SYLLABUS - 2016

INTERMEDIATE : PAPER - 5

FINANCIAL ACCOUNTING

INTERMEDIATE

STUDY NOTES

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

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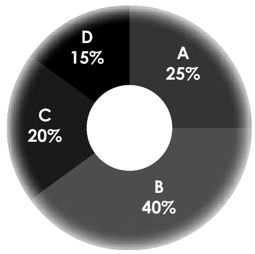
Syllabus - 2016

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-7, AS-9, AS-6 and AS-10 has been replaced by revised AS-10)

Contents

Study Note 1 : Fundamentals of Accounting

Study Note 2 : Accounting for Special Transactions

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

Study Note 4 : Preparation of Financial Statments of Non-Profit Organizations

Study Note 5 : Preparation of Financial Statements from Incomplete Records

Study Note 6 : Partnership

Study Note - 1

FUNDAMENTALS OF ACCOUNTING

This Study Note includes

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.

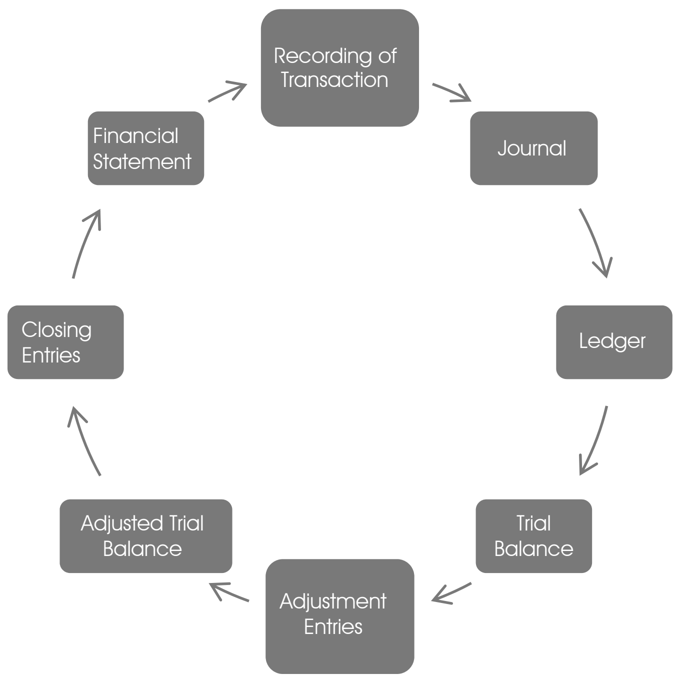
Difference between Management Accounting and Financial Accounting:

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.



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**
O wners / Inv es tors / 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 on 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.

Theory Base of Accounting

Basic Assumptions	Basic Principles	Modifying Principles
(a) Business Entity Concept	(a) Revenue Realization Concpet	(a) Materiality Concept
(b) Going Concern Concept	(b) Matching Concept	(b) Consistency Concept
(c) Money Measurement Concept	(c) Full Disclosure Concept	(c) Conservatism Concpet
(d) Accounting Period Concept	(d) Dual Aspect Concept	(d) Timeliness Concept
(e) Accrual Concept	(e) Verifiable Objective Evidence Concpet	(e) Industry Practice Concept
	(f) Historical Cost Concept	
	(g) Balance Sheet Equation Concpet	

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 recoded 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:

Assets = Liabilities + 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:

Assets = Liabilities + Owner's equity

Cash ₹ 25,00,000 = Liabilities ₹ nil + 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.

Assets = Liabilities + Owner's equity

Cash ₹ 40,00,000 = Liabilities ₹ 15,00,000 + 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 :-

Debit = Credit

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

Expenses + Losses + Assets = Revenues + Gains + Liabilities

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

Asset = Liabilities

or, Asset = Equity + 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.***

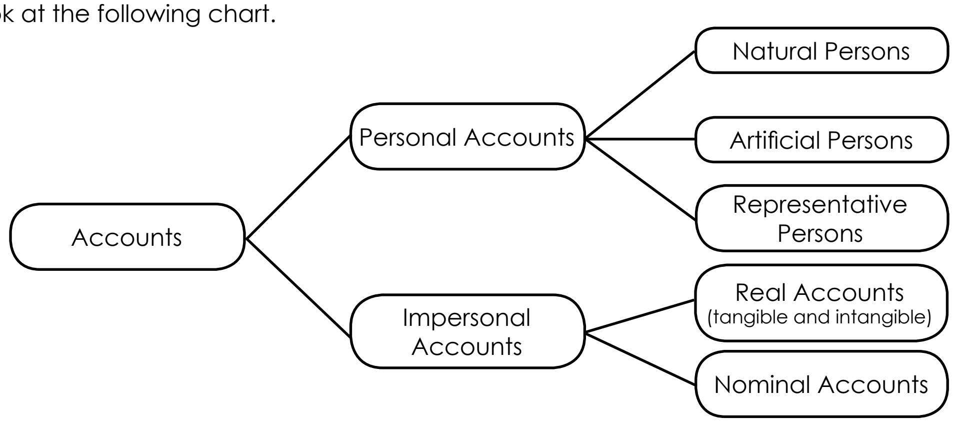
Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
Cash brought into business	1,00,000	Paid for goods purchased	50,000
Received for goods sold	25,000	Paid for rent	15,000
		Balance at the end	60,000
	1,25,000		**1,25,000**

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 Increase in Capital	Cash A/c Capital A/c	Debit Credit
(b)	Increase in Stock Decrease in Cash	Purchase A/c Cash A/c	Debit Credit
(c)	Increase in Cash Decrease in Stock	Cash A/c Sale A/c	Debit Credit
(d)	Increase in Expense Decrease in Cash	Salary A/c Cash A/c	Debit Credit
(e)	Increase in Cash Increase in Income	Cash A/c Interest A/c	Debit Credit
(f)	Increase in Stock Increase in Liability	Purchase A/c Y A/c	Debit Credit
(g)	Increase in Expense Increase in Capital	Rent A/c Capital A/c	Debit 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.

Personal Account →	Debit the receiver or who owes to business Credit the giver or to whom business owes
Real Account →	Debit what comes into business Credit what goes out of business
Nominal Account →	Debit all expenses or losses Credit all income or gains

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 dependes on Accounting Equation which is also known as Balance Sheet Equation. The basic Accounting Equation is:

Assets = Liabilities + Owner's equity

$$\left.\begin{array}{l} \text{or } A = L + P \\ \text{or } P = A - L \\ \text{or } L = A - P \end{array}\right\} \text{Where A = Assets, L = Liabilities, P = Capital}$$

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.

Now, Preliminary Expenses are not shown in the balance Sheet as per para 56 of AS-26, it is a part of other expenses which is shown in the **Profit and Loss A/c** (Part II of Schedule III in case of a Company). It is a part of **revenue expenditure**, 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 bellow:

In the books of Roy Brothers

Journal Entries

Date	Particulars	Voucher No.	Ledger Folio	Dr. Amount (₹)	Cr. 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. Amount (₹)	Cr. Amount (₹)
01-04-2013	Cash A/c Dr. To Vikas's Capital A/c To Vaibhavi's Capital A/c (Being capital brought in by the partners)		1 2 3	7,50,000	 5,00,000 2,50,000
10-04-2013	Furniture A/c Dr. To Cash A/c (Being furniture purchased in cash)	2013/F/3	4 1	25,000	 25,000
11-04-2013	Punjab National Bank A/c Dr. To Cash A/c (Being current account opened with Punjab National Bank by depositing cash)		5 1	1,00,000	 1,00,000

15-04-2013	Rent A/c Dr. To Punjab National Bank A/c (being rent paid to Realtors Properties for the month)	3	6 5	15,000	 15,000
20-04-2013	Motor Car A/c Dr. 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)	M/13/7	7 5 8	4,50,000	 50,000 4,00,000
25-04-2013	Punjab National Bank A/c Dr. Avon Pharmaceuticals A/c Dr. To Consultancy Fees A/c (Being amount received and revenue recognized for fees charged)	B13/4/1	5 9 10	2,50,000 7,50,000	 10,00,000
30-04-2013	Salary A/c Dr. To Salary payable A/c (Being the entry to record salary obligation for the month)		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 invalve 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 Coulmn 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**

Dr. **Specimen of Double Column Cash Book** **Cr.**

Receipts					Payments				
Date	**Particulars**	**L.F.**	**Cash**	**Disc. Allowed**	**Date**	**Particulars**	**L.F.**	**Cash**	**Disc. Received**

Double Column Cash Book containing contra transaction and cheque transaction

The double column Cash book has columns on both the sides of the Cash book. This cash book can have two columns on both the sides as under :

(a) Cash and Discount Columns,

(b) Cash and Bank columns,

(c) Bank and Discount columns.

(I) Contra Transactions

Transactions which relates to allowing discount or receiving discount in cash after the settlement of the dues are known as Contra Transactions.

Example:

1. Cash deposited in to Bank

   Bank A/c Dr.

   To Cash A/c

2. Cash withdrawn from Bank

   Cash A/c Dr.

   To Bank A/c

(II) Cheque Transactions

When a cheque is received and no any other information at a later date about the same is given, it will be assumed that the said cheque has already been deposited into bank on the same day when it was received. Then the entry should be as under:

Bank A/c Dr.

To Debtors/Party A/c

But if it is found that the said cheque has been deposited into the bank at a later date, then the entry will be:

(i) When the cheque is received

Cash A/c Dr.

To Debtors/Party A/c

(ii) When the same was deposited into bank at a later date

Bank A/c Dr.

To Cash A/c

(iii) When the said cheque is dishonoured by the bank

Debtors/Party A/c Dr.

To Bank A/c

Let us see an illustration for the following cash and bank transactions in the books of Mr. Abhishek

January 1 Opening cash balance was ₹ 3,800 and bank balance was ₹ 27,500

January 4 Wages paid in cash ₹ 1,500

January 5 received cheque of ₹ 19,800 from KBK enterprises after allowing discount of ₹ 200

January 7 Paid consultancy charges by cheque for ₹ 7,500

January 10 Cash of ₹ 2,500 withdrawn from bank

January 12 Received a cheque for ₹ 4,500 in full settlement of the account of Mr. X at a discount of 10% and deposited the same into the Bank.

January 15 X's cheque returned dishonoured by the Bank

In the Books of Mr. Abhishek

Dr. **Cash Book** **Cr.**

Receipts						**Payments**					
Date	**Particulars**	**L.F.**	**Cash (₹)**	**Bank (₹)**	**Discount Allowed (₹)**	**Date**	**Particulars**	**L.F.**	**Cash (₹)**	**Bank (₹)**	**Discount received (₹)**
1-Jan	Opening Balance		3,800	27,500		4-Jan	Wages paid		1,500		
5-Jan	Recd from KBK			19,800	200	7-Jan	Consultancy fees			7,500	
10-Jan	Cash withdrawn		2,500			10-Jan	Cash withdrawn			2,500	
12-Jan	Mr. X			4,500	500	15-Jan	Mr. X			4,500	500
							Closing balance		4,800	37,300	
			6,300	51,800	700				6,300	51,800	500

Please note that the balance of discount columns is not taken and these are posted directly to the respective ledger account separately. The balance of cash and bank columns are posted into cash and bank accounts periodically. The posting into ledger is explained later in this chapter.

Purchase Day Book

The purchase day book records the transactions related to credit purchase of goods only. It follows that any cash purchase or purchase of things other than goods is not recorded in the purchase day book. Periodically, the totals of Purchase Day Book are posted to Purchase Account in the ledger. The specimen Purchase Day Book is given below:

In the Books of ....

Purchase Day Book

Date	Name of the Suppliers and details of Goods purchased	Invoice reference	L. F.	Amount (₹)	Remarks

The format for Purchase Return is exactly the same; hence separate illustration is not given.

Let us see an illustration for following transactions for a furniture shop:

1. Bought 20 tables @ ₹ 500 per table from Majestic Appliances on credit @ 12% trade discount as per invoice number 22334 on 2nd March.
2. Purchased three dozen chairs @ ₹ 250 each from Metro chairs as per invoice number 1112 on 4th March.
3. Second hand furniture bought from Modern Furnitures on credit as per invoice number 375 for ₹1200 on 7th March.

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, Biils 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.***
Increase		Decrease

Dr.	***Liabilities & Capital***	***Cr.***
Decrease		Increase

Dr.	***Expenses or Loses***	***Cr.***
Increase		Decrease

Dr.	***Income or Gains***	***Cr.***
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)

(c) In case of other accounts like interest or dividend or commission received, or discount received, that the firm has made a gain (relating to Nominal Account)

At a glance:

Dr. (Debit side)	***Cr. (Credit side)***
DESTINATION Where the economic benefit reaches / is received.	SOURCE of each economic benefits
Receiver	Giver
What comes in	What goes out
All expense and losses	All income and gains

Let us now understand the mechanism of posting transaction into the ledger account. Consider the transaction: Rent paid in cash for ₹ 10,000. The journal entry for this transaction would be:

Jan 15	Rent A/c	Dr.	10,000	
	To, Cash A/c			10,000

We will open two ledger accounts namely Rent A/c and Cash A/c. Let us see how the posting is made

Rent Account

Dr. **Cr.**

Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
Jan15	To, Cash A/c		10,000				

Cash Account

Dr. **Cr.**

Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
				Jan 15	By Rent A/c		10,000

Please observe the following conventions while posting a transaction into ledger accounts. Note that both the effects of an entry must be recorded in the ledger accounts simultaneously.

(1) The posting in the account which is debited, is done on the debit side by writing the name of the account or accounts that are credited with the prefix 'To'.

(2) The posting in the account which is credited, is done on the credit side by writing the name of the account or accounts that are debited with the prefix 'By'.

Let us now see how we can create ledger account for the seven journal entries that we passed for Illustration 18.

Folio No. 1

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

Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
1.4.2013	To Vikas's capital A/c	1	500,000	10.4.2013	By Furniture A/c	1	25,000
1.4.2013	To Vaibhavi's capital A/c	1	250,000	11.4.2013	By Punjab National Bank A/c	1	1,00,000
				30.4.2013	By Balance c/d		6,25,000
			750,000				7,50,000
1.5.2013	To Balance b/d		625,000				

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

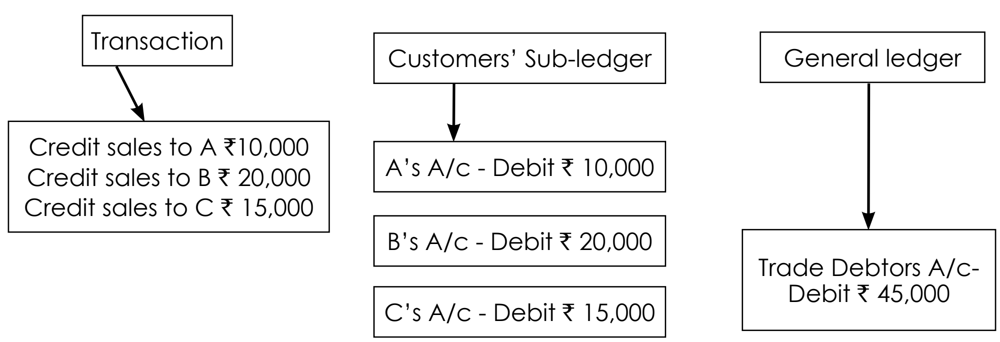
In practice, for the sake of convenience and ease of operations, the ledger is subdivided as follows:

(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:



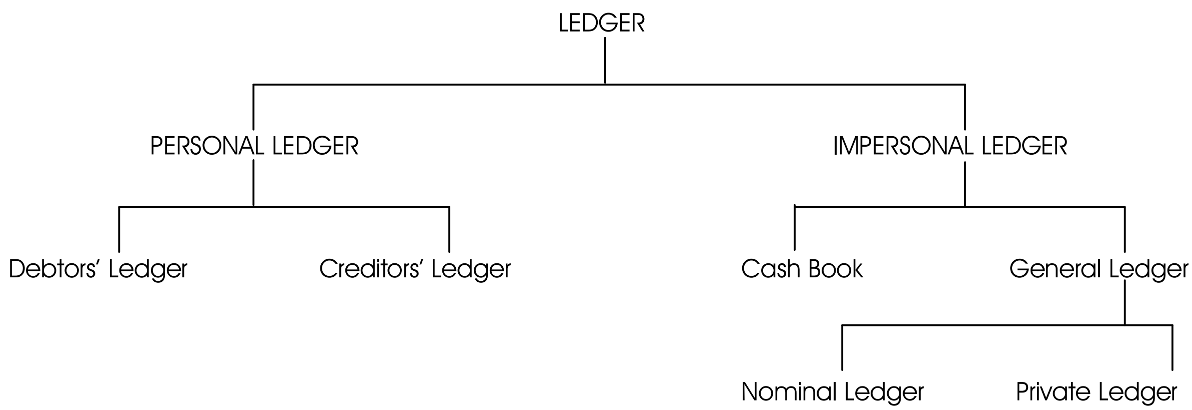
Such separation is made for better control. A person in charge of customer accounting is given responsibility of all individual customer accounting in the Customers sub-ledger, whereas another person be given responsibility for Suppliers' sub-ledger. In bigger organizations this division of labour is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

Dr. as on 31st March, 2013 Cr.

Heads of Accounts	Amount (₹)	Heads of Accounts	Amount (₹)
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.

Trial Balance based on ledger balances

Income Statement shows income & gains and expenses & losses for an accounting period. The net result is profit or loss. → Balance Sheet shows assets and liabilities & owner's equity. Profit or loss from income statement is added or deducted from owner's capital or equity.

Depending on the nature of business, the income statement is prepared in different forms like:

(a) In case of manufacturing concern, a Manufacturing, Trading and P & L A/c is prepared.

(b) In case of a trading or service organization, a Trading and P & L A/c is prepared.

The Manufacturing or Trading Accounts show Gross margins (or gross losses) and the P & L A/c shows Net Profit or Net Loss.

The Balance Sheet exhibits the list of assets (which indicate resources owned) and the liabilities & owners'capital and equity (which shows how the resources are funded).

For company type of organizations, standard formats for P & L and Balance Sheet are given in the Companies Act that is to be adhered to. The accounting should be as per the prescribed Accounting Standards.

Closing Stock

We know when goods are purchased for resale we include them in Purchases A/c, while goods sold are shown in Sales A/c. At the end of accounting period, some of these goods may remain unsold. If we show the entire cost of purchases in income statement, it will not be as per the matching concept. We should only show the cost of those goods that are sold during the period. The balance cost should be carried forward to the next accounting period through the balance sheet. How should the closing stock be valued? According to the conservative principle, the stock is valued at lower of cost or market price. If cost of stock is ₹125000 and its realizable market price is only ₹115000, then the value considered is ₹115000 only. What it means is the difference of ₹10000 is charged off to the current periods profits.

Students are advised to refer to Accounting Standard 2 - 'Valuation of Inventories' to get thorough knowledge.

Please remember the closing stock figure does not appear in the trial balance, but is valued and directly taken to the P & L A/c. The entry passed for this is:

Closing Stock A/c Dr.

To Trading and P & L A/c

In solving the examination problem, this entry is not actually passed, but the effect of its outcome is given. Here, one effect is "show closing stock as asset in Balance Sheet" and second effect is "show it on the credit side of Trading A/c".

Note : But, if the closing stock appears in the debit side of Trial Balance, it means it has already been adjusted against purchases. In that case, the closing stock will appear only in the asset side of the Balance Sheet.

Depreciation

When the business uses its assets to earn income, there is wear and tear of the asset life. Assets will have limited life and as we go on using it, the value diminishes. Again the question to be asked is – at what value should the asset be shown in the balance sheet? Consider a machine was bought on 1st April 2012 for ₹ 2,00,000. It's used for production activity throughout the year. When the final accounts are being prepared, at what value should it be shown in Balance Sheet as on 31st March 2013?

Well, according to cost principle initial entry for purchase of machine is shown at cost paid for it e.g. ₹2,00,000 in this case. But the fact that the machine is used must be recognized in financials. Hence the value in the Balance sheet must be brought down to the extent of its use. This is called as Depreciation. How is it calculated? While there are different methods of calculating depreciation (explained in subsequently), the simple idea is to spread it over the useful life of the asset, so that at the end of its life the value is zero. In our example, if useful life of the machine is taken as 10 years, the depreciation will be simply ₹ 2,00,000 ÷ 10 i.e. ₹ 20,000 every year. So a depreciation of ₹ 20,000 will be charged to the profit of every year and value of asset will be brought down by the same value.

Students are advised to refer to Accounting Standard 6 issued by ICAI to get thorough knowledge on Depreciation accounting.

The entry passed for this is:

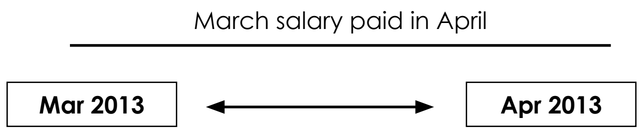
Depreciation A/c Dr.

To Fixed Asset A/c

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 is 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:

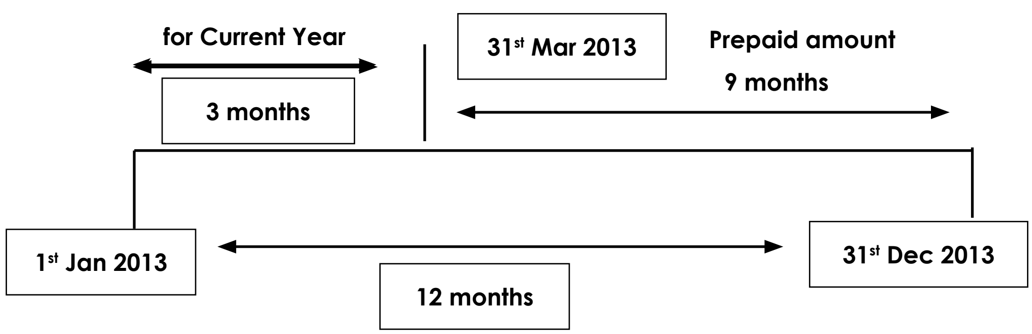
One – add in respective expense in P & L A/c and two – show as a liability in the Balance Sheet.

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 ÷ 4).

The entry for this is:



Prepaid Insurance A/c Dr.

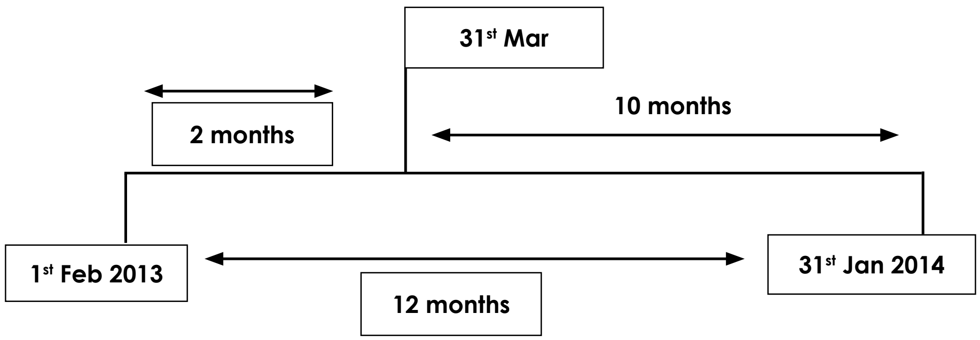
To Insurance A/c

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.

Accrued Incomes

Just as expenses accrue, there are instances of income getting accrued at the end of accounting period. The extent to which it accrues, it must be booked as income for the current accounting period. Consider, the business has put a One year fixed deposit of ₹ 1,00,000 with Citi Bank at a fixed interest of 9 % p.a. on 1st February 2013 and the interest is credited by the bank on a semi-annual basis. Also, consider that the accounting period ends on 31st March 2013. The Citi bank will credit the 1st semi-annual interest on 31st July 2013 and the next on 31st January 2014. Now, consider the following:



It can be noticed that interest for the 2 months will be considered as accrued as on 31st of March 2013 and must be taken as income for the current accounting year.

The entry for this is:

Accrued Interest A/c Dr.

To Interest A/c

The two effects while preparing final accounts are:

One – Show as income in the P & L A/c and two – show as an asset in the Balance Sheet.

Income Received in Advance

If an income is received which is not related to the current accounting period, it cannot be included in the current year's P & L A/c. So, if it's already included as income it must be reduced. The entry for this is:

Respective Income A/c Dr.

To Income received in advance A/c

The effects while preparing final account are:

One – Reduce from respective income and two – show it as liability in Balance Sheet.

Illustration 15.

Journalize the following transactions in the books of Gaurav, post them into ledger and prepare trial balance for June 2013 :

June 1: Gaurav started business with ₹ 10,00,000 of which 25% amount was borrowed from wife.

June 4: Purchased goods from Aniket worth ₹ 40,000 at 20% TD and 1/5th amount paid in cash.

June 7: Cash purchases ₹ 25,000.

June 10: Sold goods to Vishakha ₹ 30,000 at 30% TD and received 30% amount in cash.

June 12: Deposited cash into bank ₹ 20,000.

June 15: Uninsured goods destroyed by fire ₹ 5,500.

June 19: Received commission ₹ 3,500.

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. Amount (₹)	Cr. Amount (₹)
2013 1-Jun	Cash A/c	Dr.		10,00,000	
	To Capital A/c				7,50,000
	To Loan from Wife A/c				2,50,000
	(Being capital brought into business)				
4-Jun	Purchases A/c	Dr.		32,000	
	To Cash A/c				6,400
	To Aniket's A/c				25,600
	(Being goods purchased at 20% TD & 1/5th amount paid in cash)				
7-Jun	Purchases A/c	Dr.		25,000	
	To Cash A/c				25,000
	(Being cash purchases)				
10-Jun	Cash A/c	Dr.		6,300	
	Vishakha's A/c	Dr.		14,700	
	To Sales A/c				21,000
	(Being goods sold at 30% TD & 30% amount received in cash)				
12-Jun	Bank A/c	Dr.		20,000	
	To Cash A/c				20,000
	(Being cash deposited in bank)				
15-Jun	Loss by Fire A/c	Dr.		5,500	
	To Purchases A/c				5,500
	(Being uninsured goods lost by fire)				
19-Jun	Cash A/c	Dr.		3,500	
	To Commission A/c				3,500
	(Being commission received)				
22-Jun	Aniket's A/c	Dr.		25,600	
	To Cash A/c				25,500
	To Discount A/c				100
	(Being paid to Aniket in full settlement & discount received)				
25-Jun	Loss by Theft A/c	Dr.		1,000	
	To Cash A/c				1,000
	(Being cash stolen)				
27-Jun	Cash A/c	Dr.		14,500	
	Discount A/c			200	
	To Vishakha's A/c				
	(Being amount received from Vishakha & discount allowed)				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.	Amont (₹)
1/6/13	To Capital A/c		7,50,000	4/6/13	By PurchasesA/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

Vishakha's Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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

Sales Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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

Bank Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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				

Loss by Fire Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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				

Commission Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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

Discount Account

Dr. Date	Particulars	J.F.	Amt. (₹)	Date	Particulars	J.F.	Cr. 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

	Dr.	Cr.
Name of Account	(₹)	(₹)
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	-----	21000
Bank A/c	22,400	-----
Loss by Fire A/c	5,500	-----
Commission A/c	-----	3500
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.

"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, efflux 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. It is charged against profits. 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.

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

Depreciation as per Property, Plant and Equipment (AS-10) Revised

[AS 6 has been replaced by this part of AS 10 Property Plant and Equipment]

► The Property, Plant and Equipment (PPE) are generally known as tangible fixed assets in contrast to the intangible property (AS-26).

  These tangible assets are:

  • Held for use in production or supply of goods and services, for rental to others, or for administrative purposes;

  • Expected to be used during more than one period;

  • Not held for sale in the normal course of business.

  Examples of Property, Plant and Equipment: land, building, plant and machinery, furniture and fitting and office equipment etc.

► Once an item of property, plant and equipment qualifies for recognition as an asset, it is initially measured at cost.

► The cost of items of PPE comprises:

  • Purchase price, including import duties, non-refundable purchase taxes, less trade discounts and rebates.

  • Costs directly attributable to bring the asset to the location and condition necessary for it to be used in a manner intended by management.

  • Initial estimates of cost of dismantling/decommissioning, removing, and site restoration at present value if the entity has an obligation that it incurs on acquisition of the asset or as a result of using the asset other than to produce inventories. AS-29 prescribes the discounting of such provisions and provision is made at present value by applying pre-tax discount rate.

► Examples of directly attributable costs include:

  • Employee benefits of those involved in the construction or acquisition of an asset

  • Site preparation cost

  • Initial delivery and handling costs

  • Installation and assembly costs

  • Costs of testing, less the net proceeds from the sale of any product arising from test production

  • Borrowing costs to the extent permitted by AS-16, Borrowing Costs

  • Professional fees

► Examples of costs that are not directly attributable costs and therefore must be expensed in the income statement include:

  • Costs of opening a new facility (often referred to as preoperative expenses)

  • Costs of introducing a new product or service including Advertising and promotional costs

  • Costs of conducting business in a new location or with a new class of customer

  • Training costs

  • Administration and other general overheads

- Depreciation as per AS 10
  - Depreciable amount should be allocated on a systematic basis over useful life.
  - Useful life and residual value must be reviewed at least at each financial year end. If expectations differ from previous estimates the changes are to be accounted for as a change in an accounting estimate. In accordance with AS-5 "Net Profit or loss for the period, Prior Period Items and Changes in Accounting Policies" (i.e., adjusting depreciation charge for current and future periods)
  - Depreciation charge for each period should be recognized as an expense unless it is included in the carrying amount of another asset.
  - AS-10 does not specify a method to be used.
  - AS-10 requires that each part of an item of PPE that has a cost that is significant when compared to the total cost of the item should be depreciated separately.
  - Asset management policy may involve disposal of assets after a specified time therefore useful life may be shorter than economic life.
  - Repair and maintenance policies may also affect useful life (e.g., by extending it or increasing residual value) but do not negate the need for depreciation.
  - Residual value is estimated value of depreciable assets at the end of its useful life.
  - Depreciable amount is net of residual value. Residual value is often insignificant and immaterial to the calculation of the depreciable amount.
  - Depreciation is always recognized, even if fair value exceeds carrying amount, except when residual value is greater than carrying amount (in which case the depreciation charge is zero).
  - Depreciation period
    - Depreciation commences when an asset is available for use.
    - Depreciation ceases at the earlier of the date the asset is:
      - derecognised and
      - held for disposal
  - Depreciation does not cease when an asset is idle or retired from active use (unless it is fully depreciated). However, depreciation may be zero under the "units of production method".
  - Land and buildings are separable assets and are separately accounted for, even when they are acquired together:
    - Land normally has an unlimited useful life and is therefore not depreciated.
    - Buildings normally have a limited useful life and are depreciable asset.
  - Where land has a limited useful life (e.g., a landfill site, mine, quarry) it is depreciated.
- Depreciation methods as per 10
  - Straight line - a constant charge over useful life
  - Diminishing balance - a decreasing charge over useful life
  - Sum of the units - charge based on expected use or output
  - The depreciation method should also be reviewed at least of each financial year end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits from those assets, the method should be changed to suit this changed pattern. When such a change in depreciation takes place the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.
  - Three impertinent factors to be calculated:
    - Useful Life
    - Cost of Asset
    - Residual value
  - As per Schedule II of the Companies Act, 2013, depreciation to be charged on the basis of useful life of asset. Revised AS-10 also prescribes the same. Provided that where a company adopts a useful life different from what is specified in the Schedule or uses a residual value different from the limit specified above, the financial statements shall disclose such difference and provide justification in this behalf duly supported by technical advice.

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 : 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:

$$\text{Amount of Depreciation} = ₹\ 10,00,000 \times 20\% \times \frac{12}{12} = ₹\ 2,00,000$$

(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

III. Sum of the Units Method:

Depreciation for the period —

Production during the year / Estimated Total Production

Illustration 19.

A machine is purchased for ₹60,00,000, estimated life of which is 10 years residual value is ₹ 4,00,000. Expected production of the machine is 2,00,000 during its useful life.

Production pattern is as follows:

Year	Units
1-2	20,000 per year
3-6	15,000 per year
7-10	25,000 per year

Compute the amount of depreciation for each year applying Sum of the Units Method.

Solution:

Year	Computation	Depreciation (₹)
1-2	$\frac{20,000}{2,00,000} \times (60,00,000 - 4,00,000)$	5,60,000

3-6	$\frac{15,000}{2,00,000} \times (60,00,000 - 4,00,000)$	4,20,000
7-10	$\frac{25,000}{2,00,000} \times (60,00,000 - 4,00,000)$	7,00,000

Illustration 20.

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				285		285
	W.D.V.				11,115		
	Sold For				11,000		
	Loss on sale				115		
30.06.2013	Depreciation		1,296				1,296
	W.D.V.		24,624				
	Sold For		26,700				
	Profit on Sale		2,076				
01.10.2013	Purchase					20,000	
31.12.2013	Depreciation	3,888		2,660		500	7,048
01.01.2014	W.D.V.	34,992		23,940		19,500	

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 ,, Balance c/d	8,000 72,000
		80,000			80,000
01.01.12 01.07.12	To, Balance b/d ,, Bank A/c	72,000 40,000	31.12.12	By, Depreciation A/c ,, Balance c/d	9,200 1,02,800
		1,12,000			1,12,000

01.01.13 30.06.13	To, Balance b/d ,, P & L A/c (Profit on Sale) ,, Bank A/c	1,02,800 2,076 20,000	31.3.13 30.6.13 31.12.13	By, Bank (Sale) A/c ,, Depreciation A/c ,, P & L A/c (Loss on Sale) ,, Bank A/c (Sale) ,, Depreciation A/c ,, Depreciation A/c ,, Balance c/d	11,000 285 115 26,700 1,296 7,048 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 :

(i) For purchase of asset

Asset's A/c Dr.

To Cash/Bank A/c

(ii) For providing depreciation at end of year

Depreciation A/c Dr.

To Provision for depreciation A/c

(iii) For sale of assets

Cash/Bank A/c Dr.

To Asset Sales A/c

(iv) Cost of assets sold transferred from Assets Account to Sale of Assets Account.

Assets Sales A/c Dr.

To Asset's A/c.

(v) Total depreciation on asset sold transferred from provision for depreciation account.

Provision for depreciation A/c Dr.

To Asset Sales A/c

(vi) 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 21.

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. Machinery Account Cr.

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
			31.12.2013	By, Balance c/d	1,50,000
		2,50,000			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
			31.12.2012	By, Depreciation A/c (₹ 15,000 + ₹ 11,250)	26,250
		41,250			41,250
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

1. 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
2. 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 22.

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.

Dr. **Machinery Account** **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
				By, Balance c/d	70,000
		75,000			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. Total Cost = ₹ 66,000 + ₹ 5,000 + ₹ 7,000 + ₹ 1,000 + ₹ 500 + ₹ 500 = ₹ 80,000

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

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 23.

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. **Machinery Account** ***Cr.***

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
01.01.13	To, Balance b/d	9,72,000	01.07.13	By, Depreciation A/c [W.N.3]	3,240
	(9,07,200+64,800)			By, Bank A/c - Sale	45,000
				By, Loss on sale of Machine A/c	
01.07.13	To, Bank A/c (1,50,000 + 8,000)	1,58,000		[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 1st January, 2013	9,72,000
Balance as on 1st January, 2012 is 9,72,000 × 10/9 =	10,80,000
Balance as on 1st January, 2011 is 10,80,000 × 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 24.

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 25.

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

<u>Gross Profit</u>

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

<u>Gross Loss</u>

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

<u>Net Profit</u>

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

<u>Net Loss</u>

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

Illustration 26.

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

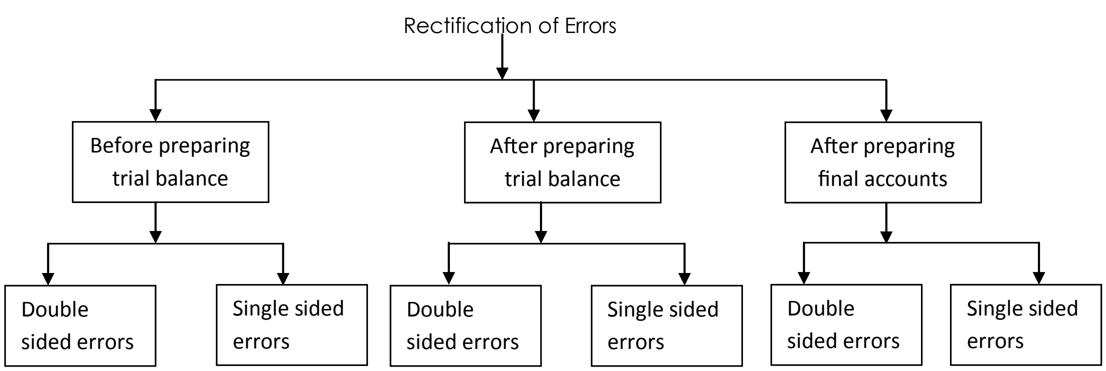
Rectification Entries (Rectification of errors): These entries are passed when errors or mistakes are discovered in accounting records. These entries are also known as Correction Entries. These entries are also passed in Journal Proper.

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 27.

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.

Solution:

In the Books of ....

Journal (without narration)

Date	Before preparation of Trial Balance	After preparation of Trial Balance	After preparation of Final Accounts
(i)	Plant A/c Dr. 10,000 To Purchase A/c 10,000	Plant A/c Dr. 10,000 To Purchase A/c. 10,000	Plant A/c Dr. 10,000 To P&L Adjustment A/c 10,000
(ii)	Sales account will be credited with ₹ 1,000	Suspense A/c Dr. 1,000 To Sales A/c 1,000	Suspense A/c Dr. 1,000 To P&L Adjustment A/c 1,000
(iii)	X Account will be debited when ₹ 900	X A/c Dr. 900 To Suspense A/c 900	X A/c Dr. 900 To Suspense A/c 900
(iv)	Purchase A/c Dr. 3,000 To T A/c 3,000	Purchase A/c Dr. 3,000 To T A/c 3,000	P&L Adjustment A/c Dr. 3,000 To T's A/c. 3,000
(v)	Salary A/c Dr. 3,000 To Wages A/c 3,000	Salary A/c Dr. 3,000 To wages A/c 3,000	P&L Adjustment A/c. Dr. 3,000 To P&L Adjustment A/c 3,000

llustration 28.

A merchant, while balancing his books of accounts notices that the T.B. did not tally. It showed excess credit of ₹ 1,700. He placed the difference to Suspense A/c. Subsequently he noticed the following errors:

(a) Goods brought from Narayan for ₹ 5,000 were posted to the credit of Narayan's A/c as ₹ 5,500

(b) An item of ₹ 750 entered in Purchase Returns Book was posted to the credit of Pandey to whom the goods had been returned.

(c) Sundry items of furniture sold for ₹ 26,000 were entered in the sales book.

(d) Discount of ₹ 300 from creditors had been duly entered in creditor's A/c but was not posted to discount A/c.

Pass necessary journal entries to rectify these errors. Also show the Suspense A/c.

Solution:

(a) Goods bought from Narayan are posted to credit of his A/c as ₹ 5,500 instead of ₹ 5,000. Here, it is correct to credit Narayan's A/c. But the mistake is extra credit of ₹ 500. This is one sided error, as posting to purchases A/c is correctly made. So the rectification entry will affect the suspense A/c. This needs to be reversed by the rectification entry:

Narayan's A/c	Dr.	500	
To Suspense A/c			500

(b) Goods bought from Pandey were returned back to him. It should have appeared on the debit side of his A/c. For rectifying we will need to debit his A/c with double the amount i.e. ₹ 1500 (₹ 750 to cancel the wrong credit and another ₹ 750 to give effect for correct debit) and the effect will go to Suspense A/c. The correction entry is:

Pandey A/c	Dr.	1,500	
To Suspense A/c			1,500

(c) Sale of furniture was recorded in sales book. What's wrong here? Remember that sales book records sale of goods only and nothing else. Sale of furniture will appear in either cash book (if sold for cash) or journal proper (if sold on credit). Hence, wrong credit to Sales A/c must be removed and credit should be given to Furniture A/c. It's important to note that this rectification entry will not affect the Suspense A/c. The correction entry is:

Sales A/c	Dr	26,000	
To Furniture A/c			26,000

(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 29.

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	Dr	200	
		To Cash			200
	Correct entry	Drawings	Dr	200	
		To cash			200
	Rectification entry	Drawings	Dr	200	
		To Trade Expenses			200
(b)	**Wrong Entry**	Nathan	Dr	300	
		To Sales			300
	Correct entry	Purchases	Dr	300	
		To Nathan			300
	Rectification entry	Purchases	Dr	300	
		Sales	Dr	300	
		To Nathan			600
(c)	**Wrong Entry**	Purchases	Dr	100	
		To Santhanam			100

Sl No.		Particulars		Debit (₹)	Credit (₹)
	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 30.

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

a. Return inward book was cast short by ₹ 500.

b. ₹ 300 received from Ram has been debited to Mr. Shyam.

c. Wages paid for the installation of a machine debited to wages account for ₹ 1,000.

d. A purchase made for ₹ 1,000 was posted to purchase account as ₹ 100.

e. Purchase of furniture amounting to ₹ 3,000 debited to purchase account.

f. Goods purchased for proprietor's use for ₹ 1,000 debited to purchase account.

Solution:

In the Books of …………

Journal

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

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**

llustration 31.

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:

(a) 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.

(b) A credit sale of ₹ 7,600 was wrongly posted as ₹ 6,700 to customer's A/c in sales ledger.

(c) Closing stock was overstated by ₹ 5,000 being totaling error in the schedule of inventory.

(d) ₹ 8900 paid to Bala was posted to the debit of Sethu as ₹ 9,800.

(e) Goods purchased from Evan Traders for ₹ 3,250 was entered in sales book as ₹ 3,520.

(f) ₹ 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:

(a) 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

(b) 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

(c) 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 enry 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 32.

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. 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.

b. Goods of the value of ₹ 230 returned by Sen were entered in the Purchase Day Book and posted therefrom to Das as ₹ 320.

c. Bad debts aggregating ₹ 505 written off during the year in the Sales Ledger but were not recorded in the general ledger.

d. Bill for ₹ 750 received from Mukherjee for repairs to Machinery was entered in the Inward Invoice Book as ₹ 650.

e. 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.

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

Illustration 33.

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:

(a) Return outward book was under cast by ₹ 100.

(b) ₹ 1,500 being the total of discount column on the credit side of the cash book was not posted.

(c) ₹ 6,000 being the cost of purchase of office furniture was debited to Purchase A/c.

(d) A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the customers A/c. in the sales ledger.

(e) The Sales A/c was under casted by ₹ 10,000 being the carry over mistakes in the sales day book.

(f) 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

Date	Particulars	L/F	Dr. Amount (₹)	Cr. Amount (₹)
(a) 2013	Suspense A/c Dr.		100	
April	To Profit & Loss Adjustment A/c			100
1	(Returns outward book was under cast now rectified).			

(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 Pofit & Loss Adjustment A/c	1,500	April	By Debtors A/c.	90
1	To Pofit & Loss Adjustment A/c	10,000	1		
	To Pofit & Loss Adjustment A/c	10,000			
		21,600			21,600

Effect on Profit

	Increase (+) ₹	**Decrease** (-) ₹
Item (a)………………………………..	-	100
(b)………………………………..	-	1,500
(c)………………………………..	-	6,000
(d) No effect	-	-
e)………………………………..	-	10,000
(f)………………………………..	10,000	-
	10,000	17,600
Profit will be decreased by	7,600	-
	17,600	17,600

Illustration 34.

The Trial Balance of a concern has agreed but the following mistakes were discovered after the preparation of final Accounts.

(a) No adjustment entry was passed for an amount of ₹ 2,000 relating to outstanding rent.

(b) Purchase book was overcast by ₹ 1,000.

(c) ₹ 4,000 depreciation of Machinery has been omitted to be recorded in the book.

(d) ₹ 600 paid for purchase of stationary has been debited to Purchase A/c.

(e) Sales books was overcast by ₹ 1,000.

(f) ₹ 5,000 received in respect of Book Debt had been credited to Sales A/c.

Show the effect of the above errors in Profit and Loss Account & Balance Sheet.

Solution:

Effects of the errors in profit and loss A/c and Balance Sheet

Profit & Loss A/c.	Balance Sheet
(a) Profit was overstated by ₹ 2,000	(a) Capital was also overstated by ₹ 2,000 & outstanding Liability was understated by 2,000.
(b) Gross profit was under stated by ₹ 1,000 & also the Net Profit.	(b) Capital was understated by ₹ 1,000.
(c) Net Profit was overstated by ₹ 4,000.	(c) Machinery was overstated by ₹ 4,000 & so the Capital A/c was also overstated by ₹ 4,000.
(d) No effect on Net Profit.	(d) No effect in Balance Sheet.
(e) Gross Profit and Net Profit were overstated by ₹ 1,000.	(e) Capital was overstated by ₹ 1,000.
(f) Gross Profit & Net Profit were overstated by ₹ 5,000.	(f) Capital & Sundry Debtors were overstated by ₹ 5,000.

Adjusting Entry

Adjusting Entries are passed in the journal to bring into the books of accounts certain unrecorded items like closing stock, depreciation on fixed assets, etc. These are needed at the time of preparing the final accounts.

E.g. Depreciation A/c Dr.

To, Fixed Assets A/c

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 machinery[7] 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 capitalized.

In the instant case, the first part f expenditure i.e., Renovation etc., 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 exists 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 × 15% × $^9/_{12}$)	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 × 15% × $^6/_{12}$)	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 × 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 × 15% × $^6/_{12}$)	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 × 10% × $^9/_{12}$)	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

(vi) Prepaid Insurance A/c

(vii) Bank Overdraft A/c

(viii) 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 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) far 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
	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
	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	+1 month
	28.2.2013
Days of Grace	+ 3 days
	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	+ 30 days
	02.03.2013
Days of Grace	+ 3 days
	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 B ills 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

Illustration 1.

On 1.4.2017 A draws a bill on B for ₹1,00,000 3 months after date. B accepts the bills signs on it and returns to A. Pass necessary journal entries in the books of A and B in each of the following cases:

1. The bill is hold by A till maturity.
2. The bill is discounted with bank on 4.4.2017 at a discount of 6 % p.a.
3. The bill is endorsed to C to make a final settlement of a due of ₹1,05,000 on 1.4.2017.

Solution:

Working notes:

1. The bill is discounted with bank for 6% p.a . so the amount of discount will be

   =100000 x 6/100 x 3/12 = 6000 x 3/12 = ₹1,500.

Calculation is made for 3 months because the bill is for three months and is discounted with the bank exactly before three months before maturity.

2. Amount due to C was for ₹ 1,05,000. However the bill is given for ₹1,00,000 to make full and final settlement. Therefore Mr. A has received ₹5,000 as discount.

Important: Students must not confuse with **discount received** and **discount on bills.**

Journal

BOOKS OF A				BOOKS OF B			
Date	**Particulars**	**Debit ₹**	**Credit ₹**	**Date**	**Particulars**	**Debit ₹**	**Credit ₹**
1.4.2017	Billls Receivable A/c	1,00,000		1.4.2017	A	1,00,000	
	To B A/c		1,00,000		To Bills Payable		1,00,000
	(for the bill drawn)				(for the bill drawn)		
Situation 1				**Situation 1**			
4.7.2017	Cash A/c	1,00,000		4.7.2017	Bills payable A/c	1,00,000	
	To Billls Receivable A/c		1,00,000		To Cash A/c		1,00,000
	Amount received at maturity				Amount paid at maturity		
Situation 2				**Situation 2**			
4.4.2017	Bank A/c	98,500		**NO ENTRY IS REQUIRED**			
	Discount on bill A/c	1,500					
	To Bills receivable A/c		1,00,000				
	Bill discounted with bank						
Situation 3				**Situation 3**			
1.4.2017	To C A/c	1,05,000		**NO ENTRY IS REQUIRED**			
	To Bills Receivable A/c		1,00,000				
	To Discount received A/c		5,000				
	The bill is endorsed to C						
AT MATURITY							
Situation 2				**Situation 2**			
4.7.2017	**NO ENTRY**			4.7.2017	Bills payable A/c	1,00,000	
					To Bank A/c		1,00,000
					Amount paid at maturity		
Situation 3				**Situation 3**			
	NO ENTRY			4.7.2017	Bills payable A/c	1,00,000	
					To Bank A/c		1,00,000
					Amount paid at maturity		

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 2.

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

In the books of Sagar

Journal Entries

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

In the books of Kamal

Journal Entries

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

In the books of Amal

Journal Entries

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

In the books of State Bank of India

Journal Entries

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

Illustration 3.

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

Illustration 4.

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

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 Dr. To Bills Payable A/c (Being acceptance of Bala's bill)		1,20,000	 1,20,000
July, 25	Bills Payable A/c Dr. To Bala's A/c (Being cancellation of the bill for renewal)		1,20,000	 1,20,000
August,1	Interest A/c Dr. To Bala's A/c (being interest due to Bala)		4,800	 4,800
August,1	Bala's A/c Dr. To Bills Payable A/c (Being Bala's bill accepted with interest)		1,24,800	 1,24,800
Nov. 30	Bills Payable A/c Dr. To Bank A/c (Being settlement of the bill due)		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 5.

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

(i) Hema's acceptance to Nanda for ₹ 5,000 renewed for 3 month with interest at 10% p.a.

(ii) Nalini's acceptance to Hema was for ₹ 10,000 was retired one month before due date at a discount of 12% p.a.

(iii) Discounted Natasha's acceptance to Hema for ₹ 4,000 with the bank for ₹ 3,920

(iv) 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.

(v) 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 Dr. To, Nanda's A/c (Being cancellation of Nanda's bill for renewal)		5,000	 5,000
	Interest A/c Dr. To, Nanda's A/c (Being interest due to Nanda)		125	 125
	Nanda's A/c Dr. To, Bills Payable A/c (Being acceptance given for new bill)		5,125	 5,125

(ii)	Bank A/c	Dr.		9,900	
	Discount A/c	Dr.		100	
	To, Bills Receivable A/c				10,000
	(Being Nalini's acceptance retired at discount)				
(iii)	Bank A/c	Dr.		3,920	
	Discount A/c	Dr.		80	
	To, Bills Receivable A/c				4,000
	(Being Natasha's acceptance discounted)				
(iv)	Neela's A/c	Dr.		3,500	
	To, Bills Receivables A/c				3,500
	(Being Neela's acceptance cancelled for renewal)				
	Cash A/c	Dr.		100	
	To, Interest A/c				100
	(Being interest received from Neela in cash)				
	Bills Receivable A/c	Dr.		3,500	
	To, Neela's A/c				3,500
	(Being Neela acceptance for new bill)				
(v)	Bills Receivable A/c	Dr.		1,200	
	To, Geeta A/c				1,200
	Geeta A/c	Dr.		1,200	
	To, Bills Receivable A/c				1,200

Illustration 6.

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

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	Dr.		4,000	
	To, Y A/c				4,000
	(Goods purchased from Y)				
Jan 1	Y A/c	Dr.		4,000	
	To, Bills Payable A/c				4,000
	(Bills accepted for 3 months)				
March 1	Bills Payable A/c	Dr.		4,000	
	To, Cash A/c				3,956
	To, Rebate Received A/c				46
	(Bills retired under a rebate of 12% p.a.)				

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	Dr.	Drawer A/c	Dr.
	To, Drawee A/c		To, B/P A/c	
Discounting with bank	Bank A/c	Dr.		
	Discount A/c	Dr.	No Entry	
	To, B/R A/c			
Payment on due date	Drawee A/c	Dr.	B/P A/c	Dr.
	To, Bank A/c		To, Bank A/c	

Illustration 7.

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 8.

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

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 9.

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.		3,000	
	To, Ratan A/c				3,000
	(Bill drawn for mutual accommodation and accepted by Ratan.)				
	Bank A/c	Dr.		2,925	
	Discount A/c	Dr.		75	
	To, Bills Receivable A/c				3,000
	(Bill discounted by the bank.)				
	Ratan A/c	Dr.		1,000	
	To, Bank A/c				975
	To Discount A/c				25
	(1/3 Proceeds remitted to Ratan.)				
	Ratan A/c	Dr.		3,750	
	To, Bills Payable A/c				3,750
	(Bill accepted.)				
	Bank A/c	Dr.		175	
	Discount A/c	Dr.		75	
	To, Ratan A/c				250
	(Proceeds received from Ratan including discount charges.)				
	Bills Payable A/c	Dr.		3,750	
	To, Ratan A/c				3,750
	(Bill dishonored since e became insolvent.)				
	Ratan A/c	Dr.		2,250*	
	To, Bank A/c				1,800
	To Deficiency A/c				450
	(Cash paid to Ratan @80 paise in the rupee and balance transferred to deficiency account.)				

***** 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 To, Bills Payable A/c (Bill accepted for mutual accommodation)	Dr.		3,000	 3,000
	Bank A/c Discount A/c To, Rahim A/c ($\frac{1}{3}$ proceeds received from Rahim including discount)	Dr. Dr.		975 25	 1,000
	Bills Receivable A/c To, Rahim A/c (Bill drawn and accepted by Rahim)	Dr.		3,750	 3,750
	Bank A/c Discount A/c To, Bills Receivable A/c (Bill discounted)	Dr. Dr.		3,625 125	 3,750
	Rahim A/c To, Bank A/c "Discount A/c (Proceeds remitted to Rahim including discount)	Dr.		250	 175 75
	Rahim A/c To, Bank A/c (Bill honoured at maturity)	Dr.		3,750	 3,750
	Bills Payable A/c To, Bank A/c (Bill honoured at maturity)	Dr.		3,000	 3,000
	Bank A/c Bad Debt A/c To, Rahim A/c (Amount realised from the official liquidator of Rahim @ 80 paise in the rupee and the balance proved bad)	Dr. Dr.		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 as 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 Dr. To Goods Sent on Consignment	No Entry
On expenses for sending goods	Consignment A/c Dr. To Cash/Bank/Creditors for Expenses A/c	No Entry
For advance received from consignee	Cash/ Bank/ Bill Receivables A/c Dr. To Consignee's Personal A/c	Consignor's Personal A/c Dr. To Cash/ Bank/ Bills Payable A/c
On expenses incurred by consignee	Consignment A/c Dr. To Consignee's Personal A/c	Consignor's Personal A/c Dr. To Cash/ Bank/ Creditors for expenses A/c
On consignee reporting sales	Consignee's Personal A/c Dr. To Consignment A/c	Cash/ Bank/ Consignment Debtors A/c Dr. To Consignor's Personal A/c
For commission due	Consignment A/c Dr. To Consignee's Personal A/c	Consignor's Personal A/c Dr. To Commission A/c
For Bad Debts	Consignment A/c Dr. To Consignee's Personal A/c	Consignor's Personal A/c Dr. To Consignment Debtors A/c
For closing the consignment account	For profit : Consignment A/c Dr. To General Profit and Loss A/c. For Loss General Profit and Loss A/c Dr. To Consignment A/c	No entry
For the final settlement	Cash/ Bank/ B/R A/c Dr. To Consignee A/c	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 Dr. To Trading/ Purchases A/c	No entry
On closing stock	Stock on Consignment A/c Dr. To Consignment A/c	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 Dr. To, Consignment A/c
(ii)	**For Bad Debts –** No Entry
(iii)	**For Del Credere Commission —** Consignment A/c Dr. To, Consignee's Personal A/c

(b) When Del Credere Commission is not given

(i)	**For Credit Sales –** Consignment Debtors A/c Dr. To, Consignment A/c
(ii)	**For Bad Debts –** Consignment A/c Dr. To, Consignment Debtors A/c
(iii)	**(a) For realization of Cash —** Cash A/c Dr. To, Consignment Debtors A/c if collected by Consignor
	(b) Consignee's Personal A/c Dr. To, Consignment Debtors A/c 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 Dr. To, Consignor A/c
(ii)	**For Bad Debts –** Bad Debts A/c Dr. To, Consignment Debtors A/c
(iii)	**For realization of cash from cash from Debtors —** Cash/ Bank A/c Dr. To, Consignment Debtors A/c
(iv)	**For Closing Bad Debts A/c-** Commission Received A/c Dr. To, Bad Debts A/c

(b) When Del Credere Commission is not given –

There will be no entry against a bad debts entry in the books of consignee.

IN THE BOOKS OF CONSIGNOR

CONSIGNMENT ACCOUNT

Dr. **Cr.**

To Goods sent on consignment- at cost/ IP	₹	By Goods sent on consignment – loading	₹
To Bank – expenses incurred by consignor		By Consignee – sale	
To Consignee – expenses incurred by consignee + commission (ordinary + del credere)		By Consignment debtors – credit sale	
To Consignment debtors – bad debt (if Del credere commission is not paid)		By Goods lost in transit – at cost / IP	
To Stock Reserve – unloading		By Unsold stock - at cost / IP	
To Abnormal Loss – unloading			
To P/L A/c : profit on consignment		By P/L A/c : loss on consignment	

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.

The entry will be:

Stock on Consignment A/c Dr.

To, Consignment A/c

Needless to say that unsold stock on consignment will appear in the asset side of Balance Sheet.

Illustration 10.

X Ltd. of Gujrat purchased 5,000 sarees @ ₹ 100 per saree. Out of these 3,000 sarees were sent on consignment to Y Ltd. of Kolkata at the selling price of ₹ 150 per saree. The consignors paid ₹ 5,000 for packing and freight.

Y Ltd. sold 2,500 sarees @ ₹160 per saree and incurred ₹ 500 for selling expenses and remitted ₹2,50,000 to Gujrat on account. They are entitled to a commission of 5% on total sales plus a further of 25% commission on any surplus price realized over ₹ 150 per saree.

1,500 sarees were sold at Gujrat @ ₹ 110 per saree.

Owing to fall in market price, the value of stock of saree in hand is to be reduced by 5%. Your are required to prepare (i) Consignment Account, and (ii) Y Ltd. Account.

Solution:

(i) In the books of X Ltd.

Dr. Consignment Account Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Goods Sent on Consignment A/c (300 × ₹100)	3,00,000		By Y Ltd. A/c —sale proceeds (2,500 × ₹160)	4,00,000
	" Bank A/c —paying freight	5,000		" Stock on Consignment A/c (W.N. 1)	45,125
	" Y Ltd A/c				
	—selling expenses	500			
	—commissions (W.N. 2)	26,250			
	" Profit and Loss A/c —profit on consignment transferred	1,13,375			
		4,45,125			4,45,125

Dr. Y Ltd. A/c Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
	To Consignment A/c —sale proceeds	4,00,000		By Bank A/c —advance	2,50,000
				" Consignment A/c	
				—selling expenses	500
				—commissions	26,250
				" Balance c/d	1,23,250
		4,00,000			4,00,000

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,

Value of closing stock will be = Total Value of goods sent × $\frac{\text{Unsold quantity}}{\text{Good quantity received by consignee}}$

Illustration 11.

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.	27,000

∴ Value of unsold stock (1,000 – 800 – 100) = 100 kgs. will be = ₹ 27,000 x $\frac{100 \text{ kgs.}}{900 \text{ kgs.}}$

= ₹ 3,000

(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 12.

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		18,75,000	By, Zing A/c	19,87,500
(5,000 x ₹ 375)			- Sale proceeds (3,975 x ₹ 500)	
To, Bank A/c			By, Consignment Debtors A/c	
- Freight	50,000		- Credit Sales (25 x ₹ 500)	12,500
- Insurance	7,500	57,500	By, Abnormal Loss A/c (W.N. 1)	1,93,250
To, Zing A/c			By, Stock on Consignment A/c	2,01,250
- Custom Duty	72,000		(W.N.2)	
- Godown Rent, Advertisement etc	10,000			
- Commissions @5% on total Sales		1,82,000		
(4,000×500×5%)	1,00,000			
To, Consignment Debtors A/c				
- Bad Debts		12,500		
To, Profit and Loss A/c				
- Profit on Consignment transferred		2,67,500		
		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	
$\left(\frac{₹\ 19,32,500 \times 500}{5,000}\right)$	(1,93,250)
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 13.

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				2013		
Jan. 1	To Goods sent on Consignment A/c		8,00,000	Jan. 7	By, Abnormal Loss A/c	21,250
	(1,000 x ₹ 800)			Mar.31	By, Central Oil Co. A/c	9,00,000
Mar.31	To, Bank A/c – Expenses		50,000		Sale proceeds	
	To, Central Oil Co. A/c				(750 x ₹ 1,200)	
	Freight	11,250			By, Stock on	1,76,842
	Godown Rent	10,000			Consignment A/c	
	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			2013		
Mar.31	To, Consignment to Kolkata A/c -Sale Proceeds	9,00,000	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			2013		
Jan. 7	To, Consignment to Kolkata A/c	21,250	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**

Therefore, Value of Stock = $200 \times ₹\ \frac{₹\ 8,40,000}{950}$ = ₹ 1, 76, 842 (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 14.

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. **Consignment Account** **Cr.**

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 - Freight and Misc. Expenses - Godown Rent	 4,000 3,000	By, Abnormal Loss A/c	11,000
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% - Del credere Commission @ 5%	 5,000 2,500		
To, Profit and Loss A/c - Profit on Consignment A/c	 9,500		
	83,000		**83,000**

Dr. **Y Account** **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To, Consignment A/c – Sale proceeds	50,000	By, Consignment A/c - Expenses - Commission	 7,000 7,500
		By, Balance c/d	35,500
	50,000		**50,000**

Dr. **Abnormal Loss Account** **Cr.**

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 - Loss transferred	4,000
	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

$\therefore$ 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	5,000
Invoice Price of 100 sets	55,000
Less: Lost In Transit	11,000
$\frac{20 \times 55,000}{100}$	44,000
Add: Non recurring Expenses of Mr. Y	4,000
I. P. of 80 sets	48,000

$\therefore$ 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 15.

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

Dr. Consignment to Patna Account Cr.

Particulars		Amount (₹)	Particulars	Amount (₹)
To Goods Sent on Consignment A/c		50,000	By, Goods Sent on Consignment A/c	10,000
To, Bank A/c			- Loading	
Freight	2,500			
Insurance	1,500	4,000	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	7,300		
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. Goods Destroyed by Fire Account 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. Pandey Account 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**

$\therefore$ Goods available for sale $\frac{9}{10} - (\frac{1}{9}\text{th of } \frac{9}{10}) = \frac{9}{10} - \frac{1}{10} = \frac{8}{10}$

Goods sold $\frac{1}{2}$ $\therefore$ Unsold goods = $\frac{8}{10} - \frac{1}{2} = \frac{3}{10}$th

$\therefore$ Value of unsold stock = ₹ 44,800 x $\frac{3}{10} \times \frac{10}{8}$ = ₹ 16,800

Loading on goods destroyed = ₹ 10,000 x $\frac{2}{10}$ = ₹ 2,000

Loading on unsold stock = ₹ 10,000 x $\frac{3}{10}$ = ₹ 3,000.

Illustration 16.

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 accidently 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

Dr. Consignment to Delhi Account 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

M/s Gupta & Sons' Account

Dr. Particulars	Amount (₹)	Particulars	Amount (₹) Cr.
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 17.

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

Dr. Consignment to Rita Agencies Account 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. Rita Agencies Account 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

Dr. **Sangita Machine Corporation Account** **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 18.

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

Dr. Consignment to Delhi Account Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To, Goods Sent on Consignment A/c	28,400	By, Goods Sent on Consignment A/c	7,500
To, Y A/c – Commission	2,394	(Loading) ₹ (28,400- 20,900)	
To, Stock Reserve A/c	1,700	By, Shyam A/c – Sale proceeds	26,760
₹(6,920 – 5,220)		By, Stock on Consignment A/c	6,920
To, Profit and Loss A/c-	8,686		
Profit on consignment transferred			
	41,180		41,180

Dr. Shyam Account Cr.

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. Goods sent on Consignment Account Cr.

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 19.

R of Ranchi consigned goods costing ₹ 1,60,000 to B of Bombay. The terms of the consignment were:

(a) Consignee to get a commission of 5 per cent on cash sales and 4 per cent on credit sales.

(b) 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: $\frac{20,000}{1,60,000}$ x ₹ 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

The basic features of a Joint Venture business are :

(i) It is done for a specific purpose and hence has a limited duration.

(ii) The partners are called co-venturers.

(iii) The profit or loss on joint venture is shared between the co-venturers in the agreed ratio.

(iv) The co-venturers may or may not contribute initial capital.

(v) The JV is dissolved once the purpose of the business is over.

(vi) The accounts of the co-venturers are settled immediately on dissolution.

(vii) A joint venture has no name.

Accounting Entries

There may be three ways of maintaining the books of account for the joint venture business. They are:

(a) Where separate books of accounts are maintained

(b) Where no separate books of accounts are maintained

(c) Memorandum Joint Venture

(a) When Separate Books are Maintained

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to know profit or loss on account of the joint venture.

(a) Like a normal P & L A/c, a "Joint Venture A/c" is opened which records all transactions related to the activities carried out. The net result of this a/c will be either profit or loss.

(b) To record cash/bank transactions a "Joint Bank A/c" is maintained. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution of the venture.

(c) To record transaction related to co-venturers, "Co-Venturers' personal A/cs" are also maintained.

The accounting entries are normally as follows:

No.	Transaction	Entry
1	Contribution of co-venturers	Joint Bank A/c Dr. [with total] To, Co-Venturers A/c [with individual sum contributed]
2	On purchase of goods	Joint Venture A/c Dr. To, Joint Bank/ Supplier's/ Co-Venturers A/c
3	On making payment to suppliers of goods	Supplier's A/c. Dr. [with total] To, Cash/ Joint Bank/ B/P A/c [with payment made] To, Joint Venture A/c [with discount received]
4	On supply of goods out of own stock by any of the co-venturers	Joint Venture A/c Dr. To, Co-Venturer's Personal A/c
5	On payment of expenses	Joint Venture A/c Dr. To, Joint Bank/ Co-Venturers A/c

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

ACCOUNTING SYSTEM

1. When a separate set of books is kept
2. When no separate set of books is kept

Generally when the size of the business is large a **separate set of books** is maintained by opening the following accounts:

(a) Joint Bank account

(b) Joint Venture account and

(c) Co venturers account

Follow the following format to understand how the accounts are maintained:

Joint Venture Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Joint Bank Account – Purchase		By Joint Bank Account – Sales	
To Co Venturers A/C – Goods Supplied By Co Venturers		By Co Venturers A/c – Goods Taken Over By Co Venturers	
To Joint Bank Account – Expenses		By Debtors A/c – Credit Sale	
To Crditors – Credit Purchase			
To Co Venturers A/C – Profit On Venture			
Total		Total	

Joint Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Co Venturers Account – Cash Introduced By Co Venturers		By Creditors – Payment To Creditors	
To Debtors – Collection From Debtors		By Joint Venture – Purchase	
To Joint Venture – Sales		By Joint Venture – Expenses	
		BY Co Venturers – Final Payment	
Total		Total	

Co Ventures Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Joint Venture – Goods Taken Over		By Joint Bank Account – Cash Introduced	
		BY CO VENTURERS – GOODS SUPPLIED	
To Joint Bank – Final Payment			
Total		Total	

1. **JOINT VENTURE ACCOUNT :** in this account in the debit side all expenses(paid personally by the co venturers or out of join bank) irrespective of its nature (i.e capital or revenue) are recorded. In the credit side all sales (to outsiders as well a to the co venturers) are recorded. I n this way the difference is considered as profit / Loss on venture transferred to co venturers account in their profit sharing ratio.

2. **JOINT BANK ACCOUNT :** This is basically the cash book of the business. All cash inflows are recorded in the debit side and the outflows are recorded in the credit side. Final settlement of the co venturers are lastly put into this account so that it tallies.

3. **CO VENTURERS ACCOUNT :** It is like the capital account in the partnership business and is opened in multicolumnar form to record the transaction of individual venture. Balance in this account refer to the claim of a co venture to / from the business and is settled through the joint bank account.

Note :

1. Since the type of business is very short lived normally a firm name is not used in this kind of business.

2. As a basic feature of accounting for special transaction all transactions are recorded in the name of joint venture. You must refer to consignment accounts where all expenses and incomes were charged to a single consignment account. Similarly here all expenses and incomes of the business are recorded in the name of joint venture account so that the transactions of the main business are not mixed with this kind of terminable business.

Illustration 20.

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:

(a) Advance received from the company ₹ 50,00,000

(b) Wages to contractors ₹ 10,00,000

(c) Bought materials ₹ 60,00,000

(d) Material supplied by Prabir ₹ 10,00,000

(e) Material supplied by Mihir ₹ 15,00,000

(f) 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 To, Joint Venture A/c - loss	18,00,000 10,00,000	By, Joint Bank A/c	25,00,000
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 To, Joint Venture A/c – Loss	300,000 500,000	By, Joint Bank A/c	15,00,000
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 21.

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 paisa per share, 20% at a price of ₹ 9.75 less brokerage 50 paisa 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	10,000	By, Joint Bank A/c	9,063
Cost of 1,000 shares @ ₹ 10		Sale proceeds of shares	
		By, P's Capital A/c	1,125
To, Capital A/c		Shares taken	
– Profit on Venture :		By, Q's Capital A/c	1,125
– P-788		Shares taken	
– 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.	250	
	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%		9,063

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	Dr.
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	Dr.
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	Dr. Dr.
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	Dr.
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	Dr.
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	Dr.
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	Dr.
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	Dr.
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	Dr. Dr.

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.

When the size of the business is small and co venturers are living in distant places this method is generally applicable and in that case the venturers write transactions in his own books. This may again be done in two ways:

(a) **When venturer maintains a complete records of all joint venture transactions:**

Each co-venturer will record the transactions in the following ledger —

Joint venture account and personal account of joint venture. For example if Anil and Mukesh are two venturers Anil will keep Joint venture account and Mukesh account . In the same way Mukesh will keep Joint Venture account and Anil account.

Example:

Anil and Mukesh enter into a venture to take a job for ₹2,40,000. they provide the following information regarding the expenditure incurred by them:

	ANIL	MUKESH
	₹	₹
Materials	68,000	50,000
Cement	13,000	17,000
Wages		27,000
Architects fees	10,000	
License fees		5,000
Plant		20,000

Plant was valued at ₹10,000 at the end of the contract and Mukesh agreed to take it at that value. Contract amount was received by Anil. Show necessary accounts.

Solution:

IN THE BOOKS OF ANIL

JOINT VENTURE ACCOUNT

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c:		By Bank A/c : contract price	2,40,000
Materials	68,000	By Mukesh A/c : plant taken over	10,000
Cement	13,000		
Architects Fees	10,000		
To Mukesh A/c:			
Materials	50,000		
Cement	17,000		
Wages	27,000		
License Fees	5,000		
Plant	20,000		
To Mukesh A/c: Share of Profit	20,000		
To P/L A/c : Share of Profit	20,000		
Total	2,50,000	Total	2,50,000

CO VENTURER (MUKESH) ACCOUNT

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Joint Venture A/c	10,000	By Joint venture A/c	1,19,000
		By Plant	10,000
To Balance C/d	1,29,000		
Total	1,39,000	Total	1,39,000

IN THE BOOKS OF MUKESH

JOINT VENTURE ACCOUNT

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Anil A/c:		By Anil A/c : Contract Price	2,40,000
Materials	68,000	By Mukesh A/c : Plant Taken Over	10,000
Cement	13,000		
Architects Fees	10,000		
To Bank A/c:			
Materials	50,000		
Cement	17,000		
Wages	27,000		
License Fees	5,000		
Plant	20,000		
To Mukesh A/c: Share of Profit	20,000		
To P/L A/C : Share of Profit	20,000		
Total	2,50,000	Total	2,50,000

CO VENTURER (ANIL) ACCOUNT

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Joint Venture A/c	2,40,000	By Joint Venture A/c	91,000
		By Joint Venture	20,000
		By Balance C/d	1,29,000
Total	2,40,000	Total	2,40,000

(b) **When venturer maintains a records of his own transactions (memorandum method)**

Example:

A and B decided to work on a joint venture for the sale of electric motors. On 21.05.2016 A purchased 200 electric motors @ ₹175 each and dispatched 150 motors to B incurring ₹1,000 as freight and insurance charges, 10 motors were damaged in transit. On 01.02.2017 ₹500 was received by A from the insurance company in full settlement of claim. On 15.03.2017 A sold 50 motors @₹225 each. He received ₹15,000 from B on 01.04.2017.

On 25.05.2017 B took delivery of motors and incurred the following expenses:

Clearing charges ₹125, repairs charges for the damaged motors in transit ₹300, and godown rent ₹600, B sold the electric motors as follows:

On 01.02.2017 10 damaged motors @₹.170 each, on 15.03.2018 40 motors @₹200/- each and 01.04.2017 20 motors @₹315 each, on 03.04.2017 80 motors @ ₹250 each.

It is agreed that they are entitled to commission @ 10 % on the respective sales effected by them and that profits and losses will be shared by A and B in the ratio of 2:1. B remits to A the balance of money due on 30.04.2017. Prepare joint venture A/c with B in the books of A and Memorandum joint venture account.

Solution:

IN THE BOOKS OF A

JOINT VENTURE WITH B ACCOUNT

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c : Purchase	35,000	By Bank : Insurance Claim	500
To Bank A/c : Freight	1,000	By Bank : Sale Proceeds	11,250
To Commission Received	1,125	By Bank : Amount Received	15,000
To P/L A/c: Share Of Profit	4,000	By Bank : Balance Received	14,375
Total	41,125	Total	41,125

MEMORANDUM JOINT VENTURE ACCOUNT

Dr. **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To A :			By A :		
Cost of Motors	35,000		Sale	11,250	
Freight And Insurance	18,000		Insurance Claim	500	11,750
Commission	1,125	37,125			
To B :					
Clearing Charges	125		By B : Sale		36,000
Repairs	300				
Godown Rent	600				
Commission	3,600	4,625			
To Net Profit:					
A 2/3	4,000				
B 1/3	2,000	6,000			
Total		47,750	Total		47,750

Illustration 22.

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

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	Dr.	
	To, Joint Venture with …………..A/c		
1.	(b) On discounting Bills Receivable:		
	Bank A/c	Dr.	(with net proceeds)
	Joint Venture with …………..A/c	Dr.	(with discount)
	To, Bills Receivable A/c		(with total)
2.	On purchase of goods:		
	Joint Venture with …………..A/c	Dr.	(with total)
	To, Cash/Bank A/c		(with cash purchase)
	To, Supplier's A/c		(with credit purchase)
3.	On making payment to supplier		
	Supplier's A/c	Dr.	(with total)
	To, Cash/Bank/Bills Payable A/c		(with payment made)
	To, Joint Venture with …………..A/c		(with discount received)
4.	On supply of goods out of own stock:		
	Joint Venture with …………..A/c	Dr.	
	To, Purchases/Goods sent on Joint Venture A/c		(if supplies at cost)
	To, Sales A/c		(if supplies at profit)
5.	On payment of expenses:		
	Joint Venture with …………..A/c	Dr.	(with total)
	To, Cash/Bank A/c		(with cash expenses)
	To, Creditor's A/c		(with outstanding expenses)
6.	On sale of goods:		
	Cash/Bank A/c	Dr.	(with cash sales)
	Customer's A/c	Dr.	(with credit sales)
	To, Joint Venture with …………..A/c		(with total)
7.	On receiving payment from a customer:		
	Cash/Bank A/c	Dr.	(with the payment received)
	Joint Venture with …………..A/c	Dr.	(discount allowed/bad debt)
	To, Customer's A/c		(with total)

8.	On taking away of unsold goods: Goods sent on Joint Venture A/c Dr. To, Joint Venture with ………….A/c	
9.	On considering some commission/salary to the Co-Venturer: Joint Venture with ………….A/c Dr. To, Commission/Salary A/c	
10.	On recording the share of Profit/Loss: (a) When profit- Joint Venture with ………….A/c Dr. To, Profit & Loss A/c (b) When loss- Profit & Loss A/c Dr. To, Joint Venture with ………….A/c	
11.	On settlement of balance of Joint Venture with ……..A/c: (a) When there is a debit balance: Cash/Bank A/c Dr. To, Joint Venture with ………….A/c (b) When there is a credit balance: Joint Venture with ………….A/c Dr. To, Cash/Bank A/c	

Illustration 23.

M and N decided to work in partnership with the following scheme, agreeing to share profits as under :

M — ¾th share.

N—¼th 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 — ¾	54,750				
To, N — ¼	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
		By, Bank : Sale Proceeds	50,000
To, Share of Profit	54,750		
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 24.

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 25.

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

Dr. Consignment to Lodha Account 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	
To, Lodha's A/c :		(stock transferred on conversion to JV)	11,250
Freight & Carriage	1,000		
Commission	2,400		
To, P & L A/c	11,850		
	59,250		**59,250**

Dr. Lodha's Account 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**

Dr. Joint Venture with Lodha Account 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

Dr. Daga's Account (as consignor) 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 26.

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 (₹)**
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**

Books of Sunit

Dr. **Satish's Account** Cr.

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To, Joint Venture A/c - sales	1,80,000	By, Joint Venture A/c - expenses	32,500
To, Bank A/c - balance paid	71,950	By, Joint Venture A/c - cost of shares	1,50,000
		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 CLAIM (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 To Purchase (less returns) To Any other Expense like Wages, etc. chargeable to Trading A/c To Gross Profit (Calculated at usual rate on sales)		By Sales (less returns) By Stock on sale Return (If goods sent on approval are lying with customers but yet to be confirmed, then Cost price of such goods) 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 27.

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 (bal. fig.)	1,00,000 (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	6,000
	66,000

Amount of Claim	₹
Closing Stock	1,32,000
Less: Stock Salvaged	4,000
Actual Value of Stock last	1,28,000
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) x100

= (₹ 60,000/₹ 1,20,000)×100

= 50%

Illustration 28.

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			2013		
Jan 1	To Balance b/d	70,000	May 31	By Cash Received	3,40,000
May 31	,, Sales (bal. fig.)	3,40,000		,, Bad Debts	3,500[1]
				,, Balance c/d	66,500
		4,10,000		(excluding form agent)	4,10,000

Creditors Account

Dr. **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013			2013		
May, 31	To Cash paid	2,20,000	Jan. 1	By Balance b/d	20,000
	,, Discount Received	1,000	2013		
	,, Balance c/d	30,000	May 31	,, Purchase (bal. fig)	2,31,000
		2,51,000			2,51,000

Godown Stock Account

Dr. **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2012		34,000	2012	By Cost of Goods Sold	2,29,066[2]
May, 31	To Balance b/d		May	,, Stock at Agents	3,067[3]
	(₹ 36,000 – ₹ 2,000)	2,31,000	31.	,, Stock Destroyed by fire (bal. fig)	32,867
	,, Purchase from the Creditors)	2,65,000			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 ($^2/_3$ 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 × $^2/_3$)
	5,067
Less: Agents' hand at the beginning	2,000
	3,067

Illustration 29.

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	5,200	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	41,360
Loss of Stock	**1,65,440**

Amount of claim applying Average Clause

$$\text{Amount of Claim} = \text{Actual Loss} \times \frac{\text{Amount of Policy}}{\text{Value of stocks at the date of fire}}$$

= ₹ 1,65,440 × (₹ 1,60,000/ ₹ 2,06,800)

= ₹ 1,28,000

Illustration 30.

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. **Cr.**

Particulars	Amount ₹	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 × 100 = 20%

Trading A/c for the period (from 1.1.13-1.4.13)

Dr. **Cr.**

Particulars	Amount ₹	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 × (1,71,000 / 2,28,000) = 1,50,000/-

Illustration 31.

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	4,800	3,05,200	Add: Loss on value of abnormal items	200	80,200
" Gross Profit (bal. fig.)		1,00,000	(₹5,000 – ₹4,800)		
		4,80,200			**4,80,200**

$$\text{Percentage of Gross Profit on sales} = \frac{₹\ 1,00,000}{₹\ 4,00,000} \times 100$$

$$= 25\%$$

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)	2,000	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%	3,05,200	4,800	3,10,000	,, Gross Loss			
on sales	1,00,000	---	1,00,000		---	5,000	5,000
	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	5,000
	79,100

Illustration 32.

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	1,20,700
Less: Stock Salvaged	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 × $\frac{\text{Net Profit + Insured Standing Charges}}{\text{Net Profit + All Standing Charges}}$ or

   Additional Expenses × $\frac{\text{Gross Profit on Annual Turnover}}{\text{Gross Profit on Annual Turnover + Uninsured Standing Charges}}$

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 × $\frac{\text{Policy Value}}{\text{Gross Profit on Aannual Turnover}}$

Illustration 33.

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

= (Net Profit + Insured Standing Charges) / Sales x 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 34.

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.

(i) The net profit for the year ended 31st December, 2012 was ₹ 20,000

(ii) 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.

(iii) 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.

(iv) The savings in insured standing charges in consequence of the fire amounted to ₹ 1,500.

(v) 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 31st December, 2012	95,000
Less: Actual Sales (four months ended 31st December, 2013)	15,000
Short Sales	80,000

Reduction of Gross Profit

$$\text{G.P. Ratio} = \frac{\text{Net Profit + Insured Standing Charges}}{\text{Turnover}} \times 100$$

= [₹ 20,000 + ₹ 28,000/ ₹ 2,40,000) × 100] = 20%

∴ Reduction in gross profit in short sales = ₹ 80,000 x 20% = ₹ 16,000

Additional cost of working for mitigating damage ₹ 600

As all standing charges are not insured, amount admissible for additional expenses

$$= \frac{\text{Net Profit + Insured Standing Charges}}{\text{Net Profit + All Insured Standing Charges}} \times \text{Additional Expenses}$$

$$= \frac{₹\ 20{,}000 + ₹\ 28{,}000}{₹\ 20{,}000 + ₹\ 30{,}000} \times ₹\ 600 = ₹\ 576$$

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

$$\text{Net Claim} = \frac{\text{Policy Amount}}{\text{Gross Profit on Aannual Turnover}} \times \text{Gross Claim} \quad = \frac{₹\ 42{,}000}{₹\ 49{,}000^*} \times ₹\ 15{,}076 \quad = ₹\ 12{,}922$$

* Gross Profit on Annual Turnover = Sales for 12 months ended 31st August, 2012 is ₹ 2,45,000

= ₹ 2,45,000 × 20% = ₹ 49,000

Illustration 35.

A fire occurred on 1st July, 2013 in the premises of A. Ltd. and business was practically disorganized up to 30th November 2013. From the books of account, the following information was extracted:

Sl. No.	Particulars	Amount ₹
1.	Actual turnover from 1st July 2013 to November, 2013	1,20,000
2.	Turnover from 1st July to 30th 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 30th 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		1,20,000
(i.e., from 1.7.2013 to 30.11.2013)		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) $\frac{\text{Net Profit+Insured Standing Charges}}{\text{Net Profit +All Standing Charges}} \times \text{Additional Expenses}$	16,972	16,972
$= \frac{3,96,000}{₹4,20,000} \times ₹\ 18,000 = 16,972$		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 : $\frac{₹3,00,000}{₹10,00,000}$ x 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:

(i) Give Journal Entries and

(ii) 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 1st April, 2013	2,20,500
Stock at cost on 31st March, 2014	2,38,800
Purchases less returns, year ended 31st March, 2014	11,94,000
Sales less returns, year ended 31st March, 2014	14,61,000
Purchases less returns, 1st April, 2014 to 15th December, 2014	10,15,000
Sales less returns, 1st April, 2014 to 15th 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:

(i) Consignment Account and

(ii) 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

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 BAD DEBTS

Debts : The amount which is receivable from a person or a concern for supplying goods or services is called Debt.

Debts may be classified into :

(i) Bad debts;

(ii) Doubtful debts and

(iii) Good debts

(i) Bad Debts : Bad debts are uncollectable or irrecoverable debt or debts which are impossible to collect is called Bad Debts. If it is definitely known that amount recoverable from a customer can not be realized at all, it should be treated as a business loss and should be adjusted against profit. In short, the amount of bad debt should be transferred to Profit and Loss Account for the current year to confirm the principles of matching.

(ii) Doubtful Debts : The debts which will be receivable or cannot be ascertainable at the date of preparing the final accounts (i.e., the debts which are doubtful to realise) is known as doubtful debts. Practically it cannot be treated as a loss on that particular date, as such, it cannot be written off. But, it should be charged against Profit and Loss Account on the basis of past experience of the firm.

(iii) Good Debts : The debts which are not bad i.e., there is neither any possibility of bad debts nor any doubts about its realization, is called good debts. As such, no provision is necessary for it.

Provisions for Doubtful Debts

For any business purchase and sales are the most regular and main activity. This attracts business connection with lots of people either giving or taking benefits of credit.

Debtors are those persons who take the benefit of delayed payment and creditors allow credit period to pay later. That means in each case there is a time gap between the date of sale or purchase and the date of recovery of cash or payment of cash. During this period there are three possibilities regarding the activities of debtors:

1. The debt will be collected in time.
2. The debt may not be collected at all.
3. The debt may be cleared before due date.

Similarly during this period there are three possibilities regarding the activities of creditors:

1. The debt will be paid in time.
2. The debt may not be paid at all.
3. The debt may be cleared before due date.
   (a) In the above explanation in case 1 when the debts are collected in time we call the debtors to be good.
   (b) In the above explanation in case 2 when the debts are not collected at all we call the debtors to be bad.
   (c) In the above explanation in case 3 when the debts are collected before due date we call the debtors to be good and they are allowed cash discount as a reward to pay earlier.

Whatever be the case, from the date of sale to the date of ultimate collection of debt there remains an anxiety on behalf of the seller for which a seller makes provision from profit and loss account to protect such loss beforehand. Let us see the following chart:

	Debtors ↓	
1. Bad	**2. Doubtful**	**3. Good**

The debtors becoming bad are deleted from the list of debtors and the amount is deducted for the amount of gross debtors. The balance remains is all doubtful and hence provision for doubtful debt is maintained on the amount of doubtful debt. When such provision is also deducted from the net debtors the balance remains is expected to be good and are supposed to clear their dues in due time. Therefore a provision for discount allowed is made on such amount.

Let us see the same chart with some figure added:

	Debtors (₹1,00,000) ↓	
1. Bad (₹2,000)	**2. Doubtful (₹98,000)**	**3. Good (₹88,200)**

The above chart is explained below which will help to solve sums.

		₹
	Debtors	1,00,000
Less	Bad debt	2,000
	Doubtful	98,000
Less Provision for doubtful debt @10 %(say)		9,800
	Good	88,200
Less provision for discount @ 5% (say)		4,410
	Net balance	83,790

Accounting Steps

The 1st year

(a) For Bad Debts

Bad Debts A/c Dr.

To Sundry Debtors A/c

(b) For creating provision for Doubtful Debts

Profit and Loss A/c Dr.

To Provision for Doubtful Debts A/c

(c) For Transferring Bad Debts

Profit and Loss A/c Dr.

To Bad Debts A/c

The Second/ subsequent year

(a) (i) For Bad Debts

Bad Debts A/c Dr.

To Sundry Debtors A/c

(ii) Profit and Loss A/c Dr.

To Bad Debts A/c

(b) For provision of Doubtful Debts

(i) If closing provision is more than the opening provision-

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

Example:

The provision for Doubtful Debt A/c shows a balance of ₹5,000 on Jan 01, 2014. The bad debt during the year 2014 amounted to ₹3,000. The sundry debtors on Dec 31 2014 were ₹ 50,000. On Dec 31 2014 there was an additional bad debt of ₹ 3000. Create a new provision @ 10 % on debtors. Bad debt recovered ₹ 500.

You are required to show necessary ledger accounts and balance sheet.

Solution:

Provision for Doubtful Debt Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bad Debt	6,000	By Balance b/d	5,000
(3000+3000)			
To Balance c/d	4,700	By P/L A/C	5,700
(50000-3000) × 10%			
	10,700		10,700

Bad Debt Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Sundry Debtors	6,000	By Provision for Doubtful Debt A/c	6,000
(3,000+3,000)			
	6,000		6,000

Bad Debt Recovery Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To P/L A/c	500	By Bank A/c	500
	500		500

Profit and Loss Account (includes)

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Provision for Doubtful Debt A/c		By	
New Provision	4,700		
Add Bad Debt	6,000		
	10,700		
Less Old Provision	5,000		
	5,700		

Balance sheet (includes)

Liabilities	₹	Assets	₹
		Sundry Debtors	50,000
		Less Further Bad Debt	3,000
			47,000
		Less New Provision	4,700
			42,300

Note 1. Similar treatment will be done for discount allowed and provision for discount allowed.

Note 2. Further bad debt should only be deducted from the debtors because the bad debt during the year is already adjusted with debtors.

Illustration 1.

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 ....

Dr. **Bad Debts Account** **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. **Provision for Bad Debts Account** **Cr.**

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
31.12.2012	To, Balance c/d (5% on ₹1,25,000)	6,250	01.01.2012 31.12.2012	By, Balance b/d "Profit and Loss A/c (Bal Trf)	5,000 1,250
		6,250			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 31st Dec, 2012** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Bad Debts A/c		3,000		
" Provision for Bad Debts	6,250			
Less: Existing Provision	5,000	1,250		

Dr. **Profit and Loss Account (Extract) 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: Existing Provision <u>2,500</u>	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 "Balance c/d (5% on ₹1,25,000)	3,000 6,250	2012 Jan. 1 2012 Dec. 31	By, Balance b/d "Profit and Loss A/c (Bal fig)	5,000 4,250
		9,250			9,250
2013 Dec. 31	To, Bad debts A/c "Profit and Loss A/c "Balance c/d (2.5% on 1,00,000)	2,500 1,250 2,500	2013 Jan.1	By, Balance b/d	6,250
		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 Less: Old	 6,250 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 Less: Provision required	6,250 2,500	 3,750

The Balance Sheet under this method will be similar to the First Method stated above.

Illustration 2.

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)

Dr. For the year ended 31st Dec, 2013 Cr.

Particulars	(₹)	Particulars	(₹)
To Bad Debts A/c. 900 Add: Further Bad Debts 400	1,300	By, Provision for Bad Debts A/c Existing Provision 5,000 Less: New Provision 2,000	3,000

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

Provision for Discount On Debtors:

We know that Cash discount is allowed by the suppliers to customer for prompt settlement of cash. Naturally a provision is created for this purpose. Thus, the provision which is created on Sundry Debtors for allowing discount on receipt of Cash in that accounting period is called Provision for Discount on Debtors. It is needless to say that if the customer pays their debts before the due dates, they may claim discounts and that is why discount is allowed to debtors for prompt settlement is an usual way. Where goods are sold on credit, debtors accounts are debited but the amount may not be realized in this same accounting periods. Naturally, a possible aims to allow discount whether cash is received. The same will happen in the next accounting period. Due to this reason a provision for discount on debtors is made on the basis of past experience at an estimate rate on Sundry Debtors. Care should be taken while calculating discount. Discount should be calculated at a specified rate on of debtors (i.e. after discounting bad debts and provision for bad debts)

Accounting Steps

For the First year

(a) (i) For Discount Allowed-

Discount Allowed A/c Dr.

To, Sundry Debtors A/c

(ii) When Discount Allowed is transferred

Discount Allowed A/c Dr.

To, Sundry Debtors A/c

(b) For Provision for Discount on Debtors –

Profit & Loss A/c Dr.

To, Provision for Disc on Debtors A/c

For the Second/ Subsequent year

(a) (i) For Discount Allowed-

Discount Allowed A/c Dr.

To, Sundry Debtor A/c

(ii) For Provision for Discount on Debtors –

Provision for Discount on Debtor A/c Dr.

To, Discount Allowed A/c

(b) Next year provision is estimated-

(i) If new provision is more than old one-

Profit and Loss A/c Dr.

To, Provision for Discount on Debtor A/c

(ii) If new provision is less than old one-

Provision for Discount on Debtor A/c Dr.

To, Profit and Loss A/c

Illustration 3.

On 01.04.2012, M/s Singh Bros. had a provision for bad debts of ₹ 6,500 against their book debts. During 2012-13, ₹ 4,200 proved irrecoverable and it was desired to maintain the provision for bad debts @4% on debtors which stood at ₹ 1,95,000 before writing off Bad Debts. They also decided to maintain a provision for discount on debtors @2%. Show Provision for Bad Debt Account and Provision for Discount on Debtors Account as would appear in the books of the firm in 2012-13.

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	7,632	31-3-2013	" Profit & Loss A/c	5,332
	(4% on ₹1,95,000-₹4,200 or ₹1,90,800)			-further provision required	
		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	3,663	1-4-2012	By, Balance b/d	—
	[2% on (₹1,95,000-₹4,200 - ₹ 7,632)]		31-3-2013	" Profit & Loss A/c	3,663
				-further provision required	
		3,663			3,663

Illustration 4.

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 much, transferred to current year's Profit and Loss Account. Now, if the amount of bad dent 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 5.

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	To, Sundry Debtors A/c	3,000	2013	By, Provision for Bad Debt A/c	3,800
Sept. 30			Dec. 31		
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	To, Bad Debt A/c	3,800	2013	By, Balance b/d	5,000
Dec. 31	" Balance c/d	3,920	Dec. 31		
	[10% on ₹ 39,200			" Profit & Loss A/c	2,720
	(₹ 40,000 - ₹ 800)]			-for the provision required	
		7,720			7,720

Workings : Calculation of '%' of Provision for bad debts —

(5,000/50,000 × 100) = 10%

Profit & Loss Account (Extract)

Dr. **For the year ended 31.12.2012** **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

3.3 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 6.

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

Dr. **For the year ended 31st March, 2013.** 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. - Gross profit transferred		98,000			
		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		Gross Profit	
(transferred from Trading A/c)		(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 7.

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				
Add: further Bad Debts	2,000	4,000	" Discount received		2,000
" Depreciation on Plant & Machinery @10% on ₹ 80,000		8,000	" Provisions for Bad Debts	4,000	
" Capital A/c. (Net Profit Transferred)		66,100	Less: New Provision @ 5% on (₹ 40,000 – ₹ 2,000)	1,900	2,100
		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 To Transfer to General Reserve To Surplus carried to Capital A/c		By Net profit transferred from P & L A/c	
Total		Total	

Illustration 8.

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

Dr. **For the year ended 31st March, 2013** **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		1970[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:

1. **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

2. **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 if 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) Long term Liabilities: Loans from banks or financial Institutions Current Liabilities: Sundry creditors Bills payable Advances from customers Outstanding expenses		Fixed Assets: Land less depreciation Building less depreciation Plant and Machinery less depreciation Vehicles less depreciation Computer systems less depreciation Office equipments less depreciation Current Assets: Stocks Sundry debtors less provisions Bills receivables Cash in hand Cash at bank Prepaid expenses Advances to suppliers	
Total		**Total**	

Method of preparing:

Normally final accounts are prepared from the ledger balances. Trial balance may also be given to prepare final account. All items in the trial balance should be posted once to any of the above three part depending on its nature. There may be some additional information for which adjustment entry is required to be passed. Effect of these adjustments must be posted twice in any of the three parts depending on the nature of the transaction.

For example if there is an outstanding rent as an additional information, it should be added to Rent A/c in P/L A/c and should be recorded as a liability in the balance sheet. However, if outstanding rent is already there in the trial balance it will be posted once to the balance sheet as liability.

Let us illustrate the whole process with an example.

The trial balance of a business is given below:

ITEM	DR.	CR.	ITEM	DR.	CR.
Returns	25,900	10,900	Purchase	3,40,000	
Disc. received		5,200	Reserve		75,000
Sales		6,12,700	Wages	65,800	
Commission		11,500	Discount allowed	6,500	
Bills receivable	60,000		Sundry debtors	85,800	
Carriage inward	14,900		Freight	12,400	
Plant &machinery	85,600		Bills payable		44,800
Investments	22,400		Furniture	48,600	
Sundry creditors		40,000	Carriage outward	15,200	
Salaries	15,500		Opening stock	35,900	

Freehold premises	1,05,000		Cash at bank	24,700	
Drawings	5,300				
Capital		1,50,000	Cash in hand	1,600	
6% Bank Loan		20,000	Prov. For D/D		1,000
				9,71,100	**9,71,100**

Prepare Trading Account and Profit and Loss Account for the year ended 31.12.2017 and a balance sheet as on that date after taking into account the following adjustments:

1. The market price of the closing stock is ₹ 1,00,000 which includes a profit margin of ₹15,000.
2. Outstanding liabilities for salaries ₹4,500 and for wages ₹ 9,800.
3. Depreciate Furniture by 15 % and Plant and Machinery by 20%.
4. Sundry Debtors include ₹1,800 as bad which is to be written off.
5. Create a provision for bad debt @ 5 % on sundry debtors.
6. Goods distributed as free sample ₹ 500.
7. Goods lost by fire ₹ 20,800 and insurance claim admitted for ₹ 16,000.
8. Goods drawn for personal use ₹ 2,100.
9. Commission received ₹ 1,500 is yet to be earned.

Solution:

First scan the items in the Trial Balance to identify their positions in this way

ITEM	POSITION	TREATMENT	ITEM	POSITION	TREATMENT
Returns	Trading	Adjusted against sales and purchase	Purchase	Trading	Expense
Disc. received	P/L	Income	Reserve	B/S	Liability
Sales	Trading	Income	Wages	Trading	Expenses
Commission	P/L	Income	Discount allowed	P/L	Expenses
Bills receivable	B/S	Asset	Sundry debtors	B/S	Asset
Carriage inward	Trading	Expense	Freight	Trading	Expenses
Plant &machinery	B/S	Asset	Bills payable	B/S	Liability
Investments	B/S	Asset	Furniture	B/S	Asset
Sundry creditors	B/S	Liability	Carriage outward	P/L	Expenses
Salaries	P/L	Expense	Opening stock	Trading	
Freehold premises	B/S	Asset	Cash at bank	B/S	Asset
Capital	B/S	Liability	Cash in hand	B/S	Asset
Drawings	B/S	Deducted from capital			
6% Bank loan	B/S	Liability	Prov for D/D	P/L	Adjusted against new prov.

You have almost done the sum. Now consider the adjustment entries one by one which will be posted twice.

1. **Closing stock** will be posted to Trading A/c as well as in the Balance Sheet as an Asset.
2. **Outstanding Expenses** will be added with respective item and will be posted to the Liability side of the Balance Sheet.
3. **Depreciation** will be posted to the P/L A/c and will be deducted from the respective Asset in the Balance Sheet.
4. **Bad Debt** will be debited to P/L A/c and will be deducted from the Sundry Debtors in the Balance Sheet. Provision will be debited in the P/L A/c and again will be deducted from the Sundry Debtors.
5. **Goods Distributed as Free Sample** is to be treated as advertisement expenses and to be debuted to P/L A/c. Since it an outflow of stock it is to be either credited in the Trading A/c or may be deducted from purchase.
6. **Goods Lost by Fire** will also be credited to Trading A/c as an outflow of stock and will be debited to P/L A/c as loss (after adjusting the insurance claim.). So the insurance claim admitted will be posted to the Asset side of the Balance Sheet as the amount is expected to be received shortly.
7. **Commission** that is received but not yet earned is a liability and to be posted to the Balance Sheet accordingly. At the same time this is to be deducted from the commission earned in the P/L A/c since it is not yet earned in this year.
8. **Goods Drawn for Personal Use** is again an item of outflow of stock and may be credited to Trading A/c or may be deducted from Purchase. This is to be deducted from the Capital A/c as well as erosion of capital.
9. **6% interest on Bank loan** is also to be provided. Here you can assume the loan is taken at the mid of the year and in that case the interest to be debited to P/L A/c will be 6/100 × 20000 × 6/12 = ₹600. As a liability this is again to be posted to the Balance sheet accordingly.

Now keep on posting as scanned above. This is shown below:

Trading account for the year ended 31.12.2017

Particulars	₹	Particulars	₹
To Opening stock	35,900	By Sales	6,12,700
To Purchase	3,40,000	Less returns	(25,900)
Less returns	(10,900)	By Closing stock*	85,000
Less free sample	(500)		
Less drawings	(2,100)		
To Wages/direct expenses	65,800	By Abnormal loss	20,800
Add/less: due / advance	9,800	(Goods lost by fire)	
To Carriage inward	14,900		
To Freight	12,400		
To P/L A/c :	2,27,300		
(GP transferred)			
Total	**6,92,600**	**Total**	**6,92,600**

* ₹1,00,000 - ₹15,000 = ₹85,000. (Taken at Cost)

Profit and loss account for the year ended 31.12.2017

Particulars	₹	Particulars	₹
To Salaries	15,500	By Gross profit c/d	2,27,300
Add: due	+4,500	By Discount received	5,200
		By Commission	11,500
		Less: not yet earned	(1,500)
To Abnormal loss (20800-16000)	4,800		
To Discount allowed	6,500		
To Bad debts	1,800		
To Depreciation: On Plant	7,290		
On Furniture	17,120		
To Provision for bad debt (new prov.)	4,200		
Less Old provision	(1,000)		
To Interest on bank loan	600		
To carriage outward	15,200		
To Advertisement (free sample)	500		
To Capital account	1,65,490		
(NP transferred)			
Total	**2,42,500**	**Total**	**2,42,500**

Balance sheet as on 31.12.2017

Liabilities	₹	Assets	₹
Capital	1,50,000	Freehold premises	1,05,000
Add NP	+1,65,490	Plant and machinery	85,600
Less Drawings (5300+2100)	(7,400)		
Reserves	75,000	Less depreciation	(17,120)
Sundry creditors	40,000	furniture	48,600
Bills payable	44,800	Less depreciation	(7,290)
Outstanding salaries	4,500	investments	22,400
Outstanding wages	9,800	Closing stock	85,000
Accrued interest	600	Sundry debtors	85,800
Unearned Commission	1,500	Less bad debt	(1,800)
6% Bank loan	20,000	Less prov for bad debt	(4,200)
		Bills receivable	60,000
		Cash at bank	24,700
		Cash in hand	1,600
		Insc. Claim admitted	16,000
	5,04,290		**5,04,290**

Illustrations 9.

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 :			Sales	35,00,000	
Finished goods		2,00,000	*Less:* Sales Returns	1,00,000	34,00,000
Purchases	22,00,000				
Less: Purchases returns	50,000	21,50,000	Closing stock		
Carriage inwards		50,000	Finished goods		4,00,000
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
			Loose tools		1,00,000
Current Liabilities:					
Sundry creditors		4,00,000			
Outstanding salaries & wages		30,000	Current Assets:		
			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 10.

Mr. Arvindkumar had a small business enterprise. He has given the trial balance as at 31st March 2013

Particulars	**Debit (₹)**	**Credit (₹)**
Mr. Arvinkumar'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	
			Less: Goods on approval	(12,000)	
Citi Bank Overdraft		7,600	Less: Bad debts	(6,000)	
Bills payable		16,000	Less: Related to landlord	(2,400)	
Commission payable		30,000	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	18,000
Profit after works manager's commission	1,32,000
Commission to General Manager	12,000
(1,32,000/110 x 100)	

Illustrations 11.

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			
To. Depreciation		13,500	By, Interest on Bank deposits		5,750
To, Advertising		2,00,000	By, Net Loss		1,01,750
		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 Less: Depreciation	1,35,000 13,500	
	1,61,000				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 12.

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. Gross Profit transferred		2,55,000			
		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
			Debtors		1,70,500
Loan Account		90,000	Cash at Bank		65,000
Sundry Creditors		2,64,000	Cash in hand		3,000
		6,78,000			6,78,000

Illustration 13.

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		
`` Audit Fees		1,000	(15% on ₹ 30,000)		4,500
`` Printing & Stationery		1,500	`` Discount Received		1,800
`` 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 14.

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

Dr. **for the year ended 31st March, 2013** 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. -Gross Profit transferred		1,56,700
`` Travelling Expenses		6,500	`` Sale of old papers		1,500
`` Printing & Stationery		1,500	`` Profit on Joint Venture (40% of ₹ 15,000)		6,000
`` Electricity & Telephone		6,800	`` Profit on replacement of Motor Car (W. N. 2) [(1,20,000–(56,000+40,000)]		24,000
`` Rent	18,000				
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	
			Less: Depreciation	24,000	
Amount payable to Reddy (60,000 - 6,000)		54,000			96,000
Outstanding Liabilities:			Stock		75,000
Salaries	2,500		Debtors	96,000	
Rent	6,000		Less: Due from Trivedi	4,000	
		8,500			92,000
			Cash		5,900
			Bank		53,000
			Prepaid Salary		1,500
		4,58,400			4,58,400

Workings

1. **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	96,000
Profit on replacement		**24,000**

3. **Closing Stock**

   Maximum allowable limit (100 – 20)% = 80% of stock.

   Overdraft is ₹ 60,000 which is equal to 80%.

   So, closing stock $= ₹\ 60,000 \times \frac{100}{80}$

   $= ₹\ 75,000.$

FINAL ACCOUNTS OF PARTNERSHIP FIRM

Illustration 15.

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

Dr. **for the year ended 31st March, 2013** **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:		
			X:	360	
To, Salary			Y:	300	660
Y:		4,800			
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

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

Treatments of some adjustments:

1. **If closing stock is in the trial balance:** the amount of closing stock will appear in Balance Sheet only since it is already adjusted with purchase.
2. **If both cost and market value of stock is given in the adjustment:** the amount of closing stock should be taken at cost or market price whichever is lower.
3. **Goods distributed as free sample:** the amount should be deducted from purchase and should be debited in the Profit and Loss Account. Alternatively it may be directly recorded in the credit side of the Trading A/c and debited to P/L A/c as advertisement expenses.

4. **Wages paid for installation of machinery:** to be deducted from wages and to be added with the cost of machinery. Depreciation will be calculated on the value of machinery after adding the cost of installation.
5. **Carry forward of advertisement expenses for the next year:** this is a case of deferred revenue expenditure. The carry forward amount should be deducted from the advertisement expenses in P/L A/c and to be shown in the asset side of the Balance Sheet as fictitious asset.
6. **Pilferage of cash:** to be debited to P/L A/c and to be deducted from the balance of cash in hand.
7. **Dishonour of cheque received from a debtor:** to be deducted from the cash at bank and to be added back to the amount of debtor. Provision for doubtful debt to be calculated on the adjusted value of such debtors.
8. **Unexpired insurance premium:** unexpired means the benefit is yet to receive. In simple terms it means prepaid insurance. Therefore the amount is to be deducted from the insurance in P/L A/c and to be shown as current asset in the Balance Sheet.
9. **When same party is debtor as well as creditor:** this is a case of mutual indebtedness. It is termed as set off. The rule is to deduct the lower amount from both debtor as well as creditor. Remember that any provision is to be made after this adjustment.
10. **Under valuation of opening stock:** opening stock undervalued means the closing stock of last year was undervalued due to which the gross profit of the last year as well as the net profit was also undervalued. Ultimately the capital is also understated. So, in current year the opening stock should be increased and capital also to be increased by the amount of such undervaluation.

SELF EXAMINATION QUESTIONS:

1. 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
   (A) Realisation
   (B) Accrual
   (C) Conservatism
   (D) None of the above

2. Contingent Liability would appear
   (A) On the liability side
   (B) On the asset side
   (C) As a note in Balance Sheet
   (D) None of the above

3. Bad debts Recovered ₹750. It will be
   (A) Credited to Bad debts A/c
   (B) Credited to debtor's personal A/c
   (C) Debited to creditor's personal A/c
   (D) Credited to bad debts recovered A/c

4. 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
   (A) ₹50,000
   (B) ₹44,000
   (C) ₹46,000
   (D) 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 NON-PROFIT ORGANIZATIONS

This Study Note includes

4.1 Preparation of Financial Statements of Non-Profit Organizations

4.1 PREPARATION OF FINANCIAL STATEMENTS OF NON-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:

(a) 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.

(b) 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.

(c) 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.

(d) 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.

(e) 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.

(f) 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	90
	2,090
Less : Subscription outstanding on 1.4.2012	200
	1,890
Add : Subscription paid in advance on 31.3.2012	50
	1,940
Less : Subscription received in advance on 31.3.2013	40
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
		[200 + 140]	
	3,480		3,480
To, Balance b/d:		By, Balance b/d (2013)	80
For 2012	200		
For 2013	140		

Note: Opeaning 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	(₹60,000)
Balance to be carried forward	**₹9,80,000**

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. **Cr.**

Particulars	Amount (₹)	Amount (₹)	Particulars	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	1,000	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)	37,800	
			1,20,700
		Deficit	14,520

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. **for the year ended 31st December, 2013** **Cr.**

Expenditure	Amount (₹)	Amount (₹)	Income	Amount (₹)	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	61,470
" 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		Premises at Cost	1,17,000	
Add: Surplus	43,490	1,08,620	Less: Depreciation	59,430	57,570
Creditors (for bar purchase)		1,290	Car at Cost	46,800	
Secretary's honorarium			Less: Depreciation	9,360	37,440
outstanding		1,000	Bar Stock		2,610
			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	1,290			
	18,600			
Less: Opening creditors for purchase	1,770	16,830		
To, Income and Expenditure A/c (Gross profit Transferred)		6,000		
		24,960		24,960

2. Calculation of Depreciation of Premises

W.D.V	₹
Cost Price	87,000
Less: Accumulated Dep	56,400
	30,600
Add: Purchase	30,000
	60,600

Depreciation of Premises: 60,600 x 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	
			Less: Depreciation @ 10%	(17,725)	1,77,275
Investment Reserve Fund		1,85,000			
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.

From the following Receipts and Payments account prepare an Income and Expenditure account for the year ended 31.12.2016

Receipts and Payments Account for the year ended 31.12.2016

Receipts	₹	Payments	₹
To Balance b/d : Cash in hand	1,200	By Purchase of furniture	10,000
: Cash at Bank	3,400	By Rent	3,600
To Subscriptions	24,500	By Honourarium	4,000
To Entrance fees	3,000	By Salaries	2,100
		By Sports expenses	4,700
		By Sundry expenses	1,100
		By Printing and Stationery	800
		By Balance c/d : Cash in hand	1,700
		: Cash at Bank	4,100
	32,100		**32,100**

Additional information:

Particulars	**31.12.2015**	**31.12.2016**
	₹	₹
Subscription due	2,100	3,200
Subscriptions received in advance	1,400	2,700
Rent outstanding	600	300
Salaries paid in advance	1,200	900
Furniture	18,000	23,000

60 % of the entrance fees are to be capitalized. Interest on savings bank account for ₹280 has not been entered in the cash book. An old furniture (WDV ₹ 8,000) was exchanged at an agreed price of ₹ 5,000 for a new furniture costing ₹ 15,000.

Solution:

Income and Expenditure Account for the year ended 31.12.2016

Expenditure	₹	Income	₹
To Rent	3,300	By Subscriptions	24,300
To Honourarium	4,000	By Entrance fees (3000 × 40%)	1,200
To Salaries	2,400	By Interest	280
To Sports expenses	4,700		
To Sundry expenses	1,100		
To Printing and stationery	800		
To Loss on exchange of furniture	3,000		
To Depreciation on furniture	2,000		
To Surplus	**4,480**		
	25,780		**25,780**

Note :

1. **Subscription**

	₹
Subscription	24,500
Add: due for 2016	3,200
Add : advance for 2015	1,400
Less : advance for 2016	2,700
Less : due for 2015	2,100
Transfer to income and expenditure A/c	**24,300**

2. **Salaries**

Salaries	2,100
Add : advance for 2015	1,200
Less : advance for 2016	900
Transfer to income and expenditure A/c	**2,400**

3. **Rent**

Rent	3,600
Add: due for 2016	300
Less : due for 2015	600
Transfer to income and expenditure A/c	**3,300**

4. **Loss on exchange of furniture**

WDV of furniture	8,000
Less : agreed price of exchange	5,000
Loss transferred to I & E A/c	**3,000**

5. **Depreciation on furniture**

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By Creditors	5,000
To Creditors	15,000	By Loss on Exchange	3,000
		By Balance c/d	23,000
		By Depreciation	2,000
	33000		**33000**

Illustration 10.

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	200	5,000	Add: Outstanding	1,000	20,000
`` Playground maintenance	1,000		`` Locker Rent		600
Add: Outstanding	1,000	2,000	`` Sundry Income	1,060	
`` Rent		8,000	-Add: Outstanding	540	1,600
`` Depreciation on:			`` Profit on Refreshment		8,000
Furniture	14,600				
Library Books	2,500	17,100	`` Deficit		
			(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			Less: Depreciation	14,600	1,31,400
		2,00,000	Library Books	25,000	
Creditors for Furniture		16,000	Less: Depreciation	2,500	22,500
Outstanding Salaries		200	9% Govt. Bond		1,60,000
Outstanding Expenses for Playground			Subscription Receivable		1,000
		1,000	Accrued Sundry Income		540
			Bank Term Deposit		15,000
Bank overdraft		1,08,140	Deficit		1,900
		3,42,340			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 11.

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
		" Fixed assets	
up to 31-03-2012	14,000	purchased	80,000
for 2012-13	1,50,000		
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:

(a) 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.

(b) Income receivable on 31-03-2013 on ICICI bond is ₹30,000 and on Govt. Securities is ₹24,000

(c) Prepaid expenses on 31-3-2013 amounts to ₹7,000

(d) Outstanding expenses as on 31-3-2013 ₹8,000

(e) Depreciation to be provided is ₹12,500

(f) 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	1,85,000	By, Received during year	1,80,000
(balancing figure)		By, Closing receivable :	
To, Closing advance received	16,000	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	3,96,200	5,01,200	Govt. Securities	3,00,000	
Subscription Recd in Advance		16,000	Less: sold	80,000	2,20,000
Outstanding Expenses		8,000	Fixed Deposit	2,00,000	
			Add: Addition	1,25,000	
				3,25,000	
			Less: Matured	75,000	2,50,000
			ICICI Bond		3,00,000
			Accrued Interest:		
			Govt. Securities	24,000	
			ICICI Bonds	30,000	54,000
			Outstanding Subscription:		
			2011 -12	1,000	
			2012 -13	25,000	
				26,000	
			Less: Prov. for doubtful debt	2,000	24,000
			Prepaid Expenses		7,000
			Fixed Assets	95,000	
			Add: Additions	80,000	
				1,75,000	
			Less: Depreciation	12,500	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	92,000
Cost of disposed investment	80,000
Profit on disposal	12,000

Illustration 12.

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

(a) 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.

(b) 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.

(c) 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

(a) 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.

(b) 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.

(c) 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.

(d) 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 13.

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:					
Printing and Stationery		400	Cricket Equipment	25,000	
Manager's Salary:			Less: Depreciation 10%	2,500	22,500
(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 14.

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		By Balance b/d	40
for 2012	20		
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:

1. In the case of non-profit organization donations received by the organization are reflected in
   (A) Income and Expenditure Account
   (B) Capital Account
   (C) Receipts and Payments Account
   (D) None of the above

2. Which of the following item(s) is (are) shown in the Income and Expenditure Account?
   (A) Only items of Capital nature
   (B) Only items of Revenue nature, which are received during the period of Accounts
   (C) Only items of Revenue nature pertaining to the period of Accounts
   (D) Both the items of Capital and Revenue nature

3. 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:

   (A) ₹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 Parished

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	4,66,100
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	8,48,000	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	10,000
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. **I**ncome 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

5.1 PREPARATION OF FINANCIAL STATEMENTS FROM INCOMPLETE RECORDS

Introduction

"Single entry system is considered as a no system at all. Experts believe unlike double entry system it has no scientific basis. Questions may arise – "why should this to be learnt"? It is true that like double entry system it has no such scientific system. However it is also true that arithmetically through a simple statement business logics can be explained and profit can be ascertained by comparing the opening capital and closing capital under single entry system.

The traditional concept of profit is closing capital minus opening capital. For example if a peddler starts his day with ₹ 1,000 and finds ₹ 1,200 in his hand at the end of the day he considers ₹ 200 as his net earnings for the day. However this ignores the financial happenings during the day. During the day he may take lunch and spent ₹ 50. In that case his earning increases by ₹50 because even if spending ₹50 for personal consumption he is left with ₹200. so his actual earnings become ₹250. On the other hand he may bring ₹ 100 from home during afternoon for his business which will reduce his net earnings by ₹ 100".

Thus the formula for ascertaining profit is modified as (Closing Capital + Drawings – Opening Capital - Further Introduction of Capital). From the above example profit = ₹(1,200 + 50 -1,000 -100 = 150). Small traders, grocery shop owners may maintain such type of accounts which may not follow the true spirit of double entry system and it may not be possible to record all transactions. This results in incomplete recording of the transactions in the books. This is the reason it is called "final accounts from incomplete records".

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.

(a) **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.

(b) **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.

(c) **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.

(d) **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.

(e) **Lack of uniformity :** It lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.

(f) **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:

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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

Capital = 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.

1. Preparation of Final Accounts —

Under this system two statements are prepared – a. Statement of profit and loss and b. Statement of affairs.

Step 1 — Prepare statement of affairs at the beginning as well as at the year end to find out the opening and closing capital respectively.

Step 2 — Prepare statement of profit and loss to ascertain the trading profit.

Step 3 — Prepare statement of affairs as at the year end to show the financial position of the business.

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
		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	6 0 0	1500
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.

Mr. Raman starts a business with ₹30,000 cash as her capital on January 1, 2016. At the close of the year the financial position of her business was as follows:

Creditors ₹20,000, Cash at Bank ₹15,000, Debtors ₹25,000, Stock ₹20,000, Plant ₹40,000.

During the year, Mr Raman drew ₹ 1000 every month. On July 1 2016, he introduced further capital amounting to ₹15000.

You are required to ascertain profit or loss made by her during the year. Following adjustments are required to be made:

Plant to be depreciated at 10 % and reserve of 2 ½ % is to be raised against debtors.

Statement of Profit and Loss for the year ended 31.12.2016

Dr. **Cr.**

Particulars	₹	Particulars	₹
Capital (closing)	80,000	Cash at bank	15,000
– Balancing Figure		Debtors	25,000
Creditors	20,000	Stock	20,000
		Plant	40,000
	1,00,000		**1,00,000**
Opening capital	30,000	Closing Capital	80,000
Further introduction of capital	15,000	Drawings (1000 × 12)	12,000
Trading profit	47,000		
	92,000		**92,000**
		Trading profit	47,000
Depreciation (40,000 × 10%)	4,000		
Reserve for bad debt (25,000 × 2.5%)	625		
Net profit	42,375		
	47,000		**47,000**

Statement of Affairs for the year ended 31.12.2016

Particulars	₹	Particulars	₹
Capital	30,000	Cash at Bank	15,000
Further capital	15,000	Debtors(25,000 - 625)	24,375
Drawings	(12,000)	stock	20,000
Net profit	42,375	Plant(40,000 - 4,000)	36,000
Creditors	20,000		
	95,375		95,375

Illustration 4.

The following information is available from Sachin who maintains books of accounts on single entry system.

Particulars	01.04.2016 ₹	31.03.2017 ₹
Cash and bank	20,000	21,000
Sundry debtors	17,000	25,000
Stock	40,000	60,000
Furniture	29,000	29,000
Creditors	32,000	22,000
10 % loan from Mrs. Sachin	30,000	30,000

Sachin withdrew ₹5,000 from the business every month for meeting his household expenses. During the year he sold investments held by him privately for ₹35,000 and invested the amount in his business. At the end of the year 2015-16, it was found that full years interest t on loan from Mrs. Sachin had not been paid. Depreciation @ 10% p.a was to be provided on furniture for the full year. Shop assistant was to be given a share of 5% on the profits ascertained before charging such share. Calculate profit earned during the year ended 31.03.2016 by Sachin.

Solution:

Statement of profit and loss for the year ended 31.03.2017

Particulars	Amount ₹	Amount ₹	Particulars	Amount ₹	Amount ₹
Capital (opening & closing)	44,000	83,000	Cash at bank	20,000	21,000
– Balancing figure			Debtors	17,000	25,000
Creditors	32,000	22,000	Stock	40,000	60,000
Loan from Mrs Sachin	30,000	30,000	Furniture	29,000	29,000
	1,06,000	**1,35,000**		**1,06,000**	**1,35,000**
Opening Capital		44,000	Closing Capital		83,000
Further introduction of capital		35,000	Drawings (5,000x12)		60,000
Trading profit		64,000			
		1,43,000			**1,43,000**
			Trading profit		64,000
Depreciation (29,000x10%)		2,900			
Interest on loan (30,000x10%)		3,000			

Net profit		58,100			
		64,000			**64,000**
Commission to shop assistant			Net profit		58,100
(58,100x 5%)		2,905			
Net profit		5,5195			
		58,100			**58,100**

Statement of Affairs for the year ended 31.03.2017

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
Capital	44,000	Cash at bank	21,000
Further capital	35,000	Debtors	25,000
Drawings	(60,000)	Stock	60,000
Net profit	55,195	Furniture(29,000 - 2,900)	26,100
Creditors	22,000		
Interst on loan	3,000		
Commission to assistant	2,905		
Loan from Mrs Sachin	30,000		
	1,32,100		**1,32,100**

1. Open Debtors Account to ascertain credit sales as a balancing figure
2. Open Creditors Account to ascertain credit purchase as a balancing figure
3. Prepare opening balance sheet to find opening capital.
4. Cash or Bank account to ascertain cash or bank balance.

Following points may be remembered to complete the process of conversion:

1. Open the trading, profit and loss account and balance sheet at the same time. Keep putting the information as available to these formats where they should go. The process will be like filling up blank forms.
2. Prepare necessary ledger accounts as and when will be needed to find missing information.
3. Ensure to give double entry effect of the missing information.

Go through the following illustration and follow the steps as indicated.

Illustration 5.

The books of Mr. Z showed the following information:

	January 1, 2016	**December 31, 2016**
	₹	₹
Bank balance	nil	50,000
Debtors	nil	87,500
Creditors	nil	46,000
Stock	50,000	62,500
Fixed assets	7,500	9,000

The following are the details of the bank transactions (figures in ₹.)

Receipts from customers	3,40,000	Expenses paid	49,250
Payment to Creditors	2,80,000	Drawings	25,000
Capital brought in	5,000	Purchase of Fixed Assets	5,000
Sale of Fixed Assets	1,750		

Other information:

1. Cost of goods sold ₹ 2,60,000;
2. Gross profit @25% on cost of goods sold;
3. Book value of fixed assets sold ₹ 2,500.

Prepare trading, profit & loss account for the year ended December 31, 2016.

Solution :

In the above example the missing informations are:

Sales, purchase, opening bank balance, opening balance of debtors, opening balance of creditors and opening capital. To find out we need to open the debtors account, creditors account, bank account and opening balance sheet.

Since sales as well as opening balance of debtors are unknown we need to apply the formula to find out sales as :

Sales = Cost of goods sold + Gross profit

Or, ₹2,60,000 + 25% of ₹2,60,000 = ₹3,25,000.

Again purchases as well as opening balance of creditors is unknown therefore we need to apply the formula as:

Opening stock + Purchase – Closing stock = Cost of goods sold.

Or, ₹50,000 + Purchase – ₹62,500 = ₹2,60,000

Or, Purchase = ₹2,60,000 + ₹12,500 = ₹2,72,500.

Now let us open the required accounts

Debtors Account

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	1,02,500	By Bank A/c	3,40,000
To Sales A/c	3,25,000	By Balance c/d	87,500
	4,27,500		**4,27,500**

Form the above account we get the opening balance of debtors as balancing figure which will be transferred to the opening Balance Sheet.

Creditors Account

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Bank A/c	2,80,000	By Balance c/d	53,500
To Balance c/d	46,000	By Purchase A/c	2,72,500
	3,26,000		**3,26,000**

Form the above account we get the opening balance of creditors as balancing figure which will be transferred to the opening Balance Sheet.

Bank Account

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	62,500	By Creditors A/c	2,80,000
To Debtors A/c	3,40,000	By Expenses A/c	49,250
To Capital A/c	5,000	By Drawings A/c	25,000
To Fixed Assets A/c	1,750	By Fixed Assets A/c	5,000
		By Balance c/d	50,000
	4,09,250		**4,09,250**

From the above account we get the opening bank balance which is again transferred to opening balance sheet.

Balance sheet as on 1.1.2016

Liabilities	Amount ₹	Assets	Amount ₹
Capital A/c	1,69,000	Fixed Assets A/c	7,500
Creditors A/c	53,500	Stock A/c	50,000
		Debtors A/c	10,250
		Bank A/c	62,500
	2,22,500		**2,22,500**

Putting all the balances we get the opening capital as balancing figure.

Fixed Assets

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	7,500	By Bank A/c	1,750
To Bank A/c	5,000	By Loss on sale(2,500 -1,750)	750
		By Depreciation A/c (balancing figure)	1,000
		By Balance c/d	9,000
	12,500		**12,500**

Putting all the balances we get the depreciation as balancing figure. In these cases you have to apply common sense to find out the balancing figure. As we have purchase, sale, loss on sale, opening and closing balance the balancing figure must be depreciation.

Trading & Profit & Loss Account for the year ended 31.12.2016

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To opening stock	50,000	By sales	3,25,000
To purchase	2,72,500	By closing stock	62,500
To Gross Profit	65,000		
	3,87,500		**3,87,500**
To expenses	49,250	By Gross Profit	65,000
To depreciation	10,00		
To loss on sale	750		
To net profit	14,000		
	65,000		**65,000**

Balance sheet as on 31.12.2016

Liabilities	Amount ₹	Assets	Amount ₹
Capital	1,69,000	Fixed assets	9,000
Net pfofit	14,000	Stock	62,500
Further capital	5,000	Debtors	87,500
	1,88,000	Bank	50,000
Less drawings	25,000		
	1,63,000		
Creditors	46,000		
	2,09,000		**2,09,000**

Illustration 6.

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
		,, Balance c/d	15,000
	35,000		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 7.

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		
To Salary & wages	9,000	By Gross Profit b/d	47,140
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	70	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:**		
			Stock-in-trade		19,000
Sundry Creditors		19,500	Sundry Debtors		88,000
			Cash at Bank		4,000
			Cash in hand		100
		1,30,430			1,30,430

2. Mr. Jaiswal commenced business as a Cloth Merchant on 1stJanuary, 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 depreciauon 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 4- 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 Crdditors 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	100	2,900	"	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	1,100		Less: Depreciation	60	540
	3,100		Stock-in-trade		1300
Less : Drawings (280 + 100)	380	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 personsl 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

(2)	Receipts from customers during the year—		
	Amount deposited into Bank		12,020
	Add: Expenses met out of receipts		
	Personal	800	
	Business	700	1,500
			13,520

(3)	Sales faring the year—	₹
	Receipts from customers as in (2)	13,520
	Add: Sundry Debtors at the end	1,150
		14,670
	Less : Sundry Debtors at the beginning (1,150-100)	1,050
		13,620
(4)	Purchases during the year—	
	Payments to suppliers	11,850
	Add: Sundry Creditors at the end	400
		12,250
	Less : Sundry Creditors at the beginning	200
		12,050

(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		
	14,720		14,720
To Business Expenses	700	By Gross Profit b/d	1,670
Net Profit—transferred to Capital	970		
	1,670		1,670

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	4,170	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	38,000
	48,000
Less: Closing Stock Cost of goods sold	4,000
	44,000
Add : Gross Profit: 20% on Sales i.e., 25% on cost	11,000
Total Sales	55,000
Less: Credit Sales	7,000
Cash Sales	48,000

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	Bank		Cash	Bank
	₹	₹		₹	₹
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

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	70,360
Less: Returns	400	58,630			
" 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
	39,560		Cash in hand	1,200
Less: Drawings	3,180	36,380	Cash at bank	6,880
Sundry Creditors		12,400		
Outstanding Expenses		330		
		49,110		49,110

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
	33,320		33,320

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 er 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 encased 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

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 x 3/5 = 12/25; Y's share = 4/5x2/5 = 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 × 1/2 = 4/10; Q's share = 4/5 × 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 – Nil = 4/24 – 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 :

1. **Old Ratio** = Profit Sharing Ratio of existing Partners (before admission of new partner)

   = Given or Equal (If not mentioned)

2. **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.

3. **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.

2. ***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

(i) 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)

(ii) 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

(iii) 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	x x x	By Partners Capital A/c	x x x
(Share of Revaluation Profit)		(Share of Revaluation loss)	
	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 Libilities (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 Revarsal 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 amought 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 and an adjustment is to be made through the Capital A/c.	New Partner's Capital *Dr.* To Old Partners Capitals [Premium Money]	Sacrifice Ratio	Or, old ratio if the mutual ratio between old Partners remain unchanged.
7.	New partner pays only a portion of the Premium but cannot pay the remaining portion: For Portion Paid	Cash/Bank *Dr.* To Old Partners Capitals [Portion Paid]	Sacrifice 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.

"Para 16 of AS 10 specifies that goodwill can be recorded in the books only when some consideration in money or money's worth has been paid for it. It means that only purchased goodwill can be recorded in the books. At the time of admission, retirement or death of partners, goodwill cannot be raised in the books of the firm because no consideration in money or money's worth has been paid for it".

Explanation and treatment:

New partner is allowed to enter the business by paying some amount as premium for goodwill. We must learn this treatment of goodwill before knowing the accounting treatment of admission of a new partner.

TREATMENT OF GOODWILL WHEN A NEW PARTNER IS ADMITTED:

1. When the new partner brings premium for goodwill:

When the new partner brings an amount as premium for goodwill such amount will be shared by the old partners in sacrificing ratio and the entry will be –

Bank A/c…………. Dr.

To Old Partners Capital A/c

Sacrificing ratio:

It is the difference between the old ratio and new ratio. This is illustrated with an example:

Say Sujata and Sutapa are partners sharing profits in the ratio of 2:1. Sanjukta enters in the business with $1/5^{th}$ share of profit. Now new ratio will be calculated as follows:

1-1/5=4/5 is the share left for Sujata and Sutapa. So Sujata will get 4/5 x 2/3 = 8/15 and sutapa will get 4/5x 1/3= 4/15. Sanjukta is getting 1/5 =3/15. Thus the new ratio becomes 8:4:3. (eliminating the common dinominator)

In that case sacrificing ratio will be calculated as follows:

	Sujata	**Sutapa**	**Sanjukta**
Old ratio	2/3=10/15	1/3=5/15	Nil
New ratio	8/15	4/15	3/15
Sacrificing ratio	2/15	1/15	(3/15)

From the above table you can understand sacrificing partners are Sujata and Sutapa and gaining partner is Sanjukta where sacrifice is 2:1 and gain is 2+1=3. i.e the sacrifice made by old partners is exactly equal to the gain by the new partner.

2. When the new partner fails to bring premium for goodwill:

If the new partner fails to bring the necessary premium for goodwill his capital account is debited by such amount and credited to the old partners capital account.

New partners capital A/c…………. Dr.

To old partners capital A/c

Note : after issuance of AS-10 read with AS-26 the question of raising the amount of Goodwill and writing it off is no longer valid. Always follow the principle of capital adjustment as discussed above.

Other than adjustment of goodwill when a new partner is admitted the balance sheet of the firm is reformed i.e assets and liabilities are revalued as a measure of current update. This change in the value of assets and liabilities may lead to profit or loss on revaluation. To find out such profit or loss a Revaluation account is opened. The profit or loss on such revaluation is shared by the old partners in their old profit sharing ratio.

A standard format of Revaluation Account

Dr. **Revaluation Account** **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Decrease in the value of assets		By Increase in the value of assets	
To Increase in the value of liabilities		By Decrease in the value of liabilities	
To Profit on revaluation		By Loss on revaluation	
Total		**Total**	

Note: Remember to take the difference in value only (not the changed value). For example, if the value of building is revalued as ₹20,00,000 form ₹18,00,000 then take ₹2,00,000 in the revaluation account.

To solve the standard problem on admission of partner you have to open one revaluation account one composite capital account of all partners and a new balance sheet giving all such effects.

Example:

Anik and babul were carrying on business in partnership sharing profits and losses in the ratio of 3:2. On December 31, 2017 their balance Sheet was as follows:

Balance Sheet

Liabilities	₹	Assets	₹
Capital : Anik	30,200	Land and Building	40,000
Babul	35,400	Furniture	10,600
Bank Loan	20,000	Stock	38,500
Sundry Creditors	20,800	Debtors	19,000
Bills payable	10,000	Cash	20,300
Workmen compensation fund	12,000		
Total	**1,28,400**	**Total**	**1,28,400**

On January 1, 2018 Charu was admitted to partnership on the following conditions:

a. Charu would be entitled to 1/3rd share in profits.

b. Charu would bring ₹30,000 as his capital.

c. He would not be able to bring his share of Goodwill in cash for ₹10,000.

d. The book value of land and building will be increased by ₹10,000, that of furniture would be reduced to ₹10,000 and stock would be reduced by 10%.

e. A provision for bad debts @ 5% of sundry debtors would be created

f. The actual liability of workmen compensation fund is estimated at ₹2,000.

g. Bank loan would be paid off.

Prepare Revaluation Account, Partners Capital Accounts and the Balance sheet of the new firm.

Solution:

Dr. **Revaluation Account** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Furniture	600	By Land and Building	10,000
To Stock	3,850		
To Provision for bad debt	950		
To Capital A/C:			
Anik – 3/5th	2,760		
Babul – 2/5th	1,840		
	10,000		**10,000**

Capital Account

Dr. **Cr.**

Particulars	Anik ₹	Babul ₹	Charu ₹	Particulars	Anik ₹	Babul ₹	Charu ₹
To Anik			6,000	By balance b/f	30,200	35,400	-
To Babul			4,000	By cash			30,000
				By Revaluation	2,760	1,840	-
				By Workmen C F	6,000	4,000	-
To balance c/f	44,960	45,240	20,000	(₹10,000 in 3:2)			
				By charu	6,000	4,000	-
	44,960	**45,240**	**30,000**		**44,960**	**45240**	**30,000**

Balance Sheet

Liabilities	₹	Assets	₹
Capital : Anik	44,960	Land and Building	50,000
Babul	45,240	Furniture	10,000
Charu	20,000	Stock	34,650
Sundry Creditors	20,800	Debtors (19,000 – 950)	18,050
Bills payable	10,000	Cash (20,300 + 30,000 – 20,000)	30,300
Workmen compensation fund	2,000		
Total	**1,43,000**	**Total**	**1,43,000**

Note : Take care of the phrases like " increased to" and " increase by". For <u>increase by</u> take the whole amount in revaluation account and for <u>increased to</u> take the difference amount.

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 00 Add: Capital Expenditure wrongly charged against profits 00 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**	**Super Profit = Future maintainable profits – Normal Return on Capital Employed** **Goodwill = Super Profit × No. of years** **Steps to be followed** **Steps (a) Calculation of Capital employed OR Average Capital Employed** 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 — - 00 (if the profits remain undistributed) **Average Capital Employed** — 000 **Step (b) Average Annual Adjusted Profits (Maintainable)** — **00** Same as shown under Method 1. But debenture interest, if any, should be added back with Profits before making provision for taxation **Step (c) Calculate Normal Return on Capital Employed or Average Capital Employed** [Say at 10% or 12%, etc. — as may be given or assumed] **Step(d) Deduct Normal Return (c) from Average Maintainable Profits (b).** The difference is called **Annual Super Profit** **Step (e) Goodwill = Annual Super Profit × No. of Years for which the Super Profit can be maintained.** [Usually expressed as...years purchase of super profit]	(i) Calculation of Average capital Employed **cannot be made if current years' profits** are not separately given. (ii) Trading Profits exclude any non trading income like Interest on Non-trading investments. (iii) Adjustments against profits including provision for managerial remuneration, should be made. [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. (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. (vi) For calculating capital employed, proposed dividend need not be deducted. [Please see valuation of shares']
3.	**Capitalization of Profits Methods** **(A) Profits** **(B) Capi-talization of Super Profits**	Under the method follow these steps – (a) Calculate Annual Maintainable Profit as shown above. (b) Calculate normal Capital Employed capitalizing the above profit by applying the normal rate of return. $\text{Normal Capital Employed} = \frac{\text{Maintainable Profit}}{\text{Normal Rate of Return}} \times 100$ (c) Calculate actual Capital Employed (d) Goodwill = Normal Capital Employed – Actual capital Employed. (a) Calculate Super profit as said under Method 2. (b) $\text{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$	Here also the profits should be adjusted considering necessary adjustments for managerial remunerations, change of depreciation, etc.
4.	**Annuity Method**	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. Calculate Super Profit as discussed before **Goodwill=Annual Super ProfitxPresent Value of Annuity of ₹1.**	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.

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 × 5/1	=	₹ 1,50,000 [Taking Z's Capital as base]
Less : Combined Adjusted Capital		
80,000 + 20,000 + 30,000	=	₹ 1,30,000
Hidden Goodwill	=	₹ 20,000

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.

(i) Average Capital employed in the business ₹ 7,00,000.

(ii) Net trading profit of the firm for the past three years ₹ 1,47,600; ₹ 1,48,100 and ₹ 1,52,500.

(iii) Rate of Interest expected from capital having regard to the risk involved —18%.

(iv) Fair remuneration to the partners for their services 12,000 per annum.

(v) Sundry Assets (excluding goodwill) of the firm ₹ 7,54,762.

(vi) Sundry Liabilities ₹ 31,329.

(vii) 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	11,400

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 googwill for 1/6 in there.

Therefore, Full value of Goodwill = 9,000 × 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	$\frac{3}{6}$ 5/8 - 3/6 = (30 - 24)/48 = 6/48 (Sacrifice)	$\frac{2}{6}$ 3/8 - 2/6 = (18 - 16)/48 = 2/48 (Sacrifice)	$\frac{1}{6}$ Nil -1/6 = (0 - 8)/48 = 8/48 (Gain)

Journal Entries

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
	Gargi's Capital A/c *Dr.*		33,750	
	Khana's Capital A/c *Dr.*		20,250	
	To Goodwill A/c			54,000
	(Goodwill Account written off between the old partners in old ratio)			
	Bank A/c *Dr.*		9,000	
	To Gargi's Capital A/c			6,750
	To Khana's Capital A/c			2,250
	(Premium for Goodwill brought in by new partner and shared by old partners in their sacrifice ratio 3 : 1)			

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 raitio 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

1. 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.
2. 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 × 1/3 = 1/4;

Bimal's new share = 3/4 × 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 *Dr.* To Charu's Capital A/c [Amount invested as capital contribution by Charu]		9,000	 9,000
1.1.13	Charu's A/c *Dr.* To Amal's Capital A/c [3/5] To Bimal's Capital A/c [2/5] [Premium paid by Chanu 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 [1/3 of ₹ 3,600] *Dr.* Bimal's Capital A/c [2/3 of ₹ 3,600] *Dr.* To Charu's Capital A/c [Adjustment made for Charu's own Goodwill brought into the business]		1,200 2,400	 3,600

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	20,000	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		
		1,38,000		1,38,000

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	65,000	90,000	Bills Receivable	10,000
Reserve		20,000	Debtors	30,000
Creditors		25,000	Cash at Bank	40,000
Bills Payable		5,000		
		1,40,000		1,40,000

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	2,000	10,000		
		12,000		12,000

Dr. **Capital Account** *Cr.*

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
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 ₹	*Assets*	Amount ₹	Amount ₹
Capital A/c :			Furniture		30,000
A	75,000		Stock		39,500
B	45,000		Debtors	30,000	
C	30,000	1,50,000	Less : R/B/Debts	1,500	
		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 (Sacrifice)

B = 1/5 - 3/10 = (2 - 3)/10 = 1/10 (Gains)

C = 2/10 (Gains)

∴ Entire goodwill to be credited to A's Capital Account. B will have to pay A for goodwill

= ₹ 20,000 × 10/2 x 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 x 5/10 x 10/2	= ₹ 75,000
And B should bring for 3/10	= ₹ 30,000 x 3/10 x 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	10,000	60,000	Bill Receivable	5,000
			Debtors	7,500
Reserve		29,800	Cash in hand and at Bank	2,500
Creditors		6,200		
Bills Payable		4,000		
		1,00,000		1,00,000

Lime is to be admitted as a partner with effect from 1st January, 2013 on the following terms

(a) 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.

(b) Lime will be entitled to : 1/6th share in the profits of the firm.

(c) The assets will be revalued as follows Land and Building— ₹ 56,000; Furniture — ₹ 12.000; Stock— ₹ 16,000; Debtors — ₹ 7,000

(d) The claim of a creditor for ₹ 2,300 is paid at ₹ 2,000.

(e) 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.* Amount ₹	*Cr.* Amount ₹
01.01.13	Bank A/c *Dr.*		15,000	
	To Lime's Capital A/c			
	[Being amount contributed by lime on admission as a new partner]			15,000
"	Bank A/c *Dr.*		12,000	
	To Brick's Capital A/c [3/6]			
	To Sand's Capital A/c [2/6]			6,000
	To Cement's Capital A/c [1/6]			4,000
	[Being premium for goodwill brought in by new partner and credited to old partners Capitals in their sacrifice ratio 3:2:1]			2,000
"	Land and Buildings A/c *Dr.*		6,000	
	To Revaluation A/c			
	[Being value of Land & Buildings appreciated on revaluation]			6,000
"	Revaluation A/c *Dr.*		7,500	
	To Furniture A/c			
	To Stock A/c			3,000
	To Provision for Bad Debts A/c			4,000
	[Being values of assets decreased on revaluation]			5 0 0
"	Creditors A/c *Dr.*		2,300	
	To Bank A/c			
	To Revaluation A/c			2,000
	[Being creditors claim discharged at a discount]			3 0 0
"	Brick's Capital A/c *Dr.*		600	
	Sand's Capital A/c *Dr.*		400	
	Cement's Capital A/c *Dr.*		200	
	To Revaluation A/c			
	[Loss on revaluation debited to' old partners in old ratio 3 : 2 :1]			1,200
"	Reserve A/c *Dr.*		29,800	
	To Brick's Capital A/c			
	To Sand's Capital A/c			14,900
	To Cement's Capital A/c			9,933
	[Reserve A/c closed and credited to old partners in old ratio 3 : 2 :1]			4,967
"	Brick's Capital A/c *Dr.*		7,450	
	Sand's Capital A/c *Dr.*		4,967	
	Cement's Capital A/c *Dr.*		2,483	
	To Bank A/c			
	[Half of the Reserve withdrawn by old partners]			14,900
"	Brick's Capital A/c *Dr.*		3,000	
	Sand's Capital A/c *Dr.*		2,000	
	Cement's Capital A/c *Dr.*		1,000	
	To Bank A/c			
	[Half of the premium money withdrawn by old partners]			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				
Sand	26,566		Furniture		12,000
Cement	13,284		Stock		16,000
Lime	15,000		Debtors		
Creditors [6,200 – 2,300]		94,700	*Less* : Provision for Bad Debts	7,500	
Bills Payable		3,900	Bill Receivable	500	7,000
		4,000	Cash in hand and at		
			Bank [Note 2]		5,000
					6,600
		1,02,600			1,02,600

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
	29,500
Less: Paid to creditors	2,000
Less: Portion of Reserve withdrawn	14,900
Less: Share of premium withdrawn	6,000
	6,600

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	—
	39,850	26,566	13,284	15,000

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

1. 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.

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 *Dr.* *Cr.*

Date	Particulars		L.F.	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	2000
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 Dr.		3,000	
	To Arun's Capital A/c			1,800
	To Anand's Capital A/c			1,200
	(Goodwill A/c raised and credited to existing partners in old ratio 3 : 2)			
	Arun Capital A/c Dr.		1,440	
	Anand Capital A/c Dr.		960	
	Ashok Capital A/c Dr.		600	
	To Goodwill A/c			3,000
	(Being the Goodwill written off)			
	Creditors A/c Dr.		2,000	
	To Bank A/c (actual payment at 95%)			
	To Revaluation A/c			1,900
	(A creditor paid off and the discount received credited to revaluation A/c)			100
	Revaluation A/c Dr.		2,100	
	To Arun's Capital A/c			
	To Anand's Capital A/c			1,260
	(Being Revaluation profit credited to old partners in the ratio 3 : 2)			840

Dr. Capital Accounts Cr.

Date 2013	Particulars	Arun ₹	Anand ₹	Ashok ₹	Date 2013	Particulars	Arun ₹	Anand ₹	Ashok ₹
31.3.	To General Res	5,760	3,840	2,400	31.3.	By Balance b/d	12,000	10,000	-
	,, Goodwill A/c	1,440	960	600		,, Bank A/c			20,000
						,, Bank A/c (Premium)	1,800	1,200	-
	" Balance c/d	16,860	13,240	17,000					
						,, Goodwill A/c	1,800	1,200	
						,, General Res A/c	7,200	4,800	-
						,, Revaluation A/c	1,260	840	-
		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 :

(i) Poushali should bring in ₹ 10,000 as capital and to pay ₹ 3,500 for goodwill as she will get 1/4th share in profits.

(ii) 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.

(iii) 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

1. 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.

(a) 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
	2,650	By Reversal of Items b/d	2,020
To Reversal of Items b/d		By Partners Capital A/c (In New Ratio) [Loss on Revaluation]	
		Baisakhi 270	
		Sarbani 203	
		Poushali 157	630
	2,650		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	900	675	525	1.4.12	By Balance b/d	20000	15000	-
	Reserve	270	203	157		By General	1,200	900	-
	To M. Rev. A./c				31.3.13	Reserve	-	-	10000
						By Bank A/c	360	270	-
						By M. Rev. A/c	2000	1500	-
						By Bank A/c (Premium) at 4:3.			
		22,390	16,792	9,318					
	To Balance c/d	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	9,318		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
		65,600		65,600

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 a 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	5,000	39,000
L	40,000		Stock		20,000
	50,000	90,000	Cash in hand		25,000
		1,34,000			1,34,000

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	Bank A/c	Dr.		28,600	
July 1	To M's Capital A/c				25,000
	To Goodiwll A/c				3,600
	(Cash to be brought in by M As capital)				
	Goodwill A/c	Dr.		3,600*	
	To K's Capital A/c				3,600
	(Value of goodwill credited to K's Capital only)				
	Reserve A/c	Dr.		14,000	
	To K's Capital A/c				8,750
	To L's Capital A/c				5,250
	(Reserve credited to old partners capital accounts in 5:3)				
	K : Capital A/c	Dr.		4,000	
	L : Capital A/c	Dr.		8,000	
	M : Capital A/c	Dr.		2,000	
	To Reserve A/c				14,000
	(Reserve shown at its original value)				
	Revaluation A/c	Dr.		10,000	
	To Patents A/c				10,000
	(Patent eliminated from the book)				
	Reserve for Bad Debts A/c	Dr.		2,800	
	To Revaluation A/c				2,800
	(Excess provision written back)				
	K's Capital A/c	Dr.		4,500	
	L's Capital A/c	Dr.		2,700	
	To Revaluation A/c				7,200
	(Loss on revaluation transferred)				

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	2,200	41,800
M	23,000	1,11,400	Stock		20,000
Reserve		14,000	Cash & Bank		
Creditors		30,000	(25,000 + 28,600)		53,600
		1,55,400			1,55,400

**Goodwill should be credited to the sacrificing ratio which is computed as under :

K = 5/8 - 2/7 = (35 - 16)/56 = 19/56 (Sacrifice)

L = 3/8 - 4/7 = (21 - 32)/56 = 11/56 (Gains)

M = 1/7 (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 x 11/56 x 56/8)

Illustration 12.

Red and White are partners in a firm sharing profits and losses is 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
	98,000		Stock	60,000
		2,48,000	Debtors	90,000
General Reserve		84,000	Cash	12,000
Sundry Creditors		1,70,000		
		5,02,000		5,02,000

Blue joined the firm as a partner from this date and the following terms and conditions were agreed upon :

(a) Red, White and Blue will share the future profits of the firm in the ratio 5:3:2, respectively.

(b) Blue would first pay ₹ 10,000 as his share of Goodwill and this sum is to be retained in the business.

(c) The value of Machinery is to be increased by ₹ 20,000 and stock is to be written down by 10%.

(d) 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	89,000	4,45,000	Stock (60,000 – 6,000)	54,000
			Debtors	90,000
Sundry Creditors		1,70,000	Cash (12,000+10,000+89,000)	1,11,000
Current A/c (Red)		8,700	Current A/c (White)	8,700
		6,23,700		6,23,700

* 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 & While will be in proportion of Blue

Red = ₹ 3,56,000 × 5/8 = ₹ 2,22,500 – ₹ 2,13,800 = ₹ 8,700

White = ₹ 3,56,000 × 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	77,000	1,97,000	Motor Car	75,000
			Stock	50,000
General Reserve		30,000	Sundry Debtors	90,000
Sundry Creditors		96,000	Cash at Bank	18,000
		3,23,000		3,23,000

Smooth was admitted as a new 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	7,632	7,632	—
				(a sacrificing ratio is 1 : 1)			
				" 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		6,480	76,480
			Add : For Rectification		
Sundry Creditors		1,00,000			
(₹ 96,000+ ₹ 4,000)			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	
	30,000			1,000	20,000
		42,000	Stock-in-trade		10,750
			Fixture & Fittings		250
			Profit and Loss Account		4,000
		62,000			62,000

On 1.1.2013 they admit C as a partner on the following terms :

(a) The new profit sharing ratio of A, B and C becomes 5 :3 : 2.

(b) 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.

(c) The Reserve for bad debts is to be raised to 10% of Sundry Debtors.

(d) Stock-in-trade is to be revalued at ₹ 12,000 but the effect is not be shown in the books.

(e) Fixture & Fittings are to be reduced to ₹ 150.

(f) 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.		9,420	
	To C's Capital A/c				7,280
	To Goodwill A/c				1,600
	(Goodwill and capital to be brought in by C in cash)				
	Goodwill A/c	Dr.		1,600	
	To A's Capital A/c				800
	To B's Capital A/c				800
	(Goodwill to be credited to A and B's capital account in sacrificing ratio)				
	A's Capital A/c	Dr.		400	
	B's Capital A/c	Dr.		400	
	To Bank A/c				800
	(Half of the goodwill to be distributed)				
	A's Capital A/c	Dr.		2,400	
	B's Capital A/c	Dr.		1,600	
	To Profit and Loss A/c				4,000
	(Debit balance of P&L A/c transferred to A and B's capital in 3 : 2)				
	Profit and Loss Adjustment A/c	Dr.		1,200	
	To Reserve for Bad Debts A/c				1,100
	To Fixture and Fitting A/c				100
	(Value of assets is reduced on revaluation before C's admission)				
	A's Capital A/c	Dr.		720	
	B's Capital A/c	Dr.		480	
	To Profit and Loss Adjustment A/c				1,200
	(Loss on revaluation transferred to A and B's capital in 3 : 2)				
	C's Capital A/c	Dr.		250	
	To A's Capital A/c				125
	To B's Capital A/c				125
	(Effect of stock on revaluation adjusted on C's admission)				

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	720	480	—	" Bank	—	—	7,820
" A's Capital	—	—	125	" Goodwill	800	800	—
" B's Capital	—	—	125	" C's Capital	125	125	—
" Bank (Withdraw of goodwill)	400	400	—				
" Balance c/d	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	21,000	
C	7,570	45,420	*Less* : Prov. for Bad Debts	2,100	18,900
Sundry Creditors		20,000	Stock		10,750
			Furniture and Fixtures (₹ 250 – ₹ 100)		150
		65,420			65,420

Working :

1. **Goodwill to be brought in by C :**

	₹
Agreed value of goodwill	20,000
Less : as per Balance Sheet	12,000
Under valuation	8,000

∴ C is to bring ₹ 8,000 x 1/5 = 1,600

Sacrificing ratio :

A 3/5 - 5/10 = (6-5)/10 = 1/10 (Sacrifices)

B 2/5 - 3/10 = (4-3)/10 = 1/10 (Sacrifices)

C 1/10 + 1/10 = 2/10 (gains)

∴ 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	1,200	5,200
		36,800
Add: Premium brought in by		
C 1,600 x ½	800	
Stock revalued	250	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	8,000	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		1,400	1.1.13	By Machinery A/c		2,400
	To Provision On Debtors A/c		300		By Stock A/c		1,100
	To Capital A/c:						
	(Profit on Revaluation)						
	Baichung [3/8]	675					
	Tausif [3/8]	675					
	Vijayan [2/8]	450	1,800				
			3,500				3,500

Dr. **Capital Account** *Cr.*

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	26,000				By Reserve [3:3:2]	1,800	1,800	1,200
	(Balance transferred)	–				By Revaluation A/c	675	675	450
	To Balance c/d		16,225	12,150		" Goodwill	3,750	3,750	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	12,150		Furniture Stock		5,000
		28,375	Debtors		9,600
Baichung's 6% Loan		26,000	*Less* : Provision		
Sundry Creditors		8,700	Cash at Bank	4,300	
			[4,700–4,225]	300	4,000
					475
		63,075			63,075

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
			1.1.14	By Balance b/d	13,000
30.6.14	To Bank A/c [6500+390]	6,890	31.06.14	By Interest A/c [6% of 13,000 for 6 months]	390
31.12.14	To Bank A/c [6,500+195]	6,695	31.12.14	By Interest A/c [6% of 6,500 for 6 months]	195
		13,585			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:

(i) 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.

(ii) 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.

(iii) The valuations arising out of the above agreement were Goodwill ₹ 56,800 and Fixture ₹ 10,980.

(iv) 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 Fixtures A/c To Profit & Loss Adjustment A/c [Values of assets increased on revaluation]	Dr. Dr.	16,800 2,780	 19,580
	Profit & Loss Adjustment A/c To Provision for doubtful debts A/c [Provision created @ 2% on Debtors]	Dr.	1,870	 1,870
	Profit & Loss Adjustment A/c To A's Capital A/c [3/11] To B's Capital A/c [4/11] To C's Capital A/c [4/11] [Profit on Revaluation shared among all partners as 3 : 4 : 4]	Dr.	17,710	 4,830 6,440 6,440
	A's Capital A/c To A's Loan A/c [Transfer of A's dues to his Loan A/c]	Dr.	1,32,760	 1,32,760
	B's Capital A/c [3/5] C's Capital A/c [2/5] To Goodwill A/c To Provision for doubtful debts A/c [Goodwill Account written off and provision on debtors increased by 4% further on ₹ 93,500]	Dr. Dr.	36,324 24,216	 56,800 3,740

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 :

(a) Profits earned by the firm : 2010 — ₹ 17,000; 2011 — ₹ 18,000
2012 — ₹ 24,000; 2013 — ₹ 28,896

(b) B's share of goodwill is to be taken at two years' purchase of the average of his share of profit of the previous two years.

(c) The partners have drawn exactly what they could draw under the agreement.

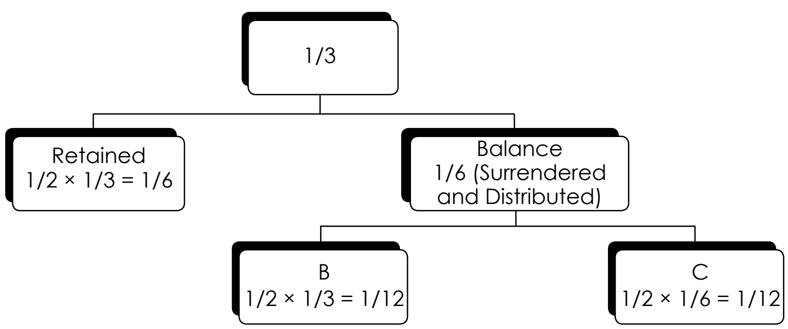
Solution :

Workings:

1. Profit Sharing Ratios among the Partners in different accounting years.

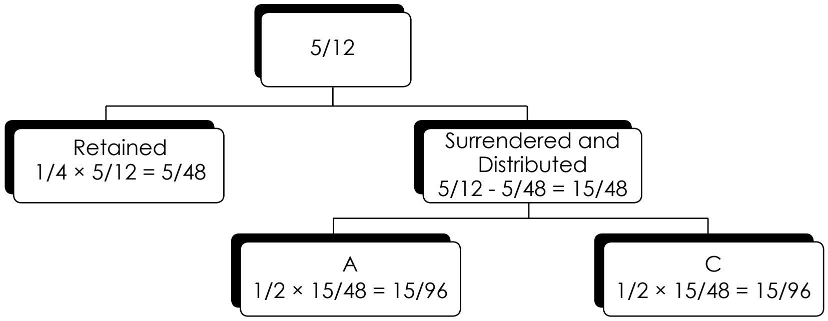
Year	A	B	C
2010	$\frac{1}{2}$	$\frac{1}{2}$	—
2011	$\frac{1}{3}$	$\frac{1}{3}$	$\frac{1}{3}$
2012	$\frac{1}{3}-(\frac{1}{2}\text{ of }\frac{1}{3})=\frac{1}{6}$	$\frac{1}{3}+\frac{1}{2}\text{ of }\frac{1}{6}=\frac{5}{12}$	$\frac{1}{3}+\frac{1}{2}\text{ of }\frac{1}{6}=\frac{5}{12}$
2013	$\frac{1}{6}+\frac{1}{2}\text{ of }\frac{15}{48}=\frac{31}{96}$	$\frac{1}{4}\text{ of }\frac{5}{12}=\frac{5}{48}$ **Share of profit surrendered** $\frac{3}{4}\text{ of }\frac{5}{12}=\frac{15}{48}$	$\frac{5}{12}+\frac{1}{2}\text{ of }\frac{15}{48}=\frac{55}{96}$
2013	$\frac{1}{6}+\frac{1}{2}\text{ of }\frac{15}{48}=\frac{31}{96}$	$\frac{1}{4}\text{ of }\frac{5}{12}=\frac{5}{48}$ Share of profit surrendered $\frac{3}{4}\text{ of }\frac{5}{12}=\frac{15}{48}$	$\frac{5}{12}+\frac{1}{2}\text{ of }\frac{15}{48}=\frac{55}{96}$

A's Share of profit :



∵ B's & C's profit sharing ratio for 2012 = $\frac{1}{3}+\frac{1}{12}=\frac{4+1}{12}+\frac{5}{12}$

B's Share of Profit :



A's profit sharing ratio for 2013 $= \frac{1}{6} + \frac{15}{96} = \frac{31}{96}$

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
		₹ 16,000

Average of this 16,000 $= \frac{16,000}{2}$ = ₹ 8,000; Two years purchase of the above amount = 2 × ₹ 8,000 = ₹16,000.

B's Capital Account

Dr. ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.12.10	To Cash (Drawings) " Balance c/d	4,800 5,700	1.1.10 31.12.10	By Cash — (Contribution) " Profit and Loss A/c — (Share of Profit) (₹ 17,000 x 1/2)	2,000 8,500
		10,500			10,500
31.12.10	To Cash — Drawings " Balance c/d	4,800 7,900	1.1.10 31.12.10	By Balance b/d " Goodwill — Share of Premium (₹ 2,000 x 1/2) " Profit and Loss A/c — Share of Profit (₹ 18,000 ×1/3)	5,700 1,000 6,000
		12,700			12,700
31.12.11	To Cash — Drawings " Balance c/d	4,800 13,100	1.1.11 31.12.11	By Balance b/d " Profit and Loss A/c — Share of Profit (₹ 24,000 x 5/12)	7,900 10,000
		17,900			17,900
31.12.12	To B's Loan A/c — amount transferred	32,110	1.1.12 31.12.12	By Balance b/d " Profit and Loss A/c — (Share of Profit) (₹ 28,896 x 5/48) " Goodwill	13,100 3,010 16,000
		32,110			32,110

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	20,000	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		
		93,900		93,900

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 :

1. **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.

2. R retired on 31st March, 2013, that is, after 3 months from the date of the last year ending. Estimated Profits for 3 months = 3/12 of 9,000 = ₹ 2,250. The retiring partner should be credited with 1/3rd 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.

3. 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. Amount ₹	Cr. 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				By Balance b/d	30,000	20,000	20,000
- Written off	3,300	3,300	3,300	" P & L Suspense A/c	-	-	7 5 0
" R's Loan A/c							
(Transfer)	-	-	25,150	" Revaluation A/c			
				(Sh. of Profit)			
				" General Reserve	6,366	6,367	6,367
To Balance c/d	34,400	24,400	-		1,334	1,333	1,333
	37,700	27,700	28,450		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	24,400	58,800	*Add*: Appreciation	18,000	58,000
			Investment at Cost		5,000
R's Loan A/c		25,150	Stock		9,400
Investment Fluctuation		300	Debtors		10,000
Fund			Cash at Bank		10,000
Trade Creditors		17,900	P & L Suspense A/c		750
		1,02,150			1,02,150

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.	8,000	42,000
Cone	60,000				
Circle	20,000		Furniture		1,000
		1,20,000	Sundry Debtors	80,000	
Reserve		30,000	*Less* : Prov. for Doubtful Debts	3,000	77,000
Sundry Creditors		60,000	Stocks		50,000
			Cash at Bank		40,000
		2,10,000			2,10,000

On 31st Mardh 2013 Conre retired and Compass an 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.		30,000	
	To Compass's Capital A/c				15,000
	To Cone's Capital A/c				10,000
	To Circle's Capital A/c				5,000
	(Reserve transferred to the capital accounts of the partners in 3 : 2 : 1)				
	Machinery A/c	Dr.		3,000	
	To Revaluation A/c				3,000
	(Value of the machinery increased on Cone's retirement)				
	Revaluation A/c	Dr.		2,700	
	To Stock A/c				1,000
	To Furniture A/c				400
	To Provision for Bad Debts A/c				1,000
	To Outstanding Expenses A/c				300
	(Value of the assets reduced on Cone's retirement)				
	Revaluation A/c	Dr.		300	
	To Compass's Capital A/c				150
	To Cone's Capital A/c				100
	To Circle's Capital A/c				50
	(Profit on revaluation transferred to the capital accounts of the partners)				
	Compass's Capital A/c	Dr.		2,400	
	Circle's Capital A/c	Dr.		5,600	
	To Cone's Capital A/c				8,000
	(Cone's share of goodwill to be adjusted against remaining partner's capital accounts in the gaining ratio of 3 : 7)				
	Profit and Loss Suspense A/c	Dr.		18,000	
	To Compass's Capital A/c				9,000
	To Cone's Capital A/c				6,000
	To Circle's Capital A/c				3,000
	(Estimated profit transferred to the capital accounts of the partners)				
	Cone's Capital A/c	Dr.		84,100	
	To Bank A/c				84,100
	(Payment is made to Cone on his retirement)				
	Bank A/c	Dr.		46,100	
	To Compass's Capital A/c				16,430
	To Circle's Capital A/c				29,670
	(Cash to be brought in by Compass and Circle as per agreement)				

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 × 2/6 = 8,000 to be adjusted against Compass's and Circle capital in 3 : 7.

Computation of ratio :

Compass = 3/5 - 3/6 = 3/30 (gain)

Circle = 2/5 - 1/6 = 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		(to be maintained)	
(balance figure)	46,100		
	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	46,100
Combined adjusted capitals	1,30,300

∴ Compass's Cap. = 1,30,300 x 3/5 = 78,180

Circle's Cap. = 1,30,300 x 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	2,00,000		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	25,000	1,50,000		
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

Average Annual Profits = $\dfrac{1{,}00{,}000 + 1{,}40{,}000 + 1{,}20{,}000}{3}$ = ₹ 1,20,000

$\therefore$ Goodwill = 3 × 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. Similarity 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	-
					" X's Current A/c (Transfer)	1,70,000	-	-	-
To Balance c/d	-	1,00,000	2,00,000	1,00,000	" 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
				" Y's Current A/c	60,000	-	-
To X's Current A/c	-	60,000	60,000	" Z's Current A/c	60,000	-	-
To Balance c/d	-	75,000	25,000	" Cash A/c	-	60,000	60,000
	1,70,000	1,35,000	85,000		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	1,00,000	4,00,000	Stock		50,000
			Debtors		1,00,000
Partner's Current A/cs :			Cash at Bank (W5)		1,00,000
Y	75,000				3,00,000
Z	25,000	1,00,000			
Bank loan (Secured)		2,00,000			
Sundry Creditors		1,50,000			
		8,50,000			8,50,000

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	20,000	45,000		
		1,85,000		1,85,000

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	₹ 40,000
		₹ 45,000

So, Average Annual Profits = 45,000/3 = ₹ 15,000. Goodwill = 2 x ₹ 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 – 5,250	10,500		
	20,000		20,000
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 – 1,750	10,500
	20,000		20,000

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 × 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 :	13,130	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 :			Goodwiill	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	4,000	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 1/5th 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 1/5th share Chakraborty's premium is ₹ 3,200.

Full value of Goodwill = 3,200 × 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 = 1/70 × 16,000 = 229

Narang's = 4/70 × 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 = 1/5

Balance left = 1- 1/5 = 4/5 to be shared in 3:3:2

Shukla's Share = 4/5 × 3/8 = 3/10;

Narang's Share = 4/5 × 2/8 = 2/10;

Jain's Share = 4/5 × 3/8 = 3/10

New Ratio = 3/10 : 3/10 : 2/10 : 2/10 = 3 : 3 : 2 : 2

(d) Sacrifice/Gains = Old Ratio – New Ratio

	Shukla ₹	**Jain** ₹	**Narang** ₹	**Ckakraborty** ₹
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 Dr. Grewal's Capital A/c Dr. Jain's Capital A/c Dr. Narang's Capital A/c Dr.		1,200 900 600 300	
	To Profit & Loss A/c			3,000
	[Unshared loss written off in old ratio 4 : 3 : 2 : 1]			
	Grewal's Capital A/c Dr.		5,600	
	To Shukla's Capital A/c			3,200
	To Jain's Capital A/c			1,600
	To Narang's Capital A/c			800
	[Retiring partners credited to continuing partners in their remaining profit sharing ratio 4 : 2 : 1 on their private payments to the retiring partner]			
	Cash A/c Dr.		5,000	
	To Chakraborti's Capital A/c			5,000
	[Cash brought in by the incoming partner as capital]			
	Shukla's Capital A/c Dr.		2,590	
	Chakraborti's Capital A/c Dr.		1,260	
	To Cash A/c			3,850
	[Out of premium paid by the incoming partner, true premium credited to Shukla for his sole sacrifice, the balance being credited to Chakrabarti himself]			
	Cash A/c Dr.		3,850	
	To Jain's Capital A/c			2,410
	To Narang's Capital A/c			1,440
	[Additional Cash invested to make capitals proportionate to new profit sharing ratio]			

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	3,740	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	70,000	2,50,000	Sundry Debtors	96,000
Bank overdraft		20,000	Cash at Bank	18,000
Sundry Creditors		56,000		
		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	16,000	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		16,000	By, Profit and Loss A/c	
(25% of ₹ 64,000)			- Net Profit	64,000
,, Share of Profit:				
- 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	-
						,, Bank A/c	-	-	1,00,000
					31.12.12	,, Share of profit	16,000	16,000	16,000
		1,12,000	1,02,000	1,16,000			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

Mita = ₹ 2,55,00 x 2/3 = ₹ 1,70, 000

Lata = ₹ 2,55,000 x 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	26,000	
		1,28,000
To be brought in by Mita		42,000

3. **Revaluation Account**

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Capital A/c		By Goodwill A/c	20,000
,, Profit on Revaluation		,, Fixed Assets A/c	20,000
Gita 26,000		,, Prov. For Depreciation A/c.	12,000
Mita 26,000	52,000		
	52,000		52,000

Bank Account

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	8,000	By Gita's capital A/C	1,30,000
To Mita's capital 42,000		,, Balance c/d	5,000
Lata's Capital 85,000	1,27,000		
	1,35,000		1,35,000

Journal

Date	Particulars		L.F.	Debit ₹	Credit ₹
1.4.13	Goodwill A/c	Dr.		20,000	
	Fixed Asset A/c	Dr.		20,000	
	Prov. for Depreciation A/c	Dr.		12,000	
	To Revaluation A/c				52,000
	(Increased value of assets transferred to Revaluation A/c).				
	Revaluation A/c	Dr.		52,000	
	To Gita' s Capital A/c				26,000
	,, Mita's Capital A/c				26,000
	(Profit on revaluation transferred).				
	Gita's Capital A/c	Dr.		1,30,000	
	To Bank A/c				1,30,000
	(Amount paid to Gita)				
	Bank A/c	Dr.		1,27,000	
	To Mita's Capital A/c				42,000
	,, Lata's Capital A/c				85,000
	(Additional cash to be brought in to make their capital in proportion).				

Balance Sheet
as at April 1, 2013

Liabilities	Amount ₹	Assets	Amount ₹
Capital:		Goodwill	30,000
Mita	1,70,000	Fixed Assets	1,40,000
Lata	85,000	Stock	60,000
Creditor	20,000	Debtors	40,000
		Cash at Bank	5,000
	2,75,000		2,75,000

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	20,000	50,000	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		
		1,00,000		1,00,000

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	(1,000)	
Adjusted Loss	(9,000)	

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 *Dr.* *Cr.*

Date	Particulars	L. F.	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 Dr. 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)		13,000	 2,600 5,200 5,200
	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c [Value of Goodwill reduced]		1,000 2,000 2,000	 5,000
	Profit & Loss Suspense A/c Dr. To C's Capital A/c [Estimated share of Profit till his date of death transferred to the decreased partner's Capital]		500	 500
	C's Capital A/c Dr. To C's Executors A/c [Total dues to the deceased partner transferred to his Executor's A/c]		27,700	 27,700

Dr. **Capital Accounts** **Cr.**

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
				-		" P & L Suspense A/c	-	-	500
	To Balance c/d	10,267	20,533						
		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	20,533	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) Trausfer 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 (Discount, if any received on payment/ discharge) (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.
5. External liabilities paid off	Realization A/c. .... Dr. To Cash/Bank A/c (actual amt. paid)	
6. External liabilities taken over by any partner	Realization A/c. .... Dr. To Particular Partner's Cap. A/c (agreed value)	
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	1,200	23,000
B	10,000		Stock		7800
C	7,000	44,500	Furnitures		1,000
		52,000			52,000

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
			Capital Account A :		
Sundry Assets	17,000		Fixtures	800	
Debtors	24,200		Debtors	17,200	
Stock	7,800				18,000
Fixtures	1,000		B: Stock	7,000	
		50,000	Sundry Assets	7,200	
					14,200
,, Bank – Expenses		270	C: Sundry Assets		8,000
,, Capital Account			By Bank: Collection from Debtors		2,100
C- Interest on loan		30	By Loss on realization:		
			A (3/5)	4,080	
			B (1/5)	1,360	
			C (1/5)	1,360	6,800
		50,300			50,300

Capital Account

Dr. Cr.

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Dissolution Assets taken	18,000	14,200	8,000	By Balance b/d	27,500	10,000	7,000
				,, Creditors	6,000	-	-
,, Dissolution A/c Loss	4,080	1,360	1,360	,, Loan(with interest)	-	-	1,530
,, Bank — Final payment	11,420	-	-	,, Bank Final receipts	-	5,560	830
	33,500	15,560	9,360		33,500	15,560	9,360

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	830	6,390		
		11,690		11,690

Working Notes: ₹

1. Realization of Sundry Assets:

Sundry Assets (Book Value)	17,000
Less: Taken by B [7,200 x (100/90)]	8,000
Remaining at book value	9,000

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)	20,000
	4,200

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	500		Bad Debts	500	9,500
Salary Outstanding		18,500			
		2,000	Stock at Invoice Price	10,000	
			Less: Price loading	2,000	8,000
			Investments	8,000	
			Less: Fluctuation Fund	500	7,500
					2,000
			Capital Account –Z		23,500
		1,10,500	Bank		1,10,500

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 as 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		
To Stock (at I. P.)		10,000	Fund A/c		500
To Investments A/c		8,000	By Joint Life Policy Fund A/c		10,000
To Pro. for Disc. on		500	By Creditors A/c		19,000
Creditors A/c			By Outstanding Salary A/c		2,000
To Y's Capital A/c		10,000	By X' Capital A/c		6,000
[Creditors taken			(Investments taken over)		
over- see Note]			By Bank A/c :		
To Bank A/c :			Joint Life Policy	10,000	
Creditors paid off	7,500		Fixed Assets	70,000	
Unrecorded liability	2,500		Stock	7,000	
paid [1/2 × 5,000]			Debtors	9,800	
Outstanding Salary	2,000		Unrecorded Assets (Sold)	1,300	
Outstanding Expense	1,100	13,100	Bad Debt Recovered	800	98,100
To Y's Cap. A/c		1,600			
[Salary 400 × 4]					
To Partner's Capital A/c					
(Profit on Realization)					
X [2/5]	9,960				
Y [2/5]	9,960				
Z [1/5]	4,980	24,900			
		1,38,100			1,38,100

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 :

(a) The surviving partners/continuing partners continue to carry on the business of the firm.

(b) The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.

(c) 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 :

(i) Interest on unsettled capital = ₹ 52,000 × 6% × 6 months = ₹ 1,560

(ii) 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 × 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 –

(i) That the solvent partners should bring in cash equal to their respective shares of the loss on realization;

(ii) 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	24,000	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 10,000	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: 8,000	40,000
	1,00,000		**1,00,000**

Dr. Partners Capital Acounts Cr.

Particulars	P	Q	R	Particulars	P	Q	R
				By Balance b/d	5,000	3,000	2,000
To Realization A/c	20,000	12,000	8,000	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.

Ilustration 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	
To X's Capital A/c			42,000
(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

This method is applicable when all the partners are solvent. The following steps are to be followed to calculate the surplus capital:

1. Adjusted capital: the balance lying in the capital accounts of the partners are adjusted with the undistributed profit or loss, drawings and reserves.

2. Base capital: the adjusted capital is divided by the unit of profit share and the minimum amount is called the base capital. For example if profit sharing ratio is 5:3:2 the respective capitals will be divided by 5, 3 and 2 respectively.
3. Proportionate capital: the amount is ascertained by multiplying the base capital with unit of profit share. For example if base capital is ₹20,000 it is multiplied by 5,3 and 2 respectively.
4. Surplus capital: it is ascertained by the difference of adjusted capital and the proportionate capital.

The process continues until we get an absolute surplus.

Example: (Computation of Surplus Capital)

Balance of Capital Accounts

X : ₹ 35000, Y: ₹33000, AND Z : ₹18000. Reserves ₹ 10000. Profit sharing ratio 5:3:2.

Statement Showing Surplus Capital

Particulars		₹	**X** ₹	**Y** ₹	**Z** ₹
Capital balance	A		35,000	33,000	18,000
Add reserves (5:3:2)	B		5,000	3,000	2,000
Adjusted capital	C		40,000	36,000	20,000
Unit share of profit	D		5	3	2
Capital per unit of profit share	E		8,000	12,000	10,000
Base capital (being minimum)	F	8,000			
Unit share of profit	G		5	3	2
Proportionate capital (FXG)	H		40,000	24,000	16,000
Surplus capital (C-H)	I		0	12,000	4,000
Unit share of profit	J			3	2
Capital per unit of profit share	K			4,000	2,000
Base capital (being minimum)	L	2,000			
Unit share of profit	M			3	2
Proportionate capital (LXM)	N			6,000	4,000
Absolute surplus capital(I-N)	O			6,000	0

Implication:

The above table indicates that Y will get the first preference of settlement by ₹6,000. Thereafter, Y and Z will be settled in the ratio of 3:2. Any balance left will then be open to X Y and Z in the ratio of 5:3:2.

Example: (Distribution of Cash)

A B and C were partners sharing profits and losses as 2:1:1. The balance sheet as on 31.03.2018 when they dissolved their partnership was as under:

Liabilities	₹	Assets	₹
Capital :			
A	60,000	Sundry assets	1,85,000
B	50,000	Cash	15,000
C	30,000		
Reserves	10,000		
B's Loan	20,000		
Creditors	20,000		
Government due	10,000		
	2,00,000		**2,00,000**

₹ 2,000 was spent for packaging of materials before sale. The realization were made on different dates as under:

April ₹15,000; May ₹20,000; June ₹ 30,000; July ₹ 60,000; August ₹40,000.

The collections were distributed as and when realized. Prepare a statement showing the distribution of cash collected.

Solution:

Computation of Surplus Capital

Particulars		₹	X ₹	Y ₹	Z ₹
Capital balance	A		60,000	50,000	30,000
Add reserves (2:1:1)	B		5,000	2,500	2,500
Adjusted capital	C		65,000	52,500	32,500
Unit share of profit	D		2	1	1
Capital per unit of profit share	E		32,500	52,500	32,500
Base capital (being minimum)	F	32,500			
Unit share of profit	G		2	1	1
Proportionate capital (FXG)	H		65,000	32,500	32,500
Surplus capital (C-H)	I		0	20,000	0
Unit share of profit	J		-	-	-
Capital per unit of profit share	K		-	-	-
Base capital (being minimum)	L		-	-	-
Unit share of profit	M		-	-	-
Proportionate capital (LXM)	N		-	-	-
Absolute surplus capital(I-N)	O		-	-	-

Statement Showing Distribution of Cash

Particulars	Amount	External Debt		B's Loan	Partners Capital		
		Govt. Due	Creditors		A	B	C
Balance as on 31.03.2018	15,000	10,000	20,000	20,000	65,000	52,500	32,500
Less: expense for packaging	2,000						
	13,000						
Payment of govt. dues	10,000	10,000					
	3,000	NIL					
Payment to creditors	3,000		3,000				
	NIL		17,000	20,000	65,000	52,500	32,500
1ST Realisation	15,000						
Payment to creditors	15,000		15,000				
			2,000	20,000	65,000	52,500	32,500
2nd Realisation	20,000						
Payment to creditors	2,000		2,000				
Paid to B	18,000			18,000			
				2,000	65,000	52,500	32,500
3rd Realisation	30,000						
Paid to B	2,000			2,000			
Payment of surplus capital to B	20,000					20,000	
Payment to partners(2:1:1)	8,000				4,000	2,000	2,000
					61,000	30,500	30,500
4th Rrealisation	60,000						
Paid to partners(2:1:1)	60,000				3,0000	15,000	15,000
					31,000	15,500	15,500
5th Realisation	40,000						
Paid to partners(2:1:1)	40,000				20,000	10,000	10,000
Loss on Realisation					11,000	5,500	5,000

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 dome 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	41,500	24,900	16,600
(Cash and Equipment)	41,500	29,400	19,600
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	27,000	97,000	Current Accounts :		
			K	4,000	
			J	3,000	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 :

(i) May — ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500.

(ii) June — Balance of debtors realised ₹ 10,000. Balance of stock fetched ₹ 24,000.

(iii) August — Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.

(iv) 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 ₹	Capital K ₹	Capital 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. * Includes value of Machinery ₹ 10,000 and Cash ₹ 2,300		16,400	12,300*	12,300

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)

	Particualr	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			14,220	9,480	4,740
	(being excess over estimated			390	260	130
	expenses ₹ 780)					
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	17,280	—	5,760
I	Revised Surplus Capital [E-H]	5,400	—	—
J	Distribution Sequence			
	First ₹ 5,400 [To East]	5,400	—	—
	Next ₹ 23,040 [To East & North in the ratio of 3 : 1]	17,280	—	5,760
	Balance ₹ 19,200 [To East, South & North in the ratio of 3 : 2 : 1]	9,600	6,400	3,200

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	(x)
Maximum Loss	xxx

(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 Capial	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 billl 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	31,500	1,80,000	Stock	97,700
Current Accounts :			Debtors	56,400
E	26,400		Bank	29,700
G	6,000	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			43,650	(46,500)	5,550	
	and G in the ratio of their fixed capitals i.e.						
	1,13,100 : 31,500			(36,370)	46,500	(10,130)	
	Balance Adjustment of G's Deficiency			7,280	—	(4,580)	
	(charged to E)			(4,580)		4,580	
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			80,100	53,400	26,700	1,60,200
	(₹1,60,200 – ₹21,900)						
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			66,000	44,000	22,000	1,32,000
	(₹ 1,32,000 – ₹ 96,000)			18,000	12,000	6,000	36,000
M	Cash paid on 30th June			48,000	32,000	16,000	96,000
N	Unpaid Balance (L – N)			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	(xxx)
Purchase consideration	xxxx

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 relisation (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 :

1. 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)

2. 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 overby 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.

1. 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]

2. 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]

3. 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:

(a) The capital of the partnership firm would be ₹ 3,00,000 and to be contributed by them in the ratio of 2:1.

(b) 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) 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.

(d) 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. Amount ₹	Cr. 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
	2,41,487	1,48,750
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.	1,18,987	1,01,750
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:

(i) 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.

(ii) The capital of the new partner (the sole proprietorship) is equal to the purchase consideration agreed upon.

(iii) Calculation and treatment for goodwill and Capital reserve are same as explained in situation (A).

(iv) 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.

(v) Goodwill of the firm is to be adjusted by crediting the Partners' Capital Accounts in their old profit-sharing ratio.

(vi) 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	-
	46,000	28,000		46,000	28,000

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: Liabillties 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. **Realisation Account** **Cr.**

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
				By Realisation A/c	1,000
		11,000			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	Dr.		15,000	
	To Revaluation A/c				
	(Increase in the Value of Building)				15,000
	Revaluation A/c	Dr.		1,000	
	To Stock A/c				
	To Provision for Bad Debt A/c				800
	(Decrease in the value of assets)				200
	Revaluation A/c	Dr.		14,000	
	To X Capital A/c				
	To Y Capital A/c				10,500
	(Profit on revaluation transferred)				3,500
	Goodwill A/c	Dr.		10,000	
	To X Capital A/c				
	To Y Capital A/c				7,500
	(Goodwill raised in the books)				2,500
	Goodwill A/c	Dr.		1,500	
	Stock A/c	Dr.		16,800	
	Bills Receivable A/c	Dr.		5,000	
	Debtors A/c	Dr.		6,000	
	To Loan A/c				5,000
	To Creditors A/c				13,000
	To Provision for Bad Debt A/c				300
	To Z Capital A/c				11,000
	(Assets and liabilities taken over)				

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	
Crditors	39,000	Less: Provision	5 0 0	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:

(a) that the value of the goodwill of CD & Co. would be ₹ 12,000;

(b) that the investments of CD & Co. to be sold out for ₹ 24,000 and the realised cash will be introduced in the acquiring business;

(c) that the stock of CD & Co. to be reduced to ₹ 22,000;

(d) that the machinery of CD & Co. will be increased by 40%;

(e) 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 :

(i) Assets are to be revalued as follows :
Goodwill- ₹ 16,000; Stock - ₹ 40,000; Machinery - ₹ 84,000; Furniture - ₹ 7,200;

(ii) 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. **Realisation Account** **Cr.**

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 - 8,700	17,400			
		123,400			123,400

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

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
	To Balance b/d	2,000		By Realisation A/c	26,000
	To Investments A/c	24,000			
		26000			26,000

Dr. **Partners' Capital Accounts** **Cr.**

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. **Partners' Capital Accounts** **Cr.**

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		Goodwill	28,000
A B C D	83,600	Machinery	1,12,000
	53,600	Furniture	12,600
Bills payable	47,700	Stock	62,000
	35,700	Debtors	48,000
	70,000	Cash (26,000 + 12,000 – 10,000)	28,000
	2,90,600		2,90,600

Journal

Date	Particulars		L.F	Dr. Amount ₹	Cr. Amount ₹
1.4.13	Bank Loan A/c	Dr.		10,000	
	To Cash A/c				10,000
	(Being the bank loan repaid)				
	Goodwill A/c	Dr.		16,000	
	To A's Capital A/c				8,000
	To B's Capital A/c				8,000
	(Being the goodwill raised)				
	Stock A/c	Dr.		8,000	
	Machinery A/c	Dr.		24,000	
	To Revaluation A/c				32,000
	(Being increase in the value of assets)				
	Revaluation A/c	Dr.		800	
	To Furniture A/c				800
	(Being the decrease in the value of furniture)				
	Revaluation A/c	Dr.		31,200	
	To A's Capital A/c				15,600
	To B's Capital A/c				15,600
	(Being the profit on revaluation transferred to Partners' Capital A/cs in the profit-sharing ratio)				
	Goodwill A/c	Dr.		12,000	
	Machinery A/c	Dr.		28,000	
	Furniture A/c	Dr.		5,400	
	Stock A/c	Dr.		22,000	
	Debtors A/c	Dr.		30,000	
	Cash A/c	Dr.		26,000	
	To Bills Payable A/c				
	To C 's Capital A/c				40,000
	To D's Capital A/c				47,700
	(Being the introduction of capital by C & D)				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 :

1. All fixed assets are to be devalued by 20%.
2. All stock in trade is to be appreciated by 50%.
3. 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.
4. 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.
5. 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.
6. 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		10,000	*7,000
(₹ 5,000 – 2,000)]	(A)	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. Amount ₹	Cr. 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

Date	Particulars		L.F.	Dr. Amount ₹	Cr. Amount ₹
31.3.13	Realisalion 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
	(Sundry creditors transferred)				
	RW & Co. A/c	Dr.		5,000	
	To Realisation A/c				5,000
	(Purchase consideration due)				
	C's Capital A/c	Dr.		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.		4,750	
	To D's Capital A/c				4,750
	(Being the necessary amount brought in by D to make up his required capital contribution)				
	C's Capital A/c	Dr.		7,250	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	To Cash A/c				6,250
	(Capital accounts of the partners closed by transfer to RW & Co. and balance paid by cash)				
	Alternatively Shows:				
	C's Capital A/c	Dr.		6,250	
	To Cash A/c				6,250
	(Being the C's Capital is paid off)				
	C's Capital A/c	Dr.		1,000	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	(Being the Partner's Capital transferred to RW & Co.)				

Realization Account

Dr. ***Cr.***

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. Amount ₹	Cr. Amount ₹
31.3.13	Realisalion A/c	Dr.		6,00,000	
	To Fixed Assets A/c				4,80,000
	To Stock-in-trade A/c				45,000
	To Sundry Debtors A/c				75,000
	(Different Assets transferred)				
	Creditors A/c	Dr.		1,80,000	
	To Realisation A/c				1,80,000
	(Sundry creditors transferred)				
	P. Ltd A/c	Dr.		7,20,000	
	To Realisation A/c				7,20,000
	(Purchase consideration due)				
	Bank A/c	Dr.		3,60,000	
	Debentures in P Ltd.	Dr.		1,80,000	
	Shares in P Ltd.	Dr.		1,80,000	
	To P. Ltd A/c				
	(Purchase consideration Received)				7,20,000
	Bank A/c	Dr.		60,000	
	To Realisation A/c				60,000
	(Debtors realized)				
	Realisation A/c	Dr.		1,71,000	
	To Bank A/c				1,71,000
	(Payment to Creditors)				
	Realisation A/c	Dr.		1,89,000	
	To X Capital A/c				1,13,400
	To Y Capital A/c				75,600
	(Profit on realisation transferred to Capital Account)				
	Loan from X	Dr.		2,10,000	
	To X Capital				2,10,000
	(Loan Balance transferred)				
	X Capital A/c	Dr.		30,000	
	To Y Capital A/c				30,000
	(Adjustment for compensation)				
	X Capital A/c	Dr.		4,13,400	
	To Share in P Ltd				1,53,000
	To Debenture in P Ltd. To Bank A/c				1,80,000
	(Final settlement of accounts of X)				80,400
	Y Capital A/c	Dr.		45,600	
	To Shares in P Ltd.				27,000
	To Bank				18,600
	(Fianal settlement of accounts of Y)				

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

Bank Account

Dr. **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Realisation A/c	60,000	By Balance b/d	1,50,000
(Debtors realised)		By Realisation A/c	1,71,000
To S Ltd. A/c	3,60,000	(Crs payment)	
(Purchase Consideration)		By Capital A/c - X	80,400
		By Capital A/c - Y	18,600
	4,20,000		4,20,000

Partners' Capital Accounts

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		<u>7,20,000</u>
Discharged:		
In Cash	3,60,000	
By Debentures	<u>1,80,000</u>	<u>5,40,000</u>
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 = ₹ <u>60,000</u>

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 _ 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 l/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 = $^1/_6$ and A's sacrifice = $^1/_4$ - $^1/_6$ = (3 - 2)/12 = $^1/_{12}$

Hence, Sacrifice ratio of A & B = $^1/_{12}$: $^1/_6$ or 1 : 2

New Profit Sharing Ratio:

New share of A = $^5/_9$ - $^1/_{12}$ = (20 - 3)/36 = $^{17}/_{36}$

New shares of B = $^4/_9$ - $^1/_6$ = (8-3)/18 = $^5/_{18}$ = $^{10}/_{36}$

Share of C = $^1/_4$ or $^9/_{36}$

Share of C = $^1/_4$ or $^9/_{36}$

Hence, New Ratio of A. B & C = 17 : 10 : 9.

(ii)

Journal Entries

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c Dr. To Goodwill A/c (Amount of goodwill brought by C)	2,50,000	 2,50,000
Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c (Amount of goodwill shared by A&B in sacrifice ratio 1 : 2)	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 where 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:

(i) Average capital employed in the business ₹ 5,00,000.

(ii) Net trading profit of the firm for the last three years ₹ 1,50,000; ₹ 1,70,000 and ₹ 1,90,000.

(iii) Rate of return expected from capital having regard to risk involved @ 15% per annum.

(iv) 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

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 prepare 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 abstruction 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.

In the General Ledger

Debtors' Ledger Adjustment Account

Dr. **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Balance b/d		By Balance b/d	
To G L Adj. A/c:		By G L Adj. A/c:	
All transactions for which debtors balance increase.		All transactions for which debtors balance decrease.	
Example:		**Example:**	
Credit sales		Cash collected from debtors	
BR dishonoured		Discount allowed	
Interest for delayed payment		Bad debt	
		Sales returns	
		Bills receivables	
To Balance c/d		By Balance c/d	

In the general ledger

Creditors' Ledger Adjustment Account

Dr. **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Balance b/d		By Balance b/d	
To G L Adj A/c:		By G L Adj A/c:	
All transactions for which creditors balance decrease.		All transactions for which creditors balance increase.	
Example:		**Example:**	
Purchase Returns		Credit Purchase	
Cash paid to creditors			
Discount Received			
Bills Payable accepted			
To Balance c/d		By Balance c/d	

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	
	Adjustment A/c—			Adjustment A/c—	
	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 Samaresh

In Sales Ledger

Debtors Ledger Adjustment Account

Dr. *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013	To Sales Ledger Adj. A/c		2013	By Balance b/d	6,210
Jan. 31	Cash	4,851	Jan. 1	,, Sales Ledger Adj. A/c-	
	Dis. Allowed	120		Sales	3,330
	Returns Inward	180	Jan. 31	B/R Dishonoured	1,200
	B/R	1,200			
	Bad Debts	819			
	,, Balance c/d	3,570			
		10,740			10,740
			Feb. 1	By Balance b/d	3,370

A Account

Dr. *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013			2013		
Jan. 1	To Balance b/d	1,530	Jan. 11	By Cash	1,500
,, 2	,, Sales	1,710	,, ,,	,, Dis. Allowed	30
,, 25	,, B/R Dishonoured	1,200	,, 19	,, B/R	1,200
			,, 31	,, Balance c/d	1,710
		4,440			4,440

B Account

Dr. *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013			2013		
Jan. 1	To Balance b/d	1,620	Jan. 9	By Balance b/d	300
,, 12	,, Sales	600	,, 14	,, Returns Inward	180
			,, 22	,, Cash	900
			,, 31	,, Balance c/d	840
		2,220			2,220

C Account

Dr. *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013			2013		
Jan. 1	To Balance b/d	1,890	Jan. 18	By Cash	1,800
,, 31	,, Sales	1,020	,, ,,	,, Dis. Allowed	90
			,, 31	,, Balance c/d	1,020
		2,910			2,910

D Account

Dr. *Cr.*

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013			2013		
Jan. 1	To Balance b/d	1,170	Jan. 28	By Cash	351
				,, Bad Debts	819
		1,170			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 31st 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. ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
?	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. ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
?	To Debtors Ledger Adjustment A/c		?	By Balance b/d	4,500
				,, Debtors' Ledger Adjustment A/c	
	Cash & Cheque Received	20,000		Sales	32,000
				B/R Dishonoured	700
	Returns Inwards	3,000		Charges	20
	Discount Allowed	2,000			
	B/R	2,000			
	,, Balance c/d	10,220			
		37,220			37,220
				,, Balance b/d	10,220

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			2012		
April 1	To Balance b/d	1,000	April 1	By Balance b/d	10,000
2013	" General Ledger		2013	General Ledger	
March. 31	Adjustment A/c :		March. 31	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	To Balance b/d	4,000	2013	By Balance b/d	20,200
April 1			April 1		

In the Creditors Ledger

General Ledger Adjustment Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount
2012			2012		
April 1	To Balance b/d	10,000	April 1	By Balance b/d	1,000
2013	" Creditors Ledger		2013	" Creditors Ledger	
March 31	Adjustment A/c :		March 31	Adjustment A/c :	
	Purchase	40,000		Returns Outward	2,000
	Bills Payable	2,000		Cash	20,000
	dishonoured			Discount Received	3,000
	Interest	100		Bills receivable	2,000
	Sundry Charges	100		Bills Payable	4,000
	" Balance c/d	4,000		Bills Payable (renewed)	1,000
				Transfer	3,000
				" Balance c/d	20,200
		56,200			56,200
2013	To Balance b/d	20,200	2013	By Balance b/d	4,000
April 1			April 1		

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	Dr.		3,000	
	To General ledger Adjustment A/c				3,000
	General Ledger Adjustment A/c	Dr.		3,000	
	To Debtors Ledger Adjustment A/c				3,000
	or Direct Entry				
	Creditors Ledger Adjustment A/c	Dr.		3,000	
	To Debtors ledger Adjustment A/c				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	To Balance b/d	15,000	2013	By Balance b/d	200
Jan. 1	,, Creditors Ledger		Jan. 1	Creditors Ledger	
Dec. 31	Adjustment A/c:		Dec.31	Adjustment A/c	
	Purchases	8,000		Cash	8,500
	Bills Payable Withdrawn	500		Discount Received	
	Bills Receivable			(9,000 – 8,500)	500
	Dishonoured (as	300		Returns Outward	700
	endorsed)			Bills Payable	2,000
	Interest	20		Bills Receivable endorsed	800
	,, Balance c/d	350		Transfer	600
				,, Balance c/d	10,870
		24,170			24,170
	To Balance b/d	10,870			
2014			2014	By Balance b/d	350
Jan. 1			Jan. 1		

In the General Ledger

Debtors Ledger Adjustment Account

Dr. ***Cr.***

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013	To Balance b/d	20,000	2013	By Balance b/d	300
Jan. 1	General Ledger		Jan. 1	,, General Ledger	
Dec.31	Adjustment A/c:		Dec.31	Cash	14,100
	Sales	19,000		Discount Allowed (15,000 – 14,100)	
	B/R endorsed				900
	Dishonoured	300			
	Bills Dishonoured	400		Bills Receivable Received	3,000
	Interest	30		Transfer	600
	,, Balance c/d	450		,, Balance c/d	21,280
		40,180			40,180
2014	To Balance b/d	21,280	2014	By Balance b/d	450
Jan. 1			Jan. 1		

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-payament, 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

Amount of Credit sales will be $\frac{₹60,000 \times 100}{120}$ = ₹50,000

2. Cash received

Cash received is 60% of opening Debtors plus Credit sales i.e. ₹40,000 + ₹50,000 = ₹90,000

Cash Received ₹90,000 × $\frac{60}{100}$ = ₹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.

 (i) 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.

 (ii) 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.

 (iii) 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.

 (iv) 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.

 (v) 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, licencee, 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]

If the user is a manufacturer and royalties are calculated on the basis of production, the actual royalties are debited to Manufacturing Account. Where royalties are calculated on the basis of sales, they are debited to Profit and Loss Account.

In case of a limited company, which does not prepare Manufacturing Account separately, the actual royalties are debited to Profit and Loss Account and they are shown in production or manufacturing section of the Profit and Loss Account.

Treatment of Short workings

As per agreed terms, short workings can be recouped in the year when the actual royalty is more than the Minimum rent. Any short workings, which cannot be recouped within the specified period becomes irrecoverable and it should be charged to Profit and Loss Account in the year in which the period ends.

However, the recoupable short workings should be carried forward and they are shown in the Balance Sheet as a Current Asset.

The relationship between Minimum rent, Actual Royalty and Royalty payable are in below : Minimum rent = Actual Royalty + Short workings.

(b) Where the actual royalty is more than the minimum rent :

(i) Royalties (payable) Account Dr.

To Landlord Account

[Actual royalties for the period]

(ii) Landlord Account Dr.

To Short workings Account

(Short workings, if any, recouped)

(iii) Landlord Account Dr.

To Bank Account

To Income Tax Payable Account

(iv) Profit & Loss Account Dr.

To Short workings Account

(Short workings, which can not be recouped)

(v) Manufacturing / Profit & Loss Account Dr.

To Royalties (payable) Account

Important Points to note :

1. When the royalty agreement does not contain a clause for minimum rent, the question of short workings and its recoupment does not arise.
2. The landlord is always entitled to get either the minimum rent or the actual royalty whichever is higher subject to any adjustment for short workings recouped.

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

									Fig in (₹)
Year	**Output (Tons)**	**Actual Royalties**	**Min. Rent**	**Excess Short Workings**	**Shortworkings**				**Amount**
					Occurred	**Recouped**	**Written off or lapsed**	**C/F**	**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 By Short workings A/c	75,000 75,000
		150,000			150,000
31.03.08	To Bank A/c	150,000	31.03.08	By Royalties A/c By Short workings A/c	90,000 60,000
		150,000			150,000
31.03.09	To Bank A/c To Short workings A/c	150,000 37,500	31.03.09	By Royalties A/c	187,500
		187,500			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 31.03.08	To Balance b/d To Landlord A/c	75,000 60,000	31.03.08	By Balance c/d	135,000
		135,000			135,000
1.4.08	To Balance b/d	135,000	31.03.09	By Landlord A/c By Profit & Loss A/c By Balance c/d	37,500 37,500 60,000
		135,000			135,000
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	34,500
				" Short-working A/c	40,500
		75,000			75,000
2010	To Bank A/c	75,000	2010	By Royalty A/c	54,000
				" Short-working A/c	21,000
		75,000			75,000
2011	To Bank A/c	75,000	2011	By Royalty A/c	75,000
		75,000			75,000
2012	To Bank A/c	75,000	2012	By Royalty A/c	82,500
	To Short-Working A/c	7,500			
		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	40,500	2010	By Balance c/d	61,500
	" B. S. Ltd. A/c (Landlord)	21,000			
		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	7,500
				" Profit and Loss A/c	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 Dr. [Minimum rent]
To Royalty Receivable Account [Actual Royalties for the period]
To Royalty Suspense Account/ [Short fall in Royalties]
Or Shortworkings Allowable A/c

(ii) Bank Account Dr. [Net amount paid]
Tax Deducted at source Dr. [Tax deducted at source]
To Lessee Account [Minimum rent]

(iii) Royalties Receivable Account Dr.
To Profit & Loss Account [Transfer]

(b) Where the actual royalty is more than the minimum rent :

(ii) Royalty Suspense Account/ Dr.
Or Short workings Allowable A/c
To Lessee Account [Recoupment of Short workings, if any]

(iii) Bank Account Dr. [Net amount paid]
Tax Deducted at source Dr. [Tax deducted at source]
To Lessee Account

(iv) Royalties (Receivable) Account Dr.
To Profit & Loss Account [Transfer]

(v) Royalty Suspense Account/ Dr.
Or Short workings Allowable A/c
To Profit and Loss Account [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

Dr. **Royalty Receivable Account** *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.**

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			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			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 lesee 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 :

1. 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 @ ¼ 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	To Bank A/c	12,000	2009	By Royalty A/c	11,800
March, 31	To Income Tax Payable A/c	3,000	March, 31	By Shortworkings A/c	3,200
		15,000			15,000
2010	To Bank A/c	12,000	2010	By Royalty A/c	17,500
March, 31	To Income Tax Payable A/c	3,000	March, 31		
	To Short workings A/c (Recoupment)	2,500			
		17,500			17,500

2011	To Bank A/c	12,000	2011	By Royalty A/c	16,000
March, 31	To Income Tax Payable A/c	3,000	March, 31		
	To Short workings A/c(Recoupment)	1,000			
		16,000			16,000
2012	To Bank A/c	19,200	2012	By Royalty A/c	24,000
March, 31	To Income Tax Payable A/c	4,800	March, 31		
		24,000			24,000

Dr. **Shortworking Account** ***Cr.***

Date	Particulars	Amount	Date	Particulars	Amount
2009	To Balance b/f	800	2009	By Balance c/d	4,000
March, 31	To Landlord A/c	3,200	March, 31		
		4,000			4,000
2010	To Balance b/d	4,000	2010	By Landlord A/c	2,500
March, 31			March, 31	By Balance c/d	1,500
		4,000			4,000
2011	To Balance b/d	1,500	2011	By Landlord A/c	1,000
March, 31			March, 31	By P/L c/d	500
		1,500			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. **Royalty Account** *Cr.*

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. **Shortworkings Account** *Cr.*

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
				By, Balance c/d	12,000
		19,600			19,600
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:

1. Ground Rent or Surface rent means

(A) Minimum Royalty payable

(B) Maximum Royalty payable

(C) Fixed rent payable in addition to minimum rent

(D) Rent recovered at the end of lease term

2. Excess of minimum rent over royalty is know as

(A) Maximum rent

(B) Excess workings

(C) Short workings

(D) Deficiency of actual royalty

3. Short workings can be recouped out of

(A) Minimum rent

(B) Excess of actual Royalty over minimum rent

(C) Excess of minimum rent over actual Royalty

(D) Profit and Loss Account

Answer:

1. (C)	2. (C)	3. (B)

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

1. Royalty is a Revenue Expenditure to Lessor.
2. As per agreed term in the Royalty agreement, short workings can be recouped in the year when the actual royalty is more than minimum rent.
3. Royalty account is a nominal account in nature.

EXERCISE:

1. On 1st April, 2010 Rukmani Limited leased a coal mine at a minimum rent of ₹36,000 for the first year, ₹ 60,000 for second year and there after ₹ 1,20,000 per annum merging into a royalty of ₹ 3 per tonne with right to recoup short workings over two years after occurring short workings. The output for first year years is as follows:

Year	1	2	3	4
Coal output (in tones)	6,000	17,200	44,000	1,00,000

You are required to prepare Royalty Account, Short workings Account and Landlord's Account in the books of Rukmani Ltd.

Answer:

[Short working 2010-11 — ₹18,000

2011-12 — ₹8,400

Short working recouped 2012-13 — ₹12,000

2013-14 — ₹8,400

Transferred to P&L A/c 2012-13 — ₹6,000.]

2. On 1st April, 2009 Mahi Limited obtained a mine on lease from Kachari Limited. The terms were as follows:

(i) Royalty at ₹25 per tonne raised.

(ii) Minimum Rent ₹1,50,000 per annum.

(iii) Short workings can be recouped in the next two years only but subject to a maximum of ₹ 37,500 per year. In the event of strike, the minimum rent would be taken pro-rata on the basis of actual working days but in the event of lockout, the lease would enjoy concession in respect of minimum rent for 50% of the period of lockout. In addition to the above, Mahi Ltd. has been granted a right to receive cash subsidy equal to 50% of the Unrecoupable shortworkings by the State Government up to the first 5 years of the lease.

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 ne cessary 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 SYSTEM

This Study Note includes

9.1 Hire-Purchase and Installment System

9.1. HIRE-PURCHASE AND INSTALLMENT SYSTEM

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 ₹	Analysis of Instalments: 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, ₹ 45000 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	40,000
Total	2,50,000

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:

(i) $X + I = 40,000$

(ii) $X + 2I = 45,000$

(iii) $X + 3I = 50,000$

(iv) $X + 4I = 55,000$

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	Dr.	xxxx	
	To, Hire Vendor A/c [Cash price]			xxxx
2.	Hire Vendor A/c	Dr.	xxxx	
	To, Bank A/c [Down payment]			xxxx
3.	Interest A/c	Dr.	xxxx	
	To, Hire Vendor A/c			xxxx
4.	Hire Vendor A/c	Dr.	xxxx	
	To, Bank A/c [Instalment amount]			xxxx
5.	P/L A/c	Dr.	xxxx	
	To, Interest A/c			xxxx
	To, Depreciation A/c			xxxx

Interest Suspense Method:

	Particulars		Debit (₹)	Credit (₹)
1.	Hire Purchase Asset A/c [Cash Price]	Dr.	xxxx	
	Interest Suspense A/c [Total Interest]	Dr.	xxxx	
	To, Hire Vendor A/c [H.P price]			xxxx
2.	Hire Vendor A/c	Dr.	xxxx	
	To, Bank A/c [Down payment]			xxxx
3.	Interest A/c	Dr.	xxxx	
	To, Interest Suspense A/c			xxxx
4.	Hire Vendor A/c	Dr.	xxxx	
	To, Bank A/c [Instalment amount]			xxxx
5.	P/L A/c	Dr.	xxxx	
	To, Interest A/c			xxxx
	To, Depreciation A/c			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 =		30,000	34,000
Less: Cash Price			30,000
∴ **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) ***Dr.*** ***Cr.***

Date	Particulars		L/F	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.				1,300
	To Depreciation A/c.				6,000

2010	Interest A/c. Dr.		1,065	
Dec. 31.	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	Interest A/c. Dr.		818	
Dec. 31.	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	Interest A/c. Dr.		559	
Dec. 31.	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	Interest A/c. Dr.		258	
Dec. 31.	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			2009		
Jan. 1.	To Mr. Y A/c.	30,000	Dec. 31.	By Depreciation A/c.	6,000
				`` Balance c/d.	24,000
		30,000			30,000
2010			2010		
Jan. 1.	To Balance b/d.	24,000	Dec. 31.	By Depreciation A/c.	6,000
				`` Balance c/d.	18,000
		24,000			24,000
2011			2011		
Jan. 1.	To Balance b/d.	18,000	Dec. 31.	By Depreciation A/c.	6,000
				`` Balance c/d.	12,000
		18,000			18,000
2012			2012		
Jan. 1.	To Balance b/d.	12,000	Dec. 31.	By Depreciation A/c.	6,000
				`` Balance c/d.	6,000
		12,000			12,000
2013			2012		
Jan. 1.	To Balance b/d.		Dec. 31.	By Depreciation A/c.	6,000
		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.	(a) A A/c Dr.	7,92,500	
To B A/c	To HP Sales A/c		7,92,500
(b) B A/c Dr.	(b) Bank A/c Dr.	1,58,500	
To Bank A/c	To A A/c		1,58,500
31.12.2011			
(c) Interest A/c Dr.	(c) A A/c Dr.	63,400	
To B A/c	To Interest A/c		63,400
(d) B A/c Dr.	(d) Bank A/c Dr.	2,21,900	
To Bank A/c	To A A/c		2,21,900
(e) Depreciation A/c Dr.	(e) No Entry	1,58,500	
To Machines A/c			1,58,500
(f) Profit & Loss A/c Dr.	(f) No Entry	1,58,500	
To Depreciation A/c			1,58,500
(g) Profit & Loss A/c Dr.	(g) Interest A/c Dr.	63,400	
To Interest A/c	To Profit & Loss A/c		63,400
31.12.2012			
(a) Interest A/c Dr.	(b) A A/c Dr.	47,550	
To B A/c	To Interest A/c		47,550
(b) B A/c Dr.	(b) Bank A/c Dr.	2,06,050	
To Bank A/c	To A A/c		2,06,050
(c) Depreciation A/c Dr.	(c) No Entry	1,26,800	
To Machines A/c			1,26,800
(d) Profit & Loss A/c Dr.	(d) No Entry	1,26,800	
To Depreciation A/c			1,26,800
(e) Profit & Loss A/c Dr.	(e) Interest A/c Dr.	47,550	
To Interest A/c	To Profit & Loss A/c		47,550
31.12.2013			
(a) Interest A/c Dr.	(c) A A/c Dr.	31,700	
To B A/c	To Interest A/c		31,700
(b) B A/c Dr.	(b) Bank A/c Dr.	1,90,200	
To Bank A/c	To A A/c		1,90,200
(c) Depreciation A/c Dr.	(c) No Entry	1,01,440	
To Machines A/c			1,01,440
(d) Profit & Loss A/c Dr.	(d) No Entry	1,01,440	
To Depreciation A/c			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	1st yr	2nd yr	3rd yr	4th yr	Assets	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th 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**

An Extract of Balance Sheet of B

Liabilities	1st yr	2nd yr	3rd yr	4th yr	Assets	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th yr (₹)
					Current Assets:				
					Hire Purchase Debtors – A	4,75,500	3,17,000	1,58,500	-

Default and Repossession

If a hire purchaser fails to pay any instalment on the stipulated date, the hire purchaser is said to be at default. In case of default by the hire purchaser, the hire vendor may repossess the goods. Repossession means taking back the possession of goods by the hire vendor. Subject to agreement, the repossession may be either complete or partial.

Meaning of Complete or Full Repossession

In case of complete or full repossession the hire vendor takes back the possession of all the goods.

Journal Entries under Complete or Full Repossession

All 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 Closing Hire Vendor's Account Hire Vendor's A/c Dr. To Asset A/c **Note:** This entry is passed with the amount due to the hire-vendor.	**1. On Repossession of goods** Goods Repossessed A/c Dr. To Hire Purchaser's A/c **Note:** This entry is passed with the revalued amount of goods repossessed.
2. For Closing Asset Account **(i) If the Book Value of the Asset exceeds the amount due to Hire-Vendor** Profit & Loss A/c Dr. To Asset A/c **(ii) If the amount due to Hire-Vendor exceeds the Book Value of the Asset** Asset A/c Dr. To Profit & Loss A/c	**2. For amount spent on reconditioning of Goods Repossessed** Goods Repossessed A/c Dr. To Cash A/c/Bank A/c **3. For sale of Goods Repossessed** Cash A/c/Bank A/c /Debtors A/c Dr. To Goods Repossessed A/c **4. For loss on sale of Goods Repossessed** Profit & Loss A/c Dr. To Goods Repossessed A/c **Note:** In case of profit, a reverse entry will be passed.

Illustration 7.

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, B repossessed all the machines on 01.01.2013 and valued them on the basis of 40% p.a. depreciation on W.D.V. basis. B after incurring ₹6,000 on repairs sold the machines for ₹2,66,000 on 30th June 2013. Prepare the relevant accounts in the books of A and B.

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$\times$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% of X (i.e. down payment) 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) $\times$ 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) By Balance c/d	2,80,000 6,00,000
		10,80,000			**10,80,000**
01.01.12 31.12.12	To Balance b/d To Interest A/c [₹6,00,000 × 10/100]	6,00,000 60,000	31.12.12	By Balance c/d	6,60,000
		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

Step1: 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% 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 1st Year [40% of ₹6,00,000]	₹2,40,000
C. Book Value in the beginning of 2nd year	₹3,60,000
D. Less: Depreciation for 2nd year [40% of ₹3,60,000]	₹1,44,000
E. Book Value at the end of 2nd 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:

1. Value of a tempo left with the buyer = ₹50,000 × 80/100 × 80/100 = ₹32,000
2. Value of Tempos taken away by the seller = ₹50,000 × 2 × 70/100 × 70/100 = ₹49,000
3. 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 negotitation, 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 (Balancing Figure) [3,75,000-3,20,387]	54,613		By Balance c/d	3,51,975
		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 [₹7,45,000 × 5%]	37,250
		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 [₹5,72,250 × 5%]	28,613
		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
			31.12.2012	By Interest A/c	46,200
	To Balance c/d	2,80,000		[10% on ₹4,62,000]	
		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)** ₹
	280,000			
Down Payment	91,000	91,000	0	91,000
	189,000			
End of 1st year	57,100	76,000	18,900	57,100
	131,900			
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	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
				" Interest A/c	13,190
		1,45,090			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
				By Bank (Installment) A/c	76,000
	To Interest A/c	18,900		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. **Trucks Account** *Cr.*

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. **Hire Vendor's Account** *Cr.*

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% ÷ 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	1,08,000
	allowed by Vendor (₹ 1,08,000 – 25% of ₹ 1,08,000)	81,000
(ii)	Loss on surrender of 3 trucks	
	Book value of 3 turcks surrendered [(₹ 1,00,000 × 3) less 20% of ₹ 3,00,000]	2,40,000
	Less : Credit allowed by Vendor against these 3 Trucks	81,000
	Loss on surrender of 3 Trucks	1,59,000

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 rapairs 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
				By Balance c/d	80,000
		1,00,000			1,00,000
01.01.11	To Balance b/d	80,000	31.12.11	By Depreciation A/c	16,000
				By Balance c/d	64,000
		80,000			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
				By Balance c/d	20,480
		64,000			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	
	To Balance c/d	52,500		[(₹ 1,00,000 – ₹ 25,000) × 10%]	7,500
		1,07,500			1,07,500
31.12.11	To Cash	30,000	01.01.11	By Balance b/d	52,500
	To Balance c/d	27,750	31.12.11	By Interest A/c [52,500 × 10%]	5,250
		57,750			57,750
31.12.12	To Computers A/c (surrendered)	20,580	01.01.12	By Balance b/d	27,750
	To Balance c/d	9,420	31.12.12	By Interest A/c	2,250
		30,000			30,000

Working Notes :

(i) Total Interest = Hire Purchase Price – Cash Price

= [₹ 25,000 + (₹ 30,000 × 3)] – (₹ 20,000 × 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]	39,420
	20,580

(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]	29,280
	30,720

(v) Loss on Surrender = Book value – Agreed Value = ₹ 30,720 – ₹ 20,580 = ₹ 10,140

In the Books of Chirag Computers

Dr. **B & Brothers Account** *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
				By Balance c/d	52,500
		1,07,500			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. **Goods Repossessed Account** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
30.06.13	To B & Brothers A/c	20,580	30.06.13	By Cash A/c (sales)	30,000
30.06.13	To Cash A/c (Repairs)	5,000			
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 know as
   (A) Capital value of asset
   (B) Book value of asset
   (C) Hire purchase price of asset
   (D) Hire purchase charges

Answer:

1. (A)	2. (B)	3. (C)	4. (B)	5. (C)

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

1. 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.
2. Excess of hire-purchase price over cash price is known as penalty imposed on hire purchaser by the vendor.
3. 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:
   (i) Gauru & Co.'s Account and Returned Stock Account in the books of Machinery Mart.
   (ii) 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 × (20/100) = 1,26,390	1,73,610
(ii) 31-3-14	3,00,000	4,58,340 × (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 × 15% = 53,531	89,218
2,67,654	1,29,366	2,67,654 × 15% = 40,148	89,218
1,78,436	1,15,972	1,78,436 × 15% = 26,754	89,218
89,218	1,02,601	89,218 × 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

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)		×××	By Sales made at Branch	
To Goods sent from Head Office	×××		(net of returns)	
Less : Goods returned to H.O	×××	×××	— Cash	×××
To Purchases (made directly by Branch, if any)		×××	— Credit	×××
To Direct Expenses at Branch (if any)		×××	By Closing Stock at Branch (at Cost)	×××
To Gross proft c/d		×××		
		×××		**×××**
To Various expenses incurred at Branch		×××		
(including Bad Debts if any)			By Gross profit b/d	×××
To General P&L Account		×××		
(Net Profit transferred)		**×××**		**×××**

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. **Cr.**

Particulars	Amount ₹	Amount ₹	Particulars	Amount ₹	Amount ₹
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
			,, Closing Stock	8,000	
,, Gross Profit c/d		25,000	Add: Pilferage of Stock	1,000	9,000
		75,000			**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 Net Profit transferred		12,000			
		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. **Cr.**

Particulars	Amount ₹	Amount ₹	Particulars	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		($\frac{1}{4}$× 60,000)		
Less: Loading ($\frac{1}{4}$× 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 ₹
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		10,000	By Sales:		
(₹12,000 x $\frac{100}{120}$)			Cash	46,000	
			Credit	1,00,000	1,46,000
,, Goods sent to Branch			,, Closing Stock	12,500	
(₹1,32,000 x $\frac{100}{120}$)		1,10,000	(₹15,000 x $\frac{100}{120}$)		
,, Gross Profit c/d		41,000	Add: Stock Destroyed	2,500	15,000
			(Bal. fig.)		
		1,61,000			**1,61,000**
,, Branch Expense		6,000	By Gross Profit b/d		41,000
,, Discount Allowed		13,365			
,, Stock Destroyed by fire		2,500			
[₹ 3,000 – 500]					
,, 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 x$\frac{120}{150}$) 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 on Branch Stock: (₹2,52,000 x $\frac{40}{140}$)	72,000	---	By Opening Stock Reserve Provision for unrealized profit (₹7,00,000 x $\frac{40}{140}$)	2,00,000	-
On H.O. Stock: (₹16,80,000 x $\frac{40}{140}$)	4,80,000	---			
,, General P&L A/c (Net profit Transferred)	21,44,000	1,40,000			
	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 x $\frac{40}{140}$ = ₹2,00,000

on Closing stock of H.O. = ₹16,80,000 x $\frac{40}{140}$ = ₹4,80,000

on Closing stock of Branch = ₹2,52,000 x $\frac{40}{140}$ = ₹72,000.

Illustration 5.

White ltd. With their head office at Kolkata, invoiced goods to their Ranchi branch at 20% less than list price, which is cost plus 100%, with instruction that cash sales are made at invoice price and credit sales at list price. From the following particulars, prepare branch stock account and branch stock adjustment account for the year ended 31.12.2018.

Stock on 1.1.2018 (at invoice price) ₹ 2,400

Debtors on 1.1.2018 ₹ 2,000

Cash received from debtors ₹ 17,127

Goods received from H.O (at invoice price) ₹ 26,400

Goods returned to H.O ₹200 Sales- cash: ₹ 9,200

Credit: ₹ 20,000

Expenses at branch ₹ 3,473

Remittance to H.O ₹ 24,000

Debtors on 31.12.18 ₹ 4,873

Stock on 31.12.2018 ₹ 3,520.

Solution:

IN THE BOOKS OF WHITE Ltd.

Ranchi Branch Stock Account

Dr. **Cr.**

Date	Particulars	Amount(₹)	Date	Particulars	Amount(₹)
2018 Jan. 1	To Balance b/d	2,400	2018 Dec.31	By Goods Sent to Branch A/c(return)	200
Dec.31	To Goods Sent to Branch A/c	26,400		By Bank A/c(cash sales)	9,200
	To Surplus in Stock A/c	120		By Branch Debtors A/c	20,000
	To Ranchi Branch Adjustment A/c(note 1)	4,000		By Balance c/d	3,520
		32,920			**32,920**

Ranchi Branch Stock Adjustment Account

Dr. **Cr.**

Date	Particulars	Amount(₹)	Date	Particulars	Amount(₹)
2018 Dec.31	To Stock Reserve A/c(note 6)	1,320	2018 Dec.31	By Ranchi Branch Stock A/c(note 1)	4,000
	To Gross Profit c/d(transferred to Branch PL a/c)	13,450		By Stock Reserve A/c(note 4)	900
				By Surplus in Stock A/c(note 3)	45
				By Goods Sent to Branch A/c(note 5)	9,825
		14,770			**14,770**

Working Notes:

1. Let, cost price be ₹ 100. The list price is 100% of cost price.

   Therefore, list price = 100+100 = 200.

   The invoice price is 20% less than list price, i.e: ₹200 - 20% of ₹200 = ₹200-₹40=₹160.

   Cash sales are made at invoice price, i.e: ₹ 160 whereas, credit sales are made at list price, i.e: ₹ 200. Amount charged on credit sales is more than invoice price=₹200-₹160=₹40. i.e: 40/200×100=20% of list price. Goods sold on credit = ₹20,000-amount charged in excess of invoice price=20% of ₹ 20,000 = ₹ 4.000

2. If cost is ₹ 100 then invoice price is ₹ 160. Therefore loading on invoice price = 60/160×100

   = 37.5%

   Loading on surplus: 37.5% of 120= ₹ 45. This ₹ 45 represents loading. Therefore it is to be credited to branch stock adjustment account. The balance ₹ 75(120-45) is to be credited to branch PL account.

3. Loading on opening stock = 37.5% of ₹ 2,400= ₹ 900

4. Loading on goods sent to branch(net) = 37.5% of (₹26,400-200)= ₹ 9,825

5. Loading on closing stock = 37.5% of ₹3,520= ₹ 1,320

6. Expenses at branch of ₹ 3,473 will be charged to branch PL account

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 (i) If credit side exceeds the debit side (ii) If debit side exceeds the credit side	Branch A/c Dr. To General Profit & Loss A/c 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:
  (a) 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.
  (b) 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 6.

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	
Goods returned by Branch to H.O (at cost)	78,000	expenses:	
Goods returned by Customers to Branch	57,000	Salaries	3,00,000
Cash received by Branch from its Customers		Rent and Insurance	1,20,000
	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	
Petty Cash	2,500	(return by branch)	78,000
Furniture	60,000	By Balance c/d:	
To Goods sent to Branch A/c	52,20,000	Stock	18,84,000
To Bank A/c (Remittance by H.O.)	4,98,700	Debtors	12,52,000
To Balance c/d (creditors)	60,000	Petty Cash	1,200
To Net Profit t/f to General P&L A/c	19,98,000	Furniture (₹ 60,000 – ₹ 6,000)	54,000
	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 7.

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	Shown on the credit side of Branch Account by way of Increased Closing either Cash/Bank Balance or remittance to H.O.	No Treatment
(b)Admitted but not yet received	Shown Insurance Co. as a debtor at the end on the credit side of Branch Account.	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 8.

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	30,000	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		
			Stock	15,000	
,, Goods sent to Branch		1,000	Debtors	4,000	
(Loading on returns)			Petty Cash	1,000	20,000
,, Closing Stock Reserve		3,000			
(₹ 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) To Goods sent to Branch (at Cost) To Branch Adjustment A/c (loading, if any)	Dr.
(b)	Goods returned by Branch to HO	Goods sent to Branch Account (at Cost) Branch Adjustment A/c (loading, if any) To Branch Stock A/c (total value of goods)	Dr. Dr.
(c)	Assets provided by HO to Branch either by way of fresh purchase or by way of transfer from HO	Branch Assets Account To (Main) Cash Account/Vendor Account [or] To (HO) Assets Account (in case of transfer)	Dr.
(d)	Cash sent to Branch for expenses	Branch Cash Accout To (Main) Cash Account	Dr.
(e)	Cash Sales at the Branch	Branch Cash Account To Branch Stock Account	Dr.
(f)	Credit Sales at the Branch	Branch Debtors Account To Branch Stock Account	Dr.
(g)	Collection from Branch Debtors	Branch Cash Account To Branch Debtors Account	Dr.
(h)	Sales Returns at the Branch	Branch Stock Account To Branch Debtors Account	Dr.
(i)	Discounts / Bad Debts etc.	Branch Expenses Account To Branch Debtors Account	Dr.
(j)	Various expenses incurred at Branch	Branch Expenses Account To Branch Cash Account	Dr.
(k)	Branch Expenses directly met by HO	Branch Expenses Account To (Main) Cash Account	Dr.
(l)	Remittances made by Branch to Head Office	(Main) Cash Account To Branch Cash Account	Dr.
(m)	Goods Lost in Transit/Stolen etc.	Goods Lost in Transit A/c (at cost) Branch Adjustment (loading if any) To Branch Stock Account (total value of goods)	Dr. Dr.
	At the End of the Year : Closing Entries		
(n) (o)	Recording Closing Stock at Branch Excess of Sale Price over Invoice Price	Closing Stock at Branch Account (incl. Loading) To Branch Stock Account Branch Stock Account To Branch Adjustment Account	Dr. Dr.
(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 To Stock Reserve (closing) **Note :** Stock Reserve on Opening Stock is credited to Branch Adjustment A/c.	Dr.
(q)	Recording Gross Profit at Branch	Branch Adjustment Account To Branch P & L Account	Dr.
(r)	Depreciation on Branch Assets, (if any)	Branch Expenses Account To Branch Assets Account	Dr.
(s)	Transfer of Branch Expenses	Branch P & L Account To Branch Expenses Account	Dr.
(t)	Recording Net Profit at Branch	Branch P & L Account To General P & L Account	Dr.

Illustration 9.

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	1,75,000	2,75,000
2013 Mar. 31	,, Goods sent to Branch A/c	3,25,000				
	,, Branch Debtors A/c (Returns Inward)	500		,, Goods Sent to Branch A/c Returned from Branch		10,000
				,, Pilferage A/c		2,000
				,, Lost by Fire A/c		5,000
				,, Chennai Branch A/c Goods transferred but in-transit		15,000
				,, 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 Mar. 31	To Goods sent to Branch A/c Load on goods returned (10,000 x $\frac{1}{5}$) Branch Stock A/c	2,000	2013 Mar. 31	By Balance b/d Load on Opening Stock (₹ 30,000 x $\frac{1}{5}$)	6,000
	,, Pilferage A/c (Loading) (₹ 2,000 x $\frac{1}{5}$)	400		,, Goods sent to Branch A/c Loading (₹ 3,25,000 x $\frac{1}{5}$)	65,000
	,, Lost by fire (Loading) (₹ 5,000 x $\frac{1}{5}$)	1,000			
	,, Chennai Branch A/c (Loading) (₹ 15,000 x $\frac{1}{5}$)	3,000			
	,, Branch Profit and Loss A/c Gross Profit transferred (bal. fig.)	54,900			
	,, Balance c/d Load on Closing Stock (₹ 48,500 x $\frac{1}{5}$)	9,700			
		71,000			71,000

Branch Profit and Loss Account

Dr. **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2013 Mar. 31	To Branch Debtors A/c Bad Debts	500	2013 Mar.31	By Branch Stock Adjustment A/c – Gross Profit	54,900
	,, Insurance	500			
	,, 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		01.04.12	By Balance b/d	6,000
	– Transfer	6,000	31.03.13	,, Branch Stock	
				Adjustment A/c	9,700
	,, Balance c/d	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 –	
31.03.13				Expenses (bal. fig.)	33,820
	,, 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 Dr. To Goods Sent to Branch A/c	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 Dr. To Branch A/c	HO A/c. Dr. To Goods Recd. From H. O. A/c
3.	Branch Expenses incurred at Branch Office	—	Expenses A/c Dr. To Cash / Bank A/c
4.	Branch expenses paid for by the Head Office	Branch A/c Dr. To Cash/Bank A/c	Expenses A/c. Dr. To H.O. A/c
5.	Purchases made from parties other than H.O. by Branch	—	Purchases A/c Dr. To Bank/ Creditors A/c
6.	Sales effected by the Branch		Cash/Debtors A/c Dr. To Sales A/c
7.	Collection from Debtors received directly by the H.O.	Cash/Bank A/c Dr. To Branch A/c	H.O. A/c Dr. To Sundry Debtors A/c
8.	Payment by H.O. for Purchase made by the Branch	Branch A/c Dr. To Bank A/c	Purchases/Creditors A/c Dr. To H.O. A/c
9.	Purchase of Asset by Branch	—	Sundry Assets A/c Dr. To Bank/Liability
10.	Asset account maintained at H.O. and asset purchased by Branch	Branch Asset A/c Dr. To Branch A/c	H.O. A/c Dr. To Bank/Creditors A/c
11.	Depreciation when asset account is maintained by H.O.	Branch A/c Dr To Branch Asset A/c	Depreciation A/c Dr. To H.O. A/c
12.	Remittance of Funds by H.O. to Branch	Branch A/c Dr. To Bank A/c	Bank A/c Dr. To H.O. A/c
13.	Remittance of Funds to H.O. by Branch	Bank A/c Dr. To Branch A/c	Ho A/c Dr. To Bank A/c
14.	Transfer of Goods between different branches	Recipient Branch A/c Dr. To Supplying Branch A/c	(i) Supplying Branch A/c Dr. To Goods recd. from H.O. A/c (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 Dr. To Service Charges A/c	Expense A/c Dr. To H.O. A/c
16.	Cash-in-transit	Cash-in-transit A/c. Dr. To Branch A/c.	Cash-in-transit A/c. Dr. To H.O. A/c.
17.	Goods-in-transit	Goods-in-transit A/c. Dr. To Branch A/c.	Goods-in-transit A/c. Dr. To H.O. A/c.

Illurstration 10.

Journalise the following transactions in the books of Head Office. Delhi Branch and Agra Branch :

(a) Goods worth ₹ 50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.

(b) Delhi Branch draws a bill receivable for ₹ 40,000 on Agra Branch which sends its acceptance.

(c) Delhi Branch received ₹ 10,000 from Agra Branch.

(d) Goods worth ₹ 20,000 were returned by a customer of Agra Branch to Delhi Branch.

(e) Agra Branch collected ₹ 20,000 from a customer of Delhi Branch.

Solution :

Journal of Head Office

Particulars		**L.F.**	***Dr.*** **Amount** ₹	***Cr.*** **Amount** ₹
(a) Agra Branch A/c	Dr.		50,000	
To Delhi Branch A/c				50,000
(Being the goods supplied by Delhi Branch to Agra Branch)				
(b) Delhi Branch A/c	Dr.		40,000	
To Agra Branch A/c				40,000
(Being a B/R drawn by Delhi upon Agra Branch)				
(c) Delhi Branch A/c	Dr.		10,000	
To Agra Branch A/c				10,000
(Being Cash sent by Agra Branch to Delhi Branch)				
(d) Delhi Branch A/c	Dr.		20,000	
To Agra Branch A/c				20,000
(Being the goods returned by customer of Agra Branch to Delhi Branch)				
(e) Agra Branch A/c	Dr.		20,000	
To Delhi Branch A/c				20,000
(Being the Cash collected by Agra Branch from a customer of Delhi Branch				

Journal of Delhi Branch

Particulars		**L.F.**	***Dr.*** **Amount** ₹	***Cr.*** **Amount** ₹
(a) H.O. A/c	Dr.		50,000	
To Goods sent to Branch A/c				50,000
(Being the goods supplied to Agra Branch)				
(b) Bills Receivable A/c	Dr.		40,000	
To H.O. A/c				40,000
(Being the acceptance of a B/R received from Agra Branch)				
(c) Cash A/c	Dr.		10,000	
To H.O. A/c				10,000
(Being the cash received from Agra Branch)				
(d) Goods Sent to Branch A/c	Dr.		20,000	
To H.O. A/c				20,000
(Being the goods received from a customer of Agra Branch)				
(e) H.O. A/c	Dr.		20,000	
To Debtors A/c				20,000
(Being the cash collected by Agra Branch from our customer)				

Journal of Agra Branch

Particulars		L.F.	Dr. Amount ₹	Cr. Amount ₹
(a) Goods sent to Branch A/c	Dr.		50,000	
To H.O. A/c				50,000
(Being the goods received from Delhi Branch)				
(b) H.O. A/c	Dr.		40,000	
To Bill Payable A/c				40,000
(Being a B/P accepted for Delhi Branch)				
(c) H.O. A/c	Dr.		10,000	
To Cash A/c				10,000
(Being cash paid to Delhi Branch)				
(d) H.O. A/c	Dr.		20,000	
To Debtors A/c				
(Being the goods returned by customer of Delhi Branch)				20,000
(e) Cash A/c	Dr.		20,000	
To H.O. A/c				
(Being the Cash received from a customer of Delhi Branch)				20,000

Ilustration 11.

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) Recived B/R from Ahmedabad branch ₹ 9,000.

(iii) Recived cash from Ahmedabad branch ₹ 5,000.

Solution :

Journal of Head Office

Particulars		L.F.	Dr. Amount ₹	Cr. 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
	15,000	36,000	14,000	9,000	18,000	9,000	27,000	20,000
Balance	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 12.

Journalise the following transactions in the books of the Head Office.

(a) Goods returned by Thane Branch on 28th March, worth ₹ 10,000 to its Head Office not received by the head office upto 31st March.

(b) Goods worth ₹ 20,000 sent by the Head Office to its Coimbatore Branch on 29th March, were received on 3rd April following.

(c) ₹ 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. Amount ₹	Cr. Amount ₹
(a)	Goods-in-transit A/c Dr.		10,000	
	To Thane Branch A/c			
	(Being the goods returned by Thane Branch not yet received)			10,000
(b)	Goods-in-transit A/c Dr.		20,000	
	To Coimbatore Branch A/c			
	(Being the goods sent to Coimbatore Branch not yet received by Branch)			20,000
(c)	Cash-in-transit A/c Dr.		50,000	
	To Coimbatore Branch A/c			
	(Being the Cash sent by Coimbatore Branch not yet received)			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		i.e. Opening stock, Purchase, Return Inwards, Wages and other items appearing in the debit side.
	Branch Trading A/c	Dr.	
	To Branch A/c		
(b)	For all revenue incomes related to Trading A/c		i.e. Sales, Closin g Stock and Return Outwards and other items that appear in the credit side.
	Branch A/c	Dr.	
	To Branch Trading A/c		
(c)	For gross profit of the Branch		
	Branch Trading A/c	Dr.	
	To Branch P&L A/c		

In case of gross loss, the entry will be reversed.

(d)	For all revenue expenses related to P&L A/c		i.e. items that appear in the debit side of the P & L Account.
	Branch P & L A/c	Dr.	
	To Branch (All Revenue Expenses) A/c		
(e)	For all revenue incomes related to P & L A/c		i.e. items that appear in the credit side of the P & L Account.
	Branch (All Revenue Incomes) A/c	Dr.	
	To Branch P&L A/c		
(f)	For net profit of the Branch		
	Branch P&L A/c	Dr.	
	To General P&L A/c		

In case of net loss, the entry will be reversed.

(g) For branch assets.

Branch Assets A/c	Dr.
To Branch A/c	

(h) For branch liabilities.

Branch A/c	Dr.
To Branch Liabilties A/c	

(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 13.

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 Dr.		65,600	
	To Branch A/c			65,600
	(Items of Br. Trading incorporated)			
	₹ 12,000 + ₹ 35,600 + ₹ 18,000)			
	Branch A/c Dr.		93,400	
	To Branch Trading A/c			93,400
	(Items of Br. Trading incorporated i.e.,			
	₹ 76,000 + ₹ 12,000 + ₹ 5,400)			
	Branch Trading A/c Dr.		27,800	
	To Branch Profit & Loss A/c			27,800
	(Gross Profit transferred) [₹ 93,400 – ₹ 65,600]			
	Branch Profit and Loss A/c Dr.		5,860	
	To Branch A/c			5,860
	(Item of Branch Profit & Loss incorporated i.e., ₹ 3,000 + ₹ 1,920 + ₹ 940)			

	Branch Profit and Loss A/c Dr. To General Profit & Loss A/c (Net Profit Transferred) [₹ 27,800 – ₹ 5,860]			21,940	21,940
	Goods-in-Transit A/c Dr. To Branch A/c (Goods-in-Transit adjusted)			5,000	5,000
	Remittance (Cash)-in-Transit A/c Dr. To Branch A/c (Remittance-in-Transit adjusted)			2,400	2,400
	Branch Asset A/c Dr. To Branch A/c (Branch Asset incorporated) [₹ 2,800 + ₹ 5,400 + ₹ 7,400 + ₹ 3,560]			19,160	19,160
	Branch A/c Dr. To Branch Liabilities A/c (Branch liabilities incorporated)			3,700	3,700

Dr. **Branch Trading and Profit and Loss Account** **Cr.**

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To, Branch A/c			By, Branch A/c		
Stock	12,000		Sales	76,000	
Purchase	35,600		Goods supplied to H.O.	12,000	
Goods from H.O.	18,000	65,600	Closing Stock	5,400	93,400
To, Branch Profit and Loss A/c		27,800			
(Gross Profit transferred)		**93,400**			**93,400**
To, Branch A/c			By, Branch Trading A/c		27,800
Salaries	3,000		- Gross Profit		
Rent	1,920				
Office Expenses	940	5,860			
To, General Profit and Loss A/c		21,940			
(Net Profit transferred)		**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
				,, Branch P&L A/c		5,860
31.03.13	,, Branch Trading A/c	93,400		,, Goods-in-Transit A/c		5,000
	,, Branch Liabilities A/c			,, Remittance-in-Transit A/c		2,400
	Creditors	3,700		,, Branch Assets A/c		
				Furniture	2,800	
				Stock	5,400	
				Debtors	7,400	
				Cash	3,560	19,160
		98,020				98,020

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	21,940	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 Net Profit	21,940		,, Balance c/d	15,460*
		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
,, Purchase A/c
,, Goods Received from H.O. A/c
,, All revenue expenses
} Actual amount

(b) For all revenue incomes that appear in the credit side of Branch Trading A/c

Sales A/c Dr.
Closing Stock A/c Dr.
All revenue incomes A/c Dr.
} Actual amount
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 14.

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 1st 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 Dr.		2,650	
	To Head Office A/c			2,650
	(Depreciation on fixed assets maintained in head office books @ 10% on Machinery and 15% on Furniture)			
	Rent A/c Dr.		150	
	To Outstanding Rent A/c			150
	(Rent Outstanding)			
	Cash-in-Transit A/c Dr.		4,000	
	To Head Office A/c			4,000
	(Cash remitted to H.O. but not received within 31st December)			
	Head Office A/c Dr.		50,150	
	To Opening Stock			8,200
	,, Purchases			12,800
	,, Wages			6,550
	,, Manufacturing Expenses			3,400
	,, Rent (1,700 + 150)			1,850
	,, Salaries			5,500
	,, General Expenses			2,000
	,, Goods received from H.O.			7,200
	,, Depreciation			2,650
	(Above items transferred to H.O. A/c)			
	Discount A/c Dr.		150	
	Sales A/c Dr.		34,950	
	Purchase Returns A/c Dr.		300	
	Closing Stock A/c Dr.		14,350	
	To Head Office A/c			49,750
	(Above items transferred to H.O. A/c)			
	Head Office A/c Dr.		23,100	
	To Closing Stock A/c			14,350
	,, Debtors A/c			4,000
	,, Bank A/c			750
	,, Cash-in-Transit A/c			4,000
	(Assets transferred to H.O. A/c)			
	Creditors A/c Dr.		2,700	
	Outstanding Rent A/c Dr.		150	
	To Head Office A/c			2,850
	(Liabilities transferred to H.O. A/c)			

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
				,, Depreciation A/c	2,650
	,, Sundry Assets	23,100		,, 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				2,650
	(Depreciation on fixed assets @ 10% Monthly and @ 15% or Furniture in H.O. Books.)				
	Rent A/c	Dr.		150	
	To Outstanding Rent A/c				150
	(Rent Outstanding)				
	Cash-in-Transit A/c	Dr.		4,000	
	To Head Office A/c				4,000
	(Cash remitted to H.O. but in transit)				
	Head Office A/c	Dr.		400	
	To Profit & Loss A/c				400
	(Net Loss Transferred.) [₹50,150 – 49,750]				
	Head Office A/c	Dr.		23,100	
	To Closing Stock				14,350
	,, Debtors				4,000
	,, Cash at Bank				750
	,, Cash-in-Transit				4,000
	(Asset transferred to H.O. A/c)				
	Creditors A/c	Dr.		2,700	
	Outstanding Rent A/c	Dr.		150	
	To Head Office A/c				2,850
	(Various Liabilities transferred to H.O. A/c)				

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 15.

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 remmittance 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 — Remittance	11,00,000
		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 16.

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 :

1. 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.
2. 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.
3. It was agreed that the branch should be charged with ₹ 300 for Administration Services, rendered by the Head Office during the year.
4. 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).
5. Depreciation of Branch Assets, of which accounts are maintained by the Head Office, not provided for ₹ 250.
6. 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		**Fixed Assets :**		
Add : Net Profit of :			—Head Office	36,000	
—Head Office	14,560		—Branch	16,000	
—Branch	2,510	1,17,070	**Less :** Depreciation	(250)	51,750
Creditors :			**Stock :**		
—Head Office	3,960		—Head Office	34,200	
—Branch	1,920	5,880	—Branch	10,740	
			—Goods in Transit	440	45,380
			Debtors :		
			—Head Office	7,820	
			—Branch	4,840	12,660
			Creditors:		
			—Head Office	10,740	
			—Branch	1,420	
			—In Transit	1,000	13,160
		1,22,950			**1,22,950**

2. **Journal Entries in the books of Head Office** **Dr.** **Cr.**

Sl. No.	Particulars		Amt. (₹)	Amt. (₹)
1	Goods in Transit A/c	Dr.	440	
	To Branch A/c			440
	(Being the goods invoiced on 30.3.2013 not yet received by the branch as on the Balance Sheet date)			
2	Branch A/c	Dr.	300	
	To Profit & Loss A/c			300
	(Being amount of Administrative Services rendered by the HO to the Branch)			
3	Profit & Losss A/c	Dr.	400	
	To Branch A/c			400
	(Being the amount of uninsurd stock stolen on way to Branch)			
4	Branch A/c	Dr.	250	
	To Branch Fixed Assets			250
	(Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books)			
5	Branch Profit & Loss A/c	Dr.	2,510	
	To Profit & Loss A/c			2,510
	(Being Profit shown by the Branch Profit & Loss Account transferred to (General) Profit & Loss Account)			

3.

Dr. **Head Office Profit and Loss Account** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Branch — Uninsured Stock stolen	400	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	Dr.	1,000	
	To Head Office A/c			1,000
	(Being cash sent on 31.3.2013 not yet received by the HO)			
2	Profit & Loss A/c	Dr.	300	
	To Head Office A/c			300
	(Being administrative services rendered by the Head Office)			
3	Profit & Loss A/c	Dr.	250	
	To Head Office A/c			250
	(Being depreciation on Branch Fixed Assets for which accounts are maintained in the Head Office books)			
4	Profit & Loss Account	Dr.	2,510	
	To Head Office A/c			2,510
	(Being profit transferred to Head Office Account)			

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 17.

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 from, 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			
,, Depreciation	1,05,000	20,000	By Gross Profit b/d	9,60,000	1,71,000
,, Stock Adjustment (for closing) 20% of (45,000+15,000)	12,000	---	,, Stock Adjustment (for opening)	12,000	---
,, Provision for Bad Debts (new)	15,000	9,000	,, Provision for Bad Debts (old)	27,000	7,500
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		1,00,500		Less: Depreciation	1,25,000	11,25,000
(25,500 + 75,000)			17,50,500	Current Assets		
Current A/c – H.O.		5,25,000		Stock		
Less: Branch (Cr.)	3,60,000			H.O.	36,000	
Cash-in-transit	1,50,000			Branch	45,000	
Goods-in-transit	15,000	5,25,000			81,000	
			Nil	Less: Stock Adj.	12,000	69,000
Creditors			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			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 —

a. **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.

b. **Control :** Availability of separate cost and profit figures for each department facilitates control. Proper control and fixation of responsibility is easier.

c. **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.	• 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.**	• 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.	• 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 18.

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 Stock	2,748	2,401	5,149
,, Wages	1,340	240	1,580				
,, 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]				
,, Lighting and Heating	160	80	240[2]	,, Dis. Received (4 :3)	76	57	133[7]
,, Discount Allowed (on Sales)	245	196	441[3]	,, Net Loss	339	---	---
,, 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	1,124		Less: Depreciation	420	3,780
	10,654		Furniture and Fittings	600	
Less: Drawings	900	9,754	Less: Depreciation	60	540
Sundry Creditors		3,737			
Outstanding Liabilities:			Closing Stock:		
Lighting and Heating		180	Dept. A	2,748	
			Dept. B	2,401	5,149
			Sundry Debtors		1,820
			Prepaid Rent		370
			Cash at Bank		1,980
			Cash in Hand		32
		13,671			13,671

Workings:

Allocation of Expenses and Incomes

Sl. No.	**Expense/Income**	**Basis**	**Dept. A**	**Dept. B**
1	Carriage Inward	Purchase (4:3)	=₹ 469 x 4/7 = ₹ 268	= ₹ 469 x 3/7 = ₹ 201
2	Lighting & Heating (₹ 420 + ₹ 180) Factory part = 600 x 3/5 = Office part = 600 x 2/5 =	₹ 600 (Given) 360 240	 = ₹ 360 x 2/3 = ₹ 240 = ₹ 240 x 2/3 = ₹ 160	 = ₹ 360 x 1/3 = ₹ 120 = ₹ 240 x 1/3 = ₹ 80
3	Discount Allowed	= Sales	= ₹ 441 x (16900/30420) = ₹ 245	= ₹ 441 x (13520/30420) = ₹ 196
4	Advertisement	= Sales	= ₹ 738 x (16900/30420) = ₹ 410	= ₹ 738 x (13520/30420) = ₹ 328
5	Salaries	2 : 1	= ₹ 1,320 x (2/3) = ₹ 880	= ₹ 1,320 x (1/3) = ₹ 440
6	Rent ₹ 1,500 = (₹ 1,870 – ₹ 370) Factory part = 1,500 x 3/5 = 900 Office part = 1,500 x 2/5 =600	2 : 1 2 : 1	 = ₹ 900 x (2/3) = ₹ 600 = ₹ 600 x (2/3) = ₹ 400	 = ₹ 900 x (1/3) = ₹ 300 = ₹ 600 x (1/3) = ₹ 200
7	Discount Received	Purchase (4:3)	= ₹ 133 x (4/7) = ₹ 76	= ₹ 133 x (3/7) = ₹ 57

Illustration 19.

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			Servicing and Repair Jobs	(C)	35,000
Repair Job	(C)	80,000	Stock on 31st March		
			Transistors	(A)	60,100
Salaries and wages		48,000	Tape Recorders	(B)	20,300
Rent		10,800	Spare parts for servicing &		
Sundry Expenses		11,000	repair jobs	(C)	44,600
Net Profit		40,200			
		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 :

(a) Transistors and Tape Recorders are sold at the Showroom. Servicing and Repairs are carried out at the Workshop.

(b) 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.

(c) Workshop Rent is ₹ 500 per month. Showroom Rent is to be divided equally between Departments A and B.

(d) 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 20.

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. Amount ₹	Cr. Amount ₹
?	Department Trading (B) A/c Dr.		30,000	
	To Department Trading (A) A/c			30,000
	(Goods are transferred to Department B from Department A.)			

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 21.

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 x 1/5 = ₹ 6,000	22,000 x 1/11 = ₹ 2,000	8,000
Department - B	28,000 x 15/100 = ₹ 4,200	---	24,000 x 20/100 = ₹ 4,800	9,000
Department - C	12,000 x 1/6 = ₹ 2,000	10,000 x 1/5 = ₹ 2,000	---	4,000

Illustrations 22.

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 1st 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 31st 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**		**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 ÷ 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 × 15% = 5,625	45,000 × 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 23.

A & co. has two departments P & Q. department P sells goods to department Q at normal selling prices. From the following particulars, prepare departmental Trading & PL account for the year ended 31.03.2018 and also ascertain the net profit to be transferred to Balance Sheet:

Particulars	Department P (₹)	Department Q (₹)
Opening stock	5,00,000	NIL
Purchases	28,00,000	3,00,000
Goods from P	NIL	8,00,000
Wages	3,50,000	2,00,000
Travelling expenses	20,000	1,60,000
Closing stock at cost to the department	8,00,000	2,09,000
Sales	30,00,000	2,00,0000
Printing & Stationery	30,000	25,000

The following expenses incurred for both the departments were not apportioned between the departments:

Salaries ₹ 3,30,000, advertisement expenses ₹1,20,000,General expenses ₹ 5,00,000,Depreciation is to be charged @30% on the machinery worth ₹ 96,000.

The advertisement expenses of the departments are to be apportioned in the turnover ratio. Salaries and depreciation are to be apportioned in the ratio 2:1 and 1:3 respectively. General expenses are to be apportioned in the ratio 3:1.

Solution:

A & CO.

Departmental Trading and P/L Account for the year ended 31.03.2018

Dr. **Cr.**

Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)	Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)
To Opening Stock	5,00,000	Nil	5,00,000	By Sales	30,00,000	20,00,000	50,00,000
To Purchases	28,00,000	3,00,000	31,00,000	By Goods transferred to Q	8,00,000		
To Goods from P		8,00,000		By Closing Stock	8,00,000	2,09,000	10,09,000
To Wages	3,50,000	2,00,000	5,50,000				
To Gross Profit c/d	9,50,000	9,09,000	18,59,000				
	46,00,000	**22,09,000**	**60,09,000**		**46,00,000**	**22,09,000**	**60,09,000**
To Travelling Expenses	20,000	1,60,000	1,80,000	By Gross Profit b/d	9,50,000	9,09,000	18,59,000
To Printing & Stationery	30,000	25,000	55,000				
To Salaries (2:1)	2,20,000	1,10,000	3,30,000				
To Advertisement Expenses (3:2)	72,000	48,000	1,20,000				
To General Expenses (3:1)	3,75,000	1,25,000	5,00,000				
To Depreciation (1:3)	7,200	21,600	28,800				
To Net Profit c/d	2,25,800	4,19,400	6,45,200				
	9,50,000	**9,09,000**	**18,59,000**		**9,50,000**	**9,09,000**	**18,59,000**
				By Net Profit b/d			6,45,200
To Provision for unrealised profit on closing stock (note 2)			38,000				
To Capital A/c (net profit transferred)			**6,07,200**				

Working notes:

1. Gross profit ratio of department P = 9,50,000/(30,00,000 + 8,00,000)×100 = 25%
2. Proportionate P department's stock in department Q

   (Purchase from department P/total purchases of department Q)*total stock of department Q

   = ₹(8,00,000/11,00,000) × ₹2,09,000 = ₹1,52,000

   Unrealised profit = 25% of ₹1,52,000 = ₹ 38,000

Illustration 24.

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 (Note10)	8 0 0
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)	7 5 0		
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.

1. Break up of Opening Stock Department wise is: K - ₹ 37,890; L - ₹ 24,000 and M - ₹ 20,000.
2. Total Purchases were as under: K - ₹ 1,40,700; L - ₹ 80,600; M - ₹ 44,400.
3. Salaries and Wages include ₹ 12,000 wages of Department M. The balance Salaries should be apportioned to the three departments as 4:4:1.
4. Rent is to be apportioned in the ratio of floor space which is as 2:2:5.
5. Selling Expenses and Discount Allowed are to be apportioned in the ratio of Turnover.
6. Depreciation on assets should be equally charged to the three departments.
7. Sales made by the three departments were: K - ₹ 1,80,000; L - ₹ 1,30,000 and M - ₹ 90,000.
8. 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.
9. Departments K and L sold goods worth ₹ 10,700 and ₹ 600 respectively to Department M.
10. Discounts received are traceable to Departments K, L and M as ₹ 400; ₹ 250 and ₹ 150 respectively.
11. 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**		**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			
To Disc. (18:13:9)	5 4 0	3 9 0	2 7 0		4 0 0	2 5 0	1 5 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 x 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	7,718	50,296		
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	3,764			
(bal.fig)		15,054		
		67,060		**67,060**

Illustration 25.

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 M to S	35,000	—
By S to M	—	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
			By Closing Stock Purchased		
To Transfer :			Goods	4,500	6,000
Purchased Goods	10,000	8,000	Finished Goods out of t/f	4,800	2,800
Finished Goods	40,000	35,000	Balance	19,200	11,200
To Wages	12,000	8,000	By Return of Finished Goods	10,000	7,000
To Carriage Inwards	2,000	2,000			
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	(7,000)	(10,000)
Net Sales [A]	**168,000**	**142,000**
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	4,000	(4,500+6,000)		
(2,000+2,000)		By Finished Goods	38,000	48,500
To Stock Reserve:		(24,000+14,000)		
[24,000 × 20%] × 32.4%	1,555			
[14,000 × 20%] × 22.9%	641			
To Net Profit	82,304			
	3,00,500			**3,00,500**

Illustration 26.

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, bur 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 × 25/125 = 3,000	11,000 × 10/110 = 1,000	4,000
From Department Y to X and Z at 15% and 20% of Sales	14,000 × 15/100 = 2,100	Nil	12,000 × 20/100 = 2,400	4,500
From Department Z to X and Y at 20% and 25% of Cost	6,000×20/120 = 1,000	5,000×25/125 = 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 × 36,000 = 4,000	1/9 × 27,000 = 3,000	1/9 × 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 27.

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 ÷ 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:

1. Bad debts are apportioned among departments in the proportion of
   (A) Sales of each department
   (B) Number of units sold each department
   (C) Cost of sales of each department
   (D) None of the above

(2) 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
   (A) ₹16,250
   (B) ₹13,000
   (C) ₹21,667
   (D) 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 @ $33^1/_3$% 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

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.		24,500	
	To Delhi Branch A/c			24,500
	(Being amount received here from Delhi Branch customer)			
(ii)	Delhi Branch Fixed Assets (Computer) A/c Dr.		80,000	
	To Jaipur Branch A/c			80,000
	(Being amount paid by Jaipur Branch for purchase of Computer for Delhi Branch)			
(iii)	Jaipur Branch A/c Dr.		45,000	
	To Delhi Branch A/c			45,000
	(Being reversal of wrong entry)			
(iv)	Goods in Transit A/c Dr.		4,800	
	To Delhi Branch A/c			4,800
	(Being goods returned by Delhi Branch on 26/3/13 lying in transit)			

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:

1. 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:

Memorandum Branch Debtors Account

Dr. **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

4. 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
		„ Branch Stock A/c—returns		2,000
31-12-2015		„ Branch P/L A/c :		
To Branch Stock A/c	43,800	Bad Debts	500	
—credit sales *(balancing figure)*		Discount Allowed	1,300	1,800
		„ Balance c/f		22,500
	55,800			55,800

Dr. **Goods Sent to Branch Account** Cr.

3l-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	(balancing figure)	
		„ 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 1,300	1,800		
„ 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 recipts 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 $\frac{1}{4}\times15{,}000$)	
Debtors 12,000	27,000	31-12-15	3,750
31-12-2015		By Bank—remittances	38,600
To Goods Sent to Branch A/c	74,000	„ Goods Sent to Branch A/c	
„ Goods Sent to Branch A/c		—load on goods sent ($\frac{1}{4}\times 74{,}000$)	18.500
—load on returns by Branch	500	„ Goods Sent to Branch A/c	
($\frac{1}{2}\times 2{,}000$)		—returns by Branch	2,000
" Stock Reserve—load on closing stock		„ Balance c/f:	
($\frac{1}{4}\times 39{,}000$)	9,750	Stock 39,000	
" Profit & Loss A/c		Debtors[3] 19,200	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 31-12-2015 To Balance c/f	 3,750 9,750	By Balance b/f —load on opening stock 31-12-2015 By Delhi Branch A/c —load on closing stock	 3,750 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 „ Delhi Branch A/c —returns by Branch „ Trading A/c —cost of net goods transferred	18,500 2,000 54,000	By Delhi Branch A/c —goods sent „ Delhi Branch A/c —load on returns	 74,000 500
	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 daring 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

Dr. **Branch Stock Account** **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 : ($^1/_4 \times 1,00,000$)	1,50,000	„ Goods Sent to Branch A/c —returns from branch	780
		„ Goods Lost at Branch A/c	1.260
„ Branch Debtors—returns from customers	300	„ Balance c/f	2,700
„ Branch Adjustment A/c —apparent gross profit transferred	840		
	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.**

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 branch: $\frac{1}{3}\times 780$	260
„ Trading A/c —transfer	99,480		
	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	260	By Balance b/f— load on opening stock: 1/3 × 2,250	750
" Goods Lost at Branch A/c —load on goods lost	420	31-12-84	
" Branch Profit & Loss A/c —gross profit transferred	50,010	By Goods Sent to Branch —load on goods sent	50,000
Balance c/f—load on closing stock: 1/3 × 2,700	900	" Branch Stock A/c	840
	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 —credit sales	27,600	—returns from customers[1]	2,230
		Balance c/f	
	28,920		28,920

Note: 'Returns 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.

Goods Lost at Branch Account

Dr. **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 ×1,260	420
		„ Bank—amount recovered from insurance co.	730
		„ Branch P/L A/c— transfer —uncovered loss	110
	1,260		1,260

Branch Profit & Loss Account

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 – branch net profit transferred	13,120		
	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 —credit sales	27,600	27,600
To Goods Sent to Branch	1,50,000	1,00,000			
„ Branch Debtors —returns from customers	300	300	, Goods Sent to Branch —returns from branch	780	520
,, Branch P/L A/c —gross profit transferred	840	50,010	„ Goods Lost at Branch A/c	1,260	840
			„ 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 -returns from branch	520	To Branch Stock A/c	1,00,000
,, 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	13120		
	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: 1/3 × 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	
—normal loss	2,000	stock : 1/5 × 20,000	
,, Loss-in-Transit A/c		,, Goods Sent to Branch A/c	4,000
—load on loss-in-transit	2,000	—load on goods sent	
,, Pilferage A/c		,, Branch Stock A/c—apparent	16,000
—load on pilferage	800	gross profit	
,, Branch Profit & Loss A/c			62,000
—gross profit transferred	72,400		
,, Balance c/f—load on closing			
stock : 1/4 × 24,000	4,800		
	82,000		82,000

Dr. **Loss in-Trans it Account** **Cr.**

	₹		₹
To Branch Stock A/c	10,000	By Branch Adjustment A/c	2,000
		— load on loss-in-transit : 1/5 × 10,000	6000
		,, 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 × 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 Ale	3,200		
,, General Profit A 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:

(i) Kolkata Branch paid ₹ 25,000 as salary to a visiting Head Office Official. The branch has debited the amount to salaries account.

(ii) 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.

(iii) Depreciation on branch assets, of which accounts are maintained by the Head Office, not provided for ₹ 5,500.

(iv) Goods worth ₹ 30,000 were returned by a customer of Kolkata Branch to Head Office.

(v) ₹ 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 Dhoora 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;Deptt. 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 331/3% 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 = ₹16,575.

Study Note - 11

COMPUTERISED ACCOUNTING SYSTEM

This Study Note includes

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 the these user requirement 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 complete.

4. Frequent changes made to the system with inadequate change management procedure may result in 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 won 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 won has a very good track record of deliverables.

Study Note - 12

ACCOUNTING STANDARDS

This Study Note includes

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 organisaitons 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 relity of the transactions not by its legal form. Like in hire purchaser 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 crones -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 disclosd, 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)

Objective:

The objective of this standard is to formulate the method of compu¬tation of cost of inventories/stock, to determine the value of closing stock/ inventory at which, the inventory is to be shown in balance sheet till its' sale and recognition as revenue.

Accounting Standard-2 is not applicable in following cases:

- Work-in-progress arising under construction contract including directly related to service contract (AS-7 Construction contracts).
- Work-in-progress arising in ordinary course of business for service providers (Incomplete consultancy services, Incomplete merchant bank activities, Medical services in progress)
- Financial Instrument held as stock-in-trade (Shares, Debentures, Bonds etc.)
- Producer's inventories like livestock, agricultural and forest pro¬ducts, mineral oils, ores and gases. Such inventories are valued at net realisable value.

Inventories include:

- Held for sale in the ordinary course of business (finished goods)
- In the process of production of such sale (raw material and work-in-progress)
- In the form of materials or supplies to be consumed in production process or in the rendering of services (stores, spares, raw material, consumables).
- Inventories do not include machinery.

Spare parts and servicing equipments —

Inventories consists of—

- goods purchased and held for resale
- Inventories also consists finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools held for use in the production process.
- Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS-10, Property, Plant and Equipment (PPE).
- Machinery spares, not specific to a particular item of fixed asset and which can be used generally for various items of fixed assets, should be treated as inventories for the purpose of AS-2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.

Inventories should be valued at lower of cost and net realisable value.

Steps for valuation of Inventories:

1. Determination of cost of inventories;
2. Determination of net realisable value;
3. Comparison between the cost and net realisable value. The comparison should be made item by item or by group of items.

Cost of inventory consists the following —

1. Cost of purchase
2. Cost of conversion
3. Other costs incurred in bringing the inventories to their present location and condition

1. Cost of purchase includes —
   - Purchase price, Duties and Taxes, Freight inward, other expenditures directly attributable to the acquisition.

     Less:
   - Duties and taxes recoverable by enterprises from taxing authorities, Trade discount, Rebate, Duty drawback, Other similar items.
2. Cost of conversion —

   It consists of the cost directly related to the units + Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.

   Fixed Production overhead means Indirect cost of production that re¬mains relatively constant regardless of volume of production. Allocation of fixed production overhead is done on normal capacity.

   Variable Production overhead means indirect cost of production that varies directly or nearly directly with the volume of production. Allocation of variable production overhead is done on actual production.

   In aces of Joint-products, when the cost of conversion of each product is not identifiable separately, total cost of conversion is allocated between the products on the rational and consistent basis.

   If by-products, scrap or waste materials are not of material value, they are measured at net realisable value, then the net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.
3. Other costs: Cost incurred in bringing the inventories to their present location and condition.

   Items to be excluded from the cost of Inventories:
   - Abnormal amounts of wasted materials, labour, other production costs;
   - Storage cost;
   - Administrative overhead;
   - Selling and distribution cost;
   - Interest and borrowing cost. However, if AS-16 allows such cost to be included it, can form part of the cost.

Cost formula

Specific identification method means directly linking the cost to the specific item of inventories.

If in any case, specific identification method is not applicable the cost of inventories is valued by the following methods:

- FIFO (First In First Out)
- Weighted Average cost.

When it is not practical to calculate the cost, the following methods may be followed to ascertain cost:

♦ Standard Cost

♦ Retail Method

Net Realisable Value —

Net realisable value means the estimated selling price in ordinary course of business, less estimated cost of completion and estimated cost necessary to make the sale. It is estimated on the basis of most reliable evidence at the time of valuation. The estimation of net realisable value also considers the purpose for which the inventory is held. The estimation is made as at each balance sheet date.

Estimation of net realisable value —

♦ If finished product in which raw material and supplies used is sold at cost or above cost, then the estimated realisable value of raw material and supplies is considered more than its cost. Therefore inventories of raw material will be valued at cost.

♦ If finished product in which raw material and supplies used is sold below cost. Then the estimated realisable value of raw material or supplies is equal to replacement price of raw material or supplies and this raw material will be valued at replacement price.

Disclosure in the financial statement

- Accounting policy adopted in measuring inventories.
- Cost formula used.
- Classifications of inventories are:
  (i) Raw materials and components
  (ii) Work-in-progress
  (iii) Finished goods
  (iv) Stock-in-trade (in respect of goods acquired for trading)
  (v) Stores and spares
  (vi) Loose tools
  (vii) Others(specific nature)

Illustration 5.

Flow 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:

Cost per kg = Direct Material + Direct Labour + Variable Production overhead + Fixed production overhead*

= ₹ 100 + ₹ 20 + ₹ 10 + ₹10

= ₹ 140.

*Fixed Production overhead per kg = $\frac{₹10,00,000}{1,00,000}$ = ₹ 10 per kg.

Therefore, value of closing stock of finished goods will be ₹ 2,80,000 (i.e. 2,000 kg x ₹ 140)

12.3 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.

Recognisition 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 = (Cost to Date × 100) / (Cumulative Cost Incurred + 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 contact 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 × 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	**12.00**

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)

Years

Particulars	I	II	III
1. Initial contract revenue	2000	2000	2000
2. Revenue increase due to escalation in IInd 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

12.4 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 form 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.

12.5 PROPERTY, PLANT AND EQUIPMENT (AS 10)

Accounting Standard (AS) 10 Property, Plant and Equipment

Objective

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about investment made by an enterprise in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

This Standard does not apply to:

(a) biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and

(b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, AS 19, Leases, requires an enterprise to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

Investment property, as defined in AS 13, Accounting for Investments, should be accounted for only in accordance with the cost model prescribed in this standard.

Definitions

The following terms are used in this Standard with the meanings specified:

Biological Asset is a living animal or plant.

Agricultural Activity is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Agricultural Produce is the harvested product of biological assets of the enterprise.

Bearer plant is a plant that

(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than a period of twelve months; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

The following are not bearer plants:

(i) plants cultivated to be harvested as agricultural produce ;

(ii) plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales;

(iii) annual crops.

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap.

Once an item of property, plant and equipment qualifies for recognition as an asset, it will be initially measured at cost.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Accounting Standards.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Enterprise - specific value is the present value of the cash flows an enterprise expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Gross carrying amount of an asset is its cost or other amount substituted for the cost in the books of account, without making any deduction for accumulated depreciation and accumulated impairment losses.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than a period of twelve months.

Recoverable amount is the higher of an asset's net selling price and its value in use.

The **residual value** of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

(a) the period over which an asset is expected to be available for use by an enterprise ; or

(b) the number of production or similar units expected to be obtained from the asset by an enterprise.

Recognition Criteria

The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

- it is probable that future economic benefits associated with the item will flow to the enterprise; and
- the cost of the item can be measured reliably.

Items such as spare parts are usually treated as inventory and to be recognized in the Profit and Loss Account as and when consumed.

Standby equipments and major spare parts are treated as property, plant and equipment when they are expected to be used over more than one period. They are included in non-current assets from the date the cost is incurred.

Items which can be used exclusively with an item of Property, Plant and Equipment are accounted for as Property, Plant and Equipment.

This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to specific circumstances of an enterprise. Any type of expenditure that meets these recognition criteria must be accounted for as an asset. As per this standard individually insignificant items can be aggregated. An enterprise may decide to expense an item which could otherwise have been included as property, plant and equipment, because the amount of the expenditure is not material.

An Accounting Standard on Agriculture is under formulation, which will, inter alia, cover accounting for livestock. Till the time, the Accounting Standard on Agriculture is issued, accounting for livestock meeting the definition of Property, Plant and Equipment, will be covered as per AS 10 (Revised), Property, Plant and Equipment.

An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:

(a) initially to acquire or construct an item of property, plant and equipment; and

(b) subsequently to add to, replace part of, or service it.

Initial Costs

- The definition of 'property, plant and equipment' covers tangible items which are held for use or for administrative purposes.

  The term 'administrative purposes' has been used in wider sense to include all business purposes other than production or supply of goods or services or for rental for others.

- Items of property, plant and equipment may also be acquired for safety or environmental reasons. Such items of property, plant and equipment qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.
- The resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, Impairment of Assets.

Subsequent Costs

- Enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred.
- The purpose of such expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.
- Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Similarly, major parts of conveyor system, such as, conveyor belts, wire ropes, etc., may require replacement several times during the life of the conveyor system.
- Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle of this standard an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions.
- A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.
- The derecognition of the carrying amount occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

Elements of Cost

The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non –refundable purchase taxes,, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Examples of directly attributable costs are:

(a) costs of employee benefits of those involved in the construction or acquisition of an asset;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing less the net proceeds from the sale of any product arising from test production

(f) professional fees.

Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility or business, such as, inauguration costs;

(b) costs of introducing a new product or service(including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer

(d) training costs

(e) administration and other general overhead costs.

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the output of an item builds up; and

(c) costs of relocating or reorganising part or all of the operations of an enterprise.

Cost of dismantling or decommissioning

- The elements of cost to be incorporated in the initial recognition of an asset are to include in the estimated costs of its eventual dismantlement cost. That is, the cost of the asset is "grossed up" for these estimated terminal costs, with the offsetting credit being posted to a liability account.
- It is important to stress that recognition of a liability can only be affected when all the criteria set forth in AS-29 for the recognition in provisions are met.
- It seems odd to capitalize decommissioning costs that are not going to emerge until later in the asset's life. However, if there is an obligation as a direct consequence of acquiring or constructing property, plant and equipment to incur further costs in the future that cannot be avoided.
- A provision is recognized in accordance with AS-29. Therefore, the decommissioning costs at the end of the asset's life are just as much a cost of acquiring or constructing the asset as the costs incurred at the start of the asset's life.
- Decommissioning or similar costs such as dismantling expenditure can often arise in connection with operating leases and leasehold improvements.

Cost of self-constructed asset —

It is determined using the same principles as for an acquired asset. If any entity makes similar assets for sale in the normal course of business, the cost of the asset will be the same as the cost of constructing an asset for sale. Therefore, any internal profits are to be eliminated in arriving at such costs. Any abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. AS-16 the Borrowing Costs establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

AS-10 specifies that — any exchange of items of property, plant and equipment are measured at fair value, unless:

(a) the exchange transaction lacks commercial substance or

(b) the fair value of neither of the assets exchanges can be measured reliably.

If the acquired item is not measured at fair value, its cost is measured at the **carrying amount** of the asset given up.

Whether an exchange transaction has commercial substance depends on the extent to which the reporting entity's future cash flows are expected to change as a result of the transaction. If the expected cash flows after the exchange differ from what would have been expected without this occurring, the exchange has commercial substance and is to be accounted for at fair value. If the transaction does not have commercial substance, or the fair value of neither the asset received nor the asset given up can be measured reliably, then the asset acquired is valued at the carrying amount of the asset given up less settle-up paid or received in cash or a cash equivalent, this is often referred to as boot.

Measurement after Recognition

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment.

Cost Model

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation Model

Should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

Revaluations

Fair value

Land and Buildings - Market value is determined by appraisal normally done by professionally qualified valuers.

Plant and Equipment

- Fair value is usually market value which determined by appraisal.
- If there is no market based evidence of fair value, fair value is estimated using
  - Depreciated replacement cost; or
  - An income approach

Frequency of Revaluation

- It must be made sufficiently regularly to ensure no material difference between carrying amount and fair value at the end of the reporting period.
- Frequency of revaluation depends on movements in fair values. When the fair value differs materially from carrying amount, a further revaluation will be necessary.
- Items within a class may be revalued on a rolling basis within a short period of time, if revaluations are kept up to date.

At the date of the revaluation accumulated depreciation is either:

- Restated proportionately with the change in gross carrying amount

- Elimination against gross carrying amount and the net amount restated to the revalued amount, the latter method is simpler and most commonly used for buildings.

Depreciation

- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- An enterprise allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
- A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.
- To the extent that an enterprise depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an enterprise has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
- An enterprise may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
- **The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.**
- Sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see AS 2). Similarly, the depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26, Intangible Assets.

The Depreciable amount of an Asset shall be allocated over its useful life on systematic basis.

Factors to be considered —

- Expected usage assessed by reference to expected capacity or physical output;
- Expected physical wear and tear
- Technical obsolescence arising from changes or improvements in production; or changes in market demand for product or service output
- Legal or similar limits on the use
- Asset management policy may involve disposal of assets after a specified time therefore useful life may be shorter than economic life.
- Repair and maintenance policies may also affect useful life but do not negate the need for depreciation.

Residual value

— is the estimated value of depreciable assets at the end of its useful life.

— Depreciable amount is the amount net of residual value. Residual value is often insignificant and immaterial to the calculation of the depreciable amount.

— Depreciation is always recognized, even if fair value exceeds carrying amount, except when residual value is greater than carrying amount

Period of Depreciation

- It commences when an asset is available for use.
- It ceases at the earlier of the date the asset is:
  - retired from active use and
  - held for disposal
- Depreciation does not cease when an asset is idle or retired from active use
- Depreciation may be zero under the "units of production method".

Land and buildings are separable assets and are separately accounted for, even when they are acquired together:

  - Land has an unlimited useful life and is not depreciated.
  - Buildings have a limited useful life and are depreciable asset.
- Where land has a limited useful life ,it is depreciated.

Methods of Depreciation

- Straight line
- Diminishing balance
- Sum of the units
- Review periodically and, if significant, change method to reflect a change in pattern of consumption of future benefits. Account for as a change in accounting estimate and adjust depreciation charge for current and future period.

The depreciation method should also be reviewed at least of each financial year end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits, the method should be changed to suit this changed pattern.

When such a change in depreciation takes place the change should be known and accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.

Impairment is necessary

- To determine whether an item of Property, Plant and Equipment is impaired an entity applies AS-28, Impairment of Assets and the Impairment losses are accounted for accordance with AS-28.

Derecognition — Accounting treatment

- **In Balance Sheet:** Eliminate on disposal or when no future economic benefits are expected from use ("retirement") or disposal.
- **Statement of Profit and Loss:** Recognize gain or loss (difference between estimated net disposal proceeds and carrying amount) in profit or loss unless a sale and leaseback (AS-19).
- Gains are not classified as revenue.
- The revenue recognition principle in AS -9 Revenue Recognition, for sales of goods applies also to sales of items of Property, Plant and Equipment only to determine the date of sale.

Disclosure

The financial statements should disclose, for each class of property, plant and equipment:

(a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) assets retired from active use and held for disposal;

(iii) acquisitions through business combinations ;

(iv) increases or decreases resulting from revaluations under paragraphs 34, 42 and 43 and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS 28;

(v) impairment losses recognised in the statement of profit and loss in accordance with AS 28;

(vi) impairment losses reversed in the statement of profit and loss in accordance with AS 28

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and

(ix) other changes.

The financial statements should also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) Expenditures on account of property, plant and equipment in course of construction.

(c) Contractual commitment for the acquisition of property, plant and equipment.

12.6 IND AS

IND AS 1: PRESENTATION OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information that is useful in making economic decisions. This standard prescribes the basis for the presentation of general purpose financial statements in order to ensure comparability both with the entity's financial statements of previous periods and with those of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Financial statements are prepared on a going concern basis unless management intends to either liquidate the entity or to cease trading, or has no realistic alternative but to do so. Management prepares its financial statements, except for cash flow information, under the accrual basis of accounting. There are minimum disclosures to be made in the financial statements and in the notes under Ind AS.

An entity shall present a single statement of profit and loss, with profit and loss and other comprehensive income presented in separate sections within the same statement. The sections shall be presented together with the profit and loss section presented first, followed directly by the other comprehensive section.

An entity shall present, with equal prominence, all of the financial statements in a complete set of financial statements. Financial statements disclose corresponding information for the preceding period, unless a standard or interpretation permits or requires otherwise.

Material items

The nature and amount of items of income and expense are disclosed separately where they are material. Disclosure may be in the statement or in the notes. Such income and expenses might include restructuring costs; write-downs of inventories or property, plant and equipment; litigation settlements; and gains or losses on disposals of property, plant and equipment.

Presentation of true and fair view

Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. The application of Ind AS, with additional disclosures when necessary, is presumed to result in financial statements that present a true and fair view.

Going concern and accrual basis of accounting

An entity shall prepare financial statements on a going concern basis unless management intends to either liquidate the entity or cease trading, or has no realistic alternative but to do so.

An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

Offsetting

An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by Ind AS.

Balance sheet

The balance sheet presents an entity's financial position at a specific point in time. Subject to meeting certain minimum presentation and disclosure requirements, management may use its judgement regarding the form of presentation, such as which sub-classifications to present and what information to disclose on the face of the statement or in the notes.

Ind AS 1 specifies that the following items, as a minimum, are presented on the face of the balance sheet:

Assets: Property, plant and equipment; investment property; intangible assets; financial assets; investments accounted for using the equity method; biological assets; deferred tax assets; current tax assets; inventories; trade and other receivables; and cash and cash equivalents;

Equity: Issued capital and reserves attributable to the parent's owners; and non-controlling interest;

Liabilities: Deferred tax liabilities; current tax liabilities; financial liabilities; provisions; and trade and other payables.

Assets and liabilities held for sale: The total of assets classified as held for sale and assets included in disposal groups classified as held for sale; and liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105, 'non-current assets held for sale and discontinued operations'.

Current and non-current assets and liabilities are presented as separate classifications in the statement, unless the presentation based on liquidity provides reliable and more relevant information.

Statement of profit and loss

The statement of profit and loss presents an entity's performance over a specific period. The statement of profit and loss includes all items of income and expense and includes each component of other comprehensive income classified by nature.

Items to be presented in statement of profit and loss

Ind AS 1 specifies certain items presented in the statement of profit and loss.

Additional line items or sub-headings are presented in this statement when relevant to an understanding of the entity's financial performance.

Any item of income or expense is not presented as extraordinary item in the statement of profit and loss or in the notes.

The expenses are classified in the statement of profit and loss based on the nature of expense.

Other comprehensive income

An entity shall present items of other comprehensive income grouped into those that will be reclassified subsequently to profit or loss and those that will not be reclassified. An entity shall disclose reclassification adjustments relating to the components of other comprehensive income.

An entity presents each component of other comprehensive income in the statement either as:

(i) net of its related tax effects, or

(ii) before its related tax effects, with the aggregate tax effect of these components shown separately.

An entity needs to also disclose reclassification adjustments relating to components of other comprehensive income.

Statement of changes in equity

The following items are presented in the statement of changes in equity:

Total comprehensive income for the period, showing separately the total amounts attributable to the parent's owners and to non-controlling interest.

For each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8, 'Accounting policies, changes in accounting estimates, and errors'.

For each component of equity, reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from the following:

(i) Profit or loss

(ii) Other comprehensive income.

Transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Any item recognised directly in equity such as capital reserve on bargain purchase in a business combination transaction.

The amounts of dividends recognised as distributions to owners during the period, and the related amount of dividends per share, shall be disclosed.

Statement of cash flows

Cash flow statements are addressed in a separate summary dealing with the requirements of Ind AS 7.

Notes to the financial statements

The notes are an integral part of the financial statements. Notes provide information additional to the amounts disclosed in the 'primary' statements. They also include accounting policies, critical accounting estimates and judgements, disclosures on capital and puttable financial instruments classified as equity.

Ind AS 1 requires disclosures regarding reconciliation between the carrying amount at the beginning and the end of the period for each component of equity including disclosure regarding recognition of bargain purchase gain arising on business combination in line with the treatment prescribed in this regard in Ind AS 103.

Key Differences:

1. Ind AS 1 is significantly different from the corresponding AS 1. While Ind AS sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content, AS 1 does not offer any standard outlining overall requirements for presentation of financial statements. The format and disclosure requirements are set out under Schedule III to the Companies Act, 2013.

2. Ind AS 1 requires the presentation of a statement of comprehensive income as part of financial statements.

This statement presents all items of income and expense recognized in profit or loss, together with all other items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other Ind ASs. An entity is required to present a single statement of profit or loss and other comprehensive income presented in two sections. The sections will be presented together, with the profit or loss section presented first followed directly by the other comprehensive income**.** The concept of "other comprehensive income" does not currently exist under Indian GAAP, however, information relating to movement in reserves, etc., is generally presented in the caption reserves and surplus in the balance sheet.

3. Ind AS 1 requires presentation of all transactions with equity holders in their capacity as equityholders in the statement of changes in equity (SOCIE). The SOCIE is considered to be an integral part of financial statements. The concept of a SOCIE is not there under current Indian GAAP; however, information relating to appropriation of profits, movement in capital and reserves, etc., is presented on the face of the profit and loss account and in the captions share capital and reserves and surplus in the balance sheet. Under the Companies Act, SOCIE is required to be prepared only if applicable. Furthermore, under Ind AS 1 minority interest (referred to as noncontrolling interest) is presented as a component of equity while under the current Indian GAAP it is presented separately from liabilities and equity.

4. Ind AS 1 requires disclosure of:

   (a) Critical judgments made by management in applying accounting policies

   (b) Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year

   (c) Information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital, There are no such disclosures required under current Indian GAAP.

5. Ind AS 1 prohibits any item to be presented as an extraordinary item, either on the face of the income statement or in the notes, while AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, in Indian GAAP, specifically requires disclosure of certain items as extraordinary items.

6. Ind AS 1 requires a third balance sheet as at the beginning of the earliest comparative period, where an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements, to be included in a complete set of financial statements. AS 5 requires the impact of material changes in accounting policies to be shown in financial statements. There is no requirement to present an additional balance sheet.

7. Ind AS 1 requires dividends recognized as distributions to owners and related amounts per share to be presented in the statement of changes in equity or in the notes. The presentation of such disclosures in the statement of profit and loss is not permitted. Under Indian GAAP, a proposed dividend is shown as appropriation of profit in the profit and loss account.

8. Under Ind AS 1, an entity whose financial statements comply with Ind ASs is required to make an explicit and unreserved statement of such compliance in the notes. Such requirement is not there in current Indian GAAP.

Impact on financial reporting

Ind AS 1 essentially sets out overall requirements for presentation of financial statements. While financial statement presentation under Schedule III of the Companies Act is similar to Ind AS 1, differences still remain. Ind AS 1 significantly impacts the presentation of financial statements. These affects are covered under the following broad parameters:

- **Enhanced transparency and accountability**

  The disclosure of information required by Ind AS 1, with reference to critical judgments made by management in applying accounting policies and to key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, is not only likely to bring improved transparency in financial statements, but it is also expected to put additional onus on entities to ensure that estimates and judgments made are justifiable, since, they are publicly accountable for them.

- **Better presentation of financial statements**

  Under Ind AS 1, each entity should present its balance sheet using current and non-current assets and liabilities classifications on the face of the balance sheet, except, when a presentation based on liquidity provides information that is reliable and more relevant. Furthermore, SOCIE is mandatory. While Schedule III of the Companies Act requires presentation using the current and non-current classification, it does not mention about "order of liquidity" for presentation of assets and liabilities in balance sheet. In addition, SOCIE is required to be presented only if applicable.

IND AS 2: INVENTORIES

Ind AS 2 applies to all inventories, except financial instruments (Ind AS 32 and Ind AS 109) and biological assets related to agricultural activity at the point of harvest.

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 cost of completion and the estimated costs necessary to make the sale.

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Valuation: Inventories are valued at the lower of cost or net realisable value.

Cost shall include:

- Costs of purchase, (including import duties, non-refundable taxes, transportation and handling charges net of trade discount and rebates received)
- Costs of conversion, (include all fixed and variable manufacturing overheads)
- Other costs incurred in bringing the inventories to their present location and condition.

Cost does not include:

- Abnormal loss
- Storage Cost (unless such cost are necessary)
- Administrative Overheads
- Selling Costs
- Interest cost when inventories are purchased with deferred settlement terms.
- Foreign exchange difference arising directly on the recent acquisition of inventories invoiced in a foreign currency.
- Costs incurred to fulfil a contract with a customer that do not give rise to inventories are accounted for in accordance with Ind AS 115.
- Borrowing costs are included in cost of inventories to the extent conditions are met as per Ind AS 23.

Cost Formulas

Inventory which are not interchangeable, specific costs are attributed to the specific individual items of inventory.

For the item which are interchangeable, FIFO or weighted average costs formulas are allowed Cost of inventories may not be recoverable if a) Inventories are damage, b) Selling price have declined, c) Estimated cost of completion to be incurred have increased.

Expenses Recognition

- Inventories are recognised as an expense in the period in which the related revenue is recognised.
- Any write-down to NRV any inventory losses are also recognised as an expense when they occur.
- Any reversal should be recognised in the income statement in the period in which the reversal occurs.

Disclosure

(a) Accounting policies adopted for measuring inventories;

(b) Total carrying amount of inventories and the amount of classification;

(c) Inventories carried at fair value less costs to sell;

(d) Amount of inventories recognised as an expense;

(e) Write-down of inventories recognised as an expense;

(f) Amount of any reversal of any write-down;

(g) Circumstances or events that led to the reversal of write-down of inventories;

(h) Inventories pledged as security for liabilities.

Major Changes in Ind AS 2 vis-à-vis IAS 2 Not Resulting in Carve Out:

Classification of Expenses: Paragraph 38 of IAS 2 dealing with recognition of inventories as an expense based on function-wise classification, has been deleted keeping in view the fact that option provided in IAS 1 to present an analysis of expenses recognized in profit or loss using a classification based on their function within the entity has been removed and Ind AS 1 requires only nature-wise classification of expenses.

Major Changes in IND AS 2 vis-à-vis Notified AS 2:

(i) Subsequent Recognition: Ind AS 2 deals with the subsequent recognition of cost/carrying amount of inventories as an expense, whereas the existing AS 2 does not provide the same.

(ii) Inventory of Service Provider: Ind AS 2 provides explanation with regard to inventories of service providers whereas the existing AS 2 does not contain such an explanation.

(iii) Machinery Spares: The existing AS 2 explains that 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 AS 10, 'Accounting for fixed assets'. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.

(iv) Inventory held by Commodity Broker-traders: Ind AS 2 does not apply to measurement of inventories held by commodity broker-traders, who measure their inventories at fair value less costs to sell. However, this aspect is not there in the existing AS 2.

(v) Definition of Fair Value and Distinction between NRV and Fair Value: Ind AS 2 defines fair value and provides an explanation in respect of distinction between 'net realizable value' and 'fair value'. The existing AS 2 does not contain the definition of fair value and such explanation.

(vi) Subsequent assessment of NRV: Ind AS 2 provides detailed guidance in case of subsequent assessment of net realizable value. It also deals with the reversal of the write-down of inventories to net realizable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements. The existing AS 2 does not deal with such reversal.

(vii) Inventories acquired on Deferred Settlement terms: An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, for example a difference between purchase price for normal credit terms and the amount paid, is recognized as interest expense over the period of financing.

(viii) Exclusion from its Scope but Guidance given: Ind AS 2 excludes from its scope only the measurement of inventories held by producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products though it provides guidance on the measurement of such inventories, However, the existing AS 2 excludes from its scope such type of inventories.

(ix) Cost formulae: The existing AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition whereas Ind AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.

(x) Disclosures: Ind AS 2 requires more disclosures as compared to the existing AS 2.

DIFFERENCES BETWEEN IND AS 11 ON 'CONSTRUCTION CONTRACTS', AND EXISTING AS 7 (REVISED 2002) ON CONSTRUCTION CONTRACTS:

(i) Existing AS 7 includes borrowing costs as per AS 16, Borrowing Costs, in the costs that may be attributable to contract activity in general and can be allocated to specific contracts, whereas Ind AS 11 does not specifically make reference to Ind AS 23.

(ii) Existing AS 7 does not recognise fair value concept as contract revenue is measured at consideration received/receivable, whereas Ind AS 11 requires that contract revenue shall be measured at fair value of consideration received/receivable.

(iii) Existing AS 7 does not deal with accounting for Service Concession Arrangements, i.e., the arrangement where private sector entity (an operator) constructs or upgrades the infrastructure to be used to provide the public service and operates and maintains that infrastructure for a specified period of time, whereas Appendix A of Ind AS 11 deals with accounting aspects involved in such arrangements and Appendix B of Ind AS 11 deals with disclosures of such arrangements.

(iv) Agreements for construction of real estate are scoped in Ind AS 11. The effect of this inclusion is that percentage of completion method is to be applied for such agreements, whereas IASB has issued IFRIC 15 according to which in certain cases completed contract method would be applicable.

DIFFERENCES BETWEEN IND AS 18 ON REVENUE AND THE EXISTING AS 9 (ISSUED 1985) ON REVENUE RECOGNITION:

Measurement of revenue is briefly covered in the definition of revenue in the existing AS 9, while Ind AS 18 deals separately in detail with measurement of revenue. The differences between Ind AS 18 on Revenue and the existing AS 9 (Issued 1985) on Revenue Recognition are as under:

(i) Definition of 'revenue' given in the Ind AS 18 is broad compared to the definition of 'revenue' given in existing AS 9 because it covers all economic benefits that arise in the ordinary course of activities of an entity which result in increases in equity, other than increases relating to contributions from equity participants. On the other hand, as per the existing AS 9, revenue is gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

(ii) Revenue arising from agreements of real estate development are specifically scoped out from Ind AS18. Existing AS 9 does not exclude the same.

(iii) As per existing AS 9, revenue is recognised at the nominal amount of consideration receivable. Ind AS 18 requires the revenue to be measured at fair value of the consideration received or receivable.

(iv) Ind AS 18 specifically deals with the exchange of goods and services with goods and services of similar and dissimilar nature. In this regard specific guidance is given regarding barter transactions involving advertising services. This aspect is not dealt with in the existing AS 9.

(v) Ind AS 18 provides guidance on application of recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Existing AS 9 does not specifically deal with the same.

(vi) For recognition of revenue in case of rendering of services, existing AS 9 permits the use of completed service contract method. Ind AS 18 requires recognition of revenue using percentage of completion method only.

(vii) Existing AS 9 requires the recognition of revenue from interest on time proportion basis. Ind AS 18 requires interest to be recognised using effective interest rate method.

(viii) Disclosure requirements given in the Ind AS 18 are more detailed as compared to existing AS 9.

(ix) Ind AS 18 specifically provides guidance regarding revenue recognition in case the entity is under any obligation to provide free or discounted goods or services or award credits to its customers due to any customer loyalty programme. Existing AS 9 does not deal with this aspect.

(x) Ind AS 18 deals with accounting of transfer of property, plant and equipment by the customers to the entity, which are used by the entity to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. Existing AS 9 does not deal with this aspect.

(xi) Existing AS 9 specifically deals with disclosure of excise duty as a deduction from revenue from sales transactions. Ind AS 18 does not specifically deal with the same.

IND AS 16: PROPERTY, PLANT AND EQUIPMENT

Objective:

The objective of this Standard is to prescribe the **accounting treatment** for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment.

Major Changes in IND AS 16 vis-à-vis Notified AS10 and Notified AS 6:

(i) **Accounting for Real Estate Developers:** Existing AS 10 specifically excludes accounting for real estate developers from its scope, whereas Ind AS 16 does not exclude such developers from its scope.

(ii) **Criteria for Initial Recognition:** Ind AS 16, apart from defining the term property, plant and equipment, also lays down the following criteria which should be satisfied for recognition of items of property, plant and equipment:

(a) It is probable that future economic benefits associated with the item will flow to the entity, and

(b) the cost of the item can be measured reliably.

Existing AS 10 does not lay down any specific recognition criteria for recognition of a fixed asset. As per the standard, any item which meets the definition of a fixed asset should be recognized as a fixed asset.

(iii) **Subsequent Expenditure:** As per Ind AS 16, initial costs as well as the subsequent costs are evaluated on the same recognition principles to determine whether the same should be recognized as an item of property, plant and equipment. Existing AS 10 on the other hand, prescribes separate recognition principles for subsequent expenditure. As per existing AS 10, subsequent expenditures related to an item of fixed asset are capitalized only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.

(iv) **Major Spare-parts:** Ind AS 16 requires that spare parts, stand-by equipment and servicing equipment are recognized in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory. As per existing AS 10, only those spares are required to be capitalized which can be used only in connection with a fixed asset and whose use is expected to be irregular.

(v) **Component Approach:** Ind AS 16 is based on the component approach. Under this approach, each major part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item id depreciated separately. As a corollary, cost of replacing such parts is capitalized, if recognition criteria are met with consequent derecognition of the replaced part. The cost of replacing those parts which have not been depreciated separated is also capitalized with the consequent derecognition of the replaced parts. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

Existing As 10, however, does not mandatorily require full adoption of the component approach. It recognizes the said approach in only one paragraph by stating that accounting for a tangible fixed asset may be improved if total cost thereof is allocated to its various parts. Apart from this, neither existing AS 10 nor existing AS 6 deals with the aspects such as separate depreciation of components, capitalizing the cost of replacement, etc.

(vi) **Cost of Major Inspections:** Ind AS 16 requires that the cost of major inspections should be capitalized with consequent derecognition on any remaining carrying amount of the cost of the previous inspection. Existing AS 10 does not deal with this aspect.

(vii) **Cost of Dismantling and Removal of the Item of PPE and Restoring the Site:** In line with the requirement of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', for creating a provision towards the costs of dismantling and removing the item of property, plant and equipment and restoring the site on which it is located at the time the item is acquired or constructed, Ind AS 16 requires that the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is locted should be includd in the cost of the respective item of property plant and equipment. Existing AS 10 does not contain any such requirement.

(viii) **Cost Model or Revaluation Model as its Accounting Policy:** Ind AS 16 requires an entity to choose either the cost model or the revaluation model as its accounting policy and to apply that policy to an entire class of property plant and equipment. It requires that under revaluation model, revaluation be made with reference to the fair value of items of property plant and equipment. It also requires that revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

Existing AS 10 recognises revaluation of fixed assets. However, the revaluation approach adopted therein is ad hoc in nature, as it does not require the adoption of fair value basis as its accounting policy or revaluation of assets with regularity. It also provides an option for selection of assets within a class for revaluation on systematic basis.

(ix) **Transfers from Revaluation Surplus:** Ind AS 16 provides that the revaluation surplus included in equity in respect of an item of property plant and equipment may be transferred to the retained earnings when the asset is derecognized. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between the depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the retained earnings are not made through profit or loss. As compared to the above, neither existing AS 10 nor existing AS 6 deals with the transfers from revaluation surplus. To deal with this aspect, the Institute of Chartered Accountants of India issued a Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets. The Guidance Note provides that if a company has transferred the difference between the revalued figure and the book value of fixed assets to the 'Revaluation Reserve' and has changed the additional depreciation related thereto to its profit and loss account, it is possible to transfer an amount equivalent to accumulated additional depreciation from the revaluation reserve to the profit and loss account or to the general reserve as the circumstances may permit, provided suitable disclosure is made in the accounts. However, the said Guidance Note also recognizes that it would be prudent not to charge the additional depreciation arising due to revaluation against the revaluation reserve.

(x) **Restatement with Reference to Observable Market Data:** Ind AS 16 requires that when the carrying amount of asset is adjusted to the revalued amounts then gross carrying amount may be restated with reference to observable market data or restated proportionately to the change in the carrying amount. Existing AS 10 does not require any reference to observable market data.

(xi) Self Constructed Assets: With regard to self-constructed assets, Ind AS 16, specifically states that the cost of abnormal amounts of wasted material, labour or other resources incurred in the construction of an asset is not included in the cost of the assets. Existing AS 10 while dealing with self-constructed fixed assets does not mention the same.

(xii) Discounting in Case Payment is Deferred Beyond Normal Credit Terms: Ind AS 16 provides that the cost of a property plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit unless such interest is capitalized in accordance with Ind AS 16. Similarly, the concept of cash price equivalent has been followed in case of disposal of fixed assets also. Existing AS 10 does not contain this requirement.

(xiii) Fixed assets jointly Owned: Existing AS 10 specifically deals with the fixed assets owned by the entity jointly with others. Ind AS 16 does not specifically deal with this situation.

(xiv) Several Assets purchased for a Consolidated Consideration: Existing AS 10 specifically deals with the situation where several assets are purchased for a consolidated price. It provides that the consideration should be apportioned to the various assets on the basis of their respective fair values. However, Ind AS 16 does not specifically deal with this situation.

(xv) Review of Residual value and useful Life: Ind AS 16 requires that the residual value and useful life of an asset be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5. Under existing AS 6, such a review is not obligatory as it simply provides that useful life of an asset may be reviewed periodically.

(xvi) Review of Depriciation Method: Ind AS 16 requires that the depreciation method applied to an asset should be reviewed at least at each financial year end and , if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. In existing AS 6, change in depreciation method can be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements.

(xvii) Change in Depreciation Method: Ind AS 16 requires that change in depreciation method should be considered as a change in accounting estimate and treated accordingly. In existing AS 6, it is considered as a change in accounting policy and treated accordingly.

(xviii) Compensation from third Parties for Items of PPE that were Impaired, Lost or Given Up: ind AS 16 requires that compensation from third parties for items of property plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable. Existing AS 10 does not specifically deal with this aspect.

(xix) Gains on De-recognition of Items of PPE: Ind AS 16 specifically provides that gains arising on derecognition of an item of property plant and equipment should not be treated as revenue as defined in AS 9. Existing As 10 is silent on this aspect.

(xx) Subsequent Sale of PPE held for Rental to Others, in ordinary course of Business: Ind AS 16 deals with the situation where entities hold the items of property, plant and equipment for rental to others and subsequently sell the same. No such provision is there in exiting AS 10.

(xxi) Accounting for items of Fixed Assets held for Sale: Ind AS 16 does not deal with the assets 'held for sale' because the treatment of such assets is covered in Ind AS 105, Non-current assets Held for Sale and Discontinued Operations. Existing AS 10 deals with accounting for fixed assets retired from active use and held for sale.

(xxii) PPE acquired in Exchange for a Non-Monetary Asset: Ind AS 16 requires that if property, plant and equipment is acquired in exchange for a non-monetray asset, it should be recognized at its fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable.

The existing standard requires that when a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. Existing AS 10 also prescribes an alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

(xxiii) Accounting for Changes in Measurement of Certain Items: Ind AS 16 includes Appendix A which addresses how the changes in the measurement of an existing decommissioning, restoration and similar liabilities that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for.

(xxiv) Certain Guidance: Ind AS 16 provides guidance on measuring 'Stripping Costs in the Production Phase of a Surface Mine'. Existing AS does not contain this guidance.

(xxv) Disclosures: The disclosure requirements of Ind AS 16 are significantly elaborate as compared to AS 10/ AS 6.

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 × 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 - 1 & 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

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]

PREVIOUS TERMS QUESTION PAPERS

INTERMEDIATE EXAMINATION

June 2019 **P-5(FAC)**

Syllabus 2016

Financial Accounting

Time Allowed: 3 Hours Full Marks: 100

The figures in the margin on the right side indicate full marks.

Both the sections are to be answered subject to instructions given aganist each.

[All workings must form part of your answer.]

SECTION - A

1. Answer the following questions:

(a) Choose the most appropriate one from the given following alternatives: 1×10=10

(i) Which of the following is a resource owned by the business with the purpose of using it for generating future profits?

(A) Loan from Bank

(B) Owner's Capital

(C) Trade Mark

(D) All of the above

(ii) Chandu & Co.'s Account is a

(A) Real Account

(B) Nominal Account

(C) Representative Personal Account

(D) Artificial Personal Accounts

(iii) Purchase of a laptop for office use wrongly debited to Purchase Account. It is an error of

(A) Omission

(B) Commission

(C) Principle

(D) Misposting

(iv) Which of the following term is most suitable for writing off Patent?

(A) Depletion

(B) Amortization

(C) Depreciation

(D) All of the above

(v) Memorandum Joint Venture Account is prepared when

(A) the separate set of books is maintained for Joint Venture.

(B) the each Co-venturer keeps records of all transactions.

(C) the each Co-venturer keeps records of their own transactions only.

(D) All of the above cases

(vi) Which of the following commission is allowed by the consignor to the consignee to encourage the consignee for putting-up hard work in introducing new product in the market?

(A) Del-credere Commission

(B) Over-riding Commission

(C) Hard work Commission

(D) Ordinary Commission

(vii) If Ram's acceptance which was endorsed by us in favour of Saleem is dishonoured, then the amount will be debited in our books to

(A) Saleem

(B) Ram

(C) Bills Receivable Account

(D) None of the above

(viii) In case of a Club, the excess of expenditure over income is called as

(A) Surplus

(B) Deficit

(C) Capital Fund

(D) Investment in Fixed Assets

(ix) A Charitable Institution has 250 members with a annual subscription of ₹ 5,000 each. The subscription received during 2018-19 were ₹ 11,25,000, which include ₹ 65,000 and ₹ 25,000 for the years of 2017-18 and 2019-20 respectively. Amount of outstanding subscription for the 2018-19 will be

(A) ₹ 90,000

(B) ₹ 1,25,000

(C) ₹ 2,15,000

(D) ₹ 1,90,000

(x) The following are details of closing stock items in Aarvi Limited:

Items	Historical Cost (₹ in Lakh)	Net Realisable Value (₹ in Lakh)
A	30	27
B	15	18
C	35	35
D	40	45

The value of Closing Stock will be

(A) ₹ 120 Lakh

(B) ₹ 125 Lakh

(C) ₹ 117 Lakh

(D) ₹ 128 Lakh

(b) Match the following in Column-I with the appropriate in Column-II: 1x5=5

	Column-I		Column-II
(1)	Highest Relative Capital Method	(A)	Departmental Accounts
(2)	Basis of Apportionment of Expenses	(B)	Insurance Claim
(3)	Partial Repossession	(C)	AS-9
(4)	Indemnity Period	(D)	Piecemeal Distribution
(5)	Revenue Recognition	(E)	Hire Purchase

(c) State whether the following statements are *True* or *False*. 1x5=5

(i) All these items of revenue nature which received during the period of accounts, are only shown in the Income and Expenditure Account.

(ii) When the capitalization of profits method is used then the value of goodwill on the basis of future maintainable profits is more than that of on the basis of super profits.

(iii) In case of transfer from Creditors Ledger to Debtors Ledger, the Debtors Ledger Adjustment Account should be debited.

(iv) Unrecoupable short-workings should be charged to Profit and Loss Account.

(v) In the Stock and Debtors Method of accounting, balance of Branch Stock Account shows either Gross Profit or Gross Loss.

(d) Fill in the blanks: 1x5=5

(i) Net Worth is excess of _______________ over ______________.

(ii) The Sales ₹ 180 Lakh, Purchases ₹ 129 Lakh and Opening Stock ₹ 33 Lakh. If the rate of Gross Profit is 50% on cost, then the value of closing stock will be ________________.

(iii) In case of Loss of Profit Policy, Gross Profit is the sum of Net Profit plus ____________Standing Charges.

(iv) Interest to be allowed @ 0.75 per cent per month on Partners Capital of ₹ 60 Lakh; Manager's Commission @ 5 per cent of Net Profit before charging such commission. If the Net Profit before charging interest on capital and manager's commission amounted to ₹ 14.85 Lakh, then manager's commission will be _______________.

(v) A machinery was purchased on Hire Purchase System. Its cash price was ₹ 5,20,000 which was payable in annual instalments of ₹ 1,80,000 each including interest @ 15 per cent per annum. The amount of interest included in 2nd instalment would be ______________.

SECTION – B

Answer *any five* questions from the remaining seven questions. Each question carries 15 marks. 15×5=75

2. (a) Rectify the following errors: 8

(i) A Credit Sale of goods to X ₹ 3,000 posted as ₹ 30,000.

(ii) A Cash Sale of goods to Y ₹ 3,000 posted as ₹ 30,000.

(iii) A Credit Sale of Furniture to Z ₹ 3,000 posted as ₹ 30,000.

(iv) A Credit Sale of goods of ₹ 3,000 to Krishan entered in the purchases book, as ₹ 30,000 and posted therefrom to the credit of Kishan as ₹ 3,000.

(v) A Cash Sale of goods of ₹ 3,000 to Krishan posted to the credited of Kishan as ₹ 30,000.

(vi) A Credit Purchase of old machinery from Sohan for ₹ 17,000 was entered in the Purchases Book as purchase from Mohan for ₹ 71,000. ₹ 3,000 paid as Repair Charges of this Machinery debited to General Expenses Account.

(vii) A Bill drawn on Meenu for ₹ 30,000 was passed through bills payable book with ₹ 3,000 and posted therefrom to the credit of Meena as ₹ 300.

(viii) Sales included a sale of furniture having a book of value of ₹ 900 for ₹ 850 on 31st March, 2018.

(b) Mr. Kanan is running a business of readymade garments. He does not maintain his books of accounts under double entry system. While assessing the income of Mr. Kanan for the financial year 2018-19, Income Tax Officer feels that he has not disclosed the full income earned by him from his business. He provides you the following information:

On 31st March, 2018	
Sundry Assets	₹ 16,65,000
Liabilities	₹ 4,13,000
On 31st March, 2019	
Sundry Assets	₹ 28,40,000
Liabilities	₹ 5,80,000
Mr. Kanan's drawings for the year 2018-19	₹ 32,000 per month
Income declared to the Income Tax Officer	₹ 9,12,000

During the year 2018-19, one life insurance policy of Mr. Kanan was matured and amount received ₹ 50,000 was retained in the business.

State whether the Income Tax Officer's contention is correct. Explain by giving your working. 7

3. Following is the Trial Balance as on 31st March, 2019 of Bajrang Traders:

Particulars	Debit (₹)	Credit (₹)
Stock on 01.04.2018	1,35,000	
Purchases and Sales	28,50,000	46,25,000
Returns	35,000	22,500
Carriage Inwards	24,000	
Carriage Outwards	33,000	
Wages	1,25,000	
Salaries	3,52,000	
Printing and Stationery	6,500	
Insurance Premium	15,000	
Repairs	11,000	
Discounts Allowed	30,500	
Discounts Received		15,500
Bad Debts	28,000	
Provision for Bad Debts		35,000

Advertisement	38,000	
Interest on Investment		42,000
Drawings	2,10,000	
Investment	8,00,000	
Furniture and Fixtures	3,50,000	
Office Equipments	2,45,000	
Land and Building	15,00,000	
Sundry Debtors and Creditors	6,90,000	4,55,000
Establishment Expenses	35,000	
Capital		31,05,000
Cash at Bank	7,24,000	
Cash in Hand	63,000	
Total	83,00,000	83,00,000

Additional Information:

(i) Closing Stock of goods amounted to ₹ 1,85,000 and of stationery amounted to ₹ 1,500.

(ii) Depreciation to be charged on Land and Building @ 10%; On Office Equipments @ 5%; and On Furniture and Fixtures @ 10%.

(iii) Insurance Premium paid on 1st July, 2018 for one year.

(iv) Write off further as bad debts ₹ 5,000 and maintain a provision for bad debts of 5% on debtors.

(v) Provision made for discount on debtors @ 2%.

(vi) Goods costing ₹ 12,500 used for given free samples to customers.

(vii) Goods costing ₹ 25,000 were sent on approval basis to a customer for ₹ 40,000 on 26th March, 2019. This was recorded as actual sales but approval did not receive till 31st March, 2019.

(viii) Outstanding salaries were for one month.

(ix) Investment made at 7.50% per annum on 1st May, 2018.

You are required to prepare Trading Account and Profit & Loss Account for the year ended 31st March, 2019 and a Balance Sheet as on that date. 15

4. A, B and C were partners in a firm sharing profits & losses in the ratio of 3 : 1 : 1 agreed upon dissolution of there partnership. 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	1,200	23,000
B	10,000		Stock		7,800
C	7,000	44,500	Furniture		1,000
		52,000			52,000

It is agreed as follows:

(i) Goodwill is to be ignored.

(ii) 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 that figure.

(iii) 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%).

(iv) C takes over the remaining sundry assets at 90% of book values less ₹ 100 allowances and assumes responsibility for the discharge of the loan, together with accruing interest of ₹ 30 which has not been recorded in the books of the firm.

(v) 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. 15

5. (a) Rukmani Stores, Delhi invoiced goods to its Jaipur Branch @ 20% less than the Catalogue price which is cost plus 50% with instructions that cash sales were to be made at invoice price and credit sales at catalogue price and allow discount on prompt payment. The following details related to branch are provided by Rukmani Stores for the year ended 31st March, 2019:

	₹
Invoiced Stock: On 01.04.2018	4,50,000
On 31.03.2019	5,10,000
Branch Debtors: On 01.04.2018	3,60,000
Branch Furniture: On 01.04.2018	1,20,000
Cash Sales	13,60,000
Credit Sales	21,50,000
Goods Invoiced to Branch	32,10,000
Goods returned by Branch (Invoice Price)	84,000
Expenses Paid by H.O.: Rent	1,25,000
Salaries	1,80,000
Petty Expenses paid by Branch	11,000
Cash received from Branch Debtors	18,65,000
Remittances by Branch to H.O.	32,00,000
Discount allowed to Branch Debtors	1,85,000
Branch Bad debts	15,800
Goods Returned by Branch Debtors	12,600

It was decided to make provision for discount of ₹ 42,500 on closing debtors for prompt payment. Depreciate the furniture @ 10% per annum.

You are required to prepare Jaipur Branch Account and Goods Sent to Branch Account in the books of Rukmani Stores. 8

(b) The following information related to various debtors for the year ended 31st March, 2019, are supplied by Nakul Limited:

Particulars	A(₹)	B(₹)	C(₹)	D(₹)	E(₹)
Balance on 01.04.2018	25,000 (Dr.)	18,000 (Dr.)	4,500 (Cr.)	39,000 (Dr.)	22,000 (Dr.)
Goods Sold	2,85,000	1,98,000	2,60,000	38,000	2,16,000
Sales Return	5,400	7,200	15,000		7,500
Cash & Cheques Collected	1,86,000	1,52,000	1,95,000	42,000	2,25,000
B/R Received	48,000	41,000	38,000	32,000	—
Discount Allowed	9,000	7,000	8,500	900	11,200
Bad Debts	—	—	—	16,000	—
B/R Dishonoured	11,000	—	8,500	13,000	—
Interest & Other Charges	600	200	300	900	—

On 31st March, 2019, A and C also stood in Purchase Ledger having credit balances of ₹ 3,600 and ₹ 5,100 respectively.

You are required to prepare Debtors Ledger Adjustment Account in General Ledger. 7

6. (a) On 31st January, 2019 the premises of Toli Textiles Limited were destroyed by fire. The records of the company revealed the following particulars:

	₹
Stock on 01.04.2017	11,35,000
Stock on 31.03.2018	12,64,100
Purchase Less returns, during the year ended 31st March, 2018	65,45,000
Sales Less returns, during the year ended 31st March, 2018	91,00,000
Purchase Less return, from 01.04.2018 to 31.01.2019	56,64,000
Sales Less returns, from 01.04.2018 to 31.01.2019	78,24,000

In valuing stock on 31st March, 2018 ₹ 45,900 had been written off out of certain stock which was of a poor selling line, having cost ₹ 1,37,700. A portion of these goods were sold in October, 2018 at a loss ₹ 11,080 on the original cost of ₹ 55,080. The remaining stock of this goods on the date of fire was to be valued at 80% of its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout. The stock salvaged from fire was ₹ 1,23,800.

You are required to compute the amount of claim to be lodged for loss of stock. The stock was insured for ₹ 12,50,000. 7

(b) The following particulars relate to hire purchase transactions:

(i) X purchased three cars from Y on hire purchase basis, the cash price of each car being ₹ 2,00,000.

(ii) The hire purchaser charged depreciation @ 20% on diminishing balance method.

(iii) Two cars were seized by on hire vendor when second instalment was not paid at the end of the second year. The hire vendor valued the two cars at cash price less 30% depreciation charged under it diminishing balance method.

(iv) The hire vendor spent ₹ 10,000 on repairs of the cars and then sold them for a total amount of ₹ 1,70,000.

You are required to compute:

(I) Agreed value of two cars taken back by the hire vendor.

(II) Book value of car left with the hire purchaser.

(III) Profit or loss to hire purchaser on two cars taken back by their hire vendor.

(IV) Profit or loss of cars repossessed, when sold by the hire vendor. 8

7. (a) A infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Finance Officer wants to account/recognize license fee as income for 12 months during current year under audit and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not. 6

(b) State briefly the factors to be considered while selecting pre-packaged accounting software. 6

(c) From the following particulars ascertain the value of unsold stock on Consignment. 3

Goods sent (1000 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.)	

8. Write short notes on any three of the following: 5×3=15

(a) The Accrual concept.

(b) Provision for Discount on Debtors

(c) Features of Income and Expenditure Account

(d) Maximum Possible Loss Method

INTERMEDIATE EXAMINATION

December 2018

P-5(FAC)
Syllabus 2016

Financial Accounting

Time Allowed: 3 Hours | Full Marks: 100

The figures in the margin on the right side indicate full marks.

Both the sections are to be answered subject to instructions given aganist each.

[All workings must form part of your answer.]

SECTION - A

1. Answer the following questions:

(a) Choose the most appropriate one from the given following alternatives: 1×10=10

(i) Both cash and credit transactions are recorded, on the basis of

(A) Accounting Period Concept

(B) Going Concern Concept

(C) Business Entity Concept

(D) Accrual Concept

(ii) Which of the following book is both a journal and a ledger?

(A) Cash Book

(B) Sales Day Book

(C) Bills Receivable Book

(D) Journal Proper

(iii) Interest received in advance account is a

(A) Nominal Account

(B) Real Account

(C) Artificial Personal Account

(D) Representative Personal Account

(iv) Shiva draws a bill on Sanat on 25th October, 2018 for 90 days, the maturity date of the bill will be

(A) 27th January, 2019

(B) 26th January, 2019

(C) 25th January, 2019

(D) 28th January, 2019

(v) Peeru and Simu are entered in the business of buy and sale of food grain for a period of one year and sharing the profit in the ratio of 3 : 2, this agreement is a

(A) Partnership

(B) Consignment

(C) Joint-venture

(D) Lease

(vi) At the end of the year 2017-18, Prepaid Insurance Premium ₹ 7,500 was appeared in the Trial Balance, it will be shown

(A) only in Profit & Loss Account.

(B) only in Balance Sheet.

(C) both in Profit & Loss Account and in Balance Sheet.

(D) not in Both in Profit & Loss Account and in Balance Sheet.

(vii) Contingent Liability would appear

(A) on the liabilities side of the Balance Sheet.

(B) on the assets side of the Balance Sheet.

(C) as a note in the Balance Sheet.

(D) None of the above

(viii) Debtors Ledger Adjustment Account is opened in the

(A) Debtors Ledger

(B) Creditors Ledger

(C) General Ledger

(D) Both Creditors Ledger and General Ledger

(ix) Generally sacrifice ratio is concerned with the situation of

(A) Admission of a new partner

(B) Retirement of a partner

(C) Dissolution of firm

(D) Conversion of firm into company

(x) KCS purchased a machine from JPS on hire purchase system, whose cash price was ₹8,64,000. ₹2,16,000 being paid on delivery and balance in three annual instalments of ₹2,88,000 each. The amount of interest included in first installment would be

(A) ₹ 72,000

(B) ₹ 57,600

(C) ₹ 1,08,000

(D) ₹ 36,000

(b) Match the following: 1×5=5

Column-I		Column-II	
(1)	Dead Rent	(A)	Bills Receivable
(2)	Marshalling	(B)	Consignment
(3)	Protesting	(C)	Liquidity Order
(4)	Account Sales	(D)	Accounting Policies
(5)	Substance over form	(E)	Royalty

(c) Fill in the blanks: 1×5=5

(i) While posting an opening entry in the ledger, in case of an Account having debit balance, in 'Particulars' column the words ___________ are written on debit side.

(ii) Depreciation Accounting is the process of __________ and not ___________

(iii) Finished goods are normally valued at cost or ___________ whichever is lower.

(iv) The relation between Consignee and Consignor is that of ____________

(v) The relationship between Co- venturers is that of _______________

(d) State with reason whether the following statements are true or false (No marks shall be awarded without valid reason): 1×5=5

(i) Bank reconciliation statement is prepared to arrive at the bank balance.

(ii) Deferred revenue expenditure is current year's revenue expenditure to be paid in the later years.

(iii) Reducing balance method for depreciation is followed to have a uniform charge for depreciation and repairs and maintenance together.

(iv) Reserve for Discount on Creditors has a credit balance.

(v) A promissory note can be made payable to the bearer.

SECTION – B

Answer any five from the following.

Each Question carries 15 marks. 15 ×5=75

2. (a) A bookkeeper extracted the following Trial Balance as on 31st March, 2018:

Heads of Accounts	Dr. Balance (₹)	Cr. Balance (₹)
Furniture	20,000	--------
Capital	--------	2,00,000
Debtors	2,00,000	--------
Stock (1st April, 2017)	1,04,000	--------
Creditors	---------	80,000
Trade Expenses	50,000	------
Sales	---------	8,58,000
Wages	30,000	--------

Stock (31st March, 2018)	98,000	--------
Machinery	---------	50,000
Purchases	6,25,000	--------
Wife's loan to the business	50,000	--------
Discount Allowed	--------	4,000
Drawings made by the Proprietor	--------	45,000
Motor Van	60,000	-------
Total	12,37,000	12,37,000

You are required to:

(i) State the errors giving reasons,

(ii) Redraft the Trial Balance correctly. 7

(b) Ram Prakash keeps his books on Single Entry System. From the following information provided by him, prepare Trading and Profit & Loss Account for the year ended 31st March, 2018 and Balance Sheet as at that date:

Particulars	31st March, 2017 (₹)	31st March, 2018 (₹)
Furniture	1,00,000	1,20,000
Stock of Goods-in-Trade	60,000	20,000
Sundry Debtors	1,20,000	1,40,000
Prepaid Expenses	------	4,000
Sundry Creditors	40,000	?
Unpaid Expenses	12,000	20,000
Cash	22,000	6,000

Receipts and payment during the year were as follows:

Particulars	₹
Receipts from Debtors	4,20,000
Paid to Creditors	2,00,000
Transportation	40,000
Drawings	1,20,000
Sundry Expenses	1,40,000
Furniture Purchased	20,000

Other Information: There were considerable amount of Cash Sales. Credit Purchases during the year amounted ₹ 2,30,000. Provide a provision for Doubtful Debts to the extent of 10% on Debtors. 8

3. The following information provided by the Nav Yuvak Mandal, Delhi for the first year ended 31st March, 2018:

(i) Donations received for building ₹25 Lakh.

(ii) Other incomes and receipts were:

(₹ in '000)

Particulars	Capital Income (₹)	Revenue Income (₹)	Actual Receipt (₹)
Entrance fees	------	251	251
Life Membership fees	105	-----	105
Subscription	------	1160	1151
Play Ground rent	------	120	110
Refreshment account	------	115	115
Sundry incomes	-------	62	49

(iii) Expenditures and actual payment were:

(₹ in '000)

Particulars	Capital Expenditure (₹)	Revenue Expenditure (₹)	Actual Payment (₹)
Land	800	...	800
Books	236	...	202
Furniture	345	...	315
Honorarium and salaries	...	165	131
Maintenance of play ground	...	52	50
Refreshment account	...	79	79
Insurance Premium	...	12	15
Sundry expenses	...	70	65

Others: Donation were utilized to the extent of ₹13 Lakh in construction of building, balance were unutilized. In order to keep in safe, 8% Government Securities were purchased on 31st December, 2017 for ₹10.50 Lakh. Remaining amount was put in bank as term deposit on 31st March, 2018. During the year 2017-18, Subscription received in advance ₹52,000 for the year 2018-19. Depreciation to be charged on Building and Furniture @ 10% and on Books @ 15%.

You are required to prepare the Receipts & Payments Account, Income & Expenditure Account and Balance Sheet as on 31st March, 2018. 15

4. (a) A, B and C are partners in a firm sharing profits and losses as 3 : 2 : 1. Their Balance Sheet as on 31st March, 2018 was as follows:

(₹ in Lakh)

Liabilities	Amount (₹)	Assets	Amount (₹)
Partners' Capital A/c:		Land and Building	210
A	145	Plant and Machinery	255
B	110	Stock	125
C	75	Debtors	95
General Reserve	165	Bills Receivable	25

Partners' Loan:		Cash in Hand	3
A	30	Cash at Bank	37
B	20		
Sundry Creditors	205		
	750		750

B died on 1st August, 2018. His account is to be settled under the following terms:

(i) Goodwill will be valued at 3 years purchase of last four accounting years average profit. Profits were : 2014-15 ₹ 135 Lakh, 2015-16 ₹ 145 Lakh, 2016-17 ₹ 131 Lakh and 2017-18 ₹ 165 Lakh.

(ii) Land and Building will be valued at ₹ 250 Lakh and Plant and Machinery will be valued at ₹ 240 Lakh.

(iii) For the purpose of calculating B's share in the profits of 01.04.2018 to 31.07.2018, the profits for the year 2017-18 will be taken as base.

(iv) Interest on Partners' Loan will be calculated @ 6% per annum.

(v) A sum of ₹50 Lakh to be paid immediately to B's Executor and the balance to be paid on 1st December, 2018 together with interest @ 10% per annum.

You are required to pass necessary journal entries to record the above transactions and amount payable to B' s Executor's Account. 15

5. (a) The following information provided by the Shobha Departmental Store for the year ended 31st March, 2018:

Department	Purchase(units)	Sales	Closing Stock(units)
X	2500	2550 units @ ₹ 160 per unit	250
Y	5000	4800 units @ ₹180 per unit	400
Z	6000	6240 units @ ₹ 200 per unit	140

The total value of purchases is ₹ 15 Lakh. It is observed that the rate of gross profit is the same in each department.

You are required to prepare the Departmental Trading Account for the year ended 31 st March, 2018. 9

(b) Following information is available from the books of Simu & Co. for the year ended 31st March, 2018:

(i) Total Sales amounted to ₹ 560 Lakh including the sale of old Machinery for ₹ 8 Lakh (Book Value ₹ 15 Lakh). The total Cash Sales were 80% less than the total Credit Sales.

(ii) Cash collection from debtors amounted to 75% of the aggregate of the opening debtors and the Credit Sales for the period. Debtors were allowed Cash discounts for ₹ 15.60 Lakh.

(iii) Bills Receivable drawn during the year totaled ₹45 Lakh of which bills amounting to ₹ 28 Lakh were endorsed in favour of Creditors. Out of these endorsed B/R, some bills for ₹ 4.60 Lakh were dishonoured for non-payment as the parties became insolvent, their estate realizing nothing.

(iv) Cheques received from Sundry Customers for ₹41 Lakh were dishonoured; a sum of ₹ 5 Lakh is irrecoverable.

(v) Bad Debts written off in the earlier years was recovered of ₹ 7.50 Lakh.

(vi) Transfers from Creditors Ledger to Debtors Ledger were of ₹ 38 Lakh.

(vii) Sundry Debtors, as on 1st April, 2017, stood at ₹ 128 Lakh.

You are required to show the General Ledger Adjustments Accounts in the Debtors Ledger. 6

6. (a) CCL wants to take up a loss of profit policy. Turnover during the current year is expected to increase by 20%. The company will avail overdraft facilities from its bank @ 15% interest to boost up the sales. The average daily overdraft balance will be around ₹ 3 Lakh. All other fixed expenses will remain same. The following further details are also available from the previous year's account:

	₹
Total variable expenses	24,00,000
Fixed expenses:	
Salaries	3,30,000
Rent, Rates and Taxes	30,000
Travelling expenses	50,000
Postage, Telegram, Telephone	60,000
Director's fees	10,000
Audit fees	20,000
Miscellaneous income	70,000
Net Profit	4,20,000

Determine the amount of policy to be taken for the current year. 7

(b) Mansi Ltd. acquires the lease of a mine from Nanu Ltd. on the following terms:

(i) Minimum Rent of ₹40 Lakh per annum merging into a royalty of ₹50 per tonne.

(ii) Shortworkings are recoverable out of future earnings subject to:

(I) Only half of the excess earnings over minimum rent may be used for this purpose.

(II) No Shortworkings may be carried forward for recoupment if output falls below 40000 Tonnes, in any year.

Output for the first four years was : 32000 Tonnes; 48000 Tonnes; 64000 Tonnes and 112000 Tonnes respectively.

Prepare the necessary accounts for above four years in the books of the Lessee. 8

7. (a) In a production process, normal waste is 5% of input. 5000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,900. The entire quantity of waste is on stock at the year end. State with reference to Accounting standard, the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss, if any and the value of closing inventories. 8

(b) Enumerate the advantages of computerized Accounting. 7

8. Write short notes on *any three* of the following: 5×3=15

   (i) Applicability and Non-Applicability of Garner vs. Murray Rule

   (ii) Consequential Loss Policy

   (iii) Distinction between Hire Purchase Agreement and Instalment Purchase Agreement

   (iv) Distinction between Fundamental accounting assumptions and Accounting policies

INTERMEDIATE EXAMINATION

June 2018 **P-5(FAC)**

Syllabus 2016

Financial Accounting

Time Allowed: 3 Hours Full Marks: 100

The figures in the margin on the right side indicate full marks.

Both the sections are to be answered subject

to instructions given aganist each.

All workings must form part of your answer.

SECTION - A

1. Answer the following questions:

(a) Choose the most appropriate one from the given following alternatives: 1×10=10

(i) Which of the following is not a Qualitative Characteristics of Financial Statement?

(A) Cost Principle

(B) Understandability

(C) Relevance

(D) Reliability

(ii) Name the book in which, entries are recorded on the basis of credit notes issued.

(A) Sales Book

(B) Purchase Book

(C) Sales Return Book

(D) Purchase Return Book

(iii) Exception to consistency principle is

(A) Cost Principle

(B) Going Concern Principle

(C) Matching Principle

(D) Prudence Principle

(iv) Interest charged by vendor in Hire Purchase System, is calculated on the basis of

(A) Outstanding hire purchase price

(B) Outstanding cash price

(C) Installment amount

(D) Cost price of the asset

(v) The balance in consignment account shows

(A) Amount receivable from consignee

(B) Amount payable to consignee

(C) Profit/ loss on consignment

(D) Closing stock with consignee

(vi) Provision for bad debts is

(A) Real Account

(B) Nominal account

(C) Personal account

(D) None of the above

(vii) The business is treated as distinct and separate from its owners on the basis of the

(A) Going concern concept

(B) Conservatism concept

(C) Matching concept

(D) Business entity concept

(viii) Due to retrospective effect on revision of salary of employees, the arrears of salary relating to past years, payable in current year is

(A) Prior - period item

(B) Extra - ordinary item

(C) Ordinary item requiring separate disclosure

(D) Contingent item

(ix) Discount given in the Sales - Invoice itself is

(A) Cash discount

(B) Trade discount

(C) Rebate

(D) Allowance

(x) Canteen expenses are apportioned among departments in the proportion of

(A) Departmental floor space

(B) Departmental direct wages

(C) Departmental sales

(D) Departmental No. of employees

(b) Match the following in Column-I with the appropriate Column-II: 1×5=5

Column-I		Column-II	
(i)	Receipt & Payment A/c	(a)	AS-10
(ii)	Revaluation model of Asset	(b)	Consignment
(iii)	Proforma Invoice	(c)	Not-for-Profit Organization
(iv)	Stage of Completion Method	(d)	Hire Purchase
(v)	Partial Repossession	(e)	AS-7
		(f)	AS-6

(c) State whether the following statements given below are true or false: 1×5=5

(i) Receipt & Payment Account only records the revenue nature of receipts and expenses.

(ii) Sales Book records both cash and credit sales.

(iii) Normal loss of goods sent on consignment is shown in Consignment Account.

(iv) In case of trading concern, cost of goods sold and cost of sales are same.

(v) In Proprietorship business, Income-tax payable is shown as a liability in Balance Sheet.

(d) Fill in the blanks: 1x5=5

(i) The Bank A/c is a _____________ Account.

(ii) Assets are classified as non-current asset and current assets as per ______ Principle.

(iii) __________ Amount is the higher of asset's net selling price and its value in use.

(iv) The ______________ Loss is included in the valuation of inventories.

(v) _________________ is the amount by which minimum rent exceeds the actual royalty.

Section - B
Answer any five from the following.
Each question carries 15 marks.

2. (a) The Trial Balance of S Ltd. as on 31/03/2018 showed the credit in excess by ₹ 415 which was been carried to Suspense Account. On a closed scrutiny of the books, the following errors were revealed:

(i) A cheque of ₹ 3,456 received from AB Ltd. after allowing it a discount of ₹ 46 was endorsed to CD Ltd. in full settlement for ₹ 3,500. The cheque was finally dishonoured but no entries are passed in the books of account.

(ii) Goods of the value of ₹ 230 returned by PQ Ltd. were entered in Purchase Day book and posted there from to MN Ltd. as ₹ 320.

(iii) Bad debts aggregating ₹ 505 written off during the year in Sales Ledger but were not recorded in General Ledger.

(iv) Bill for ₹ 750 received from Z Ltd. for repairs to Machinery was entered in the Inward Invoice Book as ₹650.

(v) Goods worth ₹ 1,234 purchased from Y Ltd. on 28/03/2018 had not been entered in Day book and credited to Y Ltd. but Goods were not delivered till 5th April, 2018. The title of Goods was however passed on 28/03/2018 and was taken into stock on 31-03-2018.

(vi) ₹ 79 paid for Freight on Machinery was debited to Freight account as ₹ 97.

Pass the necessary Journal Entries to rectify the above mentioned errors. 8

(b) A company maintains its reserve for bad debts @ 5% and a reserve for discount on debtors @ 2%. You are given the following details:

Particulars	2016	2017
Bad debts	800	1,500
Discount allowed	1,200	500
Sundry debtors (before providing all bad debts and discounts)	60,000	42,000

On 01/01/2016, 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 for the year 2016 and 2017. 7

3. Following is the summary of Receipts and Payments of Radix Clinic for the year ended 31st March, 2017:

	₹
Opening Cash Balance	56,000
Donation Received (including ₹ 50,000 for Building Fund.)	1,55,000
Payment to creditors for Medicines Supply	2,10,000
Salaries	70,000
Purchase of Medical Equipments	1,05,000
Medical Camp Collections	87,500
Subscription Received	3,50,000
Interest on Investments @ 9% p.a.	63,000
Honorarium to Doctors	1,90,000
Telephone Expenses	6,000
Medical Camp Expenses	10,500
Miscellaneous Expenses	7,000

Additional Information:

Sl. No		01.04.2016	31.03.2017
1.	Subscription Due	10,500	15,400
2.	Subscription Received in Advance	8,400	4,900
3.	Stock of Medicine	70,000	1,05,000
4.	Medical Equipments	1,47,000	2,14,200

5.	Building	3,50,000	3,15,000
6.	Creditor for Medicine Supply	63,000	91,000
7.	Investments	7,00,000	7,00,000

You are required to prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31st March, 2017 and the Balance Sheet as on 31st March, 2017. 15

4. The following information relates to the business of ABC Enterprises, who requests you to prepare a Trading and profit & loss A/c for the year ended 31st March, 2017 and a Balance Sheet as on that date:

(a) Assets and Liabilities as on:

	01.04.2016 (₹)	31.03.2017 (₹)
Furniture	60,000	63,500
Stock	80,000	70,000
Sundry Debtors	1,60,000	?
Sundry Creditors	1,10,000	1,50,000
Prepaid Expenses	6,000	7,000
Outstanding Expenses	20,000	18,000
Cash in Hand & Bank Balance	12,000	26,250

(b) Cash transaction during the year:

(i) Collection from Debtors, after allowing discount of ₹15,000 amounted to ₹5,85,000.

(ii) Collection on discounting of Bills of Exchange, after deduction of discount of ₹ 1,250 by bank, totalled to ₹61,250.

(iii) Creditors of ₹4,00,000 were paid ₹3,92,000 in full settlement of their dues.

(iv) Payment of Freight inward of ₹30,000.

(v) Amount withdrawn for personal use ₹70,000.

(vi) Payment for office furniture ₹10,000.

(vii) Investment carrying annual interest of 6% were purchased at ₹ 95 (200 shares, face value ₹ 100 each) on 1st October, 2016 and payment made thereof.

(viii) Expenses including salaries paid ₹ 95,000.

(ix) Miscellaneous receipts of ₹ 5,000.

(c) Bills of exchange drawn on and accepted by customers during the year amounted to ₹1,00,000. Of these, bills of exchange of ₹20,000 were endorsed in favour of creditors. An endorsed bill of exchange of ₹ 4,000 was dishonoured.

(d) Goods costing ₹ 9,000 were used as advertising material.

(e) Goods are invariably sold to show a gross profit of 20% on sales.

(f) Difference in cash book, if any, is to be treated as further drawing or introduction of capital by proprietor of ABC enterprises.

(g) Provide at 2% for doubtful debts on closing debtor. 15

5. (a) (i) M/s. Zed Laptop Co. has a hire-purchase department and goods are sold on hire-purchase adding 25% to cost. From the following information (all figures are at hire-purchase price), Prepare Hire-Purchase Trading Account for the year ending, March 31, 2017:

	₹
April 01, 2016 goods with customers (Installments not yet due)	80,000
Goods sold on Hire-purchase during the year	4,00,000
Cash received during the year from customers	3,00,000
Installments due but not yet received at the end of the year, customers paying	10,000

5

(ii) M/s. Big Systematic Ltd. maintains self-balancing ledgers preparing control accounts at the end of each calendar month.

On 3rd January, 2018 the accountant of the company located the following errors in the books of account:

(A) An amount of ₹ 8,700 received from customer Mehra was credited to Mehta, another customer.

(B) The sales book for December, 2017 was under cast by ₹ 1,000.

(C) Goods invoiced at ₹ 15,600 were returned to supplier, M/s Mega Ltd. but no entry was made in the books for this return made on 28th December, 2017.

Pass the necessary Journal Entries to rectify the above mentioned errors. 5

(b) On 15th December, 2017, a fire occurred in the premises of M/s. OM Exports. Most of the stocks were destroyed. Cost of Stock salvaged being ₹ 1,40,000. From the books of account, the following particulars were available:

(i) Stock at the close of account on 31st March, 2017 was valued at ₹ 9,40,000.

(ii) Purchases from 01.04.2017 to 15-12-2017 amounted to ₹ 13,20,000 and the sales during that period amounted to ₹ 20,25,000.

On the basis of his accounts for the past three years, it appears that average gross profit ratio is 20% on sales.

Compute the amount of the claim, if the stock were insured for ₹ 4,00,000. 5

6. A and B were partners of a firm sharing profits and losses in the ratio 2:1. The Balance Sheet of the firm as at 31st March, 2017 was as under:

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
Capital Accounts:		Plant and Machinery	5,00,000
A	8,00,000	Building	9,00,000
B	4,00,000	Sundry Debtors	2,50,000
Reserves	5,25,000	Stock	3,00,000
Sundry Creditors	2,75,000	Cash	1,50,000
Bills Payable	1,00,000		
	21,00,000		21,00,000

They agreed to admit P and Q into the partnership on the following terms:

(i) The firm's goodwill to be valued at 2 years' purchase of the weighted average of the profits' of the last 3 years. The relevant figures are:

Year ended 31.03.2014 - Profit ₹ 37,000

Year ended 31.03.2015 - Profit ₹ 40,000

Year ended 31.03.2016 - Profit ₹ 45,000

(ii) The value of the stock and Plant & Machinery were to be reduced by 10%.

(iii) Building was to be valued at ₹ 10,11,000.

(iv) There was an unrecorded liability of ₹ 10,000.

(v) A, B, P & Q agreed to share profits and losses in the ratio 3:2:1:1.

(vi) The value of reserve, the values of liabilities and the values of assets other than cash were not to be altered.

(vii) P and Q were to bring capitals equal to their shares of Profit considering B's capital as base after all adjustments.

You are required to prepare:

(1) Memorandum Revaluation Account,

(2) Partner's Capital Accounts and

(3) The Balance Sheet of the newly constructed firm. 15

7. (a) (i) (A) X sells goods to Y for ₹ 2,00,000. Instead of one bill of ₹ 2,00,000, X draws three bills of exchange on Y for ₹ 40,000; ₹ 60,000 and ₹ 1,00,000. What is the value involved in drawing three bills instead of one?

(B) Sunny draws a bill on Vivek for three months. On the due date, Vivek finds himself in financial difficulties and requests Sunny to renew the bill for a further period of one month. Sunny agrees to his request. What is the virtue involved in renewing the bill?

(C) What is the value involved in accepting an accommodation bill?

(D) What is the reason that a drawer cannot file a suit against drawee in case of dishonour of an accommodation bill? 1x4=4

(ii) Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹ 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premises of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹ 15,00,000 ready for dispatch. Raj Ltd. accounted ₹ 15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS-9. 5

(b) X Ltd. has its H.O. in Delhi and a branch in Mumbai. H.O. supplied goods to its branch at cost plus $33^1/_3$%. From the particulars given below prepare a Branch Trading Account for the year ended 31st March 2018 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. 6

8. Write short notes on *any three* of the following: 5×3=15

(a) Operating cycle of Consignment Arrangement.

(b) Disadvantages of a Computerized Accounting Package.

(c) Features of Single Entry System.

(d) Bearer Plant.

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