,000 |
| | Revised Equation | 24,000 | 2,000 + | 22,000 |
| 18 | Paid to Das & Co. for ₹ 1,000 | -1,000 | -1,000 | |
| | Revised Equation | 23,000 = | 1,000 + | 22,000 |
| 22 | Received from B.Banerjee for ₹ 300 | +300 -300 | | |
| | Revised Equation | 23,000 = | 1,000 + | 22,000 |
| 25 | Paid salary for ₹ 6,000 | - 6,000 | | -6,000 |
| | Revised Equation | 17,000 = | 1,000 + | 16,000 |
| 30 | Received Interest for ₹ 5,000 | +5,000 | | +5,000 |
| | Revised Equation | 22,000 = | 1,000 + | 21,000 |
| 31 | Paid Wages for ₹3,000 | -3,000 | | -3,000 |
| | Revised Equation | 19,000 = | 1,000 + | 18,000 |

Accrual Basis and Cash Basis of Accounting

(i) Accrual Basis of Accounting

Accrual Basis of Accounting is a method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts for the period in which they accrue. This basis includes consideration relating to deferrals, allocations, depreciation and amortization. This basis is also referred to as mercantile basis of accounting. Under the Companies Act 1956, all companies are required to maintain the books of accounts according to accrual basis of accounting

(ii) Cash Basis of Accounting

Cash Basis of Accounting is a method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.

Distinction between Accrual Basis of Accounting and Cash Basis of Accounting

Accrual basis of accounting differs from Cash basis of accounting in the following respects:

| Basis of Distinction | Accrual Basis of Accounting | Cash Basis of Accounting |
|--|---|--|
| 1. Prepaid/Outstanding Expenses/accrued/unaccrued Income in Balance Sheet. | Under this, there may be prepaid/outstanding expenses and accrued/unaccrued incomes in the Balance Sheet. | Under this, there is no prepaid/outstanding expenses or accrued/unaccrued incomes. |
| 2. Higher/lower Income in case of prepaid expenses and accrued income | Income Statement will show a relatively higher income | Income Statement will show lower income. |
| 3. Higher/lower income incase of outstanding expenses and unaccrued income | Income Statement will show a relatively lower income. | Income Statement will show higher income. |
| 4. Recognition under the Companies Act. 1956. | This basis is recognized under the Companies Act, 1956. | This basis is not recognized under the Companies Act, 1956. |
| 5. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g. FIFO/LIFO/SLM/ WDV | Under this, an accountant has options. | Under this an accountant has no option to make a choice as such. |

Hybrid or Mixed Basis

Is the combination of both the basis i.e. Cash as well as Accrual basis. Incomes are recorded on Cash basis but expenses are recorded on Accrual basis.

This is not a system of accounting on its own. It is a combination of the Cash Basis Accounting and Accrual Basis Accounting. This system is based on the concept of conservatism.

Under the hybrid system of accounting, incomes are recognised as in Cash Basis Accounting i.e. when they are received in cash and expenses are recognised on accrual basis i.e. during the accounting period in which they arise irrespective of when they are paid.

Illustration 7.

Mr. Anil Roy, a junior lawyer, provides the following particulars for the year ended 31st December, 2012:

| | ₹ |
|--|--------|
| Fees received in cash in 2013 | 60,000 |
| Salary paid to Staff in 2013 | 8,000 |
| Rent of office in 2013 | 14,000 |
| Magazine and Journal for 2013 | 1,000 |
| Travelling and Conveyance paid in 2013 | 3,000 |
| Membership Fees paid in 2013 | 1,600 |
| Office Expenses paid in 2013 | 10,000 |

Additional Information:-

Fees include ₹ 3,000 in respect of 2012 and fees not yet received is ₹ 7,000. Office rent includes ₹ 4,000 for previous year and rent of ₹ 2,000 not yet paid. Membership fees is paid for 2 years.

Compute his net income for the year 2013, under – (a) Cash Basis, (b) Accrual Basis and (c) Mixed or Hybrid Basis.



Solution:

Statement of Income (Cash Basis)
For the year ended 31st December, 2013

| Particulars | Amount (₹) | Amount (₹) |
|-------------------------|------------|------------|
| Fees received | | 60,000 |
| Less : | | |
| Salary | 8,000 | |
| Office Rent | 14,000 | |
| Magazine & Journal | 1,000 | |
| Travelling & Conveyance | 3,000 | |
| Membership Fees | 1,600 | |
| Office Expenses | 10,000 | 37,600 |
| Net Income | | 22,400 |

(ii)

Mr. Anil Roy

Statement of Income (Accrual Basis)
For the year ended 31st December, 2013

| Particulars | | Amount (₹) | Amount (₹) |
|---|--------|------------|------------|
| Fees received | | 60,000 | |
| Add: Accrued fees for 2012 | | 7,000 | |
| | | 67,000 | |
| Less: Fees for 2011 received in 2012 | | 3,000 | 64,000 |
| Less : | | | |
| Salary | | 8,000 | |
| Office Rent | 14,000 | | |
| Add: Outstanding rent | 2,000 | | |
| | 16,000 | | |
| Less: Rent for 2011 paid in 2012 | 4,000 | 12,000 | |
| Magazine & Journal | | 1,000 | |
| Travelling & Conveyance | | 3,000 | |
| Membership Fees | 1,600 | | |
| Less: Advance fee paid for 2013 (½ x 1600) | 800 | 800 | |
| Office Expenses | | 10,000 | 34,800 |
| Net Income | | | 29,200 |

Mr. Anil Roy
Statement of Income (Mixed or Hybrid Basis)
For the year ended 31st December, 2013

| Particulars | Amount (₹) | Amount (₹) | Amount (₹) |
|-------------------------|------------|------------|------------|
| Fees received | | | 60,000 |
| Less : | | | |
| Salary | | 8,000 | |
| Office Rent | 14,000 | | |
| Add: Outstanding rent | 2,000 | | |
| | 16,000 | | |
| Less: Fees for 2011 | 4,000 | 12,000 | |
| Magazine & Journal | | 1,000 | |
| Travelling & Conveyance | | 3,000 | |
| Membership Fees | 1,600 | | |
| Less: Advance | 800 | 800 | |
| Office Expenses | | 10,000 | 34,800 |
| Net Income | | | 25,200 |

1.4 CAPITAL & REVENUE TRANSACTIONS

The concepts of capital and revenue are of fundamental importance to the correct determination of accounting profit for a period and recognition of business assets at the end of that period. The distinction affects the measurement of profit in a number of accounting periods.

Capital has been defined by economists as those assets which are used in the production of goods and rendering of services for further production of assets. In accounting, on the other hand, the capital of a business is increased by that portion of the periodic income which has not been consumed by the owner.

The relationship between capital and revenue is that of between a tree and its fruits. It is the tree which produces the fruits, and it is the fruit that can be consumed. If the tree is tendered with care, it will produce more fruits, conversely, if the tree is destroyed, there will be no more fruits. Likewise, revenue comes out of capital and capital is the source of revenue. Capital is invested by a person in the business so that it may produce revenue. Moreover, as a fruit may give birth to another new tree, different revenues may also produce further new capital.

Capital can be brought in by a person into the business in different forms-cash or kind. When capital is brought in the form of cash, it is spent away on various items of assets that make the business a running concern. Capital of the firm is thus, represented by its inventory of assets.

Capital of a business can be increased in a two fold way:

1. When the owner brings in more capital to the business; and/or
2. When the owner does not consume the entire periodic income.

When the owner brings in further capital to his business, the amount is credited to the Capital Account. Likewise, the net income for a period is credited to the Capital Account, and if his drawings are less than that income, the capital is increased by the difference. Example, Capital ₹ 500, Profit ₹ 300, drawings ₹ 350. So the revised capital will be ₹ 450 (₹ 500 + ₹ 300 - ₹ 350)



The difference between the two terms 'revenue' and 'receipt' should be carefully distinguished. A receipt is the inflow of money into business, whereas revenue is the aggregate exchange value received for goods and services provided to the customers.

Capital and Revenue Expenditures

Capital expenditure is the outflow of funds to acquire an asset that will benefit the business for more than one accounting period. A capital expenditure takes place when an asset or service is acquired or improvement of a fixed asset is effected. These assets are expected to provide benefits to the business in more than one accounting period and are not intended for resale in the ordinary course of business. In short, it is an expenditure on assets which is not written off completely against income in the accounting period in which it is acquired.

Revenue expenditure is the outflow of funds to meet the running expenses of a business and it will be of benefit for the current period only. A revenue expenditure is incurred to carry on the normal course of business or maintain the capital assets in a good condition.

It may be pointed out here that an expenditure need not necessarily be a payment made to somebody in cash - it may be made by the exchange of another asset, or by assuming a liability. Expenditure incurrence and expenditure recognition are distinct phenomena. Expenditure incurrence refers to the receipt of goods and services, whereas expenditure recognition is a matter to be decided whether the expenditure is of capital or revenue nature. For example, the buying of an asset is a capital expenditure but charging depreciation against profit is a revenue expenditure, over the entire life of that asset. On the application of periodicity, accrual and matching concepts, accountants identify all revenue expenditures for a given period for ascertaining profit. An expenditure which cannot be identified to a particular accounting period is considered of capital nature.

The accounting treatment of capital and revenue expenditure are as under:

Revenue expenditures are charged as an expense against profit in the year they are incurred or recognised. Capital Expenditures are capitalised-added to an Asset Account.

The following are the points of distinction between Capital Expenditure and Revenue Expenditure:

| Sl. No. | Capital Expenditure | Sl. No. | Revenue Expenditure |
|---------|--|---------|--|
| 1. | The economic benefits of Capital Expenditures are enjoyed for more than one accounting period. | 1. | The economic benefits of Revenue Expenditures are enjoyed within a particular accounting period. |
| 2. | Capital Expenditures are of non-recurring in nature. | 2. | Revenue Expenditures are of recurring in nature. |
| 3. | All Capital Expenditures eventually become Revenue Expenditures like depreciation | 3. | Revenue Expenditures are not generally capital expenditures. |
| 4. | Capital Expenditures are not matched with Capital Receipts. | 4. | All Revenue Expenditures are matched with Revenue Receipts. |

Rules for Determining Capital Expenditure

An expenditure can be recognised as capital if it is incurred for the following purposes:

An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in business to earn profits and not meant for resale, will be treated as a capital expenditure. For example, if a second hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor cars, for re-sale, then it will be a revenue expenditure because he deals in second hand motor cars.

When an expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition, it is recognised as a capital expenditure. The expenditure is capitalised and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure.

For example, if one buys a machine for ₹ 5,00,000 and pays ₹ 20,000 as transportation charges and ₹40,000 as

installation charges, the total cost of the machine comes upto ₹ 5,60,000. Similarly, if a building is purchased for ₹1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹1,05,000.

If an expenditure is incurred, to increase earning capacity of a business that will be considered as of capital nature. For example, expenditure incurred for shifting the factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.

Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example, legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.

Thus, one useful way of recognising an expenditure as capital is to see that the business will own something which qualifies as an asset at the end of the accounting period.

Some examples of Revenue Expenditure

- (i) Salaries and wages paid to the employees;
- (ii) Rent and rates for the factory or office premises;
- (iii) Depreciation on plant and machinery;
- (iv) Consumable stores;
- (v) Inventory of raw materials, work-in-progress and finished goods;
- (vi) Insurance premium;
- (vii) Taxes and legal expenses; and
- (viii) Miscellaneous expenses.

Replacement of Fixed Assets

The above rules of capital and revenue expenditure do not hold good when an existing asset is replaced for another. If an asset is replaced with a similar kind of asset, the expenditure incurred is treated as Revenue Expenditure. For example, if a set of weighing machines in a shop becomes defective and is replaced with a similar set, the cost of replacement should be treated as revenue expenditure and it should be charged to the Profit and Loss Account. However, if an asset is replaced with an asset which is superior than the previous one, the expense is partly capital and partly revenue. For example, if a manual typewriter costing ₹ 5,000 is replaced with an electronic typewriter costing ₹ 15,000, then ₹ 5,000 will be revenue expenditure and the excess value of the new typewriter over the old one, ₹ 10,000 will be capital expenditure.

Deferred Revenue Expenditures

Deferred revenue expenditures represent certain types of assets whose usefulness does not expire in the year of their occurrence but generally expires in the near future. These type of expenditures are carried forward and are written off in future accounting periods. Sometimes, we make some revenue expenditure but it eventually becomes a capital asset (generally of an intangible nature). If one undertake substantial repairs to the existing building, the deterioration of the premises may be avoided. We may engage our own employees to do that work and pay them at prevailing wage-rate, which is of a revenue nature. If this expenditure is treated as a revenue expenditure and the current year's-profit is charged with these expenses, we are making the current year to absorb the entire expenses, though the benefit of which will be enjoyed for a number of accounting years. To overcome this difficulty, the entire expenditure is capitalised and is added to the asset account. Another example is an insurance policy. A business can pay insurance premium in advance, say, for a 3 year period. The right does not expire in the accounting period in which it is paid but will expire within a fairly short period of time (3 years). Only a portion of the total premium paid should be treated as a revenue expenditure (portion pertaining to the current period) and the balance should be carried forward as an asset to be written off in subsequent years.

AS 26 - Intangible Asset does not accept this view. As per AS-26, "Expenditure incurred to provide future economic benefit to an enterprise that can be recognized as an expense when it is incurred. e.g. expenditure incurred on Scientific Research is recognized as an expense when it is incurred". In short, the whole amount of expenditure is treated as expense for the current year only and will not proportionately be transferred as deferred charge.

Capital and Revenue Receipts

A receipt of money may be of a capital or revenue nature. A clear distinction, therefore, should be made between capital receipts and revenue receipts.

A receipt of money is considered as capital receipt when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year.

Additional capital introduced by the proprietor; by partners, in case of partnership firm, by issuing fresh shares, in case of a company; and, by selling assets, previously not intended for resale.

A receipt of money is considered as revenue receipt when it is received from customers for goods supplied or fees received for services rendered in the ordinary course of business, which is a result of the firm's activity in the current period. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period.

The following are the points of difference between capital receipts and revenue receipts:

| Sl. No. | Revenue Receipt | Sl. No. | Capital Receipt |
|---------|---|---------|--|
| 1. | It has short-term effect. The benefit is enjoyed within one accounting period. | 1. | It has long-term effect. The benefit is enjoyed for many years in future. |
| 2. | It occurs repeatedly. It is recurring and regular. | 2. | It does not occur again and again. It is nonrecurring and irregular. |
| 3. | It is shown in profit and loss account on the credit side, as an income for the year | 3. | It is shown in the Balance Sheet on the liability side. |
| 4. | It does not produce capital receipt. | 4. | Capital receipt, when invested, produces revenue receipt e.g. when capital is invested by the owner, business gets revenue receipt (i.e. sale proceeds of goods etc.). |
| 5. | This does not increase or decrease the value of asset or liability. | 5. | The capital receipt decreases the value of asset or increases the value of liability e.g. sale of a fixed asset, loan from bank etc. |
| 6. | Sometimes, expenses of capital nature are to be incurred for revenue receipt, e.g. purchase of shares of a company is capital expenditure but dividend received on shares is a revenue receipt. | 6. | Sometimes expenses of revenue nature are to be incurred for such receipt e.g. on obtaining loan (a capital receipt) interest is paid until its repayment. |

Capital and Revenue Profits

While ascertaining the trading profit of a business for a particular period, a proper distinction is to be made between capital and revenue profits. If profit arises out of an ordinary nature, being the outcome of the ordinary function and object of the business, it is termed as 'Revenue Profit'. But, when a profit arises out of a casual and non-recurring transaction, it is termed as Capital Profit. Revenue profit arises out of the sale of the merchandise that the business deals in.

Capital Profit arises from:

- (a) Profit prior to incorporation;
- (b) Premium received on issue of shares;
- (c) Profit made on re-issue of forfeited shares;
- (d) Redemption of Debenture at a discount;
- (e) Profit made on sale or revaluation of a Fixed Asset.

Generally, capital profits arise out of the sale of assets other than inventory at a price more than its book value or in connection with the raising of capital or at the time of purchasing an existing business. For example, if an asset, whose book value is ₹ 5,000 on the date of sale, is sold for ₹ 6,000 then ₹ 1,000 will be considered as capital profit.

Likewise, issue of shares at a premium is also a capital profit. Revenue profits are distributed to the owners of the business or transferred to General Reserve Account, being shown in the balance sheet as a retained earning. Capital profits are generally capitalised-transferred to a capital reserve account which can only be utilised for setting off capital losses in future. Capital profits of a small amount (arising out of selling of one asset) is taken to the Profit and Loss Account and added with the revenue profit-applying the concept of materiality.

Capital and Revenue Losses

While ascertaining losses, revenue losses are differentiated from capital losses, just as revenue profits are distinguished from capital profits. Revenue losses arise from the normal course of business by selling the merchantable at a price less than its purchase price or cost of goods sold or where there is a declining in the current value of inventories. Capital losses may result from the sale of assets, other than inventory for less than written down value or the diminution or elimination of assets other than as the result of use or sale (flood, fire, etc.) or in connection with raising capital of the business (issue of shares at a discount) or on the settlement of liabilities for a consideration more than its book value (debenture issued at par but redeemed at a premium). Treatment of capital losses are same as that of capital profits. Capital losses arising out of sale of fixed assets generally appear in the Profit and Loss Account (being deducted from the net profit). But other capital losses are adjusted against the capital profits. Where the capital losses are substantial, the treatment is different. These losses are generally shown on the balance sheet as fictitious assets and the common practice is to spread that over a number of accounting years as a charge against revenue profits till the amount is fully exhausted.

Illustration 9.

State whether the following are capital, revenue or deferred revenue expenditure.

- (i) Carriage of ₹ 7,500 spent on machinery purchased and installed.
- (ii) Heavy advertising costs of ₹ 20,000 spent on the launching of a company's new product.
- (iii) ₹ 200 paid for servicing the company vehicle, including ₹ 50 paid for changing the oil.
- (iv) Construction of basement costing ₹ 1,95,000 at the factory premises.

Solution:

- (i) Carriage of ₹ 7,500 paid for machinery purchased and installed should be treated as a Capital Expenditure.
- (ii) Advertising expenses for launching a new product of the company should be treated as a Revenue Expenditure. (As per AS-26)
- (iii) ₹ 200 paid for servicing and oil change should be treated as a Revenue Expenditure.
- (iv) Construction cost of basement should be treated as a Capital Expenditure.

Illustration 10.

Classify the following items as capital or revenue expenditure :

- (i) An extension of railway tracks in the factory area;
- (ii) Wages paid to machine operators;
- (iii) Installation costs of new production machine;
- (iv) Materials for extension to foremen's offices in the factory;
- (v) Rent paid for the factory;
- (vi) Payment for computer time to operate a new stores control system,
- (vii) Wages paid to own employees for building the foremen's offices. Give reasons for your classification.

Solution :

- (i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.
- (ii) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only.

- (iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (iv) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit only the current period.
- (vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.
- (vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Illustration 11.

State with reasons whether the following are Capital Expenditure or Revenue Expenditure:

- (i) Expenses incurred in connection with obtaining a licence for starting the factory were ₹ 10,000.
- (ii) ₹ 1,000 paid for removal of stock to a new site.
- (iii) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get full efficiency.
- (iv) ₹ 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
- (v) ₹ 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
- (vi) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Solution :

- (i) ₹ 10,000 incurred in connection with obtaining a license for starting the factory is a Capital Expenditure. It is incurred for acquiring a right to carry on business for a long period.
- (ii) ₹ 1,000 incurred for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of the asset and it is also required for starting the business on the new site.
- (iii) ₹ 5,000 incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.
- (iv) ₹ 2,000 incurred for defending the title to the firm's assets is a Revenue Expenditure.
- (v) ₹ 10,000 incurred on advertising is to be treated as a Revenue Expenditure. [As per As-26]
- (vi) Cost of construction of Factory shed of ₹ 1,00,000 is a Capital Expenditure, similarly cost of construction of small huts for storing building materials is also a Capital Expenditure.

Illustration 12.

State clearly how you would deal with the following in the books of a Company :

- (i) The redecoration expenses ₹ 6,000.
- (ii) The installation of a new Coffee-making Machine for ₹ 10,000.
- (iii) The building of an extension of the club dressing room for ₹ 15,000.
- (iv) The purchase of snacks & food stuff ₹ 2,000.
- (v) The purchase of V.C.R. and T.V. for the use in the club lounge for ₹ 15,000.

Solution :

- (i) The redecoration expenses of ₹ 6,000 shall be treated as a Revenue Expenditure.
- (ii) The installation of a new Coffee - Making Machine is a Capital Expenditure because it is the acquisition of an asset.

- (iii) ₹ 15,000 spent for the extension of club dressing room is a Capital Expenditure because it creates an asset of a permanent nature.
- (iv) The purchase of snacks & food stuff of ₹ 2,000 is a Revenue Expenditure.
- (v) The purchase of V.C.R. and T.V. for ₹ 15,000 is a Capital Expenditure, because it is the acquisition of assets.

Double Entry System, Books of Prime Entry, Subsidiary Books:

Double Entry System -

Books of Prime Entry

A journal is often referred to as Book of Prime Entry or the book of original entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called as 'Journalisation'. The entry made in this book is called a 'journal entry'.

Functions of Journal

- (i) Analytical Function: Each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.
- (ii) Recording Function: Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explain, the transaction in simple language. Narration means to narrate – i.e. to explain. It starts with the word – Being ...
- (iii) Historical Function: It contains a chronological record of the transactions for future references.

Advantages of Journal

The following are the advantages of a journal :

- (i) Chronological Record : It records transactions as and when it happens. So it is possible to get a detailed day-to-day information.
- (ii) Minimising the possibility of errors : The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into debit and credit aspect.
- (iii) Narration : It means explanation of the recorded transactions.
- (iv) Helps to finalise the accounts : Journal is the basis of ledger posting and the ultimate Trial Balance.
- (v) The Trial balance helps to prepare the final accounts.
- (vi) The specimen of a journal book is shown below.

| Date | Particulars | Voucher number | Ledger folio | Debit amount (₹) | Credit amount (₹) |
|----------|---|----------------|---|------------------|-------------------|
| dd-mm-yy | Name of A/c to be debited Name of A/c to be credited (narration describing the transaction) | ----- | Reference of page number of the A/c in ledger | ----- | ----- |

Explanation of Journal

- (i) Date Column: This column contains the date of the transaction.
- (ii) Particulars: This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- (iii) Voucher Number: This Column contains the number written on the voucher of the respective transaction.
- (iv) Ledger Folio (L.F.): This column contains the folio (i.e. page no.) of the ledger, where the transaction is posted.
- (v) Dr. Amount and Cr. Amount: This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

All the columns are filled in at the time of entering the transaction except for the column of ledger folio. This is filled at the time of posting of the transaction to 'ledger'. This process is explained later in this chapter.



Example:

As per voucher no. 31 of Roy Brothers, on 10.05.2013 goods of ₹ 50000 were purchased. Cash was paid immediately. Ledger Folios of the Purchase A/c and Cash A/c are 5 and 17 respectively. Journal entry of the above transaction is given below:

In the books of Roy Brothers

Journal Entries

| Date | Particulars | Voucher No. | Ledger Folio | Dr. | Cr. |
|------------|--|-------------|--------------|------------|------------|
| | | | | Amount (₹) | Amount (₹) |
| 10.05.2013 | Purchase A/c Dr. To, Cash A/c (Being goods purchased for Cash) | 31 | 5 17 | 50,000 | 50,000 |

Illustration 13.

Let us illustrate the journal entries for the following transactions: 2012

April

- 1 Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of ₹ 5,00,000 and ₹ 2,50,000 respectively.
- 10 Bought office furniture of ₹ 25,000 for cash. Bill No. - 2013/F/3
- 11 Opened a current account with Punjab National Bank by depositing ₹ 1,00,000
- 15 Paid office rent of ₹ 15,000 for the month by cheque to M/s Realtors Properties. Voucher No. 3
- 20 Bought a motor car worth ₹ 4,50,000 from Millennium Motors by making a down payment of ₹ 50,000 by cheque and the balance by taking a loan from HDFC Bank. Voucher No. M/13/7
- 25 Vikas and Vaibhavi carried out a consulting assignment for Avon Pharmaceuticals and raised a bill for ₹ 10,00,000 as consultancy fees. Bill No. B13/4/1 raised. Avon Pharmaceuticals have immediately settled ₹ 2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into Bank.
- 30 Salary of one receptionist @ ₹ 5,000 per month and one officer @ ₹ 10,000 per month. The salary for the current month is payable to them.

Solution:

The entries for these transactions in a journal will look like:

In the Books of Vikash & Vaibhavi

Journal Entries

Journal Folio-1

| Date | Particulars | Voucher number | L.F | Dr. | Cr. |
|------------|--|----------------|-----|------------|------------|
| | | | | Amount (₹) | Amount (₹) |
| 01-04-2013 | Cash A/c Dr. | | 1 | 7,50,000 | |
| | To Vikas's Capital A/c | | 2 | | 5,00,000 |
| | To Vaibhavi's Capital A/c (Being capital brought in by the partners) | | 3 | | 2,50,000 |
| 10-04-2013 | Furniture A/c Dr. | 2013/F/3 | 4 | 25,000 | |
| | To Cash A/c (Being furniture purchased in cash) | | 1 | | 25,000 |
| 11-04-2013 | Punjab National Bank A/c Dr. | | 5 | 1,00,000 | |
| | To Cash A/c (Being current account opened with Punjab National Bank by depositing cash) | | 1 | | 1,00,000 |

| | | | | | | |
|------------|--|------------|---------|--------------|----------------------|--------------------|
| 15-04-2013 | Rent A/c To Punjab National Bank A/c (being rent paid to Realtors Properties for the month) | Dr. | 3 | 6 5 | 15,000 | 15,000 |
| 20-04-2013 | Motor Car A/c To Punjab National Bank A/c To Loan from HDFC Bank A/c (Being car purchased from Millennium Motors by paying down payment and loan arrangement) | Dr. | M/13/7 | 7 5 8 | 4,50,000 | 50,000 4,00,000 |
| 25-04-2013 | Punjab National Bank A/c Avon Pharmaceuticals A/c To Consultancy Fees A/c (Being amount received and revenue recognized for fees charged) | Dr. Dr. | B13/4/1 | 5 9 10 | 2,50,000 7,50,000 | 10,00,000 |
| 30-04-2013 | Salary A/c To Salary payable A/c (Being the entry to record salary obligation for the month) | Dr. | | 11 12 | 15,000 | 15,000 |

Subsidiary Books

Although once understood, the entries are easy to be written, but if transactions are too many, it may become difficult to manage them and retrieve. Imagine there are 25 purchase transactions in a day. Because the journal will record all transaction chronologically, it may be possible that the purchase transactions could be scattered i.e. they may not all come together one after the other. Now, at the end of the day if the owner wants to know the total purchases made during the day, the accountant will spend time first to retrieve all purchase transactions from journal and then take total. This involve time.

This being the greatest limitation of journal, it is generally sub-divided into more than one journal. On what logic is such a sub-division made? It is done on the basis of similar transactions which are clubbed in a single book e.g. purchase transactions, sales transaction etc. The sub-division of journal is done as follows:

| Transaction | Subsidiary Book |
|---|--|
| All cash and bank transactions | Cash Book - has columns for cash, bank and cash discount |
| All credit purchase of goods – only those Goods that are purchased for resale are covered here. | Purchase Day Book or Purchase register |
| All credit sale of goods | Sales Day Book or sales register |
| All purchase returns – i.e. return of goods back to suppliers due to defects | Purchase Return Book or Return Outward Book |
| All sales returns – i.e. return of goods back from customers | Sales Return Book or Return Inward Book |
| All bill receivables – these are bills accepted by customers to be honoured at an agreed date. This is dealt with in depth later in the study note | Bills Receivable Book |
| All bills payable - these are bills accepted by the business to be honoured by paying to suppliers at an agreed date. | Bills Payable Book |
| For all other transactions not covered in any of the above categories – i.e. purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries. | Journal Proper |

Let us see the formats for each of these and examples as illustration.



Recording of Cash and Bank Transactions

Cash Book

A Cash Book is a special journal which is used for recording all cash receipts and all cash payments. Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

Cash Book as the only Book of Original Entry

This Cash Book records all types of transactions even if there are some credit transactions i.e. all transactions are recorded and not like the ordinary Cash Book where only cash transactions are recorded. For non cash transactions, that will be two entries in the cash Book, ultimately that will be no effect in Cash Balance. For example, if goods are sold to Mr. X on credit for ₹ 5,000, the entries will be

| | | Dr. | Cr. |
|-----|--------------------------|-------------|-------|
| (1) | Cash A/c To Sales A/c | Dr 5,000 | 5,000 |
| (2) | X A/c To Cash A/c | Dr 5,000 | 5,000 |

Although the original entry is

| | | |
|-----------------------|-------------|-------|
| X A/c To Sales A/c | Dr 5,000 | 5,000 |
|-----------------------|-------------|-------|

Types of Cash Book

There are different types of Cash Book as follows:

- (i) **Single Column Cash Book**- Single Column Cash Book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the payment side, this book is nothing but a Cash Account and there is no need to open separate cash account in the ledger.
- (ii) **Double Column Cash Book**- Cash Book with Discount Column has two amount columns, one for cash and other for Discount on each side. All cash receipts and cash discount allowed are recorded on the debit side and all cash payments and discount received are recorded on the credit side.

Triple Column Cash Book- Triple Column Cash Book has three amount columns, one for cash, one for Bank and one for discount, on each side. All cash receipts, deposits into book and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on the credit side. In fact, a triple-column cash book serves the purpose of Cash Account and Bank Account both. Thus, there is no need to create these two accounts in the ledger.

Dr. Specimen of Single Column Cash Book Cr.

| Receipts | | | | Payments | | | |
|----------|-------------|------|------|----------|-------------|------|------|
| Date | Particulars | L.F. | Cash | Date | Particulars | L.F. | Cash |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |

4. Purchased seven book racks from Mayur Furnitures for ₹ 4900 paid for in cash on 6th March.
5. Purchased Machinery for ₹ 30000 from Kirloskar Ltd on 9th March as per invoice number 37.

**In the Books of Furniture Shop
Purchase Day Book**

| Date | Name of the Suppliers and Details of goods purchased | Invoice reference | L. F. | Amount (₹) |
|-----------|---|-------------------|-------|------------|
| 2nd March | Majestic Appliances 20 tables @ ₹ 500 and 12% trade discount [(20 × ₹ 500) = ₹ 10000 less 12% discount i.e., ₹ 1,200] | 22334 | | 8,800 |
| 4th March | Metro Chairs 3 dozen chairs @ 250 per chair | 1112 | | 9,000 |
| 7th March | Modern Furnitures | 375 | | 1,200 |
| | Total | | | 19,000 |

Please note that the transaction for purchase of book rack will not be entered in the purchase book as it is not purchased on credit. (Where will it go then? It will go to the cash book!). Similarly purchase of machinery will not form part of purchase book. It will be entered in Journal Proper.

Sales Day Book

The sales day book records transaction of credit sale of goods to customers. Sale of other things, even on credit, will not be entered in the sales day book but will be entered in Journal Proper. If goods are sold for cash, it will be entered in cash book. Total of sales day book is periodically posted to sales account in the ledger. The specimen of a sales day book is given below.

**In the books of
Sales Day Book**

| Date | Particulars | Invoice reference | L. F. | Amount | Remarks |
|------|-------------|-------------------|-------|--------|---------|
| | | | | | |
| | | | | | |
| | | | | | |

The format of sales return book is exactly the same as in the case of Purchase Day Book.

Let us see how will be the following transaction recorded in the books of a Cloth Merchant.

- 1st July Sold Tip Top clothing 50 suits of ₹ 2,200 each on two months credit on invoice number -2
- 11th July Sold to New India Woolen 100 sweaters @ ₹ 250 each on invoice number 55
- 13th July Received an order from Modern clothing for 100 trousers @ ₹ 500 at trade discount of 10%
- 17th July Sold 50 sarees to Lunkad brothers @ ₹ 750 each
- 25th July Sold T-shirts at exhibition hall for cash for ₹ 7,500

**In the books of Cloth Merchant
Sales Day Book**

| Date | Particulars | Invoice reference | L. F. | Amount |
|-----------|--|-------------------|-------|----------|
| 1st July | Tip Top Clothing 50 suits @ ₹ 2,200 | 2 | | 1,10,000 |
| 11th July | New India Woolen 100 sweaters @ ₹ 250 | 55 | | 25,000 |
| 17th July | Lunkad brother 50 sarees @ ₹ 750 | | | 37,500 |
| | Total | | | 1,72,500 |

Here again, cash sales at exhibition hall are not recorded. Also, merely getting an order for goods is not a transaction to be entered in sales book.



Other Subsidiary Books – Returns Inward, Return Outward, Bills Receivable, Bills Payable.

(i) Return Inward Book- The transactions relating to goods which are returned by the customers for various reasons, such as not according to sample, or not up to the mark etc contain in this book. It is also known as Sales Return Book.

Generally when a customer returns good to suppliers he issues a Debit Note for the value of the goods returned by him. Similarly the supplier who receives those goods issues a Credit Note.

Returns Inward Day Book

| Date | Particulars | Outward Invoice | L.F. | Details | Totals | Remarks |
|------|-------------|-----------------|------|---------|--------|---------|
| | | | | | | |

(ii) Return Outward Book- This book contains the transactions relating to goods that are returned by us to our creditors e.g. goods broken in transit, not according to the sample etc. It's also known as Purchase Return Book.

Return Outward Day Book

| Date | Particulars | Debit Note | L.F. | Details | Totals | Remarks |
|------|-------------|------------|------|---------|--------|---------|
| | | | | | | |

(iii) Bills Receivable Book- It is such a book where all bills received are recorded and therefrom posted directly to the credit of the respective customer's account. The total amounts of the bills so received during the period (either at the end of the week or month) is to be posted in one sum to the debit of Bills Receivable A/c.

Bills Receivable Day Book

| No. of Bills | Date of Receipt of Bill | From whom | Name of the Receiver | Name of Drawer | Name of Acceptor | Date of Bill | Due Date | L.F. | Amount of Bill | How disposed off |
|--------------|-------------------------|-----------|----------------------|----------------|------------------|--------------|----------|------|----------------|------------------|
| | | | | | | | | | | |

(iv) Bills Payable Book- Here all the particulars relating to bills accepted are recorded and therefrom posted directly to the debit of the respective creditor's account. The total amounts of the bills so accepted during the period (either at the end of the week or month) is to be posted in one sum to the credit of Bills Payable A/c.

Bills Payable Day Book

| No. of Bills | Date of Acceptance | To whom given | Name of Drawer | Name of the Payee | Where Payable | Date of Bill | Term | Due Date | L.F. | Amount of Bill | How disposed off |
|--------------|--------------------|---------------|----------------|-------------------|---------------|--------------|------|----------|------|----------------|------------------|
| | | | | | | | | | | | |

Journal Proper

We know that usual transactions are recorded in primary books of accounts. If any transaction is not recorded in the primary books the same is recorded in Journal Proper. It includes Credit Purchase and Credit Sales of Assets; Transfer Entries; Opening Entries; Closing Entries; Adjusting Entries and Rectification of Errors.

However, these are explained in subsequent Para.

Ledger Accounts

Ledger is the main book or principal book of account. The entries into ledger accounts travel through the route of journal and subsidiary books. The ledger book contain all accounts viz. assets, liabilities, incomes or gains, expenses or losses, owner's capital and owner's equity. The ledger is the book of final entry and hence is a permanent record. There is a systematic way in which transactions are posted into a ledger account. Once the transactions are posted for an accounting period, the ledger accounts are balanced (i.e. the difference between debit side and credit side is calculated). These balances are used to ultimately prepare the financial statement like Profit

and Loss A/c and Balance Sheet. The ledger may also be divided as General ledger and Sub-ledgers. While the General Ledger will have all ledger accounts, the sub-ledgers will have individual accounts of customers and suppliers. If there are 10 customers, the general ledger will not have 10 individual accounts for each customer. Instead, these 10 customer account will exist in what is called as 'Receivables or Debtors Ledger' and the general ledger will have only one account that represents the customers. This is named as Debtors Control Account. Similar is the case of supplier accounts. Such sub-ledgers are necessary for better control over individual accounts. Also, this will avoid the general ledger from becoming too big, especially when number of customers and suppliers is large.

The specimen of a typical ledger account is given below.

| Dr. | | Ledger-Account | | | | Cr. | |
|------|-------------|----------------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |

Ledger Posting

As and when the transaction takes place, it is recorded in the journal in the form of journal entry. This entry is posted again in the respective ledger accounts under double entry principle from the journal. This is called ledger posting.

The rules for writing up accounts of various types are as follows:

- Assets : Increases on the left hand side or the debit side and decreases on the credit side or the right hand side.
- Liabilities : Increases on the credit side and decreases on the debit side.
- Capitals : The same as liabilities.
- Expenses : Increases on the debit side and decreases on the credit side.
- Incomes or gain : Increases on the credit side and decrease on the debit side.

To summarise

| | | | | | |
|------------|--------------------------|------------|------------|----------------------------------|------------|
| Dr. | Assets | Cr. | Dr. | Liabilities & Capital | Cr. |
| Increase | | Decrease | Decrease | | Increase |
| Dr. | Expenses or Loses | Cr. | Dr. | Income or Gains | Cr. |
| Increase | | Decrease | Decrease | | Increase |

The student should clearly understand the nature of debit and credit.

A debit denotes:

- (a) In the case of a person that he has received some benefit against which he has already rendered some service or will render service in future. When a person becomes liable to do something in favour of the firm, the fact is recorded by debiting that person's account : (relating to Personal Account)
- (b) In case of goods or properties, that the value and the stock of such goods or properties has increased, (relating to Real Accounts)
- (c) In case of other accounts like losses or expenses, that the firm has incurred certain expenses or has lost money. (relating to Nominal Account)

A credit denotes:

- (a) In case of a person, that some benefit has been received from him, entitling him to claim from the firm a return benefit in the form of cash or goods or service. When a person becomes entitled to money or money's worth for any reason. The fact is recorded by crediting him (relating to Personal Account)
- (b) In the case of goods or properties, that the stock and value of such goods or properties has decreased. (relating to Real Accounts)

Folio No. 2

| Dr. Mr. Vikas's Capital Account | | | | Cr. | | | |
|---------------------------------|----------------|-------|------------|----------|----------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 30.4.2013 | To Balance c/d | | 5,00,000 | 1.4.2013 | By Cash A/c | 1 | 5,00,000 |
| | | | 5,00,000 | | | | 5,00,000 |
| | | | | 1.5.2013 | By Balance b/d | | 5,00,000 |

Folio No. 3

| Dr. Mrs. Vaibhavi's Capital Account | | | | Cr. | | | |
|-------------------------------------|-------------|-------|------------|----------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | | | | 1.4.2013 | By Cash A/c | 1 | 2,50,000 |

Folio No. 4

| Dr. Furniture Account | | | | Cr. | | | |
|-----------------------|-------------|-------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 10.04.2013 | To Cash | | 25,000 | | | | |

Folio No. 5

| Dr. Punjab National Bank Account | | | | Cr. | | | |
|----------------------------------|-------------------------|-------|------------|-----------|------------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 11.4.2013 | To Cash A/c | 1 | 1,00,000 | 15.4.2013 | By Rent A/c | 1 | 15,000 |
| 25.4.2013 | To Consultancy Fees A/c | 1 | 2,50,000 | 20.4.2013 | By Motor Car A/c | 1 | 50,000 |

Folio No. 6

| Dr. Rent Account | | | | Cr. | | | |
|------------------|-----------------------------|-------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 15.4.2013 | To Punjab National Bank A/c | 1 | 15,000 | | | | |

Folio No. 7

| Dr. Motor Car Account | | | | Cr. | | | |
|-----------------------|-----------------------------|-------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 20.4.2013 | To Punjab National Bank A/c | 1 | 50,000 | | | | |
| " | To Loan from HDFC Bank A/c | 1 | 4,00,000 | | | | |

Folio No. 8

| Dr. Loan from HDFC Bank Account | | | | Cr. | | | |
|---------------------------------|-------------|-------|------------|-----------|------------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | | | | 20.4.2013 | By Motor Car A/c | 1 | 4,00,000 |

Folio No. 9

| Dr. Avon Pharmaceuticals Account | | | | Cr. | | | |
|----------------------------------|-------------------------|-------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 25.4.2013 | To Consultancy Fees A/c | 1 | 7,50,000 | | | | |

Folio No. 10

| Dr. Consultancy Fees Account | | | | Cr. | | | |
|------------------------------|-------------|-------|------------|-----------|-----------------------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | | | | 25.4.2013 | By Punjab National Bank A/c | 1 | 2,50,000 |
| | | | | 25.4.2013 | By Avon Pharmaceuticals A/c | 1 | 7,50,000 |



Folio No. 11

| Dr. Salary Account | | | | Cr. | | | |
|--------------------|-----------------------|-------|------------|------|-------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 30.4.2013 | To Salary payable A/c | 1 | 15,000 | | | | |

Folio No. 12

| Dr. Salary Payable Account | | | | Cr. | | | |
|----------------------------|-------------|-------|------------|-----------|---------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | | | | 30.4.2013 | By Salary A/c | 1 | 15,000 |

Please carefully observe the posting of journal entries into various ledger accounts. Do you see some further calculation in the cash A/c and Mr. Vikas's Capital A/c? What is done is that after posting all transactions to these accounts, the difference between the debit and credit sides is calculated. This difference is put on the side with smaller amount in order to tally grand totals of both sides. The convention is to write "To Balance c/d" or "By Balance c /d" as the case may be. This procedure is normally done at the end of an accounting period. This process is called as "balancing of ledger accounts".

Once the ledgers are balanced for one accounting period, the balance needs to be carried forward to the next accounting period as a running balance. This is done by writing "To Balance b/d" or "By balance b/d" as the case may be after the grand totals. This is also shown in the Cash A/c and Mr. Vikas's Capital Account.

Could you now attempt to balance the other ledger accounts and carry the balances to the next accounting period?

Important note : Please remember that the balances of personal and real accounts only are carried down to the next accounting period as they represent resources and obligations of the business which will continue to be used and settled respectively in future. Balances of nominal accounts (which represent incomes or gains and expenses or losses) are not carried down to the next period. These balances are taken to the Profit and Loss Account (or Income statement) prepared for the period. The net result of the P & L Account will show either net income or net loss which will increase or decrease the owner's equity.

In the above example, please note that the balances of Rent A/c, Consultancy Fees Account and Salary Account will not be carried down to the next period, but to the P & L Account of that period.

Posting to Ledger Accounts from Subsidiary books

In the above section, we explained posting to ledger accounts directly on the basis of journal entries. In practice, however, we know that use of subsidiary books is in vogue. Let us see how the posting to ledger accounts is done based on these records.

For each of the subsidiary books, there is a ledger account e.g. for purchase book, there is Purchase Account, for sales book there's Sales A/c, for cash book there will be Cash A/c as well as Bank A/c and so on.

Let us continue with illustration seen in the section 1.17.3.1.3 above and post the totals into respective ledger accounts. It considered that there was a Purchase of ₹ 19,000 and Sales of ₹ 1,72,500.

| Dr. Cash Account | | | | Cr. | | | |
|------------------|----------------|-------|------------|------|----------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| 1st Jan | To Balance b/d | | 3,800 | | By Wages A/c | | 1,500 |
| | To Bank A/c | | 2,500 | | By Balance c/d | | 4,800 |
| | | | 6,300 | | | | 6,300 |

| Dr. Purchases Account | | | | Cr. | | | |
|-----------------------|----------------------------------|-------|------------|------|--------------------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | To Sundries as per purchase book | | 19,000 | | By Transfer to P & L A/c | | 19,000 |

| Dr. | | Sales Account | | | | Cr. | |
|------|--------------------------|---------------|------------|------|-------------------------------|-------|------------|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) |
| | To Transfer to P & L A/c | | 1,72,500 | | By Sundries as per sales book | | 1,72,500 |

Typical Ledger Account Balances

We have seen how to balance various ledger accounts. It can be seen that while some accounts will show debit balance, while the other will show credit balance. Is there any relationship between the type of account (whether it is the account of asset, liability, capital, owner's equity, incomes or gain, expenses or losses) and the kind of balance (debit or credit) it should show?

The answer is generally 'Yes'. You may test to find the following are typical relationships.

| Type of Account | Type of balance |
|----------------------------------|-----------------|
| All asset accounts | Debit balance |
| All liability accounts | Credit balance |
| Capital & Owner's equity account | Credit balance |
| Expenses or loss accounts | Debit balance |
| Incomes or gain accounts | Credit balance |

Let us test these possibilities for confirmation. How does one go about testing this? Consider 'Cash A/c'. Whenever business receives cash we debit it, and whenever it is paid we credit it. Is it possible to see a situation that credits to cash are more than debits? In other words could we have negative cash in hand? No. Cash account will therefore always show a debit balance. So is true for all real asset accounts. After solving problems, if the contrary is observed, there is every chance that an error has been made while passing the accounting entries.

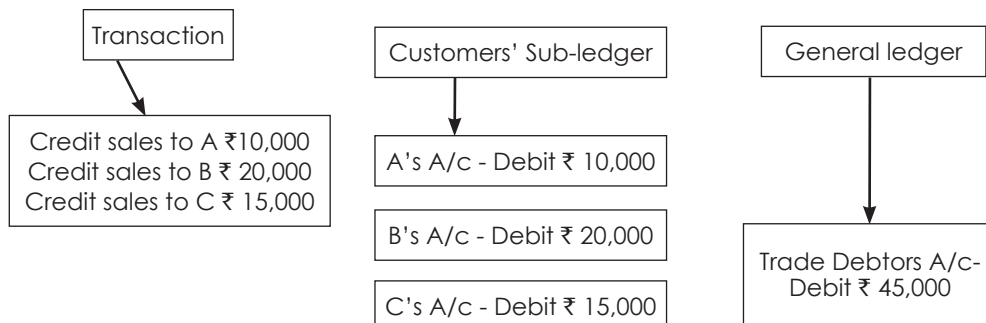
The Structure of Ledger

In practice, for the sake of convenience and ease of operations, the ledger is subdivided as follows:

- (a) General Ledger: This contains all main ledger accounts excepting individual accounts of customers, vendors and employees. For these categories there will be only one representative account in the general ledger e.g. for customers – Trade Debtors A/c (or Trade Receivables Control A/c), for suppliers – Trade Creditors A/c (or Trade Payables A/c) etc.
- (b) Sub-Ledgers: These are primarily, Customers' Ledger, Suppliers Ledger, Employees ledger etc. The customer ledger will have all individual accounts of all customers. Suppliers' ledger will have all individual accounts of all suppliers. Employee ledger will have individual accounts of all employees.

The balances of all individual accounts must tally with the balance reflected in the representative A/c in the general ledger. For this a periodical reconciliation is a must.

For example, if business has 3 customers A, B, and C; then an A/c for each of them is opened in the sub-ledger called Customers Ledger and General Ledger will have only one A/c by the name of Trade Debtors A/c. All transactions with each of them will be recorded in the individual accounts as well as the control ledger. See the following:





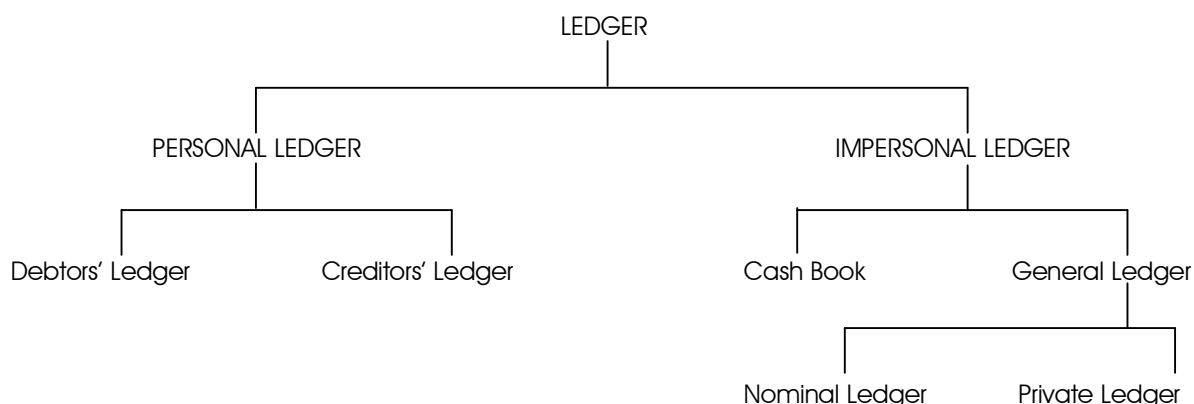
Such separation is made for better control. A person in charge of customer accounting is given responsibility of all individual customer accounting in the Customers sub-ledger, whereas another person be given responsibility for Suppliers' sub-ledger. In bigger organizations this division of labour is an absolute necessity. The person looking after General ledger is different.

Simultaneous posting of transactions into sub-ledgers A/cs and representative A/cs in general ledger may be quite tedious in manual accounting. But computerised accounting automates this process as well.

Subdivisions of Ledger

Practically, the Ledger may be divided into two groups -

(a) Personal Ledger & (b) Impersonal Ledger. They are again sub-divided as :



Personal Ledger: The ledger where the details of all transactions about the persons who are related to the accounting unit, are recorded, is called the Personal Ledger.

Impersonal Ledger: The Ledger where details of all transactions about assets, incomes & expenses etc. are recorded, is called Impersonal Ledger.

Again, Personal Ledger may be divided into two groups:

Viz. (a) Debtors' Ledger, & (b) Creditors' Ledger.

(a) Debtors' Ledger: The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc. are recorded, is called Debtors' Ledger.

(b) Creditors' Ledger: The ledger where the details of transactions about the persons from whom goods are purchased on credit, pay to them etc. are recorded, is called Creditors' Ledger.

Impersonal Ledger may, again be divided into two group, viz, (a) Cash Book; and (b) General Ledger.

(a) Cash Book: The Book where all cash & bank transactions are recorded, is called Cash Book.

(b) General Ledger: The ledger where all transactions relating to real accounts, nominal accounts, details of Debtors' Ledger and Creditors' Ledger are recorded, is called General Ledger.

General Ledger may, again, be divided into two groups. Viz, Nominal Ledger; & Private Ledger.

(a) Nominal Ledger: The ledger where all transactions relating to incomes and expenses are recorded, is called Nominal Ledger.

(b) Private Ledger: The Ledger where all transactions relating to assets and liabilities are recorded, is called Private Ledger.

Advantages of sub-division of Ledger.

The advantages of sub-division of ledger are:

- (a) **Easy to Divide work :** As a result of sub-division, the division of work is possible and records can be maintained efficiently by the concerned employee.
- (b) **Easy to handle :** As a result of sub-division, the size and volume of ledger is reduced.
- (c) **Easy to collect information:** From the different classes of Ledger a particular type of transactions can easily be found out.
- (d) **Minimizations of mistakes:** As a result of sub-division, chances of mistakes are minimized.
- (e) **Easy to compute:** As a result of sub-division, the accounting work may be computed quickly which is very helpful to the management.
- (f) **Fixation of responsibility:** Due to sub-division, allotment of different types of work to different employees is done for which concerned employee will be responsible.

Trial Balance

After the transactions are posted to various ledger accounts (either from journal or from subsidiary books) and they are balanced, the next stage is to draw up the list of all balances. We know that some ledger accounts will show 'debit balance' (debit side greater than the credit side), while the other will reflect a 'credit balance' (credit side being higher than debit side). All account balances are listed to ensure that the total of all debit balances equals the total of all credit balances. Why does this happen? Remember the dual aspect concept studied earlier in this study note?. According to this concept, every debit has equal corresponding credit. This list of balances is called Trial Balance.

According to the Dictionary for Accountants by Eric. L. Kohler, Trial Balance is defined as "a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements". According to Rolland, "The final list of balances, totaled and combined, is called Trial Balance".

As this is merely a listing of balances, this will always be as on a particular date. Further it must be understood that Trial Balance does not form part of books of account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts.

When this list with tallied debit and credit balances is drawn up, the arithmetical accuracy of basic entries, ledger posting and balancing is ensured. However, it does not guarantee that the entries are correct in all respect. This will be explained later in this chapter.

Although it is supposed to be prepared at the end of accounting period, computerized accounting packages are capable of providing instant Trial Balance reports even on daily basis, as the transactions are recorded almost on line.

Let us prepare the trial balance for the ledger accounts from the illustration 18.

Trial Balance as on...

| Account name | Debit (₹) | Credit (₹) |
|--------------------------|-----------|------------|
| Cash A/c | 6,25,000 | |
| Vikas's capital A/c | | 5,00,000 |
| Vaibhavi's capital A/c | | 2,50,000 |
| Furniture A/c | 25,000 | |
| Punjab National Bank A/c | 2,85,000 | |
| Rent A/c | 15,000 | |
| Motor Car | 4,50,000 | |
| Loan from HDFC A/c | | 4,00,000 |
| Avon Pharmaceuticals | 7,50,000 | |
| Consultancy fees A/c | | 10,00,000 |
| Salary A/c | 15,000 | |
| Salary payable A/c | | 15,000 |
| Total | 21,65,000 | 21,65,000 |

It can be seen that the totals of debit and credit balances is exactly matching. This is the result of double entry book-keeping wherein every debit has equal corresponding credit.

Feature's of a Trial Balance

1. It is a list of debit and credit balances which are extracted from various ledger accounts.
2. It is a statement of debit and credit balances.
3. The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
4. It does not prove arithmetical accuracy which can be determined by audit.
5. It is not an account. It is only a statement of account.
6. It is not a part of the final statements.
7. It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
8. It is a link between books of accounts and the Profit and Loss Account and Balance Sheet.

Preparation of Trial Balance:

1. It may be prepared on a loose sheet of paper.
2. The ledger accounts are balanced at first. They will have either "debit-balance" or "credit balance" or "nil-balance".
3. The accounts having debit-balance is written on the debit column and those having credit-balance are written on the credit column.

The sum total of both the balances must be equal, for "Every debit has its corresponding and equal credit".

Purpose of a Trial Balance

It serves the following purposes :

1. To check the arithmetical accuracy of the recorded transactions.
2. To ascertain the balance of any Ledger Account.
3. To serve as an evidence of fact that the double entry has been completed in respect of every transaction.
4. To facilitate the preparation of final accounts promptly.

Is Trial Balance indispensable?

It is a mere statement prepared by the accountants for his own convenience and if it agrees, it is assumed that at least arithmetical accuracy has been done although there may be a lot of errors.

Trial Balance is not a process of accounts, but its preparation helps us to finalise the accounts. Since it is prepared on a particular date, as at / as on is stated.

Trial Balance – Utility and Interpretation

The utility of Trial balance could be found in the following:

- (1) It forms the basis for preparation of Financial Statements i.e. Profit and Loss Account and Balance Sheet.
- (2) A tallied trial balance ensures the arithmetical accuracy of the entries made. If the trial balance does not tally, the errors can be found out, rectified and then financial statements can be prepared.
- (3) It acts as a quick reference. One can easily find out the balance in any ledger account without actually referring to the ledger.
- (4) If the listing of ledger accounts is systematically done in the trial balance, one can do quick time analysis. Hence, listing is usually done in the sequence of Asset accounts, Liability accounts, Capital accounts, Owner's equity accounts, Income or gain accounts and Expenses or losses accounts in that order.

One can draw some quick inferences from trial balance by interpreting the same. If one plots monthly trial balances side by side, one can analyse the movement of balances in various accounts e.g. one can see how expenses are increasing or decreasing or showing a trend of movements. By comparing the owner's equity balances as on two dates, one can interpret the business result e.g. if the equity has gone up, one can interpret that business has earned net profit and vice versa.

Trial Balance and Errors

We have seen that a tallied Trial Balance (T. B.) ensures arithmetical accuracy. What does it mean? It means entries have been passed as per double entry, that every debit has equal corresponding credit. If the T.B. does not tally, there could be errors in transaction entry. Such errors are called 'Errors affecting trial balance'. These can be:

- (a) Only one effect of a transaction is posted to ledger e.g. for rent paid in cash, if entry is posted to cash but not to rent account, then obviously the T.B. will not match.
- (b) Posting of wrong amount in one of the ledger accounts e.g. rent of ₹ 1,000 is paid in cash. The posting to Rent A/c is done for ₹ 1,000, Cash A/c is recorded at ₹ 10,000. The T.B. will not tally.
- (c) If one of the posting is entered twice, T.B. will not match.
- (d) If the balance in a ledger is not correctly taken to the T.B. e.g. the Rent A/c has a balance of ₹1,000, but while taking it to the T.B. it is taken as ₹ 100, the T.B. will through up difference.
- (e) Taking balance to the wrong side in the T.B. e.g. a debit balance of ₹ 5,00,000 in Debtors A/c is taken as credit balance in the TB, then there will be a mismatch.
- (f) Wrong carry forwards also will result in the T.B. mismatch.

No financial statements can be prepared if the T.B. does not tally. Hence, the errors will have to be rectified before proceeding further. The accountants therefore endeavour to minimize errors by being more careful and by doing periodical scrutiny of the entries.

Errors which are not disclosed by a Trial Balance

The following errors cannot be detected by a Trial Balance :

- (a) **Errors of Omission:** When the transaction is not at all recorded in the books of accounts, i.e. neither in the debit side nor in the credit side of the account – trial balance will agree.
- (b) **Errors of Commission:** Where there is any variation in figure/amount, e.g. instead of ₹ 800 either ₹80 or ₹ 8,000 is recorded, in both sides of ledger accounts – trial balance will agree.
- (c) **Errors of Principal:** When accounts are prepared not according to double entry principle e.g. Purchase of a Plant wrongly debited to Purchase Account – Trial balance will agree.
- (d) **Errors of Misposting:** When wrong posting is made to a wrong account instead of a correct one although amount is correctly recorded, e.g., sold goods to B but wrongly debited to D's Account – trial balance will agree.
- (e) **Compensating Errors:** When one error is compensated by another error e.g. Discount Allowed ₹100 not debited to Discount Allowed Account, whereas interest received ₹100, but not credit to Interest Account – trial balance will agree.

Procedure to locate Errors:

If the Trial Balance does not agree, the following procedure should carefully be followed:

- (i) At first, check all ledger account balance one by one.
- (ii) Addition of both the columns (Debit and Credit) should be checked.
- (iii) If any difference comes divide the same by 2 and see whether the said figure appear on the correct side or not.
- (iv) Additions of the subsidiary books, and ledger accounts to be checked up.
- (v) Posting from subsidiary books to the ledger to be checked up.
- (vi) Opening balance of all account whether brought forward correctly or not to be checked up.
- (vii) Even if the trial balance does not agree upto this level checking should be started again from the journal and book of original entry using tick mark.

Illustration 14.

From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March,2013.
 Capital ₹ 80,000 ; Sales ₹10,00,000; Adjusted Purchase ₹ 8,00,000; Current A/c(Cr) ₹ 10,000; Petty Cash ₹10,000;
 Sales Ledger Balance ₹ 1,20,000; Purchase Ledger Balance ₹ 60,000; Salaries ₹24,000; Carriage Inwards ₹ 4,000;
 Carriage Outward ₹ 6,000; Discount Allowed ₹ 10,000; Building ₹ 80,000; Outstanding Expenses ₹ 10,000; Prepaid



Insurance ₹ 2,000 ; Depreciation ₹ 4,000 ; Cash at Bank ₹ 80,000 ; Loan A/c (Cr) ₹ 66,000; Profit & Loss A/c(Cr) ₹ 20,000; Bad Debts Recovered ₹ 2,000 ; Stock at 31.03.2013 ₹ 1,20,000; Interest Received ₹ 10,000; Accrued Interest ₹ 4,000; Investment ₹ 20,000; Provision for Bad Debts (01.04.2012) ₹ 6,000 ; General Reserve ₹ 20,000.

Solution:

**Trial Balance of Mr. Sen
as on 31st March, 2013**

| Dr. | Amount (₹) | Cr. | Amount (₹) |
|--------------------------|------------------|--------------------------|------------------|
| Heads of Accounts | | Heads of Accounts | |
| Adjusted Purchase | 8,00,000 | Capital | 80,000 |
| Petty Cash | 10,000 | Sales | 10,00,000 |
| Sales Ledger Balance | 1,20,000 | Current A/c | 10,000 |
| Salaries | 24,000 | Purchase Ledger Balance | 60,000 |
| Carriage Inward | 4,000 | Outstanding Expenses | 10,000 |
| Discount Allowed | 10,000 | Loan A/c | 66,000 |
| Building | 80,000 | Profit & Loss A/c(cr) | 20,000 |
| Prepaid Insurance | 2,000 | Bad Debts Recovered | 2,000 |
| Depreciation | 4,000 | Interest Received | 10,000 |
| Cash at Bank | 80,000 | Provision for Bad debts | 6,000 |
| Stock (31.03.2013) | 1,20,000 | General Reserve | 20,000 |
| Accrued Interest | 4,000 | | |
| Investment | 20,000 | | |
| Carriage outward | 6,000 | | |
| | 12,84,000 | | 12,84,000 |

Note: Closing Stock will appear in Trial Balance since there is adjusted purchase.

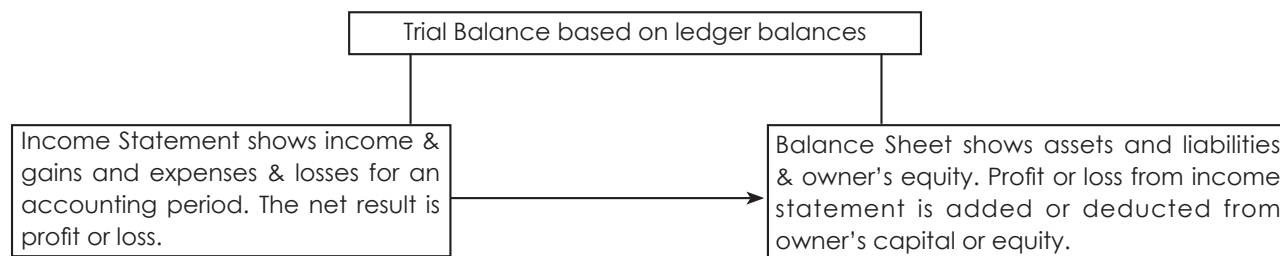
Adjusted purchase = Opening Stock + Purchase - Closing Stock.

It may be noted that if only adjusted purchase is considered then the matching concept is affected. Hence, to satisfy the matching concept, closing stock is also considered in Trial Balance.

Measurement, Valuation and Accounting Estimates

At the end of the last section, it was stated that Trial Balance forms the basis for preparing financial statements. However, there are certain other tasks that have to be completed before these final accounts are prepared. You know that accounting entries are made on the basis of actual transactions carried out during an accounting period. These are all included in the trial balance. However, there could be certain other business realities which are to be recognized as either asset, liability, income, gain, expense, loss or a combination thereof. As we know the matching concept necessitates the consideration of all aspects which may affect the financial result of the business. Technically these are called as adjustments for which entries need to be passed, without which the financial statements will not give a true and fair view of business activity. We discuss some of these entries and adjustments in the following sections.

Before discussing these, let us understand the meaning of Income Statement and Balance Sheet.

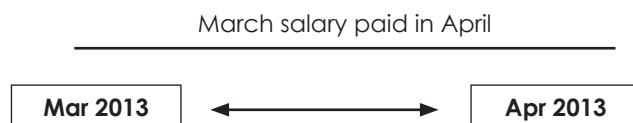




The effect given is one – include in the P & L A/c as expense for the period and two – reduce from asset value in the Balance Sheet.

Accrued Expenses or Outstanding Expenses

There may be expenses incurred for the current accounting period, but not actually paid for. The matching concept, however, necessitates that this expense must be recognized as expense for the current year and should not be deferred till its actual payment. Typically, we know salary for the month is normally paid in the 1st week of the next month. Imagine the accounting period close on 31st March. The salary for the month of March is not paid till 31st March. But it is related to this month, it must be booked as expense for the current month and also as a liability payable in the next month (which is in next accounting period). This can be shown as follows:



The entry for this is:

Expense A/c Dr.
 To Outstanding Expense A/c or Expense payable A/c

The two effects when preparing the final accounts are:

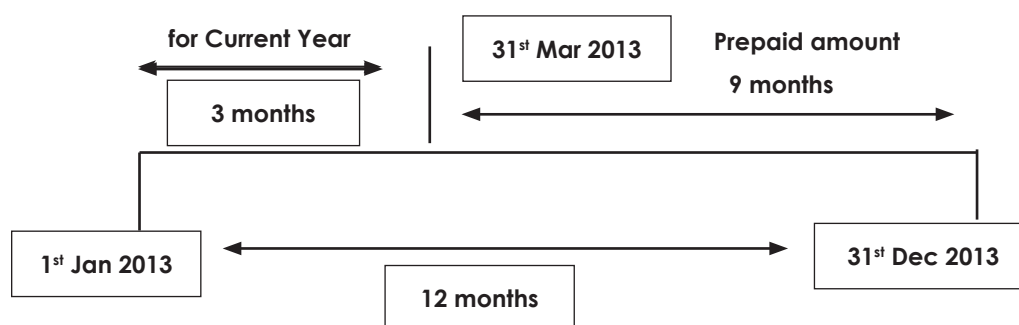
One – add in respective expense in P & L A/c and two – show as a liability in the Balance Sheet.

Prepaid Expenses

At times we may pay for certain expenses which are period related. For example, the business has taken an insurance policy against fire on which the annual premium payable is ₹ 75,000. The policy is taken on 1st January 2013 valid till 31st December 2013. But the company's accounting period ends on 31st March 2013. When considering the insurance expense for the accounting year, what amount should be considered? See the following.

As can be seen, out of the total premium period of 12 months, only 3 months are related to the current accounting period and the remaining 9 months' premium is related to the next accounting period. Hence only 3 months' premium is to be considered as expense for the current year i.e. ₹ 18750 ($75000 \div 4$).

The entry for this is:



Prepaid Insurance A/c Dr.
 To Insurance A/c

The two effects while preparing final accounts are:

One – Reduce from respective expense in P & L A/c and two – show as an asset in the Balance Sheet.



- June 22: Paid to Aniket ₹ 25,500 in full settlement of A/c.
 June 25: Cash stolen from cash box ₹ 1,000.
 June 27: Received from Vishakha ₹ 14,500 and discount allowed ₹ 200.
 June 30: Interest received ₹ 2,400 directly added in our bank account.

Solution:

**In the books of Gourav
Journal Entries**

| Date | Particulars | L.F. | Dr. | Cr. |
|---------------|--|------|-----------------|----------------------|
| | | | Amount (₹) | Amount (₹) |
| 2013 1-Jun | Cash A/c Dr. To Capital A/c To Loan from Wife A/c (Being capital brought into business) | | 10,00,000 | 7,50,000 2,50,000 |
| 4-Jun | Purchases A/c Dr. To Cash A/c To Aniket's A/c (Being goods purchased at 20% TD & 1/5th amount paid in cash) | | 32,000 | 6,400 25,600 |
| 7-Jun | Purchases A/c Dr. To Cash A/c (Being cash purchases) | | 25,000 | 25,000 |
| 10-Jun | Cash A/c Dr. Vishakha's A/c Dr. To Sales A/c (Being goods sold at 30% TD & 30% amount received in cash) | | 6,300 14,700 | 21,000 |
| 12-Jun | Bank A/c Dr. To Cash A/c (Being cash deposited in bank) | | 20,000 | 20,000 |
| 15-Jun | Loss by Fire A/c Dr. To Purchases A/c (Being uninsured goods lost by fire) | | 5,500 | 5,500 |
| 19-Jun | Cash A/c Dr. To Commission A/c (Being commission received) | | 3,500 | 3,500 |
| 22-Jun | Aniket's A/c Dr. To Cash A/c To Discount A/c (Being paid to Aniket in full settlement & discount received) | | 25,600 | 25,500 100 |
| 25-Jun | Loss by Theft A/c Dr. To Cash A/c (Being cash stolen) | | 1,000 | 1,000 |
| 27-Jun | Cash A/c Dr. Discount A/c To Vishakha's A/c (Being amount received from Vishakha & discount allowed) | | 14,500 200 | 14,700 |

| | | | | |
|--------|---|--|-----------|-----------|
| 30-Jun | Bank A/c To Interest A/c (Being interest received directly added into bank account) | | 2,400 | 2,400 |
| | | | 1,150,700 | 1,150,700 |

| Dr. Cash Account | | | | Cr. | | | |
|------------------|-----------------------|------|------------|---------|----------------------|------|------------|
| Date | Particulars | J.F. | Amount (₹) | Date | Particulars | J.F. | Amount (₹) |
| 1/6/13 | To Capital A/c | | 7,50,000 | 4/6/13 | By Purchases A/c | | 6,400 |
| 1/6/13 | To Loan from Wife A/c | | 2,50,000 | 7/6/13 | By Purchases A/c | | 25,000 |
| 10/6/13 | To Sales A/c | | 6,300 | 12/6/13 | By Bank A/c | | 20,000 |
| 19/6/13 | To Commission A/c | | 3,500 | 22/6/13 | By Aniket's A/c | | 25,500 |
| 27/6/13 | To Vishakha's A/c | | 14,500 | 25/6/13 | By Loss by Theft A/c | | 1,000 |
| | | | | 30/6/13 | By Balance c/d | | 9,46,400 |
| | | | 10,24,300 | | | | 10,24,300 |
| 1/7/13 | To Balance b/d | | 9,46,400 | | | | |

| Dr. Capital Account | | | | Cr. | | | |
|---------------------|----------------|------|----------|--------|----------------|------|----------|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 30/6/13 | To Balance c/d | | 7,50,000 | 1/6/13 | By Cash A/c | | 7,50,000 |
| | | | 7,50,000 | | | | 7,50,000 |
| | | | | 1/7/13 | By Balance b/d | | 7,50,000 |

| Dr. Loan from Wife Account | | | | Cr. | | | |
|----------------------------|----------------|------|------------|--------|----------------|------|----------|
| Date | Particulars | J.F. | Amount (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 30/6/13 | To Balance c/d | | 2,50,000 | 1/6/13 | By Cash A/c | | 2,50,000 |
| | | | 2,50,000 | | | | 2,50,000 |
| | | | | 1/7/13 | By Balance b/d | | 2,50,000 |

| Dr. Purchases Account | | | | Cr. | | | |
|-----------------------|-----------------|------|----------|---------|-----------------|------|----------|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 4/6/13 | To Cash A/c | | 6,400 | 15/6/13 | By Loss by fire | | 5,500 |
| 4/6/13 | To Aniket's A/c | | 25,600 | 30/6/13 | By Balance c/d | | 51,500 |
| 7/6/13 | To Cash A/c | | 25,000 | | | | 57,000 |
| | | | 57,000 | | | | |
| 1/7/13 | To Balance b/d | | 51,500 | | | | |

| Dr. Aniket's Account | | | | Cr. | | | |
|----------------------|-------------|------|----------|--------|------------------|------|----------|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 22/6/13 | To Cash A/c | | 25,500 | 4/6/13 | By Purchases A/c | | 25,600 |



| | | | | | | | |
|---------|-----------------|--|--------|--|--|--|--------|
| 22/6/13 | To Discount A/c | | 100 | | | | |
| | | | 25,600 | | | | 25,600 |

| Dr. | | Vishakha's Account | | | | | | Cr. |
|---------|--------------|--------------------|----------|---------|-----------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 10/6/13 | To Sales A/c | | 14,700 | 27/6/13 | By Cash A/c | | 14,500 | |
| | | | | 27/6/13 | By Discount A/c | | 200 | |
| | | | 14,700 | | | | 14,700 | |

| Dr. | | Sales Account | | | | | | Cr. |
|---------|----------------|---------------|----------|---------|-------------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 30/6/13 | To Balance c/d | | 21,000 | 10/6/13 | By Cash A/c | | 6,300 | |
| | | | | 10/6/13 | By Vishakha's A/c | | 14,700 | |
| | | | 21,000 | | | | 21,000 | |
| | | | | 1/7/13 | By Balance b/d | | 21,000 | |

| Dr. | | Bank Account | | | | | | Cr. |
|---------|-----------------|--------------|----------|---------|----------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 12/6/13 | To Cash A/c | | 20,000 | 30/6/13 | By Balance c/d | | 22,400 | |
| 30/6/13 | To Interest A/c | | 2,400 | | | | | |
| | | | 22,400 | | | | 22,400 | |
| 1/7/13 | To Balance b/d | | 22,400 | | | | | |

| Dr. | | Loss by Fire Account | | | | | | Cr. |
|---------|------------------|----------------------|----------|---------|----------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 15/6/13 | To Purchases A/c | | 5,500 | 30/6/13 | By Balance c/d | | 5,500 | |
| | | | 5,500 | | | | 5,500 | |
| 1/7/13 | To Balance b/d | | 5,500 | | | | | |

| Dr. | | Commission Account | | | | | | Cr. |
|---------|----------------|--------------------|----------|---------|----------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 30/6/13 | To Balance c/d | | 3,500 | 19/6/13 | By Cash A/c | | 3,500 | |
| | | | 3,500 | | | | 3,500 | |
| | | | | 1/7/13 | By Balance b/d | | 3,500 | |

| Dr. | | Discount Account | | | | | | Cr. |
|---------|-------------------|------------------|----------|---------|-----------------|------|----------|-----|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) | |
| 27/6/13 | To Vishakha's A/c | | 200 | 22/6/13 | By Aniket's A/c | | 100 | |
| | | | | 30/6/13 | By Balance c/d | | 100 | |
| | | | 200 | | | | 200 | |

| | | | | | | |
|--------|----------------|--|-----|--|--|--|
| 1/7/13 | To Balance b/d | | 100 | | | |
|--------|----------------|--|-----|--|--|--|

| Dr. | | Loss by Theft Account | | | | Cr. | |
|---------|----------------|-----------------------|----------|---------|----------------|------|----------|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 25/6/13 | To Cash A/c | | 1,000 | 30/6/13 | By Balance c/d | | 1,000 |
| | | | 1,000 | | | | 1,000 |
| 1/7/13 | To Balance b/d | | 1,000 | | | | |

| Dr. | | Interest Account | | | | Cr. | |
|---------|----------------|------------------|----------|---------|----------------|------|----------|
| Date | Particulars | J.F. | Amt. (₹) | Date | Particulars | J.F. | Amt. (₹) |
| 30/6/13 | To Balance c/d | | 2,400 | 30/6/13 | By Bank A/c | | 2,400 |
| | | | 2,400 | | | | 2,400 |
| | | | | 1/7/13 | By Balance b/d | | 2,400 |

Trial Balance as on 30.6.13

| Name of Account | Dr. (₹) | Cr. (₹) |
|--------------------|------------|------------|
| Cash A/c | 9,46,400 | ---- |
| Capital A/c | ---- | 7,50,000 |
| Loan from Wife A/c | ---- | 2,50,000 |
| Purchases A/c | 51,500 | ---- |
| Aniket's A/c | ---- | ---- |
| Vishakha's A/c | ---- | ---- |
| Sales A/c | ---- | 21,000 |
| Bank A/c | 22,400 | ---- |
| Loss by Fire A/c | 5,500 | ---- |
| Commission A/c | ---- | 3,500 |
| Discount A/c | 100 | ---- |
| Loss by Theft A/c | 1,000 | ---- |
| Interest A/c | ---- | 2,400 |
| Total | 10,26,900 | 10,26,900 |

1.5 ACCOUNTING FOR DEPRECIATION

A business or concern holds fixed assets for regular use and not for resale. The capability of a fixed asset to render service cannot be unlimited. Except land, all other fixed assets have a limited useful life. The benefit of a fixed asset is received throughout its useful life. So its cost is the price paid for the 'Series of Services' to be received or enjoyed from it over a number of years and it should be spread over such years.

Depreciation means gradual decrease in the value of an asset due to normal wear and tear, obsolescence etc. In short, depreciation means the gradual diminution, loss or shrinkage in the utility value of an asset due to wear and tear in use, effluxion of time or introduction of technology in the market. A certain percentage of total cost of fixed assets which has expired and as such turned into expense during the process of its use in a particular accounting period.

Indian Accounting Standard (AS 6) states that "Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset."



“Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is the portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be the measurement of the effect of all such occurrences.”

The above definition may be criticized as under:

- (i) It does not classify properly what is meant by systematic and rational manner. The word 'rational' may mean that it should reasonably be related to the expected benefits in any case.
- (ii) Historical cost and any other kind of cost should be allocated or not does not defined by this definition.
- (iii) Some Accountants are in a belief that depreciation is nothing but an arbitrary allocation of cost. According to them, all the conventional methods say allocation of historical cost over a number of years is arbitrary.

Certain Useful Terms

Amortization - Intangible assets such as goodwill, trademarks and patents are written off over a number of accounting periods covering their estimated useful lives. This periodic write off is known as *Amortization* and that is quite similar to depreciation of tangible assets. The term amortization is also used for writing off leasehold premises. Amortization is normally recorded as a credit to the asset account directly or to a distinct provision for depreciation account. Though the write off of intangibles that have no limited life is not approved by some Accountants, some concerns do amortize such assets on the ground of conservatism.

Depletion - This method is specially suited to mines, oil wells, quarries, sandpits and similar assets of a wasting character. In this method, the cost of the asset is divided by the total workable deposits of the mine etc. And by following the above manner rate of depreciation can be ascertained. Depletion can be distinguishable from depreciation in physical shrinkage or lessening of an estimated available quantity and the latter implying a reduction in the service capacity of an asset.

Obsolescence – The term 'Obsolescence' refers to loss of usefulness arising from such factors as technological changes, improvement in production methods, change in market demand for the product output of the asset or service or legal or medical or other restrictions. It is different from depreciation or exhaustion, wear and tear and deterioration in that these terms refer to functional loss arising out of a change in physical condition.

Dilapidation - In one sentence Dilapidation means a state of deterioration due to old age or long use. This term refers to damage done to a building or other property during tenancy.

Nature of Depreciation

Depreciation is a term applicable in case of plant, building, equipment, machinery, furniture, fixtures, vehicles, tools etc. These long-term or fixed assets have a limited useful life, i.e. they will provide service to the entity (in the form of helping in the generation of revenue) over a limited number of future accounting periods. Depreciation implies gradual decrease in the value of an asset due to normal wear and tear, obsolescence etc. In short, depreciation means the gradual diminution, loss or shrinkage in the utility value of an asset due to wear and tear in use, effluxion of time or introduction of technology in the market. It makes a part of the cost of assets chargeable as an expense in profit and loss account of the accounting periods in which the assets helped in earning revenue.

Thus, **International Accounting Standard (IAS)-4** provides that “Depreciation is the allocation of the depreciable amount of an asset over its estimated useful life.”

In Accounting Research Bulletin No. 22, **AICPA** observed that “Depreciation for the year is the portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be the measurement of the effect of all such occurrences.”

Causes of Depreciation

A. Internal Causes

- (i) **Wear and tear** : Plant & machinery, furniture, motor vehicles etc. suffer from loss of utility due to vibration, chemical reaction, negligent handling, rusting etc.
- (ii) **Depletion (or exhaustion)** : The utility or resources of wasting assets (like mines etc.) decreases with regular extractions.

B. External or Economic Causes

- (i) **Obsolescence** : Innovation of better substitutes, change in market demand, imposition of legal restrictions may result into discarding an asset.
- (ii) **Inadequacy** : Changes in the scale of production or volume of activities may lead to discarding an asset.

C. Time element : With the passage of time some intangible fixed assets like lease, patents, copy-rights etc., lose their value or effectiveness, whether used or not. The word “amortization” is a better term to speak for the gradual fall in their values.

D. Abnormal occurrences : An accident, fire or natural calamity can damage the service potential of an asset partly or fully. As a result the effectiveness of the asset is affected and reduced.

Characteristics of Depreciation

The Characteristics of Depreciation are:

- (i) It is a **charge against profit**.
- (ii) It indicates **diminution in service potential**.
- (iii) It is an **estimated loss** of the value of an asset. It is not an **actual loss**.
- (iv) It depends upon different **assumptions**, like effective life and residual value of an asset.
- (v) It is a process of allocation and not of valuation.
- (vi) It arises mainly from an **internal cause** like wear and tear or depletion of an asset. But it is treated as any expense charged against profit like rent, salary, etc., which arise due to an **external transaction**.
- (vii) Depreciation on any particular asset is **restricted** to the working life of the asset.
- (viii) It is charged on **tangible fixed assets**. It is not charged on any current asset. For allocating the costs of intangible fixed assets like goodwill, etc., a certain amount of their total costs may be charged against periodic revenues. This is known as **amortization**.

Objective and Necessity for Providing Depreciation

Eric Kohler defined depreciation as “the lost usefulness, expired utility, the diminution in service yield.” Its measurement and charging are necessary for cost recovery. It is treated as a part of the expired cost for an asset. For determination of revenue, that part or cost should be matched against revenue. The objects or necessities of charging depreciation are:

- (i) **Correct calculation of cost of production:** Depreciation is an allocated cost of a fixed asset. It is to be calculated and charged correctly against the revenue of an accounting period. It must be correctly included within the cost of production.
- (ii) **Correct calculation of profits:** Costs incurred for earning revenues must be charged properly for correct calculation of profits. The consumed cost of assets (depreciation) has to be provided for correct matching of revenues with expenses.
- (iii) **Correct disclosure of fixed assets at reasonable value:** Unless depreciation is charged, the depreciable asset cannot be correctly valued and presented in the Balance Sheet. Depreciation is charged so that the Balance Sheet exhibits a true and fair view of the affairs of the business.
- (iv) **Provision of replacement cost:** Depreciation is a non-cash expense. But net profit is calculated after charging it. Through annual depreciation cash resources are saved and accumulated to provide replacement cost at the end of the useful life of an asset.
- (v) **Maintenance of capital:** A significant portion of capital has to be invested for purchasing fixed assets. The values of such assets are gradually reduced due to their regular use and passage of time. Depreciation on the assets is treated as an expired cost and it is matched against revenue. If it is not charged the profits will remain inflated. This will cause capital erosion.
- (vi) **Compliance with technical and legal requirements:** Depreciation has to be charged to comply with the

relevant provisions of the Companies Act and Income Tax Act.

Note: As per Companies Act 1956, a company have to provide for depreciation on fixed assets before declaration of dividends.

Methods of Charging Depreciation

There are different concepts about the nature of depreciation. Moreover, the nature of all fixed assets cannot be the same. As a result, different methods are found to exist for charging depreciation. A broad classification of the methods may be summarized as follows:

Capital/Source of Fund

- (i) Sinking Fund Method
- (ii) Annuity Method
- (iii) Insurance Policy Method

Time Base

- (i) Fixed Installment Method
- (ii) Reducing Balance Method
- (iii) Sum of Years' Digit Method
- (iv) Double Declining Method

Use Base

- (i) Working Hours Method
- (ii) Mileage Method
- (iii) Depletion Service Hours Method
- (iv) Unit method

Price Base

- (i) Revaluation Method
- (ii) Repairs Provision Method

Some important Methods of Charging Depreciation are discussed as below :

I. Fixed/Equal Instalment OR Straight Line Method

Features:

- (i) A fixed portion of the cost of a fixed asset is allocated and charged as periodic depreciation.
- (ii) Such depreciation becomes an equal amount in each period.
- (iii) The formula for calculation of depreciation is : $\text{Depreciation} = (V-S)/n$

Where,

V = Cost of the asset

S = Residual value or the expected scrap value of the asset n = Estimated life of the asset

Illustration: 16

| Machine No. | Cost of Machine (₹) | Expenses incurred at the time of purchase to be capitalized (₹) | Estimated Residual Value (₹) | Expected Useful Life in years |
|-------------|------------------------|--|---------------------------------|-------------------------------|
| 1 | 90,000 | 10,000 | 20,000 | 8 |
| 2 | 24,000 | 7,000 | 3,100 | 6 |

| | | | | |
|---|----------|--------|--------|---|
| 3 | 1,05,000 | 20,000 | 12,500 | 3 |
| 4 | 2,50,000 | 30,000 | 56,000 | 5 |

Solution:

| Machine No | Cost of Machine (₹) | Expenses incurred at the time of purchase to be capitalize (₹) | Total Cost of Asset = (b+c) (₹) | Estimated Residual Value (₹) | Expected Useful Life in years | Depreciation = (d-e)/f (₹) | Rate of Depreciation under SLM = (g/d)×100 |
|------------|---------------------|--|---------------------------------|------------------------------|-------------------------------|----------------------------|--|
| a | b | c | d | e | f | g | h |
| 1 | 90,000 | 10,000 | 1,00,000 | 20,000 | 8 | 10,000 | 10% |
| 2 | 24,000 | 7,000 | 31,000 | 3,100 | 6 | 4,650 | 15% |
| 3 | 1,05,000 | 20,000 | 1,25,000 | 12,500 | 5 | 22,500 | 18% |
| 4 | 2,50,000 | 30,000 | 2,80,000 | 56,000 | 10 | 22,400 | 8% |

Illustration 17.

A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2014 if this machine is purchased on:

- (a) 1st April, 2013
- (b) 1st July, 2013
- (c) 1st October, 2013
- (d) 1st January, 2014

Solution:

Here, Total Cost of Asset = Purchased Price + Cost of Cartage and Installation
 = ₹ 7,00,000 + ₹ 3,00,000 = ₹ 10,00,000

Amount of Depreciation:

$$= \text{Total Cost of Asset} \times \text{Rate of Depreciation} \times \frac{\text{Period from the date of purchase to date of closing accounts}}{12}$$

- (a) The machine was purchased on 1st April, 2013:
 Amount of Depreciation = ₹ 10,00,000 × 20% × $\frac{12}{12}$ = ₹ 2,00,000
- (b) 1st July, 2013
 Amount of Depreciation = ₹ 10,00,000 × 20% × $\frac{9}{12}$ = ₹ 1,50,000
- (c) 1st October, 2013
 Amount of Depreciation = ₹ 10,00,000 × 20% × $\frac{6}{12}$ = ₹ 1,00,000
- (d) 1st January, 2014
 Amount of Depreciation = ₹ 10,00,000 × 20% × $\frac{3}{12}$ = ₹ 50,000

II. Reducing / Diminishing Balance Method or Written Down Value Method

Features:

- (i) Depreciation is calculated at a fixed percentage on the original cost in the first year. But in subsequent years it is calculated at the same percentage on the written down values gradually reducing during the expected working life of the asset.



- (ii) The rate of allocation is constant (usually a fixed percentage) but the amount allocated for every year gradually decreases.

Illustration 18.

On 1.1.2011 a machine was purchased for ₹ 1,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2013.

Solution:

| Year | Opening Book Value (₹) | Rate | Depreciation (₹) | Closing Book Value (₹) |
|------|------------------------|------|------------------|------------------------|
| 2011 | 1,50,000 | 10% | 15,000 | 1,35,000 |
| 2012 | 1,35,000 | 10% | 13,500 | 1,21,500 |
| 2013 | 1,21,500 | 10% | 12,150 | 1,09,350 |

Note: Cost of the machine (i.e. Opening Book Value for the year 2011)

= Cost of Purchase + Cost of Installation

= ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

Illustration 19.

On 1.1.11 machinery was purchased for ₹ 80,000. On 1.7.12 additions were made to the amount of ₹ 40,000. On 31.3.2013, machinery purchased on 1.7.2012, costing ₹ 12,000 was sold for ₹ 11,000 and on 30.06.2013 machinery purchased on 1.1.2014 costing ₹ 32,000 was sold for ₹ 26,700. On 1.10.2013, additions were made to the amount of ₹ 20,000. Depreciation was provided at 10% p.a. on the Diminishing Balance Method.

Show the Machinery Accounts for three years from 2011-2013. (year ended 31st December)

Solution:

Statement of Depreciation

| Date | Particulars | Machines – I Cost = ₹ 80,000 | | Machines – II Cost = ₹ 40,000 | | Machines – III Cost = ₹ 20,000 | Total Depreciation |
|------------|----------------|---------------------------------|--------------|----------------------------------|------------|-----------------------------------|-----------------------|
| | | ₹ | ₹ | ₹ | ₹ | ₹ | ₹ |
| 01.01.2011 | Book Value | 48,000 | 32,000 | | | | |
| 31.12.2011 | Depreciation | 4,800 | 3,200 | | | | 8,000 |
| 01.01.2012 | W.D.V. | 43,200 | 28,800 | | | | |
| 01.07.2012 | Purchase | | | 28,000 | 12,000 | | |
| 31.12.2012 | Depreciation | 4,320 | 2,880 | 1,400 | 600 | | 9,200 |
| 01.01.2013 | W.D.V. | 38,880 | 25,920 | 26,600 | 11,400 | | |
| 31.03.2013 | Depreciation | | | | <u>285</u> | | 285 |
| | W.D.V. | | | | 11,115 | | |
| | Sold For | | | | 11,000 | | |
| | Loss on sale | | | | <u>115</u> | | |
| 30.06.2013 | Depreciation | | 1,296 | | | | 1,296 |
| | W.D.V. | | 24,624 | | | | |
| | Sold For | | 26,700 | | | | |
| | Profit on Sale | | <u>2,076</u> | | | | |
| 01.10.2013 | Purchase | | | | | 20,000 | |
| 31.12.2013 | Depreciation | 3,888 | | 2,660 | | 500 | 7,048 |
| 01.01.2014 | W.D.V. | <u>34,992</u> | | <u>23,940</u> | | <u>19,500</u> | |

| Dr. | | Machinery Account | | Cr. | |
|----------|-------------------------------|-------------------|----------|-----------------------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 01.01.11 | To, Bank A/c | 80,000 | 31.12.11 | By, Depreciation A/c | 8,000 |
| | | | | ,, Balance c/d | 72,000 |
| | | 80,000 | | | 80,000 |
| 01.01.12 | To, Balance b/d | 72,000 | 31.12.12 | By, Depreciation A/c | 9,200 |
| 01.07.12 | ,, Bank A/c | 40,000 | | ,, Balance c/d | 1,02,800 |
| | | 1,12,000 | | | 1,12,000 |
| 01.01.13 | To, Balance b/d | 1,02,800 | 31.3.13 | By, Bank (Sale) A/c | 11,000 |
| 30.06.13 | ,, P & L A/c (Profit on Sale) | 2,076 | | ,, Depreciation A/c | 285 |
| | ,, Bank A/c | 20,000 | 30.6.13 | ,, P & L A/c (Loss on Sale) | 115 |
| | | | | ,, Bank A/c (Sale) | 26,700 |
| | | | 31.12.13 | ,, Depreciation A/c | 1,296 |
| | | | | ,, Depreciation A/c | 7,048 |
| | | | | ,, Balance c/d | 78,432 |
| | | 1,24,876 | | | 1,24,876 |

Provision for Depreciation Account

Provision of depreciation is the collected value of all depreciation. Provision of depreciation account is the account of provision of depreciation. With making of this account we are not credited depreciation in asset account, but transfer every year depreciation to provision of depreciation account. Every year we adopt this procedure and when assets are sold we will transfer sold asset's 'total depreciation' to credit side of asset account, for calculating correct profit or loss on fixed asset. This provision uses with any method of calculating depreciation.

There are following features of provision for depreciation account:

- Fixed asset is made on its original cost and every year depreciation is not transfer to fixed asset account.
- Provision of depreciation account is Conglomerated value of all old depreciation.
- This system can be used both in straight line and diminishing method of providing depreciation.

The journal entries will be :

- For purchase of asset

| | |
|------------------|-----|
| Asset's A/c | Dr. |
| To Cash/Bank A/c | |
- For providing depreciation at end of year

| | |
|-----------------------------------|-----|
| Depreciation A/c | Dr. |
| To Provision for depreciation A/c | |
- For sale of assets

| | |
|--------------------|-----|
| Cash/Bank A/c | Dr. |
| To Asset Sales A/c | |
- Cost of assets sold transferred from Assets Account to Sale of Assets Account.

| | |
|------------------|-----|
| Assets Sales A/c | Dr. |
| To Asset's A/c. | |
- Total depreciation on asset sold transferred from provision for depreciation account.

| | |
|--------------------------------|-----|
| Provision for depreciation A/c | Dr. |
| To Asset Sales A/c | |
- Profit or loss on sale of assets will be transferred from asset sale account to Profit or Loss Account.



Disposal of an Asset

When an asset is sold because of obsolescence or inadequacy or any other reason, the cost of the asset is transferred to a separate account called "Asset Disposal Account". The following entries are to be made:

- (i) When the cost of the asset is transferred:

| | |
|-------------------------------|-----|
| Asset Disposal A/c | Dr. |
| To, Asset A/c (original cost) | |
- (ii) When depreciation provided on the asset is transferred:

| | |
|--------------------------------|-----|
| Provision for Depreciation A/c | Dr. |
| To, Asset Disposal A/c | |
- (iii) For charging depreciation for the year of sale:

| | |
|------------------------|-----|
| Depreciation A/c | Dr. |
| To, Asset Disposal A/c | |
- (iv) When cash received on sale of asset:

| | |
|------------------------|-----|
| Bank/Cash A/c | Dr. |
| To, Asset Disposal A/c | |
- (v) When loss on disposal is transferred to Profit & Loss A/c:

| | |
|------------------------|-----|
| Profit & Loss A/c | Dr. |
| To, Asset Disposal A/c | |
- (vi) When profit on disposal is transferred to Profit & Loss A/c:

| | |
|-----------------------|-----|
| Asset Disposal A/c | Dr. |
| To, Profit & Loss A/c | |

Illustration 20.

S & Co. purchased a machine for ₹ 1,00,000 on 1.1.2011. Another machine costing ₹ 1,50,000 was purchased on 1.7.2012. On 31.12.2013, the machine purchased on 1.1.2011 was sold for ₹ 50,000. The company provides depreciation at 15% on Straight Line Method. The company closes its accounts on 31st December every year. Prepare – (i) Machinery A/c, (ii) Machinery Disposal A/c and (iii) Provision for Depreciation A/c.

Solution:

| S & Co. | | | | | |
|--------------------------|-----------------|------------|------------|----------------------------|------------|
| Dr. | | | Cr. | | |
| Machinery Account | | | | | |
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 1.1.2011 | To, Bank A/c | 1,00,000 | 31.12.2011 | By, Balance c/d | 1,00,000 |
| | | 1,00,000 | | | 1,00,000 |
| 1.1.2012 | To, Balance b/d | 1,00,000 | | | |
| 1.7.2012 | To, Bank A/c | 1,50,000 | 31.12.2012 | By, Balance c/d | 2,50,000 |
| | | 2,50,000 | | | 2,50,000 |
| 1.1.2013 | To, Balance b/d | 2,50,000 | 31.12.2013 | By, Machinery Disposal A/c | 1,00,000 |
| | | 2,50,000 | 31.12.2013 | By, Balance c/d | 1,50,000 |
| | | 1,50,000 | | | 2,50,000 |
| 1.1.2014 | To, Balance b/d | 1,50,000 | | | |

| Dr. | | | Provision for Depreciation Account | | | Cr. | | |
|------------|----------------------------|------------|------------------------------------|---|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 31.12.2011 | To, Balance c/d | 15,000 | 31.12.2011 | By, Depreciation A/c | 15,000 | | | |
| | | 15,000 | | | 15,000 | | | |
| 31.12.2012 | To, Balance c/d | 41,250 | 1.1.2012 | By, Balance b/d | 15,000 | | | |
| | | 41,250 | 31.12.2012 | By, Depreciation A/c (₹ 15,000 + ₹ 11,250) | 26,250 | | | |
| 31.12.2013 | To, Machinery Disposal A/c | 30,000 | 1.1.2013 | By, Balance b/d | 41,250 | | | |
| 31.12.2013 | To, Balance c/d | 33,750 | 31.12.2013 | By, Depreciation A/c | 22,500 | | | |
| | | 63,750 | | | 63,750 | | | |
| | | | 1.1.2014 | By, Balance b/d | 33,750 | | | |

| Dr. | | | Machinery Disposal Account | | | Cr. | | |
|------------|-------------------|------------|----------------------------|-------------------------------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 31.12.2013 | To, Machinery A/c | 1,00,000 | 31.12.2013 | By, Provision for Depreciation A/c | 30,000 | | | |
| | | | | By, Depreciation A/c | 15,000 | | | |
| | | | | By, Bank A/c | 50,000 | | | |
| | | | | By, Profit & Loss A/c(Loss on Sale) | 5,000 | | | |
| | | 1,00,000 | | | 1,00,000 | | | |

Working Notes

- Depreciation for the machine purchased on 1.7.2012
For the year 2012 (used for 6 months) = ₹ 1,50,000 × 15% × 6/12 = ₹ 11,250
For the year 2013 (used for full year) = ₹ 1,50,000 × 15% = ₹ 22,500
- Depreciation for the machine purchased on 1.1.2011
Depreciation = ₹ 1,00,000 × 15% = ₹ 15,000
So, Depreciation for 2 years = ₹ 15,000 × 2 = ₹ 30,000

Profit or Loss on Sale of Assets – Method of Depreciation Calculation

Sometimes an asset is sold before the completion of its useful life for some unavoidable circumstances (due to obsolescence etc.) including a part of the asset which is no longer required in future. If the sale price is less than the WDV, there will be loss, and vice versa. The profit & loss on sale of asset is adjusted in the year of Sale in Profit & Loss Account.

Accounting Treatment**a. Where no provision for depreciation account is maintained:**

WDV of the amount sold will be transferred to 'Assets Disposal Account'. The entries will be as follows:

(i) WDV of asset has been transferred to Asset Disposal A/c

| | |
|--------------------|-----|
| Asset Disposal A/c | Dr. |
| To Asset A/c | |

(ii) In case of Sale of an Asset

| | |
|-----------------------|-----|
| Cash/Bank A/c | Dr. |
| To Asset Disposal A/c | |



(iii) For depreciation (if any)

Depreciation (P & L A/c) Dr.
 To Asset Disposal A/c

(iv) In case of Profit on Sale of Asset

Asset Disposal A/c Dr.
 To Profit & Loss A/c

(v) In case of Loss on Sale of Asset

Profit & Loss A/c Dr.
 To Asset Disposal A/c

b. Alternative Approach

In this situations, all adjustments are to be prepared through the assets account. The entries are as follows:

(i) In case of Assets sold

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

(ii) In case of Depreciation

Depreciation (Profit & Loss) A/c Dr.
 To Assets A/c

(iii) In case of Profit on Sale

Assets A/c Dr.
 To Profit & Loss

(iv) In case of Loss on Sale

Profit & Loss A/c Dr.
 To Assets A/c

Illustration 21.

On 1st April, 2011, Som Ltd. purchased a machine for ₹66,000 and spent ₹5,000 on shipping and forwarding charges, ₹7,000 as import duty, ₹1,000 for carriage and installation, ₹500 as brokerage and ₹500 for an iron pad. It was estimated that the machine will have a scrap value of ₹ 5,000 at the end of its useful life which is 15 years. On 1st January, 2012 repairs and renewals of ₹ 3,000 were carried out. On 1st October, 2013 this machine was sold for ₹ 50,000. Prepare Machinery Account for the 3 years.

Solution:

| In the books of Som Ltd. Machinery Account | | | | | |
|---|-----------------|------------|------------|------------------------------|------------|
| Dr. | | | Cr. | | |
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 01.04.2011 | To, Bank A/c | 66,000 | 31.03.2012 | By, Depreciation A/c | 5,000 |
| | To, Bank A/c | 14,000 | | By, Balance c/d | 75,000 |
| | | 80,000 | | | 80,000 |
| 01.04.2012 | To, Balance b/d | 75,000 | 31.03.2013 | By, Depreciation A/c | 5,000 |
| | | 75,000 | | By, Balance c/d | 70,000 |
| | | | | | 75,000 |
| 01.04.2013 | To, Balance b/d | 70,000 | 01.10.2013 | By, Depreciation A/c | 2,500 |
| | | | | By, Bank A/c (sale) | 50,000 |
| | | | | By, Profit & Loss A/c (Loss) | 17,500 |
| | | 70,000 | | | 70,000 |

Working Note :

$$1. \quad \text{Total Cost} = ₹ 66,000 + ₹ 5,000 + ₹ 7,000 + ₹ 1,000 + ₹ 500 + ₹ 500 = ₹ 80,000$$

$$\text{Depreciation} = \frac{\text{Total Cost} - \text{Scrap Value}}{\text{Expected life}} = \frac{80,000 - 5,000}{15} = ₹ 5,000$$

The amount spent on repairs and renewals on 1st January, 2012 is of revenue nature and hence, does not form part of the cost of asset.

Change of Method

As per AS-6, the depreciation method selected should be applied consistently from period to period. Change in depreciation method should be made only in the following situations:

- (i) For compliance of statute.
- (ii) For compliance of accounting standards.
- (iii) For more appropriate presentation of the financial statement.

Procedure to be followed in this case:

- (i) Depreciation should be recalculated applying the new method from the date of its acquisition/ installation till the date of change of method.
- (ii) Difference between the total depreciation under the new method and the accumulated depreciation under previous method till the date of change may be surplus/ deficiency.
- (iii) The said surplus is credited to Profit & Loss Account under the head "depreciation written Back".
- (iv) Deficiency is charged to Profit & Loss Account.
- (v) The journal entries will be :

- (a) If old value is less

Profit and Loss A/c.

Dr.

To, Assets A/c.

- (b) If old value is more



Asset A/c.

Dr.

To, Profit and Loss A/c.

- (vi) The above change of depreciation method should be treated as change in accounting policy and its post effect should be disclosed and quantified.

Illustration 22.

Ram Ltd. which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on 1st January, 2013 ₹ 9,72,000 on the debit side of Machinery Account.

During the year 2013 machinery purchased on 1st January, 2011 for ₹ 80,000 was sold for ₹ 45,000 on 1st July, 2013 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000.

The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method with effect from 1st January, 2010. Difference of depreciation up to 31st December, 2013 to be adjusted. The rate of depreciation remains the same as before. Show Machinery Account.

Solution:

In the books of Ram Ltd.

| Dr. | | | Cr. | | |
|--------------------------|--------------------------------------|------------|----------|---|------------|
| Machinery Account | | | | | |
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 01.01.13 | To, Balance b/d (9,07,200+64,800) | 9,72,000 | 01.07.13 | By, Depreciation A/c [W.N.3] | 3,240 |
| | | | | By, Bank A/c - Sale | 45,000 |
| 01.07.13 | To, Bank A/c (1,50,000 + 8,000) | 1,58,000 | | By, Loss on sale of Machine A/c [W.N.4] | 16,560 |
| | | | 31.12.13 | By, Depreciation A/c: | |
| | | | | - For the year 2012 | 1,12,000 |
| | | | | - For ½ year [1,58,000×10%×½] | 7,900 |
| | | | | By, Profit & Loss A/c : Adjustment | 11,200 |
| | | | | By, Balance c/d : | |
| | | | | - M ₁ (9,07,200 – 1,12,000 – 11,200) | 7,84,000 |
| | | | | - M ₂ | Nil |
| | | | | - M ₃ (1,58,000 – 7,900) | 1,50,100 |
| | | 11,30,000 | | | 11,30,000 |

Working Notes :

- (1) At 10% depreciation on Diminishing Balance Method :

| | ₹ |
|---|----|
| If balance of machinery in the beginning of the year is | 10 |
| Depreciation for the year is | 1 |
| Balance of Machinery at the end of the year | 2 |

By using the formula, balance of asset on 1st January 2010 will be calculated as follows:

| | ₹ |
|--|-----------|
| Balance as on 1 st January, 2013 | 9,72,000 |
| Balance as on 1 st January, 2012 is $9,72,000 \times 10/9 =$ | 10,80,000 |
| Balance as on 1 st January, 2011 is $10,80,000 \times 10/9 =$ | 12,00,000 |

This balance, ₹ 12,00,000 is composed of 2 machines, one of ₹ 11,20,000 and another of ₹ 80,000.

| | ₹ |
|--|----------|
| Depreciation at 10% p.a. on Straight Line Method on ₹ 11,20,000 | 1,12,000 |
| Total Depreciation for 2011 and 2012 (₹ 1,12,000 x 2) | 2,24,000 |
| Total Depreciation charged for 2011 and 2012 on Diminishing Balance Method (1,12,000 + 1,00,800) | 2,12,800 |
| Balance to be charged in 2013 to change from Diminishing Balance Method to Straight Line Method | 11,200 |

- (2) Machine purchased on 1st January, 2011 for ₹ 80,000 shows the balance of ₹ 64,800 on 1st January 2013 as follows :

| | ₹ |
|------------------------------|--------|
| Purchase price | 80,000 |
| Less : Depreciation for 2011 | 8,000 |
| | 72,000 |
| Less : Depreciation for 2012 | 7,200 |
| Balance as on Jan. 1, 2013 | 64,800 |

- (3) On second machine (original purchase price ₹ 80,000), depreciation at 10% p.a. on ₹ 64,800 for 6 months, viz., ₹ 3,240 has been charged to the machine on July 1 2013 i.e., on date of sale.

- (4) Loss on sale of (ii) machine has been computed as under:

| | ₹ |
|---|--------|
| Balance of the machine as on 1.1.2013 | 64,800 |
| Less : Depreciation for 6 months up to date of sale | 3,240 |
| Balance on date of sale | 61,560 |
| Less : Sale proceeds | 45,000 |
| Loss on sale | 16,560 |

Illustration 23.

M/s. Hot and Cold commenced business on 01.07.2008. When they purchased a new machinery at a cost of ₹ 8,00,000. On 01.01.2010 they purchased another machinery for ₹ 6,00,000 and again on 01.10.2012 machinery costing ₹ 15,00,000 was purchased. They adopted a method of charging depreciation @ 20% p.a. on diminishing balance basis.

On 01.07.2012, they changed the method of providing depreciation and adopted the method of writing off the Machinery Account at 15% p.a. under straight line method with retrospective effect from 01.07.2008, the adjustment being made in the accounts for the year ended 30.06.2013.

The depreciation has been charged on time basis. You are required to calculate the difference in depreciation to be adjusted in the Machinery on 01.07.2012, and show the Machinery Account for the year ended 30.06.2013.



Solution:

In the books of M/s Hot and Cold

Dr. Machinery Account Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------|---|-------------|---------|---------------------|-------------|
| 01.07.12 | To, Balance b/d | 6,73,280 | 30.6.13 | By Depreciation A/c | 3,78,750 |
| | To, Profit and Loss A/c (Depreciation Overcharged) | 21,720 | | By Balance c/d | 18,16,250 |
| 01.10.12 | To, Bank A/c (Purchase) | 15,00,000 | | | |
| | | 21,95,000 | | | 21,95,000 |

Workings:

1. Statement of Depreciation:

| Date | Particulars | Machine – I ₹ | Machine – II ₹ | Total Depreciation ₹ |
|------------|--------------------|------------------|-------------------|-------------------------|
| 01.07.2008 | Book Value | 8,00,000 | | |
| 30.06.2009 | Depreciation @ 20% | 1,60,000 | | 1,60,000 |
| 01.07.2009 | W.D.V. | 6,40,000 | | |
| 01.01.2010 | Bank (Purchase) | | 6,00,000 | |
| 30.06.2010 | Depreciation @ 20% | 1,28,000 | 60,000 | 1,88,000 |
| 01.07.2010 | W.D.V. | 5,12,000 | 5,40,000 | |
| 30.06.2011 | Depreciation @ 20% | 1,02,400 | 1,08,000 | 2,10,400 |
| 01.07.2011 | W.D.V. | 4,09,600 | 4,32,000 | |
| 30.06.2012 | Depreciation @ 20% | 81,920 | 86,400 | 1,68,320 |
| 01.07.2012 | W.D.V. | 3,27,680 | 3,45,600 | |
| | | 6,73,280 | | 7,26,720 |

2. Depreciation Overcharged:

Now depreciation under Straight Line Method

| | |
|--|------------|
| On ₹ 8,00,000 @ 15% = ₹ 1,20,000 × 4 years (from 01.07.2008 to 30.06.2012) | ₹ 4,80,000 |
| On ₹ 6,00,000 @ 15% = ₹ 90,000 × 2.5 years (from 01.01.2010 to 30.06.2012) | ₹ 2,25,000 |
| | ₹ 7,05,000 |

Depreciation overcharged = Reducing Balance Basis – Straight Line Basis

$$= ₹ (7,26,720 - 7,05,000)$$

$$= ₹ 21,720$$

3. Depreciation for the year:

| | |
|---------------------------------------|------------|
| On ₹ 14,00,000 @ 15% for the year | ₹ 2,10,000 |
| On ₹ 15,00,000 @ 15% for the 9 months | ₹ 1,68,750 |
| | ₹ 3,78,750 |

1.6 RECTIFICATION OF ERRORS

Opening Entries: The opening entry is an item which is passed in the Journal Proper or General Ledger. The purpose of passing this entry is to record the opening balances of the accounts transferred from the previous year to the new year. The accounts which are appearing on the assets side of Balance Sheet are debited in the opening entry while which accounts are appearing in the liabilities side are credited.

At the end of each accounting period, the books of accounts need to be closed for preparation of final accounts. Also, in the beginning of the new accounting period, new books of accounts are to be opened. For this purpose, opening and closing entries need to be passed. These entries are passed in journal proper.

The opening entries are passed only for those ledger A/c balances which are carried forward from earlier period to the current accounting period. In other words, the balances of assets, liabilities and owners' capital and equity accounts are only considered for such opening entries. The opening entry is passed with the closing balances of assets and liabilities & capital accounts in the last year's balance sheet.

The entry can be given as:

| | |
|-------------------------|-----|
| All Asset A/cs | Dr. |
| To All Liabilities A/c | |
| To Owners' Capital A/cs | |

Illustration 24.

Consider the following balances in the Balance Sheet as on 31st March 2013. Pass the opening entry on 1st April 2013.

| | |
|----------------------|----------|
| Subodh's Capital A/c | 2,75,000 |
| Loan from HDFC Bank | 4,25,000 |
| Plant and machinery | 3,30,000 |
| Cash in hand | 20,000 |
| Balance at Citi Bank | 1,75,000 |
| Trade Debtors | 3,55,000 |
| Closing Stock | 1,35,000 |
| Trade Payables | 2,95,000 |
| Outstanding Expenses | 40,000 |
| Prepaid Insurance | 20,000 |

Solution:

The opening entry will be as follows:

| | | |
|-----------------------------|-----|----------|
| Plant and machinery A/c | Dr. | 3,30,000 |
| Cash in hand A/c | Dr. | 20,000 |
| Balance at Citi Bank A/c | Dr. | 1,75,000 |
| Trade Debtors A/c | Dr. | 3,55,000 |
| Closing Stock A/c | Dr. | 1,35,000 |
| Prepaid Insurance | Dr. | 20,000 |
| To Subodh's Capital A/c | | 2,75,000 |
| To Loan from HDFC Bank A/c | | 4,25,000 |
| To Trade Payables A/c | | 2,95,000 |
| To Outstanding Expenses A/c | | 40,000 |



Closing Entries: All the expenses and gains or income related nominal accounts must be closed at the end of the year. In order to close them, they are transferred to either Trading A/c or Profit and Loss A/c. Journal entries required for transferring them to such account is called a 'closing entry'.

The Closing Entries are passed on the basis of trial balance for transferring the balances to Trading and Profit and Loss A/c. These entries are mainly for:

- (a) Transferring purchases and direct expenses (goods related) to Trading A/c

| | |
|----------------------------------|-----|
| Trading A/c | Dr. |
| To Opening stock A/c | |
| To Purchases A/c | |
| To Factory expenses A/c | |
| To Freight & carriage inward A/c | |

- (b) Transferring sales and closing stocks

| | |
|-------------------|-----|
| Sales A/c | Dr. |
| Closing Stock A/c | Dr. |
| To Trading A/c | |

- (c) Transferring gross profit or gross loss to P & L A/c

Gross Profit

| | |
|--------------|-----|
| Trading A/c | Dr. |
| To P & L A/c | |

Gross Loss

| | |
|----------------|-----|
| P & L A/c | Dr. |
| To Trading A/c | |

- (d) Transferring expenses

| | |
|---------------------------|-----|
| P & L A/c | Dr. |
| To Respective expense A/c | |

- (e) Transferring Incomes

| | |
|------------------------|-----|
| Respective income A/cs | Dr. |
| To P & L A/c | |

- (f) Transferring Net profit or Net loss

Net Profit

| | |
|----------------|-----|
| P & L A/c | Dr. |
| To Capital A/c | |

Net Loss

| | |
|--------------|-----|
| Capital A/c | Dr. |
| To P & L A/c | |

Illustration 25.

Pass closing entries for the following particulars as on 31st March 2013 presented by X Ltd.

| Particulars | Amount (₹) |
|-------------------|------------|
| Opening stock | 10,000 |
| Purchases | 50,000 |
| Wages | 5,000 |
| Returns outward | 5,000 |
| Sales | 1,00,000 |
| Returns inward | 10,000 |
| Salaries | 8,000 |
| Insurance | 1,000 |
| Bad debts | 3,000 |
| Interest received | 3,000 |
| Discount allowed | 4,000 |
| Discount received | 3,000 |
| Closing stock | 15,000 |

Solution:**In the Books of X Ltd.****Journal**

| Date | Particulars | LF | Dr. | Cr. |
|-----------------------------------|---|----|-----------------------------|-------------------------------------|
| | | | Amount (₹) | Amount (₹) |
| 2013 31 st March | Trading A/c Dr. To, Opening Stock A/c To, Purchases A/c To, Wages A/c To, Returns inward A/c (Transfer to balances for closing the latter accounts) | | 75,000 | 10,000 50,000 5,000 10,000 |
| | Sales A/c Dr. Returns outward A/c Dr. Closing Stock A/c Dr. To, Trading A/c (Transfer of balances for closing the former accounts) | | 1,00,000 5,000 15,000 | 1,20,000 |
| | Trading A/c Dr. To, Profit and Loss A/c (Gross profit transferred) | | 45,000 | 45,000 |
| | Profit and Loss A/c Dr. To, Salaries A/c To, Insurance A/c To, Bad Debts A/c To, Discount allowed A/c (Transfer of balances for closing the latter accounts) | | 16,000 | 8,000 1,000 3,000 4,000 |
| | Interest received A/c Dr. Discount received A/c Dr. To, Profit and Loss A/c (Transfer of balances for closing the former accounts) | | 3,000 3,000 | 6,000 |
| | Profit and Loss A/c Dr. To, Capital A/c (Net profit transferred to Capital A/c) | | 35,000 | 35,000 |

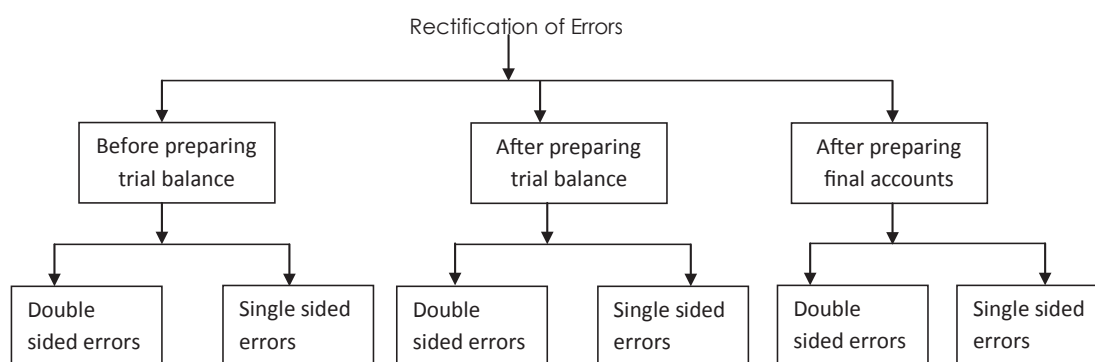
Rectification Entries (Rectification of errors): These entries are passed when errors or mistakes are discovered in accounting records. These entries are also known as Correction Entries. These entries are also passed in Journal Proper.

In this study note, you were introduced to the reasons why errors could occur and to the fact that while some errors affect trial balance and some errors do not affect it. In this section, we will see in depth how the corrections are made to the wrong entries.

When the errors affecting the T.B. are made, the normal practice is to put the difference to an A/c called as 'Suspense A/c' till the time errors are located. On identification of errors, the one effect goes to the correct A/c and the other effect to the Suspense A/c. This is done for one sided errors e.g. if sales book total is wrongly taken, but individual customers are correctly debited. Such error will cause difference in trial balance as only Sales A/c is wrongly credited. In such cases the rectification entry will be passed through Suspense A/c. In all other cases the rectification is done by debiting or crediting the correct A/c head and by crediting or debiting the wrong A/c head.

Let us recapitulate the types of errors and the ways to rectify them in the following table

| Type of error | Rectification |
|--|--|
| (a) Error of principle – entering revenue expense as capital expense or vice versa or entering revenue receipt as capital receipt or vice versa. | A journal entry is passed to give correct effect. |
| (b) Error of Omission – transaction forgotten to be entered in books of accounts. | Simply, the correct entry is passed. |
| (c) Errors of commission – entering to wrong head of account. | Debit or credit wrong A/c head and post it to correct head. |
| (d) Compensating errors – more than one error that could compensate effect of each other. | Pass correcting entry |
| (e) Wrong totaling of subsidiary books | As it affects T.B., pass through Suspense A/c |
| (f) Posting on wrong side of an A/c | Pass an entry with double effect – one to cancel wrong side and other to give effect on correct side |
| (g) Posting of wrong amount | Pass entry with differential amount |



A. Before Preparation of Trail Balance

If errors are detected before the preparation of Trail Balance, the effect of each error should be known.

The errors are of two types: viz

(a) Double Sided Error; (b) Single Sided Error

(a) **Double Sided Error:**

The following principles should be followed for the purpose.

- (i) What was the correct entry?
- (ii) What entry had been done?
- (iii) Rectifying entry.

Example: Purchased a Building for ₹ 3,00,000 wrongly passed through purchase account.

Solutions:

| | | | | |
|-------|---------------------------------|-----|----------|----------|
| (i) | Building A/c To Cash A/c | Dr. | 3,00,000 | 3,00,000 |
| (ii) | Purchase A/c To Cash A/c | Dr. | 3,00,000 | 3,00,000 |
| (iii) | Building A/c To Purchase A/c | Dr. | 3,00,000 | 3,00,000 |

(b) Single Sided Error

Under the circumstances, no separate entry is required but the affected account should be rectified by appropriate posting.

Example: Purchase account was overcast by ₹ 10,000.

Solution:

The correction to be made in Purchase Account in the following manner.

| Dr. | | Purchase Account | | Cr. | |
|-------------|---|--------------------------|--|-----|--------|
| Particulars | ₹ | Particulars | | | ₹ |
| | | By Error - Wrong posting | | | 10,000 |

So, purchase account should be credited by ₹ 10,000.

B. After Preparation of Trial Balance

If the errors are detected after the preparations of trial balance, the following procedure should be followed:

- (a) Double Sided Errors; and (b) Single Sided Errors.
- (a) **Double Sided Errors:**
 - Same as method (A) above i.e., before preparation of Trial Balance.
- (b) **Single Sided Errors:**
 - In case of Single side errors, relevant account to be rectified by applying Suspense Account.

Suspense Account

If the Trial Balance does not agree we cannot prepare final accounts. In order to prepare final account, the difference so appeared in trail balance is to be passed through Suspense Account. When the errors will be located and rectified suspense account will automatically be Nil or closed. The suspense account will appear in the Balance Sheet. When it appears in the debit side of trial balance, the same will appear in the assets side of the Balance Sheet and vice-versa.

Example: Sales Day Book was overcast by ₹ 1,000.

| | | | | |
|-----------------|---|-----------|-------|--|
| | ₹ | | ₹ | |
| Sales A/c | | Dr. 1,000 | | |
| To Suspense A/c | | | 1,000 | |



C. After Preparation of Final Accounts

If the errors are detected after the preparation of final accounts the following steps should carefully be followed.

(a) For Double Sided Errors

- (i) Same as (A) before preparation of Trial Balance or (B) after preparation of Trail Balance. But all the nominal accounts are to be replaced by Profit and Loss Adjustment Account. And the rest one will be same as (A) or (B) stated earlier.
- (ii) Suspense Account will be carried forward to the next year; and
- (iii) Real and Personal Accounts are to be carried forward to the next year.

Example: Purchase a Plant wrongly debited to Purchase Account for ₹ 10,000

Solution:

(i) If after Trial Balance

| | |
|-----------------|-----|
| Plant A/c | Dr. |
| To Purchase A/c | |

(ii) If after Final Account

| | |
|-----------------------------------|-----|
| Plant A/c | Dr. |
| To Profit and Loss Adjustment A/c | |

(b) for Single Sided Errors:

Same principle is to be followed like (B) after preparation of Trial Balance and all the nominal account are to be preplaced by Profit and Loss Adjustment Account.

Example – Discount allowed was not posted to discount Account for ₹ 500.

Solution:

(i) If after Trial Balance

| | |
|----------------------|-----|
| Discount Allowed A/c | Dr. |
| To Suspense A/c | |

(ii) If after Final Account

| | |
|--------------------------------|-----|
| Profit and Loss Adjustment A/c | Dr. |
| To Suspense A/c | |

Illustration 26.

Rectify the following errors assuming that the errors were detected (a) Before the Preparation of Trial Balance; (b) After the preparation of Trial Balance and (c) After the preparation of Final Accounts.

- (i) Purchase Plant for ₹ 10,000 wrongly passed through Purchase Account.
- (ii) Sales Day Book was cast short by ₹ 1,000.
- (iii) Cash paid to Mr. X for ₹ 1,000 was posted to his account as ₹ 100.
- (iv) Purchase goods from Mr. T for ₹ 3,500 was entered in the Purchase Day Book as ₹ 500.
- (v) Paid salary for ₹ 3,000 wrongly passed through wages account.



- (d) The discount received from creditor is not entered in discount A/c but was correctly recorded in creditors' A/c. This is one sided error and will therefore be routed through suspense for correction. A discount is received; it must be credited being an income.

| | | |
|--------------------------|----|-----|
| Suspense A/c | Dr | 300 |
| To Discount received A/c | | 300 |

Let us now see how suspense A/c will look like. Excess credit of ₹ 1,700 in Trial Balance will be shown on the debit side of suspense A/c. This will bring in total debit equal to total credit.

| Dr | | | | Suspense Account | | | | Cr | | | |
|------|----------------------|-------|------------|------------------|-------------|-------|------------|----|--|--|--|
| Date | Particulars | J. F. | Amount (₹) | Date | Particulars | J. F. | Amount (₹) | | | | |
| | To Balance b/d | | 1,700 | | By Narayan | | 500 | | | | |
| | To Discount received | | 300 | | By Pandey | | 1,500 | | | | |
| | | | 2,000 | | | | 2,000 | | | | |

Please observe that after correcting passing all rectification entries, the Suspense A/c tallies automatically.

Illustration 28.

Pass necessary journal entries to rectify the following errors:

- (a) An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.
- (b) Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.
- (c) A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.
- (d) ₹ 150 received from Malhotra was credited to Mehrotra.
- (e) ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.
- (f) A bill of ₹ 2,750 for extension of building was debited to building repairs A/c
- (g) Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not posted.
- (h) Old furniture sold for ₹ 200 to Sethi was recorded in sales book.
- (i) The period end total of sales book was under cast by ₹ 100.
- (j) Amount of ₹ 80 received as interest was credited to commission.

Solution:

| Sl No. | Particulars | | Debit (₹) | Credit (₹) |
|--------|----------------------------|-------------------|-----------|------------|
| (a) | Wrong Entry | Trade Expenses | 200 | |
| | | To Cash | | 200 |
| | Correct entry | Drawings | 200 | |
| (b) | | To cash | | 200 |
| | Rectification entry | Drawings | 200 | |
| | | To Trade Expenses | | 200 |
| (b) | Wrong Entry | Nathan | 300 | |
| | | To Sales | | 300 |
| | Correct entry | Purchases | 300 | |
| | | To Nathan | | 300 |
| | Rectification entry | Purchases | 300 | |
| | | Sales | 300 | |
| | To Nathan | | | 600 |

| Sl No. | | Particulars | | Debit (₹) | Credit (₹) |
|--------|----------------------------|---------------------|----|-----------|------------|
| (c) | Wrong Entry | Purchases | Dr | 100 | |
| | | To Santhanam | | | 100 |
| | Correct entry | Santhanam | Dr | 100 | |
| | | To Sales | | | 100 |
| | Rectification entry | Santhanam | Dr | 200 | |
| | | To Sales | | | 100 |
| | | To Purchases | | | 100 |
| (d) | Wrong Entry | Cash | Dr | 150 | |
| | | To Mehrotra | | | 150 |
| | Correct entry | Cash | Dr | 150 | |
| | | To Malhotra | | | 150 |
| | Rectification entry | Mehrotra | Dr | 150 | |
| | | To Malhotra | | | 150 |
| | | | | | |
| (e) | Wrong Entry | Dhawan | Dr | 375 | |
| | | To cash | | | 375 |
| | Correct entry | Salary | Dr | 375 | |
| | | To cash | | | 375 |
| | Rectification entry | Salary | Dr | 375 | |
| | | To Dhawan | | | 375 |
| | | | | | |
| (f) | Wrong Entry | Building Repairs | Dr | 2,750 | |
| | | To Cash | | | 2,750 |
| | Correct entry | Buildings | Dr | 2,750 | |
| | | To Cash | | | 2,750 |
| | Rectification entry | Buildings | Dr | 2,750 | |
| | | To Building Repairs | | | 2,750 |
| | | | | | |
| (g) | Wrong Entry | No entry passed | | | |
| | Correct entry | Sales Returns | Dr | 500 | |
| | | To Akashdeep | | | 500 |
| | Rectification entry | Sales Returns | Dr | 500 | |
| | | To Asashdeep | | | 500 |
| | | | | | |
| (h) | Wrong Entry | Sethi | Dr | 200 | |
| | | To Sales | | | 200 |
| | Correct entry | Sethi | Dr | 200 | |
| | | To Furniture | | | 200 |
| | Rectification entry | Sales | Dr | 200 | |
| | | To Furniture | | | 200 |
| | | | | | |
| (i) | Wrong Entry | No entry passed | | | |
| | Correct entry | Suspense | Dr | 100 | |
| | | To Sales | | | 100 |
| | Rectification entry | Suspense | Dr | 100 | |
| | | To Sales | | | 100 |
| | | | | | |
| (j) | Wrong Entry | Cash | Dr | 80 | |
| | | To Commission | | | 80 |
| | Correct entry | Cash | Dr | 80 | |
| | | To Interest | | | 80 |
| | Rectification entry | Commission | Dr | 80 | |
| | | To Interest | | | 80 |



Effect of Errors on Profit or Loss

Some errors may affect the profit or loss for the period while other won't. How to find it out? Remember, the P & L A/c reflects items of incomes, gains, expenses and losses. All these accounts are nominal accounts. When an error occurs which affects a nominal account, it will affect profit or loss otherwise not. So, errors that affect real and personal accounts will not affect profit or loss.

Illustration 29.

Rectifying the following errors by way of journal entries and work out their effect on profit or loss of the concern:

- Return inward book was cast short by ₹ 500.
- ₹ 300 received from Ram has been debited to Mr. Shyam.
- Wages paid for the installation of a machine debited to wages account for ₹ 1,000.
- A purchase made for ₹ 1,000 was posted to purchase account as ₹ 100.
- Purchase of furniture amounting to ₹ 3,000 debited to purchase account.
- Goods purchased for proprietor's use for ₹ 1,000 debited to purchase account.

Solution:

In the Books of

Journal

| Date | Particulars | L.F | Dr. | Cr. |
|------|--|-----|------------|------------|
| | | | Amount (₹) | Amount (₹) |
| (a) | Return Inward A/c To, Suspense A/c (Return Inward Book was cast short, now rectified.) | Dr. | 500 | 500 |
| (b) | Suspense A/c To, Ram A/c To Shyam A/c (Received from Mr. Ram has been debited to Mr. Shyam A/c, now rectified.) | Dr. | 600 | 300 300 |
| (c) | Machinery A/c To, Wages/c (Wages paid for maintenance of machinery debited to Wages A/c, now rectified.) | Dr. | 1,000 | 1,000 |
| (d) | Purchase A/c To, Suspense A/c (Purchase account was short by ₹ 900, now rectified.) | Dr. | 900 | 900 |
| (e) | Furniture A/c To, Purchase A/c (Furniture purchased wrongly debited to purchase account, now rectified) | Dr. | 3,000 | 3,000 |
| (f) | Drawings A/c To, Purchase A/c (Goods purchased for proprietor's use, debited to purchase account, now rectified.) | Dr. | 1,000 | 1,000 |

Effect on Profit

| Items | Particulars | Increase (₹) | Decrease (₹) |
|-------|---------------------------|--------------|--------------|
| (a) | Decrease in Profit | | 500 |
| (b) | No Effect in Profit | - | - |
| (c) | Increase in Profit | 1,000 | - |
| (d) | Decrease in Profit | | 900 |
| (e) | Increase in Profit | 3,000 | - |
| (f) | Increase in Profit | 1,000 | - |
| | Total | 5,000 | 1,400 |
| | Increase in Profit | - | 3,600 |
| | | 5,000 | 5,000 |

Illustration 30.

The books of M/s Shakti trading for the year ended 31st March 2013 were closed with a difference that was posted to Suspense A/c. The following errors were found subsequently:

- Goods of ₹ 12,500 returned to Thick & Fast Corporation were recorded in Return Inward book as ₹ 21,500 and from there it was posted to the debit of Thick & Fast Corporation.
- A credit sale of ₹ 7,600 was wrongly posted as ₹ 6,700 to customer's A/c in sales ledger.
- Closing stock was overstated by ₹ 5,000 being totaling error in the schedule of inventory.
- ₹ 8900 paid to Bala was posted to the debit of Sethu as ₹ 9,800.
- Goods purchased from Evan Traders for ₹ 3,250 was entered in sales book as ₹ 3,520.
- ₹ 1,500, being the total of discount column on the payment side of the cash book was not posted.

Rectify the errors and pass necessary entries giving effects to Suspense A/c and P & L Adjustment A/c.

Solution:

- There are 2 errors: one – return outward is wrongly recorded as return inward and two – amount is also recorded wrongly. First, we need to remove extra debit to Thick & Fast corporation i.e. ₹ 9,000 (21,500-12,500) by crediting it. Also we need to remove wrong credit of ₹ 21,500 in sales return by debiting it and credit ₹ 12,500 to Purchase returns A/c.

The rectification entry will be:

| | | | |
|-------------------------|-----|--------|--|
| Suspense A/c | Dr. | 21,500 | |
| To Thick & Fast Corp | | 9,000 | |
| To P & L Adjustment A/c | | 12,500 | |

- In this case, error has occurred only in customer's A/c. hence, profit or loss won't be affected and the P & L Adjustment A/c will not be in picture. As customer's A/c is debited for ₹ 6,700 instead of ₹ 7,600, it needs to be corrected.

The rectification entry will be:

| | | | |
|--------------------|-----|-----|-----|
| Sundry Debtors A/c | Dr. | 900 | |
| To Suspense A/c | | | 900 |

- Over casting of closing stock had affected profit which must be reduced through P & L Adjustment A/c.

The rectification entry is:

| | | | |
|----------------------|-----|-------|-------|
| P & L Adjustment A/c | Dr. | 5,000 | |
| To Suspense A/c | | | 5,000 |



(d) As only personal accounts are affected, there won't be an effect on Profits. So rectification will be done through Suspense A/c only. The rectification entry is:

| | | | |
|--------------|--------------|-------|-------|
| Bala A/c | Dr. | 8,900 | |
| Suspense A/c | Dr. | 900 | |
| | To Sethu A/c | | 9,800 |

(e) This transaction involves correction of purchase as well as sales, and hence will affect profit. As the purchases were booked as sales, we will need to cancel sales by debiting and freshly debit purchase. So overall effect on profit will be 3,250 + 3,520 i.e. 6,770. The rectification entry will be:

| | | | |
|----------------------|-----------------|-------|-------|
| P & L Adjustment A/c | Dr. | 6,770 | |
| | To Evan Traders | | 6,770 |

(f) If discount is appearing on payment side of cash book, it indicates discount received while making payment and is an item of income. Hence, it will affect profit. The accounting entry will be:

| | | | |
|--------------|-------------------------|-------|-------|
| Suspense A/c | Dr. | 1,500 | |
| | To P & L Adjustment A/c | | 1,500 |

Illustration 31.

You are presented with a trial balance of S Ltd as on 30.06.2013 showing the credit is in excess by ₹ 415 which was been carried to Suspense Account. On a close scrutiny of the books, the following errors were revealed:

- A cheque of ₹ 3,456 received from Sankar after allowing him a discount of ₹ 46 was endorsed to Sharma in full settlement for ₹ 3,500. The cheque was finally dishonored but no entries are passed in the books.
- Goods of the value of ₹ 230 returned by Sen were entered in the Purchase Day Book and posted therefrom to Das as ₹ 320.
- Bad debts aggregating ₹ 505 written off during the year in the Sales Ledger but were not recorded in the general ledger.
- Bill for ₹ 750 received from Mukherjee for repairs to Machinery was entered in the Inward Invoice Book as ₹ 650.
- Goods worth ₹ 1,234 Purchased from Mr. Y on 28.6.2013 had been entered in Day Book and credited to him but was not delivered till 5th June 2013. Stock being taken by the purchase on 30.06.2013. The title of the goods was, however, passed on 28.06.2013.
- ₹ 79 paid for freight on Machinery was debited to freight account as ₹ 97.

You are required to pass the necessary journal entries for correcting the books.

Solution:

In the books of S Ltd. Journal

| Date | Particulars | L.F. | Dr. Amount (₹) | Cr. Amount (₹) |
|------|--|------|-------------------|-------------------|
| (a) | Sankar A/c | Dr. | 3,502 | |
| | Discount Received A/c | Dr. | 44 | |
| | To, Sharma A/c | | | 3500 |
| | To Discount Allowed A/c | | | 46 |
| | (Cheque received from Sankar was endorsed to Sharma after allowing discount ₹46, it was dishonored, now rectified) | | | |

| | | | | |
|-----|--|------------|------------|------------------|
| (b) | Return Inward A/c Das A/c To, Purchase A/c To, Sen A/c To Suspense A/c (Goods returned by sen for ₹ 230 wrongly recorded in Purchase Day Book as an credit to Das as ₹ 320, now rectified.) | Dr. Dr. | 230 320 | 230 230 90 |
| (c) | Bad debts A/c To Suspense A/c (Bad debts written off but not recorded, now rectified) | Dr. | 505 | 505 |
| (d) | Repairs A/c To, Purchase A/c To, Mukherjee A/c (Repairs of machinery for ₹ 750, wrongly recorded as ₹ 650 on Purchase A/c, now rectified.) | Dr. | 750 | 650 100 |
| (e) | Goods- in- Transit A/c To Trading A/c (Goods were in Transit which were not considered, now rectified) | Dr. | 1,234 | 1,234 |
| (f) | Machinery A/c Suspense A/c To Freight A/c (amount paid for freight on machinery was wrongly debited to freight account, now rectified) | Dr | 79 18 | 97 |

Illustration 32.

The books of accounts of A Co. Ltd. for the year ending 31.3.2013 were closed with a difference of ₹21,510 in books carried forward. The following errors were detected subsequently:

- Return outward book was under cast by ₹ 100.
- ₹ 1,500 being the total of discount column on the credit side of the cash book was not posted.
- ₹ 6,000 being the cost of purchase of office furniture was debited to Purchase A/c.
- A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the customers A/c. in the sales ledger.
- The Sales A/c was under casted by ₹ 10,000 being the carry over mistakes in the sales day book.
- Closing stock was over casted by ₹ 10,000 being casting error in the schedule or inventory.

Pass rectification entries in the next year.

Prepare suspense account and state effect of the errors in determination of net profit of last year.



Solution:

In the Books of A Co. Ltd.

Journal

| | | | Dr. | Cr. |
|------------------------|---|------------|-------------------|-------------------|
| Date | Particulars | L/F | Amount (₹) | Amount (₹) |
| (a) 2013 April 1 | Suspense A/c Dr. To Profit & Loss Adjustment A/c (Returns outward book was under cast now rectified). | | 100 | 100 |
| (b) | Suspense A/c Dr. To Profit & Loss Adjustment A/c (Discount received was not recorded, now rectified). | | 1,500 | 1,500 |
| (c) | Office Furniture A/c Dr. To Profit & Loss Adjustment A/c (Office furniture purchased wrongly debited to Purchase A/c, now rectified.) | | 6,000 | 6,000 |
| (d) | Debtors' A/c Dr. To Suspense A/c (Debtors account was posted ₹ 670 in place of ₹ 760, now rectified.) | | 90 | 90 |
| (e) | Suspense A/c Dr. To Profit & Loss Adjustment A/c (Sales account was under casted, now rectified) | | 10,000 | 10,000 |
| (f) | Profit & Loss Adjustment A/c Dr. To Closing Stock A/c (Closing Stock was overcastted, now rectified.) | | 10,000 | 10,000 |

Dr.

Suspense Account

Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-------------|---------------------------------|-------------------|-------------|--------------------------------|-------------------|
| 2013 | To Profit & Loss Adjustment A/c | 100 | 2013 | By Difference in Trial Balance | 21,510 |
| April | To Profit & Loss Adjustment A/c | 1,500 | April | By Debtors A/c. | 90 |
| 1 | To Profit & Loss Adjustment A/c | 10,000 | 1 | | |
| | To Profit & Loss Adjustment A/c | 10,000 | | | |
| | | 21,600 | | | 21,600 |



SELF EXAMINATION QUESTIONS:

1. The following account has a credit balance
 - (A) Plant and Equipment A/c
 - (B) Purchase Returns A/c
 - (C) Purchase A/c
 - (D) None of the above
2. The concept that business is assumed to exist for an indefinite period and is not established with the objective of closing down is referred to as
 - (A) Money Measurement concept
 - (B) Going Concern concept
 - (C) Full Disclosure concept
 - (D) Dual Aspect concept
3. The outflow of funds to acquire an asset that will benefit the business for more than one accounting period is referred to as
 - (A) Miscellaneous Expenditure
 - (B) Revenue Expenditure
 - (C) Capital Expenditure
 - (D) Deferred Revenue Expenditure
4. Which of the following purpose is served from the preparation of Trial Balance?
 - (A) To check the arithmetical accuracy of the recorded transactions
 - (B) To ascertain the balance of any ledger account
 - (C) To facilitate the preparation of final accounts promptly
 - (D) All of the above.
5. An amount spent for replacement of worn out part of machine is
 - (A) Capital Expenditure
 - (B) Revenue Expenditure
 - (C) Deferred revenue
 - (D) Capital Loss
6. Sukku Limited purchased a machine on 1st July, 2013 for ₹8,90,000 and freight and transit insurance premium paid ₹25,000 and ₹15,000 respectively. Installation expenses were ₹ 40,000 and salvage value after 5 year will be ₹50,000. Under straight line method for the year ended 31st March, 2014 the amount of depreciation will be
 - (A) ₹1,35,750
 - (B) ₹1,81,000
 - (C) ₹1,84,000
 - (D) ₹1,38,000
7. Purchase Cost of machinery ₹7,20,000; Carriage inwards ₹15,000; Transit insurance ₹8,000; Establishment Charges ₹25,000; Workshop Rent ₹25,000; Salvage value ₹50,000 and estimated working life 8 years. On the basis of straight line method the amount of depreciation for third year will be
 - (A) ₹96,000
 - (B) ₹89,750
 - (C) ₹88,750
 - (D) ₹91,875

- (8) The cost of a Fixed Assets of a business has to be written off over its
- (A) Natural Life
 - (B) Accounting Life
 - (C) Physical Life
 - (D) Estimated Economic Life

Answer:

| | | | | | | | |
|--------|--------|--------|--------|--------|--------|--------|--------|
| 1. (B) | 2. (B) | 3. (C) | 4. (D) | 5. (B) | 6. (D) | 7. (B) | 8. (D) |
|--------|--------|--------|--------|--------|--------|--------|--------|

State whether the following statement is True (or) False:

1. Original cost minus scrap value is the depreciable value of asset.
2. Compensation paid to employees who are retrenched is Revenue expenditure.
3. The useful life of a depreciable asset is the period over which the asset is expected to be used by the enterprise, which is generally greater than the physical life.
4. After the transactions are posted to various ledger accounts (either from journal or from subsidiary books), they are balanced while preparing Trial Balance for an enterprise. (added,)
5. Depreciation is charge against profit.
6. One of the objectives achieved by providing depreciation is saving cash resources for future replacement of assets.
7. As per concept of conservatism, the Accountant should provide for all possible losses but should not anticipate profit.
8. Wages incurred by departmental workers of a factory in installing a new machinery⁷ is a revenue expenditure.
9. As per the going concern concept, the enterprise should continue to exist in the foreseeable future.
10. Trial balance would not disclose error of omission.
11. Purchase of a technical know-how is revenue expenditure
12. Inauguration expenses on opening of a new Branch of an existing business will be revenue expenditure.
13. Every debit must have its corresponding and equal(benefit, credit)

QUESTIONS:

1. **State whether the following items are in the nature of Capital, Revenue and/or Deferred Revenue Expenditure.**
 - (i) **Expenditure on special advertising campaign ₹ 66,000; suppose the advantage will be received for six years.**
 - (ii) **An amount of ₹ 8,000 spent as legal charges for abuse of Trade Mark.**
 - (iii) **Legal charges of ₹ 15,000 incurred for raising loan.**
 - (iv) **Share issue expenses ₹ 5,000.**
 - (v) **Freight charges on a new machine ₹ 1,500 and erection charges ₹ 1,800 for that machine.**

Answer:

- (i) Revenue expenditure ₹ 66,000.
- (ii) Revenue expenditure ₹ 8,000.
- (iii) Capital expenditure ₹ 15,000.
- (iv) Capital expenditure ₹ 5,000.
- (v) Capital expenditure = ₹ 1,500 + ₹ 1,800 = ₹ 3,300.

2. Classify the following Accounts into Personal, Real and Nominal Accounts. Also state whether it is recorded as asset, liability, expenses/loss or revenue:

- (i) Returns Inward Account
- (ii) Bad Debt Recovered Account
- (iii) Interest On Investment Account
- (iv) Outstanding Rent Account and
- (v) Capital Work-in-Progress Account

Answer:

- (i) Nominal, Revenue
- (ii) Nominal, Revenue
- (iii) Nominal, Revenue
- (iv) Personal, Liability
- (v) Real, Asset

3. Classify the following under personal, real and nominal accounts.

| | | | |
|-------|------------------|--------|-----------------------|
| (i) | Patent Rights | (vi) | Advertisement |
| (ii) | Outstanding Rent | (vii) | Export duty |
| (iii) | Drawings | (viii) | Securities and Shares |
| (iv) | Live Stock | (ix) | Suspense |
| (v) | Bank Overdraft | (x) | Work-in-progress |

Answer:

| | | |
|------------------|--------|-----------------------|
| Personal Account | (ii) | Outstanding Rent |
| | (iii) | Drawings |
| | (v) | Bank Overdraft |
| Real Account | (i) | Patent Rights |
| | (iv) | Live Stock |
| | (viii) | Securities and Shares |
| | (x) | Work-in-progress |
| Nominal Account | (vi) | Advertisement |
| | (vii) | Export duty |
| | (ix) | Suspense |

4. Mr. X is owner of a Cinema Hall. He spent a heavy amount for complete renovation of the hall, for installation of air-condition machines and for sitting arrangement with cushion seats. As a result the revenue has been doubled. He also spent for few more doors for emergency exit. State your opinion amount the treatment of the entire expenditure.

Answer:

The size of the expenditure is not the criteria to decide whether subsequent expenditure should be capitalized. The important question is whether the expenditure increases the future benefits from the asset beyond its pre-assessed standard of performance as per AS-10. Only then it should be capitalized.

In the instant case, the first part of expenditure i.e., Renovation etc., should be capitalized because it has enhanced the revenue earning capacity of the hall. The second part of expenditure for making more emergency exits does not enhance the revenue of the asset. So it should be charged to revenue.

5. Mr. Agarwal could not agree the Trial Balance. He transferred to the Suspense Account of ₹ 296, being excess of the debit side total. The following errors were subsequently discovered.
- (i) Sales Day Book was overcast by ₹ 300
 - (ii) An amount of ₹ 55, received from Mr. Y was posted to his account as ₹ 550
 - (iii) Purchases Return Book total on a folio was carried forward as ₹ 221, instead of ₹ 112
 - (v) A car sale of ₹ 1,235 duly entered in the Cash Book but posted to Sales A/c as ₹ 235
 - (vi) Rest of the difference was due to wrong total in Salaries A/c. Show the Journal entries to rectify the above errors.

Answer:

| Date | Particulars | | Amount (₹) | Amount (₹) |
|-------|---|-----|--------------|------------|
| (i) | Sales A/c To, Suspense A/c (Being Sales Book overcast by now rectified) | Dr. | 300 | 300 |
| (ii) | Y A/c To Suspense a/c (Being amount received from Mr. Agarwal for ₹ 55 wrongly recorded as ₹ 550 now rectified.) | | 495 | 495 |
| (iii) | Returns Outward A/c To, Suspense A/c (Being the total of purchases returns book was carried forward as ₹ 221, instead of ₹ 112 now rectified) | | 109 | 109 |
| (iv) | Suspense A/c Sales A/c To, Car A/c / Sale of Asset A/c (Being cash sales being ₹ 1,235 recorded only ₹ 235 as Sales A/c now rectified) | | 1,000 235 | 1,235 |
| (v) | Suspense A/c To, Salaries A/c (Being Salary A/c was overcast by ₹ 200 now rectified) | | 200 | 200 |

6. Shyama Limited purchased a second-hand plant for ₹ 7,50,000 on 1st July, 2011 and immediately spent ₹ 2,50,000 in overhauling. On 1st January, 2012 an additional machinery at a cost of ₹ 6,50,000 was purchased. On 1st October, 2013 the plant purchased on 1st July, 2011 became obsolete and it was sold for ₹ 2,50,000. On that date a new machinery was purchased at a cost of ₹ 15,00,000. Depreciation was provided @ 15% per annum on diminishing balance method. Books are closed on 31st March in every year. You are required to prepared Plant and Machinery Account upto 31st March, 2014.

Answer:

Books of Shyama Limited
Plant & Machinery Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|---------|--------------------------------------|-----------|---------|--------------------------------------|-----------|
| 1.7.11 | To Bank A/c (7,50,000 + 2,50,000) | 10,00,000 | 31.3.12 | By Depreciation A/c | 1,36,875 |
| 1.1.12 | To Bank A/c | 6,50,000 | 31.3.12 | By Balance c/d | 15,13,125 |
| | | 16,50,000 | | | 16,50,000 |
| 1.4.12 | To Balance b/d | 15,13,125 | 31.3.13 | By Depreciation @ 15% on ₹ 15,13,125 | 2,26,969 |
| | | | | By Balance c/d | 12,86,156 |
| | | 15,13,125 | | | 15,13,125 |
| 1.4.13 | To Balance b/d | 12,86,156 | | By Bank A/c (Sale) | 2,50,000 |
| 1.10.13 | To Bank A/c | 15,00,000 | | By P&L A/c (Loss on Sale) | 4,47,797 |
| | | | | By Depreciation A/c | 2,48,845 |
| | | | | By Balance c/d | 18,39,514 |
| | | 27,86,156 | | | 27,86,156 |

Working Notes:

Written down value of Machinery which is purchased on 01.07.2011.

| Particulars | ₹ |
|--|-----------|
| On 01.07.2011 | 10,00,000 |
| Less: Depreciation for 2011 – 12 of 9 months $(10,00,000 \times 15\% \times \frac{9}{12})$ | 1,12,500 |
| W.D.V. for 2012-13 | 8,87,500 |
| Less: Depreciation for 2012-13 | 1,33,125 |
| W.D.V. for 2013-14 | 7,54,375 |
| Less: Depreciation for 6 months on $(7,54,375 \times 15\% \times \frac{6}{12})$ | 56,578 |
| W.D.V. | 6,97,797 |
| Less: Selling Price | 2,50,000 |
| Less: On Sale of Machinery | 4,47,797 |

Total Depreciation

(a) Machinery Purchased on 01.01.2012

| Particulars | ₹ |
|---|----------|
| On 01.01.2012 | 6,50,000 |
| Less: Depreciation for 3 months of 2011 - 12 | 24,375 |
| W.D.V. | 6,25,625 |
| Less: Depreciation for 2012-13 $(6,25,625 \times 15\%)$ | 93,844 |
| W.D.V. | 5,31,781 |
| Less: Depreciation for 2013-14 | 79,767 |
| W.D.V. | 4,52,014 |

(b)

| Particulars | ₹ |
|---|-----------|
| Machinery Purchased on 01.01.2013 | 15,00,000 |
| Less: Depreciation for 6 months $(15,00,000 \times 15\% \times \frac{6}{12})$ | 1,12,500 |
| | 13,87,500 |

∴ Total Depreciation ₹ $(1,12,500 + 79,767 + 56,578)$ = ₹ 2,48,845.

7. On 31st December, 2011 two machines which were purchased on 1.10.2008 costing ₹ 50,000 and ₹ 20,000 respectively had to be discarded and replaced by two new machines costing ₹ 50,000 and ₹ 25,000 respectively.

One of the discarded machine was sold for ₹ 20,000 and other for ₹ 10,000. The balance of Machinery Account on April 1, 2011 was ₹ 3,00,000 against which the depreciation provision stood at ₹ 1,50,000. Depreciation was provided @ 10% on Reducing Balance Method.

Prepare the Machinery Account, Provision for Depreciation Account and Machinery Disposal Account.

Answer:

Machinery Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|--------|----------------|----------|----------|-------------------------|----------|
| 1.4.11 | To Balance b/d | 3,00,000 | 31.12.11 | By Machine Disposal A/c | 70,000 |
| | To Bank A/c | 75,000 | 31-3.12 | By Balance c/d | 3,25,000 |
| | | 3,75,000 | | | 3,75,000 |

Provision for Depreciation Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|---------|---|----------|---------|----------------|----------|
| 1.4.11 | To Machine Disposal A/c (16,135 + 4,040) | 20,175 | 1.4.11 | By Balance b/d | 1,50,000 |
| 31.3.12 | To Balance c/d | 1,41,314 | 31.3.12 | By P/L A/c | 11,489 |
| | | 1,61,489 | | | 1,61,489 |

Machine Disposal Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|--------|----------------|--------|----------|--|--------|
| 1.4.11 | To Machine A/c | 70,000 | 31.12.11 | By Provision for Depreciation A/c | 16,135 |
| | | | | By Provision for Depreciation (on two machine for 9 months) | 4,040 |
| | | | | By Bank A/c | 30,000 |
| | | | | By P/L A/c (Balancing Figure) | 19,825 |
| | | 70,000 | | | 70,000 |

Working Note: 1. Calculation of Depreciation of Two Discarded machine till 1.4.2012

| Particulars | M-1 | M-2 | Total |
|--|--------|--------|--------|
| Value of Machine as on 1-10-2008 | 50,000 | 20,000 | 70,000 |
| Less: Depreciation for 2008-09 @ 10% (from 1.10.08 to 31.3.09) | 2,500 | 1,000 | 3,500 |
| | 47,500 | 19,000 | 66,500 |
| Less: Depreciation for 2009-10 @ 10% | 4,275 | 1,900 | 6,650 |
| | 42,750 | 17,100 | 59,850 |
| Less: Depreciation for 2009-10 @ 10% | 4,275 | 1,710 | 5,985 |
| | 38,475 | 15,390 | 53,865 |

Hence, Provision for Depreciation on Machine Disposal = 3,500 + 6,650 + 5,985 = 16,135.

Working Note: 2. Depreciation on Discarded Machine:

| Particulars | ₹ |
|--|--------|
| Book Value of machine as on 01.04.2011 | 53,865 |
| Less: Depreciation @ 10% for 9 months (till 31.12.2011) $(53,865 \times 10\% \times \frac{9}{12})$ | 4,040 |
| Value of Discarded Machine as on selling date | 49,825 |

Working Note: 3. Depreciation of Machine in use:

| Particulars | ₹ | ₹ |
|--|----------|----------|
| Value of Machine on 1.4.11 | | 3,00,000 |
| Less: Cost of Discarded Machine | | 70,000 |
| | | 2,30,000 |
| Less: Provision for Depreciation on 1.4.11 | 1,50,000 | |
| Less: Depreciation on Discarded Machine 1.4.11 | 16,135 | 1,33,865 |
| | | 96,135 |
| Depreciation @ 10% on ₹ 96,135 | | 9,614 |
| Add: Depreciation for 3 months on 75,000 @ 10% | | 1,875 |
| Total Depreciation | | 11,489 |



EXERCISE:

1. Classify the following Accounts into Personal, Real and Nominal Accounts:

- (i) Patent Rights A/c
- (ii) Drawings A/c
- (iii) Purchase Return A/c
- (iv) South Sports Club A/c
- (v) Prepaid Insurance A/c
- (vi) Bank Overdraft A/c
- (vii) Free samples A/c

Answer:

Real A/c (i)

Personal A/c (ii), (iv), (v), (vii)

Nominal A/c (iii), (vi), (vii)

2. State which of the following items are (i) Capital Expenditure; (ii) Revenue expenditure; (iii) Deferred Revenue expenditure:

- (i) Legal charges of ₹ 15,000 incurred for raising loan.
- (ii) An amount of ₹ 7,500 spent as legal charges for abuse of Trade-Mark.
- (iii) Carriage paid on a new machine purchased for ₹ 18,000.
- (iv) ₹ 25,000 spent on construction of animal-huts.

Answer:

Capital Expenditure (i), (iii), (iv)

Revenue Expenditure (ii)

3. The total of debit side of the Trial Balance of Lotus Stores as at 31.03.2016 is ₹ 3,65,000 and that of the credit side is ₹ 2,26,000.

After checking, the following mistakes were discovered:

| Items of account | Correct figures (as it should be) (₹) | Figures as it appears in the Trial Balance (₹) |
|------------------|--|---|
| Opening Stock | 15,000 | 10,000 |
| Rent and Rates | 36,000 | 63,000 |
| Sundry Creditors | 81,000 | 18,000 |
| Sundry Debtors | 1,04,000 | 1,58,000 |

Ascertain the correct total of the Trial Balance.

Answer:

The correct total is — ₹ 2,89,000

4. On 1st April, 2010, M/s. N. R. Sons & Co. purchased four machines for ₹ 2,60,000 each. On 1st April, 2011, one machine was sold for ₹ 2,05,000. On 1st July, 2012, the second machine was destroyed by fire and insurance claim received ₹ 1,75,000 on 15th July, 2012. A new machine costing ₹ 4,50,000 was purchased on 1st October, 2012. Books are closed on 31st March every year and depreciation has been charged @ 15% per annum on diminishing balance method. You are required to prepare machinery account for 4 years still 31st March, 2014. (Calculations to be shown in nearest rupee).

Answer:

Machinery A/c Balance as on 01.04.2014 (Dr.) ₹6,25,256.

Depreciation as on 31.03.2014 — ₹1,10,339.

Study Note - 2

ACCOUNTING FOR SPECIAL TRANSACTIONS



This Study Note includes

- 2.1 Bills of Exchange
- 2.2 Consignment Accounting
- 2.3 Joint Venture Accounts
- 2.4 Insurance Claim (Loss of Stock and Loss of Profit)

2.1 BILL OF EXCHANGE

Introduction

Business activity involves exchange of goods or services for money. A business transaction gets 'closed' if the exchange is settled immediately. When goods are purchased from supermarket and paid for in cash the settlement is instant. Same is the case when we go to a restaurant, have food and pay either by cash or credit card. Most of the settlements are not on cash basis, where payment for goods or services is deferred at the behest of both parties to the transaction. Such deferred payments are done through instruments like cheques, pay order, letter of credit, promissory note, bills of exchange, hundies etc. These instruments facilitate credit transactions and hence sometimes they are referred to as credit instruments or negotiable instruments. Even in ancient times some credit instrument like hundies were extremely popular.

In case of credit transaction, the supplier normally gets a promise from the customer that he will settle the payment at a future date as agreed. It could either be a promissory note or bill of exchange. The promissory note is written by the customer as an undertaking to pay the money, whereas the bill of exchange is a note drawn by the seller and accepted by the buyer. In India, the Negotiable Instruments Act 1981 governs the provisions for bills of exchange. As per this act, the bill of exchange is defined as " an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain some of money only to the order of the certain person or to the bearer of the instrument"

Based on this definition the following features of a bill of exchange are noticed:

- (a) It's an instrument in writing.
- (b) It contains an unconditional order.
- (c) It's signed by the drawer.
- (d) It's drawn on a specific person.
- (e) There is an order to pay a specific sum of money.
- (f) It must be dated.
- (g) It specifies to whom the payment is to be made e.g. to the maker or to person mentioned by him or to the bearer.
- (h) The amount of money to be paid must be certain.
- (i) It must be properly stamped
- (j) It may be made payable on demand, or after a definite period of time.

Whereas, a bill of exchange is drawn by seller and accepted by buyer; a promissory note, on the other hand, is created by the buyer as an undertaking to pay to the seller.

Specimen of a bill of exchange:

| | |
|---|-------------------|
| Stamp | Address of Drawer |
| | Date |
| Three months after date pay to a sum of ₹ 50,000 (Fifty Thousands only) for the value received. | |
| To B accepted | |
| (B's signature & stamp) | A (Drawer) |

Parties to Bill of Exchange

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

- (a) **Drawer:** He is a person who draws the bill. Typically, he is the seller or a creditor.
- (b) **Drawee:** He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the drawer on the due date.
- (c) **Payee:** He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.
- (d) **Endorsee:** He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.
- (e) **Drawee in case of need:** Sometimes the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it: such a person is called the 'Drawee in case of need'.

Calculation of Due Date

Date of Maturity is also known as Due Date. The date on which the amount of the bill becomes payable is called 'Due Date' or 'Date of Maturity'. The period between the date of drawing of the bill and the due date is called Tenure of the Bill. To compute due date, three days (called Grace Period) are included to the date of maturity of the period of the bill.

The date of maturity of the period of bills depends on whether the bill is payable on date or bill is payable on sight. If the bill is payable on date, the date of maturity is computed by including tenure of bill to the making of the bill.

Date of maturity can be understood with the help of the following example:

| | |
|-----------------|------------|
| Date of Drawing | 12.12.2012 |
| Tenure | + 3 Months |
| | <hr/> |
| | 12.03.2013 |

However, If the bill becomes due at sight, the date of maturity is counted by including tenure of the bill to the date of acceptance of the bill. In that case, the due date of the bill is calculated as follows:

| | |
|--------------------|------------|
| Date of Acceptance | 16.12.2012 |
| Tenure | + 3 months |
| | <hr/> |
| | 16.3.2013 |

The due date of the bill after including grace period of 3 days is 15.3.2013 if the bill is payable at date and 19.3.2013 if the bill is payable at sight.

For computing the date of maturity, following points should be noted:

1. Days of grace are allowed on bills payable on maturity of a fixed period. In case of bills payable on demand, amount is required to be paid on presentation and no grace period is allowed.

2. If period of the bill matures on a date which is not there in the month in question, then the due date is taken as the last date of the month. For example, if a bill is drawn on 31.1.2013 and the period of the bill is 3 months, the period bill becomes payable on 30.4.2013 and after including grace days, due date is 3.5.2013.
3. In case the expiry date of a bill falls on a holiday, the bill becomes payable on the preceding day. But when the maturity date is a bank holiday or a Sunday and the second day of grace is also a holiday, the bill is payable on the next working day.
4. The tenure of the bill can be explained in months or in days. The due date of bill should be computed considering this fact in mind. Hence, if S draws bill on A on 31.1.2013 of one month, the maturity date of the bill is computed as follows :

| | |
|-----------------|-----------------|
| Date of Drawing | 31.1.2013 |
| Tenure | <u>+1 month</u> |
| | 28.2.2013 |
| Days of Grace | <u>+ 3 days</u> |
| | 03.03.2013 |

However, if tenure of the bill is 30 days, the expiry date of the bill is computed as follows :

| | |
|-----------------|------------------|
| Date of Drawing | 31.1.2013 |
| Tenure | <u>+ 30 days</u> |
| | 02.03.2013 |
| Days of Grace | <u>+ 3 days</u> |
| | 5.3.2013 |

Hence, tenure of one month and 30 days are different.

Acceptance of a Bill of Exchange

When the drawee puts his signature across the face of a bill of exchange with or without the words "accepted", it is called acceptance.

A bill, except in certain special cases, requires acceptance; otherwise the liability of the drawee cannot be established thereon.

Acceptance may be General or Qualified. When the drawee accepts liability to pay the amount mentioned in the bill in full, without any condition or limitation, it is a case of general acceptance. When the drawee accepts subject to some qualifications as regards amount, tenor, domicile etc. it is a case of qualified acceptance.

Discounting a Bill

If the holder of a bill wants to get the money of the bill before its due date, he can do so by selling the bill to a bank or a Discounting House who in consideration of a charge called discount, provides him with ready cash. This is known as discounting the bill. Discount charged by the bank is the interest at a certain rate per cent per annum on the amount of the bill for its unexpired period, i.e., the period from the date of discounting upto the date of maturity. This discount has no connection with the cash discount and must not be confused therewith.

Dishonour of Bill

Dishonour of a Bill means that the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place. At the time of dishonour of a bill, original relationship between the parties is restored, that is, the drawee again becomes the debtor of the drawer in his books and drawer is treated then as a creditor in the books of drawee. Moreover, the drawer becomes liable here to compensate the bank (or for that matter endorsee) if the bill is not retained by the drawer till date of the maturity.

To provide a legal evidence of dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'. The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'. These charges are to be paid by the holder of the bill on the date of default. Actually the acceptor of the bill is liable for the dishonour, the noting charges paid by the holder are to be reimbursed by the acceptor.

Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

Retirement of Bill

Sometimes the drawee pays the bill before the date of maturity. Under the circumstances, the drawer allows certain amount of rebate or discount which is calculated on certain percentage p.a. basis. The rebate is calculated from the date of payment to the date of maturity.

Accounting entries

For the convenience of accounting, bills are classified into (i) Bills Receivable and (ii) Bills Payable. All bills are –

- (i) Bills Receivable to those who receive the bills, and
- (ii) Bills Payable to those who accept the bills.

Thus, the same bill is both a Bill Receivable and a Bill Payable.

Holder, of the bill, however, has following four options available to him :

- (a) He may retain the bill till the date of maturity
- (b) He may get the bill discounted
- (c) He may endorse it to a third party in settlement of a debt
- (d) He may send it to his banker for collection.

Usual entries for bill transactions are given below:

| Transactions | Drawer's Books | Drawee's Books |
|---|--|--|
| When the bill is drawn and accepted | Bills Receivable A/c ... Dr. To Drawee's A/c | Drawer's A/c ... Dr. To Bills Payable A/c |
| When the bill is duly honoured on maturity | Bank A/c ... Dr. To Bills Receivable A/c (This entry will be made if the drawer retains the bill till due date and receives payment) | Bills Payable A/c ... Dr. To Bank A/c |
| When the bill is endorsed to a creditor | Endorsee's A/c ... Dr. To Bills Receivable A/c | |
| When the bill is discounted with the bank | (i) Bank A/c ... Dr. To Bills Receivable A/c (with full amount of the bill) | |
| | (ii) Discount on Bills A/c ... Dr. To Bank A/c (with the amount of discount) | |
| | Alternative combined entry : Bank A/c ... Dr. Discount on Bills A/c ... Dr. To Bills Receivable A/c | |
| When the bill is sent to bank for collection and the bill is duly collected | (i) When sent: Bills for Collection A/c ... Dr. To Bills Receivable A/c | |
| | (ii) When collected: Bank A/c ... Dr. To Bills for Collection A/c | |

| Transactions | Drawer's Books | Drawee's Books |
|--|---|--|
| When the bill is retired before maturity | Bank A/c ... Dr. Discount on Bills (or Rebate) A/c ... Dr. To Bills Receivable A/c | Bills Payable A/c ... Dr. To Bank A/c ` Discount on Bills (or Rebate) A/c |
| When the bill is dishonoured | (i) If retained by the drawer till maturity: Drawee's A/c ... Dr. To Bills Receivable A/c | Bills Payable A/c ... Dr. To Drawer's A/c |
| | (ii) If discounted with Bank Drawee's A/c ... Dr. To Bank A/c | Bills Payable A/c ... Dr. To Drawer's A/c |
| | (iii) If endorsed to a creditor: Drawee's A/c ... Dr. To Endorsee's A/c | Bills Payable A/c ... Dr. To Drawer's A/c |
| | (iv) If sent to Bank for collection: Drawee's A/c ... Dr. To Bills for Collection A/c | Bills Payable A/c ... Dr. To Drawer's A/c |
| When Noting Charges are paid on dishonoured bill | (i) If paid by drawer: Drawee's A/c ... Dr. To Bank A/c | Noting Charges A/c ... Dr. To Drawer's A/c |
| | (ii) If paid by endorsee: Drawee's A/c ... Dr. To Endorsee's A/c | Noting Charges A/c ... Dr. To Drawer's A/c |
| | (iii) If paid by discounting Bank: Drawee's A/c ... Dr. To Bank A/c | Noting Charges A/c ... Dr. To Drawer's A/c |
| When the bill is renewed for a further period | (i) For cancellation of the old bill: Drawee's A/c ... Dr. To Bills Receivable A/c | Bills Payable A/c ... Dr. To Drawer's A/c |
| | (ii) For interest on the extended period: Drawee's A/c ... Dr. To Interest A/c | Interest A/c ... Dr. To Drawer's A/c |
| | (iii) For drawing the new bill : Bills Receivable A/c ... Dr. To Drawee's A/c | Drawer's A/c ... Dr. To Bills Payable A/c |

Types of Bills of Exchange

(a) Trade bill: This bill is drawn to settle a trade transaction.

(b) Accommodation bill: This bill is used without a trade transaction and is for mutual benefit. If Mr. X is in need of money, he draws a bill on his friend Mr. Y who accepts it. This bill is then discounted with bank (bank will pay money before due date) and the money is shared between X and Y. On the due date, Y will pay to the bank and X will pay Y his share.

Law generally does not recognise such bills.

Proportionate Discount Charges

If the date of maturity of a bill falls on a date of a month within the accounting year, discounting of bill can be done without any problem. But when the date of maturity falls on a month of the next year i.e. the due date falls on two accounting periods, problem will arise. In such a situation, proportionate amount of discount will be charged to Profit and Loss Account. This can be understood with the help of the following example:

A bill was drawn on 1st November, 2013 for ₹20,000 for 3 months. The bill was discounted by the bank on same day @12% p.a. Therefore, the total amount of discount will be ₹600 (i.e. $20,000 \times \frac{12}{100} \times \frac{3}{12}$).

So 2/3rd of ₹600, i.e. ₹400 will be transferred to Profit and Loss Account for the year ended 31st December, 2013.

Treatment of Discount in the Books of the Bank

The following entries are recorded in the books of the bank:

a. When the bill is discounted:

| | |
|-----------------------------|-----|
| Bill Discounted A/c | Dr. |
| To, Customer's Current A/c | |
| To, Discounting on Bill A/c | |

b. When amount is received from the drawee:

| | |
|--------------------------|-----|
| Cash A/c | Dr. |
| To, Bills Discounted A/c | |

| | Transactions | Entries in the books of Drawer | Entries in the books of Drawee |
|---|---|---|---|
| 1 | If the bill is drawn | Bills Receivable A/c Dr. To, Drawee A/c | Drawer A/c Dr. To, Bills Payable A/c |
| 2 | If the bill is discounted by the bank | Cash/Bank A/c Dr. Discount A/c Dr. To, Bills Receivable A/c | — |
| 3 | If the bill is honoured at the due date | — | Bills Payable A/c Dr. To, Cash / Bank A/c |

Insolvency of Drawee (Acceptor)

Insolvency of acceptor means that he cannot pay the amount owed by him. Therefore, on insolvency of the acceptor, bill will be treated as dishonoured and entries for dishonour of bill will be passed in the books of respective parties. Later on, when some amount is realized from the property or estate of the insolvent acceptor, entry for cash received is passed and the balance of amount due from the insolvent acceptor is treated as bad debts. In the books of acceptor the amount not paid is transferred to deficiency account (or profit and loss account). Normally, the amount paid by the insolvent person is expressed as percentage of the amount due and is called the 'Rate of Dividend'. For example, if ₹25,000 is payable by Mr. A to Mr. B and Mr. A is declared insolvent and a dividend of 20% is declared, journal entries for the final settlement are passed as under:

In the books of Mr. A

| Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|--------------------|------|------------|------------|
| Mr. B A/c | Dr. | 25,000 | |
| To, Cash A/c | | | 5,000 |
| To, Deficiency A/c | | | 20,000 |

In the books of Mr. B

| Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|---------------|------|------------|------------|
| Cash A/c | Dr. | 5,000 | |
| Bad Debts A/c | Dr. | 20,000 | |
| To, Mr. A A/c | | | 25,000 |



In case of insolvency, it is better to prepare acceptor's account to work out the amount finally owed by him. Then, calculate cash received on account of dividend declared and the amount of bad debts.

Illustration 1.

Sagar purchased goods worth ₹ 1,000 from Ravi for which the latter drew a bill on the former, payable after one month. Sagar accepted it and returned it to Ravi. Ravi endorsed it to Kamal, and Kamal to Amal. Amal discounted the bill with State Bank of India at 6% p.a. On maturity, the bill was dishonoured, noting charge being ₹ 10.

Show the entries in the books of all the parties including the books of State Bank of India.

Solution:

In the books of Ravi Journal Entries

| Date | Particulars | L. F. | Dr. (₹) | Cr. (₹) |
|------|---|-------|---------|---------|
| | Sagar A/c To, Sales A/c (Goods sold to Sagar) | Dr. | 1,000 | 1,000 |
| | Bills Receivable A/c To, Sagar A/c (Bills drawn and accepted by Sagar for 1 month) | Dr. | 1,000 | 1,000 |
| | Kamal A/c To, Bills Receivable A/c (Bill endorsed to Kamal) | Dr. | 1,000 | 1,000 |
| | Sagar A/c To, Kamal A/c (Bill endorsed to Kamal dishonoured by Sagar including noting charge of ₹ 10) | Dr. | 1,010 | 1,010 |

In the books of Sagar Journal Entries

| Date | Particulars | L. F. | Dr. (₹) | Cr. (₹) |
|------|--|-------|---------|---------|
| | Purchase A/c To, Ravi A/c (Goods purchased from Ravi) | Dr. | 1,000 | 1,000 |
| | Ravi A/c To, Bills Payable A/c (Bill accepted for 1 month) | Dr. | 1,000 | 1,000 |
| | Bill Payable A/c To, Ravi A/c (Bill dishonoured at maturity, noting charge being ₹ 10) | Dr. | 1,000 | 1,010 |
| | Noting Charge A/c To, Ravi A/c | Dr. | 10 | |

In the books of Kamal
Journal Entries

| Date | Particulars | L. F. | Dr. (₹) | Cr. (₹) |
|------|--|-------|---------|---------|
| | Bills Receivable A/c To, Ravi A/c (Bill received from Ravi) | Dr. | 1,000 | 1,000 |
| | Amal A/c To, Bills Receivable A/c (Bill received from Ravi endorsed to Amal) | Dr. | 1,000 | 1,000 |
| | Ravi A/c To, Amal A/c (Bill endorsed to Amal dishonoured on maturity, noting charge being ₹ 10.) | Dr. | 1,010 | 1,010 |

In the books of Amal
Journal Entries

| Date | Particulars | L. F. | Dr. (₹) | Cr. (₹) |
|------|--|------------|----------|---------|
| | Bills Receivable A/c To, Kamal A/c (Bill received from Kamal.) | Dr. | 1,000 | 1,000 |
| | Bank A/c Discount A/c To, Bills Receivable A/c (Bill received from Kamal discounted by the Bank at 6% p.a.) | Dr. Dr. | 995 5 | 1,000 |
| | Kamal A/c To, Bank A/c (Bill received from Kamal dishonoured, noting charge being ₹ 10.) | Dr. | 1,010 | 1,010 |

In the books of State Bank of India
Journal Entries

| Date | Particulars | L. F. | Dr. (₹) | Cr. (₹) |
|------|--|-------|---------|-------------|
| | Bill Discounted A/c To, Amal's Current A/c To, Discount A/c (Amal's bill discounted which is due after 1 month.) | Dr. | 1,000 | 995 5 |
| | Amal's Current A/c To, Bills Discounted A/c To, Cash A/c (Bill received from Amal dishonoured at maturity, noting charge being ₹ 10.) | Dr. | 1,010 | 1,000 10 |



Illustration 2.

Sunil owed Anil ₹ 80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April. Sunil accepts it and returns it to Anil. On 15th April, Anil discounts it with Citi Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of ₹ 100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of ₹ 3,000 on 1st July. Before the new bill became due, Sunil retires the bill with a rebate of ₹ 500. Show journal entries in books of Anil.

Solution:

Journal entries in the books of Anil

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|-----------|--|------------|-----------------|---------|
| April, 1 | Bills Receivables A/c To, Sunil's A/c (Being acceptance by Sunil) | Dr | 80,000 | 80,000 |
| April, 15 | Bank A/c Discount A/c To, Bills Receivables A/c (Being discounting of the bill @ 12% p.a. & discounting charges for 2.5 months) | Dr Dr | 78,000 2,000 | 80,000 |
| June, 30 | Sunil's A/c To, Bank A/c (Being dishonour of the bill & noting charges paid by bank) | Dr. | 80,100 | 80,100 |
| June, 30 | Bank A/c To, Cash (Being cash paid to bank) | Dr. | 80,100 | 80,100 |
| July, 1 | Sunil's A/c To, Interest (Being interest due from Sunil) | Dr. | 3,000 | 3,000 |
| July, 1 | Bills Receivables A/c To, Sunil's A/c (Being new acceptance by Sunil for ₹ 80,100 & interest of ₹ 3,000) | Dr. | 83,100 | 83,100 |
| July, 1 | Bank A/c Rebate A/c To, Bills Receivables A/c (Being the amount received on retirement of the bill) | Dr. Dr. | 82,600 500 | 83,100 |

Illustration 3.

On 1st April Mr. Bala draws a bill of ₹ 1,20,000 on Mr. Lala for the amount due for 4 months. On getting acceptance, on 5th April, Bala endorses it to Mr. Kala in full settlement of his claim of ₹1,40,000 by paying the difference in cash. Lala approached Bala on 25th July saying that he needed to renew the bill for a further period of 4 months at an interest of 12% p.a. which Bala accepted. A fresh bill including interest was accepted by Lala on 1st August. Bala settled his liability to Kala by cheque. This was duly settled on the due date. Pass journal entries in the books of Bala and Lala. Also show Bills Receivables A/c and bills Payable A/c.

Solution:**Journal entries in the Books of Bala**

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|-----------|---|------|----------|--------------------|
| April 1 | Bills Receivables A/c To, Lala's A/c (Being acceptance by Lala) | Dr. | 1,20,000 | 1,20,000 |
| April 5 | Kala's A/c To, Cash A/c To, Bills Receivables A/c (Being bill endorsed to Kala & cash payment made to him) | Dr. | 1,40,000 | 20,000 1,20,000 |
| July 25 | Lala's A/c To, Kala's A/c (Being cancellation of bill for renewal) | Dr. | 1,20,000 | 1,20,000 |
| July 25 | Lala's A/c To, Interest A/c (Being interest due from Lala) | Dr. | 4,800 | 4,800 |
| July 25 | Kala's A/c To, Bank A/c (Being claim of Mr. Kala settled) | Dr. | 1,20,000 | 1,20,000 |
| August, 1 | Bills Receivables A/c To Lala's A/c (Being acceptance by Lala with interest) | Dr | 1,24,800 | 1,24,800 |
| Nov. 31 | Bank A/c To Bills Receivables A/c (Being payment received on due date) | Dr | 1,24,800 | 1,24,800 |

| Dr. | | Bills Receivable Account | | Cr. | |
|-----------|-------------|--------------------------|-----------|-------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| April, 1 | To Lala A/c | 1,20,000 | August, 5 | By Kala A/c | 1,20,000 |
| August, 1 | To Lala A/c | 1,24,800 | Nov. 30 | By Bank A/c | 1,24,800 |
| | | 2,44,800 | | | 2,44,800 |

Journal entries in the Books of Lala

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|-----------|--|------|----------|----------|
| April, 1 | Bala's A/c To Bills Payable A/c (Being acceptance of Bala's bill) | Dr. | 1,20,000 | 1,20,000 |
| July, 25 | Bills Payable A/c To Bala's A/c (Being cancellation of the bill for renewal) | Dr. | 1,20,000 | 1,20,000 |
| August, 1 | Interest A/c To Bala's A/c (being interest due to Bala) | Dr. | 4,800 | 4,800 |
| August, 1 | Bala's A/c To Bills Payable A/c (Being Bala's bill accepted with interest) | Dr. | 1,24,800 | 1,24,800 |
| Nov. 30 | Bills Payable A/c To Bank A/c (Being settlement of the bill due) | Dr. | 1,24,800 | 1,24,800 |



| Dr. | | Bills Payable Account | | Cr. | |
|----------|-------------|-----------------------|-----------|-------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| July, 25 | To Bala A/c | 1,20,000 | April, 1 | By Bala A/c | 1,20,000 |
| Nov. 30 | To Bank A/c | 1,24,800 | August, 1 | By Bala A/c | 1,24,800 |
| | | 2,44,800 | | | 2,44,800 |

Illustration 4.

Pass journal entries in the books of Hema for the following transactions :

- Hema's acceptance to Nanda for ₹ 5,000 renewed for 3 month with interest at 10% p.a.
- Nalini's acceptance to Hema was for ₹ 10,000 was retired one month before due date at a discount of 12% p.a.
- Discounted Natasha's acceptance to Hema for ₹ 4,000 with the bank for ₹ 3,920
- Neela requests Hema to renew her acceptance for ₹ 3,500 for 3 months. Hema accepted on the condition that interest of ₹ 100 was paid in cash which Neela did.
- Received an acceptance from Geeta for ₹ 1,200 and it was endorsed to Seeta in full settlement of her claim.

Solution:

In the Books of Hema Journal Entries

| | Particulars | L.F | Debit (₹) | Credit (₹) |
|-------|---|------------|--------------|------------|
| (i) | Bills Payable A/c To, Nanda's A/c (Being cancellation of Nanda's bill for renewal) | Dr. | 5,000 | 5,000 |
| | Interest A/c To, Nanda's A/c (Being interest due to Nanda) | Dr. | 125 | 125 |
| | Nanda's A/c To, Bills Payable A/c (Being acceptance given for new bill) | Dr. | 5,125 | 5,125 |
| (ii) | Bank A/c Discount A/c To, Bills Receivable A/c (Being Nalini's acceptance retired at discount) | Dr. Dr. | 9,900 100 | 10,000 |
| (iii) | Bank A/c Discount A/c To, Bills Receivable A/c (Being Natasha's acceptance discounted) | Dr. Dr. | 3,920 80 | 4,000 |
| (iv) | Neela's A/c To, Bills Receivables A/c (Being Neela's acceptance cancelled for renewal) | Dr. | 3,500 | 3,500 |
| | Cash A/c To, Interest A/c (Being interest received from Neela in cash) | Dr. | 100 | 100 |
| | Bills Receivable A/c To, Neela's A/c (Being Neela acceptance for new bill) | Dr. | 3,500 | 3,500 |
| (v) | Bills Receivable A/c To, Geeta A/c | Dr. | 1,200 | 1,200 |
| | Geeta A/c To, Bills Receivable A/c | Dr. | 1,200 | 1,200 |

Illustration 5.

X bought goods from Y for ₹ 4,000. Y draws a bill on 1.1.2013 for 3 months which was accepted by X for this purpose. On 1.3.2013, X arranged to retire the bill at a rebate of 12% p.a. Show the entries in the books of X and Y.

Solution:

In the books of Y
Journal

| Date | Particulars | L.F | Dr. (₹) | Cr. (₹) |
|---------------|--|------------|-------------|---------|
| 2013 Jan 1 | X A/c To, Sales A/c (Goods sold to X) | Dr. | 4,000 | 4,000 |
| Jan 1 | Bills Receivable A/c To, X A/c (Bills drawn for 3 months) | Dr. | 4,000 | 4,000 |
| March 1 | Cash A/c Rebate Allowed A/c To, Bills Receivable A/c (Bills retired under a rebate of 12% p.a.) | Dr. Dr. | 3,954 46 | 4,000 |

Rebate = ₹ 4,000 x 12/100 x 35/365 (1st March to 4th April) = ₹ 46.

In the books of X
Journal

| Date | Particulars | L.F | Dr. (₹) | Cr. (₹) |
|---------------|--|-----|---------|-------------|
| 2013 Jan 1 | Purchase A/c To, Y A/c (Goods purchased from Y) | Dr. | 4,000 | 4,000 |
| Jan 1 | Y A/c To, Bills Payable A/c (Bills accepted for 3 months) | Dr. | 4,000 | 4,000 |
| March 1 | Bills Payable A/c To, Cash A/c To, Rebate Received A/c (Bills retired under a rebate of 12% p.a.) | Dr. | 4,000 | 3,956 46 |

Operating Cycle of the Accommodation Bill of Exchange

The basis for accommodation bill is not a trade transaction. It is drawn to accommodate the financial requirements of drawer or even a drawee. This transaction presupposes trust and understanding between the parties to the transaction. The drawer normally discounts this bill with the bank. The amount received from bank is either retained by the drawer for himself or shared between the drawer and the drawee. On the date of maturity, the drawee settles the bill with bank by effecting payment. The drawer will pay the drawee either full amount of the bill or his share. Accounting entries for accommodation bill are:

| Situations | Drawer's books | Drawee's books |
|-----------------------|---|---------------------------|
| Drawing of a bill | B/R A/c To, Drawee A/c | Drawer A/c To, B/P A/c |
| Discounting with bank | Bank A/c Discount A/c To, B/R A/c | No Entry |
| Payment on due date | Drawee A/c To, Bank A/c | B/P A/c To, Bank A/c |

Illustration 6.

Following information is given to you by Govind from his books:

On 1st April 2012 he had with him bills of ₹ 1,50,000 accepted by his customers and ₹ 1,00,000 worth accommodation bills accepted by his friends. He had accepted bills worth ₹ 90,000 for his suppliers and ₹ 75,000 worth accommodation bills for his friends.

During the year the following transactions took place:

- (i) He raised bills of ₹ 3,75,000 which were accepted by his customers.
- (ii) He accepted bills of ₹ 2,25,000 for his suppliers.
- (iii) He accepted accommodation bills of ₹ 60,000 for his friends.
- (iv) His friend accepted accommodation bills of ₹ 1,25,000 for him.
- (v) He honoured on due dates trade bills of ₹ 1,75,000 and accommodation bills of ₹ 85,000.
- (vi) He received payments on due dates for trade bills of ₹ 4,00,000 and accommodation bills of ₹ 1,50,000.
- (vii) He endorsed bills of ₹ 25,000 to his suppliers, which were honoured by the acceptors.
- (viii) His customers endorsed bills of ₹ 30,000 to him which he accepted in favour of his suppliers.
- (ix) Accommodation bills were settled on the due dates and money was paid and received duly.

Prepare Bills Receivable A/c and Bills Payable A/c for both trade and accommodation bills.

Solution:

| Dr. | | | Bills Receivable Account | | | Cr. | | |
|-----------|----------------|------------|--------------------------|------------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 1.4.2012 | To Balance b/d | 1,50,000 | 31.3.2013 | By Bank A/c | 4,00,000 | | | |
| 31.3.2013 | To Debtors A/c | 3,75,000 | 31.3.2013 | By Suppliers A/c | 25,000 | | | |
| | | | 31.3.2013 | By Balance c/d | 1,00,000 | | | |
| | | 5,25,000 | | | 5,25,000 | | | |

| Dr. | | | Bills Payable Account | | | Cr. | | |
|-----------|-----------------|------------|-----------------------|------------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 31.3.2013 | To, Bank A/c | 1,75,000 | 1.4.2012 | By Balance b/d | 90,000 | | | |
| 31.3.2013 | To, Debtors A/c | 30,000 | 31.3.2013 | By Suppliers A/c | 2,25,000 | | | |
| 31.3.2013 | To, Balance c/d | 1,10,000 | | | | | | |
| | | 3,15,000 | | | 3,15,000 | | | |

| Dr. | | | Accommodation Bills Receivable Account | | | Cr. | | |
|-----------|-----------------------------|------------|--|-----------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 1.4.2012 | To, Balance b/d | 1,00,000 | 31.3.2013 | By, Bank A/c | 1,50,000 | | | |
| 31.3.2013 | To, Friends A/c (acceptors) | 1,25,000 | 31.3.2013 | By, Balance c/d | 75,000 | | | |
| | | 2,25,000 | | | 2,25,000 | | | |

| Dr. | | | Accommodation Bills Payable Account | | | Cr. | | |
|-----------|-----------------|------------|-------------------------------------|---------------------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 31.3.2013 | To, Bank A/c | 85,000 | 1.4.2012 | By, Balance b/d | 75,000 | | | |
| 31.3.2013 | To, Balance c/d | 50,000 | 31.3.2013 | By, Friends A/c (drawers) | 60,000 | | | |
| | | 1,35,000 | | | 1,35,000 | | | |

| Dr. | | | Friends (acceptors of bills) Account | | | Cr. | | |
|-----------|-----------------|------------|--------------------------------------|---------------------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 31.3.2013 | To, Bank A/c | 1,50,000 | 1.4.2012 | By, Balance b/d | 1,00,000 | | | |
| 31.3.2013 | To, Balance c/d | 75,000 | 31.3.2013 | By, Accommodation B/R A/c | 1,25,000 | | | |
| | | 2,25,000 | | | 2,25,000 | | | |

| Dr. | | | Friends (drawers of bills) Account | | | Cr. | | |
|-----------|---------------------------|------------|------------------------------------|-----------------|------------|-----|--|--|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | | | |
| 1.4.2012 | To, Balance b/d | 75,000 | 31.3.2013 | By, Bank A/c | 85,000 | | | |
| 31.3.2013 | To, Accommodation B/P A/c | 60,000 | 31.3.2013 | By, Balance c/d | 50,000 | | | |
| | | 1,35,000 | | | 1,35,000 | | | |

Illustration 7.

Vijay draws a bill for ₹ 60,000 and Anand accepts the same for mutual accommodation of both of them to the extent of Vijay 2/3rd and Anand 1/3rd. Vijay discounts it with bank for ₹ 56,400 and remits 1/3rd share to Anand. Before the due date, Anand draws another bill for ₹ 84,000 on Vijay in order to provide funds to meet the first bill on same sharing basis. The second bill is discounted at ₹ 81,600. With these proceeds, the first bill is settled and ₹ 14,400 were remitted to Vijay. Before the due date of the second bill, Vijay becomes insolvent and Anand receives a dividend of only 50 paise in a rupee in full satisfaction. Pass journal entries in the books of Vijay.

Solution:

In case of accommodation bills, the proceeds of discounting are shared by parties as agreed. The discounting charges are also shared in agreed proportion. Here, the ratio between Vijay and Anand is given as two-thirds and one-third. The first bill of ₹ 60,000 is discounted at ₹ 56,400 which means the discounting charges are ₹ 3,600. The share of each one is:

| | 1st Bill | | 2nd Bill | |
|---------------|--------------|--------------|--------------|--------------|
| | Proceeds (₹) | Discount (₹) | Proceeds (₹) | Discount (₹) |
| Vijay (2/3rd) | 37,600 | 2,400 | 54,400 | 1,600 |
| Anand (1/3rd) | 18,800 | 1,200 | 27,200 | 800 |
| Total | 56,400 | 3,600 | 81,600 | 2,400 |

Further, as Vijay has become insolvent, the amount due to Anand is settled at 50% of total. To calculate this amount, it's necessary to post all transactions to Anand's account and arrive at the balance.



In the Books of Vijay
Journal Entries

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|------|--|------------|-----------------|------------------|
| | Bills Receivable A/c To, Anand's A/c (Being bill drawn on Anand) | Dr. | 60,000 | 60,000 |
| | Bank A/c Discount A/c To, Bills Receivables A/c (Being discounting of bill) | Dr. Dr. | 56,400 3,600 | 60,000 |
| | Anand's A/c To, Bank A/c To, Discount A/c (Being 1/3rd proceeds paid to Anand) | Dr. | 20,000 | 18,800 1,200 |
| | Anand's A/c To, Bills payable A/c (being acceptance of bill) | Dr. | 84,000 | 84,000 |
| | Bank A/c Discount A/c To, Anand's A/c (Being proceeds of discounting 2nd bill) | Dr. Dr. | 14,400 1,600 | 16,000 |
| | Bills Payable A/c To, Anand's A/c (Being dishonour of bill) | Dr. | 84,000 | 84,000 |
| | Anand's A/c To, Bank A/c To, Deficiency A/c (Being payment of 50% & balance proved to be bad) | Dr. | 56,000 | 28,000 28,000 |

| Dr. | | Anand's Account | | Cr. | |
|--------------------|----------|-----------------|----------|-----|----------|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To, Bank A/c | 18,800 | By B/R A/c | 60,000 | | |
| To, Discount A/c | 1,200 | By Bank A/c | 14,400 | | |
| To, B/P A/c | 84,000 | By Discount A/c | 1,600 | | |
| | | By B/P A/c | 84,000 | | |
| To, Bank A/c | 28,000 | | | | |
| To, Deficiency A/c | 28,000 | | | | |
| | 1,60,000 | | | | 1,60,000 |

Illustration 8.

Rahim, for mutual accommodation, draws a bill for ₹ 3,000 on Ratan. Rahim discounted it for ₹ 2,925. He remits ₹ 975 to Ratan. On the due date, Rahim is unable to remit his dues to Ratan to enable him to meet the bill. He, however, accepts a bill for ₹ 3,750 which Ratan discounts for ₹ 3,625. Ratan sends ₹ 175 to Rahim after discounting the above bill. Rahim becomes insolvent and a dividend of 80 paise in the rupee is received from his estate.

Pass the necessary journal entries in the books of both the parties.

Solution:

**In the books of Rahim
Journal Entries**

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|------|--|------|-------------|--------------|
| | Bills Receivable A/c Dr. To, Ratan A/c (Bill drawn for mutual accommodation and accepted by Ratan.) | | 3,000 | 3,000 |
| | Bank A/c Dr. Discount A/c Dr. To, Bills Receivable A/c (Bill discounted by the bank.) | | 2,925 75 | 3,000 |
| | Ratan A/c Dr. To, Bank A/c To Discount A/c (1/3 Proceeds remitted to Ratan.) | | 1,000 | 975 25 |
| | Ratan A/c Dr. To, Bills Payable A/c (Bill accepted.) | | 3,750 | 3,750 |
| | Bank A/c Dr. Discount A/c Dr. To, Ratan A/c (Proceeds received from Ratan including discount charges.) | | 175 75 | 250 |
| | Bills Payable A/c Dr. To, Ratan A/c (Bill dishonored since e became insolvent.) | | 3,750 | 3,750 |
| | Ratan A/c Dr. To, Bank A/c `` Deficiency A/c (Cash paid to Ratan @80 paise in the rupee and balance transferred to deficiency account.) | | 2,250* | 1,800 450 |

* This amount can be ascertained by preparing Ratan's Account in Rahim's book.



In the books of Ratan
Journal Entries

| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|------|---|------|--------------|------------|
| | Rahim A/c Dr. To, Bills Payable A/c (Bill accepted for mutual accommodation) | | 3,000 | 3,000 |
| | Bank A/c Dr. Discount A/c Dr. To, Rahim A/c ($\frac{1}{3}$ proceeds received from Rahim including discount) | | 975 25 | 1,000 |
| | Bills Receivable A/c Dr. To, Rahim A/c (Bill drawn and accepted by Rahim) | | 3,750 | 3,750 |
| | Bank A/c Dr. Discount A/c Dr. To, Bills Receivable A/c (Bill discounted) | | 3,625 125 | 3,750 |
| | Rahim A/c Dr. To, Bank A/c "Discount A/c (Proceeds remitted to Rahim including discount) | | 250 | 175 75 |
| | Rahim A/c Dr. To, Bank A/c (Bill honoured at maturity) | | 3,750 | 3,750 |
| | Bills Payable A/c Dr. To, Bank A/c (Bill honoured at maturity) | | 3,000 | 3,000 |
| | Bank A/c Dr. Bad Debt A/c Dr. To, Rahim A/c (Amount realised from the official liquidator of Rahim @ 80 paise in the rupee and the balance proved bad) | | 1,800 450 | 2,250 |

Note:

Sharing discount:

After discounting of the 1st bills, Rahim received ₹ 2,000 (including discount)

Add: Amount remitted by Ratan (after discounting of the 2nd bill). ₹ 175

Total benefit received by Rahim. ₹ 2,175

Now,

After discounting of the 2nd bill Ratan received ₹ 3,625 (Net)

∴ Proportion of Rahim to Ratan = $\frac{₹ 2,175}{₹ 3,625} \times 125 = ₹ 75$

∴ Rahim is to bear = ₹ 75 of discounting charges, and the balance by Ratan.

2.2 CONSIGNMENT ACCOUNTING

Introduction

The sales activity of any business can be organized in different ways. With the customers spread all over, the business entity cannot afford to have only minimum selling points nor can it have its own resources to have the outlets all over. The business volumes cannot be limited in any case. The core competence of a manufacturing company is to produce a good quality product. It creates a network of its own outlets, dealers, commission agents, institutions etc to distribute its products efficiently and effectively. Thus the selling may be handled directly through own salesmen or indirectly through agents.

In case of direct selling, the company usually has depots all over. The stocks are transferred to these depots and from there finally sold to ultimate customers. This involves huge expenses and problems of maintaining the same on a permanent basis. Hence, the firm could appoint agents to whom stocks will be given. These agents distribute the products to ultimate customers and receive commission from the manufacturer. One such way of indirect selling is selling through consignment agents. The relationship between consignor and consignee is that of Principal-Agent relationship.

Difference between Sale and Consignment

1. In sale the property in goods is transferred to the buyer immediately whereas in consignment the property is transferred to the buyer only when goods are sold by the consignee. The ownership of goods remains with the consignor when goods are transferred to the consignee by the consignor.
2. In sale, the risk attaching to the goods passes with ownership to the buyer. In case of a consignment, the risk attaching to the goods does not pass to the consignee who acts as a mere agent. If there is any damage or loss to the goods it is borne by the consignor provided the consignee has taken reasonable care of the goods and the damage or loss is not due to his negligence.
3. The relationship of consignor and consignee is that of a principal and an agent as in a contract of agency whereas the relationship of buyer and seller is governed by the Sale of Goods Act.
4. Unsold goods on consignment are the property of the consignor and may be returned if not saleable in the market whereas goods sold on sale basis are normally not returnable unless there is some defect in them.

Main Terms of Consignment Trade

Consignor – He is the person who sends goods to agents e.g. a manufacturer or wholesaler.

Consignee – He is the agent to whom goods are sent for selling.

Proforma Invoice – When the consignor sends the goods to the consignee, he prepares only a proforma invoice and not an invoice. A proforma invoice looks like an invoice but is really not one. The objective of the proforma invoice is only to convey information to the consignee regarding quantity, varieties and prices of goods sent and expenses incurred and not to make him liable like a trade debtor.

Over-riding Commission – It is an extra commission allowed over and above the normal commission is generally offered for the following reasons :

- (i) When the agent is required to put in hard work in introducing a new product in the market.
- (ii) Where he is entrusted with the work of supervising the performance of other agents in a particular area.
- (iii) For effecting sales at prices higher than the price fixed by the consignor.

Ordinary Commission – This is a fee payable by consignor to consignee for sale of goods when the consignee does not guarantee the collection of money from ultimate customer. The % of such commission is generally lower.



Del Credre Commission – This is additional commission payable to the consignee for taking over additional responsibility of collecting money from customers. In case, the customers do not pay the consignee takes over the loss of bad debts in his books. Although it's paid for taking over risk of bad debts that arise out of credit sales only, this commission is calculated on total sales and not on credit sales.

Account Sales – This is a periodical statement prepared by consignee to be sent to the consignor giving details of all sales (cash and credit), expenses incurred and commission due for sales, destroyed-in-transit or in godown and deducting the amount of advance remitted by him.

Operating Cycle of Consignment Arrangement

- (i) Goods are sent by consignor to the consignee.
- (ii) Consignee may pay some advance or accept a bill of exchange.
- (iii) Consignee will incur expenses for selling the goods.
- (iv) Consignee maintains records of all cash and credit sale.
- (v) Consignee prepares a summary of results called as Account sales.
- (vi) Consignor pays commission to the consignee.

Sometimes, the consignor may send the goods at a price higher than cost so that the consignee gets no knowledge of the real cost of goods which is confidential for the consignor.

Accounting for Consignment Business

The consignor and consignee keep their own books of accounts. The consignor may send goods to many consignees. Also, a consignee may act as agent for many consignors. It is appropriate that both of them would want to know profit or loss made on each consignment. There are certain new accounts that are to be opened in addition to regular accounts as cash or bank.

The objective of consignor in making accounts relating to consignment is two-fold viz.

- (i) To ascertain the results (profit/loss) of consignment and incorporate them in his profit and loss account.
- (ii) To make final settlement with the consignee.

To achieve these objectives, he prepares respectively two accounts, viz. 'Consignment Account' and 'Consignee Account'. The former is a nominal account and latter is a personal account. A separate consignment account as well as consignee account is prepared in respect of every consignment. It is important to observe that the two accounts are prepared by the consignor in addition to other accounts in his ledger to incorporate the results of consignments in his books.

When goods are dispatched on Consignment no entry can be made in the Sales Account as this is not a sale, and, until the goods are sold, they remain the legal property of the consignor. For the same reason the consignee's personal account cannot be debited with the value of the goods consigned. He is not a debtor until the goods are sold.

As an agent, the consignee is not liable to pay for the goods received on consignment. Therefore, he makes no entry in his financial books on such receipts. As, however, he is liable to account for the goods received, he keeps an adequate record in an appropriate memorandum book. Apart from this his only concern is to record the expenses he has incurred, the sales, his commission and his financial relationship with the consignor. A personal account for the consignor is the only additional account a consignee needs to record his consignment transactions.

Let us see the entries in the books of consignor as well as consignee :

| Situations | Consignor's books | Consignee's books |
|---|---|---|
| On sending goods | Consignment A/c To Goods Sent on Consignment | Dr. No Entry |
| On expenses for sending goods | Consignment A/c To Cash/Bank/Creditors for Expenses A/c | Dr. No Entry |
| For advance received from consignee | Cash/ Bank/ Bill Receivables A/c To Consignee's Personal A/c | Dr. Consignor's Personal A/c Dr. To Cash/ Bank/ Bills Payable A/c |
| On expenses incurred by consignee | Consignment A/c To Consignee's Personal A/c | Dr. Consignor's Personal A/c Dr. To Cash/ Bank/ Creditors for expenses A/c |
| On consignee reporting sales | Consignee's Personal A/c To Consignment A/c | Dr. Cash/ Bank/ Consignment Debtors A/c Dr. To Consignor's Personal A/c |
| For commission due | Consignment A/c To Consignee's Personal A/c | Dr. Consignor's Personal A/c Dr. To Commission A/c |
| For Bad Debts | Consignment A/c To Consignee's Personal A/c | Dr. Consignor's Personal A/c Dr. To Consignment Debtors A/c |
| For closing the consignment account | For profit : Consignment A/c To General Profit and Loss A/c. For Loss General Profit and Loss A/c To Consignment A/c | Dr. No entry Dr. |
| For the final settlement | Cash/ Bank/ B/R A/c To Consignee A/c | Dr. Consignor A/c Dr. To Cash/ Bank/ B/P A/c |
| For closing the Goods Sent on Consignment Account | Goods sent on Consignment A/c To Trading/ Purchases A/c | Dr. No entry |
| On closing stock | Stock on Consignment A/c To Consignment A/c | Dr. No Entry |

Del Credere Commission and Bad Debts

Sometimes the consignor allows an extra commission to the consignee in order to cover the risk of collection from customer on account of credit sales which is known as Del Credere Commission. Naturally, if debt is found to be irrecoverable the same must be borne by the consignee. There will be no effect in the books of consignor. In short, credit sales will be treated as cash sales to consignor. If no Del credere commission is given by the consignor to the consignee, the amount of Bad debts must be borne by the consignor.

Entries in the Books of Consignor

(a) When Del Credere Commission is given

| | | |
|-------|--|-----|
| (i) | For Credit Sales – Consignee's Personal A/c To, Consignment A/c | Dr. |
| (ii) | For Bad Debts – No Entry | |
| (iii) | For Del Credere Commission – Consignment A/c To, Consignee's Personal A/c | Dr. |

(b) When Del Credere Commission is not given

| | | |
|-------|---|----------------------------------|
| (i) | For Credit Sales – Consignment Debtors A/c To, Consignment A/c | Dr. |
| (ii) | For Bad Debts – Consignment A/c To, Consignment Debtors A/c | Dr. |
| (iii) | (a) For realization of Cash – Cash A/c To, Consignment Debtors A/c | Dr. if collected by Consignor |
| | (b) Consignee's Personal A/c To, Consignment Debtors A/c | Dr. if collected by Consignee |

Entries in the Books of Consignee

(a) When Del Credere Commission is given

| | | |
|-------|--|-----|
| (i) | For Credit Sales – Consignment Debtors A/c To, Consignor A/c | Dr. |
| (ii) | For Bad Debts – Bad Debts A/c To, Consignment Debtors A/c | Dr. |
| (iii) | For realization of cash from cash from Debtors – Cash/ Bank A/c To, Consignment Debtors A/c | Dr. |
| (iv) | For Closing Bad Debts A/c- Commission Received A/c To, Bad Debts A/c | Dr. |

(b) When Del Credere Commission is not given –

There will be no entry against a bad debts entry in the books of consignee.

Valuation of Stock

Unsold stock on consignment should properly valued; otherwise final accounts cannot be prepared. Usually, unsold stock on consignment is value at cost price plus proportionate expenses of the consignor plus proportionate non recurring expenses of consignee.

Alternatively, total cost of goods plus total expenses incurred by the consignor plus total non recurring expenses of the consignee are to be added and stock should valued on the basis of proportionate unsold goods.

But it must be remember while valuing stock on consignment, the usual principle for valuation of stock, that stock should be valued at cost price or market price whichever is less.

Workings:

1. Valuation of unsold stock

| | (₹) |
|---|--------|
| Total cost (500 × ₹100)(without considering expenses) | 50,000 |
| Less: Reduction in price @5% | 2,500 |
| | 47,500 |
| Less: Y Ltd.'s commission @5% | 2,375 |
| | 45,125 |

2. Computation of Commissions

| | (₹) |
|--|----------|
| Total sales @₹160 per saree (2,500 × ₹160) | 4,00,000 |
| Less: In excess of ₹150 per saree | 3,75,000 |
| Surplus price realised | 25,000 |
| Commission to be calculated as under: | |
| On total sales @5% (₹4,00,000 × 5%) | 20,000 |
| Add: 25% on ₹25,000 | 6,250 |
| | 26,250 |

1,500 sarees which were sold @₹110 is not related to consignment account

Losses on Consignment

There are two types of losses which may arise in case of a consignment transaction, viz.

- (a) Normal Loss, and
- (b) Abnormal Loss

(a) Normal Loss – Normal Losses arise as a result of natural causes, e.g. evaporation, leakage, breakage etc., and they are inherent in nature. Since normal loss is a charge against gross profit no additional adjustment is required for this purpose. Moreover, as the same is a part of cost of goods, when valuation of unsold stock is made in case of consignment account the quantity of such loss (not the amount) should be deducted from the total quantity of the goods received by the consignee in good condition. Thus,

$$\text{Value of closing stock will be} = \text{Total Value of goods sent} \times \frac{\text{Unsold quantity}}{\text{Good quantity received by consignee}}$$

Illustration 10.

From the following particulars ascertain the value of unsold stock on Consignment.

| | |
|--|----------|
| Goods sent (1,000 kgs.) | ₹ 20,000 |
| Consignor's expenses | ₹ 4,000 |
| Consignees non-recurring expenses | ₹ 3,000 |
| Sold (800 kgs.) | ₹ 40,000 |
| Loss due to natural wastage (100 kgs.) | |

Solution:

| Value of unsold stock | ₹ |
|--|---------------|
| Total cost of goods sent | 20,000 |
| Add : Consignor's expenses | 4,000 |
| Add : Non-recurring expenses | 3,000 |
| Cost of (1,000 kgs – 100 kgs) = 900 kgs. | <u>27,000</u> |

$$\begin{aligned} \therefore \text{Value of unsold stock (1,000 – 800 – 100) = 100 kgs. will be} &= ₹ 27,000 \times \frac{100 \text{ kgs.}}{900 \text{ kgs.}} \\ &= ₹ 3,000 \end{aligned}$$

(b) Abnormal Losses - Abnormal Losses arises as a result of negligence/ accident etc., e.g., theft, fire etc. Before ascertaining the result of the consignment, value of abnormal loss should be adjusted. The method of calculation is similar to the method of calculating unsold stock. Sometimes insurance company admits the claim in part or in full. The same should also be adjusted against such abnormal loss.

While valuing the abnormal loss the proportionate expenses are taken only upto the stage of the loss. For example, if goods are lost in the transit on way to the consignee's place, the value of abnormal loss will include the basic cost of the goods plus proportionate expenses of the consignor only and not the proportionate expenses of consignee because consignee has spent nothing on account of these goods.

Treatment of Abnormal Loss

(i) For abnormal Loss –

| | |
|--------------------|----|
| Abnormal Loss A/c | Dr |
| To Consignment A/c | |

(ii) For the insurance claim due / received by the consignor -

| | |
|------------------------|----|
| Insurance Co./Bank A/c | Dr |
| To Abnormal Loss A/c | |

(iii) If goods are not insured -

| | |
|----------------------|----|
| Profit & Loss A/c | Dr |
| To Abnormal Loss A/c | |

(iv) For transferring the net loss -

| | |
|----------------------|----|
| Profit & Loss A/c | Dr |
| To Abnormal Loss A/c | |

Illustration 11.

5,000 shirts were consigned by Raizada & Co. of Delhi to Zing of Tokyo at cost of ₹ 375 each. Raizada & Co. paid freight ₹ 50,000 and Insurance ₹ 7,500.

During the transit 500 shirts were totally damaged by fire. Zing took delivery of the remaining shirts and paid ₹ 72,000 on custom duty.

Zing had sent a bank draft to Raizada & Co. for ₹ 2,50,000 as advance payment. 4,000 shirts were sold by him at ₹ 500 each. Expenses incurred by Zing on godown rent and advertisement etc. amounted to ₹ 10,000. He is entitled to a commission of 5%

One of the customer to whom the goods were sold on credit could not pay the cost of 25 shirts.



Prepare the Consignment Account and the Account of Zing in the books of Raizada & Co. Zing settled his account immediately. Nothing was recovered from the insurer for the damaged goods.

Solution:

In the books of Raizada & Co.

| Dr. | | Consignment Account | | Cr. | |
|--|------------------|---|------------|-----|------------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Goods Sent on Consignment A/c (5,000 x ₹ 375) | 18,75,000 | By, Zing A/c | | | 19,87,500 |
| To, Bank A/c | | - Sale proceeds (3,975 x ₹ 500) | | | |
| - Freight | 50,000 | By, Consignment Debtors A/c | | | |
| - Insurance | 7,500 | - Credit Sales (25 x ₹ 500) | | | 12,500 |
| To, Zing A/c | | By, Abnormal Loss A/c (W.N. 1) | | | 1,93,250 |
| - Custom Duty | 72,000 | By, Stock on Consignment A/c (W.N.2) | | | 2,01,250 |
| - Godown Rent, Advertisement etc | 10,000 | | | | |
| - Commissions @5% on total Sales (4,000×500×5%) | 1,00,000 | | | | |
| To, Consignment Debtors A/c | | | | | |
| - Bad Debts | | | | | |
| To, Profit and Loss A/c | | | | | |
| - Profit on Consignment transferred | | | | | |
| | | | | | |
| | 23,94,500 | | | | 23,94,500 |

| Dr. | | Zing Account | | Cr. | |
|---------------------|------------------|---------------------|------------|-----|------------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Consignment A/c | | By, Bank Draft A/c | | | |
| Sale Proceeds | 19,87,500 | Advance | | | 2,50,000 |
| | | By, Consignment A/c | | | |
| | | Expenses & Com. | | | 1,82,000 |
| | | By, Bank A/c | | | |
| | | Final Settlement | | | 15,55,500 |
| | | | | | |
| | 19,87,500 | | | | 19,87,500 |

| Dr. | | Abnormal Loss Account | | Cr. | |
|---------------------|-----------------|-------------------------|------------|-----|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Consignment A/c | 1,93,250 | By, Profit and Loss A/c | | | 1,93,250 |
| | | | | | |
| | 1,93,250 | | | | 1,93,250 |

Workings:**1. Valuation of goods Lost-in-transit and unsold Stock:****(₹)**

| | |
|---|------------------|
| Total Cost | 18,75,000 |
| Add: Consignor's Expenses | 57,500 |
| C.P. of 5,000 Shirts | 19,32,500 |
| Less: Lost-in-transit | (1,93,250) |
| $\left(\frac{₹ 19,32,500 \times 500}{5,000} \right)$ | |
| Add: Non-recurring Ex. of Consignee | 72,000 |
| C.P. of 4,500 Shirt | 18,11,250 |

2. Value of unsold Stock $\frac{₹18,11,250 \times 500}{4,500} = ₹ 2,01,250$

Note:

Since Del Credere Commission is not given by the consignor to the consignee, amount of bad debt is to be charged against Consignment Account.

Simultaneous Normal Loss and Abnormal Loss**Illustration 12.**

Lubrizols Ltd. of Mumbai consigned 1,000 barrels of lubricant oil costing ₹ 800 per barrel to Central Oil Co. of Kolkata on 1.1.2013. Lubrizols Ltd. paid ₹ 50,000 as freight and insurance. 25 barrels were destroyed on 7.1.2013 in transit. The insurance claim was settled at ₹ 15,000 and was paid directly to the consignor.

Central Oil took delivery of the consignment on 19.1.2013 and accepted a bill drawn upon them by Lubrizols Ltd., for ₹ 5,00,000 for 3 months. On 31.3.2013 Central Oil reported as follows:

- (i) 750 barrels were sold as ₹ 1,200 per barrel.
- (ii) The other expenses were:

| | (₹) |
|-------------------------------------|------------|
| Clearing charges | 11,250 |
| Godown Rent | 10,000 |
| Wages | 30,000 |
| Printing, Stationery, Advertisement | 20,000 |

25 barrels of oil were lost due to leakage which is considered to be normal loss.

Central Oil Co. is entitled to a commission of 5% on all the sales affected by them. Central Oil Company paid the amount due in respect of the consignment on 31st March itself.

Show the Consignment Account, the Account of Central Oil Co., and the Lost –in-Transit Account as they will appear in the books of Lubrizols Ltd.



Solution:

In the books of Lubrizols Ltd.

| Dr. Consignment to Kolkata Account | | | | Cr. | | |
|------------------------------------|---|------------|------------------|----------------|----------------------------------|------------------|
| Date | Particulars | Amount (₹) | Amount (₹) | Date | Particulars | Amount (₹) |
| 2013 Jan. 1 | To Goods sent on Consignment A/c (1,000 x ₹ 800) | | 8,00,000 | 2013 Jan. 7 | By, Abnormal Loss A/c | 21,250 |
| Mar.31 | To, Bank A/c – Expenses | | 50,000 | Mar.31 | By, Central Oil Co. A/c | 9,00,000 |
| | To, Central Oil Co. A/c | | | | Sale proceeds (750 x ₹ 1,200) | |
| | Freight | 11,250 | | | By, Stock on Consignment A/c | 1,76,842 |
| | Godown Rent | 10,000 | | | | |
| | Wages | 30,000 | | | | |
| | Printing etc. | 20,000 | 71,250 | | | |
| | To, Central Oil Co. A/c | | | | | |
| | Commissions @5% | | 45,000 | | | |
| | To, Profit on Consignment A/c (Transferred to Profit & Loss A/c) | | 1,31,842 | | | |
| | | | 10,98,092 | | | 10,98,092 |

| Dr. Central Oil Co. Ltd. Account | | | | Cr. | |
|----------------------------------|---|-----------------|---------------|--------------------------------|-----------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 2013 Mar.31 | To, Consignment to Kolkata A/c -Sale Proceeds | 9,00,000 | 2013 Jan.7 | By, Bills Receivable A/c | 5,00,000 |
| | | | Mar.31 | By, Consignment to Kolkata A/c | |
| | | | | - Expenses | 71,250 |
| | | | | - Commission | 45,000 |
| | | | | By, Bank (amount due) | 2,83,750 |
| | | 9,00,000 | | | 9,00,000 |

| Dr. Abnormal Loss Account | | | | Cr. | |
|---------------------------|-----------------------------------|---------------|---------------|-------------------------------------|---------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 2013 Jan. 7 | To, Consignment to Kolkata A/c | 21,250 | 2013 Jan.7 | By Bank-Insurance Claim A/c | 15,000 |
| | | | Mar.31 | By, Profit and Loss A/c (bal. fig.) | 6,250 |
| | | 21,250 | | | 21,250 |

Workings:

Valuation of Goods Lost-in-transit and Unsold Stock:

| | |
|--|-----------------|
| Total Cost (1,000 x ₹ 800) | 8,00,000 |
| Add: Consignor's Expenses | 50,000 |
| Value of 1,000 barrels | 8,50,000 |
| Less: Lost-in-transit $25 \times \frac{₹ 8,50,000}{1,000}$ | 21,250 |
| Add: Non-recurring expenses of Consignee | 11,250 |
| Value of (1,000 – 25 – 25) = 950 Kg. | 8,40,000 |

$$\text{Therefore, Value of Stock} = 200 \times ₹ \frac{₹ 8,40,000}{950} = ₹ 1, 76, 842 \text{ (App.)}$$

Invoice Price Method

Sometimes, the Consignor does not want to reveal the cost of goods to the Consignee and therefore, invoices goods at a price which is higher than the Cost Price. Such price is known as 'Invoice Price' and the difference between the Invoice Price and the Cost Price is called 'loading'. It may also be noted that invoice price need not necessarily be same as selling price unless the Consignor directs the Consignee to sell the goods at the invoice price itself.

When goods are sent at invoice price, to ascertain correct profit/loss on consignment, the items recorded at invoice price should be brought down to Cost Price level. For this purpose, the loading included in various items (like Opening Stock, Goods Sent on Consignment, Goods Returned by Consignee, Closing Stock) should be eliminated by passing the necessary adjusting entries in the books of Consignor only.

Entries in the books of Consignor :

| | When goods are invoiced at cost | When goods are invoiced at invoice price |
|---------------------------------------|--|---|
| For goods sent on consignment | Consignment A/c ... Dr. To Goods Sent on Consignment A/c (with the cost of goods) | Consignment A/c ... Dr. To Goods Sent on Consignment A/c (with the invoice price of goods) |
| Adjustment Entry for removing loading | No Entry | Goods Sent on Consignment A/c ... Dr. To Consignment A/c (with the amount of loading) |
| For goods returned by consignee | Goods Sent on Consignment A/c ... Dr. To Consignment A/c (with the cost of goods) | Goods Sent on Consignment A/c ... Dr. To Consignment A/c (with the invoice price of goods) |
| Adjustment Entry for removing loading | No Entry | Consignment A/c ... Dr. To Goods Sent on Consignment A/c (with the amount of loading) |
| For opening stock | Consignment A/c ... Dr. To Stock on Consignment A/c (with the cost of opening stock) | Consignment A/c ... Dr. To Stock on Consignment A/c (with the invoice price of opening stock) |
| Adjustment Entry for removing loading | No Entry | Stock Reserve A/c ... Dr. To Consignment A/c (with the amount of loading) |
| For closing stock | Stock on Consignment A/c ... Dr. To Consignment A/c (with the cost of closing stock) | Stock on Consignment A/c ... Dr. To Consignment A/c (with the invoice price of closing stock) |
| Adjustment Entry for removing loading | No Entry | Consignment A/c ... Dr. To Stock Reserve A/c (with the amount of loading) |



Illustration 13.

Mr. X, the consignor, consigned goods to Mr. Y 100 Radio sets valued ₹ 50,000. This was made by adding 25% on cost. Mr. X paid ₹ 5,000 for freight and insurance. 20 sets are lost – in- transit for which Mr. X recorded ₹ 5,000 from the Insurance company.

Mr. Y received remaining goods in good condition. He incurred ₹ 4,000 for freight and miscellaneous expenses and ₹ 3,000 for godown rent. He sold 60 sets for ₹ 50,000. Show the necessary ledger account in the books of Mr. X assuming that Mr. Y was entitled to an ordinary Commission of 10% on sales and 5% Del Credere Commission on sales. He also reported that ₹ 1,000 were provide bad .

Solution:

In the books of Mr.X

| Dr. | | Cr. | |
|-----------------------------------|---------------|--|---------------|
| Consignment Account | | | |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Goods Sent on Consignment A/c | 50,000 | By, Goods Sent on Consignment A/c (Loading) (₹ 50,000x25/125) | 10,000 |
| To, Bank A/c – Expenses | 5,000 | By, Y A/c – Sale Proceeds | 50,000 |
| To, Y A/c | | By, Abnormal Loss A/c | 11,000 |
| - Freight and Misc. Expenses | 4,000 | | |
| - Godown Rent | 3,000 | | |
| To, Abnormal Loss A/c (Loading) | 2,000 | By, Stock on Consignment A/c | 12,000 |
| To, Stock surplus A/c | 2,000 | | |
| To, Y A/c | | | |
| - Commission (ordinary) @ 10% | 5,000 | | |
| - Del credere Commission @ 5% | 2,500 | | |
| To, Profit and Loss A/c | | | |
| - Profit on Consignment A/c | 9,500 | | |
| | 83,000 | | 83,000 |

| Dr. | | Cr. | |
|-------------------------------------|---------------|---------------------|---------------|
| Y Account | | | |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment A/c – Sale proceeds | 50,000 | By, Consignment A/c | |
| | | - Expenses | 7,000 |
| | | - Commission | 7,500 |
| | | By, Balance c/d | 35,500 |
| | 50,000 | | 50,000 |

| Dr. | | Cr. | |
|-----------------------|---------------|--------------------------------|---------------|
| Abnormal Loss Account | | | |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment A/c | 11,000 | By, Consignment A/c (Loading) | 2,000 |
| | | By, Bank A/c – Insurance Claim | 5,000 |
| | | By, Profit and Loss A/c | 4,000 |
| | | - Loss transferred | |
| | 11,000 | | 11,000 |

Workings:

| (1) Calculation of Loading: | I.P. | Load | C.P. |
|-----------------------------|--------|---------------------------------|------------|
| | 125 | 25 | 100 |
| | 50,000 | $\frac{100 \times 50,000}{125}$ | = ₹ 40,000 |

∴ Loading = ₹(50,000 – 40,000) = ₹ 10,000

Loading Per Set = ₹ 10,000 ÷ 100 = ₹ 100

(2) Valuation of Goods Lost – in – transit and Unsold stock

| | ₹ |
|--|---------------|
| Total Invoice Price | 50,000 |
| Add: Consignor's Expenses | <u>5,000</u> |
| Invoice Price of 100 sets | 55,000 |
| Less: Lost In Transit | <u>11,000</u> |
| $\frac{20 \times 55,000}{100}$ | 44,000 |
| Add: Non recurring Expenses of Mr. Y | <u>4,000</u> |
| I. P. of 80 sets | <u>48,000</u> |
| ∴ For Unsold Stock of (100 – 20 -60) = 20 sets | |
| $= \frac{48,000 \times 20}{80}$ | = ₹ 12,000 |

(3) Loading on Abnormal Loss = 20 x ₹ 100 = ₹ 2,000

(4) Stock surplus = 20 sets x ₹ 100 = ₹ 2,000

(5) Since Del Credere Commission is given there will not be any entry for bad debts.

Illustration 14.

On 1.7.2012, Mantu of Chennai consigned goods of the value of ₹ 50,000 to Pandey of Patna. This was made by adding 25% on cost. Mantu paid ₹ 2,500 for freight and ₹ 1,500 for insurance. During transit $\frac{1}{10}$ th of the goods was totally destroyed by fire and a sum of ₹ 2,400 was realised from the insurance company. On arrival of the goods, Pandey paid ₹ 1,800 as carriage to godown. During the year ended 30th June 2013, Pandey paid ₹ 3,600 for godown rent and ₹ 1,900 for selling expenses. $\frac{1}{9}$ th of the remaining goods was again destroyed by fire in godown and nothing was recorded from the insurance company. On 1.6.2013, Pandey sold half ($\frac{1}{2}$) the original goods for ₹ 30,000 and charged a commission of 5% on sales as on 30.6.2013, Pandey sent a bank draft to Mantu for the amount so far due from him.

You are required to prepare the following ledger accounts in the books of Mantu of Chennai for the year ended 30.6.2013.

(a) Consignment to Patna Account; (b) Goods Destroyed by Fire Account; and (c) Personal Account of Pandey.



Solution:

**In the books of Mantu of Chennai
Consignment to Patna Account**

| Dr. | | | Cr. |
|----------------------------------|---------------|--|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To Goods Sent on Consignment A/c | 50,000 | By, Goods Sent on Consignment A/c - Loading | 10,000 |
| To, Bank A/c | | | |
| Freight | 2,500 | | |
| Insurance | 1,500 | By, Pandey A/c | 30,000 |
| To, Pandey A/c | | Sale Proceeds | |
| Carriage Inward | 1,800 | By, Goods Destroyed by Fire A/c | 11,000 |
| Godown Rent | 3,600 | By, Stock on Consignment A/c | 16,800 |
| Selling Expenses | 1,900 | | |
| To, Pandey A/c | | | |
| Commission (5% on ₹ 30,000) | 1,500 | | |
| To, Goods Destroyed by Fire A/c | 2,000 | | |
| Loading | | | |
| To, Stock Suspense A/c | 3,000 | | |
| Loading on unsold stock | | | |
| | 67,800 | | 67,800 |

Note: There is no normal Profit or Loss on Consignment.

| Dr. | | | Cr. |
|------------------------------|---------------|--------------------------------|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment to Patna A/c | | By, Consignment to Patna A/c | 2,000 |
| In transit | 5,400 | Loading | |
| In Godown | 5,600 | By, Bank A/c – Insurance claim | 2,400 |
| | | By, Profit & Loss A/c | 6,600 |
| | 11,000 | | 11,000 |

| Dr. | | | Cr. |
|------------------------------|---------------|------------------------------|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment to Patna A/c | | By, Consignment to Patna A/c | |
| Sale proceeds | 30,000 | Expense | 7,000 |
| | | Commission | 1,500 |
| | | By, Draft A/c | 21,200 |
| | 30,000 | | 30,000 |

Working:**Valuation of goods destroyed by fire and unsold stock**

| Particulars | Amount (₹) |
|---|---------------|
| Invoice Price of Goods sent | 50,000 |
| Add: Consignor's Expenses | 4,000 |
| | 54,000 |
| Less: Lost-in-Transit ($\frac{1}{10}$ x ₹ 54,000) | 5,400 |
| Goods received ($\frac{9}{10}$ th of ₹ 54,000) | 48,600 |
| Add: Non- recurring expenses of Pandey | 1,800 |
| | 50,400 |
| Less: Value of goods destroyed by fire in godown ($\frac{1}{9}$ th of ₹ 50,400) | 5,600 |
| Value of $\frac{8}{10}$ th | 44,800 |

$$\therefore \text{Goods available for sale } \frac{9}{10} - \left(\frac{1}{9} \text{ th of } \frac{9}{10}\right) = \frac{9}{10} - \frac{1}{10} = \frac{8}{10}$$

$$\text{Goods sold } \frac{1}{2} \therefore \text{Unsold goods} = \frac{8}{10} - \frac{1}{2} = \frac{3}{10} \text{ th}$$

$$\therefore \text{Value of unsold stock} = ₹ 44,800 \times \frac{3}{10} \times \frac{10}{8} = ₹ 16,800$$

$$\text{Loading on goods destroyed} = ₹ 10,000 \times \frac{2}{10} = ₹ 2,000$$

$$\text{Loading on unsold stock} = ₹ 10,000 \times \frac{3}{10} = ₹ 3,000.$$

Illustration 15.

Shri Babubhai oil mills of Baroda sent 10000 kg of oil to M/s Gupta & Sons in Delhi. The cost of oil is ₹ 40 per kg. Babubhai paid ₹ 5,000 as freight and ₹ 2,500 as insurance. In transit 250 kg of oil was accidentally destroyed for which insurance company paid ₹ 450 in full settlement to Babubhai.

M/s Gupta & Sons took delivery of the balance. Later they reported that 7500 kg was sold @ ₹ 60 per kg. Expenses incurred by them were rent ₹ 2,000, advertisement ₹ 5,000 and salaries ₹ 5000. M/s Gupta & Sons are entitled to commission of 3% and Del Credre commission of 1.5%. One customer who purchased 1000 kg paid only 80% of the amount due. M/s Gupta & Sons also reported loss of 100 kg due to leakage. The final amount due was settled. Prepare necessary ledger accounts in the books of Babubhai.

Solution:

In the Books of Shri Babubhai
Consignment to Delhi Account

| Dr. | | Cr. | |
|--------------------------------------|------------|-----------------------------------|------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Goods Sent on Consignment A/c | 4,00,000 | By, M/s Gupta & Sons' A/c (sales) | 4,50,000 |
| To, Bank A/c (Freight and Insurance) | 7,500 | By, Abnormal Loss A/c | 10,188 |
| To, M/s Gupta & Sons' A/c : | | By, Consignment Stock A/c | 86,849 |
| Expenses | 12,000 | | |
| Commission | 20,250 | | |
| To P & L A/c (Balancing figure) | 1,07,287 | | |
| | 5,47,037 | | 547,037 |



| Dr. | | M/s Gupta & Sons' Account | | Cr. | |
|---------------------|------------|----------------------------------|------------|-------------|------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment A/c | 4,50,000 | By, Consignment A/c (expenses) | 12,000 | | |
| | | By, Consignment A/c (commission) | 20,250 | | |
| | | By, Bank A/c | 4,17,750 | | |
| | 4,50,000 | | 450,000 | | |

| Calculation of Abnormal Loss: 250 kg of oil lost in transit | | |
|---|----------|--------|
| Cost of 250 kg @ 40/kg | 10,000 | |
| Proportionate expenses of Babubhai (250/10000*7500) | 188 | 10,188 |
| Calculation of closing stock | | |
| | Kg | |
| Oil consigned to Delhi | 10,000 | |
| Less: Lost in transit | (250) | |
| Less: Normal loss due to leakage | (100) | |
| Less: Quantity sold | (7,500) | |
| Stock in hand | 2,150 | |
| | ₹ | |
| Basic cost of stock consigned @ ₹ 40 | 400,000 | |
| Less : Cost of abnormal loss | (10,188) | |
| Cost of stock after normal loss of 100kg | 389,812 | |
| Thus cost of 2150 kg (3,89,812/9,650*2150) | 86,849 | |
| Calculation of commission | | |
| Ordinary @ 3% on 4,50,000 | 13,500 | |
| Del Credre @ 1.5% on 4,50,000 | 6,750 | |
| | 20,250 | |

As the consignee has paid Del Credre Commission, the responsibility of bad debts is his. Hence no entry is needed to be passed in the books of consignor.

Illustration 16.

Sangita Machine Corporation sent 200 sewing machines to Rita agencies. It spent ₹ 7500 on packing. The cost of each machine was ₹ 2,000, but it was invoiced at 20% above cost. 20 machines were lost in transit & insurance company accepted claim of ₹ 20,000 only.

Rita agencies paid freight of ₹ 9,000, carriage ₹ 3,600, Octroi ₹ 1,800 and rent ₹ 1800. They sold 150 machines at ₹ 3,500 per machine. They were entitled to commission of 5% on invoice price and additional 20% of any excess realized on invoice price and 2% Del Credre commission. They accepted a bill drawn by Sangita Machine Corporation for ₹ 3,00,000 and remitted the balance by demand draft along with account sale. Draw up necessary ledger accounts in the books of Sangita Machine Corporation and Rita Agencies.

Solution:

Books of Sangita Machine Corporation
Consignment to Rita Agencies Account

| Dr. | | | Cr. |
|-------------------------------------|-----------------|--|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Goods Sent on Consignment A/c | 4,80,000 | By Goods Sent on Consignment A/c (loading) | 80,000 |
| To, Bank A/c (Packing Expenses) | 7,500 | By Abnormal Loss A/c | 48,750 |
| To Rita Agencies A/c | | By Consignment Stock A/c | 75,525 |
| Freight | 9,000 | By Rita Agencies' A/c (sales 150 @ 3500) | 5,25,000 |
| Carriage | 3,600 | | |
| Octroi | 1,800 | | |
| Rent | 1,800 | | |
| Commission | 61,500 | | |
| To Abnormal loss A/c (load removed) | 8,000 | | |
| To Stock Reserve A/c | 12,000 | | |
| To P & L A/c | 1,44,075 | | |
| | 7,29,275 | | 7,29,275 |

| Dr. | | | Cr. |
|--------------------|-----------------|---------------------------------|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To Consignment A/c | 5,25,000 | By Consignment A/c (expenses) | 16,200 |
| | | By Consignment A/c (commission) | 61,500 |
| | | By Bills Receivable A/c | 3,00,000 |
| | | By Bank A/c (balancing figure) | 1,47,300 |
| | 5,25,000 | | 5,25,000 |

Calculation of abnormal loss 20 machines lost in transit

| | |
|--|-----------------|
| Cost of 20 machines @ ₹ 2400 | ₹ 48,000 |
| Proportionate expenses of Babubhai (20/200*7500) | ₹ 750 |
| | ₹ 48,750 |

Calculation of Closing Stock

| | |
|--|--------|
| | ₹ |
| Invoice value of 30 machines @ 2400 | 72,000 |
| Add : Consignor's proportionate expenses | 1,125 |
| Add : Consignee's proportionate expenses | 2,400 |
| | 75,525 |
| Stock reserve 30 machines @ ₹400 | 12,000 |



Calculation of Commission

| | | |
|--|---------|-----|
| Invoice price of machines sold | ₹ | |
| (2400*150) | 360,000 | |
| Commission @ 5% on this | 18,000 | (a) |
| Excess over invoice value | | |
| (5,25,000-3,60,000) | 165,000 | |
| Commission @ 20% on this | 33,000 | (b) |
| Del Credre Commission @ 2% on 5,25,000 | 10,500 | (c) |
| Total Commission (a+b+c) | 61,500 | |

Books of Rita Agencies Sangita Machine Corporation Account

Dr.

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|---------------------------------|------------|-----------------------------|------------|
| To, Cash A/c (expenses) | 16,200 | By, Consignment A/c (sales) | 5,25,000 |
| To, Commission A/c | 61,500 | | |
| To, Bills Payable A/c | 3,00,000 | | |
| To, Bank A/c (balancing figure) | 1,47,300 | | |
| | 5,25,000 | | 5,25,000 |

Advance from Consignee as Security Money:

Usually the consignor takes certain some of money as advance by way of cash/draft/bill etc from the consignee against the goods that are sent for sale to the consignee. The so called advance money is automatically adjusted against the total dues in order to determine the net amount payable. If the advance money is not treated as security money, then the entire amount of advance money may be adjusted even if a part of goods are sold. But if the advance money is treated as security money, in that case, the proportionate amount of such advance money will be carried forward. The entries in the books of both consignee and consignor will be:

| In the books of Consignor | | In the books of Consignee | |
|---------------------------------|-----|---------------------------|-----|
| Cash/ Draft/Bill Receivable A/c | Dr. | Consignor A/c | Dr. |
| To, Consignee's Personal A/c | | To, Cash/ Draft/B/P A/c | |

Illustration 17.

Ram of Patna consigns to Shyam of Delhi for sale at invoice price or over. Shyam is entitled to a commission @ 5% on invoice price and 25% of any surplus price realized. Ram draws on Shyam at 90 days sight for 80% of the invoice price as security money. Shyam remits the balance of proceeds after sales, deducting his commission by sight draft.

Goods consigned by Ram to Shyam costing ₹ 20,900 including freight and were invoiced at ₹ 28,400. Sales made by Shyam were ₹ 26,760 and goods in his hand unsold at 31st Dec, represented an invoice price of ₹ 6,920. (Original cost including freight ₹ 5,220). Sight draft received by Ram from Shyam upto 31st Dec was ₹ 6,280. Others were in- transit.

Prepare necessary Ledger Accounts in the books of Ram.

Solution:

**In the books of Ram
Consignment to Delhi Account**

| Dr. Particulars | Amount (₹) | Particulars | Amount (₹) |
|---|---------------|---|---------------|
| To, Goods Sent on Consignment A/c | 28,400 | By, Goods Sent on Consignment A/c (Loading) ₹ (28,400- 20,900) | 7,500 |
| To, Y A/c – Commission | 2,394 | By, Shyam A/c – Sale proceeds | 26,760 |
| To, Stock Reserve A/c ₹(6,920 – 5,220) | 1,700 | By, Stock on Consignment A/c | 6,920 |
| To, Profit and Loss A/c- Profit on consignment transferred | 8,686 | | |
| | 41,180 | | 41,180 |

| Dr. Particulars | Amount (₹) | Particulars | Amount (₹) |
|---------------------------------|---------------|--|---------------|
| To, Consignment to Delhi A/c | 26,760 | By, Bills Receivable A/c | 22,720 |
| To, Balance c/d (₹ 6,920 x 80%) | 5,536 | By, Consignment to Delhi A/c - commission | 2,394 |
| | | By, Draft A/c | 6,280 |
| | | By, Draft- in- Transit A/c | 902 |
| | 32,296 | | 32,296 |

| Dr. Particulars | Amount (₹) | Particulars | Amount (₹) |
|------------------------------|---------------|------------------------------|---------------|
| To, Consignment to Delhi A/c | 7,500 | By, Consignment to Delhi A/c | 28,400 |
| To, Trading A/c (bal.fig) | 20,900 | | |
| | 28,400 | | 28,400 |

Workings:

| | |
|------------------------------------|---------------|
| Calculation of Commission: | ₹ |
| Invoice value of goods | 28,400 |
| Less: Unsold stock | 6,920 |
| Invoice value of goods sold | 21,480 |
| Total sale proceeds | 26,760 |
| Less: Invoice value of goods sold | 21,480 |
| Surplus price | 5,280 |
| Commission @ 5% on ₹ 21,480 | 1,074 |
| Add: @ 25% on ₹ 5,280 | 1,320 |
| | 2,394 |

Deficiency of Stock

The consignee may discover some deficiency in stock on his actual physical stock taking. The value of loss arising out of such deficiency will be calculated in the same way as the value of unsold stock. This will be brought into account by debiting Stock Deficiency Account and crediting Consignment Account. Stock Deficiency Account will be closed by transfer to the debit of Consignment Account or preferably of Profit & Loss Account. If, however, there is an arrangement that any deficiency of stock will be made good by the consignee, the Deficiency Account will be closed by transfer to the debit of the Consignee's Personal Account.



Illustration 18.

R of Ranchi consigned goods costing ₹ 1,60,000 to B of Bombay. The terms of the consignment were:

- Consignee to get a commission of 5 per cent on cash sales and 4 per cent on credit sales.
- Any goods taken by the consignee himself or goods lost through consignee's negligence, shall be valued at cost plus 12½ per cent and no commission will be allowed on them.

The expenses incurred by the consignor were: Carriage and freight ₹ 6,720 and Insurance ₹ 3,440. The consignor received ₹ 50,000 as advance against the consignment. Account Sales together with a draft for the balance due was received by the consignor showing the following position:

Goods costing ₹ 1,28,000 were sold for cash at ₹ 1,40,000 and on credit at ₹ 1,08,000. Goods costing ₹ 8,000 were taken by B and goods costing ₹ 4,000 were lost through B's negligence. The expenses incurred by B were: Advertisement ₹ 1,720; other selling expenses ₹ 1,080.

Show the ledger accounts in the books of R.

Solution:

| Books of R | | | |
|--|-------------------------------|---------------------------|---------------|
| Dr. | Consignment to Bombay Account | | Cr. |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To Goods Sent on Consignment A/c | 1,60,000 | By B: | |
| " Bank—Expenses : | | Cash sales | 1,40,000 |
| Carriage and freight | 6,720 | Goods taken over: | |
| Insurance | 3,440 | 8,000+ 12½ % | 9,000 |
| " B A/c : | | Goods Lost: 4,000 + 12½% | 4,500 |
| Advertisement | 1,720 | " Consignment Debtors A/c | |
| Selling expenses | 1,080 | — Credit sales | 1,08,000 |
| Commission on: | | " Consignment Stock A/c | 21,270 |
| Cash sales | 7,000 | (W.N. 1) | |
| Credit sales | 4,320 | | |
| " Profit on Consignment transferred to P/L A/c | 98,490 | | |
| | 2,82,770 | | 2,82,770 |

Working Note:

1.

| Valuation of unsold stock | ₹ |
|-------------------------------|----------|
| Cost price of goods sent | 1,60,000 |
| Add: Expenses : 6,720 + 3,440 | 10,160 |
| | 1,70,160 |

Value of unsold stock: $\frac{20,000}{1,60,000} \times ₹ 1,70,160 = ₹ 21,270$

B (Consignee) Account**Dr.****Cr.**

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|--------------------------------|------------|-------------------------------|------------|
| To Consignment to Bombay A/c : | | By Bank—advance | 50,000 |
| Cash sales | 1,40,000 | " Consignment to Bombay A/c : | |
| Goods taken over | 9,000 | Advertisement | 1,720 |
| Goods lost | 4,500 | Selling expenses | 1,080 |
| | | Commission | 11,320 |
| | | " Bank—remittance | 89,380 |
| | 1,53,500 | | 1,53,500 |

Consignment Debtors Account**Dr.****Cr.**

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|------------------------------|------------|----------------|------------|
| To Consignment to Bombay A/c | 1,08,000 | By Balance c/f | 1,08,000 |
| | 1,08,000 | | 1,08,000 |

Goods Sent on Consignment Account**Dr.****Cr.**

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|---------------------------|------------|------------------------------|------------|
| To Trading A/c – transfer | 1,60,000 | By Consignment to Bombay A/c | 1,60,000 |
| | 1,60,000 | | 1,60,000 |

Return of Goods by the Consignee

If any goods are returned by the consignee to the consignor, Goods Sent on Consignment Account is debited and Consignment Account is credited. Consignment Account is debited with expenses paid by the Consignee on such return. In Consignee's book, however, no entry is required for return, because no entry is passed for receiving the goods. For expenses on return Consignor's A/c is debited and bank is credited.

2.3 JOINT VENTURE ACCOUNTS**Introduction**

Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multi-skills. In such cases, an individual person may not be able to muster all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

The business activities for which Joint Ventures (JV) are formed could be :

- Construction of dams, bridges, roads etc
- Buying & selling of goods for a particular season
- Producing a film
- Purchasing land selling plots

| No. | Transaction | Entry |
|-----|---|---|
| 6 | For sale of goods sold | For cash Joint Bank A/c Dr. To Joint Venture A/c For credit Customer's A/c Dr. To, Joint Venture A/c By any Co-venturers Co- Venturer's A/c Dr. To, Joint Venture A/c |
| 7 | On receiving payment from a customer | Cash/ Joint Bank/ B/R A/c Dr. [with payment received] Joint Venture A/c Dr. [with discount allowed/ bad debts] To, Customer's A/c [with total] |
| 8 | Contract / sale price received in form of shares / cash | Joint Bank A/c Dr. Shares A/c Dr. To Joint Venture A/c |
| 9 | Commission / salary to co-venturers | Joint Venture A/c Dr. To Co-Venturers A/c |
| 10 | Unsold goods taken over by co-venturers | Co-Venturers A/c Dr. To Joint Venture A/c |
| 11 | Shares taken over by co-venturers | Co-Venturers A/c Dr. To Shares |
| 12 | If shares are sold in open market | Joint Bank A/c Dr. To Shares |
| 13 | For profit on joint venture | Joint Venture A/c Dr. To Co-Venturers A/c |
| 14 | For loss on joint venture | Co-Venturers A/c Dr. To Joint Venture A/c |
| 15 | For final distribution of funds | In case of a debit balance Joint Bank A/c Dr. To, Co-Venturer's Personal A/c In case of a credit balance Co-Venturers A/c Dr. To Joint Bank A/c |



Illustration 19.

Prabir and Mihir doing business separately as building contractors undertake jointly to build a skyscraper for a newly started public limited company for a contract price of ₹ 1,00,00,000 payable as ₹ 80,00,000 in cash and the balance by way of fully paid equity shares of the new company. A Bank A/c was opened for this purpose in which Prabir paid ₹ 25,00,000 and Mihir ₹ 15,00,000. The profit sharing ratio was agreed as 2:1 between Prabir and Mihir. The transactions were:

- Advance received from the company ₹ 50,00,000
- Wages to contractors ₹ 10,00,000
- Bought materials ₹ 60,00,000
- Material supplied by Prabir ₹ 10,00,000
- Material supplied by Mihir ₹ 15,00,000
- Architect's fees paid from Joint Bank account ₹ 21,00,000

The contract was completed and the price was duly paid. The joint venture was duly closed by Prabir taking all the shares at ₹ 18,00,000 and Mihir taking over the balance material for ₹ 3,00,000. Prepare the Joint Venture A/c, Joint Bank A/c, Co-venturer's A/cs and Shares A/c.

Solution:

| Dr. | | Joint Venture Account | | Cr. | |
|---------------------------------|-------------|------------------------------------|-------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Joint Bank A/c – wages | 10,00,000 | By, Joint Bank A/c - advance | 50,00,000 | | |
| To, Joint Bank A/c - material | 60,00,000 | By, Joint Bank A/c - balance price | 30,00,000 | | |
| To, Joint Banks A/c - Architect | 21,00,000 | By, Shares A/c – received | 20,00,000 | | |
| To, Prabir A/c - material | 10,00,000 | By, Mihir A/c - stock taken | 3,00,000 | | |
| To, Mihir A/c - material | 15,00,000 | By, Prabir A/c - 2/3rd loss | 10,00,000 | | |
| To, Shares A/c - loss | 2,00,000 | By, Mihir A/c - 1/3rd loss | 5,00,000 | | |
| | 1,18,00,000 | | 1,18,00,000 | | |

| Dr. | | Joint Bank Account | | Cr. | |
|---------------------------------|-------------|-----------------------------------|-------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Prabir A/c | 25,00,000 | By, Joint Venture A/c – wages | 10,00,000 | | |
| To, Mihir A/c | 15,00,000 | By, Joint Venture A/c – materials | 60,00,000 | | |
| To, Joint Venture A/c - advance | 50,00,000 | By, Joint Venture A/c – Architect | 21,00,000 | | |
| To, Joint Venture A/c - balance | 30,00,000 | By, Prabir A/c - balance paid | 7,00,000 | | |
| | | By, Mihir A/c - balance paid | 22,00,000 | | |
| | 1,20,00,000 | | 1,20,00,000 | | |

| Dr. | | Prabir's Account | | Cr. | |
|-----------------------------------|------------|----------------------------------|------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Shares A/c – taken | 18,00,000 | By, Joint Bank A/c | 25,00,000 | | |
| To, Joint Venture A/c - loss | 10,00,000 | | | | |
| To, Joint Bank A/c - Balance paid | 7,00,000 | By, Joint Venture A/c - material | 10,00,000 | | |
| | 35,00,000 | | 35,00,000 | | |

| Dr. | | Mihir's Account | | Cr. | |
|-------------------------------------|------------|------------------------------|------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Joint Venture A/c – stock taken | 300,000 | By, Joint Bank A/c | 15,00,000 | | |
| To, Joint Venture A/c – Loss | 500,000 | | | | |
| To, Joint Bank A/c - Balance paid | 22,00,000 | By, Joint Venture - material | 15,00,000 | | |
| | 30,00,000 | | 30,00,000 | | |

| Dr. | | Shares Account | | Cr. | |
|-----------------------|------------|------------------------------|------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Joint Venture A/c | 20,00,000 | By, Prabir A/c | 18,00,000 | | |
| | | By, Joint Venture A/c - loss | 2,00,000 | | |
| | 20,00,000 | | 20,00,000 | | |

Illustration 20.

P and Q entered into a joint venture for underwriting the subscription at par of 25,000 shares of ₹ 10 each of a Joint Stock Company. They agreed to share profits or losses in the ratio of $\frac{3}{5}$ and $\frac{2}{5}$, respectively. The consideration for guaranteeing the subscription was 250 other shares of ₹ 10 each fully paid to be issued to them.

The public took up 24,000 of the shares and the remaining shares of the guaranteed issue were taken up by P and Q who provide cash equally. The entire shareholding of the venture was then sold through other brokers, 60% at a price of ₹ 9.50 less brokerage 50 paise per share, 20% at a price of ₹ 9.75 less brokerage 50 paise per share and the balance were taken over by P and Q equally at ₹ 9.00 per share.

Prepare a Joint Venture Account, the Joint Bank Account, and Capital Accounts of P and Q.

Solution :**In the books of P and Q**

| Dr. | | Joint Venture Account | | Cr. | |
|---|------------|---|------------|-----|--|
| Particular | Amount (₹) | Particular | Amount (₹) | | |
| To, Joint Bank A/c Cost of 1,000 shares @ ₹ 10 | 10,000 | By, Joint Bank A/c Sale proceeds of shares | 9,063 | | |
| To, Capital A/c – Profit on Venture : | | By, P's Capital A/c Shares taken | 1,125 | | |
| – P-788 | | By, Q's Capital A/c Shares taken | 1,125 | | |
| – Q-525 | 1,313 | | | | |
| | 11,313 | | 11,313 | | |

| Dr. | | Joint Bank Account | | Cr. | |
|-----------------------|------------|-----------------------|------------|-----|--|
| Particular | Amount (₹) | Particular | Amount (₹) | | |
| To, P's Capital A/c | 5,000 | By, Joint Venture A/c | 10,000 | | |
| To, Q's Capital A/c | 5,000 | (Cost of shares) | | | |
| To, Joint Venture A/c | 9,063 | By, P's Capital A/c | 4,663 | | |
| | | By, Q's Capital A/c | 4,400 | | |
| | 19,063 | | 19,063 | | |

| Dr. | | Capital Account | | Cr. | |
|-----------------------|--------------|-----------------|---------------------------|--------------|--------------|
| Particular | P Amount (₹) | Q Amount (₹) | Particular | P Amount (₹) | Q Amount (₹) |
| To, Joint Venture A/c | 1,125 | 1,125 | By Joint Book A/c | | |
| – Shares taken | | | (Cost of shares) | 5,000 | 5,000 |
| “Joint Bank A/c | 4,663 | | “Joint Venture Profit A/c | 788 | |
| — Final Payment | | 4,400 | “Joint Venture Profit A/c | | 525 |
| | 5,788 | 5,525 | | 5,788 | 5,525 |



Working :

Cost of 1,000 shares @ ₹ 10 = ₹ 10,000 to be contributed by P and Q equally, i.e., ₹ 5,000 each

Calculation of sale proceeds :

| | ₹ | |
|---|------------|--------------|
| Share purchased | 1,000 | |
| Taken as Com. | <u>250</u> | |
| | 1,250 | |
| 60% of 1,250 = 750 × ₹ 9 (i.e. ₹ 9.50 – .50) = | | ₹ 6,750 |
| 20% of 1,250 = 250 × ₹ 9.25 (i.e. ₹ 9.75 – .50) = | | ₹ 2,313 |
| 80% | | <u>9,063</u> |

20% of 1,250 = 250 × ₹ 9 = ₹ 2,250 to be taken by P and Q equally, i.e. ₹ 1,125 each.

(b) When no Separate Books of Accounts are Maintained

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank A/c is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also settled the same way.

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e. done by himself and by his co-venturer as well.

The accounting entries are:

| In books of Co-venturer A | | In books of co-venturer B |
|---|------------|---|
| When goods are supplied and expenses paid by A | | |
| Joint Venture A/c To, Goods A/c To, Cash / Bank A/c | Dr. | Joint Venture A/c To, A's A/c |
| When goods are supplied by B and expenses paid by B | | |
| Joint Venture A/c To, B's A/c | Dr. | Joint Venture A/c To, Goods A/c To, Cash / Bank A/c |
| When advance is given by A to B or bill accepted by A | | |
| B's A/c To, Cash / Bank A/c To, B/P A/c | Dr. | Cash / Bank A/c B/R A/c To, A's A/c |
| When sale proceeds are received by A | | |
| Cash / Bank A/c To, Joint Venture A/c | Dr. | A's A/c To, Joint Venture A/c |
| When sale proceeds are received by B | | |
| B's A/c To, Joint Venture A/c | Dr. | Cash / Bank A/c To, Joint Venture A/c |
| For unsold goods taken over by A | | |
| Goods A/c To Joint Venture A/c | Dr. | A's A/c To Joint Venture A/c |
| For unsold goods taken over by B | | |
| B's A/c To, Joint Venture A/c | Dr. | Goods A/c To, Joint Venture A/c |
| For profit on joint venture business | | |
| Joint Venture A/c To, B's A/c To, P & L A/c | Dr. | Joint Venture A/c To, A's A/c To, P & L A/c |
| For loss on joint venture business | | |
| B's A/c P & L A/c To, Joint Venture A/c | Dr. Dr. | A's A/c P & L A/c To, Joint Venture A/c |

After closure the business of joint venture, the co-venturer who has received surplus cash will remit it to the other co-venturer.

As a variation from this system, the co-venturers may decide to maintain a separate 'Memorandum Joint Venture A/c' in joint books. In this transactions made by each co-venturer is shown against their name. This A/c will show profit or loss. The co-venturers will keep an account called "Joint venture with co-venturer A/c" wherein all transactions done by him only are recorded.

Illustration 21.

John and Smith entered into a joint venture business to buy and sale garments to share profits or losses in the ratio of 5:3. John supplied 400 bales of shirting at ₹ 500 each and also paid ₹ 18,000 as carriage & insurance. Smith supplied 500 bales of suiting at ₹ 480 each and paid ₹ 22,000 as advertisement & carriage. John paid ₹ 50,000 as advance to Smith.

John sold 500 bales of suiting at ₹ 600 each for cash and also all 400 bales of shirting at ₹ 650 each for cash. John is entitles for commission of 2.5% on total sales plus an allowance of ₹ 2,000 for looking after business. The joint venture was closed and the claims were settled.

Prepare Joint Venture A/c and Smith's A/c in the books of John and John's A/c in the books of Smith.

Solution:

| Books of John | | | |
|-------------------------------------|-----------------------|----------------------|------------|
| Dr. | Joint Venture Account | | Cr. |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Goods A/c - shirting (400x500) | 2,00,000 | By, Cash A/c – sales | |
| To, Bank A/c - carriage & insurance | 18,000 | shirting (500 x 600) | 3,00,000 |
| To, Smith A/c - suiting (500x480) | 2,40,000 | suiting (400 x 650) | 2,60,000 |
| To, Smith A/c - advt & Carriage | 22,000 | | |
| To, Commission A/c - 2.5% | 14,000 | | |
| To, Allowance A/c | 2,000 | | |
| To, P & L A/c (5/8th share) | 40,000 | | |
| To, Smith A/c (3/8th share) | 24,000 | | |
| | 5,60,000 | | 5,60,000 |

| Smith's Account | | | |
|-----------------------------|-----------------|----------------------------------|------------|
| Dr. | Smith's Account | | Cr. |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Cash A/c - advance | 50,000 | By, Joint Venture A/c - suiting | 2,40,000 |
| To, Cash A/c - balance paid | 2,36,000 | By, Joint Venture A/c - expenses | 22,000 |
| | | By, Joint Venture A/c - profit | 24,000 |
| | 2,86,000 | | 2,86,000 |

| Books of Smith | | | |
|-------------------------------|----------------|------------------------------------|------------|
| Dr. | John's Account | | Cr. |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Joint Venture A/c - sales | 5,60,000 | By, Cash A/c - advance | 50,000 |
| | | By, Joint Venture A/c - shirting | 2,00,000 |
| | | By, Joint Venture A/c - expenses | 18,000 |
| | | By, Joint Venture A/c - commission | 14,000 |
| | | By, Joint Venture A/c - Allowance | 2,000 |
| | | By, Joint Venture A/c - profit | 40,000 |
| | | By, Cash A/c - balance paid | 2,36,000 |
| | 5,60,000 | | 5,60,000 |



(c) Memorandum Joint Venture Account

When all the parties keep accounts, the method adopted for recording the transactions relating to joint venture, is called Memorandum Joint venture method. Here each Co-Venturer records only those joint venture transactions which are affected by him with the help of a personal account designed as 'Joint Venture with.....(Name of the other Co-Venturer).....Account'. It is debited with the amount of purchases/supplies made and expenses incurred by the Venturer.

Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturer and on receipt of the aforesaid statement, each Co-Venturer prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions.

Since this account is in fact, not a part and parcel of double entry system the word 'memorandum' is prefixed.

Journal Entries: The journal entries which may be required at any point of time, are summarized below:

| | | |
|---|------------|--|
| 1. (a) On receipt of any amount/Bills Receivable from other Co-Venturer: Cash/Bank/Bills Receivable A/c To, Joint Venture withA/c | Dr. | |
| 1. (b) On discounting Bills Receivable: Bank A/c Joint Venture withA/c To, Bills Receivable A/c | Dr. Dr. | (with net proceeds) (with discount) (with total) |
| 2. On purchase of goods: Joint Venture withA/c To, Cash/Bank A/c To, Supplier's A/c | Dr. | (with total) (with cash purchase) (with credit purchase) |
| 3. On making payment to supplier Supplier's A/c To, Cash/Bank/Bills Payable A/c To, Joint Venture withA/c | Dr. | (with total) (with payment made) (with discount received) |
| 4. On supply of goods out of own stock: Joint Venture withA/c To, Purchases/Goods sent on Joint Venture A/c To, Sales A/c | Dr. | (if supplies at cost) (if supplies at profit) |
| 5. On payment of expenses: Joint Venture withA/c To, Cash/Bank A/c To, Creditor's A/c | Dr. | (with total) (with cash expenses) (with outstanding expenses) |
| 6. On sale of goods: Cash/Bank A/c Customer's A/c To, Joint Venture withA/c | Dr. Dr. | (with cash sales) (with credit sales) (with total) |
| 7. On receiving payment from a customer: Cash/Bank A/c Joint Venture withA/c To, Customer's A/c | Dr. Dr. | (with the payment received) (discount allowed/bad debt) (with total) |

| | | | |
|-----|---|----------------|--|
| 8. | On taking away of unsold goods: Goods sent on Joint Venture A/c To, Joint Venture withA/c | Dr. | |
| 9. | On considering some commission/salary to the Co-Venturer: Joint Venture withA/c To, Commission/Salary A/c | Dr. | |
| 10. | On recording the share of Profit/Loss: (a) When profit- Joint Venture withA/c To, Profit & Loss A/c (b) When loss- Profit & Loss A/c To, Joint Venture withA/c | Dr. Dr. | |
| 11. | On settlement of balance of Joint Venture withA/c: (a) When there is a debit balance: Cash/Bank A/c To, Joint Venture withA/c (b) When there is a credit balance: Joint Venture withA/c To, Cash/Bank A/c | Dr. Dr. | |

Illustration 22.

M and N decided to work in partnership with the following scheme, agreeing to share profits as under :

M — $\frac{3}{4}$ th share.

N — $\frac{1}{4}$ th share.

They guaranteed the subscription at par of 10,00,000 shares of ₹ 1 each in U Ltd. And to pay all expenses up to allotment in consideration of U. Ltd. issuing to them 50,000 other shares of ₹1 each fully paid together with a commission @ 5% in cash which will be taken by M and N in 3 : 2.

M and N introduced cash as follows:

| | ₹ |
|-------------------------|-------|
| M— Stamp Charges, etc., | 4,000 |
| Advertising Charges | 3,000 |
| Printing Charges | 3,000 |
| N— Rent | 2,000 |
| Solicitor's Charges | 3,000 |

Application fell short of the 10,00,000 shares by 30,000 shares and N introduced ₹ 30,000 for the purchase of those shares.

The guarantee having been fulfilled, U Ltd. handed over to the venturers 50,000 shares and also paid the commission in cash. All their holdings were subsequently sold by the venturer N receiving ₹ 18,000 and M ₹ 50,000.

Write-up necessary accounts in the books of both the parties on the presumption that Memorandum Joint Venture Account is opened for the purpose.



Solution :

| Dr. | | Memorandum Joint Venture Account | | Cr. | |
|----------------------------|------------|----------------------------------|-------------------------------------|------------|-----------------|
| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
| To, N : Cost or Shares | | 30,000 | By M : Commission ($\frac{3}{5}$) | | 30,000 |
| To, M : Stamp Charges etc, | 4,000 | | N : Commission ($\frac{2}{5}$) | | 20,000 |
| Advertising Charges | 3,000 | | By M : Sale Proceeds | | 50,000 |
| Printing Charges | 3,000 | 10,000 | N : Sale Proceeds | | 18,000 |
| To, N : Rent | 2,000 | | | | |
| Solicitor's Charges | 3,000 | 5,000 | | | |
| To, Profit on Venture : | | | | | |
| To, M — $\frac{3}{4}$ | 54,750 | | | | |
| To, N — $\frac{1}{4}$ | 18,250 | 73,000 | | | |
| | | 1,18,000 | | | 1,18,000 |

In the books of M

| Dr. | | Joint Venture with N | | Cr. | |
|---|---------------|--------------------------|---------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Bank : Stamp, Adv. and Printing Charges | 10,000 | By, Bank : Commission | 30,000 | | |
| To, Share of Profit | 54,750 | By, Bank : Sale Proceeds | 50,000 | | |
| To, Bank (Remittance) | 15,250 | | | | |
| | 80,000 | | 80,000 | | |

In the books of N

| Dr. | | Joint Venture with M | | Cr. | |
|---|---------------|--------------------------|---------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Bank : Cost of Shares | 30,000 | By, Bank : Commission | 20,000 | | |
| To, Bank : Rent and Solicitor's Charges | 5,000 | By, Bank : Sale Proceeds | 18,000 | | |
| To, Share of Profit | 18,250 | By, Bank (Remittance) | 15,250 | | |
| | 53,250 | | 53,250 | | |

Joint Venture Business on Consignment Principle

The co-venturers may decide to appoint an agent for selling goods on their behalf on consignment basis. He is allowed expenses and commission on sales. The agent would remit the cash to co-venturers. In such case in addition to Joint Venture A/c and the co-venturer's A/c a separate Account is maintained for the agent as well.

The Agent's A/c is debited with the sales proceeds received by him and credited with the expenses incurred and commission payable to him.

Hence additional entries are:

- (i) Goods sold by the agent
 Agent's A/c Dr.
 To, Joint Venture A/c

- (ii) Expenses & commission entitled to agent
 Joint Venture A/c Dr.
 To, Agent's A/c
- (iii) Payment received from agent
 Bank A/c Dr.
 To, Agent's A/c
- (iv) Cash paid by agent to co-venturers
 Co-Venturers' A/c Dr.
 To, Agent's A/c

Illustration 23.

Sahani and Sahu entered into a joint venture to sale 800 bags of food grains. The business risks are to be shared in the ratio of 3:2 between them. Sahani supplied 400 bags at ₹ 800 per bag and paid freight ₹ 8,000 and insurance ₹ 2,000. Sahu sent 400 bags at ₹ 1,000 per bag. He paid ₹ 2,500 as freight, Insurance ₹ 8,000 and sundry expenses as ₹ 500. Sahani paid ₹ 50,000 as advance to Sahu.

They appointed Sandeep as agent for sale of grains. Sandeep sold all bags at ₹ 1,200 per bag. He deducted ₹ 21,000 as his expenses and commission of 5% on sales. He remitted ₹ 6,00,000 by cheque to Sahani and the balance to Sahu by way of a bill of exchange. The co-venturers settled their accounts. Prepare Joint Venture A/c Sahu's A/c and Sandeep's A/c in the books of Mr. Sahani.

Solution:

| Books of Sahani | | | |
|-------------------------------------|------------------------------|------------------------------------|-----------------|
| Dr. | Joint Venture Account | | Cr. |
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Food grains A/c (400*800) | 3,20,000 | By, Sandeep A/c - sales (800*1200) | 9,60,000 |
| To, Bank A/c - freight & insurance | 10,000 | | |
| To, Sahu A/c -food grains(400*1000) | 4,00,000 | | |
| To, Sahu A/c - expenses | 11,000 | | |
| To, Sandeep A/c - expenses | 21,000 | | |
| To, Sandeep A/c - commission 5% | 48,000 | | |
| To, Profit & Loss A/c 3/5th share | 90,000 | | |
| To, Sahu A/c 2/5th share | 60,000 | | |
| | 9,60,000 | | 9,60,000 |

| Dr. | Sahu's Account (Co-venturer) | | Cr. |
|------------------------------|-------------------------------------|--------------------------------------|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Bank A/c - advance | 50,000 | By, Joint Venture A/c - grains | 4,00,000 |
| To, Sandeep A/c - bill | 2,91,000 | By, Joint Venture A/c - expenses | 11,000 |
| To, Bank A/c - final balance | 1,30,000 | By, Joint Venture A/c - profit share | 60,000 |
| | 4,71,000 | | 4,71,000 |

| Dr. | Sandeep's Account (Agent) | | Cr. |
|-------------------------------|----------------------------------|------------------------------------|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Joint Venture A/c - sales | 9,60,000 | By, Joint Venture A/c - expenses | 21,000 |
| | | By, Joint Venture A/c - commission | 48,000 |
| | | By, Bank A/c - cheque received | 6,00,000 |
| | | By, Sahu A/c - Bill | 2,91,000 |
| | 9,60,000 | | 9,60,000 |



Conversion of Consignment in to JV

A variation could be that an ongoing consignment arrangement may get converted into a joint venture arrangement. In Such case, a normal accounting for consignment business is done till the conversion. Upon the conversion, the balance stock on consignment is transferred to the Joint Venture A/c and from that day onwards, accounting is done on the basis of principles followed for joint venture.

Illustration 24.

Daga of Kolkata sent to Lodha of Kanpur goods costing ₹ 40,000 on consignment at a commission of 5% on gross sales. The packaging and forwarding charges incurred by consignor amounted to ₹ 4,000. The consignee paid freight and carriage of ₹ 1,000 at Kanpur. Three-fourth of the goods were sold for ₹ 48,000. Then the consignee remitted the amount due from him to consignor along with the account sale, but he desired to return the goods still lying unsold with him as he was not agreeable to continue the arrangement of consignment. He was then persuaded to continue on joint venture basis sharing profit or loss as Daga 3/5th and Lodha 2/5th.

Daga then supplied another lot of goods of ₹ 20,000 and Lodha sold out all the goods in his hand for ₹ 50,000 (gross). Daga paid expenses ₹ 2,000 and Lodha ₹ 1,700 for the second lot of goods.

Show necessary Ledger A/c in the books of both parties. No final settlement of balance due is yet made.

Solution:

Books of Daga Consignment to Lodha Account

| Dr. | | | Cr. |
|--------------------------------------|---------------|---|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Goods Sent on Consignment A/c | 40,000 | By, Lodha's A/c (sales) | 48,000 |
| To, Bank A/c (packing & dispatching) | 4,000 | By, Joint Venture with Lodha A/c (stock transferred on conversion to JV) | 11,250 |
| To, Lodha's A/c : | | | |
| Freight & Carriage | 1,000 | | |
| Commission | 2,400 | | |
| To, P & L A/c | 11,850 | | |
| | 59,250 | | 59,250 |

Lodha's Account

| Dr. | | | Cr. |
|----------------------------|---------------|----------------------------------|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To Consignment A/c - sales | 48,000 | By, Consignment A/c- expenses | 1,000 |
| | | By, Consignment A/c - commission | 2,400 |
| | | By, Cash A/c | 44,600 |
| | 48,000 | | 48,000 |

Joint Venture with Lodha Account

| Dr. | | | Cr. |
|------------------------------|---------------|-----------------|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Consignment to Lodha A/c | 11,250 | By, Balance c/d | 42,280 |
| To, Goods A/c | 20,000 | | |
| To, Bank A/c - expenses | 2,000 | | |
| To, P & L A/c (profit) | 9,030 | | |
| | 42,280 | | 42,280 |

Books of Lodha Daga's Account (as consignor)

| Dr. | | | Cr. |
|---------------------------|---------------|----------------------|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Cash A/c- expenses | 1,000 | By, Bank A/c – sales | 48,000 |
| To, Commission A/c | 2,400 | | |
| To, Bank A/c - remittance | 44,600 | | |
| | 48,000 | | 48,000 |

| Dr. | | Joint Venture with Daga Account | | Cr. | |
|-------------------------|---------------|---------------------------------|------------|-----|---------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Cash A/c - expenses | 1,700 | By, Bank A/c – sales | 50,000 | | |
| To, P & L A/c (profit) | 6,020 | | | | |
| To, Balance c/d | 42,280 | | | | |
| | 50,000 | | | | 50,000 |

Working note:

| Dr. | | Memorandum Joint Venture Account | | Cr. | |
|-------------------------|---------------|----------------------------------|----------|-----|---------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To, Daga A/c - goods | 11,250 | By, Lodha A/c – sales | 50,000 | | |
| To, Daga A/c- goods | 20,000 | | | | |
| To, Daga A/c- expenses | 2,000 | | | | |
| To, Lodha A/c- expenses | 1,700 | | | | |
| To, Net Profit : | | | | | |
| Daga 3/5th Share | 9,030 | | | | |
| Lodha 2/5th share | 6,020 | | | | |
| | 50,000 | | | | 50,000 |

Illustration 25.

Satish and Sunit made a JV to underwrite the subscription at par of the equity share capital of Soft Systems Ltd. consisting of 100,000 shares of ₹ 10 each. They agreed to pay all expenses up to the allotment of shares. They agreed to share profits or losses in the ratio of 3:2. The consideration in return for this underwriting was allotment of 12,000 other shares of ₹ 10 each at par to be issued to them fully paid. Satish provided for ₹ 12,000 registration fees, ₹ 11,000 advertisement, ₹ 7,500 for printing & distributing prospectus and ₹ 2,000 for printing & stationery. Sunit paid ₹ 3,000 office rent, ₹ 13,750 as legal charges, and ₹ 9,000 salary of clerks. The issue fell short by 15,000 shares. Satish took these over on joint A/c by paying for the same in full. He sold the entire holding at ₹ 12 (net). Sunit sold the 12,000 shares allotted as consideration at the same price.

Prepare necessary ledger accounts in the books of both parties.

Solution:**Books of Satish**

| Dr. | | Joint Venture Account | | Cr. | |
|-------------------------------------|-----------------|-------------------------|------------|-----|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Bank A/c - expenses : | | By, Bank A/c- sales | | | |
| Registration Fees | 12,000 | 15000 shares @12 | 1,80,000 | | |
| Advertising | 11,000 | By, Sunit's A/c – sales | | | |
| Prospectus Printing | 7,500 | 12000 shares @12 | 1,44,000 | | |
| Printing & Stationery | 2,000 | | | | |
| To, Sunit's A/c - expenses : | | | | | |
| Office rent | 3,000 | | | | |
| Legal charges | 13,750 | | | | |
| Salary | 9,000 | | | | |
| To, Bank A/c - 15,000 shares @ ₹ 10 | 1,50,000 | | | | |
| To, P & L A/c (3/5th share) | 69,450 | | | | |
| To, Sunit A/c (2/5th share) | 46,300 | | | | |
| | 3,24,000 | | | | 3,24,000 |



| Dr. | | Sunit's Account | | Cr. | |
|-------------------------------|-----------------|----------------------------------|------------|--------------------------------|-----------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Joint Venture A/c - sales | 1,44,000 | By, Joint Venture A/c - expenses | 25,750 | By, Joint Venture A/c - profit | 46,300 |
| | | By, Bank A/c - balance paid | 71,950 | | |
| | 1,44,000 | | | | 1,44,000 |

| Dr. | | Books of Sunit | | Cr. | |
|-------------------------------|-----------------|----------------------------------|------------|--|-----------------|
| | | Satish's Account | | | |
| Particulars | Amount (₹) | Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Joint Venture A/c - sales | 1,80,000 | By, Joint Venture A/c - expenses | 32,500 | By, Joint Venture A/c - cost of shares | 1,50,000 |
| To, Bank A/c - balance paid | 71,950 | By, Joint Venture A/c - profit | 69,450 | | |
| | 2,51,950 | | | | 2,51,950 |

Joint Ventures running for more than one accounting period:

If a joint venture runs for more than one accounting period, it poses a special problem of calculation of the closing stock. The stock should be valued on the basis of basic cost plus proportionate non-recurring expenses and it should be shown in the memorandum joint venture account on the credit side at the end of the year and on the debit side of the memorandum joint venture account of the next year. The other accounts should be made in the usual manner. However, if the co-ventures are interested in an interim settlement at the end of the first year, they should bring in their proportionate share in the value of the closing stock in their respective 'Joint Venture with Co-Venturer Account' and finally settle their account. The share of stock should be carried forward and shown on the debit side of the 'Joint Venture with Co-venturer Account';

2.4 INSURANCE CLAIMS (Loss of Stock and Loss of Profit)

In course of running a business, an abnormal or accidental loss may occur in the form of a fire, theft, natural calamity, strike, etc. As a result, the assets of the business and mainly stock of goods are destroyed partially or wholly. Such an accident also causes a disruption of the normal business activities. To replenish the mutilated assets, the business immediately needs some money. So, to cover the risks of such losses, it takes on a policy with the Insurance Companies so as to recover a part or whole of the loss.

The business pays insurance premium yearly or quarterly or as per agreement. If any accidental loss occurs, the business has to compute the amount of loss and file a claim for compensation to the Insurance Company. The Insurance Company, in turn, appoints loss assessors to investigate the reasons and extent of the loss. As per the report of the loss assessor, insurance claims are met.

Loss of Stock

Of the different forms of accidental losses, loss by fire is the most common one. A fire insurance policy is taken to cover two types of losses: 1. Loss of assets (including Stock) and 2. Loss of Profits.

As stocks constitute a considerable portion of the working capital of any business and specially for trading concerns, any loss of stock directly affects the solvency of the business. A business has to cover this risk adequately. If stock records and stock are destroyed, it becomes difficult to ascertain the amount of stock lost. When the loss suddenly occurs, up-to-date value of stock does not become available.

Computation of claim for Loss of Stock:

It requires two steps:

1. Calculation of value of stock on the date of fire:

If exact value of stock is not available, a Memorandum (or Estimated) Trading Account has to be prepared starting from the very next date of the last accounting period and ending on the date of fire. Its Specimen is given below :

Trading Account

For the period (1st day of the current accounting year to the date of fire)

| Dr. | | Cr. | |
|---|--------|---|--------|
| Particulars | Amount | Particulars | Amount |
| To Opening Stock | | By Sales (less returns) | |
| To Purchase (less returns) | | By Stock on sale Return | |
| To Any other Expense like Wages, etc. chargeable to Trading A/c | | (If goods sent on approval are lying with customers but yet to be confirmed, then Cost price of such goods) | |
| To Gross Profit (Calculated at usual rate on sales) | | By Stock on consignment (lying with consignee at cost) | |
| | | By Closing Stock (Balancing figure) | |
| | | | |

Note :

- (a) Usual rate of gross profit may not be given. In that case, it should be found out from information given. If required a Trading Account for the preceding accounting period/periods may have to be prepared to find out the rate of gross profit.
- (b) Adjustments may be necessary while preparing the Trading Accounts of the current period and preceding accounting years for slow-moving items, abnormal or defective items not fetching same rate of gross profit, goods distributed as samples, goods taken away by proprietors, over or under valuation of stocks, omission of recording of stocks, etc.

2. Calculation of Actual Claim

| | | |
|-------|--|---|
| (i) | Take the book value of stock on date of fire (ascertained from the memorandum Trading Account) | — |
| (ii) | Deduct : The value of any stock saved or salvaged | — |
| (iii) | Actual value of stock lost | — |

The Insurance Policy contains provisions regarding the claim for Stock Lost.

Please remember that-

- (i) Even if the insured value of the goods is higher, the claim should be limited to the amount of actual loss.
- (ii) If actual loss exceeds the amount of the insured value, the claim is to be limited usually by applying the Average clause.

Average Clause: It is a clause contained in a fire insurance policy. It encourages full insurance and discourages under-insurance. The insured person also has to bear a portion of loss himself in case the value of-stock lost is more than the value of the policy. The net claim as per this clause is—

$$\text{Net Claim} = \text{Actual Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

In this respect, it should be remembered that—

- (a) If there is any Salvaged Stock, that is deducted from the Value of Stock on the date of fire. If there is no Salvaged Stock, It is a case of total loss. The net claim should be limited to the Policy Value.
- (b) Average clause cannot be applied in case the Policy value is equal to or more than the Actual Stock Lost [that is, there is equal or over insurance].

Elimination of Abnormal/ Defective Items : Goods which cannot fetch the usual rate of gross profit are considered as unusual or abnormal items.



For preparing the Memorandum Trading Account, the portion of the value of such goods which has not yet been written off, should be deducted from the Opening Stock. If any such goods have been purchased in the current period, the Cost Price of such goods should be deducted from purchases. If any portion of such goods have been sold in the current period, the Selling Price should be deducted from current sales. Lastly if any portion of such goods remains unsold on the date of fire, the agreed value of such portion should be added with the estimated value of normal stock to arrive at the estimated value of (total) stock on that date.

Similar adjustments may be required while preparing the Trading Account of the last financial year/s, if abnormal items existed then.

As an alternative measure, columnar Trading Account Showing normal and abnormal items separately may be prepared.

Illustration 26.

A fire occurred on 15th September 2013 in the premises of Sen & Co. from the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock.

| Particulars | Amount ₹ |
|-------------------------------------|-------------|
| Stock at cost on 1.1.2012 | 40,000 |
| Stock at cost on 1.1.2013 | 60,000 |
| Purchases in 2012 | 80,000 |
| Purchase from 1.1.2012 to 15.9.2013 | 1,76,000 |
| Sales in 2012 | 1,20,000 |
| Sales from 1.1.2013 to 15.9.2013 | 2,10,000 |

During the current year cost of purchase has risen by 10% above last years' level. Selling prices have gone up by 5%. Salvage value of stock after fire was ₹ 4,000.

Solution:

Memorandum Trading Account for the period from 1.1.2013 to 15.9.2013

Dr.

Cr.

| Particulars | Current Year ₹ | Last Year ₹ | Particulars | Current Year ₹ | Last Year ₹ |
|------------------|-------------------|----------------|-------------------|-------------------|----------------|
| To Opening Stock | 60,000 | 60,000 | By, Sales | 2,10,000 | 2,00,000 |
| „ Purchase | 1,76,000 | 1,60,000 | By, Closing Stock | 1,32,000 | 1,20,000 |
| „ Gross Profit | 1,06,000 | 1,00,000 | | | |
| | (bal. fig.) | (50% of Sales) | | | |
| | 3,42,000 | 3,20,000 | | 3,42,000 | 3,20,000 |

Working:

1. Value of Closing Stock

| | |
|---------------------------------------|---------------|
| | ₹ |
| Stock at last years' level | 60,000 |
| Add: 10% increase in cost of purchase | <u>6,000</u> |
| | <u>66,000</u> |

Amount of Claim

| | |
|-----------------------------------|-----------------|
| | ₹ |
| Closing Stock | 1,32,000 |
| Less: Stock Salvaged | <u>4,000</u> |
| Actual Value of Stock last | <u>1,28,000</u> |

Actual Value of Stock Loss

Trading Account (for ascertaining rate of Gross Profit)
For the year ended 31.12.2012

Dr.

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|------------------------------|-------------|--------------------------|-------------|
| To, Opening Stock | 40,000 | By, Sales (less returns) | 1,20,000 |
| To, Purchase (less returns) | 80,000 | By, Closing Stock | 60,000 |
| To, Gross profit (bal. fig.) | 60,000 | | |
| | 1,80,000 | | 1,80,000 |

∴ Percentage of gross profit on sales = (Gross Profit/Sales) × 100

$$= (\text{₹ } 60,000 / \text{₹ } 1,20,000) \times 100$$

$$= 50\%$$

Illustration 27.

Mr. X's godown was destroyed by fire on 1.6.2013 when the goods in stock were insured for ₹ 60,000. The following particulars are given:

Balance Sheet (Extract)
as at 31st December 2012

| Liabilities | Amount ₹ | Asset | Amount ₹ |
|--------------------|-------------|---|-------------|
| Creditor for goods | 20,000 | Stock (including goods held by agent ₹ 2,000) | 36,000 |
| | | Debtors | 70,000 |

Transactions upto 31st May, 2013 include:

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|----------------------------|-------------|------------------------|-------------|
| Cash Received from Debtors | 3,40,000 | Cash paid to Creditors | 2,20,000 |
| Bad Debt written off | 3,500 | Discount Received | 1,000 |
| Balance on 31.5.2013: | | | |
| Debtors | 70,000 | | |
| Creditors | 30,000 | | |

Additional information

- (i) Debtors on 31.5.2013, included an amount owing from the agent from sales to date ₹ 4,000 less 10% commission and his expenses amounting to ₹ 100 on 31.5.2013 – the agent still held the said goods valued at ₹ 3,600 (at selling price).
- (ii) Sales (total) for the periods include ₹ 1,600 for goods which have the selling price reduced by 50% and also ₹ 6,000 reduced by 25%.
- (iii) The normal mark up is 50% on cost and except the above, all sales can be assumed to be at the full selling price.
- (iv) All the goods were destroyed and there was no salvage value of the goods.

Calculate the amount of claim.



Solution:

**In the Books of Mr. X
Debtors Account**

| Dr. | | | Cr. | | |
|---------------|---------------------|-------------|----------------|------------------------|--------------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan 1 | To Balance b/d | 70,000 | 2013 May 31 | By Cash Received | 3,40,000 |
| May 31 | „ Sales (bal. fig.) | 3,40,000 | | „ Bad Debts | 3,500 ¹ |
| | | 4,10,000 | | „ Balance c/d | 66,500 |
| | | | | (excluding form agent) | 4,10,000 |

Creditors Account

| Dr. | | | Cr. | | |
|-----------------|---------------------|-------------|----------------|-----------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 May, 31 | To Cash paid | 2,20,000 | 2013 Jan. 1 | By Balance b/d | 20,000 |
| | „ Discount Received | 1,000 | 2013 May 31 | „ Purchase (bal. fig) | 2,31,000 |
| | „ Balance c/d | 30,000 | | | 2,51,000 |
| | | 2,51,000 | | | |

Godown Stock Account

| Dr. | | | Cr. | | |
|-----------------|--------------------------------|-------------|--------------------|--------------------------------------|-----------------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2012 May, 31 | To Balance b/d | 34,000 | 2012 May 31. | By Cost of Goods Sold | 2,29,066 ² |
| | (₹ 36,000 – ₹ 2,000) | 2,31,000 | | „ Stock at Agents | 3,067 ³ |
| | „ Purchase from the Creditors) | 2,65,000 | | „ Stock Destroyed by fire (bal. fig) | 32,867 |
| | | | | | 2,65,000 |

Thus, amount of claim which will be lodged for ₹ 32,867.

Workings:

1. Bad Debts

| Particulars | Amount ₹ |
|---|-------------|
| Sales | 4,000 |
| Less: Commission @10% 400 | 500 |
| Expenses 100 | 3,500 |

2. Cost of Goods Sold

| Sales ₹ | Normal Selling Price ₹ | Cost ($\frac{2}{3}$ of Selling Price) ₹ |
|----------------------|---------------------------|---|
| 1,600 | 3,200 | 2,133 |
| 6,000 | 8,000[6,000 × (100/75)] | 5,333 |
| 3,32,400 (bal. fig.) | - | 2,21,600 |
| 3,40,000 | | 2,29,066 |

3. Stock at Agent

| Sales (₹) | Cost (₹) |
|-------------------------------------|-----------------------|
| 4,000 | 2,667 (₹ 4,000 × 2/3) |
| — | 2,400 (₹ 3,600 × 2/3) |
| Less: Agents' hand at the beginning | 5,067 |
| | 2,000 |
| | 3,067 |

Illustration 28.

X Ltd. has taken out a fire policy of ₹ 1,60,000 covering its stock. A fire occurred on 31st March, 2013. The following particulars are available :

| | ₹ |
|-----------------------------------|----------|
| Stock as on 31.12.2012 | 60,000 |
| Purchases to the date of fire | 2,60,000 |
| Sales to the date of fire | 1,80,000 |
| Carriage Inwards | 1,600 |
| Commission on purchase to be paid | @2% |
| Gross Profit Ratio @ 50% on cost | |

You are asked to ascertain (i) total loss of stock; (ii) amount of claim to be made against the Insurance Company assuming that the policy was subject to average clause. Stock salvage amounted to ₹ 41,360.

Solution:

In the books of X Ltd.
Memorandum Trading Account

Dr. **for the period ended 31st March, 2013** Cr.

| Particulars | ₹ | ₹ | Particulars | ₹ |
|---------------------------------|--------------|----------|-----------------|----------|
| To, Opening Stock | | 60,000 | By, Sales | 1,80,000 |
| “ Purchase | 2,60,000 | | “ Closing Stock | 2,06,800 |
| Add: Carriage Inward | 1,600 | | (bal. figure) | |
| Add: Com. on Purchase | <u>5,200</u> | 2,66,800 | | |
| “ Gross Profit | | 60,000 | | |
| (@ 50% on cost or 33 % on sale) | | | | |
| | | 3,86,800 | | 3,86,800 |

Note: Carriage Inward and Com. on Purchase are direct expenses and hence, these are added to purchases.

Loss of Stock:

| | ₹ |
|---------------------------|------------------------|
| Stock at the date of fire | 2,06,800 |
| Less: Stock Salvaged | <u>41,360</u> |
| Loss of Stock | <u>1,65,440</u> |

Amount of claim applying Average Clause

$$\begin{aligned} \text{Amount of Claim} &= \text{Actual Loss} \times \frac{\text{Amount of Policy}}{\text{Value of stocks at the date of fire}} \\ &= ₹ 1,65,440 \times \frac{₹ 1,60,000}{₹ 2,06,800} \\ &= ₹ 1,28,000 \end{aligned}$$



Illustration 29.

A fire occurred in the premises of Sri. G. Vekatesh on 1.4.2013 and a considerable part of the stock was destroyed. The stock salvaged was ₹ 28,000. Sri Venkatesh had taken a fire insurance policy for ₹ 17,10,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim which the company should claim from the insurance company for the loss of stock by fire. The following particulars are available:

| | ₹ | | ₹ |
|---------------------------------|-----------|--------------------------|----------|
| Purchases for the year 2012 | 9,38,000 | Stock on 1.1.12 | 1,44,000 |
| Sales for the year 2012 | 11,60,000 | Stock on 31.12.2012 | 2,42,000 |
| Purchases from 1.1.13 to 1.4.13 | 1,82,000 | Wages paid during 2012 | 1,00,000 |
| Sales from 1.1.13-1.4.13 | 24,00,000 | Wages paid 1.1.13-1.4.13 | 1,80,000 |

Sri Venkatesh had in June 2012 consigned goods worth ₹ 50,000, which unfortunately were lost in an accident. Since there was no insurance cover taken, the loss had to be borne by him full.

Stocks at the end of each year for and till the end of calendar year 2011 had been valued at cost less 10%. From 2012, however there was a change in the valuation of closing stock which was ascertained by adding 10% to its costs.

Solution:

In order to find the rate of gross profit on sales for the year 2012, the following Trading Account is to be prepared for the same year as:

Trading Account For the year ended 31st Dec. 2012

| Dr. | Particulars | Amount ₹ | Cr. | Particulars | Amount ₹ |
|-----|--|------------------|-----|--|------------------|
| | To, Opening Stock | 1,60,000 | | By, Sales | 11,60,000 |
| | 1,44,000 × (100/90) | | | By, Stock lost by Accident | 50,000 |
| | To, Purchases | 9,38,000 | | By, Closing Stock (2,42,000 × 100/110) | 2,20,000 |
| | To, Wages | 1,00,000 | | | |
| | To, Profit & Loss A/c (G.P. transferred) | 2,32,000 | | | |
| | | 14,30,000 | | | 14,30,000 |

Rate of Gross Profit on Sales = $2,32,000 / 11,60,000 \times 100 = 20\%$

Trading A/c for the period (from 1.1.13-1.4.13)

| Dr. | Particulars | Amount ₹ | Cr. | Particulars | Amount ₹ |
|-----|--|-----------------|-----|-------------------|-----------------|
| | To, Opening Stock | 2,20,000 | | By, Sales | 2,40,000 |
| | To, Purchases | 1,82,000 | | By, Closing Stock | 2,28,000 |
| | To, Wages | 18,000 | | | |
| | To, Profit & Loss A/c (G.P. @20% of sales) | 48,000 | | | |
| | | 4,68,000 | | | 4,68,000 |

Amount of Claim = Stock destroyed – Salvaged
 = ₹ 2,28,000 – ₹ 28,000
 = ₹ 2,00,000

As the policy amount is less than the value of stock destroyed, average clause is applicable. Here, the amount of claim will be:

Net Claim = Loss of Stock × (Amount of Policy / Stock at the date of fire)
 = $2,00,000 \times (1,71,000 / 2,28,000) = 1,50,000/-$

Illustration 30.

On 1.4.2013, godown of Y Ltd. was destroyed by fire. The records of the company revealed the following particulars:

| | ₹ |
|--|----------|
| Stock on 1.1.2012 | 75,000 |
| Stock on 31.12.2012 | 80,000 |
| Purchases during 2012 | 3,10,000 |
| Sales during 2012 | 4,00,000 |
| Purchase from 1.1.2013 to the date of fire | 75,000 |
| Sales from 1.1.2013 to the date of fire | 1,00,000 |

In valuing Closing Stock of 2012, ₹ 5,000 was written off whose cost was ₹ 4,800. Part of this stock was sold in 2013 at a loss of ₹ 400, at ₹ 2,400. Stock salvaged was ₹ 5,000. The godown and the cost of which was fully insured.

Indicate from above amount of claim to be made against the insurance company.

Solution:

(a) For ascertaining the rate of Gross Profit

In the books of X Ltd.**Trading Account**

Dr. for the year ended 31.12.2012 Cr.

| Particulars | ₹ | ₹ | Particulars | ₹ | ₹ |
|---|--------------|-----------------|--------------------------------------|------------|-----------------|
| To, Opening Stock | | 75,000 | By, Sales | | 4,00,000 |
| “ Purchases | 3,10,000 | | “ Closing Stock | 80,000 | |
| Less: Purchase of Abnormal items of goods | <u>4,800</u> | 3,05,200 | Add: Loss on value of abnormal items | <u>200</u> | 80,200 |
| “ Gross Profit (bal. fig.) | | 1,00,000 | (₹5,000 – ₹4,800) | | |
| | | 4,80,200 | | | 4,80,200 |

$$\begin{aligned} \text{Percentage of Gross Profit on sales} &= \frac{\text{₹ } 1,00,000}{\text{₹ } 4,00,000} \times 100 \\ &= 25\% \end{aligned}$$

**Memorandum Trading Account
for the period ended 31st March, 2013**

Dr. Cr.

| Particulars | ₹ | Particulars | ₹ | ₹ |
|-----------------------------------|-----------------|--|--------------|-----------------|
| To, Opening Stock | 80,200 | By, Sales | 1,00,000 | |
| “ Purchases | 75,000 | Less: Sale of abnormal Stock (₹ 2,400 – ₹ 400) | <u>2,000</u> | 98,000 |
| “ Gross Profit (@25% on ₹ 98,000) | 24,500 | “ Closing Stock (bal. fig.) | | 81,700 |
| | 1,79,700 | | | 1,79,700 |



**Alternative approach
In a combined form**

**Trading Account
for the year ended 31st December, 2013**

Dr.

Cr.

| Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ | Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ |
|------------------------------|----------------|------------------|----------|-----------------|----------------|------------------|----------|
| To Opening Stock | 75,000 | --- | 75,000 | By Sales | 4,00,000 | --- | 4,00,000 |
| „ Purchase | | | | „ Closing Stock | 80,200 | (-) 200 | 80,000 |
| „ Gross Profit @25% on sales | 3,05,200 | 4,800 | 3,10,000 | „ Gross Loss | | 5,000 | 5,000 |
| | 1,00,000 | --- | 1,00,000 | | | | |
| | 4,80,200 | 4,800 | 4,85,000 | | 4,80,200 | 4,800 | 4,85,000 |

**Memorandum Trading Account
for 3 months ending 31st March, 2013**

Dr.

Cr.

| Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ | Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ |
|------------------|----------------|------------------|----------|-----------------|----------------|--------------------|----------|
| To Opening Stock | 80,200 | (-) 200 | 80,000 | By Sales | 98,000 | 2,000 | 1,00,000 |
| „ Purchase | | | | „ Closing Stock | 81,700 | 2,400 ¹ | 84,100 |
| „ Gross Profit | 75,000 | --- | 75,000 | (bal. fig) | | | |
| | 24,500 | 4,600 | 29,100 | | | | |
| | 1,79,700 | 4,400 | 1,84,100 | | 1,79,700 | 4,400 | 1,84,100 |

1. 50% of ₹ 4,800 i.e., remaining abnormal stocks are valued at cost.

Amount of Claim

| | |
|------------------------------------|----------------------|
| | ₹ |
| Value of Stock at the date of fire | 84,100 |
| Less: Stock Salvaged | <u>5,000</u> |
| | <u>79,100</u> |

Illustration 31.

On 30.09.2013 the stock of Harshvardhan was lost in a fire accident. From the available records the following information is made available to you to enable you to prepare a statement of claim of the insurer:

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|---|----------|---|----------|
| Stock at cost on 1.4.2012 | 75,000 | Sales less returns for the year ended 31.3.2013 | 6,30,000 |
| Stock at cost on 31.3.2013 | 1,04,000 | Purchase less returns up to 30.09.2013 | 2,90,000 |
| Purchases less returns for the year ended 31.3.2013 | 5,07,500 | Sales less returns up to 30.09.2013 | 3,68,100 |

In valuing the stock on 31.03.2013 due to obsolescence 50% of the value of the stock which originally cost ₹ 12,000 had been written-off. In May 2013, ¾th of these stocks had been sold at 90% of original cost and it is now expected that the balance of the obsolete stock would also realize the same price, subject to the above, G.P had remained uniform throughout stock to the value of ₹ 14,400 was salvaged.

Solution:

**Memorandum Trading Account
for the period ended 30.09.2013**

Dr.

Cr.

| Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ | Particulars | Normal Items ₹ | Abnormal Items ₹ | Total ₹ |
|-----------------------|-------------------|---------------------|------------|-----------------|-------------------|---------------------|------------|
| To Opening Stock | 98,000 | 6,000 | 1,04,000 | By Sales | 3,60,000 | 8,100 | 3,68,100 |
| „ Purchase | 2,90,000 | --- | 2,90,000 | (Less returns) | | | |
| (Less: Returns) | | | | „ Closing Stock | 1,18,000 | 2,700 | 1,20,700 |
| „ Gross Profit | 90,000 | 4,800 | 94,800 | | | | |
| (25% on Normal Sales) | 4,78,000 | 10,800 | 4,88,800 | | 4,78,000 | 10,800 | 4,88,800 |

∴ Amount of Claim

Stock at the date of fire
Less: Stock Salvaged

₹
1,20,700
14,400
1,06,300

Workings:

**Trading Account
for the year ended 31.03.2013**

Dr.

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|----------------------------|-------------|--------------------------|-----------------------|
| To Opening Stock | 75,000 | By Sales (Less: Returns) | 6,30,000 |
| „ Purchase (Less: Returns) | 5,07,500 | „ Closing Stock | 1,10,000 ¹ |
| „ Gross Profit | 1,57,500 | | |
| | 7,40,000 | | 7,40,000 |

So, Percentage of Gross Profit on sales = $\frac{₹ 1,57,500}{₹ 6,30,000} \times 100 = 25\%$

1. Closing Stock

| Particulars | Amount ₹ |
|------------------------|-------------|
| Closing Stock | 1,04,000 |
| Add: Stock Written off | 6,000 |
| | 1,10,000 |

2. Sale of Abnormal Items of goods

$$₹ 12,000 \times \frac{3}{4} \times (90/100) = ₹ 8,100$$

3. Closing Stock of Abnormal Items

$$₹ 12,000 \times \frac{1}{4} \times (90/100) = ₹ 2,700$$



B. LOSS OF PROFIT

Introduction

A fire may create a consequential loss to a business over and above the instantaneous damage of stock. It disrupts normal activities for some time during which the business has to go on paying standing charges like rent, salaries etc. without any effective return. It also causes a loss of profits which the business could have earned if normality was not disturbed by the accident.

A business may cover the risk of such loss by taking out a "Loss of Profit" or "Consequential Loss Policy". It is a separate Policy. But any claim under this Policy is admitted provided the claim for loss of asset is also admitted under a different policy.

We should remember that loss of profit insurance cover the following risk which happened as a result of fire. Viz, (a) Loss of Net Profit; (b) payments made for standing (fixed) overhead charges, e.g., Salaries, Rent, Depreciation etc. (c) Any additional cost of working.

Certain Important Terms

Standing Charges

Standing charges or fixed overhead charges are to be paid even if there is a reduction in turnover or stoppage of work which include; Rent, Rates and Taxes; Salaries to payment Staffs; Depreciation of fixed Assets, Director's Remuneration; Sundry standing charges which are restricted to 5% of the total of specified insured standing charges. Under loss of profit insurance, gross profit means net profit + insured standing charges.

Indemnity Period

"The period commences at the date of damage and ends not later than the stated number of months thereafter. This is the maximum period in respect of which the insurers are liable and should the business recover and becomes normal before the expiry of such period, liability at once ceases." In short, it comes from the period of damage upto the date when the business begins its normal operational activities or it is the period commencing on the day on which the damages occurs and may vary from three months to a period of years. The period is selected by the proposer and should be sufficient to extend over the full period of any likely interruption.

Indemnity

Indemnity is the difference between the actual profit earned after the damage and that which should have been earned had no damage occurred.

Standard Turnover

The turnover during that period in the twelve months immediately preceding the date of the damage which corresponds with the indemnity period.

Annual Turnover

It is the period of 12 months immediately before the date of damage.

Net Profit

It is the ordinary net profit of the business which is disclosed by the income statement excluding capital receipts and payments. It excludes non-operating income (i.e., income from investment) for the purpose of insurance indemnity.

Gross Profit

Gross Profit is the total of the net profit plus insured standing charges. If there is no net profit the amount would be insured standing charges less such a proportion of any net trading loss.

Example:

| Particulars | Amount ₹ |
|---|-------------|
| Gross Profit (from Trading Account) (Sale ₹ 16,000 Less: non-standing charges ₹ 4,000) | 12,000 |
| All standing charges | 15,000 |
| Net Loss | 3,000 |
| Insured standing charges say | 14,000 |

Now, for profit for insurance purpose

Gross profit will be considered as: ₹ 14,000/15,000 × ₹ 12,000 = ₹ 11,200

Calculation of the amount of claim under "loss of Profit" Policy

1. Find out the rate of Gross Profit [after considering trend of business etc.]
2. Find out the short sales [Standard turnover – Actual turnover of the period of dislocation]
3. Find out Gross Profit on short sales.
4. Find out the Amount Admissible for Additional Expenses

It should be the minimum of :

(a) Actual expenses (b) Gross profit on additional sales generated by additional expenditure

and (c) Additional expenses $\times \frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Standing Charges}}$ or

Additional Expenses $\times \frac{\text{Gross Profit on Annual Turnover}}{\text{Gross Profit on Annual Turnover} + \text{Uninsured Standing Charges}}$

5. Add (3) and (4). From the total deduct saving in any insured standing charge during the period of indemnity. The result is gross claim.

6. Under average clause : Net Claim = Gross Claim $\times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}}$

Illustration 32.

From the following particulars prepare a claim for loss of profits under the Consequential Loss Policy.

Date of Fire: June 30, 2013

Period of indemnity: Six Months

| Particulars | Amount ₹ |
|--|-------------|
| Sum Insured | 25,000 |
| Turnover for the year ended June 30, 2013 | 1,00,000 |
| Net Profit for the accounting year ending March 31, 2013 | 6,250 |
| Standing charges for the accounting year ending March 31, 2013 | 14,250 |
| Turn Over for the year ending March 31, 2013 | 99,000 |
| Turn Over for the indemnity period from 1.7.13 – 31.12.13 | 28,000 |
| Turn Over for the period from 1.7.12 – 31.12.12 | 55,000 |

The turnover of the year 12-13 had shown a tendency of increase of 10% over the turnover of the preceding year.

Solution:**Short Sales**

| Particulars | Amount ₹ |
|--|---------------|
| Standard Turnover (from 1.7.12 – 31-12-12) | 55,000 |
| Add: 10% increase in 12-13 | 5,500 |
| | 60,500 |
| Less: Actual Sales | 28,000 |
| Short Sales | 32,500 |

Rate of gross Profit on Sales

$$= (\text{Net Profit} + \text{Insured Standing Charges}) / \text{Sales} \times 100 = 20.70\%$$

Gross Claim

| Particulars | Amount ₹ |
|---|--------------|
| Gross Profit on short sales = 32,500 x 20.70% | 6,730 |
| Add : Increased Cost of Workings | NIL |
| | 6,730 |
| Less: Saving in Standing Charges | NIL |
| Amount of Gross Claim | 6,730 |

Illustration 33.

There was a serious fire in the premises of M/s ABC on 1.9.2013. Their business activities were interrupted until 31st December, 2013, when normal trading conditions were re-established. M/s. ABC are insured under the loss or profit policy for ₹ 42,000 the period of indemnity being six months. You are able to ascertain the following information.

- The net profit for the year ended 31st December, 2012 was ₹ 20,000
- The annual insurable standing charges amounted to ₹ 30,000, of which ₹ 2,000 were not included in the definition of insured standing charges under the policy.
- The additional cost of working in order to investigate the damage caused by the fire amounted to ₹ 600 and but for the expenditure the business would have had to shut down.
- The savings in insured standing charges in consequence of the fire amounted to ₹ 1,500.
- The turnover for the period for four months ended April 30, August 31, December 31, in each of the years 2012 and 2013 was as follows:

| Year | Amount ₹ | Amount ₹ | Amount ₹ |
|------|-------------|-------------|-------------|
| 2012 | 65,000 | 80,000 | 95,000 |
| 2013 | 70,000 | 80,000 | 15,000 |

You are required to compute the relevant claim under the terms of the loss of profit policy.

Solution:

Short Sales

| Particulars | Amount (₹) |
|--|------------|
| Standard Turnover (four months ended 31 st December, 2012) | 95,000 |
| Less: Actual Sales (four months ended 31 st December, 2013) | 15,000 |
| Short Sales | 80,000 |

Reduction of Gross Profit

$$\text{G.P. Ratio} = \frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Turnover}} \times 100$$

$$= [\text{₹ } 20,000 + \text{₹ } 28,000 / \text{₹ } 2,40,000] \times 100 = 20\%$$

$$\therefore \text{Reduction in gross profit in short sales} = \text{₹ } 80,000 \times 20\% = \text{₹ } 16,000$$

Additional cost of working for mitigating damage ₹ 600

As all standing charges are not insured, amount admissible for additional expenses

$$= \frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Insured Standing Charges}} \times \text{Additional Expenses}$$

$$= \frac{\text{₹ 20,000} + \text{₹ 28,000}}{\text{₹ 20,000} + \text{₹ 30,000}} \times \text{₹ 600} = \text{₹ 576}$$

Total Claim

| Particulars | Amount ₹ |
|-----------------------------------|-------------|
| Gross Profit on short sales | 16,000 |
| Add: Additional cost of workings | 576 |
| | 16,576 |
| Less: Savings in Standing Charges | 1,500 |
| Gross Claim | 15,076 |

Applying Average Clause

$$\text{Net Claim} = \frac{\text{Policy Amount}}{\text{Gross Profit on Annual Turnover}} \times \text{Gross Claim} = \frac{\text{₹ 42,000}}{\text{₹ 49,000}^*} \times \text{₹ 15,076} = \text{₹ 12,922}$$

* Gross Profit on Annual Turnover = Sales for 12 months ended 31st August, 2012 is ₹ 2,45,000
 = ₹ 2,45,000 × 20% = ₹ 49,000

Illustration 34.

A fire occurred on 1st July, 2012 in the premises of A. Ltd. and business was practically disorganized up to 30th November 2012. From the books of account, the following information was extracted:

| Sl. No. | Particulars | Amount ₹ |
|---------|---|-------------|
| 1. | Actual turnover from 1 st July 2013 to November, 2013 | 1,20,000 |
| 2. | Turnover from 1 st July to 30 th November, 2012 | 4,00,000 |
| 3. | Net Profit for the last financial year | 1,80,000 |
| 4. | Insured Standing Charges for the last financial year | 1,20,000 |
| 5. | Turnover for the last financial year | 10,00,000 |
| 6. | Turnover for the year ending 30 th June, 2013 | 11,00,000 |
| 7. | Total Standing Charges for the year | 1,44,000 |

The company incurred additional expenses amounting to ₹ 18,000 which reduced the loss in turnover. There was also a savings during the indemnity period of ₹ 4,972.

The company holds a 'Loss of Profit' policy for ₹ 3,30,000 having an indemnity period for 6 months. There has been a considerable increase in trade and it has been agreed that an adjustment of 20% be made in respect of upward trend in turnover.

Compute claim under 'Loss of Profit Insurance'.



Solution:

| Particulars | Amount ₹ |
|---|-------------|
| Short Sales: | |
| Standard Turnover (from 1.7.2012 to 30.11.2012) | 4,00,000 |
| Add: Increase @ 20% | 80,000 |
| | 4,80,000 |
| Less: Actual Sales during indemnity period (i.e., from 1.7.2013 to 30.11.2013) | 1,20,000 |
| | 3,60,000 |
| ∴ Gross Profit @30% on Short Sales (₹ 3,60,000 x 30%) = | 1,08,000 |
| Additional Expenses: | |
| Least of the following: | |
| (a) Actual amount | 18,000 |
| (b) Gross Profit on additional sales @30% | 36,000 |
| (c) $\frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Standing Charges}} \times \text{Additional Expenses}$ | 16,972 |
| $= \frac{3,96,000}{₹4,20,000} \times ₹ 18,000 = 16,972$ | 16,972 |
| | 1,24,972 |
| Less: Saving in Expenses | 4,972 |
| | 1,20,000 |

Net Claim = Amount of Claim x (Amount of Policy/G.P. on Annual Adjusted Turnover
= ₹ 1,20,000 x (₹ 3,30,000/₹ 3,96,000) = ₹ 1,00,000

Note:

1. Rate of Gross Profit : $\frac{₹ 3,00,000}{₹ 10,00,000} \times 100 = 30\%$

QUESTIONS:

1. Babai sold goods to Kachari for ₹ 90,000 on 1st April, 2014 for which the later accepted three bills of ₹ 30,000 each due respectively in 1,2 and 3 months. The first bill is retained by Babai and is duly met. The second bill was discounted (discount being ₹ 600) and is met in due course. The third bill is also discounted (discount being ₹ 900) and is dishonoured, the Noting charges being ₹ 150.

New arrangements were duly made whereby Kachari pays Cash ₹ 10,150 and accepted and new bill due in 2 months for the balance of the amount with interest at 15% p.a. The bill is retained, on due date the same is dishonoured, noting charges being ₹ 180. Kachari declared insolvent on 15th Sept. 2014 and 35 paise in a rupee were received from his estate.

Required:

Pass Journal entries in the Books of Babai.

[Answer: Total of Journal Entries — ₹2,82,660. Interest on renewal of bills — [₹20,000 × 15% × 2/12] =₹500., Received from estate - ₹20,680 × 0.35 =₹7,238.]

2. Gouru and Gyani were friends and in need of funds. On 1st April, 2015 Gouru drew a bill for ₹ 2,00,000 for three months on Gyani. On 04.04.2015 Gouru got the bill discounted at 15% per annum and remitted half of the proceeds to Gyani. On the due date, Gyani could not meet the bill, instead, Gouru accepted Gyani's bill for ₹ 1,20,000 on 4th July, 2015 for two months. This was discounted by Gyani at 15% per annum and out this ₹

19,500 was paid to Gouru after deducting ₹ 500 discounting charges. Due to financial crisis, Gouru became insolvent and the bill drawn on his was dishonoured and his estate paid 40%.

- Days of grace for discount purposes may be ignored.

Required:

- Give Journal Entries and
- Prepare Gyani's Account – in the books of Gouru.

[Answer: Total of Journal Entries — ₹8,80,000, Amount transferred to Deficiency A/c - ₹1,20,000 × 60% = ₹72,000.]

3. On 15th December, 2014 the premises of Nagar Ltd. were destroyed by fire, but sufficient records were saved from which the following particulars were ascertained:

| | ₹ |
|--|-----------|
| Stock at cost on 1 st April, 2013 | 2,20,500 |
| Stock at cost on 31 st March, 2014 | 2,38,800 |
| Purchases less returns, year ended 31 st March, 2014 | 11,94,000 |
| Sales less returns, year ended 31 st March, 2014 | 14,61,000 |
| Purchases less returns, 1 st April, 2014 to 15 th December, 2014 | 10,15,000 |
| Sales less returns, 1 st April, 2014 to 15 th December, 2014 | 11,62,000 |

In valuing stock for Balance Sheet as at 31st March, 2014 ₹ 6,900 had been written off for certain stock which was a poor selling line, having cost of ₹ 20,700. A portion of these goods were sold in June, 2014 at a loss of ₹ 750 on the original cost of ₹ 10,350. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout. The stock salvaged was ₹ 17,500. The stock was insured for ₹ 2,50,000.

Required:

Calculate the amount of claim to be lodged with the Insurance company for Loss of Stock.

[Answer: Rate of Gross Profit 20%, Amount of Claim — ₹2,36,679]

4. Mr. Naitik sends goods to the value of ₹ 9,37,500 at cost to Mr. Jatin on consignment basis to be sold at 5% commission on sales on 01.01.2015. Jatin accepted a bill of ₹ 2,50,000 drawn by Naitik for 4 months on the same date. Naitik discounted the bill with his banker @ 15% p.a. on 04.02.2015. Naitik incurred ₹ 75,000 by way of freight and other expenses, whereas expenses of Jatin were ₹ 50,000 out of which 60% were non-recurring. Jatin sent the final balance of ₹ 7,68,750 to Naitik on 31.03.2015 along with account sales. The Gross Profit margin is 25% on Sales and 10% of Goods Remained unsold with Jatin.

You are required to prepare:

- Consignment Account and
- Jatin Account – in the books of Mr. Naitik.

[Answer: Amount transferred to General P & L A/c — ₹1.10.500, Amount of goods sold on consignment — (₹9,37,500/0.90)×0.90 = ₹11,25,000

Or , (₹8,43,750/0.75)×0.90 = ₹11,25,000]

5. X and Y entered into a joint venture for purchase and sale of some household items. They agreed to share profits and losses in the ratio of their respective contributions. X contributed ₹ 10,000 in cash and Y ₹ 13,000.



The whole amount was placed in a Joint Bank Account. Goods were purchased by X for ₹ 10,000 and expenses paid by Y amounted to ₹ 2,000. They also purchased goods for ₹ 15,000 through the Joint Bank Account. The expenses on purchase and sale of the articles amounted to ₹ 6,000 (including those met by Y). Goods costing ₹ 20,000 were sold for ₹ 45,000 and the balance were lost by fire.

Prepare Joint Venture Account, Joint Bank Account and the Ventures' Accounts closing the venture.

[Profit on Joint venture: X - ₹8,000; Y - ₹6,000.]

6. Jiban and Mitrik decided to work in joint venture with the following scheme, agreeing to share profits in the ratio of 2/3 and 1/3:

They guaranteed the subscription at par of 50 lakhs shares of ₹ 10 each in Rainbow Ltd. and to pay all expenses up to allotment in consideration of RAINBOW LTD. issuing to them 3,00,000 other shares of ₹ 10 each fully paid together with a commission @ 5% in cash which will be taken by Jiban and Mitrik in 3 : 2.

Co-ventures introduced cash as follows:

| | | |
|--------|---------------------|------------|
| JIBAN | Stamp charges, etc. | ₹ 1,65,000 |
| | Advertising charges | ₹ 1,35,000 |
| | Car expenses | ₹ 1,54,000 |
| | Printing charges | ₹ 1,88,000 |
| MITRIK | Rent | ₹ 1,30,000 |
| | Solicitor's charges | ₹ 80,000 |

Application fell short of the 50 lakhs shares by 1,20,000 shares and Mitrik introduced ₹ 12,00,000 for the purchase of those shares.

The guarantee having been fulfilled, Rainbow Ltd. handed over to the ventures 3,00,000 shares and also paid the Commission in cash. All their holdings were subsequently sold by the venture Mitrik receiving ₹ 12,50,000 and Jiban ₹ 25,00,000.

You are required to prepare the:

- (i) Memorandum Joint Venture Account and
- (ii) Joint Venture Account with Mitrik – in the Books of JIBAN.

[Answer: Share of Profit on Joint Venture: Jiban —₹27,98,667, Mitrik —₹13,99,333.]

Study Note - 3

PREPARATION OF FINANCIAL STATEMENTS OF PROFIT ORIENTED ORGANIZATIONS



This Study Note includes

- 3.1 Introduction
- 3.2 Preparation of Financial Statements
- 3.3 Bad Debts

3.1 INTRODUCTION

Preparation of final accounts is the final destination of the accounting process. As discussed earlier these final accounts include two statements – Income statement which reflects the outcome of business activities during an accounting period (i.e. profit or loss) and the balance sheet which show the position of the business at the end of the accounting period (i.e. resources owned as assets and sources of funds as liabilities plus capital). The objective of financial statements is to provide information about the financial strength, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities and equity are directly related to an organization's financial position. Reported income and expenses are directly related to an organization's financial performance.

Financial statements are intended to be understandable by readers who have "a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently".

In this chapter, we will see how conceptually these statements are prepared and what each of them contains.

3.2 PREPARATION OF FINANCIAL STATEMENTS

Profitability Statement – This statement is related to a complete accounting period. It shows the outcome of business activities during that period in a summarized form. The activities of any business will include purchase, manufacture, and sell.

Balance Sheet – Business needs some resources which have longer life (say more than a year).

Such resources are, therefore, not related to any particular accounting period, but are to be used over the useful life thereof. The resources do not come free. One requires finance to acquire them. This funding is provided by owners through their investment, bank & other through loans, suppliers by way of credit terms. The Balance Sheet shows the list of resources and the funding of the resources i.e. assets and liabilities (towards owners and outsiders). It is also referred as sources of funds (i.e. liabilities & capital) and application of funds (i.e. assets). Let us discuss these statements in depth.

Trading Account: It is an account which is prepared by a merchandising concern which purchases goods and sells the same during a particular period. The purpose of it to find out the gross profit or gross loss which is an important indicator of business efficiency.

The following items will appear in the debit side of the Trading Account:

- (i) **Opening Stock:** In case of trading concern, the opening stock means the finished goods only. The amount of opening stock should be taken from Trial Balance.
- (ii) **Purchases:** The amount of purchases made during the year. Purchases include cash as well as credit purchase. The deductions can be made from purchases, such as, purchase return, goods withdrawn by the proprietor, goods distributed as free sample etc.

(iii) **Direct expenses:** It means all those expenses which are incurred from the time of purchases to making the goods in suitable condition. This expenses includes freight inward, octroi, wages etc.

(iv) **Gross profit:** If the credit side of trading A/c is greater than debit side of trading A/c gross profit will arise.

The following items will appear in the credit side of Trading Account:

(i) **Sales Revenue:** The sales revenue denotes income earned from the main business activity or activities. The income is earned when goods or services are sold to customers. If there is any return, it should be deducted from the sales value. As per the accrual concept, income should be recognized as soon as it is accrued and not necessarily only when the cash is paid for. The Accounting standard 7 (in case of contracting business) and Accounting standard 9 (in other cases) define the guidelines for revenue recognition. The essence of the provisions of both standards is that revenue should be recognized only when significant risks and rewards (vaguely referred to as ownership in goods) are transferred to the customer. For example, if an invoice is made for sale of goods and the term of sale is door delivery; then sale can be recognized only on getting the proof of delivery of goods at the door of customer. If such proof is pending at the end of accounting period, then this transaction cannot be taken as sales, but will be treated as unearned income.

(ii) **Closing Stocks:** In case of trading business, there will be closing stocks of finished goods only. According to convention of conservatism, stock is valued at cost or net realizable value whichever is lower.

(iii) **Gross Loss:** When debit side of trading account is greater than credit side of trading account, gross loss will appear.

| Dr | Trading Account for the year ended | | Cr |
|----------------------------|------------------------------------|----------------------------|--------|
| Particulars | Amount | Particulars | Amount |
| Opening stock: | | Sales | |
| Finished goods | | less sales returns | |
| Purchases | | Closing stock | |
| Less: purchase returns | | Finished goods | |
| Gross Profit | | Gross Loss | |
| (transferred to P & L A/c) | | (transferred to P & L A/c) | |
| Total | | Total | |

Preparation of Trading Account

Illustration 1.

Following are the ledger balances presented by M/s. P. Sen as on 31st March 2013.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|------------------|---------------|-----------------------|---------------|
| Stock (1.4.2012) | 10,000 | Sales | 3,00,000 |
| Purchase | 1,60,000 | Return Inward | 16,000 |
| Carriage Inwards | 10,000 | Return Outward | 10,000 |
| Wages | 30,000 | Royalty on Production | 6,000 |
| Freight | 8,000 | Gas and Fuel | 2,000 |

Additional Information:

- (1) Stock on 31.3.2013: (i) Market Price ₹ 24,000; (ii) Cost Price ₹ 20,000;
- (2) Stock valued ₹ 10,000 were destroyed by fire and insurance company admitted the claim to the extent of ₹ 6,000.
- (3) Goods purchased for ₹ 6,000 on 29th March, 2013, but still lying in-transit, not at all recorded in the books.
- (4) Goods taken for the proprietor for his own use for ₹ 3,000.
- (5) Outstanding wages amounted to ₹ 4,000.
- (6) Freight was paid in advance for ₹ 1,000.



Solution:

**In the books of M/s. P. Sen
Trading Account
For the year ended 31st March, 2013.**

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|---------------------------------|---------------|---------------|-----------------------|---------------|---------------|
| To Openign Stock | | 10,000 | By, Sales | 3,00,000 | |
| To Purchase | 1,60,000 | | Less: Return Inward | 16,000 | 2,84,000 |
| Less: Return Outward | 10,000 | | | | |
| | 1,50,000 | | By, Closing Stock | 20,000 | |
| Less: Goods taken by Proprietor | 3,000 | | Add: Stock Destroyed | 10,000 | |
| | 1,47,000 | | | 30,000 | |
| Add: Goods-in-transit | 6,000 | 1,53,000 | Add: Goods-in-Transit | 6,000 | 36,000 |
| To Wages | 30,000 | | | | |
| Add: Outstanding | 4,000 | 34,000 | | | |
| To, Carriage Inwards | | 10,000 | | | |
| To, Freight | 8,000 | | | | |
| Less: Prepaid | 1,000 | 7,000 | | | |
| To, Royalty on production | | 6,000 | | | |
| To, Gas & fuel | | 2,000 | | | |
| To, Profit & Loss A/c. | | 98,000 | | | |
| - Gross profit transferred | | | | | |
| | | 3,20,000 | | | 3,20,000 |

Note: (a) Stock should be valued as per cost price or market price whichever is lower.

(b) The claim which was admitted by insurance company and the loss of stock, will not appear in Trading Account.

Profit and Loss Account:

The following items will appear in the debit side of the Profit & Loss A/c:

- (i) **Cost of Sales:** This term refers to the cost of goods sold. The goods could be manufactured and sold or can be directly identified with goods.
- (ii) **Other Expenses:** All expenses which are not directly related to main business activity will be reflected in the P & L component. These are mainly the Administrative, Selling and distribution expenses. Examples are salary to office staff, salesmen commission, insurance, legal charges, audit fees, advertising, free samples, bad debts etc. It will also include items like loss on sale of fixed assets, interest and provisions. Students should be careful to include accrued expenses as well.
- (iii) **Abnormal Losses:** All abnormal losses are charged against Profit & Loss Account. It includes stock destroyed by fire, goods lost in transit etc.

The following items will appear in the credit side of Profit & Loss A/c:

- (i) **Revenue Incomes:** These incomes arise in the ordinary course of business, which includes commission received, discount received etc.
- (ii) **Other Incomes:** The business will generate incomes other than from its main activity. These are purely incidental. It will include items like interest received, dividend received, etc. The end result of one component of the P & L A/c is transferred over to the next component and the net result will be transferred to the balance sheet as addition in owners' equity. The profits actually belong to owners of business. In case of company organizations, where ownership is widely distributed, the profit figure is separately shown in balance sheet.

| Dr | | Profit and Loss Account for the year ended | | Cr | |
|--|--------|--|--------|----|--|
| Particulars | Amount | Particulars | Amount | | |
| Gross Loss (transferred from Trading A/c) | | Gross Profit (transferred from Trading A/c) | | | |
| Administrative expenses | | Other Income | | | |
| Office salaries | | Interest received | | | |
| Communication | | Commission received | | | |
| Travel & Conveyance | | Profit on sale of assets | | | |
| Office rent | | Rent received | | | |
| Depreciation of office assets | | Net loss | | | |
| Audit fees | | | | | |
| Insurance | | | | | |
| Repairs & maintenance | | | | | |
| Selling & Distribution expenses | | | | | |
| Advertising | | | | | |
| Salesmen commission | | | | | |
| Delivery van expenses/Depreciation on delivery vans/Bad debts | | | | | |
| Financial expenses | | | | | |
| Bank charges | | | | | |
| Interest on loans | | | | | |
| Loss on sale of assets | | | | | |
| Net profit | | | | | |
| Total | | Total | | | |

Preparations of Profit & Loss Account

Illustration 2.

From the following particulars presented by Sri Tirlhankar for the year ended 31st March 2013, Prepare Profit and Loss Account.

Gross Profit ₹ 1,00,000, Rent ₹ 22,000; Salaries, ₹ 10,000; Commission (Cr.) ₹ 12,000; Insurance ₹ 8,000; Interest (Cr.) ₹ 6,000; Bad Debts ₹ 2,000; Provision for Bad Debts (1.4.2012) ₹ 4,000; Sundry Debtors ₹40,000; Discount Received ₹2,000; Plant & Machinery ₹ 80,000.

Adjustments:

- (a) Outstanding salaries amounted to ₹ 4,000;
- (b) Rent paid for 11 months;
- (c) Interest due but not received amounted to ₹ 2,000
- (d) Prepaid Insurance amounted to ₹ 2,000;
- (e) Depreciate Plant and Machinery by 10% p.a.
- (f) Further Bad Debts amounted to ₹ 2,000 and make a provision for Bad Debts @5% on Sundry Debtors.
- (g) Commissions received in advance amounted to ₹ 2,000.



Solution

In the Books of Sri Tirlhankar Profit and Loss Account for the year ended 31st March 2013

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|--|---------------|-----------------|--|---------------|-----------------|
| To Rent | 22,000 | | By Trading A/c. | | 1,00,000 |
| Add: Outstanding | 2,000 | 24,000 | -Gross Profit | | |
| " Salaries | 10,000 | | " Commission | 12,000 | |
| Add: Outstanding | 4,000 | 14,000 | Less: Received in advance | 2,000 | 10,000 |
| " Insurance | 8,000 | | " Interest | 6,000 | |
| Less: Prepaid | 2,000 | 6,000 | Add: Accrued Interest | 2,000 | 8,000 |
| " Bad Debts | 2,000 | | " Discount received | | 2,000 |
| Add: further Bad Debts | 2,000 | 4,000 | " Provisions for Bad Debts | 4,000 | |
| " Depreciation on Plant & Machinery @10% on ₹ 80,000 | | 8,000 | Less: New Provision @ 5% on (₹ 40,000 – ₹ 2,000) | 1,900 | 2,100 |
| " Capital A/c. (Net Profit Transferred) | | 66,100 | | | |
| | | 1,22,100 | | | 1,22,100 |

Profit and Loss Appropriation Account

We know that the net profit or loss is added to or deducted from owner's equity. The net profit may be used by the business to distribute dividends, to create reserves etc. In order to show these adjustments, a P & L Appropriation A/c is maintained. Distribution of profits is only appropriation and does not mean expenses. After passing such distribution entries, the remaining surplus is added in owner's equity.

The format of P & L Appropriation A/c is given below

Dr.

Profit and Loss Appropriation Account for the year ended _____

Cr.

| Particulars | Amount | Particulars | Amount |
|-----------------------------------|--------|--|--------|
| To Proposed dividend | | By Net profit transferred from P & L A/c | |
| To Transfer to General Reserve | | | |
| To Surplus carried to Capital A/c | | | |
| Total | | Total | |

Illustration 3.

X, Y and Z are three Partners sharing profit and Losses equally. Their capital as on 01.04.2012 were: X ₹ 80,000 ; Y ₹ 60,000 and Z ₹ 50,000.

They mutually agreed on the following points (as per partnership deed)

(a) Interest on capital to be allowed @ 5% P.a. (b) X to be received a salary @ ₹ 500 p.m. (c) Y to be received a commission @ 4% on net profit after charging such commission. (d) After charging all other items 10% of the net profit to be transferred General Reserve.

Profit from Profit and Loss Account amounted to ₹ 66,720. Prepare a Profit and Loss Appropriation Account for the year ended 31st March, 2013.

Solution:

In the books of X, Y and Z
Profit and Loss Appropriation Account
For the year ended 31st March, 2013

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|--------------------------|------------|--------------------|-------------------------|------------|------------|
| To, Interest on Capital: | | | By, Profit and Loss A/c | | 66,720 |
| X | 4,000 | | | | |
| Y | 3,000 | | | | |
| Z | 2,500 | 9,500 | | | |
| “ Salaries | | | | | |
| X : (₹500 x 12) | | 6,000 | | | |
| “ Commission | | | | | |
| Y | | 1,970 ¹ | | | |
| “ General Reserve | | 4,925 ² | | | |
| “ Net Divisible Profit | | | | | |
| X | 14,775 | | | | |
| Y | 14,775 | | | | |
| Z | 14,775 | 44,325 | | | |
| | | 66,720 | | | 66,720 |

Workings:

- Net Profit before charging Y's Commission** = ₹ (66,720 – 15,500) = ₹ 51,220
Less: Y's Commission @ 4% i.e.- $\left(\frac{4}{104} \times ₹ 51,220\right)$ = ₹ 1,970
49,250
- Transfer to General Reserve** = ₹ 49,250 x 10% = ₹ 4,925

Balance Sheet: Horizontal format of Balance Sheet is also used by the business other than company

A. Liabilities

(a) Capital: This indicates the initial amount the owner or owners of the business contributed. This contribution could be at the time of starting business or even at a later stage to satisfy requirements of funds for expansion, diversification etc. As per business entity concept, owners and business are distinct entities, and thus, any contribution by owners by way of capital is liability.

(b) Reserves and Surplus: The business is a going concern and will keep making profit or loss year by year. The accumulation of these profit or loss figures (called as surpluses) will keep on increasing or decreasing owners' equity. In case of non-corporate forms of business, the profits or losses are added to the capital A/c and not shown separately in the balance sheet of the business.

(c) Long Term or Non-Current Liabilities: These are obligations which are to be settled over a longer period of time say 5-10 years. These funds are raised by way of loans from banks and financial institutions. Such borrowed funds are to be repaid in installments during the tenure of the loan as agreed. Such funds are usually raised to meet financial requirements to procure fixed assets. These funds should not be generally used for day-to-day business activities. Such loan are normally given on the basis of some security from the business e.g. against a charge on the fixed assets. So, long term loan are called as "Secured Loan" also.

(d) Short Term or Current Liabilities: A liability shall be classified as Current when it satisfies any of the following :

- It is expected to be settled in the organisation's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is due to be settled within 12 months after the Reporting Date, or
- The organization does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a Liability that could, at the option of the counterparty, result in its settlement by the issue of Equity Instruments do not affect its classification)



Current liabilities comprise of :

- (i) **Sundry Creditors** - Amounts payable to suppliers against purchase of goods. This is usually settled within 30-180 days.
- (ii) **Advances from customers** – At times customer may pay advance i.e. before they get delivery of goods. Till the business supplies goods to them, it has an obligation to pay back the advance in case of failure to supply. Hence, such advances are treated as liability till the time they get converted to sales.
- (iii) **Outstanding Expenses:** These represent services procured but not paid for. These are usually settled within 30–60 days e.g. phone bill of Sept is normally paid in Oct.
- (iv) **Bills Payable:** There are times when suppliers do not give clean credit. They supply goods against a promissory note to be signed as a promise to pay after or on a particular date.

These are called as bills payable or notes payable.

- (v) **Bank Overdrafts:** Banks may give fund facilities like overdraft whereby, business is permitted to issue cheques up to a certain limit. The bank will honour these cheques and will recover this money from business. This is a short term obligation.

B. Assets

In accounting language, all debit balances in personal and real accounts are called as assets. Assets are broadly classified into fixed assets and current assets.

(a) Fixed Assets: These represent the facilities or resources owned by the business for a longer period of time. The basic purpose of these resources is not to buy and sell them, but to use for future earnings. The benefit from use of these assets is spread over a very long period. The fixed assets could be in tangible form such as buildings, machinery, vehicles, computers etc., whereas some could be in intangible form viz. patents, trademarks, goodwill etc. The fixed assets are subject to wear and tear which is called as depreciation. In the balance sheet, fixed assets are always shown as “original cost less depreciation”.

(b) Investments: These are funds invested outside the business on a temporary basis. At times, when the business has surplus funds, and they are not immediately required for business purpose, it is prudent to invest it outside business e.g. in mutual funds or fixed deposit. The purpose is to earn a reasonable return on this money instead of keeping them idle. These are assets shown separately in balance sheet.

Investments can be classified into Current Investments and Non-current Investments.

Non-current Investments are investments which are restricted beyond the current period as to sale or disposal.

Whereas, current investments are investments that are by their nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.

(c) Current Assets: An asset shall be classified as Current when it satisfies any of the following :

- It is expected to be realised in, or is intended for sale or consumption in the organisation's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is due to be realised within 12 months after the Reporting Date, or
- It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle a Liability for at least 12 months after the Reporting Date.

Current assets comprise of:

(i) Stocks: This includes stock of raw material, semi-finished goods or WIP, and finished goods.

Stocks are shown at lesser of the cost or market price. Provision for obsolescence, if any, is also reduced. Generally, stocks are physically counted and compared with book stocks to ensure that there are no discrepancies. In case of discrepancies, the same are adjusted to P & L A/c and stock figures are shown as net of this adjustment.

(ii) Debtors: They represent customer balances which are not paid. The bad debts or a provision for bad debt is reduced from debtors and net figure is shown in balance sheet.

(iii) Bills receivables: Credit to customers may be given based on a bill to be signed by them payable to the business at an agreed date in future. At the end of accounting period, the bills accepted but not yet paid are shown as bills receivables.

(iv) Cash in Hand: This represents cash actually held by the business on the balance sheet date. This cash may be held at various offices, locations or sites from where the business activity is carried out. Cash at all locations is physically counted and verified with the book balance. Discrepancies if any are adjusted.

(v) Cash at Bank: Dealing through banks is quite common. Funds held as balances with bank are also treated as current asset, as it is to be applied for paying to suppliers. The balance at bank as per books of accounts is always reconciled with the balance as per bank statement, the reasons for differences are identified and required entries are passed.

(vi) Prepaid Expenses: They represent payments made against which services are expected to be received in a very short period.

(vii) Advances to suppliers: When amounts are paid to suppliers in advance and goods or services are not received till the balance sheet date, they are to be shown as current assets. This is because advances paid are like right to claim the business gets.

Please note that both current assets and current liabilities are used in day-to-day business activities. The current assets minus current liabilities are called as working capital or net current assets. The following report is usual horizontal form of balance sheet. Please note that the assets are normally shown in descending order of their liquidity. Also, capital, long term liabilities and short term liabilities are shown in that order.

In case other than Company :

| Liabilities | Amount | Assets | Amount |
|--|--------|---------------------------------------|--------|
| Capital (separate figures are shown for each owner) | | Fixed Assets: | |
| Long term Liabilities: | | Land less depreciation | |
| Loans from banks or financial Institutions | | Building less depreciation | |
| Current Liabilities: | | Plant and Machinery less depreciation | |
| Sundry creditors | | Vehicles less depreciation | |
| Bills payable | | Computer systems less depreciation | |
| Advances from customers | | Office equipments less depreciation | |
| Outstanding expenses | | Current Assets: | |
| | | Stocks | |
| | | Sundry debtors less provisions | |
| | | Bills receivables | |
| | | Cash in hand | |
| | | Cash at bank | |
| | | Prepaid expenses | |
| | | Advances to suppliers | |
| Total | | Total | |



Illustrations 4.

Following is the Trial Balance of M/s Brijesh and Sons. Prepare final accounts for the year ended on 31st March 2013.

| Particulars | Debit (₹) | Credit (₹) |
|--|------------------|------------------|
| Stock as on 01.04.2012: Finished goods | 2,00,000 | |
| Purchases and Sales | 22,00,000 | 35,00,000 |
| Bills receivables | 50,000 | |
| Returns | 1,00,000 | 50,000 |
| Carriage Inwards | 50,000 | |
| Debtors and Creditors | 2,00,000 | 4,00,000 |
| Carriage Outwards | 40,000 | |
| Discounts | 5,000 | 5,000 |
| Salaries and wages | 2,20,000 | |
| Insurance | 60,000 | |
| Rent | 60,000 | |
| Wages and salaries | 80,000 | |
| Bad debts | 10,000 | |
| Furniture | 4,00,000 | |
| Brijesh's capital | | 5,00,000 |
| Brijesh's drawing | 70,000 | |
| Loose tools | 1,00,000 | |
| Printing & stationery | 30,000 | |
| Advertising | 50,000 | |
| Cash in hand | 45,000 | |
| Cash at bank | 2,00,000 | |
| Petty Cash | 5,000 | |
| Machinery | 3,00,000 | |
| Commission | 10,000 | 30,000 |
| Total | 44,85,000 | 44,85,000 |

Adjustments: (i) Finished goods stock. Stock on 31st March was valued at Cost price ₹ 4,20,000 and market price ₹ 400,000. (ii) Depreciate furniture @ 10% p.a. and machinery @ 20% p.a. on reducing balance method. (iii) Rent of ₹ 5,000 was paid in advance. (iv) Salaries & wages due but not paid ₹ 30,000. (v) Make a provision for doubtful debts @ 5% on debtors. (vi) Commission receivable ₹ 5,000.

Solution :

| Dr. | | Trading Account for the year ended 31st March 2013 | | Cr. | |
|-----------------------------------|------------|--|---------------------------------|------------|------------|
| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
| Opening stock : Finished goods | | 2,00,000 | Sales | 35,00,000 | |
| Purchases | 22,00,000 | | Less: Sales Returns | 1,00,000 | 34,00,000 |
| Less: Purchases returns | 50,000 | 21,50,000 | Closing stock Finished goods | | 4,00,000 |
| Carriage inwards | | 50,000 | | | |
| Wages & salaries | | 80,000 | | | |
| Gross Profit c/d | | 13,20,000 | | | |
| | | 38,00,000 | | | 38,00,000 |

Dr. Profit & Loss Account for the year ended 31st March 2013 Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|----------------------------------|------------|------------|---------------------|------------|------------|
| Administrative expenses | - | | Gross Profit b/d | | 13,20,000 |
| Salaries & wages | 2,20,000 | | Discount received | | 5,000 |
| Add: Not paid | 30,000 | 2,50,000 | Commission received | 30,000 | |
| Depreciation on furniture | | 40,000 | Add : receivable | 5,000 | 35,000 |
| Depreciation of Machinery | | 60,000 | | | |
| Insurance | | 60,000 | | | |
| Rent | 60,000 | | | | |
| Less: Paid in advance | 5,000 | 55,000 | | | |
| Printing & Stationery | | 30,000 | | | |
| Selling & Distribution expenses: | | | | | |
| Advertising | | 50,000 | | | |
| Carriage Outwards | | 40,000 | | | |
| Discounts | | 5,000 | | | |
| Bad debts | | 10,000 | | | |
| Commission | | 10,000 | | | |
| Provision for doubtful debts | | 10,000 | | | |
| Net profit | | 740,000 | | | |
| | | 13,60,000 | | | 13,60,000 |

Dr. Balance Sheet as on 31st March 2013 Cr.

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|-------------------------------|------------|------------|------------------------------------|------------|------------|
| Brijesh's Capital | 5,00,000 | | Fixed Assets: | | |
| Less : Drawings | 70,000 | | Furniture | 400,000 | |
| Add : Net Profit for the year | 7,40,000 | 11,70,000 | Less: Depreciation | 40,000 | 3,60,000 |
| Long term Liabilities: | | - | Machinery | 300,000 | |
| | | | Less: Depreciation | 60,000 | 2,40,000 |
| Current Liabilities: | | | Loose tools | | 1,00,000 |
| Sundry creditors | | 4,00,000 | Current Assets: | | |
| Outstanding salaries & wages | | 30,000 | Stocks | | 4,00,000 |
| | | | Sundry debtors | 200,000 | |
| | | | Less: Provision for doubtful debts | 10,000 | 1,90,000 |
| | | | Bills receivables | | 50,000 |
| | | | Cash in hand | | 45,000 |
| | | | Cash at bank | | 2,00,000 |
| | | | Petty cash | | 5,000 |
| | | | Prepaid Rent | | 5,000 |
| | | | Commission receivable | | 5,000 |
| | | 16,00,000 | | | 16,00,000 |

Notes :

- (1) Closing stock is valued at market price here as it is less than cost price (conservatism concept)
- (2) Returns in debit column mean sales return, while that in credit column means purchase returns
- (3) Discounts in debit column mean allowed (expense) and that in credit means received (income)
- (4) Commission in debit column mean allowed (expense) and that in credit means received (income)
- (5) There are two peculiar items given in the TB. One is Salaries & wages and the other is Wages and salaries. The interpretation is – where first reference is made to wages, it's assumed to be directly for goods and taken to Trading A/c. If the first reference is to salaries, it's assumed to be related to office and taken to P & L.

Illustrations 5.

Mr. Arvindkumar had a small business enterprise. He has given the trial balance as at 31st March 2013

| Particulars | Debit (₹) | Credit (₹) |
|-------------------------------|-----------|------------|
| Mr. Arvindkumar's Capital | | 1,00,000 |
| Machinery | 36,000 | |
| Depreciation on machinery | 4,000 | |
| Repairs to machinery | 5,200 | |
| Wages | 54,000 | |
| Salaries | 21,000 | |
| Income tax of Mr. Arvindkumar | 1,000 | |
| Cash in had | 4,000 | |
| Land & Building | 1,49,000 | |
| Depreciation on building | 5,000 | |
| Purchases | 2,50,000 | |
| Purchase returns | | 3,000 |
| Sales | | 4,98,000 |
| Citi Bank | | 7,600 |
| Accrued Income | 3,000 | |
| Salaries outstanding | | 4,000 |
| Bills receivables | 30,000 | |
| Provision for doubtful debts | | 10,000 |
| Bills payable | | 16,000 |
| Bad debts | 2,000 | |
| Discount on purchases | | 7,080 |
| Debtors | 70,000 | |
| Creditors | | 62,520 |
| Opening stock | 74,000 | |
| Total | 7,08,200 | 7,08,200 |

Additional information:

- (1) Stock as on 31st March 2013 was valued at ₹ 60,000
- (2) Write off further ₹ 6,000 as bad debt and maintain a provision of 5% on doubtful debt.
- (3) Goods costing ₹ 10,000 were sent on approval basis to a customer for ₹ 12,000 on 30th March, 2013. This was recorded as actual sales.

- (4) ₹ 2,400 paid as rent for office was debited to Landlord's A/c and was included in debtors.
- (5) General Manager is to be given commission at 10% of net profits after charging his commission.
- (6) Works manager is to be given a commission at 12% of net profit before charging General Manager's commission and his own.

You are required to prepare final accounts in the books of Mr. Arvindkumar.

Solution :

In the books of Mr. Arvindkumar

Dr. Trading Account for the year ended 31st March 2013 Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|-------------------------|------------|------------|------------------------|------------|------------|
| Opening stock: | | | Sales | 4,98,000 | |
| Finished goods | | 74,000 | Less: Sent on approval | (12,000) | 4,86,000 |
| Purchases | 2,50,000 | | | | |
| Less: Purchases returns | (3,000) | 2,47,000 | Closing stock: | | |
| | | | Finished goods | 60,000 | |
| Wages | | 54,000 | Add sent on approval | 10,000 | 70,000 |
| Gross Profit c/d | | 181,000 | | | |
| | | 5,56,000 | | | 5,56,000 |

Dr. Profit and Loss Account for the year ended 31st March 2013 Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|----------------------------------|------------|------------|-------------------|------------|------------|
| Administrative expenses: | | | Gross Profit b/d | | 1,81,000 |
| Salaries | | 21,000 | Discount received | | 7,080 |
| Repairs to machinery | | 5,200 | | | |
| Depreciation of Machinery | | 4,000 | | | |
| Depreciation of Building | | 5,000 | | | |
| Rent | | 2,400 | | | |
| Selling & Distribution expenses: | | | | | |
| Bad debts | 2,000 | | | | |
| Additional bad debts | 6,000 | | | | |
| Provision for doubtful debts | 2,480 | | | | |
| Less: Provision opening | (10,000) | 480 | | | |
| Commission to works manager | | 18,000 | | | |
| Commission to General Manager | | 12,000 | | | |
| Net profit | | 1,20,000 | | | |
| | | 1,88,080 | | | 1,88,080 |



Balance Sheet as on 31st March 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|------------------------------|------------|------------|------------------------------------|------------|------------|
| Arvind kumar's Capital | 1,00,000 | | Fixed Assets: | | |
| Less: drawings (income tax) | (1,000) | | Land & building | | 1,49,000 |
| Add: Net Profit for the year | 1,20,000 | 2,19,000 | Machinery | | 36,000 |
| Long term Liabilities: | | - | Current Assets: | | |
| Current Liabilities: | | | Stocks | 60,000 | |
| Sundry creditors | | 62,520 | Add: Sent on approval | 10,000 | 70,000 |
| Outstanding salaries | | 4,000 | Sundry debtors | 70,000 | |
| Citi Bank Overdraft | | 7,600 | Less: Goods on approval | (12,000) | |
| Bills payable | | 16,000 | Less: Bad debts | (6,000) | |
| Commission payable | | 30,000 | Less: Related to landlord | (2,400) | |
| | | | Less: Provision for doubtful debts | (2,480) | 47,120 |
| | | | Bills receivable | | 30,000 |
| | | | Cash in hand | | 4,000 |
| | | | Accrued Income | | 3,000 |
| | | 3,39,120 | | | 3,39,120 |

Notes:

- (1) The closing entries are passed for the items: depreciation, accrued income, outstanding salary. Hence, they are directly taken to the respective places in Balance sheet and P & L A/c.
- (2) Income tax paid for Mr. Arvindkumar will be treated as drawings.
- (3) Commission payable to works manager & general manager is computed as below:

| | |
|---|-----------------|
| | ₹ |
| Profit before charging any commission | 1,50,000 |
| Commission to works manager @ 12% on 1,50,000 | <u>18,000</u> |
| Profit after works manager's commission | <u>1,32,000</u> |
| Commission to General Manager | <u>12,000</u> |
| (1,32,000/110 x 100) | |

Illustrations 6.

Abhay runs a small shop and deals in various goods. He has not been able to tally his trial balance and has closed it by taking the difference to Suspense A/c. It is given below.

| Particulars (as on 31st March 2013) | Debit (₹) | Credit (₹) |
|-------------------------------------|-----------|------------|
| Abhay's capital | | 1,50,000 |
| Drawings | 75,000 | |
| Fixed assets | 1,35,000 | |
| Opening stock | 36,500 | |
| Purchases & returns | 6,75,000 | 13,500 |
| Sales & returns | 34,000 | 8,50,000 |
| Due from customer & to creditors | 95,000 | 3,25,000 |

| | | |
|---------------------------------|------------------|------------------|
| Expenses | 45,750 | |
| Cash | | 3,000 |
| Bank deposits & interest earned | 55,000 | 5,750 |
| Suspense A/c | | 4,000 |
| Advertising | 2,00,000 | |
| Total | 13,51,250 | 13,51,250 |

Mr. Abhay has requested you to help him in tallying his trial balance and also prepare his final accounts. On investigation of his books you get the following information:

- (i) Closing Stock on 31st March 2013 was ₹ 45,000 at cost and could sell over this value.
- (ii) Depreciation of ₹ 13,500 needs to be provided for the year.
- (iii) A withdrawal slip indicated a cash withdrawal of ₹ 15,000 which was charged as drawing. However, it was noticed that ₹ 11,000 was used for business purpose only and was entered as expenses in cash book.
- (iv) Goods worth ₹ 19,000 were purchased on 24th March 2013 and sold on 29th March 2013 for ₹23,750. Sales were recorded correctly, but purchase invoice was missed out.
- (v) Purchase returns of ₹ 1,500 were routed through sales return. Party's A/c was correctly posted.
- (vi) Expenses include ₹ 3,750 related to the period after 31st March 2013.
- (vii) Purchase book was over-cast by ₹ 1,000. Posting to suppliers' A/c is correct.
- (viii) Advertising will be useful for generating revenue for 5 years.

Solution: Rectification of errors:

- (a) Cash withdrawn was recorded as

| | | | |
|----------|---------|--------|--------|
| Cash A/c | Dr | 15,000 | |
| | To Bank | | 15,000 |

But it was charged to drawing and ₹ 11,000 was recorded as expenses as well i.e.

| | | | |
|--------------|---------|--------|--------|
| Drawings A/c | Dr | 15,000 | |
| Expenses A/c | Dr | 11,000 | |
| | To Cash | | 26,000 |

This resulted in negative cash of ₹ 11,000. The rectification entry to be passed is

| | | | |
|----------|-------------|--------|--------|
| Cash A/c | Dr | 11,000 | |
| | To Drawings | | 11,000 |

- (b) Omitted transaction to be recorded

| | | | |
|---------------|-------------------|--------|--------|
| Purchases A/c | Dr | 19,000 | |
| | To Suppliers' A/c | | 19,000 |

- (c) Incorrect recording of purchase returns corrected by

| | | | |
|--------------|------------------------|-------|-------|
| Suspense A/c | Dr | 3,000 | |
| | To Purchase return A/c | | 1,500 |
| | To sales return A/c | 1,500 | |

- (d) Incorrect expenses rectified by

| | | | |
|----------------------|-----------------|-------|-------|
| Prepaid expenses A/c | Dr | 3,750 | |
| | To Expenses A/c | | 3,750 |

- (e) Over-casting of purchase book rectified by

| | | | |
|--------------|--------------|-------|-------|
| Suspense A/c | Dr | 1,000 | |
| | To Purchases | | 1,000 |

Based on these rectifications we can now proceed to complete the final accounts.



Dr.

Trading Account for the year ended 31st March, 2013

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|------------------------------|------------|------------|--------------------|------------|------------|
| To Opening stock | - | 36,500 | By Sales | 8,50,000 | |
| To Purchases | 6,75,000 | | Less: Returns | (34,000) | |
| Less: Returns | (13,500) | | Add: Rectification | 1,500 | 8,17,500 |
| Less: Additional returns | (1,500) | | By Closing stock | | 45,000 |
| Add: Purchases missed out | 19,000 | | | | |
| Less: Over-casting rectified | (1,000) | 6,78,000 | | | |
| To Gross Profit c/d | | 1,48,000 | | | |
| | | 8,62,500 | | | 8,62,500 |

Dr.

Profit and Loss Account for the year ended 31st March, 2013

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|------------------|------------|------------|-------------------------------|------------|------------|
| To, Expenses | 45,750 | | By, Gross Profit b/d | | 1,48,000 |
| Less : Prepaid | 3,750 | 42,000 | By, Interest on Bank deposits | | 5,750 |
| To, Depreciation | | 13,500 | By, Net Loss | | 1,01,750 |
| To, Advertising | | 2,00,000 | | | |
| | | 2,55,500 | | | 2,55,500 |

Balance Sheet as on 31st March, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|------------------------------|------------|------------|----------------------------|------------|------------|
| Abhay's Capital | 1,50,000 | | Fixed Assets | | |
| Add: Wrong charge to drawing | 11,000 | | Gross Block | 1,35,000 | |
| | 1,61,000 | | Less: Depreciation | 13,500 | 1,21,500 |
| Less: Drawings | 75,000 | 86,000 | Current Assets: | | |
| Current Liabilities: | | | Stocks | | 45,000 |
| Sundry Creditors | 3,25,000 | | Sundry Debtors | | 95,000 |
| Add: Missed out purchase | 19,000 | 3,44,000 | Cash in hand | (3,000) | |
| | | | Add: Rectification | 11,000 | 8,000 |
| | | | Fixed deposit with Bank | | 55,000 |
| | | | Prepaid expenses | | 3,750 |
| | | | Miscellaneous Expenditure: | | |
| | | | Profit & Loss (Dr.) | | 1,01,750 |
| | | 4,30,000 | | | 4,30,000 |

Note : The expenditure incurred on intangible items after the date AS 26 became/becomes mandatory (01.04.2003 or 01.04.2004, as the case may be) would have to be expensed when incurred since these do not meet the definition of an 'asset' as per AS 26. Hence, full amount of Advertisement expense is charged to Profit & Loss Account.

Illustration 7.

Mr. Oswal maintains his accounts on Mercantile basis. The following Trial Balance has been prepared from his books as at 31st March, 2013 after making necessary adjustments for outstanding and accrued items as well as depreciation:

**Trial Balance
as at 31st March, 2013**

| Particulars | Dr. (₹) | Cr. (₹) |
|-------------------------------------|------------|------------|
| Plant and Machinery | 2,12,500 | |
| Sundry Creditors | | 2,64,000 |
| Sales | | 6,50,000 |
| Purchases | 4,20,000 | |
| Salaries | 40,000 | |
| Prepaid Insurance | 370 | |
| Advance Rent | 2,000 | |
| Outstanding Salary | | 6,000 |
| Advance Salary | 2,500 | |
| Electricity Charges | 2,650 | |
| Furniture and Fixtures | 72,000 | |
| Opening Stock | 50,000 | |
| Outstanding Electricity Charges | | 450 |
| Insurance | 1,200 | |
| Rent | 10,000 | |
| Miscellaneous Expenses | 14,000 | |
| Cash in hand | 3,000 | |
| Investments | 80,000 | |
| Drawings | 24,000 | |
| Dividend from Investments | | 8,000 |
| Accrued Dividend from Investments | 1,500 | |
| Depreciation on Plant and Machinery | 37,500 | |
| Depreciation on Furniture | 8,000 | |
| Capital Account | | 2,11,970 |
| Telephone Charges | 6,000 | |
| Sundry Debtors | 1,70,500 | |
| Stationery and Printing | 1,200 | |
| Cash at Bank | 65,000 | |
| Interest on Loan | 8,000 | |
| Interest Due but not paid on loan | | 1,500 |
| Loan Account | | 90,000 |
| | 12,31,920 | 12,31,920 |

Additional Information:

- (i) Salaries include ₹ 10,000 towards renovation of Proprietor's residence.
- (ii) Closing Stock amounted to ₹ 75,000.

Mr. Oswal, however, request you to prepare a Trading and Profit & Loss Account for the year ended 31st March, 2013 and a Balance Sheet as on that date following cash basis of accounting.



Solution:

**In the books of Mr. Oswal
Trading and Profit and Loss Account
for the year ended 31st March, 2013**

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|-----------------------------|---------------|---------------|---------------------------|---------------|---------------|
| To, Opening Stock | | 50,000 | By, Sales | | 6,50,000 |
| `` Purchases | | 4,20,000 | `` Closing Stock | | 75,000 |
| `` Profit & Loss A/c. | | 2,55,000 | | | |
| Gross Profit transferred | | 7,25,000 | | | 7,25,000 |
| To, Salaries | 40,000 | | By, Trading A/c. | | |
| Less: Outstanding | 6,000 | | -Gross Profit transferred | | 2,55,000 |
| Salaries | 34,000 | | `` Dividend | 8,000 | |
| Add: Advance Salary | 2,500 | | Less: Accrued Dividend | 1,500 | 6,500 |
| | 36,500 | | | | |
| Less: Renovation (Drawings) | 10,000 | 26,500 | | | |
| `` Insurance | 1,200 | | | | |
| Add: Prepaid | 370 | 1,570 | | | |
| `` Rent | 10,000 | | | | |
| Add: Advance Rent | 2,000 | 12,000 | | | |
| `` Electricity Charges | 2,650 | | | | |
| Less: Outstanding | 450 | 2,200 | | | |
| `` Miscellaneous Expenses | | 14,000 | | | |
| `` Stationery & Printing | | 1,200 | | | |
| `` Depreciation: | | | | | |
| Plant & Machinery | 37,500 | | | | |
| Furniture & Fixtures | 8,000 | 45,500 | | | |
| `` Interest on Loan | 8,000 | | | | |
| Less: Outstanding | 1,500 | 6,500 | | | |
| `` Telephone Charges | | 6,000 | | | |
| `` Capital Account | | | | | |
| Net Profit transferred | | 1,46,030 | | | |
| | | 2,61,500 | | | 2,61,500 |

Balance Sheet as at 31st March, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|-----------------------------------|---------------|---------------|---|---------------|---------------|
| Capital Account | 2,11,970 | | Plant and Machinery (at cost less depreciation) | | 2,12,500 |
| Add: Net Profit | 1,46,030 | | Furniture & Fixtures (at cost less depreciation) | | 72,000 |
| | 3,58,000 | | Investments | | 80,000 |
| Less: Drawings (24,000+10,000) | 34,000 | 3,24,000 | Stock-in-Trade | | 75,000 |
| Loan Account | | 90,000 | Debtors | | 1,70,500 |
| Sundry Creditors | | 2,64,000 | Cash at Bank | | 65,000 |
| | | 6,78,000 | Cash in hand | | 3,000 |
| | | | | | 6,78,000 |

Illustration 8.

The following Trial Balance has been prepared from the books of Mr. Sexena as on 31st March, 2013 after making necessary adjustments for depreciation on Fixed Assets, outstanding and accrued items and difference under Suspense Account.

Trial Balance as at 31st March, 2013

| Particulars | Dr. (₹) | Particulars | Cr. (₹) |
|---------------------------|------------|-----------------------|------------|
| Machineries | 1,70,000 | Sundry Creditors | 82,000 |
| Furniture | 49,500 | Capital Account | 2,45,750 |
| Sundry Debtors | 38,000 | Outstanding Expenses: | |
| Drawings | 28,000 | Salaries | 1,500 |
| Travelling Expenses | 6,500 | Printing | 600 |
| Insurance | 1,500 | Audit Fees | 1,000 |
| Audit Fees | 1,000 | Bank Interest | 1,200 |
| Salaries | 49,000 | Discounts | 1,800 |
| Rent | 5,000 | Sales (Less Return) | 6,80,000 |
| Cash in hand | 7,800 | | |
| Cash at Bank | 18,500 | | |
| Stock-in-trade (1-4-2012) | 80,000 | | |
| Prepaid Insurance | 250 | | |
| Miscellaneous Expenses | 21,200 | | |
| Discounts | 1,200 | | |
| Printing & Stationery | 1,500 | | |
| Purchase (Less Returns) | 4,60,000 | | |
| Depreciation: | | | |
| Machineries | 30,000 | | |
| Furniture | 5,500 | | |
| Suspense Account | 39,400 | | |
| | 10,13,850 | | 10,13,850 |

On the subsequent scrutiny following mistakes were noticed:

- (i) A new machinery was purchase for ₹ 50,000 but the amount was wrongly posted to Furniture Account as ₹ 5,000.
- (ii) Cash received from Debtors ₹ 5,600 was omitted to be posted in the ledger.
- (iii) Goods withdrawn by the proprietor for personal use but no entry was passed ₹ 5,000.
- (iv) Sales included ₹ 30,000 as goods sold cash on behalf of Mr. Thakurlal who allowed 15% commission on such sales for which effect is to be given.

You are further told that:-

- (a) Closing stock on physical verification amounted to ₹ 47,500.
- (b) Depreciation on Machineries and Furniture has been provided @ 15% and 10%, respectively, on reducing balancing system.

Full year's depreciation is provided on addition.

You are requested to prepare a Trading and Profit & Loss Account for the year ended 31st March 2013 and a Balance Sheet as on that date so as to represent a True and Correct picture.



Solution:

**In the books of Mr. Sexena
Trading and Profit and Loss Account
for the year ended 31st March, 2013**

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|--|---------------|---------------|--|---------------|---------------|
| To, Opening Stock | | 80,000 | By, Sales (₹ 6,80,000 - ₹ 30,000) | | 6,50,000 |
| `` Purchases | 4,60,000 | | `` Closing Stock | | 47,500 |
| Less: Drawings | 5,000 | 4,55,000 | | | |
| `` Profit & Loss A/c. | | | | | |
| Gross Profit transferred | | 1,62,500 | | | |
| | | 6,97,500 | | | 6,97,500 |
| To, Salaries: | | 49,000 | By, Trading A/c. (Gross Profit) | | 1,62,500 |
| `` Rent | | 5,000 | `` Bank Interest | | 1,200 |
| `` Insurance | | 1,500 | `` Selling Commission (15% on ₹ 30,000) | | 4,500 |
| `` Audit Fees | | 1,000 | `` Discount Received | | 1,800 |
| `` Printing & Stationery | | 1,500 | | | |
| `` Miscellaneous Expenses | | 21,200 | | | |
| `` Discount Allowed | | 1,200 | | | |
| `` Travelling Expenses | | 6,500 | | | |
| `` Depreciation: | | | | | |
| Machinery | 37,500 | | | | |
| Furniture | 5,000 | 42,500 | | | |
| `` Capital Account (Net Profit transferred) | | 40,600 | | | |
| | | 1,70,000 | | | 1,70,000 |

**Balance Sheet
as at 31st March, 2013**

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|--------------------------------------|---------------|---------------|------------------------|-----------------------|---------------|
| Capital Account | 2,45,750 | | Machinery | 2,50,000 ¹ | |
| Add: Net Profit | 40,600 | | Less: Depreciation | 37,500 | 2,12,500 |
| | 2,86,350 | | | | |
| Less: Drawings (28,000+5,000) | 33,000 | 2,53,350 | Furniture | 50,000 ² | |
| | | | Less: Depreciation | 5,000 | 45,000 |
| Sundry Creditors | | 82,000 | Stock | | 47,500 |
| Outstanding Liabilities: | | | Debtors (38,000-5,600) | | 32,400 |
| Salaries | 1,500 | | Cash | | 7,800 |
| Audit Fees | 1,000 | | Bank | | 18,500 |
| Printing | 600 | 3,100 | Prepaid Insurance | | 250 |
| Thakurlal's A/c. (30,000 - 4,500) | | 25,500 | | | |
| | | 3,63,950 | | | 3,63,950 |

Notes:

| | | ₹ |
|----|--|----------|
| 1. | Machinery as per Trial Balance | 1,70,000 |
| | Add: Depreciation | 30,000 |
| | | 2,00,000 |
| | Additions | 50,000 |
| | | 2,50,000 |
| 2. | Furniture | 49,500 |
| | Add: Depreciation | 5,500 |
| | | 55,000 |
| | Less: Wrong Debit | 5,000 |
| 3. | Suspense A/c. is eliminated by item | 50,000 |
| | (i) ₹ 45,000 (50,000 – 5,000) and item | |
| | (ii) by 5,600 (debited), respectively. | |

Illustration 9.

The following Trail Balance has been extracted from the books of Mr. Agarwal as on 31.3.2013:

Trial Balance as on 31.3.2013

| Particulars | Dr. (₹) | Particulars | Cr. (₹) |
|-------------------------|------------|----------------------|------------|
| Purchase | 6,80,000 | Sales | 8,38,200 |
| Sundry Debtors | 96,000 | Capital Account | 1,97,000 |
| Drawings | 36,000 | Sundry Creditors | 1,14,000 |
| Bad Debts | 2,000 | Outstanding Salary | 2,500 |
| Furniture & Fixtures | 81,000 | Sale of Old Papers | 1,500 |
| Office Equipments | 54,000 | Bank Overdraft (UBI) | 60,000 |
| Salaries | 24,000 | | |
| Advanced Salary | 1,500 | | |
| Carriage Inward | 6,500 | | |
| Miscellaneous Expenses | 12,000 | | |
| Travelling Expenses | 6,500 | | |
| Stationery & Printing | 1,500 | | |
| Rent | 18,000 | | |
| Electricity & Telephone | 6,800 | | |
| Cash In Hand | 5,900 | | |
| Cash at Bank (SBI) | 53,000 | | |
| Stock (1.4.2012) | 50,000 | | |
| Repairs | 7,500 | | |
| Motor Car | 56,000 | | |
| Depreciation: | | | |
| Furniture | 9,000 | | |
| Office Equipment | 6,000 | | |
| | 15,000 | | |
| | 12,13,200 | | 12,13,200 |

Additional Information:

- (i) Sales includes ₹ 60,000 towards goods for cash on account of a joint venture with Mr. Reddy who incurred ₹ 800 as forwarding expenses. The joint venture earned a profit of ₹ 15,000 to which Mr. Reddy is entitled to 60%
- (ii) The motor car account represents an old motor car which was replaced on 1.4.2012 by a new motor car costing ₹ 1,20,000 with an additional cash payment of ₹ 40,000 laying debited to Purchase Account.



- (iii) UBI has allowed an overdraft limit against hypothecation of stocks keeping a margin of 20%. The present balance is the maximum as permitted by the Bank.
- (iv) Sundry Debtors include ₹ 4,000 as due from Mr. Trivedi and Sundry Creditors include ₹ 7,000 as payable to him.
- (v) On 31.3.2013 outstanding rent amounted to ₹ 6,000 and you are informed that 50% of the total rent is attributable towards Agarwal's resident.
- (vi) Depreciation to be provided on motor car @ 20% (excluding sold item).

Mr. Agarwal requests you to prepare a Trading and Profit & Loss Account for the year ended 31.3.2013 and a Balance Sheet as on that date.

Solution.

**In the books of Mr. Agarwal
Trading and Profit and Loss Account
for the year ended 31st March, 2013**

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|---|---------------|---------------|--|---------------|---------------|
| To, Opening Stock | | 50,000 | By, Sales | 8,38,200 | |
| `` Purchases | 6,80,000 | | Less: Sale on account of Joint Venture | 60,000 | 7,78,200 |
| Less: Motor Car | 40,000 | 6,40,000 | `` Closing Stock (W.N. 1) | | 75,000 |
| `` Carriage Inward | | 6,500 | | | |
| `` Profit & Loss A/c -Gross Profit transferred | | 1,56,700 | | | |
| | | 8,53,200 | | | 8,53,200 |
| To, Salaries | | 24,000 | By, Trading A/c. | | |
| `` Travelling Expenses | | 6,500 | -Gross Profit transferred | | 1,56,700 |
| `` Printing & Stationery | | 1,500 | `` Sale of old papers | | 1,500 |
| `` Electricity & Telephone | | 6,800 | `` Profit on Joint Venture (40% of ₹ 15,000) | | 6,000 |
| `` Rent | 18,000 | | `` Profit on replacement of Motor Car (W. N. 2) [(1,20,000-(56,000+40,000))] | | 24,000 |
| Add: Outstanding | 6,000 | | | | |
| | 24,000 | | | | |
| Less: Drawings | 12,000 | 12,000 | | | |
| `` Bad Debts | | 2,000 | | | |
| `` Miscellaneous Expenses | | 12,000 | | | |
| `` Repairs | | 7,500 | | | |
| `` Depreciation on: | | | | | |
| Furniture | 9,000 | | | | |
| Office Equipment | 6,000 | | | | |
| Motor Car (W.N. 3) | 24,000 | 39,000 | | | |
| `` Capital Account - Net Profit transferred | | 76,900 | | | |
| | | 1,88,200 | | | 1,88,200 |

Balance Sheet
as at 31st March, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|---|------------|------------|------------------------|------------|------------|
| Capital Account | 1,97,000 | | Furniture & Fixtures | 90,000 | |
| Add: Net Profit | 76,900 | | Less: Depreciation | 9,000 | |
| | 2,73,900 | | | | 81,000 |
| Less: Drawings (36,000+12,000) | 48,000 | | Office Equipment | 60,000 | |
| | | 2,25,900 | Less: Depreciation | 6,000 | |
| Bank Overdraft | | 60,000 | | | 54,000 |
| Creditors | 1,14,000 | | Motor Car | 56,000 | |
| Less: Due to Trivedi | 4,000 | | Additions | 1,20,000 | |
| | | 1,10,000 | | 1,76,000 | |
| | | | Less: Sold | 56,000 | |
| | | | | 1,20,000 | |
| Amount payable to Reddy (60,000 - 6,000) | | 54,000 | Less: Depreciation | 24,000 | |
| Outstanding Liabilities: | | | | | 96,000 |
| Salaries | 2,500 | | Stock | | 75,000 |
| Rent | 6,000 | | Debtors | 96,000 | |
| | | 8,500 | Less: Due from Trivedi | 4,000 | |
| | | | | | 92,000 |
| | | | Cash | | 5,900 |
| | | | Bank | | 53,000 |
| | | | Prepaid Salary | | 1,500 |
| | | 4,58,400 | | | 4,58,400 |

Workings1. **Depreciation on Motor Car**

on new motor car i.e., @ 20% on ₹ 1,20,000 = ₹ 24,000

2. **Profit on Replacement of Motor Car**

| | | |
|------------------------------|---------------|---------------|
| | | ₹ |
| Cost of new Motor Car | | 1,20,000 |
| Less: Exchange Value | 56,000 | |
| Cash Payment | 40,000 | |
| Profit on replacement | 24,000 | 96,000 |

3. **Closing Stock**

Maximum allowable limit (100 – 20)% = 80% of stock.

Overdraft is ₹ 60,000 which is equal to 80%.

$$\begin{aligned} \text{So, closing stock} &= ₹ 60,000 \times \frac{100}{80} \\ &= ₹ 75,000. \end{aligned}$$



FINAL ACCOUNTS OF PARTNERSHIP FIRM

Illustration 10.

From the following particulars prepare a Final Accounts of M/s. X & Y for the year ended 31st March 2013.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|------------------|------------|------------------|------------|
| Sales | 8,20,000 | Land | 11,000 |
| Opening Stock | 3,00,000 | Purchase | 3,80,000 |
| Loan (Dr.) | 20,000 | Interest (Cr.) | 1,000 |
| Wages | 60,000 | Salaries | 40,000 |
| Carriage Inwards | 4,000 | Carriage Outward | 2,000 |
| Returns inward | 4,000 | Returns Outwards | 3,000 |
| Furniture | 10,000 | Trade charges | 8,000 |
| Drawings | | Capital | |
| – X | 12,000 | – X | 24,000 |
| – Y | 10,000 | – Y | 16,000 |
| Cash | 3,000 | | |

Additional Information:

- (i) Closing Stock amounted to ₹ 1,20,000;
 - (ii) Provide Interest on drawings (on an average 6 months) and interest on capital @ 6% and 4% respectively.
 - (iii) Y is to get a salary of ₹ 400 p.m.
 - (iv) X is to get a commissions @ 2% on gross sales
 - (v) 50% of the profit is to be transferred to Reserve Fund.
 - (vi) Depreciations on furniture @ 10% p.a.
- The partners share profit and loss equally.

Solution:

In the books of M/s. X & Y

Dr. **Trading and Profit and Loss Account for the year ended 31st March, 2013** Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|----------------------------|------------|------------|----------------------|------------|------------|
| To, Opening Stock | | 3,00,000 | By, Sales | 8,20,000 | |
| `` Purchases | 3,80,000 | | Less: Return Inwards | 4,000 | 8,16,000 |
| Less: Returns Outwards | 3,000 | 3,77,000 | `` Closing Stock | | 1,20,000 |
| `` Wages | | 60,000 | | | |
| `` Carriage Inward | | 4,000 | | | |
| `` Profit & Loss A/c | | | | | |
| -Gross Profit transferred | | 1,95,000 | | | |
| | | 9,36,000 | | | 9,36,000 |
| To, Salaries | | 40,000 | By, Trading A/c. | | |
| `` Carriage Outward | | 2,000 | - Gross Profit | | 1,95,000 |
| `` Trade Charges | | 8,000 | `` Interest | | 1,000 |
| `` Depreciation on: | | | | | |
| - Furniture | | 1,000 | | | |
| To, P&L Appropriation A/c. | | | | | |
| - Net Profit transferred | | 1,45,000 | | | |
| | | 1,96,000 | | | 1,96,000 |

| Profit and Loss Appropriation Account for the year ended 31st March, 2013 | | | | | |
|---|---------------|---------------|---------------------------|---------------|---------------|
| Dr. | | | Cr. | | |
| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
| To, Interest on Capital | | | By, Profit and Loss A/c | | 1,45,000 |
| X: | 960 | | -Net Profit | | |
| Y: | 640 | 1,600 | By, Interest on Drawings: | | |
| To, Salary | | | X: | 360 | |
| Y: | | 4,800 | Y: | 300 | 660 |
| To, Commission – X | | 16,400 | | | |
| `` Reserve Fund (50%) | | 61,430 | | | |
| `` Net Divisible Profit | | | | | |
| X: | 30,715 | | | | |
| Y: | 30,715 | | | | |
| | | 61,430 | | | |
| | | 1,45,660 | | | 1,45,660 |

Capital Account

| Capital Account | | | | | |
|-------------------------|----------|----------|------------------------|----------|----------|
| Dr. | | | Cr. | | |
| Particulars | X (₹) | Y (₹) | Particulars | X (₹) | Y (₹) |
| To, Drawings | 12,000 | 10,000 | By, Balance b/d. | 24,000 | 16,000 |
| `` Interest on Drawings | 360 | 300 | `` Interest on Capital | 960 | 640 |
| `` Balance c/d. | 59,715 | 41,855 | `` Salary | --- | 4,800 |
| | | | `` Commission | 16,400 | --- |
| | | | `` Share of Profit | 30,715 | 30,715 |
| | 72,075 | 52,155 | | 72,075 | 52,155 |

**Balance Sheet
as at 31st March, 2013**

| Liabilities | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|--------------|------------|--------------------|------------|------------|
| Capital : | | Land | | 11,000 |
| X | 59,715 | Furniture | 10,000 | |
| Y | 41,855 | Less: Depreciation | 1,000 | 9,000 |
| Reserve Fund | 61,430 | Loan | | 20,000 |
| | | Closing Stock | | 1,20,000 |
| | | Cash | | 3,000 |
| | 1,63,000 | | | 1,63,000 |

Profit and Loss A/c Dr.
To Provision for Doubtful debts A/c

(ii) If Closing Balance is less than opening provision -

Provision for Doubtful Debts A/c Dr.
To Profit and Loss A/c

Illustration 11.

Prepare Bad Debts Accounts, Provision for Bad Debts Accounts under each of the above methods from the following information and also the Profit and Loss Account and Balance sheet:-

| | | |
|------------|-------------------------|------------|
| 01.01.2012 | Provision for Bad Debts | ₹ 5,000 |
| 31.12.2012 | Bad Debts written off | ₹ 3,000 |
| | Sundry Debtors | ₹ 1,25,000 |
| 31.12.2013 | Bad Debts written off | ₹ 2,500 |
| | Sundry Debtors | ₹ 1,00,000 |

Provision for Doubtful debts to be provided for @ 5% for 2012 and 2.5% for 2013.

Solution: First Method

**In the Books of
Bad Debts Account**

| Dr. | | | Cr. | | |
|------------|------------------------|------------|------------|-------------------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 31.12.2012 | To, Sundry Debtors A/c | 3,000 | 31.12.2012 | By, Profit and Loss A/c | 3,000 |
| | | 3,000 | | | 3,000 |
| 31.12.2013 | To, Sundry Debtors A/c | 2,500 | 31.12.2013 | By, Profit and Loss A/c | 2,500 |
| | | 2,500 | | | 2,500 |

| Dr. | | | Cr. | | |
|--|---|----------------|------------|--------------------------------|------------|
| Provision for Bad Debts Account | | | | | |
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 31.12.2012 | To, Balance c/d (5% on ₹1,25,000) | 6,250 | 01.01.2012 | By, Balance b/d | 5,000 |
| | | 6,250 | 31.12.2012 | "Profit and Loss A/c (Bal Trf) | 1,250 |
| | | | | | 6,250 |
| 31.12.2013 | To, Profit and Loss A/c "Balance c/d (2.5% on 1,00,000) | 3,750 2,500 | 01.01.2013 | By, Balance b/d | 6,250 |
| | | 6,250 | | | 6,250 |

| Dr. Profit and Loss Account (Extract) for the year ended 31 st Dec, 2012 | | | | | Cr. |
|---|--------------------------|-------|-------------|--|-----|
| Particulars | | (₹) | Particulars | | (₹) |
| To | Bad Debts A/c | | | | |
| " | Provision for Bad Debts | 6,250 | | | |
| | Less: Existing Provision | 5,000 | | | |
| | | | | | |

| Dr. Profit and Loss Account (Extract) for the year ended 31 st Dec., 2013 | | | | Cr. | |
|--|---------------|-------|-----------------------------|-------|-------|
| Particulars | | (₹) | Particulars | | (₹) |
| To | Bad Debts A/c | 2,500 | By, Provision for Bad Debts | 6,250 | |
| | | | Less: Existing Provision | 2,500 | |
| | | | | | 2,750 |

Balance Sheet (Extract) as at 31st December, 2012

| Liabilities | | (₹) | (₹) | Assets | | (₹) | (₹) |
|-------------|--|-----|-----|------------------|----------|-----|----------|
| | | | | Debtors | 1,25,000 | | |
| | | | | Less : Bad debts | 6,250 | | 1,18,750 |
| | | | | | | | |



Balance Sheet (Extract) as at 31st December, 2013

| Liabilities | (₹) | (₹) | Assets | (₹) | (₹) |
|-------------|-----|-----|------------------|----------|--------|
| | | | Debtors | 1,00,000 | |
| | | | Less : Bad debts | 2,500 | 97,500 |
| | | | | | |

Second Method

Dr. Bad Debts Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-----------------|------------------------|------------|-----------------|--|------------|
| 2012 Dec. 31 | To, Sundry Debtors A/c | 3,000 | 2012 Dec. 31 | By, Provision for Bad Debts A/c - Transfer | 3,000 |
| | | 3,000 | | | 3,000 |
| 2013 Dec. 31 | To, Sundry Debtors A/c | 2,500 | 2013 Dec. 31 | By, Provision for Bad Debts A/c - Transfer | 2,500 |
| | | 2,500 | | | 2,500 |

Dr. Provision for Bad Debts Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-----------------|------------------------------------|------------|-----------------|--------------------------------|------------|
| 2012 Dec. 31 | To, Bad Debts A/c | 3,000 | 2012 Jan. 1 | By, Balance b/d | 5,000 |
| | "Balance c/d (5% on ₹1,25,000) | 6,250 | 2012 Dec. 31 | "Profit and Loss A/c (Bal fig) | 4,250 |
| | | 9,250 | | | 9,250 |
| 2013 Dec. 31 | To, Bad debts A/c | 2,500 | 2013 Jan.1 | By, Balance b/d | 6,250 |
| | "Profit and Loss A/c | 1,250 | | | |
| | "Balance c/d (2.5% on 1,00,000) | 2,500 | | | |
| | | 6,250 | | | 6,250 |

Profit and Loss Account (Extract)

Dr. For the year ended 31st December, 2012 Cr.

| Particulars | (₹) | (₹) | Particulars | (₹) |
|-----------------------------|-------|-------|-------------|-----|
| To Bad Debts | | 3,000 | | |
| To Provision for Bad Debts: | | | | |
| — New | 6,250 | | | |
| Less: Old | 5,000 | 1,250 | | |
| | | 4,250 | | |

Profit and Loss Account (Extract)

Dr. For the year ended 31st Dec, 2013 Cr.

| Particulars | (₹) | Particulars | (₹) | (₹) |
|-------------------|-------|-----------------------------|-------|-------|
| To Bad Debts A/c. | 2,500 | By, Provision for Bad Debts | 6,250 | |
| | | Less: Provision required | 2,500 | 3,750 |
| | | | | |

The Balance Sheet under this method will be similar to the First Method stated above.

Illustration 12.

On 01.01.2013 the balance of Provision for doubtful debts was ₹ 5,000. The Bad Debts during the year were ₹900. The Sundry Debtors as on 31.12.2013 stood at ₹ 40,400 out of these debtors of ₹ 400 are bad and cannot be realized. The Provision for Doubtful Debts is to be raised to 5% on Sundry Debtors. Show the necessary ledger accounts and the balance sheet.

Solution:**In the Books of****Dr. Bad Debts Account Cr.**

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------------|------------------------|------------|----------------|---------------------------------|------------|
| 2013 Dec 31 | To, Balance b/d | 900 | 2013 Dec 31 | By, Provision for Bad debts A/c | 1,300 |
| " | To, Sundry Debtors A/c | 400 | | | |
| | | 1,300 | | | 1,300 |

Dr. Provision for Bad Debts Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------------|---|------------|---------------|-----------------|------------|
| 2013 Dec 31 | To, Bad Debts A/c | 1,300 | 2013 Jan 1 | By, Balance b/d | 5,000 |
| " | To, Profit and Loss A/c | 1,700 | | | |
| " | To, Balance c/d [5% on (40,400-400)] | 2,000 | | | |
| | | 5,000 | | | 5,000 |

Dr. Sundry Debtors Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------------|-----------------|------------|----------------|-------------------|------------|
| 2013 Dec 31 | To, Balance b/d | 40,400 | 2013 Dec 31 | By, Bad debts A/c | 400 |
| | | | " | By Balance c/d | 40,000 |
| | | 40,400 | | | 40,400 |

**Profit and Loss Account (Extract)
For the year ended 31st Dec, 2013****Dr. Cr.**

| Particulars | (₹) | Particulars | (₹) |
|-----------------------------------|-------|----------------------------------|-------|
| To Bad Debts A/c. 900 | | By, Provision for Bad Debts A/c | |
| Add: Further Bad Debts <u>400</u> | 1,300 | Existing Provision 5,000 | 3,000 |
| | | Less: New Provision <u>2,000</u> | |
| | | | |

**Balance Sheet (Extract)
As at 31st December, 2013**

| Liabilities | (₹) | (₹) | Assets | (₹) | (₹) |
|-------------|-----|-----|-------------------------------|--------|--------|
| | | | Debtors | 40,400 | |
| | | | Less : Bad debts | 400 | |
| | | | | 40,000 | |
| | | | Less: Provision for Bad debts | 2,000 | 38,000 |
| | | | | | |

Solution:

In the books of

Dr. Provision for Bad Debt Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-----------|---|------------|-----------|--|------------|
| 31-3-2013 | To, Bad Debts A/c | 4,200 | 1-4-2012 | By, Balance b/d | 6,500 |
| 31-3-2013 | " Balance c/d (4% on ₹1,95,000-₹4,200 or ₹1,90,800) | 7,632 | 31-3-2013 | " Profit & Loss A/c -further provision required | 5,332 |
| | | 11,832 | | | 11,832 |

Dr. Provision for Discount on Debtors Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-----------|--|------------|-----------|--|------------|
| 31-3-2013 | To, Balance c/d [2% on (₹1,95,000-₹4,200 - ₹ 7,632)] | 3,663 | 1-4-2012 | By, Balance b/d | — |
| | | 3,663 | 31-3-2013 | " Profit & Loss A/c -further provision required | 3,663 |
| | | | | | 3,663 |

Illustration 14.

A company maintains its reserve for bad debts @ 5% and a reserve for discount on debtors @ 2%.

You are given the following details :

| | 2012 (₹) | 2013 (₹) |
|------------------|-------------|-------------|
| Bad debts | 800 | 1,500 |
| Discount allowed | 1,200 | 500 |

Sundry debtors (before providing all bad debts and discounts) amounted to ₹ 60,000 on 31.12.2012 and ₹ 42,000 on 31.12.2013.

On 1.1.2012, Reserve for bad debts and Reserve of discount on debtors had balance of ₹ 4,550 and ₹ 800 respectively.

Show Reserve for Bad Debts and Reserve for Discount on Debtors Account.

Solution.

In the books of

Dr. Reserve for Bad Debts Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|------------|--|------------|------------|--|------------|
| 31-12-2012 | To, Bad Debts A/c. | 800 | 1-1-2012 | By, Balance b/d | 4,550 |
| 31-12-2012 | To, Profit and Loss A/c. (provision found excess) | 850 | | | |
| 31-12-2012 | To, Balance c/d (5% on ₹ 58,000) | 2,900 | | | |
| | | 4,550 | | | 4,550 |
| 31-12-2013 | To, Bad Debt A/c. | 1,500 | 1-1-2013 | By, Balance b/d | 2,900 |
| | To, Balance c/d (5% on ₹ 40,000) | 2,000 | 31-12-2013 | By, Profit and Loss A/c. (for the provision required) | 600 |
| | | 3,500 | | | 3,500 |



Dr. Reserve for Discount on Debtors Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|------------|--|------------|------------|--|------------|
| 31-12-2012 | To, Discount Allowed A/c. | 1,200 | 1-1-2012 | By, Balance b/d | 800 |
| 31-12-2012 | To Balance c/d (2% on ₹ 58,000-₹ 2,900) | 1,102 | 31-12-2013 | " Profit & Loss A/c -further provision required | 1,502 |
| | | 2,302 | | | 2,302 |
| 31-12-2013 | To, Discount Allowed A/c. | 500 | 1-1-2013 | By, Balance b/d | 1,102 |
| 31-12-2013 | To Balance c/d (2% on ₹ 40,000-₹ 2,000) | 760 | 31-12-2013 | " Profit & Loss A/c -further provision required | 158 |
| | | 1,260 | | | 1,260 |

Recovery of Bad Debts

We know that bad debt is a loss and as such, transferred to current year's Profit and Loss Account. Now, if the amount of bad debt is received in any succeeding year the same will be credited to Profit and Loss of that year as an income that is, recovery of bad debt is as income i.e., clear profit.

Accounting Steps

(a) When bad debts are recovered

Cash/Bank A/c. Dr.
To Bad Debts Recovery A/c.

(b) When the same is transferred

Bad Debts Recovery A/c. Dr.
To Profit & Loss A/c.

Illustration 15.

On 31.12.2012, Sundry Debtors and Provision for Doubtful Debts are ₹ 50,000 and ₹ 5,000 respectively. During the year 2013, ₹ 3,000 are bad and written off on 30.9.2013, an amount of ₹ 400 was received on account of a debt which was written off as bad last year on 31.12.2013, the debtors left was verified and it was found that sundry debtors stood in the books were ₹ 40,000 out of which a customer Mr. X who owed ₹ 800 was to be written off as bad.

Prepare Bad Debt A/c. Provision for Doubtful A/c. assuming that some percentage should be maintained for provision for Doubtful debt as it was on 31.12.2012.

Show also how the illustration appear in Profit & Loss A/c. and Balance Sheet.

Solution:

In the books of

Dr. Bad Debt Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|------------------|------------------------|------------|-----------------|--------------------------------|------------|
| 2013 Sept. 30 | To, Sundry Debtors A/c | 3,000 | 2013 Dec. 31 | By, Provision for Bad Debt A/c | 3,800 |
| Dec. 31 | To, X A/c. | 800 | | | |
| | | 3,800 | | | 3,800 |

Dr. Provision for Doubtful Debt Account Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|-----------------|--|------------|-----------------|--|------------|
| 2013 Dec. 31 | To, Bad Debt A/c | 3,800 | 2013 Dec. 31 | By, Balance b/d | 5,000 |
| | " Balance c/d [10% on ₹ 39,200 (₹ 40,000 - ₹ 800)] | 3,920 | | " Profit & Loss A/c -for the provision required | 2,720 |
| | | 7,720 | | | 7,720 |

Workings : Calculation of '%' of Provision for bad debts —
 $(5,000/50,000 \times 100) = 10\%$

Profit & Loss Account (Extract)

For the year ended 31.12.2012

Dr.

Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|---------------|------------|------------|--|------------|------------|
| To, Bad Debts | | 3,400 | By Bad Debts Recovery A/c | | 400 |
| | | | " Provision for Bad Debts: Existing | 5,000 | |
| | | | Less: Provision Required | 3,920 | 1,080 |

Balance Sheet (Extract)

As at 31.12.2013

| Liabilities | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|-------------|------------|-------------------------------|------------|------------|
| | | Sundry Debtors | 40,000 | |
| | | Less: Bad Debts | 800 | |
| | | | 39,200 | |
| | | Less: Provision for Bad Debts | 3,920 | 35,280 |

SELF EXAMINATION QUESTIONS:

- At the year end, an amount outstanding for electricity consumed during that year will be dealt in the Accounts for the year by following the accounting concept of
 - Realisation
 - Accrual
 - Conservatism
 - None of the above
- Contingent Liability would appear
 - On the liability side
 - On the asset side
 - As a note in Balance Sheet
 - None of the above
- Bad debts Recovered ₹750. It will be
 - Credited to Bad debts A/c
 - Credited to debtor's personal A/c
 - Debited to creditor's personal A/c
 - Credited to bad debts recovered A/c
- When Sales = ₹1,80,000, Purchase = ₹1,60,000, Opening Stock = ₹34,000 and rate of the Gross Profit is 20% on cost, the Closing Stock would be
 - ₹50,000
 - ₹44,000
 - ₹46,000
 - None of the above

Answer:

| | | | |
|--------|--------|--------|--------|
| 1. (B) | 2. (C) | 3. (D) | 4. (B) |
|--------|--------|--------|--------|



State whether the following statement is True (or) False:

1. Advance payment of Tax is shown in the Liabilities side of Balance Sheet.
2. Inventory valuation affects only the income statement

QUESTIONS:

1. Prepare trading and profit and loss account for the year ended 31st December, 2014 from the following details:

| | ₹ | | ₹ |
|---------------------------|----------|-------------------------|--------|
| Purchase | 1,50,000 | Rent, rates and taxes | 2,450 |
| Sales | 2,70,000 | Interest received | 540 |
| Returns outward | 20,000 | Discount allowed | 600 |
| Returns inward | 30,000 | Discount received | 460 |
| Wages | 25,000 | Insurance charges | 500 |
| Salaries | 15,000 | Bad debts | 650 |
| Carriage inward | 3,000 | Trade expenses | 200 |
| Carriage outward | 2,000 | Advertisement | 900 |
| Duty and clearing charges | 500 | Depreciation : on plant | 1,250 |
| Factory rent | 2,500 | on furniture | 300 |
| Office rent | 1,500 | Stock on 1.1.14 | 37,000 |
| Fuel and power | 1,000 | Stock on 31.12.14 | 55,000 |
| Travelling and conveyance | 950 | | |

[Answer: Gross Profit ₹ 96,000, Net Profit ₹ 70,700.]

2. The following is the trial balance of Hari as on 31st March, 2014. You are requested to prepare the trading and profit and loss account for the year ended 31st March, 2014 and a balance sheet as on that date after making the necessary adjustments:

| | Dr. ₹ | Cr. ₹ |
|-----------------------------|----------|----------|
| Purchases | 3,10,000 | |
| Sales | | 4,20,000 |
| Discount on sales | 20,000 | |
| Stock of goods as on 1.4.13 | 50,000 | |
| Cash in hand | 2,100 | |
| Cash at bank | 12,000 | |
| Mr. Hari's capital | | 2,88,600 |
| Drawings | 4,000 | |
| Rates and taxes | 5,000 | |
| Salaries | 32,000 | |
| Postage and telephones | 11,500 | |
| Commission paid to salesmen | 35,000 | |
| Insurance | 9,000 | |
| Furniture and fittings | 22,000 | |
| Advertising | 17,000 | |

| | | |
|-------------------------|-----------------|-----------------|
| Printing and stationery | 3,000 | |
| Motor car | 48,000 | |
| Bad debts | 2,000 | |
| Cash discounts | 4,000 | |
| General expenses | 14,000 | |
| Carriage inwards | 22,000 | |
| Carriage outwards | 10,000 | |
| Wages | 20,000 | |
| Sundry creditors | | 40,000 |
| Sundry debtors | 96,000 | |
| | 7,48,600 | 7,48,600 |

The following adjustments are to be made:

- (i) Stock on 31st March, 2014 was valued at ₹ 1,45,000.
- (ii) Mr. Hari has taken out for personal use goods costing ₹ 5,000 out of purchases during the year.
- (iii) Furniture purchased for ₹ 10,000 was wrongly included in purchases.
- (iv) ₹ 5,000 due from a debtor included in sundry debtors has become bad.
- (v) Creditors include a balance of ₹ 4,000 to the credit of Mr. Ram in respect of which it has been settled that only ₹ 1,000 is to be paid to him.
- (vi) Provision for bad debts to be created at 5% on sundry debtors.
- (vii) Depreciate furniture and fittings by 10% and motor car by 25%.
- (viii) The salesmen are entitled to a commission of 10% on sales.

[Answer: Gross Profit ₹1,58,000, Net Loss ₹11,250, Balance Sheet Total - ₹3,10,350]

3. From the following trial balance and information, prepare trading and profit and loss account of Mr. Rishabh for the year ended 31.3.14 and a balance sheet as on that date :

| | Dr. ₹ | Cr. ₹ |
|--|----------|----------|
| Capital | - | 1,00,000 |
| Drawings | 12,000 | - |
| Land and buildings | 90,000 | - |
| Plant and machinery | 20,000 | - |
| Furniture | 5,000 | — |
| Sales | — | 1,40,000 |
| Returns outward | — | 4,000 |
| Debtors | 18,400 | - |
| Loan from Gajanand on 1.7.13 @ 6% p.a. | — | 30,000 |
| Purchases | 80,000 | — |
| Returns inward | 5,000 | — |
| Carriage | 10,000 | - |
| Sundry expenses | 600 | - |
| Printing and stationery | 500 | — |
| Insurance expenses | 1,000 | - |
| Provision for bad and doubtful debts | — | 1,000 |

| | | |
|-----------------------------------|----------|----------|
| Provision for discount on debtors | — | 380 |
| Bad debts | 400 | — |
| Profit of textile department | - | 10,000 |
| Stock of general goods on 1.4.13 | 21,300 | - |
| Salaries and wages | 18,500 | - |
| Creditors | — | 12,000 |
| Trade expenses | 800 | - |
| Stock of textile goods on 31.3.14 | 8,000 | - |
| Cash at bank | 4,600 | — |
| Cash in hand | 1,280 | - |
| | 2,97,380 | 2,97,380 |

Information:

- (i) Stock of general goods on 31.3.14 valued at ₹ 27,300.
- (ii) Fire occurred on 23.3.14 and ₹ 10,000 worth of general goods were destroyed. The insurance company accepted claim for ₹ 6,000 only and paid the claim money on 10.4.14.
- (iii) Bad debts amounting to ₹ 400 are to be written off. Provision for bad and doubtful debts is to be made at 5% and for discount at 2% on debtors. Make a provision of 2% on creditors for discount.
- (iv) Received ₹ 6,000 worth of goods on 27.3.14 but the invoice of purchase was not recorded in purchases book.
- (v) Rishabh took away goods worth ₹ 2,000 for personal use but no record was made thereof.
- (vi) Charge depreciation at 2% on land and buildings, 20% on plant and machinery, and 5% on furniture.
- (vii) Insurance prepaid amounts to ₹ 200.

[Answer: Gross Profit ₹61,000, Net Loss ₹38,098, Balance Sheet Total - ₹1,73,088

Purchases — ₹(80,000 + 6,000) – ₹2,000 = ₹84,000]

4. On 1st April, 2013 the balance of provision for bad and doubtful debts was ₹ 13,000. The bad debts during the year 2013-14 were ₹ 9,500. The sundry debtors as on 31st March, 2014 stood at ₹ 3,25,000 out of these debtors of ₹ 2,500 are bad and cannot be realized. The provision for bad and doubtful debts is to be raised to 5% on sundry debtors.
 - (i) Pass necessary adjustment entries for bad debts and its provision on 31st March, 2014.
 - (ii) Prepare the necessary ledger accounts.
 - (iii) Show the relevant items in the profit and loss account and Balance Sheet.

**[Answer: Provision for Bad and Doubtful Debts as on 31st March, 2014 (as per P & L A/c) — ₹15,125,
Sundry Debtors as on 31st March, 2014 (as per Balance Sheet) — ₹3,06,375.]**

5. On 31st December, 2014 sundry debtors and provision for bad debts stood at ₹ 60,000 and ₹ 4,500 respectively. During the year 2015, bad debts amounting to ₹ 3,460 were written off. On 30th June, 2015 an amount of ₹ 240 was received on account of a debt written off as bad last year. The debtors list on 31st December, 2015 was verified and it was found that amongst sundry debtors amounting to ₹ 40,680, Sri Becharam who owed ₹ 680 was to be written off as bad. It was decided to maintain the provision for bad debts at the same percentage as it was on 31st December, 2014.

Prepare bad debts account and provision for bad debts account. Also show how the relevant items would appear in the profit and loss account and balance sheet.

**[Answer: Provision for Bad Debts as on 31st March, 2014 (as per P & L A/c) — ₹2,400,
Sundry Debtors as on 31st March, 2014 (as per Balance Sheet) — ₹37,000]**

Study Note - 4

PREPARATION OF FINANCIAL STATEMENTS OF NOT-FOR PROFIT ORGANIZATIONS



This Study Note includes

4.1 Preparation of Financial Statements of Not-for Profit Organizations

4.1 PREPARATION OF FINANCIAL STATEMENTS OF NOT-FOR PROFIT ORGANIZATIONS

Until now, we have seen accounting treatment for business transaction of business entities whose main objective is to earn profit. There are certain organisations that are not established for making profit but to provide some service. These services are generally given to members who make subscriptions to avail them. These are also called as non-trading entities. The examples of such organisations are:

Gymkhana / sports clubs; Educational institutions; Public hospitals; Libraries; Cultural clubs like Rotary or Lions club; Religious institutions; Charitable trusts

These organisations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc. The accounting of such organisations is based on similar principles followed by the other organisations. Given the nature of these institutions, there are certain items of revenue and expenses that need special understanding so that accounting treatment could be correctly decided.

Special Items

There are certain items of revenue and expenses that are unique for the non-trading entities. They could be listed as:

| Revenue items | Expenditure items |
|-----------------|---------------------|
| Donations | Upkeep of grounds |
| Entrance fees | Tournament expenses |
| Subscriptions | Prizes |
| Grants received | Events |

Let us see what accounting treatment should be given to some of the special items:

- Entrance Fees – These are received at the time of admission of a new member and thus are one-time fees. They are non-recurring in nature. It could be either capitalized as they are non-recurring or taken as revenue as per the rules of the institution. There's a view that addition of member is an ongoing activity and thus every year the institute will get entrance fees. So it may be taken as a normal revenue receipt.
- Donations – They could be used for meeting capital or revenue expenses. If donations are received for a special purpose, the amount is credited to a fund from which the amounts are disbursed. The fund may be invested in specified securities. Income from such investments is credited to the fund A/c only. Small donation amounts which are not earmarked for any specific purpose may be treated as revenue receipts.
- Legacy – Many times trusts are formed in the memory of certain persons by their will. In such case after the demise of the person, the funds pass on to the institution. Such legacies are of course one-time and therefore should be taken to the capital fund.
- Endowments – Sometimes, donations are also in the form of endowments to be used as per instructions of the donor. These are to be treated as capital receipts.
- Life membership fees – These could be taken as capital receipts and every year a charge is debited based on some logic. In other words, when received, it could be treated as deferred receipt in the balance sheet and every year a specific amount is credited to I & E A/c.
- Subscriptions – These are annual receipts and therefore taken as revenue receipts. These must be recognised as revenue on the accrual concept.

Financial Statements

These non-profit organisations prepare:-

Receipt and Payment Account – This is similar to cash book. Entries are made on cash basis and items pertaining to previous year or current year or subsequent years are also recorded. Receipts are shown on debit side and payments are shown on credit side. Capital as well as revenue items are entered in the R & P A/c. This account is real account in nature. No provisions are recorded in this account. The account has an opening and a closing balance which is reflected as an asset in the balance sheet.

Features of Receipts and Payments Account

1. It is an Account which contains all Cash and Bank transactions made by a nonprofit organization during a particular financial period.
2. It starts with the opening balances of Cash and Bank. All Cash Receipts both capital & revenue during the period are debited to it.
3. All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
4. While recording the Cash and Bank transactions all entries are made on Cash Basis.
5. It is a summary of Cash Book.
6. It follows Real Account.

Income and Expenditure Account – This is similar to the Profit and loss A/c and is prepared exactly based on same principles. As the name suggests only revenue items are recorded herein. Incomes are recorded on the credit side while the expenses on the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are pertaining to current period. Previous and subsequent year items are to be excluded. This account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called as deficit.

Features of Income and Expenditure Account

1. It follows Nominal Account.
2. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
3. Similarly all revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital incomes and Expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Balance Sheet – It is prepared as on the last day of the accounting period. It also has assets and liabilities and prepared based on accounting equation. But, there's no capital account. Instead there is a capital fund. The surplus or deficit from Income & Expenditure A/c is adjusted against this capital fund at the end of the year.

Receipt and Payment Account

| Receipts | Amount (₹) | Payments | Amount (₹) |
|---|------------|---|------------|
| Starts with opening balance | | | |
| All receipts - capital or revenue | | All payments - Capital or revenue | |
| May be related to any period previous, current or subsequent. | | May be related to any period previous, current or subsequent. | |
| | | Ends with closing balance | |



Income and Expenditure Account

| Expenses | Amount (₹) | Income | Amount (₹) |
|--------------------------------|------------|--------------------------------|------------|
| Only revenue expenses | | Only revenue receipts | |
| Only related to current period | | Only related to current period | |
| Shows either surplus | | Or shows deficit | |

Difference between Receipts and Payments Account and Income and Expenditure Account

| | Receipts & Payments Account | Income & Expenditure Account |
|-----|---|---|
| 1. | It is a summarised Cash Book | It closely resembles the Profit & Loss Account of a Trading concern. |
| 2. | Receipts are debited and Payments are credited. | Incomes are credited and Expenditures are debited. |
| 3. | Transactions are recorded on Cash basis. | Transactions are recorded on Accrual Basis |
| 4. | Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded. | Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added. |
| 5. | It records both Capital and Revenue transactions. | It records Revenue transactions only. |
| 6. | It serves the purpose of a Real Account. | It serves the purpose of a Nominal Account. |
| 7. | It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances. | It does not record such balances, rather its final balance shows a surplus or a deficit for the period. |
| 8. | It does not record notional loss or noncash expenses like bad debts, depreciations etc. | It considers all such expenses for matching against revenues |
| 9. | Its closing balance is carried forward to the same account of the next accounting Period. | Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet. |
| 10. | It helps to prepare an Income & Expenditure A/c. | It helps to prepare a Balance Sheet. |

Fund Asset Accounting and its peculiarities:

Following are the concepts of some funds which are generally maintained by organizations:

- (i) **Capital Fund** : It is also called "General Fund" or "Accumulated Fund." It is actually the Capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually "Surplus" or "Deficit" during a period is added with or deducted from it. A portion of Capitalised incomes like donations may be added with it.
- (ii) **Special Fund**: It may be created out of special donation or subscription or out of a portion of the "Surplus". For example a club may have a "Building Fund". It may be used for meeting some specific expenses or for acquiring an asset. If any income is derived out of investments made against this fund or if any profit or loss occurs due to sale of such investments, such income or profit or loss is transferred to this fund.

Other Treatments

(a) If the Special Fund is used to meet an expense

Special Fund A/c Dr.

To Bank A/c (amt. of expense)

The balance of the Fund is shown as a liability.

If the balance is transferred to Capital Fund, the entry will be—

Special Fund A/c Dr.

To Capital Fund A/c (Balance of Special Fund)

(b) If the Special Fund is used to purchase an asset

Asset A/c Dr.
 To Bank A/c (Cost of the asset)
 Special Fund A/c Dr.
 To Capital Fund A/c (Special Fund closed)

(iii) Donations

- (a) Donation received for a particular purpose should be credited to Special Fund. For example, Donation received for Building should be credited to Building Fund A/c.
- (b) For other donations received the by-laws or rules of the concern should be followed.
- (c) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund. Recurring donations received should be credited to Income & Expenditure Account.
- (d) Donation paid by the concern should be debited to Income & Expenditure Account.

(iv) Legacy received : It is to be directly added with Capital Fund after deduction of tax,(if any). It is a kind of donation received according to the will made by a deceased person.

(v) Entrance Fees or Admission Fees

- (a) The rules or by-laws of the concern should be followed.
- (b) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.
- (c) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

(vi) Subscriptions

- (a) Annual subscriptions are credited to Income & Expenditure Account on accrual basis.
- (b) Life membership subscription is usually credited to a separate account shown as a liability.

Annual Subscription apportioned out of that is credited to Income & Expenditure Account and deducted from the liability. Thus the balance is carried forward till the contribution by a member is fully exhausted. If any member dies before hand, the balance of his life Membership contribution is transferred to Capital Fund or General Fund.

Illustration 1.

On 31st December 2012, a club had subscription in arrears of ₹16,000 and in advance ₹4,000. During the year ended 31-12-2013, the club received subscription of ₹2,08,000 of which ₹10,400 was related to 2014. On 31st December 2012, there were 4 members who had not paid subscription for 2013 @ ₹1,600 per person. Write up subscription A/c for the year 2013.

Solution:

A single subscription account should be prepared to reflect both advance and arrears figures. The balancing figure will reflect the subscription amount that will be recognised as Income and transferred to I & E A/c as shown below:

| Dr. | | Subscription Account | | Cr. | |
|---------------------------------|------------|---------------------------|------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Balance b/d (arrears) | 16,000 | By, Balance b/d (advance) | 4,000 | | |
| To, I & E A/c (income for 2013) | 1,92,000 | By, R & P A/c (received) | 2,08,000 | | |
| To, Balance c/d (advance) | 10,400 | By, Balance c/d (arrears) | 6,400 | | |
| | 2,18,400 | | 2,18,400 | | |



Illustration 2.

The sports club of Orissa had received in 2012-2013 ₹ 2,000 towards subscription. Subscription for 2011-12 unpaid on 1.4.2012 were ₹ 200.

Subscriptions paid in advance on 31.3.2012 were ₹ 50 and the same on 31.3.2013 was ₹ 40. Subscriptions for 2012-2013 unpaid on 31.3.2013 were ₹ 90.

Show how the subscriptions item will appear in the Income and Expenditure Account.

Solution:

| Particulars | Amount (₹) |
|--|---------------|
| Subscriptions received during the year 2012-2013 | 2,000 |
| Add : Subscription outstanding on 31.3.2013 | <u>90</u> |
| | 2,090 |
| Less : Subscription outstanding on 1.4.2012 | <u>200</u> |
| | 1,890 |
| Add : Subscription paid in advance on 31.3.2012 | <u>50</u> |
| | 1,940 |
| Less : Subscription received in advance on 31.3.2013 | <u>40</u> |
| Subscription Income for 2012-2013 | 1,900 |

Illustration 3.

The amount of Subscription appears in the Income and Expenditure Account of South Indian Club is ₹ 3,000.

Adjustments were made in respect of the following:

Subscription for 2012 unpaid at 1st Jan. 2013, ₹ 400; ₹ 200 of which was received in 2013.

Subscription paid in advance at 1.1.2013 ₹ 100.

Subscription paid in advance at 31.12.2013 ₹ 80.

Subscription for 2013 unpaid at 31.12.2013 ₹ 140.

Prepare Subscription Account.

Solution:

| Dr. | | Subscription Account | | Cr. | |
|---------------------------------------|--------------|-----------------------------|--------------|-----|--|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To, Balance b/d | 400 | By, Balance b/d | 100 | | |
| To, Income & Expenditure A/c | 3,000 | By, Cash Received (bal fig) | 3,040 | | |
| To, Balance (paid in advance to 2013) | 80 | By, Balance c/d | 340 | | |
| | <u>3,480</u> | [200 + 140] | <u>3,480</u> | | |
| To, Balance b/d: | | By, Balance b/d (2013) | 80 | | |
| For 2012 | 200 | | | | |
| For 2013 | 140 | | | | |

Note: Opening Outstanding Subscription = ₹ 400, ₹ 200 received in 2013.

Illustration 4.

From the following information, prepare the Subscription Account for the year ending on March, 31, 2013

- (i) Subscription in arrears on 31.03.2012 ₹ 1,500
- (ii) Subscription received in advance on 31.03.2012 ₹ 1,000
- (iii) Amount of Subscription received during 2012-13 ₹ 40,000, which includes ₹500 for the year 2011-12, ₹ 1,500 for the year 2013-14.
- (iv) Subscription outstanding ₹ 1,000.

Solution:

| Dr. | Subscription Account | | Cr. |
|------------------------------|----------------------|-----------------|------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Balance b/d | 1,500 | By, Balance b/d | 1,000 |
| To, Income & Expenditure A/c | 39,500 | By, Bank A/c | 40,000 |
| | | By, Balance c/d | |
| | | For 2011-12 | 500 |
| To, Balance c/d | | For 2012-13 | 1,000 |
| For 2013-14 | 1,500 | | |
| | 42,500 | | 42,500 |

Illustration 5.

The accumulated balance of Life Membership fees at the beginning of the year 2012 was ₹6,40,000. This represents the balance of life membership fees paid by 20 members since the club started about 6 years ago. In the current year, 10 new life memberships were received totaling ₹ 4,00,000.

It's the policy of the club to spread these fees over 20 years to income. The amount payable per person is always ₹40,000.

What is the amount to be recognised as income for the current year and what amount will be deferred through the balance sheet?

Solution:**Income to be recognised for new members**

| | |
|-----------------------------------|-----------|
| Life membership fees per person | ₹40,000 |
| Income to be spread over | 20 years |
| Income to be recognised each year | ₹2,000 |
| Members added during the year | 10 |
| Income to be recognised (10×2000) | ₹20,000 |
| Amount to be carried forward | ₹3,80,000 |



Income to be recognised for old members

| | |
|--|----------------|
| No. of members | 20 |
| Income to be recognised each year | ₹2,000 |
| Income to be recognised (20×2000) | ₹40,000 |
| Total income to be recognised (20,000+40,000) | ₹60,000 |

Amount to be shown in the balance sheet

| | |
|--------------------------------------|-------------------------|
| Accumulated Balance | ₹6,40,000 |
| Add: New fees received | ₹4,00,000 |
| Less: Recognised as income | <u>(₹60,000)</u> |
| Balance to be carried forward | <u>₹9,80,000</u> |

Restaurant Trading and Bar Trading

Some clubs have Restaurant and Bar facilities for members and outsiders. Under the circumstances, Restaurant Trading or Bar Trading Account is opened to ascertain the Restaurant or Bar profit, it is just like Trading Account which is opened in case of a trading concern. The Restaurant or Bar profit so ascertained from Restaurant Trading or Bar Trading is transferred to the Income and Expenditure Account as we generally transfer the Gross Profit from Trading Account to Profit and Loss Account in case of Trading concern. Hence, the method of preparing a Restaurant or Bar Trading Account is just like the method of preparing a Trading Account.

Illustration 6.

The following summary of the Cash Book has been prepared by the treasurer of a club:

| Receipts | Amount (₹) | Payments | Amount (₹) |
|---------------------------------------|-----------------|--------------------------------------|-----------------|
| To Balance b/d | 4,740 | By Wages – outdoor staff | 13,380 |
| " Subscriptions | 29,720 | " Restaurant Purchase | 50,400 |
| " Entrance Fees | 3,200 | " Rent – 18 months' to July 30, 2013 | 7,500 |
| " Restaurant Receipts | 56,800 | " Rates | 2,700 |
| " Games & Competition Receipts | 13,640 | " Secretary's Salary | 3,120 |
| " Due to Secretary for Petty Expenses | 80 | " Lighting | 7,200 |
| | | " Competition Prizes | 4,000 |
| | | " Printing & Postage etc. | 6,000 |
| | | " Placed in Fixed Deposit | 8,000 |
| | | " Balance c/d | 5,880 |
| | 1,08,180 | | 1,08,180 |

On April 1, 2012 the club's assets were:- Furniture ₹ 48,000, Restaurant stock ₹ 2,600; Stock of prizes ₹ 800; ₹ 5,200 was owing for supplies to the restaurant.

On March, 31, 2013, the Restaurant stocks were ₹ 3,000 and prizes in hand were ₹ 500, while the club owed ₹ 5,600 for restaurant supplies.

It was also found that subscriptions unpaid at March 31, 2013, amounted to ₹ 1,000 and that the figure of ₹ 29,720 shown in the Cash Book included ₹ 700 in respect of previous year and ₹ 400 paid in advance for the following year.

Prepare an account showing the Profit or Loss made on the Restaurant and a General Income and Expenditure Account for the year ended 31.3.2013, together with a Balance Sheet as at that date, after writing 10% off the Furniture.

Solution:

Restaurant Trading Account
For the year ended 31st March, 2013

| Dr. | Amount (₹) | Amount (₹) | Cr. | Amount (₹) | Amount (₹) |
|--|---------------|---------------|----------------------------|---------------|---------------|
| To Opening Stock A/c | | 2,600 | By Restaurant Receipts A/c | | 56,800 |
| " Purchases A/c | 50,400 | | " Closing Stock A/c | | 3,000 |
| " Add: Outstanding for 31.3.13 | 5,600 | | | | |
| | 56,000 | | | | |
| Less: Outstanding for 01.04.12 | 5,200 | | | | |
| | | 50,800 | | | |
| " Income & Expenditure A/c (G.P. transferred) | | 6,400 | | | |
| | | 59,800 | | | 59,800 |

Balance Sheet
as at 1st April, 2012

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|---------------------------------------|---------------|---------------------------|---------------|
| Accumulated Fund: (bal. fig.) | 50,390 | Furniture and Equipment | 48,000 |
| Owing for supplies to Restaurant | 5,200 | Restaurant Stock | 2,600 |
| Outstanding Rent (Jan. to March 2012) | 1,250 | Stock of Prize | 800 |
| | | Outstanding Subscriptions | 700 |
| | | Cash and Bank | 4,740 |
| | 56,840 | | 56,840 |



Income and Expenditure Account
For the year ended 31st March, 2013

Dr.

Cr.

| Expenditure | Amount (₹) | Amount (₹) | Income | Amount (₹) | Amount (₹) |
|---|---------------|---------------|--|---------------|---------------|
| To Wages | | 13,380 | By Subscription : Subscription already received | 29,720 | |
| `` Rent | 7,500 | | Less: Outstanding for 1.4.12 | 700 | |
| `` Less: Outstanding on 1.4.2012 | 1,250 | | | 29,020 | |
| | 6,250 | | Add: Outstanding for 2013 | 1,000 | |
| `` Less: Prepaid for 3 months (7,500 x 3/18) | 1,250 | 5,000 | | 30,020 | |
| `` Rates | | 2,700 | Less: Received in advance | 400 | 29,620 |
| `` Secretary's Salary | | 3,120 | `` Games Competition Receipts | | 13,640 |
| `` Lighting, Cleaning, Services | | 7,200 | `` Restaurant Trading – Gross Profit | | 6,400 |
| `` Competition Prize | 4,000 | | | | |
| `` Add: Opening Stock | 800 | | | | |
| | 4,800 | | | | |
| `` Less: Closing Stock | 500 | 4,300 | | | |
| `` Printing, Postage and Sundries | | 6,000 | | | |
| `` Dep. on Furniture and Equipment @ 10% | | 4,800 | | | |
| `` Surplus – Excess of income over expenditure | | 3,160 | | | |
| | | 49,660 | | | 49,660 |

Balance Sheet as at 31st March, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|----------------------------------|---------------|---------------|---------------------------|---------------|---------------|
| Accumulated Fund: | | | Furniture and Equipment | 48,000 | |
| Balance on 1.4.2012 | 50,390 | | Less: Depreciation | 4,800 | 43,200 |
| Add: Surplus | 3,160 | 53,550 | Restaurant Stock | | 3,000 |
| Entrance fees | | 3,200 | Stock of Prize | | 500 |
| Subscription received in advance | | 400 | Outstanding Subscriptions | | 1,000 |
| Owing for supplies to Restaurant | | 5,600 | Prepaid Rent | | 1,250 |
| Outstanding Petty Expenses | | 80 | Fixed Deposit with Bank | | 8,000 |
| | | | Cash and Bank | | 5,880 |
| | | 62,830 | | | 62,830 |

Illustration 7.

'Citizen Club' was registered in a city and the accountant prepared the following Receipts and Payments Account for the year ended Dec. 31, 2013 and showed a deficit of ₹ 14,520 :

| | | (₹) | (₹) |
|------------|--|---------------|---------------|
| Receipts : | Subscriptions | 62,130 | |
| | Fair Receipts | 7,200 | |
| | Variety Show Receipts (net) | 12,810 | |
| | Interest | 690 | |
| | Bar Collection | 22,350 | |
| | Cash spent more | <u>1,000</u> | 1,06,180 |
| Payments : | Premises | 30,000 | |
| | Honorarium to Secretary | 12,000 | |
| | Rent | 2,400 | |
| | Rates and Taxes | 3,780 | |
| | Printing and Stationery | 1,410 | |
| | Sundry Expenses | 5,350 | |
| | Wages | 2,520 | |
| | Fair Expenses | 7,170 | |
| | Bar Purchase- payments | 17,310 | |
| | Repairs | 960 | |
| | New Car (less proceeds of old car ₹ 9,000) | <u>37,800</u> | 1,20,700 |
| | | | <u>14,520</u> |
| | Deficit | | <u>14,520</u> |

The additional information should be obtained:

| | | 1.1.2013 | 31.12.2013 |
|--|--------|-----------------|-------------------|
| | | (₹) | (₹) |
| Cash in hand | | 450 | - |
| Bank balance as per Pass Book | 24,690 | 10,440 | |
| Cheques issued not presented for Sundry Expenses | | 270 | 90 |
| Subscriptions due | | 3,600 | 2,940 |
| Premises at Cost | | 87,000 | 1,17,000 |
| Accumulated dep. on Premises | | 56,400 | - |
| Car at Cost | | 36,570 | 46,800 |
| Accumulated dep. on Car | | 30,870 | - |
| Bar Stock | 2,130 | 2,610 | |
| Creditors for Bar Purchases | | 1,770 | 1,290 |

Cash overspent represents honorarium to secretary not withdrawn due to Cash deficit. His annual honorarium is ₹ 12,000. Depreciation on premises and car is to be provided at 5% and 20% on written-down value.

You are required to prepare the correct Receipts and Payments Account, Income and Expenditure Account and Balance Sheet as at Dec. 31, 2013.



Solution:

In the Books of Citizen Club
Receipts and Payments Account
for the year ended 31st December, 2013

| Dr. | | Cr. | |
|-------------------------|------------|------------------------------|------------|
| Receipts | Amount (₹) | Payments | Amount (₹) |
| To Balance b/d | 450 | By, Premises | 30,000 |
| " Bank (24,690 – 270) | 24,420 | " Honorarium to Secretary | 11,000 |
| " Subscription | 62,130 | " Rent | 2,400 |
| " Fair Receipts | 7,200 | " Rates and Taxes | 3,780 |
| " Variety Show Receipts | 12,810 | " Printing and Stationery | 1,410 |
| " Interest | 690 | " Sundry Expenses | 5,350 |
| " Bar Receipts | 22,350 | " Wages | 2,520 |
| | | " Fair Expenses | 7,170 |
| | | " Bar Purchases | 17,310 |
| | | " Repairs | 960 |
| | | " New Car | 37,800 |
| | | " Bank Balance (10,440 – 90) | 10,350 |
| | 1,30,050 | | 1,30,050 |

Income and Expenditure Account

| Dr. | | | Cr. | |
|--|------------|------------|--|------------|
| Expenditure | Amount (₹) | Amount (₹) | Income | Amount (₹) |
| To Honorarium to Secretary | 11,000 | | By, Subscriptions | 62,130 |
| Add: Outstanding | 1,000 | 12,000 | Add: Outstanding for 2012 | 2,940 |
| " Rent | | 2,400 | | 65,070 |
| " Rates and Taxes | | 3,780 | Less: Outstanding for 2011 | 3,600 |
| " Printing and Stationery | | 1,410 | " Fair receipts | 7,200 |
| " Sundry Expenses | | 5,350 | " Variety show receipts | 12,810 |
| " Wages | | 2,520 | " Interest | 690 |
| " Fair Expenses | | 7,170 | " Profit on sale of old car [(₹ 9,000 - (36,570 - 30,870))] | 3,300 |
| "Repairs | | 960 | " Profit on Bar Trading | 6,000 |
| "Depreciation on: Premises@ 5% on 60,600 | | 3,030 | | |
| Car @20% on 46,800 | | 9,360 | | |
| " Surplus—Excess of Income over Expenditure | | 43,490 | | |
| | | 91,470 | | 91,470 |

Balance Sheet
as at 31st December, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|---------------------------------------|---------------|---------------|--------------------------|---------------|---------------|
| Capital Fund as on 1.1.13 | 65,130 | 1,08,620 | Premises at Cost | 1,17,000 | |
| Add: Surplus | 43,490 | | Less: Depreciation | 59,430 | 57,570 |
| Creditors (for bar purchase) | | | Car at Cost | 46,800 | |
| Secretary's honorarium outstanding | | | Less: Depreciation | 9,360 | 37,440 |
| | | | Bar Stock | | 2,610 |
| | | 1,000 | Outstanding Subscription | | 2,940 |
| | | | Cash at bank | | 10,350 |
| | | 1,10,910 | | | 1,10,910 |

Balance Sheet
as at 1st January, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|-------------------------------|---------------|---------------|--------------------------|---------------|---------------|
| Capital Fund (bal. in figure) | | 65,130 | Premises at Cost | 87,000 | |
| Creditors (for bar purchase) | | 1,770 | Less: Depreciation | 56,400 | 30,600 |
| | | | Car at Cost | 36,570 | |
| | | | Less: Depreciation | 30,870 | 5,700 |
| | | | Bar Stock | | 2,130 |
| | | | Outstanding Subscription | | 3,600 |
| | | | Cash at bank | | 24,420 |
| | | | Cash in Hand | | 450 |
| | | 66,900 | | | 66,900 |

Dr. **Bar Trading Account for the year ended 31.12.2013** **Cr.**

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) |
|--|---------------|---------------|-------------------|---------------|
| To, Opening stock | | 2,130 | By, Bar Receipts | 22,350 |
| To, Bar Purchase | 17,310 | | By, Closing Stock | 2,610 |
| Add: closing creditors for bar purchase | <u>1,290</u> | | | |
| Less: Opening creditors for purchase | 18,600 | | | |
| | <u>1,770</u> | 16,830 | | |
| To, Income and Expenditure A/c (Gross profit Transferred) | | 6,000 | | |
| | | <u>24,960</u> | | <u>24,960</u> |

2. Calculation of Depreciation of Premises

| | |
|-----------------------|----------------------|
| W.D.V | ₹ |
| Cost Price | 87,000 |
| Less: Accumulated Dep | <u>56,400</u> |
| | 30,600 |
| Add: Purchase | <u>30,000</u> |
| | <u>60,600</u> |

Depreciation of Premises: $60,600 \times 5\% = 3,030$



Illustration 8.

Prepare Income & Expenditure A/c for the year ended 31-12-2013 and the balance sheet as on 31-12-2013 in the books of an Education society.

| Particulars | Debit (₹) | Credit (₹) |
|-----------------------------|-----------|------------|
| Library Books | 2,30,000 | |
| Books Added during the year | 52,200 | |
| Furniture | 1,59,500 | |
| Addition to Furniture | 35,500 | |
| Buildings | 37,89,000 | |
| Investment | 21,25,000 | |
| Creditors | | 1,77,900 |
| Debtors | 59,700 | |
| Investment Reserve Fund | | 1,85,000 |
| Entrance Fees | | 2,02,600 |
| Examination Fees | | 32,500 |
| Certificate Fees | | 7,800 |
| Subscriptions Received | | 2,75,800 |
| Hire Charges | | 95,500 |
| Interest | | 85,000 |
| Other Receipts | | 4,400 |
| Salary | 1,55,900 | |
| Printing & Stationery | 8,500 | |
| Postage & Telephone | 2,500 | |
| Insurance | 10,400 | |
| Examination Expenses | 24,000 | |
| Periodicals | 15,600 | |
| Prizes Fund | | 2,15,000 |
| Prizes Investments | 2,10,400 | |
| Prizes Investment Income | | 10,200 |
| Prizes Given | 9,500 | |
| Prizes Bank Balance | 2,450 | |
| Donations (capital) | | 1,99,000 |
| General Expenses | 5,250 | |
| Capital Fund | | 54,71,720 |
| Bank Balance | 65,500 | |
| Cash in Hand | 1,520 | |
| Total | 69,62,420 | 69,62,420 |

Additional information :

Subscription receivable ₹22,500, subscription received for 2014 ₹7,850, Interest accrued on investments ₹6,250, salary outstanding for 2013 ₹12,500, Prepaid insurance ₹4,500.

Depreciate Books @ 15%, Building @ 1% and Furniture @ 10%.

Solution:**Dr.****Income & Expenditure Account for the year ended 31.12.2013****Cr.**

| Expenditure | Amount (₹) | Amount (₹) | Income | Amount (₹) | Amount (₹) |
|------------------------------|-------------------|-------------------|---------------------|-------------------|-------------------|
| To Salary | 1,55,900 | | By Examination fees | | 32,500 |
| Add: Outstanding | 12,500 | 1,68,400 | By Certificate fees | | 7,800 |
| To Printing & Stationery | | 8,500 | By Subscriptions | 2,75,800 | |
| To Postage & Telephone | | 2,500 | Add: Receivable | 22,500 | |
| To Insurance | 10,400 | | Less: Pre-received | (7,850) | 2,90,450 |
| Less: Prepaid | (4,500) | 5,900 | By Hire charges | | 95,500 |
| To Examination Expenses | | 24,000 | By Interest | | 85,000 |
| To Periodicals | | 15,600 | By Other Receipts | | 4,400 |
| To General Expenses | | 5,250 | By Accrued interest | | 6,250 |
| To Depreciation on Books | | 38,415 | | | |
| To Depreciation on Building | | 37,890 | | | |
| To Depreciation on Furniture | | 17,725 | | | |
| To Surplus | | 1,97,720 | | | |
| | | 5,21,900 | | | 5,21,900 |

Balance Sheet as at 31.12.2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|----------------------------------|-------------------|-------------------|--------------------------|-------------------|-------------------|
| | | | Buildings | 37,89,000 | |
| | | | Less: Depreciation @ 1% | (37,890) | 37,51,110 |
| Capital Fund | 54,71,720 | | Library Books | 2,30,000 | |
| Add: Entrance fees | 2,02,600 | | Add: Purchased in 2012 | 52,200 | |
| Add: Donations | 1,99,000 | | Less: depreciation @ 15% | (38,415) | 2,43,785 |
| Add: Surplus | 1,97,720 | 60,71,040 | Furniture & fixture | 1,59,500 | |
| | | | Add: Purchased in 2012 | 35,500 | |
| Investment Reserve Fund | | 1,85,000 | Less: Depreciation @ 10% | (17,725) | 1,77,275 |
| Prize Fund | 2,15,000 | | Investment | | 21,25,000 |
| Add: Fund Income | 10,200 | | Prize Investments | | 2,10,400 |
| Less: Fund Expenses | (9,500) | 2,15,700 | Debtors | | 59,700 |
| Creditors | | 1,77,900 | Prize Bank balance | | 2,450 |
| Subscription received in advance | | 7,850 | Bank balance | | 65,500 |
| Salary Outstanding | | 12,500 | Cash in hand | | 1,520 |
| | | | Subscription receivable | | 22,500 |
| | | | Interest Accrued | | 6,250 |
| | | | Prepaid Insurance | | 4,500 |
| | | 66,69,990 | | | 66,69,990 |



Illustration 9.

The following information was obtained from the books of Young Bengal Club as on 31-03-2013 at the end of first year of the club. Prepare the Receipts & Payments A/c, Income & Expenditure A/c and Balance sheet of the club

- (1) Donations received for Building & Books - ₹ 2,00,000
- (2) Other revenue incomes and receipts were:

| | Rev. Income (₹) | Actual Receipts (₹) |
|---------------------|-----------------|---------------------|
| Entrance fees | 17,000 | 17,000 |
| Subscription | 20,000 | 19,000 |
| Locker rent | 600 | 600 |
| Sundry Income | 1,600 | 1,060 |
| Refreshment account | Nil | 16,000 |

- (3) Other revenue expenditure and actual payments were

| | Rev. Exp (₹) | Actual Payment (₹) |
|----------------------------|--------------|--------------------|
| Land (cost ₹10,000) | Nil | 10,000 |
| Furniture (cost ₹ 146,000) | Nil | 130,000 |
| Salaries | 5,000 | 4,800 |
| Maintenance of play ground | 2,000 | 1,000 |
| Rent | 8,000 | 8,000 |
| Refreshment account | Nil | 8,000 |

Donations were utilized to the extent of ₹25,000 for buying books, balance were unutilized. In order to keep it safe, 9% Govt. Securities were purchased on 31-3-2013 for ₹1, 60,000. Remaining amount was put in bank as term deposit on 31-3-2013. Depreciate Furniture and books @ 10% for the whole year.

Solution:

Dr. Receipt and Payments for the year ended 31.3.2013 Cr.

| Receipts | Amount (₹) | Payments | Amount (₹) |
|--|------------|------------------------|------------|
| To Donations | 2,00,000 | By Library books | 25,000 |
| To Entrance fees | 17,000 | By Land | 10,000 |
| To Subscription | 19,000 | By Furniture | 1,30,000 |
| To Locker Rent | 600 | By Salaries | 4,800 |
| To Sundry income | 1,060 | By Maintenance | 1,000 |
| To Refreshment A/c | 16,000 | By Rent | 8,000 |
| | | By Refreshment A/c | 8,000 |
| To Balance c/d (Overdraft) (Bal. fig.) | 1,08,140 | By 9% Govt. Securities | 1,60,000 |
| | | By Term deposits | 15,000 |
| | 3,61,800 | | 3,61,800 |

Income and Expenditure Account for the year ended 31.3.2013

Dr.

Cr.

| Expenditures | ₹ | ₹ | Incomes | ₹ | ₹ |
|---------------------------|--------------|--------|--|--------------|--------|
| To Salary | 4,800 | | By Subscriptions | 19,000 | |
| Add: Outstanding | <u>200</u> | 5,000 | Add: Outstanding | <u>1,000</u> | 20,000 |
| `` Playground maintenance | 1,000 | | `` Locker Rent | | 600 |
| Add: Outstanding | <u>1,000</u> | 2,000 | `` Sundry Income | 1,060 | |
| `` Rent | | 8,000 | -Add: Outstanding | <u>540</u> | 1,600 |
| `` Depreciation on: | | | `` Profit on Refreshment | | 8,000 |
| Furniture | 14,600 | | `` Deficit | | |
| Library Books | <u>2,500</u> | 17,100 | (Excess of Expenditure over Income) | | 1,900 |
| | | 40,100 | | | 40,100 |

Balance Sheet as at 31st March 2013

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|---|---|----------|-------------------------|---------------|----------|
| Capital Fund | | --- | Land | | 10,000 |
| Entrance Fees | | 17,000 | Furniture | 1,46,000 | |
| Donation for Building. Library Room Fund | | 2,00,000 | Less: Depreciation | <u>14,600</u> | 1,31,400 |
| Creditors for Furniture | | 16,000 | Library Books | 25,000 | |
| Outstanding Salaries | | 200 | Less: Depreciation | <u>2,500</u> | 22,500 |
| Outstanding Expenses for Playground | | 1,000 | 9% Govt. Bond | | 1,60,000 |
| Bank overdraft | | 1,08,140 | Subscription Receivable | | 1,000 |
| | | 3,42,340 | Accrued Sundry Income | | 540 |
| | | | Bank Term Deposit | | 15,000 |
| | | | Deficit | | 1,900 |
| | | | | | 3,42,340 |

Workings:

(1)

Refreshment Account

Dr.

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|---|---------------|--------------------------|---------------|
| To, Payment for Refreshment | 8,000 | By, Refreshment Receipts | 16,000 |
| To, Income and Expenditure A/c (Profit on Refreshment) | 8,000 | | |
| | 16,000 | | 16,000 |

(2) **Calculation of Term Deposit:**

Donation Recd – (library books purchase + 9% Govt. Securities)
 = 2,00,000 – (25,000 + 1,60,000)
 = 2,00,000 – 1,85,000
 =15,000

(3) Since there was no capital fund

(4) Donation received for Building and Library Room is treated as capital item.

(5) Since the investment in Govt. Securities has been made at the closing date of the year, no interest has accrued.

Illustration 10.

Following is the receipt and payment A/c of a club for the year ended 31-03-2013

Dr. Receipt and Payments for the year ended 31.3.2013 Cr.

| Receipts | Amount (₹) | Payments | Amount (₹) |
|--------------------------------|------------|-----------------------------|------------|
| To Opening balance: | | By Administrative expenses | 1,25,000 |
| Cash | 3,000 | “ Programme expenses | 2,75,000 |
| Bank | 7,000 | “ F.D. with bank | 1,25,000 |
| “ Membership fees received: | | “ Investment in ICICI Bonds | 3,00,000 |
| up to 31-03-2012 | 14,000 | “ Fixed assets | |
| for 2012-13 | 1,50,000 | purchased | 80,000 |
| for 2013-14 | 16,000 | | |
| “ Advertisements | 5,00,000 | | |
| “ F.D. with bank | 75,000 | | |
| “ Interest on savings A/c | 700 | | |
| “ Interest on F.D | 22,000 | “ Closing balance: | |
| “ Sale of tickets - Programmed | 25,000 | Cash | 2,700 |
| “ Govt. Security Maturity | | Bank | 5,000 |
| (cost 80,000 & interest 8,000) | 1,00,000 | | |
| | 9,12,700 | | 9,12,700 |

The club informs you that:

- Membership fee for 2012-13 due is ₹25,000; and ₹1,000 from a member who has not yet paid for 2011-12 as well. A provision needs to be done on this.
- Income receivable on 31-03-2013 on ICICI bond is ₹30,000 and on Govt. Securities is ₹24,000
- Prepaid expenses on 31-3-2013 amounts to ₹7,000
- Outstanding expenses as on 31-3-2013 ₹8,000
- Depreciation to be provided is ₹12,500
- Programme is an annual feature.

The Balance Sheet as on 31-3-2012 is also provided as below:

Balance Sheet as at 31.03.2012

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|--------------------------|------------|-------------------------|------------|
| Trust fund | 5,00,000 | Cash | 3,000 |
| Accumulated surplus | 1,05,000 | Bank Account | 7,000 |
| Subscriptions in advance | 10,000 | Fixed Deposit | 2,00,000 |
| Outstanding Expenses | 10,000 | Govt. Securities | 3,00,000 |
| | | Fixed Assets | 95,000 |
| | | Subscription receivable | 15,000 |
| | | Prepaid expenses | 5,000 |
| | 6,25,000 | | 6,25,000 |

Prepare Income and Expenditure Account and the Closing Balance Sheet for the year 2012-13.

Solution:

Dr. Subscription Account Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|-------------------------------------|------------|---|------------|
| To, Opening receivable | 15,000 | By, Opening advance received | 10,000 |
| To, I & E A/c (balancing figure) | 1,85,000 | By, Received during year | 1,80,000 |
| To, Closing advance received | 16,000 | By, Closing receivable : for 2011-12 | 1,000 |
| | | for 2012-13 | 25,000 |
| | 2,16,000 | | 2,16,000 |

Dr. Expenses Account Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|-------------------------|------------|----------------------------------|------------|
| To, Opening prepaid | 5,000 | By, Opening outstanding | 10,000 |
| To, Bank | 1,25,000 | By, I & E A/c (balancing figure) | 1,21,000 |
| To, Closing outstanding | 8,000 | By, Closing prepaid | 7,000 |
| | 1,38,000 | | 1,38,000 |

Provision for doubtful Subscriptions Account

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|-------------|------------|----------------|------------|
| For 2011-12 | 1,000 | By Balance c/d | 2,000 |
| For 2012-13 | 1,000 | | |
| | 2,000 | | 2,000 |



Dr. Income & Expenditure Account for the year ended 31.3.2013

Cr.

| Expenditures | | ₹ | Incomes | | ₹ |
|--------------|---------------------------|----------|---------|----------------------------------|----------|
| To | Administrative Expenses | 1,21,000 | By | Subscriptions | 1,85,000 |
| " | Depreciation on Assets | 12,500 | " | Interest Income | 84,700 |
| " | Provision on subscription | 2,000 | | [700+22,000+30,000+24,000+8,000] | |
| " | Surplus | 3,96,200 | " | Surplus from Programme | 2,50,000 |
| | | | | [25,000 + 5,00,000 – 2,75,000] | |
| | | | " | Profit on sale of investment | 12,000 |
| | | 5,31,700 | | | 5,31,700 |

Balance Sheet as at 31st March 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|------------------------------|-----------------|------------|-------------------------------|-----------------|------------|
| Trust Fund | | 5,00,000 | Cash | | 2,700 |
| Accumulated surplus | 1,05,000 | | Bank | | 5,000 |
| Add: surplus for 2012-13 | <u>3,96,200</u> | 5,01,200 | Govt. Securities | 3,00,000 | |
| Subscription Recd in Advance | | 16,000 | Less: sold | <u>80,000</u> | 2,20,000 |
| Outstanding Expenses | | 8,000 | Fixed Deposit | 2,00,000 | |
| | | | Add: Addition | <u>1,25,000</u> | |
| | | | | 3,25,000 | |
| | | | Less: Matured | <u>75,000</u> | 2,50,000 |
| | | | ICICI Bond | | 3,00,000 |
| | | | Accrued Interest: | | |
| | | | Govt. Securities | 24,000 | |
| | | | ICICI Bonds | <u>30,000</u> | 54,000 |
| | | | Outstanding Subscription: | | |
| | | | 2011 -12 | 1,000 | |
| | | | 2012 -13 | <u>25,000</u> | |
| | | | | 26,000 | |
| | | | Less: Prov. for doubtful debt | <u>2,000</u> | 24,000 |
| | | | Prepaid Expenses | | 7,000 |
| | | | Fixed Assets | 95,000 | |
| | | | Add: Additions | <u>80,000</u> | |
| | | | | 1,75,000 | |
| | | | Less: Depreciation | <u>12,500</u> | 1,62,500 |
| | | 10,25,200 | | | 10,25,200 |

| | |
|----------------------------------|---------------|
| Profit on disposal of Investment | ₹ |
| Amount received | 1,00,000 |
| Less: Interest | 8,000 |
| Net received | <u>92,000</u> |
| Cost of disposed investment | 80,000 |
| Profit on disposal | <u>12,000</u> |

Illustration 11.

Prepare the Balance Sheet of Ocean Blue club based on following information:

₹

| | | | |
|-----------------------------------|--------|-------------------------------|--------|
| Furniture (before depreciation) | 8,000 | Outstanding consultancy | 1,000 |
| Depreciation on furniture | 800 | Allowances outstanding | 800 |
| Building fund | 30,000 | Capital Grants | 10,000 |
| Income from building fund | 2,000 | Entrance fees (50% be funded) | 4,000 |
| Fixed deposits | 20,000 | Legacies received(funded) | 8,000 |
| Opening General fund | 10,000 | Prize fund | 10,000 |
| Excess of income over expenditure | 20,000 | Income of prize fund | 1,000 |
| Opening balance of capital fund | 60,000 | Expenses of prize fund | 800 |
| Cost of swimming pool | 40,000 | Investment of prize fund | 10,000 |
| Equipments | 20,000 | Balance in current A/c | 10,000 |
| Investment of general fund | 36,000 | Cash in hand | 800 |
| Subscription outstanding | 10,000 | | |

Solution:**Balance Sheet as at**

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|--------------------------|------------|------------|------------------------|------------|------------|
| Capital Fund | | | Fixed Assets: | | |
| Op balance | 60,000 | | Swimming Pool | | 40,000 |
| Add: Capital grants | 10,000 | | Equipments | | 20,000 |
| Add: Legacies | 8,000 | | Furniture | 8,000 | |
| Add: Entrance fees (50%) | 2,000 | 80,000 | Less: Depreciation | 800 | 7,200 |
| General Fund | | | Investment | | |
| Op balance | 10,000 | | General fund | 36,000 | |
| Surplus | 20,000 | 30,000 | Prize fund | 10,000 | 46,000 |
| Building Fund | | | Receivables | | |
| Op balance | 30,000 | | Subscription | | 10,000 |
| Add: Income | 2,000 | 32,000 | Cash & bank | | |
| Prize Fund | | | Cash in hand | 800 | |
| Op balance | 10,000 | | Current A/c | 10,000 | |
| Add: Income | 1,000 | | Fixed deposit | 20,000 | 30,800 |
| Less: Expenses | 800 | 10,200 | | | |
| Allowances | | | | | |
| Outstanding | | 800 | | | |
| Consultancy | | | | | |
| Outstanding | | 1,000 | | | |
| | | 1,54,000 | | | 1,54,000 |



Preparation of opening and closing Balance Sheet from a given Receipt and Payment Account and Income and Expenditure Account

Students must remember –

A. While preparing opening Balance Sheet

- At first, take the opening balance of Cash and Bank which are given in the Receipts and Payments Account as “Balance b/d”. The same will appear in the assets side of the opening Balance Sheet.
- All the opening assets will appear in the assets side of the opening Balance Sheet which are given in the form of adjustments. Similarly, all the opening liabilities will also appear in the liabilities side of the opening Balance Sheet.
- Ascertain the difference between the assets side and the liabilities side of the opening Balance Sheet which will be treated as “Capital Fund”.

B. While preparing closing Balance Sheet

- At first, take the closing balance of Cash and Bank which are given in the Receipts and Payments Account as “Balance c/d”. The same will appear in the asset side of the closing Balance Sheet.
- All the opening fixed asset which have appeared in the asset side of the opening Balance Sheet (after charging all adjustments), if not sold or cost, including addition, if any.
- All the closing current liabilities including capital fund, surplus or deficit (which we get from income and Expenditure Account), other funds like, Donation, Entrance Fees etc. also appear in the liabilities side of the closing Balance Sheet.
- Now, each individual item of Receipts and Payments Account should be compared with each individual item of Income and Expenditure Account and the same is to be adjusted accordingly. It must be remembered that items which are appeared in the credit side of the Receipts and Payments Account must be compared with the items which is appeared in the debit side of Income and Expenditure and vice-versa.

Illustration 12.

The following are the items of Receipts and Payments of the Bengal Club as summarized from the books of account maintained by the Secretary:

| Receipts | Amount (₹) | Payments | Amount (₹) |
|----------------------------------|---------------|----------------------------|---------------|
| Opening Balance 1.1.2013 | 4,200 | Manager's Salary | 1,000 |
| Entrance Fees 2012 | 1,000 | Printing and Stationery | 2,600 |
| Do 2013 | 10,000 | Advertising | 1,800 |
| Subscriptions 2012 | 600 | Fire Insurance | 1,200 |
| Do 2013 | 15,000 | Investments Purchased | 20,000 |
| Interest Received on Investments | 3,000 | Closing Balance 31.12.2013 | 7,600 |
| Subscriptions 2014 | 400 | | |
| | 34,200 | | 34,200 |

It was ascertained from enquiry that the following represented a fair picture of the Income and Expenditure of the Club for the year 2013 for audit purpose:

| Expenditure | Amount (₹) | Amount (₹) | Income | Amount (₹) |
|-----------------------------------|------------|---------------|-------------------------|---------------|
| Manager's Salary | | 1,500 | Entrance Fees | 10,500 |
| Printing & Stationery | 2,000 | | Subscription | 15,600 |
| Add: Accrued | 400 | 2,400 | Interest on Investments | 4,000 |
| Advertising (accrued Nil) | | 1,600 | | |
| Audit Fees | | 500 | | |
| Fire Insurance | | 1,000 | | |
| Depreciation | | 4,940 | | |
| Excess of Income over Expenditure | | 18,160 | | |
| | | 30,100 | | 30,100 |

You are required to prepare the Balance Sheet of the Club as on 31.12.2012 and 31.12.2013, it being given that the values of the Fixed Assets as on 31.12.2012 were: Building ₹ 44,000, Cricket Equipment ₹ 25,000 and Furniture ₹ 4,000. The rates of depreciation are Building 5%, Cricket Equipments 10%, Furniture 6%.

Your are entitled to make assumptions as may be justified.

Solution:

**In the books of Bengal Club
Balance Sheet as at 31st December, 2012**

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|---|---------------|-------------------------|---------------|
| Outstanding Liabilities: | | Building | 44,000 |
| Advertisement (1,800 – 1,600) | 200 | Furniture | 4,000 |
| Printing and Stationery (2,600 – 2,000) | 600 | Cricket Equipment | 25,000 |
| Capital Fund | 78,000 | Entrance Fees in arrear | 1,000 |
| (Balancing figure) | | Subscription in arrear | 600 |
| | | Cash | 4,200 |
| | 78,800 | | 78,800 |

Balance Sheet as at 31st December, 2013

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|--|------------|---------------|---|------------|---------------|
| Capital Fund: | | | Building | 44,000 | |
| Balance on 1.1.2012 | 78,000 | | Less: Depreciation 5% | 2,200 | 41,800 |
| Add: Excess of Income over Expenditure | 18,160 | 96,160 | Furniture | 4,000 | |
| Subscription Received in Advance | | 400 | Less: Depreciation 6% | 240 | 3,760 |
| Outstanding Liabilities: | | | Cricket Equipment | 25,000 | |
| Printing and Stationery | | 400 | Less: Depreciation 10% | 2,500 | 22,500 |
| Manager's Salary: (1,500 – 1,000) | | 500 | Investments | | 20,000 |
| Audit Fees | | 500 | Subscriptions in arrear (15,600 – 15,000) | | 600 |
| | | | Entrance Fees in arrear (10,500 – 10,000) | | 500 |
| | | | Accrued Interest on Investments (4,000 – 3,000) | | 1,000 |
| | | | Prepaid Insurance (1,200 – 1,000) | | 200 |
| | | | Cash | | 7,600 |
| | | 97,960 | | | 97,960 |



Note: Advertisement expenses and Printing and Stationery which were paid in excess over Income and Expenditure A/c are assumed to be outstanding for the previous year.

Preparation of Receipts and Payments Account from a given Income and Expenditure Account and a Balance Sheet

Preparation of Receipts and Payments Account

Preparation of Receipts and Payments Account has already been highlighted in the previous paragraph. But if we are asked to prepare a Receipts & Payments Account from a given Income and Expenditure Account and the opening Balance Sheet, in that case, we are to consider each and individual items both from Income and Expenditure Account and the Balance Sheet.

Illustration 13.

The Income and Expenditure Account of the Calcutta Club is:

**Income and Expenditure Account
for the year ended 31st December, 2013**

| Dr. | | Cr. | |
|-------------------------------------|-------------|-----------------|-------------|
| Expenditure | Amount ₹ | Income | Amount ₹ |
| To Salaries | 1,750 | By Subscription | 2,000 |
| „ General Expenses | 500 | „ Donation | 1,050 |
| „ Depreciation | 300 | | |
| „ Excess of Income over expenditure | 500 | | |
| | 3,050 | | 3,050 |

Adjustments are made in respect of the following:

- (1) Subscription for 2012 unpaid at 1.1.2013 ₹ 200; ₹ 180 of which was received in 2013.
- (2) Subscription paid in advance at 1.1.2013 ₹ 50.
- (3) Subscription paid in advance at 31.12.2013 ₹ 40.
- (4) Subscription for 2012 unpaid at 31.12.2013 ₹ 70.
- (5) Sundry Asset at the beginning of the period ₹ 2,600; Sundry Asset after depreciation ₹ 2,700 at the end of the period.
- (6) Cash balance at 1.1.2013 ₹ 160.

Prepare a Receipts and Payments Account.

Solution:

**In the books of Calcutta Club
Receipts and Payments Account
for the year ended 31st December, 2013**

| Dr. | | Cr. | |
|---------------------------------|-------------|--------------------|-------------|
| Receipts | Amount ₹ | Payments | Amount ₹ |
| To Balance b/d | 160 | By Salaries | 1,750 |
| „ Donations | 1,050 | „ General Expenses | 500 |
| „ Subscriptions (Cash received) | 2,100 | „ Sundry Assets | 400 |
| | | „ Balance c/d | 660 |
| | 3,310 | | 3,310 |

Workings:**Subscription Account****Dr.****Cr.**

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--|-------------|---|-------------|
| To Balance b/d | 200 | By balance b/d | 50 |
| „ Income & Expenditure A/c | 2,000 | „ Cash Received (bal. fig.) | 2,100 |
| „ Balance (received in advance for 2014) | 40 | „ Balance (Unpaid for 2012) (200 - 180)c/d | 20 |
| | | „ Balance (Unpaid for 2013) c/d | 70 |
| | 2,240 | | 2,240 |
| To Balance b/d for 2012 | 20 | By Balance b/d | 40 |
| for 2013 | 70 | | |

Sundry Assets Account**Dr.****Cr.**

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|------------------------|-------------|-----------------|-------------|
| To Balance b/d | 2,600 | By Depreciation | 300 |
| „ Purchase (bal. fig.) | 400 | By Balance c/d | 2,700 |
| | 3,000 | | 3,000 |

SELF EXAMINATION QUESTIONS:

- In the case of non-profit organization donations received by the organization are reflected in
 - Income and Expenditure Account
 - Capital Account
 - Receipts and Payments Account
 - None of the above
- Which of the following item(s) is (are) shown in the Income and Expenditure Account?
 - Only items of Capital nature
 - Only items of Revenue nature, which are received during the period of Accounts
 - Only items of Revenue nature pertaining to the period of Accounts
 - Both the items of Capital and Revenue nature
- Salary debited to Income and Expenditure Account for the year was ₹48,000. Outstanding ? salary paid in the beginning of the year and the outstanding salary at the end of the year were ₹6,000 and ₹7,500 respectively. The amount of Salary to be shown in Receipts and Payments Account will be:
 - ₹48,000



- (B) ₹40,500
- (C) ₹54,000
- (D) ₹46,500

4. Which of the following item does not match with receipts and payments account?

- (A) It is a summarized cash book
- (B) Transactions are recorded in it on cash basis
- (C) It records revenue transactions only
- (D) It serves the purpose of a real account

5. Receipts and payments Account records

- (A) Only revenue nature receipts
- (B) Only capital nature receipts and payment
- (C) Only revenue nature receipts and payments
- (D) Both the revenue and capital nature receipts and payments

6. The Income and expenditure Account and the Receipts and Payments Account of a Local Club at the end of a particular year show the following amounts:

| | As per Income Expenditure A/c (₹) | As per Receipts and Payments A/c (₹) |
|------------------|--------------------------------------|---|
| Printing Charges | 7,500 | 6,900 |
| Rent Paid | 12,000 | 11,000 |

When there were no outstanding of Rent and Printing charges at the beginning of that year, the difference of ₹1,600 will be shown in the Balance Sheet at the end of the year as:

- (A) Asset
- (B) Liabilities
- (C) Ignored
- (D) Capital Fund

7. Income Statement of a charitable institution is known as

- (A) Profit and Loss A/c
- (B) Receipts and payments A/c
- (C) Income and Expenditure A/c
- (D) Statement of Affairs

8. The Receipts and Payments Account generally begins with

- (A) Credit Balance
- (B) Debit Balance
- (C) Both Debit and Credit Balance
- (D) None of the above

Answer:

| | | | | | | | |
|--------|--------|--------|--------|--------|--------|--------|--------|
| 1. (A) | 2. (C) | 3. (D) | 4. (C) | 5. (D) | 6. (B) | 7. (C) | 8. (B) |
|--------|--------|--------|--------|--------|--------|--------|--------|

State whether the following statement is True (or) False:

1. Income and Expenditure Account is prepared by adopting accrual principle of accounting
2. Receipts and Payment Account is a Real Account.
3. Life membership fee is a Capital nature receipt.
4. Transactions are recorded on accrual basis in the 'Income and Expenditure Account'.
5. Revenue nature receipts and payments which relates to a particular accounting period are shown in the Income and Expenditure.
6. Items of receipts and payments which are revenue in nature and which relate to any accounting period, are shown in the Income and Expenditure Account.
7. Subscription is a revenue nature receipt.

QUESTIONS:

1. From the following Receipts and Payments Account of Jaipur Krida Parishad for the year ended 31st March, 2014 and additional information given, prepare an income and expenditure account for the year ended 31st March, 2014 and balance sheet as on 31st March, 2014.

Receipts and Payments Account for the ended 31.3.14

| Receipts | Amount (₹) | Payment | Amount (₹) |
|--------------------------------|---------------|------------------------------|------------|
| Opening Balance : Cash | 18,600 | Secretary Honorarium | 1,25,000 |
| Bank | 55,450 | Staff Salaries | 4,10,000 |
| Subscription | 4,30,000 | Charities | 25,000 |
| Sale of Old News Papers | 3,500 | Printing & Stationary | 15,000 |
| Legacies | 80,000 | Postage expenses | 1,500 |
| Interest on investment | 25,000 | Rates & Taxes | 8,500 |
| Endowment Fund Receipts | 1,50,000 | Upkeep of group | 65,000 |
| Proceeds of Sports & Concerts | 1,45,600 | Purchase of sports materials | 2,10,000 |
| Advertisement in the Year Book | 1,15,400 | Miscellaneous Expenses | 55,850 |
| | | Closing balance: Cash | 24,500 |
| | | Bank | 83,200 |
| | 10,23,550 | | 10,23,550 |

Additional Information:

Assets and liabilities as on 31st March, 2013 and 31st March, 2014 were as follows:-

| Particulars | 31.03.13(₹) | 31.03.14(₹) |
|----------------------------------|-------------|-------------|
| Outstanding subscription | 45,600 | 85,600 |
| Subscription received in advance | 12,400 | 16,300 |
| Office equipments | 80,000 | 68,000 |
| Furniture | 60,000 | 54,000 |
| Ground land | 5,00,000 | 5,00,000 |
| Sports material | 20,000 | 27,000 |
| Outstanding staff salaries | 40,000 | 50,000 |

There was no purchase and sale of office equipments and furniture during the year. Legacies receipts shall be capitalized. Investments are made in securities, the rate of interest being 9% per annum, the date of investment was 1st July, 2012 and the amount of investment was ₹ 3,00,000. Due date of interest was 31st March every year.



Answer:

Jaipur Krida Parishad
Income & Expenditure Account for the year ending 31st March, 2014

| Expenditure | Amount (₹) | Income | Amount (₹) | Amount (₹) |
|--|------------|---|------------|------------|
| To Secretary Honorarium | 1,25,000 | By Subscription | 4,30,000 | |
| | | Add: | | |
| | | Adv. On 31.03.2013 | 12,400 | |
| | | Out. On 31.03.2014 | 85,600 | |
| | | | 5,28,000 | |
| | | Less: | | |
| | | Out on 31.03.13 | 45,600 | |
| | | Adv on 31.03.14 | 16,300 | 61,900 |
| To Staff Salary (4,10,000 – 40,000 + 50,000) | 4,20,000 | By Interest on Investment (25,000 + 2,000) @ 9% on 3,00,000 | | 27,000 |
| To Charities | 25,000 | By Sale Old News Paper | | 3,500 |
| To Printing and Stationary | 15,000 | By Proceeds of Sports Concert | | 1,45,600 |
| To Postage & Telephone Exp. | 1,500 | By Advertisement | | 1,15,400 |
| To Rates & Taxes | 8,500 | By Deficit (excess of expenditure over income) | | 1,79,250 |
| To Upkeeps of Grounds | 65,000 | | | |
| To Sports Material Used (2,10,000 + 20,000 – 27,000) | 2,03,000 | | | |
| To Misc. Expenses | 55,850 | | | |
| To Depreciation: | | | | |
| Furniture 6,000 | | | | |
| Office Equipments 12,000 | 18,000 | | | |
| | 9,36,850 | | | 9,36,850 |

Balance Sheet as on 31st March, 2014

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------------|------------|--------------------------|------------|
| Subscription Received in Advance | 16,300 | Cash in hand | 24,500 |
| Outstanding Salary | 50,000 | Cash at bank | 83,200 |
| Legacies | 80,000 | Subscription outstanding | 85,600 |
| Endowment fund | 1,50,000 | Accrued interest | 2,000 |
| Capital Fund 1.4.13 | 10,27,250 | Sports material | 27,000 |
| Less: Deficit | 1,79,250 | Investment | 3,00,000 |
| | | Office Equipment | 68,000 |
| | | Furniture | 54,000 |
| | | Ground land | 5,00,000 |
| | 11,44,300 | | 11,44,300 |

Working Note:

Balance Sheet as on 31st March, 2013

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------------|------------|--------------------------|------------|
| Subscription received in advance | 12,400 | Cash in hand | 18,600 |
| Outstanding Staff salary | 40,000 | Cash at bank | 55,450 |
| Capital fund (b/f) | 10,27,250 | Subscription outstanding | 45,600 |
| | | Sports material | 20,000 |
| | | Investment | 3,00,000 |
| | | Office equipment | 80,000 |
| | | Furniture | 60,000 |
| | | Ground land | 5,00,000 |
| | 10,79,650 | | 10,79,650 |

2. The Income & Expenditure Account of Jayashree Sangha Club for the year ended 31.12.2012 as given below:

| Expenditure | ₹ | Income | ₹ |
|------------------------------|--------|-------------------------|--------|
| To Salaries | 20,500 | By Subscription | 52,000 |
| To Newspaper | 1,500 | By Sale of Newspaper | 2,500 |
| To Audit Fees | 2,500 | By Admission Fees | 12,000 |
| To General Expenses | 22,000 | By Donation | 15,000 |
| To Printing & Stationery | 7,500 | By Miscellaneous Income | 500 |
| To Travelling Expenses | 2,000 | | |
| To Rent | 3,500 | | |
| To Depreciation of Furniture | 2,500 | | |
| To Surplus | 20,000 | | |
| | 82,000 | | 82,000 |

The following is the Balance Sheet of the Club as on 31.12.2011

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------------|------------|----------------------|------------|
| Outstanding salary | 2,000 | Furniture | 15,000 |
| Subscription received in advance | 2,500 | Sports equipment | 20,000 |
| Accumulated fund | 45,500 | Accrued Subscription | 5,000 |
| | | Cash at Bank | 10,000 |
| | 50,000 | | 50,000 |

Prepare Receipts & Payments Account for the year ended 31.12.2012 taking into account the following adjustments:

- (i) Subscription received in advance ₹ 1,500
- (ii) Salary due for ₹ 1,500 but not paid for the year
- (iii) 60% of the admission fee to be capitalized
- (iv) Subscription due for 2012 but not received ₹ 3,000



Answer:

Jayashree Sangha Club
Receipt and Payment Account for the year ended 31.12.2012

| Receipts | ₹ | Payments | ₹ |
|----------------------------------|----------|------------------------------|----------|
| To Balance b/d | 10,000 | By Salary A/c (W/N – 2) | 21,000 |
| To Admission Fees ₹ 12,000 ÷ 40% | 30,000 | By General Expenses | 22,000 |
| To Sale of News Paper | 2,500 | By Audit Fees | 2,500 |
| To Donation | 15,000 | By Printing & Stationary | 7,500 |
| To Misc. Income | 500 | By Rent | 3,500 |
| To Subscription (W/N-1) | 53,000 | By Travelling Expenses | 2,000 |
| | | By News Paper | 1,500 |
| | | By Balance c/d at 31.12.2012 | 51,000 |
| | 1,11,000 | | 1,11,000 |

Balance Sheet of the Club as on 31.12.2011

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------------|------------|--------------------------|------------|
| Accumulated Fund 45,500 | | Sports Equipment | 20,000 |
| Add: Surplus 20,000 | 65,500 | Furniture 15,000 | |
| Admission Fees | 18,000 | Less: Depreciation 2,500 | 12,500 |
| Subscription received in advance | 1,500 | Accrued Subscription | 3,000 |
| Outstanding Salaries | 1,500 | Cash at Bank | 51,000 |
| | 86,500 | | 86,500 |

Working Notes:

(1) Subscription received during the year

| Particulars | ₹ | ₹ |
|--|-------|--------|
| Subscription on accrual basis for 2012 | | 52,000 |
| Add: Subscription of 2011 received in 2012 | | 5,000 |
| Subscription received in advance | | 1,500 |
| | | 58,500 |
| Less: Subscription for 2012 | 3,000 | |
| Subscription for 2012 received in 2011 | 2,500 | 5,500 |
| | | 53,000 |

(2) Salary paid in 2012

| Particulars | ₹ |
|--|--------|
| Salary as per Income & Expenditure A/c | 20,500 |
| Add: Paid for 2011 | 2,000 |
| Less: Outstanding for 2012 | 1,500 |
| | 21,000 |

3. Following is the Balance Sheet of the Rashtriya Club as on 1st April, 2014:

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|--|---------------|----------------------------|---------------|
| Capital Fund | 5,42,500 | Investment in 4% bonds | 1,50,000 |
| Creditors | 1,00,000 | Stock | 60,000 |
| Subscription received in advance for 2014-15 | 30,000 | Outstanding subscriptions: | |
| Outstanding salaries | 70,000 | For 2012-13 | 1,90,000 |
| | | For 2013-14 | 3,00,000 |
| | | Balance at Bank | 42,500 |
| | 7,42,500 | | 7,42,500 |

Following balances on 31st March, 2015:

Creditors ₹ 50,000; Subscriptions for 2015-16 ₹ 40,000; Cash at Bank ₹ 1,77,000; Arrears of Subscriptions for 2013-14 ₹ 1,00,000; Arrears of Subscriptions for 2014-15 ₹ 2,70,000; Members arrears for provisions sold ₹ 40,000.

Details of Transactions during 2014-15:

Subscription received out of arrears of 2012-13 ₹ 1,80,000; Arrears of 2013-14 ₹ 1,70,000; Cash sales of provisions ₹ 1,20,000; Salaries paid ₹ 4,00,000; Interest received ₹ 4,500; 4% Bonds purchased ₹ 1,00,000 on 1.4.2014; Cash purchases of provision 9,00,000; Credit sale of provision to members ₹ 9,00,000.

Other information:

Subscription during 2014-15 was ₹ 7,00,000; Total purchase of provision ₹ 10,90,000; Profit on provisions ₹ 1,20,000; the salaries for the year 2014-15 were ₹ 4,50,000 Rent ₹ 20,000.

You are required to prepare the Receipts and Payments Account, and the Income and Expenditure Account for the year ending 31st March, 2015.

Answer:

Receipts and Payments Account
for the year ended 31st March, 2015

Dr.

Cr.

| Receipts | ₹ | Payments | ₹ |
|--------------------------------|-----------|---------------------------|-----------|
| To Balance in hand | 42,500 | By Salaries | 4,00,000 |
| To Subscriptions for: | | By Investment purchased | 1,00,000 |
| 2012-13 | 1,80,000 | By Purchase of provisions | 90,000 |
| 2013-14 | 1,70,000 | By Creditors (W.N.3) | 10,50,000 |
| 2014-15 (W.N.4) | 4,00,000 | By Balance in hand | 1,77,000 |
| To Cash Sales | 1,20,000 | | |
| To Interest | 4,500 | | |
| To Debtors (W.N.2) | 8,60,000 | | |
| To Subscriptions (for 2015-16) | 40,000 | | |
| | 18,17,000 | | 18,17,000 |



Income and Expenditure Account
For the year ended 31st March, 2015

| Dr. | | Cr. | |
|---|----------|------------------------------|----------|
| Expenditure | ₹ | Incomes | ₹ |
| To Salaries | 4,50,000 | By Subscriptions for 2014-15 | 7,00,000 |
| To Rent | 20,000 | By Interest | 4,500 |
| To Bad Debts (W.N.4) (Subscription for 2013-14) | 30,000 | Add: Accrued interest | 5,500 |
| To Excess of Income over expenditure | 3,30,000 | By Profit on Provision | 1,20,000 |
| | 8,30,000 | | 8,30,000 |

Working Notes:

(1) Provisions Account

| Dr. | | Cr. | |
|------------------|-----------|--------------------------------------|-----------|
| Particulars | ₹ | Particulars | ₹ |
| To Opening Stock | 60,000 | By Sales - Credit ₹ 9,00,000 | |
| To Purchases | 10,90,000 | Cash ₹ 1,20,000 | 10,20,000 |
| To Profit | 1,20,000 | By Closing Stock (Balance in figure) | 2,50,000 |
| | 12,70,000 | | 12,70,000 |

(2) Debtors Account

| Dr. | | Cr. | |
|-----------------------|----------|---------------------|----------|
| Particulars | ₹ | Particulars | ₹ |
| To Sale of Provisions | 9,00,000 | By Cash (Bal. Fig.) | 8,60,000 |
| | | By Balance c/d | 40,000 |
| | 9,00,000 | | 9,00,000 |

(3) Creditors Account

| Dr. | | Cr. | |
|---------------------|-----------|----------------|-----------|
| Particulars | ₹ | Particulars | ₹ |
| To Cash (Bal. Fig.) | 10,50,000 | By Balance b/d | 1,00,000 |
| To Balance c/d | 50,000 | By Provisions | 10,00,000 |
| | 11,00,000 | | 11,00,000 |

(4) Subscription Account

| Dr. | | | | Cr. | | | |
|-------------------------------|----------|----------|----------|------------------|----------|----------|-----------|
| Particulars | 2012-13 | 2013-14 | 2014-15 | Particulars | 2012-13 | 2013-14 | 2014-15 |
| To Balance b/d | 1,90,000 | 3,00,000 | — | By Balance b/d | — | — | 30,000 |
| To Income and Expenditure A/c | — | — | 7,00,000 | By Cash A/c | 1,80,000 | 1,70,000 | 4,00,000* |
| | | | | By Bad Debts A/c | — | 30,000 | — |
| | | | | By Balance c/d | 10,000* | 1,00,000 | 2,70,000 |
| | 1,90,000 | 3,00,000 | 7,00,000 | | 1,90,000 | 3,00,000 | 7,00,000 |

*means balancing figure.

EXERCISE:

1. Jodhpur Club furnishes you the Receipts and Payments Account for the year ended 31.03.2013.

| Receipts | Amount (₹) | Payment | Amount (₹) |
|-------------------------|------------|--|------------|
| Cash in hand (01.04.12) | 40,000 | Salary | 20,000 |
| Cash in bank (01.04.12) | 1,00,000 | Repair expenses | 5,000 |
| Donations | 50,000 | Furniture | 60,000 |
| Subscriptions | 1,20,000 | Investments | 60,000 |
| Entrance fee | 10,000 | Miscellaneous Expenses | 5,000 |
| Interest on investments | 1,000 | Insurance premium | 2,000 |
| Interest from banks | 4,000 | Billiards table and other sports items | 80,000 |
| | | Stationary expenses | 1,500 |
| | | Drama expenses | 5,000 |
| Sale of old newspaper | 1,500 | Cash in hand (31.03.13) | 26,500 |
| Sale of drama tickets. | 10,500 | Cash in bank (31.03.13) | 72,000 |
| | 3,37,000 | | 3,37,000 |

Additional information:

- (i) Subscriptions in arrear for 2012-13 ₹ 9,000 and subscription in advance for the year 2013-14 ₹ 3,500.
- (ii) ₹ 400 was the insurance premium outstanding as on 31.03.2012.
- (iii) Miscellaneous expenses prepaid ₹ 900.
- (iv) 50% of donation is to be capitalized.
- (v) Entrance fees to be treated as revenue income.
- (vi) 8% interest has accrued on investments for five months.
- (vii) Billiards table and other sports equipments costing ₹ 3,00,000 were purchased in the financial year 2011-12 and of which ₹ 80,000 was not paid 31.03.12. There is no charge for Depreciation to be considered.

You are required to prepare income and expenditure account for the year ended 31.03.13 and Balance Sheet of the Club as at 31.03.13.

Answer:

- (i) **Excess of Income over Expenditure - ₹1,41,500;**
- (ii) **Balance Sheet Total as on 01.04.2012 — ₹4,40,000;**
- (iii) **Balance Sheet Total as on 31.03.2013 — ₹5,30,400.**

2. The Income and Expenditure Account of the Bhartia Club for the year ended 31st March, 214 is as follows:

Dr.

Cr.

| Expenditure | ₹ | Income | ₹ |
|----------------------------|--------|--------------------------------------|----------|
| To Salaries | 95,000 | By Subscription | 1,50,000 |
| To General Expenses | 20,000 | By Entrance Fee | 5,000 |
| To Audit Fee | 5,000 | By Collection for Annual Sports Meet | 65,000 |
| To Stationery and Printing | 9,000 | | |
| To Secretary's Honorarium | 20,000 | | |
| To Interest | 2,000 | | |
| To Bank Charges | 1,000 | | |



| | | | |
|--------------------------------------|----------|--|----------|
| To Depreciation | 6,000 | | |
| To Expenditure on Annual Sports Meet | 50,000 | | |
| To Surplus | 12,000 | | |
| | 2,20,000 | | 2,20,000 |

Other Information:

| Expenditure | ₹ |
|--|----------|
| Subscription outstanding on 31.03.2013 | 12,000 |
| Subscription received in advance on 31.03.2013 | 9,000 |
| Subscription outstanding on 31.03.2014 | 15,000 |
| Subscription received in advance on 31.03.2014 | 5,400 |
| Salaries outstanding on 31.03.2013 | 8,000 |
| Salaries outstanding on 31.03.2014 | 9,000 |
| Audit fee outstanding on 31.03.2013 | 4,000 |
| Audit fee outstanding on 31.03.2014 | 5,000 |
| General expenses period on 31.03.2014 | 1,200 |
| Sports equipments as on 31.03.2014 | 52,000 |
| Sports equipments after depreciation on 31.03.2014 | 54,000 |
| Other balances as on 31.03.2014: | |
| Freehold Ground | 2,00,000 |
| Bank Loan | 40,000 |
| Cash & Bank | 32,000 |

You are required to prepare the Receipts and Payments Account for the year ended 31st March, 2014 and Balance sheet as at 31st March, 2014.

Answer:

- (i) Receipts and payment A/c Balance for the year ended 31.03.2014 — ₹32,000;
- (ii) Subscription Received during 2013-14 — ₹1,43,400.
- (iv) Salary paid during 2013-14 — ₹94,000.
- (v) Balance Sheet Total as on 31.03.2014 — ₹3,02,200.

3. Income and Expenditure Account and the Balance Sheet of Nav Bharat Club are as under:

Income and Expenditure Account for the year ending 31st March, 2012

| Dr. | | Cr. | |
|--------------------------|--------|---------------------------|--------|
| Expenditure | ₹ | Income | ₹ |
| To Upkeep of Ground | 21,000 | By Subscription | 56,640 |
| To Printing & Stationery | 2,800 | By Sale of old newspapers | 530 |
| To Salaries | 28,000 | By Lectures | 8,000 |
| To Depreciation: | | By Entrance Fee | 2,900 |
| Ground & Building 9,000 | | By Miscellaneous Incomes | 1,200 |
| Furniture 1,000 | 10,000 | | |
| To Repairs | 3,500 | | |
| To Surplus | 3,970 | | |
| | 69,270 | | 69,270 |

Balance Sheet as at 31st March 2012

| Liabilities | Amount (₹) | Amount (₹) | Assets | Amount (₹) | Amount (₹) |
|-------------------------|---------------|---------------|--------------------|---------------|---------------|
| Capital Fund: | | | Ground & Building | | 1,43,200 |
| Opening Balance | 1,56,430 | | Furniture | | 9,000 |
| Add: Entrance Fee | 2,900 | | Sports Prize Fund: | | |
| Add: Surplus | 3,970 | 1,63,300 | Investment | 43,000 | |
| Sports Prize Fund: | | | Subscription | 2,600 | |
| Opening Balance | 51,000 | | Cash and Bank | 19,400 | 65,000 |
| Add: Interest | 4,500 | | | | |
| | 55,500 | | | | |
| Less: Prizes | 6,500 | 49,000 | | | |
| Outstanding Salary | | 4,200 | | | |
| Subscription in Advance | | 700 | | | |
| | | 2,17,200 | | | 2,17,200 |

The following adjustments have been made in the above accounts:

- (i) Upkeep of ground ₹ 1,500 and printing and stationery ₹ 510 relating to 2010-2011 were paid in 2011-12.
- (ii) One-half of entrance fee has been capitalized.
- (iii) Subscription outstanding in 2010-11 was ₹ 3,100 and for 2011-12 ₹ 2,600.
- (iv) Subscription received in advance in 2010-11 was ₹ 1,100 and in 2011-12 for 2012-13 ₹ 700.
- (v) Outstanding salary on 31.03.2011 was ₹ 3,600.

Prepare Receipts & Payments Account for the year ended on 31st March, 2012.

Answer:

- (i) Receipts and payments A/c Balance 19,400,**
- (ii) Subscription received during 2011-12 ₹56,740.**

Study Note - 5

PREPARATION OF FINANCIAL STATEMENTS FROM INCOMPLETE RECORDS



This Study Note includes

5.1 Preparation of Financial Statements from Incomplete Records

5.1 PREPARATION OF FINANCIAL STATEMENTS FROM INCOMPLETE RECORDS

Introduction

Many times small business organizations do not maintain a comprehensive accounting system which is based on the double entry principle. The businessman is usually happy with the minimum information like the balances of cash and bank accounts and whether he has made a profit or loss. These people maintain rough or sketchy records that serve a limited purpose. Because, the principle of double entry is not followed, it is often referred to as a 'single entry system'. Such system maintains only personal accounts and cash book. Expenses and incomes are reflected in the cash book, whereas personal accounts reflect the debtors' and creditors' position. This system usually follows the principle of 'cash basis accounting' and hence no accrual or non-cash entries are passed. For example, entries like depreciation, provision for expenses, accrued incomes have no place under such system.

Features of Single Entry System:

Single Entry System has the following features.

- Maintenance of books by a sole trader or partnership firm** : The books which are maintained according to this system can be kept only by a sole trader or by a partnership firm.
- Maintenance of cash book** : In this system it is very often to keep one cash book which mixes up business as well as private transactions.
- Only personal accounts are kept** : In this system, it is very common to keep only personal accounts and to avoid real and nominal accounts. Therefore, sometimes, this is precisely defined as a system where only personal accounts are kept.
- Collection of information from original documents** : For information one has to depend on original vouchers, example, in the case of credit sales, the proprietor may keep the invoice without recording it anywhere and at the end of the year the total of the invoices gives an idea of total credit sales of the business.
- Lack of uniformity** : It lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.
- Difficulty in preparation of final accounts** : It is much difficult to prepare trading, profit and loss account and balance sheet due to the absence of nominal and real accounts in the ledger.

Difference between single entry system and double entry system:

The distinctions between double entry system and single entry system are as follows:

- In double entry system both the aspects (debit and credit) of all the transactions are recorded. But in single entry system, there is no record of some transactions, some transactions are recorded only in one of their aspects whereas some other transactions are recorded in both of their aspects.
- Under double entry system, various subsidiary books such as sales book, purchases book etc are maintained. Under single entry system, no such subsidiary books except cash book which is also considered as a part of ledger is maintained.
- In the case of double entry system, there is a ledger which contains personal, real and nominal accounts. But in single entry system, the ledger contains some personal accounts only.
- Under double entry system, preparation of trial balance is possible whereas it is not possible to prepare a trial balance in single entry system. Hence accuracy of work is uncertain.

- (v) Under double entry system, Trading A/c, Profit & Loss A/c and the Balance Sheet are prepared in a scientific manner. But under single entry system, it is not possible – only a rough estimate of profit or loss is made and a Statement of Affairs is prepared which resembles a balance sheet in appearance but which does not present an accurate picture of the financial position of the business.

Benefits of single entry system

- (a) It's quick and easy to maintain.
- (b) One doesn't require employing a qualified accountant.
- (c) This is extremely useful for business run by individuals where the volume of activity is not large.
- (d) It is economical as it does not need a comprehensive record keeping.

Weaknesses of single entry system

- (a) As principle of double entry is not followed, the trial balance cannot be prepared. As such, arithmetical accuracy cannot be guaranteed.
- (b) Profit or loss can be found out only by estimates as nominal accounts are not maintained.
- (c) It is not possible to make a balance sheet in absence of real accounts. d) It is very difficult to detect frauds or errors.
- (d) Valuation of assets and liabilities is not proper.
- (e) The external agencies like banks cannot use financial information. A bank cannot decide whether to lend money or not.
- (f) It is quite likely that the business and personal transactions of the proprietor get mixed.

The method

As the records are incomplete, how does a businessman find out whether he has made a profit or loss? There is no fixed methodology but some techniques can give rough calculations that help assessing the business results. Consider a businessman had cash of ₹15,000. He purchased goods for ₹10,000, sold the same for ₹17,000. Here, the estimate of profit is ₹7,000 (17,000-10,000) and a closing cash of ₹22,000. Another way is to find out the increase or decrease in capital (or net assets).

This method is called statement of affairs method. The statement of affairs is similar to the Balance Sheet with regard to the format and is based on the same accounting equation of

$$\text{Capital} = \text{Assets less Liabilities}$$

The opening as well as closing statement of affairs is made on the basis of information available. Then a statement of profit or loss is prepared. This is made by considering the changes in capital due to additional money brought in by the businessman and the drawings made by him during the period.

Statement of Profit and Loss for the year ended.....

| Particulars | Amount (₹) | Amount (₹) |
|--|------------|------------|
| Capital (at the end) | XX | |
| Less : Capital (at the beginning) | XX | XX |
| Add : Drawings | | XX |
| Less : Further Capital (if any) | | XX |
| Profit/Loss | | XX |
| Less : Adjustments, if any say, Bad debts, Depreciation etc. | | XX |
| Net Profit/Loss for the period | | XX |
| Less : Appropriation items : | | |
| (i) Interest on partner's capital | XX | |
| (ii) Partners' salaries etc. | XX | XX |
| Divisible Profit | | XX |



Illustration 1.

Mr. Prakash keeps his accounts on single entry system. He has given following information about his assets and liabilities.

| Item | On 31-3-2015 | On 31-3-2016 |
|-------------------|--------------|--------------|
| Creditors | 55,200 | 58,500 |
| Cash at bank | 600 | 1,500 |
| Bills payable | 26,400 | 28,200 |
| Bills receivables | 16,200 | 18,300 |
| Debtors | 45,600 | 56,000 |
| Stock in trade | 31,000 | 47,300 |
| Machinery | 66,200 | 78,000 |
| Computer | 18,000 | 17,000 |

During the year, Prakash brought in additional ₹7,500 cash in business. He withdrew goods of ₹2,100 and cash of ₹7,200 for his personal use. Interest on opening capital is to be given at 5% and interest on drawing is to be charged at 10%.

Prepare statement of profit or loss for the year ended 31-03-2016.

Solution:

Here the information about opening and closing capital is not given. Both these figures can be computed based on statement of affairs as on 31-03-2015 and 31-03-2016. These can be worked out on the basis of information given. The balancing figures in both statements will represent capital figures as on those two days.

These figures will then be used together with the information to find out profit or loss. The interest on capital will increase it while, interest on drawings will result in decrease in capital. This will be included in the statement of profit or loss for the year ended 31-03-2016.

Statement of Affairs as on 31-3-2016

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------|------------|-------------------|------------|
| Creditors | 55,200 | Cash at Bank | 600 |
| Bills payable | 26,400 | Bills receivables | 16,200 |
| Capital (balancing figure) | 96,000 | Debtors | 45,600 |
| | | Stock in trade | 31,000 |
| | | Machinery | 66,200 |
| | | Computers | 18,000 |
| | 1,77,600 | | 1,77,600 |

Statement of Affairs as on 31-3-2016

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------|------------|-------------------|------------|
| Creditors | 58,500 | Cash at Bank | 1,500 |
| Bills payable | 28,200 | Bills receivables | 18,300 |
| Capital (balancing figure) | 131,400 | Debtors | 56,000 |
| | | Stock in trade | 47,300 |
| | | Machinery | 78,000 |
| | | Computers | 17,000 |
| | 2,18,100 | | 2,18,100 |

Statement of profit or loss for the year ended 31-03-2016

| Particulars | Amount (₹) |
|---|---------------|
| Closing Capital as per statement of affairs as on (31-3-2015) | 1,31,400 |
| Less: Opening Capital as per statement of affairs as on (31-3-2013) | (96,000) |
| Increase or decrease in capital | 35,400 |
| Add: Drawings (goods + cash) | 9,300 |
| Add: Interest on drawings @ 10% on ₹ 9,300 | 930 |
| Less: Interest on opening capital @ 5% (96,000 * 5%) | (4,800) |
| Less: Fresh capital introduced | (7,500) |
| Net Profit or loss for the year | 33,330 |

Illustration 2.

On 1st April 2012, Neha started a beauty Parlour. She acquired a shop for ₹12,00,000 and paid ₹2,00,000 for interior fittings. She put ₹4,00,000 into business bank A/c. She carried on till 31st March 2013, when she wanted to know what the parlour has earned over the period. She has approached you to find out the business results with following information as on 31-03- 2013:

In addition to the shop and fitting she had following possessions: Stock ₹6,00,000, Motor car (purchased on 30-09-2012) ₹5,50,000, Cash at bank ₹2,50,000. Based on her limited knowledge she has told you to charge depreciation of 2% p.a. on shop, 5% p.a. on fittings and 20% on car.

On 31-3-2013, ₹ 1,40,000 was payable to creditors, and ₹ 1,00,000 to a friend for money borrowed for business. She had withdrawn ₹ 2,000 per month from the business.

Prepare her statement of profit or loss for the year.

Solution:**Statement of Affairs as on 01-04-2012**

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------|------------|----------|------------|
| Capital (balancing figure) | 18,00,000 | Shop | 12,00,000 |
| | | Fittings | 2,00,000 |
| | | Bank | 4,00,000 |
| | 18,00,000 | | 18,00,000 |

Statement of Affairs as on 31-3-2013

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|----------------------------|------------|---|------------|
| Creditors | 1,40,000 | Shop (12,00,000 Less 2% of 12,00,000) | 11,76,000 |
| Loan from Friend | 1,00,000 | Fittings (2,00,000 Less 5% of 2,00,000) | 1,90,000 |
| Capital (balancing figure) | 24,71,000 | Cash at Bank | 2,50,000 |
| | | Motor car [5,50,000 × 20% × ½] | 4,95,000 |
| | | Stock in trade | 6,00,000 |
| | 27,11,000 | | 27,11,000 |



Statement of profit or loss for the year ended 31.03.2013

| Particulars | Amount (₹) |
|---|-------------|
| Closing Capital as per statement of affairs as on 31-3-2013 | 24,71,000 |
| Less: Opening Capital as per statement of affairs as on 31-3-2012 | (18,00,000) |
| Increase or (decrease) in capital | 6,71,000 |
| Add: drawings (2000*12) | 24,000 |
| Net Profit or loss for the year | 6,95,000 |
| Note: | |
| Depreciation calculation | |
| Shop @ 2% for 1 year on ₹ 1,200,000 | 24,000 |
| Fittings @ 5% for 1 year on ₹ 200,000 | 10,000 |
| Car @20% for 6 months on ₹ 550,000 | 55,000 |

Alternative method: Conversion of single entry to double entry:

It may be possible to prepare the P & L A/c and Balance Sheet for such organizations by converting the records into double entry method. In this method, various ledger accounts are prepared e.g. sales, purchases, debtors, creditors, Trading A/c, cash book. As full information is not available the balancing figure in each of these accounts needs to be correctly interpreted. For example, if we know opening & closing balances in Debtors' A/c and the cash received from debtors; then the balancing figure will obviously indicate sales figures. Also, if we know opening and closing balances of creditors & credit purchases figures; then the balancing figure will certainly mean cash paid to creditors.

Once these figures are calculated, it's easy to prepare the financial statements in regular formats.

Illustration 3.

From the following particulars presented by Rama Brothers, who maintain their accounts under Single Entry System, calculate total purchase and total sales.

| Particulars | Balance on | |
|------------------|---------------|----------------|
| | 1.4.2012 ₹ | 31.3.2013 ₹ |
| Debtors | 28,000 | 24,000 |
| Bills Receivable | 14,000 | 15,000 |
| Creditors | 16,000 | 32,000 |
| Bills Payable | 8,000 | 15,000 |

| Transaction during the year | Amount ₹ |
|--|-------------|
| Cash Received from Debtors | 2,00,000 |
| Cash paid to creditors | 1,60,000 |
| Discount Allowed | 1,000 |
| Discount Received | 2,000 |
| Bad Debts | 3,000 |
| Returns Inwards | 5,000 |
| Return Outward | 6,000 |
| Bills Receivable dishonoured | 4,000 |
| Cash paid against Bills Payable | 10,000 |
| Cash Received against Bills Receivable | 16,000 |
| Cash Sales | 60,000 |
| Cash Purchase | 40,000 |

Solution:

In the books of Rama Brothers
Bills Receivable Account

| Dr. | | Cr. | |
|------------------------------------|-------------|----------------------------|-------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Balance b/d | 14,000 | By Cash | 16,000 |
| „ Total Debtors c/d (bal. fig.) | 21,000 | „ Debtors (B/R Dishonours) | 4,000 |
| | 35,000 | „ Balance c/d | 15,000 |
| | | | 35,000 |

Total Debtors Account

| Dr. | | Cr. | |
|----------------------------|-------------|------------------------|-------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Balance b/d | 28,000 | By Cash Received | 2,00,000 |
| „ B/R Dishonoured | 4,000 | „ Discount Allowed | 1,000 |
| „ Credit Sales (bal. fig.) | 2,22,000 | „ Dab Debts | 3,000 |
| | | „ Returns Inward | 5,000 |
| | | „ Bills Receivable A/c | 21,000 |
| | | „ Balance c/d | 24,000 |
| | 2,54,000 | | 2,54,000 |

Bills Payable Account

| Dr. | | Cr. | |
|---------------|-------------|-----------------------------|-------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Cash | 10,000 | By Balance b/d | 8,000 |
| „ Balance c/d | 15,000 | „ Creditors A/c (bal. fig.) | 17,000 |
| | 25,000 | | 25,000 |

Total Creditors Account

| Dr. | | Cr. | |
|---------------------|-------------|-------------------------------|-------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Cash Paid | 1,60,000 | By Balance b/d | 16,000 |
| „ Discount Received | 2,000 | „ Credit Purchase (bal. fig.) | 2,01,000 |
| „ Returns Outwards | 6,000 | | |
| „ Bills Payable | 17,000 | | |
| „ Balance c/d | 32,000 | | |
| | 2,17,000 | | 2,17,000 |



Calculate of Total Sales

| Particulars | Amount ₹ |
|--------------|-------------|
| Total Sales: | |
| Cash Sales | 60,000 |
| Credit Sales | 2,22,000 |
| | 2,82,000 |

Calculate Total Purchase

| Particulars | Amount ₹ |
|-----------------|-------------|
| Total Purchase: | |
| Cash Purchase | 40,000 |
| Credit Purchase | 2,01,000 |
| | 2,41,000 |

Illustration 4.

Mrs. Laxmi, a retail trader needs final accounts for the year ended 31-03-2013 for the purpose of taking a bank loan. However, she informs you that principle of double entry had not been followed. With following inputs, prepare a Profit & Loss A/c for the year ended 31-03-2013 and Balance sheet as on 31-03-2013. Details of receipts and payments:

- (1) Cash deposited in bank ₹3,500
- (2) Dividend on personal A/c deposited into bank ₹250
- (3) Tuition fees of Laxmi's daughter paid by cheque ₹4,500
- (4) Rent for the year by cheque ₹ 9,000
- (5) Cash received from debtors ₹ 52,500
- (6) Paid to creditors ₹ 40,025
- (7) Salaries & wages paid in cash ₹ 9,000
- (8) Transportation in cash ₹ 2,750
- (9) Office electricity in cash ₹ 6,600
- (10) Electricity (house) in cash ₹ 7,200
- (11) General expenses in cash ₹ 890.

Opening and closing balances of assets & liabilities:

| Particulars | 31-3-2012 | 31-3-2013 |
|-------------|-----------|-----------|
| Stock | 42,500 | 22,500 |
| Bank | 55,500 | 20,500 |
| Cash | 10,850 | 10,500 |
| Debtors | 16,800 | 14,800 |
| Creditors | 15,600 | 22,800 |
| Investments | 15,000 | 15,000 |

She also informs you that she draws ₹6,000 from bank on monthly basis and some debtors deposit cheques directly in bank.

Solution:

| Dr. | | Stock Account | | Cr. | |
|-----------------------|------------|-----------------------------|------------|-----|----------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To Balance b/d | 42,500 | By Cost of sales (bal. fig) | 90,135 | | |
| To Purchases (credit) | 47,225 | By Balance c/d | 22,500 | | |
| To Cash (purchases) | 22,910 | | | | |
| | 1,12,635 | | | | 1,12,635 |

| Dr . | | Bank Account | | Cr. | |
|-------------------------------|------------|----------------------------|------------|-----|----------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To Balance b/d | 55,500 | By Drawings (tuition fees) | 4,500 | | |
| To Cash A/c | 3,500 | By Rent | 9,000 | | |
| To Capital (dividend) | 250 | By Creditors | 40,025 | | |
| To Debtors (balancing figure) | 86,775 | By Drawings (@ ₹ 6,000 pm) | 72,000 | | |
| | | By Balance c/d | 20,500 | | |
| | 1,46,025 | | | | 1,46,025 |

| Dr. | | Cash Account | | Cr. | |
|----------------|------------|---------------------------------|------------|-----|--------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To Balance b/d | 10,850 | By Bank | 3,500 | | |
| To Debtors | 52,500 | By Salaries & wages | 9,000 | | |
| | | By Transportation | 2,750 | | |
| | | By Electricity | 6,600 | | |
| | | By Drawings (electricity) | 7,200 | | |
| | | By General expenses | 890 | | |
| | | By Purchases (balancing figure) | 22,910 | | |
| | | By Balance c/d | 10,500 | | |
| | 63,350 | | | | 63,350 |

| Dr. | | Debtors Account | | Cr. | |
|--|------------|-----------------|------------|-----|----------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To Balance b/d | 16,800 | By Cash | 52,500 | | |
| To Sales (credit Sales) (balancing figure) | 1,37,275 | By Bank | 86,775 | | |
| | | By Balance c/d | 14,800 | | |
| | 1,54,075 | | | | 1,54,075 |

| Dr. | | Creditors Account | | Cr. | |
|----------------|------------|-----------------------------------|------------|-----|--------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | | |
| To Bank | 40,025 | By Balance b/d | 15,600 | | |
| To Balance c/d | 22,800 | By Purchases (credit) (bal. fig.) | 47,225 | | |
| | 62,825 | | | | 62,825 |



Dr.

Mrs. Laxmi's capital Account

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|----------------------------|------------|----------------------------|------------|
| To Drawings (tuition fees) | 4,500 | By Balance b/d (bal. fig.) | 1,25,050 |
| To Drawings (electricity) | 7,200 | By Bank (dividend) | 250 |
| To Drawings (bank) | 72,000 | | |
| To Balance c/d | 41,600 | | |
| | 1,25,300 | | 1,25,300 |

Dr.

Trading Account

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|----------------------|------------|----------------------|------------|
| To Opening stock A/c | 42,500 | By Sales A/c | 1,37,275 |
| To Purchases A/c | 70,135 | By Closing Stock A/c | 22,500 |
| To Gross profit c/d | 47,140 | | |
| | 1,59,775 | | 1,59,775 |

Dr.

Profit & Loss Account

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|---------------------|------------|---------------------|------------|
| To Rent | 9,000 | By Gross Profit b/d | 47,140 |
| To Salary & wages | 9,000 | | |
| To Transportation | 2,750 | | |
| To Electricity | 6,600 | | |
| To General Expenses | 890 | | |
| To Net Profit c/d | 18,900 | | |
| | 47,140 | | 47,140 |

Balance sheet as on 31st March 2013

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|----------------------------|------------|-------------|------------|
| Creditors | 22,800 | Stock | 22,500 |
| Capital (balancing figure) | 41,600 | Bank | 20,500 |
| Net profit | 18,900 | Cash | 10,500 |
| | | Debtors | 14,800 |
| | | Investment | 15,000 |
| | 83,300 | | 83,300 |

QUESTIONS:

1. Mr. Kumar kept no books of accounts for his business. An analysis of his rough Cash Book for the calendar year 2015 shows the following particulars :

| Receipts | ₹ | Payments | ₹ |
|----------------------------|--------|-------------------------------|--------|
| Received from Debtors | 60,000 | Overdraft on 1-1-2015 | 7,400 |
| Further Capital introduced | 5,000 | Paid to Creditors | 25,000 |
| | | Business Expenses | 10,000 |
| | | Wages paid | 15,500 |
| | | Proprietor's drawings | 3,000 |
| | | Balance at Bank on 31-12-2015 | 4,000 |
| | | Cash in hand | 100 |
| | 65,000 | | 65,000 |

The following information are also available:

| | On 31-12-2014 ₹ | On 31-12-2015 ₹ |
|------------------------|--------------------|--------------------|
| Debtors | 53,000 | 88,000 |
| Creditors | 15,000 | 19,500 |
| Stock-in-trade | 17,000 | 19,000 |
| Plant and Machinery | 20,000 | 20,000 |
| Furniture and Fittings | 1,400 | 1,400 |

All his sales and purchases were on credit

From the above particulars prepare Trading' and Profit and Loss Account for the year ended 31 -12-2015 and a Balance Sheet as at that date after providing for dcprcciauon on Plant and Machinery @ 10 per cent, and on Furniture and Fittings @ 5 per cent, per annum.

Solution:**Working:****Balance Sheet as at 31-12-2014**

| Liabilities | ₹ | Assets | ₹ |
|----------------------------|--------|------------------------|--------|
| Creditors | 15,000 | Debtors | 53,000 |
| Bank Overdraft | 7,400 | Stock-in-trade | 17,000 |
| Capital (balancing figure) | 69,000 | Furniture and Fittings | 1,400 |
| | | Plant & Machinery | 20,000 |
| | 91,400 | | 91,400 |

Dr.**Total Debtors Account****Cr.**

| | ₹ | | ₹ |
|----------------------------|----------|---------------|----------|
| To Balance b/f | 53,000 | By Cash | 60,000 |
| " Sales (balancing figure) | 95,000 | " Balance c/f | 88,000 |
| | 1,48,000 | | 1,48,000 |



Dr. Total Creditors Account Cr.

| | ₹ | | ₹ |
|---------------|--------|--------------------------------|--------|
| To Cash | 25,000 | By Balance b/f | 15,000 |
| " Balance c/f | 19,500 | " Purchases (balancing figure) | 29,500 |
| | 44,500 | | 44,500 |

Mr. Kumar

Trading and Profit & Loss Account

Dr. for the year ended 31st December, 2015 Cr.

| | ₹ | | ₹ |
|--|----------|---------------------|----------|
| To Opening Stock | 17,000 | By Sales | 95,000 |
| " Purchases | 29,500 | " Closing Stock | 19,000 |
| " Wages | 15,500 | | |
| Gross Profit c/d | 52,000 | | |
| | 1,14,000 | | 1,14,000 |
| To Business Expenses | 10,000 | By Gross Profit b/d | 52,000 |
| " Depreciation: | | | |
| on Plant & Machinery 2,000 | | | |
| on Furniture & Fittings <u>70</u> | 2,070 | | |
| " Net Profit—transferred to Capital | 39,930 | | |
| | 52,000 | | 52,000 |

Balance Sheet as at 31st December, 2015

| Liabilities | | ₹ | Assets | | ₹ |
|------------------|----------|----------|------------------------|--------|----------|
| Capital: | | | Fixed Assets: | | |
| as on 1-1-92 | 69,000 | | Plant & Machinery | 20,000 | |
| Add: Fresh | | | Less: Depreciation | 2,000 | 18,000 |
| Capital put in | 5,000 | | Furniture & Fittings | 1,400 | |
| Net Profit | 39,930 | | Less: Depreciation | 70 | 1,330 |
| | 1,13,930 | | | | |
| Less: Drawings | 3,000 | 1,10,930 | Current Assets: | | |
| Sundry Creditors | | 19,500 | Stock-in-trade | | 19,000 |
| | | | Sundry Debtors | | 88,000 |
| | | | Cash at Bank | | 4,000 |
| | | | Cash in hand | | 100 |
| | | 1,30,430 | | | 1,30,430 |

Preparation of Financial Statements from Incomplete Records

2. Mr. Jaiswal commenced business as a Cloth Merchant on 1st January, 2015, with a capital of ₹ 2,000. On the same day, he purchased furniture for cash ₹ 600. The books are maintained by Single Entry. From the following particulars (i) calculate the cash on hand as on 31-12-15, (ii) prepare a Trading and Profit and Loss Account for the year ending 31st December, 2015 and (iii) a Balance Sheet as on that date :

| | ₹ |
|---|-------|
| Sales (including cash sales of ₹ 1,400) | 3,400 |
| Purchases (including cash purchases of ₹ 800) | 3,000 |
| Jaiswal's drawings | 240 |
| Salaries of Staff | 400 |
| Bad Debts written off | 100 |
| Business Expenses | 140 |
| Stock of goods on 31-12-2015 | 1,300 |
| Sundry Debtors on 31 -12-2015 | 1,040 |
| Sundry Creditors on 31-12-2015 | 720 |

Mr. Jaiswal took cloth costing ₹ 100 from the shop for private use and paid ₹ 40 cash to his son, but omitted to record these transactions in his books. Provide depreciation on furniture at 10 per cent per annum.

Solution:

Workings:

Dr. Cash Book Cr.

| | ₹ | | ₹ |
|---------------------------------------|-------|---|-------|
| To Capital | 2,000 | By Furniture | 600 |
| “ Sales | 1,400 | “ Purchases | 800 |
| “ Sundry Debtors (as per Debtors A/c) | 860 | “ Drawings (240 - 40) | 280 |
| | | “ Salaries | 400 |
| | | “ Business Expenses | 140 |
| | | “ Sundry Creditors (as per Creditors A/c) | 1,480 |
| | | “ Balance c/f | 560 |
| | 4,260 | | 4,260 |

Total Debtors Account

| | ₹ | | ₹ |
|------------------------|-------|---------------------------|-------|
| To Sales (3,400-1,400) | 2,000 | By Bad Debts | 100 |
| | | “ Cash (balancing figure) | 860 |
| | | “ Balance c/f | 1,040 |
| | 2,000 | | 2,000 |

Total Creditors Account

| | ₹ | | ₹ |
|----------------------------|-------|----------------------------|-------|
| To Cash (balancing figure) | 1,480 | By Purchases (3,000 – 800) | 2,200 |
| “ Balance c/f | 720 | | |
| | 2,200 | | 2,200 |



**Mr. Jaiswal Trading and Profit & Loss Account
for the year ended 31st December, 2015**

| | | ₹ | | | ₹ |
|----|-----------------------------------|------------|----|------------------|-------|
| To | Purchases | 3,000 | By | Sales | 3,400 |
| " | Less: Cloth taken for private use | <u>100</u> | " | Closing Stock | 1,300 |
| " | Gross Profit c/d | 1,800 | | | |
| | | 4,700 | | | 4,700 |
| To | Salaries | 400 | By | Gross Profit b/d | 1,800 |
| " | Bad Debts | 100 | | | |
| " | Business Expenses | 140 | | | |
| " | Depreciation on Furniture | 60 | | | |
| " | Net Profit—transferred to Capital | 1,100 | | | |
| | | 1,800 | | | 1,800 |

Balance Sheet as at 31st December 2015

| Liabilities | | ₹ | Assets | | ₹ |
|-----------------------------|--------------|-------|--------------------|-----------|-------|
| Capital | 2,000 | | Furniture | 600 | |
| Add: Net Profit | <u>1,100</u> | | Less: Depreciation | <u>60</u> | 540 |
| | 3,100 | | Stock-in-trade | | 1,300 |
| Less : Drawings (280 + 100) | <u>380</u> | 2,718 | Sundry Debtors | | 1,040 |
| Sundry Creditors | | 720 | Cash | | 560 |
| | | 3,440 | | | 3,440 |

3. N is a small trader. He maintains no books but only an account with a bank in which all takings are lodged after meeting business expenses and his personal drawings and in which all payments for business purchases are passed through.

You are required to ascertain his trading result for the year ended 31-3-15 and Balance Sheet as on that date from the following information:

- (i) The bank statement shows deposits during the year of ₹ 12,020 and withdrawals of ₹ 11,850.
- (ii) The Assets and Liabilities on 31-3-16 were: Stock— ₹ 1,100; Book Debts— ₹ 1,150; Bank balance—₹ 320; Furniture—₹ 2,000 and Trade creditors— ₹ 400.
- (iii) In the absence of reliable information, estimates are supplied on the following matters:
 - (a) The Stock and Book Debts have each increased by ₹ 100 during the year. There was no purchase or sale of furniture during the year.
 - (b) The trade creditors were ₹ 200 on 1-4-95.
 - (c) During the year the personal expenses amounted to ₹ 800 and business expenses ₹ 700.

Solution:

Workings—

| | | |
|-----|----------------------------------|--------|
| (1) | Statement of Bank Balance | ₹ |
| | Balance on 31-3-16 | 320 |
| | Add: Withdrawals during the year | 11,850 |
| | | 12,170 |
| | Less : Deposits during the year | 12,020 |
| | Balance as on 1-4-15 | 150 |

Preparation of Financial Statements from Incomplete Records

| | | | |
|-----|--|------------|---------------|
| (2) | Receipts from customers during the year— | | |
| | Amount deposited into Bank | | 12,020 |
| | Add: Expenses met out of receipts | | |
| | Personal | 800 | |
| | Business | <u>700</u> | 1,500 |
| | | | <u>13,520</u> |
| (3) | Sales during the year— | | ₹ |
| | Receipts from customers as in (2) | | 13,520 |
| | Add: Sundry Debtors at the end | | <u>1,150</u> |
| | | | 14,670 |
| | Less : Sundry Debtors at the beginning (1,150-100) | | <u>1,050</u> |
| | | | <u>13,620</u> |
| (4) | Purchases during the year— | | |
| | Payments to suppliers | | 11,850 |
| | Add: Sundry Creditors at the end | | <u>400</u> |
| | | | 12,250 |
| | Less : Sundry Creditors at the beginning | | <u>200</u> |
| | | | <u>12,050</u> |
| (5) | Capital on 1-4-15 | | |

Balance Sheet as at 1-4-15

| Liabilities | ₹ | Asstes | ₹ |
|--------------------------|-------|-------------------|-------|
| Sundry Creditors Capital | 200 | Furniture | 2,000 |
| (balancing figure) | 4,000 | Stock (1,100-100) | 1,000 |
| | | Sundry Debtors | 1,050 |
| | | Bank | 150 |
| | 4,200 | | 4,200 |

Mr. N

Trading and Profit & Loss Account

| | | | |
|-----------------------------------|-----------------------------------|---------------------|---------------|
| Dr. | for the year ended 31-3-16 | | Cr. |
| | ₹ | | ₹ |
| To Opening Stock | 1,000 | By Sales | 13,620 |
| Purchases | 12,050 | “ Closing Stock | 1,100 |
| “ Gross Profit c/d | 1,670 | | |
| | <u>14,720</u> | | <u>14,720</u> |
| To Business Expenses | 700 | By Gross Profit b/d | 1,670 |
| Net Profit—transferred to Capital | 970 | | |
| | <u>1,670</u> | | <u>1,670</u> |



Balance Sheet as at 31-3-2016

| Liabilities | ₹ | Assets | ₹ |
|----------------------|-------|----------------|-------|
| Capital as on 1-4-15 | 4,000 | Furniture | 2,000 |
| Add: Net Profit | 970 | Stock | 1,100 |
| | 4,970 | Sundry Debtors | 1,150 |
| Less: Drawings | 800 | Bank | 320 |
| Sundry Creditors | 4,00 | | |
| | 4,570 | | 4,570 |

4. The Statement of Affairs of Mr. M on Saturday, the 31st December 2015 was as follows:

| | ₹ | | ₹ |
|------------------------|--------|--------------|--------|
| Capital | 50,000 | Fixed Assets | 30,000 |
| Sundry Creditors | 10,000 | Stock | 10,000 |
| Liability for Expenses | 1,000 | Debtors | 15,000 |
| | | Bank | 5,000 |
| | | Cash | 1,000 |
| | 61,000 | | 61,000 |

Mr. M did not maintain his books on the Double Entry System. But he carefully follows the following system:

1. Every week he draws ₹ 200.
2. After meeting his weekly sundry expenses (₹ 100 on average) and his drawings, the balance of weekly collections is banked at the commencement of the next week.
3. No cash purchase is made and creditors are paid by cheques.
4. Sales are at fixed price which include 20% profit on sales.
5. Credit sales are few and are noted in a diary. Payments are received in cheques only from such parties.
6. Expenses other than sundries and other special drawings are made in cheques.
7. All unpaid bills are kept in a file carefully.

The following are his bank transactions for 13 weeks :

| | ₹ | | ₹ |
|-------------------|--------|---------------------------------------|--------|
| Balance on Jan. 1 | 5,000 | Creditors paid | 40,000 |
| Cheques deposited | 2,000 | Rent paid | 600 |
| Cash deposited | 42,000 | Expenses (other than Sundry Expenses) | 3,000 |
| | | Balance on April 1 | 5,400 |
| | 49,000 | | 49,000 |

After 13 weeks on 1st April (Monday) the entire cash was missing when it was to be deposited in the bank. The following further facts are ascertained :

1. Stock on that day was valued at ₹ 4,000 ;
2. Sundry Debtors amounted to ₹ 20,000 as per diary ;
3. Sundry Creditors were ₹ 8,000 as per unpaid bills file. Find out the amount of cash missing.

Solution:

| Dr. | Sundry Debtors Account | | Cr. |
|------------------------------------|------------------------|---------------|--------|
| | ₹ | | ₹ |
| To Balance b/f | 15,000 | By Bank | 2,000 |
| To Credit Sales (balancing figure) | 7,000 | “ Balance c/f | 20,000 |
| | 22,000 | | 22,000 |

| Dr. | Sundry Creditors Account | | Cr. |
|----------------|--------------------------|--|--------|
| | ₹ | | ₹ |
| To Bank | 40,000 | By Balance b/f | 10,000 |
| To Balance c/f | 8,000 | By Credit Purchases (balancing figure) | 38,000 |
| | 48,000 | | 48,000 |

| Dr. | Cash Account | | Cr. |
|----------------|--------------|-------------------------------------|--------|
| | ₹ | | ₹ |
| To Balance b/f | 1,000 | By Drawings: (13 x ₹ 200) | 2,600 |
| “ Cash Sales | 48,000 | “ Sundry Expenses : (13 x ₹ 100) | 1,300 |
| | | “ Bank | 42,000 |
| | | “ Balance being cash missing | 3,100 |
| | 49,000 | | 49,000 |

| | |
|--|---------------|
| Note: Calculation of Cash Sales— | ₹ |
| Opening Stock | 10,000 |
| Add: Purchases | <u>38,000</u> |
| | 48,000 |
| Less: Closing Stock Cost of goods sold | <u>4,000</u> |
| | 44,000 |
| Add : Gross Profit: 20% on Sales i.e., 25% on cost | <u>11,000</u> |
| Total Sales | 55,000 |
| Less: Credit Sales | <u>7,000</u> |
| Cash Sales | <u>48,000</u> |

5. The following information is supplied from defective records. You are required to prepare Trading and Profit & Loss Account for the year ended 31st December, 2015 and Balance Sheet as on that date:

| | 1st January 2015 ₹ | 31st January 2015 ₹ |
|--------------------------|--------------------------|---------------------------|
| Creditors | 15,770 | 12,400 |
| General Expenses owing | 600 | 330 |
| Sundry assets | 11,610 | 12,040 |
| Stock | 8,040 | 11,120 |
| Cash in hand and at Bank | 6,960 | 8,080 |
| Debtors | ? | 17,870 |



Details relating to the year's transactions :

| | ₹ |
|--|--------|
| Cash and discount credited to Debtors | 64,000 |
| Returns from Debtors | 1,450 |
| Bad debts | 420 |
| Sales—Cash and Credit | 71,810 |
| Discount allowed by Creditors | 700 |
| Returns to Creditors | 400 |
| Capital introduced (paid into Bank) | 8,500 |
| Receipts from Debtors (paid into Bank) | 62,500 |
| Cash purchases | 1,030 |
| Expenses paid by cash | 9,570 |
| Purchase of machinery by cheque | 430 |
| Withdrawn from Bank into cash | 9,240 |
| Drawings by cheque | 3,180 |
| Cash payment into Bank | 5,000 |
| Cash in hand at end | 1,200 |
| Payments to Creditors by cheque | 60,270 |

Solution:

Workings—

Balance Sheet as at 1-1-2015

| Liabilities | ₹ | Assets | ₹ |
|----------------------------|--------|----------------|--------|
| Sundry Creditors | 15,770 | Sundry Assets | 11,610 |
| Outstanding Expenses | 600 | Stock-in-trade | 8,040 |
| Capital (balancing figure) | 26,770 | Sundry Debtors | 16,530 |
| | | Cash in hand | 2,960 |
| | | Cash at Bank | 4,000 |
| | 43,140 | | 43,140 |

Dr.

Cash Book

Cr.

| | Cash | | | Cash | |
|----------------------|--------|--------|-------------------|--------|--------|
| | ₹ | ₹ | | ₹ | ₹ |
| To Balance b/f | 2,960 | 4,000 | By Cash Purchases | 1,030 | — |
| " Capital introduced | — | 8,500 | " Expenses | 9,570 | — |
| " Debtors | — | 62,500 | " Machinery | — | 430 |
| " Bank (C) | 9,240 | | " Cash (C) | — | 9,240 |
| " Cash (C) | — | 5,000 | " Drawings | — | 3,180 |
| " Cash Sales | 4,600 | — | " Creditors | — | 60,270 |
| | | | " Bank (C) | 5,000 | — |
| | | | " Balance c/f | 1,200 | 6,880 |
| | 16,800 | 80,000 | | 16,800 | 80,000 |

Note : Opening Cash Book Balances: Cash at Bank : Balancing figure i.e., 80,000 - (8,500+62,500+5,000) = ₹4,000

Preparation of Financial Statements from Incomplete Records

Cash in hand : 6,960 - 4,000 = ₹ 2,960

Cash Sales : Balancing figure i.e., 16,800 - (2,960 + 9,240) = ₹ 4,600.

| Dr. | Sundry Debtors Account | | Cr. |
|-----------------------------------|------------------------|---------------|--------|
| | ₹ | | ₹ |
| To Balance b/f (balancing figure) | 16,530 | By Cash | 62,500 |
| “ Sales (71,810 – 4,600) | 67,210 | “ Discount | 1,500 |
| | | “ Bad Debts | 420 |
| | | “ Returns | 1,450 |
| | | “ Balance c/f | 17,870 |
| | 83,740 | | 83,740 |

| Dr. | Sundry Creditors Account | | Cr. |
|-------------|--------------------------|------------------------------|--------|
| | ₹ | | ₹ |
| To Bank | 60,270 | By Balance b/f | 15,770 |
| Discount | 700 | Purchases (balancing figure) | 58,000 |
| Returns | 400 | | |
| Balance c/f | 12,400 | | |
| | 73,770 | | 73,770 |

Books of.

Trading and Profit & Loss Account

| Dr. | for the year ended 31st December, 2015 | | Cr. |
|-------------------------------------|--|---------------------|--------|
| | ₹ | | ₹ |
| To Opening Stock | ₹ 8,040 | By Sales: Cash | 4,600 |
| | | Credit | 67,210 |
| To Purchases: Cash | 1,030 | | 71,810 |
| Credit | 58,000 | | |
| | 59,030 | Less: Returns | 1,450 |
| Less: Returns | 400 | | 70,360 |
| “ Gross Profit c/d | 14,810 | “ Closing Stock | 11,120 |
| | 81,480 | | 81,480 |
| “ Expenses | 9,300 | By Gross Profit b/d | 14,810 |
| “ Discount | 1,500 | “ Discount | 700 |
| “ Bad Debts | 420 | | |
| “ Net Profit transferred to Capital | 4,290 | | |
| | 15,510 | | 15,510 |



Balance Sheet as at 31st December, 2015

| Liabilities | | ₹ | Assets | ₹ |
|----------------------------|---------------|---------------|----------------|---------------|
| Capital as on 1-1-15 | 26,770 | | Sundry Assets | 12,040 |
| Add : Fresh Capital put in | 8,500 | | Stock-in-trade | 11,120 |
| Net Profit | 4,290 | | Sundry Debtors | 17,870 |
| | <u>39,560</u> | | Cash in hand | 1,200 |
| Less: Drawings | 3,180 | 36,380 | Cash at bank | 6,880 |
| | | | | |
| Sundry Creditors | | 12,400 | | |
| Outstanding Expenses | | 330 | | |
| | | <u>49,110</u> | | <u>49,110</u> |

EXERCISE:

1. Mr. Dave does not maintain his accounts strictly on double entry system. The following statement of affairs was, however, prepared by him as on 31st March, 2014:

Statement of Affairs

| | ₹ | | ₹ |
|------------------|---------------|---------------------|---------------|
| Capital account | 28,000 | Leasehold land | 2,075 |
| Sundry creditors | 3,170 | Plant and machinery | 4,940 |
| Bills payable | 2,150 | Stock-in-trade | 9,673 |
| | | Book debts | 15,550 |
| | | Cash in hand | 1,082 |
| | <u>33,320</u> | | <u>33,320</u> |

On 31st March, 2015 it was learnt that he had introduced further capital of ₹1,000 on 1st July, 2014 and he had drawn ₹1,580 on various dates during the year. It was also ascertained that the proprietor had taken ₹75 worth of goods for his own use.

Statement prepared on the same date disclosed that book debts were ₹14,640, creditors were ₹2,039 and bills payable were ₹1,775. The stock was valued at ₹11,417 and the cash in hand amount to ₹917 on the same date.

You are required to prepare: (a) a statement of profit or loss for the year 2014 – 15; and (b) a statement of affairs of Dave as on 31st March, 2015 taking into consideration the following:

5% reserve to be created on book debts, 7 ½ % depreciation to be written off plant and machinery, ₹125 to be written off the lease, 5% interest to be allowed on capital.

[Answer: Net Profit ₹1,602, Total of Statement of Affairs — ₹32,761]

2. Mr. A does not maintain complete double entry books of accounts. From the following details determine profit for the year and prepare a statement of affairs as at the end of the year.

₹1,000 (cost) furniture was sold for ₹5,000 on 1st January, 2014. 10% depreciation is to be charged on furniture. Mr. A has drawn ₹1,000 per month. ₹2,000 was invested by Mr. A in 2014.

| | 01.01.14 | 31.12.14 |
|----------------------|----------|-------------------|
| | ₹ | ₹ |
| Stock | 40,000 | 60,000 |
| Debtors | 30,000 | 40,000 |
| Cash | 2,000 | 1,000 |
| Bank | 10,000 | 5,000 (overdraft) |
| Creditors | 15,000 | 25,000 |
| Outstanding expenses | 5,000 | 8,000 |
| Furniture (cost) | 3,000 | 2,000 |

Bank balance on 1st January, 2014 is as per cash book, but the bank overdraft on 31st December, 2014 is as per bank statement. ₹2,000 cheques drawn in December, 2014 have not been encashed within the year.

[Answer: Net Profit ₹7,800, Total of Statement of Affairs — ₹1,02,800]



Study Note - 6

PARTNERSHIP

This Study Note includes

- 6.1 Admission of Partner
- 6.2 Retirement of Partner
- 6.3 Death of Partner
- 6.4 Dissolution of a Partnership Firm
- 6.5 Insolvency of a Partner
- 6.6 Amalgamation of Firms and Conversion to a Company
- 6.7 Conversion or Sale of a Partnership Firm to a Company

6.1 ADMISSION OF PARTNER

Partners of a continuing business may, by common consent, decide to admit a new partner for additional capital, technical skill or managerial efficiency. At the time of such admission, the usual adjustments required are: (1) Adjustment regarding Profit Sharing Ratio; (2) Adjustment regarding Valuation of Assets and Liabilities; (3) Adjustment regarding Goodwill; (4) Adjustments regarding accumulated Profits or Losses and (5) Adjustment regarding Capital Contribution of New partner and Capitals of existing partners.

1. **Adjustment regarding Profit Sharing Ratio** : The new partner becomes entitled to a share of future profits which is sacrificed by the existing (old) partners in his favour. The sacrifice may be made by one or all of the existing partners. **The new profit sharing ratio has to be found out.**

It should be noted that :

- (a) The new profit sharing ratio may be agreed upon by the partners. [It may be given and we need not calculate it]
- (b) The mutual profit sharing ratio among the existing partners may remain unaltered after giving away the new partner's share.

Example : X and Y were partners sharing profit/losses as 3 : 2. They admit as a new partner giving him 1/5th share of future profits. What should be the new profit sharing ratio?

Solution : Z's share = 1/5 Balance = 1 – 1/5 = 4/5

X's share = $4/5 \times 3/5 = 12/25$; Y's share = $4/5 \times 2/5 = 8/25$; Z's share = $1/5 = 5/25$. The new profit sharing ratio = 12 : 8 : 5.

- (c) The mutual profit sharing ratio among existing partners may be changed by agreement.

Example : P and Q were partners sharing profits/losses as 4 : 3. R is admitted as a new partner for 1/5 th share. P and Q decide to share the balance of profits equally.

Solution : R's share = 1/5 Balance = 1 – 1/5 = 4/5.

P's share = $4/5 \times 1/2 = 4/10$; Q's share = $4/5 \times 1/2 = 4/10$; R's share = $1/5 = 2/10$. New Ratio = 4 : 4 : 2 or 2 : 2 : 1.

- (d) If the sacrifice made individually by the existing partners is given then New Ratio should be calculated by deducting the sacrifice from the old ratio.

Example : A, B & C were partners sharing profits/loses as 3 : 2 : 1. They admitted D as a new partner giving him 1/6th share of future profits. D acquired 3/24 th share from A and 1/24 share from B. Calculate the new Profit Sharing Ratio.

Solution : New Ratio = Old Ratio – Sacrifice Ratio

A = $3/6 - 3/24 = 12/24 - 3/24 = 9/24$; B = $2/6 - 1/24 = 8/24 - 1/24 = 7/24$; C = $1/6 - \text{Nil} = 4/24 - \text{Nil} = 4/24$; D = $3/24 + 1/24 = 4/24$ The new ratio = 9 : 7 : 4 : 4.

Thus regarding Profit Sharing Ratio we can sum up as follows :

- Old Ratio** = Profit Sharing Ratio of existing Partners (before admission of new partner)
= Given or Equal (If not mentioned)
- New Ratio** = Future Profit Sharing Ratio among all partners (including new partner, after his admission)
= Given **or** = Old Ratio – Sacrificing Ratio made by each of existing partners.
- Sacrificing ratio** = Share of an existing partner under Old Ratio – his Share under new ratio.

But unless otherwise mentioned the mutual profit sharing Ratio between the existing partners will remain unaltered. In that case Sacrifice Ratio = Old Ratio.

It will be evident from subsequent discussions that proper use of the above ratios will be required for solving problems regarding Admission of a new partner.

- Adjustment Regarding Valuation of Assets and Liabilities :** The Book values of assets as shown in the Balance Sheet may not reflect their current realizable values. Similarly the liabilities included in the Balance Sheet may not exhibit their actual position. Whenever a change takes place in a partnership business in the form of admission or retirement or death of a partner or due to change in profit sharing ratio, revaluation of assets or liabilities become necessary.

The effect of Revaluation are given in two ways : (a) **by incorporation the changes of the Balance Sheet Values** and (b) **without changing the Balance Sheet values.**

(a) By Incorporating Changes in the Balance sheet values

Prepare : Revaluation Account

- For decrease in the value of assets, increase in the value of liabilities, provision for unrecorded liabilities:
Revaluation A/c Dr
To Assets A/c (with the decrease in value)
To Liabilities A/c (with the increase in value)
- For increase in the value of assets, decrease in the value of liabilities, unrecorded assets
Assets A/c Dr (with the increase in value)
Liabilities A/c Dr (with the decrease in value)
To Revaluation A/c
- For profit on revaluation :
Revaluation A/c Dr
To old partners capital A/c (in their old profit sharing ratio) [For loss on revaluation, the reverse entry should be made]

Proforma :

| Revaluation Account | | | |
|--|-------|--|-------|
| Dr. | | Cr. | |
| Particulars | ₹ | Particulars | ₹ |
| To Assets (Decrease) | x x x | By Assets (Increase) | x x x |
| To Liabilities (Increase) | x x x | By Liabilities (Decrease) | x x x |
| To Partners Capital A/c (Share of Revaluation Profit) | x x x | By Partners Capital A/c (Share of Revaluation loss) | x x x |
| | x x x | | x x x |

(b) Without changing the Balance sheet Values

Prepare : Memorandum Revaluation Account

- (i) Record increase/decrease in the value of assets and liabilities as discussed.
- (ii) Share the profit or loss on Revaluation amongst the old partners in their old profit sharing Ratio.
- (iii) Reverse the increase/decrease in the value of assets and liabilities.
- (iv) After reversal, calculate profit or loss.
- (v) Share the profit/loss, after reversal amongst all the partners (including the new partner) in their new profit sharing ratio.

Memorandum Revaluation Account

| Dr. | | Cr. | |
|---|----------------|---|-----|
| Particulars | ₹ | Particulars | ₹ |
| To Assets (Decrease) | x x | By Assets (Increase) | x x |
| To Liabilities (Increase) | x x | By Liabilities (Decrease) | x x |
| To Partners Capital A/c (Share of Revaluation Profit) [Old Partners in old Profit sharing Ratio] | x x x x | By Partners Capital A/c (Share of Revaluation loss) [Old Partners in their Old profit sharing ratio] | x x |
| | xxx | | xxx |
| To Reversal of Items b/d | x x | By Reversal of Items b/d | x x |
| To Partners Capital A/c (Revaluation Profit amount all partners in new profit sharing Ratio) | x x | By Partners capital A/c (Revaluation loss amount all partners in their new Profit sharing Ratio) | x x |
| | xxx | | xxx |

3. Adjustment regarding Goodwill : It is being separately discussed later.

Adjustment Regarding Goodwill

Goodwill is an invisible force that helps a business to earn more than the normal return on investment enjoyed by similar businesses. It is the sum total of the reputation and other favourable attributes built up by a business. Goodwill results into larger number of customers, higher turnover and more profits for a business. The additional profits earned by the business or its "super profits" indicate that it has goodwill. Thus goodwill is a real but intangible asset.

When the amount paid for the purchase of a business is in excess of its net assets, such excess payment is treated as "Goodwill at Cost" or "Purchased Goodwill".

Where there is no purchase or sale but a change of constitution takes place like admission of a new partner etc., the value of goodwill may be recognised as "Inherent/Potential" Goodwill. Accounting Treatment of Goodwill as Read with the Relevant Accounting Standard issued by the ICAI.

(A) Accounting Standard 10 (AS—10) to related is 'Accounting for Fixed Assets'.

(B) Paragraph 16 of this standard stipulates that "Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is excess of the value of the net assets of the business taken over the excess is to be termed as 'goodwill'."

Illustration 1.

X and Y were partners sharing profits as 4 : 3. Z joined as a new partner. The new profit sharing ratio between X, Y and Z was agreed to be 7 : 5 : 3. The Goodwill of the firm was valued at ₹ 84,000. But Z could not pay any premium for goodwill.

Solution :

Step 1 : Calculate Z's premium : $3/15$ of ₹ 84,000 = ₹ 16,800

Step 2 : Calculate sacrifices made by X and Y : $X = (4/7 - 7/15) = 11/105$

$Y = 3/7 - 5/15 = 10/105$ Sacrifice Ratio : 11:10.

| | |
|---------------------|--------|
| Z's Capital A/c Dr. | 16,800 |
| To X's Capital A/c | 8,800 |
| To Y's Capital A/c | 8,000 |

Treatment of Goodwill (At the time of Admission of a New Partner)

| Sl. No | Case | Journal Entry | Ratio used | Remarks |
|--------|--|--|---|---|
| 1. | New Partner pays Premium for Goodwill. | Cash/Bank..... Dr. To Old Partners Capital (Premium money) | Sacrifice Ratio | (1) If mutual ratio between old partners do not change sacrifice ratio = Old Ratio (2) If Goodwill stands at or is raised to full value, no premium should be paid. |
| 2. | If the premium or its part is immediately withdrawn by old partners | Old Partners Capital..... Dr. To Bank (Amount withdrawn) | As withdrawn | |
| 3. | New Partner pays Premium although Goodwill appears in the Books at full value | Either Old Partners Capital Dr. To Goodwill (written off) Cash/Bank..... Dr. To New Partner's Capital [Premium Money treated as part of new partner's capital] | Old Ratio | Write off Goodwill if it is already existing in the Books. |
| 4. | New Partner pays privately for premium for Goodwill to old partners | No Entry | | Not a transaction of the business. |
| 5. | New Partner cannot pay the Premium temporarily, but a loan account is opened. | Loan to New Partner..... Dr. To Old Partners Capital A/c | Sacrifice Ratio | OR old ratio if the mutual ratio between old partners do not change. |
| 6. | New Partner is unable to pay the Premium (a) A Goodwill Account is raised at its full value (b) A Goodwill Account is raised and written off | Goodwill A/c Dr. To Old Partners Capital A/c [Full Value] (i) Goodwill A/c.... Dr. To Old Partners Capitals (Raised) (ii) All Partners Capital A/c.. Dr. (including new partner) To Goodwill (Written off) | Old Ratio Old Ratio New Ratio | 'Full value may be given or may have to be calculated. For example, the new partner for his $2/5$ th the share failed to pay premium ₹ 5,000. Full value = $(5000 \times 5)/2$ = ₹ 12,500 As a result No GOODWILL ACCOUNT will appear in the Balance Sheet |



| | | | | | |
|----|--|--|----------------|----------------------------------|---|
| 7. | New Partner is unable to pay the Premium and an adjustment is to be made through the Capital A/c. | New Partner's Capital To Old Partners Capitals [Premium Money] | Dr. | Sacrifice Ratio | Or, old ratio if the mutual ratio between old Partners remain unchanged. |
| 8. | New partner pays only a portion of the Premium but cannot pay the remaining portion: (a) For Portion Paid (b) For unpaid Portion | (a) Cash/Bank To Old Partners Capitals [Portion Paid] (b) Goodwill To Old Partners Capital [Goodwill for unpaid portion] | Dr. Dr. | Sacrifice Ratio Old Ratio | Or, old ratio 'Goodwill is valued on the basis of unpaid Premium. For example, the new partner for his 2/5th share paid ₹ 12,000 out of ₹20,000 Premium. Unpaid Premium for 2/5th share = ₹8,000. Value of Goodwill = (8,000 × 5)/2 = ₹ 20,000 |
| 9. | If Goodwill Account already appears in the Books and Goodwill is to be raised at its full value (a) If Book value is lower than full value (b) If Book value is more than full value | (a) Goodwill To Old Partners Capital A/c [Full value—Book Value] (b) Old Partners Capital To Goodwill [Book value — Full Value] | Dr. Dr. | Old Ratio Old Ratio | |

Valuation of Inherent or Non-Purchased Goodwill

| Serial No. | Name of the Method | Description of the method | Other Consideration |
|------------|--------------------------------|---|--|
| 1. | Average Profits Methods | Under this method - Value of Goodwill = Agreed Number of Years (Purchase) × Average Maintainable Profits Average Maintainable/Profit Average Annual Profits 00 [Simple average or may be weighted average considering the trend of profits] Less: "Exceptional/Casual Income 00 Add: Abnormal Loss 00 Add: Capital Expenditure wrongly charged against profits 00 Less: Provision for Taxation (As may be required) 00 Adjusted Maintainable Profits 000 ("Adjustments for undercharged or overcharged Depreciation or under or over valuation of stocks to be made, if required) | (i) If profits are fluctuating, simple average is taken. If profits show an increasing trend, weights may be used. If profits constantly decrease, the lowest of the profits after adjustments may be considered. (ii) Exceptional Income or Expense of any particular year, should better be adjusted against the profit of that year. (iii) More weightage is usually given to later years. |

| | | | | | | | | | | | | | | | | | | | | | |
|--|--|---|--|----|-------------------|--|--|--|---|--|--|------|--|------|-----------------------------------|----|--|------|---------------------------------|-----|--|
| 2. | Super Profits Method | <p>Super Profit = Future maintainable profits – Normal Return on Capital Employed</p> <p>Goodwill = Super Profit × No. of years</p> <p>Steps to be followed</p> <p>Steps (a) Calculation of Capital employed OR Average Capital Employed</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Sundry Assets</td> <td style="text-align: right;">00</td> </tr> <tr> <td colspan="2">Excluding:</td> </tr> <tr> <td>(i) Goodwill But including Goodwill at Cost Paid for</td> <td></td> </tr> <tr> <td>(ii) Non-trading assets and (iii) Fictitious Assets</td> <td></td> </tr> <tr> <td>Less: (i) Current Liabilities & Provisions</td> <td style="text-align: right;">- 00</td> </tr> <tr> <td style="padding-left: 20px;">(ii) Contingent & Probable Liabilities</td> <td style="text-align: right;">- 00</td> </tr> <tr> <td style="padding-left: 40px;">(Trading) Capital Employed</td> <td style="text-align: right; border-top: 1px solid black;">00</td> </tr> <tr> <td>Less: ½ of Current years trading profits after taxation (if the profits remain undistributed)</td> <td style="text-align: right;">- 00</td> </tr> <tr> <td style="text-align: right;">Average Capital Employed</td> <td style="text-align: right; border-top: 1px solid black; border-bottom: 1px solid black;">000</td> </tr> </table> <p>Step (b) Average Annual Adjusted Profits (Maintainable) 00</p> <p>Same as shown under Method 1. But debenture interest, if any, should be added back with Profits before making provision for taxation</p> <p>Step (c) Calculate Normal Return on Capital Employed or Average Capital Employed</p> <p>[Say at 10% or 12%, etc. — as may be given or assumed]</p> <p>Step(d) Deduct Normal Return (c) from Average Maintainable Profits (b).</p> <p>The difference is called Annual Super Profit</p> <p>Step (e) Goodwill = Annual Super Profit × No. of Years for which the Super Profit can be maintained.</p> <p>[Usually expressed as...years purchase of super profit]</p> | Sundry Assets | 00 | Excluding: | | (i) Goodwill But including Goodwill at Cost Paid for | | (ii) Non-trading assets and (iii) Fictitious Assets | | Less: (i) Current Liabilities & Provisions | - 00 | (ii) Contingent & Probable Liabilities | - 00 | (Trading) Capital Employed | 00 | Less: ½ of Current years trading profits after taxation (if the profits remain undistributed) | - 00 | Average Capital Employed | 000 | <p>(i) Calculation of Average capital Employed cannot be made if current years' profits are not separately given.</p> <p>(ii) Trading Profits exclude any non trading income like Interest on Non-trading investments.</p> <p>(iii) Adjustments against profits including provision for managerial remuneration, should be made.</p> <p>(iv) If there is any change in the value of any fixed asset on revaluation, that does not affect Annual Trading Profit. But adjustment for over charged or undercharged depreciation may be required to adjust the profits.</p> <p>(v) If there is any decrease in the value of any Current Asset like bad debts or reduction of stock and that has not been adjusted, the adjustment should be made for finding out correct Trading Profit of the current year.</p> <p>(vi) For calculating capital employed, proposed dividend need not be deducted.</p> <p>[Please see valuation of shares']</p> |
| Sundry Assets | 00 | | | | | | | | | | | | | | | | | | | | |
| Excluding: | | | | | | | | | | | | | | | | | | | | | |
| (i) Goodwill But including Goodwill at Cost Paid for | | | | | | | | | | | | | | | | | | | | | |
| (ii) Non-trading assets and (iii) Fictitious Assets | | | | | | | | | | | | | | | | | | | | | |
| Less: (i) Current Liabilities & Provisions | - 00 | | | | | | | | | | | | | | | | | | | | |
| (ii) Contingent & Probable Liabilities | - 00 | | | | | | | | | | | | | | | | | | | | |
| (Trading) Capital Employed | 00 | | | | | | | | | | | | | | | | | | | | |
| Less: ½ of Current years trading profits after taxation (if the profits remain undistributed) | - 00 | | | | | | | | | | | | | | | | | | | | |
| Average Capital Employed | 000 | | | | | | | | | | | | | | | | | | | | |
| 3. | Capitalization of Profits Methods (A) Profits (B) Capitalization of Super Profits | <p>Under the method follow these steps –</p> <p>(a) Calculate Annual Maintainable Profit as shown above.</p> <p>(b) Calculate normal Capital Employed capitalizing the above profit by applying the normal rate of return.</p> $\text{Normal Capital Employed} = \frac{\text{Maintainable Profit}}{\text{Normal Rate of Return}} \times 100$ <p>(c) Calculate actual Capital Employed</p> <p>(d) Goodwill = Normal Capital Employed – Actual capital Employed.</p> <p>(a) Calculate Super profit as said under Method 2.</p> <p>(b) Goodwill = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$</p> | <p>Here also the profits should be adjusted considering necessary adjustments for managerial remunerations, change of depreciation, etc.</p> | | | | | | | | | | | | | | | | | | |
| 4. | Annuity Method | <p>It is a derivative of super profit concept. If super profit is expected to be earned uniformly over a number of years, Goodwill is computed with the help of Annuity Table.</p> <p>Calculate Super Profit as discussed before</p> <p>Goodwill=Annual Super Profit×Present Value of Annuity of ₹1.</p> | <p>Here also similar principles as said before should be followed for calculating — Capital Employed or Average Capital Employed, Annual Average Profits and Annual Super Profits.</p> | | | | | | | | | | | | | | | | | | |

Illustration 2.

X and Y are partners having Capitals of ₹ 80,000 and ₹ 20,000 respectively and a profit sharing ratio of 4 : 1. Z is admitted for 1/5 th share in the profits of the firm and he pays ₹ 30,000 as Capital. Find out the value of the Goodwill.

Solution:

| | | | |
|----------------------------------|----------------------------|---|---|
| Total Capital of the firm | $30,000 \times 5/1$ | = | ₹ 1,50,000 [Taking Z's Capital as base] |
| Less : Combined Adjusted Capital | | | |
| | $80,000 + 20,000 + 30,000$ | = | <u>₹ 1,30,000</u> |
| Hidden Goodwill | | = | <u>₹ 20,000</u> |

Illustration Regarding Valuation of Goodwill

Valuation of Goodwill for a non corporate assessee

Illustration 3.

From the following information, calculate the value of goodwill by super profit method.

- Average Capital employed in the business ₹ 7,00,000.
- Net trading profit of the firm for the past three years ₹ 1,47,600; ₹ 1,48,100 and ₹ 1,52,500.
- Rate of Interest expected from capital having regard to the risk involved —18%.
- Fair remuneration to the partners for their services 12,000 per annum.
- Sundry Assets (excluding goodwill) of the firm ₹ 7,54,762.
- Sundry Liabilities ₹ 31,329.
- Goodwill valued at 2 years' purchase

Solution:

| Years | Profits Given ₹ | Adjusted Profits after Considering Remunerations ₹ |
|---|--------------------|---|
| 1st | 1,47,600 | 1,35,600 |
| 2nd | 1,48,100 | 1,36,100 |
| 3rd | 1,52,500 | 1,40,500 |
| Total Profits | 4,48,200 | 4,12,200 |
| Average Adjusted Annual Profits (4,12,200/3) | | ₹ 1,37,400 |
| Less : Normal Return on Capital @ 18% of ₹ 7,00,000 | | 1,26,000 |
| Super Profits | | <u>11,400</u> |

Therefore Goodwill = Super profit × year of Purchase = 11,400 × 2 = 22,800.

Illustration 4.

New partner pays premium for Goodwill but Goodwill Account is appearing at the Balance Sheet at full value.

Gargi and Khana were partners sharing profits and losses as 5 : 3. They agreed to admit Lilabati as a new partner on payment of ₹ 9,000 as premium for Goodwill. The new profit sharing ratio was agreed as 3 : 2 : 1. The Goodwill Account appearing in the books amounted to ₹ 54,000. Pass the necessary Journal Entries.

Solution:

Points to be noted

Lilabati brought in ₹ 9,000 as his share of premium for goodwill for 1/6 in there.

Therefore, Full value of Goodwill = $9,000 \times 6/1 = 54,000$

There is neither overvaluation nor undervaluation.

| Calculation of Sacrifice | Gargi | Khana | Lilabati |
|--------------------------|--|--|---|
| Old Ratio | $\frac{5}{8}$ | $\frac{3}{8}$ | — |
| New Ratio | $\frac{3}{6}$ | $\frac{2}{6}$ | $\frac{1}{6}$ |
| | $5/8 - 3/6 = (30 - 24)/48 = 6/48$ (Sacrifice) | $3/8 - 2/6 = (18 - 16)/48 = 2/48$ (Sacrifice) | Nil - $1/6 = (0 - 8)/48 = 8/48$ (Gain) |

Journal Entries

| Date | Particulars | L.F. | Dr. | Cr. |
|------|---|------|------------------|----------------|
| | | | Amount ₹ | Amount ₹ |
| | Gargi's Capital A/c <i>Dr.</i> Khana's Capital A/c <i>Dr.</i> To Goodwill A/c (Goodwill Account written off between the old partners in old ratio) | | 33,750 20,250 | 54,000 |
| | Bank A/c <i>Dr.</i> To Gargi's Capital A/c To Khana's Capital A/c (Premium for Goodwill brought in by new partner and shared by old partners in their sacrifice ratio 3 : 1) | | 9,000 | 6,750 2,250 |

Illustration 5.

Where the new partner pays premium for goodwill and also brings his own goodwill to the business.

Amal and Bimal are partners sharing profits in the ratio of 2 : 3. Charu is admitted as a partner on 1st January, 2013 and he pays into the firm cash ₹ 9,000 out of which ₹ 3,000 is premium on his admission to a quarter share, the ratio between Amal and Bimal to be 1 : 2.

Charu also brings into the business his own Goodwill to be run as a separate unit and the Goodwill is agreed at ₹ 4,800.

Show the entries required to give effect to the above arrangements (for both the units separately).

Solution:

Points to be noted

- For the First unit, ₹ 3,000 paid as premium should be shared by Amal and Bimal in their sacrifice ratio. We should calculate the new ratio and the sacrifice ratio.
- For the 2nd unit, an adjustment should be made for Charu's own goodwill to be credited to his capital and debited to Amal and Bimal in remaining ratio 2 : 3, excluding Charu's share.

Working Notes :

1. Calculation of New Profit Sharing Ratio

Charu's share = $1/4$; Balance left = $1 - 1/4 = 3/4$. Amal's new share = $3/4 \times 1/3 = 1/4$;

Bimal's new share = $3/4 \times 2/3 = 2/4$ and Charu's new share = $1/4$.

New Ratio = 1:2:1 Sacrifice Ratio = 3 : 2. [= Old Ratio - New Ratio]



Journal Entries

Dr.

Cr.

| Date | Particulars | L.F. | Amount ₹ | Amount ₹ |
|--------|--|------|--------------|----------------|
| 1.1.13 | Bank A/c <i>Dr.</i> To Charu's Capital A/c [Amount invested as capital contribution by Charu] | | 9,000 | 9,000 |
| 1.1.13 | Charu's A/c <i>Dr.</i> To Amal's Capital A/c [3/5] To Bimal's Capital A/c [2/5] [Premium paid by Charu and credited to Amal and Bimal in their sacrifice ratio 3: 2] | | 3,000 | 1,800 1,200 |
| 1.1.13 | Amal's Capital A/c [2/10 of ₹ 4,800] <i>Dr.</i> Bimal's Capital A/c [3/10 of ₹ 4,800] <i>Dr.</i> To Charu's Capital A/c [Adjustment made for Charu's own Goodwill brought into the business] | | 960 1,440 | 2,400 |

4. Regarding Accumulated Profits/Losses or Reserve & Surplus

It is needless to state that if there is any accumulated profits or losses or other surpluses, the same should be transferred to old partner's Capital or Current Account as per old profit sharing ratio before the admission of new partner :

Entries

(a) For transferring accumulated profits

| | |
|------------------------------|---------------------------------------|
| Profit & Loss A/c (Cr.) | Dr. |
| General Reserve A/c | Dr. (as per old profit sharing ratio) |
| Any other Surpluses A/c | Dr. |
| To Old Partner's Capital A/c | |

(b) For transferring accumulated losses

| | |
|---------------------------|-----|
| Old Partner's Capital A/c | Dr. |
| To Accumulated Losses A/c | |

Illustration 6.

X, Y and Z were in partnership sharing profits and losses in the ratio 3 : 2 : 1. Their Balance Sheet stood as under:

Balance Sheet as at 1.4.2012

| Liabilities | | ₹ | Assets | | ₹ |
|-----------------------------|---------------|-----------------|-------------------------|--|-----------------|
| Capital | | | Fixed Assets | | 80,000 |
| X | 40,000 | | Machinery Replacement | | 15,000 |
| Y | 30,000 | | Investment: | | |
| Z | <u>20,000</u> | 90,000 | Investment (MV ₹ 7,000) | | 10,000 |
| General Reserve | | 12,000 | Current Asset | | 33,000 |
| Machinery Replacement Fund | | 16,000 | | | |
| Investment Fluctuation Fund | | 15,000 | | | |
| Current Liabilities | | 5,000 | | | |
| | | <u>1,38,000</u> | | | <u>1,38,000</u> |

Show the entries for accumulated profits/reserves assuming that Mr. T is admitted as partner for 1/5th share.

Solution:

**In the books of.....
Journal**

| Date | Particulars | L.F. | Debit ₹ | Credit ₹ |
|------|--|------|------------|-------------|
| | General Reserve A/c Dr. | | 12,000 | |
| | Investment Fluctuation Fund A/c Dr. | | 12,000 | |
| | (₹ 15,000 – ₹ 3,000) | | | |
| | To X - Capital A/c | | | 12,000 |
| | To Y - Capital A/c | | | 8,000 |
| | To Z - Capital A/c | | | 4,000 |
| | (Accumulated profits are distributed in 3 : 2 : 1) | | | |

5. Regarding Adjustment of Capital

When a new partner is admitted, the total amount of capital is determined on the basis of new partners' capital and his profit sharing ratio. On the basis of new profit sharing ratio old partners' capital is to be ascertained. Thereafter, existing capital (after considering all adjustments) is to be compared with the capital so ascertained on the basis of new profit sharing ratio, and excess if any, is to be withdrawn by the partner concerned and deficit, if any, is to be brought in by the concerned partner. Sometimes, the excess or deficit, is to be adjusted against the current account of the partners.

Illustration 7.

A and B are partner in a firm sharing profit and losses in the ratio of 4 : 1. Their Balance Sheet as on 31st March 2013 stood as follows :

| Liabilities | | ₹ | Assets | | ₹ |
|---------------|---------------|-----------------|------------------|--|-----------------|
| Capital A/c | | | Furniture | | 20,000 |
| A | 25,000 | | Stock | | 40,000 |
| B | <u>65,000</u> | 90,000 | Bills Receivable | | 10,000 |
| Reserve | | 20,000 | Debtors | | 30,000 |
| Creditors | | 25,000 | Cash at Bank | | 40,000 |
| Bills Payable | | 5,000 | | | |
| | | <u>1,40,000</u> | | | <u>1,40,000</u> |

They agreed to take C as a partner with effect from 1st April 2013 on the following terms :

- (a) A, B and C will share profit and losses in the ratio of 5 : 3 : 2.
- (b) C will bring ₹ 20,000 as premium for goodwill and ₹ 30,000 as capital.
- (c) Half of the Reserve is to be withdrawn by the partners.
- (d) The asset will be revalued as follows : Furniture ₹ 30,000; Stock ₹ 39,500; Debtors ₹ 28,500.
- (e) A creditor of ₹ 12,000 has agreed to forgo his claim by ₹ 2,000.
- (f) After making the above adjustments, the capital accounts of A and B should be adjusted on the basis of C's capital, by bringing cash or withdrawing cash as the case may be.

Show Revaluation Account, Partners' Capital Account and the Balance Sheet of the new firm :



Solution :

In the books of A, B and C

Dr.

Revaluation Account

Cr.

| Particulars | | Amount ₹ | Particulars | | Amount ₹ |
|----------------------------|--------------|-------------|------------------|--|-------------|
| To Stock A/c | | 500 | By Furniture A/c | | 10,000 |
| To Prov. for Bad Debts A/c | | 1,500 | By Creditors A/c | | 2,000 |
| To Profit on Revaluation: | | | | | |
| A | 8,000 | | | | |
| B | <u>2,000</u> | 10,000 | | | |
| | | 12,000 | | | 12,000 |

Dr.

Capital Account

Cr.

| Particulars | A | | | Particulars | B | | |
|-------------------------|--------|--------|--------|---------------------|--------|--------|--------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To A's Capital A/c | — | 10,000 | — | By Balance b/d | 25,000 | 65,000 | — |
| To Bank A/c | 8,000 | 2,000 | — | By Bank | — | — | 30,000 |
| To Bank A/c (bal. fig.) | — | 14,000 | — | By Revaluation | | | |
| To Balance c/d | 75,000 | 45,000 | 30,000 | — Profit | 8,000 | 2,000 | — |
| | | | | By Reserve | 16,000 | 4,000 | — |
| | | | | By Goodwill | 20,000 | — | — |
| | | | | By Capital A/c | 10,000 | — | — |
| | | | | By Bank (bal. fig.) | 4,000 | — | — |
| | 83,000 | 71,000 | 30,000 | | 83,000 | 71,000 | 30,000 |

**Balance Sheet
as at 1st April, 2013**

| Liabilities | Amount ₹ | Amount ₹ | Assefs | Amount ₹ | Amount ₹ |
|--------------------------|---------------|-------------|---|--------------|-------------|
| Capital A/c : | | | Furniture | | 30,000 |
| A | 75,000 | | Stock | | 39,500 |
| B | 45,000 | | Debtors | 30,000 | |
| C | <u>30,000</u> | 1,50,000 | Less : R/B/Debts | <u>1,500</u> | |
| | | 23,000 | | | 28,500 |
| Creditors (25,000–2,000) | | 5,000 | Bills Receivable | | 10,000 |
| Bills Payable | | | Cash at Bank | | 70,000 |
| | | | (₹40,000 + ₹50,000 - ₹10,000 + ₹4,000 - ₹14,000) | | |
| | | 1,78,000 | | | 1,78,000 |

Workings :**1. Sharing of Goodwill**

Sacrificing Ratio :

$$A = 4/5 - 5/10 = (8 - 5)/10 = 3/10 \text{ (Sacrifice)}$$

$$B = 1/5 - 3/10 = (2 - 3)/10 = 1/10 \text{ (Gains)}$$

$$C = 2/10 \text{ (Gains)}$$

∴ Entire goodwill to be credited to A's Capital Account. B will have to pay A for goodwill

$$= ₹ 20,000 \times 10/2 \times 1/10$$

$$= ₹ 10,000.$$

2. Adjustment of Capital

C brings for 2/10 ₹ 30,000

∴ A will have to bring for 5/10 = ₹ 30,000 × 5/10 × 10/2 = ₹ 75,000

And B should bring for 3/10 = ₹ 30,000 × 3/10 × 10/2 = ₹ 45,000

Illustration 8.

Special Points : (a) Journal Entries; (b) Portion of Premium for Goodwill and Reserve withdrawn; (c) Discount received on payment of creditor.

Brick, Sand and Cement were partners in a firm sharing profits and losses in the ratio of 3:2:1 respectively. Following is their Balance Sheet as on 31st December, 2012.

| Liabilities | ₹ | ₹ | Assets | ₹ |
|--------------------|---------------|-----------------|--------------------------|-----------------|
| Capital Accounts : | | | Land & Buildings | 50,000 |
| Brick | 30,000 | | Furniture | 15,000 |
| Sand | 20,000 | | Stock | 20,000 |
| Cement | <u>10,000</u> | 60,000 | Bill Receivable | 5,000 |
| Reserve | | 29,800 | Debtors | 7,500 |
| Creditors | | 6,200 | Cash in hand and at Bank | 2,500 |
| Bills Payable | | 4,000 | | |
| | | <u>1,00,000</u> | | <u>1,00,000</u> |

Lime is to be admitted as a partner with effect from 1st January, 2013 on the following terms

- Lime will bring in ₹ 15,000 as Capital and ₹ 12,000 as premium for goodwill. Half of the premium will be withdrawn by the partners.
- Lime will be entitled to : 1/6th share in the profits of the firm.
- The assets will be revalued as follows Land and Building— ₹ 56,000; Furniture— ₹ 12,000; Stock— ₹ 16,000; Debtors— ₹ 7,000
- The claim of a creditor for ₹ 2,300 is paid at ₹ 2,000.
- Half of the Reserve is to be withdrawn by the partners.

Record the Journal entries (including cash transactions) in the books of the firm and show the opening Balance Sheet of the new firm.



Solution :

**Books of Brick, Sand, Cement and Lime
Journal Entries**

| Date | Particulars | L.F. | Dr. | Cr. |
|----------|--|------|-------------------------|--------------------------|
| | | | Amount ₹ | Amount ₹ |
| 01.01.13 | Bank A/c <i>Dr.</i> To Lime's Capital A/c [Being amount contributed by lime on admission as a new partner] | | 15,000 | 15,000 |
| " | Bank A/c <i>Dr.</i> To Brick's Capital A/c [3/6] To Sand's Capital A/c [2/6] To Cement's Capital A/c [1/6] [Being premium for goodwill brought in by new partner and credited to old partners Capitals in their sacrifice ratio 3:2:1] | | 12,000 | 6,000 4,000 2,000 |
| " | Land and Buildings A/c <i>Dr.</i> To Revaluation A/c [Being value of Land & Buildings appreciated on revaluation] | | 6,000 | 6,000 |
| " | Revaluation A/c <i>Dr.</i> To Furniture A/c To Stock A/c To Provision for Bad Debts A/c [Being values of assets decreased on revaluation] | | 7,500 | 3,000 4,000 500 |
| " | Creditors A/c <i>Dr.</i> To Bank A/c To Revaluation A/c [Being creditors claim discharged at a discount] | | 2,300 | 2,000 300 |
| " | Brick's Capital A/c <i>Dr.</i> Sand's Capital A/c <i>Dr.</i> Cement's Capital A/c <i>Dr.</i> To Revaluation A/c [Loss on revaluation debited to old partners in old ratio 3 : 2 : 1] | | 600 400 200 | 1,200 |
| " | Reserve A/c <i>Dr.</i> To Brick's Capital A/c To Sand's Capital A/c To Cement's Capital A/c [Reserve A/c closed and credited to old partners in old ratio 3 : 2 : 1] | | 29,800 | 14,900 9,933 4,967 |
| " | Brick's Capital A/c <i>Dr.</i> Sand's Capital A/c <i>Dr.</i> Cement's Capital A/c <i>Dr.</i> To Bank A/c [Half of the Reserve withdrawn by old partners] | | 7,450 4,967 2,483 | 14,900 |
| " | Brick's Capital A/c <i>Dr.</i> Sand's Capital A/c <i>Dr.</i> Cement's Capital A/c <i>Dr.</i> To Bank A/c [Half of the premium money withdrawn by old partners] | | 3,000 2,000 1,000 | 6,000 |

Balance Sheet as on 1.1.2013

| Liabilities | Amount | Amount | Assets | Amount | Amount |
|----------------------------|---------------|-----------------|--------------------------------|------------|-----------------|
| | ₹ | ₹ | | ₹ | ₹ |
| Capital Accounts : [Note3] | | | Land & Buildings | | 56,000 |
| Brick | 39,850 | | Furniture | | 12,000 |
| Sand | 26,566 | | Stock | | 16,000 |
| Cement | 13,284 | | Debtors | | |
| Lime | <u>15,000</u> | | Less : Provision for Bad Debts | 7,500 | |
| Creditors [6,200 – 2,300] | | 94,700 | Bill Receivable | <u>500</u> | 7,000 |
| Bills Payable | | 3,900 | Cash in hand and at | | |
| | | 4,000 | Bank [Note 2] | | 5,000 |
| | | | | | 6,600 |
| | | <u>1,02,600</u> | | | <u>1,02,600</u> |

Working Notes :

1. It is assumed that after giving 1/6th share of profits to Lime, the balance will be shared by old partners in old ratio 3 : 2 : 1. So, Sacrifice Ratio = Old Ratio = 3 : 2 : 1.

| 2. Cash and Bank | ₹ |
|--|---------------|
| As per last Balance Sheet | 2,500 |
| Add: Lime's Capital Contribution and Premium (net) | 27,000 |
| | <u>29,500</u> |
| Less: Paid to creditors | 2,000 |
| Less: Portion of Reserve withdrawn | 14,900 |
| Less: Share of premium withdrawn | 6,000 |
| | <u>6,600</u> |

| 3. Capital | Brick | Sand | Cement | Lime |
|---|---------------|---------------|---------------|---------------|
| Balances | 30,000 | 20,000 | 10,000 | — |
| Add: Capital brought in | — | — | — | 15,000 |
| Add: Share of Premium for Goodwill | 6,000 | 4,000 | 2,000 | — |
| Add: Share of Reserves | 14,900 | 9,933 | 4,967 | — |
| Less: Share of Reserves withdrawn | 7,450 | 4,967 | 2,483 | — |
| Less: Share of Premium for goodwill withdrawn | 3,000 | 2,000 | 1,000 | — |
| Less: Loss on Revaluation | 600 | 400 | 200 | — |
| | <u>39,850</u> | <u>26,566</u> | <u>13,284</u> | <u>15,000</u> |

Illustration 9.

Arun and Anand were partners sharing profits in the ratio of 3:2. Their position as on 31st March, 2013 was as under :

| Liabilities | ₹ | Assets | ₹ |
|-----------------------------|--------|---------------------|--------|
| Arun's Capital | 12,000 | Land and Buildings | 8,000 |
| Anand's Capital | 10,000 | Plant and Machinery | 10,000 |
| General Reserve | 12,000 | Sundry Debtors | 11,000 |
| Workmen's Compensation Fund | 4,000 | Stock | 12,000 |
| Sundry Creditors | 12,000 | Cash at Bank | 9,000 |
| | 50,000 | | 50,000 |

They decided to admit Ashok for a 20% profit on the following terms : (a) The liability on Workmen's Compensation Fund is to be determined at ₹ 2,000; (b) Ashok to bring in ₹ 3,000 as premium out of his share of ₹ 3,600. He is also to bring in ₹ 20,000 as his capital; (c) General Reserve is to be maintained at its original value; (d) ₹ 2,000 out of creditors to be paid at 5% discount.

Pass the necessary journal entries to give effect to the above arrangement; to show the capital accounts and prepare the Balance Sheet of the new firm.

Points to be noted

- Ashok pays premium ₹ 3,000. This should be shared by Arun and Anand in their sacrifice ratio, which is eventually the old ratio 3 : 2. For the unpaid Premium [₹ 3,600 — ₹ 3,000 = ₹ 600]. Goodwill Account to be raised at ₹ 3,000 × 1/5 = 600. This is to be credited to old partners in old ratio 3 : 2.
- For General Reserve to be maintained, the following adjustment will be required.

| Particulars | Arun ₹ | Anand ₹ | Ashok ₹ |
|---|-------------|-------------|-------------|
| Credited in Old Ratio between old partners (12,000 as 3 : 2) | 7,200 (Cr.) | 4,800 (Cr.) | |
| Debited in New Ratio (12 : 8 : 5) | 5,760 (Dr.) | 3,840 (Dr.) | 2,400 (Dr.) |
| Net Effect | 1,440 (Cr.) | 960 (Cr.) | 2,400 (Dr.) |

Solution:

Arun, Anand and Ashok Journal Entries

| Date | Particulars | L.F. | Dr. | Cr. |
|---------|---|------|-------------|----------------|
| | | | Amount ₹ | Amount ₹ |
| 31.3.13 | Workmen's Compensation Fund A/c [₹ 4,000 — ₹ 2,000] To Revaluation A/c (Value of liability reduced) | Dr. | 2,000 | 2,000 |
| 31.3.13 | Bank A/c To Ashok's Capital A/c (Amount contributed as capital by incoming partner) | Dr. | 20,000 | 20,000 |
| | Bank A/c To Arun's Capital A/c To Anand's Capital A/c (Premium for Goodwill paid by incoming partner and shared by existing partners in their sacrificing ratio 3 : 2) | Dr. | 3,000 | 1,800 1,200 |

| | | | | |
|---|-------------------|--|---------------------|----------------|
| Goodwill A/c To Arun's Capital A/c To Anand's Capital A/c (Goodwill A/c raised and credited to existing partners in old ratio 3 : 2) | Dr. | | 3,000 | 1,800 1,200 |
| Arun Capital A/c Anand Capital A/c Ashok Capital A/c To Goodwill A/c (Being the Goodwill written off) | Dr. Dr. Dr. | | 1,440 960 600 | 3,000 |
| Creditors A/c To Bank A/c (actual payment at 95%) To Revaluation A/c (A creditor paid off and the discount received credited to revaluation A/c) | Dr. | | 2,000 | 1,900 100 |
| Revaluation A/c To Arun's Capital A/c To Anand's Capital A/c (Being Revaluation profit credited to old partners in the ratio 3 : 2) | Dr. | | 2,100 | 1,260 840 |

Dr. Capital Accounts Cr.

| Date 2013 | Particulars | Arun ₹ | Anand ₹ | Ashok ₹ | Date 2013 | Particulars | Arun ₹ | Anand ₹ | Ashok ₹ |
|--------------|-----------------------------------|----------------|--------------|--------------|--------------|--|--|--|----------------------------|
| 31.3. | To General Res ,, Goodwill A/c | 5,760 1,440 | 3,840 960 | 2,400 600 | 31.3. | By Balance b/d ,, Bank A/c ,, Bank A/c (Premium) ,, Goodwill A/c ,, General Res A/c ,, Revaluation A/c | 12,000 1,800 1,800 7,200 1,260 | 10,000 1,200 1,200 4,800 840 | - 20,000 - - - |
| | " Balance c/d | 16,860 | 13,240 | 17,000 | | | | | |
| | | 24,060 | 18,040 | 20,000 | | | 24,060 | 18,040 | 20,000 |
| | | | | | 1.4. | By Balance b/d | 16,860 | 13,240 | 17,000 |

Balance Sheet as on 01.04.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|-----------------------------|-------------|-------------|----------------------------------|-------------|-------------|
| Capital Accounts': | | | Land and Buildings | | 8,000 |
| Arun | 16,860 | | Plant and Machinery | | 10,000 |
| Anand | 13,240 | | Stock | | 12,000 |
| Ashok | 17,000 | 47,100 | Debtors | | 11,000 |
| General Reserve | | 12,000 | Cash at Bank | | 30,100 |
| Workmen's Compensation Fund | | 2,000 | [9,000 + 20,000 + 3,000 - 1,900] | | |
| Sundry Creditors | | 10,000 | | | |
| | | 71,100 | | | 71,100 |



Illustration 10.

No alteration of book values of assets and liabilities

Baisakhi and Srabani are partners sharing profits and losses in proportion to their capitals. Their Balance Sheet as on 31st March, 2013 is given below :

| Liabilities | ₹ | Assets | ₹ |
|-----------------|--------|-------------------|--------|
| Creditors | 15,000 | Freehold Premises | 10,000 |
| General Reserve | 2,100 | Machinery | 3,500 |
| Capitals : | | Furniture | 1,750 |
| Baisakhi | 20,000 | Office Equipments | 550 |
| Srabani | 15,000 | Stock | 14,100 |
| | | Bill Receivable | 3,060 |
| | | Debtors | 17,500 |
| | | Bank | 1,590 |
| | | Cash | 50 |
| | 52,100 | | 52,100 |

On 1st April, 2013 they admit Poushali on the following conditions :

- Poushali should bring in ₹ 10,000 as capital and to pay ₹ 3,500 for goodwill as she will get 1/4th share in profits.
- A provision of 2% to be raised against debtors, stock to be reduced by 5%, Freehold Premises to be revalued at ₹ 12,650, Machinery at ₹ 2,800, Furniture at ₹ 1,540 and Office equipments at ₹ 495.
- Partners agreed that the values of assets and liabilities should remain unaltered.

Show the necessary accounts and prepare the opening Balance Sheet of the new firm.

Points to be noted

- The Partners have decided not to alter the book values of the assets and liabilities. The effects of revaluation may be ascertained by preparing a Memorandum Revaluation Account as follows.
 - Calculation of Profit/Loss on Revaluation.

Memorandum Revaluation Account

Dr.

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--|-------------|---|-------------|
| To Provision for bad debts (@ 2% of 17,500) | 350 | By Freehold Premises | 2,650 |
| To Stock | 705 | | |
| To Machinery | 700 | | |
| To Furniture | 210 | | |
| To Office Equipments | 55 | | |
| To Partners Capital A/c's | | | |
| Baisakhi : (4/7) | 360 | | |
| Srabani : (3/7) | 270 | | |
| | 2,650 | | 2,650 |
| To Reversal of Items b/d | 2,650 | By Reversal of Items b/d | 2,020 |
| | | By Partners Capital A/c (In New Ratio) | |
| | | [Loss on Revaluation] | |
| | | Baisakhi | 270 |
| | | Sarvani | 203 |
| | | Poushali | 157 |
| | 2,650 | | 630 |
| | | | 2,650 |

- (b) As General Reserve is to remain unaltered, similar adjustment will be required to be shared among old partners in old ratio and then written back among all partner's in new ratio.
2. Calculation of net effects on Capital Accounts. New Profit Sharing Ratio : 12 : 9 : 7

Solution :

Capital Accounts

Dr.

Cr.

| Date | Particulars | Baisakhi Amount ₹ | Srabani Amount ₹ | Poushli Amount ₹ | Date | Particulars | Baisakhi Amount ₹ | Srabani Amount ₹ | Poushali Amount ₹ |
|---------|--------------------|----------------------|---------------------|---------------------|---------|-------------------------------|----------------------|---------------------|----------------------|
| 31.3.13 | To General Reserve | 900 | 675 | 525 | 1.4.12 | By Balance b/d | 20000 | 15000 | - |
| | To M. Rev. A./c | 270 | 203 | 157 | 31.3.13 | By General Reserve | 1,200 | 900 | - |
| | | | | | | By Bank A/c | - | - | 10000 |
| | | | | | | By M. Rev. A/c | 360 | 270 | - |
| | | | | | | By Bank A/c (Premium) at 4:3. | 2000 | 1500 | - |
| | To Balance c/d | 22,390 | 16,792 | 9,318 | | | | | |
| | | 23,560 | 17,670 | 10,000 | | | 23,560 | 17,670 | 10,000 |

Balance Sheet as at 1.4.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ |
|------------------|--------------|---------------|--------------------------|---------------|
| Capitals: | | | Freehold Premises | 10,000 |
| Baisakhi | 22,390 | | Machinery | 3,500 |
| Srabani | 16,792 | | Furniture | 1,750 |
| Poushali | <u>9,318</u> | | Office Equipments | 550 |
| | | 48,500 | Stock | 14,100 |
| General Reserve | | 2,100 | Bill Receivable | 3,060 |
| | | | Debtors | 17,500 |
| Sundry Creditors | | 15,000 | Bank | |
| | | | [1,590 + 10,000 + 3,500] | 15,090 |
| | | | Cash | 50 |
| | | <u>65,600</u> | | <u>65,600</u> |

Illustration 11.

K and L are two partners sharing profits and losses in the ratio of 5:3. Their Balance Sheet as at 30th June, 2013 is as follows :

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|-------------------|---------------|-----------------|------------------------------|--------------|-----------------|
| Creditors | | 30,000 | Furniture | | 40,000 |
| Reserve | | 14,000 | Patent | | 10,000 |
| Capital Account : | | | Debtors | 44,000 | |
| K | | | Less : Reserve for Bad Debts | <u>5,000</u> | 39,000 |
| L | 40,000 | | Stock | | 20,000 |
| | <u>50,000</u> | 90,000 | Cash in hand | | 25,000 |
| | | <u>1,34,000</u> | | | <u>1,34,000</u> |



On 1st July, 2013, they take M into partnership. M brings ₹ 25,000 as his capital and brings ₹ 3,600 as his share of goodwill. The new profit sharing ratio of K, L and M is 2:4:1. Patent is written off from the books and a reserve for Bad Debt is created at 5%. Reserve appears in the books of new firm at its original figure.

Show the necessary Journal entries to carry out the above transactions and prepare a Balance Sheet of the new firm as at 1st July, 2013.

Solution:

**In the books of K. L. M.
Journal**

| Date | Particulars | L.F. | Debit ₹ | Credit ₹ |
|----------------|---|-------------------|-------------------------|-----------------|
| 2013 July 1 | Bank A/c To M's Capital A/c To Goodwill A/c (Cash to be brought in by M As capital) | Dr. | 28,600 | 25,000 3,600 |
| | Goodwill A/c To K's Capital A/c (Value of goodwill credited to K's Capital only) | Dr. | 3,600* | 3,600 |
| | Reserve A/c To K's Capital A/c To L's Capital A/c (Reserve credited to old partners capital accounts in 5:3) | Dr. | 14,000 | 8,750 5,250 |
| | K : Capital A/c L : Capital A/c M : Capital A/c To Reserve A/c (Reserve shown at its original value) | Dr. Dr. Dr. | 4,000 8,000 2,000 | 14,000 |
| | Revaluation A/c To Patents A/c (Patent eliminated from the book) | Dr. | 10,000 | 10,000 |
| | Reserve for Bad Debts A/c To Revaluation A/c (Excess provision written back) | Dr. | 2,800 | 2,800 |
| | K's Capital A/c L's Capital A/c To Revaluation A/c (Loss on revaluation transferred) | Dr. Dr. | 4,500 2,700 | 7,200 |

Capital Account

Dr.

Cr.

| Particulars | K ₹ | L ₹ | M ₹ | Particulars | K ₹ | L ₹ | M ₹ |
|-------------------|--------|--------|--------|-------------------|---------|--------|--------|
| To Reserve A/c | 4,000 | 8,000 | 2,000 | By Balance b/d | 40,000 | 50,000 | — |
| " Revaluation A/c | 4,500 | 2,700 | — | " Goodwill A/c | 3,600 | — | — |
| — Loss | — | — | — | " Reserve A/c | 8,750 | 5,250 | — |
| " K's Capital A/c | — | 4,950 | — | " L's Capital A/c | 4,950** | — | — |
| " Balance c/d | 48,800 | 39,600 | 23,000 | " Bank | — | — | 25,000 |
| | 56,850 | 55,250 | 25,000 | | 57,300 | 55,250 | 25,000 |

Balance Sheet as on July 1, 2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|-------------|---------------|-----------------|-------------------|--------------|-----------------|
| Capitals: | | | Furniture | | 40,000 |
| K | 48,800 | | Debtors | 44,000 | |
| L | 39,600 | | Less : R/B/Debts | <u>2,200</u> | 41,800 |
| M | <u>23,000</u> | 1,11,400 | Stock | | 20,000 |
| Reserve | | 14,000 | Cash & Bank | | |
| Creditors | | 30,000 | (25,000 + 28,600) | | 53,600 |
| | | <u>1,55,400</u> | | | <u>1,55,400</u> |

**Goodwill should be credited to the sacrificing ratio which is computed as under :

$$K = 5/8 - 2/7 = (35 - 16)/56 = 19/56 \text{ (Sacrifice)}$$

$$L = 3/8 - 4/7 = (21 - 32)/56 = 11/56 \text{ (Gains)}$$

$$M = 1/7 \text{ (Gains)} = 8/56$$

∴ Entire goodwill should be credited to K's Capital only.

Since L is gaining 11/56 from K, he must have to pay in proportionate amount to K as under, i.e., if M brings for 8/56 ₹ 3,600, L should pay for 11/56 ₹ 4,950 (i.e. ₹ 3,600 × 11/56 × 56/8)

Illustration 312.

Red and White are partners in a firm sharing profits and losses in the ratio of 3:2. On 1st July 2013 the positions of the firm as follows :

| Liabilities | ₹ | ₹ | Assets | ₹ |
|--------------------|---------------|-----------------|-----------|-----------------|
| Capital Accounts : | | | Building | 50,000 |
| Red | | | Machinery | 2,50,000 |
| White | 1,50,000 | | Furniture | 40,000 |
| | <u>98,000</u> | | Stock | 60,000 |
| | | 2,48,000 | Debtors | 90,000 |
| General Reserve | | 84,000 | Cash | 12,000 |
| Sundry Creditors | | 1,70,000 | | |
| | | <u>5,02,000</u> | | <u>5,02,000</u> |

Blue joined the firm as a partner from this date and the following terms and conditions were agreed upon :

- Red, White and Blue will share the future profits of the firm in the ratio 5:3:2, respectively.
- Blue would first pay ₹ 10,000 as his share of Goodwill and this sum is to be retained in the business.
- The value of Machinery is to be increased by ₹ 20,000 and stock is to be written down by 10%.
- Blue would introduce such an amount of Capital in Cash which should be proportionate to the combined Capital accounts of Red and White after making all adjustments.

It was decided that the Capital Accounts of Red and White would be adjusted on the basis of Blue's Capital by opening Current Accounts.

Show the Capital Accounts of the partners and the Balance Sheet of the firm after Blue's admission.



Solution :

Capital Account

Dr.

Cr.

| Particulars | Red ₹ | White ₹ | Blue ₹ | Particulars | Red ₹ | White ₹ | Blue ₹ |
|----------------|----------|------------|-----------|---------------------------|----------|------------|-----------|
| To Current A/c | — | 8,700 | — | By Balance b/d | 1,50,000 | 98,000 | — |
| " Balance c/d | 2,22,500 | 1,33,500 | 89,000 | " General Reserve | 50,400 | 33,600 | — |
| | | | | " Goodwill | 5,000 | 5,000 | — |
| | | | | " Revaluation — Profit | 8,400 | 5,600* | — |
| | | | | | 2,13,800 | 1,42,200 | — |
| | | | | " Bank | — | — | 89,000 |
| | | | | " Current A/c | 8,700 | — | — |
| | 2,22,500 | 1,423,200 | 89,000 | | 2,22,500 | 1,423,200 | 89,000 |

Balance Sheet

as at 1st July, 2013

| Liabilities | ₹ | ₹ | Assets | ₹ |
|-------------------|---------------|-----------------|-------------------------------|-----------------|
| Capital A/c : | | | Building | 50,000 |
| Red | 2,22,500 | | Machinery (2,50,000 + 20,000) | 2,70,000 |
| White | 1,33,500 | | Furniture | 40,000 |
| Blue | <u>89,000</u> | 4,45,000 | Stock (60,000 – 6,000) | 54,000 |
| Sundry Creditors | | 1,70,000 | Debtors | 90,000 |
| Current A/c (Red) | | 8,700 | Cash (12,000+10,000+89,000) | 1,11,000 |
| | | <u>6,23,700</u> | Current A/c (White) | 8,700 |
| | | | | <u>6,23,700</u> |

* Profit on Revaluations = (₹ 20,000 Increased Value of Machinery – ₹ 6,000 (Stock decreased))
= ₹ 14,000 in 3:2.

Workings:

1. Capital introduced by Blue

1/4 th of the combined adjusted capital of Red & White i.e. ₹ 3,56,000 (₹ 2,13,800 + ₹ 1,42,200) × 1/4 = ₹ 89,000.

2. Now, capital account of Red & White will be in proportion of Blue

$$\text{Red} = ₹ 3,56,000 \times 5/8 = ₹ 2,22,500 - ₹ 2,13,800 = ₹ 8,700$$

$$\text{White} = ₹ 3,56,000 \times 3/8 = ₹ 1,33,500 - ₹ 1,42,200 = (-) ₹ 8,700$$

— to be transferred to Current Accounts.

Illustration 13.

Quick and Slow are partners in a firm sharing profits and losses in the ratio of 3 : 2. The Balance Sheet of the firm as on 31st March, 2013 was as under :

| Liabilities | | ₹ | Assets | | ₹ |
|------------------|---------------|-----------------|----------------------|--|-----------------|
| Capital Accounts | | | Furniture & Fixtures | | 60,000 |
| Quick | 1,20,000 | | Office Equipments | | 30,000 |
| Slow | <u>77,000</u> | 1,97,000 | Motor Car | | 75,000 |
| General Reserve | | 30,000 | Stock | | 50,000 |
| Sundry Creditors | | 96,000 | Sundry Debtors | | 90,000 |
| | | | Cash at Bank | | 18,000 |
| | | <u>3,23,000</u> | | | <u>3,23,000</u> |

Smooth was admitted as a new partner with effect from 1st April, 2013 and it was agreed that he would bring some private furniture worth ₹ 10,000 and private stock costing ₹ 8,000 and in addition contribute ₹ 50,000 cash towards capital.

He would also bring proportionate share of goodwill which is to be valued at two year' purchase of the average profits of the last three years.

The profits of the last three years were :

| | ₹ |
|---------|--------|
| 2012-13 | 52,000 |
| 2011-12 | 32,000 |
| 2010-11 | 28,000 |

However, on a checking of the past records, it was noticed that on 1.4.2011 a new furniture costing ₹ 8,000 was purchased but wrongly debited to revenue, and in 2012-13 a purchase invoice for ₹ 4,000 dated 25.3.2013 has been omitted in the books. The firm charges depreciation on Furniture @ 10% p.a.

Your calculation of goodwill is to be made on the basis of correct profits.

On revaluation value of Stock is to be reduced by 5% and Motor car is worth ₹ 85,000. Smooth duly paid the required amount for goodwill and cash towards capital.

It was decided that the future profits of the firm would be shared as Quick — 50%, Slow — 30% and Smooth — 20%.

Assuming the above — mentioned arrangements were duly carried out, show the Capital

Accounts of the partners and the Balance Sheet of the firm after Smooth's admission.



Solution :

Capital Account

Dr.

Cr.

| Particulars | Quick ₹ | Slow ₹ | Smooth ₹ | Particulars | Quick ₹ | Slow ₹ | Smooth ₹ |
|----------------|------------|-----------|-------------|--|------------|-----------|-------------|
| To Balance c/d | 1,51,620 | 1,00,624 | 68,000 | By Balance b/d | 1,20,000 | 77,000 | — |
| | | | | " General Reserve | 18,000 | 12,000 | — |
| | | | | " Revaluation A/c — Profit | 4,500 | 3,000 | — |
| | | | | " Goodwill A/c (a sacrificing ratio is 1 : 1) | 7,632 | 7,632 | — |
| | | | | " Furniture | — | — | 10,000 |
| | | | | " Stock | — | — | 8,000 |
| | | | | " Bank | — | — | 50,000 |
| | | | | " Advertisement (for Profit) | 1,488 | 992 | — |
| | 1,51,620 | 1,00,624 | 68,000 | | 1,51,620 | 1,00,624 | 68,000 |

Balance Sheet

as at April 1, 2013

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|---|----------|----------|-----------------------------|--------|----------|
| Capital Accounts : | | | Furniture & Fittings | 60,000 | |
| Quick | 1,51,620 | | Add : Brought in by Smooth | 10,000 | |
| Slow | 1,00,624 | | | 70,000 | |
| Smooth | 68,000 | 3,20,244 | Add : For Rectification | 6,480 | 76,480 |
| Sundry Creditors (₹ 96,000+ ₹ 4,000) | | 1,00,000 | Office Equipment | | 30,000 |
| | | | Motor car | | 85,000 |
| | | | Stock | 50,000 | |
| | | | Add : Brought in by Smooth | 8,000 | |
| | | | | 58,000 | |
| | | | Less : Revaluation | 2,500 | 55,500 |
| | | | Sundry Debtors | | 90,000 |
| | | | Bank (18,000+50,000+15,264) | | 83,264 |
| | | 4,20,244 | | | 4,20,244 |

Working :**1. Calculation of goodwill**

| Year | Profit ₹ | Adjustment | Corect Profit ₹ |
|---------|-------------|---|--------------------|
| 2010-11 | 28,000 | — | 28,000 |
| 2011-12 | 32,000 | Add: 8,000 (New furniture) Less: 800 (Depreciation) | 39,200 |
| 2012-13 | 52,000 | Less: 4,000 (purchase omitted) Less: 720 (Depreciation on new furniture) For 2nd years | 47,280 |
| | | Total | 1,14,480 |

∴ Value of goodwill ₹ 1,14,480 ÷ 3 = ₹ 38,160 × 2 = ₹ 76,320

Smooth should bring ₹ 76,320 × 20% = ₹ 15,264.

2. Adjusted Profit

| | |
|---------------------------|-------------------------------|
| Furniture and Fixture A/c | Dr. 6,480 (8,000 – 800 – 720) |
| To Creditors | 4,000 |
| " Quick's Capital A/c | 1,488 |
| " Slow's Capital A/c | 992 |

3. Profit on revaluations

Motor Car – Stock = ₹ 10,000 – ₹ 2,500 = ₹ 7,500

Illustration 14.

A and B are partners in a firm sharing profits and losses in the ratio 3 : 2. Their Balance Sheet as on 31.12.2012 stood as follows :

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|------------------|---------------|---------------|------------------------------|--------------|---------------|
| Sundry Creditors | | 20,000 | Goodwill | | 12,000 |
| Capital Account | | | Cash in hand | | 15,000 |
| A | | | Sundry Debtors | | |
| B | 12,000 | | Less : Reserve for Bad Debts | 21,000 | |
| | <u>30,000</u> | | | <u>1,000</u> | 20,000 |
| | | 42,000 | Stock-in-trade | | 10,750 |
| | | | Fixture & Fittings | | 250 |
| | | | Profit and Loss Account | | 4,000 |
| | | <u>62,000</u> | | | <u>62,000</u> |

On 1.1.2013 they admit C as a partner on the following terms :

- The new profit sharing ratio of A, B and C becomes 5 : 3 : 2.
- Agreed value of Goodwill is ₹ 20,000 and C brings the necessary premium for Goodwill in cash, half of which is retained in the business. Book value of Goodwill should remain undisturbed.
- The Reserve for bad debts is to be raised to 10% of Sundry Debtors.
- Stock-in-trade is to be revalued at ₹ 12,000 but the effect is not to be shown in the books.
- Fixture & Fittings are to be reduced to ₹ 150.
- C should bring further sum in cash in order to make his capital equal to 1/5 th of the combined adjusted capital of A and B.

Show the necessary journal entries and the Capital Accounts of the partners and also prepare the Balance Sheet of the new firm as at 1.1.2013.



Solution.

**In the books of A, B and C
Journal**

| Date | Particulars | L.F. | Debit ₹ | Credit ₹ |
|----------------|--|------|----------------|----------------|
| 2013 Jan. 1 | Bank A/c Dr. To C's Capital A/c To Goodwill A/c (Goodwill and capital to be brought in by C in cash) | | 9,420 | 7,280 1,600 |
| | Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c (Goodwill to be credited to A and B's capital account in sacrificing ratio) | | 1,600 | 800 800 |
| | A's Capital A/c Dr. B's Capital A/c Dr. To Bank A/c (Half of the goodwill to be distributed) | | 400 400 | 800 |
| | A's Capital A/c Dr. B's Capital A/c Dr. To Profit and Loss A/c (Debit balance of P&L A/c transferred to A and B's capital in 3 : 2) | | 2,400 1,600 | 4,000 |
| | Profit and Loss Adjustment A/c Dr. To Reserve for Bad Debts A/c To Fixture and Fitting A/c (Value of assets is reduced on revaluation before C's admission) | | 1,200 | 1,100 100 |
| | A's Capital A/c Dr. B's Capital A/c Dr. To Profit and Loss Adjustment A/c (Loss on revaluation transferred to A and B's capital in 3 : 2) | | 720 480 | 1,200 |
| | C's Capital A/c Dr. To A's Capital A/c To B's Capital A/c (Effect of stock on revaluation adjusted on C's admission) | | 250 | 125 125 |

Capital Account

Dr.

Cr.

| Particulars | A ₹ | B ₹ | C ₹ | Particulars | A ₹ | B ₹ | C ₹ |
|--------------------------------------|--------|--------|--------|----------------|--------|--------|--------|
| To Profit and Loss — Loss | 2,400 | 1,600 | — | By Balance b/d | 12,000 | 30,000 | — |
| " Profit and Loss Adj. A/c — Loss | — | — | — | " Bank | — | — | 7,820 |
| " A's Capital | 720 | 480 | — | " Goodwill | 800 | 800 | — |
| " B's Capital | — | — | 125 | " C's Capital | 125 | 125 | — |
| " Bank (Withdraw of goodwill) | — | — | 125 | | | | |
| " Balance c/d | 400 | 400 | — | | | | |
| | 9,405 | 28,445 | 7,570 | | | | |
| | 12,925 | 30,925 | 7,820 | | 12,925 | 30,925 | 7,820 |

Balance Sheet
as at 1st January, 2013

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|------------------|--------------|---------------|---|--------------|---------------|
| Capital : | | | Goodwill | | 12,000 |
| A | 9,405 | | Cash (₹ 15,000 + ₹ 9,420 – ₹ 800) | | 23,620 |
| B | 28,445 | | Sundry Debtors | | |
| C | <u>7,570</u> | 45,420 | Less : Prov. for Bad Debts | 21,000 | |
| Sundry Creditors | | 20,000 | | <u>2,100</u> | 18,900 |
| | | | Stock | | 10,750 |
| | | | Furniture and Fixtures (₹ 250 – ₹ 100) | | 150 |
| | | <u>65,420</u> | | | <u>65,420</u> |

Working :

1. Goodwill to be brought in by C :

| | | | |
|---------------------------------------|---------------|---|--------------|
| | ₹ | Sacrificing ratio : | |
| Agreed value of goodwill | 20,000 | A $3/5 - 5/10 = (6-5)/10 = 1/10$ | (Sacrifices) |
| Less : as per Balance Sheet | <u>12,000</u> | B $2/5 - 3/10 = (4-3)/10 = 1/10$ | (Sacrifices) |
| Under valuation | <u>8,000</u> | C $1/10 + 1/10 = 2/10$ | (gains) |
| ∴ C is to bring ₹ 8,000 x 1/5 = 1,600 | | ∴ Goodwill to be shared between A and B equally i.e. (1 : 1) | |

2. Adjustments for increased value of Stock

Since the increased value of stock is not to be shown in the books, the effect of the same will be:

Increased value of stock ₹ 1,250 (₹ 12,000 – ₹ 10,750)

| | Credit ₹ | Debit ₹ | Net Effect ₹ |
|---|--------------------------------|---------------------------------|-----------------|
| A | 750 $\left(\frac{2}{5}\right)$ | 625 $\left(\frac{5}{10}\right)$ | 125 (Cr.) |
| B | 500 $\left(\frac{2}{5}\right)$ | 375 $\left(\frac{3}{10}\right)$ | 125 (Cr.) |
| A | — | 250 $\left(\frac{2}{10}\right)$ | 250 (Dr.) |

3. Capital to be brought in By C

| | | |
|--|--------------|--------|
| Existing capital of A and B | | 42,000 |
| Less: P & L A/c (Dr.) | 4,000 | |
| Loss on Revaluation | <u>1,200</u> | 5,200 |
| | | 36,800 |
| Add: Premium brought in by C $1,600 \times \frac{1}{2}$ | 800 | |
| Stock revalued | <u>250</u> | 1,050 |
| | | 37,850 |

∴ C is to bring: ₹ 37,850 × $\frac{1}{5}$ = ₹ 7,570 + ₹ 250 (for stock) = ₹ 7,820.

6.2 RETIREMENT OF PARTNER

Introduction

A Partner may leave the firm by taking retirement. Normally the retirement takes place by consent of all the partners and / or by other mode of communication by the intended partner to all other partners.

In case of retirement, for paying off the retiring partner(s) some adjustment are required to be done in the books of accounts.

Steps for Adjustments / Books of Accounts :

Following steps to be taken and books of accounts to be prepared to calculate the due of retiring partner.

(1) Revaluation of Assets and liabilities.

This is required for giving the share of net assets of the firm. Treatments are:

Profit or loss on revaluation to be transferred to all the partners in old Profit Sharing ratio.

If the remaining partners decide not to alter the book value of assets or liabilities then the profit or loss on revaluation as distributed earlier should be reversed through remaining partner's capital account in new profit sharing ratio. We shall have to prepare Memorandum Revaluation Account.

(2) Undistributed profit or loss.

Any undistributed profit or loss including reserve is to be transferred in old profit sharing ratio.

Journal entries :**In case of undistributed profit or reserves:**

| | |
|--|-----|
| Profit & Loss A/c | Dr. |
| Reserve A/c | Dr. |
| To Old Partners Capital A/c (In old P.S.R) | |

In case of undistributed Loss

| | |
|--------------------------|-----|
| Old Partners Capital A/c | Dr. |
| To Profit & Loss A/c | |

(3) Adjustment regarding goodwill:

At the time of retirement the retiring partner is also eligible for share of goodwill of the firm. This can be made in the following ways :

- (a) Raising of goodwill : (If goodwill is already existing in the Balance sheet the difference shall be raised)

| | |
|--|-----|
| Goodwill A/c | Dr. |
| (Value of goodwill – existing goodwill in the balance sheet) | |
| To All Partners Capital A/c (Old P.S.R) | |

- (b) Goodwill raised and written off :

(i) Raise goodwill as discussed above.

(ii) Write off goodwill

| | |
|-------------------------------|-----|
| Existing partners Capital A/c | Dr. |
| To Goodwill A/c | |

Settlement of Dues to the Retiring Partner :

The retiring partner becomes entitled to get back his dues from the firm which consists of the following :

- (i) Balance of his capital and current account at the time of retirement.
- (ii) Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities.
- (iii) Salary, commission, interest on capital, if any and all other dues till the date of retirement.
- (iv) Any adjustment in drawings and interest thereon.

Payment of dues.

- (i) Payment at a time. Subject to availability of the fund, the payment may be made at a time. Journal entry :

| | |
|--------------------------------|-----|
| Retiring Partner's Capital A/c | Dr. |
| To Bank A/c | |

- (ii) If part payment be made by giving assets :

| | |
|--------------------------------|-----|
| Retiring Partner's Capital A/c | Dr. |
| To Assets A/c | |



(iii) If the dues are transferred to Loan account.

Retiring Partner's Capital A/c Dr.
 To Retiring partners' Loan A/c

(iv) If the existing partners bring in cash for making payment :

Bank/Cash A/c Dr.
 To Existing Partners' Capital A/c

(v) For interest due on Retiring Partners Loan A/c

Interest on Retiring Partner's Loan A/c Dr.
 To Retiring Partner's Loan account.

Illustration 15.

The Balance Sheet of Baichung, Tausif and Vijayan who shared profits and losses in the ratio 3:3:2 respectively was as follows on 31st December, 2013 :

| | | | | |
|-------------------|--------------|--------|--------------|--------|
| Capitals : | | | Machinery | 31,600 |
| Baichung | 24,000 | | Furniture | 6,400 |
| Tausif | 10,000 | | Stock | 8,500 |
| Vijayan | <u>8,000</u> | 42,000 | Debtors | 4,300 |
| Reserve | | 4,800 | Cash at Bank | 4,700 |
| Creditors | | 8,700 | | |
| | | 55,500 | | 55,500 |

Baichung retired from the business on 1st January, 2013. Revaluation of assets were made as : Machinery ₹ 34,000, Furniture ₹ 5,000, Stock ₹ 9,600, Debtors ₹ 4,000 and Goodwill ₹ 10,000.

Baichung was paid ₹ 4,225 immediately and the balance was transferred to a Loan Account for payment in 4 equal half-yearly installments together with interest @ 6% p.a.

Show the necessary accounts, the Balance Sheet of the firm immediately after Baichung's retirement and his Loan Account till finally paid off.

Solution:

Books of Baichung, Tausif and Vijayan Revaluation Account

| Dr. | | | | Cr. | | | |
|--------|--|-------------|--|--------|----------------------------------|-------------|----------------|
| Date | Particulars | Amount ₹ | Amount ₹ | Date | Particulars | Amount ₹ | Amount ₹ |
| 1.1.13 | To Furniture A/c To Provision On Debtors A/c To Capital A/c: (Profit on Revaluation) Baichung [3/8] Tausif [3/8] Vijayan [2/8] | | 1,400 300 675 675 <u>450</u> | 1.1.13 | By Machinery A/c By Stock A/c | | 2,400 1,100 |
| | | | <u>3,500</u> | | | | <u>3,500</u> |

| Dr. | | | | | Cr. | | | | |
|-----------------|---|---------------|-------------|--------------|--------|----------------------------------|---------------|--------------|--------------|
| Capital Account | | | | | | | | | |
| Date | Particulars | Baichung ₹ | Tausif ₹ | Vijayan ₹ | Date | Particulars | Baichung ₹ | Tausif ₹ | Vijayan ₹ |
| 1.1.13 | To Bank A/c | 4,225 | | | 1.1.13 | By Balance b/d | 24,000 | 10,000 | 8,000 |
| | To 6% Loan A/c (Balance transferred) | 26,000 - | | | | By Reserve [3:3:2] | 1,800 | 1,800 | 1,200 |
| | To Balance c/d | | 16,225 | 12,150 | | By Revaluation A/c " Goodwill | 675 3,750 | 675 3,750 | 450 2,500 |
| | | 30,225 | 16,225 | 12,150 | | | 30,225 | 16,225 | 12,150 |

**Tausif and Vijayan
Balance Sheet as at 1.1.13**

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------|---------------|-------------|------------------|-------------|---------------|
| Capitals : | | | Goodwill | | 10,000 |
| Tausif | 16,225 | | Machinery | | 34,000 |
| Vijayan | <u>12,150</u> | 28,375 | Furniture Stock | | 5,000 |
| Baichung's 6% Loan | | 26,000 | Debtors | | 9,600 |
| Sundry Creditors | | 8,700 | Less : Provision | | |
| | | | Cash at Bank | 4,300 | |
| | | | [4,700-4,225] | <u>300</u> | 4,000 |
| | | | | | 475 |
| | | 63,075 | | | <u>63,075</u> |

Baichung's Loan 6% Account

| Dr. | | | Cr. | | |
|----------|-------------------------|-------------|----------|--|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 1.1.13 | To Bank A/c | 7,280 | 1.1.13 | By Baichung's Capital A/c | 26,000 |
| | [1/4 of 26,000+780] | | 30.6.13 | By Interest | 780 |
| 31.12.13 | To Bank A/c | 7,085 | | [6% of 26,000 for 6 months] | |
| | [1/4 of 26,000+585] | | | By Interest A/c of | 585 |
| | To Balance c/d | 13,000 | | [6% of (26,000 - 6,500) for 6 months] | |
| | | 27,365 | | | 27,365 |
| 30.6.14 | To Bank A/c [6500+390] | 6,890 | 1.1.14 | By Balance b/d | 13,000 |
| 31.12.14 | To Bank A/c [6,500+195] | 6,695 | 31.06.14 | By Interest A/c [6% of 13,000 for 6 months] | 390 |
| | | 13,585 | 31.12.14 | By Interest A/c [6% of 6,500 for 6 months] | 195 |
| | | | | | 13,585 |



Illustration 16.

A, B and C were in partnership sharing profits in the proportion of 5:4:3. The Balance Sheet of the firm as on 31st March, 2013 was as under :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|---------------------------|-------------|----------------|-------------|
| Capital Accounts : | | Goodwill | 40,000 |
| A | 1,35,930 | Fixtures | 8,200 |
| B | 95,120 | Stock | 1,57,300 |
| C | 61,170 | Sundry Debtors | 93,500 |
| Sundry Creditors | 41,690 | Cash | 34,910 |
| | 3,33,910 | | 3,33,910 |

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore entered into as on 31st March, 2013, the terms of which were as follows:

- The Profit & Loss Account for the year ended 31st March, 2013, which showed a net profit of ₹48,000 was to be reopened. B was to be credited with ₹4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing ratio was to be revised as from 1st April, 2012 to 3:4:4.
- Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The Fixtures were to be revalued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.
- The valuations arising out of the above agreement were Goodwill ₹56,800 and Fixture ₹10,980.
- B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate Goodwill from the Balance Sheet, to retain the Fixtures on the books at revised value, and to increase the provision for doubtful debts to 6%.

You are required to submit the Journal Entries necessary to give effect to the above arrangement and to draw up the Capital Accounts of the partners after carrying out all adjustment entries as stated above.

Solution :

Books of the Firm A, B & C Journal Entries

| Date | Particulars | | Dr. Amount ₹ | Cr. Amount ₹ |
|---------|---|-----|--------------------|--------------------|
| 31.3.13 | A's Capital A/c [5/12 of ₹48,000] | Dr. | 20,000 | |
| | B's Capital A/c [4/12 of ₹48,000] | Dr. | 16,000 | |
| | C's Capital A/c [3/12 of ₹48,000] | Dr. | 12,000 | |
| | To Profit & Loss Adjustment A/c | | | 48,000 |
| | [Profits of ₹48,000 already shared by A, B & C as 5 : 4 : 3 written back] | | | |
| | Profit & Loss Adjustment A/c | Dr. | 4,000 | |
| | To B's Capital A/c | | | 4,000 |
| | [B Credited with bonus of ₹4,000 for his extra work] | | | |
| | Profit & Loss Adjustment A/c | Dr. | 44,000 | |
| | To A's Capital A/c [3/11 of ₹44,000] | | | 12,000 |
| | To B's Capital A/c [4/11 of ₹44,000] | | | 16,000 |
| | To C's Capital A/c [4/11 of ₹44,000] | | | 16,000 |
| | [The remaining profits re-distributed as 3 : 4 : 4] | | | |

| | | | |
|---|-----|----------|----------|
| Goodwill A/c | Dr. | 16,800 | |
| Fixtures A/c | Dr. | 2,780 | |
| To Profit & Loss Adjustment A/c | | | 19,580 |
| [Values of assets increased on revaluation] | | | |
| Profit & Loss Adjustment A/c | Dr. | 1,870 | |
| To Provision for doubtful debts A/c | | | 1,870 |
| [Provision created @ 2% on Debtors] | | | |
| Profit & Loss Adjustment A/c | Dr. | 17,710 | |
| To A's Capital A/c [3/11] | | | 4,830 |
| To B's Capital A/c [4/11] | | | 6,440 |
| To C's Capital A/c [4/11] | | | 6,440 |
| [Profit on Revaluation shared among all partners as 3 : 4 : 4] | | | |
| A's Capital A/c | Dr. | 1,32,760 | |
| To A's Loan A/c | | | 1,32,760 |
| [Transfer of A's dues to his Loan A/c] | | | |
| B's Capital A/c [3/5] | Dr. | 36,324 | |
| C's Capital A/c [2/5] | Dr. | 24,216 | |
| To Goodwill A/c | | | 56,800 |
| To Provision for doubtful debts A/c | | | 3,740 |
| [Goodwill Account written off and provision on debtors increased by 4% further on ₹ 93,500] | | | |

Dr.

Capital Accounts

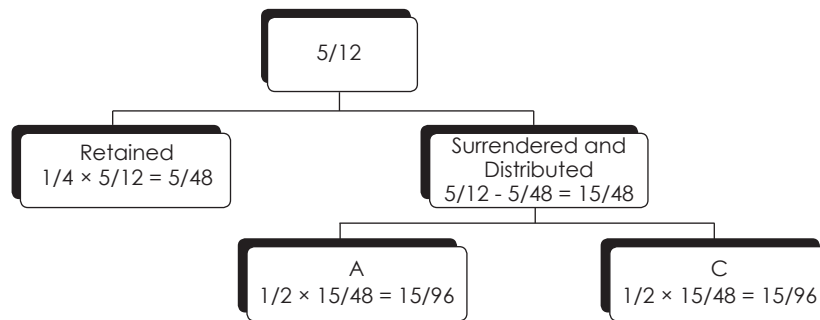
Cr.

| Date 2013 | Particulars | A ₹ | B ₹ | C ₹ | Date 2013 | Particulars | A ₹ | B ₹ | C ₹ |
|-----------|--|----------|----------|--------|-----------|---|----------|----------|--------|
| 31.3 | To Profit & Loss Adjustment A/c | 20,000 | 16,000 | 12,000 | 31.3 | By Balance b/d | 1,35,930 | 95,120 | 61,170 |
| | To Loan A/c (Balance Transferred) | 1,32,760 | - | - | | By Profit & Loss Adjustment A/c (Bonus) | - | 4,000 | - |
| | To Goodwill & Provision for Doubtful Debts | - | 36,324 | 24,216 | | By Profit & Loss Adjustment A/c | 12,000 | 16,000 | 16,000 |
| | To Balance c/d | - | 69,236 | 47,394 | | By Profit & Loss Adjustment A/c | 4,830 | 6,440 | 6,440 |
| | | 1,52,760 | 1,21,560 | 83,610 | | | 1,52,760 | 1,21,560 | 83,610 |

Illustration 17.

On 1.1.2010, A and B started a firm of Cost Accountants sharing profits and losses equally. Each of the partners contributed ₹ 2,000 towards his capital of the firm and was allowed to draw ₹ 400 p.m. in anticipation of profits. On 1.1.2011, they admitted C as a third partners with equal share and he contributed ₹ 3,000 towards his capital and a further sum of ₹ 2,000 towards premium for goodwill. He too was entitled to draw ₹ 400 p.m. From 1.1.2012, A got a part-time job of cost consultant elsewhere and considering that he would be unable to devote his full time towards the business of the firm agreed to leave half of his share in the profits to be apportioned equally between B and C and his drawings was reduced to ₹ 200 p.m. for 1st January, 2012. On 1.1.2013, B got a full time job and in consequence A had to leave his part-time job and to devote full time in the firm. It was arranged that B will remain only a quarter of his earlier share in the firm and would be drawing nothing from 1.1.2013. A and C would be drawing @ ₹ 600 p.m. instead. The interest surrendered by B would be apportioned equally by A and C. On 31st Dec. 2013, B decided to retire altogether from the firm.

You are required to ascertain the amount due to B by the firm from the following particulars :



$$\text{A's profit sharing ratio for 2013} = \frac{1}{6} + \frac{15}{96} = \frac{31}{96}$$

$$\text{C's profit sharing ratio for 2012} = \frac{5}{12} + \frac{15}{96} = \frac{55}{96}$$

2. Goodwill

B retires on 31.12.13 and for the purpose of calculating goodwill 'previous two years' should be taken 2012 and 2011. Thus, the value of goodwill will be:

| | | |
|--|---------------------------------|-----------------|
| B's Share of Annual Profits of the previous two years: | 2012 = $\frac{5}{12}$ of 24,000 | = ₹ 10,000 |
| | 2011 = $\frac{1}{3}$ of 18,000 | = ₹ 6,000 |
| | | <u>₹ 16,000</u> |

Average of this 16,000 = $\frac{16,000}{2}$ = ₹ 8,000; Two years purchase of the above amount = $2 \times ₹ 8,000$ = ₹ 16,000.

B's Capital Account

| Dr. | | | Cr. | | |
|----------|---|-------------|----------|---|---------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 31.12.10 | To Cash (Drawings) | 4,800 | 1.1.10 | By Cash — (Contribution) | 2,000 |
| | " Balance c/d | 5,700 | 31.12.10 | " Profit and Loss A/c — (Share of Profit) (₹ 17,000 × 1/2) | 8,500 |
| | | 10,500 | | | 10,500 |
| 31.12.10 | To Cash — Drawings | 4,800 | 1.1.10 | By Balance b/d | 5,700 |
| | " Balance c/d | 7,900 | 31.12.10 | " Goodwill — Share of Premium (₹ 2,000 × 1/2) | 1,000 |
| | | 12,700 | | " Profit and Loss A/c — Share of Profit (₹ 18,000 × 1/3) | 6,000 |
| 31.12.11 | To Cash — Drawings | 4,800 | 1.1.11 | By Balance b/d | 12,700 |
| | " Balance c/d | 13,100 | 31.12.11 | " Profit and Loss A/c — Share of Profit (₹ 24,000 × 5/12) | 7,900 |
| | | 17,900 | | | 10,000 |
| 31.12.12 | To B's Loan A/c — amount transferred | 32,110 | 1.1.12 | By Balance b/d | 17,900 |
| | | 32,110 | 31.12.12 | " Profit and Loss A/c — (Share of Profit) (₹ 28,896 × 5/48) | 13,100 |
| | | | | " Goodwill | 3,010 |
| | | | | | 16,000 |
| | | | | | <u>32,110</u> |

Illustration 18.

P, Q & R were equal partners. R retired on 31st March, 2013. The Balance Sheet of the firm as on 31st December, 2012 was as follows :

| Liabilities | | Amount ₹ | Assets | | Amount ₹ |
|-----------------------------|---------------|---------------|-----------------------|--|---------------|
| Capitals : | | | Goodwill | | 18,900 |
| P | 30,000 | | Buildings | | 40,000 |
| Q | 20,000 | | Investments (at Cost) | | 5,000 |
| R | <u>20,000</u> | 70,000 | Stock | | 10,000 |
| | | | Debtors | | 10,000 |
| | | | Cash at Bank | | 10,000 |
| Investment Fluctuation Fund | | 1,200 | | | |
| Provision for Bad Debts | | 800 | | | |
| General Reserve | | 4,000 | | | |
| Trade Creditors | | 17,900 | | | |
| | | <u>93,900</u> | | | <u>93,900</u> |

On 31.3.13 the following adjustments were considered : (a) Buildings were appreciated by ₹ 18,000; Book Debts were considered good; Investments were considered worth ₹ 4,700 and Stock was valued at ₹ 9,400; (b) Goodwill was considered equivalent to the average annual profits of the last three years; (c) R's share of Profit up to the date of his retirement was calculated on the basis of the average annual profits of the preceding three years which were ₹ 8,000; ₹ 9,000 and ₹ 10,000.

Show the Journal Entries and prepare the Balance Sheet immediately after R's retirement.

Solution:

Working notes :

- Valuation of Goodwill** : Average Annual Profits = $\frac{8,000 + 9,000 + 10,000}{3} = ₹ 9,000$ Decrease in value of Goodwill = ₹ 18,900 – ₹ 9,000 = ₹ 9,900

This shall be shared amongst all the Partners' in their old ratio.

- R retired on 31st March, 2013, that is, after 3 months from the date of the last year ending. Estimated Profits for 3 months = $\frac{3}{12}$ of 9,000 = ₹ 2,250. The retiring partner should be credited with $\frac{1}{3}$ rd of 2,250 = ₹ 750.

Either the continuing Partners' Capital accounts should be debited in their Gaining Ratio OR Profit and Loss Suspense Account may be debited.

- Investment at cost was shown at ₹ 5,000. Now It is valued at ₹ 4,700. Loss on Revaluation is ₹ 300.

The fluctuation fund in excess of ₹ 300 (that is ₹ 1,200 - ₹ 300 = 900) should be transferred to Revaluation Account.

**In the books of P, Q & R
Journal Entries**

| Date | Particulars | L.F. | Dr. | Cr. |
|---|--|--------|-------------|-------------|
| | | | Amount ₹ | Amount ₹ |
| 31.3.13 | P's Capital A/c Dr. | | 3,300 | |
| | Q's Capital A/c Dr. | | 3,300 | |
| | R's Capital A/c Dr. | | 3,300 | |
| | To Goodwill A/c | | | |
| | [Value of Goodwill written down and partners capitals debited in old ratio 1 : 1: 1] | | | 9,900 |
| | Profit & Loss Suspense A/c Dr. | | 750 | |
| | To R's Capital A/c | | | 75 |
| | [Adjustment made for retiring partner's estimated share of profit] | | | |
| Buildings A/c Dr. | | 18,000 | | |
| Provision for Bad Debts A/c Dr. | | 800 | | |
| Investment Fluctuation Fund A/c [1,200 - 300] Dr. | | 900 | | |
| To Revaluation A/c | | | | |
| [Adjustment made for revaluation of assets and liabilities] | | | 19,700 | |
| Revaluation A/c Dr. | | 600 | | |
| To Stock A/c | | | 600 | |
| [Value of stock reduced on revaluation] | | | | |
| Revaluation A/c Dr. | | 19,100 | | |
| To P's Capital A/c | | | 6,366 | |
| To Q's Capital A/c | | | 6,367 | |
| To R's Capital A/c | | | 6,367 | |
| [Profit on Revaluation shared by all partners equally] | | | | |
| General Reserve A/c Dr. | | 4,000 | | |
| To P's Capital A/c | | | 1,334 | |
| To Q's Capital A/c | | | 1,333 | |
| To R's Capital A/c | | | 1,333 | |
| [Undistributed Reserve shared equally by all partners] | | | | |
| R's Capital A/c Dr. | | 25,150 | | |
| To R's Loan A/c | | | 25,150 | |
| [Dues to the retiring partner transferred to Loan A/c] | | | | |



Partners Capital Accounts

Dr.

Cr.

| Particulars | P ₹ | Q ₹ | R ₹ | Particulars | P ₹ | Q ₹ | R ₹ |
|----------------------------------|--------|--------|--------|--------------------------------------|--------|--------|--------|
| To Goodwill A/c - Written off | 3,300 | 3,300 | 3,300 | By Balance b/d | 30,000 | 20,000 | 20,000 |
| " R's Loan A/c (Transfer) | - | - | 25,150 | " P & L Suspense A/c | - | - | 7 5 0 |
| To Balance c/d | 34,400 | 24,400 | - | " Revaluation A/c (Sh. of Profit) | 6,366 | 6,367 | 6,367 |
| | 37,700 | 27,700 | 28,450 | " General Reserve | 1,334 | 1,333 | 1,333 |
| | | | | | 37,700 | 27,700 | 28,450 |

P and Q

Balance Sheet as at 31st March, 2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------------------|---------------|-------------|--------------------|---------------|-----------------|
| Capital : | | | Goodwill | | 9,000 |
| P | 34,400 | | Buildings | 40,000 | |
| Q | <u>24,400</u> | 58,800 | Add: Appreciation | <u>18,000</u> | 58,000 |
| R's Loan A/c | | 25,150 | Investment at Cost | | 5,000 |
| Investment Fluctuation Fund | | 300 | Stock | | 9,400 |
| Trade Creditors | | 17,900 | Debtors | | 10,000 |
| | | 1,02,150 | Cash at Bank | | 10,000 |
| | | | P & L Suspense A/c | | 750 |
| | | | | | <u>1,02,150</u> |

Illustration 19.

Compass, Cone and Circle are in partnership sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 31st December, 2012 was as follows :

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|--------------------|---------------|----------|---------------------------------|--------------|-----------------|
| Capital accounts : | | | Machinery (at Cost) | 50,000 | |
| Compass | 40,000 | | Less : Provision for Dep. | <u>8,000</u> | 42,000 |
| Cone | 60,000 | | Furniture | | 1,000 |
| Circle | <u>20,000</u> | | Sundry Debtors | 80,000 | |
| Reserve | | 1,20,000 | Less : Prov. for Doubtful Debts | <u>3,000</u> | 77,000 |
| Sundry Creditors | | 30,000 | Stocks | | 50,000 |
| | | 60,000 | Cash at Bank | | 40,000 |
| | | 2,10,000 | | | <u>2,10,000</u> |

On 31st March 2013 Cone retired and Compass and Circle continued in partnership, sharing profits and losses in the ratio of 3 : 2. It was agreed that adjustments were to be made in the Balance Sheet as on 31st March, 2013, in respect of the following :

(a) The Machinery was to be revalued at ₹ 45,000; (b) The Stock was to be reduced by 2%; (c) The Furniture was to be reduced to ₹ 600; (d) The Provision for Doubtful Debts would be ₹ 4,000; (e) A provision of ₹ 300 was to be made for Outstanding Expenses.

The Partnership agreement provided that on the retirement of a partner, goodwill was to be valued at ₹ 24,000 and Cone's share of the same was to be adjusted into the accounts of Compass and Circle. The profit up to the date of retirement was estimated at ₹ 18,000.

Cone was to be paid off in full, Compass and Circle were to bring such an amount in cash so as to make their capital in proportion to the new profit sharing ratio. Subject to the condition that a cash balance of ₹ 20,000 was to be maintained as working capital.

Pass the necessary journal entire to give effect to the above arrangements and prepare the partners' Capital Accounts on 31st March, 2013.

Solution:

**In the books of Compass, Cone and Circle
Journal**

| Date | Particulars | L.F. | Debit ₹ | Credit ₹ |
|-----------|--|------|----------------|------------------------------|
| 31.3.2013 | Reserve A/c Dr. To Compass's Capital A/c To Cone's Capital A/c To Circle's Capital A/c (Reserve transferred to the capital accounts of the partners in 3 : 2 : 1) | | 30,000 | 15,000 10,000 5,000 |
| | Machinery A/c Dr. To Revaluation A/c (Value of the machinery increased on Cone's retirement) | | 3,000 | 3,000 |
| | Revaluation A/c Dr. To Stock A/c To Furniture A/c To Provision for Bad Debts A/c To Outstanding Expenses A/c (Value of the assets reduced on Cone's retirement) | | 2,700 | 1,000 400 1,000 300 |
| | Revaluation A/c Dr. To Compass's Capital A/c To Cone's Capital A/c To Circle's Capital A/c (Profit on revaluation transferred to the capital accounts of the partners) | | 300 | 150 100 50 |
| | Compass's Capital A/c Dr. Circle's Capital A/c Dr. To Cone's Capital A/c (Cone's share of goodwill to be adjusted against remaining partner's capital accounts in the gaining ratio of 3 : 7) | | 2,400 5,600 | 8,000 |
| | Profit and Loss Suspense A/c Dr. To Compass's Capital A/c To Cone's Capital A/c To Circle's Capital A/c (Estimated profit transferred to the capital accounts of the partners) | | 18,000 | 9,000 6,000 3,000 |
| | Cone's Capital A/c Dr. To Bank A/c (Payment is made to Cone on his retirement) | | 84,100 | 84,100 |
| | Bank A/c Dr. To Compass's Capital A/c To Circle's Capital A/c (Cash to be brought in by Compass and Circle as per agreement) | | 46,100 | 16,430 29,670 |



Dr.

Capital Account

Cr.

| Particulars | Compass ₹ | Cone ₹ | Circle ₹ | Particulars | Compass ₹ | Cone ₹ | Circle ₹ |
|--------------------|--------------|-----------|-------------|---------------------|--------------|-----------|-------------|
| To Cone's Capital | 2,400 | — | 5,600 | By Balance b/d | 40,000 | 60,000 | 20,000 |
| " Bank (bal. fig.) | — | 84,100 | — | " Reserve | 15,000 | 10,000 | 5,000 |
| " Balance c/d | 78,180 | — | 52,120 | " Revaluation | | | |
| | | | | — Profit | 150 | 100 | 50 |
| | | | | " Share of Profit | 9,000 | 6,000 | 3,000 |
| | | | | " Compass's Capital | — | 2,400 | — |
| | | | | " Circle's Capital | — | 5,600 | — |
| | | | | " Bank (bal. fig.) | 16,430 | — | 29,670 |
| | 80,580 | 84,100 | 57,720 | | 80,580 | 84,100 | 57,720 |
| | | | | By Balance b/d | 78,180 | — | 52,120 |

Working Notes :

1. Total value of goodwill ₹ 24,000

∴ Cone's share of goodwill = $24,000 \times \frac{2}{6} = 8,000$ to be adjusted against Compass's and Circle capital in 3 : 7.

Computation of ratio :

Compass = $\frac{3}{5} - \frac{3}{6} = \frac{3}{30}$ (gain)

Circle = $\frac{2}{5} - \frac{1}{6} = \frac{7}{30}$ (gain)

2.

Bank Account

Dr.

Cr.

| Particulars | ₹ | Particulars | ₹ |
|--|----------|--------------------|----------|
| To Balance b/d | 40,000 | By Cone's Capital | 84,100 |
| " Profit — increase in Cash | 18,000 | " Balance c/d | 20,000 |
| " Compass and Circle's Capital (balance figure) | 46,100 | (to be maintained) | |
| | 1,04,100 | | 1,04,100 |

3. Total adjusted capitals of Compass and Circle :

| | |
|--|-----------------|
| | ₹ |
| Compass's Capital (40,000 + 15,000 + 150 + 9,000 – 2,400) | 61,750 |
| Circle's Capital : (20,000 + 5,000 + 50 + 3,000 – 5,600) | 22,450 |
| Add : Total Cash to be brought in | <u>46,100</u> |
| Combined adjusted capitals | <u>1,30,300</u> |

∴ Compass's Cap. = $1,30,300 \times \frac{3}{5} = 78,180$

Circle's Cap. = $1,30,300 \times \frac{2}{5} = 52,120$

ADMISSION – CUM - RETIREMENT

We have separately explained the treatment of admission of partner and the retirement of a partner. Now, we are going to highlight the combined changes effect of simultaneous admission and retirement. It should be remembered that no separate treatment is practically needed i.e. same principles for admission and retirement are followed but only two sets of transactions are incorporated simultaneously.

Illustration 20.

X, Y, & Z were equal partners. Their Balance Sheet as on 31.12.12 was as follows :

| | | | |
|-------------------------|-----------------|--------------------------|----------|
| Partners' Capital | | Land & Freehold Property | 1,00,000 |
| X | 1,00,000 | Plant & Machinery | 2,00,000 |
| Y | 1,00,000 | Furniture & Equipment | 50,000 |
| Z | <u>2,00,000</u> | Stock in-trade | 1,00,000 |
| Partner's Current A/c : | 4,00,000 | Sundry Debtors | 1,00,000 |
| X | 50,000 | Balance with Bankers | 1,50,000 |
| Y | 75,000 | | |
| Z | <u>25,000</u> | | |
| Sundry Creditors | 1,50,000 | | |
| | 7,00,000 | | 7,00,000 |

On 1.1.13 X retired and it was agreed that he should be paid all his dues in full on that date. For this purpose, goodwill was to be calculated on the basis of 3 years purchase of past 3 years profits which amounted to ₹ 1,00,000, ₹ 1,40,000 and ₹ 1,20,000 respectively.

In order to meet his obligation, a bank loan was arranged on 1.1.13 for ₹ 2,00,000 pledging the fixed assets as security.

Further, to compensate a loyal manager Q, it was agreed between Y and Z that Q should be admitted as a partner, who should bring in, over and above a capital of ₹ 1,00,000, his share of Goodwill in cash to serve as working capital. Y and Z agreed to forego 1/3rd of their individual share of profits to Q.

Prepare the opening Balance Sheet of the firm as on 1.1.13.

Solution :**Working Notes :**

(1) Valuation of Goodwill

$$\text{Average Annual Profits} = \frac{1,00,000 + 1,40,000 + 1,20,000}{3} = ₹ 1,20,000$$

$$\therefore \text{Goodwill} = 3 \times 1,20,000 = ₹ 3,60,000$$

Premium to be paid by Q = 1/3 of 3,60,000 = ₹ 1,20,000 and to be shared by Y and Z equally. Similarly X should be provided ₹ 1,20,000 by Y and Z equally.

(2)

Journal Entries

| | | | | |
|-----|---|-----|----------|----------|
| (a) | Y's Current A/c | Dr. | 60,000 | |
| | Z's Current A/c | Dr. | 60,000 | |
| | To X's Current A/c | | | 1,20,000 |
| | (Being X's share of goodwill adjusted against existing partners Y & Z in their gaining ratio 1:1) | | | |
| (b) | Cash A/c | Dr. | 1,00,000 | |
| | To Q's Capital A/c | | | 1,00,000 |
| | (Being Capital contributed by C) | | | |



| | | | |
|-----|--------------------|--------------|--------|
| (c) | Cash A/c | Dr. 1,20,000 | |
| | To Y's Current A/c | | 60,000 |
| | To Z's Current A/c | | 60,000 |

(Being Q's share of premium for goodwill share between Y & Z in their sacrificing ratio)

| | | | |
|-----|------------------|--------------|----------|
| (d) | Bank A/c | Dr. 2,00,000 | |
| | To Bank Loan A/c | | 2,00,000 |

(Being loan taken from Bank against hypothecation of fixed assets)

(3)

Dr. Partner Capital Accounts Cr.

| Particulars | X | Y | Z | Q | Particulars | X | Y | Z | Q |
|--------------------------------|----------|----------|----------|----------|---------------------------------|----------|----------|----------|----------|
| To Cash A/c (Final settlement) | 2,70,000 | - | - | - | By Balance b/d | 1,00,000 | 1,00,000 | 2,00,000 | - |
| To Balance c/d | - | 1,00,000 | 2,00,000 | 1,00,000 | " X's Current A/c (Transfer) | 1,70,000 | - | - | - |
| | | | | | " Cash A/c (Capital introduced) | - | - | - | 1,00,000 |
| | 2,70,000 | 1,00,000 | 2,00,000 | 1,00,000 | | 2,70,000 | 1,00,000 | 2,00,000 | 1,00,000 |

(4) Partners Current Account

Dr. Cr.

| Particulars | X | Y | Z | Particulars | X | Y | Z |
|---------------------------|----------|----------|--------|-------------------|----------|----------|--------|
| To X's Capital A/c (Tran) | 1,70,000 | - | - | By Balance b/d | 50,000 | 75,000 | 25,000 |
| To X's Current A/c | - | 60,000 | 60,000 | " Y's Current A/c | 60,000 | - | - |
| To Balance c/d | - | 75,000 | 25,000 | " Z's Current A/c | 60,000 | - | - |
| | 1,70,000 | 1,35,000 | 85,000 | " Cash A/c | - | 60,000 | 60,000 |
| | | | | | 1,70,000 | 1,35,000 | 85,000 |

(5)

Dr. Balance with Bankers Account Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|------------------------------------|-------------|--------------------|-------------|
| To Balance b/d | 1,50,000 | By X's Capital A/c | 2,70,000 |
| To Bank Loan A/c | 2,00,000 | | |
| To Cash A/c (Premium for goodwill) | 1,20,000 | | |
| To Q's capital A/c | 1,00,000 | By Balance c/d | 3,00,000 |
| | 5,70,000 | | 5,70,000 |

Balance Sheet as at 1.1.13

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------------|-----------------|-----------------|----------------------------|-------------|-----------------|
| Partners' Capital A/cs : | | | Land and Freehold Property | | 1,00,000 |
| Y | 1,00,000 | | Plant & Machinery | | |
| Z | 2,00,000 | | Furniture & Equipment | | 2,00,000 |
| Q | <u>1,00,000</u> | 4,00,000 | Stock | | 50,000 |
| Partner's Current A/cs : | | | Debtors | | 1,00,000 |
| Y | 75,000 | | Cash at Bank (W5) | | 1,00,000 |
| Z | <u>25,000</u> | 1,00,000 | | | 3,00,000 |
| Bank loan (Secured) | | 2,00,000 | | | |
| Sundry Creditors | | 1,50,000 | | | |
| | | <u>8,50,000</u> | | | <u>8,50,000</u> |

Illustration 21.

P, Q and R were partners sharing Profits & Losses as 2 : 3 : 5. P retired on 31.3.13 and X joined as a new partner on the same date, the new profit sharing ratio between Q, R and X being 2 : 3 : 1. The Balance Sheet of P, Q & R on 31.3.2013 was as follows :

| | | | |
|------------------|-----------------|----------------|-----------------|
| Sundry Creditors | 50,000 | Cash in hand | 2,000 |
| Loan from X | 50,000 | Cash at Bank | 93,000 |
| General Reserve | 40,000 | Sundry Debtors | 30,000 |
| Capitals : | | Stock | 20,000 |
| P | 10,000 | Machinery | 30,000 |
| Q | 15,000 | Buildings | 10,000 |
| R | <u>20,000</u> | | |
| | <u>1,85,000</u> | | <u>1,85,000</u> |

X was admitted on the following terms :

(1) Machinery was to be depreciated by ₹ 3,000 (2) Buildings were revalued at ₹ 30,000 (3) Stock was to be written off by ₹ 5,000 (4) Provision of 5% was made against doubtful debts (5) General Reserve would be apportioned among the partners (6) The firm's Goodwill was to be valued at two years purchase of the average profits of the last three years (7) The amount due to P was retained in the business as a loan but X's Capital contribution should be 1/5th of the combined adjusted capitals of Q and R. His capital would be transferred from his Loan Account, (8) the Goodwill would be wiped off from the books after X's admission. (9) Partners decided not to alter the book values of assets & liabilities after admission.

The profits/losses during the last 3 years had been 31.3.11 ₹ 20,000 (Profit) 31.3.12 ₹ 15,000 (loss) and 31.3.13 ₹ 40,000 (Profit).

Show the necessary Accounts and Balance Sheet of the firm.



Solution:

Working Notes :

1. Valuation of Goodwill

| | | |
|---------------------------|---------|-----------------|
| Profits for years ended : | 31.3.11 | ₹ 20,000 |
| | 31.3.12 | ₹ (15,000) |
| | 31.3.13 | ₹ <u>40,000</u> |
| | | ₹ <u>45,000</u> |

So, Average Annual Profits = $45,000/3 = ₹ 15,000$. Goodwill = $2 \times ₹ 15,000 = ₹ 30,000$

For Goodwill raised :

| | | | |
|--------------|-----|--------|--------|
| Goodwill A/c | Dr. | 30,000 | |
| To P | | | 6,000 |
| To Q | | | 9,000 |
| To R | | | 15,000 |

For Goodwill written off :

| | | |
|---|-----|--------|
| Q | Dr. | 10,000 |
| R | Dr. | 15,000 |
| X | Dr. | 5,000 |

To Goodwill 30,000

Dr.

Memorandum Revaluation Account

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|---|---------------|--------------------------|---------------|
| To Machinery | 3,000 | By Building | 20,000 |
| " Stock | 5,000 | | |
| " Prov. for doubtful Debts | 1,500 | | |
| " P/Capital A/c (Share of Rev. Profit) | | | |
| P – 2,100 | | | |
| Q – 3,150 | | | |
| R – <u>5,250</u> | 10,500 | | |
| | <u>20,000</u> | | <u>20,000</u> |
| To Reversal of Items b/d Building | | By Reversal of Items b/d | |
| | | Machinery | 3,000 |
| | | Stock | 5,000 |
| | | Provision for D/Debts | 1,500 |
| | | By P/Capital A/c | |
| | | (Share of Rev. Profit) | |
| | | Q – 3,500 | |
| | | R – 5,250 | |
| | | X – <u>1,750</u> | 10,500 |
| | <u>20,000</u> | | <u>20,000</u> |

Partners Capital Accounts

Dr.

Cr.

| | P ₹ | Q ₹ | R ₹ | S ₹ | | P ₹ | Q ₹ | R ₹ | S ₹ |
|----------------------------|--------|--------|--------|--------|---|--------|--------|--------|--------|
| To Mem. Rev A/c | | | | | By Balance b/d | 10,000 | 15,000 | 20,000 | - |
| - Sh. of loss | - | 3,500 | 5,250 | 1,750 | By General Reserve | 8,000 | 12,000 | 20,000 | - |
| To Goodwill written off | - | 10,000 | 15,000 | 5,000 | By Memorandum Revaluation A/c (Sh. of profit) | 2,100 | 3,150 | 5,250 | - |
| To P's loss A/c (transfer) | 26,100 | | | | By Goodwill raised | 6,000 | 9,000 | 15,000 | - |
| To Balance c/d | | 25,650 | 40,000 | 13,130 | By Loan from X A/c (Transfer) | - | - | - | 19,880 |
| | 26,100 | 39,150 | 60,250 | 19,880 | | 26,100 | 39,150 | 60,250 | 19,880 |

Capital Balance of X = $1/5$ of $(25,650 + 40,000) = 1/5 \times 65,650 = 13,130$

Therefore from X's loan A/c : Loan from X A/c Dr. 19,880

To X's Capital A/c 19,880

Q, R & X

Balance sheet as at 31.3.13

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|-------------------|-------------|--------------|-------------|
| S/Creditors | 50,000 | Building | 10,000 |
| Loan for X | 30,120 | Machinery | 30,000 |
| Loan from P | 26,100 | Stock | 20,000 |
| Capitals : | | Debtors | 30,000 |
| Q : 25,650 | | Cash in hand | 2,000 |
| R : 40,000 | | Cash at Bank | 93,000 |
| X : <u>13,130</u> | 78,780 | | |
| | 1,85,000 | | 1,85,000 |

Illustration 22.

Shukla, Grewal, Jain and Narang were partners sharing profits and losses as 4 : 3 : 2 : 1. Their Balance Sheet as on 31.03.13 was as follows :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|---------------------|-------------|-----------------------------------|-------------|
| Capital : | | Goodwill | 9,000 |
| Shukla 7,000 | | Stock Debtors | 2,000 |
| Grewal 6,500 | | Cash | 11,000 |
| Jain 5,000 | | Profit and Loss (Dr. Balance) A/c | 5,000 |
| Narang <u>4,000</u> | 22,500 | | 3,000 |
| Sundry Creditors | 7,500 | | |
| | 30,000 | | 30,000 |



On that date Grewal retired and the amount due to him was paid privately by the other partners in their profit sharing ratio. Chakraborty was then admitted as a new partner. The latter paid ₹ 5,000 as capital and ₹ 3,200 as his share of goodwill, his share being $\frac{1}{5}$ th of the future profits. Shukla, Jain and Narang resolved to share the remaining profits as 3 : 3 : 2. It was also decided that the capitals of Shukla, Jain, Narang and Chakraborty should be made proportionate to their new profit sharing ratio and for this they should bring in or withdraw cash, as necessary.

Show necessary Journal Entries to give effect the above transactions.

Solution:

1. The undistributed loss should be shared by Shukla, Grewal, Jain and Narang (the old partners) in old ratio 4 : 3 : 2 : 1.
2. Grewal retired and the amount due to him was paid privately by the other Partners, Shukla, Jain, Narang in their profit sharing ratio.
- 3.

(a) For $\frac{1}{5}$ th share Chakraborty's premium is ₹ 3,200.

Full value of Goodwill = $3,200 \times \frac{5}{1} = 16,000$

(b) Write off Goodwill as per B/S

| | | |
|-------------------------------------|-----|-------|
| Shukla's Capital A/c | Dr. | 5,143 |
| Jain's Capital A/c | Dr. | 2,571 |
| Narang's Capital A/c | Dr. | 1,286 |
| To Goodwill A/c | | 9,000 |
| (Goodwill written off in 4 : 2 : 1) | | |

Jain & Narang shall also pay to Shukla the only sacrificing partner, in their gaining ratio. Jain's share = $\frac{1}{70} \times 16,000 = 229$

Narang's = $\frac{4}{70} \times 16,000 = 914$

| | | |
|-------------------------|-----|-------|
| Jain's Capital A/c | Dr. | 229 |
| Narang's Capital A/c | Dr. | 914 |
| Cash A/c | Dr. | 3,200 |
| To Shukla's Capital A/c | | 4,343 |

(c) New Profit Sharing Ratio

Chakraborty's Share = $\frac{1}{5}$

Balance left = $1 - \frac{1}{5} = \frac{4}{5}$ to be shared in 3:3:2

Shukla's Share = $\frac{4}{5} \times \frac{3}{8} = \frac{3}{10}$;

Narang's Share = $\frac{4}{5} \times \frac{2}{8} = \frac{2}{10}$;

Jain's Share = $\frac{4}{5} \times \frac{3}{8} = \frac{3}{10}$

New Ratio = $\frac{3}{10} : \frac{3}{10} : \frac{2}{10} : \frac{2}{10} = 3 : 3 : 2 : 2$

(d) Sacrifice/Gains = Old Ratio – New Ratio

| | Shukla ₹ | Jain ₹ | Narang ₹ | Chakraborty ₹ |
|-------------------------------------|----------------------|-------------|-------------|------------------|
| Old Ratio [S : J : N = 4 : 2 : 1] | 4/7 | 2/7 | 1/7 | - |
| New Ratio [S : J : N : C] | 3/10 | 3/10 | 2/10 | 2/10 |
| Differences | 19/70 (Sacrifice) | 1/70 (Gain) | 4/70 (Gain) | 14/70 (Gain) |

4. Adjustment of Capital Balances

| Particulars | Shukla ₹ | Jain ₹ | Narang ₹ | Chakraborty ₹ |
|---|-----------------|------------------|------------------|------------------|
| Capital as per last Balance Sheet | 7,000 | 5,000 | 4,000 | 5,000 |
| Add: Grewal's Capital acquired against private Payment (6,500 – 900) in 4:2:1 | 3,200 | 1,600 | 800 | - |
| Adjustment for goodwill | | | | |
| - Write off Goodwill as per B/s | (5,143) | (2,571) | (1,286) | - |
| - Adjustment for goodwill | 4,343 | (229) (600) | (914) | - |
| - Share of loss | (1,200) | | (300) | - |
| Adjusted Capitals | 8,200 | 3,200 | 2,300 | 5,000 |
| Therefore, Capital in Profit Sharing Ratio (3:3:2:2) | 5,610 | 5,610 | 3,740 | 3,740 |
| | 2,590 Excess | 2,410 Deficit | 1,440 Deficit | 1,260 Excess |

Journal Entries

Dr.

Cr.

| Date | Particulars | L. F. | Amount ₹ | Amount ₹ |
|------|--|--------------------------|----------------------------|-----------------------|
| | Shukla's Capital A/c Capital A/c A/c c To Profit & Loss A/c [Unshared loss written off in old ratio 4 : 3 : 2 : 1] | Dr. Dr. Dr. Dr. | 1,200 900 600 300 | 3,000 |
| | Grewal's Capital A/c To Shukla's Capital A/c To Jain's Capital A/c To Narang's Capital A/c [Retiring partners credited to continuing partners in their remaining profit sharing ratio 4 : 2 : 1 on their private payments to the retiring partner] | Dr. | 5,600 | 3,200 1,600 800 |
| | Cash A/c To Chakraborti's Capital A/c [Cash brought in by the incoming partner as capital] | Dr. | 5,000 | 5,000 |
| | Shukla's Capital A/c Chakraborti's Capital A/c To Cash A/c [Out of premium paid by the incoming partner, true premium credited to Shukla for his sole sacrifice, the balance being credited to Chakraborti himself] | Dr. Dr. | 2,590 1,260 | 3,850 |
| | Cash A/c To Jain's Capital A/c To Narang's Capital A/c [Additional Cash invested to make capitals proportionate to new profit sharing ratio] | Dr. | 3,850 | 2,410 1,440 |



Shukla, Jain, Narang & Chakraborty
Balance Sheet as at 1.4.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|----------------|--------------|-------------|------------------------|-------------|-------------|
| Capital A/cs : | | | Stock | | 2,000 |
| Shukla | 5,610 | | Debtors | | 11,000 |
| Jain | 5,610 | | Cash [5,000 + 5,000 + | | 13,200 |
| Narang | 3,740 | | 3,200 + 3,850 – 3,850] | | |
| Chakraborty | <u>3,740</u> | 18,700 | | | |
| Creditors | | 7,500 | | | |
| | | 26,200 | | | 26,200 |

Illustration 23.

X, Y and Z are partners sharing profits and losses in the proportion to 3:2:2, respectively. The Balance Sheet of the firm as on 01.01.2013 was as follows:

| Liabilities | Amount (₹) | Assets | Amount (₹) |
|-------------------|---------------|---------------------|------------|
| Capital Accounts; | | Plant and Machinery | 72,000 |
| X | 1,00,000 | Furniture | 28,000 |
| Y | 80,000 | Stock | 1,12,000 |
| Z | <u>70,000</u> | Sundry Debtors | 96,000 |
| Bank overdraft | | Cash at Bank | 18,000 |
| Sundry Creditors | | | |
| | | 3,26,000 | 3,26,000 |

X retired on 01.01.2013 on which date R is admitted as new partner. For the purpose of adjusting the rights as between on partners' goodwill to be valued at ₹ 84,000 and Sundry Debtors and Stock to be reduced by ₹ 16,000 and to ₹ 1,00,000 respectively. X is to receive ₹ 44,000 in cash on the date of retirement and the balance due to him is to remain as loan at 8% p.a. Repayment of loan to be made at the end of each year by annual installments representing 25% of the future profit before charging interest on loan.

R is to bring in ₹ 1,00,000 in cash as his capital on the date of admission. The new partners are to share profits and losses equally after paying the interest on X's Loan.

The net profit for the year ended 31st December 2013, is ₹ 64,000 before taking into account the installment payable to X.

You are required to show:

- (a) Profit and Loss Appropriation Account for the year ended 31st December, 2012.
- (b) Capital Accounts of the new partners; and
- (c) X's Loan Account as on 31st Dec, 2013.

Solution:

In the books of X, Y, Z and R
Revaluation Account

| Dr. | | Cr. | |
|-----------------------------|---------------|--------------|------------|
| Particulars | Amount (₹) | Particulars | Amount (₹) |
| To, Provision for Bad Debts | 16,000 | By, Goodwill | 84,000 |
| " Stock | 12,000 | | |
| " Share of Profit: | | | |
| - X 3/7 | 24,000 | | |
| - Y 2/7 | 16,000 | | |
| - Z 2/7 | <u>16,000</u> | | |
| | 56,000 | | |
| | 84,000 | | 84,000 |

Capital Account

| Dr. | | | | Cr. | | | |
|----------------------|----------|----------|----------|-------------------|----------|----------|----------|
| Particulars | X (₹) | Y (₹) | Z (₹) | Particulars | X (₹) | Y (₹) | Z (₹) |
| To, Bank – Repayment | 44,000 | - | - | By, Balance c/d | 1,00,000 | 80,000 | 70,000 |
| „ X's Loan A/c | 80,000 | - | - | „ Revaluation A/c | | | |
| „ Balance c/d | - | 96,000 | 86,000 | - Profit | 24,000 | 16,000 | 16,000 |
| | 1,24,000 | 96,000 | 86,000 | | 1,24,000 | 96,000 | 86,000 |

Profit and Loss Appropriation Account
for the year ended 31.12.2013

| Dr. | | | Cr. | |
|---|---------------|-------------------------|---------------|--------|
| Particulars | Amount (₹) | Particulars | Amount (₹) | |
| To, Loan Redemption Fund A/c (25% of ₹ 64,000) | 16,000 | By, Profit and Loss A/c | | |
| „ Share of Profit: | | - Net Profit | | 64,000 |
| - Y (1/3) | 16,000 | | | |
| - Z (1/3) | 16,000 | | | |
| - R (1/3) | 16,000 | | | |
| | 48,000 | | | |
| | 64,000 | | | 64,000 |

Capital Account

| Dr. | | | | | Cr. | | | | |
|----------|-----------------|----------|----------|----------|----------|-------------------|----------|----------|----------|
| Date | Particulars | Y (₹) | Z (₹) | R (₹) | Date | Particulars | Y (₹) | Z (₹) | R (₹) |
| 31.12.12 | To, Balance c/d | 1,12,000 | 1,02,000 | 1,16,000 | 1.1.12 | By, Balance c/d | 96,000 | 86,000 | - |
| | | | | | 31.12.12 | „ Bank A/c | - | - | 1,00,000 |
| | | | | | | „ Share of profit | 16,000 | 16,000 | 16,000 |
| | | 1,12,000 | 1,02,000 | 1,16,000 | | By, Balance b/d | 1,12,000 | 1,02,000 | 1,16,000 |

X's Loan Account (8%)

| Dr. | | | Cr. | | |
|-----------------|----------------|---------------|----------------|--------------------------|---------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 2012 Dec. 31 | To Bank A/c | 16,000 | 2012 Jan. 1 | By X's Capital A/c | 80,000 |
| | To Balance c/d | 70,400 | | " Interest [80,000 × 8%] | 6,400 |
| | | 86,400 | | | 86,400 |
| | | | | By balance c/d | 70,400 |



Illustration 24.

Gita and Mita are equal partners. Gita, by agreement, retires and Lata joins the firm on the basis of one third share of profits on 01.04.2013. The balances of the books as on 31st March 2013 were:

| Particulars | Dr. ₹ | Cr. ₹ |
|----------------------------|----------|----------|
| Good will | 10,000 | |
| Fixed Assets at Cost | 1,20,000 | |
| Current Assets: | | |
| Stock | 60,000 | |
| Debtors | 40,000 | |
| Bank Balance | 8,000 | |
| Creditors | | 20,000 |
| Provision for Depreciation | | 12,000 |
| Capital Accounts: | | |
| Gita | | 1,04,000 |
| Mita | | 1,02,000 |
| | 2,38,000 | 2,38,000 |

Goodwill and Fixed Assets valued at ₹ 30,000 and ₹ 1,40,000 respectively and it was agreed to be written up accordingly before admission of Lata as partner. Sufficient money is to be introduced so as to enable Gita to be paid off and leave ₹ 5,000 cash at Bank; Mita and Lata are to provide such sum as to make their Capitals proportionate to their share of profit. Assuming the agreement was carried out, show the journal entries required and prepare the Balance Sheet after admission of Lata.

All working should form part of your answer.

Solution:

I. Capital of the new firm

| Particulars | Amount ₹ |
|-----------------|-------------|
| Good will | 30,000 |
| Fixed Asset | 1,40,000 |
| Stock | 60,000 |
| Debtors | 40,000 |
| Cash at Bank | 5,000 |
| | 2,75,000 |
| Less: Creditors | 20,000 |
| | 2,55,000 |

$$\text{Mita} = ₹ 2,55,00 \times \frac{2}{3} = ₹ 1,70,000$$

$$\text{Lata} = ₹ 2,55,000 \times \frac{1}{3} = ₹ 85,000$$

II. Amount to be brought in by Mita

| Particulars | Amount ₹ | Amount ₹ |
|--------------------------|---------------|-----------------|
| Capital to be maintained | | 1,70,000 |
| Less: Opening balance | 1,02,000 | |
| Profit on Revaluation | <u>26,000</u> | |
| | | <u>1,28,000</u> |
| To be brought in by Mita | | 42,000 |

6.3 DEATH OF PARTNER

If a partner dies, the partnership is usually dissolved. But if the surviving partners desire so, they may purchase the share of the deceased partner and carry on the business. In that case they have to decide (1) the total amount payable to the legal representative or executor of the deceased partner and (2) the mode of such payment.

Total Amount Payable includes:

- (i) The deceased partner's Capital and / Current Accounts last Balance.
- (ii) His share of undistributed profit/loss.
- (iii) His share of revaluation profit/loss
- (iv) His share of goodwill.
- (v) His share of Joint Life Policy, if any and
- (vi) His share of profit/loss made by the firm between the last year ending and the date of his death.

The accounting procedure involved is similar to that followed in case of retirement of a partner. The mode of payment depends on the agreement between the partners. It may be :

- (i) **Lump Sum Payment :** If the firm has sufficient funds, the total amount payable on account of the deceased partner is transferred to his Representative's Account (or Executor). Such Representative's Account is debited and Bank Account is credited on payment of the dues.
- (ii) **Instalment Payment/Loan Payment :** The firm may not have enough funds to make prompt payment. In such a case, the total amount payable is transferred to a loan account in the name of the legal representative or executor. The loan is paid off gradually by installments after considering interest on unpaid balance. The word "Loan" may or may not be appended with the Account. But its gradual payment will definitely resemble the payment of loan.

Illustration 25.

The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1 : 2 : 2 as on 31st December, 2012.

| | | | |
|-----------------------------|-----------------|--------------|-----------------|
| Sundry Creditors | 10,000 | Goodwill | 15,000 |
| Capital A/c : | | Debtors | 10,000 |
| A | 10,000 | Machinery | 20,000 |
| B | 20,000 | Buildings | 30,000 |
| C | <u>20,000</u> | Stock | 10,000 |
| General Reserve | 5,000 | Cash at Bank | 5,000 |
| Investment Fluctuation Fund | 3,000 | Investments | 10,000 |
| Bad Debts Reserve | 2,000 | | |
| Bank Loan | 30,000 | | |
| | <u>1,00,000</u> | | <u>1,00,000</u> |

C died on 31st March, 2013. His account is to be settled under the following terms :

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March '13 is to be calculated proportionately on the average profit of 3 years. The profits were : 2008 ₹ 3,000, 2009 ₹ 7,000, 2010 ₹ 10,000, 2011 ₹ 14,000, 2012 loss ₹ 12,000. During 2012 a Moped costing ₹ 4,000 was purchased and debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are : Stock ₹ 12,000, Building ₹ 35,000, Machinery ₹ 25,000 and Investments ₹ 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Solution:**Working Notes :****1. Adjusted profit for 2012**

| | |
|---|----------------|
| Loss | (12,000) |
| Add : Cost of Moped | |
| Wrongly treated as Travelling Expense | 4,000 |
| Less : Depreciation not charged on Moped @25% | |
| on ₹ 4,000 | <u>(1,000)</u> |
| Adjusted Loss | <u>(9,000)</u> |

2. Valuation of Goodwill

Total Profit/Loss for the last 5 years = 3,000 + 7,000 + 10,000 + 14,000 – 9,000 = ₹ 25,000

Average Profit = ₹ 25,000/5 = ₹ 5,000; Goodwill = 2 × ₹ 5,000 = ₹ 10,000

But Goodwill is appearing at Balance Sheet at ₹ 15,000. Over valuation of Goodwill ₹ 5,000 should be written off among A, B & C as 1 : 2 : 2.

The balance of Goodwill between A & B in the ratio 1 : 2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years [2010, 2011 & 2012] = (10,000 + 14,000 – 9,000)/3 = ₹ 5,000

Estimated Profit for 3 months [Jan to March, '13] = ₹ 5,000 × 3/12 = ₹ 1,250

C's share of profit = ₹ 1,250 × 2/5 = ₹ 500

Solution :**Books of A, B & C****Journal Entries**

| Date | Particulars | L. F. | Dr. | Cr. |
|------|---|-------|-------------|-------------|
| | | | Amount ₹ | Amount ₹ |
| | Stock A/c Dr. | | 2,000 | |
| | Buildings A/c Dr. | | 5,000 | |
| | Machinery A/c Dr. | | 5,000 | |
| | Moped A/c [4,000 – Depr. 1,000] Dr. | | 3,000 | |
| | To Revaluation A/c | | | 15,000 |
| | [Values of assets increased on revaluation] | | | |
| | General Reserve A/c Dr. | | 5,000 | |
| | Investment Fluctuation Fund A/c Dr. | | 3,000 | |
| | Bad Debts Reserve A/c Dr. | | 2,000 | |
| | To A's Capital A/c | | | 2,000 |
| | To B's Capital A/c | | | 4,000 |
| | To C's Capital A/c | | | 4,000 |
| | [Transfer of Reserves etc. to Partners Capitals in 1 : 2 : 2] | | | |
| | Revaluation A/c Dr. | | 2,000 | |
| | To Investment A/c | | | 2,000 |
| | [Value of investments reduced] | | | |



| | | | | |
|--|-------------------|--|-------------------------|-------------------------|
| Revaluation A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being profit on revaluation shared in 1 : 2 : 2) | Dr. | | 13,000 | 2,600 5,200 5,200 |
| A's Capital A/c B's Capital A/c C's Capital A/c To Goodwill A/c [Value of Goodwill reduced] | Dr. Dr. Dr. | | 1,000 2,000 2,000 | 5,000 |
| Profit & Loss Suspense A/c To C's Capital A/c [Estimated share of Profit till his date of death transferred to the deceased partner's Capital] | Dr. | | 500 | 500 |
| C's Capital A/c To C's Executors A/c [Total dues to the deceased partner transferred to his Executor's A/c] | Dr. | | 27,700 | 27,700 |

| Dr. | | | | | Cr. | | | | |
|------------------|--|--------|--------|--------|-----------|-----------------------|--------|--------|--------|
| Capital Accounts | | | | | | | | | |
| Date 2011 | Particulars | A ₹ | B ₹ | C ₹ | Date 2011 | Particulars | A ₹ | B ₹ | C ₹ |
| 31.3 | To Goodwill A/c | 1,000 | 2,000 | 2,000 | 31.3 | By Balance b/d | 10,000 | 20,000 | 20,000 |
| | To Goodwill A/c | 3,333 | 6,667 | - | | " Revaluation A/c | 2,600 | 5,200 | 5,200 |
| | To C's Executors A/c (Balance transferred) | | | 27,700 | | " Sundry Reserves A/c | 2,000 | 4,000 | 4,000 |
| | To Balance c/d | 10,267 | 20,533 | - | | " P & L Suspense A/c | - | - | 500 |
| | | 14,600 | 29,200 | 29,700 | | | 14,600 | 29,200 | 29,700 |

A and B
Balance Sheet as at 31.3.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------|---------------|----------|----------------------------------|----------|----------|
| Capital A/cs : | | | Buildings | | 35,000 |
| A | 10,267 | | Machinery | | 25,000 |
| B | <u>20,533</u> | 30,800 | Moped | | 3,000 |
| C's Executor's A/c | | 27,700 | (cost less depreciation) | | |
| Bank Loan | | 30,000 | Investments | | 8,000 |
| Sundry Creditors | | 10,000 | Stock | | 12,000 |
| | | | Debtors | | 10,000 |
| | | | Bank | | 5,000 |
| | | | Profit & Loss Suspense A/c (Dr.) | | 500 |
| | | 98,500 | | | 98,500 |

6.4 DISSOLUTION OF A PARTNERSHIP FIRM

Whenever a reconstitution takes place within a Partnership in the form of admission, retirement or death of a Partner, the existing partnership is dissolved. The Partnership firm, may however, continue, if the remaining partners desire so. But if the partnership firm is discontinued for any reason, that is called Dissolution of the firm. Dissolution of Firm – when does it take place [in accordance with the Indian Partnership Act of 1932]

1. By Mutual consent of all the partners or in accordance with a contract made by them [Section 40]
2. By Notice – given in writing, by any partner to all other partners if the Partnership is at will [Section 43].
3. On the happening of any one of the following events : [Section 42] : (i) expiry of the term, where the Partnership was constituted for a fixed term; (ii) completion of the adventure for which the firm was constituted; (iii) Death of a partner, (iv) Adjudication of a Partner as insolvent.
4. Compulsory Dissolution [Section 41]
 - (i) Where all the partners or all but one are adjudged insolvent.
 - (ii) If any event occurs making it unlawful for the business of the firm to be carried on.
5. Dissolution by Court: According to Section 44 of the Indian Partnership Act the court, at the suit of a partner, may dissolve a firm on any one of the grounds namely –
 - (i) insanity of a partner;
 - (ii) permanent incapability of a partner to do his duties;
 - (iii) if a partner is guilty of misconduct that might affect prejudicially the carrying on of the business;
 - (iv) If a partner willfully or persistently commits breach of agreement;
 - (v) If a partner transfers all his shares to a third party or has allowed his share to be charged under the Provisions of Rule 49 of order XXI of the First Schedule to the Code of Civil Procedure, 1908;
 - (vi) If the court considers that the business cannot be carried on except at loss;
 - (vii) On any other ground on which the court considers the dissolution as just and equitable.

Settlement of Accounts on Dissolution

According to Section 48 of the Indian Partnership Act the following rules should be observed for settlement of Accounts after dissolution, subject to agreement by partners :

- (a) **Regarding Losses** : “Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits”. [Section 48(1)]
- (b) **Regarding Assets** : “The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :
 - (i) in paying the debts of the firm to third parties;
 - (ii) In paying each partner ratably what is due to him from the firm for advances as distinguished from capital;
 - (iii) In paying to each partner ratably what is due to him as capital; and
 - (iv) The residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits.” [Section 48(2)]

Accounting Entries Regarding Dissolution

The two separate aspects of Dissolution for which accounting entries have to be made are:

[A] Realization of Assets and Payment of liabilities and [B] Settlement of the dues of the Partners,

[A] Realization of Assets and Payment of liabilities

- (i) Prepare Realisation Account
- (ii) Transfer all assets (except cash, bank & fictitious assets) and liabilities at book values to Realisation Account.



Journal Entries

| Item/Purpose | Entry | Special Points to be noted |
|--|--|--|
| 1. Transfer of book values of assets as recorded in the Balance Sheet | Realization A/c Dr. To Sundry Assets [Book value] (including goodwill if any, shown in the Balance Sheet) Realization A/c Dr. To Debtors A/c Provision for Bad Debts A/c Dr. To Realization A/c. | (a) Cash or Bank A/c are not to be credited unless the firm, as a whole, is sold out as a going concern. (b) Debit balance of any Cap. A/c etc. or Debit balance of P/L A/c not to be transferred to Realization A/c. (c) If there is any Provision for bad Debts, debit Realization A/c and credit Debtors A/c with gross figure. Then debit Provision A/c and credit Realization A/c. Same treatment for Provision for Depreciation. |
| 2. Realization/Sale of above assets | Cash/Bank A/c (amt. realized) Dr. OR Partners Cap. A/c Dr. (agreed value at which a partner takes over an asset/assets) To Realization A/c. | |
| 3. Shares etc. received as purchase consideration | in exchange of the firm's assets. Shares A/c Dr. To Realization A/c. (agreed value) | |
| 4. Closing the External liabilities | External Liabilities A/c Dr. (such as creditors, outstanding expenses, Bank Loan etc.) To Realization A/c. (book value) | (a) Alternatively – this entry may be passed (combining 4,5 & 6) Liability A/c Dr. To Bank A/c (actual amt. paid) OR, To Partners Cap. A/c (agreed value) To Realization A/c |
| 5. External liabilities paid off | Realization A/c. Dr. To Cash/Bank A/c (actual amt. paid) | (Discount, if any received on payment/discharge) |
| 6. External liabilities taken over by any partner | Realization A/c Dr. To Particular Partner's Cap. A/c (agreed value) | (b) Where assets and liabilities are taken over by another business on making some lump sum payment, separate entries for realization of assets and / payment of liabilities need not be made. |
| 7. Unrecorded asset sold or taken over by any partner | Cash / Bank A/c Dr. Partners Capital A/c Dr. To Realisation A/c | |
| 8. If any unrecorded liability is paid. | Realization A/c Dr. To Cash/Bank A/c (actual amt.) | |
| 9. If shares etc. received and shown in (3) above are sold out or transferred to partners. | Cash/Bank A/c Dr. OR, Partners Cap. A/c Dr. [excluding insolvent partner] To shares A/c | For sale, there may be profit or loss on sale which is transferred to Realization A/c. |

| | | |
|--|---|--|
| 10. Payment of Expenses of Realization. | Realization A/c Dr. To Cash/Bank A/c (if paid by the firm) OR To Partners Cap. A/c (if paid by any partner) | If a partner bears such expenses personally in pursuance of a separate agreement – NO ENTRY is required. |
| 11. Balance of Realization Account representing Profit or Loss on Realization. | Realization A/c Dr. To Partners Cap. A/c (Profit shared in Profit Sharing Ratio) OR, Partner's Cap. A/c Dr. To Realization A/c. (Loss shared in Profit Sharing Ratio) | |

[B] Settlement of Partners Dues – through Capital Accounts

| Item/Purpose | Entry | Special Points to be noted |
|--|---|---|
| 1. Prepare Capital Accounts with balance as per Balance Sheet before the dissolution. | By Balance b/d (Cr. balance) To Balance b/d (Dr. balance) | |
| 2. Transfer of Current A/c, if any. | Partner's Current A/c ... Dr. To Partner's Cap. A/c. (Credit Balance) OR Partner's Capital A/c ... Dr. To Partner's Current A/c (Debit balance) | |
| 3. Undistributed Profit, Reserve, Joint Life Policy Reserve, Investment Fluctuation Fund, Contingency Reserve etc. transfer. | Profit & Loss (Cr.) A/c... Dr. OR, Any Reserve A/c Dr. To Partner's Capital A/cs [Profit sharing ratio] | |
| 4. Undistributed Loss, Fictitious/Unrealizable Assets etc. transfer. | Partners Capital A/c... Dr. To Profit & Loss (Dr.) A/c OR, To Fictitious Assets A/c (Profit Sharing Ratio) | Example of unrealizable Asset- Advertisement Suspense A/c |
| 5. Any loan taken from any partner | Partner's Loan A/c Dr. To Cash/Bank A/c | U/s 48 Repayment of loan should enjoy priority over repayment of capital. |

| | | |
|---|---|---|
| 6. Any loan given to any partner | Cash/Bank A/c..... Dr. To Partner's Loan A/c OR Partner's Capital A/c Dr. To Partner's Loan A/c | If such amount is realized. Adjustment of loan against Capital |
| 7. If any Partner's Capital A/c shows a debit balance (after balancing) | Cash/Bank A/c..... Dr. To Particulars Partner's Capital A/c [Cash brought in to make up the shortfall] | If the deficient partner is insolvent, treatment will be different- Vide – Insolvency of Partner. |
| 8. Payment of credit balance (after final balancing) | Particulars Partner's Cap. A/c Dr. To Cash/Bank A/c | Same as above |

Illustration 26.

A, B and C sharing profits in 3 : 1 : 1 agree upon dissolution. They each decide to take over certain assets and liabilities and continue business separately.

Balance Sheet as on date of dissolution

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|-------------|---------------|---------------------------|---------------|
| Creditors | 6,000 | Cash at Bank | 3,200 |
| Loan | 1,500 | Sundry Assets | 17,000 |
| Capitals: | | Debtors | 24,200 |
| A | 27,500 | Less: Bad Debts Provision | <u>1,200</u> |
| B | 10,000 | Stock | 7800 |
| C | <u>7,000</u> | Furnitures | 1,000 |
| | 44,500 | | |
| | <u>52,000</u> | | <u>52,000</u> |

It is agreed as follows:

- (1) Goodwill is to be ignored.
- (2) A is to take over all the Fixtures at ₹ 800; Debtors amounting to ₹ 20,000 at ₹ 17, 200. The creditors of ₹ 6,000 to be assumed by A at the figure.
- (3) B is to take over all the stocks at ₹ 7,000 and certain of the sundry assets at ₹ 7,200 (being book value less 10%)
- (4) C is take over the remaining sundry assets at 90% of book values less ₹ 100 allowances and assume responsibility for the discharge of the loan, together with accruing interest of ₹ 30 which has not been recorded in the books of the firm.
- (5) The expenses of dissolution were ₹ 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare Realisation Account, partners' Capital Accounts and Bank Account.

Solution:

In the books of A, B and C
Realisation Account

| Dr. | | Cr. | |
|---------------------|---------------|----------------------------------|---------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Sundry Assets: | | By Provision for bad debts | 1,200 |
| Sundry Assets | 17,000 | Capital Account A : | |
| Debtors | 24,200 | Fixtures | 800 |
| Stock | 7,800 | Debtors | <u>17,200</u> |
| Fixtures | <u>1,000</u> | | 18,000 |
| | 50,000 | B: Stock | 7,000 |
| „ Bank – Expenses | 270 | Sundry Assets | <u>7,200</u> |
| „ Capital Account | | | 14,200 |
| C- Interest on loan | 30 | C: Sundry Assets | 8,000 |
| | | By Bank: Collection from Debtors | 2,100 |
| | | By Loss on realization: | |
| | | A (3/5) | 4,080 |
| | | B (1/5) | 1,360 |
| | | C (1/5) | <u>1,360</u> |
| | <u>50,300</u> | | 6,800 |
| | | | <u>50,300</u> |

Capital Account

| Dr. | | Cr. | | | | | |
|-------------------|---------------|---------------|--------------|-----------------------|---------------|---------------|--------------|
| Particulars | A ₹ | B ₹ | C ₹ | Particulars | A ₹ | B ₹ | C ₹ |
| To Dissolution | 18,000 | 14,200 | 8,000 | By Balance b/d | 27,500 | 10,000 | 7,000 |
| Assets taken | | | | „ Creditors | 6,000 | - | - |
| „ Dissolution A/c | 4,080 | 1,360 | 1,360 | „ Loan(with interest) | - | - | 1,530 |
| Loss | | | | „ Bank | | | |
| „ Bank — | | | | Final receipts | - | 5,560 | 830 |
| Final payment | 11,420 | - | - | | | | |
| | <u>33,500</u> | <u>15,560</u> | <u>9,360</u> | | <u>33,500</u> | <u>15,560</u> | <u>9,360</u> |

Bank Account

| Dr. | | Cr. | |
|-------------------------|---------------|------------------------|---------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Balance b/d | 3,200 | By Dissolution Account | |
| „ Dissolution A/c | | Expenses | 270 |
| Collection from Debtors | 2,100 | „ Capital Account: | |
| „ Capital Accounts: | | A | 11,420 |
| B | 5,560 | | |
| C | <u>830</u> | | |
| | 6,390 | | |
| | <u>11,690</u> | | <u>11,690</u> |



Working Notes:

₹

1. Realization of Sundry Assets:

| | |
|-------------------------------------|--------------|
| Sundry Assets (Book Value) | 17,000 |
| Less: Taken by B [7,200 x (100/90)] | <u>8,000</u> |
| Remaining at book value | <u>9,000</u> |

Taken by C: 90% of Book value

i.e. (9,000 x (90/100) = 8,100 – 100 for allowance = 8,000

2. Collection from Debtors:

| | |
|-----------------------------|---------------|
| Debtors (Book Value) | 24,200 |
| Less: Taken by (Book value) | <u>20,000</u> |
| | <u>4,200</u> |

Remaining at 50% i.e., ₹ 2100

Illustration 27.

X, Y and Z sharing profits & Losses in the ratio of 2 : 2: 1 agreed upon dissolution of their partnership on 31st December, 2012 on which date their Balance Sheet was as under :

| Liabilities | | Amount ₹ | Assets | | Amount ₹ |
|------------------------|------------|-----------------|--|--------------|-----------------|
| Capital : | | | Fixed Assets | | 50,000 |
| X | | 40,000 | Joint Life Policy (at surrender Value) | | 10,000 |
| Y | | 30,000 | | | |
| Reserve Fund | | 10,000 | | | |
| Joint Life Policy Fund | | 10,000 | Debtors | 10,000 | |
| Creditors | 19,000 | | Less : Provision for | | |
| Less: Prov | <u>500</u> | | Bad Debts | <u>500</u> | 9,500 |
| Salary Outstanding | | 18,500 | | | |
| | | 2,000 | Stock at Invoice Price | 10,000 | |
| | | | Less: Price loading | <u>2,000</u> | 8,000 |
| | | | Investments | 8,000 | |
| | | | Less: Fluctuation Fund | <u>500</u> | 7,500 |
| | | | | | 2,000 |
| | | | Capital Account –Z | | 23,500 |
| | | <u>1,10,500</u> | Bank | | <u>1,10,500</u> |

Investments were taken over by X at ₹ 6,000, creditors of ₹ 10,000 were taken over by Y who has agreed to settle account with them at ₹ 9,900. Remaining creditors were paid ₹ 7,500. Joint Life Policy was surrendered and Fixed Assets realized ₹ 70,000, Stock and Debtors realized ₹ 7,000 and ₹ 9,000 respectively. One customer, whose account

was written off as bad, now paid ₹ 800 which is not included in ₹ 9,000 mentioned above. There was an unrecorded asset estimated at ₹ 3,000, half of which was handed over to an unrecorded liability of ₹ 5,000 in settlement of claim of ₹ 2,500 and the remaining half was sold in the market which realized ₹ 1,300.

Y took over the responsibility of completing the dissolution and he is granted a salary of ₹ 400 per month. Actual expenses amounted to ₹ 1,100. Dissolution was completed and final payments were made on 30th April, 2013.

You are required to prepare the Realization Account, Capital Account and Bank Account.

Solution :

| Dr. | | Realization Account | | Cr. | |
|---|--------------|---------------------|---|-------------|-----------------|
| Particulars | Amount ₹ | Amount ₹ | Particulars | Amount ₹ | Amount ₹ |
| To Fixed Assets A/c | | 50,000 | By Provision on Debtors A/c | | 500 |
| To Joint Life Policy A/c | | 10,000 | By Provision on Stock A/c | | 2,000 |
| To Debtors A/c | | 10,000 | By Investment Fluctuation Fund A/c | | 500 |
| To Stock (at I. P.) | | 10,000 | By Joint Life Policy Fund A/c | | 10,000 |
| To Investments A/c | | 8,000 | By Creditors A/c | | 19,000 |
| To Pro. for Disc. on Creditors A/c | | 500 | By Outstanding Salary A/c | | 2,000 |
| To Y's Capital A/c [Creditors taken over- see Note] | | 10,000 | By X' Capital A/c (Investments taken over) | | 6,000 |
| To Bank A/c : | | | By Bank A/c : | | |
| Creditors paid off | 7,500 | | Joint Life Policy | 10,000 | |
| Unrecorded liability paid [$1/2 \times 5,000$] | 2,500 | | Fixed Assets | 70,000 | |
| Outstanding Salary | 2,000 | | Stock | 7,000 | |
| Outstanding Expense | <u>1,100</u> | 13,100 | Debtors | 9,800 | |
| To Y's Cap. A/c | | 1,600 | Unrecorded Assets (Sold) | 1,300 | |
| [Salary 400×4] | | | Bad Debt Recovered | <u>800</u> | 98,100 |
| To Partner's Capital A/c (Profit on Realization) | | | | | |
| X [$2/5$] | 9,960 | | | | |
| Y [$2/5$] | 9,960 | | | | |
| Z [$1/5$] | <u>4,980</u> | 24,900 | | | |
| | | <u>1,38,100</u> | | | <u>1,38,100</u> |



Dr. Bank Account Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--------------------|-------------|----------------------|-------------|
| To Balance b/f | 23,500 | By Realization A/c | |
| To Realization A/c | | Creditors | 7,500 |
| Joint Life Policy | 10,000 | Unrecorded Liability | 2,500 |
| Fixed Assets | 70,000 | Outstanding Salary | 2,000 |
| Stock | 7,000 | Expenses | 1,100 |
| Debtors | 9,800 | By X's Capital A/c | 47,960 |
| Unrecorded Assets | 1,300 | By Y's Capital A/c | 55,560 |
| | | By Z's Capital A/c | 4,980 |
| | 1,21,600 | | 1,21,600 |

Dr. Partners Capital Account Cr.

| Date 2013 | Particulars | X ₹ | Y ₹ | Z ₹ | Date 20123 | Particulars | X ₹ | Y ₹ | Z ₹ |
|--------------|---------------------------------|--------|--------|--------|---------------|--------------------------------|--------|--------|--------|
| 1 . 1 | To Balance b/d | - | - | 2,000 | 1 . 1 | By Balance b/d | 40,000 | 30,000 | - |
| 30.4 | To Realization A/c | 6,000 | - | - | 30.4 | By Reserve Fund [2:2:1] | 4,000 | 4,000 | 2,000 |
| | To Bank A/c (Balance withdrawn) | 47,960 | 55,560 | 4,980 | | By Realization A/c (Profit) | 9,960 | 9,960 | 4,980 |
| | | | | | | By Realization A/c (Creditors) | - | 10,000 | - |
| | | | | | | By Realization A/c (Salary) | - | 1,600 | - |
| | | 53,960 | 55,560 | 6,980 | | | 53,960 | 55,560 | 6,980 |

Note :

1. Unrecorded Asset and unrecorded liability were not recorded. Any part of such asset utilized to discharge any part of such liability and discount received there on have been ignored.
But unrecorded asset realized (debts previously written off now recovered) has been recorded. Similarly unrecorded asset sold has been recorded.
2. Y took over creditors of ₹10,000. This has been recorded. How he settles such liability is his personal matter. The discount on payment does not benefit the firm.

Special considerations for a retiring partner and the estate of a deceased partner in relation to debts contracted by the partnership firm:

- (a) debts due on the date of retirement/death: the retiring partner and the estate of the deceased partner is liable for the whole of the debts due by the firm at the date of retirement or death, to the extent of their share.
- (b) debts incurred after retirement: where the notice of retirement is not published in accordance with law, the retiring partner is liable for debts contracted after retirement.
- (c) deceased/ insolvent partner: the estate of a deceased or bankrupt partner will not be liable for debts contracted by the firm after the death or bankruptcy.

Applicability of Section 37 of the Partnership Act:

In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the dues are not settled, then such retired partner or the executor is entitled to the following :

Maximum of :

Interest @ 6% p.a. on the amount due to them (i.e. if the amount is unsettled, like, rate of interest on loan to be allowed to the retired partner or the executor is not mentioned)

Or

The share of profit earned for the amount due to the partner

Conditions :

- The surviving partners/continuing partners continue to carry on the business of the firm.
- The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.
- There is no contract to the contrary of the options contained in Section 37 i.e. share in the profits or interest @ 6% p.a. on the unsettled capital.

Example : Unsettled capital of C ₹ 52,000 (Date of retirement : 30.9.12, financial year 2012-13). Net Profit earned by the firm after C's retirement ₹ 25,000. Capitals of A: ₹ 57,000 and B: ₹ 76,000)

C is entitled to the maximum of the following :

- Interest on unsettled capital = ₹ 52,000 × 6% × 6 months = ₹ 1,560
- Profit earned out of unsettled capital = Profit × Retired or Deceased Partner's unsettled Dues/ Total Capital of the firm (including the amount due to the retired or deceased partner)

$$= ₹ (25,000 \times 52,000) / (₹ 52,000 + 57,000 + 76,000) = ₹ 7,027.$$

6.5 INSOLVENCY OF A PARTNER

If a partner becomes insolvent and fails to pay his debit balance of Capital A/c either wholly or in part, the unrecoverable portion is a loss to be borne by the solvent partners. The question now arises is that, in what ratio they will share this loss. Prior to the decision in the leading case of Garner vs. Murray this loss was borne by the solvent partners in the profit sharing ratio just like ordinary losses.

Decision in Garner vs. Murray Case

Justice Joyee held in the case of Garner vs. Murray that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss). Unless otherwise agreed, the decision in Garner vs. Murray requires –

- That the solvent partners should bring in cash equal to their respective shares of the loss on realization;
- That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

In case of fixed capital system, capitals as per last Balance Sheet represent last agreed capitals. In case of fluctuating capital system, however, all necessary adjustments in respect of reserved, unappropriated profits or losses (but not realization profit or loss), Drawings A/c., undisclosed liabilities and assets etc. must be made to get last agreed capitals. A partner who has nil or negative balance in his capital account before dissolution does not contribute anything to the loss arising as a result of insolvency of a partner.

Criticism of the decision of Garner vs. Murray

The following criticism may be advocated against the decisions laid down in Garner vs. Murray principle:

- (i) If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;
- (ii) This principle does not apply if there are only two partners;
- (iii) In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on reasilation which is immaterial and useless; and
- (iv) If any solvent partner who possess more private asset but contributes less capital, he will naturally, as per Garner vs. Murray decision, bear less amount of deficiency of the insolvent partner than the other solvent partner who possess less private assets but contributes more capital to the firm. This is not justified.

Applicability in India

According to sub section (ii) of Sec 48(b) of the Indian Partnership Act, if a partner becomes insolvent or otherwise incapable of paying his share of the contribution, the solvent partners must share ratably the available assets (including their own contribution to the capital deficiency). That is to say, the available assets will be distributed in proportion to their capitals.

Thus, under the Indian Partnership Act also the solvent partners are required to make good their share of the realization loss (i.e., capital deficiency). The total cash available after making good the solvent partners' share of capital deficiency shall be shared by the solvent partners in proportion to their capitals. As a result of this the ultimate debit balance of the insolvent partner's Capital A/c. is borne by the solvent partners in capital ratio.

The provision of the Indian Partnership Act in this respect are, thus, similar to the rules laid down by the decision in Garner vs. Murray.

When there is a specific provision in the Partnership Deed as to how the deficiency of an insolvent partner is to be borne by the solvent partners, such provision must be followed, because the provision of the Act will apply only when there is no specific agreement.

Illustration 28.

A, B and C are in partnership sharing profit and losses equally and agreed to dissolve the firm on 30.06.2012. On that date their Balance Sheet stood as follows:

Balance Sheet
as at 30th June, 2013

| Liabilities | Amount ₹ | Asset | Amount ₹ |
|-----------------|-------------|-------------------|-------------|
| Capital A/c | | Sundry Asset | 50,000 |
| A 34,000 | | Profit & Loss A/c | 12,000 |
| B <u>24,000</u> | 58,000 | Capital A/c | |
| Creditors | 12,000 | C | 8,000 |
| | 70,000 | | 70,000 |

The assets are realised at 50% of the book value. Realization expenses amounted to ₹ 5,000. C became insolvent and received ₹ 2,000 from his estates.

Close the book of the firm under (i) Fixed Capital Method and (ii) Fluctuating Capital Method applying Garner Vs. Murray principles.

Solution:**In the books of A, B & C**

| Dr. Realization Account | | Cr. | |
|-------------------------|-------------|---------------------|-------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Sundry Asset A/c | 50,000 | By Bank A/c | |
| `` Bank A/c | | Amount Realised | 25,000 |
| Expense | 5,000 | `` Capital A/c | |
| | | Loss on Realization | |
| | | A 10,000 | |
| | | B 10,000 | |
| | | C <u>10,000</u> | 30,000 |
| | 55,000 | | 55,000 |

Working:

(a) Under Fixed Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partner A and B as per their last agreed capital given in the Balance Sheet i.e., 17:12.

(b) Under Fluctuating Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partners A & B as the following adjusted capital which will be considered as the last agreed capital i.e., after adjusting the debit balance of Profit and Loss Account.

| Particulars | A ₹ | B ₹ |
|---|-----------|-----------|
| Capital as per Balance Sheet | 34,000 | 24,000 |
| Less: Debit balance of P&L A/c (equally) | (-) 4,000 | (-) 4,000 |
| | 30,000 | 20,000 |

∴ Ratio = 3:2

(a) Capital Account under Fixed Capital Method

| Dr. Capital Account | | | | Cr. | | | |
|----------------------|--------|--------|--------|----------------|--------|--------|--------|
| Particulars | A ₹ | B ₹ | C ₹ | Particulars | A ₹ | B ₹ | C ₹ |
| To Balance b/d | --- | --- | 8,000 | By Balance b/d | 34,000 | 24,000 | --- |
| `` Realisation A/c | | | | `` Bank A/c | --- | --- | 2,000 |
| Loss | 10,000 | 10,000 | 10,000 | `` Bank A/c | 10,000 | 10,000 | --- |
| `` Profit & Loss A/c | | | | `` A's Capital | --- | --- | 11,724 |
| Loss | 4,000 | 4,000 | 4,000 | `` B's Capital | --- | --- | 8,276 |
| `` C's Capital A/c | 11,724 | 8,276 | --- | | | | |
| `` Bank A/c | 18,276 | 11,724 | --- | | | | |
| (bal. fig.) | | | | | | | |
| | 44,000 | 34,000 | 22,000 | | 44,000 | 34,000 | 22,000 |



| Dr. | | Bank Account | | Cr. | |
|----------------|--------|--------------------|---|--------|--|
| Particulars | ₹ | Particulars | ₹ | | |
| To Balance b/d | 25,000 | By Realisation A/c | | | |
| `` Capital A/c | | Expenses | | 5,000 | |
| A 10,000 | | `` Creditors | | 12,000 | |
| B 10,000 | | `` Capital A/c | | | |
| C 2,000 | | A | | 18,276 | |
| | 22,000 | B | | 11,724 | |
| | 47,000 | | | 47,000 | |

(b) Under Fluctuating Capital Method

| Dr. | | Capital Account | | | | | | Cr. | |
|----------------------|--------|-----------------|--------|----------------|--------|--------|--------|-----|--|
| Particulars | A ₹ | B ₹ | C ₹ | Particulars | A ₹ | B ₹ | C ₹ | | |
| To Balance b/d | --- | --- | 8,000 | By Balance b/d | 34,000 | 24,000 | --- | | |
| `` Realisation A/c | | | | `` Bank A/c | 10,000 | 10,000 | --- | | |
| Loss | 10,000 | 10,000 | 10,000 | `` Bank A/c | --- | --- | 2,000 | | |
| `` Profit & Loss A/c | | | | `` A's Capital | --- | --- | 12,000 | | |
| Loss | 4,000 | 4,000 | 4,000 | `` B's Capital | --- | --- | 8,000 | | |
| `` C's Capital A/c | 12,000 | 8,000 | --- | | | | | | |
| `` Bank A/c | 18,000 | 12,000 | --- | | | | | | |
| (bal. fig.) | | | | | | | | | |
| | 44,000 | 34,000 | 22,000 | | 44,000 | 34,000 | 22,000 | | |

| Dr. | | Bank Account | | Cr. | |
|--------------------|--------|--------------------|---|--------|--|
| Particulars | ₹ | Particulars | ₹ | | |
| To Realisation A/c | 25,000 | By Realisation A/c | | | |
| Assets realized | | Expenses | | 5,000 | |
| `` Capital A/c | | `` Creditors | | 12,000 | |
| A | 10,000 | `` Capital A/c | | | |
| B | 10,000 | A | | 18,000 | |
| C | 2,000 | B | | 12,000 | |
| | 47,000 | | | 47,000 | |

IF ALL THE PARTNERS ARE INSOLVENT

Since all partners are insolvent, creditors cannot expect to be paid in full. In such a case Sundry Creditors should not be transferred to Realization Account. Cash in hand together with the amount realized on sale of assets and surplus from private estate of partners, if any, less expenses will be applied in making payment to the creditors. The balance of Creditors Account represents the deficiency to be borne by them which to be transferred to a Deficiency Account. The balance of Capital Accounts should also to be transferred to the Deficiency Account to close the books. Alternatively, the deficiency to be borne by the Creditors may be directly adjusted in between Creditors Account and Capital Accounts.

The following entries required to be passed :

- (i) To pay-off the creditors

| | | |
|-------------------|-----|-------------------|
| Creditors A/c | Dr. | (Total Creditors) |
| To Bank A/c | | (Amount paid) |
| To Deficiency A/c | | (Amount unpaid) |

(ii) When deficiency is transferred

Deficiency A/c Dr.
 To Partners' Capital A/c

Illustration 29.**Balance Sheet as at 30.10.13**

| Liabilities | Amount ₹ | Asset | Amount ₹ |
|------------------|-----------------|--------------|-----------------|
| Capitals | | Fixed Assets | 1,00,000 |
| P | 5,000 | | |
| Q | 3,000 | | |
| R | 2,000 | Cash | 10,000 |
| Bank Loan | 60,000 | | |
| Sundry Creditors | 40,000 | | |
| | 1,10,000 | | 1,10,000 |

All the partners were declared insolvent. Profit sharing ratio : 5 : 3 : 2. Assets realized ₹60,000. Prepare necessary ledger accounts to close the books of the firm.

Solution :

Dr. **Realisation Account** **Cr.**

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|-----------------|-----------------|---|-----------------|
| To Fixed Assets | 1,00,000 | By Cash A/c (realisation) | 60,000 |
| | | By Partners Capital A/cs (loss on realisation) | |
| | | P: 20,000 | |
| | | Q: 12,000 | |
| | | R: <u>8,000</u> | 40,000 |
| | 1,00,000 | | 1,00,000 |

Dr. **Partners Capital Accounts** **Cr.**

| Particulars | P | Q | R | Particulars | P | Q | R |
|--------------------|---------------|---------------|--------------|-------------------|---------------|---------------|--------------|
| To Realization A/c | 20,000 | 12,000 | 8,000 | By Balance b/d | 5,000 | 3,000 | 2,000 |
| | | | | By Deficiency A/c | 15,000 | 9,000 | 6,000 |
| | 20,000 | 12,000 | 8,000 | | 20,000 | 12,000 | 8,000 |

Dr. **Deficiency Account** **Cr.**

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|----------------------------|---------------|------------------|---------------|
| To Partners Capital A/cs : | | | |
| P | 15,000 | By Bank Loan A/c | 18,000 |
| Q | 9,000 | By Creditors | 12,000 |
| R | 6,000 | | |
| | 30,000 | | 30,000 |



Dr. Bank Loan Account Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|-------------------|---------------|----------------|---------------|
| To Deficiency A/c | 18,000 | By Balance b/d | 60,000 |
| To Cash A/c | 42,000 | | |
| | 60,000 | | 60,000 |

Dr. Creditors Account Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|-------------------|---------------|----------------|---------------|
| To Deficiency A/c | 12,000 | By Balance b/d | 40,000 |
| To Cash A/c | 28,000 | | |
| | 40,000 | | 40,000 |

Dr. Cash Account Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--------------------|---------------|------------------|---------------|
| To Balance b/d | 10,000 | By Bank Loan A/c | 42,000 |
| To Realisation A/c | 60,000 | By Creditors A/c | 28,000 |
| | 70,000 | | 70,000 |

Note :

The total deficiency of the partners i.e. the firm is ₹30,000. This is shared between the external liabilities in the ratio of their amount outstanding ₹60,000 : ₹40,000 = 3 : 2

| | | | |
|-------------------|-----|--------|--------|
| Bank Loan A/c | Dr. | 18,000 | |
| Creditors A/c | Dr. | 12,000 | |
| To Deficiency A/c | | | 30,000 |

Return of Premium to a partner on dissolution before expiry of term :

Conditions :

- (i) A partner was admitted in the partnership firm for a fixed term period,
- (ii) Such partner had paid a premium for goodwill at the time of admission.
- (iii) The partnership firm has dissolved.

Exceptions : The partner will not be entitled to any claim under any of the following conditions :

- (i) the firm is dissolved due to death of a partner
- (ii) the dissolution is due to the misconduct of the partner claiming refund
- (iii) dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Amount of Refund: the amount to be repaid will be determined having regard to the terms upon which the admission was made and to the length of the period agreed upon and the period that has expired.

Liability of other partners: the amount of refund payable shall be borne by the other partners in their profit sharing ratio.

Illustration 30.

X was admitted into partnership for 5 years, for which he paid a premium of ₹1,20,000. After 39 months, the partnership firm was dissolved due to misconduct of Mr.Z, another partner of the firm. Y, being the third partner. Profit Sharing Ratio : Y : Z : X = 5 : 3 : 2.

Solution:

X is entitled to claim the refund of premium paid at the time of admission, since the admission was for a fixed term period and the firm is getting dissolved due to a misconduct of Mr.Z, another partner of the firm.

The amount of refund is

= (Total Premium Paid × Unexpired term of the partnership)/Total term of the partnership

= 1,20,000 × 21/60 = ₹42,000

This shall be shared by the other partners Y and Z in their profit sharing ratio 3 : 2.

| | | | |
|--|-----|--------|--------|
| Y's Capital A/c | Dr. | 25,200 | |
| Z's Capital A/c | Dr. | 16,800 | |
| | | | 42,000 |
| To X's Capital A/c | | | |
| (Being premium paid during admission now refunded to X after adjusting capitals of other partners) | | | |

PIECEMEAL DISTRIBUTION

Till now the discussion was based on the implicit assumption that all assets were realized and settlement was done on the same date. In fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

The order of the payment will be as follows :

- (i) Realisation expenses
- (ii) For provision for expenses that are to be made
- (iii) Preferential creditors (say, Income Tax or any payment made to the Government)
- (iv) Secured creditors – upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors
- (v) Unsecured creditors – in proportion to the amount of debts, if more than one creditor
- (vi) Partners' loan – if there is more than one partner – in that case, in proportion to the amount of loan
- (vii) Partners' capital – the order of payment may be made by any one of the following two methods:
 - (a) Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method
 - (b) Maximum Possible Loss Method

Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital (determined on the basis of minimum capital per unit of profit) to determine surplus capital of the partners. Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio. This ensures that final balances of partners show their share of realisation profit/loss and thus, no settlement need to be done at that point of time.

Illustration 31.

Partners M, N and P have called upon you to assist them in winding up the affairs of their partnership on 30th June, 2013. Their Balance Sheet as on that date is given below :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|------------------|-------------|---------------------|-------------|
| Sundry Creditors | 17,000 | Cash at Bank | 6,500 |
| Capital | | Sundry Debtors | 22,000 |
| Accounts : M | 67,000 | Stock in trade | 13,500 |
| N | 45,000 | Plant and Equipment | 99,000 |
| P | 31,500 | Loan : M | 12,000 |
| | | Loan : N | 7,500 |
| | 1,60,500 | | 1,60,500 |

- (a) The partners share profits and losses in the ratio of 5 : 3 : 2.
 (b) Cash is distributed to the partners at the end of each month.
 (c) A summary of liquidation transaction are as follows :

July :

- ₹ 16,000 — collected from Debtors; balance is irrecoverable.
 ₹ 10,000 — received from sale of entire stock.
 ₹ 1,000 — liquidation expenses paid.
 ₹ 8,000 — cash retained in the business at the end of the month.

August :

- ₹ 1,500 — liquidation expenses paid; as part of the payment of his capital, P accepted an equipment for ₹ 10,000 (book value ₹ 4,000).
 ₹ 2,500 — cash retained in the business at the end of the month.

September :

- ₹ 75,000 — received on sale of remaining plant and equipment.
 ₹ 1,000 — liquidation expenses paid. No cash is retained in the business.

Required : Prepare a Schedule of cash payments as on 30th September, showing how the cash was distributed.

Solution :

Statement showing the Distribution of Cash (According to Proportionate Capital Method)

| Particulars | Creditors ₹ | Capital | | |
|---|----------------|---------|--------|--------|
| | | M ₹ | N ₹ | P ₹ |
| A. Balance Due | 17,000 | 55,000 | 37,500 | 31,500 |
| B. Amount distributed as on 31st July | 17,000 | — | — | 6,500 |
| C. Balance Due (A – B) | — | 55,000 | 37,500 | 25,000 |
| D. Cash paid to 'N' and Equipment given to P on 31st August. | | — | 4,000 | 10,000 |
| E. Balance due (C – D) | | 55,000 | 33,500 | 15,000 |
| F. Amount paid to partners on 30th September | | 41,500 | 25,400 | 9,600 |
| G. Loss on Realisation (Unpaid Balance) [E – F] | | 13,500 | 8,100 | 5,400 |

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capital

| Particulars | M | N | P |
|---|--------|--------|--------|
| A Balance of Capital Accounts | 67,000 | 45,000 | 31,500 |
| B Less : Loan | 12,000 | 7,500 | — |
| C Actual Capital (A – B) | 55,000 | 37,500 | 31,500 |
| D Profit sharing ratio | 5 | 3 | 2 |
| E Actual Capital ÷ Profit sharing ratio | 11,000 | 12,500 | 15,750 |
| F Proportionate Capitals taking M's Capital as Base Capital | 55,000 | 33,000 | 22,000 |
| G Excess of Actual Capitals over Proportionate Capitals (C - F) | | 4,500 | 9,500 |
| H Profit Sharing Ratio | — | 3 | 2 |
| I Surplus Capital ÷ Profit Sharing Ratio | — | 1,500 | 4,750 |
| J Revised Proportionate Capital taking N's Capital as Base Capital | — | 4,500 | 3,000 |
| K Excess of Surplus Capital over Revised Proportionate Capitals (G - J) | — | — | 6,500 |

Scheme of distribution of available cash : First instalment up to ₹ 6,500 will be paid to P. Next instalment up to ₹ 7,500 will be distribution between N and P in the ratio of 3 : 2. Balance realisation will be distributed among M, N and P in the ratio of 5 : 3 : 2.

(ii) Statement showing the Calculation of Cash Available for Distribution

| Particulars | July ₹ | August ₹ | September ₹ |
|--|-----------|-------------|----------------|
| A Opening Balance | 6,500 | 8,000 | 2,500 |
| B Add : Net amount realised (Gross amount — Expenses) | 25,000 | (1,500) | 74,000 |
| C Less : Closing Balance | 8,000 | 2,500 | — |
| D Amount available for distribution (A + B – C) | 23,500 | 4,000 | 76,500 |

(iii) Statement showing the Manner of Distribution of amount available in August and September

| Particulars | July ₹ | August ₹ | September ₹ |
|--|-----------|-------------|----------------|
| First ₹ 7,500 | — | 4,500 | 3,000 |
| Balance ₹ 83,000 (Cash and Equipment) | 41,500 | 24,900 | 16,600 |
| Less : Actual Distribution in August | — | 4,000 | 10,000 |
| Manner of Distribution in September | 41,500 | 25,400 | 9,600 |

Illustration 32.

The firm of Blue Collars presented you with the following Balance Sheet drawn as on 31st March 2013 :

| Liabilities | | Amount ₹ | Assets | | Amount ₹ |
|--------------------|---------------|-----------------|---------------------|--------------|-----------------|
| Sundry Creditors | | 37,000 | Cash in hand | | 3,000 |
| Capital Accounts : | | | Sundry Debtors | | 34,000 |
| L | 40,000 | | Stock in trade | | 39,000 |
| K | 30,000 | | Plant and Machinery | | 51,000 |
| J | <u>27,000</u> | 97,000 | Current Accounts : | | |
| | | | K | 4,000 | |
| | | | J | <u>3,000</u> | 7,000 |
| | | 1,34,000 | | | 1,34,000 |

Partners shared profits and losses in the ratio of 4 : 3 : 3. Due to difference among the partners, it was decided to wind up the firm, realise the assets and distribute cash among the partners at the end of each month.

The following realisations were made :

- May — ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500.
- June — Balance of debtors realised ₹ 10,000. Balance of stock fetched ₹ 24,000.
- August — Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.
- September — Part of machinery valued in the books at ₹ 5,000 was taken by K, in part discharge at an agreed value of ₹ 10,000. Balance of machinery was sold for ₹ 30,000 (net).

Partners decided to keep a minimum cash balance of ₹ 2,000 in the first 3 months and ₹ 1,000 thereafter.

Required : Show how the amounts due to partners will be settled.

Solution :

**(i) Statement showing the Distribution of Cash
(According to Proportionate Capital Method)**

| Particulars | Creditors ₹ | Capital | | |
|---|----------------|---------|---------|--------|
| | | L ₹ | K ₹ | J ₹ |
| A Amount due | 37,000 | 40,000 | 26,000 | 24,000 |
| B Amount distribution as on 31st May | 35,500 | — | — | — |
| C Balance Due (A - B) | 1,500 | 40,000 | 26,000 | 24,000 |
| D Amount Distributed as on 30th June | | | | |
| First ₹ 1,500 | 1,500 | | | |
| Next ₹ 5,333 | — | 5,333 | — | — |
| Next ₹ 4,667 | — | 2,667 | 2,000 | — |
| Balance ₹ 22,500 | — | 9,000 | 6,750 | 6,750 |
| E Balance due (C - D) | | 23,000 | 17,250 | 17,250 |
| F Amount Distributed as on 31st August | | 7,360 | 5,520 | 5,520 |
| G Balance Due (E - F) | | 15,640 | 11,730 | 11,730 |
| H Add : Profit on realisation (₹ 41,000 - ₹ 39,100) | | 760 | 570 | 570 |
| I Amount Distributed (including Machinery taken by K) as on 30th September. | | 16,400 | 12,300* | 12,300 |
| * Includes value of Machinery ₹ 10,000 and Cash ₹ 2,300 | | | | |

Working Notes :

- (i) Assumption : As the firm is dissolved due to difference among the partners, all partners are presumed to be solvent and the problem has been worked out on the basis of the highest relative capital.

(ii) Statement showing the Calculation of Highest Relative Capitals

| Particulars | L ₹ | K ₹ | J ₹ |
|--|--------|--------|--------|
| A Actual Capitals | 40,000 | 26,000 | 24,000 |
| B Profit sharing ratio | 4 | 3 | 3 |
| C Actual Capitals ÷ Profit ratio | 10,000 | 8,667 | 8,000 |
| D Proportionate Capitals taking J's Capital as Base Capital | 32,000 | 24,000 | 24,000 |
| E Surplus Capital of L and K (A - D) | 8,000 | 2,000 | — |
| F Profit sharing ratio | 4 | 3 | — |
| G Surplus Capital ÷ Profit sharing ratio | 2,000 | 667 | — |
| H Revised Proportionate Capital of L and J | 2,667 | 2,000 | — |
| I Revised Surplus Capital of L (E - H) | 5,333 | — | — |

While distributing surplus among partners, 1st instalment up to ₹ 5,333 will be paid to L, next instalment up to ₹ 4,667 will be distributed between L and K in the ratio of 4 : 3 and the Balance among L, K and J in the ratio of 4 : 3 : 3.

(iii) Statement showing the Calculation of Cash available each month

| Particulars | May ₹ | June ₹ | August ₹ | September ₹ |
|--|----------|-----------|-------------|----------------|
| A Opening Balance | 3,000 | 2,000 | 2,000 | 1,000 |
| B Add : Amount realised Less Expenses | 34,500 | 34,000 | 17,400 | 30,000 |
| C Less : Closing blance | 2,000 | 2,000 | 1,000 | — |
| D Total Cash available for Distribution (A+B-C) | 35,500 | 34,000 | 18,400 | 31,000 |

Dr.

(iv) Realisation Account

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--------------------------------------|-------------|--------------------------|-------------|
| To Sundry Debtors | 34,000 | By Sundry Creditors | 37,000 |
| To Stock in trade | 39,000 | By Cash/Bank | 1,17,000 |
| To Plant and Machinery | 51,000 | By L (Assets taken over) | 10,000 |
| To Cash/Bank : | | | |
| Creditors | 37,000 | | |
| Expenses | 1,100 | | |
| To Profit transferred to Capital A/c | 1,900 | | |
| | 1,64,000 | | 1,64,000 |



Illustration 33.

A partnership firm was dissolved on 30th June, 2013. Its Balance Sheet on the date of dissolution was as follows :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|------------------|-----------------|---------------|-----------------|
| Capitals : | | Cash | 5,400 |
| Atrik | 38,000 | Sundry Assets | 94,600 |
| Mohit | 24,000 | | |
| Rupa | 18,000 | | |
| Loan A/c — Mohit | 5,000 | | |
| Sundry Creditors | 15,000 | | |
| | 1,00,000 | | 1,00,000 |

The assets were realised in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 14,500 in full settlement of their account. Expenses of realisation were estimated to be ₹ 2,700 but actual amount spent on this account was ₹ 2,000. This amount was paid on 15th September. Draw up a Memorandum of distribution of Cash, which was realised as follows :

| | |
|-------------------|----------|
| On 5th July | ₹ 12,600 |
| On 30th August | ₹ 30,000 |
| On 15th September | ₹ 40,000 |

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Solution :

Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)

| | Particulars | Creditors ₹ | Mohit's Loan ₹ | Atrik ₹ | Mohit ₹ | Rupa ₹ |
|---|------------------------------------|----------------|----------------------|------------|------------|-----------|
| A | Balance Due | 15,000 | 5,000 | 38,000 | 24,000 | 18,000 |
| B | Cash paid (₹ 5,400 – ₹ 2,700) | 2,700 | — | — | — | — |
| C | Balance unpaid (A - B) | 12,300 | 5,000 | 38,000 | 24,000 | 18,000 |
| D | 1st installment of ₹ 12,600 | 11,800 | 800 | — | — | — |
| E | Balance unpaid (C - D) | 500 | 4,200 | 38,000 | 24,000 | 18,000 |
| F | Less : Written-off | 500 | | | | |
| G | 2nd installment of ₹ 30,000 | | 4,200 | 16,320 | 2,320 | 7,160 |
| H | Balance unpaid (E-F-G) | | | 21,680 | 21,680 | 10,840 |
| I | 3rd installment (₹ 40,000 + ₹ 700) | | | 16,280 | 16,280 | 8,140 |
| J | Unpaid Balance | | | | | |
| | (H-I) = Loss on Realisation | | | 5,400 | 5,400 | 2,700 |

Working Notes :**(i) Statement showing the Calculation of Highest Relative Capitals**

| | Particulars | Atrik ₹ | Mohit ₹ | Rupa ₹ |
|---|---|------------|------------|-----------|
| A | Actual Capitals | 38,000 | 24,000 | 18,000 |
| B | Profit-sharing ratio | 2 | 2 | 1 |
| C | Actual Capitals ÷ Profit Sharing Ratio | 19,000 | 12,000 | 18,000 |
| D | Proportionate Capitals taking Mohit's Capital as Base Capital | 24,000 | 24,000 | 12,000 |
| E | Surplus Capital [A-D] | 14,000 | Nil | 6,000 |
| F | Surplus Capital ÷ Profit Sharing Ratio | 7,000 | — | 6,000 |
| G | Revised Proportionate capitals taking Rupa's Capital as the basis | 12,000 | — | 6,000 |
| H | Revised Surplus Capital (E - G) | 2,000 | — | — |

(ii) Distribution of Second Instalment of ₹ 30,000

| Particulars | Mohit's Loan | Atrik | Mohit | Rupa |
|------------------------------------|-----------------|--------|-------|-------|
| First ₹ 4,200 | 4,200 | — | — | — |
| Next ₹ 2,000 (Absolute Surplus) | | 2,000 | — | — |
| Next ₹ 18,000 (Balance of Surplus) | | 12,000 | — | 6,000 |
| Balance ₹ 5,800 (2 : 2 : 1) | | 2,320 | 2,320 | 1,160 |
| Total 30,000 | 4,200 | 16,320 | 2,320 | 7,160 |

Illustration 34.

East, South and North are in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively. They decide to dissolve the business on 31st July, 2013 on which date their Balance Sheet was as follows :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|----------------------|---------------|--------------------|---------------|
| Capital Accounts : | | Land and Buildings | 30,810 |
| East | 38,700 | Motor car | 5,160 |
| South | 10,680 | Investment | 1,080 |
| North | 11,100 | Stock | 19,530 |
| Loan account : North | 3,000 | Debtors | 11,280 |
| Creditors | 10,320 | Cash | 5,940 |
| | 73,800 | | 73,800 |



The assets were realised piecemeal as follows and it was agreed that cash should be distributed as and when realised :

| | | |
|------|-----------|--------|
| | | ₹ |
| 14th | August | 10,380 |
| 20th | September | 27,900 |
| 16th | October | 3,600 |

North took over investment as follows at a value of:-

| | | |
|------|----------|--------|
| 15th | November | 1,260 |
| 18th | November | 19,200 |

Dissolution expenses were originally provided for an estimated amount of ₹ 2,700, but actual amount spent on 25th October was ₹ 1,920. The creditors were settled for ₹ 10,080.

Required : Prepare a statement showing distribution of cash amongst the partners, according to Proportionate Capital Method.

Solution :

**Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)**

| Particular | Creditors ₹ | Loan ₹ | East ₹ | South ₹ | North ₹ |
|--|----------------|-----------|-----------|------------|------------|
| A Balance Due | 10,320 | 3,000 | 38,700 | 10,680 | 11,100 |
| B Paid to Creditors [₹ 5,940 – ₹ 2,700] | 3,240 | — | — | — | — |
| C Balance Due (A - B) | 7,080 | 3,000 | 38,700 | 10,680 | 11,100 |
| D Amount paid on 14th August | 6,840 | 3,000 | 540 | | |
| | 240 | — | 38,160 | 10,680 | 11,100 |
| E Less : Written off | (240) | — | — | — | — |
| F Balances Due (D - E) | | | 38,160 | 10,680 | 11,100 |
| G Amount paid on 20th September | | | | | |
| (i) First 4,860 (i.e. ₹ 5,400 – ₹ 540) | | | 4,860 | — | — |
| (ii) Balance ₹ 23,040 | | | 33,300 | 10,680 | 11,100 |
| H Balance Due (F - G) | | | 17,280 | — | 5,760 |
| I Amount paid on 16th October | | | 16,020 | 10,680 | 5,340 |
| J Balance Due (H-I) | | | 1,800 | 1,200 | 600 |
| K Amount paid on 25th October (being excess over estimated expenses ₹ 780) | | | 14,220 | 9,480 | 4,740 |
| | | | 390 | 260 | 130 |
| L Balance due (J - K) | | | 13,830 | 9,220 | 4,610 |
| M Cash brought in by North | | | 630 | 420 | 210 |
| N Balance Due (L-M) | | | 13,200 | 8,800 | 4,400 |
| O Amount paid on 18th November | | | 9,600 | 6,400 | 3,200 |
| P Balance unpaid (N-O) | | | 3,600 | 2,400 | 1,200 |

Working Note :**Statement Showing the Calculation of Highest Relative Capitals**

| | Particulars | East ₹ | South ₹ | North ₹ |
|---|---|-----------|------------|------------|
| A | Actual Capitals | 38,700 | 10,680 | 11,100 |
| B | Profit Sharing Ratio | 3 | 2 | 1 |
| C | Actual Capital ÷ Profit Sharing Ratio | 12,900 | 5,340 | 11,100 |
| D | Proportionate capitals taking South's Capital as Base Capital (being the smallest) × PSR | 16,020 | 10,680 | 5,340 |
| E | Surplus capital (i.e. Excess of Actual Capitals over proportionate capital) [A-D] | 22,680 | — | 5,760 |
| F | Profit Sharing Ratio | 3 | — | 1 |
| G | Surplus Capital ÷ Profit Sharing Ratio | 7,560 | — | 5,760 |
| H | Revised Proportionate Capitals taking North's Capital as Base Capital | 5,400 | — | — |
| I | Revised Surplus Capital [E-H] | — | — | — |
| J | Distribution Sequence | 5,400 | — | — |
| | First ₹ 5,400 [To East] | 17,280 | — | 5,760 |
| | Next ₹ 23,040 [To East & North in the ratio of 3 : 1] | 9,600 | 6,400 | 3,200 |
| | Balance ₹ 19,200 [To East, South & North in the ratio of 3 : 2 : 1] | | | |

MAXIMUM LOSS METHOD :**Steps**

- (1) Prepare a statement showing distribution of cash
- (2) Pay off the external Liabilities
- (3) After all the payment is made for the external liabilities, the partners will be paid off.

| | |
|-----------------------------------|------------|
| Total Due of Partners | xxx |
| Less : Net/Balance of Realisation | <u>(x)</u> |
| Maximum Loss | <u>xxx</u> |

- (4) The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.
- (5) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.
- (6) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.
- (7) Repeat the steps (3) to (6) till final realisation.



PROBLEMS ON MAXIMUM LOSS METHOD

Illustration 35.

The following is the Balance Sheet of X, Y and Z, who were sharing in the ratio 5 : 3 : 2, on 31st December, 2012 when they decided to dissolve the partnership.

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|-------------|------------------|--------------|------------------|
| X's Capital | 55,000 | Cash | 20,000 |
| Y's Capital | 37,500 | Other assets | 13,04,000 |
| Z's Capital | 31,500 | | |
| Y's Loan | 2,00,000 | | |
| Creditors | 10,00,000 | | |
| | 13,24,000 | | 13,24,000 |

Note : There was a bill for ₹ 4,000 due on 1.4.2013 under discount.

Other assets realised as under :

1st January : ₹ 8,85,000, 1st February : ₹ 3,00,000 ; 1st March : ₹ 8,000; 1st April : ₹ 5,000; 1st May : ₹ 10,000. The expenses of realisation were expected to be ₹ 5,000, but ultimately amounted to ₹ 4,000 only and were paid on 1st May. The acceptor of the bill under discount met the bill on the due date.

Required : Prepare a statement showing the monthly distribution of cash according to Maximum Loss Method.

Solution:

Statement showing the Distribution towards Firm's Outside debts' & Partners' Loan

| Particulars | Creditors ₹ | Y's Loan ₹ |
|---|----------------|---------------|
| A Amount Due | 10,00,000 | 2,00,000 |
| B Amount paid on 1st Jan. (₹ 20,000 + ₹ 8,85,000 – ₹ 5,000) | 9,00,000 | — |
| C Balance Due (A - B) | 1,00,000 | 2,00,000 |
| D Amount paid on 1st February | 1,00,000 | 2,00,000 |
| E Balance Due (C - D) | Nil | Nil |

**Statement showing the Distribution of Cash
(According to Maximum Loss Method)**

| Particulars | Total ₹ | X ₹ | Y ₹ | Z ₹ |
|--|------------|--------|---------|---------|
| (i) Distribution of ₹ 4,000 | | | | |
| A. Amount due as on 1st March | 1,24,000 | 55,000 | 37,500 | 31,500 |
| Less : Max. Possible Loss if the remaining nothing (₹ 1,24,000 – ₹ 4,000) in the ratio of 5 : 3 : 2 | 1,20,000 | 60,000 | 36,000 | 24,000 |
| Note : Cash available = ₹ 8,000 – ₹ 4,000 (Reserved for discounted B/R) = ₹ 4,000 Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315 | — | 5,000 | (2,717) | (2,283) |
| | — | — | (1,217) | 5,217 |
| Adjustment of Y's Deficiency (charged to Z) | — | — | 1,217 | (1,217) |
| B. Cash paid as on 1st March | 4,000 | — | — | 4,000 |
| (ii) Distribution of ₹ 9,000 (including amount kept reserved for B/R no longer required) | | — | | |
| C. Balance due (A-B) | 1,20,000 | 55,000 | 37,500 | 27,500 |
| Less : Max. Possible Loss (₹ 1,20,000 – ₹ 9,000) | 1,11,000 | 55,500 | 33,300 | 22,200 |
| Note : Cash available = ₹ 5,000 + ₹ 4,000 = ₹ 9,000 | | (500) | 4,200 | 5,300 |
| Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315 | — | 500 | (272) | (228) |
| D. Cash paid as on 1st April | 9,000 | — | 3,928 | 5,072 |
| (iii) Distribution of ₹ 11,000 | | | | |
| E. Balance due (C-D) | 1,11,000 | 55,000 | 33,572 | 22,428 |
| Less : Max. Possible Loss (₹ 1,11,000 – ₹ 11,000) | 1,00,000 | 50,000 | 30,000 | 20,000 |
| F. Cash paid as on 1st May | 11,000 | 5,000 | 3,572 | 2,428 |
| G. Unpaid Balance (E - F) | 1,00,000 | 50,000 | 30,000 | 20,000 |

Illustration 36.

The following is the Balance Sheet of P, Q and R on 31st August, 2012 when they decided to dissolve the partnership. They share profits in the ratio of 2 : 2 : 1.

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|-------------|---------------|---------------|---------------|
| Creditors | 2,000 | Sundry Assets | 48,500 |
| P's Loan | 5,000 | Cash | 500 |
| P's Capital | 15,000 | | |
| Q's Capital | 18,000 | | |
| R's Capital | 9,000 | | |
| | 49,000 | | 49,000 |



The assets realised the following sums in instalments.

I— ₹ 1,000, II— ₹ 3,000, III— ₹ 3,900, IV— ₹ 6,000, V— ₹ 20,000.

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only.

Required : Show, how at each stage, the cash received should be distributed among partners according to Maximum Loss Method.

Solution :

Statement showing the Realisation and Distribution of Cash

| Installments | Realisation ₹ | Creditors ₹ | Partners' Loans ₹ | Partners' Capital ₹ |
|--|------------------|----------------|-------------------------|---------------------------|
| (I) (After taking into account cash and amount set aside for expenses) | 1,000 | 1,000 | | |
| (II) | 3,000 | 1,000 | 2,000 | |
| (III) | 3,900 | | 3,000 | 900 |
| (IV) | 6,000 | — | — | 6,000 |
| (V) (including saving in expenses) | 20,100 | — | — | 20,100 |
| | 34,000 | 2,000 | 5,000 | 27,000 |

**Statement showing the Distribution of Cash among partners
(According to Maximum Loss Method)**

| Particulars | Total ₹ | P ₹ | Q ₹ | R ₹ |
|--|------------|--------|--------|--------|
| (i) Distribution of ₹ 900 | | | | |
| A. Balance Due | 42,000 | 15,000 | 18,000 | 9,000 |
| B. Less : Max. Possible loss, if the remaining assets prove to be worthless (₹ 42,000 – ₹ 900) in the ratio (2 : 2 : 1) | 41,100 | 16,440 | 16,440 | 8,220 |
| C. Deficiency of P's Capital charged to Q and R in the ratio of their Capitals i.e., 18,000 : 9,000 (Garner vs. Murray) | — | 1,440 | (960) | (480) |
| D. Amount paid | 900 | — | 600 | 300 |
| (ii) Distribution of ₹ 6,000 | | | | |
| E. Balance after payment (A - D) | 41,100 | 15,000 | 17,400 | 8,700 |
| F. Less : Max. Possible loss (₹ 41,100 – ₹ 6,000) | 35,100 | 14,040 | 14,040 | 7,020 |
| G. Amount paid | 6,000 | 960 | 3,360 | 1,680 |
| (iii) Distribution of ₹ 20,100 | | | | |
| H. Balance after payment (E - G) | 35,100 | 14,040 | 14,040 | 7,020 |
| I. Less : Max. Possible loss (₹ 35,100 – ₹ 20,100) | 15,000 | 6,000 | 6,000 | 3,000 |
| J. Amount paid | 20,100 | 8,040 | 8,040 | 4,020 |
| K. Unpaid balance (H - J) | 15,000 | 6,000 | 6,000 | 3,000 |

Illustration 37.

Rahul, Roshan and Rohan were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The partnership was dissolved on 30th June, 2013 when the position was as follows :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|--------------------|---------------------|----------------|---------------------|
| Capitals : | | Cash in hand | 28,000 |
| Rahul | 1,40,000 | Sundry Debtors | 2,94,000 |
| Roshan | 70,000 | Stock in trade | 1,12,000 |
| Rohan | 14,000 | | |
| Creditors | 2,10,000 | | |
| | 4,34,000 | | 4,34,000 |

There was bill for ₹ 10,000, due on 30th November, 2013, under discount. It was agreed that the net realisations should be distributed in their due order (at end of each month) but as safely as possible. The realisations and expenses were as under :

| Date | Stock and Debtors ₹ | Expenses ₹ |
|----------------|--------------------------------|-----------------------|
| 31st July | 84,000 | 7,000 |
| 31st August | 1,26,000 | 5,400 |
| 30th September | 70,000 | 4,900 |
| 31st October | 77,000 | 3,500 |
| 30th November | 35,500 | 3,500 |

The Stock was completely disposed off and amounts due from debtors were realised, the balance being irrecoverable. The acceptor of the bill under discount met the bill on the due date. Prepare a Statement showing the piecemeal distribution of cash according to Maximum Loss Method.



Solution :

**Statement showing the Distribution of Cash
(According to Maximum Loss Method)**

| Particulars | Creditors ₹ | Rahul ₹ | Roshan ₹ | Rohan ₹ |
|--|----------------|------------|-------------|------------|
| A Balance Due | 2,10,000 | 1,40,000 | 70,000 | 14,000 |
| B Cash on hand on 30th June paid to creditors | 28,000 | — | — | — |
| C Balance outstanding (A – B) | 1,82,000 | 1,40,000 | 70,000 | 14,000 |
| D Cash paid on 31st July | 77,000 | — | — | — |
| E Balance outstanding (C – D) | 1,05,000 | 1,40,000 | 70,000 | 14,000 |
| F ₹ 1,05,000 paid to creditors on 31st August | 1,05,000 | — | — | — |
| G Balance outstanding (E – F) | — | 1,40,000 | 70,000 | 14,000 |
| Balance available for distribution (₹1,20,600 – ₹ 1,05,000 – ₹ 10,000) = ₹ 5,600 | | | | |
| Less : Maximum loss (₹ 2,24,000 – ₹ 5,600) in ratio of 3 : 2 : 1 | | (1,09,200) | (72,800) | (36,400) |
| Balance | | 30,800 | (2,800) | (22,400) |
| Deficiency of Roshan and Rohan's capital charged to Rahul | | (25,200) | 2,800 | 22,400 |
| H Cash paid on 31st August | | 5,600 | — | — |
| I Balance outstanding (G – H) | | 1,34,400 | 70,000 | 14,000 |
| Less : Maximum Loss (₹ 2,18,400 – ₹ 65,100) | | (76,650) | (51,100) | (25,550) |
| Balance | | 57,750 | 18,900 | (11,550) |
| Deficiency of Rohan's capital charged to Rahul and Roshan (2 : 1) | | (7,700) | (3,850) | 11,550 |
| J Cash paid on 30th September | | 50,050 | 15,050 | — |
| K Balance outstanding (I – J) | | 84,350 | 54,950 | 14,000 |
| Less : Maximum loss (₹ 1,53,300 – ₹ 73,500) | | (39,900) | (26,600) | (13,300) |
| L Cash paid on 31st October | | 44,450 | 28,350 | 700 |
| M Balance outstanding (K – L) | | 39,900 | 26,600 | 13,300 |
| Less : Maximum loss (₹ 79,800 – ₹42,000*) | | (18,900) | (12,600) | (6,300) |
| N Cash paid on 30th November | | 21,000 | 14,000 | 7,000 |
| O Unpaid Balance (M – N) | | 18,900 | 12,600 | 6,300 |

***Note :** Cash available on 30th November = (₹ 35,500 – ₹ 3,500) + ₹ 10,000 (Reserved for Discounted B/R, now no longer required) = ₹ 42,000.

Illustration 38.

E, F and G were partners in a firm, sharing profits and losses in the ratio of 3 : 2 : 1, respectively. Due to extreme competition, it was decided to dissolve the partnership on 31st December, 2013. The Balance Sheet on that date was as follows :

| Liabilities | | Amount ₹ | Assets | | Amount ₹ |
|---------------------|---------------|-----------------|------------------------|--|-----------------|
| Capitals Accounts : | | | Machinery | | 1,54,000 |
| E | 1,13,100 | | Furniture and Fittings | | 25,800 |
| F | 35,400 | | Investments | | 5,400 |
| G | <u>31,500</u> | 1,80,000 | Stock | | 97,700 |
| Current Accounts : | | | Debtors | | 56,400 |
| E | 26,400 | | Bank | | 29,700 |
| G | <u>6,000</u> | 32,400 | Current Account : F | | 18,000 |
| Reserves | | 1,08,000 | | | |
| Loan Account : G | | 15,000 | | | |
| Creditors | | 51,600 | | | |
| | | 3,87,000 | | | 3,87,000 |

The realisation of assets is spread over the next few months as follows :

February, Debtors, ₹ 51,900; March : Machinery, ₹ 1,39,500; April, Furniture, etc. ₹ 18,000; May : G agreed to take over Investments at ₹ 6,300; June, Stock, ₹ 96,000.

Dissolution expenses, originally provided, were ₹ 13,500, but actually amounted to ₹ 9,600 and were paid on 30th April. The partners decided that after creditors were settled for ₹ 50,400, all cash received should be distributed at the end of each month in the most equitable manner.

Required : Prepare a statement of actual cash distribution as is received following "Maximum Loss basis".

Solution :

**Statement showing the Distribution of Cash
(According to Maximum Loss Method)**

| Particular | Creditors G's Loan | | Capital Accounts | | | |
|--|--------------------|--------|------------------|----------|----------|------------|
| | ₹ | ₹ | E ₹ | F ₹ | G ₹ | Total ₹ |
| A Balance due [Creditors net of discount] | 51,600 | 15,000 | 1,93,500 | 53,400 | 55,500 | 3,02,400 |
| Paid to Creditors and G | 50,400 | 15,000 | — | — | — | — |
| B Balance due (A - B) Max. Possible | — | — | 1,93,500 | 53,400 | 55,500 | 3,02,400 |
| C Loss if remaining assets fetch nothing (₹ 3,02,400 – ₹ 2,700) in the ratio of 3 : 2 : 1 | | | 1,49,850 | 99,900 | 49,950 | 2,99,700 |
| Adjustment of F's Deficiency between E and G in the ratio of their fixed capitals i.e. 1,13,100 : 31,500 | | | 43,650 | (46,500) | 5,550 | |
| Balance Adjustment of G's Deficiency (charged to E) | | | (36,370) | 46,500 | (10,130) | |
| D Cash paid to E on 28th Feb. | | | 2,700 | — | — | 2,700 |
| E Balance due (C - D) | | | 1,90,800 | 53,400 | 55,500 | 2,99,700 |
| Possible Max. Loss (₹ 2,99,700 – ₹ 1,39,500) | | | | | | |
| F Cash paid on 31st Mar. | | | 80,100 | 53,400 | 26,700 | 1,60,200 |
| G Balance Due (E - F) | | | 1,10,700 | — | 28,800 | 1,39,500 |
| Possible Max. Loss (₹1,60,200 – ₹21,900) | | | 80,100 | 53,400 | 26,700 | 1,60,200 |
| H Cash paid on 30th April | | | 69,150 | 46,100 | 23,050 | 1,38,300 |
| I Balance Due (G - H) | | | 10,950 | 7,300 | 3,650 | 21,900 |
| J Maximum Loss (₹1,38,300 – ₹ 6,300) | | | 69,150 | 46,100 | 23,050 | 1,38,300 |
| K Cash brought in by G | | | 66,000 | 44,000 | 22,000 | 1,32,000 |
| L Balance Due (I + K) | | | 3,150 | 2,100 | 1,050 | (6,300) |
| Possible Max. Loss (₹ 1,32,000 – ₹ 96,000) | | | 66,000 | 44,000 | 22,000 | 1,32,000 |
| M Cash paid on 30th June | | | 18,000 | 12,000 | 6,000 | 36,000 |
| N Unpaid Balance (L - N) | | | 48,000 | 32,000 | 16,000 | 96,000 |
| | | | 18,000 | 12,000 | 6,000 | 36,000 |

Working Note :

Statement showing the Calculation of Cash Available for Distribution

| Particular | February ₹ | March ₹ | April ₹ | May ₹ | June ₹ |
|---|---------------|------------|------------|----------|-----------|
| A Opening Balance | 29,700 | — | — | — | — |
| B Add : Net Amount realised | 51,900 | 1,39,500 | 18,000 | — | 96,000 |
| C Less : Provision for Expenses | 13,500 | — | — | — | — |
| D Add : Provision no longer required | — | — | 3,900 | — | — |
| E Cash available for distribution (A + B - C + D) | 68,100 | 1,39,500 | 21,900 | — | 96,000 |

6.6 AMALGAMATION OF FIRMS AND CONVERSION TO A COMPANY

Introduction

As defined earlier, a Partnership firm is formed with two or more persons. But it can also be formed in any of the following ways.

- (A) When two or more sole proprietors forms new partnership firm;
- (B) When one existing partnership firm absorbs a sole proprietorship;
- (C) When one existing partnership firm absorbs another partnership firm;
- (D) When two or more partnership firms form new partnership firm.

The amalgamation is used to be done to avoid competition amongst them and to maximize the profit of the firm/firms.

Accounting entries under different situation are in below:

(A) When two or more sole proprietors form a new partnership firm

When two or more sole proprietorship businesses amalgamate to form a new partnership firm, the existing sets of books will be closed and a new set of books of accounts to be opened, recording all assets, liabilities and transactions of the partnership.

Steps to be taken for the existing books.

Step 1 : Prepare the Balance Sheet of the business on the date of dissolution.

Step 2 : Open a Realisation Account and transfer all assets and liabilities, except cash in hand and cash at bank, at their book values.

However, cash in hand and cash at bank are transferred to Realisation Account only when they are taken over by the new firm.

Step 3 : All undistributed reserves or profits or losses (appearing in the balance sheet) are to be transferred to Partners' Capital Accounts.

Step 4 : Calculate Purchase Consideration on the basis of terms and conditions agreed upon by the parties. Generally, purchase consideration is calculated on the basis of agreed value of assets and liabilities taken over by the new firm. The purchase consideration is calculated as under:

| | |
|--|--------------|
| Agreed values of assets taken over | xxxx |
| Less: Agreed values of liabilities assumed | <u>(xxx)</u> |
| Purchase consideration | <u>xxxx</u> |

Step 5 : Credit Realisation Account by the amount of Purchase Consideration.

Step 6 : If there are any unrecorded assets or liabilities, they are to be recorded.

Step 7 : The Profit or loss on realisation (balancing figure of Realisation Account) to be transferred to the Capital Account of the proprietor.

Step 8 : To ensure that all the accounts of the Sole Proprietor's business are closed.

Accounting Entries in the Books of Amalgamating Sole Proprietors :

- For transferring sundry assets to Realisation Account

| | | |
|--|-----|----------------|
| Realisation A/c | Dr. | |
| To Sundry Assets A/c | | [Individually] |
| (Assets transferred to Realisation Account at their book values except Cash and Bank i.e. if not taken over by the new firm) | | |

- For transferring sundry liabilities to Realisation Account

| | | |
|---|-----|----------------|
| Liabilities A/c | Dr. | |
| To Realisation A/c | | [Individually] |
| (Liabilities transferred to Realisation Account at their book values) | | |



3. For the amount of purchase consideration
New Firm A/c Dr.
 To Realisation A/c
(Purchase consideration due from the new firm)
4. For assets taken over by the proprietor
Capital A/c Dr.
 To Realisation A/c
(Assets taken over by the proprietor)
5. For realisation of assets not taken over by the new firm
Bank A/c Dr.
 To Realisation A/c
(Realisation of assets not taken over by the new firm)
6. For recording of unrecorded assets
Assets A/c Dr.
 To Capital A/c
(Unrecorded assets are recorded)
7. For realisation of unrecorded assets
Bank A/c Dr.
 To Assets A/c
(Realisation of unrecorded assets)
(Note: If unrecorded assets are taken over by the new firm,
it is also transferred to Realisation Account along with other assets.)
8. For payment of liabilities not taken over
Realisation A/c Dr.
 To Bank A/c
(Payment of liabilities not taken over by the new firm)
9. For recording of unrecorded liabilities
Capital A/c Dr.
 To Liabilities A/c
(Being the unrecorded liabilities are recorded)
10. For payment of unrecorded liabilities
Liabilities A/c Dr.
 To Bank A/c
(Payment of unrecorded liabilities)
(Note : If unrecorded liabilities are taken over by the new firm,
it is also transferred to Realisation Account along with other liabilities.)
11. For liabilities taken over by the proprietor
Realisation A/c Dr.
 To Capital A/c
(Being liabilities assumed by the proprietor)
12. For realisation expenses
Realisation A/c Dr.
 To Bank A/c
(Realisation expenses paid)

13. For profit on realisation
 Realisation A/c Dr.
 To Capital A/c
 (Profit on realisation transferred to Capital Account)
14. For loss on realisation
 Capital A/c Dr.
 To Realisation A/c
 (Loss on realisation transferred to Capital Account)
15. For accumulated profits / reserves
 Reserves A/c Dr.
 Profit and Loss A/c Dr.
 To Capital A/c
 (Undrawn profits transferred to Capital Account)
16. For accumulated losses
 Capital A/c Dr.
 To Profit and Loss A/c (if any)
 (Accumulated losses transferred to Capital A/c)
17. For settlement of purchase consideration by the New firm
 Capital in New Firm A/c Dr.
 To New Firm A/c
 (Settlement of purchase consideration)
18. For final adjustment
 Capital A/c Dr.
 To Capital in New Firm A/c
 To Bank A/c (if any)
 (Final adjustment to close the books of account)

Accounting Entries in the Books of the New Firm

The new firm records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is, more than the net assets (assets minus liabilities) acquired, it represents goodwill. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents capital reserve.

- If the net acquired assets is equal to purchase consideration.
 Assets A/c Dr. [Acquired value]
 To Liabilities A/c [Assumed value]
 To Partners' Capital A/c [Purchase consideration]
- If the net acquired asset is more than the purchase consideration:
 Assets A/c Dr. [Acquired value]
 To Liabilities A/c [Assumed value]
 To Partners' Capital A/c [Purchase consideration]
 To Capital Reserve A/c [Purchase consideration - net assets]
- If the net acquired asset is less than the amount of purchase consideration, it represents goodwill.
 Assets A/c Dr. [Acquired value]
 Goodwill A/c Dr. [Purchase consideration - net assets]
 To Liabilities A/c [Assumed value]
 To Partners' Capital A/c [Purchase consideration]



Illustration 39.

A and B carry on independent business and their position on 31.03.2013 are reflected in the Balance Sheet given below :

| Liabilities | A ₹ | B ₹ | Assets | A ₹ | B ₹ |
|--------------------------------|----------|----------|------------------------|----------|----------|
| Sundry creditors for purchases | 1,10,000 | 47,000 | Stock-in-trade | 1,70,000 | 98,000 |
| Sundry creditors for expenses | 750 | 2,000 | Sundry Debtors | 89,000 | 37,000 |
| Bills payable | 12,500 | - | Cash at bank | 13,000 | 7,500 |
| Capital A/c | 1,53,000 | 95,500 | Cash in hand | 987 | 234 |
| | | | Furniture and Fixtures | 2,750 | 1,766 |
| | | | Investments | 513 | — |
| | 2,76,250 | 1,44,500 | | 2,76,250 | 1,44,500 |

Both of them want to form a partnership firm from 1.4.2013 in the style of AB & Co. on the following terms:

- The capital of the partnership firm would be ₹ 3,00,000 and to be contributed by them in the ratio of 2:1.
- The assets of the individual businesses would be evaluated by C at which values, the firm will take them over and the value would be adjusted against the contribution due by A and B.
- C gave his valuation report as follows :

Assets of A : Stock-in trade to be written-down by 15% and a portion of the sundry debtors amounting to ₹9,000 estimated unrealisable; furniture and fixtures to be valued at ₹ 2,000 and investments to be taken at market value of ₹ 1,000.

Assets of B : Stocks to be written-up by 10% and sundry debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book values.

- The firm is not to consider any creditors other than the dues on account of purchases made.

You are required to pass necessary Journal entries in the books of A and B. Also prepare the opening Balance Sheet of the firm as on 1.4.2013.

Solution :

In the books of A Journal

| Date | Particulars | | Dr. Amount ₹ | Cr. Amount ₹ |
|---------------|--|-----|--------------------|--------------------|
| 2013 Apr.1 | Realisation A/c | Dr. | 2,76,250 | |
| | To Stock-in-trade A/c | | | 1,70,000 |
| | To Sundry Debtors A/c | | | 89,000 |
| | To Cash at bank A/c | | | 13,000 |
| | To Cash in hand A/c | | | 987 |
| | To Furniture & Fixture A/c | | | 2,750 |
| | To Investments A/c | | | 513 |
| | (Transfer of different Assers to Realisation A/c) | | | |
| | Creditors for Goods A/c | Dr. | 1,10,000 | |
| | Creditors for Expenses A/c | Dr. | 750 | |
| | Bills Payable A/c | Dr. | 12,500 | |
| | To Realisation A/c | | | 1,23,250 |
| | (Transfer of different liabilities to Realisation A/c) | | | |
| | AB & Co. A/c (Note 1) | Dr. | 1,18,987 | |
| | To Realisation A/c | | | 1,18,987 |
| | (Purchase consideration due) | | | |

| | | | |
|---|-----|----------|----------|
| Capital A/c To Realisation A/c (Realisation loss transferred to Capital A/c) | Dr. | 34,013 | 34,013 |
| Capital in AB & Co. A/c To AB & Co. A/c (Settlement of purchase consideration) | Dr. | 1,18,987 | 1,18,987 |
| Capital A/c To Capital in AB & Co. A/c (Final adjustment to close the books of account) | Dr. | 1,18,987 | 1,18,987 |

**In the books of B
Journal**

| Date | Particulars | | Dr. | Cr. |
|----------------|--|------------|-----------------|---|
| | | | Amount ₹ | Amount ₹ |
| 2013 Apr. 1 | Realisation A/c To Stock-in-trade A/c To Sundry Debtors A/c To Cash at bank A/c To Cash in hand A/c To Furniture & Fixture A/c (Transfer of different Assers to Realisation A/c) | Dr. | 1,44,500 | 98,000 37,000 7,500 234 1,766 |
| | Creditors for Goods A/c Creditors for Expenses A/c To Realisation A/c (Transfer of different liabilities to Realisation A/c) | Dr. Dr. | 47,000 2,000 | 49,000 |
| | AB & Co. A/c To Realisation A/c (Purchase consideration due) | Dr. | 1,01,750 | 1,01,750 |
| | Realisation A/c To Capital A/c (Realisation Profit transferred to Capital A/c) | Dr. | 6,250 | 6,250 |
| | Capital in AB & Co. A/c To AB & Co. A/c (Settlement of purchase consideration) | Dr. | 1,01,750 | 1,01,750 |
| | Capital A/c To Capital in AB & Co. A/c (Final adjustment to close the books of account) | Dr. | 1,01,750 | 1,01,750 |

Balance Sheet of AB & Co. as on 01.04.2013

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|--------------------------------|-------------|-----------------------------------|-------------|
| Capital Accounts : | | Furniture & Fittings | 3,766 |
| A | 2,00,000 | Investments | 1,000 |
| B | 1,00,000 | Stock-in-trade | 2,52,300 |
| Sundry creditors for purchases | 1,57,000 | Sundry Debtors | 1,11,450 |
| Bills payable | 12,500 | Cash at bank | 99,763 |
| | | (13,000 + 7,500 + 81,013 - 1,750) | |
| | | Cash in hand (987 + 234) | 1,221 |
| | 4,69,500 | | 4,69,500 |

Working :

(1) Calculation of purchase consideration :

| Particulars | A (₹) | B (₹) |
|---|-----------------|-----------------|
| Furniture | 2,000 | 1,776 |
| Investments | 1,000 | - |
| Stock-in-trade | 1,44,500 | 1,07,800 |
| Sundry Debtors | 80,000 | 31,450 |
| Cash at bank | 13,000 | 7,500 |
| Cash in hand | 987 | 234 |
| | <u>2,41,487</u> | <u>1,48,750</u> |
| Less : Sundry creditors for purchases | 1,10,000 | 47,000 |
| Bills payable (Assumed arising out of credit purchases) | 12,500 | - |
| Net assets taken over by the AB & Co. | <u>1,18,987</u> | <u>1,01,750</u> |
| Capital as per agreement | 2,00,000 | 1,00,000 |
| Less: Net assets taken over | 1,18,987 (+) | 1,01,750 (-) |
| Cash to be introduced (+) / withdrawn (-) | 81,013 | 1,750 |

(B) When an existing partnership firm absorbs a sole proprietorship

When a sole proprietorship is taken over by an existing firm, the original business of the sole proprietor is dissolved and compensated by a share of the partnership firm which is acquiring it. In this case, assets and liabilities of the sole proprietorship business are taken over by the partnership firm at agreed values. **The procedures for closing the books of account of the sole proprietorship are same as explained earlier.**

However, the following points are to be noted:

- The assets and liabilities of the sole proprietorship taken over by the existing firm, are added with the existing assets and liabilities of the firm.
- The capital of the new partner (the sole proprietorship) is equal to the purchase consideration agreed upon.
- Calculation and treatment for goodwill and Capital reserve are same as explained in situation (A).
- Before amalgamation, all the assets and liabilities of the firm may be revalued. Any profit or loss on revaluation is transferred to the Partners' Capital Accounts in the old profit-sharing ratio.
- Goodwill of the firm is to be adjusted by crediting the Partners' Capital Accounts in their old profit-sharing ratio.
- Balance of reserve and surplus of the firm is also to be credited to partners' Capital Accounts in the old profit-sharing ratio.

Illustration 40.

Following are the Balance Sheets of partners X and Y (sharing profits and losses in the ratio of their capital) and the sole proprietor Z as on 31.03.2013 :

| Liabilities | Partners X & Y | Sole Proprietor Z | Assets | Partners X & Y | Sole Proprietor Z |
|---------------|----------------|-------------------|------------------|----------------|-------------------|
| Capital X Y Z | 15,000 | - | Goodwill | - | 2,000 |
| Creditors | 5,000 | - | Building | 25,000 | - |
| Loan | - | 10,000 | Stock | 10,000 | 15,000 |
| | 26,000 | 13,000 | Bills receivable | 5,000 | 5,000 |
| | - | 5,000 | Debtors | 4,000 | 6,000 |
| | | | Cash in Hand | 2,000 | - |
| | <u>46,000</u> | <u>28,000</u> | | <u>46,000</u> | <u>28,000</u> |

The partners decided to admit Z as a partner and Z agreed to amalgamate his business with that of the partnership on the following terms :

1. The new profit-sharing ratio among X, Y, and Z will be in the ratio of their capitals.
2. The building is to be appreciated by ₹ 15,000 and provision @ 5 % is to be created on debtors.
3. The goodwill of the partnership is valued at ₹ 10,000 and of the sole proprietor at ₹ 1,500; both are to be recorded in the books.
4. Stock is to be taken at ₹ 9,200 and ₹ 16,800, respectively of the firm and the sole proprietor.

Prepare ledger accounts to close the books of Z, to make necessary Journal entries in the books of the firm and prepare the Balance Sheet of the re-constituted partnership.

Solution :**Working Note : Calculation of purchase consideration**

| Assets taken over : | ₹ | ₹ |
|--------------------------------------|--------|--------|
| Goodwill | 1,500 | |
| Stock | 16,800 | |
| Bills receivable | 5,000 | |
| Debtors | 6,000 | 29,300 |
| Less: Liabilities taken over: | | |
| Creditors | 13,000 | |
| Loan | 5,000 | |
| Provision for bad debts | 300 | 18,300 |
| Purchase consideration | | 11,000 |

| In the books of Z | | | | | |
|---------------------|-------------------------|-------------|------|-----------------------|-------------|
| Dr. | | | Cr. | | |
| Realisation Account | | | | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| | To Goodwill A/c | 2,000 | | By Creditors A/c | 13,000 |
| | To Stock A/c | 15,000 | | By Loan A/c | 5,000 |
| | To Bills receivable A/c | 5,000 | | By Partners X & Y A/c | 11,000 |
| | To Debtors A/c | 6,000 | | | |
| | To Capital A/c - Profit | 1,000 | | | |
| | | 29,000 | | | 29,000 |

| Capital Account | | | | | |
|-----------------|-----------------------|-------------|------|--------------------|-------------|
| Dr. | | | Cr. | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| | To Partners X & Y A/c | 11,000 | | By Balance b/d | 10,000 |
| | | 11,000 | | By Realisation A/c | 1,000 |
| | | | | | 11,000 |



Partners X & Y Account

Dr.

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|------|--------------------|-------------|------|----------------|-------------|
| | To Realisation A/c | 11,000 | | By Capital A/c | 11,000 |
| | | 11,000 | | | 11,000 |

**In the Books of X & Y
Journals**

Dr.

Cr.

| Date | Particulars | L.F | Amount ₹ | Amount ₹ |
|------|---|--------------------------|-----------------------------------|----------------------------------|
| | Building A/c To Revaluation A/c (Increase in the Value of Building) | Dr. | 15,000 | 15,000 |
| | Revaluation A/c To Stock A/c To Provision for Bad Debt A/c (Decrease in the value of assets) | Dr. | 1,000 | 800 200 |
| | Revaluation A/c To X Capital A/c To Y Capital A/c (Profit on revaluation transferred) | Dr. | 14,000 | 10,500 3,500 |
| | Goodwill A/c To X Capital A/c To Y Capital A/c (Goodwill raised in the books) | Dr. | 10,000 | 7,500 2,500 |
| | Goodwill A/c Stock A/c Bills Receivable A/c Debtors A/c To Loan A/c To Creditors A/c To Provision for Bad Debt A/c To Z Capital A/c (Assets and liabilities taken over) | Dr. Dr. Dr. Dr. | 1,500 16,800 5,000 6,000 | 5,000 13,000 300 11,000 |

Balance Sheet of X, Y & Z (after absorption) as at 01.04.13

| Liabilities | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|-----------------|-------------|------------------|-------------|-------------|
| Capital Account | | Goodwill | | 11,500 |
| - X | 33,000 | Building | | 40,000 |
| - Y | 11,000 | Stock | | 26,000 |
| - Z | 11,000 | Bills Receivable | | 10,000 |
| Loan | 5,000 | Debtors | 10,000 | |
| Creditors | 39,000 | Less: Provision | <u>500</u> | 9,500 |
| | | Cash in hand | | 2,000 |
| | 99,000 | | | 99,000 |

(C) When one firm takes over another firm

In this case, the procedures for closing of books are same as earlier. The assets of the absorbed firm added with the firm who absorbed the firm.

The treatment for capital reserve and goodwill are same as before.

Illustration 41.

Following is the Balance sheet of AB & Co. and CD & Co. as on 31.03.2013.

| Liabilities | AB (₹) | CD (₹) | Assets | AB (₹) | CD (₹) |
|---------------|-----------|-----------|----------------|-----------|-----------|
| Bank Loan | 10,000 | - | Stock-in-trade | 32,000 | 24,000 |
| Bills Payable | 30,000 | 40,000 | Sundry Debtors | 18,000 | 30,000 |
| Capital A | 60,000 | - | Machinery | 60,000 | 20,000 |
| Capital B | 30,000 | - | Cash in hand | 12,000 | 2,000 |
| Capital C | | 36,000 | Furniture | 8,000 | 6,000 |
| Capital D | | 24,000 | Investments | - | 18,000 |
| | 130,000 | 100,000 | | 130,000 | 100,000 |

AB & Co. absorbed CD & Co. on 01.04.2013 on the following terms:

- that the value of the goodwill of CD & Co. would be ₹ 12,000;
- that the investments of CD & Co. to be sold out for ₹ 24,000 and the realised cash will be introduced in the acquiring business;
- that the stock of CD & Co. to be reduced to ₹ 22,000;
- that the machinery of CD & Co. will be increased by 40%;
- that the Furniture of CD & Co. will be reduced by 10%.

It was further agreed that for AB & Co., following are the adjustments to be made :

- Assets are to be revalued as follows :
Goodwill- ₹ 16,000; Stock - ₹ 40,000; Machinery - ₹ 84,000; Furniture - ₹ 7,200;
- Bank loan to be repaid

Show necessary Ledger Accounts to close the books of CD & Co. and to prepare necessary Journal entry and Balance Sheet of AB & Co. after absorption.

Solution :**Workings :****Calculation of purchase consideration**

| Assets taken over : | ₹ |
|------------------------------------|---------------|
| Machinery | 28,000 |
| Furniture | 5,400 |
| Stock | 22,000 |
| Debtors | 30,000 |
| Cash (₹ 24,000 + ₹ 2,000) | 26,000 |
| Goodwill | 12,000 |
| | 1,23,400 |
| Less : Liability taken over | |
| – Bills payable | |
| Purchase consideration | 40,000 |
| | 83,400 |



In the books of CD & Co.

| Dr. | | | Cr. | | |
|----------------------------|----------------------------|-------------|------|----------------------|-------------|
| Realisation Account | | | | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| | To Stock-in-trade | 24,000 | | By Bills Payable A/c | 40,000 |
| | “ Sundry Debtors | 30,000 | | By AB & Co A/c | 83,400 |
| | “ Machinery | 20,000 | | | |
| | “ Cash in hand | 26,000 | | | |
| | “ Furniture | | | | |
| | To Partners' Capital A/cs: | 6,000 | | | |
| | C - 8,700 | | | | |
| | D - <u>8,700</u> | 17,400 | | | |
| | | 123,400 | | | 123,400 |

| Dr. | | | Cr. | | |
|---------------------|--------------------|-------------|------|--------------------|-------------|
| Cash Account | | | | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| | To Balance b/d | 2,000 | | By Realisation A/c | 26,000 |
| | To Investments A/c | 24,000 | | | |
| | | 26,000 | | | 26,000 |

| Dr. | | | | Cr. | | | |
|-----------------------------------|---------------------------|--------|--------|------|-------------------------------------|--------|--------|
| Partners' Capital Accounts | | | | | | | |
| Date | Particulars | C ₹ | D ₹ | Date | Particulars | C ₹ | D ₹ |
| | To Capital in AB & co A/c | 47,700 | 35,700 | | By Balance b/d | 36,000 | 24,000 |
| | | | | | By Profit on Sale of Investment A/c | 3,000 | 3,000 |
| | | | | | By Realisation A/c | 8,700 | 8,700 |
| | | 47,700 | 35,700 | | | 47,700 | 35,700 |

In the books of AB & Co.

| Dr. | | | | Cr. | | | |
|-----------------------------------|----------------|--------|--------|------|--------------------|--------|--------|
| Partners' Capital Accounts | | | | | | | |
| Date | Particulars | A ₹ | B ₹ | Date | Particulars | A ₹ | B ₹ |
| | To Balance c/d | 83,600 | 53,600 | | By Balance b/d | 60,000 | 30,000 |
| | | | | | By Goodwill A/c | 8,000 | 8,000 |
| | | | | | By Revaluation A/c | 15,600 | 15,600 |
| | | 83,600 | 53,600 | | | 83,600 | 53,600 |

Balance Sheet as on 01.04.2013

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|-----------------------------|-------------|---------------------------------|-------------|
| Capital Accounts A B C D | 83,600 | Goodwill | 28,000 |
| | 53,600 | Machinery | 1,12,000 |
| Bills payable | 47,700 | Furniture | 12,600 |
| | 35,700 | Stock | 62,000 |
| | 70,000 | Debtors | 48,000 |
| | 2,90,600 | Cash (26,000 + 12,000 – 10,000) | 28,000 |
| | | | 2,90,600 |

Journal

| Date | Particulars | L.F | Dr. | Cr. |
|--------|---|--|---|----------------------------|
| | | | Amount ₹ | Amount ₹ |
| 1.4.13 | Bank Loan A/c To Cash A/c (Being the bank loan repaid) | Dr. | 10,000 | 10,000 |
| | Goodwill A/c To A's Capital A/c To B's Capital A/c (Being the goodwill raised) | Dr. | 16,000 | 8,000 8,000 |
| | Stock A/c Machinery A/c To Revaluation A/c (Being increase in the value of assets) | Dr. Dr. | 8,000 24,000 | 32,000 |
| | Revaluation A/c To Furniture A/c (Being the decrease in the value of furniture) | Dr. | 800 | 800 |
| | Revaluation A/c To A's Capital A/c To B's Capital A/c (Being the profit on revaluation transferred to Partners' Capital A/cs in the profit-sharing ratio) | Dr. | 31,200 | 15,600 15,600 |
| | Goodwill A/c Machinery A/c Furniture A/c Stock A/c Debtors A/c Cash A/c To Bills Payable A/c To C 's Capital A/c To D's Capital A/c (Being the introduction of capital by C & D) | Dr. Dr. Dr. Dr. Dr. Dr. | 12,000 28,000 5,400 22,000 30,000 26,000 | 40,000 47,700 35,700 |

(D) When two or more partnership firms form a new partnership firm

When two or more partnership firms amalgamate to form a new partnership firm, the books of account of the old firm is to be closed. In the books of each old firm, a Realisation Account to be opened. The accounting entries of the amalgamating firm is same as before as they were absorbed.

Illustration 42.

Two partnership firms, carrying on business under the style of R & Co. (Partners A & B) and W & Co. (Partners C & D) respectively, decided to amalgamate into RW & Co. with effect from 1st April 2013. The respective Balance Sheets of both the firms as on 31st March, 2013 are in below :

| Liabilities | R (₹) | W (₹) | Assets | R (₹) | W (₹) |
|-------------|--------|--------|----------------|--------|--------|
| Capital B | 19,000 | - | Goodwill | - | 5,000 |
| Capital C | - | 10,000 | Machinery | 10,000 | - |
| Capital D | - | 2,000 | Stock-in-trade | 20,000 | 5,000 |
| Bank Loan | 15,000 | - | Sundry Debtors | 10,000 | 10,000 |
| Creditors | 10,000 | 9,500 | Cash in hand | - | 1,500 |
| | | | Capital - A | 4,000 | - |
| | 44,000 | 21,500 | | 44,000 | 21,500 |

Profit sharing ratios are : A & B = 1:2; C & D = 1:1. Agreed terms are :

- All fixed assets are to be devalued by 20%.
- All stock in trade is to be appreciated by 50%.
- R & Co. owes ₹ 5,000 to W & Co. as on 31st March 2013. This is settled at ₹ 2,000. Goodwill is to be ignored for the purpose of amalgamation.
- The fixed capital accounts in the new firm (RW & Co.) are to be : Mr A ₹ 2,000; Mr. B ₹ 3,000; Mr C ₹ 1,000 and D ₹ 4,000.
- Mr. B takes over bank overdraft of R & Co. and contributed to Mr. A the amount of money to be brought in by Mr. A to make up his capital contribution.
- Mr C is paid off in cash from W & Co. and Mr. D brings in sufficient cash to make up his required capital contribution.

Pass necessary Journal entries to close the books of both the firms as on 31st March 2013.

Solution :

Calculation of Purchase Consideration

| Assets taken over : | | R & Co. | W & Co. |
|--|-------|---------|---------|
| Plant & Machinery | | 8,000 | - |
| Stock-in-trade | | 30,000 | 7,500 |
| Sundry Debtors [(* After adjustment of ₹ 3,000 (₹ 5,000 – 2,000)] | (A) | 10,000 | *7,000 |
| | | 48,000 | 14,500 |
| Liability taken over: | | | |
| Sundry Creditors [(* ₹ (10,000 – 3000)] | (B) | *7,000 | 9,500 |
| Purchase consideration | (A-B) | 41,000 | 5,000 |

In the books of R & Co.
Journals

| Date | Particulars | L.F | Dr. | Cr. |
|---|--------------------------------|--------|-------------|-------------|
| | | | Amount ₹ | Amount ₹ |
| 31.3.13 | Realisation A/c Dr. | | 40,000 | |
| | To Plant and Machinery A/c | | | 10,000 |
| | To Stock-in-trade A/c | | | 20,000 |
| | To Sundry Debtors A/c | | | 10,000 |
| | (Different assets transferred) | | | |
| | Sundry Creditors A/c Dr. | | 10,000 | |
| | To Realisation A/c | | | 10,000 |
| (Sundry creditors transferred to Realisation Account) | | | | |
| Bank Loan A/c Dr. | | 15,000 | | |
| To B Capital A/c | | | 15,000 | |
| (Bank overdraft taken over by B) | | | | |
| RW & Co. A/c Dr. | | 41,000 | | |
| To Realisation A/c | | | 41,000 | |
| (Purchase consideration due) | | | | |
| Realisation A/c Dr. | | 11,000 | | |
| To A Capital A/c | | | 3,667 | |
| To B Capital A/c | | | 7,333 | |
| (Profit on realisation transferred to partners capital in the ratio of 1:2) | | | | |
| B Capital A/c Dr. | | 2,333 | | |
| To A Capital A/c | | | 2,333 | |
| (Deficit in A's capital made good by B) | | | | |
| A Capital A/c Dr. | | 2,000 | | |
| B Capital A/c (3,000 + 36,000) Dr. | | 39,000 | | |
| To RW & Co. A/c | | | 41,000 | |
| (Capital accounts of the partners closed by transfer to RW & Co.) | | | | |
| Alternatively Shows: | | | | |
| A Capital A/c Dr. | | 2,000 | | |
| B Capital A/c Dr. | | 3,000 | | |
| Loan from B A/c Dr. | | 36,000 | | |
| To RW & Co. A/c | | | 41,000 | |

Note : It should be noted that the credit balance in B's capital account is ₹ 39,000. His agreed capital in RW & Co is ₹ 3,000 only. Since there is no liquid assets in R & Co. from which B can be repaid, the excess amount of ₹ 36,000 should be taken over by RW & Co. as loan from B.



**In the books of W & Co.
Journals**

| | | | Dr. | Cr. |
|--|--|------|-------------|-------------|
| Date | Particulars | L.F. | Amount ₹ | Amount ₹ |
| 31.3.13 | Realisation A/c Dr. | | 20,000 | |
| | To Goodwill A/c | | | 5,000 |
| | To Stock-in-trade A/c | | | 5,000 |
| | To Sundry Debtors A/c | | | 10,000 |
| | (Different Assets transferred) | | | |
| | Sundry Creditors A/c Dr. | | 9,500 | |
| | To Realisation A/c | | | 9,500 |
| RW & Co. A/c Dr. | To Realisation A/c | | 5,000 | |
| | (Purchase consideration due) | | | 5,000 |
| C's Capital A/c Dr. | To Realisation A/c | | 2,750 | |
| | D's Capital A/c Dr. | | 2,750 | |
| | To Realisation A/c | | | 5,500 |
| | (Loss on realisation transferred to Capital Account equally) | | | |
| Cash A/c Dr. | To D's Capital A/c | | 4,750 | |
| | (Being the necessary amount brought in by D to make up his required capital contribution) | | | 4,750 |
| C's Capital A/c Dr. | To RW & Co. A/c | | 7,250 | |
| | D's Capital A/c Dr. | | 4,000 | |
| | To Cash A/c | | | 5,000 |
| | (Capital accounts of the partners closed by transfer to RW & Co. and balance paid by cash) | | | 6,250 |
| | Alternatively Shows: | | | |
| C's Capital A/c Dr. | To Cash A/c | | 6,250 | |
| | (Being the C's Capital is paid off) | | | 6,250 |
| C's Capital A/c Dr. | To RW & Co. A/c | | 1,000 | |
| | D's Capital A/c Dr. | | 4,000 | |
| | (Being the Partner's Capital transferred to RW & Co.) | | | 5,000 |

Realization Account

| Particulars | R & Co. ₹ | W & Co. ₹ | Particulars | R & Co. ₹ | W & Co. ₹ |
|------------------|--------------|--------------|----------------|--------------|--------------|
| To Goodwill | - | 5,000 | By Creditors | 10,000 | 9,500 |
| “ Machinery | 10,000 | - | By RW & Co. | 41,000 | 5,000 |
| “ Stock-in-trade | 20,000 | 5,000 | By C's Capital | | 2,750 |
| “ Sundry Debtors | 10,000 | 10,000 | By D's Capital | | 2,750 |
| “ Cash in hand | - | | | | |
| “ A's Capital | 3,667 | | | | |
| “ B's Capital | 7,333 | | | | |
| | 51,000 | 20,000 | | 51,000 | 20,000 |

Partners' Capital Accounts of R & Co.

| Dr. | | | | Cr. | | | |
|--------|------------------|----------|----------|--------|-----------------------------|----------|----------|
| Date | Particulars | A (₹) | B (₹) | Date | Particulars | A (₹) | B (₹) |
| 2013 | To Balance b/d | 4,000 | — | 2013 | By Balance b/d | — | 19,000 |
| Mar 13 | `` A Capital A/c | — | 2,333 | Mar 31 | `` Realisation A/c (Profit) | 3,667 | 7,333 |
| | `` Loan A/c | — | 36,000 | | `` Bank overdraft A/c | — | 15,000 |
| | `` R W & Co. A/c | 2,000 | 3,000 | | `` B's Capital A/c | 2,333 | — |
| | | 6,000 | 41,333 | | | 6,000 | 41,333 |

Partners' Capital Accounts of W & Co.

| Dr. | | | | Cr. | | | |
|--------|---------------------------|----------|----------|--------|----------------|----------|----------|
| Date | Particulars | C (₹) | D (₹) | Date | Particulars | C (₹) | D (₹) |
| 2013 | To Realisation A/c (Loss) | 2,750 | 2,750 | 2013 | By Balance b/d | 10,000 | 2,000 |
| Mar 31 | `` Cash A/c | 6,250 | — | Mar 31 | `` Cash A/c | — | 4,750 |
| | `` R W & Co. A/c | 1,000 | 4,000 | | | | |
| | | 10,000 | 6,750 | | | 10,000 | 6,750 |

6.7 CONVERSION OR SALE OF A PARTNERSHIP FIRM TO A COMPANY

For various reasons, an existing partnership may sell its entire business to an existing Joint Stock Company. It can also convert itself into a Joint Stock Company. The former case is the absorption of a partnership firm by a Joint Stock Company but the latter case is the flotation of a new company to take over the business of the partnership.

In either of the above cases, the existing partnership firm is dissolved and all the books of account are closed. Broadly, the procedure of liquidation of the partnership business is same as what has already been explained in "Amalgamation of Partnership"

Some important points :

- (1) The Purchase Consideration is satisfied by the Company either in the form of cash or shares or debentures or a combination of two or more of these. The shares may be equity or preference shares. The shares may be issued at par, at a premium or at a discount. For the partnership, the issue price is relevant which may form a part of the purchase consideration.
- (2) In the absence of any agreement, share received from purchasing company should be distributed among the partners in the same ratio as profits and losses are shared.

Accounting Entries in the books of selling firms.

1. For transferring different assets to Realisation Account
 Realisation A/c Dr. [Individually]
 To Sundry Assets A/c
 (Assets transferred to Realisation Account at their book values)
2. For transferring different liabilities to Realisation Account
 Liabilities A/c Dr. [Individually]
 To Realisation A/c
 (Liabilities transferred to Realisation Account at their book values)



3. For purchase consideration due
Purchasing Co. A/c Dr
 To Realisation A/c
(Purchase consideration due from the new firm)

4. For assets taken over by the proprietor
Capital A/c Dr
 To Realisation A/c
(Assets taken over by the proprietor)

5. For realisation of assets not taken over by the Company
Bank A/c Dr.
 To Realisation A/c
(Realisation of assets not taken over by the new firm)

6. For recording unrecorded assets
Assets A/c Dr
 To Capital A/c
(Unrecorded assets recorded)

7. For realisation of unrecorded assets
Bank A/c Dr
 To Assets A/c

8. For payment of liabilities not taken over
Realisation A/c Dr
 To Bank A/c
(Payment of liabilities not taken over by the new firm)

9. For recording unrecorded liabilities
Capital A/c Dr
 To Liabilities A/c
(Being the unrecorded liabilities recorded)

10. For payment of unrecorded liabilities
Liabilities A/c Dr
 To Bank A/c
(Payment of unrecorded liabilities)

(Note: If unrecorded liabilities are taken over by the Company, it is also transferred to Realisation Account along with other liabilities.)

11. For liabilities taken over by the proprietor
Realisation A/c Dr
 To Capital A/c
(Being liabilities assumed by the proprietor)

12. For realisation expenses
Realisation A/c Dr.
 To Bank A/c
(Realisation expenses paid)

13. For profit on realisation
 Realisation A/c Dr
 To Capital A/c
 (Profit on realisation transferred to Capital Account)
14. For loss on realisation
 Capital A/c Dr
 To Realisation A/c
 (Loss on realisation transferred to Capital Account)
15. For accumulated profits / reserves
 Reserves A/c Dr
 Profit and Loss A/c Dr
 To Capital A/c
 (Undrawn profits transferred to Capital Account)
16. For Loss : Reverse entry of 15.
17. For transferring partners' current accounts (Credit balances) to capital accounts
 Partners' Current A/cs Dr.
 To Partners' Capital A/cs
 If there is a debit balance in current account, the reverse entry shall be recorded.
18. For Settlement of purchase consideration by the company
 Shares in Purchasing Co. Dr.
 Debentures in Purchasing Co. Dr.
 Cash A/c Dr.
 To Purchasing Co. A/c
19. For final adjustment
 Partners' Capital A/cs Dr.
 To Shares in Purchasing Co. A/c
 To Debenture in Purchasing Co. A/c
 To Cash A/c

Accounting Entries in the books of the Purchasing Company

The purchasing company will record all the assets and liabilities at agreed values. Calculation of Goodwill and Capital Reserve same as explained earlier.

1. For assets and liabilities taken over:

(When net assets taken over is less than the Purchase consideration)

| | | |
|--------------------|-----|--------------------------|
| Assets A/c | Dr. | (Agreed Value) |
| Goodwill A/c | Dr. | (Balancing figure) |
| To Liabilities A/c | | (Agreed Value) |
| To Firm A/c | | (Purchase Consideration) |

(Being different assets and liabilities taken over)



(When net assets taken over is more than the Purchase consideration)

| | | |
|------------------------|-----|--------------------------|
| Assets A/c | Dr. | (Agreed Value) |
| To Liabilities A/c | | (Agreed Value) |
| To Firm A/c | | (Purchase Consideration) |
| To Capital Reserve A/c | | (Balancing Figure) |

(Being different assets and liabilities taken over)

2. For discharge of Purchase Consideration:

| | |
|---------------------------|-------------------------------|
| Firm A/c | Dr (Purchase Consideration) |
| To Share Capital A/c | (Face value of shares issued) |
| To Securities Premium A/c | (if any) |
| To Debentures A/c | |
| To Bank A/c | |

Illustration 43.

X and Y were in partnership in XY & Co. sharing profits in the proportions 3:2. On 31st March 2013, they accepted an offer from P. Ltd. to acquire at that date their fixed assets and stock at an agreed price of ₹7,20,000. Debtors, creditors and bank overdraft would be collected and discharged by the partnership firm.

The purchase consideration of ₹7,20,000 consisted of cash ₹3,60,000, debentures in P Ltd. (at par) ₹1,80,000 and 12,000 Equity Shares of ₹10 each in P. Ltd. X will be employed in P. Ltd. but, since Y was retiring X agreed to allow him ₹30,000 in compensation, to be adjusted through their Capital Accounts. Y was to receive 1,800 shares in P. Ltd. and the balance due to him in cash. The Balance Sheet of the firm as on 31.03.2013 is in below :

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|---------------------|-------------|---------------------|-------------|
| X's Capital Account | 1,20,000 | Fixed Assets | 4,80,000 |
| Loan from X | 2,10,000 | Stock | 45,000 |
| Bank overdraft | 1,50,000 | Debtors | 75,000 |
| Creditors | 1,80,000 | Y's Capital Account | 60,000 |
| | 6,60,000 | | 6,60,000 |

The sale of the assets to P. Ltd. took place as agreed; the debtors realised ₹60,000 and creditors were settled for ₹1,71,000. The firm then ceased business. You are required to pass necessary Journal entries and show: (a) Realisation Account (b) Bank Account (c) Partners' Capital Accounts.

In the books of XY & Co.
Journals

| Date | Particulars | L.F | Dr. | Cr. |
|---------|---|-----|----------------------------------|--------------------------------|
| | | | Amount ₹ | Amount ₹ |
| 31.3.13 | Realisation A/c Dr. To Fixed Assets A/c To Stock-in-trade A/c To Sundry Debtors A/c (Different Assets transferred) | | 6,00,000 | 4,80,000 45,000 75,000 |
| | Creditors A/c Dr. To Realisation A/c (Sundry creditors transferred) | | 1,80,000 | 1,80,000 |
| | P. Ltd A/c Dr. To Realisation A/c (Purchase consideration due) | | 7,20,000 | 7,20,000 |
| | Bank A/c Dr. Debentures in P Ltd. Dr. Shares in P Ltd. Dr. To P. Ltd A/c (Purchase consideration Received) | | 3,60,000 1,80,000 1,80,000 | 7,20,000 |
| | Bank A/c Dr. To Realisation A/c (Debtors realized) | | 60,000 | 60,000 |
| | Realisation A/c Dr. To Bank A/c (Payment to Creditors) | | 1,71,000 | 1,71,000 |
| | Realisation A/c Dr. To X Capital A/c To Y Capital A/c (Profit on realisation transferred to Capital Account) | | 1,89,000 | 1,13,400 75,600 |
| | Loan from X Dr. To X Capital (Loan Balance transferred) | | 2,10,000 | 2,10,000 |
| | X Capital A/c Dr. To Y Capital A/c (Adjustment for compensation) | | 30,000 | 30,000 |
| | X Capital A/c Dr. To Share in P Ltd To Debenture in P Ltd. To Bank A/c (Final settlement of accounts of X) | | 4,13,400 | 1,53,000 1,80,000 80,400 |
| | Y Capital A/c Dr. To Shares in P Ltd. To Bank (Final settlement of accounts of Y) | | 45,600 | 27,000 18,600 |



| Dr. | | Realisation Account | | Cr. | |
|------------------------------------|-------------|--------------------------------|-------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To Fixed Assets A/c | 4,80,000 | By Creditors A/c | 1,80,000 | | |
| To Stock A/c | 45,000 | By Bank A/c (Debtors realised) | 60,000 | | |
| To Debtors A/c | 75,000 | By P Ltd A/c (Purch. Consid.) | | | |
| To Bank A/c (creditors payment) To | 1,71,000 | Bank | 3,60,000 | | |
| X's Capital A/c (profit) | 1,13,400 | Debentures in P Ltd | 1,80,000 | | |
| To Y's Capital A/c (profit) | 75,600 | Shares in P Ltd. | 1,80,000 | | |
| | 9,60,000 | | 9,60,000 | | |

| Dr. | | Bank Account | | Cr. | |
|---|-------------|--------------------------------------|-------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To Realisation A/c (Debtors realised) | 60,000 | By Balance b/d | 1,50,000 | | |
| To S Ltd. A/c (Purchase Consideration) | 3,60,000 | By Realisation A/c (Cr's payment) | 1,71,000 | | |
| | | By Capital A/c - X | 80,400 | | |
| | | By Capital A/c - Y | 18,600 | | |
| | 4,20,000 | | 4,20,000 | | |

| Dr. | | | | Cr. | | | |
|-----|--------------------------------|----------|----------|-----|--------------------------------|----------|----------|
| Dt. | Particulars | X | Y | Dt. | Particulars | X | Y |
| | To Balance b/d | - | 60,000 | | By Balance b/d | 1,20,000 | - |
| | To Y Capital A/c | 30,000 | | | By Loan from X | 2,10,000 | - |
| | To Shares in P Ltd | 1,53,000 | 27,000 | | By Realisation A/c (profit) | 1,13,400 | 75,600 |
| | To Debentures in P Ltd A/c | 1,80,000 | | | By X 's Capital A/c | - | 30,000 |
| | To Bank A/c (final payment) | 80,400 | 18,600 | | | | |
| | | 4,43,400 | 1,05,600 | | | 4,43,400 | 1,05,600 |

Note :

Value of equity shares

| | | | |
|--|----------|----------|----------|
| Total Purchase consideration | | ₹ | 7,20,000 |
| Discharged: | | | |
| In Cash | 3,60,000 | | |
| By Debentures | 1,80,000 | 5,40,000 | |
| Balance by 12,000 Equity shares of ₹ 10 per each | | 1,80,000 | |
| So the cost of each equity share be ₹ 1,80,000/12,000 = ₹ 15 per share. | | | |
| Thus in the books of P Ltd. Security premium will be ₹ 12,000 × 5 = ₹ 60,000 | | | |

SELF EXAMINATION QUESTIONS:

1. Realisation account is opened at the time of
 - (A) Admission of a new partner
 - (B) Retirement of a partner
 - (C) Dissolution of the Firm
 - (D) In all the above situations

2. A and B are partners sharing profit/loss in the ratio of 3:2. They admit C into partnership for $\frac{1}{6}$ share in the profit which he acquired equally from old partners. The new profit sharing ratio will be
 - (A) 3 : 2 : 1
 - (B) 1 : 1 : 1
 - (C) 31 : 19 : 10
 - (D) 14 : 6 : 4

3. Realization account is a
 - (A) Representative personal account
 - (B) Artificial personal account
 - (C) Real account
 - (D) Nominal account

4. A and B are partners in a firm sharing profits in the ratio of 4:3. They agreed to admit C in the firm for 1/6th share in profit. The new profit sharing ratio of A, B and C will be
 - (A) 4:3:1
 - (B) 3 : 2 : 1
 - (C) 8 : 2 : 3
 - (D) 20: 15 : 7

5. Generally gain ratio is concerned with the situation of
 - (A) Admission of a new partner
 - (B) Retirement of a partner
 - (X) Dissolution of firm
 - (Δ) Piece mean distribution

6. In partnership when a new Partner brings his share of Goodwill in cash, then the amount of such Goodwill will be credited to Partners' capitals as per the following ratio :
 - (A) Old Profit sharing ratio
 - (B) Sacrifice ratio
 - (C) Gain ratio
 - (D) None of the above

Answer:

| | | | | | |
|--------|--------|--------|--------|--------|--------|
| 1. (C) | 2. (C) | 3. (D) | 4. (D) | 5. (B) | 6. (B) |
|--------|--------|--------|--------|--------|--------|

State whether the following statement is True (or) False:

1. Gain Ratio is generally concerned with the situation of admission of a Partner.
2. When there is no agreement among the partners, the profit or loss of the firm will be shared in their capital ratio.
3. In absence of partnership deed the Profit or Loss should be distributed among partners in their Capital Ratio.

QUESTIONS:

1. A and B were partners sharing profit or loss in the ratio of 5 : 4. C entered as partner for 1/4th shares in profits and he brought ₹ 2,50,000 for goodwill. C acquired 1/6th share from B and remaining from A. You are required to:
 - (i) Calculate sacrifice ratio and new profit sharing ratio.
 - (ii) Pass journal entries in the books of the firm for the distribution of goodwill.

Answer:

(i) B's Sacrifice = $\frac{1}{6}$ and A's sacrifice = $\frac{1}{4} - \frac{1}{6} = \frac{3 - 2}{12} = \frac{1}{12}$

Hence, Sacrifice ratio of A & B = $\frac{1}{12} : \frac{1}{6}$ or 1 : 2

New Profit Sharing Ratio:

New share of A = $\frac{5}{9} - \frac{1}{12} = \frac{(20 - 3)}{36} = \frac{17}{36}$

New shares of B = $\frac{4}{9} - \frac{1}{6} = \frac{(8-3)}{18} = \frac{5}{18} = \frac{10}{36}$

Share of C = $\frac{1}{4}$ or $\frac{9}{36}$

Share of C = $\frac{1}{4}$ or $\frac{9}{36}$

Hence, New Ratio of A, B & C = 17 : 10 : 9.

(ii)

Journal Entries

| Particulars | Dr. (₹) | Cr. (₹) |
|---|-----------------|--------------------|
| Bank A/c To Goodwill A/c (Amount of goodwill brought by C) | Dr. 2,50,000 | 2,50,000 |
| Goodwill A/c To A's Capital A/c To B's Capital A/c (Amount of goodwill shared by A&B in sacrifice ratio 1 : 2) | Dr. 2,50,000 | 83,333 1,66,667 |

EXERCISE:

1. X, Y and Z are partners in a firm. The firm has agreed to give to partners interest @ 15% per annum on their capital contributions. The amount of interest on Y's capital is more than the Interest on Z's capital by ₹10,500 and X's capital is $1\frac{2}{3}$ times of Z's capital. If the firm's total capital is ₹11,70,000, then calculate the amount of capital and interest thereon of each partner.

Answer:

| | | |
|-----------------|---------------------|----------------------------|
| [Capital | X — 5,00,000 | Interest X — 75,000 |
| | Y — 3,70,000 | Interest X — 55,500 |
| | Z — 3,00,000 | Interest X — 45,000 |

2. A, B and C started a partnership firm on 01.01.2012. A introduced ₹ 10,000 on 01.01.2012 and further introduced ₹ 4,000 on 1.7.2012. B introduced ₹ 25,000 at first on 1.1.2012 but withdraw ₹ 5,000 from the business on 31.09.2012. C introduced ₹ 15,000 at the beginning on 1.1.2012, increased it by ₹ 5,000 on 1.4.2012 and reduced it to ₹ 10,000 on 1.11.2012.

During the year 2012 they made a net profit of ₹ 75,500. The partners decided to provide interest on their capitals at 10% p.a. and to divide the balance of profit in their effective capital contribution ratio.

Prepare the Profit and Loss Appropriation Account for the year ended 31.12.2012.

Answer:

[Share of Profit —

A — ₹15,948

B — ₹31,565

C — ₹22,704

Total of Profit and Loss Appropriation Account for the year ended 31.12.2012 — ₹75,000]

3. Ashok & BaJa who were in partnership sharing 7/12 and 5/12 respectively admitted Chand as a partner giving him 1/5th share from 01.04.2011. The new profit sharing ratio is 7 : 5 : 3. Chand brought ₹ 96,000 towards goodwill to be shared by Ashok & BaJa in their sacrificing ratio. The amount so brought was however credited to Chand's capital account by mistake.

The Trial Balance of the firm as on 31st March, 2012 is given below:

| | Dr. (₹) | Cr. (₹) |
|---------------------|-----------|-----------|
| Ashok's capital | | 3,36,000 |
| Bala's capital | | 2,40,000 |
| Chand's capital | | 2,24,000 |
| Sundry Creditors | | 48,000 |
| Current year profit | | 2,20,000 |
| Other Assets | 7,70,000 | |
| Ashok's drawing | 1,45,600 | |
| Bala's drawing | 1,04,000 | |
| Chand's drawing | 20,400 | |
| Cash in hand | 28,000 | |
| Total: | 10,68,000 | 10,68,000 |

Interest on drawings is to be ignored but interest on capital is to be charged at 5% per annum which was not made so far. Prepare new Balance Sheet as at 31.03.2012 giving effect to above adjustments/omissions.

Answer:

[Balance Sheet total as on 31.03.2012 — ₹7,98,000]

4. Sachin & Ganguly are partners of a firm SG & Co. From the following Information calculate the value of goodwill by super profit method and capitalization method:
- Average capital employed in the business ₹ 5,00,000.
 - Net trading profit of the firm for the last three years ₹ 1,50,000; ₹ 1,70,000 and ₹ 1,90,000.
 - Rate of return expected from capital having regard to risk involved @ 15% per annum.
 - Goodwill to be valued at 2 years' purchase.

Answer:

[Value of Goodwill under —

- (i) Super Profit method — ₹1,90,000;
- (ii) Capitalisation Method — ₹6,33,333]

5. A, B and C were carrying on business as equal partners. On 01.04.2012, A retires from partnership and his capital account showed a credit balance of ₹ 2,25,000 after all the adjustments. Show the relevant Ledger accounts in the books of the firm after A's retirement, if:

- (i) Full payment to A is made in cash immediately after retirement.
- (ii) The payment is made to A in two equal yearly installments plus interest @ 15% per annum.
 - (iii) The life annuity of ₹ 50,000 per annum with 12% interest per annum is payable assuming that the annuitant passes away immediately after payment of the second annuity.

Answer:

[(i) A's Capital A/c - balance b/d 2,25,00

(ii) A's Loan A/c — Total as on

2012-13 — ₹2,58,750];

2013-14 — ₹1,29,375]

6. X, Y and Z are in partnership sharing Profits and Losses in the ratio 2:2:1. Partnership deed provides that all the partners are entitled to interest @ 9% per annum on fixed capital of ₹ 10,00,000 contributed in profit sharing ratio. Z is entitled for 10% commission of net profit after such commission, for special performance. On 1/9/2014, it was decided to retire X on health grounds and admit A, the son of X as partner with 1/5th share in Profit and Loss. Other decisions taken on this date were as follows:

- (i) Firm's fixed capital to be raised to ₹ 15,00,000 and partners to maintain fixed capital in profit sharing ratio and, interest on capital shall be paid @ 10% per annum from 1/9/2014.
- (ii) No commission to be paid to Z from 1/9/2014.
- (iii) Goodwill is assessed at ₹ 3,00,000.
 - (iv) X was paid ₹ 2,50,000 in cash on retirement.
 - (v) Balance claim payable to X was to be credited to A's fixed capital account and current account.
 - (vi) Profit for the accounting year 2014-15 before interest on capital, Z's commission was ₹ 9,00,000.

You are required to prepare:

- (i) Profit and Loss Appropriation Account of the firm for the year ended 31st March, 2015.
- (ii) Partners Current Accounts.

Answer:

[(i) P&L Appropriation A/c total as on 31.03.2015 — ₹ 5,25,000.

7. Ram, Rahim and Robert are partners in a firm sharing profit and losses in the proportion of 3:3:2. Their Balance Sheet as on 31.03.2013 was as follows:

| Liabilities | ₹ | | Assets | ₹ |
|----------------------------|----------|----------|-------------------|----------|
| Partners Capital Accounts: | | | Bank | 55,000 |
| Ram | 75,000 | | Stock | 69,000 |
| Rahim | 75,000 | | Investments | 6,000 |
| Robert | 1,00,000 | 2,50,000 | Debtors | 70,000 |
| Partners Current Account: | | | Land and Building | 1,25,000 |
| Ram | 15,000 | | Goodwill | 25,000 |
| Rahim | 25,000 | | | |
| Robert | 12,500 | 52,500 | | |
| Sundry Creditors | | 47,500 | | |
| | | 3,50,000 | | 3,50,000 |

They decided to dissolve the firm on 01.04.2013. They report the result of realization as follows:

| | | |
|-------------------|--------|----------------------|
| Land and Building | 90,000 | Realized in cash |
| Debtors | 60,000 | Realized in cash |
| Investments | 5,500 | Taken over by Ram |
| Stock | 75,500 | Taken over by Rahim |
| Goodwill | 18,000 | Taken over by Robert |

The realization expenses amounted to ₹ 2,000. Close the accounts of the firm.

Answer:

[Loss transferred to current A/c —

Ram — ₹ 18,000;

Rahim — ₹ 18,000;

Robert — ₹ 12,000.]

Study Note - 7

SELF BALANCING LEDGER



This Study Note includes

7.1 Self Balancing Ledger

7.1. SELF BALANCING LEDGER

Under Self Balancing Ledger system each ledger is prepared under double entry system and a complete trial balance can also be prepared by taking up the balances of ledger accounts. Within the ledger itself principles of double entry is completed. Under this method three ledger accounts are prepared, viz, General Ledger Adjustment Account which is maintained under Debtors Ledger and Creditors Ledger and Debtors or Sales Ledger Adjustment Account and Creditors or Purchase Ledger Adjustments Accounts which are maintained under General Ledger.

The use of these ledgers are:

Debtors Ledger: It is also known as Sold Ledger or Sales Ledger which is maintained for recording personal accounts of trade debtors. If this ledger is maintained customers account (i.e., to whom we sell goods on credit) are taken out from the general ledger and the same is maintained in this ledger. In short, this ledger deals with account relating to trade debtors.

Creditors Ledger: It is also known as Bought Ledger or Purchase Ledger which is prepared for recording personal accounts of trade creditors. By preparing this ledger creditors account (i.e., from whom we purchase goods on credit) are taken out from the general ledger and the same is maintained in this ledger. In short, this ledger deals with accounts relating to trade creditors.

General or Nominal Ledger: Needless to say that in this ledger all real accounts, nominal accounts and remaining personal accounts are opened for example:

Personal Account: Drawings, Capital, Bank, Outstanding Salary etc.

Real Account: Plant & Machinery, Land & Building, B/R, Stock, etc.

Nominal Account: Salaries, Rent, Insurance, Carriage etc.

Preparation of Trial Balance

By taking up the balances from all the three ledgers a trial balance can be prepared. We cannot prepare a trial balance from any single ledger. e.g., a trial balance cannot be prepared by taking up only the balances from debtor's ledger as it has no credit balance and so also in case of creditor's ledger as it has no debit balance. Moreover, In case of errors it becomes very difficult to locate and detect such error or errors if the trial balance is prepared by taking up either from debtors ledger only or from creditors ledger only and at the same time trial balance will not agree. Thus, the system under which each ledger is made to balance is called self-balancing system. It must be remembered that the ledger which does not balance scrutiny of the same is practically very limited.

Advantages of Self-Balancing System.

The advantages of Self-Balancing system are:

- (a) If ledgers are maintained under self-balancing system it becomes very easy to locate errors.
- (b) This system helps to prepare interim account and draft final accounts as a complete trial balance can be prepared before the abstraction of individual personal ledger balances.
- (c) Various works can be done quickly as this system provides sub-division of work among the different employees.
- (d) This system is particularly useful (i) where there are a large number of customers or suppliers and (ii) where it is desired to prepare periodical accounts.

- (e) Committing fraud is minimized as different ledgers are prepared by different clerks.
- (f) Internal check system can be strengthened as it becomes possible to check the accuracy of each ledger independently.

Entries in Sales or Debtors Ledger

Two types of entries are recorded, one the usual double entry and the other is self-balancing entry. Naturally, when a transaction occurs, the normal entry is to be recorded under double entry principle i.e., one account that is related to debtors/customers and the other is related to general ledger. But under self-balancing system, the entries are recorded for the adjustment account and that is why, the entries are recorded with the periodical total of Sales Day Book, Return Inward Book etc.

So, accounts which are recorded to debtors will be passed through Debtors Ledger Adjustment Account and the others are passed through General Ledger Adjustment Account.

| | Transaction | Usual Entry | Self-Balancing Entry |
|----|---|---|--|
| 1. | For Credit Sales | Individual Customer A/c Dr. (in Debtors Ledger) To, Sales A/c (in General Ledger) | Debtors Ledger Adjustment A/c Dr. (in General Ledger) To, General Ledger Adjustment A/c (in Debtors Ledger) |
| 2. | For Cash/Cheque received from customers | Cash A/c Dr. (in General Ledger) To, Individual Customer A/c (in Debtors Ledger) | General Ledger Adjustment A/c Dr. (in Debtors Ledger) To, Debtors Ledger Adjustment A/c (in General Ledger) |
| 3. | For Discount Allowed or allowance to customers | Discount Allowed A/c Dr. Or, Allowances A/c Dr. (in General Ledger) To, Individual Customer A/c (in Debtors Ledger) | Do |
| 4. | For Bad Debts | Bad Debts A/c Dr. (in General Ledger) To, Individual Customer A/c (in Debtors Ledger) | Do |
| 5. | For Bills Receivable received from customers | Bills Receivable A/c Dr. (in General Ledger) To, Individual Customer A/c (in Debtors Ledger) | Do |
| 6. | For Returns Inward | Returns Inward A/c Dr. (in General Ledger) To, Individual Customer A/c (in Debtors Ledger) | Do |
| 7. | For Bills/Cheques Received /Dishonoured | Individual Customer A/c Dr. (in Debtors Ledger) To, Bills Receivable/Bank A/c (in General Ledger) | Debtors Ledger Adjustment A/c Dr. (in General Ledger) To, General Ledger Adjustment A/c (in Debtors Ledger) |
| 8. | For interest on Customer's overdue account or cost of carriage charged to Customers | Individual Customer A/c Dr. (in Debtors Ledger) To, Interest/ Charges A/c (in General Ledger) | |



Op. Dt = Opening date of the accounting period

Cl. Dt = Closing date of the accounting period

Proforma

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|--------|---|--------|--------|--|--------|
| Op. Dt | To, Balance b/d | ** | Op. Dt | By, Balance b/d (if any) | ** |
| Cl. Dt | “ General Ledger Adjustment A/c Credit Sales | ** | Cl. Dt | “ General Ledger Adjustment A/c: | |
| | “ Carriage and Sundry Charges Debited to customer- | ** | | “ Cash/ Cheque received | ** |
| | “ Bills Receivable Dishonoured | ** | | “ Bad Debts | ** |
| | “ Cheque received and dishonoured | ** | | “ Return Inward | ** |
| | “ Interest and Charges etc. | ** | | “ Discount Allowed | ** |
| | “ Refund- Cash paid to customers | ** | | “ Other Allowances | ** |
| | “ B/R discounted and dishonoured | ** | | “ Bills Receivable | ** |
| | “ B/R endorsed and dishonoured | ** | | “ Transfer to or from other Ledgers | ** |
| | “ Interest charged to overdue account | ** | | | |
| | “ Balance c/d (if any) | ** | | “ Balance c/d | ** |
| | | ** | | | ** |

In the Debtors Ledger

Dr. General Ledger Adjustment Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|--------|---|--------|--------|---|--------|
| Op. Dt | To, Balance b/d (if any) | ** | Op. Dt | By, Balance b/d (if any) | ** |
| Cl. Dt | “ Debtors / Sold Ledger Adjustment A/c | | Cl. Dt | “ Debtors /Sold Ledger Adjustment A/c: | |
| | “ Cash/ Cheque received | ** | | “ Carriage and Sundry Charges | ** |
| | “ Bad Debts | ** | | “ Bills Receivable Dishonoured | ** |
| | “ Returns Inward | ** | | “ Cheque received and dishonoured | ** |
| | “ Discount Allowed | ** | | “ Interest and Charges etc. | ** |
| | “ Other Allowance | ** | | “ Refund-Cash paid paid to customers | ** |
| | “ Bills Receivable | ** | | “ B/R discounted and dishonoured | ** |
| | “ Transfer to or from other Ledger | ** | | “ B/R endorsed and dishonoured | ** |
| | | | | “ Interest charged to overdue account | ** |
| | “ Balance c/d | ** | | “ Balance c/d (if any) | ** |
| | | ** | | | ** |

Note: Self –balancing entries will only be made for those transactions which affect two ledgers. Naturally, if a transaction occurs which affects the same ledger (in both sides), say, general ledger, no entry is to be required. For example, Cash Sales, which actually affect two sides of general ledger, is not to be recorded. For the same reason, Provision/Reserve for bad debts, Recovery of bad debts, Trade Discount, Bills Receivable discounted or matured etc. will not appear at all.

Illustration 1.

From the following information prepare (1) Debtors Ledger Adjustment Account in the General Ledger, and (2) General Ledger Adjustment Account in the Debtors Ledger:

| Particulars | Amount ₹ |
|---|-------------|
| Opening balance of Sundry Debtors | 40,000 |
| | 2,000 |
| Cash and cheques receipts | 1,60,000 |
| Credit Sales as per Sales Day Book | 2,00,000 |
| Discount Allowed | 6,000 |
| Returns Inward | 4,000 |
| Bad Debts | 3,000 |
| Bills Receivable Received | 20,000 |
| Bills Receivable Discounted | 2,000 |
| Provision for Bad Debts | 2,000 |
| Closing Credit Balance of Sundry Debtors | 6,000 |
| Transfer from Debtors Ledger to Creditors Ledger | 1,000 |
| Transfer from Creditors Ledgers to Debtors Ledger | 1,200 |

Solution :

In the books of
In the General Ledger
Debtors Ledger Adjustment Account

Dr.**Cr.**

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|------|------------------|-------------|------|------------------------------|-------------|
| ? | To Balance b/d | 40,000 | ? | By Balance b/d | 2,000 |
| | „ General Ledger | | | „ General Ledger (Dr.) | |
| | Adjustment A/c— | | | Adjustment A/c— (Cr.) | |
| | Credit Sales | 2,00,000 | | Cash and Cheques | 1,60,000 |
| | „ Balance c/d | 6,000 | | Returns Inward | 4,000 |
| | | | | Discount Allowed | 6,000 |
| | | | | Bad Debts | 3,000 |
| | | | | Bills Receivable | 20,000 |
| | | | | Transfer to Cr. Ledger | 1,000 |
| | | | | „ Transfer from Creditors to | |
| | | | | Debtors Ledger | 1,200 |
| | | | | „ Balance c/d | 48,800 |
| | | 2,46,000 | | | 2,46,000 |
| ? | To Balance b/d | 48,800 | ? | By Balance b/d | 6,000 |



**In the Debtors Ledger
General Ledger Adjustment Account**

Dr.

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|------|---|-------------|------|-------------------|-------------|
| ₹ | To Balance b/d | 2,000 | ₹ | By Balance b/d | 40,000 |
| | .. Debtors Ledger | | | .. Debtors Ledger | |
| | Adjustment A/c — | | | Adjustment A/c— | |
| | Cash and Cheques | 1,60,000 | | Credit Sales | 2,00,000 |
| | Returns Inward | 4,000 | | .. Balance c/d | 6,000 |
| | Discount Allowed | 6,000 | | | |
| | Bad Debts | 3,000 | | | |
| | Bills Receivable | 20,000 | | | |
| | Transfer to Cr. Ledger | 1,000 | | | |
| | .. Transfer from Creditors to Debtors Ledger | 1,200 | | | |
| | .. Balance c/d | 48,800 | | | |
| | | 2,46,000 | | | 2,46,000 |
| ₹ | To Balance b/d | 6,000 | ₹ | By Balance b/d | 48,800 |

Illustration 2.

Samaresh keeps his ledger on self-balancing system. From the following particulars, you are required to write-up the individual Debtors' Account and the General Ledger Adjustment Account (in Sales ledger) during the month of January 2013:

(i) Individual Debtor's balances on 1.1.2013;

A - ₹1,530; B - ₹1,620; C - ₹1,890; and D - ₹1,170;

(ii) Transactions during the month:

Jan 2. Sold goods to A ₹ 1,710;

9. Received from B on account ₹ 300;

11. Received from A ₹ 1,500 in full settlement of his balance on 1.1.2013;

12. Sold goods to B ₹ 600;

14. B returned goods which were damaged-in-transit amounting to ₹ 180;

18. Received from C ₹ 1,800 and allowed him discount ₹ 90;

19. Received from A, a bill of exchange for ₹ 1,200 accepted by X payable on 25th January;

22. Received from B ₹ 900;

25. A's bill returned dishonoured;

28. D became insolvent and 30 paise in the rupee was received from his estate in full and final settlement;

30. Sold goods to C ₹ 1,020.

Solution :

In the books of Samarash
In Sales Ledger
Debtors Ledger Adjustment Account

| Dr. | | | Cr. | | |
|-----------------|--|--|---|---|--|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 31 | To Sales Ledger Adj. A/c Cash Dis. Allowed Returns Inward B/R Bad Debts ,, Balance c/d | 4,851 120 180 1,200 819 3,570 | 2013 Jan. 1 Jan. 31 Feb. 1 | By Balance b/d ,, Sales Ledger Adj. A/c- Sales B/R Dishonoured By Balance b/d | 6,210 3,330 1,200 10,740 3,370 |
| | | 10,740 | | | 10,740 |
| | | | | | 3,370 |

A Account

| Dr. | | | Cr. | | |
|---------------------------------|--|-------------------------|---|--|-------------------------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 1 ,, 2 ,, 25 | To Balance b/d ,, Sales ,, B/R Dishonoured | 1,530 1,710 1,200 | 2013 Jan. 11 ,, ,, 19 ,, 31 | By Cash ,, Dis. Allowed ,, B/R ,, Balance c/d | 1,500 30 1,200 1,710 |
| | | 4,440 | | | 4,440 |

B Account

| Dr. | | | Cr. | | |
|-------------------------|----------------------------|--------------|---|--|--------------------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 1 ,, 12 | To Balance b/d ,, Sales | 1,620 600 | 2013 Jan. 9 ,, 14 ,, 22 ,, 31 | By Balance b/d ,, Returns Inward ,, Cash ,, Balance c/d | 300 180 900 840 |
| | | 2,220 | | | 2,220 |

C Account

| Dr. | | | Cr. | | |
|-------------------------|----------------------------|----------------|--------------------------------|--|----------------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 1 ,, 31 | To Balance b/d ,, Sales | 1,890 1,020 | 2013 Jan. 18 ,, ,, 31 | By Cash ,, Dis. Allowed ,, Balance c/d | 1,800 90 1,020 |
| | | 2,910 | | | 2,910 |



D Account

Dr.

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------------|----------------|-------------|-----------------|-------------|-------------|
| 2013 Jan. 1 | To Balance b/d | 1,170 | 2013 Jan. 28 | By Cash | 351 |
| | | 1,170 | | „ Bad Debts | 819 |
| | | | | | 1,170 |

Workings:

| | | | |
|-----|--|-----------|--|
| (a) | Total Debtors' balance as on 1.1.2013 | = A+B+C+D | = ₹ 1,530+₹ 1,620+₹ 1,890+ ₹ 1,170 = ₹ 6,210 |
| (b) | Total Sales | = A+B+C | = ₹ 1,710+₹ 600+₹ 1,020 = ₹ 3,330 |
| (c) | Total Cash Received | = A+B+C+D | = ₹ 300+₹ 1,500+₹ 1,800+ ₹ 900+ ₹ 351 = ₹ 4,851 |
| (d) | Total Discount Allowed | = A+C | = ₹ 30+₹ 90 = ₹ 120 |
| (e) | Returns Inward | = B | = ₹ 180 |
| (f) | Bad Debts | = D | = ₹ 819 |
| (g) | B/R Dishonoured | = A | = ₹ 1,200 |
| (h) | Total Debtors' balance as on 31 st January, 2013. | = A+B+C | = ₹ 1,710+₹ 840+₹ 1,020 = ₹ 3,570 |

Illustration 3.

The summarized analysis of the accounts of the outstanding debtors of a firm at the date of the annual closing of amount as under:

| Debtors | Goods Sold during the year ₹ | Goods returned during the year ₹ | Cash & cheque received during the year ₹ | Discount allowed during the year ₹ | Bill of exchange received during the year ₹ |
|---------|------------------------------------|--|---|--|--|
| P | 3,000 | --- | 2,000 | 500 | --- |
| Q | 2,000 | 500 | 1,000 | --- | --- |
| R | 5,000 | --- | 3,000 | --- | --- |
| S | 10,000 | 1,000 | 6,000 | 500 | 1,000 |
| T | 12,000 | 1,500 | 8,000 | 1,000 | 1,000 |

Debtors' balance at the beginning of the year was ₹ 4,500. Out of the above receipts of a bill for ₹ 700 given by S was dishonoured, noting charges amounting to ₹ 20. Prepare Debtors Ledger Adjustment Account in General Ledger and General Ledger Adjustment Account in Debtors Ledger.

Solution :

In the General Ledger
Debtors Ledger Adjustment Account

| Dr. | | Amount | | | Amount | Cr. |
|------|----------------------------------|--------|------|----------------------------------|--------|--------|
| Date | Particulars | ₹ | Date | Particulars | ₹ | |
| ? | To Balance b/d | 4,500 | ? | By General Ledger Adjustment A/c | | |
| | ,, General Ledger Adjustment A/c | | | Cash & Cheque Received | 20,000 | |
| | Sales | 32,000 | | Returns Inwards | 3,000 | |
| | B/R Dishonoured | 700 | | Discount Allowed | 2,000 | |
| | Charges | 20 | | B/R | 2,000 | |
| | | | | ,, Balance c/d | 10,220 | |
| | | 37,220 | | | | 37,220 |
| | ,, Balance b/d | 10,220 | | | | |

In Debtors Ledger
General Ledger Adjustment Account

| Dr. | | Amount | | | Amount | Cr. |
|------|----------------------------------|--------|------|-----------------------------------|--------|--------|
| Date | Particulars | ₹ | Date | Particulars | ₹ | |
| ? | To Debtors Ledger Adjustment A/c | | ? | By Balance b/d | 4,500 | |
| | Cash & Cheque Received | 20,000 | | ,, Debtors' Ledger Adjustment A/c | | |
| | Returns Inwards | 3,000 | | Sales | 32,000 | |
| | Discount Allowed | 2,000 | | B/R Dishonoured | 700 | |
| | B/R | 2,000 | | Charges | 20 | |
| | ,, Balance c/d | 10,220 | | | | |
| | | 37,220 | | ,, Balance b/d | 10,220 | |
| | | | | | | 37,220 |

Workings:

Sales = ₹ 3,000 + ₹ 2,000 + ₹ 5,000 + ₹ 10,000 + ₹ 12,000 = ₹ 32,000

Returns Inward = ₹ 500 + ₹ 1,000 + ₹ 1,500 = ₹ 3,000

Discount Allowed = ₹ 500 + ₹ 500 + ₹ 1,000 = ₹ 2,000

B/R = ₹ 1,000 + ₹ 1,000 = ₹ 2,000

Cash & Cheque Received = ₹ 2,000 + ₹ 1,000 + ₹ 3,000 + ₹ 6,000 + ₹ 8,000
= ₹ 20,000



Contra Transaction or Adverse Balance

Sometimes it may happen that debtors ledger shows a credit balance and creditor ledger shows a debit balance i.e., the adverse balance of debtors ledger and creditors ledger. Usually, credit, balance in debtors ledger may happen on account of advance taken from creditors or allowances given to customers for different products after closing the accounts. Similarly, debit balance in creditors ledger may appear on account of excess payment made or goods returned to creditors after closing the accounts etc. Thus, these contra transactions are to be adjusted. But, student must remember that credit balance in one ledger must not be set off against debit balance of another ledger. These should be treated separately.

Entries in Purchases or Creditors Ledger

In this ledger also two types of entries are to be passed viz; one deals with creditors ledger and the other deals with general ledger. At the same time, self-balancing entries should be made for adjustment accounts accordingly. Like Debtors ledger entries to be recorded with periodical total of Purchase Day Book; Returns Outward Book etc.

The entries to be made are:

| | Transaction | Usual Entry | Self-Balancing Entry |
|----|---|---|--|
| 1. | For Credit Purchases | Purchase A/c Dr. (in General Ledger) To, Creditors A/c (in Creditors Ledger) | General Ledger Adjustment A/c Dr. (in Creditors Ledger) To, Creditors Ledger Adjustment A/c (in General Ledger) |
| 2. | For Cash paid to Creditors | Creditors A/c Dr. (in Creditors Ledger) To, Cash A/c (in General Ledger) | Creditors Ledger Adjustment A/c Dr. (in General Ledger) To, General Ledger Adjustment A/c (in Creditors Ledger) |
| 3. | For Discount Received from Creditors | Creditors A/c Dr. (in Creditors Ledger) To, Discount Received A/c (in General Ledger) | Do |
| 4. | For Bills Accepted in favour of Creditors | Creditors A/c Dr. (in Creditors Ledger) To, Bills Payable A/c (in General Ledger) | Do |
| 5. | For Purchases Return | Creditors A/c Dr. (in Creditors Ledger) To, Returns Outward A/c (in General Ledger) | Do |
| 6. | For Bills Payable Dishonoured | Bills Payable A/c Dr. (in General Ledger) To, Creditors A/c (in Creditors Ledger) | General Ledger Adjustment A/c Dr. (in Creditors Ledger) To, Creditors Ledger Adjustment A/c (in General Ledger) |
| 7. | For Interest and Charges charged by Creditors | Interest / Charges A/c Dr. (in General Ledger) To, Creditors A/c (in Creditors Ledger) | Do |

In General Ledger

Dr. Creditors Ledger Adjustment Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|--------|---------------------------------|--------|--------|----------------------------------|--------|
| 2013 | | | 2013 | | |
| Jan. 1 | To, Balance b/d | ** | Jan.1 | By Balance b/d (if any) | ** |
| Dec.31 | “ General Ledger Adjustment A/c | | Dec.31 | “ General Ledger Adjustment A/c: | |
| | “ Cash Paid | ** | | “ Credit Purchases | ** |
| | “ Bills Payable Accepted | ** | | “ Bills Payable Dishonoured | ** |
| | “ Discount Received | ** | | “ Interest and Charges | ** |
| | “ Returns Outward | ** | | “ Balance c/d(if any) | ** |
| | “ Balance c/d | ** | | | |
| | | ** | | | ** |

In the Creditors Ledger

Dr. General Ledger Adjustment Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|--------|--|--------|--------|--|--------|
| 2013 | | | 2013 | | |
| Jan.1 | To, Balance b/d | ** | Jan.1 | By, Balance b/d (if any) | ** |
| Dec.31 | “ Creditors/Bought Ledger Adjustment A/c | | Dec.31 | “ Creditors/Bought Ledger Adjustment A/c | |
| | “ Credit Purchases | ** | | “ Cash Paid | ** |
| | “ Bills Payable Dishonoured | ** | | “ Bills Payable Accepted | ** |
| | “ Interest and Charges | ** | | “ Discount Received | ** |
| | “ Balance c/d | ** | | “ Returns Outward | ** |
| | | ** | | “ Balance c/d(if any) | ** |
| | | ** | | | ** |

Illustration 4.

Prepare the Creditors Ledger Adjustment Account as it would appear in General Ledger and General Ledger Adjustment Account as it would appear in Creditors Ledger for the year ended 31st March 2013 from the following particulars.

| Particulars | ₹ | Particulars | ₹ |
|---|--------|---|-------|
| Sundry Creditors (on 1.4.2012) (Cr.) | 10,000 | Bills Payable issues during the year | 4,000 |
| (Dr.) | 1,000 | Bills Payable dishonoured | 2,000 |
| Purchases (including Cash Purchase of ₹ 10,000) | 50,000 | Bills Payable renewed | 1,000 |
| Returns Outward | 2,000 | Interest on Bills Payable renewed | 100 |
| Cash paid to Creditors | 20,000 | Sundry Charges paid for dishonor of Bills Payable | 100 |
| Discount allowed by Creditors | 3,000 | Total of set-off in Debtors Ledger | 3,000 |
| Trade Discount | 1,000 | Sundry Creditors (on 31.3.2013) (Dr.) | 4,000 |
| Bills Receivable endorsed to Creditors | 2,000 | | |



Solution:

**In the General Ledger
Creditors Ledger Adjustment Account**

| Dr. | | | Cr. | | |
|-------------------|--------------------------------------|---------------|-------------------|------------------------------------|---------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 2012 April 1 | To Balance b/d | 1,000 | 2012 April 1 | By Balance b/d | 10,000 |
| 2013 March. 31 | " General Ledger Adjustment A/c : | | 2013 March. 31 | General Ledger Adjustment A/c : | |
| | Returns Outward | 2,000 | | Purchase | 40,000 |
| | Cash and cheques | 20,000 | | Bills Payable dishonoured | 2,000 |
| | Discount Received | 3,000 | | Interest | |
| | Bills receivable | 2,000 | | Sundry Charges | 100 |
| | Bills Payable | 4,000 | | " Balance c/d | 100 |
| | Bills Payable (renewed) | 1,000 | | | 4,000 |
| | Transfer | 3,000 | | | |
| | " Balance c/d | 20,200 | | | |
| | | 56,200 | | | 56,200 |
| 2013 April 1 | To Balance b/d | 4,000 | 2013 April 1 | By Balance b/d | 20,200 |

**In the Creditors Ledger
General Ledger Adjustment Account**

| Dr. | | | Cr. | | |
|------------------|--|--------|------------------|--|--------|
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2012 April 1 | To Balance b/d | 10,000 | 2012 April 1 | By Balance b/d | 1,000 |
| 2013 March 31 | " Creditors Ledger Adjustment A/c : | | 2013 March 31 | " Creditors Ledger Adjustment A/c : | |
| | Purchase | 40,000 | | Returns Outward | 2,000 |
| | Bills Payable dishonoured | 2,000 | | Cash | 20,000 |
| | Interest | 100 | | Discount Received | 3,000 |
| | Sundry Charges | 100 | | Bills receivable | 2,000 |
| | " Balance c/d | 4,000 | | Bills Payable | 4,000 |
| | | | | Bills Payable (renewed) | 1,000 |
| | | | | Transfer | 3,000 |
| | | | | " Balance c/d | 20,200 |
| | | 56,200 | | | 56,200 |
| 2013 April 1 | To Balance b/d | 20,200 | 2013 April 1 | By Balance b/d | 4,000 |

TRANSFER ENTRIES

Sometimes a person may be treated both as a debtor as well as a creditor to the firm. In other words the firm purchase goods from him and also it sells goods to him. Under the circumstances, the lower of the amount payable to and receivable from such person is to be set-off. The so called set-off amount is to be deducted both from the debtors as well as from the creditors. This is known as transfer entry.

The entry for this purpose will be Creditors Account debited and Debtors Account credit. As a result of this transfer both debtors ledger and creditors ledger together with general ledger are affected. For example, debtors include ₹ 10,000 due from Mr. A whereas Creditor include ₹ 8,000 due to Mr. A.

| Usual entry is | | ₹ | ₹ |
|---------------------------------|------------------------------|-------|-------|
| (a) A (in Creditors Ledger) A/c | Dr. | 8,000 | |
| | To A (in Debtors ledger) A/c | | 8,000 |

Under Self-balancing, the entry will be

| | | | |
|-------------------------------------|----------------------------------|-------|-------|
| (a) Creditors Ledger Adjustment A/c | Dr. | 8,000 | |
| | To General Ledger Adjustment A/c | | 8,000 |
| (b) General Ledger Adjustment A/c | Dr. | 8,000 | |
| | To Debtors Ledger Adjustment A/c | | 8,000 |
| Or | | | |

Direct Entry:

| | | | |
|---------------------------------|----------------------------------|-------|-------|
| Creditors Ledger Adjustment A/c | Dr. | 8,000 | |
| | To Debtors Ledger Adjustment A/c | | 8,000 |

Illustration 5.

X Ltd. furnished the following particulars:

Debtors ledger include ₹ 5,000 due from Sen & Co. whereas creditors ledger include ₹ 3,000 due to Sen & Co.

Solution:**In the books of X Ltd.****Journal (without narration)**

| Date | Particulars | L/F | Amount ₹ | Amount ₹ |
|------|---|-----|-------------|-------------|
| ? | Creditors Ledger Adjustment A/c To General ledger Adjustment A/c | Dr. | 3,000 | 3,000 |
| | General Ledger Adjustment A/c To Debtors Ledger Adjustment A/c | Dr. | 3,000 | 3,000 |
| | <u>or Direct Entry</u> | | | |
| | Creditors Ledger Adjustment A/c To Debtors ledger Adjustment A/c | Dr. | 3,000 | 3,000 |



General Illustrations

Illustration 6.

From the following particulars, which have been extracted from the book of G & Co., for the year ended 31.12.2013, prepare General Ledger Adjustment Account in the Creditors ledger and Debtors Ledger Adjustment Account in the General Ledger:

| Particulars | | Amount |
|---|-----|--------|
| | | ₹ |
| Debtors balance (1.1.2013) | Dr. | 20,000 |
| | Cr. | 300 |
| Creditors balance (1.1.2013) | Dr. | 200 |
| | Cr. | 15,000 |
| Purchases (including Cash ₹ 4,000) | | 12,000 |
| Sales (including Cash ₹ 6,000) | | 25,000 |
| Cash paid suppliers in full settlement of claims of ₹ 9,000 | | 8,500 |
| Cash received from customers in full settlement of claims of ₹ 15,000 | | 14,100 |
| Bills payable accepted (including renewals) | | 2,000 |
| Bills Payable withdrawn upon renewals | | 500 |
| Interest on Bills Payable renewed | | 20 |
| Bills Receivable received | | 3,000 |
| Bills Receivable endorsed | | 800 |
| Bills Receivable as endorsed dishonoured | | 300 |
| Bills Receivable discounted | | 1,400 |
| Bills Receivable dishonoured | | 400 |
| Interest charged on dishonoured bills | | 30 |
| Transfer from one ledger to another ledger | | 600 |
| Returns (Cr.) | | 700 |
| Debtors balance (31.12.2013) Cr. | | 450 |
| Creditors balance (31.12.2013) Dr. | | 10,870 |

Solution :

In the books of G & Co.
In the Creditors Ledger
General Ledger Adjustment Account

| Dr. | | | Cr. | | |
|----------------|--|-------------|----------------|--|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 1 | To Balance b/d | 15,000 | 2013 Jan. 1 | By Balance b/d | 200 |
| Dec. 31 | „ Creditors Ledger Adjustment A/c: Purchases | 8,000 | Dec. 31 | Creditors Ledger Adjustment A/c Cash | 8,500 |
| | Bills Payable Withdrawn | 500 | | Discount Received (9,000 – 8,500) | 500 |
| | Bills Receivable | 300 | | Returns Outward | 700 |
| | Dishonoured (as endorsed) | 20 | | Bills Payable | 2,000 |
| | Interest | 20 | | Bills Receivable endorsed | 800 |
| | „ Balance c/d | 350 | | Transfer | 600 |
| | | 24,170 | | „ Balance c/d | 10,870 |
| | To Balance b/d | 10,870 | | | 24,170 |
| 2014 Jan. 1 | | | 2014 Jan. 1 | By Balance b/d | 350 |

In the General Ledger
Debtors Ledger Adjustment Account

| Dr. | | | Cr. | | |
|----------------|--|-------------|----------------|---------------------------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 Jan. 1 | To Balance b/d | 20,000 | 2013 Jan. 1 | By Balance b/d | 300 |
| Dec. 31 | General Ledger Adjustment A/c: Sales | 19,000 | Dec. 31 | „ General Ledger Cash | 14,100 |
| | B/R endorsed | 300 | | Discount Allowed (15,000 – 14,100) | 900 |
| | Dishonoured | 400 | | Bills Receivable Received | 3,000 |
| | Bills Dishonoured | 30 | | Transfer | 600 |
| | Interest | 450 | | „ Balance c/d | 21,280 |
| | „ Balance c/d | 40,180 | | | 40,180 |
| 2014 Jan. 1 | To Balance b/d | 21,280 | 2014 Jan. 1 | By Balance b/d | 450 |



Illustration 7.

The following information is avail from the books of the trader for the period 1st Jan. to 31st March 2013:

- (1) Total Sales amounted to ₹70,000 including the sale of old furniture for ₹10,000(book value is ₹12,300). The total cash sales were 80% less than total credit sales.
- (2) Cash collection from Debtors amounted to 60% of the aggregated of the opening Debtors and Credit sales for the period. Discount allowed to them amounted to ₹2,600
- (3) Bills receivable drawn during the period totaled ₹7,000 of which bills amounting to ₹3,000 were endorsed in favour of suppliers.Out of these endorsed bills, a Bill receivable for ₹ 1,600 was dishonoured for non-payment, as the party became insolvent and his estate realized nothing.
- (4) Cheques received from customer of ₹5,000 were dishonoured; a sum of ₹500 is irrecoverable.
- (5) Bad Debts written-off in the earlier year realized ₹ 2,500.
- (6) Sundry debtors on 1st January stood at ₹40,000.

You are required to show the Debtors Ledger Adjustment Account in the General Ledger.

Solution.

In the General Ledger Debtors Ledger Adjustment Account

Dr.

Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------|---------------------|------------|----------|-------------------|------------|
| 2013 | | | 2013 | | |
| Jan 1 | To Balance b/d | 40,000 | Jan 1 | By General Ledger | |
| March 31 | “ General Ledger | | March 31 | Adjustment A/c : | |
| | Adjustment A/c : | | | Cash | 54,000 |
| | - Sales | 50,000 | | Discount Allowed | 2,600 |
| | -Bills Receivable | 1,600 | | Bills Receivable | 7,000 |
| | Dishonoured | | | Bad Debts | 2,100 |
| | -Cheque Dishonoured | 5,000 | | “ Balance c/d | 30,900 |
| | | 96,600 | | | 96,600 |
| April 1 | To Balance b/d | 30,900 | | | |

Workings:

1. Computation of Credit Sales

Cash Sales were 80% less than Credit Sales. So, if credit sales are ₹ 100 Cash Sales will be ₹ 20; Total Sales (Cash+Credit) will be ₹120. Total Sales (₹ 70,000 - ₹ 10,000) = ₹ 60,000

$$\text{Amount of Credit sales will be } \frac{\text{₹}60,000 \times 100}{120} = \text{₹}50,000$$

2. Cash received

Cash received is 60% of opening Debtors plus Credit sales i.e. ₹40,000 + ₹50,000 = ₹90,000

$$\text{Cash Received } \text{₹}90,000 \times \frac{60}{100} = \text{₹}54,000$$

EXERCISE:

1. MR. ANUBHAV GOYAL keeps his ledger on Self Balancing System.

The following particulars are extracted from his Books:

| Date | Particulars |
|-------------|---|
| March, 2015 | |
| 1 | Purchased from Mr. Akash ₹ 7,500. |
| 3 | Paid ₹ 3,000 after adjusting the initial advance in full to Mr. Akash. |
| 10 | Paid ₹ 2,500 to Mr. Dev towards the purchases made in February in full. |
| 12 | Paid advance to Mr. Giridhar ₹ 6,000. |
| 14 | Purchased goods from Mr. Akash ₹ 6,200. |
| 20 | Returned goods worth ₹ 1,000 to Mr. Akash |
| 24 | Settled the balance due to Mr. Akash at a discount of 5%. |
| 26 | Goods purchased from Mr. Giridhar against the advance paid already. |
| 29 | Purchased from Mr. Nathan ₹ 3,500. |

Goods return to Mr. Prem ₹ 1,200. The goods were originally purchased for cash in the month of February, 2015. You are required to prepare the Creditors Ledger Adjustment Account as would appear in General Ledger for the month of March, 2015.

[Answer: Balance c/d (Dr.) – 3,500]

2. Following information is available from the books of a trader from January 1 to March 31, 2011.
- Total Sales amounted to ₹ 60,000 including the sale of old furniture for ₹ 1,200 (Book Value ₹ 3,500). The total Cash Sales were 80% less than the total Credit Sales.
 - Cash collection from debtors amounted to 60% of the aggregate of the opening debtors and the Credit Sales for the period. Debtors were allowed Cash discounts for ₹ 2,600.
 - Bills Receivable drawn during the three months totalled ₹6,000 of which bills amounting to ₹ 3,000 were endorsed in favour of suppliers. Out of these endorsed B/R, a B/R for ₹ 600 was dishonoured for non-payment as the party became insolvent, his estate realizing nothing.
 - Cheques received from Sundry Customers for ₹ 6,000 were dishonoured; a sum of ₹ 500 is irrecoverable, Bad Debts written off in the earlier years realized ₹2,500.
 - Sundry Debtors, as on 1st January 2011, stood at ₹ 40,000.

You are required to show the Debtors Ledger Adjustments Accounts in the General Ledger.

[Answer: Balance c/d (Cr.) – ₹32,000]

3. Prepare Total Creditors Account for the year ended on 31.03.2013 from the data given below:

| | |
|----------------------------------|----------|
| | ₹ |
| Creditors Balance on 01.04.2012 | 38,000 |
| Credit Purchases during the year | 2,67,000 |
| Bills payable accepted | 62,000 |
| Cash paid to Creditors | 1,37,000 |
| B/R endorsed to creditors | 16,000 |
| Endorsed B/R dishonoured | 3,000 |
| B/P dishonoured | 2,000 |
| Purchase returns | 11,000 |
| Discount received | 6,000 |
| Transfer from Debtors ledger | 7,000 |

[Answer: Balance c/d (Dr.) - ₹ 71,000.]

Study Note - 8

ROYALTIES



This Study Note includes

8.1 Royalties

8.1. ROYALTIES

Introduction

The owner of an asset (e.g. mines, quarries, patent, copyright, etc), as a business arrangement, may allow other party (lessee, licensee, publisher, etc) the right to use that asset against some consideration. Such consideration is calculated with reference to the quantity produced or sold. This payment to the owner by the user of the asset is termed as **Royalty**.

We can therefore say that the royalty is the amount of consideration paid by a party to the owner of the asset in return for the right to use that asset.

For example, when a publisher publishes a book, he makes a payment to the author which is based on the number of copies sold known as royalty.

The following are some of cases where one party paid to another in the form of Royalty:

1. where the owner of a mine allows another the right to extract minerals from land;
2. where right such as patents or copyrights are licensed in favour of another;
3. where an author, artist or designer gives exclusive rights to another to copy the work.

Common terms Used in Connection with Accounting for Royalty :

1. Minimum Rent / Dead Rent

A contract is entered into between the landlord and the lessee for payment of royalty, usually calculated upon the quantum of production or sale at a certain stipulated rate.

So, if there is little or no production or sale, the landlord would receive little or no royalty at all, thus affects the monetary interest of the landlord as well as the lessee. It is normally not acceptable to the owner, since sale or production mostly depends on the capacity of the person to whom the rights have been given. To avoid such a situation, the landlord and the lessee agreed upon a minimum periodical amount that the landlord will receive from the lessee, even if the actual royalty as calculated on the basis of actual production or sale is less than such minimum amount.

This assured and mutually agreed periodical minimum amount is known as "**Minimum Rent**".

Example: Suppose royalty per ton of production is ₹ 10 and the minimum (annual) rent is ₹ 4,00,000. Now, the actual production is 35,000 tons, then actual royalty would become ₹ 3,50,000. In this case the minimum rent of ₹ 4,00,000 will have to be paid by the lessee. On the other hand, if the actual production is 46,000 tons, then the actual royalty would become ₹ 4,60,000. In this case ₹ 4,60,000 will have to be paid by the lessee.

Thus, as there is a stipulation for minimum rent, then either the minimum rent or the actual royalty whichever is more shall have to be paid by the lessee.

The minimum rent is also called dead rent, certain rent, fixed rent, etc.

2. Short workings/Redeemable Dead Rent

Short workings is the amount by which the minimum rent exceeds the actual royalty. It is the difference between Actual Rent and Minimum Rent.

In the above example, the short workings is ₹ 50,000 (₹ 4,00,000 – ₹ 3,50,000). Where there is short workings in any period the lessee is liable to pay the minimum rent and, in effect, short workings becomes the part of the minimum rent and not represented by the use of rights.

The question of short workings will arise only when there is a stipulation for minimum rent in the agreement.

3. Excess working

It refers to the amount by which the actual royalty exceeds the minimum rent. In the above example, the excess workings is ₹ 60,000 (₹ 4,60,000 – ₹ 4,00,000) if the production is 46,000 tons.

4. Ground Rent/Surface Rent

It refers to the fixed yearly or half-yearly rent payable by the lessee to the landlord in addition to the minimum rent.

5. Recoupment of Short workings

Generally the royalty agreement contains a provision for carrying forward of short workings with a view to adjust it in the future. In the subsequent years, such shortworking is adjusted against the surplus royalty. This process of adjustment is called recoupment of short workings. The right of recoupment of short workings enables the lessee to recover the excess payment, made in the earlier years to meet the condition of payment of minimum rent. A time is usually agreed upon the number of years for which such short workings can be recouped. This time limit for recoupment of short workings may be fixed or fluctuating. If the short workings cannot be recouped within the specified time, they lapse and are charged to Profit and Loss Account in the year when that specified time limit for recoupment ends.

(i) Fixed right :

When the lessee can recoup shortworkings within a certain period from the date of the lease it is known as fixed right. For example, short workings can be recouped within three years from the date of the lease. So, after three years from the date of the lease the short workings cannot be recouped.

(ii) Fluctuating right :

In this type of agreement, lessee can recoup short workings of any year during the next following year(s). For example, shortworkings can be recouped in the year subsequent to the year of short workings.

6. Strike and Lockout, etc :

If agreement so provides, the minimum rent may be proportionately reduced in the event of strike and/ or lockout. So special entry is required for the same except the adjustment of minimum rent for that particular year.

Accounting Entries in the Books of the Lessee/Licencee/Publisher etc.

1. Where a minimum rent exists with right to recoup short workings

(a) Where the actual royalty is less than the minimum rent

| | | |
|-------|---------------------------------------|---------------------------------------|
| (i) | Royalties (payable) Account | Dr. [Actual royalties for the period] |
| | Short workings Account | Dr. [Minimum rent - Actual royalties] |
| | To Landlord Account | [Minimum rent] |
| (ii) | Landlord Account | Dr. [Minimum rent] |
| | To Bank Account | [Net amount paid] |
| | To Income Tax Payable Account | [Tax deducted at source] |
| (iii) | Manufacturing / Profit & Loss Account | Dr. [Transfer] |
| | To Royalties (payable) Account | [Actual royalties for the period] |

Illustration 1.

The Bihar Coal Co. Ltd. holds a lease of coal mines for a period of twelve years, commencing from 1st April 2006. According to the lease, the company is to pay ₹ 7.50 as royalty per ton with a minimum rent of ₹ 150,000 per year. Short workings can, however, be recovered out of the royalty in excess of the minimum rent of the next two years only. For the year of a strike the minimum rent is to be reduced to 60%. The output in tons for the 6 years ending 31st March, 2012 is as under :

2006-07 :10,000; 2007-08 :12,000; 2008-09:25,000; 2009-10: 20,000; 2010-11: 50,000; and 2011-12: 15,000 (strike). Write up the necessary Ledger Accounts in the books of Bihar Coal Co. Ltd.

Solution :

In the books of Bihar Coal Co. Ltd.
Statement showing Royalty Payable

| Year | Output (Tons) | Actual Royalties | Min. Rent | Excess Short Workings | Shortworkings | | | | Fig in (₹) |
|---------|---------------|------------------|-----------|-----------------------|---------------|----------|-----------------------|---------|------------|
| | | | | | Occurred | Recouped | Written off or lapsed | C/F | Amount |
| | | | | | | | | | Payable |
| 2006-07 | 10,000 | 75,000 | 150,000 | 0 | 75,000 | 0 | 0 | 75,000 | 150,000 |
| 2007-08 | 12,000 | 90,000 | 150,000 | 0 | 60,000 | 0 | 0 | 135,000 | 150,000 |
| 2008-09 | 25,000 | 187,500 | 150,000 | 37,500 | 0 | 37,500 | 37,500 | 60,000 | 150,000 |
| 2009-10 | 20,000 | 150,000 | 150,000 | 0 | 0 | 0 | 60,000 | 0 | 150,000 |
| 2010-11 | 50,000 | 375,000 | 150,000 | 225,000 | 0 | 0 | 0 | 0 | 375,000 |
| 2011-12 | 15,000 | 112,500 | 90,000 | 22,500 | 0 | 0 | 0 | 0 | 112,500 |

Dr.**Royalties Account****Cr.**

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------|-----------------|------------|----------|----------------------|------------|
| 31.03.07 | To Landlord A/c | 75,000 | 31.03.07 | By Profit & Loss A/c | 75,000 |
| 31.03.08 | To Landlord A/c | 90,000 | 31.03.08 | By Profit & Loss A/c | 90,000 |
| 31.03.09 | To Landlord A/c | 187,500 | 31.03.09 | By Profit & Loss A/c | 187,500 |
| 31.03.10 | To Landlord A/c | 150,000 | 31.03.10 | By Profit & Loss A/c | 150,000 |
| 31.03.11 | To Landlord A/c | 375,000 | 31.03.11 | By Profit & Loss A/c | 375,000 |
| 31.03.12 | To Landlord A/c | 112,500 | 31.03.12 | By Profit & Loss A/c | 112,500 |



Dr.

Landlord Account

Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------|-----------------------|------------|----------|-----------------------|------------|
| 31.03.07 | To Bank A/c | 150,000 | 31.03.07 | By Royalties A/c | 75,000 |
| | | | | By Short workings A/c | 75,000 |
| 31.03.08 | To Bank A/c | 150,000 | 31.03.08 | By Royalties A/c | 150,000 |
| | | 150,000 | | By Short workings A/c | 90,000 |
| 31.03.09 | To Bank A/c | 150,000 | 31.03.09 | By Royalties A/c | 150,000 |
| | To Short workings A/c | 150,000 | | | 187,500 |
| | | 37,500 | | | 187,500 |
| 31.03.10 | To Bank A/c | 150,000 | 31.03.10 | By Royalties A/c | 150,000 |
| | | 150,000 | | | 150,000 |
| 31.03.11 | To Bank A/c | 375,000 | 31.03.11 | By Royalties A/c | 375,000 |
| | | 375,000 | | | 375,000 |
| 31.03.12 | To Bank A/c | 112,500 | 31.03.12 | By Royalties A/c | 112,500 |
| | | 112,500 | | | 112,500 |

Dr.

Short workings Account

Cr.

| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
|----------|-----------------|------------|----------|----------------------|------------|
| 31.03.07 | To Landlord A/c | 75,000 | 31.03.07 | By Balance c/d | 75,000 |
| | | 75,000 | | | 75,000 |
| 1.4.07 | To Balance b/d | 75,000 | 31.03.08 | By Balance c/d | 135,000 |
| 31.03.08 | To Landlord A/c | 60,000 | | | 135,000 |
| | | 135,000 | | | 135,000 |
| 1.4.08 | To Balance b/d | 135,000 | 31.03.09 | By Landlord A/c | 37,500 |
| | | 135,000 | | By Profit & Loss A/c | 37,500 |
| | | | | By Balance c/d | 60,000 |
| 1.4.09 | To Balance b/d | 60,000 | 31.03.10 | By Profit & Loss A/c | 60,000 |
| | | 60,000 | | | 60,000 |

Illustration 2.

A. Ltd. obtain from B.S. Ltd. a lease of some coal-bearing land, the terms being a royalty of ₹ 15 per ton of coal raised subject to a minimum rent of ₹ 75,000 p.a. with a right of recoupment of short-working over the first four years of the lease. From the following details, show (i) Short-working Account, (ii) Royalty Account and (iii) B.S. Ltd. Account in the books of A. Ltd.

| Year | Sales (Tons) ₹ | Closing Stock (Tons) ₹ |
|------|-------------------|---------------------------|
| 2009 | 2,000 | 300 |
| 2010 | 3,500 | 400 |
| 2011 | 4,800 | 600 |
| 2012 | 5,600 | 500 |
| 2013 | 8,000 | 800 |

Solution:**Workings:**

[Coal raised i.e., Production = Sales + Closing Stock – Opening Stock.]

| Year | Sales | + | Closing Stock | - | Opening Stock | = | Net Production |
|------|-------|---|---------------|---|---------------|---|----------------|
| 2009 | 2,000 | + | 300 | - | Nil | = | 2,300 |
| 2010 | 3,500 | + | 400 | - | 300 | = | 3,600 |
| 2011 | 4,800 | + | 600 | - | 400 | = | 5,000 |
| 2012 | 5,600 | + | 500 | - | 600 | = | 5,500 |
| 2013 | 8,000 | + | 800 | - | 500 | = | 8,300 |

In the books of A. Ltd.

Memorandum Royalty Statement

| Year | Quantity | Rate ₹ | Royalty ₹ | Minimum Rent ₹ | Short working ₹ | Recoupment ₹ | Short working carried forward ₹ | Short working Transferred to P&L A/c or lapsed ₹ | Payment to Landlord ₹ |
|------|----------|-----------|--------------|----------------------|-----------------------|-----------------|--|--|--------------------------------|
| 2009 | 2,300 | 15 | 34,500 | 75,000 | 40,500 | --- | 40,500 | --- | 75,000 |
| 2010 | 3,600 | 15 | 54,000 | 75,000 | 21,000 | --- | 61,500 | --- | 75,000 |
| 2011 | 5,000 | 15 | 75,000 | 75,000 | --- | --- | 61,500 | --- | 75,000 |
| 2012 | 5,500 | 15 | 82,500 | 75,000 | --- | 7,500 | --- | 54,000 | 75,000 |
| 2013 | 8,300 | 15 | 1,24,500 | 75,000 | --- | --- | --- | --- | 1,24,500 |



Dr.

B. S. Ltd. (Landlord) Account

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|------|-------------------------------------|-------------|------|---------------------------------------|-------------|
| 2009 | To Bank A/c | 75,000 | 2009 | By Royalty A/c " Short-working A/c | 34,500 |
| | | 75,000 | | | 40,500 |
| 2010 | To Bank A/c | 75,000 | 2010 | By Royalty A/c " Short-working A/c | 54,000 |
| | | 75,000 | | | 21,000 |
| 2011 | To Bank A/c | 75,000 | 2011 | By Royalty A/c | 75,000 |
| | | 75,000 | | | 75,000 |
| 2012 | To Bank A/c To Short-Working A/c | 75,000 | 2012 | By Royalty A/c | 82,500 |
| | | 7,500 | | | 82,500 |
| | | 82,500 | | | 82,500 |
| 2013 | To Bank A/c | 1,24,500 | 2013 | By Royalty A/c | 1,24,500 |
| | | 1,24,500 | | | 1,24,500 |

Dr.

Short-Working Account

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|------|--|-------------|------|--|-------------|
| 2009 | To B. S. Ltd. A/c (Landlord) | 40,500 | 2009 | By Balance c/d | 40,500 |
| | | 40,500 | | | 40,500 |
| 2010 | To Balance b/d " B. S. Ltd. A/c (Landlord) | 40,500 | 2010 | By Balance c/d | 61,500 |
| | | 21,000 | | | 61,500 |
| | | 61,500 | | | 61,500 |
| 2011 | To Balance b/d | 61,500 | 2011 | By Balance c/d | 61,500 |
| | | 61,500 | | | 61,500 |
| 2012 | To Balance b/d | 61,500 | 2012 | By B. S Ltd. (Landlord) A/c " Profit and Loss A/c | 7,500 |
| | | 61,500 | | | 54,000 |
| | | 61,500 | | | 61,500 |

| Dr. | | Royalty Account | | Cr. | |
|------|-------------------|-----------------|------|----------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2009 | To B. S. Ltd. A/c | 34,500 | 2009 | By Profit & Loss A/c | 34,500 |
| 2010 | To B. S. Ltd. A/c | 54,000 | 2010 | By Profit & Loss A/c | 54,000 |
| 2011 | To B. S. Ltd. A/c | 75,000 | 2011 | By Profit & Loss A/c | 75,000 |
| 2012 | To B. S. Ltd. A/c | 82,500 | 2012 | By Profit & Loss A/c | 82,500 |
| 2013 | To B. S. Ltd. A/c | 1,24,500 | 2013 | By Profit & Loss A/c | 1,24,500 |

Accounting Entries in the Books of the Landlord / Lessor

1. Where a minimum rent exists with right to recoup short workings

(a) Where the actual royalty is less than the minimum rent :

- (i) Lessee Account
 To Royalty Receivable Account
 To Royalty Suspense Account/
Or Shortworkings Allowable A/c
- Dr. [Minimum rent]
 [Actual Royalties for the period]
 [Short fall in Royalties]

- (ii) Bank Account
 Tax Deducted at source
 To Lessee Account
- Dr. [Net amount paid]
 Dr. [Tax deducted at source]
 [Minimum rent]

- (iii) Royalties Receivable Account
 To Profit & Loss Account
- Dr.
 [Transfer]

(b) Where the actual royalty is more than the minimum rent :

- (ii) Royalty Suspense Account/
Or Short workings Allowable A/c
 To Lessee Account
- Dr.
 [Recoupment of Short workings, if any]

- (iii) Bank Account
 Tax Deducted at source
 To Lessee Account
- Dr. [Net amount paid]
 Dr. [Tax deducted at source]

- (iv) Royalties (Receivable) Account
 To Profit & Loss Account
- Dr.
 [Transfer]

- (v) Royalty Suspense Account/
Or Short workings Allowable A/c
 To Profit and Loss Account
- Dr.
 [Short workings, which can not be recouped]



Illustration 3.

For the same figures as given in illustration 1, prepare necessary accounts in the books of Landlord.

Solution :

In the books of Landlord
Royalty Receivable Account

| Dr. | | | Cr. | | |
|----------|----------------------|------------|----------|-----------------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 31.03.07 | To Profit & Loss A/c | 75,000 | 31.03.07 | By Bihar Coal Co.Ltd | 75,000 |
| 31.03.08 | To Profit & Loss A/c | 90,000 | 31.03.08 | By Bihar Coal Co. Ltd | 90,000 |
| 31.03.09 | To Profit & Loss A/c | 1,87,500 | 31.03.09 | By Bihar Coal Co. Ltd | 1,87,500 |
| 31.03.10 | To Profit & Loss A/c | 1,50,000 | 31.03.10 | By Bihar Coal Co. Ltd | 1,50,000 |
| 31.03.11 | To Profit & Loss A/c | 3,75,000 | 31.03.11 | By Bihar Coal Co. Ltd | 3,75,000 |
| 31.03.12 | To Profit & Loss A/c | 1,12,500 | 31.03.12 | By Bihar Coal Co. Ltd | 1,12,500 |

Dr. Bihar Coal Co. Ltd. (Lessee) Account Cr.

| Dr. | | | Cr. | | | |
|----------|-----------------------------|------------|----------|-------------------------------|------------|---------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) | |
| 31.03.07 | To Royalties Receivable A/c | 75,000 | 31.03.07 | By Bank A/c | 150,000 | |
| | To Shortworkings Susp.A/c | 75,000 | | | | |
| | | 150,000 | | | | |
| 31.03.08 | To Royalties Receivable A/c | 90,000 | 31.03.08 | By Bank A/c | 150,000 | |
| | To Shortworkings Susp.A/c | 60,000 | | | | |
| | | 150,000 | | | | |
| 31.03.09 | To Royalties Receivable A/c | 187,500 | 31.03.09 | By Bank A/c | 150,000 | |
| | | | | By Shortworkings Susp. A/c | 37,500 | |
| | | 1,87,500 | | | 1,87,500 | |
| 31.03.10 | To Royalties Receivable A/c | 150,000 | 31.03.10 | By Bank A/c | 150,000 | |
| | | 150,000 | | | | 150,000 |
| | | | | | | |
| 31.03.11 | To Royalties Receivable A/c | 375,000 | 31.03.11 | By Bank A/c | 375,000 | |
| | | 375,000 | | | | 375,000 |
| | | | | | | |
| 31.03.12 | To Royalties Receivable A/c | 112,500 | 31.03.12 | By Bank A/c | 112,500 | |
| | | 112,500 | | | | 112,500 |

| Dr. | | Shortworkings Suspense Account | | Cr. | |
|----------|-----------------------|--------------------------------|----------|-----------------------|------------|
| Date | Particulars | Amount (₹) | Date | Particulars | Amount (₹) |
| 31.03.07 | To Balance c/d | 75,000 | 31.03.07 | By Bihar Coal Co. Ltd | 75,000 |
| | | | 1.4.07 | By Balance b/d | 75,000 |
| 31.03.08 | To Balance c/d | 1,35,000 | 31.03.08 | By Bihar Coal Co. Ltd | 60,000 |
| | | 1,35,000 | | | 1,35,000 |
| 31.03.09 | To Bihar Coal Co. Ltd | 37,000 | 1.4.08 | By Balance b/d | 135,000 |
| | To Profit & Loss A/c | 37,500 | | | |
| | To Balance c/d | 60,000 | | | |
| | | 1,35,500 | | | 1,35,500 |
| 31.03.10 | To Profit & Loss A/c | 60,000 | 1.04.09 | By Balance b/d | 60,000 |
| | | 60,000 | | | 60,000 |

Illustration 4.

The following information has been obtained from the books of a lessee relating to the years 2008-09 to 2011-12 :

Payments to Landlord (after tax deducted @ 20% at Source) :

| | | |
|-----------------------------|---------|----------|
| | 2008-09 | ₹ 12,000 |
| | 2009-10 | ₹ 12,000 |
| | 2010-11 | ₹ 12,000 |
| | 2011-12 | ₹ 19,200 |
| Short-working recovered : | 2009-10 | ₹ 2,500 |
| | 2010-11 | ₹ 1,000 |
| Short-working written-off : | 2010-11 | ₹ 500 |

Balance of Short-working Account forward on April 1, 2008 ₹ 800 (which are in 2008-09). According to the terms of agreement short-working is recoverable within the next two years following the year in which short-working arises.

You are required to show the necessary accounts in the books of the lessee for the four years ended 31st March 2012.

Solution :

Before preparing the ledger accounts we are to find out some missing information :

- The recoupment which was made in 2009-10 for ₹ 2,500 is inclusive of ₹ 800 of 2007-08 and the balance ₹ 1,700 for 2008-09.

Again, the short-working which was recovered and written-off ₹ 1,000 and ₹ 500 (i.e., ₹ 1,500), respectively, in 2010-11 are also for the year 2008-09. So, the total short-working for 2008-09 amounted to ₹ 3,200 (i.e., ₹ 1,700 + ₹ 1,500).



2. Rate of taxes @ 20% on gross i.e., 25% (i.e., $\frac{20}{80} = \frac{1}{4}$) on net amount paid.

3. Actual Payment = Annual Royalty + Short-working – Recoupment.

Thus, actual royalty is calculated as under :

| | 2008-09 ₹ | 2009-10 ₹ | 2010-11 ₹ | 2011-12 ₹ |
|--|--------------|--------------|--------------|--------------|
| Payment to landlord (after tax) | 12,000 | 12,000 | 12,000 | 19,200 |
| Add : Back Tax Deducted at Source @ $\frac{1}{4}$ th | 3,000 | 3,000 | 3,000 | 4,800 |
| Payment to landlord (before Tax) | 15,000 | 15,000 | 15,000 | 24,000 |
| Less : Short-working | 3,200 | — | — | — |
| Add : Recoupment | — | 2,500 | 1,000 | — |
| | 11,800 | 17,500 | 16,000 | 24,000 |

In the Books of Lessee

Dr. Royalty Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|-------------------|-----------------|--------|-------------------|-------------|--------|
| 2009 March, 31 | To Landlord A/c | 11,800 | 2009 March, 31 | By P/L A/c | 11,800 |
| 2010 March, 31 | To Landlord A/c | 17,500 | 2010 March, 31 | By P/L A/c | 17,500 |
| 2011 March, 31 | To Landlord A/c | 16,000 | 2011 March, 31 | By P/L A/c | 16,000 |
| 2012 March, 31 | To Landlord A/c | 24,000 | 2012 March, 31 | By P/L A/c | 24,000 |

Dr. Landlord Account Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|-------------------|---------------------------------------|--------|-------------------|----------------------|--------|
| 2009 March, 31 | To Bank A/c | 12,000 | 2009 March, 31 | By Royalty A/c | 11,800 |
| | To Income Tax Payable A/c | 3,000 | | By Shortworkings A/c | 3,200 |
| | | 15,000 | | | 15,000 |
| 2010 March, 31 | To Bank A/c | 12,000 | 2010 March, 31 | By Royalty A/c | 17,500 |
| | To Income Tax Payable A/c | 3,000 | | | |
| | To Short workings A/c (Recoupment) | 2,500 | | | |
| | | 17,500 | | | 17,500 |

| | | | | | |
|-------------------|--|------------------------------------|-------------------|----------------|------------------|
| 2011 March, 31 | To Bank A/c To Income Tax Payable A/c To Short workings A/c(Recoupment) | 12,000 3,000 1,000 16,000 | 2011 March, 31 | By Royalty A/c | 16,000 16,000 |
| 2012 March, 31 | To Bank A/c To Income Tax Payable A/c | 19,200 4,800 24,000 | 2012 March, 31 | By Royalty A/c | 24,000 24,000 |

| Dr. | | | Shortworking Account | | | Cr. | | |
|-------------------|-----------------------------------|-----------------------|----------------------|-----------------------------------|-------------------------|-----|--|--|
| Date | Particulars | Amount | Date | Particulars | Amount | | | |
| 2009 March, 31 | To Balance b/f To Landlord A/c | 800 3,200 4,000 | 2009 March, 31 | By Balance c/d | 4,000 4,000 | | | |
| 2010 March, 31 | To Balance b/d | 4,000 4,000 | 2010 March, 31 | By Landlord A/c By Balance c/d | 2,500 1,500 4,000 | | | |
| 2011 March, 31 | To Balance b/d | 1,500 1,500 | 2011 March, 31 | By Landlord A/c By P/L c/d | 1,000 500 1,500 | | | |

Illustration 5.

A fire occurred in the office premises of lessee in the evening of 31.3.2012 destroying most of the books and records. From the documents saved, the following information is gathered:

Short-working recovered :

2009-10 ₹ 4,000 (towards short-workings which arose in 2006-07)

2010-11 ₹ 8,000 (including ₹ 1,000 for short-working 2007-08)

2011-12 ₹ 2,000

Short-working lapsed :

2008-09 ₹ 3,000

2009-10 ₹ 3,600

2011-12 ₹ 2,000

A sum of ₹ 50,000 was paid to the landlord in 2008-09. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years following the year in which Short-workings arise.

Information as regards payments to landlord subsequent to the year 2008-09 is not readily available.

Show the Short – working Account and the Royalty Account in the books of lessee.

Solution:

Working Notes:

Analysis of payments

| Year | Minimum Rent ₹ | Royalty ₹ | Actual Payment ₹ | Shortworking ₹ | | | |
|---------|-------------------|--------------|---------------------|-------------------|----------|--------|-----------------|
| | | | | Occurred | Recouped | Lapsed | Carried Forward |
| 2007-08 | - | - | - | - | - | - | 11,600 |
| 2008-09 | 50,000 | 39,000 | 50,000 | 11,000 | - | 3,000 | 19,600(C) |
| 2009-10 | 50,000 | 54,000 | 50,000 | - | 4,000 | 3,600 | 12,000(B) |
| 2010-11 | 50,000 | 58,000 | 50,000 | - | 8,000 | - | 4,000(A) |
| 2011-12 | 50,000 | 52,000 | 50,000 | - | 2,000 | 2,000 | - |

Analysis of Royalty Payable:

| | | ₹ | ₹ |
|---------------------------|-----------------------------|-----------------|--------|
| Royalty in 2008-09 | Minimum Rent – Shortworking | 50,000 - 11,000 | 39,000 |
| Royalty in 2009-10 | Minimum Rent + Recoupment | 50,000 + 4,000 | 54,000 |
| Royalty in 2010-11 | Minimum Rent + Recoupment | 50,000 + 8,000 | 58,000 |
| Royalty in 2011-12 | Minimum Rent + Recoupment | 50,000 + 2,000 | 52,000 |

Explanation of the above mentioned Analysis:

- (i) 2008-09 ₹50,000 was paid but there was no recoupment. ∴ ₹50,000 was the payment for Minimum Rent. This has been posted in the minimum rent column, every year.
- (ii) In 2011-12 Shortworking recouped + Shortworking lapsed = ₹2,000 + ₹2,000 = ₹4,000. This has been posted as the amount carried forward in 2010-11. **(A)**
- (iii) In 2010-11 ₹8,000 has been recouped. So, the closing balance of its preceding year 2009-10 was = ₹(4,000+8,000) = ₹12,000. **(B)**
- (iv) In 2009-10 Shortworkings adjusted = amount recouped + amount lapsed = ₹(4,000+3,600) = ₹7,600. In its preceding year 2008-09, the closing balance was ₹(12,000+7,600) = ₹19,600. **(C)**
- (v) No Shortworking occurred in 2009-10, 2010-11, 2011-12. ∴ All Shortworkings occurred in 2008-09 or before.
- (vi) Shortworking can be recovered within next 3 years.
∴ Total Shortworking adjusted in 2011-12 ₹4,000 must be related to 2008-09.
Again out of ₹8,000 recouped in 2010-11. ₹1,000 is related to 2007-08.
∴ Balance ₹7,000 was related to 2008-09.
∴ Total Shortworking of 2008-09 = ₹4,000 + ₹7,000 = ₹11,000.
- (vii) Opening Balance of Short working in 2007-08 = Closing balance + Amount recouped + Amount Lapsed – Amount of Shortworking occurred i.e. ₹(19,600+3,000-11,000) = ₹11,600

In the books of

| Dr. | | | Cr. | | |
|-----------------|------------------|-------------|---------|-------------------------|-------------|
| Royalty Account | | | | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2008-09 | To, Landlord A/c | 39,000 | 2008-09 | By, Profit and Loss A/c | 39,000 |
| | | 39,000 | | | 39,000 |
| 2009-10 | To, Landlord A/c | 54,000 | 2009-10 | By, Profit and Loss A/c | 54,000 |
| | | 54,000 | | | 54,000 |
| 2010-11 | To, Landlord A/c | 58,000 | 2010-11 | By, Profit and Loss A/c | 58,000 |
| | | 58,000 | | | 58,000 |
| 2011-12 | To, Landlord A/c | 52,000 | 2011-12 | BY, Profit and Loss A/ | 52,000 |
| | | 52,000 | | | 52,000 |

| Dr. | | | Cr. | | |
|-----------------------|------------------|-------------|---------|-------------------------|-------------|
| Shortworkings Account | | | | | |
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2008-09 | To, Balance b/d | 11,600 | 2008-09 | By, Profit and Loss A/c | 3,000 |
| | To, Landlord A/c | 11,000 | | By, Balance c/d | 19,600 |
| | | 22,600 | | | 22,600 |
| 2009-10 | To, Balance b/d | 19,600 | 2009-10 | By, Landlord A/c | 4,000 |
| | | | | By, Profit and Loss A/c | 3,600 |
| | | 19,600 | | By, Balance c/d | 12,000 |
| 2010-11 | To, Balance b/d | 12,000 | 2010-11 | By, Landlord A/c | 8,000 |
| | | | | By, Balance c/d | 4,000 |
| | | 12,000 | | | 12,000 |
| 2011-12 | To, Balance b/d | 4,000 | 2011-12 | By, Landlord A/c | 2,000 |
| | | | | By, Profit and Loss A/c | 2,000 |
| | | 4,000 | | | 4,000 |

SELF EXAMINATION QUESTIONS:

- Ground Rent or Surface rent means
 - Minimum Royalty payable
 - Maximum Royalty payable
 - Fixed rent payable in addition to minimum rent
 - Rent recovered at the end of lease term
- Excess of minimum rent over royalty is know as
 - Maximum rent
 - Excess workings
 - Short workings
 - Deficiency of actual royalty

The production during the first six years was as follows: -

| Year | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
|---------------------|---------|---------|---------|---------|--------------------------------|--------------------------|
| Production (Tonnes) | 2000 | 3000 | 8000 | 9000 | 4000 | 6000 |
| | | | | | (Period of strike for 73 days) | (Lockout for two months) |

Show the necessary Ledger Accounts in the books of Mahi Limited.

Answer:

[Short working 2009-10 — ₹1,00,000

2010-11 — ₹75,000

Short workings recouped 2011-12 — ₹37,500

2012-13 — ₹37,500

2014-15 — ₹12,500

Transferred to P&L A/c 2011-12 — ₹31,250

2012-13 — ₹18,750

Closing balance of short workings as 2014-15 — ₹7,500.]

Study Note - 9

HIRE-PURCHASE AND INSTALLMENT PURCHASE SYSTEM



This Study Note includes

9.1 Hire-Purchase and Installment Purchase System

9.2. HIRE-PURCHASE AND INSTALLMENT PURCHASE SYSTEMS

HIRE-PURCHASE SYSTEM Introduction :

It is not always possible by a purchaser to meet up the higher demand for goods due to immediate cash payment. To meet this demand the concept of Hire Purchase is very popular in the market.

Under this system the purchaser (**Hirer**) pays the entire amount in staggered way viz. monthly, quarterly or yearly with some interest. Under this system the goods are sold with the following conditions:

Possession of goods is delivered to a hirer but the title to the goods (Ownership) are transferred only when the agreed sum (Hire Purchase price) is paid by the hirer.

Such hirer has a right to terminate the agreement at any time before the property so passes. That means he has the option to return the goods in which case he need not pay installments falling due thereafter. However, the hirer cannot recover the sums already paid as such sums legally represent hire charges of the goods in question.

The hire-purchaser, during that period of possession of goods, cannot damage, destroy, pledge or sell such goods. He is supposed to take all such care of goods as a prudent person does in his own goods.

In case of Installment Sale, it is not only the possession of goods but also the *ownership* in goods is transferred to the buyer immediately at the time of agreement.

Further, in installment system if the buyer stops the payment of dues, then he does not have the right of seizing his goods. The differences between installment sale and hire-purchase are as below:

| Particulars | Hire Purchase | Installment Sale |
|-------------------------------|---|--|
| Ownership | Stipulates the time at which the ownership passes to the buyer. It is usually on the payment of last installment. | Ownership passes at the time of sale. |
| Default in making payment | Seller can repossess the goods. In that case the installment so far paid is treated to be Hiring charges. | Seller does not have any other right except the right of suing the buyer for the non-payment of price. |
| Right of sale or other wise | No right to sale or otherwise transfer the goods since the legal position of the hirer is bailee. | Right to sale or otherwise transfer the goods. |
| Loss or damages to the goods. | Any loss occurring to goods has to be borne by the seller if the buyer takes reasonable care. | Any loss occurring to goods has to be borne by the buyer. |

SITUATION – I : WHEN RATE OF INTEREST, TOTAL CASH PRICE AND IN STALLMENTS ARE GIVEN**Illustration 1.**

X purchases a car on hire-purchase system on 1.1.11. The total cash price of the car is ₹4,50,000 payable ₹90,000 down and three installments of ₹1,70,000, ₹1,50,000 and ₹1,08,460 payable at the end of first, second and third year respectively. Interest is charged at 10% p.a.

You are required to calculate interest paid by the buyer to the seller each year.

Solution: Following table is useful for calculating interest paid with each installment :

Analysis of Instalments

| Year | Opening Balance of Cash Price ₹ | Installments ₹ | Payment towards Principal/Cash Price ₹ | Payment towards Interest ₹ | Closing Balance of Cash Price ₹ |
|----------|------------------------------------|-------------------|---|-------------------------------|------------------------------------|
| 01.01.11 | 4,50,000 | 90,000 | 90,000 | - | 3,60,000 |
| 31.12.11 | 3,60,000 | 1,70,000 | 1,34,000 | 36,000 | 2,26,000 |
| 31.12.12 | 2,26,000 | 1,50,000 | 1,27,400 | 22,600 | 98,600 |
| 31.12.13 | 98,600 | 1,08,460 | 98,600 | 9,860 | - |

SITUATION – II : WHEN RATE OF INTEREST AND INSTALLMENTS ARE GIVEN BUT TOTAL CASH PRICE IS NOT GIVEN.**Illustration 2.**

X purchased a T.V on hire-purchase system. As per terms he is required to pay ₹3000 down, ₹4000 at the end of first year, ₹3000 at the end of second year, and ₹5000 at end of third year. Interest is charged at 12% p.a.

You are required to calculate total cash price of T.V and interest paid with each installment.

Solution :

| Calculation of Cash Price | Installment ₹ | Analysis of Instalments | |
|-----------------------------------|------------------|-------------------------|-----------------|
| | | Interest ₹ | Cash Price ₹ |
| 3rd Instalment | | | |
| (-) Interest (12/112 × 5,000) | 5,000 | | |
| | 536 | | |
| Balance of Cash Price | 4,464 | 536 | 4,464 |
| (+) 2nd Instalment | 3,000 | | |
| | 7,464 | | |
| (-) Interest (12/112 × 7,464) | 800 | 800 | 2,200 |
| Balance of Cash Price | 6,664 | | |
| (+) 1st Instalment | 4,000 | | |
| | 10,664 | | |
| (-) Interest (12/112 × 10,664) | 1,143 | 1,143 | 2,857 |
| Balance of Cash Price | 9,521 | | |
| (+) Down Payment Total Cash Price | 3,000 | - | 3,000 |
| | 12,521 | 2,479 | 12,521 |

SITUATION – III : WHEN ONLY INSTALLMENTS ARE GIVEN, BUT CASH PRICE AND RATE OF INTEREST ARE NOT GIVEN.**Illustration 3.**

X & Co. purchased a Motor car on April 1, 2009 on hire-purchase paying ₹60,000 cash down and balance in four annual installments of ₹55,000, ₹50,000, ₹45,000 and ₹40,000 each Installment comprising equal amount of cash price at the end of each accounting period. You are required to calculate total cash price and amount of interest in each Installment.



Solution : Hire-purchase Price

| | |
|-----------------|-----------------|
| Down Payment | 60,000 |
| 1st installment | 55,000 |
| 2nd installment | 50,000 |
| 3rd installment | 45,000 |
| 4th installment | <u>40,000</u> |
| Total | <u>2,50,000</u> |

As each installment comprises equal amount of cash price the differences in installment amounts are due to interest amount only. Assuming X is the amount of Cash Price in each installment and I is the amount of interest.

Thus for the installments, starting from last installment, we have the following equations:

$$\begin{aligned} \text{(i)} \quad X + I &= 40,000 \\ \text{(ii)} \quad X + 2I &= 45,000 \\ \text{(iii)} \quad X + 3I &= 50,000 \\ \text{(iv)} \quad X + 4I &= 55,000 \end{aligned}$$

Subtracting any preceding equation from the following equation we get $I = ₹ 5,000$ and by substituting the value of I in any equation we get $X = ₹ 35,000$.

The hire-purchase price is divided into cash price and interest parts as under :

| Particulars | Cash Price ₹ | Interest ₹ | Installment ₹ |
|---------------------|-----------------|---------------|------------------|
| Down Payment | 60,000 | - | 60,000 |
| First installment | 35,000 | 20,000 | 55,000 |
| Second installment | 35,000 | 15,000 | 50,000 |
| Third installment | 35,000 | 10,000 | 45,000 |
| Fourth installment | 35,000 | 5,000 | 40,000 |
| Total | 2,00,000 | 50,000 | 250,000 |
| Total Cash Price | 2,00,000 | | |
| Hire Purchase Price | 2,50,000 | | |
| Total Interest | 50,000 | | |

SITUATION – I V : WHEN REFERENCE TO ANNUITY TABLE RATE OF INTEREST AND INSTALLMENTS ARE GIVEN BUT TOTAL CASH PRICE IS NOT GIVEN.

In such questions the reference to annuity table gives the present value of the annuity for a number of years at a certain rate of interest. This present worth is equal to total cash price. Therefore, with the help of annuity tables the total cash price of the total installments given can be calculated and then question can be solved by the first method.

Illustration 4.

On 1.1.2010 X purchase a plant from Y on hire purchase system. The hire purchase rate was settled at ₹ 60,000, payable as to ₹ 15,000 on 1.1.2010 and ₹ 15,000 at the end of three successive year. Interest was charged @5% p.a. The asset was to be depreciated in the books of the purchaser at 10% p.a. on Reducing Balance Method. Given the present value of an annuity of Re. 1 p.a. @5% interest is ₹ 2.7232.

Ascertain the cash price.

Solution :

| | |
|--------------------|---|
| Amount of Interest | Present value |
| ₹ 1 | ₹ 2.7232 |
| ₹ 15,000 | $\frac{₹ 15,000 \times 2.7232}{1} = ₹ 40,848$ |

∴ Cash Price = ₹ 40,848 + ₹ 15,000 (down) = ₹ 55,848.

ACCOUNTING TREATMENT

Accounting treatment in the books of buyer is presented in below :

In the Books of the Hire-Purchaser

The following methods are followed:

- (1) Cash Price Method
- (2) Interest Suspense Method

Cash Price Method:

| | Particulars | | Debit (₹) | Credit (₹) |
|----|---|-----|-----------|--------------|
| 1. | Hire Purchase A/c To, Hire Vendor A/c [Cash price] | Dr. | xxxx | xxxx |
| 2. | Hire Vendor A/c To, Bank A/c [Down payment] | Dr. | xxxx | xxxx |
| 3. | Interest A/c To, Hire Vendor A/c | Dr. | xxxx | xxxx |
| 4. | Hire Vendor A/c To, Bank A/c [Instalment amount] | Dr. | xxxx | xxxx |
| 5. | P/L A/c To, Interest A/c To, Depreciation A/c | Dr. | xxxx | xxxx xxxx |

Interest Suspense Method:

| | Particulars | | Debit (₹) | Credit (₹) |
|----|---|------------|--------------|--------------|
| 1. | Hire Purchase Asset A/c [Cash Price] Interest Suspense A/c [Total Interest] To, Hire Vendor A/c [H.P price] | Dr. Dr. | xxxx xxxx | xxxx |
| 2. | Hire Vendor A/c To, Bank A/c [Down payment] | Dr. | xxxx | xxxx |
| 3. | Interest A/c To, Interest Suspense A/c | Dr. | xxxx | xxxx |
| 4. | Hire Vendor A/c To, Bank A/c [Instalment amount] | Dr. | xxxx | xxxx |
| 5. | P/L A/c To, Interest A/c To, Depreciation A/c | Dr. | xxxx | xxxx xxxx |



Illustration 5.

On 1.1.2009 Mr. X took delivery from Mr. Y of 5 machines on a hire purchase system. ₹ 4,000 being paid on delivery and the balance in five installments of ₹ 6,000 each, payable annually on 31st December. The vendor company charges 5% interest p.a. on yearly balances. The cash price of 5 machines was ₹ 30,000. Show the entries (without narration) Assets Account, Mr. Y Account for 5 years assuming that the purchaser charges depreciation @20% on straight line method.

Solution:

Computation of Interest

| | | |
|------------------------|---------------|--------|
| Hire-purchase price | ₹ | ₹ |
| Down payment | 4,000 | |
| Interest ₹ 6,000 x 5 = | <u>30,000</u> | 34,000 |
| Less: Cash Price | <u>30,000</u> | |

∴ Interest ₹ 4,000

Analysis of Payments of Vendors

| Year | Opening Balance of Cash Price ₹ | Towards Principal ₹ | Towards Interest ₹ | Installment ₹ | Closing balance of Cash Price ₹ |
|------------|------------------------------------|------------------------|-----------------------|------------------|------------------------------------|
| 01.01.2009 | 30,000 | 4,000 | --- | --- | 26,000 |
| 31.12.2009 | 26,000 | 4,700 | 1,300 | 6,000 | 21,300 |
| 31.12.2010 | 21,300 | 4,935 | 1,065 | 6,000 | 16,365 |
| 31.12.2011 | 16,365 | 5,182 | 818 | 6,000 | 11,183 |
| 31.12.2012 | 11,183 | 5,441 | 559 | 6,000 | 5,742 |
| 31.12.2013 | 5,742 | 5,742 | 258 (bal. fig.) | 6,000 | NIL |
| | | | 4,000 | | |

In the Books of Mr. X

Journal (without narrations)

| Date | Particulars | L/F | Dr. | Cr. |
|-----------------|--|-----|-------------|----------------|
| | | | Amount ₹ | Amount ₹ |
| 2009 Jan. 1. | Assets A/c. Dr. | | 30,000 | |
| | To Mr. Y A/c. | | | 30,000 |
| | Mr. Y A/c. Dr. | | 4,000 | |
| | To Bank A/c. | | | 4,000 |
| Dec. 31. | Interest A/c. Dr. | | 1,300 | |
| | To Mr. Y A/c. | | | 1,300 |
| | Mr. Y A/c. Dr. | | 6,000 | |
| | To Bank A/c. | | | 6,000 |
| | Depreciation A/c. Dr. | | 6,000 | |
| | To Assets A/c. | | | 6,000 |
| | Profit & Loss A/c. Dr. | | 7,300 | |
| | To Interest A/c. To Depreciation A/c. | | | 1,300 6,000 |

Hire-Purchase and Installment Purchase Systems

| | | | | | |
|------------------|----------------------|-----|--|-------|-------|
| 2010 Dec. 31. | Interest A/c. | Dr. | | 1,065 | |
| | To Mr. Y A/c. | | | | 1,065 |
| | Mr. Y A/c. | Dr. | | 6,000 | |
| | To Bank A/c. | | | | 6,000 |
| | Depreciation A/c. | Dr. | | 6,000 | |
| | To Assets A/c. | | | | 6,000 |
| | Profit & Loss A/c. | Dr. | | 7,065 | |
| | To Interest A/c. | | | | 1,065 |
| | To Depreciation A/c. | | | | 6,000 |
| 2011 Dec. 31. | Interest A/c. | Dr. | | 818 | |
| | To Mr. Y A/c. | | | | 818 |
| | Mr. Y A/c. | Dr. | | 6,000 | |
| | To Bank A/c. | | | | 6,000 |
| | Depreciation A/c. | Dr. | | 6,000 | |
| | To Assets A/c. | | | | 6,000 |
| | Profit & Loss A/c. | Dr. | | 6,818 | |
| | To Interest A/c. | | | | 818 |
| | To Depreciation A/c. | | | | 6,000 |
| 2012 Dec. 31. | Interest A/c. | Dr. | | 559 | |
| | To Mr. Y A/c. | | | | 559 |
| | Mr. Y A/c. | Dr. | | 6,000 | |
| | To Bank A/c. | | | | 6,000 |
| | Depreciation A/c. | Dr. | | 6,000 | |
| | To Assets A/c. | | | | 6,000 |
| | Profit & Loss A/c. | Dr. | | 6,559 | |
| | To Interest A/c. | | | | 559 |
| | To Depreciation A/c. | | | | 6,000 |
| 2013 Dec. 31. | Interest A/c. | Dr. | | 258 | |
| | To Mr. Y A/c. | | | | 258 |
| | Mr. Y A/c. | Dr. | | 6,000 | |
| | To Bank A/c. | | | | 6,000 |
| | Depreciation A/c. | Dr. | | 6,000 | |
| | To Assets A/c. | | | | 6,000 |
| | Profit & Loss A/c. | Dr. | | 6,258 | |
| | To Interest A/c. | | | | 258 |
| | To Depreciation A/c. | | | | 6,000 |



Dr.

Asset Account

Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|-----------------|-----------------|--------|------------------|----------------------|--------|
| 2009 Jan. 1. | To Mr. Y A/c. | 30,000 | 2009 Dec. 31. | By Depreciation A/c. | 6,000 |
| | | 30,000 | | `` Balance c/d. | 24,000 |
| | | | | | 30,000 |
| 2010 Jan. 1. | To Balance b/d. | 24,000 | 2010 Dec. 31. | By Depreciation A/c. | 6,000 |
| | | 24,000 | | `` Balance c/d. | 18,000 |
| | | | | | 24,000 |
| 2011 Jan. 1. | To Balance b/d. | 18,000 | 2011 Dec. 31. | By Depreciation A/c. | 6,000 |
| | | 18,000 | | `` Balance c/d. | 12,000 |
| | | | | | 18,000 |
| 2012 Jan. 1. | To Balance b/d. | 12,000 | 2012 Dec. 31. | By Depreciation A/c. | 6,000 |
| | | 12,000 | | `` Balance c/d. | 6,000 |
| | | | | | 12,000 |
| 2013 Jan. 1. | To Balance b/d. | 6,000 | 2012 Dec. 31. | By Depreciation A/c. | 6,000 |
| | | 6,000 | | | 6,000 |

DEFAULT AND REPOSSESSION**Note:**

It has been observed that Hire Purchase Trading Account (Debtors) method and Stock and Debtors method of ascertaining profit or loss on sale of goods of small value under hire purchase system based on the simplified approach are not fully compliant with AS 19 "Leases" since loading amount contains both profit as well as interest element.

As both companies and other than companies are involved in Hire Purchase Trading it is necessary to prepare the company accounts in compliance with Accounting Standards as per Companies Act, 2013.

Accordingly it is proposed to follow the methods other than Hire Purchase Trading Account (Debtors) Method and Stock and Debtors Method in case of Companies.

Meaning of Sales Method

Sales method follows a practical approach and practically (of course not technically) treats the hire purchaser as owner of the asset. Under this method, the asset is recorded at full cash price on the basis of 'substance over form'. This method is more appropriate since the intention all along is to buy the asset.

Journal Entries

The various accounting entries in the books of the hire purchaser and hire vendor are shown below:

| Case | In the Books of Hire Purchaser | In the Books of Hire Vendor |
|---|--|---|
| 1. On transfer of Possession | Asset A/c Dr. To Hire Vendor's A/c | Hire Purchaser's A/c Dr. To H.P. Sales A/c |
| 2. On making Down Payment | Hire Vendor's A/c Dr. To Bank A/c | Bank A/c Dr. To Hire Purchaser's A/c |
| 3. On making Interest due on unpaid balance | Interest A/c Dr. To Hire Vendor's A/c | Hire Purchaser's A/c Dr. To Interest A/c |
| 4. On making payment of Instalment | Hire Vendor's A/c Dr. To Bank A/c | Bank A/c Dr. To Hire Purchaser's A/c |
| 5. On providing Depreciation | Depreciation A/c Dr. To Asset A/c | No Entry |
| 6. On closure of Depreciation A/c | Profit & Loss A/c Dr. To Depreciation A/c | No Entry |
| 7. On closure of Interest A/c | Profit & Loss A/c Dr. To Interest A/c | Interest A/c Dr. To Profit & Loss A/c |

Disclosure in Balance Sheet

At the end of each accounting period the balances of relevant accounts appear in the Balance Sheet as shown below:

Disclosure in Balance Sheet

| Balance Sheet of Hire Purchaser | | | | Balance Sheet of Hire Vendor | | | |
|---------------------------------|---|--|------------|------------------------------|---|-----------------------|------------|
| Liabilities | ₹ | Assets | ₹ | Liabilities | ₹ | Assets | ₹ |
| | | Fixed Assets: | | | | Current Assets: | |
| | | Asset (at full cash price) | xxx | | | Hire Purchase Debtors | xxx |
| | | Less: Depreciation till date | xxx | | | | |
| | | Less: Balance in Hire Vendor's Account | xxx | | | | |
| | | | xxx | | | | xxx |

Illustration 6.

On 01.01.2011 A purchased five Machines each costing ₹ 1,58,500 each from B Payment was to be made 20% down and the remainder in four equal annual instalments commencing from 31.12.2011 with interest at 10% p.a. A writes off depreciation @20% on the diminishing balance.

Give the necessary journal entries and ledger accounts in the books of A and B under Sales Method. Also show how the relevant of items will appear in the Balance Sheet.



Solution:

Journal

| Journal A | Journal B | Dr. (₹) | Cr.(₹) |
|--|--|----------------|---------------|
| 01.01.2011 | | | |
| (a) Machines A/c Dr. To B A/c | (a) A A/c Dr. To HP Sales A/c | 7,92,500 | 7,92,500 |
| (b) B A/c Dr. To Bank A/c | (b) Bank A/c Dr. To A A/c | 1,58,500 | 1,58,500 |
| 31.12.2011 | | | |
| (c) Interest A/c Dr. To B A/c | (c) A A/c Dr. To Interest A/c | 63,400 | 63,400 |
| (d) B A/c Dr. To Bank A/c | (d) Bank A/c Dr. To A A/c | 2,21,900 | 2,21,900 |
| (e) Depreciation A/c Dr. To Machines A/c | (e) No Entry | 1,58,500 | 1,58,500 |
| (f) Profit & Loss A/c Dr. To Depreciation A/c | (f) No Entry | 1,58,500 | 1,58,500 |
| (g) Profit & Loss A/c Dr. To Interest A/c | (g) Interest A/c Dr. To Profit & Loss A/c | 63,400 | 63,400 |
| 31.12.2012 | | | |
| (a) Interest A/c Dr. To B A/c | (b) A A/c Dr. To Interest A/c | 47,550 | 47,550 |
| (b) B A/c Dr. To Bank A/c | (b) Bank A/c Dr. To A A/c | 2,06,050 | 2,06,050 |
| (c) Depreciation A/c Dr. To Machines A/c | (c) No Entry | 1,26,800 | 1,26,800 |
| (d) Profit & Loss A/c Dr. To Depreciation A/c | (d) No Entry | 1,26,800 | 1,26,800 |
| (e) Profit & Loss A/c Dr. To Interest A/c | (e) Interest A/c Dr. To Profit & Loss A/c | 47,550 | 47,550 |
| 31.12.2013 | | | |
| (a) Interest A/c Dr. To B A/c | (c) A A/c Dr. To Interest A/c | 31,700 | 31,700 |
| (b) B A/c Dr. To Bank A/c | (b) Bank A/c Dr. To A A/c | 1,90,200 | 1,90,200 |
| (c) Depreciation A/c Dr. To Machines A/c | (c) No Entry | 1,01,440 | 1,01,440 |
| (d) Profit & Loss A/c Dr. To Depreciation A/c | (d) No Entry | 1,01,440 | 1,01,440 |

| | | | | | |
|-----------------------|-----|----------------------|-----|----------|----------|
| (e) Profit & Loss A/c | Dr. | (e) Interest A/c | Dr. | 31,700 | |
| To Interest A/c | | To Profit & Loss A/c | | | 31,700 |
| | | | | | |
| 31.12.2014 | | | | | |
| (a) Interest A/c | Dr. | (d) A A/c | Dr. | 15,850 | |
| To B A/c | | To Interest A/c | | | 15,850 |
| (b) B A/c | Dr. | (b) Bank A/c | Dr. | 1,74,350 | |
| To Bank A/c | | To A A/c | | | 1,74,350 |
| (c) Depreciation A/c | Dr. | (c) No Entry | | 81,152 | |
| To Machines A/c | | | | | 81,152 |
| (d) Profit & Loss A/c | Dr. | (d) No Entry | | 81,152 | |
| To Depreciation A/c | | | | | 81,152 |
| (e) Profit & Loss A/c | Dr. | (e) Interest A/c | Dr. | 15,850 | |
| To Interest A/c | | To Profit & Loss A/c | | | 15,850 |

Dr. Machines Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|----------------|-----------------|----------|---------------------|-----------------|
| 01.01.11 | To B A/c | 7,92,500 | 31.12.11 | By Depreciation A/c | 1,58,500 |
| | | | | By Balance c/d | 6,34,000 |
| | | 7,92,500 | | | 7,92,500 |
| 01.01.12 | To Balance b/d | 6,34,500 | 31.12.12 | By Depreciation A/c | 1,26,800 |
| | | | | By Balance c/d | 5,07,200 |
| | | 6,34,500 | | | 6,34,500 |
| 01.01.13 | To Balance b/d | 5,07,200 | 31.12.13 | By Depreciation A/c | 1,01,440 |
| | | | | By Balance c/d | 4,05,760 |
| | | 5,07,200 | | | 5,07,200 |
| 01.01.14 | To Balance b/d | 4,05,760 | 31.12.14 | By Depreciation A/c | 81,152 |
| | | | | By Balance c/d | 3,24,608 |
| | | 4,05,760 | | | 4,05,760 |

Dr. B's Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|--------------------------------------|-----------------|----------|--|-----------------|
| 01.01.11 | To Bank A/c [Down Payment] | 1,58,500 | 01.01.11 | By Machines A/c | 7,92,500 |
| 31.12.11 | To Bank A/c [₹1,58,500 + ₹63,400] | 2,21,900 | 31.12.11 | By Interest A/c [[₹7,92,500 - ₹1,58,500] × 10/100] | 63,400 |
| | To Balance c/d | 4,75,500 | | | |
| | | 8,55,900 | | | 8,55,900 |
| 31.12.12 | To Bank A/c [₹1,58,500 + ₹47,550] | 2,06,050 | 01.01.12 | By Balance b/d | 4,75,500 |
| | To Balance c/d | 3,17,000 | 31.12.12 | By Interest A/c [₹4,75,500 × 10/100] | 47,550 |
| | | 5,23,050 | | | 5,23,050 |



| | | | | | |
|----------|--------------------------------------|-----------------|----------|--|-----------------|
| 31.12.13 | To Bank A/c [₹1,58,500 + ₹31,700] | 1,90,200 | 01.01.13 | By Balance b/d | 3,17,000 |
| | To Balance c/d | 1,58,500 | 31.12.13 | By Interest A/c [₹ 3,17,000 × 10/100] | 31,700 |
| | | 3,48,700 | | | 3,48,700 |
| 31.12.14 | To Bank A/c [₹1,58,500 + ₹15,850] | 1,74,350 | 01.01.14 | By Balance b/d | 1,58,500 |
| | | | 31.12.14 | By Interest A/c [₹1,58,500 × 10/100] | 15,850 |
| | | 1,74,350 | | | 1,74,350 |

An Extract of Balance Sheet of A

| Liabilities | 1 st yr | 2 nd yr | 3 rd yr | 4 th yr | Assets | 1 st yr (₹) | 2 nd yr (₹) | 3 rd yr (₹) | 4 th yr (₹) |
|-------------|--------------------|--------------------|--------------------|--------------------|------------------------------|------------------------|------------------------|------------------------|------------------------|
| | | | | | Fixed Assets: | | | | |
| | | | | | Machines | 7,92,500 | 7,92,500 | 7,92,500 | 7,92,500 |
| | | | | | Less: Depreciation till date | 1,58,500 | 2,85,300 | 3,86,740 | 4,67,892 |
| | | | | | Less: Balance due To B | 4,75,500 | 3,17,000 | 1,58,500 | - |
| | | | | | | 1,58,500 | 1,90,200 | 2,47,260 | 3,24,608 |

Ledger Accounts in the books of B

| Dr. | | | A's Account | | | Cr. | | |
|----------|-----------------|-----------------|-------------|-------------------------------|-----------------|-----|--|--|
| Date | Particulars | ₹ | Date | Particulars | ₹ | | | |
| 01.01.11 | To Sales A/c | 7,92,500 | 01.01.11 | By Bank A/c [Down payment] | 1,58,500 | | | |
| 31.12.11 | To Interest A/c | 63,400 | 31.12.11 | By Bank A/c | 2,21,900 | | | |
| | | | | By Balance c/d | 4,75,500 | | | |
| | | 8,55,900 | | | 8,55,900 | | | |
| 01.01.12 | To Balance b/d | 4,75,500 | 31.12.12 | By Bank A/c | 2,06,050 | | | |
| 31.12.12 | To Interest A/c | 47,550 | 31.12.12 | By Balance c/d | 3,17,000 | | | |
| | | 5,23,050 | | | 5,23,050 | | | |
| 01.01.13 | To Balance b/d | 3,17,000 | 31.12.13 | By Bank A/c | 1,90,200 | | | |
| 31.12.13 | To Interest A/c | 31,700 | | By Balance c/d | 1,58,500 | | | |
| | | 3,48,700 | | | 3,48,700 | | | |
| 01.01.14 | To Balance b/d | 1,58,500 | 31.12.14 | By Bank A/c | 1,74,350 | | | |
| 31.12.14 | To Interest A/c | 15,850 | | | | | | |
| | | 1,74,350 | | | 1,74,350 | | | |



Solution:

Computation of Cash Price and Periodic Interest

| A Instalment Number | B Closing Balance after the Payment of Instalment | C Instalment Amount | D = B + C Closing Balance before the payment of Instalment | E = D × R/ (100 + R) Interest D × 10/110 | F = D - E Opening Balance |
|---------------------------|--|---------------------------|---|---|---------------------------------|
| IV | — | 2,20,000 | 2,20,000 | 20,000 | 2,00,000 |
| III | 2,00,000 | 2,40,000 | 4,40,000 | 40,000 | 4,00,000 |
| II | 4,00,000 | 2,60,000 | 6,60,000 | 60,000 | 6,00,000 |
| I | 6,00,000 | 2,80,000 | 8,80,000 | 80,000 | 8,00,000 |

Let the cash price be 'X'

$X = ₹ 8,00,000 + 20\% \text{ of } X \text{ (i.e. down payment)} \quad 0.8X = ₹ 8,00,000$

$X = ₹ 8,00,000 / 0.8 = ₹ 10,00,000$

Ledger Accounts in the book of A

Dr. Machinery Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|---------------------|------------------|----------|---------------------|------------------|
| 01.01.11 | To B's A/c | 10,00,000 | 31.12.11 | By Depreciation A/c | 2,00,000 |
| | | | | By Balance c/d | 8,00,000 |
| | | 10,00,000 | | | 10,00,000 |
| 01.01.12 | To Balance b/d | 8,00,000 | 31.12.12 | By Depreciation A/c | 2,00,000 |
| | | | | By Balance c/d | 6,00,000 |
| | | 8,00,000 | | | 8,00,000 |
| 01.01.13 | To Balance b/d | 6,00,000 | 01.01.13 | By B's A/c | 6,60,000 |
| | To P&L A/c (Profit) | 60,000 | | | |
| | | 6,60,000 | | | 6,60,000 |

Dr. B's Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|--------------------------------------|------------------|----------|---|------------------|
| 01.01.11 | To Bank A/c (Down payment) | 2,00,000 | 01.01.11 | By Machinery A/c | 10,00,000 |
| 31.12.11 | To Bank A/c [₹2,00,000 + ₹80,000] | 2,80,000 | 31.12.11 | By Interest A/c [(₹10,00,000 - ₹2,00,000) × 10/100] | 80,000 |
| | To Balance c/d | 6,00,000 | | | |
| | | 10,80,000 | | | 10,80,000 |
| 31.12.12 | To Balance c/d | 6,60,000 | 01.01.12 | By Balance b/d | 6,00,000 |
| | | | | By Interest A/c (₹6,00,000 × 10/100)] | 60,000 |
| 01.01.13 | To Machinery A/c | 6,60,000 | 01.01.13 | By Balance b/d | 6,60,000 |

Ledger Accounts in the books of B

| Dr. | | A's Account | | Cr. | |
|----------|---|------------------|----------|--------------------------------------|------------------|
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.01.11 | To H.P. Sales A/c | 10,00,000 | 01.01.11 | By Bank A/c (Down Payment) | 2,00,000 |
| 31.12.11 | To Interest A/c [[₹10,00,000 - ₹2,00,000) × 10/100] | 80,000 | 31.12.11 | By Bank A/c (₹2,00,000 + ₹80,000) | 2,80,000 |
| | | | | By Balance c/d | 6,00,000 |
| | | 10,80,000 | | | 10,80,000 |
| 01.01.12 | To Balance b/d | 6,00,000 | 31.12.12 | By Balance c/d | 6,60,000 |
| 31.12.12 | To Interest A/c [₹6,00,000 × 10/100] | 60,000 | | | |
| | | 6,60,000 | | | 6,60,000 |
| 01.01.13 | To Balance b/d | 6,60,000 | 01.01.13 | By H.P. Goods Repossessed A/c | 3,60,000 |
| | | | | By Profit & Loss A/c | 3,00,000 |
| | | 6,60,000 | | | 6,60,000 |

| Dr. | | H.P. Goods Repossessed Account | | Cr. | |
|----------|-------------|--------------------------------|----------|-------------|-----------------|
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.01.13 | To A's A/c | 3,60,000 | 30.06.13 | By Bank A/c | 2,66,000 |
| | To Bank A/c | 6,000 | | By P&L A/c | 1,00,000 |
| | | 3,66,000 | | | 3,66,000 |

Partial Repossession

In case of partial repossession, the hire vendor takes back the possession of a part of the goods.

Practical Steps under Partial Repossession

Step 1: Calculate Book value of Goods Repossessed

- A. Cost
- B. Less: Depreciation upto date of repossession
- C. Book value of Goods Repossessed

Step 2: Calculate Agreed Value of Goods Repossessed

Step 3: Loss on default = Book Value – Agreed Value



Journal Entries Under Partial Repossession

Entries till the date of default are passed in the usual manner. The additional Entries are as follows:

| Books of Hire Purchaser | Books of Hire Vendor |
|--|---|
| 1. For transfer of the agreed value of Goods Repossessed Hire Vendor's A/c Dr. To Asset A/c | 1. On Repossession of Goods at agreed value H.P. Goods Repossessed A/c Dr. To Hire Purchaser's A/c |
| 2. For Transfer of Loss on default Profit & Loss A/c Dr. To Asset A/c Note: In case of profit on default, the reverse entry will be passed | 2,3,4—Same entries as in case of complete repossession. |

Illustration 8.

On 1.1.2011, A purchased 5 Machines from B. Payment was to be made—20% down and the balance in four annual instalments of ₹2,80,000, ₹ 2,60,000, ₹ 2,40,000 and ₹ 2,20,000 commencing from 31.12.2011. The vendor charged interest @ 10% p.a. A, writes off depreciation @ 20% p.a. on the original cost.

On A's failure to pay the instalment due on 31.12.2012, after negotiations on 01.01.2013 B agreed to leave two machines with A adjusting the value of the other three machines against the amount due. The machines being valued at cost less 40% p.a. depreciation on W.D.V basis, B after spending ₹6000 on repairs of each of such machines sold @ ₹70,000 on 30th June 2013. Prepare the relevant accounts in the books of A and B.

Solution:

| A Instalment Number | B Closing Balance after the payment of Instalment | C Instalment Amount | D= B+C Closing Balance before the payment of Instalment | E = $D \times R / (100 + R)$ Interest $D \times 10/110$ | F = D-E Opening Balance |
|---------------------------|--|---------------------------|--|---|-------------------------------|
| IV | - | 2,20,000 | 2,20,000 | 20,000 | 2,00,000 |
| III | 2,00,000 | 2,40,000 | 4,40,000 | 40,000 | 4,00,000 |
| II | 4,00,000 | 2,60,000 | 6,60,000 | 60,000 | 6,00,000 |
| I | 6,00,000 | 2,80,000 | 8,80,000 | 80,000 | 8,00,000 |

Let the cash price be 'X'

$X = ₹8,00,000 + 20\% \text{ of } X$ (i.e. down payment)

$0.8X = ₹8,00,000$

$X = ₹8,00,000 / 0.8 = ₹10,00,000$

| Dr. | | Machinery Account | | Cr. | |
|----------|----------------|-------------------|----------|---------------------------------|------------------|
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.01.11 | To B A/c | 10,00,000 | 31.12.11 | By Depreciation A/c | 2,00,000 |
| | | | | By Balance c/d | 8,00,000 |
| | | 10,00,000 | | | 10,00,000 |
| 01.01.12 | To Balance b/d | 8,00,000 | 31.12.12 | By Depreciation A/c | 2,00,000 |
| | | | | By Balance c/d | 6,00,000 |
| | | 8,00,000 | | | 8,00,000 |
| 01.01.13 | To Balance b/d | 6,00,000 | 01.01.13 | By B A/c | 2,16,000 |
| | | | | By P&L A/c [loss on default] | 1,44,000 |
| | | | | By Depreciation A/c | 80,000 |
| | | | | By Balance c/d | 1,60,000 |
| | | 6,00,000 | | | 6,00,000 |

| Dr. | | B's Account | | Cr. | |
|----------|--|----------------------|----------|---|------------------|
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.01.11 | To Bank A/c (Down payment) | 2,00,000 | 01.01.11 | By Machinery A/c | 10,00,000 |
| 31.12.11 | To Bank A/c [₹2,00,000 + ₹80,000] To Balance c/d | 2,80,000 6,00,000 | 31.12.11 | By Interest A/c [(₹10,00,000 - ₹2,00,000) × 10/100] | 80,000 |
| | | 10,80,000 | | | 10,80,000 |
| 31.12.12 | To Balance c/d | 6,60,000 | 01.01.12 | By Balance b/d | 6,00,000 |
| | | | 31.12.12 | By Interest A/c [(₹6,00,000 × 10/100)] | 60,000 |
| 01.01.13 | To Machinery A/c | 6,60,000 | 01.01.13 | By Balance b/d | 6,60,000 |

Working Notes

1. Calculation of Book value of Goods Repossessed

| | |
|---|-----------|
| A. Cost [₹2,00,000 × 3] | ₹6,00,000 |
| B. Less: Depreciation for 2 years [₹6,00,000 × 20% × 2] | ₹2,40,000 |
| | ₹3,60,000 |

2. Calculation of Agreed value of Goods Repossessed

| | |
|---|-----------|
| A. Cost [₹2,00,000 × 3] | ₹6,00,000 |
| B. Less: Depreciation for 1 st Year [40% of ₹6,00,000] | ₹2,40,000 |
| C. Book Value in the beginning of 2 nd year | ₹3,60,000 |
| D. Less: Depreciation for 2 nd year [40% of ₹3,60,000] | ₹1,44,000 |
| E. Book Value at the end of 2 nd Year | ₹2,16,000 |

2. Loss on Default = Book Value – Agreed Value = ₹3,60,000 - ₹2,16,000 = ₹1,44,000



Dr. **A's Account** Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|---|------------------|----------|--------------------------------------|------------------|
| 01.01.11 | To H.P. Sales A/c | 10,00,000 | 01.01.11 | By Bank A/c (Down payment) | 2,00,000 |
| 31.12.11 | To Interest A/c [(₹10,00,000 - ₹2,00,000) × 10/100] | 80,000 | 31.12.11 | By Bank A/c [₹2,00,000 + ₹80,000] | 2,80,000 |
| | | | | By Balance c/d | 6,00,000 |
| | | 10,80,000 | | | 10,80,000 |
| 01.01.12 | To Balance b/d | 6,00,000 | 31.12.12 | By Balance c/d | 6,60,000 |
| 31.12.12 | To Interest A/c [₹6,00,000 × 10/100] | 60,000 | | | |
| | | 6,60,000 | | | 6,60,000 |
| 01.01.13 | To Balance b/d | 6,60,000 | 01.01.13 | By H.P. Goods Repossessed A/c | 2,16,000 |
| | | | | By Balance c/d | 4,44,000 |
| | | 6,60,000 | | | 6,60,000 |

Dr. **H.P. Goods Repossessed Account** Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|---------------------------------------|-----------------|----------|-------------------|-----------------|
| 01.01.13 | To A's A/c | 2,16,000 | 30.06.13 | By Bank A/c | 2,10,000 |
| | To Bank A/c (Repairs) [₹6,000 × 3] | 18,000 | | By P&L A/c (Loss) | 24,000 |
| | | 2,34,000 | | | 2,34,000 |

Illustration 9.

A Transport purchased from Kolkata Motors 3 Tempos costing ₹50,000 each on the hire purchase system on 1.1.2011. Payment was to be made ₹30,000 down and the remainder in 3 equal annual instalments payable on 31.12.2011, 31.12.2012 and 31.12.2013 together with interest @ 9% p.a. A Transport writes off depreciation at the rate of 20% p.a. on the diminishing balance. It paid the instalment due at the end of the first year i.e. 31.12.2011 but could not pay the next on 31.12.2012. Kolkata Motors agreed to leave one Tempo with the purchaser on 31.12.2012 adjusting the value of the other 2 Tempos against the amount due on 31.12.2012. The Tempos were valued on the basis of 30% depreciation annually on W.D.V. basis.

Required: Show the necessary accounts in the books of A Transport for the year 2011, 2012, 2013.

Solution:

Dr. **Tempos Account** Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|---|-----------------|----------|---|-----------------|
| 01.01.11 | To Kolkata Motors' A/c (₹50,000 × 3) | 1,50,000 | 31.12.11 | By Depreciation A/c (20% on ₹1,50,000) | 30,000 |
| | | | | By Balance c/d | 1,20,000 |
| | | 1,50,000 | | | 1,50,000 |
| 01.01.12 | To Balance b/d | 1,20,000 | 31.12.12 | By Depreciation A/c | 24,000 |

| | | | | | |
|----------|----------------|-----------------|----------|--|-----------------|
| | | | 31.12.12 | By Kolkata Motors' A/c (Value of 2 tempos taken away) | 49,000 |
| | | | 31.12.12 | By P&L A/c (Loss on Default) | 15,000 |
| | | | 31.12.12 | By Balance c/d (value of one tempo left) | 32,000 |
| | | 1,20,000 | | | 1,20,000 |
| 01.01.13 | To Balance b/d | 32,000 | 31.12.13 | By Depreciation A/c | 6,400 |
| | | | 31.12.13 | By Balance c/d | 25,600 |
| | | 32,000 | | | 32,000 |

Dr. Kolkata Motor's Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|----------------------------|-----------------|----------|--------------------------------------|-----------------|
| 01.01.11 | To Bank A/c (Down Payment) | 30,000 | 01.01.11 | By Tempos A/c (₹50,000 × 3) | 1,50,000 |
| 31.12.11 | To Bank A/c | 50,800 | 31.12.11 | By Interest A/c (9% on ₹1,20,000) | 10,800 |
| 31.12.11 | To Balance c/d | 80,000 | | | |
| | | 1,60,800 | | | 1,60,800 |
| 31.12.12 | To Tempos A/c | 49,000 | 01.01.12 | By Balance b/d | 80,000 |
| 31.12.12 | To Balance c/d | 38,200 | 31.12.12 | By Interest A/c (9% on ₹80,000) | 7,200 |
| | | 87,200 | | | 87,200 |
| 31.12.13 | To Bank A/c | 41,638 | 01.01.13 | By Balance b/d | 38,200 |
| | | | 31.12.13 | By Interest A/c (9% on ₹38,200) | 3,438 |
| | | 41,638 | | | 41,638 |

Working Notes:

- Value of a tempo left with the buyer = ₹50,000 × 80/100 × 80/100 = ₹32,000
- Value of Tempos taken away by the seller = ₹50,000 × 2 × 70/100 × 70/100 = ₹49,000
- Loss on Tempos taken away = Book Value – Agreed Value
= [2 × ₹50,000 × 80/100 × 80/100] - ₹49,000 = ₹15,000.

Illustration 10.

On 1 January 2012, A purchased from B a plant valued at ₹7,45,000; payment to be made by four semi-annual instalments of ₹2,10,000 each; interest being charged at 5% per half year. A paid the first instalment on 1st July 2012 but failed to pay the next. B repossessed the plant on 4 January 2013. On 5 January 2013, after negotiation, A was allowed to retain the plant of which the original cash price was ₹3,90,000 and he was to bear the loss on the remainder which was taken over by B on that date for ₹3,75,000. B waived the interest after 31st December 2012. Another agreement was signed for payment of the balance amount.

Show by ledger accounts the necessary records in the books of A charging depreciation at 10% per annum half yearly on the written down value.



Solution:

Dr. Machinery Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|------------|----------------------|-----------------|------------|---------------------|-----------------|
| 01.01.2012 | To B's A/c | 7,45,000 | 30.06.2012 | By Depreciation A/c | 37,250 |
| | | | | By Balance c/d | 7,07,750 |
| | | 7,45,000 | | | 7,45,000 |
| 01.07.2012 | To Balance b/d | 7,07,750 | 31.12.2012 | By Depreciation A/c | 35,388 |
| | | | | By Balance c/d | 6,72,362 |
| | | 7,07,750 | | | 7,07,750 |
| 01.01.2013 | To Balance b/d | 6,72,362 | 05.01.2013 | By B's A/c | 3,75,000 |
| | To Profit & Loss A/c | 54,613 | | By Balance c/d | 3,51,975 |
| | (Balancing Figure) | | | | |
| | [3,75,000-3,20,387] | | | | |
| | | 7,26,975 | | | 7,26,975 |

Dr. B's Account Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|------------|------------------|-----------------|------------|-------------------------------|-----------------|
| 30.6.2012 | To balance c/d | 7,82,250 | 01.01.2012 | By Plant on Hire Purchase A/c | 7,45,000 |
| | | | 30.06.2012 | By Interest A/c | 37,250 |
| | | | | [₹7,45,000 × 5%] | |
| | | 7,82,250 | | | 7,82,250 |
| 01.07.2012 | To Bank A/c | 2,10,000 | 01.07.2012 | By Balance b/d | 7,82,250 |
| 31.12.2012 | To Balance c/d | 6,00,863 | 31.12.2012 | By Interest A/c | 28,613 |
| | | | | [₹5,72,250 × 5%] | |
| | | 8,10,863 | | | 8,10,863 |
| 05.01.2013 | To Machinery A/c | 3,75,000 | 01.01.2013 | By Balance b/d | 6,00,863 |
| | To Balance c/d | 2,25,863 | | | |
| | | 6,00,863 | | | 6,00,863 |

Working Note:

Calculation of Book Value of Plant Repossessed and Retained

| | Repossessed (₹) | Retained (₹) |
|---|-----------------|--------------|
| A. Cash Price of the Plant | 3,55,000 | 3,90,000 |
| B. Less: Depreciation @10% for 6 months | (17,750) | (19,500) |
| C. Book Value | 3,37,250 | 3,70,500 |
| D. Less: Depreciation @10% for 6 months | (16,863) | (18,525) |
| E. Book Value | 3,20,387 | 3,51,975 |

Illustration 11.

Z sold 3 Machinery for a total cash sale price of ₹6,00,000 on hire purchase basis to X on 01.01.2011. The terms of agreement provided for 30% as cash down and the balance of the cash price in three equal instalments together with interest at 10% per annum compounded annually. The instalments were payable as per the following schedule:

1st instalment on 31.12.2012; 2nd instalment on 31.12.2013 and 3rd instalment on 31.12.2014. X paid the 1st instalment on time but failed to pay thereafter. On his failure to pay the second instalment, Z repossessed two machineries and valued them at 50% of the cash price. X charges 10% p.a. depreciation on straight line method.

Prepare necessary ledger accounts in the books of X for 2011-2013.

Solution:

| Dr. | | | Machinery Account | | | Cr. | | |
|------------|----------------|-----------------|-------------------|------------------------|-----------------|-----|--|--|
| Date | Particulars | ₹ | Date | Particulars | ₹ | | | |
| 01.01.2011 | To Z's A/c | 6,00,000 | 31.12.2011 | By Depreciation A/c | 60,000 | | | |
| | | | | By Balance c/d | 5,40,000 | | | |
| | | 6,00,000 | | | 6,00,000 | | | |
| 01.01.2012 | To Balance b/d | 5,40,000 | 31.12.2012 | By Depreciation A/c | 60,000 | | | |
| | | | | By Balance c/d | 4,80,000 | | | |
| | | 5,40,000 | | | 5,40,000 | | | |
| 01.01.2013 | To Balance b/d | 4,80,000 | 31.12.2013 | By Depreciation A/c | 60,000 | | | |
| | | | | By Z's A/c | 2,00,000 | | | |
| | | | | By Profit and Loss A/c | 80,000 | | | |
| | | | | (balancing figure) | | | | |
| | | | | By Balance c/d | 1,40,000 | | | |
| | | 4,80,000 | | | 4,80,000 | | | |

| Dr. | | | Z's Account | | | Cr. | | |
|------------|---|-----------------|-------------|---|-----------------|-----|--|--|
| Date | Particulars | ₹ | Date | Particulars | ₹ | | | |
| 01.01.2011 | To Bank A/c | 1,80,000 | 31.12.2011 | By Machinery A/c | 6,00,000 | | | |
| 31.12.2011 | To Balance c/d | 4,62,000 | | By Interest A/c [10% on (₹6,00,000 - ₹1,80,000)] | 42,000 | | | |
| | | 6,42,000 | | | 6,42,000 | | | |
| 31.12.2012 | To Bank A/c (1,40,000 + 42,000 + 46,200) | 2,28,200 | 01.01.2012 | By Balance c/d | 4,62,000 | | | |
| | To Balance c/d | 2,80,000 | 31.12.2012 | By Interest A/c [10% on ₹4,62,000] | 46,200 | | | |
| | | 5,08,200 | | | 5,08,200 | | | |
| 31.12.2013 | To Machinery A/c | 2,00,000 | 01.01.2013 | By Balance b/d | 2,80,000 | | | |
| | To Balance c/d | 1,08,000 | 31.12.2013 | By Interest A/c | 28,000 | | | |
| | | 3,08,000 | | | 3,08,000 | | | |



Working Notes:

1. Book value of machine left and repossessed

| | 1 left | 2 repossessed |
|--|----------|---------------|
| A. Costs | 2,00,000 | 4,00,000 |
| B. Less: Depreciation for 3 years @10% | (60,000) | (1,20,000) |
| | 1,40,000 | 2,80,000 |

2. Agreed Value of 2 Machinery Repossessed = Cash Price – 50% of cash price

$$= ₹(4,00,000 - 2,00,000) = ₹2,00,000$$

3. Loss on Default = Agreed Value – Book Value

$$= ₹(2,00,000 - 2,80,000) = ₹80,000$$

Illustration 12.

X purchased a truck for ₹ 2,80,000, payment to be made ₹ 91,000 down and 3 installments of ₹ 76,000 each at the end of each year. Rate of interest is charged at 10% p.a. Buyer depreciates assets at 15% p.a. on written down value method.

Because of financial difficulties, X, after having paid down payment and first installment to the end of 1st year could not pay second installment and seller took possession of the truck. Seller, after spending ₹ 9,200 on repairs of the asset sold for ₹ 150,000. Show the relevant accounts in the books of the purchaser & the vendor.

Solution:

| Particulars | Total Cash Price ₹ | Installment Paid @ 10% Int ₹ | Interest Paid ₹ | Paid towards Cash Price (Installment-Interest) ₹ |
|-----------------|-----------------------|---------------------------------|--------------------|---|
| Down Payment | 280,000 | | | |
| | 91,000 | 91,000 | 0 | 91,000 |
| End of 1st year | 189,000 | | | |
| | 57,100 | 76,000 | 18,900 | 57,100 |
| End of 2nd Year | 131,900 | | | |
| | 62,810 | 76,000 | 13,190 | 62,810 |
| End of 3rd Year | 69,090 | | | |
| | 69,090 | 76,000 | 6,910 | 69,090 |
| Total | 0 | 3,19,000 | 39,000 | 2,80,000 |

In the Books of X

Dr.

Car Account

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------|---------------|-------------|------|---------------------|-------------|
| 1st Year | To Vendor A/c | 2,80,000 | | By Depreciation A/c | 42,000 |
| | | | | By Bal c/d | 2,38,000 |
| | | | | | 2,80,000 |
| | | 2,80,000 | | | 35,700 |
| 2nd Year | To Bal b/d | 2,38,000 | | By Depreciation A/c | 1,45,090 |
| | | | | By Vendors A/c | 57,210 |
| | | 2,38,000 | | By P/L A/c | 2,38,000 |
| | | | | (Bal. figure) | |

| Dr. | | | Vendors Account | | | Cr. | | |
|----------|--|-------------|-----------------|-------------------------|-------------|-----|--|--|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ | | | |
| 1st Year | To Bank (Down Payment) | 91,000 | | By Car (Cash Price) A/c | 2,80,000 | | | |
| | To Bank (Installment) | 76,000 | | By Interest A/c | 18,900 | | | |
| | To Bal c/d | 1,31,900 | | | | | | |
| | | 2,98,900 | | | 2,98,900 | | | |
| 2nd Year | To Asset A/c (Default- Assets taken over | 1,45,090 | | By Balance b/d | 1,31,900 | | | |
| | | 1,45,090 | | " Interest A/c | 13,190 | | | |
| | | | | | 1,45,090 | | | |

In the Books of Vendor

| Dr. | | | X Account | | | Cr. | | |
|-------------|-------------------------------|-------------|-----------|---------------------------|-------------|-----|--|--|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ | | | |
| 1st Year | To Hire Purchase Sales A/c | 2,80,000 | | By Bank (Down) A/c | 91,000 | | | |
| | To Interest A/c | 18,900 | | By Bank (Installment) A/c | 76,000 | | | |
| | | | | By Balance c/d | 1,31,900 | | | |
| | | 2,98,900 | | | 2,98,900 | | | |
| 2nd Year | To Balance b/d | 1,31,900 | | By Goods Repossessed A/c | 1,45,090 | | | |
| | To Interest A/c | 13,190 | | | | | | |
| | | 1,45,090 | | | 1,45,090 | | | |
| | | | | | | | | |

| Dr. | | | Goods Repossessed Account | | | Cr. | | |
|------|--------------------------------|-------------|---------------------------|-------------------------|-------------|-----|--|--|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ | | | |
| | To X A/c (Purchaser) A/c | 1,45,090 | | By Bank (Sales) A/c | 1,50,000 | | | |
| | To Bank (Repairing Charge) A/c | 9,200 | | By P/L A/c (Bal Figure) | 4,290 | | | |
| | | 1,54,290 | | | 1,54,290 | | | |

Illustration 13.

Z Associates purchased seven trucks on hire purchase on 1st July, 2012. The cash purchase price of each truck was ₹ 1,00,000. The company has to pay 20% of the cash purchase price at the time of delivery and the balance in five half yearly instalment starting from 31st December, 2012 with interest at 5% per annum at half yearly rates. On the Company's failure to pay the instalment due on 30th June 2013, it was agreed that the Company would return 3 trucks to the vender and the remaining four would be retained. The vendor agreed to allow him a credit for the amount paid against these 3 trucks less 25%. Show the relevant Accounts in the books of the purchaser and vendor assuming the books are closed in June every year and depreciation @ 20% p.a. is charged on Trucks. Vendor after spending ₹2,000 on repairs sold away all the three trucks for ₹ 80,000.



Solution :

In Books of Hire-Purchaser

| Dr. | | | Cr. | | |
|----------------|---|----------|----------|---|----------|
| Trucks Account | | | | | |
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.07.12 | To Hire Vendor's A/c (Cost of Trucks @ ₹ 1,00,000 each) | 7,00,000 | 30.06.13 | By Depreciation A/c | 1,40,000 |
| | | | | By Hire Vendor's A/c (Value of 3 Trucks returned to Vendor) | 81,000 |
| | | | | By P & L A/c (Loss on surrender) | 1,59,000 |
| | | | | By Balance c/d [4/7 of (₹7,00,000 - ₹1,40,000)] | 3,20,000 |
| | | 7,00,000 | | | 7,00,000 |

| Dr. | | | Cr. | | |
|-----------------------|---|----------|----------|-----------------------------------|----------|
| Hire Vendor's Account | | | | | |
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.07.12 | To Bank A/c (7,00,000 × 20/100) | 1,40,000 | 01.07.12 | By Trucks A/c | 7,00,000 |
| | | | 31.12.12 | By Interest A/c [5,60,000 × 2.5%] | 14,000 |
| 31.12.12 | To Bank A/c [(20% of 5,60,000 + 14,000)] | 1,26,000 | 30.06.13 | By Interest A/c [4,48,000 × 2.5%] | 11,200 |
| 30.06.13 | To Trucks A/c (Value of Trucks surrendered) | 81,000 | | | |
| 30.06.13 | To Balance c/d | 3,78,200 | | | |
| | | 7,25,200 | | | 7,25,200 |

Rate of interest is $[5\% \div 2] = 2.5\%$ for half year.

Working Notes :

| | | |
|------|--|---------------------------|
| (i) | Credit allowed by Vendor against 3 trucks | ₹ |
| | Total amount of principal paid against 7 trucks (₹ 1,40,000 + ₹ 1,12,000) | 2,52,000 |
| | Total amount of principal paid against 3 trucks (₹ 2,52,000 × 3/7) Credit allowed by Vendor (₹ 1,08,000 – 25% of ₹ 1,08,000) | 1,08,000 <u>81,000</u> |
| (ii) | Loss on surrender of 3 trucks | |
| | Book value of 3 trucks surrendered [(₹ 1,00,000 × 3) less 20% of ₹ 3,00,000] | 2,40,000 |
| | Less : Credit allowed by Vendor against these 3 Trucks | <u>81,000</u> |
| | Loss on surrender of 3 Trucks | <u>1,59,000</u> |

In Books of Hire Vendor

Dr.

Z Associates Account

Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|-------------------|----------|----------|--------------------------|----------|
| 01.07.12 | To H.P. Sales A/c | 7,00,000 | 01.07.12 | By Bank A/c | 1,40,000 |
| 31.12.12 | To Interest A/c | 14,000 | 31.12.12 | By Bank A/c | 1,26,000 |
| 30.06.13 | To Interest A/c | 11,200 | 30.06.13 | By Goods Repossessed A/c | 81,000 |
| | | | 30.06.13 | By Balance c/d | 3,78,200 |
| | | 7,25,200 | | | 7,25,200 |

Dr.

Goods Repossessed Account

Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|---------|---------------------------|--------|---------|--|--------|
| 30.6.13 | To Banerjee & Co. | 81,000 | 30.6.13 | By Bank A/c (Sales) | 80,000 |
| 30.6.13 | To Cash A/c (expenses) | 2,000 | 30.6.13 | By Profit & Loss A/c (Loss on Sale) | 3,000 |
| | | 83,000 | | | 83,000 |

Illustration 14.

On 1.1.2010, B & Brothers bought 5 computers from Chirag Computers on hire-purchase. The cash price of each computer was ₹ 20,000. It was agreed ₹ 30,000 each at the end of each year. The Vendor charges interest @ 10% p.a. The buyer depreciates computers at 20% p.a. on the diminishing balance method.

B & Brothers paid cash down of ₹ 5,000 each and two instalments but failed to pay the last instalment. Consequently, the Computer Traders repossessed three sets, leaving two sets with the buyer and adjusting the value of 3 sets against the amount due. The sets repossessed were valued on the basis of 30% depreciation p.a. on the written down value. The sets repossessed were sold by the Chirag Computers for ₹ 30,000 after necessary repairs amounting to ₹ 5,000 on 30th June 2013.

Required : Open the necessary ledger account in the books of both the parties.

Solution :

In the Books of B & Brothers

Dr.

Computers Account

Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|----------------------------|----------|----------|--|----------|
| 01.01.10 | To Chirag Computers A/c | 1,00,000 | 31.12.10 | By Depreciation A/c | 20,000 |
| | | 1,00,000 | | By Balance c/d | 80,000 |
| | | 80,000 | | | 1,00,000 |
| 01.01.11 | To Balance b/d | 80,000 | 31.12.11 | By Depreciation A/c | 16,000 |
| | | 80,000 | | By Balance c/d | 64,000 |
| | | 64,000 | | | 80,000 |
| 31.12.12 | To Balance b/d | 64,000 | 31.12.12 | By Depreciation A/c | 12,800 |
| | | | | By Chirag Computers (computers surrendered) | 20,580 |
| | | | | By P & L A/c - Loss on surrender | 10,140 |
| | | 64,000 | | By Balance c/d | 20,480 |
| | | | | | 64,000 |



Dr.

Chirag Computers Account

Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|----------|--------------------------------|----------|----------|---------------------------------|----------|
| 01.01.10 | To Cash A/c | 25,000 | 01.01.10 | By Computers A/c | 1,00,000 |
| 31.12.10 | To Cash A/c | 30,000 | 31.12.10 | By Interest A/c | 7,500 |
| | To Balance c/d | 52,500 | | [(₹ 1,00,000 – ₹ 25,000) × 10%] | 1,07,500 |
| | | 1,07,500 | | | 52,500 |
| 31.12.11 | To Cash | 30,000 | 01.01.11 | By Balance b/d | 5,250 |
| | To Balance c/d | 27,750 | 31.12.11 | By Interest A/c | 57,750 |
| | | 57,750 | | [52,500 × 10%] | 27,750 |
| | | 20,580 | | | 2,250 |
| 31.12.12 | To Computers A/c (surrendered) | 9,420 | 01.01.12 | By Balance b/d | |
| | To Balance c/d | 30,000 | 31.12.12 | By Interest A/c | 30,000 |
| | | | | | |

Working Notes :

(i) Total Interest = Hire Purchase Price – Cash Price

$$= [₹ 25,000 + (₹ 30,000 \times 3)] - (₹ 20,000 \times 5)$$

$$= ₹ 1,15,000 - ₹ 1,00,000 = ₹ 15,000$$

(ii) Interest for 3rd year = ₹ 15,000 – ₹ 7,500 – ₹ 5,250 = ₹ 2,250

(iii) Agreed Value of 3 Computers Repossessed on the basis of depreciation @ 30% p.a.

| | |
|---|-----------------|
| | ₹ |
| Cost (Cash Price) of 3 Computers | 60,000 |
| Less : Depreciation @ 30% p.a. for 3 years [₹ 18,000 + ₹ 12,600 + ₹ 8,820] | <u>39,420</u> |
| | <u>20,580</u> |
| (iv) Book Value of 3 Computers Repossessed on the basis of depreciation @ 20% p.a | |
| Cost (Cash Price) of 3 Computers | 60,000 |
| Less : Depreciation @ 20% WDV for 3 years [₹ 12,000 + ₹ 9,600 + ₹ 7,680] | <u>29,280</u> |
| | <u>30,720</u> |
| (v) Loss on Surrender = Book value – Agreed Value = ₹ 30,720 – ₹ 20,580 = | ₹ <u>10,140</u> |

**In the Books of Chirag Computers
B & Brothers Account**

| Dr. | | | Cr. | | |
|----------|-------------------|----------|----------|--------------------------|----------|
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 01.01.10 | To H.P. Sales A/c | 1,00,000 | 01.01.10 | By Cash A/c | 25,000 |
| 31.12.10 | To Interest A/c | 7,500 | 31.12.10 | By Cash A/c | 30,000 |
| | | 1,07,500 | | By Balance c/d | 52,500 |
| | | | | | 1,07,500 |
| 01.01.11 | To Balance b/d | 52,500 | 31.12.11 | By Cash A/c | 30,000 |
| 31.12.11 | To Interest A/c | 5,250 | 31.12.11 | By Balance c/d | 27,750 |
| | | 57,750 | | | 57,750 |
| 01.01.12 | To Balance b/d | 27,750 | 31.12.12 | By Goods Repossessed A/c | 20,580 |
| 31.12.12 | To Interest A/c | 2,250 | | By Balance c/d | 9,420 |
| | | 30,000 | | | 30,000 |

| Dr. | | | Cr. | | |
|----------------------------------|-------------------------------|--------|----------|-------------|--------|
| Goods Repossessed Account | | | | | |
| Date | Particulars | ₹ | Date | Particulars | ₹ |
| 30.06.13 | To B & Brothers A/c | 20,580 | 30.06.13 | By Cash A/c | 30,000 |
| 30.06.13 | To Cash A/c (Repairs) | 5,000 | | (sales) | |
| 30.06.13 | To Profit & Loss A/c (Profit) | 4,420 | | | |
| | | 30,000 | | | 30,000 |

SELF EXAMINATION QUESTIONS:

1. In the hire purchase system interest charged by vendor is calculated on the basis of
 - (A) Outstanding cash Price
 - (B) Hire purchase Price
 - (C) Installment amount
 - (D) None of the above

2. Shiva purchased a laptop on hire-purchase system. As per terms, he is required to pay ₹ 7,500 down, ₹10,000 at the end of first year, ₹7,500 at the end of second year, and ₹12,500 at the end of third year. Interest is charged at 12% per annum. The interest payable with the installment at the end of second year will be
 - (A) ₹900
 - (B) ₹1,999
 - (C) ₹804
 - (D) ₹1,760

3. Excess of hire purchase price over cash price is know as
 - (A) Installment
 - (B) Cash down payment
 - (C) Interest
 - (D) Capital value of asset

4. Arti Ltd. purchased a machine on hire purchase system for a cash price ₹5,00,000 to be paid as ₹78,700 cash down and the balance by three equal annual installment of ₹ 2,00,000 each. If interest is charged @ 20% per annum then amount of interest payable in second installment will be
 - (A) ₹1,00,000
 - (B) ₹61,112
 - (C) ₹33,328
 - (D) ₹84,260

5. In Hire Purchase system cash price plus interest is known as
- Capital value of asset
 - Book value of asset
 - Hire purchase price of asset
 - Hire purchase charges

Answer:

| | | | | |
|--------|--------|--------|--------|--------|
| 1. (A) | 2. (B) | 3. (C) | 4. (B) | 5. (C) |
|--------|--------|--------|--------|--------|

State whether the following statement is True (or) False:

- In a hire purchase system of maintaining accounts, when there is default in making payments in appropriate time, the owner takes back the ownership of the goods.
- Excess of hire-purchase price over cash price is known as penalty imposed on hire purchaser by the vendor.
- In Hire Purchase transaction the right to sell or transfer of the goods remains with Seller.

QUESTIONS:

1. On 01.01.2010 Dola Ltd. purchased a Taxi from Sayan Ltd., on hire purchase system. A Down payment of ₹15,000 and 3 equal instalments together with interest @ 5% per annum on the outstanding balance of capital sum are to be made. The amount of last installment payment was ₹15,750. Depreciation has to be provided @ 10% under reducing balance method.

At the end of 3rd year the taxi was sold for ₹25,000 in cash.

Prepare Taxi Account and Vendor Account in the books of Dola Ltd.

Answer:

| | | |
|--------------------------------------|----------------------|---------------|
| [Depreciation on 31.12.2010 — | 31.12.2010 | ₹6,000 |
| | 31.12.2011 | ₹5,400 |
| | 31.12.2012 | ₹4,860 |
| Interest for | 2010 — ₹2,250 | |
| | 2011 — ₹1,500 | |
| | 2012 — ₹750] | |

2. On 1st April, 2012 Gauru & Co. purchased a machinery on hire purchases system from Machinery Mart for a cash price of ₹ 7,50,000 to be paid as ₹ 1,18,050 cash down and the balance by three equal annual installments of ₹ 3,00,000 each. Interest is charged @ 20% per annum. Gauru & Co. has decided to write off depreciation on machinery @ 15% per annum on diminishing balance method. Gauru & Co. paid the installment due at the end of the first year but could not pay the next installments. On 31st March, 2014 the Machinery Mart took the possession of the machinery. On 15th April, 2014 the Machinery Mart spent ₹30,000 on the repairs of the machinery and sold it for ₹1,80,000 on 20th April, 2014. Installment due on 31.03.2014 was paid by Gauru & Co. on 10th April. You are required to prepare:
- Gauru & Co.'s Account and Returned Stock Account in the books of Machinery Mart.
 - Machinery Account and Machinery Mart's Account in the books of Gauru & Co.

Answer:

Calculation of Interest included in each instalment.

| Installment | Amount of Installment (₹) | Interest (₹) | Payment of Cash Price (₹) |
|------------------------|---------------------------|---------------------------------------|---------------------------|
| 1 | 3 | 4 | (3 - 4) = 5 |
| Cash down on 1-04-2012 | 1,18,050 | — | 1,18,050 |
| (i) 31-03-13 | 3,00,000 | $6,31,950 \times (20/100) = 1,26,390$ | 1,73,610 |
| (ii) 31-3-14 | 3,00,000 | $4,58,340 \times (20/100)$ | 2,08,332 |
| (iii) 31-03-15 | 3,00,000 | 49,992 | 2,50,008 |

3. On 1st April, 2010 Guru purchased a machinery for cash price of ₹5,06,872 on hire purchase system from Machinery Mart. Payment to be made ₹1,50,000 down and the balance by four equal annual installments. Interest is charged @ 15% per annum. Guru depreciates machinery at 20% per annum on written down value method. Guru paid down payment and first two installments but could not pay the remaining installments. On 31st March, 2013 the Machinery Mart took possession of machinery.

You are required to prepare Machinery Account and Machinery Mart Account in the books of Guru.

Since the problem is silent regarding the amount of equal instalment, it is assumed that the balance of cash price will be paid equally along with the interest on the amount outstanding.

Answer:

Calculation of Interest

| Opening Cash Price | Installment | Interest | Payment of Principle |
|--------------------|-------------|---------------------------------|----------------------|
| 5,06,872 | 1,50,000 | — | 1,50,000 |
| 3,56,872 | 1,42,749 | $3,56,872 \times 15\% = 53,531$ | 89,218 |
| 2,67,654 | 1,29,366 | $2,67,654 \times 15\% = 40,148$ | 89,218 |
| 1,78,436 | 1,15,972 | $1,78,436 \times 15\% = 26,754$ | 89,218 |
| 89,218 | 1,02,601 | $89,218 \times 15\% = 13,383$ | 89,218 |

4. Exe Ltd. purchased a vehicle for ₹2,80,000, down payment to be made ₹91,000 and 3 installments of ₹76,000 each at the end of each year. Rate of interest is charged at 10% p.a.

Buyer depreciates assets at 15% on written down value method.

Because of financial difficulties, Exe Ltd. after having paid the down payment and first installment at the end of 1st year, could not pay the second installment. Hence, the seller took possession of the vehicle. The Seller after spending ₹ 9,200 on repairs of the asset, sold it for ₹1,50,000. Show the relevant accounts in the books of the purchaser and the vendor.

Answer:

Calculation on Interest

| Particulars | Total Cash Price | Installment Paid @10% Int. | Interest Paid | Paid towards Cash Price (installment -Int.) |
|-----------------|------------------|----------------------------|---------------|---|
| | 2,80,000 | | | |
| Down Payment | 91,000 | 91,000 | NIL | 91,000 |
| | 1,89,000 | | | |
| End of 1st year | 57,100 | 76,000 | 18,900 | 57,100 |
| | 1,31,900 | | | |
| End of 2nd year | 62,810 | 76,000 | 13,190 | 62,810 |
| | 69,090 | | | |
| End of 3rd year | 69,090 | 76,000 | 6,910 | 69,090 |
| TOTAL | Nil | 3,19,000 | 39,000 | 2,80,000 |

Study Note - 10

BRANCH AND DEPARTMENTAL ACCOUNTS



This Study Note includes

10.1 Branch Accounts

10.2 Departmental Accounts

10.1 BRANCH ACCOUNTS INCLUDING FOREIGN BRANCH

A Branch is a subordinate division of an office.

Section 2(14) of the Companies Act, 2013 defines a Branch Office as-

- Any establishment described as a Branch by the Company

Classification of Branches :

A. Inland Branches:

- (i) Dependent Branches : branches in respect of which the whole of the accounting records are kept at Head Office only.
- (ii) Independent Branches : branches which maintain independent accounting records.

B. Foreign Branches : branches which are located in a foreign country(i.e. in a country other than in which the company is incorporated and registered)

Dependent Branches

Branch Accounts can be maintained at the Head Office, particularly when the business policies and administration of the Branch are wholly controlled by the Head office.

The Branch prepares the periodic returns based on which the accounting records are maintained at the Head Office.

Methods of Accounting :

- (i) Final Accounts Method;
- (ii) Debtors Method and
- (iii) Stock and Debtors Method.

FINAL ACCOUNTS METHOD

Final Accounts Method

Under this method, the profit or loss of the branch is ascertained by preparing the Branch Trading and Profit and Loss Account in place of Branch Account.

(a) At cost price**Branch Trading and Profit & Loss Account**

Dr.

Cr.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--|-------------|---|-------------|
| To Opening Stock at Branch (at Cost) | xxx | By Sales made at Branch (net of returns) | |
| To Goods sent from Head Office | xxx | — Cash | xxx |
| Less : Goods returned to H.O. | xxx | — Credit | xxx |
| To Purchases (made directly by Branch, if any) | xxx | By Closing Stock at Branch (at Cost) | xxx |
| To Direct Expenses at Branch (if any) | xxx | | |
| To Gross profit c/d | xxx | | xxx |
| | xxx | | xxx |
| To Various expenses incurred at Branch (including Bad Debts if any) | xxx | By Gross profit b/d | xxx |
| To General P&L Account | xxx | | |
| (Net Profit transferred) | xxx | | xxx |

Illustration 1.

From the following particulars prepare Branch Trading and Profit and Loss Account in the books of Head Office:

The Delhi stores invoiced goods to its Patna Branch at cost which sells both for cash and credit. Cash received by the branch is remitted to H.O. Branch expense are paid direct from the H.O. except petty expense which are met by the branch.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|------------------------|-------------|-----------------------------|-------------|
| Opening Balance: | | Rates & Taxes | 3,000 |
| Stock | 5,000 | Salary & Wages | 6,000 |
| Debtors | 20,000 | Petty expense by the branch | 1,000 |
| Petty Cash | 1,000 | Pilferage of goods | 1,000 |
| Goods from H.O. | 50,000 | Closing Balance: | |
| Cash Sales | 30,000 | Stock | 8,000 |
| Credit Sales | 40,000 | Debtors | 25,000 |
| Sales Return | 4,000 | Petty Cash | 800 |
| Bad Debts | 1,000 | | |
| Discount Allowed | 1,000 | | |
| Goods returned to H.O. | 5,000 | | |



Solution:

In the books of H.O.
Branch Trading and Profit and Loss Account
for the year ended.....

| Dr. | Amount | Amount | Cr. | Amount | Amount |
|------------------------|--------|---------------|-------------------------|--------|---------------|
| Particulars | ₹ | ₹ | Particulars | ₹ | ₹ |
| To Opening Stock | | 5,000 | By Sales: | | |
| „ Goods sent to Branch | 50,000 | | Cash Sales | | 30,000 |
| Less: Returns | 5,000 | 45,000 | Credit Sales | 40,000 | |
| | | | Less: Return | 4,000 | 36,000 |
| „ Gross Profit c/d | | 25,000 | „ Closing Stock | 8,000 | |
| | | 75,000 | Add: Pilferage of Stock | 1,000 | 9,000 |
| | | | | | 75,000 |
| To Pilferage of Stock | | 1,000 | By Gross Profit b/d | | 25,000 |
| „ Bad Debt | | 1,000 | | | |
| „ Discount Allowed | | 1,000 | | | |
| „ Rates & Taxes | | 3,000 | | | |
| „ Salaries & wages | | 6,000 | | | |
| „ Petty Expense | | 1,000 | | | |
| „ General P & L A/c | | 12,000 | | | |
| Net Profit transferred | | | | | |
| | | 25,000 | | | 25,000 |

(b) At Invoice Price

If goods are invoiced above cost, the loading (i.e, profit element) on Opening Stock, Goods Sent from Head office (net of returns) and Closing Stock are **reversed**, to ascertain the true profits.

Illustration 2.

X Ltd. has its H.O. in Delhi and a branch in Mumbai. H.O. supplied goods to its branch at cost plus $33\frac{1}{3}\%$. From the particulars given below prepare a Branch Trading Account in the books of H.O.

| Particulars | Amount | Particulars | Amount |
|-----------------------------|----------|-------------------------------|----------|
| | ₹ | | ₹ |
| Opening Stock (I.P.) | 40,000 | Sales: | |
| Goods sent to Branch (I.P.) | 2,50,000 | Cash | 1,00,000 |
| Return to H.O. (I.P.) | 10,000 | Credit | 3,00,000 |
| | | Discount allowed to customers | 10,000 |
| | | Closing Stock (I.P.) | 60,000 |

It is estimated that 2% of the goods received are lost through natural wastage.

Solution:

**In the books of H.O.
Trading Account
for the year ended.....**

| Dr. | Amount ₹ | Amount ₹ | Cr. | Amount ₹ | Amount ₹ |
|---|-------------|-----------------|---------------------------------|-------------|-----------------|
| To Opening Stock | 40,000 | | By Sales: | | |
| Less: Loading | 10,000 | 30,000 | Cash | 1,00,000 | |
| | | | Credit | 3,00,000 | 4,00,000 |
| „ Goods sent to Branch | 2,50,000 | | „ Closing Stock | 60,000 | |
| Less: Returns to H.O. | 10,000 | | Less : Loading | 15,000 | 45,000 |
| | 2,40,000 | | ($\frac{1}{4} \times 60,000$) | | |
| Less: Loading ($\frac{1}{4} \times 2,40,000$) | 60,000 | 1,80,000 | | | |
| [$\frac{1}{3}$ on CP = $\frac{1}{4}$ on SP] | | | | | |
| „ Gross Profit c/d | | 2,35,000 | | | |
| | | 4,45,000 | | | 4,45,000 |

Note:

1. Discount allowed to customer will appear in Branch Profit & Loss Account.
2. Loss through natural wastage is a normal loss and as such, the same should be charged against branch gross profit. So, no adjustment is required.

Illustration 3.

Y Ltd. with its H.O. in Delhi invoiced goods to its branch at Patna at 20% less than the catalogue price which is cost plus 50%, with instruction that cash sales were to be made at invoice price and credit sales at catalogue price less discount at 15% on prompt payment.

From the following particulars, prepare the Branch Trading and Profit and Loss Account for the year ended 31st March 2013 in H.O. books so as to show the actual profit and loss for the branch for the year.

| Particulars | Amount ₹ | Particulars | Amount ₹ | Amount ₹ |
|-----------------------------------|-------------|-------------------------------------|-------------|-------------|
| Stock on 1.4.2012 (Invoice Price) | 12,000 | Discount allowed to Debtors | 13,365 | |
| Debtors („) | 10,000 | Expense | 6,000 | |
| Goods received from H.O. (I.P.) | 1,32,000 | Remittance to H.O. | 1,20,000 | |
| Cash sales | 46,000 | Debtors (31.03.2013) | 11,000 | |
| Credit Sales | 1,00,000 | Cash in hand (31.03.2013) | 5,635 | |
| Cash received from Debtors | 85,635 | Stock on 31.03.2013 (Invoice Price) | 15,000 | |

It was further reported that a part of stock at the branch was lost by fire (not covered by insurance) during the year whose value is to be ascertained and provisions should be made for discount to be allowed to Debtors as on 31.03.2013 on the basis of years trend of prompt payment.



Solution:

In the books of H.O.
Branch Trading & Profit and Loss Account
for the year ended 31st March, 2013

Dr.

Cr.

| Particulars | Amount ₹ | Amount ₹ | Particulars | Amount ₹ | Amount ₹ |
|--|-------------|-----------------|---|-------------|-----------------|
| To Opening Stock (₹12,000 × $\frac{100}{120}$) | | 10,000 | By Sales: | | |
| „ Goods sent to Branch (₹1,32,000 × $\frac{100}{120}$) | | 1,10,000 | Cash | 46,000 | |
| „ Gross Profit c/d | | 41,000 | Credit | 1,00,000 | 1,46,000 |
| | | 1,61,000 | „ Closing Stock (₹15,000 × $\frac{100}{120}$) | 12,500 | |
| „ Branch Expense | | 6,000 | Add: Stock Destroyed (Bal. fig.) | 2,500 | 15,000 |
| „ Discount Allowed | | 13,365 | | | 1,61,000 |
| „ Stock Destroyed by fire [₹ 3,000 – 500] | | 2,500 | By Gross Profit b/d | | 41,000 |
| „ Provision for Discount | | 1,337 | | | |
| „ General Profit & Loss A/c (Net Profit Transferred) | | 17,798 | | | |
| | | 41,000 | | | 41,000 |

Working:

1. Cost price Catalogue Price Invoice Price (Cat. Price – 20%)
 ₹100 = ₹100 + 50% = ₹150 – ₹30
 = ₹150 = ₹120
2. Stock Destroyed by fire

| Particulars | Amount ₹ | Amount ₹ |
|--|-------------|-------------|
| Opening Stock (I.P.) | | 12,000 |
| Add: Goods Sent (I.P.) | | 1,32,000 |
| | | 1,44,000 |
| Less: Cash Sales | 46,000 | |
| Invoice value of goods sold on credit (₹1,00,000 × $\frac{120}{150}$) 80,000 | 80,000 | |
| Closing Stock (I.P.) | 15,000 | 1,41,000 |
| Stock Destroyed by fire | | 3,000 |

3. Provision for Discount on Debtors

Prompt payment by Debtors ₹89,100 (i.e., ₹13,365 x $\frac{100}{15}$)

Out of ₹1,10,000 (i.e., 1,00,000 + 10,000), Portion of prompt payment $\frac{89,100}{1,10,000} \times 100 = 81\%$

∴ for closing debtors of ₹11,000 prompt payment to be made for ₹8,910 i.e. (₹11,000 × 81%)

So, Provision for Discount will be ₹8,910 x $\frac{50}{100} = ₹ 1,337$

Wholesale and Retail profit at Branch

A branch may be operated both under the retail profit basis as well as under wholesale profit basis. For instance, the cost price of a product is ₹100, the retail price is ₹160, and the wholesale price is ₹150. Now, under retail profit basis there will be a profit of ₹60 (i.e., ₹160 - ₹100) earned by the branch. But if it is sold under wholesale basis, the amount of profit will be ₹50. Usually, it is the usual practice to debit branch with wholesale profit basis to know the usual profit made by a branch. For this purpose, H.O. Trading account will be credited with goods sent to branch at wholesale price. At the same time, closing stock at branch should be valued as per wholesale price basis. For this, H.O. should make proper reserve on closing stock at branch. The entry will be

Profit & Loss A/c Dr. (Wholesale price - Cost price.)
 To Stock Reserve A/c

Illustration 4.

X Ltd. has a retail branch at Puri. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Delhi H.O. to branch at Puri at Wholesale price. From the following particulars ascertain the profit made at H.O. and branch for the year ended 31st March 2013.

| Particulars | H.O. ₹ | Branch ₹ |
|---|-----------|-------------|
| Stock on 01.04.2012 | 7,00,000 | --- |
| Purchase | 42,00,000 | --- |
| Goods sent to Branch (at invoice price) | 15,12,000 | --- |
| Sales | 42,84,000 | 14,40,000 |
| Stock on 31.03.2013 | 16,80,000 | 2,52,000 |
| Expenses | 80,000 | 40,000 |

Sales at H.O. are made only on wholesale basis and that at branch only to customers. Stock at H.O. is valued at invoice price.



Solution:

In the books of H.O.
Puri Branch Trading Account
for the year ended 31st March, 2013

Dr.

Cr.

| Particulars | H.O. | Branch | Particulars | H.O. | Branch |
|----------------------------------|-----------|-----------|---------------------------------|-----------|-----------|
| | ₹ | ₹ | | ₹ | ₹ |
| To Opening Stock (I.P.) | 7,00,000 | --- | By Sales | 42,84,000 | 14,40,000 |
| „ Goods sent to Branch (I.P.) | --- | 15,12,000 | „ Goods sent to Branch (I.P.) | 15,12,000 | --- |
| „ Purchase | 42,00,000 | --- | „ Closing Stock | | |
| „ Gross Profit c/d | 25,76,000 | 1,80,000 | | 16,80,000 | 2,52,000 |
| | 74,76,000 | 16,92,000 | | 74,76,000 | 16,92,000 |
| To Expenses | 80,000 | 40,000 | By Gross Profit b/d | 25,76,000 | 1,80,000 |
| „ Closing Stock Reserve | 72,000 | --- | By Opening Stock Reserve | 2,00,000 | - |
| on Branch Stock: | | | Provision for unrealized profit | | |
| (₹2,52,000 × $\frac{40}{140}$) | 4,80,000 | --- | (₹7,00,000 × $\frac{40}{140}$) | | |
| On H.O. Stock: | | | | | |
| (₹16,80,000 × $\frac{40}{140}$) | | | | | |
| | 21,44,000 | | | | |
| „ General P&L A/c | | 1,40,000 | | | |
| (Net profit Transferred) | 27,76,000 | 1,80,000 | | 27,76,000 | 1,80,000 |

Working:

Let Cost price ₹100; Wholesale Price = ₹100 + ₹40 = ₹140; Invoice price ₹140; Selling Price at H.O. ₹140.

Selling price at Branch ₹100 + ₹60 = ₹160.

As goods are sent to branch at wholesale price i.e., ₹140, branch stock should be valued at the same price.

Wholesale profit on opening stock of H.O. = ₹7,00,000 × $\frac{40}{140}$ = ₹2,00,000

on Closing stock of H.O. = ₹16,80,000 × $\frac{40}{140}$ = ₹4,80,000

on Closing stock of Branch = ₹2,52,000 × $\frac{40}{140}$ = ₹72,000.

DEBTORS METHOD :

This method is usually adopted when the branch is of small size. Under this method, the head office maintains separate Branch Account for each branch. Its purpose is to ascertain profit or loss made by each branch.

Journal Entries under Debtors Method:

| Situation | Journal |
|--|---|
| 1. To record Opening Balances of Branch Assets | Branch A/c Dr. To Branch Assets (Individually) |
| 2. To record Opening Balances of Branch Liabilities | Branch Liabilities (Individually) Dr. To Branch A/c |
| 3. When goods are supplied by the Head Office/another Branch to Branch | Branch A/c Dr. To Goods sent to Branch A/c |
| 4. When goods are returned by the Branch / Branch Customers directly to the Head Office | Goods Sent to Branch A/c Dr. To Branch A/c |
| 5. When goods are supplied by the Branch to another Branch as per instructions of Head office | Goods Sent to Branch A/c Dr. To Branch A/c |
| 6. When goods are supplied by the Head office but not received by the Branch head | Goods-in Transit A/c Dr. To Branch A/c |
| 7. When the Head Office meets the branch expenses or sends cash to the Branch for meeting expenses | Branch A/c Dr. To Cash/Bank A/c |
| 8. When remittances are received by the Head Office from the Branch/ Branch Customers | Cash/Bank A/c Dr. To Branch A/c |
| 9. When remittances are sent by the Branch but not received by the Head office | Cash in-transit A/c Dr. To Branch A/c |
| 10. When the balance in Goods sent to Branch Account is transferred | Goods sent to Branch A/c Dr. To Purchases A/c (in case of Trading concerns) or, To Trading A/c (in case of manufacturing concerns) |
| 11. To record the closing balances of Branch Assets | Branch Assets A/c (Individually) Dr. To Branch A/c |
| 12. To record the closing balances of Branch Liabilities | Branch A/c Dr. To Branch Liabilities (Individually) |
| 13. To record Profit or Loss | Branch A/c Dr. |
| (i) If credit side exceeds the debit side | To General Profit & Loss A/c |
| (ii) If debit side exceeds the credit side | General Profit & Loss A/c Dr. To Branch A/c |



Format of Branch Account

A format of Branch Account is given below:

BRANCH ACCOUNT

| Dr. | | Cr. | |
|--------------------------------------|-----|---|-----|
| Particulars | ₹ | Particulars | ₹ |
| To Balance b/d: | | By Balance b/d: | |
| Stock | XXX | Creditors | XXX |
| Debtors | XXX | Outstanding Expenses | XXX |
| Petty Cash | XXX | By Bank (remittances to H.O.): | |
| Fixed Assets | XXX | by Branch | XXX |
| Prepaid Expenses | XXX | by Branch Debtors directly to H.O. | XXX |
| To Goods sent to Branch A/c: | | By Goods Sent to Branch A/c: | |
| Goods sent by H.O. | XXX | Returned by Branch | XXX |
| Goods sent by other Branches | XXX | Returned by Branch debtors directly to H.O. | XXX |
| To Bank (Remittances by H.O.) | XXX | Sent to other Branches | XXX |
| To Balance c/d: | | By Balance c/d: | |
| Creditors | XXX | Stock-in-hand | XXX |
| Outstanding Expenses | XXX | Stock-in-transit | XXX |
| *To Net Profit t/f to General P&LA/c | XXX | Cash in-transit | XXX |
| | | Debtors | XXX |
| | | Petty Cash | XXX |
| | | Fixed Assets | XXX |
| | | Prepaid Expenses | XXX |
| | | *By Net Loss t/f to General P&LA/c | XXX |
| | XXX | | XXX |

*Only one figure shall appear.

- The following **transactions do not appear in the Branch Account:**
 - (a) Expenses incurred by Branch out of cash, since either reduced cash balance at the end is decreased or the liability at the end is increased.
 - (b) Purchase of Goods/Fixed Assets by Branch, since book value of Goods/Fixed assets at the end is increased and either the amount of remittances is reduced or the Creditors at the end are increased.
 - (c) Sale of Goods/Fixed Assets by Branch since book value of Goods/Fixed assets at the end is decreased and either the amount of remittances is increased or the Debtors at the end are increased.
 - (d) Bad debts, discount allowed, sales returns by customers to branch, cash received by Branch from Branch Debtors, etc., since the debtors at the end appear at the adjusted figure.
 - (e) Depreciation and Profit/Loss on sale of fixed assets since fixed assets at the end appear at the adjusted figure.
 - (f) Abnormal Losses since stock at the end appears at the adjusted figure.

- When the branch is not authorised to keep any sum out of collections, expenses incurred by Branch out of petty cash maintained may be dealt with as under:
 - In case the petty cash is maintained on Imprest System, the expenses met by the branch are to be shown in the same manner as the branch expenses met by the Head Office. In such a case, petty cash balance at the end appears at the same amount at which it appears in the beginning.
 - In case the petty cash is not maintained on Imprest System, the expenses met by branch are automatically charged to the Branch Account since the petty cash at the end appears at the adjusted figure.
- When goods are returned either by Branch Debtors to the H.O. directly or are sent by one branch to another branch, the entry will be same as in the case of goods returned by the Branch to the H.O.
- In case any insurance claim is admitted and paid to the Branch, either the Bank balance at the end will increase or the remittances to H.O., will increase. In case, the insurance claim is admitted but not paid, the insurance company will appear as a debtor at the end.
- To ascertain any missing figure, relating to Stock and /or Debtors, Memorandum Branch Stock Account & Memorandum Branch Debtors Account has to be prepared.

Illustration 5.

From the following information, prepare Delhi Branch Account in the books of head office for the year ending on 31st March 2013:

| Particulars | ₹ | Particulars | ₹ |
|--|-----------|--------------------------------------|-----------|
| Opening Stock (at cost) | 17,80,000 | Discount allowed to Customers | 5,000 |
| Opening Debtors | 1,40,000 | Bad Debts written off | 10,000 |
| Opening Petty Cash | 2,500 | Credit sales | 72,94,000 |
| Furniture (in the beginning) | 60,000 | Cash Sales | 3,20,000 |
| Opening Creditors | 60,000 | Petty Expenses paid by Branch | 80,000 |
| Goods sent to Branch (at Cost) | 52,20,000 | Cheques sent to Branch for expenses: | |
| Goods returned by Branch to H.O (at cost) | 78,000 | Salaries | 3,00,000 |
| Goods returned by Customers to Branch | 57,000 | Rent and Insurance | 1,20,000 |
| Cash received by Branch from its Customers | 61,10,000 | Petty Cash | 78,700 |

Goods are sold to customers at cost plus 50%. Depreciate the furniture @ 10% p.a.

Solution:

Delhi Branch Account in the books of H.O.

| Dr. | | Cr. | |
|--------------------------------------|-----------|--|-----------|
| Particulars | ₹ | Particulars | ₹ |
| To Balance b/d: | | By Balance b/d: creditors | 60,000 |
| Stock | 17,80,000 | By Bank A/c (Remittance from Branch) | 64,30,000 |
| Debtors | 1,40,000 | By Goods sent to Branch A/c (return by branch) | 78,000 |
| Petty Cash | 2,500 | By Balance c/d: | |
| Furniture | 60,000 | Stock | 18,84,000 |
| To Goods sent to Branch A/c | 52,20,000 | Debtors | 12,52,000 |
| To Bank A/c (Remittance by H.O.) | 4,98,700 | Petty Cash | 1,200 |
| To Balance c/d (creditors) | 60,000 | Furniture (₹ 60,000 – ₹ 6,000) | 54,000 |
| To Net Profit t/f to General P&L A/c | 19,98,000 | | |
| | 97,59,200 | | 97,59,200 |



Working Notes:

(i) Dr. Memorandum Branch Debtors Account Cr.

| Particulars | ₹ | Particulars | ₹ |
|-----------------|-----------|----------------------------|-----------|
| To Balance b/d | 1,40,000 | By Returns to Branch | 57,000 |
| To Credit Sales | 72,94,000 | By Discount allowed | 5,000 |
| | | By Bad Debts | 10,000 |
| | | By Cash received by Branch | 61,10,000 |
| | | By Balance c/d | 12,52,000 |
| | 74,34,000 | | 74,34,000 |

(ii) Dr. Memorandum Branch Stock Account Cr.

| Particulars | ₹ | Particulars | ₹ |
|-----------------------------|-----------|---|-----------|
| To Balance b/d | 17,80,000 | By Goods sent to Branch A/c (Return) | 78,000 |
| To Goods sent to Branch A/c | 52,20,000 | By Cost of Goods sold | 50,38,000 |
| | | [(3,20,000+72,94,000 - 57,000)x100/150] | |
| | | By Balance c/d | 18,84,000 |
| | 70,00,000 | | 70,00,000 |

(iii) Dr. Memorandum Branch Petty Cash Account Cr.

| Particulars | ₹ | Particulars | ₹ |
|-------------------------|--------|-----------------------|--------|
| To Balance b/d | 2,500 | By Petty Expenses A/c | 80,000 |
| To Remittance from H.O. | 78,700 | By Balance c/d | 1,200 |
| | 81,200 | | 81,200 |

(iv) Dr. Memorandum Branch Cash Account Cr.

| Particulars | ₹ | Particulars | ₹ |
|-------------------------|-----------|-----------------------|-----------|
| To Cash Sales | 3,20,000 | By Salaries | 3,00,000 |
| To Remittance by H.O. | 4,98,700 | By Rent & Insurance | 1,20,000 |
| To Debtors (Collection) | 61,10,000 | By Petty Cash | 78,700 |
| | | By Remittance to H.O. | 64,30,000 |
| | 69,28,700 | | 69,28,700 |

Accounting Treatment of Goods Returned and Cash Remitted by Branch Customers directly to Head Office

| Item | Treatment in Branch A/c | Treatment in Memorandum Branch Debtors A/c |
|---|--|---|
| 1. Goods returned by Branch customers directly to H.O. | Treat like goods returned by Branch to H.O. and thus, show the Cost/ Invoice price (as the case may be) of these goods on credit side of Branch Account. | Show the selling price of these goods on credit side of Branch Debtors Account. |
| 2. Cash remitted by Branch customers directly to H.O. | Treat like cash remitted by branch to H.O. and thus, show on the credit side of Branch Account. | Show on the credit side of Branch Debtors Account. |

Illustration 6.

Taking the same information as given in previous Illustration 3 along with the following information, prepare the Delhi Branch Account:

- (i) Goods returned by Branch Customers directly to H.O. ₹ 12,000
(ii) Cash remitted by Branch Customers directly to H.O. ₹ 2,80,000

Solution:

| Delhi Branch Account | | | |
|-------------------------------------|-----------------------------|--------------------------------------|-----------------|
| Dr. | In the Books of H.O. | | Cr. |
| Particulars | ₹ | Particulars | ₹ |
| To Balance b/d: | | By Balance b/d: (creditors) | 60,000 |
| Stock | 17,80,000 | By Bank A/c (Remittance from Branch) | |
| Debtors | 1,40,000 | Remittance by Branch | 64,30,000 |
| Petty cash | 2,500 | Direct Remittance by Branch | |
| Furniture | 60,000 | customers | 2,80,000 |
| To Goods sent to Branch A/c | 52,20,000 | By Goods sent to Branch A/c: | |
| To Bank A/c (Remittance by H.O.) | 4,98,700 | Return by Branch | 78,000 |
| To Balance c/d: (creditors) | 60,000 | Direct Return by Branch | |
| To Net Profit t/f to General P&LA/c | 19,94,000 | customers [12,000 x 100/150] | 8,000 |
| | | By Balance c/d: | |
| | | Stock | 18,84,000 |
| | | Debtors | 9,60,000 |
| | | Petty Cash | 1,200 |
| | | By Furniture (₹ 60,000 – ₹ 6,000) | 54,000 |
| | 97,55,200 | | 97,55,200 |

Working Notes:

| (i) Dr. | Memorandum Branch Debtors Account | | Cr. |
|--------------------|--|---------------------------------|-----------------|
| Particulars | ₹ | Particulars | ₹ |
| To Balance c/d | 1,40,000 | By Returns to Branch | 57,000 |
| To Credit Sales | 72,94,000 | By Returns to H.O. | 12,000 |
| | | By Discount allowed | 5,000 |
| | | By Bad Debts | 10,000 |
| | | By Cash remitted to H.O. | 2,80,000 |
| | | By Cash remitted to Branch | 61,10,000 |
| | | By Balance c/d | 96,0000 |
| | 74,34,000 | | 74,34,000 |



(ii) Dr.

Memorandum Branch Stock Account

Cr.

| Particulars | ₹ | Particulars | ₹ |
|-----------------------------|-----------|--|-----------|
| To Balance b/d | 17,80,000 | By Goods sent to Branch A/c: | |
| To Goods Sent to Branch A/c | 52,20,000 | — Return by Branch | 78,000 |
| | | — Direct Return by Branch | 8,000 |
| | | Customers [₹ 12,000 x 100/150] | |
| | | By Cost of Net Goods Sold [(3,20,000+72,94,000-57,000-12,000)x100/150] | 50,30,000 |
| | | By Balance c/d | 18,84,000 |
| | 70,00,000 | | 70,00,000 |

(iii) & (iv) Memorandum Branch Petty Cash Account and Memorandum Branch Cash Account - Refer to Working Note [(iii) & (iv) of Illustration 5].

Accounting Treatment of Goods Sent to Another Branch and Goods received from Another Branch

| Item | Treatment in Branch A/c | Treatment in Memorandum Branch Stock A/c |
|---|---|---|
| 1. Goods sent to another branch | Treat like goods returned to H.O. and thus, show on the credit side of Branch Account. | Treat like goods returned to H.O. and thus, show on the credit side of Branch Stock Account. |
| 2. Goods received from another branch. | Treat like goods received from H.O. and thus, show on the debit side of Branch Account. | Treat like goods received from H.O. and thus, show on the debit side of Branch Stock Account. |

Accounting Treatment of Normal Loss, Abnormal Loss, Insurance Claim and Agreed Allowance/Trade Discount

| Item | Treatment in Branch A/c | Treatment in Memorandum Branch Stock A/c |
|---|---|---|
| 1. Normal loss | Normal loss does not appear in the Branch Account since the Closing Stock appears at the adjusted figure. | Cost/Invoice price (as the case may be) of normal loss appears on the credit side of Branch Stock Account in order to reduce the figure of Closing Stock. |
| 2. Abnormal loss | Abnormal loss does not appear in the Branch Account since the Closing Stock appears at the adjusted figure. | Cost/Invoice price (as the case may be) of abnormal loss appears on the credit side of Branch Stock Account in order to reduce the figure of Closing Stock. |
| 3. Insurance claim (a) Admitted and received (b) Admitted but not yet received | Shown on the credit side of Branch Account by way of Increased Closing either Cash/Bank Balance or remittance to H.O. Shown Insurance Co. as a debtor at the end on the credit side of Branch Account. | No Treatment No Treatment |
| 4. Agreed allowance/Trade discount | Agreed Allowance/Trade Discount does not appear in the Branch Account since the closing debtors appear at the adjusted figure. | Cost/Invoice Price (as the case may be) of Agreed Allowance/ Trade Discount appears on the credit side of Branch Stock Account. |

Illustration 7.

Prepare a Branch account in the books of Head Office from the following particulars for the year ended 31st March, 2013 assuming that H.O. sold goods at cost price 25%.

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|-----------------------------|-------------|----------------------------|-------------|
| Stock on 1.4.2012 (I.P.) | 12,500 | Bad Debts | 2,000 |
| Debtors (..) | 5,000 | Allowances to customers | 1,000 |
| Purchase (..) | 1,000 | Returns Inwards | 1,000 |
| Goods sent to branch (I.P.) | 40,000 | Charges sent to Bank: | |
| Goods return to H.O. (I.P.) | 5,000 | Rates & Taxes | 3,000 |
| Cash Sales | 12,000 | Salaries | 8,000 |
| Cash received from Debtors | 30,000 | Misc. Exps. | 1,000 |
| | | Stock on 31.03.2013 (I.P.) | 15,000 |
| | | Debtors (..) | 4,000 |
| | | Petty Cash (..) | 1,000 |

Solution:

**In the books of H.O.
Branch Account**

Dr.

Cr.

| Particulars | Amount ₹ | Amount ₹ | Particulars | Amount ₹ | Amount ₹ |
|------------------------------|-------------|-------------|-------------------------------|---------------|-------------|
| To Balance b/d | | | By Stock Reserve (Loading) | | 2,500 |
| Stock | 12,500 | | .. Bank A/c: | | |
| Debtors | 5,000 | | Cash Sales | 12,000 | |
| Petty Cash | 1,000 | 18,500 | .. Cash Received from Debtors | <u>30,000</u> | 42,000 |
| .. Goods sent to branch | | 40,000 | .. Goods sent to branch | | 5,000 |
| .. Bank A/c: | | | (Return to H.O.) | | |
| Rates & Taxes | 3,000 | | .. Goods sent to branch | | 8,000 |
| Salaries | 8,000 | | >Loading) | | |
| Misc. Expenses | 1,000 | 12,000 | By Balance c/d | | |
| .. Goods sent to Branch | | 1,000 | Stock | 15,000 | |
| (Loading on returns) | | | Debtors | 4,000 | |
| .. Closing Stock Reserve | | 3,000 | Petty Cash | <u>1,000</u> | 20,000 |
| (₹ 15,000 x $\frac{1}{5}$) | | | | | |
| .. General Profit & Loss A/c | | 3,000 | | | |
| | | 77,500 | | | 77,500 |

Note: Here, loading is $\frac{25}{125} = \frac{1}{5}$ of invoice price. Hence, loading on opening stock will be ₹12,500 x $\frac{1}{5}$ = ₹2,500 and so on.



STOCK AND DEBTORS METHOD

When there are large number of transactions, this method is particularly maintained by the H.O. to make efficient control over the branches. Under this method, we are to open (a) Branch Stock Account (at invoice price); (b) Branch Debtors Account; (c) Branch Adjustment Account (for recording loading for goods and for ascertaining gross profit) (d) Branch Profit and Loss Account (for ascertaining branch net profit) (e) Goods Sent to Branch Account. In addition to above, there are certain accounts which may also be opened; viz (a) Branch Expense Account; (b) Branch Cash Account; (c) Branch Fixed Asset Account (d) Abnormal Loss / Lost-in-Transit Account etc.

Under this method, the most important account is the Branch Adjustment Account which helps to ascertain Gross Profit. It takes only the loading on Opening Stock, Closing Stock, Goods Sent to Branch, Goods Returned by Branch, any abnormal loss, Surpluse of stock etc.

Apparent Profit and Apparent Loss

An unusual increase or decrease in the value of stock arises at Branch Stock Account due to inaccurate prediction of the expected selling price of the goods which are invoiced by the H.O. Usually H.O. sent goods after charging certain percentage of profit. But in reality, the said goods are sold either at a higher or at a lower price rather than the price fixed by the H.O. for which Branch Stock Account shows either a surplus of stock which is known here as Apparent Profit or a Shortage of stock which is known as Apparent Loss. The said apparent profit or loss should be recorded as under.

(a) For Apparent Profit

Branch Stock A/c Dr.
 To Apparent Profit A/c
Apparent Profit A/c Dr.
 To Branch (Stock) Adjustment A/c

(b) In case of Apparent Loss, the entry will be reversed

Stock and Debtors Method : (for dependent branches)

1. **Ledger Accounts :** The following accounts are maintained by the Head office under the Stock and Debtors System—
- | | |
|--|--|
| (a) Branch Stock Account (or Branch Trading A/c) | — to ascertain Gross Profit |
| (b) Branch Profit and Loss Account | — to ascertain Net profit |
| (c) Branch Debtors Account | — to record Receivables/Credit Sales, if any. |
| (d) Branch Expenses Account | — to record expenses incurred at Branch |
| (e) Branch Cash Account | — to control Branch Cash position / remittances |
| (f) Branch Adjustment Account | — to reverse Loading i. e. unrealised profits, if any. |
| (g) Goods sent to Branch Account | — to record goods sent/returned |
| (h) Branch Assets Account | — to record Assets at Branch, if any. |

2. Journal Entries :

| No | Transaction | Journal Entry |
|---|--|---|
| (a) | Goods sent to Branch by HO | Branch Stock Account (total Value of goods) Dr. To Goods sent to Branch (at Cost) To Branch Adjustment A/c (loading, if any) |
| (b) | Goods returned by Branch to HO | Goods sent to Branch Account (at Cost) Dr. Branch Adjustment A/c (loading, if any) Dr. To Branch Stock A/c (total value of goods) |
| (c) | Assets provided by HO to Branch either by way of fresh purchase or by way of transfer from HO | Branch Assets Account Dr. To (Main) Cash Account/Vendor Account [or] To (HO) Assets Account (in case of transfer) |
| (d) | Cash sent to Branch for expenses | Branch Cash Account Dr. To (Main) Cash Account |
| (e) | Cash Sales at the Branch | Branch Cash Account Dr. To Branch Stock Account |
| (f) | Credit Sales at the Branch | Branch Debtors Account Dr. To Branch Stock Account |
| (g) | Collection from Branch Debtors | Branch Cash Account Dr. To Branch Debtors Account |
| (h) | Sales Returns at the Branch | Branch Stock Account Dr. To Branch Debtors Account |
| (i) | Discounts / Bad Debts etc. | Branch Expenses Account Dr. To Branch Debtors Account |
| (j) | Various expenses incurred at Branch | Branch Expenses Account Dr. To Branch Cash Account |
| (k) | Branch Expenses directly met by HO | Branch Expenses Account Dr. To (Main) Cash Account |
| (l) | Remittances made by Branch to Head Office | (Main) Cash Account Dr. To Branch Cash Account |
| (m) | Goods Lost in Transit/Stolen etc. | Goods Lost in Transit A/c (at cost) Dr. Branch Adjustment (loading if any) Dr. To Branch Stock Account (total value of goods) |
| At the End of the Year : Closing Entries | | |
| (n) | Recording Closing Stock at Branch | Closing Stock at Branch Account (incl. Loading) Dr. To Branch Stock Account |
| (o) | Excess of Sale Price over Invoice Price | Branch Stock Account Dr. To Branch Adjustment Account |
| (p) | Recording Unrealised Profit on Closing Stock i.e. Stock Reserve (after this entry, the Branch Adjustment Account will show Gross Profit) | Branch Adjustment Account Dr. To Stock Reserve (closing) Note : Stock Reserve on Opening Stock is credited to Branch Adjustment A/c. |
| (q) | Recording Gross Profit at Branch | Branch Adjustment Account Dr. To Branch P & L Account |
| (r) | Depreciation on Branch Assets, (if any) | Branch Expenses Account Dr. To Branch Assets Account |
| (s) | Transfer of Branch Expenses | Branch P & L Account Dr. To Branch Expenses Account |
| (t) | Recording Net Profit at Branch | Branch P & L Account Dr. To General P & L Account |



Illustration 8.

Multichained Stores Ltd. Delhi, has its branches at Lucknow and Chennai. It charges goods to its Branches at cost plus 25%. Following information is available of the transactions of the Lucknow Branch for the year ended on 31st March 2013:

| Particulars | Amount ₹ |
|--|-------------|
| Balances on 01.04.2012 | |
| Stock (at invoice price) | 30,000 |
| Debtors | 10,000 |
| Petty Cash | 50 |
| Transactions during 2012-13 (Lucknow Branch): | |
| Goods send to Lucknow Branch (at invoice price) | 3,25,000 |
| Goods returned to Head Office (at invoice price) | 10,000 |
| Cash Sales | 1,00,000 |
| Credit Sales | 1,75,000 |
| Goods pilfered (at invoice price) | 2,000 |
| Goods lost by fire (at invoice price) | 5,000 |
| Insurance Co. paid to H.O. for loss by fire at Lucknow | 3,000 |
| Cash sent for petty expenses | 34,000 |
| Bad debts at Branch | 500 |
| Goods transferred to Chennai Branch under H.O. advice | 15,000 |
| Insurance charges paid by H.O. | 500 |
| Goods returned by Debtors | 500 |
| Balance on 31.03.2013 | |
| Petty Cash | 230 |
| Debtors | 14,000 |

Goods worth ₹15,000 (including above) sent by Lucknow Branch to Chennai Branch was in-transit on 31.03.2013.

Show the following accounts in the books of Multichained Stores Ltd.: (a) Lucknow Branch Stock Account; (b) Lucknow Branch Debtors Account; (c) Lucknow Branch Adjustment Account; (d) Lucknow Branch Profit & Loss Account, and (e) Stock Reserve Account.

Solution:

In the books of H.O.
Lucknow Branch Stock Account

| Dr. | | | Cr. | | |
|-----------------|---|-------------|----------------|--|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2012 Apr.1 | To Balance b/d | 30,000 | 2013 Mar.31 | By Branch Cash A/c – Cash Sales 1,00,000 ,, Branch Debtors Credit Sales <u>1,75,000</u> | 2,75,000 |
| 2013 Mar. 31 | ,, Goods sent to Branch A/c | 3,25,000 | | ,, Goods Sent to Branch A/c | 10,000 |
| | ,, Branch Debtors A/c (Returns Inward) | 500 | | Returned from Branch | |
| | | | | ,, Pilferage A/c | 2,000 |
| | | | | ,, Lost by Fire A/c | 5,000 |
| | | | | ,, Chennai Branch A/c | 15,000 |
| | | | | Goods transferred but in-transit | |
| | | | | ,, Balance c/d | 48,500 |
| | | 3,55,500 | | | 3,55,500 |

Lucknow Branch Debtors Account

| Dr. | | | Cr. | | |
|-----------------|---------------------------------------|-------------|----------------|--|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2012 Apr.1 | To Balance b/d | 10,000 | 2013 Mar.31 | By Branch P&L A/c – Bad Debts | 500 |
| 2013 Mar. 31 | ,, Branch Stock A/c – Credit Sales | 1,75,000 | | ,, Branch Stock | |
| | | | | Returns Inward | 500 |
| | | | | ,, Branch Cash A/c | |
| | | | | Collection from Customers (bal. fig.) | 1,70,000 |
| | | | | ,, Balance c/d | 14,000 |
| | | 1,85,000 | | | 1,85,000 |



Lucknow Branch Stock Adjustment Account

| Dr. | | | Cr. | | |
|---------|---|-------------|---------|--|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 | To Goods sent to Branch A/c | | 2013 | By Balance b/d | |
| Mar. 31 | Load on goods returned (10,000 × $\frac{1}{5}$) | 2,000 | Mar. 31 | Load on Opening Stock (₹ 30,000 × $\frac{1}{5}$) | 6,000 |
| | Branch Stock A/c | | | „ Goods sent to Branch A/c Loading (₹ 3,25,000 × $\frac{1}{5}$) | 65,000 |
| | „ Pilferage A/c (Loading) (₹ 2,000 × $\frac{1}{5}$) | 400 | | | |
| | „ Lost by fire (Loading) (₹ 5,000 × $\frac{1}{5}$) | 1,000 | | | |
| | „ Chennai Branch A/c (Loading) (₹ 15,000 × $\frac{1}{5}$) | 3,000 | | | |
| | „ Branch Profit and Loss A/c | | | | |
| | Gross Profit transferred (bal. fig.) | 54,900 | | | |
| | „ Balance c/d | | | | |
| | Load on Closing Stock (₹ 48,500 × $\frac{1}{5}$) | 9,700 | | | |
| | | 71,000 | | | 71,000 |

Branch Profit and Loss Account

| Dr. | | | Cr. | | |
|---------|--|-------------|--------|------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 2013 | To Branch Debtors A/c | | 2013 | By Branch Stock | |
| Mar. 31 | Bad Debts | 500 | Mar.31 | Adjustment A/c – | |
| | „ Insurance | 500 | | Gross Profit | 54,900 |
| | „ Pilferage (at cost) | 1,600 | | | |
| | „ Stock Lost by Fire | 1,000 | | | |
| | „ Petty Expenses | 33,820 | | | |
| | „ General P&L A/c – Branch Profit transferred | 17,480 | | | |
| | | 54,900 | | | 54,900 |

Stock Reserve Account

| Dr. | | | Cr. | | |
|----------|---------------------------------------|-------------|----------|----------------------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 31.03.13 | To Stock Adjustment A/c – Transfer | 6,000 | 01.04.12 | By Balance b/d | 6,000 |
| | „ Balance c/d | 9,700 | 31.03.13 | „ Branch Stock Adjustment A/c | 9,700 |
| | | 15,700 | | | 15,700 |

Workings:

The following two accounts should also be opened:

Stock Lost by Fire Account

| Dr. | | | Cr. | | |
|----------|-----------------------------|-------------|----------|--------------------------------|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 31.03.13 | To Lucknow Branch Stock A/c | 5,000 | 31.03.13 | By Branch Stock Adjustment A/c | 1,000 |
| | | | | „ Bank – Insurance claim | 3,000 |
| | | | | „ Branch P&L A/c (bal. fig.) | 1,000 |
| | | 5,000 | | | 5,000 |

Petty Cash Account

| Dr. | | | Cr. | | |
|----------|------------------|-------------|----------|---|-------------|
| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
| 01.04.12 | To Balance b/d | 50 | 31.03.13 | By Branch P&L A/c – Expenses (bal. fig.) | 33,820 |
| 31.03.13 | „ Cash - General | 34,000 | | „ Balance c/d | 230 |
| | | 34,050 | | | 34,050 |

INDEPENDENT BRANCH

When there are voluminous transactions in a Branch, they prepare the accounts independently. They purchase and sell goods independently and also sell the goods which are sent by H.O.. As the branches are owned by H.O., the profit or loss so made by the branch is enjoyed by H.O. These branches prepare a Trial Balance, Trading and Profit and Loss Account and a Balance Sheet at the end of the year. As such, they maintain a Head Office Account and on contrary H.O. maintains a Branch Account. All sorts of transactions, e.g., remittance of cash, transfer of goods etc. are to be passed through these accounts.

Needless to say that where H.O. receives the accounts from the branches, it incorporates profit of the branches as –

Branch A/c..... Dr.

To Profit & Loss A/c

Sometimes, the balance of branch account in H.O. books and H.O. accounts in branch books do not agree. If that be so, the same must be adjusted accordingly i.e., Goods-in-Transit or Cash-in-Transit etc. At last the Branch Balance Sheet is amalgamated with H.O. Balance Sheet by eliminating inter-branch/H.O. transaction as per the respective heads of assets and liabilities.



INDEPENDENT BRANCHES

Accounting Steps :

| S No. | Transaction | HO Books | Branch Books |
|-------|--|---|---|
| 1. | Goods sent by H.O. to Branch | Branch A/c To Goods Sent to Branch A/c | Dr. Goods Recd. from H.O. A/c. Dr. To H.O. A/c |
| 2. | Goods returned by Branch to H.O. | Goods Sent to Branch A/c To Branch A/c | Dr. HO A/c. Dr. To Goods Recd. From H. O. A/c |
| 3. | Branch Expenses incurred at Branch Office | — | Expenses A/c To Cash / Bank A/c |
| 4. | Branch expenses paid for by the Head Office | Branch A/c To Cash/Bank A/c | Dr. Expenses A/c. Dr. To H.O. A/c |
| 5. | Purchases made from parties other than H.O. by Branch | — | Purchases A/c To Bank/ Creditors A/c |
| 6. | Sales effected by the Branch | | Cash/Debtors A/c To Sales A/c |
| 7. | Collection from Debtors received directly by the H.O. | Cash/Bank A/c To Branch A/c | Dr. H.O. A/c Dr. To Sundry Debtors A/c |
| 8. | Payment by H.O. for Purchase made by the Branch | Branch A/c To Bank A/c | Dr. Purchases/Creditors A/c Dr. To H.O. A/c |
| 9. | Purchase of Asset by Branch | — | Sundry Assets A/c To Bank/Liability |
| 10. | Asset account maintained at H.O. and asset purchased by Branch | Branch Asset A/c To Branch A/c | Dr. H.O. A/c Dr. To Bank/Creditors A/c |
| 11. | Depreciation when asset account is maintained by H.O. | Branch A/c To Branch Asset A/c | Dr. Depreciation A/c Dr. To H.O. A/c |
| 12. | Remittance of Funds by H.O. to Branch | Branch A/c To Bank A/c | Dr. Bank A/c Dr. To H.O. A/c |
| 13. | Remittance of Funds to H.O. by Branch | Bank A/c To Branch A/c | Dr. Ho A/c Dr. To Bank A/c |
| 14. | Transfer of Goods between different branches | Recipient Branch A/c To Supplying Branch A/c | Dr. (i) Supplying Branch A/c Dr. To Goods recd. from H.O. A/c Dr. (ii) Goods recd. from H.O. A/c Dr. To H.O. A/c |
| 15. | Charging the Branch service charges by H.O. | Branch (Expenses) A/c To Service Charges A/c | Dr. Expense A/c Dr. To H.O. A/c |
| 16. | Cash-in-transit | Cash-in-transit A/c. To Branch A/c. | Dr. Cash-in-transit A/c. Dr. To H.O. A/c. |
| 17. | Goods-in-transit | Goods-in-transit A/c. To Branch A/c. | Dr. Goods-in-transit A/c. Dr. To H.O. A/c. |

Illustration 9.

Journalise the following transactions in the books of Head Office, Delhi Branch and Agra Branch :

- Goods worth ₹ 50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.
- Delhi Branch draws a bill receivable for ₹ 40,000 on Agra Branch which sends its acceptance.
- Delhi Branch received ₹ 10,000 from Agra Branch.
- Goods worth ₹ 20,000 were returned by a customer of Agra Branch to Delhi Branch.
- Agra Branch collected ₹ 20,000 from a customer of Delhi Branch.

Solution :**Journal of Head Office**

| Particulars | L.F. | Dr. | Cr. |
|---|------|-------------|-------------|
| | | Amount ₹ | Amount ₹ |
| (a) Agra Branch A/c To Delhi Branch A/c (Being the goods supplied by Delhi Branch to Agra Branch) | Dr. | 50,000 | 50,000 |
| (b) Delhi Branch A/c To Agra Branch A/c (Being a B/R drawn by Delhi upon Agra Branch) | Dr. | 40,000 | 40,000 |
| (c) Delhi Branch A/c To Agra Branch A/c (Being Cash sent by Agra Branch to Delhi Branch) | Dr. | 10,000 | 10,000 |
| (d) Delhi Branch A/c To Agra Branch A/c (Being the goods returned by customer of Agra Branch to Delhi Branch) | Dr. | 20,000 | 20,000 |
| (e) Agra Branch A/c To Delhi Branch A/c (Being the Cash collected by Agra Branch from a customer of Delhi Branch) | Dr. | 20,000 | 20,000 |

Journal of Delhi Branch

| Particulars | L.F. | Dr. | Cr. |
|--|------|-------------|-------------|
| | | Amount ₹ | Amount ₹ |
| (a) H.O. A/c To Goods sent to Branch A/c (Being the goods supplied to Agra Branch) | Dr. | 50,000 | 50,000 |
| (b) Bills Receivable A/c To H.O. A/c (Being the acceptance of a B/R received from Agra Branch) | Dr. | 40,000 | 40,000 |
| (c) Cash A/c To H.O. A/c (Being the cash received from Agra Branch) | Dr. | 10,000 | 10,000 |
| (d) Goods Sent to Branch A/c To H.O. A/c (Being the goods received from a customer of Agra Branch) | Dr. | 20,000 | 20,000 |
| (e) H.O. A/c To Debtors A/c (Being the cash collected by Agra Branch from our customer) | Dr. | 20,000 | 20,000 |



Journal of Agra Branch

| Particulars | L.F. | Dr. | Cr. |
|---|------|-------------|-------------|
| | | Amount ₹ | Amount ₹ |
| (a) Goods sent to Branch A/c To H.O. A/c (Being the goods received from Delhi Branch) | Dr. | 50,000 | 50,000 |
| (b) H.O. A/c To Bill Payable A/c (Being a B/P accepted for Delhi Branch) | Dr. | 40,000 | 40,000 |
| (c) H.O. A/c To Cash A/c (Being cash paid to Delhi Branch) | Dr. | 10,000 | 10,000 |
| (d) H.O. A/c To Debtors A/c (Being the goods returned by customer of Delhi Branch) | Dr. | 20,000 | 20,000 |
| (e) Cash A/c To H.O. A/c (Being the Cash received from a customer of Delhi Branch) | Dr. | 20,000 | 20,000 |

Illustration 10.

A Delhi head office passes one entry at the end of each month to adjust the position arising out of inter-branch transactions during the month. From the following inter-branch transactions in March 2013, make the entries in the books of Delhi Head office.

(a) Kolkata Branch :

- (i) Received goods from Patna branch ₹ 9,000 and Ahmedabad branch ₹ 6,000.
- (ii) Sent goods to Ahmedabad branch ₹ 15,000 and Patna branch ₹ 12,000.
- (iii) Sent acceptances to Patna branch ₹ 6,000 and Ahmedabad branch ₹ 3,000.

(b) Kanpur branch [apart from (a) above] :

- (i) Sent goods to Ahmedabad branch ₹ 9,000.
- (ii) Received B/R from Ahmedabad branch ₹ 9,000.
- (iii) Received cash from Ahmedabad branch ₹ 5,000.

Solution :

Journal of Head Office

| Particulars | L.F. | Dr. | Cr. |
|-----------------------|------|-------------|-------------|
| | | Amount ₹ | Amount ₹ |
| Kanpur Branch A/c | Dr. | 5,000 | |
| Patna Branch A/c | Dr. | 9,000 | |
| Ahmedabad Branch A/c | Dr. | 7,000 | |
| To Kolkata Branch A/c | | | 21,000 |

Statement of Inter-branch Transactions

| Particulars | Kolkata | | Kanpur | | Patna | | Ahmedabad | |
|----------------|----------|----------|----------|----------|----------|----------|-----------|----------|
| | Dr. ₹ | Cr. ₹ | Dr. ₹ | Cr. ₹ | Dr. ₹ | Cr. ₹ | Dr. ₹ | Cr. ₹ |
| Goods Received | 15,000 | – | – | – | – | 9,000 | – | 6,000 |
| Goods Sent | – | 27,000 | – | – | 12,000 | – | 15,000 | – |
| Acceptance | – | 9,000 | – | – | 6,000 | – | 3,000 | – |
| Goods Sent | – | – | – | 9,000 | – | – | 9,000 | – |
| B/R Received | – | – | 9,000 | – | – | – | – | 9,000 |
| Cash | – | – | 5,000 | – | – | – | – | 5,000 |
| Balance | 15,000 | 36,000 | 14,000 | 9,000 | 18,000 | 9,000 | 27,000 | 20,000 |
| | 21,000 | – | – | 5,000 | – | 9,000 | – | 7,000 |
| | 36,000 | 36,000 | 14,000 | 14,000 | 18,000 | 18,000 | 27,000 | 27,000 |

Illustration 11.

Journalise the following transactions in the books of the Head Office.

- Goods returned by Thane Branch on 28th March, worth ₹ 10,000 to its Head Office not received by the head office upto 31st March.
- Goods worth ₹ 20,000 sent by the Head Office to its Coimbatore Branch on 29th March, were received on 3rd April following.
- ₹ 50,000 remitted by Coimbatore Branch to Head Office on 28th March was received on 4th April.

Solution :**Journal of Head Office**

| Particulars | L.F. | Dr. | Cr. |
|--|------|---------------|-------------|
| | | Amount ₹ | Amount ₹ |
| (a) Goods-in-transit A/c To Thane Branch A/c (Being the goods returned by Thane Branch not yet received) | | Dr. 10,000 | 10,000 |
| (b) Goods-in-transit A/c To Coimbatore Branch A/c (Being the goods sent to Coimbatore Branch not yet received by Branch) | | Dr. 20,000 | 20,000 |
| (c) Cash-in-transit A/c To Coimbatore Branch A/c (Being the Cash sent by Coimbatore Branch not yet received) | | Dr. 50,000 | 50,000 |

Incorporation of Branch Trial Balance in Head Office Books.

While discussing independent branch in the previous paragraphs it has been stated that branch prepares its own trial balance and the same is sent to the H.O. for incorporation. Naturally, after receiving the trial balance from branch H.O. incorporates with its own accounts the same to prepare and ascertain the net result of the concern. There are two methods for incorporating branch trial balance in H.O. Book.



It can be prepared in two ways :

(a) First Method

All revenue items are passed through Branch Trading and Profit & Loss Account and Profit or Loss so made (in the Profit and Loss Account) together with assets and liabilities are passed through Branch Account for the purpose of preparing consolidated Balance Sheet in the Books of H.O.

Incorporation Entries

- | | | |
|--|-----|--|
| (a) For all revenue expenses related to Trading A/c Branch Trading A/c To Branch A/c | Dr. | i.e. Opening stock, Purchase, Return Inwards, Wages and other items appearing in the debit side. |
| (b) For all revenue incomes related to Trading A/c Branch A/c To Branch Trading A/c | Dr. | i.e. Sales, Closing Stock and Return Outwards and other items that appear in the credit side. |
| (c) For gross profit of the Branch Branch Trading A/c To Branch P&L A/c | Dr. | |

In case of gross loss, the entry will be reversed.

- | | | |
|---|-----|---|
| (d) For all revenue expenses related to P&L A/c Branch P & L A/c To Branch (All Revenue Expenses) A/c | Dr. | i.e. items that appear in the debit side of the P & L Account. |
| (e) For all revenue incomes related to P & L A/c Branch (All Revenue Incomes) A/c To Branch P&L A/c | Dr. | i.e. items that appear in the credit side of the P & L Account. |
| (f) For net profit of the Branch Branch P&L A/c To General P&L A/c | Dr. | |

In case of net loss, the entry will be reversed.

- | | | |
|--|-----|--|
| (g) For branch assets. Branch Assets A/c To Branch A/c | Dr. | |
| (h) For branch liabilities. Branch A/c To Branch Liabilities A/c | Dr. | |

(b) Second Method / Abridged Method

This method is applicable only when net profit or net loss is given instead of detailed information about all revenue expense and income. Under this method, only net profit/net loss will be transferred to Branch Account. Branch Assets and Branch Liabilities will not appear in branch account and this branch account will show a balance. The same must be equal to the difference between assets and liabilities, i.e., in other words, net worth of the business.

Illustration 12.

Salt Lake Corporation presented the following trial balance on 31.03.2013 to the H.O. at New Delhi.

| Particulars | Debit Amount ₹ | Particulars | Credit Amount ₹ |
|------------------------|-------------------|------------------------|--------------------|
| Delhi H.O. | 6,480 | Sales | 76,000 |
| Stock 1.4.2012 | 12,000 | Goods supplied to H.O. | 12,000 |
| Purchase | 35,600 | Creditors | 3,700 |
| Goods Return From H.O. | 18,000 | | |
| Salaries | 3,000 | | |
| Debtors | 7,400 | | |
| Rent | 1,920 | | |
| Misc. Expense | 940 | | |
| Furniture | 2,800 | | |
| Cash and Bank | 3,560 | | |
| | 91,700 | | 91,700 |

Additional Information:

The branch account on H.O. books on 31.03.2013 stood at ₹ 920 (Debit).

On 31.03.2013, the, H.O. forwarded goods to the value of ₹5,000 to the branch which are received on 3rd July.

A cash remittance of ₹2,400 by branch on 29th March 2013, was received by the H.O. on 2nd April 2013.

Closing Stock was valued at ₹5,400

Show the incorporation entries in the books of H.O. showing separate Branch Trading and Branch Profit and Loss Account, and Prepare Branch Account and Branch Balance Sheet also in H.O. books.

(a) First Method

In the Books of H.O.

| Journal | | Dr. | Cr. | |
|----------|---|-----|-------------|-------------|
| Date | Particulars | L/F | Amount ₹ | Amount ₹ |
| 31.03.13 | Branch Trading A/c To Branch A/c (Items of Br. Trading incorporated) ₹ 12,000 + ₹ 35,600 + ₹ 18,000 | Dr. | 65,600 | 65,600 |
| | Branch A/c To Branch Trading A/c (Items of Br. Trading incorporated i.e., ₹ 76,000 + ₹ 12,000 + ₹ 5,400) | Dr. | 93,400 | 93,400 |
| | Branch Trading A/c To Branch Profit & Loss A/c (Gross Profit transferred) [₹ 93,400 – ₹ 65,600] | Dr. | 27,800 | 27,800 |
| | Branch Profit and Loss A/c To Branch A/c (Item of Branch Profit & Loss incorporated i.e., ₹ 3,000 + ₹ 1,920 + ₹ 940) | Dr. | 5,860 | 5,860 |



| | | | | |
|---|-----|--|--------|--------|
| Branch Profit and Loss A/c To General Profit & Loss A/c (Net Profit Transferred) [₹ 27,800 – ₹ 5,860] | Dr. | | 21,940 | 21,940 |
| Goods-in-Transit A/c To Branch A/c (Goods-in-Transit adjusted) | Dr. | | 5,000 | 5,000 |
| Remittance (Cash)-in-Transit A/c To Branch A/c (Remittance-in-Transit adjusted) | Dr. | | 2,400 | 2,400 |
| Branch Asset A/c To Branch A/c (Branch Asset incorporated) [₹ 2,800 + ₹ 5,400 + ₹ 7,400 + ₹ 3,560] | Dr. | | 19,160 | 19,160 |
| Branch A/c To Branch Liabilities A/c (Branch liabilities incorporated) | Dr. | | 3,700 | 3,700 |

Dr. Branch Trading and Profit and Loss Account Cr.

| Particulars | Amount (₹) | Amount (₹) | Particulars | Amount (₹) | Amount (₹) |
|--|----------------------------|------------------|--|---------------------------|---------------|
| To, Branch A/c Stock Purchase Goods from H.O. | 12,000 35,600 18,000 | | By, Branch A/c Sales Goods supplied to H.O. Closing Stock | 76,000 12,000 5,400 | |
| To, Branch Profit and Loss A/c (Gross Profit transferred) | | 65,600 27,800 | | | 93,400 |
| | | 93,400 | | | 93,400 |
| To, Branch A/c Salaries Rent Office Expenses | 3,000 1,920 940 | | By, Branch Trading A/c - Gross Profit | | 27,800 |
| To, General Profit and Loss A/c (Net Profit transferred) | | 5,860 21,940 | | | |
| | | 27,800 | | | 27,800 |

Branch Account

Dr. Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------|--------------------------|----------|----------|-----------------------------|---------------|
| 01.04.12 | To Balance b/d | 920 | 31.03.13 | By Branch Trading A/c | 65,600 |
| 31.03.13 | „ Branch Trading A/c | 93,400 | | „ Branch P&L A/c | 5,860 |
| | „ Branch Liabilities A/c | | | „ Goods-in-Transit A/c | 5,000 |
| | Creditors | 3,700 | | „ Remittance-in-Transit A/c | 2,400 |
| | | | | „ Branch Assets A/c | |
| | | | | Furniture | 2,800 |
| | | | | Stock | 5,400 |
| | | | | Debtors | 7,400 |
| | | | | Cash | <u>3,560</u> |
| | | | | | 19,160 |
| | | 98,020 | | | <u>98,020</u> |

**Branch Balance Sheet
as at 31st March, 2013**

| Liabilities | | Amount ₹ | Assets | | Amount ₹ |
|-----------------------|---------------|-------------|--------------|--|-------------|
| H.O. A/c | | | Furniture | | 2,800 |
| Opening balance (Dr.) | 6,480 | | Stock | | 5,400 |
| Less: Net Profit | <u>21,940</u> | 15,460 | Debtors | | 7,400 |
| Creditors | | 3,700 | Cash at Bank | | 3,560 |
| | | 19,160 | | | 19,460 |

(b) Second Method/Abridged Method

Branch Account

Dr.

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------|------------------|-------------|----------|-----------------------------|-------------|
| 01.04.12 | To Balance b/d | 920 | 31.03.13 | By Goods-in-Transit A/c | 5,000 |
| | | | | „ Remittance-in-Transit A/c | 2,400 |
| 31.03.13 | „ Branch P&L A/c | 21,940 | | „ Balance c/d | 15,460* |
| | Net Profit | | | | |
| | | 22,860 | | | 22,860 |

* **Note:** This is the difference between Branch Assets and Branch Liabilities
(₹19,160 – ₹3,700) = ₹15,460.

Closing of Branch Books

Branch closes its accounts at the end of the financial year by passing the following entries:

In this situation Accounts can be prepared by two methods.

Method – 1

All revenue items are passed through H.O. Account.

Journal entries

(a) For all revenue expenses that appear in the debit side of Branch Trading A/c

| | | |
|--------------------------------|-----|---------------|
| H.O. A/c | Dr. | |
| To Opening Stock A/c | } | Actual amount |
| „ Purchase A/c | | |
| „ Goods Received from H.O. A/c | | |
| „ All revenue expenses | | |

(b) For all revenue incomes that appear in the credit side of Branch Trading A/c

| | | | |
|-------------------------|-----|---|---------------|
| Sales A/c | Dr. | } | Actual amount |
| Closing Stock A/c | Dr. | | |
| All revenue incomes A/c | Dr. | | |
| To H.O. A/c | | | |



| | | | |
|---------------------------------|-----|---|---------------|
| (c) For all Branch Assets: | | | |
| H.O. A/c | Dr. | } | Actual amount |
| To Branch Assets A/c | | | |
| (d) For all Branch Liabilities: | | | |
| Branch Liabilities A/c | Dr. | } | Actual amount |
| To H.O. A/c | | | |

Method - 2

In this case, net profit or net loss is transferred to Head Office Account. But treatment of branch assets and branch liabilities will remain the same.

| | | | |
|----------------------|-----|---|-------------------------------|
| (a) For Net Profit: | | | |
| Profit & Loss A/c | Dr. | } | with the amount of net profit |
| To H.O. A/c | | | |
| (b) For Net Loss: | | | |
| H.O. A/c | Dr. | } | with the amount of net loss |
| To Profit & Loss A/c | | | |

Illustration 13.

A Chennai Head Office has an independent Branch at Ahmedabad. From the following particulars, give journal entries to close the books of the Ahmedabad Branch. Show also the Chennai Head Office account in the branch books.

Ahmedabad Branch
Trial Balance as at 31st December, 2013

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|----------------------------------|-------------|------------------|-------------|
| Stock on 1 st January | 8,200 | Creditors | 2,700 |
| Purchases | 12,800 | Sales | 34,950 |
| Wages | 6,550 | Head Office | 14,000 |
| Manufacturing Expenses | 3,400 | Discount | 150 |
| Rent | 1,700 | Purchase Returns | 300 |
| Salaries | 5,500 | | |
| Debtors | 4,000 | | |
| General Expenses | 2,000 | | |
| Goods received from H.O. | 7,200 | | |
| Cash at Bank | 750 | | |
| | 52,100 | | 52,100 |

- (a) Closing Stock at Branch ₹ 14,350.
- (b) The branch fixed assets maintained at H.O. books were: Machinery ₹ 25,000, Furniture ₹ 1,000. Depreciations are to be allowed at 10% on Machinery and 15% on Furniture.
- (c) Rent due ₹ 150.
- (d) A remittance of ₹ 4,000 made by the Branch on 29th Dec. 2013 was received by Head Office on 4th January, 2014.

Solution:**(i) As per Method 1****In the books of Branch**

| | | Journal | | Dr. | Cr. |
|-------------|--|--------------------------|--------------------------------|---------------------|--|
| Date | Particulars | L/F | Amount ₹ | Amount ₹ | |
| 31.12.13 | Depreciation A/c To Head Office A/c (Depreciation on fixed assets maintained in head office books @ 10% on Machinery and 15% on Furniture) | Dr. | 2,650 | | 2,650 |
| | Rent A/c To Outstanding Rent A/c (Rent Outstanding) | Dr. | 150 | | 150 |
| | Cash-in-Transit A/c To Head Office A/c (Cash remitted to H.O. but not received within 31st December) | Dr. | 4,000 | | 4,000 |
| | Head Office A/c To Opening Stock ,, Purchases ,, Wages ,, Manufacturing Expenses ,, Rent (1,700 + 150) ,, Salaries ,, General Expenses ,, Goods received from H.O. ,, Depreciation (Above items transferred to H.O. A/c) | Dr. | 50,150 | | 8,200 12,800 6,550 3,400 1,850 5,500 2,000 7,200 2,650 |
| | Discount A/c Sales A/c Purchase Returns A/c Closing Stock A/c To Head Office A/c (Above items transferred to H.O. A/c) | Dr. Dr. Dr. Dr. | 150 34,950 300 14,350 | | 49,750 |
| | Head Office A/c To Closing Stock A/c ,, Debtors A/c ,, Bank A/c ,, Cash-in-Transit A/c (Assets transferred to H.O. A/c) | Dr. | 23,100 | | 14,350 4,000 750 4,000 |
| | Creditors A/c Outstanding Rent A/c To Head Office A/c (Liabilities transferred to H.O. A/c) | Dr. Dr. | 2,700 150 | | 2,850 |



Dr.

Head Office Account

Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|----------|---|--------|----------|---|--------|
| | | ₹ | | | ₹ |
| 31.12.13 | To Sundries- (debit balance of Revenue items) | 50,150 | 31.12.12 | By Balance b/d | 14,000 |
| | „ Sundry Assets | 23,100 | | „ Depreciation A/c | 2,650 |
| | | | | „ Cash-in-Transit A/c | 4,000 |
| | | | | „ Sundries –Credit Balance of Revenue items | 49,750 |
| | | | | „ Sundry Liabilities | 2,850 |
| | | 73,250 | | | 73,250 |

(ii) As per Method 2

In the books of Branch

Journal

Dr.

Cr.

| Date | Particulars | L/F | Amount | Amount |
|----------|--|-----|--------|--------|
| | | | ₹ | ₹ |
| 2013 | Depreciation A/c | Dr. | 2,650 | |
| Dec. 31. | To Head Office A/c (Depreciation on fixed assets @ 10% Monthly and @ 15% or Furniture in H.O. Books.) | | | 2,650 |
| | Rent A/c | Dr. | 150 | |
| | To Outstanding Rent A/c (Rent Outstanding) | | | 150 |
| | Cash-in-Transit A/c | Dr. | 4,000 | |
| | To Head Office A/c (Cash remitted to H.O. but in transit) | | | 4,000 |
| | Head Office A/c | Dr. | 400 | |
| | To Profit & Loss A/c (Net Loss Transferred.) [₹ 50,150 – 49,750] | | | 400 |
| | Head Office A/c | Dr. | 23,100 | |
| | To Closing Stock | | | 14,350 |
| | „ Debtors | | | 4,000 |
| | „ Cash at Bank | | | 750 |
| | „ Cash-in-Transit (Asset transferred to H.O. A/c) | | | 4,000 |
| | Creditors A/c | Dr. | 2,700 | |
| | Outstanding Rent A/c | Dr. | 150 | |
| | To Head Office A/c (Various Liabilities transferred to H.O. A/c) | | | 2,850 |

Head Office Account

Dr.

Cr.

| Date | Particulars | Amount ₹ | Date | Particulars | Amount ₹ |
|----------|-----------------------|-------------|----------|-----------------------|-------------|
| 31.12.13 | To Profit & Loss A/c | 400 | 31.12.13 | By Balance b/d | 14,000 |
| | Net Loss | | | „ Depreciation A/c | 2,650 |
| | „ Closing Stock A/c | 14,350 | | „ Cash-in-Transit A/c | 4,000 |
| | „ Debtors A/c | 4,000 | | „ Credit A/c | 2,700 |
| | „ Cash at Bank | 750 | | „ Outstanding Rent | 150 |
| | „ Cash-in-Transit A/c | 4,000 | | | |
| | | 23,500 | | | 23,500 |

Illustration 14.

A merchant of Kolkata opens a new branch in Mathura, which trades independently of the Head Office. The transactions of the Branch for the year ended 31.3.2013 are as under :

| Particulars | Amount ₹ | Amount ₹ |
|--|-------------|-------------|
| Goods supplied by Head Office | | 20,00,000 |
| Purchases from outsiders : | | |
| — Credit | | |
| — Cash | 15,55,000 | |
| Sales : | 3,00,000 | 18,55,000 |
| — Credit | | |
| — Cash | 25,05,000 | |
| | 4,60,000 | 29,65,000 |
| Cash received from Customers | | 30,45,000 |
| Trade Creditors Paid | | 14,25,000 |
| Expenses paid by Branch | | 8,95,000 |
| Furniture purchased by Branch on credit | | 3,50,000 |
| Cash received from Head Office initially | | 4,00,000 |
| Remittances to Head Office | | 11,00,000 |

Prepare the Trading and Profit and Loss Account, Balance Sheet, Head Office Account in the books of Branch :

1. The account of the Branch Fixed Assets are maintained in the Head Office books.
2. Write off depreciation on furniture at 5 percent per annum for full year.
3. A remittance of ₹ 2,00,000 from the Branch to the Head Office is in transit.
4. The Branch value its closing stock at ₹ 12,00,000.



Solution :

IN BRANCH BOOKS

1. Trading and Profit and Loss Account for year ended 31.3.2013

| Particulars | Amount ₹ | Amount ₹ | Particulars | Amount ₹ | Amount ₹ |
|------------------------------|-------------|------------------|------------------------------|-------------|------------------|
| To Goods Supplied by HO | | 20,00,000 | By Sales : | | |
| To Purchase | | | — Credit | 25,05,000 | |
| — Credit | 15,55,000 | | — Cash | 4,60,000 | 29,65,000 |
| — Cash | 3,00,000 | 18,55,000 | | | |
| To Gross Profit c/d | | 3,10,000 | By Closing Stock | | 12,00,000 |
| | | 41,65,000 | | | 41,65,000 |
| To Expenses | | 8,95,000 | By Gross Profit b/d | | 3,10,000 |
| To Depreciation on Furniture | | 17,500 | By HO — Transfer of net loss | | 6,02,500 |
| | | 9,12,500 | | | 9,12,500 |

2.

| Dr. | | Branch Cash Account | | Cr. | |
|----------------------------------|------------------|---------------------|------------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To Head Office (initial Receipt) | 4,00,000 | By Cash Purchases | 3,00,000 | | |
| To Cash Sales | 4,60,000 | By Trade Creditors | 14,25,000 | | |
| To Trade Debtors | 30,45,000 | By Expenses | 8,95,000 | | |
| | | By Head Office A/c | 11,00,000 | | |
| | | — Remittance | | | |
| | | By Balance c/d | 1,85,000 | | |
| | 39,05,000 | | 39,05,000 | | |

3.

| Dr. | | Head Office Account | | Cr. | |
|--|------------------|-------------------------------|------------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To Creditors for Furniture | 3,50,000 | By Cash (Initial Receipt) | 4,00,000 | | |
| To Cash (remittance) | 11,00,000 | By Goods received from HO A/c | 20,00,000 | | |
| To Profit & Loss A/c (Loss for the Year) | 6,02,500 | By Depreciation on Furniture | 17,500 | | |
| To Balance c/d — balancing | 5,65,000 | By Cash in Transit | 2,00,000 | | |
| | 26,17,500 | | 26,17,500 | | |

4. Balance Sheet as on 31.3.2013

| Liabilities | Amount ₹ | Assets | Amount ₹ |
|--|------------------|------------------------------------|------------------|
| Sundry Trade Creditors (₹ 15,55,000 – ₹ 14,25,000) | 1,30,000 | Closing Stock | 12,00,000 |
| Creditors for Furniture | 3,50,000 | Cash in Transit | 2,00,000 |
| Advances from Trade Debtors (₹ 30,45,000 – ₹ 25,05,000) | 5,40,000 | Cash in Hand (As per Cash Book) | 1,85,000 |
| Head Office A/c | 5,65,000 | | |
| | 15,85,000 | | 15,85,000 |

Illustration 15.

The Head Office of Z Ltd. and its Branch keep their own books prepare own Profit and Loss Account. The following are the balances appearing in the two sets of the books as on 31.3.2013 after ascertainment of profits and after making all adjustments except those referred to below :

| Particulars | Head Office | | Branch Office | |
|---------------------|-----------------|-----------------|---------------|---------------|
| | Dr. (₹) | Cr. (₹) | Dr. (₹) | Cr. (₹) |
| Capital | — | 1,00,000 | — | — |
| Fixed Assets | 36,000 | — | 16,000 | — |
| Stock | 34,200 | — | 10,740 | — |
| Debtors & Creditors | 7,820 | 3,960 | 4,840 | 1,920 |
| Cash | 10,740 | — | 1,420 | — |
| Profit & Loss | — | 14,660 | — | 3,060 |
| Branch Account | 29,860 | — | — | — |
| Head Office Account | — | — | — | 28,020 |
| Total | 1,18,620 | 1,18,620 | 33,000 | 33,000 |

Prepare the Balance Sheet of the business as on 31.3.2013 and the journal entries necessary (in both sets of books) to record the adjustments dealing with the following :

- On 31.3.2013, the branch had sent a cheque for ₹ 1,000 to the head office, not received by them nor credited to the branch till next month.
- Goods valued at ₹ 440 had been forwarded by the head office to the branch and invoiced on 30.3.2013, but were not received by the branch nor dealt with in their books till next month.
- It was agreed that the branch should be charged with ₹ 300 for Administration Services, rendered by the Head Office during the year.
- Stock stolen in transit from the Head Office to the Branch and charged to the Branch by the Head Office but not credited to the Head Office in the Branch Books as the Manager declined to admit any liability, ₹ 400 (not covered by insurance).
- Depreciation of Branch Assets, of which accounts are maintained by the Head Office, not provided for ₹ 250.
- The balance of Profits shown by the Branch is to be transferred to HO Books.



Solution :

1. Balance Sheet of Z Ltd. as at 31.03.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|------------------------------|-------------|-----------------|----------------------------|--------------|-----------------|
| Capital | 1,00,000 | 1,17,070 | Fixed Assets : | | 51,750 |
| Add : Net Profit of : | | | | —Head Office | |
| —Head Office | 14,560 | | —Branch | 16,000 | |
| —Branch | 2,510 | | Less : Depreciation | (250) | |
| Creditors : | | 5,880 | Stock : | | 45,380 |
| —Head Office | 3,960 | | —Head Office | 34,200 | |
| —Branch | 1,920 | | —Branch | 10,740 | |
| | | | —Goods in Transit | 440 | |
| | | | Debtors : | | 12,660 |
| | | | —Head Office | 7,820 | |
| | | | —Branch | 4,840 | |
| | | | Creditors: | | 13,160 |
| | | | —Head Office | 10,740 | |
| | | | —Branch | 1,420 | |
| | | | —In Transit | 1,000 | |
| | | 1,22,950 | | | 1,22,950 |

2. Journal Entries in the books of Head Office

| Sl. No. | Particulars | Dr. | Cr. |
|---------|---|--------------|----------|
| | | Amt. (₹) | Amt. (₹) |
| 1 | Goods in Transit A/c To Branch A/c (Being the goods invoiced on 30.3.2013 not yet received by the branch as on the Balance Sheet date) | Dr. 440 | 440 |
| 2 | Branch A/c To Profit & Loss A/c (Being amount of Administrative Services rendered by the HO to the Branch) | Dr. 300 | 300 |
| 3 | Profit & Loss A/c To Branch A/c (Being the amount of uninsured stock stolen on way to Branch) | Dr. 400 | 400 |
| 4 | Branch A/c To Branch Fixed Assets (Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books) | Dr. 250 | 250 |
| 5 | Branch Profit & Loss A/c To Profit & Loss A/c (Being Profit shown by the Branch Profit & Loss Account transferred to (General) Profit & Loss Account) | Dr. 2,510 | 2,510 |

3.

| Dr. | | Head Office Profit and Loss Account | | Cr. | |
|------------------------------------|---------------|-------------------------------------|---------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To Branch — Uninsured Stock stolen | 4 0 0 | By Balance b/d | 14,660 | | |
| To Profit — Transferred | 14,560 | By Branch Administration Expenses | 300 | | |
| | 14,960 | | 14,960 | | |

4. Journal Entries in the books of Branch Office

| S. No. | Particulars | Dr. Amt. (₹) | Cr. Amt. (₹) |
|--------|---|-----------------|-----------------|
| 1 | Cash in Transit A/c To Head Office A/c (Being cash sent on 31.3.2013 not yet received by the HO) | Dr. 1,000 | 1,000 |
| 2 | Profit & Loss A/c To Head Office A/c (Being administrative services rendered by the Head Office) | Dr. 300 | 300 |
| 3 | Profit & Loss A/c To Head Office A/c (Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books) | Dr. 250 | 250 |
| 4 | Profit & Loss Account To Head Office A/c (Being profit transferred to Head Office Account) | Dr. 2,510 | 2,510 |

5.

| Dr. | | Branch Profit and Loss Account | | Cr. | |
|---------------------------------------|--------------|--------------------------------|--------------|-----|--|
| Particulars | Amount ₹ | Particulars | Amount ₹ | | |
| To HO A/c – Administrative Services | 300 | By Balance b/d | 3,060 | | |
| To HO A/c – Depn. on Branch Assets | 250 | | | | |
| To Profit – Transferred to HO Account | 2,510 | | | | |
| | 3,060 | | 3,060 | | |



Illustration 16.

Puskar Enterprise has its H.O. in Ranchi and a branch in Imphal. The following Trial Balance has been extracted from the books of accounts as at 31st March, 2013:

| Particulars | Head Office | | Branch Office | |
|--------------------------------------|-------------|-----------|---------------|-----------|
| | Dr. ₹ | Cr. ₹ | Dr. ₹ | Cr. ₹ |
| Capital | --- | 16,50,000 | --- | --- |
| Debtors | 3,00,000 | --- | 1,80,000 | --- |
| Creditors | --- | 1,50,000 | --- | --- |
| Purchases | 27,42,000 | --- | --- | --- |
| Sales | --- | 25,50,000 | --- | 13,11,000 |
| Goods sent to Branch at I.P. | --- | 11,40,000 | 11,25,000 | --- |
| Fixed Assets (Net) | 10,50,000 | --- | 2,00,000 | --- |
| Stock (1.4.2012) | 24,000 | --- | 60,000 | --- |
| Stock Adjustment (Unrealised Profit) | --- | 12,000 | --- | --- |
| H.O./Branch Current A/c | 5,25,000 | --- | --- | 3,60,000 |
| Administrative & Selling Expenses | 8,41,500 | --- | 74,500 | --- |
| Cash and Bank | 46,500 | --- | 39,000 | --- |
| Provision for Bad Debts | --- | 27,000 | --- | 7,500 |
| | 55,29,000 | 55,29,000 | 16,78,500 | 16,78,500 |

Other relevant information:

- (1) All goods are purchased by the H.O. Goods are sent to branch at cost plus 25%.
- (2) Stock 31.3.2013 are valued at:
H.O. ₹ 36,000
Branch ₹ 45,000 (Invoice Price)
- (3) Depreciation is to be provided on fixed assets at 10% on book value.
- (4) Bad debts provision is to be maintained at 5% on debtors as at the end of the year.
- (5) Cash-in-transit from branch to H.O. at 31st March 2013 was ₹1,50,000.
- (6) Goods-in-transit from H.O. to branch at 31st March, 2013 at invoice price was ₹15,000.

Prepare in Columnar form, the branch and H.O. Trading and Profit and Loss Accounts for the year ended 31st March, 2013 and a combined Balance Sheet of Puskar Enterprises as on that date.

Solution:

In the books of H.O.
Columnar Trading and Profit and Loss Account

| Dr. | | | | | Cr. |
|---|-----------|-------------|-------------------------------------|-----------|-------------|
| Particulars | H.O. ₹ | Branch ₹ | Particulars | H.O. ₹ | Branch ₹ |
| To Opening Stock | 24,000 | 60,000 | By Sales | 25,50,000 | 13,11,000 |
| „ Purchases | 27,42,000 | --- | „ Goods Sent to Branch | 11,40,000 | --- |
| „ Goods from H.O. | --- | 11,25,000 | „ Closing Stock | 36,000 | 45,000 |
| „ Gross Profit c/d | 9,60,000 | 1,71,000 | | | |
| | 37,26,000 | 13,56,000 | | 37,26,000 | 13,56,000 |
| To Adm. & Selling Exp. | 8,41,500 | 74,500 | By Gross Profit b/d | 9,60,000 | 1,71,000 |
| „ Depreciation | 1,05,000 | 20,000 | „ Stock Adjustment (for opening) | 12,000 | --- |
| „ Stock Adjustment (for closing) 20% of (45,000+15,000) | 12,000 | --- | „ Provision for Bad Debts (old) | 27,000 | 7,500 |
| „ Provision for Bad Debts (new) | 15,000 | 9,000 | | | |
| Net Profit | 25,500 | 75,000 | | | |
| | 9,99,000 | 1,78,500 | | 9,99,000 | 1,78,500 |

Balance Sheet (Combined)
as at 31st March 2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------------------------|-------------|-------------|---------------------------|-------------|-------------|
| Capital | 16,50,000 | | Fixed Assets | 12,50,000 | |
| Add: Net Profit (25,500 + 75,000) | 1,00,500 | | Less: Depreciation | 1,25,000 | 11,25,000 |
| Current A/c – H.O. | 5,25,000 | 17,50,500 | Current Assets | | |
| Less: Branch (Cr.) | 3,60,000 | | Stock | | |
| Cash-in-transit | 1,50,000 | | H.O. | 36,000 | |
| Goods-in-transit | 15,000 | | Branch | 45,000 | |
| | 5,25,000 | | | 81,000 | |
| Creditors | | Nil | Less: Stock Adj. | 12,000 | 69,000 |
| | | 1,50,000 | Goods-in-Transit | | 15,000 |
| | | | Debtors | | |
| | | | H.O. | 3,00,000 | |
| | | | Branch | 1,80,000 | |
| | | | | 4,80,000 | |
| | | | Less; Prov. for Bad Debts | 24,000 | 4,56,000 |
| | | | Cash at Bank | | |
| | | | H.O. | 46,500 | |
| | | | Branch | 39,000 | |
| | | | Cash-in-transit | 1,50,000 | 2,35,500 |
| | | 19,00,500 | | 1,50,000 | 2,35,500 |
| | | | | | 19,00,500 |

10.2 DEPARTMENTAL ACCOUNTS

Introduction

Departmental Accounts helps in identifying the performance of each department. Each department is considered to be an Activity Centre. It is a tool which helps management in decision-making.

Departmentation offers the following advantages —

- Proper Allocation :** Expenses that relate to a particular department are estimated on an exact basis. Hence, cost and profits of each department is estimated more accurately.
- Control :** Availability of separate cost and profit figures for each department facilitates control. Proper control and fixation of responsibility is easier.
- Proper absorption :** The processing times of different products in different departments may vary. Specific cost analysis on a department-wise basis facilitates scientific cost absorption and cost assignment. This provides the right platform for product-pricing decisions also.

Difference between Branch Account and Departmental Account

The main differences between a Branch Account and a Department Accounts are:

| Sl. No. | Points | Branch Accounts | Departmental Accounts |
|---------|-------------------------|--|--|
| 1 | Allocation of expenses | In case of branch accounting allocation of common expenses does not arise. | Allocation of common wealth is the fundamental consideration here. |
| 2 | Result of the operation | It shows that trading result of each individual branch. | It shows the trading result of each individual department. |
| 3 | Maintenance of accounts | Method of Branch Accounting depends on the nature and type of branch whether dependent or independent. | It is centrally maintained. |
| 4 | Types of accounting | It is practically a condensation of accounts. | It is a segment of accounts. |
| 5 | Control | It is not possible to control all branch by the H.O. | Effective control is possible by the departmental supervisors who is closely related and who is to keep a constant watch over the departments. |

Bases of Apportionment of Expenses :

| Nature of Expense | Treatment | Examples |
|------------------------|---|--|
| Specific Charge | When a certain expense is specifically incurred for one department, it should be charged in full to that department only. | <ul style="list-style-type: none"> • Depreciation of machinery on value of machinery; • Insurance on stock on the value of stock. |
| Shared Common Expenses | When benefits of certain expenses are shared by all departments and are capable of precise allocation , they should be apportioned to all departments on an appropriate and equitable basis . | <ul style="list-style-type: none"> • Rent is apportioned based on Floor Space occupied by each department. • Lighting Expenses is apportioned basis of on the number of light points (or) on the basis of floor area. • Canteen subsidy on the basis of No. of workers. |
| General Expenses | Common expenses which are not capable of accurate apportionment to various departments are dealt with judiciously , based on facts and circumstances of each case. | <ul style="list-style-type: none"> • Administration Expenses like Office Salaries may be apportioned equally among all departments or alternatively debited to General P&L Account. • Selling and Distribution Expenses may be apportioned based on Sales ratio. |

Illustration 17.

From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the year ended 31.12.2013 and a Balance Sheet as at the date in the books of Sri S. Maity:

| Particulars | Dr. ₹ | Cr. ₹ |
|------------------------|----------|----------|
| Stock (1.1.2013): | | |
| Dept. A | 5,400 | |
| Dept. B | 4,900 | |
| Purchases: | | |
| Dept. A | 9,800 | |
| Dept. B | 7,350 | |
| Sales: | | |
| Dept. A | | 16,900 |
| Dept. B | | 13,520 |
| Wages: | | |
| Dept. A | 1,340 | |
| Dept. B | 240 | |
| Rent | 1,870 | |
| Salaries | 1,320 | |
| Lighting and Heating | 420 | |
| Discount Allowed | 441 | |
| Discount Received | | 133 |
| Advertising | 738 | |
| Carriage Inward | 469 | |
| Furniture and Fittings | 600 | |
| Plant and Machinery | 4,200 | |
| Sundry Debtors | 1,820 | |
| Sundry Creditors | | 3,737 |
| Capital | | 9,530 |
| Drawings | 900 | |
| Cash in hand | 32 | |
| Cash at Bank | 1,980 | |
| | 43,820 | 43,820 |

The following information is also provided:

Rent and Lighting and Heating are to be allocated between Factory and Office in the ratio of 3:2.

Rent, Lighting and Heating, Salaries and Depreciation are to be apportioned to A and B Depts. as 2:1.

Other expenses and incomes are to be apportioned to A and B Depts. on suitable basis.



The following adjustments are to be made:

Rent Prepaid ₹370; Lighting and Heating outstanding ₹180; Depreciation of Furniture and Fittings @ 10% p.a. and Plant and Machinery @ 10% p.a.

The Stock at 31.12.2012: Dept. A ₹2,748; Dept. B ₹2,401.

Solution:

In the books of Sri S. Maity

Departmental Trading and Profit & Loss Account for the year ended 31.12.2013

Dr.

Cr

| Particulars | Dept. A ₹ | Dept. B ₹ | Total ₹ | Particulars | Dept. A ₹ | Dept. B ₹ | Total ₹ |
|--------------------------|--------------|--------------|--------------------|---------------------|--------------|--------------|------------------|
| To Opening Stock | 5,400 | 4,900 | 10,300 | By Sales | 16,900 | 13,520 | 30,420 |
| „ Purchase | 9,800 | 7,350 | 17,150 | „ Closing | 2,748 | 2,401 | 5,149 |
| „ Wages | 1,340 | 240 | 1,580 | Stock | | | |
| „ Carriage Inwards (4:3) | 268 | 201 | 469 ¹ | | | | |
| „ Rent | 600 | 300 | 900 ⁶ | | | | |
| „ Lighting and Heating | 240 | 120 | 360 ² | | | | |
| „ Gross Profit c/d | 2,000 | 2,810 | 4,810 | | | | |
| | 19,648 | 15,921 | 35,569 | | 19,648 | 15,921 | 35,569 |
| To Rent | 400 | 200 | 600 ⁶ | By Gross Profit b/d | 2,000 | 2,810 | 4,810 |
| „ Advertisement | 410 | 328 | 738 ⁴ | | | | |
| „ Salaries (2:1) | 880 | 440 | 1,320 ⁵ | „ Dis. Received | 76 | 57 | 133 ⁷ |
| „ Lighting and Heating | 160 | 80 | 240 ² | (4 :3) | 339 | --- | --- |
| „ Discount Allowed | | | | „ Net Loss | | | |
| (on Sales) | 245 | 196 | 441 ³ | | | | |
| „ Dep. On (2:1) | | | | | | | |
| Plant & Machinery | 280 | 140 | 420 | | | | |
| Furniture & Fixture | 40 | 20 | 60 | | | | |
| „ Net Profit | --- | 1,463 | 1,124 | | | | |
| | 2,415 | 2,867 | 4,943 | | 2,415 | 2,867 | 4,943 |

Balance Sheet as at 31.12.2013

| Liabilities | Amount ₹ | Amount ₹ | Assets | Amount ₹ | Amount ₹ |
|--------------------------|--------------|---------------|------------------------|--------------|---------------|
| Capital | 9,530 | | Plant and Machinery | 4,200 | |
| Add: Net Profit | <u>1,124</u> | | Less: Depreciation | <u>420</u> | 3,780 |
| | 10,654 | | Furniture and Fittings | 600 | |
| Less: Drawings | <u>900</u> | 9,754 | Less: Depreciation | <u>60</u> | 540 |
| Sundry Creditors | | 3,737 | | | |
| Outstanding Liabilities: | | | Closing Stock: | | |
| Lighting and Heating | | 180 | Dept. A | 2,748 | |
| | | | Dept. B | <u>2,401</u> | 5,149 |
| | | | Sundry Debtors | | 1,820 |
| | | | Prepaid Rent | | 370 |
| | | | Cash at Bank | | 1,980 |
| | | | Cash in Hand | | 32 |
| | | <u>13,671</u> | | | <u>13,671</u> |

Workings:

Allocation of Expenses and Incomes

| Sl. No. | Expense/Income | Basis | Dept. A | Dept. B |
|---------|---------------------------------------|----------------|---------------------------------|---------------------------------|
| 1 | Carriage Inward | Purchase (4:3) | = ₹ 469 × 4/7 = ₹ 268 | = ₹ 469 × 3/7 = ₹ 201 |
| 2 | Lighting & Heating (₹ 420 + ₹ 180) | ₹ 600 (Given) | | |
| | Factory part = 600 × 3/5 = | 360 | = ₹ 360 × 2/3 = ₹ 240 | = ₹ 360 × 1/3 = ₹ 120 |
| | Office part = 600 × 2/5 = | 240 | = ₹ 240 × 2/3 = ₹ 160 | = ₹ 240 × 1/3 = ₹ 80 |
| 3 | Discount Allowed | = Sales | = ₹ 441 × (16900/30420) = ₹ 245 | = ₹ 441 × (13520/30420) = ₹ 196 |
| 4 | Advertisement | = Sales | = ₹ 738 × (16900/30420) = ₹ 410 | = ₹ 738 × (13520/30420) = ₹ 328 |
| 5 | Salaries | 2 : 1 | = ₹ 1,320 × (2/3) = ₹ 880 | = ₹ 1,320 × (1/3) = ₹ 440 |
| 6 | Rent ₹ 1,500 = (₹ 1,870 – ₹ 370) | 2 : 1 | | |
| | Factory part = 1,500 × 3/5 = 900 | | = ₹ 900 × (2/3) = ₹ 600 | = ₹ 900 × (1/3) = ₹ 300 |
| | Office part = 1,500 × 2/5 = 600 | 2 : 1 | = ₹ 600 × (2/3) = ₹ 400 | = ₹ 600 × (1/3) = ₹ 200 |
| 7 | Discount Received | Purchase (4:3) | = ₹ 133 × (4/7) = ₹ 76 | = ₹ 133 × (3/7) = ₹ 57 |



Illustration 18.

The Trading and Profit & Loss Account of Bindas Ltd. for the year ended 31st March is as under :

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|--|-----------------|---|-----------------|
| Purchases | | Sales | |
| Transistors (A) | 1,60,000 | Transistors (A) | 1,75,000 |
| Tape Recorders (B) | 1,25,000 | Tape Recorders (B) | 1,40,000 |
| Spare parts for Servicing and Repair Job (C) | 80,000 | Servicing and Repair Jobs (C) | 35,000 |
| Salaries and wages | 48,000 | Stock on 31st March | |
| Rent | 10,800 | Transistors (A) | 60,100 |
| Sundry Expenses | 11,000 | Tape Recorders (B) | 20,300 |
| Net Profit | 40,200 | Spare parts for servicing & repair jobs (C) | 44,600 |
| | 4,75,000 | | 4,75,000 |

Prepare Departmental Accounts for each of the three Departments A, B and C mentioned above after taking into consideration the following :

- Transistors and Tape Recorders are sold at the Showroom. Servicing and Repairs are carried out at the Workshop.
- Salaries and wages comprise as follows: Showroom 3/4th and Workshop 1/4th
It was decided to allocate the Showroom Salaries and Wages in ratio 1:2 between Departments A and B.
- Workshop Rent is ₹ 500 per month. Showroom Rent is to be divided equally between Departments A and B.
- Sundry Expenses are to be allocated on the basis of the turnover of each Department.

Solution :

Departmental P&L Accounts for the year ended 31st March (Amount in ₹)

Dr.

Cr.

| Particulars | A ₹ | B ₹ | C ₹ | Particulars | A ₹ | B ₹ | C ₹ |
|---------------------|-----------------|-----------------|---------------|------------------|-----------------|-----------------|---------------|
| To Purchases | 1,60,000 | 1,25,000 | — | By Sales | 1,75,000 | 1,40,000 | — |
| To Spares | — | — | 80,000 | By Services | — | — | 35,000 |
| To Salary & Wages | 12,000 | 24,000 | 12,000 | By Closing Stock | 60,100 | 20,300 | 44,600 |
| To Rent | 2,400 | 2,400 | 6,000 | By Net Loss | — | — | 19,500 |
| To Sundry Expenses* | 5,500 | 4,400 | 1,100 | | | | |
| To Net Profit | 55,200 | 4,500 | | | | | |
| | 2,35,100 | 1,60,300 | 99,100 | | 2,35,100 | 1,60,300 | 99,100 |

Note : Sundry Expenses are apportioned in the ratio of Turnover (5:4:1) i.e. 1,75,000:1,40,000:35,000.

Inter Departmental Transfer

Transfer made by one department to another may be recorded either:

- **At Cost Price; and**
- **At Invoice Price i.e., Market Based Price.**

At Cost Price

When transfers are made, Recipient Department should be debited at cost price and Transferring Department should be credited at Cost Price.

Illustration 19.

Make an appropriate entry for inter transfer of goods from one department to another.

Department A transferred goods for ₹30,000 to Department B.

Solution:

**In the Books of...
Journal**

| Date | Particulars | L/F | Dr. | Cr. |
|------|--|-----|-------------|-------------|
| | | | Amount ₹ | Amount ₹ |
| ? | Department Trading (B) A/c Dr. To Department Trading (A) A/c (Goods are transferred to Department B from Department A.) | | 30,000 | 30,000 |

At Invoice Price i.e., Provision for unrealized Profit.

In case of goods transfer from one department to another, no problem arises if all goods are sold within the year. On the other hand, problem arises where all goods are not sold. Under the circumstances, appropriate adjustments must be made against the unsold stock for ascertaining the correct profit or loss. As such, provision to be made for both opening stock and closing stock. The entries for this purpose are:

For Opening Stock Reserve:

Opening Stock Reserve A/c Dr.
 To General Profit and Loss A/c

For Closing Stock Reserve:

General Profit and Loss A/c Dr.
 To Closing Stock Reserve A/c

Illustration 20.

Department A sells goods to Department B at a profit of 25% on cost and to department C at 10% profit on cost. Department B sells goods to Department A and Department C at a profit of 15% and 20% on sales respectively. Dept. C charges 20% and 25% profit on cost and department A and department b respectively.

Department managers are entitled to 10% commission on net profit after eliminating unrealised profit on department sales being eliminated. Departmental profit after charging managers commission but before adjustment of unrealized profits are: Dept. A ₹ 72,000; Dept. B ₹ 54,000; and Dept. C ₹ 36,000. Stock lying at different departments at the end of the year are:



| Particulars | Department A | Department B | Department C |
|----------------------------|--------------|--------------|--------------|
| | ₹ | ₹ | ₹ |
| Transfer from Department A | --- | 30,000 | 22,000 |
| Transfer from Department B | 28,000 | --- | 24,000 |
| Transfer from Department C | 12,000 | 10,000 | --- |

Find out the correct departmental profit after charging manager's commission.

Solution:

Computation of correct Profit

| Particulars | Department A | Department B | Department C |
|---|--------------|--------------|--------------|
| | ₹ | ₹ | ₹ |
| Profit after charging manager's commission. | 72,000 | 54,000 | 36,000 |
| Add back: Manager's Commission @ 1/9th | 8,000 | 6,000 | 4,000 |
| | 80,000 | 60,000 | 40,000 |
| Less: Unrealised Profit on stock | 8,000 | 9,000 | 4,000* |
| Profit before charging Manager's Commission | 72,000 | 51,000 | 36,000 |
| Less: Manager's Commission @10% | 7,200 | 5,100 | 3,600 |
| Correct profit after charging commission | 64,800 | 45,900 | 32,400 |

Workings:

Computation of unrealized Profit on Stock

| Particulars | Department A | Department B | Department C | Total |
|----------------|----------------------------------|-------------------------------|----------------------------------|-------|
| | ₹ | ₹ | ₹ | |
| Department - A | --- | $30,000 \times 1/5 = ₹ 6,000$ | $22,000 \times 1/11 = ₹ 2,000$ | 8,000 |
| Department - B | $28,000 \times 15/100 = ₹ 4,200$ | --- | $24,000 \times 20/100 = ₹ 4,800$ | 9,000 |
| Department - C | $12,000 \times 1/6 = ₹ 2,000$ | $10,000 \times 1/5 = ₹ 2,000$ | --- | 4,000 |

Illustrations 21.

Snow White Ltd has two departments — Cloth and Readymade Clothes. Ready Made Clothes are made by the Firm itself out of cloth supplied by the Cloth Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit and Loss Accounts for the year ended 31st March 2013.

| Particulars | Cloth Department | Readymade Clothes (RM) |
|---|------------------|------------------------|
| | ₹ | ₹ |
| Opening Stock on 1 st April, 2012 | 3,00,000 | 50,000 |
| Purchases | 20,00,000 | 15,000 |
| Sales | 22,00,000 | 4,50,000 |
| Transfer to Readymade Clothes Department | 3,00,000 | — |
| Expenses - Manufacturing | — | 60,000 |
| Selling | 20,000 | 6,000 |
| Closing Stock on 31 st March, 2013 | 2,00,000 | 60,000 |

The Stock in the Readymade Clothes Department may be considered as consisting of 75% Cloth and 25% other expenses. The Cloth Department earned Gross Profit at the rate of 15% during the year 2011-12.

General Expenses of the business as a whole came to ₹ 1,10,000.

Solution :**Departmental Trading and Profit and Loss A/c for the year ended 31st March 2013****Dr.****Cr.**

| Particulars | Cloth (₹) | RM (₹) | Total (₹) | Particulars | Cloth (₹) | RM (₹) | Total (₹) |
|--------------------------------------|------------------|---------------|------------------|---------------------|------------------|-----------------|------------------|
| To Opg. Stock | 3,00,000 | 50,000 | 3,50,000 | By Sales | 22,00,000 | 4,50,000 | 26,50,000 |
| To Purchases | 20,00,000 | 15,000 | 20,15,000 | By Tfr. to RM | 3,00,000 | — | 3,00,000 |
| To Tfr from Cloth Dept. | — | 3,00,000 | 3,00,000 | By Closing Stock | 2,00,000 | 60,000 | 2,60,000 |
| To Mfg. Exps. | | 60,000 | 60,000 | | | | |
| To Gross Profit | 4,00,000 | 85,000 | 4,85,000 | | | | |
| | 27,00,000 | 10,000 | 32,10,000 | | 27,00,000 | 5,10,000 | 32,10,000 |
| To Selling Exp. | 20,000 | 6,000 | 26,000 | | 4,00,000 | 85,000 | 4,85,000 |
| To Profit c/d | 3,80,000 | 79,000 | 4,59,000 | By Gross Profit | | | |
| | 4,00,000 | 85,000 | 4,85,000 | By Profit b/d | | | 4,59,000 |
| To Gen. Exp. | | | 1,10,000 | | | | |
| To Stock Reserve (See Note below) | | | 1,575 | | | | |
| To Net profit | | | 3,47,425 | | | | |
| | | | 4,59,000 | | | | 4,59,000 |

Note 1 : Stock Reserve to be additionally provided is $7,200 - 5,625 = ₹ 1,575$; calculated as under :

| Particulars | On Opening Stock | On Closing Stock |
|--|------------------------------|----------------------------------|
| Rate of GP on Sales in Cloth Dept | Given = 15% | $4,00,000 \div 25,00,000 = 16\%$ |
| Element of Cloth Stock in Readymade Clothes | 75% of 50,000 = 37,500 | 75% of 60,000 = 45,000 |
| Stock Reserve required to be maintained | $37,500 \times 15\% = 5,625$ | $45,000 \times 16\% = 7,200$ |

Note 2: In this case, it is possible to ascertain the Reserve already created against Unrealised Profit in the Opening Stock. In the absence of information, the Reserve should be calculated on the difference in the Opening and Closing Stocks i.e. ₹ 10,000 in this question. Since the Closing Stock has increased, the Reserve calculated would be debited to P&L A/c. In case of decrease in Stocks, the Reserve would be credited to P&L A/c.



Illustration 22.

Samudra & Co, a Partnership Firm has three departments viz. K, L, M which are under the charge of the Partners B, C and D respectively. The following Consolidated P&L Account is given below :

| Dr. | Profit and Loss Account | | Cr. |
|-----------------------------------|-------------------------|---------------------------------|-----------------|
| Particulars | Amount ₹ | Particulars | Amount ₹ |
| To Opening Stocks (Note 1) | 81,890 | By Sales (Note 7) | 4,00,000 |
| To Purchases (Note 2) | 2,65,700 | By Closing Stocks (Note 8) | 89,000 |
| To Salaries and Wages (Note 3) | 48,000 | By Discounts Received (Note 10) | 800 |
| To Rent Expenses (Note 4) | 10,800 | | |
| To Selling Expenses (Note 5) | 14,400 | | |
| To Discount Allowed (Note 5) | 1,200 | | |
| To Depreciation (Note 6) | 750 | | |
| To Net Profit for the year | 67,060 | | |
| | 4,89,800 | | 4,89,800 |

From the above Account and the following additional information, prepare the Departmental P&L Accounts for the year ended 31st March, 2013.

- Break up of Opening Stock Department wise is: K - ₹ 37,890; L - ₹ 24,000 and M - ₹ 20,000.
- Total Purchases were as under: K - ₹ 1,40,700; L - ₹ 80,600; M - ₹ 44,400.
- Salaries and Wages include ₹ 12,000 wages of Department M. The balance Salaries should be apportioned to the three departments as 4:4:1.
- Rent is to be apportioned in the ratio of floor space which is as 2:2:5.
- Selling Expenses and Discount Allowed are to be apportioned in the ratio of Turnover.
- Depreciation on assets should be equally charged to the three departments.
- Sales made by the three departments were: K - ₹ 1,80,000; L - ₹ 1,30,000 and M - ₹ 90,000.
- Break up of Closing Stock Department wise is: K - ₹ 45,100; L - ₹ 22,300 and M - ₹ 21,600. The Closing Stock of Department M includes ₹ 5,700 goods transferred from Department K. However, Opening Stock does not include any goods transferred from other departments.
- Departments K and L sold goods worth ₹ 10,700 and ₹ 600 respectively to Department M.
- Discounts received are traceable to Departments K, L and M as ₹ 400; ₹ 250 and ₹ 150 respectively.
- Partners are to share the profits as under: (a) 75% of the Profits of Departments K, L and M to the respective Partner in Charge, (b) Balance Profits to be credited as 2:1:1.

Solution :**1. Departmental P&L Accounts for the year ended 31st March, 2013****Dr.****Cr.**

| Particulars | K (₹) | L (₹) | M (₹) | Particulars | K (₹) | L (₹) | M (₹) |
|---------------------|-----------------|-----------------|-----------------|---------------------|---------------|---------------|---------------|
| To Opening Stock | 37,890 | 24,000 | 20,000 | By Sales | 1,80,000 | 1,30,000 | 90,000 |
| To Purchases | 1,40,700 | 80,600 | 44,400 | By Transfer | 10,700 | 6 0 0 | — |
| To Inter-Dept Trf | — | — | 11,300 | By Closing Stock | 45,100 | 22,300 | 21,600 |
| To Wages | — | — | 12,000 | | | | |
| To Gross Profit c/d | 57,210 | 48,300 | 23,900 | | | | |
| | 2,35,800 | 1,52,900 | 1,11,600 | | | | |
| To Salaries (4:4:1) | 16,000 | 16,000 | 4,000 | By Gross Profit b/d | 57,210 | 48,300 | 23,900 |
| To Rent (2:2:5) | 2,400 | 2,400 | 6,000 | By Discounts | | | |
| To Selling Exp | 6,480 | 4,680 | 3,240 | Received | 4 0 0 | 2 5 0 | 1 5 0 |
| To Disc. (18:13:9) | 5 4 0 | 3 9 0 | 2 7 0 | | | | |
| To Depreciation | 2 5 0 | 2 5 0 | 2 5 0 | | | | |
| To Net Profit c/d | 31,940 | 24,830 | 10,290 | | | | |
| | 57,610 | 48,550 | 24,050 | | 57,610 | 48,550 | 24,050 |

2. Computation of Stock Reserve

From the above profits, Stock Reserve should be eliminated on the Closing Stock.

- GP Rate in Department K = $(57,210 \times 100) / 1,90,700 = 30\%$.
- Stock Reserve = 30% on ₹ 5,700 = ₹ 1,710.

Dr.**3. Profit and Loss Appropriation Account****Cr.**

| Particulars | Amount ₹ | Particulars | Amount ₹ |
|------------------------------------|---------------|----------------------------|---------------|
| To Stock Reserve | 1,710 | By Profit b/d | 67,060 |
| To Profits transferred to Capital: | | (31,940 + 24,830 + 10,290) | |
| B : 75% of 31,940 | 23,955 | | |
| C : 75% of 24,830 | 18,623 | | |
| D : 75% of 10,290 | <u>7,718</u> | | |
| To balance profits trfd in 2: 1: 1 | | | |
| B : 50% of 15,054 | 7,527 | | |
| C : 25% of 15,054 | 3,763 | | |
| D : 25% of 15,054 | <u>3,764</u> | | |
| (bal.fig) | 15,054 | | |
| | 67,060 | | 67,060 |



Illustration 23.

Pooma Ltd. has 2 departments M & S. From the following particulars, prepare Departmental Trading Account & Consolidated Trading Account for the year ended 31st March, 2013.

| Particulars | M (₹) | S (₹) |
|--|----------|----------|
| Opening Stock | 20,000 | 12,000 |
| Purchases | 92,000 | 68,000 |
| Carriage Inwards | 2,000 | 2,000 |
| Wages | 12,000 | 8,000 |
| Sales (excluding inter departmental transfers) | 1,40,000 | 1,12,000 |
| Purchased Goods transferred | | |
| By S to M | 10,000 | — |
| By M to S | — | 8,000 |
| Finished Goods transferred | | |
| By S to M | 35,000 | — |
| By M to S | — | 40,000 |
| Return of Finished Goods | | |
| By M to S | 10,000 | — |
| By S to M | — | 7,000 |
| Closing Stock | | |
| Purchased Goods | 4,500 | 6,000 |
| Finished Goods | 24,000 | 14,000 |

Purchased Goods have been transferred at their respective departmental Purchase Cost & Finished Goods at Departmental Market Price. 20% of Finished Stock (Closing) at each Department represented Finished Goods received from the other Department.

Solution :

1. Departmental Trading, Profit & Loss Account for the year ended 31st March, 2013

Dr.

Cr.

| Particulars | M (₹) | S (₹) | Particulars | M (₹) | S (₹) |
|-----------------------------|-----------------|-----------------|-----------------------------|-----------------|-----------------|
| To Opening Stock | 20,000 | 12,000 | By Sales | 140,000 | 112,000 |
| To Purchases | 92,000 | 68,000 | By Transfer: | | |
| | | | Purchased Goods | 8,000 | 10,000 |
| | | | Finished Goods | 35,000 | 40,000 |
| To Transfer : | | | By Closing Stock Purchased | | |
| Purchased Goods | 10,000 | 8,000 | Goods | 4,500 | 6,000 |
| Finished Goods | 40,000 | 35,000 | Finished Goods out of t/f | 4,800 | 2,800 |
| To Wages | 12,000 | 8,000 | Balance | 19,200 | 11,200 |
| To Carriage Inwards | 2,000 | 2,000 | By Return of Finished Goods | 10,000 | 7,000 |
| To Return of Finished Goods | 7,000 | 10,000 | | | |
| To Gross Profit | 38,500 | 46,000 | | | |
| | 2,21,500 | 1,89,000 | | 2,21,500 | 1,89,000 |

2. Calculation of Gross Profit Ratio

| Particulars | M (₹) | S (₹) |
|---|-----------------------|-----------------------|
| Sales | 140,000 | 112,000 |
| Add : Transfer of Finished Goods | 35,000 | 40,000 |
| Less : Return of Finished Goods | <u>(7,000)</u> | <u>(10,000)</u> |
| Net Sales [A] | <u>168,000</u> | <u>142,000</u> |
| Gross Profit [B] as calculated below | 38,500 | 46,000 |
| Gross Profit Ratio [B ÷ A] | 22.9% | 32.4% |

3. Consolidated Trading Account for the year ended 31st March, 2013

Dr.

Cr.

| Particulars | Amount (₹) | Particulars | Amount (₹) |
|-----------------------------------|-----------------|---------------------------------|-----------------|
| To Opening Stock (20,000+12,000) | 32,000 | By Sales (1,40,000 + 1,12,000) | 2,52,000 |
| To Purchases (92,000 + 68,000) | 160,000 | By Closing Stock | |
| To Wages (12,000 + 8,000) | 20,000 | By Purchase Goods 10,500 | |
| To Carriage Inwards (2,000+2,000) | 4,000 | (4,500+6,000) | |
| To Stock Reserve: | | By Finished Goods <u>38,000</u> | 48,500 |
| [24,000 × 20%] × 32.4% | 1,555 | (24,000+14,000) | |
| [14,000 × 20%] × 22.9% | 641 | | |
| To Net Profit | 82,304 | | |
| | 3,00,500 | | 3,00,500 |

Illustration 24.

Department X sells goods to Department Y at a profit of 25% on cost & to Department Z at a profit of 10% on cost. Department Y sells goods to X & Z at a profit of 15% & 20% on sales, respectively.

Department Z charges 20% & 25% profit on cost to Department X & Y, respectively.

Department Managers are entitled to 10% Commission on Net Profit subject to Unrealised profits on Departmental sales being eliminated.

Departmental profits after charging manager's commission, but before adjustment of unrealised profits are : X = ₹ 36,000; Y = ₹ 27,000; Z = ₹ 18,000

Stocks lying at different departments at the year end are as under :

| Particulars | X (₹) | Y (₹) | Z (₹) |
|----------------------------|--------|--------|--------|
| Transfer from Department X | — | 15,000 | 11,000 |
| Transfer from Department Y | 14,000 | — | 12,000 |
| Transfer from Department Z | 6,000 | 5,000 | — |

Find out the correct Departmental Profits after charging Managers' Commission.

Solution :

1. Computation of Unrealised Profits

| Particulars of transfer to | Department X (₹) | Department Y (₹) | Department Z (₹) | Total (₹) |
|---|-----------------------------------|-----------------------------------|-----------------------------------|--------------|
| From Department X to Y and Z at 25% and 10% of Cost | Nil | $15,000 \times 25/125$ = 3,000 | $11,000 \times 10/110$ = 1,000 | 4,000 |
| From Department Y to X and Z at 15% and 20% of Sales | $14,000 \times 15/100$ = 2,100 | Nil | $12,000 \times 20/100$ = 2,400 | 4,500 |
| From Department Z to X and Y at 20% and 25% of Cost | $6,000 \times 20/120$ = 1,000 | $5,000 \times 25/125$ = 1,000 | Nil | 2,000 |

2. Computation of Correct Departmental Profits after charging Manager's Commission correctly

| Particulars | Department X (₹) | Department Y (₹) | Department Z (₹) |
|--|--------------------------------|--------------------------------|--------------------------------|
| Profits after charging Manager's Commission | 36,000 | 27,000 | 18,000 |
| Add : Wrong Commission = 10% of Profits = 1/10 on Profits before charging commission = 1/9 on Profits after charging commission | $1/9 \times 36,000$ = 4,000 | $1/9 \times 27,000$ = 3,000 | $1/9 \times 18,000$ = 2,000 |
| Profits before charging commission | 40,000 | 30,000 | 20,000 |
| Less : Unrealised Profits i.e. Stock Reserve | 4,000 | 4,500 | 2,000 |
| Profits qualifying for commission | 36,000 | 25,500 | 18,000 |
| Less : Commission at 10% of above | 3,600 | 2,550 | 1,800 |
| Correct Profits after charging commission | 32,400 | 22,950 | 16,200 |

Illustration 25.

The following details are available in respect of a business for a year.

| Department | Opening Stock | Purchase | Sales |
|------------|---------------|-------------|-----------------------------|
| X | 120 units | 1,000 units | 1,020 units at ₹ 20.00 each |
| Y | 80 units | 2,000 units | 1,920 units at ₹ 22.50 each |
| Z | 152 units | 2,400 units | 2,496 units at ₹ 25.00 each |

The total value of purchases is ₹ 1,00,000. It is observed that the rate of Gross Profit is the same in each department. Prepare Departmental Trading Account for the above year.

Solution :

1. Computation of Closing Stock Quantity (in units)

| Particulars | X | Y | Z |
|----------------------|------------|------------|-----------|
| Opening Stock | 120 | 80 | 152 |
| Add: Purchases | 1,000 | 2,000 | 2,400 |
| Less: Units Sold | (1,020) | (1,920) | (2,496) |
| Closing Stock | 100 | 106 | 56 |

2. Computation of Gross Profit Ratio

We are informed that the GP Ratio is the same for all departments. Selling Price is given for each department's products but the Sale Quantity is different from that of Purchase Quantity. To find the Uniform GP Rate, the sale value of Purchase Quantity should be compared with the Total Cost of Purchase, as under. Assuming all purchases are sold, the sale proceeds would be

| | | |
|---------------------------------------|------------------------|----------------------|
| Department X | 1,000 units @ ₹ 20.00 | 20,000 |
| Department Y | 2,000 units @ ₹ 22.50 | 45,000 |
| Department Z | 2,400 units @ ₹ 25.00 | 60,000 |
| Total Sale Value of Purchase Quantity | 125,000 | |
| Less : Cost of Purchase | 1,00,000 | |
| Gross Profit Amount | 25,000 | |
| Gross Profit Ratio | $25,000 \div 1,25,000$ | 20% of Selling Price |

3. Computation of Profit and Cost for each article

| Department | Selling Price | Profit at 1/5 of SP | Cost = Sales – Profit |
|--------------|---------------|-----------------------|-----------------------|
| Department X | ₹ 20.00 | 1/5 of ₹ 20.00 = 4.00 | ₹ 16.00 |
| Department Y | ₹ 22.50 | 1/5 of ₹ 22.50 = 4.50 | ₹ 18.00 |
| Department Z | ₹ 25.00 | 1/5 of ₹ 25.00 = 5.00 | ₹ 20.00 |

Dr. 4. Departmental Trading Account for the year ended...**Cr.**

| Particulars | X (₹) | Y (₹) | Z (₹) | Total (₹) | Particulars | X (₹) | Y (₹) | Z (₹) | Total (₹) |
|-----------------|--------|--------|--------|-----------|--------------|--------|--------|--------|-----------|
| To Op. stock | 1,920 | 1,440 | 3,040 | 6,400 | By Sales | 20,400 | 43,200 | 62,400 | 126,000 |
| To Purchase | 16,000 | 36,000 | 48,000 | 100,000 | By Cl. stock | 1,600 | 2,880 | 1,120 | 5,600 |
| To Gross Profit | 4,080 | 8,640 | 12,480 | 25,200 | | | | | |
| | 22,000 | 46,080 | 63,520 | 131,600 | | 22,000 | 46,080 | 63,520 | 131,600 |

Opening and Closing Stocks are valued at Cost as indicated in WN 3 above. Sale Amount in the Trading Account is computed for the Sale Quantity only. Gross Profit is calculated at 20% of Sale Value.

SELF EXAMINATION QUESTIONS:

- Bad debts are apportioned among departments in the proportion of
 - Sales of each department
 - Number of units sold each department
 - Cost of sales of each department
 - None of the above
- The goods are transferred from department X to Department Y at selling price which includes a profit of 25% on cost. Stock valued at ₹65,000 in Department Y, is ₹18,000, then the amount of stock reserve on closing stock will be
 - ₹16,250
 - ₹13,000
 - ₹21,667
 - None of the above



- (3) Goods are transferred from Department X to Department Y at a price so as to include a profit of 33.33% on cost. If the value of closing stock of Department Y is ₹18,000, then the amount of stock reserve on closing stock will be
- (A) ₹6,000
(B) ₹4,500
(C) ₹9,000
(D) None of the above

Answer:

| | | |
|--------|--------|--------|
| 1. (A) | 2. (B) | 3. (B) |
|--------|--------|--------|

State whether the following statement is True (or) False:

1. Branch Stock Account is always prepared at cost price.
2. In Branch Accounting system, the Branch prepares the periodic returns based on which the accounting records are maintained at the Head office.
3. At the time of preparation of departmental profit and loss account discount received is allocated among various departments on the basis of departmental sales.
4. Goods in transit are recorded in the books of H.O.
5. When the goods are returned by Branch, goods sent to Branch account will be debited in the books of Head Office.
6. Branch account is prepared in the books of Head office under debtors' method of accounting

QUESTIONS:

1. Priya Sales Corporation of Jaipur has a Branch at Kota to which goods are sent @ $33\frac{1}{3}\%$ above cost. The Branch makes sales both for cash and on credit. Branch expenses are paid direct from Head Office and the Branch has to remit all cash received into the Head Office Bank Account at Kota.

Following further details are given for the year ended 31st March, 2012:

| Particulars | (₹) |
|---|-----------|
| Goods sent to Branch (at invoice price) | 18,00,000 |
| Goods returned by Branch (at invoice price) | 20,000 |
| Stock at Branch on 1.4.2011 (at invoice price) | 2,40,000 |
| Branch Debtors on 1.4.2011 | 2,15,000 |
| Sales during the year: | |
| - Cash | 5,80,000 |
| -Credit | 11,40,000 |
| Cash received from Branch debtors | 10,45,000 |
| Discount allowed to by Branch to debtors | 14,800 |
| Bad debts | 9,200 |
| Sales return at Kota Branch | 25,000 |
| Salaries and wages at Branch | 1,80,000 |
| Rent, Rates and Taxes at Branch | 42,000 |
| Sundry expenses at Branch | 15,000 |
| Stock at Branch on 31.3.2012 (at invoice price) | 3,60,000 |

Branch and Departmental Accounts

You are required to show Branch Stock Account, Branch Adjustment Account, Branch Expenses Account, Branch Debtors Account, Branch Goods sent to Branch Account and Branch Profit & Loss Account in the books of the Head Office.

Answer:

Books of Priya Sales Corporation Branch Stock Account

| Dr. | | Cr. | |
|--------------------------------------|-----------|--------------------------------------|-----------|
| Particulars | Amount | Particulars | Amount |
| To Balance b/d | 2,40,000 | By Goods sent to Branch A/c (Return) | 20,000 |
| To Goods sent to Branch A/c | 1,80,000 | By Bank A/c (Cash Sales) | 5,80,000 |
| To Branch Debtors A/c (Returns) | 25,000 | By Branch Debtors A/c (Credit Sales) | 11,40,000 |
| To Branch Adjustment A/c | 35,000 | By Balance c/d | 3,60,000 |
| (Excess of sales over invoice price) | | | |
| | 21,00,000 | | 21,00,000 |

Branch Adjustment Account

| Dr. | | Cr. | |
|-----------------------------------|----------|--------------------------------------|----------|
| Particulars | Amount | Particulars | Amount |
| To Stock Reserve A/c | 90,000 | By Stock Reserve A/c (Opening stock) | 60,000 |
| (Closing stock - 25% on 3,60,000) | 4,50,000 | (25% on 2,40,000) | |
| To Branch P/L A/c | | By Goods sent to Branch A/c | 4,45,000 |
| | | (18,00,000-20,000=17,80,000 × 25%) | |
| | | By Branch Stock A/c | 35,000 |
| | 5,40,000 | | 5,40,000 |

Branch Expenses Account

| Dr. | | Cr. | |
|-----------------------------------|----------|--|----------|
| Particulars | Amount | Particulars | Amount |
| To Bank A/c (Salaries & Wages) | 1,80,000 | By Branch Profit & Loss A/c (transfer) | 2,37,000 |
| To Bank A/c (Rent, rates & taxes) | 42,000 | | |
| To Bank A/c (Sundry exp.) | 15,000 | | |
| | 2,37,000 | | 2,37,000 |

Branch Debtors Account

| Dr. | | Cr. | |
|---------------------|-----------|---|-----------|
| Particulars | Amount | Particulars | Amount |
| To Balance b/d | 2,15,000 | By Bank A/c | 10,45,000 |
| To Branch Stock A/c | 11,40,000 | By Branch Stock A/c (Sales return) | 25,000 |
| | | By Branch P/L A/c | 24,000 |
| | | (Discount ₹ 14,800 & Bad debts ₹ 9,200) | |
| | | By Balance c/d | 2,61,000 |
| | 13,55,000 | | 13,55,000 |



Goods sent to Branch Account

| Dr. | | Cr. | |
|--------------------------------|-----------|---------------------|-----------|
| Particulars | Amount | Particulars | Amount |
| To Branch Stock A/c (Return) | 20,000 | By Branch Stock A/c | 18,00,000 |
| To Branch Adjustment A/c | 4,45,000 | | |
| To Purchases A/c (Trading A/c) | 13,35,000 | | |
| | 18,00,000 | | 18,00,000 |

Branch Profit & Loss Account

| Dr. | | Cr. | |
|---|----------|--------------------------|----------|
| Particulars | Amount | Particulars | Amount |
| To Branch Exp. A/c | 2,37,000 | By Branch Adjustment A/c | 4,50,000 |
| To Branch Debtors A/c (Discount & Bad debts) | 24,000 | | |
| To Profit & Loss A/c (Branch Net profit) | 1,89,000 | | |
| | 4,50,000 | | 4,50,000 |

2. Pass the Journal entries in the books of Head Office to record the following transactions for the year ending 31st March, 2013:

- (i) Head Office collected ₹ 24,500 from a customer of Delhi Branch.
- (ii) Jaipur Branch paid ₹ 80,000 for purchase of Office Computer by Head Office for Delhi Branch.
- (iii) Goods sent by Head Office to Jaipur Branch valued ₹ 45,000 wrongly Debited to Delhi Branch in the Books of Head Office.
- (iv) Goods returned by Delhi Branch valued ₹ 4,800 on 26th March, 2013, was received by Head Office on 3rd April, 2013.

Answer:

Journal Entries in the books of Head Office

| Date | Particulars | L.F. | Amount (Dr.) | Amount (Cr.) |
|-------|---|------|-----------------|-----------------|
| (i) | Bank A/c Dr. To Delhi Branch A/c (Being amount received here from Delhi Branch customer) | | 24,500 | 24,500 |
| (ii) | Delhi Branch Fixed Assets (Computer) A/c Dr. To Jaipur Branch A/c (Being amount paid by Jaipur Branch for purchase of Computer for Delhi Branch) | | 80,000 | 80,000 |
| (iii) | Jaipur Branch A/c Dr. To Delhi Branch A/c (Being reversal of wrong entry) | | 45,000 | 45,000 |
| (iv) | Goods in Transit A/c Dr. To Delhi Branch A/c (Being goods returned by Delhi Branch on 26/3/13 lying in transit) | | 4,800 | 4,800 |

3. A head office in Calcutta supplies goods to its branch at Madras at cost. The branch sells the goods for cash and on credit and remits the proceeds to the head office promptly, the branch expenses being met by the head office by cheque. The following are the transactions relating to the branch for the year ended 31st December, 2015 :

| | ₹ |
|---|--------|
| Stock at Branch on 01-01-2015 | 6,000 |
| Debtors at Branch on 01-01-2015 | 8,000 |
| Goods sent to Branch during the year | 45,000 |
| Total sales at Branch (including cash sales ₹ 22,000) | 74,000 |
| Goods returned by Branch | 2,000 |
| Goods returned by Customers | 2,000 |
| Collections from Debtors | 42,000 |
| Discount allowed | 2,000 |
| Bad Debt written off | 1,000 |

Cheques sent by Head Office towards Branch Expenses—

| | ₹ | ₹ | | ₹ |
|-----------------------------|-------|---|--|-------|
| Salaries | 5,000 | | | |
| Rent | 2,500 | | | |
| Petty expenses | 500 | | | |
| | 8,000 | | | |
| Stock at Branch on 31-12-15 | | | | 9,000 |

Prepare Branch Account and Goods sent to Branch Account in the H. O. books.

Solution:

**In the Books of H. O.
Madras Branch Account**

| Dr. | | | | | Cr. |
|-----------------------------|-------|--------|---------------------------------|--------|--------|
| | ₹ | ₹ | | ₹ | ₹ |
| 01.01.15 | | | 31.12.15 | | |
| To Balance b/f | | | By bank – remittances received: | | |
| Stock | 6,000 | | Cash Sales | 22,000 | |
| Debtors | 8,000 | 14,000 | Collection from Debtors | 42,000 | 64,000 |
| 31-12-15 | | | | | |
| To Goods Sent to branch A/c | | 45,000 | By Goods Sent to Branch A/c | | |
| „ Bank A/c – expenses: | | | – Returns | | 2,000 |
| Salaries | 5,000 | | By Balance c/f | | |
| Rent | 2,500 | | By Stock | 9,000 | |
| Petty expenses | 500 | 8,000 | By Debtors (WN 1) | 13,000 | 22,000 |
| To Profit & Loss A/c | | | | | |
| – Branch Profit transferred | | 21,000 | | | |
| | | 88,000 | | | 88,000 |



| Dr. | Goods Sent to branch Account | | Cr. |
|------------------------------|------------------------------|-----------------------|--------|
| | ₹ | | ₹ |
| 31-12-15 | | 31-12-15 | |
| To Madras Branch A/c | 2,000 | By Madras Branch A(c) | 45,000 |
| „ Trading (or Purchases) A/c | | | |
| —transfer | 43,000 | | |
| | 45,000 | | 45,000 |

Working Note:

- The figure for closing debtors has not been supplied in the problem. It can be ascertained by preparing a Memorandum Branch Debtors A/c as under:

| Dr. | Memorandum Branch Debtors Account | | Cr. |
|--------------------------------|-----------------------------------|--------------------|--------|
| | ₹ | | ₹ |
| To Balance b/f | 8,000 | By Bank—collection | 42,000 |
| „ Credit Sales (74,000-22,000) | 52,000 | „ Discount Allowed | 2,000 |
| | | „ Returns Inward | 2,000 |
| | | „ Bad Debt | 1,000 |
| | | „ Balance c/f | 13,000 |
| | 60,000 | | 60,000 |

- A head office in Calcutta has a branch in Ahmedabad to which goods are invoiced at cost price. The following are the transactions between the head office and the branch for the year ending December 31st, 2015:

| | ₹ | ₹ |
|---------------------------------------|--------|--------|
| Stock at Branch on 01-01-2015 | | 12,500 |
| Debtors at Branch on 01-01-2015 | | 12,000 |
| Petty Cash at Branch on 01-01-2015 | | 300 |
| Goods sent to Branch | | 45,000 |
| Remittances from Branch : | | |
| Cash Sales | 16,000 | |
| Money received from Debtors | 29,500 | 45,500 |
| Goods returned to H. O. | | 3,000 |
| Bad Debts at Branch | | 500 |
| Discount allowed to Branch Debtors | | 1,300 |
| Goods returned by customers to Branch | | 2,000 |
| Cheques sent to Branch— | | |
| for Salaries and Wages | 9,000 | |
| for Insurance | 3,000 | |
| for Petty Cash | 510 | 12,510 |
| Stock at Branch on 31-12-2015 | | 15,000 |
| Debtors at Branch on 31-12-2015 | | 22,500 |
| Petty Cash at Branch on 31-12-2015 | | 200 |

Write up the ledger accounts in the books of H. O. to record the above transactions.

Solution:**Books of H. O.**

| Dr. | | Branch Stock Account | | Cr. | |
|---|--------|-------------------------------|--------|-----|--|
| 01-01-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Balance b/f | 12,500 | By Bank—cash sales A/c | 16,000 | | |
| 31-12-2015 | | „ Branch Debtors—credit sale- | 43,800 | | |
| To Goods Sent to Branch A/c | 45,000 | „ Goods Sent to Branch A/c | | | |
| „ Branch Debtors—returns from customers | 2,000 | —returns from Branch | 3,000 | | |
| „ Branch P/L A/c—gross profit transferred | 18,300 | „ Balance c/f | 15,000 | | |
| | 77,800 | | 77,800 | | |

| Dr. | | Branch Debtors Account | | Cr. | |
|---|--------|----------------------------|--------|-----|-------|
| 1-1-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Balance b/f | 12,000 | By Bank—collection | 29,500 | | |
| 31-12-2015 | | „ Branch Stock A/c—returns | 2,000 | | |
| To Branch Stock A/c | 43,800 | „ Branch P/L A/c : | | | |
| —credit sales (<i>balancing figure</i>) | | Bad Debts | 500 | | |
| | | Discount Allowed | 1,300 | | 1,800 |
| | | „ Balance c/f | 22,500 | | |
| | 55,800 | | 55,800 | | |

| Dr. | | Goods Sent to Branch Account | | Cr. | |
|----------------------|--------|------------------------------|--------|-----|--|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Branch Stock A/c | 3,000 | By Branch Stock A/c | 45,000 | | |
| —returns from Branch | | | | | |
| „ Trading A/c | 42,000 | | | | |
| —transfer | | | | | |
| | 45,000 | | 45,000 | | |

| Dr. | | Branch Petty Cash Account | | Cr. | |
|----------------|-----|-----------------------------|-----|-----|--|
| 1-1-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Balance b/f | 300 | By Branch Expenses A/c | | | |
| 31-12-2015 | | —petty expenses | 610 | | |
| To Bank | 510 | (<i>balancing figure</i>) | | | |
| | | „ Balance e/f | 200 | | |
| | 810 | | 810 | | |

| Dr. | | Branch Expenses Account | | Cr. | |
|-------------------------|--------|-------------------------|--------|-----|--|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Bank- | | By Branch P/L A/c | 12,610 | | |
| Salaries & Wages | 9,000 | —transfer | | | |
| Insurance | 3,000 | | | | |
| „ Branch Petty Cash A/c | | | | | |
| —petty expenses | 610 | | | | |
| | 12,610 | | 12,610 | | |



| Dr. | | Branch Profit & Loss Account | | Cr. | |
|---------------------------------|--------------|------------------------------|--------|-----|--|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Branch Expenses | 12,610 | By Branch Stock A/c | 18,300 | | |
| „ Branch Debtors A/c : | | — gross profit | | | |
| — Bad Debts | 500 | | | | |
| — Discount allowed | <u>1,300</u> | | | | |
| „ General Profit & Loss A/c | | | | | |
| — Branch net profit transferred | 3,890 | | | | |
| | 18300 | | 18300 | | |

5. A H. O. invoiced to their Delhi Branch during the year ended 31-12-2015 goods at selling price (being $33\frac{1}{8}\%$ added to cost) amounting to ₹ 74,000. The credit sales of the Branch were ₹ 31,000 and cash sales ₹ 17,000. The Branch returned ₹ 2,000 stock at invoice price and had returns from customers ₹ 1,000. The discounts allowed to customers by the Branch amounted to ₹ 1,200. The Branch remitted to H.O. ₹ 38,600 being the amount of cash sales and receipts from customers. The opening and closing stocks of the Branch were ₹ 15,000 and ₹ 39,000 respectively at selling price. The Branch had Debtors of ₹ 12,000 at the beginning. Loss through pilferage was ascertained to be ₹ 1,000 at selling price.

Write up the necessary accounts to record the above in the books of H. O. under synthetic method.

Solution:

**In the Books of H. O.
Delhi Branch Account**

| Dr. | | Cr. | |
|---------------------------------------|---------------|---|---------------|
| 1-1-2015 | ₹ | 1-1-2015 | ₹ |
| To Balance b/f : | | By Stock Reserve—load on | |
| Stock | 15,000 | opening stock $\frac{1}{4} \times 15,000$ | 3,750 |
| Debtors | <u>12,000</u> | 31-12-15 | |
| | 27,000 | By Bank—remittances | 38,600 |
| 31-12-2015 | | „ Goods Sent to Branch A/c | |
| To Goods Sent to Branch A/c | 74,000 | —load on goods sent $(\frac{1}{4} \times 74,000)$ | 18,500 |
| „ Goods Sent to Branch A/c | | „ Goods Sent to Branch A/c | |
| —load on returns by Branch | 500 | —returns by Branch | 2,000 |
| $(\frac{1}{2} \times 2,000)$ | | „ Balance c/f: | |
| “ Stock Reserve—load on closing stock | | Stock | 39,000 |
| $(\frac{1}{4} \times 39,000)$ | 9,750 | Debtors ³ | <u>19,200</u> |
| “ Profit & Loss A/c | | | 58,200 |
| —Branch profit transferred | 9,800 | | |
| | 1,21,050 | | 1,21,050 |

Stock Reserve Account

| Cr. | | Dr. | |
|----------------------------------|--------|---|--------|
| 01-01-2015 | ₹ | 01-01-2015 | ₹ |
| To Delhi Branch A/c —transfer | 3,750 | By Balance b/f —load on opening stock | 3,750 |
| 31-12-2015 To Balance c/f | 9,750 | 31-12-2015 By Delhi Branch A/c —load on closing stock | 9,750 |
| | 13,500 | | 13,500 |

Goods Sent to Branch Account

| Dr. | | Cr. | |
|---|-----------------|--|--------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ |
| To Delhi Branch A/c —load on goods sent | 18,500 2,000 | By Delhi Branch A/c —goods sent | 74,000 |
| „ Delhi Branch A/c —returns by Branch | 54,000 | „ Delhi Branch A/c —load on returns | 500 |
| „ Trading A/c —cost of net goods transferred | | | |
| | 74,500 | | 74,500 |

Working Notes :

1. In examination problems while calculating 'load' care should be taken to ascertain whether the percentage is stated on cost or selling price. $33\frac{1}{3}\%$ of $\frac{1}{3}$ of cost means $\frac{1}{4}$ of selling price.
2. It must be noted that goods pilfered (normal or abnormal) should not be shown in the Branch A/c under the synthetic method.
3. Closing balance of Branch Debtors has been ascertained by preparing a Memorandum Branch Debtors A/c as under:

Memorandum Branch Debtors Account

| | | | |
|----------------|--------|-------------------------------------|--------|
| | ₹ | | ₹ |
| To Balance b/f | 12,000 | By Bank—collection (38,600 -17,000) | 21,600 |
| „ Credit Sales | 31,000 | „ Returns Inward | 1,000 |
| | | „ Discount Allowed | 1,200 |
| | | „ Balance c/f (balancing figure) | 19,200 |
| | 43,000 | | 43,000 |

6. During the year ended 31st December, 2015, X & Co. of Madras sent to their Branch at Bombay goods costing ₹ 1,00,000. They used to invoice to the Branch at a price designed to show a gross profit of $33\frac{1}{3}\%$ per cent on invoice price. Collections at the Branch from debtors amounting to ₹ 26,390 were all sent to Head Office. Branch transactions during the year were:
 Cash Sales— ₹ 1,21,050
 Credit Sales— ₹ 27,600
 Goods returned by customers— ₹ 300
 Goods returned to Head Office— ₹ 780 (invoice price)



| | on 31-12-14 ₹ | on 31-12-15 ₹ |
|--------------------------|------------------|------------------|
| Stock (at invoice price) | 2,250 | 2,700 |
| Sundry Debtors | 1,320 | 2,230 |

Goods at the Branch of ₹ 1,260 (invoice price) were lost. Insurance Company paid ₹ 730 on the claim. Branch expenses, paid by Head Office, amount to ₹ 36,780.

Show the necessary Ledger Accounts as would appear in the Head Office books recording the above transactions relating to the Branch including Branch Profit & Loss Account.

Solution:

**Branch Stock Adjustment A/c Method
Books of Head Office
Branch Stock Account**

| Dr. | | Cr. | |
|--|----------|--|----------|
| 1-1-2015 | ₹ | 31-12-2015 | ₹ |
| To Balance b/f | 2,250 | By Bank—cash sales | 1,21,050 |
| 31-12-2015 | | „ Branch Debtors—credit sales | 27,600 |
| To Goods Sent to Branch A/c : ($\frac{1}{4} \times 1,00,000$) | 1,50,000 | „ Goods Sent to Branch A/c —returns from branch | 780 |
| „ Branch Debtors—returns from customers | 300 | „ Goods Lost at Branch A/c | 1,260 |
| „ Branch Adjustment A/c —apparent gross profit transferred | 840 | „ Balance c/f | 2,700 |
| | 1,53,390 | | 1,53,390 |

Note: 'The difference in Branch Stock A/c is due to difference in invoice price and selling price and hence this has been transferred to Branch Adjustment A/c as apparent gross profit.

Dr. Goods Sent to Branch Account Cr.

| Dr. | | Cr. | |
|--|----------|---|----------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ |
| To Branch Stock Adjustment A/c — load on goods sent: $\frac{1}{4} \times 1,50,000$ | 50,000 | By Branch Stock a/ c | 1,50,000 |
| „ Branch Stock A/c —returns from branch | 780 | „ Branch Stock Adjustment A/c — load on returns from | |
| „ Trading A/c —transfer | 99,480 | branch: $\frac{1}{3} \times 780$ | 260 |
| | 1,50,260 | | 1,50,260 |

| Dr. | | Branch Stock Adjustment Account | | Cr. | |
|--|--------|--|---|-----|--------|
| 31-12-2015 | ₹ | 1-1-2015 | ₹ | | |
| To Goods Sent to Branch —load on returns from branch | | By Balance b/f— load on opening stock: $1/3 \times 2,250$ | | | 750 |
| “ Goods Lost at Branch A/c —load on goods lost | 260 | 31-12-84 | | | |
| “ Branch Profit & Loss A/c —gross profit transferred | 420 | By Goods Sent to Branch —load on goods sent | | | 50,000 |
| Balance c/f—load on closing stock: $1/3 \times 2,700$ | 50,010 | “ Branch Stock A/c | | | 840 |
| | 900 | | | | |
| | 51,390 | | | | 51,590 |

| Dr. | | Branch Debtors Account | | Cr. | |
|---------------------|--------|--------------------------------------|---|-----|--------|
| 1-1-15 | ₹ | 31-12-2015 | ₹ | | |
| To Balance b/f | 1,320 | By Bank—collections | | | 26,390 |
| 31-12-15 | | „ Branch Stock A/c | | | 300 |
| To Branch Stock A/c | | —returns from customers ¹ | | | 2,230 |
| —credit sales | 27,600 | Balance c/f | | | |
| | 28,920 | | | | 28,920 |

Note: ¹Returns from customers do not require any adjustment for load, because the question of load element arises only for transactions between the H.O. and Branch.

| Dr. | | Goods Lost at Branch Account | | Cr. | |
|---------------------|-------|--|---|-----|-------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Branch Stock A/c | 1,260 | By Branch Stock Adjustment A/c — load on goods lost: $1/3 \times 1,260$ | | | 420 |
| | | „ Bank—amount recovered from insurance co. | | | 730 |
| | | „ Branch P/L A/c— transfer —uncovered loss | | | 110 |
| | 1,260 | | | | 1,260 |

| Dr. | | Branch Profit & Loss Account | | Cr. | |
|---------------------------------|--------|--|---|-----|--------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ | | |
| To Branch Expenses | 36,780 | By Branch Stock Adjustment A/c — gross profit | | | 50,010 |
| To Goods Lost at branch A/c | 110 | | | | |
| To General P/L A/c | 13,120 | | | | |
| — branch net profit transferred | 50,010 | | | | 50,010 |



Double Column Method

Dr. Branch Stock Account Cr.

| | Invoice (memo.) | Actual | | Invoice (memo.) | Actual |
|-------------------------|--------------------|----------|------------------------|--------------------|----------|
| 1-1-2015 | ₹ | ₹ | 31-12-2015 | ₹ | ₹ |
| To Balance b/f | 2,250 | 1,500 | By Bank—cash sales | 1,21,050 | 1,21,050 |
| 31-12-2015 | | | „ Branch Debtors | | |
| To Goods Sent to Branch | 1,50,000 | 1,00,000 | —credit sales | 27,600 | 27,600 |
| „ Branch Debtors | | | „ Goods Sent to Branch | | |
| —returns from customers | 300 | 300 | —returns from branch | 780 | 520 |
| „ Branch P/L A/c | | | „ Goods Lost at | | |
| —gross profit | | | Branch A/c | 1,260 | 840 |
| transferred | 840 | 50,010 | „ Balance c/f | 2,700 | 1,800 |
| | 1,53,390 | 1,51,810 | | 1,33,390 | 1,51,810 |

Note: Sales and Sales returns appear at selling price in both the columns.

Dr. Goods Sent to Branch Account Cr.

| | | | |
|--------------------------|----------|---------------------|----------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ |
| To Branch Stock A/c | 520 | To Branch Stock A/c | 1,00,000 |
| -returns from branch | | | |
| „ Trading A/c – transfer | 99,480 | | |
| | 1,00,000 | | 1,00,000 |

Dr. Goods Lost at Branch Account Cr.

| Dr. | Cr. | | |
|---------------------|-----|-------------------------------|-----|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ |
| To Branch Stock A/c | 840 | By Bank—amount recovered from | |
| | | insurance co. | 730 |
| | | „ Branch P/L A/c—transfer | 110 |
| | 840 | | 840 |

Dr. Branch Profit & Loss Account Cr.

| | | | |
|--|--------|---------------------|--------|
| 31-12-2015 | ₹ | 31-12-2015 | ₹ |
| To Branch Expenses | 36,780 | By Branch Stock A/c | |
| To Goods Lost at Branch A/c | 110 | —gross profit | 50,010 |
| To General P/L A/c – branch profit transferred | | | |
| | 13,120 | | |
| | 50,010 | | 50,010 |

Note : Under Double Column Method Branch Debtors A/c will be as in the first method and there will be no Branch Adjustment A/c.

7. Bombay Traders Ltd. sends goods to its Madras Branch at cost plus 25 per cent. From the following particulars you are required to show the necessary ledger accounts in the Head Office books :

| | ₹ |
|---|----------|
| Opening stock at Branch at cost to Branch | 20,000 |
| Goods sent to Branch at invoice price | 80,000 |
| Loss-in-transit at invoice price | 10,000 |
| Pilferage at invoice price | 4,000 |
| Normal loss through wastage at invoice price | 2,000 |
| Sales | 1,22,000 |
| Expenses | 32,000 |
| Closing stock at Branch at cost to Branch | 24,000 |
| Recovered from Insurance Company against loss-in-transit | 6,000 |

Solution:

| Dr. | Books of Mumbai Traders Ltd. | | Cr. |
|--|------------------------------|---|----------|
| Branch Stock Account | | | |
| | ₹ | | ₹ |
| To Branch b/f | 20,000 | By Sales A/c | 1,22,000 |
| „ Goods Sent to Branch A/c | 80,000 | „ Loss-in-Transit A/c | 10,000 |
| „ Branch Adjustment A/c —apparent gross profit transferred | 62,000 | „ Pilferage A/c | 4,000 |
| | | „ Branch Adjustment A/c —normal loss | 2,000 |
| | | „ Balance c/f | 24,000 |
| | 1,62,000 | | 1,62,000 |

| Dr. | Goods sent to branch Account | | Cr. |
|---|------------------------------|---------------------|--------|
| | ₹ | | ₹ |
| To Branch Adjustment A/c — load on goods sent: $\frac{1}{3} \times 80,000$ | 16,000 | By Branch Stock A/c | 80,000 |
| By Trading A/c – transfer | 64,000 | | |
| | 80,000 | | 80,000 |



Dr.

Branch Adjustment Account

Cr.

| | ₹ | | ₹ |
|---|--------|---|--------|
| To Branch Stock A/c | | By Balance b/f— load on opening stock : $1/5 \times 20,000$ | |
| —normal loss | 2,000 | „ Goods Sent to Branch A/c | 4,000 |
| „ Loss-in-Transit A/c | | —load on goods sent | |
| —load on loss-in-transit | 2,000 | „ Branch Stock A/c—apparent gross profit | 16,000 |
| „ Pilferage A/c | | | |
| —load on pilferage | 800 | | |
| „ Branch Profit & Loss A/c | | | 62,000 |
| —gross profit transferred | 72,400 | | |
| „ Balance c/f—load on closing stock : $1/4 \times 24,000$ | 4,800 | | |
| | 82,000 | | 82,000 |

Dr.

Loss in-Transit Account

Cr.

| | ₹ | | ₹ |
|---------------------|--------|---|--------|
| To Branch Stock A/c | 10,000 | By Branch Adjustment A/c | 2,000 |
| | | — load on loss-in-transit : $1/5 \times 10,000$ | 6,000 |
| | | „ Bank—Insurance claim | 2,000 |
| | | „ Branch Profit & Loss A/c | |
| | 10,000 | | 10,000 |

Dr.

Pilferage Account

Cr.

| | ₹ | | ₹ |
|---------------------|-------|---|-------|
| To Branch Stock A/c | 4,000 | By Branch Adjustment A/c | 800 |
| | | —load on pilferage : $1/5 \times 4,000$ | 3,200 |
| | | „ Branch Profit & Loss A/c | |
| | 4,000 | | 4,000 |

Dr.

Branch Profit & Loss Account

Cr.

| | ₹ | | ₹ |
|---------------------------------|--------|--------------------------|--------|
| To Expenses A/c | 32,000 | By Branch Adjustment A/c | 72,400 |
| „ Loss-in-Transit A/c | 2,000 | — gross profit | |
| „ Pilferage A/c | 3,200 | | |
| „ General Profit & Loss A/c | 35,200 | | |
| — branch net profit transferred | | | |
| | 72,400 | | 72,400 |

Note : 1. At cost to Branch means at invoice price from H.O.

EXERCISE:

1. From the following information, prepare Branch Account showing the profit or loss of the branch.

| | ₹ |
|----------------------|----------|
| Opening Stock | 30,000 |
| Goods sent to branch | 90,000 |
| Sales | 1,20,000 |
| Expenses: Salaries | 10,000 |
| Other Expenses | 4,000 |

The closing stock could not be ascertained, but it is known that the branch usually sells at cost plus 20%. The branch manager is entitled to a commission of 5% on the profit of the branch before charging such commission.

Answer:

Branch Profit (transferred to P&L A/c) — ₹5,700

2. A company with its Heads Office at Kolkata has a Branch at Chennai. The Branch receives all goods from Head Office who remits cash for all expenses. Total sales by Branch for year ended 31.03.2012 amounted to ₹ 6,50,000 out of which 75% on Credit. Other details for Chennai Branch were as under:

| Particulars | 01.04.2011 | 30.03.2012 |
|-------------|------------|------------|
| Stock | 4,000 | 30,000 |
| Debtor | 45,000 | 30,000 |
| Petty Cash | 250 | --- |

Petty Cash sent by Head Office ₹ 3,000 but ₹ 2,500 is spent for Petty Expenses. The expenses of ₹ 45,000 are actually spent by Branch. All sales are made by the Branch at Cost plus 25%.

You are required to prepare the Chennai Branch A/c in the books of Head Office for the year ended 31.03.2012.

Answer:

Branch Profit (transferred to General P&L A/c — ₹82,500]

3. Jaggu & Co., (Delhi) operates a branch at Jaipur to which goods are invoiced at wholesale price which is cost plus 25%. The branch sells the goods at the retail price which is wholesale price plus 20%.

The following information provided for the year ended 31.03.2014:

| | ₹ |
|--|-----------|
| Stock at the branch on 01.04.2013 | 1,65,000 |
| Goods invoiced to the branch during the year | 17,82,000 |
| Expenses of the branch for the year | 1,10,000 |
| Gross profit made by the branch | 3,30,000 |
| Stock at the branch on 31.03.2014 | 1,98,000 |

Some goods were destroyed by the fire during the year.

You are required to prepare, Branch Stock Account, Branch Profit & Loss Account and Branch Stock Reserve Account in the books of Head Office for the year ended 31st March, 2014.

Answer:

Branch Stock A/c – Gross Profit c/d — ₹3,30,000

Branch P&L A/c – Profit transferred — ₹1,21,000

Branch Stock A/c – Closing ₹39,600

4. Pass the journal entries to rectify or adjust the following in the books of Kolkata Branch for the year ending 31st March, 2014:
- Kolkata Branch paid ₹ 25,000 as salary to a visiting Head Office Official. The branch has debited the amount to salaries account.
 - Goods costing ₹ 15,000 purchased by Kolkata Branch, but payment made by Head Office. The Head Office has wrongly debited this amount to its own purchase account.
 - Depreciation on branch assets, of which accounts are maintained by the Head Office, not provided for ₹ 5,500.
 - Goods worth ₹ 30,000 were returned by a customer of Kolkata Branch to Head Office.
 - ₹ 40,000 remitted by Kolkata Branch to Head Office on 29th March, 2014 was received on 3rd April, 2014.

Answer:

Total of Journal Entries — ₹75,500.

5. The proprietors of Dhooora Departmental store wish to ascertain approximately separate net profits of their two particular departments A and B for the year ended 31st March, 2015. It is not possible to take stock on that date. However, normal rates of Gross Profit (before charging direct expenses) for the department concerned were 40% and 30% on sales respectively. There are six departments in the stores. The following figures were extracted from the books for the year ending 31st March, 2015:

| | Department A (₹) | Department B (₹) |
|-----------------------|------------------|------------------|
| Stock (April 1, 2014) | 3,00,000 | 2,80,000 |
| Sales | 14,00,000 | 12,00,000 |
| Purchases | 9,00,000 | 7,20,000 |
| Direct Expenses | 1,83,000 | 2,84,000 |

The total indirect expenses of all the six departments for the period were ₹ 3,60,000. These expenses (except one-third which is to be divided equally) are to be charged in proportion to departmental sales. The total sales of the other departments were ₹14,00,000. The Manager of each department is also entitled to a commission of 2 per cent on the turnover of his department. Prepare Departmental Trading and Profit & Loss account in columnar form for the year ending 31st March, 2015 making a stock reserve of 5% for each department on the estimated value of stock on 31st March, 2015.

Answer:

Gross Profit – Dept. A - ₹377; Dept. B – ₹76.

Net Profit – Dept. A - ₹227;

Net Loss – Dept. B - ₹48]

6. Surya Co. Ltd. has three departments.
In made purchases during the financial year 2012-13 as below
- Dept. A = 2,000 units
Dept. B = 4,000 units at a total cost of ₹ 2,00,000

Dept. C = 4,800 units

Stock as on 01.04.2012

Dept. A = 240 units

Dept. B = 160 units

Dept. C = 304 units

Sales made were

Dept. A = 2040 units at ₹ 20 each

Dept. B = 3840 units at ₹ 22.50 each

Dept. C = 4992 units at ₹ 25 each

The rate of gross profit is uniform for all the departments. Assume the unit price of opening stock and purchase unit cost are uniform.

Prepare Departmental Trading Account.

Answer:

Departmental Gross Profit Dept. A – ₹8,160, Dept. B - ₹17,280, Dept. C - ₹24,960]

7. M/s Chandu stores has three departments viz. A, B and C. At the end of the year 31st March 2013 goods were included in departmental stocks out of inter-departmental transfers loading their own cost as follows:

From A to B ₹ 25,000 and to C ₹ 18,000 respectively at a profit of 25% on cost.

From B to A and C ₹ 9,000 and ₹ 6,000 respectively at a profit of 33 1/3% on cost.

From C to A and B ₹ 25,000 and ₹ 27,000 respectively at a profit of 20% on transfer price.

Departmental Managers are entitled to 10% commission on net profit subject to unrealized profit on departmental transfers being eliminated. Departmental profits after charging Manager's commission but before adjustment of unrealised profits are:

A— ₹ 1,57,500; B— ₹ 1,62,000; C— ₹ 2,16,000.

You are required to calculate the amount of unrealised profits, correct amount of Manager's commission and departmental profits after charging Manages commission.

Answer:

Correct amount of Managers Commission — Dept. A - ₹16,640, Dept. B - ₹17,625 and Dept. C - ₹22,960

Correct amount of Departmental Profit — Dept. A - ₹1,49,760, Dept. B - ₹1,58,625, Dept. C – 2,06,640.]

8. A firm has two departments, Cloth and Readymade Garments. The Readymade Garments were generally made by the firm itself out of cloth supplied by the cloth department at its usual selling price. The stock in the Readymade Garments Department may be considered as consisting of 65% cloth and 35% of other expenses. The opening rate of gross profit of the Cloth Department is 25% and the closing Rate of gross profit is 30%. The opening stock was ₹ 2,40,000 and the closing stock was ₹ 2,85,000 in the Readymade Garments Department.

You are required to ascertain the amount of provision to be made for unrealized profit.

Answer:

Amount of provision for unrealized profit already made on opening stock of Readymade Garments = ₹ 2,40,000 × 65% × 25% = ₹ 39,000.

Amount of provision required for closing stock of Readymade Garments = ₹ 2,85,000 × 65% × 30% = ₹ 55,575.

Additional provision for unrealized profit to be made at the end of the year = ₹ 55,575 - 39,000 = 7,16,575.

Study Note - 11

COMPUTERISED ACCOUNTING SYSTEM



This Study Note includes

11.1 Computerised Accounting System

11.1. COMPUTERISED ACCOUNTING SYSTEM

SALIENT FEATURES OF COMPUTERISED ACCOUNTING SYSTEM

Computer information system environment exists when one or more computer(s) of any type or size is (are) involved in the processing of any information, whether those computers are operated by the entity or by a third party. A computerised accounting environment will therefore have the following salient features:

1. The processing of information will be by one or more computers.
2. The computer or computers may be operated by the entity or by a third party.
3. The processing of financial information by the computer is done with the help of one or more computer softwares.
4. A computer software includes any program or routine that performs a desired function or set of functions and the documentation required to describe and maintain that program or routine.
5. The computer software used for the accounting system may be an acquired software or may be developed specifically for the business.
6. Acquired software may consist of a spread sheet package or may be prepackaged accounting software.

SIGNIFICANCE OF COMPUTERISED ACCOUNTING SYSTEM

1. The speed with which accounts can be maintained is several fold higher.
2. Automatic Correct Balancing of Ledger Accounts
3. Automatic Tailied Trial balance unless some mistake is made while recording the opening balance.
4. Automatic Income Statement
5. Automatic Balance Sheet

Threat to Computerised Accounting System

The only concerns that has increased today are concerns for controls, security and integrity of the computer system as more and more information is stored not in the hard print but as soft copies inside the computer. Issue like unauthorised access to the data either through the local area network or through the internet by hacking into the company server are becoming potential threat to the computer usage.

CLASSIFICATION AND CODIFICATION OF ACCOUNTS

Some computerised accounting softwares support a coded accounting system and some support even a non-coded accounting system. A coded accounting system is more convenient where there are numerous account heads and the complexity is high. It also to some extent reduces the possibility of the same account existing in several names due to spelling mistakes or abbreviations used.

A proper codification requires a systematic grouping of accounts. The major groups or heads could be Assets, Liabilities, Revenue Receipts, Capital Receipts, Revenue Expenditure, Capital Expenditure. The sub-groups or minor heads could be "Cash" or "Receivables" or "Payables" and so on. The grouping and codification is dependant upon the type of organisation and the extent of sub-division required for reporting on the basis of profit centres or product lines. There could a classification based on geographical location as well.

The main unit of classification in accounts should be the **major head** which should be divided into **minor heads**, each of which should have a number of subordinate heads, generally shown as **sub-heads**. The sub-heads are further divided into **detailed heads**. Sometimes major heads may be divided into 'sub-major heads' before their further division into minor heads.

The Major heads, Minor heads, Sub-heads and Detailed heads together may constitute a four tier arrangement of the classification structure of Accounts.

PRE-PACKAGED ACCOUNTING SOFTWARE

1. There are several prepackaged accounting software which are available in the market and are used extensively for small and medium sized organisations.
2. These softwares are easy to use, relatively inexpensive and readily available.
3. The installation of these softwares are very simple. An installation diskette or CD is provided with the software which can be used to install the software on a personal computer. A network version of this software is also generally available which needs to be installed on the server and work can be performed from the various workstations or nodes connected to the server.
4. Along with the software an user's manual is provided which guides the user on how to use the software.
5. After installation of the software, the user should check the version of the software to ensure that they have been provided with the latest.
6. The vendor normally provides regular updates to take care of the changes of law as well as add features to the existing software.
7. These softwares normally have a section which provides for the creation of a company. The name, address, phone numbers and other details of the company like VAT registration number, PAN and TAN numbers are feeded into the system. The accounting period has to be set by inserting the first and the last day of the financial year.

The next step in the use of this software could be the creation of accounts. This is done by adding the accounts along with their codes into the master file files. Each account has to be classified into whether it is an asset or liability or an income or expenditure to the system. The opening balances are to be entered into the master file files. The company parameters need to be set at this point of time so that the accounts which are the cash, bank, sundry debtors, sundry creditors, etc. are known to the system. The customers' names, addresses and other basic details are also entered in the customer master file. Similarly, the creditors details are entered into the creditor master file files. Product details are entered through the product master file files. Here the unit of measurement and the opening stock quantities including the values are provided. The system of valuation of stock like the FIFO, LIFO, Weighted average, etc. are defined in the product master file files.

ADVANTAGES OF PRE-PACKAGED ACCOUNTING SOFTWARE

| | |
|---|--|
| 1. Easy to Install | The CD containing set up file is to be inserted and run to complete the installation according to instructions as per user's manuals. |
| 2. Relatively Inexpensive | These packages are available at very cheap prices. |
| 3. Easy to Use | These packages are mostly menu driven with the help options. Further the user manual provides most of the solutions to problems that the user may face while using the software. |
| 4. Simple Backup Procedure | Housekeeping section provides a menu for backup. The backup can be taken on CD or hard disk. |
| 5. Certain Flexibility of Report Formats Provided by some of the Softwares | This allows the user to make the invoice, challan, GRNs look the way they want. |
| 6. Very Effective for Small and Medium size Businesses | Most of their functional areas are covered by these standardised packages. |

DISADVANTAGES OF PRE-PACKAGED ACCOUNTING SOFTWARE

| | |
|--|---|
| 1. Does not cover Peculiarities of Specific Business | A standard package may not be able to take care of the complexities of a specific business. |
| 2. Does not cover all Functional Areas | These packages may not cover all functional areas such as production process. |
| 3. Customisation may not be Possible: is not Sufficient or Serve the Purpose: | These packages may not be customised as per needs of customers. |
| 4. Reports Generated | All reports required for exercising management control may not be available in a standard package. |
| 5. Lack of Security | Security is generally missing in a pre-packaged accounting package since any person can view data of all companies with common access password. |
| 6. Bugs in the software | Certain bugs may remain in the software which takes long to be rectified by the vendor and is common in the initial years of the software. |

CONSIDERATIONS FOR SELECTION OF PRE-PACKAGED ACCOUNTING SOFTWARE

The following factors should be considered while selecting pre-packaged accounting software:

| | |
|--|--|
| 1. Fulfillment of Business Requirements | The purchaser should ensure whether the available software meets all the business requirements. |
| 2. Completeness of Reports: | The purchaser should ensure whether the available software can provide all the reports required by business. |
| 3. Ease of Use | The purchaser should ensure whether the available software is easy to operate. |
| 4. Cost | The software should not involve very high installation and running cost. |
| 5. Reputation of the vendor | It should be ensured whether the vendor has good reputation and good track records or not. |
| 6. Regular updates | It should be ensured whether the vendor is prepared to give updates. |

CUSTOMISED ACCOUNTING SOFTWARE

Meaning — A customised accounting software is one which is developed on the basis of specific requirements of the organisation.

A feasibility study is first made before the decision to develop a software is made. The life cycle of a customized accounting software begins with the organisation providing the user requirements. Based on these user requirements the system analyst prepares a requirement specification which is given for approval by the user management. Once the requirement specification is approved, the designing process begins. Development, testing and implementation are the other components of the system development life cycle.

ADVANTAGES OF A CUSTOMISED ACCOUNTING PACKAGE

1. The functional areas which are not covered in pre-packaged software gets computerised.
2. The input screens can be tailor made to match the input documents for ease of data entry.
3. It provides many MIS reports as per the specification of the organisation.
1. It facilitates the use of Bar-code scanners as input devices suitable for the specific needs of an individual organisation.
4. It can suitably match with the organisational structure of the company.

DISADVANTAGES OF A CUSTOMISED ACCOUNTING PACKAGE

1. Requirement specifications are incomplete or ambiguous resulting in a defective or incomplete system.
2. Bugs may remain in the software because of inadequate testing.
3. Documentation may not be complete.

4. Frequent changes made to the system with inadequate change management procedure may result in system compromise.
5. Vendor may not be unwilling to give support of the software due to other commitments.
6. Vendor may not be willing to part with the source code or enter into an escrow agreement.
7. Control measures may be inadequate.
8. There may be delay in completion of the software due to problems with the vendor or inadequate project management.

The choice of customised accounting packages is made on the basis of evaluation of vendor proposals. The proposals are evaluated as to the suitability, completeness, cost and vendor proposals. Generally preference is given to a vendor who has a very good track record of deliverables.

SELF EXAMINATION QUESTIONS:

1. List the significances of computerised accounting system.

Solution:

Significance of computerised accounting system

- The speed with which accounts can be maintained is several fold higher;
- Automatic Correct Balancing of Ledger Accounts;
- Automatic Tailied Trial balance unless some mistake is made while recording the opening balance;
- Automatic Income Statement;
- Automatic Balance Sheet.

2. State the matters to be considered for selection of pre-packaged accounting software.

Solution:

The following factors should be considered while selecting pre-packaged accounting software:

| | |
|--|--|
| 1. Fulfillment of Business Requirements | The purchaser should ensure whether the available software meets all the business requirements. |
| 2. Completeness of Reports: | The purchaser should ensure whether the available software can provide all the reports required by business. |
| 3. Ease of Use | The purchaser should ensure whether the available software is easy to operate. |
| 4. Cost | The software should not involve very high installation and running cost. |
| 5. Reputation of the vendor | It should be ensured whether the vendor has good reputation and good track records or not. |
| 6. Regular updates | It should be ensured whether the vendor is prepared to give updates. |

3. Discuss the disadvantages of customized accounting package.

Solution:

1. Requirement specifications are incomplete or ambiguous resulting in a defective or incomplete system.
2. Bugs may remain in the software because of inadequate testing.
3. Documentation may not complete.
4. Frequent changes made to the system with inadequate change management procedure may result in system compromise.
 5. Vendor may not be unwilling to give support of the software due to other commitments.
 6. Vendor may not be willing to part with the source code or enter into an escrow agreement.
 7. Control measures may be inadequate.
 8. There may be delay in completion of the software due to problems with the vendor or inadequate project management.

The choice of customised accounting packages is made on the basis of evaluation of vendor proposals. The proposals are evaluated as to the suitability, completeness, cost and vendor proposals. Generally preference is given to a vendor who has a very good track record of deliverables.

Study Note - 12

ACCOUNTING STANDARDS



This Study Note includes

- 12.1 AS-1 : Disclosure of Accounting Policies
- 12.2 AS-2 : Valuation of Inventories
- 12.3 AS-6 : Depreciation Accounting
- 12.4 AS-7 : Construction Companies
- 12.5 AS-9 : Revenue Recognition
- 12.6 AS-10 : Accounting For Fixed Assets

ACCOUNTING STANDARD

Accounting standard is a method or an approach established and issued by recognized expert accountancy body. It is used in preparing financial statement viz., Profit & Loss Account and Balance Sheet of various concerns operating different fields.

The main purpose of formulating accounting standard is to standardize the diverse accounting policies with views eliminating to the extent possible the incomparability of information provided in financial statements within or across the organization. So that the users of aforesaid statements don't get confused while evaluating the results to take various decisions viz., to subscribe in equality shares, or subscribe in debenture of that concern.

To discuss on whether such standards are necessary in present days it will be beneficial to go through the advantages and disadvantages which they are said to provide.

ADVANTAGES OF ACCOUNTING STANDARD

1. It provides the accountancy profession with useful working rules.
2. It assists in improving quality of work performed by accountant.
3. It strengthens the accountant's resistance against the pressure from directors to use accounting policy which may be suspected in that situation in which they perform their work.
4. It ensures the various users of financial statements to get complete crystal information on more consistent basis from period to period.
5. It helps the users compare the financial statements of two or more organisations engaged in same type of business operation.

DISADVANTAGES OF ACCOUNTING STANDARD

1. Users are likely to think that said statements prepared using accounting standard are infallible.
2. They have been derived from social pressures which may reduce freedom.
3. The working rules may be rigid or bureaucratic to some user of financial statement.
4. The more standards there are, the more costly the financial statements are to produce.

12.1 DISCLOSURE OF ACCOUNTING POLICIES (AS 1)

This standard deals with disclosure of significant accounting policies followed in the preparation and presentation of the financial statements and is mandatory in nature.

The accounting policies refer to the specific accounting principles adopted by the enterprise.

Proper disclosure would ensure meaningful comparison both inter/intra enterprise and also enable the users to properly appreciate the financial statements.

Financial statements are intended to present a fair reflection of the financial position financial performance and cash flows of an enterprise.

Areas involving different accounting policies by different enterprises are:

- Methods of depreciation, depletion and amortization
- Treatment of expenditure during construction
- Treatment of foreign currency conversion/translation.
- Valuation of inventories
- Treatment of intangible assets
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts
- Valuation of fixed assets
- Treatment of contingent liabilities

Fundamental Accounting Assumptions

Certain basic assumptions, in the preparation of financial statements are accepted and their use are assumed, no separate disclosure is required except for noncompliance in respect of —

- (a) Going Concern: continuing operation in the foreseeable future and no interim necessity of liquidation or winding up or reducing scale of operation.
- (b) Consistency: accounting policies are consistent from one period to another
- (c) Accrual:
 - (i) Revenues and costs are accrued i.e. they are earned or incurred (not actually received or paid) and recorded in the financial statements
 - (ii) Extends to matching revenue against relevant costs.

Factors governing the selection and application of accounting policies are:

Prudence : Generally maker of financial statement has to face uncertainties at the time of preparation of financial statement. These uncertainties may be regarding collectability of receivables, number of warranty claims that may occur. Prudence means making of estimates, which is required under conditions of uncertainty.

Substance over form : It means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions not by its legal form. Like in hire purchase if the assets are purchased on hire purchase by the hire purchaser the assets are shown in the books of hire purchaser in spite of the fact that the hire purchaser is not the legal owner of the assets purchased. Under the purchase the purchaser, becomes the owner only on the payment of last instalment. Therefore the legal form of the transaction is ignored and the transaction is accounted as per as substance.

Materiality : Financial Statement should disclose all the items and facts which are sufficient enough to influence the decisions of reader or /user of financial statement.

- (a) As to the disclosure of all material items, individually or in aggregate in the context of fair presentation of financial statements as a whole if its omission or misstatement could influence the economic or financial decision of the user relying upon the financial statements.

- (b) Depends on the size of the items or errors judged in the particular circumstances of its omissions or misstatements.
- (c) Is a cutoff point rather than being a primary qualitative characteristic which information must have.
- (d) This is a matter of judgment, varies from one entity to another and over one period to another.

AS-1 requires that all "significant" (i.e. only accounting policy that is useful for an understanding by the user of the financial statements) accounting policies adopted in the preparation and presentation of financial statements, should be disclosed by way of 'Note in one place as the note No I (this is the basis of the preparation of financial statements.)

Changes in Accounting Policies :

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in the later period should be disclosed.

In the case of a change in accounting policies, having material effect in the current period, the amount by which any item in the financial statements, is affected by such change should also be disclosed to the extent as ascertainable, otherwise the fact that the effect is not (wholly or partially) ascertainable, should be disclosed.

The following are not considered as changes in accounting policies :

- (a) Accounting policies adopted for events or transactions that differ in substance at present (introducing Group Gratuity Scheme for employees in place of adhoc ex-gratia payment earlier followed.)
- (b) Accounting policies pertains to events or transactions which did not occur previously or that were immaterial.

Illustration 1.

Jivandeep Ltd. had made a right issue in 2010. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to be ended on 31st March 2012. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of ₹ 10 crores. The Board, in consultation with the Managing Director, decided on the following:

- (i) Value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (₹ 30 crores).
- (ii) Provide depreciation for the year on straight line basis or account of substantial additions in gross block during the year, instead of on the Reducing Balance Method, which had been hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crores -which would have been provided had the old method been followed-by ₹ 18 crores.
- (iii) Not to provide for "after-sales expenses" during the warranty period. Till the last year, provision at 2% on sales used to be made under the concept of "matching of cost against revenue" and actual expenses used to be charged against the provision. The Board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.
- (iv) Provide for permanent fall in the value of investment-which fall had taken place over the past 5 years-the provision being ₹ 10 crores.

As chief accountant of the company, you are asked by the Managing Director to draft the Notes on Accounts for inclusion in the annual report for 2011-2012.

Solution:

According to AS 1: "in the case of a change in accounting policies which has a material effect in the current period should be disclosed, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable wholly or in part, the fact should be indicated." Naturally, the **Notes on Accounts** must disclose the change.

Notes on Accounts

- (i) Till last year, it was the practice of valuing inventory at prime cost but during the year the same was valued at works cost. Due to this change the closing inventory was valued at ₹ 50 crores and, accordingly, profit was increased by ₹ 20 crores (i.e. ₹ 50 crores - ₹ 30 crores) due to the change of the method of valuation.

- (ii) During the year the company decided to change the method of providing for depreciation from reducing balance method to straight line method. Due to this change, the amount of depreciation was undercharged i.e., instead of charging ₹ 45 crores it was charged by ₹ 27 crores and, as a consequence, the profit was increased by ₹ 18 crores (i.e., ₹ 45 crores minus ₹ 27 crores).
- (iii) It was the practice of the company to make provision of @ 2% on sales for 'After-Sales expenses' during the warranty period. It may be assumed that as a result of improved techniques and methods in production the possibility of defects became very rare. Consequently, the company took decision not to make any provision for after-sales expense' during warranty period. As a result of this change, the profit would be increased by ₹ 12 crores.
- (iv) As a result of permanent fall in the value of investments which took place over the last 5 years the company decided to make provision to the extent of ₹ 10 crores. Due to this effect the profit would be reduced by ₹ 10 crores.

Illustration 2.

Which one is the correct one? Fundamental accounting assumptions as per AS 1 are:

- (a) Going Concern, Matching and Consistency;
- (b) Money Measurement, Going Concern and Prudence;
- (c) Accounting Period, Going Concern and Entity Concept; and
- (d) Going Concern, Consistency and Accruals.

Solution:

As per AS 1, the fundamental accounting assumptions are: Going Concern, Consistency and Accruals.

Illustration 3.

Explain, in short, the relevant Disclosures of Accounting Policies as per AS 1.

Solution:

As per AS 1, the Disclosures of Accounting Policies are: All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

If the fundamental accounting assumptions, viz, Going Concern, Consistency and Accruals, are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

Illustration 4.

Explain the methods/criteria for the selection and application of Accounting Policies.

Solution:

The major considerations governing the selection and application of accounting policies are:

Prudence – Generally maker of financial statement has to face uncertainties at the time of preparation of financial statement. These uncertainties may be regarding collectability of recoverable, number of warranty claims that may occur. Prudence means making of estimates that are required under conditions of uncertainty.

Substance over form – It means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions not by its legal form.

Materiality – Financial Statement should disclose all the items and facts which are sufficient enough to influence the decisions of reader or/ user of financial statement.

12.2 VALUATION OF INVENTORIES (AS 2)

The objective of this standard is to formulate the method of computation of cost of inventories/stock, determine the value of closing stock/inventory at which, the inventory is to be shown in balance sheet till it is not sold and recognised as revenue.

At the outset AS-2 excludes the following though appears to be inventory in common parlance:

- (a) Work-in-progress in construction contract and directly related service contract (ref: AS-7), inventories not forming part of construction work-in-progress will attract AS-2
- (b) Work-in-progress arising in the ordinary course of business of service providers.
- (c) Shares, debentures and other financial instruments held as stock-in-trade (ref: AS-13 as Current Investments)
- (d) Producer's inventories like livestock, agricultural and forest product, mineral oil/gasses as measured at net realizable value as per trade practices at certain stage of production.

Inventories are assets:

- (a) held for sale in the ordinary course of business;
- (b) in the process of production for such sale; or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets.

Measurement of inventories

Inventories should be valued at lower of cost and net realizable value.

Valuation of Inventories requires (i) determination of cost of inventories, (ii) Determination of net realizable value of inventories, and comparison between the two.

The following terms are used in this Standard with the meanings specified:

Cost of inventories includes:

- **Cost of Purchase**
- **Cost of Conversion**
- **Other costs**

Costs of Purchase

The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

Costs of Conversion

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred

in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials.

The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are assigned to each unit of production on the basis of the actual usage of the production facilities.

A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other Costs

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include overheads other than production overheads or the costs of designing products for specific customers in the cost of inventories.

Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories.

Exclusions from the Cost of Inventories

In determining the cost of inventories it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- (a) abnormal amounts of wasted materials, labour, or other production costs;
- (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (d) selling and distribution costs.

Cost Formulas

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been purchased or produced. However, when there are large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs is inappropriate since, in such circumstances, the method of selecting those items that remain in inventories could be used to predetermine effects on profit or loss.

The cost of inventories, other than those dealt with specific projects should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

A variety of cost formulas is used to determine the cost of inventories other than those for which specific identification of individual costs is appropriate. The formula used in determining the cost of an item of inventory needs to be selected with a view to provide the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

Techniques for the Measurement of Cost

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the

inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Disclosure under AS-2

- (a) The accounting policy adopted in measuring inventories
- (b) The cost formula used
- (c) Carrying amount (value) of inventory commonly classified under Raw Material and Components, Work-in-Progress, Finished goods and Stores, Spares and Loose tools.
- (d) Schedule-VI and AS-2 disclosure are at par

Illustration 5.

How do you deal with the following?

On 31.3.2012, the closing stock of Gourav Ltd. includes 10,000 units costing @ ₹ 10 i.e., ₹ 1,00,000. But the current market price as on that date was @ ₹ 9 i.e., ₹ 90,000.

Solution:

According to AS 2, Valuation of Inventories will be lower of cost and Net Realisable Value. In the present case the cost is ₹(10×10,000) i.e. ₹1,00,000 and the Net Realisable Value is ₹90,000. Therefore the inventories will be valued at ₹90,000 i.e. at Net Realisable Value.

Illustration 6.

From the following information presented by P Ltd. ascertain the value of stock to be included in Balance Sheet:

Cost Price of certain stock amounted to ₹ 60,000; being obsolete, it can be used for production purposes after incurring ₹ 10,000 for modification. The same could be used as a by-product for an existing product, the purchase price for the same amounts to ₹ 40,000.

Solution:

Cost price of the product (given) ₹ 60,000.

Net Realisable Value of the product ₹ 40,000 – ₹ 10,000 = ₹ 30,000. Inventories are valued at lower of Cost and Net Realisable value. Hence, ₹ 30,000 should be treated as the Value of Stock to be included in Balance Sheet.

Illustration 7.

How will you deal with the following situation?

“A company deals in purchase and sale of timber and has included notional interest charges calculated (on the paid-up share capital and free reserves) in the value of stock of timber as at the Balance Sheet date as part of cost of holding the timber”.

Solution:

According to para 12 of AS 2, **Valuation of Inventories**, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Hence, the valuation of closing stock of timber cannot be considered as it is not in conformity with AS 2.

Illustration 8.

The company deals in three products A, B and C which are neither similar nor interchangeable. At the time of closing of its account for the year 2012-13, the historical cost and net realisable value of the items of closing stock are determined as:

| Items | Historical cost (₹ In lakhs) | Net Realisable Value (₹ In lakhs) |
|-------|---------------------------------|--------------------------------------|
| A | 40 | 28 |
| B | 32 | 32 |
| C | 16 | 24 |

What will be the value of closing stock?

Solution:

According to AS 2, **Valuation of Inventories**, para 5, inventories should be valued as per the cost or net realisable value, whichever is lower. Thus, inventories should be valued as per itemwise as:

| Items | Historical cost (₹ In lakhs) | Net Realisable Value (₹ In lakhs) | Valuation of Closing Stock (₹ In lakhs) |
|-------|---------------------------------|--------------------------------------|--|
| A | 40 | 28 | 28 |
| B | 32 | 32 | 32 |
| C | 16 | 24 | 16 |
| | 88 | 84 | 76 |

So, Closing Stock should be valued at ₹ 76 lakhs.

Illustration 9.

Z Co. Ltd. purchased goods at the cost of ₹ 40 lakhs in Oct. 2012, Till March 2013, 75% of the stocks were sold. The company wants to disclose closing stock at ₹ 10 lakhs. The expected sales value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent.

Advise: What is the correct closing stock to be disclosed as at 31.3.2013?

Solution:

The stand of the company to disclose the closing stock at ₹ 10 lakhs is not in line with AS-2. As per AS 2-Valuation of Inventories, para 5, inventory should be valued as per cost price or net realisable value, whichever is lower. In the problem, cost price is ₹ 10 lakhs, but the net realisable value is ₹ 11,00,000 x 90% = ₹ 9,90,000. So, the value of closing stock should be taken as ₹ 9,90,000 being the lower.

Illustration 10.

How would you deal with the following in the annual accounts of a company for the year ended 31.3.2013?

"The company has to pay delayed cotton clearing charges over and above the negotiated price for asking delayed delivery of cotton from the supplier's godown. Up to 2011-12, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2012-13. This would result into decrease in profit by ₹ 7.60 lakhs."

Solution:

As per para 12, AS 2, *Valuation of Inventories*, interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. Thus, it becomes quite clear that delayed cotton clearing charges which were treated in the nature of interest must not be included while valuing closing stock as per the provision of AS 2 and it is not in compliance with AS 2 which was done up to 2010-11.

But from year 2011-12, the company decided to change the earlier view i.e. they decided to exclude the same from the valuation of closing stock which is, no doubt, in compliance with AS 2.

As a result of change in accounting policy regarding valuation of stock the profit was reduced by is. 7.60 lakhs which must be disclosed in the financial statement or per AS 1 as Notes to Account.

Illustration 11.

Sonar Bhandar deals in old colour TVs. It has 4 TVs the particulars of which are given below :

You are asked to compute the value of stock to be included, in Balance Sheet for the year ended 31st March 2013:

| TVs | Onida ₹ | Philips ₹ | EC ₹ | Sony ₹ | Total ₹ |
|--|------------|--------------|---------|-----------|------------|
| Cost Price | 10,000 | 20,000 | 35,000 | 50,000 | 1,15,000 |
| (Expenses incurred to bring into salable conditions) | 3,000 | 2,000 | 5,000 | - | 10,000 |
| Net Realisable Value | 18,000 | 30,000 | 36,000 | 55,000 | 1,39,000 |

Solution:

As per para 5, AS 2 *Valuation of Inventories*, inventories should be valued at the lower of cost or net realisable value on an item-by-item basis, which are:

| TVs | Onida ₹ | Philips ₹ | EC ₹ | Sony ₹ | Total ₹ |
|---------------------------------|------------|--------------|---------|-----------|------------|
| Cost Price (including expenses) | 13,000 | 22,000 | 40,000 | 50,000 | 1,25,000 |
| Net Realisable Value | 18,000 | 30,000 | 36,000 | 55,000 | 1,39,000 |
| Value of Stock | 13,000 | 22,000 | 36,000 | 50,000 | 1,21,000 |

Value of Stock to be included in Balance Sheet will be ₹ 1,21,000.

Illustration 12.

The following particulars are presented by M Ltd. (deals in clothing) as on 31.3.2013:

Compute the value of stock as per AS 2.

| | |
|------------------------|--------|
| Stock held by M Ltd. | ₹ |
| (Cost Price) | 10,550 |
| (Net Realisable Value) | 11,500 |

The details of such stocks were:

| | Cost Price ₹ | Net Realisable Value ₹ |
|-----------|-----------------|---------------------------|
| Cotton | 5,600 | 4,960 |
| Woolen | 3,450 | 4,540 |
| Synthetic | 1,500 | 2,000 |
| | 10,550 | 11,500 |

Solution:**Valuation of Stock as per AS 2**

As per AS 2, para 21, inventories are usually valued at lower of cost and net realisable value on an item-by-item basis:

| | Cost Price ₹ | Net Realisable ₹ | Value of Closing Stock ₹ |
|-----------|-----------------|---------------------|-----------------------------|
| Cotton | 5,600 | 4,960 | 4,960 |
| Woolen | 3,450 | 4,540 | 3,450 |
| Synthetic | 1,500 | 2,000 | 1,500 |
| | 10,550 | 11,500 | 9,910 |

Hence, value of stock will be considered for ₹ 9,910 as per AS 2.

Illustration 13.

The total stock of A Ltd. as on 31.3.2013 was ₹ 5,00,000 of which stock amounting to ₹ 31,000 were not ascertained as per AS 2.

Compute the value of the said stocks as per AS 2 for inclusion in financial statements as on that date.

| Type of Product | Cost of Materials ₹ | Production Expenses incurred ₹ | Selling and Distribution expense to be incurred ₹ | Estimated Selling Price ₹ |
|-----------------|------------------------|-----------------------------------|--|------------------------------|
| P | 10,000 | 2,000 | 1,000 | 15,000 |
| S | 5,000 | --- | 500 | 4,500 |
| T | 12,000 | 3,000 | 2,000 | 18,000 |
| | 27,000 | 5,000 | 3,500 | 37,500 |

Solution:

As per para 21, AS 2, inventories are usually written-down to net realisable value on item-by-item basis. Thus, value of stock will be computed as:

| Type of Product | Cost Price (including Production Exp.) ₹ | Net Realisable Value (excluding Selling & Distribution Expenses from Selling Price) ₹ | Value of Stock to be taken (lower of Cost Price & Net Realisable Value) ₹ |
|-----------------|---|--|--|
| P | 12,000 (₹10,000 + ₹ 2,000) | 14,000 (₹15,000 – ₹ 1,000) | 12,000 |
| S | 5,000 (–) | 4,000 (₹ 4,500 – ₹ 500) | 4,000 |
| T | 15,000 (₹12,000 + ₹ 3,000) | 16,000 (₹18,000 – ₹ 2,000) | 15,000 |
| | | | 31,000 |

So, Value of Stock will be ₹ 31,000 for inclusion in financial statements as per AS 2.

Illustration 14.

X Ltd. presented the following particular as on 31.3.2013: Compute the value of stock as on 31.3.2013.

The total cost of product:

| | Cost per unit ₹ |
|------------------------------|--------------------|
| Cost of materials (₹12 each) | 50 |
| Manufacturing inputs | 30 |
| Total Cost | 80 |
| Profit | 20 |
| Selling Price | 100 |

On 31.3.2013, selling price has gone down suddenly from ₹ 100 to ₹ 70. Price of raw material has also gone down to ₹ 8 each. X Ltd. had in its stock 6,000, units of materials which was bought as per the above rate on the same date.

Solution:

according to para 24, AS 2, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written-down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. In this case, the total cost of ₹ 80 exceeds the net realisable value, i.e., selling price, of ₹ 70 (as the price of raw materials had gone down from ₹ 12 to ₹ 8). So, inventories should be valued @ ₹ 70 each and, as such, the total value of stock would be ₹ 4,20,000 (i.e., ₹ 6,000 units x ₹ 70).

Illustration 15.

State with reference to accounting standards how you will value the inventories in the following cases:

- (i) Raw materials were purchased at ₹ 100 per kilo. Prices of raw materials are on the decline. The finished goods in which the raw materials is incorporated is expected to be sold at below cost. 10,000 Kgs. of raw materials is on stock at the year end. Replacement cost is ₹ 80 per kg.
- (ii) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year-end.

(iii) Per kg of finished goods consisted of:

| | ₹ |
|-------------------------------------|-----|
| Material Cost | 100 |
| Direct Labour | 20 |
| Direct Variable Production Overhead | 10 |

Fixed production charges for the year on normal capacity of one lakh kg is ₹ 10 lakhs. 2,000 kg of finished goods are on stock at the year end.

Solution:

(i) As per para 24, AS 2, materials and other supplies held for use in the production of inventories are not written-down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value.

In this case, cost of raw material was ₹ 100 per kg. But the finished goods (which are produced from the said raw materials) are expected to realise at below the Cost Price. So, the value of 10,000 kg of raw materials will be @ ₹ 80 per kg (i.e. on the basis of replacement cost) ₹ 8,00,000.

(ii) As per para 13, AS 2, in determining the cost of inventories it is appropriate to exclude abnormal amount of wasted materials, labour or other production expenses in the period in which they are incurred.

Information

Input 5,000 MT; Normal loss 5% of 5,000 MT = 250 MT.

Wastage 300 MT; Abnormal loss = 300 MT – 250 MT = 50 MT

Cost of one MT of input = ₹ 1,000. So cost of 250 MT should be included in the cost of finished goods. But the cost of entire abnormal wastage (i.e. 1,000 x ₹ 50) ₹ 50,000 should be charged against Profit and Loss Account of the company.

(iii) As per para 9, AS 2, the allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Thus, the cost of finished goods per kg will be:

$$\begin{aligned} \text{Cost per kg} &= \text{Direct Material} + \text{Direct Labour} + \text{Variable Production overhead} + \text{Fixed production overhead*} \\ &= ₹ 100 + ₹ 20 + ₹ 10 + ₹ 10 \\ &= ₹ 140. \end{aligned}$$

$$\text{*Fixed Production overhead per kg} = \frac{₹ 10,00,000}{1,00,000} = ₹ 10 \text{ per kg.}$$

Therefore, value of closing stock of finished goods will be ₹ 2,80,000 (i.e. 2,000 kg x ₹ 140)

12.3 DEPRECIATION ACCOUNTING (AS 6)

“Depreciation Accounting” (AS 6) (Revised)

The Accounting Standard regarding depreciation was issued at first in 1982. But it was revised in 1994. The revised standard (AS 6) is now mandatorily applicable to all concerns in India for accounting periods commencing on or after 1.4.1995. The important matters to be noted from (AS 6) are :

What is Depreciation as per AS-6?

Depreciation is a measure of wearing out, consumption or other loss of value of a **depreciable asset** arising from use and passage of time. Depreciation is nothing but distribution of total cost of assets over its useful life.

“**Depreciable Assets**” are the assets which : -

- (a) are expected to be used for more than one accounting period;
- (b) have limited useful life;
- (c) are held by an enterprise for use in production or supply of goods and services, for rental to others or for administrative purposes but not for sale in the ordinary course of business.

AS-6 is not applicable to the following assets:

- Forests, Plantations
- Wasting Assets, Minerals and Natural Gas
- Expenditure on research and development
- Goodwill
- Live stock – Cattle, Animal Husbandry.

How to calculate Depreciation?

Following are required to ascertain the depreciation of a Depreciable Asset:

- Historical cost or other amount in place of historical cost like revalued amount
- Estimated useful life of depreciable assets
- Estimated residual or scrap value of depreciable assets

Computation of Depreciation:

$$= \frac{\text{Cost} - (\text{Residual Value at the end of useful life})}{\text{Estimated useful in no. of years}}$$

How to ascertain the cost of depreciable assets?

Cost of depreciable assets is the total cost spent in connection with the acquisition; installation and commissioning of the assets as well as for add item or improvement of the depreciable assets.

“**Useful Life**” of a depreciable asset is the period over which the assets are expected to be used by the enterprise, which is generally shorter than the physical life.

Useful Life of a depreciable asset depends on the following factors –

- Predetermined by legal contractual limits
- Depends upon the number of shifts for which the asset is to be used
- Repair and Maintenance policy of the enterprise

- The technological obsolescence
- Innovation/improvement in the production method
- Change in demand of output
- Legal or other restrictions.

Estimated residual or scrap value:

This is the estimated value of a depreciable asset at the end of its useful life.

Change in Method of Depreciation:

The method selected for charging depreciation should be consistently followed. However, if situations demand (like change of statute, compliance with Accounting Standard, etc.) a change of method may be made, that would result in change in accounting policy (which may be required by statute or for compliance with an Accounting Standards or for more appropriate presentation of financial statement), In that case -

- if the change affects the state of affairs of Balance Sheet and Profit and Loss account of the current period or the Financial Statements of later period, then such change must be disclosed in financial statement. The amount, by which the financial statement is affected, should be disclosed to the extent it is ascertainable.
- the depreciation should be recalculated under the new method with effect from the date of the asset coming into use till the date of change of method, that is, with retrospective effect. Difference between the total depreciation under new method and the accumulated depreciation under the old method till the date of change of method should be computed first. Then the resultant surplus or deficiency is to be charged to credit and debit side of the Profit and Loss A/c respectively.

Change in Useful Life:

If there is a change in useful life of an asset, outstanding depreciable amount on the date of change in estimated useful life of asset is required to be allocated over the revised remaining useful life.

Any addition or extension essential for an existing asset, should be depreciated over the remaining life of the asset.

If the historical cost of an asset changes due to exchange fluctuations, price adjustments, etc. the depreciation on the revised unamortized depreciable amount should be provided prospectively for the rest of the life of the asset.

For any asset revalued, the provision for depreciation should be made on the revalued amount for the remaining useful life of the asset.

In the financial statements, the matters to be disclosed are-

- The historical cost or any amount substituting it;
- Total depreciation for the period for each class of assets;
- The related accumulated depreciation.

The method of charging depreciation should also be disclosed.

12.4 CONSTRUCTION CONTRACTS (AS 7)

Introduction:

Construction Contracts: As per **AS-7** – Construction Contract is a contract specifically negotiated for the construction of an Asset or combination of Assets closely interrelated or interdependent, for example, contract for construction of building, dam, bridge, road etc. This Accounting Standard (AS) further mentions that the following are also included in construction contracts.

- Contracts for rendering of services which are directly related to the construction of Assets, for example, service of architect, and
- Contract for destruction or restoration of Asset and the restoration of the environment following the demolition of Asset.
- For example, if the existing structure/building in a plot of land has to be demolished before new building as per new design is constructed, the destruction of building is construction contract.

Types of Construction Contracts: Construction contracts are of two types:—

Fixed Price Contracts: In these contracts, contractor agrees for fixed price of the contract or fixed rate per unit.

Cost plus Contracts: In these contracts, contractor is reimbursed the cost is defined plus fixed percentage of fee/profit.

Some construction contracts may be a mix of the both.

Objective: Accounting for long-term construction contracts involves question as to when revenue should be recognized and how to measure the revenue in the books of contractor. There may be following two ways to determine profit or loss:

- On year to year basis based on percentage of completion or
- On completion of the contract.

However, the revised standard has eliminated the existing option, by adopting only percentage of completion method for recognizing the revenue. This method justifies the accrual system of accounting which is fundamental accounting assumption. The primary objective of this AS is the allocation of 'contract revenue' and 'contract cost' to the accounting period in which construction work is performed.

Applicability: This Standard is applicable in accounting for construction contracts in contractor's financial statements. In other words the AS does not apply to customer (Contractee). This would not be applicable for the construction projects undertaken by the enterprise on its own account as a commercial venture in the nature of production activities.

Calculation of profit or loss of a construction contract: Profit or loss of construction contract is equal to (Contract Revenue – Contract Cost).

Measurement of Contract Revenue: As per Para 31 of AS, the contract revenue and contract cost associated with the construction contract should recognize revenue and expenses respectively with reference to stage of completion of the contract activity at the reporting date.

Recognition of revenue and expenses by reference to the stage of completion of a contract is generally referred as the Percentage of Completion Method; under this method revenue is recognized as revenue in the statement of profit/loss in the accounting period in which work is performed.

Determination of stage of completion: Stage of completion may be determined in a variety of ways like:

- Cost to cost method: the percentage of completion would be estimated by comparing total cost incurred to date with total cost expected for the entire contract:—

Percentage of Completion = $(\text{Cost to Date} \times 100) / (\text{Cumulative Cost Incurred} + \text{Estimated Cost to Complete})$

Current revenue from contract = Contract price × Percentage of completion – Revenue previously recognized

- By survey of work performed
- Completion of physical proportion of the contract work

While calculating the contract cost to date as mentioned above in formula following contract cost should be excluded.

- Contract cost that relates to future activity on the contract such as cost of material that have been delivered to a contract site or set aside for use of a contract but not used and applied.
- Payment made to sub-contractors in advance of work performed under the sub-contract.

Basic principles of recognition of revenue and expenses

Basic principles are as under:

- Revenue recognized in the period in which work is performed;
- Expenses recognized in the period in which the work to which expenses relate is performed.

Conditions for recognizing the contract revenue - Following conditions must be fulfilled for recognizing the contract revenue:

- Total contract revenue can be measured reliably
- It is probable that economic benefits associated with contract will flow to the enterprise / contractor
- Total contract cost and cost upto the stage of completion is measured reliably
- Contract cost attributable to contract can be clearly identified.

Uncertainty in collection amounts to expenses - When an uncertainty arises about the collectability of an amount already included in contract revenue and already recognized in profit and loss statement, it amounts to expense. This uncollectable amount of which recovery has ceased to be probable is recognized as an expense rather than as an adjustments to contract revenue.

When outcome of contract cannot be estimated reliably

In those circumstances the revenue should be recognized only to the extent of contract costs incurred of which recovery is probable, thus no profit is recognized. However contract cost recovery of which is not probable is recognized as an expense resulting in loss. But when the uncertainties no longer exist and contract outcome can be reliably estimated, recognition should be done as per this accounting standard.

Contract costs consist of the following:

Specific costs to contract - These are as under:

- Site labour cost including supervision
- Cost of material used in construction
- Depreciation of plant and equipments used on the contract
- Cost of moving plant, equipments and materials from contract site
- Cost of hiring plant
- Cost of design and technical assistance
- Estimated cost of rectification and guarantee work including expected warranty cost
- Claim from third parties
- Pre-contract cost. If it is probable that contract will be obtained

These costs should be reduced **by incidental income if any not** included in contract revenue, for example, sale of surplus/scrap material, disposal of plant and equipment at the end of contract.



Cost attributable to contract - These costs are:

- Insurance.
- Cost of design and technical assistance that is not directly related to a specific contract.
- Construction overheads.

Cost specifically chargeable to customers under the terms of contract - These costs are:

- Some general administration cost/for which reimbursement is specified.
- Development cost.
- Reimbursement of any other cost.

Cost excluded

Following costs are excluded from contract cost unless specifically chargeable under terms of contract:

- General administration cost
- Selling cost
- Research and development
- Depreciation cost of idle plant and equipment
- Cost incurred in securing the contract. Pre-contract cost - if it is not probable that contract will be obtained.

However, costs that relate directly to a contract and which are incurred in securing the contract if they can be separately identified and it is probable that contract will be obtained, such costs are also included in contract cost.

Contract revenue consists of the following :-

- Revenue/price agreed as per Contract.
- Revenue arising due to escalation clause.
- Claims - Claims is the amount that contractors seek to collect from the customer as reimbursement of cost not included in contract price.
- Increase in revenue due to increase in units of output.
- Increase or decrease in revenue due to change or variation in scope of work to be performed.
- Incentive payments to the contractors.
- Decrease in contract revenue due to penalties.

Provision for expected losses: When it is probable that total contract cost will exceed total contract revenue, the expected losses should be recognized as an expense irrespective of —

- Whether or not work has been commenced
- Stage of completion of contract
- The amount of profit on other contracts which are not treated as a single contract.

Effect of change in estimate in construction contract: As the recognition of revenue and expenses in construction contract is based on reliable estimate, nevertheless the estimate is bound to vary from one accounting period to another accounting period of the construction contract; the effect of change in estimate of contract revenue or contract cost is accounted as change in accounting estimate as per AS-5.

As per Para 21 of AS-5 the change in accounting estimates does not bring the adjustment within the definition of an extraordinary item or prior period items. Therefore, changed estimates are used to determine the amount of contract revenue and contract expenses recognized in the statement of profit and loss in the period in which the changes is made and in subsequent periods.

Disclosure by contractors: An enterprise (contractor) should disclose the following policy:

- The method used to determine the stage of completion of contract in progress
- The method used to determine the contract revenue recognized in the period.

In addition to policy disclosure following disclosures is also required to be made by the enterprise (contractor):

- The amount of contract revenue recognized in the period
- Contract cost incurred and recognized profit (less recognized losses) upto the reporting period
- Advance received
- Gross amount due from customers for contract work [(cost incurred + recognised profit) – (recognized losses + progress billing)]
- Gross amount due to customer for contract work [(recognized losses + progress billing) – (cost incurred + recognized profit)].

Significant differences among AS-7, IFRS/IAS-11 and US GAAP: After the issue of AS-7 (revised) in 2002 the only method prescribed is percentage completion method to recognize the contract revenue, which is the same as AS-11. However, US GAAP in certain circumstances allows another method i.e. completed contract method for recognition of contract revenue.

US GAAP provides detailed guidance on the use of estimate in accounting for construction contract, however, no such guidance is provided under AS-7 and IAS-11.

Illustration 16.

A firm of contractors obtained a contract for completion of bridges across river Revathi. The following details are available in the records kept the year ended 31st March, 2012:

| Particulars | ₹ in Lakhs |
|---------------------------------|------------|
| Total Contract Price | 1,000 |
| Works Certified | 500 |
| Works not Certified | 105 |
| Estimated further cost | 495 |
| Progress payment received | 400 |
| Progress payment to be received | 140 |

The firm seeks your advice and assistance in presentation of accounts keeping in view the requirements of AS-7 "Accounting for Construction Contract".

Solution:

As per AS 7, 'Construction Contract', when it is probable that total contract costs will exceed total revenue, the expected loss should be immediately recognized as an expense. The amount of such a loss is determined irrespective of (a) Whether or not work has commenced on the contract, (b) the stage of completion of contract activity as per AS 7.

We are to compute the anticipated loss and current loss which are computed as:

Anticipated or Foreseeable Loss

| Particulars | ₹ in lakhs |
|---|--------------|
| Cost of Total Contract: | |
| Work Certified | 500 |
| Add: Work not certified | 105 |
| Add: Estimated further cost to completion | 495 |
| | 1,100 |
| Less: Contract Price | 1,000 |
| Anticipated / Foreseeable loss | 100 |



Work-in-Progress/Stage of Completion: = Work certified+ Work not certified

= ₹ (500 +105) = ₹ 605

% of work completed

$605/1100 \times 100 = 55\%$

Recognition of Contract Revenue:

Total Contract Price x 55% = ₹ (1,000 × 55%) = ₹ 550 lakhs

Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= [605 + Nil – 100 – (400 + 140)] ₹ In lakhs

= [605 – 100 – 540] ₹ In lakhs

Amount due to customers = ₹ 35 lakhs

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

The relevant disclosures under AS 7 (Revised) are given below:

| Particulars | ₹ In lakhs |
|--|------------|
| Contract revenue | 550 |
| Contract expenses | 605 |
| Expected Losses | 45 |
| Recognized profits less recognized losses | (100) |
| Progress billings (400 + 140) | 540 |
| Retentions (billed but not received from contractee) | 140 |
| Gross amount due to customers | 35 |

Illustration 17.

On 31.12.2012, Viswakarma Construction Company Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31.03.2013, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of the additional cost for completion was ₹ 32,01,000.

What is the additional provision for foreseeable loss which must be made in the final accounts for the year ended 31.03.12 As per provisions AS 7 on " Accounting for construction contract?"

Solution:

As per AS 7, 'Construction Contract', when it is probable that total contract costs will exceed total revenue, the expected loss should be immediately recognized as an expense. The amount of such a loss is determined irrespective of (a) Whether or not work has commenced on the contract, (b) the stage of completion of contract activity as per AS 7, (c) the amount of profit expected to arise on other contracts which are not treated as a single contract.

In this case the anticipated losses are calculated as follows:

Anticipated or Foreseeable Loss

| Particulars | ₹ in lakhs |
|---------------------------------------|---------------------|
| Cost incurred | 64.99 |
| Add: Additional cost for computation | 32.01 |
| | 97.00 |
| Less: Contract Price | 85.00 |
| Anticipated / Foreseeable loss | <u>12.00</u> |

Thus, as per AS 7, the whole amount of anticipated loss should be recognized and to be adjusted accordingly against the profit of the current year.

Illustration 18.

Calculate the contract revenue from the following details

(₹ In Crores)

| Particulars | Years | | |
|--|-------|------|------|
| | I | II | III |
| 1. Initial contract revenue | 2000 | 2000 | 2000 |
| 2. Revenue increase due to escalation in II nd year | — | 400 | — |
| 3. Claim | | | 200 |
| 4. Incentive Payment | | | 300 |
| 5. Penalties | | 100 | |

Solution:**Calculation of contract revenue**

| Particulars | I | II | III |
|---------------------------------------|------|-------|-------|
| Initial contract value | 2000 | 2000 | 2000 |
| Increase in revenue due to escalation | — | 400 | 400 |
| Claims | — | — | 200 |
| Incentive | — | — | 300 |
| Penalties | — | (100) | (100) |
| Contract revenue | 2000 | 2300 | 2800 |

Illustration 19.

Assume a ₹10,00,000 contract that requires 3 years to complete and incurs a total cost of ₹8,10,000. The following data pertain to the construction period:

| Particulars | Yr. I | Yr. II | Yr. III |
|---|----------|----------|----------|
| Cumulative costs incurred to date | 3,00,000 | 7,20,000 | 8,10,000 |
| Estimated cost yet to be incurred at year end | 6,00,000 | 80,000 | — |
| Progressive billing made during the year | 2,00,000 | 7,40,000 | 60,000 |
| Collections of billings | 1,50,000 | 6,00,000 | 2,50,000 |

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS-7.

Solution:

| Particulars | Yr. I | Yr. II | Yr. III |
|--|---|---|--|
| Initial amount of Revenue agreed in contract | 10,00,000 | 10,00,000 | 10,00,000 |
| Variation | — | — | — |
| Total contract Revenue (A) | 10,00,000 | 10,00,000 | 10,00,000 |
| Contract cost incurred | 3,00,000 | 7,20,000 | 8,10,000 |
| Contract cost yet to be incurred to complete | 6,00,000 | 80,000 | — |
| Total Estimated contract cost (B) | 9,00,000 | 8,00,000 | 8,10,000 |
| Estimated profit (A-B) | 1,00,000 | 2,00,000 | 1,90,000 |
| Stage of completion | $\frac{3,00,000}{9,00,000} \times 100$ 33.1/3% | $\frac{7,20,000}{8,00,000} \times 100$ 90% | $\frac{8,10,000}{8,10,000} \times 100$ 100% |



Revenue expense and profit recognized in Profit & Loss Statement

| | Upto the reporting date | Recognized in Prior year | Recognized in Current year |
|------------------------------|-------------------------|--------------------------|----------------------------|
| Year I | | | |
| Revenue (10,00,000 x 3.1/3%) | 3,33,333 | --- | 3,33,333 |
| Cost incurred | 3,00,000 | --- | 3,00,000 |
| Profits | 33,333 | --- | 33,333 |
| Year II | | | |
| Revenue (10,00,000 x 90%) | 9,00,000 | 3,33,333 | 5,66,667 |
| Cost incurred | 7,20,000 | 3,00,000 | 4,20,000 |
| Profits | 1,80,000 | 33,333 | 1,46,667 |
| Year III | | | |
| Contract revenue earned | 10,00,000 | 9,00,000 | 1,00,000 |
| Cost incurred | 8,10,000 | 7,20,000 | 90,000 |
| Profits | 1,90,000 | 1,80,000 | 10,000 |

Contract Disclosure (AS-7)

(Amount in ₹)

| | Yr. I | Yr. II | Yr. III |
|--|----------|----------|-----------|
| 1. Contract revenue recognized | 3,33,333 | 9,00,000 | 10,00,000 |
| 2. Contract expenses recognized | 3,00,000 | 7,20,000 | 8,10,000 |
| 3. Recognized Profit (Loss) | 33,333 | 1,80,000 | 1,90,000 |
| 4. Contract cost incurred | 3,00,000 | 7,20,000 | 8,10,000 |
| 5. Contract cost that releases to future activity recognized as an asset | NIL | NIL | NIL |
| 6. Progress Billing | 2,00,000 | 9,40,000 | 10,00,000 |
| 7. Unbilled contract revenue | 1,33,333 | NIL | NIL |
| 8. Advances | 1,50,000 | 6,00,000 | 2,50,000 |
| 9. Contract cost incurred and recognized Profit (Less recognized loss) | 3,33,333 | 9,00,000 | 10,00,000 |
| 10. Gross amount due from customer | 1,33,333 | NIL | NIL |
| 11. Gross amount due to customer | NIL | 40,000 | NIL |
| 12. Retention | 50,000 | 1,90,000 | NIL |

12.5 REVENUE RECOGNITION (AS 9)

Objective: The standard explains when the revenue should be recognized in profit and loss account also mentions the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as:

- Sale of goods
- Rendering the services
- Use of enterprises resources by others yielding interest, dividend and royalties

In other words, revenue is charge made to customers/clients for goods supplied and services rendered.

This Standard does not deal with the following aspects of revenue recognition to which special considerations apply:

- (i) Revenue arising from construction contracts; [AS 7 on 'Construction Contracts']
- (ii) Revenue arising from hire-purchase, lease agreements;
- (iii) Revenue arising from government grants and other similar subsidies;
- (iv) Revenue of insurance companies arising from insurance contracts.

Examples of items not included within the definition of "revenue" for the purpose of this Standard are:

- (i) Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets e.g. appreciation in the value of fixed assets;
- (ii) Unrealised holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products;
- (iii) Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
- (iv) Realised gains resulting from the discharge of an obligation at less than its carrying amount;
- (v) Unrealised gains resulting from the restatement of the carrying amount of an obligation.

Timing of Revenue Recognition: Revenue from sale or rendering of services should be recognized at the time of sale or rendering of services. However if at the time of sale or rendering of services there is a significant uncertainty in ultimate collection of the revenue, then the revenue recognition is postponed and in such cases revenue should be recognized only when it becomes reasonably certain that ultimate collection will be made. It also applies to the revenue arising out of escalation of price; export incentive, interest etc.

Revenue from Sale of Goods: Revenue is recognized when all the following **conditions** are fulfilled:

- Seller has transferred the ownership of goods to buyer for a price.

Or

- All significant risks and rewards of ownership have been transferred to buyer
- Seller does not retain any effective control of ownership on the transferred goods
- There is no significant uncertainty in collection of the amount of consideration (i.e. cash, receivables etc.)

If delivery is delayed at buyer's request and buyer takes title and accept billing, then the revenue should be recognized immediately but goods must be in hand of seller, identified and ready for delivery at the time of recognition of revenue.

Revenue Recognition when delivery of goods sold subject to **certain conditions:**

- **Installation and Inspection:** Revenue should be recognized when goods are installed at the buyer's place to his satisfaction and inspected and accepted by the buyer.
- **Sale on Approval:** Revenue should be recognized when buyer confirms his desire to buy such goods through communication.

- **Guaranteed Sales:** Revenue should be recognized as per the substance of the agreement of sale or after the reasonable period has expired.
- **Warranty Sales:** Revenue should be recognized immediately but the provision should be made to cover unexpired warranty.
- **Consignment Sales:** Revenue should be recognized only when the goods are sold to third party.
- **Special Order and Shipments:** Revenue from such sales should be recognized when the goods are identified and ready for delivery.
- **Subscription for Publication:** When items delivered vary in value from period to period, the revenue should be recognized on the basis of sales value of those items delivered. When items delivered do not vary in value from period to period, the revenue should be recognized on straight-line basis over time.
- **Installment Sales:** Revenue of sales price excluding interest should be recognized on the date of sale. Interest should be recognized proportionately to the unpaid balance.

Revenue from Rendering of Services: Revenue from rendering of service is generally recognized as the service is performed. The performance of service is measured by following two methods:

- (i) Completed Service Contract Method:** Revenue is recognized when service is about to be completed and no significant uncertainties exist about collection of the amount of service charges.
- (ii) Proportionate Completion Method:** The revenue recognized under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis.

The norms for revenue recognition for rendering of services under special condition are as follows:

- **Advertising and Insurance Agency Commission:** Advertising commission is recognized when advertisement appears before public and for insurance agency commission on the effective commencement or renewal date of the policies respectively.
- **Financial Service Commission:** Generally, commission charged for arranging or granting loan and other facilities should be recognized when a loan is sanctioned and accepted by borrower.
- **Admission Fee:** Revenue from artistic performance, banquets and other special events should be recognized when event takes place.
- **Tuition Fee:** Revenue should be recognized over the period of instruction.
- **Entrance and Membership Fee:** Entrance fees are generally capitalized and membership fees should be recognized on systematic and rational basis having regard to timing and nature of service provided.

Some Special Treatment of Revenue Recognition

Revenue from interest: Revenue from interest should be recognized on time proportion basis.

Revenue from royalties: It is recognized on accrual basis as per terms of agreement.

Revenue from dividend: It is recognized when declaring company declares dividend.

When uncertainty of collection of revenue arises subsequently after the revenue recognition, it is better to make provision for the uncertainty in collection rather than adjustment in already recognised revenue.

Disclosure: When revenue recognition is postponed, the disclosure of the circumstances necessitating the postponement should be made.

Treatment of Inter-Divisional Transfers: ICAI has announced that inter-divisional transfers/sales are not the revenue as per AS-9 "Revenue Recognition". Since in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers.

Significant difference among AS-9, IFRS/IAS-18 & US GAAP:

- The definition of "Revenue" is almost same in AS-9 and in IFRS/IAS-18; however there is no specific standard for recognizing the revenue under US GAAP. There are several pronouncements in US having varying degree of authority on an ad hoc basis.

- Under IFRS/IAS-18, the revenue recognition from rendering of services is done on the basis of percentage of completion method whereas in AS-9 revenue from rendering of services can be recognized on proportionate completion method or completed service method.
- Under IAS-18/US GAAP revenue from interest is recognized using the effective interest method.
- IFRS/IAS-18 contains the provisions for revenue swaps; however no such corresponding provisions are in AS-9.

Illustration 20.

When can revenue be recognized in the case of transaction of sale of goods?

Solution:

According to AS-9, **Revenue Recognition**, revenue from the sales transaction should be recognized only when the following provision are made/satisfied:

The seller has transferred the property in the goods to the buyer for consideration. The transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. If such risks are not involved/ associated with sale, revenue in such a situation is recognized at the time of transfer of risks and rewards of ownership to the buyer.

Moreover, no uncertainty should exist regarding the amount of consideration which will be derived from such sale of goods.

Illustration 21.

X Ltd. has recognized ₹ 10 lakhs on accrual basis from dividends on units of mutual fund of the face value of ₹ 50 lakhs held by it as at the end of the financial year 31st March, 2013. The dividends on mutual funds were declared @ 20% on 15th July 2013. The dividends were proposed on 10th April, 2013 by the declaring company. Whether the treatment is as per the relevant Accounting Standard?

Solution:

As per AS 9 , dividends from investment in shares are not recognized in the statement of Profit and Loss until a right to receive payment is established.

In the present case the dividend was proposed on 10th April, 2013, but the scheme was declared on 15th July, 2013. Thus, it is quite clear that right to receive payment is established on 15th July, 2013. So, income from dividend on units of mutual fund must be recognized by X Ltd. for the year ended 31st March, 2014.

It may be mentioned here that the recognition of ₹ 10 lakhs under accrual basis in the year 2012-13 is not as per AS -9.

Illustration 22.

Arjun Ltd. sold farm equipment through its dealer. One of the conditions at the time of sale is payment of consideration in 14 days and, in the event of delay, interest is chargeable @ 15% p.a. The company has not realized interest from the dealers in the past. However, for the year ended 31.03.2013, it wants to recognized interest due on the balances due from dealers. The account is ascertained at ₹ 9 lakhs.

Decide whether the income by way of interest from dealers is eligible for recognition as per AS 9.

Solution:

As per AS 9, effect of uncertainties on Revenue Recognition, where the liability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. It may be appropriate to recognize the revenue only when it is reasonably certain that the ultimate collection will be made.

However, in the present case, it has been found that the company did not realized the amount of interest in the past for delayed payment made by dealers. Thus, interest can be recognized only when the ultimate collection is made or taken. Hence, in the present case, interest income is not to be considered as recognized revenue.

Illustration 23.

Y co. Ltd. used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties, respectively from Y Ltd. during the year 2012-13.

**Solution:**

As per AS 9, revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following bases:

- (i) **Interest** on time proportion basis taking into account outstanding and the rate applicable.
- (ii) **Royalties** on an accrual basis in accordance with the terms of the relevant agreement.

Illustration 24.

Advise B Ltd. about the treatment of the following in the final statement of accounts for the year ended 31st March, 2013.

"As a result of a recently announced price revision granted by the Govt. of India w.e.f 01.07.2012 the company stands to receive ₹ 5,20,000 from its customers in respect of sales made in 2012-13."

Solution:

It becomes quite clear from the above question that, as a result of price revision granted by the Govt. additional sales are to be made for ₹ 5,20,000 in 2012-13, although the accounts are prepared for the year ended 31.03.13.

According to AS 9, if the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim ; e.g. for escalation of price etc. Revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection, will be made revenue is recognized at the time of sale or rendering services.

Thus, if there is no uncertainty as to the ultimate collection of ₹ 5,20,000, it should be recognized as revenue and may be treated accordingly in the financial statement for the period ended 31.03.2013.

Illustration 25.

Advise P Ltd. about the treatment of the following in final statement of accounts for the year ended 31.03.13:

A claim lodged with the Railways in March 2010, for loss of goods of ₹ 2,00,000 had been passed for payment in March 2013 for ₹ 1,50,000. No entry was passed in the books of the company when claim was lodged.

Solution:

It becomes clear from the above statement that accounts were prepared for the year ended 31.03.13. The problem states that there was a loss amounting for ₹ 2,00,000 in 2009-10, which was lodged in March 2010 with the Railways. The problem further states that, when the claim was lodged, no entry was passed in the books of account. This corroborate AS 9 and it says," Revenue recognition is postponed if there is any uncertainty regarding its ultimate collection."

But, ₹ 1,50,000 was settled for payment against the claim of ₹ 2,00,000 in March 2013. Needless to say that the revenue is recognized in the Financial Statement prepared for the period ended 31.03.2013 as it was passed for payment.

Illustration 26.

How would you deal with the following in the annual accounts of a company for the year ended 31.03.2013:

The Board of Directors decided on 31.03.2013 to increase the sale price of certain items retrospectively from 01.01.2013.

In view of this price revision w.e.f 01.01.2013, the company has to receive ₹ 15 lakh from its customers in respect of sales made from 01.01.13 to 31.03.13 and the accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2012-13.

Solution:

As per AS 9, revenue should be recognized only when there is no uncertainty about its ultimate collection. If any uncertainty regarding ultimate collection exists, revenue recognition is postponed. As such, whether the said ₹ 15 lakhs will be treated as recognized depends on its nature of certainty. If no uncertainty exists, the same should be treated as recognized revenue and, in the opposite case, it should be postponed.

Illustration 27.

TVSM Ltd. has taken a transit insurance policy. Suddenly, in the year 2012-13, the percentage of accident has gone up to 7% and the company wants to recognize insurance claim as revenue in 2012-13. In accordance with relevant accounting standard.

Do you agree?

Solution:

As per AS 9, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collections, revenue is recognized at the time of sale or rendering services. Moreover, consideration receivable should reasonably be determinable. Revenue recognition is postponed if not determinable within a reasonable limit.

Thus, in this case, since there are uncertainties, recognition of revenue should be postponed by the company.

Illustration 28.

Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with Registrar subsequent to Balance Sheet date.

But before finalization, is it possible to recognize the sale and the gain at the Balance Sheet date? Give your views with reasons.

Solution:

As per AS 9, **Revenue Recognition:** A key criterion for determining when to recognize revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and reward of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognized at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time of ownership passes.

In the present case, sale of immovable property with a gain on such sale should be recognized at the Balance Sheet date although registration for such sale had been done subsequent to the Balance Sheet date. It may be mentioned here that registration cannot bring any uncertainty as it was nothing but a technical matter.

Illustration 29.

SCL Ltd. sells agricultural products to dealers, One of the conditions of sale is that interest is payable at the rate of 2% p.m. for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2012-13, the company wants to recognize the interest receivable.

Do you agree?

Solution:

As per AS 9, **Revenue Recognition** requires that revenue is measurable at the time of sale. Interest, royalties, dividends should be recognized as revenue only where there will not be any uncertainty regarding the ultimate collection. It may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made. When there is no uncertainty as to ultimate collection, revenue is recognized at the time of sale even though payments are made by installment.

In the present case, however, SCL Ltd. cannot recognize the entire amount of interest as revenue. Recovery of interest @ 10% on outstanding balance is merely estimated which is uncertain to ultimate collection.

12.6 ACCOUNTING FOR FIXED ASSETS (AS 10)

Fixed assets for the purpose of the statement are those held by an enterprise with the intention of being used for the purpose of producing or providing goods or services and not held for sale in the normal course of business and applies to financial statements prepared on historical cost/substituted cost basis.

The following items need special consideration and normally not covered under this statement unless the expenditure on individual items are separable and identified.

- (a) forest, plantation and similar regenerative natural resources
- (b) wasting assets and non-generative resources (mineral rights, exploration of mineral, oil and natural gas)
- (c) expenditure on real estate development
- (d) livestock

Fixed assets shall be shown in financial statement either at historical cost or revalued price.

Historical Cost consists the following:

- Purchase price
- Import duties and other non-refundable taxes
- Any directly attributable cost of bringing the asset to the working condition for its intended use like:
 - Site preparation
 - Delivery and handling cost
 - Installation cost
 - Professional fees (i.e. Fees of Engineers and Architects)
 - Expenditure incurred on start up and commission of the project including the expenditure on test runs less income by sale of products
 - Administrative and other general overheads are specifically attributable for construction/acquisition/ installation of the fixed assets.
 - Amount of Govt. grants received/receivable against fixed asset should be deducted from the cost of fixed assets
 - Loss/gain on deferred payment on foreign currency liability if option under AS – 11 is exercised.
 - Price adjustment, changes in duties or similar factors.

Historical cost of a self-constructed fixed assets – Such fixed asset, which was constructed by in-house efforts, is called self-constructed fixed asset.

It includes the following:

- All costs which directly related to the specific asset.
- All costs that are attributable to the construction activity should be allocated to specific assets.
- Any internal profit included in the cost should be eliminated.

When fixed assets are revalued, these assets are shown at revalued price in financial statement. Generally, component valuer does revaluation through appraisal. Revaluations may be done using price index appropriate to the concerned fixed assets.

Apart from direct cost, all directly attributable cost to bring the asset concerned to their working condition for intended use also forms the part of fixed asset.

Subsequent expenditure after the initial capitalization that increases the future benefits from the existing assets beyond the previously assessed standard of performance (e.g. increase in quality of output, substantial reduction in operating cost) is capitalized to form the gross book value.

Financial statements are normally prepared on the basis of historical cost but sometimes a part or all of fixed assets, are restated (revalued) and substituted for historical cost. The commonly accepted and preferred method of restating is by appraisal by a competent valuer.

As per Schedule VI, every B/S subsequent to revaluation shall disclose the increased figure with the date of increase in place of the original cost for the first 5 (five) years, but the fact of such revaluation will continue to be disclosed till such time such assets appear in the B/S.

Revaluation is made for an entire class of assets or the selection of assets on a systematic basis (fact of which should be appropriately stated).

An increase in net book value arising on revaluation of fixed assets should be credited to "Owner's Fund" under "Revaluation Reserve" unless the decrease on any previously revaluation recorded as a change in P/L A/c or "Revaluation Reserve" if increase in previous occasion was credited thereto.

All material items retired from active use and not disposed off should be stated at the lower of net book value or net realizable value as a separate item in the Schedule of Fixed Assets.

Depreciation as per AS-6 should be charged on the total value of fixed assets including revalued portion.

Cost of asset acquired in exchange of existing assets: (i.e. consideration paid is non-monetary) - The cost of acquisition of fixed assets is determined under the different situations differently as under:—

- **Fixed Assets exchanged not similar.** - Assets acquired should be recorded either at fair market value of asset given up or fair market value of asset acquired, if this is more clearly evident
- **Fixed Assets exchanged are similar.** - Fixed assets acquired is recorded at fair market value of asset given up or Fair market value of asset acquired, if this is more clearly evident or Net Book value of the asset given up
- **Fixed Assets acquired in exchange of share or other securities.** - (when payment of fixed assets is made in shares or securities) Assets should be recorded at - either fair market value of asset purchased or fair market value of share or securities, whichever is more clearly available.

Maximum amount of revaluation - Revaluation of fixed assets should be restricted to the net recoverable amount of fixed asset.

Accounting treatment of revaluation - Treatment in accounting under different situations is as under:—

- First time revaluation (upward)
 - Increase in net book value is credited to owner's interest under the head 'Revaluation Reserve'.
- First time revaluation (Downward)
 - Decrease in net book value is charged to the profit & loss account.
- First revaluation (downward) subsequent revaluation (upward)
 - Decrease in net book value is charged to the Profit & Loss Account in the year in which downward revaluation was done.
 - Amount of revaluation that can be credited to Profit & Loss Account is restricted to the amount of devaluation earlier written off. Balance amount of revaluation should be credited to revaluation reserve.
- First revaluation (upward) subsequent revaluation (downward)
 - Increase in the net book value is credited to owner's interest under the head 'Revaluation Reserve'.
 - Amount of devaluation can be charged to revaluation reserve to the extent the revaluation reserve earlier credited is unutilized, the balance amount of devaluation is charged to profit and loss account.

Valuation of fixed assets in special cases

- Assets acquired on hire purchase terms: Such assets are recorded at their cash price. However, the recording will be done as per AS-19.



- Cost of jointly held assets: Either the original cost, accumulated depreciation, and written down value should be stated in the balance sheet in the proportion in which the entity has right to utilize the asset. Or Pro rata cost of such jointly owned assets is grouped together with similar fully owned assets.
- Fixed assets acquired at consolidated price: Cost of each fixed asset should be determined on a fair basis as per valuation by competent valuers.

Improvements and Repair

There are two accounting treatments of cost of improvement and repairs. These accounting treatments depend upon the following conditions:

- After the improvements and repairs, expected future benefits from fixed assets do not change. The expenses of improvements and repairs are charged to profit & loss account.
- After the improvement and repairs, expected future benefits from fixed asset will increase beyond the previously assessed standard performance. These expenses on improvements and repairs are included in the gross book value of fixed asset.

Addition or extension of capital nature to an existing asset

- If integral part of existing asset- it is generally added to gross book value of existing assets.
- If separate identity and capable to be used after the disposal of existing asset - it is accounted for separately.

Retirement and disposals

- Fixed assets are deleted from the financial statement either on disposal or on expected economic benefit is over.
- Gains or losses arising on disposal are generally recognized in profit & loss account.

Treatment of Fixed assets are retired from active use and held for disposal—

- Such asset is stated at the lower of net book value and net realisable value in the financial statement.
- Any expected loss is recognized immediately in the profit & loss statement.
- It should be separately shown in financial statement i.e., balance sheet.

Disposal of previously revalued fixed assets -If there is profit, then it is credited to profit & loss account.

If there is loss, then it can be adjusted against the balance of revaluation reserve (arising out of revaluation of the same asset). If any.

Disclosure in addition to AS-1 and AS-6, should be made under AS-10 in the following lines :

- (a) Gross and net book value of fixed assets at the beginning and end of an accounting period with additions, disposals, acquisitions and other movements.
- (b) Expenditures incurred on account of fixed assets in the course of constructional acquisition
- (c) Revalued amounts substituted for historical cost, the basis of selection for revaluation, the method adopted, the year of appraisal, involvement of external valuer.
- (d) The revalued amounts of each class of fixed assets are presented in the B/S separately without netting off the result of revaluation of various classes of fixed assets.

Illustration 30.

Explain the provisions contained in the Accounting Standard in respect of Revaluation of Fixed Assets.

Solution:

As per paras 27, 28 and 29 and 30 of AS 10-Accounting for Fixed Assets the provisions relating to the revaluation of fixed assets are:

When a fixed assets is revalued in financial statements an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis and should be disclosed -para 27.

The revaluation in financial statements of a class of assets should not result in the net book value of that class being greater than the recoverable amount of assets of that class-para 28.

When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss statements-para 29.

An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than decrease arising on revaluation previously recorded as charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on evaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reserved to utilise, it may be charged directly to that account para 30.

Illustration 31.

Explain the provisions for valuation of fixed assets in special cases as AS 10.

Solution:

As per paras 15.1, 15.2 and 15.3 of AS 10, Accounting for Fixed Assets, the provisions relating to the valuation of fixed asset in special cases are:

As per para 15.1- In the case of fixed assets acquired on hire-purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which, if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

Where an enterprise owns fixed assets jointly with other (otherwise than as a partner in a firm), the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written-down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register. - Para 15.2

Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers. - Para 15.3

Illustration 32.

During the current year 2012-13, X Ltd. made the following expenditure relating to its plant building:

₹ (in 00 000)

| | |
|--|-----|
| Routine Repairs | 4 |
| Repairing | 1 |
| Partial replacement of roof tiles | 0.5 |
| Substantial improvement to the electrical wiring system which will increase efficiency | 10 |

How much amount should be capitalized?

Solution:

According to para 12.1, AS 10, Accounting for Fixed Assets, only expenditure that increases the future benefits from the existing assets beyond its previously assessed standard of performance is included in the gross book value i.e. an increase in capacity. Thus, in the present case, 'Repairs' amounting to ₹ 5 lakhs and partial replacement of roof tiles should be charged to Profit and Loss Account as revenue expenditure. But the amount incurred for substantial improvement to the electrical wiring system amounting to ₹ 10 lakhs which will increase efficiency should be treated as capital expenditure.

Illustration 33.

A company obtained term loan during the year ended 31.3.2012, to an extent of ₹ 650 lakhs for modernisation and development of its factory. Building worth ₹ 120 lakhs were completed and Plant and Machinery worth ₹ 350 lakhs were installed by 31.3.2012. A sum of ₹ 70 lakhs has been advanced for assets, the installation of which is expected in the following year. ₹ 110 lakhs has been utilised for Working Capital requirements. Interest paid on the loans of ₹ 650 lakhs during the year 2011-12 amounted to ₹ 58.50 lakhs.

Flow should the interest amount be treated in the accounts of the company?

Solution:

As per para 10.1 of AS 10, Accounting for Fixed Assets-Self-constructed fixed assets-while arising at the gross book value of self-constructed fixed assets, cost includes all direct costs and attributable costs which are required for the construction of such fixed assets (any internal profits are eliminated in arising at such costs).

In the present case, interest on borrowed Capital should be included with the gross book value of the assets. But interest paid which are related to Working Capital should be charged to Profit and Loss Account.

The particulars of the problem are:

Term loan taken ₹ 650 during the year ended 31.3.2012 and interest paid on such term loan ₹ 58.50 lakh during the said period.

Utilisation of Term Loan

| | ₹ (in lakh) | Allocation of Interest | ₹ (in lakh) |
|------------------------|-------------|--------------------------------------|-------------|
| Building | 120 | $\frac{₹ 120}{₹ 650} \times ₹ 58.50$ | 10.80 |
| Plant and Machinery | 350 | $\frac{₹ 350}{₹ 650} \times ₹ 58.50$ | 31.50 |
| Installation of Assets | 70 | $\frac{₹ 70}{₹ 650} \times ₹ 58.50$ | 6.30 |
| — Advanced | | | |
| Working Capital | 110 | $\frac{₹ 110}{₹ 650} \times ₹ 58.50$ | 9.90 |
| Total | 650 | Total | 58.50 |

Illustration 34.

From the following particulars determine the amount of profit to be transferred to Profit and Loss Account in each of the companies for the period 2013:

In 1993, identical building space purchased for official purposes by X Ltd. and Y Ltd. for ₹ 10,00,000 for each space. X Ltd. revalued the same building for ₹ 15,00,000 in 1998 and recorded the revaluation in the books of accounts accordingly. Y Ltd. did not make any revaluation like X Ltd. Both X Ltd. and Y Ltd. however, sold their respective office space for ₹ 20,00,000 in 2013. (Ignore depreciation and tax).

Solution:

Statement for Ascertaining the Amount of Profit to be Transferred to Profit and Loss Account

| | X Ltd. ₹ | | Y Ltd. ₹ | |
|--|-------------|-----------|-------------|-----------|
| Sales Proceeds in 2012 | 20,00,000 | | 20,00,000 | |
| Less: Cost : | | | | |
| Cost Price | 10,00,000 | | 10,00,000 | |
| Transferred to Revaluation Reserve (₹ 15,00,000 – ₹ 10,00,000) | 5,00,000 | 15,00,000 | --- | 10,00,000 |
| Realised Profit in 2012 | | 5,00,000 | | 10,00,000 |

Therefore,

For X Ltd. (i) ₹ 5,00,000 to be credited to Profit & Loss Accounts of 2013.

(ii) Revaluation Reserve amounting to ₹ 5,00,000 to be transferred to General Reserve.

For Y Ltd. (i) ₹ 10,00,000 to be credited to Profit and Loss Account of 2013.

Illustration 35.

On 1.1.2008, Z Ltd acquired a freehold land & building for ₹ 10,00,000. It decided the following for the purpose of depreciation on such building:

- the building part, valued ₹ 8,00,000 depreciated on straight line method for 25 years having no scrap value.
- the land part valued ₹ 2,00,000, no depreciation will be charged on it.

On 1.1.2013, it was decided that the value of land and building would be ₹ 20,00,000, divided into: Land ₹ 5,00,000 and building ₹ 15,00,000.

It has also been further estimated that the useful life of the Land and Building would be further 20 years.

Ascertain the amount of depreciation to be charged annually over the useful life of Land and Building, the WDV of the same to be shown in Balance Sheet of every year.

Calculate also the surplus on revaluation of land and building in (1) Before Revaluation, and (2) After the Revaluation.

Solution:(i) **Before the Revaluation**

$$\text{Annual depreciation on Building} = \frac{\text{₹ } 8,00,000}{25 \text{ years}} = \text{₹ } 32,000$$

Naturally, for the 1st 5 years, annual depreciations to be made @ ₹ 32,000 each.

The W.D.V of Building for the year ended:

| Particulars | ₹ |
|--|----------|
| (i) 31.12.2008 (₹ 10,00,000 – ₹ 32,000) | 9,68,000 |
| (ii) 31.12.2009 (₹ 9,68,000 – ₹ 32,000) | 9,36,000 |
| (iii) 31.12.2010 (₹ 9,36,000 – ₹ 32,000) | 9,04,000 |
| (iv) 31.12.2011 (₹ 9,04,000 – ₹ 32,000) | 8,72,000 |
| (v) 31.12.2012 (₹ 8,72,000 – ₹ 32,000) | 8,40,000 |



(ii) After the Revaluation

Depreciation to be charged on building by the following new rate

$$\frac{\text{₹ } 15,00,000}{20} = \text{₹ } 75,000 \text{ p.a.}$$

From 1.1.2013, the WDV of the building to be reduced by ₹ 75,000. The building part will totally be depreciated after 20 years but the value of the land will be ₹ 5,00,000.

Profit on Revaluation

| | ₹ |
|---------------------------------------|------------------|
| Value of Land and Building | 20,00,000 |
| Less: Net Book Value as on 31.12.2012 | 8,40,000 |
| ∴ Surplus | 11,60,000 |

As per para 30, AS, 10, this surplus amounting to ₹ 11,60,000 should be transferred to Revaluation Reserve.

Illustration 36.

Amrit Ltd. expects that a plant has become useless which is appearing in the books at ₹ 20 lakhs gross value. The company charges SLM depreciation on a period of 10 years estimated life and estimated scrap value of 3%. At the end of 7th year the plant has been assessed as useless. Its estimated net realisable value is ₹ 6,20,000. Determine the loss/gain on retirement of the fixed assets.

Solution:

Cost of the plant ₹ 20,00,000

Estimated realisable value ₹ 60,000

Depreciable amount ₹ 19,40,000

Depreciation per year ₹ 1,94,000

Written down value at the end of 7th Year = 20,00,000 - (1,94,000 X 7) = ₹ 6,42,000

As per of AS-10 items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement. Accordingly, the loss of ₹ 22,000 (6,42,000-6,20,000) to be shown in the and loss account and asset of ₹6,20,000 to be shown in the balance sheet separately.

Illustration 37.

A company has purchased plant and machinery in the year 2009-10 for ₹ 90. A balance of ₹ 10 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2012-13. The company treated it as income and credited to profit and loss account during 2012-13.

Whether accounting treatment of the company is correct. If not, state with reasons.

Solution:

As per AS-10 the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors. Hence, the treatment done by the company is not correct. ₹ 10 lakhs should be deducted from the cost of fixed assets.

Illustration 38.

On December 1, 2013, Mitra Ltd. purchased ₹6,00,000 worth of land for a factory site. Mitra Ltd. razed an old building on the property and sold the materials it salvaged from the demolition. Mitra Ltd. incurred additional costs and realized salvage proceeds during December 2013 as follows:

| | |
|--|----------|
| Demolition of old building | ₹ 50,000 |
| Legal fees for purchase contract and recording ownership | ₹ 10,000 |
| Title guarantee insurance | ₹ 12,000 |
| Proceeds from sale of salvaged materials | ₹ 8,000 |

In its December 31, 2013 Balance Sheet, Mitra Ltd. should report a balance in the land account.

Solution:

As per AS-10, the cost of land should include all expenditure incurred preparing it for its ultimate use (such as factory site) is considered part of the cost of land. Before the land can be used as a building site, it must be purchased (involving costs such as purchase price, legal fees, and title insurance) and the old building must be razed (cost of demolition less proceeds from sale of scrap). The total balance in the land account should be ₹ 6,64,000.

| | |
|---|------------|
| Purchase price | ₹ 600,000 |
| Legal Fees | ₹10,000 |
| Title Insurance | ₹12,000 |
| Net cost of demolition (₹ 50,000 - ₹ 8,000) | ₹42,000 |
| | ₹ 6,64,000 |

Illustration 39.

On March 31, 2013, Winn Company traded in an old machine having a carrying amount of ₹ 1,68,000, and paid cash difference of ₹ 60,000 for a new machine having a total cash price of ₹ 2,05,000. On March 31, 2013, what amount of loss should Winn Company recognize on this exchange?

Solution:

As per AS-10, When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. The cash price of the new machine represents its fair market value (FMV). The FMV of the old machine can be determined by subtracting the cash portion of the purchase price (₹ 60,000) from the total cost of the new machine. ₹ 2,05,000 - ₹ 60,000 = ₹ 1,45,000. Since the book value of the machine ₹ 1,68,000 exceeds its FMV on the date of the trade in ₹ 1,45,000, the difference of ₹ 23,000 must be recognized as a loss, however, if the FMV of the old machine had exceeded its book value, the gain would not be recognized.

Illustration 40.

One customer from whom ₹ 10 lakhs are recoverable for credit sales given a motor car in full settlement of dues. The directors estimate that the market value of the motor car transferred is ₹ 10.50 lakhs. As on the date of the balance sheet the car has not been registered in the name of the auditee. As an auditor, what would you do in this situations?

**Solution:**

The motor car has been acquired in exchange for another assets i.e. receivables. The fair value of motor car is ₹ 10.50 lakhs and that of receivable ₹ 10 lakhs. As per AS-10 the asset acquired in an exchange of assets should be valued at the fair market value of assets acquired or the asset given up, whichever is more clearly evident. Here fair market value of the assets given up obviously more clearly evident. Hence, the motor car should be valued at ₹ 10 lakhs. Also the motor car should be recognised as an asset even though it is not yet registered in auditee's name. This is because legal title is not necessary for an asset to exist. What is necessary is control as per the framework for preparation and presentation of financial statements. Applying substance over form we find since price has been settled, the auditee has control, hence it should be reflected as an asset along with a note to the effect that the registration in auditee name is pending.

Illustration 41.

A publishing company undertook repair and overhauling of its machinery at a cost of ₹ 5.00 lakhs to maintain them in good condition and capitalized the amount, as it is more than 25% of the original cost of the machinery. As an auditor, what would you do in this situation?

Solution:

Size of the expenditure is not the criteria to decide whether subsequent expenditure should be capitalized. The important question is whether the expenditure increases the expected future benefits from the asset beyond its pre-assessed standard of performance as per AS-10. Only then it should capitalize. Since in this case, only the benefits are maintained at existing level, the expenditure should not be capitalized. If under the circumstances the amount is material the auditor should qualify his report.

Illustration 42.

Is Project under sale fixed or current asset?

Solution:

According AS-10, Accounting for Fixed Assets. Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realizable value and shown separately in the financial statements.

In view of the above, the ASB opined that project under sale, which was originally treated, as fixed asset would continue to be a fixed asset even if it is under sale and will not, therefore, be classified as a current asset. However, if an enterprise were a dealer of projects, then the project under sale would be an inventory and will be classified as a current asset.

SELF EXAMINATION QUESTIONS:

1. AS- 2 is not applicable to
 - (A) Inventories held for sale in ordinary course of business
 - (B) Work in progress arising in the ordinary course of business of service provider
 - (C) Inventories in the process of production for sale in ordinary course of business
 - (D) Inventories in form of material or supplies for the process of production

2. A Company purchase a machine costing ₹15 lakh for its production process. It paid freight ₹25,000, Cartage ₹2,000 and installation charges ₹18,000. The company spent an additional amount of ₹40,000 for testing and preparing the Machine for use. As per AS-10, the amount that should be recorded as the cost of machine would be:
 - (A) ₹15,00,000
 - (B) ₹15,25,000
 - (C) ₹15,85,000
 - (D) ₹15,65,000

3. Accounting standards in India are issued by
 - (A) Comptroller and Auditor general of India
 - (B) Reserve bank of India
 - (C) The Institute of Accounting standards of India
 - (D) The Institute of Chartered Accountants of India

4. AS- 6 is not applicable on
 - (A) Live stock
 - (B) Goodwill
 - (C) Wasting asset
 - (D) All of the above

Answer:

| | | | |
|--------|--------|--------|--------|
| 1. (B) | 2. (C) | 3. (D) | 4. (D) |
|--------|--------|--------|--------|

State whether the following statement is True (or) False:

1. According to AS-2 Inventories are held for sale in normal course of business.
2. As per AS-2, inventory should normally be valued at historical cost or market value whichever is lower.

QUESTIONS:

1. From the following data, Compute the Percentage of Completion & P/L Account (Extract) -7 would appear in the books of a contractor as per AS-7

| | | |
|-----------------------------------|------------|--|
| Contract Price | ₹350 lakhs | |
| Cost incurred to date as follows: | | |
| Material | ₹250 lakhs | |

| | | |
|----------------------------|------------|-----------|
| Labour Charge | ₹100 lakhs | |
| Other Expenses | ₹50 lakh | ₹400 lakh |
| Estimated Cost to Complete | | ₹100 lakh |

Calculation of total cost of Contract

| | ₹ Lakhs |
|--|---------|
| Cost incurred to date: | |
| Material | 250 |
| Labour | 100 |
| Overhead | 50 |
| | 400 |
| Add estimated cost to complete | 100 |
| Estimated total cost on completion of contract | 500 |

Hence, percentage of completion = $400/500 \times 100 = 80\%$

Revenue recognised as a percentage to Contract price = 80% Of ₹350 L = ₹280 lakhs.

As per As -7, when the total construction cost of the contract will exceed total contract revenue, the expected loss should be recognised immediately.

Accordingly, expenses to be recognised in the Profit and Loss A/c will be:

| | |
|--|--------|
| Total Foreseeable Loss (₹ 500 L – ₹350L) | ₹150 L |
| Less Loss for the Current year (₹400 – ₹280 L) | 120 L |

Expected loss to be recognised immediately ₹ 30 L

Profit and Loss Account (Extract)

| | ₹ lakh | | ₹ lakh |
|--|--------|-------------------|--------|
| To Construction cost | 400 | By Contract Price | 280 |
| To Estimated loss on completion of contract to be provided | 30 | | |

MATCHING QUESTIONS

Match the following in Column I with the appropriate item in Column II Column - I & Column - II

| | Column - I | | Column - II |
|-----|---|----|--------------------------------|
| 1. | Minimum Rent | A. | Sinking Fund |
| 2. | Work certified | B. | Secret Reserve |
| 3. | Method of Charging Depreciation | C. | Contract A/c |
| 4. | Undervaluation of asset | D. | Royalty |
| 5. | Purchase Day Book | E. | Credit Balance |
| 6. | Both a journal and a ledger | F. | Cash Book |
| 7. | Provision for Bad and Doubtful Debt Account | G. | AS – 2 |
| 8. | Rebate on Bill Discounted | H. | Computerised Accounting System |
| 9. | Automatic Balance Sheet | I. | Subsidiary Book |
| 10. | Developed on the basis of specific requirements of the organisation | J. | Bill of Exchange |
| 11. | Inventories are valued at lower of cost or net realisable value | K. | Customised Accounting Software |

| | | | |
|-----|-------------------------------------|----|-----------------------------|
| 12. | Accounting for Depreciation | L. | Insurance Claim |
| 13. | Indemnity Period | M. | Hire Purchase |
| 14. | Partial Repossession | N. | AS – 6 |
| 15. | Prepares the accounts independently | O. | Independent Branch |
| | | P. | No matching statement found |

EXERCISE:

1. (a) State the criteria which should be fulfilled by a depreciable asset as per AS-6.
 (b) Toly Enterprise ordered 10,000 units of material X at ₹ 135 per unit. The purchase price includes excise duty @ ₹ 8 per unit, in respect of which full CENVAT Credit is admissible. Freight incurred amounted to ₹ 88,500. Normal transit loss is 5%. The enterprise actually received 9,400 units and consumed 8,500 units.
 You are required to ascertain the value of inventory as per AS-2.

Answer:**[Value of inventory — 900 unites @ ₹143 = ₹ 1,28,700]**

2. The cost of production of Product X is ₹450 which includes per unit cost of Material, Labour and overheads of ₹250, ₹110 and ₹90 respectively. At the end of the accounting year on 31.03.2013 the replacement cost of Raw Material is ₹210 per unit.
 There are 500 units of raw material in stock on 31.03.2013.
 Calculate as per AS-2 the value of closing stock or Raw Material when:
 (i) Finished Product is sold at ₹420 per unit.
 (ii) Finished Product sold at ₹490 per unit.

Answer:**[(i) ₹1,05,000;****(ii) ₹ 1,25,000]**