Financial Accounting - II

Fourth Edition

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Preface to the Fourth Edition

The aim of bringing out the latest edition of this book is to keep it updated according to the changes in the syllabus structures of different Universities. ‘Choice Based Credit System’ (CBCS) is being adopted throughout the country to bring uniformity in the syllabus of different Universities and this book has been a modest approach in this direction.

Financial Accounting – II has been structured as per CBCS syllabus prescribed by the University of Calcutta, Kalyani University, Burdwan University and West Bengal State University for the students of B.Com. (General and Honours) Semester – III.

A sincere effort has been made throughout the book to give students a clear view of the subject. Considering the changing students’ need, a considerable restructuring of the book has been done, especially in terms of pedagogy.

Previous years’ CU question papers with solutions have been provided after every chapter. The question papers are further segregated into two categories: ‘For General Course Students’ and ‘For Honours Course Students’. They will enable the students to assess the kind of questions asked in the University examination and also help them in evaluating their conceptual understanding.

An exclusive section named ‘Special Problems’ has been dedicated for advance learners which includes questions that are more challenging and are of higher order of difficulty.

A number of colleagues, friends and students have helped in the preparation of this book. The author thanks each and every one of them. A special thanks to Mr. S. Rangarajan for typesetting and formatting the book.

Utmost care has been taken to make this book error-free, but still if any error comes up, please feel free to write to the author about it at *pmhanif@gmail.com*. All suggestions will be most welcome.

AUTHORS

Preface to the First Edition

Financing Accounting - Vol. I has received a good initial response. In continuation with our efforts, we are pleased to present to our readers this volume (*Financial Accounting - Vol. II*) designed in accordance with the latest syllabus of different universities.

As in the previous volume, greatest care has been taken to make the book well-balanced with text and problems. We have included numerous fully solved problems (more than 400), interspersed within the text. In addition, a variety of chapter-end exercises, including multiple choice questions, have been provided for the benefit of the users of this book. Special emphasis has been given to problems set for various university examinations. All this will help the students clear their concepts thoroughly.

Utmost care has been taken to make this book error-free. The readers are, however, welcome to point out the errors that may have crept in inadvertently. They can also send in their suggestions for further improvement in the book at *pmhanif@gmail.com*

We thank Mr. S Rangarajn for typesetting and formatting this book. Our students have always been a source of inspiration and happiness. They never cease to raise good points. We have tried to incorporate all such points in the book.

We specially thank Master M H Kabir for mapping the newly designed Rupee symbol '₹' throughout this book.

AUTHORS

Syllabus

Calcutta University (B.Com. Honours)

C3.1CG Financial Accounting - II

Marks : 100

Internal Assessment	20 marks
Semester-end Examinations	80 marks
Total	**100 marks**

Marks shown against the units indicate marks for Semester-end Examinations

Unit	Topic	Details	Marks allotted	Where you can find in the Book
1.	**Partnership Accounts-I**	Correction of appropriation items with retrospective effect. Change in constitution of firm - Change in P/S ratio, admission, retirement and retirement-cum- Admission - Treatment of Goodwill, Revaluation of Assets & Liabilities (with/without alteration of books), Treatment of Reserve and Adjustment relating to Capital, Treatment of Joint Life Policy, Death of a Partner.	15	Chapter 1 Chapter 2 Chapter 3 Chapter 4 Chapter 5
2.	**Partnership Accounts-II**	Accounting for Dissolution of Firm - Insolvency of one or more partner, consideration of private estate and private liabilities. Piecemeal distribution - Surplus capital basis, maximum possible loss basis.	15	Chapter 6
3.	**Branch Accounting**	Concept of Branch, Different types of Branches. Synthetic Method - Preparation of Branch Account. Preparation of Branch Trading and Profit and Loss Account (at cost and at I.P.) - Normal and Abnormal Loss. Analytical Method - Preparation of Branch Stock, Adjustment etc. A/c (at cost & I.P.) - normal & abnormal losses. Independent Branch - concept of wholesale profit.	10	Chapter 7

Unit	Topic	Details	Marks allotted	Where you can find in the Book
4.	**Hire Purchase and Instalment Payment System**	Meaning: Difference with Instalment Payment System; Recording of Transaction in the books of buyer - allocation of interest - use of Interest Suspense A/c - Partial and Complete Repossession. Books of Seller - Stock and Debtors A/c (with repossession). Books of Seller - H.P. Trading A/c without HP Sales and HP Debtors and General Trading A/c (with repossession). Concept of Operating and Financial Lease - Basic Concept only.	10	Chapter 8
5.	**Departmental Accounts**	Concept, Objective of Preparation of Departmental Accounts, Apportionment of common cost; Preparation of Departmental Trading and Profit and Loss Account, Consolidated Trading and Profit and Loss Account, Inter-departmental transfer of goods at cost, cost plus and at selling price and elimination of unrealized profit.	10	Chapter 9
6.	**Investment Accounts**	Maintenance of Investment Ledger; Preparation of Investment Account (transaction with brokerage, STT, cum & ex-interest), Valuation of Investment under FIFO and Average method; Investment Account for Shares (with Right Shares, Bonus Shares and Sale of Right). Relevant Accounting Standard.	10	Chapter 10
7.	**Business Acquisition and Conversion of Partnership into Limited Company**	Profit/Loss prior to Incorporation; Accounting for Acquisition of Business. Conversion of Partnership into Limited Company - with and without same set of books	10	Chapter 11 Chapter 12
	TOTAL		**80**	

Relevant Accounting Standards issued by the Institute of Chartered Accountants of India are to be followed.

Brief Contents

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1

Correction of Appropriation Items

Introduction

A partnership firm, from time to time, may discover errors made in the measurement of net income in prior accounting periods. Examples include errors in the computation of depreciation or inventory valuation, wrong distribution of divisible profits and omission of accruals of revenues and expenses. When such errors are discovered, corrections are not generally treated as part of the measurement of net income for the current accounting period. Instead, ***prior period adjustments are made through the partners' capital accounts by means of a single journal entry***.

Illustration 1

A and B started a partnership on 1.1.2016 with resepective capital contributions of ₹ 1,20,000 and ₹ 40,000. Their Capital Account balances as on 31.12.2017 were :

A—₹ 2,09,500 and B—₹ 90,500.

The transactions recorded in the Capital Accounts during these two years were interest on capital @ 10% p.a. on initial investments and allocations of incomes. On 31.12.2017, it was further discovered that drawings of ₹ 42,000 by A and ₹ 30,000 by B had been wrongly treated as business expenses.

You are required to a pass a single Journal Entry to adjust the Partners' Capital Accounts correctly on 31.12.2017.

Solution

Working Notes

(1) Ascertainment of Total Profit for 2 years

Particulars	A (₹)	B (₹)
Balance of capital as on 1.1.2016	1,20,000	40,000
Add: Interest on capital for 2 years @ 10% p.a.	24,000	8,000
Add: Profit credited for 2 years (Balancing fig.)	65,500	42,500
Balance of capital on 31.12.2017	2,09,500	90,500

(2) Ascertainment of Correct Profit

Particulars	₹
Profits already credited ₹ (65,500 + 42,500)	1,08,000
Add: Drawings shown as expense ₹ (42,000 + 30,000)	72,000
Corrected profits to be shared equally	1,80,000

(4) Ascertainment of Correct Capital Balances

Particulars	A (₹)	B (₹)
Balance of capital as on 31.12.2017	2,09,500	90,500
Less: Drawings previously not charged	42,000	30,000
	1,67,500	60,500
Add: Profits to be credited (Note 3)	24,500	47,500
Corrected capital balances as on 31.12.2017	1,92,000	1,08,000

(3) Adjustment of Sharing of Profits

Particulars	A (₹)	B (₹)
Profits that should have been credited (Note 2)	90,000	90,000
Less: Profits that actually have been credited	65,500	42,500
Profit that should be credited further	24,500	47,500

(5) Adjustment of Partners' Capital Accounts

Particulars	A (₹)	B (₹)
Capital balances as on 31.12.2017 (given)	2,09,500	90,500
Corrected balances as on 31.12.2017 (Note 4)	1,92,000	1,08,000
Required adjustment : excess (+) / short (–)	(+) 17,500	(–) 17,500

Required Journal Entry for Correction

Particulars		Dr. (₹)	Cr. (₹)
A Capital A/c	Dr.	17,500	
To B Capital A/c			17,500
(Being the Partners' Capital Accounts adjusted)			

Illustration 2

Following is the Profit and Loss Appropriation Account of A & Co for the year ended 31.12.2017 :

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital A/c			By Profit & Loss A/c (Net Profit)		50,000
X — 6% on ₹ 50,000		3,000	By Interest on Drawings A/c		
Y — 6% on ₹ 30,000		1,800	X — 5% on ₹ 12,000	600	
To Partners' Salary A/c — X		3,600	Y — 5% on ₹ 10,000	500	1,100
To Share of Profit A/c					
X	25,620				
Y	17,080	42,700			
		51,100			51,100

The entries were duly passed in the books but the following discrepancies were subsequently discovered:
(1) Interest on capital should be charged at 5% and that on drawings at 6% p.a.;
(2) X was not entitled to any partnership salary but Y was entitled to a salary of ₹ 200 p.m. not yet drawn by him;
(3) Profits to be shared in capital ratio; and,
(4) A loan on ₹10,000 stood in books in the name of A carrying 6% interest p.a.
Pass Journal entries to set these right.

Solution **Statement Showing the Required Corrections**

Particulars	P&L Adj. A/c		X Capital		Y Capital		O/s expenses	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
For 1% interest on capital to be received back from the partners		800	500		300			
For 1% more interest on Drawings to be charged		220	120		100			
For salary of ₹ 3,600 for X to be received back and Y is to be paid ₹ 2,400 on account of salary		1,200	3,600			2,400		
For interest on A's loan of ₹ 600 to be paid	600							600
For wrong sharing of profit written back		42,700	25,620		17,080			
For sharing the net adjusted profit (5:3)	44,320			27,700		16,620		
TOTAL	44,920	44,920	29,840	27,700	17,480	19,020		600
Net effect			(Dr.)	2,140	(Cr.)	1,540	(Cr.)	600

Required Journal Entry for Correction

Particulars		Dr.	Cr.
X Capital A/c	Dr.	2,140	
To Y Capital A/c			1,540
To Outstanding Expenses A/c			600
(Being the required adjustment for setting right all the discrepancies)			

Illustration 3

A, B and C are partners in a firm of solicitors since 1.1.2015. They maintain accounts on cash basis and share profits and losses in the ratio of 5:3:2 after allowing salaries of ₹ 8,000 p.a. to A, ₹ 5,000 p.a. to B and ₹ 2,000 p.a. to C. Besides, C's share is guaranteed to a fixed minimum of ₹ 5,000 (including his salary).

In 2018, they decide to change the method of accounting to mercantile basis with retrospective effect. The relevant information is furnished below :

Year	Profit before Partners' Salaries	O/S Exp. on 31st Dec.	Accrued fees on 31st Dec.
2015	₹ 24,000	₹ 6,000	₹ 5,000
2016	₹ 28,000	₹ 5,000	₹ 8,000
2017	₹ 40,000	₹ 3,000	₹ 5,000

Pass a single-entry adjusting the partners' accounts to give effect to the above change.

Solution

Working Notes : **(1) Profit as have already been distributed under Cash Basis**

Particulars	Total (₹)	A	B	C
2015 — Profit for the year	24,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
	9,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	6,000	3,750	2,250	
2016 — Profit for the year	28,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
	13,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	10,000	6,250	3,750	
2017 — Profit for the year	40,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
Balance to A, B and C in the ratio 5:3:2	25,000	12,500	7,500	5,000
Total profit as has been distributed		46,500	28,500	17,000

(2) Profits to be distributed on Mercantile Basis

(a) Calculation of profits under mercantile basis

Particulars	2015	2016	2017
Profit as per cash basis	24,000	28,000	40,000
Less: Outstanding expenses as on 31st December	6,000	5,000	3,000
	18,000	23,000	37,000
Add: Outstanding expenses as on 1st January	—	6,000	5,000
	18,000	29,000	42,000
Add: Accrued fees as on 31st December	5,000	8,000	5,000
	23,000	37,000	47,000
Less: Accrued fees as on 1st January	—	5,000	8,000
Profits under mercantile basis	23,000	32,000	39,000

(b) Share of the above profits

Particulars	Total (₹)	A	B	C
2015 — Profit as above	23,000			
Less: Salary to partners	15,000	8,000	5,000	2,000
	8,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	5,000	3,125	1,875	
2016 — Profit as above	32,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
Balance to the partners in the ratio of 5 : 3 : 2	17,000	8,500	5,100	3,400
2017 — Profit as above	39,000			
Less: Salary to partners	15,000	8,000	5,000	2,000
Balance to the partners in the ratio of 5 : 3 : 2	24,000	12,000	7,200	4,800
Total Profit as to be distributed		47,625	29,175	17,200

Statement Showing the Adjustments to be Made

Particulars	A	B	C
Profit to be distributed as per mercantile basis	47,625	29,175	17,200
Profit as have already been distributed	46,500	28,500	17,000
Profits to be credited	1,125	675	200

Required Journal Entry for Adjustment

Particulars		Dr.	Cr.
Accrued Fees A/c	Dr.	5,000	
To Outstanding Expenses A/c			3,000
To A Capital A/c			1,125
To B Capital A/c			675
To C Capital A/c			200
(Being the required adjustment of wrong distribution of profit)			

Illustration 4

After the accounts of a partnership have been prepared, it is discovered that for the year 2015, 2016 and 2017, interest has been credited upon Partners' Capital Accounts at 5% p.a., although no provision is made for interest in the partnership agreement. The amounts involved are :

	2015	2016	2017
X	₹ 3,250	₹ 3,500	₹ 3,600
Y	₹ 2,100	₹ 2,000	₹ 2,150
Z	₹ 900	₹ 1,100	₹ 1,100

You are required to put through an adjusting entry as on 1st January, 2015, assuming that the profits are shared in the following proportions :

Year	X	Y	Z
2015	1/2	3/10	1/5
2016	2/5	2/5	1/5
2017	3/10	2/5	3/10

You are not required to calculate compound interest on the adjustments.

Solution **Statement Showing the required Adjustments**

Particulars	P&L Adj. A/c		X Capital		Y Capital		Z Capital	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
2015 — For interest on capital credited previously, now written back		6,250	3,250		2,100		900	
Above profit shared in the ratio of 5:3:2	6,250			3,125		1,875		1,250
2016 — For interest on capital credited previously, now written back		6,600	3,500		2,000		1,100	
Above profit shared in the ratio of 2:2:1	6,600			2,640		2,640		1,320
2017 — For interest on capital credited previously, now written back		6,850	3,600		2,150		1,100	
Above profit shared in the ratio of 3:4:3	6,850			2,055		2,740		2,055
TOTAL (₹)	19,700	19,700	10,350	7,820	6,250	7,255	3,100	4,625
Net effect			(Dr.) 2,530		(Cr.) 1,005		(Cr.) 1,525	

Required Journal Entry for Adjustment

Particulars		Dr.	Cr.
X Capital A/c	Dr.	2,530	
To Y Capital A/c			1,005
To Z Capital A/c			1,525
(Being the required adjustment of wrong distribution of profit)			

Illustration 5

S, T and Q were partners sharing profits in the proportion of 3:2:1. Their capitals on 31st December, 2017, stood at ₹ 45,000, ₹ 15,000 and ₹ 15,500 respectively after adjustments of net profit of ₹ 18,000 for the year ending that date and drawings of ₹ 6,000, ₹ 4,000 and ₹ 2,000 respectively. It was discovered that while ascertaining the profits, the accountant did not take into consideration the following matters :

1. Interest @ 6% p.a. on capital as on January 1, 2017.
2. Q was entitled to a salary of ₹ 2,000 p.a. of which ₹ 490 was unpaid.

3. Till 31st December, 2016, partners were sharing profits equally. Land costing ₹ 12,000 was purchased on the date of reallocation of profit, but no entry has been passed in that respect for which each partner contributed equal capital.
4. A loan of ₹ 5,000 from T as brought-forward from 2016 carrying interest at 8% p.a. was merged into his capital on July 1, 2017. No interest on loan was, however, charged to Profit and Loss Account.

You are required to work out a Profit and Loss Adjustment Account and show the Journal Entries necessary for readjustments of Capital Accounts and the revised Capital Accounts of partners, assuming that all their dues are to be adjusted in the Capital Accounts.

Solution **Ascertainment of Capital Balances on which Interest is to be Charged**

Particulars	S	T	Q
Capital at the end (31.12.2017)	45,000	15,000	15,500
Less: Profit of ₹ 18,000 distributed in the ratio 3:2:1	9,000	6,000	3,000
	36,000	9,000	12,500
Add: Drawings during the period	6,000	4,000	2,000
	42,000	13,000	14,500
Add: Capital brought-in to acquire land	4,000	4,000	4,000
	46,000	17,000	18,500
Less: Loan of ₹ 5,000 from T merged on 1.7.2017	—	5,000	—
Opening Capital of the Partners (1.1.2017)	46,000	12,000	18,500

Dr. **Profit and Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Interest on Capital A/c (S — ₹ 2,760; T — ₹ 720; Q — ₹ 1,110)	4,590	By Profit & Loss A/c (Net Profit)	18,000
To Partners' Salary A/c — Q	490		
To Partners' Loan A/c: T — 8% on ₹ 5,000 for 6 months	200		
To Share of Profit A/c (S — ₹ 6,360; T — ₹ 4,240; Q — ₹ 2,120)	12,720		
	18,000		18,000

Statement showing the required Adjustments

Particulars	P&L Adj. A/c		S Capital		T Capital		Q Capital	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
For interest on capital to be paid	4,590			2,760		720		1,110
For unpaid salary to Q	490							490
For interest on loan to T	200					200		
For sharing of profit	12,720			6,360		4,240		2,120
For sharing of the above losses in the ratio 3:2:1		18,000	9,000		6,000		3,000	
TOTAL (₹)	18,000	18,000	9,000	9,120	6,000	5,160	3,000	3,720
Net effect				(Cr.) 120		(Dr.) 840		(Cr.) 720

Required Journal Entry for Adjustment

Particulars		Dr.	Cr.
Land A/c	Dr.	12,000	
To S Capital A/c			4,000
To T Capital A/c			4,000
To Q Capital A/c			4,000
(Being the land recorded in the books)			
T Capital A/c	Dr.	840	
To S Capital A/c			120
To Q Capital A/c			720
(Being the adjustments made as per the above statement)			

Dr. **Partners' Capital Accounts (Adjusted)** **Cr.**

Date	Particulars	S	T	Q	Date	Particulars	S	T	Q
31.12.2017	To S Capital A/c	—	120	—	31.12.2017	By Balance b/d	45,000	15,000	15,500
"	To Q Capital A/c	—	720	—	"	By Land A/c	4,000	4,000	4,000
"	To Balance c/d	49,120	18,160	20,220	"	By T Capital A/c	120	—	720
		49,120	19,000	20,220			49,120	19,000	20,220

Correction of Profits When a Manager is Treated as a Partner

A situation may arise when a partnership firm promotes one of its employees to partnership status, who has provided money into the partnership as a security deposit that carries interest at a specified rate. Moreover, the person may be entitled to a minimum amount of salary or a percentage of profit as bonus, before the profits are distributed to the partners. There is usually no significant change in the finances or operating routines. But, on becoming a partner, the previous employee may not be entitled to any of the benefits he has been enjoying so far. Instead, he will be entitled to a fixed percentage of profits. His security deposit will be treated as a capital contribution. If the adjustments are to be made with retrospective effect, the difference between the amount that he has received in prior years and the amount that he is entitled to as a partner will also be adjusted through the Partners' Capital Accounts by passing a single journal entry.

Illustration 6

A and B commenced business on 1.7.2015 as partners with capitals of ₹ 1,80,000 and ₹ 1,20,000 respectively. The capitals remain fixed and carry interest @ 10% p.a. Profits and losses are to be shared in proportion to their capitals.

They appointed C as their manager on 1.7.2015 at a salary of ₹ 9,600 p.a. plus a bonus of 5% of the profits after charging such bonus and interest on capital. C had to deposit on 1.7.2015 ₹ 80,000 as security carrying interest @ 12% p.a.

In June 2018, it was settled that C should be treated as a partner from the commencement of the business. It was agreed that he should be entitled to 1/5th of the profits and his security deposit would be treated as his capital carrying interest @ 10% p.a. instead of the 12% he had received.

It was further agreed that this new arrangement should not result in C's share for any of these years being less than he had already received under the original agreement and terms of his appointment.

The profits before charging C's bonus and interest on capital of partners or giving effect to the new arrangement were:

For the year ended : 2015-16 : ₹ 60,000; 2016-17 : ₹ 1,20,000; 2017-18 : ₹ 1,60,000.

Show by a single journal entry to give effect to the new arrangement with explanatory computation.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Working Notes

(1) Statement Showing Amount Due to C as Manager

Particulars	2015-16	2016-17	2017-18
Salary	9,600	9,600	9,600
Interest on security deposit (@ 12% on ₹ 80,000)	9,600	9,600	9,600
Bonus (5% of net profit after charging bonus and interest on capital) :			
2015-16 : 5/105 of ₹ [60,000 – 10% of (1,80,000 + 1,20,000)]	1,429		
2016-17 : 5/105 of ₹ [1,20,000 – 10% of (1,80,000 + 1,20,000)]		4,286	
2017-18 : 5/105 of ₹ [1,60,000 – 10% of (1,80,000 + 1,20,000)]			6,190
	20,629	23,486	25,390

(2) Statement Showing C's Share of Profits as the Partner

Particulars	2015-16	2016-17	2017-18
Net profit before C's bonus and interest on capital but after charging C's salary and interest on security deposit (as given)	60,000	1,20,000	1,60,000
Add: C's salary and interest on security deposit (added back since not payable) — ₹ (9,600 + 9,600)	19,200	19,200	19,200
Profit before interest on capital to the partners	79,200	1,39,200	1,79,200
Less: Interest on capital : 10% of ₹ (1,80,000 + 1,20,000 + 80,000)	38,000	38,000	38,000
Divisible profits	41,200	1,01,200	1,41,200
C's share of profits — 1/5th of divisible profits	8,240	20,240	28,240

(3) Statement Showing Difference in Payment to C as the Manager and as the Partner

Particulars	2015-16	2016-17	2017-18
(A) C's share as the partner :	₹	₹	₹
Interest on capital (@ 10% on ₹ 80,000)	8,000	8,000	8,000
Share of profit (Working Note 2)	8,240	20,240	28,240
Total C's share as the partner	16,240	28,240	36,240
(B) C's share as the manager (Working Note 1)	20,629	23,486	25,390
Difference in payment (being less than what he had received as the manager)	—	4,754	10,850

In 2015-16 C got as the manager more than what he was to receive as a partner. Therefore, no adjustment is required. But, in 2016-17 and 2017-18, as the manager he received less.

Therefore, the total difference he is to receive as a partner is ₹ (4,754 + 10,850) = ₹ **15,604**.

Required Journal Entry for Adjustment

Particulars		Dr. (₹)	Cr. (₹)
A Capital A/c	Dr.	9,362	
B Capital A/c	Dr.	6,242	
To C Capital A/c			15,604
(Being the difference payable to C adjusted through the Partners' Capital Accounts in the profit sharing ratio of 3 : 2)			

PRACTICAL QUESTIONS

1. A, B and C are partners in a firm. Following are their summarised capital accounts :

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2017	To Drawings A/c	12,000	12,000	12,000	1.1.2017	By Balance b/d	20,000	30,000	40,000
	To Balance c/d	23,000	33,000	43,000	31.12.2017	By Sh. of Profit A/c	15,000	15,000	15,000
		35,000	45,000	55,000			35,000	45,000	55,000

On 1.1.2018, it is agreed that the following would be effective retrospectively from 1.1.2017:

(1) A shall be entitled to a salary of ₹ 750 p.m.

(2) Interest shall be allowed on partners' capital at 5% on the opening balances.

(3) Profits shall be shared in proportion to opening balance in capital accounts.

(4) C's share of profit exclusive of interest on capital shall not fall below ₹ 15,000, the deficit, if any, being contributed by A out of his share.

You are required to show by a single journal entry to give effect to the above arrangement.

2. A, B and C were partners. On 1.4.2017, they admitted, their manager, D as a partner. Profits and losses in the new partnership were to be shared in the ratio of 4 : 3 : 2 : 1 respectively. In addition, C is to get a salary of ₹ 600 p.m.

D had previously been paid a salary of ₹ 1,000 p.m. and a commission of 3% of the profits, after charging his salary and commission but before charging out partners' salary. It was agreed that for the first year of the new partnership, any excess of his share of profit over the sum he would have earned had he remained as manager increased by ₹ 700, should be charged to A's share of profits.

On considering the draft accounts for the year ended 31.3.2018, the partners agreed to the following adjustments:

(a) to provide a staff bonus of ₹ 5,500;

(b) that A's son E, an employee of the business, should receive an additional bonus of ₹ 250 chargeable against his father's share of profit;

(c) that ₹ 500 of B's share of profits should be credited to C.

The profits for the year ended 31.3.2018, before making the above adjustments and before charging C's salary amounted to ₹ 32,000.

You are required to prepare a statement showing the division of profits among the partners.

3. The partnership accounts of A and B, sharing profits in the ratio of 3 : 2, were maintained on cash basis right from its formation. Now, the partners decided for change into mercantile basis with retrospective effect. Following details are given in this respect (all in ₹). Pass the required journal entry.

	2015	2016	2017
Rent outstanding	5,000	4,000	6,000
Salaries paid in advance	3,000	2,000	4,000
Prepaid insurance premium	3,500	2,500	—
Outstanding insurance premium	—	—	2,000

4. A and B had been in partnership for many years as architects, sharing profits equally. It had been their custom to ignore fees, etc., earned on uncompleted matters when preparing annual accounts. On 1.1.2017, they entered into a new partnership agreement under which the profits earned in any year were to be distributed as follows :

Upto ₹ 12,000 — equally; Excess over ₹ 12,000 — 1/3rd to A and 2/3rd to B.

Although they shared profits in accordance with the new agreement, they continued to prepare their accounts upon the old basis, i.e., ignoring fees earned on uncompleted work. At the end of 2018, it was pointed out to them that they were not following the terms of their agreement, and it was agreed that such correcting entries as might be necessary, should be put through as on 31.12.2017.

The profits already dealt with were : 2015 — ₹ 11,500; 2016 — ₹ 12,210; 2017 — ₹ 13,350.

The outstanding fees not brought into account on 31st December each year were :
2014 — ₹ 960; 2015 — ₹ 1,280; 2016 — ₹ 1,550; 2017 — ₹ 920.

Assuming that the books were duly closed at the end of each year, give the entries necessary to correct the Partners' Accounts.

5. A, B and C are partners in a firm with Head Office in Kolkata and Branches in Mumbai and Chennai. They share profits and losses in the ratio of 5:3:2. B and C (respectively managing Mumbai and Chennai Branches) are also entitled to a fixed salary of ₹ 5,000 p.a. and to a commission equal to 30% of profit of their respective branches after deducting therefrom the aforesaid salary and an amount equal to 10% of the average capital employed in the branch. Interest on capital is to be allowed at 5% p.a. Besides, if the share of C (including salary, interest and commission), is less than ₹ 30,000, the shortfall is to be borne by A.

From the following information, prepare the Profit and Loss Appropriation Account for the year ended 31.12.2017:

(a) Capital: A — ₹ 2,00,000; B — ₹ 80,000; C — ₹ 60,000. Drawings: A — ₹ 30,000; B — ₹ 17,500; C — ₹ 14,000.

(b) Assets as on 31.12.2017 : Kolkata — ₹ 2,35,900; Mumbai — ₹ 93,800; Chennai — ₹ 72,100.
Liabilities as on 31.12.2017 : Kolkata — ₹ 21,400; Mumbai — ₹ 12,200; Chennai — ₹ 8,500.

(c) Profit for the year ended 31.12.2017 without adjustments:
Kolkata — ₹ 63,350; Mumbai — ₹ 31,900; Chennai — ₹ 27,600.

It is ascertained that the net assets of Mumbai and Chennai branches have registered an increase of ₹ 5,200 and ₹ 3,200 respectively as compared to the beginning of the year.

Guide to Answers

1. **Required journal entry : Debit — B ₹ 3,000; Credit : A — ₹ 1,000 and C — ₹ 2,000.**
2. **Share of profit : A — ₹ 10,028; B — ₹ 7,319; C — ₹ 6,313 and D — ₹ 2,590.**
3. **Debit : A — ₹ 2,400 and B — ₹ 1,600.**
4. **Adjusted Profits : 2011 — ₹ 960; 2012 — ₹ 11,820; 2013 — ₹ 12,480; and 2014 — ₹ 12,720.**
Debit : Outstanding Fees — ₹ 920.
Credit : A Capital — ₹ 520 and B Capital — ₹ 400.
5. **Average capital employed : Mumbai ₹ 79,000; Chennai — ₹ 62,000; Commission payable : B — ₹ 5,700; C — ₹ 4,920.**
Share of profit : A — ₹ 42,581; B — ₹ 25,569; C — ₹ 17,080 (minimum guarantee).

2

Change in the Profit-sharing Ratio

Introduction

From time to time it may be necessary to change the profit-sharing ratios of the partners. A partner's share of profit may be increased because he has considerably increased his capital in relation to the other partner(s), or because he takes on a much more active role in running the partnership business. The share of a partner may be decreased if he withdraws capital or spends less time in the business. When there is a change in the profit-sharing ratio, the agreement of all the partners are needed and the guidance of the partnership deed should be followed. A change in the profit-sharing ratio between the partners is a change in the constitution of partnership. In effect, the old partnership is dissolved and a new partnership is formed, though the books of account are maintained in the usual manner. When a change in the profit-sharing ratio takes place in a partnership firm, one (or more) partner(s) purchases an interest in the business from another partner(s). Therefore, the aggregate amount of gain by one or more partner(s) is equal to the aggregate amount of sacrifices made by the other partner(s).

The required adjustments in regard to change in the share of profit, revaluation of assets and liabilities, treatment of goodwill or reserves or joint life policy or partners' capitals are same as what we have done in case of admission or retirement or death of a partner. The account of a partner will be ***debited*** when he makes a ***gain*** in his share of profit. Conversely, his account will be ***credited*** when he makes a ***sacrifice***.

Adjustments For Change in the Profit-Sharing Ratio

When there is a change in the profit-sharing ratio, different adjustments are required in respect of the following:

1. Change in the Share of Profit
2. Goodwill
3. Revaluation of Assets and Liabilities
4. Reserves or Accumulated Losses
5. Joint Life Policy
6. Partners' Capital

Change In the Share of Profit

A change in the profit-sharing ratio results in a new partnership, although daily operations of the firm currently are not affected. One or more partners may be entitled to an additional share of future profits. At the same time, the combined shares of the remaining partners will be reduced by the same proportion.

Illustration 1

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. They have decided to change the profit sharing ratio to 2 : 2 : 1. Calculate the sacrifice / gain made by each partner.

Solution **Statement Showing Sacrifice / Gain made by each Partner**

Particulars	Old Ratio	New Ratio	Sacrifice / Gain
A	3/6	2/5	3/6 – 2/5 = 3/30 (Sacrifice)
B	2/6	2/5	2/6 – 2/5 = 2/30 (Gain)
C	1/6	1/5	1/6 – 1/5 = 1/30 (Gain)

Illustration 2

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 3. They have decided to change the profit sharing ratio. A surrendered 1/4th of his share and B surrendered 1/3rd of his share in favour of C. Calculate the new profit-sharing ratio.

Solution **Calculation of New Profit Sharing Ratio**

Particulars	Old Ratio	New Ratio	New Profit Sharing Ratio
A	4/10	4/10 – (1/4 of 4/10) = 4/10 – 1/10 = 3/10	A : B : C
B	3/10	3/10 – (1/3 of 3/10) = 3/10 – 1/10 = 2/10	= 3/10 : 2/10 : 5/10
C	3/10	3/10 + 1/10 + 1/10 = 5/10	= 3 : 2 : 5

Treatment of Goodwill

When there is a change in the profit sharing ratio, an adjustment is necessary in respect of goodwill. The goodwill can be treated in the books of account in any of the following manner :

Case 1 : Goodwill is raised in the books of the firm at full value but it is written-off immediately

In this case, goodwill is raised by crediting all the partners in the old ratio and written-off in the new ratio. The following entries are passed :

(i) ***For raising goodwill***

Goodwill Account	Dr.	[Full value]
To All Partners' Capital Accounts		[Old ratio]

(ii) ***For writing-off goodwill***

All Partners' Capital Accounts	Dr.	[New ratio]
To Goodwill Account		[Full value]

Case 2 : Adjustment is to be made without opening Goodwill Account

In this case, the adjustment for goodwill is to be made through the partners' capital accounts. The account of a partner will be debited if he makes a gain in his right of goodwill. Conversely, his account will be credited when he makes a sacrifice in his right of goodwill. The entry will be :

(Gaining) Partners' Capital Account	Dr.
To (Sacrificing) Partners' Capital Account	

Illustration 3

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 :1. They have decided to change the profit-sharing ratio to 2 : 2 : 1

The goodwill of the firm is valued at ₹ 12,000.

Pass Journal Entries under the following cases when :

(a) adjustment is to be made without opening Goodwill Account

(b) when goodwill is raised in the books of the firm at full value but written-off immediately.

Solution

In the books of the firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
(a)	B Capital A/c (Note 1)	Dr.	800	
	C Capital A/c	Dr.	400	
	To A Capital A/c			1,200
	(Being the adjustment for goodwill through the Partners' Capital Accounts)			
(b)	Goodwill A/c	Dr.	12,000	
	To A Capital A/c			6,000
	To B Capital A/c			4,000
	To C Capital A/c			2,000
	(Being the goodwill raised at its full value before change in the constitution of the firm and credited to partners in the old ratio)			
	A Capital A/c	Dr.	4,800	
	B Capital A/c	Dr.	4,800	
	C Capital A/c	Dr.	2,400	
	To Goodwill A/c			12,000
	(Being the goodwill written-off in the new profit-sharing ratio)			

Working Note : **(1) Adjustment for Goodwill**

Particulars	A	B	C
Right of goodwill before change in the profit-sharing ratio (3 : 2 : 1)	6,000	4,000	2,000
Right of goodwill after change in the profit-sharing ratio (2 : 2 : 1)	4,800	4,800	2,400
	(Sacrifice) 1,200 Cr.	(Gain) 800 Dr.	(Gain) 400 Dr.

Illustration 4

The following is the Balance Sheet of A and B, who are equal partners as on 31.12.2017 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	15,000	Sundry Assets	28,000
	B	9,000		
Creditors		4,000		
		28,000		28,000

From 1.1.2018, the partners decided to share profits and losses in the ratio of 2 : 1. For this purpose, the goodwill of the firm is valued at ₹ 6,000 which will not be shown in the Balance Sheet.

Pass necessary Journal Entries and re-draft the Balance Sheet.

Solution

In the books of the firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 Jan. 1	A Capital A/c (Note 1)	Dr.	1,000	
	To B Capital A/c			1,000
	(Being the adjustment for goodwill made through the Partners' Capital Accounts)			

Working Note : **(1) Adjustment for Goodwill**

Particulars	A	B
Right of goodwill before change in the profit-sharing ratio (1 : 1)	3,000	3,000
Right of goodwill after change in the profit-sharing ratio (2 : 1)	4,000	2,000
	(Gain) 1,000	(Sacrifice) 1,000

Balance Sheet of A and B as at 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A : ₹ (15,000 – 1,000)	14,000	Sundry Assets	28,000
	B : ₹ (9,000 + 1,000)	10,000		
Creditors		4,000		
		28,000		28,000

Revaluation of Assets and Liabilities

At the time of change in the profit sharing ratio, it may be necessary to revalue the assets and liabilities of the firm, so that each partner gets his fair share of the firm's net assets. Therefore, revaluation should be made in the interest of all the partners. Just like admission or retirement / death, here also a Revaluation Account is prepared for calculating profit or loss on revaluation.

Accounting entries to be passed in the books of account will depend upon the situation :

(a) When the value of assets and liabilities are to be shown in the Balance Sheet at ***revalued figures***.

(b) When the value of assets and liabilities are to be shown in the Balance Sheet at ***original figures***.

When the Value of Assets and Liabilities are to be shown in the Balance Sheet at Revalued Figures

(a) If the value of the assets increase

Assets Account	Dr. [Revised value *minus* original book value]
To Revaluation Account	

(b) If the value of the assets decrease

Revaluation Account	Dr. [Original book value *minus* revised value]
To Assets Account	

(c) If the value of the liabilities increase

Revaluation Account	Dr. [Revised amount *minus* original amount]
To Liabilities Account	

(d) If the value of the liabilities decrease

Liabilities Account	Dr. [Original amount *minus* revised amount]
To Revaluation Account	

(e) The Revaluation Account is closed by transferring the balance to the All Partners' Capital Accounts in the old profit sharing ratio

(i) ***If there is a profit on revaluation, i.e., the total of the credit side of the Revaluation Account is greater than that of the debit side.***

Revaluation Account	Dr.
To All Partners' Capital Account	[Old ratio]

(ii) ***If there is a loss on revaluation, i.e., the total of the debit side of the Revaluation Account is greater than that of the credit side.***

All Partners' Capital Account	Dr. [Old ratio]
To Revaluation Account	

In this context, it should be noted that after change in the profit sharing ratio, the assets and liabilities appear in the Balance Sheet at *revised value*.

Illustration 5

The following is the Balance Sheet of A and B as on 31.12.2017 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	54,000	Land	6,000
	B	37,000	Buildings	40,000
Creditors		25,000	Furniture	3,750
			Stock	25,000
			Debtors	20,000
			Investments	15,250
			Bank	4,500
			Cash	1,500
		1,16,000		1,16,000

The partners shared profits and losses in the ratio of 2 : 1.

From 1.1.2018, they agreed to share profits and losses equally.

For this purpose, the following particulars are provided :

(a) Buildings are to be appreciated by 25%;

(b) Current value of furniture is to be taken at ₹ 2,750;

(c) C is valued at ₹ 15,000.

Prepare Revaluation Account, Partners' Capital Accounts and show the revised Balance Sheet as at 1.1.2018.

Solution

In the books of the firm

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Furniture A/c		1,000	By Land	9,000
To Partners' Capital A/cs :	₹		By Buildings A/c	10,000
A —	12,000			
B —	6,000	18,000		
		19,000		19,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
2018 Jan. 1	To Balance c/d	66,000	43,000	2018 Jan. 1	By Balance b/d	54,000	37,000
					By Revaluation A/c	12,000	6,000
		66,000	43,000			66,000	43,000

Balance Sheet of A and B as at 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A	66,000	Land	15,000
	B	43,000	Buildings	50,000
Creditors		25,000	Furniture	2,750
			Stock	25,000
			Debtors	20,000
			Investments	15,250
			Bank	4,500
			Cash	1,500
		1,34,000		1,34,000

When the Value of Assets and Liabilities are to be shown in the Balance Sheet at Original Figures

All the partners may decide that the revised value of assets and liabilities are not to be shown in the books of account. In this case, a Memorandum Revaluation Account is opened. This account is divided into two parts. In the first part, like the Revaluation Account, any increase in the value of assets and/or decrease in the value of liabilities is credited to this account.

Likewise, any decrease in the value of assets and/or increase in the value of liabilities is debited to this account. If the credit side of the Memorandum Revaluation Account is more than the debit side, there is a profit. This profit should be transferred to the All Partners' Capital Accounts in the old profit sharing ratio. The Journal Entry is as under:

Memorandum Revaluation Account Dr.
To All Partners' Capital Accounts [Old ratio]

If the debit side of the Memorandum Revaluation Account is more than the credit side, there is a loss which is transferred to All Partners Capital Accounts in the old profit sharing ratio. The Journal Entry is as under :

All Partners' Capital Accounts Dr. [Old ratio]
To Memorandum Revaluation Account

In the second part of the Memorandum Revaluation Account, reverse entries are passed to complete the double entry. Any account which is debited in the first part is to be credited now.

Likewise, any account which is credited in the first part, is to be debited now. The profit on revaluation is to be transferred to All Partners' Capital Accounts in the new profit sharing ratio. The Journal Entry is as under:

Memorandum Revaluation Account Dr.
To All Partners' Capital Accounts [new ratio]

If there is a loss on revaluation, it should be transferred to all Partners' Capital Accounts in the new profit sharing ratio. The journal entry is as under :

All Partners' Capital Accounts Dr.
To Memorandum Revaluation Account [new ratio]

In connection with Memorandum Revaluation Account, the following points should be remembered:
1. If the first part of this account shows a profit, the second part must show a loss and vice versa.
2. The book value of assets and liabilities do not change.
3. The resultant profit or loss on revaluation is adjusted through the Partners' Capital Accounts.

Illustration 6

The following is the Balance Sheet of A, B and C as on 31.12.2017 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	10,000	Land	4,000
	B	5,000	Buildings	6,000
	C	3,000	Plant and Machinery	4,000
Creditors		7,500	Stock	5,500
			Debtors	3,100
			Bills Receivable	2,000
			Bank	900
		25,500		25,500

On 1.1.2018, the assets of the firm were revalued as under : Land ₹ 8,000; Buildings ₹ 8,500; Plant and machinery ₹ 3,500. The partners agree that from 1.1.2001, they will share profits and losses in the ratio of 3 : 2 : 1 instead of their former ratio of 2 : 2 : 1. They do not, however, want to alter the book value of the assets.

Prepare Memorandum Revaluation Account, Partners' Capital Accounts and the revised Balance Sheet as at 1.1.2018.

Solution

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

Particulars	₹	Particulars	₹
To Plant and Machinery A/c	500	By Land A/c	4,000
To Partners' Capital A/cs (profit) :		By Buildings A/c	2,500
(A ₹ 2,400; B ₹ 2,400; C ₹ 1,200)	6,000		
	6,500		6,500
To Land A/c	4,000	By Plant and Machinery A/c	500
To Building A/c	2,500	By Partners' Capital A/cs (loss) :	
		(A ₹ 3,000; B ₹ 2,000; C ₹ 1,000)	6,000
	6,500		6,500

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018	To Revaluation A/c (loss)	3,000	2,000	1,000	2018	By Balance b/d	10,000	5,000	3,000
Jan.1	To Balance c/d	9,400	5,400	3,200	Jan.1	By Revaluation A/c (profit)	2,400	2,400	1,200
		12,400	7,400	4,200			12,400	7,400	4,200

Balance Sheet of A, B and C as at 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A	9,400	Land	4,000
	B	5,400	Building	6,000
	C	3,200	Plant and Machinery	4,000
Creditors		7,500	Stock	5,500
			Debtors	3,100
			Bills Receivable	2,000
			Bank	900
		25,500		25,500

Reserves and Accumulated Losses

An adjustment is required for any reserve / accumulated losses appearing in the Balance Sheet at the time of change in the profit-sharing ratio. The adjustment entry will be :

General Reserve Account	Dr.	
Profit and Loss Account	Dr.	
Other Reserves Account	Dr.	
To All Partners' Capital Accounts		[Old ratio]

If there is any accumulated loss in the Balance Sheet, the journal entry will be as follows :

All Partners' Capital Accounts Dr. [Old ratio]

To Profit and Loss Account

After change in the profit-sharing ratio, the partners may decide that the reserve is to be shown in the books at its original figure (or agreed figure). Under this situation, reserve is written-off by debiting Reserve Account and crediting All Partners' Capital Accounts in the old profit-sharing ratio. Thereafter, reserve is raised in the books at its original figure (or agreed figure) by debiting All Partners' Capital Accounts in the new ratio and crediting the Reserve account.

The accounting entries are as under :

(i) ***When reserve is written-off***

Reserve account Dr.

To All Partners' Capital Accounts [Old ratio]

(ii) ***When reserve is to be shown in the new Balance Sheet at agreed figure***

All Partners' Capital Accounts Dr. [New ratio]

To Reserve Account

Illustration 7

The following is the Balance Sheet of A, B and C as on 1.1.2018 :

Liabilities	₹	Assets	₹
Capital Accounts :		Building	50,000
(A ₹ 60,000; B ₹ 50,000; C ₹ 40,000)	1,50,000	Machinery	40,000
General Reserve	48,000	Furniture	20,000
Creditors	12,000	Stock	30,000
		Debtors	20,000
		Bank	50,000
	2,10,000		2,10,000

The partners share profits and losses in the ratio of 3 : 2 : 1. Now, they have decided to change that to 2 : 2 : 1. The partners have further decided the following :

(a) An amount of ₹ 30,000 should be withdrawn from the business by the partners.

(b) General reserve is to appear in the books at ₹ 18,000.

Prepare Partners' Capital Accounts and re-draft the Balance Sheet.

Solution

In the books of the Firm

Partners' Capital Accounts

Dr. **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018	To Bank A/c (withdrawn)	15,000	10,000	5,000	2018	By Balance b/d	60,000	50,000	40,000
Jan.1	To General Reserve A/c	7,200	7,200	3,600	Jan.1	By General Reserve A/c	24,000	16,000	8,000
	To Balance c/d	61,800	48,800	39,400					
		84,000	66,000	48,000			84,000	66,000	48,000

Balance Sheet of the New Firm as on 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A	61,800	Building	50,000
	B	48,800	Machinery	40,000
	C	39,400	Furniture	20,000
General Reserve		18,000	Stock	30,000
Creditors		12,000	Debtors	20,000
			Bank (₹ 50,000 – ₹ 30,000)	20,000
		1,80,000		1,80,000

Adjustment for Joint Life Policy

Under a change in the profit-sharing ratio, the adjustment for joint life policy will depend on the manner in which the joint life policy is treated in the books of account.

*Case 1 : **When the premium paid is treated as revenue expense***

Under this case, the adjustment of surrender value of joint life policy is to be made through the Partners' Capital Accounts. The partner, who makes a gain in his right of joint life policy will be debited. Conversely, the partner, who suffers a loss in his right of joint life policy will be credited. The journal entry is as under :

(Gaining) Partners' Capital Account Dr.
    To (Sacrificing) Partners' Capital Account

*Case 2 : **When joint life policy appears in the Balance Sheet***

When the surrender value of the joint life policy appears as an asset in the Balance Sheet, no adjustment is required for change in the profit-sharing ratio. But if the partners decide not to show that in the Balance Sheet, it will be written-off by debiting all the partners in the new profit-sharing ratio and crediting Joint Life Policy Account. The entry will be :

All Partners' Capital Accounts Dr. [New Ratio]
    To Joint Life Policy Account

Illustration 8

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. They have decided to change their profit-sharing ratio to 2 : 2 : 1. They took a joint life policy of ₹ 60,000. The surrender value of the policy on the date of change in the constitution is ₹ 15,000. Pass Journal Entries under the following cases :

(a) When the surrender value does not appear in the books and the partners have decided not to show that in the books also.
(b) When the surrender value appears as an asset but the partners decided not to show that in the Balance Sheet.

Solution

In the books of the firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
(a)	B Capital A/c (Note 1)	Dr.	1,000	
	C Capital A/c	Dr.	500	
	To A Capital A/c			1,500
	(Being the adjustment of surrender value of joint life policy through the Partners' Capital Accounts due to change in the constitution of the firm)			
(b)	A Capital A/c	Dr.	6,000	
	B Capital A/c	Dr.	6,000	
	C Capital A/c	Dr.	3,000	
	To Joint Life Policy A/c			15,000
	(Being the Joint Life Policy written-off from the books in the new ratio of 2 : 2 : 1)			

Working Note : **(1) Adjustment for Joint Life Policy**

Particulars	A	B	C
Right of Joint Life Policy before change in the profit-sharing ratio (3 : 2 : 1)	7,500	5,000	2,500
Right of Joint Life Policy after change in the profit-sharing ratio (2 : 2 : 1)	6,000	6,000	3,000
	(Loss) 1,500 Cr.	(Gain) 1,000 Dr.	(Gain) 500 Dr.

*Case 3 : **When joint life policy reserve account is maintained***

When alongwith Joint Life Policy Account, Joint Life Policy Reserve Account is also maintained in the books of account, the adjustment is to be made as under :

Joint Life Policy Reserve Account is to be written-off by debiting all the partners in the old profit-sharing ratio. Again, Joint Life Policy Reserve Account is to appear in the books by debiting all the partners in the new profit-sharing ratio and crediting Joint Life Policy Reserve Account. The entries are :

(i) *When joint life policy reserve is written-off*
Joint Life Policy Reserve Account Dr.
    To All Partners' Capital Accounts [Old ratio]

(ii) *When joint life policy is to be shown again in the Balance Sheet*
All Partners' Capital Accounts Dr. [New ratio]
    To Joint Life Policy Reserve Account

Illustration 9

The following is the Balance Sheet of A, B and C as on 1.1.2018 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	40,000	Building	40,000
	B	30,000	Machinery	20,000
	C	25,000	Furniture	10,000
Joint Life Policy Reserve		20,000	Stock	15,000
Creditors		5,000	Debtors	5,000
			Joint Life Policy	20,000
			Cash and Bank	10,000
		1,20,000		1,20,000

The partners share profits and losses in the ratio of 4 : 3 : 3, but have decided to change that to 2 : 2 : 1. Prepare Partners' Capital Accounts and re-draft the Balance Sheet.

Solution

In the books of the Firm
Partners' Capital Accounts

Dr. **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018	To Joint Life Policy Reserve A/c	8,000	8,000	4,000	2018	By Balance b/d	40,000	30,000	25,000
Jan. 1	To Balance c/d	40,000	28,000	27,000	Jan. 1	By Joint Life Policy Reserve A/c	8,000	6,000	6,000
		48,000	36,000	31,000			48,000	36,000	31,000

Balance Sheet of the New Firm as on 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A	40,000	Building	40,000
	B	28,000	Machinery	20,000
	C	27,000	Furniture	10,000
Joint Life Policy Reserve		20,000	Stock	15,000
Creditors		5,000	Debtors	5,000
			Joint Life Policy	20,000
			Cash and Bank	10,000
		1,20,000		1,20,000

Adjustment of Capital

Sometimes, after the change in the profit-sharing ratio, the partners may decide to make their capitals proportionate to their profit-sharing ratio or some other ratio. In this case, capital account balances of all the partners will be changed. Some partner(s) will bring in money to make-up the deficit of his capital or others will withdraw their excess capital.

The total required capital can be ascertained as under :

Particulars		₹	₹
Opening combined capital			***
Add:	Goodwill to be adjusted	***	
	Revaluation profit	***	
	Reserve	***	***
			***
Less:	Revaluation loss	***	
	Debit balance of Profit and Loss Account	***	***
	Required adjusted capital		***

Illustration 10

The following is the Balance Sheet of A and B, who shared profits and losses in the ratio of 2 : 1, as on 1.1.2018 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	30,000	Land and Buildings	29,000
	B	20,000	Furniture	8,000
Reserve		15,000	Stock	24,000
Creditors		20,000	Debtors	15,000
			Bank	6,000
			Cash	3,000
		85,000		85,000

On the above date, the partners changed their profit-sharing ratio to 3 : 2. Following are agreed upon : (i) The value of land and buildings will be ₹ 50,000; (ii) Reserve to be maintained at ₹ 30,000; (iii) The total capital of the partners will be ₹ 60,000, which will be shared by the partners in their new profit-sharing ratio.

Prepare Partners' Capital Accounts and the revised Balance Sheet.

Solution

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
2018 Jan. 1	To Reserve A/c (See Note)	18,000	12,000	2018 Jan. 1	By Balance b/d	30,000	20,000
	To Balance c/d (required)	36,000	24,000		By Reserve A/c (See Note)	10,000	5,000
					By Land and Buildings A/c	14,000	7,000
					By Cash A/c (Balancing figure)	—	4,000
		54,000	36,000			54,000	36,000

Balance Sheet of A and B as on 1st January, 2018

Liabilities		₹	Assets	₹
Capital Accounts :	A	36,000	Land and Buildings	50,000
	B	24,000	Furniture	8,000
Reserve		30,000	Stock	24,000
Creditors		20,000	Debtors	15,000
			Bank	6,000
			Cash (₹ 3,000 + ₹ 4,000)	7,000
		1,10,000		1,10,000

Tutorial Note : Reserve appearing in the Balance Sheet before the change in the profit-sharing ratio will be distributed between the partners—in their old ratio, i.e., 2 : 1. When it is again brought back in the books the Partners' Capital Accounts will be debited in the new ratio, i.e., 3:2. A's Capital Account will be debited by ₹ 3/5 × ₹ 30,000 = ₹ 18,000 and B's Capital Account will be debited by ₹ 2/5 × ₹ 30,000 = ₹ 12,000.

Illustration 11

Raju, Shastri and Tanka are partners in a firm, sharing profits and losses in the ratio of 5 : 3 : 2. Their Balance Sheet as on 31st March 2017 stood as follows:

Liabilities		₹	Assets		₹
Sundry Creditors		25,000	Cash at Bank		10,000
General Reserve		20,000	Sundry Debtors	22,000	
Shastri's Loan Account		15,000	Less: Provision for Bad Debts	2,000	20,000
Capital Accounts	₹		Furniture		10,000
Raju	25,000		Plant and Machinery		35,000
Shastri	10,000		Stock		25,000
Tanka	5,000	40,000			
		1,00,000			1,00,000

From 1st April, 2017 the partners decided to change their profit- sharing ratio as 2 : 1 : 2 instead of their former ratio of 5 : 3 : 2 and for that purpose the following adjustments were agreed upon: (i) The Provision for Bad Debts was to be raised to 10%; and, (ii) Furniture was to be appreciated by ₹ 5,200. They did not, however, want to alter the book values of the assets and reserves but record the change by passing one single journal entry.

The Profit and Loss Account of the firm for the year ended 31st March, 2018 showed a net profit of ₹ 22,900.

You are required: (a) to show the single Journal Entry adjusting the partners' capitals as on 1st April, 2017 and (b) to prepare the Profit and Loss Appropriation Account for the year ended 31st March, 2018 after taking into consideration the following adjustments: (i) Interest on Capital at 5% p.a.; (ii) Interest on Shastri's Loan, and (iii) Transfer 25% of the divisible profit to the General Reserve after charging such Reserve.

Solution

Working Notes: (1) Ascertainment of Profit or Loss on required Adjustments

	₹
Value of furniture to be appreciated	5,200
Less: Further provision for bad debts to be created (₹ 2,200 – ₹ 2,000)	200
	5,000
Add: General reserve to be distributed (appearing in the Balance Sheet)	20,000
Profit to be shared	25,000

(2) Ascertainment of Adjusted Capitals

Particulars	Raju	Shastri	Tanka
Profit credited in the old profit-sharing ratio (5 : 3 : 2)	12,500	7,500	5,000
Profit debited in the new profit-sharing ratio (2 : 1 : 2)	10,000	5,000	10,000
Net effect on Capitals	(+) 2,500	(+) 2,500	(–) 5,000

Capital as per the Balance Sheet on 31.3.2017	25,000	10,000	5,000
Net effect on capital (as above)	(+) 2,500	(+) 2,500	(–) 5,000
Adjusted capitals as on 1.4.2017	27,500	12,500	—

Required Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
	Tanka Capital A/c	Dr.	5,000	
	To Raju Capital A/c			2,500
	To Shastri Capital A/c			2,500
	(Being the required adjustment)			

Dr. Profit and Loss Appropriation Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Interest on Capital A/c		By Profit & Loss A/c — Net Profit	22,900
Raju : ₹ 1,375; Shastri : ₹ 625	2,000		
To Interest on Loan A/c — Shastri (6% on ₹ 15,000)	900		
To General Reserve A/c*	4,000		
To Share of Profit A/c	16,000		
Raju : ₹ 6,400; Shastri : ₹ 3,200; Tanka : ₹ 6,400			
	22,900		22,900

* Divisible profit before transferring to General Reserve is ₹ 20,000. Therefore reserve is to be created : 25 / 125 of ₹ 20,000, i.e., ₹ 4,000.

Illustration 12

A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1 respectively. Their Balance Sheet as at 31.3.2018 was as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		1,50,000	Cash	40,000
General Reserve		1,20,000	Bills Receivable	90,000
Partners' Capital Accounts :	A	2,10,000	Sundry Debtors	1,80,000
	B	1,40,000	Stock	1,20,000
	C	70,000	Fixed Assets	2,60,000
		6,90,000		6,90,000

From 1.4.2018, they agreed to alter their profit sharing ratio as 4 : 6 : 5. It is also decided that :

(a) The fixed assets be valued at ₹ 3,21,000.

(b) The stock be reduced to ₹ 1,10,000.

(c) A provision of 5% on sundry debtors be made for doubtful debts.

(d) The goodwill of the firm at this date be valued at three years' purchase of the average net profits of the last five years before charging insurance premium.

There is a joint life insurance policy for ₹ 2,00,000 for which an annual premium of ₹ 10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31.3.2018 was ₹ 81,000.

The net profits of the firm for the last five years were ₹ 16,000, ₹ 20,000, ₹ 25,000, ₹ 23,000 and ₹ 26,000.

Goodwill and surrender value of the joint life policy are not to appear in the books.

Draft journal entries necesary to adjust the profit sharing ratio of the partners and prepare Partners' Capital Accounts and the Balance Sheet after giving effect to the above. ***[C.A. (Foundation) — Adapted]***

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 April 1	Fixed Assets A/c	Dr.	61,000	
	To Revaluation A/c			61,000
	(Being the fixed assets revalued at ₹ 3,21,000)			
	Revaluation A/c	Dr.	19,000	
	To Stock A/c			10,000
	To Provision for Doubtful Debts A/c			9,000
	(Being the downward revaluation of stock and creation of provision for doubtful debts)			
	Revaluation A/c	Dr.	42,000	
	To A Capital A/c			21,000
	To B Capital A/c			14,000
	To C Capital A/c			7,000
	(Being the profit on revaluation transferred to Partners' Capital Accounts in the old profit sharing ratio)			

B Capital A/c (Note 1)	Dr.	6,400	
C Capital A/c	Dr.	16,000	
To A Capital A/c			22,400
(Being the adjustment for goodwill through the Partners' Capital Accounts)			
B Capital A/c (Note 2)	Dr.	5,400	
C Capital A/c	Dr.	13,500	
To A Capital A/c			18,900
(Being the adjustment for joint life policy through the Partners' Capital Accounts)			
B Capital A/c	Dr.	8,000	
C Capital A/c	Dr.	20,000	
To A Capital A/c			28,000
(Being the adjustment for general reserve through the Partners' Capital Accounts)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To A Capital A/c	—	6,400	16,000	By Balance b/d	2,10,000	1,40,000	70,000
To A Capital A/c	—	5,400	13,500	By Revaluation A/c	21,000	14,000	7,000
To A Capital A/c	—	8,000	20,000	By B Capital A/c	6,400	—	—
To Balance c/d	3,00,300	1,34,200	27,500	By C Capital Ac	16,000	—	—
				By B Capital A/c	5,400	—	—
				By C Capital A/c	13,500	—	—
				By B Capital A/c	8,000	—	—
				By C Capital A/c	20,000	—	—
	3,00,300	1,54,000	77,000		3,00,300	1,54,000	77,000

Balance Sheet of the Firm (after Change in the Constitution)

Liabilities		₹	Assets		₹
Capitals :	A	3,00,300	Fixed Assets		3,21,000
	B	1,34,200	Stock		1,10,000
	C	27,500	Sundry Debtors	1,80,000	
General Reserve		1,20,000	Less: Provision for Doubtful Debts	9,000	1,71,000
Sundry Creditors		1,50,000	Bills Receivable		90,000
			Cash		40,000
		7,32,000			7,32,000

Working Notes :

(1) Valuation of Goodwill

Particulars	₹
Total net profit for 5 years	1,10,000
Add: Premium charged against profit (₹ 10,000 x 5)	50,000
	1,60,000

Total profit for 5 years

Average profit : ₹ 1,60,000 / 5 = ₹ 32,000. Value of goodwill = ₹ 32,000 x 3 = ₹ 96,000

Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before change in the profit sharing ratio (3 : 2 : 1)	48,000	32,000	16,000
Right of goodwill after change in the profit sharing ratio (4 : 6 : 5)	25,600	38,400	32,000
Sacrifice (–) / Gain (+)	(–) 22,400	(+) 6,400	(+) 16,000

(2) Adjustment for Joint Life Policy

Particulars	A (₹)	B (₹)	C (₹)
Right of joint life policy before change in the profit sharing ratio (3 : 2 : 1)	40,500	27,000	13,500
Right of joint life policy after change in the profit sharing ratio (4 : 6 : 5)	21,600	32,400	27,000
Sacrifice (–) / Gain (+)	(–) 18,900	(+) 5,400	(+) 13,500

(3) Adjustment for General Reserve

Particulars	A (₹)	B (₹)	C (₹)
Right of general reserve before change in the profit sharing ratio (3 : 2 : 1)	60,000	40,000	20,000
Right of general reserve after change in the profit sharing ratio (4 : 6 : 5)	32,000	48,000	40,000
Sacrifice (–) / Gain (+)	(–) 28,900	(+) 8,000	(+) 20,000

Change in the Profit Sharing Ratio During an Accounting Year

A change in the profit sharing ratio among the partners may occur at some time during the accounting period. In such a case, it will be necessary to divide the profit before appropriations into the periods prior to and after the change. This is usually done on a time basis. The interest on capital, salaries and share of retained profit are computed for each period separately.

Illustration 13

A, B and C have been in partnership for many years sharing profits and losses in the ratio of 3 : 2 : 1 respectively.

The following data for the year ended 31.12.2017 have been extracted from the partnership books :

Sales ₹ 7,40,000; Cost of goods sold ₹ 4,60,000; General expenses ₹ 30,000; Depreciation ₹ 10,000.

The partners have agreed that from 1.7.2017, A will be entitled to a salary of ₹ 30,000 p.a. and the balance of the profits will be shared equally. Sales have been taken place evenly throughout the year and all sales earned a uniform rate of gross profit. No entries to reflect the change in profit sharing ratio have been made in the books before the year end.

You are required to prepare the Trading and Profit and Loss Account, and the Profit and Loss Appropriation Account for the year ended 31.12.2017.

Solution

A, B and C

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Cost of Goods Sold	4,60,000	By Sales	7,40,000
To Gross Profit c/d	2,80,000		
	7,40,000		7,40,000
To General Expenses	30,000	By Gross Profit b/d	2,80,000
To Depreciation	10,000		
To Net Profit c/d	2,40,000		
	2,80,000		2,80,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars	1.1.2017 to 30.6.2017	1.7.2017 to 31.12.2017	Particulars	1.1.2017 to 30.6.2017	1.7.2017 to 31.12.2017
To Partner's Salary A/c	—	15,000	By Net Profit b/d	1,20,000	1,20,000
To Share of Profit A/c : A	60,000	35,000			
B	40,000	35,000			
C	20,000	35,000			
	1,20,000	1,20,000		1,20,000	1,20,000

Illustration 14

A, B and C (without capital) are partners sharing profits and losses in the ratio of 3 : 2 : 1 respectively. Their capital account balances as on 1.1.2017 were : A — ₹ 45,000; B — ₹ 25,000.

A and B are entitled to interest on capital @ 10% p.a.; and in addition A is to get a salary of ₹ 250 p.m.

On 1.7.2017 partners decided that the new profit sharing ratio among A, B and C will be 2 : 2 : 1 respectively and C is to bring in ₹ 20,000 as capital. On the same date, they also decided that the total capital of the firm will be ₹ 1,00,000 and it will be adjusted in the profit sharing ratio. For A and B, any excess or deficiency is to be paid off or brought in cash. Interest on capital will be allowed @ 12% p.a. to all the partners. As regards partners' salaries, instead of A, B will be getting @ ₹ 500 p.m. The net profit for the year ended 31.12.2017 is ₹ 22,000 (which is assumed to be earned evenly throughout the period).You are required to prepare Profit and Loss Appropriation Account for the year ended 31.12.2017, Partners' Capital and Current Accounts.

Solution

A, B and C

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars		1.1.2017 to 30.6.2017	1.7.2017 to 31.12.2017	Particulars	1.1.2017 to 30.6.2017	1.7.2017 to 31.12.2017
To Interest on Capital A/c :	A	2,250	2,000	By Profit and Loss A/c — Net Profit	11,000	11,000
	B	1,250	2,000			
	C	—	1,000			
To Partners' Salaries A/c :	A	1,500	—			
	B	—	3,000			
To Share of Profit A/c :	A	3,000	1,200			
	B	2,000	1,200			
	C	1,000	600			
		11,000	11,000		11,000	11,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
July 1	To Cash A/c	5,000	—	—	Jan 1	By Balance b/d	45,000	25,000	—
Dec. 31	To Balance c/d (as required)	40,000	40,000	20,000	July 1	By Cash A/c	—	15,000	20,000
		45,000	40,000	20,000			45,000	40,000	20,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Dec. 31	To Balance c/d	9,950	9,450	2,600	Dec. 31	By Interest on Capital A/c	4,250	3,250	1,000
						By Partners' Salaries A/c	1,500	3,000	—
						By Share of Profit A/c	4,200	3,200	1,600
		9,950	9,450	2,600			9,950	9,450	2,600

Illustration 15

A and B are partners in an old established trading business. Their partnership agreement provides for interest on partners' capital @ 5% p.a., a salary of ₹ 3,900 p.a. payable to B, and interest to be charged at 5%, on the total drawings for the year. Net profit after these adjustments is to be divided in the ratio of 4 : 1 to A and B respectively.

The agreement was varied as from 1.9.2017 in that B's salary was reduced to ₹ 3,000 p.a., and the profit sharing ratio became 3:2 to A and B respectively. The partners agreed to assume that profits and drawings accrued evenly over the year.

The following information is provided :

Particulars		₹	₹
Net Profit for the year 2017			12,060
Capital Accounts —	A	30,000	
	B	24,000	54,000
Current Accounts —	A	6,516	
	B	3,264	9,780
Drawings	A	9,480	
	B	4,500	13,980

You are required to prepare : (1) Profit and Loss Appropriation Account for the year ended 31.12.2017; and (2) Partners' Current Accounts.

Solution

A and B

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars	Jan to Aug	Sept to Dec	Particulars	Jan to Aug	Sept to Dec
To Interest on Capital A/c (Note 1)			By Net Profit	8,040	4,020
A	1,000	500	By Interest on Drawings A/c (Note 3)		
B	800	400	A	316	158
To Partner's Salary A/c — B (Note 2)	2,600	1,000	B	150	75
To Share of Profit A/c					
A	3,285	1,412			
B	821	941			
	8,506	4,253		8,506	4,253

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
2017				2017			
Dec. 31	To Drawings A/c	9,480	4,500	Jan. 1	By Balance b/d	6,516	3,264
"	To Interest on Drawings A/c	474	225	Dec. 31	By Interest on Capital A/c	1,500	1,200
"	To Balance c/d	2,759	5,101	"	By Partner's Salary A/c	—	3,600
				"	By Share of Profit A/c	4,697	1,762
		12,713	9,826			12,713	9,826

Working Notes :

(1) Interest on Capital

Particulars	A (₹)	B (₹)
@ 5% p.a. on Capital	1,500	1,200
Jan to Aug (8 months)	1,000	800
Sept to Dec (4 months)	500	400
	1,500	1,200

(2) Partner's Salary — B	
Jan to Aug (8 months)	₹ 3,900 / 12 x 8 = ₹ 2,600
Sept to Dec (4 months)	₹ 3,000 / 12 x 4 = ₹ 1,000

(3) Interest on Drawings	A (~)	B (~)
At 5% on total Drawings	474	225
Jan to Aug (8 months)	316	150
Sept to Dec (4 months)	158	75
	474	225

Illustration 16

X and Y are in partnership sharing profits and losses equally. Their accounts are made up to 31st December each year. They have decided that from 1.10.2017, the profit sharing ratio is to become X 3/5th and Y 2/5th.

Their Balance Sheet at 31.12.2017 prior to sharing profits is as under :

Liabilities		₹	Assets	₹
Capitals :	X	80,000	Sundry Assets	2,10,000
	Y	70,000		
Profit for the year		60,000		
		2,10,000		2,10,000

It was decided that the impact of the change in profit sharing ratio would be affected at 31.12.2017 when the sundry assets were revalued at ₹ 2,50,000. The goodwill was valued at ₹ 25,000 but no goodwill account is to be maintained in the books. It is to be assumed that profits have been earned evenly throughout the period.

You are required to prepare Profit and Loss Appropriation Account for the year ended 31.12.2017 and the Partners' Capital Accounts.

Solution **X and Y**

Dr. **Profit and Loss Appropriation Account for the year ended 31st December, 2017** **Cr.**

Particulars	1.1.2017 to 30.9.2017	1.10.2017 to 31.12.2017	Particulars	1.1.2017 to 30.9.2017	1.10.2017 to 31.12.2017
To Share of Profit A/c :			By Net Profit b/d	45,000	15,000
X	22,500	9,000			
Y	22,500	6,000			
	45,000	15,000		45,000	15,000

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

Date	Particulars	X	Y	Date	Particulars	X	Y
2017				2017			
Dec. 31	To Goodwill A/c	15,000	10,000	Jan. 1	By Balance b/d	80,000	70,000
"	To Balance c/d	1,29,000	1,21,000	Dec. 31	By Share of Profit A/c	31,500	28,500
				"	By Sundry Assets A/c	20,000	20,000
				"	By Goodwill A/c	12,500	12,500
		1,44,000	1,31,000			1,44,000	1,31,000

Illustration 17

The following information relates to the partnership of A and B (until 30.9.2017) and A, B and C (from 1.10.2017) :

1. The net profit for 2017 was ₹ 24,000. The profit sharing ratio changed on 1.4.2017 from A 40%, B 60%, to equal shares. No adjustments were required to the partnership goodwill at that date. The profit sharing ratio changed again on 1.10.2017 when C was admitted as a partner. The share of profit became A 40%, B 40%, C 20%.
2. C was unable to introduce cash into the partnership, but brought in furniture with an agreed value of ₹ 20,000.
3. On C's admission to the partnership, goodwill was valued at 1.5 times the average net profit for 2014, 2015 and 2016. The net profit figure for 2014, 2015 and 2016 were ₹ 8,000, ₹ 10,000 and ₹ 12,000 respectively.
4. C had drawings of ₹ 1,500 in the 3 months to 31.12.2017.

(a) Calculate the profit share for each of the three partners for 2017.

(b) Show a journal entry recording the adjustment of goodwill among partners at 1.10.2017.

(c) Show C's capital account for the 3 months ended 31.12.2017 in as much detail as possible.

Solution

(a) Share of Profit (calculated on a time basis)

Partners	1.1.2017 – 31.3.2017 ₹	1.4.2017 – 30.9.2017 ₹	1.10.2017 – 31.12.2017 ₹	Total ₹
A	2,400	6,000	2,400	10,800
B	3,600	6,000	2,400	12,000
C	—	—	1,200	1,200
	6,000	12,000	6,000	24,000

(b) Required Journal Entry

C Capital Account	Dr.	₹ 3,000	
To B Capital Account			₹ 3,000
(Being the required adjustment for goodwill)			

Workings :

Value of goodwill = ₹ (8,000 + 10,000 + 12,000) / 3 x 1.5 = ₹ **15,000**.

Required Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before C's admission (4 : 6)	6,000	9,000	—
Right of goodwill after C's admission (4 : 4 : 2)	6,000	6,000	3,000
Sacrifice (–) / Gain (+)	—	(–) 3,000	(+) 3,000

Dr. (c) C Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Oct 1	To B Capital A/c (Goodwill)	3,000	Oct 1	By Furniture A/c	20,000
Dec. 31	To Drawings A/c	1,500	Dec. 31	By Share of Profit A/c	1,200
"	To Balance c/d	16,700			
		21,200			21,200

Illustration 18

A and B are partners in an old established business. Their partnership agreement provides that :

(a) Interest @ 10% p.a. is paid on partners' fixed capital.

(b) B is credited with a salary of ₹ 30,000 p.a.

(c) The balance profit or loss is divided between A and B in the ratio of 3 : 2 respectively.

The balances on the partenrs' capital and current accounts at 1.1.2017 were as follows (all balances are in credit) :

Partners	Capital Accounts (₹)	Current Accounts (₹)
A	1,20,000	10,000
B	80,000	7,000

During the year ended 31.12.2017, the partnership net profit carried to the appropriation account was ₹ 1,60,000 arising uniformly throughout the year. The partners' cash drawings during 2017 were as follows :

A — ₹ 5,000; B — ₹ 6,000

After reviewing the draft accounts for 2017, A and B decided to admit their senior clerk, C, as a partner w.e.f. 1.10.2017.

C has been in the business for many years and from the beginning of 2017 has received a salary of ₹ 40,000 p.a. payably monthly.

For some years, the partnership has used a house owned by C for offices and paid him a rent of ₹ 10,000 p.a. It has now been agreed that w.e.f. 1.10.2017, the property is transferred at its market valuation of ₹ 60,000 to the partnership as C's fixed capital.

After stating that there will be no partners' salaries, the new partnership agreement provides that :

(i) Interest @ 10% p.a. is to be paid on partners' fixed capital.

(ii) The balance of profit or loss is to be shared among A, B and C in the ratio of 5 : 3 : 2.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31.12.2017. Also prepare the Partners' Capital and Current Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars		Jan to Sept	Oct to Dec	Particulars	Jan to Sept	Oct to Dec
To Interest on Capital A/c :	A	9,000	3,000	By Net Profit b/d	1,20,000	40,000
	B	6,000	2,000	By Salary — written back (Note 1)	—	10,000
	C	—	1,500	By Rent — written back (Note 1)	—	2,500
To Partner's Salary A/c :	B	22,500	—			
To Share of Profit A/c :	A	49,500	23,000			
	B	33,000	13,800			
	C	—	9,200			
		1,20,000	52,500		1,20,000	52,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Dec. 31	To Balance c/d	1,20,000	80,000	60,000	Jan. 1	By Balance b/d	1,20,000	80,000	—
					Oct. 1	By Building A/c	—	—	60,000
		1,20,000	80,000	60,000			1,20,000	80,000	60,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Dec. 31	To Drawings A/c :				Jan. 1	By Balance b/d	10,000	7,000	—
	Cash	5,000	6,000	—	Dec. 31	By Interest on Capital A/c	12,000	8,000	1,500
	Salary	—	—	10,000	"	By Partner's Salary A/c	—	22,500	—
	Rent	—	—	2,500	"	By Share of Profit A/c	72,500	46,800	9,200
"	To Balance c/d	89,500	78,300	—	"	By Balance c/d	—	—	1,800
		94,500	84,300	12,500			94,500	84,300	12,500

Working Note :

(1) At the time of calculating profit ₹ 1,60,000 for the year, salary and rent of C were taken into consideration. As per agreement amongst the partners, no salary and rent is payable to C from 1.10.2017. Therefore, three months' salary and rent are to be written-back.

Key Points

- A change in the profit-sharing ratio between the partners is a change in the constitution of partnership.
- When a change in the profit-sharing ratio takes place in a partnership firm, one (or more) partner(s) purchases an interest in the business from another partner(s).
- A change in the profit-sharing ratio results in a new partnership, although daily operations of the firm currently are not affected.
- When there is a change in the profit sharing ratio, an adjustment is necessary in respect of goodwill.
- At the time of change in the profit sharing ratio, it may be necessary to revalue the assets and liabilities of the firm, so that each partner gets his fair share of the firm's net assets.
- An adjustment is required for any reserve / accumulated losses appearing in the Balance Sheet at the time of change in the profit-sharing ratio. The adjustment entry will be :

General Reserve Account	Dr.
Profit and Loss Account	Dr.
Other Reserves Account	Dr.
To All Partners' Capital Accounts	[Old ratio]

THEORETICAL QUESTIONS

1. Why is it necessary to revalue assets and liabilities of the firm in case of change in the profit-sharing ratio ?
2. What are the effects of change in the profit-sharing ratio of the partners ?
3. State the treatment of goodwill in case of change in the profit-sharing ratio of the partners.
4. How will you deal with accumulating profits and losses at the time of change in the profit-sharing ratio of the partners?

PRACTICAL QUESTIONS

1. A and B are partners sharing profits and losses in the ratio of 3 : 1. Their capitals were : A — ₹ 60,000; B ₹ 20,000. They decided to change the profit-sharing ratio to 5 : 3 with effect from 1.1.2018. The goodwill of the firms is to be valued at 2 years' purchase of 3 years' average profits. They also decided that their capitals should be proportionate to their profit-sharing ratio. The profits of the firms for 2015, 2016 and 2017 were ₹ 22,000; ₹ 28,000 and ₹ 34,000 respectively. Pass necessary Journal Entries. Also, show the Partners' Capital Accounts.

2. The following is the Balance Sheet of A, B and C who share profits equally as on 1.1.2018.

Liabilities	₹	Assets	₹
Capitals : A	30,000	Land	15,000
B	20,000	Building	35,000
C	20,000	Furniture	20,000
Reserve	15,000	Stock	10,000
Creditors	10,000	Debtors	15,000
Bills Payable	5,000	Cash and bank	5,000
	1,00,000		1,00,000

On the above date, the partners changed their profit-sharing ratio to 2 : 2 : 1. Following are agreed upon : (i) The value of land is ₹ 30,000; (ii) Reserve is to be maintained at ₹ 30,000; (iii) The total capital of the partners will be ₹ 1,00,000 which will be shared by them in their new profit-sharing ratio; (iv) Building is to be increased by ₹ 5,000 and furniture is to be decreased by ₹ 10,000.
You are required to prepare the revised Balance Sheet. Preparation of Ledger Accounts is not required.

3. The following is the Balance Sheet of A, B and C who share profits in the ratio of 3 : 2 : 1 as on 1.1.2018 :

Liabilities	₹	Assets	₹
Capitals : A	30,000	Land	15,000
B	25,000	Building	30,000
C	20,000	Plant and Machinery	20,000
Reserve	15,000	Joint Life Policy	12,000
Joint Life Policy Reserve	12,000	Stock	15,000
Creditors	3,000	Debtors	10,000
		Cash	3,000
	1,05,000		1,05,000

From the above date, the partners decided to share profits equally. Following are agreed upon :
(i) The value of the land will be ₹ 21,000;
(ii) Joint life policy will not be shown;
(iii) Half of the reserve will be withdrawn by the partners;
(iv) The total capital of the partners will be ₹ 90,000. Any deficiency is to be brought in cash and the surplus is to to be transferred to a Loan Account carrying interest @ 12% p.a.
Prepare necessary Ledger Accounts and re-draft the Balance Sheet.

4. A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 1.1.2017 was as under :

Liabilities	₹	Assets	₹
Capital Accounts : (A ₹ 30,000; B ₹ 20,000; C ₹ 10,000)	60,000	Fixed Assets	40,000
		Stock	40,000
General Reserve	12,000	Debtors	30,000
Capital Reserve	9,000	Bank	10,000
Creditors	39,000		
	1,20,000		1,20,000

On the above date, the partners decided to change their profit sharing ratio to 1 : 2 : 3. Goodwill was valued at ₹ 18,000. No entries were, however, passed to give effect to this change.
The Balance Sheet of the firm as on 31.12.2017 was as under :

Liabilities		₹	Assets	₹
A Capital	30,000		Fixed Assets	36,000
Less: Drawings	5,000	25,000	Stock	55,000
B Capital	20,000		Debtors	45,000
Less: Drawings	3,000	17,000	Advances	14,000
C Capital	10,000			
Less: Drawings	4,000	6,000		
General Reserve		36,000		

Capital Reserve	9,000		
Creditors	50,000		
Bank Overdraft	7,000		
	1,50,000		1,50,000

You are required to pass necessary Journal Entries to give effect to the above change in the constitution of the firm on 1.1.2017. Draw also the revised Balance Sheet as on 31.12.2017 [Assume that there will be no reserve in the new Balance Sheet].

5. The following is the Balance Sheet of A, B and C as on 1.1.2018 :

Liabilities		₹	Assets	₹
Capital Accounts :	A	40,000	Land	10,000
	B	20,000	Building	50,000
	C	20,000	Machinery	40,000
Reserve		20,000	Furniture	10,000
Creditors		15,000	Stock	5,000
Bills Payable		15,000	Debtors	5,000
			Bank	10,000
		1,30,000		1,30,000

The partners share profits in the ratio of 2 : 2 : 1, but, on the above date, they have decided to change that to 2 : 1 : 1. The following adjustments are required :

(a) The value of the land is ₹ 15,000.
(b) The value of machinery and furniture are to be increased by ₹ 15,000 and ₹ 5,000 respectively.
(c) The value of stock and debtors are to be decreased by ₹ 3,000 and ₹ 2,000 respectively.
(d) The capitals of the partners are to be adjusted according to the new profit-sharing ratio. For that, necessary capital to be brought-in or excess capital to be writhdrawn. No reserve will be shown in the new Balance Sheet.

Prepare necessary Ledger Accounts and re-draft the Balance Sheet.

6. The firm of A, B and C has existed for some years, profit being shared as 2/5, 2/5 and 1/5 respectively. C, however, feels that this arrangement has not been satisfactory to him and requires to be placed on some basis as regards profits as A and B. He further wants that this arrangement shall apply not only to future profits but also retrospectively to the profits of the past three years which were ₹ 26,000, ₹ 22,100 and ₹ 25,805. A and B have no objection to this. They further agree that in making such adjustment regards should be given to ₹ 6,500 value of goods which had been charged to profits but which actually were taken privately by B and ₹ 3,900 of office equipment for which no Asset Account had been opened in the books but charged to the Profit and Loss Account. Plant and Machinery of the firm had not been depreciated over the past years and it was estimated that the total of the amounts which should have been written off was ₹ 9,035. It was further agreed that after adjustment the Capital Accounts were to be equalized without, however, increasing or reducing the total capital of the firm.

Show the Adjustment Account and the Capital Accounts of the partners after giving effect to the above agreement, assuming that immediately after the distribution of last year's profits, Capital Accounts stood as : A—₹ 52,000; B—₹ 39,000; C—₹ 27,430.

7. A, B and C are partners in a firm sharing profits and losses as 8 : 5 : 3. Their Balance Sheet as at 31st December, 2017, was as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		1,50,000	Cash	40,000
General Reserve		80,000	Bills Receivable	50,000
Partners' Loan Accounts :	A	40,000	Sundry Debtors	60,000
	B	30,000	Stock	1,20,000
Partners' Capital Accounts :	A	1,00,000	Fixed Assets	2,80,000
	B	80,000		
	C	70,000		
		5,50,000		5,50,000

From 1st January, 2018 they agreed to alter their profit-sharing ratio as 5 : 6 : 5. It is also decided that :

(a) the fixed asets should be valued at ₹ 3,31,000;
(b) a provision of 5% on sundry debtors to be made for doubtful debts;
(c) the goodwill of the firm at this date be valued at three years' purchases of the average net profits of the last five years before, charging insurance premium; and
(d) the stock be reduced to ₹ 1,12,000.

There is a joint life insurance policy for ₹ 2,00,000 for which an annual premium of ₹ 10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31st December, 2017 was ₹ 78,000.

The net profit of the firm for the last five years were : ₹ 14,000; ₹ 17,000; ₹ 20,000; ₹ 22,000 and ₹ 27,000. Goodwill and the surrender value of the joint policy was not to appear in the books.
Draft Journal Entries necessary to adjust the Capital Accounts of the partners.

Guide to Answers

Practical Questions

1. **Value of Goodwill ₹ 56,000.**
2. **Balance Sheet total ₹ 1,45,000.**
3. **Balance Sheet total ₹ 1,00,500.**
4. **Balance Sheet total ₹ 1,50,000.**
5. **Revaluation Profit ₹ 20,000; Balance Sheet total ₹ 1,35,000; Cash to be brought-in by — A : ₹ 4,000; C : ₹ 2,000.**
6. **Balance of Adjustment Account ₹ 75,270 (Cr.)**
   Balance of Partners' Capital Accounts : A — ₹ 37,765; B — ₹ 37,765; C — ₹ 37,765.
   Cash brought-in by — B : ₹ 9,737 and by C : ₹ 26.
   Cash taken away by A ₹ 9,763.

3

Admission of a Partner

Introduction

A person may be admitted as a new partner in a partnership firm with the consent of all the partners. A new partner is admitted for different reasons such as more capital, influence or special skill, etc.

Whenever a new partner is admitted, it has the effect of bringing the old partnership to an end and transferring the business to new partnership. Generally, public announcements are made (through newspaper) about new partner additions so that third parties transacting business with the partnership are aware of the change in the partnership. After admission, the new partner acquires two rights :

(i) he becomes the part owner of the assets of the firm; and

(ii) he is entitled to share part of the profits of the business. At the same time, he becomes partly liable for any liability of the business incurred after admission and any loss incurred by the firm.

Effects of Admission of a Partner

The effects of admission of a new partner are the following :

1. The admission of a partner constitutes the termination of old partnership and the beginning of a new one.
2. The new partner is entitled to a share of future profits and, in effect, the combined shares of the old partners will be reduced.
3. The new partner has to contribute an agreed amount of capital to the business.
4. The new partner acquires ownership rights of the assets and also become liable for the liabilities of the business.
5. Separate accounts should be prepared for the old and new partnership.
6. An adjustment is to be made in regard to undrawn profits or accumulated losses.
7. The goodwill of the firm has to be valued and some adjustments are to be made.
8. The assets and liabilities of the firm are to be revalued and proper adjustments are to be made.

Adjustments for Admission of a New Partner

At the time of admission of a new partner, different adjustments are required in respect of the following :

1. Change in the profit sharing ratio
2. Goodwill
3. Revaluation of assets and liabilities
4. Reserve and surplus
5. Partners' capitals

1. Change in the Profit Sharing Ratio

New Profit Sharing Ratio

When a new partner is admitted, he is entitled to a share of future profits. In effect, there will be a change in the old profit sharing ratio. The new partner may acquire his share of profit either from one partner or from all partners. At the time of calculating the new ratio the above matters are to be taken into consideration.

In this connection, it should be noted that, *unless otherwise agreed, the profit sharing ratio between the existing partners will remain same*. We will discuss the different situations as under :

Situation 1 : When the share of the new partner is given and the remaining profit will be shared by the old partners in the given new profit sharing ratio.

In this situation, first new partner's share of profit will be deducted from total, i.e., from 1. The remaining share will be distributed amongst the old partners in the given new ratio. The following illustration will clear the matter.

Illustration 1

A, B, C and D are in partnership sharing profits and losses in the ratio of 36 : 24 : 20 : 20 respectively. E joins the partnership for 20% share. A, B, C and D would, in future, share profits among themselves as 3/10, 4/10, 2/10, and 1/10 respectively.

Calculate new profit sharing ratio after E's admission.

Solution

E joins the firm for 20% or 1/5th share. Therefore, the balance 4/5th (1 – 1/5) will be shared by the old partners in the ratio of 3/10 : 4/10 : 2/10 : 1/10.

The new profit sharing ratio is :

A — 4/5 × 3/10 = 12/50; B — 4/5 × 4/10 = 16/50; C — 4/5 × 2/10 = 8/50; D — 4/5 × 1/10 = 4/50; E — 1/5 or 10/50.

New profit sharing ratio = A : B : C : D : E = 12 : 16 : 8 : 4 : 10 = **6 : 8 : 4 : 2 : 5**.

Situation 2 : When the share of the new partner is given, which he acquires from other partners in an agreed ratio.

In this situation, the share of each old partner is to be calculated after deducting the share of profit to the extent he has surrendered in favour of the new partner. The following ***Illustration*** will clear the matter.

Illustration 2

Bijender and Narender are partners in a firm sharing profits in the ratio of 3 : 2. They admit Surender as a partner for 1/4th share in the profits. Surender acquires his share from Bijender and Narender in the ratio of 2 : 1. Calculate the new profit sharing ratio.

Solution

Surender's share of profit in the firm is 1/4 which he acquires from Bijender and Narender in the ratio of 2 : 1.

It means Bijender has surrendered 2/3 of 1/4, i.e., 2/12 and

Narender has surrendered 1/3 of 1/4 = 1/12.

Bijender's share of profit in the new firm : 3/5 – 2/12 = (36 – 10) / 60 = 26/60.

Narender's share of profit in the new firm : 2/5 – 1/12 = (24 – 5) / 60 = 19/60.

Surender's share of profit in the new firm : 1/4 or 15/60.

New profit sharing ratio = Bijender : Narender : Surender = 26/60 : 19/60 : 15/60 = 26 : 19 : 15.

Alternatively, Calculation of New Profit Sharing Ratio

Partners	Old Ratio	Share Acquired or Surrendered	New Ratio	New Profit Sharing Ratio
Bijender	3/5	2/3 x 1/4 = 2/12	3/5 – 2/12 = 26/60	Bijender : Narender : Surender
Narender	2/5	1/3 x 1/4 = 1/12	2/5 – 1/12 = 19/60	= 26/60 : 19/60 : 15/60
Surender	—	2/12 + 1/12	2/12 + 1/12 = 1/4 or 15/60	or 26 : 19 : 15

Situation 3 : When the old partners are surrendering a part of their share of profit in favour of the new partner.

In this situation the new partner's share of profit will be the sum total of share of profit surrendered by the old partners. Old partner's share of profit will be reduced to the extent surrendered in favour of the new partner. The following ***Illustrations*** will clear the matter.

Illustration 3

X and Y were partners sharing profits in the ratio of 3 : 2. They admitted P and Q as new partners. X surrendered 1/3rd of his share in favour of P and Y surrendered 1/4th of his share in favour of Q.

Calculate the new profit sharing ratio of X, Y, P and Q.

Solution

X's old share of profit = 3/5. X surrendered 1/3rd of his share, i.e., 3/5 × 1/3 = 3/15 (It means X has surrendered 3/15 in favour of P).
X's share of profit in the new firm = 3/5 – 3/15 = (9 – 3) /15 = 6/15.
Y's old share of profit = 2/5. Y surrendered 1/4th of his share, i.e., 2/5 × 1/4 = 2/20 (It means Y has surrendered 2/20 in favour of Q).
Y's share of profit in the new firm = 2/5 – 2/20 = (8 – 2) / 20 = 6/20.
P's share of profit in the new firm = 3/15.
Q's share of profit in the new firm = 2/20.
Therefore, new profit sharing ratio
= X : Y : P : Q = 6/15 : 6/20 : 3/15 : 2/20 = 24/60 : 18/60 : 12/60 : 6/60
= 24 : 18 : 12 : 6 or **4 : 3 : 2 : 1**.

Alternatively, Calculation of New Profit Sharing Ratio

Partners	Old Ratio	New Share	New Profit Sharing Ratio
X	3/5	3/5 – (1/3 of 3/5) = 3/5 – 1/5 = 2/5	X : Y : P : Q
Y	2/5	2/5 – (1/4 of 2/5) = 2/5 – 1/10 = 3/10	= 2/5 : 3/10 : 1/5 : 1/10
P	—	1/3 of 3/5 = 1/5	or
Q	—	1/4 of 2/5 = 1/10	**4 : 3 : 2 : 1**

Illustration 4

A and B are partners sharing profits in the ratio of 3 : 2. A surrenders 1/6th of his share and B surrenders 1/4th of his share in favour of C, a new partner. What is the new ratio ?

Solution

A's old share of profit = 3/5. A surrenders 1/6th of his share, i.e., 3/5 x 1/6 = 3/30 or 1/10
(It means A has surrendered 1/10th in favour of C).
A's share of profit in the new firm : 3/5 – 1/10 = (6 – 1) / 10 = 5/10.
B's old share of profit = 2/5. B surrenders 1/4th of his share, i.e., 2/5 x 1/4 = 2/20 = 1/10
(It means B has surrendered 1/10 in favour of C).
B's share of profit in the new firm = 2/5 – 1/10 = (4 – 1) / 10 = 3/10.
C's share of profit in the new firm = 1/10 + 1/10 = 2/10.
New profit sharing ratio = A : B : C = 5/10 : 3/10 : 2/10 or **5 : 3 : 2**.

Alternatively, Calculation of New Profit Sharing Ratio

Partners	Old Ratio	Share Acquired or Surrendered	New Ratio	New Profit Sharing Ratio
A	3/5	3/5 x 1/6 = 3/30 or 1/10	3/5 – 1/10 = 5/10	A : B : C
B	2/5	2/5 x 1/4 = 2/20 or 1/10	2/5 – 1/10 = 3/10	= 5/10 : 3/10 : 2/10
C	—	1/10 + 1/10	1/10 + 1/10 = 2/10	or **5 : 3 : 2**

Illustration 5

R and S are partners sharing profits in the ratio of 5 : 3. T joins the firm as a new partner. R gives 1/4 of his share and S gives 2/5 of his share to the new partner. Find out the new ratio.

Solution

R's old share of profit = 5/8. He gives 1/4 of 5/8 to T, i.e., 5/8 × 1/4 = 5/32
(It means that R has surrendered 5/32 in favour of T).
R's share of profit in the new firm = 5/8 – 5/32 = (20 – 5) / 32 = 15/32.
S's old share of profit = 3/8. He gives 2/5 of 3/8 to T, i.e., 3/8 × 2/5 = 6/40
(It means that S has surrendered 6/40 in favour of T).
S's share of profit in the new firm = 3/8 – 6/40 = (15 – 6) / 40 = 9/40.
T's share of profit in the new firm = 5/32 + 6/40 = (25 + 24) / 160 = 49/160.
New profit sharing ratio = R : S : T = 15/32 : 9/40 : 49/160 or 75 : 36 : 49.

Alternatively, Calculation of New Profit Sharing Ratio

Partners	Old Ratio	Share Acquired or Surrendered	New Ratio	New Profit Sharing Ratio
R	5/8	5/8 x 1/4 = 5/32	5/8 – 5/32 = 15/32	R : S : T
S	3/8	3/8 x 2/5 = 6/40	3/8 – 6/40 = 9/40	= 15/32 : 9/40 : 49/160
T	—	5/32 + 6/40	5/32 + 6/40 = 49/160	or **75 : 36 : 49**

Illustration 6

Singh, Gupta and Lal are partners in a firm sharing profits in the ratio of 3 : 2 : 3. They admitted Jain as a new partner. Singh surrendered 1/3rd of his share in favour of Jain. Gupta surrendered 1/4th of his share in favour of Jain and Lal surrendered 1/5th of his share in favour of Jain. Calculate the new profit sharing ratio.

Solution

Singh's old share of profit = 3/8. He surrenders 1/3 to Jain, i.e., 3/8 × 1/3 = 3/24
(It means Singh has surrendered 3/24 in favour of Jain).
Singh's share of profit in the new firm = 3/8 – 3/24 = (9 – 3) /24 = 6/24.
Gupta's old share of profit = 2/8. He surrenders 1/4 to Jain, i.e., 2/8 × 1/4 = 2/32
(It means Gupta has surrendered 2/32 in favour of Jain).
Gupta's share of profit in the new firm = 2/8 – 2/32 = (8 – 2) / 32 = 6/32.
Lal's old share of profit = 3/8. He surrenders 1/5 to Jain, i.e., 3/8 × 1/5 = 3/40
(It means Lal has surrendered 3/40 in favour of Jain).
Lal's share of profit in the new firm = 3/8 – 3/40 = (15 – 3)/40 = 12/40.
Jain's share of profit in the new firm = 3/24 + 2/32 + 3/40 = (30 + 15 + 18)/240 = 63/240.
New profit sharing ratio = Singh : Gupta : Lal : Jain = 6/24 : 6/32 : 12/40 : 63/240
= 60 : 45 : 72 : 63 or **20 : 15 : 24 : 21**.

Alternatively, Calculation of New Profit Sharing Ratio

Partners	Old Ratio	New Share	New Profit Sharing Ratio
Singh	3/8	3/8 – (1/3 of 3/8) = 3/8 – 1/8 = 2/8	Singh : Gupta : Lal : Jain
Gupta	2/8	2/8 – (1/4 of 2/8) = 2/8 – 1/16 = 3/16	= 2/8 : 3/16 : 12/40 : 21/80
Lal	3/8	3/8 – (1/5 of 3/8) = 3/8 – 3/40 = 12/40	= **20 : 15 : 24 : 21**
Jain	—	1/8 + 1/16 + 3/40 = 21/80	

Illustration 7

Find out the new ratio :

(i) A and B are partners. They admit C for 1/4 share. In future, the ratio between A and B would be 2 : 1.
(ii) A and B are partners sharing profits in the ratio of 3 : 2. They admit C for 3/7th profit which he acquires 2/7th from A and 1/7th from B.
(iii) K, L and M are partners sharing in the ratio of 3 : 2 : 1. They admit N for 1/6th share. M would retain his original share.

Solution

(i) Let the total share be 1. C is admitted for 1/4 share. Therefore, 1 – 1/4 = 3/4 remains for A and B which they will share in the ratio of 2 : 1. The final profit sharing ratio will be :
A — 2/3 of 3/4 = 6/12; B — 1/3 of 3/4 = 3/12; C — 1/4 = 3/12
A : B : C = 6 : 3 : 3 = **2 : 1 : 1**.

(ii) After admission of C the final profit sharing ratio will be:
A — 3/5 – 2/7 = (21 – 10) / 35 = 11/35 B — 2/5 – 1/7 = (14 – 5) / 35 = 9/35 C — 3/7 or 15/35. A : B : C = **11 : 9 : 15**.

(iii) Let the total share be 1. N is admitted for 1/6 share.
Therefore, 1 – 1/6 = 5/6 remains for K, L and M but M will retain his original share, i.e., 1/6.
In effect, 5/6 – 1/6 = 4/6 will be shared by K and L in the ratio of 3 : 2.
The final profit sharing ratio will be :
K — 3/5 of 4/6 = 12/30 L — 2/5 of 4/6 = 8/30
M — 1/6 = 5/30 N — 1/6 = 5/30.
∴ K : L : M : N = **12 : 8 : 5 : 5**.

Sacrificing Ratio

When a new partner is admitted into the partnership for a certain share of profit, the combined shares of the old partners will be reduced. The ratio in which the old partners are surrendering their share of profit in favour of the new partner is called ***sacrificing ratio***. Any one partner or all partners may sacrifice in favour of the new partner. Again, the sacrifice may be in the old ratio or in other ratio.

Calculation of sacrificing ratio is necessary when the new partner will bring premium for goodwill in cash. This premium for goodwill is distributed between old partners in the ratio of their sacrifice.

Calculation of sacrificing ratio under different situations are shown below :

Situation 1 : When both old profit sharing ratio and new profit sharing ratio are given

In this case, sacrificing ratio is calculated by deducting new profit sharing ratio from the old profit sharing ratio.

Sacrificing Ratio = Old Ratio – New Ratio

The following ***Illustrations*** will clear the matter :

Illustration 8

A and B are partners sharing profits in the ratio of 3 : 2. C is admitted as a partner. The new profit sharing ratio among A, B and C is 5 : 3 : 2. Find out the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	3/5	5/10	3/5 – 5/10 = 1/10 (Sacrifice)	A : B = 1/10 : 1/10 = 1 : 1
B	2/5	3/10	2/5 – 3/10 = 1/10 (Sacrifice)	
C	—	2/10	1/10 + 1/10 = 2/10 (Gain)	

Illustration 9

X and Y are partners sharing profits in the ratio of 3 : 2. They admit Z into partnership. The new profit sharing ratio is 3 : 3 : 2. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
X	3/5	3/8	3/5 – 3/8 = 9/40 (Sacrifice)	X : Y = 9 : 1
Y	2/5	3/8	2/5 – 3/8 = 1/40 (Sacrifice)	
Z	—	2/8	0 – 2/8 = 10/40 (Gain)	

Illustration 10

Gopal and Gobind are partners sharing profits and losses in the ratio of 3 : 2. From 1st January, 2018 they have decided to admit Guru as a partner. The new profit sharing ratio will be 7 : 5 : 8. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
Gopal	3/5	7/20	3/5 – 7/20 = 5/20 (Sacrifice)	Gopal : Gobind 5 : 3
Gobind	2/5	5/20	2/5 – 5/20 = 3/20 (Sacrifice)	
Guru	—	8/20	0 – 8/20 = 8/20 (Gain)	

Illustration 11

Sun and Moon are partners sharing profits in the ratio of 3 : 2. They admit Jupiter into the firm for 3/7th profit. The new profit sharing ratio is 11 : 9 : 15. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
Sun	3/5	11/35	3/5 – 11/35 = 10/35 (Sacrifice)	Sun : Moon = 10 : 5 = 2 : 1
Moon	2/5	9/35	2/5 – 9/35 = 5/35 (Sacrifice)	
Jupiter	—	15/35	0 – 15/35 = 15/35 (Gain)	

Illustration 12

A, B and C are in partnership sharing profits and losses in the ratio of 5 : 4 : 1 respectively. Two new partners are introduced, D and E. The profits are now to be shared in the ratio of 3 : 4 : 1 : 2 : 2 respectively. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	5/10	3/12	5/10 – 3/12 = 15/60 (Sacrifice)	A : B : C = 15 : 4 : 1
B	4/10	4/12	4/10 – 4/12 = 4/60 (Sacrifice)	
C	1/10	1/12	1/10 – 1/12 = 1/60 (Sacrifice)	
D	—	2/12	0 – 2/12 = 10/60 (Gain)	
E	—	2/12	0 – 2/12 = 10/60 (Gain)	

Tutorial Note : Sum total of sacrifice must be equal to sum total of the gain.

Situation 2 : When the new partner gets his share of profit from all the partners and there is no change in the profit sharing ratio of the old partners.

In this case, new profit sharing ratio is to be calculated first. For calculating new ratio, new partner's share of profit is to be deducted from the total, i.e., 1. The balance should be divided between the old partners in the ***old*** ratio. After calculating new ratio, the sacrificing ratio is to be calculated in the usual manner.

Sacrificing Ratio = Old Ratio – New Ratio

The following Illustrations will clear the matter.

Illustration 13

A, B and C are partners sharing profits in the ratio of 4 : 3 : 2. D is admitted for 1/3rd share in future profits. What is the sacrificing ratio ?

Solution

Calculation of New Profit Sharing Ratio

D is admitted for 1/3rd share in future profits. Therefore, 1 – 1/3 = 2/3 is available to A, B and C which they will share in the ratio 4 : 3 : 2.

A's share will be = 4/9 of 2/3 = 8/27 B's share will be = 3/9 of 2/3 = 6/27

C's share will be = 2/9 of 2/3 = 4/27 D's share will be = 1/3 = 9/27

New profit sharing ratio = A : B : C : D = 8 : 6 : 4 : 9.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	4/9	8/27	4/9 – 8/27 = 4/27 (Sacrifice)	A : B : C = 4 : 3 : 2
B	3/9	6/27	3/9 – 6/27 = 3/27 (Sacrifice)	
C	2/9	4/27	2/9 – 4/27 = 2/27 (Sacrifice)	
D	—	9/27	0 – 9/27 = 9/27 (Gain)	

Tutorial Note : It should be noted that in this case, the sacrificing ratio will always be the ***old*** profit sharing ratio.

Situation 3 : When new partner gets his share of profit from all the partners and there is a change in the profit sharing ratio of the old partners.

In this case also, new profit sharing ratio is to be calculated first. For calculating new ratio, new partner's share of profit is to be deducted from the total, i.e., 1. The balance should be divided between the old partners in the ***new*** ratio. After calculating new ratio, the sacrificing ratio is to be calculated in the usual manner.

Sacrificing Ratio = Old Ratio – New Ratio

The following ***Illustrations*** will clear the matter.

Illustration 14

A and B are partners sharing profits and losses in the ratio of 3 : 2. They admit C into the partnership for 1/4th share. In future, A and B will share the profits equally.

You are required to calculate the new profit sharing ratio and the sacrificing ratio.

Solution

Calculation of New Profit Sharing Ratio

C is coming for 1/4th share. The remaining 1 – 1/4 = 3/4th share will be divided between A and B equally. Therefore, the new profit sharing ratio will be :

A's share of profit = 1/2 of 3/4 = 3/8
B's share of profit = 1/2 of 3/4 = 3/8
C's share of profit = 1/4 = 2/8

New profit sharing ratio = A : B : C = 3 : 3 : 2.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	3/5	3/8	3/5 – 3/8 = 9/40 (Sacrifice)	A : B = 9 : 1
B	2/5	3/8	2/5 – 3/8 = 1/40 (Sacrifice)	
C	—	2/8	0 – 2/8 = 10/40 (Gain)	

Illustration 15

P and Q are partners sharing profits and losses in the ratio of 4 : 3. They admit R into the partnership for 1/5th share. P and Q decide to share future profits in the ratio of 2 : 1. Calculate the new profit sharing ratio and the sacrificing ratio.

Solution

Calculation of New Profit Sharing Ratio

R is coming for 1/5th share. Therefore, the balance 4/5th (1 – 1/5) is to be shared by P & Q in the ratio of 2:1. Therefore, the new profit sharing ratio will be :

P's share of profit = 2/3 of 4/5 = 8/15
Q's share of profit = 1/3 of 4/5 = 4/15
R's share of profit = 1/5 = 3/15

New profit sharing ratio = P : Q : R = 8 : 4 : 3.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
P	4/7	8/15	4/7 – 8/15 = 4/105 (Sacrifice)	P : Q = 4 : 17
Q	3/7	4/15	3/7 – 4/15 = 17/105 (Sacrifice)	
R	—	3/15	0 – 3/15 = 21/105 (Gain)	

Illustration 16

K, L and M are partners sharing profits and losses in the ratio of 3 : 2 : 1. They admit N for 1/6th share and M should retain his original share. You are required to calculate the new profit sharing ratio and the sacrificing ratio.

Solution

Calculation of New Profit Sharing Ratio

N is coming for 1/6th share and M retains his original share (which is also 1/6th). Therefore, total share of N and M is 1/6th + 1/6th = 2/6th. Balance of share remains for K and L is 1 – 2/6 = 4/6 or 2/3, which will be shared by K and L in the ratio 3 : 2.

Therefore, new profit sharing ratio will be :

K's share of profit = 3/5 of 2/3 = 6/15
L's share of profit = 2/5 of 2/3 = 4/15
M's share of profit = 1/6
N's share of profit = 1/6

New profit share ratio = K : L : M : N = 6/15 : 4/15 : 1/6 : 1/6 = 12 : 8 : 5 : 5.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
K	3/6	12/30	3/6 – 12/30 = 3/30 (Sacrifice)	K : L = 3 : 2
L	2/6	8/30	2/6 – 8/30 = 2/30 (Sacrifice)	
M	1/6	5/30	1/6 – 5/30 = 0	
N	—	5/30	0 – 5/3 = 5/30 (Gain)	

Situation 4 : When the old partners surrender a part of their share in favour of the new partner.

In this case also new profit sharing ratio is to be calculated first. For calculating new share of profit of the old partner, the share surrendered will be deducted from the old share of profit. New partner's share of profit will be the total of share surrendered by the old partners in his favour. Sacrificing ratio will be calculated in the usual manner.

Sacrificing Ratio = Old Ratio – New Ratio

The following ***Illustrations*** will clear the matter.

Illustration 17

A and B are partners sharing profits in the ratio of 7 : 3. A surrenders 1/7th of his share and B surrenders 1/3rd of his share in favour of C, a new partner.

What is the new ratio and what is the sacrificing ratio ?

Solution **Calculation of New Profit Sharing Ratio**

Partners	Old Ratio	New Ratio	New Profit Sharing Ratio
A	7/10	7/10 – (1/7 of 7/10) = 7/10 – 1/10 = 6/10	A : B : C = 6/10 : 2/10 : 2/10 = 6 : 2 : 2
B	3/10	3/10 – (1/3 of 3/10) = 3/10 – 1/10 = 2/10	
C	—	1/10 + 1/10 = 2/10	

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	7/10	6/10	7/10 – 6/10 = 1/10 (Sacrifice)	A : B = 1/10 : 1/10 = 1 : 1
B	3/10	2/10	3/10 – 2/10 = 1/10 (Sacrifice)	
C	—	2/10	1/10 + 1/10 = 2/10 (Gain)	

Illustration 18

A and B are partners sharing profits in the ratio of 4 : 1. A surrenders 1/4th of his share and B surrenders 1/2 of his share in favour of C, a new partner. What is the new ratio and the sacrificing ratio ?

Solution **Calculation of New Profit Sharing Ratio**

Partners	Old Ratio	New Ratio	New Profit Sharing Ratio
A	4/5	4/5 – (1/4 of 4/5) = 4/5 – 1/5 = 3/5	A : B : C = 3/5 : 1/10 : 3/10 = 6 : 1 : 3
B	1/5	1/5 – (1/2 of 1/5) = 1/5 – 1/10 = 1/10	
C	—	1/5 + 1/10 = 3/10	

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	4/5	6/10	4/5 – 6/10 = 2/10 (Sacrifice)	A : B = 2 : 1
B	1/5	1/10	1/5 – 1/10 = 1/10 (Sacrifice)	
C	—	3/10	0 – 3/10 = 3/10 (Gain)	

Situation 5 : When only one of the old partners is sacrificing.

Sometimes it may happen that only one partner is sacrificing. In this case, it will not be possible to calculate the sacrificing ratio. The total sacrifice of that partner will be equal to the share of profit sacrificed in favour of the new partner as well as the other old partner(s). The following ***Illustrations*** will clear the matter.

Illustration 19

Quick and Slow are in partnership sharing profits and losses in the ratio of 4 : 1. They admit Smooth into the firm for an equal share. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing / Gaining Ratio
Quick	4/5	1/3	4/5 – 1/3 = 7/15 (Sacrifice)	Here, sacrificing ratio cannot be calculated because only Quick is sacrificing 7/15th of his share. However, on Smooth's admission, Slow is gaining 2/15th. The gaining ratio between Slow and Smooth will be 2 : 5.
Slow	1/5	1/3	1/5 – 1/3 = 2/15 (Gain)	
Smooth	—	1/3	0 – 1/3 = 5/15 (Gain)	

Illustration 20

P, Q and R were on partnership terms sharing profits and losses in the ratio of 6 : 3 : 1. They decided to take S into partnership with effect from April 1, 2018. The new profit sharing ratio between P, Q, R and S will be 3 : 3 : 3 : 1. Find out the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing / Gaining Ratio
P	6/10	3/10	6/10 – 3/10 = 3/10 (Sacrifice)	Here, sacrificing ratio cannot be calculated because only P is sacrificing 3/10th of his share. However, on S's admission, R is gaining 2/10. The gaining ratio between R and S will be 2 : 1.
Q	3/10	3/10	3/10 – 3/10 = 0 (Sacrifice)	
R	1/10	3/10	1/10 – 3/10 = 2/10 (Gain)	
S	—	1/10	0 – 1/10 = 1/10 (Gain)	

2. Goodwill

Meaning of Goodwill

Goodwill is viewed in accounting as the combination of those intangible attributes of a business which permit it to earn above-average profit. Goodwill may arise from such attributes of a business as a favourable location, superior management team, secret or patented manufacturing process, etc.

Goodwill has been defined by different persons in different manner. Some of these are reproduced here.

"*Goodwill is nothing more than the probability that the old customers will resort to the old place*" (Lord Eldon).

"*The value of business connections, the value of the probability that present customers will continue to buy in spite of the allurements of competing dealers*." (Hatfield)

"*The element of an established business which makes the business as a going concern worth more than its book value, that is, its net worth as shown by the books*." (Walton)

"*It is the influence that the proprietor or his organisation has upon the purchasing public through which he is enabled to attract and retain patronage.*" (Wildman)

"*Goodwill is the benefit and advantage of good name, reputation and connection of business. It is the attractive force which brings in customers. It is the one thing which distinguishes an old established business from a new business at its start — Goodwill is composed of a variety of elements. It differs in the composition in different trades and in different business in the same trade.*" (Lord Maenaghten)

Nature of Goodwill

1. It is an intangible asset but not a fictitious asset.
2. The value of goodwill is highly dependent on the subjective judgment of the valuer.
3. It cannot have an existence separate from the organisation.
4. It is difficult to place a cost on goodwill. It is fluctuating with the changing fortunes of the company.

Classification of Goodwill

Goodwill can be classified into two categories :

(1) Purchased Goodwill

(2) Non-Purchased or Inherent Goodwill.

Purchased Goodwill When one business is taken over by another business, the excess of purchase consideration over its net asset value is referred to as ***purchased goodwill***.

The following are the important features of purchased goodwill :

(i) It arises on purchase of a business.

(ii) It is recorded in the books of account.

(iii) It is amortised (i.e., depreciated) over its useful economic life.

(iv) It is shown in the Balance Sheet as an asset.

Non-purchased Goodwill Non-purchased goodwill is referred to as internally generated goodwill which arises from a number of attributes that an on- going business possesses.

The following are the important features of non-purchased goodwill :

(i) It is internally generated over years.

(ii) A cost cannot be placed on this type of goodwill.

(iii) It is not recorded generally in the books of account.
(iv) Valuation depends on subjective judgment of the valuer.

Positive and Negative Goodwill

Since goodwill is the difference between the value of a business as a whole and the fair value of its separate net assets, goodwill can be both positive and negative.

Non-purchased goodwill exists in all businesses. Positive goodwill arises when the value of the business as a whole is more than the fair value of the separate net assets. If the real worth of the business is less than the sum of the fair values of the separate net assets, it represents negative goodwill.

Treatment of Purchased Goodwill

Following are the possible methods of accounting for purchased goodwill: (a) Carry it as an asset in the Balance Sheet indefinitely; (b) amortise it over its estimated useful life; (c) adjust against capital reserves on acquisition; and (d) charge as an expense against profits in the year of acquisition.

At the time of admission of a new partner, it is necessary to value the goodwill and due credit should be given to the old partners for their efforts to bring the firm to the present stage of super-profit earning capacity and their sacrifice of a fraction of future super-profits. On admission, a new partner acquires a claim to share the future super-profits and he should compensate the old partners for the sacrifices made by them.

Factors to be Taken into Consideration in Valuing Goodwill

1. The prestige and reputation attached to the name of a business or its products (for example, Arrow shirts, Levi's jeans, etc.).
2. The location of the business premises (for example, news magazine store or fast food centre next to railway station).
3. Possession of patents, trademarks, brand names and specified technical knowhow (for example, intel pentium chip).
4. Superior management team.
5. Outstanding sales force.
6. Good labour relations.
7. Good public 'image'.
8. Number of outlets for products.
9. Number of service locations for products.
10. Experienced workforce.
11. Existing contracts for supply of goods in future (for example, defence equipment supply).
12. Established list of customers.
13. Established licence to trade.
14. Good relation with customers.
15. Favourable government regulation.

Need for Valuation of Goodwill

Purchased goodwill arises at the time of acquisition of business. In this case, the value of goodwill is the difference between the purchase consideration and net assets taken over. However, the need for valuation of non-purchased goodwill arises in the following circumstances :

1. When a new partner is admitted.
2. When an existing partner retires or dies.
3. When there is a change in the profit sharing ratio of the existing partners without admission, retirement or death of a partner.
4. When there is amalgamation of two or more partnership firms.
5. When a partnership firm is converted into a limited company.
6. Where a partnership firm is sold.

Methods of Valuation of Non-Purchased Goodwill

At the time of valuation of goodwill, the provisions of the partnership deed must be taken into consideration and valuation should be done on that line. If the partnership deed is silent, the valuation should be done in such a manner as must have been agreed upon by the partners. Generally calculation of goodwill is based on "number of years' purchase" of average profit or super profit.

Generally the following methods are adopted for the valuation of the goodwill :

(a) Average profit method
(b) Super profit method
(c) Capitalisation of average profit method
(d) Capitalisation of super profit method
(e) Annuity method.

(a) Average Profit Method Under this method goodwill is calculated by multiplying the 'average profit' by a certain number of years' purchases as agreed by the partners. Average profit is calculated on the basis of the past few years' profits. While calculating the average profit, precaution should be taken in respect of any abnormal items of profit or loss which may affect future profit. (***Note*** : Add abnormal losses and deduct abnormal gains).

The following steps are followed for calculating goodwill under this method :

Step 1 : Calculate normal profit of each year after adding abnormal losses and deducting abnormal gains.

Step 2 : Calculate average profit as follows :

$$\text{Average Profit} = \frac{\text{Total Profits (after adjustments)}}{\text{Number of years}}$$

Step 3 : Calculate goodwill as follows : Goodwill = Average Profit × Number of years' purchase

Illustration 21

X, Y and Z are partners sharing profits and losses in the ratio of 5 : 3 : 2. They admit A for 1/5th share. For the purpose of admission of A, the goodwill of the firm should be valued on basis of 3 years' purchase of last 4 years' average profits. The profits were :

Year	₹
2014	1,00,000
2015	1,20,000
2016	1,30,000
2017	1,50,000

Calculate the value of goodwill.

Solution

Calculation of Average Profit

Year	Profit (₹)
2014	1,00,000
2015	1,20,000
2016	1,30,000
2017	1,50,000
Total Profit	5,00,000

Average Profit = ₹ 5,00,000 / 4 = ₹ 1,25,000.

Goodwill = Average Profit × Number of years' purchase = ₹ 1,25,000 × 3 = ₹ 3,75,000.

Illustration 22

Ram and Rahim are partners sharing profits and losses in the ratio of 3 : 2. They admit Laxman for 1/5th share. For this purpose, the goodwill of the firm should be valued on the basis of 3 years' purchase of last 5 years average profits. The profits were :

Year	₹
2013	50,000
2014	60,000
2015	40,000

2016	65,000
2017	80,000

The profit of 2016 was calculated after charging ₹ 5,000 for loss of goods by fire. Calculate goodwill of the firm.

Solution

Calculation of Average Profit

Year	Profit (₹)
2013	50,000
2014	60,000
2015	40,000
2016	70,000 (See Note)
2017	80,000
Total Profit	3,00,000

Average Profit = ₹ 3,00,000 / 5 = ₹ 60,000.

Goodwill = Average Profit × Number of years' purchase = ₹ 60,000 x 3 = ₹ 1,80,000.

Note: In 2016, profit of ₹ 65,000 was arrived at after charging an abnormal item of ₹ 5,000 (loss of goods by fire). Therefore, the normal profit of 2016 = ₹ 65,000 + 5,000 = ₹ 70,000.

Illustration 23

A, B and C were in partnership sharing profits and losses in ratio 6 : 3 : 1. They decided to take D into partnership from 1st January, 2018. For this purpose, goodwill is to be valued at 60% of the average annual profits of the previous three or four years, whichever is higher.

The average profits for the purpose of goodwill for the past four years were :	₹
Year ending on 31st December 2017	48,000
Year ending on 31st December 2016	30,300
Year ending on 31st December 2015	31,200
Year ending on 31st December 2014	42,200

Calculate the value of goodwill.

Solution

Calculation of Average Profit

Based on 3 years' Profits	₹	Based on 4 years' Profits	₹
2017	48,000	2017	48,000
2016	30,300	2016	30,300
2015	31,200	2015	31,200
	1,09,500	2014	42,200
Average Profit = ₹ 1,09,500 / 3 = ₹ 36,500.			1,51,700
		Average Profit = ₹ 1,51,700 / 4 = ₹ 37,925.	

4 years' average profit is higher than the 3 years' average profit. Therefore, the value of goodwill will be 60% of ₹ 37,925 = ₹ 22,755.

Illustration 24

A, B and C are partners sharing profits and losses equally. They agree to admit D for equal share. For this purpose, the value of goodwill is to be calculated on the basis of 4 years' purchase of average profit of last 5 years. The profits were :

Year	₹
2013	6,000 (Profit)
2014	14,000 (Profit)
2015	20,000 (Profit)
2016	28,000 (Profit)
2017	24,000 (Loss)

On 1st January, 2017 a moped costing ₹ 8,000 was purchased and debited to travelling expenses account, on which depreciation is to be charged @ 25%. Calculate the value of goodwill after adjusting the above.

Solution

Calculation of Average Profit

Year	₹
2013	6,000 (Profit)
2014	14,000 (Profit)
2015	20,000 (Profit)
2016	28,000 (Profit)
2017	*18,000 (Loss)
Total Profit	50,000

Average Profit = ₹ 50,000 / 5 = ₹ 10,000.

Goodwill = Average Profit × Number of years' Purchase = ₹ 10,000 × 4 = ₹ 40,000.

***Note** = In 2017, a moped costing ₹ 8,000 was purchased but it was wrongly debited to Travelling Expenses Account. After rectification, the loss of 2017 will be reduced by ₹ 8,000. The depreciation on moped ₹ 2,000 (25% of ₹ 8,000) was not charged to Profit and Loss Account of 2017. Therefore, the final loss of 2017 will be : ₹ 24,000 – 8,000 + 2,000 = ₹ 18,000.

Illustration 25

Red and White are partners sharing profits and losses in the ratio of 60 : 40. Due to financial difficulties, they decided to admit Blue as partner from 1.4.2018 on the following terms :

(1) Blue will be given 40% share of the profit.

(2) Goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm.

The profits of the previous three years were as follows :

For the year ended 31.3.2018 — Profit ₹ 30,000 (after debiting loss of stock by fire ₹ 40,000).

For the year ended 31.3.2017 — Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.3.2016 — Profit ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

You are required to value the goodwill.

Solution **Calculation of Normal Profits**

Year ended on 31st March	2018 (₹)	2017 (₹)	2016 (₹)
Profit / Loss for the year	30,000	(80,000)	1,05,000
Add : Abnormal loss of stock by fire	40,000	—	—
Add : Voluntary retirement compensation	—	1,10,000	—
Less : Profit on sale of assets	—	—	25,000
Normal Profits	70,000	30,000	80,000

Normal Average Profit = ₹ (70,000 + 30,000 + 80,000) /3 = ₹ 60,000

Goodwill = 2 years' purchase of 3 years' normal average profit = ₹ 60,000 × 2 = ₹ 1,20,000.

The main disadvantage of the above method of valuation of goodwill is that any trend in the level of profitability is not reflected. If the simple average is used, i.e., each year's profits are given the same weightage, no discrimination is made between a business that has rising profits and one that has falling profits. To avoid this, weighted average profit can be calculated by giving more weightage to the profits of recent years.

The weighted average is calculated as follows :

$$\text{Weighted Average Profit} = \frac{\text{Total Products (Profit} \times \text{Weight)}}{\text{Total Weights}}$$

In this case, goodwill is calculated as follows :

Goodwill = Weighted Average Profit × Number of years' Purchase

Illustration 26

Sachin and Sourav are partners sharing profits and losses in the ratio of 3 : 2 and for the last four years they have been entitled to annual salaries of ₹ 1,20,000 and ₹ 1,00,000 respectively. The annual accounts have shown the following net profit before charging partners' salaries :

Year ended on 31st December 2015 — ₹ 3,50,000; 2016 — ₹ 2,45,000; and 2017 — ₹ 3,20,000.

On 1st January, 2018 David is admitted to the partnership for 2/5 shares (without any salary). The goodwill for this purpose is to be valued at 4 years' purchase of weighted average profit of last three years (after allowing same salaries to partners); profits to be weighted as 1 : 2 : 3, the greatest weight being given to the last year. Calculate the value of goodwill.

Solution **Calculation of Weighted Average Profit**

Year	Profits before Salary	Salary	Profits after Salary	Weights	Products
2015	3,50,000	2,20,000	1,30,000	1	1,30,000
2016	2,45,000	2,20,000	25,000	2	50,000
2017	3,20,000	2,20,000	1,00,000	3	3,00,000
				6	4,80,000

Weighted Average Profit = ₹ 4,80,000 / 6 = ₹ 80,000.

Goodwill = Weighted Average Profit × Number of Years' Purchase = ₹ 80,000 × 4 = ₹ 3,20,000.

(b) Super Profit Method Under this method goodwill is calculated by multiplying the 'super profit' by a certain number of years' purchase as agreed by the partners. 'Super profit' is the excess of actual profit over the normal profit. The super profit is the return from risking money in a business over and above that could be earned by depositing that money elsewhere at a fixed rate of interest. For calculating goodwill under this method, the following steps are followed :

Step 1 : Calculate capital employed.
Step 2 : Calculate normal profit by multiplying capital employed with normal rate of return.
Step 3 : Calculate average maintainable profit of the firm.
Step 4 : Calculate the difference between the average maintainable profit and normal return as calculated above. This difference is called ***super-profit*** (if it is positive).
Step 5 : Multiply that super profit by the number of years' purchase. The product will be called ***goodwill***.

Illustration 27

X and Y are partners sharing profits and losses equally. They decide to admit Z for an equal share. For this purpose the goodwill of the firm is to be valued at 4 years' purchase of super profit. The capital employed in the firm is ₹ 2,00,000. The normal rate of return may be taken as 12% p.a. Average maintainable profit of the firm is ₹ 30,000. Calculate the value of goodwill.

Solution

Capital employed = ₹ 2,00,000 (given)
Normal profit = Capital employed × normal rate of return = ₹ 2,00,000 × 12% = ₹ 24,000
Average maintainable profit = ₹ 30,000 (given)
Super profit = Average maintainable profit – normal profit = ₹ 30,000 – ₹ 24,000 = ₹ 6,000
Goodwill = Super profit × No. of years' purchase = ₹ 6,000 × 4 = ₹ 24,000.

Illustration 28

A firm earned net profits during the last five years as follows :
I — ₹ 7,000; II — ₹ 6,500; III — ₹ 8,000; IV — ₹ 7,500; and V — ₹ 6,000.

The capital investment of the firm is ₹ 40,000. A fair return on capital in the market is 12%. Find out the value of goodwill of the business if it is based on three years' purchase of average super profits of the past five years.

Solution

Total profit for the last 5 years = ₹ (7,000 + 6,500 + 8,000 + 7,500 + 6,000) = ₹ 35,000.
Average maintainable profit = ₹ 35,000 / 5 = ₹ 7,000.
Capital employed = ₹ 40,000 (given)
Normal profit = Capital employed × Expected rate of return = ₹ 40,000 × 12% = ₹ 4,800
Super profit = Average profit — Normal profit = ₹ 7,000 – ₹ 4,800 = ₹ 2,200.
Goodwill = Super profit × No. of years' purchase = ₹ 2,200 × 3 = ₹ 6,600.

Illustration 29

On April 1, 2018, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. The Partners' Capital Accounts showed a balance of ₹ 60,000 and reserve constituted the rest. If the normal rate of return is 10% and the goodwill of the firm is ₹ 24,000 at 4 years' purchase of super profits, find the average profits of the firm.

Solution

Goodwill is 4 years' purchase of super profits, which is ₹ 24,000.
Therefore, Goodwill = Super profits × 4
or, ₹ 24,000 = Super profits × 4
or, Super profits = ₹ 24,000 / 4 = ₹ 6,000.
Again, Normal profits = Capital employed × Normal rate of return
= (Capital + Reserve) × 10% = ₹ 75,000 × 10% = ₹ 7,500.
Super profits are the excess of average profits over normal profits.
Therefore, Super profits = Average profits – Normal profits
or, ₹ 6,000 = Average profits – ₹ 7,500
or, Average profits = ₹ 7,500 + ₹ 6,000 = ₹ 13,500.

Illustration 30

On 1st April, 2018, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. Its creditors amounted to ₹ 5,000 on that date. The firm had a reserve fund of ₹ 10,000 while Partners' Capital Accounts showed a balance of ₹ 60,000. If the normal rate of return is 20% and the goodwill of the firm is valued at ₹ 24,000, at 4 years' purchase of super profit, find the average profits per year of the existing firm.

Solution

Goodwill is 4 years' purchase of super profits, which is ₹ 24,000.
Therefore, Goodwill = Super profits × 4
or, ₹ 24,000 = Super profits × 4
or, Super profits = ₹ 24,000 / 4 = ₹ 6,000
Again, Normal profits = Capital employed × Normal rate of return
= (Capital + reserve) × 20%
= (₹ 60,000 + 10,000) × 20%
= ₹ 14,000.
Super profits are the excess of average profits over normal profits.
Therefore, Super profits = Average profits – Normal profits.
or, ₹ 6,000 = Average profits – ₹ 14,000.
or, Average profits = ₹ 14,000 + ₹ 6,000 = ₹ 20,000.

Illustration 31

The following particulars are available in respect of the business carried by A and K.

(i) Capital employed ₹ 3,00,000.
(ii) Trading profit : 2014 — ₹ 61,000; 2015 — ₹ 75,000; 2016 — ₹ 10,000 (Loss) and 2017 — ₹ 1,05,000.
(iii) Rate of return on capital invested in this type of business 12%.
(iv) Remuneration from alternative employment of the partners who are engaged full time in this business ₹ 18,000 p.a.

You are required to calculate the value of goodwill on the basis of 3 years' purchase of super profits of the business calculated on the average profit of the last 4 years.

Solution

Calculation of Average Profits

Particulars	₹
2014	61,000
2015	75,000
2016	(10,000)
2017	1,05,000
	2,31,000
Average Profit = ₹ 2,31,000 / 4 = 57,750	

Calculation of Super Profit

Particulars	₹
Average Profits	57,750
Less: Remuneration of alternative employment	18,000
Average Trading Profits	39,750
Less: Normal Interest @ 12% on ₹ 3,00,000	36,000
Super Profits	3,750
Goodwill = 3 years' purchase of super profits = ₹ 3,750 × 3 = ₹ 11,250.	

(c) Capitalization of Average Profit Method Under this method, the firm is valued by applying the following formula :

$$\text{Total value of the firm} = \frac{\text{Average maintainable profit}}{\text{Normal rate of return}} \times 100$$

After calculating the value of the firm in the above manner, the net assets of the firm is deducted from this and the balance is goodwill.

Now, if we take the above example then the total value of the firm will be:
15,000/10 x 100 = ₹ 1,50,000. The net assets of the firm are ₹ 1,00,000.
Therefore, the value of goodwill will be ₹ 1,50,000 – ₹ 1,00,000 = ₹ 50,000.

(d) Capitalization of Super-profits Method Under this method, goodwill is calculated by capitalizing super-profits at agreed rate. The goodwill is calculated directly by applying the following formula:

$$\text{Goodwill} = \frac{P - rc}{m}$$

where, P = Adjusted forecast maintainable profit;
r = Normal rate of return;
c = Capital employed;
m = Capitalization ratio.

Illustrative Example 1

(i) The adjusted forecast maintainable profit is ₹ 40,000; (ii) Capital employed is ₹ 2,00,000; (iii) Normal rate of return is 15%; and (iv) Capitalization rate is 20%. Calculate goodwill.

$$\text{Goodwill} = \frac{40{,}000 - 15\% \times 2{,}00{,}000}{20\%} = ₹\ 50{,}000$$

(e) Annuity Method Under this method, goodwill is calculated by taking the average super-profit as the value of an annuity over a certain number of years. The present value of the above annuity, discounted at the given rate of interest (normal rate of return) is the value of the goodwill.

Therefore, the value of the goodwill is: Average super-profits x Annuity.

The following formula can also be applied for valuing goodwill:

$$V = \frac{a}{i}\left[1 - \frac{1}{(1 + i)^n}\right]$$

where, V = Value of Goodwill;
a = Average super profit;
i = Rate of interest per annum
n = Number of years.

Illustrative Example 2

The net profits of a business, after providing for income-tax for the last 5 years were: ₹ 80,000; ₹ 1,00,000; ₹ 1,20,000; ₹ 1,25,000 and ₹ 2,00,000 respectively. The capital exmployed in the business is ₹ 10,00,000 and the normal rate of return is 10%. Calculate the value of the goodwill on the basis of the annuity method taking the present value of the annuity of Re 1 for 5 years at 10% is 3.7907 (approx).

Solution

Total profits for the 5 years	₹ 6,25,000
Average profit (₹ 6,25,000/5)	₹ 1,25,000
Less: Normal return (10% on ₹ 10,00,000)	₹ 1,00,000
Average super-profit	₹ 25,000

Therefore, goodwill = Average super-profit x annuity = ₹ 25,000 x 3.7907 (approx) = ₹ 94,768 (approx).

Alternatively, Given that: a = ₹ 25,000; n = 5; and i = 10%. Therefore, the value of goodwill will be as follows:

$$V = ₹\ \frac{25{,}000}{10\%}\left[1 - \frac{1}{(1 + 10\%)^5}\right] = ₹\ 94{,}770 \text{ (approx.)}$$

Illustrative Example 3

A partnership firm is about to admit more partners and decides that goodwill is to be raised in the books. The partners are considering 3 different methods of calculating each:

(a) On the basis of two years' purchase of the average profits over the last 5 consecutive years. These were: 2017 — ₹ 36,000; 2016 — ₹ 28,000; 2015 — ₹ 26,000; 2014 — ₹ 38,000; 2013 — ₹ 46,000.

(b) On the basis of three years' purchase of total super-profits of the last 5 years. For this purpose the normal profit is to be taken as ₹ 30,000 p.a.

(c) On the basis of capitalizing the average super-profit. For this purpose the following information is provided: (i) adjusted forecast maintainable profits ₹ 60,000; (ii) normal rate of return 20%; (iii) capital employed ₹ 2,00,000; and (iv) the capitalisation rate 25%.

You are required to calculate the value of the goodwill on the basis of each of the 3 methods (a) to (c) above.

Solution

(a) Total profit of the last 5 years = ₹ 1,74,000. Average profit is ₹ 1,74,000/5 = ₹ 34,800. Therefore, goodwill = ₹ 34,800 x 2 = ₹ 69,600.

(b) Average profit (as above) = ₹ 34,800 Less: Normal profit ₹ 30,000 = Super-profit ₹ 4,800. The total super-profits for 5 years = ₹ 4,800 x 5 = ₹ 24,000. Therefore, Goodwill = ₹ 24,000 x 3 = ₹ 72,000.

(c) Applying the formula: $Goodwill = \dfrac{P - rc}{m}$

{₹ 60,000 – (₹ 2,00,000 × 20%)}/25% = ₹ (60,000 – ₹ 40,000)/.25 = ₹ 80,000.

where, P = Adjusted forecast maintainable profit;
r = Normal rate of return;
c = Capital employed;
m = Capitalization ratio.

The Admission of a New Partner and Treatment of Goodwill

At the time of admission of a partner, an adjustment is necessary in respect of goodwill. The goodwill can be treated in the books of account in any of the following manner :

Case 1 : When premium for goodwill is paid privately.

Case 2 : When premium of goodwill is paid and retained in the business.

Case 3 : When premium for goodwill is paid and withdrawn by the old partners.

Case 4 : When the incoming partner cannot bring premium for goodwill.

Case 5 : When a loan account is raised in the name of the incoming partner.

Case 6 : Hidden goodwill.

Case 7 : Goodwill raised and written-off.

Case 8 : When the incoming partner brings personal goodwill into the business.

Case 9 : When goodwill appears in the old Balance Sheet and the incoming partner pays premium for goodwill or pays partly the premium for goodwill.

Case 10 : When the incoming partner can bring only a portion of the required amount of premium for goodwill. There is no goodwill appearing in the Balance Sheet.

Case 1 : When premium for goodwill is paid privately

Sometimes, the new partner may pay premium to the old partners privately. In this case, no entry is passed in the books of the firm as it is not a transaction of the firm.

Case 2 : When premium for goodwill is paid and retained in the business

When cash is brought in by the new partner for goodwill, it is called premium. This premium is to be shared by the existing partners in the sacrificing ratio. The sacrificing ratio is to be calculated by deducting new ratio from old ratio for each partner.

Accounting Entries

1. For premium for goodwill brought in cash by the new partner

Cash / Bank Account Dr. [Actual amount of premium]
To Premium for Goodwill Account

2. For capital brought in cash by the new partner

Cash / Bank Account Dr. [Actual amount of capital]
To New Partners' Capital Account

3. For sharing of premium for goodwill

Premium for Goodwill Account Dr. [Actual amount of premium]
To Old Partners' Capital Account [Sacrificing ratio]

Illustration 32

Sachin and Kapil are partners sharing profits and losses in the ratio of 2 : 1. They agree to admit Amit into partnership who brings in ₹ 24,000 for 1/4th share of goodwill.

Make necessary journal entries to record the above transactions.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr. To Premium for Goodwill A/c (Being the amount of premium for goodwill brought in by Amit)		24,000	24,000

	Premium for Goodwill A/c Dr. To Sachin Capital A/c (Note 1) To Kapil Capital A/c (Being the premium for goodwill brought in by Amit, shared by Sachin and Kapil on the basis of their sacrifice)		24,000	 16,000 8,000

Working Note : (1) Since there is no change in the profit sharing ratio between Sachin and Kapil, their old ratio will be their sacrificing ratio.

Illustration 33

On 1st January, 2018, A and B sharing profits two-thirds and one-third respectively, agree to admit C into partnership on condition that he pays ₹ 30,000 as capital and ₹ 9,000 for one-sixth share of goodwill which he acquires equally from A and B. Give journal entries necessary to record these transactions.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2018 Jan. 1	Bank A/c Dr. To Premium for Goodwill A/c To C Capital A/c (Being the amount of premium for goodwill and capital brought in by C)		39,000	 9,000 30,000
"	Premium for Goodwill A/c Dr. To A Capital A/c To B Capital A/c (Being the premium for goodwill brought in by C, shared by A and B on the basis of their sacrifice)		9,000	 4,500 4,500

Illustration 34

A and B are in partnership with capitals of ₹ 10,000 and ₹ 6,000 and sharing profits two-thirds and one-third respectively. On 1st January, 2018, they agree to admit C into partnership with a one-sixth share on condition that he brings in ₹ 5,500 (₹ 4,000 to represent his capital and ₹ 1,500 to represent goodwill). The whole of ₹ 5,500 is to remain in the business.

Give journal entries to record these transactions, the relative shares of A and B remaining the same as before and state the future shares of the partners.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2018 Jan. 1	Bank A/c Dr. To C Capital A/c To Premium for Goodwill A/c (Being the amount of capital and premium for goodwill brought in by C)		5,500	 4,000 1,500
"	Premium for Goodwill A/c Dr. To A Capital A/c (Note 1) To B Capital A/c (Note 1) (Being the premium for goodwill shared by the old partners on the basis of their sacrifice)		1,500	 1,000 500

Working Note : (1) Since the profit sharing ratio between A and B does not change after the admission of C, their old profit sharing ratio is their sacrificing ratio.

Calculation of New Profit Sharing Ratio :

C joins the business for 1/6th share. The remaining 5/6th (1 – 1/6) will be shared by A and B in the ratio of 2 : 1. Therefore, the new profit sharing ratio among A, B and C is as under : A — $5/6 \times 2/3 = 10/18$; B — $5/6 \times 1/3 = 5/18$; C = 1/6 or, A : B : C = 10 : 5 : 3.

Illustration 35

X and Y are partners sharing profits and losses in the ratio of 3 : 2. Z is coming in as a new partner who pays ₹ 25,000 as premium for goodwill. The profit sharing ratio among X, Y and Z is equal.

Pass necessary journal entries assuming that premium money is retained in the business.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Cash A/c Dr. To Premium for Goodwill A/c (Being the amount of premium for goodwill brought in by Z)		25,000	 25,000
	Premium for Goodwill A/c Dr. To X Capital A/c (Note 1) To Y Capital A/c (Note 1) (Being the premium for goodwill shared by X and Y in the ratio of 4 : 1)		25,000	 20,000 5,000

Working Note : (1) The premium for goodwill of ₹ 25,000 brought in by Z is to be shared by X and Y in the ratio of their sacrifice which is calculated as under :

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
X	3/5	1/3	3/5 – 1/3 = 4/15 (Sacrifice)	X : Y
Y	2/5	1/3	2/5 – 1/3 = 1/15 (Sacrifice)	= 4 : 1
Z	—	1/33	0 – 1/3 = 5/15 (Gain)	

X will get 4/5th of ₹ 25,000 = ₹ 20,000; Y will get 1/5th of ₹ 25,000 = ₹ 5,000.

Illustration 36

A, B and C are partners, sharing profits in the ratio of 4 : 3 : 2. D is admitted as a partner who brings in ₹ 30,000 as his capital and ₹ 10,000 for his share of goodwill. The new profit sharing ratio will be A, B, C and D = 3 : 2 : 2 : 2.

Journalise the above arrangement in the books.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr. To D Capital A/c To Premium for Goodwill A/c (Being the amount of capital and premium for goodwill brought in by D)		40,000	 30,000 10,000
	Premium for Goodwill A/c (Note 1) Dr. To A Capital A/c To B Capital A/c (Being the premium for goodwill credited to A and B on the basis of their sacrifice)		10,000	 5,000 5,000

Working Note : (1) The premium for goodwill of ₹ 10,000 brought in by D will be shared by the existing partners in the sacrificing ratio. Sacrificing ratio is calculated as follows :

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	4/9	3/9	4/9 – 3/9 = 1/9 (Sacrifice)	A : B
B	3/9	2/9	3/9 – 2/9 = 1/9 (Sacrifice)	= 1 : 1
C	2/9	2/9	2/9 – 2/9 = Nil	
D	—	2/9	0 – 2/9 = 2/9 (Gain)	

The premium for goodwill will be shared between A and B equally. C will not get anything because he does not sacrifice anything.

Alternatively,

The premium for goodwill to be shared by the existing partners can be ascertained as follows :

D brings in ₹ 10,000 as premium for goodwill for 2/9th share. Therefore, the total value of goodwill of the firm = ₹ 10,000 × 9/2 = ₹ 45,000. The sharing of premium money is calculated as follows :

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before admission (4 : 3 : 2)	20,000	15,000	10,000	—
Right of goodwill after admission (3 : 2 : 2 : 2)	15,000	10,000	10,000	10,000
Sacrifice (–) / Gain (+)	(–) 5,000	(–) 5,000	—	(+)10,000

In this method there is no need of calculating sacrificing ratio. The amount of premium to be shared can be calculated directly. Therefore, A will get ₹ 5,000 and B will get ₹ 5,000.

Illustration 37

P and Q are in partnership sharing profits and losses in the ratio 4 : 1. They admit R into the firm, R paying a premium of ₹ 60,000 for an equal share. Draft journal entries showing the appropriation of premium money.

Solution

R pays ₹ 60,000 as Premium for Goodwill. Therefore, total value of the Goodwill is ₹ 60,000 x 3/1 = ₹ 1,80,000. The future profit-sharing ratio among partners are equal and R is coming for 1/3rd share. The appropriation of premium money is calculated as:

Particulars	P (₹)	Q (₹)	R (₹)
Right of goodwill before admission (4 : 1)	1,44,000	36,000	—
Right of goodwill after admission (1 : 1 : 1)	60,000	60,000	60,000
Sacrifice (–) / Gain (+)	(–) 84,000	(+) 24,000	(+) 60,000

We get, the sacrifice of P is ₹ 84,000, of which he gives to Q (₹ 24,000) and to R (₹ 60,000). Therefore, entire premium money brought in by R to be credited to P. Also, Q is to pay P an amount equal to ₹ 24,000.

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

Date	Particulars		L.F.	₹	₹
	Bank A/c	Dr.		60,000	
	To Premium for Goodwill A/c				60,000
	(Being premium for goodwill brought in by R)				
	Premium for Goodwill A/c	Dr.		60,000	
	Q Capital A/c	Dr.		24,000	
	To P Capital A/c				84,000
	(Being the premium and the proportionate amount of Q's gain credited to P)				

Illustration 38

A, B and C are in partnership sharing profits and losses in the ratio of 5 : 4 : 1 respectively. Two new partners are introduced, D and E. The profits are now to be shared in the ratio of 3 : 4 : 2 : 2 : 1 respectively. D is to pay in ₹ 30,000 for his share of the Goodwill but E has insufficient cash to pay for Goodwill. Both the new partners introduced ₹ 40,000 each as their Capital. You are required to pass necessary journal entries (no Goodwill Account is to be opened).

Solution

In the books of the Firm

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

Date	Particulars		L.F.	₹	₹
	Bank A/c	Dr.		1,10,000	
	To D Capital A/c				40,000
	To E Capital A/c				40,000
	To Premium for Goodwill A/c				30,000
	(Being capital brought in by D and E @ ₹ 40,000 each and in addition D brought in premium for goodwill ₹ 30,000 for 1/6th share)				
	C Capital A/c	Dr.		12,000	
	E Capital A/c	Dr.		15,000	
	Premium for Goodwill A/c	Dr.		30,000	
	To A Capital A/c				45,000
	To B Capital A/c				12,000
	(Being the adjustment for goodwill)				

Working Notes : D is paying ₹ 30,000 for 2/12th share.
Therefore, total value of goodwill = ₹ 30,000 x 12/2 = ₹ 1,80,000

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	E (₹)
Right of goodwill before admission	90,000	72,000	18,000	—	—
Right of goodwill after admission	45,000	60,000	30,000	30,000	15,000
Sacrifice (–) / Gain (+)	(–) 45,000	(–) 12,000	(+) 12,000	(+) 30,000	(+) 15,000

Illustration 39

E and F are partners sharing profits and losses in the ratio of 4 : 1 respectively. G is admitted as a partner for which he pays ₹ 10,000 as premium for goodwill and in future E, F and G decide to share profits and losses in the ratio of 2 : 1 : 1 respectively.

You are required to pass a single journal entry to give effect to the above arrangement.

Solution

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bank A/c	Dr.		10,000	
	F Capital A/c	Dr.		2,000	
	To E Capital A/c				12,000
	(Being the premium and the proportionate amount of F's gain credited to E)				

Working Note :

(1) G brings in ₹ 10,000 as premium for goodwill for 1/4 share in the profit. Therefore, the total value of goodwill of the firm = ₹ 10,000 × 4/1 = ₹ 40,000. The ***sharing of premium money is calculated*** as under :

Particulars	E (₹)	F (₹)	G (₹)
Right of goodwill before admission (4 : 1)	32,000	8,000	—
Right of goodwill after admission (2 : 1 : 1)	20,000	10,000	10,000
Sacrifice (–) / Gain (+)	(–) 12,000	(+) 2,000	(+) 10,000

Case 3 : When premium for goodwill is paid and withdrawn by the old partners.

In this case also, the premium brought in by the new partner will be shared by the old partners in the sacrificing ratio. However, the premium money is not retained in the business fully or partly.

Accounting Entries

1. For premium for goodwill brought in cash by the new partner

Cash / Bank Account Dr. [Actual amount of premium]
To Premium for Goodwill Account

2. For capital brought in by the new partner

Cash / Bank Account Dr. [Actual amount of capital]
To New Partners' Capital Account

3. For sharing of premium for goodwill

Premium for Goodwill Account Dr. [Actual amount of premium]
To Old Partners' Capital Account [Sacrificing ratio]

4. For withdrawal of premium money fully / partly

Old Partners' Capital Account Dr. [Amount withdrawn]
To Cash / Bank Account

Illustration 40

Strong and Weak are partners sharing profits and losses in the ratio of 4 : 3. They admit Able into partnership for 1/5th share who pays ₹ 7,000 in cash for goodwill. Strong and Weak decide to share future profits equally between themselves. No Goodwill Account appears in the books. They withdrew the premium money from business. Pass necessary journal entries.

Solution

In the books of Strong, Weak and Able
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Cash A/c	Dr.		7,000	
	To Premium for Goodwill A/c				7,000
	(Being the amount of premium for goodwill brought in by Able)				
	Premium for Goodwill A/c	Dr.		7,000	
	To Strong Capital A/c (Note 1)				6,000
	To Weak Capital A/c (Note 1)				1,000
	(Being the premium for goodwill credited to the old partners on the basis of their sacrificing ratio 6 : 1)				
	Strong Capital A/c	Dr.		6,000	
	Weak Capital A/c	Dr.		1,000	
	To Cash A/c				7,000
	(Being the withdrawal of premium money by the partners)				

Working Note : (1) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
Strong	4/7	1/2 of 4/5 = 4/10	4/7 – 4/10 = 12/70 (Sacrifice)	Strong : Weak = 12 : 2 = 6 : 1
Weak	3/7	1/2 of 4/5 = 4/10	3/7 – 4/10 = 2/70 (Sacrifice)	
Able	—	1/5 or 2/10	0 – 2/10 = 14/70 (Gain)	

Illustration 41

A and B are equal partners. C is coming as a new partner who pays ₹ 8,000 as premium for goodwill. The new profit sharing ratio among A, B and C is 4 : 3 : 2. Pass necessary journal entries showing the appropriation of premium money assuming that the premium for goodwill is immediately withdrawn by the old partners.

Solution

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Cash A/c	Dr.		8,000	
	To Premium for Goodwill A/c				8,000
	(Being the premium for goodwill brought in by C)				
	Premium for Goodwill A/c (Note 1)	Dr.		8,000	
	To A Capital A/c				2,000
	To B Capital A/c				6,000
	(Being the premium for goodwill shared by A and B in the ratio of 1 : 3)				
	A Capital A/c	Dr.		2,000	
	B Capital A/c	Dr.		6,000	
	To Cash A/c				8,000
	(Being the premium withdrawn by A and B)				

Working Note : (1) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	1/2	4/9	1/2 – 4/9 = 1/18 (Sacrifice)	A : B = 1 : 3
B	1/2	3/9	1/2 – 3/9 = 3/18 (Sacrifice)	
C	—	2/9	0 – 2/9 = 4/18 (Gain)	

Illustration 42

X and Y are in partnership, sharing profits and losses in the ratio of 5 : 3. They admit Z into partnership and the new profit sharing ratio is 4 : 3 : 3. Value of goodwill is agreed at ₹ 10,000. Z contributes ₹ 20,000 as capital and necessary amount of premium, half of which is retained in the business. Show the journal entries.

Solution

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bank A/c	Dr.		23,000	
	To Z Capital A/c				20,000
	To Premium for Goodwill A/c				3,000
	(Being cash brought in by Z for his capital and share of premium for goodwill)				
	Premium for Goodwill A/c	Dr.		3,000	
	To X Capital A/c				2,250
	To Y Capital A/c				750
	(Being the premium for goodwill shared by X and Y in the ratio of 3 : 1)				
	X Capital A/c	Dr.		1,125	
	Y Capital A/c	Dr.		375	
	To Bank A/c				1,500
	(Being 1/2 of the premium for goodwill withdrawn by X and Y)				

Working Note : (1) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
X	5/8	4/10	5/8 – 4/10 = 18/80 (Sacrifice)	18 : 6 = 3 : 1
Y	3/8	3/10	3/8 – 3/10 = 6/80 (Sacrifice)	
Z	—	3/10	0 – 3/10 = 24/80 (Gain)	

Case 4 : When the incoming partner cannot bring premium for goodwill

In this case the necessary adjustment for goodwill is done through the Capital Accounts of the partners. The New Partner's Capital Account will be debited with his share of goodwill and the Old Partners' Capital Accounts will be credited in the sacrificing ratio.

No goodwill will be shown in the Balance Sheet after admission.

In this connection, Para 36 of AS—10 is very important. This para states 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 in excess of the value of the net assets of the business taken over, the excess should be termed as Goodwill'.

The effects of the above provision of AS—10 in Partnership Accounts are the following :

1. ***Only purchased goodwill to be recorded in the books of accounts.***
2. ***Non-purchased goodwill (internally generated goodwill) will be adjusted through Partners' Capital Accounts. In effect, this goodwill cannot be shown in the Partnership Balance Sheet.***

Accounting Entries

New Partner's Capital Account Dr. [Share of goodwill]
To Old Partners' Capital Account [Sacrificing ratio]

Illustration 43

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. Z joins the firm for 1/4th share and is to pay ₹ 25,000 as premium for goodwill but cannot pay anything. There is no goodwill in the current Balance Sheet. As between X and Y they decided to share profits and losses equally. You are required to pass necessary journal entry.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Z Capital A/c Dr.		25,000	
	To X Capital A/c (Note 1)			22,500
	To Y Capital A/c (Note 1)			2,500
	(Being the adjustment for goodwill on Z's admission)			

Working Notes :

(1) Z is admitted for 1/4 share in future profit. Therefore, 1 – 1/4 = 3/4 is available to X and Y which they will share equally.

X's share will be = 1/2 of 3/4 = 3/8
Y's share will be = 1/2 of 3/4 = 3/8
Z's share will be = 1/4 or 2/8
The new profit-sharing ratio = **3 : 3 : 2**.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
X	3/5	3/8	3/5 – 3/8 = 9/40 (Sacrifice)	X : Y = 9 : 1
Y	2/5	3/8	2/5 – 3/8 = 1/40 (Sacrifice)	
Z	—	2/8	0 – 2/8 = 10/40 (Gain)	

Illustration 44

Jadeja and Robin are partners sharing profits and losses in the ratio of 2 : 1. They admit Kapil as a partner who is unable to bring premium for goodwill in cash. Goodwill is to be valued at 2 years' purchase of the last three years' average profits. The profits for the last three years were ₹ 50,000, ₹ 40,000 and ₹ 45,000. The profit sharing ratio among the partners has been agreed to be 2 : 1 : 1. No goodwill will be shown in the Balance Sheet.

Calculate the value of goodwill and make necessary journal entries.

Solution

Total profits of last three years (₹ 50,000 + ₹ 40,000 + ₹ 45,000) = ₹ 1,35,000.
Average profit for the last three years = ₹ 1,35,000 / 3 = ₹ 45,000.
Goodwill = Average profit × No. of years' purchase = ₹ 45,000 × 2 = ₹ 90,000.

In the books of Jadeja, Robin and Kapil
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Kapil Capital A/c Dr. To Jadeja Capital A/c (Note 1) To Robin Capital A/c (Note 1) (Being the adjustment for Goodwill on Kapil's admission)		22,500	 15,000 7,500

Working Note : **(1) Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
Jadeja	2/3	2/4	2/3 – 2/4 = 2/12 (Sacrifice)	Jadeja : Robin = 2 : 1
Robin	1/3	1/4	1/3 – 1/4 = 1/12 (Sacrifice)	
Kapil	—	1/4	0 – 1/4 = 3/12 (Gain)	

Kapil's share of goodwill = ₹ 90,000 × 1/4 = ₹ **22,500**.

Case 5 : When a loan account is raised in the name of the incoming partner.

In this case, a Loan Account is opened in the name of the new partner. An amount equal to premium for goodwill is debited to Loan Account and credited to Premium for Goodwill Account. The amount of premium is distributed amongst the old partners in the sacrificing ratio.

Journal Entries

(1) New Partner's Loan Account Dr. [Share of goodwill]
To Premium for Goodwill Account [Share of goodwill]
(2) Premium for Goodwill Account Dr. [Share of goodwill]
To Old Partners' Capital Account [Sacrificing ratio]
Alternatively,
New Partner's Loan Account Dr. [Share of goodwill]
To Old Partners' Capital Account [Sacrificing ratio]

Illustration 45

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. C is admitted for 1/4 share and he is to pay ₹ 20,000 as premium for goodwill. He was not in a position to pay premium in cash. It was decided that a Loan Account is to be opened for this purpose. You are required to pass necessary journal entries to record the above.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	C Loan A/c Dr. To Premium for Goodwill A/c (Being the amount of premium debited to C's Loan A/c)		20,000	 20,000
	Premium for Goodwill A/c Dr. To A Capital A/c (Note 1) To B Capital A/c (Note 1) (Being the premium for goodwill credited to Partners' Capital A/cs in the sacrificing ratio)		20,000	 12,000 8,000

Working Note :

(1) Profit sharing ratio between A and B is not changing. Therefore, the sacrificing ratio will be the old profit sharing ratio, i.e., 3:2.
A' share of premium = ₹ 20,000 × 3/5 = ₹ 12,000
B's share of premium = ₹ 20,000 × 2/5 = ₹ 8,000
Alternatively, the above amount can be calculated as follows :
Total value of goodwill = ₹ 20,000 × 4/1 = ₹ **80,000**.

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	48,000	32,000	—
Right of goodwill after admission (9 : 6 : 5*)	36,000	24,000	20,000
Sacrifice (–) / Gain (+)	(–) 12,000	(–) 8,000	(+) 20,000

*New profit sharing ratio :

1 – 1/4 = 3/4

A's share = 3/5 of 3/4 9/20

B's share = 2/5 of 3/4 6/20

C's share = 1/4 5/20

Illustration 46

J and R are partners. V is admitted as a partner for 1/4 share of profit but is unable to contribute premium for goodwill in cash amounting to ₹ 8,000 and so it is decided to raise a Loan Account in the name of V.

You are required to pass a single journal entry in order to give effect to the above problem.

Solution

In the books of the Firm

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	V Loan A/c Dr.		8,000	
	To J Capital A/c			4,000
	To R Capital A/c			4,000
	(Being the adjustment for premium for goodwill)			

Working Note : Profit sharing ratio has not been given. Therefore, profit sharing ratio between J and R is 1 : 1. After admission of V, profit sharing ratio between J and R is not changing. Therefore, the sacrificing ratio will be the old ratio, i.e., 1 : 1.

Case 6 : Hidden Goodwill

In some cases, the value of goodwill is not given in the question. This hidden goodwill is calculated with reference to the total capital of the firm and the profit sharing ratio. The following examples will clear the matter.

Illustration 47

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. Their capitals are ₹ 1,20,000 and ₹ 80,000 respectively. They admit Z as a new partner who will get 1/6th share in the profits of the firm. Z brings in ₹ 50,000 as his capital.

Find out the amount of goodwill on the basis of the above information.

Solution

Z brings ₹ 50,000 as his capital for 1/6th share of profit. Therefore, total capital of the firm will be ₹ 50,000 × 6/1 = ₹ 3,00,000 and the capital of the old partners should be ₹ 2,50,000 (₹ 3,00,000 – 50,000). But the combined capital of old partners is ₹ 2,00,000 (₹ 1,20,000 + 80,000).

Therefore, the goodwill of the firm should be ₹ 2,50,000 – ₹ 2,00,000 = ₹ 50,000.

Illustration 48

A and B are partners with capitals of ₹ 13,000 and ₹ 9,000 respectively. They admit C as a partner with 1/5th share in the profits of the firm. C brings in ₹ 8,000 as capital. Give journal entries to record goodwill.

Solution

C brings in ₹ 8,000 as capital for 1/5th share of profit. Therefore, the total capital of the firm will be ₹ 8,000 × 5/1 = ₹ 40,000 and the capitals of the old partners should be ₹ 32,000 (₹ 40,000 – ₹ 8,000). But their combined capital is ₹ 22,000 (₹ 13,000 + ₹ 9,000). In effect, the goodwill of the firm will be ₹ 32,000 – ₹ 22,000 = ₹ 10,000.

Since C joins the business for 1/5th share, ₹ 2,000 (₹ 10,000 × 1/5) will be treated as premium for goodwill, out of ₹ 8,000 capital brought in by him.

In the books of the Firm

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr.		8,000	
	To C Capital A/c			6,000
	To Premium for Goodwill A/c			2,000
	(Being the amount of capital and premium for goodwill brought in by C)			

	Premium for Goodwill A/c Dr.
	    To A Capital A/c
	    To B Capital A/c
	(Being the premium for goodwill credited to the old partners on the basis of their sacrifice, i.e., equally)
			2,000	
				1,000
				1,000

Case 7 : Goodwill raised and written-off

When the new partner can not bring premium for goodwill, the adjustments for goodwill can be done by raising and writing-off goodwill.

In this case, goodwill is raised at its full value by crediting the old partners in the old ratio and immediately it is written-off by debiting all the partners (including new partner) in the new ratio.

Journal Entries

(a) ***For raising goodwill in the books at its full value***

Goodwill Account Dr. [Full value]
    To Old Partners' Capital Account [Old ratio]

(b) ***For writing-off goodwill***

All Partners' Capital Account Dr. [New ratio]
    To Goodwill Account [Full value]

Illustration 49

A, B and C are partners sharing profits and losses in the ratio of 2 : 2 : 1. D is admitted as a partner. The new profit sharing ratio is 2 : 2 : 1 : 1. The total value of goodwill is ₹ 1,20,000.

Pass necessary journal entries to record the above.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹

	Goodwill A/c Dr.
	    To A Capital A/c
	    To B Capital A/c
	    To C Capital A/c
	(Being the raising of goodwill at its full value)
			1,20,000	
				48,000
				48,000
				24,000

	A Capital A/c Dr. B Capital A/c Dr. C Capital A/c Dr. D Capital A/c Dr. To Goodwill A/c (Being the writing-off of the full value of goodwill in the new profit sharing ratio)		40,000 40,000 20,000 20,000	 1,20,000

Illustration 50

A and B are partners sharing profits and losses in the ratio of 3 : 2. They admit C as a partner who is unable to bring goodwill in cash but pays ₹ 16,000 as his capital. A Goodwill Account is raised in the books of the firm. Goodwill of the firm is valued at two years' purchase of three years' profits. The profits for the three years were ₹ 10,000; ₹ 8,000 and ₹ 9,000. The new profit sharing ratio will be 5 : 2 : 2. The partners decided to write off goodwill after C's admission.

Make journal entries.

Solution

Average profit = (₹ 10,000 + ₹ 8,000 + ₹ 9,000) / 3 = ₹ 9,000.

Value of Goodwill = Two year's purchase of average profit = ₹ 9,000 × 2 = ₹ **18,000**.

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr. To C Capital A/c (Being cash brought in by C as his capital)		16,000	 16,000

	Goodwill A/c Dr.		18,000	
	To A Capital A/c			10,800
	To B Capital A/c			7,200
	(Being the raising of goodwill at its full value)			
	A Capital A/c Dr.		10,000	
	B Capital A/c Dr.		4,000	
	C Capital A/c Dr.		4,000	
	To Goodwill A/c			18,000
	(Being the writing off of the full value of goodwill in the new profit sharing ratio)			

Case 8 : When the incoming partner brings personal goodwill into the business

At the time of admission, the new partner may bring some assets and liabilities and his personal goodwill. All the assets and liabilities including goodwill is recorded in the books of the firm at agreed value. The difference between the assets and liabilities will be treated as capital of the new partner. However, after recording the goodwill, it is written in the new ratio.

Illustration 51

X and Y are partner of a firm sharing profits and losses in the ratio 2 : 1. They admit Z for 1/4th share of profit.

Z brought into partnership —

Book debts of — ₹ 40,000; Computers of — ₹ 50,000;

Goodwill of his connection valued at — ₹ 30,000 (as agreed by X and Y)

Balance in cash, so as to make his capital of — ₹ 1,50,000.

Pass necessary journal entry to record the above (assume that no goodwill is to be shown in the books of account)

Solution

In the books of the Firm

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Goodwill A/c Dr.		30,000	
	Sundry Debtors A/c Dr.		40,000	
	Computers A/c Dr.		50,000	
	Cash A/c (Balancing figure) Dr.		30,000	
	To Z Capital A/c			1,50,000
	(Being different assets brought in by Z as his capital)			
	X Capital A/c Dr.		15,000	
	Y Capital A/c Dr.		7,500	
	Z Capital A/c Dr.		7,500	
	To Goodwill A/c			30,000
	(Being the goodwill written-off in the new ratio 2 : 1 : 1)			

Case 9 : When goodwill appears in the Old Balance Sheet and the incoming partner pays premium for goodwill or pays partly the premium for goodwill

In rare case it may happen that the new partner is bringing premium for goodwill though the goodwill is appearing in the Balance Sheet.

In this situation the following steps are followed :

Step 1 : Write-off the goodwill already appearing in the Balance Sheet.

Old Partners' Capital Account Dr. [Old ratio]
To Goodwill Account

Step 2 : Record the premium brought-in by the new partner

Cash / Bank Account Dr.
To Premium for Goodwill Account

Step 3 : Distribute the premium for goodwill among the old partners in the sacrificing ratio

Premium for Goodwill Account Dr.
To Old Partners' Capital Account [Sacrificing ratio]

Step 4 : If part of the premium for goodwill brought-in by the new partner, pass adjusting entry for ***premium not brought-in***

New Partner's Capital Account Dr. [Premium not brought-in]
To Old Partners' Capital Account [Sacrificing ratio]

Note : No goodwill will be shown in the Balance Sheet as per AS—10.

Illustration 52

A and B are partners sharing profits equally. They admit C into partnership, C paying only ₹ 1,000 for premium out of his share of premium of ₹ 1,800 for 1/4th share of profit. Goodwill Account appears in the books at ₹ 6,000. All the partners have decided that goodwill should not appear in the new firm's books.

Give the necessary journal entries.

Solution

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Goodwill A/c (Note 1)	Dr.		6,000	
	To A Capital A/c				3,000
	To B Capital A/c				3,000
	(Being the goodwill written-off in the ratio 1 : 1)				
	Bank A/c	Dr.		1,000	
	To Premium for Goodwill A/c				1,000
	(Being the premium for goodwill brought-in by the new partner)				
	Premium for Goodwill A/c	Dr.		1,000	
	To A Capital A/c				500
	To B Capital A/c				500
	(Being the distribution of premium for goodwill in the sacrificing ratio 1 : 1)				
	C Capital A/c	Dr.		800	
	To A Capital A/c				400
	To B Capital A/c				400
	(Being the adjustment for premium for goodwill not brought in cash)				

Working Notes :

(1) New Profit-Sharing Ratio :

C joins for 1/4 share. Therefore 3/4 (1 – 1/4) share remains for A and B.

A's share = 3/4 × 1/2 = 3/8 B's share = 3/4 × 1/2 = 3/8 C's share = 1/4 or 2/8

New profit-sharing ratio = A : B : C = **3 : 3 : 2**.

(2) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	1/2	3/8	1/2 – 3/8 = 1/8 (Sacrifice)	A : B
B	1/2	3/8	1/2 – 3/8 = 1/8 (Sacrifice)	= 1 : 1
C	—	2/8	0 – 1/4 = 2/8 (Gain)	

Illustration 53

P and S are partners sharing profits in the ratio of 3 : 2. Their books showed goodwill at ₹ 20,000. R is admitted with 1/5th share which he acquires equally from P and S. R brings in ₹ 20,000 as his capital and ₹ 10,000 as his share of goodwill. You are required to give journal entries to carry out the above arrangement.

Solution

In the books of P, S and R
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	P Capital A/c	Dr.		12,000	
	S Capital A/c	Dr.		8,000	
	To Goodwill A/c				20,000
	(Being the goodwill written off before R's admission)				
	Bank A/c	Dr.		30,000	
	To R Capital A/c				20,000
	To Premium for Goodwill A/c				10,000
	(Being the amount of capital and premium for goodwill brought in by R)				

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Premium for Goodwill A/c Dr. To P Capital A/c To S Capital A/c (Being the premium for goodwill shared by the old partners on the basis of their sacrifice, i.e., equally)		10,000	 5,000 5,000

Tutorial Note : When goodwill is to be written off before admission of new partner (as appearing in the Balance Sheet), it should be debited to Old Partners' Capital Account in ***old ratio***.

Illustration 54

B and C are partners sharing profits in the ratio of 3 : 2. Goodwill appears in the books at ₹ 3,000. D is admitted into partnership on payment of ₹ 20,000 for goodwill for 1/4th share. B and C are sharing profits between themselves in the same proportion as before.

(a) Calculate the sacrificing ratio; and

(b) Record the transactions assuming Goodwill Account will not appear in the books of B, C and D.

Solution

(a) Since the profit sharing ratio between B and C does not change after the admission of D, their old profit sharing ratio will be their sacrificing ratio, i.e., 3 : 2.

In the books of B, C and D
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	B Capital A/c Dr. C Capital A/c Dr. To Goodwill A/c (Being the goodwill written off before D's admission)		1,800 1,200	 3,000
	Cash A/c Dr. To Premium for Goodwill A/c (Being the amount of premium for goodwill brought in by D)		20,000	 20,000
	Premium for Goodwill A/c Dr. To B Capital A/c To C Capital A/c (Being the premium for goodwill shared by the old partners on the basis of their sacrifice)		20,000	 12,000 8,000

Illustration 55

A and B are partners sharing profits in the ratio of 5 : 3. They admit C as a partner. C pays a premium of ₹ 1,500 for 1/4th share of profit, which he acquires from A and B in equal proportions. Goodwill Account appears in the books at ₹ 1,600. Give the necessary journal entries.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	A Capital A/c Dr. B Capital A/c Dr. To Goodwill A/c (Being the goodwill written off before C's admission)		1,000 600	 1,600
	Bank A/c Dr. To Premium for Goodwill A/c (Being the premium for goodwill brought in by C)		1,500	 1,500
	Premium for Goodwill A/c Dr. To A Capital A/c (Note 1) To B Capital A/c (Note 1) (Being the premium for goodwill shared by the old partners on the basis of their sacrifice)		1,500	 750 750

Working Note :

(1) Premium for goodwill ₹ 1,500 will be shared by A and B equally because C acquired 1/4th share in equal proportions.

Illustration 56

A and B are partners sharing profits in the ratio of 3 : 2. They admit C into partnership. C pays a premium of ₹ 1,000 for 1/4th share of profit. The new ratio is 3 : 3 : 2. Goodwill Account appears in the books at ₹ 1,000. Pass necessary journal entries.

Solution

In the books of A, B and C
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A Capital A/c	Dr.		600	
	B Capital A/c	Dr.		400	
	To Goodwill A/c				1,000
	(Being the goodwill written off before C's admission)				
	Bank A/c	Dr.		1,000	
	To Premium for Goodwill A/c				1,000
	(Being the premium brought in by C)				
	Premium for Goodwill A/c	Dr.		1,000	
	To A Capital A/c (Note 1)				900
	To B Capital A/c (Note 1)				100
	(Being the premium for goodwill shared by the old partners in the sacrificing ratio)				

Working Note : **(1) Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	3/5	3/8	3/5 – 3/8 [(24 – 15) / 40] = 9/40 (Sacrifice)	A : B = 9 : 1
B	2/5	3/8	2/5 – 3/8 = [(16 – 15) / 40] = 1/40 (Sacrifice)	
C	—	2/8	0 – 2/8 = 10/40 (Gain)	

Illustration 57

A and B are partners sharing profits in the ratio of 3 : 2. They admit C as a new partner. C pays a premium of ₹ 3,000 for 3/10th share of profits which he acquires from A and B in the ratio of 2 : 1. Goodwill Account appears in the books at ₹ 2,000. Give the necessary journal entries.

Solution

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A Capital A/c	Dr.		1,200	
	B Capital A/c	Dr.		800	
	To Goodwill A/c				2,000
	(Being the goodwill written off prior to the admission of C)				
	Bank A/c	Dr.		3,000	
	To Premium for Goodwill A/c				3,000
	(Being the amount of premium for goodwill brought in by C)				
	Premium for Goodwill A/c	Dr.		3,000	
	To A Capital A/c				2,000
	To B Capital A/c				1,000
	(Being the premium for goodwill credited to the old partners on the basis of their sacrifice, i.e., in the ratio of 2 : 1)				

Illustration 58

A and B sharing profits in the ratio of 3 : 2, admit C for 20% share in profits. C pays ₹ 2,000 for goodwill. New profit sharing ratio is 2 : 2 : 1. Goodwill already appears at ₹ 6,000. Give journal entries in connection with goodwill.

Solution

C joins the business for 20% or 1/5th share and pays ₹ 2,000 for goodwill. Therefore the total value of the goodwill is 5/1 × ₹ 2,000 = ₹ 10,000.

The appropriation of premium money is as under :

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	6,000	4,000	—
Right of goodwill after admission (2 : 2 : 1)	4,000	4,000	2,000
Sacrifice (–) / Gain (+)	(–) 2,000	—	(+) 2,000

On C's admission, B does not make any sacrifice. Therefore, the entire premium for goodwill brought in by C will be given to A.

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A Capital A/c	Dr.		3,600	
	B Capital A/c	Dr.		2,400	
	To Goodwill A/c				6,000
	(Being the goodwill written off before C's admission)				
	Bank A/c	Dr.		2,000	
	To Premium for Goodwill A/c				2,000
	(Being the amount of premium for goodwill brought in by C)				
	Premium for Goodwill A/c	Dr.		2,000	
	To A Capital A/c				2,000
	(Being the premium for goodwill credited to A)				

Illustration 59

A, B and C are partners sharing profits in the ratio of 5 : 3 : 2. Goodwill is appearing in the books at ₹ 50,000. D is admitted to the partnership, the new profit sharing ratio among A, B, C and D being 3 : 3 : 2 : 2.

Give the journal entries for goodwill if the new partner D brings in ₹ 1,00,000 for capital and cash for his share of goodwill. The goodwill of the firm is valued at ₹ 1,20,000 and is not to appear in the books after D's admission.

Solution

Statement Showing the Premium to be Brought in and its Distribution

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before D's admission (5 : 3 : 2)	60,000	36,000	24,000	—
Right of goodwill after D's admission (3 : 3 : 2 : 2)	36,000	36,000	24,000	24,000
Sacrifice (–) / Gain (+)	(–)24,000	—	—	(+)24,000

In regard to goodwill D makes a gain of ₹ 24,000. Therefore, he is to bring premium for goodwill ₹ 24,000. A makes a sacrifice of ₹ 24,000. He is to get the entire amount of premium for goodwill. B and C do not make any sacrifice. Therefore, they are not entitled to any premium for goodwill.

In the books of the Firm

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A Capital A/c	Dr.		25,000	
	B Capital A/c	Dr.		15,000	
	C Capital A/c	Dr.		10,000	
	To Goodwill A/c				50,000
	(Being the goodwill written off before D's admission)				
	Bank A/c	Dr.		1,24,000	
	To D Capital A/c				1,00,000
	To Premium for Goodwill A/c				24,000
	(Being the amount of capital and premium for goodwill brought in by D)				
	Premium for Goodwill A/c	Dr.		24,000	
	To A Capital A/c				24,000
	(Being the premium for goodwill credited to A alone, since he only makes the sacrifice)				

Case 10 : When the incoming partner can bring only a portion of the required amount of premium for goodwill. There is no goodwill appearing in the Balance Sheet.

In this case, whatever premium for goodwill brought in by the new partner will be shared by the old partners in the sacrificing ratio.

Accounting Entries

1. For premium for goodwill brought in cash by the new partner

Cash / Bank Account Dr. [Actual amount of premium]

To Premium for Goodwill Account

2. For capital brought in cash by the new partner

Cash / Bank Account Dr. [Actual amount of capital]
To New Partners' Capital Accounts

3. For sharing of premium for goodwill

Premium for Goodwill Account Dr. [Actual amount of premium]
To Old Partners' Capital Accounts [Sacrificing ratio]

In addition to the above entries, New Partner's Capital Account will be debited with the amount of premium not brought in and Old Partners' Capital Account will be credited in the sacrificing ratio.

Illustration 60

A and B are partners of a firm sharing profits and losses in the ratio of 2 : 3. They admit 'C' as a new partner. The new profit/loss sharing ratio is 1 : 2 : 1. 'C' brings 60% of his due for goodwill. For this purpose the goodwill is valued at 3 years purchase of last 5 years' average profits.

Net profit for last 5 years are as under :

1999 — ₹ 40,000; 2000 — ₹ 35,000; 2001 — ₹ 25,000; 2002 — ₹ 38,000 and 2003 — ₹ 45,000.

Calculate the value of goodwill and show how transaction of goodwill be recorded in the books of the firm without opening Goodwill Account. ***[C.U.B.Com. (Hons.) — 2004]***

Solution

Calculation of Average Profit

Year	Profit (₹)
1999	40,000
2000	35,000
2001	25,000
2002	38,000
2003	45,000
Total Profit	1,83,000

Average profit = ₹ 1,83,000 / 5 = ₹ 36,600.

Goodwill = Average Profit × Number of year's Purchase

= ₹ 36,600 × 3 = ₹ 1,09,800.

C's share of goodwill = 2/5 of ₹ 1,09,800 = ₹ 43,920.

Cash brought in by C = 60% of ₹ 43,920 = ₹ 26,352.

Solution

In the books of the Firm

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr.		26,352	
	To Premium for Goodwill A/c			26,352
	(Being premium for goodwill brought in by C to the extent of 60% of the premium in cash)			
	Premium for Goodwill A/c Dr.		26,352	
	To A Capital A/c			13,176
	To B Capital A/c			13,176
	(Being division of premium between A and B in the ratio 1 : 1)			
	C Capital A/c Dr.		17,568	
	To A Capital A/c			8,784
	To B Capital A/c			8,784
	(Being the adjustment of goodwill for the portion of premium not brought-in by C)			

Working Note : **(1) Calculation of Sacrificing Ratio**

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	2/5	1/5	2/5 – 1/5 = 1/5 (Sacrifice)	A : B = 1 : 1
B	3/5	2/5	3/5 – 2/5 = 1/5 (Sacrifice)	
C	—	2/5	0 – 2/5 = 2/5 (Gain)	

Illustration 61

Red and White are two partners sharing profits and losses in the ratio of 5 : 4. They take Pink into partnership. Pink brings ₹ 20,000 as capital and ₹ 3,600 as premium for goodwill out of his share of ₹ 5,400. The new profit sharing ratio of the partners is 5 : 4 : 3. The new firm decided that no goodwill will appear in the books. Pass necessary journal entries.

Solution

The amount of premium brought in by Pink will be shared between Red and White in the sacrificing ratio which is calculated as under :

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
Red	5/9	5/12	5/9 – 5/12 = 5/36 (Sacrifice)	Red : White = 5 : 4
White	4/9	4/12	4/9 – 4/12 = 4/36 (Sacrifice)	
Pink	—	3/12	0 – 3/12 = 9/36 (Gain)	

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Cash A/c Dr. To Pink Capital A/c To Premium for Goodwill A/c (Being capital and premium for goodwill brought in by Pink in cash)		23,600	 20,000 3,600
	Premium for Goodwill A/c Dr. To Red Capital A/c To White Capital A/c (Being the premium shared by Red and White in their sacrificing ratio)		3,600	 2,000 1,600
	Pink Capital A/c Dr. To Red Capital A/c To White Capital A/c (Being the adjustment of goodwill for the portion of premium not brought-in by Pink)		1,800	 1,000 800

Illustration 62

A and B sharing profits in the ratio of 2 : 1, admit C for 1/4th share in profits. C pays ₹ 20,000 for capital and ₹ 3,000 out of his share of ₹ 4,000 for goodwill. After admission they decided not to show goodwill. Give journal entries in connection with C's admission.

Solution

In the books of the Firm

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr. To C Capital A/c To Premium for Goodwill A/c (Being the amount brought-in by C as his capital and premium for goodwill)		23,000	 20,000 3,000
	Premium for Goodwill A/c Dr. To A Capital A/c To B Capital A/c (Being the premium for goodwill shared by A and B in their ratio of sacrifice)		3,000	 2,000 1,000
	C Capital A/c (Note 2) Dr. To A Capital A/c To B Capital A/c (Being the adjustment of goodwill for the portion of premium not brought-in by C)		1,000	 667 333

Working Notes :

(1) C joins for 1/4th share. Therefore, 3/4th (1 – 1/4) share remains for A and B. A's share = 2/3 of 3/4 = 2/4; B's share = 1/3 of 3/4 = 1/4; C's share = 1/4. Therefore, new profit sharing ratio = A : B : C = 2 : 1 : 1.

(2) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	2/3	2/4	2/3 – 2/4 = 2/12 (Sacrifice)	A : B = 2 : 1
B	2/3	1/4	1/3 – 1/4 = 1/12 (Sacrifice)	
C	—	1/4	0 – 1/4 = 3/12 (Gain)	

Illustation 63

K, L and M with respective capitals of ₹ 30,000, ₹ 20,000 and ₹ 10,000 and sharing profit in the ratio of 3 : 2 : 1 agreed to admit N for a sixth share on the lines that he brings in ₹ 20,000 as capital and ₹ 10,000 as Premium for Goodwill and that M should retain his original share. N paid in his capital money but in respect of premium he could bring in only ₹ 5,000. You are required to:

(i) Give the Journal entries to carry out the above arrangements;
(ii) Construct the Capital Accounts of the partners; and
(iii) Work out the new profit-sharing ratio of the partners.

Solution

In the books of the Firm

(i) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bank A/c	Dr.		25,000	
	To N Capital A/c				20,000
	To Premium for Goodwill A/c				5,000
	(Being the premium for goodwill and capital brought in by N)				
	Premium for Goodwill A/c	Dr.		5,000	
	To K Capital A/c				3,000
	To L Capital A/c				2,000
	(Being the premium for goodwill shared by K and L in their sacrificing ratio 3:2)				
	N Capital A/c	Dr.		5,000	
	To K Capital A/c				3,000
	To L Capital A/c				2,000
	(Being the adjustment of goodwill for the portion of premium not brought-in by N)				

Dr. (ii) Partners' Capital Accounts Cr.

Particulars	K (₹)	L (₹)	M (₹)	N (₹)	Particulars	K (₹)	L (₹)	M (₹)	N (₹)
To K Capital A/c	—	—	—	3,000	By Balance b/d	30,000	20,000	10,000	—
To L Capital A/c	—	—	—	2,000	By Bank A/c	—	—	—	20,000
To Balance c/d	36,000	24,000	10,000	15,000	By Premium for Goodwill A/c	3,000	2,000	—	—
					By N Capital A/c	3,000	2,000	—	—
	36,000	24,000	10,000	20,000		36,000	24,000	10,000	20,000

(iii) Ascertainment of New Profit-Sharing Ratio

N is coming for 1/6th share and M retains his original share (which is also1/6th). Therefore, share of N and M is 1/6th + 1/6th = 2/6th. Balance of share remains for K and L is 1 – 2/6th = 4/6th or 2/3rd, which will be shared by K and L in the ratio 3 : 2. Therefore, K gets 2/3 × 3/5 = 2/5th share and L gets 2/3 × 2/5 = 4/15th share. The new profit sharing ratio among K, L, M and N is 2/5 : 4/15 : 1/6: 1/6 or 12 : 8 : 5 : 5.

Working Note : (1) Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
K	3/6	12/30	3/6 – 12/30 = 3/30 (Sacrifice)	K : L = 3 : 2
L	2/6	8/30	2/6 – 8/30 = 2/30 (Sacrifice)	
M	1/6	5/30	1/6 – 5/30 = Nil	
N	—	5/30	0 – 5/30 = 5/30 (Gain)	

Illustration 64

(a) A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. X who joins the firm for 1/3 share is to pay ₹ 25,000 as premium for goodwill but he cannot pay anything. As between A and B, they decided to share profits and losses equally. Pass the required journal entries in respect of the goodwill.

(b) A and B are equal partners. C comes in as a new partner who pays ₹ 6,000 as premium for goodwill. The new profit sharing ratio among A, B and C is 1 : 2 : 3. Pass necessary journal entries showing the appropriation of premium money assuming that the premium for goodwill is immediately withdrawn by the old partners.

(c) A partnership firm is about to admit a partner and decides theat goodwill is to be raised in the books. The basis is two years' purchase of the average profits over the last five consecutive years.
Profit : ₹ 36,000; ₹ 28,000; ₹ 25,000; ₹ 37,000; ₹ 45,000.
Calculate value of goodwill.

Solution (a)

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	X Capital A/c	Dr.		25,000	
	To A Capital A/c (Note 1)				20,000
	To B Capital A/c (Note 1)				5,000
	(Being the adjustment for goodwill on X's admission)				
	Alternatively,				
	Goodwill A/c (Note 2)	Dr.		75,000	
	To A Capital A/c				45,000
	To B Capital A/c				30,000
	(Being the goodwill raised in the books at its full value)				
	A Capital A/c	Dr.		25,000	
	B Capital A/c	Dr.		25,000	
	X Capital A/c	Dr.		25,000	
	To Goodwill A/c (Note 3)				75,000
	(Being the goodwill written-off in the new ratio)				

Solution (b)

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Cash A/c	Dr.		6,000	
	To Premium for Goodwill A/c				6,000
	(Being the premium for goodwill brought in by cash)				
	Premium for Goodwill A/c	Dr.		6,000	
	To A Capital A/c (Note 4)				4,000
	To B Capital A/c (Note 4)				2,000
	(Being the premium for goodwill credited to A and B on the basis of their sacrifice)				
	A Capital A/c	Dr.		4,000	
	B Capital A/c	Dr.		2,000	
	To Cash A/c				6,000
	(Being the premium money withdrawn by the old partners)				

Solution (c)

$$\text{Average Profit} = \frac{36{,}000 + 28{,}000 + 25{,}000 + 37{,}000 + 45{,}000}{5}$$

$$= \frac{1{,}71{,}000}{5} = ₹\ 34{,}200$$

Value of Goodwill = 2 × Average Profit = 2 × ₹ 34,200 = ₹ **68,400**.

Working Notes :

(1) X is admitted for 1/3 share in future profit. Therefore, 1 – 1/3 = 2/3 is available to A and B which they will share equally.
A's share will be = 1/2 of 2/3 = 2/6
B's share will be = 1/2 of 2/3 = 2/6
X's share will be = 1/3 or 2/6.
The new profit sharing ratio = 2 : 2 : 2 or 1 : 1 : 1.

Calculation of Sacrificing Ratio

Partners	Old Ratio	New Ratio	Sacrifice / Gain	Sacrificing Ratio
A	3/5	1/3	3/5 – 1/3 = 4/15 (Sacrifice)	
B	2/5	1/3	2/5 – 1/3 = 1/15 (Sacrifice)	4 : 1
X	—	1/3	0 – 1/3 = 5/15 (Gain)	

(2) X is joining the firm for 1/3 share and he is required to pay ₹ 25,000 as premium for goodwill but cannot pay anything. So goodwill is to be raised at its full value = ₹ 25,000 × 3/1 = ₹ **75,000**.

(3) As per AS—10, only purchased goodwill is recorded in the books of account. Therefore, the entire goodwill ₹ 75,000 is to be written-off immediately in the new ratio. In the Balance Sheet no goodwill is to be shown.

(4) C is joining the firm for 3/6 share. He is paying ₹ 6,000 as premium for goodwill. The total value of goodwill = ₹ 6,000 × 6/3 = ₹ 12,000.

The sharing of premium money is calculated as follows :

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (1 : 1)	6,000	6,000	—
Right of goodwill after admission (1 : 2 : 3)	2,000	4,000	6,000
Sacrifice (–) / Gain (+)	(–) 4,000	(–) 2,000	(+) 6,000

Special Problems

Illustration 65

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2 respectively. Their summarised Balance Sheet as on 31.3.2018 is as under :

Liabilities		₹	Assets	₹
Capital :	A	90,000	Fixed Assets	1,60,000
	B	60,000	Current Assets	75,000
Current Liabilities		85,000		
		2,35,000		2,35,000

On 1.4.2018, C is admitted to the partnership.

Prepare the appropriate journal entries for each of the following :

(i) C ***purchases*** $33^1/_3$% of A's interest for ₹ 35,000.

(ii) C ***contributes*** ₹ 70,000 to obtain a 25% interest in the firm.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
(i)	Cash A/c (Note 1)	Dr.	35,000	
	To C Capital A/c			30,000
	To Premium for Goodwill A/c			5,000
	(Being the amount of capital and premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	5,000	
	To A Capital A/c			5,000
	(Being the premium for goodwill brought in by C credited to A for his sacrifice)			
	A Capital A/c (₹ 5,000 + 30,000)	Dr.	35,000	
	To Cash A/c			35,000
	(Being the premium for goodwill and 1/3rd of capital withdrawn by A)			
(ii)	Cash A/c (Note 2)	Dr.	70,000	
	To C Capital A/c			50,000
	To Premium for Goodwill A/c			20,000
	(Being the required amount of money as capital and premium for goodwill brought in by C to obtain a 25% interest in the firm)			
	Premium for Goodwill A/c	Dr.	20,000	
	To A Capital A/c			12,000
	To B Capital A/c			8,000
	(Being the premium for goodwill shared by the old partners on the basis of their sacrifice)			

Working Notes :

(1) 1/3rd of A's Capital = ₹ 30,000. C is paying ₹ 35,000 for acquiring 1/3 share of A. Therefore, ₹ 5,000 (₹ 35,000 – ₹ 30,000) will be treated as premium for goodwill.

(2) 3/4 value of the firm = ₹ 1,50,000. Therefore, total value of the firm = ₹ 2,00,000 (₹ 1,50,000 / 3 × 4). C's contribution for 1/4 interest in the firm should be ₹ 2,00,000 × 1/4 = ₹ 50,000. However, C is contributing ₹ 70,000. Therefore, the difference ₹ 20,000 (₹ 70,000 – ₹ 50,000) will be treated as premium for goodwill and it will remain in the business.

Illustration 66

P and Q are partners in a firm sharing profits and losses in the ratio of 3 : 2 respectively. They admit R as a partner on 1.1.1997 on the basis of his buying 1/5th of P's share and 1/6th of Q's share. On 1.1.1999, they permit R to purchase a further 1/10th of their remaining shares. How much did R pay each of the others on each occasion for goodwill, assuming that the goodwill of the firm was ₹ 30,000 on the first occasion and ₹ 40,000 on the second ?

What is the ultimate share of each partner in the business ? ***[C.U.B.Com. (Hons.) — 2000, 2009]***

Solution

First occasion	**Second occasion**
R gets from P — 1/5 × 3/5 = 3/25	R gets from P — 1/10 × 36/75 = 36/750
R gets from Q — 1/6 × 2/5 = 2/30 = 1/15	R gets from Q — 1/10 × 25/75 = 25/750
Therefore, Share of R = 3/25 + 1/15 = 14/75	Therefore, Share of R = 14/75 + 36/750 + 25/750 = 201/750
Sacrificing ratio of P and Q = 3/25 : 1/15 = 9 : 5.	Sacrificing ratio of P and Q = 36/750 : 25/750 = 36 : 25.
R is to bring in premium for goodwill = ₹ 30,000 × 14/75 = ₹ 5,600.	R is to bring in premium for goodwill = ₹ 40,000 × 61/750 = ₹ 3,253.
The premium for goodwill of ₹ 5,600 will be shared by P and Q as under :	The premium for goodwill of ₹ 3,253 will be shared by P and Q as under :
P — ₹ 5,600 × 9/14 = ₹ 3,600; Q — ₹ 5,600 × 5/14 = ₹ 2,000.	P — ₹ 3,253 × 36/61 = ₹ 1,920; Q — ₹ 3,253 × 25/61 = ₹ 1,333.
New profit sharing ratio :	New profit sharing ratio :
P — 3/5 – 3/25 = 36/75	P — 36/75 – 36/750 = 324/750
Q — 2/5 – 1/15 = 25/75	Q — 25/75 – 25/750 = 225/750
R — 3/25 + 1/15 = 14/75	R — 14/75 + 36/750 + 25/750 = 201/750
P : Q : R = 36 : 25 : 14.	**P : Q : R = 108 : 75 : 67**.

Illustration 67

The following is the Balance Sheet of A and B, who share profits in the ratio of 3 : 2.

Liabilities		₹	Assets	₹
Capital :	A	80,000	Assets	2,00,000
	B	50,000		
Creditors		70,000		
		2,00,000		2,00,000

The business has been valued and the net worth is ₹ 1,80,000. It is decided to introduce a new partner, C who has ₹ 60,000 to contribute. The profits are to be shared in the ratio of 4 : 3 : 3.

Show the Balance Sheet when :

(a) goodwill has been entered in the accounts but eliminated after the admission of C;

(b) the payment made to the partners if C pays a premium for admission to the partnership.

Solution

The net worth as per the Balance Sheet is ₹ 1,30,000 (₹ 2,00,000 – 70,000). But, the actual net worth is ₹ 1,80,000. Therefore, the difference of ₹ 50,000 (₹ 1,80,000 – 1,30,000) represents goodwill.

Dr. **(a) Partners' Capital Accounts** **Cr.**

Date	Particulars	A (₹)	B (₹)	C (₹)	Date	Particulars	A (₹)	B (₹)	C (₹)
	To Goodwill A/c	20,000	15,000	15,000		By Balance b/d	80,000	50,000	—
	To Balance c/d	90,000	55,000	45,000		By Bank A/c	—	—	60,000
						By Goodwill A/c	30,000	20,000	—
		1,10,000	70,000	60,000			1,10,000	70,000	60,000

Balance Sheet of A, B and C as at . . .

Liabilities		₹	Assets	₹
Capital : A		90,000	Assets	2,00,000
	B	55,000	Bank	60,000
	C	45,000		
Creditors		70,000		
		2,60,000		2,60,000

(b) Workings :
Adjustment of Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	30,000	20,000	—
Right of goodwill after admission (4 : 3 : 3)	20,000	15,000	15,000
Sacrifice (–) / Gain (+)	(–) 10,000	(–) 5,000	(+) 15,000

Therefore, C is to bring in ₹ 15,000 as premium for goodwill and it will be shared by A ₹ 10,000 and B ₹ 5,000.

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

Date	Particulars	A (₹)	B (₹)	C (₹)	Date	Particulars	A (₹)	B (₹)	C (₹)
	To Balance c/d	90,000	55,000	60,000		By Balance b/d	80,000	50,000	—
						By Bank A/c	—	—	60,000
						By Premium for Goodwill	10,000	5,000	—
		90,000	55,000	60,000			90,000	55,000	60,000

Balance Sheet of A, B and C as at . . .

Liabilities		₹	Assets	₹
Capital :	A	90,000	Assets	2,00,000
	B	55,000	Bank (₹ 60,000 + 15,000)	75,000
	C	60,000		
Creditors		70,000		
		2,75,000		2,75,000

3. Revaluation of Assets and Liabilities

Revaluation is the recording of an asset or a liability at its current value. It is a process of placing a different valuation on an asset or a liability from its book value. At the time of admission of a new partner, it is found necessary to revalue the assets and liabilities of the firm. Buildings could have appreciated substantially due to being in a particularly favourable position; some of the debtors need to be written-off as bad, stock may not reflect the current market values; or the creditors might require some amendment.

The new partner should not be given any benefit of appreciation in the value of assets. Similarly, he should not be burdened for any undisclosed liabilities or losses. For proper adjustment in respect of appreciation or depreciation, a Revaluation Account (Profit and Loss Adjustment Account) should be opened, to which all the items of increase or decrease in the value of assets and liabilities are shown. Therefore, the purpose of preparing a Revaluation Account is to recognise the above events on a current value rather than on a historical cost basis. The balance of Revaluation Account represents profit or loss on revaluation and it is finally closed by transfer to old Partners' Capital Accounts in the old profit-sharing ratio.

Sometimes, either intentionally or by mistake, one or more assets and/or liabilities are not recorded in the books of account. But while preparing Revaluation Account, if all the partners agree, these assets and liabilities are to be recorded. Effectively, the creation of a new asset is a profit on revaluation and recognition of an unrecorded liability in the books is a loss on revaluation.

From the above, it can be comprehended that the practice of asset or liability revaluation is to state fully the true economic condition of the partnership firm at the time of admission of a partner and to assign the changes in asset and liability values to the old partners who have been managing the business during the time the changes in values occured. It should be remembered that revaluation is a comparatively rare event in accounting and is used only where balance sheet values have become conspicuously misleading. Revaluation should be done by independent valuers and it should be ensured that sufficient evidence exists for any revaluation in order to prevent valuation abuses.

Accounting entries to be passed in the books of account will depend upon the situation:

(a) When value of assets and liabilities are to be shown in the Balance Sheet at ***Revalued Figures***.

(b) When value of assets and liabilities are to be shown in the Balance Sheet at ***Original Figures***.

(a) When value of assets and liabilities are to be shown in the Balance Sheet at revalued figures

The relevant Journal entries are as follows:

(a) If the values of the assets increase

Assets Account	Dr. [Revised value *minus* original book value]
To Revaluation Account	

(b) If the values of the assets decrease

Revaluation Account	Dr. [Original book value *minus* revised value]
To Assets Account	

(c) If the amount of liabilities increase

Revaluation Account	Dr. [Revised amount *minus* original amount]
To Liabilities Account	

(d) If the amount of the liabilities decrease

Liabilities Account	Dr. [Original amount *minus* revised amount]
To Revaluation Account	

(e) The Revaluation Account should be closed by transfer to the old Partners' Capital Accounts in the old profit-sharing ratio

(i) If there is profit on Revaluation, i.e., the total of the credit side of the revaluation account is greater than that of the debit side:

Revaluation Account	Dr.	
To Old Partners' Capital Accounts		[Old ratio]

(ii) If there is loss on Revaluation, i.e., the total of the debit side of the revaluation account is greater than that of the credit side:

Old Partners' Capital Accounts	Dr. (Old ratio)
To Revaluation Account	

In this connection, Para 30 of AS—10 is also important. This para states that '***An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revalutaion of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account***'.

In case of Partnership, revaluation profit or loss is transferred directly to Partners' Capital Accounts. Therefore, an increase in net book value arising on revaluation of fixed assets may be credited to Revaluation Account (in place of Revaluation Reserve Account because it will be utilimately closed by transferring to Partners' Capital Accounts) and loss on revaluation of fixed assets may be debited to Revaluation Account (in place of Profit and Loss Account because it will be ultimately closed by transferreing to Partners' Capital Accounts).

In this chapter or elsewhere the effects of revaluation of fixed assets have been shown through the Revaluation Account (in place of Revaluation Reserve Account / Profit and Loss Account because the effect will be same on Partners' Capital Accounts).

Illustration 68

A, B and C were in partnership, sharing profits and losses as to A — 1/2, B — 1/3rd and C — 1/6th. As from 1st January, 2018 they admitted D into partnership on the following terms :

D to have a 1/6th share which he purchased entirely from A paying A ₹ 8,000 for that share of goodwill. Of this amount, A had withdrawn ₹ 6,000 and put the balance in the firm as additional capital. As a condition to admission of D as a partner D also brought in ₹ 5,000 capital into the firm. It was further agreed that the investments should be valued at its market value of ₹ 3,600 and plant be valued at ₹ 5,800.

The Balance Sheet of the old firm on 31.12.2017 was as :

Cash at bank ₹ 8,000; Debtors ₹ 12,000; Stock ₹ 10,000; Investments at cost ₹ 6,000; Furniture ₹ 2,000; Plant ₹ 7,000; Creditors ₹ 21,000; Capital : A ₹ 12,000; B ₹ 8,000 and C ₹ 4,000. The profits for the year 2018 were ₹ 12,000 and the drawings were : A ₹ 6,000, B ₹ 6,000, C ₹ 3,000 and D ₹ 3,000.

You are required to journalise the opening adjustments, prepare the opening Balance Sheet of the new firm as on 1st January, 2018 and give the capital account of each partner as on 31st December, 2018. ***[C.A. (Foundation) — Adapted]***

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 Jan. 1	Bank A/c	Dr.	13,000	
	To Premium for Goodwill A/c			8,000
	To D Capital A/c			5,000
	(Being the premium for goodwill and capital brought in by D)			
	Premium for Goodwill A/c	Dr.	8,000	
	To A Capital A/c			8,000
	(Being the premium credited to A's Capital)			
	A Capital A/c	Dr.	6,000	
	To Bank A/c			6,000
	(Being the premium withdrawn by A to the extent of ₹ 6,000)			
	Revaluation A/c	Dr.	3,600	
	To Investment A/c			2,400
	To Plant A/c			1,200
	(Being the revaluation of investment and plant on D's admission)			
	A Capital A/c	Dr.	1,800	
	B Capital A/c	Dr.	1,200	
	C Capital A/c	Dr.	600	
	To Revaluation A/c			3,600
	(Being loss on revaluation transferred to Old Partners' Capital Account in the old ratio of 3 : 2 : 1)			

Balance Sheet (after D's admission) as at 1st January, 2018

Liabilities	₹	Assets	₹
Capital A/c : A ₹ (12,000 + 8,000 – 6,000 – 1,800)	12,200	Plant and Machinery	5,800
Capital A/c : B ₹ (8,000 – 1,200)	6,800	Furniture	2,000
Capital A/c : C ₹ (4,000 – 600)	3,400	Investment	3,600
Capital A/c : D	5,000	Stock	10,000
Creditors	21,000	Debtors	12,000
		Cash at Bank ₹ (8,000 + 13,000 – 6,000)	15,000
	48,400		48,400

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

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
1.1.2018	To Bank A/c	6,000	—	—	—	1.1.2018	By Balance b/d	12,000	8,000	4,000	—
	To Revaluation A/c*	1,800	1,200	600	—	"	By Bank A/c	—	—	—	5,000
31.12.2018	To Drawings A/c	6,000	6,000	3,000	3,000	"	By Premium for Goodwill	8,000	—	—	—
"	To Balance c/d	10,200	4,800	2,400	4,000	31.12.2018	By Net Profit**	4,000	4,000	2,000	2,000
		24,000	12,000	6,000	7,000			24,000	12,000	6,000	7,000

* Revaluation Loss = ₹ 3,600 (₹ 1,200 for plant and ₹ 2,400 for investments).

**New Profit Sharing Ratio will be 4 : 4 : 2 : 2 or 2 : 2 : 1 : 1.

Tutorial Note : D purchased 1/6th share entirely from A. In this situation, generally total capital of the firm should remain the same. However, this question has been solved as per the direction in the question.

Illustration 69

The following is the Balance Sheet of A and B, a partnership business, as at 31st December, 2017:

Liabilities			₹	Assets	₹
Creditors			40,000	Cash at Bank	12,000
Capitals:	A	48,000		Plant and Machinery	50,000
	B	54,000	1,02,000	Furniture	10,000
				Stock	40,000
				Debtors	30,000
			1,42,000		1,42,000

The partners decided to revalue the assets and liabilities as under on the admission of partner C on 1.1.2018, who brings in ₹ 30,000 as capital: Plant and Machinery ₹ 60,000; Debtors ₹ 27,000; Furniture ₹ 9,500; and Stock ₹ 36,000.

An amount of ₹ 3,000 included in creditors is no longer a liability and hence requires to be properly adjusted and ₹ 2,000 is to be paid to the creditors which is not recorded in the books.

A contingent liability of ₹ 500 not included in the above Balance Sheet had to be cleared.

Show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet after C's admission.

Solution

In the books of the firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Debtors A/c	3,000	By Plant and Machinery A/c	10,000
To Furniture A/c	500	By Creditors A/c (no longer a liability)	3,000
To Stock A/c	4,000		
To Creditors A/c (unrecorded)	2,000		
To Bank A/c (contingent liability paid)	500		
To Partners' Capital A/cs: A : ₹ 1,500; B : ₹ 1,500	3,000		
	13,000		13,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	49,500	55,500	30,000	By Balance b/d	48,000	54,000	—
				By Revaluation A/c	1,500	1,500	—
				By Bank A/c	—	—	30,000
	49,500	55,500	30,000		49,500	55,500	30,000

Balance Sheet (after C's admission) as at 1st January, 2018

Liabilities	₹	Assets	₹
Capital A/c : A	49,500	Plant and Machinery	60,000
Capital A/c : B	55,500	Furniture	9,500
Capital A/c : C	30,000	Stock	36,000
Creditors ₹ (40,000 – 3,000 + 2,000)	39,000	Debtors	27,000
		Cash at Bank ₹ (12,000 + 30,000 – 500)	41,500
	1,74,000		1,74,000

Tutorial Note : Revaluation profit is shared by A and B equally as the profit sharing ratio has not been mentioned.

Illustration 70

Following is the Balance Sheet of A and B, who share profits and losses as 3 : 2 respectively, as at 31st December, 2017:

Liabilities		₹	Assets		₹
Capitals :	A	35,000	Land and Building		30,000
	B	30,000	Plant and Machinery		20,000
Reserve		10,000	Stock		10,000
Creditors		25,000	Debtors	20,000	
			Less: Provision for Doubtful Debts	1,000	19,000
			Bank		11,000
			Cash		10,000
		1,00,000			1,00,000

On 1st January, 2018 C joins the firm and brings in the following assets :

Stock — ₹ 21,000; Investments — ₹ 12,000; Cash — ₹ 15,000; and Debtors — ₹ 10,000.

Following were agreed upon :

(i) The new profit sharing ratio among A, B and C will be equal.

(ii) The capitals of the partners should also be equal taking C's capital as base.

(iii) The reserve of the new firm will be ₹ 15,000.

(iv) Provision for doubtful debts is to be created @ 10% on total debtors.

(v) An investment provision of ₹ 2,000 is to be created.

You are required to prepare the Balance Sheet of the new firm.

Solution **Balance Sheet of A, B and C as at 1st January, 2018**

Liabilities			₹	Assets		₹
Capitals :	A	50,000		Land and Building		30,000
	B	50,000		Plant and Machinery		20,000
	C	50,000	1,50,000	Stock ₹ (10,000 + 21,000)		31,000
Reserve			15,000	Debtors ₹ (20,000 + 10,000)	30,000	
Creditors			25,000	Less: Provision for Doubtful Debts @ 10%	3,000	27,000
				Investments	12,000	
				Less: Investment Provision	2,000	10,000
				Bank ₹ (11,000 + 14,600 + 21,400)		47,000
				Cash ₹ (10,000 + 15,000)		25,000
			1,90,000			1,90,000

Working Notes :

Dr. **(1) Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Reserve A/c	5,000	5,000	5,000	By Balance b/d	35,000	30,000	—
To Provision for Doubtful Debts A/c (Note 2)	600	400	1,000	By Stock A/c	—	—	21,000
				By Investments A/c	—	—	12,000
To Investment Provision A/c (Note 3)	—	—	2,000	By Cash A/c	—	—	15,000
To Balance c/d (*taking C's capital as base)	*50,000	*50,000	50,000	By Debtors A/c	—	—	10,000
				By Reserve A/c	6,000	4,000	—
				By Bank A/c (Balancing figure)	14,600	21,400	—
	55,600	55,400	58,000		55,600	55,400	58,000

(2) Debtors of A and B were ₹ 20,000. Provision for doubtful debts is to be maintained at 10%. Therefore, new provision for doubtful debts for these Debtors will be ₹ 2,000. To create further provision of ₹ 1,000, capital of A and B will be debited in the ratio of 3 : 2 respectively.
For the debtors ₹ 10,000 brought-in by C, entire provision is to be created by debiting C's Capital Account.

(3) Investment provision is to be created by debiting C's Capital Account only.

Illustration 71

The Balance Sheet of A and B, who share profits and losses as 3 : 1 respectively as on 1.1.2018 is as under :

Liabilities		₹	Assets	₹
Capital Accounts :	A	50,000	Plant and Machinery	50,000
	B	30,000	Furniture and Fixture	20,000
Reserve		10,000	Stock	10,000
Creditors		10,000	Debtors	5,000
			Bank	15,000
		1,00,000		1,00,000

The partners are unable to bring in any additional capital in order to increase the plant capacity.

To increase the capital base of the firm to ₹ 1,50,000, they admitted C as an equal partner on the above date. To join the business, C was required to pay a sum of ₹ 70,000.

Show Journal Entries, Partners' Capital Accounts and the Balance Sheet after C's admission.

Solution **In the books of the Firm**

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

Date	Particulars		₹	₹
2018	Reserve A/c	Dr.	10,000	
Jan. 1	To A Capital A/c			7,500
	To B Capital A/c			2,500
	(Being the reserve transferred to the old partners in old profit sharing ratio)			
	Bank A/c	Dr.	70,000	
	To C Capital A/c			60,000
	To Premium for Goodwill A/c (Note 1)			10,000
	(Being the amount of capital and premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	10,000	
	B Capital A/c (Note 2)	Dr.	2,500	
	To A Capital A/c			12,500
	(Being the entire amount of premium for goodwill credited to A, also B is required to pay A a sum of ₹ 2,500)			
	A Capital A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being the premium for goodwill received in cash, withdrawn by A)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To A Capital A/c	—	2,500	—	By Balance b/d	50,000	30,000	—
To Bank A/c	10,000	—	—	By Reserve A/c	7,500	2,500	—
To Balance c/d	60,000	30,000	60,000	By Bank A/c	—	—	60,000
				By Premium for Goodwill A/c	10,000	—	—
				By B Capital A/c	2,500	—	—
	70,000	32,500	60,000		70,000	32,500	60,000

Balance Sheet (after C's Admission) as at 1st January, 2018

Liabilities			₹	Assets	₹
Capital Accounts :	A	60,000		Plant and Machinery	50,000
	B	30,000		Furniture and Fixture	20,000
	C	60,000	1,50,000	Stock	10,000
Creditors			10,000	Debtors	5,000
				Bank ₹ (15,000 + 70,000 – 10,000)	75,000
			1,60,000		1,60,000

Working Notes :

(1) The total capital of A and B was ₹ 90,000 (₹ 50,000 + ₹ 30,000 + ₹ 10,000). To increase the capital base to ₹ 1,50,000, C is required to bring in ₹ 60,000 (₹ 1,50,000 – ₹ 90,000). But he brings in ₹ 70,000. Therefore, the excess of ₹ 10,000 represents premium for goodwill.

(2) C brings in ₹ 10,000 for 1/3 share. Therefore, the value of the goodwill is ₹ 10,000 × 3/1 = ₹ 30,000.

Adjustment in Regard to Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 1)	(₹)	22,500	7,500	—
Right of goodwill after admission (1 : 1 : 1)	(₹)	10,000	10,000	10,000
Gain (+) / Sacrifice (–)	(₹)	(–) 12,500	(+) 2,500	(+) 10,000

Illustration 72

Rain and Storm are partners in a firm sharing profits and losses as 3 : 2 respectively. Their Balance Sheet on 31.12.2017 stands as under :

Liabilities		₹	Assets		₹
Creditors			Cash		4,000
Capital Accounts :	₹	35,000	Debtors	22,000	
Rain	40,000		Less: Provision for doubtful debts	2,000	20,000
Storm	20,000	60,000	Stock		18,000
			Machinery		20,000
			Land and Building		33,000
		95,000			95,000

On 1.1.2018, they agreed to take Dust as a partner on the following conditions :

(i) The goodwill of the firm shall be valued at ₹ 23,750 and Dust shall pay his share of goodwill in cash.

(ii) Dust shall contribute ₹ 15,000 as his share of capital.

(iii) Land and Building shall be valued at ₹ 42,000. Machinery shall be depreciated by ₹ 5,000. Provision for doubtful debts shall be raised to ₹ 3,000 and another provision shall be made for a probable liability for damages amounting to ₹ 1,300.

(iv) The profit and loss sharing ratio shall be so adjusted that, between Rain and Storm the former ratio is maintained, while between Storm and Dust there shall be the same ratio as between Rain and Storm.

(v) The capital shall be adjusted (without disturbing the ultimate total capital) so as to correspond with the new ratio, the excess or deficit being transferred to their respective current accounts.

Show journal entries to give effect to the above arrangement and prepare the opening Balance sheet of the new firm.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 Jan. 1	Land and Building A/c	Dr.	9,000	
	To Revaluation A/c			9,000
	(Being the upward revaluation of land and building)			

Revaluation A/c	Dr.	7,300	
To Machinery A/c			5,000
To Provision for Doubtful Debts A/c			1,000
To Liability for Damages A/c			1,300
(Being the downward revaluation of machinery and provision for doubtful debts and creating liability for damages)			
Revaluation A/c (₹ 9,000 – 7,300)	Dr.	1,700	
To Rain Capital A/c			1,020
To Storm Capital A/c			680
(Being profit on revaluation transferred to old partners' capital accounts in the ratio of 3 : 2)			
Cash A/c	Dr.	20,000	
To Premium for Goodwill A/c (Note 2)			5,000
To Dust Capital A/c			15,000
(Being the premium for goodwill and capital brought in by Dust for his 4/9th share of profit)			
Premium for Goodwill A/c (Note 3)	Dr.	5,000	
To Rain Capital A/c			3,000
To Storm Capital A/c			2,000
(Being premium for goodwill shared by the old partners on the basis of their sacrificing ratio, i.e., 3 : 2)			
Rain Capital A/c (Note 4 and 5)	Dr.	5,320	
To Rain Current A/c			5,320
(Being the excess capital transferred to Current Account)			
Storm Current A/c (Note 4 and 5)	Dr.	3,120	
Dust Current A/c	Dr.	2,200	
To Storm Capital A/c			3,120
To Dust Capital A/c			2,200
(Being the shortage capitals transferred to current accounts)			

Balance Sheet of the New Firm as on 1st January, 2018

Liabilities		₹	Assets		₹
Capital Accounts :			Land and Building		42,000
Rain	38,700		Machinery		15,000
Storm	25,800		Stock		18,000
Dust	17,200	81,700	Debtors	22,000	
Current Accounts :			Less: Provision for doubtful debts	3,000	19,000
Rain		5,320	Cash (₹ 4,000 + 20,000)		24,000
Creditors		35,000	Current Accounts :		
Liability for Damages		1,300	Storm	3,120	
			Dust	2,200	5,320
		1,23,320			1,23,320

Working Notes :

(1) Calculation of New Profit Sharing Ratio

The profit sharing ratio between Rain and Storm is 3 : 2, and profit sharing ratio between Storm and Dust will also be 3 : 2.

Therefore, share of Dust = $\frac{2/5}{3} \times 2 = 4/15$

The new profit sharing ratio = 3/5 : 2/5 : 4/15
= 9 : 6 : 4.

(2) Premium for goodwill brought in by Dust = ₹ 23,750 / 19 × 4 = ₹ 5,000.

(3) The partners' old profit sharing ratio (3 : 2) is their sacrificing ratio.

(4) Total capital of the new firm

Opening capital + Capital and premium brought in by Dust + Revaluation profit
= ₹ (60,000 + 15,000 + 5,000 + 1,700) = ₹ 81,700

Rain's share = ₹ 81,700 × 9/19 = ₹ 38,700

Storm's share = ₹ 81,700 × 6/19 = ₹ 25,800

Dust's share = ₹ 81,700 × 4/19 = ₹ 17,200.

Dr. (5) Partners' Capital Accounts Cr.

Particulars	Rain	Storm	Dust	Particulars	Rain	Storm	Dust
To Partners' Current A/cs (Balancing figure)	5,320	—	—	By Balance b/d	40,000	20,000	—
				By Bank A/c	—	—	15,000

To Balance c/d (Note 4)	38,700	25,800	17,200	By Premium for Goodwill A/c	3,000	2,000	—
				By Revaluation A/c	1,020	680	—
				By Partners' Current A/cs (Balancing figure)	—	3,120	2,200
	44,020	25,800	17,200		44,020	25,800	17,200

Illustration 73

A and B are in partnership, sharing profits and losses in the ratio of 3 : 2 respectively. Interest is charged on partners' drawings @ 8% p.a.

On 1.1.2017, C was admitted into partnership, with future profits or losses to be shared equally and interest on drawings to continue @ 8% p.a. He brought in ₹ 52,000 as his share of capital. Goodwill was calculated as twice the average profits after interest on drawings for 2014, 2015 and 2016.

Details of drawings and profits before interest in those years were :

Drawings : 2014 — ₹ 20,000; 2015 — ₹ 30,000; 2016 — ₹ 37,500.

Profit before interest : 2014 — ₹ 30,800; 2015 — ₹ 30,200; 2016 — ₹ 31,000.

The partners' capital balances on 31.12.2016 were : A ₹ 45,000; B ₹ 35,000.

Net profit for 2017 was ₹ 60,000 before interest. Drawings at the end of 2018 totalled :

A ₹ 24,000; B ₹ 22,000; C ₹ 20,000.

Prepare Profit and Loss Appropriation Account for the year ended 31.12.2017 and the Partners' Capital Accounts. Assume that all drawings were made on the first day of the year.

Solution

Workings :

	₹
Total profit for 3 years : ₹ (30,800 + 30,200 + 31,000)	92,000
Add: Interest on drawings for 3 years : @ 8% on ₹ (20,000 + 30,000 + 37,500)	7,000
Total profit for 3 years after interest on Drawings	99,000

Therefore, Goodwill = ₹ 99,000 / 3 × 2 = ₹ 66,000.

Statement Showing Required Adjustment for Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 2)	(₹)	39,600	26,400	—
Right of goodwill after admission (1 : 1 : 1)	(₹)	22,000	22,000	22,000
Sacrifice (–) / Gain (+)	(₹)	(–) 17,600	(+) 4,400	(+) 22,000

Required journal entry :

C Capital Account	Dr.	22,000	
To A Capital Account			17,600
To B Capital Account			4,400
(Being the required adjustment for goodwill)			

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars		₹	Particulars		₹
To Share of Profit A/c :			By Net Profit b/d		60,000
A	21,760		By Interest on Drawings A/c :		
B	21,760		A	1,920	
C	21,760	65,280	B	1,760	
			C	1,600	5,280
		65,280			65,280

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Jan. 1	To A Capital A/c	—	—	17,600	Jan. 1	By Balance b/d	45,000	25,000	—
"	To B Capital A/c	—	—	4,400	"	By Bank A/c	—	—	52,000
Dec. 31	To Drawings A/c	24,000	22,000	20,000	"	By C Capital A/c	17,600	4,400	—
"	To Interest on Drawings A/c	1,920	1,760	1,600	Dec. 31	By Share of Profit A/c	21,760	21,760	21,760
"	To Balance c/d	58,440	27,400	30,160					
		84,360	51,160	73,760			84,360	51,160	73,760

Illustration 74

A and B are in partnership and share profits and losses in the ratio of 3 : 2 respectively. Interest is paid on capital at 7% p.a. The partners' capital and current accounts balances at 31.12.2016 were :

Capital Account : A ₹ 35,600 (Cr.); B ₹ 28,400 (Cr.);

Current Account : A ₹ 1,400 (Cr.); B ₹ 1,800 (Dr.)

The only change to the capital balances since 2014 has been A's introduction of ₹ 10,000 on 1.7.2016.

On 1.1.2017, C was admitted paying ₹ 45,000 which represented a payment for goodwill and an additional sum as capital. Goodwill was calculated as 1.5 times average profits before interest on capital for the previous 3 years. Profits after interest for those years were : 2014 ₹ 31,640; 2015 ₹ 42,870; 2016 ₹ 62,400. The new profit and loss sharing ratio for A, B and C was 7 : 5 : 3 respectively.

The net profit before interest for the year ended 31.12.2017 was ₹ 82,660.

Drawings were : A ₹ 24,000; B ₹ 18,000; C ₹ 16,000.

Prepare Profit and Loss Appropriation Account for the year ended 31.12.2017, Partners' Capital and Current Accounts.

Solution

Workings :

		₹
Total profit after interest for 3 years : ₹ (31,640 + 42,870 + 62,400)		1,36,910
Add: Interest on capital for 3 years @ 7% p.a. on ₹ (35,600 + 28,400)	13,440	
Less: Interest @ 7% p.a. on ₹ 10,000 for 6 months	350	13,090
Profit for 3 years before interest on capital		1,50,000

Therefore, Goodwill = ₹ 1,50,000 / 3 × 1.5 = ₹ 75,000

C's share of goodwill = ₹ 75,000 / 15 × 3 = ₹ 15,000.

Out of ₹ 45,000 brought in by C, ₹ 15,000 is to be treated as premium for goodwill and the balance ₹ 30,000 (₹ 45,000 – ₹ 15,000) is to be treated as capital.

Statement Showing Required Adjustment for Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 2)	(₹)	45,000	30,000	—
Right of goodwill after admission (7 : 5 : 3)	(₹)	35,000	25,000	15,000
Sacrifice (–) / Gain (+)	(₹)	(–) 10,000	(–) 5,000	(+) 15,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars		₹	Particulars	₹
To Interest on Capital A/c :			By Net Profit b/d	82,660
A — On ₹ 35,600 @ 7% p.a.	2,492			
B — On ₹ 28,400 @ 7% p.a.	1,988			
C — On ₹ 30,000 @ 7% p.a.	2,100	6,580		
To Share of Profit A/c :				
(A — ₹ 35,504; B — ₹ 25,360; C — ₹ 15,216)		76,080		
		82,660		82,660

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Dec. 31	To Balance c/d	35,600	28,400	30,000	Jan. 1	By Balance b/d	35,600	28,400	—
					"	By Bank A/c	—	—	30,000
		35,600	28,400	30,000			35,600	28,400	30,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Jan. 1	To Balance b/d	—	1,800	—	Jan. 1	By Balance b/d	1,400	—	—
Dec. 31	To Drawings A/c	24,000	18,000	16,000	"	By Premium for Goodwill A/c	10,000	5,000	—
"	To Balance c/d	25,396	12,548	1,316	Dec. 31	By Interest on Capital A/c	2,492	1,988	2,100
					"	By Share of Profit A/c	35,504	25,360	15,216
		49,396	32,348	17,316			49,396	32,348	17,316

Tutorial Note : When Capital Account is maintained under fixed capital method, premium for goodwill will be credited to Current Account.

Illustration 75

Gopal and Govind are partners sharing profits and losses in the ratio of 60 : 40. The firm's Balance Sheet as on 31.03.2018 was as follows :

Liabilities	₹	Assets	₹
Capital Accounts :		Fixed Assets	3,00,000
Gopal	1,20,000	Investments	50,000
Govind	80,000	Current Assets	2,00,000
Long Term Loan	2,00,000	Loans and Advances	1,00,000
Current Liabilities	2,50,000		
	6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as a partner from 1.4.2018 on the following terms :

Guru will be paid 40% of the profits. Guru will bring in cash ₹ 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows :

For the year ended 31.03.2016 — Profit ₹ 20,000 (includes insurance claim received of ₹ 40,000).

For the year ended 31.03.2017 — Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.03.2018 — Profit ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2018 as follows : Fixed Assets (Net) — ₹ 4,00,000; Investments — Nil; Current Assets — ₹ 1,80,000; Loans and Advances — ₹ 1,00,000.

The new profit sharing ratio after the admission of Guru was 35 : 25 : 40.

Pass Journal Entries on admission. Show goodwill calculation and prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet as on 1.4.2018 after the admission of Guru.

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 April 1	Bank A/c	Dr.	1,24,000	
	To Premium for Goodwill A/c (Note 1)			24,000
	To Guru Capital A/c			1,00,000
	(Being premium for goodwill and capital brought in by Guru)			
	Premium for Goodwill A/c	Dr.	24,000	
	To Gopal Capital A/c			15,000
	To Govind Capital A/c			9,000
	(Being the premium for goodwill shared by the old partners on the basis of their sacrifice)			
	Revaluation A/c	Dr.	70,000	
	To Investments A/c			50,000
	To Current Assets A/c			20,000
	(Being the downward revaluation of investments and current assets)			
	Fixed Assets A/c	Dr.	1,00,000	
	To Revaluation A/c			1,00,000
	(Being the upward revaluation of fixed assets)			
	Revaluation A/c	Dr.	30,000	
	To Gopal Capital A/c			18,000
	To Govind Capital A/c			12,000
	(Being the profit on revaluation shared by the old partners in their old profit sharing ratio)			

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

Particulars	₹	Particulars	₹
To Investments A/c	50,000	By Fixed Assets A/c	1,00,000
To Current Assets A/c	20,000		
To Partners' Capital A/cs:			
Gopal : ₹ 18,000; Govind : ₹ 12,000	30,000		
	1,00,000		1,00,000

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

Particulars	Gopal	Govind	Guru	Particulars	Gopal	Govind	Guru
To Balance c/d	1,53,000	1,01,000	1,00,000	By Balance b/d	1,20,000	80,000	—
				By Bank A/c	—	—	1,00,000
				By Premium for Goodwill A/c	15,000	9,000	—
				By Revaluation A/c	18,000	12,000	—
	1,53,000	1,01,000	1,00,000		1,53,000	1,01,000	1,00,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Guru Capital A/c	1,00,000	By Balance c/d	1,24,000
To Premium for Goodwill A/c	24,000		
	1,24,000		1,24,000

Balance Sheet as at 1st April, 2018 (after Guru's admission)

Liabilities	₹	Assets	₹
Capitals: Gopal	1,53,000	Fixed Assets	4,00,000
Govind	1,01,000	Current Assets (includes a bank balance of ₹ 1,24,000)	3,04,000
Guru	1,00,000	Loans and Advances	1,00,000
Long Term Loan	2,00,000		
Current Liabilities	2,50,000		
	8,04,000		8,04,000

Working Note : **(1) Calculation of Goodwill and its Adjustment**

Year ended on 31st March		2016	2017	2018
Profit / (Loss) for the year	(₹)	20,000	(80,000)	1,05,000
Adjustment for abnormal items	(₹)	*(40,000)	1,10,000	(25,000)
Normal Profit / (Loss)	(₹)	(20,000)	30,000	80,000

*Insurance claim received ₹ 40,000 included in the Profit for the year ended on 31 March, 2016 has been treated as abnormal item as nothing has been mentioned in the question regarding its nature.

Three years' total profit = – 20,000 + 30,000 + 80,000 = ₹ 90,000. Average profit ₹ 90,000 / 3 = ₹ 30,000. Goodwill is two years' purchase of average profit = ₹ 30,000 x 2 = ₹ 60,000. Therefore, premium for Goodwill to be brought in by Guru is 40% of ₹ 60,000 = ₹ 24,000. This premium for goodwill will be shared by Gopal and Govind as under :

	Gopal (₹)	Govind (₹)	Guru (₹)
Right of goodwill before admission (3 : 2)	36,000	24,000	—
Right of goodwill after admission (7 : 5 : 8)	21,000	15,000	24,000
Sacrifice (–) / Gain (+)	(–) 15,000	(–) 9,000	(+) 24,000

Illustration 76

A, B and C are partners sharing profits and losses in the ratio of 3:2:1. D is admitted as a new partner on 31.12.2017 for an equal share and is to pay ₹ 25,000 as capital. Following is the Balance Sheet on the date of admission:

Liabilities	₹	Assets	₹
Capital : A	30,000	Land and Buildings	25,000
Capital : B	30,000	Plant and Machinery	20,000
Capital : C	20,000	Furniture and Fixture	15,000
Creditors	15,000	Stock	10,000
Bills payable	5,000	Debtors	15,000
		Bills receivable	10,000
		Bank	5,000
	1,00,000		1,00,000

Following are the required adjustments on D's admission:

(i) Out of the creditors, a sum of ₹ 5,000 is owing to D.

(ii) Bills worth ₹ 8,000 were discounted with the bankers, out of which, a bill of ₹ 2,000 was dishonoured on 31.12.2017, but no entry has been passed for that. Due dates of the other discounted bills fall in January, 2018.

(iii) Unexpired insurance premium ₹ 600.

(iv) Expenses debited in the Profit and Loss Account includes a sum of ₹ 1,000 paid for B's personal life insurance policy.

(v) A provision for bad debts @ 5% is to be created against Debtors.

(vi) Expenses on revaluation amounting to ₹ 1,010 is paid by A.

(vii) During 2017, part of the furniture was sold for ₹ 2,500. The book value of the furniture sold was ₹ 4,000 and the written-down value on the date of sale is ₹ 3,500. The proceeds were wrongly credited to the Sales Account.

Required: Necessary Ledger Accounts and the Balance Sheet after D's admission.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Provision for bad debts A/c (Note 2)	850	By Prepaid Insurance Premium A/c	600
To A Capital A/c	1,010	By B Capital A/c	1,000
To Furniture A/c (Note 4)	4,000	By Partners' Capital A/cs	4,260
		(A – ₹ 2,130; B – ₹ 1,420; C – ₹ 710)	
	5,860		5,860

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	—	1,000	—	—	By Balance b/d	30,000	30,000	20,000	—
To Revaluation A/c	2,130	1,420	710	—	By Creditors A/c	—	—	—	5,000
To Balance c/d	28,880	27,580	19,290	25,000	By Bank A/c	—	—	—	20,000
					By Revaluation A/c	1,010	—	—	—
	31,010	30,000	20,000	25,000		31,010	30,000	20,000	25,000

Balance Sheet as at 31st December, 2017 (after D's admission)

Liabilities		₹	Assets		₹
Capitals :	A	28,880	Land and Buildings		25,000
	B	27,580	Plant and Machinery		20,000
	C	19,290	Furniture & Fixture		11,000
	D	25,000	Stock		10,000
Creditors		10,000	Debtors	17,000	
Bills payable		5,000	Less: Provision for bad debts	850	16,150
			Bills receivable		10,000
			Bank — ₹ (5,000 + 20,000 – 2,000)		23,000
			Prepaid Insurance Premium		600
		1,15,750			1,15,750

Working Notes:

(1) Contingent liability for bills discounted ₹ 6,000;

(2) Debtors after adjustment of bills dishonoured = ₹ 17,000. Provision is to be created @ 5%, i.e. ₹ 850.

(3) Capital brought in cash (₹ 25,000 – ₹ 5,000) = ₹ 20,000.

(4) For sale of furniture, the actual rectifying entry will be :

Sales Account	Dr.	₹ 2,500	
Depreciation Account ₹ (4,000 – 3,500)	Dr.	₹ 500	
Loss on Sale of Furniture Account	Dr.	₹ 1,000	
To Furniture Account			₹ 4,000

As all the nominal accounts have been closed at the time of preparing final account for 2017, the rectifying entry to be passed through Revaluation Account.

Revaluation Account	Dr.	₹ 4,000	
To Furniture Account			₹ 4,000

Alternatively,

Old Partners' Capital Account	Dr.	(old ratio)
To Furniture Account		

If alternative entry is passed, the loss on revaluation will be ₹ 260 only.

Illustration 77

P, Q and R were on partnership terms sharing profits and losses in the ratio of 6:3:1. They decided to take S into partnership with effect from April 1, 2017 on the following terms and conditions:

(i) S is to bring in his proportionate share of goodwill in cash. Goodwill is not to be brought into the books but necessary adjustments are to be made in the old Partners' Capital Accounts.

(ii) Goodwill to be valued at 60% of the average annual profits of the previous three or four years, whichever is the higher.

(iii) The average profits for the purpose of goodwill for the past years, were:
Year ending March 31, 2017 ₹ 48,000 Year ending March 31, 2016 ₹ 30,300
Year ending March 31, 2015 ₹ 31,200 Year ending March 31, 2014 ₹ 42,200

(iv) The new profit-sharing ratio between P, Q, R and S will be 3 : 3 : 3 : 1.

(v) S should bring in ₹ 20,000 as capital.

(vi) The new partner is to receive an annual salary of ₹ 12,000 in addition to his share of profit. R personally guaranteed that the aggregate of salary and share of profit of the new partner shall not be less than ₹ 25,000 p.a.
The draft accounts for the year ending March 31, 2018 showed a profit of ₹ 1,32,800 before taking into account the salary of S.

Show the Journal entries (including cash entries) passed at the time of admission of the partner and also the distribution of the net profit for the year ending March 31, 2018 between the partners.

Solution **In the books of P, Q and R**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017	Bank A/c	Dr.	22,275	
April 1	To Premium for Goodwill A/c (Note 1)			2,275
	To S Capital A/c			20,000
	(Being the capital and premium for goodwill brought in by X)			
	Premium for Goodwill A/c	Dr.	2,275	
	R Capital A/c	Dr.	4,551	
	To P Capital A/c			6,826
	(Being the appropriation of premium money)			

Statement Showing Distribution of Profit for the year ended 31st March, 2018

Particulars	P (₹)	Q (₹)	R (₹)	S (₹)
Salary	—	—	—	12,000
Balance (₹ 1,32,800 – ₹ 12,000) in the ratio 3 : 3 : 3 : 1	36,240	36,240	36,240	12,080
	36,240	36,240	36,240	24,080
Excess payable to S by R	—	—	(–) 920	(+) 920
Share of profit	36,240	36,240	35,320	25,000

Working Note :

(1) Calculation of the Value of the Goodwill and its adjustment : Average profit for the last three years is ₹ 36,500; Average profit for the last four years is ₹ 37,925; Goodwill is 60% of ₹ 37,925 = ₹ 22,755. Proportionate share of S on goodwill is ₹ 2,275.

Particulars	P (₹)	Q (₹)	R (₹)	S (₹)
Right of goodwill before admission (6 : 3 : 1)	13,653	6,827	2,275	—
Right of goodwill after admission (3 : 3 : 3 : 1)	6,827	6,827	6,826	2,275
Sacrifice (–) / Gain (+)	(–) 6,826	—	(+) 4,551	(+) 2,275

Illustration 78

Red, White and Blue are partners sharing profits as 4:3:2. For any change in partnership, goodwill is to be valued at 2.5 times the average profits for 4 years — but no Goodwill Account is to be raised. The profits are: 2014 — ₹ 50,000; 2015 — ₹ 60,000; 2016 — ₹ 56,000; 2017 — ₹ 86,000. On 31.12.2017, White and Blue acquire from Red an additional one-ninth share in the firm. On 1.1.2018, Red's son Pink is admitted. His share is to be 1/7th, of which a proportion calculated to produce ₹ 5,500 p.a. on the basis of the past profits, is ceded to him by his father; balance is to be purchased from White and Blue in proportion to their shares immediately prior to Pink's admission.

Show the present ratio and also pass Journal entries.

Solution **Calculation of Profit Sharing Ratio (Before Pink's Admission)**

Partners	Old ratio	Sacrifice/gain	New ratio
Red	4/9	(1/9 + 1/9) = 2/9 (sacrifice)	4/9 – 2/9 = 2/9
White	3/9	1/9 (gain)	3/9 + 1/9 = 4/9
Blue	2/9	1/9 (gain)	2/9 + 1/9 = 3/9

Average profits (50,000 + 60,000 + 56,000 + 86,000)/4 = ₹ 63,000; Value of goodwill = 63,000 x 2.5 = ₹ 1,57,500.

Adjustment for goodwill due to change in the profit sharing ratio

Particulars	Red (₹)	White (₹)	Blue (₹)
Right of goodwill before change (4 : 3 : 2)	70,000	52,500	35,000
Right of goodwill after change (2 : 4 : 3)	35,000	70,000	52,500
Sacrifice (–) / Gain (+)	(–) 35,000	(+) 17,500	(+) 17,500

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	White Capital A/c	Dr.	17,500	
	Blue Capital A/c	Dr.	17,500	
	To Red Capital A/c			35,000
	(Being adjustment for change in the profit-sharing ratio)			

Proportion that can produce ₹ 5,500 p.a. = 5,500 /63,000 = 11/126.
Pink's total share = 1/7; his father providing 11/126, so remaining (1/7 – 11/126) = 7/126 are to be purchased from White and Blue in the ratio 4:3. White will sell = 7/126 x 4/7 = 4/126; Blue will sell = 7/126 x 3/7 = 3/126.

Calculation of Profit Sharing Ratio (After Pink's Admission)

Partners	Old ratio	Sacrifice/gain	New ratio
Red	2/9	11/126 (sacrifice)	2/9 – 11/126 = 17/126
White	4/9	4/126 (sacrifice)	4/9 – 4/126 = 52/126
Blue	3/9	3/126 (sacrifice)	3/9 – 3/126 = 39/126
Pink	Nil	1/7 or 18/126 (gain)	= 18/126

Adjustment for goodwill on Pink's Admission

	Red (₹)	White (₹)	Blue (₹)	Pink (₹)
Right of goodwill before admission (2 : 4 : 3)	35,000	70,000	52,500	—
Right of goodwill after admission (17 : 52 : 39 : 18)	21,250	65,000	48,750	22,500
Sacrifice (–) / Gain (+)	(–) 13,750	(–) 5,000	(–) 3,750	(+) 22,500

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Pink Capital A/c ₹ (22,500 – 13,750)	Dr.	8,750	
	To White Capital A/c			5,000
	To Blue Capital A/c			3,750
	(Being adjustment for goodwill on Pink's admission)			

No entry is required for the amount ceded by Red ₹ 13,750.

(b) When value of assets and liabilities are to be shown in the Balance Sheet at original figures

All the partners may decide that the revised values of assets and liabilities should not be shown in the Balance Sheet to avoid ***departure from historical cost***. In this case, a Memorandum Revaluation Account is opened. Any increase in the value of assets (and/or decrease in the liabilities) is credited to Memorandum Revaluation Account. Similarly, any decrease in the value of assets (and/or increase in the liabilities) is debited to Memorandum Revaluation Account. If the credit side of the Memorandum Revaluation Account is more than the debit side, there is a profit. This profit should be transferred to Old Partners' Capital Accounts in the old profit-sharing ratio. The Journal entry will be:

Memorandum Revaluation Account Dr.
To Old Partners' Capital Accounts

If the debit side of the Memorandum Revaluation Account is more than the credit side, there is a loss which is transferred to Old Partners' Capital Accounts in the old profit-sharing ratio. The journal entry will be:

Old Partners' Capital Accounts Dr.
To Memorandum Revaluation Account

After completing the above procedure, reverse entries are made for increase in the values of assets and/or decrease in the liabilities, and decrease in the values of assets and/or increase in the liabilities) in the lower portion of the Memorandum Revaluation Account. The profit on revaluation is to be transferred to all Partners' Capital Accounts in the ***new profit-sharing ratio***.

The Journal entry will be :

Memorandum Revaluation Account Dr.
To All Partners' Capital Accounts (New ratio)

The loss on revaluation should be transferred to all partners' Capital Accounts in the new profit-sharing ratio. The Journal entry will be:

All Partners' Capital Accounts Dr. (New ratio)
To Memorandum Revaluation Account

It should be noted that if there is a profit in the upper portion of the Memorandum Revaluation Account, the lower protion of the Memorandum Revaluation Account must show a loss. Conversely, if the upper portion of the Memorandum Revaluation Account shows a loss, the lower portion of the Memorandum Revaluation Account must show a profit.

It should be noted that when a Memorandum Revaluation Account is prepared, the book values of assets and liabilities do not change — they remain at their historical cost to the partnership. In effect, the resultant profit or loss on revaluation is adjusted through the Partners' Capital Accounts. In this way, the amount invested as a capital by the incoming partner may be set at a level that reflects the current fair value of the partnership, even though the book values of assets and liabilities of the existing partnership remain unchanged in the books of accounts.

Illustration 79

A and B are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 31.3.2018 is given below:

Liabilities	₹	Assets	₹
Creditors	30,000	Freehold premises	2,00,000
Bills Payable	20,000	Plant	40,000
Capital A/c		Furniture	20,000
A	2,00,000	Office equipment	25,000
B	1,00,000	Stock	30,000
		Debtors	25,000
		Bank	10,000
	3,50,000		3,50,000

On 1.4.2018 they admit C on the following terms: (1) C will bring ₹ 50,000 as capital and ₹ 10,000 for goodwill for 1/5 share; (2) Provision for doubtful debts is to be made on debtors @ 2%; (3) Stock to be written down by 10%; (4) Freehold premises is to be revalued at ₹ 2,40,000, plant at ₹ 35,000, furniture ₹ 25,000 and office equipment ₹ 27,500; (5) Partners agreed that the values of the assets and liabilities remain the same and, as such, there should not be any change in their book values as a result of the above-mentioned adjustments. You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

Solution

Dr. Memorandum Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts A/c	500	By Freehold premises A/c	40,000
To Stock A/c	3,000	By Furniture A/c	5,000
To Plant A/c	5,000	By Office equipment A/c	2,500
To Profit on Revaluation A/c			
A Capital — 3/5	23,400		
B Capital — 2/5	15,600		
	47,500		47,500
To Freehold premises A/c	40,000	By Provision for Doubtful Debts A/c	500
To Furniture A/c	5,000	By Stock A/c	3,000
To Office equipment A/c	2,500	By Plant A/c	5,000
		By Loss on Revaluation A/c	
		A Capital — 12/25	18,720
		B Capital — 8/25	12,480
		C Capital — 5/25	7,800
	47,500		47,500

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

Particulars	A	B	C	Particulars	A	B	C
To Loss on revaluation A/c	18,720	12,480	7,800	By Balance b/d	2,00,000	1,00,000	—
To Balance c/d	2,10,680	1,07,120	42,200	By Bank A/c	—	—	50,000
				By Premium for Goodwill A/c	6,000	4,000	—
				By Profit on revaluation A/c	23,400	15,600	—
	2,29,400	1,19,600	50,000		2,29,400	1,19,600	50,000

Balance Sheet as at 1st April, 2018

Liabilities	₹	Assets	₹
Creditors	30,000	Freehold premises	2,00,000
Bills Payable	20,000	Plant	40,000
Capital A/c		Furniture	20,000
A	2,10,680	Office equipment	25,000
B	1,07,120	Stock	30,000
C	42,200	Debtors	25,000
		Bank (₹ 10,000 + ₹ 50,000 + ₹ 10,000)	70,000
	4,10,000		4,10,000

Illustration 80

The Balance Sheet of A, B and C, who share profits and losses as 3 : 2 : 1 respectively, as on 1.4.2018 is as follows :

Liabilities		₹	Assets		₹
Capital Accounts :	A	90,000	Building		80,000
	B	80,000	Machinery		70,000
	C	70,000	Debtors	40,000	
Current Accounts :	A	12,000	Less: Provision for Doubtful Debts	2,000	38,000
	B	8,000	Stock		1,05,000
Creditors		60,000	Cash		22,000
			Current Account : C		5,000
		3,20,000			3,20,000

D is admitted as a partner on the above date for 1/5th share in the profit and loss. Following are agreed upon :

(1) The profit and loss sharing ratio among the old partners will be equal.

(2) D brings in ₹ 75,000 as capital but is unable to bring in the required amount of premium for goodwill.

(3) An appropriate valuation of goodwill is to be made under the said circumstances based on all partners' capitals.

(4) Assets and liabilities are to be revealed as follows —
Building ₹ 1,03,000; Machinery ₹ 64,000; Provision for doubtful debts @ 10% on Debtors.

(5) Necessary adjustments regarding goodwill and profit or loss on revaluation are to be made through the Partners' Current Accounts.

(6) Except cash, the values of assets and liabilities are not to be altered in the Balance Sheet of the new firm.

(7) Capital Accounts of the old partners in the new firm should be proportionate to the new profit and loss sharing ratio — taking D's capital as base. The existing partners will not bring in any further capital. The necessary adjustments are to be made through the Partners' Current Accounts.

Prepare a Memorandum Revaluation Account, Partners' Capital and Current Accounts, and the Balance Sheet of the new firm after admission.

Solution

In the books of the Firm

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

Particulars	₹	Particulars	₹
To Machinery A/c	6,000	By Building A/c	23,000
To Provision for Doubtful Debts A/c	2,000		
To Partners' Current A/cs : (A—₹ 7,500; B—₹ 5,000; C—₹ 2,500)	15,000		
	23,000		23,000
To Building A/c	23,000	By Machinery A/c	6,000
		By Provision for Doubtful Debts A/c	2,000
		By Partners' Current A/cs (A—₹ 4,000; B—₹ 4,000; C—₹ 4,000; D—₹ 3,000))	15,000
	23,000		23,000

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance c/d (Note 1)	1,00,000	1,00,000	1,00,000	75,000	By Balance b/d	90,000	80,000	70,000	—
					By Bank A/c	—	—	—	75,000
					By Partners' Current A/cs (Balancing figure)	10,000	20,000	30,000	—
	1,00,000	1,00,000	1,00,000	75,000		1,00,000	1,00,000	1,00,000	75,000

Dr. **Partners' Current Accounts** **Cr.**

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	5,000	—	By Balance b/d	12,000	8,000	—	—
To Memorandum Revaluation A/c	4,000	4,000	4,000	3,000	By Memorandum Revaluation A/c	7,500	5,000	2,500	—
To Goodwill A/c (Note 2)	8,000	8,000	8,000	6,000	By Goodwill A/c (Note 2)	15,000	10,000	5,000	—
To Partners' Capital A/cs	10,000	20,000	30,000	—	By Balance c/d	—	9,000	39,500	9,000
To Balance c/d	12,500	—	—	—					
	34,500	32,000	47,000	9,000		34,500	32,000	47,000	9,000

Balance Sheet after D's Admission

Liabilities			₹	Assets		₹
Capital Accounts :	A	1,00,000		Building		80,000
	B	1,00,000		Machinery		70,000
	C	1,00,000		Stock		1,05,000
	D	75,000	3,75,000	Debtors	40,000	
Current Accounts :	A		12,500	Less: Provision for Doubtful Debts	2,000	38,000
Creditors			60,000	Cash ₹ (22,000 + 75,000)		97,000
				Current Accounts : B		9,000
				C		39,500
				D		9,000
			4,47,500			4,47,500

Working Notes :

(1) D joins the business for 1/5th share and brings in ₹ 75,000 as capital. Therefore, the total capital of the new firm will be ₹ 3,75,000 (₹ 75,000 × 5/1). The total capital of A, B and C will be ₹ 3,00,000 (₹ 3,75,000 – ₹ 75,000), which will be shared by them equally, i.e., ₹ 1,00,000 each.

(2) The total capital of A, B and C before the admission of D is ₹ 2,55,000 (₹ 90,000 + ₹ 80,000 + ₹ 70,000 + ₹ 12,000 + ₹ 8,000 – ₹ 5,000) plus the revaluation profit of ₹ 15,000, i.e., ₹ 2,70,000. But the capitals of A, B and C, after the admission of D, will be ₹ 3,00,000, without the existing partners bringing in any further capital. Therefore, the difference ₹ 30,000 (₹ 3,00,000 – ₹ 2,70,000) represents goodwill.

4. Reserve and Accumulated Profits / Losses

At the time of admission of a new partner any undrawn profit or retained earning and accumulated loss should be transferred to the Capital Accounts of the old partners in the ***old profit-sharing ratio***.

The Journal entry will be:

(i) Profit and Loss Account Dr.
General Reserve Account Dr.
Other Retained Earnings Account Dr.
To Old Partners' Capital Accounts [Old ratio]

If there is any accumulated loss, it should be transferred to the Old Partners' Capital/Current Accounts by passing the following entry:

Old Partners' Capital Accounts Dr. [Old ratio]
To Profit and Loss Account

All partners may decide that the reserve to be shown in the books of the new firm at its orginal figure.

Under this situation, Reserve is written-off first by debiting Reserve Account and crediting Old Partners' Capital Accounts in the old profit sharing ratio, then Reserve is raised in the books at its original value (or agreed value) by debiting All Partners' Capital Accounts in new profit sharing ratio and crediting the Reserve Account.

(i) General Reserve Account Dr.
To Old Partners' Capital Accounts [Old ratio]
(Being general reserve transferred to Old Partners' Capital Accounts in the old ratio).
(ii) All Partners' Capital Accounts Dr. [New Ratio]
To General Reserve Account [Agreed value]
(Being general reserve brought back in the books of account by debiting all partners in the new ratio)

Students must pass necessary entries for reserve and surplus or accumulated losses even if the question is silent on that point.

Illustration 81

A, B and C were Partners in a firm sharing profits and losses in the ratio 3:2:1 respectively. Following is their Balance Sheet as on 31.12.2017:

Liabilities	₹	Assets	₹
Capital — A	30,000	Land and Building	50,000
Capital — B	20,000	Furniture	15,000
Capital — C	10,000	Stock	20,000
Reserve	29,800	Bills Receivable	5,000
Creditors	6,200	Debtors	7,500
Bills Payable	4,000	Cash at bank	2,500
	1,00,000		1,00,000

D is to be admitted as a partner w.e.f. 1.1.2018 on the following terms :

(a) D 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) D will be entitled to 1/6th share in the profits of the firm; (c) The assets, will be revalued as: 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; and (e) Half of the Reserve to be withdrawn by the partners. Prepare necessary Ledger Accounts and the opening Balance Sheet of the new firm. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

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

Particulars	₹	Particulars	₹
To Furniture A/c	3,000	By Land and Building A/c	6,000
To Stock A/c	4,000	By Creditors A/c — Discount	300
To Debtors A/c	500	By Partners' Capital A/cs	
		(A — ₹ 600; B — ₹ 400; C — ₹ 200)	1,200
	7,500		7,500

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	600	400	200	—	By Balance b/d	30,000	20,000	10,000	—
To Bank A/c – reserve	7,450	4,967	2,483	—	By Reserve A/c	14,900	9,934	4,966	—
To Bank A/c – premium	3,000	2,000	1,000	—	By Premium for Goodwill A/c	6,000	4,000	2,000	—
To Balance c/d	39,850	26,567	13,283	15,000	By Bank A/c	—	—	—	15,000
	50,900	33,934	16,966	15,000		50,900	33,934	16,966	15,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	2,500	By Partners' Capital A/cs — Premium	6,000
To Premium for Goodwill A/c	12,000	By Partners' Capital A/cs — Reserve	14,900
To D Capital A/c	15,000	By Creditors A/c	2,000
		By Balance c/d	6,600
	29,500		29,500

Balance Sheet as at 1st January, 2018

Liabilities	₹	Assets	₹
Capital — A	39,850	Land and Building	56,000
Capital — B	26,567	Furniture	12,000

Capital — C	13,283	Stock	16,000
Capital — D	15,000	Bills Receivable	5,000
Creditors (₹ 6,200 – ₹ 2,300)	3,900	Debtors	7,000
Bills Payable	4,000	Cash at Bank	6,600
	1,02,600		1,02,600

5. Adjustment of Capital

When a new partner is admitted into the partnership, he is to bring in capital.

The amount of capital to be brought in by the new partner will depend upon the agreement between the partners. In some cases, the capital of the new partner is determined on the basis of the adjusted combined capital of the old partners.

Sometimes after admission of a new partner, all the partners may decide to make their capitals proportionate to the profit sharing ratio or other ratios. In that case, old partners' capitals will be changed. Some partners will bring in new capital to make up deficit of his capital and others will withdraw their excess capital.

Adjustments under different situations are shown below :

Case 1 : When the new partner will bring proportionate capital of the firm

For calculating the capital to be brought in by the new partner, the following steps are to be followed:

Step 1. Calculate the adjusted combined capital of the old partners as follows :

Opening combined capital	****
Add : Goodwill to be adjusted	****
Add : Revaluation profit	****
Add : Reserve and surplus of the old partners	****
	****
Less : Revaluation loss	****
Less : Profit and Loss Account (Debit balance)	****
Adjusted combined capital of old partners	****

Step 2. Calculate the combined share of profit of the old partners after deducting the share of new partner.

Step 3. Calculate the total capital of the firm based on adjusted combined capital as calculated in Step 1 above.

Step 4. Calculate the capital of the new partner based on total capital of the firm as calculated in Step 3.

Case 2 : When the old partners' capital to be fixed on the basis of the capital of the new partner

For calculating the revised capital of the old partners in the new partnership, the following steps are to be followed :

Step 1 : Calculate total capital of the firm with the help of the following formula :

$$\text{Total capital of the firm} = \frac{\text{Capital of the new partner}}{\text{Share of profit of the new partner}}$$

Step 2 : Calculate the proportionate capital of the old partners on the basis of the new profit sharing ratio.

Step 3 : Ascertain the present capital of the old partners (after all adjustments)

Step 4 : Find out the surplus capital / deficit capital by comparing proportionate capital (ascertained in Step 2) and present capital (ascertained in Step 3).

Surplus occurs when Present capital is greater than Proportionate capital
Deficit occurs when Present capital is less than Proportionate capital

Step 5 : Pass necessary journal entry for adjusting the above surplus / deficit.

It should be noted that surplus capital is transferred to Current Account or it may be withdrawn by the old partners as per agreement between the partners. Similarly, the deficit capital is brought in by the old partner or it is transferred to Current Accounts of the old partner.

Illustration 82

The following is the Balance Sheet of A and B as at March 31, 2007. C is admitted as a partner on that date when the position of A and B was as under :

Liabilities	₹	Assets	₹
A's Capital	10,000	Debtors	11,000
B's Capital	8,000	Land and Building	8,000
Creditors	12,000	Plant and Machinery	10,000
General Reserve	16,000	Stock of Goods	12,000
Workmen's Compensation Fund	4,000	Cash and Bank Balance	9,000
	50,000		50,000

A and B shared profits in the proportion of 3 : 2. The following terms of admission are agreed upon :

(a) Revaluaton of Assets : Land and Buildings ₹ 18,000 and Stock of Goods ₹ 16,000.

(b) The liability on Workmen's Compensation Fund is determined at ₹ 2,000.

(c) C brought in as his share of goodswill ₹ 10,000 in cash.

(d) C was to bring further cash as would make his capital equal to 20% of the combined capitals of partners A and B after above revaluation and adjustments are carried out.

(e) the future profit sharing proportions are : A — 2/5th; B — 2/5th; and C — 1/5th.

Prepare the new Balance Sheet of the firm and the Capital Accounts of the Partners. ***[C.U.B.Com. (Hons.) — 2008]***

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	39,200	20,800	12,000	By Balance b/d	10,000	8,000	—
				By Premium for Goodwill (Note 2)	10,000	—	—
				By General Reserve	9,600	6,400	—
				By Workmen's C. Fund	1,200	800	—
				By Revaluation A/c (Note 2)	8,400	5,600	—
				By Bank (Note 1)	—	—	12,000
	39,200	20,800	12,000		39,200	20,800	12,000

Balance Sheet as at 31st March, 2007

Liabilities	₹	Assets	₹
Partners' Capital A/cs : A	39,200	Land and Building	18,000
B	20,800	Plant and Machinery	10,000
C	12,000	Stock of Goods	16,000
Creditors	12,000	Debtors	11,000
Workmen's Compensation Fund	2,000	Cash and Bank (Note 4)	31,000
	86,000		86,000

Working Notes :

	₹
(1) Opening combined capital ₹ (10,000 + 8,000)	18,000
Add: Goodwill premium	10,000
Revaluation profit ₹ (10,000 + 4,000)	14,000
General reserve	16,000
Workmen's compensation fund ₹ (4,000 – 2,000)	2,000
Adjusted combined capital of A and B	60,000

(2) Revaluation Account

Particulars	₹	Particulars	₹
To Partners' Capital A/cs		By Land and Building A/c	10,000
A (3/5)	8,400	By Stock of Goods A/c	4,000
B (2/5)	5,600		
	14,000		14,000

(3) Adjustment of Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	30,000	20,000	—
Right of goodwill after admission (2 : 2 : 1)	20,000	20,000	10,000
Sacrifice (–) / Gain (+)	(–)10,000	Nil	(+) 10,000

Total value of goodwill = ₹ 10,000 × 5/1 = ₹ **50,000**.
(4) Cash at Bank = ₹ 9,000 + 10,000 + 12,000 = ₹ **31,000**.

Illustration 83

A, B and C are partners sharing profits and losses in the ratio of 2 : 3 : 5. On 31st May, 2018, their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capitals :	A	36,000		Cash	18,000
	B	44,000		Bills Receivable	24,000
	C	52,000	1,32,000	Furniture	28,000
Creditors			64,000	Stock	44,000
Bills Payable			32,000	Debtors	42,000
Profit and Loss Account			14,000	Investments	32,000
				Machinery	34,000
				Building	20,000
			2,42,000		2,42,000

They admit D into partnership on the following terms :

(1) Furniture, investments and machinery to be depreciated by 15%
(2) Stock is revalued at ₹ 48,000.
(3) Building to be valued at ₹ 26,000.
(4) Outstanding rent amounted to ₹ 1,800.
(5) Prepaid salaries ₹ 800.
(6) D to bring ₹ 32,000 towards capital for 1/6th share and other partners to re-adjust their Capital Accounts on the basis of their profit sharing ratio.
(7) Adjustments of capitals to be made by cash.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and Balance Sheet of the new firm.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Furniture A/c (15% of ₹ 28,000)	4,200	By Stock A/c (₹ 48,000 – 44,000)	4,000
To Investments A/c (15% of ₹ 32,000)	4,800	By Prepaid Salaries A/c	800
To Machinery A/c (15% of ₹ 34,000)	5,100	By Building A/c	6,000
To Outstanding Rent A/c	1,800	By Partners' Capital A/cs :	
		A	1,020
		B	1,530
		C	2,550
	15,900		15,900

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D (₹)
To Revaluation A/c	1,020	1,530	2,550	—	By Balance b/d	36,000	44,000	52,000	—
To Cash A/c (Note 2)	5,780	—	—	—	By Profit & Loss A/c	2,800	4,200	7,000	—
To Balance c/d	32,000	48,000	80,000	32,000	By Cash A/c	—	—	—	32,000
(Note 2)					By Cash A/c (Note 2)	—	1,330	23,550	—
	38,800	49,530	82,550	32,000		38,800	49,530	82,550	32,000

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By A Capital A/c	5,780
To D Capital A/c	32,000	By Balance c/d	69,100
To B Capital A/c	1,330		
To C Capital A/c	23,550		
	74,880		74,880

Balance Sheet of A, B, C and D as at 1st June, 2018

Liabilities			₹	Assets	₹
Capitals :	A	32,000		Building	26,000
	B	48,000		Machinery	28,900
	C	80,000		Furniture	23,800
	D	32,000	1,92,000	Investments	27,200
Creditors			64,000	Stock	48,000
Outstanding Rent			1,800	Debtors	42,000
Bills Payable			32,000	Bills Receivable	24,000
				Cash	69,100
				Prepaid Salaries	800
			2,89,800		2,89,800

Working Notes :

(1) Calculation of New Profit Sharing Ratio

D joins the firm for 1/6th share of profit. Therefore, 1 – 1/6 = 5/6th will be shared by A, B and C in the ratio of 2 : 3 : 5.

So, A's share of profit = 2/10 of 5/6 = 10/60

B's share of profit = 3/10 of 5/6 = 15/60

C's share of profit = 5/10 of 5/6 = 25/60

D's share of profit = 1/6 or 10/60

The new profit sharing ratio = A : B : C : D = 10 : 15 : 25 : 10 = 2 : 3 : 5 : 2

(2) Calculation of Amount of Capital to be Withdrawn / Introduced

Step 1 : Calculation of total capital of the new firm

$$\text{Total capital of the firm} = \frac{\text{Capital of the new partner}}{\text{Share of profit of the new partner}}$$

$$= ₹\ 32,000 \times 6/1 = ₹\ 1,92,000$$

Step 2 : Calculation of proportionate capital of the old partners on the basis of the new profit sharing ratio

A's capital = ₹ 1,92,000 × 2/12 = ₹ 32,000;

B's capital = ₹ 1,92,000 × 3/12 = ₹ 48,000;

C's capital = ₹ 1,92,000 × 5/12 = ₹ 80,000.

Step 3 : Present capital of the old partners

A : ₹ (36,000 + 2,800 + 1,200 – 2,220) = ₹ 37,780; B : ₹ (44,000 + 4,200 + 1,800 – 3,330) = ₹ 46,670; C : ₹ (52,000 + 7,000 + 3,000 – 5,550) = ₹ 56,450.

Step 4 : Ascertainment of Capital to be Withdrawn or Brought in

Particulars	A (₹)	B (₹)	C (₹)
Required new capital (see Step 2)	32,000	48,000	80,000
Present capital (see Step 3)	37,780	46,670	56,450
Withdrawn (–) / Brought in (+)	(–) 5,780	(+)1,330	(+)23,550

Illustration 84

A and B share profits and losses as 3 : 1. Their Balance Sheet as on 30th June 2018 is as under:

Liabilities	₹	Assets		₹
A Capital	60,000	Land and Building		50,000
B Capital	32,000	Furniture		2,000
Creditors	75,000	Debtors	33,000	
General reserve	8,000	Less: Provision for doubtful debts	1,000	32,000
		Bills Receivable		6,000
		Stock in trade		40,000
		Cash at bank		45,000
	1,75,000			1,75,000

C is admitted on 1.7.2018 on the following terms:

(1) C to bring in ₹ 20,000 as his capital and to be entitled to a fifth share in the profits.

(2) Goodwill valued at ₹ 50,000. C was to bring half of his share of goodwill in cash and other half was to be purchased by him from the existing partners by book adjustment. The necessary amount was debited to C's current account. No Goodwill Account was to be raised in the books.

(3) The value of stock and furniture was to be reduced by 10% and the reserve for doubtful debts was to be brought to 10% of debtors.

(4) Value of land and building was to be increased by 15%.

(5) The capitals of partners in the new firm are to be in the profit sharing ratio — the capital of C being taken as the basic capital. The excess amount of capital, if any, to be paid-off in cash.

You are required to prepare Journal entries, Capital Accounts of the partners and the new Balance Sheet.

Solution

Working Notes : C is coming for 1/5th share. Therefore, 4/5th remains for A and B which will be shared in the ratio of 3 : 1. A will get 3/4 of 4/5 = 3/5; B will get 1/4 of 4/5 = 1/5 and C 1/5. Now, the capital brought in by C is ₹ 20,000 for 1/5th share. The total capital of the firm will be 5/1 x 20,000 = ₹ 1,00,000.

A = 3/5 of 1,00,000 = ₹ 60,000; B = 1/5 of 1,00,000 = ₹ 20,000; and C = ₹ 20,000.

In the books of A, B and C

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 July 1	Bank A/c	Dr.	25,000	
	To C Capital A/c			20,000
	To Premium for Goodwill A/c			5,000
	(Being the amount of capital and 50% of the premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	5,000	
	To A Capital A/c			3,750
	To B Capital A/c			1,250
	(Being the premium for goodwill credited to the old partners on the basis of their sacrifice)			
	C Current A/c	Dr.	5,000	
	To A Capital A/c			3,750
	To B Capital A/c			1,250
	(Being the adjustment through the current account of C for non-payment of 50% of the premium for goodwill)			
	General Reserve A/c	Dr.	8,000	
	To A Capital A/c			6,000
	To B Capital A/c			2,000
	(Being the general reserve credited to the old partners in the old profit sharing ratio)			
	Revaluation A/c	Dr.	6,500	
	To Stock A/c			4,000
	To Furniture A/c			200
	To Provision for Doubtful Debts A/c			2,300
	(Being the decrease in the value of the above assets and also creation of provision for doubtful debts)			
	Land and Building A/c	Dr.	7,500	
	To Revaluation A/c			7,500
	(Being the increase in the value of land and building)			
	Revaluation A/c	Dr.	1,000	
	To A Capital A/c			750
	To B Capital A/c			250
	(Being the profit on revaluation credited to old partners)			
	A Capital A/c	Dr.	14,250	
	B Capital A/c	Dr.	16,750	
	To Bank A/c			31,000
	(Being excess money withdrawn by the partners to make their capital in the ratio of the new partner)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Bank A/c	14,250	16,750	—	By Balance b/d	60,000	32,000	—
To Balance c/d	60,000	20,000	20,000	By Bank A/c	—	—	20,000
				By Premium for Goodwill A/c	3,750	1,250	—
				By C Current A/c	3,750	1,250	—
				By Revaluation A/c	750	250	—
				By General Reserve A/c	6,000	2,000	—
	74,250	36,750	20,000		74,250	36,750	20,000

Balance Sheet as at 1st July, 2018

Liabilities	₹	Assets		₹
A Capital	60,000	Land and Building		57,500
B Capital	20,000	Furniture		1,800
C Capital	20,000	Stock in trade		36,000
Creditors	75,000	Debtors	33,000	
		Less: Provision for doubtful debts	3,300	29,700
		Bills Receivable		6,000
		Cash at bank		39,000
		C Current A/c		5,000
	1,75,000			1,75,000

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 85

The Balance Sheet of M/s PQ, a partnership firm, as on 31st December, 2014 was as follows :

Liabilities	₹	Assets	₹
P's Capital	45,300	Land and Buildings	60,000
Q's Capital	53,100	Furniture	16,000
Bank Loan	30,000	Stock	57,700
Sundry Creditors	31,200	Sundry Debtors	28,000
Bills Payable	15,000	Cash	30,900
Workmen's Compensation Fund	18,000		
	1,92,600		1,92,600

P and Q share profits and losses in the ratio of 3 : 2. On 1st January, 2015, they admitted R to the partnership firm on the following conditions :

(a) R would bring ₹ 45,000 as capital. He would not bring his share of goodwill of ₹ 15,000 in cash and so the amount of goodwill would be raised in the books and written off.

(b) R would be entitled to 1/3rd share in profits.

(c) The new profit and loss sharing ratio between P, Q and R will be 6 : 4 : 5.

(d) The value of land and building to be increased by ₹ 15,000 and that of furniture to be reduced by ₹ 1,000. The stock should be reduced by 10%. A provisionb for bad debts is to be created @ 5% on Sundry Debtors.

(e) The actual liability of workmen's compensation fund is estimated at ₹ 3,000.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm after the admission of the new partner. ***[C.U.B.Com. (General) — 2016]***

Solution

In the books of M/S PQ

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Furniture A/c	1,000	By Land and Buildings A/c	15,000
To Stock A/c	5,770		
To Provision for Bad Debts A/c (Note 2)	1,400		
To Partners' Capital A/cs :			
P	4,098		
Q	2,732		
	15,000		15,000

Partners' Capital Accounts

Dr. **Cr.**

Particulars	P	Q	R	Particulars	P	Q	R
To Goodwill A/c (Note 1)	—	—	15,000	By Balance b/d	45,300	53,100	—
To Balance c/d	67,398	67,832	30,000	By Bank A/c	—	—	45,000
				By Goodwill A/c (Note 1)	9,000	6,000	—
				By Workmen's Compensation Fund (Note 3)	9,000	6,000	—
				By Revaluation A/c	4,098	2,732	
	67,398	67,832	45,000		67,398	67,832	45,000

Balance Sheet of M/s PQ as at 1st January, 2015

Liabilities	₹	Assets		₹
P Capital	67,398	Land and Building		75,000
Q Capital	67,832	Furniture		15,000
R Capital	30,000	Stock		51,930
Sundry Creditors	31,200	Sundry Debtors	28,000	
Bills Payable	15,000	Less: Provision for bad debts	1,400	26,600
Workmen Compensation Fund	3,000	Cash (Note 3)		45,900
	2,14,430			2,14,430

Working Notes :

(1) R's share of goodwill = ₹ 15,000. Therefore, the total value of goodwill = 15,000 × 3/1 = ₹ **45,000**.

Statement Showing the Adjustment for Goodwilll

Particulars	P (₹)	Q (₹)	R (₹)
Right of goodwill before admission (3 : 2)	27,000	18,000	—
Right of goodwill after admission (6 : 4 : 5))	18,000	12,000	15,000
Sacrifice (–) / Gain (+)	9,000	6,000	(15,000)

(2) Balance of Workmen's Compensation Fund 18,000

Less: Actual Liability of Workmen's Compensation Fund 3,000

Excess 15,000

This excess amount will be credited to P and Q in the profit-sharing ratio, i.e., 3 : 2.

P's share will be (15,000 ÷ 5) × 3 = 9,000

Q's share will be (15,000 ÷ 5) × 2 = 6,000

Total 15,000

(3) Cash Balance after Admission :

Opening balance	30,900	
Add: Capital brought-in	45,000	75,900
Less: Loan paid		30,000
		45,900

Illustration 86

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as on 31st December, 2013 was as follows : :

Liabilities	₹	Assets	₹
Creditors	37,000	Cash at Bank	3,500
Capital Accounts :		Debtors	30,000
A	40,000	Stock	36,000
B	30,000	Furniture	7,500
		Machinery	30,000
	1,07,000		1,07,000

On 01.01.2014 they decided to admit C as a new partner for 1/5th share in the profits subject to the following adjustments:

(a) ₹ 2,500 was to be provided for doubtful debts.

(b) Furniture was revalued at ₹ 6,500, Machinery at ₹ 35,000, Stock at ₹ 34,000 and Goodwill at ₹ 10,000.

(c) Investments worth ₹ 5,000 (not shown in the books) were to be taken into account.

(d) C was to bring required premium for Goodwill and proportionate capital.

(e) Future profit sharing ratio as between A and B was to be equal.

Show Journal Entries, Capital Accounts of the partners and prepare opening Balance Sheet of the new firm.

[C.U.B.Com. (General) — 2014]

Solution

In the books of A and B

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		2,500	By Machinery A/c	5,000
To Furniture A/c		1,000	By Investment A/c	5,000
To Stock A/c		2,000		
To Partners Capital A/cs :				
A	2,700			
B	1,800	4,500		
		10,000		10,000

Premium for Goodwill = ₹ 10,000 × 1/5 = ₹ **2,000**.

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance c/d	44,700	31,800	19,125	By Balance b/d	40,000	30,000	—
				By Revaluation A/c	2,700	1,800	—
				By Bank A/c (Premium for Goodwill)	2,000	—	—
				By Bank A/c	—	—	19,125
	44,700	31,800	19,125		44,700	31,800	19,125

Balance Sheet of A, B and C as on 1st January, 2014

Liabilities	₹	Assets		₹
Capital A/cs :		Machinery		35,000
A	44,700	Furniture		6,500
B	31,800	Investment		5,000
C	19,125	Stock		34,000
Creditors	37,000	Debtors	30,000	
		Less: Provision for Bad Debts	2,500	27,500
		Bank (₹ 3,500 + 2,000 + 19,125)		24,625
	1,32,625			1,32,625

Working Notes :

(1) C's Share = 1/5

Balance left for A + B = 1 – 1/5 = 4/5

A's share = 4/5 × 1/2 = 4/10

B's share = 4/5 × 1/2 = 4/10

C's share = 1/5 × 2/2 = 2/10

or

4 : 4 : 2 or 2 : 2 : 1.

Sacrificing Ratio = Old Ratio – New Ratio

$$A = \frac{3}{5} - \frac{2}{5} = \frac{3-2}{5} = \frac{1}{5}$$

$$B = \frac{2}{5} - \frac{2}{5} = \text{Nil}$$

(2) Capital Introduced by C

A + B Capital = ₹ 44,700 + ₹ 31,800 = ₹ 76,500

4/5 share = ₹ 76,500

1 share = ₹ 76,500 × 5/4 = ₹ 95,625

1/5 share = ₹ 95,625 × 5/4 × 1/5 = ₹ **19,125**

Illustration 87

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet on 31.12.2010 stands as under :

Liabilities		₹	Assets		₹
Creditors		70,000	Cash		8,000
Capital Accounts :			Debtors	44,000	
A	80,000		Less: Provision for Doubtful Debts	4,000	40,000
B	40,000	1,20,000	Stock		36,000
			Machinery		40,000
			Land and Building		66,000
		1,90,000			1,90,000

On 1.1.2011, they agreed to take C as a partner on the following conditions :

(i) The goodwill of the firm shall be valued at ₹ 47,500 and C shall pay his share of goodwill in cash.

(ii) C shall contribute ₹ 30,000 as his share of capital.

(iii) Land and Building shall be valued at ₹ 84,000. Machinery shall be depreciated by ₹ 10,000. Provision for doubtful debts shall be raised to ₹ 6,000 and another provision shall be made for a probable liability for damages amounting to ₹ 2,600.

(iv) The new profit and loss sharing ratio between A, B and C will be 9:6:4.

(v) The capital shall be adjusted (without disturbing the ultimate total capital) so as to correspond with the new ratio, the excess or deficit being transferred to their respective current accounts.

Prepare Revaluation Account, Partners' Capital Accounts and the opening Balance Sheet of the new firm.

[C.U.B.Com. (General) — 2011]

Solution

Sacrificing Ratio = Old Ratio – New Ratio

$A = \frac{3}{5} - \frac{9}{19} = \frac{57 - 45}{95} = 12/95 \qquad B = \frac{2}{5} - \frac{6}{19} = \frac{38 - 30}{95} = 8/95$

Sacrificing Ratio = 12 : 8, i.e., 3 : 2

Premium for goodwill brought in by C = 47,500 × 4/19 = ₹ 10,000.

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Machinery		10,000	By Land and Buildings	18,000
To Provision for Bad Debts		2,000		
To Provision for Liability for Damages		2,600		
To Partners' Capital A/cs :				
A : 3/5	2,040			
B : 2/5	1,360	3,400		
		18,000		18,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	88,040	45,360	30,000	By Balance b/d	80,000	40,000	—
				By Premium for Goodwill (3 : 2)	6,000	4,000	—
				By Revaluation (Profit)	2,040	1,360	—
				By Cash (Capital)	—	—	30,000
	88,040	45,360	30,000		88,040	45,360	30,000
To Current A/c	10,640	—	—	By Balance b/d	88.040	45.360	30.000
To Balance c/d	77,400	51,600	34,400	By Current A/c (See below)	—	6.240	4.400
	88,040	51,600	34,400		88,040	51,600	34,400

Adjustment of Capital

Particulars	A	B	C	Total
Adjusted Capital (after all adjustments)	88,040	45,360	30,000	1,63,400
Total Capital in new profit sharing ratio (9 : 6 : 4)	77,400	51,600	34,400	1,63,400
Transferred to Current A/c	10,640	(6,240)	(4,400)	Nil

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	8,000	By Balance c/d	48,000
To Premium for Goodwill A/c	10,000		
To C Capital A/c	30,000		
	48,000		48,000

Balance Sheet of A, B and C as at 31.1.2011 (after admission)

Liabilities	₹	Assets		₹
Creditors	70,000	Cash		48,000
Provision for Damages	2,600	Debtors	44,000	
Current A/c :		Less: Provision for Doubtful Debts	6,000	38,000
A	10,640	Current A/c :		
Capital A/cs :		B		6,240
A	77,400	C		4,400
B	51,600	Stock		36,000
C	34,400	Machinery		30,000
		Land and Building		84,000
	2,46,640			2,46,640

[For Honours Candidates Only]

Illustration 88

X and Y are in a partnership sharing profits and losses in 3 : 2 ratio. Z was admitted as the new partner. Before admitting Z into partnership, the Balance Sheet of X and Y was as under :

Balance Sheet as on 31.12.2014

Liabilities	₹	Assets	₹
X Capital	15,000	Land and Building	12,000
Y Capital	12,000	Plant and Machinery	15,000
Sundry Creditors	18,000	Stock	18,000
General Reserve	24,000	Sundry Debtors	16,000
Workment's Compensation Fund	6,000	Cash	14,000
	75,000		75,000

On 1st January, 2015, Z was admitted to partnership on the following conditions :

(1) The future profit sharing ratio will be : X 2/5th; Y 2/5th and Z 1/5th.

(b) Revaluation of assets — Land and Building ₹ 27,000 and Stock ₹ 24,000.

(c) The actual liability of Workmen's Compensation Fund is estimated at ₹ 3,000.

(d) Z brought in ₹ 15,000 as his share of Goodwill in cash.

(e) Z would bring further cash as would be necessary so as to make his capital equal to 20% of combined capital of partners X and Y after above revaluation and adjustments are carried out.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm after the admission of the new partner.

[C.U.B.Com. (Hons.) — 2016]

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Partners' Capital A/cs :		By Land and Building A/c	15,000
X (3/5)	12,600	By Stock A/c	6,000
Y (2/5)	8,400		
	21,000		21,000

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015		₹	₹	₹	2015		₹	₹	₹
	To Balance c/d	58,800	31,200	18,000	Jan. 1	By Balance b/d	15,000	12,000	—
						By General Reserve A/c	14,400	9,600	—
						By Workmen Compensation Fund	1,800	1,200	—
						By Premium for Goodwill (Note 1)	15,000	—	—
						By Revaluation A/c	12,600	8,400	—
						By Cash A/c (Note 2)	—	—	18,000
		58,800	31,200	18,000			58,800	31,200	18,000

Balance Sheet as at 1st January, 2015

Liabilities	₹	Assets	₹
By Partners' Capital A/cs :		Land and Building	27,000
X	58,800	Plant and Machinery	15,000
Y	31,200	Stock	24,000
Z	18,000	Sundry Debtors	16,000
Sundry Creditors	18,000	Cash (Note 3)	47,000
Workmen Compensation Fund	3,000		
	1,29,000		1,29,000

Working Notes :

(1) Premium for goodwill brought-in by Z is ₹ 15,000 for his 1/5 share of profit. This premium for goodwill should be distributed in the sacrificing ratio between X and Y.

Calculation of Sacrificing Ratio

Partners	Share of Old Profit	New Share of Profit	
X	$\frac{3}{5}$	$\frac{2}{5}$	$\frac{3}{5} - \frac{2}{5} = \frac{1}{5}$ (Sacrifice)
Y	$\frac{2}{5}$	$\frac{2}{5}$	$\frac{2}{5} - \frac{2}{5} = 0$

In this case, only X sacrificed. Therefore, the entire premium for goodwill will be credited to X.

(2) Combined Capital of X and Y

	₹
X Capital	58,800
Y Capital	31,200
	90,000

Z's capital = 20% of ₹ 90,000 = ₹ 18,000.

(3) Cash after admission : ₹ 14,000 + ₹ 15,000 + ₹ 18,000 = ₹ **47,000**.

Illustration 89

A and B are partners in a firm sharing profits and losses in the ratio of 4 : 1. Their Balance Sheet as on 31st March, 2014 is as under :

Liabilities	₹	Assets	₹
Capital Accounts :		Furniture	25,000
A	30,000	Stock	50,000
B	70,000	Bills Receivable	12,000
Reserve	25,000	Debtors	40,000
Creditors	30,000	Cash at Bank	38,000
Bills Payable	10,000		
	1,65,000		1,65,000

They agreed to take C as a partner with effect from 1st April, 2014 on the following terms :

(a) A, B and C will share profits and losses in the ratio of 5 : 3 : 2.

(b) C will bring ₹ 15,000 as premium for goodwill and ₹ 35,000 as capital.

(c) The assets will be revalued as follows : Furniture ₹ 35,000; Stock ₹ 48,500 and Debtors ₹ 38,500.

(d) A creditor for ₹ 15,000 has agreed to forgo his claim by ₹ 4,000.

(e) After making the above adjustments, the Capital Account 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 and Partners' Capital Account and prepare Balance Sheet of the new firm on 1st April, 2014. ***[C.U.B.Com. (Hons.) — 2014]***

Solution

Sacrificing Ratio = Old Ratio – New Ratio

$A = \frac{4}{5} - \frac{5}{10} = \frac{8-5}{10} = \frac{3}{10}$ $\qquad B = \frac{1}{5} - \frac{3}{10} = \frac{2-3}{10} = \frac{1}{10}$ (Gain)

Gain by B = 15,000 × 10/2 × 1/10 = 7,500.

Total capital of the firm on the basis of C's capital = ₹ 35,000 × 10/2 = ₹ 1,75,000.

A's Capital = ₹ 1,75,000 × 5/10 = ₹ 87,500

B's Capital = ₹ 1,75,000 × 3/10 = ₹ 52,500

C's Capital = ₹ 1,75,000 × 2/10 = ₹ 35,000

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

Date	Particulars		₹	Date	Particulars	₹
	To Stock		1,500		By Furniture	10,000
	To Provision for Bad Debts		1,500		By Creditors	4,000
	To Partner's Capital A/cs :					
	A	8,800				
	B	2,200	11,000			
			14,000			14,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
	To A Capital (Gain)		7,500			By Balance b/d	30,000	70,000	
	To Bank (Cash withdrawn)		17,200			By Reserve	20,000	5,000	
	To Balance c/d	87,500	52,500	35,000		By Bank (Note 1)	15,000		
						By Bank			35,000
						By Revaluation (Profit)	8,800	2,200	
						By B Capital (Gain)	7,500		
						By Bank (Cash brought in)	6,200		
		87,500	77,200	35,000			87,500	77,200	35,000

Balance Sheet of A, B and C as at 1st April, 2014

Liabilities	₹	Assets			₹
Capital :		Furniture			35,000
A	87,500	Stock			48,500
B	52,500	Bills Receivable			12,000
C	35,000	Debtors	40,000		
Creditors (₹ 30,000 – 4,000)	26,000	Less: Provision for Bad Debts		1,500	38,500
Bills Payable	10,000	Bank			77,000
	2,11,000				2,11,000

Working Notes :

(1) Premium brought in by C ₹ 15,000. B has not sacrificed anything. Therefore, the entire amount of premium will be credited to A's Capital Account.

Dr. (2) Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	38,000		By B Capital	17,200
	To A Capital (Premium for Goodwill)	15,000		By Balance c/d	77,200
	To A Capital	6,200			
	To C Capital	35,000			
		94,200			94,200

Special Problems

Illustration 90

A and B are in partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their Balance Sheet on 31st March, 2018 was as follows: Cash ₹ 1,000; Sundry Debtors ₹ 25,000; Stock ₹ 22,000; Plant and Machinery ₹ 4,000; Sundry Creditors ₹ 12,000; Bank Overdraft ₹ 15,000; A's Capital ₹ 15,000; B's Capital ₹ 10,000. On 1st April 2018, they admitted C into partnership on the following terms :

(a) C is to purchase one-third of the Goodwill for ₹ 2,000 and provide ₹ 10,000 as Capital. Goodwill not to appear in the books.

(b) Future profits and losses are to be shared by A, B and C equally.

(c) Plant and machinery is to be reduced by 10% and ₹ 500 is to be provided for estimated bad debts. Stock is to be taken at a valuation of ₹ 24,940.

(d) By bringing in or withdrawing cash, the capitals of A and B are to be made proportionate to that of C on their profit sharing basis.

Set out entires to the above arrangements in the firm's journal, give the Partners' Capital Accounts in the tabular form and submit the opening Balance Sheet of the new firm.

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018	Cash A/c	Dr.	12,000	
April 1	To Premium for Goodwill A/c			2,000
	To C Capital A/c			10,000
	(Being the premium for goodwill and capital brought in by C)			
	Premium for Goodwill A/c	Dr.	2,000	
	B Capital A/c (Note 1)	Dr.	500	
	To A Capital A/c			2,500
	(Being the adjustment in regard to the premium for goodwill)			

Revaluation A/c	Dr.	900	
To Plant and Machinery A/c			400
To Provision for Bad Debts A/c			500
(Being the downward revaluation of Plant and Machinery and a creation of provision of bad debts)			
Stock A/c	Dr.	2,940	
To Revaluation A/c			2,940
(Being the upward revaluation of stock)			
Revaluation A/c (₹ 2,940 – ₹ 900)	Dr.	2,040	
To A Capital A/c			1,530
To B Capital A/c			510
(Being the profit on revaluation transferred to old Partners' Capital Accounts in the old profit sharing ratio)			
A Capital A/c	Dr.	9,030	
B Capital A/c	Dr.	10	
To Cash A/c			9,040
(Being the excess capital withdrawn)			

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

Particulars	A	B	C	Particulars	A	B	C
To A Capital A/c (Goodwill)	—	500	—	By Balance b/d	15,000	10,000	—
To Cash A/c (Balancing figure)	9,030	10	—	By Premium for Goodwill A/c	2,000	—	—
To Balance c/d	10,000	10,000	10,000	By B Capital A/c (Goodwill)	500	—	—
				By Revaluation A/c	1,530	510	—
				By Cash A/c	—	—	10,000
	19,030	10,510	10,000		19,030	10,510	10,000

Balance Sheet (after C's admission) as at 1st April, 2018

Liabilities		₹	Assets		₹
Capital Accounts :	A	10,000	Plant and Machinery (₹ 4,000 – ₹ 400)		3,600
	B	10,000	Stock		24,940
	C	10,000	Sundry Debtors	25,000	
Sundry Creditors		12,000	Less : Provision for Bad Debts	500	24,500
Bank Overdraft		15,000	Cash (₹ 1,000 + 12,000 – 9,030 – 10)		3,960
		57,000			57,000

Working Note :

(1) Adjustment of Premium for Goodwill

C brings in ₹ 2,000 as premium for goodwill. Therefore, the value of the goodwill is ₹ 2,000 x 3/1 = ₹ 6,000.

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 1)	4,500	1,500	—
Right of goodwill after admission (1 : 1 : 1)	2,000	2,000	2,000
Sacrifice (–) / Gain (+)	(–) 2,500	(+) 500	(+) 2,000

Illustration 91

A and B are partners sharing profits and losses equally. Their Balance Sheet as on 31.12.2016 was as follows :

Liabilities		₹	Assets	₹
Capital Accounts	A	60,000	Premises	30,000
	B	70,000	Furniture	14,000
Creditors		30,000	Stock	74,000
			Debtors	24,000
			Bank	18,000
		1,60,000		1,60,000

On 1.1.2017, they decided to admit C as a partner on the following items :

(1) C should pay ₹ 60,000 as capital for being entitled to one-third share of profits. The remaining profits are to be shared by the old partners equally.

(2) Stock to be valued at ₹ 70,000 and premises to be taken at 95% of book value.

(3) After the conclusion of the first trading year, Goodwill is to valued at three times of the net profit of the year in excess of ₹ 30,100. Such goodwill should be divided between A and B in the ratio of their sacrifices in favour of C.

Transactions during the year ended 31.12.2017 were as follows : Purchases ₹ 5,30,000; Sales ₹ 6,00,000; Payments for purchases at 98% in full settlement at ₹ 4,80,200; Collection from debtors (after allowing 5% against a prompt payment of dues ₹ 40,000) ₹ 3,38,000; Sundry expenses ₹ 18,000; Administration expenses ₹ 60,000; Drawings of partners : A ₹ 5,000; B ₹ 4,000 and C ₹ 3,000.

On 31.12.2017, Stock was ₹ 1,20,000. Depreciation was to be provided on furniture ₹ 900. C contributed sufficient cash to make his capital proportionate to his share of profit after goodwill was calculated and given effect.

You are required to prepare : (a) The amended Balance Sheet of the firm on 1.1.2017; and (b) The Balance Sheet of the firm on 31.12.2017 after giving effect to the required adjustments.

Solution **Balance Sheet as on 1st January, 2017**

Liabilities		₹	Assets	₹
Capital (Note 3) :	A	57,250	Premises (95% of ₹ 30,000)	28,500
	B	67,250	Furniture	14,000
	C	60,000	Stock	70,000
Creditors		30,000	Debtors	24,000
			Bank ₹ (18,000 + 60,000)	78,000
		2,14,500		2,14,500

Balance Sheet as on 31st December, 2017

Liabilities		₹	Assets		₹
Capital (Note 3)	A	77,950	Premises		28,500
	B	88,950	Furniture	14,000	
	C	83,450	Less: Depreciation	900	13,100
Creditors (Note 5)		70,000	Stock		1,20,000
Bank Overdraft (Note 6)		1,25,250	Debtors (Note 4)		2,84,000
		4,45,600			4,45,600

Working Notes :

Dr. **(1) Trading and Profit and Loss Account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	70,000	By Sales	6,00,000
To Purchases	5,30,000	By Closing Stock	1,20,000
To Gross Profit c/d	1,20,000		
	7,20,000		7,20,000
To Sundry Expenses	18,000	By Gross Profit b/d	1,20,000
To Administrative Expenses	60,000	By Discount Received (₹ 4,80,200/98 x 2)	9,800
To Discount Allowed (5% on ₹ 40,000)	2,000		
To Depreciation on Furniture	900		
To Share of Profit : (A — ₹ 16,300; B — ₹ 16,300; C — ₹ 16,300)	48,900		
	1,29,800		1,29,800

(2) Valuation of Goodwill : 3 times of the net profits of the year 2017 in excess of ₹ 30,100. Therefore, the value of the goodwill is 3 × ₹ (48,900 – 30,100) = ₹ 56,400.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
1.1.2017	To Revaluation A/c**	2,750	2,750	—	1.1.2017	By Balance b/d	60,000	70,000	—
	To Balance c/d	57,250	67,250	60,000		By Bank A/c	—	—	60,000
		60,000	70,000	60,000			60,000	70,000	60,000
31.12.2017	To Drawings A/c	5,000	4,000	3,000	1.1.2017	By Balance b/d	57,250	67,250	60,000
	To Goodwill A/c	18,800	18,800	18,800	31.12.2017	By Share of Profit A/c	16,300	16,300	16,300
	To Balance c/d	77,950	88,950	*83,450		By Goodwill A/c (Note 2)	28,200	28,200	—
						By Bank A/c (Bal. fig.)	—	—	28,950
		1,01,750	1,11,750	1,05,250			1,01,750	1,11,750	1,05,250

* 1/2 of ₹ (77,950 + 88,950) — combined capital of A and B after goodwill adjustment.

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

Particulars	₹	Particulars	₹
To Stock A/c	4,000	By Partners' Capital A/cs :	
To Premises A/c	1,500	A	2,750
		B	2,750
	5,500		5,500

(4) Debtors Account

Dr.	₹	Cr.	₹
To Balance b/d	24,000	By Bank A/c	3,38,000
To Sales A/c	6,00,000	By Discount Allowed A/c	2,000
		By Balance c/d	2,84,000
	6,24,000		6,24,000

(5) Creditors Account

Dr.	₹	Cr.	₹
To Bank A/c	4,80,200	By Balance b/d	30,000
To Discount Recd. A/c	9,800	By Purchases A/c	5,30,000
To Balance c/d	70,000		
	5,60,000		5,60,000

(6) Bank Account

Dr.	₹	Cr.	₹
To Balance b/d	78,000	By Creditors A/c	4,80,200
To Debtors A/c	3,38,000	By Sundry Exp. A/c	18,000
To C Capital A/c	28,950	By Adm. Exp. A/c	60,000
To Balance c/d	1,25,250	By Drawings A/c	12,000
	5,70,200		5,70,200

Illustration 92

A and B are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet stood as under on 1.1.2018 :

Liabilities		₹	Assets		₹
Capital Accounts	A	29,000	Buildings		35,000
	B	15,000	Machinery		19,000
Reserve		10,000	Furniture		5,000
Creditors		28,500	Stock		15,000
Outstanding Expenses		4,000	Debtors	9,400	
			Less: Provision for Bad Debts	400	9,000
			Prepaid Insurance		1,500
			Cash		2,000
		86,500			86,500

C is admitted as a new partner introducing a capital of ₹ 21,000. The capitals of the partners are to be adjusted in the new profit-sharing ratio, which is 5 : 3 : 2 — taking C's capital as base. C is to bring premium for goodwill in cash. Goodwill amount being calculated on the basis of C's share in the profits and capital contributed by him. Following revaluations are made : (i) Stock to be depreciated by 5%; (ii) Provision for bad debts is to be raised to ₹ 500; (iii) Furniture to be depreciated by 10%; (iv) Buildings are revalued at ₹ 41,350.

Prepare necessary Ledger Accounts and the Balance Sheet of the new firm.

Solution

In the books of the firm

Revaluation Account

Dr. Particulars	₹	Cr. Particulars	₹
To Stock A/c	750	By Buildings A/c	6,350
To Provision for Bad Debts A/c	100		
To Furniture A/c	500		
To Partners' Capital A/cs — profit (A — ₹ 3,000; B — ₹ 2,000)	5,000		
	6,350		6,350

Partners' Capital Accounts

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018 Jan.1	To Balance c/d (Note 1)	52,500	31,500	21,000	2018 Jan.1	By Balance b/d	29,000	15,000	—
						By Reserve A/c	6,000	4,000	—
						By Revaluation A/c	3,000	2,000	—
						By Cash A/c	—	—	21,000
						By Premium for Goodwill A/c (Note 1)	3,000	2,000	—
						By Cash A/c (Bal. Fig.)	11,500	8,500	—
		52,500	31,500	21,000			52,500	31,500	21,000

Balance Sheet of the New Firm as at 1st January, 2018

Liabilities			₹	Assets	₹
Capital Accounts :	A	52,500		Buildings	41,350
	B	31,500		Machinery	19,000
	C	21,000	1,05,000	Furniture	4,500
Creditors			28,500	Stock	14,250

Outstanding Expenses		4,000	Debtors	9,400	
			Less: Provision for Bad Debts	500	8,900
			Prepaid Insurance		1,500
			Cash ₹ (2,000 + 21,000 + 5,000 + 11,500 + 8,500)		48,000
		1,37,500			1,37,500

Working Note (1) : C is bringing in ₹ 21,000 for his 2/10th share in profit. Therefore, total capital of the firm will be ₹ 21,000 / 2 x 10 = ₹ 1,05,000.

A's capital = 5/10 x ₹ 1,05,000 = ₹ 52,500; B's capital = 3/10 x ₹ 1,05,000 = ₹ 31,500. Combined capital of A and B will be ₹ 84,000. At present, combined capital of A and B after adjustment of Revaluation Profit and Reserve = ₹ (29,000 + 15,000 + 10,000 + 5,000) = ₹ 59,000. Therefore, value of goodwill = ₹ (84,000 – 59,000) = ₹ 25,000. C's share of goodwill = ₹ 25,000 / 10 × 2 = ₹ 5,000.

Illustration 93

Ranu and Mili are partners in a firm sharing profits and losses in the ratio of 2/3rd and 1/3rd.

The Balance Sheet of the firm on 31.12.2017 was as follows :

Liabilities			₹	Assets		₹
Creditors			7,000	Investments		25,000
Investment Provision			2,000	Stock		15,000
General Reserve			10,500	Debtors	20,000	
Workmen Compensation Fund			6,000	Less: Provision for bad debts	2,500	17,500
Capital Accounts :	Ranu	30,000		Bills Receivable		12,500
	Mili	24,500	54,500	Bank		10,000
			80,000			80,000

On the above date, Manisha is admitted for 2/5th share in the profits or losses of the firm. Following adjustments were made at the time of admission :

(a) Manisha is required to bring in ₹ 50,000 as capital.

(b) Her goodwill was calculated at ₹ 12,000.

(c) Ranu and Mili purchased a machinery on hire purchase system for ₹ 15,000 of which only ₹ 500 are to be paid. Both machinery and unpaid liability did not appear in the Balance Sheet.

(d) There was a joint life policy on the lives of Ranu and Mili for ₹ 75,000. Surrender value of the policy on the date of admission amounted to ₹ 12,000.

(e) Accrued incomes not appearing in the books were ₹ 500.

(f) Market value of investments is ₹ 22,500.

(g) Claim on account of compensation is estimated at ₹ 750.

(h) S, an old customer, whose account was written-off as bad, has promised to pay ₹ 1,750 in settlement of the full claim.

(i) Provision for bad debts is required at ₹ 3,000.

Prepare Revaluation Account, Partners' Capital Accounts and Opening Balance Sheet after the admission of Manisha.

Solution **In the books of the firm**

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

Liabilities	₹	Assets	₹
To Investment Provision A/c (Note 1)	500	By Accrued Income A/c	500
To Provision for Bad Debts A/c	500	By Workmen Compensation Fund A/c (Note 2)	5,250
To Creditors A/c (hire purchase)	500	By Joint Life Policy A/c	12,000
To Partners' Capital A/cs — profit		By Machinery A/c	15,000
(Ranu — ₹ 20,833; Mili — ₹ 10,417)	31,250		
	32,750		32,750

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

Date	Particulars	Ranu	Mili	Manisha	Date	Particulars	Ranu	Mili	Manisha
	To Goodwill A/c	12,000	6,000	12,000		By Balance b/d	30,000	24,500	—
	To Balance c/d	65,833	42,417	38,000		By Revaluation A/c	20,833	10,417	—
						By General Reserve A/c	7,000	3,500	—
						By Goodwill A/c (Note 3)	20,000	10,000	—
						By Bank A/c	—	—	50,000
		77,833	48,417	50,000			77,833	48,417	50,000

Balance Sheet of the firm (after Manisha's admission)

Liabilities	₹	Assets		₹
Capital A/c		Machinery		15,000
Ranu	65,833	Investment		25,000
Mili	42,417	Stock		15,000
Manisha	38,000	Debtors	20,000	
Creditors	7,500	Less: Provision for bad debts	3,000	17,000
Investment Provision ₹ (2,000 + 500)	2,500	Bills Receivable		12,500
Workmen Compensation Fund ₹ (6,000 – 5,250)	750	Joint Life Policy		12,000
		Accrued Income		500
		Bank ₹ (10,000 + 50,000)		60,000
	1,57,000			1,57,000

Working Notes :

(1) Since there is a fall in the market value of investments of ₹ 2,500, investment provision is increased from ₹ 2,000 to ₹ 2,500.

(2) Workmen compensation fund is nothing but retained profit. Therefore, it is credited to Revaluation Account. Alternatively, it could have been credited to Partners' Capital Accounts in the old profit sharing ratio.

(3) Since Manisha is not paying the required amount of premium for goodwill. Therefore, ₹ 30,000 goodwill will be adjusted through the Capital Accounts of the partners.

(4) There will be no entry for the promise made by S, since it is an event and not a transaction.

Illustration 94

Taylor and Best were in partnership sharing profits and losses in the ratio 2/3 and 1/3 respectively. The partnership deed provided :

1. Interest @ 8% p.a. is to be allowed on fixed capital accounts. No interest is to be allowed on current accounts but 10% p.a. is to be charged on any debit balance at the commencement of the year.
2. Goodwill is to be valued at 1.5 times the average annual profits of the previous four or five years' whichever is lower.

The partners agreed to take Watson into partnership as on 1.1.2017 and he introduced ₹ 5,000 into the business. It was agreed that fixed capital of the business should be ₹ 20,000 contributed by the partners in their profit sharing ratio, any surplus or deficiency being transferred to their current accounts.

Taylor was to be entitled to a prior share of the profits of ₹ 500 and the balance was to be shared — Taylor 2/5; Best 2/5 and Watson 1/5. In addition, it was agreed that Watson's share of the profits should not be less than ₹ 3,500 p.a.

Agreed profits for goodwill purposes of the past five years are as under:

2012 ₹ 10,420; 2013 ₹ 11,760; 2014 ₹ 9,400; 2015 ₹ 13,820; 2016 ₹ 14,600.

No account for goodwill is maintained in the books. Adjusting entries for the transactions between the partners being made in their current accounts.

Partners accounts as on 31.12.2016 were as follows:

Fixed Capital : Taylor 10,000; Best 6,000;

Current Account : Taylor 3,400 (Cr.); Best 1,200 (Cr.).

The draft accounts for the year ended 31.12.2017 before taking into account interest on partners' accounts, show a profit of ₹ 16,400.

Partners' drawings during the year are : Taylor ₹ 5,000; Best ₹ 2,500 and Watson ₹ 1,500.

You are required to prepare :

(a) a statement showing the division of profit for the year ended 31.12.2017; and

(b) the Partners' Current Accounts for the year ended 31.12.2017, recording therein the entries necessary upon Watson's admission as a partner.

Solution

Statement showing Division of Profit for the year ended 31st December, 2017

Particulars	₹	₹
Profit before interest on capital and current account		16,400
Add: **Interest on debit balance of Current A/c** (See Partners' Current Accounts)		
Best : @ 10% on ₹ 2,000	200	
Watson : @ 10% on ₹ 2,600	260	460
		16,860

Less: **Interest on Fixed Capital**		
Taylor : @ 8% on ₹ 8,000	640	
Best : @ 8% on ₹ 8,000	640	
Watson : @ 8% on ₹ 4,000	320	1,600
Divisible profit		15,260
Less: Taylor's prior share of profit		500
		14,760
Less: Watson's guaranteed share of profit		3,500
Balance should be shared by Taylor and Best equally		11,260

So, Taylor's share of profit = ₹ 500 + 1/2 of ₹ 11,260 = ₹ 6,130; Best's sh. of profit = 1/2 of ₹ 11,260 = ₹ 5,630; Watson's share of profit = ₹ 3,500.

Dr. **Partners' Current Accounts** **Cr.**

Particulars	Taylor	Best	Watson	Particulars	Taylor	Best	Watson
To Goodwill A/c (written off)*	7,200	7,200	3,600	By Balance b/d	3,400	1,200	—
To Taylor's Capital A/c	—	2,000	—	By Goodwill A/c (raised)*	12,000	6,000	—
To Balance c/d	10,200	—	—	By Taylor's Capital A/c	2,000	—	1,000
				By Balance c/d	—	2,000	2,600
	17,400	9,200	3,600		17,400	9,200	3,600
To Balance b/d	—	2,000	2,600	By Balance b/d	10,200	—	—
To Interest on Current A/c	—	200	260	By Interest on Capital A/c	640	640	320
To Drawings A/c	5,000	2,500	1,500	By Share of Profit A/c	6,130	5,630	3,500
To Balance c/d	11,970	1,570	—	By Balance c/d	—	—	540
	16,970	6,270	4,360		16,970	6,270	4,360

* Adjustment for goodwill must be done through the Capital Account of the partners but in this case, it has been done through the Current Account of the partners as per the requirement of the question.

Working Notes :

(1) Valuation of Goodwill : 5 years' Average profit = (₹ 14,600 + 13,820 + 9,400 + 11,760 + 10,420) / 5 = ₹ 12,000; 4 years' Average profit = (₹ 14,600 + 13,820 + 9,400 + 11,760) / 4 = ₹ 12,355; Therefore, value of goodwill = (₹ 12,000 x 1.5) = ₹ 18,000.

(2) Total capital of the firm = ₹ 20,000.

So, Taylor's share of capital = 2/5 of ₹ 20,000 = ₹ 8,000; Best's share of capital = 2/5 of ₹ 20,000 = ₹ 8,000 and; Watson's share of capital = 1/5 of ₹ 20,000 = ₹ 4,000.

Admission of a Partner During An Accounting Year

So far we have seen that a partner is admitted to the partnership at the commencement of a new year. But in practical situation, a partner may be admitted during the course of an accounting year.

When a new partner is admitted during the course of an accounting year, the following steps should be followed:

Step 1 Divide the accounting period into two portions: (a) The pre-admission period; and (b) The post-admission period.

Step 2 Divide the whole profit between these two periods on the basis of either time or turnover. If the basis has been given in the problem, then that should be followed.

Step 3 Divide the whole expenses between these two periods on the basis of either time or turnover as the case may be. Care should be taken for the expenses which are exclusively related to pre-admission period or post-admission period. If the basis for allocation of expenses has been given in the problem, then that should be followed. If no hint has been given, then it is logical to allocate fixed expenses such as rent, rates and taxes, etc, on the basis of time and other expenses on the basis of turnover.

Step 4 Calculate profit of each period separately. Divide pre-admission period's profit in the ***old ratio*** amongst, old partners and divide post admission period's profit amongst all partners in the ***new ratio***.

Step 5 Pass necessary entries in the usual manner for other matters in relation to admission.

Illustration 95

J and K have been trading in partnership for several years, sharing profits and losses equally after allowing for interest on their capitals at 8% per annum.

At 1st September, 2017 their manager, L, was admitted as a partner and was to have a one- fifth share of the profits after interest on capitals, J and K shared the balance equally but guaranteed that L's share should not fall below ₹ 6,000 p.a. L was not required to introduce any capital at the date of admission but agreed to retain ₹ 1,500 of his profit share at the end of each year to be credited to his Capital Account until the balance reached ₹ 7,500. Until that time no interest was to be allowed on his capital.

Goodwill, calculated as a percentage of the profits of the last five years', was agreed at ₹ 15,000 at 1st September, 2017, and L paid into the business sufficient cash for his share. No Goodwill Account was to be left in the books.

Land and Buildings was professionally valued at the same date at ₹ 28,400 and this figure was to be brought into the books, while the book vaue of the equipment and vehicles was, by mutual agreement, to be reduced to ₹ 15,000 at that date.

L had previously been entitled to bonus of 5% of the gross profit, payable half-yearly; the bonus together with his manager's salary were to cease when he became a partner.

The trial balance at the end of the 2017 financial year is given below. No adjustments had yet been made in respect of L's admission, and the amount he introduced for goodwill had been put to his current account. The drawings of all the partners have been charged to their current accounts.

It can be assumed that the gross profit and trading expenses accrued evenly throughout the year. Depreciation on the equipment and Vehicles is to be charged at 20% per annum on the book value.

Dr. Trial Balance as at 31st December, 2017 Cr.

Current Account — J	7,800	Capital Account — J	30,000
Current Account — K	7,100	Capital Account — K	15,000
Land and Building	18,000	Current Account — L	1,800
Equipment and Vehicles	21,000	Gross profit	42,000
Stock	9,200	Creditors	3,100
Trading expenses	15,000		
Manager's salary	4,000		
Manager's bonus	1,050		
Debtors	4,850		
Bank balance	3,900		
	91,900		91,900

Required : Profit and Loss Account and Partners' Capital and Current Accounts for the year ended 31.12.2017.

Solution

Dr. Profit and Loss Account for the Pre-admission Period Cr.

Particulars	₹	Particulars	₹
To Trading expenses (8/12th)	10,000	By Gross Profit (42,000 / 12) x 8	28,000
To Manager's salary	4,000		
To Manager's bonus (Note 1)	1,400		
To Depreciation (Note 2)	2,800		
To Net Profit c/d	9,800		
	28,000		28,000
To Interest on capital A/c — J	1,600	By Net Profit b/d	9,800
To Interest on capital A/c — K	800		
To Share of Profit — J	3,700		
To Share of Profit — K	3,700		
	9,800		9,800

Dr. Profit and Loss Account for the Post-admission Period Cr.

Particulars	₹	Particulars	₹
To Trading expenses A/c (4/12th)	5,000	By Gross Profit (42,000 / 12) x 4	14,000
To Depreciation A/c	1,000		
To Net Profit c/d	8,000		
	14,000		14,000

To Interest on capital A/c — J (Note 6)	936	By Net Profit b/d	8,000
To Interest on capital A/c — K (Note 6)	536		
To Share of Profit — J	2,264		
To Share of Profit — K	2,264		
To Share of Profit — L (Note 7)	2,000		
	8,000		8,000

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

Particulars	J	K	L	Particulars	J	K	L
To Balance c/d	35,100	20,100	1,500	By Balance b/d	30,000	15,000	—
				By L Current A/c (goodwill)	1,500	1,500	—
				By Revaluation A/c	3,600	3,600	—
				By L Current A/c	—	—	1,500
	35,100	20,100	1,500		35,100	20,100	1,500

Dr. **Partners' Current Accounts** **Cr.**

Particulars	J	K	L	Particulars	J	K	L
To Balance b/d	7,800	7,100	—	By Balance b/d	—	—	1,800
To J Capital A/c (goodwill)	—	—	1,500	By Int. on capital A/c (total)	2,536	1,336	—
To K Capital A/c (goodwill)	—	—	1,500	By Share of Profit (total)	5,964	5,964	2,000
To L Capital A/c (transfer)	—	—	1,500	By Arrears of Bonus A/c	—	—	350
To Balance c/d	700	200	—	By Balance c/d	—	—	350
	8,500	7,300	4,500		8,500	7,300	4,500

Balance Sheet of J, K & L as at 31st December, 2017

Liabilities	₹	Assets	₹
Capital A/c		Land and Building	28,400
(J — ₹ 35,100; K — ₹ 20,100; L — ₹ 1,500)	56,700	Equipment (Less Depreciation: ₹ 1,000)	14,000
Current A/c		Stock	9,200
(J — ₹ 700; K — ₹ 200; L — (–) ₹ 350)	550	Debtors	4,850
Creditors	3,100	Bank	3,900
	60,350		60,350

Working Notes :

(1) Total gross profit = ₹ 42,000. Gross profit of pre-admission period is ₹ 28,000. Manager's bonus @ 5% is ₹ 1,400. Out of which ₹ 1,050 has been paid and ₹ 350 is due and it is credited to L's current account.

(2) Depreciation of pre-admission period = 21,000 x 20/100 x 8/12 = ₹ 2,800

(3) Depreciation of Post-admission period = 15,000 x 20/100 x 4/12 = ₹ 1,000

(4) Book value of equipment on the date of admission is (₹ 21,000 – ₹ 2,800) = ₹ 18,200.

(5) Profit on revaluation = ₹ (28,400 –18,000) = ₹ 10,400; Loss on revaluation = ₹ (18,200 –15,000) = ₹ 3,200; Net profit on revaluation ₹ 7,200.

(6) Interest on Partners' Capital Accounts from 1st September has been calculated on the adjusted capital balances after taking goodwill and revaluation on profit, i.e., J's capital ₹ 35,100 and K's capital ₹ 20,100.

(7) L's share of profit from 1st September has been paid at the guranteed rate of ₹ 6,000 p.a.

Key Points

- Whenever a new partner is admitted, it has the effect of bringing the old partnership to an end.
- After admission, the new partner acquires two rights :
  (i) he becomes the part owner of the assets of the firm; and
  (ii) he is entitled to share part of the profits of the business. At the same time, he becomes partly liable for any liability of the business incurred after admission and any loss incurred by the firm.
- The ratio in which the old partners are surrendering their share of profit in favour of the new partner is called ***sacrificing ratio***.
- Goodwill can be classified into two categories : (1) Purchased Goodwill; and (2) Non-Purchased or Inherent Goodwill.
- Generally the following methods are adopted for the valuation of the goodwill :
  (a) Average profit method; (b) Super profit method; (c) Capitalisation of average profit method; (d) Capitalisation of super profit method; and (e) Annuity method.

THEORETICAL QUESTIONS

1. What do you mean by Goodwill ? What are the different types of Goodwill ?
2. State the treatment of Purchased Goodwill.
3. What are the different methods of Valuing Non-Purchase Goodwill ?
4. State the treatment of Goodwill on admission of a new partner.

PRACTICAL QUESTIONS

1. Karuna and Ramen are partners in a firm. They share profits and losses as Karuna 60% and Ramen 40%. Their Balance Sheet as on 31st December, 2017 was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Plant	50,000
Capital — Karuna	1,00,000	Motor car	10,000
Capital — Ramen	60,000	Stock	40,000
		Debtors	1,10,000
		Cash	10,000
	2,20,000		2,20,000

The partners agree to admit Pratip as a partner on the following terms: (a) Plant was to be reduced by 10% and a provision for Doubtful Debts @ 2.5% on Debtors is to be made. (b) The Motor Car is to be taken by Karuna for her personal use at a cost of ₹ 8,000. (c) Pratip is to pay ₹ 20,000 as Goodwill premium to the old partners and the said amount is to remain in the business. (d) Pratip is to get 1/4th share of the future profits of the firm and is also to introduce half the combined adjusted Capital of the old partners. Show the journal entries in the books of the firm and prepare the Balance Sheet of the new firm.

2. X and Y are partners sharing profits and losses in proportion to their capital. Their Balance Sheet as at 31.3.2018 is given below:

Liabilities	₹	Assets	₹
Creditors	9,000	Freehold premises	10,000
Bills payable	6,000	Plant	3,500
Reserve	2,100	Furniture	1,750
Capital — X	20,000	Office equipment	550
Capital — Y	15,000	Stock	14,100
		Bills Receivable	3,060
		Debtors	17,500
		Bank	1,590
		Cash	50
	52,100		52,100

On 1.4.2018 they admit Z on the following terms:
(1) Z is to bring in ₹ 10,000 as his capital and to pay ₹ 3,500 for goodwill and he will get 1/4th share of profit.
(2) Provision for bad debts is to be made on debtors at 2%.
(3) Stock to be written-down by 5%.
(4) Freehold premises is to be revalued at ₹ 11,400, Plant at ₹ 2,800, Furniture ₹ 1,540 and office equipment ₹ 495.
(5) Partners agreed that the values of the assets and liabilities are remaining the same and, as such, there should be no change in their book value as a result of the above-mentioned adjustment.
You are required to make necessary adjustments in the Capital Accounts of the partners and show the Balance Sheet of the new firm.

3. G and S were partners to a manufacturing concern sharing profits and losses equally on 31st December, 2017. The firms books revealed the following position:

Liabilities	₹	Assets	₹
Partners' Capital — G	20,000	Cash in hand	152
Partners' Capital — S	16,000	Cash at bank	4,900
Sundry Creditors	15,000	Bills Receivable	1,888
Bills Payable	4,000	Sundry Debtors	21,000
		Stock	4,800

		Plant and Machinery	7,000
		Furniture & fittings	1,700
		Freehold premises	13,560
	55,000		55,000

On 1st January, 2018, it was agreed to admit T into partnership on the following terms:
That he should bring into business sundry debtors amounting to ₹ 2,400 (Less a provision of 10% for bad debts). Sundry creditors amounting to ₹ 500 and also goodwill of his business at a valuation of ₹ 1,500.
His capital in the new business is to be ₹ 5,000, the balance of which he pays in cash and in consideration thereof he receives one fifth share of the profits of the firm.
It was mutually agreed that the following adjustments should be made as regards the business of G and S.
Stock to be reduced by ₹ 800; Plant and Machinery to be increased by ₹ 300; Fixtures and fittings to be completely written off. It was further agreed that after the above adjustments had been effected, S should introduce sufficient cash to make his capital equal to that of G. From the above particulars show the opening balance sheet of the new firm as at 1st January, 2018 and state in what proportions the profits and losses will be shared.

4. M/s A, B and C is a firm sharing profits and losses 2:2:1. Their Balance Sheet as on 31.3.2018 is as under:

Liabilities	₹	Assets	₹
Sundry Creditors	12,850	Land and Building	25,000
Outstanding Liabilities	1,500	Furniture	6,500
General Reserve	6,500	Stock	11,750
Capital — A	12,000	Sundry Debtors	5,500
Capital — B	12,000	Cash in hand	140
Capital — C	5,000	Cash at bank	960
	49,850		49,850

They agreed to take in D from 1.4.2018 on the following terms:

1. D shall bring in ₹ 5,000 towards his capital;
2. Value of stock should be increased by ₹ 2,500;
3. Bad Debts amounting to ₹ 550 to be written off;
4. Furniture to be depreciated by 10%;
5. Value of land and building to be enhanced by 20%;
6. Value of Goodwill is ₹ 15,000;
7. New profit sharing ratio among A, B, C and D is 5:5:3:2;
8. Goodwill Account written-off after his admission. Outstanding liabilities include ₹ 1,000 due to X which has been paid by A. Entries were not made in the books.

Required: Revaluation Account, Partners' Capital Accounts and the new Balance Sheet.

5. A and B are in partnership sharing profits and losses as 2:1. As from 1.10.2016, they take C as a partner who will have 1/6th share. As between A and B, they decide to share equally, C brings in ₹ 50,000 as capital and ₹ 4,000 as premium for Goodwill. Following is the Balance Sheet as on 30.9.2017:

Liabilities	₹	Assets	₹
Capital — A	62,500	Cash	7,000
Capital — B	37,500	Stock	50,000
Creditors	50,000	Debtors	30,000
		Plant	25,000
		Investments	38,000
	1,50,000		1,50,000

The assets are revalued as : Stock ₹ 55,000; Plant ₹ 20,000; Investment ₹ 35,000; A provision for bad debts to be created against debtors @ 5%. It is further agreed that A alone is to be charged for any loss on revaluation. The profits after depreciating plant @ 5% p.a. for the year ended 30.9.2017 is ₹ 1,20,000 and the drawings of the partners are: A — ₹ 40,000; B — ₹ 40,000; C — ₹ 10,000.
You are required to journalise the opening adjustments and draw up the Balance Sheet as on 30.9.2017.

6. A and B are partners in a firm sharing profits and losses in 7:3. The balance sheet as at 31.3.2018 is as follows:

Liabilities	₹	Assets		₹
Sundry Creditors	40,000	Cash in hand		36,000
Bank overdraft	20,000	Sundry Debtors	46,000	
Reserve	10,000	Less: Provision for bad debts	2,000	44,000
Capital — A	50,000	Furniture		30,000
Capital — B	40,000	Stock in trade		50,000
	1,60,000			1,60,000

On 1.4.2018 C joins the firm as a 3rd partner for 1/4th share of the future profits of the firm on the following terms:
(a) Goodwill is valued at ₹ 40,000 and C is to bring necessary amount in cash as premium for goodwill.
(b) 20% of the reserve is to remain as a provision against bad and doubtful debts.
(c) Stock-in-trade is to be reduced by 40% and furniture is to be reduced to 40%.
(d) A is to pay off the Bank overdraft.
(e) C is to introduce ₹ 30,000 as his share of capital to which amount other partners' capital shall have to be adjusted.
You are required to show the necessary journal entries to carry out the above transactions and prepare an amended Balance Sheet of the firm immediately after C has become a partner.

7. The following is the Balance Sheet of a partnership firm as on 31.12.2017:

Liabilities	₹	Assets	₹
Capital — A	1,00,000	Property	70,000
Capital — B	82,000	Motor car	15,000
General Reserve	10,000	Furniture	2,000
Loan from A	10,000	Debtors	50,000
Sundry Creditors	30,000	Stock	90,000
Outstanding expenses	3,000	Cash	8,000
	2,35,000		2,35,000

A and B has been sharing profits in the ratio of 3:2. On 1.1.2018, they decide to take C as a partner on the following terms and conditions:
(i) The new profit sharing ratio will be 2:1:1;
(ii) C is to bring in ₹ 75,000 as capital;
(iii) Property and motor car are to be revalued at ₹ 90,000 and ₹ 13,000 respectively and a provision for doubtful debts to be created at 5%;
(iv) C is to bring in required amount of premium for goodwill which will be valued on the basis of two years' purchase of the last three years' average profits which are as under:
2015 — ₹ 10,000; 2016 — ₹ 12,000; 2017 — ₹ 15,000.
The above profits are subject to the following adjustments:
2015 — Bad debts previously written-off ₹ 800 credited to Debtors Account.
Closing stock undervalued by ₹ 2,500.
2016 — Furniture purchased ₹ 600 debited to Purchase Account — depreciation chargeable at 10% on reducing balance method. Closing Stock understated by ₹ 2,000.
2017 — A purchase invoice of ₹ 2,001 was omitted from the books. Closing Stock undervalued by ₹ 2,000.
(v) The amount of premium to be credited to old partners' loan accounts.
You are required to pass necessary Journal entries and to draw up the Balance Sheet as on 1.1.2018.

8. A and B are in partnership sharing profits and losses in the ratio 4:3 and for the last four years they have been entitled to annual salaries of ₹ 90,000 and ₹ 1,50,000 respectively, but not to interest on capitals.
The annual accounts have shown the following net profits before charging salaries:
Year ended on 31st March, 2016 ₹ 3,52,360 (Profit); 2017 ₹ 2,20,000 (Profit); 2018 ₹ 4,20,000 (Profit).
On 1st April, 2018 C is admitted to partnership on the following terms:
(i) From 1st April 2018 profits and losses are to be shared as follows: A 4/9; B 1/3 and C 2/9.
(ii) C is to bring in ₹ 1,80,000 cash for his 2/9 share of capital.
(iii) C is to bring in an additional amount to purchase his share of partnership goodwill, valued at four year's purchase of the weighted average profits of the last three years (after allowing for salaries), profits to be weighted 1:2:3, the greatest weight being given to the last year.
(iv) C is entitled to a salary of ₹ 1,20,000 p.a.; A and B to get the same salaries as before.
No Goodwill Account is to be opened in the books: any adjustments in respect of Goodwill are to be made through the Partners' current Accounts.
The balances on the Partner's Accounts on 1st April 2018 are as follows:

	Capital	Current
A	₹ 3,60,000 (Cr.)	₹ 84,000 (Cr.)
B	₹ 2,70,000 (Cr.)	₹ 32,000 (Dr.)

Prepare Partners' Capital and Current Accounts at 1st April, 2018, incorporating the entries arising on the admission of C.

9. D, H, F were equal partners of the firm 'Enterprise' and the following Balance Sheet as at 1.7.2018 was produced by them:

	₹	₹	₹
Fixed Assets			
Land		1,19,000	
Building		1,95,000	
Furniture		24,000	3,38,000
Working Capital			
Stock	1,14,000		
Debtors	1,08,000		
Cash	6,000	2,28,000	
Less: Creditors	33,000		
Bills payable	60,000	93,000	1,35,000
Total assets			4,73,000
Represented by :			
D Capital		2,17,000	
H Capital		1,66,000	
F Capital		90,000	4,73,000

On 1.7.2018 they agreed to take R as an equal partner on the following terms:
(a) R should bring ₹ 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ₹ 60,000; (b) Provision for loss on stock and provision for bad debts to be made at 10% and 5% respectively; (c) The value of building was to be taken at ₹ 2,70,000; (d) The total capital of the new firm was fixed at ₹ 4,00,000 and the Partners Accounts be in their profit sharing ratio. Any excess is to be transferred to Current Account or deficit to be introduced in cash.
You are required to prepare the Profit and Loss Adjustment Account, Capital Accounts of the partners and the Balance Sheet.

10. A, B and C are partners in a firm of accountants who maintain accounts on a cash basis sharing profits and losses in the ratio of 2:3:1. Their Balance Sheet as on March 31, 2018 on which date D is admitted as a partner, is as follows:

Liabilities	₹	Assets	₹
B Capital	35,000	Furniture	10,000
C Capital	22,000	Motor Car	20,000
		Cash at bank	18,000
		A Capital	9,000
	57,000		57,000

D is given 1/4 share of the profits and losses in the firm and the profit and loss sharing ratio as between the other partners remains as before. The following adjustments are to be made prior to D's admission:

(a) The motor car is taken over by B at a value of ₹ 25,000.
(b) The furniture is revalued at ₹ 18,000.
(c) Goodwill is valued at ₹ 50,000. It is agreed among A, B and C that C is interested in goodwill only up to a value of ₹ 30,000.
(d) Fees billed but not realized ₹ 11,000 are brought into account.
(e) Expenses incurred but not paid, ₹ 3,000 are provided for.

D brings in ₹ 20,000 in cash as his capital contribution. He is also to be credited with ₹ 20,000 for having agreed to amalgamate his separate practice as Chartered Accountant with this firm. The partners have decided not to show any goodwill in their new books of account.
Pass necessary Journal entries and prepare the Balance Sheet of the firm after D's admission.

11. K and L are two partners sharing profits and losses in the ratio of 5:3. Their Balance Sheet as at 30th. June, 2018 is as follows:

Liabilities	₹	Assets		₹
Creditors	30,000	Furniture		40,000
Reserve	14,000	Patent		10,000
Capital		Debtors	44,000	
K	40,000	Less: Provision for Bad Debt	5,000	39,000
L	50,000	Stock		20,000
		Cash in hand		25,000
	1,34,000			1,34,000

On 1st July, they take M into partnership. M brings ₹ 25,000 as his capital. The new profit sharing ratio of K, L and M is 2:4:1. Patent is written-off from the books and a Provision 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, 2018.

12. 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, 2018 was as under:

Liabilities			₹	Assets	₹
Capital Accounts :				Furniture and Fixtures	60,000
	Quick	1,20,000		Office Equipments	30,000
	Slow	77,000	1,97,000	Motor Car	75,000
General Reserve			30,000	Stock	50,000
Sundry Creditors			96,000	Sundry Debtors	90,000
				Cash at Bank	18,000
			3,23,000		3,23,000

Smooth was admitted as a new partner with effect from 1st April, 2018 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 years' purchase of the average profits of the last three years. The profits of the last three years were: 2017-10 ₹ 52,000; 2016-09 ₹ 32,000; 2015-08 ₹ 28,000.

However, on a checking of the past records, it was noticed that on 1.4.2016 a new furniture costing ₹ 8,000 was purchased but wrongly debited to revenue, and in 2017-10 a purchase invoice for ₹ 4,000 dated 25.3.2018 has been omitted in the books. The firm charges depreciation on Furniture @ 10% p.a. on original cost.

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 Revaluation Account, Capital Accounts of the partners and the Balance Sheet of the firm after Smooth's admission.

Guide to Answers

Practical Questions

1. **Loss on revaluation ₹ 9,750; Share of premium ₹ 12,000 (Karuna), ₹ 8,000 (Ramen). Capital brought in by Pratip ₹ 81,125; Balance Sheet ₹ 3,03,375.**
2. **Loss on revaluation ₹ 620; Capital Accounts: - X - ₹ 22,212; Y - ₹ 16,658; Z - ₹ 9,630; Balance Sheet 65,600.**
3. **Loss on revaluation ₹ 2,200; Capital Accounts: G - ₹ 18,900; S - ₹ 18,900; T - ₹ 5,000; New ratio 2:2:1; Balance Sheet ₹ 62,300.**
4. **Profit on revaluation ₹ 6,300; Capital Accounts: A - ₹ 19,120; B - ₹ 18,120; C - ₹ 7,560; D - ₹ 3,000; Balance Sheet - ₹ 61,150.**
5. **Loss on revaluation of ₹ 4,500 to be debited to A's account in full. Entire premium to be taken by A and in addition A's account to be credited with ₹ 2,000 and B's capital to be debited by ₹ 2,000. Balance Sheet Plant - ₹ 19,000; Investments - ₹ 35,000; Working capital - ₹ 1,25,500; Capital Accounts: A - ₹ 74,000; B - ₹ 45,500; C - ₹ 60,000; Total ₹ 1,79,500.**
6. **Future profit sharing ratio 21:9:10; sacrificing ratio 7:3; Capital Accounts: A - ₹ 63,000; B - ₹ 27,000; C - ₹ 30,000; Cash in hand ₹ 76,000; Revaluation loss ₹ 38,000; Balance Sheet ₹ 1,60,000.**
7. **Adjusted profit for 3 years ₹ 38,285; Total value of goodwill ₹ 25,524; C is to bring in ₹ 6,381 as premium for goodwill and which will be shared by A & B as ₹ 2,553 and ₹ 3,828 respectively. Profit on revaluation ₹ 15,460; Balance Sheet ₹ 3,35,127.**
8. **Av. profits (₹ 6,12,360/6) = ₹ 1,02, 060; Goodwill ₹ 4,08,240; C's share of goodwill ₹ 90,720; which has been shared by A and B in the ratio of 4:3.**
   Capital Accounts: — A - ₹ 3,60,000; B - ₹ 2,70,000; C - ₹ 1,80,000.
   Current Accounts.:- A - ₹ 1,35,840; B - ₹ 6,880 (all credit balance).
9. **Profit on revaluation : ₹ 58,200; Balance Sheet total : ₹ 7,84,200.**
10. **Balance Sheet total ₹ 67,000.**
11. **Loss of revaluation : ₹ 7,200; Balance Sheet total ₹ 1,51,800.**
12. **Revaluation profit : ₹ 9,900; Balance Sheet total ₹ 4,20,153.**

4

Retirement of a Partner

Introduction

A partner may retire from the firm for different reasons such as differences with the other partners, better business opportunity, old age, etc. The retirement of a partner results in a new partnership, although daily operation of the firm currently are not affected. According to Sec. 32(1) of the Indian Partnership Act, a partner can retire in the following three ways :

(i) with the consent of all the other partners (such consent may be expressed or implied);
(ii) in accordance with an express agreement by the partners; and
(iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

Effects of Retirement of A Partner

The effects of retirement of a partner are the following :

1. The retirement of a partner will terminate the old partnership and a new partnership will be created.
2. An adjustment is to be made in regard to undrawn profit or accumulated losses.
3. The assets and liabilities of the firms are to be revalued and proper adjustments are to be made.
4. The goodwill of the firm has to be valued and some adjustments are to be made.
5. The combined shares of the remaining partners will be increased.
6. The claim of the retiring partners is to be determined.
7. The continuing partners may find it difficult to pay off the entire claim of the retiring partner.

Gaining Ratio

After retirement of a partner(s) the combined share of the remaining partners will be increased. The ratio in which the remaining partners are acquiring the share of the retiring partner is called gaining ratio. Calculation of gaining ratio is necessary particularly when only retiring partner's share of goodwill/reserve is to be adjusted.

Difference between Sacrificing Ratio and Gaining Ratio

	Sacrificing Ratio		Gaining Ratio
1.	It is generally calculated at the time of admission of a new partner.	1.	It is generally calculated at the time of retirement/death of a partner.
2.	It is the ratio in which the old partners are surrendering their share of profit in favour of the new partner.	2.	It is the ratio in which the remaining partners are acquiring the share of the retiring/ deceased partner.
3.	It is calculated when premium for goodwill brought in by the new partner is to be distributed amongst the old partner.	3.	It is calculated when only the retiring partner's share of goodwill/ reserve is to be adjusted.
4.	Sacrificing ratio = Old ratio – New ratio	4.	Gaining ratio = New ratio – Old ratio.

Adjustments For Retirement of A Partner

At the time of retirement of a partner, different adjustments are required. These are as follows :

1. Adjustment in regard to goodwill.
2. Adjustment in regard to revaluation of assets and liabilities.
3. Adjustment in regard to undistributed profits and losses.
4. Adjustment in regard to joint life policy.
5. Adjustment in regard to share of profits from the date of the last Balance Sheet to the date of retirement.

1. Adjustment in Regard to Goodwill

At the time of retirement of a partner, an adjustment is necessary in respect of goodwill. The retiring partner is entitled to his share in the goodwill of the firm. In the absence of any agreement, goodwill is to be distributed in the profit-sharing ratio. The valuation of goodwill is done on the basis of the provisions of the partnership deed. If the partnership deed is silent, the valuation should be done in such a manner as must have been agreed upon by the partners (methods of valuation of goodwill have already been discussed in the Chapter on Admission of a Partner).

In this connection, Para 36 of AS—10 is very important. This para states 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 in excess of the value of the net assets of the business takenover, the excess should be termed as Goodwill'.

The effects of the above provision of AS—10 in Partnership Accounts are the following :

1. ***Only purchased goodwill to be recorded in the books of accounts.***
2. ***Non-purchased goodwill (internally generated goodwill) will be adjusted through Partners' Capital Accounts. In, effect this goodwill cannot be shown in the Partnership Balance Sheet.***

This goodwill can be treated in the books of account in any of the following manner.

Case 1 : When there is no goodwill in the present Balance Sheet and goodwill is raised in the books of the firm at full value but it is written-off immediately

In this case, goodwill is raised by crediting all the partners in the old ratio and written-off in the new ratio. The following entries are passed :

(i) ***For raising goodwill***

Goodwill Account	Dr.	[Full value]
To All Partners' Capital Accounts		[Old ratio]

(ii) ***For writing off goodwill***

Continuing Partners' Capital Accounts	Dr.	[New ratio]
To Goodwill Account		[Full value]

Illustration 1

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 3. C retires from the business. At present goodwill is not appearing in the Balance Sheet.

The agreed value of goodwill is ₹ 1,00,000. It has been decided by A and B to share future profits and losses equally and goodwill not to be shown in the new Balance Sheet.

Pass necessary Journal Entries in respect of goodwill.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c	Dr.	1,00,000	
	To A Capital			40,000
	To B Capital			30,000
	To C Capital			30,000
	(Being the goodwill raised in the books at full value by crediting the partners in their old orifit-sharing ratio i.e., 4 : 3 : 3)			
	A Capital A/c	Dr.	50,000	
	B Capital A/c	Dr.	50,000	
	To Goodwill A/c			1,00,000
	(Being the goodwill written-off in the books by debiting the remaining partners in their new profit-sharing ratio, i.e., 1 : 1)			

Case 2 : When there is no goodwill in the present Balance Sheet but only retiring partners'share of goodwill is to be adjusted

In this case, retiring partners' share of goodwill is raised in the books by crediting the ***retiring partner*** only. It is then written-off by debiting the remaining partners in the ***gaining ratio***.

The following entries are passed :

(i) ***For raising retiring partner's share of goodwill***

Goodwill Account Dr. [Retiring partner's share]

To Retiring Partner's Capital Account

(ii) ***For writing off the goodwill***

Continuing Partners' Capital Accounts Dr. [Gaining ratio]

To Goodwill Account

Alternatively, the following entry can be passed :

Continuing Partners' Capital Accounts Dr. [Gaining ratio]

To Retiring Partner's Capital Account [Share of retiring partner]

Illustration 2

Red, White and Blue are equal partners. White retires, his share of goodwill is ₹ 18,000. The remaining partners have decided to continue the business sharing profits and losses in the ratio of 3 : 2. At present there is no goodwill in the Balance Sheet and in future goodwill is not to be shown in the Balance Sheet. Give Journal Entry.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c	Dr.	18,000	
	To White Capital A/c			18,000
	(Being White's share of goodwill raised in the books)			
	Red Capital A/c (Note 1)	Dr.	14,400	
	Blue Capital A/c (Note 1)	Dr.	3,600	
	To Goodwill A/c			18,000
	(Being the goodwill written-off in the books by debiting the continuing partners in the gaining ratio 4 : 1)			
	Alternatively,			
	Red Capital A/c	Dr.	14,400	
	Blue Capital A/c	Dr.	3,600	
	To White Capital A/c			18,000
	(Being the required adjustment through the Capital Accounts of the partners in regard to goodwill)			

Working Note : **(1) Calculation of Gaining Ratio**

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Red	3/5	1/3	3/5 — 1/3 = 4/15 (Gain)	Red : Blue = 4/15 : 1/15 = 4 : 1
White	—	1/3	0 – 1/3 = 5/15 (Sacrifice)	
Blue	2/5	1/3	2/5 – 1/3 = 1/15 (Gain)	

It should be noted that without calculating the gaining ratio, the amount to be adjusted in respect of goodwill can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Red (₹)	White (₹)	Blue (₹)
Right of goodwill before retirement (1 : 1 : 1)	18,000	18,000	18,000
Right of goodwill after retirement (3 : 2)	32,400	—	21,600
Gain (+) / Sacrifice (–)	(+) 14,400	(–) 18,000	(+) 3,600

Tutorial Note : In the alternative method if the full value of goodwill has not been given, then it is to be calculated on the basis of retiring partner's share of goodwill (as has been done in this case, i.e., ₹ 18,000 × 3/1 = ₹ 54,000).

Illustration 3

Ram, Shyam and Rahim are partners sharing profits in the ratio of 4:3:2. Shyam retires and the goodwill is valued at ₹ 21,600. No goodwill appears as yet in the books of the firm. Assuming that Ram and Rahim will share profits in the future in the ratio of 5:3, pass entries for goodwill separately under the following conditions: (a) When Goodwill Account is raised but written-off; (b) When only Shyam's Goodwill Account is raised and then written-off; and (c) When only Shyam's share of goodwill is adjusted through the Capital Account of Ram and Rahim.

Solution **In the books of Ram, Shyam and Rahim**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
(a) (i)	Goodwill A/c	Dr.	21,600	
	To Ram Capital A/c			9,600
	To Shyam Capital A/c			7,200
	To Rahim Capital A/c			4,800
	(Being the goodwill raised in the books at full value crediting the partners in their old profit sharing ratio, 4:3:2)			
(ii)	Ram Capital A/c	Dr.	13,500	
	Rahim Capital A/c	Dr.	8,100	
	To Goodwill A/c			21,600
	(Being goodwill written-off in the books by debiting the remaining partners in their new ratio, 5:3)			
(b) (i)	Goodwill A/c	Dr.	*7,200	
	To Shyam Capital A/c			7,200
	(Being Shyam's share of goodwill raised)			
(ii)	Ram Capital A/c	Dr.	*3,900	
	Rahim Capital A/c	Dr.	*3,300	
	To Goodwill A/c			7,200
	(Being Shyam's share of goodwill written-off by debiting the remaining partners in the gaining ratio, 13:11)			
(c)	Ram Capital A/c	Dr.	3,900	
	Rahim Capital A/c	Dr.	3,300	
	To Shyam Capital A/c			7,200
	(Being Shyam's share of goodwill adjusted through the Capital Account of Ram and Rahim)			

*Shyam's share of goodwill = ₹ 21,600 x 1/3 = ₹ 7,200; The gaining ratio of Ram and Rahim is 13:11.

Calculation of Gaining Ratio

Partners	Ram	Shyam	Rahim
Old Ratio (4 : 3 : 2)	4/9	3/9	2/9
New Ratio (5 : 3)	5/8	—	3/8
New ratio – Old ratio	(5/8 – 4/9)		(3/8 – 2/9)
Gain	13/72		11/72

Case 3 : When there is no goodwill in the present Balance Sheet and adjustment to be done without opening Goodwill Account

In this case, continuing Partners' Capital Accounts will be debited in the gaining ratio and retiring Partner's Capital Account will be credited with his share of goodwill. The entry will be :

Continuing Partners' Capital Accounts	Dr.	[Gaining ratio]
To Retiring Partner's Capital Account		[Share of goodwill of retiring partner]

Illustration 4

Ravi, Mukesh, Naresh and Yogesh are partners in a firm sharing profits in the ratio of 2 : 2 : 1 : 1. On Mukesh's retirement, the goodwill of the firm is valued at ₹ 90,000. Ravi, Naresh and Yogesh decided to share future profits equally. Pass the necessary Journal Entry for the treatment of goodwill without opening Goodwill Account.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Naresh Capital A/c (Note 1)	Dr.	15,000	
	Yogesh Capital A/c (Note 1)	Dr.	15,000	
	To Mukesh Capital A/c			30,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Working Note :

(1) Mukesh is entitled to 2/6th share of goodwill, i.e., ₹ 90,000 / 6 × 2 = ₹ 30,000. This amount will be debited to continuing partners in the gaining ratio. The gaining ratio is calculated as follows :

Calculation of Gaining Ratio

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Ravi	1/3	2/6	1/3 – 2/6 = Nil	Naresh : Yogesh = 1 : 1
Mukesh	–	2/6	2/6 (Sacrifice)	
Naresh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	
Yogesh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	

Naresh and Yogesh are gaining equally. Therefore, ₹ 30,000 will be debited to Naresh and Yogesh equally, i.e., ₹ 15,000 each. ***Alternatively***, without calculating gaining ratio, the amount of goodwill to be adjusted can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Ravi (₹)	Mukesh (₹)	Naresh (₹)	Yogesh (₹)
Right of goodwill before retirement (2 : 2 : 1 : 1)	30,000	30,000	15,000	15,000
Right of goodwill after retirement (1 : 1 : 1)	30,000	–	30,000	30,000
Gain (+) / Sacrifice (–)	Nil	(–) 30,000	(+) 15,000	(+) 15,000

Mukesh is sacrificing ₹ 30,000. Naresh and Yogesh are gaining ₹ 15,000 each. Ravi is not gaining anything.

Illustration 5

A, B and C are partners sharing profits in the ratio of 4 : 3 : 3. On C's retirement the value of firm's goodwill was agreed at ₹ 30,000. A and B agreed to share profits and losses in future in the ratio of 7 and 3 respectively. Give necessary Journal Entry in relation to goodwill, without opening its accounts.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	A Capital A/c	Dr.	9,000	
	To C Capital A/c			9,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Working Note : **(1) Calculation of Gaining Ratio**

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
A	7/10	4/10	7/10 – 4/10 = 3/10 (Gain)	Here, gaining ratio cannotbe calculated because only A is gaining
B	3/10	3/10	3/10 – 3/10 = Nil	
C	–	3/10	0 – 3/10 = 3/10 (Sacrifice)	

Alternative Working Note :

Statement Showing the Required Adjustment for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (4 : 3 : 3)	12,000	9,000	9,000
Right of goodwill after retirement (7 : 3)	21,000	9,000	–
Gain (+) / Sacrifice (–)	(+) 9,000	Nil	(–) 9,000

C is sacrificing ₹ 9,000. Only A is gaining ₹ 9,000. B is not gaining anything. Therefore A Account will be debited with ₹ 9,000 and C Account will be credited with ₹ 9,000.

Illustration 6

Surender, Ramesh, Naresh and Mohan are partners in a firm sharing profits in 2 : 1 : 2 : 1 ratio. On the retirement of Naresh, the goodwill was valued at ₹ 72,000. Surender, Ramesh and Mohan decided to share future profits equally. Pass the necessary Journal Entry for the treatment of goodwill, without opening Goodwill Account.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Ramesh Capital A/c	Dr.	12,000	
	Mohan Capital A/c	Dr.	12,000	
	To Naresh Capital A/c			24,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Working Note :

(1) Naresh is entitled to 2/6th share of goodwill, i.e., ₹ 72,000 × 2/6 = ₹ 24,000. This amount will be debited to continuing Partners' Capital Accounts in the gaining ratio. The gaining ratio is calculated as under:

Calculation of Gaining Ratio

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Surender	1/3	2/6	1/3 – 2/6 = Nil	Ramesh : Mohan = 1 : 1
Ramesh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	
Naresh	–	2/6	0 – 2/6 = 2/6 (Sacrifice)	
Mohan	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	

Ramesh and Mohan are gaining equally. Therefore, ₹ 24,000 will be debited to Ramesh and Mohan equally, i.e., ₹ 12,000 each.
Alternatively, the above amount can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Surender (₹)	Ramesh (₹)	Naresh (₹)	Mohan (₹)
Right of goodwill before retirement (2 : 1 : 2 : 1)	24,000	12,000	24,000	12,000
Right of goodwill after retirement (1 : 1 : 1)	24,000	24,000	–	24,000
Gain (+) / Sacrifice (–)	Nil	(+) 12,000	(–) 24,000	(+) 12,000

Illustration 7

X, Y and Z were partners in a firm sharing profits in the ratio of 3 : 2 : 1. Z retired and the new profit-sharing ratio between X and Y was 1 : 2. On Z's retirement the goodwill of the firm was valued at ₹ 30,000.

Pass necessary Journal Entry for the treatment of goodwill on Z's retirement without opening Goodwill Account.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Y Capital A/c	Dr	10,000	
	To X Capital A/c			5,000
	To Z Capital A/c			5,000
	(Being the adjustment for goodwill on Z's retirement)			

Working Note : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (3 : 2 : 1)	15,000	10,000	5,000
Right of goodwill after retirement (1 : 2)	10,000	20,000	–
Gain (+) / Sacrifice (–)	(–) 5,000	(+) 10,000	(–) 5,000

In this case, only Y is gaining. Both X and Z are sacrificing. Therefore, Y capital will be debited with ₹ 10,000 and X capital will be credited with ₹ 5,000 and Z capital will be credited with ₹ 5,000.

Case 4 : When there is goodwill in the present Balance Sheet

In this case, the revised value of goodwill is to be compared with the book value of goodwill (i.e., which is appearing in the Balance Sheet). Accounting entries are to be passed accordingly.

(i) ***If the revised value of goodwill > book value of goodwill***

Goodwill Account	Dr.	[Difference]
To All Partners' Capital Accounts		[Old ratio]

(ii) ***If the revised value of goodwill < book value of goodwill***

All Partners' Capital Account Dr. [Old ratio]

To Goodwill Account [Difference]

(iii) As per AS—10 para 36 no goodwill is to be shown in the Balance sheet unless it is a purchased goodwill. Therefore, after retirement, goodwill is to be written-off by debiting continuing partners in the new ratio.

(iv) If there is no change in the value of goodwill, then existing goodwill is written-off by debiting continuing parters in the new ratio.

Illustration 8

Pass Journal entries under the following circumstances:

(a) A, B and C are partners sharing profits and losses equally. A retires. B and C decided to share profits and losses in the ratio 4:1. The value of the goodwill is ₹ 45,000.

(b) A, B and C are partners sharing profits and losses in the ratio 4:3:2. B retires. The value of the goodwill is ₹ 45,000. A and C decide to share profits and losses in ratio of 3:2.

Solution

In the books of A, B and C

Journal

Date	Particulars	Dr. ₹	Cr. ₹
(a)	B Capital A/c Dr.	21,000	
	To A Capital A/c		15,000
	To C Capital A/c		6,000
	(Being the adjustment for goodwill made through the capital accounts of the partners)		
(b)	Goodwill A/c Dr.	45,000	
	To A Capital A/c		20,000
	To B Capital A/c		15,000
	To C Capital A/c		10,000
	(Being the goodwill raised to its full value before B's retirement)		
	A Capital A/c Dr.	27,000	
	C Capital A/c Dr.	18,000	
	To Goodwill A/c		45,000
	(Being the goodwill written-down to its old figure after B's retirement by debiting A and B in the ratio of 3 : 2)		

Illustration 9

A, B and C are equal partners. B retires. His share of goodwill is ₹ 9,000. The remaining partners have decided to continue the business sharing profit in the ratio of 3 : 2. Goodwill is not to be shown in the Balance Sheet. Give Journal entry.

Solution

In the books of A, B and C

Journal

Date	Particulars	Dr. ₹	Cr. ₹
	A Capital A/c Dr.	7,200	
	C Capital A/c Dr.	1,800	
	To B Capital A/c		9,000
	(Being the required adjustment through the capital accounts of the partners in regard to goodwill)		

Calculation of Gaining Ratio

Partners	A	B	C
Old Ratio (1 : 1 : 1)	1/3	1/3	1/3
New Ratio (3 : 2)	3/5	—	2/5
New ratio – Old ratio	(3/5 – 1/3)		(2/5 – 1/3)
Gain	4/15		1/15

Therefore, the gaining ratio of A : C = 4 : 1.

Alternatively,

Partners		A	B	C
Right of goodwill before retirement	(₹)	9,000	9,000	9,000
Right of goodwill after retirement	(₹)	16,200	—	10,800
Gain (+) / Sacrifice (–)	(₹)	(+) 7,200	(–) 9,000	(+) 1,800

Illustration 10

X, Y and Z are partners sharing profits and losses of 4 : 3 : 2. Z retires from the business. The value of goodwill is ₹ 90,000. Goodwill appearing in the Balance Sheet at ₹ 54,000. X and Y decided to share profits and losses in the ratio of 3 : 1. Pass necessary Journal Entries.

Solution **In the books of the Firm**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c (₹ 90,000 – ₹ 54,000)	Dr.	36,000	
	To X Capital A/c			16,000
	To Y Capital A/c			12,000
	To Z Capital A/c			8,000
	(Being goodwill raised to its full value by crediting all partners in the old ratio, i.e., 4 : 3 : 2)			
	X Capital A/c	Dr.	67,500	
	Y Capital A/c	Dr.	22,500	
	To Goodwill A/c			90,000
	(Being the goodwill written-off in the new ratio, i.e., 3 : 1)			

Illustration 11

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. C retires from the business. the value of goodwill has been agreed at ₹ 60,000. At present, goodwill appearing in the books at ₹ 90,000. After retirement, no goodwill is to be shown. Pass necessary Journal Entries.

Solution **In the books of the Firm**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	A Capital A/c	Dr.	15,000	
	B Capital A/c	Dr.	10,000	
	C Capital A/c	Dr.	5,000	
	To Goodwill A/c (₹ 90,000 –₹ 60,000)			30,000
	(Being the adjustment for goodwill on C's retirement)			
	A Capital A/c	Dr.	36,000	
	B Capital A/c	Dr.	24,000	
	To Goodwill A/c			60,000
	(Being the goodwill written-off in the new ratio, i.e., 3 : 2)			

Illustration 12

Pass Journal Entries under the following circumstances:

(a) X, Y and Z are partners sharing profits and losses in the ratio 2:2:1. X retires. His share of goodwill is ₹ 6,000. Goodwill appears in the books at its full value and it has been decided not to show goodwill in the books. Y and Z decided to share profit and losses in the ratio 3:2.

(b) A, B and C are partners sharing profits and losses equally. A retires. B and C decided to share profits and losses in the ratio 4:1. The value of the goodwill is ₹ 45,000. Goodwill does not appear in the books. The continuing partners decide not to show goodwill in the books.

Solution **Journal**

Date	Particulars		Dr. ₹	Cr. ₹
(a)	Y Capital A/c (Note 1)	Dr.	9,000	
	Z Capital A/c (Note 1)	Dr.	6,000	
	To Goodwill A/c			15,000
	(Being goodwill written-off from the books after X's retirement)			
	Goodwill A/c (Note 2)	Dr.	45,000	
	To A Capital A/c			15,000
	To B Capital A/c			15,000
	To C Capital A/c			15,000
	(Being goodwill raised to its full value by crediting all partners in the old ratio)			
	B Capital A	Dr.	36,000	
	C Capital A	Dr.	9,000	
	To Goodwill A/c (Note 2)			45,000
	(Being goodwill written-off in the new ratio)			
	Alternatively,			
	B Capital A/c	Dr.	21,000	
	To A Capital A/c			15,000
	To C Capital A/c			6,000
	(Being the adjustment for goodwill made through the capital accounts of the partners)			

Working Notes :

(1) X's share of goodwill is ₹ 6,000 for 2/5th share of profit. Therefore, total goodwill = ₹ 6,000 × 5/2 = ₹ 15,000. Goodwill already appearing in the Balance Sheet at full value. Therefore no further goodwill is to be raised. However, for writing off goodwill, Y and Z capital will be debited in the **new ratio**.

(2) In this case, goodwill is to be raised in the old ratio and to be written-off in the new ratio.

2. Adjustment in Regard to Revaluation of Assets and Liabilities

Unless otherwise agreed, on retirement, a partner is entitled to have the assets and liabilities of a firm revalued on a proper basis at the date of retirement, so that he gets his fair share of the firm's net assets. The purpose of revaluation is to convert the book values of the assets and liabilities into net market values.

Just like admission, here also, a Revaluation Account is prepared to ascertain the profit or loss on revaluation. The profit/loss on revaluation is transferred to All Partners' Capital Accounts in the old profit sharing ratio. After retirement, the assets and liabilities appear in the Balance Sheet at ***revised value.***

The continuing partners may decide ***not*** to show the assets and liabilities in their revised values, i.e., assets and liabilities are to appear in the ***Original Values***. In such a situation, a Memorandum Revaluation Account is prepared. The profit or loss on revaluation is transferred to ***All Partners' Capital Accounts in the old ratio.***

Thereafter, the same amount is put below the line on the reverse side of the Memorandum Account and it is closed by transferring to the Capital Accounts of the ***continuing partners in the new ratio***.

In this connection, Para 30 of AS—10 is also important. This para states that '***An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revalutaion of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account***'.

In case of Partnership, revaluation profit or loss is transferred directly to Partners' Capital Accounts. Therefore, an increase in net book value arising on revaluation of fixed assets may be credited to Revaluation Account (in place of Revaluation Reserve Account because it will be utilimately closed by transferring to Partners' Capital Accounts) and loss on revaluation of fixed assets may be debited to Revaluation Account (in place of Profit and Loss Account because it will be ultimately closed by transferreing to Partners' Capital Accounts).

In this chapter or elsewhere the effects of revaluation of fixed assets have been shown through the Revaluation Account (in place of Revaluation Reserve Account / Profit and Loss Account because the effect will be same on Partners' Capital Accounts).

Computation of Retiring Partner's Interest in the Firm

For calculating the amount of money payable to the retiring partner, the following items should be considered:

1. Opening balance of Capital and Current Account of retiring partner.
2. Share of undistributed reserve and profit.
3. Share of revaluation profit or loss.
4. Share of profit till the date of his retirement.
5. Share of firm's goodwill.
6. The salary or/and interest due to the retiring partner till the date of his retirement.
7. The drawing and interest thereon, of the retiring partner.

Illustration 13

P, Q and R are partners sharing profits and losses in the ratio of 3 : 2 : 1. Following is their Balance Sheet as at 31st March, 2018:

Liabilities	₹	Assets	₹
Capital Accounts :		Plant and Machinery	2,00,000
P	2,00,000	Stock	1,00,000

Q	1,50,000	Debtors	1,00,000
R	1,00,000	Cash	1,00,000
Creditors	50,000		
	5,00,000		5,00,000

Q retires from the business from 1st April, 2018. The following was agreed upon retirement of Q.

(1) Plant and machinery has been revalued at ₹ 3,00,000.

(2) Stock has been revalued at ₹ 90,000.

(3) A sum of ₹ 15,000 is to be written-off from debtors.

(4) The goodwill of the firm has been valued at ₹ 1,50,000 but no Goodwill Account is to be raised in the books of account.

(5) P and R will continue to carry on the business and shall share profits and losses equally in future.

(6) Amount payable by Q shall remain in the business as loan.

You are required to :

(i) prepare Revaluation Account;

(ii) prepare Partners' Capital Accounts; and

(iii) show the Balance Sheet of P and R as on 1st April, 2018.

Solution

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

Particulars	₹	Particulars	₹
To Stock A/c	10,000	By Plant and Machinery A/c	1,00,000
To Debtors A/c	15,000		
To Partners' Capital A/cs :			
P	37,500		
Q	25,000		
R	12,500		
	1,00,000		1,00,000

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

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Q Capital A/c (Note 1)	—	—	50,000	By Balance b/d	2,00,000	1,50,000	1,00,000
To Q Loan A/c	—	2,25,000	—	By Revaluation A/c	37,500	25,000	12,500
To Balance c/d	2,37,500	—	62,500	By R Capital A/c (Note 1)	—	50,000	—
	2,37,500	2,25,000	1,12,500		2,37,500	2,25,000	1,12,500

Balance Sheet of P and R as on 1st April, 2018

Liabilities	₹	Assets	₹
Capital Accounts :		Plant and Machinery	3,00,000
P	2,37,500	Stock	90,000
R	62,500	Debtors	85,000
Q Loan	2,25,000	Cash	1,00,000
Creditors	50,000		
	5,75,000		5,75,000

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	P (₹)	Q (₹)	R (₹)
Right of goodwill before retirement (3 : 2 : 1)	75,000	50,000	25,000
Right of goodwill after retirement (1 : 1)	75,000	—	75,000
Gain (+) / Sacrifice (–)	Nil	(–) 50,000	(+) 50,000

Illustration 14

A partnership consists of three partners with capital, sharing profits and drawings as follows :

Partners	Capital (₹)	Profit (%)	Drawings (₹)
A	1,50,000	50	15,000
B	1,00,000	30	10,000
C	50,000	2018,000	

Capital is chargeable with 5% interest per annum.

B and C each receive a salary of ₹ 7,500 per annum, capital to remain fixed.

A had loaned a further of ₹ 1,00,000 to the partnership at 4% per annum interest.

Profit for the year, before charging partners' salaries, interest on loan and capital was ₹ 1,00,000.

A retired at the end of the year, and B and C, in accordance with agreement, take over his share. Total goodwill is valued at ₹ 1,25,000. Fixed assets revalued upwards by ₹ 25,000.

You are required to prepare Profit and Loss Appropriation Account and Partners' Current Accounts. Also determine the amount due to A (No account is required).

Solution

Dr. Profit and Loss Appropriation Account for the year ended ... Cr.

Particulars			₹	Particulars	₹
To Interest on Capital A/c :	A	7,500		By Net Profit (Less Interest on Loan)	
	B	5,000		[₹ 1,00,000 – (4% of ₹ 1,00,000)]	96,000
	C	2,500	15,000		
To Partners' Salaries A/c :	B	7,500			
	C	7,500	15,000		
To Share of Profit A/c :	A	33,000			
	B	19,800			
	C	13,200	66,000		
			96,000		96,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Drawings A/c	15,000	10,000	10,000	By Interest on Capital A/c	7,500	5,000	2,500
To A Loan A/c	25,500	—	—	By Partners' Salaries A/c	—	7,500	7,500
To Balance c/d	—	22,300	13,200	By Share of Profit A/c	33,000	19,800	13,200
	40,500	32,300	23,200		40,500	32,300	23,200

Calculation of Amount Due to A

Liabilities	₹
Capital Account Balance	1,50,000
Current Account Balance	25,500
Loan Account Balance	1,00,000
Accrued Interest on Loan	4,000
Share of Goodwill (50% of ₹ 1,25,000)	62,500
Revaluation Profit (50% of ₹ 25,000)	12,500
	3,54,500

Illustration 15

A and B were in partnership sharing profits equally. At 1.1.2018, their Balance Sheet was as follows :

Liabilities		₹	Assets	₹
Capital Accounts :	A	60,000	Freehold Premises	30,000
	B	20,000	Plant and Machinery	15,000
Current Accounts :	A	12,000	Motor Van	16,000
	B	5,000	Stock	14,000
Creditors		7,500	Debtors	12,000
			Bank Balance	17,500
		1,04,500		1,04,500

B retired on 1.1.2018 when the assets were revalued as follows :

Freehold Premises ₹ 40,000; Plant and Machinery ₹ 10,000; Motor Van ₹ 10,000.

It was also agreed that stock which had cost ₹ 7,000 was now worth ₹ 3,000, and further stock which had cost ₹ 2,000 now had nil value.

Debtors at 1.1.2018 included bad debts of ₹ 2,000; no provision for doubtful debts had been made in the past but a provision equal to 4% of debtors as at 1.1.2018 should be created.

The adjustments for the foregoing matters was made in the books as at 1.1.2018. B was paid by cheque ₹ 10,000 and the balance transferred to his Loan Account.

You are required to prepare necessary Ledger Accounts and the Balance Sheet of A, after B's retirement.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars		₹
To Plant and Machinery A/c	5,000	By Freehold Premises A/c		10,000
To Motor Van A/c	6,000	By Partners' Capital A/cs : A	4,700	
To Stock A/c (₹ 4,000 + ₹ 2,000)	6,000	B	4,700	9,400
To Debtors A/c	2,000			
To Provision for Doubtful Debts A/c (Note 1)	400			
	19,400			19,400

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

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Revaluation A/c (Loss)	4,700	4,700	By Balance b/d	60,000	20,000
To Bank A/c	—	10,000	By B Current A/c	—	5,000
To B Loan A/c	—	10,300			
To Balance c/d	55,300				
	60,000	25,000		60,000	25,000

B Loan Account

Particulars	₹	Particulars	₹
To Balance c/d	10,300	By Partners' Capital A/cs	10,300

Balance Sheet after B's Retirement

Liabilities	₹	Assets		₹
Capital Account	55,300	Freehold Premises		40,000
Current Account	12,000	Plant and Machinery		10,000
B Loan	10,300	Motor Van		10,000
Creditors	7,500	Stock		8,000
		Debtors (₹ 12,000 – 2,000)	10,000	
		Less: Provision for Doubtful Debts	400	9,600
		Bank (₹ 17,500 – 10,000)		7,500
	85,100			85,100

Working Notes :

Partners	R (₹)
(1) Debtors as per Balance Sheet	12,000
Less: Bad Debts	2,000
	10,000
Provision for Bad Debts 4% of ₹ 10,000 = ₹ 400.	

Illustration 16

X, Y and Z are partners sharing profits in the ratio of their capitals. Y retired from the firm on 31.12.2017, the date on which the Balance Sheet of the firm was as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	4,000	Cash		5,400
Bills Payable	2,500	Debtors	6,000	
Outstanding Salary	500	Less: Provision for bad debts	400	5,600
Capitals :		Stock		10,000
X	30,000	Machinery		28,000
Y	24,000	Land and Buildings		30,000
Z	18,000			
	79,000			79,000

The following adjustments were made :

(i) Buildings appreciated by 20%; stock depreciated by 10%; provision for doubtful debts was to be 5%; and a reserve for legal charges payable was to be made at ₹ 900.

(ii) Goodwill of the firm be valued at ₹ 12,000 and Y's share in it be adjusted into the Capital Accounts of X and Z without opening Goodwill Account.

(iii) ₹ 24,000 from Y's Capital Account be transferred to his Loan Account and balance be paid in cash.

(iv) New profit-sharing ratio of X and Z is decided to be 3 : 2.

Give the necessary Ledger Accounts and the Balance Sheet of the firm after Y's retirement.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Stock A/c (10% on ₹ 10,000)		1,000	By Land and Buildings A/c (20% on ₹ 30,000)	6,000
To Provision for Legal Charges A/c		900	By Provision for Bad Debts A/c (₹ 500 – 400)	100
To Partners' Capital A/cs :	₹			
X	1,750			
Y	1,400			
Z	1,050	4,200		
		6,100		6,100

Dr. Partners' Capital Accounts Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Y Capital A/c (Note 1)	2,200	—	1,800	By Balance b/d	30,000	24,000	18,000
To Cash A/c (Balancing figure)	—	5,400	—	By Revaluation A/c	1,750	1,400	1,050
To Y's Loan A/c	—	24,000	—	By X Capital A/c (Note 1)	—	2,200	—
To Balance c/d	29,550	—	17,250	By Z Capital A/c (Note 1)	—	1,800	—
	31,750	29,400	19,050		31,750	29,400	19,050

Balance Sheet of X and Z as on 31st December, 2017

Liabilities	₹	Assets		₹
Capitals :		Land and Buildings (₹ 30,000 + 6,000)		36,000
X	29,550	Machinery		28,000
Z	17,250	Stock (₹ 10,000 – 1,000)		9,000
Y's Loan Account	24,000	Debtors	6,000	
Sundry Creditors	4,000	Less: Provision for Bad Debts (₹ 400 – 100)	300	5,700
Outstanding Salary	500	Bills Payable		2,500
		Provision for Legal Charges		900
	78,700			78,700

Working Notes : (1) Statement Showing the Required Adjustment for Goodwill

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (5 : 4 : 3)	5,000	4,000	3,000
Right of goodwill after retirement (3 : 2)	7,200	—	4,800
Gain (+) / Sacrifice (–)	(+) 2,200	(–) 4,000	(+) 1,800

Required Journal Entry :

X Capital Account	Dr.	2,200	
Z Capital Account	Dr.	1,800	
To Y Capital Account			4,000

Illustration 17

D, R and L were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The draft Balance Sheet as on 31.3.2018 was as follows :

Liabilities			₹	Assets		₹
Capital Accounts :	D	24,000		Buildings		12,000
	R	12,000		Plant and Equipment		18,800
	L	6,000	42,000	Stock		9,200
Current Accounts :	D	1,920		Debtors	12,400	
	R	1,680		Less: Provision for Doubtful Debts	1,200	11,200
	L	1,120	4,720	Balance at Bank		16,120
Loan — D			5,000			
Creditors			15,600			
			67,320			67,320

D retired on 31.3.2018 and, R and L continued in partnership sharing profits and losses in the ratio of 2 : 1. D's loan was repaid on 1.4.2018 and it was agreed that the remaining balance due to him, other than that of the Current Account, should remain as loan to the partnership.

For the purpose of D's retirement, it was agreed that —

(i) Buildings be revalued at ₹ 24,000 and the plant and equipment at ₹ 15,800.

(ii) The provision for doubtful debts was to be increased by ₹ 400.

(iii) A provision of ₹ 500 included in creditors was no longer required.
(iv) ₹ 1,200 was to be written-off the stock in respect of damaged items included therein.
(v) A provision of ₹ 4,240 be made in respect of outstanding legal charges.
(vi) The goodwill of the firm to be valued at ₹ 14,400. Both the partners decided that goodwill should not appear in the books of account of the firm.

You are required to prepare :
(a) Revaluation Account;
(b) Capital and Current Accounts of the partners;
(c) Balance Sheet of R and L as on 1.4.2018.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Plant and Equipment A/c	3,000	By Buildings A/c	12,000
To Provision for Doubtful Debts A/c	400	By Creditors A/c	500
To Stock A/c	1,200		
To Provision for Legal Charges A/c	4,240		
To Partners' Capital A/cs (D — ₹ 1,830; R — ₹ 1,220; L — ₹ 610):	3,660		
	12,500		12,500

Dr. Partners' Capital Accounts Cr.

Particulars	D (₹)	R (₹)	L (₹)	Particulars	D (₹)	R (₹)	L (₹)
To D Loan A/c	33,030	—	—	By Balance b/d	24,000	12,000	6,000
To Goodwill A/c	—	9,600	4,800	By Revaluation A/c (Note 1)	1,830	1,220	610
To Balance c/d	—	8,420	4,210	By Goodwill A/c	7,200	4,800	2,400
	33,030	18,020	9,010		33,030	18,020	9,010

Dr. Partners' Current Accounts Cr.

Particulars	D (₹)	R (₹)	L (₹)	Particulars	D (₹)	R (₹)	L (₹)
To Bank A/c	1,920	—	—	By Balance b/d	1,920	1,680	1,120
To Balance c/d		1,680	1,120				
	1,920	1,680	1,120		1,920	1,680	1,120

Balance Sheet of R and L as on 1st April, 2018

Liabilities			₹	Assets		₹
Capital Accounts :	R	8,420		Building		24,000
	L	4,210	12,630	Plant and Equipment		15,800
Current Accounts :	R	1,680		Stock		6,000
	L	1,120	2,800	Debtors	12,400	
D's Loan			33,030	Less: Provision for Doubtful Debts	1,600	10,800
Creditors (₹ 15,600 – 500)			15,100	Bank (₹ 16,120 – 5,000 – 1,920)		9,200
Provision for Legal Charges			4,240			
			67,800			67,800

Tutorial Note : Profits and losses arising out of revaluation of assets and liabilities directly affect the Partners' Capital Account. Therefore, it is to be transferred to Partners' Capital Accounts but not Partners' Current Accounts.

Illustration 18

A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. At 1.1.2018, their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capital Accounts :	A	1,00,000		Fixed Assets	1,06,644
	B	50,000		Stock	71,116
	C	25,000	1,75,000	Debtors	42,655
Current Accounts :	A	24,000		Bank	24,863
	B	10,000			
	C	1,000	35,000		
Creditors			35,278		
			2,45,278		2,45,278

A retired on the above date and B and C decided to share profits and losses in the ratio of 2 : 1. Accordingly, it was agreed that —

(a) The balances on their Current Accounts would be transferred to their respective Capital Accounts.

(b) Goodwill would be valued at ₹ 24,000.

(c) Fixed assets would be revalued at ₹ 1,00,000, stock ₹ 70,000 and a debtor for ₹ 1,240 would be written-off as bad.

(d) A reserve of ₹ 30,000 is to be created.

(e) The entire amount due to A would be transferred to his Loan Account.

A took over an unrecorded asset at ₹ 3,000 against the amount due to him.

Prepare necessary Ledger Accounts and the Balance Sheet after A's retirement.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars			₹
To Fixed Assets A/c	6,644	By A A/c (Note 1)			3,000
To Stock A/c	1,116	By Partners' Capital A/cs :	A	3,000	
To Debtors A/c	1,240		B	2,000	
			C	1,000	6,000
	9,000				9,000

Partners' Capital Accounts

Dr. **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c (Note 1)	3,000	—	—	By Balance b/d	1,00,000	50,000	25,000
To Revaluation A/c	3,000	2,000	1,000	By Partners' Current A/cs	24,000	10,000	1,000
To Goodwill A/c	—	16,000	8,000	By Goodwill A/c	12,000	8,000	4,000
To A Loan A/c	1,30,000	—	—				
To Reserve A/c (2 : 1)	—	20,000	10,000				
To Balance c/d	—	30,000	11,000				
	1,36,000	68,000	30,000		1,36,000	68,000	30,000

Balance Sheet after A's retirement

Liabilities			₹	Assets	₹
Capital :	A	30,000		Fixed Assets	1,00,000
	B	11,000	41,000	Stock	70,000
Reserve			30,000	Debtors	41,415
A Loan			1,30,000	Bank	24,863
Creditors			35,278		
			2,36,278		2,36,278

Working Notes :

(1) Unrecorded assets taken over by A at an agreed value of ₹ 3,000. A's Capital will be debited and Revaluation Account will be credited.

(2) Reserve to be created by debiting B and C Capital in the new profit-sharing ratio, i.e., 2 : 1. A has nothing to do with the Reserve.

3. Adjustment in Regard to Undistributed Profits and Losses

When a partner is retiring from the partnership, an adjustment entry is required for any reserve/accumulated losses appearing in the Balance Sheet at the time of retirement. The Journal Entry will be as follows :

General Reserve Account Dr.
Profit and Loss Account Dr.
Other Reserves Account Dr.
  To All Partners' Capital Accounts [Old ratio]

If there is any accumulated loss in the Balance Sheet at the time of retirement, the Journal Entry will be as follows :

All Partners' Capital Accounts Dr. [Old ratio]
  To Profit and Loss Account

After retirement, remaining partners may decide that the reserve to be shown in the books of the new firm at its original figure (or agreed figure). Under this situation, reserve is written-off first by debiting Reserve Account and crediting All Partners' Capital Accounts in the old profit-sharing ratio, then reserve is raised in the books at its original figure (or agreed figure) by debiting Remaining Partners' Capital Accounts in the new ratio and crediting the Reserve Account.

The accounting entries will be as follows :

(i) ***When reserve is written-off***

Reserve Account	Dr.	
To All Partners' Capital Accounts		[Old ratio]

(ii) ***When reserve is to be shown in the new Balance Sheet at agreed figure***

Remaining Partners' Capital Accounts	Dr.	[New ratio]
To Reserve Account		[Agreed amount]

Students must pass necessary entries for reserve and surplus or accumulated losses even if the question is silent on that point.

Illustration 19

X, Y and Z were partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet of the firm as on 31st December, 2017 was as follows :

Liabilities	₹	Assets		₹
Capital Accounts :		Buildings		3,00,000
X	2,00,000	Plant and Machinery		2,00,000
Y	2,00,000	Furniture		50,000
Z	1,50,000	Stock-in-Trade		1,50,000
General Reserve	75,000	Sundry Debtors	1,00,000	
Creditors	1,25,000	Less: Provision for bad debts	5,000	95,000
Bills Payable	60,000	Cash		15,000
	8,10,000			8,10,000

On 1st January, 2018, Y retired. The terms of his retirement provided the following :

(1) Plant and machinery and furniture were to be depreciated by 5% and 10% respectively.
(2) Stock and building were to be appreciated by 20% and 10% respectively.
(3) Provision for doubtful debts was to be increased to ₹ 7,500.
(4) The goodwill of the firm was to be valued at ₹ 1,00,000.
(5) The amount due to Y was to be transferred to a separate Loan Account.

You are required to show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm as on 1st January, 2018.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Plant and Machinery A/c	10,000	By Stock A/c	30,000
To Furniture A/c	5,000	By Building A/c	30,000
To Provision for Bad Debts A/c	2,500		
To Partners' Capital A/cs :			
X	17,000		
Y	17,000		
Z	8,500		
	60,000		60,000

Partners' Capital Accounts

Dr. **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Y Loan A/c	—	2,87,000	—	By Balance b/d	2,00,000	2,00,000	1,50,000
To Goodwill A/c (2 : 1)	66,667	—	33,333	By Revaluation A/c	17,000	17,000	8,500
To Balance c/d	2,20,333	—	1,60,167	By Goodwill A/c (Note 1)	40,000	40,000	20,000
				By General Reserve A/c (Note 2)	30,000	30,000	15,000
	2,87,000	2,87,000	1,93,500		2,87,000	2,87,000	1,93,500

Balance Sheet of X and Z as on 31st January, 2018

Liabilities	₹	Assets	₹
Capital Accounts :		Buildings (₹ 3,00,000 + 30,000)	3,30,000
X	2,20,233	Plant and Machinery (₹ 2,00,000 – 10,000)	1,90,000
Z	1,60,167	Furniture (₹ 50,000 – 5,000)	45,000

Y Loan	2,87,000	Stock-in-Trade ₹ (1,50,000 + 30,000)		1,80,000
Creditors	1,25,000	Sundry Debtors	1,00,000	
Bills Payable	60,000	Less: Provision for bad debts	7,500	92,500
		Cash		15,000
	8,52,500			8,52,500

Working Notes :

(1) Goodwill is to be raised in the books at its full value by crediting all Partners' Capital Accounts in the old ratio, i.e., 2 : 2 : 1 and immediately it is to be written-off by debiting continuing partners in the new profit-sharing ratio, i.e. 2 : 1.

(2) General Reserve is to be distributed amongst the old partners even when the question is silent on this point. General Reserve Account is debited and Old Partners' Capital Accounts are credited in the old ratio, i.e., 2 : 2 : 1.

Illustration 20

A, B and C are partners sharing profits and losses equally. The Balance Sheet of the firm as on 31st December, 2017 stood as follows :

Liabilities	₹	Assets		₹
Capital Accounts :		Goodwill		19,500
A	30,000	Land and Buildings		40,000
B	20,000	Investments (at cost)		5,000
C	20,000	Stock		10,000
Contingency Reserve	6,000	Debtors	10,000	
Investment Fluctuation Fund	1,2000	Less: Provision for bad debts	800	9,200
Creditors	12,800	Cash at bank		3,300
		Cash in hand		3,000
	90,000			90,000

C retires on 1st January, 2018. In order to arrive at the balance due to C, it was mutually agreed that:

(1) Land and Buildings be valued at ₹ 50,000.
(2) Investment fluctuation fund be brought down to ₹ 500.
(3) Contingency reserve is no longer required.
(4) Debtors are all good.
(5) Stock to be taken at ₹ 9,000.
(6) Amount due to C will be transferred to his Loan Account carrying interest @ 12% p.a.
(7) Goodwill be valued at one year's purchase of the average profits of the past five years. The profits of the preceding five years were :
2013 — ₹ 11,500; 2014 — ₹ 14,000; 2015 — ₹ 9,000; 2016 — ₹ 8,000; and 2017 — ₹ 10,000.

You are required to show :

(i) Revaluation Account;
(ii) Partners' Capital Accounts; and
(iii) Balance Sheet of the new firm as on 1st January, 2018.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c ₹ (10,000 – 9,000)	1,000	By Land and Buildings A/c	10,000
To Partners' Capital A/cs :		By Investment Fluctuation Fund A/c (Note 2)	700
A	3,500	By Provision of Bad Debts A/c	800
B	3,500		
C	3,500		
	11,500		11,500

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c (Note 1)	6,500	6,500	6,500	By Balance b/d	30,000	20,000	20,000
To C Loan A/c	—	—	22,500	By Contingency Reserve A/c	2,000	2,000	2,000
To C Capital A/c	1,750	1,750	—	By A Capital A/c	—	—	1,750
To Balance c/d	27,250	17,250	—	By B Capital A/c	—	—	1,750
				By Revaluation A/c	3,500	3,500	3,500
	35,500	25,500	29,000		35,500	25,500	29,000

Balance Sheet of A and B as on 1st January, 2018

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Buildings	50,000
A	27,250	Investments (at cost)	5,000
B	17,250	Stock	9,000
12% C Loan	22,500	Debtors	10,000
Investment Fluctuation Fund	500	Cash at bank	3,300
Creditors	12,800	Cash in hand	3,000
	80,300		80,300

Working Notes :

(1) Ascertainment of Goodwill :

(a) Total profits of last 5 years = (₹ 11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.

(b) Average profit = ₹ 52,500 / 5 = ₹ 10,500.

(c) New value of goodwill = ₹ 10,500 × 1 = ₹ 10,500.

Goodwill already appearing in the books at ₹ 19,500. It is to be written-off first by debiting all partners equally. After this, goodwill is to be adjusted as follows :

Working Notes : (1) Statement Showing the Required Adjustment for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (equally)	3,500	3,500	3,500
Right of goodwill after retirement (equally)	5,250	5,250	—
Gain (+) / Sacrifice (–)	(+) 1,750	(–) 1,750	3,500

Required Journal Entry :

A Capital Account	Dr.	1,750	
B Capital Account	Dr.	1,750	
To C Capital Account			3,500

(2) Investment fluctuation fund is created to guard against the fall in the price of the investment. At the time of retirement, investment fluctuation fund is required to the extent of ₹ 500 only. Therefore, the balance of ₹ 700 will be transferred to Revaluation Account.

4. Adjustment in Regard to Joint Life Policy

When a partner is retiring from the partnership, an adjustment is required in respect of Joint Life Policy. Joint Life Policy should be adjusted according to situations.

Case 1 : When there is no Joint Life Policy in the present Balance Sheet and Joint Life Policy will be shown in the Balance Sheet after retirement

In this case, Joint Life Policy Account will be debited at surrender value and All Partners' Capital Accounts will be credited in the old ratio. Joint Life Policy will be shown in the Balance Sheet at surrender value.

Joint Life Policy Account Dr.
  To All Partners' Capital Accounts

Illustration 21

A, B and C are partners sharing profits in the ratio of 4 : 3 : 2. Their Balance Sheet on 31st March, 2018 was as follows :

Liabilities			₹	Assets	₹
Creditors			33,000	Cash	10,000
General Reserve			27,000	Debtors	15,000
Capitals :	A	70,000		Stock	30,000
	B	45,000		Machinery	50,000
	C	30,000	1,45,000	Land and Building	1,00,000
			2,05,000		2,05,000

The firm had a joint life policy for ₹ 40,000. The surrender value of the policy was ₹ 13,500 as on 31st March, 2018. B retires on the above date on the following conditions :

(a) Land and building be appreciated by 20%.

(b) Goodwill to be valued at ₹ 18,000.

(c) A provision for doubtful debts of 5% is to be created and machinery and stock be written down by 10% and 5% respectively.

(d) A provision of ₹ 1,500 be made in respect of legal charges.

B to be paid ₹ 5,000 and balance be transferred to his Loan Account. Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of A and C.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c (5% on ₹ 15,000)		750	By Land and Building A/c (20% of ₹ 1,00,000)	20,000
To Machinery A/c (10% of ₹ 50,000)				
To Stock A/c (5% of ₹ 30,000)	1,500			
To Provision for Legal Charges A/c	1,500	3,000		
To Partners' Capital A/cs :				
A	5,000			
B	3,750			
C	2,500	11,250		
		20,000		20,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	12,000	—	6,000	By Balance b/d	70,000	45,000	30,000
To Cash A/c	—	5,000	—	By General Reserve A/c	12,000	9,000	6,000
To B's Loan A/c	—	63,250	—	By Goodwill A/c	8,000	6,000	4,000
To Balance c/d	89,000	—	39,500	By Joint Life Policy A/c	6,000	4,500	3,000
				By Revaluation A/c	5,000	3,750	2,500
	1,01,000	68,250	45,500		1,01,000	68,250	45,500

Balance Sheet of A and C as on 31st March, 2018

Liabilities	₹	Assets		₹
Capitals :		Land and Building ₹ (1,00,000 + 20,000)		1,20,000
A	89,000	Machinery ₹ (50,000 – 5,000)		45,000
C	39,500	Stock ₹ (30,000 – 1,500)		28,500
B's Loan	63,250	Debtors	15,000	
Creditors	33,000	Less: Provision for doubtful debts	750	14,250
Provision for Legal Charges	1,500	Joint Life Policy		13,500
		Cash ₹ (10,000 – 5,000)		5,000
	2,26,250			2,26,250

Case 2 : When there is no Joint Life Policy in the present Balance Sheet and Joint Life Policy will not be shown in the Balance Sheet after retirement

In this case, adjustment is done through the Partners' Capital Accounts by passing the following entry :

Continuing Partners' Capital Accounts Dr. [Gaining Ratio]
To Retiring Partners' Capital Accounts [Share of surrender value]

Illustration 22

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. They had taken out a Joint Life Policy of the face value of ₹ 2,00,000. On 31st December, 2017 its surrender value was ₹ 40,000. On this date the Balance sheet of the firm stood as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		53,000	Fixed Assets	2,50,000
Outstanding Expenses		7,000	Stock	1,10,000
Reserve		30,000	Book Debts	90,000
Capital A/cs :	A	2,00,000	Cash at Bank	20,000
	B	1,00,000		
	C	80,000		
		4,70,000		4,70,000

On that date, B decided to retire and for that purpose —
(a) Goodwill was valued at ₹ 1,50,000.
(b) Fixed Assets were valued at ₹ 3,00,000.
(c) Stock was considered as worth ₹ 10,000.
Amount due to B will be transferred to his Loan Account earning interest @ 10% p.a. Goodwill was to be passed through books without raising a Goodwill Account.
The Joint Life Policy was also not to appear in the Balance Sheet.
Prepare :
(1) Revaluation Account;
(2) Partners' Capital Accounts; and
(3) Balance Sheet after B's retirement.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c	1,00,000	By Fixed Assets A/c	50,000
		By Partners' Capital A/cs :	
		A	25,000
		B	15,000
		C	10,000
	1,00,000		1,00,000

Partners' Capital Accounts

Dr. **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c (Loss)	25,000	15,000	10,000	By Balance b/d	2,00,000	1,00,000	80,000
To B Capital A/c (Note 1)	15,000	—	30,000	By Reserve A/c	15,000	9,000	6,000
To B Capital A/c (Note 2)	4,000	—	8,000	By A Capital A/c (Note 1)	—	15,000	—
To B Loan A/c	—	1,51,000	—	By C Capital A/c (Note 1)	—	30,000	—
To Balance c/d	1,71,000	—	38,000	By A Capital A/c (Note 2)	—	4,000	—
				By B Capital A/c (Note 2)	—	8,000	—
	2,15,000	1,66,000	86,000		2,15,000	1,66,000	86,000

Balance Sheet (after B's retirement) as on 31st December, 2017

Liabilities		₹	Assets	₹
Capital A/cs :	A	1,71,000	Fixed Assets	3,00,000
	C	38,000	Stock	10,000
B Loan		1,51,000	Book Debts	90,000
Sundry Creditors		53,000	Cash at Bank	20,000
Outstanding Expenses		7,000		
		4,20,000		4,20,000

Working Notes :

(1) Adjustment for Goodwill (₹ 1,50,000)

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (5 : 3 : 2)	75,000	45,000	30,000
Right of goodwill after retirement (3 : 2)	90,000		60,000
Gain (+) / Sacrifice (–)	(+) 15,000	(–) 45,000	(+) 30,000

(2) Adjustment for Joint Life Policy (₹ 40,000)

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (5 : 3 : 2)	20,000	12,000	8,000
Right of goodwill after retirement (3 : 2)	24,000	—	16,000
Gain (+) / Sacrifice (–)	(+) 4,000	(–) 12,000	(+) 8,000

Journal Entry

A Capital Account	Dr.	4,000	
C Capital Account	Dr.	8,000	
To B Capital Account			12,000

Alternatively:

Joint Life Policy can be adjusted by calculating Gaining Ratio which is as follows :

Partners	A (₹)	B (₹)	C (₹)
Old Profit Sharing Ratio	5/10	3/10	2/10
New Profit Sharing Ratio	3/5	–	2/5
Gaining Ratio	(6 – 5) / 10		(4 – 2) / 10
	= 1/10	= 3/10	= 2/10

Gaining Ratio — A : C = 1 : 2.

B's share of the surrender value = 3/10 of ₹ 40,000 = ₹ 12,000 and it is to be borne by A and C in the Gaining Ratio, i.e., 1 : 2.

A will bear = 1/3 of ₹ 12,000 = ₹ 4,000.C will bear = 2/3 of ₹ 12,000 = ₹ 8,000.

Illustration 23

On 31st March, 2018, the Balance Sheet of M/s. A, B and C sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	1,00,000	Land and Buildings	2,00,000
Capital A/cs :		Machinery	3,00,000
A	2,00,000	Closing Stock	1,00,000
B	3,00,000	Sundry Debtors	1,00,000
C	2,00,000	Cash and Bank Balances	1,00,000
	8,00,000		8,00,000

On 31st March, 2018, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis :

(1) Land and Buildings be appreciated by 30%.

(2) Machinery is to be depreciated by 20%.

(3) Closing Stock is to be valued at ₹ 75,000.

(4) Provision for bad debts is to be made at 5%.

(5) Old credit balances of Sundry Creditors ₹ 20,000 is to be written-back.

(6) Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000.

(7) Goodwill of the entire firm be valued at ₹ 1,40,000 and A's share of the Goodwill be adjusted in the accounts of B and C who share the future profits equally. No Goodwill Account being raised.

(8) The capital of the firm is to be the same as before retirement. Individual capital be in their profit-sharing ratio.

(9) Amount due to A is to be settled on the following basis : 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash and Bank Account and Balance Sheet as on 1.4.2018 of M/s. B and C.

Solution

In the books of M/s A, B and C

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Machinery A/c	60,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	25,000	By Sundry Creditors A/c	20,000
To Provision for Bad Debts A/c	5,000	By Partners' Capital A/cs	10,000
(A : ₹ 2,857; B : ₹ 4,286; C : ₹ 2,857)			
	90,000		90,000

Cash and Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A Capital A/c	1,30,000
To Joint Life Policy A/c	80,000	By Balance c/d	2,40,000
To B Capital A/c	30,000		
To C Capital A/c	1,60,000		
	3,70,000		3,70,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c	2,857	4,286	2,857	By Balance b/d	2,00,000	3,00,000	2,00,000
To A Capital A/c (Goodwill)	—	10,000	30,000	By J.L.P. A/c	22,857	34,286	22,857
To Bank A/c (50% paid-off)	1,30,000	—	—	By B Capital A/c (Goodwill)	10,000	—	—
To A Loan A/c	1,30,000	—	—	By C Capital A/c (Goodwill)	30,000	—	—
To Balance c/d (required)	—	3,50,000	3,50,000	By Bank A/c (Bal. figure)	—	30,000	1,60,000
	2,62,857	3,64,286	3,82,857		2,62,857	3,64,286	3,82,857

Balance Sheet of M/s B and C as on 1st April, 2018

Liabilities		₹	Assets		₹
Partners' Capital A/cs :	₹		Land and Buildings		2,60,000
B	3,50,000		Machinery		2,40,000
C	3,50,000	7,00,000	Closing Stock		75,000
A's Loan Account		1,30,000	Sundry Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for Bad Debts	5,000	95,000
			Cash and Bank Balances		2,40,000
		9,10,000			9,10,000

Working Notes : Calculation of Share of Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (2 : 3 : 2)	40,000	60,000	40,000
Right of goodwill after retirement (1 : 1)	—	70,000	70,000
Gain (+) / Sacrifice (–)	(–) 40,000	(+) 10,000	(+) 30,000

In this case, Joint Life Policy will be treated as an asset. Any revaluation of Joint Life Policy will be done through Revaluation Account.

Case 3 : When there is Joint Life Policy in the Balance Sheet

Illustration 24

A, B & C were partners sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31.03.2018 was as follows:

Liabilities	₹	Assets		₹
Sundry Creditors	12,500	Cash at Bank		1,500
General Reserve	18,000	Sundry Debtors	15,000	
Capital A/cs :		Less: Provision for bad debts	1,500	13,500
(A — ₹ 40,000; B — ₹ 21,000; C — ₹ 20,000)	81,000	Stock		12,500
Joint Life Policy	8,000	Office Equipments		14,000
		Furniture		12,000
		Building		50,000
	1,11,500			1,11,500

B retired on 1.4.2018 subject to the following conditions :

(i) Office equipment revalued at ₹ 15,900.
(ii) Building revalued at ₹ 75,000. Furniture is to written-down by ₹ 2,000 and stock is reduced to ₹ 10,000.
(iii) Provision for bad debts is to be calculated @ 5% on debtors.
(iv) Goodwill of the firm is to be valued at ₹ 18,000. But no Goodwill Account is to be raised.
(v) Joint Life Policy is to be shown at surrendered value. The surrender value is ₹ 7,500.
(vi) Amount due to B is to be transferred to his Loan Account.
(vii) The new profit sharing ratio will be 2 : 1.

You are required to prepare : Revaluation Account, Partners' Capital Accounts and Balance Sheet immediately after B's retirement.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	2,500	By Office Equipments A/c	1,900
To Furniture A/c	2,000	By Buildings A/c	25,000
To Joint Life Policy A/c	500	By Provision for Bad Debts A/c	
To Partners' Capital A/c :	22,650	(₹ 1,500 — 5% of ₹ 15,000)	750
(A — ₹ 11,325; B — ₹ 7,550; C — ₹ 3,775)			
	27,650		27,650

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c (Note 1)	3,000	—	3,000	By Balance b/d	40,000	21,000	20,000
To B Loan A/c	—	40,550	—	By General Reserve A/c	9,000	6,000	3,000
To Balance c/d	57,325	—	23,775	By A Capital A/c (Note 1)	—	3,000	—
				By C Capital A/c (Note 1)	—	3,000	—
				By Revaluation A/c	11,325	7,550	3,775
	60,325	40,550	26,775		60,325	40,550	26,775

Balance Sheet (after B's retirement) as on 1st April, 2018

Liabilities		₹	Assets		₹
Sundry Creditors		12,500	Cash at Bank		1,500
Loan — B		40,550	Debtors	15,000	
Capital :	A	57,325	Less: Provision for bad debts	750	14,250
	C	23,775	Stock		10,000
Joint Life Policy		7,500	Office Equipments		15,900
			Furniture		10,000
			Buildings		75,000
		1,34,150			1,34,150

Working Notes : (1) Calculation of Share for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (3 : 2 : 1)	9,000	6,000	3,000
Right of goodwill after retirement (2 : 1)	12,000	—	6,000
Gain (+) / Sacrifice (–)	(+) 3,000	(–) 6,000	(+) 3,000

5. Adjustment in Regard to Share of Profits from the Date of the last Balance Sheet to the Date of Retirement

So far we have seen that a partner is retiring from the partnership either at the beginning or at the end of the accounting year. But in practical situation, a partner may retire during the course of an accounting year. In this case, the retiring partner is entitled to a share of profit of the current year up to the date of retirement, in addition to his share of goodwill, revaluation on profit and reserve. His share of interim profit is calculated on the basis of the provision in the partnership deed. If the partnership deed is silent, the amount of profit should be calculated in such a manner as must have been agreed by the partners. The interim profit can be calculated by adopting any of the following two methods.

Method 1 : Calculation of Interim Profit based on Past Profits

In this case the following steps are followed :

Step 1 : Calculate average profit based on the last few years' profit.

Step 2 : Calculate the profit of that particular period (from the beginning of the year to the date of retirement).

Step 3 : Calculate the share of profit of the retiring partner based on old profit-sharing ratio.

Step 4 : Pass necessary Journal Entries as follows :

Profit and Loss Suspense Account Dr.
To Retiring Partner's Capital Account [Retiring partner's share of profit]

OR

Continuing Partners' Capital Account Dr. [Old ratio]
To Retiring Partner's Capital Account

It should be noted that when actual Profit and Loss Account will be prepared at the end of the accounting period, the balance of this Profit and Loss Suspense Account will be transferred to Profit and Loss Appropriation Account. ***Alternatively***, the Continuing Partners' Capital Account is debited in the old ratio and Profit and Loss Suspense Account is credited. Till adjustment, Profit and Loss Suspense Account is shown in the interim Balance Sheet.

Illustration 25

A, B and C are partners sharing profits and losses in the ratio of 2 : 2 : 1. C retires on 31st March, 2018. The Balance Sheet of the firm on 31st December, 2017 stood as follows :

Liabilities	₹	Assets	₹
Capital A/cs :		Land and Buildings	1,00,000
A	60,000	Investments	12,500
B	60,000	Stock	25,000
C	40,000	Debtors	40,000
General Reserve	40,000	Cash at Bank	22,500
Creditors	10,000	Cash in Hand	10,000
	2,10,000		2,10,000

In order to arrive at the balance due to C, it was mutually agreed that :

(1) Land and buildings be valued at ₹ 1,20,000.
(2) Investment be valued at ₹ 10,000.
(3) Stock be taken at ₹ 30,000.
(4) Goodwill be valued at two year's purchase of the average profit of the past five years. Goodwill will not appear in the books of the reconstituted firm.
(5) C's share of profit up to the date of retirement be calculated on the basis of average profit of the preceding three years. The profits of the preceding five years were as under : 2013—₹ 20,000; 2014—₹ 23,500; 2015—₹ 30,000; 2016—₹ 27,500; and 2017—₹ 32,500.
(6) Amount payable to C to be transferred to his Loan Account carrying interest @ 15% p.a.

You are required to prepare : (i) Revaluation Account; (ii) Partners' Capital Accounts; and (iii) a Balance Sheet as at 31st March, 2018.

Solution

Dr. (i) Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Investment A/c	2,500	By Land and Building	20,000
To Partners' Capital A/cs :		By Stock	5,000
A	9,000		
B	9,000		
C	4,500		
	25,000		25,000

Dr. (ii) Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	26,700	26,700	—	By Balance b/d	60,000	60,000	40,000
To 15% C Loan A/c	—	—	64,680	By Goodwill A/c	21,360	21,360	10,680
To Balance c/d	79,660	79,660	—	By General Reserve A/c	16,000	16,000	8,000
				By Revaluation A/c	9,000	9,000	4,500
				By Profit & Loss Suspense A/c	—	—	1,500
	1,06,360	1,06,360	64,680		1,06,360	1,06,360	64,680

(iii) Balance Sheet of A and B as on 31st March, 2018

Liabilities	₹	Assets	₹
Capital A/cs :		Land and Buildings	1,20,000
A	79,660	Investment	10,000
B	79,660	Stock	30,000
15% C Loan	64,680	Debtors	40,000
Creditors	10,000	Cash at Bank	22,500
		Cash in Hand	10,000
		Profit & Loss Suspense A/c	1,500
	2,34,000		2,34,000

Working Notes :

(1) Calculation of Goodwill

(a) Average profit = (₹ 20,000 + 23,500 + 30,000 + 27,500 + 32,500) / 5 = ₹ 26,700.
(b) Goodwill = 2 year's purchase of average profit = 2 × ₹ 26,700 = ₹ 53,400.

(2) Calculation of C's Share of Profit

(a) Average profit (based on last three years) = (₹ 30,000 + 27,500 + 32,500) / 3 = ₹ 30,000.
(b) Profit for the month of January, February and March, 2018 = ₹ 30,000/12 × 3 = ₹ 7,500.
(c) C's share of profit = 1/5th of ₹ 7,500 = ₹ 1,500.

Illustration 26

A, B and C are equal partners. C retires on 31.3.2018. The Balance Sheet of the firm as on 31.12.2017 stood as follows:

Liabilities		₹	Assets		₹
Creditors		12,900	Cash in hand		1,000
Contingency Reserve		4,000	Cash at bank		4,000
Investment Fluctuation Fund		1,200	Debtors	10,000	
Partners' Capitals:	₹		Less: Provision for bad debts	800	9,200
A	30,000		Stock		10,000
B	20,000		Investments (cost)		5,000
C	20,000	70,000	Land and Buildings		40,000
			Goodwill		18,900
		88,100			88,100

In order to arrive at the balance due to C, it was mutually agreed that:

1. Land and Buildings be valued at ₹ 50,000;
2. Investment Fluctuation Fund be brought to ₹ 500;
3. Debtors are all good;
4. Stock be taken at ₹ 9,400;
5. Goodwill be valued at one year's purchase of the average profits of the past five years;
6. C's share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The profits for the preceding five years were as under:

2013—₹ 11,500; 2014—₹ 14,000; 2015—₹ 9,000; 2016—₹ 8,000; 2017—₹ 10,000.

Required: Journal entries, C's Capital Account and the revised Balance Sheet (show your workings).

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 March 31	Land and Buildings A/c	Dr.	10,000	
	Investment Fluctuation Fund A/c	Dr.	700	
	Provision for Bad Debts A/c	Dr.	800	
	To Revaluation A/c			11,500
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	600	
	To Stock A/c			600
	(Being the decrease in the value of stock)			
	Revaluation A/c	Dr.	10,900	
	To A Capital A/c			3,634
	To B Capital A/c			3,633
	To C Capital A/c			3,633
	(Being the profit on revaluation transferred to Partners' Capital Accounts)			
	A Capital A/c (Note 1)	Dr.	667	
	B Capital A/c	Dr.	667	
	To C Capital A/c			1,334
	(Being the required adjustment made for contingency reserve)			
	A Capital A/c	Dr.	2,800	
	B Capital A/c	Dr.	2,800	
	C Capital A/c	Dr.	2,800	
	To Goodwill A/c (Note 2)			8,400
	(Being the goodwill written-down to its agreed value)			
	A Capital A/c	Dr.	375	
	B Capital A/c	Dr.	375	
	To C Capital A/c (Note 3)			750
	(Being the required adjustment made for profit)			
	C Capital A/c	Dr.	22,917	
	To C Loan A/c			22,917
	(Being the balance of C's capital transferred to his Loan Account)			

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

Particulars	₹	Particulars	₹
To Goodwill A/c	2,800	By Balance b/d	20,000
To C Loan A/c	22,917	By Revaluation A/c	3,633

		By A Capital A/c – contingency reserve	667
		By B Capital A/c – contingency reserve	667
		By A Capital A/c – profit	375
		By B Capital A/c – profit	375
	25,717		25,717

Balance Sheet as on 31st March, 2018 (Revised)

Liabilities	₹	Assets	₹
Creditors	12,900	Cash in hand	1,000
Contingency Reserve	4,000	Cash at bank	4,000
Investment Fluctuation Fund	500	Debtors	10,000
C Loan Account	22,917	Stock	9,400
Partners' Capitals:		Investments	5,000
A ₹ (30,000 + 3,634 – 667 – 2,800 –375)	29,792	Land and Buildings	50,000
B ₹ (20,000 + 3,633 – 667 – 2,800 – 375)	19,791	Goodwill	10,500
	89,900		89,900

Working Notes : (1) Statement Showing the Required Adjustment for Contingency Reserve

Partners	A (₹)	B (₹)	C (₹)
Right of contingency reserve before retirement (1 : 1 : 1)	1,333	1,334	1,333
Right of contingency reserve after retirement (1 : 1)	2,000	—	2,000
Partners to be Debited (+) / Credited (–)	(+) 667	(–) 1,334	(+) 667

(2) Ascertainment of Goodwill

Total profit for the last 5 years — ₹ (11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.

Average profit — ₹ 52,500 / 5 = ₹ 10,500.

Goodwill is one year's purchase of average profits of the past five years, i.e., ₹ 10,500 × 1 = ₹ 10,500.

Therefore, reduction in the value of goodwill = ₹ 18,900 – ₹ 10,500 = ₹ 8,400.

(3) Ascertainment of C's Share of Profit from 1.1.2018 to 31.3.2018

Total profit for the last 3 years — ₹ (9,000 + 8,000 + 10,000) = ₹ 27,000.

Average profit — ₹ 27,000 / 3 = ₹ 9,000.

Average profit for the 3 months, i.e., (1.1.2018 to 31.3.2018) — ₹ 9,000 × 3/12 = ₹ 2,250.

Therefore, C's share of profit — ₹ 2,250 / 3 = ₹ 750.

Method 2 : Calculation of Interim Profit after Preparing Interim Final Accounts

In this case, an interim Final Account is prepared up to the date of retirement. The profit of this interim Final Account is transferred to Partners' Capital Accounts by passing the following entry :

Profit and Loss Appropriation Account	Dr.	[Total profit of the interim period]
To All Partners' Capital Account		[Old ratio]

Mode of Payment of Retiring Partners' Interest

The provision of the partnership deed is to be taken into consideration while deciding the mode of payment to retiring partner. If there is no partnership deed, the partners should decide it mutually. The amount payable to the retiring partner can be paid off in one of the following manner :

In One Lump Sum

When the amount payable to the retiring partner is small and there is enough cash in hand, the entire amount can be paid off in full just after retirement. The entry is :

Retiring Partner's Capital Account	Dr.	[Full amount]
To Cash/Bank Account		

In Instalments

When the amount payable to the retiring partner is substantial and enough cash/bank balance is not there, the amount is paid in instalments. The number of instalments, rate of interest, the time and amount of each instalment is decided by the partners mutually if there is no provision in the partnership deed in this respect.

Generally, the amount payable to the retiring partner is transferred to his Loan Account. The Loan Account is credited with the periodic interest and debited with the instalment paid.

The Journal Entries are :

(i) When amount due to retiring partner is transferred to his Loan Account

Retiring Partner's Capital Account Dr.
To Retiring Partner's Loan Account

(ii) For interest on the balance due

Interest Account Dr.
To Retiring Partner's Loan Account

(iii) For payment of instalment

Retiring Partner's Loan Account Dr.
To Bank/Cash Account

By Way of Annuity

The remaining partners may agree to settle the claim of the retiring partner by paying him a fixed annual amount called an annuity either for a certain number of years or for the whole life of the retiring partner. In this case, the total amount payable to the retiring partner is transferred to an Annuity Suspense Account, which must be credited with interest at a fixed rate per annum on the diminishing balance and debited with the amount of annuity paid.

In the event of death of the retiring partner before the amount is exhausted, the balance of the Annuity Suspense Account is transferred to remaining Partners' Capital Account in the profit-sharing ratio. When the credit balance of the Annuity Suspense Account is exhausted before the death of the retiring partner, subsequent instalment of annuity is charged to Profit and Loss Appropriation Account of the continuing partners.

Illustration 27

On 31st December, 2015 P retired from active partnership and his share of the following was ascertained on the date of retirement :

Goodwill ₹ 20,000; Interest on Capital ₹ 500; Salary ₹ 1,500; Drawings ₹ 20,000; Interest on Drawings ₹ 2,000; Share of Profit ₹ 25,000; Capital ₹ 75,000.

The amount due to P was to be kept with the firm as a loan bearing interest @ 10% p.a. was to be paid to P by annual instalments of ₹ 50,000 each, interest being calculated @ 10% p.a., on the unpaid balances. The first instalment was paid on 31st December, 2016. You are required to prepare P's Capital Account and also P's Loan Account until the payment of the whole amount due to him was made.

Solution

In the books of the Firm

Dr. P Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Drawings A/c	20,000	31.12.2015	By Balance b/d	75,000
	To Interest on Drawings A/c	2,000		By Goodwill A/c	20,000
	To P Loan A/c	1,00,000		By Interest on Capital A/c	500
				By Partners' Salary A/c	1,500
				By Profit and Loss A/c (Share of Profit)	25,000
		1,22,000			1,22,000

Dr. P Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Balance c/d	1,00,000	31.12.2015	By P Capital A/c	1,00,000
31.12.2016	To Bank A/c (₹ 50,000 + 10,000)	60,000	1.1.2016	By Balance b/d	1,00,000
	To Balance c/d	50,000	31.12.2016	By Interest A/c	10,000
		1,10,000			1,10,000
31.12.2017	To Bank A/c	55,000	1.1.2017	By Balance b/d	50,000
			31.12.2017	By Interest A/c	5,000
		55,000			55,000

Illustration 28

The Balance Sheet of M, N and O who are sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively was as follows on 30.6.2015 :

Liabilities		₹	Assets	₹
Bills payable		6,000	Cash in hand	150
Sundry creditors		12,900	Cash at bank	25,500
Capitals :	₹		Bills receivable	5,400
M	40,000		Book debts	17,800
N	25,000		Stock	22,300
O	20,000	85,000	Furniture	3,500
Profit and Loss A/c		4,500	Plant and Machinery	9,750
			Building	24,000
		1,08,400		1,08,400

M retires from business from 1st July, 2015. Assets were revalued as under :

Stock ₹ 20,000; Furniture ₹ 3,000; Plant and Machinery ₹ 9,000; Building ₹ 20,000; and ₹ 850 are to be provided for doubtful debts. The goodwill of the firm is agreed to be valued at ₹ 6,000. M is to be paid ₹ 11,050 in cash on retirement and balance in three equal yearly instalments with interest at 5% per annum.

Prepare Revaluation Account, M's Capital Account and M's Loan Account till it is finally closed.

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c	2,300	By Partners' Capital A/cs :	
To Furniture A/c	500	M	4,200
To Plant and Machinery A/c	750	N	2,800
To Building A/c	4,000	O	1,400
To Provision for Doubtful Debts A/c	850		
	8,400		8,400

M Capital Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Revaluation A/c	4,200	By Balance b/d	40,000
To Cash A/c	11,050	By Goodwill A/c (1/2 of ₹ 6,000)	3,000
To M Loan A/c	30,000	By Profit and Loss A/c	2,250
	45,250		45,250

M Loan Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2016	To Cash A/c (₹ 10,000 + 1,500)	11,500	1.7.2015	By M Capital A/c	30,000
	To Balance c/d	20,000	30.6.2016	By Interest A/c	1,500
		31,500			31,500
30.6.2017	To Cash A/c (₹ 10,000 + 1,000)	11,000	1.7.2016	By Balance b/d	20,000
	To Balance c/d	10,000	30.6.2017	By Interest A/c	1,000
		21,000			21,000
30.6.2018	To Cash A/c	10,500	1.7.2017	By Balance b/d	10,000
			30.6.2018	By Interest A/c	500
		10,500			10,500

Illustration 29

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 2. Their Balance Sheet as on 31st December, 2013 was as follows :

Liabilities	₹	Assets		₹
Capital A/cs :		Land and Buildings		1,20,000
A	87,800	Plant and Machinery		37,000
B	60,800	Stock		36,000
C	43,800	Debtors	25,000	
Creditors	41,400	Less: Provision for Bad Debts	500	24,500
		Cash at bank		15,800
		Cash in hand		500
	2,33,800			2,33,800

B retired on 1st January, 2014 and these adjustments were agreed upon before ascertaining the amount payable to B:

(1) Land and building to be appreciated by 15%.
(2) Provision for bad debts raised to 5% on debtors.
(3) A provision of ₹ 650 is to be made for outstanding expenses.
(4) Stock to be reduced to ₹ 32,000.
(5) Goodwill to be valued at ₹ 45,000 and B's share to be adjusted into the accounts of A and C who decided to continue the business sharing profits and losses in the ratio of 5 : 3.

Amount payable to B will be paid in four equal annual instalment plus interest @ 10% on balance due. First instalment was paid on 31st December, 2014.

You are required to show: (i) Revaluation Account; (ii) Partners' Capital Accounts just after retirement of B; and (iii) B's Loan Account till it is finally closed.

Solution **In the books of the Firm**

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

Particulars		₹	Particulars	₹
To Provision for Bad Debts A/c		750	By Land and Building A/c	18,000
To Outstanding Expenses A/c		650		
To Stock A/c		4,000		
To Partners' Capital A/cs :	A	5,600		
	B	4,200		
	C	2,800		
		18,000		18,000

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c (Note 1)	8,125	—	6,875	By Balance b/d	87,800	60,800	43,800
To B Loan A/c	—	80,000	—	By A Capital A/c	—	8,125	—
To Balance c/d	85,275	—	39,725	By C Capital A/c	—	6,875	—
				By Revaluation A/c	5,600	4,200	2,800
	93,400	80,000	46,600		93,400	80,000	46,600

Dr. **B Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bank A/c (₹ 20,000 + 8,000)	28,000	1.1.2014	By B Capital A/c	80,000
	To Balance c/d	60,000	31.12.2014	By Interest A/c	8,000
		88,000			88,000
31.12.2015	To Bank A/c (₹ 20,000 + 6,000)	26,000	1.1.2015	By Balance b/d	60,000
	To Balance c/d	40,000	31.12.2015	By Interest A/c	6,000
		66,000			66,000
31.12.2016	To Bank A/c (₹ 20,000 + 4,000)	24,000	1.1.2016	By Balance b/d	40,000
	To Balance c/d	20,000	31.12.2016	By Interest A/c	4,000
		44,000			44,000
31.12.2017	To Bank A/c	22,000	1.1.2017	By Balance b/d	20,000
			31.12.2017	By Interest A/c	2,000
		22,000			22,000

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (4 : 3 : 2)	20,000	15,000	10,000
Right of goodwill after retirement (5 : 3)	28,125	—	16,875
Gain (+) / Sacrifice (–)	(+) 8,125	(–) 15,000	(+) 6,875

Illustration 30

A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Following is their Balance Sheet as at 31st March 2018:

Liabilities	₹	Assets	₹
Capital — A	4,00,000	Plant and Machinery	4,00,000
Capital —B	3,00,000	Stock	2,00,000
Capital — C	2,00,000	Debtors	2,00,000
Creditors	1,00,000	Cash & Bank balances	2,00,000
	10,00,000		10,00,000

B retires from the business owing to illness from 1st April 2018. The following was agreed upon retirement of B:

(i) The goodwill of the firm has been valued at ₹ 3,00,000 but no Goodwill Account is to be raised in the books.
(ii) Plant and Machinery has been revalued at ₹ 6,00,000 and stock revalued at ₹ 1,80,000.
(iii) A sum of ₹ 30,000 out of debtors was agreed to be bad and was to be written-off.
(iv) A and C will continue to carry on the business and shall share profits and losses equally in future.
(v) Amount payable to B shall remain in the business as loan carrying interest at 18% p.a.

You are required: (a) To give Journal entries to give effect to the above, (b) To Prepare Revaluation Account, and (c) To prepare the opening Balance Sheet of A and C as at 1st April, 2018 : (i) When changes in assets and liabilities are to be brought into books. (ii) When changes in assets and liabilities are not to be brought into books.

Solution (Case i) **In the books of A, B and C**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 April 1	C Capital A/c	Dr.	1,00,000	
	To B Capital A/c			1,00,000
	(Being the adjustment for goodwill on B's retirement)			
	Plant & Machinery A/c	Dr.	2,00,000	
	To Revaluation A/c			2,00,000
	(Being the value of the plant increased to ₹ 6,00,000)			
	Revaluation A/c	Dr.	50,000	
	To Stock A/c			20,000
	To Sundry Debtors A/c			30,000
	(Being the value of stock and sundry debtors reduced to ₹ 1,80,000 and ₹ 1,70,000 respectively)			
	Revaluation A/c	Dr.	1,50,000	
	To A Capital A/c			75,000
	To B Capital A/c			50,000
	To C Capital A/c			25,000
	(Being the profit on revaluation on B's retirement shared by the partners in their profit sharing ratio, 3:2:1)			
	B Capital A/c	Dr.	4,50,000	
	To B Loan A/c			4,50,000
	(Being the balance of B's Capital Account transferred to B's Loan Account)			

Calculation of Share of Goodwill

Partners		A	B	C
Share of goodwill before retirement (old ratio)	(₹)	1,50,000	1,00,000	50,000
Share of goodwill after retirement (new ratio)	(₹)	1,50,000	—	1,50,000
Gain (+) / Sacrifice (–)	(₹)		(–) 1,00,000	(+) 1,00,000

Therefore, on account of goodwill, B sacrifices ₹ 1,00,000 and he gives the entire amount to C. The share of goodwill of A remains unaffected. Therefore, B is to get ₹ 1,00,000 from C.

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

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Stock A/c	20,000	2018 April 1	By Plant & Machinery A/c	2,00,000
	To Sundry Debtors A/c	30,000			
	To Partners' Capital A/cs (A — ₹ 75,000; B — ₹ 50,000; C — ₹ 25,000)	1,50,000			
		2,00,000			2,00,000

Balance Sheet of A and C as at 1st April, 2018

Liabilities	₹	Assets	₹
Capital — A	4,75,000	Plant and Machinery	6,00,000
Capital — C	1,25,000	Stock	1,80,000
Loan — B	4,50,000	Debtors	1,70,000
Creditors	1,00,000	Cash and Bank balances	2,00,000
	11,50,000		11,50,000

Solution (Case ii) **In the books of A, B and C**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 April 1	C Capital A/c	Dr.	1,00,000	
	To B Capital A/c			1,00,000
	(Being the adjustment for goodwill)			
	Plant and Machinery A/c	Dr.	2,00,000	
	To Memorandum Revaluation A/c			2,00,000
	(Being the value of plant and machinery increased to ₹ 6,00,000)			

Memorandum Revaluation A/c To Stock A/c To Sundry Debtors A/c (Being the value of stock and sundry debtors reduced to ₹ 1,80,000 and ₹ 1,70,000 respectively)	Dr.	50,000	 20,000 30,000
Memorandum Revaluation A/c To A Capital A/c To B Capital A/c To C Capital A/c (Being the profit on revaluation transferred to A, B & C Capital in the old ratio 3:2:1)	Dr.	1,50,000	 75,000 50,000 25,000
Memorandum Revaluation A/c To Plant and Machinery A/c (Being the value of plant and machinery reduced to ₹ 4,00,000)	Dr.	2,00,000	 2,00,000
Stock A/c Sundry Debtors A/c To Memorandum Revaluation A/c (Being the value of stock and sundry debtors increased to ₹ 2,00,000 each)	Dr. Dr.	20,000 30,000	 50,000
A Capital A/c C Capital A/c To Memorandum Revaluation A/c (Being the loss on revaluation written back in the new ratio)	Dr. Dr.	75,000 75,000	 1,50,000
B Capital A/c To B Loan A/c (Being the balance of B's Capital Account transferred to B's Loan Account)	Dr.	4,50,000	 4,50,000

Dr. Memorandum Revaluation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Stock	20,000	2018 April 1	By Plant & Machinery	2,00,000
	To Sundry Debtors	30,000			
	To Partners' Capital A/cs (A — ₹ 75,000; B — ₹ 50,000; C — ₹ 25,000)	1,50,000			
		2,00,000			2,00,000
	To Plant and Machinery	2,00,000		By Stock	20,000
				By Sundry Debtors	30,000
				By Partners' Capital (A — ₹ 75,000; C — ₹ 75,000)	1,50,000
		2,00,000			2,00,000

Balance Sheet of A and C as at 1st April, 2018

Liabilities	₹	Assets	₹
Capital — A	4,00,000	Plant and Machinery	4,00,000
Capital —C	50,000	Stock	2,00,000
Loan — B	4,50,000	Debtors	2,00,000
Creditors	1,00,000	Cash and Bank balances	2,00,000
	10,00,000		10,00,000

Illustration 31

The Balance Sheet of X, Y and Z who share profits in proportion to their capital, stood as follows on March 31, 2018 :

Liabilities	₹	Assets		₹
Capital Accounts :		Land and Buildings		25,000
X	20,000	Plant and Machinery		8,500
Y	15,000	Stock		8,000
Z	10,000	Debtors	5,000	
Creditors	6,900	Less: Provision	100	4,900
		Cash at Bank		5,500
	51,900			51,900

Y retired on the above date and the following was agreed upon :

(a) That stock to be depreciated by 6%.

(b) That the provision for doubtful be brought up to 5% on Debtors.

(c) That the land and buildings be appreciated by 20%.

(d) That a provision of ₹ 770 be made in respect of outstanding legal charges.

(e) That the goodwill of the entire firm be fixed at ₹ 10,800 and Y's share of it be adjusted into the accounts of X and Z who are going to share future profits in the ratio of 5 : 3.

(f) That the assets and liabilities (except Cash at Bank) were to appear in the Balance Sheet at their ***old figures***.
(g) That the entire capital of the firm as newly constituted be fixed at ₹ 28,000 between X and Z in the proportion of 5 : 3 (actual cash to be brought in or paid off, as the case may be).

Show the Balance Sheet after Y's retirement.

Solution **Balance Sheet of X and Z as at 31st March, 2018**

Liabilities	₹	Assets		₹
Partners' Capital A/cs :		Land and Building		25,000
X (Note 2)	17,500	Plant and Machinery		8,500
Z (Note 2)	10,500	Stock		8,000
Y Loan A/c (Note 2)	19,800	Debtors	5,000	
Creditors	6,900	Less: Provision for Doubtful Debts	100	4,900
		Cash at Bank (Note 4)		8,300
	54,700			54,700

Working Notes :

Dr. **(1) Memorandum Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Stock	480	By Land and Building	5,000
To Provision for Doubtful Debts	150		
To Provision for Legal charges	770		
To Partners' Capital A/cs :			
X (4/9)	1,600		
Y (3/9)	1,200		
Z (2/9)	800		
	5,000		5,000
To Land and Building	5,000	By Stock	480
		By Provision for Doubtful Debts	150
		By Provision for Legal Charges	770
		By Partners' Capital A/cs :	
		X (5/8)	2,250
		Y (3/8)	1,350
	5,000		5,000

Dr. **(2) Partners' Capital Accounts** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Memorandum Revaluation A/c	2,250	—	1,350	By Balance b/d	20,000	15,000	10,000
To Y Capital A/c (Note 3)	1,950	—	1,650	By Memorandum Revaluation A/c	1,600	1,200	800
To Y Loan A/c	—	19,800	—	By X Capital A/c (Note 3)	—	1,950	—
To Balance c/d*	17,500	—	10,500	By Z Capital A/c (Note 3)	—	1,650	—
				By Bank (Cash brought in)	100	—	2,700
	21,700	19,800	13,500		21,700	19,800	13,500

* Total Capital = ₹ 28,000. X's Capital = ₹ 28,000 / 8 × 5 = ₹ 17,500; Z's Capital = ₹ 28,000 / 8 × 3 = ₹ 10,500.

(3) Adjustment for Goodwill

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (4 : 3 : 2)	4,800	3,600	2,400
Right of goodwill after retirement (5 : 3)	6,750	—	4,050
Gain (+) / Sacrifice (–)	(+) 1,950	(–) 3,600	(+) 1,650

(4) Bank Balance after Retirement

	₹
Opening Balance	5,500
Add: Cash brought in by :	
X	100
Z	2,700
	8,300

Illustration 32

Prakash, Akash and Bikash were partners of a firm sharing profits or losses in the ratio of 4 : 3 : 3. Their Balance Sheet on 31st March, 2003 is as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			Land	2,80,000
Prakash	2,30,000		Building	1,00,000
Akash	1,20,000		Plant and Machinery	1,80,000
Bikash	1,50,000	5,00,000	Furniture	70,000
Reserve		2,05,000	Stock	40,000
Sundry Creditors		50,000	Debtors	30,000
			Advertisement	10,000
			Cash at bank	40,000
			Cash in hand	5,000
		7,55,000		7,55,000

On 31 December, 2003 Akash retired on the basis of following terms :

(i) The goodwill of the firm is to be valued at ₹ 1,25,000.

(ii) Land is to be appreciated by 20%.

(iii) Building, plant and machinery and furniture are to be depreciated by 10%.

(iv) Stock is to be revalued at ₹ 50,000.

(v) 5% provision for doubtful debts is to made on debtors.

(vi) Advertisement is to be written off fully.

(vii) The amount payable to Akash is to be paid in 5 equal instalments with interest at 10% p.a.; the first instalment is being payable on 31 December, 2003.

After Akash's retirement Prakash and Bikash will share profit or loss equally and also make their capital equal. The goodwill cannot be shown in books of accounts of the firm. It's average annual profit for the last five years was ₹ 1,50,000.

You are required to prepare — (a) Revaluation Account; (b) Partners' Capital Accounts; (c) Akash's Loan Account upto 31 December, 2007; and, (d) Balance Sheet of Prakash and Bikash immediately after Akash's retirement.

[C.U.B.Com. (Hons.) — 2004]

Solution

In the books of the Firm

Dr. (a) Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Building A/c	10,000	By Land A/c (appreciated)	56,000
To Plant and Machinery A/c	18,000	By Stock A/c (appreciated)	10,000
To Furniture A/c	7,000		
To Provision for Bad Debts A/c	1,500		
To Advertisement A/c (written off)	10,000		
To Partner's Capital A/cs :			
Prakash (4/10)	7,800		
Akash (3/10)	5,850		
Bikash (3/10)	5,850		
	66,000		66,000

Dr. (b) Partners' Capital Accounts Cr.

Particulars	Prakash (₹)	Akash (₹)	Bikash (₹)	Particulars	Prakash (₹)	Akash (₹)	Bikash (₹)
To Akash Capital A/c (goodwill)	12,500	—	25,000	By Balance b/d	2,30,000	1,20,000	1,50,000
To 10% Akash Loan A/c	—	2,58,600	—	By Reserve A/c	82,000	61,500	61,500
To Bank A/c (Note 3)	57,475	—	—	By Revaluation A/c	7,800	5,850	5,850
To Balance c/d	2,49,825	—	2,49,825	By Prakash Capital A/c (Note 1)	—	12,500	—
				By Bikash Capital A/c (Note 1)	—	25,000	—
				By Profit & Loss Suspense A/c	—	33,750	—
				By Bank A/c (Note 3)	—	—	57,475
	3,19,800	2,58,600	2,74,825		3,19,800	2,58,600	2,74,825

(d) Balance Sheet of Prakash and Bikash as at 31st December, 2003

Liabilities	₹	Assets	₹
Capital Accounts :		Land	3,36,000
Prakash	2,49,825	Building	90,000
Bikash	2,49,825	Plant and Machinery	1,62,000
Sundry Creditors	50,000	Furniture	63,000
10% Akash Loan	2,06,880	Stock	50,000

Bank Overdraft (Note 4)	11,720	Debtors	30,000	
		Less: Provision for Doubtful Debts	1,500	28,500
		Cash in hand		5,000
		Profit and Loss Suspense		33,750
	7,68,250			7,68,250

Working Notes : **(1) Adjustment for Goodwill**

Partners	Prakash (₹)	Akash (₹)	Bikash (₹)
Right of goodwill before retirement (4 : 3 : 3)	50,000	37,500	37,500
Right of goodwill after retirement (1 : 1)	62,500	—	62,500
Gain (+) / Sacrifice (–)	(+) 12,500	(–) 37,500	(+) 25,000‘

(2) Akash's Share of Current Year's Profit upto 31st December, 2003 :

Total profits for 9 months (1.4.2003 to 31.12.2003) = ₹ 1,50,000 / 12 × 9 = ₹ **1,12,500**.

Akash's Share = ₹ 1,12,500 / 10 × 3 = ₹ **33,750**.

Journal Entry :

Profit and Loss Suspense Account Dr. 33,750

To Akash Capital Account 33,750

(3) The adjusted capital accounts of Prakash and Bikash after Akash's retirement are :

Prakash : ₹ 2,30,000 + ₹ 82,000 + ₹ 7,800 – ₹ 12,500 = ₹ 3,07,300.

Bikash : ₹ 1,50,000 + ₹ 61,500 + ₹ 5,850 – ₹ 25,000 = ₹ 1,92,350.

Therefore, total capital of Prakash and Bikash = ₹ 3,07,300 + ₹ 1,92,350 = ₹ 4,99,650.

Prakash capital : 1/2 of ₹ 4,99,650 = ₹ 2,49,825

Bikash capital : 1/2 of ₹ 4,99,650 = ₹ 2,49,825

Cash to be withdrawn by Prakash = ₹ 3,07,300 – ₹ 2,49,825 = ₹ 57,475.

Cash to be brought in by Bikash = ₹ 2,49,825 – ₹ 1,92,350 = ₹ 57,475.

(5) Amount payable to Akash on 31.12.2003 = 1/5 of ₹ 2,58,600 = ₹ 51,720. At that time, the bank balance was ₹ 40,000 only. It is assumed that the payment was made by availing overdraft facility of the bank. Therefore, bank overdraft = ₹ 51,720 – ₹ 40,000 = ₹ 11,720.

Dr. **(c) 10% Akash Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2003	To Bank A/c (1st instalment paid)	51,720	31.12.2003	By Akash Capital A/c	2,58,600
31.12.2003	To Balance c/d	2,06,880			
		2,58,600			2,58,600
31.12.2004	To Bank A/c (₹ 51,720 + ₹ 20,688)	72,408	1.4.2004	By Balance b/d	2,06,880
31.12.2004	To Balance c/d	1,55,160	31.12.2004	By Interest @ 10%	20,688
		2,27,568			2,27,568
31.12.2005	To Bank A/c (₹ 51,720 + ₹ 15,516)	67,236	1.4.2005	By Balance b/d	1,55,160
31.12.2005	To Balance c/d	1,03,440	31.12.2005	By Interest @ 10%	15,516
		1,70,676			1,70,676
31.12.2006	To Bank A/c (₹ 51,720 + ₹ 10,344)	62,064	1.4.2006	By Balance b/d	1,03,440
31.12.2006	To Balance c/d	51,720	31.12.2006	By Interest @ 10%	10,344
		1,13,784			1,13,784
31.12.2007	To Bank A/c	56,892	1.4.2007	By Balance b/d	51,720
			31.12.2007	By Interest @ 10%	5,172
		56,892			56,892

Illustration 33

A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31.03.2018 stood as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	12,500	Cash at Bank		1,500
General Reserve	18,000	Sundry Debtors	15,000	
Capital A/cs :		Less: Provision for bad debts	1,500	13,500
(A — ₹ 40,000; B — ₹ 21,000; C — ₹ 20,000)	81,000	Stock		12,500
		Joint Life Policy		8,000
		Office Equipments		14,000
		Furniture		12,000
		Building		50,000
	1,11,500			1,11,500

B retired on 1.4.2018 subject to the following conditions :

(i) A typewriter purchased on 1.10.2017 for ₹ 2,000 debited to office expenses account is to be brought into account charging depreciation @ 10% p.a.

(ii) Building revalued at ₹ 75,000. Furniture is to written-down by ₹ 2,000 and stock is reduced to ₹ 10,000.

(iii) Provision for bad debts is to be calculated @ 5% on debtors.

(iv) Goodwill of the firm is to be valued at ₹ 18,000. But no Goodwill Account is to be raised.

(v) Joint Life Policy is to be shown at surrendered value. The surrender value is ₹ 7,500.

(vi) Amount due to B is to be transferred to his Loan Account.

(vii) A and C will share profits and losses in the ratio of 2 : 1 and their capitals are to be adjusted in the profit sharing ratio.

You are required to prepare : Revaluation Account, Partners' Capital Accounts and Balance Sheet immediately after B's retirement.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c	2,500	By Office Equipments A/c (Note 1)	1,900
To Furniture A/c	2,000	By Buildings A/c	25,000
To Joint Life Policy A/c	500	By Provision for Bad Debts A/c	
To Partners' Capital A/c :		(₹ 1,500 — 5% of ₹ 15,000)	750
(A — ₹ 11,325; B — ₹ 7,550; C — ₹ 3,775)	22,650		
	27,650		27,650

Partners' Capital Accounts

Dr. **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c (Note 3)	3,000	—	3,000	By Balance b/d	40,000	21,000	20,000
To B Loan A/c		40,550		By General Reserve A/c	9,000	6,000	3,000
To Bank A/c (Note 2)	3,258	—	—	By A Capital A/c (Note 3)	—	3,000	—
To Balance c/d (Note 2)	54,067	—	27,033	By C Capital A/c (Note 3)	—	3,000	—
				By Revaluation A/c	11,325	7,550	3,775
				By Bank A/c (Note 2)	—	—	3,258
	60,325	40,550	30,033		60,325	40,550	30,033

Balance Sheet (after B's retirement) as at 1st April, 2018

Liabilities		₹	Assets		₹
Sundry Creditors		12,500	Cash at Bank		1,500
Loan — B		40,550	Debtors	15,000	
Capital :	A	54,067	Less: Provision for bad debts	750	14,250
	C	27,033	Stock		10,000
			Joint Life Policy		7,500
			Office Equipments ₹ (14,000 + 1,900)		15,900
			Furniture		10,000
			Buildings		75,000
		1,34,150			1,34,150

Working Notes :

(1) The typewriter purchased was wrongly debited to office expenses account, but it should have been debited to office equipments account. In effect, depreciation for 6 months (from 1.10.2017 to 31.3.2018) has not been provided. Therefore, ₹ 2,000 – ₹ 100 (depreciation for 6 months) = ₹ 1,900 should be added to Office Equipments Account.

(2) Ascertainment of Required Closing Capital

The adjusted capital accounts of A and C after B's retirement are : A — ₹ (40,000 + 9,000 + 11,325 – 3,000) = ₹ 57,325; C — ₹ (20,000 + 3,000 + 3,775 – 3,000) = ₹ 23,775. Therefore, total capital of A and C is ₹ (57,325 + 23,775) = ₹ 81,100, which will be shared by A and C in the new profit-sharing ratio, i.e., 2 : 1. Therefore, capital of A will be ₹ 81,100 x 2/3 = ₹ 54,067; and, capital of C will be ₹ 81,000 x 1/3 = ₹ 27,033. In effect, A will take away ₹ 3,258 (₹ 57,325 – 54,067) and C will introduce additional capital of the same amount of ₹ 3,258 (₹ 27,033 – 23,775).

(3) Calculation of Share of Goodwill

Partners		A	B	C
Right of goodwill prior to retirement (3 : 2 : 1)	(₹)	9,000	6,000	3,000
Right of goodwill after retirement (2 : 1)	(₹)	12,000	—	6,000
Gain (+) / Sacrifice (–)	(₹)	(+) 3,000	(–) 6,000	(+) 3,000

Illustration 34

A, B and J are partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet as at 31.12.2017 is as follows :

Liabilities		₹	Assets		₹
Capitals :	A	65,600	Land and Building		72,000
	B	43,700	Machinery		35,500
	J	32,200	Furniture		10,400
Reserve		22,000	Motor Car		18,000
Creditors		18,000	Stock		19,800
			Debtors	23,700	
			Less: Provision for Doubtful Debts	1,500	22,200
			Bank		3,600
		1,81,500			1,81,500

B retires on 31.12.2017 but A and J continue in partnership sharing profits in the ratio of 3 : 2 respectively. The terms of retirement provide the following :

(a) Goodwill is to be valued at 2 years' purchase of the average annual profits of the last 3 years, but it should not be shown in the books. The profits of the last 3 years are :2014 — ₹ 12,100; 2015 — ₹ 8,480; 2016 — ₹ 10,920.

(b) The value of land and building is to be appreciated by 20%. Machinery is to valued at ₹ 32,000 and provision for doubtful debts to be maintained at ₹ 1,800.

(c) A furniture costing ₹ 3,000 purchased on 1.7.2016 but was debited to Purchases Account. This asset is to be taken into account charging depreciation @ 10% p.a. under Straight Line Method.

(d) Annual insurance premium of ₹ 2,400 paid on 1.4.2017 had been entirely charged to Profit and Loss Account.

(e) B will take over the motor car at ₹ 16,000 and a bank loan of ₹ 50,000 is to be arranged for the balance amount payable to him on his retirement.

(f) The capital of the new firm will be readjusted by bringing in or paying off cash so that the capital of A and J be in the new profit sharing ratio.

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

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of the Firm

Revaluation Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Machinery A/c	3,500	31.12.2017	By Land and Building A/c	14,400
	To Provision for Doubtful Debts A/c	300		By Furniture A/c (Note 1)	2,550
	To Motor Car A/c (₹ 18,000 – 16,000)	2,000		By Prepaid Insurance A/c (₹ 2,400 x 3/12)	600
	To Partners' Capital A/cs : (A —₹ 4,700; B — ₹ 4,700; C — ₹ 2,350)	11,750			
		17,550			17,550

Partners' Capital Accounts

Dr. **Cr.**

Date	Particulars	A	B	J	Date	Particulars	A	B	J
31.12.2017	To Motor Car A/c	—	16,000	—	31.12.2017	By Balance b/d	65,600	43,700	32,200
	To B Capital A/c (Goodwill)	4,580	—	4,580		By Reserve A/c	8,800	8,800	4,400
	To Bank A/c (Note 3)	9,186	50,360	—		By Revaluation A/c	4,700	4,700	2,350
	To Balance c/d	65,334	—	43,556		By A Capital A/c (Goodwill)	—	4,580	—
						By J Capital A/c (Goodwill)	—	4,580	—
						By Bank A/c (Note 3)	—	—	9,186
		79,100	66,360	48,136			79,100	66,360	48,136

Balance Sheet of the new firm as at 31st December, 2017

Liabilities		₹	Assets		₹
Capitals :	A	65,334	Land and Building		86,400
	J	43,556	Machinery		32,000
Bank Loan		50,000	Furniture (₹ 10,400 + 2,550)		12,950
Creditors		18,000	Stock		19,800
			Debtors	23,700	
			Less: Provision for Doubtful Debts	1,800	21,900
			Bank (₹ 3,600 + 50,000 – 50,360)		3,240
			Prepaid Insurance		600
		1,76,890			1,76,890

Working Notes :

(1) Furniture is to be recorded in the books at its written-down value, which is cost less depreciation for 1.5 years (1.7.2016 to 31.12.2017), where cost is ₹ 3,000, accumulated depreciation is @ 10% p.a. on ₹ 3,000 for 1.5 years is ₹ 450. Therefore, W.D.V. of furniture is ₹ 3000 – ₹ 450 = ₹ 2,550.

(2) Calculation of Goodwill

Correct profit for 2016 = Profit (as given) + Purchase of furniture, being treated as purchases – depreciation not charged thereon for 6 months = ₹ (10,920 + 3,000 – 150) = ₹ 13,770.

Average profit for 3 years = ₹ (12,100 + 8,480 + 13,770) / 3 = ₹ 11,450.

Goodwill is 2 years' purchase of average profits = ₹ 11,450 × 2 = ₹ **22,900**.

Calculation of Share of Goodwill

Partners		A	B	J
Right of goodwill prior to retirement (2 : 2 : 1)	(₹)	9,160	9,160	4,580
Right of goodwill after retirement (3 : 2)	(₹)	13,740	—	9,160
Gain (+) / Sacrifice (–)	(₹)	(+) 4,580	(–) 9,160	(+) 4,580

(3) Ascertainment of Required Closing Capital of A and J

The adjusted capital account balances of A and J after B's retirement are :

A — ₹ (65,600 + 8,800 + 4,700 – 4,580) = ₹ 74,520.

J — ₹ (32,200 + 4,400 + 2,350 – 4,580) = ₹ 34,370.

Total capital of A and J is ₹ (74,520 + 34,370) = ₹ 1,08,890, which will be shared in their new profit sharing ratio, i.e., 3 : 2.

Therefore, Capital of A will be = ₹ 1,08,890 × 3 / 5 = ₹ 65,334

Capital of J will be = ₹ 1,08,890 × 2 / 5 = ₹ 43,556

In effect, A will take away ₹ (74,520 – 65,334) = ₹ 9,186.

J will bring in ₹ (43,556 – 34,370) = ₹ 9,186.

Illustration 35

On 31st March, 2018, the Balance Sheet of M/s. A, B and C sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		1,00,000	Land and Buildings	2,00,000
Capital A/cs :			Machinery	3,00,000
A	2,00,000		Closing Stock	1,00,000
B	3,00,000		Sundry Debtors	1,00,000
C	2,00,000	7,00,000	Cash and Bank Balances	1,00,000
		8,00,000		8,00,000

On 31st March, 2018, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis :

(1) Land and Buildings be appreciated by 30%.
(2) Machinery is to be depreciated by 20%.
(3) Closing Stock is to be valued at ₹ 75,000.
(4) Provision for bad debts is to be made at 5%.
(5) Old credit balances of Sundry Creditors ₹ 20,000 is to be written-back.
(6) Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000.
(7) Goodwill of the entire firm be valued at ₹ 1,40,000 and A's share of the Goodwill be adjusted in the accounts of B and C who share the future profits equally. No Goodwill Account being raised.
(8) The capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.
(9) Amount due to A is to be settled on the following basis : 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash and Bank Account and Balance Sheet as on 1.4.2018 of M/s. B and C.

[C.A. (Foundation) — Adapted]

Solution

In the books of M/s. A, B and C

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Machinery A/c	60,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	25,000	By Sundry Creditors A/c	20,000
To Provision for Bad Debts A/c	5,000	By Partners' Capital A/cs	10,000
		(A : ₹ 2,857; B : ₹ 4,286; C : ₹ 2,857)	
	90,000		90,000

Dr. **Cash and Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A Capital A/c	1,30,000
To Joint Life Policy A/c	80,000	By Balance c/d	2,40,000
To B Capital A/c	30,000		
To C Capital A/c	1,60,000		
	3,70,000		3,70,000

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

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	2,857	4,286	2,857	By Balance b/d	2,00,000	3,00,000	2,00,000
To A Capital A/c (Goodwill)	—	10,000	30,000	By J.L.P. A/c	22,857	34,286	22,857
To Bank A/c (50% paid-off)	1,30,000	—		By B Capital A/c (Goodwill)	10,000	—	—
To A Loan A/c	1,30,000	—		By C Capital A/c (Goodwill)	30,000	—	—
To Balance c/d (required)	—	3,50,000	3,50,000	By Bank A/c (Bal. figure)	—	30,000	1,60,000
	2,62,857	3,64,286	3,82,857		2,62,857	3,64,286	3,82,857

Balance Sheet of M/s. B and C as on 1st April, 2018

Liabilities		₹	Assets		₹
Partners' Capital A/cs :	₹		Land and Buildings		2,60,000
B	3,50,000		Machinery		2,40,000
C	3,50,000	7,00,000	Closing Stock		75,000
A's Loan Account		1,30,000	Sundry Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for Bad Debts	5,000	95,000
			Cash and Bank Balances		2,40,000
		9,10,000			9,10,000

Working Note : **Calculation of Share of Goodwill**

Particulars	A (₹)	B (₹)	C (₹)
Right of Goodwill before retirement (2 : 3 : 2)	40,000	60,000	40,000
Right of Goodwill after retirement (1 : 1)	—	70,000	70,000
Sacrifice (–) / Gain (+)	(–) 40,000	(+) 10,000	(+) 30,000

Illustration 36

Gold, Silver and Diamond are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Gold retires on 1.4.2018 on which date the Balance Sheet of the firm stood as under :

Liabilities		₹	Assets	₹
Capital Accounts :			Goodwill	10,000
Gold	80,000		Furniture	30,000
Silver	50,000		Office Equipments	25,000
Diamond	40,000	1,70,000	Building	60,000
General Reserve		20,000	Stock	77,000
Sundry Creditors		90,000	Sundry Debtors	75,000
Bills Payable		15,000	Cash	18,000
		2,95,000		2,95,000

It is provided in the Deed of Partnership that in the event of death or retirement of a partner, goodwill is to be valued at 2 years' purchase of the average profits of the last 4 years. The profits for the last 4 years were : 2017-18 : ₹ 30,000; 2016-17 : ₹ 24,000; 2015-16 : ₹ 20,000; 2014-2015 : ₹ 18,000.

Furniture and Building are revalued at ₹ 25,000 and ₹ 75,000 respectively, stock is overvalued by 10%.

It was decided that Gold should be paid ₹ 50,000 immediately on retirement and the balance on his Capital Account is to be treated as a loan to the firm. Silver and Diamond contribute necessary sums in equal proportions for payments to Gold and to leave ₹ 20,000 cash as working capital. Assuming, that above mentioned arrangements are given effect to, you are required to show the Revaluation Account, Cash Account and the Capital Accounts of the partners. Also show the Balance Sheet of the firm after Gold's retirement.

Solution **In the books of the Firm**

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

Particulars	₹	Particulars	₹
To Furniture A/c	5,000	By Building A/c	15,000
To Stock A/c (Note 2)	7,000		
To Partners' Capital A/cs :	3,000		
Gold — ₹ 1,500; Silver — ₹ 900; Diamond — ₹ 600			
	15,000		15,000

Dr. Partners' Capital Accounts Cr.

Particulars	Gold	Silver	Diamond	Particulars	Gold	Silver	Diamond
To Bank A/c	50,000	—	—	By Balance b/d	80,000	50,000	40,000
To Gold Loan A/c	59,500	—	—	By General Reserve A/c	10,000	6,000	4,000
To Goodwill A/c	—	27,600	18,400	By Goodwill A/c (Note 1)	18,000	10,800	7,200
To Balance c/d	—	66,100	59,400	By Revaluation A/c	1,500	900	600
				By Cash A/c	—	26,000	26,000
	1,09,500	93,700	77,800		1,09,500	93,700	77,800

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By Gold Capital A/c	50,000
To Partners' Capital A/cs (Balancing figure) Silver — ₹ 26,000; Diamond — ₹ 26,000	52,000	By Balance c/d	20,000
	70,000		70,000

Balance Sheet (after Gold's retirement) as on 1st April, 2018

Liabilities		₹	Assets	₹
Capital A/cs :			Building	75,000
Silver	66,100		Office Equipments	25,000
Diamond	59,400	1,25,500	Furniture	25,000
Gold Loan A/c		59,500	Stock	70,000
Sundry Creditors		90,000	Sundry Debtors	75,000
Bills Payable		15,000	Cash	20,000
		2,90,000		2,90,000

Working Notes :

(1) Calculation of the Value of the Goodwill and its Treatment

Total profit for the last 4 years ₹ (30,000 + 24,000 + 20,000 + 18,000) = ₹ 92,000. Average profit (₹ 92,000 ÷ 4) = ₹ 23,000. Goodwill is 2 years' purchase of the average profits of the last 4 years, i.e., ₹ 23,000 x 2 = ₹ 46,000. Goodwill Account has already been raised at ₹ 10,000. Therefore, before Gold's retirement, Goodwill Account is to be raised further by ₹ 36,000, i.e., ₹ (46,000 – 10,000). Thereafter, goodwill is to be written off in the new profit-sharing ratio, i.e., 3 : 2.

(2) Actual Value of Stock = $\frac{77{,}000}{110} \times 100$ = ₹ 70,000. Therefore, it is overvalued by ₹ 77,000 – 70,000 = ₹ 7,000.

Illustration 37

A, B, C and D were partners in a firm sharing profits and losses in the ratio of 4 : 3 : 2 : 1. The Balance Sheet of the firm as on 31st December, 2017 is given below :

Liabilities	₹	Assets	₹
A's Capital	4,00,000	Land and Building	3,40,000
B's Capital	3,00,000	Plant and Machinery	4,50,000
C's Capital	2,00,000	Furniture and Fittings	1,20,000
D's Capital	1,00,000	Fixed Deposit with Bank	80,000
Reserves	50,000	Stock-in-trade	35,000
Bills Payable	12,000	Sundry Debtors	26,000
Sundry Creditors	8,000	Bills Receivable	10,000
Bank Overdraft	5,000	Cash in Hand	14,000
	10,75,000		10,75,000

On 30th September, 2018, D retired from the firm. The partnership deed of the firm had the following provisions regarding the procedure to be followed in the event of retirement of a partner :

(a) The retiring partner will be entitled to his share of profit in proportion to the number of months he served as a partner in the year of his retirement. The profit of the year immediately preceding the year of his retirement will be taken as the basis for calculating his share of profit.

(b) The retiring partner will be entitled to a share of goodwill on the basis of two years' purchase of the average profit of the three years preceding the year of his retirement. The profits of 2015, 2016 and 2017 were ₹ 66,000, ₹ 87,000 and ₹ 72,000 respectively.

(c) No Goodwill Account will be raised in the books, but the retiring partner's share of goodwill is to be adjusted through the Capital Accounts of the continuing partners.

(d) Reserve, undistributed profit or loss, if any, must be transferred to the Capital Accounts of the partners.

A, B and C decided to share the future profits and losses equally and to maintain a fixed capital of ₹ 2,00,000 each, making necessary addition or withdrawal of cash immediately without affecting the bank overdraft balance. The total amount due to D will remain in the business of the firm as loan, earning 10% interest per annum.

Show the Journal Entries and the Capital Accounts of the partners on the basis of the above mentioned conditions which were duly complied with.

Solution

In the books of the Firm

Journal Entry

Date	Particulars		Dr. ₹	Cr. ₹
2018	Reserves A/c	Dr.	50,000	
Sept. 30	To A Capital A/c			20,000
	To B Capital A/c			15,000
	To C Capital A/c			10,000
	To D Capital A/c			5,000
	(Being the reserves transferred to Partners' Capital Accounts before D's retirement)			
	Profit and Loss Suspense A/c (Note 1)	Dr.	5,400	
	To D Capital A/c			5,400
	(Being D's share of profit transferred to his Capital Account)			
	B Capital A/c (Note 2)	Dr.	5,000	
	C Capital A/c	Dr.	20,000	
	To A Capital A/c			10,000
	To D Capital A/c			15,000
	(Being the adjustment in regard to Goodwill made through the Partners' Capital Accounts)			
	D Capital A/c	Dr.	1,25,400	
	To 10% D Loan A/c			1,25,400
	(Being D's capital transferred to D's Loan Account)			
	Cash A/c	Dr.	10,000	
	To C Capital A/c			10,000
	(Being the amount of capital brought in by C to make his capital equal to ₹ 2,00,000)			
	A Capital A/c	Dr.	2,30,000	
	B Capital A/c	Dr.	1,10,000	
	To Cash A/c			3,40,000
	(Being excess money withdrawn by the partners to make their capitals equal to ₹ 2,00,000)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To A & D Capital A/c	—	5,000	20,000	—	By Balance b/d	4,00,000	3,00,000	2,00,000	1,00,000
To 10% D Loan A/c	—	—	—	1,25,400	By Reserves A/c	20,000	15,000	10,000	5,000
To Cash A/c (Note 3)	2,30,000	1,10,000	—	—	By P & L Suspense A/c	—	—	—	5,400
To Balance c/d	2,00,000	2,00,000	2,00,000	—	By B & C Capital A/c	10,000	—	—	15,000
					By Cash A/c	—	—	10,000	
	4,30,000	3,15,000	2,20,000	1,25,400		4,30,000	3,15,000	2,20,000	1,25,400

Working Notes :

(1) Profit for the year 2017 is ₹ 72,000. Profit for 9 months will be ₹ 72,000 ÷ 12 x 9 = ₹ 54,000. D will get 1/10 of ₹ 54,000, i.e., ₹ 5,400.

(2) Valuation of Goodwill

Average profit of last three years = $\frac{(66{,}000 + 87{,}000 + 72{,}000)}{3}$ = ₹ 75,000.

Goodwill = ₹ 75,000 x 2 = ₹ 1,50,000.

Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of Goodwill before D's retirement (4 : 3 : 2 : 1)	60,000	45,000	30,000	15,000
Right of Goodwill after D's retirement (1 : 1 : 1)	50,000	50,000	50,000	—
Sacrifice (–) / Gain (+)	(–) 10,000	(+) 5,000	(+) 20,000	(–) 15,000

(3) It is assumed that on the date of retirement, i.e., 30th September, 2018 the firm has sufficient cash balance to pay off the excess capital of A and B, though the last Balance Sheet as on 31st December, 2017 does not show sufficient cash.

Illustration 38

X and Y are partners sharing profits equally. It has been agreed that if a partner retires, the other partner, if he desires to carry on the business, shall pay to the retiring partner his share by four equal half yearly instalments, plus interest @ 5% p.a. with half-yearly rests. Goodwill is to be valued on the basis of five years capitalization of the average annual super profits of 3 preceding financial years, fixed assets being revalued for the purpose. The Balance Sheet of the firm as 31.12.2017 is as follows:

Liabilities	₹	Assets	₹
Creditors	9,160	Cash in hand	13,000
Capital — X	22,420	Book debts	10,200
Capital — Y	16,650	Closing stock	5,730
		Building	19,300
	48,230		48,230

Y retires on 1.1.2018 and X decides to carry on the business. The profits for the three years ended on 31.12.2018 were ₹ 13,500 ; ₹ 14,500; and ₹ 14,000.

For the purpose of dissolution, building has been revalued at ₹ 24,800. No interest on capital was charged and partners did not draw any salary.

Show the computation of goodwill; prepare Y's Loan Account. Assume that normal managerial remuneration is ₹ 6,000 p.a. and normal return on capital is 12%.

Solution

In the books of X

Dr. Y Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2017	To Bank A/c (₹ 6,507.50 + ₹ 650.75)	7,158.25	1.1.2017	By Y Capital A/c (See Note)	26,030.00
31.12.2017	To Bank A/c (₹ 6,507.50 + ₹ 488.06)	6,995.56	30.6.2017	By Interest A/c (For 6 months)	650.75
31.12.2017	To Balance c/d	13,015.00	31.12.2017	By Interest A/c (for 6 months on ₹ 19,522.50)	488.06
		27,168.81			27,168.81
30.6.2018	To Bank A/c (₹ 6,507.50 + ₹ 325.38)	6,832.88	1.1.2018	By Balance b/d	19,522.50
31.12.2018	To Bank A/c (₹ 6,507.50 + ₹ 162.69)	6,670.19	30.6.2018	By Interest A/c (for 6 months on ₹ 13,0775)	325.38
			31.12.2018	By Interest A/c (for 6 months on ₹ 6,507.50)	162.69
		13,503.07			13,503.07

Working Note :

Capital Employed		₹	Average Annual Super Profit	₹	Amount due to Y	₹
Assets :			**Average Profit :**		**Capital :**	16,650
Cash	13,000		(13,500 + 14,500 + 14,000)/3	14,000	Share of Revaluation profit	
Book Debt	10,200		Less: Managerial Remuneration	6,000	(1/2 of ₹ 5,500)	2,750
Closing Stock	5,730			8,000	Share of goodwill	
Building	24,800	53,730	Less: Normal rate of return @ 12%	5,348	(1/2 of ₹ 13,260)	6,630
Liabilities : Creditors		9,160	**Super profit**	2,652		26,030
		44,570	Value of goodwill ₹ 2,652 x 5 =	13,260		

Illustration 39

A, B and C are partners in a firm sharing profits and losses in the ratio of 5:3:2 respectively. The partnership deed provides that in the event of retirement of any of the partners, the total amount due to him would be settled by an annuity payable to him. On 31st March, 2013, B retires and the total amount payable on account of his share of goodwill, profits and interest was calculated as ₹ 7,000. On the date of retirement, the capital of A, B and C stood at ₹ 20,000; ₹ 13,000 and ₹ 10,000 respectively. As per deed, the amount was commuted into an annuity of ₹ 2,000, which was to be paid on 1st January each year. The 1st instalment was, however paid, on 1st April 2013. On 2nd January 2018 Mr B died. Prepare Annuity Suspense Account assuming that the unpaid portion thereof carried interest @ 10% p.a. (After B's retirement, A & C shared profit and losses in the ratio of 5:3.)

Solution

In the books of A&C

Dr. Annuity Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Bank A/c	2,000	1.4.2013	By Capital A/c (₹ 13,000 + ₹ 7,000)	20,000
31.12.2013	To Balance c/d	19,350	31.12.2013	By Interest A/c @ 10% on ₹ 18,000	1,350
		21,350			21,350
1.1.2014	To Bank A/c	2,000	1.1.2014	By Balance b/d	19,350
31.12.2014	To Balance c/d	19,085	31.12.2014	By Interest A/c @ 10% on ₹ 17,350	1,735
		21,085			21,085
1.1.2015	To Bank A/c	2,000	1.1.2015	By Balance b/d	19,085
31.12.2015	To Balance c/d	18,794	31.12.2015	By Interest A/c @ 10% on ₹ 17,085	1,709
		20,794			20,794

1.1.2016	To Bank A/c	2,000	1.1.2016	By Balance b/d	18,794
31.12.2016	To Balance c/d	18,473	31.12.2016	By Interest A/c @ 10% on ₹ 16,794	1,679
		20,473			20,473
1.1.2017	To Bank A/c	2,000	1.1.2017	By Balance b/d	18,473
31.12.2017	To Balance c/d	18,120	31.12.2017	By Interest A/c @ 10% on ₹ 16,473	1,647
		20,120			20,120
1.1.2018	To Bank A/c	2,000	1.1.2018	By Balance b/d	18,120
2.1.2018	To A Capital A/c (5/8)	10,075			
2.1.2018	To C Capital A/c (3/8)	6,045			
		18,120			18,120

Illustration 40

A, B and C are in partnership sharing profits and losses in the ratio of 3:2:1. The Balance Sheet as on 31.12.2017 is:

Liabilities	₹	Assets		₹
Capital — A	40,000	Machinery at cost	50,000	
Capital — B	60,000	Less: Provision for depreciation	8,000	42,000
Capital — C	20,000	Furniture		1,000
Reserve	30,000	Sundry Debtors	80,000	
Sundry Creditors	60,000	Less: Provision for bad debts	3,000	77,000
		Stock		50,000
		Bank		40,000
	2,10,000			2,10,000

On March 31, 2018, B retired and A and C continued in partnership sharing profits and losses in the ratio of 3:2. It was agreed that the following adjustments were to be made in the Balance Sheet as on March 31, 2018:

(a) The machinery was to be revalued at ₹ 45,000.
(b) The stock was to be reduced by 2%.
(c) The provision for doubtful debts would be ₹ 4,000.
(d) The furniture was to be reduced to ₹ 600.
(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 B's share of the same was to be adjusted into the accounts of A and C. The profits up to the date of retirement were estimated at ₹ 18,000. B was to be paid off in full. A and C were to bring such an amount in cash so as to make their capitals 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. Prepare necessary Journal entries to give effect to the above arrangements and prepare the Partners' Capital Accounts as on 31.3.2018. Also prepare the Balance Sheet as on that date.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 March 31	A Capital A/c (Note 1)	Dr.	2,400	
	C Capital A/c	Dr.	5,600	
	To B Capital A/c			8,000
	(Being the adjustment for goodwill made through the Capital Account of the partners)			
	Revaluation A/c	Dr.	2,700	
	To Stock A/c			1,000
	To Provision for Doubtful Debts A/c			1,000
	To Furniture A/c			400
	To Provision for Outstanding Expenses A/c			300
	(Being the decrease in assets and increase in liabilities transferred to Revaluation Account)			
	Provision for Depreciation on Machinery A/c	Dr.	3,000	
	To Revaluation A/c			3,000
	(Being the increase in the value of machinery transferred to Revaluation Account)			
	Revaluation A/c	Dr.	300	
	To A Capital A/c			150
	To B Capital A/c			100
	To C Capital A/c			50
	(Being the profit on revaluation transferred to Partners' Capital Accounts in the ratio of 3 : 2 : 1)			
	Reserve A/c	Dr.	30,000	
	To A Capital A/c			15,000
	To B Capital A/c			10,000
	To C Capital A/c			5,000
	(Being the reserve transferred to Partners' Capital Accounts in the ratio of 3 : 2 : 1)			

A Capital A/c	Dr.	1,800	
C Capital A/c	Dr.	4,200	
To B Capital A/c			6,000
(Being B's share of profit upto the date of retirement adjusted through the Capital Accounts of the partners)			
Bank A/c	Dr.	64,100	
To A Capital A/c			27,230
To C Capital A/c			36,870
(Being the required amount of cash brought in by A and C)			
B Capital A/c	Dr.	84,100	
To Bank A/c			84,100
(Being the amount of B paid up in full)			

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c —goodwill	2,400	—	5,600	By Balance b/d	40,000	60,000	20,000
To B Capital A/c — profit	1,800	—	4,200	By A Capital A/c — goodwill	—	2,400	—
To Bank A/c	—	84,100	—	By C Capital A/c — goodwill	—	5,600	—
To Balance c/d	78,180	—	52,120	By Revaluation A/c	150	100	50
				By Reserve A/c	15,000	10,000	5,000
				By A Capital A/c — profit	—	1,800	—
				By C Capital A/c — profit	—	4,200	—
				By Bank A/c	27,230	—	36,870
	82,380	84,100	61,920		82,380	84,100	61,920

Balance Sheet as on 31st March, 2018

Liabilities	₹	Assets		₹
Capital — A	78,180	Machinery at cost	50,000	
Capital — C	52,120	Less: Provision for depreciation	5,000	45,000
Sundry Creditors	60,000	Furniture		600
Outstanding expenses	300	Sundry Debtors	80,000	
		Less: Provision for bad debts	4,000	76,000
		Stock		49,000
		Bank		20,000
	1,90,600			1,90,600

Working Notes : **(1) Adjustment for Goodwill**

Partners		A	B	C
Right of goodwill prior to retirement	(₹)	12,000	8,000	4,000
Right of goodwill after retirement	(₹)	14,400	—	9,600
Gain (+) / Sacrifice (–)	(₹)	(+) 2,400	(–) 8,000	(+) 5,600
(2) Adjustment for Profit				
Right of profit prior to retirement	(₹)	9,000	6,000	3,000
Right of profit after retirement	(₹)	10,800	—	7,200
Gain (+) / Sacrifice (–)	(₹)	(+) 1,800	(–) 6,000	(+) 4,200

(3) Cash to be brought in by A and C	₹
Amount payable to B	84,100
Add: Required cash balance	20,000
	1,04,100
Less: Existing cash balance	40,000
Cash to be brought in by A and C	64,100
Adjusted capital of A ₹ (40,000 + 150 + 15,000 — 2,400 — 1,800)	50,950
Adjusted capital of C ₹ (20,000 + 50 + 5,000 — 5,600 — 4,200)	15,250
Cash to be brought in by A and C (as ascertained)	64,100
Total combined capital of A and C	1,30,300
The combined capital of A and C will be shared in the ratio 3 : 2; Therefore,	
Closing capital of A will be (3/5 of ₹ 1,30,300)	78,180
Closing capital of C will be (2/5 of ₹ 1,30,300)	52,120
Cash to be brought in by A ₹ (78,180 — 50,950)	27,230
Cash to be brought in by C ₹ (52,120 — 15,250)	36,870
Total cash to be brought in by A and C (checked)	64,100

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By B Capital A/c	84,100
To A Capital A/c	27,230	By Balance c/d	20,000
To C Capital A/c	36,870		
	1,04,100		1,04,100

Illustration 41

A, B and C are equal partners. C retires on 31.3.2018. The Balance Sheet of the firm as on 31.12.2017 stood as follows:

Liabilities		₹	Assets		₹
Creditors		12,900	Cash in hand		1,000
Contingency Reserve		4,000	Cash at bank		4,000
Investment Fluctuation Fund		1,200	Debtors	10,000	
Partners' Capitals:	₹		Less: Provision for bad debts	800	9,200
A	30,000		Stock		10,000
B	20,000		Investments (cost)		5,000
C	20,000	70,000	Land and Buildings		40,000
			Goodwill		18,900
		88,100			88,100

In order to arrive at the balance due to C, it was mutually agreed that:

1. Land and Buildings be valued at ₹ 50,000; 2. Investment Fluctuation Fund be brought to ₹ 500; 3. Debtors are all good; 4. Stock be taken at ₹ 9,400; 5. Goodwill be valued at one year's purchase of the average profits of the past five years; 6. C's share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The profits for the preceding five years were as under: 2013 ₹ 11,500; 2014 ₹ 14,000; 2015 ₹ 9,000; 2016 ₹ 8,000; 2017 ₹ 10,000.

Required: Journal entries, C's Capital Account and the revised Balance Sheet (show your workings).

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018	Land and Buildings A/c	Dr.	10,000	
March 31	Investment Fluctuation Fund A/c	Dr.	700	
	Provision for Bad Debts A/c	Dr.	800	
	To Revaluation A/c			11,500
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	600	
	To Stock A/c			600
	(Being the decrease in the value of stock)			
	Revaluation A/c	Dr.	10,900	
	To A Capital A/c			3,634
	To B Capital A/c			3,633
	To C Capital A/c			3,633
	(Being the profit on revaluation transferred to Partners' Capital Accounts)			
	A Capital A/c (Note 1)	Dr.	667	
	B Capital A/c	Dr.	667	
	To C Capital A/c			1,334
	(Being the required adjustment made for contingency reserve)			
	A Capital A/c	Dr.	2,800	
	B Capital A/c	Dr.	2,800	
	C Capital A/c	Dr.	2,800	
	To Goodwill A/c (Note 2)			8,400
	(Being the goodwill written-down to its agreed value)			
	A Capital A/c	Dr.	375	
	B Capital A/c	Dr.	375	
	To C Capital A/c (Note 3)			750
	(Being the required adjustment made for profit)			
	C Capital A/c	Dr.	22,917	
	To C Loan A/c			22,917
	(Being the balance of C's capital transferred to his Loan Account)			

Dr. C Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goodwill A/c	2,800		By Balance b/d	20,000
	To C Loan A/c	22,917		By Revaluation A/c	3,633
				By A Capital A/c – contingency reserve	667
				By B Capital A/c – contingency reserve	667
				By A Capital A/c – profit	375
				By B Capital A/c – profit	375
		25,717			25,717

Balance Sheet as on 31st March, 2018 (revised)

Liabilities	₹	Assets	₹
Creditors	12,900	Cash in hand	1,000
Contingency Reserve	4,000	Cash at bank	4,000
Investment Fluctuation Fund	500	Debtors	10,000
C Loan Account	22,917	Stock	9,400
Partners' Capitals:		Investments	5,000
A ₹ (30,000 + 3,634 – 667 – 2,800 – 375)	29,792	Land and Buildings	50,000
B ₹ (20,000 + 3,633 – 667 – 2,800 – 375)	19,791	Goodwill	10,500
	89,900		89,900

Working Notes: (1) Statement Showing the Required Adjustment for Contingency Reserve:

Partners		A	C	B
Right of contingency reserve prior to retirement (1 : 1 : 1)	(₹)	1,333	1,334	1,333
Right of contingency reserve after retirement (1 : 1)	(₹)	2,000	—	2,000
Partners to be debited (+) / credited (–)	(₹)	(+) 667	(–) 1,334	(+) 667

(2) Ascertainment of Goodwill

Total profit for the last 5 years — ₹ (11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.
Average profit — ₹ 52,500 / 5 = ₹ 10,500.
Goodwill is one years' purchase of average profits of the past five years, i.e., ₹ 10,500 x 1 = ₹ 10,500.
Therefore, reduction in the value of goodwill = ₹ 18,900 – ₹ 10,500 = ₹ 8,400.

(3) Ascertainment of C's Share of Profit from 1.1.2018 to 31.3.2018

Total profit for the last 3 years — ₹ (9,000 + 8,000 + 10,000) = ₹ 27,000.
Average profit — ₹ 27,000 / 3 = ₹ 9,000.
Average profit for the 3 months, i.e., (1.1.2018 to 31.3.2018) — ₹ 9,000 × 3/12 = ₹ 2,250.
Therefore, C's share of profit — ₹ 2,250 / 3 = ₹ 750.

Illustration 42

X, Y and Z were in partnership sharing profits and losses as one- half, one-fourth and one-fourth respectively. It was agreed that interest should be allowed @10% p.a. on Partners' Capital Accounts and charged @ 8% p.a. on their drawings.

No interest was to be allowed or charged on current accouts. The following are the particulars of their Capital Accounts, Current Accounts and drawings (as shown by the draft accounts):

		Capital Accounts balance on 1.1.2017	Current Account balance on 1.1.2017	Drawings for the year to 31.12.2017	Interest on Drawings
X	(₹)	1,50,000 (Cr.)	20,000 (Cr.)	30,000	2,000
Y	(₹)	80,000 (Cr.)	10,000 (Cr.)	20,000	760
Z	(₹)	60,000 (Cr.)	10,000 (Dr.)	20,000	1,400

The draft accounts for the year to 31st December 2017 showed a net profit of ₹ 1,20,000 before taking into account interest on Partners' Capital Accounts balances and drawings. The audit of the draft accounts revealed the following errors:

1. The rent of X's private house, amounting to ₹ 1,500 and paid on 31st December, 2017, had been included in rents charged in Profit and Loss Account.
2. Repairs amounting to ₹ 20,000 had been treated as additions to machinery, depreciation on which had been charged @ 20%.
3. The premium, amounting to ₹ 6,000, on Y's life insurance policy, and paid on 30th June, 2017 had been included on insurance charges in the Profit and Loss Account.

Z retired from the partnership on 31st December 2017, and agreed to leave the amount due to him from the firm as a loan repayable by agreed instalments. X and Y agreed to continue in partnership sharing profits and losses as two-third and one-third. In ascertaining the amount due to Z from the firm and for the purposes of the new partnership, it was agreed to make the following adjustments :

1. Goodwill to be valued at ₹ 1,44,000, but no account for goodwill to be raised in the books.
2. The value of freehold premises to be increased by ₹ 40,000.
3. The provision for bad debts to be increased by ₹ 12,000.

You are required to prepare:

(a) The Profit and Loss Appropriation Account for the year ended 31st December, 2017, making all the necessary adjustments for the errors revealed, and

(b) Partners' Capital and Current Accounts (in columnar form) for the year ended 31st December 2017, incorporating the adjustments on Z's retirement.

Solution

Working Notes :

(1) Ascertainment of Net Profit

Particulars	₹
Net profit as per Draft Accounts	1,20,000
Add: Rent of X wrongly charged to Profit & Loss A/c	1,500
Add: Depreciation wrongly debited in Profit & Loss A/c	4,000
Add: Premium on Y's Life insurance policy wrongly charged in Profit & Loss A/c	6,000
	1,31,500
Less: Repairs wrongly capitalised	20,000
Net profit	1,11,500

(2) Adjustment in Regard to Goodwill

Partners		X	Y	Z
Right of goodwill prior to Z's retirement (2 : 1 : 1)	(₹)	72,000	36,000	36,000
Right of goodwill after Z's retirement (2 : 1)	(₹)	96,000	48,000	—
Gain (+) / Sacrifice (–)	(₹)	(+) 24,000	(+) 12,000	(–) 36,000

Dr. **(3) Revaluation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Provision for Bad Debts A/c	12,000		By Freehold premises A/c	40,000
	To Partners' Capital A/cs: A — 14,000; B—7,000 ; C—7,000	28,000			
		40,000			40,000

(4) Adjustment for Y's Interest on Drawings

	₹
Interest on drawings (as given)	760
Add: Interest for life insurance premium paid by the firm (@ 8% on ₹ 6,000 for 6 months)	240
Y's interest on drawings	1,000

(5) Adjustment in Regard to Drawings

	X	Y
Drawings (as given)	30,000	20,000
Add: Rent of X's house paid by the firm	1,500	—
Add: Life insurance premium of Y paid by the firm	—	6,000
Drawings of X and Y	31,500	26,000

Dr. **Profit and Loss Appropriation Account for the year ended 31st December, 2017** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Interest on Capital A/c X — 15,000; Y — 8,000; Z — 6,000	29,000		By Net profit (Note 1)	1,11,500
	To Share of Profit A/c X — 43,450; Y — 21,725; Z — 21,725	86,900		By Interest on Drawings A/c X — 2,000; Y — 1,000; Z — 1,400	4,400
		1,15,900			1,15,900

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

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
31.12.2017	To Z Capital A/c —*	24,000	12,000	—	1.1.2017	By Balance b/d	1,50,000	80,000	60,000
"	To Z Current A/c —	—	—	3,675	31.12.2017	By X Capital A/c —*	—	—	24,000
"	To Z Loan A/c —	—	—	99,325	"	By Y Capital A/c —*	—	—	12,000
"	To Balance c/d	1,40,000	75,000		"	By Revaluation A/c (Note 3)	14,000	7,000	7,000
		1,64,000	87,000	1,03,000			1,64,000	87,000	1,03,000

* Goodwill

Dr. **Partners' Current Accounts** **Cr.**

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1.1.2017	To Balance b/d	—	—	10,000	1.1.2017	By Balance b/d	20,000	10,000	—
31.12.2017	To Drawings A/c (Note 5)	31,500	26,000	20,000	31.12.2017	By Interest on Capital A/c	15,000	8,000	6,000
"	To Int. on Drawings A/c	2,000	1,000	1,400	"	By Share of profit A/c	43,450	21,725	21,725
"	To Balance c/d	44,950	12,725	—	"	By Z Capital A/c —	—	—	3,675
		78,450	39,725	31,400			78,450	39,725	31,400

Unsettled Accounts of A Retiring Partner

As per the provision of Section 37 of the Indian Partnership Act —

"Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm."

Illustration 43

A, B and C were carrying on business in partnership sharing profit and losses equally. On June 30, 2018, C retired from the firm and A and B agreed to share profits and losses in the ratio of 3:2. C continued his association with the firm as an adviser. The parties agreed that from July 1, 2018:

1. C was to be credited with a retainership fee of ₹ 2,000 p.m. while he remained the adviser.
2. The partners decided to bring into the accounts of the firm the various assets which up to now were unrecorded. The various assets on June 30, 2018 were: goodwill ₹ 60,000; office equipment ₹ 18,000; library books ₹ 3,000.
3. The values of the office equipment and library books were to be retained in the books but goodwill was not to be recorded as a permanent asset.
4. C's Capital Account was to bear the whole cost of ₹ 10,000, a payment on March 30, 2018, for providing an annuity for a long-service employee who retired on that date.

The firm's profit for the year ended September 30, 2018, which is deemed to have accrued evenly, amounted to ₹ 90,000, after deduction of the cost of the pension but before adjusting for any of the events listed above. Other relevant figures are: Credit balances on Capital Accounts (1.10.2017) : A — ₹ 45,000; B — ₹ 35,000; and, C — ₹ 55,000

Drawings during the year ended 30.9.2018 : A — ₹ 7,000; B — ₹ 9,000; and, C — ₹ 6,000

All entries relevant to partners' entitlements are effected in their Capital Accounts. You are required to write up, in columnar from, the Capital Accounts of A, B and C for the year ended September 30, 2018, transferring the balance in C's Capital Account to C's Loan Account.

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To Goodwill A/c	36,000	24,000	—	By Balance b/d	45,000	35,000	55,000
To Profit & Loss A/c (annuity)	—	—	10,000	By Goodwill A/c	20,000	20,000	20,000
To Drawings A/c	7,000	9,000	6,000	By Revaluation A/c	7,000	7,000	7,000
To C Loan A/c	—	—	1,03,670	By Profit & Loss A/c (upto 30th June)	25,000	25,000	25,000
To Balance c/d	61,398	58,932	—	By Retainership Fees A/c	—	—	6,000
				By Profit & Loss A/c (Note 3) (after 30th June)	7,398	4,932	6,670
	1,04,398	91,932	1,19,670		1,04,398	91,932	1,19,670

Working Notes :

Dr. **(1) Profit and Loss Appropriation Account (upto 30th June, 2018)** **Cr.**

Particulars	₹	Particulars	₹
To Partners' Capital A/cs: (A — 25,000; B — 25,000; C — 25,000)	75,000	By Adjusted Net profit (₹ 90,000 + 10,000) x 9/12	75,000
	75,000		75,000

Dr. (2) Profit and Loss Appropriation Account (1st July to 30th September, 2018) Cr.

Particulars	₹	Particulars	₹
To Retainership fees A/c	6,000	By Adjusted Net profit	
To C share of Profit (as per Sec 37) (Note 3)	6,670	(₹ 90,000 + 10,000) x 3/12	25,000
To Partners' Capital A/cs:			
(A — ₹ 7,398; B — ₹ 4,932)	12,330		
	25,000		25,000

(3) Calculation of C's Share of Profit After Retirement

Partners	A	B	C
Opening capital (1.10.2017)	45,000	35,000	55,000
Add: Goodwill	20,000	20,000	20,000
Revaluation Profit (₹ 18,000 + 3,000)	7,000	7,000	7,000
	72,000	62,000	82,000
Less: Proportionate drawing (except C)	5,250	6,750	6,000
	66,750	55,250	76,000
Less: Annuity	—	—	10,000
Capital as on 30.6.2018	66,750	55,250	66,000

C share of profit = 19,000 x (66,000/1,88,000) = ₹ 6,670. Interest @ 6% p.a. = ₹ 990.
C will get higher of the two, i.e., ₹ 6,670

Admission cum Retirement

Illustration 44

A, B and C were partners, sharing profits in the ratio of 3 : 2 : 1. On 1.1.2018, B retired and D is admitted to the partnership, bringing in an amount of capital equal to a third of the new partnership's net assets.

The Balance Sheet of A, B and C as on 1.1.2018 was as under :

Liabilities		₹	Assets		₹
Capitals :	A	11,25,000	*Fixed Assets* :		
	B	7,50,000	Building		8,40,000
	C	3,75,000	*Current Assets* :		
			Stock		15,00,000
Current Liabilities :			Debtors	6,00,000	
Creditors		10,50,000	Less: Provision for Doubtful Debts	60,000	5,40,000
			Bank		4,20,000
		33,00,000			33,00,000

The terms of the changes to the partnership were as follows :

1. Goodwill was valued at ₹ 3,00,000.
2. Stock was written-down by ₹ 60,000.
3. Provision for doubtful debts was to be reduced to 5%.
4. D brought in equipments worth ₹ 3,45,000 and the balance by cheque.
5. The amount due to B was paid by cheque.
6. The new profit sharing ratio was to be equal.

Prepare necessary Ledger Accounts and the Balance Sheet of the new firm.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	60,000	By Provision for Doubtful Debts A/c	30,000
		By Partners' Capital A/cs :	
		(A ₹ : 15,000; B : ₹ 10,000; C : ₹ 5,000)	30,000
	60,000		60,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	15,000	10,000	5,000	—	By Balance b/d	11,25,000	7,50,000	3,75,000	—
To Goodwill A/c	1,00,000	—	1,00,000	1,00,000	By Goodwill A/c	1,50,000	1,00,000	50,000	—

To Bank A/c	—	8,40,000	—	—	By Equipment A/c	—	—	—	3,45,000
To Balance c/d (Note 1)	11,60,000	—	3,20,000	7,40,000	By Bank A/c (Balancing figure)	—	—	—	4,95,000
	12,75,000	8,50,000	4,25,000	8,40,000		12,75,000	8,50,000	4,25,000	8,40,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,20,000		By B Capital A/c	8,40,000
	To D Capital A/c	4,95,000		By Balance c/d	75,000
		9,15,000			9,15,000

Balance Sheet of the New Firm

Liabilities		₹	Assets		₹
Capitals :	A	11,60,000	**Fixed Assets** :		
	C	3,20,000	Building		8,40,000
	D	7,40,000	Equipments		3,45,000
Current Liabilities :			**Current Assets** :		
Creditors		10,50,000	Stock		14,40,000
			Debtors	6,00,000	
			Less: Provision for Doubtful Debts	30,000	5,70,000
			Bank		75,000
		32,70,000			32,70,000

Working Note :

(1) D is to bring in an amount of capital equal to a third of the new partnership's net assets. This means his capital balance is to be 1/2 of the combined adjusted capital of A and C, i.e., 1/2 of ₹ (11,60,000 + 3,20,000) = ₹ 7,40,000.

Illustration 45

Dowell & Co. is a partnership firm with partners A, B and C, sharing profits and losses in the ratio of 10 : 6 : 4. The Balance Sheet of the firm as on 31st March, 2018 is as under :

Liabilities			₹	Assets	₹
Capitals :	A	80,000		Land	10,000
	B	20,000		Buildings	2,00,000
	C	30,000	1,30,000	Plant and Machinery	1,30,000
Reserves (Unappropriated profit)			20,000	Furniture	43,000
Long-term Debt			3,00,000	Investments	12,000
Bank overdraft			44,000	Stock	1,30,000
Trade creditors			1,70,000	Debtors	1,39,000
			6,64,000		6,64,000

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st April, 2018. For this purpose, the following adjustments are to be made :

(i) Goodwill is to be valued at ₹ 1,00,000 but the same will not appear as an asset in the books of the reconstituted firm.

(ii) Buildings, Plant and Machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at ₹ 15,000. Provision of 20% is to be made on debtors to cover doubtful debts.

(iii) In the reconstituted firm, the total capital will be ₹ 2,00,000 which will be contributed by A, C and D in their new profit-sharing ratio, which is 2 : 2 : 1.

(iv) The surplus funds, if any, will be used for repaying the bank overdraft.

(v) The amount due to the retiring partner shall be transferred to his Loan Account.

You are to prepare : (a) Revaluation Account; (b) Partners' Capital Accounts; (c) Bank Account; and, (d) Balance Sheet of the reconstituted firm as on 1st April, 2018. ***[C.A. (Foundation) —Adapted]***

Solution **In the books of Dowell & Co.**

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

Particulars	₹	Particulars	₹
To Buildings A/c	10,000	By Investments A/c	3,000
To Plant and Machinery A/c	26,000	By Partners' Capital A/cs :	
To Provision for Bad Debts A/c	27,800	A — ₹ 30,400; B — ₹ 18,240; C — ₹ 12,160	60,800
	63,800		63,800

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Goodwill A/c	40,000	—	40,000	20,000	By Balance b/d	80,000	20,000	30,000	—
To Revaluation A/c	30,400	18,240	12,160	—	By Goodwill A/c	50,000	30,000	20,000	—
To Investments A/c	—	15,000	—	—	By Reserves A/c	10,000	6,000	4,000	—
To B Loan A/c	—	22,760	—	—	By Bank A/c	10,400	—	78,160	60,000
To Balance c/d	80,000	—	80,000	40,000					
	1,50,400	56,000	1,32,160	60,000		1,50,400	56,000	1,32,160	60,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To A Capital A/c	10,400		By Balance b/d	44,000
	To C Capital A/c	78,160		By Balance c/d	1,04,560
	To D Capital A/c	60,000			
		1,48,560			1,48,560

Balance Sheet (of the reconstituted firm) as at 1st April, 2018

Liabilities			₹	Assets		₹
Capitals :	A	80,000		Land		10,000
	C	80,000		Building		1,90,000
	D	40,000	2,00,000	Plant and Machinery		1,04,000
Loan — B			22,760	Furniture		43,000
Long-term Debt			3,00,000	Stock		1,30,000
Trade Creditors			1,70,000	Debtors	1,39,000	
				Less : Provision for bad debts	27,800	1,11,200
				Bank		1,04,560
			6,92,760			6,92,760

Illustration 46

A, B and C are in partnership sharing profits and losses equally. On 31.12.2017, the firm's Balance Sheet was as follows:

Liabilities			₹	Assets	₹
Capital :	A	40,000		Sundry Assets	88,000
	B	30,000		Cash	10,000
	C	20,000	90,000		
Sundry Creditors			8,000		
			98,000		98,000

On that date C decided to retire. The value of goodwill (which does not appear in the above Balance Sheet) was agreed to be ₹ 12,000. Sundry assets were taken to have increased in value by ₹ 24,000 on revaluation.

Draw up the re-adjusted Balance Sheet showing the amount due to C.

On C's retirement, D comes in as a partner. He pays no premium but brings ₹ 18,000 in cash as capital. Profits and Losses are now to be shared by A, B and D in the ratio of 3 : 3 : 2.

Draw up the Balance Sheet on D's admission after restoring the sundry assets to their original value and wiping out goodwill.

[C.U.B.Com. (Hons.) — Adapted]

Solution **Balance Sheet after C's Retirement**

Liabilities			₹	Assets	₹
Capital : (Note 1)	A	46,000		Sundry Assets ₹ (88,000 + 24,000)	1,12,000
	B	36,000	82,000	Cash	10,000
Loan — C			32,000		
Sundry Creditors			8,000		
			1,22,000		1,22,000

Balance Sheet after D's Admission

Liabilities			₹	Assets	₹
Capital : (Note 2)	A	38,500		Sundry Assets	88,000
	B	28,500		Cash (₹ 10,000 + ₹ 18,000)	28,000
	D	9,000	76,000		
Loan — C			32,000		
Sundry Creditors			8,000		
			1,16,000		1,16,000

Working Notes :

Dr. (1) Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To C Loan A/c	—	—	32,000	By Balance b/d	40,000	30,000	20,000
To Goodwill A/c	6,000	6,000	—	By Goodwill A/c (old ratio)	4,000	4,000	4,000
To Balance c/d	46,000	36,000	—	By Sundry Assets A/c (old ratio)	8,000	8,000	8,000
	52,000	42,000	32,000		52,000	42,000	32,000

Dr. (2) Partners' Capital Accounts Cr.

Particulars	A	B	D	Particulars	A	B	D
To Sundry Assets A/c (new ratio)	9,000	9,000	6,000	By Balance b/d (as above)	46,000	36,000	—
To Goodwill A/c (new ratio)	4,500	4,500	3,000	By Cash A/c	—	—	18,000
To Balance c/d	38,500	28,500	9,000	By Goodwill A/c	6,000	6,000	—
	52,000	42,000	18,000		52,000	42,000	18,000

Illustration 47

A, B and C are in partnership, sharing profits in the ratio of 3 : 2 : 1 and preparing their accounts to 30th June each year. At 1.7.2017, their capital accounts showed the following balances :

A — ₹ 3,35,000; B — ₹ 2,80,000; C — ₹ 3,10,000.

On 31.12.2017, A retired and D is admitted into the partnership. He introduced ₹ 2,00,000 as capital and also paid ₹ 1,50,000 as premium for goodwill. The new profit sharing ratio among B, C and D became 2 : 1 : 1 respectively.

The following adjustments are required to arrive at the amount due to A :

(1) The value of goodwill was agreed to be worth ₹ 6,00,000.

(2) Fixed assets are to be revalued upwards by ₹ 3,00,000.

(3) The net profit for the year ended 30.6.2018 was ₹ 4,00,000 (agreed to accrue evenly) before allowing for the following —

(a) Bad debts of ₹ 50,000 relating to the first half to be written-off;

(b) A left the amount due to him as a loan and received interest @ 10% p.a. for the half year ended 30.6.2018. The interest was paid to him on 30.6.2018.

Partners' drawings during the year were :

A ₹ 60,000 (all before 31st December); B ₹ 60,000 (₹ 30,000 in each half year)

C ₹ 40,000 (₹ 20,000 in each half year); D ₹ 25,000 (all after 31st December).

Prepare Profit and Loss Appropriation Account for the year ended 30.6.2018 and the Partners' Capital Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 30th June, 2018 Cr.

Particulars	1.7.2017 to 31.12.2017	1.1.2018 to 30.6.2018	Particulars	1.7.2017 to 31.12.2017	1.1.2018 to 30.6.2018
To Share of Profit A/c : A	75,000	—	By Net Profit b/d (Note 2)	1,50,000	1,60,000
B	50,000	80,000			
C	25,000	40,000			
D	—	40,000			
	1,50,000	1,60,000		1,50,000	1,60,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2017						2017					
Dec. 31	To A Capital A/c	—	1,00,000	50,000	—	Jul 1	By Balance c/d	3,35,000	2,80,000	3,10,000	—
"	To Drawings A/c	60,000	30,000	20,000	—	Dec. 31	By Fixed Assets A/c	1,50,000	1,00,000	50,000	—
"	To A's Loan A/c	8,00,000	—	—	—	"	By Premium for Goodwill A/c (Note 1)	1,50,000	—	—	—
"	To Balance c/d	—	3,00,000	3,15,000	2,00,000	"	By B Capital A/c (Note 1)	1,00,000	—	—	—
						"	By C Capital A/c (Note 1)	50,000	—	—	—
						"	By Bank A/c	—	—	—	2,00,000
						"	By Share of Profit A/c	75,000	50,000	25,000	—
		8,60,000	4,30,000	3,85,000	2,00,000			8,60,000	4,30,000	3,85,000	2,00,000

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2018						2018					
Jun 30	To Drawings A/c	—	30,000	20,000	25,000	Jan. 1	By Balance b/d	—	3,00,000	3,15,000	2,00,000
"	To Balance c/d	—	3,50,000	3,35,000	2,15,000	Jun 30	By Share of Profit A/c	—	80,000	40,000	40,000
		—	3,80,000	3,55,000	2,40,000			—	3,80,000	3,55,000	2,40,000

Working Notes :

(1) Statement Showing the Required Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before retirement (3 : 2 : 1)	3,00,000	2,00,000	1,00,000	—
Right of goodwill after admission (2 : 1 : 1)	—	3,00,000	1,50,000	1,50,000
Sacrifice (–) / Gain (+)	(–) 3,00,000	(+) 1,00,000	(+) 50,000	(+) 1,50,000

Therefore, entire premium for goodwill will go in favour of A. Also, B and C are to pay A ₹ 1,00,000 and ₹ 50,000 respectively.

(2) Adjusted Profit for Distribution

Particulars			1.7.2017 to 31.12.2017 ₹	1.1.2018 to 30.6.2018 ₹
Profit divided equally			2,00,000	2,00,000
	Less:	Bad Debts	50,000	—
		Interest on Loan of A @ 10% p.a. on ₹ 8,00,000 for 6 months (See Partners' Capital A/cs)	—	40,000
Adjusted Profit for Distribution			1,50,000	1,60,000

Illustration 48

A, B and C are in partnership, compiling their accounts to 30th September each year and sharing profits in the ratio of 3 : 2 : 1. The summarised partnership Balance Sheet at 30th September, 2017 is shown below :

Liabilities		₹	Assets	₹
Capitals :	A	6,00,000	Sundry Net Assets	16,00,000
	B	6,00,000		
	C	4,00,000		
		16,00,000		16,00,000

In the year ended 30th September 2018, the following events took place :

(1) On 31.3.2018, A retired. In settling the amount due to him, goodwill was valued at ₹ 6,00,000, and a plot of land owned by the partnership was revalued upwards by ₹ 1,20,000. The balance due to A remained in the partnership as a loan, carrying no interest.
B and C continued the partnership business from 1.4.2018, sharing profits in the ratio of 2 : 1.

(2) On 1.7.2018, D joined the partnership and from this date the profit sharing ratio became 2 : 1 : 1.
D brought in ₹ 3,00,000 as capital, plus a further ₹ 1,50,000 for a one quarter share of the goodwill valued at this date at ₹ 6,00,000.

The total profit for the year ended 30.9.2018 was ₹ 6,00,000. The following basis of allocating the profit was agreed:

(a) A bad debt of ₹ 30,000 charged in arriving at the profit of ₹ 6,00,000 should be related to the six months ended 31.3.2018.

(b) Apart from the above adjustment, the profit should be divided —
6 months ended 31.3.2018 — 60%,
3 months ended 30.6.2018 — 20%,
3 months ended 30.9.2018 — 20%.

The partners' drawings for the year were (all figures in ₹) :

Partners	A	B	C	D
6 months ended 31.3.2018	50,000	40,000	30,000	—
3 months ended 30.6.2018	—	30,000	30,000	—
3 months ended 30.9.2018	—	40,000	30,000	25,000

You are required to prepare a Profit and Loss Appropriation Account for the year ended 30.9.2018. Also prepare the Partners' Capital Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 30th September, 2018 Cr.

Particulars		1.10.2017 to 31.3.2018	1.4.2018 to 30.6.2018	1.7.2018 to 30.9.2018	Particulars	1.10.2017 to 31.3.2018	1.4.2018 to 30.6.2018	1.7.2018 to 30.9.2018
To Share of Profit A/c :	A	1,74,000	—	—	By Net Profit b/d (Note 1)	3,48,000	1,26,000	1,26,000
	B	1,16,000	84,000	63,000				
	C	58,000	42,000	31,500				
	D	—	—	31,500				
		3,48,000	1,26,000	1,26,000		3,48,000	1,26,000	1,26,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2018						2017					
Mar. 31	To Goodwill A/c	—	4,00,000	2,00,000	—	Oct 1	By Balance b/d	6,00,000	6,00,000	4,00,000	—
"	To Drawings A/c	50,000	40,000	30,000	—	2018					
"	To A's Loan A/c	10,84,000	—	—	—	Mar 31	By Land A/c	60,000	40,000	20,000	—
"	To Balance c/d	—	5,16,000	3,48,000	—	"	By Goodwill A/c	3,00,000	2,00,000	1,00,000	—
						"	By Share of Profit A/c	1,74,000	1,16,000	58,000	—
		11,34,000	9,56,000	5,78,000	—			11,34,000	9,56,000	5,78,000	—
Jun 30	To Drawings A/c	—	30,000	30,000	—	April 1	By Balance b/d	—	5,16,000	3,48,000	—
"	To Balance c/d	—	5,70,000	3,60,000	—	Jun 30	By Share of Profit A/c	—	84,000	42,000	—
		—	6,00,000	3,90,000	—			—	6,00,000	3,90,000	—
Sept 30	To Drawings A/c	—	40,000	30,000	25,000	July 1	By Balance b/d	—	5,70,000	3,60,000	—
"	To Balance c/d	—	6,93,000	4,11,500	3,06,500	"	By Bank A/c	—	—	—	3,00,000
						"	By Premium for Goodwill A/c	—	1,00,000	50,000	—
						Sept 30	By Share of Profit A/c	—	63,000	31,500	31,500
		—	7,33,000	4,41,500	3,31,500			—	7,33,000	4,41,500	3,31,500

Working Note :

(1) Profit before charging bad debts = ₹ (6,00,000 + 30,000) = ₹ 6,30,000. This profit is to be allocated in different periods in the given ratio and, thereafter, bad debt is to be deducted as under (all figures in rupees) :

Particulars	1.10.2017 to 31.3.2018	1.4.2018 to 30.6.2018	1.7.2018 to 30.9.2018
Profit of ₹ 6,30,000 shared in the ratio — 6 : 2 : 2	3,78,000	1,26,000	1,26,000
Less : Bad Debts	30,000	—	—
Adjusted Profit for Distribution	3,48,000	1,26,000	1,26,000

Illustration 49

Ram, Rahim and Robert are partners, sharing profits and losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2018 and in his place Richard would be admitted as a partner with new profit sharing ratio between Ram, Rahim and Richard at 3 : 2 : 1.

Balance Sheet of Ram, Rahim and Robert as at 31.3.2018

Liabilities	₹	Assets	₹
Capital Accounts :		Cash in Hand	20,000
Ram	1,00,000	Cash at Bank	1,00,000
Rahim	1,50,000	Sundry Debtors	5,00,000
Robert	2,00,000	Stock in Trade	2,00,000
General Reserve	2,00,000	Plant and Machinery	3,00,000
Sundry Creditors	8,00,000	Land and Building	5,30,000
Loan from Richard	2,00,000		
	16,50,000		16,50,000

Retirement of Robert and admission of Richard is on the following terms :

(a) Plant and Machinery to be depreciated by ₹ 30,000.

(b) Land and Building to be valued at ₹ 6,00,000.
(c) Stock to be valued at 95% of book value.
(d) Provision for doubtful debts @ 10% to be provided on debtors.
(e) General Reserve to be apportioned amongst Ram, Rahim and Robert.
(f) The firm's goodwill to be valued at 2 years purchase of the average profits of the last 3 years.
The relevant figures are :
Year ended 31.3.2015 — Profit ₹ 50,000;
Year ended 31.3.2016 — Profit ₹ 60,000;
Year ended 31.3.2017 — Profit ₹ 55,000.
(g) Out of the amount due to Robert ₹ 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.
(h) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare : (i) Capital Accounts of the Partners; and (ii) Balance Sheet of the reconstituted firm.

Solution

In the books of the Firm

Dr. **Partners' Capital Accounts** [all figures in ₹ '000] **Cr.**

Particulars	Ram	Rahim	Robert	Richard	Particulars	Ram	Rahim	Robert	Richard
To Revaluation A/c (Note 1)	10	6	4	—	By Balance b/d	100	150	200	—
To Robert's Loan A/c	—	—	200	—	By General Reserve A/c	100	60	40	—
To Bank A/c (bal. fig.)	—	—	58	—	By Goodwill A/c	55	33	22	—
To Balance c/d	245	237	—	—					
	255	243	262	—		255	243	262	—
To Goodwill (written off)	55	36.667		18.333	By Balance b/d	245	237	—	—
To Balance c/d	190	200.333		195.167	By Loan from Richard	—	—	—	200
					By Bank A/c (Note 3)	—	—	—	13.5
	245	237	—	213.50		245	237	—	213.50

Ram, Rahim and Richard
Balance Sheet of A and C as at . . .

Liabilities	₹	Assets		₹
Capital Accounts :		Land and Building		6,00,000
Ram	1,90,000	Plant and Machinery		2,70,000
Rahim	2,00,333	Stock-in-trade		1,90,000
Richard	1,95,167	Sundry Debtors	5,00,000	
Sundry Creditors	8,00,000	Less: Provision for Doubtful Debts	50,000	4,50,000
Robert's Loan	2,00,000	Cash at Bank (Note 4)		55,500
		Cash in Hand		20,000
	15,85,500			15,85,000

Working Notes :

Dr. **(1) Revaluation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Plant and Machinery A/c	30,000		By Land and Building A/c	70,000
	To Stock-in-trade	10,000		By Partners' Capital A/cs :	
	To Provision for Doubtful Debts	50,000		Ram (5/10)	10,000
				Rahim (3/10)	6,000
				Robert (2/10)	4,000
		90,000			90,000

(2) Calculation of Value of Goodwill :
Total profits of last 3 years : ₹ (60,000 + 50,000 + 55,000) = ₹ 1,65,000.
Average profit = ₹ 1,65,000 / 3 = ₹ 55,000.
Goodwill = 2 years' purchase of average profit = 2 × ₹ 55,000 = ₹ 1,10,000.

(3) Combined Capital of Ram and Rahim

	₹
Ram : ₹ (2,45,000 – 55,000)	1,90,000
Rahim : ₹ (2,37,000 – 33,667)	2,00,333
	3,90,333
Richard's Capital (50% of ₹ 3,90,333)	1,95,167
Cash to be brought in : ₹ (2,00,000 – 18,333 – 1,95,167)	13,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,00,000		By Robert's Capital (paid off)	58,000
	To Richard's Capital (Brought in)	13,500		By Balance c/d	55,500
		1,13,500			1,13,500

Illustration 50

A and B are equal partners. A by agreement, retires and C joins the firm on the basis of one third share of profits on 1.1.2018. The balance of the books as on 31.12.2017 were :

Dr. Cr.

Fixed Assets — at cost	1,30,000	Sundry Creditors	20,000
Stock	60,000	Provision for depreciation	12,000
Sundry Debtors	40,000	Capital Accounts	
Bank balance	8,000	A	1,04,000
		B	1,02,000
	2,38,000		2,38,000

Fixed Assets are valued at ₹ 1,40,000 and it was agreed to be written-up accordingly before admission of C as partner. Sufficient money is to be introduced so as to enable A to be paid off and leave ₹ 5,000 cash at bank; B and C 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 C. (All workings should form part of your answer).

Solution

In the books of the Firm

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

Date	Particulars		₹	₹
2018	Fixed Assets A/c (Note 1)	Dr.	22,000	
Jan. 1	To Revaluation A/c			22,000
	(Being the value of fixed assets increased)			
	Revaluation A/c	Dr.	22,000	
	To A Capital A/c			11,000
	To B Capital A/c			11,000
	(Being profit on revaluation transferred to Partners' Capital Accounts in the profit-sharing ratio)			
	Bank A/c	Dr.	1,12,000	
	To B Capital A/c (Note 3)			37,000
	To C Capital A/c (Note 3)			75,000
	(Being the amount brought in cash by B & C to make their capital ₹ 1,70,000 & ₹ 85,000 respectively)			
	A Capital A/c	Dr.	1,15,000	
	To Bank A/c			1,15,000
	(Being the amount due to A paid off)			

Balance Sheet of B & C as at 1st January, 2018

Liabilities	₹	Assets		₹
Capital A/cs :		Fixed Assets	1,52,000	
B	1,50,000	Less: Provision for Depreciation	12,000	1,40,000
C	75,000	Stock		60,000
Sundry Creditors	20,000	Sundry Debtors		40,000
		Cash at bank		5,000
	2,45,000			2,45,000

Working Notes :

(1) AS—10 Para 29 states that 'When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to Profit and Loss Statement'. It means that at the time of upward revaluation of fixed asset, accumulated / provision for depreciation will remain the same. Only the cost of the fixed asset will be revised upwards.

In this problem, fixed asset is ₹ 1,30,000 (at cost) and provision for depreciation is ₹ 12,000. Therefore, net book value is ₹ 1,18,000 (₹ 1,30,000 – ₹ 12,000). But it has been revalued at ₹ 1,40,000. Therefore, cost of the fixed asset will be increased by ₹ 22,000 (₹ 1,40,000 – ₹ 1,18,000). In the Balance Sheet the cost of fixed asset will be (₹ 1,30,000 + ₹ 22,000) = ₹ 1,52,000 ***less*** provision for depreciation ₹ 12,000. Net book value = ₹ 1,52,000 – ₹ 12,000 = ₹ 1,40,000.

(2) For calculating capital of B and C in the new firm, a projected Balance Sheet is to be prepared :

Projected Balance Sheet

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Fixed Assets	1,40,000
Combined capital of B & C (balancing figure)	2,25,000	Stock	60,000
		Sundry Debtors	40,000
		Cash at bank	5,000
	2,45,000		2,45,000

B's share of capital: 2/3 of ₹ 2,25,000 = ₹ 1,50,000; C's share of capital: 1/3 of ₹ 2,25,000 = ₹ 75,000.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Bank A/c	1,15,000	—	—	By Balance b/d	1,04,000	1,02,000	—
To Balance c/d	—	1,50,000	75,000	By Revaluation A/c	11,000	11,000	—
				By Bank A/c (balancing figure)	—	37,000	75,000
	1,15,000	1,50,000	75,000		1,15,000	1,50,000	75,000

Dr. **(4) Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	8,000		By A Capital A/c	1,15,000
	To B Capital A/c	37,000		By Balance c/d	5,000
	To C Capital A/c	75,000			
		1,20,000			1,20,000

Illustration 51

Dosi and Desai are in partnership as equal partners. Dosi, by agreement, retires and his son Dinesh joins the firm on the basis that he would get 1/3rd share of the profits. The balances in the books of M/s Dosi and Desai were:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Bank	8,000	Capital Accounts:	
Debtors	15,000	Dosi	23,000
Stock	26,000	Desai	20,000
		Creditors	6,000
	49,000		49,000

Goodwill is agreed at ₹ 30,000 and it is to be adjusted through Partners' Capital Accounts. Sufficient money is to be introduced so as to enable Dosi to be paid off and leave ₹ 4,000 in the bank; Desai and Dinesh are to provide such sum as to make their capitals proportionate to their shares of profit. Dosi agreed to contribute from his capital half of the amount Dinesh has to provide. Assuming the agreement was carried out, show the Journal entries and prepare the Balance Sheet of the firm of M/s Desai and Dinesh.

Solution

In the books of M/s Desai and Dinesh

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

Date	Particulars		₹	₹
	Desai Capital A/c	Dr.	5,000	
	Dinesh Capital A/c	Dr.	10,000	
	To Dosi Capital A/c			15,000
	(Being the necessary adjustment for goodwill)			
	Bank A/c	Dr.	11,500	
	Dosi Capital A/c	Dr.	11,500	
	To Dinesh Capital A/c			23,000
	(Being 1/2 of the amount, contributed by Dosi, transferred to Dinesh Capital Account — the balance 1/2 brought in by him in cash)			
	Bank A/c	Dr.	11,000	
	To Desai Capital A/c			11,000
	(Being the required amount brought in by Desai to make his capital proportionate to his share of profit)			
	Dosi Capital A/c	Dr.	26,500	
	To Bank A/c			26,500
	(Being the amount due to Dosi paid off)			

Balance Sheet of M/s Desai and Dinesh as at ...

Liabilities	₹	Assets	₹
Capital Accounts :		Stock	26,000
Desai	26,000	Debtors	15,000
Dinesh	13,000	Bank	4,000
Creditors	6,000		
	45,000		45,000

Working Notes : (1) For calculating the required capital of Desai and Dinesh in the new firm, a projected Balance Sheet is to be prepared:

Projected Balance Sheet

Liabilities	₹	Assets	₹
Creditors	6,000	Stock	26,000
Combined Capital of Desai & Dinesh (balancing figure)	39,000	Debtors	15,000
		Bank	4,000
	45,000		45,000

Desai's share of capital 2/3 of ₹ 39,000 = ₹ 26,000; Dinesh's share of capital 1/3 of ₹ 39,000 = ₹ 13,000;

Total amount to be brought in by Dinesh = ₹ 13,000 Capital + ₹ 10,000 Premium for Goodwill = ₹ 23,000. 1/2 of this amount is to be given to him by Dosi and the balance is to be brought in by him in cash = ₹ 11,500.

Dr. (2) Partners' Capital Accounts Cr.

Particulars	Dosi	Desai	Dinesh	Particulars	Dosi	Desai	Dinesh
To Dinesh Capital A/c	11,500	—	—	By Balance b/d	23,000	20,000	—
To Dosi Capital A/c	—	5,000	10,000	By Desai Capital A/c	5,000	—	—
To Bank A/c	26,500	—	—	By Dinesh Capital A/c	10,000	—	—
To Balance c/d	—	26,000	13,000	By Bank A/c		11,000	11,500
				By Dosi Capital A/c	—	—	11,500
	38,000	31,000	23,000		38,000	31,000	23,000

(3) Adjustment in Regard to Goodwill

Partners		Dosi	Desai	Dinesh
Right of goodwill prior to retirement (1 : 1)	₹	15,000	15,000	—
Right of goodwill after retirement (2 : 1)	₹	—	20,000	10,000
Gain (+) / Sacrifice (–)	₹	(–) 15,000	(+) 5,000	(+) 10,000

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 52

A, B and C are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2 respectively. The Balance Sheet of the firm as on 31.12.2014 was as follows :

Liabilities		₹	Assets		₹
Capital Accounts :			Land and Building		1,60,000
A	1,00,000		Furniture		4,000
B	60,000		Stock		6,000
C	40,000	2,00,000	Debtors	50,000	
General Reserve		40,000	Less: Provision	4,000	46,000
			Bank		24,000
		2,40,000			2,40,000

B retires on 31.12.2014 subject to the following conditions :

(i) Furniture to be depreciated by 10% and land and Building to be appreciated by 10%.

(ii) Provision for Doubtful Debts to be increased to ₹ 6,000.

(iii) The goodwill of the firm is to be valued at ₹ 40,000.

(iv) Of the amount outstanding to B ₹ 20,000 will be paid immediately and the balance amount due to B will be transferred to a separate Loan Account of B.

A and C agreed to continue the business and share the future profits and losses in the ratio of 3 : 2 respectively. Change in the value of assets and liabilities are to be recorded in the books.

Show Revaluation Account and Partners' Capital Account. Prepare the Balance Sheet after retirement of B.

[C.U.B.Com. (General) — 2015]

Solution

In the books of A, B and C

Revaluation Account

Dr. Particulars		₹	Particulars	Cr. ₹
To Furniture A/c		400	By Land and Building A/c	16,000
To Provision for Bad and Doubtful Debts A/c		2,000		
To Partners' Capital A/cs :				
A	6,800			
B	4,080			
C	2,720	13,600		
		16,000		16,000

Statement Showing the Required Adjustment for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (5 : 3 : 2)	20,000	12,000	8,000
Right of goodwill after retirement (3 : 2)	24,000	—	16,000
Gain (+) / Sacrifice (–)	(+) 4,000	(–) 12,000	(+) 8,000

Partners' Capital Accounts

Dr. Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	Cr. C (₹)
To B Capital A/c (Goodwill)	4,000	—	8,000	By Balance b/d	1,00,000	60,000	40,000
To Bank A/c	—	20,000	—	By General Reserve A/c	20,000	12,000	8,000
To B Loan A/c	—	68,080	—	By Revaluation A/c (Profit)	6,800	4,080	2,720
To Balance c/d	1,22,800	—	42,720	By A Capital A/c (Goodwill)	—	4,000	—
				B B Capital A/c (Goodwill)	—	8,000	—
	1,26,800	88,080	50,720		1,26,800	88,080	50,720

Balance Sheet of A and C as on 31st December, 2014

Liabilities	₹	Assets		₹
Capital :		Land and Building		1,76,000
A	1,22,800	Furniture		3,600
C	42,720	Stock		6,000
B Loan	68,080	Debtors	50,000	
		Less: Provision for Bad Debts	6,000	44,000
		Bank (₹ 24,000 – 20,000)		4,000
	2,33,600			2,33,600

Illustration 53

Dolly and Molly were working in partnership sharing profits equally. On 31st March, 2013 Dolly decided to retire and in her place, it was decided that Jolly, her daughter would be admitted as a partner from 1st April, 2013 and her share in profits will be one-third.

The Balance Sheet of the firm as on 31.03.2013 was as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	44,100	Goodwill	45,000
Capital Accounts :		Land and Building	1,20,150
Dolly	1,62,900	Motor Car	36,000
Molly	1,44,000	Furniture	27,900
		Sundry Debtors	72,450
		Cash and Bank Balances	49,500
	3,51,000		3,51,000

It was further decided as follows :

(i) The goodwill should be raised to ₹ 60,000.

(ii) The motor car would be taken over by Dolly at its book value.

(iii) The value of land and buildings would be increased by ₹ 24,840.

(iv) Molly and Jolly would introduce sufficient capital to pay off Dolly and to leave thereafter a sum of ₹ 22,050 as working capital in a manner that the capitals of the new partners will be in proportion to their profit sharing ratio.

(v) The capital payable by Jolly will be gifted to her by her mother.

(vi) The new partners will not show goodwill as an asset.

Show Partners Capital Accounts and the Balance Sheet as on 01.04.2013.

[C.U.B.Com. (General) — 2013]

Solution **Balance Sheet as at 1st April, 2013**

Liabilities		₹	Assets	₹
Creditors		44,100	Land and Building	1,44,990
Capital :			Furniture	27,900
Molly (2/3)	1,48,860		Debtors	72,450
Jolly (1/3)	74,430	2,23,290	Cash / Bank	22,050
		2,67,390		2,67,390

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

Particulars	Dolly (₹)	Molly (₹)	Jolly (₹)	Particulars	Dolly (₹)	Molly (₹)	Jolly (₹)
To Goodwill A/c	—	40,000	20,000	By Balance b/d	1,62,900	1,44,000	—
To Motor Car A/c	36,000	—	—	By Goodwill A/c	7,500	7,500	—
To Jolly Capital A/c	94,430	—	—	By Dolly Capital A/c	—	—	94,430
To Bank A/c	52,390	—	—	By Revaluation A/c (Profit)	12,420	12,420	—
To Balance c/d	—	1,48,860	79,430	By Bank A/c	—	24,940	—
	1,82,820	1,88,860	94,430		1,82,820	1,88,860	94,430

Note : New profit sharing ratio between Molly and Jolly will be : Molly : 2/3; and Jolly 1/3.

Illustration 54

A, B and C are three partners in a firm sharing profits and losses in proportion to their capital. The Balance Sheet of A, B and C stood as follows as at 31st March, 2012 :

Liabilities		₹	Assets		₹
Capital Accounts :			Building		60,000
A	60,000		Machinery		25,000
B	20,000		Stock		20,000
C	40,000	1,20,000	Debtors	10,000	
Creditors		12,000	Less: Provision	200	9,800
			Cash		17,200
		1,32,000			1,32,000

C retires on 31st March, 2012 and it was agreed that :

(a) Provision for bad debts be created at 5% on debtors.

(b) Building be appreciated by 25%.

(c) Provision of ₹ 4,500 be made in respect of outstanding bill for repairs.

(d) Goodwill of the firm be fixed at ₹ 24,000 and C's share of the same be adjusted into the accounts of A and B. The new profit sharing ratio will be 3 : 1 in between A and B respectively.

(e) Total capital of the firm be fixed at ₹ 60,000 after C's retirement. A and B are to contribute or withdraw cash in order to maintain their capital in profit sharing ratio.

(f) Total amount due to C be transferred to his Loan Account.

Prepare Profit and Loss Adjustment Account, Partners' Capital Accounts and also the Balance Sheet after C's retirement.

[C.U.B.Com. (General) — 2012]

Solution

Dr. **Profit and Loss Adjustment Account** **Cr.**

Particulars		₹	Particulars	₹
To Provision for Bad Debts		300	By Building A/c	15,000
To Provision for Repairs		4,500		
To Partners' Capital A/cs :				
A	5,100			
B	1,700			
C	3,400	10,200		
		15,000		15,000

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
	To C Capital A/c	6,000	2,000	—		By Balance b/d	60,000	20,000	40,000
	To C Loan A/c	—	—	51,400		By Revaluation A/c	5,100	1,700	3,400
	To Cash A/c (bal. fig.))	14,100	4,700	—		By A Capital A/c	—	—	6,000
	To Balance c/d	45,000	15,000	—		By B Capital A/c	—	—	2,000
		65,100	21,700	51,400			65,100	21,700	51,400

Balance Sheet of A and B as on 1.4.2012

Liabilities	₹	Assets		₹
Capital :		Building		75,000
A	45,000	Machinery		25,000
B	15,000	Stock		20,000
C Loan	51,400	Debtors	10,000	
Creditors	12,000	Less: Provision for Bad Debts	500	9,500
Provision for Repairs	4,500			
Bank Loan / O.D.	1,600			
	1,29,500			1,29,500

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	17,200		By A Capital A/c	14,100
	To Bank Loan A/c	1,600		By B Capital A/c	4,700
		18,800			18,800

Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Goodwill raised (3 : 1 : 2)	12,000	4,000	8,000
Goodwill written-off (3 : 1)	18,000	6,000	—
	(–) 6,000	(–) 2,000	8,000

A Capital Account	Dr.	₹ 6,000	
B Capital Account	Dr.	₹ 2,000	
To C Capital Account			₹ 8,000

Adjustment for Capital :

A = ₹ 60,000 × 3/4 = ₹ 45,000

B = ₹ 60,000 × 1/4 = ₹ 15,000

Illustration 55

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet on 31.12.2010 stands as under :

Liabilities		₹	Assets		₹
Creditors		70,000	Cash		8,000
Capital Accounts :			Debtors	44,000	
A	80,000		Less: Provision for Doubtful Debts	4,000	40,000
B	40,000	1,20,000	Stock		36,000
			Machinery		40,000
			Land and Building		66,000
		1,90,000			1,90,000

On 1.1.2011, they agreed to take C as a partner on the following conditions :

(i) The goodwill of the firm shall be valued at ₹ 47,500 and C shall pay his share of goodwill in cash.

(ii) C shall contribute ₹ 30,000 as his share of capital.

(iii) Land and Building shall be valued at ₹ 84,000. Machinery shall be depreciated by ₹ 10,000. Provision for doubtful debts shall be raised to ₹ 6,000 and another provision shall be made for a probable liability for damages amounting to ₹ 2,600.

(iv) The new profit and loss sharing ratio between A, B and C will be 9:6:4.

(v) The capital shall be adjusted (without disturbing the ultimate total capital) so as to correspond with the new ratio, the excess or deficit being transferred to their respective current accounts.

Prepare Revaluation Account, Partners' Capital Accounts and the opening Balance Sheet of the new firm.

[C.U.B.Com. (General) — 2011]

Solution

Sacrificing Ratio = Old Ratio – New Ratio

$$A = \frac{3}{5} - \frac{9}{19} = \frac{57 - 45}{95} = 12/95 \qquad B = \frac{2}{5} - \frac{6}{19} = \frac{38 - 30}{95} = 8/95$$

Sacrificing Ratio = 12 : 8, i.e., 3 : 2

Premium for goodwill brought in by C = 47,500 × 4/19 = ₹ 10,000.

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

Particulars		₹	Particulars	₹
To Machinery		10,000	By Land and Buildings	18,000
To Provision for Bad Debts		2,000		
To Provision for Liability for Damages		2,600		
To Partners' Capital A/cs :				
A : 3/5	2,040			
B : 2/5	1,360	3,400		
		18,000		18,000

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

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	88,040	45,360	30,000	By Balance b/d	80,000	40,000	—
				By Premium for Goodwill (3 : 2)	6,000	4,000	—
				By Revaluation (Profit)	2,040	1,360	—
				By Cash (Capital)	—	—	30,000
	88,040	45,360	30,000		88,040	45,360	30,000
To Current A/c	10,640	—	—	By Balance b/d	88.040	45.360	30.000
To Balance c/d	77,400	51,600	34,400	By Current A/c (See below)	—	6.240	4.400
	88,040	51,600	34,400		88,040	51,600	34,400

Adjustment of Capital

Particulars	A	B	C	Total
Adjusted Capital (after all adjustments)	88,040	45,360	30,000	1,63,400
Total Capital in new profit sharing ratio (9 : 6 : 4)	77,400	51,600	34,400	1,63,400
Transferred to Current A/c	10,640	(6,240)	(4,400)	Nil

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

Particulars	₹	Particulars	₹
To Balance b/d	8,000	By Balance c/d	48,000
To Premium for Goodwill A/c	10,000		
To C Capital A/c	30,000		
	48,000		48,000

Balance Sheet of A, B and C as at 31.1.2011 (after admission)

Liabilities	₹	Assets		₹
Creditors	70,000	Cash		48,000
Provision for Damages	2,600	Debtors	44,000	
Current A/c :		Less: Provision for Doubtful Debts	6,000	38,000
A	10,640	Current A/c :		
Capital A/cs :		B		6,240
A	77,400	C		4,400
B	51,600	Stock		36,000
C	34,400	Machinery		30,000
		Land and Building		84,000
	2,46,640			2,46,640

[For Honours Candidates Only]

Illustration 56

On 31st December, 2014, the Balance Sheet of the partnership business of A, B and C sharing profits and losses in the ratio of 1 : 1 : 1 stands as follows :

Balance Sheet as on 31st December, 2014

Liabilities		₹	Assets	₹
Capital Accounts :			Land and Buildings	70,000
A	40,000		Plant and Machinery	60,000
B	50,000		Furniture	10,000
C	60,000	1,50,000	Stock	21,000
General Reserve		24,000	Sundry Debtors	40,000
Sundry Creditors		20,000	Bank	8,000
Bills Payable		15,000		
		2,09,000		2,09,000

A retires from the business on 31.12.2014 as per the following terms and conditions. B and C will continue the business sharing profits and losses in the new ratio of 3 : 2.

(a) Depreciation is to be written off at 15% on Machinery and 10% on Furniture.
(b) The value of Building is to be increased to ₹ 90,000 and the value of Stock is to be increased by ₹ 7,000.
(c) A provision of ₹ 2,000 is to be created for Bad and Doubtful Debts.
(d) Goodwill of the firm is valued at ₹ 45,000.
(e) B and C have to adjust their capitals in their new profit sharing ratio and bring in cash to pay off A and leave ₹ 20,000 in bank for working capital.
(f) The goodwill account is to be closed after retirement of A.

Prepare Revaluation Account, Partners' Capital Account and the Balance Sheet of the new firm.

[C.U.B.Com. (Hons.) — 2015]

Solution

In the books of A, B and C

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Plant and Machinery A/c (15% of ₹ 60,000)		9,000	By Land and Buildings (₹ 90,000 – 70,000)	20,000
To Furniture (10% of ₹ 10,000)		1,000	By Stock	7,000
To Provision for Bad and Doubtful Debts		2,000		
To Partners' Capital A/cs :				
A	5,000			
B	5,000			
C	5,000	15,000		
		27,000		27,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To A Capital A/c	—	12,000	3,000	By Balance b/d	40,000	50,000	60,000
To Bank A/c	68,000	—	—	By Revaluation A/c	5,000	5,000	5,000
To Balance c/d	—	1,20,600	80,400	By General Reserve A/c	8,000	8,000	8,000
				By B Capital A/c	12,000	—	—
				By C Capital A/c	3,000	—	—
				By Bank A/c (Note 4)	—	69,600	10,400
	68,000	1,32,600	83,400		68,000	1,32,600	83,400

Balance Sheet of B and C as on 31st December, 2014

Liabilities	₹	Assets		₹
Capitals :		Land and Buildings		90,000
B	1,20,600	Plant and Machinery		51,000
C	80,400	Furniture		9,000
Creditors	20,000	Stock		28,000
Bills Payable	15,000	Debtors	40,000	
		Less: Provision for Bad and Doubtful Debts	2,000	38,000
		Bank		20,000
	2,36,000			2,36,000

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (1 : 1 : 1)	15,000	15,000	15,000
Right of goodwill after retirement (3 : 2)	—	27,000	18,000
Gain (+) / Sacrifice (–)	(–) 15,000	(+) 12,000	(+) 3,000

(2) Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	8,000	By A Capital A/c	68,000
To B Capital A/c (Note 4)	69,600	By Balance c/d (Balancing figure)	20,000
To C Capital A/c (Note 4)	10,400		
	88,000		88,000

	₹
(3) Total Cash to be Brought-in	
Amount to be paid to A	68,000
Add: Cash to be kept	20,000
	88,000
Less: Cash in hand at present	8,000
	80,000
(4) Cash to be Brought-in by B and C	
Capital of B (before cash brought in) (50,000 + 5,000 + 8,000 – 12,000)	51,000
Capital of C (before cash brought in) (60,000 + 5,000 + 8,000 – 3,000)	70,000
Add: New capital (cash to be brought in)	80,000
Total Capital after cash brought in	2,01,000
B's revised Capital (3/5 of ₹ 2,01,000)	1,20,600
Less: B's Capital before cash brought in	51,000
Cash to be brought in by B	69,600
C's revised capital (2/5 of ₹ 2,01,000)	80,400
Less: C's capital before cash brought in	70,000
Cash to be brought in by C	10,400

Key Points

- According to Sec. 32(1) of the Indian Partnership Act, a partner can retire in the following three ways :
  (i) with the consent of all the other partners (such consent may be expressed or implied)
  (ii) in accordance with an express agreement by the partners; and
  (iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.
- The effects of the above provision of AS—10 in Partnership Accounts are the following :
  1. Only purchased goodwill to be recorded in the books of accounts.
  2. Non-purchased goodwill (internally generated goodwill) will be adjusted through Partners' Capital Accounts. In, effect this goodwill cannot be shown in the Partnership Balance Sheet.
- The ratio in which the remaining partners are acquiring the share of the retiring partner is called gaining ratio.

THEORETICAL QUESTIONS

1. How is goodwill treated at the time of retirement of a partner?
2. What are the different ways in which a partner can retire from the firm?
3. Why are assets and liabilities revalued at the time of retirement?
4. Explain the mode of payment to a retired partner.
5. Explain the procedure of computation of retired partner's interest in the firm.

PRACTICAL QUESTIONS

1. A, B and C were partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet of the firm as on 31.12.2017 was as follows :

Liabilities		₹	Assets		₹
Sundry Creditors		25,000	Cash		3,000
Bills Payable		12,000	Sundry Debtors	20,000	
Capital Accounts :			Less: Provision for Bad Debts	1,000	19,000
A	40,000		Closing Stock		30,000
B	40,000		Furniture		10,000
C	30,000	1,10,000	Plant and Machinery		40,000
Reserve		15,000	Buildings		60,000
		1,62,000			1,62,000

On 31.12.2017, B retired. The terms of retirement provided the following :

(a) The goodwill of the firm was to be valued at ₹ 20,000.

(b) Furniture, plant and machinery were to be depreciated by 10% and 5% respectively.

(c) Stock and building were to be appreciated by 20% and 10% respectively.

(d) Provision for doubtful debts was to be increased to ₹ 1,500.

(e) The reserve was to be transferred to the Capital Accounts of the partners.

(f) The amount due to B was to be transferred to a separate Loan Account earning interest @ 10% p.a.

Show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after B's retirement.

2. A, B and C are partners sharing profits and losses 4/7ths, 2/7ths, 1/7ths respectively. Their Balance Sheet on 31st December 2017 was as follows :

Liabilities	₹	Assets	₹
Capital A/cs :		Goodwill	15,000
A	45,000	Stock	22,500
B	30,000	Debtors	16,500
C	25,000	Land and Building	30,000
Bills Payable	3,000	Machinery	39,750
General Reserve	10,500	Motor Van	7,750
Creditors	22,500	Cash	4,500
	1,36,000		1,36,000

On the same date A retired from the business and the following adjustments were made :

(i) Firm's goodwill was valued at ₹ 36,000.

(ii) Assets and liabilities are to be revalued as : Stock ₹ 18,000; Land and Building ₹ 33,900; Debtors ₹ 15,750; Machinery ₹ 37,500; Creditors ₹ 21,000.

(iii) B to bring in ₹ 30,000 and C ₹ 7,500 as additional capital.

(iv) A was to be paid ₹ 24,300 in cash and the balance of his Capital Account to be transferred to his Loan Account.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and the Balance Sheet of the firm after A's retirement.

3. A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Their Balance Sheet on 31.12.2017 was :

Liabilities	₹	Assets	₹
Capital Accounts:		Cash at bank	3,500
A	45,000	Debtors	30,000
B	35,000	Stock	25,000
C	25,000	Plant	40,000
Reserve	15,000	Building	50,000
Profit & Loss A/c	12,000	Furniture	4,000
Creditors	20,500		
	1,52,500		1,52,500

C retires on that date subject to the following conditions:

(i) Goodwill of the firm is to be valued at ₹ 36,000;

(ii) Building is to be appreciated by 20%;

(iii) Plant & Furniture are to be depreciated by 10% and 15% respectively; and

(iv) Provision is to be made for doubtful debts at 5%;

A and B are to bring in cash, if necessary, in their profit-sharing ratio to pay off C's dues on retirement and leave a sum of ₹ 10,000 as working capital.

Prepare Revaluation Account, Partners' Capital Account and new Balance Sheet as at 1.1.2018.

4. A, B and C carried on partnership sharing profits as 4:3:2. Their balance Sheet on 30.6.2018 was as follows:

Liabilities	₹	Assets		₹
Creditors	41,400	Cash in hand		500
Capital — A	87,800	Cash at bank		21,000
Capital — B	66,000	Debtors	25,000	
Capital — C	43,800	Less: Provision for doubtful debts	500	24,500
		Stock		36,000
		Plant and Machinery		37,000
		Land and Buildings		1,20,000
	2,39,000			2,39,000

B Retired on 1.7.2018 and these adjustments were agreed upon before ascertaining the amount payable to B:

1. Provision for Doubtful Debts raised to 5% on debtors;
2. Land and Buildings to be appreciated by 15%;
3. A provision of ₹ 650 is to be made for outstanding legal charges;
4. Goodwill to be valued at ₹ 45,000 and B's share to be adjusted into the Accounts of A and C who decided to continue the business sharing profit as 5:3;

5. Stock to be reduced to ₹ 32,000;
6. The capital of the new firm to be adjusted in proportion to their new profit-sharing ratio and actual cash to be brought in or paid off by or to the continuing partners, as the case may be.

B agreed to leave the amount due to him by the firm as loan to the firm carrying interest at 6% p.a. Pass Journal entries and make the Balance Sheet following the retirement of B.

5. A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. They had taken out a joint life policy of the face value of ₹ 2,00,000. On 31st December, 2017, its surrender value was ₹ 40,000. On this date the Balance Sheet of the firm stood as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	53,000	Fixed Assets	2,50,000
Outstanding Expenses	7,000	Stock	1,10,000
Reserve	30,000	Book Debts	90,000
Capital A/cs :		Cash at Bank	20,000
(A — ₹ 2,00,000; B — ₹ 1,00,000; C — ₹ 80,000)	3,80,000		
	4,70,000		4,70,000

On that date B decided to retire and for that purpose : (a) Goodwill was valued at ₹ 1,50,000; (b) Fixed assets were valued at ₹ 3,00,000; and (c) Stock was considered as worth ₹ 10,000. B was to be paid in cash brought in by A and C in such a way so as to make their capital proportionate to their new profit sharing ratio which was to be 3 : 2 respectively. Goodwill was to be passed through books without raising a Goodwill Account; the joint life policy was also not to appear in the Balance Sheet. Prepare Ledger Accounts and the resultant Balance Sheet.

6. The Balance Sheet of A, B and C, who were sharing profits in the ratio of 4:3:2 respectively stood as follows on 31.12.2017 :

Liabilities	₹	Assets		₹
Sundry Creditors	4,140	Cash at Bank		3,300
Capital — A	12,000	Sundry Debtors	3,045	
Capital — B	9,000	Less: Provision	105	2,940
Capital — C	6,000	Stock		4,800
		Plant and Machinery		5,100
		Land and Building		15,000
	31,140			31,140

B having given notice to retire from the firm, the following adjustments in the books of the firm were agreed upon:

1. That the land and building be appreciated by 10%;
2. That the provision for bad and doubtful debts is no longer necessary;
3. That the stock be appreciated by 20%;
4. That the adjustment be made in the accounts to rectify a mistake previously made whereby B was credited in excess by ₹ 810, while A and C were debited in excess of ₹ 420 and ₹ 390 respectively.
5. That goodwill of the firm be fixed at ₹ 5,400 and B's share of the same be adjusted to that of A and C who are going to share in future profits in the ratio of 2:1.
6. That the entire capital of the firm, as newly constituted, will be readjusted by bringing in or paying of cash so that the future capital of A and C be in the ratio of 2:1.

Pass Journal entries and prepare the Balance Sheet of the new firm showing B's balance as loan.

7. P, Q and R are in partnership sharing profits and losses in the ratio of 2 : 2 : 1. P retired on 31.12.2017 and on that date, the Balance Sheet of the firm was as under :

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Building	10,000
P	16,000	Plant and Machinery	6,000
Q	8,000	Furniture	2,000
R	8,000	Stock	7,000
Creditors	12,000	Debtors	15,000
		Cash	4,000
	44,000		44,000

On P's retirement, Goodwill is valued at ₹ 10,000 and the assets are revalued as follows : Land and Building ₹ 12,000; Plant and machinery ₹ 5,000; Furniture ₹ 1,500; Debtors ₹ 12,500. While apportioning profits for the year

2017, an amount of ₹ 3,000 was given to P in excess, Q and R provide cash in their profit sharing ratio in order to pay-off P.

You are required to pass Journal Entries, prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet after P's retirement.

8. A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of their business as on 31.3.2018 is given below :

Liabilities	₹	Assets	₹
Capital Accounts :		Machinery	40,000
A	50,000	Furniture	20,000
B	40,000	Motor Car	30,000
C	30,000	Stock	25,000
Reserve	12,000	Debtors	75,000
Creditors	60,000	Cash	2,000
	1,92,000		1,92,000

A retired w.e.f. 1.4.2018. Goodwill of the firm was valued at ₹ 24,000. On revaluation, machinery and furniture are to be appreciated by 10%. Debtors include ₹ 1,500 as bad and doubtful and are to be written-off. Value of stock is to be reduced to ₹ 23,000. Creditors include ₹ 800 as no more payable. It was decided that due effect is to be given to the retiring partners' capital account as his share of goodwill without raising any goodwill account. B and C are to share the future profits in equal proportions. Amounts payable to A is to be treated as a loan to the firm.

You are required to prepare the Revaluation Account, Capital Accounts of the partners and the Balance Sheet of the firm after A's retirement.

9. A, B and C were partners sharing profits in the ratio of 3 : 2 : 1. On 1st January, 2018, B retired, on that date Balance Sheet was as follows :

Liabilities	₹	Assets	₹
General Reserve	6,000	Plant	30,000
Expenses Owing	2,000	Patents	3,000
Bills Payable	5,000	Debtors	9,500
Creditors	10,000	Stock	11,000
Capital Accounts :		Cash	500
A	12,000		
B	10,000		
C	9,000		
	54,000		54,000

The terms were :

(i) Goodwill was to be valued to ₹ 12,000 but no Goodwill Account was to be raised.

(ii) New ratio between A and C will be 3 : 2.

(iii) Expenses owing are to be brought down to ₹ 1,500; Plant is to be valued at 10% less and patents at ₹ 4,000.

(iv) The total capital of new firm will be fixed at ₹ 25,000 to be contributed by partners in profit sharing ratio.

Prepare Ledger Accounts to record the above and prepare Balance Sheet after B's retirement.

10. A, B and C were carrying on business in partnership, sharing profits and losses in the ratio of 2 : 1 : 1. On December 31, 2017 B decided to retire from the firm and the following terms were agreed upon :

(a) A typewriter purchased on January 1, 2016 for ₹ 1,200 was charged to the Office Expenses Account in 2017 and has to be brought into account after allowing 15% p.a. depreciation on the reducing balance basis.

(b) Furniture and fittings are to be written-down by ₹ 603 and stock by ₹ 5,000.

(c) The provision for bad and doubtful debts standing in the books at ₹ 4,000 are to be reduced by 25%.

(d) A liability in respect of workmen's compensation for ₹ 2,100 not acknowledged by the partnership as a valid claim, is however, to be provided for.

(e) Goodwill of the firm is valued at ₹ 24,000.

(f) The capital accounts of the partners on December 31, 2017 stood at A — ₹ 20,001, B — ₹ 15,001 and C — ₹ 10,001.

A and C agree that the Goodwill is to be adjusted through Capital Accounts of the partners and the amount payable to B shall be brought in by them in their new profit-sharing ratio.

You are required to pass Journal Entries to record the above transactions.

11. A, B and C are in partnership sharing profits and losses in the ratio of 2 : 2: 1 respectively. It was agreed that in case of retirement or death of a partner, the value of goodwill shall be determined at 1.5 years' purchase of the average profits of the last four years. C retired from his business w.e.f. 1.7.2018 and the following matters came up for consideration in connection therewith:
   (i) Capital expenditure of ₹ 30,000 incurred on 15.11.2014, wrongly debited to Purchase Account is to be written-back and depreciation at 10% is to be charged annually on the closing balance on reducing balance method.
   (ii) No adjustment was made for goods worth ₹ 10,000 taken over by A on 28.2.2018.
   (iii) The profits for four years ended on 30th June : 2015, 2016, 2017, 2018 were ₹ 1,20,000, ₹ 1,50,000, ₹ 1,40,000, ₹ 1,60,000 respectively.
   (iv) C's Capital Account stood at ₹ 5,50,000 as on 30.6.2018.

   You are required to draw up the Capital Account of C and to find out the amount finally due to him.

12. A, B and C were in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively. The summarized Balance Sheet of the firm as on 31.3.2018 stood as follows :

Liabilities	₹	Assets		₹
Capital — A	1,20,000	Freehold Land and Building		80,000
Capital — B	60,000	Plant and Machinery		30,000
Capital — C	40,000	Motor Cars		12,000
Loan — A	20,000	Stock		56,000
Creditors	40,000	Debtors	60,000	
		Less: Provision for Doubtful Debts	6,000	54,000
		Cash at bank		48,000
	2,80,000			2,80,000

A retired on March 31, 2018 to commence business individually, and B and C continued in partnership sharing profits and losses equally.

It was agreed that A should take over certain plant and machinery valued at ₹ 7,500 and one of the firm's cars at the book value of ₹ 5,000.

It was further agreed that for the purpose of both of the dissolution and continuation of partnership, the following adjustments should be made in the Balance Sheet as on March 31, 2018 :

1. Freehold Land and Buildings should be revalued at ₹ 1,00,000 and Plant and Machinery (inclusive of that taken by A) at ₹ 25,000.
2. The provision for doubtful debts should be increased by ₹ 1,500.
3. A provision of ₹ 2,500 included in creditors for a possible claim for damages was no longer required.
4. The stock should be reduced by ₹ 4,000 in respect of obsolete and damaged items.

In accordance with the terms of the partnership deed, the total value of goodwill on March 31,2018 was agreed at ₹ 1,80,000. In view of the fact that A intended to retain some of the customers of the firm, it was agreed that the value of the proportion of goodwill to be purchased by him was ₹ 60,000. The continuing partners B and C decided that goodwill should not appear in the books of the new partnership as an asset and the necessary adjustments should be made through the Capital Accounts of the partners. Pending the introduction of further capital in cash by the continuing partners, the amount due to A was agreed to be transferred to Loan Account. You are required to prepare the Revaluation Account, the Partners' Capital Accounts and the Balance Sheet of the new firm.

13. A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 5 respectively. The following are the particulars of the personal accounts of the partners :

	A	B	C
1. Capital Accounts (1.1.2017)	20,000	12,000	35,000
2. Current Accounts (1.1.2017)	(Cr.) 4,000	(Dr.) 1,000	(Cr.) 6,000
3. Drawings during the year 2017	2,400	3,800	4,600
4. Interest on drawings	300	500	600

The partnership firm earned a profit of ₹ 1,200 in the year 2017. A retired from 31.12.2017 and it was agreed to settle his accounts on the following terms :

(a) Accounts for the year 2017 should be thoroughly scrutinised and rectified. Accordingly, the following discrepancies were found out during the scrutiny:
   (i) An amount of ₹ 100 paid towards life insurance of A was wrongly debited to Taxes and Insurance Account of the firm.
   (ii) Goods worth ₹ 200 taken by B were not recorded in the books of accounts.

(iii) Wages paid ₹ 420 for extension of office building were treated as wages. The depreciation of building was charged at 2%.
(iv) Bad debts of ₹ 300 were omitted while preparing the Profit and Loss Account.

(b) The share of A should be distributed in the ratio of 3 : 5 between B and C.
(c) The following assets should be revalued :
(i) Stock to be depreciated by ₹ 1,000; (ii) Machinery to be depreciated by ₹ 2,500; (iii) Building to be appreciated by ₹ 5,500.
(d) Interest on capital to be charged at 6% and no interest on Current Accounts.
(e) Goodwill to be estimated at ₹ 6,000 and to be adjusted accordingly.

Prepare Profit and Loss Appropriation Account, Revaluation Account, Partners' Capital and Current Accounts.

14. On 1.1.2014, A and B started a firm, sharing profits and losses equally. Each of the partners contributed ₹ 2,000 towards the capital of the firm and was allowed to draw ₹ 400 p.m. in anticipation of profits. On 1.1.2015, they admitted C as a third partner 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 1.1.2016, A got a part-time job elsewhere and considered 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. from 1.1.2016.

On 1.1.2017, 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 retain only a quarter of his earlier share in the firm and would be drawing nothing from 1.1.2017. A and C would be drawing @ ₹ 600 p.m. instead. The interest surrendered by B would be apportioned equally by A and C.

On 31.12.2017, 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 : 2014 — ₹ 17,000; 2015 — ₹ 18,000; 2016 — ₹ 24,000; 2017 — ₹ 28,896.
(b) B's share of goodwill is to be taken at 2 years' purchase of the average of his share of profits of the previous two years.
(c) The partners have drawn exactly what they could draw under the agreement.

15. On 31.12.2017, the Balance Sheet of M/s. A, B and C, sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities	₹	Assets		₹
Creditors	1,08,000	Cash at Bank		80,000
Capital A/cs:		Debtors	1,00,000	
A	4,50,000	Less: Provision for Doubtful Debts	2,000	98,000
B	3,00,000	Stock		90,000
C	1,50,000	Machinery		2,40,000
		Land and Building		5,00,000
	10,08,000			10,08,000

On that date, B wants to retire from the firm and the remaining partners decide to carry on the firm. The following readjustment of assets and liabilities have been agreed upon before the ascertainment of the amount payable to B :

(i) that out of the amount of insurance premium which was debited annually entirely to Profit and Loss Account, ₹ 10,000 be carried forward for unexpired insurance on 31.12.2017;
(ii) that the land and building be appreciated by 10%.
(iii) that the provision for doubtful debts be brought up to 5% on debtors;
(iv) that machinery be depreciated by 5%;
(v) that a provision for ₹ 15,000 be made in respect of an outstanding bill for repairs;
(vi) that the goodwill of the entire firm be fixed at ₹ 1,80,000 and B's share of the same adjusted in the accounts of A and C who share future profits in the proportion of 3/4th and 1/4th respectively (no goodwill account being raised); and,
(vii) that B be paid ₹ 50,000 in cash and the balance be transferred to his Loan Account.

Prepare Revaluation Account, the Capital Accounts of the Partners and the Balance Sheet of the firm of A and C.

16. A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. On 31.1.2018, B decides to retire and their Capital Accounts on that date are A — ₹ 60,000; B — ₹ 45,000; and C — ₹ 50,000. Their Current Accounts on that date are A — ₹ 5,000 (Cr.); B — ₹ 2,300 (Dr.) and C — 3,000 (Cr.).

    The partnership deed provided that in case of retirement, the retiring partner should be entitled to a share of the goodwill of the firm to be calculated on the average of the profits of last three years' ending on 31.3.2018 which comes to ₹ 12,000 and that the payment of the total interest of the retiring partner shall be made by annual instalments of ₹ 10,000 each. The retiring partner will be entitled to interest also at 6% on the unpaid balance. The first instalment was paid on 31.3.2018.

    Show B's Loan Account until the whole payment due to him is made.

17. A, B and C were in partnership till 31.12.2016, when C retired from partnership. The amount due to him after necessary adjustments arising in connection with such retirement was ₹ 1,00,000. At the request of the other partners, he agreed to leave the amount with the new firm as loan on the following terms and conditions :

    (i) Repayment of loan to be made at the end of each year by annual instalments representing 40% of future annual profits after charging salary of ₹ 7,500 p.a. to each partner.

    (ii) Interest @ 5% p.a. calculated on the balance outstanding at the beginning of the year to be credited, but such interest will not be taken into account for calculation of 40% stated above.

    Profits before charging partners' salaries, were as follows : 2012 — ₹ 15,000; 2013 — ₹ 1,03,125; 2014 — ₹ 1,11,875; 2015 — ₹ 1,15,000; 2016 — ₹ 1,43,250.

    You are required to show C's Loan Account for all these years as it would appear in the books of the firm.

18. A, B and C were in partnership sharing profits and losses in the ratio 3:2:1. Their Balance Sheet as on 31.3.2018 was as under:

Liabilities	₹	Assets	₹
Capital — A	60,000	Machinery	80,000
Capital — B	50,000	Furniture	15,000
Capital — C	40,000	Motor car	30,000
Sundry Creditors	72,000	Stock	50,000
Bank loan	30,000	Sundry Debtors	60,000
Other liabilities	20,000	Cash at bank	37,000
	2,72,000		2,72,000

A retired on 1.4.2018 and the partnership deed provided *inter alia* that in the event of admission, retirement or death of a partner, the assets and liabilities are to be revalued and that goodwill of the firm is to be computed on the basis of 2 years' purchase of the correct profit of the last 4 years.

It is discovered that the accounts required adjustments owing to certain mistakes in earlier years. On 1.10.2015, repairs to machinery for ₹ 6,000 had been wrongly debited to Machinery Account; and on 1.4.2016, a piece of furniture, whose book value was ₹ 2,000 was disposed of for ₹ 800 but the proceeds were wrongly credited to Sales Account. The partners had been charging depreciation on all fixed assets at 10% p.a. on the reducing balance system on a time basis. Profits for the last four years without adjusting the above mentioned mistakes were as follows:

2014-15 – ₹ 20,000; 2015-16 – ₹ 24,000; 2016-17 – ₹ 32,000; 2017-18 – ₹ 36,000.

Revaluation on the date of retirement was: Machinery — ₹ 90,000; Furniture — ₹ 10,000; Motor car — ₹ 22,000.

B and C, decided to share future profits, after A's retirement, in the ratio of 3:2. It was further agreed that the retiring partner shall be credited with his due proportion of goodwill, without raising a Goodwill Account in the books.

A is to be paid 50% of the amount due to him on retirement immediately and the balance is to be transferred to his Loan Account carrying interest at 6% p.a. B and C are to bring necessary cash (in their new ratio) subject to the condition that a cash balance of ₹ 20,000 is to be maintained as working capital.

Show the Capital Accounts of the partners and the Balance Sheet of the firm after all the above mentioned transactions have been carried out. Ignore fractions. (All working should form part of your answer.)

19. A, B and C were partners sharing profits/losses in the ratio of A 40%, B 35% and C 25%. The draft Balance Sheet of the partnership as on December 31, 2017 was as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	30,000	Cash in Hand and at Bank		67,000
Bills Payable	8,000	Stock		42,000
Loan from B	30,000	Sundry Debtors	34,000	
		Less: Provision for Doubtful Debts	6,000	28,000

Current Accounts: (A — ₹ 12,000; B — ₹ 8,000; C — ₹ 6,000)	26,000	Plant and Machinery (at cost) Less : Provision for Depreciation	80,000 28,000	52,000
Capital Accounts: (A — ₹ 90,000; B — ₹ 50,000; C — ₹ 30,000)	1,70,000	Premises (at cost)		75,000
	2,64,000			2,64,000

B retired on December 31, 2017. A and C continued partnership sharing profits/losses in the ratio of A— 60% and C— 40%. It was agreed that the amount then remaining due to him, a sum of ₹ 80,000, should remain as loan to the partnership and the balance be carried forward as ordinary trading liability. The following adjustments were agreed to be made to the above mentioned Balance Sheet.

(a) ₹ 10,000 should be written-off from the premises;

(b) Plant and machinery were revalued at ₹ 58,000;

(c) Provision for doubtful debts to be increased by ₹ 1,200;

(d) ₹ 5,000 due to creditors for expenses had been omitted from the books of account;

(e) ₹ 4,000 to be written-off from stock; and

(f) Provide ₹ 1,200 for professional charges in connection with revaluation.

As per the deed of partnership, in the event of the retirement of a partner, goodwill was to be valued at an amount equal to one year's purchase of the average profits of the preceding three years on the date of retirement. Before determining the said average profits, a notional amount of ₹ 80,000 should be charged for remuneration to partners. The profits before charging such remuneration were : Year ended 31.12.2015 — ₹ 1,44,000; Year ended 31.12.2016 — ₹ 1,68,000; and Year ended 31.12.2017 — ₹ 1,88,200 (as per draft accounts).

It was agreed that for the purpose of valuing goodwill, the amount of profit for year 2017 be recomputed after charging the loss on revaluation in respect of premises and stock that unprovided, expenses (except professional expenses) and increase in provision for doubtful debts. The continuing partners decided to eliminate the Goodwill Account from their books.

You are required to prepare: (i) Revaluation Account; (ii) Capital Accounts (merging Current Accounts therein); (iii) B's Account showing balance due to him; (iv) Balance Sheet of A and C as on January 1,2018.

20. A, B and C sharing profits and losses as 4:3:1 had their capitals on 1.4.2018: ₹ 15,000; ₹15,000; and ₹10,000 respectively. The Deed provided: (i) that interest would be payable on capital at 10% p.a.; (ii) that in case of retirement, the goodwill would be valued at two years' purchase of the average divisible profits of the last five years; (iii) that the profit of the retiring partner to the date of retirement would be estimated on the basis of the average divisible profit of the last three years, and (iv) that the firm would effect a joint life policy of ₹ 30,000, charging the premium as expense.

A retired with effect from 1.10.2018. The surrender-value of the policy as on that date was ascertained at ₹ 8,000 and to that date drawings amounted to A — ₹ 3,000; B — ₹ 2,000 and C — ₹ 1,000. Profits after charging interest and policy premium were:

2017-18 — ₹ 10,000; 2016-17 — ₹ 9,500; 2015-16 — ₹ 7,200; 2014-15 — ₹ 8,800; 2013-14 — ₹ 8,000.

A's final claim was met to the extent of claims on revenue accounts out of the assets of the business and the rest out of cash brought in by B and C in such proportions as to set their capitals at balances equated to their shares in the profits. Prepare the Capital Accounts of A, B and C.

21. A, B and C are partners sharing profits and losses in the ratio of 3 : 3 : 4. The Balance Sheet as on 31.12.2017 is :

Liabilities	₹	Assets	₹
Sundry Creditors	12,000	Cash at Bank	3,000
Bills Payable	18,000	Bills receivable	11,000
6% Mortgage Loan	17,000	Stock	25,000
Capital Accounts		Sundry Debtors	20,000
(A — ₹ 50,000; B — ₹ 45,000; C — ₹ 65,000)	1,60,000	Furniture	5,000
General Reserve	10,000	Plant and Machinery	40,000
		Land and Building	1,13,000
	2,17,000		2,17,000

The firm earned profits as follows for the past five years: 2013 — ₹ 14,000; 2014 — ₹ 16,500; 2015 — ₹ 15,000; 2016 — ₹ 15,000 and 2017 — ₹ 15,800.

On December 31, 2017, C retired from partnership and in order to ascertain the amount due to C, the accounts of 2017 were verified and the following mistakes were detected:

(i) A bill receivable for ₹ 1,000 which was dishonoured and became irrecoverable, was not taken into consideration while preparing the final accounts.
(ii) An amount of ₹ 200 paid for the rent of the house occupied by C was wrongly debited to the Rent Account of the firm.
(iii) Goods worth ₹ 1,500 given by B to the firm were not taken into account.
(iv) An outstanding bill for ₹ 500 towards electricity was not paid and the same was not adjusted while preparing the final accounts.
(v) Purchase of machinery of July 1, 2017 at a cost of ₹ 9,500 was wrongly treated as the Purchase Account and the expenses of ₹ 500 incurred towards erection of the machinery were charged to the Machinery Repairs Account. Depreciation on the Machinery Account was charged at 10% p.a.

The partners agreed to rectify the mistakes noted above and the following adjustments were made to settle the accounts of C:

(i) A provision was made at 5% on Sundry Debtors; (ii) Stock was revalued at ₹ 21,925; (iii) Plant and Machinery were depreciated by 15%; (iv) Land and building were appreciated by 20%; (v) Sundry creditors for ₹ 2,900 will not rank; (vi) Goodwill of the firm should be ascertained at three times the average profit of the last five years. The Goodwill Account should not appear in the books. Goodwill of C should be shared by A and B; (vii) The Capital of C should be purchased by A and B in the ratio of 3:2; (viii) Since C was in urgent need of ₹ 50,000, the partners are required to make payment to him in cash in their new profit-loss sharing ratio and the balance of C's capital will be treated as loan; and (ix) The partners are also required to adjust their capitals in cash in proportion to their new profit-loss sharing ratio.

You are required to prepare the Profit and Loss Adjustment Account, Revaluation Account, Capital Accounts of the partners and also the Balance Sheet after the retirement of C.

Admission cum Retirement

22. The following is the Balance Sheet of A and B as at 30th June, 2018 on which date A retired and his son D joined that firm from 1st July, 2018 with one-fourth share in the profits of the business :

Liabilities	₹	Assets	₹
Capital Accounts :		Land	12,000
A	50,000	Plant	40,000
B	31,000	Investments	14,000
Creditors	10,000	Debtors	15,000
		Cash at Bank	10,000
	91,000		91,000

The following adjustments and arrangements have been agreed upon for the purposes of retirement and admission of partners :

1. Land to be written upto ₹ 30,000 and Plant to ₹ 50,000;
2. Sufficient money to be introduced so as to leave ₹ 11,000 cash after payment of amount due to Raman;
3. B and D to provide such fund as would make their capitals proportionate to their share of profit.

Show the Journal Entries to record the above transactions.

23. A, B and C are partners sharing profit and losses in the proportion of 3 : 2 : 1. Following is the Balance Sheet as at 31.12.2017:

Liabilities	₹	Assets	₹
Capital A/cs:		Building	10,000
(A — ₹ 65,000; B — ₹ 38,000; C — ₹ 28,000)	1,31,000	Debtors	61,400
Reserve	38,400	Sundry Assets	1,48,000
Creditors	50,000		
	2,19,400		2,19,400

C desires to retire from the firm on 1.1.2018. In terms of agreement :

Building is to be revalued at ₹ 50,000. Debtors at ₹ 41,400 and Sundry Assets at ₹ 1,50,000. The amount payable to the retired partner is for the present to be treated as loan with 5% interest.

On the same day, i.e., on 1.1.2018, D is admitted as a partner on payment of ₹ 32,000. Profit and loss are henceforth to be shared as 4:3:2 among A, B and D. No alteration is to be made in the book value of the assets other than cash brought in by D and Reserve.

Draw up the final Balance Sheet as at 1.1.2018 on the above basis after admission of D.

24. A, B and C were in partnership sharing profits and losses in the ratio 3 : 2 : 1. Their Balance Sheet as on 31.3.2018 was as follows :

Liabilities	₹	Assets		₹
Capital A/cs :		Plant and Machinery		1,70,000
(A — ₹ 50,000; B — ₹ 80,000; C — ₹ 90,000)	2,20,000	Furniture and Fixtures		30,000
General Reserve	18,000	Trade Debtors	1,79,000	
Workmen's Accidental Compensation Fund	50,000	Less: Provision	10,000	1,69,000
Trade Creditors	1,07,000	Cash in hand		26,000
	3,95,000			3,95,000

C retired on that date. It was agreed that :

(a) Plant and machinery to be revalued at ₹ 1,94,000. Provision on debtors be kept at ₹ 19,000 and liability for workmen's accident compensation was decided at ₹ 23,000.

(b) C should get, apart from other amounts due to him, his share in goodwill ₹ 40,000.

(c) The total amount payable to C was brought by A and B in their profit sharing ratio.

Immediately after this, they admitted D as a partner on his bringing ₹ 80,000 as share in goodwill and ₹ 1,40,000 as capital. It was agreed that A and B, as between themselves, will share profits and losses equally.

You are required to prepare : (i) Revaluation Account; (ii) Partners' Capital Accounts; (iii) Balance Sheet after all the adjustments are carried out.

25. A, B, C and D were in partnership sharing profits and losses as 4 : 3 : 2 : 1 respectively. The following is their Balance Sheet as on 31.12.2017 :

Liabilities	₹	Assets	₹
Capital Account — A	50,000	Furniture	40,000
Capital Account — B	70,000	Stock	20,000
Capital Account — C	60,000	Debtors	1,50,000
Capital Account — D	20,000	Bills Receivable	30,000
Trade Creditors	50,000	Profit & Loss A/c	10,000
	2,50,000		2,50,000

On the above date, B retired and the amount due to him was paid by the other partners in their profit-sharing ratio. It was agreed as among A, C and D that they should share in future as 3 : 3 : 2. E was then admitted as a partner on his bringing in ₹ 60,000 as capital and ₹ 20,000 as goodwill for 1/5th share in the future profits.

Show the Journal Entries for the above transactions and prepare the Balance Sheet of A, C, D and E after E's admission.

26. A, B and C were partners, sharing profits and losses in the proportion of 3 : 2 : 2 respectively. The Balance Sheet of the firm as on 1.1.2017 was as follows :

Liabilities	₹	Assets	₹
Capital Account — A	50,000	Plant and Machinery	36,000
Capital Account — B	40,000	Furniture	24,000
Capital Account — C	35,000	Stock	56,000
Bank Overdraft	10,000	Debtors	48,000
Sundry Creditors	28,000	Cash at Bank	9,000
	1,63,000		1,63,000

A retired on 1.1.2017, on which date D was admitted as a new partner. For the purpose of adjusting the rights as among the old partners, goodwill was to be valued at ₹ 42,000 and Sundry Debtors and Stock were to be reduced by ₹ 8,000 and ₹ 6,000 respectively. A was to receive ₹ 22,000 in cash on the date of retirement and the balance due to him was to remain on loan at 8% p.a., interest payable on 31st December each year on which date the firm closes its accounts. D was to bring in ₹ 50,000 in cash as his capital on the date of admission. The new partners were to share profits and losses equally after allowing interest on loan from A.

The net profit for the year ended 31.12.2017 was ₹ 33,200 before taking into account interest on loan from A. You are to prepare the following :

1. Capital Accounts of the partners as on 31.12.2017;
2. A's Loan Account as on 31.12.2017;
3. Profit and Loss Appropriation Account for the year ended 31.12.2017.

27. A, B and C are partners sharing profits equally. Their Balance Sheet on 30.6.2018 was :

Liabilities	₹	Assets	₹
Capital Account — A	1,00,000	Land and Property	1,00,000
Capital Account — B	1,00,000	Plant and Machinery	2,00,000
Capital Account — C	2,00,000	Furniture	50,000
Current Account — A	50,000	Stock-in-trade	1,00,000
Current Account — B	75,000	Debtors	1,00,000
Current Account — C	25,000	Cash at bank	1,50,000
Creditors	1,50,000		
	7,00,000		7,00,000

On 1.7.2018 A retires and it is agreed that he should be paid in full on that date all his dues. So, goodwill is calculated on the basis of 3 years' purchase of average profits of the past 3 years, such profits amounted to ₹ 1,00,000; ₹ 1,20,000 and ₹ 1,40,000. In order to meet this obligation, a bank loan is arranged as at 1.7.2018 for ₹ 2,00,000 by pledging fixed assets as security. To compensate a loyal manager D, it is agreed between B and C that D should be admitted as a partner who would bring in over and above a capital of ₹ 1,00,000, his share of goodwill in cash to serve as working capital. B and C agree to forego one-third of their individual share of profit to D. Show Journal and the Balance Sheet.

28. A, B and C are partners sharing profits and losses in the ratio of 6 : 5 : 3. Work-in-progress was not brought into the accounts. The Balance Sheet of the partnership as on 31.3.2018 showed the following position :

Liabilities	₹	Assets	₹
Capital A/cs :		Fixed Assets	35,350
A	25,000	Debtors	73,500
B	18,000	Bank	10,450
C	8,700		
Sundry Creditors	67,600		
	1,19,300		1,19,300

On the above date, A retired from the partnership and it was agreed to admit D as a partner on the following terms :

1. Goodwill was agreed at ₹ 13,720 and it is to be adjusted accordingly.
2. A is to take his car out of the partnership assets at an agreed value of ₹ 1,000. The car had been included in the accounts as on 31.3.2018 at a written-down value of ₹ 594.
3. Although work-in-progress had not been and will not be included in the partnership accounts, the new partners were to credit A with his share based on an estimate that work-in-progress was equivalent to 20% of the debtors.
4. The new partnership of B, C and D were to share profits in the ratio of 5 : 3 : 2. The initial capital of ₹ 25,000 subscribed in the profit-sharing ratio.
5. B, C and D were each to pay A the sum of ₹ 5,000 out of their personal resources in part repayment of his share of the partnership.
6. A to lend to D any amount required to make up his capital in the firm from the money due to him, and any further balance due to A was to be left in the new partnership as a loan bearing, interest at 9% p.a. Any adjustment required to the Capital Accounts of B and C were to be paid into or withdrawn from the partnership Bank Account.

You are required to prepare the Partners' Capital Accounts and the Balance Sheet.

29. Sun, Moon and Jupiter are partners in a business, sharing profits and losses in the ratio of 5 : 3 : 2.

It is provided, in the partnership deed, that the goodwill of the firm shall be equal to 2.5 times the average annual profits of the four years to the date of change, and that the consideration for the changes in the partners' shares, is to be calculated on this basis, but the Goodwill Account is not be brought into the firm's books. Profits, of the firm, have been : 2014 – ₹ 30,000; 2015 – ₹ 32,000; 2016 – ₹ 28,000; and 2017– ₹ 46,000. It was agreed that :

(a) On December 31, 2017 Moon and Jupiter should each acquire from Sun, an additional 1/10th share in the firm.

(b) On January 1, 2018 Venus (son of Sun) should be admitted into the partnership on the following terms : His share to be one-eighth, of which a proportion, calculated to produce ₹ 3,400 p.a. on the basis of the annual average of the past profits set out above, is to be ceded to him by his father, the balance to be purchased by him (Venus) from Moon and Jupiter, in proportion to their respective shares as they were immediately prior to the admission of Venus.

(c) On December 31, 2018 Sun should retire and the continuing partners should acquire his share of goodwill in such proportion as would make them equal owners of the same, the value of goodwill remaining unchanged and the item of goodwill not to be brought into the books as an asset.

You are required :

(i) to set out the Journal Entries necessary to record the foregoing matters in the books of the firm; and

(ii) to set out the revised proportion in which the partners share the profits following the admission of Venus. (Calculations to be made to the nearest rupee).

Guide to Answers

Practical Questions

1. **Revaluation profit — ₹ 8,500; Balance Sheet total — ₹ 1,70,500.**
2. **Revaluation loss — ₹ 2,100; Balance Sheet total — ₹ 1,30,600.**
3. **Revaluation profit — ₹ 3,900; Balance Sheet total — ₹ 1,62,900.**
4. **Revaluation profit — ₹ 12,600; Balance Sheet total — ₹ 2,52,250.**
5. **Revaluation loss — ₹ 50,000; Balance Sheet total — ₹ 4,20,000.**
6. **Transfer to B's Loan Account ₹ 10,845; Balance Sheet ₹ 33,705.**
7. **Revaluation loss ₹ 2,000; Amount paid to P ₹ 16,200; Capital Account balances — Q ₹ 17,333; R : ₹ 12,667; Balance Sheet — ₹ 42,000.**
8. **Revaluation profit ₹ 3,300; A's Loan Account ₹ 69,650; Capital balances : B — ₹ 41,100; C — ₹ 24,500; Balance Sheet ₹ 1,94,500.**
9. **Revaluation loss ₹ 1,500; B's Loan Account ₹ 15,500; Balance Sheet ₹ 57,000.**
10. **Revaluation loss ₹ 5,836; Amounnt paid to B ₹ 19,542.**
11. **C's share of goodwill ₹ 44,980 (app.); C's share of adjusted profit ₹ 5,940 (app.); Amount due to C ₹ 6,00,920.**
12. **Revaluation profit ₹ 12,000; A's Loan Account ₹ 1,63,500; Capital Balance — B ₹ 64,000; C ₹ 12,000; Balance Sheet ₹ 2,77,000.**
13. **Revaluation profit ₹ 2,000; Adjusted profit ₹ 1,000; Capital Account balances — A ₹ 22,400; B ₹ 11,350; C ₹ 35,250; Current Account balances — A ₹ 2,100; B ₹ 4,900 (Dr.); C ₹ 2,400.**
14. **B's share of profit : ₹ 8,500; ₹ 6,000; ₹ 10,000; ₹ 3,010; B's share of goodwill ₹ 16,000; Amount due to B ₹ 32,110.**
15. **Entry for unexpired insurance : Unexpired insurance (Dr.) and Revaluation Account (Cr.); Goodwill to be adjusted through Capital Accounts : Debit A's capital ₹ 45,000 and C's capital ₹ 15,000; Credit B's capital ₹ 60,000; Profit on revaluation ₹ 30,000. B's Loan's Account ₹ 3,20,000; Capital Account balances — A ₹ 4,20,000; C ₹ 1,40,000; Balance Sheet ₹ 10,03,000.**
16. **Amount payable to B — ₹ 46,700; Interest — 1st ₹ 2,202; 2nd ₹ 1,734; 3rd ₹ 1,238; 4th ₹ 712; 5th ₹ 155.**
17. **Interest — 1st ₹ 5,000; 2nd ₹ 5,250; 3rd ₹ 3,750; 4th ₹ 2,000; 5th ₹ 100.**
18. **Revaluation loss ₹ 3,000; Value of goodwill ₹ 52,800; A's Loan Account ₹ 42,470; Bank balance ₹ 20,000; Capital balances — B ₹ 50,181; C ₹ 37,349; Balance Sheet ₹ 2,52,000.**
19. **Revaluation loss ₹ 15,400; Value of goodwill ₹ 80,000; Amount due to B ₹ 1,10,610; Capital balances — A ₹ 79,840; B ₹ 20,150; Balance Sheet ₹ 2,54,800.**
20. **Total Capital of B and C — ₹ 30,775; Cash to be brought-in by B — ₹ 21,275 and by C — ₹ 2,425; Value of goodwill ₹ 17,400; Profit for 6 months upto the date of retirement — ₹ 4,450; Claim of A on Revenue Account — ₹ 3,975; Claim of A on the rest — ₹ 23,700.**
21. **Share of Profit : A ₹ 2,010; B ₹ 2,010; C 2,680; Revaluation profit ₹ 14,000; Adjusted capital of A and B — ₹ 1,45,000; Goodwill — ₹ 49,800.**

Admission-cum-Retirement

22. **Revaluation profit ₹ 28,000; Capital balances — B ₹ 82,500; D ₹ 27,500; Balance Sheet ₹ 1,20,000.**
23. **Revaluation profit ₹ 62,000; Capital balances — A ₹ 85,422; B ₹ 50,800; D — ₹ 27,111; Balance Sheet ₹ 2,51,400.**
24. **Revaluation profit ₹ 42,000; Payment to C ₹ 1,40,000; Capital balances — A ₹ 2,04,000; B ₹ 1,56,000; D ₹ 1,40,000; Balance Sheet ₹ 6,30,000.**
25. **Goodwill ₹ 1,00,000; Profit sharing ratio A, C, D and E is 3 : 3 : 2 : 2. Balance Sheet ₹ 3,20,000.**
26. **Share of profit to B, C and D ₹ 10,000 each; A's Loan Account ₹ 40,000; Capital balances : B — ₹ 44,000; C — ₹ 49,000; D— ₹ 46,000.**
27. **Share of goodwill of A ₹ 1,20,000; D will bring in premium ₹ 1,20,000; Amount paid to A ₹ 2,70,000; Cash balance ₹ 3,00,000; Balance Sheet ₹ 8,50,000.**
28. **A's share of W.I.P. ₹ 6,300; Capitals — A ₹ 12,500; B ₹ 7,500; D ₹ 5,000; Balance Sheet ₹ 1,07,360.**
29. **Sun : Moon : Jupiter : Venus = 168 : 44 : 37 : 175.**

5

Death of a Partner

Introduction

The accounting procedures on the death of a partner are very similar to those that cover a partner's retirement. The retirement of a partner is voluntary in character and can be anticipated but death of a partner may occur any time. When a partner dies, a firm has to face the following problems : (1) Calculation of deceased partner's financial interest in the firm; and (2) Determination of the mode of payment.

Ascertainment of Financial Interest

The executors of the deceased partner have the following claims from the firm:

(i) Balance of Capital Account of the deceased partner as per the last Balance Sheet.
(ii) Share of Goodwill of the firm.
(iii) Share of accumulated Profit/Reserve.
(iv) Share of revaluation Profit/Loss.
(v) Share of Joint Life Policy taken by the firm.
(vi) Share of profit from the date of the last Balance Sheet to the date of death.

The problems relating to first four items have already been discussed chapter 29 (Retirement of a partner).

Here, we will discuss the matters relating to:

(i) Joint Life Insurance Policy; and
(ii) Profits earned by the firm from the date of the last Balance Sheet to the date of death.

(i) Joint Life Insurance Policy

Partners commonly take out a joint life insurance policy on the lives of all the partners to provide cash to pay the amount due to the executors of the deceased partner.

The insurance policy matures on the happening of the *first death*. When a partner dies, the firm receives the policy money and it is distributed amongst the partners (including the deceased partner) in the profit-sharing ratio. The main advantage of this policy is that it removes the hardship which might be caused by the untimely death of a partner.

The joint life insurance policy may be dealt with in the accounts by any of the following methods:

(a) ***Without taking surrender value into account***.
(b) ***Taking surrender value into account***.

Meaning of Surrender Value Surrender value is the amount receivable on a life insurance policy that is cancelled before the end of its term. In other words, it is the amount which an insurance company is prepared to return to the policy-holder if the policy is surrendered. The surrender value is calculated according to a formula adopted by the insurance company which is made known to the policyholder at the time he takes out the policy. It is usually specified in the contract. Surrender values are very low during the early years of a policy. Surrender value of a policy develops after the first few years that the policy is in force and accumulates subsequently by annual increments which is generally equal to a portion of the aggregate amount of premium paid. It should be noted that the policy issued by the Life Insurance Corporation of India acquires surrender value after two annual premiums have been paid. However, in examination problems, we may find exceptions to this rule. At any point of time, the surrender value of policy represents an asset.

Meaning of 'with profits' or 'without profits' Policy In case of a ''without profits'' policy, the holder will get only the amount specified in the policy. In case of a 'with profits' policy, the holder will get the amount specified in the policy *plus bonuses declared on each valuation.*

(a) Without taking Surrender Value into Account

Under this method, premia paid on the policy are charged to Profit and Loss Account as an expense, thus reducing divisible profits and, in effect, charging the partners with the cost of the policy in their profit sharing ratio. No Joint Life Insurance Policy is opened in the books and nothing is shown in the Balance Sheet. At any time, the surrender value of policy represents a secret reserve. On the death of a partner, the cash received is debited to Bank Account and credited to Partners' Capital Accounts (including deceased partner) in the profit-sharing ratio. The cash so made available can be applied for payment to the executors of the deceased partner.

Summary of Accounting Entries

(a) For recording payment of premia

Joint Life Insurance Premium Account	Dr.	
To Bank Account		

(b) For closing Premium Account

Profit and Loss Account	Dr.	
To Joint Life Insurance Premium Account		

(c) For recording the receipts of policy money

Bank Account	Dr.	[Amount received]
To Joint Life Policy Account		

(d) For distributing policy money

Joint Life Policy Account	Dr.	
To All Partners' Capital Accounts		[Old ratio]

Instead of passing (c) & (d) entries above, we can pass a combined entry:

Bank Account	Dr.	[Amount received]
To All Partners' Capital Accounts		[Old ratio]

(b) Taking Surrender Value into Account

This method can be divided into: (a) Joint Life Policy Method; and (b) Joint Life Policy Reserve Method.

(a) Joint Life Policy Method : Under this method, a Joint Life Policy Account is opened in the books. The premia are debited to Joint Life Policy Account as and when paid. At the end of each year, the book value of the policy is adjusted to its surrender value by transferring the difference between the premium paid and the increase in the surrender value to Profit and Loss Account. The policy will appear in the Balance Sheet at its ***Surrender Value*** on the assets side.

Summary of Accounting Entries

(a) For recording payments of premia

Joint Life Policy Account	Dr.	
To Bank Account		

(b) For adjusting the book value of policy with its surrender value

Profit and Loss Account Dr.
To Joint Life Policy Account

(c) For realization of Policy money

Bank Account Dr.
To Joint Life Policy Account

(d) The credit balance of Joint Life Policy Account is transferred to Partners' Capital Accounts in the old Profit-Sharing ratio.

(b) Joint Life Policy Reserve Method : Under this method also a Joint Life Policy Account is opened in the books, to which the premia are debited as and when paid. At the end of each year, an amount equal to annual premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Reserve Account. The book value of the policy is adjusted to its surrender value by a transfer from Joint Life Policy Reserve Account. After adjustment, the Joint Life Policy will appear on the assets side of the Balance Sheet at surrender value and Joint Life Policy Reserve will also appear in the Balance Sheet, but on the liabilities side. On the death of a partner, the money received under the policy will be debited to Bank Account and credited to Joint Life Policy Account. The ultimate balance of the Joint Life Policy Account is transferred to Joint Life Policy Reserve Account. The final balance of the Joint Life Policy Reserve Account is transferred to Partners' Capital Accounts (including the deceased) in the old profit-sharing ratio.

Summary of Accounting Entries

(a) For recording payment of premia

Joint Life Policy Account Dr.
To Bank Account

(b) For appropriation of amount equal to annual premium

Profit and Loss Appropriation Account Dr.
To Joint Life Policy Reserve Account

(c) For adjusting the difference between the premium paid and the increase in the surrender value

Joint Life Policy Reserve Account Dr.
To Joint Life Policy Account

(d) For realization of policy money

Bank Account Dr.
To Joint Life Policy Account

(e) For transferring the credit balance of Joint Life Policy Account

Joint Life Policy Account Dr.
To Joint Life Policy Reserve Account

(f) The final balance of the Joint Life Policy Reserve Account is transferred to Partners' Capital Accounts in the old profit-sharing ratio (including deceased partner)

Individual Policies

Instead of joint life policy, partners may take individual policies for each partner. In the event of the death of a partner, the policy of the deceased partner will mature and the firm is entitled to the full value of the policy. In such a case, the deceased partner's legal representatives will be entitled to the proportional share of: (a) the total value of the policy matured; plus (b) surrender values of the other policies.

(ii) Ascertainment of share of profit from the date of last Balance Sheet to the date of death

The executors of the deceased partner are entitled to a share of profit earned by the firm from the date of last Balance Sheet and to the date of death. The profits of this period will be calculated on the basis of the provision of the partnership deed. Generally, the following two methods are followed for finding out the profit of the said period: (a) on the basis of time; and (b) on the basis of turnover.

(a) On the Basis of Time: Under this method, profits of the year is distributed between the pre-death period and post-death period on time basis assuming that profits have been accrued evenly throughout the year. The pre-death period's profit is distributed among all the partners (including deceased) in the old profit-sharing ratio.

Example: A, B & C were partners sharing profits and losses in the ratio of 3:2:1. On 1st March 2018, C died. The average profits of the firm for the last four years were ₹ 72,000. Assume the date of closing to be 31st December every year.

C's share of profit is calculated as follows:

Total profit for the year	₹ 72,000
Pre-death period's profit (2 months)	₹ 12,000
Post -death period's profit (10 months)	₹ 60,000
C's share of profit 1/6 of ₹ 12,000	₹ 2,000

(b) On the Basis of Turnover: Under this method, profit for the year is distributed on the basis of turnover between pre-death period and post-death period. The pre-death period's profit is divided among all partners (including the deceased) in the old profit-sharing ratio.

Example: X, Y & Z are equal partners. On 30th June 2017, X died. The profit for the year ended on 31st December 2017 is ₹ 60,000. The total turnover for the year 2017 is ₹ 6,00,000. Turnover up to 30th June 2017 is ₹ 4,50,000.

X's share of profit is calculated as follows:

Total Profit for the year	₹ 60,000
Pre-death period's profit = 60,000 x 4,50,000/6,00,000	₹ 45,000
X's share of profit 1/3 of ₹ 45,000	₹ 15,000

Mode of Payment

Similar to that of 'Retirement of a Partner'.

Illustration 1

X, Y & Z are partners sharing profits and losses in the ratio of 2:2:1. On 1st January 2015, they took out a joint life policy of ₹ 1,00,000. Annual premium of ₹ 5,000 was payable on 1st January each year. Last premium was paid on 1st January 2018. Y died on 1st March, 2018, and policy money was received on 31st March, 2018.

The surrender value of policy as on 31st December each year were as follows :

2015 — Nil ; 2016 — ₹ 1,000; 2017 — ₹ 2,500.

Show necessary accounts and Balance Sheet as on 31st December, each year, assuming that:

1. The premium is charged to Profit and Loss Account every year.
2. The premium is debited to Joint Life Policy Account and the balance of the Joint Life Policy Account is adjusted every year to its surrender value.
3. The premium is debited to Joint Life Policy Account and a sum equal to premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Fund.

Solution

Case 1 : In this case, premium paid is charged to Profit and Loss Account every year, so nothing will appear in the Joint Life Policy Account and in the Balance Sheets of 2015; 2016 and 2017.

However, in 2018 the Joint Life Policy Account will appear as follows:

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Partners' Capital A/cs (X — 40,000; Y — 40,000; Z — 20,000)	1,00,000	31.3.2018	By Bank A/c (policy money received)	1,00,000
		1,00,000			1,00,000

Case 2

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c—Premium	5,000	31.12.2015	By Profit & Loss A/c	5,000
1.1.2016	To Bank A/c—Premium	5,000	31.12.2016	By Profit & Loss A/c	4,000
			31.12.2016	By Balance c/d	1,000
		5,000			5,000

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	1,000	31.12.2017	By Profit & Loss A/c	3,500
1.1.2017	To Bank A/c—Premium	5,000	31.12.2017	By Balance c/d	2,500
		6,000			6,000
1.1.2018	To Balance b/d	2,500	31.3.2018	By Bank A/c (policy money received)	1,00,000
1.1.2018	To Bank A/c—Premium	5,000			
31.3.2018	To Partners' Capital A/cs (X—37,000; Y—37,000; Z—18,500)	92,500			
		1,00,000			1,00,000

Balance Sheet as at 31st December, 2015

Liabilities	₹	Assets	₹
		Joint Life Policy	Nil

Balance Sheet as at 31st December, 2016

Liabilities	₹	Assets	₹
		Joint Life Policy	1,000

Balance Sheet as at 31st December, 2017

Liabilities	₹	Assets	₹
		Joint Life Policy	2,500

Case 3

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c—Premium	5,000	31.12.2015	By Joint Life Policy Fund A/c	5,000
1.1.2016	To Bank A/c—Premium	5,000	31.12.2016	By Joint Life Policy Fund A/c	4,000
			31.12.2016	By Balance c/d	1,000
		5,000			5,000
1.1.2017	To Balance b/d	1,000	31.12.2017	By Joint Life Policy Fund A/c	3,500
1.1.2017	To Bank A/c—Premium	5,000	31.12.2017	By Balance c/d	2,500
		6,000			6,000
1.1.2018	To Balance b/d	2,500	31.3.2018	By Bank A/c (policy money received)	1,00,000
1.1.2018	To Bank A/c—Premium	5,000			
31.3.2018	To Joint Life Policy Fund A/c	92,500			
		1,00,000			1,00,000

Dr. **Joint Life Policy Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Joint Life Policy A/c	5,000	31.12.2015	By Profit & Loss Appropriation A/c	5,000
31.12.2016	To Joint Life Policy A/c	4,000	31.12.2016	By Profit & Loss Appropriation A/c	5,000
31.12.2016	To Balance c/d	1,000			
		5,000			5,000
31.12.2017	To Joint Life Policy A/c	3,500	1.1.2017	By Balance b/d	1,000
31.12.2017	To Balance c/d	2,500	31.12.2017	By Profit & Loss Appropriation A/c	5,000
		6,000			6,000
31.3.2018	To Partners' Capital A/cs (X—38,000; Y—38,000; Z—19,000)	95,000	1.1.2018	By Balance b/d	2,500
			31.3.2018	By Joint Life Policy A/c	92,500
		95,000			95,000

Balance Sheet as at 31st December, 2015

Liabilities	₹	Assets	₹
Joint Life Policy Fund	Nil	Joint Life Policy	Nil

Balance Sheet as at 31st December, 2016

Liabilities	₹	Assets	₹
Joint Life Policy Fund	1,000	Joint Life Policy	1,000

Balance Sheet as at 31st December, 2017

Liabilities	₹	Assets	₹
Joint Life Policy Fund	2,500	Joint Life Policy	2,500

Illustration 2

X, Y and Z are partners in a firm, sharing profits in the ratio of 2 : 2 : 1. They took out a Joint Life Policy in 2014 for ₹ 65,000. On 1st February, 2018, Z died. The surrender value of the policy appearing in the books on that date was ₹ 15,000. Pass the necessary Journal Entries to close the Joint Life Policy Account.

Solution

In the books of the firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 ?	Bank A/c	Dr.	65,000	
	To Joint Life Policy A/c			65,000
	(Being the receipt of the policy value)			
	Joint Life Policy A/c : ₹ (65,000 – 15,000)	Dr.	50,000	
	To X Capital A/c			20,000
	To Y Capital A/c			20,000
	To Z Capital A/c			10,000
	(Being the balance of the Joint Life Policy Account transferred to all the Partners' Capital Accounts in the ratio of 2 : 2 : 1)			

Illustration 3

M/s A, B and C who share profits and losses in the ratio of 3:2:2, arranged for a joint life policy of the partners of ₹ 50,000 from 5.3.2015 in order to provide for the repayment of the deceased partner's share. The annual premium of ₹ 1,000 is debited to the Joint Life Policy Account. The premia were paid on 5th March of every year and the last of such premium was paid in 2018. The surrender values of the policy in the various years are: 2015 — Nil; 2016 — ₹ 100; 2017 — ₹ 250. A died on 14.4.2018 and the policy amount was secured in full on 30.4.2018. Show the Joint Life Policy Account and the Joint Life Policy Reserve Account assuming that the accounts were closed on 30th April every year.

Solution

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
5.3.2015	To Bank A/c—Premium	1,000	30.4.2015	By Joint Life Policy Reserve A/c	1,000
5.3.2016	To Bank A/c—Premium	1,000	30.4.2016	By Joint Life Policy Reserve A/c	900
			30.4.2016	By Balance c/d	100
		1,000			1,000
1.5.2016	To Balance b/d	100	30.4.2017	By Joint Life Policy Reserve A/c	850
5.3.2017	To Bank A/c—Premium	1,000	30.4.2017	By Balance c/d	250
		1,100			1,100
1.5.2017	To Balance b/d	250	30.4.2018	By Bank A/c (money received)	50,000
5.3.2018	To Bank A/c—Premium	1,000			
30.4.2018	To Joint Life Policy Reserve A/c	48,750			
		50,000			50,000

Dr. Joint Life Policy Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Joint Life Policy A/c	1,000	30.4.2015	By Profit & Loss Appropriation A/c	1,000
30.4.2016	To Joint Life Policy A/c	900	30.4.2016	By Profit & Loss Appropriation A/c	1,000
30.4.2016	To Balance c/d	100			
		1,000			1,000
30.4.2017	To Joint Life Policy A/c	850	1.5.2016	By Balance b/d	100
30.4.2017	To Balance c/d	250	30.4.2017	By Profit & Loss Appropriation A/c	1,000
		1,100			1,100
30.4.2018	To Partners' Capital A/cs :		1.5.2017	By Balance b/d	250
	(A—21,000; B—14,000; C—14,000)	49,000	30.4.2018	By Joint Life Policy A/c	48,750
		49,000			49,000

Illustration 4

The following is the Balance Sheet of V. Fishy & Co. as at 31st December, 2017.

Balance Sheet as at 31st December, 2017

Liabilities	₹	Assets	₹
Capital : Mahseer	4,100	Machinery	5,000
Salmon	4,100	Furniture	2,800
Carp	4,500	Fixture	2,100

General Reserve	1,500	Cash		1,500
Creditors	2,350	Stock		950
		Debtors	4,500	
		Less: Provision for Bad Debts	300	4,200
	16,550			16,550

Carp died on 3rd January, 2018 and the following agreement was to be put into effect :

(a) Assets were to be revalued : Machinery to ₹ 5,850; Furniture to ₹ 2,300; Stock to ₹ 750.

(b) Goodwill was valued at ₹ 3,000 and Carp was to be credited with his share, without using a Goodwill Account.

(c) ₹ 1,000 was to be paid away to the executors of the dead partner on 5th January, 2018.

You are required to show :

(i) The Journal Entry for Goodwill adjustment.

(ii) The Revaluation Account and Capital Accounts of the partners.

(iii) Which account would be debited and which account credited if the Provision for Bad Debts in the Balance Sheet was to be found unnecessary to maintain at the death of Carp ?

Solution

Workings **(i) Statement Showing the Required Adjustment for Goodwill**

Particulars		Mahseer	Salmon	Carp
Right of goodwill before death (1 : 1 : 1)*	(₹)	1,000	1,000	1,000
Right of goodwill after death (1 : 1)*	(₹)	1,500	1,500	—
Gain (+) / Sacrifice (–)	(₹)	(+) 500	(+) 500	(–) 1,000

* Profit sharing ratio is equal before or after the death of Carp because nothing has been mentioned in respect of profit-sharing ratio.

In the books of the firm

Journal **Dr. Cr.**

Date	Particulars		₹	₹
2018	Mahseer Capital A/c	Dr.	500	
Jan. 3	Salmon Capital A/c	Dr.	500	
	To Carp Capital A/c			1,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Dr. **(ii) Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Furniture A/c (₹ 2,800 – 2,300)	500	By Machinery A/c (₹ 5,850 – 5,000)	850
To Stock A/c (₹ 950 – 750)	200		
To Partners' Capital A/cs : (Mahseer—₹ 50; Salmon—₹ 50; Carp—₹ 50)	150		
	850		850

Dr. **Partners' Capital Account** **Cr.**

Particulars	Mahseer	Salmon	Carp	Particulars	Mahseer	Salmon	Carp
To Carp Capital A/c (Goodwill)	500	500	—	By Balance b/d	4,100	4,100	4,500
To Cash A/c	—	—	1,000	By General Reserve A/c	500	500	500
To Carp Executors A/c	—	—	5,050	By Revaluation A/c (Profit)	50	50	50
To Balance c/d	4,150	4,150	—	By Mahseer Capital A/c (Goodwill)	—	—	500
				By Salmon Capital A/c (Goodwill)	—	—	500
	4,650	4,650	6,050		4,650	4,650	6,050

(iii) Provision for Bad Debts Account is a credit balance. To close this, this account is to be debited. It becomes a gain for the partners. Therefore, either Partners' Capital Accounts (including Carp) or Revaluation Account is to be credited.

Illustration 5

Bimla and Nutan were partners. The partnership deed provides inter alia :

(i) That the accounts be balanced on 31st December each year.

(ii) That the profits be divided as follows :
Bimla : one-half; Nutan : one-third; and carried to Reserve Account : one-sixth.

(iii) That in the event of death of a partner, his executor will be entitled to the following :
(a) the capital to her credit at the date of death; (b) her proportion of profit to date of death based on the average profits of the last three completed years; (c) her share of goodwill based on three years' purchases of the average profits for the three preceding completed years.

Trial Balance on 31st December, 2017

Particulars	Dr. (₹)	Cr. (₹)
Bimla Capital		90,000
Nutan Capital		60,000
Reserve		30,000
Bills Receivable	50,000	
Investments	40,000	
Cash	1,10,000	
Creditors		20,000
	2,00,000	2,00,000

The profits for the three years were : 2015 : ₹ 42,000; 2016 : ₹ 39,000; and 2017 : ₹ 45,000. Nutan died on 1st May, 2018. Show the calculation of Nutan's (i) Share of profits; (ii) Share of Goodwill; and (iii) Draw up Nutan's Executors Account as would appear in the firm's ledger transferring the amount to her Loan Account.

Solution

(i) Ascertainment of Nutan's Share of Profit	₹	(ii) Ascertainment of Value of Goodwill	₹
2015	42,000	2015	42,000
2016	39,000	2016	39,000
2017	45,000	2017	45,000
Total profit	1,26,000	Total profit for 3 years	1,26,000
Average profit	42,000	Average profit	42,000
4 Months' Profit	14,000	Goodwill—3 years' purchase of Average Profit	1,26,000
Nutan's Share in Profit (2/5th* of ₹ 14,000)	**5,600**	**Nutan's Share of Goodwill (*2/5 of ₹ 1,26,000)**	**50,400**

* Profit sharing ratio between Bimla and Nutan = 1/2 : 1/3 = 3 : 2. Therefore, Nutan's share of Profit = 2/5.

Dr. Nutan's Executors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 May 1	To Nutan Loan A/c	1,28,000	2018 Jan. 1	By Nutan Capital A/c	60,000
			May 1	By Reserves A/c (2/5th of ₹ 30,000)	12,000
			May 1	By Goodwill A/c (share of goodwill)	50,400
			May 1	By P/L Suspense A/c (share of profit)	5,600
		1,28,000			1,28,000

Illustration 6

R, S and T were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On 31st December, 2016, their Balance Sheet stood as under :

Liabilities		₹	Assets	₹
Sundry Creditors		55,000	Leasehold	1,00,000
Reserve Fund		30,000	Patents	30,000
Capital Accounts :			Machinery	1,50,000
R	1,50,000		Stock	50,000
S	1,25,000		Debtors	40,000
T	75,000	3,50,000	Cash at Bank	65,000
		4,35,000		4,35,000

T died on 1st May, 2017. It was agreed that :

(a) Goodwill be valued at $2^1/_2$ years purchase of last four years' profits which were :
2013 — ₹ 55,000; 2014 — ₹ 50,000; 2015 — ₹ 60,000 and 2016 — ₹ 75,000.

(b) Machinery be valued at ₹ 1,40,000. Patents be valued at ₹ 40,000; Leasehold be valued at ₹ 1,25,000 on 1st May, 2017.

(c) For the purpose of calculating T's share in the profits of 2017, the profits in 2017 should be taken to have accrued on the same scale as in 2016.

(d) A sum of ₹ 21,000 to be paid immediately to the executors of T and the balance to be paid in four equal half-yearly instalments together with interest @ 10% interest per annum.

Pass the necessary journal entries to record the above transactions. Also show T Capital Account and T's Executors Account for 2017.

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017 May 1	Revaluation A/c	Dr.	10,000	
	To Machinery A/c			10,000
	(Being the downward revaluation of machinery)			

Patents A/c	Dr.	10,000	
Leasehold A/c	Dr.	25,000	
To Revaluation A/c			35,000
(Being the upward revaluation of patents and leasehold)			
Revaluation A/c (₹ 35,000 – ₹ 10,000)	Dr.	25,000	
To R Capital A/c			12,500
To S Capital A/c			7,500
To T Capital A/c			5,000
(Being the profit on revaluation transferred to Partners' Capital Accounts in the ratio of 5 : 3 : 2)			
R Capital A/c	Dr.	18,750	
S Capital A/c	Dr.	11,250	
To T Capital A/c			30,000
(Being the adjustment of goodwill)			
Profit and Loss Suspense A/c (Note 2)	Dr.	5,000	
To T Capital A/c			5,000
(Being the proportionate share of profit for 2017 credited to T's Capital Account)			
Reserve Fund A/c	Dr.	30,000	
To R Capital A/c			15,000
To S Capital A/c			9,000
To T Capital A/c			6,000
(Being the reserve fund transferred to Partners' Capital Accounts)			
T Capital A/c	Dr.	1,21,000	
To T's Executors A/c			1,21,000
(Being T's Capital Account balance transferred to his Executor's Account)			
T's Executors A/c	Dr.	21,000	
To Bank A/c			21,000
(Being the payment of ₹ 21,000 to T's executors)			

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

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
May 1	To T's Executors A/c	1,21,000	May 1	By Balance b/d	75,000
				By Revaluation A/c (profit)	5,000
				By R Capital A/c	18,750
				By S Capital A/c	11,250
				By Profit and Loss Suspense A/c	5,000
				By Reserve Fund A/c	6,000
		1,21,000			1,21,000

Dr. **T's Executors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
May 1	To Bank A/c	21,000	May 1	By T Capital A/c	1,21,000
Oct. 31	To Bank A/c (₹ 25,000 + 5,000)	30,000	Oct. 31	By Interest A/c (₹ 1,00,000 x 10/100 x 6/12)	5,000
Dec. 31	To Balance c/d	76,250	Dec. 31	By Interest A/c (₹ 75,000 x 10/100 x 2/12)	1,250
		1,27,250			1,27,250

Working Notes :

(1) Ascertainment of Goodwill	₹	**(2) Ascertainment of T's share of profit for January to April 2017**	₹
2013	55,000	Profit of 2016	75,000
2014	50,000	Profit for 4 months	25,000
2015	60,000	T's share of profit—1/5th of ₹ 25,000	5,000
2016	75,000		
Total profit	2,40,000		
Average profit	60,000		
Goodwill ($2^1/_2$ years purchase of average profit)	1,50,000		

Illustration 7

The following was the Balance Sheet of A, B and C who share profits in the ratio of 1:2:2 as on 31.12.2017. C died on 31st March, 2018. His account has to be settled under the following terms :

Liabilities	₹	Assets	₹
Sundry creditors	10,000	Debtors	25,000
Capital (A—10,000; B—20,000; C—20,000)	50,000	Machinery	20,000

General Reserve	5,000	Building	30,000
Investment Fluctuation Fund	3,000	Stock	10,000
Bad Debts Reserve	2,000	Cash at bank	5,000
Bank Loan	30,000	Investments	10,000
	1,00,000		1,00,000

Goodwill is to be calculated at the rate of 3 years' purchase on the basis of the average of 5 years' profit or loss. Profit for January to March 2018 is to be calculated proportionately on the average profit of 3 years. The profits are: 2013 ₹ 3,000; 2014 ₹ 7,000; 2015 ₹ 10,000; 2016 ₹ 14,000; and 2017 Loss ₹ 12,000. During 2017, a moped costing ₹ 4,000 was purchased and debited to Travelling Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are: Building ₹ 37,000; and Machinery ₹ 25,000. Investment is valued at ₹ 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal Entries and Capital Accounts of the partners.

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018	A Capital A/c	Dr.	2,000	
March 31	B Capital A/c	Dr.	4,000	
	To C Capital A/c			6,000
	(Being the adjustment for goodwill)			
	Building A/c	Dr.	7,000	
	Machinery A/c	Dr.	5,000	
	To Revaluation A/c			12,000
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	2,000	
	To Investments A/c			2,000
	(Being the decrease in the value of investments)			
	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 Capital A/c			2,000
	To B Capital A/c			4,000
	To C Capital A/c			4,000
	(Being the transfer of the above reserves to the Partners' Capital Accounts in their profit-sharing ratio)			
	Moped A/c	Dr.	3,000	
	To A Capital A/c			600
	To B Capital A/c			1,200
	To C Capital A/c			1,200
	(Being the cost less depreciation value of moped recorded in the books)			
	Profit and Loss Suspense A/c	Dr.	500	
	To C Capital A/c			500
	(Being the estimated profit of 3 months credited to C)			
	Revaluation A/c	Dr.	10,000	
	To A Capital A/c			2,000
	To B Capital A/c			4,000
	To C Capital A/c			4,000
	(Being distribution of profit on revaluation in the profit-sharing ratio)			
	C Capital A/c	Dr.	35,700	
	To C Executors A/c			35,700
	(Being the estimated payable to C is transferred to his Executors Account)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To C Capital A/c	2,000	4,000	—	By Balance b/d	10,000	20,000	20,000
To C Executors A/c	—	—	35,700	By Revaluation A/c	2,000	4,000	4,000
To Balance c/d	12,600	25,200	—	By A Capital A/c	—	—	2,000
				By B Capital A/c	—	—	4,000
				By General & Other Reserve A/c	2,000	4,000	4,000
				By Moped A/c	600	1,200	1,200
				By Profit & Loss Suspense A/c	—	—	500
	14,600	29,200	35,700		14,600	29,200	35,700

Balance Sheet as on 31st March, 2018

Liabilities	₹	Assets	₹
Capital A/cs (A — 12,600; B — 25,200)	37,800	Building	37,000
Bank Loan	30,000	Machinery	25,000
Sundry creditors	10,000	Investments	8,000
C Executors A/c	35,700	Moped	3,000
		Stock	10,000
		Debtors	25,000
		Bank	5,000
		Profit and Loss Suspense A/c	500
	1,13,500		1,13,500

Working Notes :

(1) Ascertainment of Goodwill	₹	**(2) Ascertainment of C' share of profit for Jan to Mar 2018**	₹
2013	3,000	2015	10,000
2014	7,000	2016	14,000
2015	10,000	2017*	(–) 9,000
2016	14,000	Total profit for 3 years	15,000
2017*	(–) 9,000	Average profit	5,000
Total profit	25,000	3 months' profit	1,250
Average profit	5,000	C' share in profit	500
Goodwill (3 years' purchase of Average profit)	**15,000**		

*Loss 2017—₹ 12,000; Less cost of moped—₹ 4,000; Add: Depreciation 25% = ₹ 1,000; So actual loss of 2017 = ₹ 9,000.

Illustration 8

A, B and C were in partnership sharing profits and losses in the ratio of 5 : 4 : 3 respectively. A died on 31.12.2017, on which date the Balance Sheet of the firm was as under:

Liabilities	₹	Assets		₹
Capital Accounts:		Leasehold Premises	40,000	
(A—₹ 42,500; B—₹ 30,000; C—₹ 22,500)	95,000	Less: Accumulated depreciation	4,000	36,000
Current Accounts:		Plant	46,000	
(A—₹ 4,250; B—₹ 6,500; C—₹ 5,750)	16,500	Less: Accumulated depreciation	13,500	32,500
Loan Account: A	20,000	Stock		27,000
Creditors	21,250	Debtors	21,000	
		Less: Provision for doubtful debts	3,750	17,250
		Bank		40,000
	1,52,750			1,52,750

B and C decided to carry on the business sharing profits and losses in the ratio of 7 : 5 respectively. The following adjustments were made on 31.12.2017:

(a) Plant, stock and debtors were valued at ₹ 34,500, ₹ 24,300 and ₹ 16,850 respectively; (b) Valuer's charge of ₹ 700 was to be provided for; and (c) Goodwill was to be valued as equal to 3 years' purchase of super profits. The required return was to be calculated as 25% on partners' capital, current and loan accounts, and was to be set against weighted average profits of the last three years. The profits were: 2017 ₹ 52,000; 2016 ₹ 46,000; 2015 ₹ 45,250.

₹ 25,000 was repaid to A's executors on 1.1.2018, the balance owing to be a loan to the partnership.

Required: Necessary Ledger Accounts and the Balance Sheet on 1.1.2018.

Solution

Working Notes: **(a) Ascertainment of Goodwill and the Required Adjustment**

Year	Profit (₹)	Weight	₹
2015	45,250	1	45,250
2016	46,000	2	92,000
2017	52,000	3	1,56,000
		6	2,93,250

Weighted average profit ₹ 2,93,250/6 = ₹ 48,875.

Capital + Current + Loan Accounts
= ₹ 95,000 + ₹ 16,500 + ₹ 20,000 = ₹ 1,31,500.
Required return = 25% x ₹ 1,31,500 = ₹ 32,875.
Weighted average profit ₹ 48,875
Less: Required return ₹ 32,875
₹ 16,000
Therefore, goodwill is ₹ 16,000 x 3 = ₹ 48,000.

Partners		A	B	C
Right of goodwill before A's death (5 : 4 : 3)	(₹)	20,000	16,000	12,000
Right of goodwill after A's death (7 : 5)	(₹)	—	28,000	20,000
Gain (Cr.) / Sacrifice (Dr.)	(₹)	(Cr.) 20,000	(Dr.) 12,000	(Dr.) 8,000

In the books of the firm

Revaluation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Stock A/c	2,700	By Accumulated Depreciation A/c (Plant)	2,000
To Provision for bad debts A/c	400	By Partners' Capital A/cs:	
To Valuer's charges A/c	700	(A – ₹ 750; B – ₹ 600; C – ₹ 450)	1,800
	3,800		3,800

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

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	750	600	450	By Balance b/d	42,500	30,000	22,500
To A Capital A/c—goodwill	—	12,000	8,000	By B Capital A/c—goodwill	12,000	—	—
To Executors of A	61,750	—	—	By C Capital A/c—goodwill	8,000	—	—
To Balance c/d	—	17,400	14,050				
	62,500	30,000	22,500		62,500	30,000	22,500

Dr. **Executors of A Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	25,000	By A Capital A/c	61,750
To Balance c/d	61,000	By A Current A/c	4,250
		By A Loan A/c	20,000
	86,000		86,000

Balance Sheet as at 1st January, 2018 (after A's death)

Liabilities	₹	Assets		₹
Capital Accounts:		Leasehold Premises	40,000	
(B—₹ 17,400; C—₹ 14,050)	31,450	Less: Accumulated depreciation	4,000	36,000
Current Accounts:		Plant	46,000	
(B—₹ 6,500; C—₹ 5,750)	12,250	Less: Accumulated depreciation	11,500	34,500
Executors of A	61,000	Stock		24,300
Sundry Creditors (including valuer's charges of ₹ 700)	21,950	Debtors	21,000	
		Less: Provision for doubtful debts	4,150	16,850
		Bank (₹ 40,000 – 25,000)		15,000
	1,26,650			1,26,650

Illustration 9

A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. C died on 28th February, 2018. The Balance Sheet of the firm as on that date was as follows :

Liabilities	₹	Assets	₹
A's Capital A/c	1,20,000	Plant and Machinery	1,20,000
B's Capital A/c	80,000	Furniture and Fittings	75,000
C's Capital A/c	40,000	Investments	20,000
A's Current A/c	8,000	Stock-in-Trade	32,000
B's Current A/c	2,500	Sundry Debtors	25,000
Reserve	30,000	Bills Receivable	11,000
Bills Payable	17,000	Cash at Bank	18,500
Sundry Creditors	20,000	Cash in Hand	11,000
		C's Current A/c	5,000
	3,17,500		3,17,500

The following decisions were taken by the surviving partners :

(a) Goodwill is valued at ₹ 30,000.

(b) A Provision for Bad Debts is to be raised at 5% on debtors.

(c) While Plant and Machinery to be depreciated by 10%, Furniture is to be appreciated by 5%.

(d) Revised value of stock-in-trade will be ₹ 26,500.

(e) The fixed capital method is to be converted into the fluctuating capital method by transferring the Current Account balances to the respective Partners' Capital Accounts.

Prepare a Revaluation Account, Capital Account of the three partners, showing the necessary adjustment at C's death, and prepare C's Executors Account to show that C's Executor was paid off in two half-yearly equal instalments plus the interest at 10% p.a. on the unpaid balance, the first instalment was paid on 31st August, 2018.

Solution

In the books of the firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	1,250	By Furniture and Fittings A/c	3,750
To Plant and Machinery A/c	12,000	By Partners' Capital A/cs	
To Stock-in-trade A/c	5,500	(A : ₹ 7,500; B : ₹ 5,000; C : ₹ 2,500)	15,000
	18,750		18,750

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	7,500	5,000	2,500	By Balance b/d	1,20,000	80,000	40,000
To Partners' Current A/c	—	—	5,000	By Reserve A/c	15,000	10,000	5,000
To Goodwill A/c	18,000	12,000	—				
To C's Executors A/c	—	—	42,500	By Goodwill A/c	15,000	10,000	5,000
To Balance c/d	1,32,500	85,500	—	By Partners' Current A/cs	8,000	2,500	—
	1,58,000	1,02,500	50,000		1,58,000	1,02,500	50,000

Dr. C's Executors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 Aug.31	To Bank A/c	23,375	2018 Mar 1	By C Capital A/c	42,500
	To Balance c/d	21,250	Aug 31	By Interest A/c (for 6 months)	2,125
		44,625			44,625
2016 Feb 28	To Bank A/c	22,313	2018 Sept 1	By Balance b/d	21,250
			2016 Feb 28	By Interest A/c (for 6 months)	1,063
		22,313			22,313

Illustration 10

The following is the Balance Sheet of the firm ABC as on 31.12.2017. Their profit sharing ratio is 3 : 2 : 1.

Liabilities		₹	Assets	₹
Capital Accounts :			Fixed Assets	40,000
A : ₹ 16,000; B : ₹ 12,000; C : ₹ 10,000		38,000	Sundry Debtors	32,000
Current Accounts :			Joint Life Policy	6,000
A : ₹ 4,000; B : ₹ 3,000; C : ₹ 1,000		8,000	Stock	24,000
Reserves		18,000	Bank	9,000
Profit and Loss Account :			Cash	3,000
Opening Balance	6,000			
Profit for the period	14,000	20,000		
Creditors		20,000		
Bank Overdraft		10,000		
		1,14,000		1,14,000

B died on 31.3.2018. His account has to be settled and paid. For the year 2018, proportionate profit of 2017 is to be taken into account. For 2017, a bad debt of ₹ 2,000 has to be adjusted. Goodwill has to be calculated 3 times of the four years' average profits. A policy is taken on the joint life of partners for ₹ 35,000 and the premium of ₹ 2,000 has to be paid on February 1, every year. The profits for 2016 is ₹ 16,000, 2015 ₹ 20,000 and 2014 is ₹ 12,000. Goodwill Account need not be kept in the accounts. Calculate the amount payable to B's heirs. Show necessary Ledger Accounts of all partners and other detailed calculations.

Solution

In the books of firm

Dr. Partners' Current Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c—transfer	—	25,000	—	By Balance b/d	4,000	3,000	1,000
To Balance c/d	35,500	—	11,500	By Reserve A/c	9,000	6,000	3,000
				By Profit and Loss A/c (4)	9,000	6,000	3,000
				By P&L Suspense A/c	—	1,000	—
				By Joint Life Policy A/c	13,500	9,000	4,500
	35,500	25,000	11,500		35,500	25,000	11,500

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c—Goodwill	11,250	—	3,750	By Balance b/d	16,000	12,000	10,000
To Bank A/c	—	52,000	—	By A Capital A/c (Goodwill)	—	11,250	—
To Balance c/d	4,750	—	6,250	By C Capital A/c (Goodwill)	—	3,750	—
				By B Current A/c	—	25,000	—
	16,000	52,000	10,000		16,000	52,000	10,000

Dr. **Joint Life Policy Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Bank A/c—policy value	35,000
To Bank A/c—premium paid in February 2018	2,000		
To Partners' Current A/cs (A—₹ 13,500; B—₹ 9,000; C—₹ 4,500)	27,000		
	35,000		35,000

Working Notes :

(1) Calculation of Goodwill

Total profit for the last 4 years	₹
2017 (₹ 14,000 – ₹ 2,000)	12,000
2016	16,000
2015	20,000
2014	12,000
	60,000

Average profit = ₹ 60,000 / 4 = ₹ 15,000

Goodwill is 3 years' purchase of the average profit of last 4 years = ₹ 15,000 x 3 = ₹ 45,000.

(2) Adjustment for Goodwill

Particulars		A	B	C
Right of goodwill before death (3 : 2 : 1)	(₹)	22,500	15,000	7,500
Right of goodwill after death (3 : 1)	(₹)	33,750	—	11,250
Gain (+) / Sacrifice (–)	(₹)	(+) 11,250	(–) 15,000	(+) 3,750

(3) Calculation of B's share of profits
Profit for 2017 — ₹ 12,000. Profit for 3 months — ₹ 12,000 / 12 x 3 = ₹ 3,000. B's share is 2/6th of ₹ 3,000 = ₹ 1,000.

(4) After adjustment of bad debts, the balance of Profit and Loss Account comes to ₹ 18,000 (₹ 20,000 – ₹ 2,000).

Illustration 11

A, B and C share profits and losses in the ratio of 5:3:2. Partner A died on February 20, 2018. The Profit and Loss Account for the period up to the date of death and the Balance Sheet as on that date were prepared.

Balance Sheet as on 20th February, 2018

Liabilities	₹	Assets	₹
Capital Accounts:		Land	6,000
(A—12,000; B—16,000; C—12,000)	40,000	Machinery	35,000
Loan from A	5,000	Furniture	6,000
General Reserve	7,000	Stock	9,000
Creditors	22,000	Debtors	15,000
		Bank	3,000
	74,000		74,000

In addition to the assets shown above, the firm had three life policies in the name of each partner, at an insured value of ₹ 20,000 each, the premiums of which were charged to the Profit and Loss Account.

According to the partnership deed, on the death of a partner, the assets and liabilities are to be revalued by a valuer. The revalued figures were:

1. Land ₹ 21,000; machinery ₹ 45,000; debtors are subject to a provision for doubtful debts at 10%; and furniture ₹ 7,000.
2. Provision for taxation to be created for ₹ 1,500.
3. Death claim for policy in the name of A realised in full and the surrender value of the other two policies were ₹ 7,500 each.

The business will be continued by B and C, henceforth sharing profits and losses equally. The net balance due to A is transferred to a Loan Account, which will be paid off later.

Show the Capital Account, Revaluation Account and the New Balance Sheet of the firm.

Solution

In the books of the Firm

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

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts A/c	1,500	By Land A/c	15,000
To Provision for Taxation A/c	1,500	By Machinery A/c	10,000
To Partners' Capital A/cs (A—11,500; B—6,900; C—4,600)	23,000	By Furniture A/c	1,000
	26,000		26,000

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

Particulars	A	B	C	Particulars	A	B	C
To A Executors A/c	44,500	—	—	By Balance b/d	12,000	16,000	12,000
To Balance c/d	—	35,500	25,000	By Bank A/c (J.L.P.)	10,000	6,000	4,000
				By General Reserve A/c	3,500	2,100	1,400
				By Joint Life Policy A/c	7,500	4,500	3,000
				By Revaluation A/c	11,500	6,900	4,600
	44,500	35,500	25,000		44,500	35,500	25,000

Balance Sheet (after A's death)

Liabilities	₹	Assets	₹
Capital Accounts:		Land	21,000
(B—35,500; C—25,000)	60,500	Machinery	45,000
A Executors A/c	49,500	Furniture	7,000
Creditors	22,000	Stock	9,000
Provision for taxation	1,500	Joint Life Policy (surrender value)	15,000
		Debtors (₹ 15,000 Less: Provision—1,500)	13,500
		Bank (₹ 3,000 + 20,000)	23,000
	1,33,500		1,33,500

Working Notes :

Dr. **(1) Joint Life Policy Account** **Cr.**

Particulars	₹	Particulars	₹
To A Capital A/c*	7,500	By Balance c/d	15,000
To B Capital A/c*	4,500		
To C Capital A/c*	3,000		
	15,000		15,000

* Surrender value of remaining two policies ₹ 15,000 : ₹ (7,500 + 7,500) is to be credited to Partners' Capital Account in the profit sharing ratio and the surrender value of the policies are to be shown in the Balance Sheet.

Dr. **(2) A's Executors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance c/d	49,500	By A Loan A/c	5,000
		By A Capital A/c	44,500
	49,500		49,500

Illustration 12

R, S and T were partners sharing profits and losses in the proportion of 1/2, 1/3 and 1/6 respectively. T expired on 31st May, 2017.

Partnership agreement provided that:

(a) Interest on fixed capital to be allowed at 12% p.a.

(b) T to be Credited with salary of ₹ 18,000 p.a.

(c) On the death of any of the partners, his heir will receive in addition to the balance in the Fixed Capital and Current Account:

(i) Salary and interest on Capital.

(ii) Share of proportionate profit from last Balance Sheet to the date of death based on annual average profits of last 3 years (after interest on capital and salary to the partners).

(iii) Share of goodwill calculated at twice the average profits of last 3 years (before interest on capital and salary to the partners).

(iv) Share of profit on joint assurance policy.

Following further information is available :

	(A) Fixed Capitals on 31.3.2017	(B) Current Accounts (Cr.) 31.3.2017
R	₹ 3,00,000	₹ 50,000
S	₹ 2,00,000	₹ 10,000
T	₹ 1,00,000	₹ 20,000

(C) Joint Life Policy—₹ 1,00,000.

(D) There is no change in capital and current accounts since 31.3.2017.

(E) Joint Life Policy realised ₹ 1,50,000 (on 15.6.2017, amount due to T paid on receipt of policy amount.)

(F) Profits (before interest and salary) were :
2016-14—₹ 1,24,000; 2015-13 — ₹ 1,20,000; 2014-12—₹ 80,000; 2013-11—₹ 1,30,000.

(G) The firm closes its books on 31st March, decided to continue the firm and not to raise goodwill.

Show the following accounts in the books of the firm relating to the above transactions:
(a) Current Accounts of partners;
(b) Profit and Loss Adjustment Account; and
(c) Heir of T's Loan Account.

Solution

In the books of the Firm

Profit & Loss Adjustment Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Partners' Current A/cs (R—₹ 25,000; S—₹ 16,667; T—₹ 8,333)	50,000	By Joint Life Policy A/c (profit)*	50,000
	50,000		50,000
To Partners' Current A/cs—T (Note 3)		By Balance c/d	15,500
Profit	500		
Salary	3,000		
Interest	2,000		
To Partners' Current A/cs—R (Interest)	6,000		
To Partners' Current A/cs—S (Interest)	4,000		
	15,500		15,500

* Alternatively, it can be directly credited to Partners' Current Accounts.

Partners' Current Accounts

Dr. Particulars	R	S	T	Particulars	R	S	Cr. T
31.5.2017	₹	₹	₹	1.4.2017	₹	₹	₹
To T Current A/c – goodwill	21,600	14,400	—	By Balance b/d	50,000	10,000	20,000
To Heir of T's Loan A/c	—	—	69,833	31.5.2017			
To Balance c/d	59,400	16,267	—	By R Current A/c – goodwill	—	—	21,600
				By S Current A/c – goodwill	—	—	14,400
				By P & L Adjustment A/c:			
				Profit on J.L. Policy A/c	25,000	16,667	8,333
				Profit	—	—	500
				Salary	—	—	3,000
				Interest	6,000	4,000	2,000
	81,000	30,667	69,833		81,000	30,667	69,833

Heir of T's Loan Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
15.6.2017	To Balance c/d	1,69,833	1.4.2017	By T Capital A/c	1,00,000
				By T Current A/c	69,833
		1,69,833			1,69,833

Working Notes:

(1) Ascertainment of Proportionate Profit	₹
2016-14	1,24,000
2015-13	1,20,000
2014-12	80,000
Total profit	3,24,000
Average profit (₹ 3,24,000/3)	1,08,000
Therefore, proportionate profit for 2 months	**18,000**

(2) Ascertainment of T's Share of Goodwill			₹
Average profit (as calculated)			1,08,000
Total value of goodwill (₹ 1,08,000 x 2)			2,16,000
T's share of goodwill (1/6 of ₹ 2,16,000)			36,000
Required Journal Entry			
R Current A/c	Dr.	21,600	
S Current A/c	Dr.	14,400	
To T Current A/c			36,000

(3) Ascertainment of Profit after Interest and Salary	₹
Proportionate profit	18,000
Less: Interest for 2 months (R — ₹ 6,000 + S — ₹ 4,000 + T — ₹ 2,000)	12,000
	6,000
Less: Salary of T for 2 months (₹ 1,500 x 2)	3,000
Profit after interest and salary	3,000
Therefore, T's share of profit is 1/6 of ₹ 3,000	500

(4) Adjustment for Goodwill

Partners		R	S	T
Right of goodwill before death (3 : 2 : 1)	₹	1,08,000	72,000	36,000
Right of goodwill after death (3 : 2)	₹	1,29,600	86,400	—
Gain (+) / Sacrifice (–)	₹	(+) 21,600	(+) 14,400	(–) 36,000

Unsettled Accounts of A Deceased Partner

As per the provision of Section 37 of the Indian Partnership Act:

"Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm".

Illustration 13

The following is the Balance Sheet of A, B and C as on 31.12.2016, sharing profits in the ratio 4:3:1.

Liabilities	₹	Assets	₹
Capital Account — A	1,00,000	Property and Assets	2,28,000
Capital Account — B	70,000	Joint Survivorship Policy	32,000
Capital Account — C	20,000	Bank	50,000
Creditors	1,20,000		
	3,10,000		3,10,000

On 1.1.2017, D was admitted as a partner, entitling him to 1/5th share of the profit. D paid ₹ 30,000 on account of capital and also ₹ 20,000 as his share of Goodwill (the latter sum to remain in the business.)

On 30.6.2017, A died. The joint survivorship policy realised ₹ 50,000. The share of the deceased partner in the goodwill of the firm was determined at ₹ 36,000.

The Profit and Loss Account for the period ending 30.6.2017 disclosed a profit of ₹ 45.000.

The surviving partners carried on the business, profit-sharing ratio remains unchanged. Net profit for the period from 1.7.2017 to 31.12.2017 amounted to ₹ 33,000.

Drawings of the partners were:	A	B	C	D
For 6 months upto 30.6.2017 (₹)	13,000	10,000	4,000	7,500
For 6 months upto 31.12.2017 (₹)	Nil	8,000	5,000	7,000

A sum of ₹ 50,000 was advanced by B as loan to facilitate payment in full on 1.12.2017 of the deceased partner's share.

Show the Partners' Capital Accounts and draft the Balance Sheet as on 31.12.2017. The Balances of 'Creditors' and 'Property and Assets' as on 31.12.2017 were ₹ 1,17,000 and ₹ 2,37,000 respectively.

Solution

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

Particulars	A	B	C	D	Particulars	A	B	C	D
30.6.2017	₹	₹	₹	₹	1.1.2017	₹	₹	₹	₹
To A Capital A/c (goodwill)	—	18,000	6,000	12,000	By Balance b/d	1,00,000	70,000	20,000	—
					By Bank A/c	—	—	—	30,000
To Drawings A/c	13,000	10,000	4,000	7,500	By Premium (goodwill)	10,000	7,500	2,500	—
To Balance c/d	1,60,000	69,750	19,250	19,500	By B Capital A/c	18,000	—	—	—
					By C Capital A/c	6,000	—	—	—
					By D Capital A/c (goodwill)	12,000	—	—	—
					By J.S. Policy A/c	9,000	6,750	2,250	—
					By Share of Profit	18,000	13,500	4,500	9,000
	1,73,000	97,750	29,250	39,000		1,73,000	97,750	29,250	39,000
31.12.2017					1.7.2017				
To Bank A/c	1,76,387	—	—	—	By Balance b/d	1,60,000	69,750	19,250	19,500
To Drawings A/c	—	8,000	5,000	7,000	By Interest on Loan A/c	—	250	—	—
To Balance c/d	—	70,182	16,977	17,954	By Share of profit A/c (Note 3)	16,387	8,182	2,727	5,454
	1,76,387	78,182	21,977	24,954		1,76,387	78,182	21,977	24,954

Balance Sheet as at 31st December, 2017

Liabilities	₹	Assets	₹
Capital Account — B	70,182	Property and Assets	2,37,000
Capital Account — C	16,977	Bank (balancing figure)	35,113
Capital Account — D	17,954		
Loan from B	50,000		
Creditors	1,17,000		
	2,72,113		2,72,113

Working Notes : **(1) Calculation of new profit-sharing ratio after D's admission**.
D was admitted for 1/5 share. The balance 4/5 share will be enjoyed by A, B & C in the ratio 4:3:1. Therefore, the new ratio will be: A = 4/5 x 4/8 = 16/40; B = 4/5 x 3/8 = 12/40; C = 4/5 x 1/8 = 4/40; D = 1/5 = 8/40; A : B : C : D = 4 : 3 : 1 : 2.

Dr. (2) Profit & Loss Appropriation Account for 6 months upto 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To A Capital (share of profit u/s 37)	16,387	By Net profit	33,000
To Interest on B Loan @ 6% for ₹ 50,000 for 1 month	250		
To Partners' Capital A/cs (A —8,182; C — 2,727; D — 5,454)	16,363		
	33,000		33,000

(3) Profits for 5 months = ₹ 33,000/6 x 5 = ₹ 27,500; Ratio of capital = 160 : 69.75 : 19.25 : 19.50; So A's share of profit for unsettled accounts = (27,500 x 160)/268.50 = ₹ 16,387.

(4) Interest on B's loan @ 6% p.a. is payable for one month as per Indian Partnership Act, 1932.

Illustration 14

A and B have been in partnership business for some years, sharing profits in the proportions of 3/5th and 2/5th respectively, after salary entitlements of ₹ 8,000 and ₹ 12,000 per annum respectively. Accounts are made upto 30th June in each year.

Their partnership agreement provides, on the death of a partner for : (i) revaluation of the firm's assets — net gain or loss to be dealt with in the capital accounts in the profit-sharing ratio; (ii) the amount due to a deceased partner's personal representatives to be the amount standing to the credit of his Capital Account, including salary and profits to date of death, less drawings on account; (iii) ₹ 10,000 to be paid immediately and the balance one year after death; and (iv) an annuity of ₹ 6,000 payable half-yearly in arrears to a deceased partner's widow.

A died on 31.12.2016, when the lease of the partnership premises was deemed to be worth ₹ 40,000, goodwill ₹ 25,000 and all other assets at their book values. Non-profit life insurance policies had been taken out on each partner's policy, being debited to him. A's life was insured for ₹ 50,000 and B's for ₹ 20,000. The surrender value of the policy on B's life on 31.12.2016 was ₹ 2,200, and the benefit thereof was assigned to him at that value by A's personal representatives.

On 31.3.2017, C was taken into partnership by B on the terms that he should : (i) introduce ₹ 25,000 as partnership capital; and (ii) receive 1/5th share of profits, after charging the annuity to A's widow, with no provision for partners' salaries.

Profits and losses are assumed to accrue evently throughout the year. The partnership Trial Balance as on 30.6.2017 was as follows :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Lease	15,000		Capital Account — A (30.6.2016)		37,000
Stock on 30th June, 2017	65,000		Capital Account — B (30.6.2016)		12,900
Gross trading Profit for year ended 30.6.2017		1,82,000	Sundry Debtors	33,000	
Office salaries and expenses	82,000		Sundry Creditors		41,000
Life Assurance Policy Premium :			Cash paid in by C		25,000
On A's life, paid in Nov., 2016	650		Cash paid to personal representative of A	10,000	
On B's life, paid in May, 2017	250		Partners' Drawings — A	27,000	
Cash from life assurance policy on A's life		50,000	Partners' Drawings — B	46,000	
Annuity to A's widow, paid on 30.6.2017	3,000		Partners' Drawings — C	5,000	
Balance at bank	61,000		TOTAL	3,47,900	3,47,900

You are required to prepare : (a) the Capital Accounts of partners and the account of the personal representative of A, covering the year ended 30.6.2017; (b) the Partnership Balance Sheet as on 30.6.2017.

Solution

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	D	Particulars	A	B	D
To Bank A/c — Drawings	27,000	46,000	5,000	By Balance b/d	37,000	12,900	—
To Insurance Premium :				By Revaluation A/c	15,000	10,000	—
on A's life (See Note)	—	650	—	By Goodwill A/c	15,000	10,000	—
on B's life	—	250	—	By Salaries A/c (upto 31.12.2016)	4,000	6,000	—
To Executor of A A/c	—	2,200	—	By Sh. of Profit (upto 31.12.2016)	24,000	16,000	—
(assignment of policy)				By Bank A/c — Capital	—	—	25,000
To Executor of A A/c	68,000	—	—	By Bank A/c — Policy of A	—	50,000	—
(final claim of A)				By Sh. of Profit (upto 31.3.2017)	—	23,500	—
To Balance c/d	—	98,100	24,700	By Sh. of Profit (upto 30.6.2017)	—	18,800	4,700
	95,000	1,47,200	29,700		95,000	1,47,200	29,700

Tutorial Note : Here life insurance policy has been taken out on each partner's life for the benefit of other. It means on the death of A, B is to get the policy money. Conversely on B's death, A will get the policy money. Again insurance premium of A's policy to be borne by B and Premium on B's Policy to be borne by A. A died before the payment of premium of B's policy, so it is payable by B.

Dr. **Executor of A Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	10,000	By A Capital A/c	68,000
To Balance c/d	60,200	By B Capital A/c	2,200
	70,200		70,200

Balance Sheet as at 30th June, 2017

Liabilities	₹	Assets	₹
Capital Account — B	98,100	Goodwill	25,000
Capital Account — C	24,700	Lease	40,000
Executors of A	60,200	Stock	65,000
Creditors	41,000	Debtors	33,000
		Balance at bank	61,000
	2,24,000		2,24,000

Working Notes :

Dr. **(1) Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To A Capital A/c (3/5)	15,000	By Lease A/c (₹ 40,000 – 15,000)	25,000
To B Capital A/c (2/5)	10,000		
	25,000		25,000

Dr. **Profit and Loss Appropriation Capital Accounts** **Cr.**

Particulars	First 6 months	Next 3 months	Last 3 months	Particulars	First 6 months	Next 3 months	Last 3 months
To Salaries — A	6,000	—	—	By Net Profit * ₹ 1,00,000			
To Salaries — B	4,000	—	—	(apportioned on time basis)	50,000	25,000	25,000
To Annuity Accrued	—	1,500	1,500				
To Share of Profit A/c — A	24,000	—	—				
To Share of Profit A/c — B	16,000	23,500	18,800				
To Share of Profit A/c — C	—	—	4,700				
	50,000	25,000	25,000		50,000	25,000	25,000

* Net profit – Gross profit ₹ 1,82,000 – Office salaries ₹ 82,000 = ₹ 1,00,000.

Illustration 15

A, B and C are in partnership, sharing profits and losses equally. Interest on capital and partnership salaries is not provided. The Balance Sheet as at 30.6.2017 was as under :

Liabilities		₹	Assets	₹
Capital Account — A	9,000		Buildings	17,000
Capital Account — B	8,000		Equipment	3,300
Capital Account — C	8,000	25,000	Stock	900
Current Account — A	140		Debtors	2,020
Current Account — B	200	340	Bank	2,840
Creditors		820	Current Account — C	100
		26,160		26,160

A died suddenly on 31.10.2017.

The partnership agreed provides that in the event of the death of a partner, the sum to be paid to his estate will be the amount of his capital and current account balances at the last financial year and adjusted by his share of profit or loss since that date together with his share of goodwill. A formula for calculation of goodwill is given, and its application produced figure of ₹ 7,500. No goodwill account is to remain in the books after any change of the partnership constitution.

The stock value at 31st October has been calculated and all other accounts balanced off, including provisions for depreciation, accrued expenses and prepaid expenses. This results in the following position at 31st October:

Buildings ₹ 17,000; Equipment (including additions ₹ 400) ₹ 3,480; Stock ₹ 1,100; Debtors ₹ 2,230; Bank balance ₹ 3,370; Creditors ₹ 980.

There were no additions to, or reductions of, the capital accounts during the four months, but the following drawings have been made : A ₹ 2,000; B ₹ 1,600; C ₹ 1,800.

B has also been agreed that the share should be repaid in three equal instalments, the first payment being made as on the day after the day of death.

The surviving partners agree that D (son of A) should be admitted as a new partner w.e.f 1st November, and it is agreed that he will bring into the business ₹ 4,000 as his capital together with a premium for his share of the goodwill using the existing valuation. The new profit-sharing agreement is B : 2/5th; C : 2/5th and D 1/5th.

Required : (a) Show the partnership Balance Sheet as at 1st November, 2017, on the assumption that the above transactions have been completed by that date.

Solution

Working Notes : (1) Statement showing the Profit for the period from 1.7.2017 to 31.10.2017

Particulars	₹
Combined capital as on 31.10.2017 (assets – liabilities) [₹ 17,000 + 3,480 + 1,100 + 2,230 + 3,370 – 980]	26,200
Add: Combined drawings for the period [₹ 2,000 + 1,600 + 1,800]	5,400
	31,600
Less: Combined capital as on 1.7.2017 (Capital and Current Accounts) [₹ 9,000 + 8,000 + 8,000 + 140 + 200 – 100]	25,240
Profit for the period	6,360

(2) Statement showing the Adjustment in regard to Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before A's death (1 : 1 : 1)	2,500	2,500	2,500	—
Right of goodwill after D's admission (2 : 2 : 1)	—	3,000	3,000	1,500
Premium to be received (–) / paid (+)	(–) 2,500	(+) 500	(+) 500	(+) 1,500

Dr. (3) Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To A Capital — goodwill	—	500	500	1,500	By Balance b/d	9,000	8,000	8,000	—
To Executors of A A/c	11,500	—	—	—	By B Capital — goodwill	500	—	—	—
To Balance c/d	—	7,500	7,500	4,000	By C Capital — goodwill	500	—	—	—
					By D Capital — goodwill	1,500	—	—	—
					By Bank A/c — capital & premium	—	—	—	5,500
	11,500	8,000	8,000	5,500		11,500	8,000	8,000	5,500

Dr. (4) Partners' Current Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	100	By Balance c/d	140	200	—
To Drawings	2,000	1,600	1,800	By Share of Profit A/c	2,120	2,120	2,120
To Executors of A A/c	260	—	—				
To Balance c/d	—	720	220				
	2,260	2,320	2,120		2,260	2,320	2,120

Balance Sheet as at 1st November, 2017

Liabilities		₹	Assets	₹
Capital Account — B	7,500		Buildings	17,000
Capital Account — C	7,500		Equipment	3,480
Capital Account — D	4,000	19,000	Stock	1,100
Current Account — B	720		Debtors	2,230
Current Account — C	220	940	Bank [₹ 3,370 + 5,500 – (1/3 x 11,760)]	4,950
Executors of A [2/3 x (₹ 11,500 + 250)]		7,840		
Creditors		980		
		28,760		28,760

Key Points

- Surrender value is the amount receivable on a life insurance policy that is cancelled before the end of its term.
- In case of a "without profits" policy, the holder will get only the amount specified in the policy. In case of a 'with profits' policy, the holder will get the amount specified in the policy *plus bonuses declared on each valuation.*

THEORETICAL QUESTIONS

1. What problems arise when a partner dies ? As an accountant, how will you deal with them?
2. Why do the partners take a Joint Life Policy ? What are the different methods adopted for accounting Joint Life Policy?
3. What is surrender value? When is it paid ?

PRACTICAL QUESTIONS

1. A and B sharing profits and losses in the ratio of 3 : 2 took out joint life policy on January 1, 2014 for ₹ 20,000. The annual premium payable on the policy was ₹ 2,000. The surrender value is nil in the first year but thereafter it increases by ₹ 1,600 per annum. On December 31, 2017 A dies. Show the Policy Account and Policy Reserve Account in the books of the firm from 2014 to 2017.
2. A and B, sharing profits in the ratio of 3 : 2, took out a joint life policy on 1st January, 2015 of ₹ 20,000 for 20 years paying annual premium of ₹ 1,000. The surrender values were : 2015 : ₹ nil; 2016 : ₹ 200; 2017 : ₹ 550; 2018: ₹ 970. B dies on 8th March, 2018 and claim was received on 30th April, 2018. Prepare Joint Life Policy Account and Joint Life Policy Reserve Account.
3. A and B are in partnership sharing profits and losses in the ratio 3 : 2. They insure their lives jointly for ₹ 75,000 at an annual premium of ₹ 3,500 to be debited to the business. B died three months after the date of the last Balance Sheet. According to the partnership deed the legal personal representatives of B are entitled to the following payments: (a) his capital as per the last Balance Sheet; (b) interest on above capital @ 3 per cent per annum to the date of death; (c) his share of profits to the date of death calculated on the basis of last year's profits; and (d) his drawings are to bear interest at an average rate of 2% on the amount irrespective of the period. The net profits for the last three years, after charging insurance premium, were ₹ 20,000, ₹ 25,000 and ₹ 30,000 respectively. B's capital as per last Balance Sheet was ₹ 40,000 and his drawings to the date of death were ₹ 5,000. Draw B's Account to be rendered to his representatives.
4. A, B and C carried on business in the partnership sharing profits as 3 : 2 : 1. The Balance Sheet on 31st December, 2017 showed their capitals to be : A ₹ 10,400; B ₹ 5,000; C ₹ 3,000. On 28th February, 2018 A died and you are required to prepare necessary accounts for presentation to his executors having regard to the following facts :
   (i) The firm had insured the partners' lives severally, A for ₹ 9,000; B for ₹ 4,800; and C for ₹ 2,400. The premiums have been charged to Profit and Loss Account and the surrender value on 28th February 2018 amounted in each case to one-fourth of the sum assured;
   (ii) Capital carried interest at 5% p.a.;
   (iii) A's drawings from 1st January, 2018 to the date of his death amounted to ₹ 1,200;
   (iv) A's share of profits for the portion of the current financial year for which he lived was to be taken at the sum calculated on the average of the last three completed years and Goodwill was to be valued on the basis of two years' purchase of the average profits of those three years. The annual profits were ₹ 9,200; ₹ 7,400 and ₹ 8,600 respectively.
5. A, B and C were partners sharing profits in the proportion of one-half, one-fourth and one-fourth respectively. Their Balance Sheet on 31st December, 2017 was as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	4,000	Cash	1,000
A's Capital	10,000	Sundry Debtors	4,500
B's Capital	6,000	Stock-in-Trade	5,500
C's Capital	4,000	Loan to A	3,000
		Freehold Property	10,000
	24,000		24,000

A died on 1st January, 2018. The firm had affected an assurance of ₹ 10,000 on the joint lives of the three partners and the amount on the policy was realised on 1st February, 2018. According to the partnership agreement, the goodwill was to be calculated at two years' purchase of average profits of three completed years preceding the death or retirement of a partner. The deceased partner's share of capital and goodwill, etc., was paid out in cash on 1st March, 2018, the available cash balance being supplemented by a loan from the firm's bankers on the security of the freehold property. The net profits of the years 2015, 2016 and 2017 were ₹ 5,500, ₹ 4,800 and ₹ 6,600 respectively. You are required to show the Ledger Accounts of the partners and the Balance Sheet of B and C as it would stand after A's share is paid out. (Ignore interest)

6. A, B and C are partners sharing profits and losses in the proportion of 3 : 2 : 1 and their Balance Sheet on 31st December, 2017 stood as under :

Liabilities		₹	Assets	₹
Bills Payable		7,560	Cash in hand	250
Creditors		12,300	Bank	960
Reserve		3,000	Debtors	7,450
Capitals :			Bills Receivable	3,300
A	10,000		Stock	12,470
B	6,000		Investment	10,430
C	4,000	20,000	Buildings	8,000
		42,860		42,860

B died on 28th February 2018 and according to the deed of partnership, his executors are entitled to be paid as under:

(i) The capital to his credit at the time of his death and interest upon the time of his death at 6% p.a.

(ii) His proportionate share of Reserve.

(iii) His share of profit for the period based on the figure of the previous year.

(iv) Goodwill according to his share of profits to be calculated by taking twice the amount of the average profits of the last three years. The profits of the previous years were : 2015 : ₹ 7,800; 2016 : ₹ 9,000; and 2017 : ₹ 9,600.

The investments were sold for ₹ 16,200 and his executors were paid out. Pass the necessary Journal Entries and write the account of the executors of B.

7. The partnership agreement of a firm consisting of three partners A, B and C who share profits and losses in the ratio of 2 : 1 : 1 and whose fixed capital are ₹ 10,000; ₹ 6,000 and ₹ 4,000 respectively, provide as follows :

(a) That partners be allowed interest @ 10% p.a. on their fixed capitals, but no interest be allowed on undrawn profits or charged on drawings.

(b) That, upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.

(c) That an insurance policy of ₹ 10,000 each to be taken in individual names of each partner, the premium to be charged to the profit of the firm.

(d) That, upon the death of a partner, he be credited with his share of the profits, interest on capital, etc., calculated upon 31st December, following his death.

(e) That, the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.

(f) That the partnership books be closed annually on 31st December.

A died on 30th September, 2017, the amount standing to the credit of his Current Account on 31st December, 2016, was ₹ 450 and from that date to the date of death he had withdrawn ₹ 3,000 from the business.

An unrecorded liability of ₹ 2,000 was discovered on 30th September, 2016. It was decided to record it and be immediately paid-off.

The trading results of the firm (before charging interest on capital) had been as follows : 2014 : profit ₹ 9,640; 2015: profit ₹ 6,720; 2016 : loss ₹ 640; and 2017 : profit ₹ 3,670.

Assuming the surrender value of the policy to be 20% of the sum assured, you are required to prepare an account showing the amount due to A's legal representative as on 31st December, 2017.

8. A and B are partners. The Partnership deed provides, ***inter alia***, that:

1. The accounts be balanced on December 31 every year.
2. The profits be divided 1/2 to A 1/3 to B and 1/6 carried to a Reserve Account.
3. In the event of the death of a partner, his executors be entitled to be paid out :
   (a) the capital to his credit at the date of death;
   (b) his portion of the reserve at the date of last Balance Sheet;
   (c) his portion of profits upto the date of death based on the average profits of the last three completed years; and
   (d) his portion of the total profit for the three preceding years by way of goodwill.

On December 31,2017, the Ledger Balances were :

	Dr.	Cr.
A Capital A/c		90,000
B Capital A/c		60,000
Reserve		30,000
Creditors		30,000
Bills Receivable	20,000	
Investment	50,000	
Cash	1,40,000	
	2,10,000	2,10,000

The profits of the three preceding years were: 2015—₹ 42,000; 2016—₹ 39,000; and 2017—₹ 45,000.
B dies on May 1, 2018. Show the account between the firm and B's executors as on May 1, 2018.

9. The firm of P, Q and R, who share profits and losses in the ratio of 2:2:1, took out, joint supervisorship policy on 10th January, 2015 for ₹ 25,000 in order to provide a fund for repayment of a deceased partner's share. The last annual premium of ₹ 625 was paid on 10th January, 2018 and Q died on 15th February, 2018.
The surrender values of the policy were as follows :
in 2015—Nil, in 2016—₹ 175, in 2017—₹ 300. The policy amount was realized in full on Q's death.
Show the Joint Life Policy Account in firm's books which are closed on 31st December, each year.

10. A and B entered into partnership on 1.1.2015, the former introducing a capital of ₹ 90,000 and the latter ₹ 30,000. They effect a policy of insurance for ₹ 45,000 upon their joint lives in order to enable the survivor, in case of death of one, to pay out in cash part of the other's interest. The net profits before charging interest on capital as at the beginning of each year at 6% p.a. and on drawings (averaged at 4% p.a.) were as follows:

Year	Net profit (₹)	A's Drawings (₹)	B's Drawings (₹)
2015	34,800	10,000	5,000
2016	37,628	12,000	7,000
2017	38,100	14,000	7,500

Profits and losses were divided between A and B in the ratio of 2:1 respectively. The annual insurance premium which is ₹ 3,600 is charged to profit and loss account as a business expense. On 31.3.2018, A died. According to the terms of the partnership deed, the deceased partner's executors are entitled to receive his share of the capital as it stood on 31.12.2017 plus the three months share of the profit, calculated upon the previous year's rate of profit and share of goodwill which is reckoned at two-thirds of the previous three years' profits after adjusting for interest on capital and drawings but without deducting the premiums paid on the joint life insurance policy.
Make up A's Account showing the amount for which B shall be liable to account to his executors.
Workings of adjusted net profits and computation of A's share of goodwill will be considered as a part of the answer.
Calculations are to be made to the nearest rupee ignoring fractions, wherever arising.

11. For some years, X has been carrying on proprietorship business with a capital of ₹ 77,500 and his accounts are closed annually on 31st March.
On 1st April, 2015 Y joined him as a partner with 1/3rd interest in the profit and goodwill. Y introduced a sum of ₹ 40,000 on account of capital and it was agreed that X be credited with goodwill of ₹ 22,500.
The deed of partnership provided inter alia:
(a) Capital and Current Account kept separately; (b) Drawings be—X ₹ 3,600 per month, Y ₹ 2,000 per month including salary as mentioned below; (c) Y be allowed salary of ₹ 6,000 per annum; and (d) Interest be allowed on capitals at 5% per annum.
On the death of a partner, executors be entitled to: (a) Balance of capital and current accounts; (b) Interest on capital and salary upto the date of death; (c) Accruing share of profit to be based on the profits for the completed year immediately preceding thedate of death; and (d) Share of goodwill, the value of which is to be calculated at two years' purchase of the average profits (after charging interest on capital and partner's salary) for 3 completed years immediately precedingthe date of death.
Profits before charging interest on capital and partner's salaries were given as: Year ending 31st March, 2016, ₹ 67,000, year ending on 31st March, 2017—₹ 70,000; and year ending 31st March, 2018—₹ 77,000.
On 30th September, 2017 Y introduced additional capital of ₹, 16,000.
Y died on 30th June, 2018. It was ascertained that upto 31st March 2018, he had drawn the amount as mentioned in (b) above and from 1st April, 2018 to the date of death his drawings had been ₹ 5,500.
Prepare:
(i) Profit and Loss Appropriation Account for each of the three years ending 31st March, 2016, 2017, 2018;
(ii) Y's Capital and Current Accounts to show respective balances on 31st March, 2018; and (iii) A chart showing computation of the amount due to the executor of the deceased as on 30th June, 2018.

Guide to Answers

Practical Questions

3. **Share of profit ₹ 3,000; Amount due to B's Executors ₹ 68,200.**
4. **Share of profit ₹ 700; Share of Goodwill ₹ 8,400; Amount due to A's Executors ₹ 23,787.**
5. **Amount due to A's Executors ₹ 17,634; Balance Sheet ₹ 25,634.**
6. **Amount due to B's Executors ₹ 13,460.**

7. **Share of profit ₹ 835; Share o f Goodwill ₹ 3,240; Share of Joint Life Policy ₹ 7,000; Amount due to A's Executors ₹ 18,525.**
8. **A's share of goodwill ₹ 38,800; Closing capital ₹ 3,00,000 – Opening capital ₹ 2,40,000 = ₹ 60,000 + Drawings ₹ 1,72,800 = ₹ 2,32,800 (Net profit for 6years). Amount payable ₹ 1,77,200.**
9. **B's share of profit ₹ 5,600; B's share of goodwill ₹ 50,400; Amount payable to B's Executor ₹ 1,28,000.**
10. **A's share of goodwill ₹ 42,957; Amount payable to A's Executors ₹ 2,09,488.**
11. **Profit after charging interest on capital and partners' salaries : 2016 — ₹ 54,000; 2017 — ₹ 57,000; 2018 — ₹ 63,600. Amount payable to Executors of Y ₹ 99,867.**

6

Accounting for Dissolution of the Firm

Introduction

Technically, a partnership is terminated or dissolved whenever a new partner is admitted or an old partner retires or dies. The formation or dissolution of a partnership, however, does not necessarily indicate that the business is to be discontinued. ***The business may be continued without interruption, if the remaining partners resolve in its favour***.

The process of breaking up and discontinuing a Partnership business is called ***Dissolution of the firm***. The dissolution of the firm ***spells an end to the business***.

Dissolution by the Partners

The partnership firm may be dissolved by the partners mutually for the following reasons:

1. A business may be formed for a fixed term or for a specific purpose, and is wound up at the end of that term or when that purpose has been achieved.
2. A sharp fall in sales revenue due to changes in technology and product obsolescence may force the partners to dissolve the firm.
3. A continuous high demand for firm's products may tempt the partners to dissolve the firm and to form a limited company for additional capital and limited liability.
4. Sudden death or retirement of a partner may force other partners to dissolve the firm.
5. The business of the firm may become illegal and it may be required to dissolve the firm. This may happen due to change in law. ***For example***, a certain drug manufactured by the firm was legal and after amendment in law, the manufacturer of the drug is banned. In this case, partners may go for the dissolution of the firm.

Dissolution by the Court

Section 44 of the Indian Partnership Act states that:

At the suit of a partner, the court may dissolve a firm on any of the following grounds, namely :

(a) that a partner has become of unsound mind in which case, the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner;

(b) that a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner;

(c) that a partner, other than the partner suing, is guilty of misconduct which is likely to affect prejudicially the carrying on the business, regard being had to the nature of the business;

(d) that a partner, other than the partner suing, willfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business; or, otherwise so conduct himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in the partnership with him;

(e) that a partner, other than the partner suing, has in any way transferred the whole of his interest in the firm 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; or has allowed it to be sold in the recovery of arrears of land-revenue or of any dues recoverable as arrears of land-revenue due by the partner;

(f) that the business of the firm cannot be carried on without a loss; or

(g) on any other ground which renders it just and emitable that the firm should be dissolved.

Steps in the Dissolution Process

1. The ***first step*** in the dissolution process is to prepare a Balance Sheet of the firm as on the date of dissolution. Where both the date of dissolution and the date of Balance Sheet are same, no fresh Balance Sheet is required to be prepared. At the time of preparing the Balance Sheet on the date of dissolution, the effect of all transactions between the date of last Balance Sheet and the date of dissolution must be taken into consideration. [***See Illustration 14, page 6.21***]
2. In the ***next step*** of the dissolution process, non-cash assets that are not acceptable for distribution in their present form are sold and converted into cash. If the realised sales value is more than the book value of the assets, there is a gain from the sale. If it is less than the book value, it will be a loss. Procedurally, gains and losses on the realisation of assets is collected in one account (known as Realisation Account). The balance of the Realisation Account is transferred to Partners' Capital/ Current Accounts in the agreed profit-sharing ratio before any cash is distributed to them. In the preceding chapters, we have seen that we prepare a Revaluation Account when the assets are retained in the partnership, on the occasion of admission or retirement or death. In case of dissolution, instead of a Revaluation Account, a Realisation Account is prepared because the assets are to be sold or realised.
3. The ***last step*** in the dissolution is to distribute the available cash to creditors and partners.

Settlement of Accounts

Section 48 of the Indian Partnership Act,1932 states that:

"In settling the accounts of a firm after dissolution, the following rules, subject to the agreement by the partners, shall be observed:

(a) 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 were entitled to share profits.

(b) 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 rateably what is due to him from the firm for advances as distinguished from capital;

(iii) in paying to each partner rateably what is due to him on account of capital; and

(iv) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits."

Accounting Entries for Dissolution

On the dissolution of a partnership firm, the work that has to be done is divided into two sections :

(a) Realisation of assets and settlement of liabilities, and
(b) Settlement of the accounts of the partners.

(a) Realisation of Assets and Settlement of Liabilities

Whatever may be the reason for dissolving the partnership, the accounts have to be closed. A special account — called a ***Realisation Account*** — is used to record the closing transactions, showing the net gain or loss that has resulted from the realisation of assets and settlement of liabilities.

1. To close the various assets accounts

All the tangible assets appearing in the Balance Sheet (awaiting realisation) are all having debit balances. These assets are closed by transferring to the Realisation Account by crediting them at their respective book values. The following entry is passed:

Realisation Account	Dr.
To Land and Buildings Account	
To Plant and Machinery Account	
To Furniture and Fixture Account	
To Stock Account	
To Sundry Debtors Account	

In this connection, we are to remember the following:

(i) Cash or Bank Account will not be transferred to Realisation Account because they are not to be realised — they can be distributed in their present form instead. A separate Cash and Bank Account will be opened with the balance as appearing in the last Balance Sheet. Students should remember that bank overdraft will not be transferred to Realisation Account. However, Bank Loan Account must be transferred to Realisation Account because the cash or overdraft can also be settled in liquid form.

(ii) Sometimes, in the Balance Sheet some assets are shown at their net realisable market values or some assets at their unexpired portion. The example for the former is:

Sundry Debtors	₹ 40,500
Less : Provision for doubtful debts	₹ 500
	₹ 40,000

The example for the other is provision for depreciation, which appears as under:

Asset (at Cost)	₹ 1,00,000
Less : Provision for depreciation	₹ 10,000
	₹ 90,000

In fact, the accounts like provision for doubtful debts or provision for depreciation, etc, are called ***Valuation Accounts*** or ***Contra-Asset Accounts***. They are having credit balances and they should appear in the liability side of a Balance Sheet. But they appear on the debit side as a deduction from the main Asset Account . The assets should be transferred to the debit side of the Realisation Account at the ***gross figures*** and provisions should be transferred to the credit side of the Realisation Account.

For example, to close Sundry Debtors and provisions for doubtful debts, following entries are to be passed:

Realisation Account	Dr. ₹ 40,500	
To Sundry Debtors Account		₹ 40,500
Provision for Doubtful Debts Account	Dr. ₹ 500	
To Realisation Account		₹ 500

Similarly, to close an asset and Provisions for Depreciation Account following two entries will be passed:

Realisation Account	Dr. ₹ 1,00,000	
To Plant and Machinery Account		₹ 1,00,000
Provision for Depreciation Account	Dr. ₹ 10,000	
To Realisation Account		₹ 10,000

2. To close the various outside liabilities accounts

The various outside liabilities awaiting final settlement are to be transferred to the Realisation Account at the book values. The following entry is passed:

Sundry Creditors Account	Dr.	
Bills Payable Account	Dr.	
Outstanding Expenses Account	Dr.	
Bank Loan Account	Dr.	
To Realisation Account		

3. When the assets are sold

The proceeds or the amounts received on the sale of the assets are credited to Realisation Account and debited to Cash or Bank Account.

The following entry is passed:

Cash/Bank Account	Dr.	
To Realisation Account		

4. When some of the assets are taken over by a partner/partners

One or more of the assets may be taken over by a partner or by the partners at agreed valuation. When a partner (partners) takes over any asset, the claim of Capital Account is reduced by the taken over value of the assets. . The following entry is passed:

Partner's Capital Account	Dr. [Agreed value]	
To Realisation Account		

5. When outside liabilities of the firm are settled

After realisation of assets, the outside liabilities must be paid off first. The following entry is passed:

Realisation Account	Dr. [Actual amount paid]	
To Cash/Bank Account		

6. When some of the assets are taken over by creditors

No entry is required to be passed for assets taken over by the creditors. The actual amount paid to creditors (after adjusting the agreed value of the assets) to be debited to Realisation Account. For example, amount due to the creditors is ₹ 50,000. The creditors agree to take over a machinery of ₹ 40,000 at an agreed value of ₹ 35,000. The balance amount paid to the creditors in cash.

In this case journal entry will be:

Realisation Account (₹ 50,000 – ₹ 35,000)	Dr.	₹ 15,000	
To Cash Account			₹ 15,000

7. When unrecorded liabilities are paid

At the time of dissolution, if a liability exists which has not been recorded in the books, will have a priority over payment to partners along with other creditors .

At the time of payment the following entry is to be passed:

Realisation Account	Dr.	
To Bank Account		

8. When one of the partners agrees to discharge a liability personally

Without paying off one of the creditors directly, one of the partners may take the responsibility to settle the creditors. In such a case, Realisation Account is debited and Partner's Capital Account is credited. The effect is that the claim of the partner against the firm is increased by the amount of liability assumed. The following entry will be passed:

Realisation Account	Dr. [Assumed amount of liability]	
To Partner's Capital Account		

9. When dissolution expenses are incurred

Some expenses are definitely to be incurred during the process of liquidation. This is a loss to the firm and each partner must share this loss. Dissolution expenses must have a priority over payment to creditors. When one of the partners takes the responsibility of meeting the realisation expenses, generally a fixed sum is credited to his Capital Account. In such a case, the partnership firm has nothing to do with the actual expenses incurred by the partner towards realisation expenses (unless otherwise agreed).

The following entry will be passed:

(i) Realisation Account Dr.
  To Cash/Bank Account

or

(ii) Realisation Account Dr. [Agreed amount]
  To Partners' Capital Accounts

10. For closing the Realisation Account

After passing all the above entries the Realisation Account is balanced and the balance is transferred to the Partners' Capital Accounts in their profit-sharing ratio. If a credit balance exists in the Realisation Account, it shows a net profit on realisation. It will be a net loss on realisation, when it shows a debit balance. The following entry will be passed according to the situation:

(i) For Profit

Realisation Account Dr.
  To Partners' Capital Accounts

(ii) For Loss

Partners' Capital Accounts Dr.
  To Realisation Account

(b) Settlement of the Accounts of the Partners

After closing the Realisation Account and transferring the balance to the Partners' Capital Accounts, the next step is to settle the accounts of the partners among themselves. Since all the tangible assets and liabilities accounts are closed, the Balance Sheet leaves only the following accounts:

Liabilities	₹	Assets	₹
Partners' Capital A/cs		Preliminary Expenses A/c	
Partners' Current A/cs		Advertisement Suspense A/c	
Partners' Loan A/cs		Profit & Loss A/c (Dr.)	
General Reserve		Partners' Capital A/cs (overdrawn)	
Investment Fluctuation Fund A/c		Partners' Current A/cs (overdrawn)	
Joint Life Policy Fund A/c		Partners' Loan A/cs	

1. First Partners' Capital Accounts are to be opened with the balances as are appearing in the Balance Sheet on the date of dissolution. When the partners are maintaining ***fixed capital method***, Current Accounts balances are closed by transferring to the respective Capital Accounts of the Partners by passing the following entry:

   Partners' Current Accounts Dr.
     To Partners' Capital Accounts

   For a debit Current Account balance, the entry will be:

   Partners' Capital Accounts Dr.
     To Partners' Current Accounts

2. Secondly, if there is any Reserve/Joint Life Policy/Investment Fluctuation Fund or Profit or Loss Account (Cr.) balance in the Balance Sheet, these should be transferred to the Partner's Capital Accounts in the profit-sharing ratio. The entry will be:

   Reserve Fund/Profit and Loss Account/Investment Fluctuation Fund Account Dr.
   Joint Life Policy Fund Account Dr.
     To Partners' Capital Accounts

Conversely, if there are any fictitious assets in the Balance Sheet like Profit and Loss Account (Dr.) balance, preliminary expenses, advertisement suspense, etc, these should be debited to Partners' Capital Accounts in the profit-sharing ratio. The entry will be:

Partners' Capital Accounts Dr.
  To Preliminary Expenses Account
  To Advertisement Suspense Account
  To Profit and Loss Account (Dr.)

3. If the Partner has advanced any loan to the business, a Partner's Loan Account will be opened with the balance appearing in the Balance Sheet.

4. Finally, the Capital Accounts of the Partners are to be closed. The way this is done depends on the solvency of the partners. Following are the three cases to be considered in this regard. The procedure of closing the Partners' Capital Accounts will be different in each of the following cases:

Case 1 : Where all the partners are solvent.

Case 2 : Where some of the partners are solvent and others are insolvent.

Case 3 : Where all the partners are insolvent.

Case 1 : Where All the Partners are Solvent

(i) Where all the partners are solvent, the loan from any partner is to be paid first. The entry will be:

Partners' Loan Account Dr.
  To Bank/Cash Account

If a partner has taken any loan from the firm, he is required to bring in the amount in cash to the business. The entry will be:

Bank Account Dr.
  To Partner Loan Account

(ii) Thereafter, Partners' Capital Accounts are to be balanced. If one of the Partner's Capital Account shows a debit balance, the respective partner is to bring in the required amount to the business to make up his deficiency. The entry will be:

Cash/Bank Account Dr.
  To Partner's Capital Account

The final payment is to be made to partners having credit balance in their Capital Accounts .The entry will be:

Partners' Capital Accounts Dr.
  To Cash/Bank Account

After the claim of the partners are settled, there will be no balance in the Cash/Bank Account.

Illustration 1

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. They decided to dissolve the partnership business as on 31st December, 2017. Following is the Balance Sheet on the date of dissolution :

Liabilities	₹	Assets	₹
Capitals :		Machinery	31,000
A	20,000	Furnitures	3,000
B	10,000	Stock	10,000
C	2,000	Debtors	6,000
Bank overdraft	6,000		
Sundry creditors	12,000		
	50,000		50,000

The following assets were realised in cash: Machinery at ₹ 22,000; 50% of the stock at ₹ 3,500; and Debtors were collected at 15% less than their book values. Remaining 50% of the stock was taken over by A at ₹ 3,200. Furniture was taken over by B at ₹ 2,400. Realisation expenses were ₹ 300.

Pass necessary Journal Entries to close the books of the firm and also prepare Realisation Account, Bank Account and Partners' Capital Accounts.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars	₹	₹
2017 Dec. 31	Realisation A/c Dr.	50,000	
	To Machinery A/c		31,000
	To Furniture A/c		3,000
	To Stock A/c		10,000
	To Debtors A/c		6,000
	(Being the transfer of various assets to Realisation Account at book values on dissolution of the firm)		
	Sundry Creditors A/c Dr.	12,000	
	To Realisation A/c		12,000
	(Being the transfer of Sundry Creditors Account to Realisation Account at book value on dissolution of the firm)		
	Bank A/c Dr.	30,600	
	To Realisation A/c		30,600
	(Being the realisation of various assets)		

Realisation A/c To Bank A/c (Being the liability to sundry creditors discharged by payment)	Dr.	12,000	12,000
Realisation A/c To Bank A/c (Being the payment of realisation expenses)	Dr.	300	300
A Capital A/c B Capital A/c To Realisation A/c (Being the assets taken over by the partners)	Dr. Dr.	3,200 2,400	5,600
A Capital A/c B Capital A/c C Capital A/c To Realisation A/c (Being loss on realisation transferred to Partners' Capital Accounts in the profit-sharing ratio)	Dr. Dr. Dr.	7,050 4,700 2,350	14,100
Bank A/c To C Capital A/c (Being the amount brought in by C to make up deficiency of his Capital Account)	Dr.	350	350
A Capital A/c B Capital A/c To Bank A/c (Being the final payment to partners on dissolution)	Dr. Dr.	9,750 2,900	12,650

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017	To Machinery A/c	31,000	2017	By Sundry Creditors A/c	12,000
Dec. 31	To Furniture A/c	3,000	Dec. 31	By Bank A/c (assets realised)	30,600
	To Stock A/c	10,000		By A Capital A/c (stock taken over)	3,200
	To Debtors A/c	6,000		By B Capital A/c (furniture taken over)	2,400
	To Bank A/c (sundry creditors paid)	12,000		By Partners' Capital A/cs (loss):	
	To Bank A/c (expenses)	300		(A—₹ 7,050; B—₹ 4,700; C—₹ 2,350)	14,100
		62,300			62,300

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017	To Realisation A/c	30,600	2017	By Balance b/d (Note 1)	6,000
Dec. 31	To C Capital A/c	350	Dec. 31	By Realisation A/c (payment to creditors)	12,000
				By Realisation A/c (expenses)	300
				By Capital A/c (A—₹ 9,750; B—₹ 2,900)	12,650
		30,950			30,950

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Realisation A/c	3,200	2,400	—	2017	By Balance b/d	20,000	10,000	2,000
Dec 31	To Realisation A/c (loss)	7,050	4,700	2,350	Dec 31	By Bank A/c	—	—	350
	To Bank A/c	9,750	2,900	—					
		20,000	10,000	2,350			20,000	10,000	2,350

Working Note : (1) Bank overdraft represents adverse balance in the Bank Account. Therefore, it should not be transferred to Realisation Account.

Illustration 2

A, B and C are in partnership sharing profits and losses in the ratio of 5:3:2. They decide to dissolve their partnership and the Balance Sheet at the date of the dissolution is as follows :

Liabilities	₹	Assets		₹
Sundry creditors	6,000	Freehold property		52,000
Bills payable	3,000	Plant		30,000
Bank overdraft	1,500	Stock in trade		40,000
Reserve fund	5,000	Furniture		5,000
Capital — A	53,500	Sundry debtors	17,500	
Capital — B	44,100	Less: Provision for bad debts	500	17,000
Capital — C	39,400	Cash in hand		8,500
	1,52,500			1,52,500

A is to take the freehold property at ₹ 35,000, B is to take the stock-in-trade at ₹ 35,000 and C is to take furniture at ₹ 3,000. Sundry debtors realised ₹ 16,000 and Plant realised ₹ 40,000. Cost of dissolution was ₹ 2,000. Close the books of the firm showing the Realisation Account, Capital Accounts and Cash Account.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Freehold property A/c	52,000		By Provision for bad debt A/c	500
	To Plant A/c	30,000		By Sundry creditors A/c	6,000
	To Stock-in-trade A/c	40,000		By Bills payable A/c	3,000
	To Furniture A/c	5,000		By Partners' Capital A/cs:	
	To Sundry Debtors A/c	17,500		A (freehold property taken over)	35,000
	To Cash A/c (expenses)	2,000		B (stock taken over)	35,000
	To Cash A/c (sundry creditors paid)	6,000		C (furniture taken over)	3,000
	To Cash A/c (bills payable paid)	3,000		By Cash A/c (assets realised)	56,000
				By Partners' Capital A/cs: (loss)	
				(A : 8,500; B : 5,100; C : 3,400)	17,000
		1,55,500			1,55,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
	To Realisation A/c	35,000	35,000	3,000		By Balance b/d	53,500	44,100	39,400
	To Realisation A/c (loss)	8,500	5,100	3,400		By Reserve fund A/c	2,500	1,500	1,000
	To Cash A/c (final payment)	12,500	5,500	34,000					
		56,000	45,600	40,400			56,000	45,600	40,400

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/f	8,500		By Bank overdraft A/c	1,500
	To Realisation A/c: (assets realised)			By Realisation A/c (expenses)	2,000
	Sundry debtors	16,000		By Realisation A/c (liabilities paid)	9,000
	Plant	40,000		By A Capital A/c	12,500
				By B Capital A/c	5,500
				By C Capital A/c	34,000
		64,500			64,500

Tutorial Note : Sundry debtors should be transferred to Realisation Account at its gross figure, i.e., ₹ 17,500 and Provision for Bad Debts should be transferred to the credit side of the Realisation Account.

Illustration 3

X, Y and Z are in partnership sharing profits and losses equally. They decided to dissolve the partnership on 1st October, 2017 on which date the Balance Sheet of the firm was as follows :

Liabilities	₹	Assets	₹
Capital : X	20,000	Premises	25,650
Capital : Y	12,000	Machinery	10,800
Reserve	6,000	Stock	8,420
Sundry creditors	20,260	Sundry debtors	15,800
Bank loan	5,120	Bills receivable	850
		Capital : Z	1,280
		Cash at bank	580
	63,380		63,380

The assets realised the following amounts : Premises ₹ 16,000; Machinery ₹ 10,000; Stock ₹ 9,000; Debtors ₹ 15,000; Bills receivable ₹ 850. The goodwill was sold for ₹ 2,500. Discount amounting to ₹ 260 were allowed by creditors while paying their claims. The expenses of realisation amounted to ₹ 540. During the course of dissolution a liability for damages was settled at ₹ 9,000 against ₹ 7,000 provided in the books of the firm.

Prepare the Accounts necessary to show the result of the realisation and also to close the books of the firm (calculations may be made to the nearest rupee).

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Oct. 1	To Premises A/c	25,650	2017 Oct. 1	By Sundry creditors A/c	20,260
	To Machinery A/c	10,800		By Bank loan A/c (Note 1)	5,120
	To Stock A/c	8,420		By Bank A/c (assets realised)	53,350

	To Sundry debtors A/c	15,800		By Partners' Capital A/cs: (loss on realisation)	
	To Bills receivable A/c	850		X	3,484
	To Bank A/c (payment to creditors)	20,000		Y	3,483
	To Bank A/c (extra payment for damages)	2,000		Z	3,483
	To Bank A/c (expenses)	540			
	To Bank A/c (loan paid)	5,120			
		89,180			89,180

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Oct. 1	To Balance b/f	580	2017 Oct. 1	By Realisation A/c (sundry creditors paid)	20,000
	To Realisation A/c (assets realised)	53,350		By Realisation A/c (loan paid)	5,120
	To Z Capital A/c	2,763		By Realisation A/c (damages)	2,000
				By Realisation A/c (expenses)	540
				By X Capital A/c	18,516
				By Y Capital A/c	10,517
		56,693			56,693

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

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2017 Oct. 1	To Balance b/f	—	—	1,280	2017 Oct. 1	By Balance b/f	20,000	12,000	—
	To Realisation A/c (loss)	3,484	3,483	3,483		By Reserve A/c	2,000	2,000	2,000
	To Bank A/c	18,516	10,517	—		By Bank A/c	—	—	2,763
		22,000	14,000	4,763			22,000	14,000	4,763

Working Note : (1) Bank loan is a separate account. For closing this account, it is transferred to Realisation Account.

Illustration 4

P, Q and R are partners sharing profits and losses in the ratio of 2 : 2 : 1. Their Balance Sheet as on 31st March, 2008 is as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry Debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		48,000		
		3,00,000		3,00,000

They decided to dissolve the firm. the following are the amounts realised from the assets :

Particulars	₹
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry Debtors	44,400

Creditors allowed a discount of 5% and realisation expenses amounted to ₹ 1,500. A bill for ₹ 4,200 due for sales tax was received during the course of realisation and this was also paid.

You are required to prepare :

(a) Realisation Account; (b) Partners' Capital Accounts; and (c) Cash Account. ***[C.A. (IPCC) — November, 2009]***

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
2008 Mar 31	To Plant and Machinery A/c		1,08,000	2008 Mar 31	By Creditors A/c		48,000
	To Fixtures A/c		24,000		By Cash A/c :		
	To Stock A/c		60,000		Plant and Machinery	1,02,000	
	To Sundry Debtors A/c		48,000		Fixtures	18,000	
	To Cash A/c (Creditors)		45,600		Stock	84,000	
	To Cash A/c (Sales tax)		4,200		Sundry Debtors	44,400	2,48,400
	To Cash A/c (Realisation expenses)		1,500				
	To Partners Capital A/cs :						
	P	2,040					
	Q	2,040					
	R	1,020	5,100				
			2,96,400				2,96,400

Dr. — Partners' Capital Accounts — Cr.

Date	Particulars	P	Q	R	Date	Particulars	P	Q	R
2008 Mar 31	To Cash A/c (Final Payment)	1,46,040	74,040	37,020	2008 Mar 31	By Balance b/d	1,20,000	48,000	24,000
						By Reserve Fund A/c	24,000	24,000	12,000
						By Realisation A/c	2,040	2,040	1,020
		1,46,040	74,040	37,020			1,46,040	74,040	37,020

Dr. — Cash Account — Cr.

Date	Particulars	₹	Date	Particulars	₹
2008 Mar 31	To Balance b/d	60,000	2008 Mar 31	By Realisation A/c :	
	To Realisation A/c (Assets realised)	2,48,400		Creditors	45,600
				Expenses	1,500
				Sales Tax	4,200
				By Partners' Capital A/cs :	
				P	1,46,040
				Q	74,040
				R	37,020
		3,08,400			3,08,400

Illustration 5

A, B and C were partners in a firm sharing profits and losses in the ratio of 3:2:1. They decided to dissolve their firm w.e.f. 31.12.2017, the Balance Sheet on which date was as follows:

Liabilities	₹	Assets		₹
Creditors	25,000	Machinery		45,000
Loan on mortgage	20,000	Stock		20,000
Joint life policy reserve	12,000	Debtors	30,000	
Capital Account — A	45,000	Less: Provision	1,500	28,500
Capital Account — B	30,000	Joint life policy		15,000
Capital Account — C	15,000	Patents		20,000
		Cash at bank		18,500
	1,47,000			1,47,000

Additional information in connection with the dissolution was as follows:

(a) Joint Life Policy was surrendered and insurance company paid a sum of ₹ 18,000;
(b) B took some of the patents at ₹ 3,500 whose book value was ₹ 5,000;
(c) The remaining assets were realised as follows —
Machinery ₹ 30,000; Stock ₹ 15,500; Debtors ₹ 25,500; Patents 50% of the book value;
(d) Liabilities were paid and discount of ₹ 1,250 was allowed by the creditors;
(e) Expenses of dissolution amounted to ₹ 1,500.

Prepare the necessary Ledger Accounts to close the books of the firm.

Solution

In the books of the Firm

Dr. — Realisation Account — Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Machinery A/c	45,000	2017 Dec. 31	By Provision for Doubtful Debts A/c	1,500
	To Stock A/c	20,000		By Creditors A/c	25,000
	To Debtors A/c	30,000		By Loan on Mortgage A/c	20,000
	To Joint Life Policy A/c	15,000		By B Capital A/c (patents taken over)	3,500
	To Patents A/c	20,000		By Bank A/c (policy realised)	18,000
	To Bank A/c (creditors payment)	23,750		By Bank A/c (assets realised):	
	To Bank A/c (expenses paid)	1,500		Machinery	30,000
	To Bank A/c (loan repaid)	20,000		Stock	15,500
				Debtors	25,500
				Patents (50% of ₹ 15,000)	7,500
				By Partners' Capital A/cs: (A - ₹ 14,375; B - ₹ 9,583; C - ₹ 4,792)	28,750
		1,75,250			1,75,250

Dr. — Partners' Capital Accounts — Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017 Dec. 31	To Realisation A/c	—	3,500	—	2017 Dec. 31	By Balance b/d	45,000	30,000	15,000
	To Realisation A/c (loss)	14,375	9,583	4,792		By Joint Life Policy Reserve A/c	6,000	4,000	2,000
	To Bank A/c (final payment)	36,625	20,917	12,208					
		51,000	34,000	17,000			51,000	34,000	17,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Balance b/d	18,500	2017 Dec. 31	By Realisation A/c (loan)	20,000
	To Realisation A/c (policy realised)	18,000		By Realisation A/c (creditors)	23,750
	To Realisation A/c (assets sold)	78,500		By Realisation A/c (expenses)	1,500
				By Partners' Capital A/cs: (A - ₹ 36,625; B - ₹ 20,917; C - ₹ 12,208)	69,750
		1,15,000			1,15,000

Illustration 6

A, B and C share the profits of a business in the ratio of 2:2:1 respectively. They decide to dissolve the firm on 31st December, 2017 when their Balance Sheet appears as below :

Liabilities	₹	Assets		₹
Capital A/c : A	20,000	Building		37,000
Capital A/c : B	10,000	Machinery		17,000
Capital A/c : C	1,000	Furniture		8,000
Reserve Fund	10,000	Investment		10,000
Joint Life Policy Fund	15,000	Stock		1,500
Investment Fluctuation Fund	5,000	Debtors	8,000	
C's Loan	10,000	Less: Provision for bad debts	400	7,600
Mrs A's Loan	3,000	Joint Life Policy		15,000
Creditors	21,000	Bank		6,900
Acceptances	15,000	Profit & Loss		2,000
		C's Drawings		5,000
	1,10,000			1,10,000

A agrees to pay his wife's loan. Joint Life Policy is surrendered for ₹ 13,500 and the investment taken by B for ₹ 6,000. The remaining assets realised as below : Building ₹ 60,000; Machinery ₹ 7,000; Furniture ₹ 5,000; Stock ₹ 1,200 and Debtors 80%. Acceptances are met in full but creditors are paid ₹ 20,500 (in final settlement) including an investment worth ₹ 4,500 unrecorded in the books. Realization expenses amount to ₹ 4,800.

Journalise the entries to complete the dissolution of the firm, and show the Realization, Bank and Partners' Capital Accounts.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		Dr. ₹	Cr. ₹
2017 Dec 31	Realisation A/c	Dr.	96,500	
	To Building A/c			37,000
	To Machinery A/c			17,000
	To Furniture A/c			8,000
	To Investment A/c			10,000
	To Stock A/c			1,500
	To Debtors A/c			8,000
	To Joint Life Policy A/c			15,000
	(Being transfer of various assets to Realisation Account at book values on dissolution of the firm)			
	Provision for Bad Debts A/c	Dr.	400	
	Creditors A/c	Dr.	21,000	
	Acceptances A/c	Dr.	15,000	
	To Realisation A/c			36,400
	(Being the transfer of various liabilities to Realisation Account)			
	A Capital A/c	Dr.	800	
	B Capital A/c	Dr.	800	
	C Capital A/c	Dr.	400	
	To Profit & Loss A/c			2,000
	(Being debit balance of P/L transferred to Partners' Capital Accounts in the profit-sharing ratio)			
	C Capital A/c	Dr.	5,000	
	To C Drawings A/c			5,000
	(Being the balance of drawings transferred to Capital Account)			
	Reserve Fund A/c	Dr.	10,000	
	Joint Life Policy Fund A/c	Dr.	15,000	
	Investment Fluctuation Fund A/c	Dr.	5,000	
	To A Capital A/c			12,000
	To B Capital A/c			12,000
	To C Capital A/c			6,000
	(Being the transfer of the balances of different funds to Partners' Capital Accounts in the profit-sharing ratio)			
	Bank A/c ₹ (13,500 + 60,000 + 7,000 + 5,000 + 1,200 + 6,400)	Dr.	93,100	
	To Realisation A/c			93,100
	(Being realisation of sundry assets)			

Mrs A's Loan A/c To A. Capital A/c (Being the transfer of Mrs A's loan to A's Capital A/c)	Dr.	3,000	3,000
Realisation A/c ₹ (15,000 + 20,500 – 4,500) To Bank A/c (Being discharge of creditors and acceptances)	Dr.	31,000	31,000
Realisation A/c To Bank A/c (Being realisation expenses paid)	Dr.	4,800	4,800
C Loan A/c To Bank A/c (Being the discharge of C's loan)	Dr.	10,000	10,000
B Capital A/c To Realisation A/c (Being the investment taken over by B)	Dr.	6,000	6,000
Realisation A/c To A Capital A/c To B Capital A/c To C Capital A/c (Being profit on realisation transferred to Partners' Capital Accounts in the profit-sharing ratio)	Dr.	3,200	 1,280 1,280 640
A Capital A/c B Capital A/c C Capital A/c To Bank A/c (Being final payment on dissolution)	Dr. Dr. Dr.	35,480 16,480 2,240	 54,200

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Building A/c	37,000	2017	By Provision for Bad Debts A/c	400
Dec 31	To Machinery A/c	17,000	Dec 31	By Creditors A/c	21,000
	To Furniture A/c	8,000		By Acceptances A/c	15,000
	To Investment A/c	10,000		By Bank A/c (assets realised)	93,100
	To Stock A/c	1,500		By B Capital A/c (investment taken over)	6,000
	To Debtors A/c	8,000			
	To Joint Life Policy A/c	15,000			
	To Bank A/c (liabilities paid)	31,000			
	To Bank A/c (expenses)	4,800			
	To Partners' Capital A/c — A 2/5	1,280			
	To Partners' Capital A/c — B 2/5	1,280			
	To Partners' Capital A/c — C 1/5	640			
		1,35,500			1,35,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Balance b/d	6,900	2017	By Realisation A/c	31,000
Dec 31	To Realisation A/c (sale of assets)	93,100	Dec 31	By Realisation A/c (expenses)	4,800
				By C's Loan A/c	10,000
				By Partners' Capital A/cs: (A — ₹ 35,480; B — ₹ 16,480; C — ₹ 2,240)	54,200
		1,00,000			1,00,000

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Profit & Loss A/c	800	800	400	2017	By Balance b/f	20,000	10,000	1,000
Dec 31	To Realisation A/c (investment taken over)	—	6,000	—	Dec 31	By J.L.P. Fund A/c	6,000	6,000	3,000
						By Reserve Fund A/c	4,000	4,000	2,000
	To Drawings A/c	—	—	5,000		By Mrs A's Loan A/c	3,000	—	—
	To Bank A/c	35,480	16,480	2,240		By Investment Fluctuation Fund A/c	2,000	2,000	1,000
						By Realisation A/c	1,280	1,280	640
		36,280	23,280	7,640			36,280	23,280	7,640

Illustration 7

A, B and C were partners sharing profits and losses in the ratio of 5:3:2. The partnership was dissolved on 31.12.2017:

Liabilities	₹	Assets	₹
Sundry Creditors	10,000	Cash in hand	5,000
Capital Account : A	25,000	Furniture	2,500
Capital Account : B	15,000	Stock	7,500
Capital Account : C	10,000	Sundry Debtors	15,000
		Plant and Machinery	30,000
	60,000		60,000

C joined the firm on 1.1.2010, paying a premium for goodwill of ₹ 10,000 on the understanding that the partnership would continue for 10 years. Due to B's ill-health, the dissolution became necessary. Before C's admission, the partners were sharing profits and losses in the ratio of 3:2. Furniture and stock were realised for ₹ 2,250 and ₹ 6,750 respectively. The debtors were taken over by A at ₹ 14,250, apprehending bad debts of ₹ 750. Plant and machinery was sold for ₹ 27,500. Sundry creditors were accepted ₹ 9,500 in full satisfaction. Prepare Ledger accounts to close the books of the firm.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2017	To Furniture A/c	2,500	2017	By Sundry Creditors A/c		10,000
Dec. 31	To Stock A/c	7,500	Dec. 31	By Cash A/c:		
	To Sundry Debtors A/c	15,000		Furniture	2,250	
	To Plant and Machinery A/c	30,000		Stock	6,750	
	To Cash A/c (creditors paid)	9,500		Plant and machinery	27,500	36,500
				By A Capital A/c (Debtors taken over)		14,250
				By Partners' Capital A/cs : Loss		3,750
				(A — ₹ 1,875; B — ₹ 1,125; C — ₹ 750)		
		64,500				64,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Realisation A/c	14,250	—	—	2017	By Balance b/d	25,000	15,000	10,000
Dec. 31	To C Capital A/c (Note 1)	1,000	1,000	—	Dec. 31	By A Capital A/c (goodwill)	—	—	1,000
	To Realisation A/c	1,875	1,125	750		By B Capital A/c (goodwill)	—	—	1,000
	To Cash A/c	7,875	12,875	11,250					
		25,000	15,000	12,000			25,000	15,000	12,000

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2017	To Balance b/d	5,000	2017	By Realisation A/c		9,500
Dec. 31	To Realisation A/c	36,500	Dec. 31	By Partners' Capital A/cs:	A	7,875
					B	12,875
					C	11,250
		41,500				41,500

Working Note: (1) C paid ₹ 10,000 as premium for goodwill for 10 years but the business was dissolved after the completion of the 8th year. Therefore, unexpired portion of goodwill should be returned to C, which is ₹ 2,000 (₹ 10,000 x 2/10) by A and B. A premium of ₹ 10,000 was shared by A and B in the sacrificing ratio of 1 : 1. Therefore, their CapitalAccounts will be debited in the same ratio.

Illustration 8

Krishna and Arjun are partners in a firm. They share profits and losses in the ratio of 4:1. They decide to dissolve the firm on 31.3.2018 on which date the Balance Sheet of the same stood as follows:

Liabilities	₹	Assets		₹
Capital A/c — Krishna	16,000	Trade marks		1,200
Capital A/c — Arjun	6,000	Machinery		12,000
Bank loan	1,500	Furniture		400
Creditors for goods	8,000	Stock-in-trade		6,000
Bills payable	500	Debtors	9,000	
		Less: Provision for bad debts	400	8,600
		Cash in hand		2,800
		Profit and Loss A/c		1,000
	32,000			32,000

The realization shows the following results: (i) Debtors were realized at book value less 10%; (ii) Goodwill was sold for ₹ 1,000; (iii) Trade marks were realized for ₹ 800; (iv) Machinery and Stock-in-trade were taken over by Krishna respectively for ₹ 14,400 and ₹ 3,600; (v) An unrecorded asset estimated at ₹ 600 was sold for ₹ 200; (vi) Creditors for goods were settled at a discount of ₹ 80. The expenses on realization were ₹ 400.

Prepare Realization Account, Cash Book and Capital Accounts of the partners.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Trade Marks A/c	1,200	2018	By Provision for bad debts A/c	400
Mar 31	To Machinery A/c	12,000	Mar 31	By Bank loan A/c	1,500
	To Furniture A/c	400		By Creditors for goods A/c	8,000
	To Stock-in-trade A/c	6,000		By Bills payable A/c	500
	To Debtors A/c	9,000		By Cash A/c (assets realised):	
	To Cash A/c (payment of liabilities):			Debtors	8,100
	Bills payable	500		Goodwill	1,000
	Bank loan	1,500		Trade Marks	800
	Creditors	7,920		Unrecorded Asset	200
	To Cash A/c (expenses)	400		By Partners' Capital A/cs (assets) — Krishna	18,000
				By Partners' Capital A/c (loss) — Krishna	336
				By Partners' Capital A/c (loss) — Arjun	84
		38,920			38,920

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

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/f	2,800	2018	By Realisation A/c (payment of liabilities)	9,920
Mar 31	To Realisation A/c (realisation of assets)	10,100	Mar 31	By Realisation A/c (expenses)	400
Apr 1	To Partners' Capital A/cs — Krishna	3,136	Apr 1	By Partners' Capital A/cs — Arjun	5,716
		16,036			16,036

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

Date	Particulars	Krishna	Arjun	Date	Particulars	Krishna	Arjun
2018	To Realisation A/c	18,000	—	2018	By Balance b/f	16,000	6,000
Mar 31	To Profit and Loss A/c	800	200	Apr 1	By Cash A/c	3,136	—
	To Realisation A/c	336	84				
Apr 1	To Cash A/c	—	5,716				
		19,136	6,000			19,136	6,000

Illustration 9

A, B and C are partners in a firm, sharing profits and losses equally, whose Balance Sheet as at 30th September, 2017 was as under:

Liabilities			₹	Assets	₹
Capital Accounts :	A	20,000		Plant and Machinery (Less: Depreciation)	23,760
	B	25,000		Furniture and Fittings	4,240
	C	12,500	57,500	Sundry Debtors	14,165
Current Accounts :	A	18,600		Joint Life Policy	12,105
	C	7,200	25,800	Bills Receivable	8,610
Sundry Creditors			17,720	Stock-in-trade	29,940
Bills Payable			8,400	Current Account : B	12,400
				Cash at bank and in hand	4,200
			1,09,420		1,09,420

The value of the joint Life Policy shown in the Balance Sheet represents the surrender value of the policy taken by the firm for ₹ 30,000 to enable the settlement of accounts with a partner's estate in case of death of a partner during the continuance of the firm.

A died on 1st October, 2017. The remaining partners could not arrive at any understanding with the legal representative of A with the result that it was decided that the firm would be dissolved, subject to the following adjustments:

(a) The sum assured was realised from the insurance company;
(b) Plant and machinery realised only 70% of the book value;
(c) Furniture and fittings were taken over by partner C, at a market value of ₹ 2,500.
(d) Bills receivable and Sundry debtors had to be discounted by 4%;

(e) Stock-in-trade comprised—
(i) Easily marketable items — 70% of the total inventory which realised its full value;
(ii) Obsolete items — 10% of the total inventory which had to be discarded;
(iii) The rest of the items which realised 50% of their book value;

(f) A liability for ₹ 1,500 which had not been recorded in the firm's books had to be settled by the firm before its dissolution.

Draw up accounts showing *inter-se* settlement among the partners.

Solution

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars		₹	Date	Particulars		₹
2017	To Plant and Machinery A/c		23,760	2017	By Sundry Creditors A/c		17,720
Oct. 1	To Furniture and Fittings A/c		4,240	Oct. 1	By Bills Payable A/c		8,400
	To Sundry Debtors A/c		14,165		By Bank A/c — assets realised		
	To Joint Life Policy A/c		12,105		Plant and Machinery	16,632	
	To Bills Receivable A/c		8,610		Sundry Debtors	13,598	
	To Stock-in-trade A/c		29,940		Joint Life Policy	30,000	
	To Bank A/c — Liabilities paid				Bills Receivable	8,266	
	Sundry Creditors	19,220			Stock-in-trade	23,952	92,448
	Bills Payable	8,400	27,620		By C Capital A/c (furniture taken over)		2,500
	To Partners' Capital A/cs: (A — ₹ 210; B — ₹ 209; C — ₹ 209)		628				
			1,21,068				1,21,068

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Partners' Current A/cs	—	12,400	—	2017	By Balance b/d	20,000	25,000	12,500
Oct. 1	To Realisation A/c	—	—	2,500	Oct. 1	By Partners' Current A/cs	18,600	—	7,200
	To Cash and Bank A/c	38,810	12,809	17,409		By Realisation A/c	210	209	209
		38,810	25,209	19,909			38,810	25,209	19,909

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Balance b/d	—	12,400	—	2017	By Balance b/d	18,600	—	7,200
Oct. 1	To Partners' Capital A/cs	18,600	—	7,200	Oct. 1	By Partners' Capital A/cs	—	12,400	—
		18,600	12,400	7,200			18,600	12,400	7,200

Dr. Cash and Bank Account Cr.

Particulars	₹	Particulars		₹
To Balance b/d	4,200	By Realisation A/c		27,620
To Realisation A/c	92,448	By Partners' Capital A/cs :	A	38,810
			B	12,809
			C	17,409
	96,648			96,648

Working Note: (1) Calculation of money realised from sale of stock

		Book value	**Amount realised**
(i)	70% of ₹ 29,940	= ₹ 20,958	₹ 20,958
(ii)	10% of ₹ 29,940	= ₹ 2,994	Nil (Discarded)
(iii)	the rest	= ₹ 5,988	₹ 2,994 (50%)
		₹ 29,940	₹ 23,952

Illustration 10

Ram, Rahim and Anthony were in partnership sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. They decided to dissolve the partnership firm on 31.3.2018, when the Balance Sheet of the firm appeared as under :

Liabilities		₹	Assets	₹
Sundry Creditors		5,67,000	Goodwill	4,56,300
Bank Overdraft		6,06,450	Plant and Machinery	6,07,500
Joint Life Policy Reserve		2,65,500	Furniture	64,650
Loan from Mrs. Ram		1,50,000	Stock	2,36,700
Capital Accounts :			Sundry Debtors	5,34,000
Ram	4,20,000		Joint Life Policy	2,65,500
Rahim	2,25,000		Commission Receivable	1,40,550
Anthony	1,20,000	7,65,000	Cash in Hand	48,750
		23,53,950		23,53,950

The folowing details are relevant for dissolution :

(i) The joint life policy was surrendered for ₹ 2,32,500.
(ii) Ram took over goodwill and plant and machinery for ₹ 9,00,000.
(iii) Ram also agreed to discharge bank overdraft and loan from Mrs Ram.
(iv) Furniture and stocks were divided equally between Ram and Rahim at an agreed valuation of ₹ 3,60,000.
(v) Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.
(vi) Commission receivable was received in toto in time.
(vii) A bill discounted was subsequently returned dishonoured and proved valueless ₹ 30,750 (including ₹ 500 noting charges).
(viii) Ram paid the expenses of dissolution amounting to ₹ 18,000.
(ix) Anthony agreed to receive ₹ 1,50,000 in full satisfaction of his rights, title and interest in the firm.

You are required to show accounts relating to closing of books on dissolution of the firm.

Solution

In the books of the Firm

Realisation Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Goodwill A/c	4,56,300	2018	By Sundry Creditors	5,67,000
Mar. 31	To Plant and Machinery	6,07,500	Mar. 31	By Cash A/c :	
	To Furniture	64,650		Joint Life Policy	2,32,500
	To Stock	2,36,700		Commission Receivable	1,40,550
	To Sundry Debtors	5,34,000		By Ram Capital :	
	To Joint Life Policy	2,65,500		Goodwill + Machinery	9,00,000
	To Commission Receivable	1,40,550		Furniture + Stock	1,80,000
	To Ram Capital :			By Rahim Capital :	
	Realisation Expenses paid	18,000		Furniture + Stock	1,80,000
	To Bank A/c			By Partners' Capital A/cs :	
	Bill Dishonoured	30,750		Ram	76,950
				Rahim	51,300
				Anthony	25,650
		23,53,950			23,53,950

Cash Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	48,750	2018	By Ram Capital A/c	1,94,160
Mar. 31	To Realisation A/c : Joint Life Policy	2,32,500	Mar. 31	By Rahim Capital A/c	77,640
	Commission Receivable	1,40,550		By Anthony A/c	1,50,000
		4,21,800			4,21,800

Partners' Capital Account

Dr. **Cr.**

Particulars	Ram	Rahim	Anthony	Particulars	Ram	Rahim	Anthony
To Realisation A/c	10,80,000	1,80,000	—	By Balance b/d	4,20,000	2,25,000	1,20,000
To Realisation A/c (Loss)	76,950	51,300	25,650	By J.L.P. Reserve (Note 1)	1,32,750	88,500	44,250
To Cash A/c	—	—	1,50,000	By Loan from Mrs Ram (Note 3)	1,50,000	—	—
To Anthony Capital A/c	6,840	4,560	—	By Realisation A/c	18,000	—	—
To Cash (Balancing fig.)	1,94,160	77,640	—	By Ram Capital A/c (Note 5)	—	—	6,840
				By Rahim Capital A/c (Note 5)	—	—	4,560
				By Bank A/c (Overdraft)	6,37,200	—	—
	13,57,950	3,13,500	1,75,650		13,57,950	3,13,500	1,75,650

Bank Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Ram Capital A/c	6,37,200	2018	By Balance b/d	6,06,450
Mar. 31			Mar. 31	By Realisation A/c (Note 2)	30,750
		6,37,200			6,37,200

Working Notes :

(1) Joint Life Policy Reserve is transferred to Partners' Capital Accounts in the profit sharing ratio.

(2) For dishonour of discounted bill, the following entry is passed :

Sundry Debtors Account	Dr.	30,750	
To Bank Account			30,750

Here, nothing can be collected from Debtors. Therefore, it is to be treated as realisation loss and it is to be recorded by passing the following entry :

Realisation Account	Dr.	30,750	
To Sundry Debtors Account			30,750

However, a consolidated entry can be passed as follows to give effect the dishonour of the discounted bill:

Realisation Account	Dr.	30,750	
To Bank Account			30,750

(3) Loan from Mrs Ram has not been transferred to Realisation Account. It has been directly adjusted in Ram's Capital Account.

(4) No entry is required for assignment of Sundry Debtors in favour of Sundry Creditors in full satisfaction of their claim.

(5) Actual amount payable to Anthony is ₹ 1,38,600 (₹ 1,64,250 – ₹ 25,650) but agreed amount payable is ₹ 1,50,000. So the difference of ₹ 11,400 is to be borne by Ram and Rahim in their profit sharing ratio, i.e., 3 : 2.

Share of Ram : ₹ 11,400 × 3/5 = ₹ **6,840**

Share of Rahim : ₹ 11,400 × 2/3 = ₹ **4,560**

Illustration 11

A, B and C are in partnership as accountants carrying on practices in Calcutta and Delhi and sharing profits in the ratio of 7:6:5 respectively. Interest @ 5% p.a. is allowed on capital accounts. They decided to dissolve the firm. The terms of dissolution were as under:

1. A to retire from business, his share of goodwill being valued at ₹ 3,300 to be paid by B and C in their profit-sharing ratio.
2. B to carry on business in Calcutta, taking over at book values furniture and debtors in Calcutta, and all liabilities, he also has to pay ₹ 600 for the lease of Calcutta office which he kept on.
3. C to take over the furniture and debtors in Delhi.
4. B and C each to be credited with 2% of the amount of the book debts taken over by them respectively by way of an allowance to cover the cost of collection.
5. Each parnter to take over a third of the cash balance and to pay his own costs in connection with the dissolution.

The following Trial Balance was extracted from the firm's books as on 30.6.2017, on which date the partnership was dissolved by agreement.

Dr. **Trial Balance** Cr.

Particulars	₹	Particulars	₹
Drawings : A	3,973	Capital as on 1.7.2016	
B	1,292	A	4,000
C	816	B	4,000
Cash	318	C	3,000
Sundry Debtors : Calcutta	6,750	Profit & Loss Account before charging interest for the	
Sundry Debtors : Delhi	3,150	year ended 30.6.2017	5,716
Furniture : Calcutta	320	Sundry Creditors	78
Furniture : Delhi	175		
	16,794		16,794

You are required to close the books of the firm, assuming that partners settle their accounts through bank on 30.9.2018. Interest after 30.6.2018 to be ignored.

Solution

In the books of A, B and C

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2017	To Sundry Debtors A/c (₹ 6,750 + ₹ 3,150)	9,900	2017	By B Capital A/c — assets taken over		
June 30	To Furniture A/c (₹ 320 + ₹ 175)	495	June 30	Lease	600	
	To B Capital A/c — allowances on debtors			Debtors	6,750	
	(2% on ₹ 6,750)	135		Furniture	320	7,670
	To C Capital A/c — allowances on debtors			By C Capital A/c — assets taken over		
	(2% on ₹ 3,150)	63		Debtors	3,150	
	To Partners' Capital A/cs:			Furniture	175	3,325
	(A — ₹ 156; B — ₹ 134; C — ₹ 112)	402				
		10,995				10,995

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Drawings A/c	3,973	1,292	816	2016	By Balance b/d	4,000	4,000	3,000
June 30	To Realisation A/c —				July 1				
	assets taken over	—	7,670	3,325	2017	By Interest on Capital A/c	200	200	150
	To Cash A/c	106	106	106	June 30	By Share of Profit A/c			
Sept. 30	To Bank A/c	2,286	—	513		(₹ 5,716 – 550)	2,009	1,722	1,435
						By Realisation A/c —			
						allowances on debtors	—	135	63
						By Sundry Creditors A/c	—	78	—
						By Realisation A/c —profit	156	134	112
						By Bank A/c	—	2,799	—
		6,635	9,068	4,760			6,635	9,068	4,760

Working Notes:

(1) Profit on realisation is a capital profit.

(2) For lack of information, it has been assumed that B and C bring in necessary money to pay off A.

Illustration 12

A, B and C are partners of a firm of Chartered Accountants having offices in Bombay, Hyderabad and Bhopal, sharing profits and losses in the ratio of 5 : 3 :2 respectively. The statement of affairs of the firm as on 31.3.2018 is shown below:

Particulars	₹	₹
Capital A/c — A		15,000
Capital A/c — B		12,000
Capital A/c — C		6,000
Current A/c — A		7,550
Current A/c — B	2,575	
Current A/c — C	1,115	
Accounts Payable		4,915
Accounts Receivable — Bombay	12,000	
Accounts Receivable — Hyderabad	8,625	
Accounts Receivable — Bhopal	9,875	
Goodwill	5,000	
Cash in Hand	575	
Cash with Bank	5,700	
TOTAL	45,465	45,465

On that date, due to old age, A desires to retire from the firm and the other two partners agree and it is decided that B would take over the Bomay and Hyderabad offices and C would take over the Bhopal office with the respective assets and liabilities.

You are given the following additional information :

(a) A's share of goodwill is valued at ₹ 15,000 and would be bought by B and C in their profit-sharing ratio.

(b) Accounts payable include rent of Bhopal office for the month of February and March, 2018 at the monthly rent of ₹ 250 and the balance represents outstanding expenses of Bombay and Hyderabad offices.

(c) Cash in hand is to be utilised to pay A and other settlements inter-se to take place before 1st May, 2018 and

(d) Accounts receivable to be discounted by 2%.

Draw up Realisation Account, Partners' Capital Accounts and Cash Account.

Solution

Working Note : (1) Value of net assets taken over by B and C (all figures in ₹)

	B (Bombay and Hyderabad)	C Bhopal
Account Receivable	20,625	9,875
Less: Discount @ 2%	413	197
	20,212	9,678
Less: Accounts Payable	4,415	500
Net assets taken over	15,797	9,178

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Goodwill A/c	5,000	2018 April 1	By Accounts Payable A/c	4,915
	To Accounts Receivable A/c (₹ 12,000 + 8,625 + 9,875)	30,500		By B A/c — net assets taken over (Note 1)	15,797
				By C A/c — net assets taken over (Note 1)	9,178
				By Partners' Capital A/c — A	2,805
				By Partners' Capital A/c — B	1.683
				By Partners' Capital A/c — C	1,122
		35,500			35,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018	To Partners' Current A/cs	—	2,575	1,115	2018 April 1	By Balance b/d	15,000	12,000	6,000
	To Realisation A/c	—	15,797	9,178		By Partners' Current A/cs	7,550	—	—
	To Realisation A/c — Loss	2,805	1,683	1,122		By B Cap. A/c (Goodwill)	9,000	—	—
	To A Cap. A/c (Goodwill)	—	9,000	6,000		By C Cap. A/c (Goodwill)	6,000	—	—
	To Cash A/c	575	—	—		By Bank A/c	—	17,055	11,415
	To Bank A/c	34,170	—	—					
		37,550	29,055	17,415			37,550	29,055	17,415

Dr. Cash Account Cr.

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
2018 April 1	To Balance b/d	575	5,700	2018 ?	By A Capital A/c	575	34,170
	To B Capital A/c	—	17,055				
	To C Capital A/c	—	11,415				
		575	34,170			575	34,170

Illustration 13

X, Y and Z carrying on business since 2002, decided to dissolve their partnership on 30th June 2018, when their Balance Sheet was as under:

Liabilities			₹	Assets	₹
Creditors			34,000	Cash	25,000
Capital Accounts :	X	1,20,000		Debtors	62,000
	Y	90,000		Stock	37,000
	Z	60,000	2,70,000	Tools	8,000
				Motor Cars	12,000
				Machinery	60,000
				Freehold Building	1,00,000
			3,04,000		3,04,000

Y and Z agreed to form a new partnership to carry on the business and it is agreed that they shall acquire from the old firm the following assets at amounts shown hereinunder:

Stock — ₹ 40,000; Tools — ₹ 5,000; Motor Cars — ₹ 25,000; Machinery — ₹ 78,000; Freehold Building — ₹ 84,000; Goodwill — ₹ 60,000.

The partnership agreement of X, Y and Z provided that trading profits and losses shall be divided in the ratio of 3:2:1 and that capital profits or losses shall be divided in proportion of their capitals.

Debtors realise ₹ 59,000 and discount amounting to ₹ 720 is secured on payments due to creditors. Y and Z bring the necessary cash to pay X in the ratio of 3:2.

You are required to prepare: (i) the necessary accounts of the firm X, Y and Z; (a) if the firm Y and Z continue the same books, and (b) if the partners open new books; (ii) The opening Balance Sheet of the firm Y and Z.

Solution

(i) Continuing the same books **In the books of X, Y and Z**

Dr. Memorandum Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 July 1	To Tools A/c (₹ 8,000 – 5,000)	3,000	2018 July 1	By Stock A/c (₹ 37,000 – 40,000)	3,000
	To Freehold Buildings A/c	16,000		By Motor Car A/c (₹ 12,000 – 25,000)	13,000
	To X Capital A/c (capital ratio – 12/27)	33,333		By Machinery A/c (₹ 60,000 – 78,000)	18,000
	To Y Capital A/c (capital ratio – 9/27)	25,000		By Goodwill A/c	60,000
	To Z Capital A/c (capital ratio – 6/27)	16,667			
		94,000			94,000

	To Stock A/c	3,000		By Tools A/c	3,000
	To Motor Car A/c	13,000		By Freehold Building A/c	16,000
	To Machinery A/c	18,000		By Y Capital A/c (3/5)	45,000
	To Goodwill A/c	60,000		By Z Capital A/c (2/5)	30,000
		94,000			94,000

Tutorial Note : When same set of book is continued, the ***Memorandum Revaluation Account*** is prepared with net increase / decrease in the value of the assets and the liabilities which are taken over by the new firm.

In this regard, the following points are very important :

1. Increase in the value of assets : 'Credit' Memorandum Realisation Account (Net Increase).
2. Decrease in the value of assets : 'Debit' Memorandum Realisation Account (Net Decrease).
3. Decrease in the amount of liabilities : 'Debit' Memorandum Realisation Account (Net Increase).
4. Increase in the amount of liabilities : 'Credit' Memorandum Realisation Account (Net Decrease).

Example : Book value of stock was ₹ 37,000 but it was taken by the new firm at ₹ 40,000. Therefore, the net increase (₹ 37,000 – ₹ 40,000) = ₹ 3,000 is to be credited to Memorandum Realisation Account.

A separate ***Realisation Account*** is to be prepared for the assets and liabilities ***realised*** separately.

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Debtors A/c	62,000	2018	By Creditors A/c	34,000
July 1	To Cash A/c (Payment to Creditors)	33,280	July 1	By Cash A/c (Received from Debtors)	59,000
				By X Capital A/c (capital ratio – 12/27)	1,013
				By Y Capital A/c (capital ratio – 9/27)	760
				By Z Capital A/c (capital ratio – 6/27)	507
		95,280			95,280

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

Particulars	X	Y	Z	Particulars	X	Y	Z
To Memorandum Realisation A/c	—	45,000	30,000	By Balance b/d	1,20,000	90,000	60,000
To Realisation A/c	1,013	760	507	By Memorandum Realisation A/c	33,333	25,000	16,667
To Cash A/c	1,52,320	—	—	By Cash A/c	—	60,960	40,640
To Balance c/d	—	1,30,200	86,800				
	1,53,333	1,75,960	1,17,307		1,53,333	1,75,960	1,17,307

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

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	25,000	2018	By Realisation A/c — Creditors paid	33,280
July 1	To Realisation A/c — Debtors realised	59,000	July 1	By X Capital A/c	1,52,320
	To Y Capital A/c	60,960			
	To Z Capital A/c	40,640			
		1,85,600			1,85,600

Balance Sheet of Y and Z on 1st July, 2018

Liabilities		₹	Assets	₹
Capital Accounts :			Stock	37,000
Y	1,30,200		Tools	8,000
Z	86,800	2,17,000	Motor Cars	12,000
			Machinery	60,000
			Freehold Building	1,00,000
		2,17,000		2,17,000

(ii) Opening new books

In the books of X, Y and Z

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
2018	To Debtors A/c		62,000	2018	By Cash A/c — Debtors realised		59,000
July 1	To Stock A/c		37,000	July 1	By Creditors A/c		34,000
	To Tools A/c		8,000		By Y and Z Joint A/c:		
	To Motor Car A/c		12,000		Stock	40,000	
	To Machinery A/c		60,000		Tools	5,000	
	To Freehold Building A/c		1,00,000		Motor Car	25,000	
	To Bank A/c — creditors paid		33,280		Machinery	78,000	
	To Partners' Capital A/cs:				Freehold Building	84,000	
	X (capital ratio)	32,320			Goodwill	60,000	2,92,000
	Y (capital ratio)	24,240					
	Z (capital ratio)	16,160	72,720				
			3,85,000				3,85,000

Dr. Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Cash A/c	1,52,320	—	—	By Balance b/d	1,20,000	90,000	60,000
To Y and Z Joint A/c	—	1,75,200	1,16,800	By Realisation A/c	32,320	24,240	16,160
				By Cash A/c	—	60,960	40,640
	1,52,320	1,75,200	1,16,800		1,52,320	1,75,200	1,16,800

Dr. Y and Z Joint Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 July 1	To Realisation A/c	2,92,000	2018 July 1	By Y Capital A/c	1,75,200
				By Z Capital A/c	1,16,800
		2,92,000			2,92,000

Balance Sheet of Y and Z on 1st July, 2018

Liabilities		₹	Assets	₹
Capital Accounts :			Stock	40,000
Y	1,75,200		Tools	5,000
Z	1,16,800	2,92,000	Motor Cars	25,000
			Machinery	78,000
			Freehold Building	84,000
			Goodwill	60,000
		2,92,000		2,92,000

Working Notes: (1) Profit on realisation is a capital profit. **(2)** For lack of information, it has been assumed that Y and Z bring in necessary money to pay off X.

Illustration 14

X, Y and Z were in partnership sharing profits and losses in the ratio of 3:2:1. No interest was to be allowed on Current or Capital Accounts of the partners but their Loan Accounts were to carry an interest of 10% p.a.

Due to persistent losses and the continued illness of Y, the firm decided to get dissolved on 31st March, 2018. The accounts were closed for the last time on 31st December, 2017 on which date its Balance Sheet was as under :

Liabilities	₹	Assets	₹
Capital A/c : X	48,000	Plant & Machinery	60,000
Capital A/c : Y	33,000	Furniture & fittings	10,000
X's Loan A/c	22,000	Motor car	40,000
Trade Creditors	80,000	Stock	55,000
Bank overdraft	30,000	Sundry Debtors	40,000
		Z's Capital A/c	8,000
	2,13,000		2,13,000

Between 31st December, 2017 and 31st March, 2018 goods to the value of ₹ 30,000 were purchased and sales amounted to ₹ 45,000.

In addition to payment to trade creditors, payments made were for salaries and wages ₹ 12,000 and for general and office expenses ₹ 6,000. Drawings of each partner were ₹ 800 p.m. On 31st March, 2018 debtors, creditors and stock in trade were ₹ 60,000, ₹ 70,000 and ₹ 45,000 respectively.

In dissolution proceedings the partners agreed to transfer the entire business (with all assets and liabilities including partners' loans) as a going concern to D for a consideration of ₹ 90,000. Cost of dissolution amounted to ₹ 2,800 which were made by X.

Show necessary Journal Entries for the dissolution of the firm and also the capital accounts of the partners assuming that all of them are solvent. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

Working Notes : In this question the date of dissolution (31.3.2018) is different from the date of last Balance Sheet. So, before passing Journal Entries we will have to draw a Balance Sheet on the date of dissolution.

(1) Balance Sheet as on 31st March, 2018

Liabilities	₹	Assets	₹
Capital A/c : X (Note 6)	38,625	Plant & Machinery	60,000
Capital A/c : Y	26,083	Furniture & fittings	10,000
Trade Creditors	70,000	Motor car	40,000
Bank overdraft (Note 3)	70,200	Stock	45,000
X's Loan A/c : ₹ (22,000 + 550)	22,550	Debtors	60,000
		Capital A/c : Z	12,658
	2,27,658		2,27,658

Note : No Depreciation has been charged on Plant and Machinery and Motor car for these three months.

Dr. (2) Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Bank A/c (balancing figure)	25,000
To Sales A/c	45,000	By Balance c/d	60,000
	85,000		85,000

Dr. (3) Bank Account Cr.

Particulars	₹	Particulars	₹
To Debtors A/c	25,000	By Balance b/d	30,000
To Balance c/d	70,200	By Sundry Creditors A/c	40,000
		By Salary & Wages A/c	12,000
		By General Office Expenses A/c	6,000
		By Drawings A/c : ₹ (800 x 3 x 3)	7,200
	95,200		95,200

Dr. (4) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c (Balancing figure)	40,000	By Balance b/d	80,000
To Balance c/d	70,000	By Purchases A/c	30,000
	1,10,000		1,10,000

Dr. (5) Profit and Loss Account for the period 1st January to 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	55,000	By Sales	45,000
To Purchases	30,000	By Closing Stock	45,000
To Gross Profit c/d	5,000		
	90,000		90,000
To Salaries and Wages	12,000	By Gross Profit b/d	5,000
To General and Office Expenses	6,000	By Net Loss c/d	13,000
	18,000		18,000
To Net Loss b/d	13,000	By Partners' Capital A/cs :	
To Interest on X Loan	550	(X : ₹ 6,775; Y : ₹ 4,517; Z : ₹ 2,258)	13,550
	13,550		13,550

Dr. (6) Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Balance b/d	—	—	8,000	By Balance b/d	48,000	33,000	—
To Drawings A/c	2,400	2,400	2,400	By Balance c/d	—	—	12,658
To P / L A/c (Note 5)	6,775	4,517	2,258				
To Balance c/d	38,825	26,083	—				
	48,000	33,000	12,658		48,000	33,000	12,658
To Balance b/d	—	—	12,658	By Balance b/d	38,825	26,083	—
To Cash A/c	59,100	37,733	—	By Realisation A/c (exp)	2,800	—	—
				By Realisation A/c (profit)	17,475	11,650	5,825
				By Cash A/c	—	—	6,833
	59,100	37,733	12,658		59,100	37,733	12,658

(7) In this problem, Bank overdraft is also to be transferred to Realisation Account because the business has been taken over by D as a going concern.

In the books of X, Y and Z
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2018 Mar 31	Realisation A/c	Dr.	2,15,000	
	To Plant & Machinery A/c			60,000
	To Furniture & fittings A/c			10,000
	To Motor car A/c			40,000
	To Debtors A/c			60,000
	To Stock A/c			45,000
	(Being transfer of different assets to Realisation Account)			

Sundry Creditors A/c	Dr.	70,000	
Bank Overdraft A/c (Note 7)	Dr.	70,000	
X Loan A/c	Dr.	22,500	
To Realisation A/c			1,62,500
(Being transfer of different liabilities to Realisation Account)			
Realisation A/c	Dr.	2,800	
To X Capital A/c			2,800
(Being realisation expenses paid by X)			
Cash A/c	Dr.	90,000	
To Realisation A/c			90,000
(Being purchase consideration received from D)			
Realisation A/c	Dr.	34,950	
To X Capital A/c			17,475
To Y Capital A/c			11,650
To Z Capital A/c			5,825
(Being profit on realisation transferred to Partners' Capital Accounts in the ratio of 3:2:1)			
Cash A/c	Dr.	6,833	
To Z Capital A/c			6,833
(Being cash brought in by Z)			
X Capital A/c	Dr.	59,100	
Y Capital A/c	Dr.	37,733	
To Cash A/c			96,833
(Being money paid to X & Y in final settlement)			

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

Particulars	₹	Particulars	₹
To Realisation A/c	90,000	By X Capital A/c	59,100
To Z Capital A/c	6,833	By Y Capital A/c	37,733
	96,833		96,833

Illustration 15

A, B and C were in partnership since 1.7.2008. C received a fixed and guaranteed share of profits of ₹ 5,000 p.a. and the balance of profits and losses were divisible between A and B in the proportion of 3:2. On 1.7.2017, A and B mutually agreed with C that he should be entitled to a 1/10th share in the partnership and C paid the sum of ₹ 1,000 into the partnership funds on that date for his share of goodwill.

The firm was dissolved on 30.6.2018, as B had disclosed (prior to that date) that he had been responsible for the following irregularities:

(a) The value of stock in hand on 30.6.2017 had been inflated by B by ₹ 5,000 to cover goods (at their cost price) removed and sold by him personally for ₹ 4,000. The partners agreed that the stock should have realized ₹ 6,000. The stock on 30.6.2018 was correctly valued at ₹ 35,750.

(b) Cheques received from old debtors in June 2018, amounting to ₹ 3,000 (and in respect of which no discount was allowable) had been omitted from the books of account and appropriated by B for his own use.

(c) In March, 2018, B had got some private work done by the firm's printers; bills amounting to ₹ 400 had been passed through firm's books and debited to Printing and Stationery Account.

The Balance Sheet as on 30.6.2018 (before making adjustments on account of B's disclosure) was as follows :

Liabilities		₹	Assets		₹
Trade Creditors	40,000		Sundry Fixed Assets		5,000
Less: Reserve for discount	1,000	39,000	Stock		35,750
Bank Loan		2,000	Trade Debtors	78,000	
Capital — A		70,200	Less: Provision for discount	3,900	74,100
Capital — B		4,500	Cash		1,550
Capital — C		700			
		1,16,400			1,16,400

The goodwill and other assets except cash were taken over by A for ₹ 1,20,000. Final settlement was made on July 31, 2018. B having agreed to make good the amount due by him to the partnership. The bank loan and creditors were also paid on that date, discount being allowed as per provision. B is not to be penalised for his irregularities. Pass Journal Entries in respect of B's irregularities and prepare Ledger Accounts to close the books of the firm.

Solution

Working Note : (1) Adjustment for Stock Withdrawn by B

Particulars		A	B	C
Debit for Closing Stock inflated by B on 30.6.2017 (3 : 2)		3,000	2,000	—
Credit to be given for the Opening Stock overvalued on 1.7.2017 (27 : 18 : 5)		2,700	1,800	500
Excess Debit/Credit	(A)	(Dr.) 300	(Dr.) 200	(Cr.) 500
Actual Credit for goods withdrawn by B [Note (a)]		3,600	2,400	—
Debit for goods removed		—	6,000	—
	(B)	(Cr.) 3,600	(Dr.) 3,600	
Required Adjustment	(B – A)	(Cr.) 3,300	(Dr.) 3,800	(Cr.) 500

(a) Since goods were taken prior to 'fixed profit' to C, hence credit has been given to A and B in the ratio of 3 : 2.

In the books of A, B and C
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017 July 1	B Capital A/c	Dr.	3,800	
	To A Capital A/c			3,300
	To C Capital A/c			500
	(Being adjustment for the stock misappropriated by B)			
	B Capital A/c	Dr.	3,000	
	To Sundry Debtors A/c			3,000
	(Being money received from debtors misappropriated by B)			
	Provision for Discount on Debtors A/c (5% on ₹ 3,000)	Dr.	150	
	To A Capital A/c			90
	To B Capital A/c			60
	(Being provision for discount on debtors no longer required, adjusted)			
	B Capital A/c	Dr.	400	
	To Profit & Loss Adjustment A/c			400
	(Being B's personal expenses charged to firm's expenses, now rectified)			
	Profit & Loss Adjustment A/c	Dr.	400	
	To A Capital A/c			216
	To B Capital A/c			144
	To C Capital A/c			40
	(Being the profit transferred to Partners' Capital Accounts in the new profit sharing ratio of 27: 18: 5)			

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Sundry Fixed Assets A/c	5,000	2018 June 30	By Provision for discount on Debtors A/c	3,750
	To Stock A/c	35,750		By Sundry Creditors A/c	40,000
	To Sundry Debtors A/c	75,000		By Bank loan A/c	2,000
	To Reserve for Discount on Creditors A/c	1,000		By A Capital A/c (assets taken over)	1,20,000
	To Cash A/c (Creditors paid off)	39,000			
	To Cash A/c (loan paid)	2,000			
	To Partners' Capital A/cs : (A — ₹ 4,320; B — ₹ 2,880; C — ₹ 800)	8,000			
		1,65,750			1,65,750

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

	Particulars	₹		Particulars	₹
2018 June 30	To Balance b/d	1,550	2018 June 30	By Realisation A/c — Creditors	39,000
	To A Capital A/c	41,874		By Realisation A/c — Bank loan	2,000
				By B Capital A/c	384
				By C Capital A/c	2,040
		43,424			43,424

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018 June 30	To A Capital A/c (stock)	—	3,300	—	2018 June 30	By Balance b/d	70,200	4,500	700
	To C Capital A/c (stock)	—	500	—		By B Capital A/c (stock)	3,300	—	500
	To Sundry Debtors A/c	—	3,000	—		By Prov. for Discount A/c	90	60	—
	To P&L Adj. A/c	—	400	—		By P&L Adj. A/c	216	144	40
	To Balance c/d	73,806	—	1,240		By Balance c/d	—	2,496	—
		73,806	7,200	1,240			73,806	7,200	1,240
	To Balance b/d	—	2,496	—		By Balance b/d	73,806	—	1,240
	To Realisation A/c	1,20,000	—	—		By Realisation A/c (profit)	4,320	2,880	800
	To Cash A/c (final payment)	—	384	2,040		By Cash A/c	41,874	—	—
		1,20,000	2,880	2,040			1,20,000	2,880	2,040

Balance Sheet as on 30th June, 2018 (after making adjustment on account of B's disclosure)

Liabilities		₹	Assets		₹
Creditors	40,000		Sundry Fixed Assets		5,000
Less: Reserve for Discount	1,000	39,000	Stock		35,750
Bank overdraft		2,000	Trade Debtors	75,000	
Capital — A		73,806	Less: Provision for Bad Debts	3,750	71,250
Capital — C		1,240	Cash		1,550
			Capital — B		2,496
		1,16,046			1,16,046

Case 2 : Where Some of the Partners are Solvent and Others Insolvent

At the time of dissolution of a partnership firm, the Capital Account of a partner may show a debit balance after his share of any profit or loss on realisation has been included in his account; and if he cannot make good the whole or part of the deficiency, what should be done? In such a situation, this deficiency must be shared by all the solvent partners. Now the question arises in what ratio?

The solvent partners may share such deficiency: (i) in their profit-sharing ratio (like any business loss); or (ii) in the ratio of their last agreed capitals (as has been decided in the case of ***Garner Vs. Murray***)

Decision in Garner Vs. Murray

Garner, Murray and Wilkins were equal partners with unequal capitals.

The assets of the firm on dissolution, after satisfying all the liabilities to creditors and advance (by Murray) from partners were insufficient to repay the capitals in full. There was a deficiency of £ 635 and the capital account of Wilkins was showing a debit balance of £ 263. Nothing could be recovered from Wilkins owing to insolvency. The decision was given by Mr. Justice Joyee in 1904. His decision was as under:

> ***"The solvent partners are only liable to make good their share of the deficiency, and that the remaining assets should be divided among them in proportion to their capitals"***

In effect, the decision in Garner Vs. Murray boiled down to this:

(a) The solvent partners should contribute to the deficiency of capital (caused by loss on realisation) in cash their share only and not the insolvent partners' share.

(b) The net effect of what has been stated above is that the deficiency of capital of the insolvent partner gets distributed among the solvent partners in the ratio of their last agreed capitals.

To Illustrate:

A, B & C are partners. A countributed ₹ 1,600; B ₹ 400; and C ₹ 250; sharing profits and losses equally. (Total Capital: ₹ 1,600 + ₹ 400 + ₹ 250 = ₹ 2,250) ₹ 1,350 were left after paying off all liabilities on dissolution. Hence, capital loss is ₹ 2,250 – ₹ 1,350 = ₹ 900. If all the partners were solvent, ₹ 300 contributed by each would have restored the capital, so that A, B and C would have got back their respective capitals, namely, ₹ 1,600 (A), ₹ 400 (B) and ₹ 250 (C).

But C being insolvent and his personal properties yeilding nothing, A and B would contribute ₹ 300 each. This will bring up the funds of the firm to ₹ 1,950 from ₹ 1,350 (₹ 1350 + ₹ 600). And, according to the decision in Garner Vs. Murray, these assets (cash/bank) amounting to ₹ 1,950 should be distributed between A and B in the ratio of 4:1, that is the last agreed capital. Now let us look at the entire picture of settlement at a glance :

Particulars	A	B
Last agreed Capital	1,600	400
Less: Realisation loss (in profit and loss ratio, that is, equally)	300	300
	1,300	100
Add: Cash brought in to make good their loss	300	300
	1,600	400
Less: Distribution of ₹ 1,950 in 4:1 (ratio of last agreed Capital)	1,560	390
Loss	40	10
(FINAL) Debit balance of C (₹ 300 – ₹ 250)	**₹ 40 + ₹ 10 = ₹ 50**	

Therefore, A and B have shared the loss due to deficiency in the capital account of the insolvent partner C, in the ratio of their last agreed capital (4:1).

Criticism of Garner Vs. Murray

1. It does not apply when the firm is having only two partners.
2. It considers only the book capital of the partners, ignoring the private estate of the solvent partners. If a partner contributed more capital than that of the other partners, he will have to bear more burden than other partners contributing less capital.
3. If a partner is having a nil capital balance or a debit balance, he will not have to bear the deficiency of the insolvent partner.
4. Introduction of cash by the solvent partners to make good their share of loss on realisation is unnecessary, when the balance of the capital accounts of the solvent partners are sufficient to bear the deficiency of the insolvent partner.

Our Comments

1. It is not unjust and inequitable law to ask a partner with larger capital to bear the larger portion of the loss. Psychologically, the partners with lower capital will not react unfavourably.
2. Many authors have described that bringing cash to the extent of loss on realization is meaningless. We do not think it is meaningless. We are aware that some of the decisions of the old English judges have laid the foundation of our modern accounting theory and auditing. In fact, the knowledge of accounting of some of the English judges was far superior to many of our modern accounting stalwarts. Introduction of such further capital is an epitome of the doctrine of conservatism. As Shakespeare had rightly said that "there are many a slip between the cup and the lip". Who knows that of the C, A or B will not become insolvent without any attachable personal property.

Points to Remember

1. ***Garner Vs. Murray is applicable only when there is no agreement among the partners for sharing the deficiency in capital account of insolvent partner.***
2. ***Realisation loss should be divided in the profit sharing ratio in the usual manner.***
3. ***The solvent partners should bring in cash to make good the loss on realisation.***
4. ***Final debit balance (after debiting realization loss) of insolvent partner should be shared amongst the solvent partners in proportion to their last agreed capital.***
5. ***A solvent partner having debit balance in Capital Account will not share any loss due to insolvency of a partner.***

Applicability of Garner Vs. Murray to India

Section 48 of the Indian Partnership Act 1932 is identical with the section 44 of the Partnership Act in Great Britain and further there has been no case law in India which has examined this question. Therefore, it is justified to assume that Garner Vs. Murray will also apply in India.

Application of Garner Vs. Murray for Fixed and Fluctuating Capital

It has already been stated that the deficiency of an insolvent partner is to be borne by the solvent partners in the ratio of their ***last agreed capitals***. In this connection, the distinction between fixed and fluctuating capitals is material.

Fixed Capital When the partners follow fixed capital method, each partner will have one Capital Account and one Current Account. To determine the ratio in which the insolvency loss is to be shared, ***only Capital Accounts*** balances are to be considered (ignoring current account balance).

Fluctuating Capital When the partners follow fluctuating capital method, only one Capital Account is maintained for each partner. To ascertain the last agreed capital, all sorts of adjustments like reserves, undrawn profits or accumulated losses, drawings etc are to be made excepting the profit or loss arising out of realisation of assets and liabilities.

Firm's Debts Vs Private Debts

The joint estate of the partners as a firm and their separate estates as individuals are administered separately.

The separate estate of each partner is to be utilised first for paying his ***private debts***. Any surplus from the separate estate can be utilised for paying firm's debts. But any deficiency of his private estate is not included in the joint estate. Similarly, the joint estate of the firm is to be utilised first for paying the debts of the firm.

Illustration 16

A, B and C had been in partnership for many years and shared profits and losses in the ratio of 1:2:2. Their respective capitals were :

A — ₹ 10,000; B — ₹ 10,000; C — ₹ 2,000.

The partners decided to dissolve the partnership after a succession of losses following a fall off in demand. On dissolution, there was a loss of ₹ 15,000 to be shared among the partners. C was insolvent and unable to contribute anything towards his deficiency which had to be borne by his co-partners.

Required : Partners' Capital Accounts to record the above matters [***Apply Garner Vs. Murray***]

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To Realisation A/c – loss	3,000	6,000	6,000	By Balance b/d	10,000	10,000	2,000
To C Capital A/c (Note 2)	2,000	2,000	—	By Bank A/c (Note 1)	3,000	6,000	—
To Bank A/c	8,000	8,000	—	By A Capital A/c	—	—	2,000
				By B Capital A/c	—	—	2,000
	13,000	16,000	6,000		13,000	16,000	6,000

Working Note: (1) The solvent partners will bring in cash equal to realisation loss.
(2) Deficiency of C is borne by A and B in the capital ratio (1:1).

Illustration 17

A, B and C are in partnership, sharing profits and losses equally. The firm's Balance Sheet at 31.12.2017 was as follows:

Liabilities			₹	Assets		₹
Sundry Creditors			64,000	Cash		1,600
Capital Accounts :	A	24,000		Sundry Debtors		53,000
	B	8,000		Stock		22,200
	C	4,000	36,000	Machinery & Plant		26,000
Current Accounts :	A		10,800	Current Accounts :	B	2,000
					C	6,000
			1,10,800			1,10,800

It was decided to dissolve the firm on that date. The Machinery and Plant, Stock and Debtors were sold by the firm for ₹ 70,000. Creditors were paid off

Assuming that C is insolvent and could not meet his liability to the firm, show necessary Ledger Accounts in the books of the firm. [***Apply Garner Vs. Murray principle***.]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Sundry Debtors A/c	53,000	2017	By Creditors A/c	64,000
Dec. 31	To Stock A/c	22,200	Dec. 31	By Cash A/c (Sale of assets)	70,000
	To Machinery & Plant A/c	26,000		By Partners' Capital A/cs:	
	To Cash A/c (Payment to Creditors)	64,000		(A — ₹ 10,400; B — 10,400; C — 10,400)	31,200
		1,65,200			1,65,200

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017	To Balance b/f	1,600	2017	By Realisation A/c	64,000
Dec. 31	To Realisation A/c — sale of assets	70,000	Dec. 31	By A Capital A/c	25,500
	To A Capital A/c	10,400		By B Capital A/c	2,900
	To B Capital A/c	10,400			
		92,400			92,400

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Current A/cs	—	2,000	6,000	2017	By Balance b/d	24,000	8,000	4,000
Dec. 31	To Realisation A/c (loss)	10,400	10,400	10,400	Dec. 31	By Current A/cs	10,800	—	—
	To C Capital A/c	9,300	3,100	—		By Cash A/c (Note 1)	10,400	10,400	—
	To Cash A/c	25,500	2,900	—		By A Capital A/c	—	—	9,300
						By B Capital A/c	—	—	3,100
		45,200	18,400	16,400			45,200	18,400	16,400

Working Notses : (1) The solvent partners should bring in cash to make good the loss on realisation.

(2) C's total deficiency of ₹ 12,400 (₹ 16,400 – ₹ 4,000) should be shared by A and B in the ratio of their fixed capital ₹ 24,000: ₹ 8,000 or 3 : 1. Current Account balances are to be ignored for this purpose.

Illustration 18

The following was the Balance Sheet as at 31st March, 2018 of M/s Ideal Works in which A, B and C were partners sharing profits and losses in the ratio of 6:3:5.

Liabilities	₹	Assets	₹
A's Capital A/c	25,000	Land and Building	10,000
C's Capital A/c	15,000	Furniture	5,000
A's Current A/c	1,000	Stock-in-trade	23,100
C's Current A/c	500	Sundry Debtors	30,000
Sundry Creditors	30,000	Cash at Bank	2,500
Loan on mortgage of Land and Building	4,000	B's Current A/c	4,900
	75,500		75,500

It was decided to dissolve the partnership as on the date of the Balance Sheet. The assets of the firm is realised as under:

Land and Building ₹ 6,000; Furniture ₹ 2,000; Stock-in-trade ₹15,000 and Sundry Debtors ₹ 20,000. The expenses of realisation amounted to ₹ 2,000. The Sundry Creditors agreed to receive 75 paise in a rupee in full satisfaction of their claim. Loan on mortgage was paid. It was ascertained that B had become insolvent. B's estate had contributed only 50 paise in a rupee.

Write up the Realisation Account, Bank Account, Capital Account of the partners following the rule given in Garner Vs. Murray.

Solution

In the books of M/s Ideal Works

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2018	To Land and Building A/c	10,000	2018	By Sundry Creditors A/c		30,000
Mar 31	To Furniture A/c	5,000	Mar 31	By Mortgage Loan A/c		4,000
	To Stock-in-trade A/c	23,100		By Bank A/c (assets realised)		43,000
	To Sundry Debtors A/c	30,000		By Partners' Capital A/cs:	A	8,400
	To Bank A/c (creditor @ 75% of ₹ 30,000)	22,500			B	4,200
	To Bank A/c (mortgage Loan)	4,000			C	7,000
	To Bank A/c (expenses)	2,000				
		96,600				96,600

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2018	To Current A/c	—	4,900	—	2018	By Balance b/d	25,000	—	15,000
Mar 31	To Realisation A/c (loss)	8,400	4,200	7,000	Mar 31	By Current A/c	1,000	—	500
	To B Capital A/c (5 : 3)	2,844	—	1,706		By Bank A/c (Note 1)	8,400	—	7,000
	To Bank A/c (final payment)	23,156	—	13,794		By Bank A/c (Note 2)	—	4,550	—
						By A Capital A/c (Note 2)	—	2,884	—
						By C Capital A/c (Note 2)	—	1,706	—
		34,400	9,100	22,500			34,400	9,100	22,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar 31	To Balance b/d	2,500	2018 Mar 31	By Realisation A/c — creditors paid	22,500
	To Realisation A/c — Assets sold	43,000		By Realisation A/c — payment of mortgage loan	4,000
	To B Capital A/c (Note 2)	4,550		By Realisation A/c — expenses	2,000
	To A Capital A/c (Note 1)	8,400		By A Capital A/c	23,156
	To C Capital A/c (Note 1)	7,000		By C Capital A/c	13,794
		65,450			65,450

Working Notes :

(1) The solvent partners should bring in cash to make good the loss on realisation.

(2) B's Capital Account showing a debit balance of ₹ 9,100. But he can bring only 50% of it, i.e., ₹ 4,550. The balance amount, i.e., 4,550 should be shared by A and C in the ratio of their fixed capital, i.e., 25,000 : 15,000 or 5 : 3. The current account balances are to be ignored.

Illustration 19

The following is the Balance Sheet of A, B and C sharing profits in the ratio of 2 : 2 : 1.

Liabilities	₹	Assets	₹
Creditors	32,000	Sundry Assets	98,000
Capital : A	45,000	Cash	4,000
Capital : B	30,000	Capital : C — Overdrawn	5,000
	1,07,000		1,07,000

The firm is dissolved. Sundry assets realised ₹ 94,000 and creditors accepted ₹ 31,000 in full settlement. Expenses amounted to ₹ 2,000. C was insolvent and a final dividend of 60% was received from his estate. Show necessary accounts including Cash Book. [Apply Garner Vs Murray rule]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Assets A/c	98,000		By Creditors A/c	32,000
	To Cash A/c (payment to creditors)	31,000		By Cash A/c (realisation of assets)	94,000
	To Cash A/c (realisation expenses)	2,000		By Partners' Capital A/cs: (A — ₹ 2,000; B — 2,000; C — 1,000)	5,000
		1,31,000			1,31,000

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,000		By Realisation A/c — creditors paid	31,000
	To Realisation A/c — (realisation of assets)	94,000		By Realisation A/c — (realisation expenses)	2,000
	To Partners' Capital A/cs:			By Partners' Capital A/cs:	
	A (cash brought in to make good the firm)	2,000		A (final payment)	43,560
	B (cash brought in to make good the firm)	2,000		B (final payment)	29,040
	C (final dividend @ 60%)	3,600			
		1,05,600			1,05,600

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

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	5,000	By Balance b/d	45,000	30,000	—
To Realisation A/c (loss)	2,000	2,000	1,000	By Cash A/c (cash brought in)	2,000	2,000	—
To Partners' Capital A/cs — C	1,440	960	—	By Cash A/c (final dividend)	—	—	3,600
To Cash A/c (final payment)	43,560	29,040	—	By Partners' Capital A/cs — A	—	—	1,440
				By Partners' Capital A/cs — B	—	—	960
	47,000	32,000	6,000		47,000	32,000	6,000

Tutorial Note: Deficiency of C : ₹ (6,000 – 3,600 = 2,400) has been borne by A and B in their capital ratio, i.e., 45 : 30 or 3 : 2.

Illustration 20

A, B and C are in partnership sharing profits and losses as 3/6th, 2/6th and 1/6th respectively. The Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	38,500	Cash in hand	9,860
A's Loan Account	2,750	Sundry Debtors	30,560
Capital Account: A	15,200	Stock	18,440
Capital Account: B	11,200	Furniture	7,200
		Capital Account : C (Dr.)	1,590
	67,650		67,650

The assets realised: Stock ₹ 13,840; Furniture ₹ 5,150; and Debtors ₹ 29,200. The creditors were paid less discount amounted to ₹ 250. A and B are solvent but C is insolvent and he is unable to bring in anything. The expenses of winding up were ₹ 520. You are required to prepare: (i) Realisation Account; (ii) Cash Account; and (iii) Capital Accounts of the Partners.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
	To Sundry Debtors A/c	30,560		By Sundry Creditors A/c		38,500
	To Stock A/c	18,440		By Bank A/c:		
	To Furniture A/c	7,200		Stock	13,840	
	To Bank A/c (payment to creditors)	38,250		Furniture	5,150	
	To Bank A/c (expenses of winding up)	520		Sundry Debtors	29,200	48,190
				By Partners' Capital A/cs: (A — ₹ 4,140; B — ₹ 2,760; C — ₹ 1,380)		8,280
		94,970				94,970

Dr. A Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	2,750		By Balance b/d	2,750

Dr. Cash and Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	9,860		By Realisation A/c — creditors paid	38,250
	To Realisation A/c	48,190		By Realisation A/c — (winding-up expenses)	520
	To Partners' Capital A/cs:			By A Loan A/c	2,750
	A (cash brought in to make good the firm)	4,140		By Partners' Capital A/cs:	
	B (cash brought in to make good the firm)	2,760		A (final payment)	13,490
				B (final payment)	9,940
		64,950			64,950

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	1,590	By Balance b/d	15,200	11,200	—
To Realisation A/c (loss)	4,140	2,760	1,380	By Cash A/c (cash brought in)	4,140	2,760	—
To Partners' Capital A/cs — C	1,710	1,260	—	By Partners' Capital A/cs — A	—	—	1,710
To Cash A/c (final payment)	13,490	9,940	—	By Partners' Capital A/cs — B	—	—	1,260
	19,340	13,960	2,970		19,340	13,960	2,970

Tutorial Note: C's deficiency of ₹ 2,970 has been borne by A and B in their capital ratio, i.e., 15,200 : 11,200 or 152 : 112.

Illustration 21

P, Q, R and S, carrying on business as partners and sharing profits and losses in the ratio of 2 : 3 : 3 : 2, decided to discontinue their business from 1.1.2018. On 31.12.2017 their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Capital Accounts: (P — ₹ 10,000; Q — 4,000; R — 4,000; S — 3,000)	21,000	Plant and Machinery	30,000
Creditors	20,000	Furniture	10,000
Bills Payable	10,000	Cash at Bank	1,000
Q Loan A/c	5,000	Loss	15,000
	56,000		56,000

Further information regarding partners are stated below:

Partners		P	Q	R	S
Private Estate	(₹)	12,000	22,000	6,000	10,000
Private Liabilities	(₹)	18,000	8,000	5,000	12,000

The assets realised ₹ 26,000. The expenses of dissolution amounted to ₹ 1,000. Close the books of the firm.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 Jan. 1	To Plant and Machinery A/c	30,000	2018 Jan. 1	By Sundry Creditors A/c	20,000
	To Furniture A/c	10,000		By Bills Payable A/c	10,000
	To Bank A/c (payment of creditors and B/P)	30,000		By Bank A/c (realisation of assets)	26,000
	To Bank A/c (expenses of dissolution)	1,000		By Partners' Capital A/cs: (P — 3,000; Q — 4,500; R — 4,500; S — 3,000)	15,000
		71,000			71,000

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

Particulars	P	Q	R	S	Particulars	P	Q	R	S
To Loss	3,000	4,500	4,500	3,000	By Balance b/d	10,000	4,000	4,000	3,000
To Realisation A/c	3,000	4,500	4,500	3,000	By Bank A/c (Note 1)	—	4,500	1,000	—
To Partners' Capital A/cs:					By Partners' Capital A/cs:				
R (Note 1)	4,000	—	—	—	P	—	—	4,000	3,000
S (Note 1)	3,000	—	—	—	By Q Loan A/c	—	5,000	—	—
To Partners' Capital A/cs:					By Partners' Capital A/cs:				
P (Note 2)	—	3,000	—	—	Q (Note 2)	3,000	—	—	—
To Bank A/c	—	1,500	—	—					
	13,000	13,500	9,000	6,000		13,000	13,500	9,000	6,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	1,000	2018	By Realisation A/c — (payment of creditors)	30,000
Jan. 1	To Realisation A/c (realisation of assets)	26,000	Jan. 1	By Realisation A/c — (expenses)	1,000
	To Partners' Capital A/cs:			By Partners' Capital A/cs:	
	Q (cash brought in to make good the firm)	4,500		Q (final payment)	1,500
	R (cash brought in to make good the firm)	1,000			
		32,500			32,500

Working Notes:

(1) S cannot pay his personal liabilities, so his balance of deficiency will be ₹ 3,000. R can only pay ₹ 1,000 from his private estate, so his deficiency will be (₹ 5,000 – 1,000) = ₹ 4,000. Therefore, total deficiency of R and S will be (₹ 4,000 + ₹ 3,000) = ₹ 7,000 and this should be borne by the solvent partners (i.e., P and Q) in their capital ratio just before dissolution. But before dissolution only P has credit balance and Q has negative balance, so P will bear the whole deficiency of ₹ 7,000.

(2) After debiting the deficiency of ₹ 7,000, P's Capital Account shows a debit balance of ₹ 3,000 but P cannot bring any money and ultimately Q will have to bear it.

Illustration 22

Ajay, Vijay, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31.3.2018 :

Liabilities			₹	Assets			₹
Creditors			3,00,000	Debtors		3,50,000	
Capital Accounts :	Ajay	7,00,000		Less : Provision for bad debts		50,000	3,00,000
	Shyam	3,00,000	10,00,000	Cash			1,40,000
				Stock			2,00,000
				Other Assets			3,10,000
				Capital Accounts :	Vijay	2,00,000	
					Ram	1,50,000	3,50,000
			13,00,000				13,00,000

On 31.3.2018, the firm is dissolved and the following points are agreed upon :

Ajay is to take over debtors at 80% of book value; Shyam is to take over the stock at 95% of the value; and Ram is to discharge creditors. Other assets realise ₹ 3,00,000 and the expenses of realisation come to ₹ 30,000. Vijay is found insolvent and ₹ 21,900 is realised from his estate.

Prepare Realisation Account, Cash Account and Capital Accounts of the partners. The loss arising out of capital deficiency may be distributed following the decision in Garner vs. Murray.

[C.A. (Inter) —Adapted]

Solution

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Debtors A/c	3,50,000	2018	By Provision for Bad Debts A/c	50,000
March 31	To Stock A/c	2,00,000	March 31	By Creditors A/c	3,00,000
	To Other Assets A/c	3,10,000		By Ajay Capital A/c (debtors taken over)	2,80,000
	To Ram Capital A/c (creditors discharged)	3,00,000		By Shyam Capital A/c (stock taken over)	1,90,000
	To Cash A/c (expenses)	30,000		By Cash A/c (other assets realised)	3,00,000
				By Partners' Capital A/cs :	
				(Ajay : ₹ 28,000; Vijay : ₹ 7,000; Ram : ₹ 14,000; Shyam : ₹ 21,000)	70,000
		11,90,000			11,90,000

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

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	1,40,000	2018	By Realisation A/c (expenses)	30,000
March 31	To Realisation A/c (other assets)	3,00,000	March 31	By Partners' Capital A/cs :	
	To Partners' Capital A/cs :			Ajay	2,90,430
	Ajay	28,000		Ram	1,50,000
	Vijay	21,900		Shyam	54,470
	Ram	14,000			
	Shyam	21,000			
		5,24,900			5,24,900

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

Particulars	Ajay	Vijay	Ram	Shyam	Particulars	Ajay	Vijay	Ram	Shyam
To Balance b/d	—	2,00,000	1,50,000	—	By Balance b/d	7,00,000	—	—	3,00,000
To Realisation A/c	2,80,000	—	—	1,90,000	By Realisation A/c	—	—	3,00,000	—
To Realisation A/c (Loss)	28,000	7,000	14,000	21,000	By Cash A/c (Note 1)	28,000	—	14,000	21,000
To Vijay Capital A/c (WN 2)	1,29,570	—	—	55,530	By Cash A/c (Note 3)	—	21,900	—	—
To Cash A/c	2,90,430	—	1,50,000	54,470	By Ajay Capital A/c	—	1,29,570	—	—
					By Shyam Capital A/c	—	55,530	—	—
	7,28,000	2,07,000	3,14,000	3,21,000		7,28,000	2,07,000	3,14,000	3,21,000

Working Notes :

(1) Solvent partners should bring in cash to make good the loss on realisation.

(2) Vijay's deficiency of ₹ 1,85,100 (₹ 2,07,000 – ₹ 21,900) should be shared by Ajay and Shyam in the ratio of their capital, i.e., 7 : 3. Ram will not bear any loss on deficiency, because at the time of dissolution he had a debit balance in his Capital Account.

(3) The amount realised from the estate of Vijay.

Illustration 23

The firm of Kapil and Dev has four partners and as on 31st March, 2018, its Balance Sheet stood as follows :

Liabilities	₹	Assets	₹
Capital Accounts :		Land	50,000
F. Kapil	2,00,000	Building	2,50,000
S. Kapil	2,00,000	Office Equipments	1,25,000
R. Dev	1,00,000	Computers	70,000
Current Accounts :		Debtors	4,00,000
F. Kapil	50,000	Stocks	3,00,000
S. Kapil	1,50,000	Cash at Bank	75,000
R. Dev	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current Account :	
Current Liabilities	70,000	B. Dev	87,400
	13,80,000		13,80,000

The partners have been sharing profits and losses in the ratio of 4 : 4 : 1 : 1. It has been agreed to dissolve the firm on 1.4.2018 on the basis of the following understanding :

(a) The following assets are to be adjusted to the extent indicated with respect to the book values : Land 200%; Building 120%; Computers 70%; Debtors 95%; Stock 90%.

(b) In the case of the loan, the lenders are to be paid at their insistence a prepayment premium of 1%.

(c) B. Dev is insolvent and no amount is recoverable from him. His father, R. Dev, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

Assuming that the realisation of the assets and discharge of liabilities is carried out immediately, show the Cash Book, Realisation Account and the Partners' Capital Accounts.

Solution

In the books of M/s Kapil and Dev

Dr. **Cash Book (Bank column)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	75,000	2018	By Realisation A/c (payment of current liabilities)	70,000
April 1	To Realisation A/c (Note 1)	12,46,600	April 1	By Realisation A/c (Note 2)	5,05,000
				By Partners' Capital A/cs :	
				F. Kapil	2,42,600
				S. Kapil	3,42,600
				R. Dev	1,61,400
		13,21,600			13,21,600

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018	To Land A/c	50,000	2018	By Loan from NBFC A/c	5,00,000
April 1	To Building A/c	2,50,000	April 1	By Current Liabilities A/c	70,000
	To Office Equipment A/c	1,25,000		By Bank A/c (Note 1)	12,46,600
	To Computers A/c	70,000			
	To Debtors A/c	4,00,000			
	To Stocks A/c	3,00,000			
	To Other Current Assets	22,600			
	To Bank A/c (payment of current liabilities)	70,000			
	To Bank A/c (Note 2)	5,05,000			
	To Partners' Capital A/cs :				
	F. Kapil	9,600			
	S. Kapil	9,600			
	R. Dev	2,400			
	B. Dev	2,400			
		18,16,600			18,16,600

Dr. Partners' Capital Accounts Cr.

Particulars	F. Kapil	S. Kapil	R. Dev	B. Dev	Particulars	F. Kapil	S. Kapil	R. Dev	B. Dev
To Current A/c	—	—	—	87,400	By Balance b/d	2,00,000	2,00,000	1,00,000	—
To B. Dev Capital A/c (50% of deficiency)	—	—	42,500	—	By Current A/cs	50,000	1,50,000	1,10,000	—
					By Realisation A/c (profit)	9,600	9,600	2,400	2,400
To B. Dev Capital A/c (Note 3)	17,000	17,000	8,500	—	By R. Dev Capital A/c	—	—	—	42,500
					By F. Kapil Capital A/c	—	—	—	17,000
To Bank A/c	2,42,600	3,42,600	1,61,400	—	By S. Kapil Capital A/c	—	—	—	17,000
					By R. Dev Capital A/c (deficiency)	—	—	—	8,500
	2,59,600	3,59,600	2,12,400	87,400		2,59,600	3,59,600	2,12,400	87,400

Working Notes :

(1) For lack of specific information, it is assumed that land, building, computer, debtors and stock are realised at agreed value and other assets at their book value. Therefore, total amount realised from assets = ₹ (1,00,000 + 3,00,000 + 1,25,000 + 49,000 + 3,80,000 + 2,70,000 + 22,600) = ₹ 12,46,600.

(2) NBFC loan to be repaid by paying 1% extra, i.e., ₹ 5,00,000 + ₹ 5,000 = ₹ 5,05,000.

(3) Net deficiency of B. Dev should be shared by the remaining partners in their capital ratio of 2 : 2 : 1.

Illustration 24

A, B, C and D have been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1.

They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2018.

Liabilities	₹	Assets	₹
Capital Account: A	50,000	Premises	60,000
Capital Account: B	30,000	Furniture	20,000
Capital Reserve	7,000	Stock	50,000
General Reserve	28,000	Debtors	20,000
Trade Creditors	10,000	Cash	4,000
Mortgage Loan	40,000	Capital Overdrawn : C	5,000
		Capital Overdrawn : D	6,000
	1,65,000		1,65,000

1. The realisations were: Debtors ₹ 12,000; Furniture ₹ 8,000; Stock ₹ 30,000; and Premises ₹ 45,000.
2. Expenses of dissolution amounted to ₹ 2,000.
3. Further creditors of ₹ 6,000 had to be met.
4. General reserves unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and Cash Account assuming that C became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner Vs Murray.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018	To Premises A/c	60,000	2018	By Trade Creditors A/c	10,000
April 30	To Furniture A/c	20,000	April 30	By Mortgage Loan A/c	40,000

	To Stock A/c	50,000		By Cash A/c (realisation of assets)	95,000
	To Debtors A/c	20,000		By Partners' Capital A/cs:	
	To Cash A/c (payment of liabilities)	56,000		(A ₹ 27,000; B 18,000; C 9,000; D 9,000)	63,000
	To Cash A/c (expenses)	2,000			
		2,08,000			2,08,000

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

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	4,000	2018	By Realisation A/c (Note 1)	56,000
April 30	To Realisation A/c (Note 2)	95,000	April 30	By Realisation A/c — (expenses)	2,000
	To Partners' Capital A/cs:			By Partners' Capital A/cs:	
	(cash brought in to make good the firm)			A (final payment)	59,428
	A	27,000		B (final payment)	36,572
	B	18,000			
	D	9,000			
	To Partners' Capital A/cs: D	1,000			
		1,54,000			1,54,000

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	5,000	6,000	By Balance b/d	50,000	30,000	—	—
To Realisation A/c (loss)	27,000	18,000	9,000	9,000	By General Reserve A/c	12,000	8,000	4,000	4,000
To C Capital A/c	5,572	3,428	—	—	By Capital Reserve A/c	3,000	2,000	1,000	1,000
To Cash A/c	59,428	36,572	—	—	By Cash A/c (brought in)	27,000	18,000	—	9,000
					By A Capital A/c	—	—	5,572	—
					By B Capital A/c	—	—	3,428	—
					By Cash A/c	—	—	—	1,000
	92,000	58,000	14,000	15,000		92,000	58,000	14,000	15,000

Working Notes:

(1) Mortgage loan ₹ 40,000 + Creditors ₹ 16,000 = ₹ 56,000;

(2) Debtors ₹ 12,000 + Stock ₹ 30,000 + Furniture ₹ 8,000 + Premises ₹ 45,000 = ₹ 95,000;

(3) C's deficiency of ₹ 9,000 to be borne by A and B in the ratio of their adjusted capital, i.e., A (₹ 50,000 + 12,000 + 3,000) and B (₹ 30,000 + 8,000 + 2,000) or 65 : 40. D will not bear any loss on deficiency because his capital account shows a debit balance at the time of realisation.

Illustration 25

P, Q, R and S had been carrying on business in partnership sharing profits and losses in the ratio of 4 : 3 : 2 : 1. They decided to dissolve the partnership on the basis of following Balance Sheet as on 30th April, 2011 :

Liabilities		₹	Assets		₹
Capital Accounts :			Land and Building		2,46,000
P	1,68,000		Furniture and Fixtures		65,000
Q	1,08,000	2,76,000	Stock		1,00,000
General Reserve		95,000	Debtors		72,500
Capital Reserve		25,000	Cash in Hand		15,500
Sundry Creditors		36,000	Capital Overdrawn :		
Mortgage Loan		1,10,000	R	25,000	
			S	18,000	43,000
		5,42,000			5,42,000

(i) The assets were realised as under :
Land and Building ₹ 2,30,000; Furniture and fixtures ₹ 42,000; Stock ₹ 72,000; Debtors ₹ 65,000.

(ii) Expenses of dissolution amounted to ₹ 7,800.

(iii) Further creditors of ₹ 18,000 had to be met.

(iv) R became insolvent and nothing was realised from his private estate.

Applying the principles laid down in Garner vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account. ***[C.A. (IPCC) — November, 2011]***

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	By Land and Building A/c	2,46,000		By sundry Creditors A/c	36,000
	To Furniture and Fixtures A/c	65,000		By Mortgage Loan A/c	1,10,000

Date	Particulars	₹	Date	Particulars	₹
	To Stock A/c	1,00,000		By Cash A/c (Realisation of Assets) :	
	To Debtors A/c	72,500		Land and Building	2,30,000
	To Cash A/c :			Furniture and Fixtures	42,000
	Expenses of Dissolution	7,800		Stock	72,000
	To Cash A/c :			Debtors	65,000
	Creditors (₹ 36,000 + 18,000)	54,000		By Partners' Capital A/cs :	
	Mortgage Loan	1,10,000		P : 4/10 of ₹ 1,00,300	40,120
				Q : 3/10 of ₹ 1,00,300	30,090
				R : 2/10 of ₹ 1,00,300	20,060
				S : 1/10 of ₹ 1,00,300	10,030
		6,55,300			6,55,300

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	15,500		By Realisation A/c :	
	To Realisation A/c :			Expenses	7,800
	Land and Building	2,30,000		Creditors	54,000
	Furniture and Fixture	42,000		Mortgage Loan	1,10,000
	Stock	72,000		By Partners' Capital A/cs (Final payment) :	
	Debtors	65,000		P	2,03,364
	To Partners' Capital A/cs :			Q	1,35,576
	P	40,120			
	Q	30,090			
	S	10,030			
	To S Capital A/c (Final cash brought in)	6,000			
		5,10,740			5,10,740

Dr. Partners' Capital Accounts Cr.

Particulars	P	Q	R	S	Particulars	P	Q	R	S
To Balance b/d	—	—	25,000	18,000	By Balance b/d	1,68,000	1,08,000	—	—
To Realisation A/c	40,120	30,090	20,060	10,030	By Gen. Reserve A/c	38,000	28,500	19,000	9,500
To R Capital A/c	12,636	8,424	—	—	By Capital Reserve A/c	10,000	7,500	5,000	2,500
To Cash A/c	2,03,364	1,35,576	—	—	By Cash A/c (Note 1)	40,120	30,090	—	10,030
(Final Payment)					By P Capital A/c	—	—	12,636	—
					By Q Capital A/c	—	—	8,424	—
					By Cash A/c	—	—	—	6,000
					(Cash brought in)				
	2,56,120	1,74,090	45,060	28,030		2,56,120	1,74,090	45,060	28,030

Working Notes :

(1) P, Q and S brought cash to make good, their share of realisation loss.

(2) R's deficiency of ₹ 21,060 will be shared by P and Q in the ratio of adjusted capital. S will not share any loss on deficiency because his Capital Account shows a debit balance.
The adjusted capital has to be calculated as follows :
P : ₹ 1,68,000 + 38,000 + 10,000 = ₹ 2,16,000.
Q : ₹ 1,08,000 + 28,500 + 7,500 = ₹ 1,44,000.
Therefore, the ratio of adjusted capital = 216 : 144 or 3 : 2.
P's share of deficiency = ₹ 21,060 / 5 × 3 = ₹ 12,636.
Q's share of deficiency = ₹ 21,060 / 5 × 2 = ₹ 8,424.

Illustration 26

A, B, C and D were partners sharing profits and losses in the ratio of 3 : 3 : 2 : 2. Following was their Balance Sheet as on 31.12.1994 :

Liabilities			₹	Assets			₹
Capital Accounts :	A	60,000		Capital Accounts :	C	48,000	
	B	45,000	1,05,000		D	18,000	66,000
Creditors			46,500	Furniture			12,000
A's Loan			30,000	Trade Marks			21,000
				Stock			30,000
				Debtors		48,000	
				Less: Provision for bad debts		1,500	46,500
				Bank			6,000
			1,81,500				1,81,500

On 31.12.1994, the firm was dissolved and B was appointed to realise the assets and to pay off the liabilities. He was entitled to receive 5% commission on the amounts finally paid to other partners as ***capital***. He was to bear the expenses of realisation. The assets were realised as follows : Debtors ₹ 33,000; Stock ₹ 24,000; Furniture ₹ 3,000; Trade Marks ₹ 12,000.

Creditors were paid off in full, in addition, a contingent liability for Bills Receivable discounted materialised to the extent of ₹ 7,500. Also, there was a joint life policy for ₹ 90,000. This was surrendered for ₹ 9,000. Expenses of realisation amounted to ₹ 1,500. C was insolvent but ₹ 11,100 was recovered from his estate.

Write up Realisation Account, Bank Account and Capital Accounts of the partners.

[C.U.B.Com. (Hons.) — 1995, 1998 & 2007]

Solution

This problem could be solved in two ways :

1. When 5% commission payable to B is treated as '***Realisation Expenses***' and debited to Realisation Account.
2. When 5% commission payable to B is ***not*** treated as 'Realisation Expenses' and ***not*** debited to Realisation Account.

1. When 5% Commission to B is treated as Realisation Expenses

It has been given in the problem that B is entitled to 5% commission on the amounts finally payable to other partners as ***capital***. B will bear the realisation expenses as per agreement. The main point in this problem is that B's commission is nothing but a realisation expenses to be given to B in the form of commission.

In this case, the solution of the problem will be as follows :

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1994	To Furniture A/c	12,000	1994	By Provision for Bad Debts A/c	1,500
Dec. 31	To Trade Marks A/c	21,000	Dec. 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c (Note 1)	81,000
	To Debtors A/c	48,000		By Partners' Capital A/c :	
	To Bank A/c (Note 2)	54,000		(A : ₹ 11,153; B : ₹ 11,153	
	To B Capital A/c (Note 3) (Commission)	1,176		C : ₹ 7,435; D : ₹ 7,435)	37,176
		1,66,176			1,66,176

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1994	To Balance b/d	6,000	1994	By Realisation A/c (Note 2)	54,000
Dec. 31	To Realisation A/c (Note 1)	81,000	Dec. 31	By A's Loan A/c	30,000
	To Partners' Capital A/cs (Note 3)			By Partners' Capital A/cs : (final payment)	
	C	11,100		A	23,512
	D	25,435		B	16,023
		1,23,535			1,23,535

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	48,000	18,000	By Balance b/d	60,000	45,000	—	—
To Realisation A/c (Loss)	11,153	11,153	7,435	7,435	By Bank A/c (final dividend)	—	—	11,100	—
To C Capital A/c (Note 4)	25,335	19,000	—	—	By Realisation A/c (Comm.)	—	1,176	—	—
To Bank A/c (final settlement)	23,512	16,023	—	—	By Bank A/c	—	—	—	25,435
					By A Capital A/c (Note 4)	—	—	25,335	—
					By B Capital A/c (Note 4)	—	—	19,000	—
	60,000	46,176	55,435	25,435		60,000	46,176	55,435	25,435

Working Notes :

(1) Total assets realised = ₹ (33,000 + 3,000 + 24,000 + 12,000 + 9,000) = ₹ 81,000.

(2) Total payment = ₹ (46,500 + 7,500) = ₹ 54,000. A's loan has been paid directly.

(3) Calculation of commission payable to B :

Let B's commission = x

We can find out realisation loss before taking into account B's commission. It is ₹ 36,000.

Therefore, realisation loss after B's commission = ₹ 36,000 + x.

Share of A = 3/10 (36,000 + x) = 10,800 + 3x / 10

Share of C = 2/10 (36,000 + x) = 7,200 + 2x / 10

C's deficiency = ₹ 48,000 + (₹ 7,200 + 2x / 10) – ₹ 11,100 = ₹ 44,100 + x / 5

Share of A in C's deficiency = 4/7 of (44,100 + x/5) = ₹ 25,200 + 4x / 35
A will finally get ₹ 60,000 – (₹ 10,800 + 3x / 10 + 25,200 + 4x / 35) = ₹ 60,000 – ₹ 10,800 – 3x / 10 – 25,200 – 4x / 35
= ₹ 24,000 – (21x + 8x) / 70
= ₹ 24,000 – 29x / 70
x = 5% [24,000 – 29x / 70]
or, 5 / 100 [24.000 – 29x / 70]
or, x = 1,200 – .02071x
or, 1.0207x = 1,200
or, x = 1,200 / 1.02071
or, x = 1175.64 = 1,176 (say).

(4) C's deficiency is to be shared by A and B in their capital ratio of 60,000 : 45,000 or 4 : 3. D will not bear any deficiency loss because his capital is negative.

2. When 5% Commission Payable to B is not treated as Realisation Expenses

In this case, the 5% commission payable to B on the amount finally payable to other partners as capital is not debited to Realisation Account. The realisation loss is calculated without this commission. Commission payable to B is adjusted through Capital Account of the partners. The solution in this case will be as follows:

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1994	To Furniture A/c	12,000	1994	By Provision for Bad Debts A/c	1,500
Dec. 31	To Trade Marks A/c	21,000	Dec. 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c (Note 1)	81,000
	To Debtors A/c	48,000		By Partners' Capital A/c (Loss) :	
	To Bank A/c (Note 2)	54,000		(A : ₹ 10,800; B : ₹ 10,800	
				C : ₹ 7,200; D : ₹ 7,200)	36,000
		1,65,000			1,65,000

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1994	To Bank A/c	6,000	1994	By Realisation A/c (Note 2)	54,000
Dec. 31	To Realisation A/c (Note 1)	81,000	Dec. 31	By A's Loan A/c	30,000
	To C Capital A/c (final dividend)	11,100		By A Capital A/c	22,857
	To D Capital A/c	25,200		By B Capital A/c	16,443
		1,23,300			1,23,300

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	48,000	18,000	By Balance b/d	60,000	45,000	—	—
To Realisation A/c (Loss)	10,800	10,800	7,200	7,200	By Bank A/c (final dividend)	—	—	11,100	—
To C Capital A/c (Note 3)	25,200	18,900	—	—	By A Capital A/c	—	—	25,200	—
To B Capital A/c (Note 4)	1,143	—	—	—	By B Capital A/c	—	—	18,900	—
To Bank A/c	22,857	16,443			By Bank A/c	—	—	—	25,200
					By A Capital A/c (Note 4)	—	1,143	—	—
	60,000	46,143	55,200	25,200		60,000	46,143	55,200	25,200

Working Notes :

(1) Total Assets Realised

	₹
Debtors	33,000
Stock	24,000
Furniture	3,000
Trade Mark	12,000
J.L.P. (Surrender Value)	9,000
	81,000

(2) Total Payments

	₹
Creditors	46,500
Contingent Liabilities	7,500
	54,000

(3) Deficiency of C

	₹
Debit balance in Capital Account	48,000
Realisation Loss (2/10 of ₹ 36,000)	7,200
	55,200
Less: Final dividend	11,100
Deficiency	44,100

A and B will share the above deficiency in the capital ratio of 60 : 45 or 12 : 9 or 4 : 3.

A's share of deficiency = 4/7 × ₹ 44,100	25,200
B;s share of deficiency = 3./7 × ₹ 44,100	18,900
	44,100

It is to be noted that D will not share any deficiency because his capital account was having debit balance.

(4) B's Commission

Amount payable to A	₹
Credit balance of Capital Account	60,000
Less: Realisation Loss	(10,800)
Less: C's share of deficiency	(25,200)
Amount payable to A before B's Commission	24,000

B's Commission = $\frac{24{,}000}{105} \times 5 =$ ₹ 1.143

(5) It has not been given in the problem that Garner vs. Murray principle is to be adopted. Therefore, solvent partner will ***not*** bring cash equal to realisation loss.

Students should note the following

Sl.No.	Items	1st Method	2nd Method
1.	Realisation Loss	37,176	36,000
2.	Amount of Commission to B	1,176	1,143
3.	Final Payment to Partners : A B	 23,512 16,023	 22,857 16,443
4.	Share of Deficiency : A B	 25,335 19,000	 25,200 18,900

Authors' View

Solution under 1st method is much more logical as it is taking into consideration the realisation expenses for calculating realisation loss. It is true that under this method, the calculation of commission to B is to some extent complicated. We recommend the solution under 1st method.

In the examination if you have time, then follow 1st method, otherwise you can solve it by the 2nd method.

Illustration 27

Taana, Maana, Jaana and Raana were partners sharing profits and losses in 3 : 3 : 2 : 2. Following is their balance Sheet as on 31.03.2010 :

Liabilities			₹	Assets		₹
Capital Accounts : Taana	46,200			Capital Accounts : Jaana		48,000
Maana	30,000			Furniture		12,000
Raana	12,100		88,300	Trade Marks		21,000
Creditors			46,500	Stock		30,000
Reserve			30,000	Debtors	48,000	
Workmen Compensation Fund			10,000	Less: Provision for bad debts	1,500	46,500
				Cash at Bank		17,300
			1,74,800			1,74,800

Due to difference in opinion, the firm was dissolved on that date and Maana was appointed to realise the assets and pay off the liabilities. He was entitled to receive 5% commission on the amounts finally paid to other partners and to bear the realisation expenses. The assets realised were as follows :

Debtors — ₹ 43,000; Furniture — ₹ 8,000; Stock — ₹ 24,000; and Trade Mark — ₹ 12,000.

Creditors were paid in full. In addition, an unrecorded liability for ₹ 6,500 was also paid. Actual liability for workmen compensation amounted to ₹ 4,000. There was a Joint Life Policy for ₹ 90,000. This was surrendered for ₹ 9,000. Expenses of realisation ₹ 1,500 paid by the firm.

Jaana is declared insolvent and ₹ 17,800 realised from him. As per partnership deed, any deficiency on account of insolvency of a partner is required to be borne by solvent partners equally.

Write up Realisation Account, Bank Account and Capital Accounts of the partners in the books of the firm.

[C.U.B.Com. (Hons.) — 2010]

Solution

1. When 5% Commission Payable to Maana is treated as Realisation Expenses

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2010	To Furniture A/c	12,000	2010	By Provision for Bad Debts A/c	1,500
Mar 31	To Trade Mark A/c	21,000	Mar 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c :	
	To Debtors A/c	48,000		Debtors	43,000
	To Bank A/c :			Furniture	8,000
	Creditors	46,500		Stock	24,000
	Unrecorded Liability	6,500		Trade Mark	12,000
	To Maana Capital A/c (Commission) (Note 1)	2,341		J.L.P. (Surrendered)	9,000
				By Partners' Capital A/cs :	
				Taana	6,702
				Maana	6,702
				Jaana	4,468
				Raana	4,469
		1,66,341			1,66,341

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2010	To Balance b/d	17,300	2010	By Realisation A/c :	
Mar 31	To Realisation A/c :		Mar 31	Creditors	46,500
	Debtors	43,000		Unrecorded Liability	6,500
	Furniture	8,000		By Workmen Compensation Fund (Note 1)	4,000
	Stock	24,000		By Maana Capital A/c (Note 3)	1,500
	Trade Mark	12,000		By Taana Capital A/c	41,142
	J.L.P.	9,000		By Maana Capital A/c	25,783
	To Jaana Capital A/c	17,800		By Raana Capital A/c	5,675
		1,31,100			1,31,100

Dr. Partners' Capital Accounts Cr.

Particulars	Taana	Maana	Jaana	Raana	Particulars	Taana	Maana	Jaana	Raana
To Balance b/d	—	—	48,000	—	By Balance b/d	46,200	30,000	—	12,100
To Realisation A/c	6,702	6,702	4,468	4,469	By Reserve A/c	9,000	9,000	6,000	6,000
To Jaana Capital A/c (Note 4)	9,156	9,156	—	9,156	By Workmen Compensation Fund	1,800	1,800	1,200	1,200
To Bank A/c (Note 3)	—	1,500	—	—	By Bank A/c (Final dividend)	—	—	17,800	—
To Bank A/c (Final payment)	41,142	25,783	—	5,675	By Realisation A/c (Commission)	—	2,341	—	—
					By Taana Capital A/c	—	—	9,156	—
					By Maana Capital A/c (N - 2)	—	—	9,156	—
					By Raana Capital A/c	—	—	9,156	—
	57,000	43,141	52,468	19,300		57,000	43,141	52,468	19,300

Working Notes :

(1) Calculation of Commission Payable to Maana

Let Maana's commission be x.

The realisation loss before taking into commission payable to Maana = ₹ 20,000.

Therefore, realisation loss after Maana's commission = ₹ 20,000 + x

Share of Taana = 3/10 (₹ 20,000 + x) = 6,000 + (3x / 10)

Share of Maana = 3/10 (₹ 20,000 + x) = 6,000 + (3x / 10)

Share of Jaana = 2/10 (₹ 20,000 + x) = 4,000 + (2x / 10)

Share of Raana = 2/10 (₹ 20,000 + x) = 4,000 + (2x / 10)

Jaana's deficiency = ₹ 48,000 – 6,000 – 1,200 + (4,000 + 2x / 10) – ₹ 17,800

= ₹ 23,000 + (4,000 + 2x / 10)

= ₹ 27,000 + 2x / 10

Taana's share of deficiency of Jaana

1/3 of (27,000 + 2x / 10) or, 9,000 + 2x / 30)

Taana will finally get (46,200 + 9,000 + 1,800) – (9,000 + 2x / 30) – (6,000 + 3x / 10) = 42,000 – 11 / 30x

Raana's share of deficiency of Jaana

1/3 of (27,000 + 2x / 10)

or, 9,000 + 2x / 30

Raana will finally get :

(12,100 + 6,000 + 1,200) – (9,000 + 2x / 30) – (4,000 + 2x / 10) = 6,300 – 8 / 30x

x = 5% [(42,000 – 11 / 30x) + (6,300 – 8 / 30x)

$= 5\% \left[48{,}300 - \frac{19}{30}x\right] = 2415 - 0.03167x$

$\rightarrow 1.03167x = 2415$

$\rightarrow x = 2340.86$

(2) Workmen compensation fund in excess of claim is to be treated as reserve. It should not be transferred to Realisation Account. It will be credited to partners in the profit sharing ratio, i.e., 3 : 3 : 2 : 2, just like any other reserve. The share of difference partners had been calculated as follows :

	₹
Workmen Comepnsation Fund as per Balance Sheet	10,000
Less: Actual liability for workmen compensation	4,000
Balance Fund	6,000
Taana's share : 3/10 of ₹ 6,000	1,800
Maana's share : 3/10 of ₹ 6,000	1,800
Jaana's share : 2/10 of ₹ 6,000	1,200
Raana's share : 2/10 of ₹ 6,000	1,200
	6,000

(3) Realisation expenses ₹ 1,500 paid by the firm will be treated as personal expenses of Maana. The entry will be :

		Dr.	Cr.
Maana Capital Account	Dr.	1,500	
To Bank Account			1,500

(4) Calculation of Jaana's Deficiency

		₹
Debit balance of Capital Account		48,000
Add: Realisation loss		4,468
		52,468
Less: Share of reserve	6,000	
Less: Share of workmen compensation fund	1,200	
Less: Final Dividend	17,800	(25,000)
Deficiency		27,468

Share of Deficiency of Jaana

Taana : 1/3 of ₹ 27,468 = ₹ 9,156 Maana : 1/3 of ₹ 27,468 = ₹ 9,156 Raana : 1/3 of ₹ 27,468 = ₹ 9,156.

2. When 5% Commission Payable to Maana is not treated as Realisation Expenses

Solution

In the books of the Firm

Realisation Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Furniture A/c	12,000	2010	By Provision for Bad Debts A/c	1,500
Mar 31	To Trade Mark A/c	21,000	Mar 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c :	
	To Debtors A/c	48,000		Debtors	43,000
	To Bank A/c :			Furniture	8,000

	Creditors	46,500		Stock	24,000
	Unrecorded Liability	6,500		Trade Mark	12,000
				J.L.P. (Surrendered)	9,000
				By Partners' Capital A/cs (Share of Loss) :	
				Taana	6,000
				Maana	6,000
				Jaana	4,000
				Raana	4,000
		1,64,000			1,64,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Balance b/d	17,300	2010	By Realisation A/c :	
Mar 31	To Realisation A/c :		Mar 31	Creditors	46,500
	Debtors	43,000		Unrecorded Liability	6,500
	Furniture	8,000		By Workmen Compensation Fund (Note 1)	4,000
	Stock	24,000		By Maana Capital A/c (Note 4)	1,500
	Trade Mark	12,000		By Taana Capital A/c	40,000
	J.L.P.	9,000		By Maana Capital A/c	26,600
	To Jaana Capital A/c (Final Dividend)	17,800		By Raana Capital A/c	6,000
		1,31,100			1,31,100

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

Particulars	Taana	Maana	Jaana	Raana	Particulars	Taana	Maana	Jaana	Raana
To Balance b/d	—	—	48,000	—	By Balance b/d	46,200	30,000	—	12,100
To Realisation A/c (Loss)	6,000	6,000	4,000	4,000	By Reserve A/c	9,000	9,000	6,000	6,000
To Jaana Capital A/c (Note 2)	9,000	9,000	—	9,000	By Workmen Compensation Fund	1,800	1,800	1,200	1,200
To Maana Capital A/c	2,000	—	—	300	By Bank A/c (Final dividend)	—	—	17,800	—
To Bank A/c (Note 4)	—	1,500	—	—	By Taana Capital A/c	—	—	9,000	—
To Bank A/c (Final payment)	40,000	26,600	—	6,000	By Maana Capital A/c	—	—	9,000	—
					By Raana Capital A/c (N - 2)	—	—	9,000	—
					By Taana Capital A/c	—	2,000	—	—
					By Raana Capital A/c	—	300	—	—
	57,000	43,100	52,000	19,300		57,000	43,100	52,000	19,300

Working Notes :

(1) Workmen compensation fund in excess of claim is to be treated as reserve. It should not be transferred to Realisation Account. It will be credited to partners in the profit sharing ratio, i.e., 3 : 3 : 2 : 2, just like any other reserve. The share of difference partners had been calculated as follows :

	₹
Workmen Comepnsation Fund as per balance Sheet	10,000
Less: Actual liability for workmen compensation	4,000
Balance Fund	6,000
Taana's share : 3/10 of ₹ 6,000	1,800
Maana's share : 3/10 of ₹ 6,000	1,800
Jaana's share : 2/10 of ₹ 6,000	1,200
Raana's share : 2/10 of ₹ 6,000	1,200
	6,000

(2) Calculation of Jaana's Deficiency

		₹
Debit balance of Capital Account		48,000
Realisation Loss		4,000
		52,000
Less: Share of reserve	6,000	
Less : Share of workmen compensation fund	1,200	7,200
Net Amount due from Jaana		44,800
Less: Final Dividend		17,800
Deficiency		27,000

Share of Taana : 1/3 of ₹ 27,000 = ₹ 9,000
Share of Maana : 1/3 of ₹ 27,000 = ₹ 9,000
Share of Raana : 1/3 of ₹ 27,000 = ₹ 9,000

(3) Final Amount Payable to Partners before 5% Commission of Maana

Particulars	Taana (₹)	Maana (₹)	Raana (₹)
Credit balance of capital	46,200	30,000	12,100
Share of Reserve	9,000	9,000	6,000
Share of Workmen Compensation Fund	1,800	1,800	1,200
	57,000	40,800	19,300
Less: Realisation Loss	(6,000)	(6,000)	(4,000)
Less; Deficiency Share	(9,000)	(9,000)	(9,000)
Amount Due before Commission of 5%	42,000	25,800	6,300
Commission for payment to Taana and Raana	$\frac{42,000}{105} \times 5$ = ₹ 2,000	—	$\frac{6,300}{105} \times 5$ = ₹ 300

(4) Realisation expenses of ₹ 1,500 paid by the firm will be treated as personal expenses of Maana. The entry will be :

Maana Capital Account	Dr.	1,500	
To Bank Account			1,500

Case 3 : Where All the Partners are Insolvent

When all the partners are insolvent and the firm's assets fall short of its liabilities, the creditors of the firm cannot be paid in full. The available cash with the firm (cash in hand + final dividend received from the partners' estate) is used first for paying realisation expenses. The balance amount is paid to creditors proportionally.

In order, to close the books of the firm, Realisation Account is prepared in the usual manner without transferring the liabilities to Realisation Account. All liabilities are discharged directly to the extent possible. Any balance left unpaid is transferred to Deficiency Account. The Partners' Capital Accounts are then closed by transferring to Deficiency Account.

The Accounting Entries are :

1. For payment of liabilities

Liabilities Account	Dr.	
To Cash/Bank Account		[Actual amount paid]
To Deficiency Account		[Unpaid amount]

2. For closing Partners' Capital Accounts

Deficiency Account	Dr.
To Partners' Capital Accounts	

Illustration 28

H and N were in equal partnership. Their Balance Sheet stood as under on 31st December, 2017 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors	3,200	Machinery and Plant	1,200
H's Capital	400	Furniture	300
		Debtors	500
		Stock-in-trade	400
		Cash	180
		N's Drawings	1,020
	3,600		3,600

The assets realised were as follows: Machinery ₹ 600; Furniture ₹ 100; Debtors ₹ 400; and Stock-in-trade ₹ 300.

The expenses of realisation amounted to ₹ 140. H's private estate is not sufficient even to pay his private debts, whereas in N's private estate there is a surplus of ₹ 140 only. Give accounts to close the books of the firm

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2017	To Machinery and Plant A/c	1,200	2017	By Cash A/c:		
Dec. 31	To Furniture A/c	300	Dec. 31	Machinery	600	
	To Debtors A/c	500		Furniture	100	
	To Stock-in-trade A/c	400		Debtors	400	
	To Cash A/c (realisation expenses)	140		Stock-in-trade	300	1,400

				By Partners' Capital A/cs: (H — ₹ 570; N — ₹ 570)	1,140
		2,540			2,540

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

Date	Particulars	₹	Date	Particulars	₹
2017	To Balance b/d	180	2017	By Realisation A/c (realisation expenses)	140
Dec. 31	To Realisation A/c (assets realised)	1,400	Dec. 31	By Creditors A/c (final payment to creditors)	1,580
	To Partners' Capital A/cs : N	140			
		1,720			1,720

Dr. **Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Cash A/c	1,580	2017	By Balance b/d	3,200
Dec. 31	To Deficiency A/c	1,620	Dec. 31		
		3,200			3,200

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

Date	Particulars	H	N	Date	Particulars	H	N
2017	To Drawings A/c	—	1,020	2017	By Balance b/d	400	—
Dec. 31	To Realisation A/c (loss)	570	570	Dec. 31	By Cash A/c (final dividend)	—	140
					By Deficiency A/c	170	1,450
		570	1,590			570	1,590

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Partners' Capital A/cs:		2017	By Creditors A/c	1,620
Dec. 31	(H — ₹ 170; N — ₹ 1,450)	1,620	Dec. 31		
		1,620			1,620

Tutorial Note: When all the partners are insolvent, the balance of creditors account should not be transferred to Realisation Account. All available cash is to be used first for paying realisation expenses and the balance cash is paid to creditors. If there is any credit balance in the Creditors Account, it is transferred to Deficiency Account. The Capital Account is closed by transferring to Deficiency Account.

Illustration 29

A, B and C are equal partners, whose Balance Sheet on December 31, 2017 is as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	5,000	Cash in hand	50
A's Loan	1,000	Stock	800
Capital A/cs:		Debtors	1,000
A	800	Plant & Machinery	2,000
C	500	Furniture & Fittings	800
		Land & Buildings	2,000
		B's Capital (overdrawn)	650
	7,300		7,300

Due to lack of liquidity and weak financial position of the partners, the firm is dissolved. A and C are not able to contribute anything and a sum of ₹ 200 received from B. All of them are declared insolvent. The assets are realised: Stock ₹ 500; Plant and Machinery ₹ 1,000; Furniture and Fittings ₹ 200; Land & Buildings ₹ 800; and Debtors ₹ 550 only. Realisation expenses amounted to ₹ 50. You are required to close the firm's books.

[C.U.B.com. (Hons.) — Adapted]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2017	To Stock A/c	800	2017	By Cash A/c:		
Dec. 31	To Debtors A/c	1,000	Dec. 31	Stock	500	
	To Plant & Machinery A/c	2,000		Plant & Machinery	1,000	
	To Furniture & Fittings A/c	800		Furniture & Fittings	200	
	To Land & Buildings A/c	2,000		Land & Buildings	800	
	To Cash A/c (realisation expenses)	50		Debtors	550	3,050
				By Partners' Capital A/cs:		
				(A — ₹ 1,200; B — ₹ 1,200; C — ₹ 1,200)		3,600
		6,650				6,650

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

Date	Particulars	₹	Date	Particulars	₹
2017	To Balance b/d	50	2017	By Realisation A/c (expenses)	50
Dec. 31	To Realisation A/c (assets realised)	3,050	Dec. 31	By Creditors A/c (final payment)	3,250
	To Partners' Capital A/cs : B	200			
		3,300			3,300

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Cash A/c (final payment)	3,250	2017	By Balance b/d	5,000
Dec. 31	To Deficiency A/c	1,750	Dec. 31		
		5,000			5,000

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017	To Partners' Capital A/cs:		2017	By Sundry Creditors A/c	1,750
Dec. 31	(B — ₹ 1,650; C — ₹ 700)	2,350	Dec. 31	By Partners' Capital A/cs : A	600
		2,350			2,350

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017	To Balance b/d	—	650	—	2017	By Balance b/d	800	—	500
Dec. 31	To Realisation A/c (loss)	1,200	1,200	1,200	Dec. 31	By Cash A/c (final div.)	—	200	—
	To Deficiency A/c	600	—	—		By A Loan A/c	1,000	—	—
						By Deficiency A/c	—	1,650	700
		1,800	1,850	1,200			1,800	1,850	1,200

Illustration 30

Following is the Balance Sheet as on 31st March, 2018 of a firm, having three partners, Alfa, Beta and Gama sharing profits and losses equally.

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Cash	3,120
Loan (secured by furniture)	10,000	Stock	15,630
Capital A/cs:		Debtors	4,720
Alfa	8,000	Furniture	9,530
Beta	6,000	Profit and Loss	12,000
Gama	1,000		
	45,000		45,000

The firm was dissolved due to insolvency of all the partners. Stock was sold for ₹ 9,900 while furniture fetched ₹ 5,000. ₹ 4,100 were recovered from debtors. Realisation expenses totalled ₹ 220.

Nothing could be recovered from Beta and Gamma, but ₹ 600 could be collected from Alfa's private estate. Close the books of the firm.

Solution

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Stock A/c	15,630	2018	By Cash A/c (assets realised) :	
Mar 31	To Debtors A/c	4,720	Mar 31	Stock 9,900	
	To Furniture A/c	9,530		Furniture 5,000	
	To Cash A/c (expenses)	220		Debtors 4,100	19,000
				By Partners' Capital A/cs:	
				(Alfa : 3,700; Beta : 3,700; Gama : 3,700)	11,100
		30,100			30,100

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

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	3,120	2018	By Realisation A/c (expenses)	220
Mar 31	To Realisation A/c (assets realised)	19,000	Mar 31	By Loan A/c (upto realisable value of furniture)	5,000
	To Partners' Capital A/cs : Alfa	600		By Loan A/c	3,500
				By Sundry Creditors A/c	14,000
		22,720			22,720

Dr. **Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar 31	To Cash A/c (upto realised value of furniture)	5,000	2018 Mar 31	By Balance b/d	10,000
	To Cash A/c (Note 1)	3,500			
	To Deficiency A/c	1,500			
		10,000			10,000

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar 31	To Cash A/c (Note 1)	14,000	2018 Mar 31	By Balance b/d	20,000
	To Deficiency A/c	6,000			
		20,000			20,000

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

Date	Particulars	Alfa	Beta	Gama	Date	Particulars	Alfa	Beta	Gama
2018 Mar 31	To Profit and Loss A/c	4,000	4,000	4,000	2018 Mar 31	By Balance b/d	8,000	6,000	1,000
	To Realisation A/c (loss)	3,700	3,700	3,700		By Cash A/c	600	—	—
	To Deficiency A/c	900	—	—		By Deficiency A/c	—	1,700	6,700
		8,600	7,700	7,700			8,600	7,700	7,700

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar 31	To Beta Capital A/c	1,700	2018 Mar 31	By Loan A/c	1,500
	To Gama Capital A/c	6,700		By Sundry Creditors A/c	6,000
				By Alfa Capital A/c	900
		8,400			8,400

Working Note : (1) Loan is secured by furniture and has a priority over sundry creditors upto the amount realised from furniture — which is ₹ 5,000. For the remaining loan, it is at par with sundry creditors. Total cash available to pay out loan and sundry creditors is ₹ 17,500 (₹ 3,120 + ₹ 19,000 + 600 – 220 – 5,000) which will be shared by Loan and Sundry Creditors in the ratio of their resultant claim, i.e., 5,000 : 20,000 = 1 : 4.

Illustration 31

X, Y and Z were in partnership sharing profits and losses in the ratio of 1/5 : 3/10 : 1/2. They prepared the following Balance Sheet as on 30.6.2018, when they decided to dissolve.

Liabilities	₹	Assets	₹
Capital A/cs:		Plant & Machinery	50,000
X	30,000	Sundry Debtors	2,00,000
Y	40,000	Advance to X	20,000
Z	30,000	Profit and Loss A/c (Balance)	80,000
Trade Creditors	1,20,000	Cash	10,000
Loan from Z (advanced 1.7.2017)	20,000		
Loan from Bank on Book debts and Plant	1,20,000		
	3,60,000		3,60,000

You ascertain that the balance in Profit and Loss Account is prior to charging interest, Plant and Machinery and Debtors realised ₹ 2,00,000. X's private estate which was valued at ₹ 70,000 has a liability thereon ₹ 30,000. The private estate realised only ₹ 40,000. Y is insolvent. Z can pay only 50 paise in the rupee of what is payable on his own account to the partnership.

Show Realisation Account, Cash Account and Partners' Capital Accounts. The loss on realisation is to be determined after considering the amount ultimately paid to creditors.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Plant & Machinery A/c	50,000	2018	By Trade Creditors A/c	1,20,000
June 30	To Sundry Debtors A/c	2,00,000	June 30	By Loan from Bank A/c	1,20,000
	To Cash A/c (payment of bank loan)	1,20,000		By Cash A/c (realisation of assets)	2,00,000
	To Cash A/c (payment to creditors)	1,02,933		By Partners' Capital A/cs: (X — ₹ 6,586; Y — ₹ 9,880; Z — 16,467)	32,933
		4,72,933			4,72,933

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Balance b/d	10,000	2018 June 30	By Realisation A/c (payment of bank loan)	1,20,000
	To Realisation A/c	2,00,000		By Realisation A/c (payment to creditors)	1,02,933
	To Partners' Capital A/cs: (X — ₹ 10,000; Z — ₹ 2,933 — Note 4)	12,933			
		2,22,933			2,22,933

Dr. Deficiency Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Partners' Capital A/cs (X — ₹ 2,826; Z — ₹ 2,934)	5,760	2018 June 30	By Partners' Capital A/cs : Y	5,760
		5,760			5,760

Dr. Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Profit & Loss A/c (2 : 3 : 5) (including interest on loan of Z @ 6%)	16,240	24,360	40,600	By Balance b/d	30,000	40,000	30,000
				By Loan A/c (incl. interest @ 6%)	—	—	21,200
To Advance A/c	20,000	—	—	By Cash A/c (₹ 40,000 – 30,000)	10,000	—	2,933
To Realisation A/c	6,586	9,880	16,467	By Deficiency A/c	2,826	—	2,934
To Deficiency A/c	—	5,760	—				
	42,826	40,000	57,067		42,826	40,000	57,067

Working Notes:

Dr. (1) Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Plant & Machinery A/c	50,000	2018 June 30	By Trade Creditors A/c	1,20,000
	To Sundry Debtors A/c	2,00,000		By Loan from Bank A/c	1,20,000
	To Cash A/c (payment of bank loan)	1,20,000		By Cash A/c (realisation of assets)	2,00,000
	To Cash A/c (payment to creditors)	X + 1,00,000		By Loss on Realisation A/c	X + 30,000
		X + 4,70,000			X + 4,70,000

Dr. (2) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Balance b/d	10,000	2018 June 30	By Realisation A/c (payment of bank loan)	1,20,000
	To Realisation A/c	2,00,000		By Realisation A/c (payment to creditors)	X + 1,00,000
	To X Capital A/c (₹ 40,000 – ₹ 30,000)	10,000			
	To Z Capital A/c	X			
		X + 2,20,000			X + 2,20,000

Dr. (3) Z Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 June 30	To Profit & Loss A/c	40,600	2018 June 30	By Balance b/d	30,000
	To Realisation A/c (1/2 loss)	X/2 + 15,000		By Loan A/c (including interest)	21,200
				By Cash A/c	1/2 (X/2 + 4,400)
				By Deficiency A/c	1/2 (X/2 + 4,400)
		X/2 + 55,600			X/2 + 55,600

(4) Let the amount brought in by Z = X
X = 1/2 (X/2 + 4,400);
or, 2X = X/2 + 4,400;
or, 4X = X + 8,800;
or, 3X = 8,800;
or, X = 2,933.
Therefore, Z will bring in ₹ 2,933.

Gradual Realisation of Assets and Piece-meal Distribution

In all the previous illustrations, one of the following two assumptions has been made:

(i) all the assets are realised simultaneously and all the liabilities are settled together, before the partners are paid off; or

(ii) when the assets were sold gradually, partners are paid off after realisation of ***all the assets*** and payment of all the liabilities.

In actual practice, the above assumptions are unrealistic. In fact, when a partnership is in the process of being dissolved, assets are sold gradually one after another to fetch maximum possible price. However, all the assets may be realised at a time if the business is being sold as a single unit.

When the assets are realised individually (some through agent or tender or auction), it may take several months to realise all the assets. The partners, in such a case, do not wish to wait till all the assets are realised. It is universally accepted practice that an interim distribution is made to the partners for their claims (of course, after paying off creditors) as and when cash is available for this purpose. There are two problems associated with this practice.

First, the profit-sharing ratio of the partners may not be as per their capital contribution.

Secondly, there is uncertainty of future realisations.

Therefore, when one asset is realised, partners are not paid off in their profit-sharing ratio. Instead, available cash is distributed in such a fashion that a partner, who has contributed more capital as compared to other partners, gets his ***surplus capital*** back in priority.

At the same time, at every stage of distribution, each partner bears his share of possible losses, thus avoiding overpayment to any partner and the necessity of recoupment from him at a subsequent stage. For achieving these objectives, any of the following ***two methods*** may be adopted:

(i) Surplus Capital Method; or

(ii) Maximum Loss Method

Priority of Distribution

When the assets are realised gradually, available cash at any particular point of time should be utilised in the following manner:

1. To meet the realisation expenses.
2. To pay off preferential creditors (e.g., government rates and taxes, etc)
3. To pay off other creditors. All the creditors are to be paid off in the ratio of their individual claim. But a secured creditor get a priority over ordinary creditors upto the amount realised from that particular asset by which his claim is secured by the firm. But for the balance of his claim, he is at par with other ordinary creditors.
4. To pay off partners' loans.
5. To pay off partners' capitals.

Surplus Capital Method

This method is suitable when the following two conditions are satisfied:

(a) the partners' profit-sharing ratio is not as per their capital contribution; and

(b) all the partners are solvent and are likely to remain so.

The partners with the absolute surplus capitals are paid off first, followed by payment to others having surplus capitals. At last, payment is to be made to the partners in the profit-sharing ratio. The surplus capital is calculated as follows :

Step 1 Divide adjusted capital (Capital Account + Current Account + Share of Reserve) of each partner by his profit-sharing ratio. The smallest quotient should be taken as ***Base Capital***.

Step 2 Calculate relative capital by multiplying base capital and profit-sharing ratio of each partner.

Step 3 Calculate surplus capital by deducting relative capital (Step 2) from adjusted capital of each partner.

Step 4 Divide surplus capital (Step 3) by profit-sharing ratio of each partner. The smallest quotient should be taken as ***Revised Base Capital***.

Step 5 Again, calculate relative capital by multiplying revised base capital and profit-sharing ratio.

Step 6 Calculate absolute surplus capital by deducting revised base capital from surplus capital (Step 3).

Illustration 32 (a)

From the following information calculate absolute surplus capital:

(i) Partners' Capital Accounts balances as per last Balance Sheet : A ₹ 40,000; B ₹ 25,000; C ₹ 10,000.

(ii) General Reserve as per last Balance Sheet : ₹ 12,000.

(iii) Profit Sharing Ratio 3 : 2 : 1.

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	Capital Accounts	40,000	25,000	10,000
	General Reserve (3 : 2 : 1)	6,000	4,000	2,000
	(1) **Adjusted Capital**	46,000	29,000	12,000
	(2) Profit-sharing ratio	3	2	1
STEP 1	(3) [(1)/ (2)]	15,333	14,500	$\boxed{12,000}$
	(4) Base Capital (being smallest)	—	—	12,000
STEP 2	(5) Relative Capital (4) x (2)	36,000	24,000	12,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	10,000	5,000	—
STEP 4	(7) [(6) / (2)]	3,333	2,500	—
	(8) Revised Base Capital (being smaller)	—	$\boxed{2,500}$	—
STEP 5	(9) Relative Capital [(8) x (2)]	7,500	5,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	2,500	Nil	Nil

Illustration 32 (b)

P, Q and R are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet is as follows :

Liabilities	₹	Assets	₹
P's Capital	24,000	Sundry Assets	50,000
Q's Capital	16,000		
R's Capital	10,000		
	50,000		50,000

They dissolved the firm and the assets were realised as: (i) 1st instalment ₹ 20,000; (ii) 2nd instalment ₹ 12,000 (iii) 3rd instalment ₹ 3,000. Prepare a statement showing how the amounts realised should be distributed as and when they are received.

Solution

Calculation of Absolute Surplus Capital

		P (₹)	Q (₹)	R (₹)
	(1) Capital Accounts	24,000	16,000	10,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	$\boxed{8,000}$	8,000	10,000
	(4) Base Capital (being smallest)	8,000	—	—
STEP 2	(5) Relative Capital (4) x (2)	24,000	16,000	8,000
STEP 3	(6) [(1) – (5)] **Surplus Capital**	Nil	Nil	2,000

Statement Showing Priority of Distribution

First, ₹ 2,000 to be paid to R. The balance of first realisation ₹ (20,000 – 2,000) = 18,000 to be paid to P, Q and R in the profit-sharing ratio. All subsequent realisations also to be distributed among P, Q and R in the profit-sharing ratio.

Statement Showing Distribution of Proceeds of Realisation

	Amount available (₹)	Capitals P (₹)	Q (₹)	R (₹)
Amount due		24,000	16,000	10,000
First Realisation	20,000			
Less: Paid to R (surplus capital)	2,000	—	—	2,000
Balance	18,000			
Less: Paid to P, Q and R (3 : 2 : 1)	18,000	9,000	6,000	3,000
Balance due		15,000	10,000	5,000
Second Realisation	12,000			
Less: Paid to P, Q and R (3 : 2 : 1)	12,000	6,000	4,000	2,000

Balance due		9,000	6,000	3,000
Third Realisation	3,000			
Less: Paid to P, Q and R (3 : 2 : 1)	3,000	1,500	1,000	500
Balance due (being loss on realisation)		7,500	5,000	2,500

Illustration 33

A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. The partnership was dissolved on 30.9.1995 when the Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Capitals : A : ₹ 12,000; B : ₹ 11,000; C : ₹ 3,000	26,000	Cash	8,000
Loan : A : ₹ 6,000; B : ₹ 10,000	16,000	Debtors	19,000
Creditors	25,000	Stock	40,000
	67,000		67,000

It was agreed that net realisations should be distributed in due order at the end of each month. The realisations and expenses were as follows (all figures in ₹) :

	October '95	November '95	December '95	January '96	February '96
Debtors	5,000	3,000	5,000	2,000	3,000
Stock	8,000	8,000	12,000	10,600	1,000
Expenses	2,000	1,000	1,000	2,000	500

The stock was completely disposed off. It was agreed that C should take over the remaining debtors of ₹ 100.

Show the distribution of cash as and when realised. ***[C.U. B.Com. (Hons.) — 1996]***

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	12,000	11,000	3,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	4,000	5,500	$\boxed{3{,}000}$
	(4) Base Capital (being smallest)	—	—	3,000
STEP 2	(5) Relative Capital (4) x (2)	9,000	6,000	3,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	3,000	5,000	—
STEP 4	(7) [(6) / (2)]	$\boxed{1{,}000}$	2,500	—
	(8) Relative Base Capital (being smaller)	1,000	—	—
STEP 5	(9) Relative Capital [(8) x (2)]	3,000	2,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	—	3,000	—

Statement Showing Priority of Distribution

First, ₹ 25,000 to be paid to the creditors.
Next, ₹ 16,000 to be paid to A and B in the ratio of 3 : 5 for their loan.
Next, ₹ 3,000 to be paid to B for Absolute Surplus.
Next, ₹ 5,000 to be paid to A and B in the ratio of 3 : 2.
Balance to be paid to A, B and C in the ratio of 3 : 2 : 1.

Cash Available in Each Month

Month	Debtors	Stock	Expenses	Cash Available
October 1995	5,000	8,000	2,000	11,000
November 1995	3,000	8,000	1,000	10,000
December 1995	5,000	12,000	1,000	16,000
January 1996	2,000	10,600	2,000	10,600
February 1996	3,000	1,000	500	3,500

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Loan A	Loan B	Capitals A	Capitals B	Capitals C
Amount Due		25,000	6,000	10,000	12,000	11,000	3,000
Cash (Note 1)	8,000						
Less : Paid to Creditors	8,000	8,000	—	—	—	—	—
Balance Due		17,000	6,000	10,000	12,000	11,000	3,000
Net Realisation of October 1995	11,000						
Less : Paid to Creditors	11,000	11,000	—	—	—	—	—
Balance Due		6,000	6,000	10,000	12,000	11,000	3,000
Net Realisation of November 1995	10,000						
Less : Paid to Creditors	6,000	6,000					

	4,000						
Less : Paid to A and B (Loan) 3 : 5	4,000	—	1,500	2,500	—	—	—
Balance Due			4,500	7,500	12,000	11,000	3,000
Net Realisation of December 1995	16,000						
Less : Paid to A and B (Loan)	12,000		4,500	7,500	—	—	—
	4,000						
Less : Paid to B (Absolute Surplus)	3,000		—	—	—	3,000	—
	1,000						
Less: Paid to A and B (3 : 2)	1,000		—	—	600	400	—
Balance Due					11,400	7,600	3,000
Net Realisation of January 1996	10,600						
Less : Paid to A and B (3 : 2)	4,000				2,400	1,600	—
	6,600						
Less : Paid to A, B and C (3 : 2 : 1)	6,600				3,300	2,200	1,100
Balance Due					5,700	3,800	1,900
Net Realisation of February 1996	3,500						
Add : Debtors taken over by C	100						
	3,600						
Less : Paid to A, B and C (3 : 2 : 1)	3,600				1,800	1,200	*600
Balance left unpaid (Being loss on realisation)					3,900	2,600	1,300

Working Note : (1) It is assumed that cash was distributed immediately.
* It includes ₹ 100 for debtors.

Illustration 34

A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 1. They decided to dissolve the business on 31.12.1995, on which date their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capital Accounts :	A	38,700		Land and Buildings	30,810
	B	10,680		Motor Car	5,160
	C	11,100	60,480	Investments	1,080
Loan Account :	C		3,000	Stock	19,530
Creditors			10,320	Debtors	11,280
				Cash	5,940
			73,800		73,800

The assets were realised piece-meal as follows and it was agreed that cash should be distributed as and when realised. 15.1.1996 — ₹ 10,380; 20.2.1996 — ₹ 27,900; 23.3.1996 — ₹ 3,600; 15.4.1996 — C took over investments at a value of ₹ 1,260; 27.4.1996 — ₹ 19,200.

Dissolution expenses were originally provided for an estimated amount of ₹ 2,700 but actual amount spent on 29.3.1996 was ₹ 1,920. The creditors were settled for ₹ 10,080.

You are required to prepare a statement showing distribution of cash amongst the partners.

[I.C.W.A. (Inter) — June, 1996]

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	38,700	10,680	11,100
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	12,900	$\boxed{5,340}$	11,100
	(4) Base Capital (being smallest)	—	5,340	—
STEP 2	(5) Relative Capital (4) x (2)	16,020	10,680	5,340
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	22,680	—	5,760
STEP 4	(7) [(6) / (2)]	7,560	—	$\boxed{5,760}$
	(8) Relative Base Capital (being smaller)	—	—	5,760
STEP 5	(9) Relative Capital [(8) x (2)]	17,280	—	5,760
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	5,400	—	—

Statement Showing Priority of Distribution

First, ₹ 10,080 to be paid to the creditors (adjusting discount) after providing ₹ 2,700 for dissolution expenses.
Next, ₹ 3,000 to be paid to C for loan.
Next, ₹ 5,400 to be paid to A for Absolute Surplus.
Next, ₹ 23,040 to be paid to A and C in the ratio of 3 : 1.
Balance to be paid to A, B and C in the ratio of 3 : 2 : 1.

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Loan C	Capitals A	Capitals B	Capitals C
Amount Due		10,320	3,000	38,700	10,680	11,100
Cash in hand	5,940					
Less: Provision for dissolution expenses	2,700					
	3,240					
Less: Paid to the Creditors	3,240	3,240				
Balance Due		7,080	3,000	38,700	10,680	11,100
Realisation of 15.1.1996	10,380					
Less: Paid to the Creditors	6,840	6,840	—	—	—	—
	3,540	240	—	—	—	—
Less: Paid to C (Loan)	3,000	—	3,000			
Adjusted for discount received	—	240				
	540					
Less: Paid to A (Absolute Surplus)	540			540		
Balance Due				38,160	10,680	11,100
Realisation of 20.2.1996	27,900					
Less: Paid to A (Absolute Surplus)	4,860			4,860	—	—
	23,040					
Less: Paid to A and C (3 : 1)	23,040			17,280	—	5,760
Balance Due				16,020	10,680	5,340
Realisation of 23.3.1996	3,600					
Less: Paid to A, B and C (3 : 2 : 1)	3,600			1,800	1,200	600
Balance Due				14,220	9,480	4,740
Surplus of dissolution expenses : ₹ (2,700 – 1,920)	780					
Less: Paid to A, B and C (3 : 2 : 1)	780			390	260	130
Balance Due				13,830	9,220	4,610
Investments taken over by C (Note 1)				—	—	1,260
Realisation of 27.4.1996	19,200					
Less: Paid to A and B (Note 2)	6,300			3,780	2,520	—
	12,900					
Less : Paid to A, B and C (3 : 2 : 1)	12,900			6,450	4,300	2,150
Balance left unpaid (Being loss on realisation)				3,600	2,400	1,200

Working Note :

(1) Technically, C will be allowed to take over investments only after the realisation of 27th April.

(2) Out of realisation of 27.4.1996, ₹ 3,780 (1,260 / 1 x 3) to be paid to A and ₹ 2,520 (1,260 / 1 x 2) to B to adjust the value of investments taken over by C. The balance is to be distributed among A, B and C in the ratio of 3 : 2 : 1.

Illustration 35

Vidya, Veena and Vibha were in partnershp sharing profits and losses as 3:2:1 respectively. The partnership was dissolved on 31st March 2017 following Vidya's proceeding abroad. The Balance sheet of the firm on that date was as follows:

Liabilities	₹	Assets	₹
Capital A/cs:		Cash in hand	28,000
Vidya	1,40,000	Sundry Debtors	2,94,000
Veena	70,000	Stock-in-trade	1,12,000
Vibha	14,000		
Creditors	2,10,000		
	4,34,000		4,34,000

There was a contingent liability in respect of a bill for ₹ 10,000 due on 25th August 2017 under discount. It was agreed that the net realisation should be distributed in their due order (at the end of each month) but as safely as possible. The realisation and expenses were as under:

2017	Stock and Debtors (₹)	Expenses (₹)
April	84,000	7,000
May	1,26,000	5,400
June	70,000	4,900
July	77,000	3,500
August	35,500	3,500

The Stock was completely disposed of and amounts due from debtors were realised, the balance being irrecoverable. the acceptor of bill under discount met the bill on due date. Prepare statement showing piecemeal distribution, using Surplus Capital Method.

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	Vidya (₹)	Veena (₹)	Vibha (₹)
	(1) Capital Accounts	1,40,000	70,000	14,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	46,667	35,000	$\boxed{14,000}$
	(4) Base Capital (being smallest)	—	—	14,000
STEP 2	(5) Relative Capital (4) x (2)	42,000	28,000	14,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	98,000	42,000	—
STEP 4	(7) [(6) / (2)]	32,667	$\boxed{21,000}$	—
	(8) Revised Base Capital (being smaller)	—	21,000	—
STEP 5	(9) Relative Capital [(8) x (2)]	63,000	42,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	35,000	Nil	Nil

Cash Available in Each Month

Month	Stock and Debtors	Expenses	Cash available
April	84,000	7,000	77,000
May	1,26,000	5,400	1,20,600
June	70,000	4,900	65,100
July	77,000	3,500	73,500
August	35,500	3,500	32,000

Statement Showing Priority of Distribution

First ₹ 2,10,000 to be paid to the creditors.
Next ₹ 10,000 to be kept for Contingent liability in respect of bill under discount.
Next ₹ 35,000 to be paid to Vidya.
Next ₹ (63,000 + 42,000) = ₹ 1,05,000 to be paid to Vidya and Veena in the ratio 3:2.
Balance in the profit sharing ratio to Vidya, Veena and Vibha.

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Capitals Vidya	Veena	Vibha
Amount due		2,10,000	1,40,000	70,000	14,000
Cash in hand	28,000				
Less: Paid to the creditors	28,000	28,000	—	—	—
Balance due		1,82,000	1,40,000	70,000	14,000
Realisation of April	77,000				
Less: Paid to the creditors	77,000	77,000	—	—	—
Balance due		1,05,000	1,40,000	70,000	14,000
Realisation of May	1,20,600				
Less: Paid to the creditors	1,05,000	1,05,000	—	—	—
	15,600				
Less: Retained for contingent liability (See Note)	10,000			—	—
Less: Paid to Vidya (absolute surplus capital)	5,600		5,600		
Balance due			1,34,400	70,000	14,000
Realisation of June	65,100				
Less: Paid to Vidya (Absolute Surplus)	29,400		29,400	—	—
	35,700				
Less: Paid to Vidya and Veena (3:2)	35,700		21,420	14,280	—

Balance due			83,580	55,720	14,000
Realisation of July	73,500				
Less: Paid to Vidya and Veena (3:2)	69,300		41,580	27,720	—
	4,200				
Less: Paid to Vidya, Veena and Vibha (3:2:1)	4,200		2,100	1,400	700
Balance due			39,900	26,600	13,300
Realisation of August	32,000				
Add: Retained amount for contingent liabilities	10,000				
	42,000				
Less: Paid to Vidya, Veena and Vibha (3:2:1)	42,000		21,000	14,000	7,000
Balance left unpaid (Being loss on realisation)			18,900	12,600	6,300

Tutorial Note : After paying creditors in full, an amount should be provided for bill under discount to the extent of ₹ 10,000. If the bill is met at maturity, the amount provided earlier will be available for distribution amongst the partners.

Illustration 36

Ajay Enterprises, a partnership firm in which A, B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. The Balance Sheet of the firm as on 31st December, 2011 is as follows :

Liabilities	₹	Assets	₹
A's Capital	15,000	Factory Building	24,160
B's Capital	7,500	Plant and Machinery	16,275
C's Capital	15,000	Debtors	5,400
B's Loan A/c	4,500	Stock	12,390
Sundry Creditors	16,500	Cash at Bank	275
	58,500		58,500

On Balance Sheet date all the three partners have decided to dissolve the partnership. Since the realisation of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realised other than cash at bank and 10% of the amount distributed to the partners.

Assets were realised piece-meal as under :

Particulars	₹
First Instalment	18,650
Second Instalment	17,320
Third Instalment	10,000
Last Instalment	7,000
Dissolution Expenses were provided for estimated amount	3,000
The Creditors were settled finally for	15,900

Prepare a Statement showing Distribution of Cash amongst the Partners by Highest Relative Capital Method.

[C.A. (IPCC) — May, 2012]

Solution **Calculation of Absolute Surplus Capital**

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	15,000	7,500	15,000
	(2) Profit sharing ratio	4	3	3
STEP 1	(3) [(1) / (2)]	3,750	$\boxed{2,500}$	5,000
	(4) Base Capital (being smallest)		2,500	
STEP 2	(5) Relative Capital (4) x (2)	10,000	7,500	7,500
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	5,000	—	7,500
STEP 4	(7) [(6) / (2)]	$\boxed{1,250}$		2,500
	(8) Revised Base Capital (being smaller)	1,250		
STEP 5	(9) Relative Capital [(8) x (2)]	5,000		3,750
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	—		3,750

Statement Showing Priority of Distribution
First, ₹ 15,900 to be paid to the creditors.
next, ₹ 4,500 to be paid to B for his loan to the firm.
Next, ₹ 3,750 to be paid to C (absolute surplus)
Next, ₹ 8,750 to be paid to A and C in the ratio of 4 : 3.
Balance to be paid to A, B and C in the profit sharing ratio.

Statement Showing Distribution of Cash

Particulars	Amount Available (₹)	Creditors (₹)	B's Loan (₹)	Capital A (₹)	Capital B (₹)	Capital C (₹)
Amount Due		16,500	4,500	15,000	7,500	15,000
Cash at Bank	275					
Realisation of 1st Instalment	18,650					
	18,925					
Less: Provision for Realisation Expenses	3,000					
	15,925					
Less: C's Remuneration (1% of assets realised)	187					
	15,738					
Less: Paid to Creditors	15,738	15,738				
Balance Due		762	4,500	15,000	7,500	15,000
Realisation of 2nd Instalment	17,320					
Less: C's Remuneration (1% of assets realised)	173					
	17,147					
Less: Payment to Creditors (762 – 600) (Note 1)	162	162				
To be adjusted in Realisation Account		600				
	16,985					
Less: Re-payment of B's Loan	4,500		4,500			
	12,485					
Less: C'sRemuneration @ 10% of the amount distributed to Partners (₹ 12,485 x 10/110)	1,135					
	11,350					
Less: Paid to C (absolute surplus)	3,750					3,750
	7,600					
Less: Paid to A and C in ratio 4 : 3	7,600			4,343		3,257
Balance Due				10,657	7,500	7,993
Realisation of 3rd Instalment	10,000					
Less: C's Remuneration (1% of assets realised)	100					
	9,900					
Less: C's Remuneration @ 10% of the amount distributed to partners (₹ 9,900 x 10/110)	900					
	9,000					
Less: Paid to A and C (₹ 8,750 – 7,600) in the ratio 4 : 3	1,150			657	—	493
	7,850					
Less: Paid to A, B and C in the ratio of 4 : 3 : 3	7,850			3,140	2,355	2,355
Balance Due				6,860	5,145	5,145
Realisation of 4th and last instalment	7,000					
Less: C's Remuneration (1% of assets realised)	70					
	6,930					
Less: C's Remuneration @ 10% of the amount paid to Partners (₹6,930 x 10/110)	630					
	6,300					
Less: Paid to A, B and C in the profit sharing ratio (4:3:3)	6,300			2,520	1,890	1,890
Balance Left Unpaid (Being loss on realisation)				4,340	3,255	3,255

Note : It is assumed that the estimated amount provided for dissolution expenses is equal to ***actual*** expenses.

Illustration 37

Ananth Associates is a reputed firm. On account of certain misunderstanding between the partners, it was decided to dissolve the firm as on December 31, 2017. Their Balance Sheet as on December 31, 2017 was follows:

Liabilities		₹	Assets	₹
Capitals:			Land and Buildings	7,00,000
Ananth	3,00,000		Other Fixed Assets	3,00,000
Kishore	2,00,000		Stock-in-trade	2,00,000
Kumar (minor)	1,00,000	6,00,000	Debtors	4,00,000
Mortgage loan		3,00,000	Bills	1,50,000
Bank overdraft		3,00,000	Goodwill	30,000
Other loans		2,00,000	Cash	20,000
Creditors		2,00,000		
Kumar's loan		2,00,000		
		18,00,000		18,00,000

It was decided that Mr. Ananth shall be in charge of realisations. He shall set apart ₹ 10,000 towards expenses.

He shall be paid a remuneration of 5% on the amounts distributed to the partners towards their contributions other than loans. Assets realised were as under:

1.1.2018 Debtors ₹ 3,50,000; 15.1.2018 Fixed Assets ₹ 4,00,000;
1.2.2018 Debtors ₹ 50,000; 15.2.2018 Bills ₹ 1,40,000;
1.3.2018 Fixed Assets ₹ 50,000; 15.3.2018 Land and Building ₹ 8,00,000.

Prepare a statement showing how the moneys received on various dates will be distributed assuming that:

(i) the actual expenses of realisation amounted to ₹ 20,005;
(ii) the firm is solvent;
(iii) the partners' sharing ratio were as under:

	Profit	Loss
Ananth	2	1
Kishore	2	1
Kumar	1	Nil
	5	2

Solution

Assumptions: (i) Mortgage loan is on security of fixed assets; (ii) Bank overdraft is secured by hypothecation of stock-in-trade.

Statement Showing Distribution of the Proceeds of Realisation

Date	Claims	Mortgage Loan	Bank Overdraft	Other Loans	Creditors	Kumar's Loan	Partners' Capitals		
							Ananth	Kishor	Kumar
1.1.2018	**Balance Due**	3,00,000	3,00,000	2,00,000	2,00,000	2,00,000	3,00,000	2,00,000	1,00,000
	Amount available (Note 1)	1,08,000	1,08,000	72,000	72,000	—	—	—	—
	Balance Due (Note 2)	1,92,000	1,92,000	1,28,000	1,28,000	2,00,000	3,00,000	2,00,000	1,00,000
15.1.2018	Fixed Assets	1,92,000	—	—	—	—	—	—	—
	Balance (Note 2)	Nil	89,143	59,429	59,428	—	—	—	—
			1,02,857	68,571	68,572	2,00,000	3,00,000	2,00,000	1,00,000
1.2.2018	Debtors		21,429	14,285	14,286	—	—	—	—
	Balance Due		81,428	54,286	54,286	2,00,000	3,00,000	2,00,000	1,00,000
15.2.2018	Bills		60,000	40,000	40,000	—	—	—	—
	Balance Due		21,428	14,286	14,286	2,00,000	3,00,000	2,00,000	1,00,000
15.3.2018	Fixed Assets		21,428	14,286	14,286	—	—	—	—
	Balance Due		Nil	Nil	Nil	2,00,000	3,00,000	2,00,000	1,00,000
	Kumar's Loan (Note 3)					2,00,000	—	—	—
	Balance (Note 3)					—	2,80,950	1,80,950	1,00,000
						Nil	19,050	19,050	Nil*

* Kumar will get 1/5th share of the balance after paying ₹ 19,050 each to Ananth and Kishore out of proceeds of Stock-in-trade.

Working Notes:

(1) Amount available for distribution on 1st January, 2018 is ₹ 3,60,000 (cash in hand ₹ 20,000 + Debtors realised ₹ 3,50,000 – reserve for realisation expenses ₹ 10,000)

(2) Amount realised for fixed assets is ₹ 4,00,000. ₹ 1,92,000 are to be utilised for paying off Mortgage loan fully. The balance of ₹ 2,08,000 is to be utilised for paying Bank overdraft, other loan and creditors in the ratio of 3 : 2 : 2.

(3) Calculation of Amount Payable to Partners	₹
Amount realised from Land & Building on March 15, 2018	8,00,000
Less: Additional payment of realisation expenses (₹ 20,005 – ₹ 10,000)	10,005
	7,89,995
Less: Payment of Kumar's Loan	2,00,000
Amount payable to partners towards their contribution	5,89,995
Less: Ananth's commission @ 5/105	28,095
	5,61,900
Less: Paid to Kumar (since he suffers no share of loss)	1,00,000
	4,61,900
Less: Paid to Ananth (surplus capital)	1,00,000
Amount to be paid to Ananth and Kishore equally	3,61,900
Therefore, Ananth will get ₹ 1,00,000 + 1/2 of ₹ 3,61,900 = ₹ 2,80,950; and Kishore will get 1/2 of ₹ 3,61,900 = ₹ 1,80,950.	

Maximum Loss Method

This method is suitable when a partner or (partners) is known to be insolvent or is likely to be so. Under this method, every instalment realised is considered as final realisation, i.e., the remaining assets and claims are worthless. The maximum possible loss (Balance due *minus* assets realised) is distributed among all the partners in the profit-sharing ratio. Any partner(s) whose apportioned loss exceeds his balance due is assumed for this purpose to be insolvent and his negative balance will be shared by the solvent partners in their capital ratio ***[assuming Garner Vs. Murray]***. This process is repeated till the negative balance is abolished. The partners having positive balance is paid-off first.

The same principle is to be followed for all subsequent realisations.

In this connection, it should be noted that: (i) cash in hand is to be considered as first realisation; and (ii) for calculating capital ratio, balance of capital account and share of reserve and surplus are to be considered when capitals are fluctuating. However, when capitals are fixed, no adjustment is required.

Illustration 38

Partners A, B and C share profits in the proportion of 1/2, 1/3 and 1/6. Their Balance Sheet is as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Sundry Assets	80,000
A	30,000		
B	30,000		
C	20,000		
	80,000		80,000

The firm is dissolved and assets are realised as follows:

First realisation ₹ 10,000; Second realisation ₹ 15,000; and Third and final realisation ₹ 25,000.

Prepare a statement showing how the distributions should be made applying Garner v. Murray principle.

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	A	B	C
(1) Distribution of ₹ 10,000 (first realisation)				
Balance due	80,000	30,000	30,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	70,000	35,000	23,333	11,667
		(–) 5,000	(+) 6,667	(+) 8,333
Deficiency of A's capital written-off against those of B and C in the ratio of their capitals 3 : 2		(–) 5,000	3,000	2,000
Manner in which ₹ 10,000 is to be distributed		Nil	3,667	6,333
(2) Distribution of ₹ 15,000 (second realisation)				
Balance due after making payment as above	70,000	30,000	26,333	13,667
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	55,000	27,500	18,333	9,167
Manner in which ₹ 15,000 is to be distributed	15,000	2,500	8,000	4,500
(3) Distribution of ₹ 25,000 (final realisation)				
Balance due after making payment as above	55,000	27,500	18,333	9,167
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	30,000	15,000	10,000	5,000
Manner in which ₹ 25,000 is to be distributed	25,000	12,500	8,333	4,167

Illustration 39

Rahim, Antony and Prasad were in partnership sharing profits and losses in proportion to 5:4:3.

They agreed to dissolve the firm on 1st January, 2018 on which date their assets and liabilities were as under:

Liabilities		₹	Assets	₹
Creditors		76,000	Debtors	1,45,000
Loan from Antony		9,000	Stock	1,50,000
Capital Accounts:	Rahim	1,20,000	Plant	50,000
	Anthony	90,000	Furniture	10,000
	Prasad	60,000		
		3,55,000		3,55,000

The assets were realised in the following instalments and the proceeds were distributed as and when realised:

1st instalment 50,000; 2nd instalment 30,000; 3rd instalment 21,000; 4th instalment 90,000; 5th instalment 84,000.

The cost of dissolution was estimated at ₹ 5,000 and the amount was kept as reserve before distribution of the proceeds until the 3rd instalment when the actual cost of ₹ 4,000 was met.

Prepare a statement showing the distribution of each instalment realised.

Solution **Statement Showing Realisation and Distribution of Cash**

Particulars	Realisation	Expenses	Creditors	Loan from Anthony	Partners' Capitals
1st instalment	50,000	5,000	45,000	—	—
2nd instalment	30,000	—	30,000	—	—
3rd instalment including excess of realisation expenses	22,000	—	1,000	9,000	12,000
4th instalment	90,000	—	—	—	90,000
5th instalment	84,000	—	—	—	84,000
TOTAL	2,76,000	5,000	76,000	9,000	1,86,000

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	Rahim	Anthony	Prasad
(1) Distribution of ₹ 12,000.				
Balance Due	2,70,000	1,20,000	90,000	60,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	2,58,000	1,07,500	86,000	64,500
		12,500	4,000	(–) 4,500
Deficiency of Prasad's capital written-off against those of Rahim and Anthony in the ratio of their capitals 4 : 3		2,571	1,929	(+) 4,500
Manner in which ₹ 12,000 is to be distributed		9,929	2,071	Nil
(2) Distribution of ₹ 90,000 (4th instalment)				
Balance due after making payment as above	2,58,000	1,10,071	87,929	60,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	1,68,000	70,000	56,000	42,000
Manner in which ₹ 90,000 is to be distributed	90,000	40,071	31,929	18,000
(3) Distribution of ₹ 84,000 (5th instalment)				
Balance due after making payment as above	1,68,000	70,000	56,000	42,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	84,000	35,000	28,000	21,000
Manner in which ₹ 84,000 is to be distributed	84,000	35,000	28,000	21,000

Illustration 40

A, B and C were in partnership sharing profits and losses in the ratio of 3:2:1. The partnership firm was dissolved on 30.11.2016 when the position was as follows:

Liabilities	₹	Assets	₹
Sundry creditors	3,15,000	Cash in hand	50,000
Capital Accounts:		Stock-in-trade	1,60,000
A	2,10,000	Sundry Debtors	4,40,000
B	1,05,000		
C	20,000		
	6,50,000		6,50,000

The partners desired that the net realisation should be distributed according to rules at the end of each month. The realisation and expenses were as under:

	Expenses (₹)	Stock + Debtors (₹)
31.12.2016	10,000	1,25,000
31.01.2017	9,000	1,88,600
31.03.2017	7,000	1,04,650
31.08.2017	6,000	1,14,750
30.11.2017	4,000	52,000

The stock was disposed off and debtors were all realised. Set out Cash and Capital Accounts showing monthly distribution of cash realised, applying Maximum Loss Basis.

Solution **Statement Showing Realisation and Distribution of Cash**

Particulars	Realisation	Expenses	Creditors	Partners' Capitals
31.11.2016 (Cash in hand)	50,000	—	50,000	—
31.12.2016	1,25,000	10,000	1,15,000	—
31.01.2017	1,88,600	9,000	1,50,000	29,600
31.03.2017	1,04,650	7,000	—	97,650
31.08.2017	1,14,750	6,000	—	1,08,750
30.11.2017	52,000	4,000	—	48,000
TOTAL	6,35,000	36,000	3,15,000	2,84,000

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	A	B	C
(1) Distribution of ₹ 29,600				
Balance Due	3,35,000	2,10,000	1,05,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	3,05,400	1,52,700	1,01,800	50,900
	29,600	57,300	3,200	(–) 30,900
Deficiency of C's capital written-off against those of A and B in the ratio of their capitals 2 : 1		(–) 20,600	(–) 10,300	30,900
		36,700	(–) 7,100	Nil
Deficiency of B's capital written-off against A's Capital		(–) 7,100	7,100	
Manner in which ₹ 29,600 is to be distributed		29,600	Nil	Nil
(2) Distribution of ₹ 97,650				
Balance due after making payment as above	3,05,400	1,80,400	1,05,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	2,07,750	1,03,875	69,250	34,625
	97,650	76,525	35,750	(–) 14,625
Deficiency of C's capital written-off against those of A and B in the ratio of their capitals 2 : 1		(–) 9,750	(–) 4,875	14,625
Manner in which ₹ 97,650 is to be distributed	97,650	66,775	30,875	Nil
(3) Distribution of ₹ 1,08,750				
Balance due after making payment as above	2,07,750	1,13,625	74,125	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	99,000	49,500	33,000	16,500
Manner in which ₹ 1,08,750 is to be distributed	1,08,750	64,125	41,125	3,500
(4) Distribution of ₹ 48,000				
Balance due after making payment as above	99,000	49,500	33,000	16,500
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	51,000	25,500	17,000	8,500
Manner in which ₹ 48,000 is to be distributed	48,000	24,000	16,000	8,000

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

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Dec. 1	To Balance b/d	50,000	Dec. 1	By Creditors A/c	50,000
31	To Realisation A/c	1,25,000	31	By Realisation A/c (expenses)	10,000
			"	By Creditors A/c	1,15,000
		1,75,000			1,75,000
2017			2017		
Jan. 31	To Realisation A/c	1,88,600	Jan. 31	By Realisation A/c (expenses)	9,000
Mar. 31	To Realisation A/c	1,04,650	"	By Creditors A/c	1,50,000
Aug. 31	To Realisation A/c	1,14,750	"	By A Capital A/c	29,600
Nov. 30	To Realisation A/c	52,000	Mar 31	By Realisation A/c (expenses)	7,000
			"	By A Capital A/c	66,775
			"	By B Capital A/c	30,875

			Aug. 31	By Realisation A/c (expenses)	6,000
			"	By A Capital A/c	64,125
			"	By B Capital A/c	41,125
			"	By C Capital A/c	3,500
			Nov. 30	By Realisation A/c (expenses)	4,000
			"	By A Capital A/c	24,000
			"	By B Capital A/c	16,000
			"	By C Capital A/c	8,000
		4,60,000			4,60,000

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2017					2017				
Jan. 31	To Cash A/c	29,600	—	—	Jan. 1	By Balance b/d	2,10,000	1,05,000	20,000
Mar. 31	To Cash A/c	66,775	30,875	—					
Aug. 31	To Cash A/c	64,125	41,125	3,500					
Nov. 30	To Cash A/c	24,000	16,000	8,000					
"	To Realisation A/c (loss)	25,500	17,000	8,500					
		2,10,000	1,05,000	20,000			2,10,000	1,05,000	20,000

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 41

X, Y and Z are partners sharing profits and losses in the ratio of 2 : 2 : 1. The Balance Sheet as on 31.03.2016 is as follows:

Liabilities		₹	Assets	₹
Capital Accounts :			Plant and Machinery	1,10,000
X	1,30,000		Fixtures	25,000
Y	46,000		Stock	60,000
Z	24,000	2,00,000	Sundry Debtors	50,000
Reserve Fund		75,000	Cash	80,000
Creditors		50,000		
		3,25,000		3,25,000

They decided to dissolve the firm. Following amounts are realised from the assets : ₹

	₹
Plant and Machinery	1,08,000
Fixtures	22,000
Stock	69,000
Sundry Debtors	46,000

Creditors allowed a discount of 10% and realisation expenses amounted to ₹ 1,800.

You are required to prepare (a) Realisation Account, (b) Partners' Capital Accounts and (c) Cash Account.

[C.U.B.Com. (General) — 2017]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Plant and Machinery A/c	1,10,000	Mar 31	By Creditors A/c	50,000
	To Fixtures A/c	25,000		By Bank A/c :	
	To Stock A/c	60,000		Plant and Machinery	1,08,000
	To Sundry Debtors A/c	50,000		Fixtures	22,000
	To Bank A/c :			Stock	69,000
	Creditors (₹ 50,000 – 5,000)	45,000		Sundry Debtors	46,000
	Realisation Expenses	1,800			
	To Partners' Capital A/cs :				
	X	1,280			
	Y	1,280			
	Z	640			
		2,95,000			2,95,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Balance b/d	80,000	Mar 31	By Realisation A/c :	
	To Realisation A/c (Note 1)	2,45,000		Creditors Paid	45,000
				Realisation Expenses	1,800
				By Partners' Capital A/cs :	
				X	1,61,280
				Y	77,280
				Z	39,640
		3,25,000			3,25,000

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

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2016		(₹)	(₹)	(₹)	2016		(₹)	(₹)	(₹)
Mar 31	To Bank A/c	1,61,280	77,280	39,640	Mar 31	By Balance b/d	1,30,000	46,000	24,000
						By Reserve Fund A/c	30,000	30,000	15,000
						By Realisation A/c (Profit)	1,280	1,280	640
		1,61,280	77,280	39,640			1,61,280	77,280	39,640

Working Note :

(1) Amount Realised from Assets

	₹
Plant and Machinery	1,08,000
Fixtures	22,000
Stock	69,000
Sundry Debtors	46,000
	2,45,000

Illustration 42

P, Q and R shares profits and losses of a partnership firm equally. The Balance Sheet as on 31.12.2015 of the firm is given :

Liabilities	₹	Assets	₹
Capitals :		Land and Building	60,000
P	50,000	Plant and Machinery	30,000
Q	50,000	Debtors	20,000
R	5,000	Cash and Bank	10,000
Creditors	15,000		
	1,20,000		1,20,000

The firm was dissolved on the same date. At the time of dissolution estimated loss was ₹ 30,000. R became insolvent and a final dividend of 40% was recovered from his estate.

Prepare necessary accounts. ***[C.U.B.Com. (General) — 2016]***

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec 31	To Land and Building A/c	60,000	Dec 31	By Creditors A/c	15,000
	To Plant and Machinery A/c	30,000		By Bank A/c (Note 1)	
	To Debtors A/c	20,000		(Realisation of Assets — Balancing figure)	80,000
	To Bank A/c			By Partners' Capital A/c :	
	Creditors Paid	15,000		(Loss on realisation as given)	
				P	10,000
				Q	10,000
				R	10,000
		1,25,000			1,25,000

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

Date	Particulars	P	Q	R	Date	Particulars	P	Q	R
2015		(₹)	(₹)	(₹)	2015		(₹)	(₹)	(₹)
Dec 31	To Realisation A/c (Loss)	10,000	10,000	10,000	Dec 31	By Balance b/d	50,000	50,000	5,000
	To Partners' Capital A/c :					By Bank A/c :			
	R	1,500	1,500	—		Final Dividend	—	—	2,000
	To Bank A/c (Final payment)	38,500	38,500	—		By Partners' Capital A/c :			
						P	—	—	1,500
						Q	—	—	1,500
		50,000	50,000	10,000			50,000	50,000	10,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec 31	To Balance b/d	10,000	Dec 31	By Realisation A/c	
	To Realisation A/c :			Payment to Creditors	15,000
	Sale of Assets	80,000		By Partners' Capital A/cs :	
	To R Capital A/c	2,000		P	38,500
				Q	38,500
		92,000			92,000

Illustration 43

X, Y and Z are partners in a firm sharing profits and losses in the ratio of 1 : 1 : 2. The firm was dissolved on 31.03.2015 and on that date the Balance Sheet of the firm was as under :

Liabilities	₹	Assets	₹
Capitals :		Fixed Assets	1,00,000
Y	60,000	Stock	35,000
Z	1,50,000	Debtors	60,000
Creditors	30,000	Cash at Bank	25,000
		X Capital	20,000
	2,40,000		2,40,000

Prepare necessary accounts including Bank Account after considering the following aspects :

(a) Fixed Assets realised ₹ 1,17,000.

(b) Z took over the stock at 80%.

(c) Unrealised portion of Debtors ₹ 6,000.

(d) Creditors allowed 10% discount. *[C.U.B.Com. (General) — 2015]*

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Mar 31	To Fixed Assets A/c	1,00,000	Mar 31	By Creditors A/c	30,000
	To Stock A/c	35,000		By Bank A/c	
	To Debtors A/c	60,000		Sale of Fixed Assets	1,17,000
	To Bank A/c (Paid to Creditors)	27,000		Debtors (₹ 60,000 – 6,000)	54,000
	To Partners' Capital A/cs :			By Z Capital A/c	
	(Share of Realisation Profit)			Stock takenover at 80%	28,000
	X	1,750			
	Y	1,750			
	Z	3,500			
		2,29,000			2,29,000

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

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2015		(₹)	(₹)	(₹)	2015		(₹)	(₹)	(₹)
Mar 31	To Balance b/d	20,000	—	—	Mar 31	By Balance b/d	—	60,000	1,50,000
	To Realisation A/c					By Realisation A/c			
	(Stock taken over)	—	—	28,000		(Share of Realisation Profit)	1,750	1,750	3,500
	To Bank A/c (Final payment)	—	61,750	1,25,500		By Bank A/c	18,250	—	—
		20,000	61,750	1,53,500			20,000	61,750	1,53,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Mar 31	To Balance b/d	25,000	Mar 31	By Realisation A/c :	
	To Realisation A/c			Paid to Creditors	27,000
	Sale of Fixed Assets	1,17,000		By Partners' Capital A/c	
	Debtors Collected	54,000		Y	61,750
	To X Capital A/c (Cash brought in)	18,250		Z	1,25,500
		2,14,250			2,14,250

Tutorial Note : In this problem, loss on realisation has been given but the amount of realisation from sale of assets has not been given. Therefore, the balancing figure of Realisation Account will be treated as the amount realised from sale of assets.

Illustration 44

Arup, Bablu and Champak had been in partnership for many years and shared profits and losses in the ratio of 1 : 2 : 2. Their respective capitals were :

Arup : ₹ 10,000; Bablu : ₹ 10,000 and Champak : ₹ 2,000. The partners decided to dissolve the partnership after successive losses following a fall in market demand. On dissolution there was a loss of ₹ 15,000 to be shared among the partners. Champak was insolvent and unable to contribute anything towards his deficiency which had to be borne by his co-partners.

Prepare Partners' Capital Accounts to record the above matters. ***[C.U.B.Com. (General) — 2014]***

Solution

In the books of the Firm

Dr. Partners' Capital Accounts Cr.

Date	Particulars	Arup	Bablu	Champak	Date	Particulars	Arup	Bablu	Champak
		(₹)	(₹)	(₹)			(₹)	(₹)	(₹)
	To Realisation A/c	3,000	6,000	6,000		By Balance b/d	10,000	10,000	2,000
	To Champak Capital A/c	2,000	2,000	—		By Partners' Capital A/cs :			
	To Cash a/c (Final payment)	5,000	2,000	—		Arup (Note 1)	—	—	2,000
						Bablu (Note 1)	—	—	2,000
		10,000	10,000	6,000			10,000	10,000	6,000

Working Note :

(1) It has not been mentioned in the question that Garner vs. Murray Rule is to be followed. Therefore, cash has not been brought-in by the solvent partners. The deficiency of Champak has been shared by Arup and Bablu in the capital ratio, i.e., 1 : 1.

Illustration 45

The following is the Balance Sheet as on 01.01.2012 of a partnership business firm where the partners J, K and L are sharing profits and losses as 2/5th, 2/5th and 1/5th respectively.

Liabilities	₹	Assets	₹
Creditors	40,000	Sundry Assets	1,00,000
Capital : J	40,000	Cash	4,000
Capital : K	30,000	Capital : L (Overdrawn)	6,000
	1,10,000		1,10,000

The firm is dissolved on the same date.

Taking the following aspects under consideration, show necessary accounts including Cash Book.

(a) Sundry Assets realised ₹ 90,000.

(b) Creditors accepted ₹ 38,000 in full settlement.

(c) Expenses amounted to ₹ 2,000.

L was insolvent and a final dividend of 50% was received from his estate. ***[C.U.B.Com. (General) — 2013]***

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Jan 1	To Sundry Assets A/c	1,00,000	Jan 1	By Creditors A/c	40,000
	To Cash A/c :			By Cash A/c :	
	Paid to Creditors	38,000		Sundry Assets	90,000
	Realisation Expenses	2,000		By Partners' Capital A/cs :	
				J	4,000
				K	4,000
				L	2,000
		1,40,000			1,40,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	J	K	L	Date	Particulars	J	K	L
2012		(₹)	(₹)	(₹)	2012		(₹)	(₹)	(₹)
Jan 1	To Balance b/d	—	—	6,000	Jan 1	By Balance b/d	40,000	30,000	—
	To Realisation A/c					By Cash A/c (50% of total due)	—	—	4,000
	(Loss on realisation)	4,000	4,000	2,000		By Partners' Capital A/cs :			
	To L Capital Ac	2,286	1,714	—		J (Note 1)	—	—	2,286
	To Cash A/c	33,714	24,286	—		K (Note 1)	—	—	1,714
		40,000	30,000	8,000			40,000	30,000	8,000

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

Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Jan 1	To Balance b/d	4,000	Jan 1	By Realisation A/c :	
	To Realisation A/cs :			Creditors	38,000
	Sundry Assets	90,000		Realisation Expenses	2,000
	To L Capital A/c	4,000		By J Capital A/c	33,714
				By K Capital A/c	24,286
		98,000			98,000

Working Note :

(1) Total deficiency of L is ₹ 4,000 (8,000 – 4,000). This deficiency will be shared by J and K in the capital ratio, i.e., 4 : 3.
J's share of deficiency = (4,000 ÷ 7) × 4 = ₹ 2,286.
K's share of deficiency = (4,000 ÷ 7) × 3 = ₹ 1,714.

Illustration 46

A, B, C are partners in a firm sharing profits in the ratio of 2 : 2 : 1. The firm was dissolved on 1.1.2010 and on that date the Balance Sheet of the firm was as under :

Liabilities		₹	Assets	₹
Capital :			Fixed Assets	25,000
A	20,000		Stock	4,000
B	15,000	35,000	Debtors	10,000
Reserve Fund		10,000	Cash at Bank	11,000
Creditors		6,000	C Capital	1,000
		51,000		51,000

Prepare Realisation Account, Partners' Capital Accounts and Bank Account after considering the following :
(a) B took over creditors at ₹ 5,000.
(b) Fixed Assets were sold at ₹ 26,000.
(c) Debtors were bad in full.
(d) A took over stock at ₹ 3,000. ***[C.U.B.Com. (General) — 2012]***

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Jan 1	To Fixed Assets A/c	25,000	Jan 1	By Creditors A/c	6,000
	To To Stock A/c	4,000		By Bank A/c	
	To Debtors A/c	10,000		Fixed Assets Sold	26,000
	To B Capital A/c (Creditors taken over)	5,000		By A Capital A/c (Stock taken over)	3,000
				By Partners' Capital A/c :	
				A	3,600
				B	3,600
				C	1,800
		44,000			44,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Jan 1	To Balance b/d	11,000	Jan 1	By A Capital A/c	17,400
	To Realisation A/c	26,000		By B Capital A/c	20,400
	To C Capital A/c (Cash brought in)	800			
		37,800			37,800

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2010		(₹)	(₹)	(₹)	2010		(₹)	(₹)	(₹)
Jan 1	To Balance b/d		—	1,000	Jan 1	By Balance b/d	20,000	15,000	—
	To Realisation A/c					By Reserve Fund A/c	4,000	4,000	2,000
	(Stock taken over)	3,000				By Realisation A/c	—	5,000	—
	To Realisation A/c (Loss)	3,600	3,600	1,800		By Bank A/c	—	—	800
	To Bank A/c (Final payment)	17,400	20,400	—					
		24,000	24,000	2,800			24,000	24,000	2,800

[For Honours Candidates Only]

Illustration 47

A, B and C are partners in a firm and share profits and losses in the ratio of 2 : 1 : 1. Their Balance Sheet as on 31st December, 2016 was as under :

Liabilities		₹	Assets	₹
Capital Accounts :			Cash in Hand	10,000
A	76,000		Other Assets	1,90,000
B	48,000			
C	36,000	1,60,000		
Reserve Fund		10,000		
A's Loan		5,000		
Sundry Creditors		25,000		
		2,00,000		2,00,000

The partnership is dissolved and the assets were realised in instalments. the payments were made on the proportionate capital basis. Creditors were paid ₹ 20,000 in full settlement of their claims. Realisation expenses were estimated at ₹ 5,400 but actual amount spent was ₹ 4,500 which was paid on 20th March. A took furniture worth ₹ 2,000 on 15th February.

Draw up a memorandum of distribution of cash which was realised as follows :

	₹
On 20th January, 2017	15,000
On 15th February, 2017	70,000
On 20th March, 2017	84,500

Give working notes.

[C.U.B.Com. (Hons.) — 2017]

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	Capital Accounts	76,000	48,000	36,000
	Reserve Fund (2 : 1 : 1)	5,000	2,500	2,500
	(1) Adjusted Capital	81,000	50,500	38,500
	(2) Profit Sharing Ratio	2	1	1
STEP 1	(3) [(1)/(2)]	40,500	50,500	$\boxed{38,500}$
	(4) Base Capital (being smallest)	—	—	38,500
STEP 2	(5) Relative Capital (4) x (2)	77,000	38,500	38,500
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	4,000	12,000	—
STEP 4	(7) [(6) / (2)]	2,000	12,000	—
	(8) Revised Base Capital	$\boxed{2,000}$	—	—
STEP 5	(9) Relative Capital	4,000	2,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	—	10,000	—

Statement Showing Priority of Distribution

First, ₹ 20,000 to be paid to the creditors after providing ₹ 5,400 for dissolution expenses.
Next, ₹ 5,000 to be paid to A for loan.
Next, ₹ 10,000 to be paid to B for Absolute Surplus capital.
Next, ₹ 6,000 to be paid to A and B in the ratio of 2 : 1.
Balance to be paid to A, B and C in the ratio of 2 : 1 : 1.

Memorandum of Distribution of Cash

	Amount available	Creditors ₹	Loan	Capitals		
			A	A	B	C
Amount Due		25,000	5,000	81,000	50,500	38,500
Cash in Hand	10,000					
Less : Provision for Dissolution Expenses	5,400					
	4,600					
Less: Paid to Creditors	4,600	4,600				
Balance Due		20,400	5,000	81,000	50,500	38,500
Net Realisation of 20.01.2017	15,000					
Less : Paid to Creditors	15,000	15,000	—	—	—	—

Balance Due		5,400	5,000	81,000	50,500	38,500
Realisation of 15.02.2017	70,000					
Less : Paid to Creditors	5,400	5,400	—	—	—	—
	64,600					
Less : A's Loan paid	5,000		5,000	—	—	—
	59,600					
Add: Furniture takenover	2,000					—
	61,600					
Less: Paid to B (Absolute Surplus)	10,000				*10,000	
	51,600					
Less: Paid to A and B	6,000			4,000	2,000	—
	45,600					
Less: Paid to A, B and C in the ratio of 2 : 1 : 1	45,600			22,800	11,400	11,400
Balance Due		—	—	54,200	27,100	27,100
Realisation on 20.03.2017	84,500					
Add : Surplus of Dissolution Expenses (₹ 5,400 4,500)	900					
	85,400					
Less : Paid to A, B and C in the ratio of 2 : 1 : 1				42,700	21,350	21,350
Balance left unpaid (Being loss on realisation)				11,500	5,750	5,750

* ₹ 2,000 for furniture.

Illustration 48

P, Q, R and S were partners sharing profits and losses in the ratio 4 : 3 : 2 : 1. The following was their Balance Sheet as on 31st March, 2016 :

Liabilities		₹	Assets		₹
Capital Accounts :			Capital Accounts :		
P	50,000		R	45,000	
Q	40,000	90,000	S	20,000	65,000
Creditors		40,000	Furniture		15,000
P's Loan		30,000	Trademarks		18,000
			Stock		22,000
			Debtors	35,000	
			Less: Provision for Bad Debts	2,000	33,000
			Bank		7,000
		1,60,000			1,60,000

On 31st March, 2016, the firm was dissolved and Q was appointed to realise the assets and to pay the liabilities. He was entitled to receive commission as 5% on the amount finally paid to other partners towards their capital. Q was to bear expenses of realisation. The assets realised as follows :

Furniture ₹ 9,000; Trademarks ₹ 11,000; Debtors ₹ 22,000 and Stock ₹ 12,000. Creditors were paid off ₹ 35,000 in full settlement of their claim. There was a Joint Life Policy for ₹ 40,000 which was surrendered for ₹ 4,000. Expenses of realisation amounted to ₹ 2,000. R was declared insolvent and ₹ 10,400 was recovered from his estate.

Prepare Realisation Account and Partners' Capital Accounts after applying the rule in the case of Garner vs. Murray.

[C.U.B.Com. (Hons.) — 2016]

Solution

This problem could be solved in two ways :

1. When 5% commission payable to Q is treated as ***Realisation Expenses*** and debited to ***Realisation Account***.
2. When 5% commission payable to Q is ***not*** treated as Realisation Expenses and ***not*** debited to Realisation Account.

1. When 5% commission payable to Q is treated as *Realisation Expenses* and debited to Realisation Account

It has been given in the problem that Q is entitled to 5% commission on the amounts finally payable to other partners as ***capital***. It is to be noted that 'R' is insolvent and 'S' having negative capital. Therefore, 5% commission is to be calculated on the amount payable to 'P' as capital (after considering realisation loss and share of deficiency due to R's insolvency).

It is also to be noted that the commission payable to Q is nothing but realisation expenses and it is to be debited to Realisation Account. In this case, the solution of the problem will be as follows :

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Furniture A/c	15,000	Mar 31	By Provision for Bad Debts A/c	2,000
	To Trademarks A/c	18,000		By Creditors A/c	40,000
	To Stock A/c	22,000		By Bank A/c (Note 1)	58,000
	To Debtors A/c	35,000		By Partners' Capital A/cs :	
	To Bank A/c (Creditors paid)	35,000		P (4/10)	10,351
	To Q Capital A/c (Commission - Note 1)	878		Q (3/)10	7,763
				R (2/10)	5,176
				S (1/10)	2,588
		1,25,878			1,25,878

Dr. Partners' Capital Accounts Cr.

Date	Particulars	P	Q	R	S	Date	Particulars	P	Q	R	S
2016		(₹)	(₹)	(₹)	(₹)	2016		(₹)	(₹)	(₹)	(₹)
Mar 31	To Balance b/d	—	—	45,000	20,000	Mar 31	By Balance b/d	50,000	40,000	—	—
	To Realisation A/c (Loss)	10,351	7,763	5,176	2,588		By Realisation A/c (Commission)	—	878	—	—
	To R Capital A/c (Deficiency)	22,098	17,678	—	—		By Bank A/c (Final dividend)	—	—	10,400	—
	To Bank A/c (Final payment)	17,551	15,437	—	—		By P Capital A/c	—	—	22,098	—
							By Q Capital A/c	—	—	17,678	—
							By Bank A/c				22,588
		50,000	40,878	50,176	22,588			50,000	40,878	50,176	22,588

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Balance b/d	7,000	Mar 31	By Realisation A/c (Creditors paid)	35,000
	To Realisation A/c	58,000		By P Loan A/c	30,000
	To R Capital A/c (Final dividend)	10,400		By P Capital A/c	17,551
	To S Capital A/c	22,588		By Q Capital A/c	15,437
		97,988			97,988

Working Notes :

(1) Total assets realised = ₹ 9,000 + 11,000 + 22,000 + 12,000 + 4,000* = ₹ **58,000.**

* Surrender value of Joint Life Policy.

(2) R's deficiency is to be shared by P and Q in the capital ratio of 50,000 : 40,000 or 5 : 4. S will not bear any deficiency loss as his capital is ***negative***.

Calculation of Commission Payable to Q :

Let commission paid to Q = x

We can find out realisation loss before Q's commission as follows :

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Furniture A/c	15,000	Mar 31	By Provision for Bad Debts A/c	2,000
	To Trademarks A/c	18,000		By Creditors A/c	40,000
	To Stock A/c	22,000		By Bank A/c (Assets realised)	58,000
	To Debtors A/c	35,000		By Realisation Loss	25,000
	To Bank A/c (Creditors paid)	35,000			
		1,25,000			1,25,000

So realisation loss ***before*** commission is ₹ 25,000.

Q's commission = **x**

Therefore, realisation loss ***after*** Q's commission = 25,000 + x

P's share of realisation loss = $\frac{4}{10}$ (₹ 25,000 + x) = 10,000 + $\frac{4x}{10}$

R's share of realisation loss = $\frac{2}{10}$ (₹ 25,000 + x) = 5,000 + $\frac{2x}{10}$

$\therefore$ R's deficiency = ₹ 45,000 + (₹ 5,000 + $\frac{2x}{10}$) – ₹ 10,400 = ₹ 39,600 + $\frac{2x}{10}$

P's share of R's deficiency = $\frac{5}{9}$ (₹ 39,600 – $\frac{2x}{10}$)

Finally, P will get ₹ 50,000 – (₹ 10,000 + $\frac{4x}{10}$) + $\frac{5}{9}$ (₹ 39,600 + $\frac{2x}{10}$)

= ₹ 50,000 – (₹ 10,000 + $\frac{4x}{10}$ + ₹ 22,000 + ($\frac{x}{9}$)

= ₹ 18,000 – ($\frac{4x}{10}$ + $\frac{x}{9}$)

= ₹ 18,000 – $\frac{46x}{90}$

∴ Q's commission = 5% of (₹ 18,000 – $\frac{46x}{90}$)

Therefore, x= $\frac{5}{100}$ (₹ 18,000 – $\frac{46x}{90}$)

→ x = .05 (₹ 18,000 – .511x)

→ x = 900 – .0255x

→ 1.0255x = 900

→ x = $\frac{900}{1.026}$ = ₹ 878.

Therefore, Q's commission is ₹ **878**.

2. When 5% commission payable to Q is *not* treated as Realisation Expenses and *not* debited to Realisation Account

In this case, the 5% commission payable to Q on the amount finally payable to other partners as capital is ***not debited*** to Realisation Account. The realisation loss is calculated without the commission payable to Q and it is adjusted through Capital Account of the partners. The solution of the problem will be as follows :

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Furniture A/c	15,000	Mar 31	By Provision for Bad Debts A/c	2,000
	To Trademarks A/c	18,000		By Creditors A/c	40,000
	To Stock A/c	22,000		By Bank A/c (Note 1)	58,000
	To Debtors A/c	35,000		By Partners' Capital A/cs :	
	To Bank A/c (Creditors paid)	35,000		P (4/10)	10,000
				Q (3/10)	7,500
				R (2/10)	5,000
				S (1/10)	2,500
		1,25,000			1,25,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	P	Q	R	S	Date	Particulars	P	Q	R	S
2016		(₹)	(₹)	(₹)	(₹)	2016		(₹)	(₹)	(₹)	(₹)
Mar 31	To Balance b/d	—	—	45,000	20,000	Mar 31	By Balance b/d	50,000	40,000	—	—
	To Realisation A/c (Loss)	10,000	7,500	5,000	2,500		By Bank A/c (Final dividend)	—	—	10,400	—
	To R Capital A/c (Deficiency)	22,000	17,600	—	—		By P Capital A/c	—	—	22,000	—
							By Q Capital A/c	—	—	17,678	
	To Q Capital (Commission)	857	—	—	—		By Q Capital A/c (Q's Commission)	—	857	—	—
	To Bank A/c (Final payment)	17,143	15,757	—	—		By Bank A/c	—	—	—	22,500
		50,000	40,857	50,000	22,500			50,000	40,857	50,000	22,500

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
Mar 31	To Balance b/d	7,000	Mar 31	By Realisation A/c (Creditors paid)	35,000
	To Realisation A/c	58,000		By P Loan A/c	30,000
	To R Capital A/c (Final dividend)	10,400		By P Capital A/c	17,143
	To S Capital A/c	22,500		By Q Capital A/c	15,757
		97,900			97,900

Working Notes :

(1) Q's commission will be 5% of the amount finally payable to other partners as capital. In this case, only P will get some amount by way of ***capital***.

Amount Payable to P	₹
Balance of Capital	50,000
Less: Realisation Loss	(10,000)
Less: Share of Deficiency	(22,000)
	18,000

Q's commission = $\frac{18,000}{105} \times 5 =$ ₹ **857**.

Illustration 49

A, B and C are partners of a firm and share profits and losses in the ratio 4 : 3 : 3. Their Balance Sheet as on 31st December, 2014 was as under :

Liabilities		₹	Assets	₹
Capital Accounts :			Cash in Hand	2,000
A	20,000		Bank	3,000
B	12,000		Other Assets	65,000
C	8,000	40,000		
Reserve Fund		8,000		
Contingency Reserve		4,000		
A's Loan		5,000		
B's Loan		3,000		
Sundry Creditors		10,000		
		70,000		70,000

The partnership is dissolved and the assets are realised as follows :

1st Realisation	12,000
2nd Realisation	30,000
3rd Realisation	15,000

Realisation expenses were estimated at ₹ 3,000 but actual expenses was ₹ 2,500 and paid on 3rd realisation. C took stock worth ₹ 700 at the time of 2nd realisation.

Prepare a statement showing how the distribution should be made by following 'Surplus Capital Method'.

[C.U.B.Com. (Hons.) — 2015]

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	Capital Accounts	20,000	12,000	8,000
	Reserve	3,200	2,400	2,400
	Contingency Reserve	1,600	1,200	1,200
	(1) Adjusted Capital	24,800	15,600	11,600
	(2) Profit Sharing Ratio	4	3	3
STEP 1	(3) [(1)/(2)]	6,200	5,200	$\boxed{3,867}$
	(4) Base Capital	—	—	3,867
STEP 2	(5) Relative Capital (4) x (2)	15,467	11,600	11,600
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	9,333	4,000	—
STEP 4	(7) [(6) / (2)]	2,333	$\boxed{1,333}$	
	(8) Revised Base Capital	—	1,333	
STEP 5	(9) Relative Capital (8) x (2)	5,333	4,000	
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	4,000	—	

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Loan A	Loan B	Capitals A	Capitals B	Capitals C
Amount Due		10,000	5,000	3,000	24,800	15,600	11,600
Cash in Hand	2,000						
Cash at Bank	3,000						
	5,000						
Less: Provision for Realisation Expenses	3,000						

	2,000						
Less: Paid to Creditors	2,000	2,000					
Balance Due		8,000	5,000	3,000	24,800	15,600	11,600
1st Realisation	12,000						
Less : Paid to Creditors	8,000	8,000					
	4,000						
Less: Paid to A and B for loan in the ratio of 5 : 3	4,000		2,500	1,500			
Balance Due			2,500	1,500	24,800	15,600	11,600
2nd Realisation (Cash)	30,000						
Less : Paid to A and B for loan	4,000		2,500	1,500			
	26,000						
Less : Paid to A for his absolute capital	4,000				4,000		
	22,000						
Less: paid to A and B for their surplus capital	9,333				5,333	4,000	
	12,667						
Add: Realisation of Stock (taken over by C)	700						
Less: Paid to A, B and C in the ratio of 4 : 3 : 3	13,367				5,347	4,010	*4,010
Balance Due			—	—	10,120	7,590	7,590
3rd Realisation	15,000						
Add : Surplus of Realisation Expenses (₹ 3,000 – 2,500)	500						
	15,500						
Less : Paid to A, B and C in the ratio of 4 : 3 : 3	15,500				6,200	4,650	4,650
Balance left unpaid (Being loss on realisation)					3,920	2,940	2,940

*It includes ₹ 700 stock. Balance ₹ 3,310 was paid in cash.

Illustration 50

Amal, Bimal, Charu and Deben were partners in a firm sharing profits and losses in the ratio 3 : 3 : 2 : 2. The following was their Balance Sheet as at 31st December, 2013 :

Liabilities	₹	Assets		₹
Partners' Capital :		Furniture		14,000
Amal	20,000	Debtors	22,000	
Bimal	15,000	Less: Provision for Bad Debts	1,000	21,000
Amal's Loan	12,500	Cash at Bank		3,000
Sundry Creditors	25,000	Stock		12,500
		Capital :		
		Charu		16,000
		Deben		6,000
	72,500			72,500

The firm was dissolved on 31.12.2013. Bimal was appointed to realise the assets and pay off the liabilities and was entitled to receive 5% of the amount realised from the assets.

The assets realised as follows :

Furniture ₹ 11,000; Debtors ₹ 16,500; Stock ₹ 10,500.

Sundry creditors were paid in full including a contingent liability of ₹ 3,500. Realisation expenses of ₹ 1,500 were paid by the firm. Charu was insolvent and ₹ 5,000 could be recovered from his private estate.

Write up the Realisation Account, Bank Account and Capital Accounts of the partners following the rules given in Garner vs. Murray. ***[C.U.B.Com. (Hons.) — 2014]***

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec 31	To Furniture A/c	14,000	Dec 31	By Provision for Bad Debts A/c	1,000
	To Debtors A.c	22,000		By Sundry Creditors A/c	25,000
	To Stock A/c	12,500		By Bank A/c :	
	To Bank A/c (Realisation expenses)	1,500		Furniture	11,000
	To Bimal Capital A/c (Commission for realisation of assets — Note 1)	1,900		Debtors	16,500
				Stock	10,500

	To Bank A/c :			By Partners' Capital A/cs : (Loss)	
	Creditors	25,000		Amal	4,920
	Contingent Liabilities	3,500		Bimal	4,920
				Charu	3,280
				Deben	3,280
		80,400			80,400

Dr. Partners' Capital Accounts Cr.

Particulars	Amal (₹)	Bimal (₹)	Charu (₹)	Deben (₹)	Particulars	Amal (₹)	Bimal (₹)	Charu (₹)	Deben (₹)
To Balance b/d	—	—	16,000	6,000	By Balance b/d	20,000	15,000	—	—
To Realisation A/c (Loss)	4,920	4,920	3,280	3,280	By Bank A/c	4,920	4,920	—	3,280
To Charu Capital A/c	8,160	6,120	—	—	By Realisation A/c	—	1,900	—	—
To Bank A/c	11,840	10,780	—	—	By Bank A/c (Final dividend)	—	—	5,000	—
					By Amal Capital A/c (Note 2)	—	—	8,160	—
					By Bimal Capital A/c (Note 2)	—	—	6,120	—
					By Bank A/c	—	—	—	6,000
	24,920	11,820	19,280	9,280		24,920	11,820	19,280	9,280

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec 31	To Balance b/d	3,000	Dec 31	By Realisation A/c (Payment of Creditors and Contingent Liabilities)	28,500
	To Realisation A/c (Assets realised)	38,000		By Realisation A/c (Expenses)	1,500
	To Charu Capital A/c	5,000		By Amal Loan A/c	12,500
	To Amal Capital A/c	4,920		By Amal Capital A/c	11,840
	To Bimal Capital A/c	4,920		By Bimal Capital A/c	10,780
	To Deben Capital A/c	3,280			
	To Deben Capital A/c	6,000			
		65,120			65,120

Working Notes :

(1) Commission Payable to Bimal :

Assets realised ₹ 38,000 (₹ 11,000 + ₹ 16,500 + ₹ 10,500). Commission payable is @ 5%. Therefore, commission will be : 5% of ₹ 38,000 = ₹ **1,900**.

(2) Sharing of Deficiency

	₹
Total Debit balance of capital account of Charu	19,280
Less: Amount recovered from Charles Estates	5,000
Deficiency	14,280

Deficiency will be shared by Amal and Bimal in the capital ratio of 4 : 3. Deben is not insolvent but he will not share any deficiency as his capital is '***negative***'.

Amal's share (14,280 ÷ 7) × 4	8,160
Bimal's share (14,280 ÷ 7) × 3	6,120
	14,280

Illustration 51

Ajay, Bijay and Sujay were partners sharing profits and losses as 2 : 1 : 1. The Balance Sheet as on 31.12.2012 when they dissolved their partnership was under :

Liabilities		₹	Assets	₹
Capital :			Sundry Assets	1,85,000
Ajay	60,000		Cash	15,000
Bijay	50,000			
Sujay	30,000	1,40,000		
Reserve		10,000		
Govt. Dues		10,000		
Bijay's Loan		20,000		
Creditors		20,000		
		2,00,000		2,00,000

₹ 2,000 was spent for packaging of materials before sale. The realisations were made on different dates as under : January ₹ 15,000; February ₹ 20,000; March ₹ 30,000; April ₹ 60,000 and May ₹ 40,000.

The collections were distributed as and when realised. Show the distribution of cash collected.

[C.U.B.Com. (Hons.) — 2013]

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	Ajoy (₹)	Bijoy (₹)	Sujoy (₹)
	Capital Accounts	60,000	50,000	30,000
	Reserve Fund (2 : 1 : 1)	5,000	2,500	2,500
	(1) Adjusted Capital	65,000	52,500	32,500
	(2) Profit Sharing Ratio	2	1	1
STEP 1	(3) [(1)/(2)]	32,500	52,500	$\boxed{32,500}$
	(4) Base Capital	—	—	32,500
STEP 2	(5) Relative Capital (4) x (2)	65,000	32,500	32,500
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	—	20,000	—

Statement Showing Priority of Distribution

First, ₹ 10,000 to be utilised for payment of Government dues.
Next, ₹ 20,000 to be paid to Creditors.
Next, ₹ 20,000 to be paid to Bijoy for for his loan.
Next, ₹ 20,000 to be paid to Bijoy for his surplus capital.
Balance to be paid to the partners in the ratio of 2 : 1 : 1.

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Govt. Dues	Creditors	Loan	Capitals		
		₹	₹	Bijoy	Ajoy	Bijoy	Sujoy
Amount Due (After taking Reserve)		10,000	20,000	20,000	65,000	52,500	32,500
Cash in Hand	15,000						
Less: Expenses for Packing	2,000						
	13,000						
Less: Government Dues Paid	10,000	10,000					
	3,000						
Less: Paid to Creditors	3,000		3,000				
Balance Due			17,000	20,000	65,000	52,500	32,500
Realisation of January	15,000						
Less : Paid to Creditors	15,000		15,000	—	—	—	—
Balance Due			2,000	20,000	65,000	52,500	32,500
Realisation of February	20,000						
Less : Paid to Creditors	2,000		2,000	—	—	—	—
	18,000						
Less : Loan of Bijoy paid-off	18,000			18,000	—	—	—
Balance Due			—	2,000	65,000	52,500	32,500
Realisation of March	30,000						
Less: Balance loan of Bijoy paid-off	2,000			2,000			
	28,000						
Add: Surplus Capital of Bijoy	20,000					20,000	
	8,000						
Less: Paid to partners in the ratio of 2 : 1 : 1	8,000				4,000	2,000	2,000
Balance due				—	61,000	30,500	30,500
Realisation of April	60,000						
Less : Paid to partners in the ratio of 2 : 1 : 1	60,000				30,000	15,000	15,000
Balance Due					31,000	15,500	15,500
Realisation of May	40,000						
Less : Paid to partners in the ratio of 2 : 1 : 1	40,000				20,000	10,000	10,000
Balance left unpaid (Being loss on realisation)					11,000	5,500	5,500

Illustration 52

Sachin, Rahul and Laxman was three partners in a firm. They shared profits and losses equally. Their Balance Sheet as on 31st March, 2012 was as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			Land and Building	30,000
Sachin	47,000		Plant and Machinery	35,000
Laxman	35,000	82,000	Furniture	5,000
Sachin's Loan		20,000	Stock	5,000
Creditors		65,000	Debtors	5,000
			Profit and Loss Account	37,000
			Capital Account : Rahul	50,000
		1,67,000		1,67,000

Due to weak financial condition, the partners decided to dissolve the firm. The assets realised as follows :

	₹
Land and Building	26,000
Plant and Machinery	30,000
Furniture	3,000
Stock	3,000
Debtors	2,000

Expenses of realisation amounted to ₹ 3,500.

Further information regarding partners are stated below :

	Private Estates	Private Liabilities
Sachin	33,000	35,000
Rahul	27,000	36,000
Laxman	27,000	25,000

Prepare the necessary ledger accounts to close the books of the firm.

[C.U.B.Com. (Hons.) — 2013]

Solution

In the books of the Firm

Realisation Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Mar 31	To Land and Building A/c	30,000	Mar 31	By Bank A/c (Note 1) (Assets realised)	64,000
	To Plant and Machinery A/c	35,000		By Partners' Capital A/cs :	
	To Furniture A/c	5,000		Sachin	6,500
	To Stock A/c	5,000		Laxman	6,500
	To Debtors A/c	5,000		Rahul	6,500
	To Bank A/c (Realisation Expenses)	3,500			
		83,500			83,500

Bank Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012			2012		
Mar 31	To Realisation A/c (Note 1)	64,000	Mar 31	By Realisation Expenses A/c	3,500
	To Laxman Capital (Amount brought-in)	2,000		By Creditors A/c	62,500
		66,000			66,000

Partners' Capital Accounts

Dr. **Cr.**

Date	Particulars	Sachin	Laxman	Rahul	Date	Particulars	Sachin	Laxman	Rahul
2012		(₹)	(₹)	(₹)	2012		(₹)	(₹)	(₹)
Mar 31	To Balance b/d	—	—	50,000	Mar 31	By Balance b/d	47,000	35,000	—
	To Profit and Loss A/c	12,334	12,333	12,333		By Sachin Loan A/c	20,000	—	—
	To Realisation A/c	6,500	6,500	6,500		By Bank A/c (Note 2)	—	2,000	—
	To Rahul Capital A/c	34,417	34,416	—		By Sachin Capital A/c	—	—	34,417
	To Laxman Capital A/c	16,249	—	—		By Laxman Capital A/c	—	—	34,416
						By Sachin Capital A/c	—	16,249	—
						By Deficiency A/c	2,500	—	—
		69,500	53,249	68,833			69,500	53,249	68,333

Dr. **Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012 Mar 31	To Bank A/c	62,500	2012 Mar 31	By Balance b/d	65,000
	To Deficiency A/c	2,500			
		65,000			65,000

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012 Mar 31	To Sachin Capital A/c	2,500	2012 Mar 31	By Creditors A/c	2,500

Working Notes :

(1) Assets Realised :

	₹
Land and Building	26,000
Plant and Machinery	30,000
Furniture	3,000
Stock	3,000
Debtors	2,000
	64,000

(2) Laxman's private estate is more than his private liabilities. Therefore, he can bring in only ₹ 2,000 (₹ 27,000 – 25,000).

Illustration 53

Bee, Cee, Dee and Zee are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 2011 :

Liabilities	₹	Assets		₹
Creditors	3,00,000	Debtors	3,50,000	
Capital :		Less: Provision for Bad Debts	50,000	3,00,000
Bee	6,20,000	Cash		1,30,000
Zee	2,40,000	Stock		2,00,000
General Reserve	2,50,000	Investments		70,000
Bank Loan	60,000	Machinery		3,10,000
		Capital :		
		Cee		2,20,000
		Dee		1,90,000
		Preliminary Expenses		50,000
	14,70,000			14,70,000

On 31.03.2011, the firm is dissolved and the following points are agreed upon :

Bee is to take over 40% of debtors at 80% of book value.

Zee is to take over the stocks at 95% of the value.

Dee is to discharge the Sundry Creditors.

Bank to take the investments in full settlement of their loan.

Fixed assets and balance of Debtors realised ₹ 3,00,000 and ₹ 1,78,000 respectively.

Expenses of realisation amounted to ₹ 30,000.

Cee is declared insolvent and ₹ 22,000 is realised from his estate.

Prepare Realisation Account, Capital Accounts of the partners and Cash Account in the books of the firm.

[C.U.B.Com. (Hons.) — 2012]

Solution

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011 Mar 31	To Debtors A/c	3,50,000	2011 Mar 31	By Provision for Bad Debts A/c	50,000
	To Stock A/c	2,00,000		By Bank Loan A/c (Note 1)	60,000
	To Investments A/c	70,000		By Creditors A/c	3,00,000
	To Machinery A/c	3,10,000		By Bee Capital A/c (Note 3)	1,12,000
	To Dee Capital A/c	3,00,000		By Zee Capital A/c	1,90,000
	To Bank A/c (Realisation Expenses)	30,000		By Bank A/c :	
				Fixed Assets	3,00,000
				Debtors	1,78,000
				By Partners' Capital A/cs :	
				Bee	28,000
				Cee	7,000
				Dee	14,000
				Zee	21,000
		12,60,000			12,60,000

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

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Mar 31	To Balance b/d	1,30,000	Mar 31	By Realisation A/c (Expenses on realisation)	30,000
	To Realisation A/c (Note 4)	4,78,000		By Bee Capital A/c	4,30,500
	To Cee Capital A/c	22,000		By Dee Capital A/c	1,36,000
				By Zee Capital A/c	33,500
		6,30,000			6,30,000

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

Particulars	Bee	Cee	Dee	Zee	Particulars	Bee	Cee	Dee	Zee
	(₹)	(₹)	(₹)	(₹)		(₹)	(₹)	(₹)	(₹)
To Balance b/d	—	2,20,000	1,90,000	—	By Balance b/d	6,20,000	—	—	2,40,000
To Preliminary Exp. (Note 2)	20,000	5,000	10,000	15,000	By General Reserve A/c	1,00,000	25,000	50,000	75,000
To Realisation A/c (Loss)	28,000	7,000	14,000	21,000	By Realisation A/c	—	—	3,00,000	—
To Realisation A/c	1,12,000	—	—	1,90,000	(Creditors discharged)				
(Assets taken over)					By Bank A/c	—	22,000	—	—
To Cee Capital A/c	1,29,500	—	—	55,500	By Partners' Capital A/cs :				
To Bank A/c	4,30,500	—	1,36,000	33,500	Bee	—	1,29,500	—	—
					Zee	—	55,500	—	—
	7,20,000	2,32,000	3,50,000	3,15,000		7,20,000	2,32,000	3,50,000	3,15,000

Working Notes :

(1) Bank took over investment in full settlement of their loan. Therefore, no other entry is to be passed as investment and bank loan were transferred to Realisation Account.

(2) Preliminary expenses are fictitious assets. It is to be debited to ***Partners' Capital Account*** in the profit sharing ratio.

(3) Value of Debtors taken over by Bee

Balance of Debtors	₹ 3,50,000
Gross Value of Debtors taken over	40% of ₹ 3,50,000
	= **₹ 1,40,000**
Net amount of Debtors taken over	80% of ₹ 1,40,000
	= **₹ 1,12,000**

(4) Assets Realised in Cash

	₹
Fixed Assets	3,00,000
Debtors (Balance)	1,78,000
	4,78,000

(5) Calculation of Cee's Deficiency

	₹
Debit balance of Capital Account	2,20,000
Preliminary Expenses	5,000
Realisation Loss	7,000
	2,32,000
Less: Share of General Reserve	25,000
	2,07,000
Amount realised from Cee's Estate	22,000
	1,85,000

C's deficiency of ₹ 1,85,000 is to be shared by Bee and Zee in the ratio of their adjusted capital.

Dee will not bear any loss on deficiency because at the time of dissolution, he had a debit balance in his Capital Account.

(6) Calculation of Adjusted Capital

	Bee	Zee
Balance of Capital Account	6,20,000	2,40,000
Add: Share of General Reserve	1,00,000	75,000
	7,20,000	3,15,000
Less: Share of Preliminary Expenses	20,000	15,000
	7,00,000	3,00,000

Capital ratio : 7 : 3.

(7) Share of Deficiency of Cee

Bee : (1,85,000 ÷ 10) × 7	1,29,500
Zee : (1,85,000 ÷ 10) × 3	55,500
	1,85,000

Special Problems

Illustration 54

Dale, Fell and Hill were in partnership sharing profits and losses in the ratio of 3:3:2 after allowing interest on capitals at 5 per cent per annum. A summarized version of their Balance Sheet at 1st January 2017 showed :

	₹
Capital Accounts (Dale — ₹ 40,000; Fell — ₹ 40,000; Hill — ₹ 20,000)	1,00,000
Current Accounts (Dale — ₹ 200; Fell — ₹ 100; Hill — ₹ 100)	400
Loan Account (Fell — 8% p.a. interest)	5,000
Life Assurance Fund	26,000
	1,31,400
Fixed and Current Assets less Liabilities	1,05,400
Life Assurance policies	26,000
	1,31,400

Fell died on December 31st, 2017 and the other partners then decided to sell the business.

The life assurance contract was represented by 'with profits' whole life policies on the three lives and a total premium of ₹ 3,000 was paid annually in March. The Policies Account and the Fund Account were annually adjusted to surrender values. The sum payable on Fell's death was ₹ 36,000 and the surrender value immediately afterwards was ₹ 15,000. It has been agreed that all proceeds from the life assurance policies be apportioned in profit sharing ratios.

The profit for the year after charging all trading expenses was ₹ 37,200 and the partners had withdrawn ₹ 12,600; ₹ 13,500 and ₹ 7,900 respectively.

At the close of trading there was a bank balance of ₹ 800 together with ₹ 36,000 received from the insurance company. All of the remaining assets were sold and, after settling the liabilities to the creditors, the proceeds were ₹ 1,24,000. ₹ 320 was paid as legal fees and other expenses. The life assurance contract was to be re-assigned and new policies issued to Dale and Hill at values of ₹ 9,000 and ₹ 6,000 respectively.

Required : Prepare Ledger Accounts to show the closing entries, assuming that all the transactions, including final payments to Dale, Hill and to Fell's estate, were completed on December 31, 2017.

Solution

First of all, a Balance Sheet on the date of Fell's death is to be prepared, which is as under:

Balance Sheet as on 31December, 2017

Liabilities	₹	Assets	₹
Capital Accounts : (Dale — ₹ 40,000; Fell — ₹ 40,000; Hill — ₹ 20,000)	1,00,000	Net Assets other than cash at bank (Note 2)	1,04,800
Current Accounts : (Dale — ₹ 400; Hill — ₹ 400)	800	Cash at bank	800
Sundry Loan Account : Fell	5,000	Life Assurance Policies	29,000
Life Assurance Fund	29,000	Current Account — Fell (Note 3)	200
	1,34,800		1,34,800

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Net Assets other than cash at bank	1,04,800	2017 Dec. 31	By Bank A/c (sale of assets)	1,24,000
	To Life Assurance policies A/c	29,000		By Bank A/c (realisation of policy)	36,000
	To Bank A/c (expenses)	320		By Partners' Capital A/cs : (policies taken over) (Dale — 9,000; Hill — 6,000)	15,000
	To Partners' Capital A/cs : (Dale — 15,330; Fell — 15,330; Hill — 10,220)	40,880			
		1,75,000			1,75,000

Dr. Fell 8% Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Bank A/c	5,000	2017 Dec. 31	By Balance b/d	5,000

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Balance b/d	800	2017 Dec. 31	By Realisation A/c (expenses)	320
	To Realisation A/c (sale of assets)	1,24,000		By Fell — 8% Loan A/c	5,000
	To Realisation A/c (insurance policy)	36,000		By Partners' Capital A/cs : (Dale — 57,605; Fell — 66,005; Hill — 31,870)	1,55,480
		1,60,800			1,60,800

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

Date	Particulars	Dale	Fell	Hill	Date	Particulars	Dale	Fell	Hill
2017					2017				
Dec. 31	To Current A/c	—	200	—	Jan.1	By Balance b/d	40,000	40,000	20,000
	To Realisation A/c	9,000	—	6,000	Dec. 31	By Current A/c	400	—	400
	To Bank A/c	57,605	66,005	31,870		By Life Assurance Fund	10,875	10,875	7,250
						By Realisation A/c – profit	15,330	15,330	10,220
		66,605	66,205	37,870			66,605	66,205	37,870

Working Notes :

Dr. **(1) Profit & Loss Account for the year ended 31st December, 2017** **Cr.**

Particulars	₹	Particulars	₹
To Life Assurance Fund Account	3,000	By Profit after charging trading expenses	37,200
To Interest on Loan : Fell	400		
To Net profit c/d	33,800		
	37,200		37,200
To Interest on Capitals :		By Net profit b/d	33,800
(Dale — ₹ 2,000; Fell — ₹ 2,000; Hill — ₹ 1,000)	5,000		
To Balance of Net profit :			
(Dale — ₹ 10,800; Fell — ₹ 10,800; Hill — ₹ 7,200)	28,800		
	33,800		33,800

Dr. **(2) Net Assets Account (Fixed & Current Assets less Liabilities)** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,05,400	By Life Assurance Policy (premium)	3,000
To Profit after charging Trading Expenses	37,200	By Drawings: ₹ (Dale — 12,600; Fell — 13,500; Hill — 7,900)	34,000
		By Bank (shown separately)	800
		By Balance c/d	1,04,800
	1,42,600		1,42,600

Dr. **(3) Partners' Current Accounts** **Cr.**

Date	Particulars	Dale	Fell	Hill	Date	Particulars	Dale	Fell	Hill
2017					2017				
Dec. 31	To Drawings A/c	12,600	13,500	7,900	Jan. 1	By Balance b/d	200	100	100
	To Balance c/d	400	—	400	Dec. 31	By Interest on Loan A/c	—	400	—
						By Interest on Capital A/c	2,000	2,000	1,000
						By Net profit	10,800	10,800	7,200
						By Balance c/d	—	200	—
		13,000	13,500	8,300			13,000	13,500	8,300

Dr. **(4) Life Assurance Policies Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	26,000	By Balance c/d	29,000
To Bank A/c (premium paid)	3,000		
	29,000		29,000

Dr. **(5) Life Assurance Fund Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance c/d	29,000	By Balance b/d	26,000
		By Profit and Loss A/c	3,000
	29,000		29,000

Illustration 55

A, B, C and D are sharing profits and losses in the ratio of 5 : 5 : 4 : 2. Frauds committed by C during the year were found out and it was decided to dissolve the partnership on 31st March, 2010 when their Balance Sheet was as under :

Liabilities	₹	Assets	₹
Capital :		Building	1,20,000
A	90.000	Stock	85,500
B	90.000	Investments	29,000
C	—	Debtors	42,000
D	35,000	Cash	14,500
General Reserve	24,000	C Capital	15,000

Trade Creditors	47,000		
Bills Payable	20,000		
	3,06,000		3,06,000

Following information is given to you :

(i) A cheque for ₹ 4,300 received from debtor was not recorded in the books and was misappropriated by C.

(ii) Investments costing ₹ 5,400 were sold by C at ₹ 7,900 and the funds transferred to his personal account. This sale was omitted from the firm's books.

(iii) A creditor agreed to take over investments of the book value of ₹ 5,400 at ₹ 8,400. The rest of the creditors were paid off at a discount of 2%.

(iv) The other assets realised as follows :
Building : 105% of book value
Stock : ₹ 78,000
Investments : The rest of investments were sold at a profit of ₹ 4,800.
Debtors : The rest of the debtors were realised at a discount of 12%.

(v) The bills payable were settled at a discount of ₹ 400.

(vi) The expenses of dissolution amounted to ₹ 4,900.

(vii) It was found out that realisation from C's private assets would only be ₹ 4,000.

Prepare the necessary Ledger Accounts.

[C.A. (IPCC) — November, 2010]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
2010	To Building A/c		1,20,000	2010	By Trade Creditors A/c		47,000
Mar 31	To Stock A/c		85,500	Mar 31	By Bills Payable A/c		20,000
	To Investments A/c		29,000		By Cash A/c (Assets realised) :		
	To Debtors A/c		42,000		Building	1,26,000	
	To Cash A/c (Creditors paid off) (Note 2)		37,828		Stock	78,000	
	To Cash A/c (Bills Payable paid)		19,600		Investment (Note 1)	23,000	
	To Cash A/c (Expenses)		4,900		Debtors (Note 3)	33,176	260,176
	To Partners' Capital A/cs :				By C Capital A/c :		
	A	171			Collection from Debtors		4,300
	B	171			Sale of Investments		7,900
	C	137					
	D	69	548				
			3,39,376				3,39,376

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	14,500		By Realisation A/c :	
	To Realisation A/c (Sale of Assets)	2,60,176		Creditors paid off	37,828
	To C Capital A/c	4,000		Bills Payable paid off	19,600
				Expenses	4,900
				By Partners' Capital A/cs :	
				A	90,531
				B	90,531
				D	35,286
		2,78,676			2,78,676

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

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2010	To Balance b/d	—	—	15,000	—		By Balance b/d	90,000	90,000	—	35.000
Mar 31	By Realisation A/c :	—	—	—	—		By Gen. Reserve A/c	7.500	7.500	6.000	3.000
	Debtors	—	—	4,300	—		By Realisation A/c	171	171	137	69
	Investment	—	—	7,900	—		By Cash A/c	—	—	4,000	—
	To C Capital A/c	7,140	7,140	—	2,783		By Partners'				
	To Cash A/c	90,531	90,531	—	35,286		Capital A/cs:				
	(Final Payment)						A (Note 5)	—	—	7,140	—
							B (Note 5)	—	—	7,140	—
							D (Note 5)	—	—	2,783	—
		97,671	97,671	27,200	38,069			97,671	97,671	27,200	38,069

Working Notes :

(1) Amount Received on Sale of Investments | **(2) Amount Paid to Creditors**

Particulars	₹	Particulars	₹
Book Value of Investment	29,000	Book Value of Creditors	47,000
Less: Sold by C (Misappropriation)	5,400	Less: Investment takenover (Book value ₹ 5,400)	8,400
	23,600		38,600
Less: Taken over by Creditors	5,400	Less: 2% Discount Allowed	772
	18,200		37,828
Add: Profit on Sale of Investment	4,800	**(4) Deficiency of C**	
Total	23,000	Debit Balance of Capital	15,000
(3) Amount Received from Debtors		Add: Collection from Debtors	4,300
Book Value of Debtors	42,000	Add: Sale of Investments	7,900
Less: collected by C (unrealised)	4,300		27,200
	37,700	Less: Share of General Reserve	(6,000)
Less: Discount 12%	4,524	Less: Share of Realisation Fund	(137)
	33,176	Less: Cash from Estate	(4,000)
		Net Deficiency of Capital	17,063

(5) Net deficiency of C's capital ₹ 17,063 will be shared by A, B and D in their adjusted capital ratio. **The adjusted capital of** :

A = [90,000 + 7,500 (share of general reserve)] = 97,500
B = [90,000 + 7,500 (share of general reserve)] = 97,500
D = [35,000 + 3,000 (share of general reserve)] = 38,000.
The ratio of adjusted capital : 975 : 975 : 380.

Share of deficiency :

A = (17,063 / 2,330) × 975 = 7,140
B = (17,063 / 2,330) × 975 = 7,140
D = (17,063 / 2,330) × 380 = 2,783

Illustration 56

Ram, Rahim and Robert are partners of the firm 'RR Traders' for the past 5 years. The partners decided to dissolve the firm consequent to insolvency of partner Robert in October 2002. The Balance Sheet of the firm as on 31.10.2002 is furnished below. They share profits and losses equally.

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Building	5,00,000
Ram	4,50,000	Plant and Machinery	2,00,000
Rahim	4,50,000	Furniture and Fittings	50,000
Robert	2,00,000	Stock in Trade	3,00,000
General Reserve	2,10,000	Debtors	5,00,000
Creditors	2,90,000	Cash at Hand / Bank	50,000
	16,00,000		16,00,000

The partners Ram and Rahim decided to form a new firm 'RR Enterprises' and takeover all the assets and liabilities of the firm at values given below :

	₹
Land and Building	3,50,000
Plant and Machinery	1,50,000
Furniture and Fittings	20,000
Stock-in-trade	2,00,000

Debtors include ₹ 3,00,000 due from SK & Co. owned by Robert. (Nothing is recoverable from the said concern). Other debtors can be recovered fully.

Prepare :

(i) Realisation Account, Partners' Capital Accounts in the books of RR Traders; and,
(ii) The Balance Sheet of RR Enterprises (immediately after commencement).

[C.A. (PE-II) — May, 2003]

Solution

In the books of RR Traders

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2002	To Land and Building	5,00,000	2002	By Creditors	2,90,000
Oct. 31	To Plant and Machinery	2,00,000	Oct. 31	By RR Enterprises (Note 1)	6,80,000
	To Furniture and Fittings	50,000		By Partners' Capital A/cs :	
	To Stock in Trade	3,00,000		Ram	1,10,000
	To Debtors (Note 2)	2,00,000		Rahim	1,10,000
	To Cash in Hand / Bank	50,000		Robert	1,10,000
		13,00,000			13,00,000

Dr. Partners' Capital Accounts Cr.

Particulars	Ram	Rahim	Robert	Particulars	Ram	Rahim	Robert
To Sundry Debtors	—	—	3,00,000	By Balance b/d	4,50,000	4,50,000	2,00,000
To Realisation A/c	1,10,000	1,10,000	1,10,000	By General Reserve A/c	70,000	70,000	70,000
To Robert Capital A/c	70,000	70,000	—	By Cash (Note 3)	1,10,000	1,10,000	—
To Capital in RR Enterprises A/c	4,50,000	4,50,000	—	By Ram Capital (Note 4)	—	—	70,000
				By Rahim Capital (Note 4)	—	—	70,000
	6,30,000	6,30,000	4,10,000		6,30,000	6,30,000	4,10,000

Balance Sheet of RR Enterprises as at 31st October, 2002

Liabilities	₹	Assets	₹
Capital Liabilities :		**Fixed Assets** :	
Ram	4,50,000	Land and Building	3,50,000
Rahim	4,50,000	Plant and Machinery	1,50,000
Current Liabilities :		Furniture and Fittings	20,000
Creditors	2,90,000	**Current Assets** :	
		Stock-in-trade	2,00,000
		Sundry Debtors	2,00,000
		Cash in hand / bank (Note 7)	2,70,000
	11,90,000		11,90,000

Working Notes : (1) Calculation of Purchase Consideration

Particulars	₹	₹
Assets taken over (agreed value)		
Land and Building	3,50,000	
Plant and Machinery	1,50,000	
Furniture and Fittings	20,000	
Stock-in-trade	2,00,000	
Debtors (₹ 5,00,000 – ₹ 3,00,000)	2,00,000	
Cash	50,000	9,70,000
Liabilities takenover		
Creditors	2,90,000	2,90,000
		6,80,000

(2) Out of total debtors of ₹ 5,00,000 amount due from SK & Co. (owned by Robert) was ₹ 3,00,000. Nothing was recoverable. Therefore, debtors takenover by the new firm was ₹ 2,00,000 (₹ 5,00,000 – ₹ 3,00,000).

(3) Solvent partners Ram and Rahim bought in cash ₹ 1,10,000 each to make good the firm in respect of realisation loss (assumed that Garner vs. Murray Rule was followed).

(4) Robert's deficiency of ₹ 1,40,000 will be borne by Ram and Rahim in their capital ratio, i.e., ₹ 5,20,000 : ₹ 5,20,000 or 1:1.

Dr. (5) RR Enterprises Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Realisation A/c	6,80,000		By Capital in RR Enterprises A/c	9,00,000
	To Cash A/c	2,20,000			
		9,00,000			9,00,000

Dr. (6) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Partners' Capital A/cs : Ram	1,10,000		By RR Enterprises A/c	2,20,000
	Rahim	1,10,000			
		2,20,000			2,20,000

(7) Final cash balance of RR Enterprises

Particulars	₹
Balance from old firm	50,000
Add: Cash brought-in by :	
Ram	1,10,000
Rahim	1,10,000
	2,70,000

Illustration 57

Given below is the Balance Sheet of A, B and C as on 31st December, 2017 on which date they dissolved their partnership. They share profits and losses in the ratio of 4:3:3. Since the realization of assets was protracted, they decided to distribute amounts as and when feasible and to appoint C for this purpose who was to get as his remuneration 1% of the value of the assets realised other than cash at Bank and 10% of the amount distributed to the partners:

Liabilities	₹	Assets	₹
A's Capital	15,000	Cash at Bank	275
B's Capital	7,500	Sundry Assets	53,725
C's Capital	15,000		
Sundry Creditors	16,500		
	54,000		54,000

Assets realised as under:

First Instalment ₹ 16,250; Second Instalment ₹ 12,750; Third Instalment ₹ 10,000; Last Instalment ₹ 7,500.

Prepare a statement showing distribution of cash and also the necessary Journal Entries to close the books of the firm. Also show Realisation Account.

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	15,000	7,500	15,000
	(2) Profit sharing ratio	4	3	3
STEP 1	(3) [(1) / (2)]	3,750	2,500	5,000
	(4) Base Capital (being smallest)		2,500	
STEP 2	(5) Relative Capital (4) x (2)	10,000	7,500	7,500
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	5,000		7,500
STEP 4	(7) [(6) / (2)]	1,250		2,500
	(8) Revised Base Capital (being smaller)	1,250		
STEP 5	(9) Relative Capital [(8) x (2)]	5,000		3,750
STEP 6	(10) [(6) – (9)] Absolute **Surplus Capital**	—		3,750

Statement Showing Priority of Distribution

First, ₹ 16,500 to be paid to the creditors.
Next, ₹ 3,750 to be paid to C (Absolute Surplus).
Next, ₹ 8,750 to be paid to A and C in the ratio of 4:3.
Balance to be paid to A, B and C in the profit sharing ratio.

Statement Showing Distribution of Cash

	Amount available	Creditors ₹	Capitals A	Capitals B	Capitals C
Amount Due		16,500	15,000	7,500	15,000
Cash in hand	275				
Realisation of 1st Instalment	16,250				
	16,525				
Less: Paid to the creditors	16,500	16,500			
	25				
Less: Commission due to C (Note 2)	25				
Balance Due			15,000	7,500	15,000
Realisation of 2nd Instalment	12,750				
Less: Commission paid to C (Note 3) (incl. balance of 1st instalment ₹ 290 – 25)	265				

	12,485				
Less: Commission (1/11)	1,135				
	11,350				
Less: Paid to C (Absolute Surplus)	3,750				3,750
	7,600				
Less: Paid to A and C in the ratio 4:3	7,600		4,343		3,257
Balance Due			10,657	7,500	7,993
Realisation of 3rd Instalment	10,000				
Less: Commission due to C (Note 1)	100				
	9,900				
Less: Commission (1/11)	900				
	9,000				
Less: Paid to A and C in the ratio 4:3	1,150		657		493
	7,850		10,000	7,500	7,500
Less: Paid to A, B and C in the ratio 4:3:3	7,850		3,140	2,355	2,355
Balance Due			6,860	5,145	5,145
Realisation of last Instalment	7,500				
Less: Commission due to C (Note 1)	75				
	7,425				
Less: Commission (1/11)	675				
	6,750				
Less: Paid to A, B and C in the ratio 4:3:3	6,750		2,700	2,025	2,025
Balance left unpaid (Being loss on realisation)			4,160	3,120	3,120

In the books of A, B and C
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017	Realisation A/c	Dr.	53,725	
Dec. 31	To Sundry Assets A/c			53,725
	(Being sundry assets transferred to Realisation Account on dissolution of the firm)			
	Sundry Creditors A/c	Dr.	16,500	
	To Realisation A/c			16,500
	(Being sundry creditors transferred to Realisation Account on dissolution of the firm)			
1st	Bank A/c	Dr.	16,250	
Instalment	To Realisation A/c			16,250
	(Being the amount realised on first instalment on sale of assets)			
	Realisation A/c	Dr.	16,500	
	To Bank A/c			16,500
	(Being the amount paid to sundry creditors in full settlement)			
	Realisation A/c	Dr.	25	
	To Bank A/c			25
	(Being C's commission for realisation of assets paid to the extent possible)			
2nd	Bank A/c	Dr.	12,750	
Instalment	To Realisation A/c			12,750
	(Being the amount realised on 2nd instalment on sale of assets)			
	Realisation A/c	Dr.	1,400	
	To Bank A/c			1,400
	(Being C's commission paid ₹ 265 for realisation of assets and ₹ 1,135 for payment to partners)			
	A Capital A/c	Dr.	4,343	
	C Capital A/c (₹ 3,750 + ₹ 3,257)	Dr.	7,007	
	To Bank A/c			11,350
	(Being the amount paid to A and C as per distribution statement)			
3rd	Bank A/c	Dr.	10,000	
Instalment	To Realisation A/c			10,000
	(Being the amount realised on 3rd instalment on sale of assets)			

	Realisation A/c	Dr.	1,000	
	To Bank A/c			1,000
	(Being C's commission paid ₹ 100 for realisation of assets and ₹ 900 for payment to the partners)			
	A Capital A/c (₹ 657 + ₹ 3,140)	Dr.	3,797	
	B Capital A/c	Dr.	2,355	
	C Capital A/c (₹ 493 + ₹ 2,355)	Dr.	2,848	
	To Bank A/c			9,000
	(Being the amount paid to the partners towards capital as per distribution statement)			
Last Instalment	Bank A/c	Dr.	7,500	
	To Realisation A/c			7,500
	(Being the amount realised on last instalment on sale of assets)			
	Realisation A/c	Dr.	750	
	To Bank A/c			750
	(Being C's commission paid ₹ 75 for realisation of assets and ₹ 675 for payment to the partners)			
	A Capital A/c	Dr.	2,700	
	B Capital A/c	Dr.	2,025	
	C Capital A/c	Dr.	2,025	
	To Bank A/c			6,750
	(Being the final payment to the partners)			
	A Capital A/c	Dr.	4,160	
	B Capital A/c	Dr.	3,120	
	C Capital A/c	Dr.	3,120	
	To Realisation A/c			10,400
	(Being loss on realisation transferred to the Partners' Capital Accounts in the ratio of 4:3:3)			

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Dec. 31	To Sundry Assets A/c	53,725	Dec. 31	By Sundry Creditors A/c	16,500
	To Bank A/c	16,500	1st Inst.	By Bank A/c	16,250
	To Bank A/c	25	2nd Inst.	By Bank A/c	12,750
	To Bank A/c	1,400	3rd Inst.	By Bank A/c	10,000
	To Bank A/c	1,000	Last Inst.	By Bank A/c	7,500
	To Bank A/c	750		By A Capital A/c	4,160
				By B Capital A/c	3,120
				By C Capital A/c	3,120
		73,400			73,400

Working Notes: **(1) Commission Payable to C**

On assets realised	₹	On amount distributed to the partners	₹
@ 1% on ₹ 16,250	163	@ 1/11 on payment to Partners	
@ 1% on ₹ 12,750	127	on ₹ 12,485	1,135
@ 1% on ₹ 10,000	100	on ₹ 9,900	900
@ 1% on ₹ 750	75	on ₹ 7,425	675
	465		3,175

(2) Commission payable to C for assets realised is ₹ 163. But, only ₹ 25 left after paying the creditors. Therefore, ₹ 25 will be paid now and balance ₹ 138 will be paid with 2nd instalment.

(3) Commission payable to C for assets realised in 2nd instalment is ₹ 127. Total amount payable = ₹ 127 + 138 (due of 1st instalment) = ₹ 265.

Key Points

- The process of breaking up and discontinuing a Partnership business is called ***Dissolution of the firm***. The dissolution of the firm spells an end to the business.
- **Steps in the Dissolution Process**
  - ¤ The ***first step*** in the dissolution process is to prepare a Balance Sheet of the firm as on the date of dissolution.
  - ¤ In the ***next step*** of the dissolution process, non-cash assets that are not acceptable for distribution in their present form are sold and converted into cash.
  - ¤ The ***last step*** in the dissolution is to distribute the available cash to creditors and partners.
- ***In effect, the decision in Garner Vs. Murray boiled down to this:***
  - ¤ The solvent partners should contribute to the deficiency of capital (caused by loss on realisation) in cash their share only and not the insolvent partners' share.
  - ¤ The net effect of what has been stated above is that the deficiency of capital of the insolvent partner gets distributed among the solvent partners in the ratio of their last agreed capitals.
- **Criticism of Garner Vs. Murray**
  - ¤ It does not apply when the firm is having only two partners.
  - ¤ It considers only the book capital of the partners, ignoring the private estate of the solvent partners. If a partner contributed more capital than that of the other partners, he will have to bear more burden than other partners contributing less capital.
  - ¤ If a partner is having a nil capital balance or a debit balance, he will not have to bear the deficiency of the insolvent partner.
  - ¤ Introduction of cash by the solvent partners to make good their share of loss on realisation is unnecessary, when the balance of the capital accounts of the solvent partners are sufficient to bear the deficiency of the insolvent partner.
- **Firm's Debts Vs Private Debts**
  - ¤ The joint estate of the partners as a firm and their separate estates as individuals are administered separately.
  - ¤ The separate estate of each partner is to be utilised first for paying his ***private debts***. Any surplus from the separate estate can be utilised for paying firm's debts. But any deficiency of his private estate is not included in the joint estate. Similarly, the joint estate of the firm is to be utilised first for paying the debts of the firm.
- When all the partners are insolvent and the firm's assets fall short of its liabilities, the creditors of the firm cannot be paid in full. The available cash with the firm (cash in hand + final dividend received from the partners' estate) is used first for paying realisation expenses. The balance amount is paid to creditors proportionally. In order, to close the books of the firm, Realisation Account is prepared in the usual manner without transferring the liabilities to Realisation Account. All liabilities are discharged directly to the extent possible. Any balance left unpaid is transferred to Deficiency Account. The Partners' Capital Accounts are then closed by transferring to Deficiency Account.
- When the assets are realised gradually, available cash at any particular point of time should be utilised in the following manner:
  - ¤ To meet the realisation expenses.
  - ¤ To pay off preferential creditors (e.g., government rates and taxes, etc)
  - ¤ To pay off other creditors. All the creditors are to be paid off in the ratio of their individual claim. But a secured creditor get a priority over ordinary creditors upto the amount realised from that particular asset by which his claim is secured by the firm. But for the balance of his claim, he is at par with other ordinary creditors.
  - ¤ To pay off partners' loans.
  - ¤ To pay off partners' capitals.

THEORETICAL QUESTIONS

1. What do you understand by dissolution of a firm? Bring out clearly the difference between dissolution of partnership and dissolution of firm.
2. What accounting entries have to be passed for closing the books of account of the firm?
3. Explain circumstances under which a firm is dissolved.
4. Explain how the Partners' Capital Account are normally settled in the case of dissolution of the partnership firm.

5. What is the rule in Garner Vs Murray?
   In what situations would it apply?
   Does it apply to firm constituted under the Indian Partnership Act?
6. Explain the application of Garnery Vs Murray when
   (a) Capitals are fixed; and
   (b) Capitals are fluctuating.
7. Write a short note on Piece-meal distribution.

PRACTICAL QUESTIONS

When All Partners are Solvent

1. A, B and C decide to dissolve their partnership on December 31, 2017 on which date the Balance Sheet of the firm stood as follows:

Liabilities	₹	Assets	₹
Capital — A	75,000	Plant and Machinery	2,02,500
Capital — B	52,500	Stock	1,12,500
Capital — C	22,500	Sundry Debtors	90,000
Loan Account — A	75,000		
Sundry Creditors	67,500		
Bank overdraft	1,12,500		
	4,05,000		4,05,000

In order to give effect to the above decision, draw up the Realization Account, Partners' Capital Accounts and the Cash Book after taking the following into consideration:
(a) Profits had been shared amongst A, B and C as 3:2:1.
(b) A agreed to take over part of the business for which he agreed to pay ₹ 37,500 for goodwill together with half of the plant and machinery and the stock, for which he agreed to pay ₹ 1,12,500 and ₹ 60,000 respectively.
(c) The balance of the plant and machinery was sold for ₹ 75,000 and of the stock for ₹ 30,000.
(d) Sundry debtors realized ₹ 84,750.

2. Amal, Bimal and Tamal are partners in a firm sharing profits and losses as Amal 60%, Bimal 30% and Tamal 10%. They agreed to dissolve the firm when the Balance Sheet was as under :

Liabilities	₹	Assets	₹
Capital — Amal	40,000	Land	10,000
Capital — Bimal	65,000	Building	50,000
Reserve	24,000	Plant	30,000
Loan A/c — Amal	18,000	Investments	10,000
Sundry Creditors	9,000	Loose Tools	1,000
Bank Overdraft	5,000	Furniture	2,000
		Stock	41,500
		Sundry Debtors	15,000
		Capital — Tamal	1,500
	1,61,000		1,61,000

Land and Building were taken by Amal at a valuation of ₹ 12,000 and ₹ 40,000 respectively. Plant and Investment were sold at book values. Loose Tools realized ₹ 1,300 and Stock ₹ 40,000. Of the Sundry Debtors ₹ 750 proved bad. Furniture was taken by Bimal at ₹ 1,550. Creditors were paid off subject to a discount of 6%. The expenses of dissolution was ₹ 540 and a contingent liability of ₹ 600 was paid. Show the Realization Account, Bank Account and the Capital Accounts of the partners showing the final distribution.

3. Anil, Balwant and Coomar were partners, carrying on business under the name and style of Anil & Co., sharing profits and losses in the proportion of 4 : 3 : 2. Their Balance Sheet as at 31st December, 2017 was as under:

Liabilities	₹	Assets	₹
Capital A/c — Anil	40,000	Land & Building	55,000
Capital A/c — Balwant	20,000	Motor Car	15,000
Capital A/c — Coomar	10,000	Stock-in-trade	20,000
Sundry Creditors	40,000	Sundry Debtors	18,000
		Cash	2,000
	1,10,000		1,10,000

They agreed to dissolve the partnership on that date. Anil agreed to take over stock and Debtors at a discount of 10%. Balwant took over the Motor Car for ₹ 16,000. Land and Building was sold for ₹ 75,000 and expenses of sale amounted to ₹ 1,600. Creditors were settled at a discount of 1.5%. Show the relevant Ledger Accounts.

4. Cloud, Storm and Rain were partners in a firm sharing profits and losses in the ratio of 5:3:2. Due to difference in opinion, they decided to dissolve the partnership with effect from 1st April, 2018 on which date the firm's Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capital A/c — Cloud	60,000	Plant & Machineries	80,000
Capital A/c — Storm	40,000	Furniture & Fixtures	45,000
Capital A/c — Rain	30,000	Motor car	25,000
Current A/c — Cloud	8,000	Stock-in-trade	30,000
Current A/c — Storm	10,000	Sundry debtors	71,000
Sundry Creditors	1,20,000	Cash at bank	14,000
		Current A/c — Rain	3,000
	2,68,000		2,68,000

The following information is given :

(i) Plant costing ₹ 40,000 was taken over by Cloud at an agreed valuation of ₹ 45,000 and the remaining machineries realised ₹ 50,000.

(ii) Furniture & Fixtures realised ₹ 40,000.

(iii) Motor car was taken over by Storm for ₹ 30,000.

(iv) Sundry Debtors included a bad debt for ₹ 1,200 and the rest portion was realised subject to a cash discount of 10%.

(v) Stock worth ₹ 5,000 was taken over by Rain for ₹ 5,200 and the rest realised at 20% above their book value.

(vi) A creditor for ₹ 2,000 was untraceable and other creditors accepted payments allowing 15% discount. Realisation expenses amounted to ₹ 5,000.

You are required to show the Realisation Account and the Capital Accounts of the partners on dissolution showing final payments to them.

5. A, B and C give you the following Balance Sheet as on 31.12.2017.

Liabilities	₹	Assets		₹
Loan A/c — A	15,000	Plant & Machinery at cost		30,000
Capital A/c — A	30,000	Fixture & Fittings		2,000
Capital A/c — B	10,000	Stock		10,400
Capital A/c — C	2,000	Debtors	18,400	
Sundry Creditors	17,800	Less: Provision for bad debts	400	18,000
Loan on hypothecation of stock	6,200	Joint Life Policy		15,000
Joint Life Policy Reserve	12,400	Patents and Trade Marks		10,000
		Bank		8,000
	93,400			93,400

The partners shared profits and losses in the ratio of 4:2:3. The firm was dissolved on December 31, 2017 and you are given the following information:

(a) C had taken a loan from Insurers for ₹ 5,000 on the security of the Joint Life Policy. The policy was surrendered and insurers paid a sum of ₹ 10,200 after deducting ₹ 5,000 for C's loan and ₹ 300 interest thereon.

(b) One of the creditors took some of the patents whose book value was ₹ 6,000 at a valuation of ₹ 4,500. The balance to that creditor was paid in cash.

(c) The firm had previously purchased some shares in a joint stock company and had written them off on finding them useless. The shares were now found to be worth ₹ 3,000 and the loan creditor agreed to accept the shares at this value.

(d) The remaining assets realised the following amounts :
Plant and Machinery — ₹ 17,000;
Fixture and Fittings — ₹ 1,000;
Stock — ₹ 9,000;
Debtors — ₹ 16,500;
Patents — 50% of their book value.

(e) The liabilities were paid and a total discount of ₹ 500 was allowed by the creditors.

(f) The expenses of realisation amounted to ₹ 2,300.

Prepare the Realisation Account, Bank Account and the Partners' Capital Accounts.

6. A, B and C sharing profits in the ratio of 3 : 1 : 1 agree upon dissolution. They decide to divide certain assets and liabilities and continue business separately. Their Balance Sheet was as under:

Liabilities	₹	Assets		₹
Creditors	6,000	Cash		3,200
Loan	1,500	Sundry Assets		17,000
Capital A/c — A	27,500	Debtors	24,200	
Capital A/c — B	10,000	Less: Provision for bad debts	1,200	23,000
Capital A/c — C	7,000	Stock		7,800
		Fixtures		1,000
	52,000			52,000

It is agreed that:

(a) Goodwill is to be ignored.

(b) 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.

(c) 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%).

(d) C is to 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 the accruing interest of ₹ 30 which has not been recorded in the books of the firm.

(e) The expenses of dissolution were ₹ 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare:

(i) Realisation Account;

(ii) Partners' Capital Accounts; and

(iii) Cash Account.

7. X, Y and Z, carrying on business from 1980, decided to dissolve their partnership on June 30, 2018, when their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Creditors	34,000	Cash	25,000
Capital Accounts:		Debtors	62,000
X	1,20,000	Stock	37,000
Y	90,000	Tools	8,000
Z	60,000	Motor Cars	12,000
		Machinery	60,000
		Freehold building	1,00,000
	3,04,000		3,04,000

Y and Z agreed to form a new partnership to carry on the business and agreed that they shall acquire from the old firm the following assets at the amounts shown: Stock ₹ 40,000; Tools ₹ 5,000; Motor cars ₹ 25,000; Machinery ₹ 78,000; Freehold building ₹ 84,000; and Goodwill ₹ 60,000.

The partnership agreement of X, Y and Z provided that trading profits or losses shall be divided in the ratio of 3 : 2 : 1 and that capital profits or losses shall be divided in proportion to their capitals.

Debtors realise ₹ 59,000 and discount amounting to ₹ 720 is secured on payments due to creditors.

Prepare the necessary accounts of X, Y and Z giving effect to these transactions and prepare the opening Balance Sheet of Y and Z who bring the necessary cash to pay X in the ratio of 3 : 2.

8. A and B who make up their accounts annually to 31st December were in partnership sharing profits and losses in the ratio of 2:1. No interest was charged on drawings or credited to capital.

The following was the summary of the balances as on 31.12.2017 :

	₹		₹
Fixtures and fittings	22,000	Partners Capital A/c — A	31,000
Leasehold premises	50,000	Partners Capital A/c — B	10,000
Stock (opening)	7,600	Loan from A at 8% p.a.	20,000
Debtors	1,800	Creditors	6,400
Purchases	48,000	Sales	1,04,000
General expenses	16,000	Depreciation on motor vehicle as on 1.1.2017	3,600
Partners Drawings — A	6,000	Bank overdraft	26,200
Partners Drawings — B	4,800		
Motor vehicle, at cost	9,000		
Wages	36,000		
	2,01,200		2,01,200

For the purpose of closing of accounts on 31.12.2017, closing stock was valued at ₹ 6,200 and furniture and fittings at ₹ 18,000. Provision for depreciation on motor vehicle is to be made at 20% p.a. calculated on cost and for accrued general expenses ₹ 1,200. In addition, one year's interest is to be provided on A's loan.

The partnership was dissolved on 1.1.2018, it being agreed that

(i) A should take over stock for ₹ 6,000;

(ii) B should take over motor vehicle at ₹ 2,700 and part of the fittings and fixtures for ₹ 7,500;

(iii) Interest on A's loan should cease w.e.f. 1.1.2018;

During January, 2018 the following transactions took place :

(a) Leasehold premises were sold, realising a net amount of ₹ 60,000;

(b) ₹ 1,600 was collected from debtors and the balance was taken over by A;

(c) A portion of the fittings and fixtures were auctioned and realised ₹ 10,000. It was also agreed that the balance of fixtures and fittings should be taken over by B for ₹ 500;

(d) Creditors and accrued general expenses were paid in full;

(e) Realisation expenses amounted to ₹ 1,400;

(f) All amounts receivable and payable by A and B were settled.

You are required to prepare the following :

1. Profit and Loss Account for the year ended 31.12.2017 excluding profit or loss arising on dissolution;
2. Realisation Account;
3. Cash Account for January 2018;
4. Partners' Accounts showing the final settlement of dissolution.

9. Hill, Stone and Rock were in partnership owning a riding school and livery stables. Profits and losses were shared : Hill three- fifths, Stone one-fifth, Rock one-fifth. No interest was charged on drawings or credited on capital. The firm provided an instructor to the equitation classes of the local agricultural college.

The following was a summary of the Balances as on 31 December, 2017.

	₹			₹
Drawings:		Capital:		
Hill	1,500	Hill		6,000
Stone	1,200	Stone		4,400
Rock	1,000	Rock		1,690
Freehold land and buildings	8,000	Loan : Stone	3,000	
Hay and fodder, balance on January 1, 2017	250	Interest @ 6% to June 30, 2017	90	3,090
Hay and fodder purchased	1,500	Agricultural college equitation fees		150
Harness equipment and fittings	250	Sundry creditors		130
Horses valued on January 1, 2017	1,600	Hire horses and riding lessons		2,905
Horses purchased	100	Receipts from horses at livery		870
Motor vehicles	2,500	Prize money		75
Debtors	600	Sale of horses		60
Salaries and wages	2,500	Bank overdraft		2,500
Veterinary and other fees	180			
General expenses	600			
Loan interest	90			
	21,870			21,870

On 31 December 2017, hay and fodder were valued at ₹ 50, motor vehicles at ₹ 2,000, harness, equipment and fittings at ₹ 200, and horses at ₹ 1,400. Provision was needed for veterinary fees ₹ 50. With the exception of loan interest no further provisions were considered necessary.

The partnership was dissolved on 31 December 2017, on the following terms :

1. Rock was appointed instructor to the local agricultural college, and for this privilege, he paid into the partnership ₹ 200 which is to be divided between Hills and Stone.
2. He also took over assets at the following valuation:
   (i) six horses ₹ 600;
   (ii) the hay and fodder ₹ 40;
   (iii) part of the harness and equipment ₹ 75;
   (iv) a horse box ₹ 800.
3. Hill took over a motor car at a valuation of ₹ 450.
4. Net receipts from the sale of the freehold and buildings amounted to ₹ 8,750.
5. The debtors realised ₹ 530 and the remaining assets were sold by auction, the net receipts being ₹ 1,765.
6. The loan, with interest accrued to date, was repaid on 1 January, 2018.
7. The creditors were paid and a contingent liability, not brought into the accounts, was settled early in January for ₹ 250.

8. Cups and plate, not brought into the accounts, were distributed among the partners at the following valuation : Hill ₹ 20, Stone ₹ 10, Rock ₹ 60.

All transactions were completed and all amounts receivable or payable by the partners were settled before the end of January 2018.

You are required to prepare :

(a) the Profit and Loss Account for the year ended 31 December 2017, excluding any profits or losses arising on dissolution; (b) the Realisation Account; (c) the Cash Account; and (d) Partners' Capital Accounts showing the final settlement on dissolution.

10. Smart and Swift were in partnership as hotel proprietors sharing profits and losses: Smart three-fifths, Swift two-fifths. No interest was charged on drawings or credited on capital. The following was a summary of their trial balance as on 31 December 2017:

	₹		₹
Debtors	600	Bank Overdraft	4,590
Fittings and Fixtures	1,800	Loan : Smart at 6%	3,000
Foodstuffs — stock on December 31, 2016	420	Partners' Capital Accounts:	
Foodstuffs Purchased	2,600	Smart	3,000
Freehold Premises	6,000	Swift	500
General Expenses	810	Sundry Creditors	210
Partners' Drawings:		Takings	5,100
Smart	520		
Swift	750		
Motor Vehicle	700		
Wages	2,200		
	16,400		16,400

For the purposes of accounts as on 31 December 2017, the stock of foodstuffs was valued at ₹ 300 and ₹ 200 was to be written off the book value of the motor vehicle and ₹ 100 off fittings and fixtures. A provision of ₹ 60 was required for accrued general expenses and Smart was to be credited with a year's interest on his Loan Account.

The partnership was dissolved on 31 December 2017, it being agreed that:

1. Smart should take over the stock of foodstuffs for ₹ 250 and part of the fittings and fixtures for ₹ 600;
2. Swift should take over the motor vehicle for ₹ 400;
3. Interest on Smart's loan should cease as on 31 December 2017;

During January 2018:

(i) The freehold premises were sold, realising a net amount of ₹ 6,800;

(ii) ₹ 480 was collected from debtors (the balance proving irrecoverable);

(iii) The net proceeds from an auction of the balance of fittings and fixtures was received amounting to ₹ 1,400. It was agreed that the few unsold items should be taken over partly by Smart for ₹ 40 and the rest by Swift for ₹ 20.

(iv) Creditors were paid in full together with incidental realisation and dissolution expenses of ₹ 120;

(v) All amounts receivable or payable by Smart and Swift were settled.

You are required to prepare :

(a) the Profit and Loss Account for the year ended 31 December 2017, excluding any profit or loss arising on dissolution; (b) the Realisation Account; (c) the Cash Account for January 2018, and; (d) Partners' Capital Accounts (in columnar form) showing the final settlement on dissolution.

11. X, Y and Z were partners sharing profits and losses in the ratio of 3:2:1. The position of the firm as on 1.1.2017 was:

Liabilities	₹	Assets	₹
X's capital	30,000	Fixed Assets	40,000
Y's capital	20,000	Debtors	30,000
Z's capital	10,000	Stock	40,000
General Reserve	12,000	Bank Balance	10,000
Capital Reserve	9,000		
Creditors	39,000		
	1,20,000		1,20,000

On this date, the partners decided to change their profit and loss sharing ratio to 1:2:3. Goodwill was valued at ₹ 18,000. No entries were, however, passed to give effect to this change.

On 31.12.2017, the Balance Sheet of the firm was :

Liabilities		₹	Assets	₹
X's Capital	30,000		Fixed Assets	36,000
Less: Drawings	5,000	25,000	Debtors	45,000

Y's Capital	20,000		Stock	55,000
Less: Drawings	3,000	17,000	Advances	14,000
Z's Capital	10,000			
Less: Drawings	4,000	6,000		
General Reserve		36,000		
Capital Reserve		9,000		
Creditors		50,000		
Bank overdraft		7,000		
		1,50,000		1,50,000

On 31.12.2017, the firm was sold as a going concern to Y for ₹ 1,35,000. Y introduced sufficient funds to pay off X and Z.

You are asked to : (a) Pass journal entries on 31.12.2017 to give effect to the above change in the constitution of the firm on 1.1.2017 and to close the books of the firm, on sale of business; and (b) Prepare the Balance Sheet of Y as on 1.1.2018.

When one of the Partners is Insolvent

12. A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. They decided to dissolve the firm when the state of affairs was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	14,500	Bank	4,700
A's Loan Account	9,000	Sundry Debtors	18,300
Capital Account: A	25,000	Stock	14,700
Capital Account: B	12,500	Investment	8,500
		Furniture & Fixtures	2,000
		Machine	11,000
		Capital Account : C	1,800
	61,000		61,000

Investment was fully taken by A in full settlement of his loan. The other assets except Cash at bank realised ₹ 47,100. The expenses for dissolution was ₹ 600. A dispute with a creditor was settled reducing his claim by ₹ 200. C was declared insolvent and 25 p in the rupee was recovered from his estate.

Prepare Realisation Account, Bank Account and Capital Accounts of the partners to close the books of the firm. (Use Garner Vs Murray Principle).

13. A, B and C were partners in a firm dealing in toilet articles and share profits and losses in the ratio of 4 : 3 : 3. As of December 31, 2017 they decided to dissolve the firm and B was appointed to realise the assets and distribute the profits. B was to receive 5% of the amounts realised from stock and debtors as his remuneration, he is to bear all the expenses of the realisation. The Balance Sheet as on December 31, 2017 was as under:

Liabilities	₹	Assets		₹
Creditors	5,90,000	Cash at bank		15,000
Capital Accounts:		Debtors	4,55,000	
A	3,00,000	Less: Provision for doubtful debts	25,000	4,30,000
B	2,00,000	Stocks		6,00,000
		Capital Accounts : C		45,000
	10,90,000			10,90,000

B reported that the assets realised were: Debtors ₹ 4,50,000; Stock ₹ 3,50,000; Goodwill ₹ 20,000; Creditors were paid ₹ 5,75,000 in full settlement and other outstanding creditors were paid ₹ 5,000. The expenses of realisation aggregated to ₹ 6,000. A and B received ₹ 30,000 from C in full settlement of the firm's claim on him. You are required to prepare the Realisation Account, the Bank Account and Capital Accounts of the partners.

14. The following was the Balance Sheet of P, Q and R on 31st March, 2018:

Liabilities	₹	Assets	₹
P's Capital Account	25,000	Freehold Property	10,000
R's Capital Account	15,000	Furniture	5,000
P's Current Account	1,000	Stock-in-trade	23,100
R's Current Account	500	Debtors	30,000
Sundry Creditors	30,000	Cash	2,500
Loan on mortgage of Freehold Property	4,000	Q's Current Account	4,900
	75,500		75,500

The partners shared profits and losses in the proportion of 6 : 3 : 5. It was decided to dissolve the partnership as on the date of the Balance Sheet. The assets realised as under: Freehold Property ₹ 6,000; Furniture ₹ 2,000; Stock-in-trade

₹ 15,000; and Debtors ₹ 20,000. The expenses on realisation amounted to ₹ 2,000. The sundry creditors agreed to take 75 paise in the rupee in full satisfaction. It was ascertained that Q has become insolvent. A dividend of 50 p in the rupee was received from the Court Receiver.
Write-up the Realisation Account, Bank Account, Capital and Current Accounts of the partners. [***Apply Garner Vs Murray***]

15. Ram, Indra, Triveni and Umesh were partners sharing profits and losses in the ratio of 3 : 3 : 2 : 2. The Balance Sheet as on 31st March, 2018 was as under:

Liabilities	₹	Assets		₹
Sundry Creditors	46,500	Cash at bank		6,000
Ram's Loan	30,000	Sundry Debtors	48,000	
Capital Accounts:		Less: Provision for bad debts	1,500	46,500
Ram	60,000	Stock		30,000
Indra	45,000	Furniture & Fixtures		12,000
		Trade Marks		21,000
		Capital Accounts:		
		Triveni		48,000
		Umesh		18,000
	1,81,500			1,81,500

On March 31, 2018, the firm was dissolved and Indra was appointed to realise the assets and to pay off the liabilities. He was entitled to receive 5% commission on the amount finally paid to other partners as capital. He was to bear the expenses of realisation.
The assets realised as follows: Debtors ₹ 33,000; Stock ₹ 24,000; Furniture ₹ 3,000; and Trade marks ₹ 12,000.
The creditors were paid off in full, and in addition, contingent liabilities for bills receivable discounted materialised to the extent of ₹ 7,500. There was also a joint life policy for ₹ 90,000. This was surrendered for ₹ 9,000. Expenses of realisation amounted to ₹ 1,500. Triveni was insolvent, but ₹ 11,100 was received from his estate.
Write-up the necessary accounts to close the books of the firm according to the ***Garner Vs Murray rule***.

Piecemeal

16. A partnership firm has three partners : X, Y and Z with capitals as X : ₹ 20,000; Y : ₹ 10,000 and Z ₹ 10,000. The creditors amounted to ₹ 20,000 and sundry assets to ₹ 60,000. In dissolution, the assets were realised as follows: 1st instalment ₹ 20,000; 2nd instalment ₹ 20,000 and final realisation ₹ 10,000.
The partners share profits and losses in the ratio of 3 : 2 : 1.
Show the piece-meal distribution of the realisations on — (i) Surplus Capital Method; (ii) Maximum Loss Method.

17. The firm of LMS was dissolved on 31.3.2018, at which date its Balance Sheet stood as follows :

Liabilities	₹	Assets	₹
Creditors	2,00,000	Fixed assets	45,00,000
Bank Loan	5,00,000	Cash and bank	2,00,000
L's Loan	10,00,000		
Capital : L : ₹ 15,00,000; M : ₹ 10,00,000; S : ₹ 5,00,000	30,00,000		
	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building. Realisations are :

Serial Number	1	2	3	4	5
Amount in ₹	3,00,000	15,00,000	15,00,000	30,00,000	30,00,000

The Chartered Accountant firm decided to pay-off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

18. The Balance Sheet as on 31st March, 2018 of Abel, Baker and Charley, who share profits and losses in the ratio of 2 : 2 : 1 is given below:

Liabilities	₹	Assets	₹
Abel's Capital A/c	90,000	Fixed Assets	2,00,000
Baker's Capital A/c	72,000	Floating Assets	1,96,000
Charley's Capital A/c	60,000		
Abel's Advance A/c	30,000		
Baker's Advance A/c	24,000		
Sundry Creditors	72,000		
Bills Payable	48,000		
	3,96,000		3,96,000

The amounts were realised piecemeal and it was decided that the amounts received in instalments should be distributed immediately.
1st Realisation ₹ 75,000; 2nd Realisation ₹ 1,47,000; and 3rd Realisation ₹ 1,50,000.
Draw a statement to show the distribution of cash thus realised and ascertain the loss suffered by each partner, if any.

19. Luck, Duck and Pluck were partners sharing profits and losses as 2 : 1 : 1. Their Balance Sheet as on 31.12.2000 is given below and they dissolved their partnership on that date.

Liabilities	₹	Assets	₹
Creditors	15,000	Cash	9,000
Income Tax Payable	4,000	Stock	40,000
Loan from Bank (secured by pledge of stock)	30,000	Debtors	60,000
Duck's Loan	11,000	Furniture	36,000
Capital :		Motor Car	25,000
Luck	40,000		
Duck	40,000		
Pluck	30,000		
	1,70,000		1,70,000

The Bank could realise only ₹ 25,000 on disposal of stock. A sum of ₹ 3,000 was spent for motor car for getting better price. Other assets were realised as follows :
Jan. 2001 ₹ 12,000; Feb. 2001 ₹ 15,000; March 2001 ₹ 10,000; April 2001 ₹ 30,000; May 2001 ₹ 34,000.
Duck took over unsold furniture worth ₹ 1,000 at the end of May, 2001. The partners distributed the cash as and when realised. Show the distribution of Cash.

[C.U.B.Com. (Hons.) — 2003]

20. Mini, Midi and Maxi are three partners of the firm Variety Stores sharing profits and losses in the ratio of 1:2:3. On 30th June, 2017 the partnership was disssolved. The Balance Sheet of the firm on the date of dissolution was as follows:

Liabilities	₹	Assets	₹
Mini's Capital	8,000	Cash	6,000
Midi's Capital	12,000	Debtors	16,000
Maxi's Current	20,000	Stock	25,000
Loan from Mrs Maxi	6,000	Furniture & Fittings	15,000
Sundry Creditors	18,000	Bills Receivable	2,000
	64,000		64,000

The partners decided that payments should be made as and when the amounts were realised. Maxi would supervise all realisations and for this he would be entitled to a commission @ 5% on all gross realisations, but his claim would not have priority over the claims of outsiders. The realisations and expenses on various dates were as follows:

	Debtors (₹)	Stock (₹)	Furniture (₹)	Expenses (₹)
July	3,000	5,500	4,500	1,000
August	5,000	6,000	6,000	500
September	5,500	14,000	3,900	1,400
October	2,000	4,000	—	300

The Bills Receivable were drawn in May, 2017 and were payable after three months. These were duly received.
You are required to prepare a statement showing distribution of cash.

21. P,Q and R are partners sharing profits and losses in the ratio of 1/4:1/4:1/2. They decided to dissolve their business on 31.3.2018, when their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
P's Capital	10,000	Fixed Assets	82,000
Q's Capital	15,000	Stock	15,000
R's Current	25,000	Debtors	18,000
Trade Creditors	20,000	Cash	5,000
Secured Loan (secured on the fixed assets of the firm)	10,000		
Unsecured Loan	20,000		
Bank overdraft (secured against stock and book debts)	20,000		
	1,20,000		1,20,000

P is insolvent. Realisations are to be distributed monthly to creditors and partners in the order of priority. Realisations monthwise were:

	April	May	June	July
Fixed Assets (₹)	17,000	15,000	12,000	8,800
Stock and Debtors (₹)	4,000	2,000	4,000	—

Prepare a statement showing distribution of cash and the capital accounts of the partners.

22. The firm of Richpersons presented you with the following Balance Sheet drawn as at 31st March, 2017:

Liabilities	₹	Assets	₹
Sundry Creditors	37,000	Cash in hand	3,000
Partners' Capital A/cs:		Sundry Debtors	34,000
A	40,000	Stock-in-trade	39,000
B	30,000	Plant and Machinery	51,000
C	27,000	B's Current Account	4,000
		C's Current Account	3,000
	1,34,000		1,34,000

Partners shared profits and losses in the ratio of 4:3:3. Due to differences 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 2017 : ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500

(ii) June 2017 : Balance of debtors realised ₹ 10,000. Balance stock fetched ₹ 24,000.

(iii) August 2018 : Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.

(iv) September 2018 : Part of machinery valued in the books at ₹ 5,000 was taken by A 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.

Show how the amounts due to partners will be settled. All workings should form part of your answer.

23. A, B and C were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. On 31.3.2017, their Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Creditors	40,000	Furniture	8,000
A's Loan	16,000	Stock	52,000
B's Loan	12,000	Debtors	64,000
Capitals : A ₹ 30,000; B ₹ 24,000; C ₹ 6,000	60,000	Bank	4,000
	1,28,000		1,28,000

The firm was dissolved on 1.4.2017. The assets realised were as follows (all figures in ₹) :

	Stock	Debtors	Furniture	Expenses
April 30	12,000	10,000	3,000	1,000
June 30	12,000	10,000	—	1,600
July 31	16,000	30,000	4,000	3,000
August 31	10,000	4,000	—	1,000

Cash received was paid to the rightful claimants at the end of each month. Prepare the statement showing the distribution of cash.

24. A, B and C carrying on business in the partnership decided to dissolve it on and from 30th September 2017. The following was their Balance Sheet on that date:

Liabilities	₹	Assets	₹
Creditors	20,000	Fixed Assets	50,000
A's Capital	40,000	Current Assets	42,000
B's Capital	10,000	Bank	10,000
C's Capital	20,000		
General Reserve	12,000		
	1,02,000		1,02,000

As per the arrangement with the bank, the partners were entitled to withdraw an amount of ₹ 5,000 only at present and the balance amount of ₹ 5,000 could be withdrawn after 1st December, 2017. It was actually withdrawn on 20th December, 2017.

It was decided that after keeping aside an amount of ₹ 2,000 for estimated realization expenses the available cash should be distributed between the partners immediately.
The following were the realisations:
Fixed Assets: 31st October, 2017 ₹ 10,000; 25th November, 2017 ₹ 26,000; 20th December, 2017 (Final) ₹ 10,000.
Current Assets: 31st October, 2017 ₹ 19,000; 25th November, 2017 ₹ 20,000; 20th December, 2017 (Final) ₹ 9,000.
Actual realization expenses amounted to ₹ 1,550 only.
Prepare a statement showing the distribution of cash between the partners applying the "surplus capital method".

When all Partners are Insolvent

25. H and N were in equal partnership. Their Balance Sheet stood as under on 31st December, 2017 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors	3,200	Machinery and Plant	1,200
H's Capital	400	Furniture	300
		Debtors	500
		Stock-in-trade	400
		Cash	180
		N's Drawings	1,020
	3,600		3,600

The assets realised were as follows: Machinery ₹ 600; Furniture ₹ 100; Debtors ₹ 400; and Stock-in-trade ₹ 300.
The expenses of realisation amounted to ₹ 140.
H's private estate is not sufficient even to pay his private debts, whereas in N's private estate there is a surplus of ₹ 140 only.
Give accounts to close the books of the firm

26. A, B and C are equal partners, whose Balance Sheet on December 31, 2017 is as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	5,000	Cash in hand	50
A's Loan	1,000	Stock	800
Capital A/cs:		Debtors	1,000
A	800	Plant & Machinery	2,000
C	500	Furniture & Fittings	800
		Land & Buildings	2,000
		B's Capital (overdrawn)	650
	7,300		7,300

Due to lack of liquidity and weak financial position of the partners, the firm is dissolved. A and C are not able to contribute anything and a sum of ₹ 200 received from B.
All of them are declared insolvent.
The assets are realised:
Stock ₹ 500; Plant and Machinery ₹ 1,000; Furniture and Fittings ₹ 200; Land & Buildings ₹ 800; and Debtors ₹ 550 only.
Realisation expenses amounted to ₹ 50.
You are required to close the firm's books.

Guide to Answers

Practical Questions

1. **Loss on realisation ₹ 5,250; A brings in cash ₹ 62,524 after adjustment of A's loan; Final payments : B ₹ 50,750 and C ₹ 21,625.**
2. **Loss on realisation ₹ 11,000; Tamal brought ₹ 200; Final payment : Amal ₹ 13,800 after adjustment of loan; Bimal ₹ 67,350.**
3. **Profit on realisation ₹ 16,200; Final payments : Anil ₹ 13,000; Balwant ₹ 9,400; and Kumar ₹ 13,600.**
4. **Profit on realisation ₹ 26,720; Final payments : Cloud ₹ 36,360; Storm ₹ 28,016; Rain ₹ 27,144.**
5. **Loss on realisation ₹ 18,700; C brings in cash ₹ 5,400; Final payments : A ₹ 27,200; B ₹ 8,600.**
6. **Loss on realisation ₹ 6,800; B brings in cash ₹ 5,560; C brings in cash ₹ 830; Final payment to A ₹ 11,420.**
7. **Profit on realisation ₹ 72,720; Balance Sheet total ₹ 2,92,000; Y brings in cash ₹ 60,900; Z brings in cash ₹ 40,640.**
8. **Trading loss during 2017 ₹ 6,000; Realisation profit ₹ 7,500; B brings in cash ₹ 5,000; Final payments : A ₹ 19,800.**
9. **Trading loss during 2017 ₹ 2,000; Profit on realisation ₹ 600; Rock brings in cash ₹ 1,165; Final payments : Hill ₹ 3,340; Stone ₹ 2,960.**
10. **Trading loss during 2017 ₹ 1,170; Profit on realisation ₹ 770; Swift brings in cash ₹ 830; Final payment : Smart ₹ 1,530.**

11. **Profit on realisation ₹ 24,000; Final payments : X ₹ 52,500; Z ₹ 36,500; Balance Sheet ₹ 1,92,000; Goodwill (balancing figure ₹ 42,000)**
12. **Profit on realisation on ₹ 1,200; C's deficiency of ₹ 1,200 is to be shared by A and B in the ratio of 2 : 1.**
13. **Loss on realisation ₹ 2,40,000.**
14. **Loss on realisation ₹ 19,600; Final payment : P ₹ 23,156; R ₹ 13,794.**
15. **Loss on realisation ₹ 37,175.64; Ram received ₹ 23,512.95; and Indra received ₹ 14,522.18.**
16. **Surplus capital of Z ₹ 3,333; Realisation loss ₹ 10,000.**
17. **Surplus capital of ₹ 5,00,000; Realisation profit : L ₹ 15,66,667; M ₹ 15,66,667; S ₹ 15,66,667.**
18. **Surplus Capital of Charley ₹ 15,000; Loss on realisation: Abel ₹ 9,600; Baker ₹ 9,600 and Charley ₹ 4,800.**
19. **Loss on realisation ₹ 37,000. Share of Loss : Luck ₹ 18,500; Duck ₹ 9,250; and Pluck ₹ 9,250.**
20. **Surplus Capital of Mini ₹ 1,333; Loss on realisation: Mini ₹ 478; Midi ₹ 957; and Maxi ₹ 1,437.**
21. **After realisation of all assets, all the liabilities cannot be satisfied. Total shortfall is ₹ 2,200. To pay off creditors and unsecured loan, the partners would contribute in the following manner: P ₹ 550; Q ₹ 550; and R ₹ 1,100. P being insolvent, his deficiency is to be borne by Q and R in their capital ratio. Finally, Q's share of deficiency is ₹ 756 and R's share of deficiency is ₹ 1,444.**
22. **Profit on realisation A ₹ 760; B ₹ 570; C ₹ 570.**
23. **Loss on realisation A ₹ 9,800; B ₹ 5,880; C ₹ 3,920. Absolute surplus capital of B ₹ 6,000.**
24. **Profit on realisation A ₹ 150; B ₹ 150; C ₹ 150. Absolute surplus capital of A ₹ 20,000.**
25. **Realisation loss ₹ 1,140; Deficiency ₹ 1,620.**
26. **Realisation loss ₹ 3,600; Deficiency ₹ 1,750.**

7

Branch Accounting

Introduction

A branch may be defined as a section of an enterprise, ***geographically*** separated from the rest of the business, controlled by a ***head office***, and generally carrying on the same activities as of the enterprise. As a business grows, it may open up branches in different towns and cities in order to market its products/services over a large territory and thus increase its profits. ***For example***, Bata Shoe Co. Ltd. has branches in various cities all over the country. The same example holds good for a commercial bank also.

"As per the provisions of Section 2(14) of the Companies Act, 2013, branch office in relation to a company means any establishment described as a branch by the company."

It should be mentioned that a branch is ***not a separate legal entity***; it is simply a segment of a business. From an accounting standpoint, a branch is a clearly identifiable ***profit centre***. In order to exercise greater control over the branches it is necessary to ascertain profit or loss made by such branches separately. Apart from this, specialised accounting techniques have to be adopted for controlling various branch activities and for their smooth running, both at the branch level and at the head office level. The systems of accounting vary between different enterprises in accordance with their type of activities, methods of operation and the preferences of their managements.

Need for Branch Accounting

Though a branch is typically located at some distance from the head office, it carries on all its activities under its direction and control. Therefore, it is necessary that the head office and the branch obtain information from either side at regular intervals about the proper functioning of the branch. This requires the head office and the branch to keep proper books of accounts. The need for branch accounting arises as to :

(a) ascertain the profitability of each branch separately for a particular accounting period,
(b) ascertain the financial position of each branch separately at the end of that accounting period,
(c) assess the progress and performances of each branch,
(d) fulfill the audit requirements under Section 228 of the Companies Act, 1956,
(e) incorporate the profit or loss made by the branch and its assets and liabilities in the firm's final accounts,
(f) ascertain the requirements of stock and cash for each branch,
(g) ascertain whether the branch is yielding a satisfactory rate of return on capital invested in it,

(h) ascertain whether the branch should be expanded or closed,
(i) ascertain the quantity of stock held by each branch at the end of that accounting period, and
(j) ascertain the amount of commission payable to the manager, if that is based on profits.

Types of Branches

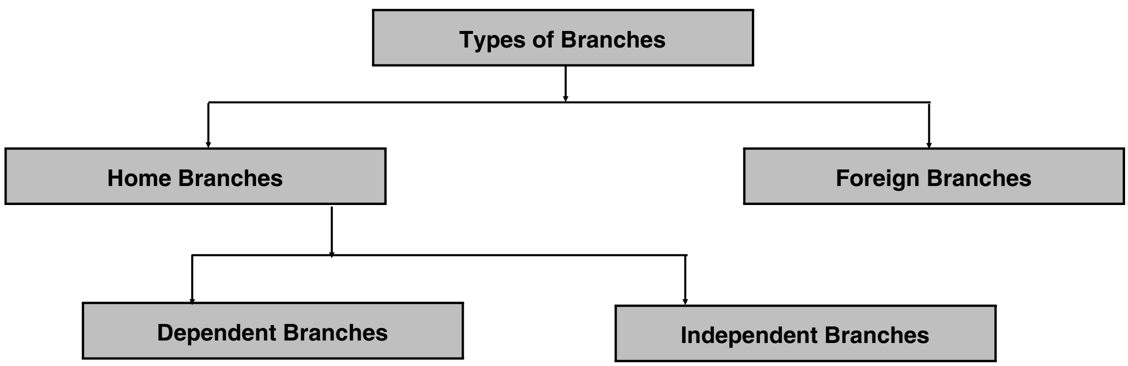
From an accounting point of view, the branches can be divided into the following main classes:

(1) Home Branches

(a) Dependent branches (where the head office maintains all the accounts)
(b) Independent branches (where the branch keeps its own accounts)

(2) Foreign Branches

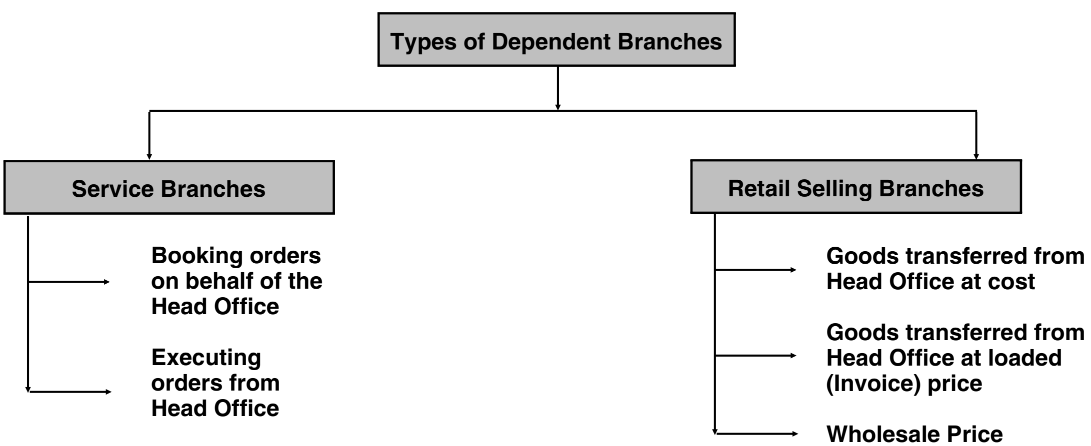
They almost invariably trade independently and record their transactions in foreign currency. Generally, such branches are registered under the respective laws of the nation.



Dependent Branches

When the policies and administration of a branch are totally controlled by the head office, who also maintains its accounts, the branch is called a ***dependent branch***.

The following are the different types of dependent branches:



Service Branches

These branches are booking or executing orders on behalf of the head office. The accounts relating to these types of branches consist mainly of expenditure accounts for salaries, wages, travelling and miscellaneous expenses, etc. Generally the branch manager is provided with a small fund (similar to a petty cash fund, which is replenished periodically) to pay for small items of expense. The branch manager is required to submit periodical (weekly or monthly) expenditure statements to the head office, upon receipt of which, the head office forwards a replacement cheque or make on-line transfer for the total amount of expenditure. For proper control of branch expenditure, the expenditure returns are analysed and total of each type of expenditure are debited to the appropriate Branch Expenditure Account and credited to the Branch Cash Account in the head office books. At the time of preparation of final accounts of the head office, the different ***Branch Expenditure Accounts are transferred to the Profit and Loss Account of the head office***.

Retail Selling Branches

For retail selling branches, the head office not only maintains all accounting records but also manufactures or purchases all or most of the required stock in bulk quantity. It is often found the most practical and economical way for the head office, (particularly with increasingly widespread use of sophisticated computers which can communicate with one another using telephone services), to undertake all the book-keeping and accounting work required, as it simply involves asking for regular 'returns' from the various branches. This practice is very useful for those organisations which operate on a large scale with numerous branches, with each branch practically being no more than a sales depot or selling outlet. The main features of retail branches are as follows:

1. A separate record of branch assets, liabilities, revenues and expenses is maintained by the head office. These branches maintain records of sales and petty expenses only but may also keep debtors accounts, if necessary. They also maintain stock register and furnish weekly or monthly stock statements to H.O.
2. All business documents originating at the branches are transmitted to the head office.
3. Goods are transferred by the head office to such branches either at cost or at loaded (invoice) price which are fixed nationally or on a local basis by the head office. The branch manager has no discretion in the fixation of price and has to sell the goods at agreed upon prices.
4. Except with the permission of the head office, such branches are not allowed to buy goods locally from the open market.
5. Goods are generally sold by such branches in cash. Though granting of credit is usually forbidden, such branches can sell goods on credit with the permission of the head office.
6. The amount collected from cash sales or debtors is either remitted to head office immediately (the same or next day) or banked intact in the account of the head office in some local bank.
7. A working fund for the branch is established and is replenished as needed. All major expenses of the branch are paid, as far as possible, by the head office. The branch manager is allowed to pay salaries and wages of the branch staff. He is allowed to incur only petty expenses like postage, telephone, etc.

Accounting Arrangements of Retail Dependent Branches

The accounting arrangement of a branch depends upon its size, the type of activities, the method of operation and the ***degree of control to be exercised by the head office***. There are ***three*** main methods of accounting for branch transactions, viz.

1. Debtors System
2. Stock and Debtors System
3. Final Accounts System

Debtors System

This system of accounting is suitable for the small-size branches. Under this, a Branch Account is opened for each branch in the head office ledger. All transactions relating to that branch are recorded in this account. The Branch Account is prepared in such a way that it discloses the profit or loss of the branch.

Head office may send goods to branch either at "***cost price***" or "***selling price***" (also called invoice price). The accounting procedure in these two cases is slightly different. Therefore, we will discuss them separately.

Cost Price Method : Under this method, at the beginning of the year the Branch Account is debited with the opening balances of assets such as stock (at cost), debtors, petty cash, furniture, prepaid expenses, accrued income, etc., lying with the branch. Similarly, it is credited with the opening balances of liabilities of the branch such as, creditors, outstanding salaries, rent etc.

The Branch Account is then debited with the amount of goods sent to the branch (at cost) and other amounts remitted to meet various expenses such as, salaries, rent, rates and taxes, etc. Likewise, the Branch Account is credited with the return of goods (at cost) by the branch, and receipts from debtors and cash sales. At the year end, Branch Account is debited with the closing values of liabilities and credited with the closing values of assets. The difference between the two sides represents profit or loss for the branch for a particular period.

Journal Entries

1. For opening balances of assets at the branch	
Branch Account	Dr.
To (Individual) Branch Assets Account	
2. For opening balances of liabilities at the branch	
(Individual) Branch Liabilities Account	Dr.
To Branch Account	
3. For goods sent to branch	
Branch Account	Dr. [At cost]
To Goods Sent to Branch Account	
4. For return of goods by branch to head office	
Goods Sent to Branch Account	Dr.
To Branch Account	
5. For remittance of cash/cheque/on-line transfer to branch for expenses (e.g., salaries, rent, petty expenses, etc.)	
Branch Account	Dr. [Actual]
To Cash/Bank Account	
6. For cash/cheque received from branch (Cash sales plus collection from debtors)	
Cash/Bank Account	Dr. [Actual including direct from debtors]
To Branch Account	
7. For 'closing balances of assets' at the branch	
(Individual) Branch Assets Account	Dr.
To Branch Account	
8. For 'closing balances of liabilities' at the branch	
Branch Account	Dr.
To Liabilities (Individual) Account	
9. For closing goods sent to branch account	
Goods Sent to Branch Account	Dr.
To Purchase Account	[Trader]
To Trading Account	[Manufacturer]
10. For credit sales	
[No entry]	
11. For normal loss	
[No entry]	
12. For goods returned by customers	
[No entry]	

13. For abnormal loss

(a) Abnormal Loss Account Dr. [Total]
To Branch Account

(b) General Profit and Loss Account Dr. [Loss]
Insurance Claim Account Dr. [Claim]
To Abnormal Loss Account [Total]

In this context, it should be noted that Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss.

14. Pilferage

One of the commonest feature of retail trade is 'shoplifting' and this has come to be regarded as a normal business loss — hence no entry is required for it.

15. Branch expenses paid by the branch

[No entry]

16. Bad debts, discount allowed to debtors

[No entry]

Reasons for not passing any entry for 10, 12 and 14 have been discussed later in details.

17. For transferring profit or loss of the branch

(i) If profit:

Branch Account Dr.
To General Profit and Loss Account

(ii) If loss:

General Profit and Loss Account Dr.
To Branch Account

It should be noted that the closing balances of branch assets and liabilities are shown in the Balance Sheet of the head office.

The Branch Account appears as follows:

In the books of the Head Office

Dr. ... Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Jan. 1	By Balance b/d:	
	Stock			Creditors	
	Debtors			Outstanding Expenses	
	Petty Cash		Dec. 31	By Bank A/c:	
	Furniture			Cash Sales	
	Prepaid Expenses			Collection from Debtors	
Dec. 31	To Goods Sent to Branch A/c			By Goods Sent to Branch A/c	
	To Bank A/c:			(Returned by Branch)	
	Rent, Rates & Taxes			By Balance c/d:	
	Petty Cash (remittance)			Stock	
	To Balance c/d:			Debtors	
	Creditors			Petty Cash	
	Outstanding Expenses			Furniture	
	To General Profit & Loss A/c (Profit)			Prepaid Expenses	
				By General Profit & Loss A/c (Loss)	

Some Typical Items

The following items are ***to be ignored*** while preparing Branch Account under this method: (i) Credit sales; Sales returns; Bad debts; Discount allowed; etc., (ii) Depreciation of fixed assets, (iii) Petty cash expenses paid by the branch, (iv) Shortage or surplus of stock, and (v) Profit or loss arising out of sale of a fixed asset. ***The reasons are explained below:***

(i) Credit sales and other related matters (such as, sales returns, bad debts, discount allowed, etc.) The Branch Account is debited with the opening balance of debtors and credited with cash received from debtors and closing balance of debtors. Credit sale, sales returns, bad debts, discount allowed, etc., are related to Debtors Account. ***For calculating closing debtors balance all these items have already been taken into consideration***. Therefore, these items are to be ignored for the preparation of Branch Account.

(ii) Depreciation on Fixed Assets The Branch Account is debited with the opening balance of fixed assets and credited with the closing balances of fixed assets after ***deducting depreciation***. Depreciation is automatically accounted for and it ***should not be shown*** in the Branch Account separately.

(iii) Petty Cash Expenses paid by the Branch The Branch Account is debited with the opening balance of petty cash and the amount of petty cash sent by the head office and is credited with the closing petty cash. For calculating closing petty cash, all expenses paid by the branch are taken into consideration. Therefore, it should be ignored for preparation of Branch Account.

(iv) Shortage or Surplus of Stock The Branch Account is debited with the opening balance of branch stock and credited with its closing balance. At the time of calculating closing balance of branch stock, shortage/surplus is taken into consideration. Therefore, it should be ignored for preparation of Branch Account.

(v) Profit/Loss on Sale of a Fixed Asset If an asset is sold for cash, the Branch Account is credited with the remittances. If it is sold on credit, the Branch Account will be credited with the Debtor for sale of asset. The profit/loss on sale of asset is already included in the remittance/debtors figure. Therefore, at the time of preparing Branch Account, profit/loss on sale of asset should not be shown separately.

(vi) Purchases by Branch The Branch Account is debited with the ***amount of remittance from head office***. Therefore, ***any direct purchase by branch should not be shown separately in the Branch Account.***

Illustration 1

From the following information relating to the Calcutta Branch for the year ending 31st March, 2018, prepare the Branch Account in the books of head office.

	₹		₹
Opening balances on 1.4.2017 :		Cheque sent to Branch:	
Stock at Branch	37,500	Salaries	22,500
Debtors at Branch	75,000	Rent & Taxes	3,750
Petty cash at Branch	750	Petty Cash	2,750
Goods Sent to Branch	6,30,000	Closing balances on 31.3.2018:	
Cash sales	1,50,000	Stock at Branch	62,500
Cash received from Debtors	5,25,000	Debtors at Branch	1,20,000
Goods returned by Branch	5,000	Petty Cash at Branch	500
Credit sales	5,70,000		

Solution

In the books of Head Office

Dr. **Calcutta Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Apr. 1	To Balance b/d:		2018 Mar. 31	By Goods Sent to Branch A/c (Returns)	5,000
	Stock	37,500		By Bank A/c:	
	Debtors	75,000		Cash sales	1,50,000
	Petty Cash	750		Cash received from Debtors	5,25,000
2018 Mar. 31	To Goods Sent to Branch A/c:	6,30,000		By Balance c/d:	
	To Bank A/c:			Stock	62,500
	Salaries	22,500		Debtors	1,20,000
	Rent & Taxes	3,750		Petty Cash	500
	Petty Cash	2,750			
	To General profit & Loss A/c	90,750			
		8,63,000			8,63,000

Tutorial Note: Under this method, credit sales and petty expenses are to be ignored.

Illustration 2

From the following particulars, prepare Branch Account in the books of the head office assuming that the sales at branch are on cash basis. (all figures are in ₹)

Opening stock at the branch	30,000	Expenses met by head office:	
Goods sent to branch	90,000	Salaries	10,000
Cash sales	1,20,000	Other expenses	4,000

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.

[C.U.B.Com (Hons.) — 2007]

Solution

In the books of the Head Office

Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d:			By Bank A/c:	
	Stock	30,000		Cash sales	1,20,000
	To Goods Sent to Branch A/c	90,000		By Balance c/d:	
	To Bank A/c:			Stock (Note 1)	20,000
	Salaries	10,000			
	Other expenses	4,000			
	To Balance c/d:				
	Manager's commission (Note 2)	300			
	To General Profit & Loss A/c	5,700			
		1,40,000			1,40,000

(1) Calculation of Closing Stock

	₹
Opening stock	30,000
Goods sent to branch (at cost)	90,000
	1,20,000
Less: Cost of goods sold (₹ 1,20,000 x 100/120)	1,00,000
	20,000

(2) Profit before commission is ₹ (1,20,000 + 20,000) – ₹ (30,000 + 90,000 + 10,000 + 4,000) = ₹ 6,000. Manager's commission is payable @ 5%. So commission is ₹ 6,000 x 5/100 = ₹ 300. Manager's commission is still payable, and, therefore, is a liability for the business at the end of the accounting period.

Illustration 3

X of Calcutta has a branch at Bombay. Goods are supplied to the branch at cost. The expenses of the branch are paid from Calcutta and the branch keeps a sales journal and the debtors ledger only. From the following information supplied by the branch, prepare a Branch Account in the books of the head office. (all figures in ₹)

Opening stock (1.4.2017)	24,000	Sundry Debtors on 31.3.2018	9,160
Closing stock (31.3.2018)	18,000	Goods received from H.O.	33,600
Credit sales	41,000	Expenses paid by H.O. for the Branch	10,400
Cash sales	17,500	Pilferage of goods by the employees	2,000
Receipt from Debtors	37,900		

Solution

In the books of the Head Office (Calcutta)

Bombay Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Apr. 1	To Balance b/d:		2018 Mar. 31	By Bank A/c:	
	Stock	24,000		Cash sales	17,500
	Debtors (Note 1)	6,060		Received from Debtors	37,900
2018 Mar. 31	To Bank A/c: (expenses)	10,400		By Balance c/d:	
	To Goods Sent to Branch A/c	33,600		Stock	18,000
	To General Profit & Loss A/c	8,500		Debtors	9,160
		82,560			82,560

Tutorial Note : **(1)** In this problem, the opening balance of debtors has not been given. Memorandum Branch Debtors Account is prepared below for finding out the opening balance of debtors.

Dr. **Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (balancing figure)	6,060	By Cash	37,900
To Sales (credit)	41,000	By Balance c/d	9,160
	47,060		47,060

(2) Pilferage of goods by the employees is very common to all businesses. So, it should be treated as a normal event. In the Branch Account, pilferage is to be ignored.

Illustration 4

From the following details regarding West Coast Branch of Bombay Trading Co., prepare a Branch Account in respect of the year 2017: (all figures in ₹)

Stock on 1.1.2017	12,000	Returns to head office	4,800
Stock on 31.12.2017	9,600	Bad debts	600
Debtors on 1.1.2017	10,000	Discounts allowed	310
Debtors on 31.12.2017	11,500	Returns from customers	3,000
Goods sent to branch during 2017	42,000	Expenses paid by head office:	
Cash sales	25,800	Salaries and wages	8,400
Credit sales	36,000	Rent (from 1.1.2017 to 31.3.2018)	5,250
Normal loss	2,000	Sundry expenses	3,600

Solution

In the books of Bombay Trading Co.

Dr. **West Coast Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan.1	To Balance b/d:		2017 Dec. 31	By Goods Sent to Branch A/c (Returns)	4,800
	Stock	12,000		By Bank A/c:	
	Debtors	10,000		Cash sales	25,800
Dec. 31	To Goods Sent to Branch A/c	42,000		Collection from debtors (Note 2)	30,590
	To Bank A/c:			By Balance c/d:	
	Salaries & wages	8,400		Stock	9,600
	Rent	5,250		Debtors	11,500
	Sundry expenses	3,600		Prepaid Rent (Note 3)	1,050
	To General Profit & Loss A/c	2,090			
		83,340			83,340

Tutorial Notes:

(1) Under this method, normal loss, credit sales, sales returns, bad debts, discount allowed to debtors, etc., are to be ignored.

(2) The amount of cash received from debtors is not given. It has been found out by preparing Memorandum Debtors Account as follows:

Dr. **Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Bad Debts	600
To Sales (credit)	36,000	By Discount allowed	310
		By Returns inward	3,000
		By Bank (Balancing figure)	30,590
		By Balance c/d	11,500
	46,000		46,000

(3) Pre-paid Rent = ₹ 5,250/15 x 3 = ₹ 1,050.

Illustration 5

The head office of a company invoices goods to its Shillong Branch at cost, who also purchases goods independently from local parties for which payments are made by the head office. All the cash collected by the Branch is banked on the same day to the credit of the head office and all expenses are directly paid by the head office except for a Petty Cash Account maintained by the branch for which periodical transfers are made from the head office.

From the following particulars, show the Branch Account as maintained in the head office books, reflecting the branch profit for the year ending 31.12.2017 :

Imprest Cash : 1.1.2017	2,000	Returns from Customers	3,000
Imprest Cash : 31.12.2017	1,850	Goods sent to Branch from H.O.:	50,000
Sundry Debtors on 1.1.2017	25,000	Transfer from H.O. for petty cash expenses	2,500
Stock on 1.1.2017		Bad debts	1,000
Transferred from H.O.	20,000	Discount to customers	2,000
Directly purchased by Branch	16,000	Cash received from customers	1,25,000
Shortage of stock	4,000	Branch Expenses	30,000
Cash Sales	45,000	Stock on 31.12.2017:	
Credit Sales	1,30,000	Transferred from H.O.	15,000
Direct Purchases	45,000	Directly purchased by Branch	12,000

Solution **In the books of the Head Office**

Dr. **Shillong Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan.1	To Balance b/d:		2017 Dec. 31	By Bank A/c:	
	Imprest cash	2,000		Cash sales	45,000
	Sundry debtors	25,000		Cash received from customers	1,25,000
	Stock ₹ (20,000 + 16,000)	36,000		By Balance c/d:	
Dec. 31	To Bank A/c:			Imprest cash	1,850
	Purchases (direct)	45,000		Sundry debtors (Note 1)	24,000
	Branch expenses	30,000		Stock ₹ (15,000 + 12,000)	27,000
	Petty cash	2,500			
	To Goods Sent to Branch A/c	50,000			
	To General Profit & Loss A/c	32,350			
		2,22,850			2,22,850

Tutorial Note: Under this method, shortage of stock, credit sales and returns by customers are to be ignored.

Working Note :

Dr. **(1) Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	25,000	By Bank	1,25,000
To Sales	1,30,000	By Bad debts	1,000
		By Discount to customers	2,000
		By Returns	3,000
		By Balance c/d	24,000
	1,55,000		1,55,000

Illustration 6

XYZ Company is having its branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, prepare Branch Account in the books of Head Office.

Particulars	₹	Particulars	₹
Stock on 1st April, 2010 (Invoice Price)	30,000	Discount Allowed to Debtors	160
Sundry Debtors on 1st April, 2010	18,000	Expenses Paid by Head Office :	
Cash in Hand as on 1st April, 2010	800	Rent	1,800
Office Furniture on 1st April, 2010	3,000	Salary	3,200
Goods Invoiced from the Head Office (Invoice Price)	1,60,000	Stationery and Printing	800
Goods Return to Head Office	2,000	Petty Expenses Paid by the Branch	600
Goods Return by Debtors	960	Depreciation to be Provided on Branch Furniture	
Cash Received from Debtors	60,000	at 10% p.a.	
Cash Sales	1,00,000	Stock on 31st March, 2011 (at Invoice Price)	28,000
Credit Sales	60,000		

[C.A. (IPCE) — May, 2011]

Solution **In the books of XYZ Company (H.O.)**

Dr. **Kolkata Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2011		
April 1	To Balance b/d :		March 31	By Stock Reserve A/c (Note 1)	6,000
	Stock	30,000		By Bank A/c (Remittances)	1,60,000
	Sundry Debtors	18,000		By Goods Sent to Branch A/c	

	Cash in Hand	800		(Returned to H.O.)	2,000
	Office Furniture	3,000		By Goods Sent to Branch A/c (Note 2)	31,600
2011				By Balance c/d :	
March 31	To Goods Sent to Branch A/c	1,60,000		Stock	28,000
	To Bank A/c :			Sundry Debtors (Note 4)	16,880
	Rent	1,800		Cash (Note 4) (₹ 800 – 600)	200
	Salary	3,200		Furniture (₹ 3,000 – 300)	2,700
	Stationery & Printing	800			
	To Stock Reserve A/c (Note 3)	5,600			
	To General Profit and Loss A/c	24,180			
		2,47,380			2,47,380

Working Notes :

(1) Loading on opening stock = 20% of ₹ 30,000 = ₹ 6,000.

(2) Loading on goods sent = 20% (₹ 1,60,000 – 2,000) = ₹ 31,600.

(3) Loading on closing stock = 20% of ₹ 28,000 = ₹ 5,600.

Dr. **(4) Memorandum Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2010	To Balance b/d	18,000	31.3.2011	By Discount Allowed A/c	160
31.3.2011	To Sales A/c	60,000		By Sales Return A/c	960
				By Bank A/c	60,000
				By Balance c/d (Balancing figure)	16,880
		78,000			78,000

Illustration 7

From the following particulars relating to Patiala Branch for the year ending 31.12.2017, prepare Branch Account in the books of head office and show how the relevant items will appear in the head office Balance Sheet as on that date.

Balances on 1.1.2017:	₹	Cash paid by debtors direct to head office	22,000
Stock	40,000	Discount allowed	1,100
Debtors	14,000	Cash sent to branch for expenses:	
Petty cash	1,500	Rent : ₹ 12,000; Salaries : ₹ 5,400; Petty cash : ₹ 4,000	
Furniture	12,000	Insurance (from 1.4.2017 to 31.3.2018)	1,600
Prepaid fire insurance	1,150	Goods returned by the branch	4,000
Outstanding salaries	2,100	Goods returned by the debtors	7,000
Goods sent to branch	2,80,000	Stock on 31.12.2017	38,000
Cash sales	3,30,000	Petty expenses paid by the branch	2,850
Credit sales	1,83,000	Provide depreciation on furniture @ 10% p.a.	
Cash received from debtors	1,35,000	Loss of stock by fire	4,800

Solution

In the books of the Head Office

Dr. **Patiala Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan.1	To Balance b/d:		2017 Jan. 1	By Balance b/d:	
	Stock	40,000		Outstanding salaries	2,100
	Debtors	14,000	Dec. 31	By Bank A/c:	
	Petty cash	1,500		Cash sales	3,30,000
	Furniture	12,000		Collection from Debtors	1,35,000
	Prepaid fire insurance	1,150		Direct payment to H.O.	22,000
Dec. 31	To Goods Sent to Branch A/c	2,80,000		By Goods sent to Branch (Returns)	4,000
	To Bank A/c:			By Loss of stock by fire (Note 5)	4,800
	Rent	12,000		By Balance c/d:	
	Salaries	5,400		Stock	38,000
	Petty cash	4,000		Debtors (Note 1)	31,900
	Insurance	1,600		Furniture (Note 3)	10,800
	To General Profit & Loss A/c	2,10,000		Petty cash (Note 2)	2,650
				Prepaid fire insurance (Note 4)	400
		5,81,650			5,81,650

Balance Sheet of Head Office [Extract]
As at 31st December, 2017

Liabilities	₹	Assets	₹
Branch Profit	2,10,000	Branch Furniture	10,800
		Branch Stock	38,000
		Branch Debtors	31,900
		Branch Petty Cash	2,650
		Branch Prepaid Fire Insurance	400

Working Notes :

Dr. **(1) Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	14,000	By Bank ₹ (1,35,000 + 22,000)	1,57,000
To Sales	1,83,000	By Discount allowed	1,100
		By Returns	7,000
		By Balance c/d	31,900
	1,97,000		1,97,000

Dr. **(2) Branch Petty Cash Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,500	By Petty expenses	2,850
To Bank	4,000	By Balance c/d	2,650
	5,500		5,500

(3) Value of furniture after depreciation will be = ₹ 12,000 – ₹ 1,200 = ₹ 10,800.

(4) Prepaid insurance = ₹ 1,600/12 x 3 = ₹ 400.

(5) The Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss. Here, goods lost by fire is an abnormal event. Therefore, abnormal is to be debited to General Profit and Loss Account and credited to Branch Account.

Illustration 8

A company with its head office at Bombay has a branch at Calcutta. The branch receives all goods from head office, who also remits cash for all expenses. Sales are made by the branch on credit as well as for cash.

Total sales by the branch for the year ending 31.3.2018 amounted to ₹ 5,60,000 out of which 20% is cash sales. The following further information is relevant:

1.4.2017: Stock — ₹ 25,000; Debtors — ₹ 60,000; Cash — ₹ 120

31.3.2018: Stock — ₹ 36,000; Debtors — ₹ 48,000; Cash — ₹ 180.

Expenses incurred by the branch: Salaries — ₹ 36,000; Rent — ₹ 12,000; Petty expenses — ₹ 5,600.

All sales are made by the branch at cost plus 25%.

You are required to prepare the Calcutta Branch Account in the books of the head office for the year ended 31st March, 2018.

Solution **In the books of the Head Office (Bombay)**

Dr. **Calcutta Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Apr. 1	To Balance b/d:		2018 Mar. 31	By Bank A/c (remittances received):	
	Stock	25,000		Cash sales (Note 1)	1,12,000
	Debtors	60,000		Collection from debtors (Note 3)	4,60,000
	Petty cash	120		By Balance c/d:	
2018 Mar. 31	To Goods Sent to Branch A/c (Note 2)	4,59,000		Stock	36,000
	To Bank A/c (remittances for expenses):			Debtors	48,000
	Salaries	36,000		Petty cash	180
	Rent	12,000			
	Petty expenses (Note 4)	5,660			
	To General Profit & Loss A/c	58,400			
		6,56,180			6,56,180

Working Notes:

(1) Cash and Credit sales	₹	**(2) Goods sent to Branch**	₹
Total sales	5,60,000	Total sales	5,60,000
Less: Cash sales (20% of ₹ 5,60,000)	1,12,000	Less: Profit (25/125 x ₹ 5,60,000)	1,12,000
Credit sales	4,48,000	Cost of sales	4,48,000
		Add: Closing stock	36,000
			4,84,000
		Less: Opening stock	25,000
		Goods sent to Branch	4,59,000

Dr. **(3) Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Bank A/c (Balancing figure)	4,60,000
To Credit Sales (Note 1)	4,48,000	By Balance c/d	48,000
	5,08,000		5,08,000

Dr. **(4) Branch Petty Cash Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	120	By Petty expenses	5,600
To Bank A/c (remittances for petty exp. - balancing fig.)	5,660	By Balance c/d	180
	5,780		5,780

Invoice Price Method : Sometimes, the head office may prefer to send goods to the branch at a higher price than cost (termed as invoice price). Method of sending goods at invoice price is excellent from the point of view of stock control. As the goods are invoiced at selling price, the head office can dictate pricing policy to its branches, as well as save work at the branch because prices have already been decided. Invoicing at selling price is generally done where goods are of standard type, pre-packed and unlikely to fluctuate in price. Where head office has little control over selling prices (as for example, with perishable goods like fruits, fish, milk, etc.) the most suitable method is that of invoicing at cost price. In addition, goods may be invoiced at selling price to keep the margin of profit a secret from the branch manager.

The method of preparation of Branch Account is the same as in the cost price method, excepting that all journal entries relating to the goods (opening stock, goods sent to branch, goods returned to head office and closing stock) are made at invoice price and proper adjustments for loading (difference between cost price and invoice price) are made at the end of the accounting period by passing some additional entries.

Journal Entries

1. For 'opening balances of assets' at the branch

Branch Account Dr.
To (Individual) Branch Assets Account [Opening stock at invoice price]

2. For 'opening balances of liabilities' at the branch

(Individual) Branch Liabilities Account Dr.
To Branch Account

3. For loading on opening stock

Stock Reserve Account Dr. [Loading on opening stock]
To Branch Account

4. For goods sent to branch

Branch Account Dr. [Invoice price]
To Goods Sent to Branch Account

5. For return of goods by branch to head office

Goods Sent to Branch Account Dr. [Invoice price]
To Branch Account

6. For loading (Net) on goods sent to branch

Goods Sent to Branch Account Dr. [Loading]
To Branch Account

7. For remittance of cash/cheque/ to branch for expenses (e.g., salaries, rent, petty expenses, etc.)

Branch Account Dr. [Actual]
To Cash/Bank Account

8. For cash/cheque received from branch (cash sales plus collection from debtors)

Cash/Bank Account Dr. [Actual including direct from debtors]
To Branch Account

9. For 'closing balances of assets' at the branch

(Individual) Branch Assets Account Dr. [Closing stock at invoice price only]
To Branch Account

10. For 'closing balances of liabilities' at the branch

Branch Account Dr.
To Branch Liabilities (Individually) Account

11. For closing goods sent to branch account

Goods Sent to Branch Account Dr.
To Purchases Account [Trader]
To Trading Account [Manufacturers]

12. For loading on closing stock

Branch Account Dr. [Loading on closing stock]
To Stock Reserve Account

13. For credit sales, normal loss, normal pilferage, goods returned by customers, etc. [No entry]

14. For abnormal loss

(a) Abnormal Loss Account Dr. [Invoice price]
To Branch Account
(b) Branch Account Dr. [Loading on abnormal loss]
To Abnormal Loss Account
(c) Bank Account Dr. [Insurance claim received]
General Profit & Loss Account Dr. [Loss]
To Abnormal Loss Account

15. Normal pilferage, branch expenses paid by the branch, bad debts, discount allowed to debtors, etc.

[No entry — ***See page 2.6 for reasons***]

16. For transferring profit or loss of the branch

(i) If profit:
Branch Account Dr.
To General Profit and Loss Account
(ii) If loss:
General Profit and Loss Account Dr.
To Branch Account

Illustration 9

Relax Ltd. supply goods to its New Delhi branch at cost plus 25%. All cash sales at branch are daily remitted to the head office, and the latter directly pays all the branch expenses. From the following particulars, show by Debtors System the result of the branch operations for the year ended December 31, 2017 : (all figures in ₹)

Stock at branch 1.1.2017 (invoice price)	3,000	Cash paid by H.O. for rent & rates	600
Goods sent to branch (invoice price)	24,000	Cash paid by H.O. for sundry expenses	2,000
Remittances from the branch	25,000	Returns from the branch (invoice price)	150
Cash paid by H.O. for salaries & wages	1,900	Stock at branch on 31.12.2017 (invoice price)	8,000

Solution

In the books of the Relax Ltd. (H.O.)

New Delhi Branch Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Remitances)	25,000
	Stock	3,000		By Stock Reserve A/c (Note 1)	600
Dec. 31	To Goods Sent to Branch A/c	24,000		By Goods Sent to Branch A/c	
	To Bank A/c:			(Returns)	150
	Salaries & wages	1,900		By Goods Sent to Branch A/c (Note 2)	4,770
	Rent & rates	600		By Balance c/d:	
	Sundry expenses	2,000		Stock	8,000
	To Stock Reserve A/c (Note 3)	1,600			
	To General Profit & Loss A/c	5,420			
		38,520			38,520

Working Notes:

(1) Loading on opening stock

Loading is 25% on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ (100 + 25) = ₹ 125. Hence, loading on invoice price = 25/125 = 1/5 or 20%. Therefore, loading on opening stock will be ₹ 3,000 x 1/5 = ₹ 600.

(2) Loading on Goods sent : Total goods sent , ₹ 24,000. Goods returned by branch at invoice price = ₹ 150. The loading on net goods sent will be ₹ 23,850 x 1/5 = ₹ 4,770.

(3) Loading on closing stock = ₹ 8,000 x 1/5 = ₹ 1,600.

Illustration 10

S. P. who carried on a retail business, opened a branch X on 1.1.2018 where all sales were on credit basis. All goods required by the branch were supplied from the head office and were invoiced to the branch at 10% above cost. The following were the transactions (all figures are in ₹) :

	Jan 2018	Feb 2018	Mar 2018
Goods sent to branch (purchase price)	40,000	50,000	60,000
Sales as shown by the branch monthly report	38,000	42,000	55,000
Cash received from debtors and remitted to head office	20,000	51,000	35,000
Returns to head office (invoice price to branch)	1,200	600	2,400

The stock of goods held by the branch on 31.3.2018 amounted to ₹ 53,400 at invoice price to branch. Record these transactions in the head office books, showing balances as on 31.3.2018 and the branch gross profit for the three months ended on that date. All working should be part of your answer.

Solution

In the books of S.P. (H.O.)

X Branch Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar. 31	To Goods Sent to Branch A/c (Note 1)	1,65,000	2018 Mar. 31	By Goods Sent to Branch A/c (Returns)	4,200
	To Stock Reserve A/c (Note 3)	4,855		By Bank A/c	1,06,000
	To General Profit & Loss A/c	37,363		By Goods Sent to Branch A/c (Note 2)	
				(Loading on net goods sent)	14,618
				By Balance c/d:	
				Stock	53,400
				Debtors (Note 4)	29,000
		2,07,218			2,07,218

Goods Sent to Branch Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Mar. 31	To X Branch A/c (Returns)	4,200	2018 Mar. 31	By X Branch A/c	1,65,000
	To X Branch A/c (Loading)	14,618			
	To Purchases A/c	1,46,182			
		1,65,000			1,65,000

Working Notes:

(1) Total goods sent = ₹ 40,000 + ₹ 50,000 + ₹ 60,000 = ₹ 1,50,000. Loading 10% of ₹ 1,50,000 = ₹ 15,000. Invoice price of goods sent = ₹ 1,50,000 + ₹ 15,000 = ₹ 1,65,000.

(2) Net loading on goods sent = 1/11 ₹ (1,65,000 – 4,200) = ₹ 14,618.

(3) Loading on closing stock 1/11 x ₹ 53,400 = ₹ 4,855.

Dr. (4) Memorandum Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2018	To Balance b/d	—	31.3.2018	By Bank A/c	1,06,000
31.3.2018	To Sales	1,35,000	31.3.2018	By Balance c/d	29,000
		1,35,000			1,35,000

Illustration 11

Mr. X has a branch in Calcutta. He invoices goods to the branch at selling price which is cost plus $33^1/_3$%. From the following particulars prepare Branch Account and Goods Sent to Branch Account in the books of Mr. X (all figures in ₹)

Stock on 1st January 2017 (invoice price)	15,000	Discount allowed to customers	300
Debtors on 1st January 2017	11,400	Bad debt written-off	250
Goods sent to branch at invoice price	67,000	Cheque sent to branch:	
Cash sales	31,000	Salaries	5,000
Credit sales	37,400	Sundry expenses	1,700
Cash received from debtors	40,000	Stock on 31st December 2017 (invoice price)	13,400

[I.C.W.A.(Inter) — Adapted]

Solution

In the books of Mr. X (H.O.)

Dr. Calcutta Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c:	
	Stock	15,000		Cash sales	31,000
	Debtors	11,400		Cash received from Debtors	40,000
Dec. 31	To Goods Sent to Branch A/c	67,000		By Stock Reserve A/c (Note 2)	3,750
	To Bank A/c :			By Goods Sent to Branch A/c (Note 3)	16,750
	Salaries	5,000		By Balance c/d:	
	Sundry expenses	1,700		Stock	13,400
	To Stock Reserve A/c (Note 4)	3,350		Debtors (Note 1)	8,250
	To General Profit & Loss A/c	9,700			
		1,13,150			1,13,150

Dr. Goods Sent to Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Calcutta Branch A/c (Loading)	16,750	?	By Calcutta Branch A/c	67,000
?	To Purchases A/c (Note 2)	50,250			
		67,000			67,000

Working Notes:

Dr. (1) Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	11,400	By Discount allowed	300
To Sales (credit)	37,400	By Bad debts	250
		By Bank	40,000
		By Balance c/d	8,250
	48,800		48,800

(2) Loading on Opening Stock

Loading is $33^1/_3$ % on cost but the given data relates to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ $(100 + 33^1/_3)$ or ₹ $133^1/_3$. Hence, loading on invoice price = $33^1/_3$ / $133^1/_3$ = 1/4 or 25%.

Therefore, loading on opening stock will be ₹ 15,000 x 1/4 = ₹ 3,750.

(3) Loading on goods sent to Branch = ₹ 67,000 x 1/4 = ₹ 16,750.

(4) Loading on closing stock = ₹ 13,400 x 1/4 = ₹ 3,350.

Illustration 12

A head office in Patna has two branches at Madras and Delhi. Goods are consigned to them at loaded figures of 10% and 20% on cost respectively. During the year, the invoices to the branches are ₹ 44,000 and ₹ 60,000 respectively.

Included in the item ₹ 44,000 are invoices for goods costing ₹ 12,000 and invoices to the Madras branch at ₹ 13,200 which should have been invoiced to the Delhi branch. Sales are all for cash, with that of Madras branch, being ₹ 22,000 and of Delhi branch ₹ 50,400. It may be assumed that the closing stocks are correct.

You are required to prepare: (i) Madras Branch Account, and (ii) Delhi Branch Account.

Solution

In the books of the Head Office (Patna)

Dr. **Branch Account** **Cr.**

Date	Particulars	Madras	Delhi	Date	Particulars	Madras	Delhi
	To Goods Sent to Branch A/c (Note 1)	30,800	74,400		By Goods Sent to Branch A/c (Note 2)	2,800	12,400
	To Stock Reserve A/c	800	4,000		By Bank A/c (Sales)	22,000	50,400
	To Profit & Loss A/c	2,000	8,400		By Balance c/d : Stock (Note 3)	8,800	24,000
		33,600	86,800			33,600	86,800

Working Notes:

(1) Net goods sent to Madras branch = ₹ 44,000 – ₹ 13,200 = ₹ 30,800.

Net goods sent to Delhi branch = ₹ 60,000 + (₹ 12,000 x 120/100) = ₹ 60,000 + ₹ 14,400 = ₹ 74,400.

(2) Loading on goods sent = Madras : 1/11 x ₹ 30,800 = ₹ 2,800; Delhi : 1/6 x ₹ 74,400 = ₹ 12,400.

(3) Value of Closing Stock at Invoice Price

	Madras (₹)	Delhi (₹)
Invoice price of goods sent	30,800	74,400
Less: Goods sold	22,000	50,400
	8,800	24,000

Illustration 13

S Ltd. maintains a branch at Calcutta to which it sends goods at cost plus 25%. Calcutta branch sells goods both in cash and on credit. All collections and cash sales are directly deposited to head office Bank Account and all expenses are paid by the head office directly. From the following information, prepare Calcutta Branch Account in the books of head office:

	₹		₹
Balances on 1.4.2017:		Cash sales	30,000
Branch stock at invoice price	30,000	Bad debts	2,000
Branch debtors	40,000	Discount allowed	3,000
Transactions during the year:		Abnormal loss of goods at invoice price	8,000
Goods sent to branch at cost	1,40,000	Cheque sent by head office to branch :	
Goods returned by branch at invoice price	10,000	Rent : ₹ 4,000; Salaries : ₹ 6,000; Petty expenses : ₹ 2,000	
Goods returned by debtors to branch	3,000	Balances on 31.3.2018:	
Credit sales	1,20,000	Debtors : ₹ 45,000; Stock at invoice price : ₹ 40,000; Outstanding rent : ₹ 1,000	

Solution

In the books of S. Ltd.

Dr. **Calcutta Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Apr. 1	To Balance b/d:		2018 Mar. 31	By Stock Reserve A/c (Note 1)	6,000
	Stock	30,000		By Goods Sent to Branch A/c (Returns)	10,000
	Debtors	40,000		By Goods Sent to Branch A/c (Note 3)	33,000
2018 Mar. 31	To Goods Sent to Branch A/c (Note 2)	1,75,000		By Bank A/c:	
	To Bank A/c:			Cash sales	30,000
	Rent	4,000		Collection from Debtors (Note 4)	1,07,000
	Salaries	6,000		By Abnormal Loss A/c (Note 6)	8,000
	Petty expenses	2,000		By Balance c/d:	
	To Abnormal Loss A/c (Note 6)	1,600		Debtors	45,000
	To Stock Reserve A/c	8,000		Stock	40,000
	To Balance c/d:				
	Outstanding Rent	1,000			
	To General Profit & Loss A/c	11,400			
		2,79,000			2,79,000

Working Notes:

(1) Loading on opening stock

Loading is 25% on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ (100 + 25) = ₹ 125. Hence, loading on invoice price = 25/125 = 1/5 or 20%. Therefore, loading on opening stock = 30,000 x 1/5 = ₹ 6,000.

(2) Invoice prices of goods sent = ₹ 1,40,000 + 25% of ₹ 1,40,000 = ₹ 1,40,000 + ₹ 35,000 = ₹ 1,75,000.

(3) Loading on net goods sent

Total goods sent, ₹ 1,75,000. Goods returned by branch at invoice price, ₹ 10,000. The loading on net goods sent is 1/5 x ₹ 1,65,000 = ₹ 33,000.

Dr. **(4) Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Returns	3,000
To Sales (credit)	1,20,000	By Bad debts	2,000
		By Discount allowed	3,000
		By Bank (Balancing figure)	1,07,000
		By Balance c/d	45,000
	1,60,000		1,60,000

(5) Under this method, credit sales, sales returns, bad debts, discount allowed to debtors, etc. are to be ignored.

(6) Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss. Here, abnormal loss at invoice price = ₹ 8,000. To calculate correct profit, ₹ 8,000 is to be credited to Branch Account and loading on such loss of ₹ 1,600 is to be debited to Branch Account. The cost of goods loss ₹ 8,000 – ₹ 1,600 = ₹ 6,400 is to be charged to General Profit and Loss Account.

Stock and Debtors System

Stock and Debtors System is generally used when the goods are sent to the branch at an invoice price and the size of the branch is large. Under this system, the head office maintains a few special accounts to exercise greater control over the branch stock and other related expenses.

These accounts usually are:

(i) Branch Stock Account;
(ii) Branch Debtors Account;
(iii) Goods Sent to Branch Account;
(iv) Branch Adjustment Account;
(v) Branch Cash Account;
(vi) Branch Expenses Account;
(vii) Branch Profit and Loss Account; and
(viii) Branch Fixed Assets Account.

The nature and functions of different accounts are given below:

Branch Stock Account : Branch Stock Account is a practical means of controlling stock at branch. This account records the transactions in regard to the stock in the branch at ***invoice price***. The debit side of this account records the inflow of stock into the branch and credit side records its outflow from the branch.

The Branch Stock Account is opened with the opening value of stock at branch and in transit (at invoice price) and debited with the invoice value of goods sent to branch and goods returned by the customers.

This account is credited with the sales (cash and credit) and goods returned to the head office (at invoice price). Ultimately, this account is credited with the closing stock of the branch at invoice price. Sometimes, it is also credited with goods in transit at the end of the year (at invoice price).

Since this account is a statement showing the reconciliation of stock, both the sides should tally and, in effect, this account cannot have any balance. But, this is only a theoretical view. In practice, there are often slight differences — usually deficiencies. For example, it is practically impossible to weigh up exactly 100 separate kg. of butter from one quintal butter slab. In some cases, there may be a surplus for different reasons such as, sale of goods above invoice price and absorption of moisture (in case of sugar, fertiliser, etc.)

In practice, it is usual to make certain allowances in respect of such unavoidable differences. If it is more than normal allowance, enquiries should be made as to the causes of the difference. Shortage/deficiency is recorded on the credit side and surplus is recorded on the debit side.

Important features of Branch Stock Account are as under:

(i) It controls branch stock.
(ii) It is maintained at invoice price.
(iii) Actual stock with the branch is shown as the balance in this account.

The ruling of the Branch Stock Account is given below:

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

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d: at branch in-transit		2017 Dec. 31	By Goods Sent to Branch A/c) (Returns to H.O. By Bank A/c (Cash sales)	

Date	Particulars	₹	Date	Particulars	₹
Dec. 31	To Goods Sent to Branch A/c			By Branch Debtors A/c (Credit sales)	
	To Branch Debtors A/c:			By Abnormal Loss by Fire A/c	
	(Returned by customers)			By Shortage in Stock (if any)	
Dec. 31	To Surplus in Stock A/c (if any)			By Balance c/d:	
				at branch	
				in-transit	
2018 Jan. 1	To Balance b/d:				
	at branch				
	in-transit				

Branch Debtors Account : Branch Debtors Account is maintained when the branch is allowed to sell goods on credit. It is used to exercise control over branch debtors. This account records transactions with the branch debtors and is prepared like any Sundry Debtors Account. Opening balance of branch debtors is brought down on the debit side of this account and this account is debited with credit sales at the branch. It is credited with the cash received, discount allowed, sales returns, bad debts, bills receivable, etc. The balance of this account represents the closing balance of debtors.

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Collection)	
Dec. 31	To Branch Stock A/c (Credit sales)			By Branch Expenses A/c:	
				Discount allowed	
				Bad debts	
				By Branch Stock A/c (Returned)	
				By Balance c/d:	
2018 Jan. 1	To Balance b/d:				

Goods Sent to Branch Account : Goods Sent to Branch Account is credited with the invoice price of goods sent to the branch by the head office and transferred from other branches and debited with the invoice price of the goods returned/transferred by the branch. This account is also debited with loading on net goods sent to the branch. The balancing figure on the debit side represents the cost of the net goods sent to the branch which is adjusted against Purchase/Trading Account by the head office. This account cannot have any opening or closing balance.

Dr. Goods Sent to Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec.31	To Branch Stock A/c (Returns)		2017 Dec. 31	By Branch Stock A/c	
	To Branch Stock A/c (Transfer)			By Branch Stock A/c (Transfer)	
	To Branch Adjustment A/c (Loading)				
	To Purcahses/Trading A/c*				

* For a trader — Purchases Account and for a manufacturer — Trading Account (In the Head Office Book).

Branch Cash Account : Branch Cash Account is prepared with a view to exercise control over the branch cash. This account is generally opened where the branch is allowed to hold cash received from debtors and use it for branch expenses and remit the balance to head office after certain interval. Generally for big branch a separate Cash Account is maintained.

This account is debited with the opening balance of cash, the cash remitted by the head office or the branches and the cash collected from the debtors. It is credited with the branch expenses and amount remitted to head office or other branches. The balance of this account represents the closing cash lying with the branch.

Dr. Branch Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Remittance to H.O.)	
Dec. 31	To Bank A/c (Remittance)			By Branch Expenses A/c:	
	To Bank A/c (Transfer from other branch)			By Bank A/c (Transfer to other branch)	
				By balance c/d:	

Branch Expenses Account : Branch Expenses Account records all branch expenses in cash. In addition, this account is debited with the items like bad debts, discount allowed, depreciation on branch fixed assets, etc. The balance of this account is transferred to Branch Profit and Loss Account and, thereby closed. (When no separate Branch Profit and Loss Account is opened, it is closed by transferring to "Branch Adjustment Account")

Dr. Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec.31	To Branch Cash A/c (Returns) To Branch Assets A/c (Depreciation) To Branch Debtors A/c Bad debts Discount allowed		2017 Dec. 31	By Branch Profit & Loss A/c	

Branch (Stock) Adjustment Account : Branch Adjustment Account is prepared with a view to ascertain the gross profit of the branch. This account summarises the profit "loading" on all transactions. This account is credited with the "stock reserve" on opening stock and loading on net goods sent to branch. It is credited with the loading on surplus in stock. This account is debited with the loading on shortage- in-stock; spoilage, pilferage, theft, loss by fire, loss in transit and "stock reserve" on closing stock. The balance of this account is transferred to Branch Profit and Loss Account.

Dr. Branch (Stock) Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec.31	To Shortage in Stock A/c (Loading) To Loss by Fire A/c (Loading) To Loss in transit A/c (Loading) To Loss by Theft A/c (Loading) To Pilferage A/c (Loading) To Stock Reserve A/c* (Loading on closing stock) To Gross Profit c/d		2017 Dec. 31	By Stock Reserve A/c* (Loading on opening stock) By Goods Sent to Branch A/c (Loading on net goods sent) By Surplus in Stock A/c (Loading on surplus) By Gross Loss c/d	

* It may be shown as **By Balance b/d** and **To Balance c/d**.

Branch Profit and Loss Account : Branch Profit and Loss Account is prepared to ascertain the net profit or loss of the branch. This account is credited with the gross profit as ascertained from the Branch Adjustment Account and cost of surplus in stock. This account is debited with the branch expenses and cost of shortage in stock, pilferage, theft, etc. If the credit side is more, it represents net profit, and it is net loss when the debit side is more.

The students should note that the branch profit should not be affected by the abnormal events beyond the control of the branch such as loss by fire, loss in transit etc. The cost of such goods should be charged to General Profit and Loss Account instead of Branch Profit and Loss Account to calculate the correct profit of the branch.

If the nature of the loss is normal (such as spoilage, pilferage, theft, etc.) and if it can be identified with the branch, the cost of such goods should be charged to Branch Profit and Loss Account.

Dr. Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec.31	To Branch Expenses A/c To Loss by Theft A/c (Cost) To Shortage in Stock A/c (Cost) To Pilferage A/c (Cost) To General Profit & Loss A/c		2017 Dec. 31	By Gross Profit b/d By Surplus in Stock A/c (Cost)	

Sometimes, a separate Branch Profit and Loss Account is not opened. In that situation, the Branch Adjustment Account will show net profit/loss of the branch. In this case, branch expenses, pilferage (cost + loading), theft (cost + loading), and shortage in stock (cost + loading) are charged to Branch Adjustment Account. Similarly, surplus in stock (cost + loading) is credited to Branch Adjustment Account.

Branch Fixed Assets Account : The head office may maintain separate asset accounts for each fixed asset. This account is debited with the opening value of asset and purchase of an asset, if any. This account is credited with the depreciation provided on the asset. The balance of the account represents the closing value of the asset.

Journal Entries

1. For goods sent to branch	
Branch Stock Account	Dr. [Invoice Price]
To Goods Sent to Branch Account	
2. For goods returned by branch to head office	
Goods Sent to Branch Account	Dr. [Invoice Price]
To Branch Stock Account	
3. For goods received from other branches	
Branch Stock Account	Dr. [Invoice Price]
To Goods Sent to Branch Account	
4. For goods transferred to other branches on advice of head office	
Goods Sent to Branch Account	Dr. [Invoice Price]
To Branch Stock Account	
5. For cash sales	
Bank Account	Dr. [Actual sales proceeds]
To Branch Stock Account	
6. For credit sales	
Branch Debtors Account	Dr.
To Branch Stock Account	
7. For bills accepted by Branch Debtors	
Bills Receivable Account	Dr.
To Branch Debtors Account	
8. For cash collected from debtors	
Bank Account	Dr.
To Branch Debtors Account	
9. For bad debts, discount allowed, etc.	
Branch Expenses Account	Dr.
To Branch Debtors Account	
10. For depreciation on branch fixed assets	
Branch Expenses Account	Dr.
To Branch Fixed Assets Account	
11. For branch expenses incurred in cash	
Branch Expenses Account	Dr.
To Cash/Bank Account	
12. For transferring branch expenses to Branch Profit and Loss Account/Branch Adjustment Account	
Branch Profit and Loss Account	Dr.
Or, Branch Adjustment Account	Dr.
To Branch Expenses Account	

13. For shortage in stock/pilferage/theft

(i) Shortage in Stock/Pilferage/Theft Account Dr. [Invoice Price]
To Branch Stock Account
(ii) Branch Adjustment Account Dr. [Loading]
Branch Profit and Loss Account Dr. [Cost]
To Shortage in Stock/Pilferage/Theft Account

14. For loss by fire/loss in transit

(i) Accidental Loss Account Dr. [Invoice Price]
To Branch Stock Account
(ii) Branch Adjustment Account Dr. [Loading]
Bank Account (insurance claim received) Dr.
Insurance Company (claim yet to receive) Dr.
General Profit and Loss Account Dr. [Loss]
To Accidental Loss Account

15. For loading on opening stock including stock in transit at the beginning

Stock Reserve Account Dr. [Loading]
To Branch Adjustment Account

16. For loading on net goods sent

Goods Sent to Branch Account Dr. [Loading]
To Branch Adjustment Account

17. For loading on closing stock including stock-in-transit at the end

Branch Adjustment Account Dr. [Loading]
To Stock Reserve Account
[In the Balance Sheet of head office, the Stock Reserve is shown as a deduction from branch stock at the end]

18. For transferring gross profit

(i) Branch Adjustment Account Dr.
To Gross Profit Account
(ii) Gross Profit Account Dr.
To Branch Profit and Loss Account

19. For transferring net profit of the branch

Branch Profit and Loss Account Dr.
To General Profit and Loss Account
(For net loss, reverse entry)

20. For closing Goods Sent to Branch Account

Goods Sent to Branch Account Dr.
To Purchases Account [Trader]
To Trading Account [Manufacturer]

Treatment of Some Typical Items

Normal loss : No treatment is required even if it is given specifically in the examination problem. However, for calculating Branch Closing Stock (when it is not given) normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.

Pilferage/Theft : In retail trade, pilferage or shoplifting is very common and this has come to be regarded as a normal business loss. The loading of such goods is charged to Branch Adjustment Account and cost is charged to Branch Profit and Loss Account.

Shortage in stock : Shortage in stock may be due to spoilage, leakage, sales in small quantity, etc. Loading on shortage in stock should be charged to Branch Adjustment Account and cost of such goods should be charged to Branch Profit and Loss Account.

Surplus in stock : Loading on surplus in stock is credited to Branch Adjustment Account and cost of such goods is credited to Branch Profit and Loss Account.

Loss by fire/loss-in-transit : Loading on goods lost by fire/in-transit should be charged to Branch Adjustment Account and the cost of such goods should be charged to **General Profit and Loss Account**.

Students should note that the branch profit should not be affected by the abnormal items. Some authors prefer to charge the cost of the goods lost by fire to Branch Profit and Loss Account. But, in our opinion, this practice should not be encouraged because heavy loss due to fire by converting branch profit into branch loss may mislead the management at the time of decision-making.

Inter-branch transfer of goods : Sometimes goods may be transferred by one branch to another branch. At the time of making entry for transferring branch, it should be treated as a transfer to head office (though the goods is actually transferred to a particular branch). Similarly, for receiving branch it will be treated as received from head office.

For the transferring branch, the entry will be:

Goods Sent to Branch Account Dr. [Invoice Price]
  To Branch Stock Account

For the receiving branch, the entry will be:

Branch Stock Account Dr. [Invoice Price]
  To Goods Sent to Branch Account

Illustration 14

On 1st January, 2017 goods costing ₹ 1,32,000 were invoiced by Madras head office to its new branch at Delhi and charged at selling price to produce a gross profit of 25% on the selling price.

At the end of the year, the return from Delhi Branch showed that the credit sales were ₹ 1,50,000.

Goods invoiced at ₹ 2,000 to Delhi branch have been returned to Madras head office.

The closing stock at Delhi branch was ₹ 24,000 at selling price.

Record the above transactions in the

(i) Delhi Branch Stock Account;
(ii) Goods Sent to Delhi Branch Account;
(iii) Delhi Branch Adjustment Account; and,
(iv) Delhi Branch Debtors Account in the head office book and close the said accounts on 31st December, 2017.

Solution

In the books of the Head Office, Madras

Dr. Delhi Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Goods Sent to Delhi Br. A/c	1,76,000	2017 Dec. 31	By Goods Sent to Delhi Br. A/c (Returns)	2,000
				By Branch Debtor A/c (Credit sales)	1,50,000
				By Balance c/d	24,000
		1,76,000			1,76,000

Dr. Goods Sent to Delhi Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Delhi Branch Stock A/c (Returns)	2,000	2017 Dec. 31	By Delhi Branch Stock A/c	1,76,000
	To Delhi Branch Adjustment A/c (Note 1)	43,500			
	To Purchases A/c (Transferred)	1,30,500			
		1,76,000			1,76,000

Dr. Delhi Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Delhi Branch Stock A/c	1,50,000	2017 Dec. 31	By Balance c/d	1,50,000

Dr. Delhi Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Stock Reserve A/c (Note 2)	6,000	2017 Dec. 31	By Goods Sent to Delhi Branch A/c (Note 1)	43,500
	To General Profit & Loss A/c	37,500			
		43,500			43,500

Working Notes:

(1) Total goods sent to Delhi branch at selling price is ₹ 1,76,000. Goods returned to head office at selling price is ₹ 2,000. Net goods sent is ₹ 1,74,000. Loading @ 25% on selling price = 25% of ₹ 1,74,000 = ₹ 43,500.

(2) Value of closing stock at selling price = ₹ 24,000. Loading on closing stock = 25% of ₹ 24,000 = ₹ 6,000.

(3) When no separate Branch Profit and Loss Account is prepared, the Branch Adjustment Account will disclose the branch profit.

Illustration 15

On January 1, 2017, the goods invoiced by Calcutta head office of a trader to its Madras branch were ₹ 48,000 at selling price, being $33^1/_3$ % on cost price. For six months ending June 30, 2017 the branch return showed that the credit sales were ₹ 29,200. The goods invoiced at ₹ 2,000 were returned by the branch to the head office. The closing stock at Madras branch on June 30, 2017 was ₹ 16,800 at selling price.

Record the above transactions, showing the Madras Branch Stock Account, Madras Branch Adjustment Account and the Goods Sent to Branch Account in Calcutta head office books and balance them on June 30, 2017.

Solution **In the books of the Head Office, Calcutta**

Dr. **Madras Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Goods Sent to Branch A/c	48,000	2017 June 30	By Goods Sent to Branch A/c (Returns)	2,000
				By Branch Debtors A/c	29,200
				By Balance c/d	16,800
		48,000			48,000
July 1	To Balance b/d	16,800			

Dr. **Madras Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 June 30	To Stock Reserve A/c (Note 2)	4,200	2017 June 30	By Goods Sent to Branch A/c (Note 1)	11,500
	To Branch Profit & Loss A/c	7,300			
		11,500			11,500

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 June 30	To Branch Stock A/c	2,000	2017 Jan. 1	By Branch Stock A/c	48,000
	To Branch Adjustment A/c (Net loading)	11,500			
	To Purchases A/c (Transfer)	34,500			
		48,000			48,000

Working Notes:

(1) Loading on goods sent (net) : Loading in $33^1/_3$ on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be (₹ 100 + $33^1/_3$) = ₹ $133^1/_3$. Hence, loading on invoice price = $33^1/_3$ / $133^1/_3$ = 1/4 or 25%. Therefore, loading on net goods sent (after return) = 1/4 (₹ 48,000 – ₹ 2,000) = ₹ 11,500.

(2) Loading on Closing stock = 1/4 x ₹ 16,800 = ₹ 4,200.

Tutorial Note: Where no separate Branch Profit and Loss Account is opened, the Branch Adjustment Account will disclose the branch profit or loss.

Illustration 16

B Ltd of Kanpur has a branch in Ambala. Goods sent to branch are invoiced at selling price, i.e., cost plus $33^1/_3$%. From the following particulars, you are required to prepare the Branch Stock Account and Branch Adjustment Account as they would appear in the head office books.

	₹
Stock on 01.04.2002 at invoice price	15,000
Stock on 31.03.2003 at invoice price	12,000
Goods sent to Ambala during the year at invoice price	1,00,000
Sales at branch :	
On Credit	32,000
For Cash	75,000
Returns to head office at invoice price	5,000
Invoice value of goods lost by fire not covered by Insurance	1,000

[C.U.B.Com. (Hons.) — 2004]

Solution

In the books of B Ltd., (H.O.)

Ambala Branch Stock Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2002 Apr 1	To Balance b/d	15,000	2003 Mar 31	By Goods Sent to Branch (Returns)	5,000
2003 Mar 31	To Goods Sent to Branch	1,00,000	"	By Cash A/c (Cash Sales)	75,000
"	To Branch Adjustment A/c (Surplus)	10,000	"	By Branch Debtors A/c (Credit Sales)	32,000
			"	By Goods Lost by Fire A/c (Note 4)	1,000
			"	By Balance c/d	12,000
		1,25,000			1,25,000

Ambala Branch Adjustment Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2003 Mar 31	To Goods Sent to Branch A/c (Note 3)	1,250	2002 Apr 1	By Stock Reserve A/c (Note 1)	3,750
"	To Goods Lost by Fire A/c (Note 4)	250	2003 Mar 31	By Goods Sent to Branch A/c (Note 2)	25,000
"	To Stock Reserve A/c (Loading on Closing Stock)	3,000	"	By Branch Stock A/c (Surplus) (Note 6)	10,000
"	To General Profit & Loss A/c (Note 5)	34,250			
		38,750			38,750

Working Notes :

(1) Goods are sent at cost + $33^1/_3$%. Therefore, the loading is 25% of Invoice Price. Loading on opening stock = 25% of ₹ 15,000 = ₹ 3,750.

(2) Loading on goods sent = 25% of ₹ 1,00,000 = ₹ 25,000.

(3) Loading on goods returned = 25% of ₹ 5,000 = ₹ 1,250.

(4) Loading on goods lost by fire = 25% of ₹ 1,000 = ₹ 250.

(5) Cost of goods lost by fire (₹ 1,000 – 250) = ₹ 750 should not be charged to Branch as it is an abnormal loss.

(6) No separate Branch Profit and Loss Account has been asked to prepare. Therefore, entire ***surplus*** has been credited to Branch Adjustment Account.

Illustration 17

BT Ltd. sends goods to the Chennai Branch at cost plus 25% on cost. From the following particulars, you are required to show the Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account in the head office books:

	₹
Opening stock at branch at invoice price	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
Sales	1,22,000
Expenses	32,000
Closing stock at branch at invoice price	24,000
Recovered from insurance company against loss-in-transit	6,000

[C.U.B.Com. (Hons.) — 2005]

Solution

In the books of BT Ltd., (H.O.)

Chennai Branch Stock Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	20,000		By Goods Lost in Transit A/c	10,000
	To Goods Sent to Branch A/c	80,000		By Pilferage A/c	4,000
	To Surplus in Stock A/c	60,000		By Sales A/c	1,22,000
				By Balance c/d	24,000
		1,60,000			1,60,000

Chennai Branch Adjustment Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Lost in Transit A/c (Note 3)	2,000		By Stock Reserve A/c (Loading on opening stock)	4,000
	To Pilferage A/c (Note 2)	800		By Goods Sent to Branch A/c (Loading)	16,000
	To Stock Reserve A/c	4,800		By Susplus in Stock A/c	12,000
	To Chennai Branch Profit & Loss A/c	24,400			
		32,000			32,000

Dr. Chennai Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Pilferage A/c	3,200		By Surplus in Stock A/c	48,000
	To Branch Expenses A/c	32,000		By Chennai Branch Adjustment A/c	24,400
	To General Profit and Loss A/c (Profit)	37,200			
		74,400			72,400

Dr. Surplus in Stock Account Cr.

Particulars	₹	Particulars	₹
To Chennai Branch Adjustment A/c (Note 1)	12,000	By Chennai Branch Stock A/c	60,000
To Chennai Branch Profit & Loss A/c (Note 1)	48,000		
	60,000		60,000

Working Notes :

(1) Surplus in stock represents excess realisation from sales by selling goods above the fixed price (i.e., cost + 25% profit). When Branch Adjustment Account and Branch Profit and Loss Account are prepared separately, loading on surplus is credited to Branch Adjustment Account and the balance of the surplus is credited to Branch Profit and Loss Account. However, when only Branch Adjustment Account is prepared, the entire surplus is credited to Branch Adjustment Account ***(See Illustration 17)***.

(2) Loading on pilferage = 25% of ₹ 4,000 = ₹ 1,000. The loading is charged to Branch Adjustment Account. The cost of goods pilfered ₹ 3,000 (₹ 4,000 – ₹ 1,000), however, is to be charged to Branch Profit and Loss Account. Generally, pilferage is treated as ***normal loss*** and that is why it is charged to Branch Profit and Loss Account [Not General Profit and Loss Account].

(3) Loading on goods lost-in-transit = 25% of ₹ 10,000 = ₹ 2,500. The loading on goods lost-in-transit is charged to Branch Adjustment Account. The net cost of goods lost in transit ₹ 2,000 (Note 4) should be charged to General Profit and Loss Account being abnormal in nature.

Dr. (4) Goods Lost-in-Transit Account Cr.

Particulars	₹	Particulars	₹
To Chennai Branch Stock A/c	10,000	By Chennai Branch Adjustment A/c (Loading)	2,000
		By Bank A/c (claim received)	6,000
		By General Profit and Loss A/c	2,000
	10,000		10,000

Illustration 18

Ram Limited of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25%. The branch makes sales both by 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 Nagpur.

From the following details, relating to the year 2009, prepare the accounts in Head Office Ledger and ascertain Branch Profit as per stock and debtors method. Branch does not maintain any books of accounts, but sends weekly returns to head office :

Particulars	₹
Goods Received from Head Office at invoice price	1,20,000
Returns to Head Office at invoice price	2,400
Stock at Nagpur Branch on 1.1.2009 at invoice price	12,000
Sales during the year — Cash	40,000
Credit	72,000
Debtors at Nagpur branch as at 1.1.2009	14,400
Cash received from Debtors	64,000
Discounts allowed to Debtors	1,200
Bad Debts during the year	800
Sales Returns at Nagpur branch	1,600
Salaries and Wages at Branch	12,000
Rent, Rates and Taxes at Branch	3,600
Office Expenses at Nagpur Branch	1,200
Stock at Branch on 31.12.2009 at invoice price	24,000

[C.A. (IPCE) — Mau, 2010]

Solution

In the books of Ram Limited (H.O.)

Nagpur Branch Stock Account

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

Date	Particulars	₹	Date	Particulars	₹
2009			2009		
Jan. 1	To Balance b/d	12,000	Dec. 31	By Bank A/c (Cash Sales)	40,000
Dec. 31	To Goods Sent to Branch A/c	1,20,000		By Branch Debtors A/c (Credit Sales)	72,000
	To Branch Debtors A/c (Returns by customers)	1,600		By Goods Sent to Branch A/c (Return by branch)	2,400
	To Branch Adjustment A/c (Surplus over Invoice Price)	4,800		By Balance c/d	24,000
		1,38,400			1,38,400

Nagpur Branch Adjustment Account

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

Date	Particulars	₹	Date	Particulars	₹
2009			2009		
Dec. 31	To Stock Reserve A/c (Note 3)	4,800	Jan. 1	By Stock Reserve A/c (Note 1)	2,400
	To Gross Profit c/d (Transferred to Branch P/L Account)	25,920	Dec. 31	By Goods Sent to Branch A/c (Note 2)	23,520
				By Branch Stock A/c (Surplus)	4,800
		30,720			30,720

Nagpur Branch Profit and Loss Account

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

Date	Particulars	₹	Date	Particulars	₹
2009	To Branch Expenses A/c	18,800	2009	By Gross Profit b/d	25,920
Dec. 31	To General Profit and Loss A/c	7,120	Dec. 31		
		25,920			25,920

Nagpur Branch Expenses Account

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

Date	Particulars	₹	Date	Particulars	₹
2009			2009		
Dec. 1	To Bank A/c (Rent)	3,600	Dec. 31	By Branch Profit and Loss A/c	18,800
	To Bank A/c (Salaries)	12,000			
	To Bank A/c (Office expenses)	1,200			
	To Branch Debtors A/c (Bad Debts)	800			
	To Branch Debtors A/c (Discount Allowed)	1,200			
		18,800			18,800

Nagpur Branch Debtors Account

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

Date	Particulars	₹	Date	Particulars	₹
2009			2009		
Jan. 1	To Balance b/d	14,400	Dec. 31	By Branch Stock A/c (Return by customers)	1,600
	To Branch Stock A/c (Credit Sales)	72,000		By Bank A/c	64,000
				By Branch Expenses A/c (Bad Debts and Discount)	2,000
				By Balance c/d	18,800
		86,400			86,400

Goods Sent to Nagpur Branch Account

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

Date	Particulars	₹	Date	Particulars	₹
2009	To Branch Stock A/c (Returned)	2,400	2009	By Branch Stock A/c	
Dec. 31	To Branch Adjustment A/c (Loading)	23,520	Dec. 31	(Goods Sent to Branch)	1,20,000
	To Purchases A/c	94,080			
		1,20,000			1,20,000

Working Notes :

(1) Stock Reserve on Opening Stock : Loading is 25% of cost, i.e., 20% of invoice price. Therefore, loading on opening stock = 20% of ₹ 12,000 = ₹ **2,400**.

(2) Loading on Goods Sent to Branch : 20% of ₹ 1,17,600 (₹ 1,20,000 – 2,400) = ₹ **23,520**.

(3) Loading on Closing Stock = 20% of ₹ 24,000 = ₹ **4,800**.

Illustration 19

X Ltd. of Calcutta has a branch at Delhi. Goods are invoiced to the branches at cost plus $33^1/_3$%. The branch remits all cash received to the head office and all expenses are paid by the head office. From the following particulars prepare Branch Stock Account, Branch Adjustment Account, Branch Debtors' Account and Branch Profit and Loss Account in the books of the head office (all figures in ₹) :

Branch Debtors on 1.1.2017	6,000	Cash received from Debtors	57,600
Branch Stock on 1.1.2017 (Invoice price)	2,400	Discount allowed to Debtors	1,400
Sales : Cash	3,000	Bad debts	300
Credit	60,000	Branch expenses paid by H.O.	15,000
Goods from head office (Invoice price)	72,000	Branch stock on 31.12.2017 (Invoice price)	11,400

Solution

In the books of X Ltd., (H.O.)

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	2,400	2017 Dec. 31	By Bank A/c (Cash sales)	3,000
Dec. 31	To Goods Sent to Branch A/c	72,000		By Branch Debtors A/c	60,000
				By Balance c/d	11,400
		74,400			74,400

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Stock Reserve A/c (Note 3)	2,850	2017 Dec. 31	By Stock Reserve A/c (Note 1)	600
	To Gross Profit c/d	15,750		By Goods Sent to Branch A/c (Note 2)	18,000
	(Transferred to Branch Profit & Loss A/c)				
		18,600			18,600

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	6,000	2017 Dec. 31	By Bank A/c	57,600
				By Branch Expenses A/c :	
				Discount allowed	1,400
				Bad debts	300
Dec. 31	To Branch Stock A/c	60,000		By Balance c/d	6,700
		66,000			66,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Branch Expenses A/c:		2017 Dec. 31	By Gross Profit b/d	15,750
	Discount allowed	1,400		By General Profit & Loss A/c (Loss)	950
	Bad debts	300			
	Cash expenses	15,000			
		16,700			16,700

Working Notes:

(1) Stock reserve on opening stock : Loading is $33^1/_3$ on cost, i.e., $33^1/_3 \div 133^1/_3$ % or 1/4 of invoice price. Therefore, loading on opening stock = 1/4 x ₹ 2,400 = ₹ 600.

(2) Loading on goods sent : 1/4 of ₹ 72,000 = ₹ 18,000.

(3) Loading on closing stock : 1/4 of ₹ 11,400 = ₹ 2,850.

Turotial Note: When a separate Branch Profit and Loss Account is opened, Branch Adjustment Account will show gross profit and Branch Profit and Loss Account will show net profit of the branch.

Illustration 20

A Calcutta firm has a retail branch at Dhanbad. All goods are supplied to the branch by the head office which invoices the goods at the selling price which is calculated at cost plus 25 per cent. All expenses incurred by the branch are paid out of an imprest account of ₹ 10,000 which is replenished by the head office every week. All collections by the branch are banked intact to the credit of the head office. The branch maintains no books of account except a memorandum debtors ledger. Physical verification of stock at the branch is done annually and the difference between the actual stock and the book balance is adjusted. (figures in ₹)

Branch Debtors A/c (Jan. 1)	25,000	Cash collections at Br. (including cash sales of ₹ 85,000)	2,85,000
Branch Stock A/c (at Invoice value — Jan. 1)	80,000	Discounts allowed to debtors	10,000
Cash at Branch	10,000	Credit sales at Branch	2,40,000
Goods sent to Branch (at Invoice value)	3,00,000	Amount sent to Branch for expenses	36,000

As at 31st December, 2017, the branch had cash on hand representing unspent impress of ₹ 8,000. The stock on hand on 31st December, 2017 valued at invoice value was ₹ 43,000.

Prepare the following accounts as appearing in the books of the head office: (a) Branch Stock Account; (b) Branch Adjustment Account; (c) Branch Debtors Account; and, (d) Branch Profit and Loss Account.

Solution

In the books of Head Offce (Calcutta)

Branch Stock Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d	80,000	2017 Dec. 31	By Bank A/c (Cash sales)	85,000
Dec. 31	To Goods Sent to Branch A/c	3,00,000		By Branch Debtors A/c	2,40,000
				By Shortage in Stock A/c	12,000
				By Balance c/d	43,000
		3,80,000			3,80,000

Branch Adjustment Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Dec. 31	To Stock Reserve A/c (Note 6)	8,600	2017 Dec. 31	By Stock Reserve A/c (Note 4)	16,000
	To Shortage in Stock A/c (Note 3)	2,400		By Goods Sent to Branch A/c (Note 5)	60,000
	To Gross Profit c/d	65,000			
		76,000			76,000

Branch Debtors Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d	25,000	2017 Dec. 31	By Bank A/c ₹ (2,85,000 – 85,000)	2,00,000
Dec. 31	To Branch Stock A/c	2,40,000		By Br. Expenses A/c (Discount allowed)	10,000
				By Balance c/d	55,000
		2,65,000			2,65,000

Branch Profit and Loss Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Dec. 31	To Branch Expenses A/c (Note 1)	48,000	2017 Dec. 31	By Gross Profit b/d	65,000
	To Shortage in Stock A/c (Note 3)	9,600			
	To General Profit & Loss A/c	7,400			
		65,000			65,000

Working Notes:

(1) Branch Expenses Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Dec. 31	To Branch Debtors A/c	10,000	2017 Dec. 31	By Branch P/L A/c	48,000
	To Branch Petty Cash A/c	38,000			
		48,000			48,000

(2) Branch Petty Cash Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d	10,000	2017 Dec. 31	By Branch Expenses A/c (Balancing figure)	38,000
Dec. 31	To Bank A/c (Remittance for expenses)	36,000		By Balance c/d	8,000
		46,000			46,000

(3) Shortage in Stock Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Dec. 31	To Branch Stock A/c	12,000	2017 Dec. 31	By Branch Adjustment A/c (Loading)	2,400
				By Branch Profit & Loss A/c (Cost)	9,600
		12,000			12,000

Tutorial Note: Shortage in stock may be due to different reasons, e.g., shoplifting, normal loss, etc. Loading on shortage in stock (1/5 of ₹ 12,000 = ₹ 2,400) is to be charged to Branch Adjustment Account and cost of shortage (4/5 of ₹ 12,000 = ₹ 9,600) is to be charged to Branch Profit and Loss Account assuming that it is normal in nature.

(4) Loading on opening stock is 1/5 of ₹ 80,000 = ₹ 16,000.

(5) Loading on goods sent to branch is 1/5 of ₹ 3,00,000 = ₹ 60,000.

(6) Loading on closing stock = 1/5 of ₹ 43,000 = ₹ 8,600.

Illustration 21

Maruti Ltd. has a branch at Lucknow. Goods are invoiced from head office at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office.

Prepare (i) Lucknow Branch Account; (ii) Surplus in Stock Account; (iii) Lucknow Branch Debtors Account; (iv) Goods Sent to Branch Account; (v) Stock Reserve Account; (vi) Lucknow Branch Adjustment Account; (vii) Lucknow Branch Expenses Account; and, (viii) Lucknow Branch Profit and Loss Account in the books of Maruti Ltd. under Stock and Debtors system to show profit earned at the branch from the following: (all figures in ₹)

Stock on 1st April 2017 (Invoice price)	15,600	Cash collected from Debtors	29,800
Debtors on 1st April 2017	8,700	Goods returned by Debtors	1,500
Goods invoiced at cost during the year	36,000	Surplus in stock (Invoice price)	300
Sales at Branch : Cash sales	35,000	Discount allowed by Debtors	350
Credit sales	30,100	Expenses at Branch	6,700

Solution

In the books of Maruti Ltd.

Dr. Lucknow Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	15,600	31.3.2018	By Bank A/c (Cash sales)	35,000
31.3.2018	To Goods Sent to Branch A/c (Note 1)	54,000		By Lucknow Br. Debtors A/c (Credit sales)	30,100
	To Lucknow Br. Debtors A/c (Returns)	1,500		By Balance c/d	6,300
	To Surplus in Stock A/c	300			
		71,400			71,400

Dr. Surplus in Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Branch Adjustment A/c (Loading)	100	31.3.2018	By Lucknow Br. Stock A/c	300
	To Branch Profit & Loss A/c (Cost)	200			
		300			300

Dr. Lucknow Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	8,700	31.3.2018	By Bank A/c	29,800
31.3.2018	To Lucknow Br. Stock A/c (Credit sales)	30,100		By Lucknow Br. Stock A/c (Sales returns)	1,500
				By Br. Expenses A/c (Discount allowed)	350
				By Balance c/d	7,150
		38,800			38,800

Dr. Goods Sent to Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Branch Adjustment A/c (Note 1)	18,000	31.3.2018	By Lucknow Br. Stock A/c	54,000
	To Purchases A/c (Transferred)	36,000			
		54,000			54,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Branch Adjustment A/c (Transferred)	5,200	1.4.2017	By Balance b/d (Loading on opening stock)	5,200
	To Balance c/d	2,100	31.3.2018	By Branch Adjustment A/c (Loading on closing stock)	2,100
		7,300			7,300

Dr. Lucknow Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Stock Reserve A/c (Loading on closing stock)	2,100	31.3.2018	By Stock Reserve A/c (Loading on opening stock)	5,200
	To Gross Profit c/d (Transferred to Branch A/c)	21,200		By Goods Sent to Branch A/c (Loading on goods sent)	18,000
				By Surplus in Stock A/c (Loading)	100
		23,300			23,300

Dr. Lucknow Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Bank A/c	6,700	31.3.2018	By Lucknow Branch Profit & Loss A/c	7,050
	To Lucknow Branch Debtors A/c (Discount allowed)	350			
		7,050			7,050

Dr. Lucknow Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Sundry Expenses	7,050	31.3.2018	By Gross Profit b/d	21,200
	To Net Profit (Transferred to General Profit & Loss A/c)	14,350		By Surplus in Stock A/c	200
		21,400			21,400

Working Notes:

(1) Invoice Price of Goods Sent	₹
Cost of goods sent	36,000
Add: Loading 50% of cost	18,000
	54,000

(2) Loading on Opening Stock

Loading is 50% of cost, i.e., 50/150 or 1/3 of invoice price. Therefore, loading on opening stock = ₹ 15,600/3 = ₹ 5,200.

(3) Loading on Closing Stock = 1/3 of ₹ 6,300 = ₹ 2,100.

Tutorial Note: "Loading" of surplus in stock (₹ 100) is to be credited to Branch Adjustment Account and "Cost" of surplus in stock (₹ 200) is to be credited to Branch Profit and Loss Account.

Illustration 22

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2006 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money returned to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained by H.O. Following further details are given for the year ending on 31.3.2007:

	₹
Cost of Goods Sent to Branch	1,00,000
Goods Received by Branch till 31.3.2007 at invoice price	1,08,000
Credit Sales for the year	1,16,000
Closing Debtors on 31.3.2007	41,600
Bad Debts written off during the year	400
Cash remitted to H.O.	86,000
Closing Cash on Hand at Branch on 31.3.2007	4,000
Cash Remitted by H.O. to Branch during the year	6,000
Closing Stock in Hand at Branch at invoice price	12,000
Expenses incurred at Branch	24,000

Draw up the necessary ledger accounts like Branch Debtors Account, Branch Stock Account, Goods Sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment Account for ascertaining gross profit and Branch Profit and Loss Account for ascertaining branch profit. *[C.A. (PE - II) — May, 2007]*

Solution

In the books of Red and Co.

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Branch Stock A/c	1,16,000	2007 Mar 31	By Branch Cash A/c (Balancing figure)	74,000
				By Bad Debts	400
				By Balance c/d	41,600
		1,16,000			1,16,000

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Goods Sent to Branch A/c	1,20,000	2007 Mar 31	By Branch Debtors A/c	1,16,000
	To Branch Adjustment A/c (Note 3)	54,000		By Branch Cash A/c	34,000
				By Goods in Transit (Note 2)	12,000
				By Balance c/d	12,000
		1,74,000			1,74,000

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Branch Adjustment A/c (Note 1)	20,000	2007 Mar 31	By Branch Stock A/c	1,20,000
"	By Purchases / Trading A/c	1,00,000			
		1,20,000			1,20,000

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

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Debtors A/c	74,000	2007 Mar 31	By Branch Expenses A/c	24,000
"	To H.O. (Remittance from H.O.)	6,000	"	By H.O. (Cash remitted)	86,000
"	To Branch Stock A/c		"	By Balance c/d	4,000
	(Cash Sales — Balancing figure)	34,000			
		1,14,000			1,14,000

Dr. **Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Branch Cash A/c	24,000	2007 Mar 31	By Branch Profit and Loss A/c	24,400
"	To Bad Debts A/c	400			
		24,400			24,400

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Stock Reserve A/c :		2007 Mar 31	By Goods Sent to Branch A/c (Note 1)	20,000
	in Hand (Note 4)	2,000	"	By Branch Stock A/c (Note 3)	54,000
	in Transit (Note 5)	2,000			
"	To Branch Profit and Loss A/c	70,000			
		74,000			74,000

Dr. **Branch Profit and Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007 Mar 31	To Branch Expenses A/c	24,400	2007 Mar 31	By Branch Adjustment A/c	70,000
"	To General Profit and Loss A/c	45,600			
		70,000			70,000

Working Notes :

(1) Loading on Goods Sent = ₹ 1,20,000 – ₹ 1,00,000 = ₹ 20,000.

(2) Goods in Transit = Invoice Price of goods sent – Invoice price of goods received by the branch = ₹ 1,20,000 – ₹ 1,08,000 = ₹ 12,000 (at invoice price).

(3) Surplus in Branch Stock Account represents excess price realisation over and above the invoice price.

(4) Loading on closing stock = 1/6 of ₹ 12,000 = ₹ 2,000.

(5) Loading on goods in transit = 1/6 of ₹ 12,000 = ₹ 2,000.

Illustration 23

Eastern Chemicals Ltd. has two branches at Bombay and Nagpur. Goods are invoiced to branches at cost plus 50%. Branches remit all cash received to the head office and all expenses are also met by head office. From the following particulars, prepare (i) Branch Stock Account; (ii) Branch Stock Adjustment Account; (iii) Branch Debtors Account; (iv) Goods Sent to Branch Account; and, (v) Branch Profit and Loss Account for the year ended 31.12.2017:

	Bombay (₹)	Nagpur (₹)		Bombay (₹)	Nagpur (₹)
Stock on 1.1.2017 (Invoice price)	18,600	31,200	Goods returned to head office	3,000	—
Debtors on 1.1.2017	13,600	17,400	Transfer from Nagpur to Bombay	4,200	4,200
Goods invoiced (Cost price)	68,000	72,000	Shortage of stock	900	—
Cash sales	50,020	70,000	Surplus in stock	—	600
Credit sales	62,000	60,200	Discount allowed to customers	400	700
Collections from debtors	60,800	59,600	Expenses at branches	10,800	13,400
Returns from debtors	2,400	3,000			

[C.U. B.Com. (Hons.)— Adapted]

Solution

In the books of Eastern Chemicals Ltd.

Dr. **Branch Stock Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Jan. 1	To Balance b/d	18,600	31,200	2017 Dec. 31	By Bank A/c (Cash sales)	50,020	70,000
Dec. 31	To Goods Sent to Branch A/c	1,02,000	1,08,000		By Branch Debtors A/c	62,000	60,200
	To Branch Debtors A/c	2,400	3,000		By Goods Sent to Br. A/c (Returns)	3,000	—
	To Goods Sent to Branch A/c (Transfer)	4,200	—		By Goods Sent to Branch A/c (Transfer)	—	4,200
	To Surplus in Stock A/c	—	600		By Shortage in Stock A/c	900	—
					By Balance c/d	11,280	8,400
		1,27,200	1,42,800			1,27,200	1,42,800

Dr. **Branch Stock Adjustment Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Dec. 31	To Shortage in Stock A/c (Note 1)	300	—	2017 Dec. 31	By Stock Reserve A/c	6,200	10,400
	To Stock Reserve A/c	3,760	2,800		By Goods sent to Br. A/c (Note 3)	34,400	34,600
	To Gross Profit c/d	36,540	42,400		By Surplus in Stock A/c (Note 2)	—	200
		40,600	45,200			40,600	45,200

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Jan. 1	To Balance b/d	13,600	17,400	2017 Dec. 31	By Bank A/c	60,800	59,600
?	To Branch Stock A/c	62,000	60,200		By Branch Stock A/c	2,400	3,000
					By Branch Exp. A/c (Disc. allowed)	400	700
					By Balance c/d	12,000	14,300
		75,600	77,600			75,600	77,600

Dr. **Goods Sent to Branch Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Dec. 31	To Branch Stock A/c	3,000	—	2017 Dec. 31	By Branch Stock A/c	1,02,000	1,08,000
	To Branch Stock A/c (Transfer)	—	4,200		By Branch Stock A/c (Transfer)	4,200	—
	To Branch Stock Adj. A/c (Note 3)	34,400	34,600				
	To Purchases A/c (Transfer)	68,800	69,200				
		1,06,200	1,08,000			1,06,200	1,08,000

Dr. **Branch Profit & Loss Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Dec. 31	To Branch Expenses A/c (Note 4)	11,200	14,100	2017 Dec. 31	By Gross Profit b/d	36,540	42,400
	To Shortage-in-stock A/c	600	—		By Surplus in Stock A/c	—	400
	To General Profit & Loss A/c	24,740	28,700				
		36,540	42,800			36,540	42,800

Working Notes :

Dr. **(1) Shortage in Stock Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Dec. 31	To Branch Stock A/c	900	—	2017 Dec. 31	By Branch Stock Adjustment A/c	300	—
					By Branch Profit & Loss A/c	600	—
		900	—			900	—

Dr. **(2) Surplus in Stock Account** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2017 Dec. 31	To Branch Stock Adjustment A/c	—	200	2017 Dec. 31	By Branch Stock A/c	—	600
	To Branch Profit & Loss A/c	—	400				
		—	600			—	600

(3) Loading on net goods sent including transfer to Bombay branch: Goods sent to branch (direct) ₹ 1,02,000 plus goods received from Nagpur ₹ 4,200 Less goods returned to head office ₹ 3,000. Therefore, net goods sent = ₹ 1,03,200. Loading is 1/3 of ₹ 1,03,200 = ₹ 34,400. Nagpur Branch: Goods sent to branch directly ₹ 1,08,000 less goods transferred to Bombay ₹ 4,200. Therefore, net goods sent to branch = ₹ 1,03,800. Loading is 1/3 of ₹ 1,03,800 = ₹ 34,600.

(4) Branch expenses : Total branch expenses are actual expenses plus discount allowed, i.e., ₹ 10,800 + ₹ 900 = ₹ 11,200 for Bombay Branch and ₹ 13,400 + ₹ 700 = ₹ 14,100 for Nagpur Branch.

> ***Tutorial Note: In case of transfer of goods between the branches, the sending branch will treat the transfer 'as if returned to head office' and receiving branch will treat that 'as if received from H.O.'***

Illustration 24

A Company with its head office at Calcutta has a branch at New Delhi. Goods are invoiced to the branch at cost plus $33^1/_3$%, which is the selling price. The following information is given in respect of the branch for the year ended 31st March, 2018:

	₹		₹
Goods Sent to branch (Invoice value)	4,80,000	Discount allowed	1,000
Stock at branch (1.4.2017) at selling price	24,000	Bad debts	1,500
Cash sales	1,80,000	Stock at branch (31.3.2018) at selling price	48,000
Returns from Debtors	6,000	Branch Debtors' balance (31.3.2018)	36,500
Branch expenses paid for cash	53,500	Collections from Debtors	2,70,000
Branch Debtors' balance (1.4.2017)	30,000	Branch Debtors' cheques returned dishonoured	5,000

You are required to prepare the Branch Stock Account, Branch Debtors' Account and the Branch Adjustment Account to reveal the profit of the branch for the year 2017-18.

Solution

In the books of Head Office, Calcutta

Dr. New Delhi Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	24,000	31.3.2018	By Bank A/c (cash sales)	1,80,000
31.3.2018	To Goods Sent to Branch A/c	4,80,000		By New Delhi Branch Debtors A/c (Note 1)	2,80,000
	To New Delhi Br. Debtors A/c (Returns)	6,000		By Shortage-in-stock A/c (Balancing figure)	2,000
				By Balance c/d	48,000
		5,10,000			5,10,000

Dr. New Delhi Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	30,000	31.3.2018	By Bank A/c (Collection)	2,70,000
31.3.2018	To Bank A/c (Dishonour of cheques)	5,000		By New Delhi Branch Stock A/c	6,000
	To New Delhi Branch Stock A/c (Note 1)	2,80,000		By New Delhi Branch Expenses A/c:	
				Bad debt ₹ 1,500	
				Discount allowed ₹ 1,000	2,500
				By Balance c/d	36,500
		3,15,000			3,15,000

Dr. New Delhi Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Branch Expenses A/c (Note 4)	56,000	1.4.2017	By Stock Reserve A/c (Note 2)	6,000
	To Shortage-in-stock A/c (Note 5)	2,000		By Goods Sent to Branch A/c (Note 3)	1,20,000
	To Stock Reserve A/c (Note 6)	12,000			
	To Net Profit (Trans. to General P & L A/c)	56,000			
		1,26,000			1,26,000

Working Notes:

(1) Credit sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is to be taken as credit sales.

(2) Loading is $33^1/_3$ on cost, i.e., $33^1/_3\% \div 133^1/_3$ % or 1/4 on invoice value. Therefore, loading on opening stock is ₹ 24,000/4 = ₹ 6,000.

(3) Loading on goods sent = ₹ 4,80,000/4 = ₹ 1,20,000.

(4) Total branch expenses = Cash expenses are ₹ 53,500 + Bad Debts ₹ 1,500 + Discount allowed ₹ 1,000 = ₹ 56,000.

(5) When no separate Branch Profit and Loss Account is prepared, the entire amount of shortage or surplus in stock is transferred to Branch Adjustment Account.
If the Branch Adjustment Account and Branch Profit and Loss Account are prepared separately, the loading on shortage/surplus is transferred to Branch Adjustment Account and cost is transferred to Branch Profit and Loss Account.

(6) Loading on closing stock = ₹ 48,000/4 = ₹ 12,000.

Illustration 25

X Ltd. has a retail branch at Allahabad. Goods are sent by the H.O. to the branch marked at selling price which is cost *plus* 25%. All the expenses of the branch are paid by the H.O. All cash collected by the branch (from customers and cash sales) is deposited to the credit of H.O. Account.

From the following particulars of the branch, prepare Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in the books of the H.O.: (all figures in ₹)

Debtors on 1.1.2017	12,000	Goods returned to H.O. at Invoice Price	5,000
Debtors on 31.12.2017	14,000	Salaries paid	6,000
Inventory with Branch at Invoice Price on 1.1.2017	16,000	Rent paid	4,000
Inventory with Branch at Invoice Price on 31.12.2017	17,000	Discount allowed to customers	2,000
Cash sales during the year	60,000	Bad debts written-off	1,000
Amount deposited in the H.O. A/c during the year	1,27,000	Spoilage at Invoice price	2,000

Solution

In this problem, credit sales and goods sent to branch are missing. Therefore, the balancing figure of Branch Debtors Account will be treated as credit sales and the balancing figure of Branch Stock Account will be treated as goods sent to branch.

In the books of X Ltd. (H.O.)

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	16,000	2017 Dec. 31	By Cash A/c (cash sales)	60,000
Dec. 31	To Goods Sent to Branch A/c (Note 2)	1,40,000		By Goods Sent to Branch A/c (Returns)	5,000
				By Branch Debtors A/c (Credit sales)	72,000
				By Spoilage A/c	2,000
				By Balance c/d	17,000
		1,56,000			1,56,000

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	12,000	2017 Dec. 31	By Bank A/c (Note 1)	67,000
Dec. 31	To Branch Stock A/c (Balancing figure)	72,000		By Discount Allowed A/c	2,000
				By Bad Debts A/c	1,000
				By Balance c/d	14,000
		84,000			84,000

Dr. Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Cash A/c (Rent + Salaries)	10,000	2017 Dec. 31	By Branch Profit & Loss A/c	13,000
	To Discount Allowed A/c	2,000			
	To Bad Debts A/c	1,000			
		13,000			13,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Spoilage A/c (Note 3)	400	2017 Dec. 31	By Stock Reserve A/c	3,200
	To Stock Reserve A/c	3,400		By Goods Sent to Branch A/c (Note 2)	27,000
	To Branch Profit & Loss A/c	26,400			
		30,200			30,200

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Branch Expenses A/c	13,000	2017 Dec. 31	By Branch Adjustment A/c	26,400
	To Spoilage A/c (Cost)	1,600			
	To General Profit & Loss A/c	11,800			
		26,400			26,400

Working Notes:

(1) Total amount deposited in H.O. Account is ₹ 1,27,000 but it includes ₹ 60,000 for cash sales. Therefore, amount collected from debtors = ₹ 1,27,000 – ₹ 60,000 = ₹ 67,000.

(2) Goods sent to branch have not been given. The balancing figure of Branch Stock Account will be treated as goods sent to branch. Total goods sent to branch = ₹ 1,40,000. ₹ 5,000 (at invoice price) has been returned to head office. Loading on net goods sent = 1/5 of ₹ 1,35,000 = ₹ 27,000.

(3) **Loading on spoilage** ₹ 400 is to be debited to Branch Adjustment Account and the balance amount ₹ 2,000 – ₹ 400 = ₹ 1,600 is to be charged to Branch Profit and Loss Account.

(4) **Loading on opening stock** = 1/5 of ₹ 16,000 = ₹ 3,200; **Loading on closing stock** = 1/5 of ₹ 17,000 = ₹ 3,400.

Illustration 26

Multichained Stores Ltd., Delhi has its branches at Lucknow and Madras. 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, 2018.

Balances on 1.4.2017: Stock ₹ 30,000; Debtors ₹ 10,000 and Petty Cash ₹ 50.

Transactions during 2017-18 (Lucknow branch) (all figures in ₹) :

Goods sent to Lucknow branch at Invoice price	3,25,000	Cash sent for Petty expenses	34,000
Goods returned to Head Office at Invoice price	10,000	Bad debts at Branch	500
Cash sales	1,00,000	Goods transferred to Madras branch under H.O. advice	15,000
Credit sales	1,75,000	Insurance charges paid by H.O.	500
Goods pilferred (Invoice price)	2,000	Goods returned by Debtors	500
Goods lost in fire (Invoice price)	5,000	Insurance Co. paid to H.O. for loss by fire at Lucknow	3,000

Balances on 31.3.2018: Petty Cash ₹ 230; Debtors ₹ 14,000. Goods worth ₹ 15,000 (included above) sent by Lucknow branch to Madras branch was in transit on 31.3.2018. 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 and Loss Account; (e) Stock Reserve Account; and, (f) Goods Sent to Lucknow Branch Account.

Solution

In the books of Multichained Stores Ltd.

Dr. Lucknow Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	30,000	31.3.2018	By Goods sent to Lucknow Br. A/c (Returns)	10,000
31.3.2018	To Goods Sent to Lucknow Branch A/c	3,25,000		By Bank A/c (Cash sales)	1,00,000
	To Lucknow Branch Debtors A/c (Returns)	500		By Goods Pilferred A/c	2,000
				By Goods Lost by Fire A/c	5,000
				By Goods Sent to Lucknow Br. A/c (Transfer)	15,000
				By Lucknow Branch Debtors A/c	1,75,000
				By Balance c/d	48,500
		3,55,500			3,55,500

Dr. Lucknow Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	10,000	31.3.2018	By Bad Debts A/c	500
31.3.2018	To Lucknow Branch Stock A/c	1,75,000		By Bank A/c (Bal. fig.) (coll. from debtors)	1,70,000
				By Lucknow Branch Stock A/c (Returns)	500
				By Balance c/d	14,000
		1,85,000			1,85,000

Dr. Lucknow Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Goods Pilferred A/c	400	31.3.2018	By Stock Reserve A/c	6,000
	To Goods Lost by Fire A/c	1,000		By Goods Sent to Branch A/c (Note 5)	60,000
	To Stock Reserve A/c	9,700			
	To Gross Profit c/d	54,900			
		66,000			66,000

Dr. Lucknow Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Goods Pilferred A/c	1,600	31.3.2018	By Gross Profit b/d	54,900
	To Branch Expenses A/c	34,820			
	To General Profit & Loss A/c (Note 6)	18,480			
		54,900			54,900

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Lucknow Branch Adjustment A/c	6,000	1.4.2017	By Balance c/d	6,000
	To Balance c/d	9,700	31.3.2018	By Lucknow Branch Adjustment A/c	9,700
		15,700			15,700

Dr. Goods Sent to Lucknow Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Lucknow Branch Stock A/c (Returns)	10,000	31.3.2018	By Lucknow Branch A/c	3,25,000
	To Lucknow Branch Stock A/c (Transfer)	15,000			
	To Lucknow Branch Adjustment A/c (Note 5)	60,000			
	To Purchases A/c	2,40,000			
		3,25,000			3,25,000

Working Notes :

Dr. (1) Petty Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	50	31.3.2018	By Branch Expenses A/c	33,820
31.3.2018	To Bank A/c	34,000		By Balance c/d	230
		34,050			34,050

Dr. (2) Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Bad Debts A/c	500	31.3.2018	By Lucknow Branch Profit & Loss A/c	34,820
	To Bank A/c (Insurance charge)	500			
	To Petty Cash A/c	33,820			
		34,820			34,820

Dr. (3) Goods Pilferred Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Lucknow Branch Stock A/c	2,000	31.3.2018	By Lucknow Branch Adj. A/c (Loading)	400
				By Lucknow Branch P & L A/c (Cost)	1,600
		2,000			2,000

Dr. (4) Goods Lost by Fire Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Lucknow Branch Stock A/c	5,000	31.3.2018	By Lucknow Branch Adj. A/c (Loading)	1,000
				By Bank A/c (Claim received)	3,000
				By General Profit & Loss A/c (Note 6)	1,000
		5,000			5,000

(5) Net Goods sent to Branch

Goods sent to branch = ₹ 3,25,000 *less* goods returned by the branch ₹ 10,000 *less* goods transferred to Madras branch ₹ 15,000 = **₹ 3,00,000. Loading = 1/5 of ₹ 3,00,000 = ₹ 60,000.**

(6) For calculating true profit of the branch, any abnormal loss should be debited to General Profit & Loss Account. Here, ₹ 1,000 has been charged to General Profit & Loss Account. However, if it is charged to Branch Profit & Loss Account, the profit would be ₹ 17,480.

Illustration 27

Madras Ltd. invoices goods to its branch at cost plus $33^1/_3$%. From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office: (all figures in ₹)

Stock at commencement at branch at invoice price	1,50,000	Return of goods to head office (invoice price)	50,000
Stock at close at branch at invoice price	1,20,000	Credit sales at branch	50,000
Goods sent to branch during the year at invoice price (including goods invoiced at ₹ 20,000 to branch on 31.3.2018 but not recd. by branch before close of the year)	10,00,000	Invoice value of goods pilferred	10,000
		Normal loss at branch due to wastage and deterioration of stock (at invoice value)	15,000
		Cash sales at branch	9,00,000

Madras Ltd. closes its books on March 31, 2018.

Solution

In the books of Madras Ltd.

Branch Stock Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
1.4.2017	To Balance b/d	1,50,000	31.3.2018	By Bank A/c (Cash sales)	9,00,000
31.3.2018	To Goods Sent to Branch A/c	10,00,000		By Goods Sent to Branch A/c (Returns)	50,000
				By Branch Debtors A/c (Credit sales)	50,000
				By Goods Pilferred A/c	10,000
				By Balance c/d: at branch	1,20,000
				in-transit	20,000
		11,50,000			11,50,000

Branch Stock Adjustment Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.3.2018	To Goods Pilferred A/c (Loading)	2,500	31.3.2018	By Stock Reserve A/c	37,500
	To Stock Reserve A/c (Note 2)	35,000		By Goods Sent to Branch A/c (Note 1)	2,37,500
	To Gross Profit c/d	2,37,500			
		2,75,000			2,75,000

Branch Profit & Loss Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.3.2018	To Goods Pilferred A/c (Cost)	7,500	31.3.2018	By Gross Profit b/d	2,37,500
	To General Profit & Loss A/c	2,30,000			
		2,37,500			2,37,500

Tutorial Note: No entry is required to be passed for normal loss, though it is given specifically in the question. The effect of normal loss is automatically adjusted in the Branch Stock Account. In this problem, normal loss of ₹ 15,000 has been neutralised by the profit on sales above invoice price of ₹ 15,000. If the entry is made for normal loss, the Branch Stock Account will be as under:

Branch Stock Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
1.4.2017	To Balance b/d	1,50,000	31.3.2018	By Bank A/c (Cash sales)	9,00,000
31.3.2018	To Goods Sent to Branch A/c	10,00,000		By Goods Sent to Branch A/c	50,000
	To Branch Stock Adjustment A/c	15,000		By Branch Debtors A/c	50,000
	(Profit on sales above invoice price)			By Goods Pilferred A/c	10,000
				By Normal Loss A/c*	15,000
				By Balance c/d: at branch	1,20,000
				in transit	20,000
		11,65,000			11,65,000

*Normal loss is to be debited to Branch Stock Adjustment Account by ₹ 15,000 and it will be credited by ₹ 15,000 for profit on sales, above invoice prices. The gross profit will remain ***unchanged***. **In the examination it is better to ignore normal loss.**

Working Notes:

(1) Total goods sent to branch is ₹ 10,00,000. Goods of ₹ 50,000 has been returned by the Branch. Therefore, net goods sent is ₹ 9,50,000. Loading on goods sent (Net) = 1/4 of ₹ 9,50,000 = ₹ 2,37,500.

(2) Stock reserve is also to be created on goods in transit in addition to closing stock at branch. Therefore, the loading is 1/4 of ₹ (1,20,000 + 20,000) = ₹ 35,000.

(3) Loading on goods pilferred is to be charged to Branch Stock Adjustment Account and cost is to be charged to Branch Profit and Loss Account.

Illustration 28

Subhash Electricals has its branches at Chandigarh and Gwalior to whom goods are invoiced at cost plus 25%.

Following information is available of the transactions at Chandigarh Branch for the year ended 31.3.2018 :

Balances on 1.4.2017 : Stock at invoice price ₹ 40,000; Debtors ₹ 12,000; Petty Cash ₹ 150.

Transactions during 2017-18 : (all figures in ₹)

Goods sent to branch at invoice price	4,20,000	Insurance company paid to head office	3,000
Goods returned to head office at invoice price	15,000	Cash sent for petty expenses	32,000
Cash sales	1,05,000	Bad debts	400
Credit sales	1,80,000	Goods transferred to Gwalior branch at invoice price	12,000
Normal loss at invoice price	350	Insurance charges paid by head office	200
Goods pilfered at invoice price	3,000	Goods returned by debtors	500
Goods lost by fire at invoice price	4,000		

Balances on 31.3.2018 : Debtors ₹ 11,000; Petty Cash ₹ 250; Stock ?

Note : Goods transferred to Gwalior Branch were in transit on 31.3.2018.

Prepare for Chandigarh Branch : (i) Branch Stock Account; (ii) Branch Adjustment Account; (iii) Branch Profit and Loss Account; (iv) Stock Reserve Account; and (v) Branch Debtors Account.

Solution

In the books of Subhas Electricals

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	40,000	31.3.2018	By Goods Sent to Branch A/c (Returns)	15,000
31.3.2018	To Goods Sent to Branch A/c	4,20,000		By Bank A/c (Cash Sales)	1,05,000
	To Branch Debtors A/c (Returns)	500		By Branch Debtors A/c (Credit Sales)	1,80,000
				By Goods Pilfered A/c	3,000
				By Goods Lost by Fire A/c	4,000
				By Goods Sent to Gwalior Branch A/c (Trans.)	12,000
				By Normal Loss A/c (Note 1)	350
				By Balance c/d	1,41,150
		4,60,500			4,60,500

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Normal Loss A/c (Note 1)	350	1.4.2017	By Branch Stock Reserve A/c (Note 6)	8,000
	To Goods Pilfered A/c (Loading-Note 4)	600		By Goods Sent to Branch A/c (Note 2)	81,000
	To Goods Lost by Fire A/c (Loading-Note5)	800			
	To Goods Sent to Gwalior Branch A/c (Note 3)	2,400			
	To Branch Stock Reserve A/c (Note 7)	28,230			
	To Branch Profit and Loss A/c	56,620			
		89,000			89,000

Dr. Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Goods Pilfered A/c (Cost)	2,400	31.3.2018	By Branch Adjustment A/c	56,620
	To Branch Expenses A/c :				
	Bad Debts	400			
	Insurance Charges	200			
	Petty Expenses (Note 8)	31,900			
	To Net Profit (Transferred to General P&L A/c)	21,720			
		56,620			56,620

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Branch Adjustment A/c	8,000	1.4.2017	By Balance b/d (Note 6)	8,000
31.3.2018	To Balance c/d	28,230	31.3.2018	By Branch Adjustment A/c (Note 7)	28,230
		36,230			36,230

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d	12,000	31.3.2018	By Branch Expenses A/c (Bad Debts)	400
31.3.2018	To Branch Stock A/c	1,80,000		By Branch Stock A/c (Returns)	500
				By Bank A/c (Cash Collected)	1,80,100
			31.3.2018	By Balance c/d	11,000
		1,92,000			1,92,000

Working Notes :

(1) For calculating Branch Closing Stock (when it is not given), normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.

(2) Loading on net goods sent: Goods sent to branch ₹ 4,20,000 less goods returned to head office ₹ 15,000. Therefore, net goods sent = ₹ 4,05,000. Loading is 1/5 of ₹ 4,05,000 = ₹ 81,000.

(3) Loading on goods transferred to Gwalior Branch: 1/5 of ₹ 12,000 = ₹ 2,400.

(4) Loading on goods pilfered: 1/5 of ₹ 3,000 = ₹ 600. Cost of goods pilfered ₹ 2,400 (₹ 3,000 – ₹ 600) will be debited to *Branch Profit and Loss Account.*

(5) Loading on goods lost by fire: 1/5 of ₹ 4,000 = ₹ 800. Cost of goods lost by fire ₹ 3,200 (₹ 4,000 – ₹ 800) will be debited to *General Profit and Loss Account.*

(6) Loading on opening stock: 1/5 of ₹ 40,000 = ₹ 8,000.

(7) Loading on closing stock: 1/5 of ₹ 1,41,150 = ₹ 28,230.

(8) Petty Expenses = Opening petty cash ₹ 150 *plus* cash sent by head office for petty cash = ₹ 32,000 *less* closing petty cash ₹ 250 = ₹ 31,900.

Sometimes, Branch Stock Account may be maintained under two columns on both the sides — Invoice Price Column and Cost Price Column. The 'Invoice Price Column' being a mere memorandum column, all double entries are with the 'Cost Price Column'.Gross Profit or Loss is disclosed by the 'Cost Price Column'. The sales and sales returns are same for both the columns.

Illustration 29

Pure Silk Company of Murshidabad has two branches, one at Calcutta and the other at Delhi. Goods are invoiced by the Murshidabad head office to its branches at cost plus 50% on cost. Both cash and credit sales are made by the branches and all cash collected by the branches is sent to the head office and the branch expenses are met by the head office. The following particulars are supplied by the branches for the year ended 31st March, 2018 :(all figures in ₹)

	Calcutta	Delhi
Stock on April 1, 2017 (Invoice Price)	18,600	31,200
Branch Debtors on April 1, 2017	13,600	17,400
Goods Received from Head Office (Cost Price)	68,000	72,000
Branch Sales : Cash	50,020	70,000
Credit	62,000	60,200
Goods Returned by Debtors	2,400	3,000
Cash Realised from Debtors	60,800	59,200
Goods returned to Head Office (Invoice Price)	3,000	Nil
Goods transferred from Delhi Branch to Calcutta Branch	4,200	4,200
Surplus of Branch Stock (Invoice Price)	Nil	600
Shortage of Branch Stock (Invoice Price)	900	Nil
Discount Allowed to Customers	400	700
Expenses at Branch	10,800	13,400

Prepare : (a) Branch Stock Accounts (in Double Columnar Form); (b) Branch Debtors Accounts; and (c) Branch Profit and Loss Accounts from the above particulars in the Head Office Ledger.

Solution **In the books of Pure Silk Company (Head Office)**

Dr. **Calcutta Branch Stock Account** **Cr.**

Date	Particulars	Invoice Price (₹)	Cost Price (₹)	Date	Particulars	Invoice Price (₹)	Cost Price (₹)
1.4.2017	To Balance b/f (Note 1)	18,600	12,400	31.3.2017	By Bank A/c (Cash Sales)	50,020	50,020
31.3.2018	To Goods Sent to Branch A/c (Note 2)	1,02,000	68,000		By Branch Debtors A/c (Credit sales)	62,000	62,000
	To Branch Debtors A/c (Returned by Debtors)	2,400	2,400		By Goods Sent to BranchA/c (Returned to Head Office)	3,000	2,000
	To Goods Sent to Branch A/c (Received from Delhi Branch)	4,200	2,800		By Shortage of Stock A/c	900	600
					By Balance c/d (Note 3)	11,280	7,520
	To Branch Profit and Loss A/c	—	36,540				
		1,27,200	1,22,140			1,27,200	1,22,140

Dr. **Delhi Branch Stock Account** **Cr.**

Date	Particulars	Invoice Price (₹)	Cost Price (₹)	Date	Particulars	Invoice Price (₹)	Cost Price (₹)
1.4.2017	To Balance b/f (Note 4)	31,200	20,800	31.3.2018	By Bank A/c (Cash Sales)	70,000	70,000
31.3.2018	To Goods Sent to Branch A/c (Note 5)	1,08,000	72,000		By Branch Debtors A/c (Credit Sales)	60,200	60,200
	To Branch Debtors A/c (Returned by Debtors)	3,000	3,000		By Goods Sent to Branch A/c (Transfer to Calcutta Branch)	4,200	2,800
	To Surplus of Stock A/c	600	400		By Balance c/d (Note 6)	8,400	5,600
	To Branch Profit and Loss A/c	—	42,400				
		1,42,800	1,38,600			1,42,800	1,38,600

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	Calcutta(₹)	Delhi (₹)	Date	Particulars	Calcutta(₹)	Delhi (₹)
1.4.2017	To Balance b/f	13,600	17,400	31.3.2018	By Bank A/c	60,800	59,200
31.3.2018	To Branch Stock A/c	62,000	60,200		By Branch Stock A/c (Returned by Customers)	2,400	3,000
					By Discount Allowed A/c	400	700
					By Balance c/d	12,000	14,700
		75,600	77,600			75,600	77,600

Dr. **Branch Profit and Loss Account** **Cr.**

Date	Particulars	Calcutta(₹)	Delhi (₹)	Date	Particulars	Calcutta(₹)	Delhi (₹)
31.3.2018	To Discount Allowed A/c	400	700	31.3.2018	By Branch Stock A/c	36,540	42,400
	To Shortage of Stock A/c	600	—		By Surplus of Stock A/c	—	400
	To Branch Expenses A/c	10,800	13,400				
	To General Profit and Loss A/c (Net Profit)	24,740	28,700				
		36,540	42,800			36,540	42,800

Working Notes:

(1) Goods are sent at cost plus 50%. It means, if cost is 100 then loading is 50 and invoice price = 100 + 50 = **150**.
Therefore, cost price of opening stock = ₹ 18,600/150 × 100 of Calcutta Branch = ₹ **12,400**.

(2) Invoice price of goods sent to Calcutta Branch = ₹ 68,000/100 × 150 = ₹ **1,02,000**.

(3) Cost price of closing stock of Calcutta Branch = ₹ 11,280/150 × 100 = ₹ **7,520**.

(4) Cost price of opening stock of Delhi Branch = ₹ 31,200/150 × 100 = ₹ **20,800**.

(5) Invoice price of goods sent to Delhi Branch = ₹ 72,000/100 × 150 = ₹ **1,08,000**.

(6) Cost price of closing stock of Delhi Branch = ₹ 8,400/150 × 100 = ₹ **5,600**.

Illustration 30

Begumpur Handloom Co-operative Ltd has a branch in Cuttack. Goods are invoiced to Cuttack at cost plus $33^1/_3$% . Cuttack Branch maintains only a Sales Ledger, except that all other transactions are recorded in Head Office book. Branch sells goods both in cash and credit. All cash collected by Branch is sent to the Head Office at regular intervals and all Branch Expenses are met by the Head Office.

The following particulars are related to the Cuttack Branch for the accounting year ended 31st December, 2017 :

	₹		₹
Stock on 1st January, 2017	24,000	Goods returned to Head Office (Invoice price)	4,000
Branch Debtors as on 1st January, 2017	18,000	Discount allowed to customers	1,600
Goods received from Head Office (Cost price)	72,000	Bad Debts	1,400
Branch Sales :		Cash sent to Branch for :	
Cash	20,000	Wages	2,000
Credit	80,000	Freight	2,500
Goods returned by Debtors	4,000	Salary and other expenses	4,000
Cash received from Debtors	72,000	Stock on 31st December, 2017 at cost	13,200

From the above particulars, prepare in the books of the Head Office:

(1) Branch Stock Account (in Double Column); (2) Branch Debtors Account; and (3) Branch Profit and Loss Account

[C.U.B.Com. (Hons) — Adapted]

Solution **In the books of Begumpur Handloom Co-operative Ltd (Head Office)**

Dr. **Cuttack Branch Stock Account** **Cr.**

Date	Particulars	Invoice Price (₹)	Cost Price (₹)	Date	Particulars	Invoice Price (₹)	Cost Price (₹)
1.1.2017	To Balance b/d	24,000	18,000	31.12.2017	By Goods Sent to Branch A/c	4,000	3,000
31.12.2017	To Goods Sent to Branch A/c (Note 1)	96,000	72,000		By Bank A/c (Cash sales)	20,000	20,000
					By Branch Debtors A/c	80,000	80,000
	To Branch Debtors A/c (Returned by Debtors)	4,000	4,000		By Stock Shortage A/c (Note 2)	2,400	1,800
	To Branch Profit and Loss A/c	—	24,000		By Balance c/d (Note 4)	17,600	13,200
		1,24,000	1,18,000			1,24,000	1,18,000

Dr. Cuttack Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	18,000	31.12.2017	By Branch Stock A/c (Goods returned)	4,000
31.12.2017	To Branch Stock A/c	80,000		By Bank A/c (Cash collected)	72,000
				By Branch Expenses A/c:	
				Discount allowed	1,600
				Bad debts	1,400
				By Balance c/d	19,000
		98,000			98,000

Dr. Cuttack Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Branch Expenses A/c :		31.12.2017	By Branch Stock A/c	24,000
	Discount allowed	1,600			
	Bad debts	1,400			
	Wages	2,000			
	Freight	2,500			
	Salary and other expenses	4,000			
	To Stock Shortage A/c (Note 3)	1,800			
	To General Profit and Loss A/c (Net profit)	10,700			
		24,000			24,000

Working Notes :

(1) Goods are sent to branch at cost plus $33^1/_3$%. Cost of goods sent to branch = ₹ 72,000. Therefore, invoice price of goods sent to branch = ₹ 72,000 + (1/3 of ₹ 72,000) = ₹ 72,000 + ₹ 24,000 = ₹ 96,000.

(2) Calculation of Stock Shortage

		₹
Opening Stock (at invoice price)	24,000	
Add: Goods sent to Branch (at invoice price)	96,000	
Add: Goods returned by the customers	4,000	1,24,000
Less: Goods returned by branch	4,000	
Less: Cash sales	20,000	
Less: Credit sales	80,000	1,04,000
Stock that should have been at the branch at invoice price		20,000
Actual stock at branch at invoice price (Note 4)		17,600
Shortage of Stock at Invoice Price		2,400

(3) Cost price of stock shortage ₹ 1,800 will be charged to Branch Profit and Loss Account because it is normal in nature.

(4) Invoice price of closing stock = ₹ 13,200/100 × 133.33 = ₹ 17,600.

Sale of Goods Above / Below Invoice Price

Sometimes goods may be sold by the branch below or above the invoice price as a matter of policy, for example, cash sales at invoice price but credit sales at 10% above invoice price. In such a situation, the Branch Stock Account does not balance. For adjusting excess/short amount realised over the invoice price, the following entries are passed:

(i) *When goods are sold above invoice price*

Branch Stock Account Dr. [Difference between actual selling price and invoice price]

To Branch Adjustment Account

(ii) *When goods are sold below invoice price*

Branch Adjustment Account Dr. [Difference between invoice price and actual selling price]

To Branch Stock Account

Illustration 31

B. Ltd., Bombay has a branch in Calcutta. Goods are sent to Branch at cost plus 50% (all figures in ₹):

Opening stock at branch at invoice price	6,00,000	Debtors paid during the year	11,00,000
Opening debtors at branch	2,00,000	Stock shortage (detected at the end of the year) at invoice price	60,000
Goods received by branch during the year	18,00,000		
Goods in transit to branch (opening) at invoice price	30,000	Goods returned by branch during the year (invoice price)	90,000
Cash sales during the year (₹ 30,000 below invoice price)	6,30,000	Bad debts written-off	20,000
Credit sales during the year (₹ 75,000 above invoice price)	12,00,000	Branch expenses	40,000

From the above information, you are required to prepare: Branch Stock Account; Branch Adjustment Account and Branch Profit and Loss Account for the year ended 31st December, 2017. (You may assume that there is stock in transit at the year-end).

Solution

In the books of B Ltd.

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Cash sales)	6,30,000
	at branch	6,00,000		By Branch Adjustment A/c (Note 2)	30,000
	in-transit	30,000		By Branch Debtors A/c	12,00,000
Dec. 31	To Goods Sent to Branch A/c (Note 1)	17,70,000		By Shortage in Stock A/c (Note 4)	60,000
	To Branch Adjustment A/c (Note 3)	75,000		By Goods Sent to Branch A/c	90,000
				By Balance c/d (Balancing figure)	4,65,000
		24,75,000			24,75,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Branch Stock A/c (Note 2)	30,000	2017 Dec. 31	By Branch Stock A/c (Note 3)	75,000
	To Shortage-in-Stock A/c	20,000		By Stock Reserve A/c (Note 5)	2,10,000
	To Stock Reserve A/c (Note 7)	1,55,000		By Goods Sent to Branch A/c (Note 6)	5,60,000
	To Gross Profit c/d	6,40,000			
		8,45,000			8,45,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Branch Expenses A/c:		2017 Dec. 31	By Gross Profit b/d	6,40,000
	Bad debts	20,000			
	Cash expenses	40,000			
	To Shortage-in-Stock A/c (Loading)	40,000			
	To General Profit & Loss A/c	5,40,000			
		6,40,000			6,40,000

Working Notes:

(1) Goods received by branch during the year is ₹ 18,00,000. It includes ₹ 30,000 opening stock in transit. Therefore, actual goods sent to branch during the year is ₹ 18,00,000 – ₹ 30,000 = ₹ 17,70,000.

(2) For sale of goods ***below*** invoice price, Branch Adjustment Account is debited and Branch Stock Account is credited.

(3) For sale of goods ***above*** invoice price, Branch Stock Account is debited and Branch Adjustment Account is credited.

(4) Loading of shortage in stock is debited to Branch Adjustment Account and "cost" is debited to Branch Profit and Loss Account. Loading of shortage-in-stock = 1/3 of ₹ 60,000 = ₹ 20,000 and Cost = ₹ 60,000 – ₹ 20,000 = ₹ 40,000.

(5) Loading on opening stock including goods-in-transit = 1/3 of ₹ (6,00,000 + 30,000) = ₹ 2,10,000.

(6) Loading on net goods sent to branch during the year = 1/3 of ₹ (17,70,000 – 90,000) = ₹ 5,60,000.

(7) Loading on closing stock = 1/3 of ₹ 4,65,000 = ₹ 1,55,000.

Illustration 32

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 31.12.2010 :

Stock on 1st 1.1.2010 (at invoice price)		2,400	Cash received from debtors	17,127
Debtors on 1.1.2010		2,000	Expenses at branch	3,473
Goods received from H.O. (at invoice price)		26,400	Remittance to H.O.	24,000
Goods returned to H.O.		200	Debtors on 31.12.2010	4,873
Sales —	Cash	9,200	Stock on 31.12.2010	3,520
	Credit	20,000		

[C.U.B.Com. (Hons.) — 2011]

Solution

In the books of White Ltd.

Dr. Ranchi Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2010 Jan. 1	To Balance b/d	2,400	2010 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

Dr. Ranchi Branch Stock Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2010 Dec. 31	To Stock Reserve A/c (Note 6)	1,320	2010 Dec. 31	By Ranchi Branch Stock A/c (Note 1)	4,000
	To Gross Profit c/d	13,450		By Stock Reserve A/c (Note 4)	900
	[Transferred to Branch P/L A/c]			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%.

(3) 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 Profit and Loss Account. [***See next Illustration***]

(4) Loading on opening stock = 37.5% of ₹ 2,400 = ₹ **900**.

(5) Loading on goods sent to branch (net) : 37.5% of (26,400 – 200) = ₹ **9,825**.

(6) Loading on closing stock : 37.5% of ₹ 3,520 = ₹ **1,320**. **(7)** Expenses at branch of ₹ 3,473 will be charged to Branch P/L Account.

Illustration 33

Dara Stores Ltd. with its head office at Delhi, invoiced goods to its branch at Ghaziabad at 20% less than the list price which is cost plus 100%, with instructions that cash sales were to be made at invoice price and credit sales at catalogue price (i.e., list price).

From the following particulars available from the branch, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account and Branch Debtors Account for the year ending 31st December, 2017. (figures in ₹)

Stock on 1st January 2017 (invoice price)			6,000	Cash received from debtors	42,817
Debtors on 1st January 2017			5,000	Expenses at branch	8,683
Goods received from head office (invoice price)			66,000	Debtors on 31st December 2017	12,183
Sales —	Cash	23,000		Stock on 31st December 2017 (invoice price)	8,800
	Credit	50,000	73,000	Remittances to head office	60,000

Solution

In the books of Dara Stores Ltd.

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	6,000	2017 Dec. 31	By Bank A/c (Cash sales)	23,000
Dec. 31	To Goods Sent to Branch A/c	66,000		By Branch Debtors A/c	50,000
	To Branch Adjustment A/c (Note 1)	10,000		By Shortage-in- Stock A/c (Note 2)	200
				By Balance c/d	8,800
		82,000			82,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Shortage-in-Stock A/c (Note 2)	75	2017 Dec. 31	By Branch Stock A/c (Note 1)	10,000
	To Stock Reserve A/c (Note 5)	3,300		By Stock Reserve A/c (Note 3)	2,250
	To Gross Profit c/d	33,625		By Goods Sent to Branch A/c (Note 4)	24,750
		37,000			37,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Dec.31	To Branch Expenses A/c	8,683	2017 Dec. 31	By Gross Profit b/d	33,625
	To Shortage-in-stock A/c (Cost)	125			
	To General Profit & loss A/c	24,817			
		33,625			33,625

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d	5,000	2017 Dec. 31	By Bank A/c	42,817
Dec. 31	To Branch Stock A/c	50,000		By Balance c/d	12,183
		55,000			55,000

Working Notes:

(1) Let the 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 x 100 = 20% of list price.
Goods sold on credit = ₹ 50,000. Amount charged in excess of invoice price = 20% of list price, i.e., 20% of ₹ 50,000 = ₹ 10,000.

(2) If cost is ₹ 100 then invoice price is ₹ 160. Therefore, loading on invoice price = 60/160 x 100 = 37.5%.
Loading on shortage = 37.5% of ₹ 200 = ₹ 75. Cost = ₹ 200 – ₹ 75 = ₹ 125.

(3) Loading on opening stock = 37.5% of ₹ 6,000 = ₹ 2,250.

(4) Loading on goods sent to branch = 37.5% of ₹ 66,000 = ₹ 24,750.

(5) Loading on closing stock = 37.5% of ₹ 8,800 = ₹ 3,300.

Final Accounts System

The head office may also prepare a Memorandum Branch Trading and Profit and Loss Account to find out the profit or loss of a branch, apart from preparing the Branch Account. Here, the Trading and Profit and Loss Account is prepared in the usual manner, after converting all figures at cost price. The reason for preparing the Memorandum Trading and Profit and Loss Account is to have full information of all transactions which are ignored in ***Debtors System*** (discussed earlier).

The following points are important:

(1) All items of Trading and Profit and Loss Account are to be converted into cost price. (if these are given at invoice price).

(2) Branch Account will be of a Personal Account in nature. It will show only the mutual transactions between head office and branch. The balance of Branch Account is nothing but net assets of the branch at the end of the accounting year.

(3) Branch Trading and Profit and Loss Account is merely a Memorandum Account and, therefore, the entries made therein do not have any double-entry effect. The only object of this account is to disclose profit made or loss incurred by the branch.

Illustration 34

B Co. having its head office at Bombay has a branch at Calcutta. You are given the following particulars relating to the Calcutta Branch for the year ending 31.12.2017: (all figures in ₹)

Stock at branch on 1.1.2017	15,700	Petty cash at branch on 1.1.2017	110
Goods sent to branch during 2017	45,600	Goods returned by branch	3,900
Total sales at branch (including ₹ 19,700 for cash sales)	73,300	Cash sent to branch for expenses:	
Cash received from debtors	52,200	Salary : ₹ 12,800; Petty Cash : ₹ 2,600; Rent : ₹ 3,000	
Branch debtors on 1.1.2017	16,900	Stock at branch on 31.12.2017	18,800
		Petty cash at branch on 31.12.2017	90

Prepare Calcutta Branch Account and Memorandum Branch Trading and Profit and Loss Account in the head office books.

Solution

In the books of B Co.
Calcutta Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Cash sales)	19,700
	Stock	15,700		By Bank A/c (Cash collected from Debtors)	52,200
	Debtors	16,900		By Goods Sent to Branch A/c	3,900
	Petty cash	110		By Balance c/d:	
Dec. 31	To Goods Sent to Branch A/c	45,600		Stock	18,800
	To Bank A/c (Remittance):			Debtors (Note 1)	18,300
	Salary	12,800		Petty Cash	90
	Petty Cash	2,600			
	Rent	3,000			
	To General Profit & Loss A/c	16,280			
		1,12,990			1,12,990

Memorandum Branch Trading and Profit & Loss Account
For the year ended 31st December, 2017

Dr. Particulars		₹	Particulars	Cr. ₹
To Opening stock		15,700	By Sales — Cash	19,700
To Goods Sent to Branch A/c	45,600		Credit	53,600
Less: Returned to H.O.	3,900	41,700	By Closing Stock	18,800
To Gross Profit c/d		34,700		
		92,100		92,100
To Salaries		12,800	By Gross Profit b/d	34,700
To Rent		3,000		
To Branch Expenses (Note 2)		2,620		
To General Profit & Loss A/c		16,280		
		34,700		34,700

Working Notes :

(1) Branch Debtors Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d	16,900	2017 Dec. 31	By Bank A/c (Collection)	52,200
	To Sales A/c (Credit)	53,600		By Balance c/d	18,300
		70,500			70,500

(2) Petty Cash Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d	110	2017 Dec. 31	By Branch Expenses A/c (Bal. Figure)	2,620
	To Bank A/c (Remittances)	2,600		By Balance c/d	90
		2,710			2,710

Tutorial Note : The students should note that the profit disclosed by the Branch Account and Branch Trading and Profit and Loss Account will be the same.

Ilustration 35

A Calcutta merchant has a branch at Delhi to which he charges out the goods at cost plus 25%. The Delhi branch keeps his own sales ledger and transmits all cash received to the head office every day. All expenses are paid from the head office. The transactions for the Branch were as follows: (all figures in ₹)

Stock on 1.1.2017	22,000	Allowances to customers	500
Debtors on 1.1.2017	200	Returns inward	1,000
Petty cash on 1.1.2017	200	Cheques sent to branch:	
Cash sales	5,300	Rent : ₹ 1,200; Wages : ₹ 400; Salaries : ₹ 1,800	
Goods sent to branch	40,000	Stock on 31.12.2017	26,000
Collections on ledger accounts	42,000	Debtors on 31.12.2017	4,000
Goods returned to head office	600	Petty cash on 31.12.2017 (including miscellanous income	250
Bad debts	600	not remitted ₹ 50)	

Prepare the Branch Account and the Branch Trading and Profit and Loss Account for the year ending 31.12.2017 in the head office books.

Solution

In the books of Head Office
Delhi Branch Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Cash sales)	5,300
	Stock	22,000		By Bank A/c (Collections)	42,000
	Debtors	200		By Goods Sent to Branch A/c (Returns)	600
	Petty cash	200		By Stock Reserve A/c (Note 1)	4,400
Dec. 31	To Goods Sent to Branch A/c	40,000		By Goods Sent to Branch A/c (Note 2)	7,880
	To Bank A/c (Remittances)			By Balance c/d:	
	Rent	1,200		Stock	26,000
	Wages	400		Debtors	4,000
	Salaries	1,800		Petty cash	250
	To Stock Reserve A/c	5,200			
	To General Profit & Loss A/c	19,430			
		90,430			90,430

Dr. **Delhi Branch Trading and Profit & Loss Account** **Cr.**
For the year ended 31st December, 2017

Particulars		₹	Particulars		₹
To Opening Stock (₹ 22,000 – ₹ 4,400)		17,600	By Sales:		
To Goods sent to Branch (Cost)	32,000		Cash	5,300	
Less: Returns to H.O. (Cost)	480	31,520	Credit	47,900	
To Wages		400		53,200	
To Gross Profit c/d		23,480	Less: Returns Inward	1,000	52,200
			By Closing Stock ₹ (26,000 – 5,200)		20,800
		73,000			73,000
To Rent		1,200	By Gross Profit b/d		23,480
To Salaries		1,800	By Miscellaneous Income		50
To Bad Debts		600			
To Allowances to Customers		500			
To General Profit & Loss A/c		19,430			
		23,530			23,530

Tutorial Note: At the time of preparing Branch Trading and Profit and Loss Account, all figures should be converted into cost.
Working Notes :
(1) 25 / 125 x ₹ 22,000 = ₹ 4,400.
(2) 25 / 125 x ₹ (40,000 – 600) = ₹ 7,880.

Illustration 36

M/s. Ayaram Gayaram, Cuttack started on April 1, 2017, two branches at Berhampur and Nagpur. All goods sold at the branches are received from the head office invoiced at cost plus 25%. All expenses relating to the branches are paid by the head office. Each branch has its own sales ledger and sends weekly statements. All cash collections are remitted daily to the head office by the branches.

The following particulars relating to the half-year ending September 30, 2017 have been extracted from the weekend statements sent by the branches: (all figures in ₹)

	Berhampur	Nagpur		Berhampur	Nagpur
Credit sales	1,25,200	1,10,000	Bad debts	6,000	—
Cash sales	78,600	85,200	Salaries	16,000	18,000
Sales returns	2,300	1,200	General expenses	2,600	1,500
Sundry Debtors	34,500	23,600	Goods received from H.O.	1,50,000	1,25,000
Rent and Taxes	3,200	4,500	Advertisement	7,500	5,200
			Stock on September 30, 2017	45,000	35,000

You are required to prepare the Branch Accounts as they would appear in the books of the head office, showing the profit or loss for the period and the Trading and Profit and Loss Account separately for each branch.

Solution **In the books of Messrs. Ayaram Gayaram**
Dr. **Branch Account** **Cr.**

Date	Particulars	Berhampur	Nagpur	Date	Particulars	Berhampur	Nagpur
2017 Apr. 1	To Goods Sent to Branch A/c	1,50,000	1,25,000	2017 Sept. 30	By Bank A/c (Cash sales)	78,600	85,200
Sept. 30	To Bank A/c (Remittances):				By Bank A/c (Note 1)	82,400	85,200
	Rent and taxes	3,200	4,500		By Goods Sent to Br. A/c (Note 2)	30,000	25,000
	Salaries	16,000	18,000		By Balance c/d:		
	General expenses	2,600	1,500		Stock	45,000	35,000
	Advertisement	7,500	5,200		Debtors	34,500	23,600
	To Stock Reserve A/c (Note 3)	9,000	7,000				
	To General Profit & Loss A/c	82,200	92,800				
		2,70,500	2,54,000			2,70,500	2,54,000

Dr. **Branch Trading and Profit & Loss Account for the 6 months ended 30th September, 2017** **Cr.**

Particulars	Berhampur	Nagpur	Particulars	Berhampur	Nagpur
To Goods Sent to Br. A/c (Note 4)	1,20,000	1,00,000	By Sales: Cash	78,600	85,200
To Gross Profit c/d	1,17,500	1,22,000	Credit	1,25,200	1,10,000
				2,03,800	1 95,200
			Less: Sales returns	2,300	1,200
				2,01,500	1,94,000
			By Closing Stock (Note 3)	36,000	28,000
	2,37,500	2,22,000		2,37,500	2,22,000

To Rent & taxes	3,200	4,500	By Gross Profit b/d	1,17,500	1,22,000
To Bad debts	6,000	—			
To Salaries	16,000	18,000			
To General expenses	2,600	1,500			
To Advertisement	7,500	5,200			
To General Profit & Loss A/c	82,200	92,800			
	1,17,500	1,22,000		1,17,500	1,22,000

Working Notes :

Dr. **(1) Branch Debtors Account** **Cr.**

Date	Particulars	Berhampur	Nagpur	Date	Particulars	Berhampur	Nagpur
2017 Sept. 30	To Sales (credit)	1,25,200	1,10,000	2017 Sept. 30	By Sales returns	2,300	1,200
					By Bad Debts	6,000	—
					By Bank A/c (balancing figure)	82,400	85,200
					By Balance c/d	34,500	23,600
		1,25,200	1,10,000			1,25,200	1,10,000

(2) Goods are sent to branch at cost plus 25%. If the cost price is ₹ 100, then profit is ₹ 25 and invoice price is ₹ 125. Therefore, loading on invoice price 25/125 is 20% of invoice price. Loading for Berhampur = 1/5 of ₹ 1,50,000 = ₹ 30,000 and loading for Nagpur = 1/5 of ₹ 1,25,000 = ₹ 25,000.

(3) Loading on closing stock :
Berhampur = 1/5 of ₹ 45,000 = ₹ 9,000 and
Nagpur = 1/5 of ₹ 35,000 = ₹ 7,000.

(4) Cost of goods sent to Branch :
Berhampur = (₹ 1,50,000 – ₹ 30,000) = ₹ 1,20,000; and
Nagpur = (₹ 1,25,000 – ₹ 25,000) = ₹ 1,00,000.

(5) Cost of closing stock :
Berhampur = (₹ 45,000 – ₹ 9,000) = ₹ 36,000; and
Nagpur = (₹ 35,000 – ₹ 7,000) = ₹ 28,000.

Wholesale and Retail Profit at Branch

Sometimes, the head office (particularly, the manufacturing concern) sells goods to actual consumers through its retail shops. In this case, the head office sends goods to the branches at wholesale prices which is cost plus a percentage of profit. The branch is likely to sell those goods at ***retail prices which is more than the wholesale prices***. The real profit earned by the branch is the difference between the retail price and the wholesale price. ***For example***, the cost price of an article is ₹ 100, the wholesale price, ₹ 160 and the retail price, ₹ 180. If an article is sold by the branch, the actual profit is ₹ 180 – ₹ 100 = ₹ 80 but the branch's real profit is ₹ 180 – 160 = ₹ 20.

This system is followed when ***a branch is treated as a profit centre***. The real cost of the branch is the wholesale price of the goods sent. But, we must remember that wholesale prices are fixed above cost. Therefore, if all the goods that have been sent to branch are sold, no problem is created. The real problem arises when a part of the stock remains unsold, which includes an element of profit made by the head office. To calculate actual profit earned, the value of unsold stock lying with the branch to be reduced from ***wholesale prices to cost prices***.

The following Journal Entry is passed at the year-end:

Profit & Loss Account (head office) Dr. [wholesale price — cost]
    To Stock Reserve Account

In the Balance Sheet, branch stock is shown after deducting stock reserve.

At the beginning of the next year, a reverse entry is passed, i.e.,

Stock Reserve Account Dr.
    To Profit and Loss Account [Head office]

The students should note the following important points:

1. Branch Trading Account is debited with the opening stock (if any) at invoice price (wholesale price).
2. Branch Trading Account is also debited with the goods sent to branch (net) at invoice price (wholesale price).
3. Branch Trading Account is credited with the retail price of goods sold.
4. Branch Trading Account is also credited with closing stock at branch at invoice price (wholesale price).
5. The Head Office Trading Account will be debited by opening stock (if any, at cost), goods purchased etc., and will be credited by direct sales (generally at wholesale price) and goods sent to branch (net) at invoice prices (wholesale price). The closing stock (at cost) of head office is also credited to Head Office Trading Account.
6. If there is any closing stock lying at branch, a Stock Reserve Account is opened by debiting Profit and Loss Account (head office) and crediting Stock Reserve Account. The amount of stock reserve is the difference between ***wholesale price and cost price*** of head office.
7. If there is any opening stock lying at branch, Stock Reserve Account is debited and head office profit and loss is credited with the loading (i.e., wholesale price of opening *less* cost price of such goods).

Illustration 37

XYZ Ltd operates a number of retail shops. Goods are invoiced at wholesale price which is cost plus 25%. Shops sell the goods at the list price which is cost plus 100%.

From the following particulars, prepare:
(a) Branch Stock Account (at wholesale price); (b) Branch Profit and Loss Account; (c) Stock Reserve Account;
(d) An extract of head office Profit and Loss Account.

Particulars:

Opening stock at shops ₹ 2,000; Goods sent to shops ₹ 8,00,000; Goods returned by shops ₹ 8,000; Goods sold at the shops ₹ 5,20,000; Goods returned by customers at the shop ₹ 20,000; Goods destroyed by fire (retail value) ₹ 6,400; Expenses at the shops ₹ 1,01,500.

Solution

In the books of XYZ Ltd.

Dr. — Branch Stock Account (at Wholesale Price) — Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,000		By Sales	5,20,000
	To Goods Sent to Shops	8,00,000		By Goods Sent to Shops (Returned)	8,000
	To Sales Returns	20,000		By Goods Destroyed by Fire (Note 2)	4,000
	To Gross Profit c/d (Note 1)	1,87,500		By Balance c/d	4,77,500
		10,09,500			10,09,500

Dr. — Branch Profit and Loss Account for the year ended . . . — Cr.

Particulars	₹	Particulars	₹
To Expenses at the Shops	1,01,500	By Gross Profit b/d	1,87,500
To Goods Destroyed by Fire (Note 2)	4,000		
To Net Profit (Transferred to H. O. Profit & Loss Account)	82,000		
	1,87,500		1,87,500

Dr. — Stock Reserve Account — Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Head Office Profit and Loss A/c (Transfer)	400		By Balance b/d (Note 3)	400
	To Balance c/d	95,500		By Head Office Profit and Loss A/c (Reserve required — Note 3)	95,500
		95,900			95,900

Dr. — Head Office Profit and Loss Account (Extract) for the year ended . . . — Cr.

Particulars	₹	Particulars	₹
To Stock Reserve (Note 3) (Reserve required for closing stock)	95,500	By Branch Profit and Loss A/c	82,000
		By Stock Reserve (Note 3) (Reserve on opening stock)	400

Working Notes:

(1) Calculation of Gross Profit

Particulars		₹
Cost Price		100
Add: Profit @ 25%		25
Wholesale Price	(A)	125
Cost Price		100
Add : Profit @ 100%		100
Retail Price	(B)	200
Gross Profit at the Shops (B – A)		75
Gross Profit = ₹ 5,00,000 x 75/200 = ₹ **1,87,500**.		

(2) Calculation of Wholesale Value of Goods Destroyed by Fire

Particulars
When retail value is ₹ 200 the wholesale value is ₹ 125
When retail value is Re 1 the wholesale value is ₹ 125/200
When retail value is ₹ 6,400 the wholesale value is ₹ 125/200 x ₹ 6,400 = ₹ 4,000

(3) Calculation of Stock Reserve

On opening stock = ₹ 2,000 x 25/125 = ₹ 400
On closing stock = ₹ 4,77,500 x 25/125 = ₹ 95,500

(4) Wholesale retail branch is treated as independent profit center. Therefore, goods destroyed by fire has been charged to wholesale branch profit and loss account

Illustration 38

Rahul Ltd operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.1997 (all figures in ₹) :

Stock at the outlet (1.4.1996)	30,000	Goods lost by fire	?
Goods invoiced to the outlet during the year	3,24,000	Expenses for the outlet for the year	20,000
Gross profit made by the outlet	60,000	Stock at the outlet (31.3.1997)	36,000

You are required to prepare the following accounts in the books of Rahul Ltd for the year ended 31.3.1997:

(a) Outlet Stock Account; (b) Outlet Profit and Loss Account; (c) Stock Reserve Account. ***[C.A. (Inter) — May 1997]***

Solution

In the books of Rahul Ltd

Dr. Outlet Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.1996	To Balance b/d	30,000	?	By Sales (Note 1)	3,60,000
?	To Goods Sent to Outlet	3,24,000	?	By Goods Lost by Fire (Note 2)	18,000
31.3.1997	To Gross Profit c/d	60,000	31.3.1997	By Balance c/d	36,000
		4,14,000			4,14,000

Dr. Outlet Profit and Loss Account for the year ended 31st March, 1997 Cr.

Particulars	₹	Particulars	₹
To Expenses of the Outlet	20,000	By Gross Profit b/d	60,000
To Goods Lost by Fire	18,000		
To Net Profit (Transferred to H. O. Profit & Loss A/c)	22,000		
	60,000		60,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.1997	To Head Office Profit and Loss A/c (Transfer)	6,000	1.4.1996	By Balance b/d (Note 3)	6,000
	To Balance c/d	7,200	31.3.1997	By Head Office Profit and Loss A/c (Reserve required — Note 3)	7,200
		13,200			13,200

Working Notes:

(1) Calculation of Sales

Particulars		₹
Cost Price		100
Add: Profit @ 25%		25
Wholesale Price	(A)	125
Wholesale Price		125
Add : Profit @ 20%		25
Retail Price	(B)	150
Gross Profit at the Outlet (B – A)		25
Retail Sales Value = ₹ 60,000 x 150/25 = ₹ **3,60,000**		

(2) Goods Lost by Fire at Wholesale Value

Particulars	₹
Opening Stock	30,000
Add: Goods Sent to Outlet	3,24,000
Add: Gross Profit	60,000
	4,14,000
Less: Sales	3,60,000
	54,000
Less: Closing Stock	36,000
	18,000

(3) Calculation of Stock Reserve : On opening stock = ₹ 30,000 × 25/125 = ₹ **6,000**.
On closing stock = ₹ 36,000 × 25/125 = ₹ **7,200**.

Illustration 39

White Ltd. has a retail branch at Gurgaon. Goods are sold on 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Calcutta head office to Gurgaon branch at wholesale price. From the following particulars, ascertain the profit made at head office and branch for the year ended 31.12.2017:

	H.O. (₹)	Branch (₹)		H.O. (₹)	Branch (₹)
Stock on 1.1.2017	1,75,000	—	Expenses (Selling)	56,000	7,000
Purchases	10,50,000	—	Sales	10,71,000	3,50,000
Goods sent (invoice price)	3,78,000	—	Stock on 31.12.2017	4,20,000	63,000

Solution

Dr. **Trading and Profit and Loss Account** **Cr.**

For the year ended 31st December, 2017

Particulars	Head Office	Gurgaon	Particulars	Head Office	Gurgaon
To Opening Stock	1,75,000	—	By Sales	10,71,000	3,50,000
To Purchases	10,50,000	—	By Goods Sent to Branch	3,78,000	—
To Goods Sent to Branch	—	3,78,000	By Closing Stock	4,20,000	63,000
To Gross Profit c/d	6,44,000	35,000			
	18,69,000	4,13,000		18,69,000	4,13,000
To Expenses (Selling)	56,000	7,000	By Gross Profit b/d	6,44,000	35,000
To Stock Reserve (Note 1)	18,000	—			
To Net Profit	5,70,000	28,000			
	6,44,000	35,000		6,44,000	35,000

Working Note: **(1)** Goods sent to branch at invoice price should be treated as sale of the head office. Some of the goods are still unsold at the branch. For calculating actual profit of the head office, a stock reserve is to be created by debiting head office Profit and Loss Account. The amount of loading will be 40 / 140 x ₹ 63,000 = ₹ 18,000.

Illustration 40

A head office sends goods to its branch at 20% less than list price, i.e., catalogue price. Goods are sold to consumers at cost plus 100%. From the following particulars, ascertain the profit made at the head office and the branch on the wholesale basis for the year ended 31.12.2017:

	H.O. (₹)	Branch (₹)
Purchases	2,00,000	—
Goods sent to branch (at invoice price)	80,000	—
Sales	1,70,000	80,000

Assume that head office sells goods to customers at catalogue price.

Solution

Trading and Profit and Loss Account

Dr. **For the year ended 31st December, 2017** **Cr.**

Particulars	Head Office	Branch	Particulars	Head Office	Branch
To Purchases	2,00,000	—	By Sales	1,70,000	80,000
To Goods Sent to Branch	—	80,000	By Goods Sent to Branch	80,000	—
To Gross Profit c/d	1,15,000	16,000	By Closing Stock (Note 2)	65,000	16,000
	3,15,000	96,000		3,15,000	96,000
To Stock Reserve (Note 3)	6,000	—	By Gross Profit b/d	1,15,000	16,000
To Net Profit	1,09,000	16,000			
	1,15,000	16,000		1,15,000	16,000

Working Notes:

(1) Let cost price be ₹ 100, then catalogue price = Cost + 100%, of Cost, i.e., ₹ 200. Invoice price = catalogue price less 20% of catalogue price = ₹ 200 – ₹ 40 = ₹ 160.

(2) Valuation of Closing Stock at Head Office	₹	**(4) Valuation of Closing Stock at Branch**	₹
Cost of goods purchased	2,00,000	Goods received from H.O. at invoice price	80,000
Less: Cost of goods sold to customers	85,000	Less: Invoice price of goods sold (160/200 x ₹ 80,000)	64,000
(100/200 x ₹ 1,70,000)		Invoice price of goods unsold	16,000
	1,15,000		
Less: Cost of goods sent to branch (100/160 x ₹ 80,000)	50,000		
Cost of goods unsold	65,000		

(3) Stock reserve for goods unsold at branch = 60/160 x ₹ 16,000 = ₹ 6,000

Illustration 41

A head office invoices goods to its branch at 20% less than the list price (i.e. catalogue price). Goods are sold to customers at cost plus 100%. From the following particulars, ascertain the profit made at the head office and the branch on the wholesale basis for the year ended 31st December 2017.

	H.O. (₹)	Branch (₹)		H.O. (₹)	Branch (₹)
Opening Stock at cost (at I.P. for Branch)	40,000	16,000	Sales	6,00,000	80,000
Purchases	4,00,000	—	Expenses	86,000	4,000
Goods sent to branch at invoice price	96,000	—			

Assume that head office sells goods to customers at catalogue price.

Solution **Trading and Profit and Loss Account**

Dr. **For the year ended 31st December, 2017** **Cr.**

Particulars	Head Office	Branch	Particulars	Head Office	Branch
To Opening Stock	40,000	16,000	By Sales	6,00,000	80,000
To Purchases	4,00,000	—	By Goods Sent to Branch	96,000	—
To Goods Sent to Branch	—	96,000	By Closing Stock (Note 2)	80,000	48,000
To Gross Profit c/d	3,36,000	16,000			
	7,76,000	1,28,000		7,76,000	1,28,000
To Expenses	86,000	4,000	By Gross Profit b/d	3,36,000	16,000
To Stock Reserve (Note 3)	18,000	—	By Stock Reserve (Note 4)	6,000	—
To Net Profit	2,38,000	12,000			
	3,42,000	16,000		3,42,000	16,000

Working Notes:

(1) Let the cost price be ₹ 100, then ***catalogue price*** = cost plus 100% of cost = ₹ 100 + ₹ 100 = ₹ 200. ***Invoice price*** = catalogue price less 20% of catalogue price = ₹ 200 – ₹ 40 = ₹ 160.

(2) Valuation of Closing Stock at Head Office	₹	(3) Valuation of Closing Stock at Branch	₹
Opening stock at cost	40,000	Opening stock at invoice price	16,000
Add: Purchases	4,00,000	Add: Goods sent to branch	96,000
	4,40,000		1,12,000
Less: Cost of goods sold to customers (100/200 x ₹ 6,00,000)	3,00,000	Less: Invoice price of goods sold (160/200 x ₹ 80,000)	64,000
	1,40,000	Invoice price of goods unsold	48,000
Less: Cost of goods sent to branch (100 / 160 x ₹ 96,000)	60,000		
Cost of goods unsold	80,000		

(3) Stock reserve for goods unsold at branch = 60/160 × ₹ 48,000 = ₹ 18,000.

(4) Stock reserve for opening a stock at branch = 60/160 × ₹ 16,000 = ₹ 6,000.

Illustration 42

P K Co Ltd with their head office at Calcutta, invoiced goods to their Bombay Branch at invoice price. The invoice price is 20% less than list price, which is cost plus 100% with instruction that sales are made at list price. From the following particulars, ascertain the profit earned by the head office and branch :(all figures in ₹)

	H.O.	Branch		H.O.	Branch
Opening Stock	40,000	32,000	Goods received from H.O. at invoice price	—	96,000
Purchases	2,00,000	—	Sales	1,70,000	80,000
Goods Sent to Branch at Cost Price	62,500	—	Trade expenses	14,000	8,000

Stocks at head office are valued at cost price but those of branch are valued at invoice price.

[C.U.B.Com. (Hons) — 1994; Same as C.U.B.Com. — 2011]

Solution

P K Co Ltd

Dr. Trading and Profit and Loss Account for the year ended . . . Cr.

Particulars	Head Office (₹)	Bombay Branch (₹)	Particulars	Head Office (₹)	Bombay Branch (₹)
To Opening Stock	40,000	32,000	By Sales	1,70,000	80,000
To Purchases	2,00,000	—	By Goods Sent to Branch	1,00,000	—
To Goods Sent to Branch	—	1,00,000	By Goods-in-Transit (Note 7)	—	4,000
To Gross Profit c/d	1,22,500	16,000	By Closing Stock (Note 2 & 3)	92,500	64,000
	3,62,500	1,48,000		3,62,500	1,48,000
To Trade Expenses	14,000	8,000	By Gross Profit b/d	1,22,500	16,000
To Stock Reserve (Note 5)	25,500	—	By Stock Reserve (Note 4)	12,000	—
To Net Profit	95,000	8,000			
	1,34,500	16,000		1,34,500	16,000

Working Notes:

(1) Let the cost price be ₹ 100,then list price = Cost *plus* 100% of cost = (₹ 100 + 100) = ₹ **200.**
Invoice price = List price less 20% = ₹ 200 less ₹ 40 = ₹ **160.**

(2) Valuation of Closing Stock at Head Office

Particulars	₹
Opening Stock at cost	40,000
Add: Purchases	2,00,000
	2,40,000
Less: Cost of Goods Sold to Customers (100/200 x ₹ 1,70,000) (Note 6)	85,000
	1,55,000
Less: Cost of Goods Sent to Branch (Given)	62,.500
Cost of Goods Unsold	92,500

(3) Valuation of Closing Stock at Branch

Particulars	₹
Opening Stock at invoice price	32,000
Add: Goods received from Head Office at invoice price	96,000
	1,28,000
Less: Invoice price of goods sold (160/200 x ₹ 80,000)	64,000
Invoice Price of Goods Unsold	64,000

(4) Stock reserve for opening stock = 60/160 × ₹ 32,000	₹ 12,000
(5) Stock reserve for closing stock = 60/160 × ₹ 64,000	₹ 24,000
Stock reserve for stock-in-transit = 60/160 × ₹ 4,000	₹ 1,500
Total	₹ 25,500

(6) It is assumed that head office sells goods to customers at list price.

(7) Invoice price of goods sent by head office = ₹ 62,500 / 100 × 160	₹ 1,00,000
Invoice price of goods received by branch	₹ 96,000
Goods-in-Transit (at invoice price)	₹ 4,000

Illustration 43

The following is the Trial Balance of Wood Crafts Limited at 31st December, 2017.

Heads of Account	Head Office Dr (₹)	Head Office Cr (₹)	Branch Dr (₹)	Branch Cr (₹)
Share Capital : authorised, issued and paid-up 50,000 Shares of Re 1 each, fully paid	—	50,000	—	—
Branch Fixtures	600	—	—	—
Head Office Remittances	—	—	21,266	—
Purchases	49,218	—	—	—
Goods to Branch	—	25,092	—	—
Head Office Stock, 1st Jan., 2017	9,846	—	—	—
Branch Office Stock, 1st Jan., 2017 (at wholesale price)	5,844	—	—	—
Head Office Fixed Assets	49,266	—	—	—
Trade Debtors	17,280	—	1,425	—
Head Office	—	—	—	1,190
Sales	—	74,562	—	24,042
Branch Purchases	25,092	—	—	—
Trade Creditors	—	6,080	—	—
Branch Remittances	—	21,266	—	—
Cash at Bank	18,210	—	200	—

Cash on Hand	50	—	10	—
Profit and Loss Account	—	25,400	—	—
Branch	1,190	—	—	—
Sundry Expenses (Head Office)	26,584	—	—	
Sundry Expenses (Branch)	1,168	—	2,331	—
Branch Stock Adjustment A/c	—	1,948	—	—
TOTAL	2,04,348	2,04,348	25,232	25,232

Head office supplies the branch with all the goods required and these are charged out at retail selling price, which is cost plus 100 per cent. At the end of the year an adjustment is made to reduce the price charged to the wholesale price, which is cost plus 50 per cent. Books are kept at the branch to record sales and certain cash transactions. All cash received by the branch is paid to the bank for credit of head office, but the branch has a local Bank Account, worked on an impress, for the payment of sundry expenses, the remittances being made monthly by head office.

The value of stocks on hand on 31st December, 2017 were :

Head office ₹ 9,460 and Branch (at retail selling price) ₹ 9,200.

From the above, prepare a columnar Trading and Profit and Loss Account for the year ended 31st December, 2017.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Head Office (₹)	Branch (₹)	Particulars	Head Office (₹)	Branch (₹)
To Opening Stock	9,846	5,844	By Sales	74,562	24,042
To Purchases	49,218	—	By Goods to Branch A/c (Note 1)	18,819	—
To Goods from Head Office (Note 1)	—	18,819	By Closing Stock (Note 2)	9,460	6,900
To Gross Profit c/d	43,777	6,279			
	1,02,841	30,942		1,02,841	30,942
To Sundry Expenses (Note 3)	26,584	3,499	By Gross Profit b/d	43,777	6,279
To Branch Stock Adjustment A/c (Note 4)	2,300	—	By Branch Stock Adjustment A/c	1,948	—
To Net Profit	16,841	2,780			
	45,725	6,279		45,725	6,279

Working Notes:

(1) Goods Sent to Branch (at wholesale price)

Goods are charged to branch at retail price which is cost plus 100%. As per Trial Balance goods sent to branch (at retail price) is ₹ 25,092. The cost of these goods sent = ₹ 25,092/2 = ₹ 12,546. Wholesale price is cost plus 50%. Therefore, wholesale price of goods sent to branch = ₹ 12,546/100 × 150 = **₹ 18,819.**

(2) Closing Stock of Branch (at wholesale price)

Stock of branch (at retail selling price) is ₹ 9,200. Cost of goods at branch = ₹ 9,200/2 = ₹ 4,600. Therefore, wholesale price of stock at branch = ₹ 4,600/100 × 150 = **₹ 6,900**.

(3) Sundry expenses of the branch = ₹ 1,168 (charged by head office) + ₹ 2,331 = **₹ 3,499**.

(4) Branch stock adjustment = ₹ 6,900 (wholesale price) – ₹ 4,600 (cost price) = **₹ 2,300**.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 44

P Ltd. invoicing goods to its branch at cost. From the following particulars, prepare Branch Account for the year ended 31st March, 2016 in the books of the company :

	₹
Branch Stock on 1st April, 2015	30,000
Branch Stock on 31st March, 2016	36,000
Branch Debtors on 1st April, 2015	22,000
Branch Debtors on 31st March, 2016	30,800
Cost of goods sent to branch during the year	1,80,000

Sales at branch :		
Cash	90,000	
Credit	1,40,800	2,30,800
Cash received from branch debtors during the year		1,29,000
Branch expenses paid by head office :		
Salaries	1,200	
Rent	800	
Petty expenses	100	2,100
Bad Debt written-off		1,000
Discount allowed to branch debtors		2,000

[C.U.B.Com. (General) — 2017]

Solution

In the books of P Ltd. (H.O.)

Dr. Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
April 1	To Balance b/d		April 1	By Bank A/c :	
	Stock :	30,000		Cash Sales	90,000
	Debtors	22,000		Collection from Debtors	1,29,000
	To Cost of Goods Sent to Branch A/c	1,80,000		By Balance c/d :	
	To Bank A/c :			Stock	36,000
	Salaries	1,200		Debtors (Note 1)	30,800
	Rent	800			
	Petty Expenses	100			
	To General Profit and Loss A/c	51,700			
		2,85,800			2,85,800

Working Note :

Dr. (1) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
April 1	To Balance b/d	22,000	April 1	By Bank A/c	1,29,000
	To Sales	1,40,800		By Bad Debts A/c	1,000
				By Discount Allowed A/c	2,000
				By Balance c/d	30,800
		1,62,800			1,62,800

Illustration 45

From the following particulars, determine profits or losses of the branch :

	₹
Opening stock at the branch	30,000
Goods sent to the branch	90,000
Sales (Cash)	1,20,000
Salaries	10,000
Other expenses	4,000

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 net profit before charging such commission.

[C.U.B.Com. (General) — 2016, 2013]

Solution

Dr. Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d :			By Bank A/c :	
	Stock	30,000		Sales	1,20,000
	To Goods Sent to Branch A/c	90,000		By Balance c/d :	
	To Bank A/c :			Stock (Note 1)	20,000
	Salaries	10,000			
	Other Expenses	4,000			
	To Manager's Commission A/c (Note 3)	300			
	To General Profit and Loss A/c	5,700			
		1,40,000			1,40,000

Working Note :

(1) Calculation of Closing Stock

Let Cost = 100
Profit = 20
Selling Price = 120

Profit is 1/6 of the selling price ($\frac{20}{120}$)

Sales = ₹ 1,20,000. Therefore, profit = 1/6 of ₹ 1,20,000 = ₹ 20,000.

Cost of goods sold = Sales – Profit
= ₹ 1,20,000 – ₹ 20,000
= ₹ **1,00,000**

Closing Stock = Opening Stock + Goods sent to Branch – Cost of Goods sold
= ₹ 30,000 + 90,000 – 1,00,000
= ₹ **20,000**

(2) Net Profit before Branch Manager's Commission = ₹ (1,20,000 + 20,000) – (30,000 + 90,000 + 10,000 + 4,000)
= ₹ 1,40,000 – ₹ 1,34,000
= ₹ **6,000**

(3) Manager's Commission = 5% of Net Profit = 5% of ₹ 6,000 = ₹ **300**.

Illustration 46

From the following details, calculate Branch's Profit or Losses :

Opening Stock at the branch — ₹ 20,000; Goods sent to branch — ₹ 1,62,000; Sales — ₹ 2,00,000; Salaries — ₹ 20,000; Expenses — ₹ 10,000.

Closing Stock could not be ascertained, but it is known that the branch usually sells at cost plus 25%. The Branch manager is entitled to a commission of 4% on net profit after charging such commission.

C.U.B.Com. (General) — 2014]

Solution

Dr. **Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d :			By Bank A/c — Sales	2,00,000
	Stock	20,000		By Balance c/d :	
	To Goods Sent to Branch A/c	1,62,000		Stock (Note 1)	22,000
	To Bank A/c :				
	Salaries	20,000			
	Expenses	10,000			
	To Manager's Commission A/c (Note 3)	385			
	To General Profit and Loss A/c	9,615			
		2,22,000			2,22,000

Working Note :

(1) Calculation of Closing Stock

Let Cost = 100
Profit = 25
Selling Price = 125

Profit is 25/125 or 1/5 of the selling price

Sales = ₹ 2,00,000. Therefore, profit = ₹ 2,00,000 × 1/5 = ₹ 40,000.

Cost of goods sold = Sales – Profit
= ₹ 2,00,000 – ₹ 40,000
= ₹ **1,60,000**

Closing Stock = Opening Stock + Goods sent to Branch – Cost of Goods sold
= ₹ 20,000 + 1,62,000 – 1,60,000
= ₹ **22,000**

(2) Net Profit before Branch Manager's Commission

Sales	2,00,000	
Closing Stock	22,000	2,22,000
Less:		
Opening Stock	20,000	
Goods Sent to Branch	1,62,000	
Expenses	10,000	
Salaries	20,000	2,12,000
		10,000

(3) Branch Manager's Commission

Manager is entitled to commission @ 4% after charging such commission. Therefore, his commission = $\frac{10,000}{104} \times 4$ = ₹ **385 (approx.)**

Illustration 47

Kolkata head office send goods to its branch at Mumbai at cost plus 20%. From the following particulars, prepare (i) Branch Stock Account and (ii) Branch Stock Adjustment Account in the books of head office :

	₹
Opening stock at branch	9,600
Opening branch Debtors	3,00,000
Closing branch stock	16,800
Goods sent to branch (invoice price)	2,89,800
Total Sales	2,58,000
Cash Sales	1,38,000
Cash received from branch Debtors ₹	1,10,000.

[C.U.B.Com. (General) — 2012]

Solution

In the books of the H.O.

Branch Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	9,600		By Bank A/c (Cash Sales)	1,38,000
	To Goods Sent to Branch A/c	2,89,860		By Branch Debtors A/c	1,20,000
				By Branch Stock Adjustment A/c (Stock Shortage)	24,660
				By Balance c/d	16,800
		2,99,460			2,99,460

Branch Stock Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Stock A/c	24,660		By Stock Reserve A/c (Note 1)	1,600
	To Stock Reserve A/c (Note 3)	2,800		By Goods Sent to Branch A/c (Note 2)	48,310
	To General Profit and Loss A/c	22,450			
		49,910			49,910

Tutorial Note : There is no need to prepare Branch Debtors Account as it has not been asked in the Question.

Working Notes :

(1) Loading at Opening Stock

Goods are sent at cost plus 20%.

Let Cost = 100
Profit = 20
Invoice Price = 120

Loading = $\frac{20}{120} \times 9,600$ = ₹ **1,600**.

(2) Loading on Goods Sent to Branch

Goods sent to Branch = ₹ 2,89,860

Loading on Goods sent to Branch $\frac{20}{120} \times 2,89,860$ = ₹ **48,310**.

(3) Loading on Closing Stock

Closing Stock = ₹ 16,800

Loading on Closing Stock $\frac{20}{120} \times 16,800$ = ₹ **2,800**.

Illustration 48

Adino Ltd. has a branch at Delhi. Goods are invoiced to the branch at cost plus 25%. Branch remits all cash received to the head office and all expenses are paid by the head office. From the following particulars, prepare Branch Stock Account, Branch Debtors Account and Branch Profit and Loss Account in the books of head office :

	₹
Stock at branch on 1.1.2010 (Cost price)	64,000
Stock at branch on 31.12.2010 (Cost price)	80,000
goods sent to branch during the year (invoice price)	2,00,000
Branch Debtors on 1.1.2010	40,000
Branch Debtors on 31.12.2010	52,000
Cash received from Debtors	1,00,000

Cash Sales	50,000
Discount allowed to Debtors	4,800
Bad Debts written off	3,200
Goods returned by branch (invoice price)	5,000
Branch expenses	16,000

[C.U.B.Com. (General) — 2011]

Solution

In the books of Adino Ltd. (H.O.)

Branch Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Jan 1	To Balance b/d (Note 1)	80,000	Jan 1	By Bank A/c :	
	To Goods Sent to Branch A/c	2,00,000		Cash Sales	50,000
				Branch Debtors (Credit Sales)	1,20,000
				By Goods Sent to Branch A/c (Return)	5,000
				By Branch Adjustment A/c	5,000
				By Balance c/d (Note 2)	1,00,000
		2,80,000			2,80,000

Branch Adjustment Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Jan 1	To Branch Stock A/c (Shortage)	5,000	Jan 1	By Stock Reserve A/c (Note 1)	16,000
	To Stock Reserve A/c (Note 2)	20,000		By Goods Sent to Branch A/c (Loading)	39,000
	To Branch Profit and Loss A/c	30,000			
		55,000			55,000

Branch Profit and Loss Account

Dr. | **Cr.**

Particulars	₹	Particulars	₹
To Branch Expenses A/c		By Branch Adjustment A/c	30,000
Bad Debts	3,200		
Discount Allowed	4,800		
To Bank A/c (Branch Expenses)	16,000		
To General Profit and Loss A/c	6,000		
	30,000		30,000

Branch Debtors Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2010		
Jan 1	To Balance b/d	40,000	Jan 1	By Bank A/c	1,00,000
	To Branch Stock A/c (Credit Sales)	1,20,000		By Bad Debts A/c	3,200
				By Discount Allowed A/c	4,800
				By Balance c/d	52,000
		1,60,000			1,60,000

Working Notes :

(1) Goods are invoiced at cost plus 25%.

Let Cost = 100
Profit = 25
Invoice Price = 125

(2) Invoice Price of Opening Stock

	₹
Opening Stock (at cost)	64,000
Add: Loading @ 25%	16,000
	80,000

(2) Invoice Price of Closing Stock

Closing Stock (at cost)	80,000
Add: Loading @ 25%	20,000
	1,00,000

(3) Loading on Goods Sent to Branch (Net)

Invoice Price of Goods sent	2,00,000
Less: Invoice Price of Goods Returned	5,000
Net Goods Sent to Branch	1,95,000

Loading on Net Goods Sent = $\frac{25}{125} \times$ 1,95,000 = ₹ **39,000**.

[For Honours Candidates Only]

Illustration 49

Green Ltd. from its head office at Kolkata invoiced goods to their Delhi branch at invoice price with instruction to sell at list price. The invoice price is 20% less than the list price and the list price is cost plus 100%. From the following particulars, prepare necessary accounts to ascertain the profit earned by the head office and Delhi branch :

	Kolkata H.O. (₹)	Delhi Branch (₹)
Opening Stock	72,000	57,600
Purchase	3,60,000	—
Goods sent to Branch (at cost price)	1,12,500	—
Goods received from H.O. at invoice price	—	1,72,800
Sales	3,06,000	1,44,000
Salaries	20,000	12,400
Rent and Rates	5,200	2,000

Stock at head office are valued at cost price and those at Delhi branch are valued at invoice price.

[C.U.B.Com. (Hons.) — 2017]

Solution

Green Ltd

Dr. Trading and Profit and Loss Account for the year ended . . . Cr.

Particulars	Head Office (₹)	Bombay Branch (₹)	Particulars	Head Office (₹)	Bombay Branch (₹)
To Opening Stock	72,000	57,600	By Sales	3,06,000	1,44,000
To Purchases	3,60,000	—	By Goods Sent to Branch	1,80,000	—
To Goods Sent to Branch	—	1,80,000	By Goods-in-Transit (Note 7)	—	7,200
To Gross Profit c/d	2,20,500	28,800	By Closing Stock (Note 2 & 3)	1,66,500	1,15,200
	6,52,500	2,66,400		6,52,500	2,66,400
To Salaries	20,000	12,400	By Gross Profit b/d	2,20,500	28,800
To Rent and Rates	5,200	2,000	By Stock Reserve (Note 4)	21,600	—
To Stock Reserve (Note 5)	45,900	—			
To Net Profit	1,71,000	14,400			
	2,42,100	28,800		2,42,100	28,800

Working Notes:

(1) Let the cost price be ₹ 100, then list price = Cost *plus* 100% of cost = (₹ 100 + 100) = ₹ **200.**
Invoice price = List price *less* 20% = ₹ 200 less ₹ 40 = ₹ **160.**

(2) Valuation of Closing Stock at Head Office

Particulars	₹
Opening Stock at cost	72,000
Add: Purchases	3,60,000
	4,32,000
Less: Cost of Goods Sold to Customers (100/200 x ₹ 3,06,000)	1,53,000
	2,79,000
Less: Cost of Goods Sent to Branch (Given)	1,12,500
Cost of Goods Unsold	1,66,500

(3) Valuation of Closing Stock at Branch

Particulars	₹
Opening Stock at invoice price	57,600
Add: Goods received from Head Office at invoice price	1,72,800
	2,30,400
Less: Invoice price of goods sold (160/200 x ₹ 1,44,000)	1,15,200
Invoice Price of Goods Unsold	1,15,200

(4) Stock reserve for opening stock = 60/160 × ₹ 57,600 ₹ 21,600
(5) Stock reserve for closing stock = 60/160 × ₹ 1,15,200 ₹ 43,200
Stock reserve for stock-in-transit = 60/160 × ₹ 7,200 ₹ 2,700
Total ₹ 45,900
(6) It is assumed that head office sells goods to customers at list price.
(7) Invoice price of goods sent by head office = ₹ 1,12,500 / 100 × 160 ₹ 1,80,000
Invoice price of goods received by branch 1,72,800
Goods-in-Transit (at invoice price) 7,200

Illustration 50

Dark Ltd. with its head office at Delhi invoiced goods to its branch at Jaipur at cost plus $33^1/_3$%. From the following information, prepare Branch Stock Account and Branch Stock Adjustment Account in the books of the head office :

	₹
Stock at branch at invoice price on 1.4.2016	1,70,000
Stock at branch at invoice price on 31.3.2017	70,000
Goods received by branch during the year at cost price	8,25,000
Goods in-transit at invoice price on 31.3.2017	1,00,000
Goods returned by branch to head office at invoice price	40,000
Cash sales at branch	10,00,000
Credit sales	1,00,000
Invoice price of goods pilfered	10,000
Stock lost due to wastage	20,000

[C.U.B.Com. (Hons.) — 2017]

Solution

In the books of Dark Ltd. (H.O.)

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2017		
April 1	To Balance b/d	2,00,000	Mar 31	By Goods Sent to Branch (Returned) A/c	40,000
	To Goods Sent to Branch A/c (Note 1)	12,00,000		By Bank A/c :	
	To Branch Adjustment A/c	40,000		Cash Sales	10,00,000
	(Surplus over Invoice Price)			By Branch Debtors A/c	1,00,000
				By Goods Pilfered A/c	10,000
				By Shortage (Wastage) A/c	20,000
				By Goods-in-transit A/c	1,00,000
				By Balance c/d	1,70,000
		14,40,000			14,40,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016			2016		
April 1	To Goods Sent to Branch A/c (Note 4)	10,000	April 1	By Stock Reserve A/c (Note 2)	50,000
	To Stock Reserve A/c :			By Goods Sent to Branch A/c (Note 3)	3,00,000
	Goods-in-transit	25,000		By Branch Stock A/c (Surplus)	40,000
	Closing Stock	42,500			
	To Goods Pilfered A/c	10,000			
	To Shortage (Wastage) A/c	20,000			
	To Net Profit (Transferred to General Profit and Loss Account)	2,82,500			
		3,90,000			3,90,000

Working Notes :

(1) Calculation of Invoice Price of Goods Sent

Goods are sent at cost plus $33\,^1/_3$%.

Cost of Goods received by the Branch	8,25,000
Add: Loading $33^1/_3$%	2,75,000
	11,00,000
Add: Invoice Price of Goods-in-transit	1,00,000
Invoice Price of Goods Sent	12,00,000

(2) Loading on Opening Stock

Loading is $33^1/_3$% of cost price.

Let Cost = 100.00
Profit = 33.33
Selling Price = 133.33

Loading on Invoice Price = $\frac{33.33}{133.33} = \frac{1}{4}$

Loading on Opening Stock = 2,00,000 $\times \frac{1}{4}$ = **₹ 50,000**.

(3) Loading on Goods Sent

Invoice Price of Goods Sent = ₹ 12,00,000 (Note 1)

Loading on Goods Sent = 12,00,000 $\times \frac{1}{4}$ = ₹ **3,00,000**.

(4) Loading on Goods Returned

Invoice Price of Goods Returned = ₹ 40,000

Loading on Goods Returned = 40,000 $\times \frac{1}{4}$ = ₹ **10,000**.

(5) Loading on Goods-in-transit

Invoice Price of Goods-in-transit = ₹ 1,00,000

Loading on Goods-in-transit = 1,00,000$\times \frac{1}{4}$ = ₹ **25,000**.

(6) Loading on Closing Stock

Closing Stock = ₹ 1,70,000

Loading on Closing Stock = 1,70,000 $\times \frac{1}{4}$ = ₹ **42,500**.

Illustration 51 (a)

Magma Ltd. has its head office in Kolkata with a branch in Mumbai. Goods are invoiced to the branch at cost plus 25%, which is the selling price. From the following particulars for the year ended 31st March, 2016, prepare Branch Stock Account, Branch Debtors Account and Branch Stock Adjustment Account as they would appear in the books of the Head Office :

	₹
Stock at Branch (1.4.2015)	30,000
Goods Sent to Branch (Invoice Price)	5,00,000
Branch Debtors Balance (1.4.2015)	20,000
Cash Sales	1,90,000
Return from Debtors	5,000
Branch Expenses Paid	52.000
Discount Allowed	1,000
Bad Debts	2,000
Collection from Debtors	2,60,000
Cheques received from Debtors returned dishonoured	5,000
Stock at Branch (31.03.2016)	54,000
Branch Debtors Balance (31.03.2016)	36,500

[C.U.B.Com. (Hons.) — 2016]

Solution

In the books of Magma Ltd. (H.O.), Kolkata

Dr. Mumbai Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	30,000	31.3.2016	By Bank A/c (cash sales)	1,90,000
	To Goods Sent to Branch A/c	5,00,000		By Mumbai Branch Debtors A/c (credit sales)	2,79,000
	To Mumbai Branch Debtors A/c (Returns)	5,000		By Mumbai Branch Stock Adjustment A/c (shortage)	12,000
				By Balance c/d	54,000
		5,35,000			5,35,000

Dr. Mumbai Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	20,000	31.3.2016	By Bank A/c (Collection)	2,60,000
	To Bank A/c (Dishonour of cheques)	5,500		By Mumbai Branch Expenses A/c :	
	To Mumbai Branch Stock A/c (Credit sales)	2,79,000		Bad debt ₹ 2,000	
				Discount allowed ₹ 1,000	3,000
				By Mumbai Branch Stock A/c (Returns)	5,000
				By Balance c/d	36,500
		3,04,500			3,04,500

Dr. Mumbai Branch Stock Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Mumbai Branch Expenses A/c (Note3)	55,000	1.4.2016	By Stock Reserve A/c (Note 1)	6,000
	To Mumbai Branch Stock A/c (shortage)	12,000		By Goods Sent to Branch A/c (Note 2)	1,00,000
	To Stock Reserve A/c (Note 4)	10,800			
	To General Profit and Loss A/c	28,200			
		1,06,000			1,06,000

Working Notes:

(1) Loading is 25% on cost, i.e., 25/125 or 1/5 on invoice price.
Loading on opening stock = 1/5 of ₹ 30,000 = ₹ **6,000**.

(2) Loading on goods sent to Branch = 1/5 of ₹ 5,00,000 = ₹ **1,00,000**.

(3) Branch Expenses :

	₹
Cash expenses paid	52,000
Bad Debts	2,000
Discount Allowed	1,000
	55,000

(4) Loading on closing stock = 1/5 of ₹ 54,000 = ₹ **10,800**.

Illustration 51 (b)

Head Office of a Company at Kolkata invoices goods to their Ranch Branch at cost plus 20% with the instructions to sell goods at cost plus 40% on cash basis only.

From the following particulars, prepare Ranchi Branch Account in the books of the Head Office :

	₹
Opening Stock at Branch (I.P.)	36,000
Goods Sent to Branch (I.P.)	1,08,000
Sales	1,68,000
Expenses at Branch remitted by Head Office :	
Salaries	10,000
Other Expenses	4,000

Closing stock could not be ascertained. The Branch Manager is entitled to a commission of 5% on the profit of the branch before charging such commission.

[C.U.B.Com. (Hons.) — 2016]

Solution

In the books of Head Office, Kolkata

Dr. Ranchi Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d : Stock	36,000		By Bank A/c (Sales)	1,68,000
	To Goods Sent to Branch A/c	1,08,000		By Stock Reserve A/c (Note 1)	6,000
	To Bank A/c :			By Goods Sent to Branch A/c (Note 2)	18,000
	Salaries	10,000		By Balance c/d : Stock (Note 3)	—
	Expenses	4,000			
	To Manager's Commission A/c (Note 5)	1,700			
	To General Profit and Loss A/c	32,300			
		1,92,000			1,92,000

Working Notes:

(1) Let Cost = 100
Profit = 20
Invoice Price = 120

Loading on invoice price = 20 ÷ 120 = 1/6
Loading on opening stock = 1/6 of ₹ 36,000 = ₹ **6,000**.

(2) Loading on goods sent to Branch = 1/6 of ₹ 1,08,000 = ₹ **18,000**.

(3) Closing Stock at Branch (I.P.) :

	₹
Opening Stock at I.P.	36,000
Goods Sent to Branch (I.P.)	1,08,000
	1,44,000
Less: Invoice Price of Goods Sold (Note 4)	1,44,000
	Nil

(4) Let Cost = 100
Profit = 40
Selling Price = 140

When selling price is 140 then cost = 100

When selling price is 1 then cost = $\frac{100}{140}$

When selling price is 1,68,000 = $\frac{100}{140} \times 1,68,000$

= **₹ 1,20,000**

Therefore, cost of goods sold	**₹ 1,20,000**
Add : Loading @ 20%	24,000
Invoice price of goods sold	1,44,000

(5) Profit before Manager's Commission

₹ 1,68,000 (Sales) + ₹ 6,000 (Loading on Opening Stock) + ₹ 18,000 (Loading on goods sent)	1,92,000
Less: ₹ 36,000 (Opening stock) + ₹ 1,08,000 (Goods sent) + ₹ 14,000 (Expenses)	1,58,000
Profit before Manager's Commission	34,000

Manager's Commission = 5% of ₹ 34,000 = ₹ **1,700**.

Illustration 52 (a)

A company has its head office at Kolkata and a retail branch at Patna. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Kolkata head office to Patna branch at wholesale price. From the following particulars, prepare Trading and Profit and Loss Account of both head office and branch for the year ended on 31st December, 2014 :

	Head Office (₹)	**Patna Office** (₹)
Opening Stock	1,25,000	14,000
Purchases	10,50,000	—
Goods sent to Branch (at invoice price)	3,78,000	—
Sales	10,71,000	4,16,000
Closing Stock	3,00,000	?
Salaries	20,000	12,000
Other Expenses	5,000	2,000

Stock at office are valued at cost price but those of branch are valued at invoice price. Sales at head office are made only on wholesale basis and that at branch only to retail customers. ***[C.U.B.Com. (Hons.) — 2015]***

Solution

Trading and Profit and Loss Account
for the year ended 31st December, 2014

Dr. [figures in ₹] **Cr.**

Particulars	Head Office	Patna Branch	Particulars	Head Office	Patna Branch
To Opening Stock	1,25,000	14,000	By Sales	10,71,000	4,16,000
To Purchases	10,50,000	—	By Goods Sent to Branch (Note 5)	3,78,000	—
To Goods Sent to Branch	—	3,78,000	By Closing Stock (Note 1)	3,00,000	28,000
To Gross Profit c/d	5,74,000	52,000			
	17,49,000	4,44,000		17,49,000	4,44,000
To Salaries	20,000	12,000	By Gross Profit b/d	5,74,000	52,000
To Other Expenses	5,000	2,000	By Stock Reserve (Note 3)	4,000	
To Stock Reserve (Note 4)	8,000	—			
To Net Profit	5,45,000	38,000			
	5,78,000	52,000		5,78,000	52,000

Working Notes :

(1) Valuation of Closing Stock of Patna Branch

	₹
Opening Stock	14,000
Goods received from H.O.	3,78,000
	3,92,000
Less: Invoice price of Goods Sold (Note 2)	3,64,000
Closing Stock at Branch	28,000

(2) Calculation of Invoice Price of Goods Sold

Let Cost = 100
Profit = 60
Selling Price = 160

When selling price is 160 then cost = 100

When selling price is 1 then cost = $\frac{100}{160}$

When selling price is 4,16,000 = $\frac{100}{160} \times 4,16,000$

= ₹ **2,60,000**

Therefore, cost of goods sold = ₹ **2,60,000**

Invoice price is cost plus 40%. Therefore, invoice price (wholesale price) of goods sold

= ₹ 2,60,000 × $\frac{140}{100}$ = ₹ 3,64,000

(3) Loading on opening stock = $\frac{40}{140} \times 14,000$ = ₹ **4,000**.

(4) Loading on closing stock = $\frac{40}{140} \times 28,000$ = ₹ **8,000**.

(5) Goods sent to Branch at invoice price should be treated as sales of the head office.

Illustration 52 (b)

Sawan & Co. of Mumbai has a branch at Siliguri. Goods are invoiced to the branch at cost plus 25%. The branch is instructed to deposit all cash collections everyday in the H.O. Account with the bank. All the expenses are paid through cheques by the head office except petty cash expenses which are paid by the branch. From the following information, prepare Siliguri Branch Account in the books of the head office :

	(₹)
Stock on 1.4.2012 (invoice price)	82,000
Stock on 31.3.2013 (invoice price)	96,000
Sundry Debtors on 1.4.2012	31,700
Sundry Debtors on 31.3.2013	42,150
Furniture and Fixtures as on 1.4.2012	23,400
Cash Sales	4,01,300
Credit Sales	3,72,100
Goods sent to Branch by Head Office (invoice price)	6,28,000
Expenses paid by Head Office	1,32,000
Petty Expenses paid by Branch	10,450
Furniture aquired by the Branch on 1.10.2012 (on permission from head office)	2,500

Depreciation is to be provided on Furniture and Fixtures @ 10% p.a. on WDV basis. ***[C.U.B.Com. (Hons.) — 2014]***

Solution

In the books of Sawan & Co. (H.O.)

Dr. Siliguri Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 April 1	To Balance b/d:		2012 April 1	By Stock Reserve A/c (Note 2)	16,400
	Stock	82,000		By Bank A/c :	
	Debtors	31,700		Cash sales	4,01,300
	Furniture	23,400		Collection from Debtors	3,61,650
2013 Mar 31	To Goods Sent to Branch A/c	6,28,000		By Goods Sent to Branch (Loading) (Note 3)	1,25,600
	To Bank A/c (Expenses)	1,32,000	2013 Mar 31	By Balance c/d:	
	To Petty Cash (Expenses)	10,450		Stock	96,000
	To Petty Cash (Furniture acquired)	2,500		Debtors	42,150
	To Stock Reserve (Note 4)	19,200		Furniture (Note 5)	23,435
	To Net Profit	1,37,285			
		10,66,535			10,66,535

Working Notes :

Dr. (1) Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	31,700		By Bank A/c (Balancing figure)	3,61,650
	To Sales (Credit)	3,72,100		By Balance c/d	42,150
		4,03,800			4,03,800

(2) Goods are invoiced at cost plus 25%.

Let Cost = 100
Profit = 25
Selling Price = 125

Loading on Opening Stock = ₹ 82,000 × $\frac{25}{125}$ = ₹ **16,400**

(3) Loading on Goods Sent = ₹ 6,28,000 × $\frac{25}{125}$ = ₹ **1,25,600**.

(4) Loading on Closing Stock = ₹ 96,000 × $\frac{25}{125}$ = ₹ **19,200**.

(5) Calculation of W.D.V. of Furniture

	₹
W.D.V. of existing furniture on 1.4.2012	23,400
Less: Depreciation for 2012-13	2,340
	21,060
Cost of furniture acquired on 1.10.2012	2,500
Less: Depreciation @ 10% p.a. for 6 months	125
	2,375

Total W.D.V. of furniture on 31.3.2013 = ₹ 21,060 + ₹ 2,375 = ₹ **23,435**.

Illustration 53

Sun Ltd. has a head office in Kolkata and also a branch at New Delhi. Goods are invoiced to the branch at cost plus $33^{1}/_{3}$% which is the selling price. From the following information in respect of the branch for the year ended 31st December, 2013, prepare a Branch Stock Account, Branch Debtors Account and Branch Adjustment Account :

	(₹)
Stock at branch on 1.1.2013 (invoice price)	20,000
Branch Debtors on 1.1.2013	30,000
Goods sent to branch (cost price)	3,60,000
Goods received by branch (invoice price)	4,70,000
Cash Sales	1,80,000
Return from Debtors	10,000
Discount allowed	1,500
Bad Debt	1,000
Collection from Debtors	2,75,000
Cheques received from Debtors but dishonoured	10,000
Branch expenses	49,000
Stock at branch on 31.12.2013	48,000
Branch Debtors on 31.12.2013	36,000

[C.U.B.Com. (Hons.) — 2014]

Solution

In the books of Sun Ltd. (H.O.)

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jan 1	To Balance b/d	20,000	Jan 1	By Bank A/c :	
	To Goods Sent to Branch A/c (Note 1)	4,80,000		Cash Sales	1,80,000
	To Branch Debtors A/c	10,000		By Branch Debtors A/c	2,83,500
	To Branch Adjustment A/c (Surplus)	11,500		By Goods-in-transit A/c	
				(₹ 4,80,000 – 4,70,000)	10,000
				By Balance b/d	48,000
		5,21,500			5,21,500

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec 31	To Stock Reserve A/c (Note 6)	14,500	Jan 1	By Stock Reserve A/c (Note 2)	5,000
	To Branch Expenses A/c (Note 4)	51,500		By Branch Stock A/c (Surplus)	11,500
	To General Profit and Loss A/c	70,500		By Goods Sent to Branch A/c (Loading)	1,20,000
		1,36,500			1,36,500

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan 1	To Balance b/d	30,000	2013 Jan 1	By Branch Stock A/c	10,000
	To Branch Stock A/c (Balancing figure)	2,83,500		By Discount Allowed A/c	1,500
	To Bank A/c (Cheque dishonoured)	10,000		By Bad Debts A/c	1,000
				By Bank A/c (Collection from Debtors)	2,75,000
				By Balance c/d	36,000
		3,23,500			3,23,500

Working Notes :

(1) Credit Sales have not been given in the Question. So the balancing figure of '***Branch Debtors Account***' is to be taken as credit sales.

(2) Loading is $33^1/_3\%$ on cost, i.e., $\frac{33\frac{1}{3}\%}{133\frac{1}{3}\%}$ or 1/4 on invoice price. Therefore, loadng on opening stock is 20,000 /4 = ₹ **5,000**.

(3) Loading on Goods Sent = 4,80,000 / 4 = ₹ 1,20,000.

(4) Total branch expenses = Cash expenses ₹ 49,000 + Bad Debts ₹ 1,000 + Discount Allowed ₹ 1,500 = ₹ **51,500**.

(5) When no separate Branch Profit and Loss Account is prepared, the entire amount of expenses is charged to Branch Adjustment Account.

(6) Loading on Closing Stock = 48,000 / 4 ₹ 12,000
Loading on Stock-in-transit = 10,000 / 4 2,500
14,500

Illustration 54

Janata Ltd. has a retail branch at Kanpur. Goods are sold to customers at cost plus 100%. The wholesale price is cost plus 80%. Goods are invoiced to Kanpur at wholesale price. From the following particulars, find out the profit made by the Head Office and Kanpur Branch for the year ended 31st March, 2013 :

	H.O. (₹)	**Kanpur Branch** (₹)
Opening Stock	50,000	—
Purchases	3,00,000	—
Goods sent to Branch (at invoice price)	1,08,000	—
Sales	3,06,000	1,00,000
Expenses	90,000	4,000

Sales at Head office are made only on wholesale basis and sales at branch are made to customers. Stock at Branch is valued at invoice price. ***[C.U.B.Com. (Hons.) — 2013]***

Solution

Janata Ltd.
Trading and Profit and Loss Account
for the year ended 31st March, 2013

Dr. [figures in ₹] **Cr.**

Particulars	Head Office	Kanpur Branch	Particulars	Head Office	Kanput Branch
To Opening Stock	50,000	—	By Goods Sent to Branch	1,08,000	—
To Purchases	3,00,000	—	By Sales	3,06,000	1,00,000
To Goods Sent to Branch	—	1,08,000	By Closing Stock (Note 1)	1,20,000	18,000
To Gross Profit c/d	1,84,000	10,000			
	5,34,000	1,18,000		5,34,000	1,18,000
To Expenses	90,000	4,000	By Gross Profit b/d	1,84,000	10,000
To Stock Reserve	8,000	—			
To Net Profit	86,000	6,000			
	1,84,000	10,000		1,84,000	10,000

Working Notes :

(1) Calculation of Closing Stock at Head Office

Let Cost = 100
Profit = 80
Wholesale Price = 180

Goods sent to Branch = ₹ 1,08,000.

(i) Cost of Goods Sent = $\frac{1,08,000}{180} \times 100$ = 60,000

(ii) Cost of Goods Sold = $\frac{3,06,000}{180} \times 100$ = 1,70,000

Total 2,30,000

(iii) Closing Stock = (Opening Stock + Purchases) – Cost
= (50,000 + 3,00,000) – 2,30,000 (Note 1)
= **₹ 1,20,000**

(2) Calculation of Closing Stock of the Branch

Sales at Branch = ₹ 1,00,000

Invoice Price of Goods Sold = $\frac{1,00,000}{200} \times 180$ = ₹ 90,000

	₹
Closing Stock :	
Invoice Price of Goods Sent	1,08,000
Less: Invoice Price of Goods Sold	90,000
	18,000

(3) Loading on Stock at Branch

Invoice Price of Stock at Branch = ₹ 18,000

Cost of Goods at Branch = $\frac{1,80,000}{180} \times 100$ = ₹ 10,000

Loading = (₹ 18,000 – 10,000) = ₹ **8,000**.

Illustration 55

A company with its head office at Delhi has a branch at Mumbai. The branch receives all goods from head office who also remits cash for all expenses. Sales are made by the branch on credit as well as for cash and all cash collections are remitted to head office.

Total sales by the branch for the year ended 31st March, 2012 amounted to ₹ 5,60,000 out of which 20% is cash sales.

The folllowing further informtion are relevant :

	01.04.2011	31.03.2012
	(₹)	(₹)
Stock-in-trade	25,000	36,000
Debtors	60,000	48,000
Petty Cash	120	180

Expenses actually incurred by the branch during the year were :

	(₹)
Salaries	36,000
Rent	12,000
Petty Expenses	5,000

All sales are made by the branch at cost plus 25%.

You are required to prepare the Mumbai Branch Account in the books of the Head Office for the year ended 31st March, 2012.

[C.U.B.Com. (Hons.) — 2013]

Solution

In the books of the H.O.
Mumbai Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011			2012		
Jan 1	To Balance b/d		Mar 1	By Bank A/c (Cash Sales)	1,12,000
	Stock in trade	25,000		By Bank A/c	4,60,000
	Debtors	60,000		(Cash collected from Debtors (Note 1)	
	Petty Cash	120		By Balance c/d :	
	To Bank A/c :			Stock in trade	36,000
	Salaries	36,000		Debtors	48,000
	Rent	12,000		Petty Cash	180
	Petty Expenses (Note 4)	5,060			
	To Goods Sent to Branch (Note 3)	4,59,000			
	To General Profit and Loss A/c	59,000			
		6,56,180			6,56,180

Working Notes :

Dr. **(1) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011			2012		
April 1	To Balance b/d	60,000	Mar 1	By Bank A/c (Collection from Debtors)	4,60,000
	To Sales (Note 5)	4,48,000		By Balance c/d	48,000
		5,08,000			5,08,000

(2) Total Sales 5,60,000

Less: Cash Sales 20% 1,12,000

Credit Sales 4,48,000

(3) Cost of Goods Sold = $\frac{5,60,000}{125} \times 100 =$ ₹ 4,48,000

Goods sent to Branch = Closing Stock + Cost of Goods Sold – Opening Stock

= 36,000 + 4,48,000 – 25,000

= ₹ **4,59,000**.

Dr. **(4) Petty Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	120		By Branch Expenses A/c	5,000
	To Bank A/c (Balancing figure)	5,060		By Balance c/d	180
		5,180			5,180

Illustration 56

C Ltd. has a branch at Lake Town where it sends goods at cost plus 50%. From the following particulars regarding the branch, prepare Branch Stock Account, Branch Adjustment Account, Branch Debtors Account and Branch Profit and Loss Account as would appear in the books of C Ltd. :

Particulars	₹	Particulars	₹
Stock at cost (1.4.2010)	20,000	Bad Debts	200
Debtors (1.4.2010)	18,000	Sales Return to Branch	3,000
Cash (1.4.2010)	5,000	Expenses Paid by H.O.	10,000
Good sent to Branch (I.P.)	99,000	Cash remitted to H.O.	80,000
Sales : Cash	27,000	Cash (31.3.2011)	6,000
Credit	79,000	Stock at I.P. (31.3.2011)	27,000
Normal Loss at cost	2,000	Debtors (31.3.2011)	30,000

[C.U.B.Com. (Hons.) — 2012]

Solution

In the books of C. Ltd. (H.O.)

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

Date	Particulars	₹	Date	Particulars	₹
2010			2011		
April 1	To Balance b/d	30,000	Mar 31	By Bank A/c (Cash Sales)	27,000
	To Goods Sent to Branch A/c	99,000		By Branch Debtors A/c (Credit Sales)	79,000
	To Branch Debtors A/c	3,000		By Balance c/d	27,000
	To Branch Adjustment A/c (Surplus)	1,000			
		1,33,000			1,33,000

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011			2011		
Mar 31	To Stock Reserve A/c	9,000	Mar 31	By Stock Reserve A/c	10,000
	To Gross Profit c/d	35,000		By Goods Sent to Branch A/c	33,000
				By Branch Stock A/c (Surplus)	1,000
		44,000			44,000

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010			2011		
April 1	To Balance b/d	18,000	Mar 31	By Bad Debts A/c	200
	To Branch Stock A/c	79,000		By Branch Stock A/c	3,000
				By Branch Cash A/c (Collection from Debtors)	63,800
				By Balance c/d	30,000
		97,000			97,000

Dr. **Branch Profit and Loss Account** **Cr.**

Particulars	₹	Particulars	₹
To Branch Petty Expenses	9,800	By Branch Adjustment A/c	35,000
To Branch Expenses (Paid by H.O.)	10,000		
To Bad Debts	200		
To General Profit and Loss A/c	15,000		
	35,000		35,000

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

Date	Particulars	₹	Date	Particulars	₹
2010			2011		
April 1	To Balance b/d	5,000	Mar 31	By Bank (H.O.) A/c	80,000
	To Branch Stock A/c	27,000		By Branch Petty Expenses (Balancing figure)	9,800
	To Branch Debtors A/c	63,800		By Balance b/d	6,000
		95,800			95,800

Special Problems

Illustration 57

Sonali Chain Stores of Calcutta has a branch in Burdwan. Goods are sent to branch at cost. Branch sells only goods received from head office. Branch sales are partly cash and partly credit. All cash collected by branch are sent to head office immediately and branch expenses are paid by head office. Following are the details of transactions relating to branch for the year ended on 31st December, 2017 : (all figures in ₹)

Stock at branch on 1.1.2017	6,800	Returns by branch customers	500
Debtors at branch on 1.1.2017	7,000	Cash received on Ledger Account	33,000
Goods in transit on 1.1.2017	4,800	Branch salary and wages paid by H.O.	6,700
Goods sent to branch during the year	78,600	Branch sundry expenses paid by H.O.	800
Goods received by branch during the year	74,800	Branch outstanding salary	1,200
Goods returned by branch	2,000	Branch prepaid wages	500
Returned goods received by H.O. during the year	1,600	Bad debts written-off	200
Cash sales at branch during the year	54,000	Wastage of stock at branch	400
Credit sales at branch during the year	35,500		

Other particulars are given below:

(a) Goods-in-transit ₹ 4,800 included goods costing ₹ 3,200 sent by H.O. to branch and goods costing ₹ 1,600 returned by branch to H.O. in previous year.

(b) During this year cash ₹ 5,000 sent by branch to H.O. on 27.12.2017 which is received by H.O. on 3.1.2018.

(c) Branch maintains a steady gross profit @ 20% on sales.

Show Branch Account in the books of head office to record the above transactions.

Solution **In the books of Sonali Chain Stores**

Dr. **Burdwan Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Dec. 31	By Bank A/c (Note 1)	
	Stock at branch	6,800		Amount received from branch	82,000
	Goods-in-transit to branch	3,200		By Goods Sent to Branch A/c	1,600
	Goods-in-transit from branch	1,600		(Goods returned by branch)	

	Debtors	7,000		By Balance c/d:	
Dec. 31	To Goods Sent to Branch A/c	78,600		Stock at branch (Note 2)	8,000
	To Bank A/c:			Goods-in-transit to branch (Note 3)	7,000
	Branch Salaries & Wages	6,700		Goods-in-transit from br. (Note 4)	2,000
	Sundry expenses	800		Debtors (Note 5)	8,800
	To Balance c/d (Outstanding salaries)	1,200		Prepaid wages	500
	To General Profit & Loss A/c	9,000		Cash in transit (given)	5,000
		1,14,900			1,14,900

Tutorial Note: (1) Profit from branch can be verified with the help of the following statement:

Dr. Supplementary Verification Statement of Profit for Branch Cr.

Particulars		₹	Particulars	₹
To Sundry expenses		800	By Gross Profit	
To Salaries & Wages	6,700		(Being 20% on net sales of (₹ 54,000 + 35,500 – 500)	17,800
Add: Outstanding	1,200		= 20% of ₹ 89,000	
	7,900			
Less: Prepaid	500	7,400		
To Bad debts		200		
To Wastage of goods		400		
To Profit (Balancing figure)		9,000		
		17,800		17,800

(2) The wastage of stock has been treated separately and it has been transferred to Profit and Loss Account. If the wastage is treated as normal, then gross profit will go down to ₹ 17,800 – ₹ 400 = ₹ 17,400. This will distrot the 'norms of steady Gross Profit of 20% on sales'. Hence, it has not been treated as normal wastage.

Working Notes: **(1)** Amount remitted by branch = ₹ 54,000 (cash sales) + ₹ 33,000 (collection from debtors) = ₹ 87,000 less ₹ 5,000 (cash in transit from branch on closing date) = ₹ 82,000.

(2) Closing Stock at Branch

This can be ascertained by considering only the physical movement (actual) of stock to and from branch as follows:

		₹
Opening stock at branch		6,800
Goods received from H.O.		74,800
Total		81,600
Less: Returned to H.O.		2,000
		79,600
Less: Goods physically leaving the branch:		
Credit sales	35,500	
Less returns	500	
Net credit sales	35,000	
Cash sales	54,000	
Total sales	89,000	
Less: Gross Profit 20%	17,800	
Cost of goods sold		71,200
		8,400
Less: Wastage		400
Closing stock (physical) at branch		8,000

(3) Closing Goods-in-Transit to Branch

	₹
Opening goods-in-transit to branch	3,200
Add: Goods sent by H.O.	78,600
Total goods travelling towards branch	81,800
Less: Goods actually received by branch	74,800
Closing goods-in-transit to branch (from H.O.)	7,000

(4) Closing goods in transit from Branch

	₹
Opening goods-in-transit from branch	1,600
Add: Goods sent to H.O.	2,000
	3,600
Less: Goods received by H.O.	1,600
Closing goods in transit from branch (to H.O.)	2,000

Dr. Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	7,000	By Bank (collection)	33,000
To Sales (credit)	35,500	By Returns	500
		By Bad debts	200
		By Balance c/d (Balancing figure)	8,800
	42,500		42,500

Illustration 58

Atlantic Paper Products sends goods to their Bhopal branch at cost plus 25%. You are given the following particulars:

	₹		₹
Opening stock at branch at its cost	5,000	Sales	25,500
Goods sent to branch at invoice price	20,000	Expenses	8,000
Loss in transit at invoice price	2,500	Closing stock at branch at cost to branch	6,000
Theft at invoice price	1,000	Claim recd. from the insurance company for loss in transit	2,000
Loss in weight (normal) at invoice price	500		

You are required to prepare in the head office books:

(a) Branch Stock Account; (b) Branch Adjustment Account; (c) Branch Profit and Loss Account; (d) Surplus in Stock Account; (e) Loss-in-transit Account; and (f) Loss by Theft Account.

Solution

In the books of Atlantic Paper Products

Branch Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Note 1)	5,000		By Loss in transit A/c	2,500
	To Goods Sent to Branch A/c	20,000		By Loss by Theft A/c	1,000
	To Surplus in Stock A/c	10,000		By Branch Debtors A/c (Note 3)	25,500
				By Balance c/d	6,000
		35,000			35,000

Branch Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Loss-in-transit A/c (Loading)	500		By Stock Reserve A/c (Note 3)	1,000
	To Loss by Theft A/c	200		By Goods Sent to Branch A/c (Note 4)	4,000
	To Stock Reserve A/c	1,200		By Surplus in Stock A/c (Note 5)	2,000
	To Gross Profit c/d	5,100			
		7,000			7,000

Branch Profit & Loss Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Expenses A/c	8,000		By Gross Profit b/d	5,100
	To Loss by Theft A/c (Note 6)	800		By Surplus in Stock A/c	8,000
	To General Profit & Loss A/c	4,300			
		13,100			13,100

Surplus in Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Adjustment A/c	2,000		By Branch Stock A/c	10,000
	To Branch Profit & Loss A/c	8,000			
		10,000			10,000

Loss-in-transit Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Stock A/c	2,500		By Branch Adjustment A/c	500
				By Bank A/c (Claim received)	2,000
		2,500			2,500

Loss by Theft Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Stock A/c	1,000		By Branch Adjustment A/c	200
				By Branch Profit & Loss A/c	800
		1,000			1,000

Tutorial Note: (1) No entry is required for normal loss; (2) Loss by theft should be treated as normal because ‘shoplifting’ is very common to all businesses particularly in the retail trade.

Working Notes:

(1) Here, opening stock value has been given at cost to the branch, i.e., at invoice price. Therefore, there is no need for converting that into the invoice price.

(2) It is assumed that all sales are made on credit.

(3) Loading is 25% on cost, i.e., 25/125 or 1/5 of invoice price. So, Loading on opening stock = 1/5 of ₹ 5,000 = ₹ 1,000.

(4) Loading on goods sent is 1/5 of ₹ 20,000 = ₹ 4,000.

(5) Loading on surplus in stock is 1/5 of ₹ 10,000 = ₹ 2,000. Loading on surplus in stock is credited to Branch Adjustment Account and cost is credited to Branch Profit and Loss Account.

(6) Loading on lost-in-transit is 1/5 of ₹ 2,500 = ₹ 500. Loading on lost-in-transit is debited to Branch Adjustment Account. Cost of goods lost-in-transit (₹ 2,000) is equal to insurance claim received. So, there is no abnormal loss which is to be transferred to the General Profit and Loss Account.

Illustration 59

Sellwell Ltd. has two branches in Cochin and Bangalore. During the year ended 31st March 2018 goods have been invoiced to the Cochin Branch at 20% above cost and to the Bangalore Branch at 25% above cost. The branches do not maintain complete books of account but the following figures are available for the year ended on 31st March 2018:

	Cochin (₹)	Bangalore (₹)		Cochin (₹)	Bangalore (₹)
Opening stock at Invoice price	10,000	10,000	Cash as on 1.4.2017	2,000	1,000
Goods sent to Branch at cost	50,000	40,000	Cash as on 31.3.2018	1,000	500
Amount remitted by Branch	80,000	80,000	Goods returned by Customers to Branch at	5,000	4,000
Amount remitted by Head Office	15,000	15,000	selling price		
Goods returned by Branch at Invoice price	3,000	—	Expenses at Branch in cash	9,000	3,000

All sales at the branches are for cash. During the year, Cochin Branch purchased fixed assets worth ₹ 4,000 and this amount is included in the figure of branch expenses. Cochin Branch transferred to the Bangalore Branch stock costing (to H.O.) ₹ 5,000 during the year. The Bangalore Branch remitted ₹ 2,000 to the Cochin Branch also during the year. There was a closing stock of ₹ 24,000 valued at invoice price at the Cochin Branch. There was no closing stock at the Bangalore Branch.

The Branch Stock Adjustment Account in the Head Office books showed the following position as on 1st April, 2017: For Cochin — ₹ 2,500 (Cr.); and For Bangalore — ₹ 2,000 (Cr.).

Prepare Branch Stock Accounts, Branch Stock Adjustment Accounts, Goods Sent to Branch Accounts, Branch Cash Accounts, Branch Expenses Account and Branch Profit and Loss Accounts in the Head Office books ignoring depreciation.

[C.A. (Inter) — Adapted]

Solution

In the books of Sellwell Ltd.

Branch Stock Accounts

Dr. | **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
1.4.2017	To Balance b/d	10,000	10,000	31.3.2018	By Goods Sent to Br. A/c (Returns)	3,000	—
31.3.2018	To Goods Sent to Branch A/c	60,000	50,000		By Goods sent to Br. A/c (Transfer : Note 2)	6,000	—
	To Branch Cash A/c (Note 1)	5,000	4,000		By Branch Cash A/c (Cash Sales)	76,000	73,500
	To Goods Sent to Branch A/c (Transfer : Note 2)	—	6,250				
	To Surplus in Stock A/c	34,000	3,250		By Balance c/d	24,000	—
		1,09,000	73,500			1,09,000	73,500
1.4.2018	To Balance b/d	24,000	—				

Branch Stock Adjustment Accounts

Dr. | **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
31.3.2018	To Gross Profit c/d	12,667	13,900	1.4.2017	By Balance b/d (Note 3)	2,500	2,000
	To Balance c/d (Note 5)	4,000	—	31.3.2018	By Goods Sent to Br. A/c (Note 4)	8,500	11,250
					By Surplus in Stock A/c (Loading)	5,667	650
		16,667	13,900			16,667	13,900
				1.4.2018	By Balance b/d	4,000	—

Goods Sent to Branch Accounts

Dr. | **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
31.3.2018	To Branch Stock A/c (Returns)	3,000	—	31.3.2018	By Branch Stock A/c	60,000	50,000
	To Branch Stock A/c (Transfer)	6,000	—		By Branch Stock A/c (Transfer)	—	6,250
	To Branch Stock Adjustment A/c	8,500	11,250				
	To Purchases A/c	42,500	45,000				
		60,000	56,250			60,000	56,250

Dr. **Branch Cash Accounts** **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
1.4.2017	To Balance b/d	2,000	1,000	31.3.2018	By Bank A/c (Remittance)	80,000	80,000
31.3.2018	To Bank A/c (Remittance)	15,000	15,000		By Branch Stock A/c (Note 1)	5,000	4,000
	To Bank A/c (From Bangalore)	2,000	—		By Branch Expenses A/c	9,000	3,000
	To Br. Stock A/c (Cash sales)	76,000	73,500		By Bank A/c (To Cochin)	—	2,000
					By Balance c/d	1,000	500
		95,000	89,500			95,000	89,500

Dr. **Branch Profit & Loss Accounts** **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
31.3.2018	To Branch Expenses A/c	5,000	3,000	31.3.2018	By Surplus in Stock A/c	28,333	2,600
	To General Profit & Loss A/c	36,000	13,500		By Gross Profit b/d	12,667	13,900
		41,000	16,500			41,000	16,500

Dr. **Branch Expenses Accounts** **Cr.**

Date	Particulars	Cochin	Bangalore	Date	Particulars	Cochin	Bangalore
31.3.2018	To Branch Cash A/c	9,000	3,000	31.3.2018	By Branch Fixed Assets A/c	4,000	—
					By Branch Profit & Loss A/c	5,000	3,000
		9,000	3,000			9,000	3,000

Working Notes:

(1) All sales at the branches are for cash. Therefore, for return of goods by customers, Cash Account is to be credited and Branch Stock Account is to be debited.

(2) Cost of goods transferred by Cochin branch to Bangalore branch is ₹ 5,000. Invoice price of such goods to Cochin branch = ₹ 5,000 + 20% of ₹ 5,000 = ₹ 6,000, whereas invoice price of the same goods to Bangalore branch = ₹ 5,000 + 25% of ₹ 5,000 = ₹ 6,250.

(3) Branch Stock Adjustment Account balance at the beginning of the year has been given as : For Cochin — ₹ 2,500 (Cr.); and for Bangalore — ₹ 2,000 (Cr.).

(4) Loading on Goods Sent (Net)

Particulars	Cochin	Bangalore
Goods sent to Branch	60,000	50,000
Less: Returned	(3,000)	—
Less: Transferred to Bangalore (₹ 5,000 + 20% of ₹ 5,000)	(6,000)	—
Add: Transferred from Cochin (₹ 5,000 + 25% of ₹ 5,000)	—	6,250
	51,000	56,250
Loading : Cochin 1/6 of ₹ 51,000; Bangalore 1/5 of ₹ 56,250	8,500	11,250

Students should note that these balances are nothing but stock reserves at the beginning of the year. Instead of opening Stock Reserve Account, an amount equal to stock reserve on closing stock can be carried forward in the Branch Stock Adjustment Account to get the same effect.

Now, one question may arise that the stock reserve for Cochin branch should have been — 1/6 of ₹ 10,000 = ₹ 1,667 but it has been given is ₹ 2,500. This is due to change in the "mark-up" percentage. Last year's "mark-up" was much higher than that of the current year.

Illustration 60

T of Calcutta has a branch at Dibrugarh. The branch does not maintain separate books of accounts. The branch has the following assets and liabilities on 31st August, 2017 and 30th September, 2017:(all figures in ₹)

	31st August, 2017	30th September, 2017
Stock of tea	1,80,000	1,50,000
Advance to suppliers	5,00,000	4,50,000
Bank balance	75,000	1,00,000
Prepaid expenses	10,000	12,000
Outstanding expenses	13,000	11,000
Creditors for purchases	3,00,000	to be ascertained

During the month, Dibrugarh branch:
(a) received by electronic mail transfer ₹ 10,00,000 from Calcutta head office;
(b) purchased tea worth ₹ 12,00,000;
(c) sent tea costing ₹ 12,30,000 to Calcutta, freight of ₹ 80,000 being payable at the destination by the receiver;
(d) spent ₹ 25,000 on office expenses;
(e) paid ₹ 3,00,000 as advance to suppliers.
(f) paid ₹ 6,50,000 to suppliers in settlement of outstanding dues.

In addition, T informs you that the Calcutta office had directly paid ₹ 3,50,000 to Dibrugarh suppliers by cheques drawn on Bank Accounts in Calcutta during the month.

T informs you that for the purpose of accounting, Dibrugarh branch is not treated as an outsider. He wants you to write the detailed accounts relating to the transactions of the Dibrugarh branch as would appear in the books of Calcutta Head office. *[C.A. (Inter) — Adapted]*

Solution **In the books of Calcutta Head Office**

Dr. Dibrugarh Branch Tea Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.9.2017	To Balance b/d	1,80,000	30.9.2017	By Tea-in-Transit to Calcutta A/c	12,30,000
30.9.2017	To Dibrugarh Branch Suppliers' A/c	12,00,000		By Balance c/d	1,50,000
		13,80,000			13,80,000

Dr. Advance to Dibrugarh Branch Suppliers' Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.9.2017	To Balance b/d	5,00,000	30.9.2017	By Dibrugarh Branch Suppliers' A/c	3,50,000
	To Dibrugarh Branch Bank A/c	3,00,000		By Balance c/d	4,50,000
		8,00,000			8,00,000

Dr. Dibrugarh Branch Suppliers' Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.9.2017	To Advance to Dibrugarh Branch Suppliers' A/c (Adjustment)	3,50,000	1.9.2017	By Balance b/d	3,00,000
	To Dibrugarh Branch Bank A/c	6,50,000		By Dibrugarh Branch Tea Stock A/c (Purchase of Tea)	12,00,000
	To Calcutta Head Office Bank A/c	3,50,000			
	To Balance c/d	1,50,000			
		15,00,000			15,00,000

Dr. Dibrugarh Branch Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.9.2017	To Balance b/d	75,000	30.9.2017	By Advance to Dibrugarh Branch Suppliers A/c	3,00,000
	To Calcutta Head Office Bank A/c	10,00,000	30.9.2017	By Dibrugarh Branch Suppliers' A/c	6,50,000
			30.9.2017	By Dibrugarh Branch Expenses A/c	25,000
			30.9.2017	By Balance c/d	1,00,000
		10,75,000			10,75,000

Dr. Dibrugarh Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.9.2017	To Prepaid Expenses A/c	10,000	1.9.2017	By Outstanding Expenses A/c	13,000
	To Dibrugarh Branch Bank A/c	25,000	30.9.2017	By Prepaid Expenses A/c	12,000
	To Outstanding Expenses A/c	11,000	30.9.2017	By Dibrugarh Branch Profit and Loss A/c	21,000
		46,000			46,000

Illustration 61

Adidas Ltd. purchases shoes from a number of manufacturers and sells these through branches. All book keeping records are kept at head office. Stock is transferred from head office to the branches at final selling price which is cost plus 10%.

The following figures relates to the year ended on 31st March, 2015: (all figures in ₹)

	Branch - 1	Branch - 2	Branch - 3
Opening Stock (at selling price)	1,10,000	1,26,500	99,000
Goods sent to Branch (at selling price)	13,20,000	15,18,000	11,88,000
Sales	13,50,000	15,20,000	11,72,000
Closing Stock (at selling price)	1,01,250	80,600	1,25,200

The opening and closing stock figures were arrived at by means of a physical stock count conducted by professional stocktakers.

Branch 2 suffered a flood during February 2015. Immediately afterwards, all the undamaged stock in the branch was transferred to Branch 1 and 3 where it was treated as normal trading stock. None of the branch managers kept proper records of the quantities transferred. The manager of Branch 2 also disposed of a large amount of stock which was so badly damaged as to be unsaleable. Again no detailed records were kept.

In accordance with their instructions, the stocktakers valued all stocks as if they were in perfect condition. They did, however, set damaged stocks to one side. The manager of Branch 2 has examined the stocks identified as damaged and has suggested that stocks valued at ₹ 27,500 be sold as 'flood damaged' at 25% of their normal selling price. This suggestion has been agreed by the head office.

The branches are designed so that theft is unlikely to be a problem. Head office is confident that losses due to shoplifting and staff fraud can be estimated at approximately ₹ 1,000 per branch per annum, valued at selling price.

You are required to :

(i) Calculate the estimated cost of stock transferred from Branch 2 to Branch 1 and 3 after flood and also the estimated cost of stock which was scrapped by the manager of Branch 2; and

(ii) Prepare Trading Account to show the gross profit of each Branch for the year.

Solution **Calculation of Estimated Cost of Stock Transferred** [figures in ₹]

Particulars	Branch - 1	Branch - 2	Branch - 3
Opening Stock	1,10,000	1,26,500	99,000
Add: Goods Sent to Branch	13,20,000	15,18,000	11,88,000
	14,30,000	16,44,500	12,87,000
Less: Normal Losses	1,000	1,000	1,000
	14,29,000	16,43,500	12,86,000
Less: Goods Sold	13,50,000	15,20,000	11,72,000
Expected Closing Stock	79,000	1,23,500	1,14,000
Actual Closing Stock	1,01,250	80,600	1,25,200
Difference (at selling price)	22,250	(42,900)	11,200

(a) Cost of Goods Received by Branch - 1 = ₹ 22,250 / 110 × 100 = ₹ **20,227**.

(b) Cost of Goods Received by Branch - 3 = ₹ 11,200 / 110 × 100 = ₹ **10,182**.

Adidas Ltd.

Dr. **Branch Trading Account for the year ended . . .** [figures in ₹] **Cr.**

Particulars	Branch - 1	Branch - 2	Branch - 3	Particulars	Branch - 1	Branch - 2	Branch - 3
To Opening Stock	1,00,000	1,15,000	90,000	By Sales	13,50,000	15,20,000	11,72,000
To Goods Sent to Branch (at cost)	12,00,000	13,80,000	10,80,000	By Closing Stock (Note 1 & 2)	92,045	55,148	1,13,818
To Transfers	20,227	—	10,182	By Transfers	—	30,409	—
To Gross Profit c/d	1,21,818	1,37,273	1,05,636	By Abnormal Loss (Note 3)	—	26,716	—
	14,42,045	16,32,273	12,85,818		14,42,045	16,32,273	12,85,818

Working Notes :

(1) Closing Stock of Branch 1 and 3 (at cost)

Branch 1 = ₹ 1,01,250 / 110 × 100 = ₹ **92,045**.

Branch 3 = ₹ 1,25,200 / 110 × 100 = ₹ **1,13,818**.

(2) Closing Stock of Branch 2 (at cost)

	₹
Counted Stock	80,600
Less: Damaged items	27,500
Perfect Stock	53,100
Cost of Perfect Stock = ₹ 53,100 × 100 / 110	48,273
Cost of Damaged items (25% of ₹ 27,500)	6,875
	55,148

(3) Valuation of Abnormal Loss by Flood

		₹
Difference of Stock at Branch 2		42,900
Less: Transferred to Branch 1	22,250	
Less: Transferred to Branch 3	11,200	33,450
Scrap Stock		9,450
(i) Cost of scrap stock = ₹ 9,450 / 110 × 100		8,591
(ii) Stock reduced (₹ 25,000* – 6,875)		18,125
		26,716

*₹ 27,500 / 110 × 100 = ₹ **25,000**.

Illustration 62

From the following information, prepare a Memorandum Trading and Profit and Loss Account of Branches and also show the Branches Account as it would appear in the head office books at the end of the year :

Dr. Branches' Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance	7,500	2017 Dec. 31	By Petty cash	3,000
Dec. 31	To Receipts from Debtors	37,500		By Bank	62,000
	To Cash Sales	25,000		By Balance	5,000
		70,000			70,000

Dr. Branches' Debtors' Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance	3,000	2017 Dec. 31	By Cash	37,500
Dec. 31	To Sales	45,000		By Discounts allowed	1,000
				By Bad Debts	1,500
				By Balance	8,000
		48,000			48,000

Dr. Branches Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance b/d:		2017 Jan. 1	By Balance b/d:	
	To Cash	7,500		By Expenses outstanding	1,000
	To Debtors	3,000	Dec. 31	By Bank	62,000
	To Furniture	7,500		By Balance	20,500
	To Stock	10,000			
Dec. 31	To Goods transferred	45,000			
	To Furniture purchased	2,500			
	To Sundry expenses	8,000			
		83,500			83,500

Closing stock at branches was ₹ 4,000 and expenses outstanding were ₹ 900. Depreciation @ 10% of the book value has to be provided on furniture. ***[C.A. (Inter) — Adapted]***

Solution

Dr. Memorandum Trading and Profit and Loss Account Cr.
For the year ended 31st December, 2017

Particulars	₹	Particulars	₹
To Opening Stock (Note 1)	10,000	By Sales : Cash (Note 2)	25,000
To Goods Sent to Branch	45,000	Credit (Note 3)	45,000
To Gross Profit c/d	19,000	By Closing Stock	4,000
	74,000		74,000
To Expenses (Note 4)	10,900	By Gross Profit b/d	19,000
To Discount Allowed (Note 5)	1,000		
To Bad Debts (Note 5)	1,500		
To Depreciation on Furniture	1,000		
To General Profit & Loss A/c	4,600		
	19,000		19,000

Dr. **Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2017 Dec. 31	To Balance b/d	20,500	2017 Dec. 31	By Balance c/d:	
	To Net Profit	4,600		Cash	5,000
	To Balance c/d (Outstanding expenses)	900		Debtors	8,000
				Furniture (Note 6)	9,000
				Stock	4,000
		26,000			26,000

Working Notes:

(1) Opening stock: From the opening balance of the Branch Account.

(2) Cash sales : From the Branch Cash Account.

(3) Credit sales : From the Branch Debtors Account.

(4) Petty cash expenses : ₹ 3,000 + Sundry expenses ₹ 8,000 + Expenses outstanding at the end ₹ 900 = ₹ 11,900 ***less*** outstanding at the beginning ₹ 1,000. Therefore, actual expenses are ₹ 10,900.

(5) Bad debts and discount : From the Branch Debtors Account.

Illustration 63

M/s. Bright & Co. with its head office in Madras, invoiced goods to its branch at Bombay, at 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. Discount on credit sales at 15% on prompt payment will be allowed. From the following particulars available from the branch, prepare the Branch Trading and Profit and Loss Account for the year ended 31st March, 2015 in the head office books, so as to show the actual profit or loss of the branch for the year 2017-18: (figures in ₹)

Stock on 1.4.2017 (invoice price)	12,000	Discount allowed to debtors	13,365
Goods received from head office (invoice price)	1,32,000	Expenses at the branch	6,000
Debtors on 1.4.2017	10,000	Remittance to head office	1,20,000
Sales (cash)	46,000	Debtors on 31.3.2018	11,000
Sales (credit)	1,00,000	Cash in hand on 31.3.2018	5,635
Cash realised from debtors	85,635	Stock on 31.3.2018 (invoice price)	15,000

It was reported that a part of stock at the branch was lost by fire during the year whose value is to be ascertained; and provision should be made for discount to be allowed to debtors as on 31st March, 2018, on the basis of the year's trend of prompt payment.

Solution

Dr. **Trading and Profit and Loss Account for the year ended 31st March, 2018** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock (Note 2)	10,000	By Sales : Cash	46,000
To Goods received from H.O. (Note 3)	1,10,000	Credit	1,00,000
To Gross Profit c/d	41,000	By Loss of Stock by Fire (Note 4)	2,500
		By Closing Stock (Note 5)	12,500
	1,61,000		1,61,000
To Branch Expenses	6,000	By Gross Profit b/d	41,000
To Discount allowed	13,365		
To Provision for Discount (Note 6)	1,337		
To General Profit & Loss A/c	20,298		
	41,000		41,000

Working Notes:

(1) Calculation of Invoice Price & Catalogue Price

	₹
Let, cost price	100
then, catalogue price	150
Invoice price ₹ (150 – 20% of ₹ 150)	120

(2) Cost Price of Opening Stock

100/120 x ₹ 12,000 = ₹ 10,000

(3) Cost Price of Goods Received

100/120 x ₹ 1,32,000 = ₹ 1,10,000

(4) Loss of Stock by Fire

Cost of opening stock (Note 2)	10,000	
Add: Cost of goods received (Note 3)	1,10,000	1,20,000
Less: Cost of goods sold:		
Cash sales (100/120 x ₹ 46,000)	38,333	
Credit sales (100/150 x ₹ 1,00,000)	66,667	1,05,000
		15,000
Cost of closing stock (Note 5)		12,500
Cost of goods lost by fire		2,500

(5) Cost of Closing Stock : 100/120 x ₹ 15,000 = ₹ 12,500

(6) Calculation of Provision for Discount:

(a) Amount of prompt-paying debtors during 2014-13 = ₹ 13,365 x 100/15 = ₹ 89,100.

(b) Total debtors of 2014-13 (₹ 10,000 opening + credit sales ₹ 1,00,000) = ₹ 1,10,000.

Ratio of prompt-paying debtors to total debtors (a) ÷ (b) = $\frac{89,100}{1,10,000}$

Provision for discount = ₹ 11,000 $\times \frac{89,100}{1,10,000} \times \frac{15}{100}$ = ₹ 1,337 (Approx.)

Tutorial Note : Loss of goods by fire of ₹ 2,500 has been charged to General Profit and Loss Account to reflect the corrected profit of the branch. If such loss is charged to Branch Profit and Loss Account, then the profit of the branch will be ₹ 17,798.

Illustration 64

M/s. Shah & Co. commenced business on 1.4.2004 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office where the goods were processed before sale. There was no loss or wastage in processing. Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales whether by Head office or by the Branch were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2005 :

	Head Office		Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Capital	—	3,10,000	—	—
Drawings	55,000	—	—	—
Purchases	19,69,500	—	—	—
Cost of Processing	50,500	—	—	—
Sales	—	12,80,000	—	8,20,000
Goods Sent to Branch	—	9,24,000	—	—
Administrative Expenses	1,39,000	—	15,000	—
Selling Expenses	50,000	—	6,200	—
Debtors	3,09,600	—	1,13,600	—
Branch Current Account	3,89,800	—	—	—
Creditors	—	6,01,400	—	10,800
Bank Balance	1,52,000	—	77,500	—
Head Office Current Account	—	—	—	2,61,500
Goods Received from H.O.	—	—	8,80,000	—
	31,15,400	31,15,400	10,92,300	10,92,300

Following further information is provided :

(i) Goods sent by Head Office to the Branch in March 2005 of ₹ 44,000 were not received by the Branch till 2.4.2005.

(ii) A remittance of ₹ 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2005.

(iii) Stock taking at the Branch disclosed a shortage of ₹ 20,000 at selling price to the branch.

(iv) Cost of unprocessed goods at Head Office on 31.3.2005 was ₹ 1,00,000.

Prepare Trading and Profit and Loss Account in columnar form and Balance Sheet of the business as a whole as at 31.3.2005. ***[C.A. (PE-II) — November, 2005]***

Solution

Shah & Co.

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2005 Cr.

Particulars	H.O. (₹)	Branch (₹)	Particulars	H.O. (₹)	Branch (₹)
To Purchases	19,69,500	—	By Sales	12,80,000	8,20,000
To Cost of Processing	50,500	—	By Goods Sent to Branch	9,24,000	—
To Goodes Received from H.O.	—	8,80,000	By Stock Shortage (Note 1)	—	16,000
To Goods in Transit	—	44,000	By Goods in Transit	—	44,000
To Gross Profit c/d	3,40,000	1,64,000	By Closing Stock :		
			Processed Goods (Note 2 & 3)	56,000	2,08,000
			Unprocessed Goods	1,00,000	—
	23,60,000	10,88,000		23,60,000	10,88,000
To Administrative Expenses	1,39,000	15,000	By Gross Profit b/d	3,40,000	1,64,000
To Selling Expenses	50,000	6,200			
To Stock Shortage	—	16,000			
To Stock Reserve	22,909	—			
To Net Profit (transferred to Capital)	1,28,091	1,26,800			
	3,40,000	1,64,000		3,40,000	1,64,000

M/s. Shah & Co.
Balance Sheet as at 31st March, 2005

Liabilities	₹	₹	Assets	₹	₹
Capital	3,10,000		**Debtors** :		
Add: Net Profit :			H.O.	3,09,600	
H.O.	1,28,091		Branch	1,13,600	4,23,200
Branch	1,26,800		**Closing Stock** :		
	5,64,891		Processed Goods :		
Less: Drawings	55,000	5,09,891	H.O.	56,000	
Creditors :			Branch	2,08,000	
H.O.	6,01,400			2,64,000	
Branch	10,800	6,12,200	Less: Stock Reserve	18,909	2,45,091
			Unprocessed Goods		1,00,000
			Bank Balance		
			H.O.	1,52,000	
			Branch	77,500	2,29,500
			Goods in Transit	44,000	
			Less: Stock Reserve	4,000	40,000
			Cash in Transit		84,300
		11,22,091			11,22,091

Working Notes :

(1) Invoice value of goods shortage = ₹ 20,000 / 125 × 100 = ₹ 16,000.

(2) Calculation of Closing Stock at Head Office

	₹
Cost of goods processed (₹ 19,69,500 + 50,500 – 1,00,000)	19,20,000
Less: Cost of goods sent to Branch (₹ 9,24,000 × 100 / 110)	8,40,000
	10,80,000
Less: Cost of Goods Sold (₹ 12,80,000 × 100/125)	10,24,000
	56,000

(3) Calculation of Closing Stock at Branch

Goods received from H.O. (at invoice price)	8,80,000
Less: Invoice value of goods sold (₹ 8,20,000 × 100 / 125)	6,56,000
	2,24,000
Less: Invoice value of goods shortage (Note 1)	16,000
	2,08,000

(4) Stock Reserve

	₹
(a) Unrealised profit on branch stock (₹ 2,08,000 × 10/110)	18,909
(b) Unrealised profit on goods in transit (₹ 44,000 × 10/110)	4,000
	22,909

Dr. **Branch Current Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	3,89,800	By Goods in Transit	44,000
		By Cash in Transit	84,300
		By Balance c/d*	2,61,500
	3,89,800		3,89,800

* It is equal to Head office Current Account balance in the books of the Branch.

Tutorial Note : At the time of preparation of Balance Sheet both the Current Accounts will be cancelled out.

Independent Branch

When the size of the branches is very large, their functions become complex. In such a situation, it is desirable or practicable for each branch to establish its own double entry book-keeping system quite separate from those of head office. Under this system of branch accounting, the branches are treated as separate, independent units. These types of branches are known as ***Independent Branches***. An independent branch is given more freedom of action, with the manager acquiring more responsibility. Apart from receiving goods from the head office, these branches are allowed to purchase goods from the open market locally. From the amount received from cash sales or debtors, they can incur expenses and can operate the bank account in their own name. The only link an independent branch has with the head office is that they are owned by the head office, because the latter provides and possesses the premises and other physical assets which a branch needs before it can become operational, and the profit or loss of the branch ultimately belongs to the head office.

The accounting arrangements are quite simple. Each branch maintains a 'Head Office Account' in its Ledger, whilst the head office maintains an account in the name of each branch, just as if individual branches were 'customers' of it. All transactions between the two are passed through these accounts, which, if book-keeping is up to date and accurate, will have equal and opposite balances.

A branch account in the head office books may have the following entries.

In the books of the Head Office

Dr. **Delhi Branch Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Bank A/c (cash received from branch)	1,90,000
To Goods Sent to Branch A/c	2,00,000	By Goods Returned from Branch A/c	10,000
To Bank A/c (Expenses paid by head office)	10,000	By Balance c/d	50,000
	2,50,000		2,50,000

In respect of the above account the following points should be noted carefully:

(1) The balance on the ***Delhi Branch Account*** (₹ 50,000) is an asset to the head office and represents the net investment by the head office in Delhi branch.

(2) The balance on the ***Head Office Account*** in the Delhi branch books (₹ 50,000) is a liability of the Delhi branch and represents its capital (i.e., the head office is financing the branch to the extent of ₹ 50,000).

(3) The balances of the two account should be equal and opposite. Where they do not, the discrepancy will be due to cash or goods in-transit.

At the end of each financial or trading period the branch either sends its Trial Balance to the head office for preparation of Trading and Profit and Loss Account and Balance Sheet or prepares its own final accounts (head office being shown as a debtor or a creditor as appropriate). In either case, the net profit made by a branch is credited to head office account; net loss, on the other hand, is debited to that account in the branch books. In this connection, it should be noted that the profit or loss made by each branch is transferred to head office (by passing the above entry), instead of being distributed in the normal way.

After receiving branch Trial Balance by the head office, a consolidated Trading and Profit and Loss Account can be prepared for the entire enterprise, together with a combined Balance Sheet.

The main features of the accounting system of an independent branch are as under:

(1) The branch maintains its entire books of account under double entry system.

(2) The branch in its books opens a Head Office Account to record all the transactions that take place between head office and the branch. This account is personal in nature. It is credited by the amount of goods received from head office and the allocated head office expenses charged to the branch, and is debited with the amount of cash sent to head office and goods returned.

(3) The head office maintains a Branch Account to record the above transactions. This is a reciprocal account of the Head Office Account maintained by the branch. This account is debited by the amount of goods sent to the branch and the allocated head office expenses charged to the branch, and is credited with the amount of cash received from branch and goods returned.

(4) At the end of the accounting period, the branch prepares its Trial Balance and Trading and Profit and Loss Account, and sends copies of these statements to the head office for incorporation.

(5) After receiving the final statements from the branch, the head office reconciles between the two balances — Branch Account as would appear in the books of head office with the Head Office Account as would appear in the books of the branch. The differences are investigated and required adjusting entries are passed in the head office books to reconcile these two balances.

(6) Lastly, the head office passes necessary Journal Entries to incorporate the branch Trial Balance in its books.

Some Special Items

The following items require some special accounting treatment in case of an independent branch:

(i) Goods-in-transit;
(ii) Cash-in-transit;
(iii) Head office expenses chargeable to branch;
(iv) Depreciation on branch fixed assets; and
(v) Inter-branch transactions.

Goods-in-Transit

It is quite common that the head office and the branch send goods to each other very frequently. The head office is to send goods to the branch at regular intervals as per the requirement of the branch and branch also returns goods to the head office what it cannot sell at a profit. When the head office sends goods to the branch, it immediately ***debits the Branch Account in its books and credits the Goods Sent to Branch Account***. But the branch will pass entry (in respect of this transaction) only when it receives the goods. Similarly, when branch sends or returns some goods to the head office, it immediately ***debits Head Office Account and credits Goods Returned to Head Office Account.*** But the head office will pass entry (in respect of this transaction), only when it receives the goods. These goods which are on the way to branch/head office are called '***Goods-in-transit***'.

Some accounting adjustment is required, if there are still some goods in transit at the end of the year. For 'goods-in-transit' the balance in the Head Office Account in the books of the branch will not tally with that of Branch Account in the books of the head office. For reconciling these balances, adjustment entry may be passed either in the books of the head office or in the books of the branch, ***but not in both sets of books***.

(a) When the adjustment entry is passed in the books of the head office:

Goods-in-Transit Account Dr.
  To Branch Account

(b) When the adjustment entry is passed in the books of the branch :

Goods-in-Transit Account Dr.
  To Head Office Account

> ***The students should remember that the above adjustment entry should be passed only in one set of books, either at head office level or branch level.***
>
> ***On principle, the adjustment entry should be passed in the books of the head office because all in-transit items are detected by the head office after receiving copy of Trial Balance (or copy of Final Accounts) and at this stage, it is not desirable to change the balances in the branch books.***
>
> ***Goods-in-Transit are shown in the Balance Sheet of head office.***

Cash-in-Transit

Branch may send cash to head office at regular intervals. At the end of the accounting period, if there is any cash-in-transit it should be adjusted just like goods-in-transit. Here also, adjustment entry may be passed either in the head office books or the branch books. For the reasons explained (in the box) above, the entry should be passed in the head office books only.

The entry will be:

Cash-in-Transit Account Dr.

To Branch Account

Illustration 65

During March 2018 Bombay head office despatched nine batches of goods to its branch at Calcutta, with each batch costing ₹ 10,000. During the same period Calcutta branch remitted three cheques of ₹ 25,000 each. At the year ended on 31st March 2018 branch had received only eight batches of goods, and the head office had received only two cheques.

The above items will appear in the respective books as follows:

In the books of Calcutta Branch

Dr. Goods from Head Office Account Cr.

Particulars	₹	Particulars	₹
To Head Office A/c (8 batches)	80,000		

Dr. Head Office Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c (3 x ₹ 25,000)	75,000	By Goods from Head Office A/c	80,000
To Balance c/d	5,000		
	80,000		80,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
		By Head Office (3 x ₹ 25,000)	75,000

In the books of the Head Office

Dr. Goods Sent to Branch Account Cr.

Particulars	₹	Particulars	₹
		By Calcutta Branch A/c (9 batches)	90,000

Dr. Calcutta Branch Account Cr.

Particulars	₹	Particulars	₹
To Goods Sent to Branch A/c	90,000	By Bank A/c (2 x ₹ 25,000)	50,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Calcutta Branch A/c (2 cheques @ ₹ 25,000 each)	50,000		

Thus, at the year end balance of Calcutta Branch Account (in the head office books) and balance of Head Office Account (in the branch books) are different. ₹ 40,000 compared with ₹ 5,000 because of the items in-transit. To reconcile the balances the following entry is to be passed in the books of the head office:

Goods-in-Transit Account (1 batch) Dr. ₹ 10,000

Cash-in-Transit Account (1 cheque of ₹ 25,000) Dr. ₹ 25,000

To Calcutta Branch Account ₹ 35,000

After adjustment, Calcutta Branch Account, Cash-in-Transit Account and Goods-in-Transit Account will appear in the books of the head office as follows:

Dr. Calcutta Branch Account Cr.

Particulars	₹	Particulars	₹
To Goods Sent to Branch A/c	90,000	By Bank A/c (2 x ₹ 25,000)	50,000
		By Goods-in-Transit A/c	10,000
		By Cash-in-Transit A/c	25,000
		By Balance c/d	5,000
	90,000		90,000

Dr. Goods-in-Transit Account Cr.

Particulars	₹	Particulars	₹
To Calcutta Branch A/c	10,000		

Dr. **Cash-in-Transit Account** **Cr.**

Particulars	₹	Particulars	₹
To Calcutta Branch A/c	25,000		

Now, both accounts have equal and opposite balances. It should be noted that goods-in-transit and cash-in-transit will appear in the head office Balance Sheet as at 31st March, 2018.

Illustration 66

From the following information, reconcile the Calcutta Head Office Account with Delhi Branch Account:

Particulars	Head Office		Delhi Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Goods Sent to Delhi Branch	—	13,02,400	—	—
Goods Received by Delhi Branch	—	—	12,80,400	—
Cash Sent by Delhi Branch	—	—	—	1,86,500
Cash Received by Head Office	1,00,000	—	—	—
Delhi Branch Account	4,11,100	—	—	—
Head Office Account	—	—	—	3,02,600

Solution **In the books of the Head Office**

Dr. **Delhi Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,11,100		By Goods-in-Transit A/c (Note 2)	22,000
				By Cash-in-Transit A/c (Note 3)	86,500
				By Balance c/d	3,02,600
		4,11,100			4,11,100

Working Notes:

(1) Net difference = ₹ 4,11,100 – ₹ 3,02,600 = ₹ 1,08,500.
(2) Difference due to goods in transit = ₹ 13,02,400 – ₹ 12,80,400 = ₹ 22,000.
(3) Difference due to cash in transit = ₹ 1,86,500 – ₹ 1,00,000 = ₹ 86,500.
(4) Journal entry in the books of the head office will be:

Goods-in-Transit Account	Dr. ₹ 22,000	
Cash-in-Transit Account	Dr. ₹ 86,500	
To Delhi Branch Account		₹ 1,08,500

Head Office Expenses Chargeable to Branch

The head office may, for acceptable reasons, like to allocate a part of its own expenses among the branches for the centralised services rendered by it. In fact, quite a good amount of time of the head office staff may be devoted in doing the jobs of the branches. Hence, the head office may well decide to charge a part of its expenditure on salaries etc., on the branches. The same may also hold true of certain other items of expenses (e.g., on advertisements). If the head office decides to put down some expenses to the branches, the following entries will be passed:

In the books of the Head Office		**In the books of the Branch**	
Branch Account	Dr.	Head Office Expenses Account	Dr.
To Expenses Account		To Head Office Account	
(Being expenses chargeable to branch)		(Being the share of head office expenses)	

Illustration 67

Journalise the following in the books of the head office as well as branch office:

Head office charges ₹ 5,000 from Calcutta Branch as head office administrative expenses.

Solution **In the books of the Head Office**

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

Date	Particulars	L.F.	₹	₹
	Calcutta Branch A/c Dr.		5,000	
	To Office Administrative Expenses A/c			5,000
	(Being office administrative expenses chargeable to branch)			

In the books of Calcutta Branch
Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
	Head Office Administrative Expenses A/c	Dr.		5,000	
	To Head Office A/c				5,000
	(Being the share of head office administrative expenses provided)				

Depreciation on Branch Fixed Assets

Branch Assets Account may be maintained at branch or at head office. Accounting entry for depreciation will differ according to situations.

(i) If the accounts of branch fixed assets are maintained at branch :

Depreciation Account Dr.
To Fixed Assets Account
[No entry is to be passed in the head office books]

(ii) If the account of branch fixed assets is maintained at head office :

In this case, all entries regarding purchase or sale of such assets are made in the head office books only. No entry is passed in the books of the branch in this respect. For example, when a branch fixed asset is purchased, the head office debits Branch Fixed Assets Account and credits Bank Account/Branch Account (if paid by branch).

As the assets are used by the branch, the depreciation for such assets is also to be charged to the branch. For depreciation the following entry is passed:

In the books of the Head Office	In the books of the Branch
Branch Account Dr.	Depreciation Account Dr.
To Branch Fixed Assets Account	To Head Office Account
(Being the depreciation on branch fixed assets)	(Being the depreciation on fixed assets)

Here, both the head office and the branch pass the required entry for depreciation. The important point to note here is that depreciation is an expense for the branch because the asset is used up by it but the Asset Account is maintained by the head office. The head office debits the branch and credits the particular Asset Account. Likewise, the branch credits the head office and debits the particular expense — Depreciation Account.

Illustration 68

Journalise the following in the books of the head office as well as branch office :

Head office has charged ₹ 10,000 as depreciation on Bangalore Branch Fixed Assets.

Solution

In the books of the Head Office
Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
	Bangalore Branch A/c	Dr.		10,000	
	To Bangalore Branch Fixed Assets A/c				10,000
	(Being the depreciation charged on branch fixed assets maintained at head office)				

In the books of Bangalore Branch
Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
	Depreciation A/c	Dr.		10,000	
	To Head Office A/c				10,000
	(Being the depreciation on fixed assets provided)				

Inter-branch Transfers

It is quite possible that one branch may send goods (or cash) to another branch directly, with of course, the consent of the head office. The usual procedure, in such a case is that the head office, in its books, should debit the receiving branch and credit the sending branch. But in the books of the head office, it regards the transaction as returning the goods to the head office and thereafter sending the goods to another branch. The following entries are passed:

Head Office	Sending Branch	Receiving Branch
Receiving Branch Account Dr. To Sending Branch Account (Being goods transferred to .... branch to .... branch)	Head Office Account Dr. To Goods Sent to H.O. Account (Being goods sent to .... branch as per head office instruction)	Goods from H.O. Account Dr. To Head Office Account (Being goods received from .... branch as per head office instruction)

Illustration 69

Journalise the following in the books of head office as well as branch offices:

Goods worth ₹ 15,000 are supplied by Kanpur Branch to Agra Branch under the instruction of the Delhi Head Office.

Solution

In the books of the Head Office (Delhi)
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Agra Branch A/c Dr. To Kanpur Branch A/c (Being the goods supplied by Kanpur Branch to Agra Branch)		15,000	15,000

In the books of Kanpur Branch
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Head Office A/c Dr. To Goods Sent to Head Office A/c (Being goods sent to Agra Branch as per Head Office instruction)		15,000	15,000

In the books of Agra Branch
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Goods from Head Office A/c Dr. To Head Office A/c (Being goods received from Kanpur Branch as per Head Office instruction)		15,000	15,000

Illustration 70

As an accountant of head office how will you record the following items while dealing with the accounts of 'Independent' branches ?

(i) Expenses incurred by head office on behalf of branch.
(ii) Depreciation of branch's fixed assets.
(iii) Goods sent by head office to branch remain in transit up to the last day of the accounting year.
(iv) Inter-branch transfers of goods.

[C.U.B.Com. (Hons.) — 2006]

Solution

In the books of the Head Office
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Branch A/c Dr. To Expenses (H.O.) A/c (Being expenses incurred by the head office on behalf of the branch now adjusted)		?	?
(ii)	Branch A/c (Note 1) Dr. To Branch Fixed Assets A/c (Being depreciation on branch fixed assets charged to Branch Account)		?	?
(iii)	Goods-in-Transit A/c Dr. To Branch A/c (Being goods sent by head office not yet received by branch now adjusted)		?	?
(iv)	Receiving Branch A/c Dr. To Sending Branch A/c (Being the necessary adjustment for transfer of goods in between the branches)		?	?

Working Note : (1) It is assumed that the Branch Fixed Assets Account is maintained by the Head Office.

Illustration 71

Give Journal Entries for the following transactions in the books of the head office:

(i) Goods sent by the head office on December 28 worth ₹ 150 to its Kanpur branch not received by the branch up to December 31.

(ii) Goods sent by Bombay branch to Kanpur branch for ₹ 300 are yet to be recorded.

(iii) Kanpur branch paid ₹ 3,000 for a machine purchased by the head office for the latter.

(iv) Provide depreciation at 10% on furniture when Kanpur Branch Furniture Account is maintained in the head office books (Furniture ₹ 25,000). ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of the Head Office

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

Date	Particulars	L.F.	₹	₹
(i)	Goods-in-Transit A/c Dr. To Kanpur Branch A/c (Being goods sent to branch by head office on 28th December not yet received by branch)		150	150
(ii)	Kanpur Branch A/c Dr. To Bombay Branch A/c (Being goods transferred by Bombay branch to Kanpur branch)		300	300
(iii)	Machinery A/c Dr. To Kanpur Branch A/c (Being the amount paid by the Kanpur branch for purchase of machine for head office)		3,000	3,000
(iv)	Kanpur Branch A/c Dr. To Branch Furniture A/c (Being depreciation provided on branch furniture @ 10% p.a. on ₹ 25,000)		2,500	2,500

Illustration 72

A Calcutta firm whose accounting year ends on 31st December has two branches — one at Allahabad, and the other at Varanasi. The branches keep a complete set of books. On 31.12.2017, the Allahabad and Varanasi Branch Accounts in the Calcutta books showed balance of ₹ 30,450 and ₹ 45,000 respectively before taking the following information into account:

(i) Goods valued at ₹ 2,000 were transferred from Allahabad branch to Varanasi branch under instruction from the head office.

(ii) Allahabad branch collected ₹ 2,500 from an Allahabad customer of the head office.

(iii) Varanasi branch paid ₹ 5,000 for certain goods purchased by the head office in Varanasi.

(iv) ₹ 5,000 remitted by Allahabad branch to Calcutta on 29th December, 2017 were received on 3rd January following.

(v) For the year 2017, the Allahabad branch showed a net loss of ₹ 1,250 and the Varanasi branch a net profit of ₹ 5,400.

Pass Journal Entries to record the above transactions in the books of the head office and then write-up the two Branch Accounts therein.

Solution

In the books of the Head Office

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

Date	Particulars	L.F.	₹	₹
2017 (i) Dec. 31	Varanasi Branch A/c Dr. To Allahabad Bank A/c (Being goods transferred from Allahabad branch to Varanasi branch under head office instruction)		2,000	2,000
(ii)	Allahabad Branch A/c Dr. To Sundry Debtors A/c (Being cash collected by Allahabad branch from head office debtors at Allahabad)		2,500	2,500
(iii)	Purchases A/c Dr. To Varanasi Branch A/c (Being the amount paid by Varanasi branch in respect of purchases of head office)		5,000	5,000
(iv)	Cash-in-Transit A/c Dr. To Allahabad Branch A/c (Being cash remitted by Allahabad branch on 29th December 2017 received by the head office on 3rd January 2018)		5,000	5,000
(v)	Profit & Loss A/c Dr. To Allahabad Branch A/c (Being the loss suffered by the Branch during 2017)		1,250	1,250
(vi)	Varanasi Branch A/c Dr. To Profit & Loss A/c (Being the profit earned by the branch during 2017)		5,400	5,400

Dr. Allahabad Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance b/d	30,450	31.12.2017	By Varanasi Branch A/c	2,000
	To Sundry Debtors A/c	2,500		By Cash-in-Transit A/c	5,000
				By Profit & Loss A/c	1,250
				By Balance c/d	24,700
		32,950			32,950

Dr. Varanasi Branch Account Cr

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance b/d	45,000	31.12.2017	By Purchases A/c	5,000
	To Allahabad Branch A/c	2,000		By Balance c/d	47,400
	To Profit & Loss A/c	5,400			
		52,400			52,400

Illustration 73

Give Journal Entries in the books of Branch A to rectify or adjust the following :

(i) Head office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch books.
(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.
(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries Account.
(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.
(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head office.
(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

[C.A. (PE - II) — November, 2004]

Solution

In the books of the Branch A
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Expenses A/c Dr.		3,500	
	To Head Office A/c			3,500
	(Being the allocated expenses of the H.O. not recorded in the books of the Branch)			
(ii)	Depreciation A/c Dr.		1,500	
	To Head Office A/c			1,500
	(Being the depreciation on branch assets provided)			
(iii)	Head Office A/c Dr.		2,000	
	To Salaries A/c			2,000
	(Being salary of H.O. staff wrongly debited to Branch Salaries Account, now rectified)			
(iv)	Head Office A/c Dr.		10,000	
	To Debtors A/c			10,000
	(Being money collected from branch debtors by H.O. has not been recorded in the books of the branch, now rectified)			
(v)	Already it is recorded in the branch books. Therefore, no entry is required			
(vi)	Head Office A/c Dr.		3,000	
	To Cash A/c			3,000
	(Being advertisement expenses paid on behalf of branch B, now adjusted)			

Illustration 74

A Calcutta 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 April, 2018, make the entries in the books of Calcutta head office.

(a) ***Delhi branch***:
(i) Received goods from Nagpur branch ₹ 9,000 and Ahmedabad branch ₹ 6,000.
(ii) Sent goods to Ahmedabad branch ₹ 15,000 and Nagpur branch ₹ 12,000.
(iii) Received bills receivable from Ahmedabad branch ₹ 9,000.
(iv) Sent acceptances to Nagpur branch ₹ 6,000 and Ahmedabad branch ₹ 3,000.

(b) ***Kanpur branch*** [apart from (a) above]:
(i) Received goods from Nagpur branch ₹ 15,000 and Delhi branch ₹ 6,000.
(ii) Cash sent to Nagpur branch ₹ 3,000 and Delhi branch ₹ 6,000.
(c) ***Nagpur branch*** [apart from (a) and (b) above]:
(i) Sent goods to Ahmedabad branch ₹ 9,000.
(ii) Received bills receivable from Ahmedabad branch ₹ 9,000.
(iii) Received cash from Ahmedabad branch ₹ 5,000 ***[I.C.W.A. (Inter) — Adapted]***

Solution **In the books of the Head Office**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018	Kanpur Branch A/c	Dr.		12,000	
April 30	Nagpur Branch A/c	Dr.		2,000	
	To Delhi Branch A/c				12,000
	To Ahmedabad Branch A/c				2,000
	(Being the adjustment for branch transactions)				

Workings **Statement Showing Inter-Branch Transactions**

Branches	Delhi Dr. ₹	Delhi Cr. ₹	Kanpur Dr. ₹	Kanpur Cr. ₹	Nagpur Dr. ₹	Nagpur Cr. ₹	Ahmedabad Dr. ₹	Ahmedabad Cr. ₹
Delhi								
Goods received	15,000	—	—	—	—	9,000	—	6,000
Goods sent	—	27,000	—	—	12,000	—	15,000	—
Bills Receivable received	9,000	—	—	—	—	—	—	9,000
Bills Payable accepted	—	9,000	—	—	6,000	—	3,000	—
Kanpur								
Goods received	—	6,000	21,000	—	—	15,000	—	—
Cash sent	6,000	—	—	9,000	3,000	—	—	—
Nagpur								
Goods sent	—	—	—	—	—	9,000	9,000	—
Bills Receivable received	—	—	—	—	9,000	—	—	9,000
Cash received	—	—	—	—	5,000	—	—	5,000
TOTAL	30,000	42,000	21,000	9,000	35,000	33,000	27,000	29,000
Balance	12,000	—	—	12,000	—	2,000	2,000	—
	42,000	42,000	21,000	21,000	35,000	35,000	29,000	29,000

Illustration 75

Show adjustment journal entry in the books of Head office at the end of April, 2003 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch accounts in its books.

A. **Delhi Branch** :
(1) Received goods from Mumbai — ₹ 35,000 and ₹ 15,000 from Kolkata.
(2) Sent goods to Chennai — ₹ 25,000; Kolkata — ₹ 20,000.
(3) Bills Receivable received — ₹ 20,000 from Chennai.
(4) Acceptances sent to Mumbai — ₹ 25,000; Kolkata — ₹ 10,000.
B. **Mumbai Branch** (apart from the above) :
(5) Received goods from Kolkata — ₹ 15,000; Delhi — ₹ 20,000.
(6) Cash sent to Delhi — ₹ 15,000; Kolkata — ₹ 7,000.
C. **Chennai Branch** (apart from the above) :
(7) Received goods from Kolkata — ₹ 30,000.
(8) Acceptances and Cash sent to Kolkata — ₹ 20,000 and ₹ 10,000 respectively.
D. **Kolkata Branch** (apart from the above) :
(9) Sent goods to Chennai — ₹ 35,000.
(10) Paid cash to Chennai — ₹ 15,000.
(11) Acceptances sent to Chennai — ₹ 15,000.
All working should form part of the answer.

[C.A. (PE - II) — May, 2003]

Solution

In the books of the Head Office
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2003	Mumbai Branch A/c	Dr.		3,000	
April 30	Chennai Branch A/c	Dr.		70,000	
	To Delhi Branch A/c				15,000
	To Kolkata Branch A/c				58,000
	(Being the adjustment for branch transactions)				

Workings **Statement Showing Inter-Branch Transactions**

Branches	Delhi		Mumbai		Chennai		Kolkata	
	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹
Delhi								
(1) Goods received	50,000	—	—	35,000	—	—	—	15,000
(2) Goods sent	—	45,000	—	—	25,000	—	20,000	—
(3) Bills Receivable received	20,000	—	—	—	—	20,000	—	—
(4) Bills Payable accepted	—	35,000	25,000	—	—	—	10,000	—
Mumbai								
(5) Goods received	—	20,000	35,000	—	—	—	—	15,000
(6) Cash sent	15,000	—	—	22,000	—	—	7,000	—
Chennai								
(7) Goods received	—	—	—	—	30,000	—	—	30,000
(8) Bills Payable accepted	—	—	—	—	—	20,000	20,000	—
(8) Cash sent	—	—	—	—	—	10,000	10,000	—
Kolkata								
(9) Goods sent	—	—	—	—	35,000	—	—	35,000
(10) Cash paid	—	—	—	—	15,000	—	—	15,000
(11) Bills Payable accepted	—	—	—	—	15,000	—	—	15,000
TOTAL	85.000	1,00,000	60,000	57,000	1,20,000	50,000	67,000	1,25,000
Balance	15.000	—	—	3,000	—	70,000	58,000	—
	1,00,000	1,00,000	60,000	60,000	1,20,000	1,20,000	1,25,000	1,25,000

Illustration 76

From the following information prepare Jaipur Branch Current Account in the head office book at Delhi and Head Office Current Account in the books of Jaipur branch. Give reasons for the entry you are making.

Particulars	Head Office		Jaipur Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Jaipur Branch Current Account	75,000	—	—	—
Head Office Current Account				75,000
Goods Sent to Jaipur Branch	65,000	—	—	
Goods Received from Head Office				62,000
Cash Sent to Head Office			55,000	—
Cash Received from Jaipur Branch	—	50,000		

Solution

Jaipur Branch Current Account will appear in Head Office Books as follows:

Dr. **Jaipur Branch Current Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	75,000		By Cash Received from Jaipur Branch A/c (2)	50,000
	To Goods Sent to Jaipur Branch A/c (1)	65,000		By Goods-in-Transit A/c (3)	3,000
				By Cash-in-Transit (4)	5,000
				By Balance c/d	82,000
		1,40,000			1,40,000

Reason : (1) — When goods are sent to branch, the following entry is passed in the Head Office books :

Branch Account	Dr.	
To Goods Sent to Branch Account		

In the Trial Balance of the head office, "Goods Sent to Branch Account" should appear on the ***credit side*** but in this case Goods Sent to Jaipur Branch ₹ 65,000 is appearing on the ***debit side*** of the trial balance. This is possible when the following entry has been made by the head office at the time of sending the goods to Jaipur branch :

Goods Sent to Jaipur Branch Account	Dr.	
To Purchases Account		

Since the Jaipur Branch Account has not been debited immediately at the time of sending the goods, at the end of the year following adjustment entry is to be passed:

Jaipur Branch Current Account	Dr. ₹ 65,000	
To Goods Sent to Jaipur Branch Account		₹ 65,000

Reason (2) — When cash is received from branch, the following entry is passed:

Bank/Cash Account	Dr.	
To Branch Account		

In the Trial Balance of the head office "Cash Received from Jaipur Branch Account" is appearing on the *credit side*, in place of "Jaipur Branch Account". Therefore, at the end of the year, the following adjustment entry is to be passed:

Cash Received from Jaipur Branch Account	Dr. ₹ 50,000	
To Jaipur Branch Current Account		₹ 50,000

Reason (3)

Goods sent to Jaipur Branch	₹ 65,000
Goods received by Jaipur Branch	₹ 62,000
Goods-in-Transit	₹ 3,000

Reason (4)

Cash sent to Head Office	₹ 55,000
Cash received from Jaipur Branch	₹ 50,000
Cash-in-Transit	₹ 5,000

In the books of the branch, the Head Office Account will appear as follows:

Dr. Head Office Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Cash Sent to Head Office A/c (6)	55,000		By Balance b/f	75,000
	To Balance c/d	82,000		By Goods Received from H .O. A/c (5)	62,000
		1,37,000			1,37,000

Reason (5) — When goods are received from head office, the following entry is passed in the Branch Book:

Goods Received from Head Office Account	Dr.	
To Head Office Account		

In the Trial Balance of the branch Goods Received from Head Office Account should appear on the ***debit side*** but in this case Goods Received from Head Office Account ₹ 62,000 is appearing on the ***credit side***. This is possible when the following entry has been made by the branch at the time of receiving goods from head office:

Purchases Account	Dr. ₹ 62,000	
To Goods Received from Head Office Account		₹ 62,000

Since, the Head Office Account has not been credited immediately at the time of receiving goods, at the end of the year, following adjustment entry is to be passed:

Goods Received from Head Office Account	Dr. ₹ 62,000	
To Head Office Account		₹ 62,000

Reason (6) — When cash is sent to head office, the following entry is passed in the branch book:

Head Office Account	Dr.	
To Cash / Bank Account		

In the Trial Balance of branch Cash Sent to Head Office is appearing on the ***debit side*** in place of ***credit side***. Therefore, at the end of the year the following adjustment entry is to be passed:

Head Office Account	Dr. ₹ 55,000	
To Cash Sent to Head Office Account		₹ 55,000

Incorporation of Branch Trial Balance in the Head Office Books

It has already been stated that an independent branch prepares its own Trial Balance and Final Accounts and remits the copies of these statements to the head office.

After receiving Branch Trial Balance, head office proceeds to incorporate it in its own books. This is absolutely necessary because the branch belongs to the head office, and if the branch Trial Balance is not incorporated in the head office books, the latter will not show correct position.

The incorporation of Branch Trial Balance can be divided into two parts:

(a) Incorporation of Branch Profit and Loss; and
(b) Incorporation of Branch Assets and Liabilities.

Incorporation of Branch Profit and Loss

For the purpose of incorporation of branch profit and loss, the head office may follow any of the following two methods:

(i) Detailed Incorporation
(ii) Abridged Incorporation

Detailed Incorporation

Under this method, incorporation is done with a view to prepare Branch Trading and Profit and Loss Account in the books of the head office. Head office opens a separate Branch Trading and Profit and Loss Account to incorporate all revenue transactions of the branch. This account is temporary in nature and is prepared to ascertain the real profit or loss of the branch after making all adjustments.

In this connection, we must remember that head office maintains only the ***Branch Account*** and the statements received from the branch do not form a part of the double entry system. Therefore, all the Journal Entries should be passed through the Branch Account maintained in the head office. The required Journal Entries are as follows:

Journal Entries

1. For items on the debit side of the Branch Trading Account

Branch Trading Account Dr.
    To Branch Account

The above entry is passed for the total amount of items like opening stock, purchases, carriage inwards, wages, processing cost, goods received from head office, sales returns, etc.

2. For items on the credit side of the Branch Trading Account

Branch Account Dr.
    To Branch Trading Account

The above entry is passed for the total amount of items like sales, goods sent to head office, closing stock, purchases returns, abnormal loss of stock, etc.

3. For Gross Profit of the Branch

Branch Trading Account Dr.
    To Branch Profit and Loss Account

4. For Gross Loss of the Branch

Branch Profit and Loss Account Dr.
    To Branch Trading Account

5. For items on the debit side of the Branch Profit and Loss Account

Branch Profit and Loss Account Dr.

To Branch Account

The above entry is passed for the total amount of items like salaries, rent, depreciation, bad debts, repairs, discount allowed, etc.

6. For items on the credit side of the Branch Profit and Loss Account

Branch Account Dr.

To Branch Profit and Loss Account

The above entry is passed for the total amount of items like discount received, miscellaneous income, etc.

7. For net profit of the Branch

Branch Profit and Loss Account Dr.

To General Profit and Loss Account

8. For net loss of the Branch

General Profit and Loss Account Dr.

To Branch Profit and Loss Account

Abridged Incorporation

Under this method, a Memorandum Trading and Profit and Loss Account is prepared for ascertaining branch profit. Only one entry is passed (in place of 8 above) for incorporating branch net profit/loss.

Branch Account Dr.

To General Profit and Loss Account

(In case of loss the above entry shall be reversed).

Incorporation of Branch Assets and Liabilities

This part of the incorporation is done with a view to include branch assets and liabilities in the annual Balance Sheet of the whole business. At the beginning of the new financial year, assets and liabilities are sent back to the books of the branch by means of reverse entries. The following entries are passed for incorporation :

Journal Entries

1. For branch assets

Branch Assets Account(s) Dr. [Individually]

To Branch Account

2. For branch liabilities

Branch Account Dr. [Individually]

To Branch Liabilities Account

Illustration 77

The following is the Trial Balance of Meerut Branch as on 31st December, 2017:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Delhi head office		5,000	Debtors	3,700	
Stock 1st January 2017	6,000		Creditors		1,850
Purchases	1,06,040		Rent	1,960	
Goods received from head office	19,000		Sundry office expenses	1,470	
Sales		1,38,000	Cash at bank	1,780	
Goods supplied to head office		6,000	Furniture	6,000	
Salaries	4,500		Depreciation on furniture	400	
			TOTAL	1,50,850	1,50,850

Stock at branch on 31st December, 2017 was valued at ₹ 7,700.

Meerut Branch Account in the head office books on 31st December, 2017 stood at ₹ 8,700 (debit balance). On 28th December, 2017 the head office forwarded goods of the value of ₹ 3,700 to the branch where they were received on 3rd January, 2018.

(i) Prepare Trading and Profit and Loss Account of Meerut branch for the year ended 31st December, 2017 and its Balance Sheet as on that date.

(ii) Pass Journal Entries in the books of the head office to incorporate the above-mentioned trial balance, and

(iii) Show Meerut Branch Account as it would be closed in the head office's ledger.

Solution

(i) In this problem, Meerut Branch Trading and Profit and Loss Account as well as Balance Sheet are to be prepared in the usual manner as if it is a separate business. The balance of Head Office Account (₹ 5,000) should be treated as Capital.

Dr. Meerut Branch Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening stock	6,000	By Sales	1,38,000
To Purchases	1,06,040	By Goods supplied to H.O. (Note 4)	6,000
To Goods received from H.O.	19,000	By Closing stock	7,700
To Gross Profit c/d	20,660		
	1,51,700		1,51,700
To Salaries	4,500	By Gross Profit b/d	20,660
To Rent	1,960		
To Sundry office expenses	1,470		
To Depreciation on furniture	400		
To Net Profit	12,330		
	20,660		20,660

Meerut Branch Balance Sheet as at 31st December, 2017

Liabilities		₹	Assets	₹
Delhi head office:			Furniture	6,000
Opening balance	5,000		Debtors	3,700
Add: Profit	12,330	17,330	Closing stock	7,700
Creditors		1,850	Cash at bank	1,780
		19,180		19,180

(ii) For incorporation of Branch Trial Balance, the following entries are to be passed:

In the books of the Head Office
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Meerut Branch Trading A/c	Dr.		1,31,040	
Dec. 31	To Meerut Branch A/c (Note 1)				1,31,040
	(Being the incorporation of opening stock purchases and goods received from head office)				
	Meerut Branch A/c	Dr.		1,51,700	
	To Meerut Branch Trading A/c (Note 2)				1,51,700
	(Being the incorporation of sales, goods supplied to head office and closing stock)				
	Meerut Branch Trading A/c	Dr.		20,660	
	To Meerut Branch Profit & Loss A/c				20,660
	(Being the gross profit transferred to Branch Profit & Loss Account)				
	Meerut Branch Profit & Loss A/c	Dr.		8,330	
	To Meerut Branch A/c (Note 3)				8,330
	(Being the incorporation of branch expenses i.e. salaries, rent etc.)				
	Meerut Branch Profit & Loss A/c	Dr.		12,330	
	To General Profit & Loss A/c				12,330
	(Being the incorporation of branch net profit)				

Goods-in-Transit A/c	Dr.		3,700	
To Meerut Branch A/c				3,700
(Being the goods sent to branch on 28th December 2017 received on 3rd Jan., 2017)				
Meerut Branch Furniture A/c	Dr.		6,000	
Meerut Branch Debtors A/c	Dr.		3,700	
Meerut Branch Stock A/c	Dr.		7,700	
Meerut Branch Cash A/c	Dr.		1,780	
To Meerut Branch A/c				19,180
(Being the incorporation of branch assets)				
Meerut Branch A/c	Dr.		1,850	
To Meerut Branch Creditors A/c				1,850
(Being the incorporation of branch liability)				

Dr. (iii) In the books of the Head Office Meerut Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance b/d	8,700	31.12.2017	By Meerut Branch Trading A/c (Note 1)	1,31,040
	To Meerut Branch Trading A/c (Note 2)	1,51,700		By Meerut Branch Profit & Loss A/c	8,330
	To Meerut Branch Creditors A/c	1,850		By Goods-in-Transit A/c	3,700
				By Meerut Branch Assets A/c	19,180
		1,62,250			1,62,250

Tutorial Notes:

(1) In Branch Trial Balance, Delhi Head Office Account shows a ***credit*** balance of ₹ 5,000. It means that in the head office book, Meerut Branch Account should show a ***debit*** balance of ₹ 5,000. But in the head office book, it shows a ***debit*** balance of ₹8,700. The difference of ₹ 3,700 is due to goods in transit.

(2) After incorporation of Branch Trial balance, the Branch Account in the head office book will not show any balance.

Working Notes:

(1) Opening stock ₹ 6,000 + Purchases ₹ 1,06,040 + Goods received from H.O. ₹ 19,000 = ₹ 1,31,040.

(2) Sales ₹ 1,38,000 + Goods supplied to H.O. ₹ 6,000 + Closing stock ₹ 7,700 = ₹ 1,51,700.

(3) Salaries ₹ 4,500 + Rent ₹ 1,960 + Office expenses ₹ 1,470 + Depreciation ₹ 400 = ₹ 8,330.

(4) Goods supplied to head office should not be treated as goods returned to head office. They have been treated as goods sold to head office.

Abridged Incorporation

Illustration 78

From information given in ***Illustration 77***, prepare Memorandum Branch Trading and Profit and Loss Account and pass necessary Journal Entries to incorporate Meerut branch balances and prepare Meerut Branch Account in the head office books.

Solution Memorandum Meerut Branch Trading and Profit and Loss Account
Dr. For the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening stock	6,000	By Sales	1,38,000
To Purchases	1,06,040	By Goods supplied to H.O.	6,000
To Goods received from H.O.	19,000	By Closing stock	7,700
To Gross Profit c/d	20,660		
	1,51,700		1,51,700
To Salaries	4,500	By Gross Profit b/d	20,660
To Rent	1,960		
To Sundry office expenses	1,470		
To Depreciation on furniture	400		
To Net Profit	12,330		
	20,660		20,660

In the books of the Head Office
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Meerut Branch A/c	Dr.		12,330	
Dec. 31	To General Profit & Loss A/c				12,330
	(Being the incorporation of branch net profit)				
	Goods-in-Transit A/c	Dr.		3,700	
	To Meerut Branch A/c				3,700
	(Being goods sent to branch on 28th December received on 3rd January 2018)				
	Meerut Branch Furniture A/c	Dr.		6,000	
	Meerut Branch Debtors A/c	Dr.		3,700	
	Meerut Branch Stock A/c	Dr.		7,700	
	Meerut Branch Cash A/c	Dr.		1,780	
	To Meerut Branch A/c				19,180
	(Being the incorporation of branch assets)				
	Meerut Branch A/c	Dr.		1,850	
	To Meerut Branch Creditors A/c				1,850
	(Being the incorporation of branch liability)				

In the books of the Head Office
Meerut Branch Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance b/d	8,700	31.12.2017	By Goods-in-Transit A/c	3,700
	To Meerut Branch Creditors A/c	1,850		By Meerut Branch Assets A/c	19,180
	To General Profit & Loss A/c	12,330			
		22,880			22,880

Tutorial Notes:

(1) The students should note that, under this method, individual items of Trading and Profit and Loss Account are not incorporated in the books of the head office. Only the net profit of the branch is incorporated. Branch profit is calculated with the help of a Memorandum Trading and Profit and Loss Account.

(2) Branch assets and liabilities are incorporated in the same manner in the case of detailed incorporation method.

Illustration 79

C. Co. Ltd. of Calcutta had a branch in Bombay which maintained its accounts independently. Accounts relating to fixed assets in the Bombay branch were, however, kept in the books of accounts of the head office. On 31st December, 2017 the Bombay branch extracted the following Trial Balance from its own books of accounts and forwarded the same to the head office.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Stock-in-Trade (1.1.2017)	20,000		Cash in hand and at bank	2,500	
Purchases	50,000		Sales		75,900
Carriage and freight inward	2,500		Sundry creditors		5,000
Goods received from head office	15,000		Miscellaneous receipts		500
Transit Insurance ch. on goods received	1,000		Purchases returns		800
Salaries	10,000		Sales returns	500	
Rents rates and taxes	3,800		Bills receivable	1,500	
General office expenses	9,000		Discount allowed	200	
Sundry debtors	7,200		Head office account		41,000
			TOTAL	1,23,200	1,23,200

The Closing stock (as at 31.12.2017) at Bombay branch was ₹ 16,000. Depreciation was to be allowed @ 15% p.a. on Branch Plant and Machinery of ₹ 25,000 and @ 20% p.a. on Branch Furniture and Fittings of ₹ 6,000. Outstanding rent in respect of the year 2017 amounted to ₹ 500. Bombay Branch account, in the head office books, showed a debit balance of ₹ 46,000 and it was revealed that the difference in the balances shown by Head Office Account and Bombay Branch Account was on account of cash-in-transit.

You are to show Journal Entries required to incorporate the above Trial Balance and other particulars in the books of the head office and also the Bombay Branch Account.

Solution

In the books of C. Co. Ltd. (H.O.)
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 Dec. 31	Bombay Branch Trading A/c	Dr.		89,000	
	To Bombay Branch A/c (Note 1)				89,000
	(Being the incorporation of opening stock, purchases, carriage and freight inward, goods received from head office, transit insurance, sales returns etc.)				
	Bombay Branch A/c	Dr.		92,700	
	To Bombay Branch Trading A/c (Note 2)				92,700
	(Being the incorporation of closing stock, sales, and purchase returns)				
	Bombay Branch Trading A/c	Dr.		3,700	
	To Bombay Branch Profit & Loss A/c				3,700
	(Being the gross profit transferred to Branch Profit & Loss Account)				
	Bombay Branch Profit & Loss A/c	Dr.		28,450	
	To Bombay Branch A/c (Note 3)				28,450
	(Being the incorporation of branch expenses)				
	Bombay Branch A/c	Dr.		500	
	To Bombay Branch Profit & Loss A/c				500
	(Being the incorporation of branch miscellaneous income)				
	General Profit & Loss A/c	Dr.		24,250	
	To Bombay Branch Profit & Loss A/c				24,250
	(Being the incorporation of branch net loss)				
	Cash-in-Transit A/c	Dr.		5,000	
	To Bombay Branch A/c				5,000
	(Being cash remitted by Bombay branch not yet received by the head office)				
	Bombay Branch A/c	Dr.		4,950	
	To Branch Plant & Machinery A/c				3,750
	To Branch Furniture & Fittings A/c				1,200
	(Being the depreciation charged on branch assets)				
	Bombay Branch Closing Stock A/c	Dr.		16,000	
	Bombay Branch Debtors A/c	Dr.		7,200	
	Bombay Branch Bills Receivable A/c	Dr.		1,500	
	Bombay Branch Cash in hand A/c	Dr.		2,500	
	To Bombay Branch A/c				27,200
	(Being the incorporation of branch assets)				
	Bombay Branch A/c	Dr.		5,500	
	To Bombay Branch Creditors A/c				5,000
	To Outstanding Rent A/c				500
	(Being the incorporation of branch liabilities)				

In the books of the C. Co. Ltd. (H. O.)
Bombay Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance b/d	46,000	31.12.2017	By Bombay Branch Trading A/c (Note 1)	89,000
	To Bombay Branch Trading A/c (Note 2)	92,700		By Bombay Branch Profit & Loss A/c	28,450
	To Bombay Branch Trading A/c	500		By Cash-in-Transit A/c	5,000
	To Branch Plant & Machinery A/c	3,750		By Bombay Branch Assets A/c	27,200
	To Branch Furniture & Fittings A/c	1,200			
	To Bombay Branch Creditors A/c	5,000			
	To Outstanding Rent A/c	500			
		1,49,650			1,49,650

Working Notes:

(1) Opening stock ₹ 20,000 + Purchases ₹ 50,000 + Carriage and freight ₹ 2,500 + Goods from head office ₹ 15,000 + Transit insurance ₹ 1,000 + Sales return ₹ 500 = ₹ 89,000.

(2) Sales ₹ 75,900 + Closing stock ₹ 16,000 + Purchase returns ₹ 800 = ₹ 92,700.

(3) Salaries ₹ 10,000 + Rent, rates (including outstanding) ₹ 4,300 + General office expenses ₹ 9,000 + Discount allowed ₹ 200 + Depreciation on Plant and Machinery ₹ 3,750 + Depreciation on Furniture and Fittings ₹ 1,200 = ₹ 28,450.

Illustration 80

A limited company with its Head Office in Bombay whose Branch Office in Delhi, which obtain goods partly from head office and partly from outsiders. The branch keeps a separate set of books. The following balances were extracted on 31.12.2017 :

Particulars	Bombay		Delhi	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Share Capital Account	—	4,00,000	—	—
Plant and Machinery	2,80,000	—	—	—
Furniture and Fixture	50,000	—	25,000	—
Loose Tools	40,000	—	18,000	—
Profit and Loss Account on 1.1.2017	—	35,000	—	—
Debtors and Creditors	2,30,000	55,000	10,000	25,000
Cash in Hand	5,000	—	2,800	—
Cash at Bank	5,000	—	6,000	—
Purchases and Sales	6,00,000	8,10,000	1,12,000	2,45,000
Salaries and Wages	30,000	—	16,000	—
Rent	15,000	—	8,500	—
General Expenses	5,000	—	7,500	—
Goods from Head Office to Branch		90,000	80,000	—
Current Accounts	70,000	—	—	55,800
Opening Stock (1.1.2017)	50,000	—	40,000	—
	13,90,000	13,90,000	3,25,800	3,25,800

The difference between the balances of the Head Office Current Account and Branch Current Account is due to goods and cheque in transit as at the date of the preparation of the Trial Balance. Rent of branch office remains unpaid ₹ 150. Plant, Furniture and Loose Tools are to be depreciated at 10% p.a., 15% p.a., and 20% p.a. respectively. Stock-in-trade valued at 31.12.2017 were as follows: Head office ₹ 65,000; Branch ₹ 35,000.

Prepare a combined Trading and Profit and Loss Account for the year ended 31.12.2017 and a Balance Sheet as at the date.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Head Office (₹)	Delhi Branch (₹)	Particulars	Head Office (₹)	Delhi Branch (₹)
To Opening Stock	50,000	40,000	By Sales	8,10,000	2,45,000
To Purchases	6,00,000	1,12,000	By Goods Sent to Branch	90,000	—
To Goods from Head Office	—	80,000	By Closing Stock	65,000	35,000
To Gross Profit c/d	3,15,000	48,000			
	9,65,000	2,80,000		9,65,000	2,80,000
To Salaries and Wages	30,000	16,000	By Gross Profit b/d	3,15,000	48,000
To Rent	15,000	8,500			
To Outstanding Rent	—	150			
To General Expenses	5,000	7,500			
To Depreciation on :					
Plant and Machinery @ 10%	28,000	—			
Furniture @ 15%	7,500	3,750			
Loose Tools @ 20%	8,000	3,600			
To Net Profit c/d	2,21,500	8,500			
	3,15,000	48,000		3,15,000	48,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Balance c/d	2,65,000	By Balance b/d	35,000
		By Net Profit b/d: Head Office	2,21,500
		Branch	8,500
	2,65,000		2,65,000

Balance Sheet of . . . as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Share Capital			**Fixed Assets**		
Authorised :			Plant and Machinery (H.O.)	2,80,000	
. . . Equity Shares of . . . each		***	less: Depreciation	28,000	2,52,000
Issued and Subscribed :			Furniture and Fixtures :		
. . . Equity shares of . . . each		4,00,000	Head Office	50,000	
Reserve and Surplus			Branch	25,000	
Profit and Loss Account		2,65,000		75,000	
Secured Loan		Nil	Less: Depreciation (₹ 7,500 + ₹ 3,750)	11,250	63,750
Unsecured Loan		Nil	Loose Tools :		
Current Liabilities and Provisions			Head Office	40,000	
Creditors :			Branch	18,000	
Head Office	55,000			58,000	
Branch	25,000	80,000	Less: Depreciation (₹ 8,000 + ₹ 3,600)	11,600	46,400
Outstanding Rent (Branch)		150	**Investments**		Nil
			Current Assets, Loans and Advances		
			Debtors :		
			Head Office	2,30,000	
			Branch	10,000	2,40,000
			Stock-in-Trade :		
			Head Office	65,000	
			Branch	35,000	1,00,000
			Goods-in-Transit		10,000
			Cash at Bank :		
			Head Office	15,000	
			Branch	6,000	21,000
			Cheque-in-Transit		4,200
			Cash in Hand :		
			Head Office	5,000	
			Branch	2,800	7,800
		7,45,150			7,45,150

Working Note : (1) In the books of the Head Office, Branch Current Account balance is ₹ 70,000 but in the books of the Delhi Branch, Head Office Current Account balance is ₹ 55,800. Total difference is ₹ 70,000 – ₹ 55,800 = ₹ 14,200. Difference due to Goods-in-Transit' is ₹ 10,000 (₹ 90,000 – ₹ 80,000) and the balance ₹ 4,200 is due to cheque-in-transit. The Branch Current Account will appear as follows:

Dr. **Delhi Branch Current Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	70,000		By Goods-in-Transit*	10,000
				By Cash-in-Transit	4,200
				By Balance c/d	55,800
		70,000			70,000

*Goods sent by head office = ₹ 90,000 but goods received by the branch ₹ 80,000. Therefore, goods of ₹ 10,000 still in transit.

Illustration 81

Imphal Branch of a business having head office in Calcutta prepares its accounts independently. The position as on 31.12.2017 is depicted below :

Particulars	Calcutta Head Office		Imphal Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Bills Receivable / Bills Payable	—	11,800	6,000	—
Debtors / Creditors	78,500	39,600	58,400	29,200
Stock	1,42,000	—	72,000	—
Cash and Bank	1,07,400	—	44,200	—
Fixed Assets	4,53,500	—	1,59,400	—
Profit and Loss Account	—	1,46,600	—	30,600
Capital	—	8,82,000	—	—
Branch Account	2,98,600	—	—	—
Head Office Account	—	—	—	2,80,200
TOTAL	10,80,000	10,80,000	3,40,000	3,40,000

It is revealed that the above accounts for the year ended 31.12.2017 were prepared without considering the following facts:

(a) Goods worth ₹ 4,400 had been despatched by the head office to Imphal on 27.12.2017 but the goods did not reach there till 2.1.2018.

(b) As per convention, the branch should be charged with ₹ 3,000 for administrative services rendered by the head office.

(c) The branch had sent a bank draft to the head office on 30.12.2017 for ₹ 10,000. But the draft reached head office after 31.12.2017.

(d) Stock stolen in transit ₹ 4,000 (uninsured). The stock was invoiced by the head office to the branch and charged to the Branch Account. But the branch manager refused to consider it in the branch books.

(e) Depreciation on some branch assets (of which accounts are maintained in head office books) not provided for ₹ 2,500.

(f) The balance of branch profit should be transferred to the head office books.

Show the necessary adjustment entries in the books of the head office and the branch and prepare the Balance Sheet of the business as on 31.12.2017. *[C.U.B.Com. (Hons.) — Adapted]*

Solution

In the books of Head Office (Calcutta)
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2017 (a) Dec. 31	Goods-in-Transit A/c Dr. To Imphal Branch A/c (Being goods sent to Imphal Branch on 27.12.2017 but the goods have not been received by branch, now adjusted)		4,400	 4,400
(b)	Imphal Branch A/c Dr. To Profit and Loss A/c (Being amount charged to Imphal Branch for admisinistrative services rendered by H.O.)		3,000	 3,000
(c)	Cash-in-Transit A/c Dr. To Imphal Branch A/c (Being bank draft sent by branch on 30.12.2017 but received by H.O. after 31.12.2017, now adjusted)		10,000	 10,000
(d)	Profit and Loss A/c Dr. To Imphal Branch A/c (Being goods stolen in transit and charged to Branch but the branch manager refused to accept it, now adjusted in the H.O. Profit and Loss Account)		4,000	 4,000
	Tutorial Note : It should be noted that after passing (a), (c) and (d) entries above, the Branch A/c balance in H.O. book will be (₹ 2,98,600 – ₹ 4,400 – ₹ 10,000 – ₹ 4,000) = ₹ 2,80,200. Now it is matching with the balance of Head Office Account (in the branch's books).			
(e)	Imphal Branch A/c Dr. To Imphal Branch Fixed Assets A/c (Being depreciation on fixed assets of Imphal Branch adjusted)		2,500	 2,500
(f)	Imphal Branch A/c Dr. To Profit and Loss A/c (Note 1) (Being the incorporation of branch profit)		25,100	 25,100
	Profit and Loss A/c (Note 3) Dr. To Capital Account (Being total profit transferred to Capital Account)		1,70,700	 1,70,700
	Branch Bills Receivable A/c Dr. Branch Debtors A/c Dr. Branch Stock A/c Dr. Branch Cash and Bank A/c Dr. Branch Fixed Assets A/c Dr. To Imphal Branch A/c (Being the incorporation of branch assets in the H.O. book)		6,000 58,400 72,000 44,200 1,59,400	 3,40,000
	Imphal Branch A/c Dr. To Branch Creditors A/c (Being the incorporation of branch liability in the H.O. book)		 29,200	 29,200
	Tutorial Note : Last four entries have not been asked in the question. Yet, these entries are required to be passed to close the Imphal Branch Account in the H.O., book (See Working Note 4 for details).			

In the books of Imphal Branch
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Profit and Loss A/c	Dr.		3,000	
Dec. 31	To Head Office A/c				3,000
	(Being the amount charged by H.O. for administrative services)				
	Profit and Loss A/c	Dr.		2,500	
	To Head Office A/c				2,500
	(Being depreciation on Branch Fixed Assets maintained at H.O. adjusted)				
	Profit and Loss A/c (Note 1)	Dr.		25,100	
	To Head Office A/c				25,100
	(Being adjusted branch profit transferred to Head Office Account)				

Tutorial Note: No entry is to be passed for Goods-in-Transit and Cash-in-Transit because these have already been adjusted in Head Office books.

Balance Sheet of . . . as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital :			Fixed Assets :		
Opening balance	8,82,000		Head Office	4,53,500	
Add: Profit	1,70,700	10,52,700	Branch	1,59,400	
Creditors :				6,12,900	
Head Office	39,600		Less: Depreciation	2,500	6,10,400
Branch	29,200	68,800	Stock :		
Bills Payable :			Head Office	1,42,000	
Head Office		11,800	Branch	72,000	2,14,000
			Debtors :		
			Head Office	78,500	
			Branch	58,400	1,36,900
			Goods-in-Transit		4,400
			Bills Receivable :		
			Branch		6,000
			Cash and Bank :		
			Head Office	1,07,400	
			Branch	44,200	1,51,600
			Cash-in-Transit		10,000
		11,33,300			11,33,300

Working Notes:

(1) Revised Net Profit of Branch

Particulars	₹
Profit as per Trial Balance	30,600
Less : Charge for Administrative Services	3,000
	27,600
Less: Depreciation of Branch Fixed Assets	2,500
	25,100

(2) Revised Net Profit on Head Office

Particulars	₹
Profit as per Trial Balance	1,46,600
Add : Charge for Administrative Services	3,000
	1,49,600
Less: Goods Stolen in Transit	4,000
	1,45,600

(3) Total profit transferred to Capital Account =₹ 1,45,600 + ₹ 25,100 = ₹1,70,700.

(4) Imphal Branch Account

Dr. | Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,98,600	By Goods-in-Transit	4,400
To Profit and Loss A/c	3,000	By Cash-in-Transit	10,000
To Imphal Branch Fixed Assets A/c	2,500	By Profit and Loss A/c	4,000
To Profit and Loss A/c	25,100	By Branch Bills Receivable A/c	6,000
To Branch Creditors A/c	29,200	By Branch Debtors A/c	58,400
		By Branch Stock A/c	72,000
		By Branch Cash and Bank A/c	44,200
		By Branch Fixed Assets A/c	1,59,400
	3,58,400		3,58,400

Illustration 82

The Head Office of a business and its branch keep their own books and each prepares its own Profit and Loss Account. The following are the balances appearing in the two sets of books as on 31st December, 2017 after ascertainment of profit and after making all adjustments except those referred to below:

Particulars	Head Office		Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Capital		1,00,000		
Fixed Assets	36,000		16,000	
Stock	34,200		10,740	
Debtors and Creditors	7,820	3,960	4,840	1,920
Cash	10,740		1,420	
Profit and Loss Account		14,660		3,060
Branch Office Account	29,860			
Head Office Account				28,020
	1,18,620	1,18,620	33,000	33,000

Set out the Balance Sheet of the business as on 31st December, 2017 and the Journal Entries necessary in the books of the Head Office to record the adjustments dealing with the following:

(a) On 31st December, 2017 the branch had sent a cheque for ₹ 1,000 to the Head Office, not received by Head Office nor credited to Branch Account till 3rd January, 2018.

(b) Goods valued at ₹ 840 had been forwarded by the Head Office to the branch and invoiced on 30th December, 2017 but were not received by the branch nor dealt with in branch's books till 11th January, 2018.

(c) The profit shown by the branch is to be transferred to the Head Office books.

(d) Branch assets and liabilities are to be recorded in the books of the Head Office.

[B.Com (Hons.) Delhi — Adapted]

Solution

The balance of Branch Account in the Head Office books and the balance of the Head office Account in the branch books are not matching. In order to reconcile the balances, the following entries are to be passed in the books of Head Office.

In the books of the Head Office
Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2017 (a) Dec. 31	Cash-in-Transit A/c	Dr.		1,000	
	To Branch A/c				1,000
	(Being cash sent by branch on 31.12.2017 but received by Head Office on 3.1.2018)				
(b)	Goods-in-Transit A/c	Dr.		840	
	To Branch A/c				840
	(Being the goods sent by Head Office on 31.12.2017 but received by branch on 11.1.2018)				
	Tutorial Note: It should be noted that after passing the above entries the Branch Account balance will be (₹ 29,860 – ₹ 1,000 – ₹ 840) = ₹ 28,020. Now it is matching with the balance of Head Office Account (in the branch's books).				
(c)	Branch A/c	Dr.		3,060	
	To Profit & Loss A/c				3,060
	(Being the incorporation of branch profit)				
(d)	Branch Fixed Assets A/c	Dr.		16,000	
	Branch Stock A/c	Dr.		10,740	
	Branch Debtors A/c	Dr.		4,840	
	Branch Cash A/c	Dr.		1,420	
	To Branch A/c				33,000
	(Being the incorporation of branch assets in the Head Office books)				
(e)	Branch A/c	Dr.		1,920	
	To Branch Creditors A/c				1,920
	(Being the incorporation of branch liability in the Head Office books)				

Balance Sheet as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	1,00,000		**Fixed Assets**		
Add: Profit:			H.O.	36,000	
H.O.	14,660		Branch	16,000	52,000
Branch	3,060	1,17,720	**Stock**		
Creditors			H.O.	34,200	
H.O.	3,960		Branch	10,740	
Branch	1,920	5,880	In-transit	840	45,780
			Debtors		
			H.O.	7,820	
			Branch	4,840	12,660
			Cash		
			H.O.	10,740	
			Branch	1,420	
			In-transit	1,000	13,160
		1,23,600			1,23,600

Special Problems

Illustration 83

A limited company has its Head Office in Delhi and a branch in Bombay where a separate set of books is used. The following are the Trial Balances extracted on 31st December, 2017:

Head Office Trial Balance	Dr. (₹)	Cr. (₹)	Branch Trial Balance	Dr. (₹)	Cr. (Rd)
Share Capital (authorised: 10,000 Equity shares of ₹ 100 each)		8,00,000	Fixed Assets	95,000	
Issued 8,000 Equity shares			Profit for 2017		31,700
Profit & Loss Account : 1.1.2017		25,310	Stock	50,460	
Interim Dividend paid - August 2017	30,000		Debtors & Creditors	19,100	10,400
General reserve		1,00,000	Cash balance	6,550	
Fixed assets	5,30,000		Head office current account		1,29,010
Stock	2,22,470				
Debtors and Creditors	50,500	21,900			
Profit for 2017		82,200			
Cash balance	62,730				
Branch Current Account	1,33,710				
	10,29,410	10,29,410		1,71,110	1,71,110

The difference between the balance of the Current Accounts in the two sets of books is accounted for as follows:

(a) Cash remitted by the branch on 31st December 2017 but received by the Head Office on 31st January 2018 ₹ 3,000.

(b) Stock stolen-in-transit from Head Office and charged to the branch by the Head Office, but not credited to the Head Office in the branch books as the Branch Manager declined to admit any liability (not covered by insurance) ₹ 1,700.

Given the Branch Current Account in the Head Office books after incorporating Branch Trial Balance through journal. Also prepare the company's Balance Sheet as on 31st December, 2017.

Solution

The balance of Branch Current Account in the Head Office books and the balance of Head Office Current Account in the branch books are not matching. In order to reconcile the balances, the following entries are to be passed in the books of the Head Office.

In the books of the Head Office
Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2017	Cash-in-transit A/c Dr.		3,000	
Dec. 31	To Branch Current A/c			3,000
	(Being cash sent by branch on 31.12.2017 but received by Head Office on 1.1.2018.)			
	Stock Stolen-in-transit A/c Dr.		1,700	
	To Branch Current Account			1,700
	(Being the loss of goods-in-transit not admitted by branch manager)			

Tutorial Note: It should be noted that after passing the above entries, the Branch Current Account balance will be (₹ 1,33,710 – ₹ 3,000 – ₹ 1,700) = ₹ 1,29,010. Now, it is matching with the balance of Head Office Current Account (in branch's book).

In order to incorporate Branch Trial Balance (after preparation of Branch Profit and Loss Account) in the Head Office book, the following Journal Entries are required:

In the books of the Head Office
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Branch Current A/c	Dr.		31,700	
Dec. 31	To Profit & Loss A/c				31,700
	(Being the incorporation of branch profit)				
	Branch Fixed Assets A/c	Dr.		95,000	
	Branch Stock A/c	Dr.		50,460	
	Branch Debtors A/c	Dr.		19,100	
	Branch Cash A/c	Dr.		6,550	
	To Branch Current A/c				1,71,110
	(Being the incorporation of branch assets)				
	Branch Current A/c	Dr.		10,400	
	To Branch Creditors A/c				10,400
	(Being the incorporation of branch liabilities)				

In the books of the Head Office
Branch Current Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12..2017	To Balance b/d	1,33,710	31.12.2017	By Cash-in-transit	3,000
	To Profit & Loss A/c	31,700		By Stock Stolen-in-transit A/c	1,700
	To Branch Creditors A/c	10,400		By Sundry Assets A/c	1,71,110
		1,75,810			1,75,810

Balance Sheet of ... as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Authorised capital:			**Fixed Assets:**		
10,000 Equity Shares of ₹ 100 each		10,00,000	H.O.	5,30,000	
Issued and Subscribed Capital:			Branch	95,000	6,25,000
8,000 Equity shares of ₹ 100 each		8,00,000	**Stock:**		
Reserve and Surplus			H.O.	2,22,470	
General Reserve		1,00,000	Branch	50,460	2,72,930
Profit & Loss A/c (Note 1)		1,07,510	**Debtors:**		
Creditors:			H.O.	50,500	
H.O.	21,900		Branch	19,100	69,600
Branch	10,400	32,300	**Cash in hand:**		
			H.O.	62,730	
			Branch	6,550	69,280
			Cash-in-transit:		3,000
		10,39,810			10,39,810

Working Note :

(1) Profit and Loss Account

Dr. Cr.

Particulars	₹	Particulars		₹
To Stock stolen-in-transit A/c	1,700	By Balance b/d		25,310
To Interim Dividend	30,000	By Current year's Profit:		
To Balance c/d	1,07,510	H.O.	82,200	
		Branch	31,700	1,13,900
	1,39,210			1,39,210

Illustration 84

A trading company has its head office at Hyderabad and a branch at Vizag. Purchases are made only at head office. Stocks required by the branch are invoiced to it by head office at selling price less 20%. The Branch Manager is entitled to a commission equal to 50% of the net profit earned by the branch on the basis of such invoice price.

The Trial Balance for the head office and branch as on 31st March, 2018 are :

Particulars	Head Office		Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Share Capital	—	10,00,000	—	—
Sundry Creditors	—	46,550	—	1,350
Land	50,000	—	—	—
Sundry Debtors	1,98,650	—	71,900	—
Opening Stock on 1.4.2017 (at cost) :				
At Hyderabad	5,74,100	—	—	—
At Vizag	71,550	—	—	—
Opening Stock at Vizag as invoiced		89,600	89,600	
Cash	89,650	—	2,450	—
Purchases	14,36,200	—	—	—
Invoicing to the Branch during the year	—	3,85,750	3,85,750	—
Manpower Cost	1,14,000	—	42,300	—
Establishment Expenses	69,950	—	18,450	—
Branch Adjustment Account	1,47,350	—	—	—
Head Office Adjustment Account	—	—	—	1,42,350
Furniture and Fixtures	37,000	—	12,000	—
Sales	—	12,66,550	—	4,78,750
	27,88,450	27,88,450	6,22,450	6,22,450

The cost of goods invoiced to branch during the year was ₹ 3,15,250. The closing stock at head office was valued at ₹ 77,100 (at cost) and ₹ 92,350 (at invoice price). Depreciation to be provided at 5% on furniture and fixtures.

Prepare the Profit and Loss Account of the company for the year ended 31st March, 2018 and the Balance Sheet as at that date. ***[ICWA (Final) — Adapted]***

Solution

The balance of Branch Adjustment Account in the head office books and the balance of Head Office Adjustment Account in the branch books are not matching. It has been assumed that the difference is due to Cash-in-transit

Dr. Trading and Profit & Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Head Office	Branch at Cost	Branch at Invoice Price	Particulars	Head Office	Branch at Cost	Branch at Invoice Price
To Opening Stock	5,74,100	71,550	89,600	By Sales	12,66,550	4,78,750	4,78,750
To Purchases	14,36,200	—	—	By Goods Sent to Branch	3,15,250	—	—
To Goods from H.O.	—	3,15,250	3,85,750	By Closing Stock	7,71,350	77,100	92,350
To Gross Profit c/d	3,42,850	1,69,050	95,750				
	23,53,150	5,55,850	5,71,100		23,53,150	5,55,850	5,71,100
To Manpower Cost	1,14,000	42,300	42,300	By Gross Profit b/d	3,42,850	1,69,050	95,750
To Establishment Expenses	69,950	18,450	18,450				
To Depreciation	1,850	600	600				
To Branch Manager's Commission (Note 1)	—	17,200	17,200				
To Net Profit	1,57,050	90,500	17,200				
	3,42,850	1,69,050	95,750		3,42,850	1,69,050	95,750

Working Note:

(1) Branch profit on the basis of invoice price = ₹ 95,750 – ₹ 42,300 – ₹ 18,450 – ₹ 600 = ₹ 34,400. Branch manager's commission is 50% of the branch profit based on invoice price. Therefore, manager's commission = 50% of ₹ 34,400 = ₹ 17,200.

Balance Sheet as at 31st March, 2018

Liabilities	₹	₹	Assets	₹	₹
Share Capital		10,00,000	Land (Head Office)		50,000
Profit and Loss Account:			Furniture and Fixture:		
Profit at Head Office	1,57,050		Head Office	37,000	
Profit at Branch	90,500	2,47,550	Branch	12,000	

Sundry Creditors				49,000	
Head Office	46,550		Less: Depreciation (₹ 1,850 + ₹ 600)	2,450	46,550
Branch	1,350	47,900	Stock :		
Manager's Commission Outstanding		17,200	Head Office	7,71,350	
			Branch	77,100	8,48,450
			Sundry Debtors:		
			Head Office	1,98,650	
			Branch	71,900	2,70,550
			Cash and Bank:		
			Head Office	89,650	
			Branch	2,450	92,100
			Cash-in-Transit		5,000
		13,12,650			13,12,650

Illustration 85

Sunil Enterprise operates a branch as well as head office. The following Trial Balance has been extracted from the books of the concern as on 31st March, 2018 :

Particulars	Head Office		Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Capital Account	—	4,71,000	—	—
Drawings	84,000	—	—	—
Plant at cost	2,40,000	—	1,20,000	—
Accumulated depreciation on plant	—	1,20,000	—	60,000
Goods to branch / from head office	—	7,92,000	7,20,000	—
Head Office Current Account	—	—	—	1,56,000
Branch Current Account	2,58,000	—	—	—
Branch stock provisions (1.4.2017)	—	6,000	—	—
Operating expenses	30,000	—	15,000	—
Purchases	22,92,000	—	—	—
Rent and rates	45,000	—	18,000	—
Sales	—	21,00,000	—	9,00,000
Stocks (1.4.2017)	1,80,000	—	36,000	—
Debtors	90,000	—	75,000	—
Creditors	—	1,35,000	—	—
Salaries and Wages	3,60,000	—	1,20,000	—
Cash and Bank	45,000	—	12,000	—
	36,24,000	36,24,000	11,16,000	11,16,000

Additional information :

(a) All goods are purchased by the head office. The goods required by the branch are invoiced by the head office to the branch at cost plus 20%. On 31st March, 2018, the head office held stocks which had cost it ₹ 2,40,000. On the same date, the branch held stocks which had been invoiced to it at ₹ 54,000.

(b) Fixed assets are to be depreciated at the rate of 50% per annum based on the reducing balance method. There had been no purchase or sale of fixed assets during the year.

(c) Goods of ₹ 72,000 invoiced by the head office to the branch were in transit on 31st March, 2018.

(d) At 31st March, 2018, cash ₹ 30,000 was in transit from the branch to the head office.

(e) The following expenses were outstanding on 31st March, 2018 :
Head Office : Salaries ₹ 2,000, Rent ₹ 1,000.
Branch : Salaries ₹ 1,000; Rent ₹ 2,000.

You are required to prepare, in columnar form, for (i) the head office, (ii) the branch and (iii) the business as a whole, the Trading and Profit and Loss Account for the year ended 31st March, 2018. Also, prepare a combined Balance Sheet as on that date.

Solution

Sunil Enterprise

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Head Office	Branch	Combined	Particulars	Head Office	Branch	Combined
To Opening Stock (Note 1)	1,80,000	36,000	2,10,000	By Sales	21,00,000	9,00,000	30,00,000
To Purchases	22,92,000	—	22,92,000	By Goods Sent to Branch	7,92,000	—	—

To Goods from Head Office	—	7,20,000	—	By Closing Stock (Note 2)	2,40,000	54,000	3,45,000
To Gross Profit c/d	6,60,000	1,98,000	8,43,000				
	31,32,000	9,54,000	33,45,000		31,32,000	9,54,000	33,45,000
To Salaries and Wages	3,62,000	1,21,000	4,83,000	By Gross Profit b/d	6,60,000	1,98,000	8,43,000
To Rent and Rates	46,000	20,000	66,000				
To Operating Expenses	30,000	15,000	45,000				
To Depreciation	60,000	30,000	90,000				
To Provision for Unrealised Profit (Note 5)	15,000	—	—				
To Net Profit c/d	1,47,000	12,000	1,59,000				
	6,60,000	1,98,000	8,43,000		6,60,000	1,98,000	8,43,000

Balance Sheet of Sunil Enterprise as at 31st March, 2018

Liabilities	₹	₹	Assets	₹	₹
Capital:			Plant (at Cost)	3,60,000	
Opening Balance	4,71,000		Less: Depreciation	2,70,000	90,000
Add: Net Profit	1,59,000		Stock (Note 2)		3,45,000
	6,30,000		Debtors		1,65,000
Less: Drawings	84,000	5,46,000	Cash and Bank		57,000
Creditors		1,35,000	Cash-in-Transit		30,000
Outstanding Expenses:					
Salaries	3,000				
Rent	3,000	6,000			
		6,87,000			6,87,000

Working Notes :

(1) Calculation of Combined Opening Stock	₹
Head Office	1,80,000
Branch (₹ 36,000 – ₹ 6,000)	30,000
Total	2,10,000

(2) Calculation of Combined Closing Stock	₹
Head Office	2,40,000
Branch (₹ 54,000 – 9,000*)	45,000
Goods-in-Transit (₹ 72,000 – 12,000**)	60,000
Total	3,45,000

* ₹ 54,000 x 20/120 = ₹ 9,000
** ₹ 72,000 x 20/120 = ₹ 12,000

(3) Branch Current Account (Head Office books)	₹
As per Trial Balance	2,58,000
Less: Goods-in-Transit	(72,000)
Less: Cash-in-Transit	(30,000)
Per Branch Book	1,56,000
Net Profit for the year	1,59,000
	3,15,000

(4) Head Office Current Account (Branch books)	₹
As per Trial Balance	1,56,000
Net Profit	1,59,000
	3,15,000

(5) Head office invoices goods to branch at cost plus 20%. At the end of the year, if there is any unsold stock at the branch, a provision for unrealised profit on closing stock (including stock-in- transit) is to be created by debiting the Head Office Profit and Loss Account.

Total provision to be created = ₹ 9,000 for branch stock *plus* ₹ 12,000 for goods-in-transit = ₹ 21,000. Since there is already a provision of ₹ 6,000, ₹ 15,000 is to be provided further.

Closing the Books of Account of the Branch

At the end of the accounting period, the books of accounts of the branch are also closed.

For the purpose of closing the books of accounts, any of the following two methods can be adopted by the branch:

Method 1

Under this method all items of Trial Balance are closed through the ***Head Office Account***. Usual entries are passed in the branch books for depreciation on fixed assets, outstanding salaries etc. The following entries are passed to close the books of the branch:

1. For revenue items on the debit side of the Branch Trading and Profit and Loss Account

Head Office Account Dr.
To Opening Stock Account
To Purchases Account

To Goods received from Head Office Account
To Wages Account
To Rent Account
To Salaries Account
To Depreciation etc. Account

2. For revenue items on the credit side of the Branch Trading and Profit and Loss Account

Sales Account	Dr.
Purchases Returns Account	Dr.
Closing Stock Account	Dr.
Discount Received Account	Dr.
To Head Office Account	

3. For branch assets

Head Office Account	Dr.
To Debtors Account	
To Cash at Bank Account	
To Cash-in-Transit Account	
To Closing Stock Account	

4. For branch liabilities

Outstanding Expenses Account	Dr.
Creditors Account	Dr.
To Head Office Account	

[After passing the above entries, the Head Office Account will not show any balance]

Illustration 86

A Madras 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 Madras Head Office Account in the branch books.

Trial Balance of Ahmedabad Branch as at 31st December, 2017

Particulars	₹.	Particulars	₹.
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 Head Office	7,200		
Cash at bank	750		
	52,100		52,100

(a) Closing stock at branch was ₹ 14,350.

(b) The branch fixed assets maintained at H.O. books were: Machinery ₹ 25,000, Furniture ₹ 1,000. Depreciation was to be allowed at 10 per cent on Machinery and 15 per cent on Furniture.

(c) Rent due was ₹ 150.

(d) A remittance of ₹ 4,000 made by the branch on 28th December, 2017 was received by the Head Office on 4th January, 2018.

Solution

In the books of the Ahmedabad Branch
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017 Dec. 31	Depreciation A/c	Dr.		2,650	
	To Head Office A/c				2,650
	(Being the depreciation on fixed assets accounts maintained by the Head Office)				

Cash-in-Transit A/c	Dr.		4,000	
To Head Office A/c				4,000
(Being the amount remitted on 28th December 2017 to Head Office but credited by it on 4th January 2018)				
Rent A/c	Dr.		150	
To Outstanding Rent A/c				150
(Being the outstanding rent paid)				
Head Office A/c	Dr.		50,150	
To Opening Stock A/c				8,200
To Purchases A/c				12,800
To Wages A/c				6,550
To Manufacturing Expenses A/c				3,400
To Rent A/c				1,850
To Salaries A/c				5,500
To General Expenses A/c				2,000
To Goods received from H.O. A/c				7,200
To Depreciation A/c				2,650
(Being the transfer of different revenue items to Head Office Account)				
Sales A/c	Dr.		34,950	
Purchase Returns A/c	Dr.		300	
Closing Stock A/c	Dr.		14,350	
Discount A/c	Dr.		150	
To Head Office A/c				49,750
(Being the transfer of different revenue items to Head Office Account)				
Head Office A/c	Dr.		23,100	
To Debtors A/c				4,000
To Cash at Bank A/c				750
To Cash-in-transit A/c				4,000
To Closing Stock A/c				14,350
(Being the assets account balances transferred)				
Creditors A/c	Dr.		2,700	
Outstanding Rent A/c	Dr.		150	
To Head Office A/c				2,850
(Being the liabilities account balances transferred)				

In the books of Ahmedabad Branch

Dr. **Head Office Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Sundry Expenses	50,150	31.12.2017	By Balance b/d	14,000
	To Sundry Assets	23,100		By Cash-in-transit	4,000
				By Sundry Revenue	49,750
				By Depreciation	2,650
				By Sundry Liabilities	2,850
		73,250			73,250

Illustration 87

Vivek & Co of Bombay have a branch in Goa. Goods sold at Goa are supplied from Bombay but no charge is made in the books as between the branch and the head office. Cash remittances are made by the branch to the head office from time to time. On September 30, 2017, the branch Balance Sheet after closing the book was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Debtors	3,00,000
Head Office Account	2,52,000	Cash at bank	12,000
		Building extension A/c transferred to H.O. A/c	Nil
	3,12,000		3,12,000

For the six months ending 31st March, 2018, the following transactions took place at Goa Branch (all figures in ₹):

Sales	3,60,000	Discount allowed	12,000
Purchases	72,000	Discount earned	1,800
Wages paid	30,000	Cash paid to creditors	90,000
Salaries (including ₹ 3,000 paid in advance)	6,000	Cash sent to bank	1,20,000

Fire Insurance premium paid for one year	4,800	Building A/c (further payments to contractors)	6,000
Manager's salary for 9 months	10,800	Cash in hand	2,400
Cash collection from Debtors	2,40,000	Cash at bank	42,000

Prepare the Head Office Account in the books of Goa branch as on 31st March 2018 to show entries after the books are closed and also the branch Balance Sheet on the same date, assuming that it is to be made on the same lines as on 30th September 2017. ***[I.C.W.A. (Final) — Adapted]***

Solution

In the books of Goa Branch of Vivek & Co
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 March 31	Salaries Paid in Advance A/c	Dr.		6,600	
	To Salaries A/c				3,000
	To Manager's Salary A/c				3,600
	(Being the adjustment for salaries paid in advance)				
"	Prepaid Insurance A/c	Dr.		2,400	
	To Fire Insurance Premium A/c				2,400
	(Being adjustment for insurance paid in advance)				
"	Head Office A/c	Dr.		1,26,600	
	To Purchases A/c				72,000
	To Wages A/c				30,000
	To Salaries A/c (₹ 6,000 – ₹ 3,000)				3,000
	To Fire Insurance A/c (₹ 4,800 – ₹ 2,400)				2,400
	To Managers' Salary A/c (₹ 10,800 – ₹ 3,600)				7,200
	To Discount Allowed A/c				12,000
	(Being the transfer of different revenue items to Head Office Account after making adjustment for advance salary and prepaid insurance premium)				
	Sales A/c	Dr.		3,60,000	
	Discount Earned A/c	Dr.		1,800	
	To Head Office A/c				3,61,800
	(Being the transfer of different revenue items to Head Office Account)				
	Head Office A/c	Dr.		6,000	
	To Building A/c				6,000
	(Being the Asset Account balance transferred to Head Office Account)				

Dr. Head Office Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018			2017		
March 31	To Purchases	72,000	Oct. 1	By Balance b/f	2,52,000
	To Wages	30,000	2018	By Sales	3,60,000
	To Salaries	3,000	March 31	By Discount Earned	1,800
	To Fire Insurance	2,400			
	To Discount Allowed	12,000			
	To Manager's Salary	7,200			
	To Building	6,000			
	To Cash and Bank (Note 1)	60,000			
	To Balance c/d	4,21,200			
		6,13,800			6,13,800

Balance Sheet of Goa Branch as at 31st March, 2018

Liabilities	₹	₹	Assets	₹	₹
Head Office Account		4,21,200	Sundry Debtors (Note 2)		4,08,000
Sundry Creditors (Note 3)		40,200	Prepaid Insurance		2,400
			Salaries Paid in Advance :		
			Manager	3,600	
			Others	3,000	6,600
			Cash at Bank		42,000
			Cash in Hand		2,400
		4,61,400			4,61,400

Working Notes :

Dr. (1) Cash and Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2018		
Oct. 1	To Balance b/f	12,000	March 31	By Wages	30,000
2018				By Salaries	6,000
March 31	To Sundry Debtors (Cash collected)	2,40,000		By Fire Insurance Premium	4,800
	To Cash "C"	1,20,000		By Salary to Manager	10,800
				By Sundry Creditors (Payment)	90,000
				By Bank "C"	1,20,000
				By Building	6,000
				By H.O. Remittance (Balancing figure)	60,000
				By Balance c/d:	
				Cash	2,400
				Bank	42,000
		3,72,000			3,72,000

Dr. (2) Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017					
Oct. 1	To Balance b/f	3,00,000	?	By Cash and Bank	2,40,000
	To Sales	3,60,000	2018	By Discount Allowed	12,000
			March 31	By Balance c/d	4,08,000
		6,60,000			6,60,000

Dr. (3) Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018			2017		
March 31	To Cash and Bank	90,000	Oct. 1	By Balance b/f	60,000
	To Discount Earned	1,800		By Purchases	72,000
	To Balance c/d	40,200			
		1,32,000			1,32,000

Method 2

Under this method, branch will pass usual closing entries for transforming all revenue items to its Trading and Profit and Loss Account. The net profit or loss is transferred to Head Office Account. Different assets and liabilities are closed through Head office Account in the usual manner. The following Journal Entries are passed:

1. For net profit

Profit and Loss Account Dr.
 To Head Office Account

2. For net loss

Head Office Account Dr.
 To Profit and Loss Account

After transferring branch profit/loss to Head Office Account, the balance of the Head Office Account in the branch books will be equal to net assets (Assets – Liabilities). Now the branch can prepare its Balance Sheet, taking net assets as capital of the branch.

However, the branch may also close the Assets and Liabilities Account by passing the following entries.

1. For closing Assets Account

Head Office Account Dr.
 To Assets Accounts [Individually]

2. For closing Liabilities Account

Liabilities Accounts Dr. [Individually]
 To Head Office Account

[After passing above entries, the Head Office Account will not show any balance].

Illustration 88

From the information given in ***Illustration 87***, pass Journal Entries in the books of Ahmedabad branch to close the books and prepare its Head Office Account.

Solution

In the books of the Head Office

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Depreciation A/c	Dr.		2,650	
Dec. 31	To Head Office Account				2,650
	(Being the depreciation on fixed assets accounts maintained by the Head Office)				
	Cash-in-Transit A/c	Dr.		4,000	
	To Head Office A/c				4,000
	(Being the amount remitted on 28th Dec., 2017 to Head Office but credited by it on 4th Jan., 2018)				
	Rent A/c	Dr.		150	
	To Outstanding Rent A/c				150
	(Being the outstanding rent paid)				
	Head Office A/c	Dr.		400	
	To Profit & Loss A/c				400
	(Being the transfer of loss)				
	Head Office A/c	Dr.		23,100	
	To Debtors A/c				4,000
	To Cash at Bank A/c				750
	To Cash-in-Transit A/c				4,000
	To Closing Stock A/c				14,350
	(Being the assets account balances transferred)				
	Creditors A/c	Dr.		2,700	
	Outstanding Rent A/c	Dr.		150	
	To Head Office A/c				2,850
	(Being liabilities account balances transferred)				

In the books of Ahmedabad Branch

Dr. Head Office Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Profit & Loss A/c	400	31.12.2017	By Balance b/d	14,000
	To Sundry Assets A/c	23,100		By Cash-in-Transit A/c	4,000
				By Depreciation A/c	2,650
				By Sundry Liabilities A/c	2,850
		23,500			23,500

Working Notes:

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		8,200	By Sales	34,950
To Purchases	12,800		By Closing Stock	14,350
Less: Returns	300	12,500		
To Wages		6,550		
To Manufacturing Expenses		3,400		
To Goods received from H.O.		7,200		
To Gross Profit c/d		11,450		
		49,300		49,300
To Rent	1,700		By Gross Profit b/d	11,450
Add: Outstanding	150	1,850	By Discount	150
To Salaries		5,500	By Net Loss	400
To General expenses		2,000		
To Depreciation:				
On Machinery	2,500			
On Furniture	150	2,650		
		12,000		12,000

Key Points

- From an accounting point of view, the branches can be divided into the following main classes:
  - ¤ Home Branches
    (a) Dependent branches (where the head office maintains all the accounts)
    (b) Independent branches (where the branch keeps its own accounts)
  - ¤ Foreign Branches
    They almost invariably trade independently and record their transactions in foreign currency.
- There are three main methods of accounting for branch transactions, viz.
  - ¤ Debtors System
  - ¤ Stock and Debtors System
  - ¤ Final Accounts System
- Under 'Debtors System', a Branch Account is opened for each branch in the head office ledger. all transactions relating to that branch are recorded in this account. the Branch Account exhibits the profit or loss for an accounting period as well as net assets laying with the branch.
- Stock and Debtors system is generally used when the goods are sent to the branch at an invoice price and the size of the branch is large. Under this system, the branch maintains a few central accounts to exercise greater control over the branch stock and other related expenses. These accounts usually are: (i) Branch Stock Account; (ii) Branch Debtors Account; (iii) Goods Sent to Branch Account; (iv) Branch Adjustment Account; (v) Branch Cash Account; (vi) Branch Expenses Account; (vii) Branch Profit and Loss Account; and (viii) Branch Fixed Assets Account.
- Sometimes, a separate Branch Profit and Loss Account is not opened. In that situation, the Branch Adjustment Account will show net profit/loss of the branch. In this case, branch expenses, pilferage (cost + loading), theft (cost + loading), and shortage in stock (cost + loading) are charged to Branch Adjustment Account. Similarly, surplus in stock (cost + loading) is credited to Branch Adjustment Account.
- **Treatment of Some Typical Items**
  - ¤ ***Normal loss*** : No treatment is required even if it is given specifically in the examination problem. However, for calculating Branch Closing Stock (when it is not given) normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.
  - ¤ ***Pilferage/Theft*** : In retail trade, pilferage or shoplifting is very common and this has come to be regarded as a normal business loss. The loading of such goods is charged to Branch Adjustment Account and cost is charged to Branch Profit and Loss Account.
  - ¤ ***Shortage in stock*** : Shortage in stock may be due to spoilage, leakage, sales in small quantity, etc. Loading on shortage in stock should be charged to Branch Adjustment Account and cost of such goods should be charged to Branch Profit and Loss Account.
  - ¤ ***Surplus in stock*** : Loading on surplus in stock is credited to Branch Adjustment Account and cost of such goods is credited to Branch Profit and Loss Account.
  - ¤ ***Loss by fire/loss-in-transit*** : Loading on goods lost by fire/in-transit should be charged to Branch Adjustment Account and the cost of such goods should be charged to **General Profit and Loss Account**.
- When the size of the branches is very large, their functions become complex. In such a situation, it is desirable or practicable for each branch to establish its own double entry book-keeping system quite separate from those of head office. Under this system of branch accounting, the branches are treated as separate, independent units. These types of branches are known as ***Independent Branches***.
- On principle, the adjustment entry should be passed in the books of the head office because all in-transit items are detected by the head office after receiving copy of Trial Balance (or copy of Final Accounts) and at this stage, it is not desirable to change the balances in the branch books.
  Goods-in-Transit are shown in the Balance Sheet of head office.
- The incorporation of Branch Trial Balance can be divided into two parts:
  - ¤ Incorporation of Branch Profit and Loss; and
  - ¤ Incorporation of Branch Assets and Liabilities.
- For the purpose of incorporation of branch profit and loss, the head office may follow any of the following two methods:
  - ¤ Detailed Incorporation
  - ¤ Abridged Incorporation

THEORETICAL QUESTIONS

1. Explain the distinguishing features between branch accounts and departmental accounts.
2. What are the main classes of branch accounts ?
3. State the objectives of keeping branch accounts.
4. What do you understand by the expression 'Branch Adjustment Account'? Explain clearly.
5. What do you understand by an 'independent branch'?
   Differentiate between a 'dependent branch' and an 'independent branch'.
   Explain briefly the system of accounting that you will adopt in each case.
6. Write a note on stock and debtors system.
7. Give Journal Entries for incorporating the branch Trial Balance in the books of head office.

PRACTICAL QUESTIONS

Debtors System [Cost Price]

1. Shetty Solvents Co. Bangalore opened a branch at Hyderabad on January 1, 2017. The following information is available in respect of the branch for the year 2017:

Particulars	₹	Particulars	₹
Goods sent to the branch	75,000	Cash remittance to branch towards petty cash	6,000
Cash sales at the branch	50,000	Petty cash at branch on 31.12.2017	500
Credit sales at the branch	60,000	Debtors of branch as on 31.12.2017	5,000
Salaries of the branch staff paid by the H.O.	15,000	Stock at the branch on 31.12.2017	27,000
Office expenses of the branch paid by the H.O.	12,000		

Prepare Branch Account to show the profit/loss from the branch for the year 2017.

2. X operates a branch at Delhi. All purchases are made by the Head Office at Madras; goods being charged out to the branch at cost price. All cash received by the branch is remitted to Madras Branch. Petty expenses are paid out of an imprest which is reimbursed by the Head Office from time to time. From the following particulars relating to Delhi branch, you are required to prepare Branch Account (for calculating profit) in the books of the Head Office.

Particulars	₹	Particulars	₹
Balances on 1.1.2017:		Petty expenses paid by branch out of imprest	700
Stock : ₹ 8,000; Petty cash : ₹ 800; Plant : ₹ 10,000		Cash sales during the year	70,000
Balances on 31.12.2017:		Sale of plant on 1.7.2017	800
Stock	7,000	(Book value on the date of sale ₹ 900)	
Goods sent to branch	50,000	Expenses paid by Head Office	5,000

It is required to write-off Plant @ 20% p.a.

3. The following information and particulars relate to New Delhi branch for the year 2017-18:
   31.3.2017 : Stock ₹ 50,000; Debtors ₹ 70,000; Petty cash ₹ 250.
   31.3.2018 : Stock ₹ 75,000; Debtors ₹ 95,000; Petty cash ₹ 120.
   Goods costing ₹ 5,50,000 was sold by the branch @ 25% on cost. Cash sales amounted to ₹ 1,50,000 and the rest credit sales.
   Branch receives all goods from Head Office. Branch spent ₹ 30,000 for salaries, ₹ 12,000 for rent and ₹ 8,000 for petty expenses (all expenses remitted by Head Office).
   You are required to prepare New Delhi Branch Account in the books of the Head Office for the year 2017-18.
4. From the following particulars relating to the Kanya-Kumari branch for the year ended 31st December, 2017, prepare Branch Account in the books of Head Office:

Particulars	₹	Particulars	₹
Goods sent to branch	28,400	Petty cash at branch on 1st January 2017	500
Cash sales	18,800	Petty cash at branch on 31st December 2017	300
Credit sales	41,200	Goods returned by the branch	1,000
Cash received from Debtors	38,000	Opening stock at branch	9,600
Cash sent to branch for expenses:		Debtors on 31st December 2017	9,000
Rent	2,000	Discount allowed to Debtors	1,000
Salaries	8,000	Bad debts written-off by the branch	2,000
Petty cash	2,000	Stock at branch on 31st December 2017	10,500

5. The Rajani Stores Ltd at Madras has a branch at Trichy. Goods are invoiced to the branch at selling price being cost plus 25%. The branch keeps its own sales ledger and deposits all cash received daily to the credit of Head Office Account opened at the State Bank of India, Trichy. All the expenses are paid by cheque from Madras. From the following details, prepare a Branch Account in the Head Office books and make the necessary adjustments therein to arrive at the actual branch profit or loss during the year 2017

Particulars	₹
Stock on 1st January, 2017	7,500
Stock on 31st December, 2017	9,000
Sundry Debtors on 1st January, 2017	4,200
Sundry Debtors on 31st December, 2017	5,400
Goods invoiced from Head Office	54,600
Rent, rates and taxes	2,400
Sundry Expenses	480
Cash Sales for the year	32,400
Credit Sales	21,000
Wages paid	2,040
Wages owing	200

Debtors System [Invoice Price]

6. Jaico Ltd. invoices goods to its Kanpur branch at cost plus 25% thereon, both cash and credit sales are effected by the branch. The branch expenses are paid direct from the Head Office. The details of transactions available for the year ended 31.3.2017 are:

Particulars	₹	Particulars	₹
Goods received from Head Office at invoice price	40,000	Discounts allowed to customers	300
Returns to Head Office at invoice price	800	Bad debts	500
Stock at Kanpur on 1.4.2016 at invoice price	8,000	Returns from customers	700
Credit sales for the year	30,000	Rent and rates	60
Cash sales for the year	18,700	Wages and salaries	1,200
Debtors as on 1.4.2016	5,200	Sundry expenses	300
Debtors as on 31.3.2017	4,200	Stock on 31.3.2017 at invoice price	6,000

Record the above transactions in the Head Office ledger and close the accounts as on 31.3.2017 and show how the relevant items will appear in the Head Office's Balance Sheet on that date.

7. X of Calcutta started on 1.4.2017, two branches at Madras and Nagpur. All goods sold at the branches are received from the Head Office invoiced at 125% of cost. All expenses relating to the branch are paid by the Head Office. Each branch has its own Sales Ledger and sends weekly statements. All cash collections are remitted daily to the Head Office by the branches. The following particulars relating to the half-year ended 30.9.2017 have been extracted from the weekly statements sent by the branches: (all figures in ₹)

Particulars	Madras	Nagpur	Particulars	Madras	Nagpur
Credit sales	1,25,200	1,10,000	Salaries	16,000	18,000
Cash sales	78,600	85,200	General expenses	2,600	1,500
Sales returns	2,300	1,200	Goods received from H.O.	1,50,000	1,25,000
Sundry debtors	34,500	23,600	Advertisement	7,500	5,200
Rent and rates	3,200	4,500	Stock on 30.9.2017	45,000	35,000
Bad debts	6,000	—			

You are required to prepare the Branch Account as they would appear in the books of the Head Office, showing the profit or loss for the period.

8. X opened a branch at Calcutta on 1.7.2017. Goods are sent from the Head Office at cost plus $33^{1}/_{3}$%. The branch is adviced to deposit cash everyday in the bank in the Head Office. From the following particulars, prepare Branch Account in the books of Head Office for the period ending 31.12.2017. Petty cash at branch is maintained on imprest system.

Particulars	₹	Particulars	₹
Cash sent to branch for expenses	500	Received from Debtors	16,000
Furniture purchased for the branch	10,000	Discount allowed	300
Goods sent to branch at invoice price	1,00,000	Bad debts	100
Expenses paid by the Head Office:		Returned by Debtors (invoice price)	800

Rent : ₹ 1,000; Salaries : ₹ 2,000; Expenses ₹ 1,000; Insurance : ₹ 600 (up to 30.6.2018)	4,600	Petty expenses paid by branch	600
Cash sales by branch	70,000	Stock at cost on 31.12.2017 (excluding stock received from Debtors)	18,000
Credit sales by branch	25,000	Depreciation on furniture @ 10% p.a.	

Stock and Debtors System

9. A Calcutta Head Office has a branch at Nagpur. Goods are invoiced by the head office to the branch at cost plus 25%. From the following particulars, prepare the (1) Branch Stock Account, (2) Goods Sent to Branch Account, (3) Branch Stock Adjustment Account, (4) Branch Debtors Account, and (5) Branch Profit and Loss Account:

Particulars			₹
Stock on 1st January, 2017 (invoice price)			30,000
Goods invoiced to branch during the year (invoice price)			1,38,000
Branch debtors on 1st January, 2017			24,000
Goods returned by branch (invoice price)			2,000
Branch Sales :	Cash	64,000	
	Credit	72,800	1,36,800
Bad debts written off			700
Discounts allowed to Debtors			500
Branch Expenses			14,500

10. Messrs. Eastern Traders, Delhi have opened a branch at Jaipur on 1.7.2017. The goods were sent by the Head Office to the branch and invoiced at selling price which was 125%, of the cost price of the Head Office.
The following are the particulars relating to the transactions of Jaipur branch:

Particulars	₹	Particulars	₹
Goods sent to branch (at cost to Head Office)	2,80,800	Cash sent to branch for:	
Sales: Cash	1,25,000	Wages	3,000
Credit	1,75,000	Freight	11,000
Cash collected from Debtors	1,56,000	Other expenses including godown rent	6,000
Discount allowed	4,000	Spoiled cloth in bales written-off at invoice price	500
Stock on June 30, 2018 at invoice price	55,500		

Prepare Branch Debtors, Branch Stock, Branch Adjustment and Branch Profit and Loss Accounts in Head Office books.

11. B Ltd. opened a branch in Hyderabad in late 2011, and forwarded goods for resale from the Head Office at Calcutta, invoiced them at selling price; the mark-up was 1/3 of selling price.
The Head Office maintained a Branch Stock Account, Goods Sent to Branch Account, Branch Debtors Account and the Branch Adjustment Account. These were written-up from weekly branch returns of cash sales, credit sales, cash received from debtors and other credits allowed to debtors.
During the year to 31st December, 2017, the following transactions took place at Hyderabad:

Particulars	₹	Particulars	₹
Goods received from Calcutta	1,80,000	Cash discount given	1,808
Goods returned to Calcutta	1,680	Cash sales	1,00,800
Bad debts	596	Credit sales	72,000
Cash received from Debtors	68,624		

The following additional information is also available in respect of the branch:
Stock on hand at selling price : 1.1.2017 : ₹ 16,080; 31.12.2017 : ₹ 21,000 and Debtors : 1.1.2017 : ₹ 6,608; and 31.12.2017 : ₹ 7,580.
You are required:
(a) to present the Ledger Accounts in the Head Office recording the above transactions; and
(b) to compute the gross profit of the branch for the period.

12. Gulshan Stores Ltd with its head office in Calcutta invoiced goods to its branch at Patna at 20% less than the list price which is cost plus 100% with instructions that cash sales were to be made at the invoice price and credit sales at the catalogue price (i.e., list price).
From the following particulars available from the branch, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account and Branch Debtors Account for the year ending 31.12.2018.

Particulars		₹
Stock on 1.1.2018 (invoice price)		6,000
Debtors on 1.1.2018		5,000
Goods received from head office (invoice price)		66,000
Sales : Cash	23,000	
Credit	50,000	73,000
Cash from debtors		42,817
Expenses at branch		8,683
Remittance to head office		60,000
Debtors on 31.12.2018		12,183
Stock on 31.12.2018 (invoice price)		8,800

13. Sunny Traders of Mumbai opened a branch shop on 1.1.2018 in Kolkata. All goods for sale at the shop are purchased by the head office and charged to the branch at retail selling price, which is cost plus $33^1/_3$%. The branch backs its takings, without deduction, for the credit of head office. Although it is a cash business, the branch manager is allowed to give credit in a few special cases.
The following information is relevant for the first three months to 31 March :

Particulars	₹
Purchases	27,130
Sales at head office	9,100
Goods sent by head office to the branch at selling price	28,000
Cash sales at branch	18,000
Credit sales by branch	2,000
Goods returned to head office at selling price	1,000
Cash collected from branch debtors	1,730
Branch expenses	1,000
Head office expenses	1,200
Closing stock at head office	2,650
Opening stock at head office	2,900
Authorised reduction in branch selling prices	820

From the above particulars, prepare :
(i) Branch Stock Account;
(ii) Branch Adjustment Account;
(iii) Branch Profit and Loss Account; and
(iv) Goods Sent to Branch Account.

14. X Ltd. has its Head Office at Bombay with branches at Calcutta and Madras. The Head Office alone makes purchases and goods sent to the branches are invoiced at cost plus 25%. Sales are made only at the branches, which remit all cash received to Bombay. From the following particulars for the year ended 30.9.2017, prepare the Branch Stock Account, Branch Adjustment Account and Goods Sent to Branch Account for the year, as they would appear in the Bombay books: (all figures in ₹)

Particulars	Calcutta	Madras	Particulars	Calcutta	Madras
Goods sent (invoice price)	30,000	25,500	Credit sales	13,000	9,250
Returns to H.O. (invoice price)	500	425	Stock on 1.10.2016 (invoice price)	5,500	7,500
Cash sales	18,500	17,125	Stock on 30.9.2017 (invoice price)	4,875	6,750

15. The P.T. Co. Ltd. invoices goods to its Kanpur branch at cost plus 25%. Both cash and credit sales are effected by the branch at these prices. Branch expenses are paid direct from the Head Office, all cash received by the branch being remitted to Head Office.
The following are the details of the transactions for the year ended 31.12.2017:

Particulars	₹	Particulars	₹
Goods received from H.O. at invoice price	2,00,000	Discounts allowed to customers	1,600
Returns to H.O. at invoice price	5,000	Bad debts written-off	3,000
Stock at branch as on 1.1.2017	50,000	Returns from customers	2,000
Credit sales	1,10,000	Rent, rates and taxes	2,400
Cash sales	1,08,000	Salaries and wages	8,000
Debtors as on 1.1.2017	38,000	Sundry expenses	1,200
Cash received from Debtors	1,16,000		

Prepare :

(i) Branch Stock, (ii) Branch Debtors, (iii) Branch Adjustment Account, and

(iv) Branch Profit and Loss Accounts in the books of the Head Office.

16. Linken Ltd. with a Head Office in Calcutta opened a branch on January 1, 2017, at Kanpur where all sales were to be made on credit basis.

All goods required by the branch were supplied by the company from Calcutta and invoiced to the branch at 20 per cent above cost. During the year ended 31st December, 2017 the following transactions took place:

Particulars	₹	Particulars	₹
Goods sent to Kanpur branch (at cost to H.O.)	22,000	Returns to Calcutta office (at cost to H.O.)	840
Sales as shown by Kanpur branch report	19,670	Cash received from debtors and remitted to Calcutta	15,190
Debtors balance at branch written-off as bad	640		

Loss of goods at branch through pilferage is estimated at 1 per cent of goods received. The stock of goods held by the branch on 31st December, 2017 amounted to ₹ 5,820 at invoiced price. You are required to record the entries in the appropriate accounts in the Head Office Ledger showing the balances as on 31st December, 2017 and the branch gross and net profits, for the year ended on that date. Assume that there are no other charges.

17. X Ltd. operates a retail branch at Bombay. All purchases are made by the Head Office in Calcutta, goods being charged out to the branch at selling price which is cost plus 25%. All the expenses of branch are paid through Head Office cheques. Cash collected from customers as also the ready money sales are daily banked to the credit of the Head Office. From the following particulars of the branch write-up necessary accounts to arrive at the branch profit or loss in the Head Office books by using stock and debtors system.

Particulars	₹	Particulars	₹
Debtors at start	10,000	Invoiced inventory at the end	15,000
Debtors at end	12,000	Salaries	6,000
Ready money sales during the year	70,000	Rent	5,000
Cash received on ledger account	65,000	Bad debts	2,000
Returns to H.O. at invoice price	5,000	Discount and allowance	3,000
Invoiced inventory at the beginning	16,000	Normal leakage and spoilage	4,000

18. Bombay Traders Ltd. sends goods to its Madras branch at cost plus 25%. The following particulars are available in respect of the branch for the year ended 31st March 2017:

Particulars	₹	Particulars	₹
Opening stock at branch at invoice price to branch	80,000	Sales	12,19,000
Goods sent to branch at invoice price	12,00,000	Expenses	60,000
Loss in transit at invoice price	15,000	Closing stock at branch at invoice price to branch	40,000
Pilferage at invoice price	6,000	Recovered from insurance co. against loss-in-transit	10,000

Show Ledger Accounts in the Head Office books for: (a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Adjustment Account; and (d) Branch Profit and Loss Account.

19. HP and Co. is a retail organisation with a number of branches. All accounts are kept at the Head Office and goods sent to branches are recorded at cost plus the expected mark-up of $33^{1}/_{3}\%$. The accounting system is designed to give the Head Office as much control as possible over the branch stocks.

At the Madras branch at 1st January, 2017, goods costing ₹ 24,000 were in stock, but some of these, costing ₹ 3,000, had been reduced in selling price to ₹ 3,200. The balances of the Madras Branch Debtors Accounts totalled ₹ 18,400 on the same date.

The following information relates to the Madras branch for the year to 31st December, 2017 or at the end of that year:

Particulars	₹	Particulars	₹
Goods sent to branch (cost)	3,72,000	Goods returned by Br. debtors direct to H.O. (selling price)	1,600
Cash sales (including all goods marked down at the beginning of the year and others costing ₹ 36,000 sold for half of the normal selling price)	3,21,200	Bad debts written-off	600
		Closing stock of goods at selling price	48,000
		Closing total of debtors' balances	16,600
Cash received from debtors	1,25,600		

You are required to prepare: (a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Adjustment Account; (d) Branch Debtors Account; and (e) Branch Profit and Loss Account.

20. B.B. Co. Ltd. with their Head Office at Calcutta, invoiced goods to their Bangalore branch at 20% less than list price, which is cost plus 100% with instruction that cash sales are to be made at invoice price and a credit sales at list price. From the following particulars, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account, and Branch Debtors Account for the year ended 31.12.2017.

Particulars	₹	Particulars	₹
Stock on 1.1.2017 (at invoice price)	24,000	Cash received from debtors	1,71,268
Debtors on 1.1.2017	20,000	Expenses at Branch	34,732
Goods received from H.O. (at invoice price)	2,64,000	Remittance to H.O.	2,40,000
Goods returned to H.O. (at invoice price)	2,000	Debtors on 31.12.2017	48,732
Sales : Cash	92,000	Stock on 31.12.2017 (at invoice price)	85,200
Credit	2,00,000		

Final Accounts System

21. A Head Office in Calcutta has a branch in Burdwan. All purchases are made by the Head Office and goods sent to the branch are invoiced at cost plus 25 per cent. All cash received by the branch is deposited to the Head Office Account in the Burdwan branch of the Head Office bank.
The branch maintains a Sales Ledger and the other necessary subsidiary books but all other branch transactions are recorded in the Head Office books.
The following information pertaining to the branch has been collected for the year ended December, 31, 2017:

Particulars	₹	Particulars	₹
Stock at branch on Jan. 1 (invoice price)	30,000	Stock at branch on Dec. 31 (invoice price)	25,000
Goods received from H.O. less returns (invoice price)	96,000	Cash sales	54,000
Credit sales less returns	43,000	Cash received from customers	41,000
Discount allowed to customers	1,000	Bad debts written-off	500
Branch expenses paid	5,700		

In the Head Office books prepare the Branch Stock Account, Branch Total Debtors Account and Branch Profit and Loss Account.

22. A Head Office in Calcutta has a branch at Haldia. All purchases are made by Head Office and goods sent to the branch are invoiced at cost plus 25%. All cash received by branch is deposited to the Head Office Account in the branch of the Head Office's bank.
The branch maintains a Sales Ledger and other necessary subsidiary books; but all other branch transactions are recorded in the Head Office books.
The following information pertaining to the branch has been collected for the year ended December 31, 2017:

Particulars	₹	Particulars	₹
Stock at branch (1.1.2017 - cost price)	96,000	Stock at Branch (31.12.2017 - cost price)	80,000
Goods received from Head Office (invoice price)	3,80,000	Cash sales	2,16,000
Credit sales	1,72,000	Discount allowed to customers	4,000
Bad debts written-off	2,000	Branch expenses paid	22,800
Cash received from customers	1,64,000		

In the Head Office books, prepare the Branch Stock Account, Branch Debtors Account and Branch Profit and Loss Account.

23. B.S. Ltd. operates a retail branch at Ranchi. All purchases are made by the Head Office in Calcutta. Goods for the branch being delivered to it direct and charge out at selling price, which is cost price plus 50 per cent. All cash received by the branch is remitted to Calcutta. Branch expenses are paid by the branch out of an imprest account which is reimbursed by Calcutta monthly.
The branch keeps a Sales Ledger and certain essential subsidiary books; but otherwise all branch transactions are recorded in the books of the Calcutta office.
On January 1, 2017, Stock-in-trade at the branch at selling price, amounted to ₹ 48,660 and Debtors to ₹ 6,440.
During the year ended December 31,2017, the following transactions took place at the branch:

Particulars	₹	Particulars	₹
Goods received by the branch at selling price	1,21,800	Cash sales	64,150
Credit sales	51,280	Goods returned to Calcutta at selling price	1,560
Reductions in selling price authorised by Head Office	970	Cash received from debtors	42,660
Debtors written-off as irrecoverable	650	Cash discounts allowed	1,120

A consignment of goods despatched to the branch in December, 2017, at a selling price of ₹ 1,200 was not received by the branch until January 6, 2018 and had not been included in its stock figure. The expenses relating to the branch for the year ended December 31, 2017 amounted to ₹ 17,290.

On December 31, 2017, Physical stock at the branch, at selling price amounted to ₹ 52,200. You are required to write-up the Branch Stock Account and the Branch Total Debtors Account maintained in Calcutta books, and to prepare the Trading and Profit and Loss Account of the branch for the year ended December 31, 2017.

24. A business has three branches at Coimbatore, Trivandrum and Bangalore. The Head Office at Madras purchases goods and sends them to branches, to be sold at a uniform percentage of profit on cost.

The following particulars are made available to you to enable you to prepare a combined Trading Account for the year ended 31st March, 2017.

Particulars	Madras (₹)	Coimbatore (₹)	Trivandrum (₹)	Bangalore (₹)
Stock on 1st April 2016	54,000	16,000	12,500	10,000
Purchases in the year	2,74,000	—	—	—
Sales	—	1,80,000	1,20,000	1,00,000
Stock on 31st March 2017	28,000	6,000	5,000	2,500
Branch Accounts on 1st April 2016:				
Coimbatore	15,000			
Trivandrum	32,000			
Bangalore	4,000			
Remittances from branches	3,20,000	1,50,000	1,60,000	70,000

Madras office invoices goods to the branches at fixed sales prices but maintains branch accounts in its Ledgers at cost price. Show Branch Accounts in Madras Head Office books.

25. The branches of a multiple shop company are supplied from the Head Office with goods at cost. The branches pay wages and minor items of petty cash, but otherwise all expenses are paid by the Head Office.

From the weekly returns of the branches, the following summaries are prepared:

Dr. Cash Account (Branches) Year 2017 Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance	1,200	2017 Dec. 31	By Cash Purchases	4,360
Dec. 31	To Cash Sales	4,13,680		By Wages	1,12,500
	To Cash on Ledger A/cs	12,350		By Expenses	2,320
				By Amount banked	3,06,550
				By Balance	1,500
		4,27,230			4,27,230
2018 Jan. 1	To Balance	1,500			

Dr. Debtors' Account (Branches) Year 2017 Cr.

Date	Particulars	₹	Date	Particulars	₹
2017 Jan. 1	To Balance	890	2017 Dec. 31	By Cash	12,350
Dec. 31	To Sales	14,350		By Allowance	480
				By Balance	2,410
		15,240			15,240
2018 Jan. 1	To Balance	2,410			

Branches Current Account (in Head Office books) appears in summarised form as follows:

Particulars		₹	Particulars	₹
2017 Jan. 1 To Balance:			2017 Jan. 1 By Balance:	
Cash	1,200		Rent & Rates	4,340
Debtors	890		Dec. 31 By Bank	3,06,550
Stocks	16,380		Dec. 31 By Balance	60
Fittings	10,000	28,470		
Dec. 31 To Goods		2,26,500		
To Cash :				
Rent & Rates		20,200		
Salaries		32,300		

Sundry expenses	2,480		
Fittings	1,000		
	3,10,950		3,10,950
Jan. 1 To Balance	60		

You are required to prepare a Memorandum Trading and Profit and Loss Account of the branches and also show the Branch Account as it would appear in the Head Office books at the end of the year.

26. X Ltd. Bombay started on 1st January, 2017 has two branches in Kanpur and Lucknow. All goods sold at the branches are received from the Head Office invoiced at cost plus 25 percent. All expenses relating to branches are paid by the Head Office. Each branch has its own Sales Ledger and sends weekly statements. All cash collections are remitted daily to Head Office by the branches. The following particulars relating to the year ended 31st December, 2017 have been extracted from the weekly statement sent by the branches: (all figures in ₹)

Particulars	Kanpur	Lucknow	Particulars	Kanpur	Lucknow
Credit sales	1,25,200	1,10,000	Salaries	16,000	18,000
Cash sales	78,600	85,000	General expenses	2,600	1,500
Sales returns	2,300	1,200	Goods received from H.O.	1,50,000	1,25,000
Sundry debtors	34,500	23,600	Advertisement	7,500	5,200
Rent and rates	3,200	4,500	Stock on 31st December 2017	45,000	35,000
Bad debts	6,000	—			

You are required to prepare the Branch Accounts as they would appear in the books of the Head Office, showing the profit and loss for the period and the Trading and Profit and Loss Account separately for each branch.

27. All purchases are made by the Head Office, all goods sold by the branches are received from the Head Office and the branches sell, maintain accounts of the debtors, collect from them and send daily collections to the Head Office. Branch expenses are met from remittances specially sent from Head Office which keeps no stock.

Particulars	Madras (₹)	Delhi (₹)	Calcutta (₹)
Bad debts	1,200	1,000	500
Debtors at commencement	23,100	19,460	21,020
Debtors at end	29,460	18,900	22,000
Sales (credit)	61,210	31,000	49,109
Return inwards	600	—	300
Allowances to Debtors	1,100	900	1,300
Sales (cash)	11,000	19,000	18,000
Goods bought and sent	40,000	30,000	29,000
General charges	500	300	200
Salaries	1,600	2,000	1,000
Opening stock	19,000	18,000	21,000
Closing stock	5,000	4,800	3,600

The expenses at the Head Office which is in Bombay amounted to ₹ 8,000 and general charges to ₹ 1,000.
Prepare the Branch Accounts as they should appear in the Head Office books and Profit and Loss Accounts showing the net results of each branch as also of the Head Office in Bombay.

Wholesale Price

28. G.K. Sports of Calcutta has a retail branch at Kanpur. Goods are sold to customers at cost plus 100%. The wholesale price is cost plus 80%. Goods are invoiced to Kanpur at wholesale price.
From the following particulars, find out the value of closing stock on 31st December, 2017 and profit made at head office and Kanpur for the year 2017.

Particulars	Head Office (₹)	Kanpur Branch (₹)
Stock on January 1, 2017	25,000	
Purchases	1,50,000	
Goods sent to Kanpur Branch (at invoice price)	54,000	
Sales	1,53,000	50,000

Sales at head office are made only on wholesale basis and that at branch only on retail basis .

29. Kanpur Trading Co. Ltd. operates a number of retail branches of its own as well as supplies goods to other stockists. The wholesale price is cost plus 20% and retail branches sell the goods at 10% above the wholesale price. Goods are sent to retail branches at wholesale price.
The following figures relate to the Lucknow Branch for the year 2017.

Particulars	₹
Opening stock	1,12,500
Goods sent to Lucknow branch (at cost to Head Office)	4,50,000
Sales at Lucknow Branch	5,77,500
Expenses incurred at Lucknow Branch	15,000
Shortage of goods (at selling price)	2,475

You are required to ascertain profit made by the Lucknow Branch.

30. White Ltd has a retail branch at Margaon. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Calcutta Head Office to Branch at Margaon at wholesale price. From the following particulars ascertain the profit made at head office and branch for the year ended December 31, 2017.

Particulars	Head Office (₹)	Margaon (₹)
Stock on 1st January, 2017	1,75,000	
Purchases	10,50,000	
Goods sent to branch (at invoice price)	3,78,000	
Sales	10,71,000	3,50,000
Stock on December 31, 2017	4,20,000	63,000

Sales at head office are made only on wholesale basis and that at branch only to customers. Stock at head office is valued at invoice price.

31. ABC Ltd operates a number of retail shops to which goods are invoiced at wholesale price which is cost plus 20%. Shops sell the goods at the list price which is wholesale price plus 10%.
From the following particulars for Shop No. 6, prepare :
(a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Profit and Loss Account; (d) Stock Reserve Account; and (e) an extract of Head Office Profit and Loss Account.:

Particulars	₹
Stock at shop on 1.1.2017	15,000
Goods invoiced to shop during 2017	1,40,000
Sales at shop during 2017	1,54,770
Goods destroyed by fire (retail value)	660
Expenses at the shop	7,200

Independent Branch

32. Journalise the following transactions in the Delhi Branch Office and Head Office books :
    (i) Head office has charged ₹ 5,000 as depreciation on Delhi Branch assets.
    (ii) Goods worth ₹ 25,000 have been supplied by Delhi Branch to Bombay Branch under the advice of Head Office.
    (iii) Delhi Branch has received ₹ 15,000 from a customer of the Head Office.
33. Journalise the following transactions in the books of Head Office as well as Branch offices :
    (i) Goods worth ₹ 5,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.
    (ii) Delhi Branch draws a bill receivable for ₹ 5,000 on Agra Branch which sends its acceptance.
    (iii) Head Office charges ₹ 4,000 from Delhi Branch as Head Office administrative expenses.
34. MTS Ltd. has a branch which closes its books of accounts every year on 31st March. This is an independent branch which maintains comprehensive books of accounts for recording their transactions.
You are required to show Journal Entries in the books of both the branch and the head office for 31st March, 2011 to rectify or adjust the following :
    (a) Branch paid ₹ 1,00,000 as salary to an official from Head office on visit to branch and debited the amount to its Salaries Account.
    (b) Head office collected ₹ 35,000 directly from a branch customer on behalf of the branch, but no intirmation was received earlier by the branch. Now the branch learns about it.
    (c) It is learnt that a remittance of ₹ 2,50,000 sent by the branch has not been received by head office till date.
    (d) Depreciation of Branch Fixed Assets, whose accounts are kept by head office in the books are not yet recorded in the Branch books for ₹ 1,25,000.
    (e) Goods sent by the head office to the branch of ₹ 40,000 but not yet received by the branch.

[C.U.B.Com. (Hons.) — 2016]

35. Head Office passes adjustment 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 January, 1996, make the entry in the books of head office :
    (a) Bombay Branch :
        (i) Received goods: ₹ 6,000 from Calcutta Branch, ₹ 4,000 from Patna Branch.
        (ii) Sent goods to: ₹ 10,000 to Patna, ₹ 8,000 to Calcutta.
        (iii) Received Bills Receivable: ₹ 6,000 from Patna.
        (iv) Sent acceptance: ₹ 4,000 to Calcutta, ₹ 2,000 to Patna.
    (b) Madras Branch (apart from the above)
        (v) Received goods: ₹ 10,000 from Calcutta, ₹ 4,000 from Bombay.
        (vi) Cash sent: ₹ 2,000 to Calcutta, ₹ 6,000 to Bombay.
    (c) Calcutta Branch (apart from the above)
        (vii) Sent goods to Patna: ₹ 6,000.
        (viii) Paid Bills Payable: ₹ 4,000 to Patna, ₹ 4,000 cash to Patna. ***[C.A. (Inter) — May, 1996]***
36. A Head Office at Bangalore has branches at Hassan and Mysore. What adjustment entries are required to be passed in the books of Head Office in regard to the following. The company closes its accounts on December 31 each year.
    (a) A remittance of ₹ 8,500 made by Hassan to the Head Office on December 28 was received by the latter on January 4.
    (b) Depreciation at 10% p.a. is to be provided on machinery at Mysore costing ₹ 75,000 the account of which is in the Head Office books.
    (c) Goods worth ₹ 20,000 sent by the Head Office to Mysore branch on December 24 were received by the latter on January 8.
    (d) The Hassan branch paid ₹ 100 dividend to a local shareholder on behalf of the Head Office.
    (e) A sum of ₹ 300 being arrears of call money was received by the Mysore office from a shareholder in November but was not communicated to the Head Office till January 3.
37. The following is the Trial Balance of Calcutta Branch as at 31st March, 2018 :

Particulars	Dr. (₹)	Cr. (₹)
Bombay Head Office	32,400	
Stock — 1st April, 2017	60,000	
Purchases	1,78,000	
Goods Received from Head Office	90,000	
Sales		3,80,000
Goods Supplied to Head Office		60,000
Salaries	15,000	
Debtors	37,000	
Creditors		18,500
Rent	9,600	
Office Expenses	4,700	
Cash in Hand and at Bank	17,800	
Furniture	14,000	
	4,58,500	4,58,500

Closing stock was valued at ₹ 27,000. The Branch Account in the books of head office stood at ₹ 4,600 (Dr.) on 31st March, 2018. On 28th March, 2018 the head office forwarded goods to the value of ₹ 25,000 to the branch where they were received on 3rd April, 2018.

Required : (a) Branch Trading and Profit and Loss Account
(b) Journal entries necessary to incorporate the above figures.
(c) Calcutta Branch Account in the books of the head office.

38. XY Company of Calcutta has a branch at Delhi. Goods sold at Delhi are supplied from Calcutta but no charge is made in the books as between the branch and the Head Office. On 31st March, 2017, the branch Balance Sheet after closing the books was as follows:

Liabilities	₹	Assets	₹
Creditors balances	40,000	Debtors balances	2,00,000
Head office	1,68,000	Building extension account closed by H.O. A/c	—
		Cash at bank	8,000
	2,08,000		2,08,000

For the six months ending with September, 2017 the following transactions took place at branch:

Particulars	₹	Particulars	₹
Sales	2,40,000	Purchases	48,000
Wages paid	20,000	Salaries (inclusive of advance of ₹ 2,000)	4,000
General expenses	1,600	Life insurance premium paid for 1 year	3,200
Manager's salary for 9 months	7,200	Cash collections from Debtors	1,60,000
Discounts allowed	8,000	Discounts earned	1,200
Cash paid to Creditors	60,000	Cash sent to bank	80,000
Building Account (further payment to contractors)	4,000	Cash in hand	1,600
Cash at bank	28,000		

Set out the Head Office account in the Delhi books as on 30th September, 2017 to show the entries after the books are closed and also the branch Balance Sheet on that same date assuming to be made up on the same lines as on 31st March, 2017.

39. Messrs. Dhyanchand & Co., Kanpur, have a branch in Delhi. The Delhi branch deals not only in the goods from the head office but buys some auxiliary goods and deals in them. They, however, do not prepare any Profit and Loss Account but close all the accounts to the head office at the end of the year and open them afresh on the basis of advice from their head office. The Fixed Assets Accounts are also maintained at the head office. The goods from the head office are invoiced at selling prices to give a profit of 20% on the sale price. The goods sent from the branch to the head office are at cost. From the following, prepare the Branch Account, Branch Trading and Profit and Loss Accounts and Branch Assets Account in the head office books:

Trial Balance of Delhi Branch as on 31.3.2018

Particulars	Dr. (₹)	Cr. (₹)
Head Office Opening Balance, 1.4.2017	15,000	
Goods from Head Office	50,000	
Purchases	20,000	
Sales		1,00,000
Opening Stock (Head Office Goods at invoice price)	4,000	
Opening Stock of other goods	500	
Goods to Head Office		3,000
Salaries	7,000	
Rent	3,000	
Office Expenditure	2,000	
Cash in Hand	500	
Cash at Bank	4,000	
Head Office Current Account		15,000
Sundry Debtors	15,000	
Sundry Creditors		3,000
	1,21,000	1,21,000

The branch balances on 1 April 2017 were as under :
Furniture ₹ 5,000; Sundry debtors ₹ 9,500; Cash ₹ 1,000; Creditors ₹ 30,000; Stock (head office goods at invoice price) ₹ 4,000; Other goods ₹ 500. The closing stock at branch of the head office goods at invoice price is ₹ 3,000 and that of purchased goods at cost is ₹ 1,000. Depreciation is to be provided at 10% on branch assets.

40. You are required to prepare the Trading and Profit and Loss Accounts and consolidated Balance Sheet of Eve Ltd. in Calcutta and its branch at Delhi. Give Journal Entries for incorporation of Delhi Branch Accounts in the head office and show the Branch Account in head office books after incorporating therein the assets and liabilities.
The trial balances as on 31st December, 2017 are as under:

Particulars	H.O. Dr. (₹)	Branch Dr. (₹)	H.O. Cr. (₹)	Branch Cr. (₹)
Manufacturing expenses	30,000	10,000	—	—
Salaries	30,000	10,000	—	—
Wages	1,00,000	40,000	—	—
Cash in hand	10,000	2,000	—	—
Purchases	1,50,000	80,000	—	—
Capital	—	—	2,00,000	—
Goods received from H.O.	—	15,000	—	—
Rent	8,000	4,000	—	—

General expenses	20,000	5,000	—	—
Sales	—	—	4,50,000	1,50,000
Goods sent to branch	—	—	15,000	—
Purchases returns	—	—	5,000	1,000
Opening stock	50,000	30,000	—	—
Discounts earned	—	—	2,000	1,000
Machinery at H.O.	1,50,000	—	—	—
Machinery at Branch	50,000	—	—	—
Furniture at H.O.	7,000	—	—	—
Furniture at branch	3,000	—	—	—
Debtors	40,000	15,000	—	—
Creditors	—	—	30,000	5,000
H.O. account	—	—	—	54,000
Branch account	54,000	—	—	—
TOTAL	7,02,000	2,11,000	7,02,000	2,11,000

Closing stock at head office was ₹ 40,000 and at branch ₹ 30,000. Depreciation is to be provided on machinery @ 20 per cent and on furniture @ 15 per cent. Rent outstanding is ₹ 500 (for branch).

Guide to Answers

Practical Questions

1. **Branch Profit — ₹ 29,500.**
2. **Branch Profit — ₹ 11,300; Depreciation ₹ 1,800.**
3. **Branch Profit — ₹ 87,500; Credit Dates — ₹ 5,37,500; Goods sent to branch — ₹ 5,75,000.**
4. **Branch Profit — ₹ 18,900; Opening balance of Debtors — ₹ 8,200.**
5. **Branch Profit — ₹ 5,800.**
6. **Branch Profit — ₹ 12,680; Cash received from Debtors — ₹ 29,500.**
7. **Branch Profit : Madras — ₹ 82,200; Nagpur — ₹ 92,800.**
8. **Branch Profit — ₹ 32,000.**
9. **Branch Profit — ₹ 10,280.**
10. **Branch Profit — ₹ 34,600. Difference in Branch Stock Account ₹ 5,000 has been treated as returns from debtors.**
11. **Gross Profit — ₹ 57,650 (after charging loading ₹ 150 for deficiency of stock). Deficiency of stock at invoice price ₹ 600.**
12. **Branch Profit — ₹ 24,817.**
13. **Branch Profit — ₹ 3,385.**
14. **Profit : Calcutta — ₹ 7,400; Madras — ₹ 5,715.**
15. **Gross Profit — ₹ 43,200; Branch Profit — ₹ 27,000.**
16. **Gross Profit — ₹ 3,580; Branch Profit — ₹ 2,720.**
17. **Branch Profit — ₹ 9,200; Credit Sales — ₹ 72,000; Supplies from H.O. — ₹ 1,50,000.**
18. **Branch Profit — ₹ 1,77,000; Gross Profit — ₹ 2,43,800.**
19. **Gross Profit — ₹ 92,800; Branch Profit — ₹ 86,200.**
20. **Net Profit — ₹ 1,00,518.**
21. **Branch Profit — ₹ 9,000.**
22. **Branch Profit — ₹ 39,200; Gross Profit — ₹ 68,000.**
23. **Branch Profit — ₹ 18,570; Gross Profit — ₹ 37,830.**
24. **Goods sent to branch at cost — ₹ 3,00,000; Goods sent to branch at invoice price — ₹ 3,75,000.**
    Closing Stock : Madras — ₹ 28,000; Coimbatore — ₹ 4,800; Trivandrum — ₹ 4,000; Bangalore — ₹ 2,000.
    Gross Profit : Coimbatore — ₹ 36,000; Trivandrum — ₹ 24,000; Bangalore — ₹ 20,000.
25. **Net Profit — ₹ 26,830; Gross Profit — ₹ 88,690.**
26. **Net Profit : Kanpur — ₹ 61,200; Lucknow — ₹ 74,800; Gross Profit : Kanpur — ₹ 96,500; Lucknow — ₹ 1,04,000.**
27. **Net Profit : Madras — ₹ 13,210; Delhi — ₹ 2,600; Calcutta — ₹ 17,409.**
28. **(i) Value of Closing Stock : H.O. — ₹ 60,000; Branch — ₹ 9,000.**
    (ii) Profit : H.O. — ₹ 88,000; Branch — ₹ 5,000; Stock reserve — ₹ 4,000.
29. **Gross Profit — ₹ 52,500; Net Profit — ₹ 35,625; Stock — ₹ 1,25,250.**
30. **Net Profit : H.O. — ₹ 5,65,000; Branch — ₹ 35,000.**
31. **Branch Profit — ₹ 6,270; Stock Reserve — ₹ 2,283.**
32. **Only journal entries.**
33. **Only journal entries.**
34. **Only journal entries.**

35. **Madras Branch Account Dr. ₹ 6,000**
Patna Branch Account Dr. ₹ 16,000
To Bombay Branch Account ₹ 6,000
To Calcutta Branch Account ₹ 16,000

36. **Only journal entries.**

37. **Branch Profit — ₹ 1,09,700; Cash in transit — ₹ 12,000.**

38. **Remittance to Head Office — ₹ 40,000; Balance Sheet total — ₹ 3,07,600; For lack of information Branch Trading and Profit and Loss Account cannot be prepared.**

39. **Branch Profit — ₹ 30,200; Stock Reserve — ₹ 600.**

40. **Head Office Profit : ₹ 92,950; Branch Loss : ₹ 22,950; Balance Sheet Total : ₹ 3,05,500.**

8

Hire Purchase and Instalment Payment System

Section A : Hire Purchase Accounts

Introduction

With an increasing demand for better life, the consumption of goods has been on the expanding scale. But, this has not been backed up by adequate purchasing power, transforming it into effectual demand, i.e, actual sale at set or settled prices. This has created the market for what is called ***hire purchase***.

When a person is unable to acquire an asset against immediate cash payment, or is not sure to make payment within a stipulated period of time he may make some arrangements with the seller to stagger the payment. This enables the purchaser to use the asset while paying for it by instalments over an agreed period of time. This type of a business deal is known as ***hire purchase transaction***. Here, the customer pays the entire amount either in monthly or quarterly or yearly instalments, while the asset — the durable (television, fridge, car, etc.,) remains the property of the seller until the buyer squares up his entire liability. For the seller the contracted instalments include his interest on the credit to the purchaser. Therefore, when the total amount is paid in instalments over a period of time, the total amount paid is certainly higher than the cash down price of the article because of the counterveiling interest charges.

Obviously, both the parties gain in the bargain. By virtue of this process, the purchaser has the immediate use of the asset without making down right payment from his own, he gets both credit and product from the same seller. From the point of view of the seller, the benefit rests in the enhancement of his sale while he recovers his own cost of credit — the credit he had from the financier — from the hire purchaser.

Thus, it is not surprising that in consumer durables, in particular, the hire purchase system has increased its share of the total market. It is to be noted that the process is being extended to the production firms where the producers obtain costly machinery and implements under this system as in a single-window operation — credit and asset from the same business entity.

Nature of Hire Purchase Agreement

Under the Hire Purchase System the customer (called the Hire Purchaser) obtains possession of the goods at the outset and can use it, while paying for it by instalments over an agreed period of time. However, the ownership of the goods remains with the seller (called the Hire Vendor) until the hire purchaser has made all the payments. Each instalment paid by the hire purchaser is treated as hire charges for using the asset. In case he fails to pay any of the instalments (even the last one) the hire vendor will take back his goods without compensating the buyer, i.e., the hire vendor is not going to pay back a part or whole of the amount received through instalments from the buyer.

The special features of the hire purchase agreement are:

(1) The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.

(2) The goods should be delivered by the hire vendor on the condition that a hire purchaser should pay the agreed amount in periodical instalments.

(3) The hire purchaser generally makes a down payment (initial payment) on signing the agreement and the balance of the amount alongwith interest is paid in instalments at regular intervals for a specified period.

(4) Each instalment including down-payment (if any) is treated as hire charges by the seller.

(5) Each instalment consists partly of a finance charge (interest) and partly of a capital payment.

(6) The hire purchaser should be given power to exercise the option to purchase the hired goods.

(7) The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.

(8) The hire purchaser has the right to terminate the agreement at any time before the property so passes.

(9) In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

Legal Position

"Hire Purchase" and "Hire Purchase Agreements" have been defined in the Hire Purchase Act, 1972. Though the Act was passed by the Parliament and had got the assent of the President, the date of coming into effect of the Act, was rescinded.

Section 2: Definition — In this Act, unless the context otherwise requires, — "hire purchase agreement" means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which —

(i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and

(ii) the property in the goods is to pass to such person on the payment of the last of such instalments, and

(iii) such person has a right to terminate the agreement at any time before the property so passes.

Accounting Arrangements of Hire Purchase Transaction

In connection with the accounting for goods sold on the hire purchase system, we should know the meaning of the following terms:

1. **Hire Vendor** : The seller in a hire purchase agreement.
2. **Hire Purchaser** : The buyer in a hire purchase agreement.
3. **Cash Price** : The amount to be paid on outright purchase in cash.
4. **Down Payment** : Initial payment made at the time of signing the hire purchase agreement.
5. **Hire Purchase Price** : The amount to be paid if the goods are purchased under the hire purchase system. It includes the cash price and interest of the future instalments.

Under a hire purchase agreement, the hire purchaser obtains possession of the goods at the outset, but the ownership is not transferred until the last instalment is paid. Therefore, on a strict legal interpretation of the facts of the transaction, the hire vendor should not take any profit out of the hire purchase transaction until the final payment is made. Similarly, the hire purchaser should not include the goods as fixed assets (as most hire purchase items are of asset type) in his Balance Sheet until the final instalment is paid.

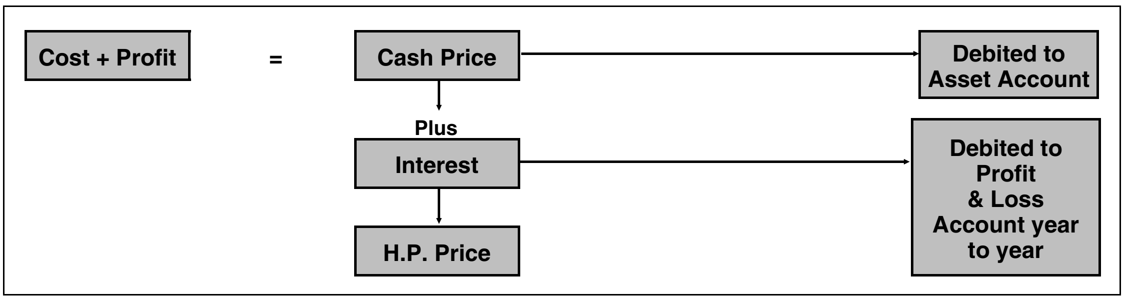
In this connection, the following points are very important :

1. AS—19 (Accounting Standard for Leases) is applicable to Hire Purchase agreement. ***Para 4*** states that "The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.
2. At the inception of the hire purchase agreement, the hire purchaser should record the asset acquired on hire purchase as an ***asset***. Assets cannot be recorded on piecemeal basis with the payment of instalments.
3. Hire purchaser should recognise the ***liability*** at the inception of the hire purchase agreement.

Books of the Hire Purchaser

To have proper accounting record, some information is required in regard to the hire purchase transactions. They are as : (1) Date of purchase of the asset; (2) Cash price of the asset; (3) Hire purchase price of the asset; (4) The amount of down payment; (5) Number and amount of each instalment; (6) Rate of interest; (7) Method and rate of depreciation; and (8) Date of closing the books of account.

Before passing journal entries the students should consider the make-up of the hire purchase price:



Recording of Asset

Method 1

Under this method, the full ***cash price*** of the asset is debited to the Asset Account and credited to the Hire Vendor Account. At the time of payment of instalment, Interest Account is debited and Hire Vendor Account is credited (with the interest on outstanding balance). When instalment is paid, the Hire Vendor Account is debited and Bank Account is credited. At the time of preparation of Final Accounts, interest is transferred to Profit and Loss Account and asset is shown in the Balance Sheet at cost less depreciation. The balance due to hire vendor is shown in the Balance Sheet as a liability (alternatively it can be shown as a deduction from Asset Account). [***See Illustration 5***]

Depreciation on asset acquired on hire purchase must be charged from the date of acquisition of possession (not from the date of legal ownership) and it is to be calculated on cash price.

Journal Entries

1. When the asset is acquired on hire purchase

Asset Account Dr. [Full cash price]

To Hire Vendor Account

2. When down payment is made	
Hire Vendor Account	Dr. [Down payment]
To Bank Account	
3. When an instalment becomes due	
Interest Account	Dr. [Interest on outstanding balance]
To Hire Vendor Account	
4. When an instalment is paid	
Hire Vendor Account	Dr. [Amount of instalment]
To Bank Account	
5. When depreciation is charged on the asset	
Depreciation Account	Dr. [Calculated on cash price]
To Asset Account	
6. For closing interest and depreciation account	
Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

Illustration 1

On January 1, 2015 Gopinath and Co. acquired a pick-up Van on hire purchase from French Motor Co. Ltd. The terms of the contract were as follows:

(a) The cash price of the van was ₹ 1,00,000.
(b) ₹ 40,000 were to be paid on signing of the contract.
(c) The balance was to be paid in annual instalments of ₹ 20,000 plus interest.
(d) Interest chargeable on the outstanding balance was 6% p.a.
(e) Depreciation at 10% p.a. is to be written-off using the straight-line method.

You are required to:

(i) Give Journal Entries and show the relevant accounts in the books of Gopinath and Co. from January 1, 2015 to December 31, 2017; and
(ii) Show the relevant items in the Balance Sheet of the purchaser as on December 31, 2015 to 2017.

Solution

In the books of Gopinath & Co.

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Pick-up Van A/c Dr. To French Motor Co. Ltd. A/c (Being the purchase of a pick-up van on hire purchase from French Motor Co. Ltd.)		1,00,000	 1,00,000
"	French Motor Co. Ltd. A/c Dr. To Bank A/c (Being the amount paid on signing the H.P. contract)		40,000	 40,000
Dec. 31	Interest A/c Dr. To French Motor Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 60,000)		3,600	 3,600
"	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 3,600) Dr. To Bank A/c (Being the payment of 1st instalment along with interest)		23,600	 23,600
"	Depreciation A/c Dr. To Pick-up Van A/c (Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)		10,000	 10,000
"	Profit & Loss A/c Dr. To Depreciation A/c To Interest A/c (Being the depreciation and interest transferred to Profit and Loss Account)		13,600	 10,000 3,600
2016 Dec. 31	Interest A/c Dr. To French Motor Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 40,000)		2,400	 2,400

	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 2,400)	Dr.		22,400	
	To Bank A/c				22,400
	(Being the payment of 2nd instalment along with interest)				
	Depreciation A/c	Dr.		10,000	
	To Pick-up Van A/c				10,000
	(Being the depreciation charged @ 10% p.a.)				
	Profit & Loss A/c	Dr.		12,400	
	To Depreciation A/c				10,000
	To Interest A/c				2,400
	(Being the depreciation and interest charged to Profit and Loss Account)				
2017 Dec. 31	Interest A/c	Dr.		1,200	
	To French Motor Co. Ltd. A/c				1,200
	(Being the interest payable @ 6% on ₹ 20,000)				
	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 1,200)	Dr.		21,200	
	To Bank A/c				21,200
	(Being the payment of final instalment along with interest)				
	Depreciation A/c	Dr.		10,000	
	To Pick-up Van A/c				10,000
	(Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)				
	Profit & Loss A/c	Dr.		11,200	
	To Depreciation A/c				10,000
	To Interest A/c				1,200
	(Being the interest and depreciation charged to Profit and Loss Account)				

Ledger of Gopinath and Co.

Dr. **Pick-up Van Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To French Motor Co. Ltd. A/c	1,00,000	31.12.2015	By Depreciation A/c	10,000
			31.12.2015	By Balance c/d	90,000
		1,00,000			1,00,000
1.1.2016	To Balance b/d	90,000	31.12.2016	By Depreciation A/c	10,000
			31.12.2016	By Balance c/d	80,000
		90,000			90,000
1.1.2017	To Balance b/d	80,000	31.12.2017	By Depreciation A/c	10,000
			31.12.2017	By Balance c/d	70,000
		80,000			80,000

Dr. **French Motor Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	40,000	1.1.2015	By Pick-up Van A/c	1,00,000
31.12.2015	To Bank A/c	23,600	31.12.2015	By Interest A/c	3,600
31.12.2015	To Balance c/d	40,000			
		1,03,600			1,03,600
31.12.2016	To Bank A/c	22,400	1.1.92016	By Balance b/d	40,000
31.12.2016	To Balance c/d	20,000	31.12.2016	By Interest A/c	2,400
		42,400			42,400
31.12.2017	To Bank A/c	21,200	1.1.2017	By Balance b/d	20,000
			31.12.2017	By Interest A/c	1,200
		21,200			21,200

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Pick-up Van A/c	10,000	31.12.2015	By Profit & Loss A/c	10,000
31.12.2016	To Pick-up Van A/c	10,000	31.12.2016	By Profit & Loss A/c	10,000
31.12.2017	To Pick-up Van A/c	10,000	31.12.2017	By Profit & Loss A/c	10,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To French Motor Co. Ltd. A/c	3,600	31.12.2015	By Profit & Loss A/c	3,600
31.12.2016	To French Motor Co. Ltd. A/c	2,400	31.12.2016	By Profit & Loss A/c	2,400
31.12.2017	To French Motor Co. Ltd. A/c	1,200	31.12.2017	By Profit & Loss A/c	1,200

Balance Sheet of Gopinath & Co. as at 31st December, 2015

Liabilities	₹	Assets	₹
French Motor Co. Ltd.	40,000	Pick-up Van	90,000

Balance Sheet of Gopinath & Co. as at 31st December, 2016

Liabilities	₹	Assets	₹
French Motor Co. Ltd.	20,000	Pick-up Van	80,000

Balance Sheet of Gopinath & Co. as at 31st December, 2017

Liabilities	₹	Assets	₹
		Pick-up Van	70,000

Method 2

This method is almost similar to Method 1, excepting the accounting for interest. Under this method, like method 1, the full cash price of the asset is debited to Asset Account and credited to the Hire Vendor Account. At the same time the entire amount of interest payable (for all instalments) is debited to the H.P. Interest Suspense Account and credited to the Hire Vendor Account. At the time of payment of each instalment, the Hire Vendor Account is debited and the Bank Account is credited. At the same time an appropriate amount of interest is removed from the H.P. Interest Suspense Account and debited to the Interest Account. At the time of preparation of Final Accounts, the interest is transferred to the Profit and Loss Account and the balance of the H.P. Interest Suspense Account is shown in the Balance Sheet as a deduction from the Hire Vendor Account. All other entries are similar to method 1.

Journal Entries

1. When the asset is acquired on hire purchase

Asset Account	Dr. [Full cash price]
To Hire Vendor Account	

2. For total interest payable

H.P. Interest Suspense Account	Dr. [Total interest]
To Hire Vendor Account	

3. When down payment is made

Hire Vendor Account	Dr.
To Bank Account	

4. For interest of the relevant period

Interest Account	Dr. [Interest of the relevant period]
To H.P. Interest Suspense Account	

5. When an instalment is paid

Hire Vendor Account	Dr.
To Bank Account	

6. When depreciation is charged on the asset

Depreciation Account	Dr. [Calculated on cash price]
To Asset Account	

7. For closing interest and depreciation account

Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

If we apply this method to the figures from ***Illustration 1***, the H.P. Interest Suspense Account, Interest Account and French Motor Co. Ltd. Accounts and Balance Sheets will appear as follows:

Dr. **H.P. Interest Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To French Motor Co. Ltd. A/c (Note 1)	7,200	31.12.2015	By Interest A/c	3,600
			31.12.2015	By Balance c/d	3,600
		7,200			7,200
1.1.2016	To Balance b/d	3,600	31.12.2016	By Interest A/c	2,400
			31.12.2016	By Balance c/d	1,200
		3,600			3,600
1.1.2017	To Balance b/d	1,200	31.12.2017	By Interest A/c	1,200

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To H.P. Interest Suspense A/c	3,600	31.12.2015	By Profit & Loss A/c	3,600
31.12.2016	To H.P. Interest Suspense A/c	2,400	31.12.2016	By Profit & Loss A/c	2,400
31.12.2017	To H.P. Interest Suspense A/c	1,200	31.12.2017	By Profit & Loss A/c	1,200

Dr. **French Motor Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	40,000	1.1.2015	By Pick-up Van A/c	1,00,000
31.12.2015	To Bank A/c	23,600	1.1.2015	By H.P. Interest Suspense A/c	7,200
31.12.2015	To Balance c/d	43,600			
		1,07,200			1,07,200
31.12.2016	To Bank A/c	22,400	1.1.2016	By Balance b/d	43,600
31.12.2016	To Balance c/d	21,200			
		43,600			43,600
31.12.2017	To Bank A/c	21,200	1.1.2017	By Balance b/d	21,200

Balance Sheet of Gopinath & Co. as at 31st December, 2015

Liabilities		₹	Assets		₹
French Motor Co. Ltd.	43,600		Pick-up Van	1,00,000	
Less: H.P. Interest Suspense	3,600	40,000	*Less*: Depreciation	10,000	90,000

Balance Sheet of Gopinath & Co. as at 31st December, 2016

Liabilities		₹	Assets		₹
French Motor Co. Ltd.	21,200		Pick-up Van	90,000	
Less: H.P. Interest Suspense	1,200	20,000	*Less*: Depreciation	10,000	80,000

Balance Sheet of Gopinath & Co. as at 31st December, 2017

Liabilities		₹	Assets		₹
			Pick-up Van	80,000	
			Less: Depreciation	10,000	70,000

Working Notes : (1) Total interest = ₹ 3,600 + ₹ 2,400 + ₹ 1,200 = ₹ 7,200.

Illustration 2

A. Co. Ltd. purchased machinery from B. Co. Ltd. on hire purchase terms. The cash price of the machinery was ₹ 1,19,145. ₹ 32,000 was to be paid on 1.1.2015 and balance in 3 instalments of ₹ 32,000 each on 31st December every year subject to interest @ 5% p.a. Depreciation is to be provided @ 15% p.a. on the diminishing balances.

Show Machinery Account and B.Co. Ltd. Account in the books of A. Co. Ltd. for 3 years upto 2017.

Solution

In the books of A. Co. Ltd.

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To B. Co. Ltd. A/c	1,19,145	31.12.2015	By Depreciation A/c	17,872
			31.12.2015	By Balance c/d	1,01,273
		1,19,145			1,19,145

1.1.2016	To Balance b/d	1,01,273	31.12.2016 31.12.2016	By Depreciation A/c By Balance c/d	15,191 86,082
		1,01,273			1,01,273
1.1.2017	To Balance b/d	86,082	31.12.2017 31.12.2017	By Depreciation A/c By Balance c/d	12,912 73,170
		86,082			86,082

Dr. B. Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015 31.12.2015 31.12.2015	To Bank A/c (Down payment) To Bank A/c (Instalment) To Balance c/d	32,000 32,000 59,502	1.1.2015 31.12.2015	By Machinery A/c By Interest A/c	1,19,145 4,357
		1,23,502			1,23,502
31.12.2016 31.12.2016	To Bank A/c To Balance c/d	32,000 30,477	1.1.2016 31.12.2016	By Balance b/d By Interest A/c	59,502 2,975
		62,477			62,477
31.12.2017	To Bank A/c	32,000	1.1.2017 31.12.2017	By Balance b/d By Interest A/c	30,477 1,523
		32,000			32,000

Working Note : (1) Calculation of Interest

2015	₹	2016	₹	2017	₹
Cash price *Less*: Down payment	1,19,145 32,000	Balance b/f *Add*: Interest @ 5%	59,502 2,975	Balance b/f *Add*: Interest @ 5%	30,477 1,523
 Add: Interest @ 5%	87,145 4,357	 *Less*: Instalment	62,477 32,000	 *Less*: Instalment	32,000 32,000
	91,502	Balance c/f	30,477		nil
Less: Instalment	32,000				
Balance c/f	59,502				

Illustration 3

On 1st January, 2015, Globe Press purchased a printing machine on the hire purchase system from Modern Machinery Co. The payment was to be made at ₹ 30,000 down and the balance in three equal annual instalments of ₹ 20,000 each payable on 31st December. The vendor company charged interest @ 8% p.a. Globe Press provided depreciation @ 10% p.a. on the diminishing balances and paid all the instalments. It closed its books on 31st December every year. The cash down value of machine was ₹ 81,543. Show the (a) Modern Machinery Co.'s Account; and (b) Printing Machine Account in the books of Globe Press for 3 years upto 31st December, 2017.

Solution

In the books of Globe Press

Dr. Printing Machine Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Modern Machinery Co. A/c	81,543	31.12.2015 31.12.2015	By Depreciation A/c By Balance c/d	8,154 73,389
		81,543			81,543
1.1.2016	To Balance b/d	73,389	31.12.2016 31.12.2016	By Depreciation A/c By Balance c/d	7,339 66,050
		73,389			73,389
1.1.2017	To Balance b/d	66,050	31.12.2017 31.12.2017	By Depreciation A/c By Balance c/d	6,605 59,445
		66,050			66,050
1.1.2018	To Balance b/d	59,445			

Dr. Modern Machinery Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015 31.12.2015 31.12.2015	To Bank A/c To Bank A/c (Instalment) To Balance c/d	30,000 20,000 35,666	1.1.2015 31.12.2015	By Printing Machine A/c By Interest A/c	81,543 4,123
		85,666			85,666

31.12.2016	To Bank A/c (Instalment)	20,000	1.1.2016	By Balance b/d	35,666
31.12.2016	To Balance c/d	18,519	31.12.2016	By Interest A/c	2,853
		38,519			38,519
31.12.2017	To Bank A/c	20,000	1.1.2017	By Balance b/d	18,519
			31.12.2017	By Interest A/c	1,481
		20,000			20,000

Working Note : (1) Calculation of Interest

2015	₹	2016	₹	2017	₹
Cash price	81,543	Balance b/f	35,666	Balance b/f	18,519
Less: Down payment	30,000	*Add*: Interest @ 8%	2,853	*Add:* Interest @ 8%	1,481
	51,543		38,519		20,000
Add: Interest @ 8%	4,123	*Less*: Instalment	20,000	*Less*: Instalment	20,000
	55,666	Balance c/f	18,519		nil
Less: Instalment	20,000				
Balance c/f	35,666				

Illustration 4

Sri S. Nandi purchased a machine on 30.6.2014 from A. Ltd. on Hire Purchase System. The cash price of the machine was ₹ 34,000. The agreement provided that he would pay ₹ 8,000 on delivery of the machine and the balance in 6 half-yearly instalments of ₹ 4,800 each. A. Ltd. charged interest at 6% per annum of half-yearly balances. The buyer closed his books of accounts on 31st December every year. Assuming that he decided to write-off depreciation on the machine at 10% p.a. under the diminishing balance method. Show the necessary Ledger Accounts in the books of Sri S. Nandi.

Solution **In the books of Sri S. Nandi**

Dr. **Machine Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To A. Ltd. A/c	34,000	31.12.2014	By Depreciation A/c (1/2 year)	1,700
			31.12.2014	By Balance c/d	32,300
		34,000			34,000
1.1.2015	To Balance b/d	32,300	31.12.2015	By Depreciation A/c	3,230
			31.12.2015	By Balance c/d	29,070
		32,300			32,300
1.1.2016	To Balance b/d	29,070	31.12.2016	By Depreciation A/c	2,907
			31.12.2016	By Balance c/d	26,163
		29,070			29,070
1.1.2017	To Balance b/d	26,163	31.12.2017	By Depreciation A/c	2,616
			31.12.2017	By Balance c/d	23,547
		26,163			26,163
1.1.2018	To Balance b/d	23,547			

Dr. **A. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To Bank A/c (Down payment)	8,000	30.6.2014	By Machinery A/c	34,000
31.12.2014	To Bank A/c	4,800	31.12.2014	By Interest A/c (6 months)	780
31.12.2014	To Balance c/d	21,980			
		34,780			34,780
30.6.2015	To Bank A/c	4,800	1.1.2015	By Balance b/d	21,980
31.12.2015	To Bank A/c	4,800	30.6.2015	By Interest A/c (6 months)	659
31.12.2015	To Balance c/d	13,574	31.12.2015	By Interest A/c (6 months)	535
		23,174			23,174
30.6.2016	To Bank A/c	4,800	1.1.2016	By Balance b/d	13,574
31.12.2016	To Bank A/c	4,800	30.6.2016	By Interest A/c	407
31.12.2016	To Balance c/d	4,656	31.12.2016	By Interest A/c	275
		14,256			14,256

30.6.2017	To Bank A/c	4,800	1.1.2017	By Balance b/d	4,656
			30.6.2017	By Interest A/c	144
		4,800			4,800

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To A. Ltd. A/c	780	31.12.2014	By Profit & Loss A/c	780
30.6.2015	To A. Ltd. A/c	659	31.12.2015	By Profit & Loss A/c	1,194
31.12.2015	To A. Ltd. A/c	535			
		1,194			1,194
30.6.2016	To A. Ltd. A/c	407	31.12.2016	By Profit & Loss A/c	682
31.12.2016	To A. Ltd. A/c	275			
		682			682
30.6.2017	To A. Ltd. A/c	144	31.12.2017	By Profit & Loss A/c	144

Dr. **Depreciation Account** **Cr**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Machinery A/c	1,700	31.12.2014	By Profit & Loss A/c	1,700
31.12.2015	To Machinery A/c	3,230	31.12.2015	By Profit & Loss A/c	3,230
31.12.2016	To Machinery A/c	2,907	31.12.2016	By Profit & Loss A/c	2,907
31.12.2017	To Machinery A/c	2,616	31.12.2017	By Profit & Loss A/c	2,616

Working Note:

(1) Calculation of Interest

2014	₹	2015	₹	2016	₹	2017	₹
Cash price	34,000	Balance b/f	21,980	Balance b/f	13,574	Balance b/f	4,656
Less: Down payment	8,000	*Add*: Interest (1/2 year)	659	*Add*: Interest (1/2 year)	407	*Add*: Interest*	144
	26,000		22,639		13,981		4,800
Add: Interest (1/2 year)	780	*Less*: Instalment	4,800	*Less*: Instalment	4,800	*Less*: Instalment	4,800
	26,780		17,839		9,181		nil
Less: Instalment	4,800	*Add:* Interest (1/2 year)	535	*Add*: Interest (1/2 year)	275		
Balance c/f	21,980		18,374		9,456		
		Less: Instalment	4,800	*Less*: Instalment	4,800		
		Balance c/f	13,574	Balance c/f	4,656		

* Actual interest comes to ₹ 139.69 but has been put at ₹ 144 for balancing purposes.

Illustration 5

M H Ltd bought a motor vehicle on 1.1.2016, for ₹ 4,34,180 under a hire-purchase agreement. The cash price was ₹ 3,60,000. The vehicle was financed by Tata Finance Ltd. The agreement required an initial deposit of ₹ 1,20,000 on acquisition, followed by two equal instalments of ₹ 1,57,090 on 31.12.2016 and 31.12.2017, hire purchase interest being calculated @ 20% p.a. on the balance at 31 December each year.

On 31.12.2015, the balance on the Motor Vehicle Account was ₹ 16,00,000 and on the provision for depreciation (motor vehicles) ₹ 7,60,000. Depreciation is calculated @ 25% p.a. on a straight line basis, assuming no residual value. No other acquisitions or disposals took place.

Prepare necessary ledger accounts for the two years ended 31.12.2016 and 31.12.2017 and also show the relevant items in the Balance Sheet of M H Ltd as at 31st December, 2016.

Solution

In the books of M H Ltd

Dr. **Motor Vehicles Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Balance b/d	16,00,000	31.12.2016	By Balance c/d	19,60,000
1.1.2016	To Tata Finance Ltd A/c	3,60,000			
		19,60,000			19,60,000
1.1.2017	To Balance b/d	19,60,000	31.12.2017	By Balance c/d	19,60,000
1.1.2017	To Balance b/d	19,60,000			

Dr. Provision for Depreciation (Motor Vehicles) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Balance b/d	12,50,000	1.1.2016	By Balance b/d	7,60,000
			31.12.2016	By Depreciation A/c (25% of ₹ 19,60,000)	4,90,000
		12,50,000			12,50,000
31.12.2017	To Balance c/d	17,40,000	1.1.2017	By Balance b/d	12,50,000
				By Depreciation A/c	4,90,000
		17,40,000			17,40,000
			1.1.2018	By Balance b/d	17,40,000

Dr. Tata Finance Ltd Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Bank A/c (Deposit)	1,20,000	1.1.2016	By Motor Vehicles A/c	3,60,000
31.12.2016	To Bank A/c (1st Instalment)	1,57,090	31.12.2016	By Interest A/c	48,000
31.12.2016	To Balance c/d	1,30,910		[20% x (₹ 3,60,000 – ₹ 1,20,000)]	
		4,08,000			4,08,000
31.12.2017	To Bank A/c (2nd Instalment)	1,57,090	1.1.2017	By Balance b/d	1,30,910
			31.12.2017	By Interest A/c (Note 1)	26,180
		1,57,090			1,57,090

Dr. Interest Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Tata Finance Ltd A/c	48,000	31.12.2016	By Profit and Loss A/c	4,800
31.12.2017	To Tata Finance Ltd A/c	26,180	31.12.2017	By Profit and Loss A/c	26,180

Balance Sheet of M H Ltd as on 31st December, 2016 (includes)

Liabilities	₹	Assets	₹
		Motor Vehicles (at cost)	19,60,000
		Less: Provision for Depreciation	12,50,000
			7,10,000
		Less: Amount Payable to Tata Finance Ltd (not yet due)	1,30,910
			5,79,090

Working Note : (1) Actual interest comes to ₹ 26,182 but has been put at ₹ 26,180 for balancing purposes.

Illustration 6

Buyers Ltd. purchased a truck on January 1, 2015 on hire purchase basis from Vendors Ltd. The cash down price was ₹ 30,000. The terms of purchase were as under:

(a) ₹ 12,000 is payable as deposit.

(b) Balance being payable by 12 quarterly instalments of ₹ 1,920, falling due from April 1, 2015.

The financial year of the company (Buyers Ltd.) ends on June 30.

On September 30, 2016 the truck was sold for ₹ 20,000 and the hire purchase balances were settled for ₹ 10,200.

Buyers Ltd. brings the Asset Account at cash price and spreads interest equally over the period of hire purchase payments. Depreciation at 20% p.a. on cost was provided up to the date of sale.

Show the Truck Account, Vendors Ltd. Account and the Interest Suspense Account in the books of Buyers Ltd.

Solution

In the books of Buyers Ltd.

Dr. Truck Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Vendors Ltd. A/c	30,000	30.6.2015	By Depreciation A/c (Note 1)	3,000
			30.6.2015	By Balance c/d	27,000
		30,000			30,000

1.7.2015	To Balance b/d	27,000	30.6.2016	By Depreciation A/c	6,000
			30.6.2016	By Balance c/d	21,000
		27,000			27,000
1.7.2016	To Balance b/d	21,000	30.9.2016	By Depreciation A/c (Note 2)	1,500
30.6.2017	To Profit & Loss A/c (Profit on sale)	500	30.9.2016	By Bank A/c (Sale proceeds)	20,000
		21,500			21,500

Dr. Vendors Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	12,000	1.1.2015	By Truck A/c	30,000
1.4.2015	To Bank A/c	1,920	1.1.2015	By Interest Suspense A/c (Note 3)	5,040
30.6.2015	To Balance c/d	21,120			
		35,040			35,040
1.7.2015	To Bank A/c	1,920	1.7.2015	By Balance b/d	21,120
1.10.2015	To Bank A/c	1,920			
1.1.2016	To Bank A/c	1,920			
1.4.2016	To Bank A/c	1,920			
30.6.2016	To Balance c/d	13,440			
		21,120			21,120
1.7.2016	To Bank A/c	1,920	1.7.2016	By Balance b/d	13,440
1.10.2016	To Bank A/c	10,200			
30.6.2017	To Interest Suspense A/c	1,320			
		13,440			13,440

Dr. Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Vendors Ltd. A/c (Note 3)	5,040	30.6.2015	By Profit & Loss A/c (Note 4)	840
			30.6.2015	By Balance c/d	4,200
		5,040			5,040
1.7.2015	To Balance b/d	4,200	30.6.2016	By Profit & Loss A/c (Note 5)	1,680
			30.6.2016	By Balance c/d	2,520
		4,200			4,200
1.7.2016	To Balance b/d	2,520	30.9.2016	By Vendors Ltd. A/c	1,320
				By Profit & Loss A/c (Balancing figure)	1,200
		2,520			2,520

Working Notes :

(1) Depreciation @ 20% on ₹ 30,000 for 6 months = ₹ 3,000

(2) Depreciation @ 20% on ₹ 30,000 for 3 months = ₹ 1,500

(4) Interest for 2014-15 = 2/12 x ₹ 5,040 = ₹ 840. Interest has been allocated on the basis of number of instalments due in each accounting period.

(5) Interest for 2015-16 = 4/12 x ₹ 5,040 = ₹ 1,680.

(3) Calculation of total interest:

Instalments ₹ 1,920 x 12	₹ 23,040
Down payment	₹ 12,000
Hire Purchase price	₹ 35,040
Less: Cash price	₹ 30,000
Total interest	₹ 5,040

Illustration 7

Mahalaxmi Traders has bought three computers since 2015. All are subject to hire purchase agreements with the vendor, XYZ Ltd. Data relating to the computers are as follows :

Particulars	Computer A	Computer B	Computer C
Date of purchase	30.6.2015	31.3.2016	31.3.2017
Cash price	₹ 80,000	₹ 60,000	₹ 60,000
Deposit	₹ 10,400	₹ 7,200	₹ 7,200
Total interest	₹ 19,200	₹ 13,200	₹ 8,000
Number of quarterly instalments	12	12	8

The hire purchase agreements state that the first quarterly instalment is due three months after the date of purchase.

It is the firm's policy to assume that hire purchase interest accrues evenly over the life of the agreement and to credit the total hire purchase price to the vendor at the date of purchase. A Hire Purchase Interest Suspense Account is maintained.

The accounting year of the firm ends on 31st December. Depreciation on computers is at 20% p.a. on the written down value. A full year's depreciation is charged against profit in the year of purchase.

Prepare the following ledger accounts for the years ended 31.12.2015, 31.12.2016 and 31.12.2017 : (a) Computers; (b) Provision for Depreciation on Computers; (c) XYZ Limited; (d) Hire Purchase Interest Suspense.

Solution

In the books of Mahalaxmi Traders

Dr. (a) Computers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jun 30	To XYZ Ltd A/c	80,000	Dec. 31	By Balance c/d	80,000
2016			2016		
Jan 1	To Balance b/d	80,000	Dec. 31	By Balance c/d	1,40,000
Mar 31	To XYZ Ltd A/c	60,000			
		1,40,000			1,40,000
2017			2017		
Jan 1	To Balance b/d	1,40,000	Dec. 31	By Balance c/d	2,00,000
Mar 31	To XYZ Ltd A/c	60,000			
		2,00,000			2,00,000

Dr. (b) Provision for Depreciation on Computers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec 31	To Balance c/d	16,000	Dec 31	By Depreciation A/c (20% on ₹ 80,000)	16,000
2016			2016		
Dec 31	To Balance c/d	40,800	Jan 1	By Balance b/d	16,000
			Dec 31	By Depreciation A/c [20% on ₹ (1,40,000 – 16,000)]	24,800
		40,800			40,800
2017			2017		
Dec 31	To Balance c/d	72,640	Jan 1	By Balance b/d	40,800
			Dec 31	By Depreciation A/c [20% on ₹ (2,00,000 – 40,800)]	31,840
		72,640			72,640

(c) The amount of the instalments is as under :

$$\frac{\text{Cash Price + Total Interest – Deposit Paid}}{\text{Number of Instalments}} = \text{Quarterly Instalment}$$

Computer A — $\frac{(80{,}000 + 19{,}200 - 10{,}400)}{12}$ = ₹ 7,400 ; Computer B — $\frac{(60{,}000 + 13{,}200 - 7{,}200)}{12}$ = ₹ 5,500

Computer C — $\frac{(60{,}000 + 8{,}000 - 7{,}200)}{8}$ = ₹ 7,600

Number of instalments in each accounting year is as under :

	2015	2016	2017
Computer A	2	4	4
Computer B	—	3	4
Computer C	—	—	3

Dr. XYZ Limited Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jun 30	To Bank A/c (Deposit A)	10,400	Jun 30	By Computers A/c	80,000
Sep 30	To Bank A/c (Instalment A)	7,400	"	By H P Interest Suspense A/c	19,200

Dec 31	To Bank A/c (Instalment A)	7,400			
"	To Balance c/d	74,000			
		99,200			99,200
2016			2016		
Mar 31	To Bank A/c (Instalment A)	7,400	Jan 1	By Balance b/d	74,000
"	To Bank A/c (Deposit B)	7,200	Mar 31	By Computers A/c	60,000
Jun 30	To Bank A/c (Instalments A & B)	12,900	"	By H P Interest Suspense A/c	13,200
Sep 30	To Bank A/c (Instalments A & B)	12,900			
Dec 31	To Bank A/c (Instalments A & B)	12,900			
"	To Balance c/d	93,900			
		1,47,200			1,47,200
2017			2017		
Mar 31	To Bank A/c (Instalment A & B)	12,900	Jan 1	By Balance b/d	93,900
"	To Bank A/c (Deposit C)	7,200	Mar 31	By Computers A/c	60,000
Jun 30	To Bank A/c (Instalments A, B & C)	20,500	"	By H P Interest Suspense A/c	8,000
Sep 30	To Bank A/c (Instalments A, B & C)	20,500			
Dec 31	To Bank A/c (Instalments A, B & C)	20,500			
"	To Balance c/d	80,300			
		1,61,900			1,61,900

Dr. (d) Hire Purchase Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jun 30	To XYZ Ltd A/c	19,200	Dec 31	By Profit and Loss A/c (Note 1)	3,200
			"	By Balance c/d	16,000
		19,200			19,200
2016			2016		
Jan 1	To Balance b/d	16,000	Dec 31	By Profit and Loss A/c (Note 2)	9,700
Mar 31	To XYZ Ltd A/c	13,200	"	By Balance c/d	19,500
		29,200			29,200
2017			2017		
Jan 1	To Balance b/d	19,500	Dec 31	By Profit and Loss A/c (Note 3)	13,800
Mar 31	To XYZ Ltd A/c	8,000	"	By Balance c/d	13,700
		27,500			27,500

Working Notes :	₹
(1) 2015 — Computer A : ₹ 19,200 x 2/12	3,200
(2) 2016 — Computer A : ₹ 19,200 x 4/12	6,400
Computer B : ₹ 13,200 x 3/12	3,300
	9,700
(3) 2017 — Computer A : ₹ 19,200 x 4/12	6,400
Computer B : ₹ 13,200 x 4/12	4,400
Computer C : ₹ 8,000 x 3/8	3,000
	13,800

Books of the Hire Vendor

There are different methods of recording hire purchase transactions in the books of the hire vendor. It is selected according to the type and value of goods sold, volume of transactions, the length of the period of purchase, etc. The different methods are discussed below:

Sales Method

A business that sells a few relatively large items on hire purchase may adopt this method. Under this method, hire purchase sale is treated as a credit sale. The only exception is that the vendor agrees to accept payments in instalments and for that he charges interest. Generally, a special Sales Day Book is maintained for recording all sales under hire purchase agreement. The hire vendor debits the hire purchaser with the ***cash price*** of the goods and the credit is given to the H.P. Sales Account. When an instalment falls due, the hire purchaser is debited with the interest on the amount owing and credit is given to the Interest Account. When the instalment is received, the Bank Account is debited and Hire Purchaser Account is credited. The amount due from the hire purchaser at the end of the year is shown in the Balance Sheet on the assets side as Hire Purchase Debtors.

Journal Entries

1. When goods are sold and delivered under hire purchase

Hire Purchaser Account Dr. [Full cash price]
 To H.P. Sales Account

2. When the down payment is received

Bank Account Dr.
 To Hire Purchaser Account

3. When an instalment becomes due

Hire Purchaser Account Dr.
 To Interest Account

4. When the amount of instalment is received

Bank Account Dr.
 To Hire Purchaser Account

5. For closing Interest Account

Interest Account Dr.
 To Profit and Loss Account

6. For closing Hire Purchase Sales Account

H.P. Sales Account Dr.
 To Trading Account

Illustration 8

On 1st January 2015, X & Co. purchased a motor car from Hindustan Auto Limited on the hire purchase system. The agreed cash selling price was ₹ 1,20,000. At the time of agreement a sum of ₹ 30,000 was paid out of the cash price of the car and the balance was payable in 3 equal annual instalments together with interest @ 10% p.a.

You are required to pass necessary Journal Entries and show important accounts in the books of Hindustan Auto Limited for the year 2015 to 2017 (Date of closing the books of account is 31st December).

Solution

In the books of Hindustan Auto Ltd.

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	X & Co. A/c Dr. To H.P. Sales A/c (Being the goods sold on hire purchase)		1,20,000	 1,20,000
Jan. 1	Bank A/c Dr. To X & Co. A/c (Being the amount received against hire purchase sale at the time of signing the agreement)		30,000	 30,000
Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 90,000)		9,000	 9,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the 1st instalment received in respect of hire purchase sale)		39,000	 39,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		9,000	 9,000
Dec. 31	H.P. Sales A/c Dr. To Trading A/c (Being the transfer of H.P. Sales Account to Trading Account)		1,20,000	 1,20,000

2016 Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 60,000)		6,000	6,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the 2nd instalment received in respect of hire purchase sale)		36,000	36,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		6,000	6,000
2017 Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 30,000)		3,000	3,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the final instalment received from X & Co.)		33,000	33,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		3,000	3,000

Ledger of Hindustan Auto Limited

Dr. **X & Co. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To H.P. Sales A/c	1,20,000	1.1.2015	By Bank A/c	30,000
31.12.2015	To Interest A/c	9,000	31.12.2015	By Bank A/c	39,000
			31.12.2015	By Balance c/d	60,000
		1,29,000			1,29,000
1.1.2016	To Balance b/d	60,000	31.12.2016	By Bank A/c	36,000
31.12.2016	To Interest A/c	6,000	31.12.2016	By Balance c/d	30,000
		66,000			66,000
1.1.2017	To Balance b/d	30,000	31.12.2017	By Bank A/c	33,000
31.12.2017	To Interest A/c	3,000			
		33,000			33,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Profit & Loss A/c	9,000	31.12.2015	By X & Co. A/c	9,000
31.12.2016	To Profit & Loss A/c	6,000	31.12.2016	By X & Co. A/c	6,000
31.12.2017	To Profit & Loss A/c	3,000	31.12.2017	By X & Co. A/c	3,000

Dr. **H.P. Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Trading A/c	1,20,000	1.1.2015	By X & Co. A/c	1,20,000

In this connection, the students should note the following:

(i) The entire profit on sale under hire purchase agreement is credited to the Profit and Loss Account of the year in which the sale has taken place.

(ii) Interest pertaining to each accounting period is credited to the Profit and Loss Account of that year.

Interest Suspense Method

This method is almost similar to the sales method, excepting the accounting for interest. Under this method, the hire purchaser is debited with full cash price and interest (total) included in the hire selling price. Credit is given to the H.P. Sales Account and Interest Suspense Account. When the instalment is received, the Bank Account is debited and the Hire Purchaser Account is credited. At the same time an appropriate amount of interest (i.e., interest for the relevant accounting period) is removed from the Interest Suspense Account and credited to the Interest Account. At the time of preparation of Final Accounts, interest is transferred to the credit of the Profit and Loss Account. The balance of the Interest Suspense Account is shown in the Balance Sheet as a deduction from Hire Purchase Debtors.

Journal Entries

1. When goods are sold and delivered under hire purchase

Hire Purchaser Account	Dr. [Full cash price + total interest]
To H.P. Sales Account	[Full cash price]
To Interest Suspense Account	[Total interest]

2. When down payment / instalment is received

Bank Account	Dr.
To Hire Purchaser Account	

3. For interest of the relevant accounting period

Interest Suspense Account	Dr.
To Interest Account	

4. For closing Interest Account

Interest Account	Dr.
To Profit and Loss Account	

5. For closing Hire Purchase Sales Account

H.P. Sales Account	Dr.
To Trading Account	

Illustration 9

Assuming the same facts as in **Illustration 8**, with an agreed cash selling price of ₹ 1,20,000 and a total addition for interest of ₹ 18,000, pass necessary Journal Entries and show X & Co. Account, Interest Suspense Account, Interest Account and H.P. Sales Account.

Solution

In the books of Hindustan Auto Ltd.
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	X & Co. A/c Dr.		1,38,000	
	To H.P. Sales A/c			1,20,000
	To Interest Suspense A/c			18,000
	(Being the goods sold on hire purchase)			
Jan. 1	Bank A/c Dr.		30,000	
	To X & Co. A/c			30,000
	(Being the amount received against hire purchase sale at the time of signing the agreement)			
Dec. 31	Interest Suspense A/c Dr.		9,000	
	To Interest A/c			9,000
	(Being the interest pertaining to 2017 transferred to Interest Account)			
Dec. 31	Bank A/c Dr.		39,000	
	To X & Co. A/c			39,000
	(Being the 1st instalment received in respect of hire purchase sale)			
Dec. 31	Interest A/c Dr.		9,000	
	To Profit & Loss A/c			9,000
	(Being the interest received from X & Co. transferred to Profit and Loss Account)			
Dec. 31	H.P. Sales A/c Dr.		1,20,000	
	To Trading A/c			1,20,000
	(Being the transfer of H.P. Sales Account to Trading Account)			
2016 Dec. 31	Bank A/c Dr.		36,000	
	To X & Co. A/c			36,000
	(Being the 2nd instalment received in respect of hire purchase sale)			
	Interest Suspense A/c Dr.		6,000	
	To Interest A/c			6,000
	(Being the interest pertaining to 2018 transferred to Interest Account)			
Dec. 31	Interest A/c Dr.		6,000	
	To Profit & Loss A/c			6,000
	(Being the interest received from X & Co. transferred to Profit and Loss Account)			

2017 Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the final instalment received from X & Co.)		33,000	33,000
Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being the interest pertaining to 2018 transferred to Interest Account)		3,000	3,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit and Loss Account)		3,000	3,000

Ledger of Hindustan Auto Limited

Dr. X & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To H.P. Sales A/c	1,20,000	1.1.2015	By Bank A/c	30,000
1.1.2015	To Interest Suspense A/c	18,000	31.12.2015	By Bank A/c	39,000
			31.12.2015	By Balance c/d	69,000
		1,38,000			1,38,000
1.1.2016	To Balance b/d	69,000	31.12.2016	By Bank A/c	36,000
			31.12.2016	By Balance c/d	33,000
		69,000			69,000
1.1.2017	To Balance b/d	33,000	31.12.2017	By Bank A/c	33,000

Dr. Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Interest A/c	9,000	1.1.2015	By X & Co. A/c	18,000
31.12.2015	To Balance c/d	9,000			
		18,000			18,000
31.12.2016	To Interest A/c	6,000	1.1.2016	By Balance b/d	9,000
31.12.2016	To Balance c/d	3,000			
		9,000			9,000
31.12.2017	To Interest A/c	3,000	1.1.2017	By Balance b/d	3,000

Dr. Interest Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Profit & Loss A/c	9,000	31.12.2015	By Interest Suspense A/c	9,000
31.12.2016	To Profit & Loss A/c	6,000	31.12.2016	By Interest Suspense A/c	6,000
31.12.2017	To Profit & Loss A/c	3,000	31.12.2017	By Interest Suspense A/c	3,000

Dr. H.P. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Trading A/c	1,20,000	1.1.2015	By X & Co. A/c	1,20,000

The balances on the Hire Purchaser's Account and Interest Suspense Account will appear in the Balance Sheet as on 31st December, 2015 as follows:

Balance Sheet of Hindustan Auto Limited as at 31st December, 2015

Liabilities	₹	Assets	₹
		X & Co. (H.P. Debtors)	69,000
		Less: Interest Suspense A/c	9,000
			60,000

Ascertainment of Total Cash Price

We know that the basis for accounting in the books of the hire purchaser is the ***total cash price***. Sometimes, (particularly in examination problems) the total cash price may not be given. For the purpose of ascertaining the total cash price we can use any of the following methods according to the need.

(1) Calculation of total cash price when no annuity table is given.

(2) Calculation of total cash price when annuity table is given.

Calculation of Total Cash Price when the Annuity Table is not Given

In this method, the interest included in the last instalment is to be calculated first with the help of the appropriate formula (explained below).

For example in a hire purchase transaction, apart from down payment, four other instalments are payable. The interest will be calculated first on the 4th instalment, then on the 3rd instalment, then on the 2nd instalment and lastly on the 1st instalment. Interest on ***down payment will be nil***.

In this connection, it should be noted that the amount of interest will go on increasing from the 4th instalment to the 3rd instalment, from the 3rd instalment to the 2nd instalment and from the 2nd instalment to the 1st instalment. It means interest element in the 1st instalment will be more than that of 2nd instalment.

We know that interest is to be calculated on the outstanding balance of cash price.

In this case, we will have to calculate the interest with the help of the total amount due on hire purchase price since the cash price is not known.

For the purpose of calculating the interest, the following steps should be followed:

Step 1 : Calculate the ratio between interest and the amount due with the help of the following formula:

$$\text{Ratio of interest and amount due} = \frac{\text{Rate of interest}}{100 + \text{Rate of interest}}$$

Step 2 : Calculate the interest included in the ***last instalment*** by applying the following formula:
Interest = Total amount due at the time of instalment x Ratio of interest and amount due (as calculated in Step 1).

Step 3 : Subtract the interest (as calculated in Step 2) from this instalment to get the amount of outstanding ***cash price*** at the time of ***last instalment***.

Step 4 : Add the cash price calculated in Step 3 to the amount of instalment due at the end of the third year.

Step 5 : Calculate the interest on the entire sum (cash price included in the 4th instalment + amount of 3rd instalment). Deduct this interest from the total amount due at the end of 3rd year to get the outstanding cash price at the time of 3rd instalment.

Step 6 : Add the cash price calculated in Step 5 to the amount of instalment due at the end of 2nd year.

Step 7 : Calculate the interest on the entire sum so obtained in Step 6.
Deduct this interest from the total amount due at the end of 2nd year to get the outstanding cash price at the time of 2nd instalment.

Step 8 : Add the cash price calculated in Step 7 to the amount of instalment due at the end of 1st year.

Step 9 : Calculate the interest on the entire sum so obtained in Step 8. Deduct this interest from the total amount due at the end of 1st year to get the outstanding cash price at the time of 1st instalment.

Step 10 : Add the cash price calculated in Step 9 to the amount of down payment, if any. The sum so obtained will be the ***total cash price***.

Illustration 10

A & Co. purchased a truck on hire purchase system. As per terms he is required to pay ₹ 70,000 down. ₹ 53,000 at the end of first year, ₹ 49,000 at the end of second year and ₹ 55,000 at the end of third year. Interest is charged @ 10% p.a.

You are required to calculate the total cash price of the truck and the interest paid with each instalment.

Solution

(1) Ratio of interest and amount due $= \frac{\text{Rate of interest}}{100 + \text{Rate of interest}} = \frac{10}{110} = 1/11$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	55,000	1/11 of ₹ 55,000 = ₹ 5,000	50,000
2nd	*99,000	1/11 of ₹ 99,000 = ₹ 9,000	90,000
1st	**1,43,000	1/11 of ₹ 1,43,000 = ₹ 13,000	1,30,000

Total cash price = ₹ 1,30,000 + 70,000 (down payment) = ₹ 2,00,000

*₹ 50,000 + 2nd instalment of ₹ 49,000 = ₹ 99,000 ** ₹ 90,000 + 1st instalment of ₹ 53,000 = ₹ 1,43,000.

Illustration 11

On 1st January, 2015, Ray & Co. purchased a motor car from Automobile Co. on the hire purchase system. At the time of agreement a sum of ₹ 24,000 was paid out of the cash down price of the car and the balance was payable in 3 equal annual instalments together with interest @ 5% p.a. The amount of the last instalment including interest was ₹ 33,600. Depreciation was to be provided at 10% p.a. on the reducing balances.

Prepare (i) Motor Car Account and (ii) Automobile Company Account in the books of Ray & Co for the year ended on 31st December 2015 to 2017.

Solution

In the books of Ray & Co.

Dr. Motor Car Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Automobile Co. A/c (Note 2)	1,15,500	31.12.2015	By Depreciation A/c	11,550
			31.12.2015	By Balance c/d	1,03,950
		1,15,500			1,15,500
1.1.2016	To Balance b/d	1,03,950	31.12.2016	By Depreciation A/c	10,395
			31.12.2016	By Balance c/d	93,555
		1,03,950			1,03,950
1.1.2017	To Balance b/d	93,555	31.12.2017	By Depreciation A/c	9,355
			31.12.2017	By Balance c/d	84,200
		93,555			93,555

Dr. Automobile Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	24,000	1.1.2015	By Motor Car A/c (Note 2)	1,15,500
31.12.2015	To Bank A/c	33,600	31.12.2015	By Interest A/c (@ 5%)	4,576
31.12.2015	To Balance c/d	62,476			
		1,20,076			1,20,076
31.12.2016	To Bank A/c	33,600	1.1.2016	By Balance b/d	62,476
31.12.2016	To Balance c/d	32,000	31.12.2016	By Interest A/c (@ 5%)	3,124
		65,600			65,600
31.12.2017	To Bank A/c	33,600	1.1.2017	By Balance b/d	32,000
			31.12.2017	By Interest A/c	1,600
		33,600			33,600

Working Notes:

(1) Ratio of interest and amount due =

$$\frac{5}{100+5} = \frac{5}{105} = \frac{1}{21}$$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	33,600	1/21 of ₹ 33,600 = ₹ 1,600	₹ 32,000
2nd	*65,600	1/21 of ₹ 65,600 = ₹ 3,124	₹ 62,476
1st	**96,076	1/21 of ₹ 96,076 = ***₹ 4,576	₹ 91,500

Total Cash Price = ₹ 91,500 + ₹ 24,000 = ₹ 1,15,500. *₹ 32,000 + ₹ 33,600 = ₹ 65,600; ** ₹ 62,476 + ₹ 33,600 = ₹ 96,076.

*** Interest for 1st year actually comes to ₹ 4,575. For balancing purposes it has been taken as ₹ 4,576.

Illustration 12

Dobsons Ltd. purchased a machine on the hire purchase system from Hind Machinery Ltd. The terms were that they would pay ₹ 20,000 down on 1.1.2013 and 5 annual instalments of ₹ 11,000 each commencing from 1.1.2014.

They charged depreciation on the machine at the rate of 15 per cent per annum under the diminishing balance system. Hind Machinery Ltd. had charged interest at the rate of 10 per cent per annum.

Show the Machinery Account and Hind Machinery Ltd. Account to record the above transactions in the books of Dobsons Ltd. till the instalments are paid off.

Dobsons' accounting year ends on 31st December in each year.

Solution

In the books of Dobsons Ltd.

Machinery Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Hind Machinery Ltd. A/c (Note 1)	61,700	31.12.2013	By Depreciation A/c	9,255
			31.12.2013	By Balance c/d	52,445
		61,700			61,700
1.1.2014	To Balance b/d	52,445	31.12.2014	By Depreciation A/c	7,867
			31.12.2014	By Balance c/d	44,578
		52,445			52,445
1.1.2015	To Balance b/d	44,578	31.12.2015	By Depreciation A/c	6,687
			31.12.2015	By Balance c/d	37,891
		44,578			44,578
1.1.2016	To Balance b/d	37,891	31.12.2016	By Depreciation A/c	5,684
			31.12.2016	By Balance c/d	32,207
		37,891			37,891
1.1.2017	To Balance b/d	32,207	31.12.2017	By Depreciation A/c	4,831
			31.12.2017	By Balance c/d	27,376
		32,207			32,207

Hind Machinery Ltd. Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Bank A/c	20,000	1.1.2013	By Machinery A/c	61,700
31.12.2013	To Balance c/d	45,868	31.12.2013	By Interest A/c	*4,168
		65,868			65,868
1.1.2014	To Bank A/c	11,000	1.1.2014	By Balance b/d	45,868
31.12.2014	To Balance c/d	38,355	31.12.2014	By Interest A/c	3,487
		49,355			49,355
1.1.2015	To Bank A/c	11,000	1.1.2015	By Balance b/d	38,355
31.12.2015	To Balance c/d	30,091	31.12.2015	By Interest A/c	2,736
		41,091			41,091
1.1.2016	To Bank A/c	11,000	1.1.2016	By Balance b/d	30,091
31.12.2016	To Balance c/d	21,000	31.12.2016	By Interest A/c	1,909
		32,000			32,000
1.1.2017	To Bank A/c	11,000	1.1.2017	By Balance b/d	21,000
31.12.2017	To Balance c/d	11,000	31.12.2017	By Interest A/c	1,000
		22,000			22,000
1.1.2018	To Bank A/c	11,000	1.1.2018	By Balance b/d	11,000

* Interest for the 1st year actually comes to ₹ 4,130 but has been put at ₹ 4,168 for balancing purposes.

Working Note:

(1) Ratio of interest and amount due =

$$\frac{10}{100 + 10} = \frac{10}{110} = \frac{1}{11}$$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
5th	₹ 11,000	1/11 of ₹ 11,000 = ₹ 1,000	₹ 10,000
4th	(₹ 10,000 + 11,000) = ₹ 21,000	1/11 of ₹ 21,000 = ₹ 1,909	₹ 19,091

3rd	(₹ 19,091 + 11,000) = ₹ 30,091	1/11 of ₹ 30,091 = ₹ 2,736	₹ 27,355
2nd	(₹ 27,355 + 11,000) = ₹ 38,355	1/11 of ₹ 38,355 = ₹ 3,487	₹ 34,868
1st	(₹ 34,868 + 11,000) = ₹ 45,868	1/11 of ₹ 45,868 = *₹ 4,168	₹ 41,700
Total Cash Price = ₹ 41,700 + ₹ 20,000 = ₹ 61,700			

* Interest for the 1st year actually comes to ₹ 4,170. For balancing purposes, it has been taken as ₹ 4,168.

Illustration 13

On July 1, 2016, Eastern Printers purchased a printing machine from HMT Ltd. on hire purchase basis, payments to be made ₹ 10,000 on the said date and the balance in three half yearly instalments of ₹ 8,200, ₹ 7,440 and ₹ 6,300 commencing from December, 2016. The vendor charged interest at 10% p.a. calculated on half yearly basis.

Eastern Printers close their books annually on December 31 and provide depreciation at 10% per annum on diminishing balances in each year.

Determine the cash price of the machine and show the necessary Ledger Accounts in the books of Eastern Printers.

Solution

In the books of Eastern Printers

Dr. Machine Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2016	To HMT Ltd. A/c (Note 1)	30,000	31.12.2016	By Depreciation A/c (1/2 year)	1,500
			31.12.2016	By Balance c/d	28,500
		30,000			30,000
1.1.2017	To Balance b/d	28,500	31.12.2017	By Depreciation A/c	2,850
			31.12.2017	By Balance c/d	25,650
		28,500			28,500
1.1.2018	To Balance b/d	25,650			

Dr. HMT Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2016	To Bank A/c	10,000	1.7.2016	By Machine A/c	30,000
31.12.2016	To Bank A/c	8,200	31.12.2016	By Interest A/c	1,000
31.12.2016	To Balance c/d	12,800			
		31,000			31,000
1.7.2017	To Bank A/c	7,440	1.1.2017	By Balance b/d	12,800
31.12.2017	To Bank A/c	6,300	1.7.2017	By Interest A/c	640
			31.12.2017	By Interest A/c	300
		13,740			13,740

Working Notes : (1) Interest is payable @ 10% p.a. but it is to be calculated at 1/2 yearly rest. The effective rate = 5% half yearly.

(1) Ratio of interest and amount due = $\frac{5}{100 + 5} = \frac{5}{105} = \frac{1}{21}$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	₹ 6,300	1/21 of ₹ 6,300 = ₹ 300	₹ 6,000
2nd	(₹ 6,000 + 7,440) = ₹ 13,440	1/21 of ₹ 13,440 = ₹ 640	₹ 12,800
1st	(₹ 12,800 + 8,200) = ₹ 21,000	1/21 of ₹ 21,000 = ₹ 1,000	₹ 20,000
Total Cash Price = ₹ 20,000 + ₹ 10,000 = ₹ 30,000.			

Calculation of Total Cash Price when the Annuity Table is Given

The ascertainment of interest included in each instalment is relatively simple with the help of an annuity table. Under this method, the interest in each instalment is calculated from the annuity table. In an ordinary annuity table, the present values of one rupee (known as factor) are given for different interest rates and different years. To get the present value of each instalment, the amount of each instalment is multiplied by these factors. The sum of these present values are added to the down payment (if any) to arrive at the total cash price of a hire purchase transaction. The different steps are summarised below:

Step 1 : Ascertain the factors (from annuity table) applicable to different years from a given rate of interest.
Step 2 : Multiply the factors with the respective instalments to arrive at the present values of different instalments.
Step 3 : Take the total of all the present values.
Step 4 : Add down payment (if any) with the total of present values (step 3) to arrive at the cash price.

An annuity table is given below:

PRESENT VALUE FACTORS
Present value of Re 1 to be received in one payment at the end of a given number of years $(1 + r)^{-n}$

Future years	Percentage rate of Discount														
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247

Illustration 14

On 1.1.2015 Sharma purchased a plant from Ahuja on the hire purchase system. The hire purchase rate was settled at ₹ 60,000 payable as to ₹ 15,000 on 1.1.2015 and ₹ 15,000 at the end of three successive years. Interest was charged at the rate of 5% p.a. The asset was to be depreciated in the books of the purchaser at 10% p.a. on the reducing instalment method.

The annuity table shows that the present value of Re 1 for one, two and three years are .9524; .9070; and .8639 respectively. Calculate the total cash price of the plant.

Solution **Calculation of Cash Price**

No. of instalments	Amount of instalment [1]	Present Value of Re 1 [2]	Present Value of the Instalment [1 x 2]
1st	₹ 15,000	.952	14,280
2nd	₹ 15,000	.907	13,605
3rd	₹ 15,000	.864	12,960
		2.723	40,845
Add: Down Payment			15,000
Total Cash Price			55,845

Tutorial Note : When the amount of each instalment is equal, we can get the present value of all instalments at a time by multiplying sum of the present value factors with the amount of instalment. For example : ₹ 15,000 x 2.7230 = ₹ 40,845.

Ascertainment of Interest

We know that the hire purchase price consists of two things : (i) cash price; and (ii) interest. Cash price is the ***capital expenditure*** incurred for the acquisition of an asset and interest is the ***revenue expense*** for the delay in making the full payment. Ascertainment of any of these two gives the answer for the other, e.g., if we ascertain the total amount of interest, it becomes very simple to ascertain the cash price just by deducting the interest from the ***hire purchase price***.

Interest is charged on the amount outstanding. Therefore, if the hire purchaser makes a down payment on signing the contract, it will not include any amount of interest. It should be noted that though the instalments of a hire purchase agreement may be equal, the interest element in each instalment is not the same.

At the time of calculating interest, students may face the following two situations:

(a) When the cash price, rate of interest and the amount of different instalements are given; and

(b) When the cash price and the amount of different instalments are given, but the rate of interest is not given.

Now, let us consider the above two situations.

(a) When the cash price, rate of interest and the amount of different instalments are given

In this situation, the total amount of interest is to be ascertained first. It is the difference between the hire purchase price (down payment + total instalments) and the cash price. To calculate the amount of interest involved in each instalment the following steps are followed:

Step 1 : Deduct down payment from the cash price. Calculate the interest at the given rate on the remaining balance. This represents the amount of interest included in the first instalment.

Step 2 : Deduct the interest of Step 1 from the amount of first instalment. The resultant figure is the cash price included in the first instalment.

Step 3 : Deduct the cash price of the 1st instalment (Step 2) from the balance due after down payment. It represents the amount outstanding after the 1st instalment is paid.

Step 4 : Calculate the interest at the given rate on the balance outstanding after the 1st instalment. Deduct this interest from the amount of the 2nd instalment to get the cash price included in the 2nd instalment.

Step 5 : Deduct the cash price of the 2nd instalment (Step 4) from the balance due after the 1st instalment. It represents the amount outstanding after the 2nd instalment is paid.

Repeat the above steps till the last instalment is paid.

Illustration 15

X Ltd. purchased a machine on hire purchase basis from Ideal Machinery Co. Ltd. on the following terms:

(a) Cash price ₹ 40,000;

(b) Down payment at the time of signing the agreement on 1.1.2017 ₹ 10,811.

(c) 5 annual instalments of ₹ 7,700, the first to commence at the end of twelve months from the date of down payment.

(d) Rate of interest is 10% p.a.

You are required to calculate the total interest and interest included in cash instalment.

Solution **Calculation of Interest**

	Total [₹]	Interest in each instalment [1]	Cash Price in each instalment [2]
Cash Price	40,000		
Less: Down Payment	10,811	Nil	₹ 10,811
Balance due after down payment	29,189		
Interest/Cash Price of 1st instalment	—	₹ 29,189 x 10/100 = ₹ 2,919	₹ 7,700 – ₹ 2,919 = ₹ 4,781
Less: Cash price of 1st instalment	4,781		
Balance due after 1st instalment	24,408		
Interest/Cash price of 2nd instalment	—	₹ 24,408 x 10/100 = ₹ 2,441	₹ 7,700 – ₹ 2,441 = ₹ 5,259
Less: Cash price of 2nd instalment	5,259		
Balance due after 2nd instalment	19,149		
Interest/Cash price of 3rd instalment	—	₹ 19,149 x 10/100 = ₹ 1,915	₹ 7,700 – ₹ 1,915 = ₹ 5,785
Less: Cash price of 3rd instalment	5,785		
Balance due after 3rd instalment	13,364		
Interest/Cash price of 4th instalment	—	₹ 13,364 x 10/100 = ₹ 1,336	₹ 7,700 – ₹ 1,336 = ₹ 6,364
Less: Cash price of 4th instalment	6,364		
Balance due after 4th instalment	7,000		

Interest/Cash price of 5th instalment	—	₹ 7,000 x 10/100 = ₹ 700	₹ 7,700 – ₹ 700 = ₹ 7,000
Less: Cash price of 5th instalment	7,000		
Total	Nil	₹ 9,311	₹ 40,000

Total interest can also be calculated as follows:
(Down payment + instalments) – Cash price = ₹ (10,811 + 7,700 x 5) – ₹ 40,000 = ₹ 9,311.

(b) When the cash price and the amount of different instalments are given, but the rate of interest is not given

When the rate of interest is not given, but the cash price and the amount of instalments are given, the following steps are followed to calculate the interest:

Step 1 : Calculate the total interest by deducting the cash price from the hire purchase price [i.e., down payment + (amount of instalment x number of instalments)].
Step 2 : Deduct down payment from the hire purchase price.
Step 3 : Calculate the amount of outstanding balance of the hire purchase price at the beginning of each year.
Step 4 : Calculate the ratio of outstanding balance of Step 3.
Step 5 : Calculate the amount of interest of each instalment on the basis of the ratio of Step 4.

Illustration 16

P. Ltd. purchases a plant on hire purchase basis for ₹ 50,000 and makes the payment in the following order: Down payment ₹ 10,000; the 1st instalment after one year ₹ 20,000; the 2nd instalment after two years ₹ 10,000; and the last instalment after three years. The cash price of the plant is ₹ 43,000.

You are required to calculate : (i) the total interest and (ii) the interest included in each instalment.

Solution

(i) Total interest = Hire Purchase Price – Cash Price = ₹ 50,000 – ₹ 43,000 = ₹ 7,000.

(ii) Hire Purchase Price outstanding at the beginning of each year

	₹
Hire Purchase price	50,000
Less: Down payment	10,000
(a) Hire Purchase Price outstanding at the beginning of the 1st year	40,000
Less: 1st instalment	20,000
(b) Hire Purchase Price outstanding at the beginning of the 2nd year	20,000
Less: 2nd instalment	10,000
(c) Hire Purchase Price outstanding at the beginning of the 3rd year	10,000
Less: 3rd instalment	10,000
	Nil
Ratio of (a) : (b) : (c) = 40 : 20 : 10 or 4 : 2 : 1 Interest of 1st instalment = 4/7 x ₹ 7,000 = ₹ 4,000; Interest of 2nd instalment = 2/7 x ₹ 7,000 = ₹ 2,000; and Interest of 3rd instalment = 1/7 x ₹ 7,000 = ₹ 1,000.	

The students should note that if the amount of each instalment is equal, the total interest can be allocated to different instalments by the sum of the years digits method (without following the steps 2 to 5). Under this method, the interest in each instalment is calculated by multiplying the total interest by a fraction based on the sum of the number of instalments. The following illustration will explain the concept.

Illustration 17

Taking the relevant data from **Illustration 15** excluding point no. (d), calculate the interest included in each instalments.

Solution

(i) Sum of the number of instalments = (5 + 4 + 3 + 2 + 1) = 15.
(ii) Total interest = ₹ (10,811 + 7,700 x 5) – ₹ 40,000 = ₹ **9,311.**
(iii) Interest of 1st instalment = 5/15 x ₹ 9,311 = ₹ 3,104
Interest of 2nd instalment = 4/15 x ₹ 9,311 = ₹ 2,483
Interest of 3rd instalment = 3/15 x ₹ 9,311 = ₹ 1,862
Interest of 4th instalment = 2/15 x ₹ 9,311 = ₹ 1,241
Interest of 5th instalment = 1/15 x ₹ 9,311 = ₹ 621

It should be noted that the amount of interest for each instalment calculated under this method will marginally vary with a given rate of interest.

Illustration 18

M/s. India Motors Ltd. sells scooters under the hire purchase system. Their payment for the sale of scooter is ₹ 1,000 on delivery, ₹ 1,040 at the end of the first year, ₹ 960 at the end of the second year, and ₹ 880 at the end of the third year, inclusive of finance charges.

Calculate the interest.

Solution

In this problem, neither the cash price nor the rate of interest is given. It may be assumed that the cash price included in each instalment (excluding down payment) is equal and the difference in the various instalments (excluding down payment) is due to the interest. It is also assumed that the rate of interest is equal althrough.

On the basis of the above assumption, we have the following equations:

Let, x = cash price included in each instalment and i = interest included in each instalment.

$x + i$ = ₹ 880 .. (i)

$x + 2i$ = ₹ 960 .. (ii)

$x + 3i$ = ₹ 1,040 .. (iii)

By adding equations (i) and (ii), we get $2x + 3i$ = ₹ 1,840 .. (iv)

By subtracting (iii) from (iv) we get

$$\begin{array}{rcr} 2x + 3i & = & ₹\ 1{,}840 \\ \underline{-x - 3i} & = & \underline{-₹\ 1{,}040} \\ \underline{x} & = & \underline{₹\ \ 800} \end{array}$$

Therefore, the cash price included in each instalment = ₹ **800**.

Details of each instalment is given in the following table: (in ₹)

	Instalment [1]	Cash Price included in each instalment [2]	Interest [1 – 2]
Down payment	1,000	1,000	Nil
1st instalment	1,040	800	240
2nd instalment	960	800	160
3rd instalment	880	800	80
Total	3,880	3,400	480

Repossession

In a hire purchase agreement the hire purchaser has an obligation to pay up to the last instalment so that the ownership of goods passes to him. If the hire purchaser fails to pay any of the instalments, the hire vendor has the right to take the asset back in its actual form without any compensation to the hire purchaser. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the asset is termed as ***repossession***.

Repossessed assets are ultimately sold to other customers after repairing or reconditioning (if necessary). Accounting figures relating to repossessed assets are segregated from those which continue under hire purchase contracts in the usual way. Repossessions are then accounted for in a separate account of that name — "Goods Repossessed Account".

So far as the repossession of assets are concerned, the hire vendor can take back the whole of the asset or a part thereof depending on the agreement between the parties. The former is called "Complete Repossession" and the latter "***Partial Repossession***".

Complete Repossession

In the case of a complete repossession, the ***hire vendor closes the Hire Purchaser's Account in his books*** by transferring the balance of the Hire Purchaser Account to the Goods Repossessed Account. Likewise, the hire ***purchaser closes the Hire Vendor's Account in his books*** by transferring the balance of the Hire Purchase Assets Account to the Hire Vendor Account.

Entries in the Books of the Hire Vendor

1. All the entries (except the entry for payment) are passed in the usual manner upto the date of default.

2. When the goods are repossessed and the account of the hire purchaser is closed.

Goods Repossessed Account Dr.
To Hire Purchaser Account

3. When repairing and reconditioning expenses are paid

Goods Repossessed Account Dr.
To Bank/Cash Account

4. When repossessed goods are sold

Bank/Cash Account Dr.
To Goods Repossessed Account

When all the above entries are incorporated in the Goods Repossessed Account, it may show a balance. If it is a debit balance, it shows a loss. Conversely, if it is a credit balance, it indicates a profit. The balance is ultimately transferred to the Profit and Loss Account.

5. For closing goods repossessed account

(i) Profit and Loss Account Dr. [***In case of Loss***]
To Goods Repossessed Account
OR
(ii) Goods Repossessed Account Dr. [***In case of Profit***]
To Profit and Loss Account

Entries in the Books of the Hire Purchaser

The hire purchaser keeps two accounts — Asset Account and the Hire Vendor Account. At the time of complete repossession, both the accounts are to be closed. The following are the important Journal Entries :

1. All entries (except the entry for payment) are passed in the usual manner up to the date of default.

2. Usual entry for depreciation is also passed.

3. When the asset is taken back and the account of the hire vendor is closed

Hire Vendor Account Dr.
To Assets Account

4. When the asset account is closed

Profit and Loss Account Dr.
To Asset Account

Generally, an asset is repossessed at a price less than the book value. Therefore, it is a loss to the hire purchaser. In case of profit, the above entry will be reversed.

Illustration 19

Modern Transporter purchased a truck on hire purchase from Hindustan Motors for ₹ 56,000. The truck was purchased on 1st January, 2016. Payment to be made ₹ 15,000 down cash and 3 instalments of ₹ 15,000 each at the end of each year. Rate of interest charged is 5% p.a. Buyer depreciates assets at 10% p.a. on written down value method. Because of financial difficulties, Modern Transporter after having paid the down cash and the first instalment at the end of the first year could not pay the second instalment and Hindustan Motors took possession of the truck.

Prepare (a) the Truck Account; and (b) the Sellers' Account in the books of the buyer assuming that the year ends on 31st December. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of Modern Transporter

Dr. Truck Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Jan 1	To Hindustan Motors A/c	56,000	2016 Dec 31	By Depreciation A/c	5,600
				By Balance c/d	50,400
		56,000			56,000

2017 Jan 1	To Balance b/d	50,400	2017 Dec 31	By Depreciation A/c By Hindustan Motors A/c By Profit and Loss A/c (Note 3)	5,040 29,452 15,908
		50,400			50,400

Dr. **Hindustan Motors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2016 Jan 1 Dec 31 Dec 31	To Bank A/c (down payment) To Bank A/c (1st instalment) To Balance c/d	15,000 15,000 28,050	2016 Jan 1 Dec 31	By Truck A/c By Interest A/c (Note 1)	56,000 2,050
		58,050			58,050
2017 Dec 31	To Truck A/c (Note 2)	29,452	2017 Jan 1	By Balance b/d By Interest A/c	28,050 1,402
		29,452			29,452

Working Notes :

(1) Calculation of Interest

Interest to be paid on ₹ (56,000 – 15,000) = ₹ 41,000 @ 5% p.a. Therefore, interest will be 5% of ₹ 41,000 = ₹ 2,050.

(2) The balance in Hindustan Motors Account will be closed by transferring the amount to Truck Account. After surrender, there will be no balance in the Hindustan Motors Account.

(3) After adjusting the balance of Hindustan Motors Account, if there is any balance in the Truck Account it should be treated as loss on surrender of asset. It is to be charged to Profit and Loss Account of the year of surrender.

Illustration 20

On 1st January 2016, C.S.T.C. purchased a bus on hire purchase from French Motor Co. Ltd. for ₹ 5,60,000. Payment to be made, ₹ 1,50,000 down payment and three instalments of ₹ 1,50,000 each at the end of each year. Rate of interest is charged at 5% p.a. C.S.T.C. depreciates the bus at 10% p.a. on written-down value method. Because of financial difficulties C.S.T.C. after having paid the down payment and 1st instalment at the end of the first year could not pay the 2nd instalment and French Motor Co. Ltd. took possession of the bus on 31.12.2017 and sold it for ₹ 3,01,100 on the same date. You are required to prepare : (a) C.S.T.C. Account and Goods Repossessed Account in the books of the French Motor Co. Ltd.; and (b) Bus Account and French Motor Co. Ltd. Account in the books of C.S.T.C.

Solution

In the books of French Motor Co. Ltd.

Dr. **C.S.T.C. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016 31.12.2016	To H.P. Sales A/c To Interest A/c	5,60,000 20,500	1.1.2016 31.12.2016 31.12.2016	By Bank A/c By Bank A/c By Balance c/d	1,50,000 1,50,000 2,80,500
		5,80,500			5,80,500
1.1.2017 31.12.2017	To Balance b/d To Interest A/c	2,80,500 14,025	31.12.2017	By Goods Repossessed A/c	2,94,525
		2,94,525			2,94,525

Dr. **Goods Repossessed Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017 31.12.2017	To C.S.T.C. A/c To Profit & Loss A/c	2,94,525 6,575	31.12.2017	By Bank A/c (Sale of repossessed bus)	3,01,100
		3,01,100			3,01,100

In the books of C.S.T.C.

Dr. **Bus Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To French Motor Co. Ltd. A/c	5,60,000	31.12.2016 31.12.2016	By Depreciation A/c By Balance c/d	56,000 5,04,000
		5,60,000			5,60,000
1.1.2017	To Balance b/d	5,04,000	31.12.2017 31.12.2017 31.12.2017	By Depreciation A/c By French Motor Co. Ltd. A/c By Profit & Loss A/c (Loss)	50,400 2,94,525 1,59,075
		5,04,000			5,04,000

Dr. French Motor Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Bank A/c	1,50,000	1.1.2016	By Bus A/c	5,60,000
31.12.2016	To Bank A/c	1,50,000	31.12.2016	By Interest A/c	20,500
31.12.2016	To Balance c/d	2,80,500			
		5,80,500			5,80,500
31.12.2017	To Bus A/c	2,94,525	1.1.2017	By Balance b/d	2,80,500
			31.12.2017	By Interest A/c	14,025
		2,94,525			2,94,525

Illustration 21

Auto Distributors Ltd. sold a motor car to Sita Travel Agency on hire purchase on terms as to payment requiring four annual instalments of ₹ 28,200 at the end of each year commencing from the date of agreement on 1st January, 2015. The rate of interest was taken at 5% p.a. and the interest is included in the annual payment of ₹ 28,200.

Show Ledger Accounts in the books of Sita Travel Agency who defaulted in the payment of the third yearly instalment whereupon the vendor re-possessed the car. Sita Travel Agency was to provide depreciation on the motor car @ 10% p.a. on the straight line method.

Solution

In the books of the Sita Travel Agency

Dr. Motor Car Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Auto Distributors Ltd. A/c (Note 2)	1,00,000	31.12.2015	By Depreciation A/c	10,000
			31.12.2015	By Balance c/d	90,000
		1,00,000			1,00,000
1.1.2016	To Balance b/d	90,000	31.12.2016	By Depreciation A/c	10,000
			31.12.2016	By Balance c/d	80,000
		90,000			90,000
1.1.2017	To Balance b/d	80,000	31.12.2017	By Depreciation A/c	10,000
			31.12.2017	By Auto Distributors Ltd. A/c	55,057
				By Profit & Loss A/c (Loss)	14,943
		80,000			80,000

Dr. Auto Distributors Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Bank A/c	28,200	1.1.2015	By Motor Car A/c	1,00,000
31.12.2015	To Balance c/d	76,795	31.12.2015	By Interest A/c (Note 2)	4,995
		1,04,995			1,04,995
31.12.2016	To Bank A/c	28,200	1.1.2016	By Balance b/d	76,795
31.12.2016	To Balance c/d	52,435	31.12.2016	By Interest A/c (Note 2)	3,840
		80,635			80,635
31.12.2017	To Motor Car A/c	55,057	1.1.2017	By Balance b/d	52,435
			31.12.2017	By Interest A/c	2,622
		55,057			55,057

Working Note: (1) Interest is payable @ 5% p.a. Therefore, the ratio of interest and amount due = $^5/_{105} = {^1/_{21}}$.

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
4th	28,200	1/21 of ₹ 28,200 = ₹ 1,343	26,857
3rd	(26,857 + 28,200) 55,057	1/21 of ₹ 55,057 = ₹ 2,622	52,435
2nd	(52,435 + 28,200) 80,635	1/21 of ₹ 80,635 = ₹ 3,840	76,795
1st	(76,795 + 28,200)1,04,995	1/21 of ₹ 1,04,995 = *₹ 4,995	1,00,000

Total cash price = ₹ 1,00,000. *Interest for 1st year actually comes to ₹ 5,000. For balancing purposes, it has been taken as ₹ 4,995.

Illustration 22

On 1st January, 2017 Ashok acquired furniture on the hire purchase system from Real Aids Ltd., agreeing to pay four semi- annual instalments of ₹ 800 each, commencing on 30th June 2017. The cash price of the items was ₹ 3,010 and an interest of 5% p.a. was chargeable.

On 30th September, 2017 Ashok expressed his inability to continue and Real Aids seized the property. It was agreed that Ashok would pay the due proportion of the instalment upto the date of seizure and also a further sum of ₹ 200 towards depreciation. At the time of repossession, Real Aids valued the furniture at ₹ 1,500.

The company after incurring ₹ 200 towards repairs of the furniture sold the items for ₹ 1,800 on 15th October, 2017.

Show the Ledger Accounts as they would appear in the books of Real Aids Ltd., working out the profit or loss on the transaction, assuming that the company passes hire purchase transactions through its books as sales.

Solution

In the books of Real Aids Ltd.

Dr. Hire Purchase Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			1.1.2017	By Ashok A/c	3,010

Dr. Ashok Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Hire Purchase Sales A/c	3,010	30.6.2017	By Bank A/c	800
30.6.2017	To Interest A/c (5/100 x 3,010 x 6/12)	75	30.9.2017	By Bank A/c (Note 1)	600
30.9.2017	To Interest A/c (5/100 x 2,285 x 3/12)	29	30.9.2017	By Goods Repossessed A/c	1,714
		3,114			3,114

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.9.2017	To Ashok A/c (Note 2)	1,714	15.10.2017	By Sales A/c	1,800
30.9.2017	To Cash A/c (Expenses)	200	31.12.2017	By Profit & Loss A/c	114
		1,914			1,914

Dr. Profit & Loss Account for the year ended 31.12.2017 [Extract] Cr.

Particulars	₹	Particulars	₹
To Goods Repossessed A/c	114	By Interest A/c ₹ (75 + 29)	104
		By Net Loss (Balancing figure)	10
	114		114

Working Notes:

(1) Amount of instalment for 6 months is ₹ 800. Therefore, amount of instalment for 3 months will be ₹ 400. Ashok paid ₹ 400 + ₹ 200 (for depreciation) = ₹ 600.

(2) Alternatively, Goods Repossessed Account can be debited at ₹ 1,500 and ₹ 214 will be charged to Profit and Loss Account. However, net loss will be the same.

Partial Repossession

In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are as usual upto the date of default (excepting entry for payment) in the books of both the parties. As a portion of the asset is still left with the hire purchaser, ***neither party closes the account of the other in their respective books***.

Assets are repossessed at a mutually agreed value (based on agreed rate of depreciation which is an enhanced rate). The hire vendor debits the Goods Repossessed Account and credit the Hire Purchaser Account with the value as agreed upon on the repossession. Similarly, the hire purchaser debits the Hire Vendor Account and credits the Assets Account with the same amount. If the repossessed value is less than the book value of the asset, the difference is charged to the Profit and Loss Account of the hire purchaser as '***loss on surrender***'.

For the remaining portion of the asset lying with the hire purchaser, he (Hire Purchaser) applies the usual rate of depreciation and shows the Asset Account at its usual written-down value.

Illustration 23

On 1.1.2016, X acquires on hire purchase from Y, machinery valued at ₹ 60,000 payable in three yearly instalments of ₹ 20,000, plus interest at 6% per annum. X paid the first instalment but could not pay the second. Y took back the machinery which cost ₹ 40,000, allowing ₹ 22,500 therefore. X paid all the interest due to that date on the full amount owing.

X had written off depreciation at 10% per annum on diminishing balance. Show Machinery Account and Y Account in the books of X. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of X

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Jan 1	To Y A/c	60,000	2016 Dec 31	By Depreciation A/c	6,000
				By Balance c/d (Note 5)	54,000
		60,000			60,000
2017 Jan 1	To Balance b/d	54,000	2017 Dec 31	By Depreciation A/c (10% of ₹ 54,000)	5,400
				By Y A/c (Note 1)	22,500
				By Profit and Loss A/c (Note 1)	9,900
				By Balance b/d	16,200
		54,000			54,000
2018 Jan 1	To Balance b/d	16,200			

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2016 Dec 1	To Bank A/c (20,000 + 3,600)	23,600	2016 Jan 1	By Machinery A/c	60,000
	To Balance c/d	40,000		By Interest A/c	3,600
		63,600			63,600
2017 Dec 1	To Machinery A/c (Note 1)	22,500	2017 Jan 1	By Balance b/d	40,000
	To Balance c/d	19,900		By Interest A/c	2,400
		42,400			42,400
			2018 Jan 1	By Balance b/d	19,900

Working Notes :

(1) Machinery costing ₹ 40,000 was taken over by Y at an agreed value of ₹ 22,500. Machinery costing ₹ 20,000 (60,000 – 40,000) is still with X.For calculating loss on surrender of machinery, the written down value as on the date of surrender is to be calculated. The calculation has been done in the following manner :

Calculation of Loss on Surrender of Machinery Costing ₹ 40,000	₹
Cost of machinery on 1.1.2016	40,000
Less: Depreciation for 2010 @ 10% on ₹ 40,000	4,000
Written down value on 1.1.2017	36,000
Less: Depreciation for 2014 (10% of ₹ 36,000)	3,600
Written down value on 31.12.2017	32,400
Less: Agreed value for surrender of machinery	22,500
Loss on surrender	9,900

Illustration 24

From the following particulars, calculate :

(i) Value of plant taken back by the vendor.
(ii) Value of plant left with the purchaser.
(iii) Profit or loss on plants taken back.
(iv) Profit or loss on plant repossessed when sold by vendor.

Particulars :

(i) X purchased 3 plants from Y costing ₹ 1,00,000 each.
(ii) Purchaser charged depreciation @ 20% p.a. on diminishing balance method.
(iii) 2 plants were seized by the vendor when second instalment was not paid at the end of the second year and vendor valued the plants at cost less 30% depreciation annually charged at diminishing balance method.
(iv) The vendor spent ₹ 40,000 on overhauling the plants and sold for ₹ 1,60,000.

Solution

	₹	₹
(i) Value of Two Plants Taken Back by the Vendor		
Cost of 2 plants seized by the vendor = ₹ 1,00,000 x 2		2,00,000
Less: Depreciation for two years @ 30% p.a. on Diminishing Balance Method —		
1st year (30% of ₹ 2,00,000)	60,000	
2nd year (30% of ₹ 1,40,000)	42,000	1,02,000
		98,000
(ii) Value of One Plant left with the Purchaser		
Cost of 1 plant		1,00,000
Less: Depreciation for two years @ 20% p.a. on Diminishing Balance Method —		
1st year (20% of ₹ 1,00,000)	20,000	
2nd year (20% of ₹ 80,000)	16,000	36,000
		64,000
(iii) Profit or Loss on Plants Taken Back		
Book value of two plants (₹ 64,000 x 2) [See (ii) above]		1,28,000
Agreed value of two plants taken over [See (i) above]		98,000
Loss on plant taken back		30,000
(iv) Profit or Loss on Plants Repossessed		
Value of 2 plants taken over by the Vendor [See (ii) above]		98,000
Add: Cost of overhauling		40,000
Total Cost		1,38,000
Sale Price		1,60,000
Profit on Sale of Repossessed Plants		22,000

Illustration 25

Rajesh purchased seven trucks on hire purchase on 1st July, 2017. The cash purchase price of each truck was ₹ 50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five half-yearly instalments starting from 31st December, 2017 with interest at 5% p.a.

On Rajesh's failure to pay the instalment due on 30th June 2018, it was agreed that Rajesh would return 3 trucks to the vendor and remaining four would be retained by him. The returning price of 3 trucks was ₹ 40,500. Rajesh charged depreciation @ 20% p.a. Vendor after spending ₹ 1,000 on repairs, sold away all three trucks for ₹ 40,000.

Show Trucks Account and Vendor's Account in the books of Rajesh and Rajesh Account and Goods Repossessed Account in the books of the vendor, assuming that their books are closed on 30th June every year.

[Delhi, B.Com. (Hons.) — Adapted]

Solution

In the books of Rajesh

Dr. Trucks Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2017	To Vendor A/c (₹ 50,000 x 7) (Cost of Trucks)	3,50,000	30.6.2018	By Depreciation A/c (20% of ₹ 3,50,000)	70,000
			30.6.2018	By Vendor A/c (Agreed value of trucks retruned)	40,500
			30.6.2018	By Profit & Loss A/c (Note 4)	79,500
			30.6.2018	By Balance c/d (Note 5)	1,60,000
		3,50,000			3,50,000
1.7.2018	To Balance b/d	1,60,000			

Dr. Vendor Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2017	To Bank A/c (Down payment)	70,000	1.7.2017	By Trucks A/c (₹ 70,000 x 5)	3,50,000
31.12.2017	To Bank A/c (Note 3)	63,000	31.12.2017	By Interest A/c (Note 1)	7,000
30.6.2018	To Trucks A/c	40,500	30.6.2018	By Interest A/c (Note 2)	5,600
30.6.2018	To Balance c/d	1,89,100			
		3,62,600			3,62,600

Working Notes :

(1) Interest is to be calculated @ 5% on ₹ (3,50,000 – 70,000) for 6 months = 5/100 x 1/2 x ₹ 2,80,000 = ₹ 7,000.

(2) Interest is to be calculated @ 5% on ₹ (3,50,000 – 70,000 + 7,000 – 63,000) for 6 months = ₹ 5,600.

(3) Amount of 1st instalment = 1/5 ₹ (3,50,000 – 70,000) + ₹ 7,000 (interest) = ₹ 56,000 + ₹ 7,000 = ₹ 63,000.

(4) Book value of three trucks returned

Cash price of 7 trucks = ₹ 50,000 x 7	= ₹ 3,50,000
Less: Depreciation for 2017-13 @ 20%	= ₹ 70,000
Book value of 7 trucks on 30.6.2018	= ₹ 2,80,000

Therefore, book value of 3 trucks = ₹ 2,80,000 / 7 x 3 = ₹ 1,20,000. Agreed value of 3 trucks = ₹ 40,500. Loss on surrender = ₹ 1,20,000 – ₹ 40,500 = ₹ 79,500.

(5) Book value of 4 trucks = ₹ 2,80,000 / 7 x 4 = ₹ 1,60,000.

In the books of Vendor

Dr. Rajesh Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2017	To H.P. Sales A/c	3,50,000	1.7.2017	By Bank A/c	70,000
31.12.2017	To Interest A/c	7,000	31.12.2017	By Bank A/c (₹ 56,00 + ₹ 7,000)	63,000
30.6.2018	To Interest A/c	5,600	30.6.2018	By Goods Repossessed A/c	40,500
			30.6.2018	By Balance c/d	1,89,100
		3,62,600			3,62,600

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2018	To Rajesh A/c	40,500	30.6.2018	By Bank A/c	40,000
30.6.2018	To Bank A/c	1,000	30.6.2018	By Profit & Loss A/c (Loss)	1,500
		41,500			41,500

Illustration 26

Arunagshu Transport Agency purchased 2 motor vans costing ₹ 80,000 each from Debika Auto Company on 1st January 2015, on the hire purchase system. The terms of payment were as follows:

Payment of ₹ 20,000 each for motor van on delivery. Remainder in three equal instalments together with interest 10% p.a. to be paid at the end of each year.

Arunagshu Transport Agency write-off 20% depreciation each year on the diminishing balance method. The hire purchaser paid two instalments due on 31st December 2015 and 2016 but could not pay the final instalment.

Debika Auto Company re-possessed one motor van adjusting its value against the amount due. The re-possession was done on the basis of 25% depreciation on the Fixed Instalment Method.

Write-up the Ledger Accounts in the books of Arunagshu Transport Agency.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of Arunagshu Agency

Dr. Motor Van Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Debika Auto Co. A/c	1,60,000	31.12.2015	By Depreciation A/c	32,000
			31.12.2015	By Balance c/d	1,28,000
		1,60,000			1,60,000
1.1.2016	To Balance b/d	1,28,000	31.12.2016	By Depreciation A/c	25,600
			31.12.2016	By Balance c/d	1,02,400
		1,28,000			1,28,000
1.1.2017	To Balance b/d	1,02,400	31.12.2017	By Depreciation A/c	20,480
			?	By Debika Auto Co A/c (Agreed value of van returned)	20,000
			?	By Profit & Loss A/c (Note 2)	20,960
			?	By Balance c/d (W. D. V. of one Motor Van still in possession)	40,960
		1,02,400			1,02,400

Dr. **Debika Auto Company Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c (Down payment)	40,000	1.1.2015	By Motor Van A/c	1,60,000
31.12.2015	To Bank A/c ₹ (40,000 + 12,000)	52,000	31.12.2015	By Interest A/c	12,000
31.12.2015	To Balance c/d	80,000			
		1,72,000			1,72,000
31.12.2016	To Bank A/c ₹ (40,000 + 8,000)	48,000	1.1.2016	By Balance b/d	80,000
31.12.2016	To Balance c/d	40,000	31.12.2016	By Interest A/c	8,000
		88,000			88,000
31.12.2017	To Motor Van A/c	20,000	1.1.2017	By Balance b/d	40,000
31.12.2017	To Balance c/d	24,000	31.12.2017	By Interest A/c	4,000
		44,000			44,000

Working Notes:

(1) Book Value of Motor Van repossessed	₹	**(2) Loss on Repossession of one Van**	₹
Cost of the Van on 1.1.2015	80,000	Cost of the Van on 1.1.2015	80,000
Less: Depreciation of 2015 @ 20%	16,000	Less: Depreciation for 2015, 2016 & 2017 @ 25% on the fixed instalment method	60,000
W.D.V. on 1.1.2016	64,000	Agreed value	20,000
Less: Depreciation of 2016 @ 20%	12,800	Book value	40,960
W.D.V. on 1.1.2017	51,200	Less: Agreed value (as above)	20,000
Less: Depreciation of 2017 @ 20%	10,240	**Loss on repossession**	20,960
Book value on 31.12.2017	40,960		

Illustration 27

Seema Agency purchased three trucks from Vishal Automobiles Ltd on 1.1.2015, under hire purchase agreement. The cash price of each truck is ₹ 1,50,000. According to the terms and conditions of Vishal Automobiles Ltd 10% of cash price is to be paid on delivery and balance cash price in three equal yearly instalments payable at the end of each year together with interest @ 10% p.a.

Seema Agency writes off 20% depreciation on straight line method. Seema Agency paid the first and second instalment in due time but failed to pay the last instalment due on 31.12.2017.

Vishal Automobiles Ltd agreed to leave two trucks with Seema Agency and take back the third one, adjusting the value against amount due. The returned truck being valued @ 30% depreciation on diminishing balance method.

Vishal Automobiles Ltd sold the re-possessed truck for ₹ 45,000 in cash on 7.1.2018 after incurring repairing expenses of ₹ 8,000.

Show Trucks Account and Vishal Automobiles Ltd Account in the books of Seema Agency and Re-possessed Truck Account in the books of Vishal Automobiles Ltd to give effect to the above transactions.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of Seema Agency

Dr. **Truck Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Vishal Automobiles Ltd A/c	4,50,000	31.12.2015	By Depreciation A/c	90,000
			31.12.2015	By Balance c/d	3,60,000
		4,50,000			4,50,000
1.1.2016	To Balance b/d	3,60,000	31.12.2016	By Depreciation A/c	90,000
			31.12.2016	By Balance c/d	2,70,000
		3,60,000			3,60,000
1.1.2017	To Balance b/d	2,70,000	31.12.2017	By Depreciation A/c	90,000
			31.12.2017	By Vishal Automobiles Ltd A/c	51,450
			31.12.2017	By Profit and Loss A/c (Note 2)	8,550
			31.12.2017	By Balance c/d (W.D.V. of Trucks still in possession)	1,20,000
		2,70,000			2,70,000

Dr. Vishal Automobiles Ltd Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c (Down payment)	45,000	1.1.2015	By Truck A/c	4,50,000
31.12.2015	To Bank A/c (₹ 1,35,000 + ₹ 40,500)	1,75,500	31.12.2015	By Interest A/c (10% of ₹ 4,05,000)	40,500
31.12.2015	To Balance c/d	2,70,000			
		4,90,500			4,90,500
31.12.2016	To Bank A/c (₹ 1,35,000 + ₹ 27,000)	1,62,000	1.1.2016	By Balance b/d	2,70,000
31.12.2016	To Balance c/d	1,35,000	31.12.2016	By Interest A/c (10% of ₹ 2,70,000)	27,000
		2,97,000			2,97,000
31.12.2017	To Truck A/c	51,450	1.1.2017	By Balance b/d	1,35,000
31.12.2017	To Balance c/d	97,050	31.12.2017	By Interest A/c	13,500
		1,48,500			1,48,500

In the books of Vishal Automobiles Ltd
Dr. Re-possessed Truck Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Seema Agency A/c (Note 1)	51,450	31.12.2017	By Balance c/d	51,450
1.1.2018	To Balance b/d	51,450	7.1.2018	By Bank A/c	45,000
?	To Bank A/c (Repairing expenses)	8,000	?	By Profit and Loss A/c	14,450
		59,450			59,450

Working Notes :

(1) Book Value of Truck Repossessed

Particulars	₹
Cost of the Truck	1,50,000
Less: Depreciation @ 20% p.a. for three years on straight line basis	90,000
	60,000

(2) Loss on Repossession of the Truck

Particulars	₹
Cost of the Truck	1,50,000
Less: Depreciation @ 30% for the year 2015	45,000
	1,05,000
Less: Depreciation @ 30% on ₹ 1,05,000 for 2016	31,500
	73,500
Less: Depreciation @ 30% on ₹ 73,500	22,050
Agreed Value of Repossessed Truck	51,450
Book Value	60,000
Less: Agreed Value	51,450
	8,550

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 28

On 1st January, 2014, D & Co. purchased machinery on hire purchase basis, the total amount payable being ₹ 2,13,500. Payment was to be made ₹ 60,000 on that date and the balance in three half-yearly instalments of ₹ 57,000, ₹ 54,500 and ₹ 42,000 commencing from 30th June, 2014. The vendor charged interest @ 10% p.a. calculated on half-yearly rests.

D & Co. close their books annually on 30th June and provide depreciation @ 10% p.a. on reducing balance method.

Determine the cash price of the machine and show Machinery Account and Hire Vendor Account in the books of D & Co.

[C.U.B.Com. (General) — 2017]

Solution

Interest is payable @ 10% p.a. Instalments are payable half-yearly. Therefore, the interets is to be calculated $^1/_2$ yearly rest. The effective rate = 5% half-yearly.

In the books of D & Co.

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Hire Vendor A/c	2,00,000	30.6.2014	By Depreciation A/c (1/2 year)	10,000
			30.6.2014	By Balance c/d	1,90,000
		2,00,000			2,00,000
1.7.2014	To Balance b/d	1,90,000	30.6.2015	By Depreciation A/c	19,000
			30.6.2015	By Balance c/d	1,71,000
		1,90,000			1,90,000
1.7.2015	To Balance b/d	1,71,000			

Dr. **Hire Vendor Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Bank A/c	60,000	1.1.2014	By Machinery A/c (Note 2)	2,00,000
30.6.2014	To Bank A/c	57,000	30.6.2014	By Interest A/c (Note 2)	7,000
30.6.2014	To Balance c/d	90,000			
		2,07,000			2,07,000
31.12.2014	To Bank A/c	54,500	1.7.2014	By Balance b/d	90,000
30.6.2015	To Bank A/c	42,000	31.12.2014	By Interest A/c (Note 2)	4,500
			30.6.2015	By Interest A/c	2,000
		96,500			96,500

Working Notes :

(1) Ratio of Interest and Amount Due = $\frac{5}{100+5} = \frac{5}{105} = \frac{1}{21}$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	₹ 42,000	1/21 of ₹ 42,000 = ₹ 2,000	₹ 40,000
2nd	(₹ 40,000 + 54,500) = ₹ 94,500	1/21 of ₹ 94,500 = ₹ 4,500	₹ 90,000
1st	(₹ 90,000 + 57,000) = ₹ 1,47,000	1/21 of ₹ 1,47,000 = ₹ 7,000	₹ 1,40,000
Total Cash Price = ₹ 1,40,000 + ₹ 60,000 = ₹ **2,00,000**.			

Illustration 29

Kamal purchased a plant from Gopal on 01.01.2010 on the hire purchase system. The hire purchase was settled at ₹ 80,000 with ₹ 25,000 payable as down payment on 01.01.2010, ₹ 20,000 at the end of first year, ₹ 20,000 at the end of second year and ₹ 15,000 at the end of third year.

Rate of depreciation is 10% p.a. on reducing balance method.

You are required to (a) calculate the total cash price of the plant and (b) prepare the Plant Account in the books of the Hire Purchaser.

[Present value of ₹ 1 for one, two and three years are 0.9524, 0.9070 and 0.8639 respectively.]

[C.U.B.Com. (General) — 2015]

Solution

Calculation of Total Cash Price

No. of instalments	Amount of instalment [1]	Present Value of Re 1 [2]	Present Value of the Instalment [1 x 2]
1st	₹ 20,000	.9524	19,048
2nd	₹ 20,000	.9070	18,140
3rd	₹ 15,000	.8639	12,959
			50,147
Add: Down Payment			25,000
Total Cash Price			75,147

In the books of Kamal
Plant Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Hire Vendor A/c	75,147	31.12.2010	By Depreciation A/c	7,515
				By Balance c/d	67,632
		75,147			75,147
1.1.2011	To Balance b/d	67,632	31.12.2011	By Depreciation A/c	6,763
				By Balance c/d	60,869
		67,632			67,632
1.1.2012	To Balance b/d	60,869	31.12.2012	By Depreciation A/c	6,087
				By Balance c/d	54,782
		60,869			60,869
1.7.2013	To Balance b/d	54,782			

Illustration 30

X Co. Ltd. purchased machinery from B Co. Ltd on hire purchase system. The cash price of the machine was ₹ 1,19,200. ₹ 32,000 was to be paid on 1.1.2007 and the balance in three instalments of ₹ 32,000 each on 31st December every year subject to interest @ 5% p.a. Depreciation is to be provided @ 15% p.a. Show Machinery Account and B Co Ltd Account in the books of X Co. Ltd.

[C.U.B.Com. (General) — 2012]

Solution

In the books of X Co. Ltd.
Machinery Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2007	To B Co. Ltd. A/c	1,19,200	31.12.2007	By Depreciation A/c	17,880
			"	By Balance c/d	1,01,320
		1,19,200			1,19,200
1.1.2008	To Balance b/d	1,01,320	31.12.2008	By Depreciation A/c	15,198
			"	By Balance c/d	86,122
		1,01,320			1,01,320
1.1.2009	To Balance b/d	86,122	31.12.2009	By Depreciation A/c	12,918
			"	By Balance c/d	73,204
		86,122			86,122
1.1.2010	To Balance b/d	73,204			

Dr. **B Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2007	To Bank A/c	32,000	1.1.2007	By Machinery A/c	1,19,200
31.12.2007	To Bank A/c	32,000	31.12.2007	By Interest A/c (Note 1)	4,360
"	To Balance c/d	59,560			
		1,23,560			1,23,560
31.12.2008	To Bank A/c	32,000	1.1.2008	By Balance b/d	59,560
"	To Balance c/d	30,538	31.12.2008	By Interest A/c (Note 2)	2,978
		62,538			62,538
31.12.2009	By Bank A/c	32,000	1.1.2009	By Balance b/d	30,538
			31.12.2009	By Interest A/c	*1,462
		32,000			32,000

Working Notes :

(1) Interest for the year 2007 = 5% of (₹ 1,19,200 – ₹ 32,000) = ₹ **4,360**.
(2) Interest for the year 2008 = 5% of ₹ 59,560 = ₹ **2,978**.
(3) Interest for the year 2009 = 5% of ₹ 30,538 = ₹ **1,527***.
*Actual interest is ₹ 1,527 but ₹ 1,462 has been taken for balancing purpose.

Illustration 31

Saif Ali Khan purchased a machine under instalment basis from Machine Trading Company on 1.1.2009. The cash price of the machine was ₹ 93,000. The payment for the purchase is to be made as under :

	(₹)
On signing the agreement	18,000
At the end of first year	30,000
At the end of second year	30,000
At the end of third year	30,000

Prepare Machine Trading Company Account (vendor) in the books of Saif Ali Khan.

[C.U.B.Com. (General) — 2011]

Solution

In the books of Saif Ali Khan

Dr. Machine Trading Company Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2009	To Bank A/c	18,000	1.1.2009	By Machinery A/c	93,000
31.12.2009	To Bank A/c	30,000	31.12.2009	By Interest A/c	7,500
"	To Balance c/d	52,500			
		1,00,500			1,00,500
31.12.2010	To Bank A/c	30,000	1.1.2010	By Balance b/d	52,500
"	To Balance c/d	27,500	31.12.2010	By Interest A/c	5,000
		57,500			57,500
31.12.2011	To Bank A/c	30,000	1.1.2011	By Balance b/d	27,500
			31.12.2011	By Interest A/c	2,500
		30,000			30,000

Working Notes :

(1) Calculation of Interest

	₹
Hire Purchase Price (₹ 18,000 + 30,000 + 30,000 + 30,000)	1,08,000
Less: Cash Price (given)	93,000
Total Interest	15,000

Since there are three instalments, total interest of ₹ 15,000 is to be divided among the instalments in the ratio of 3 : 2 : 1.

Interest for ***first*** instalment = $\frac{15,000}{6} \times 3$ = ₹ 7,500.

Interest for ***second*** instalment = $\frac{15,000}{6} \times 2$ = ₹ 5,000.

Interest for ***third*** instalment = $\frac{15,000}{6} \times 1$ = ₹ 2,500.

[For Honours Candidates Only]

Illustration 32

Roy Transport Co. purchased five trucks from French Motor Co Ltd on 1st January, 2013 on hire purchase system. The cash price of each truck was ₹ 9,60,000, 15% of the cash price was payable on the date of delivery and 25% of the cash price was payable at the end of each year for four years.

Roy Transport Co. writes off 10% depreciation annually. The hire purchaser failed to make the payment due on 31st December, 2014. French Motor Car Ltd. agreed to leave two trucks with the buyer on the condition that the value of the other trucks would be adjusted against the amount due. The trucks being valued at cost less 20% depreciation p.a.

Show the necessary accounts in the books of Roy Transport Co. upto 31st December, 2014.

[C.U.B.Com. (Hons.) — 2017]

Solution

In the books of oy Transport Co.

Dr. Trucks Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To French Motor Co. Ltd.	48,00,000	31.12.2013	By Depreciation A/c	4,80,000
			"	By Balance c/d	43,20,000
		48,00,000			48,00,000

1.1.2014	To Balance b/d	43,20,000	31.12.2014	By Depreciation A/c (Note 3)	4,80,000
			"	By French Motor Co. Ltd. A/c (Note 7)	17,28,000
			"	By Profit and Loss A/c (Note 6)	5,76,000
			"	By Balance c/d (Note 8)	15,36,000
		43,20,000			43,20,000
1.1.2015	To Balance b/d	15,36,000			

Dr. French Motor Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Bank A/c (Note 1)	7,20,000	1.1.2013	By Truck A/c	48,00,000
31.12.2013	To Bank A/c	12,00,000	31.12.2013	By Interest A/c (Note 2)	2,88,000
	To Balance c/d	31,68,000			
		50,88,000			50,88,000
31.12.2014	To Truck A/c (Note 7)	17,28,000	1.1.2014	By Balance b/d	31,68,000
	To Balance c/d	16,56,000	31.12.2014	By Interest A/c (Note 2)	2,16,000
		33,84,000			33,84,000
			1.1.2015	By Balance b/d	13,68,000

Working Notes :

(1) Down Payment = 15% of (₹ 9,60,000 × 5) = ₹ **7,20,000**.

(2) Calculation of Interest

	₹
Hire Purchase Price (₹ 7,20,000 + 48,00,000)	55,20,000
Cash Price	48,00,000
Total Interest	7,20,000

Since there are four instalments, total interest of ₹ 7,20,000 is to be divided among the instalments in the ratio of 4 : 3 : 2 : 1.

	₹
Interest for ***first*** instalment = $\frac{7,20,000}{10} \times 4$	₹ 2,88,000
Interest for ***second*** instalment = $\frac{7,20,000}{10} \times 3$	2,16,000
Interest for ***third*** instalment = $\frac{7,20,000}{10} \times 2$	1,44,000
Interest for ***fourth*** instalment = $\frac{7,20,000}{10} \times 1$	72,000
Total Interest	7,20,000

(3) Depreciation method has not been mentioned. Therefore, it has been assumed that 'Straight Line Method' was followed in the case of annual depreciation and for repossession of the truck.

	₹
(4) Book Value of Each Truck Repossessed	
Cost of each truck	9,60,000
Less: Depreciation for 2013 and 2014 (Assuming straight line method)	1,92,000
Written-down value on 31.12.2014	7,68,000
(5) Loss on Repossession of each Truck	
Cost of each truck	9,60,000
Less: Depreciation @ 20% for 2 years	3,84,000
Agreed Repossession Value per Truck	5,76,000

Loss per truck = ₹ 7,68,000 – 5,76,000 = ₹ **1,92,000**

(6) Total loss on repossession of 3 trucks = ₹ 1,92,000 × 3 = ₹ **5,76,000**.

(7) Agreed repossession value of 3 trucks = ₹ 5,76,000 × 3 = ₹ **17,28,000**.

(8) Written-down value of 2 trucks at the end of 2014 = ₹ 7,68,000 × 2 = ₹ **15,36,000**.

Illustration 33

Alpha Capital Co. purchased a machine from Beta Co. on 1st January, 2013 on hire purchase system. As per the agreement the payment should be made in three annual instalments of ₹ 12,000 each (including interest). The rate of interest was 20% p.a. The purchaser defaulted in the payment of the final instalment and the vendor re-possessed the machinery. Depreciation on machinery was provided @ 10% p.a. under reducing balance method.

Show Machinery Account and Beta Co. Account in the books of Alpha Co. at the end of the agreement period.

[C.U.B.Com. (Hons.) — 2016

Solution

In the books of Alpha Capital Co.

Machinery Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Beta Co. A/c (Note 1)	25,278	31.12.2013	By Depreciation A/c (Note 3)	2,528
			"	By Balance c/d	22,750
		25,278			25,278
1.1.2014	To Balance b/d	22,750	31.12.2014	By Deprciation A/c	2,275
			"	By Balance c/d	20,475
		22,750			22,750
1.1.2015	To Balance b/d	20,475	31.12.2015	By Depreciation A/c	2,048
			"	By Beta Co. A/c	12,000
			"	By Profit and Loss A/c	6,427
		20,475			20,475

Beta Co. Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Bank A/c	12,000	1.1.2013	By Machinery A/c	25,278
"	To Balance c/d	18,333	31.12.2013	By Interest A/c (Note 2)	5,055
		30,333			30,333
31.12.2014	To Bank A/c	12,000	1.1.2014	By Balance b/d	18,333
"	To Balance c/d	10,000	31.12.2014	By Interest A/c (Note 2)	3,667
		22,000			22,000
31.12.2015	To Machinery A/c	12,000	1.1.2015	By Balance b/d	10,000
			"	By Interest A/c	2,000
		12,000			12,000

Working Notes :

(1) Ratio of Interest and amount due $= \dfrac{20}{100 + 20} = \dfrac{20}{120} = \dfrac{1}{6}.$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	₹ 12,000	1/6 of ₹ 12,000 = ₹ 2,000	₹ 10,000
2nd	(₹ 10,000 + 12,000) = ₹ 22,000	1/6 of ₹ 14,000 = ₹ 3,667	₹ 18,333
1st	(₹ 18,333 + 12,000) = ₹ 30,333	1/6 of ₹ 30,333 = ₹ 5,055	₹ 25,278

(3) Calculation of Depreciation

2013 : 10% of ₹ 25,278 = ₹ 2,528.

2014 : 10% of (₹ 25,278 – 2,528) = ₹ 2,275.

2015 : 10% of (₹ 25,278 – 2,528 – 2,275) = ₹ 2,048.

Illustration 34

R.K. Transport Company Ltd purchased four trucks from AB Auto Ltd on 1st January, 2010 on hire purchase system. The cash price of each truck was ₹ 8,00,000. The mode of payment is as follows :

20% of cash price to be paid on delivery and 25% of cash price to be paid at the end of each year for four years.

R.K. Transport Company Ltd writes off depreciation @ 10% p.a. on diminishing balance method. The payment due on 31st December, 2011 could not be paid. AB Auto Ltd. re-possessed two trucks adjusting its value against the amount due. The re-possession was done on the basis of 25% depreciation on fixed instalment method.

Show the necessary accounts in the books of R.K. Transport Company Ltd. ***[C.U.B.Com. (Hons.) — 2015]***

Solution

In the books of R K Transport Company Ltd.

Truck Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To AB Auto Ltd. A/c	32,00,000	31.12.2010	By Depreciation A/c	3,20,000
			"	By Balance c/d	28,80,000
		32,00,000			32,00,000
1.1.2011	To Balance b/d	28,80,000	31.12.2011	By Depreciation A/c	2,88,000
			"	By AB Auto Ltd. A/c	8,00,000
			"	By Profit and Loss A/c	4,96,000
			"	By Balance c/d	12,96,000
		28,80,000			28,80,000

Dr. **AB Auto Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Bank A/c (Down payment)	6,40,000	1.1.2010	By Truck A/c	32,00,000
31.12.2010	To Bank A/c (Noe 3)	8,00,000	31.12.2010	By Interest A/c (Note 2)	2,56,000
"	To Balance c/d	20,16,000			
		34,56,000			34,56,000
31.12.2011	To Truck A/c (Note 6)	8,00,000	1.1.2011	By Balance b/d	20,16,000
"	To Balance c/d	14,08,000	31.12.2011	By Interest A/c	1,92,000
		22,08,000			22,08,000
			1.1.2012	By Balance b/d	14,08,000

Working Notes :

(1) Down payment = 20% of (₹ 8,00,000 × 4) = ₹ **6,40,000**.

(2) Calculation of Interest

	₹
Hire Purchase Price (₹ 6,40,000 + 32,00,000)	38,40,000
Cash Price (₹ 8,00,000 × 4)	32,00,000
Total Interest	6,40,000

Since there are *four* instalments, total interest of ₹ 6,40,000 is to be divided among the instalments in the ratio of 4 : 3 : 2 : 1.

Interest for ***first*** instalment = $\frac{6,40,000}{10} \times 4$	2,56,000
Interest for ***second*** instalment = $\frac{6,40,000}{10} \times 3$	1,92,000
Interest for ***third*** instalment = $\frac{6,40,000}{10} \times 2$	1,28,000
Interest for ***fourth*** instalment = $\frac{6,40,000}{10} \times 1$	64,000
Total Interest	6,40,000

(3) Amount Paid in First Instalment :

25% of Cash Price (25% of ₹ 32,00,000) = ₹ **8,00,000**.

(4) Book Value of Each Truck Repossessed :

	₹
Cost of each truck	8,00,000
Less: Depreciation for 2010 @ 10% p.a. on diminishing balance method	80,000
W.D.V. on 31.12.2010	7,20,000
Less: Depreciation for 2011 @ 10% p.a. on diminishing balance method	72,000
W.D.V. on 31.12.2011	6,48,000

(5) Loss on Repossession of each Truck :

Cost of each truck	8,00,000
Less: Depreciation @ 25% p.a. on straight line method for 2010 and 2011	4,00,000
	4,00,000

Loss per truck = ₹ 6,48,000 – 4,00,000 = ₹ **2,48,000**.

Total loss on repossession of two trucks = ₹ 2,48,000 × 2 = ₹ **4,96,000**.

(6) Agreed repossession value of two trucks = ₹ 4,00,000 × 2 = ₹ **8,00,000**.

(7) Written-down value of two trucks at the end of 2011= ₹ 6,48,000 × 2 = ₹ **12,96,000**.

Illustration 35

On 01.01.2012, XY Corporation purchased a truck on hire purchase from AB Motors for ₹ 60,000. Payment to be made ₹ 20,000 on delivery and three instalments of ₹ 15,000 each at the end of each year. Rate of interest is charged at 5% p.a. Rate of depreciation is 10% p.a. on written-down value method.

The buyer defaulted after paying down payment and the first instalment and the vendor seized the truck immediately after non- payment of the second instalment.

Prepare Truck Account and AB Motors Account in the books of XY Corporation.

[C.U.B.Com. (Hons.) — 2014]

Solution

In the books of XY Corporation

AB Motors Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	20,000	1.1.2012	By Truck A/c	60,000
31.12.2012	To Bank A/c	15,000	31.12.2012	By Interest A/c	2,000
"	To Balance c/d	27,000			
		62,000			62,000
31.12.2013	To Truck A/c (Surrender of Truck)	28,350	1.1.2013	By Balance b/d	27,000
			31.12.2013	By Interest A/c	1,350
		28,350			28,350

Truck Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To AB Motors A/c	60,000	31.12.2012	By Depreciation A/c	6,000
			"	By Balance c/d	54,000
		60,000			60,000
1.1.2013	To Balance b/d	54,000	31.12.2013	By Depreciation A/c	5,400
			"	By AB Motors A/c	28,350
			"	By Profit and Loss A/c	20,250
		54,000			54,000

Illustration 36

Ram Ltd. purchased a motor van on hire purchase from Storm Ltd on 1.1.2010. The terms of payments were ₹ 23,000 on delivery, ₹ 11,700 at the end of first year, ₹ 10,800 at the end of second year and ₹ 9,900 at the end of third year including interest. Rain Ltd. charged depreciation at 10% p.a. under diminishing balance method. Assume that Storm Ltd. charged interest @ 10% p.a. on outstanding amount at the beginning of each year.

Show Storm Ltd. Account and Motor Van Account in the books of Rain Ltd. *[C.U.B.Com. (Hons.) — 2013]*

Solution

In the books of Ram Ltd.

Motor Van Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Storm Ltd. A/c (Note 2)	50,000	31.12.2010	By Depreciation A/c	5,000
			"	By Balance c/d	45,000
		50,000			50,000
1.1.2011	To Balance b/d	45,000	31.12.2011	By Depreciation A/c	4,500
			"	By Balance c/d	40,500
		45,000			45,000
1.1.2012	To Balance b/d	40,500	31.12.2012	By Depreciation A/c	4,050
			"	By Balance c/d	36,450
		40,500			40,500
1.1.2013	To Balance b/d	36,450			

Dr. **Storm Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Bank A/c	23,000	1.1.2010	By Motor Van A/c	50,000
31.12.2010	To Bank A/c	11,700	31.12.2010	By Interest A/c	2,700
"	To Balance c/d	18,000			
		52,700			52,700
31.12.2011	To Bank A/c	10,800	1.1.2011	By Balance b/d	18,000
"	To Balance c/d	9,000	31.12.2011	By Interest A/c	1,800
		19,800			19,800
31.12.2012	To Bank A/c	9,900	31.12.2012	By Balance b/d	9,000
				By Interest A/c	900
		9,900			9,900

Working Notes :

(1) Interest is payable @ 10% p.a.

Ratio of Interest and amount due $= \frac{10}{100 + 10} = \frac{10}{110} = \frac{1}{11}$.

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	₹ 9,900	1/11 of ₹ 9,900 = ₹ 900	₹ 9,000
2nd	(₹ 9,000 + 10,800) = ₹ 19,800	1/11 of ₹ 19,800 = ₹ 1,800	₹ 18,000
1st	(₹ 18,000 + 11,700) = ₹ 29,700	1/11 of ₹ 29,700 = ₹ 2,700	₹ 27,000

Total Cash Price = ₹ 23,000 + ₹ 27,000 = ₹ **50,000**.

Illustration 37

Kolkata Transport Agency purchased 2 motor vans costing ₹ 2,40,000 each from Honda Auto Company on 1st January, 2008 on hire purchase system. The terms of payment were as follows :

Payment of ₹ 60,000 each for motor van on delivery and the remainder in three equal instalments together with interest of 10% p.a. to be paid at the end of each year,

Kolkata Transport Agency writes off depreciation @ 20% p.a. each year on the diminishing balance method. The hire purchaser paid two instalments due on 31.12.2008 and 31.12.2009, but could not pay the final instalment.

Honda Auto Company re-possessed one motor van adjusting its value against the amount due. The repossession was done on the basis of 25% depreciation on the fixed instalment method.

Write up Motor Van Account and Honda Auto Company Account in the books of Kolkata Transport Agency.

[C.U.B.Com. (Hons.) — 2012]

Solution **In the books of Kolkata Transport Agency**

Dr. **Motor Van Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2008	To Honda Auto Company A/c	4,80,000	31.12.2008	By Depreciation A/c	96,000
				By Balance c/d	3,84,000
		4,80,000			4,80,000
1.1.2009	To Balance b/d	3,84,000	31.12.2009	By Depreciation A/c	76,800
				By Balance c/d	3,07,200
		3,84,000			3,84,000
1.1.2010	To Balance b/d	3,07,200	31.12.2010	By Depreciation A/c	61,440
				By Hona Auto Company A/c (Agreed value of motor van repossessed)	60,000
				By Profit and Loss A/c (Note 2)	62,880
				By Balance c/d (W.D.V. of 1 motor van still in possession)	1,22,880
		3,07,200			3,07,200

Dr. **Honda Auto Company Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2008	To Bank A/c (Down payment)	1,20,000	1.1.2008	By Motor Van A/c	4,80,000
31.12.2008	To Bank A/c (₹ 1,20,000 + 36,000)	1,56,000	"	By Interest A/c	36,000
"	To Balance c/d	2,40,000			
		5,16,000			5,16,000
31.12.2009	To Bank A/c (₹ 1,20,000 + 24,000)	1,44,000	1.1.2009	By Balance b/d	2,40,000
"	To Balance c/d	1,20,000	31.12.2009	By Interest A/c	24,000
		2,64,000			2,64,000
31.12.2010	To Motor Van A/c (Agreed Value)	60,000	1.1.2010	By Balance b/d	1,20,000
"	To Balance c/d	72,000	31.12.2010	By Interest A/c	12,000
		1,32,000			1,32,000

Working Notes:

(1) Book Value of Motor Van Repossessed	₹	(2) Loss on repossession of one Van	₹
Cost of Motor Van on 1.1.2008	2,40,000	Cost of Van on 1.1.2008	2,40,000
Less: Depreciation for 2008 @ 20%	48,000	*Less:* Depreciation for 2008 & 2009 @ 25% on straight line method	1,80,000
	1,92,000		
Less: Depreciation for 2009 @ 20%	38,400	**Agreed Value**	60,000
	1,53,600	Book value (Note 1)	1,22,880
Less: Depreciation for 2010 @ 20%	30,720	*Less*: Agreed Value as above	60,000
Book Value on 31.12.2010	1,22,880	**Loss on Repossession**	62,880

Illustration 38

On 01.01.2008, X acquires on hire purchase from Y machinery valued at ₹ 60,000 payable in three yearly instalments of ₹ 20,000, plus interest at 6% per annum. X paid the first instalment but could not pay the second. Took back the machinery which cost ₹ 40,000, allowing ₹ 22,500 for that. As X paid all the interest due upto that date on the full amount owing.

X had written off depreciation at 10% per annum on diminishing balance. Show Machinery Account and Y Account in the books of X. ***[C.U.B.Com. (Hons.) — 2011]***

Solution

In the books of X

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2008	To Y A/c	60,000	31.12.2008	By Depreciation A/c	6,000
			"	By Balance c/d	54,000
		60,000			60,000
1.1.2009	To Balance b/d	54,000	31.12.2009	By Depreciation A/c	54,000
			"	By Y A/c	22,500
			"	By Profit and Loss A/c	9,900
			"	By Balance c/d	16,200
		54,000			54,000

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

Date	Particulars	₹	Date	Particulars	₹
31.12.2008	To Bank A/c (₹ 20,000 + 3,600)	23,600	1.1.2008	By Machinery A/c	60,000
"	To Balance c/d	40,000	31.12.2008	By Interest A/c	3,600
		63,600			63,600
31.12.2009	To Machinery A/c	22,500	1.1.2009	By Balance b/d	40,000
"	To Balance c/d	19,900	31.12.2009	By Depreciation A/c	2,400
		42,400			42,400
			1.1.2010	By Balance b/d	19,900

Working Notes :

(1) Calculation of Loss on Repossession :

	₹
Cost of Machinery on 1.1.2008	60,000
Less: Depreciation for 2008 @ 10% p.a.	6,000
W.D.V. on 1.1.2009	54,000
Less: Depreciation for 2009 @ 10%	5,400
W.D.V. on 31.12.2009 (Total)	48,600
W.D.V. of Machinery surrendered = $\frac{48,000}{60,000} \times 40,000$	32,400
Less: Agreed value of Machinery surrendered	22,500
Loss on Repossession	9,900

Special Problems

Illustration 39

GH Limited acquired three excavators from MN Limited under hire purchase agreements which provided for a deposit of 10% with the balance to be paid in three annual instalments, the first of which was due one year after the signing of the agreement and the payment of the deposit.

The date of purchase, capital cost and annual repayments are as under :

Excavator	Date of acquisition	Capital cost (₹)	Annual repayment (₹)
A	31st December 2014	15,000	5,428
B	31st December 2015	15,000	5,428
C	31st December 2016	25,000	8,042

All instalments were paid on the due dates except that when the excavator C was purchased, the vendor agreed to take back excavator A on the basis that GH Limited was to be credited with ₹ 5,000 in lieu of a deposit on excavator C and that no further payment was to be made in respect of excavator A after the instalment paid on 31st December, 2016.

The practice of GH Limited was to capitalise the cash value of each excavator immediately on purchase, crediting it to the vendor.

Each yearly instalment included interest at the rate of 10% per annum calculated on the outstanding balance at the beginning of the year. GH Limited makes up its accounts to 31st December of each year and provides depreciation on excavators at the rate of 20% on reducing balance.

You are required to write-up in the books of GH Limited in columnar form for the three years ended 31st December, 2017 :

(i) Asset Account for each Excavator; (ii) Vendors Account for Excavators; (iii) Assets Disposal Account; and (iv) Depreciation Provision Account for each Excavator.

Solution

In the books of G. H. Limited

Dr. Excavators Account Cr.

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
1.1.2015	To Balance b/d	15,000	15,000	—	31.12.2015	By Balance c/d	15,000	15,000	—
1.1.2016	To Balance b/d	15,000	15,000	—	31.12.2016	By Asset Disposal A/c	15,000	—	—
31.12.2016	To M N Limited A/c	—	—	25,000	31.12.2016	By Balance c/d	—	15,000	25,000
		15,000	15,000	25,000			15,000	15,000	25,000
1.1.2017	To Balance b/d	—	15,000	25,000	31.12.2017	By Balance c/d	—	15,000	25,000

Dr. Provision for Depreciation Account Cr.

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
31.12.2015	To Balance c/d	3,000	3,000	—	31.12.2015	By Profit & Loss A/c	3,000	3,000	—
31.12.2016	To Asset Disposal A/c	5,400	—	—	1.1.2016	By Balance b/d	3,000	3,000	—
31.12.2016	To Balance c/d	—	5,400	—	31.12.2016	By Profit & Loss A/c (Note 1)	2,400	2,400	—
		5,400	5,400	—			5,400	5,400	—

31.12.2017	To Balance c/d	—	7,320	5,000	1.1.2017	By Balance b/d	—	5,400	—
					31.12.2017	By Profit & Loss A/c (Note 2)	—	1,920	5,000
		—	7,320	5,000			—	7,320	5,000

Dr. **M. N. Limited Account** **Cr.**

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
31.12.2015	To Bank A/c (1st inst.)	5,428	5,428	—	1.1.2015	By Balance b/d**	13,500	13,500	—
31.12.2015	To Balance c/d	9,422	9,422	—	31.12.2015	By Interest A/c	1,350	1,350	—
		14,850	14,850	—			14,850	14,850	—
31.12.2016	To Bank A/c (2nd inst.)	5,428	5,428	—	1.1.2016	By Balance b/d	9,422	9,422	—
31.12.2016	To Asset Disposal A/c	4,936	—	5,000	31.12.2016	By Interest A/c	942	942	—
31.12.2016	To Balance c/d	—	4,936	20,000	31.12.2016	By Excavators A/c	—	—	25,000
		10,364	10,364	25,000			10,364	10,364	25,000
31.12.2017	To Bank A/c (3rd inst.)	—	5,428	8,042	1.1.2017	By Balance b/d	—	4,936	20,000
31.12.2017	To Balance c/d	—	—	13,958	31.12.2017	By Interest A/c	—	*492	2,000
		—	5,428	22,000			—	5,428	22,000

* Actual interest comes to ₹ 493.60 but for balancing purposes it has been taken as ₹ 492. ** (₹ 15,000 – ₹ 1,500)

Dr. **Asset Disposal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Excavators A/c	15,000	31.12.2016	By Provision for Depreciation A/c	5,400
31.12.2016	To Profit & Loss A/c	336	31.12.2016	By M.N. ltd. A/c	9,936
		15,336			15,336

Working Note :
(1) Depreciation for 2016 = 20% of ₹ (15,000 – 3,000) = ₹ 2,400.
(2) Depreciation for 2017 = 20% of ₹ (15,000 – 5,400) = ₹ 1,920 (B).

Illustration 40

Bombay Roadways Ltd. purchased three trucks costing ₹ 1,00,000 each from Hindusthan Auto Ltd. on 1st January, 2015 on the Hire Purchase System. The terms were : on delivery payment of ₹ 25,000 for each truck and balance of the principal amount in 3 equal instalments plus interest at 15% per annum to be paid at the end of each year.

Bombay Roadways Ltd. writes-off 25% depreciation each year on the Diminishing Balance Method. Bombay Roadways Ltd. paid the instalments due on 31st December, 2015 and 31st December, 2016 but could not pay the final instalment.

Hindusthan Auto Ltd. repossessed two trucks adjusting values against the amount due. The repossession was done on 1st January, 2018 on the basis of 40% depreciation on the Diminishing Balance Method.

You are required to:

(a) Write-up the ledger accounts in the books of Bombay Roadways Ltd. showing the above transactions upto 1.1.2018, and

(b) Show the balances arising from the above transactions in the Balance Sheet of Bombay Roadways Ltd. as on 31st December, 2017.

Solution **In the books of Bombay Roadways Ltd.**

Dr. **Trucks Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Hindustan Auto Ltd A/c	3,00,000	31.12.2015	By Depreciation A/c	75,000
			31.12.2015	By Balance c/d	2,25,000
		3,00,000			3,00,000
1.1.2016	To Balance b/d	2,25,000	31.12.2016	By Depreciation A/c	56,250
			31.12.2016	By Balance c/d	1,68,750
		2,25,000			2,25,000

1.1.2017	To Balance b/d	1,68,750	31.12.2017	By Depreciation A/c	42,188
			31.12.2017	By Balance c/d	1,26,562
		1,68,750			1,68,750
1.1.2018	To Balance b/d	1,26,562			

Dr. **Provision for Loss on Repossession Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Balance c/d	41,175	31.12.2017	By Profit & Loss A/c	41,175
1.1.2018	To Trucks A/c	41,175	1.1.2018	By Balance b/d	41,175

Tutorial Note : Since the company is aware of the default and since the payment was due on 31st December, 2017 the resulting loss must be provided in the accounts of 2017. It should be adjusted at the time of actual repossession.

Dr. **Hindustan Auto Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	75,000	1.1.2015	By Trucks A/c	3,00,000
31.12.2015	To Bank A/c (75,000 + 33,750)	1,08,750	31.12.2015	By Interest A/c (15% 0n ₹ 2,25,000)	33,750
31.12.2015	To Balance c/d	1,50,000			
		3,33,750			3,33,750
31.12.2016	To Bank A/c (75,000 + 22,500)	97,500	1.1.2016	By Balance b/d	1,50,000
31.12.2016	To Balance c/d	75,000	31.12.2016	By Interest A/c (15% on ₹ 1,50,000)	22,500
		1,72,500			1,72,500
31.12.2017	To Balance c/d	86,250	1.1.2017	By Balance b/d	75,000
			31.12.2017	By Interest A/c (15% 0n ₹ 75,000)	11,250
		86,250			86,250
			1.1.2018	By Balance b/d	86,250

Balance Sheets of Bombay Roadways Ltd. as at 31st December, 2017 (Extract)

Particulars	.	(₹)
I. EQUITY AND LIABILITIES		?
(1) Shareholders' Funds :		?
(2) Share Application Money Pending Allotment :		
(3) Non-current Liabilities : Deferred Payment		43,200
(4) Current Liabilities : (a) Short-term Borrowings		4,175
II. ASSETS		
(1) Non-current Assets : (a) Fixed Assets (i) Tangible Assets		1,26,562

Working Notes:

(1) Value of two Trucks Repossessed	₹	**(2) Loss on repossession of two Trucks**	₹
Cost of two Trucks on 1.1.2015	2,00,000	Cost of two trucks on 1.1.2015	2,00,000
Less: Depreciation of 2015	80,000	*Less:* Depreciation @ 25%	50,000
	1,20,000	Book value on 1.1.2016	1,50,000
Less: Depreciation of 2016	48,000	*Less*: Depreciation of @ 25%	37,500
	72,000	Book value on 1.1.2017	1,12,500
Less: Depreciation of 2017	28,800	*Less*: Depreciation @ 25%	28,125
	43,200	Book value on 1.1.2018	84,375
		Agreed value of two repossessed trucks	43,200
		Loss on repossession — Prov. to be created in 2017 accounts	41,175

Hire Purchase Agreements for Goods of Small Value

The discussion so far was limited to the hire purchase transactions for goods of substantial sales value — invariably the fixed assets and the transactions were between ***two business units***. Now, the discussion will focus on the transactions between a retailer and the consumers and the hire purchase items i.e., consumer durables like T.V., fridge, etc. It should be noted that a large volume of the transactions of goods of these nature are being contracted every day and the accounting is important only from the point of view of ***the seller*** and not the buyer.

Since the sale of items of this nature are numerous and of small value, it becomes practically inconvenient for a particular retailer to maintain separate accounts for each transaction. In this case, the retailer is not interested to know the profit earned or losses incurred on each transaction — rather he is interested in knowing the overall profit or loss arising from all the transactions in a particular accounting period. It should be noted that profit and hire purchase interest are combined into one figure and it is apportioned over the hire purchase period.

When the hire purchase transactions are numerous and value of the items are small, it is preferable to open separate ***memorandum*** hire purchase books. A Hire Purchase Sales Register is kept, to disclose both the hire purchase price and the cost price of the goods. This register should also show the number of instalments payable, amount of down payment and the number of hire purchase agreement. In addition to Hire Purchase Sales Register, a Memorandum Hire Purchase Ledger is also maintained in which accounts of the customers are kept. The sale price is debited to the individual customers' accounts and these accounts being credited with all instalments paid. The total of the "sale price" column is credited to a Control Account, which is debited with the total instalments received.

> ***It must be noted that above entries are of a memorandum nature only, and do not form a part of the double entry system. In practice, such accounts are vital and useful only for reference; but from the point of view of double entry, they are entirely useless and unnecessary***.

In the general ledger, personal aspect is ignored, the entries being recorded in total only.

A specimen of the Hire Purchase Sales Register is given below:

Hire Purchase Sales Register

S.N.	Date of Agreement	Name of Customer	Name of Article	Cost Price	H.P. Price	Down Payment	No. of Instalments	Instalments Due				Total Instalments Recd.	Instalments due but not recd.	Instalment not yet due
								1	2	3	4			

The book keeper should be very careful in recording the different items in the register and casting (totalling) of the individual column, because these are the basis for the ascertainment of the profit or loss from hire purchase business. The totals of the columns of the register are very relevant for posting to the respective Control Accounts at regular intervals.

Relevant Expressions in Regard to Hire Purchase Sales of Small Items

Before studying the different accounting methods for ascertaining profit or loss on hire purchase transactions, we should be conversant to some relevant expressions which are used frequently. These are:

(1) Cost price of goods sold on hire purchase; (2) Value of goods sold on hire purchase; (3) Cash received; (4) Hire purchase debtors; (5) Hire purchase stock; and (6) Stock at shop.

(1) Cost price of goods sold on hire purchase The hire vendor buys goods either from the manufacturers directly or from the wholesellers. He sells them either against cash or under the hire purchase system. When he sells goods against cash, he does so at a profit — at a price more than the cost price. But when he sells the goods under hire purchase, he sells them at a price which is higher than the price of cash purchase. The extra charge is just to cover the loss of interest on these transactions. However, ***the interest in these transactions are not calculated separately, applying the concept of materiality***. Profit, in this case, is calculated on the

basis of the difference between cost price and hire purchase price. This difference is generally known as 'loading'. Loading can be expressed as a percentage of cost (***known as 'mark-up'***) or as a percentage of sales value or hire purchase price (***known as 'margin'***). ***For example***, if the cost price of an item is ₹ 1,000 and the hire purchase price is ₹ 1,250, the profit is ₹ 250.

If the profit is expressed as ***a percentage of cost***, mark-up becomes 25% ($\frac{250}{1000} \times 100$). Likewise, if it is expressed as ***a percentage of the hire purchase price***, the margin becomes 20% ($\frac{250}{1250} \times 120$).

(2) Value of goods sold on hire purchase It is the total of the hire purchase price of all goods sold during the accounting period under the hire purchase system. Generally, the value of goods sold on hire purchase is given in the examination problem. If, however, it is not given, it can be worked out as follows:

(i) Applying loading rate to the cost of goods sold under hire purchase system.

(ii) [Down payment + (Number of instalments x amount of each instalment] x Number of items sold.

(3) Cash received It represents the total amount received during the accounting period in respect to ***hire purchase sales***. It includes ***down payment, instalments received in respect to previous year(s) as well as of the current year***.

(4) Hire purchase debtors Commonly, a debtor is a person to whom goods are sold on credit. There is some difference between an ***ordinary debtor*** and a ***hire purchase debtor.*** A hire purchase customer is required to pay different instalments on different due dates. In the case of hire purchase debtors it is the total amount of such instalments which have ***fallen due during a particular accounting period but have not yet been paid by the hire purchase customers***. (see example of next item). Hire purchase debtors is also known as (i) Instalments due but not yet paid; or (ii) Instalment due, customers paying, etc.

(5) Stock on hire purchase It is also known as ***instalments not yet due*** or ***goods with hire purchase customers***. Under a hire purchase agreement, some instalments fall due during the current accounting period while others fall due on the subsequent accounting year(s). The total amount of instalments which ***have not yet become due during the current accounting period is called stock on hire purchase***. It should be noted that it does not represent any ***physical stock***. For example, if the cash price of an item is ₹ 1,000 and the hire purchase price is ₹ 1,200. The payment is to be made in twenty four monthly equal instalments, i.e., ₹ 50 p.m. Out of 24 instalments, 10 instalments are due for payment during the current accounting period 2017-18 and the balance 14 instalments are due for payment in the subsequent years. In this case, the hire purchase stock will be ₹ 50 (24 – 10) = ₹ 700. In this example, let us assume that out of the 10 instalments due during 2017-18, the hire purchase customers paid only 6 instalment during the year. Therefore, the hire purchase debtors for 2017-18 will be ₹ 50 (10 – 6) = ₹ 200.

(6) Stock at shop It is the ***physical stock of unsold goods lying in the godown*** of the retailer. The cost of unsold stock in the shop has nothing to do with the ascertainment of profit or loss arising out of the hire purchase transactions. However, this figure is relevant towards the ascertainment of cost of goods sold on hire purchase, which can be ascertained by deducting the stock in the shop from the total purchases. When the ***cost of goods sold is given***, it becomes very simple to ascertain the value of goods sold on hire purchase by simply adding the percentage of mark-up.

Ascertainment of Profit/Loss

There are two common methods of ascertaining profit / loss of goods of small value sold on hire purchase. These are:

(1) the Hire Purchase Trading Account Method; and (2) the Stock and Debtors Method

Hire Purchase Trading Account Method

Under this method, a Hire Purchase Trading Account is prepared to ascertain the profit or loss. It is similar to the preparation of a Consignment Account.

(a) Debit the Hire Purchase Trading Account with:

(i) Opening balance of H.P. Stock (Instalments not yet due) brought forward from the previous year. Generally, it is shown at ***hire purchase price***. If it is given at cost, ***convert that into Hire Purchase price by adding loading***.

(ii) Opening balance of H.P. Debtors (Instalment due but not yet paid) brought forward from the previous year.

(iii) Value of goods sold on Hire Purchase during the accounting period.

(iv) Expenses incurred during the accounting period.

(v) Loss on repossession of goods.

(b) Credit the Hire Purchase Trading Account with:

(i) Cash received from hire purchase customers during the accounting period. It includes down payment, hire purchase instalments of the previous year as well as of the current year collected during the accounting period.

(ii) Instalments due but not paid on goods repossessed.

(iii) Closing balance of H.P. Stock (Instalment not yet due) at hire purchase price carried forward to the next period. If it is not given in the problem, it can be calculated by preparing Memorandum Goods with H.P. Customers Account.

(iv) The closing balance of H.P. Debtors (Instalments due but not yet paid) is carried forward to next period. If the closing balance of H.P. Debtors is not given in the problem, it can be calculated by preparing Memorandum H.P. Debtors Account.

Pass adjustment entries for the following:

(i) For loading on opening balance of Hire Purchase Stock (Instalments not yet due / Goods with H.P.Customers)

Stock Reserve Account Dr.
    To Hire Purchase Trading Account

(ii) For loading on goods sold on Hire Purchase during the year

Goods sold on Hire Purchase Account Dr.
    To Hire Purchase Trading Account

(iii) For loading on closing balance of Hire Purchase Stock Instalments not yet due / Goods with H.P. customers)

Hire Purchase Trading Account Dr.
    To Stock Reserve Account

The proforma of a Hire Purchase Trading Account is given below:

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d : Hire Purchase Stock (at H.P. price) Hire Purchase Debtors To Goods Sold on H.P. A/c (H.P. price) To Loss on Goods Repossessed A/c To Expenses A/c To Stock Reserve A/c (Loading on closing H.P. stock) To Profit & Loss A/c			By Cash A/c A/c By Goods Repossessed A/c (Instalments due but not paid) By Stock Reserve A/c (Loading on opening H.P. stock) By Goods sold on H.P. A/c (Loading on goods sold) By Balance c/d: H.P. Stock (at H.P. price) H.P. Debtors	

Illustration 41

Ram sells goods on hire purchase basis at a profit of 50% on cost. Following particulars are given relating to the business during 2017:

Particulars	₹	Particulars	₹
Hire Purchase Stock (at selling price) as on 1.1.2017	9,000	Hire Purchase Stock (at selling price) as on 31.12.2017	30,000
H.P. Debtors on 1.1.2017	5,000	H.P. Debtors on 31.12.2017	9,000
Goods sold on hire purchase during the year (at H.P. price)	87,000	Cash received from hire purchase customers during 2017	62,000

Prepare Hire Purchase Trading Account showing the profit earned for 2017.

Solution

In the books of Ram

Hire Purchase Trading Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Stock Reserve A/c (Note 1)	3,000
	Hire Purchase Stock	9,000	31.12.2017	By Goods Sold on H.P. A/c (Note 2)	29,000
	Hire Purchase Debtors	5,000	31.12.2017	By Cash A/c	62,000
31.12.2017	To Goods Sold on H.P. A/c	87,000	31.12.2017	By Balance c/d :	
31.12.2017	To Stock Reserve A/c (Note 3)	10,000		Hire Purchase Stock	30,000
31.12.2017	To Profit & Loss A/c	22,000		Hire Purchase Debtors	9,000
		1,33,000			1,33,000

Working Notes:

(1) Loading on opening balance of Hire Purchase Stock = 50/150 x ₹ 9,000 = ₹ 3,000.

(2) Loading on Goods sold on Hire Purchase = 50/150 x ₹ 87,000 = ₹ 29,000.

(3) Loading on closing balance of hire purchase stock = 50/150 x ₹ 30,000 = ₹ 10,000.

Tutorial Note: The closing balance of Instalments Due Account (H.P. Debtors Account) can be verified by preparing the following accounts:

Memorandum Hire Purchase Debtors Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	5,000	By Cash A/c (given)	62,000
To Hire Purchase Stock A/c (Note 4)	66,000	By Balance c/d	9,000
	71,000		71,000

(4) Memorandum Hire Purchase Stock Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	9,000	By Hire Purchase Debtors A/c (Balancing figure)	66,000
To Goods sold on H.P. A/c (given)	87,000	By Balance c/d (given)	30,000
	96,000		96,000

Illustration 42

A trader sells goods of small value on the hire purchase system at 60% profit on cost.

From the following information, prepare Hire Purchase Trading Account:

		₹
1.1.2017	Stock with hire purchase customers at hire purchase price	6,480
31.12.2017	Goods sold on hire purchase basis during the year	26,136
	Cash received from hire purchase customers during the year	8,400
	Hire purchase debtors	1,520
	Stock with hire purchase customers at hire purchase price	22,696

Solution

Hire Purchase Trading Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Stock Reserve A/c (Note 1)	2,430
	Hire Purchase Stock	6,480	31.12.2017	By Goods Sold on H P A/c (Note 2)	9,801
31.12.2017	To Goods Sold on H P A/c	26,136	31.12.2017	By Cash A/c	8,400
31.12.2017	To Stock Reserve A/c (Note 3)	8,511	31.12.2017	By Balance c/d :	
31.12.2017	To Profit and Loss A/c	3,720		Hire Purchase Stock	22,696
				Hire Purchase Debtors	1,520
		44,847			44,847

Working Notes :

(1) Loading on opening balance of hire purchase stock = 60/160 × ₹ 6,480 = ₹ 2,430.

(2) Loading on goods sold on hire purchase = 60/160 × ₹ 26,136 = ₹ 9,801.

(3) Loading on closing balance of hire purchase stock = 60/160 × ₹ 22,696 = ₹ 8,511.

Illustration 43

Domestic Appliances started trading on 1.1.2018 selling goods on hire purchase. Hire purchase terms require a deposit of 30% of the hire purchase selling price at the time of sale, followed by 10 equal monthly instalments, the first of which is payable on month after payment of the deposit.

A summary of the first six months' hire purchase transactions showed :

Month	January	February	March	April	May	June
Cost Price (₹)	2,400	13,200	1,500	6,000	3,900	3,600
H P Selling Price (₹)	4,000	22,000	3,000	11,000	7,000	6,000

All instalments were paid promptly on the due dates. You are requested to prepare Hire Purchase Trading Account.

Solution

Workings

Calculation of Amount of Deposits and Instalments

Month of Sale ₹	Cost of Sale ₹	HP Selling Price ₹	Deposits and Instalments Received							Instalments Not Yet Due
			Jan ₹	Feb ₹	Mar ₹	Apr ₹	May ₹	Jun ₹	Total ₹	
Jan	2,400	4,000	1,200	280	280	280	280	280	2,600	1,400
Feb	13,200	22,000	—	6,600	1,540	1,540	1,540	1,540	12,760	9,240
Mar	1,500	3,000	—	—	900	210	210	210	1,530	1,470
Apr	6,000	11,000	—	—	—	3,300	770	770	4,840	6,160
May	3,900	7,000	—	—	—	—	2,100	490	2,590	4,410
Jun	3,600	6,000	—	—	—	—	—	1,800	1,800	4,200
Total	30,600	53,000	1,200	6,880	2,720	5,330	4,900	5,090	26,120	26,880

In the books of Domestic Appliances

Dr — Hire Purchase Trading Account — Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2018	To Goods Sold on H P A/c	53,000	30.6.2018	By Goods Sold on H P A/c (Loading — ₹ 53,000 – 30,600)	22,400
30.6.2018	To Stock Reserve A/c (Note 1)	11,360			
30.6.2018	To Profit and Loss A/c	11,040	30.6.2018	By Cash A/c (Deposits and instalments received)	26,120
			30.6.2018	By Balance c/d : H P Stock	26,880
		75,400			75,400

Working Note : (1) Loading on closing balance of hire purchase stock : ₹ 22,400 / ₹ 53,000 × ₹ 26,880 = ₹ 11,360.

Calculation of Missing Figures

Sometimes in the examination, some figures required to calculate profit/loss are not given. These may be: (i) Hire Purchase Stock; (ii) Hire Purchase Debtors; (iii) Purchases; or, (iv) Cash received, etc.

Before preparing the Hire Purchase Trading Account, the missing item(s) should be calculated first. The following steps are followed:

Step 1 : Draw up the following Memorandum Accounts.
(a) Memorandum Stock at Shop Account
(b) Memorandum H.P. Stock Account / Stock with H.P. Customers Account
(c) Memorandum H.P. Debtors Account / Instalments Due Account.

Step 2 : Place the available figures in the respective accounts.

Step 3 : Balance the account having maximum figures available. It will be helpful in finding out the missing figure of that account.

Step 4 : Place the figures so calculated in Step 3 to the relevant account.

Step 5 : Continue the process of transfer until all the figures are available.

The proforma of these accounts are given below:

Dr. — Memorandum Stock at Shop Account — Cr.

Particulars	₹	Particulars	₹
To Balance b/d (at cost)		By Goods sold on Hire Purchase A/c (at cost)	
To Purchases		By Balance c/d	

Dr. **Memorandum Hire Purchase Stock Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (at H.P. price)		By Hire Purchase Debtors A/c	
To Goods sold on H.P. (at H.P. price)		By Goods Repossessed A/c (instalments not yet due)	
		By Balance c/d	

Dr. **Memorandum Hire Purchase Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (at H.P. price)		By Cash A/c	
To H.P. Stock A/c (total instalments due)		By Goods Repossessed A/c (instal. due but not yet recd.)	
		By Balance c/d	

It should be noted here that the Memorandum Stock at Shop Account shows all figures at cost, but the Memorandum H.P. Stock Account and the Memorandum H.P. Debtors Account show all figures at hire purchase price. Therefore, any figure transferred from the Memorandum Stock at Shop Account to any other account should be converted at hire purchase price. Similarly, any figure transferred to the Memorandum Stock at Shop Account from other account should be converted at cost price.

Illustration 44

ESS Ltd. has a hire purchase department. Goods are sold on hire purchase at a profit of 25% on sales price. From the following particulars, prepare Hire Purchase Trading Account in the books of ESS Ltd. for the year to 31st March, 2018:

Particulars	₹	Particulars	₹
1.4.2017		**During the year ended 31.3.2018**	
Stock in the shop	10,000	Goods sold on H.P. at H.P. price	1,76,000
Instalments due	6,000	Purchases	1,36,000
Stock out with customers at H.P. price	80,000	Cash	1,60,000
		31.3.2018	
		Stock in the shop	14,000
		Stock out with customers at H.P. price	92,000

Solution

In the books of ESS Ltd.

Dr. **Hire Purchase Trading Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2017	To Balance b/d :		31.3.2018	By Cash	1,60,000
	Stock out with Customers	80,000	31.3.2018	By Stock Reserve A/c (Note 1)	20,000
	H.P. Debtors	6,000	31.3.2018	By Goods Sold on H.P. A/c (Note 2)	44,000
31.3.2018	To Goods Sold on H.P. A/c	1,76,000	31.3.2018	By Balance c/d :	
31.3.2018	To Stock Reserve A/c (Note 3)	23,000		Stock out with Customers	92,000
31.3.2018	To Profit & Loss A/c	41,000		H.P.Debtors (Note 4)	10,000
		3,26,000			3,26,000

Working Notes:

(1) Loading on opening balance of stock with customers = 25/100 x ₹ 80,000 = ₹ 20,000.

(2) Loading on goods sold on H.P. = 25/100 x ₹ 1,76,000 = ₹ 44,000.

(3) Loading on closing balance of stock with customers = 25/100 x ₹ 92,000 = ₹ 23,000.

(4) Closing balance of instalments due (H.P., Debtors) at the end is calculated as follows:

Dr. **Memorandum Hire Purchase Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Cash A/c	1,60,000
To Stock out with Customers A/c (Note 5)	1,64,000	By Balance c/d	10,000
	1,70,000		1,70,000

Dr. (5) Memorandum Stock out with Customers Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	80,000	By H.P. Debtors A/c (Balancing figure)	1,64,000
To Goods sold on H.P. A/c (given)	1,76,000	By Balance c/d (given)	92,000
	2,56,000		2,56,000

Dr. Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Goods sold on H.P. A/c (at cost) (3/4 x ₹ 1,76,000)	1,32,000
To Purchases	1,36,000	By Balance c/d	14,000
	1,46,000		1,46,000

Turotial Note: Stock in the shop (opening and closing balance) and purchases will not be considered in the Hire Purchase Trading Account. The Memorandum Stock at Shop Account has been prepared for reconciliation purposes only.

Illustration 45

Fortunate Limited commenced business on 1st April, 2017 and gives you the following information for the year ended 31st March, 2018: Total purchases for the year amounted to ₹ 90,000. General sales totalled ₹ 85,000, stock at close amounted to ₹ 15,000. Two items were sold on hire purchase terms of which the details are given below:

	Cost	Down payment per unit	Number of further instalments per unit	Total instalment falling due in 2017-13 (excluding down payments)
Item No. 1	30 x ₹ 150	₹ 30	6 of ₹ 30	50
Item No. 2	20 x ₹ 400	₹ 80	8 of ₹ 80	30

Instalments due in 2017-13 were all received. Prepare the Hire Purchase Trading Account and General Trading Account for the year ended 31st March, 2018.

Solution

In the books of Fortunate Limited

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Goods Sold on H.P. A/c (Note 1)	20,700	31.3.2018	By Goods Sold on H.P. A/c (Note 4)	8,200
31.3.2018	To Stock Reserve A/c (Note 7)	5,736	31.3.2018	By Cash A/c (Note 5)	6,400
31.3.2018	To Profit & Loss A/c	2,464	31.3.2018	By Balance c/d :	
				Hire Purchase Stock (Note 6)	14,300
		28,900			28,900

Dr. General Trading Account for the year ended on 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Purchases A/c	90,000	By Sales A/c	85,000
To Gross Profit c/d	22,500	By Goods Sold on H.P. A/c (Note 8)	12,500
		By Closing Stock A/c	15,000
	1,12,500		1,12,500

Working Notes: **(1) Details of sales 2017-18**

Item No. 1 : (6 x 30 + ₹ 30) x 30 = ₹ 6,300

Item No. 2 : (8 x 80 + ₹ 80) x 20 = ₹ 14,400

= ₹ 20,700

(2) Profit on item no. 1 : (₹ 6,300 – 30 x ₹ 150) = ₹ 1,800. Therefore, profit included in sales = ₹ 1,800 / ₹ 6,300 = 2/7.

(3) Profit on item no. 2 : (₹ 14,400 – 20 x ₹ 400) = ₹ 6,400. Therefore, profit included in sales ₹ 6,400/14,400 = 4/9.

(4) Total profit = ₹ 1,800 + ₹ 6,400 = ₹ 8,200.

(5) Cash Received		₹	(6) Instalments not yet due		₹
Item No. 1 : Cash down (30 x ₹ 30)	900		Item No. 1 : (30 x 6 – 50) x ₹ 30	3,900	
Instalments (50 x ₹ 30)	1,500	2,400	Item No. 2 : (20 x 8 – 30) x ₹ 80	10,400	14,300
Item No. 2 : Cash down (20 x ₹ 80)	1,600		**(7) Stock Reserve**		₹
Instalments (30 x ₹ 80)	2,400	4,000	Item No. 1 : 2/7 of ₹ 3,900	1,114	
		6,400	Item No. 2 : 4/9 of ₹ 10,400	4,622	5,736

Dr. (8) Goods Sold on H.P. Account Cr.

Particulars	₹	Particulars	₹
To Hire Purchase Trading A/c (Note 4)	8,200	By Hire Purchase Trading A/c	20,700
To General Trading A/c (Balancing figure)	12,500		
	20,700		20,700

Illustration 46

Ravi Tandon commenced business as a hire purchase trader on 1.1.2017, with a capital of ₹ 1,00,000. He decided to sell vacuum cleaners (VC) and electric polishers (EP) and his terms were that payment should be made in eight equal instalments, the first payable on the date of sale and the remainder at quarterly intervals thereafter.

The following information is extracted from his books at the end of 2017 :

Items	Numbers Purchased	Numbers Sold	Cost per Unit (₹)	HP Selling Price per Unit (₹)
VCs	300	250	960	1,680
EPs	250	200	1,440	2,520

The following is the summary of the Bank Account for 2017 :

Receipts	₹	Payments	₹
Capital introduced	1,00,000	Payment in respect of purchases :	
Receipts in respect of sales :		VCs — 250 @ ₹ 960 each	2,40,000
VCs — 250 @ ₹ 840 each	2,10,000	EPs — 250 @ ₹ 1,440 each	3,60,000
EPs — 200 @ ₹ 630 each	1,26,000	Expenses	19,800
Overdraft at 31.12.2017	2,29,660	Drawings	35,000
		Bank Interest	10,860
	6,65,660		6,65,660

All instalments due from customers were received on due date. Credit for profit on sales is taken in respect of instalments received.On 31.12.2017, outstanding expenses were ₹ 4,600.

Prepare Hire Purchase Trading Account and Profit and Loss Account for the year ended 31.12.2017 and a Balance Sheet as on that date. ***[B.U.B.Com. (Hons.) — Adapted]***

Solution

In the books of Ravi Tandan

Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Goods Sold on H.P. A/c (Note 1)	9,24,000	31.12.2017	By Goods Sold on H.P. A/c	
31.12.2017	To Stock Reserve A/c (Note 4)	2,52,000		(Loading — Note 2)	3,96,000
31.12.2017	To Profit and Loss A/c	1,44,000	31.12.2017	By Bank A/c (Note 3)	3,36,000
			31.12.2017	By Balance c/d :	
				Hire Purchase Stock (Note 5)	5,88,000
		13,20,000			13,20,000

Dr. **Profit and Loss Account for the year ended 31st December, 2017** **Cr.**

Particulars		₹	Particulars	₹
To Expenses	19,800		By HP Trading A/c	1,44,000
Add: Outstanding	4,600	24,400		
To Bank Interest		10,860		
To Net Profit		1,08,740		
		1,44,000		1,44,000

Balance Sheet of Ravi Tandan as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital :			Closing Stock :		
Introduced	1,00,000		VCs — 50 @ ₹ 960 each		48,000
Add: Net Profit	1,08,740		EPs — 50 @ ₹ 1,440 each		72,000
	2,08,740		HP Stock :		
Less: Drawings	35,000	1,73,740	VCs	2,10,000	
Creditors (VCs — 50 @ ₹ 960 each)		48,000	Less: Stock Reserve	90,000	1,20,000
Outstanding Expenses		4,600	EPs	3,78,000	
Bank Overdraft		2,29,660	Less: Stock Reserve	1,62,000	2,16,000
		4,56,000			4,56,000

Working Notes :

	₹
(1) Goods Sold on Hire Purchase	
250 Vacuum Cleaners @ ₹ 1,680 each	4,20,000
200 Electric Polishers @ ₹ 2,520 each	5,04,00
	9,24,000
(2) Loading on Goods Sold	
250 Vacuum Cleaner × (₹ 1,680 – ₹ 960)	1,80,000
200 Electric Polishers × (₹ 2,520 – ₹ 1,440)	2,16,000
	3,96,000
(3) Instalment Received	
250 Vacuum Cleaners @ ₹ 840 each	2,10,000
200 Electric Polishers @ ₹ 630 each	1,26,000
	3,36,000
(4) Loading on Closing Balances of H P Stock	
On Vacuum Cleaner = ₹ 1,80,000 / ₹ 4,20,000 × ₹ 2,10,000	90,000
On Electric Polisher = ₹ 2,16,000 / ₹ 5,04,000 × ₹ 3,78,000	1,62,000
	2,52,000
(5) Hire Purchase Stock = H.P. Sales – Instalments Received	
Vacuum Cleaner = ₹ 4,20,000 – ₹ 2,10,000	2,10,000
Electric Polisher = ₹ 5,04,000 – ₹ 1,26,000	3,78,000
	5,88,000

Illustration 47

Krishna Agencies started business on 1.4.1994. During the year ended 31.3.1995, they sold undermentioned durables under two schemes — Cash Price Scheme (CPS) and Hire Purchase Scheme (HPS).

Under the CPS they priced the goods at cost plus 25% and collected it on delivery.

Under the HPS the buyers were required to sign a Hire Purchase Agreement undertaking to pay for the value of the goods including finance charges in 30 instalments, the value being calculated at cash price plus 50%.

The following are the details available at the end of 31.3.1995 with regard to the products :

Product	Numbers Purchased	Numbers Sold under CPS	Numbers sold under HPS	Cost per Unit (₹)	Number of Instalments due during the year	Number of instalments received during the year
TV sets	90	20	60	16,000	1,080	1,000
Washing Machines	70	20	40	12,000	840	800

The following were the expenses during the year :

Rent ₹ 1,20,000; Salaries ₹ 1,44,000; Commission to salesmen ₹ 12,000; Office expenses ₹ 1,20,000.

From the above information, you are required to prepare :

(a) Hire Purchase Trading Account; (b) Trading and Profit and Loss Account. ***[C.A. Inter — May 1995]***

Solution

In the books of Krishna Agencies

Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.1995	To Goods Sold on HP A/c (Note 2)	27,00,000	31.3.1995	By Goods Sold on HP A/c (Loading — Note 3)	12,60,000
31.3.1995	To Stock Reserve A/c (Note 8)	4,62,000	?	By Bank A/c (Note 5)	16,00,000
31.3.1995	To Profit and Loss A/c	7,98,000	31.3.1995	By Balance c/d :	
				HP Stock (Note 6)	9,90,000
				HP Debtors (Note 7)	1,10,000
		39,60,000			39,60,000

Dr. **Trading and Profit and Loss Account for the year ended 31st March, 1995** **Cr.**

Particulars		₹	Particulars		₹
To Purchases :			By Sales (CPS) :		
TV Sets (90 x ₹ 16,000)	14,40,000		TV Sets (20 x ₹ 20,000)	4,00,000	
Less: Cost of TV sold on HP	9,60,000	4,80,000	Washing Machines (20 x ₹ 15,000)	3,00,000	7,00,000

Washing Machines (70 x ₹ 12,000)	8,40,000		By Closing Stock :		
Less: Cost of Washing Machine sold	4,80,000		TV Sets (Note 9)	1,60,000	
on HP (40 x ₹ 12,000)		3,60,000	Washing Machine (Note 9)	1,20,000	2,80,000
To Gross Profit c/d		1,40,000			
		9,80,000			9,80,000
To Salaries		1,44,000	By Gross Profit b/d		1,40,000
To Rent		1,20,000	By HP Trading A/c		7,98,000
To Commission to Salesmen		12,000			
To Office Expenses		1,20,000			
To Net Profit		5,42,000			
		9,38,000			9,38,000

Working Notes : **(1) Calculation of Cash Price and Hire Purchase Price per Unit**

Product	Cost per Unit (₹)	Cash Price per Unit (₹)	Hire Purchase Price per Unit (₹)
TV Sets	16,000	16,000 x 125% = ₹ 20,000	20,000 x 150% = 30,000
Washing Machines	12,000	12,000 x 125% = 15,000	15,000 x 150% = 22,500

(2) Calculation of H.P. Sales

	₹
T.V. Sets : ₹ 30,000 × 60	18,00,000
Washing Machines : ₹ 22,500 × 40	9,00,000
	27,00,000

(3) Loading on Goods Sold on Hire Purchase

	₹
T.V. Sets : (₹ 30,000 – ₹ 16,000) = ₹ 14,000 × 60	8,40,000
Washing Machines (₹ 22,500 – ₹ 12,000) = ₹ 10,500 × 40	4,20,000
	12,60,000

(4) Calculation of Amount of Each Instalment

$$Instalment\ Amount = \frac{Hire\ Purchase\ Price}{Number\ of\ Instalments}.$$ T.V. Set = ₹ 30,000 / 30 = 1,000. Washing Machines = ₹ 22,500 / 30 = 750

(5) Instalments Received

	₹
T.V. Sets = 1,000 × ₹ 1,000	10,00,000
Washing Machines = 800 × ₹ 750	6,00,000
	16,00,000

(6) Calculation of Hire Purchase Stock on 31st March, 2005

Product	Total Number of Instalments	Number of Instalments Due during the year	Instalments Not Yet Due	Amount (₹)
TV Sets	1,800	1,080	1,800 – 1,080 = 720	720 x ₹ 1,000 = 7,20,000
Washing Machines	1,200	840	1,200 – 840 = 360	360 x ₹ 750 = 2,70,000
				9,90,000

(7) Calculation of Hire Purchase Debtors on 31st March, 2005

Product	Instalments Due during the year	Instalments Paid during the year	Instalments Due but not paid during the year	Amount (₹)
TV Sets	1,080	1,000	80	80 x ₹ 1,000 = 80,000
Washing Machines	840	800	40	40 x ₹ 750 = 30,000
				1,10,000

(8) Calculation of Stock Reserve

$$Stock\ Reserve = \frac{Loading\ per\ Unit}{Number\ of\ instalment\ per\ unit} \times Number\ of\ instalments\ not\ yet\ due$$

T.V. Sets = $\frac{14{,}000\ \text{(Note 3)}}{30} \times 720$ (Note 6) — ₹ 3,36,000

Washing Machines = $\frac{\text{Rs } 10{,}500\ \text{(Note 3)}}{30} \times 360$ (Note 6) — ₹ 1,26,000

₹ 4,62,000

Alternatively,

If cost is ₹ 100, selling price is ₹ 100 × 125% × 150% = ₹ 187.50

Therefore, profit is ₹ 87.50 or 87.5% on cost.

T.V. sets = ₹ 7,20,000 / 187.50 × 87.50 = ₹ 3,36,000. Washing machines = ₹ 2,70,000 / 187.50 × 87.50 = ₹ 1,26,000.

(9) Value of Closing Stock at Shop on 31st March, 2005

Product	Number of Units Purchased	Number of Units Sold	Stock (Nos.)	Cost per Unit (₹)	Value (₹)
TV Sets	90	80	10	16,000	1,60,000
Washing Machines	70	60	10	12,000	1,20,000
					2,80,000

Repossession

When goods are repossessed for default in payment, ***the number of instalments due but not yet received*** on the goods are not recoverable. The amounts of these instalments in respect to the repossessed goods are transferred from the Memorandum ***Hire Purchase Debtors Account to the Goods Repossessed Account*** by debiting the latter and crediting the former in the Memorandum Hire Purchase Ledger.

In the General Ledger, Goods Repossessed Account is debited and Hire Purchase Trading Account is credited with the instalments due but not yet received. If the selling price / market price of the goods repossessed is less than the instalments due but not paid, it represents a loss on repossession and is transferred to the Hire Purchase Trading Account by debiting the Hire Purchase Trading Account and crediting the Goods Repossessed Account. Likewise, if the selling price / market price of the goods repossessed is more than the instalments due but not paid, it represents a profit and it is credited to the Hire Purchase Trading Account.

The following are the Journal Entries for repossession :

(1) When the goods are repossessed

Goods Repossessed Account Dr. [Instalments due but not yet paid]

  To Hire Purchase Trading Account

(2) When there is a loss on repossession

[Selling price / market price is ***less*** than Instalments due but not yet paid]

Hire Purchase Trading Account Dr.

  To Loss on Repossession Account

(3) When there is a profit on repossession

[Selling price / market price is ***greater*** than Instalments due but not yet paid]

Profit on Repossession Account Dr.

  To Hire Purchase Trading Account

Illustration 48

Amar & Co. has a hire purchase department and goods are sold on hire purchase at cost plus 60%. From the following information, prepare the Hire Purchase Trading Account to ascertain the profit or loss made in the hire purchase department. Show your workings clearly.

Particulars	₹	Particulars	₹
Jan.1, 2017		Cash received during the year	56,000
Hire Purchase Stock (at H.P. price)	16,000	Goods received back from customers (instalment due ₹ 2,000) valued at	300
Dec. 31, 2017		Goods with H.P. customers at H.P. price	36,000
Goods sold on H.P. during the year	80,000	Instalments due but not yet received	2,000

Solution

In the books of Amar & Co.

Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Cash A/c	56,000
	Hire Purchase Stock	16,000	31.12.2017	By Stock Reserve A/c (Note 1)	6,000

31.12.2017	To Goods Sold on H.P. A/c	80,000		By Goods Sold on H.P. A/c (Note 2)	30,000
31.12.2017	To Loss on Goods Repossessed A/c (Note 6)	1,700		By Goods Repossessed A/c (Note 6)	2,000
31.12.2017	To Stock Reserve A/c (Note 3)	13,500		By Hire Purchase Stock (Note 3)	36,000
31.12.2017	To Profit & Loss A/c	20,800		By Hire Purchase Debtors (Note 4)	2,000
		1,32,000			1,32,000

Working Notes:

(1) Loading on opening balance of goods with customers = 60/160 x ₹ 16,000 = ₹ 6,000.

(2) Loading on goods sold on hire purchase = 60/160 x ₹ 80,000 = ₹ 30,000.

(3) Loading on closing balance of goods with customers = 60/160 x ₹ 36,000 = ₹ 13,500.

(4) Closing balance of instalment due (H.P. Debtors) can be verified by preparing the following accounts:

Dr. Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Hire Purchase Stock A/c (Note 5)	60,000	By Cash A/c	56,000
		By Goods Repossessed A/c	2,000
		By Balance c/d	2,000
	60,000		60,000

Dr. (5) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	16,000	By Hire Purchase Debtors A/c (Balancing figure)	60,000
To Goods sold on H.P. A/c (given)	80,000	By Balance c/d (given)	36,000
	96,000		96,000

(6) Instalment due on repossessed goods is ₹ 2,000. It has been valued at ₹ 300. Therefore, loss on repossession = ₹ 2,000 – ₹ 300 = ₹ 1,700. Alternatively, only ₹ 300 (realisable value of goods repossessed can be credited to H.P. Trading Account).

Illustration 49

Following are the particulars from the books of a trader who sells goods of small value on the hire purchase system at 50% profit on cost. Prepare the Hire Purchase Trading Account for the year ending December 31, 2017:

Particulars	₹	Particulars	₹
January 1 :		Goods repossessed (instalment due ₹ 8,000) valued at	
Stock with the customers	27,000	₹ 1,500 which has been included in the stock at the end	
Stock in the shop	54,000	at ₹ 1,500	
Instalments due	15,000	Cash received from customers	1,80,000
December 31 :		Goods purchased during the year	1,80,000
Stock in the shop	61,500		
Instalments due	27,000		

Solution

In the books of a Trader

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Cash A/c	1,80,000
	Stock with customers	27,000	31.12.2017	By Stock Reserve A/c (Note 4)	9,000
	Instalments due	15,000	31.12.2017	By Goods Repossessed A/c (Note 6)	8,000
31.12.2017	To Goods sold on H.P. A/c (Note 2)	2,61,000	31.12.2017	By Goods Sold on H.P. A/c (Loading)	87,000
	To Loss on Goods Repossessed A/c (Note 6)	6,500	31.12.2017	By Balance c/d :	
31.12.2017	To Stock Reserve A/c (Note 5)	29,333		Stock with Customers (Note 2)	88,000
31.12.2017	To Profit & Loss A/c	60,167		Instalments due	27,000
		3,99,000			3,99,000

Working Notes :

Dr. (1) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (cost)	54,000	By Goods sold on H.P. A/c (at cost) (Balancing figure)	1,74,000
To Purchases A/c	1,80,000	By Balance c/d (₹ 61,500 – ₹ 1,500)	60,000
	2,34,000		2,34,000

Dr. **(2) Memorandum H.P. Stock Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	27,000	By Hire Purchase Debtors A/c	2,00,000
To Goods sold on H.P. (at H.P. price) (₹ 1,74,000 x 150/100)	2,61,000	By Balance c/d	88,000
	2,88,000		2,88,000

Dr. **(3) Memorandum H.P. Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	15,000	By Cash A/c	1,80,000
To H.P. Stock A/c (Balancing figure)	2,00,000	By Goods Repossessed A/c	8,000
		By Balance c/d	27,000
	2,15,000		2,15,000

(4) Loading on opening stock with customers. It is given that loading is 50% of cost. It means, loading is 1/3 of hire purchase price. Total loading = 1/3 of ₹ 27,000 = ₹ 9,000.

(5) Loading on closing stock with customers. 1/3 of ₹ 88,000 = ₹ 29,333.

(6) Instalments due on repossessed goods is ₹ 8,000. It has been valued at ₹ 1,500. Therefore, loss on repossession is ₹ 8,000 – ₹ 1,500 = ₹ 6,500.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 50

Bablu Limited selling a popular product in H.P. system and had the following balances on dates mentioned below :

2015		(₹)
Jan. 1	Stocks out on hire at H.P. price	6,000
	Stocks in hand at shop	750
	Instalment due (customer still paying)	450
Dec. 31	Stocks out on hire at H.P. price	6,900
	Stocks in hand at shop	1,050
	Instalment due (customer still paying)	750

Prepare H.P. Trading Account for the year ended on 31.12.2015 if cash of ₹ 12,000 is received during this year by way of instalments and gross profit is reckoned at 25% on selling price. ***[C.U.B.Com. (General) — 2016, 2013]***

Solution

In the books of Bablu Limited

Dr. **Hire Purchase Trading Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d :		31.12.2015	By Cash A/c	12,000
	Stock out with Customers	6,000		By Stock Reserve A/c (Note 1)	1,500
	H.P. Debtors	450		By Goods Sold on Hire Purchase A/c (Note 2)	3,300
31.12.2015	To Goods Sold on Hire Purchase A/c (Note 5)	13,200		By Balance c/d :	
	To Stock Reserve A/c (Note 3)	1,725		Stock out with Customers	6,900
	To Profit and Loss A/c	3,075		H.P. Debtors	750
		24,450			24,450

Working Notes :

(1) Loading on Stock out on hire purchase (opening balance) = 6,000 × 25% = ₹ **1,500**.

(2) Loading on Goods Sold on hire purchase = 13,200 × 25% = ₹ **3,300**.

(3) Loading on Stock out on hire purchase (closing balance) = 6,900 × 25% = ₹ **1,725**.

Dr. (4) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	450	By Cash A/c	12,000
To Stock with Customers A/c (Balancing figure)	12,300	By Balance c/d	750
	12,750		12,750

Dr. (5) Memorandum Stock Out with Customers Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By H.P. Debtors (Note 4)	12,300
To Goods Sold on H.P. A/c (Balancing figure)	13,200	By Balance c/d	6,900
	19,200		19,200

Illustration 51

Following are the balances of F & G Ltd. who sold a special thing under H.P. System :

		(₹)
2013		
April 1	Stock out on hire at H.P. price	30,000
	Stock in hand (at the shop)	5,000
	Instalment due (customer still paying)	3,300
2014		
Mar 31	Stock out on hire at H.P. price	20,000
	Stock in hand (at the shop)	7,000
	Instalment due (customer still paying)	3,600

Prepare H.P. Trading Account in the books of F & G Ltd for the year ending 31.03.2014, if cash of ₹ 35,000 is receivd in the year by way of instalments and gross profit rate is $33^1/_3$% of selling price. ***[C.U.B.Com. (General) — 2014]***

Solution

In the books of F & G Ltd.

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Balance b/d :			By Cash A/c	35,000
	Stock Out with Customers	30,000		By Stock Reserve A/c (1/3 of ₹ 30,000)	10,000
	H.P. Debtors	3,300		By Goods Sold on H.P. A/c	8,433
	To Goods Sold on H.P. A/c (Note 2)	25,300		By Balance c/d :	
	To Stock Reserve A/c (Note)	6,667		Stock Out with Customers	20,000
	To Profit and Loss A/c	11,766		H.P. Debtors	3,600
		77,033			77,033

Dr. (1) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,300	By Cash A/c	35,000
To Stock Out with Customers A/c	35,300	By Balance c/d	3,600
	38,600		38,600

Dr. (2) Memorandum Stock Out with Customers Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	30,000	By H. P. Debtors A/c	35,300
To Goods Sold on H.P. A/c	25,300	By Balance c/d	20,000
	55,300		55,300

Dr. (3) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,000	By Goods Sold on H.P. A/c (at cost) $\frac{2}{3} \times 25,300$	16,867
To Purchases A/c	18,867	By Balance c/d	7,000
	23,867		23,867

[For Honours Candidates Only]

Illustration 52

A company sells goods on hire purchase system making profit @ $33^1/_3$% on sales. From the following particulars, prepare Hire Purchase Trading Account for the year ended 31.03.2016 :

	(₹)
2015, April 1 :	
Shop stock	90,000
Stock with customers at H.P. price	45,000
Instalment overdue	25,000
2016, March 31 :	
Shop stock (excluding repossessed stock)	1,00,000
Instalment overdue	45,000
Stock with customers at H.P. price	?
During the year :	
Cash received from customers	3,00,000
Goods purchased during the year	3,00,000
Goods repossessed (instalments due ₹ 10,000) as valued at ₹ 2,500	

[C.U.B.Com. (Hons.) — 2017]

Solution

In the books of ...

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d :		31.3.2016	By Cash A/c	3,00,000
	Stock with Customers at H.P. price	45,000		By Stock Reserve A/c (Note 4)	15,000
	Instalment Overdue	25,000		By Goods Repossessed A/c	10,000
	To Goods Sold on H.P. A/c (Note 2)	4,35,000		By Goods Sold on H.P. A/c Note 5)	1,45,000
	To Loss on Goods Repossessed A/c (Note 7)	7,500		By Balance c/d :	
	To Stock Reserve A/c Note 6)	50,000		Stock with Customers (Note 2)	1,50,000
	To Profit and Loss A/c	1,02,500		Instalment Overdue	45,000
		6,65,000			6,65,000

Working Notes :

Dr. (1) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (Given)	90,000	By Goods Sold on H.P. A/c (Cost Price) (Bal. figure)	2,90,000
To Purchases (Stock) (Given)	3,00,000	By Balance c/d (Given)	1,00,000
	3,90,000		3,90,000

Dr. (2) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	45,000	By H.P. Debtors A/c	3,30,000
To Goods Sold on H.P. A/c $2,90,000 \times \frac{3}{2}$	4,35,000	By Balance c/d (Balancing figure)	1,50,000
	4,80,000		4,80,000

(4) Loading on Opening Stock with Customers :

It is given that loading is $33^1/_3$% on Sales. ∴ Loading = $45,000 \times \frac{1}{3}$ = ₹ **15,000**.

(5) Loading on Goods Sold on H.P. : Loading = $4,35,000 \times \frac{1}{3}$ = ₹ **1,45,000**.

(6) Loading on Closing Stock with Customers : Loading = $1,50,000 \times \frac{1}{3}$ = ₹ **50,000**.

(7) Loss on Repossession = ₹ 10,000 – 2,500 = ₹ **7,500**.

Dr. (8) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	25,000	By Cash A/c (Given)	3,00,000
To Hire Purchase Stock A/c (Balancing figure)	3,30,000	By Goods Repossessed A/c (Given)	10,000
		By Balance c/d	45,000
	3,55,000		3,55,000

Illustration 53

M/s. H.P. Trader sells goods on hire purchase basis at cost plus 50%. From the following information, prepare Hire Purchase Trading Account for the year ending on 31.3.2014 :

		(₹)
2013		
April 1	Stock with customers (at H.P. price)	90,000
	Stock at shop (at cost)	1,80,000
	Instalments due but not yet received	50,000
During the year :		
	Purchases	6,00,000
	Cash received from customers	6,00,000
	Goods re-possessed (against instalments due ₹ 20,000)	5,000
2014		
Mar 31	Stock with customers (at H.P. price)	3,00,000
	Stock at (excluding repossessed goods)	2,00,000
	Instalments due but not yet received	90,000

[C.U.B.Com. (Hons.) — 2015]

Solution

In the books of H.P. Traders

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Balance b/d :		31.3.2014	By Cash A/c	6,00,000
	Stock with Customers (at HP price)	90,000	"	By Stock Reserve A/c (Note 4)	30,000
	Instalments overdue	50,000	"	By Goods Repossessed A/c	20,000
31.3.2014	To Goods Sold on HP A/c (Note 2)	8,70,000	"	By Goods Sold on HP A/c (Loading)	2,90,000
"	To Loss on Goods Repossessed A/c (Note 6)	15,000	"	By Balance c/d :	
"	To Stock Reserve A/c (Note 5)	1,00,000		Stock with Customers	3,00,000
"	To Profit and Loss A/c	2,05,000		Instalments overdue	90,000
		13,30,000			13,30,000

Working Notes :

Dr. (1) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (at cost)	1,80,000	By Goods Sold on HP (cost price)	5,80,000
To Purchases	6,00,000	By Balance c/d	2,00,000
	7,80,000		7,80,000

Dr. (2) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By HP Debtors A/c (Note 3)	6,60,000
To Goods Sold on HP A/c (Balancing figure)	8,70,000	By Balance c/d	3,00,000
	9,60,000		9,60,000

Dr. (3) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	50,000	By Cash (given)	6,00,000
To HP Stock A/c (Instalments falling due during the year)	6,60,000	By Goods Repossessed A/c (given)	20,000
		By Balance c/d (given)	90,000
	7,10,000		7,10,000

(4) Loading on Opening Stock with Customers : It is given that loading is 50% of cost. It means, loading is 1/3 of the hire purchase price. Total loading = 1/3 of ₹ 90,000 = ₹ 30,000.

(5) Loading on Closing Stock with Customers : 1/3 of ₹ 3,00,000 = ₹ 1,00,000.

(6) Instalments due on repossessed goods is ₹ 20,000. It has been valued at ₹ 5,000. Therefore, loss on repossession is ₹ 15,000.

Illustration 54

Khosla Bros., which sells products on hire purchase system, has the following balance on dates mentioned below :

		(₹)
2012		
Jan 1	Stock out on hire at hire purchase prices	12,000
	Stock at shop	1,500
	Instalments overdue	900

Dec 31	Stock out on hire at hire purchase prices	13,800
	Stock at shop	2,100
	Instalments overdue	1,500

Prepare the H.P. Trading Account for the year ending on 31.12.2012, if cash of ₹ 24,000 is received during the year by way of instalments and gross profit is reckoned at 25% on selling price.

[C.U.B.Com. (Hons.) — 2013]

Solution

In the books of Khosla Bros.
Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Balance b/d :		31.12.2012	By Cash A/c	24,000
	Stock Out on Hire at H.P. Price	12,000		By Stock Reserve A/c (Note 1)	3,000
	H.P. Debtors (Instalments over due)	900		By Goods Sold on Hire Purchase A/c	
	To Goods Sold on Hire Purchase A/c			(Note 2)	6,600
	(Note 5)	26,400		By Balance c/d :	
	To Stock Reserve A/c	3,450		Stock Out on Hire Purchase	13,800
	To Profit and Loss A/c	6,150		H.P. Debtors (Instalment overdue)	1,500
		48,900			48,900

Working Notes :

(1) Loading on Stock Out on Hire Purchase (Opening Balance) = 12,000 × 25% = ₹ **3,000**.

(2) Loading on Stock Out on Hire Purchase = 26,400 × 25% = ₹ **6,600**.

(3) Loading on Stock Out on Hire Purchase (Closing Balance) = 13,800 × 25% = ₹ **3,450**.

Dr. **(4) Memorandum Hire Purchase Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	900	By Cash A/c	24,000
To Stock Out on Hire Purchase A/c (Balancing figure)	24,600	By Balance c/d	1,500
	25,500		25,500

Dr. **(5) Memorandum Stock Out on Hire Purchase Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By H.P. Debtors A/c (Note 4)	24,600
To Goods Sold on Hire Purchase A/c (Balancing figure)	26,400	By Balance c/d	13,800
	38,400		38,400

Special Problems

Illustration 55

Rajesh Kumar is in business selling electric irons of one standard type on hire purchase terms which he buys for ₹ 600 each and sells for a total hire purchase price of ₹ 800 each — ₹ 160 payable on deposit and the balance by 8 monthly instalments of ₹ 80. His Balance Sheet on 1.1.2017 was as follows :

Liabilities	₹	Assets		₹
Capital	6,00,000	Fixed Assets		1,73,000
Creditors	71,000	Stock (200 @ ₹ 600 each)		1,20,000
		Hire Purchase Stock	4,35,200	
		Less: Provision for unrealised profit	1,08,800	3,26,400
		Bank		51,600
	6,71,000			6,71,000

During the year ended 31.12.2017, Rajesh purchased a further 950 irons at ₹ 600 each and sold 1,010 all on hire purchase terms. Cash receipts amounted to ₹ 5,69,600.

In December 2017, Rajesh repossessed 10 irons sold during the year on which customers had paid ₹ 3,200. These were brought into stock at 31.12.2017 at a valuation of ₹ 520 each.

Other incidental expenses for the year amounted to ₹ 74,000. Apart from the repossessions, all instalments were received on the due dates. Rajesh prepares his accounts on the basis of taking profits (including interest) in proportion to cash collected from debtors.

You are required to prepare Hire Purchase Trading for the year ended 31.12.2017.

Solution

In the books of Rajesh Kumar

Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Cash A/c	5,69,600
	Hire Purchase Stock	4,35,200	"	By Provision for Unrealised Profit	1,08,800
31.12.2017	To Goods Sold on HP A/c	8,08,000	"	By Goods Sold on HP A/c (Loading)	2,02,000
"	To Provision for Unrealised Profit (Note 5)	1,67,200	"	By Goods Repossessed A/c	4,800
"	To Incidental Expenses	74,000	"	By Profit on Goods Repossessed A/c (3)	400
"	To Profit and Loss A/c	70,000	"	By Balance c/d :	
				Hire Purchase Stock	6,68,800
		15,54,400			15,54,400

Working Notes :

(1) Memorandum Hire Purchase Stock Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/f	4,35,200	By HP Debtors A/c	5,74,400
To Goods Sold on HP A/c (at HP Price) (₹ 800 x 1,010)	8,08,000	By Balance c/d	6,68,800
	12,43,200		12,43,200

(2) Memorandum Hire Purchase Debtors Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To HP Stock A/c (Balancing figure)	5,74,400	By Cash A/c	5,69,600
		By Goods Repossessed A/c (Instalments due but not paid)	4,800
	5,74,400		5,74,400

(3) Goods Repossessed Account

Cr.

Particulars	₹	Particulars	₹
To HP Debtors A/c (Note 4)	4,800	By Balance c/d (₹ 520 x 10)	5,200
To Profit on Repossession	400		
	5,200		5,200

(4) Total number of instalments of irons repossessed = 10 × 8	80
Less: Instalments paid (10 × 2*)	20
Instalments due but not paid	60

Amount of instalments not paid = 60 × ₹ 80 = ₹ **4,800.**

* Total amount paid by the customers in respect of 10 repossessed irons = ₹ 3,200, i.e., ₹ 320 per iron. Out of ₹ 320, ₹ 160 is deposit and ₹160 will be treated as instalments paid, i.e., 2 instalments of ₹ 80 each.

(5) Loading on closing stock = 200 / 800 × ₹ 6,68,800 = ₹ 1,67,200.

Illustration 56

Deeyen Enterprises commenced business on January 1, 2017. During the year, the following sales were made under hire purchase arrangements:

Article	Cost ₹	Sale Price ₹	Initial Amount Paid ₹	Monthly Instalments	No. of Instalments paid in the year 2018
Radio	600	900	100	20 of ₹ 40	8
Washing Machine	800	1,200	120	12 of ₹ 90	2
Record Players	700	1,000	100	18 of ₹ 50	4

After four instalments had been paid for the record player it was returned on December 28, 2017.

Prepare: (i) the Hire Purchase Trading Account; and, (ii) the Memorandum Hire Purchase Debtors' Account for the year ending December 31, 2017.

Note: The value of goods returned may be taken at cost equivalent.

Solution

In the books of Deeyen Enterprise
Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Goods Sold on H.P. A/c (Note 1)	3,100	31.12.2017	By Goods sold on H.P. A/c (Note 5)	1,000
31.12.2017	To Loss on Goods Repossessed A/c (Note 9)	210	31.12.2017	By Cash A/c (Note 6)	1,020
31.12.2017	To Stock Reserve A/c (Note 8)	460		By Goods Repossessed A/c (Note 9)	700
31.12.2017	To Profit & Loss A/c	330		By Balance c/d :	
				Hire Purchase Stock (Note 7)	1,380
		4,100			4,100

Dr. **Memorandum Hire Purchase Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Goods Sold on H.P. A/c	3,100	By Cash A/c	1,020
		By Goods Repossessed A/c	700
		By Balance c/d	1,380
	3,100		3,100

Working Notes:

(1) Hire purchase sales = ₹ 900 + ₹ 1,200 + ₹ 1,000 = ₹ 3,100.
(2) Profit on radio = ₹ 900 – ₹ 600 = ₹ 300. Therefore, profit included in sales = ₹ 300 / ₹ 900 = 1/3.
(3) Profit on washing machine = ₹ 1,200 – ₹ 800 = ₹ 400. Therefore, profit included in sales = ₹ 400 / ₹ 1,200 = 1/3.
(4) Profit on record player = ₹ 1,000 – ₹ 700 = ₹ 300. Therefore, profit included in sales = ₹ 300 / ₹ 1,000 = 3/10.
(5) Total profit = ₹ 300 + ₹ 400 + ₹ 300 = ₹ 1,000.

(6) Cash Received		₹	**(7) Instalments not yet due**	₹
Radio : Cash down	100		Radio (20 – 8) x ₹ 40	480
Instalments (8 x ₹ 40)	320	420	W.M. (12 – 2) x ₹ 90	900
W.M. : Cash down	120			1,380
Instalments (2 x ₹ 90)	180	300	**(8) Stock Reserve**	₹
R.P. : Cash down	100		Radio : 1/3 of ₹ 480	160
Instalments (4 x ₹ 50)	200	300	W.M. 1/3 of ₹ 900	300
		1,020		460

(9) Instalments due on repossessed goods = (18 – 4) x ₹ 50 = ₹ 700. It has been valued at cost (₹ 700 less profit 3/10 = ₹ 210) = ₹ 490. Therefore, loss on repossession = ₹ (700 – 490) = ₹ 210. Alternatively, only ₹ 490 can be credited to H.P. Trading Account.

Illustration 57

Delhi Traders commences business in 2016 selling goods on hire-purchase basis on the following terms:

Cost	**Selling Price**	**Deposit Payable**	**Instalments Payable**
₹ 2,000	₹ 3,000	20%	12 Monthly

Monthly instalments are payable on the last date of the month in which the sales take places.

Other details are:

Sales	2016 — 300 Nos.	2017 — 600 Nos.
Instalment Received	2016 — ₹ 3,75,000	2017 — ₹ 10,70,000

Sales take place evenly throughout the year. In 2017, 40 items sold in 2017 on which a total of 300 instalments had been received, were repossessed.

You are required to prepare the Hire Purchase Trading Account for both the years in the books of Delhi Traders.

Solution

In the books of Delhi Traders
Hire Purchase Trading Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Goods Sold on H.P. A/c (Note 1)	9,00,000	31.12.2016	By Goods on H.P. A/c (Note 2)	3,00,000
31.12.2016	To Stock Reserve A/c (1/3 of ₹ 3,30,000)	1,10,000	"	By Cash A/c (Note 4)	5,55,000
31.12.2016	To Profit & Loss A/c	1,90,000	"	By Balance c/d :	
				Hire Purchase Stock	3,30,000
				Instalment due (₹ 3,90,000-₹ 3,75,000)	15,000
		12,00,000			12,00,000

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d :		31.12.2017	By Stock ReserveA/c	1,10,000
	Hire Purchase Stock	3,30,000	"	By Goods Sold on H.P.A/c (Note 7)	6,00,000
	Instalments due	15,000	"	By Cash A/c (Note 9)	14,30,000
31.12.2017	To Goods Sold on H.P. A/c	18,00,000	"	By Goods Repossessed A/c (Note 11)	36,000
"	To Loss on Repossession A/c (Note 11)	12,000	"	By Balance c/d :	
"	To Stock Reserve A/c	2,20,000		Hire Purchase stock (Note 10)	6,60,000
"	To Profit & Loss A/c	4,78,000		Instalements due (Note 8)	19,000
		28,55,000			28,55,000

Working Notes:
Details of sales in 2017

(1) Hire purchase sales = 300 x ₹ 3,000 = ₹ 9,00,000

(2) Cost of goods sold = 300 x ₹ 2,000 = ₹ 6,00,000

Profit = ₹ 3,00,000

∴ Profit included in sales = ₹ 3,00,000 / ₹ 9,00,000 = 1/3.

(3) Analysis of Instalments

S.No.	Period	Unit sold	Instalments Due			
			Per Unit in 2016	Total in 2016	Per Unit in 2016 for sale of 2016	Total in 2017
1.	January	25	12	300	—	—
2.	February	25	11	275	1	25
3.	March	25	10	250	2	50
4.	April	25	9	225	3	75
5.	May	25	8	200	4	100
6.	June	25	7	175	5	125
7.	July	25	6	150	6	150
8.	August	25	5	125	7	175
9.	September	25	4	100	8	200
10.	October	25	3	75	9	225
11.	November	25	2	50	10	250
12.	December	25	1	25	11	275
	Total	300		1,950		1,650
	Amount of each instalment			₹ 200		₹ 200
	Total amount			₹ 3,90,000		*₹ 3,30,000

*This is the amount of instalments not yet due in 2017.

(4) Cash received : 300 x ₹ 600 = ₹ 1,80,000 (cash down) + ₹ 3,75,000 (instalments) = ₹ 5,55,000.

(5) Details of sales in 2017 :
Since 2017 sales (600 units) are double the sales of 2016 (300 units), the number of instalments in 2017 and 2016 (in respect of sale of 2017) will also be double respectively of the figures given above for 2016 and 2017.

(6) Hire purchase sale price of goods sold (600 x ₹ 3,000) = ₹ 18,00,000

(7) Profit included in H.P. Sales : 1/3 of ₹ 18,00,000 = ₹ 6,00,000.

(8) Calculation of Instalments Due	₹
For 2017 sales (see table above)	3,30,000
For 2018 sales (2 x 1,950 x ₹ 200)	7,80,000
Instalments due in 2017 but not paid in 2016	15,000
	11,25,000
Less: Instalments due on repossessed set ₹ (480 – 300) x 200	36,000
	10,89,000
Less: Instalment received in 2017	10,70,000
	19,000

(9) Cash received : 600 x ₹ 600 = ₹ 3,60,000 (cash down) + ₹ 10,70,000 (instalments) = ₹ 14,30,000.

(10) Hire purchase stock on 31.12.2017 = 2 x ₹ 1,650 x 200 = ₹ 6,60,000.

(11) Instalment due on repossessed goods = ₹ (480 – 300) x 200 = ₹ 36,000. It has been valued at cost = ₹ 36,000 – ₹ 12,000 (1/3 profit) = ₹ 24,000. Therefore, loss on repossession = ₹ 36,000 – ₹ 24,000 = ₹ 12,000.

Stock and Debtors System

The Stock and Debtors System (similar to the system followed in case of Branch Accounts) can also be applied for the ascertainment of profit or loss on goods of small value sold on hire purchase basis. Under this system, the following accounts are opened : (i) Hire Purchase Stock Account; (ii) Hire Purchase Debtors Account; (iii) Goods Sold on Hire Purchase Account; (iv) Goods Repossessed Account; and (v) Hire Purchase Adjustment Account.

Journal Entries in the books of the Hire Vendors

(1) For goods sold on hire purchase

Hire Purchase Stock Account Dr. [H.P. Price]
  To Goods Sold on Hire Purchase Account

(2) For total instalment due during the accounting period

Hire Purchase Debtors Account Dr.
  To Hire Purchase Stock Account

(3) For money received from debtors

Bank / Cash Account Dr.
  To Hire Purchase Debtors Account

(4) For goods repossessed

Goods Repossessed Account Dr. [Unpaid instalments]
  To Hire Purchase Stock Account

(5) For loading on goods sold on hire purchase

Goods Sold on Hire Purchase Account Dr.
  To Hire Purchase Adjustment Account

(6) For loading on opening hire purchase stock

Stock Reserve Account Dr.
  To Hire Purchase Adjustment Account

(7) For loading on closing hire purchase stock

Hire Purchase Adjustment Account Dr.
  To Stock Reserve Account

(8) For loss on goods repossessed

Hire Purchase Adjustment Account Dr. [Difference between instalments unpaid and
  To Goods Repossessed Account market value of goods repossessed or loading only.]

(The above entry will be reversed when there is a profit.)

(9) For expenses incurred on hire purchase business

Hire Purchase Adjustment Account Dr.
  To Bank /Cash Account

(10) When profit on hire purchase is transferred to Profit and Loss Account

Hire Purchase Adjustment Account Dr.
  To Profit and Loss Account

(The above entry will be reversed, when there is a loss)

(11) When goods sold on hire purchase account is closed

Goods Sold on Hire Purchase Account Dr.
  To General Trading Account
    or
  To Stock at Shop Account

Illustration 58

Sambhu Bros. sells its product under the hire purchase method. The following information was available as on the dates noted below :

Particulars	1.1.2017 (₹)	31.12.2017 (₹)
Stock out on hire purchase price	90,000	1,03,000
Shop stock balance	11,250	15,750
Instalments due (customers still paying)	6,750	11,250

It is ascertained that cash of ₹ 1,80,000 has been received during the year and gross profit is reckoned at 25% of the selling price.

Prepare : (i) H.P. Trading Account; and (ii) The accounts under Stock and Debtors Method.

Solution (i) **In the books of Sambhu Bros.**

Dr. **Hire Purchase Trading Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d:		31.12.2017	By Cash A/c	1,80,000
	Hire Purchase Stock	90,000	31.12.2017	By Stock Reserve A/c (Note 1)	22,500
	Hire Purchase Debtors	6,750	31.12.2017	By Goods Sold on H. Pur. A/c (Note 2)	49,375
	To Goods Sold on Hire Purchase A/c	1,97,500		By Balance c/d:	
31.12.2017	To Stock Reserve A/c (Note 3)	25,750		Hire Purchase Stock	1,03,000
31.12.2017	To Profit & Loss A/c	46,125		Hire Purchase Debtors	11,250
		3,66,125			3,66,125

Tutorial Note : Students should prepare different accounts of the "Stock and Debtors System" as given below for finding out the relevant figures appearing in the above Hire Purchase Trading Account.

Solution (ii)

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	90,000	?	By Hire Purchase Debtors A/c	1,84,500
?	To Goods Sold on Hire Purchase A/c	1,97,500	31.12.2017	By Balance c/d	1,03,000
		2,87,500			2,87,500

Dr. **Hire Purchase Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	6,750	?	By Cash	1,80,000
?	To Hire Purchase Stock A/c (Bal. figure)	1,84,500	31.12.2017	By Balance c/d	11,250
		1,91,250			1,91,250

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Stock Reserve A/c (Note 3)	25,750	1.1.2017	By Stock Reserve A/c (Note 1)	22,500
31.12.2017	To Profit & Loss A/c	46,125	31.12.2017	By Goods Sold on Hire Purchase A/c (Note 2)	49,375
		71,875			71,875

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	11,250	?	By Goods Sold on Hire Purchase A/c	1,48,125
?	To Purchase A/c (Balancing figure)	1,52,625		(at cost) (3/4 of ₹ 1,97,500)	
			31.12.2017	By Balance c/d	15,750
		1,63,875			1,63,875

Working Notes:

(1) Goods are sold at a profit of 25% on selling price. So, loading is 1/4 of the selling price. Therefore, loading on opening balance of hire purchase stock = 1/4 of ₹ 90,000 = ₹ 22,500

(2) Loading on goods sold on hire purchase = 1/4 of ₹ 1,97,500 = ₹ 49,375.

(3) Loading on closing balance of hire purchase stock = 1/4 of ₹ 1,03,000 = ₹ 25,750.

Illustration 59

Varun sells goods on hire purchase basis also. He fixes the hire purchase price by adding 50% to the cost of the goods with him. The following are the figures relating to his hire purchase business for the year, 2017 :

Particulars	₹	Particulars	₹
Balance of Hire Purchase Stock Account as on 1.1.2017	12,000	Selling price of goods sold on hire purchase basis during the year	90,600
Balance of Hire Purchase Debtors Account as on 1.1.2017	300	Total amount of instalments that fell due during the year	92,700
Cash received from customers during the year	92,400		

A customer to whom goods for ₹ 1,200 had been sold paid only 5 instalments of ₹ 100 each. On his failure to pay the monthly instalment of ₹ 100 due on 4.12.2017, the goods were reprossessed on 27.12.2017 after due legal notice.

Prepare ledger accounts on the Stock-Debtors System for the year ended 31.12.2017.

Solution

In the books of Varun

Dr. Hire Purchase Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	12,000	?	By Hire Purchase Debtors A/c	92,700
?	To Goods Sold on Hire Purchase A/c	90,600	27.12.2017	By Goods Repossessed A/c (Instalments not yet due)	600
			31.12.2017	By Balance c/d	9,300
		1,02,600			1,02,600

Dr. Hire Purchase Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	300	?	By Cash A/c	92,400
?	To Hire Purchase Stock A/c	92,700	27.12.2017	By Goods Repossessed A/c (Instalment due but not paid)	100
			31.12.2017	By Balance c/d	500
		93,000			93,000

Dr. Hire Purchase Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Stock Reserve A/c (Note 3)	3,100	1.1.2017	By Stock Reserve A/c (Note 1)	4,000
31.12.2017	To Profit & Loss A/c	31,200	32.12.2017	By Goods sold on Hire Purchase A/c (Note 2)	30,200
			31.12.2017	By Goods Repossessed A/c (Profit)	100
		34,300			34,300

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
27.12.2017	To Hire Purchase Stock A/c	600	31.12.2017	By Balance c/d (Note 4)	800
27.12.2017	To Hire Purchase Debtors A/c	100			
31.12.2017	To Hire Purchase Adjustment A/c	100			
		800			800

Working Notes:

(1) If cost is ₹ 100, profit is ₹ 50 and hire purchase price is ₹ 100 + ₹ 50 = ₹ 150. Profit on hire purchase price = 50/150 = 1/3. Therefore, loading on opening stock = 1/3 of ₹ 12,000 = ₹ 4,000.

(2) Loading on goods sold on hire purchase = 1/3 of ₹ 90,600 = ₹ 30,200.

(3) Loading on closing balance of hire purchase stock = 1/3 of ₹ 9,300 = ₹ 3,100.

(4) It is assumed that the repossessed goods have been valued at cost i.e., 2/3 of ₹ 1,200 = ₹ 800.

Illustration 60

Furnishers Ltd. supply furnishing on hire-purchase terms at a profit of 50% over the cost. The following are the transactions for the year ending December 31, 2017 :

Particulars	₹	Particulars	₹
Jan. 1 Stock out on hire purchase at cost	20,000	Instalments realised during the year	39,000
Jan. 1 Instalments due (customers still paying)	1,800	Dec. 31 Stock out on hire purchase at cost	16,000
Goods re-possessed during the year (for instalments unpaid ₹ 300) evaluated at	150	Instalments due (customers still paying)	3,000

Prepare the Hire-Purchase Stock Account, Hire-Purchase Debtors' account and the Hire-Purchase Adjustment Account.

Solution

In the books of Furnishers Ltd.

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d (At H.P. price)	30,000	?	By Hire Purchase Debtors A/c	40,500
?	To goods Sold on Hire Purchase A/c	34,500	31.12.2017	By Balance c/d (at H.P. Price)	24,000
		64,500			64,500

Dr. **Hire Purchase Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	1800	?	By Bank A/c	39,000
?	To Hire Purchase Stock A/c	40,500		By Goods Reposs. A/c (Instalment unpaid)	300
			31.12.2017	By Balance c/d	3,000
		42,300			42,300

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Goods Repossessed A/c	150	1.1.2017	By Stock Reserve A/c (Note 1)	10,000
31.12.2017	To Stock Reserve A/c (Note 3)	8,000	?	By Goods Sold on Hire Purchase A/c (Note 2)	11,500
31.12.2017	To Profit & Loss A/c	13,350			
		21,500			21,500

Working Notes:

(1) Goods are sold at a profit of 50% on cost. It means, if cost is ₹ 100 then profit = ₹ 50 and hire purchase price = ₹ 100 + ₹ 50 = ₹ 150. Therefore loading on hire purchase price = 50/150 = 1/3. Loading on opening balance of hire purchase stock = 1/3 of ₹ 30,000 = ₹ 10,000.

(2) Loading on goods sold on hire purchase = 1/3 of ₹ 34,500 = ₹ 11,500.

(3) Loading on closing balance of hire purchase stock = 1/3 of ₹ 24,000 = ₹ 8,000.

Illustration 61

Y Ltd. sells products on hire purchase terms, the price being cost plus $33^{1}/_{3}$%. From the following particulars for 2017, prepare the Hire Purchase Stock Account, the Shop Stock Account, the Hire purchase Debtors Account, the Stock Reserve Account and the Hire Purchase Adjustment account (for profit):

Particulars	₹	Particulars	₹
2017, January, 1		**2017, December, 31**	
Stock out on hire at hire purchase price	1,20,000	Stock out on hire at hire purchase price	1,38,000
Stock in hand, at shop	15,000	Stock in hand at shop	21,000
Instalments due (Customers still paying)	9,000	Instalments due (Customers still paying)	15,000
		Cash received during the year	2,40,000

Solution

In the books of Y Ltd.

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d (At H.P. price)	1,20,000	?	By Hire Purchase Debtors A/c	2,46,000
31.12. .2017	To Goods Sold on Hire Purchase A/c	2,64,000	31.12.2017	By Balance c/d	1,38,000
		3,84,000			3,84,000

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	15,000	?	By Hire Purchase Stock A/c (3/4 of ₹ 2,64,000)	1,98,000
?	To Purchases A/c	2,04,000	31.12.2017	By Balance c/d	21,000
		2,19,000			2,19,000

Dr. **Hire Purchase Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Balance b/d	9,000	?	By Cash A/c	2,40,000
31.12.2017	To Hire Purchase Stock A/c	2,46,000	31.12.2017	By Balance c/d	15,000
		2,55,000			2,55,000

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2017	To Hire Purchase Adjustment A/c	30,000	1.1.2017	By Balance b/d	30,000
31.12.2017	To Balance c/d	34,500	31.12.2017	By Hire Purchase Adjustment A/c	34,500
		64,500			64,500

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Stock Reserve A/c (Note 3)	34,500	1.1.2017	By Stock Reserve A/c (Note 1)	30,000
31.12.2017	To Profit & Loss A/c	61,500	31.12.2017	By Goods Sold on Hire Purchase A/c (Note 2)	66,000
		96,000			96,000

Working Notes:

(1) Goods are sold at a profit of $33^1/_3$% on cost. It means, if the cost is ₹ 100, then profit is ₹ 33.33 and hire purchase price = ₹ 100 + ₹ 33.33 = ₹ 133.33. Therefore, loading on hire purchase price = 33.33/133.33 = 1/4. Loading on opening balance of hire purchase stock = 1/4 of ₹ 1,20,000 = ₹ 30,000.

(2) Loading on goods sold on hire purchase = 1/4 of ₹ 2,64,000 = ₹ 66,000.

(3) Loading on closing balance of hire purchase stock = 1/4 of ₹ 1,38,000 = ₹ 34,500.

Previous Years' C.U. Question Papers (with Solution)

[For Honours Candidates Only]

Illustration 62

Great Eastern Stores which sells products on hire purchase system, has the following balance as on dates mentioned below:

2014		(₹)
April 1	Stock out on hire purcahse at H.P. prices	12,000
	Instalments overdue	900
2015		
Mar 31	Stock out on hire purchase at H.P. prices	13,800
	Instalments overdue	1,500
	Instalments realised during the year	24,000

Prepare Hire Purchase Stock Account, Hire Purchase Debtors Account and Hire Purchase Adjustment Account assuming that gross profit is reckoned at 25% on selling price. ***[C.U.B.Com. (Hons.) — 2016]***

Solution **In the books of Great Eastern Stores**

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d (At H.P. price)	12,000	?	By Hire Purchase Debtors A/c	24,600
31.3.2015	To Goods Sold on Hire Purchase A/c	26,400	31.3.2015	By Balance c/d (at H.P. Price)	13,800
		38,400			38,400

Dr. **Hire Purchase Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	900	?	By Bank A/c	24,000
?	To Hire Purchase Stock A/c	24,600	31.12.2017	By Balance c/d	1,500
		25,500			25,500

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Stock Reserve A/c (Note 3)	3,450	1.4.2014	By Stock Reserve A/c (Note 1)	3,000
"	To Profit & Loss A/c	6,150	?	By Goods Sold on H. P. A/c (Note 2)	6,600
		9,600			9,600

Working Notes:

(1) Goods are sold at a profit of 25% on sales. The loading on opening stock = ₹ 12,000 × 25% = ₹ **3,000**.

(2) Loading on goods sold on hire purchase = 25% of ₹ 26,400 = ₹ **6,600**.

(3) Loading on closing balance of hire purchase stock = 25% of ₹ 13,800 = ₹ **3,450**.

Illustration 63

Credit Ltd. supply goods on hire purchase system at a profit of 50% over the cost. The following are the transactions for the year ending 31st December, 2013 :

Stock out on hire purchase at cost on :	(₹)
1.1.2013	60,000
31.12.2013	48,000
Instalment due (customers are still paying) on :	
1.1.2013	5,400
31.12.2013	9,000
Goods re-possessed during the year (for instalments unpaid ₹ 900) valued at	450
Instalments realised during the year	1,17,000

Prepare the Hire Purchase Stock Account, Hire Purchase Debtors Account and the Hire Purchase Adjustment Account.

[C.U.B.Com. (Hons.) — 2014]

Solution

In the books of Credit Ltd.

Dr. Hire Purchase Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d (Note 1)	90,000	31.12.2013	By Hire Purchase Debtors a/c	1,21,500
31.12.2013	To Goods Sold on Hire Purchase A/c (Balancing figure)	1,03,500	31.12.2013	By Balance c/d (Note 2)	72,000
		1,93,500			1,93,500

Dr. Hire Purchase Debtors' Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	5,400		By Bank A/c	1,17,000
	To Hire Purchase Stock A/c (Balancing figure)	1,21,500		By Goods Repossessed A/c (Instalment unpaid)	900
			31.12.2013	By Balance c/d	9,000
		1,26,900			1,26,900

Dr. Hire Purchase Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Goods Repossessed (Note 4) (Loss on repossession)	450	1.1.2013	By Stock Reserve A/c	30,000
	To Profit and Loss A/c (Balancing figure)	40,050		By Goods Sold on Hire Purchase A/c (Note 3)	34,500
	To Stock Reserve a/c	24,000			
		64,500			64,500

Working Notes :

(1) Hire purchase price = Cost + 50%. Stock out on hire purchase on 1.1.2013 at hire purchase price = ₹ 60,000 + 50% of ₹ 60,000 = ₹ 60,000 + ₹ 30,000 = ₹ 90,000.

(2) Stock out on hire purchase on 31.12.2013 at hire purchase price = ₹ 48,000 + 50% of ₹ 48,000 = ₹ 48,000 + ₹ 24,000 = ₹ 72,000.

(3) Loading on goods sold on hire purchase = 1/3 of ₹ 1,03,500 = ₹ 34,500.

(4) Goods repossessed at ₹ 900 but it has been valued at ₹ 450. Therefore, loss on repossession is ₹ 450.

Special Problems

Illustration 64

Delhi Television House sells goods both on cash and hire purchase basis and records the hire purchase transactions on the Stock and Debtors' system, and closes its books on December 31, every year.

On 1.4.2017, it sold a colour TV set and VCR to Rajan; the other particulars are as follows :

Item	T. V. Set	VCR	Item	T.V. Set	VCR
Cost price	₹ 9,000	₹ 16,000	Amount of each instalment	₹ 1,000	₹ 2,000
Down payment	₹ 2,000	4,000	Mode of payment	*Monthly*	*Bi–monthly*
Numberof instalments payable	10	8	First instalment due on	1.5.2017	1.6.2017

Rajan paid all the instalments due except for those due on 1.12.2017. It was decided that Television House will take back VCR at an agreed price of ₹ 11,000 and excess amount, if any, will be adjusted against the instalment due on TV set.

VCR repossessed was sold for ₹ 12,000 after repair; charges for which amounted to ₹ 500 only. Prepare necessary Ledger Accounts to record the above transactions and find the profits.

Solution

In the books of Television House

Hire Purchase Stock Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
1.4.2017	To Goods Sold on Hire Purchase A/c (Note 1)	32,000	1.1.2017	By Hire Purchase Debtors A/c (Down payment)	6,000
			1.5.2017	By Hire Purchase Debtors A/c (T.V.)	1,000
			1.6.2017	By Hire Purchase Debtors A/c (T.V. — ₹ 1,000 + V.C.R. — ₹ 2,000)	3,000
			1.7.2017	By Hire Purchase Debtors A/c (T.V.)	1,000
			1.8.2017	By Hire Purchase Debtors A/c (T.V. — ₹ 1,000 + V.C.R. — ₹ 2,000)	3,000
			1.9.2017	By Hire Purchase A/c (T.V.)	1,000
			1.10.2017	By Hire Purchase Debtors A/c (T.V. — ₹ 1,000 + V.C.R. — ₹.2,000)	3,000
			1.11.2017	By Hire Purchase Debtors A/c (T.V.)	1,000
			1.12.2017	By Hire Purchase Debtors A/c (T.V. — ₹ 1,000 + V.C.R. — ₹ 2,000)	3,000
			1.12.2017	By Hire Purchase Debtors A/c (Note 2) (T.V. — ₹ 2,000 + V.C.R. — ₹ 8,000)	10,000
		32,000			32,000

Hire Purchase Debtors Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
1.4.2017	To Hire Purchase Stock A/c	6,000	1.4.2017	By Cash A/c	6,000
1.5.2017	To Hire Purchase Stock A/c	1,000	1.5.2017	By Cash A/c	1,000
1.6.2017	To Hire Purchase Stock A/c	3,000	1.6.2017	By Cash A/c	3,000
1.7.2017	To Hire Purchase Stock A/c	1,000	1.7.2017	By Cash A/c	1,000
1.8.2017	To Hire Purchase Stock A/c	3,000	1.8.2017	By Cash A/c	3,000
1.9.2017	To Hire Purchase Stock A/c	1,000	1.9.2017	By Cash A/c	1,000
1.10.2017	To Hire Purchase Stock A/c	3,000	1.10.2017	By Cash A/c	3,000
1.11.2017	To Hire Purchase Stock A/c	1,000	1.11.2017	By Cash A/c	1,000
1.12.2017	To Hire Purchase Stock A/c	3,000	1.12.2017	By Goods Repossessed A/c	11,000
1.12.2017	To Hire Purchase Stock A/c (Note 2)	10,000		By Balance c/d (For T.V. only)	2,000
		32,000			32,000

Hire Purchase Adjustment Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.12.2017	To Profit & Loss A/c	7,500	1.4.2017	By Goods Sold on Hire Purchase A/c (Note 3)	7,000
			1.12.2017	By Goods Repossessed A/c	500
		7,500			7,500

Goods Repossessed Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
1.12.2017	To Hire Purchase Debtors A/c	11,000	1.12.2017	By Cash A/c (Sales)	12,000
1.12.2017	To Cash A/c (Expenses)	500			
1.12.2017	To Hire Purchase Adjustment A/c	500			
		12,000			12,000

Working Notes :

(1) Goods Sold on hire purchase

	₹
T.V. = ₹ 2,000 + (10 x ₹ 1000)	= 12,000
V.C.R. = ₹ 4,000 + (8 x ₹ 2,000)	= 20,000
	= 32,000

(2) Same customer has purchased both T.V. and V.C.R. when there is a default on 1.12.2017, all the remaining instalments are to be shown as due.

(3) Calculation of Profit on Hire Purchase Price

T.V.	₹	V.C.R.	₹
Hire Purchase price	12,000	Hire Purchase price	20,000
Less Cost price	9,000	*Less* Cost price	16,000
Profit	3,000	Profit	4,000

Total Profit = ₹ 3,000 + ₹ 4,000 = ₹ 7,000.

Illustration 65

Neeta Ltd. commenced business on 1.4.2017. The business was to sell VCPs and VCRs both for cash and on hire purchase basis. Information about terms is given below :

Items	VCPs	VCRs	Items	VCPs	VCRs
Cash price	₹ 10,000	₹ 30,000	Monthly instalments	₹ 1,000	₹ 3,000
Cost	₹ 8,000	₹ 24,000	Number of instalments	10	10
Cash down for Hire–Purchase	₹ 2,000	₹ 6,000			

The company purchased goods costing ₹ 1,00,00,000 in all and made cash sales totalling ₹ 86,00,000. Stock in hand on 31.3.2018 was valued at ₹ 12,00,000. Hire purchase transactions were as follows :

	Number sold	Instalments Collected	Instalments due (customers paying)
VCPs	20	110	9
VCRs	40	260	15

3 VCPs and 2 VCRs on which only 4 instalments were collected were repossessed and were valued at ₹ 32,000. This is not included in the figure of stock mentioned above. Prepare accounts showing the profit or loss made by the company by adopting the Stock and Debtors System.

Solution

In the books of Neeta Ltd.

Dr. Hire Purchase Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sold on Hire Purchase A/c (Note 1)	16,80,000	?	By Hire Purchase Debtors A/c (Note 5)	12,24,000
			?	By Goods Repossessed A/c (Note 6)	54,000
			31.3.2018	By Balance c/d (Note 3)	4,02,000
		16,80,000			16,80,000

Dr. Hire Purchase Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Hire Purchase Stock A/c (Note 5)	12,24,000	?	By Cash A/c (Note 2)	11,70,000
			31.3.2018	By Balance c/d (Note 7)	54,000
		12,24,000			12,24,000

Dr. Goods Sold on Hire Purchase Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Hire Purchase Adjustment A/c (Note 1)	5,60,000	?	By Hire Purchase Stock A/c	16,80,000
31.3.2018	To Purchases A/c (Transfer)	11,20,000			
		16,80,000			16,80,000

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Hire Purchase Stock A/c	54,000	31.3.2018	By Hire Purchase Adjustment A/c	22,000
			31.3.2018	By Balance c/d	32,000
		54,000			54,000

Dr. Hire Purchase Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2018	To Goods Repossessed A/c (Bad debts)	22,000	31.3.2018	By Goods Sold on Hire Purchase A/c (Loading)	5,60,000
31.3.2018	To Stock Reserve A/c (Note 4)	1,34,000			
31.3.2018	To Profit & Loss A/c	4,04,000			
		5,60,000			5,60,000

Working Notes:

(1) H.P. Sales	₹	**Cost of H.P. Sales**	₹
VCP — 20 X ₹ 12,000	2,40,000	VCP — 20 X ₹ 8,000	1,60,000
VCR — 40 X ₹ 36,000	14,40,000	VCR — 40 X ₹ 24,000	9,60,000
	16,80,000		11,20,000

Total loading on goods sold on hire purchase = ₹ 16,80,000 – ₹ 11,20,000 = ₹ 5,60,000.

(2) Cash received for VCP		Cash received for VCR	
Down payment 20 x ₹ 2,000	40,000	Down payment 40 x ₹ 6,000	2,40,000
Instalments collected 110 x ₹ 1,000	1,10,000	Instalments collected 260 x ₹ 3,000	7,80,000
	1,50,000		10,20,000

Total cash received = ₹ 1,50,000 + ₹ 10,20,000 = ₹ 11,70,000. (It is assumed that instalments collected includes instalments of repossessed goods.)

(3) Instalments not yet Due	VCP		VCR
Total instalments on 20 sets	200	Total instalments on 40 sets	400
Less : Instalments collected	110	Less : Instalments collected	260
	90		140
Less : Instalments due but not received	9	Instalments due but not received	15
	81		125
Less: Instalment not yet due on repossessed goods (3x6)	18	Less: Instalments not yet due on repossessed goods (2x6)	12
Instalments not yet due on other	63	Instalments not yet due on other	113
Amount of instalments not yet due (₹ 1,000 x 63) = ₹ 63,000		Amount of instalments not yet due (113 x ₹ 3,000) = ₹ 3,39,000	

Total amount of instalments not yet due = ₹ 63,000 + ₹ 3,39,000 = ₹ 4,02,000.

(4) Stock Reserve	VCP (₹)		VCR (₹)
Hire Purchase price per set	12,000	Hire Purchase price	36,000
Less : Cost	8,000	Less : Cost	24,000
Profit per Set	4,000	Profit per set	12,000
Reserve ₹ 4,000 / ₹ 12,000 x ₹ 63,000 = ₹ 21,000		Reserve ₹ 12,000 / ₹ 36,000 x ₹ 3,39,000 = ₹ 1,13,000	

Total Stock Reserve = ₹ 21,000 + ₹ 1,13,000 = ₹ 1,34,000.

(5) Hire Purchase total amount due	VCP		VCR
Cash down (20 x ₹ 2,000)	40,000	Cash down (40 x 6,000)	2,40,000
Instalments received (110 x 1,000)	1,10,000	Instalments received (260 x ₹ 3,000)	7,80,000
Instalments due (9 x 1,000)	9,000	Instalments due (15 x ₹ 3,000)	45,000
	1,59,000		10,65,000

Total Hire purchase amount due = ₹ 1,59,000 + ₹ 10,65,000 = ₹ 12,24,000.

(6) Instalments not yet due on repossessed goods :

VCP — 3 x 6 x ₹ 1,000	₹ 18,000
VCR — 2 x 6 x ₹ 3,000	₹ 36,000
	₹ 54,000

(7) Instalments due but not yet paid :

VCP — 9 × ₹ 1,000	₹ 9,000
VCR — 15 × ₹ 3,000	₹ 45,000
	₹ 54,000

Illustration 66

X started business on 1.1.2017 selling machine tools on hire purchase terms. During the year ended 31.12.2017, he purchased machines at a uniform price of ₹ 600 each and sold 1,900 machines at a total price under hire purchase agreements of ₹ 1,000 each, payable by an initial deposit of ₹ 300 and 10 quarterly instalments of ₹ 70.

The following Trial Balance was extracted from X's book as at 31st December, 2017 :

Particulars	Dr. (₹)	Cr. (₹)
Capital		7,60,000
Drawings	40,000	
Fixed Assets	1,00,000	
Purchases	12,00,000	
Cash collected from Customers		8,36,000
Rent, rates and insurance	45,000	
Salaries	86,000	
General Expenses	1,02,700	
Bank	1,06,300	
Creditors		84,000
Total	16,80,000	16,80,000

The personal accounts of customers are memorandum records (i.e., they are not part of the double entry system).

X prepares his annual accounts on the basis of taking credit for profit (including interest) in proportion to cash collected from customers. Prepare X's Trading and Profit and Loss Account for the year ended 31st December, 2017 and a Balance Sheet as on that date.

Solution

X

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Purchases	12,00,000	By Sales (1,900 x ₹ 1,000)	19,00,000
To Provision for Unrealised Profit (Note 2)	4,25,600	By Closing Stock (100 x ₹ 600)	60,000
To Gross Profit c/d	3,34,400		
	19,60,000		19,60,000
To Rent, rates and insurance	45,000	By Gross Profit b/d	3,34,400
To Salaries	86,000		
To General Expenses	1,02,700		
To Net Profit	1,00,700		
	3,34,400		3,34,400

Balance Sheet of X as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital :			Fixed Assets		1,00,000
Introduced	7,60,000		Closing Stock		60,000
Add : Net Profit	1,00,700		Debtors (Note 1)	10,64,000	
	8,60,700		Less : Provision for		
Less : Drawings	40,000	8,20,700	Unrealised Profit (Note 2)	4,25,600	6,38,400
Creditors		84,000	Bank		1,06,300
		9,04,700			9,04,700

Working Notes :

Dr. (1) Debtors Account Cr.

Particulars	₹	Particulars	₹
To HP Sales A/c	19,00,000	By Bank A/c	8,36,000
		By Balance c/d	10,64,000
	19,00,000		19,00,000

(2) Provision for Unrealised Profit

Total profit = ₹ 7,60,000 [1,900 × (₹ 1,000 – ₹ 600)]

Total sales = ₹ 19,00,000.

Total debtors at the end of the year = ₹ 10,64,000.

Therefore, unrealised profit = ₹ 7,60,000 / 19,00,000 × 10,64,000 = ₹ 4,25,600.

Illustration 67

Arvind Jain is a retailer selling goods for cash as well as on hire purchase. Hire purchase sales are charged out at a price 25% higher than cash sales.

In accounts for previous years, credit has been taken for all the profit earned on hire purchase sales when the goods were invoiced. It is decided that for the year ended 31.12.2017 only the profit proportionate to instalments received should be included, and adjustment should be made for the unrealised profit on transactions of previous years still uncompleted by that date.

The following is the Trial Balance of Arvind Jain as at 31st December, 2017 :

Particulars	Dr. (₹)	Cr. (₹)
Capital		22,000
Creditors		11,300
Sales — Hire purchase		60,000
Cash		14,250
Purchases	40,750	
General Trade Expenses	10,600	
Drawings	2,000	
Bank	1,200	
Stock at 1.1.2017	11,000	
Hire Purchase Debtors	42,000	
Total	1,07,550	1,,07,550

The following information is relevant :

(1) Stock as at 31.12.2017 amounted to ₹ 14,600.

(2) Included in hire purchase debtors were balances totalling ₹ 4,000 relating to hire purchase transactions from years previous to 2017. The gross profit on hire purchase sales for previous years was 45%.

(3) During 2017, goods sold in 2017 were repossessed from defaulting hire purchasers, whose outstanding balances as at 31.12.2017 amounted to ₹ 2,800. These had not been written-off from the books. Part of the repossessed goods were sold for cash, the proceeds of ₹ 1,050 being included in the total cash sales, and the remainder were included in the closing stock at ₹ 1,100. They were, however, considered to be worth only ₹ 600.

You are required to prepare : (a) the Trading and Profit and Loss Account for the year ended 31st December, 2017; and (b) the Balance Sheet as at that date.

Solution

Arvind Jain

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars		₹
To Opening Stock	11,000	By Sales (1,900 x ₹ 1,000)		
To Purchases	40,750	HP	60,000	
To Provision for Unrealised Profit (Note 4)	19,400	Cash (₹ 14,250 – 1,050)	13,200	73,200
To Gross Profit c/d (Balancing figure)	15,550	By Closing Stock (₹ 14,600 – 1,100)		13,500
	86,700			86,700
To General Trade Expenses	10,600	By Gross Profit b/d		15,550
To Loss on Repossession (Note 1)	1,150			
To Net Profit	3,800			
	15,550			15,550

Balance Sheet of Arvind Jain as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital :			Closing Stock (₹ 13,500 + 600)		14,100
Opening Balance	22,000		Hire Purchase Debtors (Note 2)	39,200	
Add : Net Profit	3,800		Less : Provision for		
	25,800		Unrealised Profit (Note 4)	19,400	19,800
Less : Drawings	2,000	23,800	Bank		1,200
Creditors		11,300			
		35,100			35,100

Working Notes :

Dr. (1) Goods Repossessed Account Cr.

Particulars	₹	Particulars	₹
To HP Debtors A/c	2,800	By Cash Sales A/c	1,050
		By Profit and Loss A/c (Loss on repossession)	1,150
		By Closing Stock A/c	600
	2,800		2,800

Dr. (2) Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	4,000	By Cash (collected from Debtors)	22,000
To Sales A/c	60,000	By Goods Repossessed A/c	2,800
		By Balance c/d	39,200
	64,000		64,000

(3) Calculation of Percentage of Profit on Hire Purchase

We assume all the sales are hire purchase sales. Therefore, we get :	₹	₹
HP Sales	60,000	
Cash Sales [(₹ 14,250 – 1,050) × 125%]	16,500	76,500
Less : Cost of Goods Sold		
Opening Stock	11,000	
Purchases	40,750	
	51,750	
Less : Closing Stock (₹ 14,600 – 1,100)	13,500	38,250
Profit		38,250

Therefore, percentage of hire purchase profit on sales = $\frac{38,250}{76,500} \times 100 = 50\%$

(4) Provision for Unrealised Profit

Total Debtors at the end of 2017 (after adjustment of repossessed goods) = ₹ 39,200. Out of this ₹ 4,000 related to previous year and ₹ 35,200 related to current year, i.e., 2017.

Rate of gross profit in the previous year was 45% but the rate of gross profit in the current year is 50%.

Therefore, unrealised profit will be :

	₹
45% of ₹ 4,000	1,800
50% of ₹ 35,200	17,600
Total	19,400

Illustration 68

Kamal Hossain has a retail outlet selling food processing equipment for cash as well as hire purchase terms. The following information has been extracted from his books as on 31.12.2017 :

Particulars	Dr. (₹)	Cr. (₹)
Capital		83,000
Shop and Administration Expenses	1,30,000	
Cash and Bank	6,208	
Cash Received from Hire Purchase Customers		3,15,468
Cash Sales		71,000
Building and Equipment at Cost	1,00,000	
Provision for Depreciation on Building and Equipment (1.1.2017)		45,000
Hire Purchase Debtors (1.1.2017)	2,268	
Provision for Unrealised Profit (1.1.2017)		1,008
Stock (1.1.2017)	15,000	
Purchases	3,42,000	
Creditors		80,000
Total	5,95,476	5,95,476

Additional information :

(1) The firm's policy is to take credit for gross profit (including interest) for hire purchase sales in proportion to the instalments collected. It does this by raising a provision against the profit included in the hire purchase debtors not yet due.

(2) The cash selling price is fixed at 50% and the hire purchase selling price at 80% respectively above the cost of goods purchased.

(3) Hire purchase sales amounted to ₹ 5,40,000 (including interest) for the year.

(4) In June 2017, the firm repossessed some goods which had been sold earlier in the year. These goods have been purchased for ₹ 3,000 and the unpaid instalments on them amounted to ₹ 3,240. They were then taken back into stock on cash terms for ₹ 3,500.

(5) Depreciation is charged on building and equipment @ 15% p.a. on cost.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2017 and a Balance Sheet as on that date.

Solution

Kamal Hossain

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		15,000	By Cash Sales	71,000	
To Purchases	3,42,000		Less: Repossessions	3,500	67,500
Less: Repossessions	3,000	3,39,000	By HP Sales	5,40,000	
To Provision for Unrealised Profit (Note 4)		98,352	Less: Repossessions	5,400	5,34,600
To Gross Profit c/d (Note 1)		1,61,748	By Closing Stock (Balancing figure)		12,000
		6,14,100			6,14,100
To Shop and Establishment Expenses		1,30,000	By Gross Profit b/d		1,61,748
To Depreciation on Building and Equipment		15,000	By Profit on Repossession (Note 2)		2,660
To Net Profit		19,408			
		1,64,408			1,64,408

Balance Sheet of Kamal Hossain as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital :			Building and Equipment	1,00,000	
Opening Balance	83,000		Less: Provision for Depreciation		
Add : Net Profit	19,408	1,02,408	(₹ 45,000 + 15,000)	60,000	40,000
Creditors		80,000	Closing Stock		12,000
			Hire Purchase Debtors (Note 3)	2,23,560	
			Less: Provision for Unrealised Profit (Note 4)	99,360	1,24,200
			Cash and Bank		6,208
		1,82,408			1,82,408

Working Notes :

(1) Calculation of Gross Profit

	₹
Profit on cash sales : ₹ (71,000 – 3,500) × 50 / 150	22,500
Profit on HP sales : ₹ (5,40,000 – 5,400) / 180 × 80	2,37,600
	2,60,100
Less: Provision for unrealised profit (Note 4)	98,352
	1,61,748

Dr. (2) Goods Repossessed Account Cr.

Particulars	₹	Particulars	₹
To Purchases A/c	3,000	By HP Sales A/c	5,400
To HP Debtors A/c	3,240	By Sales A/c	3,500
To Profit and Loss A/c (profit on repossession)	2,660		
	8,900		8,900

Dr. (3) Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,268	By Bank A/c	3,15,468
To HP Sales A/c	5,40,000	By Goods Repossessed A/c	3,240
		By Balance c/d	2,23,560
	5,42,268		5,42,268

Dr. (4) Provision for Unrealised Profit Account Cr.

Particulars	₹	Particulars	₹
To Balance c/d (₹ 2,23,560 / 180 x 80)	99,360	By Balance b/d	1,008
		By Trading A/c (Balancing figure)	98,352
	99,360		99,360

Illustration 69

R M Khan opened a business dealing in a new type of power tool of which there was one model only.

The cost price of each tool is ₹ 4,000 and he deals with them in the following ways :

(a) sells for cash from the shop for ₹ 5,600 each;

(b) sell on hire purchase when the HP selling price is ₹ 6,400, comprising a deposit of ₹ 1,600 and 8 quarterly instalments of ₹ 600 each, credit being taken immediately for the gross profit and each instalment being regarded as containing ₹ 100 interest, earned when the instalment is paid.

During the first year he bought 350 tools and these can be accounted for as follows :

Particulars	Tools
Sold for cash from shop	188
Sold on HP terms, the agreements still continuing	100
Repossessed from HP customers	2
In stock at the shop at year-end	60
	350

A summary of the cash receipts during the year shows :

Particulars		₹
Cash sales from shop		10,52,800
Hire purchase sales :		
40 — deposit only	64,000	
60 — deposit and 2 instalments	1,68,000	
	2,32,000	
Less: Instalments outstanding	3,000	2,29,000
Hire purchase repossessions — 2 deposits and one instalment each received before repossession		4,400
		12,86,200

The two tools which have been repossessed are added to the stock at the year-end at a value of ₹ 3,000 each.

When the business was started in January 2017, Khan brought in ₹ 15,00,000 cash as his capital. He has paid for all the 300 tools and also ₹ 2,50,000 as working expenses. There are no assets or liabilities other than these arising from the above. Khan has drawn from business ₹ 2,00,000 for his own use during the year.

You are required to prepare the Trading and Profit and Loss Account for the first year of business; and a Balance Sheet at 31st December, 2017.

Solution

R M Khan

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Purchases [(350 – 2) x ₹ 4,000]	13,92,000	By Sales :	
To Provision for Unrealised Interest (Note 1)	68,500	Cash	10,52,800
To Gross Profit c/d	4,72,300	HP (100 x ₹ 6,400)	6,40,000
		By Closing Stock (60 x ₹ 4,000)	2,40,000
	19,32,800		19,32,800
To Working Expenses	2,50,000	By Gross Profit b/d	4,72,300
To Net Profit	2,24,700	By Profit on Repossessions (Note 2)	2,400
	4,74,700		4,74,700

Balance Sheet of R M Khan as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital :			Closing Stock :		
Introduced	15,00,000		Good units (60 x ₹ 4,000)	2,40,000	
Add : Net Profit	2,24,700		Repossessed (2 x ₹ 3,000)	6,000	2,46,000
	17,24,700		Hire Purchase Stock (Note 6)	4,08,000	
Less : Drawings	2,00,000	15,24,700	Less : Provision for		
Creditors [(350 – 300) x ₹ 4,000]		2,00,000	Unrealised interest (Note 7)	68,000	3,40,000
			Hire Purchase Debtors	3,000	
			Less : Unrealised interest	500	2,500
			Bank (Note 3)		11,36,200
		17,24,700			17,24,700

Working Notes : (1) Calculation of Provision for Unrealised Interest

Particulars	₹
Interest not yet earned:	
40 — deposits only (i.e., 8 instalments due) : 40 x 8 x ₹ 100	32,000
60 — deposits and 2 instalments (i.e., 6 instalments due) : 60 x 6 x ₹ 100	36,000
	68,000
Add: Outstanding interest (*5 x ₹ 100)	500
	68,500

* ₹ 3,000 / 600 = 5 instalments

Dr. (2) Goods Repossessed Account Cr.

Particulars	₹	Particulars	₹
To Purchases A/c (2 x ₹ 4,000)	8,000	By Bank A/c (given)	4,400
To Profit and Loss A/c (profit on repossessions)	2,400	By Closing Stock A/c (2 x ₹ 3,000)	6,000
	10,400		10,400

Dr. (3) Bank Account Cr.

Particulars	₹	Particulars	₹
To Capital A/c	15,00,000	By Creditors A/c (300 x ₹ 4,000)	12,00,000
To Receipts (given)	12,86,200	By Working Expenses A/c	2,50,000
		By Drawings A/c	2,00,000
		By Balance c/d	11,36,200
	27,86,200		27,86,200

Dr. (4) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To HP Sales A/c	6,40,000	By HP Debtors A/c	2,32,000
		By Balance c/d (Note 6)	4,08,000
	6,40,000		6,40,000

Dr. (5) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To HP Stock A/c	2,32,000	By Bank A/c	2,29,000
		By Balance c/d	3,000
	2,32,000		2,32,000

(6) Instalments not yet Due

(i) 40 × 8 (only deposit received)	320
(ii) 60 × 6 (two instalments received)	360
	680

Amount of instalments not yet due = 680× ₹ 600 = ₹ **4,08,000**.

(7) Unrealised interest = 680 × ₹ 100 = ₹ **68,000**.

Illustration 70

Mohini Traders commenced business on 1.1.2017, selling electric toaster. They deal in one type only which costs ₹ 600 each and is sold at an uniform gross margin of 1/3 of selling price. At 30.12.2017, the firm produces the following draft accounts :

Profit and Loss Account

Particulars	₹	Particulars	₹
Purchases	72,000	Cash sales	63,900
Salaries	11,000	Hire purchase sales	10,000
Overheads	6,500	Stock at cost	23,400
Net Profit	7,800		
	97,300		97,300

Balance Sheet

Liabilities	₹	Assets	₹
Capital	40,000	Stock at cost	23,400
Net Profit	7,800	Hire Purchase Stock	6,720
Creditors	4,600	Bank	22,280
	52,400		52,400

The following information is relevant :

(1) Because of a decline in sales towards the end of the year, the owner decided to sell some of the toasters on hire purchase terms for a deposit of ₹ 200 and 10 monthly instalment of ₹ 80 each. Both the deposit and the first monthly instalments are to be paid in the month of delivery.

(2) During 2017, the number of toasters sent out on hire purchase was — October 2; November 2; December 6.

(3) The owner agrees that the gross profit on hire purchase sales is to be taken on the basis that gross profit is earned in proportion to the total cash received in the accounting period, and the hire purchase interest is earned in proportion to the instalments received in the accounting period.

Prepare : (a) two separate Trading Accounts showing gross profit on cash sales and profit taken to hire purchase sales; (b) Profit and Loss Account to show net profit of the firm; and (c) Balance Sheet as at 31st December, 2017.

Solution

Mohini Traders

Dr. (a) General Trading Account for the year ended 31st December, 2017 Cr.

Particulars		₹	Particulars	₹
To Purchases	72,000		By Cash Sales	63,900
Less: Sold on HP (10 x ₹ 600)	6,000	66,000	By Closing Stock	23,400
To Gross Profit c/d		21,300		
		87,300		87,300

Workings Notes :

(1) Calculation of Cash Selling Price ₹

	₹
Cost of each toaster	600
Gross profit (1/3 of sales or 1/2 of cost)	300
Cash selling price	900

(2) Calculation of Hire Purchase Selling Price ₹

	₹
Hire purchase terms:	
Deposit	200
10 instalments at ₹ 80 each	800
Hire Purchase Selling Price	1,000

(3) Calculation of Hire Purchase Interest

	₹
Hire purchase selling price	1,000
Less: Cash Selling Price	900
Hire Purchase Interest	100

(4) Calculation of Number of Instalments Received

October : 2	2
November : 2 + 2	4
December : 2 + 2 + 6	10
	16

(5) Calculation of Number of Instalments to be Received

Total number of toasters sold on hire purchase	10	
Number of instalments for each toaster	10	
Total instalments	10 × 10	100
Instalments received		16
Instalments to be received		84

(6) Calculation of Interest to be Received

	₹
Total interest on hire purchase (10 × ₹ 100)	1,000
Less: Interest already received (16 × ₹ 10)	160
Interest to be received	840

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2017	To Goods Sold on HP A/c (10 x ₹ 1,000)	10,000	31.12.2017	By Goods Sold on HP A/c	
	To Stock Reserve A/c (Note 1)	2,856		(Loading — 10 x ₹ (1,000 – 600)	4,000
	To Profit and Loss A/c (Note 2)	1,144		By Cash A/c (₹ 10,000 – 6,720)	3,280
				By HP Stock A/c (given)	6,720
		14,000			14,000

Working Notes :

(1) Calculation of Stock Reserve

	₹
Profit : ₹ 6,720 / ₹ 10,000 × ₹ 3,000	2,016
Interest (Note 6)	840
	2,856

(2) Calculation of Profit

Gross profit on hire purchase sales is to be taken on the basis that gross profit is earned in proportion to the total cash received in the accounting period.

During the accounting period: cash received = ₹ 3,280; Gross profit = ₹ 3,000 (10 × ₹ 300) and total H.P. Sales = ₹ 10,000 (10 × ₹ 1,000).

	₹
Therefore, (i) Gross Profit = ₹ 3,280 / 10,000 × ₹ 3,000	984
(ii) Interest earned (16 × ₹ 10)	160
	1,144

Dr. (b) Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Salaries	11,000	By Gross Profit :	
To Overheads	6,500	Cash Sales	21,300
To Net Profit	4,944	HP Sales	1,144
	22,444		22,444

(c) Balance Sheet of Mohini Traders as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital	40,000		Stock at cost		23,400
Add: Net Profit	4,944	44,944	Hire Purchase Stock	6,720	
Creditors		4,600	Less: Stock Reserve	2,856	3,864
			Bank		22,280
		49,544			49,544

Illustration 71

From the following information extracted from the books of Mohan Automobiles Ltd., prepare Hire Purchase Revenue Account for the year ended 31.12.1995, showing the profit in respect of hire purchase business of the company.

Particulars	₹
(a) Instalments due but not received as on 1.1.1995	15,000
(b) Instalments due but not received as on 31.12.1995	25,000
(c) Cash received during the year 2005 by way of hire purchase instalments	20,00,000
(d) Value of trucks 'out' on hire purchase as on 1.1.1995 at cost	1,00,000
(e) (i) Cost price of trucks 'out' on hire purchase as on 31.12.1995	10,00,000
(ii) Total amount of instalments receivable in respect of e(i) above	12,00,000
(iii) Total amount of instalments and due upto 31.12.1995 received in respect of e(i) above	10,50,000
(f) Purchase of trucks during the year 1995	20,00,000
(g) Sale of trucks otherwise than on hire purchase (at a profit of 12.5% of cost thereon)	4,50,000
(h) Body building charges in respect of some of the trucks sold on hire purchase	1,10,000
(i) Interest paid	10,000
(j) Unsold trucks on hand on 1.1.1995	50,000
(k) Unsold trucks on hand on 31.12.1995	80,000

[C.U.B.Com. (Hons.) — 1996]

Solution

Choice of Method : This problem should be solved on "Cost Price" base. This is because, excepting for the trucks in point (e) in the problem, the relationship between 'Cost Price" and 'Hire Purchase Price" is not uniform.

Also because in respect of the trucks in point (e), details are available regarding cost and sales, but in respect of other trucks, there is no clear information available, and we assume that there is no 'Closing Stock out on HP' in respect of other trucks than the trucks in point (e).

In the books of Mohan Automobiles Ltd

Dr. HP Revenue Account Cr.

Particulars	Trucks in point (e) ₹	Other Trucks ₹	Total ₹	Particulars	Trucks in point (e) ₹	Other Trucks ₹	Total ₹
To Opening HP Stock	—	1,00,000	1,00,000	By General Trading (Note 4)	—	4,00,000	4,00,000
To Opining Shop Stock	—	50,000	50,000	By HP Sales (Note 2)	10,50,000	9,60,000	20,10,000
To Purchases	10,00,000	10,00,000	20,00,000	By Closing Stock on HP (Note 3)	1,25,000	—	1,25,000
To Body Buildings	—	1,10,000	1,10,000				
To Interest	—	10,000	10,000	By Closing Shop Stock	—	80,000	80,000
To Profit	1,75,000	1,70,000	3,45,000				
	11,75,000	14,40,000	26,15,000		11,75,000	14,40,000	26,15,000

The results can be verified by drawing a Closing Balance Sheet.

Balance Sheet of Mohan Automobiles Ltd as on 31.12.1995

Liabilities		₹	Assets	₹
Opening Capital :			Bank (Note 1)	3,30,000
Debtors	15,000		Debtors	25,000
Shop Stock	50,000		HP Stock	1,25,000
HP Stock	1,00,000	1,65,000	Shop Stock	80,000
Profit				
HP	3,45,000			
General Trading	50,000	3,95,000		
		5,60,000		5,60,000

Working Notes : (1)

	₹	
Collection from HP Debtors	20,00,000	
General Sales	4,50,000	24,50,000
Purchases	20,00,000	
Body Building along with interest	1,20,000	21,20,000
		3,30,000

Dr. (2) HP Debtors Account Cr.

Particulars		₹	Particulars	₹
To Balance b/d		15,000	By Bank	20,00,000
To HP Sales :			By Balance c/d	25,000
Truck at point (e)	10,50,000			
Other Trucks	9,60,000	20,10,000		
		20,25,000		20,25,000

(3) Closing Stock of Trucks in point (e) = $\frac{\text{Instalments not matured}}{\text{Total HP Price}} \times \text{Cost} = \frac{1,50,000}{12,00,000} \times \text{Rs } 10,00,000 = ₹\ 1,25,000$

(4) Cost of trucks sold otherwise than on hire purchase [point (g)] = ₹ 4,50,000 / 112.5 × 100 = ₹ 4,00,000.

Illustration 72

M/s Tolly Electro manufactures T.V. sets and sells them both for cash and on hire purchase. The cash price is ₹ 8,000 and hire purchase price is ₹ 10,000, payable ₹ 2,000 down and the balance in four equal half-yearly instalments. The warranty period for each set is 2 years from the date of sale and the estimated amount of after-sales maintenance is ₹ 800 for each set of which ₹ 300 will be for the first year.

During the year 2018, Tolly Electro sold 100 sets on cash basis and 200 sets on hire purchase basis and incurred an amount of ₹ 40,000 on the after-sales service. Pass the Journal Entries and show the Maintenance Suspense Account for the year 2017. ***[I.C.W.A. (Final) — Adapted]***

Solution

In the books of M/s Tolly Electro

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2017	Bank A/c	Dr.		8,00,000	
	To Sales A/c				8,00,000
	(Being sale of 100 TV Sets on cash basis @ ₹ 8,000 each)				
	Hire Purchase Debtors A/c	Dr.		20,00,000	
	To Sales A/c (200 x ₹ 8,000)				16,00,000
	To Interest Suspense A/c (Note2)				4,00,000
	(Being the sale of 200 TV Sets on Hire Purchase basis @ ₹ 10,000 each)				
	Bank A/c	Dr.		4,00,000	
	To Hire Purchase Debtors A/c (200 x ₹ 2,000)				4,00,000
	(Being down payment received on 200 TV Sets @ ₹ 2,000 each)				
	Sales A/c (Note 1)	Dr.		2,40,000	
	To Maintenance Suspense A/c				2,40,000
	(Being maintenance charges included in the sales price @ ₹ 800 transferred to Maintenance Suspense Account in respect of 300 TV Sets)				
	Bank A/c	Dr.		2,00,000	
	To Hire Purchase Debtors A/c				2,00,000
	(Being first instalment received)				
	Maintenance Suspense A/c	Dr.		45,000	
	To Bank A/c				45,000
	(Being expenses incurred in respect of maintenance)				
	Interest Suspense A/c (Note 2)	Dr.		1,40,000	
	To Interest Received A/c				1,40,000
	(Being the interest for the first year transferred to Interest Received Account)				
	Interest Received A/c	Dr.		1,40,000	
	To Profit and Loss A/c				1,40,000
	(Being the amount transferred to Profit and Loss Account)				

Dr. Maintenance Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2017	To Bank A/c	40,000	2017	By Sales A/c	2,40,000
	To Balance c/d	2,00,000			
		2,40,000			2,40,000

Working Notes :

(1) Estimated Amount of Maintenance Suspense:

	₹
Year 1	300
Year 2	500
Total	800

Assuming that sales to be uniform, the allocation of maintenance charges would be :

1st year : (0.5 × ₹ 300 = ₹ 150) × 300 sets	45,000
2nd year : 0.5× 300 = ₹ 150	
0.5 × 500 = ₹ 250	
₹ 400 × 300 sets	1,20,000
3rd year : (0.5 × 500 = ₹ 250) × 300 sets	75,000
	2,40,000

(2) Calculation of Interest Allocation (all figures in ₹)

Half-year	Amount Outstanding	Instalment Amount	Ratio	Interest	Principal	Total Payable
1	8,000	2,000	4	800	1,200	2,000
2	6,000	2,000	3	600	1,400	2,000
3	4,000	2,000	2	400	1,600	2,000
4	2,000	2,000	1	200	1,800	2,000
			10	2,000	6,000	8,000

1st year : 1/2 {(₹ 800 + ₹ 600) = ₹ 700} × 200	₹ 1,40,000
2nd year : 1/2 (₹ 800 + ₹ 600) = ₹ 700	
1/2 (₹ 400 + ₹ 200) = ₹ 300	
₹ 1,000 × 200	2,00,000
3rd year : 1/2 (₹ 400 + ₹ 200) = ₹ 300 × 20100,000	
	4,00,000

Section B : Instalment Payment System

Introduction

An instalment sale is a credit sale in which payments are made in instalments over a period of time. Under this system the buyer is given the possession and also ownership of the goods right at the time of signing the agreement. If the buyer defaults, the seller cannot repossess the goods but he can sue the buyer for the amount due.

The following are the features of an Instalment Payment System :

(a) It is an outright credit sale of goods.

(b) The buyer has the facility to pay the price in instalments over a period of time.

(c) The buyer gets immediate possession as well as ownership of the goods.

(d) In the event of default by the buyer in the payment of any instalment, the seller cannot repossess the goods (because the ownership has already been transferred).

(e) In case of default, the total amount of instalments paid by the buyer are not forfeited. The seller can only bring a suit against the buyer for the unpaid instalments.

The difference between the hire purchase system and the instalment payment system is as follows:

	Hire Purchase System	Instalment Payment System
(i) Nature of Contract	It is an agreement of hiring of goods.	It is an agreement of sale of goods.
(ii) Passing of Title	The title of the goods is passed on to the buyer after the payment of the final instalment or as agreed by the parties.	The title of the goods is passed on to the buyer at the time of signing the agreement.

(iii) Rights of Seller	If the buyer fails to pay any of the instalments, the goods can be repossessed by the seller.	The seller cannot repossess the goods. He can sue the buyer for the amount due.
(iv) Rights of Disposal	The buyer cannot hire out, sell, transfer, destroy, pledge the goods.	The buyer can hire out, sell, transfer, destroy, pledge the goods and the bona fide purchaser can get good title.
(v) Return of Goods	The buyer may return goods without further payment, except for the instalments already due.	Except seller's default, goods cannot be returned. Buyer is liable to pay the amount due.
(vi) Forfeiture of Amount Received	In case of default, the total amount of instalments paid is forfeited and treated as hire charges.	In case of default, the total amount of instalments paid by the buyer cannot be forfeited.

Accounting Arrangements

Under the instalment payment system, the property in the goods passes to the buyer at the time of signing the contract. When accounting entries are to be passed in the books of the buyer and seller, this fact should be taken into account. The seller will treat the transaction as a credit sale. Likewise, the buyer treats it as an outright credit purchase (but the payment should be made in instalments). The buyer credits the seller with the total amount payable to him (including interest) and debits the Asset Account with cash price and Interest Suspense Account (with total interest).

The seller debits the buyer with full amount and credits sales account with cash price and the Interest Suspense Account with total interest. A proportionate part of the Interest Suspense Account is transferred each year to the credit of the Profit and Loss Account. The buyer maintains the Assets Account in a manner similar to that of the Hire Purchase System. The depreciated value of the asset is shown in the asset side of the Balance Sheet. The amount due to seller is shown in the Balance Sheet as a liability. The seller shows the balance due from the buyer as debtors (not as stock as in the case of Hire Purchase System) in the Balance Sheet.

The Books of the Buyer

The following journal entries are passed in the books of the buyer.

1. When the asset is acquired on instalment payment system.

Asset Account	Dr. [Full cash price]
Interest Suspense Account	Dr. [Total interest]
To Vendor Account	[Instalment price]

2. When down payment is made

Vendor Account	Dr.
To Bank Account	

3. For interest of the relevant period

Interest Account	Dr.
To Interest Suspense Account	

4. For payment of instalment

Vendor Account	Dr.
To Bank Account	

5. When depreciation is charged on the asset

Depreciation Account	Dr.
To Asset Account	

6. For closing interest and depreciation account.

Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

The Books of the Seller/Vendor

The following Journal Entries are passed in the books of the seller.

1. When goods are sold and delivered under the instalment payment system.

Purchaser Account	Dr.	[Full cash price + total interest]
To Sales Account		[Cash price]
To Interest Suspense Account		[Total interest]

2. When down payment is received

Bank Account Dr.
To Purchaser Account

3. For interest of the relevant period

Interest Suspense Account Dr.
To Interest Account

4. For receipt of the amount of instalment

Bank Account Dr.
To Purchaser Account

5. For closing interest account

Interest Account Dr.
To Profit and loss Account

6. For closing sales account

Sales Account Dr.
To Trading Account

Illustration 73

Eastern Collieries Ltd. purchased wagons from Texmaco Ltd. under the Instalment Payment System on 1st January 2016. It was agreed that ₹ 15,000 was to be paid on signing the agreement and a sum of ₹ 15,000 was to be paid annually for 3 years. The cash price of the wagons was ₹ 52,300 and the rate of interest was 10%. Depreciation is charged @ 20% on the straight line method.

You are required to give Journal entries recording the above transactions in the books of both the parties.

Solution

In the books of Eastern Collieries Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2016	Wagon A/c	Dr.		52,300	
Jan. 1	Interest Suspense A/c (Note 2)	Dr.		7,700	
	To Texmaco Ltd. A/c				60,000
	(Being the purchase of wagons from Texmaco Ltd. on instalment system)				
	Texmaco Ltd.	Dr.		15,000	
	To Bank A/c				15,000
	(being the amount paid on signing the agreement)				
Dec. 31	Interest A/c	Dr.		3,730	
	To Interest Suspense A/c				3,730
	(Being interest of 2016 on ₹ 37,300 @ 10% p.a.)				
	Texmaco Ltd. A/c	Dr.		15,000	
	To Bank A/c				15,000
	(Being the payment of 1st instalment)				
	Depreciation A/c	Dr.		10,460	
	To Wagon A/c				10,460
	(Being the depreciation charged @ 20% p.a. on ₹ 52,300)				
	Profit & Loss A/c	Dr.		14,190	
	To Interest A/c				3,730
	To Depreciation A/c				10,460
	(Being the interest and depreciation transferred to Profit & Loss Account)				

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2017 Dec. 31	Interest A/c Dr. To Interest Suspense A/c (Being interest of 2017 on ₹ 26,030 @ 10% p.a.)		2,603	 2,603
	Texmaco Ltd. A/c Dr. To Bank A/c (Being the payment of 2nd instalment)		15,000	 15,000
	Depreciation A/c Dr. To Wagon A/c (Being the depreciation charged @ 20% p.a. on ₹ 52,300)		10,460	 10,460
	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the interest and depreciation transferred to Profit and Loss Account)		13,063	 2,603 10,460
2018 Dec. 31	Interest A/c (Note 1) Dr. To Interest Suspense A/c (Being interest of 2017 on ₹ 13,633 @ 10% p.a.)		1,367	 1,367
	Texmaco Ltd. A/c Dr. To Bank A/c (Being the payment of final instalment)		15,000	 15,000
	Depreciation A/c Dr. To Wagon A/c (Being the depreciation charged @ 20% on ₹ 52,300)		10,460	 10,460
	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the interest and depreciation transferred to Profit & Loss Account)		11,827	 1,367 10,460

In the books of Texmaco Ltd.
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2016 Jan. 1	Eastern Collieries Ltd. A/c Dr. To Sales A/c To Interest Suspense A/c (Being sale of wagons on instalment payment system)		60,000	 52,300 7,700
	Bank A/c Dr. To Eastern Collieries Ltd. A/c (Being the amount received as down payment)		15,000	 15,000
Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being interest of 2016 credited to Interest Account)		3,730	 3,730
	Bank A/c Dr. To Eatern Collieries Ltd. A/c (Being the 1st instalment received)		15,000	 15,000
	Sales A/c Dr. To Trading A/c (Being the transfer of Sales Account to Trading Account)		52,300	 52,300
	Interest A/c Dr. To Profit & Loss A/c (Being the interest credited to Profit and Loss Account)		3,730	 3,730
2017 Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being interest of 2017 credited to Interest Account)		2,603	 2,603
	Bank A/c Dr. To Eastern Colleries Ltd.A/c (Being the 2nd instalment received)		15,000	 15,000
	Interest A/c Dr. To Profit & Loss A/c (Being the interest credited to Profit & Loss Account)		2,603	 2,603

2018 Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being interest of 2017 credited to Interest Account)	1,367	1,367
	Bank A/c Dr. To Eastern Collieries Ltd. A/c (Being the 3rd instalment received)	15,000	15,000
	Interest A/c Dr. To Profit & Loss A/c (Being the interest credited to Profit & Loss Account)	1,367	1,367

Working Notes: **(1) Calculation of Interest**

2016	₹	2017	₹	2018	₹
Cash Price	52,300	Balance b/d	26,030	Balance b/d	13,633
Less : Down Payment	15,000	Add : Interest @ 10%	2,603	Add : Interest @ 10%	*1,367
	37,300		28,633		15,000
Add : Interest @ 10%	3,730	Less : Instalment	15,000	Less : instalment	15,000
	41,030	Balance c/f	13,633		Nil
Less : Instalment	15,000			*Actual Interest comes to ₹ 1,363 but has been put at ₹ 1,367 for balancing purposes.	
Balance c/f	26,030				

(2) Total interest = ₹ 3,730 + ₹ 2,603 + ₹ 1,367 = ₹ 7,700.

Illustration 74

Burdwan Motor Service co. buys a motor car on instalment payment system from Hind Motors Ltd. on 1.1.2015 under which payment is to be made on December 31 for 4 years @ ₹ 50,000 per annum, interest being calculated at 5% p.a. The cash down price of the car is ₹ 1,77,300. Depreciate the car at 10% p.a. on the Diminishing Balance Method. Write-up the Motor Car Account, Vendor Account and the Interest Suspense Account in the Buyer's books over the first four years.

Solution **In the books of Burdwan Motor Service Co.**

Dr. **Motor Car Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Hind Motor Ltd. A/c	1,77,300	31.12.2015	By Depreciation A/c	17,730
			31.12.2015	By Balance c/d	1,59,570
		1,77,300			1,77,300
1.1.2016	To Balance b/d	1,59,570	31.12.2016	By Depreciation A/c	15,957
			31.12.2016	By Balance c/d	1,43,613
		1,59,570			1,59,570
1.1.2017	To Balance b/d	1,43,613	31.12.2017	By Depreciation A/c	14,361
			31.12.2017	By Balance c/d	1,29,252
		1,43,613			1,43,613
1.1.2018	To Balance b/d	1,29,252	31.12.2018	By Depreciation A/c	12,925
				By Balance c/d	1,16,327
		1,29,252			1,29,252

Dr. **Interest Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Hind Motor Ltd. A/c	22,700	31.12.2015	By Interest A/c	8,865
			31.12.2015	By Balance c/d	13,835
		22,700			22,700
1.1.2016	To Balance b/d	13,835	31.12.2016	By Interest A/c	6,808
			31.12.2016	By Balance c/d	7,027
		13,835			13,835
1.1.2017	To Balance b/d	7,027	31.12.2017	By Interest A/c	4,649
			31.12.2017	By Balance c/d	2,378
		7,027			7,027
1.1.2018	To Balance b/d	2,378	31.12.2018	By Interest A/c	2,378

Dr. **Hind Motors Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Bank A/c	50,000	1.1.2015	By Motor Car A/c	1,77,300
31.12.2015	To Balance c/d	1,50,000		By Interest Suspense A/c	22,700
		2,00,000			2,00,000
31.12.2016	To Bank A/c	50,000	1.1.2016	By Balance b/d	1,50,000
31.12.2016	To Balance c/d	1,00,000			
		1,50,000			1,50,000
31.12.2017	To Bank A/c	50,000	1.1.2017	By Balance b/d	1,00,000
31.12.2017	To Balance c/d	50,000			
		1,00,000			1,00,000
31.12.2018	To Bank A/c	50,000	1.1.2018	By Balance b/d	50,000

Working Notes : **(1) Calculation of Interest**

2015	₹	2016	₹	2017	₹	2018	₹
Cash price	1,77,300	Balance b/f	1,36,165	Balance c/f	92,973	Balance c/f	47,622
Add: Interest @ 5%	8,865	Add: Interest @ 5%	6,808	Add: Interest @ 5%	4,649	Add: Interest @ 5%	*2,378
	1,86,165		1,42,973		97,622		50,000
Less: Instalment	50,000	Less: Instalment	50,000	Less: Instalment	50,000	Less: Instalment	50,000
Balance c/f	1,36,165	Balance c/f	92,973	Balance c/f	47,622	* Actual interest comes to ₹ 2,381, but has been put at ₹ 2,378 for balancing purposes.	

Illustration 75

Coconut Growers purchase a machinery on instalment basis from Y Machinery Co. Ltd., on the following terms :-

(a) Cash down payment at the time of signing the agreement on 1.1.2014 is ₹ 10,811.

(b) Five annual instalments of ₹ 7,700, the first to commence at the end of twelve months from the date of cash down payment.

(c) Interest at 10% p.a. is charged by the seller.

(d) Depreciation at 20% p.a. on WDV basis is written off on the machinery.

(e) Machinery is sold for ₹ 15,000 on the completion of payments of instalments.

(f) Accounting year ended on 31st December in each year.

Show the Machinery Account for the entire period.

Solution **In the books of Coconut Growers**

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Y Machinery Co. Ltd. A/c (Note 1)	40,000	31.12.2014	By Depreciation A/c	8,000
			31.12.2014	By Balance c/d	32,000
		40,000			40,000
1.1.2015	To Balance b/d	32,000	31.12.2015	By Depreciation A/c	6,400
			31.12.2015	By Balance c/d	25,600
		32,000			32,000
1.1.2016	To Balance b/d	25,600	31.12.2016	By Depreciation A/c	5,120
			31.12.2016	By Balance c/d	20,480
		25,600			25,600
1.1.2017	To Balance b/d	20,480	31.12.2017	By Depreciation A/c	4,026
			31.12.2017	By Balance c/d	16,384
		20,480			20,480
1.1.2018	To Balance b/d	16,384	31.12.2018	By Depreciation A/c	3,277
31.12.2018	To Profit & Loss A/c (Profit on Sale)	1,893	31.12.2018	By Bank A/c	15,000
		18,277			18,277

Working Notes: **(1) Calculation of Cash Price**

No. of instalments	Amount of instalment	Interest	Principal
5th	7,700	* 1/11 of ₹ 7,700 = ₹ 700	7,000 (7,700 – 700)
4th	7,700	1/11 of ₹ 14,700 = ₹ 1,336	6,364 (7,700 – 1,336)
3rd	7,700	1/11 of ₹ 21,064 = ₹ 1,915	5,785 (7,700 – 1,915)
2nd	7,700	1/11 of ₹ 26,849 = ₹ 2,441	5,259 (7,700 – 2,441)
1st	7,700	1/11 of ₹ 32,108 = ₹ 2,919	4,781 (7,700 – 2,919)
	₹ 38,500	₹ 9,311	29,189
		Add : Cash Down Payment	10,811
		Cash price	40,000

* Let the amount due at the beginning of the 5th year be ₹ 100. Interest is 10%, i.e., ₹ 10. Amount payable at the end of the 5th year is ₹ 100 + 10 = ₹ 110. Therefore, the ratio between interest and the amount due = 10/110 = 1/11. (See also Note 2).

(2) Calculation of the amount due at the year-end

5th year :	₹ 7,700
4th year : ₹ (7,000 + 7,700)	₹ 14,700
3rd year : ₹ (6,364 + 7,000 + 7,700)	₹ 21,064
2nd year : ₹ (5,785 + 6,364 + 7,000 + 7,700)	₹ 26,849
1st year : ₹ (5,259 + 5,785 + 6,364 + 7,000 + 7,700)	₹ 32,108

Illustration 76

On 1st January 2015 A sells a truck to B, on the instalment payment system, on the following condition :

(1) The purchase price of the truck is ₹ 1,00,000.

(2) This amount is payable to A in four equal annual instalments along with 12% interest per annum on the outstanding balance, the first instalment being payable on the date of sale.

B, in turn, hires out the truck to A for a monthly sum of ₹ 3,000 per month from 1st January 2015. The hire charges are to be adjusted at the end of each year against the amount due to A on account of principal and interest, any difference being settled in cash. B charges 20% depreciation (on the Written Down Value method) on the truck.

All payments are made as per the agreement. On 1st January 2017, the truck is sold by B to A for ₹ 15,000 in cash.

Show in B's books, the Truck Account, the Interest Suspense Account, the Hire Charges Account; the Interest Account and A's account.

Solution

In the books of B

Truck Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To A A/c	1,00,000	31.12.2015	By Depreciation A/c	20,000
			31.12.2015	By Balance c/d	80,000
		1,00,000			1,00,000
1.1.2016	To Balance b/d	80,000	31.12.2016	By Depreciation A/c	16,000
			31.12.2016	By Balance c/d	64,000
		80,000			80,000
1.1.2017	To Balance b/d	64,000	31.12.2017	By Depreciation A/c	12,800
			31.12.2017	By Balance c/d	51,200
		64,000			64,000
1.1.2018	To Balance b/d	51,200	1.1.2018	By Cash A/c	15,000
			1.1.2018	By Loss on Sale of Truck A/c	36,200
		51,200			51,200

Interest Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To A A/c (Note 1)	18,000	31.12.2015	By Interest A/c	9,000
			31.12.2015	By balance c/d	9,000
		18,000			18,000
1.1.2016	To Balance b/d	9,000	31.12.2016	By Interest A/c	6,000
			31.12.2016	By Balance c/d	3,000
		9,000			9,000
1.1.2017	To Balance b/d	3,000	31.12.2017	By Interest A/c	3,000

Dr. **Hire Charges Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Profit & Loss A/c	36,000	31.12.2015	By A A/c	36,000
31.12.2016	To Profit & Loss A/c	36,000	31.12.2016	By A A/c	36,000
31.12.2017	To Profit & Loss A/c	36,000	31.12.2017	By A A/c	36,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2015	To Interest Suspense A/c	9,000	31.12.2015	By Profit & Loss A/c	9,000
31.12.2016	To Interest Suspense A/c	6,000	31.12.2016	By Profit & Loss A/c	6,000
31.12.2017	To Interest Suspense A/c	3,000	31.12.2017	By Profit & Loss A/c	3,000

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Cash A/c	25,000	1.1.2015	By Truck A/c	1,00,000
31.12.2015	To Hire Charges A/c	36,000	1.1.2015	By Interest Suspense A/c (Note 1)	18,000
31.12.2015	To Balance c/d	57,000			
		1,18,000			1,18,000
31.12.2016	To Hire Charges A/c	36,000	1.1.2016	By Balance b/d	57,000
31.12.2016	To Balance c/d	23,000	1.1.2016	By Cash A/c (Note2)	2,000
		59,000			59,000
31.12.2017	To Hire Charges A/c	36,000	1.1.2017	By Balance b/d	23,000
			31.12.2017	By Cash A/c (Note 2)	5,000
			31.12.2017	By Balance c/d	8,000
		36,000			36,000
1.1.2018	To Balance b/d	8,000	1.1.2018	By Cash A/c	8,000

Working Notes :

(1) Calculation of interest : For 2015 on ₹ 75,000 @ 12% = ₹ 9,000; For 2016 on ₹ 50,000 @ 12% = ₹ 6,000; For 2017 on ₹ 25,000 @ 12% = ₹ 3,000. Total ₹ 18,000.

(2) Cash settlement

Date	Principal + Interest Due	Hire Charges	Cash received
1.1.2016	₹ 25,000 + ₹ 9,000 = ₹ 34,000	₹ 36,000	₹ 2,000
1.1.2017	₹ 25,000 + ₹ 6,000 = ₹ 31,000	₹ 36,000	₹ 5,000
1.1.2018	₹ 25,000 + ₹ 3,000 = ₹ 28,000	₹ 36,000	₹ 8,000

Illustration 77

Instalment Traders Ltd sell consumer durables under instalment payment terms, under which 20% of the total dues are to be paid on delivery and the balance in eight equal quarterly instalments commencing from the last date of the quarter in which the goods have been delivered. 15% of the total dues are attributed towards interest, for which credit to revenue is taken as :

In the year of sales — 30%; Next year — 50%; The year after next — 20%.

Total dues for goods sold and delivered during the last three years had been :

1996 — ₹ 8,00,000; 1997 — ₹ 10,00,000; 1998 — ₹ 12,00,000.

On January 1, 2015, Instalment Debtors Account and Interest Suspense Account showed balances of ₹ 6,70,000 (Dr.) and ₹ 1,29,000 (Cr.) respectively.

The deliveries have been even throughout the year and all the instalments had been collected on due date. Prepare Instalment Debtors Account and Interest Suspense Account as they would appear in 1998.

[C.U.B.Com. (Hons.) — 1999]

Solution

In the books of Instalment Traders Ltd

Instalment Debtors Account

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

Date	Particulars	₹	Date	Particulars	₹
1.1.1998	To Balance b/d	6,70,000	31.12.1998	By Bank A/c (Note 4)	10,60,000
31.12.1998	To Sales A/c (Note 1)	10,20,000		By Balance c/d	8,10,000
	To Interest Suspense A/c (Note 1)	1,80,000			
		18,70,000			18,70,000

Interest Suspense Account

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

Date	Particulars	₹	Date	Particulars	₹
31.12.1998	To Profit and Loss A/c (Note 2)	1,53,000	1.1.1998	By Balance b/d	1,29,000
"	To Balance c/d	1,56,000	?	By Instalment Debtors A/c	1,80,000
		3,09,000			3,09,000

Working Notes : **(1) Statement Showing the Allocation of Total Dues for Goods Sold**

Year	Total Dues for Goods Sold (₹)	Down Payment (20%)	Balance Payable in 8 Instalments	Total Interest (15% of Dues)	Cash Price (85% of Dues)
1996	8,00,000	1,60,000	6,40,000	1,20,000	6,80,000
1997	10,00,000	2,00,000	8,00,000	1,50,000	8,50,000
1998	12,00,000	2,40,000	9,60,000	1,80,000	10,20,000

(2) Calculation of Interest to be Credited to Profit and Loss Account of Different Years

Year	Total Interest (₹)	To be credited to the Profit and Loss Account of Different Years				
		2010	2014	2015	2016	2017
1996	1,20,000	30%	50%	20%	—	—
1997	1,50,000	—	30%	50%	20%	—
1998	1,80,000	—	—	30%	50%	20%

Amount of interest to be credited to the Profit and Loss Account:	₹
20% of ₹ 1,20,000 (1996)	24,000
50% of ₹ 1,50,000 (1997)	75,000
30% of ₹ 1,80,000 (1998)	54,000
	1,53,000

(3) Calculation of Number of Instalments Payable in Subsequent Quarters

Sales	Total Number of Instalments	1st year	2nd year	3rd year
Sale in 1st Quarter of 1st year	8	4	4	—
Sale in 2nd Quarter of 1st year	8	3	4	1
Sale in 3rd Quarter of 1st year	8	2	4	2
Sale in 4th Quarter of 1st year	8	1	4	3
	32	10	16	6

From the above table, it is clear that out of sale of a particular year, down payment plus 10/32 of total instalments are realisable in the same 1st year, 16/32 in the 2nd year and 6/32 in the 3rd year.

(4) Cash Collected in 1998	₹
(i) 20% of ₹ 12,00,000 (Being down payment of 1998 sales)	2,40,000
(ii) 10/32 of ₹ 9,60,000 (Being 1st year of 1998 sale)	3,00,000
(iii) 16/32 of ₹ 8,00,000 (Being 2nd year of 1997 sale)	4,00,000
(iv) 6/32 of ₹ 6,40,000 (Being 3rd year of 1996 sale)	1,20,000
Total	10,60,000

Section C : Concept of Operating and Financial Lease

Introduction

A ***Lease*** is a contract by which the owner of an asset, the ***Lessor***, allows another person, the ***Lessee***, to use it in exchange for regular payments. Leasing has become extremely common in the business world. From the lessee's point of view, ***leasing*** provides an alternative to the purchase of an asset required for use in the business. The main distinguishing feature of leasing is that the lessee never obtains legal ownership of the asset during lease period. The advantage is that the lessee obtains the unrestricted use of the asset for a specified period without incurring major capital expenditure or incurring long-term loan, while the rental can be paid to the lessor out of the income generated by the use of the asset over that specified period.

The range of assets covered by the leasing agreements is very wide. Plant and Machinery, Land and Buildings, Cars, Ships and Aircraft are frequently leased.

Before the introduction of AS—19 : Leases, many enterprises were disclosing in the Balance Sheet neither the leased assets nor the full lease liabilities. Now, AS—19 ensures that the entity controlling the assets, irrespective of ownership, ***recognises the assets and resulting liability*** in order to provide a true and fair view of the financial position.

Objective

The objective of this Statement is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

Scope

This Statement should be applied in accounting for all leases other than:

(a) lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

This Statement applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets.

This Statement does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

Example : X Ltd. has taken on lease a fully furnished office. The lessor provides secretarial services and all office equipments. This is covered by AS—19.

Definitions

The following terms are used in this Statement with the meanings specified:

Lease

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

Finance Lease

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

Operating Lease

An operating lease is a lease other than a finance lease.

Non-cancellable Lease

A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency; or
(b) with the permission of the lessor; or
(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

Inception of the Lease

The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

Lease Term

The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Minimum Lease Payments

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or
(b) in the case of the lessor, any residual value guaranteed to the lessor:
    i. by or on behalf of the lessee; or
    ii. by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

Fair Value

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Economic Life

Economic life is either:

(a) the period over which an asset is expected to be economically usable by one or more users; or
(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Useful Life

Useful life of a leased asset is either:

(a) the period over which the leased asset is expected to be used by the lessee; or
(b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.

Residual Value

Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

Guaranteed Residual Value

Guaranteed residual value is:

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and
(b) in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

Unguaranteed Residual Value

Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.

> **Example : Magma Leasing Ltd. has given a car on lease for 4 years to Sita Travels Ltd. The cost of the car is ₹ 5,00,000. The estimated residual value of the car is ₹ 50,000 at the end of the lease.**
>
> **A dealer of 2nd hand car gives a guarantee to purchase the car for ₹ 40,000 at the end of the lease period. This ₹ 40,000 is the guaranteed residual value. The remaining ₹ 10,000 is the unguaranteed residual value.**

Gross Investment

Gross investment in the lease is the aggregate of the minimum lease payments under finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

Unearned Finance Income

Unearned finance income is the difference between:

(a) the gross investment in the lease; and
(b) the present value of
(i) the minimum lease payments under a finance lease from the standpoint of the lessor; and
(ii) any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease (***See Illustration 2***).

Net Investment

Net investment in the lease is the gross investment in the lease less unearned finance income.

Interest Rate Implicit in the Lease

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and
(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Lessee's Incremental Borrowing Rate of Interest

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Contingent Rent

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).

> **Example : Fast Food Ltd. has taken a restaurant on lease in New Delhi Railway Station. Rent payable per month is ₹ 20,000 plus 10% of sales as contingent rent.**

Hire Purchase

The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last installment and the hirer has a right to terminate the agreement at any time before the property so passes.

Classification of Leases

The classification of leases adopted in this Statement is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

Lease

Finance Lease

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred.

Operating Lease

A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by the lessor and the lessee.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a ***finance lease*** are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Indicators of situations which individually or in combination could also lead to a lease being classified as a ***finance lease*** are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

Example : Your company, Go Airways Ltd. has taken on lease an aircraft for 5 years. If the company wants to cancel the lease, it will have to pay all the remaining payment up to the end of the lease. This is a finance lease, because there is no way of paying a reduced rental.

(b) gains or losses from the ***fluctuation in the fair value of the residual fall to the lessee*** (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

Example : Magma Leasing Ltd. has given a car on lease for 4 years to Sita Travels Ltd. The cost of the car is ₹ 5,00,000. The estimated residual value is ₹ 50,000.

As per the terms and conditions of the lease, if the car's residual value is more than ₹ 50,000, When the car is sold, Sita Travels Ltd. (lessee) will receive the excess money. If it is less than ₹ 50,000, Sita Travels Ltd. will have to pay Magma Leasing Ltd. the deficit amount. This is a financial lease.

(c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than the market value.

> **Example : Your company Modern Printer Ltd. has taken on lease a printing machine for 5 years at a commercial rent from HMT Ltd. At the end of the lease period, your company can continue to rent at 1/10th of the present rental but a service contract is to be signed with the HMT Ltd.**
>
> **HMT Ltd. does not want the printing machine back. It would prefer to leave it with the lessee for a minimum rent and earn some income from service contract.**
>
> **This is a finance lease, as the lessor wants that the lessee should enjoy the entire economic life of the machine.**

Lease classification is made at the ***inception of the lease***. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Characteristics of A Finance Lease

1. Lessor retains title to asset but transfers substantially (not, of course, identically) the risks and rewards incident to owner of an asset.
2. The full cost of the asset will generally be repaid by the lessee to the lessor.
3. Lessee is responsible for insurance and maintenance of the asset.
4. Lessee cannot sell the asset without the permission of the lessor.
5. Lessee has the right of uninterrupted use of the asset till lease payments are made.
6. The contractual obligation to pay the lessor is generally non-cancellable.
7. At the end of the lease-term the lessor can take back the possession of the asset from the lessee or there can be a bargain purchase/renewal option.

Characteristics of Operating Lease

1. The lessee pays a periodic rental to the lessor for the period of the lease.
2. The lessor retains the risks and rewards of ownership.
3. The lessor assumes responsibility for repairs, maintenance and insurance.
4. An operating lease is usually short-term.
5. The lessee has use of the asset generally over a period which is less than its useful economic life.

Distinction Between Finance Lease and Operating Lease

	Finance Lease		Operating Lease
1.	The lease exists generally for the whole useful life of the asset and rentals receivable are sufficient to recoup capital outlay and show a profit.	1.	The lease period is less than the useful life of the asset. The lessor relies on subsequent leasing or eventual sale of the asset to cover the capital outlay and show a profit.
2.	The lessor usually does not deal directly in this type of asset.	2.	The lessor may very well carry on a trade in this type of asset.
3.	The lessor does not retain the risks and rewards of ownership.	3.	The lessor is usually responsible for repairs and maintenance.
4.	The lease agreement cannot generally be cancelled. the lessee has a liability for the payments.	4.	The lease can sometimes be cancelled at a short notice.

5.	The substance of the transaction is the purchase of the asset by the lessee financed by a loan from the lessor.	5.	The substance of the transaction is the short-term rental of an asset.
6.	Lessee will record it as an asset.	6.	Lessor will record it as an asset.

Illustration 1

On 1st January, 2017 Gamon India Ltd. leased a heavy duty new crane from Magma Leasing Co. Ltd. The capital cost of the crane is ₹ 25,00,000. 6 half-yearly payments of ₹ 5,00,000 are payable. 1st installment is payable on 1st January, 2018. The estimated economic life of the crane is 5 years with a nil residual value. The leasing company has offered a secondary term of 3 years for ₹ 2,00,000 per annum only. Gamon India Ltd. has not yet decided if they will accept it.

After the expiry of lease period, the crane is expected to have a residual value of ₹ 5,00,000. As per the lease agreement, Gamon India Ltd. will get 90% of the proceeds should the assets be sold.

How this lease should be classified ?

Solution

The minimum lease payment = (₹ 5,00,000 × 6)	₹	30,00,000
Fair value of the asset (capital cost)	₹	25,00,000
Finance Charge	₹	5,00,000

This will be classified as a finance lease on the following grounds :

(i) The primary lease period is 3 years which is majority of asset's economic life.

(ii) The lessee has the option to extend the lease for a secondary period at a much lower rent.

(iii)The lessee will get 90% of the proceeds of sale of the crane.

Illustration 2

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 3,00,000. The amount will be paid in 3 installments and at the termination of lease — lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000.

The Implicit Rate of Return (IRR) of the investment is 10%. The present value of annuity factor of Re 1 due at the end of 3rd year at 10%. IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

(i) State with reason whether the lease constitutes finance lease.

(ii) Calculate unearned finance income.

Solution (i)

This lease constitutes finance lease on the following grounds :

(1) The primary lease period is 3 years which is majority of assets' economic value.

(2) The present value of lease payments is 89.98% (See Working Note below) of the fair value which is substantial portion thereof.

Working Note :

Present value of residual value — ₹ 40,000 × 0.7513 = ₹ 30,052.

Present value of lease payment — ₹ 3,00,000 – ₹ 30,052 = ₹ 2,69,948.

$$\text{Percentage of fair value} = \frac{2,69,948}{3,00,000} = 89.98\%$$

Solution (ii)

$$\text{Annual lease payments} = \frac{2,69,948}{2.4868} = ₹\ 1,08,552$$

Annual lease payment has been calculated on the basis that :

[Present value of lease payments plus residual value = Fair value of the assets (cost)].	₹
Gross investment in the lease [(₹ 1,08,552 × 3) + ₹ 40,000]	3,65,656
Less: Cost of the equipment	3,00,000
Unearned finance income	65,656

Key Points

- Under the Hire Purchase System the customer (called the Hire Purchaser) obtains possession of the goods at the outset and can use it, while paying for it by instalments over an agreed period of time.
- **Hire Vendor** : The seller in a hire purchase agreement.
- **Hire Purchaser** : The buyer in a hire purchase agreement.
- **Cash Price** : The amount to be paid on outright purchase in cash.
- **Down Payment** : Initial payment made at the time of signing the hire purchase agreement.
- **Hire Purchase Price** : The amount to be paid if the goods are purchased under the hire purchase system. It includes the cash price and interest of the future instalments.
- The entire profit on sale under hire purchase agreement is credited to the Profit and Loss Account of the year in which the sale has taken place. Interest pertaining to each accounting period is credited to the Profit and Loss Account of that year.
- **Hire Purchase Price** consists of two things : (i) cash price; and (ii) interest. Cash price is the capital expenditure incurred for the acquisition of an asset and (ii) interest is the revenue expense for the delay in making the full payment. Ascertainment of any of these two gives the answer for the other, e.g., if we ascertain the total amount of interest, it becomes very simple to ascertain the cash price just by deducting the interest from the hire purchase price.
- In the case of a **complete repossession**, the hire vendor closes the Hire Purchaser's Account in his books by transferring the balance of the Hire Purchaser Account to the Goods Repossessed Account. Likewise, the hire purchaser closes the Hire Vendor's Account in his books by transferring the balance of the Hire Purchase Assets Account to the Hire Vendor Account.
- In case of a **partial repossession**, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are as usual upto the date of default (excepting entry for payment) in the books of both the parties. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.
- **Lease** : A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
- **Finance Lease** : A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.
- **Operating Lease** : An operating lease is a lease other than a finance lease.

THEORETICAL QUESTIONS

1. What are the accouting procedures to be adopted in respect of the Hire Purchase System ?
2. What is meant by Hire Purchase System and how does it differ from the Instalment Payment System ?
3. State the nature of hire purchase agreement.
4. State para 4 of AS–19 in respect of hire purchase accounting.

PRACTICAL QUESTIONS

Hire Purchase System

Section A : Cash Price is Given

1. On January 1, 2016, Sharda purchased a machine from Kusum on a hire-purchase basis. The particulars are as follows:
   (a) Cash price ₹ 10,000.
   (b) ₹ 4,000 to be paid on signing the contract.
   (c) Balance in three instalments of ₹ 2,000 plus interest.
   (d) Interest charged on outstanding balance at 5%.
   (e) Depreciation at 5% p.a. on the Straight-line Method.
   Give Journal Entries and the necessary Ledger Accounts for the year ended on 31st December, 2016, 2017 and 2018 in the books of both the parties.
2. On 1st April, 2015, A Ltd. purchased a machine from B Ltd. on hire-purchase basis. The cash price of the machine was ₹ 20,000. the payment was to be made at ₹ 5,000 on delivery and the balance in 3 equal annual instalments of ₹ 5,000, plus interest at 5% p.a. payable on 31st December each year. A. Ltd. charges depreciation at 10% p.a. on the original cost. Show Ledger Accounts in the books of A Ltd.

3. On 1st January, 2017, Sun Co. Ltd. took delivery from Star Co. Ltd. five machines on hire purchase system. A sum of ₹ 200 per machine was paid on delivery and the balance was payable in five instalments of ₹ 300 each per machine, annualy on 31st December. The vendors charge interest at the rate of 5% p.a. on the yearly balances. The cash value of each machine was ₹ 1,500. Depreciation was provided @ 10% p.a. under the Reducing Balance Method.
   (i) Show the calculation of Interest and Depreciation.
   (ii) Write up the Machinery Account and the Vendor Account in the books of Sun Co. Ltd.
4. On 1st January, 2014, J. Colliery Company purchased one car from Hindusthan Motor Ltd. The cash down price of the car was ₹ 50,000. It was agreed that ₹ 5,000 would be paid on signing the agreement and the balance by 4 equal annual instalments of ₹ 12,500 each commencing from 31st December, 2014. Colliery Company closes its books on 31st December. Depreciation is charged on car @ 10% p.a. on the Diminishing Balance Method.
   Show the necessary Ledger Accounts in the books of Hindusthan Motors Ltd. for 4 years.
5. The Madras Transport Company purchases a motor car from Bombay Motor Ltd. on a hire-purchase agreement on January 1, 2015 paying cash ₹ 10,000, and agreeing to pay three further instalments of ₹ 10,000 each on December 31 each year. The cash price of the car is ₹ 37,250 and Bombay Motor Ltd. charges interest at 5% p.a. The Madras Transport Company writes off 10% p.a. as depreciation on the Reducing Balance Method.
   Prepare necessary Ledger Accounts in the books of Bombay Motors Ltd.
6. Indian Plastics Ltd. purchased one Tempo delivery van under hire-purchase agreement from Hindustan Auto Ltd. On January 1, 2015, payments were to be made of ₹ 2,000 on that date and the balance in three equal instalments of ₹ 4,000 each on January 1, 2016,2017 and 2018. The cash price of the van was ₹ 12,894. Interest was charged @ 5% p.a. on the yearly balances. The purchaser decided to charge 20% on the written down value as depreciation each year. Show the account in the books of Indian Plastics Ltd. for the four years ending December 31, 2018.
7. On 1st January 2015 Wellman Co. Ltd purchased a machine from Machinery Co Ltd. on the hire-purchase system. The cash price of the machine was ₹ 33,525. Wellman Co. Ltd. paid ₹ 9,000 forthwith and ₹ 9,000 on 31st December every year for three years. Interest at 5% and depreciation at 10% on the diminishing balances were charged.
   Show the Machine Account, Machinery Co.Ltd. Account and Interest Suspense Account in the books of Wellman Co. Ltd. for three years.
8. On January 1, 2015, A purchased a machine (under Hire Purchase System) from B valued at ₹ 37,000. A sum of ₹ 5,000 was paid at the time of signing the contract and the balance in four yearly instalments of ₹ 8,000 plus interest at 5% payable on 31st December each year. The machine was depreciated at 10% on Diminishing Balance Method. Show Machine Account, Interest Suspense Account and Vendor's Account for four years in the books of A.
9. On 1st January, 2016, Engineer purchased machinery from Marshall on hire purchase system, over a period of three years. ₹ 5,000 was payable on delivery on 1st January, 2016 and the balance by following instalments on 31st December in each year : 2016 — ₹ 10,000; 2017 — ₹ 10,000; 2018 — Balance amount.
   Marshall charged interest at 10% p.a. on the yearly balances. The cash value of the machinery on delivery was ₹ 30,000. Depreciation at the rate of 20% p.a. on diminishing balances was written off in each year. Engineer paid all the instalments on the due date.
   Show the Machinery Account and Marshall's Account in the books of Engineer for the three years to 31st December, 2018.
10. Sri S. Gupta acquired a machine on 30.6.2017 from B.C.Ltd. on hire-purchase system. The cash price of the machine was ₹ 17,000. The agreement provided that he would pay ₹ 4,000 on the delivery of the machine and the balance in six half-yearly instalments of ₹ 2,400 each. B.C.Ltd charged interest at 6% per annum on half-yearly balances. The buyer closed his books of account on 31st December every year. Assuming that he decided to write off depreciation on the machine at 10% per annum (on diminishing balance method), show necessary Ledger Accounts in the books of S.Gupta.

Section B : Cash Price is not given

11. On 1st January, 2016, Model Industries Ltd. purchased a machine from Ideal Machineries Ltd. under hire purchase agreement. The terms were that ₹ 4,780 would be paid on delivery, that is on 1st January, 2016, and the balance in three consecutive yearly instalments of ₹ 9,261 each, payable on 31st December each year. The instalments included interest @ 5% per annum on the balance of the cash down price due.
    Calculate the cash down price of the machine and show the Machinery Account (assuming depreciation was charged @ 10% under the Reducing Balance Method) and the account of Ideal Machineries Ltd. in the books of Model Industries Ltd.
12. A machine was purchased on the 'hire purchase system'. Under the terms of agreement, out of the total purchase consideration, ₹ 5,600 would be paid on the siging of the agreement and the balance by 5 annual instalments of ₹ 3,850 each (interest being reckoned on the unpaid balance at 10% p.a.). The first instalment was paid one year after the date of purchase of the machine. Calculate the Cash down price of the machine and show the Vendor's Account and the 'Interest Paid' Account in the books of the purchaser.

13. Roadmasters Ltd. sold a motor lorry to Transport Corporation Ltd. under a hire-purchase agreement. **Terms** : ₹ 20,000 on signing the agreement on 1st January, 2015 and ₹ 20,000 in annual payments thereafter on 1st January for three years. The annual payments included the interest chargeable at 5 per cent. Present value of Re. 1 per annum for five years at 5 per cent is ₹ 4.33. Show the Transport Corporation Ltd's Account in the books of Roadmaster Ltd.

14. Madras Taxi Services Co. Ltd. purchased 3 taxis on 1.1.2016 from the Auto Services, Madras on hire purchase system. It was agreed upon to make payment as under:-

1.1.2016	On signing agreement	₹ 10,350
31.12.2016	At the end of the first year	₹ 19,965
31.12.2017	At the end of the second year	₹ 19,965
31.12.2018	At the end of the third year	₹ 19,965
	Total hire purchase price	₹ 70,245

Nothing more was payable after the 3rd instalment.
All the instalments are duly paid by the Madras Taxi Services Co. Ltd. Interest was reckoned @ 10% p.a. Depreciation was charged @ 20% p.a. on diminishing balance. Madras Taxi Services close its books on 31st December every year.
Prepare : (1) Auto Services Madras Account; (2) Taxi Account; and (3) Interest Account.

15. X Ltd purchased machinery on hire purchase system from Y Ltd on 1st January, 2016. The terms were that X Ltd would pay ₹ 20,000 down on signing the contract and 4 instalments of ₹ 11,000 each commencing from the beginning of the next year. X Ltd charged depreciation at the rate of 10% per annum on cost under diminishing balance system. Y Ltd charged interest at the rate of 10% per annum in their hire purchase contract. Prepare Machinery Account and Y Ltd Account for 5 years in the books of X Ltd.

Section C : Repossession of Goods

16. Transport Ltd. purchased three buses from Arvind motors costing ₹ 75,000 each on hire-purchase system. Payment was to be made for each bus ₹ 45,000 down and the remainder in three equal instalments together with interest at 12%. Transport Ltd. wrote off depreciation at 20% on diminishing balance. It paid the first instalment at the end of the first year but could not pay the next. Arvind Motors agreed to leave one bus with the purchaser adjusting the value of the other two buses against the amount due. The buses were valued on the basis of 30% depreciation annually on Straight Line Method.
Show the necessary entries in the books of Transport Ltd.

17. On 1st April 2017 X & Y Co. Ltd. acquired 4 machines of ₹ 50,000 each on hire-purchase system from Z Co. Ltd. The terms included cash down payment of ₹ 50,000 and payment of the balance in 3 equal annual instalments together with interest at 10% p.a.
X & Y Co Ltd. paid the first instalment but failed to pay thereafter. The machines were depreciated at 20% p.a. on diminishing balance method.
Z Co. Ltd. agreed to leave two machines with X & Y Co. Ltd. and adjust the value of the two machines against the outstanding amount after depreciating the machines taken over at 30% p.a. on diminishing balance method.
The taken over machines were sold for ₹ 1,20,000 after incurring renovation expenses of ₹ 10,000.
Show Ledger Accounts in the books of both the parties assuming that the books are closed on 31st Dec. every year.

18. X purchased seven trucks on hire-purchase on 1.7.2017. The cash purchase price of each truck was ₹ 50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five half-yearly instalments starting from 31.12.2017 with interest @ 5% p.a.
On X's failure to pay the instalment due on 30.6.2018 it was agreed that X would return three trucks to the vendor and the remaining four would be retained by him. The vendor agreed to allow him a credit for the amount paid against these three trucks less 25%.
Show the relevant accounts in the books of X assuming that his books are closed in June every year and depreciation @ 20% is charged on trucks.

Section D : Hire Purchase Trading

19. Refrigeration Limited trade in refrigerators on hire-purchase system and the accountant furnished the following information for the year 2017 :

	₹		₹
Jan 1. Stock in shop	10,000	Dec. 31 Stock in shop	14,000
Instalments due and unpaid	6,000	Instalments due and unpaid	10,000
Stock out with customers on H.P. price	80,000	Stock out with customers on H.P. price	92,000
		Cash received during the year	1,60,000

He further stated that the company makes a gross profit of one third on cost. You are required to prepare the Hire Purchase Trading Account to ascertain the profits for the year.

20. CEE Ltd. has a hire purchase department. Goods are sold on hire purchase at cost plus 40%. From the information given below, prepare Hire Purchase Trading Account in the books of CEE Ltd :

	₹
1.7.2017 Goods out on H.P. (at H.P. price)	21,000
During the year ended 30th June, 2018:	
Goods sold on H.P. (at H.P. price)	1,05,000
Cash received	70,000
Goods received back valued at (hire purchase instalments unpaid ₹. 2,800)	800
30.6.2018 Goods with H.P. Customers (at H.P. price)	45,500

21. Rosemary Enterprises sells its merchandise under hire purchase schemes. Legal title to the goods is not relinquished until the customer fully pays the instalments.
A summary of the transactions of the firm for first four years of its existence is given below (all figures in ₹):

	2015	2016	2017	2018
Sales on H.P. basis	6,66,000	9,50,000	10,20,000	11,04,000
Opening Stock	—	1,20,000	1,60,000	2,40,000
Stock at close	1,20,000	1,60,000	2,40,000	3,20,000
Purchases	6,75,000	8,00,000	8,55,000	9,20,000
Amounts realised from customers :				
2015 Sales	2,20,000	2,80,000	1,00,000	55,000
2016 Sales	—	4,00,000	2,80,000	2,00,000
2017 Sales	—	—	4,80,000	4,00,000
2018 Sales	—	—	—	3,50,000

Indicate the realised gross profit for each of the years.

22. A Ltd. which sells a product on hire-purchase terms has the following transactions for the year ending on December 31, 2017. The gross profit is 25% on selling price (figures in ₹):

Jan. 1 Stock on hire at H.P. price	4,000	Dec. 31 Stock on hire at H.P. price	4,600
Stock in hand (in the shop)	500	Stock in hand (in the shop)	700
Instalments due (customers still paying)	300	Instalments due	500
		Cash received in instalments during the year	8,000

You are required to prepare Hire Purchase Trading Account to ascertain the profit for the year 2017.

23. Choudhury Brothers commenced business on 1.7.2017. During the year ended 30.6.2018, purchases amounted to ₹ 1,08,000 and ordinary sales to ₹ 1,24,000. In addition, the following sales were made under hire purchase arrangements—

Article	Cost ₹	Sale Price ₹	Deposit Paid ₹	Monthly Instalments ₹	Instalments paid during the year
Television set	3,000	4,500	500	20 of ₹ 200	8
Washing machine	4,000	6,000	600	12 of ₹ 450	2
Refrigerator	3,500	5,000	500	18 of ₹ 250	4

Instalments on the refrigerator could not be kept up and it was retruned on 30.6.2018. Stock in trade at 30.6.2018, excluding the returned refrigerator, amounted to ₹ 14,000. Prepare the Hire Purchase Trading Account, Memorandum Hire Purchase Debtors Account and the General Trading Account for the year ended 30.6.2018.

24. Mr. Bholla commenced business on 1st January, 2017. He effected sales in cash as well as on a hire-purchase basis. During the year 2017, his purchases amounted to ₹ 14,500. The cash sales were for ₹ 12.000. the following items were sold on a hire-purchase basis as per particulars below: (all figures in ₹)

	Cost	Sale Price	Initial Payment	Instalments paid during the year
Radio	200	350	50	125
Cycle	210	350	75	125
Encyclopaedia	400	600	100	150

The instalments on the encylopaedia could not be kept up and the same was repossessed on August 31, 2017. The closing stock including the encylopaedia amounted to ₹ 5,000.
Prepare the Hire-Purchase Trading Account; Memorandum Hire Purchase Debtors' Account and the General Trading Account for the year ending December 31, 2017.

25. A manufacturing company purchased machinery on hire-purchase basis on 1st June, 2017. Soon after the installation the machine gave trouble and finally broke down on 14th August, 2017. The suppliers agreed to replace the machine. A new agreement was signed for that purpose and a sum of ₹ 500 was paid for cancelling the first agreement by the manufacturing company. The following are the necessary particulars :

Particulars	1st Machine	2nd Machine
1. Date of Purchase	1.6.2017	31.8.2017
2. Cash Price	35,000	42,860
3. Initial Payment	6,920	—
4. Allowance for payments made under cancelled agreement	—	9,500
5. Hire charges	3,240	3,840
6. Hire Purchase price	38,240	46,700
7. Number of Instalments	18	24
8. Instalment payable every month commencing on	1.7.2017	1.10.2017
9. All payment were made on due dates		
10. Ignore depreciation on machinery		

You have to prepare the following Ledger Accounts in the books of the manufacturing company for the year ending 31st March, 2018 :
(a) Machinery on H. P. Account (b) Hire-Purchase Company's Account (c) Hire-Purchase Disposal Account
(d) Hire-Purchase Interest Suspense Account.

26. A company sells goods on hire-purchase on the basis of 25% down, the balance, with 20% interest thereon being payable in 8 equal quarterly instalments on 31st March, 30th June, 30th September and 31st December each year. The first instalment is payable at the end of the quarter in which the sale is made. The company transfers 50% , 30% and 20% of the interest to the Profit and Loss Account in the first , second and third years respectively.

Balance on 1.1.2018	₹
Hire Purchase Debtors	75,735
Hire Purchase Interest Suspense	9,900

Hire-Purchase sales (exclusive of Interset), which have evenly occured over each of the three calender years, are : 2016 — ₹ 80,000; 2017 — ₹ 1,00,000; 2018 — ₹ 76,000.
All dues were promptly paid in each year.
Make out for the year 2018.
(1) Hire-Purchase Debtors Account.
(2) Hire-Purchase Interest Suspense Account and prove the opening and closing balances of the latter account.

27. X commenced business on 1.1.2016 selling television sets for cash as well as hire purchase basis.
He started with a capital of ₹ 4,50,000 and acquired leasehold premises with a 10-year life for a premium of ₹ 2,40,000, furnitures and fittings for ₹ 1,50,000 and a motor van. The motor van was acquired under a hire purchase contract. The terms were : Cash price ₹ 1,20,000; Deposit ₹ 30,000 payable on 1.1.2016; Interest rate 10% p.a.; Three equal instalments on 31st December in 2016, 2017 and 2018.
The lease and fixtures are to be depreciated over the life of the lease and the motor van is to be depreciated @ 25% p.a. on the reducing balance.
During the period 1.1.2016 to 30.4.2016, the number of sets sold were :

	January	February	March	April
Cash Sales	20	60	90	120
Hire Purchase Sales	—	30	60	90

The prices and terms of purchase and sale were :
Cost price ₹ 3,000; Cash price ₹ 4,200; Hire purchase price ₹ 5,000. Hire purchase terms — deposit of ₹ 1,700 payable on the day of sale followed by 11 monthly instalments of ₹ 300 starting in the month following the sale.
During the period 1.1.2016 to 30.4.2016, the following payments were made:
Wages to sales assistant ₹ 68,400; Rent and other expenses ₹ 1,00,000; Suppliers ₹ 11,25,000.
On 30.4.2016, the firm repossessed 3 television sets that had been sold on hire purchase on 1.2.2016 and on which only 1 instalment has been paid. X valued the 3 repossessed sets at ₹ 700 each. X decided to take credit for gross profit in proportion to cash received in the accounting period and to spread interest evenly over the life of the agreement, except for repossessed sets when it was proposed to deal with them separately and to include profit or loss on repossession as a separate item in the Profit and Loss Account.
There were 40 television sets on hand at 30.4.2016 excluding the sets that had been repossessed.
Prepare a Trading and Profit and Loss Account for the period 1.1.2016 to 30.4.2016 which shows clearly the separate contributions from cash and hire purchase sales, and a Balance Sheet as at 30.4.2016.

28. Majestic & Co. commenced business on January 1, 2017 dealing in radio sets and record players. They sell goods both directly as well as on hire purchase. You are furnished with the following information for the year ended 31st December, 2017:

	Radio sets		Record players	
Purchases	No.	1,000		100
Sales: Direct for cash	No.	800		50
On hire purchase	No.	40		20
To employees as explained below	No.	3		2
Purchase cost per unit	₹	400	₹	1,200
Direct sales price per unit	₹	500	₹	1,500
Terms of hire purchase sale:				
Cash down at the time of delivery	₹	100	₹	300
Monthly instalments	₹	50	₹	150
Number of instalments		10		12
Instalment collected		260		110
Instalments due but not yet collected		15		10

During the year the firm repossessed 3 radio sets and 2 record players for failure to pay the instalments. The hire purchase customers had paid only 4 instalments each in respect of these radio sets and record players. At the time of repossession, the radio sets were valued at ₹ 200 each and the record players were valued at ₹ 500 each. The firm spent ₹ 30 per radio set and ₹ 70 per record player on reconditioning. These sets were sold to employees at a concessional rate of ₹ 300 per radio set and ₹ 700 per record player and the amount was recovered from their salaries before the close of the year.

You are required to prepare columnar :

(i) Hire Purchase Trading Account; (ii) Goods sold on Hire Purchase Account; (iii) Purchases Account; (iv) Goods Repossessed Account; and (iv) General Trading Profit and Loss Account.

Section E : Stock and Debtors Method

29. Ramchandra sells goods on hire purchase at cost plus 50%. From the following particulars relating to the hire purchase department find out the profit for the year ending 31st December, 2017 by following stockand debtors system (all figures in ₹):

Jan 1. Stock with hire purchase customers at S.P.	4,500	Dec. 31 Cash received from customers	30,000
Stock at shop at cost	9,000	Instalments due, customers paying	4,500
Instalments due	2,500	Goods repossessed (inst. due: ₹ 1,000) valued at	250
		Stock at shop at cost (exc. repossessed goods)	10,000
		Goods purchased during the year	30,000

30. Y Ltd. sells products on hire purchase terms, the price being cost plus $33^1/_3\%$. From the following particulars for 2017, prepare Hire Purchase Stock Account, Shop Stock Account, Hire Purchase Debtors Account, Stock Reserve Account and Hire Purchase Adjustment Account (for profit) (all figures in ₹):

Jan 1. Stock out on hire at H.P. price	1,20,000	Dec. 31 Stock out on hire at H.P. price	1,38,000
Stock in hand, at shop	15,000	Stock in hand at the shop	21,000
Instalments due (customers still paying)	9,000	Instalments due (customers still paying)	15,000
		Cash received during the year	2,40,000

31. The hire purchase department of New Appliances Ltd. sells television sets and room coolers. This department was started in 2017. The relevant information for the year ended 31st December, 2017 is as follows :-

Particulars	Television	Room Cooler	Particulars	Television	Room Cooler
Cost	5,400	2,000	Monthly Instalment	600	200
Cash Price	6,300	2,400	Number of instalments	10	12
Cash down payment	900	400			

During the year, 200 television sets and 240 room coolers were sold on hire purchase basis. Four television sets on which only 3instalments could be collected and 8 room coolers on which 5 instalments had been collected were repossessed. These were valued at ₹ 20,000; after reconditioning at a cost of ₹ 2,000, they were sold out-right for ₹ 28,000. Other instalments collected and those due customers still paying were respectively as : Television sets 540 and 40; Room coolers 800 and 60.

Prepare accounts on Stocks and the Debtors system to reveal the profit of the department. Show your workings.

Section F : Instalment Payment System

32. On 1st January 2017, Sincomed Company purchased three machines from the Chemical Machineries Ltd. under instalment payment system. The cash down price of each machine was ₹ 8,865. The total amount was paid in four equal instalments of ₹ 7,500 on 31st Decmber every year. The Chemical Machineries Ltd. charged interest at 5% per annum. Charge depreciation at 10% per annum on the diminishing balances. Show the Machine Account, Chemical Machineris Ltd. Account and Interest Suspense Account in the books of the purchasing company.
33. Youth Club purchases a T.V. costing ₹ 4,500 on instalment payments system on 1st January, 2015, from S. E. C. Company. It is agreed that ₹ 1,500 will be paid on signing the agreement and the balance in 3 equal annual instalments together with interest. Interest is charged at 10% per annum. Depreciation is charged at 15% per annum on diminishing balance method. Show T.V. Account and S. E. C. Company Account in the books of Youth Club for 3 years.
34. On 1st January, 2016, the Black Colliery Co. Ltd. purchased five wagons on the instalment system from Burn & Co Ltd. The cash price of the wagons was ₹ 7,45,000 and ₹ 2,00,000 was to be paid on signing the agreement and the balance in 3 instalments of ₹ 2,00,000 each at the end of each year. Interest is charged at 5% p.a. by the Burn & Co Ltd. The company has decided to write off 10% annually on the Diminishing balance of the cash value. Make the entries and open the necessary accounts in the books of the Black Colliery Co. Ltd. and Burn & Co. Ltd.
35. Buyers Ltd. purchased a truck on 1st January, 2017 on the instalment payment system, from Vendors Ltd. The cash down price was ₹ 3,00,000. The terms of the purchase were as under :
    (i) ₹ 1,20,000 is payable as deposit.
    (ii) The balance being payable by 12 quaterly instalments of ₹ 19,200 each following due from 1st April, 2017. The financial year of Buyers Ltd. ends on 30th June.

    On 30th September, 2018, the truck was sold for ₹ 2,00,000 and the balance instalment was settled for ₹ 1,02,000. Buyers Ltd. spreads the interest equally over the instalment period. Depreciation at 20% p.a. on cost was provided upto the date of sale.

    Show Truck Account; Vendors Ltd. Accounts and Interest Suspense Account in the books of Buyers Ltd.

Section G : Lease

36. A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is ₹ 70,000. The IRP of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of the 4th year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4th year at 10% rate of interest is 0.683.

    State with reasons whether the lease constitutes finance lease.

Guide to Answers

Practical Questions

1. **Last instalment — ₹ 2,100.**
2. **Last instalment — ₹ 5,250.**
3. **Interest : 1st year — ₹ 65; 2nd year — ₹ 53; 3rd year — ₹ 41; 4th year — ₹ 28; and 5th year — ₹ 13 (Adjusted).**
4. **Total interest ₹ 5,000 [(₹ 12,500 × 4 + ₹ 5,000) – ₹ 50,000]. Interest to be charged — 1st year : ₹ 2,000; 2nd year : ₹ 1,500; 3rd year : ₹ 1,000; and last year : ₹ 500. (please see Illustration 20 for help)**
5. **Interest — 1st year : ₹ 1,364; 2nd year : ₹ 931; last year : ₹ 455. Interst of ₹ 22 has been adjusted in the last instalment.**
6. **Interest — 2016 : ₹ 545; 2017 : ₹ 372; and 2017 : ₹ 189. Interest of ₹ 2 has been adjusted in the last instalment.**
7. **Interest — 2015 : ₹ 1,226; 2016 : ₹ 838; 2017 : ₹ 411. (Interest of ₹ 18 has been adjusted in the last instalment).**
8. **1st instalment : ₹ 9,600; 2nd instalment : ₹ 9,200; 3rd instalment : ₹ 8,800; and last instalment : ₹ 8,400.**
9. **Amount payable in 2018 : ₹ 10,175.**
10. **Interest in each instalment : ₹ 390; ₹ 330; ₹ 268; ₹ 204; ₹ 138; ₹ 70.**
11. **Cash price : ₹ 30,000.**
12. **Cash price : ₹ 20,200 (approx.)**
13. **Cash price : ₹ 1,06,600 (4.33 × ₹ 20,000 +₹ 20,000).**
14. **Cash price : ₹ 60,000. Interest — 2016 : ₹ 4,965; 2017 : ₹ 3,465; 2018 : ₹ 1,815.**
15. **Cash price : ₹ 54,869.**
16. **Loss on surrender : ₹ 36,000; Value of repossessed buses : ₹ 60,000; Balance of Arvind Motors Account : ₹ 7,200 .**
17. **Loss on surrender : ₹ 15,000. Value of repossessed machinery : ₹ 49,000. Balance of Z Co. Ltd. : ₹ 61,000; Balance of Machinery Account : ₹ 64,000 on 31.3.2018.**
18. **Loss on repossession : ₹ 79,500; Credit allowed for 3 trucks : ₹ 40,500. Balance of Truck Account as on 30.6.2018 : ₹ 1,60,000.**
19. **H.P. Trading : Gross profit : ₹ 41,000.**
20. **H.P. Trading : Gross profit : ₹ 21,000; Instalments due : ₹ 7,700.**
21. **Gross profit rate — 2015 : 16.67%; 2016 : 20%; 2017 : 24%; 2018 : 23.91%. Amount of gross profit — 2015 : ₹ 36,667; 2016: ₹ 1,26,667; 2017 : ₹ 1,87,867; 2018 : ₹ 2,28,852.**

22. H.P. Trading : Gross profit : ₹ 2,050; Instalments due : ₹ 8,200; Goods sold on H.P. : ₹ 8,800; and its cost ₹ 6,600. Stock reserve : ₹ 1,150.
23. H.P. Trading : Gross profit : ₹ 1,650; General Trading — Profit : ₹ 40,500. H.P. Stock with customers : ₹ 4,600.
24. H.P. Trading : ₹ 238; H.P. Stock : ₹ 190; General Trading Profit (G.P.) : ₹ 3,077.
25. Balance of Machinery on H.P. Account on 31st March, 2018 — ₹ 42,860. Balance of Hire Purchase Company Account on 31st March, 2018 : ₹ 27,900. Balance of Interest Suspense Account on 31st March, 2018 : ₹ 1,959. Loss on disposal of Machine: ₹ 737.
26. Total instalments received in 2017 : ₹ 79,875; Outstanding instalments on 31.12.2017 : ₹ 63,900. Instalment credited to Profit and Loss Account : ₹ 12,600 ₹ (2,400 + 4,500 + 5,700). Sales : ₹ 87,400 ₹ (76,000 + 11,400).
27. Gross Profit : Cash ₹ 3,48,000; H.P. ₹ 80,424; Net Profit : ₹ 2,52,524; Total of Balance Sheet ₹ 12,00,524.
28. Net Profit : Radio Sets—₹ 86,127; Record Player—₹ 25,174; Total—₹ 1,11,301.
Cash Received : ₹ 39,500; H.P. Profit : Radio Sets—₹ 5,917; Record Player—₹ 9,914; Total—₹ 15,831.
29. H.P. Profit : ₹ 10,250; Instalments due during the year : ₹ 33,000.
30. H.P. Profit : ₹ 61,500; Instalments due during the year : ₹ 2,46,000; Purchases : ₹ 2,04,000.
31. H.P. Profit : ₹ 2,00,057; Total Stock Reserve : ₹ 2,89,943.
32. Interest — 1st year : ₹ 1,330; 2nd year : ₹ 1,021; 3rd year : ₹ 697; and 4th year : ₹ 355 (₹ 2 has been adjusted).
33. Interest — 1st year : ₹ 300; 2nd year : ₹ 200; 3rd year : ₹ 100. Last instalment : ₹ 1,100.
34. Interest — 1st year : ₹ 27,250; 2nd year : ₹ 18,612; 3rd year : ₹ 9,138 (₹ 405 has been adjusted).
35. Interest suspense — ₹ 50,400; Interest charged to Profit and Loss Account — 30.6.2017 : ₹ 8,400; 30.6.2018 : ₹ 16,800; 30.6.2003 : ₹ 12,000. Interest adjusted against Vendors Ltd. : ₹ 13,200.
36. Determination of nature of lease : Fair value of asset ₹ 7,00,000.
Unguaranteed residual value ₹ 70,000.
Present value of residual value at the end of the 4th year = ₹ 70,000 × 0.683 = ₹ 47,810.
Present value of lease payment recoverable = ₹ 7,00,000 – ₹ 47,810 = ₹ 6,52,190.
The percentage of present value of lease payment to fair value of the asset is (₹ 6.52,190 ÷ ₹ 7,00,000) × 100 = 93.17%.
Since it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a finance lease.

9

Departmental Accounts

Introduction

A business is generally split up into a number of departments when it sells different types of goods or carries on several activities under the same roof. Such departments are found in businesses of all sizes (particularly in urban areas). A department is generally a physical part of the rest of the business. It should not be assumed that departmental accounts refers only to departmental stores. In fact, they refer to the verious facets of a business. Each department is treated as a separate ***profit centre***, though none of the departments is separated geographically from the rest of the departments. This type of organisational subdivision creates a need for internal information about the operating results of each department. Since different departments may have different rates of growth, profitability and degrees of risk, managerial decisions in regard to pricing, closure etc. can be made on the basis of such information.Therefore, the various pros and cons of the actions to be taken to increase the over all profitability of the business concern can not be properly considered until the departmental profits and losses are known.

Advantages of Departmental Accounting

The main advantages of departmental accounting are as follows:

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.
4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organisation.
6. Departmental managers and staff can be rewarded properly on the basis of results.
7. It helps the management to determine the justification of capital outlay in each department.
8. It facilitates the comparison of expense items with those in other departments and in the previous period.

9. It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.
10. Departmental accounting information also provides a basis for intelligent planning and control.

Methods of Departmental Accounts

In order to ascertain the departmental profit accurately, it is necessary to identify the different expenses and revenues of each department. The accounting system must be designed in such a manner that it provides maximum information and is simple to operate.

There are two methods of keeping Departmental Accounts:

(a) where separate set of books are kept for each department; and
(b) where accounts of all the departments are kept together on columnar books.

(a) Where Separate Set of Books are Kept for Each Department

This method of accounting is employed when the size of the organisation is very large or the law of the land requires the maintenance of separate books for each department. For example, in India, general insurance company is required to prepare separate revenue account for each type of business — fire, marine, accidents, etc.

Under this method each department is regarded as a separate unit and accounts are kept independently. At the year end the trading results of all the departments are combined to get the trading results of the organisation as a whole. This method is rarely used and is also expensive in operation.

(b) Where Accounts of All Departments are Kept Together on Columnar Books

When the size of the organisation is small, the entire book keeping system for the business as a whole is generally kept by a central accounts department.

A department does not maintain a full double-entry book-keeping system of its own, but some records are normally kept regarding purchases, sales and direct expenses, stock within the department, etc. The central accounts department generally maintains an analytical or columnar Purchase and Sales Day Book to distinguish between the purchases and sales of different departments.

After ascertaining purchases and sales of each department and also the direct expenses incurred, it only requires a departmental closing stock-taking in order to prepare a Trading Account for each department. Following is a specimen of Departmental Trading Account.

ABC Departmental Store Ltd.

Dr. **Departmental Trading Account for the year ended ...** **Cr.**

Particulars	Dept. A	Dept. B	Dept. C	Total	Particulars	Dept. A	Dept. B	Dept. C	Total
To Op. Stock	4,000	10,000	15,000	29,000	By Sales	50,000	70,000	80,000	2,00,000
To Purchases	37,000	45,000	55,000	1,37,000	By Cl. Stock	10,000	5,000	20,000	35,000
To Direct Exp.	10,000	5,000	5,000	20,000					
To G. P. c/d	9,000	15,000	25,000	49,000					
	60,000	75,000	1,00,000	2,35,000		60,000	75,000	1,00,000	2,35,000
Gross profit ratio	15%	20%	25%						

Under this system, the ***gross profit*** of individual department can be determined accurately. Where it is desired to determine the departmental net profit in addition to the gross profit, each department is charged with a share of the common expenses which is apportioned on a suitable basis.

Allocation of Departmental Expenses

In practice, the following general rules are usually applied for allocation and apportionment of expenses:

1. Expenses directly related to a particular department should be charged to that department. For example, salary of employees of a particular department or bad debts from the sale of a particular department can be charged to the concerned department directly.

2. The expenses which have a direct bearing with the sales should be apportioned on the basis of net sales. For example, advertisement expenses should be apportioned on the basis of departmental sales to outside customers.
3. All other business expenses, e.g. rent, rates, lighting, heating, depreciation, insurance etc. should be apportioned on the most logical basis. The nature of the expense, and the nature of the business will determine the basis for apportionment of expenses. The basis for apportionment of some important expenses are given below:

Sl.	Expenses	Basis
1.	(a) Travelling salesman's salary and commission (b) Selling expenses (c) After-sales service (d) Discount allowed (e) Freight outwards (f) Provision for discounts on debtors (g) Sales manager's salary and other benefits	Sales of each department
2.	(a) Rent, rates and taxes (b) Air conditioning expenses (c) Heating	Area or value of floor space
3.	Lighting	Light points
4.	Insurance on Stock	Average stock carried
5.	Insurance on Building	Area
6.	Insurance on Plant & Machinery	Value of Plant & Machinery
7.	Group insurance premium	Direct wages
8.	Power	H.P. or H.P. x Hours worked
9.	(a) Depreciation (b) Repairs and renewals	Value of assets in each department
10.	(a) Canteen expenses (b) Labour welfare expenses	Number of employees
11.	Works manager's salary	Time spent in each department
12.	Carriage inwards	Purchases of each department

There are certain types of expenses, most being of a financial nature, which cannot be apportioned on a suitable basis. Examples are loss on sale of investment or assets, damages payable for the infringement of law, interest on bank loan etc. There are also some purely financial incomes which cannot be suitably apportioned among different departments. To ascertain the total profit of a business as whole profits from all the departments should be added. If department(s) suffers a loss, it should be deducted from the total profits of the other departments. This figure should be brought down in one total and all the expenses should be deducted from that figure to arrive at the net profit.

Technique of Departmental Accounts

Columnar Purchases and Sales Books, etc. (Manual System)

If the number of departments are small, it is convenient to use columnar or analytical Purchase Day Book and Sales Day Book for recording credit purchases and credit sales of each department. Return Inwards Book and Return Outwards Book are ruled in a similar manner. For recording cash sales and cash purchases, special columns are also provided in the Cash Book.

Purchases Day Book

Date	Particulars	Invoice No.	L.F.	Total ₹	Departments		
					A	B	C
2017							
April 4	Century Mills Ltd.	19 / 17		40,000	—	—	40,000
18	Bombay Dyeing Ltd.	14 / 17		50,000	50,000	—	—
30	Raymond's Mills Ltd.	17 / 17		60,000	—	60,000	—
				1,50,000	50,000	60,000	40,000

The total monthly purchases of each department are posted to the debit of the respective Department's Purchases Account. The Suppliers' Account is credited in the usual manner.

In the General Ledger the Purchases Account will appear as follows:

Dr. **Purchases Account** **Cr.**

Date	Particulars	Departments			Date	Particulars	Departments		
		A	B	C			A	B	C
30.4.2015	To S. Creditors A/c	50,000	60,000	40,000					

The same ruling will do for Sales Day Book, Returns Inwards Book and Returns Outwards Book.

Computerised System

If the number of departments are very large, the use of separate journal column for each department would result in journal of unmanageable size. Now-a-days almost all large departmental stores are using computer to record transaction data directly into a computerised accounting system. With the help of computer terminals each department enter sales information into a main computer at the time each sale is rung up. Journals, ledgers and other reports are prepared at the end of each month for the use of the management.

Distinction between Departmental Accounts and Branch Accounts

1. In case of a dependent branch, all important accounting records are kept at the head office. The branch maintains only Cash Account and Customers Account (if necessary). However, an independent branch, usually maintains its own books of account and prepares its own Trading and Profit and Loss Account. In case of Departmental Accounts, all accounting records are maintained at one place and Departmental Trading and Profit and Loss Account is prepared accordingly.
2. As the departments are not geographically separated from each other, the problem of allocation of common expenditure among different departments arises. But in case of a branch account this problem of allocation of common expenditure does not arise since branches are geographically separated from each other.
3. In case of an independent branch, at the end of the accounting year, some adjustment and reconciliation of head office and branch accounts are required. In case of Department Accounts, the question of adjustments and reconciliation of accounts does not arise.
4. At the time of finalisation of accounts of head office, the conversion of foreign branch figures may create some problems. In case of Departmental Accounts, this type of problem does not arise.

Illustration 1

The following balances as at 31.12.2017 have been extracted from the books of Sri Ram & Co which has two departments:

Particulars	Dept. A (₹)	Dept. B (₹)
Opening Stock as on 1.1.2017	25,000	20,000
Purchases	2,30,000	1,90,000
Purchase Returns	2,000	1,000
Sales	6,33,000	4,92,000
Sales Returns	3,000	2,000
Wages	1,80,000	1,60,000
Miscellaneous Charges	35,000	32,000

General:

Sundry Debtors — ₹ 1,90,000; Sundry Creditors — ₹ 1,73,000; Plant and Machinery — ₹ 2,40,000; Leaseholds — ₹ 80,000; Buildings — ₹ 1,20,000; Furniture and Fittings — ₹ 48,000; Office and Selling Expenses — ₹ 1,28,000; Cash in hand on 31.12.2017 — ₹ 8,000; Cash at Bank on 31.12.2017 — ₹ 1,10,000; Capital — ₹ 5,00,000.

Plant and Machinery is to be depreciated by 10%; Buildings by 2%; Furniture and Fittings by 5%; Leaseholds are to be written-off by ₹ 8,000. The stock on hand as on 31.12.2017: Department A — ₹ 26,000; Department B — ₹ 24,000.

All unallocated expenditure is to be apportioned in the ratio of the net sales of each department.

Prepare in columnar form, the Trading, Profit and Loss Account of the two departments and Balance Sheet of the combined business as a whole on 31.12.2017.

Solution

Sri Ram & Co

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Dept A	Dept B	Particulars	Dept A	Dept B
To Opening Stock	25,000	20,000	By Sales less returns	6,30,000	4,90,000
To Purchases less returns	2,28,000	1,89,000	By Closing Stock	26,000	24,000
To Wages	1,80,000	1,60,000			
To Gross Profit b/d	2,23,000	1,45,000			
	6,56,000	5,14,000		6,56,000	5,14,000
To Miscellaneous Charges	35,000	32,000	By Gross Profit b/d	2,23,000	1,45,000
To Depreciation:					
On Plant & Machinery	13,500	10,500			
On Furniture & Fittings	1,350	1,050			
On Building	1,350	1,050			
To Leaseholds	4,500	3,500			
To Office & Selling Expenses	72,000	56,000			
To Net Profit — transferred to Capital	95,300	40,900			
	2,23,000	1,45,000		2,23,000	1,45,000

Balance Sheet of Sri Ram & Co. as at 31st December, 2017 Cr.

Liabilities	₹	₹	Assets	₹	₹
Capital (opening)	5,00,000		Leaseholds	80,000	
Add: Profit from Dept. A	95,300		Less: Written-off	8,000	72,000
Add: Profit from Dept. B	40,900	6,36,200	Buildings	1,20,000	
Sundry Creditors		1,73,000	Less: Depreciation	2,400	1,17,600
			Plant & Machinery	2,40,000	
			Less: Depreciation	24,000	2,16,000
			Furniture & Fittings	48,000	
			Less: Depreciation	2,400	45,600
			Closing Stock (₹ 26,000 + 24,000)		50,000
			Sundry Debtors		1,90,000
			Cash at Bank		1,10,000
			Cash in hand		8,000
		8,09,200			8,09,200

Working Note : Apportionment of Unallocated Expenditure

Particulars	Dept. A	Dept. B
(a) Depreciation:		
On Plant & Machinery	$\frac{24,000}{112} \times 63 =$ ₹ 13,500	$\frac{24,000}{112} \times 49 =$ ₹ 10,500
On Furniture & Fittings	$\frac{2,400}{112} \times 63 =$ ₹ 1,350	$\frac{2,400}{112} \times 49 =$ ₹ 1,050
On Buildings	$\frac{2,400}{112} \times 63 =$ ₹ 1,350	$\frac{2,400}{112} \times 49 =$ ₹ 1,050
(b) Leasehold	$\frac{8,000}{112} \times 63 =$ ₹ 4,500	$\frac{8,000}{112} \times 49 =$ ₹ 3,500
(c) Office & Selling Expenses	$\frac{1,28,000}{112} \times 63 =$ ₹ 72,000	$\frac{1,28,000}{112} \times 49 =$ ₹ 56,000

Illustration 2

From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the year ended 31.12.2017 and a Balance Sheet as on that date in the books of P & Co. (all figures in ₹):

Particulars		Dr.	Cr.
Stock on 1.1.2017	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 inwards		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	
Total		43,820	43,820

The following information is also provided:

(a) Rent, lighting and heating, salaries and depreciation are to be apportioned to A and B Departments as 2 : 1.

(b) Other expenses and incomes are to be apportioned to A and B Departments on suitable basis.

(c) The following adjustments are to be made:
Rent pre-paid ₹ 370; Lighting and heating outstanding ₹ 180; and Depreciation on Furniture & Fittings and Plant & Machinery @ 10% p.a.

(d) The stock at 31.12.2017 : Department A — ₹ 2,748; Department B — ₹ 2,401.

Solution **P & Co.**

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Dept A	Dept B	Particulars	Dept A	Dept B
To Opening Stock	5,400	4,900	By Sales	16,900	13,520
To Purchases	9,800	7,350	By Closing Stock	2,748	2,401
To Carriage Inwards (Note 1)	268	201			
To Wages	1,340	240			
To Gross Profit b/d	2,840	3,230			
	19,648	15,921		19,648	15,921
To Rent	1,000	500	By Gross Profit b/d	2,840	3,230
To Salaries	880	440	By Discount received (Note 1)	76	57
To Lighting and heating	400	200	By Net Loss - transferred to Capital	339	—
To Discount allowed	245	196			
To Advertisement	410	328			
To Depreciation	320	160			
To Net Profit - transferred to Capital	—	1,463			
	3,255	3,287		3,255	3,287

Balance Sheet of P & Co. as at 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital (opening)	9,530		Plant and Machinery	4,200	
Add: Profit from Dept. B	1,463		Less: Depreciation	420	3,780
Less: Loss from Dept. A	339		Furniture and Fittings	600	
	10,654		Less: Depreciation	60	540
Less: Drawings	900	9,754	Sundry Debtors		1,820
Outstanding exp. for lighting and heating		180	Stock in trade		5,149
Sundry Creditors		3,737	Cash at bank		1,980
			Cash in hand		32
			Prepaid rent		370
		13,671			13,671

Working Note: (1) Carriage inwards and discount received are apportioned in the purchase ratio and discount allowed and advertisement in the sales ratio.

Particulars	Dept. A	Dept. B
(a) Carriage Inward	$\frac{469}{17,150}$ x 9,800 = ₹ 268	$\frac{469}{17,150}$ x 7,350 = ₹ 201
(b) Discount received	$\frac{133}{17,150}$ x 9,800 = ₹ 76	$\frac{133}{17,150}$ x 7,350 = ₹ 57
(c) Discount allowed	$\frac{441}{30,420}$ x 16,900 = ₹ 245	$\frac{441}{30,420}$ x 13,520 = ₹ 196
(d) Advertisement	$\frac{738}{30,420}$ x 16,900 = ₹ 410	$\frac{738}{30,420}$ x 13,520 = ₹ 328
(e) Rent (₹ 1,870 – 370)	$\frac{1,500}{3}$ x 2 = ₹ 1,000	$\frac{1,500}{3}$ x 1 = ₹ 500
(f) Lighting & heating (₹ 420 + 180)	$\frac{600}{3}$ x 2 = ₹ 400	$\frac{600}{3}$ x 1 = ₹ 200
(g) Salaries	$\frac{1,320}{3}$ x 2 = ₹ 890	$\frac{1,320}{3}$ x 1 = ₹ 440
(h) Depreciation (₹ 420 + 60)	$\frac{480}{3}$ x 2 = ₹ 320	$\frac{480}{3}$ x 1 = ₹ 160

Illustration 3

M/s Suman Hosiery Mills produces three varieties of products: Sona, Mona and Dona. The cost of production during the year 2017 of these varieties amounted to ₹ 8,00,000. Output during the year were: Sona — 4,000 units; Mona — 8,000 units and Dona — 9,600 units.

Stock on 1st January, 2017 were: Sona — 450 units; Mona — 300 units and Dona — 600 units.

Sales during the year were: Sona — 4,100 units @ ₹ 48 each; Mona — 7,700 units @ ₹ 54 each and Dona — 10,000 units @ ₹ 60 each. The rate of gross profit is the same in each case. Total departmental expenses of ₹ 96,000 were to be apportioned to various products in the ratio of 1:2:2.

Prepare Departmental Trading Account. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

M/s Suman Hosiery Mills

Dr. Departmental Trading Account for the year ended 31st December, 2017 Cr.

Particulars	Sona	Mona	Dona	Particulars	Sona	Mona	Dona
To Opening Stock (Note 1)				By Sales			
Sona (450 x ₹ 32)	14,400			Sona (4,100 x ₹ 48)	1,96,800		
Mona (300 x ₹ 36)		10,800		Mona (7,700 x ₹ 54)		4,15,800	
Dona (600 x ₹ 40)			24,000	Dona (10,000 x ₹ 60)			6,00,000
To Cost of Production:				By Closing Stock:			
Sona (4,000 x ₹ 32)	1,28,000			Sona (350 x ₹ 32)	11,200		
Mona (8,000 x ₹ 36)		2,88,000		Mona (600 x ₹ 36)		21,600	
Dona (9,600 x ₹ 40)			3,84,000	Dona (200 x ₹ 40)			8,000
To Department Gross Profit ($33^1/_3$ of Sales)	65,600	1,38,600	2,00,000				
	2,08,000	4,37,400	6,08,000		2,08,000	4,37,400	6,08,000

Tutorial Note: Departmental expenses of ₹ 96,000 should not be charged to Trading Account, because they are not directly related with production. However, for the purpose of determining departmental net profit, these expenses are to be charged to: Sona — ₹ 19,200; Mona — ₹ 38,400; and Dona — ₹ 38,400. The resultant profits will be: Sona — ₹ 46,400; Mona — ₹ 1,00,200; and Dona — ₹ 1,61,600.

Working Notes: For the purpose of calculating G.P. ratio, the cost of production to be deducted from the sale value of goods produced only.

(1) Calculation of Rate of Gross Profit and Cost of Production

	₹	₹
Sales value of goods produced:		
Sona : 4,000 x ₹ 48	1,92,000	
Mona : 8,000 x ₹ 54	4,32,000	
Dona : 9,600 x ₹ 60	5,76,000	12,00,000
Less: Total cost of production		8,00,000
Expected Gross Profit		4,00,000
(a) Rate of gross profit = $\frac{4,00,000}{12,00,000} \times 100 = 33\frac{1}{3}\%$ (on sales)		

(b) Respective departmental cost prices (i.e., Sales price less $33\ ^1/_3\%$) :
Sona : ₹ 48 – ₹ 16 = ₹ 32; Mona : ₹ 54 – ₹ 18 = ₹ 36; and Dona : ₹ 60 – ₹ 20 = ₹ 40.

(2) Calculation of Number of Units Unsold

Department	Opening Stock (+)	Production (—)	Sales (=)	Closing Stock
Sona (units)	450	4,000	4,100	350
Mona (units)	300	8,000	7,700	600
Dona (units)	600	9,600	10,000	200

Assumption : Cost of production and sales prices are constant for the last 2 years.

Illustration 4

Brahma Limited has three departments and submits the following information for the year ending on 31st March, 2011 :

Particulars	A	B	C	Total (₹)
Purchases (units)	5,000	10,000	15,000	—
Purchases (Amount)	—	—	—	8,40,000
Sales (units)	5,200	9,800	15,300	—
Selling price (₹ per unit)	40	45	50	—
Opening stock (units)	400	600	700	—

You are required to prepare Departmental Trading Account of Brahma Limited assuming that the rate of profit on sales is uniform in each case. ***[C.A. (IPCE) — May, 2011]***

Solution

Brahma Ltd

Dr. Departmental Trading Account for the year ended 31st March, 2011 Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Opening Stock (Note 4)	14,400	10,800	30,000	By Sales (Note 6)	2,08,000	4,41,000	7,65,000
To Purchases (Note 2)	1,20,000	2,70,000	4,50,000	By Closing Stock (Note 5)	9,600	16,200	21,000
To Gross Profit	83,200	1,76,400	3,06,000				
	2,17,600	4,57,200	7,86,000		2,17,600	4,57,200	7,86,000

Working Notes :

(1) Calculation of Profit Margin Rate

Particulars	₹	₹
Department A (5,000 units @ ₹ 40)	2,00,000	
Department B (10,000 units @ ₹ 45)	4,50,000	
Department C (15,000 units @ ₹ 50)	7,50,000	
Total Sales Value		14,00,000
Less: Purchases (given)		8,40,000
Gross Profit		5,60,000

$$\text{Profit Margin Rate} = \frac{\text{Gross Profit}}{\text{Sales Value}} \times 100 = \frac{5,60,000}{14,00,000} \times 100 = 40\%$$

(2) Calculation of Purchase Price and Total Purchases of Each Department

Particulars	A	B	C
Selling Price per unit (₹)	40	45	50
Less: Profit Margin @ 40%	16	18	20
Purchase Price per unit (X)	24	27	30
Number of Units Purchased (Y)	5,000	10,000	15,000
Total Purchases (X) x (Y) (₹)	1,20,000	2,70,000	4,50,000

(3) Calculation of Opening Stock of Each Department

Department	A	B	C
Closing Stock (units)	400	600	700
Add: Sales (units)	5,200	9,800	15,300
	5,600	10,400	16,000
Less: Purchases (units)	5,000	10,000	15,000
Opening Stock (units)	600	400	1,000

(4) Calculation of Value of Opening Stock

Department A : 600 × ₹ 24 = ₹ 14,400

Department B : 400 × ₹ 27 = ₹ 10,800

Department C : 10,000 × ₹ 30 = ₹ 30,000

(5) Calculation of Value of Closing Stock

Department A : 400 × ₹ 24 = ₹ 9,600

Department B : 600 × ₹ 27 = ₹ 16,200

Department C : 700 × ₹ 30 = ₹ 21,000

(6) Calculation of Sales Value

Department A : 5,200 × ₹ 40 = ₹ 2,08,000

Department B : 9,800 × ₹ 45 = ₹ 4,41,000

Department C : 15,300 × ₹ 50 = ₹ 7,65,000

Illustration 5

Rohit Choudhury is the proprietor of a retail business which has two main departments which sell respectively hardware and electrical goods. On 31.12.2017, the balances in the books of the business were as follows :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		71,000	Drawings	3,000	
Sales — Hardware		59,000	Buildings (Cost)	43,000	
Electrical		29,500	Equipments at W.D.V. — Hardware	18,000	
Purchases — Hardware	20,000		Electrical	7,000	
Electrical	10,000		Debtors and Creditors	10,200	5,319
Stock on 1.1.2017 — Hardware	2,320		Bank	5,600	
Electrical	2,136		Rent and Rates	1,580	
Salaries — Hardware	20,560		Canteen Charges	875	
Electrical	15,440		Heating and Lighting	880	
Advertising	615		Insurance of Stock	940	
Discount allowed — Hardware	400		General Administrative Expenses	2,073	
Electrical	200		**Total**	1,64,819	1,64,819

Additional information —

(i) At 31.12.2017, the following amounts were outstanding :
Salaries — Hardware ₹ 250; Electrical ₹ 170; Heating and Lighting ₹ 20.

(ii) The general administrative expenses and the rent and rates included prepayments of ₹ 33 and ₹ 80 respectively.

(iii) Stocks at 31.12.2017 were : Hardware ₹ 2,800; Electrical ₹ 2,450.

(iv) Depreciation is to be provided on equipments at 10% on W.D.V.

(v) The managers of the hardware and electrical departments are to be paid a commission of 5% of the net profit (prior to the commission payment) of the respective departments.

(vi) In apportioning the various expenses between the two departments due regard is to be given to the following information :

	Number of Workers	Average Stock Levels (₹)	Floor Area (sq.ft)
Hardware	9	2,500	4,000
Electrical	6	2,200	2,000

(vii) The general administrative expenses are primarily incurred in relation to the processing of purchases and sales invoices.

Prepare a Departmental Trading and Profit and Loss Account and the Balance Sheet.

Solution **Rohit Choudhury**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Hardware (₹)	Electrical (₹)	Particulars	Hardware (₹)	Electrical (₹)
To Opening Stock	2,320	2,136	By Sales	59,000	29,500
To Purchases	20,000	10,000	By Closing Stock	2,800	2,450
To Gross Profit c/d	39,480	19,814			
	61,800	31,950		61,800	31,950
To Salaries (including outstanding)	20,810	15,610	By Gross Profit b/d	39,480	19,814
To Advertising (Note 1)	410	205			
To Discount Allowed	400	200			
To Rent and Rates (Note 1)	1,000	500			
To Canteen Charges (Note 1)	525	350			
To Heating and Lighting (Note 1)	600	300			
To Insurance of Stock (Note 1)	500	440			
To General Administrative Exp. (Note 1)	1,360	680			
To Depreciation on Equipments	1,800	700			
To Managers' Commission	604	41			
To Net Profit (transferred to Capital)	11,471	788			
	39,480	19,814		39,480	19,814

Balance Sheet of Rohit Choudhury as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital (Opening)	71,000		Buildings (cost)		43,000
Add: Profit from Hardware	11,471		Equipments at W.D.V. (₹ 18,000 + 7,000)	25,000	
Add: Profit from Electrical	788		Less: Depreciation (₹ 1,800 + 700)	2,500	22,500
	83,259		Stock — Hardware	2,800	
Less: Drawings	3,000	80,259	Electrical	2,450	5,250
Creditors		5,319	Debtors		10,200
Outstanding :			Bank		5,600
Salaries (₹ 250 + 170)		420	Prepayments :		
Heating and Lighting		20	General Administrative Expenses		33
Commission (₹ 604 + 41)		645	Rent and Rates		80
		86,663			86,663

Working Notes :

(1) Apportionment of Common Expenses

Expenses	Basis	Hardware Department	Electrical Department
(i) Advertising	Sales	$\frac{615}{88,500} \times$ Rs 59,000 = ₹ 410	$\frac{615}{88,500} \times 29,500$ = ₹ 205
(ii) Rent and Rates	Floor Area	$\frac{1,500 \text{ (Note 3)}}{6} \times 4$ = ₹ 1,000	$\frac{1,500}{6} \times 2$ = ₹ 500
(iii) Canteen Charges	Number of Workers	$\frac{875}{15} \times 9$ = ₹ 525	$\frac{875}{15} \times 6$ = ₹ 350
(iv) Heating and Lighting	Floor Area	$\frac{900 \text{ (Note 3)}}{6} \times 4$ = ₹ 600	$\frac{900}{6} \times 2$ = ₹ 300
(v) Insurance of Stock	Average Stock Level	$\frac{940}{4,700} \times 2,500$ = ₹ 500	$\frac{940}{4,700} \times 2,200$ = ₹ 440
(vi) General Administrative Expenses	Total of Sales and Purchases	$\frac{2,040 \text{ (Note 3)}}{1,18,500} \times 79,000$ = ₹ 1,360	$\frac{2,040}{1,18,500} \times 39,500$ = ₹ 680

(2) Managers' Commission:
Hardware : 5% of ₹ 12,075 = ₹ 604 (approx.)
Electrical : 5% of ₹ 829 = ₹ 41 (approx.)
(3) Rent and Rates : ₹ 1,580 – ₹ 80 (prepaid) = ₹ 1,500;
Heating and Lighting : ₹ 880 + ₹ 20 (outstanding) = ₹ 900;
General Administrative Expenses : ₹ 2,073 – ₹ 33 (prepaid) = ₹ 2,040

Illustration 6

The following balances as at 31.12.2017 have been extracted from the books of David, the proprietor of a departmental store :

Wages and Salaries ₹ 1,42,500; Maintenance ₹ 12,360; Rent ₹ 27,050; Advertising ₹ 15,000; Sundry Debtors ₹ 41,900; Sundry Creditors ₹ 16,800; Provision for doubtful debts ₹ 5,000; Investments ₹ 50,000; Furniture ₹ 46,500; Cash ₹ 21,550; Capital Account ₹ 2,00,000; Current Account ₹ 880 (Cr.); Drawings ₹ 75,120.

The records relating to the stocks are : (all figures in ₹)

	Stock on 1.1.2017	Purchases	Purchase Returns	Stock on 31.12.2017
Dept. X	10,700	94,600	900	21,000
Dept. Y	68,000	2,20,980	2,200	61,600

Additional information :

(1) Department X sells articles for ₹ 40 each which is equivalent to 80% above cost price, while department Y sells articles for ₹ 60 each which is equivalent to double the cost price.
(2) Write off bad debts ₹ 3,300 and adjust the provision for doubtful debts to 10% of the remaining outstanding debtors. These adjustments should be apportioned equally between department X and department Y.

(3) Provide ₹ 4,000 investment income due to be received.
(4) Provide ₹ 1,150 rent due to be paid.
(5) Depreciate furniture by 10%.
(6) All general expenses should be apportioned between department X and department Y on the basis of the number of articles sold by these departments during the year.

You are required to prepare Departmental Trading and Profit and Loss Account for the year ended 31.12.2017 and a Balance Sheet as on that date.

Solution

David

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Dept. X (₹)	Dept. Y (₹)	Particulars	Dept. X (₹)	Dept. Y (₹)
To Opening Stock	10,700	68,000	By Sales (Note 1)	1,50,120	4,50,360
To Purchases	94,600	2,20,980	By Closing Stock	21,000	61,600
Less: Returns	(900)	(2,200)			
To Gross Profit c/d	66,720	2,25,180			
	1,71,120	5,11,960		1,71,120	5,11,960
To Wages and Salaries (Note 3)	47,500	95,000	By Gross Profit b/d		
To Maintenance (Note 3)	4,120	8,240	By Provision for Doubtful Debts	66,720	2,25,180
To Rent (₹ 27,050 + 1,150)	9,400	18,800	(equally — Note 2)	570	570
To Advertising (Note 3)	5,000	10,000	By Departmental Loss c/d	1,930	—
To Depreciation on Furniture (Note 3)	1,550	3,100			
To Bad Debts (equally)	1,650	1,650			
To Departmental Profit c/d	—	88,960			
	69,220	2,25,750		69,220	2,25,750
To Departmental Loss b/d		1,930	By Departmental Profit b/d		88,960
To Net Profit		91,030	By Accrued Income from Investments		4,000
		92,960			92,960

Balance Sheet of David as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital Account		2,00,000	Furniture	46,500	
Current Account :	₹		Less : Depreciation	4,650	41,850
Opening balance	880		Stock (₹ 21,000 + 61,600)		82,600
Add : Net Profit	91,030		Sundry Debtors	41,900	
	91,910		Less : Bad Debts	3,300	
Less : Drawings	75,120	16,790		38,600	
Sundry Creditors		16,800	Less : Provision for Doubtful Debts	3,860	34,740
Outstanding Rent		1,150	Investments	50,000	
			Add : Accrued Income	4,000	54,000
			Cash		21,550
		2,34,740			2,34,740

Working Notes :

(1) Calculation of Sales

Particulars	Dept X (₹)	Dept Y (₹)
Opening Stock	10,700	68,000
Add : Purchases	94,600	2,20,980
	1,05,300	2,88,980
Less: Purchases Return	900	2,200
	1,04,400	2,86,780
Less : Closing Stock	21,000	61,600
Cost of Goods Sold	83,400	2,25,180

(a) Department X sells goods at 80% above cost. Therefore, sales = ₹ 83,400 / 100 × 180 = ₹ **1,50,120**.
(b) Department Y sells goods at 100% above cost. Therefore, sales = ₹ ₹ 2,25,180 / 100 × 200 = ₹ **4,50,360**.

(2) Calculation of Excess Provision for Doubtful Debts

	₹
Balances of Sundry Debtors	41,900
Less : Bad Debts to be written off	3,300
Adjusted balance of Sundry Debtors	38,600

Existing balance of provision for doubtful debts	5,000
Less: Provision for Doubtful Debts required : 10% of ₹ 38,600	3,860
Excess	1,140

This excess provision for doubtful debts will be credited to department X and Y equally, i.e., ₹ 570 each.

(3) Calculation of Number of Articles Sold

Department X : ₹ 1,50,120 / 40 = 3,753
Department Y : ₹ 4,50,360 / 60 = 7,506
Ratio of number of articles sold : 3,753 : 7,506 or 1 : 2
All general expenses are to be apportioned in the ratio of 1 : 2.

Illustration 7

Robinhood is a retail trader whose stores has two departments dealing in clothing and sports equipment respectively. The following Trial Balance was extracted from books at 31.12.2017, the accounting year end :

Particulars	Dr. (₹)	Cr. (₹)
Sales — Clothing		1,20,000
Sports Equipment		1,60,000
Stock at cost at 1.1.2017 — Clothing	10,000	
Sports Equipment	16,000	
Purchases — Clothing and Sports Equipment	1,92,000	
Establishment Expenses — Clothing	15,000	
Sports Equipment	16,920	
Sales and Administrative Expenses — Clothing	7,400	
Sports Equipment	5,840	
Capital		20,000
Reserve		21,460
Creditors		5,800
Bank Overdraft		2,300
Debtors	8,600	
Building — At cost	20,000	
Provision for Depreciation		800
Furniture — At cost	26,000	
Provision for Depreciation		9,000
Vehicles — At cost	42,000	
Provision for Depreciation		20,400
Total	3,59,760	3,59,760

Additional information —

(a) Gross profit is earned as follows : Clothing — 1/3rd of sales; Sports equipment — 3/10th of sales.
(b) Stock is valued at cost on 31.12.2017 :
Clothing ₹ 8,000; Sports equipment ₹ 14,000
(c) Amounts prepaid at 31.12.2017 :
Establishment expenses — Clothing ₹ 300.
(d) Amount outstanding on 31.12.2017 :
Sales and administrative expenses — Clothing ₹ 200; Sports equipment ₹ 700.
(e) The sales staff receive commission in June of each year based on the gross profit earned in their department in the previous financial year :
Clothing — 2% of gross profit; Sports equipment — 3% of gross profit.
(f) In June 2017, additional furniture was acquired at a cost of ₹ 4,000 was debited to purchases.
(g) Depreciation is provided annually on fixed assets at the following percentage of the cost of assets held at the relevant accounting year end :
Building — 2%; Furniture — 10%; Vehicles — 20%.
(h) In August 2017, a motor vehicle which had been bought in January 2013 at a cost of ₹ 6,000 was scrapped, the firm did not receive anything for the scrap.
(i) The fixed assets depreciation is apportioned to departments as follows :

	Clothing	Sports Equipment
Building	1/2	1/2
Furniture	3/5	2/5
Vehicles	5/12	7/12

You are required to prepare the Trading and Profit and Loss Account for the year ended 31.12.2017 and the Balance Sheet as on that date.

Solution **Robinhood**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Clothing (₹)	Sports Equipment (₹)	Particulars	Clothing (₹)	Sports Equipment (₹)
To Opening Stock	10,000	16,000	By Sales	1,20,000	1,60,000
To Purchases (Balancing figure)	78,000	1,10,000	By Closing Stock	8,000	14,000
To Gross Profit c/d (given)	40,000	48,000			
	1,28,000	1,74,000		1,28,000	1,74,000
To Establishment Expenses (Note 1)	14,700	16,920	By Gross Profit b/d	40,000	48,000
To Sales and Administrative Exp. (Note 2)	7,600	6,540			
To Outstanding Sales Staff Comm. (Note 5)	800	1,440			
To Depreciation on (Note 3) :					
Building (1 : 1)	200	200			
Furniture (3 : 2)	1,800	1,200			
Vehicles (5 : 7)	3,000	4,200			
To Loss on Scrap of Vehicle (Note 4)	500	700			
To Net Profit (transferred)	11,400	16,800			
	40,000	48,000		40,000	48,000

Balance Sheet of Robinhood as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital (opening)	20,000		Building	20,000	
Add: Profit from Clothing	11,400		Less: Provision for depreciation	1,200	18,800
Add: Profit from Sports Equipment	16,800	48,200	Furniture (₹ 26,000 + ₹ 4,000)	30,000	
Reserve		21,460	Less: Provision for depreciation	12,000	18,000
Creditors		5,800	Vehicles (₹ 42,000 – ₹ 6,000)	36,000	
Outstanding :			Less: Provision for depreciation	22,800	13,200
Sales and Administrative Expenses (₹ 200 + 700)		900	Stock (₹ 8,000 + ₹ 14,000)		22,000
Sales Staff Commission		2,240	Debtors		8,600
Bank Overdraft		2,300	Prepaid Establishment Expenses		300
		80,900			80,900

Working Notes :

(1) Establishment Expenses

Clothing — ₹ 15,000 – ₹ 300 (prepaid) = ₹ 14,700.

(2) Sales and Administrative Expenses

Clothing — ₹ 7,400 + ₹ 200 (outstanding) = ₹ 7,600.

Sports Equipment — ₹ 5,840 + ₹ 700 (outstanding) = ₹ 6,540.

(3) Calculation of Depreciation

On Building — ₹ 20,000 @ 2% = ₹ 400.

On Furniture — ₹ 30,000 @ 10% = ₹ 3,000

On Vehicles — (₹ 42,000 – ₹ 6,000) @ 20% = ₹ 7,200.

(4) Loss on Scrap of Vehicle

	₹
Cost	6,000
Less: Accumulated depreciation (4 years @ ₹ 1,200)	4,800
Written down value on the date the asset was scrapped	1,200
Amount realised	Nil
Loss	1,200

Loss on scrap of vehicle will be shared by Clothing Department and Sports Equipment Department just like depreciation. Therefore, clothing department will bear the loss of ₹ 500 (5/12 of ₹ 1,200) and sports equipment department will bear the loss of ₹ 700 (7/12 of ₹ 1,200).

(5) Sales staff will get commission in June, 2018 on the basis of gross profit of 2017. Therefore, in the Profit and Loss Account of 2017, provision must be made for such future payment.

Illustration 8

Praveen Choudhury commenced trading on 1.4.2017 as Highway Stores, retail stationers and confectioners, with an initial capital of ₹ 30,000 which was utilised in the opening of a business Bank Account. All receipts and payments are passed through the Bank Account. The following is a summary of the items credited in the business Cash Book during the year ended 31.3.2018:

Particulars	(₹)	Particulars	(₹)
Purchase of fixtures and fittings :		Rent for the period 1.4.2017 to 30.4.2018	13,000
Stationery department	26,000	Rates for the year ended 31.3.2018	5,700
Confectionery department	15,000	Electricity	3,700
Staff salaries :		Advertising	11,000
Stationery department	22,000	Payment to suppliers	5,35,500
Confectionery department	15,400	Drawings	50,000

The purchases during the year under review were :

Stationery department ₹ 2,60,000; Confectionery department ₹ 2,92,500.

The above purchases do not include goods costing ₹ 5,000 bought by the business and then taken by Mr Choudhury for his own domestic use. The figure of ₹ 5,000 is included in payment to suppliers.

The gross profit in the stationery department is @ 20% on sales while in the confectionery department, it is @ 25% on sales. In both departments, sales in each month are always at a uniform level. The policy of Mr Choudhury is to have the month end stocks in each department just sufficient for the following month's sales. The prices of all goods bought by Highway Stores have not changed since the business began.

The sundry debtors at 31.3.2018 amounted to ₹ 90,000.

In August 2017, Mr Choudhury invested an additional capital of ₹ 90,000.

At 31.3.2018, outstanding electricity bill amounted to ₹ 1,100. Mr Choudhury has decided that expenses not incurred by a specific department should be apportioned to departments as follows :

1. Rent and rates — according to floor area occupied.
2. Electricity — according to consumption.
3. Advertising — according to turnover.

Two-thirds of the business floor space is occupied by the stationery department while three-quarters of the electricity is consumed by that department.

It has been decided that depreciation on fixtures and fittings should be provided @ 10% of the cost of assets held at the year end.

Required :

(a) A Trading and Profit and Loss Account for the year ended 31.3.2018 for the — (i) stationery department; and (ii) confectionery department.

(b) A Balance Sheet as on 31.3.2018.

Solution

Highway Stores

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Stationery (₹)	Confectonery (₹)	Particulars	Stationery (₹)	Confectionery (₹)
To Purchases	2,60,000	2,92,500	By Sales (Note 4)	3,00,000	3,60,000
To Gross Profit c/d	60,000	90,000	By Closing Stock (Note 3)	20,000	22,500
	3,20,000	3,82,500		3,20,000	3,82,500
To Staff Salaries	22,000	15,400	By Gross Profit b/d	60,000	90,000
To Rent (₹ 13,000 – 1,000)	8,000	4,000			
To Rates (Note 7)	3,800	1,900			
To Electricity (₹ 3,700 + 1,100)	3,600	1,200			
To Advertising (Note 7)	5,000	6,000			
To Depreciation on :					
Fixtures and Fittings @ 10%	2,600	1,500			
To Net Profit	15,000	60,000			
	60,000	90,000		60,000	90,000

Balance Sheet of Highway Stores as at 31st March, 2018

Liabilities		₹	Assets		₹
Capital : Introduced	30,000		Fixtures and Fittings (₹ 26,000 + 15,000)	41,000	
Add: Further introduced	90,000		Less : Depreciation	4,100	36,900
Profit from Stationery	15,000		Stock (₹ 20,000 + ₹ 22,500) (Note 3)		42,500
Profit from Confectionery	60,000		Debtors		90,000
	1,95,000		Prepaid Rent (Note 6)		1,000
Less: Drawings (₹ 50,000 + 5,000)	55,000	1,40,000			
Creditors (Note 2)		22,000			
Outstanding Electricity		1,100			
Bank Overdraft (Note 1)		7,300			
		1,70,400			1,70,400

Working Notes :

Dr. **(1) Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Cash (Capital introduced)	30,000	By Fixtures and Fittings	41,000
To Sundry Debtors (Note 5)	5,70,000	By Staff Salaries	37,400
To Cash (Further capital)	90,000	By Rent	13,000
To Balance c/d	7,300	By Rates	5,700
		By Electricity	3,700
		By Advertising	11,000
		By Creditors	5,35,500
		By Drawings	50,000
	6,97,300		6,97,300

Dr. **(2) Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank	5,35,500	By Purchases	
To Balance c/d	22,000	— Stationery	2,60,000
		— Confectionery	2,92,500
		By Drawings (Adjustment for stationery taken over)	5,000
	5,57,500		5,57,500

(3) Closing stock will be equal to next month's sale. Sales are uniform in each month.
Therefore, purchases during 2017-18 are equal to 13 months' sale. Therefore, closing stock will be —
Stationery department : ₹ 2,60,000 / 13 = ₹ 20,000. Confectionery department ₹ 2,92,500 / 13 = ₹ 22,500.

(4) Calculation of Sales

Stationery Department	₹	Confectionery Department	₹
Sales	100	Sales	100
Less: Gross Profit @ 20%	20	Less: Gross Profit @ 25%	25
Cost	80	Cost	75
Cost of Goods Sold (Purchases – Closing Stock)	2,40,000	Cost of Goods Sold (Purchases – Closing Stock)	2,70,000
Sales = $\frac{\text{Cost of Goods Sold}}{80} \times 100$	3,00,000	Sales = $\frac{\text{Cost of Goods Sold}}{75} \times 100$	3,60,000

(5) Total sales = ₹ 3,00,000 + ₹ 3,60,000 = ₹ 6,60,000. Amount due from sundry debtors at the end of the year ₹ 90,000.
Therefore, amount collected from sundry debtors = ₹ 6,60,000 – ₹ 90,000 = ₹ 5,70,000.

(6) Rent has been paid for 13 months (1.4.2017 to 30.4.2018).
Therefore, prepaid rent will be — ₹ 13,000 / 13 = ₹ 1,000.

(7) Apportionment of Common Expenses

Expenses	Basis	Stationery	Confectionery
(i) Rent	Floor Area (2 : 1)	₹ 12,000 x 2/3 = ₹ 8,000	₹ 12,000 x 1/3 = ₹ 4,000
(ii) Rates	Floor Area (2 : 1)	₹ 5,700 x 2/3 = ₹ 3,800	₹ 5,700 x 1/3 = ₹ 1,900
(iii) Electricity	Consumption (3 : 1)	₹ 4,800 x 3/4 = ₹ 3,600	₹ 4,800 x 1/4 = ₹ 1,200
(iv) Advertising	Turnover (5 : 6)	₹ 11,000 x 5/11 = ₹ 5,000	₹ 11,000 x 6/11 = ₹ 6,000

Illustration 9

X and Y are in partnership managing a small retail store which specialises in sweets and confectionary - managed by X and newspapers and periodicals - managed by Y. The partnership agreement provides for X to receive three-fifths of the profit, and Y two-fifths, each partner to be allowed 8% interest on capital and each to receive a commission of 10% of the profit of their respective sections prior to any other appropriation of profit. During the year to 31st March 2018, a trial balance extracted at that date revealed the following features. (all figures in ₹).

Particulars	Dr.	Cr.
Capital - X		14,000
Y		8,000
Current Accounts - X		2,020
Y	250	
Drawings - X	1,100	
Y	900	
Freehold shop premises	10,000	
Equipment (at written-down value) :		
Confectionery section	4,500	
Periodical section	3,500	
Purchases : Confectionery section	15,900	
Periodical section	17,700	
Stock at 1st April : Confectionery section	2,300	
Periodical section	3,100	
Sales : Confectionery section		18,500
Periodical section		21,500
Wages: Confectionery section	1,175	
Periodical section	1,470	
Miscellaneous expenses	230	
Rates	500	
Light and heat	400	
Advertising	250	
Debtors and creditors	1,800	2,100
Bad debts - Periodical section	95	
Cash in hand	950	
Cash at bank	50	
Provision for doubtful debts : Periodical section		50
Total	66,170	66,170

Additional information available:

(i) Stock at 31st March, 2018 was ₹ 3,600 in the Confectionery section, and ₹ 4,400 in the Periodical section.

(ii) The partners have agreed that rates should be apportioned between the Confectionery and Periodical sections on a 3:2 ratio, advertising on a 1:1 ratio, lighting and heating on a 2:3 ratio, and miscellaneous expenses on a 1:1 ratio.

(iii) Wages owing at 31st March, 2018 : ₹ 25 and ₹ 30 for the Confectionery and Periodical section respectively.

(iv) Advertising prepaid at 31st March, 2018 amounted to ₹ 100.

(v) The provision for doubtful debts is to be increased to 5% of the debtors of the Periodical section, which amount to ₹ 1,500 at 31st March 2018.

(vi) Equipment of both sections is to be depreciated at 10% of the written-down value at 1st April, 2017.

Required:

(a) Prepare a Trading and Profit and Loss Account for the Confectionery and the Periodical sections, and also for the business as a whole, for the year ended 31st March, 2018. (Note : A Balance Sheet is not required).

(b) Prepare an Appropriation Account for the year ended 31st March, 2018.

Solution **XY**

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Confec-tionery	Periodical	Total ₹	Particulars	Confec-tionery	Periodical	Total ₹
To Opening Stock	2,300	3,100	5,400	By Sales	18,500	21,500	40,000
To Purchases	15,900	17,700	33,600	By Closing Stock	3,600	4,400	8,000
To Wages (Note 1)	1,200	1,500	2,700				
To Gross Profit c/d	2,700	3,600	6,300				
	22,100	25,900	48,000		22,100	25,900	48,000
To Misc. Expenses	115	115	230	By Gross Profit b/d	2,700	3,600	6,300
To Rates	300	200	500				
To Advertising	75	75	150				
To Lighting & Heating	160	240	400				
To Bad Debts	—	95	95				
To Prov. for Bad Debts	—	25	25				
To Depreciation	450	350	800				
To Net Profit - transferred	1,600	2,500	4,100				
	2,700	3,600	6,300		2,700	3,600	6,300

Dr. Appropriation Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Commission:		By Net Profit	4,100
X	160		
Y	250		
To Interest on Capital:			
X	1,120		
Y	640		
To Share of Profit			
X	1,158		
Y	772		
	4,100		4,100

Working Notes:

(1) Wages : Confectionery ₹ 1,175 + outstanding ₹ 25 = ₹ 1,200; and Periodical ₹ 1,470 + outstanding ₹ 30 = ₹ 1,500.
(2) Miscellaneous expenses : Confectionery - 1/2 of ₹ 230 = ₹ 115 and Periodical - 1/2 of ₹ 230 = ₹ 115.
(3) Rates : Confectionery - 3/5 of ₹ 500 = ₹ 300 and Periodical 2/5 of ₹ 500 = ₹ 200.
(4) Advertising : Confectionery - 1/2 of (₹ 250 – ₹ 100) = ₹ 75 and Periodical 1/2 of ₹ 150 = ₹ 75.
(5) Lighting and heating : Confectionery - 2/5 of ₹ 400 = ₹ 160 and Periodical - 3/5 of ₹ 400 = ₹ 240.

Inter-Departmental Transfer

Sometimes prices are charged for goods or services transferred by one department to another department. Since each department is considered as a separate profit centre, it is necessary to have separate records for inter-departmental transfer. Generally a weekly or monthly Departmental Transfer Analysis Sheet is prepared to arrange all inter-departmental transfer. The sheet may be in the following form:

Departmental Transfer Analysis Sheet

Date	Supplying Departments			Receiving Departments		
2018	Dept X	Dept Y	Dept Z	Dept X	Dept Y	Dept Z
April 3	400	—	—	—	400	—
April 10	—	500	—	500	—	—
April 20	—	—	300	—	300	—
April 30	200	—	—	—	—	200
	600	500	300	500	700	200

At the end of the week/month, the transfer is recorded by passing the following entry:

Receiving Department Dr. [Transfer price]

To Supplying Department

Transfer prices can be cost-based or market-based. Dual pricing is also sometimes used. They are discussed below:

Cost-based Transfer Price

Under cost-based transfer pricing, the price may be based on actual cost, total cost or standard cost. Marginal cost is also sometimes used as a basis of ascertaining transfer price. Standard cost is preferred to actual cost since the inefficiency of one department cannot be passed on to another department. Taking full cost as transfer price means that the supplying departments' fixed cost becomes the variable cost of the receiving department.

Illustration 10

A firm had two departments X and Y. Department Y (which was a Manufacturing Department) received goods from Department X as its raw materials. Department X supplied the said goods to Y at cost price. From the following particulars you are required to prepare a Departmental Trading and Profit and Loss Account for the year ended on 31st December, 2017. (all figures in ₹).

Particulars	Dept X	Dept Y
Opening Stock (as on 1.1.2017)	2,50,000	75,000
Purchases (from outside suppliers)	10,00,000	20,000
Sales (to outside customers)	12,00,000	3,00,000
Closing stock (as on 31.12.2017)	1,50,000	50,000

The following information is to be taken into account:

(a) Depreciation of Buildings to be provided at 20% p.a. The value of the Building occupied by both the Departments was ₹ 1,05,000 (Department X occupying two-third portion and Department Y occupying the rest).

(b) Goods transferred from Department X to Department Y ₹ 2,50,000 at cost.

(c) Manufacturing Expenses amounted to ₹ 10,000.

(d) Selling expenses amounted to ₹ 15,000 (to be apportioned on the basis of sales of respective departments).

(e) General expenses of the business as a whole amounted to ₹ 58,000.

Solution

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2017 Cr.

Particulars	X	Y	Total	Particulars	X	Y	Total
To Opening Stock	2,50,000	75,000	3,25,000	By Sales	12,00,000	3,00,000	15,00,000
To Purchases	10,00,000	20,000	10,20,000	By Y (transfer)	2,50,000	—	—
To X (transfer)	—	2,50,000	—	By Closing Stock	1,50,000	50,000	2,00,000
To Mfg. Expenses	—	10,000	10,000	By Gross Loss c/d	—	5,000	5,000
To Gross Profit c/d	3,50,000	—	3,50,000				
	16,00,000	3,55,000	17,05,000		16,00,000	3,50,000	17,05,000
To Gross Loss b/d	—	5,000	5,000	By Gross Profit b/d	3,50,000	—	3,50,000
To Selling Expenses	12,000	3,000	15,000				
To Depreciation	14,000	7,000	21,000				
To Dept. Profit c/d	3,24,000	(15,000)	3,09,000				
	3,50,000	—	3,50,000		3,55,000	—	3,50,000
To General Expenses			58,000	By Departmental Profit b/d			3,09,000
To Net Profit			2,51,000				
			3,09,000				3,09,000

Illustration 11

A hotel proprietor has two departments, viz, (i) Apartment Department, and (ii) Meals Department. Following trial balance of the business is given on 31.12.2017: (all figures in ₹)

Provisions	15,500	Income from Apartment Department	46,000
Stock of provisions in the beginning	1,020	Income from Meals Department	32,000
Cash at bank	10,000	Capital	2,20,000

Customers Account	800	Suppliers' Account	9,800
Buildings (1/10 is used for Meals Dept.)	2,10,000	Provision for Depreciation on Buildings	24,000
Furniture and equipments	60,000	Interest	1,130
General expenses	27,410		
Interest accrued	200		
Income Tax	400		
Life Insurance Premium (for Proprietor)	1,600		
Wages	6,000		
	3,32,930		3,32,930

Additional information: (i) The servants in the Apartment Department had occupied a room worth ₹ 120 and took meals worth ₹ 60. Similarly, servants in the Meals Department had occupied a room worth ₹ 150 and took meals worth ₹ 90; (ii) Wages are charged in the proportion of half to the Apartment Department, one- quarter to the Meals Department and remaining to the General Profit and Loss Account; (iii) Increase provision for depreciation of Buildings to ₹ 30,000; (iv) A sum of ₹ 800 representing accommodation ₹ 240, and meals ₹ 560 is to be charged to proprietor of the hotel.

You are required to prepare Final Accounts (including Balance Sheet) for the year ending 31.12.2017.

Solution

Dr. Departmental Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Appartment Dept.	Meal Dept.	Particulars	Appartment Dept.	Meal Dept.
To Opening Stock of Provisions	—	1,020	By Income	46,000	32,000
To Provisions (purchases)	—	15,500	By Drawings	240	560
To Depreciation on Building	5,400	600	By Meal Dept - transfer	150	—
To Wages (Note 1)	3,000	1,500	By Appartment Dept - transfer	—	60
To Appartment Dept. - transfer	—	150			
To Meal Dept. - transfer	60	—			
To Departmental profit	37,930	13,850			
	46,390	32,620		46,390	32,620

Dr. General Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Wages (Note 1)	1,500	By Departmental Profit (₹ 37,930 + ₹ 13,850)	51,780
To General Expenses	27,410	By Interest	1,130
To Net Profit — transferred to Capital	24,000		
	52,910		52,910

Dr. Balance Sheet as at 31st December, 2017 Cr.

Liabilities		₹	Assets		₹
Capital	₹ 2,20,000		Building	₹ 2,10,000	
Add: Net Profit	₹ 24,000		Less: Provision for depreciation	₹ 30,000	1,80,000
	₹ 2,44,000		Furniture & Equipment		60,000
Less: Drawings (Note 2)	₹ 2,800	2,41,200	Customers Account		800
Suppliers Account		9,800	Interest Accrued		200
			Cash at Bank		10,000
		2,51,000			2,51,000

Working Notes:

(1) Wages as per trial balance = ₹ 6,000. Apartment Dept. will bear 1/2 of ₹ 6,000 = ₹ 3,000; Meals Dept. will bear 1/4 of ₹ 6,000 = ₹ 1,500; General Profit and Loss Account will bear ₹ 1,500.

(2) Total Drawing = ₹ 240 for accommodation + ₹ 560 for meals + ₹ 1,600 for L.I.P. + ₹ 400 for I.T. = ₹ 2,800.

(3) Departmental Transfer Analysis Sheet

Date	Nature of Service	Supplying Department (₹)		Receiving Department (₹)	
		Appartment Dept.	Meals Dept.	Appartment Dept.	Meals Dept.
?	Meal	—	60	60	—
?	Accommodation	150	—	—	150
		150	60	60	150

As per rule, receiving department will be debited and supplying department will be credited.

(i) Apppartment Dept.	Dr.	60	
To Meals Dept.			60
(ii) Meals Dept.	Dr.	150	
To Appartment Dept			150

Tutorial Note: No adjustment is required for providing facility to own departmental staff.

Illustration 12

Mohit Udyog operates a general business and the firm's Trial Balance prepared at 31.12.2017 was as follows:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Purchases : Cars	83,500		Debtors and Creditors	14,000	10,800
Petrol	27,500		Bank	4,700	
Spare parts	4,000		Cash	14,600	
Capital		62,000	Freehold Garage Premises	42,000	
Stock on 1.1.2017 : Cars	9,000		Rates and insurance	1,900	
Petrol	2,800		Sales : Cars		1,20,000
Spare parts	400		Petrol		32,000
Workshop wages	10,200		Spare parts		4,700
Plant and Equipment	7,000		Repairs		14,700
Car salesmen's salaries	7,700		Petrol pump attendant's wages	3,100	
General expenses	6,300				
Office wages	5,500		**Total**	2,44,200	2,44,200

Other information is as follows :

(1) The plant and equipment, all of which is used for repair work, is to be depreciated by 10%.

(2) Stocks at 31.12.2017 were — Cars ₹ 7,400; Petrol ₹ 1,600; Spare parts ₹ 700.

(3) No entries have been made for the following —
(i) Petrol used in demonstration runs cost ₹ 200; (ii) Parts used in repair jobs cost ₹ 750;
(iii) Repairs on cars subsequently sold were charged out at ₹ 2,400.

(4) Expenses which cannot be specifically allocated to one activity are to be apportioned —
60% to Cars; 10% to Petrol; 10% to Spare parts; 20% to Repairs.

(5) General expenses accrued amount to ₹ 300, and a provision is to be made of ₹ 500 for car salesmen's commission.

Prepare Trading and Profit and Loss Account, preferably in columnar form, to show clearly the profit or loss in each of the four main areas of business activity for the year ended 31.12.2017.

Also prepare the Balance Sheet at that date.

Solution

Mohit Udyog

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)	Particulars	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)
To Opening Stock	9,000	2,800	400	—	By Sales	1,20,000	32,000	4,700	14,700
To Purchases	83,500	27,500	4,000	—	By Inter Departmental Sales	—	200	750	2,400
To Parts used in repairs (Note 2)	—	—	—	750	By Closing Stock	7,400	1,600	700	—
To Repairs on cars sold (Note 3)	2,400	—	—	—					
To Wages	—	3,100	—	10,200					
To Gross Profit c/d	32,500	400	1,750	6,150					
	1,27,400	33,800	6,150	17,100		1,27,400	33,800	6,150	17,100
To Office wages (Note 4)	3,300	550	550	1,100	By Gross Profit b/d	32,500	400	1,750	6,150
To Rates and insurance	1,140	190	190	380	By Net Loss	—	1,000	—	—
To Salesmen's salaries and commission(7,700 + 500)	8,200	—	—	—					
To General expenses (Note 4)	3,960	660	660	1,320					
To Demonstration petrol cost (Note 1)	200	—	—	—					
To Depreciation on: Plant and Equipment	—	—	—	700					
To Net Profit	15,700	—	350	2,650					
	32,500	1,400	1,750	6,150		32,500	1,400	1,750	6,150

Balance Sheet of Mohit Udyog as at 31st December, 2017

Liabilities		₹	Assets		₹
Capital (Opening)	62,000		Freehold Garage Premises		42,000
Add: Profit from Cars	15,700		Plant and Equipment	7,000	
Add: Profit from spare parts	350		Less: Depreciation	700	6,300
Add: Profit from Repairs	2,650		Stock (₹ 7,400 + 1,600 + 700)		9,700
Less: Loss from Petrol	(1,000)	79,700	Debtors		14,000
Creditors		10,800	Bank		4,700
Outstanding : General Expenses		300	Cash		14,600
Cars Salesmen's Commission		500			
		91,300			91,300

Working Notes :

(1) Petrol used for demonstration run will be treated as selling expenses of Car department and sales of Petrol department.
(2) Spare parts used in repairs ₹ 750 will be treated as direct expenses of Repairs department and sales of Spare parts department.
(3) Repairs on car subsequently sold ₹ 2,400 will be treated as direct expenses of Car department and sales of Repairs department.

(4) Apportionment of Common Expenses

Expenses	Basis	Total (₹)	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)
(i) General Expenses	6 : 1 : 1 : 2	6,600*	3,960	660	660	1,320
(ii) Office Wages	6 : 1 : 1 : 2	5,500	3,300	550	550	1,100
(iii) Rates and Insurance	6 : 1 : 1 : 2	1,900	1,140	190	190	380

*₹ 6,300 +₹ 300(outstanding) =₹ 6,600.

Illustration 13

Shri Gangaram sells two products manufactured in his own factory. The goods are made in two departments A and B for which separate sets of accounts are maintained. Some of the manufactured goods of Department A are used as raw materials by Department B and *vice versa*. From the following particulars, you are required to ascertain the total cost of goods manufactured in these two departments:

	Dept. A	Dept. B
Total units manufactured	10,00,000	5,00,000
Total cost to manufacture (excluding inter-departmental transfers)	₹ 10,000	₹ 5,000

Department A transferred 2,50,000 units to Department B and the latter transferred 1,00,000 units to the former.

Solution

Department A has transferred 1/4th of the units produced to B, whereas Department B has transferred 1/5th of the units produced.
Let, X be the total cost of Department A and Y be the total cost of Department B.
Therefore, $X = ₹\ 10{,}000 + {}^1/_5\ Y$ ... (1) and
$Y = ₹\ 5{,}000 + {}^1/_4\ X$ ... (2)
Putting the value of Y in the first equation, we get
$X = ₹\ 10{,}000 + {}^1/_5\ (₹\ 5{,}000 + {}^1/_4\ X)$
$= ₹\ 10{,}000 + ₹\ 1{,}000 + {}^1/_{20}\ X$
or, $X - {}^1/_{20}\ X = 11{,}000$,
Therefore X = ₹ 11,579 (approx.)
Putting the value of X as ₹ 11,579 in the 2nd equation, we get
$Y = ₹\ 5{,}000 + {}^1/_4\ (₹\ 11{,}579)$
or Y = ₹ 7,895 (approx.)

Ascertainment of the Total Cost of Goods Manufactured

Particulars	Dept. A	Dept. B
Cost as ascertained above (₹)	11,579	7,895
Less: Transfers to the other department	(1/4) 2,895	(1/5) 1,579
Net cost of goods manufactured	8,684	6,316

Market-based Transfer Price

To avoid passing on inefficiencies of one department to the other, market based transfer prices may be used. It does not give any advantage to either the selling or buying department, compared with trading with the outsiders. Sometimes a standard market price may also be used.

Dual Pricing

To motivate both the departments, buying and selling departments may be debited and credited respectively with two different prices. For example, buying department may be debited with the cost price and selling department credited with the market price.

If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods are included in the unsold stock, an appropriate adjustment must be made for unrealised profit on stock. The entry is :
General Profit and Loss Account Dr.
To Provision for Unrealised Profit on Stock Account
At the beginning of the next year reverse entry will be passed.
Provision for Unrealised Profit on Stock Account Dr.
To General Profit and Loss Account

Illustration 14

Raman carries on a business of selling (both wholesale and retail) electrical materials. The wholesale and retail departments are separately organised, all goods are purchased by the wholesale department which adds one-seventh on to cost for charging out goods transferred to the retail department. At 31.12.2017, the total balance of the business as a whole is as follows :

Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000
Freehold Premises	65,000	
Motor Vans : Cost and Accumulated Depreciation (1.1.2017)	9,000	4,000
Motor Cars : Cost and Accumulated Depreciation (1.1.2017)	6,000	3,000
Fixtures etc : Cost and Accumulated Depreciation (1.1.2017)	7,800	7,300
Stock (1.1.2017) : Wholesale at Cost	65,000	
Retail and provision for unrealised profit	32,000	4,000
Debtors (31.12. 2017) : Wholesale customers only	67,100	
Creditors (31.12. 2017)		41,200
Bad Debts	6,800	
Discount Received		4,850
Discount Allowed	8,500	
Salaries : Van drivers	8,800	
Warehouse staff	24,300	
Shop staff	8,250	
Car and Van running expenses	5,400	
Other Expenses	15,500	
Sales : Wholesale		3,40,000
Retail		96,000
Purchases	3,28,000	
Cash and Bank (31.12. 2017)	400	21,800
Reserve		35,700
Total	6,57,850	6,57,850

Additional information —

(i) Transfers of goods amounted to ₹ 76,000 at transfer prices.
(ii) Stocks at 31.12.2017 : Wholesale at cost ₹ 71,500; Retail at transfer price ₹ 36,000.
(iii) There are four vans, one of which is likely to be in use by the retail department at any one time.
(iv) The two cars are used by X, who divides their time between the two departments as to two-thirds wholesale and one-third retail.
(v) Depreciation of cars and vans is at 20% p.a. on cost. It is estimated that the remaining costs of a car and a van (excluding drivers' wages) do not differ materially.
(vi) Other expenses are 80% wholesale.
(vii) No further depreciation need be provided on fixtures etc.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2017 and Balance Sheet as on that date.

Solution **Raman**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Wholesale (₹)	Retail (₹)	Total (₹)	Particulars	Wholesale (₹)	Retail (₹)	Total (₹)
To Opening Stock	65,000	32,000	97,000	By Sales	3,40,000	96,000	4,36,000
To Purchases	3,28,000	—	3,28,000	By Transfer to Retail	76,000	—	—
To Transfer from Wholesale	—	76,000	—	By Closing Stock	71,500	36,000	1,07,500
To Gross Profit c/d	94,500	24,000	1,18,500				
	4,87,500	1,32,000	5,43,500		4,87,500	1,32,000	5,43,500
To Bad Debts (Note 1)	6,800	—	6,800	By Gross Profit b/d	94,500	24,000	1,18,500
To Discounts Allowed (N 1)	8,500	—	8,500	By Discount Received (Note 2)	4,850	—	4,850
To Salaries :							
Van drivers (Note 3)	6,600	2,200	8,800				
Warehouse staff	24,300	—	24,300				
Shop staff	—	8,250	8,250				
To Van Running Expenses (Note 4a)	2,700	900	3,600				
To Car Running Expenses (Note 4b)	1,200	600	1,800				
To Other Expenses	12,400	3,100	15,500				
To Depreciation on :							
Vans (3 : 1)	1,350	450	1,800				
Cars (2 : 1)	800	400	1,200				
To Net Profit c/d	34,700	8,100	42,800				
	99,350	24,000	1,23,350		99,350	24,000	1,23,350
To Provision for Unrealised Profit on Closing Stock (Note 5)			4,500	By Reserve b/d			35,700
To Reserve c/d			78,000	By Provision for Unrealised Profit on Opening Stock			4,000
				By Net Profit b/d			42,800
			82,500				82,500

Balance Sheet of Raman as at 31st December, 2017

Liabilities	₹	Assets		₹
Capital	1,00,000	Freehold Premises		65,000
Reserve	78,000	Motor Vans (at cost)	9,000	
Creditors	41,200	Less : Accumulated Depreciation	5,800	3,200
Bank Overdraft	21,800	Motor Cars (at cost)	6,000	
		Less : Accumulated Depreciation	4,200	1,800
		Fixtures (at cost)	7,800	
		Less : Accumulated Depreciation	7,300	500
		Stock	1,07,500	
		Less : Provision for Unrealised Profit	4,500	1,03,000
		Debtors		67,100
		Cash		400
	2,41,000			2,41,000

Working Notes :

(1) Goods are sold on credit by the wholesale department only. Therefore, discount allowed is totally related to wholesale department. Similarly, bad debt is also related to wholesale department.

(2) Goods are purchased by wholesale department. Therefore, discount received is totally related to wholesale department.

(3) Out of four vans, one van is used by the retail department. Therefore, 1/4th of van driver's salary is to be borne by the retail department and 3/4th is to be borne by the wholesale department.

(4) There are four vans and two cars. Total running cost is ₹ 5,400. Running cost of a car and a van (excluding driver's salaries) do not differ materially. Therefore, entire running cost will be distributed between van and car in the ratio of 2 : 1.

Vans running cost will be — 2/3 of ₹ 5,400 = ₹ 3,600.

Cars running cost will be — 1/3 of ₹ 5,400 = ₹ 1,800.

(a) Vans running cost will be shared by wholesale department and retail department in the ratio 3 : 1.

(b) Cars running cost will be shared by wholesale department and retail department in the ratio 2 : 1.

(c) Goods are transferred to retail deprtment by adding 1/7th to cost. Therefore, the unrealised profit on closing stock will be :

₹ 36,000 × 1/8 = ₹ 4,500.

Illustration 15

From the following data, prepare Departmental Trading and Profit and Loss Account for the year ended December 31, 2006:

Particulars	Dept. A	Dept. B
Opening Stock	40,000	—
Purchases from Outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of Goods from Department A	—	50,000
Closing Stock at cost to the Department	30,000	10,000
Sales to Outsiders	2,00,000	71,000

B's entire stock represents goods from Department A which transfers them at 25% above its cost. Administrative and Selling Expenses amount to ₹ 15,000 which are to be allocated between Departments A and B in the ratio of 4 : 1 respectively. Also show the amount of provision to be made for unrealised profit. ***[C.U.B.Com. (Hons.) — 2007]***

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2006 Cr.

Particulars	Dept A (₹)	Dept B (₹)	Total (₹)	Particulars	Dept A (₹)	Dept B (₹)	Total (₹)
To Opening Stock	40,000	—	40,000	By Sales	2,00,000	71,000	2,71,000
To Purchases	2,00,000	20,000	2,20,000	By Goods transferred to B	50,000	—	—
To Goods from Dept A	—	50,000	—	By Closing Stock	30,000	10,000	40,000
To Wages	10,000	1,000	11,000				
To Gross Profit c/d	30,000	10,000	40,000				
	2,80,000	81,000	3,11,000		2,80,000	81,000	3,11,000
To Selling Expenses (4 : 1)	12,000	3,000	15,000	By Gross Profit b/d	30,000	10,000	40,000
To Net Profit c/d	18,000	7,000	25,000				
	30,000	10,000	40,000		30,000	10,000	40,000
To Provision for Unrealised Profit on Closing Stock (Note 1)			2,000	By Net Profit b/d			25,000
To Capital A/c (Net Profit transferred)			23,000				
			25,000				25,000

Working Note :

(1) Goods are transferred to Dept. A at cost plus 25%. It means the unrealised profit is 20% (25/125) on transfer price. Therefore, unrealised profit on closing stock = 20% of ₹ 10,000 = ₹ 2,000.

Illustration 16

A & Co has two departments P and Q. Department P sells goods to Department Q at normal selling prices. From the following particulars, prepare Departmental Trading and Profit and Loss Account for the year ended 31.3.2017 and also ascertain the Net Profit to be transferred to Balance Sheet :

	Department P (₹)	Department Q (₹)
Opening Stock	5,00,000	—
Purchases	28,00,000	3,00,000
Goods from P	—	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	20,00,000
Printing and Stationery	30,000	25,000

The following expenses incurred for both the departments were not apportioned between the departments :

(a) Salaries ₹ 3,30,000; (b) Advertisement expenses ₹ 1,20,000; (c) General expenses ₹ 5,00,000; (d) Depreciation is to be charged @ 30% on the machinery value of ₹ 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.

[C.U.B.Com. (Hons) — Adapted]

Solution

A & Co

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2017 Cr.

Particulars	Dept P (₹)	Dept Q (₹)	Total (₹)	Particulars	Dept P (₹)	Dept Q (₹)	Total (₹)
To Opening Stock	5,00,000	—	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 Dept 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 and 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 on Machinery (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
To Provision for Unrealised Profit on Closing Stock (Note 2)			38,000	By Net Profit b/d			6,45,200
To Capital A/c (Net Profit transferred)			6,07,200	By Provision for Unrealised Profit on Opening Stock			Nil
			6,45,200				6,45,200

Working Notes :

(1) Gross Profit Ratio of Department P = $\dfrac{9{,}50{,}000}{30{,}00{,}000 + 8{,}00{,}000} \times 100 = \mathbf{25\%}$

(2) Proportionate P Department's stock in Department Q

$$= \frac{\text{Purchase from Department P}}{\text{Total Purchases of Department Q}} \times \text{Total Stock of Department Q} = \frac{8{,}00{,}000}{11{,}00{,}000} \times \text{Rs } 2{,}09{,}000 = ₹\ 1{,}52{,}000$$

Unrealised profit = 25% of ₹ 1,52,000 = ₹ 38,000.

Illustration 17

The firm "Tantuja" has two departments - first one is "cloth" and the second is "tailoring". Tailoring department gets all its requirements of cloth from the cloth department at the usual selling price. From the following particulars prepare Departmental Trading Account and Profit and Loss Account for the year ended 31st March, 2018 : (all figures in ₹)

Particulars	Cloth Dept.	Tailoring Dept.
Manufacturing Expenses	—	1,08,000
Selling Expenses	45,000	18,000
Stock on 1.4.2017	5,40,000	72,000
Sales	36,00,000	7,20,000
Transfer of Cloth to Tailoring Dept.	4,50,000	—
Purchases	30,60,000	45,000
Stock on 31.3.2018	9,00,000	1,35,000

The stock in Tailoring Department may be assumed to consist 80% cloth and 20% other expenses. General expenses of the business for the year came to ₹ 2,07,000. In 2016-17 the Cloth Department earned a gross profit of 30% on sales.

Solution

Tantuja

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Cloth	Tailoring	Total	Particulars	Cloth	Tailoring	Total
To Opening Stock	5,40,000	72,000	6,12,000	By Sales	36,00,000	7,20,000	43,20,000
To Purchases	30,60,000	45,000	31,05,000	By Tailoring Dept. - transfer	4,50,000	—	—
To Cloth Dept. - transfer	—	4,50,000	—	By Closing Stock	9,00,000	1,35,000	10,35,000
To Manufacturing expenses	—	1,08,000	1,08,000				
To Gross Profit c/d	13,50,000	1,80,000	15,30,000				
	49,50,000	8,55,000	53,55,000		49,50,000	8,55,000	53,55,000

To Selling expenses	45,000	18,000	63,000	By Gross Profit b/d	13,50,000	1,80,000	15,30,000
To Departmental Profit c/d	13,05,000	1,62,000	14,67,000				
	13,50,000	1,80,000	15,30,000		13,50,000	1,80,000	15,30,000
To General expenses			2,07,000	By Departmental Profit b/d			14,67,000
To Provision for unrealised profit on Departmental Closing Stock (Note 2)			36,000	By Provision for unrealised profit on Departmental Opening Stock (Note 2)			17,280
To Net Profit transferred to Capital			12,41,280				
			14,84,280				14,84,280

Working Notes:

(1) Calculation of unrealised profit on stock

Rate of Gross profit in cloth department = $\frac{13,50,000}{40,50,000} \times 100 = 33\frac{1}{3}$ % on sales.

* (₹ 36,00,000 + ₹ 4,50,000) = ₹ 40,50,000.

(2) Element of cloth in tailoring department = 80%

Therefore, element of cloth in opening stock — 80% of ₹ 72,000 = ₹ 57,600

Element of cloth in closing stock — 80% of ₹ 1,35,000 = ₹ 1,08,000

Unrealised profit including in opening stock = 30% of ₹ 57,600 = ₹ 17,280

Unrealised profit included in closing stock = $33^1/_3$% on ₹ 1,08,000 = ₹ 36,000.

Illustration 18

Modern Engineering Works carried on business with two departments : Raw Materials and Manufacturing. The finished goods are produced by the Manufacturing Department with raw material supplied from Raw Materials Department at selling price.

Prepare Departmental Trading and Profit and Loss Account for the year ending on 31st December, 2007 after allocation of expenses on reasonable basis between the two departments.

Necessary particulars are furnished below :

	Raw Materials Department	Manufacturing Department
Opening Stock	60,000	10,000
Purchases	4,00,000	3,000
Raw materials transferred to Manufacturing Department	60.000	—
Sales	4,40,000	90,000
Manufacturing Expenses	—	12,000
Sellling Expenses	800	400
Closing Stock	40,000	12,000

It is estimated that the cost of closing stock in the hands of Manufacturing Department consists of 80% for raw materials and 20% for manufacturing expenses. The rate of gross profit earned during the preceding year by the Raw Materials Department was 10%. Other administrative expenses are as follows :

(i) Salaries ₹ 2,500; (ii) Insurance premium ₹ 800.

[C.U.B.Com. (Hons.) — 2008]

Solution **Modern Engineering Works**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2007 Cr.

Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)	Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)
To Opening Stock	60,000	10,000	70,000	By Sales	4,40,000	90,000	5,30,000
To Purchases	4,00,000	3,000	4,03,000	By Raw Materials transferred to Manufacturing Dept.	60,000	—	—
To Manufacturing Expenses	—	12,000	12,000				
To Raw Materials from R.M. Dept.	—	60,000	—	By Closing Stock	40,000	12,000	52,000
To Gross Profit c/d	80,000	17,000	97,000				
	5,40,000	1,02,000	5,82,000		5,40,000	1,02,000	5,82,000
To Selling Expenses	800	400	1,200	By Gross Profit b/d	80,000	17,000	97,000
To Salaries (Note 3)	2,119	381	2,500				
To Insurance Premium (Note 4)	656	144	800				
To Net Profit c/d	76,425	16,075	92,500				
	80,000	17,000	97,000		80,000	17,000	97,000

To Provision for Unrealised Profit on Closing Stock (Note 1)	1,536	By Net Profit b/d	92,500
To Capital A/c (Net Profit transferred)	91,764	By Provision for Unrealised Profit on Opening Stock	800
	93,300		93,300

Working Notes :

(1) Gross Profit Ratio of Raw Materials Department $= \dfrac{80{,}000}{(4{,}40{,}000 + 60{,}000)} \times 100 = \dfrac{80{,}000}{5{,}00{,}000} \times 100 = 16\%$

(2) Provision for Unrealised Profit on Opening Stock = (10,000 × 80%) × 10% = ₹ 800.
Provision for Unrealised Profit on Closing Stock = (12,000 × 80%) × 16% = ₹ 1,536.

(3) Salaries can be shared by the R.M. Dept and Mfg. Dept. in the ratio of Sales of each department. The ratio will be :
(4,40,000 + 60,000) : 90,000
or 5,00,000 : 90,000
or 50 : 9.
(a) Raw materials department's share = 2,500 / 59 × 50 = ₹ 2,119
(b) Manufacturing department's share = 2,500 / 59 × 9 = ₹ 381.

(4) Insurance premium can be shared by R.M. Dept. and Mfg. Dept. in the ratio of average stock of each department. The ratio will be :

$$= \frac{(60{,}000 + 40{,}000)}{2} : \frac{(10{,}000 + 12{,}000)}{2}$$

or 50,000 : 11,000
or 50 : 11
(a) Raw materials department's share = 800 / 61 × 50 = ₹ 656.
(b) Mfg. department's share = 800 / 61 × 11 = ₹ 144.

Illustration 19

O and K are two departments of Red Company of Calcutta. O Department sells goods to K Department at normal market prices. From the following particulars, prepare a Trading and Profit and Loss Account of the two departments for the year ended 31st March 2018:

Particulars	O	K	General
Stocks on April 1, 2017	12,000	Nil	—
Purchases	2,76,000	24,000	—
Goods from O Dept.	—	84,000	—
Wages	12,000	19,200	—
Salaries	8,000	5,000	—
Stock on March 31, 2018 at cost to Dept.	60,000	21,600	—
Sales	2,76,000	1,74,000	—
Stationery and Printing	2,560	1,960	—
Plant and Machinery	—	14,400	—
Salaries (General)	—	—	18,000
Miscellaneous Expenses	—	—	3,600
Advertisement	—	—	9,600
Bank charges	—	—	2,400

Depreciate Plant & Machinery by 10%. The general unallocated expenses are to be apportioned in the ratio — O:3, K:2.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Red Company

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2018 Cr.

Particulas	Dept O	Dept K	Total	Particulas	Dept O	Dept K	Total
To Opening Stock	12,000	—	12,000	By Sales	2,76,000	1,74,000	4,50,000
To Purchases	2,76,000	24,000	3,00,000	By Goods transferred to K	84,000	—	—
To Goods from Dept O	—	84,000	—	By Closing Stock	60,000	21,600	81,600
To Wages	12,000	19,200	31,200				
To Gross Profit c/d	1,20,000	68,400	1,88,400				
	4,20,000	1,95,600	5,31,600		4,20,000	1,95,600	5,31,600

To Salaries	8,000	5,000	13,000	By Gross Profit b/d	1,20,000	68,400	1,88,400
To Printing & Stationery	2,560	1,960	4,520				
To Salaries (General)	10,800	7,200	18,000				
To Miscellaneous expenses	2,160	1,440	3,600				
To Advertisement	5,760	3,840	9,600				
To Bank charges	1,440	960	2,400				
To Depreciation	—	1,440	1,440				
To Net Profit c/d	89,280	46,560	1,35,840				
	1,20,000	68,400	1,88,400		1,20,000	68,400	1,88,400
To Provision for unrealised profit on Departmental Closing Stock (Note 1)			5,600	By Net Profit b/d			1,35,840
To Capital A/c (net profit transferred)			1,30,240	By Provision for unrealised profit on Dept. Opening Stock			Nil
			1,35,840				1,35,840

Working Note:

(1) Gross profit ratio of Department O $= \dfrac{1,20,000}{(2,76,000 + 84,000)} \times 100 = 33\frac{1}{3}\ \%$

Proportionate Department O stock in Department K $= \dfrac{\text{Purchases from Dept. O}}{\text{Total Purchases of Dept. K}} \times$ Total Stock of Dept. 'K'

$= \dfrac{84,000}{1,08,000} \times 21,600 =$ ₹ 21,600. Profit thereon : $33\frac{1}{3}\%$ of 16,800 = ₹ 5,600.

Illustration 20

M/s G,B,T carried on business as Drapers and Tailors in Jaipur. The partners G,B and T were in charge of the Departments, X,Y and Z respectively. The partners are entitled to a remuneration equal to 50% of the profits (without taking the Partner's remuneration into consideration) of the respective departments of which they are in charge and the balance of the profits are to be divided among G,B and T in the ratio of 5:3:2. The following are the balances of the revenue items in the books for the year ending March 31, 2018:

Opening Stock : X — ₹ 75,780; Y — ₹ 48,000; and Z — ₹ 40,000.
Purchases : X — ₹ 2,81,400; Y — ₹ 1,61,200; and Z — ₹ 88,800.
Sales : X — ₹ 3,60,000; Y — ₹ 2,70,000; and Z — ₹ 1,80,000.
Closing Stock : X — ₹ 90,160; Y — ₹ 34,960; and Z — ₹ 43,180.
Salaries and wages — ₹ 96,000; Advertising — ₹ 4,500; Rent — ₹ 21,600; Discount allowed — ₹ 2,700;
Discount received — ₹ 1,600; Sundry expenses — ₹ 24,300; Depreciation on Furniture & Fittings — ₹ 1,500.

(i) Prepare the Departmental Accounts for each of the three departments in columnar form.
(ii) Show the distribution of profits amongst the partners after taking into account the following:
(a) Goods having a transfer price of ₹ 21,400 and ₹ 1,200 were transferred from Departments X and Y respectively to Department Z. The inter-departmental transfers are made at 125% of the cost.
(b) The various items shall be apportioned amongst the three departments in the following proportions:

Nos.	Particulars	Department X	Department Y	Department Z
1.	Rent	2	2	5
2.	Salaries	1	1	1
3.	Depreciation	1	1	1
4.	Discounts received	8	5	3
5.	All the other expenses	On the basis of the sales (excluding inter-departmental transfers) of each department.		

(c) The opening stock of Department Z does not include any goods transferred from other departments, but the closing stock includes ₹ 17,100 valued at the inter-departmental transfer prices.

Solution

G.B.T.

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2018 Cr.

Particulars	Dept. X	Dept. Y	Dept. Z	Particulars	Dept. X	Dept. Y	Dept. Z
To Opening Stock	75,780	48,000	40,000	By Sales	3,60,000	2,70,000	1,80,000
To Purchases	2,81,400	1,61,200	88,800	By Transfer	21,400	1,200	—

To Transfer	—	—	22,600	By Closing Stock	90,160	34,960	43,180
To Gross Profit c/d	1,14,380	96,960	71,780				
	4,71,560	3,06,160	2,23,180		4,71,560	3,06,160	2,23,180
To Salaries	32,000	32,000	32,000	By Gross Profit b/d	1,14,380	96,960	71,780
To Rent	4,800	4,800	12,000	By Discount received	800	500	300
To Advertising	2,000	1,500	1,000				
To Discount Allowed	1,200	900	600				
To Sundry Expenses	10,800	8,100	5,400				
To Depreciation	500	500	500				
To Departmental Profit	63,880	49,660	20,580				
	1,15,180	97,460	72,080		1,15,180	97,460	72,080

Dr. **Appropriation Account for the year ended 31st March, 2018** **Cr.**

Particulars	₹	Particulars	₹
To Provision for unrealised profit on Departmental Closing Stock (Note 1)	3,420	By Departmental Profit	1,34,120
To Net Profit c/d	1,30,700		
	1,34,120		1,34,120
To Partners' Remuneration :		By Net Profit b/d	1,30,700
G (1/2 of ₹ 63,880)	31,940		
B (1/2 of ₹ 49,660)	24,830		
T (1/2 of ₹ 20,580)	10,290		
To Share of Profit :			
G (5/10 of ₹ 63,640)	31,820		
B (3/10 of ₹ 63,640)	19,092		
T (2/10 of ₹ 63,640)	12,728		
	1,30,700		1,30,700

Working Notes: (1) 1/5 of ₹ 17,100.

Illustration 21

X Ltd. has two departments A and B. From the following particulars prepare Departmental Trading Account and Consolidated Trading Account for the year ending 31st December 2017. (all figures in ₹)

Particulars	Dept. A	Dept. B
Opening Stock at cost	40,000	24,000
Purchases	1,84,000	1,36,000
Carriage Inward	4,000	4,000
Wages	24,000	16,000
Sales	2,80,000	2,24,000
Purchased goods transferred by Dept. B to Dept. A	20,000	—
Purchased goods transferred by Dept. A to Dept. B	—	16,000
Finished goods transferred by Dept. B to Dept. A	70,000	—
Finished goods transferred by Dept. A to Dept. B	—	80,000
Return of finished goods by Dept. B to Dept. A	20,000	—
Return of finished goods by Dept. A to Dept. B	—	14,000
Closing stock of Purchased goods	9,000	12,000
Closing stock of Finished goods	48,000	28,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 20% of the finished stock (closing) at each department represented finished goods received from the other department.

Solution

X Ltd.

Dr. Departmental Trading Account for the year ended 31st December, 2017 Cr.

Particulars	Dept. A ₹	Dept. B ₹	Particulars	Dept. A ₹	Dept. B ₹
To Opening Stock	40,000	24,000	By Sales	2,80,000	2,24,000
To Purchases	1,84,000	1,36,000	By Transfer : Purchased goods	16,000	20,000
To Carriage Inwards	4,000	4,000	Finished goods	80,000	70,000
To Wages	24,000	16,000	By Returns : Finished goods	14,000	20,000
To Transfer : Purchased goods	20,000	16,000	By Closing. stock : Purchased goods	9,000	12,000
Finished goods	70,000	80,000	Finished goods	48,000	28,000
To Returns : Finished goods	20,000	14,000			
To Gross Profit c/d	85,000	84,000			
	4,47,000	3,74,000		4,47,000	3,74,000

Dr. Consolidated Trading Account for the year ended 31st December, 2017 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (₹ 40,000 + 24,000)	64,000	By Sales (₹ 2,80,000 + ₹ 2,24,000)	5,04,000
To Purchases (₹ 1,84,000 + 1,36,000)	3,20,000	By Closing Stock :	
To Carriage Inwards (₹ 4,000 + 4,000)	8,000	Purchased goods (₹ 9,000 + ₹ 12,000)	21,000
To Wages (₹ 24,000 + 16,000)	40,000	Finished goods (Note 2)	71,720
To Gross Profit	1,64,720		
	5,96,720		5,96,720

Tutorial Note : For combined Trading Account, inter-departmental transfer should be ignored.

Working Notes : (1) Calculation of Stock Reserve in Closing Stock

Particulars	Dept A (₹)	Dept B (₹)
Sales	2,80,000	2,24,000
Add: Transfer of finished goods	80,000	70,000
	3,60,000	2,94,000
Less: Return of finished goods	20,000	14,000
Sales (Net)	3,40,000	2,80,000
Gross profit	85,000	84,000
Rate of gross profit	$\frac{85,000}{3,40,000} \times 100 = 25\%$	$\frac{84,000}{2,80,000} \times 100 = 30\%$

Finished goods from other Department included in Closing Stock

Department A	₹	Department B	₹
20% of ₹ 48,000	9,600	20% of ₹ 28,000	5,600
Unrealised profit = 30% of ₹ 9,600 (30% is the G.P. ratio of Dept B)	2,880	Unrealised profit = 25% of ₹ 5,600	1,400

(2) Closing Stock of Finished Goods

	Dept A	Dept B	Total
Closing Stock (₹)	48,000	28,000	76,000
Less: Unrealised profit as calculated above	2,880	1,400	4,280
Closing stock (excluding unrealised profit)	45,120	26,600	71,720

Illustration 22

Bubbles Ltd has three operating departments. The details of operations of each department during 1998 had been as follows:

	Department I (₹)	Department II (₹)	Department III (₹)
Sales to Customers	4,00,000	6,00,000	8,00,000
Purchases from Outsiders	3,00,000	4,00,000	5,00,000
Opening Stock (out of local purchases)	80,000	1,00,000	1,20,000
Transfer to Department III	1,35,000	—	—
Closing Stock	50,000	50,000	1,00,000

Common expenses :

Selling commission ₹ 36,000; Depreciation ₹ 45,000; Administration expenses ₹ 1,60,000; Interest on capital ₹ 90,000.

Stock of department III includes 20% transfers from department I.

Prepare Departmental Trading and Profit and Loss Account and ascertain the net profit of the company after considering the following details :

	Department I (₹)	Department II (₹)	Department III (₹)
Fixed assets installed	3,60,000	2,00,000	1,60,000
Capital employed	2,00,000	3,00,000	3,00,000
Administration expenses to be shared	4/10	3/10	3/10

Department I transfers supplies to Department III at normal price less 10%. *[C.U.B.Com. (Hons) — 1999]*

Solution

Bubbles Ltd

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 1998 Cr.

Particulars	Dept I (₹)	Dept II (₹)	Dept III (₹)	Total (₹)	Particulars	Dept I (₹)	Dept II (₹)	Dept III (₹)	Total (₹)
To Opening Stock	80,000	1,00,000	1,20,000	3,00,000	By Sales	4,00,000	6,00,000	8,00,000	18,00,000
To Purchases	3,00,000	4,00,000	5,00,000	12,00,000	By Transfer to Dept III	1,35,000	—	—	—
To Transfer from Dept I	—	—	1,35,000	—	By Closing Stock	50,000	50,000	1,00,000	2,00,000
To Gross Profit c/d	2,05,000	1,50,000	1,45,000	5,00,000					
	5,85,000	6,50,000	9,00,000	20,00,000		5,85,000	6,50,000	9,00,000	20,00,000
To Selling Commission	8,000	12,000	16,000	36,000	By Gross Profit b/d	2,05,000	1,50,000	1,45,000	5,00,000
To Depreciation	22,500	12,500	10,000	45,000					
To Administrative Expenses	64,000	48,000	48,000	1,60,000					
To Interest on Capital	22,500	33,750	33,750	90,000					
To Net Profit c/d	88,000	43,750	37,250	1,69,000					
	2,05,000	1,50,000	1,45,000	5,00,000		2,05,000	1,50,000	1,45,000	5,00,000
To Provision for Unrealised Profit on Closing Stock (Note 2)				6,667	By Net Profit b/d				1,69,000
To Net Profit (Transferred)				1,62,333	By Provision for Unrealised Profit on Opening Stock				Nil
				1,69,000					1,69,000

Working Notes :

(1) Goods transferred by Department I to Department III at normal price less 10%. Normal price of goods transferred to Department III = ₹ 1,35,000 / 90 × 100 = ₹ 1,50,000.

Normal Gross Profit of Department I would have been :

	₹	₹
Sales to outside customers		4,00,000
Transfer to Department III at normal price (as calculated above)		1,50,000
		5,50,000
Less: Cost of Goods Sold :	₹	
Opening Stock	80,000	
Purchases	3,00,000	
	3,80,000	
Less: Closing Stock	50,000	3,30,000
Gross Profit		2,20,000

$$\text{Normal rate of Gross Profit} = \frac{2,20,000}{5,50,000} \times 100 = 40\%$$

(a) Cost of goods transferred to Department III = 60% of ₹ 1,50,000 = ₹ 90,000.

(b) Value of goods transferred to Department III = ₹ 1,35,000

Therefore, profit on goods transferred (b – a) = ₹ 1,35,000 – ₹ 90,000 = ₹ 45,000.

$$\text{Ratio of profit made by Department I on goods transferred to Department III} = \frac{45,000}{1,35,000} \times 100 = 33\frac{1}{3}\%$$

(2) Stock of Department III includes 20% transferred from Department I, i.e., 20% of ₹ 1,00,000 = ₹ **20,000**.

Therefore, unrealised profit on closing stock = $33^1/_3$% of ₹ 20,000 = ₹ 6,667.

Illustration 23

Vijoya Ltd has three departments, I, N and K. For the year ended 31.12.1999, the information is given below :

Paticulars	I (₹)	N (₹)	K (₹)
Stock on 1.1.1999	13,500	18,000	27,000
Materials consumed	36,000	54,000	—
Manufacturing expenses	22,500	45,000	—
Stock on 31.12.1999	18,000	63,000	36,000
Unrealised profit on stock on 1.1.1999	—	4,500	6,000
Sales	—	—	1,53,000

Each department values its stocks at cost to the department concerned. Whereas department I transferred goods to department N at 30% above departmental cost, department N transferred to departrment K at 25% above departmental cost. Other expenses were : Staff remuneration ₹ 6,000; Stationery ₹ 4,500; Rent ₹ 27,000; Depreciation ₹ 18,000; and Advertising ₹ 13,500. These expenses are to be shared by the departments in the ratio of gross profit.

Prepare Departmental Trading and Profit and Loss Account. ***[C.U.B.Com (Hons) — 2000]***

Solution

Vijoya Ltd

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 1999 Cr.

Particulars	Dept. I (₹)	Dept. N (₹)	Dept. K (₹)	Total (₹)	Particulars	Dept. I (₹)	Dept. N (₹)	Dept. K (₹)	Total (₹)
To Opening Stock	13,500	18,000	27,000	58,500	By Sales	—	—	1,53,000	1,53,000
To Direct Materials	36,000	54,000	—	90,000	By Transfer to Dept. N	70,200	—	—	—
To Manufacturing Expenses	22,500	45,000	—	67,500	By Transfer to Dept. K	—	1,55,250	—	—
To Transfer from Dept. I	—	70,200	—	—	By Closing Stock	18,000	63,000	36,000	1,17,000
To Transfer from Dept. N	—	—	1,55,250	—					
To Gross Profit c/d	16,200	31,050	6,750	54,000					
	88,200	2,18,250	1,89,000	2,70,000		88,200	2,18,250	1,89,000	2,70,000
To Staff Remuneration	1,800	3,450	750	6,000	By Gross Profit b/d	16,200	31,050	6,750	54,000
To Stationery	1,350	2,587	563	4,500	By Net Loss c/d	4,500	8,625	1,875	15,000
To Rent	8,100	15,525	3,375	27,000					
To Depreciation	5,400	10,350	2,250	18,000					
To Advertising	4,050	7,763	1,687	13,500					
	20,700	39,675	8,625	69,000		20,700	39,675	8,625	69,000
To Net Loss b/d				15,000	By Provision for Unrealised Profit on Opening Stock (₹ 4,500 + ₹ 6,000)				10,500
To Provision for Unrealised Profit on Closing Stock(Note 2)				15,989	By Profit and Loss A/c — Transfer				20,489
				30,989					30,989

Working Notes :

(1) Calculation of the Value of Transfer

(a) From Dept I to N	₹	(b) From Dept N to K	₹
Opening stock	13,500	Opening stock	18,000
Add: Materials consumed	36,000	Add: Materials consumed	54,000
Add: Manufacturing expenses	22,500	Add: Manufacturing expenses	45,000
	72,000	Add: Transfer (as calculated)	70,200
Less: Closing stock	18,000		1,87,200
Cost of goods transferred	54,000	Less: Closing stock	63,000
Add: Loading @ 30%	16,200	Cost of goods transferred	1,24,200
Value of transfer	70,200	Add: Loading @ 25%	31,050
		Value of transfer	1,55,250

(2) Calculation of Unrealised Profit on Closing Stock

(a) For Dept N	(b) For Dept K
Dept I transferred to Dept N at 30% above cost, i.e., unrealised profit included in Dept N's stock is at 30/130 on transfer price. Therefore, unrealised profit on stock $= \frac{30}{130}$ [Closing Stock $\times \frac{\text{Transfer}}{\text{Departmental Cost}}$] $= \frac{30}{130}$ [63,000 $\times \frac{70{,}200}{54{,}000 + 45{,}000 + 70{,}200}$] = ₹ 6,032 Total provision for unrealised profit = ₹ 6,032 (Dept N) + ₹ 9,957 (Dept K) = ₹ 15,989.	Dept N transferred to Dept K at 25% of cost, i.e., unrealised profit included in Dept. K's stock is 25/125 = 1/5 on transfer price. Therefore, unrealised profit on stock arising from Dept N 1/5 of ₹ 36,000 = ₹ 7,200. And unrealised profit on stock arising from Dept I = 30 / 130 (₹ 36,000 – ₹ 7,200) x (₹ 70,200 / ₹ 1,69,200) Therefore, total = (₹ 7,200 + ₹ 2,757) = ₹ 9,957.

Illustration 24

M/s Auto Garage consists of three departments — Spares, Service and Repairs. Each department is managed by a manager who is paid a commission which has been fixed @ 5%, 10% and 10% respectively of the departmental profits. In the absence or adequacy of profits, a minimum commission of ₹ 3,000 is to be paid to the manager. Inter-departmental transfers of goods and services are made on the basis of a loaded price given as under :

from Spares to Service 5% above cost
from Spares to Repairs 10% above cost
from Repairs to Service 10% above cost

For the year ended 31.3.2018, the books had already been closed and positions drawn. On a scrutiny subsequently made, it was discovered that the closing stock of the departments included inter-departmental transfers at loaded price. From the following details, you are to prepare a revised statement, recomputing the profits or losses of each of the departments.

Particulars	Spares	Service	Repairs
Book results	Loss ₹ 19,000	Profits ₹ 25,200	Profits ₹ 36,000
Inter-departmental transfers at loaded price	—	₹ 10,500 from spares and ₹ 22,000 from repairs	₹ 2,100 from spares

Solution

In the books of M/s Auto Garage

Statement Showing Recomputation of Departmental Profits and Losses for the year ended 31.3.2018

Particulars	Spares (₹)	Services (₹)	Repairs (₹)
Net Profit / Loss (Given)	(–) 19,000	25,200	36,000
Add Back : Commission of Departmental Manager (Note 1)	3,000	3,000	4,000
	(–) 16,000	28,200	40,000
Less: Adjustment of Unrealised Profits included in Stocks (Note 2)	(–) 691	—	(–) 2,000
Revised Departmental Profit / Loss	(–) 16,691	28,200	38,000
Less: Commission Payable to Departmental Manager (Note 3)	(–) 3,000	3,000	3,800
Actual Net Profit / Loss	(–) 1,961	25,200	34,200

Working Notes :

(1) Commission of Departmental Managers already taken into Consideration

Spares : This department has incurred a loss. Therefore, commission will be maximum of ₹ **3,000**.

Service : (i) Actual commission = 1/9 of ₹ 25,200 = ₹ 2,800.
(ii) Minimum commission = ₹ 3,000.
Therefore, commission will be ₹ **3,000**.

Repairs : (i) Actual commission = 1/9 of ₹ 36,000 = ₹ 4,000.
(ii) Minimum commission = ₹ 3,000.
Therefore, commission will be ₹ **4,000**.

(2) Unrealised Profit on Stock

	₹
Spares : (i) On transfer to Service Department : 5/105 × ₹ 10,500	500
(ii) On transfer to Repairs Department = 10/110 × ₹ 2,100	191
	691

Repairs : On transfer to Service Department = 10/110 × ₹ 22,000 = ₹ **2,000**.

(3) Commission payable to Departmental Managers based on correct Profit (i.e., after considering unrealised profit on stock)
Spares : This department has incurred a loss. Therefore, commission will be minimum of ₹ **3,000**.
Service : (i) Actual commission = 10% of ₹ 28,200 = ₹ 2,820.
(ii) Minimum commission = ₹ 3,000.
Therefore, commission will be ₹ 3,000.
Repairs : (i) Actual commission = 10% of ₹ 38,000 = ₹ 3,800
(ii) Minimum commission = ₹ 3,000.
Therefore, commission will be ₹ 3,800.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 25

M/s P & Co. has two departments. You are requested to prepape the trading and profit and loss account for each department for the year ended on 31st March, 2016 on the basis of following information :

Particulars	Dept. A (₹)	Dept. B (₹)
Opening Stock (1.4.2015)	20,000	25,000
Purchase	2,35,000	1,85,000
Sales	6,36,000	4,94,000
Sales Return	6,000	4,000
Closing Stock (31.3.2016)	30,000	18,000
Wages	80,000	60,000
Salaries	40,000	25,000

Other common expenses :	₹	
Rent	12,000	
Electricity	9,000	
Depreciation	19,000	
Selling expenses	7,000	
Some other relevant information is given below :	**Dept. A**	**Dept. B**
Light Points	18	9
Value of assets (₹)	3,00,000	2,40,000
Floor area (sq.ft.)	300	200

[C.U.B.Com. (General) — 2017]

Solution

M/s. P & Co.

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	Dept. A ₹	Dept. B ₹	Particulars	Dept. A ₹	Dept. B ₹
To Opening Stock	20,000	25,000	By Sales	6,36,000	4,94,000
To Purchases	2,35,000	1,85,000	Less: Sales Return	6,000	4,000
To Wages	80,000	60,000		6,30,000	4,90,000
To Gross Profit c/d	3,25,000	2,38,000	By Closing Stock	30,000	18,000
	6,60,000	5,08,000		6,60,000	5,08,000
To Salaries	40,000	25,000	By Gross Profit b/d	3,25,000	2,38,000
To Rent	7,200	4,800			
To Electricity	6,000	3,000			
To Depreciation	10,556	8,444			
To Selling Expenses	3,938	3,062			
To Net Profit	2,57,306	1,93,693			
	3,25,000	2,38,000		3,25,000	2,38,000

Working Notes : **(1) Apportionment of Common Expenses**

Expenses	Basis	Total (₹)	Dept. A (₹))	Dept. B (₹)
Rent	Floor Area 3 : 2	12,000	7,200	4,800
Electricity	Light Points 2 : 1	9,000	6,000	3,000
Depreciation	Value of Assets 5 : 4	19,000	10,556	8,444
Selling Expenses	Sales (Net) 9 : 7	7,000	3,938	3,062

Illustration 26

On the basis of the following information relating to a departmental organisation having departments X and Y, prepare Department Trading and Profit and Loss Account for the year ended 31.03.2016 :

Particulars	Dept. X (₹)	Dept. Y (₹)	Particulars	Dept. X (₹)	Dept. Y (₹)
Stock as on 1.4.2015	30,000	30,000	Stock as on 31.3.2016	40,000	30,000
Purchases	2,00,000	1,00,000	Sales	4,50,000	2,50,000
Wages	25,000	20,000	Building	4,00,000	5,00,000
Salaries	20,000	10,000	Machinery (W.D.V. as on 31.3.2016)	2,00,000	2,00,000
Goods from Dept. X (at cost)	—	10,000	No. of Staff	30	20

Other common expenses :

(a) Salaries ₹ 20,000; (b) Advertisement ₹ 14,000.

Rate of depreciation of fixed assets 10% p.a. ***[C.U.B.Com. (General) — 2016]***

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	Dept. X ₹	Dept. Y ₹	Particulars	Dept. X ₹	Dept. Y ₹
To Opening Stock	30,000	30,000	By Sales	4,50,000	2,50,000
To Purchases	2,00,000	1,00,000	By Goods Sent to Dept. Y	10,000	—
To Wages	25,000	20,000	By Closing Stock	40,000	30,000
To Goods romr Dept. X	—	10,000			
To Gross Profit c/d	2,45,000	1,20,000			
	5,00,000	2,80,000		5,00,000	2,80,000
To Salaries (Departmental)	20,000	10,000	By Gross Profit b/d	2,45,000	1,20,000
To Salaries (Common) (Note 1)	12,000	8,000			
To Advertisement (Note 2)	9,000	5,000			
To Depreciation : (Note 3)					
on Building	40,000	50,000			
on Machinery	20,000	20,000			
To Net Profit	1,44,000	27,000			
	2,45,000	1,20,000		2,45,000	1,20,000

Working Notes :

(1) Common salaries are to be divided between the departments in the ratio of number of staff, i.e., 3 : 2.

Dept. X : $\frac{20,000}{5} \times 3 =$ ₹ **12,000**.

Dept. Y : $\frac{20,000}{5} \times 2 =$ ₹ **8,000**.

(2) Advertisement expenses are to be divided between the departments in the ratio of sales, i.e., 9 : 5.

Dept. X : $\frac{14,000}{14} \times 9 =$ ₹ **9,000**.

Dept. Y : $\frac{14,000}{14} \times 5 =$ ₹ **5,000**.

(3) Depreciation :

Dept. X : on Building — ₹ 4,00,000 × 10% = ₹ **40,000**.
on Machinery — ₹ 2,00,000 × 10% = ₹ **20,000**.
Dept. Y : on Building — ₹ 5,00,000 × 10% = ₹ **50,000**.
on Machinery — ₹ 2,00,000 × 10% = ₹ **20,000**.

Illustration 27

From the following particulars of Mr. Nobel having a Departmental Organisation with two departments P and Q. Prepare a Departmental Trading and Profit and Loss Account for the year ended 31.03.2015 :

Particulars	**Department P (₹)**	**Department Q (₹)**
(i) Stock as on 01.04.2014	40,000	35,000
(ii) Purchase	2,50,000	2,00,000
(iii) Goods from Department Q	30,000	—
(iv) Salaries	60,000	45,000
(v) Wages	30,000	30,000
(vi) Sales	4,50,000	3,50,000
(vii) Other Expenses	10,000	10,000
(viii) Machinery	2,00,000	2,00,000
(ix) Stock as on 31.03.2015	35,000	40,000

Other information :

(a) Total administrative expenses ₹ 10,000.

(b) General electricity expenses ₹ 20,000.
Department P and Q have light points 20 and 30 respectively.

(c) Rate of Depreciation on Machinery @ 20% p.a. ***[C.U.B.Com. (General) — 2015]***

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Dept. P ₹	Dept. Q ₹	Particulars	Dept. P ₹	Dept. Q ₹
To Opening Stock	40,000	35,000	By Goods Sent to Dept. P	—	30,000
To Purchases	2,50,000	2,00,000	By Sales	4,50,000	3,50,000
To Goods from Dept. Q	30,000	—	By Closing Stock	35,000	40,000
To Wages	30,000	30,000			
To Gross Profit c/d	1,35,000	1,55,000			
	4,85,000	4,20,000		4,85,000	4,20,000
To Salaries	60,000	45,000	By Gross Profit b/d	1,35,000	1,55,000
To Other Expenses	10,000	10,000			
To Administrative Expenses (Note 1)	5,625	4,375			
To General Electricity (Note 2)	8,000	12,000			
To Depreciation on Machinery (Note 3)	40,000	40,000			
To Net Profit	11,375	43,625			
	1,35,000	1,55,000		1,35,000	1,55,000

Working Notes :

(1) Administrative expenses will be shared by departments in the ratio of sales, i.e., 9 : 7.

$$\text{Dept. P} = \frac{10{,}000}{16} \times 9 = ₹\ \mathbf{5{,}625}.$$

$$\text{Dept. Q} = \frac{10{,}000}{16} \times 7 = ₹\ \mathbf{4{,}375}.$$

(2) General electricity will be shared by departments in the ratio of light points, i.e., 2 : 3.

$$\text{Dept P} = \frac{20{,}000}{5} \times 2 = ₹\ \mathbf{8{,}000}.$$

$$\text{Dept. Q} = \frac{20{,}000}{5} \times 3\ ₹\ \mathbf{12{,}000}.$$

(3) Depreciation on Machinery :

Dept. P = ₹ 2,00,000 × 20% = ₹ **40,000**.

Dept. P = ₹ 2,00,000 × 20% = ₹ **40,000**.

Illustration 28

On the basis of the following information related to two departments of D & E Ltd., prepare Departmental Trading and Profit and Loss Account :

Particulars	Dept. D (₹)	Dept. E (₹)
Stock as on 1.4.2013	30,000	30,000
Purchases	3,00,000	1,00,000
Goods from D Dept. (at cost)	—	50,000
Salaries	40,000	30,000
Wages	20,000	20,000
Sales	5,00,000	2,00,000
Other Expenses	20,000	10,000
Machinery	1,00,000	1,00,000
Stock as on 31.3.2014 (at cost)	30,000	30,000

Other information :

(a) Administratie expenses of ₹ 10,000 are to be apportioned in the ratio of 3 : 2 between D and E.

(b) General electricity expenses ₹ 30,000. Department D and E have light points 30 and 20 respectively.

(c) Rate of depreciation on machinery is 10% p.a. ***[C.U.B.Com. (General) — 2014]***

Solution

D & E Ltd.

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2014 Cr.

Particulars	Dept. D ₹	Dept. E ₹	Particulars	Dept. D ₹	Dept. E ₹
To Opening Stock	30,000	30,000	By Sales	5,00,000	2,00,000
To Purchases	3,00,000	1,00,000	By Goods Transferred to Dept. E	50,000	—
To Goods Transferrd from Dept. D	—	50,000	By Closing Stock	30,000	30,000
To Wages	20,000	20,000			
To Gross Profit c/d	2,30,000	30,000			
	5,80,000	2,30,000		5,80,000	2,30,000
To Salaries	40,000	30,000	By Balance b/d	2,30,000	30,000
To Other Expenses	20,000	10,000	By Net Loss	—	36,000
To Administrative Expenses	6,000	4,000			
To General Electricity Expenses (Note 1)	18,000	12,000			
To Depreciation on Machinery (Note 2)	10,000	10,000			
To Net Profit	1,36,000	—			
	2,30,000	66,000		2,30,000	66,000

Working Notes :

(1) General electricity expenses are to be shared by the departments in the ratio of light points, i.e., 3 : 2.

Department D : $\frac{30,000}{5} \times 3 =$ ₹ **18,000**.

Department E : $\frac{30,000}{5} \times 2 =$ ₹ **12,000**.

(2) Depreciation :

Department D : ₹ 1,00,000 × 10% = ₹ **10,000**.

Department E : ₹ 1,00,000 × 10% = ₹ **10,000**.

Illustration 29

From the following particulars of a departmental organisation having two departments B and N, prepare a Departmental Trading and Profit and Loss Account for the year ended 31st March, 2012 :

Particulars	B Dept. (₹)	N Dept. (₹)
Stock as on 1.4.2011	20,000	2,000
Purchases	3,00,000	30,000
Goods from B Dept. (at cost)	—	40,000
Wages	15,000	20,000

Salaries	10,000	15,000
Stock (at cost) on 31.3.2012	20,000	7,000
Sales	4,00,000	2,00,000
Stationery	2,700	1,700
Plant and Machinery	50,000	50,000

Other information :
Salaries ₹ 18,000; Miscellaneous expenses ₹ 6,300.
Advertisement expenses ₹ 9,000; Bank charges ₹ 900.
Depreciate Plant and Machinery by 20%.
Expenses are to be apportioned between Dept. B and Dept. N in the ratio 2 : 1. ***[C.U.B.Com. (General) — 2013]***

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2012 Cr.

Particulars	Dept. B ₹	Dept. N ₹	Particulars	Dept. B ₹	Dept. N ₹
To Opening Stock	20,000	2,000	By Goods transferred to Dept. N	40,000	—
To Purchases	3,00,000	30,000	By Sales	4,00,000	2,00,000
To Goods from Dept. B	—	40,000	By Closing Stock	20,000	7,000
To Wages	15,000	20,000			
To Gross Profit c/d	1,25,000	1,15,000			
	4,60,000	2,07,000		4,60,000	2,07,000
To Salaries	10,000	15,000	By Gross Profit b/d	1,25,000	1,15,000
To Stationery	2,700	1,700			
To Depreciation on Plant and Machinery	10,000	10,000			
To Salaries (2 : 1)	12,000	6,000			
To Advertisement Expenses (2 : 1)	6,000	3,000			
To Miscellaneous Expenses (2 : 1)	4,200	2,100			
To Bank Charges (2 : 1)	600	300			
To Net Profit	79,500	76,900			
	1,25,000	1,15,000		1,25,000	1,15,000

Illustration 30

Prepare Departmental Trading and Profit and Loss Account from the following particulars assuming that the rate of gross profit is same in each case :

Particulars	Dept. A	Dept. B	Dept. C
Purchases at total cost of ₹ 1,00,000	1,000 units	2,000 units	2,400 units
Closing Stock (1.1.2010)	120 units	80 units	152 units
Sales (1.1.2010)	1,020 units	1,920 units	2,496 units
	@ ₹ 20 each	@ ₹ 22.50 each	@ ₹ 25 each

General expenses of ₹ 7,530 is to be apportioned between all the three departments in the ratio of 2 : 2 : 1.

[C.U.B.Com. (General) — 2012]

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended ... Cr.

Particulars	Dept. A (₹)	Dept. B (₹)	Dept. C (₹)	Particulars	Dept. A (₹)	Dept. B (₹)	Dept. C (₹)
To Opening Stock (Note 4)	2,240	—	4,960	By Sales (Note 6)	20,400	43,200	62,400
To Purchases (Note 2)	16,000	36,000	48,000	By Closing Stock (Note 5)	1,920	1,440	3,040
To Gross Profit c/d	4,080	8,640	12,480				
	22,320	44,640	65,440		22,320	44,640	65,440
To General Expenses	3,012	3,012	1,506	By Gross Profit b/d	4,080	8,640	12,480
To Net Profit	1,068	5,628	10,974				
	4,080	8,640	12,480		4,080	8,640	12,480

Working Notes :

(1) Calculation of Profit Margin Rate

Particulars	₹	₹
Suppose Purchase Units = Sales Units		
Department A (1,000 units @ ₹ 20)	20,000	
Department B (2,000 units @ ₹ 22.50)	45,000	
Department C (2,400 units @ ₹ 25)	60,000	
Total Sales Value		1,25,000
Less: Purchases (given)		1,00,000
Gross Profit		25,000

$$\text{Rate of Gross Profit} = \frac{25{,}000}{1{,}25{,}000} \times 100 = 20\%$$

(2) Calculation of Purchase Price and Total Purchases of Each Department

Particulars	Dept. A	Dept. B	Dept. C
Selling Price per unit (₹)	20.00	22.50	25.00
Less: Gross Profit 20% of Sales	4.00	4.50	5.00
Purchase Price per unit (X)	16.00	18.00	20.00
Number of Units Purchased (Y)	1,000	2,000	2,400
Total Purchases (X) x (Y) (₹)	16,000	36,000	48,000

(3) Calculation of Opening Stock of Each Department

Department	Dept. A	Dept. B	Dept. C
Closing Stock (units)	120	80	152
Add: Sales (units)	1,020	1,920	2,496
	1,140	2,000	2,648
Less: Purchases (units)	1,000	2,000	2,400
Opening Stock (units)	140	Nil	248

(4) Calculation of Value of Opening Stock

Department A : 140 × ₹ 16 = ₹ 2,240

Department C : 248 × ₹ 20 = ₹ 4,960

(5) Calculation of Value of Closing Stock

Department A : 120 × ₹ 16 = ₹ 1,920

Department B : 80 × ₹ 18 = ₹ 1,440

Department C : 152 × ₹ 20 = ₹ 3,040

(6) Calculation of Sales Value

Department A : 1,020 × ₹ 20 = ₹ 20,400

Department B : 1,920 × ₹ 22.50 = ₹ 43,200

Department C : 2,496 × ₹ 25 = ₹ 62,400

Illustration 31

From the following information, prepare Departmental Trading and Profit and Loss Account for the year ended 31st December, 2010 :

Particulars	Dept. A (₹)	Dept. B (₹)	Dept. C (₹)
Stock on 1.1.2010	6,000	7,000	3,000
Purchases	7,000	6,500	4,700
Sales	12,000	10,000	6,000
Direct Expenses	2,000	1,500	700
Rates of Gross Profit	40%	30%	20%

Indirect Expenses :
Sundry expenses ₹ 700; Salaries ₹ 840 and Rent ₹ 560.
The indirect expenses are charged in proportion to departmental turnover.

[C.U.B.Com. (General) — 2011]

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2010 Cr.

Particulars	Dept. A (₹)	Dept. B (₹)	Dept. C (₹)	Particulars	Dept. A (₹)	Dept. B (₹)	Dept. C (₹)
To Opening Stock	6,000	7,000	3,000	By Sales	12,000	10,000	6,000
To Purchases	7,000	6,500	4,700	By Closing Stock (Note 1)	5,800	6,500	2,900
To Direct Wages	2,000	1,500	700				
To Gross Profit c/d	2,800	1,500	500				
	17,800	16,500	8,900		17,800	16,500	8,900
To Sundry Expenses (6 : 5 : 3)	300	250	150	By Gross Profit b/d	2,800	1,500	500
To Salaries (6 : 5 : 3)	360	300	180				
To Rent (6 : 5 : 3)	240	200	120				
To Net Profit	1,900	750	50				
	2,800	1,500	500		2,800	1,500	500

Working Notes : **(1) Calculation of Closing Stock of Each Department**

Department	Dept. A	Dept. B	Dept. C
Opening Stock	6,000	7,000	3,000
Add: Purchases	7,000	6,500	4,700
	13,000	13,500	7,700
Less: Cost of Goods Sold (Note 2)	7,200	7,000	4,800
Value of Closing Stock	5,800	6,500	2,900

(2) Calculation of Cost of Goods Sold :
A : ₹ 12,000 × (100% – 40%) = ₹ 7,200.
B : ₹ 10,000 × (100% – 30%) = ₹ 7,000.
C : ₹ 10,000 × (100% – 20%) = ₹ 4,800.

(3) Ratio of Turnover :
A : B : C
12,000 : 10,000 : 6,000
or, 6 : 5 : 3

[For Honours Candidates Only]

Illustration 32

A hotel proprietor has two departments, viz., (i) Apartment Department and (ii) Meals Department. Following is the Trial Balance of the business as on 31.03.2016 :

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Food & Provision	15,500	Income from Apartment Dept.	46,000
Opening Stock of Provisions	1,020	Income from Meals Dept.	32,000
Cash at Bank	10,000	Capital	2,20,000
Customers Account	800	Suppliers Account	9,800
Building (1/10 is used for Meals Dept.)	2,10,000	Provision for Depreciation on Building	20,000
General Expenses	27,410	Provision for Depreciation on Furniture and Equipments	4,000
Furniture and Equipments	60,000	Interest	1,130
Accrued Interest	200		
Drawings	2,000		
Wages	6,000		
	3,32,930		3,32,930

Additional information :

(i) The servants of the Apartment Dept. had occupied a room for 5 days @ ₹ 120 per day and took meals worth ₹ 600. Similarly the servants of the Meals Dept. had occupied a room for 6 days @ ₹ 120 per day and took meals worth ₹ 900.

(ii) Wages are charged in the portion of 1/2 to the Apartment Dept., 1/4 to the Meals Dept. and the remaining to the General Profit and Loss Account.

(iii) Increase provision for depreciation on building to ₹ 28,000 and on furniture and equipments by ₹ 1,000.
(iv) A sum of ₹ 800 representing accommodation ₹ 240 and meals ₹ 560 is to be charged to the hotel proprietor.
You are required to prepare Departmental Profit and Loss Account for the year ended on 31.03.2016.

[C.U.B.Com. (Hons.) — 2017]

Solution

Dr. Departmental Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	Apartment Dept.	Meal Dept.	Particulars	Apartment Dept.	Meal Dept.
To Opening Stock of Provisions	—	1,020	By Income	46,000	32,000
To Food and Provisions (Purchase)	—	15,500	By Drawings	240	560
To Depreciation on :			By Apartment Dept - transfer	—	600
Building (Note 1)	7,200	800	By Meal Dept - transfer	720	—
Furniture and Equipments (Note 2)	900	100			
To Wages (Note 3)	3,000	1,500			
To Apartment Dept. - transfer	—	720			
To Meal Dept. - transfer	600	—			
To Departmental Profit	35,260	13,520			
	46,960	33,160		46,960	33,160

Tutorial Notes :

(1) No adjustment is required for providing facility to own department staff. Therefore, room charges of Apartment department and meal charges of meal department are to be ignored.

(2) It has been asked in the question to prepare '***Departmental Profit and Loss Account***'. Therefore, gross profit has not been calculated separately.

Working Notes :

(1) Depreciation on Building

	₹
Closing balance of provision for depreciation on building	28,000
Less: Opening balance of provision for depreciation on bulding	20,000
Depreciation for the year	8,000

Depreciation of Meal Dept. = 1/10 of ₹ 8,000 = ₹ 800.
Depreciation of Apartment Dept. = 9/10 of ₹ 8,000 = ₹ 7,200.

(2) Depreciation on Furniture and Equipment is ₹ 1,000. The question is silent about the sharing of this deprec iation. We assumed that it is to be shared in the same ratio of depreciation on building. Therefore, the depreciation on furniture and equipment will be shared as follows :

Meal Dept. : 1/10 of ₹ 1,000 = ₹ 100
Apartment Dept. : 9/10 of ₹ 1,000 = ₹ 900.

(3) Division of Wages :

Apartment Dept : 1/2 of ₹ 6,000 = ₹ 3,000.
Meal Dept. : 1/4 of ₹ 6,000 = ₹ 1,500.
General Profit and Loss = 1/4 of ₹ 6,000 = ₹ 1,500.

Illustration 33

M/s. Mega Co. has two departments A and B. From the following particulars, prepare Departmental Trading Account and General Profit and Loss Account for the year ended 31st March, 2016 :

Particulars	Dept. A (₹)	Dept. B (₹)
Opening Stock (at cost)	70,000	54,000
Purchases	3,92,000	2,98,000
Carriage Inward	6,000	9,000
Wages	54,000	36,000
Sales	5,72,000	4,60,000
Purchased Goods Transferred :		
By Dept. B to A	50,000	—
By Dept. A to B	—	36,000
Finished Goods Transferred :		
By Dept. B to A	1,50,000	—
By Dept. A to B	—	1,75,000
Return of Finished Goods :		
By Dept. B to A	45,000	—
By Dept. A to B	—	32,000

Closing Stock :		
Purchased Goods	24,000	30,000
Finished Goods	1,02,000	62,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price. 30% of the closing finished stock with each department represents finished goods received from the other department.

[C.U.B.Com. (Hons.) — 2016]

Solution

M/s Mega Co.

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	Dept. A ₹	Dept. B ₹	Particulars	Dept. A ₹	Dept. B ₹
To Opening Stock	70,000	54,000	By Sales	5,72,000	4,60,000
To Purchases	3,92,000	2,98,000	By Transfer : Purchased goods	36,000	50,000
To Carriage Inwards	6,000	9,000	Finished goods	1,75,000	1,50,000
To Wages	54,000	36,000	By Returns : Finished goods	32,000	45,000
To Transfer : Purchased goods	50,000	36,000	By Closing stock : Purchased goods	24,000	30,000
Finished goods	1,50,000	1,75,000	Finished goods	1,02,000	62,000
To Returns : Finished goods	45,000	32,000			
To Gross Profit c/d (transferred to General Profit and Loss Account)	1,74,000	1,57,000			
	9,41,000	7,97,000		9,41,000	7,97,000

Dr. General Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	Particulars	₹
To Stock Reserve :		By Gross Profit b/d :	
In Closing Stock of Dept. A	8,312	Dept. A	1,74,000
In Closing Stock of Dept. B	4,610	Dept. B	1,57,000
To Net Profit	3,18,078		
	3,31,000		3,31,000

Working Notes : (1) Calculation of Stock Reserve in Closing Stock

Particulars	Dept A (₹)	Dept B (₹)
Sales	5,72,000	4,60,000
Add: Transfer of finished goods	1,75,000	1,50,000
	7,47,000	6,10,000
Less: Return of finished goods	45,000	32,000
Sales (Net) (A)	7,02,000	5,78,000
Gross profit (B)	1,74,000	1,57,000
Rate of gross profit (B ÷ A) x 100	$\frac{1,74,000}{7,02,000} \times 100 = 24.786\ \%$	$\frac{1,57,000}{5,78,000} \times 100 = 27.162\ \%$

(2) Finished goods from other Department included in Closing Stock

Department A	₹	Department B	₹
Finished Goods recd. from Dept. B : 30% of ₹ 1,02,000	30,600	Finished Goods recd. from Dept. A : 30% of ₹ 62,000	18,600
Unrealised profit = 27.162% of ₹ 30,600	8,312	Unrealised profit = 24.786% of ₹ 18,600	4,610

Illustration 34

A firm has two departments - Raw materials and Manufacturing. The finished goods are produced by the manufacturing department with raw materials supplied by Raw Materials Department at selling price. From the following information, prepare Departmental Trading and Profit and Loss Account for the year ended on 31st March, 2014 :

Particulars	Raw Materials Department (₹)	Manufacturing Department (₹)
Opening Stock	60,000	10,000
Purchases	4,00,000	3,000
Raw Materials Transferred to Manufacturing Department	60,000	—
Sales	4,40,000	90,000
Manufacturing Expenses	—	12,000
Selling Expenses	800	400
Closing Stock	40,000	12,000

It is estimated that the cost of closing stock of Manufacturing Department consists of 75% of raw materials and 25% for manufacturing expenses. The rate of gross profit earned during the preceding year by the Raw Materials Department was 10%. After allocating the following expenses on reasonable basis between the two departments work out the net profit of the firm as a whole :

(i) Salaries ₹ 2,500.

(ii) Insurance premium ₹ 800. ***[C.U.B.Com. (Hons.) — 2015]***

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2014 Cr.

Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)	Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)
To Opening Stock	60,000	10,000	70,000	By Sales	4,40,000	90,000	5,30,000
To Purchases	4,00,000	3,000	4,03,000	By Raw Materials transferred to Manufacturing Dept.	60,000	—	60,000
To Manufacturing Expenses	—	12,000	12,000				
To Raw Materials from R.M. Dept.	—	60,000	60,000	By Closing Stock	40,000	12,000	52,000
To Gross Profit c/d	80,000	17,000	97,000				
	5,40,000	1,02,000	6,42,000		5,40,000	1,02,000	6,42,000
To Selling Expenses	800	400	1,200	By Gross Profit b/d	80,000	17,000	97,000
To Salaries (Note 3)	2,119	381	2,500				
To Insurance Premium (Note 4)	656	144	800				
To Net Profit c/d	76,425	16,075	92,500				
	80,000	17,000	97,000		80,000	17,000	97,000
To Provision for Unrealised Profit on Closing Stock (Note 2)			1,440	By Net Profit b/d			92,500
To Net Profit			91,810	By Provision for Unrealised Profit on Opening Stock (Note 2)			750
			93,250				93,250

Working Notes :

(1) Gross Profit Ratio of Raw Materials Department $= \dfrac{80,000}{(4,40,000 + 60,000)} \times 100 = \dfrac{80,000}{5,00,000} \times 100 = \mathbf{16\%}$

(2) Provision for Unrealised Profit on ***Opening Stock*** = (10,000 × 75%) × 10% = ₹ 750.

Provision for Unrealised Profit on ***Closing Stock*** = (12,000 × 75%) × 16% = ₹ 1,440.

(3) Salaries can be shared by the R.M. Dept and Mfg. Dept. in the ratio of Sales of each department. The ratio will be :

(4,40,000 + 60,000) : 90,000

or 5,00,000 : 90,000

or 50 : 9.

(a) Raw materials department's share = 2,500 / 59 × 50 = ₹ 2,119

(b) Manufacturing department's share = 2,500 / 59 × 9 = ₹ 381.

(4) Insurance premium can be shared by R.M. Dept. and Mfg. Dept. in the ratio of average stock of each department. The ratio will be :

$= \dfrac{(60,000 + 40,000)}{2} : \dfrac{(10,000 + 12,000)}{2}$

or 50,000 : 11,000

or 50 : 11

(a) Raw materials department's share = 800 / 61 × 50 = ₹ 656.

(b) Mfg. department's share = 800 / 61 × 11 = ₹ 144.

Illustration 35

Raju & Co. has two departments X and Y. Dept. X sells goods to Dept. Y at normal selling price. From the following particulars, prepare a Departmental Trading and Profit and Loss Account for the year ended 31st March, 2013 and also ascertain the net profit to be transferred to Balance Sheet :

Particulars	Dept. X (₹)	Dept. Y (₹)
Opening Stock	1,00,000	—
Purchases	23,00,00	2,00,000
Goods from Dept. X	—	7,00,000
Wages	1,00,000	1,60,000
Travelling Expenses	20,000	14,000
Sales (excluding Departmental transfer)	23,00,000	15,00,000
Printing and Stationery	10,000	8,000
Closing Stock at cost to the Dept.	5,00,000	1,80,000

The following expenses incurred for both the departments were not apportioned between the departments :
Salaries ₹ 2,70,000; Advertisement expenses ₹ 90,000; General expenses ₹ 8,00,000.

Depreciation should be charged at 25% on the machinery value of ₹ 96,000. Advertisement expenses are to be apportioned in the turnover ratio, salaries in 2 : 1 ratio and depreciation in 3 : 1 ratio between Departments X and Y. General expenses are to be apportioned in the ratio of 3 : 1.

[C.U.B.Com. (Hons.) — 2014]

Solution

Raju & Co

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2013 Cr.

Particulars	Dept X (₹)	Dept Y (₹)	Total (₹)	Particulars	Dept X (₹)	Dept Y (₹)	Total (₹)
To Opening Stock	1,00,000	—	1,00,000	By Sales	23,00,000	15,00,000	38,00,000
To Purchases	23,00,000	2,00,000	25,00,000	By Goods transferred to Y	7,00,000	—	—
To Goods from Dept X‘	—	7,00,000	—	By Closing Stock	5,00,000	1,80,000	6,80,000
To Wages	1,00,000	1,60,000	2,60,000				
To Gross Profit c/d	10,00,000	6,20,000	16,20,000				
	35,00,000	16,80,000	44,80,000		35,00,000	16,80,000	44,80,000
To Travelling Expenses	20,000	14,000	34,000	By Gross Profit b/d	10,00,000	6,20,000	16,20,000
To Printing and Stationery	10,000	8,000	18,000				
To Salaries (2 : 1)	1,80,000	90,000	2,70,000				
To Advertisement Exp. (Note 3)	60,000	30,000	90,000				
To General Expenses (3 : 1)	6,00,000	2,00,000	8,00,000				
To Depreciation on Machinery (3:1)	18,000	6,000	24,000				
To Net Profit c/d	1,12,000	2,72,000	3,84,000				
	10,00,000	6,20,000	16,20,000		10,00,000	6,20,000	16,20,000
To Provision for Unrealised Profit on Closing Stock (Note 2)			46,667	By Net Profit b/d			3,84,000
To Capital A/c (Net Profit transferred)			3,37,333	By Provision for Unrealised Profit on Opening Stock			Nil
			3,84,000				3,84,000

Working Notes :

(1) Gross Profit Ratio of Department X = $\dfrac{10,00,000}{23,00,000 + 7,00,000} \times 100 = \dfrac{10,00,000}{30,00,000} \times 100 = \mathbf{33\frac{1}{3}\%}$

(2) Proportionate of X Department's stock in Department Y

$$= \frac{\text{Purchase from Department X}}{\text{Total Purchases of Department Y}} \times \text{Total Stock of Department Y} = \frac{7,00,000}{9,00,000} \times 1,80,000 = ₹\ \mathbf{1,40,000}$$

Unrealised profit = $\frac{1}{3}$ of ₹ 1,40,000 = ₹ **46,667.**

(3) Advertisement expenses are to be apportioned in the ratio of turnover. The ratio will be :
(23,00,000 + 7,00,000) : 15,00,000
or, 30,00,000 : 15,00,000 or, **2 : 1.**
(a) Department X's share = 2/3 of ₹ 90,000 = ₹ 60,000.
(b) Department Y's share = 1/3 of ₹ 90,000 = ₹ 30,000.

Ilustation 36

A Ltd. has three departments X, Y and Z. From the following particulars, prepare a Departmental Trading Account for the year ended 31st December, 2012 :

Particulars	Dept. X (₹)	Dept. Y (₹)	Dept. Z (₹)
Stock on 1.1.2012	48,000	72,000	24,000
Purchases	2,92,000	2,48,000	96,000
Actual Sales	3,45,000	3,18,800	1,49,200
Gross Profit on Normal Selling Price	20%	25%	$33\frac{1}{3}\%$

During the year certain items were sold at discounts and these discounts were reflected in the sales figure shown above. The items sold at discounts were :

Particulars	Dept. X (₹)	Dept. Y (₹)	Dept. Z (₹)
Sales at Normal Price	20,000	6,000	2,000
Sales at Actual Price	15,000	4,800	1,200

[C.U.B.Com. (Hons.) — 2013]

Solution **A Ltd.**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2012 Cr.

Particulars	Dept X (₹)	Dept Y (₹)	Dept. Z (₹)	Particulars	Dept X (₹)	Dept Y (₹)	Dept. Z (₹)
To Opening Stock	48,000	72,000	24,000	By Sales (Actual)	3,45,000	3,18,800	1,49,200
To Purchases	2,92,000	2,48,000	96,000	By Closing Stock (Note 1)	60,000	80,000	20,000
To Gross Profit c/d	65,000	78,800	49,200				
	4,05,000	3,98,000	1,69,200		4,05,000	3,98,000	1,69,200

Working Notes : **(1) Calculation of Closing Stock of Each Department**

Department	Dept. X	Dept. Y	Dept. Z
Opening Stock	48,000	72,000	24,000
Add: Purchases	2,92,000	2,48,000	96,000
	3,40,000	3,20,000	1,20,000
Less: Cost of Goods Sold (Note 2)	2,80,000	2,40,000	1,00,000
Closing Stock	60,000	80,000	20,000

(2) Calculation of Cost of Goods Sold

Department	Dept. X	Dept. Y	Dept. Z
Actual Sales	3,45,000	3,18,800	1,49,200
Add: Discount Allowed	5,000	1,200	800
Sales at Normal Price (A)	3,50,000	3,20,000	1,50,000
Rate of Gross Profit	20%	25%	$33\frac{1}{3}\%$
Gross Profit (B)	70,000	80,000	50,000
Cost of Goods Sold (A – B)	2,80,000	2,40,000	1,00,000

Illustration 37

A firm has two departments, Ex and Zed. Department Ex transfers goods to Department Zed at normal selling price while Department Zed transfers goods to Department Ex at cost plus 10%. From the following figures, prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account for the year 2011 :

Particulars	Ex (₹)	Zed (₹)
Stock — 1st January, 2011	1,50,000	25,000
Sales	11,00,000	2,20,000
Purchases	6,00,000	1,15,000
Transfer to other department	1,00,000	1,50,000
Rent and Rates	10,000	15,000
Wages	1,00,000	30,000
Stock — 31st December, 2011	1,00,000	20,000
Advertisement — ₹ 15,000 (to be apportioned based on Sales excluding transfer) General expenses ₹ 23,000 (not to be apportioned) Stock on 31.12.2011 includes transferred goods as	39,600	12,000

[C.U.B.Com. (Hons.) — 2012]

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2011 Cr.

Particulars	Ex Dept. ₹	Zed Dept. ₹	Particulars	Ex Dept. ₹	Zed Dept. ₹
To Opening Stock	1,50,000	25,000	By Sales	11,00,000	2,20,000
To Purchases	6,00,000	1,15,000	By Transfer (Contra)	1,00,000	1,50,000
To Wages	1,00,000	30,000	By Closing Stock	1,00,000	20,000
To Transfer (Contra)	1,50,000	1,00,000			
To Gross Profit c/d	3,00,000	1,20,000			
	13,00,000	3,90,000		13,00,000	3,90,000
To Rent and Rates	10,000	15,000	By Gross Profit b/d	3,00,000	1,20,000
To Advertisement (Note 1)	12,500	2,500			
To Net Profit c/d	2,77,500	1,02,500			
	3,00,000	1,20,000		3,00,000	1,20,000

Dr. General Profit and Loss Account for the year ended 31st December, 2011 Cr.

Particulars	₹	Particulars	₹
To General Expenses	23,000	By Gross Profit b/d :	
Provision for Unrealised Profit on Closing Stock (Note 2)	6,600	Dept. Ex	2,77,500
To Net Profit	3,50,400	Dept. Zed	1,02,500
	3,80,000		3,80,000

Working Notes :

(1) Advertisement will be divided in the ratio of sales (excluding transfer). The ratio will be :

Ex : Zed

11,00,000 : 2,20,000

or, 5 : 1

$$\text{Ex's share} = \frac{15,000}{6} \times 5 = ₹\ 12,500.$$

$$\text{Zed's share} = \frac{15,000}{6} \times 1 = ₹\ 2,500.$$

(2) Calculation of Stock Reserve :

(a) Rate of gross profit on sales of Dept. Ex

$$= \frac{3,00,000}{(11,00,000 + 1,00,000)} \times 100 = \frac{3,00,000}{12,00,000} \times 100 = 25\%$$

Stock reserve in the closing stock of Dept. Ex = 12,000 × 25% = ₹ **3,000**.

(b) Stock reserve in the closing stock of Dept. Zed = $\frac{39,000}{110} \times 10$ = ₹ **3,600**.

Total Stock Reserve = ₹ 3,000 + ₹ 3,600 = ₹ **6,600**.

Memorandum Stock Account and Memorandum Mark-up Account

For an adequate check on department stock, sometimes a Memorandum Stock Account is maintained at selling price/inflated price. A Memorandum Mark-up Account is also maintained for the loading (selling price – cost price). Departmental gross profit comes out from the Memorandum Mark-up Account. This Account can be compared with the Branch Adjustment Account which is prepared when goods are sent to branch at inflated price (for details please refer ***Chapter 7***).

Accounting Arrangement

1. The opening stock is brought down on the debit side of the Memorandum Stock Account at selling price (cost + mark-up).
   Amount of mark-down on opening stock is brought down on the credit side of the Memorandum Stock Account.
2. The loading on opening stock is brought down on the credit side of the Memorandum Mark-up Account. Amount of mark-down on opening stock is brought down on the debit side of the Memorandum Stock Account.

3. ***For goods purchased***
   Memorandum Stock Account — Dr. [Selling price]
   To Purchases Account — [Cost price]
   To Memorandum Mark-up Account — [Loading]

4. ***For sale of goods***
   Sales Account — Dr. [Selling price]
   To Memorandum Stock Account — [Selling price]

5. ***For transfer of goods by one department to another (say by X to Y)***
   Y's Memorandum Stock Account — Dr. [Cost price]
   To X's Memorandum Stock Account — [Cost price]

6. ***For loading on transfer by X Department***
   Memorandum Mark-up Account — Dr. [Loading of X Department]
   To Memorandum Stock Account

7. ***For loading on goods received by Y Department***
   Memorandum Stock Account — Dr. [Loading of Y Department]
   To Memorandum Mark-up Account

8. Sometimes goods may have to be marked-down due to competition or due to deterioration of goods lying in stock. In such a case, the entry will be:
   Memorandum Mark-up Account — Dr. [Mark-down]
   To Memorandum Stock Account

9. ***For loss of stock***
   Loss of Stock Account — Dr. [Cost price]
   Memorandum Mark-up Account — Dr. [Loading]
   To Memorandum Stock Account — [Selling price]

10. ***For mark-down on goods lying in stock***
    Memorandum Stock Account — Dr.
    To Memorandum Mark-up Account

Now, the balance of Memorandum Stock Account will represent the closing stock at selling price. Loading on closing stock is to be carried forward. The balance of Memorandum Mark-up Account will represent gross profit.

Illustration 38

Southern Store Ltd. is a retail store operating two departments. The company maintains a Memorandum Stock Account and Memorandum Mark-up Account for each of the departments.

Supplies issued to the departments are debited to the Memorandum Stock Account of the department at cost plus the mark-up, and departmental sales are credited to this account. The mark-up on supplies issued to the departments is credited to the mark-up account for the department.

When it is necessary to reduce the selling price below the normal selling price, i.e., cost plus mark-up, the reduction (mark-down) is entered in the Memorandum Stock Account and in the mark-up account. Department Y has a mark-up of $33^1/_3$% on cost and Department Z 50% on cost.

Following information has been extracted from the records of Southern Store Ltd. for the year ended 31st December, 2017 (all figures in ₹) :

Particulars	Dept. Y	Dept. Z
Stock (1.1.2017) at cost	24,000	36,000
Purchases	1,62,000	1,90,000
Sales	2,10,000	2,85,000

1. The stock of Department Y at 1st January 2017 includes goods on which the selling price has been marked down by ₹ 510. These goods were sold in January 2017 at the reduced price.
2. Certain goods purchased in 2017 for ₹ 2,700 for department Y, were transferred during the year to department Z, and sold for ₹ 4,050. Purchase and sale are recorded in the purchases of department Y and the sales of department Z respectively, but no entries in respect of the transfer have been made.
3. Goods purcahsed in 2017 were marked down as follows: Dept. Y Dept. Z

	Dept. Y	Dept. Z
Cost	8,000	21,000
Mark down	800	4,100

At the end of the year there were some items in the stock of department Z, which had been marked down to ₹ 2,300. With this exception, all goods marked down in 2017 were sold during the year at the reduced prices.

4. During stock taking at 31st December 2017 goods which had cost ₹ 240 were found to be missing in department Y. It was determined that the loss should be regarded as irrecoverable.
5. The closing stock in both departments are to be valued at cost for the purpose of the annual accounts.

You are required to prepare for each department for the year ended 31st December 2017:

(a) a Trading Account;
(b) a Memorandum Stock Account; and
(c) a Memorandum Mark-up Account.

Solution

Southern Stores Ltd.

Dr. Trading Account for the year ended 31st December 2017 Cr.

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Opening Stock, at cost	24,000	36,000	By Sales	2,10,000	2,85,000
To Purchases	1,62,000	1,90,000	By Dept. Z - transfer	2,700	—
To Dept Y - transfer	—	2,700	By Profit & Loss A/c - goods lost	240	—
To Gross profit	51,518	92,496	By Closing stock (Note 1)	24,578	36,196
	2,37,518	3,21,196		2,37,518	3,21,196

Dr. Memorandum Stock Account Cr.

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Balance b/d (cost + mark up)	32,000	54,000	By Balance b/d (Mark-down on opening stock)	510	—
To Purchases A/c	1,62,000	1,90,000	By Sales A/c	2,10,000	2,85,000
To Memorandum Mark Up A/c			By Dept Z - transfer	2,700	—
(Mark-up on purchases)	54,000	95,000	By Memorandum Mark Up A/c		
To Dept Y - transfer	—	2,700	(mark up on transfer)	900	—
To Memorandum Mark Up A/c			By Memorandum Mark Up A/c		
(Mark up on transferred goods)	—	1,350	(marked down)	800	4,100
To Memorandum Mark Up A/c (Note 2)			By Loss of Stock A/c	240	—
(On marked down goods lying in stock)			By Memorandum Mark Up A/c		
	—	344	(on stock cost)	80	—
			By Balance c/d (closing stock)	32,770	54,294
	2,48,000	3,43,394		2,48,000	3,43,394

Dr. Memorandum Mark Up Account Cr.

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Balance b/d (Mark-down opening stock)	510	—	By Balance b/d (Mark-up on opening stock)	8,000	18,000
To Memorandum Stock A/c	900	—	By Memorandum Stock A/c		
(mark up on transfer)			(Mark up on purchase)	54,000	95,000
To Memorandum Stock A/c	800	4,100	By Memorandum Stock A/c		
(Mark-down)			(Mark up on transfer)	—	1,350
To Memorandum Stock A/c	80	—	By Memorandum Stock A/c		
(mark down on goods destroyed)			(marked down on goods lying in stock)	—	344
To Gross profit (balancing figure)	51,518	92,496			
To Balance c/d (Mark-down closing stock)	8,192	18,098			
	62,000	1,14,694		62,000	1,14,694

Working Notes : (1) Ascertainment of Closing Stock at Cost

Particulars	Dept. Y	Dept. Z
Closing stock at Invoice price (from Memorandum Stock Account)	₹ 32,770	₹ 54,294
Closing Stock at cost	3/4 of ₹ 32,770 = ₹ 24,578	2/3 of ₹ 54,294 = ₹ 36,196
Loading on closing stock	1/3 of ₹ 24,578 = ₹ 8,192	1/2 of ₹ 36,196 = ₹ 18,098

(2) Ascertainment of Mark-down in Closing Stock of Dept. Z

$$\frac{(\text{ Mark down })}{(\text{ Value after down })} \text{ x Value of closing stock } = \frac{4,100}{27,400*} \text{ x } 2,300 = .₹\ 344$$

*Value after mark-down = ₹ 21,000 + 50% of ₹ 21,000 – ₹ 4,100 = ₹ 27,400.

(3) Verification of Gross Profit	₹ Dept. Y	₹ Dept. Z
Sales	2,10,000	2,85,000
Add: Mark down (₹ 510 + ₹ 800) / (₹ 4,100 – ₹ 344)	1,310	3,756
	2,11,310	2,88,756
Gross profit (Dept Y 1/4 and Dept Z 1/3)	52,828	96,252
Less: Mark down	1,310	3,756
Gross Profit as per Memorandum Mark up Account	51,518	92,496

Illustration 39

M/s Bright & Co., had found departments A,B,C and D, each department being managed by a departmental manager whose commission was 10% of the respective departmental profit, subject to a minimum of ₹ 6,000 in each case. Inter-departmental transfers took place at a 'loaded' price as follows:

From Department A to Department B : 10% above cost; From Department A to Department D : 20% above cost

From Department C to Department D : 20% above cost; From Department C to Department B : 20% above cost

For the year ended 31st March 2018, the firm had already prepared and closed the Deparmental Trading and Profit and Loss Account. Subsequently it was discovered that the closing stock of departments had included inter-departmentally transferred goods at loaded price instead of cost price.

From the following information, prepare a statement re-computing the departmental profit or loss: (all figures in ₹).

Particulars	Dept A	Dept B	Dept C	Dept D
Final Profit / Loss	38,000 (Loss)	50,400 (profit)	72,000 (profit)	1,08,000 (profit)
Inter-departmental transfers included at loaded price in the departmental stock		70,000 (22,000 from Dept A and 48,000 from Dept C)		4,800 (3,600 from Dept C and 1,200 from Dept A)

Solution **Statement showing Recomputation of Departmental Profit or Loss**

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Final profit / loss (as computed earlier)	(38,000)	50,400	72,000	1,08,000
Add: Department manager's commission already deducted from profit (Note 1)	6,000	6,000	8,000	12,000
Profit before charging manager's commission	(32,000)	56,400	80,000	1,20,000
Less: Profit earned due to transfer of goods at loaded price and included in departmental unsold stock (Note 2)	(2,200)	—	(8,600)	—
Correct departmental profit before charging manager's commission @ 10% of department profit subject to a minimum of ₹ 6,000	(34,200) 6,000	56,400 6,000	71,400 7,140	1,20,000 12,000
	40,200	50,400	64,260	1,08,000

Working Notes:

1. Manager's commission is payable @ 10% of departmental profit before charging such commission (subject to a minimum of ₹ 6,000). Alternatively, we can say, manager's commission is payable @ 1/9 of departmental profit after charging such commission (subject to a minimum of ₹ 6,000). Therefore the manager's commission, already deducted, will be as follows:

Departments	Profit/Loss after charging commission (₹)	Commission (₹)
A	(38,000)	6,000
B	50,400	1/9 of ₹ 50,400 or 6,000 whichever is higher i.e., 6,000
C	72,000	1/9 of ₹ 72,000 = 8,000
D	1,08,000	1/9 of ₹ 1,08,000 = 12,000

2. Unrealised profit on unsold departmental stock:
   (a) Profit earned by Department A by transferring stock to: Total

   Dept B @ 110 % = Rs 22,000 × $\frac{10}{110}$ = ₹ 2,000

   Dept D @ 120 % = Rs 1,200 × $\frac{20}{120}$ = ₹ 200 — 2,200

   (b) Profit earned by Department C by transferring stock to:

   Dept D @ 120 % = Rs 3,600 × $\frac{10}{120}$ = ₹ 600

   Dept B @ 120 % = Rs 48,000 × $\frac{20}{120}$ = ₹ 8,000 — 8,600

Illustration 40

X Ltd. has a factory which has two manufacturing departments A and B. Part of the output of A Department is transferred to B Department for further processing and the balance is directly transferred to the selling department.

The entire production of B department is transferred to the selling department. Inter-department Stock transfers are made as follows:

A Department to B Department at 20% over departmental cost;
A Department to Selling Department at 30% over departmental cost;
B Department to Selling Department at 25% over departmental cost.
The following information is given for the year ending 31st December 2017 :

Particulars	Department A		Department B		Selling	
	M.T.	₹	M.T.	₹	M.T.	₹
Opening Stock	60	60,000	20	40,000	50	1,60,000
Raw material consumption	100	1,10,000	30	30,000		
Labour charges		60,000		80,000		
Sales						6,00,000
Closing Stock	40		60		60	

Out of total production in A Department 30 M.T. were for transfer to the Selling Department and the balance to B Department. The per tonne material and labour consumption in A Department on production to be transferred directly to the Selling Department is 200 per cent of the labour and material consumption on production meant for B Department.

Prepare Department Profit and Loss Account.

Solution

Working Notes :

(1) Department A	M.T.	**(2) Department B**	M.T.
Total Input	160	Total Input	140
Closing Stock	40	Closing Stock	60
Total Output	120	Total Output	80
Transfer to selling department	30	Total cost incurred (₹ 40,000 + 30,000 + 80,000 + 1,33,920)	₹ 2,83,920
Transfer to Department B	90	Less: Closing stock (60/120 ₹ (30,000 + 1,33,920)	₹ 81,960
Equivalent production in terms of these transferred to Dept B	M.T.		₹ 2,01,960
Transfer to selling department 30 x 2	60	Add: Profit @ 25% on cost	₹ 50,490
Transfer to Dept B 90 x 1	90	Transfer price	₹ 2,52,450
	150	Profit element in transfer price	₹ 22,320
	₹	(Ratio of profit = 22,320 / ₹ 1,63,920)	
Total cost incurred ₹ (60,000 + 1,10,000 + 60,000)	2,30,000	Increase in stock (81,960 – 40,000)	₹ 41,960
Less: Value of closing stock (₹ 1,10,000/100 x 40)	44,000	Additional reserve = 41,960/1,63,920 x 22,320 = ₹ 5,713	
Cost of production of 150 equivalent (MT)	1,86,000	**Amount considered for valuation of stock**	₹
(i) Transfer to Selling Dept (₹ 1,86,000/150 x 60)	74,400	Materials consumed directly	30,000
Add: Profit @ 30% on cost	22,320	Transfer from Dept A	1,33,920
Transfer price	96,720		1,63,920

(ii) Transfer to Dept B : (₹ 1,86,000/150 x 90)	1,11,600	
Add: Profit @ 20% on cost	22,320	
Transfer price	1,33,920	

(3) Selling Department	₹
(a) Profit included in transfer from Dept B	50,490
Profit included in transfer from Dept A	22,320
Total transfer (₹ 2,52,450 from A + ₹ 96,720 from B)	72,810
Ratio of profit (₹ 72,810/3,49,170)	3,49,170
Increase in stock (₹ 1,90,456 – 1,60,000)	30,456
Additional reserve required (72,810/3,49,170 x 30,456)	6,351
(b) Profit in transfer from Dept A to B	
Element of transfer from Dept A in increase in stock = 2,52,450/3,49,170 x 30,456	22,019
Profit element = 22,019 x 22,320/1,63,920	2,998
Total (a + b) = ₹ 6,351 + 2,998 = ₹ 9,349	

Solution

X Ltd

Dr. Departmental Profit & Loss Account for the year ended 31st December, 2017 Cr.

Particulars	Depart A		Dept B		Selling		Particulars	Dept A		Dept B		Selling	
	M.T.	₹	M.T.	₹	M.T.	₹		M.T.	₹	M.T.	₹	M.T.	₹
To Opening Stock	60	60,000	20	40,000	50	1,60,000	By Selling Dept - transfer	30	96,720	80	2,52,450	—	—
To Raw Materials consumed	100	1,10,000	30	30,000	—	—	By Dept B - transfer	90	1,33,920	—	—	—	—
To Labour charges	—	60,000	—	80,000	—	—	By Sales	—	—	—	—	100	6,00,000
To Dept A - transfer	—	—	90	1,33,920	30	96,720	By Closing Stock (FIFO)	40	44,000	60	81,960	60	1,90,456
To Dept B - transfer	—	—	—	—	80	2,52,450							
To Dept Profit	—	44,640	—	50,490	—	2,81,286							
	160	2,74,640	140	3,34,410	160	7,90,456		160	2,74,640	140	3,34,410	160	7,90,456

Assumptions:

1. Closing Stock of Dept. A consists of raw materials only. No work has been done on such units.
2. Closing stock of Dept B is a mixture of materials directly introduced and those transferred from Dept A. i.e., 60/120 (₹ 30,000 + ₹ 1,33,920).
3. Closing stock of Selling Dept = 60/110 (₹ 2,52,450 + ₹ 96,720).

Key Points

- A department is generally a physical part of the rest of the business. It should not be assumed that departmental accounts refers only to departmental stores. In fact, they refer to the verious facets of a business. Each department is treated as a separate ***profit centre***, though none of the departments is separated geographically from the rest of the departments.
- **Distinction between Departmental Accounts and Branch Accounts**
  - In case of a dependent branch, all important accounting records are kept at the head office. The branch maintains only Cash Account and Customers Account (if necessary). However, an independent branch, usually maintains its own books of account and prepares its own Trading and Profit and Loss Account. In case of Departmental Accounts, all accounting records are maintained at one place and Departmental Trading and Profit and Loss Account is prepared accordingly.

Key Points (contd.)

- ¤ As the departments are not geographically separated from each other, the problem of allocation of common expenditure among different departments arises. But in case of a branch account this problem of allocation of common expenditure does not arise since branches are geographically separated from each other.
- ¤ In case of an independent branch, at the end of the accounting year, some adjustment and reconciliation of head office and branch accounts are required. In case of Department Accounts, the question of adjustments and reconciliation of accounts does not arise.
- ¤ At the time of finalisation of accounts of head office, the conversion of foreign branch figures may create some problems. In case of Departmental Accounts, this type of problem does not arise.

- Under cost-based transfer pricing, the price may be based on actual cost, total cost or standard cost. Marginal cost is also sometimes used as a basis of ascertaining transfer price. Standard cost is preferred to actual cost since the inefficiency of one department cannot be passed on to another department. Taking full cost as transfer price means that the supplying departments' fixed cost becomes the variable cost of the receiving department.
- If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods are included in the unsold stock, an appropriate adjustment must be made for unrealised profit on stock. The entry is :

  General Profit and Loss Account Dr.
  To Provision for Unrealised Profit on Stock Account

  At the beginning of the next year reverse entry will be passed.

  Provision for Unrealised Profit on Stock Account Dr.
  To General Profit and Loss Account

THEORETICAL QUESTIONS

1. (a) State briefly the advantages to be derived from a system of Departmental Accounts.
   (b) What difficulties are there in the way of arriving at the net profit of each department?
2. Is there any difference between Branches and Departments, from the accounting point of view?
3. Explain the distinguishing features between Departmental Accounts and Branch Accounts and the advantages derived from Departmental Accounts.
4. How the following indirect expenses are distributed amongst different departments?
   (i) Rent; (ii) Insurance premium; (iii) Lighting; (iv) Advertisement; (v) Depreciation; and (vi) Managing Director's remuneration.

PRACTICAL QUESTIONS

1. Grewal Brothers own a business which has two departments, A and B.
   The following balances appeared in the books for the year ended 31.12.2017 :

Particulars	Dept A (₹)	Dept B (₹)	Total (₹)
Stock (1.1.2017)	5,800	6,400	12,200
Purchases	40,000	50,000	90,000
Sales	1,50,000	1,00,000	2,50,000
Wages of shop assistants			21,800
Rent, rates and insurance			4,320
Stationery and office expenses			1,260
Motor vehicle expenses and depreciation			3,240
Carriage on purchases			1,440
Light and heat			1,270

You are required to prepare a Columnar Trading Account as specified above and Profit and Loss Account (columnar form is not required) for the year ended 31.12.2017, taking into consideration the following :

(a) Carriage on purchases which is to be apportioned to the separate departments in proportion to purchases, and wages to be allocated on the same basis as sales.

(b) Stock on 31.12.2017 was: Dept A — ₹ 9,000; Dept B — ₹ 6,000.

(c) An amount owing for insurances, ₹ 120, has not been recorded in the books.

(d) The provision for doubtful debts which is shown in the books at ₹ 300 is to be increased to ₹ 400.

2. Raj Singh runs a business which has two departments. The following balances were extracted from his books on 30.6.2018 :

Particulars	Dept. A (₹)	Dept. B (₹)	Common Expenses	₹
Opening Stock on 1.1.2018	12,000	13,000	Commission payable	1,500
Purchases	24,520	36,544	Salaries	15,100
Sales	86,030	89,070	Advertising	2,500
Closing Stock	12,100	13,300	Rates	1,450
Wages	22,800	21,200	Insurance	400
Returns in	1,030	4,070	Repairs	800
Returns out	520	544	Lighting and heating	2,000

You are required to prepare Departmental Trading and Profit and Loss Account for the six month ended on 30.6.2018, after taking into account the following information :

(a) (i) Salaries of ₹ 400 are outstanding;
(ii) Rates ₹ 250 have been paid in advance; and
(iii) Insurance ₹ 80 is prepaid.

(b) Commission, salaries and advertising are to be charged to the departments in proportion to net turnover (sales minus returns in); all other expenses are to be apportioned 1/4th to department A and 3/4th to department B.

3. M/s Z & Co has two departments. You are required to prepare the Trading and Profit and Loss Account for each department for the year ended on 31st March, 2018 on the basis of the following information :

Particulars	Dept. I (₹)	Dept. II (₹)
Opening Stock (1.4.2017)	25,000	20,000
Purchases	2,30,000	1,90,000
Sales	6,33,000	4,92,000
Sales Returns	3,000	2,000
Closing Stock (31.3.2018)	30,000	18,000
Wages	80,000	60,000
Salaries	40,000	25,000

Other common expenses : Rent ₹ 15,000; Electricity ₹ 6,000; Depreciation ₹ 18,000; Selling expenses ₹ 8,000.
Some other relevant information is given below :

Particulars	Dept.A (₹)	Dept. B (₹)
Light Points	18	9
Value of Assets (₹)	1,50,000	1,20,000
Floor Area (sq.ft.)	300	200

4. A departmental stores carries on its business through five departments, A, B, C, D and E.

(i) The following information for 2017 is now made available to you:
Salaries and Commission ₹ 11,020; Rent and Rates ₹ 2,900; Insurance ₹ 1,160; Miscellaneous Expenses ₹ 2,610. All these expenses are chargeable to each department in proportion to the cost of the articles sold in the respective departments.

(ii) The following balances as at 31.12.2017 were ascertained: (all figures in ₹)

Particulars	A	B	C	D	E
Opening stock at cost	10,000	6,000	15,000	8,000	9,000
Purchases	1,00,000	60,000	20,000	52,000	60,000
Sales	96,000	62,000	19,000	46,000	60,000
Closing stock at cost	23,000	8,000	6,000	2,000	11,000

Prepare the Profit and Loss Account to show the final result of each department and also the combined results with respective percentages on sales.

5 The Trading and Profit and Loss Account of Hindustan Electronics for the year ending March 31, 2018 is as under: (all figures in ₹).

To Purchases:		By Sales:	
Transistors (X)	1,60,000	Transistors (X)	1,75,000
Tape Records (Y)	1,25,000	Tape Records (Y)	1,40,000
Spare parts for servicing & repair jobs (Z)	80,000	Servicing and repair jobs (Z)	35,000
To Wages	48,000	By Stock on 31.3.2018	
To Rent	10,800	Transistors (X)	60,100
To Sundry Expenses	11,000	Tape Records (Y)	20,300
To Net Profit	40,200	Spare parts for servicing and repair jobs (Z)	44,600
	4,75,000		4,75,000

Prepare Deparqtmental Accounts for each of the three Departments X, Y and Z 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) Wages comprise: Showroom 3/4; Workshop 1/4.
It was decided to allocate the showroom wages in the ratio of 1:2 between Departments X and Y respectively.
(c) The workshop rent is ₹ 500 per month. The rent of the showroom is to be divided equally between Dept X & Y.
(d) Sundry expenses are to be allocated on the basis of the turnover of each department.

6. The Profit and Loss Account for the year ended 31st December 2017 of D Q Holidays Limited, a company which provides holidays at several resorts in Jammu and Kashmir is as follows: (all figures in ₹).

Agents' commission	90,600	Sales of holidays	9,06,000
Hire of aeroplanes	1,05,000	Net loss for the year	10,000
Coaches from airport to resort	7,000		
Hotel accommodation	5,81,400		
Salary & expenses of resort representatives	32,000		
Brochures, advertising, head office and common costs	1,00,000		
	9,16,000		9,16,000

The managing director has complained to you, as chief accountant, that the form of presentation of this Profit and Loss Account does not tell him where or why the net loss has been incurred and is of little use for management purposes.

You are required to redesign the Profit and Loss Account, using also the information given below, so that it will overcome the complaints of the managing director. You are given the following information:

1. The public book their holidays with the company through local travel agents who were paid a commission of 10% of the gross price of the holiday.
2. Holidays were offered at six resorts in Jammu and Kashmir, namely P, Q, R, S,T and U.
3. Only one hotel was used in each resort.
4. Flights were from Delhi Airport to three airports in Jammu and Kashmir, as follows:

Airport	For resorts	Annual cost (₹)
X	P and Q	30,000
Y	R and S	40,000
Z	T and U	35,000

5. Separate coaches were used for the journey from the aiport to each resort hotel. The annual costs of these were: To Resort : P — ₹ 1,100; Q — ₹ 900; R — ₹ 1,400; S — ₹ 1,100; T — ₹ 1,700; and U — ₹ 800.
6. The annual cost of hotel accommodation at each resort were: P — ₹ 3,05,900; Q — ₹ 1,53,200; R — ₹ 22,600; S — ₹ 45,400; T — ₹ 10,200; and U — ₹ 44,100.
7. A separate representative was employed at each resort, and the annual costs were: P — ₹ 5,000; Q — ₹ 4,500; R — ₹ 6,000; S — ₹ 5,500; T — ₹ 5,700; and U — ₹ 5,300.
8. Sales of holidays at the various resorts were: P — ₹ 4,80,000; Q — ₹ 2,49,000; R — ₹ 30,000; S — ₹ 60,000; T — ₹ 24,000; and U — ₹ 68,000.

7. Shivam Ltd has three departments D1, D2 and D3. From the following particulars calculate :
1. The Departmental Gross Profit for the year ended 31st March, 2018.
2. The values of stocks as on 31st March, 2018 :

Particulars	D1 (₹)	D2 (₹)	D3 (₹)
Stock as on 1st April, 2017	24,000	36,000	12,000
Purchases	1,46,000	1,24,000	48,000
Actual Sales	1,72,500	1,59,400	74,600
Gross Profit on normal selling prices	20%	25%	$33^1/_3$%

During the year some items were sold at discount and these discounts were reflected in the values of the sales shown above. The items sold at discount were :

Particulars	D1 (₹)	D2 (₹)	D3 (₹)
Sales at normal prices	10,000	3,000	1,000
Sales at actual prices	7,500	2,400	600

8. The following is the Trial Balance as at 31st December 2017 of a firm having two partners: A and B, who agreed to share the annual profits and losses in equal proportion. They have three distinct departments of business. You are required to prepare Departmental Trading and profit and Loss Account and the Balance Sheet as at 31st December 2017. While preparing the accounts, make the following provisions and adjustments: (1) Allow and charge interest @ 5% per annum on the partners' capitals and drawings respectively; (2) Write-off as bad and irrecoverable debts amounting to ₹ 1,600 and thereafter, increase the provision for bad and doubtful debts to 5% on book-debts outstanding; (3) Bring into account the purchase of stationery on credit for ₹ 200, not accounted for the Trial balance; (4) Write-off depreciation on Furniture and Fixtures @ 5% on cost; (5) ₹ 100 of the Insurance premium are prepaid; (6) The following are the values of the closing stock in the respective departments: Department X ₹ 10,462; Department Y ₹ 10,001; Department Z ₹ 4,940; (7) Advertisement materials of the value of ₹ 300 is in hand; it has not been adjusted in the Trial Balance; (8) All expenses and losses are to be apportioned among the respective departments in the proportion of 7 : 6 : 2.

Trial Balance as at 31st December, 2017

Particulars		Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital Account : A			33,333	Salaries	6,418	
Capital Account : B			16,666	Advertising	3,612	
Drawings Account : A		4,000		Investments Income		1,200
Drawings Account : B		3,000		Investments	20,000	
Stock (1.1.2017) : Dept	X	11,438		Debtors and Creditors	8,955	5,493
	Y	9,867		Printing and Stationery	485	
	Z	2,646		Carriage Inwards	450	
Purchases and Sales : Dept	X	34,657	55,194	Commission	1,107	
	Y	32,441	47,310	Postage, Telegrams & Telephone	942	
	Z	14,111	15,769	Provision for Bad Debts		300
Inter-Dept Transfers : Dept	X		1,501	Rent and Taxes	8,148	
	Y	1,201		Furniture	5,000	
	Z	300		Insurance	403	
Returns Inward : Dept	X	3,533		Miscellaneous Expenses	1,058	
	Y	3,029		Bank Overdraft		1,519
	Z	1,009		Discount	475	
				TOTAL	1,78,285	1,78,285

9. Orchard carried on trade as a fruit grower and as a canner. On December 31, 2017 the trial balance extracted from his book was as follows:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Orchard : Capital (1.1.2017)		13,500	Bought Ledger balances:		
Drawings	1,200		Farm		200
Freehold land and premises at cost	14,900		Cannery		740
Sales during the year		800	Purchases :		
Plant and machinery at cost:			Farm	250	
Farm	1,900		Cannery	1,210	
Cannery	4,800		Wages :		
Purchases of plant and machinery			Farm	1,600	
less sales during the year	500		Cannery	2,400	

Provisions for depreciation:			Sales :		
Farm		1,100	Farm		530
Cannery		1,640	Cannery		9,950
Fruit trees and bushes at cost	800		Trade expenses	920	
Stock (1.1.2017)			Administration and motor expenses		
Farm	400		(including loan interest to Sept. 30 2017)	584	
Cannery	1,650		Repairs :		
Loan at 6% (interest payable on			Farm	80	
March 31 and September 30)		8,000	Cannery	360	
Balance at bank	864		Salaries	1,400	
Sales ledger balances	642			36,460	36,460

You are instructed to prepare the accounts and are given further information as follows:

1. Provision is to be made for depreciation for the year of plant and machinery on cost at the end of the year at the rate of 10 per cent in the case of the farm and $7^1/_2$ per cent in case of the cannery.
2. During the year tractor, included in farm plant and machinery at a cost of ₹ 600 and in respect of which depreciation of ₹ 500 had been provided was sold for ₹ 300 and was replaced by a new tractor costing ₹ 800.
3. Fruit to the value of ₹ 2,200 was supplied by the farm to the cannery.
4. Stocks in hand on December 31 2017, were valued as follows: Farm ₹ 300, Cannery ₹ 1,720.
5. Amounts owing, excluding loan interest accrued due at the end of the year were: Purchases : Cannery (included in stock but not entered in the books) ₹ 140; Trade expenses ₹ 80.
6. Bought ledger balances at the end of the year included ₹ 320 for cans supplied. Since the books were closed the supplier agreed to allow ₹ 160 as the cans were sub-standard. This allowance had been taken into account in valuing the stock on December 31, 2017.
7. All expenses except where otherwise indicated, are to be apportioned on the basis : Farm — one-fourth, Cannery — three-fourths.
8. Orchard is to be charged ₹ 2 per week for expenses incurred on his private car.
9. Freehold land, sold for ₹ 850, had cost ₹ 350.
10. Pippin, the manager of the cannery, is to be credited with 5 per cent of the cannery profits after charging his commission.

You are required to prepare (a) Trading and Profit and Loss Account showing, separately, the net profit or loss of the farm and of the cannery for the year ended December 31, 2017, and (b) Balance Sheet as on that date. Ignore taxation.

10. The following is the Trial Balance of Automatic Motors and Garage on March 31 2018:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Opening Stock :			Capital Account		76,250
Petrol and Oil	1,675		Drawings	8,500	
Spare Parts and Tyres	5,500		Sales :		
Tools	2,200		Petrol and Oil		23,000
Hire Cars	72,000		Spare Parts and Tyres		37,000
Purchases :			Garage Receipts		4,000
Tools	4,000		Repairs Department		14,000
Spare Parts and Tyres	32,000		Hire Receipts		70,000
Petrol and Oil	41,250		Licence fees & permit fees for HireCars	3,000	
Advertising Expenses	4,500		Office expenses	4,000	
Rent, Rates and Taxes	12,000		Sundry Debtors	400	
Insurance Premia :			Sundry Creditors		1,200
On Hire Cars	4,000		Commission received on cars sold		5,000
Fire, theft and burglary cases	425		Loan		4,000
Wages :			Cash in hand and at bank	2,000	
Drivers	12,000				
Repairs Department	16,500				
Office	7,500				
Garage	1,000			2,34,450	2,34,450

The following additional information is also given to you:
(a) The loan was taken on January 1, 2018 on which 12% interest is to be paid.
(b) Stock in hand on March 31, 2018 were as under:
(i) Tools ₹ 5,000; (ii) Petrol and oil ₹ 4,300; (iii) Spare parts and tyres ₹ 10,000.
(c) Petrol and oil whose value were ₹ 15,600 and ₹ 1,800 were used by hired cars and the repairs department respectively.
Besides, the owner of the garage drew petrol and oil worth ₹ 3,000 for his personal car.
(d) The repairs department performed work during the year as under:
On owner's car ₹ 600; On hire cars ₹ 7,500.
(e) Spare parts used by the repairs department in the year cost ₹ 4,000 and the hire cars ₹ 750.
(f) Depreciation on hire cars to be provided at 30% p.a.
(g) Licences and taxes amounting to ₹ 200 on owner's car have been paid and included in rent, rates and taxes.
(h) Rent, rates and taxes to be distributed as under:
(i) Repairs department 1/2; (ii) Spare parts 1/4; (iii) Garage 1/8; and (iv) Office 1/8.

You are required to prepare a : (a) Department Trading Account; (b) Profit and Loss Account for the year ending March 31, 2018; and (c) Balance Sheet as on that date.

11. From January 1 2017, Ramesh & Co have been running three departments A, B and C and the following particulars have been taken from their books on December 31 2017:
Opening Stock : January 1 : A — ₹ 36,000; B — ₹ 24,000; and C — ₹ 20,000.
Purchases : A — ₹ 1,20,000; B — ₹ 1,00,000; and C — ₹ 95,000.
Goods from other departments : A — ₹ 8,000; B — ₹ 5,000; and C — ₹ 3,000.
Direct wages : A — ₹ 54,000; B — ₹ 48,000; and C — ₹ 35,000.
Sales : A — ₹ 2,44,000; B — ₹ 1,96,000; and C — ₹ 1,44,000.
Goods to other departments : A — ₹ 6,000; B — ₹ 4,000; and C — ₹ 6,000.
Stock in hand on December 31 : A — ₹ 49,000; B — ₹ 14,000; and C — ₹ 18,000.
Carriage inward : A — ₹ 3,000; B — ₹ 2,000; and C — ₹ 2,000.
Other information:
Drawing — ₹ 8,000; Printing & Stationery — ₹ 2,400; Carriage outwards — ₹ 6,000; Salaries — ₹ 24,000; Rent & Rates — ₹ 18,000; Bad debts — ₹ 3,600; Discount allowed — ₹ 8,400; Advertisement — ₹ 12,000; Miscellaneous expenses — ₹ 6,600.
Inter-departmental supplies have been made during the year by each department at market price and the stocks at close valued at cost to A department include ₹ 4,000 worth goods supplied by B. Miscellaneous expenses include ₹ 600 on account of supplies to a partner for personal expenses.
You are required to prepare Departmental Trading and Profit and Loss Account apportioning general unallocated expenses on the basis of turnover (i.e., sales plus transfers).

12. Complex Ltd. has 3 departments: A, B and C. The following information is provided : (all figures in ₹)

Particulars	Dept A	Dept B	Dept C
Opening Stock (1.4.2017)	3,000	4,000	6,000
Consumption of direct materials	8,000	12,000	—
Wages	5,000	10,000	—
Closing stock	4,000	14,000	8,000
Sales	—	—	34,000

Stocks of each department are valued at cost to the department concerned. Stocks of A Department are transferred to B at a margin of 50% above departmental cost. Stocks of B Department are transferred to C Department at a margin of 10% above departmental cost.
Other expenses were: Salaries — ₹ 2,000; Printing and stationery — ₹ 1,000; Rent — ₹ 6,000; Insurance paid — ₹ 4,000; Depreciation — ₹ 3,000.
Allocate expenses in the ratio of departmental gross profits. Opening figures of reserves for unrealised profits on departmental stocks were: Department B — ₹ 1,000; Department C — ₹ 2,000.
Prepare Departmental Trading and Profit and Loss Account for the year ended 31st March 2018.

13. You are given the following particulars of a business having three departments:

Particulars	Purchases	Opening Stock	Sales
Department A	1,000 Units	120 Units	1,020 Units @ ₹ 20 each
Department B	2,000 Units	80 Units	1,920 Units @ ₹ 22.50 each
Department C	2,400 Units	152 Units	2,496 Units @ ₹ 25 each

Additional information:
(i) Purchases were made at a total cost of ₹ 92,000.
(ii) The rate of gross profit is the same in each case.
(iii) Purchases and sales prices are constant for the last two years.
Prepare Departmental Trading Account for the year 2018.

14. You are given the following particulars of a business having three departments:

Particulars	Purchases	Opening Stock	Closing Stock
Department A	1,500 Units	200 Units	100 Units
Department B	1,000 Units	300 Units	160 Units
Department C	2,000 Units	150 Units	200 Units

Additional information:
(i) Purchases were made at a total cost of ₹ 92,000.
(ii) The percentage of gross profit on turnover is the same in each case.
(iii) Purchases and sales prices are constant for the last 2 years.
(iv) Selling price per unit: Department A ₹ 20; Department B ₹ 25; and Department C ₹ 30.
You are required to prepare Departmental Trading Account.

15. A company manufacturing electric components operates with two departments. Transfers are made between the departments of both purchased goods and manufactured finished goods. Goods purchased are transferred at cost and manufacturing goods are transferred only at selling price as in the case with open market.
Transactions for the year ended 30th June, 2018 are given below:

Particulars	Dept X (₹)	Dept Y (₹)
Opening Stock	20,000	15,000
Sales	1,90,000	1,35,000
Wages	12,500	7,500
Purchases	1,00,000	80,000
Closing stock :		
Purchased goods	2,000	5,000
Manufactured goods	7,000	8,000

The following were the transfers from Department X to Department Y : purchased goods ₹ 6,000 and finished goods ₹ 20,000 and from Department Y to Department X : purchased goods ₹ 5,000 and finished goods ₹ 35,000.
Stocks were valued at cost to the department concerned. Only in closing stock of manufactured goods in the departments transferred finished goods are 20%.
Draw out Departmental Trading Account and the Company's Trading Account for the year ended 30th June 2018.

Guide to Answers

Practical Questions

1. **Gross Profit : Deparment A — ₹ 99,480; Department B — ₹ 40,080;**
   Net Profit : ₹ 1,29,250.
2. **Departmental Profits : A — ₹ 27,470; B — ₹ 15,110.**
3. **Departmental Profits : A — ₹ 2,57,500; B — ₹ 1,93,500.**
4. **Departmental Profits : A — ₹ 3,693; B — ₹ 462; C — ₹ 11,769 (loss); D — ₹ 15,538; and E — ₹ 1,538.**
5. **Net Profits : Department X — ₹ 55,200; Department Y — ₹ 4,500; Loss : Department Z ₹ 19,500.**

6. **Departmental Profits / Loss : Q — ₹ 15,10,000; S — ₹ 41,000 (Loss); U — ₹ 20,000 (Loss); Total (Loss) ₹ 10,000.**
7. **Departmental Gross Profit : D1 — ₹ 32,500; D2 — ₹ 39,400; D3 — ₹ 24,600.**
   Closing Stock : D1 — ₹ 30,000; D2 — ₹ 40,000; D3 — ₹ 10,000.
8. **Departmental Gross Profit : X — ₹ 17,319; Y — ₹ 10,593; and Z — ₹ 2,583.**
   Departmental Net Profit : X — RS 5,993; Y — ₹ 864; and Z — ₹ 660 (loss).
   Balance Sheet total — ₹ 57,541.
9. **Departmental Gross Profit : Farm — ₹ 780; Cannery — ₹ 4,230.**
   Departmental Net Profit : Farm — ₹ 260 (loss); Cannery — ₹ 1,200.
   Net Profit of the business as a whole — ₹ 1,590;
   Balance Sheet total — ₹ 22,966.
10. **Departmental Net Profit : Garage — ₹ 1,525; Petrol — ₹ 4,775; Spare parts — ₹ 11,300; Car Hire — ₹ 550;**
    Repairs — ₹ 7,300 (loss); Net profit transferred to Capital Account — ₹ 2,130.
    Balance Sheet total — ₹ 72,100.
11. **Departmental Profit : A — ₹ 44,500; B — ₹ 8,200; C — ₹ 7,100 (loss).**
12. **Departmental Loss : Department A — ₹ 2,000; Department B — ₹ 1,000; Department C — ₹ 1,000;**
    Net loss transferred to Profit and Loss Account ₹ 4,918.
13. **Rate of Gross Profit : 25%. Departmental Gross Profit : A — ₹ 4,080; B — ₹ 8,640; and C — ₹ 12,480.**
14. **Rate of Gross Profit : 20%. Departmental Gross Profit : A — ₹ 6,400; B — ₹ 5,700; and C — ₹ 11,700.**
15. **Departmental Gross Profit : X — ₹ 52,500; Y — ₹ 59,500; Company's Profit — ₹ 1,11,110.**
    Rate of Gross Profit : X — 25%; Y — 35%.
    Unrealised Profit on Stock : X — ₹ 49; Y — ₹ 400.

10

Investment Accounts

Introduction

Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation or for other benefits to the investing enterprise. ***Assets held as stock-in-trade are not investments***.

Investments are classified as under :

(a) A **current investment** is an investment that is by its nature readily realisable and is intended to be held for ***not*** more than one year from the date on which such investment is made. The carrying amount for current investments is the ***lower of cost or fair value***.
Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.
Market value is the amount obtainable from the sale of an investment in an open market, net of expenses, necessarily to be incurred on or before disposal.

(b) A **non-current investment** is an investment other than a current investment. Non-current investments are usually ***carried at cost***. However, when there is a decline, other than temporary, in the value of a non-current investment, the carrying amount is reduced to recognise the decline. The resultant reduction in the carrying amount is charged to the Profit and Loss Account / Statement of Profit and Loss by creating a provision for diminution. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exists.

(c) An **investment property** is held for rental income than the occupation or use. As per the provision of the Companies Act, 2013, ***it is treated as a non-current investment***. In effect, there is no need to provide depreciation.

An enterprise should disclose current investments and non-current investments distinctly in its financial statements. Current investments are shown under ***Current Assets***. Investments other than current investments are classified as non-current investments, even though they may be readily marketable. It is shown in the Balance Sheet under ***Non-current Assets***.

Cost of Investments

The cost of an investment should include acquisition charges such as brokerage, fees and duties. ***For example***, X Limited purchased 1,000 shares @ ₹ 120 each and paid brokerage @ 2%.

The acquisition cost of the investment is as under :	₹
Cost of shares (1,000 × ₹ 120)	1,20,000
Add : Brokerage (2% on ₹ 1,20,000)	2,400
Cost of acquisition	1,22,400

If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair market value of the securities issued (which in appropriate cases may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued.

For example, X Limited acquired 1,000 shares of ₹ 100 each (market value ₹ 130 each) in Y Ltd. by the issue of its 1,000 shares — face value and market value per share being ₹ 100 and ₹ 120 respectively. To ascertain the cost of the investment, in such a case, market value of the shares issued is to be considered. Therefore, the value of the investment is 1,000 × ₹ 120 = ₹ 1,20,000.

If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value (market value or net realisable value) of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

For example, X Limited acquired 1,000 shares of ₹ 100 each (market value ₹ 120 each) in exchange for a machinery (W.D.V. ₹ 90,000 and market value ₹ 1,10,000). The cost of the investment in this case, would be either the fair value of the shares acquired, i.e., ₹ 1,20,000 or the fair value of the machiney given up, i.e., ₹ 1,10,000 — which is more clearly evident.

The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

For example, X Limited purchased a flat from a co-operative society for ₹ 20,00,000. To obtain the membership of the society, X Limited had to purchase 1,000 shares of ₹ 100 each. In effect, the cost of acquisition of this investment property becomes ₹ 20,00,000 + ₹ 1,00,000 = ₹ 21,00,000.

Borrowing costs incurred (as per AS—16) in acquiring an investment property should be capitalised and included as an element of cost of an investment property.

Reclassification of Investments

Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer (para 23 of AS—13).

Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer (para 24 of AS—13). Any reduction in the carrying amount and any reversals of such reductions should be charged or credited to the Profit and Loss Account / Statement of Profit and Loss.

Fixed Income Bearing Securities

This type of security carries a fixed rate of income (interest/dividend) and that income accrues regularly but falls due on some specific due date (say, 30th June and 31st December). Investment in government securities, debentures and bonds come under this category. If a company buys 12% Debentures of X Ltd. for ₹ 1,00,000 at par and the due date of payment of interest is 30th June and 31st December, the company is entitled to get ₹ 12,000 (12% of ₹ 1,00,000) interest for one year (12% signifies rate of interest per annum on the face value) — ₹ 6,000 will be due on 30th June and the balance of ₹ 6,000 on 31st December.

Variable Income Bearing Securities

The example of a variable income bearing security is the equity share of a company, the income for an accounting period depends on the rate of dividend declared by that company.

A business can buy or sell securities freely in the stock exchange through brokers, who charge a small commission for their services known as brokerage. It is payable at the time of purchase or sale of those securities. Securities can also be purchased through banks, instead of through brokers. In such cases, a business has to pay a banker's commission in line of brokerage. Both are the same. When securities are purchased, the above expenses become part of the total cost of securities, i.e., the actual cost of securities are added with brokerage or banker's commission (as the case may be) and the stamp duty to arrive at the real cost of the securities. But when the securities are sold, the amount of brokerage or banker's commission is deducted from the sale proceeds realised to ascertain the net realisation from securities.

Securities can be purchased at face value, or at a discount or at a premium. The market prices of securities also fluctuate very frequently for reasons more than one. A security is said to be at par when acquired or sold at a price same as the face value. It is said to be at a discount, when it is sold or acquired at a price lower than its face value. Conversely, if it is above the face value, it is said to be at a premium.

It should be noted that the brokerage is calculated as a percentage of the market value of the investment.

Accounting Arrangements of Fixed Income Bearing Security

In the books of the investing company a separate Investment Account is opened for each security. It is ruled like a ledger account with some additional columns in each side. The format of Investment Account is given below :

In the books of X Ltd.
12% Debentures in ITC Ltd. Account
Dr. [Interest Payable : 30th June & 31st December] Cr.

Date	Particulars	Nominal Value	Interest or Dividend	Cost (₹)	Date	Particulars	Nominal Value	Interest or Dividend	Cost (₹)
(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)

Column 1 : Date of transaction is recorded in this column.
Column 2 : Name of the account to be credited or debited is written in this column with Pre-fix "To" or "By".
Column 3 : It is a memorandum column only. Nominal value of each transaction is recorded in this column either in value or in quantitative terms.
Column 4 : It is a (double entry) income column to record interest or dividend from investment.
Column 5 : It is a (double entry) cost / principal / capital column to record actual cost of investments after adjustment for brokerage, accrued interest, etc.

Purposes of Investment Ledger

Investment ledger is a special type of ledger which is used by the investing company to record all the details of each investment. The main objectives of maintaining on investment ledger are as follows:

(i) It facilitates proper recording of each security separately.
(ii) It facilitates collection of interest and dividend as and when they are due.
(iii) It helps to determine the value of securities at the end of the accounting period.
(iv) It helps to determine the profit or loss on sale of any security.

Sale of Investments

When an investment is sold, the difference between the carrying amount and the disposal proceeds, net of expenses, should be charged or credited to the Profit and Loss Account / Statement of Profit and Loss. When disposing of a part of the holding of an individual investment, the carrying amount is to be allocated to that part is to be determined on the basis of the ***average carrying amount of the total holding of the investment*** (para 22 of AS—13).

Purchase / Sale of Investment on the Date of Payment of Interest

When an investment is purchased / sold on the date of interest, the quotation price contains no interest. Therefore, the allocation of a quoted price between cost and revenue does not arise. The entire quoted price represents the cost of investment.

Journal Entries

1. When investment is purchased at interest date

Investment Account Dr. [(Quoted price + Brokerage) x No. of Investments]
  To Bank Account

2. When interest / dividend is received after purchase

Bank Account Dr.
  To Interest / Dividend Account

3. When investment is sold at interest date

Bank Account Dr. [(Quoted price – Brokerage) x No. of Investments]
  To Investment Account

4. For transfer of interest / dividend to the Profit and Loss Account / Statement of Profit and Loss at the year end

Interest / Dividend Account Dr.
  To Profit and Loss Account / Statement of Profit and Loss

5. At the end of the accounting year, the balance of investment is to be valued as follows :

(a) Current investments at cost or fair value, whichever is lower;
(b) Long-term investment at cost (provided no decline is anticipated);
(c) Investment properties at cost.

6. The balance of investment account represents the profit or loss on sale of investment. If it shows a credit balance, there is a profit. The entry will be :

Investment Account Dr.
  To Profit and Loss Account / Statement of Profit and Loss

If this account shows a debit balance, there is a loss. The entry will be :

Profit and Loss Account / Statement of Profit and Loss Dr.
  To Investment Account

It should be noted that interest / dividend is calculated on nominal / face value of the investment.

Illustration 1

On 1st January, 2017 HP Ltd. purchased 1,000 15% Debentures of Reliance Ltd. of ₹ 100 each @ ₹ 96 each. On 1st July, 2017, half of the Debentures were sold at ₹ 99 each. Debenture interest is payable half-yearly on 30th June and 31st December. You are required to show 15% Debentures in Reliance Ltd. Account in the books of HP Ltd. assuming that the accounting year closes on 31st December. Market price of a debenture as on 31st December is ₹ 98.

Solution

In the books of H.P. Ltd.
15% Debentures in Reliance Ltd. Account
[Interest Payable : 30th June & 31st December]

Dr. **Cr.**

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
2017					2017				
Jan. 1	To Bank A/c	1,00,000	—	96,000	Jun 30	By Bank A/c (Note 1)	—	7,500	—
Jul. 1	To Statement of Profit & Loss (Note 2)	—	—	1,500	Jul. 1	By Bank A/c (Note 2)	50,000	—	49,500
					Dec. 31	By Bank A/c (Note 3)	—	3,750	—
Dec. 31	To Statement of Profit & Loss (Note 5)	—	11,250	—	Dec. 31	By Balance c/d (Note 4)	50,000	—	48,000
		1,00,000	11,250	97,500			1,00,000	11,250	97,500

Working Notes :

(1) Interest on 30th June, 2017 will be received @ 15% on ₹ 1,00,000 for 6 months. Interest = ₹ 1,00,000 x 15/100 x 6/12 = ₹ 7,500.

(2) $^{1}/_{2}$ of the debentures were sold @ ₹ 99 each. Therefore, sale proceeds will be ₹ 99 x 500 = ₹ 49,500.

Profit on Sale of Investments on 1.7.2017	₹
Sale Proceeds	49,500
Less : Average Cost (₹ 96,000 / 1,00,000 × 50,000)	48,000
Profit on Sale	1,500

(3) Interest on 31st December, 2017 will be received @ 15% on ₹ 50,000 for 6 months. Interest = ₹ 50,000 x 15/100 x 6/12 = ₹ 3,750.

(4) At the end of the year, investment is to be valued on the basis of cost or fair value whichever is less. In this case, fair value is ₹ 98 but cost price is ₹ 96. Therefore, the value of investment on 31st December, 2017 will be ₹ 96 × 500 = ₹ 48,000.

(5) The credit balance of interest column represents interest earned during 2017. It is a revenue income and should be transferred to Profit and Loss Account / Statement of Profit and Loss at the year end. A business which holds many investments may prefer to aggregate the income in a separate account, the balance of which is transferred to Profit and Loss Account / Statement of Profit and Loss.

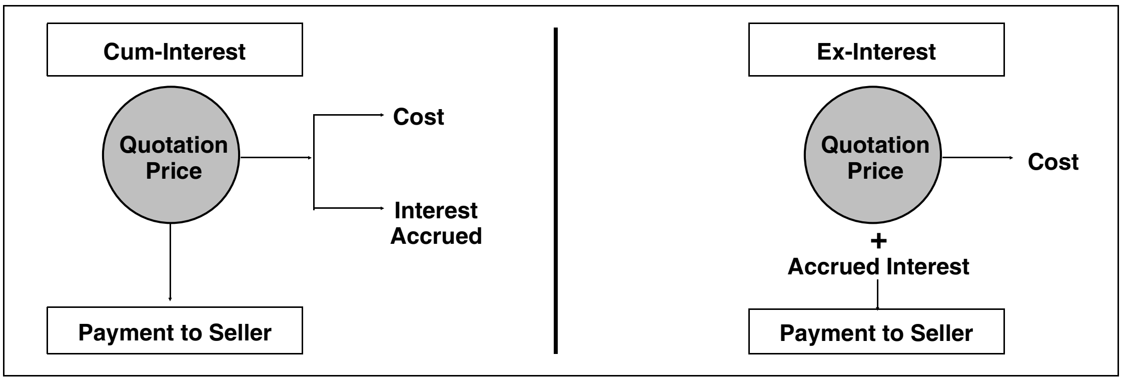
Purchase / Sale of Investment before the Date of Payment of Interest

When investments are purchased or sold before the due date of interest, a problem may arise whether the quotation price includes the interest (upto the date of purchase / sale) or not. The quotation price may be ***ex-interest*** or ***cum-interest***.

Meaning of Cum-interest and Ex-interest

'Cum' and 'Ex' are Latin words. 'Cum' means with and 'Ex' means without. The terms 'Cum-interest' and 'Ex-interest' relate to fixed interest bearing securities and come up for consideration when those securities are purchased or sold. 'Cum-interest' can be expanded as cumulative or inclusive of interest and 'Ex- interest' can be expanded as exclusive of interest. It has already been stated that interest on a fixed interest bearing security accrues on specific due dates. The important point is to note that the holder of the securities is entitled to the whole amount of interest that accrues on the due date irrespective of his period of holding. This is because a company can pay interest only to that person whose name appears in the books of the company as a holder on the date of payment of interest. The quotation, Cum-interest, not only covers the cost but also includes the interest accrued upto the date of purchase; when interest becomes due, it would be the right of the buyer to claim that. Conversely, the quotation, Ex-interest, only covers the cost of the investments and the buyer is liable to pay additional amount as interest accrued upto the date of purchase of investments.

The block diagram given below illustrates the meaning of cum-interest and ex-interest.



In this connection, the following points are important :
(i) In respect of Government securities and debentures, the price quoted is ex-interest unless otherwise stated; and (ii) In respect of Non-Government securities and debentures, it is cum-interest unless otherwise stated.

Cum-interest / Dividend Purchases

When securities are purchased 'Cum-interest' care must be taken at the time of passing entry for purchase. In this case, quotation price consists of ***cost plus accrued interest***. Investment Account will be debited with the ***cost*** only and Interest Account will be debited with accrued interest upto the date of purchase from the date of last interest paid. Bank Account will be credited with the quotation price. On receipt of first amount of interest on due date, the Interest Account will be credited with the ***whole*** amount of that period.

For calculating cost and accrued interest, the following steps should be followed :

Step 1 : Calculate the period between the date of last interest paid and the date of purchase of securities.

Step 2 : Calculate accrued interest by applying the following formula:

$$\text{Accrued Interest} = \frac{\text{Rate of interest} \times \text{Period (in months)}}{12} \times \text{Face value of securities purchased}$$

Step 3 : Calculate cost as follows :

Cost = (Quotation price x No. of securities purchased) *less* accrued interest as calculated in Step 2

Example: On 1st April 2017, X Ltd. purchased 2,000, 12% debentures of ₹ 100 each @ ₹ 98 (cum-interest). Debenture interest is payable half-yearly, on 30th June and 31st December. Date of closing the books of account is 31st December every year. Cost and accrued interest are to be calculated as follows:

Step 1 : Calculation of period (in months) From 1.1.2017 to 31.3.2017 = 3 months.

Step 2 : Accrued interest = 12% x 3/12 x ₹ 2,00,000 = ₹ 6,000.

Step 3 : Cost = (₹ 98 x 2,000) *less* ₹ 6,000 = ₹ 1,96,000 – ₹ 6,000 = ₹ 1,90,000.

Journal Entries

1. When investment is purchased cum-interest

Investment Account	Dr. [Cost]
Interest Account	Dr. [Accrued interest]
To Bank Account	[Quotation price]

2. When first interest is received on due date after purchase

Bank Account	Dr.
To Interest Account	[Whole amount of that period]

Illustration 2

On 31st March, 2017, X Ltd. purchased ₹ 2,00,000 6% Government Stock (face value of ₹ 100 each) at ₹ 95 each cum-interest. Half-yearly interest is payable on 30th June and 31st December every year.

Show entries in the investment ledger of X Ltd. for its financial year ended on 31st December, 2017, ignoring income tax and brokerage.

Solution

On 31st March, 2017 X Ltd. purchased 2,000 stocks (₹ 2,00,000 / 100) @ ₹ 95 cum-interest. Total payment was made ₹ 1,90,000 (₹ 95 × 2,000) which includes interest accrued upto 31st March, 2016 (i.e., for 3 months — January, February and March). The amount of accrued interest = ₹ 2,00,000 × 6/100 × 3/12 = ₹ 3,000. Therefore, cost of investment purchased will be : ₹ 1,90,000 – ₹ 3,000 = ₹ 1,87,000.

On 30th June, 2017 interest will be received @ 6% on ₹ 2,00,000 for the entire 6 months, i.e., 6/100 × ₹ 2,00,000 × 6/12 = ₹ 6,000.

Again on 31st December, 2017 interest will be received @ 6% on ₹ 2,00,000 for 6 months, i.e., 6/100 × ₹ 2,00,000 × 6/12 = ₹ 6,000. Net income from interest = ₹ 6,000 + ₹ 6,000 – ₹ 3,000 = ₹ 9,000 will be credited to Profit and Loss Account / Statement of Profit and Loss.

In the books of X Ltd.
6% Government Stock Account
Dr. [Interest Payable : 30th June & 31st December] Cr.

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
31.3.17	To Bank A/c	2,00,000	3,000	1,87,000	30.6.17	By Bank A/c	—	6,000	—
31.12.17	To Statement of Profit & Loss	—	9,000	—	31.12.17	By Bank A/c	—	6,000	—
						By Balance c/d	2,00,000	—	1,87,000
		2,00,000	12,000	1,87,000			2,00,000	12,000	1,87,000

In the diagrammatic form, the position is :

Payment of Interest | **Date of Acquisition** | **Payment of Interest**

Cost		Interest					
		January	February	March	April	May	June
Total cost ₹ 1,90,000 (₹ 2,00,000 at ₹ 95) includes interest for January, February and March 2017							
X Ltd. :							
(1)	On purchase, debit Interest Account with 3 months accrued interest included in purchase price and debit cost with the balance.	**Debit : Interest Account**					
(2)	On receipt of first interest in June, credit Interest Account with the whole amount.	**Credit : Interest Account**					

Ex-interest / Dividend Purchases

When securities are purchased on 'ex-interest', the quotation price consists of no accrued interest. The seller will get quotation price *plus* accrued interest. The Investment Account will be debited with quotation price *plus* brokerage (if any). Interest Account will be debited with accrued interest. Bank Account will be credited with quotation price *plus* accrued interest. On receipt of the first amount of interest, the Interest Account will be credited with whole amount of that period. Accrued interest will be calculated just like in the previous method.

Journal Entries

1. When investment is purchased ex-interest

Investment Account	Dr. [Quotation Price]
Interest Account	Dr. [Accrued interest]
To Bank Account	[Quotation Price *plus* accrued interest]

2. When first interest is received on due date after purchase

Bank Account	Dr.
To Interest Account	[Whole interest of that period]

Illustration 3

On 31st March, 2017, X Ltd. purchased ₹ 2,00,000 6% Government Stock (face value of ₹ 100 each) at ₹ 95 each ex-interest. Half-yearly interest is payable on 30th June and 31st December every year.

Show entries in the investment ledger of X Ltd. for its financial year ended on 31st December, 2017 ignoring income tax and brokerage.

Solution

On 31st March, 2017, X Ltd. purchased 2,000 stocks (₹ 2,00,000 / 100) @ ₹ 95 ex-interest. X Ltd. will have to pay ₹ 1,90,000 (₹ 95 × 200) plus accrued interest for 3 months (January, February and March) ₹ 3,000. Therefore, total payment will be ₹ 1,93,000. Investment Account will be debited with ₹ 1,90,000 and Interest Account will be debited with ₹ 3,000. The Bank Account will be credited with ₹ 1,93,000.

On 30th June, 2017, interest will be received on ₹ 2,00,000 for the entire 6 months. Net income from interest ₹ 6,000 + ₹ 6,000 – ₹ 3,000 = ₹ 9,000 will be credited to Profit and Loss Account / Statement of Profit and Loss.

In the books of X Ltd.
6% Government Stock Account
Dr. [Interest Payable : 30th June & 31st December] Cr.

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
31.3.17	To Bank A/c	2,00,000	3,000	1,90,000	30.6.17	By Bank A/c	—	6,000	—
31.12.17	To Statement of Profit & Loss	—	9,000	—	31.12.17	By Bank A/c	—	6,000	—
					31.12.17	By Balance c/d	2,00,000	—	1,90,000
		2,00,000	12,000	1,90,000			2,00,000	12,000	1,90,000

In the diagrammatic form, the position is :

Payment of Interest | **Date of Acquisition** | **Payment of Interest**

Cost		Interest					
		January	February	March	April	May	June
Cost ₹ 1,90,000 (₹ 2,00,000 at 95 contains no interest)							
X Ltd. :							
(1)	On purchase, debit Interest Account with 3 months accrued interest of ₹ 3,000 and debit cost with ₹ 1,90,000.	**Debit : Interest Account**					
(2)	On receipt of first interest in June, credit Interest Account with the whole amount.	**Credit : Interest Account**					
(3)	Further amount of interest received are credited to Interest Account.						

Cum-interest / Dividend Sales

When securities are sold "cum-interest", the sale proceeds consists of accrued interest also. Interest Account will be credited with the accrued interest and the Investment Account will be credited with the balance amount. The Bank Account will be debited with the quotation price.

Journal Entries

1. When investment is sold cum-interest

Bank Account Dr. [Quotation Price]
  To Investment Account [Quotation Price *less* accrued interest]
  To Interest Account [Accrued interest]

2. At the end of the year, profit/loss on sale of investment is transferred to Profit and Loss Account / Statement of Profit and Loss

If there is a profit on sale of investment

Investment Account Dr.
  To Profit and Loss Account / Statement of Profit and Loss

If there is a loss on sale of investment

Profit and Loss Account / Statement of Profit and Loss Dr.
  To Investment Account

It should be noted that any brokerage on sale of investment paid should be deducted from sale proceeds to get net sale proceeds.

Illustration 4

On 1st April, 2017 Janaki Ltd. had ₹ 3,00,000 6% Government Stock at ₹ 94 each (face value ₹ 100). Interest is payable half-yearly on 31st March and 30th September. The company sold ₹ 90,000 of the stock at ₹ 95 cum-interest on 1st June,

2017. Draw up 6% Government Stock Account in the Investment Ledger of the company for the year ended 31st March 2018. Ignore brokerage and income tax. The stock was quoted at ₹ 96 ex-interest at the stock exchange on that date.

Solution

On 1st June, 2017 6% Government stock of ₹ 90,000 was sold @ ₹ 95 each cum-interest. Total amount received ₹ 85,500 (₹ 95 × 900) which includes ₹ 900 (₹ 90,000 × 6/100 × 2/12) accrued interest for 2 months April and May. Therefore, net sale proceeds ₹ 85,500 – ₹ 900 = ₹ 84,600 will be credited to Investment Account and ₹ 900 will be credited to Interest Account.

On 30th September, 2017, interest will be received on ₹ 2,10,000 (₹ 3,00,000 – ₹ 90,000) for 6 months. Interest = ₹ 2,10,000 × 6/100 × 6/12 = ₹ 6,300.

On 31st March, 2018, interest will be received on ₹ 2,10,000 for 6 months. Interest = ₹ 2,10,000 × 6/100 × 6/12 = ₹ 6,300.

On 31st March, 2018, the stock of ₹ 2,10,000 will be valued @ ₹ 94 each (because cost is less than market price of ₹ 96). Therefore, the value of stock will be = ₹ 94 × 2,100 = ₹ 1,97,400.

In the books of Janaki Ltd.
6% Government Stock Account
[Interest Payable : 31st March and 30th September]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.17	To Balance b/d	3,00,000	—	2,82,000	1.6.17	By Bank A/c	90,000	900	84,600
31.3.18	To Statement of Profit & Loss	—	13,500	—	30.9.17	By Bank A/c	—	6,300	—
					31.3.18	By Bank A/c	—	6,300	—
					31.3.18	By Balance c/d	2,10,000	—	1,97,400
		3,00,000	13,500	2,82,000			3,00,000	13,500	2,82,000

In the diagramatic form, the position is :

Payment of Interest **Date of Acquisition** **Payment of Interest**

Cost	Interest					
	April	May	June	July	August	Sept.
Total proceeds of ₹ 85,500 (₹ 95 x 900) includes interest for April & May						
Janaki Ltd. :						
(1) On sale, credit Interest Account with 2 months accrued interest including in sale proceeds and credit Investment Account with the balance.	**Credit : Interest Account**					

Ex-interest / Dividend Sales

When securities are sold ex-interest, Quotation price excludes accrued interest. Investment Account will be credited with the Quotation price and Interest Account will be credited with accrued interest. The Bank Account will be debited with Quotation price *plus* accrued interest upto the date of sale.

Journal Entries

1. When investment is sold ex-interest

Bank Account Dr. [Quotation price *plus* accrued interest]
  To Investment Account [Quotation price]
  To Interest Account [Accrued interest]

2. At the end of the year, profit/loss on sale of investment is transferred to Profit and Loss Account / Statement of Profit and Loss

If there is a profit on sale of investment

Investment Account Dr.
  To Profit and Loss Account / Statement of Profit and Loss

If there is a loss on sale of investment

Profit and Loss Account / Statement of Profit and Loss Dr.
  To Investment Account

Illustration 5

On 1st April, 2017 Janaki Ltd. had current investment of ₹ 3,00,000 6% Government stock at ₹ 94 (face value ₹ 100). Interest is payable half-yearly on 31st March and 30th September. The company sold ₹ 90,000 of the stock at ₹ 95 ex-interest on 1st June, 2017. Draw up 6% Government Stock Account in the Investment Ledger of the company for the year ended 31st March, 2018. Ignore brokerage and income tax. The stock was quoted at ₹ 96 ex-interest at the stock exchange on that date.

Solution

On 1st June, 2017, 6% Government Stock of ₹ 90,000 was sold @ ₹ 95 ex-interest. This price of ₹ 95 excludes accrued interest for April and May. Total accrued interest = ₹ 90,000 × 6/100 × 2/12 = ₹ 900. Amount will be received from the buyer (₹ 95 × 900) + ₹ 900 = ₹ 86,400. Interest Account will be credited with ₹ 900 and Investment Account will be credited with ₹ 85,500. The Bank Account will be debited with ₹ 86,400.

Profit on Sale of ₹ 90,000 Stock on 1.6.2017	₹
Sale Proceeds	85,500
Less: Average Cost (₹ 2,82,000 / 3,00,000 × 90,000)	84,600
Profit on Sale	900

On 30th September, 2017 interest will be received on ₹ 2,10,000 (₹ 3,00,000 – ₹ 90,000) for 6 months. Interest = ₹ 2,10,000 × 6/100 × 6/12 = ₹ 6,300.

On 31st March, 2018, interest will be received on ₹ 2,10,000 for 6 months. Interest = ₹ 2,10,000 × 6/100 × 6/12 = ₹ 6,300.

On 31st March, 2018, the stock of ₹ 2,10,000 will be valued @ ₹ 94 each (because cost is less than market price of ₹ 96). Therefore, the value of stock will be ₹ 94 × 2,100 = ₹ 1,97,400.

In the books of Janaki Ltd.
6% Government Stock Account
[Interest Payable : 31st March and 30th September]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.17	To Balance b/d	3,00,000	—	2,82,000	1.6.17	By Bank A/c	90,000	900	85,500
1.6.17	To Statement of Profit & Loss	—	—	900	30.9.17	By Bank A/c	—	6,300	—
					31.3.18	By Bank A/c	—	6,300	—
		3,00,000	13,500	2,82,900			3,00,000	13,500	2,82,900

In the diagrammatic form, the position is :

Payment of Interest **Date of Acquisition** **Payment of Interest**

Cost		**Interest**					
		April	May	June	July	August	Sept.
Proceeds of ₹ 85,500 excludes interest for April & May							
Janaki Ltd. :							
(1)	On sale, credit Interest Account with 2 months accrued interest of ₹ 900. ₹ 85,500 will be credited to Investment Account.	**Credit : Interest Account**					

Illustration 6

On 1.1.2007, 200, 6% debentures of ₹ 100 each of Y Ltd. were held as investments by X Ltd. at a cost of ₹ 18,200. Interest is payable on December 31.

On 1.4.2007 : ₹ 4,000 of such debentures were purchased by X Ltd. @ ₹ 98 each cum-interest.

On 1.9.2007 : ₹ 6,000 debentures were sold at ₹ 96 ex-interest.

On 1.12.2007 : ₹ 8,000 debentures were sold @ ₹ 99 cum-interest.

On 31.12.2007 : X Ltd. sold ₹ 10,000 debentures @ ₹ 95 cum-interest.

Prepare the Investment Account for 6% debentures of Y Ltd. in the books of X Ltd. Ignore income tax.

[C.U.B.Com. (Hons.) — 2009]

Solution

In the books of X Ltd.
6% Debentures in Y Ltd. Account
[Interest Payable : 31st December]

Dr. **Cr.**

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.1.07	To Balance b/d	20,000	—	18,200	1.9.07	By Bank A/c (Note 2)	6,000	240	5,760
1.1.07	To Bank A/c (Note 1)	4,000	60	3,860	1.12.07	By Bank A/c (Note 3)	8,000	440	7,480
1.9.07	To Statement of Profit & Loss (Note 2)	—	—	245	31.12.07	By Bank A/c (Note 4)	10,000	600	8,900
					31.12.07	By Statement of Profit & Loss (Note 4)	—	—	292
1.12.07	To Statement of Profit & Loss (Note 3)	—	—	127					
31.12.07	To Statement of Profit & Loss (transfer)	—	1,220	—					
		24,000	1,280	22,432			24,000	1,280	22,432

Working Notes :

(1) On 1.4.07, 40 debentures were purchased @ ₹ 98 cum-interest. It means that the total payment of ₹ 3,920 (40 × ₹ 98) includes interest accrued upto 31.3.07. The amount of accrued interest = ₹ 4,000 × 6/100 × 3/12 = ₹ 60. Therefore, cost of investment purchased = ₹ 3,920 – ₹ 60 = ₹ 3,860.

(2) On 1.9.07, 60 Debentures were sold @ ₹ 98 ex-interest. It means that ₹ 5,760 (₹ 98 × 60) will be received for sale of investment and in addition ₹ 240 (₹ 6,000 × 6/100 × 8/12) will be received for interest of 8 months.

Profit on sale of 60 Debentures	₹
Sale proceeds	5,760
Less: Average Cost : $\frac{18{,}200 + 3{,}860}{200 + 40} \times 60$ = ₹ 91.92 × 60	5,515
Profit on Sale	245

(3) On 1.12.07, 80 debentures were sold @ ₹ 99 cum-interest. It means that sale proceeds of ₹ 7,920 (₹ 99 × 80) includes accrued interest of ₹ 440 (₹ 8,000 × 6/100 × 11/12). Therefore, amount received on sale of investment = ₹ 7,920 – ₹ 440 = ₹ 7,480.

Profit on Sale of 80 Debentures	₹
Sale proceeds	7,480
Less: Average cost : ₹ 91.92 × 80 (See Note 2)	7,353
Profit on Sale	127

(4) On 31.12.07, debentures were sold @ ₹ 95 cum-interest. It means that the sale proceeds of ₹ 9,500 (₹ 95 × 100) includes interest of ₹ 600 (₹ 10,000 × 6/100 × 12/12). Therefore, amount received on sale of investment = ₹ 9,500 – ₹ 600 = ₹ 8,900.

Loss on Sale of 100 Debentures	₹
Sale Proceeds	8,900
Less: Aveage Cost : ₹ 91.92 × 100	9,192
Loss on Sale	292

Illustration 7

On 1st January 2017, X Ltd. held as investment ₹ 50,000, 6% Government stock costing ₹ 47,000 (face value ₹ 100 each). On 31st March, a purchase of ₹ 2,00,000 same Government stock was made at ₹ 95 cum-interest.

On 1st July, the company sold ₹ 1,00,000 stock @ ₹ 96. On 1st October, a further ₹ 70,000 of the investment was sold at ₹ 98 cum-interest. The market price of the stock on 31.12.2017 was ₹ 99 (ex-interest).

Half-yearly interest is payable on 30th June and 31st December every year. Prepare the Investment Ledger of the company ignoring income tax and brokerage.

Solution

In the books of X Ltd.
6% Government Stock Account
[Interest Payable : 30th June & 31st December]

Dr. **Cr.**

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.1.17	To Balance b/d	50,000	—	47,000	30.6.17	By Bank A/c (Note 2)	—	7,500	—
31.3.17	To Bank A/c (Note 1)	2,00,000	3,000	1,87,000	1.7.17	By Bank A/c (Note 3)	1,00,000	—	96,000

1.7.17	To Statement of Profit & Loss (Note 3)	—	—	2,400	1.10.17	By Bank A/c (Note 4)	70,000	1,050	67,550
					31.12.17	By Bank A/c (Note 5)	—	2,400	—
1.10.17	To Statement of Profit & Loss (Note 4)	— —	— —	2,030	31.12.17	By Balance c/d (N 6)	80,000	—	74,880
31.12.17	To Statement of Profit & Loss	—	7,950	—					
		2,50,000	10,950	2,38,430			2,50,000	10,950	2,38,430

Working Notes :

(1) On 31.3.2017, ₹ 2,00,000 stocks were purchased @ ₹ 95 cum-interest. It means that the total payment of ₹ 1,90,000 (₹ 95 × 2,000) includes interest accrued upto 31.3.2017. The amount of accrued interest = ₹ 2,00,000 × 6/100 × 3/12 = ₹ 3,000. Therefore, cost of investment purchased will be ₹ 1,90,000 – ₹ 3,000 = ₹ 1,87,000.

(2) On 30.6.2017, interest will be received on entire stock holding on that date including new purchases for 6 months. The amount of interest = ₹ 2,50,000 × 6/100 × 6/12 = ₹ 7,500.

(3) On 1.7.2017, the sale of stock for ₹ 96,000 does not involve any accrued interest.

Profit on sale of face value of ₹ 1,00,000 on 1.7.2017	₹
Sale proceeds	96,000
Less: Average Cost : $\frac{47,000 + 1,87,000}{50,000 + 2,00,000}$ × ₹ 1,00,000 = ₹ 0.936 × ₹ 1,00,000	93,600
Profit on Sale	2,400

(4) On 1.10.2017, ₹ 70,000 of the investment was sold at ₹ 98 cum-interest. It means that the sale proceeds of ₹ 68,600 (₹ 98 × 700) includes accrued interest for 3 months ₹ 1,050 (₹ 70,000 × 6/100 × 3/12). Therefore, amount received on sale of investment = ₹ 68,600 – ₹ 1,050 = ₹ 67,550.

Profit on sale of 700 Govt. Stock (face value of ₹ 70,000) on 1.10.2017	₹
Sale proceeds	67,550
Less: Average Cost : 0.936 × ₹ 70,000	65,520
Profit on Sale	2,030

(5) Interest for 6 months on ₹ 80,000 will be ₹ 80,000 × 6/100 × 6/12 = ₹ **2,400**.

(6) Balance of face value of ₹ 80,000 = 0.936 × ₹ 80,000 = ₹ **74,880**.

Illustration 8

Mrs. Bhakat furnishes the details of her holding in 6% Govt. Bonds :

1.1.2009 Opening balance — face value ₹ 60,000 – cost ₹ 59,000.
1.3.2009 Purchased 100 units ex-interest at ₹ 98.
1.7.2009 Sold 200 units ex-interest at ₹ 100.
1.10.2009 Purchased 50 units at ₹ 98 cum-interest.
1.11.2009 Sold 200 units ex-interest at ₹ 99.

Mrs. Bhakat closes her books every December, 31 and interest dates at March 31 and September 30.
Show the Investment Account in the books of Mrs. Bhakat. *[C.U.B.Com. (Hons.) — 2010]*

Solution

In the books of Mrs. Bhakat
6% Government Stock Account
Dr. [Interest Payable : 31st March & 30th September] Cr.

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.1.09	To Balance b/d (Note 1)	60,000	900	59,000	31.3.09	By Bank A/c (Note 3)	—	2,100	—
1.3.09	To Bank A/c (Note 2)	10,000	250	9,800	1.7.09	By Bank A/c (Note 4)	20,000	300	20,000
1.7.09	To Statement of Profit & Loss (Note 5)	—	—	343	30.9.09	By Bank A/c (Interest)	—	1,500	—
					1.11.09	By Bank A/c (Note 6)	20,000	100	19,800
1.10.09	To Bank A/c (Note 6)	5,000	—	4,900	31.12.09	By Balance c/d	35,000	525	34,391
1.11.09	To Statement of Profit & Loss (Note 7)	—	—	148					
31.12.09	To Statement of Profit & Loss	—	3,375	—					
		75,000	4,525	74,191			75,000	4,525	74,191

Working Notes :

(1) Date of interest is 31st March and 30th September. Last interest was paid on 30th September, 2008. On 1.1.2009, accrued interest = ₹ 60,000 × 6/100 × 3/12 = ₹ 900.

(2) Accrued interest on the date of purchase = ₹ 10,000 × 6/100 × 5/12 = ₹ 250.

(3) Total interest received = ₹ 70,000 × 6% × 1/2 = 2,100.

(4) Interest accrued = ₹ 20,000 × 6/100 × 3/12 = ₹ 300.

(5) Profit on Sale of 20,000 Bonds on 1.7.2009

	₹
Sale proceeds	20,000
Less: Average Cost (68,800 / 70,000 × 20,000)	19,657
Profit on Sale	343

(6) On 1st November, 200 bonds were sold @ ₹ 99 ex-interest. It means ₹ 19,800 will be received for sale of investment and in addition ₹ 100 (20,000 × 6/100 × 1/12) will be received for interest.

Profit on Sale of 20,000 bonds on 1.11.2009

Sale proceeds	19,800
Less: Average Cost (54,043 / 55,000 × 20,000)	19,652
	148

(7) Accrued Interest on 31.12.2009 = ₹ 35,000 × 6/100 × 3/12 = ₹ **525**.

Illustration 9

On 1st April, 2017 Janaki Ltd. had ₹ 3,00,000 6% Government stock at ₹ 94 (face value ₹ 100 each). Interest is payable half-yearly on 31st March and 30th September. The company sold ₹ 90,000 of the stock at ₹ 95 ex-interest on 1st June and purchased ₹ 72,000 stock at ₹ 97 cum-interest on 1st September. A further purchase of ₹ 36,000 stock was made on 1st December at ₹ 98 ex-interest.

Draw up 6% Government Stock Account in the Investment Ledger of the company for the year ended 31st March, 2018. Ignore brokerage and income tax.

The stock was quoted at ₹ 96 at the Stock Exchange on that date.

Solution

In the books of Janaki Ltd.
6% Government Stock Account
[Interest Payable : 31st March & 30th September]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.17	To Balance b/d	3,00,000	—	2,82,000	1.6.17	By Bank A/c (Note 1)	90,000	900	85,500
1.6.17	To Statement of Profit & Loss (Note 1)	—	—	900	30.9.17	By Bank A/c (Note 3)	—	8,460	—
					31.3.18	By Bank A/c (Note 5)	—	9,540	—
1.9.17	To Bank A/c (Note 2)	72,000	1,800	68,040	31.3.18	By Balance c/d	3,18,000	—	3,00,720
1.12.17	To Bank A/c (Note 4)	36,000	360	35,280					
31.3.18	To Statement of Profit & Loss	—	16,740	—					
		4,12,000	18,900	3,86,220			4,12,000	18,900	3,86,220

Working Notes :

(1) Profit on Sale of Stock (ex-interest) on 1.6.2017	₹
Sale proceeds (900 x ₹ 95)	85,500
Less: Average Cost : (₹ 2,82,000 / 3,00,000 x 90,000)	84,600
Profit on Sale	900
Accrued int. receivable in addition (₹ 90,000 x 6/100 x 2/12) = ₹ 900	
(2) Purchase of Stock (cum - interest) on 1.9.2017	
Nominal Value	72,000
Total amount paid (720 x ₹ 97)	69,840
Less : Accrued interest for 5 months (₹ 72,000 x 6/100 x 5/12)	1,800
Cost	68,040

(3) Interest for 6 months ending on 30.9.2017	₹
Interest will be received for 6 months on entire stock holding on that date : (₹ 2,82,000 x 6/100 x 6/12)	8,460
(4) Purchase of Stock (ex - int) on 1.12.2017	
Nominal Value	36,000
Cost (360 x ₹ 98)	35,280
Accrued interest payable in addition for 2 months : (₹ 36,000 x 6/100 x 2/12)	360
(5) Interest for 6 months ending on 31.3.2018	
Interest will be received for 6 months on entire stock holding on that date : (₹ 3,18,000 x 6/100 x 6/12)	9,540

Illustration 10

On 1st March, 2017, XY Corporation Ltd purchased ₹ 30,000, 5% Government stock at ₹ 95 cum-interest. On 1st May, 2017 the company sold ₹ 10,000 of stock at ₹ 97 cum-interest.

On 15th December, 2017, another ₹ 10,000 stock was sold at ₹ 93 ex-interest.

On 31st December, 2017, the closing date of the financial year, the fair value of the stock was ₹ 92.

Half-yearly interest is received every year as on 30th June and 31st December.

Prepare a ledger account in the investment ledger assuming that the stock transfer book is closed 20 days before the date of payment of interest.

Assume investments are current investments.

Solution

In the books of XY Corporation Ltd.
5% Government Stock Account
[Interest Payable : 30th June & 31st December]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.3.17	To Bank A/c (Note 1)	30,000	250	28,250	1.5.17	By Bank A/c (Note 2)	10,000	167	9,533
1.5.17	To Statement of Profit & Loss (Note 2)	—	—	117	30.6.17	By Bank A/c (Interest)	—	500	—
					15.12.17	By Bank A/c (Note 3)	10,000	229	9,300
31.12.17	To Statement of Profit & Loss	—	896	—	"	By Statement of Profit & Loss (Note 5)	—	—	116
					31.12.17	By Bank A/c (Interest)	—	250	—
					31.12.17	By Statement of Profit & Loss	—	—	218
					31.12.17	By Balance c/d (N 4)	10,000	—	9,200
		30,000	1,146	28,367			30,000	1,146	28,367

Working Notes :

(1) Purchase of Stock (cum-interest) on 1.3.2017	₹
Nominal Value	30,000
Total amount paid (300 x ₹ 95)	28,500
Less: Accrued Interest for 2 months (30,000 x 5/100 x 2/12)	250
Cost	28,250

(3) Sale of Stock (ex-interest) on 15.12.2017	
Nominal Value	10,000
Sale Proceeds (100 x ₹ 93)	9,300
Accrued Interest for $5^{1}/_{2}$ months (10,000 x 5/100 x 11/24)	229

(5) Loss on Sale of ₹ 10,000 Stock on 15.12.2017	
Sale Proceeds	9,300
Less: Average Cost (₹ 2,82,000 / 3,00,000 x 90,000)	9,416
Loss on Sale	116

(2) Sale of Stock (cum-interest) on 1.5.2017	₹
Nominal Value	10,000
Sales Proceeds (100 x ₹ 97)	9,700
Less: Accrued Interest for 4 months (10,000 x 5/120 x 4/12)	167
	9,533
Profit on Sale of ₹ 10,000 Stock on 1.5.2017	
Sale Proceeds	9,533
Less: Average Cost (₹ 28,250 / 30,000 x 10,000)	9,416
Profit on Sale	117

(4) Cost of Stock on 31.12.2017	₹
(i) Cost Price (28,250 / 30,000 x 10,000)	9,416
(ii) Fair Value (100 x ₹ 92)	9,200
Value of Stock will be ₹ 9,200 (being lower than cost price)	

Illustration 11

Jaipur Investments Ltd. hold 1,000 15% debentures of ₹ 100 each in Udaipur Industries Ltd. as on April 1, 2017 at a cost of ₹ 1,05,000.

Interest is payable on June 30 and December 31 each year.

On May 1, 2017, 500 debentures are purchased cum-interest at ₹ 53,500.

On November 1, 2017, 600 debentures are sold ex- interest at ₹ 57,300.

On November 30, 2017, 400 debentures are purchased ex-interest at ₹ 38,400.

On December 31, 2017, 400 debentures are sold cum-interest for ₹ 55,000.

Prepare the Investment Account upto March 31, 2018.

Solution

In the books of Jaipur Investments Ltd.
15% Debentures in Udaipur Industries Ltd. Account
[Interest Payable : 30th June & 31st December]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.17	To Balance b/d (N 1)	1,00,000	3,750	1,05,000	30.6.17	By Bank A/c (Note 3)	—	11,250	—
1.5.17	To Bank A/c (Note 2)	50,000	2,500	51,000	1.17.17	By Bank A/c (Note 4)	60,000	3,000	57,300
30.11.17	To Bank A/c (Note 5)	40,000	2,500	38,400	1.11.17	By Statement of Profit & Loss (Note 4)	—	—	5,100
31.12.17	To Statement of Profit & Loss (Note 6)	—	—	11,385	31.12.17	By Bank A/c (Note 6)	40,000	3,000	52,000
31.3.18	To Statement of Profit & Loss	—	18,625	—	"	By Bank A/c (Note 7)	—	6,750	—
					31.3.18	By Balance c/d (N 8)	90,000	3,375	91,385
		1,90,000	27,375	2,05,785			1,90,000	27,375	2,05,785

Working Notes :

(1) Opening balance of ₹ 3,750 in interest column represents accrued interest for 3 months (Jan + Feb + March). Accrued interest = ₹ 1,00,000 × 15/100 × 3/12 = ₹ 3,750.

(2) On 1st May, 2017, 500 debentures were purchased cum-interest. It means that the total payment of ₹ 53,500 includes interest accrued upto 30th April, 2017. The amount of accrued interest = ₹ 50,000 × 15/100 × 4/12 = ₹ 2,500. Therefore, cost of investment will be: ₹ 53,500 – ₹ 2,500 = ₹ 51,000.

(3) On 30th June 2017, interest will be received on entire debentures holding on that date including new purchase for 6 months. The amount of interest = ₹ 1,50,000 × 15/100 × 6/12 = ₹ 11,250.

(4) On 1st November 2017, 600 debentures were sold ex-interest at ₹ 57,300. It means that the accrued interest of ₹ 3,000 (₹ 60,000 × 15/100 × 4/12) were also received in addition to ₹ 57,300.

Loss on Sale of 600 debentures on 1.11.2017	₹
Sale proceeds	57,300
Less: Average Cost : $\frac{1,05,000 + 51,000}{1,000 + 500} \times 600 = ₹\ 104 \times 600$	62,400
Loss on Sale	5,100

Closing value of 900 debentures = ₹ 104 × 900 = ₹ **93,600**.

(5) On 30th November 2017, 400 debentures were purchased ex-interest at ₹ 38,400. It means that the accrued interest of ₹ 2,500 (₹ 40,000 × 15/100 × 5/12) were also paid in addition to ₹ 38,400.

(6) On 31st December 2017, 400 debentures were sold cum-interest at ₹ 55,000. It means that the accrued interest of ₹ 3,000 (₹ 40,000 × 15/100 × 6/12) were received, which is included in ₹ 55,000. Therefore, the effective sale proceeds is ₹ 55,000 – ₹ 3,000 = ₹ 52,000.

Profit on sale of 400 debentures on 31.12.17	₹
Sale proceeds	52,000
Less: Average Cost : $\frac{93,600 + 38,400}{900 + 400} \times 400 = ₹\ 101.51 \times 400$	40,615
Profit on Sale	11,385

(7) On 31st December 2017, interest will be received on entire debentures holding on that date i.e., ₹ 90,000. Interest for 6 months = (₹ 90,000 × 15/100 × 6/12) = ₹ 6,750.

(8) On 31st March 2018, accrued interest will be for 3 months = ₹ 90,000 × 15/100 × 3/12 = ₹ 3,375. Balance of investment on 31st March, 2018 = ₹ 101.54 × 900 = ₹ 91,385.

Illustration 12

Mr. Investor furnishes the following details relating to his holding in 6% Government Bonds.

1.1.2017 Opening balance face value ₹ 60,000 – Cost ₹ 59,000
1.3.2017 100 units purchased ex-interest at ₹ 98
1.7.2017 Sold 200 units ex-interest at ₹ 100
1.10.2017 Purchased 50 units at ₹ 98 cum-interest.
1.11.2017 Sold 200 units ex-interest at ₹ 99.

Interest dates are March 31 and September 30. Mr. Investor closes his books every December 31. Show the Investment Account as it would appear in his books.

Solution

In the books of Mr. Investor
6% Government Bonds Account
[Interest Payable : 31st March & 30th September]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.1.17	To Bank A/c (Note 1)	60,000	900	59,000	31.3.17	By Bank A/c (Note 3)	—	2,100	—
1.3.17	To Bank A/c (Note 2)	10,000	250	9,800	1.7.17	By Bank A/c (Note 4)	20,000	300	20,000
1.7.17	To Statement of Profit & Loss (Note 4)	—	—	343	30.9.17	By Bank A/c (Note 5)	—	1,500	—
					1.11.17	By Bank A/c (Note 7)	20,000	100	19,800
1.10.17	To Bank A/c (Note 6)	5,000	—	4,900	31.12.17	By Balance c/d (Note 8)	35,000	525	34,393
1.11.17	To Statement of Profit & Loss (Note 7)	—	—	150					
31.12.17	To Statement of Profit & Loss	—	3,375	—					
		75,000	4,525	74,193			75,000	4,525	74,193

Working Notes :

(1) Opening balance of ₹ 900 in interest column represents accrued interest for 3 months (Oct, Nov & Dec). Accrued interest = ₹ 60,000 x 6/100 x 3/12 = ₹ 900.

(2) On 1st March 2017, 100 units were purchased ex-interest @ ₹ 98 each. The actual amount paid = ₹ 9,800 (₹ 98 × 100) for principal and ₹ 250 for accrued interest upto the date of purchase from the date of last payment of interest. Accrued interest = ₹ 10,000 × 6/100 × 5/12 = ₹ 250.

(3) On 31st March, 2017, interest will be received on entire bonds holding on that date including new purchase for 6 months. The amount of interest = ₹ 70,000 × 6 / 100 × 6/12 = ₹ 2,100.

(4) On 1st July 2017, 200 units were sold @ ₹ 100 ex-interest. Total amount received = 200 × ₹ 100 + accrued interest for 3 months (₹ 20,000 × 6/100 × 3/12) = ₹ 20,000 + ₹ 300 = ₹ 20,300.

Profit on Sale of 200 units on 1.7.2017	₹
Sale proceeds	20,000
Less: Average Cost : $\frac{59{,}000 + 9{,}800}{600 + 100} \times 200 = ₹\ 98.28 \times 200$	19,657
Profit on Sale	343

Closing value = ₹ 98.28 × 500 = ₹ 49,140.

(5) On 30th September 2017, interest will be received on entire bonds holding on that date, i.e., (₹ 60,000 + ₹ 10,000 – ₹ 20,000) = ₹ 50,000. Interest = ₹ 50,000 × 6/100 × 6/12 = ₹ 1,500.

(6) On 1st October 2017, 50 units were purchased @ ₹ 98 cum-interest. Cost of investment = 50 × ₹ 98 = ₹ 4,900. Accrued interest is nil because interest has already been paid on 30th September in 2017.

(7) On 1st November 2017, 200 units were sold @ ₹ 99 ex-interest. It means that the accrued interest of ₹ 100 (₹ 20,000 × 6/100 × 1/12) were also received in addition to ₹ 19,800 (₹ 99 × 200).

Profit on Sale of 200 units on 1.11.2017	₹
Sale proceeds	19,800
Less: Average Cost : $\frac{49{,}140 + 4{,}900}{500 + 50} \times 200 = ₹\ 98.25 \times 200$	19,650
Profit on Sale	150

(8) On 31st December 2017, interest will be for 3 months (Oct, Nov & Dec) on ₹ 35,000.
Interest = ₹ 35,000 × 6/100 × 3/12 = ₹ 525.
Balance of Investment on 31.12.2017
₹ 98.25 × 350 = ₹ 34.393 (Actual cost is coming to ₹ 34,390 but ₹ 3 has been adjusted for approximation.)

Illustration 13

Calcutta Investments holds 400, 12% debentures of ₹ 100 each in Acme Ltd., as on April 1, 2017 at a cost of ₹ 50,000. Interest is payable on June 30 and December 31 each year.

On June 1, 2017, 200 debentures are purchased cum-interest at ₹ 21,400.
On November 1, 2017, 300 debentures are sold ex-interest at ₹ 28,650.
On November 30, 2017, 200 debentures are purchased ex- interest at ₹ 19,200.
On December 31, 2017, 300 debentures are sold cum-interest for ₹ 32,250.
Prepare the Investment Account on March 31, 2018.

Solution **In the books of Calcutta Investments**

12% Debentures in Acme Ltd. Account

Dr. **[Interest Payable : 30th June & 31st December]** **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.17	To Balance b/d (Note 1)	40,000	1,200	50,000	30.6.17	By Bank A/c (Note 3)	—	3,600	—
1.6.17	To Bank A/c (Note 2)	20,000	1,000	20,400	1.11.17	By Bank A/c (Note 4)	30,000	1,200	28,650
30.11.17	To Bank A/c (Note 5)	20,000	1,000	19,200	"	By P / L A/c (Note 4)	—	—	6,550
31.3..18	To Statement of Profit & Loss	—	5,200	—	31.12.17	By Bank A/c (Note 6)	30,000	1,800	30,450
					"	By P / L A/c (Note 6)	—	—	2,190
					"	By Bank A/c (Note 7)	—	1,200	—
					31.3.18	By Balance c/d (Note 8)	20,000	600	21,760
		80,000	8,400	89,600			80,000	8,400	89,600

Working Notes :

(1) Opening balance of ₹ 1,200 in interest column represents accrued interest for 3 months (Jan + Feb + March). Accrued interest = ₹ 40,000 × 12/100 × 3/12 = ₹ 1,200.

(2) On 1st June 2017, 200 debentures were purchased cum-interest at ₹ 21,400. It means that the accrued interest for 5 months is included in total payment of ₹ 21,400. Accrued interest = ₹ 20,000 × 12/100 × 5/12 = ₹ 1,000. Therefore, cost = ₹ 21,400 – ₹ 1,000 = ₹ 20,400.

(3) On 30th June 2017, interest will be received on entire debentures holding on that date including new purchase for 6 months. The amount of interest = ₹ 60,000 x 12/100 x 6/12 = ₹ 3,600.

(4) On 1st November 2017, 300 debentures were sold ex-interest at ₹ 28,650. It means that the accrued interest of ₹ 1,200 (₹ 30,000 × 12/100 × 4/12) were also received in addition to ₹ 28,650.

Loss on Sale of 300 debentures on 1.11.2017	₹
Sale proceeds	28,650
Less: Average Cost : $\frac{50,000 + 20,400}{400 + 200} \times 300$ = ₹ 117.33 × 300	35,200
Loss on Sale	6,550

Closing value = ₹ 117.33 × 300 = ₹ 35,200

(5) On 30th November 2017, 200 debentures were purchased ex-interest at ₹ 19,200. It means that the accrued interest of ₹ 1,000 (₹ 20,000 × 12/100 × 5/12) were also paid in addition to ₹ 19,200.

(6) On 31st December 2017, 300 debentures were sold cum-interest at ₹ 32,250. It means that the accrued interest for 6 months is included in this amount. Accrued interest = ₹ 30,000 × 12/100 × 6/12 = ₹ 1,800. Therefore, net proceeds = ₹ 32,250 – ₹ 1,800 = ₹ 30,450.

Loss on Sale of 300 debentures on 31.12.17	₹
Sale proceeds	30,450
Less: Average Cost : $\frac{35,200 + 19,200}{300 + 200} \times 300$ = ₹ 108.80 × 300	32,640
Loss on Sale	2,190

(7) On 31st December, 2017, interest will be received on entire debentures holding on that date, i.e., ₹ 20,000. Interest for 6 months = ₹ 20,000 × 12/100 × 6/12 = ₹ 1,200.

(9) On 31st March, 2018, accrued interest will be for 3 months on ₹ 20,000. Accrued interest = (₹ 20,000 × 12/100 × 3/12) = ₹ 600. **Balance of investment on 31st March, 2018** : ₹ 112.80 × 200 = ₹ 21,760.

Some Adjustments for Equity Shares Investment Account

Dividend Received

When dividends on equity shares are declared from pre-acquisition profits, it may be difficult to make an allocation between pre- and post-acquisition profits excepting on an arbitrary basis (e.g., time basis). In such a case, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

Illustration 14

On April 1, 2017, Mr. Subramanium had 20,000 Equity Shares in X Ltd. Face value of the shares was ₹ 10 each but their book value was ₹ 16 per share. On June 1, 2017, Mr. Subramanium purchased 5,000 Equity Shares more in X Ltd. @ ₹ 14 each. On September 1, 2017, X Ltd. declared 15% dividend for the year 2016-17. Mr. Subramanium received the same on September 20, 2017. Show Investment Account upto September 20, 2017.

Solution **In the books of Mr. Subramanium**

Dr. **Investment in Equity Shares of X Ltd. Account** **Cr.**

Date	Particulars	Nominal Value	Dividend (₹)	Cost (₹)	Date	Particulars	Nominal Value	Dividend (₹)	Cost (₹)
1.4.17	To Balance b/d	2,00,000	—	3,20,000	20.9.17	By Bank A/c (Note 1)		30,000	7,500
1.6.17	To Bank A/c	50,000	—	70,000					

Tutorial Note : 1. Mr. Subramanium was holding 20,000 Equity Shares of X Ltd. on 1st April, 2017. Any dividend in respect of these shares will be treated as dividend from post-acquisition profit. He acquired 5,000 Equity Shares of X Ltd. on 1st June, 2017. The dividend in respect of these shares will be treated as dividend from ***pre-acquisition profit.*** Therefore, ₹ 30,000 (₹ 2,00,000 × 15/100) dividend will be credited to Income Account and ₹ 7,500 (₹ 50,000 × 15/100) dividend will be ***credited*** to Investment Account (cost column).

Bonus Shares

Bonus shares are issued by capitalising free reserves. A business receives bonus shares on the basis of existing holding, at no cost. Therefore, only the nominal value column of the Investment Account needs amendment. The total nominal value of shares received as bonus will appear in nominal value column only and nothing is recorded in the cost column. In effect, the average cost of the existing shares are reduced.

Illustration 15

On April 1, 2017, Mr. Subramanium had 20,000 Equity Shares in X Ltd. Face value of the shares was ₹ 10 each but their book value was ₹ 16 per share.

On June 1, 2017, Mr. Subramanium purchased 5,000 Equity Shares in X Ltd more @ ₹ 14 each.

On June 30, 2017, the directors of X Ltd. announced a bonus issue. Bonus was declared at the rate of one Equity Share for every five shares held and these shares were received on August 2, 2017.

Show Investment Account upto August 2, 2017.

Solution **In the books of Mr. Subramanium**

Dr. **Investment in Equity Shares of X Ltd. Account** **Cr.**

Date	Particulars	Nominal Value	Dividend (₹)	Cost (₹)	Date	Particulars	Nominal Value	Dividend (₹)	Cost (₹)
1.4.17	To Balance b/d	2,00,000	—	3,20,000					
1.6.17	To Bank A/c	50,000	—	70,000					
2.8.17	To Bonus Shares A/c	50,000	—	—					

Tutorial Note : Mr. Subramanium will receive 25,000 × 1/5 = 5,000 shares of ₹ 10 each as Bonus Shares at no cost.

Illustration 16

On 1.4.2017, X Limited had 10,000 equity shares of ABC Limited (face value being ₹ 10 each), purchased at par. The company paid brokerage at 1%. On 1.6.2017, the company purchased another lot of 5,000 shares at ₹ 12 each, brokerage being 1%. On 15.8.2017, ABC Limited issued bonus shares at two shares for every three held. On 1.1.2018, X Limited sold 10,000 shares at ₹ 11 per share, brokerage being 1%.

Show Investment Account up to 1.1.2018.

Solution **In the books of X Ltd.**

Dr. **Investment in Equity Shares of ABC Ltd. Account** **Cr.**

Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)	Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)
1.4.17	To Balance b/d	10,000	—	1,01,000	1.1.18	By Bank b/c (Note 2)	10,000	—	1,12,000
1.6.17	To Bank A/c	5,000	—	60,600	"	By Balance c/d (N 3)	15,000	—	96,960

15.12.17	To Bonus Share A/c (Note 1)	10,000	—	—					
1.1.18	To Statement of Profit & Loss	—	—	44,260					
		25,000	—	2,05,860			25,000	—	2,05,860

Working Notes :

(1) Number of bonus shares received = $\frac{10{,}000 + 5{,}000}{3} \times 2 = 10{,}000$ shares.

(2) Average cost of 25,000 shares = $\frac{1{,}01{,}000 + 60{,}600}{25{,}000}$ = ₹ 6.464 (approx.).

	₹
Sale proceeds of 10,000 shares	1,10,000
Less: Brokerage 1%	1,100
Net Proceeds	1,12,900
Less: Average cost of 10,000 shares @ ₹ 6.464	64,640
Profit on Sale	44,260

(4) Value of closing balance : 15,000 × ₹ 6.464 = ₹ 96,960.

Rights Shares

When rights shares offered are subscribed for, the cost of the rights shares is added to the carrying amount of the original holding. ***For example***, X Ltd. purchased 10,000 shares of ₹ 10 each at ₹ 25 per share of Y Ltd. during 2013-14. During 2018-17, Y Ltd offered rights issue at one share for every two held at a price of ₹ 20 per share. If X Limited subscribes to the rights issue, the carrying cost of the investment will be as under :

	₹
Cost of original holding (10,000 × ₹ 25)	2,50,000
Cost of rights issue (5,000 × ₹ 20)	1,00,000
Carrying cost of Investments	3,50,000

If rights are not subscribed but are ***sold in the market, the sale proceeds are credited to the Statement of Profit and Loss***. However, where the investments are acquired on cum-rights basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

For example, X Limited purchased 1,000 shares (cum-rights) of ₹ 10 each at ₹ 15 per share of Y Limited and paid ₹ 500 as brokerage. Y Limited offered rights issue at one share for ₹ 12 for every two held. X Limited sold the rights in the market and realised ₹ 1,000. After the rights issue was subscribed, the market value of share fell down from ₹ 15 to ₹ 14.50 per share. In such a case, the decline in the market value [₹ 500 [1,000 × (₹ 15 – ₹ 14.50)] should be adjusted against cost of investment and the balance of ₹ 500 is to be treated as income and is to be credited to Profit and Loss Account / Statement of Profit and Loss.

Illustration 17

On 1.4.2017, X Limited had 10,000 equity shares of ABC Limited, purchased at ₹ 12 each (face value being ₹ 10 per share). On 1.1.2018, ABC Limited offered two rights shares for every five shares held at a premium of ₹ 3 per share. X Limited, however, sold these rights entitlement in the market at ₹ 2 per share. On 1.2.2018 immediately after the shares became ex-right, the market price of the shares fell to ₹ 11.50 each. Show Investment Account up to 1.2.2018.

Solution

In the books of X Ltd.

Dr. **Investment in Equity Shares of ABC Ltd. Account** **Cr.**

Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)	Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)
1.4.17	To Balance b/d	10,000	—	1,20,000	1.2.18	By Bank A/c (Note 1)	—	—	5,000
					"	By Balance c/d	10,000	—	1,15,000
		10,000	—	1,20,000			10,000	—	1,20,000

Working Note :

	₹
(1) Sale of rights : 10,000 / 5 × 2 × ₹ 2	8,000
Less: Adjustment for fall in price (10,000 × 0.50)	5,000
Amount transferred to Statement of Profit and Loss	3,000

Tutorial Note : If in the above Illustration, the entire rights entitlement were sold for ₹ 3,000 (instead of ₹ 8,000), the balance of the investments would be shown at ₹ 1,17,000 (₹ 1,20,000 – ₹ 3,000), the income from sale of rights being adjusted against cost.

Illustration 18

On 1.4.2017, Sundar had 25,000 equity shares of X Ltd at a book value of ₹ 15 per share (face value ₹ 10). On 20.6.2017, he purchased another 5,000 shares of the company at ₹ 16 per share. The Directors of X Ltd announced a bonus and rights issue. No dividend was payable on these issues. The terms of the issue are as follows :

Bonus basis 1 : 6 (Date 16.8.2017); Rights basis 3 : 7 (Date 31.8.2017) Price ₹ 15 per share.

Due Date for payment 30.9.2017

Shareholders can transfer their rights in full or in part. Accordingly, Sundar sold $33^1/_3$% of his entitlement to Sekhar for a consideration of ₹ 2 per share.

Dividends: Dividends for the year ended 31.3.2017 at the rate of 20% were declared by X Ltd and received by Sundar on 31.10.2017. Dividends for shares acquired by him on 20.6.2017 are to be adjusted against the cost of purchase.

On 15.11.2017, Sundar sold 25,000 equity shares at a premium of ₹ 5 per share.

You are required to prepare in the books of Sundar : (i) Investment Account; and (ii) Profit and Loss Account.

For your exercise, assume that the books are closed on 31.12.2017 and shares are valued at average cost.

Solution

In the books of Sundar

Dr. Investment in Equity Shares of X Ltd. Account Cr.

Date	Particulars	No.	Dividend (₹)	Cost (₹)	Date	Particulars	No.	Dividend (₹)	Cost (₹)
1.4.2017	To Balance b/d	25,000	—	3,75,000	31.10.2017	By Bank A/c (Note 5)	—	50,000	10,000
20.6.2017	To Bank A/c	5,000	—	80,000	15.11.2017	By Bank A/c (Sale of Shares)	25,000	—	3,75,000
16.8.2017	To Bonus Issue A/c	5,000	—	—					
30.9.2017	To Bank A/c (Rights)	10,000	—	1,50,000	31.12.2017	By Balance c/d (Note 6)	20,000	—	2,64,444
15.11.2017	To Statement of Profit & Loss (Note 7)	—	—	44,444					
31.12.2017	To Statement of P/ L	—	50,000	—					
		45,000	50,000	6,49,444			45,000	50,000	6,49,444

Dr. Profit and Loss Account for the year ended 31st December, 2017 (Includes) Cr.

Particulars	₹	Particulars	₹
		By Income from Sale of Rights	10,000
		By Dividends	50,000
		By Profit on Sale of Shares	44,444

Working Notes :

(1) Bonus Shares $= \dfrac{25{,}000 \text{ Shares} + 5{,}000 \text{ Shares}}{6} = 5{,}000 \text{ Shares}$

(2) Rights Shares $= \dfrac{25{,}000 \text{ Shares} + 5{,}000 \text{ Shares} + 5{,}000 \text{ Shares}}{7} \times 3 = 15{,}000 \text{ Shares}$

(3) Rights shares subscribed = 2/3 × 15,000 = 10,000 Shares.

(4) Sale of rights entitlement = 1/3 × 15,000 × ₹ 2 = ₹ 10,000.
Amount received by selling rights entitlement will be credited to Profit and Loss Account / Statement of Profit and Loss [AS — 13, Para 13].

(5) Dividend received on shares held on 1.4.2017 = 25,000 × 10 × 20% = ₹ 50,000.
Dividend received on shares purchased on 20.6.2017 = 5,000 × 10 × 20% = ₹ 10,000 will be adjusted to Investment Account.

(6) At the time of calculating cost of shares, ₹ 10,000 (sale of rights) will not be taken into consideration. It will be treated as windfall gain and it will be credited to Statement of Profit and Loss. However, dividend received on shares purchased on 20.6.2017 — ₹ 10,000 will be taken into consideration.

Cost of 20,000 shares (average basis)

$$= \frac{(3{,}75{,}000 + 80{,}000 + 1{,}50{,}000 - 10{,}000)}{45{,}000} \times 20{,}000 = ₹\ 2{,}64{,}444$$

(7) Profit on Sale of 25,000 Shares on 15.11.2017 ₹

Sale Proceeds 3,75,000

Less : Average Cost $\frac{3,75,000 + 80,000 + 1,50,000 - 10,000}{45,000} \times 25,000$ 3,30,556

Profit on Sale 44,444

Illustration 19

On 1.6.2017 X acquired 3,000 equity shares of ₹ 10 each in ABC Ltd for ₹ 60,000 on *cum-right* basis :

ABC Ltd declared :

(a) a one for three bonus issue on 1.7.2017; and

(b) a one for four rights issue on 1.9.2017 at 20% premium.

X :

(a) took up half the rights issue;

(b) sold the remaining rights for ₹ 8 per share;

(c) sold half of its total shareholdings on 31.12.2017 for ₹ 37,000.

You are required to prepare the Investment Account for the year ended 31.12.2017.

Solution

In the books of X

Investment in Equity Shares of ABC Ltd. Account

Dr. **Cr.**

Date	Particulars	No.	Dividend (₹)	Cost (₹)	Date	Particulars	No.	Dividend (₹)	Cost (₹)
1.6.2017	To Bank A/c (Purchase)	3,000	—	60,000	1.9.2017	By Bank A/c (Note 4)	—	—	4,000
1.7.2017	To Bonus Issue	1,000	—	—	31.12.2017	By Bank A/c (Note 5)	2,250	—	37,000
1.9.2017	To Bank A/c (Rights)	500	—	6,000	31.12.2017	By Balance c/d (N 5)	2,250	—	31,000
31.12.2017	To Statement of Profit & Loss	—	—	6,000					
		4,500		72,000			4,500		72,000

Working Notes :

(1) Bonus Shares = $\frac{3,000 \text{ Shares}}{3} = 1,000 \text{ Shares}$

(2) Rights Shares = $\frac{3,000 \text{ Shares} + 1,000 \text{ Shares}}{4} = 1,000 \text{ Shares}$

(3) Rights shares subscribed = 1/2 of 1,000 = 500 shares.

(4) Sale of rights entitlement = 500 × ₹ 8 = ₹ 4,000.
Shares were purchased cum-right, therefore, amount received by selling rights will be credited to Invesment Account [AS — 13, Para — 13].

(5) Cost of shares on 31.12.2017 will be calculated as follows :

$$\frac{\text{Rs } (60,000 + 6,000 - 4,000)}{4,500} \times 2,250 = \text{Rs } 31,000$$

Profit on Sale of 2,250 Shares on 31.12.2017 ₹

Sale Proceeds 37,000

Less : Average Cost : $\frac{60,000 + 6,000 - 4,000}{4,500} \times 2,250$ 31,000

Profit on Sale 6,000

Tutorial Note : At the time of calculating cost of shares on 31.12.2017, amount received by selling rights will be deducted from the total cost of the shares as the shares were purchased **cum-right**.

Illustration 20

The following transactions of Investor Ltd. took place during the year ended 31st March 2018 :

2017

1st April Purchased ₹ 12,00,000, 8% bonds at ₹ 80.50 cum-interest. Interest is payable on 1st November and 1st May.

12th April Purchased 1,00,000 equity shares of ₹ 10 each in X Ltd. for ₹ 40,00,000.

1st May	Received half-year's interest on 8% bonds.
15th May	X Ltd made a bonus issue of three equity shares for every two held. Investor Ltd sold 1,25,000 shares for ₹ 20 each.
1st July	Purchased 50,000 equity shares of ₹ 10 each in C Ltd at ₹ 7.75 each.
1st October	Sold ₹ 3,00,000, 8% bonds at ₹ 81 ex-interest.
1st November	Received half-year's bond interest.
1st December	Received 18% dividend on equity shares in X Ltd.
2018	
1st January	C Ltd made a rights issue of one equity share for every two held at ₹ 5 per share. Rights sold in the market at ₹ 2.25 per share.
1st March	Received 12.5% dividend on equity shares in C Ltd.

Prepare the relevant investment account in the books of Investor Ltd for the year ended 31st March, 2018.

Solution

In the books of Investor Ltd.

8% Bonds Account

Dr. **[Interest Payable : 1st November & 1st May]** [~ in '000] **Cr.**

Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest (₹)	Cost (₹)
1.4.2017	To Bank A/c (Note 1)	1,200	40	926	1.5.2017	By Bank A/c	—	48	—
1.10.2017	To Statement of Profit & Loss (Note 2)	—	—	11,5	1.10.2017	By Bank A/c (Note 2)	300	10	243
					1.11.2017	By Bank A/c (Note 3)	—	36	—
31.3.2018	To Statement of Profit & Loss	—	84	—	31.3.2018	By Balance c/d (Note 4)	900	30	694,5
		1,200	124	937,5			1,200	124	937,5

Dr. **Investment in Equity Shares of X Ltd. Account** **Cr.**

Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)	Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)
12.4.2017	To Bank A/c	1,00,000	—	40,00,000	15.5.2017	By Bank A/c	1,25,000	—	25,00,000
15.5.2017	To Bonus Issue A/c	1,50,000	—	—	1.12.2017	By Bank A/c	—	2,25,000	—
15.5.2017	To Statement of Profit & Loss (Note 5)	—	—	5,00,000	31.3.2018	By Balance c/d	1,25,000	—	20,00,000
31.3.2018	To Statement of Profit & Loss	—	2,25,000	—					
		2,5,000	2,25,000	45,00,000			2,50,000	2,25,000	45,00,000

Dr. **Investment in Equity Shares of C Ltd. Account** **Cr.**

Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)	Date	Particulars	No. of Shares	Dividend (₹)	Cost (₹)
1.7.2017	To Bank A/c	50,000	—	3,87,500	1.3.2018	By Bank A/c (Dividend)	—	62,500	—
31.3.2018	To Statement of Profit & Loss	—	62,500	—	31.3.2018	By Balance c/d	50,000	—	3,87,500
		50,000	62,500	3,87,500			50,000	62,500	3,87,500

Tutorial Note : Amount received ₹ 56,250 (50,000 / 2 × 1 × ₹ 2.25) by selling rights entitlement will be credited to Profit and Loss Account / Statement of Profit and Loss [AS — 13, Para — 13].

Working Notes :

(1) On 1st April, 2017, 12,000, 8% bonds were purchased @ ₹ 80.50 cum-interest. Total amount paid 12,000 × ₹ 80.50 = ₹ 9,66,000 which includes accrued interest for 5 months, i.e., 1st November, 2014 to 1st April, 2017. Accrued interest will be : ₹ 12,00,000 × 8/100 × 5/12 = ₹ **40,000**. Therefore, cost = ₹ 9,66,000 – ₹ 40,000 = ₹ **9,26,000**.

(2) On 1st October, 2017, 3,000 bonds were sold @ ₹ 81 ex-interest. Total amount received = 3,000 × 81 + acccrued interest for 5 months = ₹ 2,43,000 + (3,00,000 × 8 / 100 × 5 / 12 = ₹ 10,000).

Profit on Sale of Bonds on 1.10.2017	₹
Sale Proceeds	2,43,000
Less : Average Cost : $\frac{9,26,000}{12,00,000}$ × ₹ 3,00,000	2,31,500
Profit on Sale	11,500

(3) On 1st November, 2017, interest will be received for 9,000 bonds @ 8% for 6 months, i.e., ₹ 9,00,000 × 8 / 100 × 1 / 2 = ₹ **36,000**.

(4) Cost of bonds on 31.3.2018 will be : ₹ 9,26,000 / 12,000 × 9,000 = ₹ **6,94,500**.

(5) **Profit on Sale of Shares :**
Cost per share after bonus = ₹ 40,00,000 / 2,50,000 = ₹ 16.
Profit per share sold (₹ 20 – ₹ 16) = ₹ 4.
Therefore, total profit on sale of 1,25,000 shares = ₹ 4 × 1,25,000 = ₹ **5,00,000**.

Previous Years' C.U. Question Papers (with Solution)

[For Honours Candidates Only]

Illustration 21

On 1.4.2014 Srijani Ltd. had 30,000 equity shares of ₹ 10 each in X Ltd. purchased for ₹ 2,80,000. On 15.07.2014 X Ltd. made a bonus issue of 1 fully paid-up share for 3 held. Again on 1.9.2014 X Ltd. offered right entitlement of 3 for 5 held on that date at a premium of ₹ 2 per share. Srijani Ltd. exercised one-fourth of its right entitlement and sold the balance at ₹ 4 each on 9.9.2014. On 20.08.2014, X Ltd. declared dividend of 10% for the year ended on 31.03.2014. Bonus shares were not considered for dividend. On 30.01.2015, Srijani Ltd. sold one-third of the right shares purchased at cost plus 25%. Show Investment Account in the books of Srijani Ltd. for the accounting year 2014-15. Apply average cost method.

[C.U.B.Com. (Hons.) — 2016]

Solution

In the books of Srijani Ltd.
Investment in Equity shares of X Ltd. Account

Dr. **Cr.**

Date	Particulars	No.	Dividend (₹)	Cost (₹)	Date	Particulars	No.	Dividend (₹)	Cost (₹)
1.4.2014	To Balance b/d	30,000	—	2,80,000	20.8.2014	By Bank A/c [Note 5]	—	30,000	—
15.7.2014	To Bonus Issue A/c	10,000	—	—	30.1.2015	By Bank A/c	2,000	—	30,000
1.9.2014	To Bank A/c (Rights) [Note 2 and 3]	6,000	—	72,000	31.3.2015	By Balance c/d	44,000	—	3,36,696
30.1.2015	To Statement of Profit and Loss [Note 6]	—	—	14,696					
31.3.2015	To Statement of Profit and Loss	—	30,000	—					
		46,000	30,000	3,66,696			46,000	30,000	3,66,696

Working Notes :

(1) Bonus Shares = $\frac{30,000}{3} \times 1$ = **10,000 shares.**

(2) Rights Shares = $\frac{30,000 + 10,000}{5} \times 3$ = **24,000 shares.**

(3) Rights Shares subscribed = 1/4 of 24,000 = **6,000 shares.**

(4) Sale of rights entitlement = 18,000 × ₹ 4 = ₹ **72,000**. Amount received by selling rights entitlement will be credited to Statement of Profit or Loss. [AS–13, Para 13]

(5) Dividend received on shares held on 1.4.2014 = 30,000 × ₹ 10 × 10% = ₹ **30,000**.

(6) At the time of calculating cost of shares, ₹ 72,000 (sale of rights) will not be taken into consideration. It will be treated as wind fall gain and it will be credited to Statement of Profit and Loss.
Cost of 2,000 shares (1/3rd of 6,000 rights shares subscribed)

$$= \frac{2,80,000 + 72,000}{46,000} \times 2,000 = ₹\ \mathbf{15,304.}$$

Sales Value of Shares sold = (72,000 × 1/3) × 125% = ₹ **30,000.**
Profit Sale of Shares = ₹ 30,000 – ₹ 15,304 = ₹ **14,696**.

Illustration 22

Mr P Das held 260, 12% Debentures in X Ltd. @ ₹ 110 on 01.04.2014. The face value of each debenture was ₹ 100. Interest on debentures are payable annually on 31.03 every year. The following were his transactions in the same debenture during 2014-15 :

01.07.2014 Bought 400 Debentures cum-interest @ ₹ 108.
01.09.2014 Bought 240 Debentures ex-interest @ ₹ 105.
01.01.2015 Sold 360 Debentures cum-interest @ ₹ 115.
He paid brokerage on purchase price / sale proceeds on debentures @ ₹ 0.02 for a rupee.
Make out Investment Account in the books of Mr P Das.

[C.U.B.Com. (Hons.) — 2015]

Solution

In the books of P Das
12% Debentures in X Ltd. Account
[Interest Payable : 31st March]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.4.2014	To Balance b/d	26,000	—	28,600	1.1.2015	By Bank A/c (Note 3)	36,000	3,240	37,332
1.7.2014	To Bank A/c (Note 1)	40,000	1,200	42,864	1.1.2015	By Statement of Profit and Loss (Note 4)	—	—	1,535
1.9.2014	To Bank A/c (Note 2)	24,000	1,200	25,704					
31.3.2015	To Statement of Profit and Loss	—	7,320	—	31.3.2015	By Bank A/c	—	6,480	—
					31.3.2015	By Balance c/d	54,000	—	58,301
		90,000	9,720	97,168			90,000	9,720	97,168

Working Notes :

(1) On 1.7.2014, 400 debentures were purchased @ ₹ 108 cum-interest. The total amount paid = 400 × ₹ 108 = ₹ **43,200** and it incudes accrued interest for 3 months (April, May and June). The amount of interest = ₹ 40,000 × $\frac{12}{100} \times \frac{3}{12}$ = ₹ 1,200. Therefore, cost of the debentures purchased = ₹ 43,200 – ₹ 1,200 = ₹ 42,000. Brokerage payable = ₹ 43,200 × 0.02 = ₹ 864. Therefore, total cost - ₹ **42,864**.

(2) On 1.9.2014, 240 debentures were purchased @ ₹ 105 ex-interest. The cost of the debentures purchased = 240 × ₹ 105 = ₹ **25,200**. Brokerage payable = ₹ 25,200 × 0.02 = ₹ 504. Therefore, total cost = ₹ 25,704. The interest paid to the seller for 240 debentures = 24,000 × $\frac{12}{100} \times \frac{5}{12}$ = ₹ **1,200**.

(3) On 1.1.2015, 360 debentures were sold @ ₹ 115 cum-interest. It means the sale proceeds of ₹ **41,400** (360 × ₹ 115) includes accrued interest for 9 months. The amount of interest = 36,000 × $\frac{12}{100} \times \frac{9}{12}$ = ₹ **3,240**. Brokerage Payable = ₹ 41,400 × 0.02 = ₹ **828**. Therefore, net amount received on sale of 360 debentures = ₹ 41,400 – 3,240 – 828 = ₹ **37,332**.

(4) **Loss on Sale of 360 Debentures on 1.1.2015**

(A) Sale Proceeds (Note 3) = ₹ 37,332.

Average cost = $\frac{28,600 + 42,864 + 25,704}{260 + 400 + 240} = \frac{97,168}{900}$ = ₹ **107.964** per Debenture

(B) Total cost of 360 Debentures = 360 × ₹ 107.964 = ₹ **38,867**.
Loss on sale of 360 Debentures = (37,332 – 38,867) = ₹ **1,535.**

Illustration 23

Following information relate to investment of X Ltd. in shares of Flow Ltd. You are required to make out Investment in Shares of Flow Ltd. Account in the Investment Ledger of X Ltd. Ignore Income Tax.

(a) On 1.4.2013, X Ltd. had 10,000 equity shares at ₹ 10 each in Flow Ltd. These shares were purchased for ₹ 1,32,000 on 7.9.2009.
(b) On 1.8.2013, X Ltd. purchase 2,000 more shares in Flow Ltd. at a premium of ₹ 3.50 per share.
(c) On 15.8.2013, Flow Ltd. made a bonus issue of 1 fully paid share for 2 shares held. In addition, on the same day right shares were issued, at 2 for 3 held, at a premium of ₹ 3. These shares not to rank for dividend for the year ending on 31.3.2013.
(d) 4,000 right shares were taken up by X Ltd., balance right being sold at ₹ 2.50 each on 25.10.2013.
(e) On 15.1.2014, Flow Ltd. paid a dividend of 10% for the year ending on 31.3.2013.
(f) On 20.2.2014, X Ltd. sold 5,000 shares of ₹ 19 per share.

[C.U.B.Com. (Hons.) — 2014]

Solution

In the books of X Ltd.

Dr. **Investment in Equity shares of Flow Ltd. Account** **Cr.**

Date	Particulars	No.	Dividend (₹)	Cost (₹)	Date	Particulars	No.	Dividend (₹)	Cost (₹)
1.4.2013	To Balance b/d	10,000	—	1,32,000	15.1.2014	By Bank A/c (Note 4)	—	10,000	2,000
1.8.2013	To Bank A/c	2,000	—	27,000	20.2.2014	By Bank A/c (Note 3)	5,000	—	95,000
15.8.2013	To Bonus Issue A/c (Note 1)	6,000	—	—	31.3.2014	By Balance c/d	17,000	—	1,61,500
15.8.2013	To Bank A/c (Rights) (Note 2 & 3)	4,000	—	52,000					
20.2.2014	To Statement of Profit and Loss (Note 5)	—	10,000	47,500					
		22,000	10,000	2,58,500			22,000	10,000	2,58,500

Working Notes :

(1) Bonus Shares = $\frac{(10,000 + 2,000)}{2} \times 1$ = **6,000 shares**.

(2) Rights Shares = $\frac{12,000}{3} \times 2$ = **8,000 shares**.

Rights taken up = 4,000 shares. The amount paid = 4,000 × ₹ 13.00 = ₹ **52,000**.

(3) Sales of Rights entitlement = 4,000 × ₹ 2.50 = ₹ 10,000. Amount received by selling rights entitlement will be credited to Statement of Profit and Loss [As-13, Para 13]

(4) Dividend received on 15.1.2014 = ₹ 1,20,000 × 10% = ₹ **12,000**. Out of ₹ 12,000, ₹ 2,000 is pre-acquisition dividend in respect of 2,000 shares purchased on 1.8.2013. therefore, it is to be deducted from the total cost of ₹ 27,000.

(5) Sale proceeds of shares sold = 5,000 × ₹ 19 = ₹ 95,000.

(6) Cost of Shares Sold = $\frac{1,32,000 + (27,000 - 2,000) + 52,000}{10,000 + 2,000 + 6,000 + 4,000} \times 5,000$

$= \frac{2,09,000}{22,000} \times 5,000 =$ ₹ **47,500**.

It is to be noted that at the time of calculating cost of shares, ₹ 10,000 (sale of rights) will not be taken into consideration. It will be treated as windfall gain and is to be credited to Statement of Profit and Loss. Profit on Sales = ₹ 95,000 – ₹ 47,500 = ₹ 47,500.

Illustration 24

On 15th March, 2012, AB Ltd. purchased ₹ 1,00,000, 9% Govt. Stock (interest payable on 31st March and 30th September) at ₹ 88.50 cum-interest (face value ₹ 100 each).

On 1st August, ₹ 20,000 stock is sold at ₹ 89 cum-interest and on 1st September ₹ 30,000 stock is sold at ₹ 89.25 ex-interest. On 31st December, the date of the Balance Sheet, the market price was ₹ 90.

Show 9% Govt. Stock Account assuming investments are current investments. ***[C.U.B.Com. (Hons.) — 2013]***

Solution

In the books of AB Ltd.

9% Government Stock Account

Dr. **[Interest Payable : 31st March & 30th September]** **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
15.3.12	To Bank A/c (Note 1)	1,00,000	4,125	84,375	31.3.12	By Bank A/c (Note 2)	—	4,500	—
1.8.12	To Statement of Profit	—	—	325	1.8.12	By Bank A/c (Note 3)	20,000	600	17,200
1.9.12	& Loss (Note 5)			1,462	1.9.12	By Bank A/c (Note 6)	30,000	1,125	26,775
	To Statement of Profit	—	—	—	30.9.12	By Bank A/c (Note 8)	—	2,250	—
	& Loss (Note 7)				31.12.12	By Balance c/d (Note 9)	50,000	1,125	42,187
31.12.12	To Statement of Profit & Loss	—	5,475	—					
		1,00,000	9,600	86,162			1,00,000	9,600	88,162

Working Notes :

(1) 1,000 Debentures were purchased on 15th March, 2012 @ ₹ 88.50 cum-interest. The cost of the investment is as follows :

Total price paid (1,000 × ₹ 88.50)	₹ 88,500
Less: Accrued interest for $5^1/_2$ months $(1,00,000 \times \frac{9}{100} \times \frac{5.5}{12})$	4,125
Cost of investment	84,375

(2) Interest received on 31st March 2012 = 1,00,000 × $\frac{9}{12}$ × $\frac{1}{2}$ = ₹ **4,500**.

(3) On 1.8.2012, 200 debentures were sold @ ₹ 89 cum-interest.

Total sale proceed (200 × ₹ 89)	17,800
Less: Accrued interest for 4 months (20,000 × $\frac{9}{12}$ × $\frac{4}{12}$)	600
Net amount received	17,200

(4) Cost of investment sold = $\frac{84,375}{1,000}$ × 200 = ₹ **16,875**.

(5) Profit on Sale of Investment = ₹ 17,200 – ₹ 16,875 = ₹ **325**.

(6) 300 debentures were sold on 1.9.2012 @ ₹ 89.25 ex-interest.

Net sale proceeds received = 300 × ₹ 89.25 = ₹ **26,775**.

Accrued interest for 6 months = 30,000 × $\frac{9}{100}$ × $\frac{5}{12}$ = ₹ **1,125**.

(7)

Net amount received from Sale	26,775
Less: Cost of investment = $\frac{84,375}{1,000}$ × 300	25,313
	1,462

(8) Interest received on 30.09.2012 = ₹ 50,000 × $\frac{9}{12}$ × $\frac{1}{2}$ = ₹ **2,250**.

(9) Current investment is valued at cost or fair value whichever is less.

Cost of investment at the year end = $\frac{84,375}{2}$ = ₹ 42,187.

Fair value (market value) = 5,000 × ₹ 90 = ₹ 45,000.
Therefore, the value of closing investment will be ₹ 42,187 (being lower than market value).

Accrued interest for 3 months (October, November and December) = 50,000 × $\frac{9}{100}$ × $\frac{3}{12}$ = ₹ **1,125**.

Illustration 25

Janaki Ltd. purchased on 15.3.2010, ₹ 1,00,000, 9% Govt. Stock (interest payable on 1st April, 1st July, 1st October and 1st January) at ₹ 88.50 cum-interest (face value ₹ 100 each).

On 01.08.2010 — ₹ 20,000 stock is sold at ₹ 89 cum-interest and on 01.09.2010 — ₹ 30,000 stock is sold at ₹ 89.25 ex-interest. On 31.12.2010, the date of the Balance Sheet, the market price was ₹ 90.

Show 9% Govt. Stock Account assuming investments are current investments. ***[C.U.B.Com. (Hons.) — 2012]***

Solution

In the books of Janaki Ltd.
9% Government Stock Account
Dr. [Interest Payable : 1st April; 1st July; 1st October and 1st January] Cr.

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
15.3.10	To Bank A/c (Note 1)	1,00,000	1,875	86,625	1.4.10	By Bank A/c (Note 2)	—	2,250	—
1.8.10	To Statement of Profit & Loss (Note 4)	—	—	325	1.7.10	By Bank A/c (Note 3)	—	2,250	—
					1.8.10	By Bank A/c (Note 4)	20,000	150	17,650
1.9.10	To Statement of Profit & Loss (Note 5)	—	—	788	1.9.10	By Bank A/c (Note 5)	30,000	450	26,775
					1.10.10	By Bank A/c (note 6)	—	1,125	—
31.12.10	To Statement of Profit & Loss	—	5,475	—	31.12.10	By Balance c/d (N 7)	50,000	1,125	43,313
		1,00,000	7,350	87,738			1,00,000	7,350	87,738

Working Notes :

(1) On 15th March, 1,000 stocks were purchased @ ₹ 88.50 cum-interest. It means that total payment of ₹ 88,500 (₹ 88.50 × 1,000) includes interest accrued upto 15th March. The amount of accrued interest = ₹ 1,00,000 × 9/100 × 2.5/12 = ₹ 1,875. Therefore, cost of investment purchased = ₹ 88,500 – ₹ 1,875 = ₹ 86,625.

(2) On 1st April, interest will be received for 3 months (January, February and March) on ₹ 1,00,000. Therefore, the amount of interest will be ₹ 1,00,000 × 9/100 × 3/12 = ₹ 2,250.

(3) On 1st July, interest will be received for 3 months (April, May and June) on ₹ 1,00,000. Therefore, the amount of interest will be ₹ 1,00,000 × 9/100 × 3/12 = ₹ 2,250.

(4) On 1st August, 200 stocks were sold @ ₹ 89 cum-interest. It means that sale proceeds of ₹ 17,800 (₹ 89 × 200) includes accrued interest for July ₹ 150 (₹ 20,000 × 9/100 × 1/12). Therefore, amount received for sale of investment ₹ 17,800 – ₹ 150 = ₹ 17,650.

Profit on Sale of ₹ 20,000 Stock on 1.8.2017	₹
Sale Proceeds	17,650
Less: Average Cost (₹ 86,625 / 1,00,000 × 20,000)	17,325
Profit on Sale	325

(5) On 1st September, 300 stocks were sold @ ₹ 89.25 ex-interest. It means ₹ 26,775 (₹ 89.25 × 300) will be received for sale of investment and in addition ₹ 450 (₹ 30,000 × 9/100 × 2/12) will be received for interest.

Profit on Sale of ₹ 30,000 Stock on 1.9.2017	₹
Sale Proceeds	26,775
Less: Average Cost (₹ 86,625 / 1,00,000 × 30,000)	25,987
Profit on Sale	788

(6) On 1st October, interest will be received for 3 months (July, August and September) on ₹ 50,000. Therefore, the amount of interest will be ₹ 50,000 × 9/100 × 3/12 = ₹ 1,125.

(7) Stock will be valued on 31st December on the basis of cost or fair value whichever is lower. In this case fair value (market price) of 500 stock is ₹ 45,000 (500 × ₹ 90), but cost of such investment as on that date is ₹ 43,313 (₹ 86,625 / ₹ 1,00,000 × ₹ 50,000). Therefore, the value of stock will be ₹ 43,313 (being lower of the two).
Accrued interest on 31st December will be ₹ 1,125 (₹ 50,000 × 9/100 × 3/12).

Illustration 26

Kolkata Capital Investment Ltd. bought and sold 6% Stock as follows, interest being payable on 31st March and 30th September each year :

2010
March 1 Bought ₹ 24,000 @ ₹ 90.875 ex-interest, brokerage ₹ 30
June 15 Sold ₹ 10,000 @ ₹ 92.625 cum-interest, brokerage ₹ 13
Aug. 1 Bought ₹ 6,000 @ ₹ 91.375 ex-interest, brokerage ₹ 8
Sept. 1 Sold ₹ 4,000 @ ₹ 93.125 ex-interest, brokerage ₹ 5
Dec. 1 Bought ₹ 12,000 @ ₹ 94.125 cum-interest, brokerage ₹ 15

Prepare Investment Account for the year ended 31st December 2010. [Detailed workings are to be given].

[C.U.B.Com. (Hons.) — 2011, Modified]

Solution

In the books of Kolkata Capital Investment Ltd.
6% Stock Account
[Interest Payable : 31st March & 30th September]

Dr. **Cr.**

Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)	Date	Particulars	Nominal Value	Interest (₹)	Cost (₹)
1.3.10	To Bank A/c (Note 1)	24,000	600	21,840	31.3.10	By Bank A/c (Note 2)	—	720	—
15.6.10	To Statement of Profit & Loss (Note 2)	—	—	25	15.6.10	By Bank A/c (Note 3)	10,000	125	9,125
					1.9.10	By Bank A/c (Note 5)	4,000	100	3,720
1.8.10	To Bank A/c (Note 4)	6,000	120	5,490	30.9.10	By Bank A/c (Note 6)	—	480	—
1.9.10	To Statement of Profit & Loss (Note 5)	—	—	74	31.12.10	By Balance c/d (Note 8)	28,000	420	25,774
1.12.10	To Bank A/c (Note 7)	12.000	120	11,190					
31.12.10	To Statement of Profit & Loss	—	1,005	—					
		42,000	1,845	38,619			42,000	1,845	38,619

Working Notes :

(1) Purchase of Stock (ex-interest) on 1.3.2010	₹	**(2) Interest for 6 months ending on 31.3.2010**	₹
Nominal Value	24,000	Interest will be received for 6 months on entire stock	
Cost (₹ 24,000 x 0.90875)	21,810	(₹ 24,000 x 6/100 x 6/12)	720
Add : Brokerage	30	**(3) Sale of Stock (cum-interest) on 15.3.2010**	
Total Cost	21,840	Nominal Value	10,000

Accrued interest payable in addition for 5 months = (₹ 24,000 x 6/100 x 5/12) =	600
(4) Purchase of stock (ex - interest) on 1.8.2010	
Nominal Value	6,000
Cost (₹ 6,000 x 0.91375)	5,482
Add : Brokerage	8
Total Cost	5,490
Accrued interest payable in addidition for 4 months (₹ 6,000 x 6/100 x 4/12)	120
(6) Interest for 6 months ending on 30.9. 2010	
Interest will be received on (₹ 24,000 + ₹ 6,000 – ₹ 10,000 – ₹ 4,000) = ₹ 16,000 for 6 months. Therefore, interest = ₹ 16,000 x 6/100 x 6/12 = ₹ 480.	
(7) Purchase of Stock (cum-interest) on 1.12.2010	
Nominal Value	12,000
Cost (₹ 12,000 x 0.94125)	11,295
Less : Accrued interest included (₹ 12,000 x 6/100 x 2/12)	120
	11,175
Add: Brokerage	15
	11,190
(8) Accrued Interest to be carried forward	
₹ 28,000 x 6/100 x 3/12	420
Balance of Investment on 31.12.2010 ₹ 14,584 + ₹ 11,190	25,774

Sale proceeds (₹ 10,000 x 0.92625)	9,263
Less : Accrued interest including therein (₹ 10,000 x 6/100 x 2.5/12)	125
	9,138
Less : Brokerage	13
Effective sale proceeds	9,125
Profit on Sale of ₹ 10,000 stock on 15.06.2010	
Sale Proceeds	9,125
Less: Average cost : $\frac{21,840}{24,000}$ = ₹ 10,000 = 0.91 x ₹ 10,000	9,100
Profit on Sale	25
Closing value = $\frac{21,840}{24,000} \times$ ₹ 14,000 = ₹ 12,740.	
(5) Sale of Stock (ex-interest) on 1.9.2010	
Nominal Value	4,000
Sale proceeds (₹ 4,000 x 0.93125)	3725
Less : Brokerage	5
Efffective sale proceeds	3,720
Accrued interest receivable in addition : (₹ 4,000 x 6/100 x 5/12) =	100
Profit on Sale of ₹ 4,000 stock on 1.09.2010	
Sale Proceeds	3,720
Less: Average cost : $\frac{12,740 + 5,490}{14,000 + 6,000} \times$ ₹ 4,000	3,646
Profit on Sale	74
Closing value = $\frac{12,740 + 5,490}{14,000 + 6,000}$ = ₹ **16,000**	

Key Points

- A **current investment** is an investment that is by its nature readily realisable and is intended to be held for ***not*** more than one year from the date on which such investment is made. The carrying amount for current investments is the lower of cost or fair value.
- A **non-current investment** is an investment other than a current investment. Non-current investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognise the decline. The resultant reduction in the carrying amount is charged to the Profit and Loss Account / Statement of Profit and Loss by creating a provision for diminution. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exists.
- **Purposes of Investment Ledger :** Investment ledger is a special type of ledger which is used by the investing company to record all the details of each investment. The main objectives of maintaining on investment ledger are as follows: (i) it facilitates proper recording of each security separately; (ii) it facilitates collection of interest and dividend as and when they are due; (iii) it helps to determine the value of securities at the end of the accounting period; and (iv) it helps to determine the profit or loss on sale of any security.
- **Meaning of Cum-interest and Ex-interest** : 'Cum' and 'Ex' are Latin words. 'Cum' means with and 'Ex' means without. The terms 'Cum-interest' and 'Ex-interest' relate to fixed interest bearing securities and come up for consideration when those securities are purchased or sold. 'Cum-interest' can be expanded as cumulative or inclusive of interest and 'Ex- interest' can be expanded as exclusive of interest.
- In connection with Cum-interest and Ex-interest, the following points are important : (i) In respect of Government securities and debentures, the price quoted is ex-interest unless otherwise stated; and (ii) In respect of Non-Government securities and debentures, it is cum-interest unless otherwise stated.

THEORETICAL QUESTIONS

1. Distinguish between fixed income bearing securities and variable income bearing securities.
2. Explain the different purposes of maintaining investment ledger.
3. (a) What is cum-interest or dividend ?
   (b) How is it adjusted in the books of account ?
4. (a) In what ways is ex-interest or dividend different from cum-interest or dividend ?
   (b) How is ex-interest or dividend treated in the books of account ?
5. How is dividend from pre-acquisition profit treated in the Investment Account ?
6. How is bonus shares treated in the Investment Account ?

PRACTICAL QUESTIONS

1. Mr. X furnishes the following details relating to his holding in 6% Government Bonds :
   Opening Balance face value ₹ 60,000 – Cost ₹ 59,000.
   1.3.2017 — 100 units purchased ex-interest at ₹ 98.
   1.7.2017 — Sold 200 ex-interest out of the original holding at ₹ 100.
   1.10.2017 — Purchased 50 units at ₹ 98 cum-interest.
   1.11.2017 — Sold 200 units ex-interest at ₹ 99 out of the original holding.
   Interest dates are 30th September and 31st March, Mr. X closes his books every 31st December. Show the Investment Account as it would appear in his books.
2. On 1.1.2017 Debentures in X Ltd. were held as investment by Y Ltd. to the tune of ₹ 15,000 at the cost of ₹ 16,000. Interest is payable half yearly on 30th June and 31st December. On 1.5.2017 ₹ 6,000 Debentures were purchased at ₹ 5,200 ex-interest and ₹ 3,000 at ₹ 3,060 ex-interest on 1.10.2017. On 1.12.2017 ₹ 2,000 Debentures were sold for ₹ 2,030 ex-interst.
   Show the Investment Account in the books of Y Ltd. Accounts are closed on 31st December every year.
3. Mr. A held on 1st January, 2017 ₹ 1,00,000 of $3^1/_2$% Government loan at ₹ 95,000. Three months interest had accrued. On 31st May he purchased a further ₹ 40,000 of the loan @ ₹ 96 (Net) cum-interest. On 31st July, ₹ 30,000 of the loan was sold at ₹ 94 (Net) ex-interest. On 30th November, ₹ 20,000 of the loan was sold at ₹ 96 (Net) cum-interest. Interest on the loan was paid each year on 31st March and 30th September and was collected on 4th April and 5th October. The price of the loan on 31st December 2017 was ₹ 96. Draw-up the Loan Account. Ignore income-tax and paise.
4. On 1.1.2017, 6%, 200 Debentures of ₹ 100 each in Y Ltd., were held as investments by X Ltd. at a cost of ₹ 18,200. Interest is payable on 31st December. On 1.4.2017, ₹ 4,000 of such debentures were purchased by X Ltd. @ ₹ 98 and on 1.9.2017 ₹ 6,000. Debentures were sold at ₹ 96 ex-interest. On 1.12.2017 ₹ 8,000 Debentures were sold @ ₹ 99 cum-interest. On 31.12.2017, X Ltd. sold ₹ 10,000 Debentures @ ₹ 95. Prepare Investment Account for 6% Debentures of Y Ltd. in the books of X Ltd. Ignore income-tax.
5. Nicco-Uco Finance Co. Ltd. had on 1st January 2017, 6% Government of West Bengal Bonds of the face value of ₹ 80,000 valued at ₹ 79,600 on which interest accrued for three months on that date. On 30th April, 2017 the company purchased more bonds of the face value of ₹ 60,000 at par (cum- interest) including brokerage and other expenses. It sold on 31st August, 2017, ₹ 40,000 of the bonds @ ₹ 99.75 (ex-interest), and on 30th November, 2017, ₹ 30,000 of them @ ₹ 100.60 (cum-interest), after deduction of brokerage and other expenses in both the cases. Interest falls due on 31st March and 30th September every year and is credited after collection by the bank after two days. On 31st December, 2017 the bonds were quoted at ₹ 99.65. Give the Investment Account of the bond in the books of the investment company.
6. On 1st April, 2017, XY & Co. Ltd. held 9% Debentures in B Ltd. of the face value of ₹ 10,000 at a cost of ₹ 8,000. Market value on that date was ₹ 9,000. Interest is payable on 31st December every year on 1st December, 2017. Debentures of nominal value of ₹ 6,000 were purchased for ₹ 5,000 ex-interest and on 31st December, 2017. Debentures of nominal value of ₹ 2,000 were sold cum-interest for ₹ 1,900.
   On 1st January, 2018 Debentures of nominal value of ₹ 6,000 were brought at ₹ 5,800. The market value of the Debentures on 31st March, 2018 was at ₹ 90. Make out 9% Debentures Account in the books of XY & Co. Ltd., showing profit and loss on sale of investment. Stocks on 31st March each year are valued at lower of cost or fair value.

7. Bonanza Limited held on 1st April, 2017 ₹ 2,00,000 of 9% Government Loan (2017) at ₹ 1,90,000 (face value of Loan ₹ 100 each). Three month's interest had accrued on the above date.
   On 31st May, 2017 the company purchased the same Government Loan of the face value of ₹ 80,000 at ₹ 95 (net) cum-interest. On 1st June, 2017, ₹ 60,000 face value of the loan was sold at ₹ 94 (net) ex-interest.
   Interest on the loan was paid each year on 30th June and 31st December and was credited by the bank on the same date. On 30th November, 2017, ₹ 40,000 face value of the Loan was sold at ₹ 97 (net) cum-interest.
   On 1st December, 2017, the company purchased the same loan ₹ 10,000 at per ex-interest. On 1st March, 2018 the company sold ₹ 10,000 face value of the loan at ₹ 95 ex-interest. The market price of the loan on 31st March, 2018 was ₹ 96. Draw up the 9% Government Loan (2017) Account in the books of Bonanza Limited.
   The loan held by the company shall be valued at total average cost or market price, whichever is lower. Calculation shall be made to the nearest rupee or multiple thereof.
8. Mr. Shape dealt on the stock exchange and had purchased and sold leading scripts but did not maintain his accounts in a proper manner. He furnished the following data :
   Investments on hand as on July 1, 2017 :
   300 — 3% Conversion loan 2017-2018 of ₹ 100 each purchased at ₹ 60.
   250 — Equity shares of ₹ 10 each of Everlite Ltd. at ₹ 18 per share.
   100 — 9% preference shares of ₹ 100 each on Prosperous Ltd. at ₹ 95 per share.
   Transactions during the year :
   Purchases : 750 equity shares of ₹ 10 each of Everlite Ltd. at ₹ 23.
   250 equity shares of ₹ 10 each of Small Ltd. at ₹ 9.
   125 equity shares of ₹ 10 each of bright shipping Ltd. at ₹ 12.
   Sold : 100 — 3% Conversion loan 2017-2018 at ₹ 65.
   100 — 9% Preference shares of Prosperous Ltd. at ₹ 99.
   Interest / Dividends received :
   3% conversion loan — interest received — ₹ 900.
   9% preference shares of Prosperous Ltd. — ₹ 9,000.
   Everlite Ltd. — Dividend at 20% on 1,000 shares — ₹ 2,000.
   Everlite Ltd. issued bonus shares and Mr. Shape received 1,000 equity shares of the company as bonus shares.
   You are required to show the Investment Account in Mr. Shape's books
9. On 1.1.2017, X Ltd. had 10,000 equity shares of ₹ 10 each in Alpha Ltd. purchased for ₹ 1,25,000. The company unlike investment companies does not make any apportionments of dividends (received or receivable) in between capital and revenue.
   On 15.5.2017, Alpha Ltd. made a bonus issue of 1 fully paid share for 2 held on 15.5.2017. In addition, on the same day rights shares were issued at 3 for 5 held on that date at a premium of ₹ 3, ₹ 7 to be paid on application and the balance in one call after a month. These shares are not to rank for dividend for the year ending 30th June, 2017. 2,000 rights shares were taken up by X Ltd. Balance rights being sold at ₹ 2 each on 25.5.2017.
   On 15.10.2017, the company declared a dividend of 20% for the year ending 30th June, 2017.
   Make out the Investment Account in the books of X Ltd. Ignore income-tax.
10. In preparing the financial statements of R Ltd for the year ended 31.3.2018, you come across the following information. State with reasons, how would you deal with them in the financial statements :
    An unquoted long-term investment is carried in the books at a cost of ₹ 2,00,000. The published accounts of the unlisted company received in March, 2018 showed that the company was incurring cash losses with declining market share and the long-term investment may not fetch more than ₹ 20,000.
11. On April 1, 2017 Singh had 20,000 equity shares in X Ltd. The face value of the shares were ₹ 10 each but their book value was ₹ 16 per share.
    On June 1, 2017, Singh purchased 5,000 more equity shares in the company at a premium of ₹ 4 per share.
    On June 30, 2017, the directors of X Ltd. issued a bonus and rights issue. Bonus was declared at the rate of one equity shares for every five shares held, and these shares were received on August 2, 2017.
    The terms of the rights issue were :
    (1) Rights shares to be issued to the existing holders on August 10, 2017.
    (2) Rights issue would entitle the holders to subscribe to additional equity shares in the company at the rate of one share per every three shares held at ₹ 15 per share — the whole sum being payable on September 30, 2017.
    (3) Existing shareholders may, to the extent of their entitlement, either wholly or in part, transfer their rights to outsiders.
    (4) Singh exercised his option of 50% of his entitlements, under the issue and the balance of rights he sold to Ananth for a consideration of ₹ 1.50 per share.

(5) Dividends for the year ended March 31, 2017 at a rate of 15% were declared by the company and received by Singh on October 20, 2017.

(6) On November 1, 2017 Singh sold 20,000 equity shares at a premium of ₹ 3 per share.

Show the Investment Account as it would appear in Singh's books as on December 31, 2017 and the value of shares held (average basis) on that date assuming the accounting year is April 1 to March 31.

12. Raghav Rathore carried out the following transactions in connection with his investments during the year ended 31 March, 2017 :

2016

April 15	Purchased ₹ 4,00,000, 12% convertible debentures in Salora Ltd at ₹ 125.50. Interest is payable on 15 September and 15 March. The debentures are convertible into equity shares of ₹ 10 each at the rate of ₹ 20 for each equity share.
June 1	Purchased ₹ 10,00,000, 12% debentures in Sumana Ltd for ₹ 11,00,000. Interest is due for payment on 1 October and 1 April.
June 15	Converted the debentures in Salora Ltd into equity shares. On this date, the market price of the shares was ₹ 20. The accrued interest to date was paid.
August 25	Received 20% dividend on the equity shares in Salora Ltd.
December 15	Salora Ltd made a rights issue of one equity share for every 20 shares held at ₹ 16 per share. The market value of shares was ₹ 20.

2017

January 10	Rathore sold the right for ₹ 3 per share.
March 15	Sold 4,000 equity shares in Salora Ltd at ₹ 25 per share.

You are required to record the above transactions in the Ledger of Rathore. Maintain separate account for each category of investment. Ignore tax and brokerage charges. Rathore's accounting year ends on 31 March.

Guide to Answers

Practical Questions

1. **Profit on sale of investment — ₹ 467 (Total);**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 3,375;
   Cost of Investment at the end of the year — ₹ 34,367 (Face value ₹ 35,000).
2. **Profit on sale of investment — ₹ 10;**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 1,567;
   Cost of investment at the end of the year — ₹ 22,267 (Face value — ₹ 22,000).
3. **Profit on sale of investment — ₹ 83;**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 4,347;
   Cost of investment at the end of the year — ₹ 85,667 (Face value — ₹ 90,000).
4. **Profit on sale of investment — ₹ 680;**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 1,220;
   Cost of investment at the end of the year — ₹ 9,500.
5. **Profit on sale of investment — ₹ 330;**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 6,250.
6. **Profit on sale of investment — ₹ 120;**
   Interest transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 1,170;
   Cost of investment at the end of the year — ₹ 17,200 (Face value — ₹ 20,000).
7. **Nominal value — ₹ 1,12,000; Amount — ₹ 1,68,500;**
   Interest — ₹ 18,525.
8. **3% Conversion Loan : Profit on sale — ₹ 500;**
   Value of investment at the year end — ₹ 12,000.
   Equity Shares (Everlite Ltd.) :
   Value of investment at the year end — ₹ 21,750.
   9% Preference Shares : Profit on sale — ₹ 400,
   Value of investment at the year end — ₹ 85,500.
9. **Dividend transferred to Profit and Loss Account / Statement of Profit and Loss — ₹ 20,000;**
   Cost of investment at the end of the year — ₹ 1,51,000. (Face value ₹ 1,70,000).
   Sale of rights entitlement = ₹ 8,000 (4,000 × ₹ 2) will be credited to Profit and Loss Account / Statement of Profit and Loss as per AS—13, Para 13.
10. **A provision for diminution of ₹ 1,80,000 should be made to recognise this permanent decline in value.**

11. Cost of investment at the end of the year — ₹ 1,96,111;
Loss on sale of shares ₹ 1,429. (Sale of rights for ₹ 7,500 will be credited to Profit and Loss Account / Statement of Profit and Loss as the shares were not purchased cum-rights.)

12. (a) Cost of debentures purchased on 15th April — ₹ 4,98,000 (₹ 5,02,000 – ₹ 4,000).
(b) Sale of rights entitlement ₹ 4,000 will be credited to Profit and Loss Account / Statement of Profit and Loss.
Profit on sale of 4,000 shares in Salora Ltd. on 15th March, 2017 — ₹ 400.
(c) Cost of investment in equity shares of Salora Ltd. at the year end — ₹ 3,98,400.
(d) Cost of investment in 12% debentures of Sumana Ltd. at the year end — ₹ 10,80,000.

11

Business Acquisition

Section A : Profit or Loss Prior to Incorporation

Introduction

In many cases, a new company is formed exclusively to acquire an existing business unit and take it over as a going concern, from a date prior to its ***own incorporation***. In such cases, the business unit is purchased first, and the registration of the acquiring company takes place later. ***For example***, Sarvottam Pvt. Ltd. is incorporated on 1st April, 2018 to take over the running business of Uttam Bros. from 1st January, 2018. The profit earned (or loss suffered) during the pre-incorporation period (in our example: 1st January to 31st March 2018) is called ***profit (loss) prior to incorporation***. Legally, this profit is not available for distribution as dividend, since a company cannot earn profit before it comes into existence. However, profit earned after incorporation is available for distribution as dividend. Profit earned before incorporation is a ***capital profit*** and profit earned after incorporation is a ***revenue profit***.

After incorporation, a public limited company is required to obtain a certificate of commencement of business. Here, the question may arise as to whether the pre-acquisition profit to be calculated based on the date of incorporation or date of obtaining certificate of commencement ?

It is a common practice that the date of incorporation should be taken as the basis for calculation of pre-acquisition profit since obtaining a certificate of commencement of business is purely a legal formality.

The accounting treatment of pre-incorporation profit (or loss) is totally different from Post-incorporation profit (or loss). Thus, it is necessary to compute both the amount of pre- and post-incorporation profit (loss).

Methods of Computing Profit Prior to Incorporation

There are different methods of computing profit prior to incorporation. They are:

First Method

Under this method, a separate Profit and Loss Account is prepared for the pre-incorporation period as distinguished from Profit and Loss Account for post-incorporation period. On the incorporation date, stock is taken, a Final Account is prepared, and the old books of account are closed.This method of profit determination, though simple and accurate, is inconvenient and expensive because the business activities have to be suspended for a few days for stock taking.

For the above reasons, this method is not generally followed in practice. In the books of the new company, acquisition entries are passed on the same date after taking into consideration the assets and liabilities on the date of incorporation, which thus would include the results ***up to that date***.

The entries are:

(i) Land & Building Account	Dr.	At the value on the date of incorporation
Plant & Machinery Account	Dr.	
Sundry Debtors Account	Dr.	
Stock Account	Dr.	
Cash at Bank	Dr.	
Cash in Hand	Dr.	
To Liabilities Account		
To Vendors Account		At the value on the date of incorporation
(ii) Vendors Account	Dr.	Purchase consideration
To Equity Share Capital Account		

Second Method

Under this method profit is calculated as follows:

Step 1 Prepare a Trading Account for the entire period (pre- and post-incorporation periods combined).

Step 2 Allocate gross profit and expenses (indirect) between pre- and post-incorporation period on the basis of the following principles:

(i) Gross profit is allocated in the ***ratio of sales*** of each period.

(ii) Fixed portion of an expense is allocated on ***the basis of time***.

(iii) Expenses related to sales, e.g., traveller's commission, discount allowed; advertisement; salaries of salesmen; carriage outward; after-sales service cost, etc, are allocated on ***the basis of sales***.

(iv) Expenses related to time, e.g., rent, rates and taxes; insurance; depreciation, salaries of general staff, etc. are allocated on ***the basis of time***.

(v) Expenses which are exclusively related to pre- or post-incorporation period must be charged entirely to that period's profit. Some examples are:

(a) Preliminary expenses, director's fees, debenture interest, etc are to be charged against post-incorporation profit.

(b) Partner's salaries, interest on partners' capital, etc are to be charged against the profit of pre-incorporation period.

Students should remember the following for ready reference :

List of Expenses which are Allocated in Ratio of Sales		List of Expenses which are Allocated on Basis of Time	
1.	Gross Profit	1.	Rent, Rates and Taxes
2.	Bad Debts	2.	Depreciation
3.	Discount Allowed	3.	Salaries of General Staff
4.	Carriage Outwards	4.	Insurance
5.	Selling Expenses	5.	Interest on Purchase Consideration
6.	Salesmen's Commission	6.	Audit Fees
7.	Advertisement Expenses	7.	General Expenses

8.	Delivery Expenses	8.	Printing and Stationery
9.	Free Samples	9.	Office Expenses
10.	After-sales service cost	10.	Fixed Expenses
11.	Salaries of Salesmen	11.	Miscellaneous Expenses
12.	Sales Promotion Expenses	12.	Fixed Distribution Expenses
13.	Variable Distribution Expenses	13.	Administrative Expenses
		14.	General Travelling Expenses

Step 3 Net profit/loss of respective periods are calculated after deducting apportioned expenses and acquisition entries are passed at the ***end of the accounting year***.

Accounting Treatment of Pre-incorporation Profit/Loss

Profit Prior to Incorporation

Any profit prior to incorporation may be dealt with as follows:

(a) Credited to Capital Reserve Account
(b) Credited to Goodwill Account to reduce the amount of goodwill arising from acquisition of business.
(c) Utilised to write down the value of fixed assets acquired.

Loss Prior to Incorporation

Any loss prior to incorporation may be dealt with as follows:

(a) Debited to Goodwill Account
(b) Debited to Capital Reserve Account arising from acquisition of business.
(c) Debited to a Suspense Account, which can be written-off later as a fictitious asset.

Accounting Treatment of Post-incorporation Profit/Loss

Any profit / loss after incorporation is transferred to Profit and Loss Appropriation Account. Post-incorporation profit can be distributed as dividend.

Illustration 1

Star Ltd was incorporated on 1st July, 2017 to acquire a running business with effect from 1st April, 2017. The accounts for the year ended 31st March, 2018 disclosed the following :

(i) There was a gross profit of ₹ 3,00,000.
(ii) The sales for the year amounted to ₹ 12,00,000 of which ₹ 2,40,000 were for the first six months.
(iii) The expenses debited to the Profit and Loss Account included — directors' fees : ₹ 15,000; bad debts : ₹ 3,600; advertising : ₹ 12,000 (under a contract amounting to ₹ 1,000 per month); salaries and general expenses : ₹ 64,000; preliminary expenses written off ₹ 5,000; and donation to a political party given by the company ₹ 5,000.

Prepare a statement showing the amount of profit made before and after incorporation.

Solution **Star Ltd.**

Statement Showing Apportionment of Profit between Pre- and Post- incorporation Period

Particulars	Notes	Basis	Total ₹	Pre-incorporation 1.4.2017 to 30.6.2017 (3 months)	Post-incorporation 1.7.2017 to 31.3.2018 (9 months)
Gross Profit (A)	1	Sales (1:9)	3,00,000	30,000	2,70,000
Less : **Expenses** (B)					
Bad Debts		Sales (1:9)	3,600	360	3,240
Advertising		Direct	12,000	3,000	9,000
Salaries and General Expenses	2	Time (1:3)	64,000	16,000	48,000
Director's Fees	3	Direct	15,000	—	15,000
			94,600	19,360	75,240

Net Profit (A – B)		2,05,400	10,640	1,94,760
Less: **Appropriations** :				
Preliminary Expenses (Note 4)	5,000			
Donation (Note 4)	5,000	10,000	—	10,000
		1,95,400	10,640	1,84,760
			Capital Profit	Net Profit

Tutorial Note : Capital profit is transferred to **Capital Reserve Account** and Net profit is transferred to **Statement of Profit and Loss**.

Working Notes :

(1) Total sales for the year 2017-18 = ₹ 12,00,000. Sales for the first 6 months (1.4.2017 to 30.9.2017) = ₹ 2,40,000. Therefore, sales per month during first 6 months = ₹ 2,40,000 / 6 = ₹ 40,000.
In effect, sales of first three months (1.4.2017 to 30.6.2017) = ₹ 40,000 × 3 = ₹ 1,20,000.
Sales of next nine months (1.7.2017 to 31.3.2018) = ₹ 12,00,000 – ₹ 1,20,000 = ₹ 10,80,000.
Ratio of Sales = 1,20,000 : 10,80,000 = 1 : 9. It is assumed that sales are evenly occurred during first six months.

(2) These expenses generally accrue evenly throughout the year and are, therefore, divided on the ***time basis***, i.e., 3 : 9 or 1 : 3.

(3) Directors' fees are paid in case of company only. These must naturally be shown in the post-incorporation period.

(4) Preliminary expenses and donation are not charges against profit. These are treated as appropriations.

Illustration 2

The promoters of proposed New Wave Ltd. purchased a running business on 1st January, 2017 from Mr. Ultra Modern. New Wave Ltd was incorporated on 1st May, 2017. The combined Profit and Loss Account of the company prior to and after the date of incorporation is as under:

Profit & Loss Account for the year ended on 31.12.2017

	₹		₹
To Rent, rates, insurance, electricity & salaries	12,000	By Gross profit	1,50,000
To Directors' sitting fees	3,600	By Discount received from creditors	6,000
To Preliminary expenses	4,900		
To Carriage outwards and selling expenses	5,500		
To Interest paid to Vendors	10,000		
To Profit	1,20,000		
	1,56,000		1,56,000

Following further information is available:

(1) Sales up to 30.4.2017 were ₹ 3,00,000 out of total sales of ₹ 15,00,000 of the year.

(2) Purchases up to 30.4.2017 were ₹ 300,000 out of total purchases of ₹ 9,00,000 of the year.

(3) Interest paid to Vendors on 1.11.2017 @ 12% p.a on ₹ 1,00,000 being purchase consideration.

From the above information, prepare Profit & Loss Account for the year ended 31st December, 2017, showing the profit earned prior to and after incorporation and also show the transfer of the same to the appropriate accounts.

Solution

New Wave Ltd.

Statement of Profit and Loss for the year ended 31st December, 2017

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit	(1)	1,50,000	30,000	1,20,000
Discount Received	(7)	6,000	2,000	4,000
Total (A)		1,56,000	32,000	1,24,000
Less: Expenses (B)				
Rent, Rates and Insurance, Electricity and Salaries	(2)	12,000	4,000	8,000
Directors' Sitting Fees	(3)	3,600	—	3,600
Preliminary Expenses	(4)	4,900	—	4,900
Carriage Outward	(5)	5,500	1,100	4,400
Interest o Vendor	(6)	10,000	4,000	6,000
		36,000	9,100	26,900
Net Profit (A – B)		1,20,000	22,900 Capital Profit	97,100 Revenue Profit
Transferred to			Capital Reserve	Statement of Profit and Loss

Working Notes:

(1) For 4 months to 30th April, sales amounted to ₹ 3,00,000 and for the remaining 8 months, sales were (₹ 15,00,000 - ₹ 3,00,000) ₹ 12,00,000. Gross profit is apportioned in the ratio of 3:12 or 1:4 (assuming the gross rate was uniform throughout the year).

Therefore, the gross profit is apportioned as: Pre — $\frac{1,50,000}{5} \times 1$ = ₹ 30,000. Post — $\frac{1,50,000}{5} \times 4$ = ₹ 1,20,000.

(2) These expenses generally accrue evenly throughout the year and are therefore divided on the time basis, pre:post 4 months : 8 months or 1:2.

(3) Directors' sitting fees and preliminary expenses are generally found in case companies. These must naturally be shown in post-incorporation period.

(4) Strictly, to Appropriation Account. Alternatively, it can be written off against post-incorporation profit.

(5) Carriage outward has been apportioned in the ratio of sales, i.e.

Pre — $\frac{5,500}{5} \times 1$ = ₹ 1,100 Post — $\frac{5,500}{5} \times 4$ = ₹ 4,400

(6) Interest accrues on the basis of time. Therefore it is divided on the time basis. Interest has been paid for a total of 10 months (January to October). 4 months related to pre-incorporation period and 6 months to post-incorporation period. Therefore, it is split as:

Pre — $\frac{10,000}{10} \times 4$ = ₹ 4,000 Post — $\frac{10,000}{10} \times 6$ = ₹ 6,000

(7) For 4 months to 30th April, purchases amounted to ₹ 3,00,000 and for the remaining 8 months, purchases were: (₹ 9,00,000 - 3,00,000) = ₹ 6,00,000.

Discount received is apportioned in the ratio of 3:6 or 1:2. Therefore discount received is apportioned as:

Pre — $\frac{6,000}{3} \times 1$ = ₹ 2,000. Post — $\frac{6,000}{3} \times 2$ = ₹ 4,000.

Illustration 3

From the following information, calculate the ratio of Sales in each case separately.

(a) (i) Date of acquisition — 1st April, 2017; date of incorporation — 1st July, 2017 and date of closing the books of accounts — 31st March, every year.

(ii) The sales for the year ending on 31st March, 2018 were ₹ 24,00,000 of which ₹ 4,80,000 were sold during the first six months of the accounting period.

(b) (i) The accounts were made up to 31st December, 2017. The company was incorporated on 1st May, 2017 to take over a business from the preceding 1st January.

(ii) Total sales for the year were ₹ 12,00,000. It is ascertained that the sales for November and December are one and half times the average of those for the year, whilst those for February and April are only half the average.

(c) (i) X Ltd. was incorporated on 1st July, 2017 to take the existing business of X from 1st April, 2017. Date of closing the books of account — 31st March, 2018.

(ii) Monthly sales in April 2017, February 2018 and March 2018 are double the average monthly sales for remaining months of the year.

(d) (i) S. Ltd. was incorporated on 1st August, 2017, to take over the running business of Kabir Bros. with effect from 1st April, 2017. The company received the certificate of commencement of business on 1st October, 2017.

(ii) Total sales for the year, which amounted to ₹ 16,00,000 arose evenly upon the date of certificate of commencement, whereafter they recorded an increase of 2/3rd during the remaining period.

[C.U.B.Com. (Hons.) — Adapted]

Solution

(a) Sales of first 6 months = ₹ 4,80,000. Average sale of first 6 months = ₹ 4,80,000 / 6 = ₹ 80,000 per month.

Pre-incorporation period consist of 3 months (i.e., April, May and June). The sales of those 3 months = ₹ 80,000 × 3 = ₹ 2,40,000. Sales of remaining 9 months = ₹ 24,00,000 – ₹ 2,40,000 = ₹ 21,60,000.

Therefore, the ratio of sales = ₹ 2,40,000 : ₹ 21,60,000 or 1 : 9.

(b) Let the average of monthly sales = x. The sales of different months can be shown as follows :

Month	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec
Sales	1x	0.5x	1x	0.5x	1x	1x	1x	1x	1x	1x	1.5x	1.5x

Date of incorporation

The ratio of Sales = 3x : 9x or 1 : 3.

(c) Let the average monthly sales be x. The sales of different months can be shown as follows:

Month	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March
Sales	$2x$	$1x$	1x	1x	1x	1x	1x	1x	1x	1x	2x	2x

Date of incorporation

The ratio of sales = $4x$: $11x$ or 4 : 11.

(d) Let the average monthly sales = x. The sales of different months can be shown as follows :

Month	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March
Sales	$1x$	$1x$	1x	1x	1x	1x	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$

Date of incorporation   Certificate of commencement

The ratio of sales = $4x$: $12x$ or 1 : 3.

Illustration 4

A firm which was carrying on business from 1st January, 2017 gets itself incorporated as a company on 1st May, 2017. The first accounts are drawn up to 30th September, 2017. The gross profit for the period is ₹ 56,000. The general expenses are ₹ 14,220; directors' fees ₹ 12,000 p.a.; formation expenses ₹, 1,500. Rent up to 30th June is ₹ 1,200 p.a., after which it is increased to ₹ 3,000 per annum. Salary of the manager, who upon incorporation of the company was made a director, is ₹ 6,000 p.a. His remuneration thereafter is included in the above figure of fees to directors.

Give Profit and Loss Account showing pre-and post-incorporation profits. The net sales are ₹ 8,20,000, the monthly average of which for the first four months of 2017 is one half of that of the remaining period. the company earned a uniform profit. Interest and tax may be ignored.

Solution   Statement of Profit and Loss for 9 months ended on 30th September, 2017

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit (A)	(1)	56,000	16,000	40,000
Less : Expenses (B) :				
General Expenses	(2)	14,220	6,320	7,900
Directors' Fees	(3)	5,000	—	5,000
Formation Expenses	(4)	1,500	—	1,500
Rent	(5)	1,350	400	950
Manager's Salary	(6)	2,000	2,000	—
		24,070	8,720	15,350
Net Profit (A – B)			7,280 Capital Profit	24,650 Revenue Profit
Transferred to			Capital Reserve	Statement of Profit and Loss

Working Notes:

(1) Let the average monthly sales of first four months be ₹ 100. Then the average monthly sales of next five months will be ₹ 200. Total sales of first four months = ₹ 100 x 4 = ₹ 400 and that of next five months = ₹ 200 x 5 = ₹ 1,000. The ratio of sales = 400:1000 or 2:5.

The gross profit is apportioned on the basis of sales, i.e. 2:5. Therefore, the gross profit is apportioned as:

Pre — $\frac{56{,}000}{7} \times 2$ = ₹ 16,000   Post — $\frac{56{,}000}{7} \times 5$ = ₹ 40,000.

(2) General expenses accrue evenly throughout the period and are, therefore, divided on the basis of time.

Pre — $\frac{14{,}220}{9} \times 4$ = ₹ 6,320   Post — $\frac{14{,}220}{9} \times 5$ = ₹ 7,900.

(3) Directors' fees payable @ ₹ 1,000 per month. It is to be found in company only.
So ₹ 5,000 (5 x ₹ 1,000) must naturally be shown in post-period incorporation period.

(4) Strictly, to Appropriation Account. Alternatively, it can be written-off against pre-incorporation profit.

(5) Rent for first four months = ₹ 100 x 4 = ₹ 400. For next five months = (₹ 100 x 2) + (₹ 250 x 3) = ₹ 950.
(6) Salary to manger is related to pre-incorporation period only. Salary to be charged = ₹ 500 x 4 = ₹ 2,000.

Illustration 5

Star Pvt. Ltd. was incorporated on 1st March, 2017 to acquire a running business with effect from 1st January, 2017. The purchase consideration was agreed at ₹ 90,000 to be satisfied by issue of :

3,000 equity shares of ₹ 10 each fully paid-up and ₹ 60,000, 8% Debentures.

The following Profit and Loss Account for the year ended 31st December, 2017 is presented to you :

Particulars	₹	Particulars	₹
Staff Salary	12,000	Gross Profit	80,000
Selling and Distribution Expenses	6,000		
Rent and Rates	4,200		
Debenture Interest	3,600		
Bad Debt (there was no cash sales)	1,000		
Preliminary Expenses	25,000		
Interest on Purchase Consideration	2,250		
Balance	25,950		
	80,000		80,000

You obtain the following additional information :

(i) Sales for the year was ₹ 4,00,000, whereas sales incurred by the Company after incorporation was ₹ 3,00,000.
(ii) The shares and 8% Debentures were issued to the Vendor on 1st April, 2017.
(iii) Interest at 10% per annum was paid on the purchase consideration from 1st January, 2017 to the date of payment.

Prepare a Statement showing the amount of profit made before and after incorporation.

[C.U,B.Com. (Hons.) — Adapted]

Solution

Star Pvt. Ltd.
Statement Showing the Profit Before and After Incorporation

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit (A)	(1)	80,000	20,000	60,000
Less : Expenses (B) :				
Staff Salary	(2)	12,000	2,000	10,000
Selling and Distribution Expenses	(3)	6,000	1,500	4,500
Rent and Rates	(4)	4,200	700	3,500
Debenture Interest	(5)	3,600	—	3,600
Bad Debts	(6)	1,000	250	750
Preliminary Expenses		25,000	—	25,000
Interest on Purchase Consideration		2,250	1.500	750
		54,050	5,950	48,100
Net Profit (A – B)		25,950	14,050 Capital Profit	11,900 Revenue Profit
Transferred to			Capital Reserve	Statement of Profit and Loss

Working Notes :

(1) Total sales for the year = ₹ 4,00,000. Post-incorporation sales = ₹ 3,00,000. Therefore, pre-incorporation profit = ₹ 4,00,000 – 3,00,000 = ₹ 1,00,000.
Ratio of sales between pre-incorporation period and post-incorporation period = 1,00,000 : 3,00,000 = 1 : 3.
The gross profit is apportion on the basis of sales, i.e., 1 : 3. Therefore, gross profit is apportioned as :

Pre — $\frac{80,000}{4} \times 1$ = ₹ 20,000; Post — $\frac{80,000}{4} \times 3$ = ₹ 60,000

(2) Staff salary is divided on the basis of time :

Pre — $\frac{12,000}{12} \times 2$ = ₹ 2,000 Post — $\frac{12,000}{12} \times 10$ = ₹ 10,000

(3) Selling and distribution expenses are divided in the ratio of sales, i.e., 1 : 3.

Pre — $\frac{6,000}{4} \times 1 =$ ₹ 1,500 Post — $\frac{6,000}{4} \times 3 =$ ₹ 4,500

(4) Rent and rates are divided in the ratio of time, i.e., 2 : 10

Pre — $\frac{4,200}{12} \times 2 =$ ₹ 700 Post — $\frac{4,200}{12} \times 10 =$ ₹ 3,500

(5) Debenture interest is related to post-incorporation period.

(6) Bad Debts are related to sales. Therefore, bad debts are to be divided in the ratio of sales, i.e., 1 : 3.

Pre — $\frac{1,000}{4} \times 1 =$ ₹ 250 Post — $\frac{1,000}{4} \times 3 =$ ₹ 750.

(7) Interest on Purchase Consideration is payable for 3 months (1st January to 31st March). Total Interest = ₹ 90,000 × 10% × 3/12 = ₹ 2,250.

Pre-incorporation period's Interest = 2,250 / 3 × 2 = 1,500; **Post-incorporation period's Interest** = ₹ 2,250 / 3 × 1 = 750

Illustration 6

Mr. X formed a private limited company under the name and style of Exe Pvt. Ltd. to take over his existing business as from first April 2017, but the company was not incorporated until First July 2017.

No entries relating to transfer of the business were entered in the books, which were carried on without a break till 31st March, 2018.

The following balances were extracted from the books as on 31st March, 2018.

Heads of Account	Dr.	Cr.
Opening Stock	43,000	
Purchases	1,89,000	
Carriage Outwards	3,300	
Travellers' Commission	7,500	
Office Salaries	21,000	
Administration expenses	19,900	
Rent and Rates	12,000	
Director's fee	18,000	
Fixed assets	1,00,000	
Current Assets excluding stock	34,000	
Preliminary expenses	5,200	
Sales		2,78,000
Mr X's capital A/c on 1.4.2017		2,30,000
Current Liabilities		37,000

You are also given that:

(a) Stock on 31st March, 2018, ₹ 44,000.

(b) The gross profit ratio is constant and monthly sales in April 2017, February 2018 and March 2018 are double the average monthly sales for remaining months of the year.

(c) The purchase consideration was agreed to be satisfied by the issue of 3,000 equity shares of ₹ 100 each.

(d) The preliminary expenses are to be written off.

(e) You are to assume that carriage outwards and travellers' commission vary in direct proportion to sales.

You are required to prepare Profit and Loss Account for the year ended on 31st March, 2018, apportioning the profit or loss of the periods before and after incorporation. Depreciation shall be provided at 25% p.a. on fixed Assets.

[C.U.B.com. (Hons.) — Adapted]

Solution

Exe Pvt. Ltd.
Statement of Profit and Loss for the year ended 31st March, 2018

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit (A)	(1)	90,000	24,000	66,000
Less : Expenses (B) :				
Carriage Outwards	(2)	3,300	880	2,420
Traveller's Communication	(2)	7,500	2,000	5,500
Office Salaries	(2)	21,000	5,250	15,750
Administrative Expenses	(3)	19,900	4,975	14,925
Rent and Rates	(3)	12,000	3,000	9,000
Director's Fees	(4)	18,000	—	18,000
Preliminary Expenses	(5)	5,200	—	5,200
Depreciation	(6)	25,000	6,250	18,750
		1,11,900	22,355	89,545
Net Profit (A – B)		(21,900)	1,645 Capital Profit	(23,545) Revenue Loss
Transferred to			Capital Reserve	Statement of Profit and Loss

Working Notes:

In this problem the gross profit has not been given. so, first of all, a statement is to be prepared for calculating gross profit.

(1) Calculation of Gross Profit

		₹
Sales		2,78,000
Less: Cost of goods sold		
Opening Stock	43,000	
Add: Purchases	1,89,000	
	2,32,000	
Less: Closing Stock	44,000	1,88,000
Gross Profit		90,000

Gross profit is apportioned in the ratio of sales which is calculated as follows:

Let the average monthly sales of April 2017, February 2018 and March 2018, be ₹ 100, then average monthly sales of remaining 9 months are ₹ 50. Therefore, the sales of pre-incorporation and post-incorporation period will be:

Pre-incorporation period	₹	Post-incorporation period	₹
April, 2017	100	July 2017 to Jan 2018 @ ₹ 50	350
May, 2017	50	February, 2018	100
June, 2017	50	March, 2018	100
	200		550

Therefore, sales ratio = 20:55 or 4:11. Gross profit of pre-incorporation period

$= \frac{90,000}{15} \times 4 =$ ₹ 24,000 and that of Post-incorporation period $= \frac{90,000}{15} \times 11 =$ ₹ 66,000

(2) Carriage outwards: Pre — $\frac{3,300}{15} \times 4 =$ ₹ 880 ; Post — $\frac{3,300}{15} \times 11 =$ ₹ 2,420

Travellers' commission : Pre — $\frac{7,500}{15} \times 4 =$ ₹ 2,000 ; Post — $\frac{7,500}{15} \times 11 =$ ₹ 5,500

(3) These expenses accrue evenly throughout the year and are therefore divided on the time basis, i.e. 3:9.

(4) Directors' fees are paid in case of company only. These must naturally be shown in post-incorporation period.

(5) Strickly to Appropriation Account, it can be written-off against pre-incorporation profit.

(6) Depreciation is apportioned on the basis of time, i.e. 3:9 or 1:3.

Illustration 7

Kalyan Kumar formed a private limited company under the name of Kalyan Pvt. Ltd. to take over his existing business as from April 1, 2017, but the company could not be incorporated till July 1, 2017. No entries relating to transfer of the business were entered in the books, which were carried on without a break till March 31, 2018. The following Trial Balance was extracted from the books as on March 31, 2018:

Heads of Account	Dr.	Cr.
Inventory, April 1, 2017	4,300	
Sales		27,800
Purchases	18,900	
Carriage outwards	330	
Travellers' commission	750	
Office salaries and expenses	2,100	
Rent and rates	1,200	
Kalyan Kumar's Capital A/c, April 1, 2017		23,000
Directors' Fees	1,800	
Fixed assets — Tangible	13,400	
Current liabilities		3,700
Current assets (other than stock)	11,200	
Preliminary expenses	520	
TOTAL	54,500	54,500

You are also given the following information:

(a) Inventory on March 31, 2018, ₹ 4,400.

(b) The purchase consideration was agreed at ₹ 30,000 to be satisfied by the the issue of 3,000 equity shares of ₹ 10 each.

(c) The gross profit margin is constant and the monthly sales in April, 2017, February, 2018 and March, 2018 are double the monthly sales for the remaining months of the year.

(d) The preliminary expenses are to be written-off.

(e) You are to assume that carriage outwards and travellers' commission vary in direct proportion to sales.

You are required to calculate Gross Profit and prepare a Statement of Profit and Loss for the year ended March 31, 2018 apportioning the periods before and after incorporation, and a Balance Sheet as on that date. Ignore depreciation.

Solution

Kalyan Pvt. Ltd.
Calculation of Gross Profit

Particulars		₹
Sales		27,800
Add : Closing Stock		4,400
		32,200
Less : Purchases	18,900	
Less: Opening Inventories	4,300	23,200
Gross Profit		9,000

Statement of Profit and Loss for the year ended 31st March, 2018

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit (A)	(3)	9,000	2,400	6,600
Less : Expenses (B) :				
Carriage Outward	(4)	330	88	242
Travellers' Commission	(4)	750	200	550
Office Salaries	(5)	2,100	525	1,575
Rent and Rates	(5)	1,200	300	900
Directors' Fees	(6)	1,800	—	1,800
Preliminary Expenses	(7)	520	—	520
		6,700	1,113	5,587
Net Profit (A – B)		2,300	1,287 Capital Profit	1,013 Revenue Profit
Transferred to			Capital Reserve	Statement of Profit and Loss

Balance Sheet of Kalyan Pvt. Ltd. as at 31st March, 2018

Particulars	Note No.	(₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	30,000
(b) Reserves and Surplus	(2)	2,300
(2) Share Application Money Pending Allotment :		
(3) Non-current Liabilities :		
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		3,700
(d) Short-term Provisions		—
TOTAL		36,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(8)	13,400
(ii) Intangible Assets — Goodwill	(9)	7,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		4,400
(c) Trade Receivables		—
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		11,200
TOTAL		36,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Issued, Subscribed and Paid-up Capital :	
3,000 Equity Shares of ₹ 10 each (Issued for consideration other than cash)	30,000
(2) Reserve and Surplus	
(i) Capital Reserve — Pre-incorporation Profit	1,287
(ii) Profit and Loss	1,013
	2,300

Working Notes:

(3) to **(7)** are similar to previous ***Illustration***.

(8) These figures are subject to depreciation.

(9) Goodwill represents the difference between the amount of purchase consideration and balance of capital of Kalyan. ₹ 30,000 – ₹ 23,000 = ₹ 7,000.

Illustration 8

The partners of Maitri Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st January, 2017. The consideration was agreed at ₹ 1,17,00,000 based on the firm's Balance Sheet as at 31st December, 2016.

However, due to some procedural difficulties, the company could be incorporated only on 1st April, 2017. Meanwhile, the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% p.a. The same books of accounts were continued by the company which closed its account for the first time on 31st March, 2018.

Prepare the following summarised Profit and Loss Account (all figures in ₹):

Sales	2,34,00,000
Cost of goods sold	1,63,80,000
Salaries	11,70,000
Depreciation	1,80,000
Advertisements	7,02,000
Discounts	11,70,000
Managing director's remuneration	90,000
Miscellaneous office expenses	1,20,000
Office-cum-showroom rent	7,20,000
Interest	9,51,000
	2,14,83,000
Profit	19,17,000

The company's only borrowing was a loan of ₹ 50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm, from 1st April 2017 but the salaries trebled from that date. It had to occupy additional space from 1st July, 2017, rent for which was ₹ 30,000 p.m.

Prepare a Statement of Profit and Loss in columnar form apportioning costs and revenue between pre-incorporation and post- incorporation periods. Also, suggest, how the pre-incorporation profits are to be dealt with.

MA (P) Ltd.

Statement of Profit and Loss for 15 months ended on 31st March, 2018

Particulars	Note No.	Total ₹	Pre-incorporation* ₹ ('000)	Post-incorporation** ₹ ('000)
Gross Profit (A)	(1)	7,020	780	6,240
Less : Expenses (B) :				
Salaries	(2)	1,170	90	1,080
Depreciation	(3)	180	36	144
Advertisement	(4)	702	78	624
Discounts	(4)	1,170	130	1,040
MD's Remuneration	(5)	90	—	90
Miscellaneous Office Expenses	(3)	120	24	96
Rent	(6)	720	90	630
Intereset	(7)	951	351	600
		5,103	799	4,304
Net Profit (A – B)		1,917	(19) Capital Loss	1,936 Revenue Profit
Transferred to			Goodwill	Statement of Profit and Loss

* Pre-incorporation period = 3 months (1.1.2017 to 31.3.2017)

** Post-incorporation period = 12 months (1.4.2017 to 31.3.2018)

Pre-incorporation profit may be dealt with as follows :

(i) Credited to Capital Reserve;

(ii) Credited to Goodwill Account to reduce the amount of goodwill;

(iii) Utilise to reduce the value of fixed assets acquired.

Working Notes:

(1) Gross profit = Sales – Cost of goods sold = ₹ 2,34,00,000 – 1,63,80,000 = ₹ 70,20,000.

Gross Profit is apportioned in the ratio of sales which is calculated as follows:

Let , the average monthly sales of 3 months ending on 31st March, 2017 = ₹ 100.The average monthly sales of remaining 12 months starting from 1st April 2017 = ₹ 100 x 2 =200. The total sales of pre-incorporation period will be = 100 x 3 = ₹ 300 and that of post-incorporation period will be ₹ 200 x 12 = 2400. Therefore, the ratio of sales will be: 3:24 or 1:8.

Gross profit of Pre — $\frac{70,20,000}{9} \times 1$ = ₹ 7,80,000

Post — $\frac{70,20,000}{9} \times 8$ = ₹ 62,40,000

(2) Let, the pre-incorporation monthly salary =₹ 100 . Therefore, the monthly salary of post-incorporation period = ₹ 100 x 3 = 300. Total salary of pre-incorporation period =₹ 100 x 3 =300 and that of post-incorporation period =₹ 300 x 12 = 3,600. Hence, the ratio = 300 : 3,600 or1:12

(3) These expenses have been apportioned on the basis of time:3:12 or1:4.

(4) Advertisement and discounts are apportioned in the ratio of sales i.e., 1:8.

(5) **Managing Directors' remuneration is related to post-incorporation period.**

(6) Rent to be apportioned as follows:

Total rent as per Profit and Loss Account	= ₹ 7,20,000
Less : Additional rent for 9 months @ ₹ 30,000	= ₹ 2,70,000
Rent of old premises for 15 months	₹ 4,50,000

Therefore, rent of pre-incorporation period is calculated as = $\frac{4,50,000}{15} \times 3$ = ₹ 90,000

and that of post-incorporation period = $\frac{4,50,000}{15} \times 12$ + ₹ 2,70,000 = ₹ 6,30,000.

(7) Interest for the pre-incorporation period is calculated as

$\frac{12}{100} \times \text{Rs } 1,17,00,000 \times \frac{3}{12} = \text{Rs } 3,51,000.$

The balance interest (₹ 9,51,000 – ₹ 3,51 000) = ₹ 6,00,000 is related to post-acquisition period.

(8) Treatment of Pre-incorporation Loss:
Pre-incorporation loss can be treated in the books of accounts in any of the following manners:
(a) It can be debited to Goodwill Account;
(b) It can be debited to Capital Reserve Account arising from acquisition transaction.

Illustration 9

Chaitanya Industries Private Ltd was incorporated on 1.2.2017. It took over the proprietary business of Chaitanya, with effect from 1.1.2017. The Balance Sheet of Chaitanya as at 31st December 2016 is as follows:

Liabilities	₹	Assets	₹
Capital	4,31,500	Sundry debtors	25,700
Trade creditors	17,000	Building	1,10,000
Loans	8,500	Machinery	3,00,000
Creditors expenses	2,500	Loss	23,800
	4,59,500		4,59,500

It was agreed to pay ₹ 4,50,000 in equity shares to Chaitanya. The company decided to close its first year's accounts as at 31st December 2017. The following are the further details furnished to you:

Sales ₹ 3,00,000; Purchases ₹ 1,40,000; Salaries and wages ₹ 40,000; General expenses ₹ 32,000; Freight ₹ 4,700; Interest paid ₹ 8,000; Inventories ₹ 22,000; Additions to building ₹ 38,000; Depreciation may be provided at 10% on assets including additions.

The company has requested you to prepare:

(1) the journal entries for the take-over;
(2) Chaitanya's Account; and
(3) A Statement of Profit and Loss showing separately pre-incorporation and post-incorporation profits for the year ending 31st December 2017.

Solution **In the Books of Chaitanya Industries (Pvt.) Ltd.**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017	Goodwill A/c (Balancing figure)	Dr.	42,300	
Jan. 1	Building A/c	Dr.	1,10,000	
	Machinery A/c	Dr.	3,00,000	
	Sundry Debtors A/c	Dr.	25,700	
	To Loan A/c			8,500
	To Trade Creditors A/c			17,000
	To Creditors for Expenses A/c			2,500
	To M/s Chaitanya (Vendors) A/c			4,50,000
	(Being sundry assets and liabilities of M/s Chaitanya taken over as per agreement dated ...)			

M/s Chaitanya (Vendors) A/c To Equity Shares Capital A/c (Being the issue of shares for satisfying purchase consideration)	Dr.	4,50,000	4,50,000

Dr. M/s Chaitanya Account Cr.

Particulars	₹	Particulars	₹
To Share capital	4,50,000	By Sundries (net assets taken over)	4,50,000
	4,50,000		4,50,000

Working Notes:

(1) Calculation of Gross Profit

Sales		3,00,000
Purchases	1,40,000	
Freight	4,700	
	1,44,700	
Less: Closing Inventories	22,000	1,22,700
		1,77,300

For lack of information, Gross Profit and all expenses have been apportoned on the basis of time, i.e., 1 : 11.

(2) Depreciation on Building : 10% (₹ 1,10,000 + ₹ 38,000) = ₹ 14,800.

Chaitanya Industries (Pvt.) Ltd.
Statement of Profit and Loss for the year ended 31st December, 2017

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit (A)	(1)	1,77,300	14,775	1,62,525
Less : Expenses (B) :				
Salaries and Wages		40,000	3,333	36,667
General Expenses		32,000	2,667	29,333
Interest Paid		8,000	667	7,333
Depreciation on :				
Building	(2)	14,800	1,233	13,567
Machinery		30,000	2,500	27,500
		1,24,800	10,400	1,14,400
Net Profit (A – B)		52,500	4,375 Capital Profit	48,125 Revenue Profit
Transferred to			Capital Reserve	Statement of Profit and Loss

Illustration 10

The Sai Deep Ltd. was incorporated on 1st August, 2017, to take over the running business of Krishna Bors with effect from 1st April, 2017. The company received the certificate of commencement of business on 1st October, 2017. The following Profit and Loss Account was prepared for the year ended 31st March, 2018 :

Dr. Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars	₹
To Office Salaries	21,000	By Gross Profit b/d	80,000
To Partners' Salaries	6,000	By Share Transfer Fees	1,000
To Advertisement	4,400		
To Printing & Stationery	1,500		
To Travelling Expenses	4,000		
To Office Rent	9,600		
To Electricity Charges	900		
To Auditors Charges	600		
To Directors Charges	1,000		
To Bad Debts	1,200		
To Commission on Sales	4,000		
To Preliminary Expenses	700		
To Debenture Interest	1,800		

To Interest on Capital	1,600		
To Depreciation	2,100		
To Net Profit	20,600		
	81,000		81,000

Additional information :

(1) Total Sales for the year, which amounted to ₹ 8,00,000 arose evenly up to the date of certificate of commencement, whereafter they recorded an increase of 2/3 during the remaining period. Gross profit was an uniform rate of 10% of selling price throughout the year and a commission of 0.5% was paid on sales.

(2) Office rent was paid @ ₹ 8,400 p.a. up to 30th September, 2017 and thereafter it was paid @ ₹ 10,800 p.a.

(3) Travelling expenses include ₹ 1,600 towards sales promotion.

(4) Bad Debts written off—

(a) A debt of ₹ 400 taken over from the vendor;

(b) A debt of ₹ 800 in respect of goods sold in September 2017.

Depreciation includes ₹ 600 for assets acquired in the post-incorporation period.

Show the "pre" and "post" incorporation results and also state how the results of pre- and post-incorporation is dealt with.

Solution

Sai Deep Ltd.

Statement of Profit and Loss for the year ended 31st March, 2018

Particulars	Note No.	Total ₹	Pre-incorporation ₹	Post-incorporation ₹
Gross Profit	(1)	80,000	20,000	60,000
Share Transfer Fees	(17)	1,000	—	1,000
Total (A)		81,000	20,000	61,000
Less : Expenses (B) :				
Office Salaries	(2)	21,000	7,000	14,000
Partners' Salaries	(3)	6,000	6,000	—
Advertisement	(4)	4,400	1,100	3,300
Printing and Stationery	(5)	1,500	500	1,000
Travelling Expenses	(6)	2,400	800	1,600
Sales Promotion	(6a)	1,600	400	1,200
Office Rent	(7)	9,600	2,800	6,800
Electricity Charges	(8)	900	300	600
Auditor's Charges	(9)	600	200	400
Directors' Charges	(10)	1,000	—	1,000
Bad Debts	(11)	1,200	400	800
Commission on Sales	(12)	4,000	1,000	3,000
Preliminary Expenses	(13)	700	—	700
Debenture Interest	(14)	1,800	—	1,800
Interest on Capital	(15)	1,600	1,600	—
Depreciation	(16)	2,100	700	1,400
		60,400	22,800	37,600
Net Profit (A – B)		20,600	(2,800) Capital Loss	23,400 Revenue Profit
Transferred to			Goodwill Account	Statement of Profit and Loss

Working Notes :

(1) Let the average monthly sales = x. The sales of different months can be shown as follows:

Month	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March
Sales	1x	1x	1x	1x	1x	1x	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$

Date of incorporation   Certificate of commencement

Ratio of sales = 4x : 12x or 1 : 3.

Gross Profit is apportioned in the ratio of sales:

Pre — $\frac{80,000}{4} \times 1 =$ ₹ 20,000 ; Post — $\frac{80,000}{4} \times 3 =$ ₹ 60,000

The date of incorporation is 1st August, 2017. The date of obtaining Certificate of Commencement is 1st October, 2017. It is common practice that the date of incorporation should be taken as the basis of calculation of pre-acquisition profit.

(2) Pre-incorporation period consist of 4 months and post-incorporation period consist of 8 months. Therefore, the ratio of time = 4 : 8 or 1 : 2. Office salaries are apportioned in the ratio of time.

Pre — $\frac{21,000}{3} \times 1 =$ ₹ 7,000 ; Post — $\frac{21,000}{3} \times 2 =$ ₹ 14,000

(3) Partners' salary is exclusively related to pre-acquisition period.

(4) Advertisement is apportioned in the ratio of sales.

Pre — $\frac{4,400}{4} \times 1 =$ ₹ 1,100 ; Post — $\frac{4,400}{4} \times 3 =$ ₹ 3,300

(5) Printing and staionery is apportioned in the ratio of time , i.e., 1 : 2.

Pre — $\frac{1,500}{3} \times 1 =$ ₹ 500 ; Post — $\frac{1,500}{3} \times 2 =$ ₹ 1,000

(6) Travelling expenses are apportioned in the ratio of time, i.e., 1 : 2.

Pre — $\frac{2,400}{3} \times 1 =$ ₹ 800 ; Post — $\frac{2,400}{3} \times 2 =$ ₹ 1,600

(6a) Promotion expenses are apportioned in the ratio of sales, i.e., 1 : 3.

Pre — $\frac{1,600}{4} \times 1 =$ ₹ 400 ; Post — $\frac{1,600}{4} \times 3 =$ ₹ 1,200

(7) Office rent is to be apportioned on actual basis.

Pre — $\frac{8,400}{12} \times 4 =$ ₹ 2,800 ; Post — $\frac{8,400}{12} \times 2 + \frac{10,800}{12} \times 6 =$ ₹ 5,400 + ₹ 1,400 = ₹ 6,800

(8) Electricity charges are apportioned in the ratio of time, i.e., 1 : 2.

Pre — $\frac{900}{3} \times 1 =$ ₹ 300 ; Post — $\frac{900}{3} \times 2 =$ ₹ 600

(9) Auditor's charges are apportioned in the ratio of time, i.e., 1 : 2.

Pre — $\frac{600}{3} \times 1 =$ ₹ 200 ; Post — $\frac{600}{3} \times 2 =$ ₹ 400

(10) Directors' charges are paid in case of company only. These must naturally be shown in the post-incorporation period.

(11) Bad debts are to be apportioned on actual basis : Pre — ₹ 400; Post — ₹ 800.

(12) Commission on sales is apportioned in the ratio of sales, i.e., 1 : 3.

Pre — $\frac{4,000}{4} \times 1 =$ ₹ 1,000 ; Post — $\frac{4,000}{4} \times 3 =$ ₹ 3,000

(13) Preliminary expenses are related to post-incorporation period.

(14) Debentures interest is related to post-incorporation period.

(15) Interest on capital is related to pre-acquisition period.

(16) Depreciation is apportioned in the ratio of time, i.e., 1 : 2.

Pre — $\frac{2,100}{3} \times 1 =$ ₹ 700 ; Post — $\frac{2,100}{3} \times 2 =$ ₹ 1,400

(17) Share transfer fees are related to post-incorporation period.

Previous Years' C.U. Question Papers (with Solution)

[For General Candidates Only]

Illustration 11

From the following information, calculate the ratio of sales between pre-incorporation and post-incorporation period in each case separately :

(a) (i) X Ltd. was incorporated on 1.7.2016 to take the existing business of Mr P from 01.04.2016. Date of closing the books of accounts is 31.03.2017.

(ii) Monthly sales in April 2016, February 2017, March 2017 are double the average monthly sales for remaining months of the year.

(b) (i) S Ltd. was incorporated on August 1, 2016 to take over the running business of Bhadury Bros. with effect from 1.4.2016. The company received the certificate of commencement of business on 1.10.2016.

(ii) Total sales for the year 2016-17 was ₹ 16,00,000 arose evenly upon the date of commencement of certificate, whereafter they recorded an increase of 2/3rd during the remaining period.

[C.U.B.Com. (General) — 2017]

Solution

(a) Let the average of monthly sales = x. The sales of different months can be shown as follows :

Month	April '16	May '16	June '16	July '16	Aug '16	Sept '16	Oct '16	Nov '16	Dec '16	Jan '17	Feb '17	Mar '17
Sales	2x	1x	1x	1x	1x	1x	1x	1x	1x	1x	2x	2x

Date of incorporation

The ratio of Sales = $4x : 11x$ or 4 : 11.

(b) Let the average monthly sales be x. The sales of different months can be shown as follows:

Month	April '16	May '16	June '16	July '16	Aug '16	Sept '16	Oct '16	Nov '16	Dec '16	Jan '17	Feb '17	Mar '17
Sales	1x	1x	1x	1x	1x	1x	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$

Date of incorporation Date of commencement

The ratio of sales = $4x : (2x + \frac{30}{3}x)$

or $4x : 12x$ or 1 : 3.

(1) Sales of pre-incorporation period = $\frac{16,00,000}{4} \times 1 =$ ₹ 4,00,000.

(2) Sales of post-incorporation period = $\frac{16,00,000}{4} \times 3 =$ ₹ 12,00,000.

> ***Tutorial Note*** : Date of issue of commencement certificate has nothing to do with the calculation of pre-incorporation and post-incorporation profit. The ***date of incorporation*** is the main factor for deciding pre-incorporation and post-incorporation period.

Illustration 12

Silver Ltd. was incorporated on 30th September, 2014 to take over the business of Mr Amal with effect from 1st April, 2014. The financial accounts of the business for the year ended 31st March, 2015 disclosed the following information :

Particulars	₹	₹
Sales : April to September, 2014	1,20,000	
October, 2014 to March, 2015	1,80,000	3,00,000
Less: Purchases : April to September, 2014	75,000	
October,2014 to March, 2015	1,20,000	1,95,000
Gross Profit		1,05,000
Less : Salaries	15,000	

Selling Expenses	3,000	
Depreciation	1,500	
Directors' Remuneration	750	
Debenture Interest	90	
Administrative Expenses	4,500	24,840
Profit for the year		80,160

You are required to prepare a statement apportioning the profit between the prior to and after incorporation of Silver Ltd.

[C.U.B.Com. (General) — 2016]

Solution **Silver Ltd.**

Statement Showing Apportionment of Profit between Pre- and Post-Incorporation Period

Particulars	Note No.	Basis	Total ₹	Pre-incorporation 6 Months (₹)	Post-incorporation 6 Months (₹)
Gross Profit **(A)**	(1)	Actual	1,05,000	45,000	60,000
Less : Expenses (B) :					
Salaries		Time	15,000	7,500	7,500
Selling Expenses		Sales (2 : 3)	3,000	1,200	1,800
Depreciation		Time	1,500	750	750
Directors' Remuneration		Post	750	—	750
Debenture Interest			90	—	90
Administrative Expenses			4,500	2,250	2,250
			24,850	11,700	13,140
Net Profit (A – B)			80,160	33,300	48,860

Working Note :

(1) Calculation of Gross Profit :

Pre-acquisition period (April to September) : ₹ 1,20,000 – 75,000 = ₹ **45,000**.

Post-acquisition period (October to March) : ₹ 1,80,000 – 1,20,000 = ₹ **60,000**.

Illustration 13

A company was incorporated on 1st May, 2013 to take over business of a going concern from 1st January of the same year. The total turnover for the year ended 31st December was ₹ 2,00,000 (detailed as ₹ 60,000 for the period up to 1st May and ₹ 1,40,000 for the following period). The gross profit is ₹ 70,000 and the Profit and Loss Account is given below. Ascertain the profit prior to incorporation.

Particulars	₹	Particulars	₹
Rent & Taxes	3,240	Gross Profit	70,000
Fuel	2,040		
Interest on Loan	1,200		
Carriages	3,000		
Bank Charges	420		
Repairs	1,380		
General Office Expenses	2,400		
Bad Debt	600		
Salaries	7,800		
Directors' Fees	2,000		
Insurance	720		
Discount Allowed	5,000		
Commission on Sales	10,000		
Net Profit	30,200		
	70,000		70,000

[C.U.B.Com. (General) — 2014]

Solution

Statement Showing the Profit Before and After Incorporation

Particulars	Note No.	Basis	Total ₹	Pre-incorporation (Jan. to April) (₹)	Post-incorporation (May to Dec.) (₹)
Gross Profit **(A)**		Sales (3 : 7)	70,000	21,000	49,000
Less : Expenses (B) :					
Rates and Taxes		Time (1 : 2)	3,240	1,080	2,160
Fuel		Time (1 : 2)	2,040	680	1,360
Interest on Loan		Time (3 : 7)	1,200	400	800
Carriage		Sales (1 : 2)	3,000	900	2,100
Bank Charges		Time (1 : 2)	420	140	280
Repairs		Time (1 : 2)	1,380	460	920
General Office Expenses		Time (3 : 7)	2,400	800	1,600
Bad Debts		Sales (1 : 2)	600	180	420
Salaries		Time (1 : 2)	7,800	2,600	5,200
Directors' Fees		Post	2,000	—	2,000
Insurance		Time (1 : 2)	720	240	480
Discount Allowed		Sales (3 : 7)	5,000	1,500	3,500
Commission on Sales		Sales (3 : 7)	10,000	3,000	7,000
			39,800	11,980	27,800
Net Profit (A – B)			30,200	9,020	21,180

[For Honours Candidates Only]

Illustration 14

From the following information, calculate the ratio of sales in each case separately.

(a) (i) Date of acquisition — 1st April, 2014; Date of incorporation — 1st July, 2014 and Date of closing the books of accounts — 31st March every year.

(ii) the sales for the year ending on 31st March 2015 were ₹ 24,00,000 of which ₹ 4,80,000 were sold during the first six months of the accounting period.

(b) (i) The accounts were made up to 31st March, 2015. The company was incorporated on 1st August, 2014 to take over a business from the preceding 1st April.

(ii) Total sales for the year were ₹ 12,00,000. It is observed that the sales for February and March 2015 are one and half times of the average of those for the year, whilst those for May and July 2014 are only half of the average.

(c) (i) S Ltd. was incorporated on 1st July, 2014 to take the existing business of P from 1st April, 2014. Date of closing the books of accounts — 31st March, 2015.

(ii) Monthly sales in April 2014, February 2015 and March 2015 are double the average monthly sales for remaining months of the year.

(d) (i) D Ltd. was incorporated on 1st August, 2014 to take over the running of SRK Bros. with effect from 1st April, 2014. The company received the certificate of commencement of business on 1st October, 2014.

(ii) Total sales for the year, which amounted to ₹ 32,00,000 arose evenly upon the date of certificate of commencement, whereafter sales recorded an increase of $^{2}/_{3}$rd during the remaining period.

[C.U.B.Com. (Hons.) — 2016]

Solution

(a) Sales for first 6 months = ₹ 4,80,000. Average sales of first 6 months = ₹ 4,80,000 / 6 = ₹ 80,000 per month. Pre-incorporation period consist of 3 months (i.e., April, May and June). The sales of these 3 months = ₹ 80,000 × 3 = ₹ 2,40,000. Sales of remaining 9 months = ₹ 24,00,000 – ₹ 2,40,000 = ₹ 21,60,000. Therefore, the ratio of sales = ₹ 2,40,000 : ₹ 21,60,000 or **1 : 9**.

(b) Let the average monthly sales be x. The sales of different months can be shown as follows :

Month	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Sales	1x	0.5x	1x	0.5x	1x	1x	1x	1x	1x	1x	1.5x	1.5x

Date of Incorporation

Ratio of Sales = 3x : 9x or **1 : 3**.

(c) Let average monthly sales be x. The sales of different months can be shown as follows :

Month	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Sales	2x	1x	1x	1x	1x	1x	1x	1x	1x	1x	2x	2x

↓ Date of Incorporation

The ratio of sales = 4x : 11x or **4 : 11**.

(d) Let average monthly sales be x. The sales of different months can be shown as follows :

Month	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Sales	1x	1x	1x	1x	1x	1x	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$

↓ Date of Incorporation ↓ Certificate of Commencement

The ratio of sales = 4x : 12x or **1 : 3.**

Illustration 15

C Ltd. was incorporated on 1.8.2013 to take over the business of K with effect from 1.4.2013; certificate of commencement was however, received on 1.10.2013. Given below is the Profit and Loss Account for the year ended 31.03.2014 :

Particulars	₹	Particulars	₹
Office Salaries	21,000	Gross Profit	1,20,000
Office Rent	9,600	Share Transfer Fees	1,000
Auditors Charges	600		
Directors Charges	1,000		
Administrative Expenses	18,000		
Commission on Sales	4,000		
Preliminary Expenses	700		
Debenture Interest	1,600		
Interest on Capital	1,800		
Depreciation	2,100		
Net Profit	60,600		
	1,21,000		1,21,000

Additional information : Sales for the year arose evenly upto the date of certificate of commencement, thereafter they recorded an increase on 2/3. Rate of GP was at a uniform.

Office rent was paid @ ₹ 8,400 p.a. upto 30.9.2013 and thereafter @ ₹ 10,800 p.a.

Show the pre and post incorporation results. ***[C.U.B.Com. (Hons.) — 2014]***

Solution

Statement Showing Apportionment of Profit between Pre- and Post-Incorporation

Particulars	Note No.	Basis	Total ₹	Pre-incorporation 4 Months (₹)	Post-incorporation 8 Months (₹)
Gross Profit	(1)	Sales (1 : 3)	1,20,000	30,000	9,000
Share Transfer Fees		Direct (Post)	1,000	—	1,000
Total (A)			1,21,000	30,000	91,000
Less : Expenses (B) :					
Office Salaries		Time (1 : 2)	21,000	7,000	14,000
Office Rent	(2)	As per Contract	9,600	2,800	6,800
Auditor's Charges		Time (1 : 2)	600	200	400
Directors' Charges		Direct (Post)	1,000	—	1,000
Administrative Expenses		Time (1 : 2)	18,000	6,000	12,000
Commission on Sales		Sales (1 : 3)	4,000	1,000	3,000
Preliminary Expenses		Direct (Post)	700	—	700
Debenture Interest		Direct (Post)	1,600	—	1,600
Interest on Capital		Direct (Pre)	1,800	1,800	—
Depreciation		Time (1 : 2)	2,100	700	1,400
Total (B)			60,400	19,500	40,900
Net Profit (A – B)			60,600	10,500	50,100

Working Notes : (1) Calculation of Ratio of Sales
Let the average monthly sales be x. The sales of different months can be shown as follows:

Month	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March
Sales	$1x$	$1x$	$1x$	$1x$	$1x$	$1x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$	$1\frac{2}{3}x$

Date of incorporation (end of July) Date of commencement (end of Sept)

The ratio of sales = $4x : (2x + \frac{30}{3}x)$

or $4x : 12x$ or 1 : 3.

(2) Calculation of Rent

(i) April, 2013 to September, 2013 = $\frac{8,400}{12}$ = ₹ 700 p.m.

(ii) October, 2013 to March, 2014 = $\frac{10,800}{12}$ = ₹ 900 p.m.

(a) Rent for pre-incorporation period = ₹ 700 × 4 = ₹ **2,800**.

(b) Rent for post-incorporation period = (₹ 700 × 2) + (900 × 6) = ₹ **6,800**.

Key Points

- Any profit prior to incorporation may be dealt with as follows:
  (a) Credited to Capital Reserve Account
  (b) Credited to Goodwill Account to reduce the amount of goodwill arising from acquisition of business.
  (c) Utilised to write down the value of fixed assets acquired.
- Any loss prior to incorporation may be dealt with as follows:
  (a) Debited to Goodwill Account
  (b) Debited to Capital Reserve Account arising from acquisition of business.
  (c) Debited to a Suspense Account, which can be written-off later as a fictitious asset.
- Profit earned before incorporation is a ***capital profit*** and profit earned after incorporation is a ***revenue profit***.
- It is a common practice that the date of incorporation should be taken as the basis for calculation of pre-acquisition profit since obtaining a certificate of commencement of business is purely a legal formality.

THEORETICAL QUESTIONS

1. Explain the different methods of computing profit prior to incorporation.
2. State the accounting treatment of pre-incorporation profit / loss.
3. State the accounting treatment of post-incorporation profit / loss.
4. Write short notes on:
   (a) Profit prior to incorporation; (b) Loss prior to incorporation;
   (c) Certificate of incorporation; (d) Certificate of commencement of business.

PRACTICAL QUESTIONS

1. Shiva and Bishnu working in partnership registered a Joint Stock Company under the name of "Om Bishnu Ltd" on 1st September, 2017 to take over their existing business with effect from 1st April, 2017. (all figures in ₹)

Dr. Profit & Loss Account for the year ended 31.03.2018 Cr.

To Salaries & wages	10,000	By Gross Profit b/d	84,000
To Debentures interest	5,000		
To Depreciation	2,000		
To Interest on purchase consideration (upto 30.9.2017)	10,800		
To Selling commission	12,000		
To Director's fees	800		

To Preliminery expenses written-off	1,000		
To Provision for taxes	5,000		
To Dividend on equity shares @ 5%	6,000		
To Balance carried down	31,400		
	84,000		84,000

Sales for the year totalled ₹ 2,25,000, out of which ₹ 1,50,000 related to the period from 1st September, 2017, to 31st March, 2018.

Prepare a statement apportioning the profits between post- and pre- incorporation period indicating your basis of allocation. ***[I.C.W.A. (Inter) — Adapted]***

2. Pawan Ltd was incorporated on 1st March, 2018 and received its certificate of commencement of business on 1st April, 2018. The company bought the business of Pramod Ltd with effect from 1st November, 2017. From the following figures relating to the year ending October, 2018, find out the profit available for dividends :
   (i) Sales for the year were ₹ 3,00,000 out of which sales upto 1st March were ₹ 1,25,000.
   (ii) Gross profit for the year was ₹ 90,000.
   (iii) Expenses debited to the Profit and Loss Account were :

	₹
Rent	4,500
Salaries	7,500
Directors' fees	2,400
Interest on debentures	2,500
Audit fees	750
Discount on sales	1,800
Depreciation	12,000
General expenses	2,400
Advertising	9,000
Stationery and printing	1,800
Commission on sales	3,000
Bad debts	*750
Interest to vendor on purchase consideration upto 1.5.2018	1,500

*₹ 250 relate to debts created prior to incorporation.

[C.S. (Inter) — Adapted]

3. A company was incorporated on 1st May, 2017 to take over a business from the preceding 1st January. The accounts were made upto 31st December, 2017 as usual and the Trading and Profit and Loss Account gave the following result:

Particulars	₹	Particulars	₹
To Opening Stock	1,40,000	By Sales	12,00,000
To Purchases	9,10,000	By Closing Stock	1,50,000
To Gross Profit c/d	3,00,000		
	13,50,000		13,50,000
To Rent, Rates and Insurance	18,000	By Gross Profit b/d	3,00,000
To Director's Fees	20,000		
To Salaries	51,000		
To Office Expenses	48,000		
To Travellers' Commission	12,000		
To Discounts	15,000		
To Bad Debts	3,000		
To Audit Fees	8,500		
To Depreciation	6,000		
To Debenture Interest	4,500		
To Net Profit	1,14,000		
	3,00,000		3,00,000

It is ascertained that the sales for November and December are one and half times the average of those for the year, whilst those for February and April are only half the average.

Apportion the year's profit between the pre-incorporation and the post-incorporation period.

[C.S. (Inter) — Adapted]

4. Sarvottam Ltd was incorporated on January 1, 2017 with an authorised capital of ₹ 50,000 to take over the running business of Uttam Bros. from October 1, 2016. The following is the summarised Profit and Loss Account for the year ending September 30,2017.

	₹	₹
Sales from 1.10.2016 to 31.12.2016	60,000	
Sales from 1.1.2017 to 30.9.2017	1,90,000	2,50,000
Cost of Sales for the year	1,54,000	
Administrative expenses	17,680	
Selling commission	8,750	
Goodwill written-off	2,000	
Interest to Vendors (loan repaid on 1.2.2017)	3,730	
Distribution expenses (60% variables)	12,500	
Preliminary expenses	3,300	
Debenture interest	3,200	
Depreciation	4,440	
Directors' fees	1,000	2,16,600
Net profit		33,400

The company deals in only one product. The cost of sales per unit was reduced by 10% in the post-incorporation period, as compared to the pre-incorporation period.

Prepare a statement showing the net profit of the pre-and post-incorporation period. Also show the basis of apportionment. ***[C.S. (Inter) — Adapted]***

5. Adarsh Udyog Ltd incorporated on 1st May, 2017, received the certificate to commence business on 31st May, 2017. It had acquired a running business from Gupta and Co with effect from 1st January, 2017. The purchase consideration was ₹ 50,00,000 of which ₹ 10,00,000 was to be paid in cash and ₹ 40,00,000 in the form of fully paid shares. The company also issued shares for ₹ 40,00,000 for cash. Machinery costing ₹ 25,00,000 was then installed. Assets acquired from the vendors were : machinery — ₹ 30,00,000; stock — ₹ 6,00,000; and patents — ₹ 4,00,000.

During the year 2017 the total sales were ₹ 1,80,00,000, the sales per month in the first half-year being one-half of what they were in the latter half-year.

The net profit of the company, after charging the following expenses, was ₹ 10,00,000 :

Depreciation—₹ 5,40,000; Audit fees — ₹ 26,000; Director's fees —₹ 60,000; Preliminary expenses—₹ 10,000; Office expenses — ₹ 2,40,000; Selling expenses — ₹ 1,98,000; Interest to vendors — ₹ 50,000

Ascertain the pre-incorporation and post-incorporation amounts of profit and prepare the Balance Sheet of the company as on 31st December, 2017. The closing stock was valued at ₹ 7,00,000. ***[C.S. (Inter) — Adapted]***

6. X and Y who were working as partners formed a limited company in the name of XY(P) Ltd, on 1st June, 2017 to take over their existing business, with the consideration being a sum of ₹ 4,80,000 and the condition that until the amount was discharged, they would pay interest @6% p.a. from 1st January, 2017. The amount was paid on June 30, 2017. To discharge the purchase consideration, the company issued 30,000 Equity Shares of ₹ 10 each at a premium of ₹ 1 each for cash and allotted 7% Debentures of the face value of ₹ 2,00,000 to the vendors at par. The following was the Profit and Loss Account of XY (P) Ltd for the year ended 31.12.2017.

Dr.			Cr.
To Purchases including stock	2,00,000	By Sales	2,70,000
To Freight and cartage	10,000	By Closing stock	21,000
To Gross profit c/d	81,000		
	2,91,000		2,91,000
To Salaries and wages	15,000	By Gross Profit b/d	81,000
To Debenture interest	7,000		
To Depreciation	1,500		
To Interest on purchase consideration	14,400		
To Selling commission	13,500		
To Directors' fees	1,200		
To Preliminary expenses written-off	1,800		
To Provision for taxation	8,000		
To Dividend on equity shares	7,500		
To Balance c/d	11,100		
	81,000		81,000

You are required to prepare a statement apportioning the balance between the post- and pre-incorporation periods assuming that the sales in the post-incorporation period were double the same in the pre-incorporation period. Show how these figures would appear in the Balance Sheet of XY (P) Ltd. ***[C.S. (Inter) — Adapted]***

7. A decides to convert his business into a limited company with effect from 1st January, 2017 and issues for cash 10,000 equity shares of ₹ 10 each at par to his friends and customers. From the proceeds vendor was paid ₹ 80,000 plus the amount of reimbursement of his outlay in the formation of the company amounting to ₹ 4,200, the balance due being settled by the allotment of the remaining 2,000 shares at par on new book opened.

Trial Balance as at 31st December, 2017

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Capital (₹ 64,000 on 1.1.2017)	20,000		Bad debts	1,450	
Formation expenses	4,200		Debtors and creditors	33,500	21,500
Shares issued		80,000	Furniture and fixtures	7,000	
Purchases and sales	1,80,000	2,24,500	Land	45,000	
Stock on 1.1.2017	13,000		Cash and Bank balance	5,850	
General expenses	16,000		TOTAL	3,26,000	3,26,000

Stock on 31st December, 2017, ₹ 25,500.

The furniture and fixtures are revalued at ₹ 10,500 and debtors at ₹ 12,000, out of which ₹ 1,100 proved to be bad.

A is to get a salary of ₹ 12,000 p.a. commencing from the date of incorporation, i.e., March 1st, 2017 and interest @ 6% p.a. to that date on the principal amount due to him.

Profit prior to incorporation to be calculated on time basis excluding A's salry and interest to be charged against such profit.

Prepare the Trading and Profit and Loss Account for the year ended 31st December, 2017 and the balance sheet as at that date, giving effect to all necessary adjustments, none of which has been entered in the books, except that A's Capital has been debited with each proceeds of the share-issue paid to him, formation expenses and ₹ 4,000 on account of salary. No further amounts of salary and interest due to him have been paid. Ignore income-tax.

[C.S. (Inter) — Adapted]

8. Rowlock Ltd. was incorporated on 1st October, 2017 to acquire Rowlock's mail order business, with effect from 1st June, 2017.

The purchase consideration was agreed at ₹ 35,000 to be satisfied by the issue on 1st December, 2017 to Rowlock or his nominee of : 20,000 equity shares of Re 1 each, fully paid and ₹ 15,000, 7% Debentures. The entries relating to the transfer were not made in the books which were carried on without a break until 31st May, 2017.

On 1st May, 2018 the Trial Balance extracted from the books showed the following :

Particulars	₹	Particulars	₹
Sales	52,185	Director's salary	1,000
Purchases	38,829	Debenture Interest (gross)	525
Wrapping	840	Fixed Assets	25,000
Postage	441	Current Assets (other than Stock)	9,745
Warehouse rent and rates	921	Current Liabilities	4,162
Packing expenses	1,890	Formation expenses	218
Office expenses	627	Capital Account — Rowlock, 31st May, 2017	29,450
Stock on 31st May, 2017	5,261	Drawings Account — Rowlock	500

You also ascertain the following:

(1) Stock, 31st May 2018 amounted to ₹ 4,946.

(2) The average monthly sales for June, July and August were one-half of those for the remaining months of the year. The gross profit margin were constant throughout the year.

(3) Wrapping, postage and packing expenses varied in direct proportion to sales, while office expenses were constant each month.

(4) Formation expenses are to be written off.

You are required to prepare the Trading and Profit and Loss Account for the year ended 31st May, 2017 apportioned between the periods before and after incorporation and Balance Sheet as on the date. ***[C.S. (Inter) — Adapted]***

9. New Ventures Ltd. was incorporated on 1st July, 2017 with an authorised capital consisting of 5,000 equity shares of ₹ 10 each to take over the running business of Rundown Brothers as from 1st April, 2017. The following is the summarised Profit and Loss Account for the year ended 31st March, 2018:

Dr. Profit and Loss Account for the year ended 31st March, 2018 Cr.

Particulars	₹	Particulars		₹
Cost of Sales for the year	16,000	Sales		
Administrative Expenses	1,768	1st April, 2017 to 30th June, 2017	6,000	
Selling Commission	875	1st July, 2017 to 31st March, 2018	19,000	25,000
Goodwill written off	200			
Interest paid to Vendors (Loan repaid on 1st August)	373			
Distribution Expenses (60 per cent variable)	1,250			
Preliminary Expenses written off	330			
Debenture Interest	320			
Depreciation	444			
Directors Fees	100			
Net Profit	3,340			
	25,000			25,000

The company deals in one type of product. The unit cost of sales was reduced by 10 per cent in the post-incorporation period as compared to the pre-incorporation period in the year. You are required to apportion the net profit amount between pre-incorporation and post-incorporation periods showing the basis of apportionment.

10. A company was incorporated on 1st July, 2017 to take over the business of Mr M as and from 1st April, 2017. Mr M's Balance Sheet as at that date was as under :

Liabilities	₹	Assets	₹
Trade Creditors	36,000	Building	80,000
Capital	1,94,000	Furniture and Fittings	10,000
		Debtors	90,000
		Stock	30,000
		Bank	20,000
	2,30,000		2,30,000

Debtors and Bank balances are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue M with 10,000 equity shares of ₹ 10 each, ₹ 8 per share paid and cash of ₹ 56,000.

The company issued to the public for cash 20,000 equity shares of ₹ 10 each on which by 31st March, 2018, ₹ 8 per share was called and paid up except in the case of 1,000 shares on which the third call of ₹ 2 per share had not been realised. In the case of 2,000 shares, the entire face value of the shares had been realised. The share issue was underwritten for 2 % commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following were shown by the books of account of the company on 31st March, 2018 :

	₹
Discount (including ₹ 1,000 allowed on vendor's debtors)	6,000
Preliminary expenses	10,000
Director's fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2017 was ₹ 52,000. Depreciation at 10% on Furniture and fittings and at 5% on Building is to be provided. Collections from debtors belonging to the vendor were ₹ 60,000 in the period.

Prepare the Trading and Profit and Loss Account for the period ended 31st March, 2018 of the limited company and its Balance Sheet as at that date.

11. S. Nigam decided to covert his business into a limited company as and from 1st April, 2017, and decided to become a director on a monthly salary of ₹ 1,000. The company was duly incorporated on 1st May, 2017 under the name of M/s Nigam Limited and received a commencement certificate on 1st June, 2017. On 1st May, 2017, 18,000 equity shares of ₹ 10 each were issued for cash and S Nigam retained 2,000 equity shares as part consideration.

Out of proceeds of the issue, S Nigam was paid ₹ 1,40,000 as the balance of the purchase price and ₹ 15,000 for expenses incurred by him in connection with the formation of the company. S Nigam continued same set of books and accounts. The Trial Balance, before adjustment, at 31st March, 2018 is as follows :

Particulars	Dr. (₹)	Cr. (₹)
Capital Account (S Nigam)	25,000	
New Company Account (Nigam Limited)		1,80,000
Sales		6,00,000
Stock (1.4.2017)	18,000	
Purchases	4,40,000	
Salaries	55,000	
Administrative Expenses	44,000	
Selling Expenses	6,000	
Bad Debts Written-off	3,500	
Creditors		66,500
Debtors	1,00,000	
Building	1,20,000	
Cash at Bank	35,000	
	8,46,500	8,46,500

Shri Nigam has not been credited with salary to date nor has he received anything on account. the stock at 31st March, 2018 is valued at ₹ 8,000.

A revaluation on 1st April, 2017 showed that the building was worth ₹ 1,30,000 and that ₹ 5,000 of debts were doubtful or bad. Against the latter it was agreed to provide ₹ 4,000. Actually only debts to the value of ₹ 2,000 have proved to be bad, the balance having been collected by the company.

Capital of Shri Nigam on 1st April, 2017 was ₹ 1,30,000.

Prepare Balance Sheet of M/s Nigam Limited as at 31st March, 2018 with relative Profit and Loss Account to the date, giving effect to the adjustments necessary, but yet unrecorded, on account of the change of ownership.

[C.A. (Inter) — Adapted]

12. Tara Industries Ltd. agreed to take-over the business of Sri K. Basak from 31st March, 2017 in consideration of ₹ 66,000 to be discharged by the issue of equity shares only. On that day, the Balance Sheet of Sri K. Basak was:

Liabilities	₹	Assets	₹
Sundry creditors	30,000	Cash balances	2,000
Loans : S. Sarkar	6,000	Sundry debtors	22,000
Capital	60,000	Furniture	15,000
		Machinery	45,000
		Goodwill	10,000
		Profit & Loss Account	2,000
	96,000		96,000

The company was registered on 1st May, 2017 as a public limited company and obtained a commencement certificate to business on 1st July, 2017. The authorised capital was ₹ 5,00,000 divided into 50,000 equity shares of ₹ 10 each. The company issued for cash 15,000 equity shares to the public at a premium of ₹ 2 per share. The same set of books were continued by the Company and no entries were passed in the books for the take-over of business. Loan from S. Sarkar was repaid before 31st March, 2018.

Apart from this information, the following balances as on 31st March, 2018 were also given:

Particulars	₹	Particulars	₹
Sundry creditors	34,500	Bank overdraft	21,000
Cash balance	8,000	Purchases	1,81,000
Salary and wages	68,000	Freight	6,000
Sales	3,00,000	Other expenses	10,000
New Machinery	95,000	Interest paid	3,000

You are required to prepare the final accounts of Tara Industries Ltd for 2017-18 after taking into account stock of ₹ 15,000 on 31st March, 2018 and after providing for depreciation on assets at 10%.

13. ABC Ltd. was incorporated on 1.5.2017 to take over the business of DEF and Co. from 1.1.2017. The Profit and Loss Account given by ABC Ltd for the year ended 31.12.2017 is as under:

Dr. Profit and Loss Account for the year ended 31.12.2017 Cr.

Particulars	₹	Particulars	₹
To Rent and Taxes	90,000	By Gross Profit	10,64,000
To Salaries including manager's Salary of ₹ 85,000	3,31,000	By Interest on Investment	36,000

To Carriage Outwards	14,000		
To Printing and Stationery	18,000		
To Interest on Debentures	25,000		
To Sales Commission	30,800		
To Bad Debts (related to Sales)	91,000		
To Underwriting Commission	26,000		
To Preliminary Expenses	28,000		
To Audit Fees	45,000		
To Loss on Sale of Investments	11,200		
To Net Profit	3,90,000		
	11,00,000		11,00,000

Prepare a Statement showing allocation of pre-incorporation and post-incorporation profits after considering the following information:

(i) G.P. ratio was constant throughout the year.

(ii) Sales for January and October were $1^1/_2$ times the average monthly sales while sales for December were twice the average monthly sales.

(iii) Bad Debts are shown after adjusting a recovery of ₹ 7,000 of Bad Debt for a sale made in July 2018.

(iv) Manager's salary was increased by ₹ 2,000 p.m. from 1.5.2017.

(v) All investments were sold in April 2017.

14. Green Ltd. was established on 1st August, 2013 and received the Certificate of Commencement of business on 1st November, 2013. The company bought the business of Purple & Co. with effect from 1st April, 2013.

From the following information for the year ended on 31st March, 2014, find out the profit available for dividends.

(i) Sales for the year ₹ 12,00,000 out of which sales upto 1st August, 2013 was ₹ 5,00,000.

(ii) Gross Profit for the year was ₹ 3,60,000.

(iii) Expenses shown in the Statement of Profit and Loss were as under :

	₹
Salaries	24,000
Rent	12,000
Audit fees	12,000
Directors' fees	9,600
Interest on Debenture	10,000
Commission	19,200
Depreciation	51,000
General Expenses	16,800
Bad Debts (₹ 1,000 prior to incorporation)	3,000

[C.S. (Inter) — June, 2015]

Guide to Answers

Practical Questions

1. **Profit prior to incorporation — ₹ 10,000; Post-incorporation profit — ₹ 21,400.**
2. **Profit prior to incorporation — ₹ 20,850; Post-incorporation profit — ₹ 19,250.**
3. **Profit prior to incorporation — ₹ 23,667; Post-incorporation profit — ₹ 90,333.**
4. **Profit prior to incorporation — ₹ 6,522; Post-incorporation profit — ₹ 32,878.**
5. **Profit prior to incorporation — ₹ 1,28,000; Post-incorporation profit — ₹ 8,72,000; Balance Sheet total — ₹ 88,72,000.**
6. **Profit prior to incorporation — ₹ 3,625; Post-incorporation profit — ₹ 7,475.**
7. **Capital Reserve — ₹ 5,408; Goodwill — ₹ 54,000; Balance Sheet — ₹ 1,55,950.**
8. **Profit prior to incorporation — ₹ 1,834; Post-incorporation Profit — ₹ 4,745.**
9. **Profit prior to incorporation — ₹ 496; Post-incorporation Profit — ₹ 3,374.**
10. **Profit prior to incorporation — ₹ 26,000; Post-incorporation Profit — ₹ 69,000; Balance Sheet total — ₹ 4,02,000.**
11. **Profit prior to incorporation — ₹ 9,250; Post-incorporation Profit — ₹ 26,250; Balance Sheet total — ₹ 3,02,750.**
12. **Closing Balance of Debtors is ₹ 1,52,000. Goodwill ₹ 18,000. Profits prior to incorporation — ₹ 2,625. Post incorporation profit — ₹ 28,875.**
13. **Profit prior to incorporation — ₹ 1,71,900; Post-incorporation profit — ₹ 2,18,100.**
14. **Profit available for dividend — ₹ 1,09,000.**

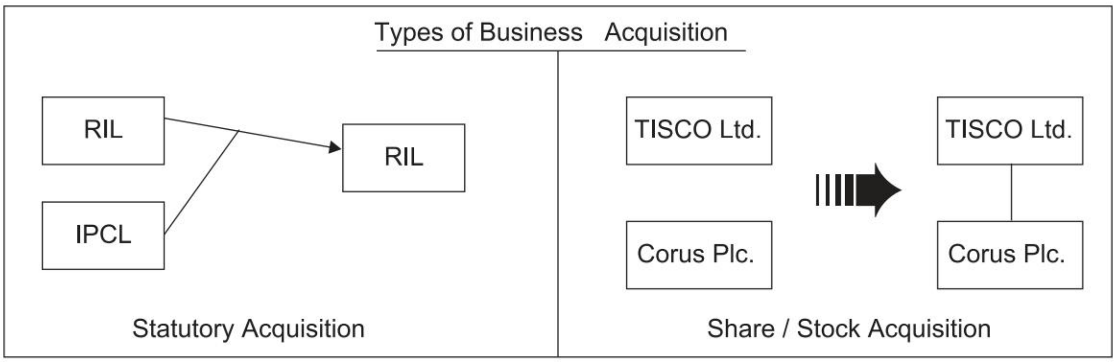
Section B : Accounting for Acquisition of Business

Introduction

Companies historically have attempted to grow through new product development and capturing new markets. This growth is called ***organic growth***. In the recent past, it has been observed that the desired growth can be easily accomplished through acquisition of other companies. For example, acquisition of Corus by Tata Steel Co. Ltd. in 2011. The growth through acquisition is called the ***inorganic growth***.

Business acquisition is a continuing and frequent phenomenon in the business environment. By expanding into new markets or acquiring other companies already in those markets, companies can develop new earning potential, and those in cyclical industries can add greater stability to earning through diversification.

Types of Business Acquisition



Business acquisition may take one of the several legal forms.

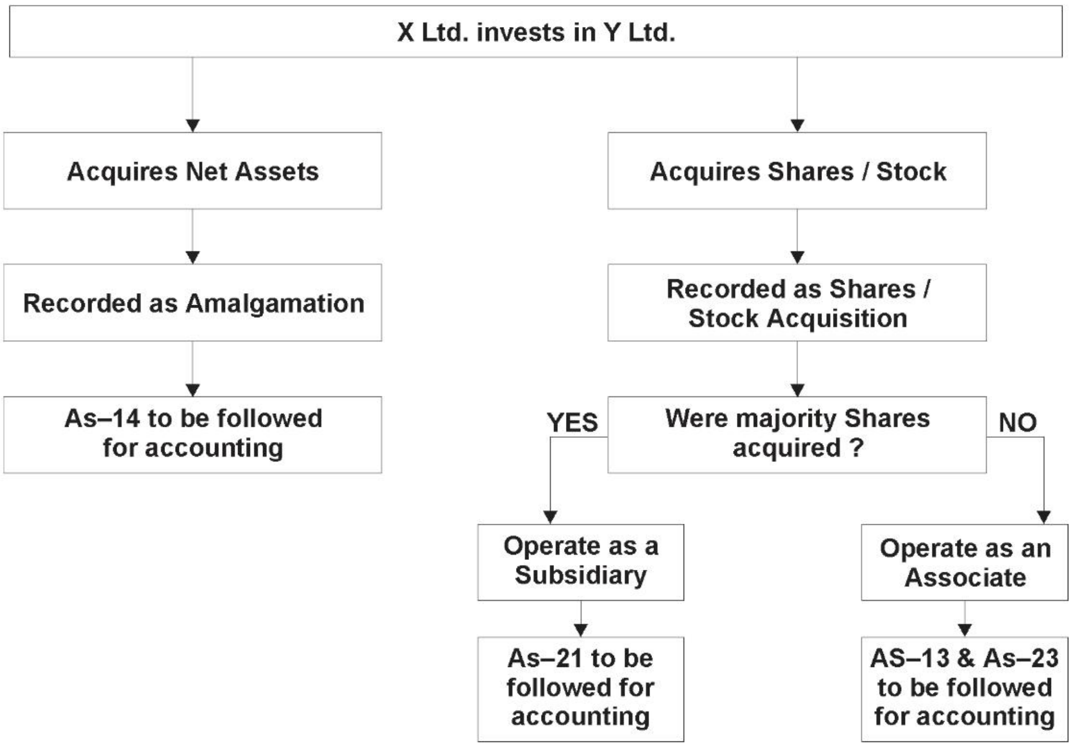
Statutory Acquisition

In a statutory acquisition, the acquiring company will survive and the acquired company loses its separate legal identity. The assets and liabilities of the acquired company are transferred to the acquiring company, the acquired company will be liquidated. After acquisition, the acquired company will be operated as a division of the acquiring company. In our above example, IPCL will be liquidated and it will be operated as a division of RIL after acquisition.

Share / Stock Acquisition

A share acquisition occurs when one company acquires the voting shares of another company and two companies continue to operate as a separate legal entity. Neither of the companies are liquidated. If the majority shares are acquired, the relationship between the two companies will be ***Parent*** and ***Subsidiary***. If the majority shares are not acquired it will be treated as an ***Associate Company***.

Determining the Type of Business Acquisition



Acquisition of Assets and Liabilities

Sometimes one company acquires another company's assets and liabilities through direct negotiations with its management. The transferor company (selling company) will get shares and other securities of the transferee company (purchasing company). These shares and securities are distributed amongst the shareholders of the transferor company. The books of accounts of the transferor company will be closed for ever. The transferee company will record different assets taken over and liabilities assumed, and the consideration given in exchange.

A number of accounting and reporting issues arise when assets and liabilities are taken over by the transferee company. One of the issues involves how to account for the business acquisition.

Requirement of the Companies Act, 2013 in Respect of Mergers and Acquisition / Amalgamation

The Companies Act, 2013 has simplified the process of mergers, amalgamation and acquisitions. It will help domestic and cross-border mergers and acquisitions. Some of the key requirements relating to mergers/ amalgamation are given below :

1. The application to be made to the Tribunal for approval of the Scheme of the amalgamation or merger of the companies.
2. The Tribunal will not approve a Scheme of amalgamation or merger unless the accounting treatment prescribed in the Scheme is in confirmity with the notified Accounting Standard. It is important to

note that a certification from the company's auditor in this respect is also to be submitted to the Tribunal and it is applicable to all types of companies.

3. The Companies Act, 2013 restricts a transferee company from holding the shares in its own name or in the name of a trust. Any inter-company investments between companies must be cancelled.
4. The Tribunal after satisfying itself that the procedure has been complied with, may, by order, sanction the scheme of amalgamation / merger or by a subsequent order, make provision for the following matters, namely—
   (a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;
   (b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person.
5. In case of merger / amalgamation of companies, the following documents should also be circulated :
   (a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
   (b) confirmation that a copy of the draft scheme has been filed with the Registrar;
   (c) a report adopted by the directors of the merging companies, explaining effect of compromise on each class of shareholders, key managerial personnel, promotors and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;
   (d) the report of the expert with regard to valuation, if any;
   (e) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

Merger of Listed Companies with Unlisted Companies

Where the transferor company is a listed company and the transferee company is an unlisted company,—

(a) the transferee company shall remain an unlisted company until it becomes a listed company;
(b) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal:
    Provided that the amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it.

Fast-track Merger or Amalgamation

The Companies Act, 2013 has introduced the new concept of fast-track merger or amalgamation. Under this scheme, merger or amalgamation may be entered into between two or more *small companies* or between a holding company and its *wholly-owned subsidiary company* or such other class or classes of companies as may be prescribed, subject to the following, namely:—

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within ***thirty*** days is issued by the transferor company or companies and the transferee company;
(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ***ninety per cent*** of the total number of shares;
(c) each of the companies involved in the merger files a ***declaration of solvency***, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing ***nine-tenths in value of the creditors*** or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

Methods of Accounting for Acquisition

There are two main methods of accounting for acquisition :

(a) The Pooling of Interests Method; and

(b) The Purchase Method.

> ***It should be noted that the Accounting Standard deals with the accounting procedures only in the books of the transferee company. So far as the books of the transferor company are concerned, the normal procedures are to be followed for closing the books of account through Realisation Account.***

Pooling of Interests Method

The pooling of interests method of accounting is adopted when all the following five conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

The unique attributes of this type of amalgamation are the carryforward of assets and liabilities at book values and the carryforward of retained earnings. In addition, equity shareholders of the transferor companies continue to have a proportionate share in the transferee company.

Characteristics of Pooling of Interests Method

1. Pooling of interests accounting treats an amalgamation as a '***non-event***', in that the combining companies are viewed as if they always had been together.
2. The unique attributes of pooling of interests accounting are the carry forward of assets and liabilities at book values and the carry forward of retained earnings.
3. Under pooling of interests accounting, ***no goodwill*** is recorded as arising from the amalgamation.
4. All costs associated with the amalgamation or with issuing the shares used in the amalgamation are expended as incurred; none of the costs of bringing about the amalgamation are ***capitalised***.
5. Under pooling of interests accounting, the carry forward of retained earnings of the acquired company may give management more flexibility with respect to dividends subsequent to the amalgamation.

While making accounting entries under this method, the following matters should be taken into consideration :

1. All assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the adjustment required for 'Changes in Accounting Policies and Prior Period and Extraordinary Items').
2. The identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation.
3. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in the financial statements of the tranferee company.
4. No goodwill account should be accounted for as a result of amalgamation in the books of the transferee company.
5. The balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

Accounting Entries in the Books of the Purchasing Company (Transferee Company)

1. For acquisition of the business

Business Purchase Account	Dr.	[with the amount of purchase consideration]
To Liquidator of Transferor Company Account		

(Being the amount payable to the liquidator of . . . Ltd under the scheme of amalgamation)

2. For assets, liabilities and resources taken over

Sundry Assets Accounts	Dr.	[Individually, at book value]
To Sundry Liabilities Account		[Individually, at book value]
To Reserves Account		[See Note below]
To Profit and Loss Account		
To Business Purchase Account		[With purchase consideration]

(Being different assets and liabilities are taken over under the scheme of amalgamation)

[**Note**: After adjustment of the difference between the amount recorded as share capital issued and the amount of share capital of the transferor company.]

3. For Payment of Purchase Consideration

Liquidator of Transferor Company Account	Dr.	
To Share Capital Account		[Issued]
To Securities Premium Account		[Premium]
To Cash Account		[For fractional shares and for dissenting shareholders]
To Non-Cash Consideration Account		[Fair value for dissenting shareholders in the form of debentures, etc.]

(Being the discharge of purchase consideration)

Illustration 1

The summarised Balance Sheets of A Ltd and B Ltd as at 1.4.2018 are as under :

Balance Sheets of A Ltd. and B Ltd.as at 1st April, 2018

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	3,00,000	2,00,000
(b) Reserves and Surplus	(2)	50,000	60,000
(2) Share Application Money Pending Allotment :			
(3) Non-current Liabilities :			
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables — Sundry Creditors		10,000	5,000
TOTAL		3,60,000	2,65,000
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets — Land and Building		2,50,000	1,60,000
(2) Current Assets :			
(a) Current Investments		—	—
(b) Inventories		30,000	40,000
(c) Trade Receivables — Sundry Debtors		10,000	20,000
(d) Cash and Cash Equivalents	(4)	70,000	45,000
TOTAL		3,60,000	2,65,000

Notes to Accounts :

Particulars	A Ltd. (₹)	B Ltd. (₹)
(1) Share Capital		
Authorised Capital :		
Equity Shares of ₹ ... each	?	?
Preference Shares of ₹ ... each	?	?
	?	?
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each	2,00,000	1,00,000
12% Preference Shares of ₹ 10 each	1,00,000	—
9% Preference Shares of ₹ 10 each	—	1,00,000
	3,00,000	2,00,000
(2) Reserve and Surplus		
General Reserve	30,000	50,000
Profit and Loss Account	20,000	10,000
	50,000	60,000

On the above date, A Ltd decided to absorb B Ltd under the following terms and conditions :

1. A Ltd will take over all the assets and liabilities of B Ltd.
2. The equity-shareholders of B Ltd will be given 11,000 equity shares of ₹ 10 each at par.
3. 9% preference shares of B Ltd will be converted into 12% preference shares of A Ltd. The number of preference shares to be issued should be such that it would bring the same amount of dividend, as before.

You are required to :
(i) Show the necessary ledger accounts to close the books of B Ltd.;
(ii) Pass journal entries in the books of A Ltd.; and
(iii) Prepare the Balance Sheet of A Ltd after absorption.

Solution **Calculation of Purchase Consideration**

Particulars	₹
Equity Shareholders — (11,000 x ₹ 10)	1,10,000
9% Preference Shareholders — (*₹ 9,000 / 12%)	75,000
* 9% of ₹ 1,00,000 (Preference shares)	1,85,000

(i) In the books of B Ltd

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Land and Buildings A/c	1,60,000	2018	By Creditors A/c	5,000
Apr. 1	To Stock A/c	40,000	Apr. 1	By A Ltd A/c (Purchase Consideration)	1,85,000
"	To Debtors A/c	20,000	"	By Sundry Preference Shareholders A/c	25,000
"	To Cash and Bank A/c	45,000	"	By Sundry Equity Shareholders A/c (Loss)	50,000
		2,65,000			2,65,000

Dr. **A Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Realisation A/c	1,85,000	2018	By Equity Shares in A Ltd A/c	1,10,000
Apr. 1			Apr. 1	By 12% Preference Shares in A Ltd A/c	75,000
		1,85,000			1,85,000

Dr. **Equity Shares in A Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To A Ltd. A/c	1,10,000	2018	By Sundry Equity Shareholders A/c	1,10,000
Apr. 1			Apr. 1		
		1,10,000			1,10,000

Dr. **12% Preference Shares in A Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To A Ltd. A/c	75,000	2018	By Sundry Preference Shareholders A/c	75,000
Apr. 1			Apr. 1		
		75,000			75,000

Dr. **Sundry Preference Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To 12% Preference Shares in A Ltd. A/c	75,000	2018	By 9% Preference Share Capital A/c	1,00,000
Apr. 1	To Realisation A/c	25,000	Apr. 1		
		1,00,000			1,00,000

Dr. **Sundry Equity Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Realisation A/c	50,000	2018	By Equity Share Capital A/c	1,00,000
Apr. 1	To Equity Shares in A Ltd A/c	1,10,000	Apr. 1	By Reserve A/c	50.000
			"	By Profit and Loss A/c	10,000
		1,60,000			1,60,000

(ii) In the books of A Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 Apr. 1	Business Purchase A/c	Dr.		1,85,000	
	To Liquidator of B Ltd A/c				1,85,000
	(Being the amount payable to the liquidator of B Ltd as per agreement dated . . .)				
	Land and Buildings A/c	Dr.		1,60,000	
	Stock A/c	Dr.		40,000	
	Debtors A/c	Dr.		20,000	
	Cash and Bank A/c	Dr.		45,000	
	To Reserve A/c [₹ 50,000 – (₹ 1,85,000 – 2,00,000)]				65,000
	To Profit and Loss A/c				10,000
	To Creditors A/c				5,000
	To Business Purchase A/c				1,85,000
	(Being the different assets and liabilities taken over and the difference between share capital issued and the amount of share capital of B Ltd, adjusted against reserves)				
	Liquidator of B Ltd A/c	Dr.		1,85,000	
	To Equity Share Capital A/c				1,10,000
	To 12% Preference Share Capital A/c				75,000
	(Being the issue of necessary shares against purchase consideration)				

A Ltd
Balance Sheet as at 1st April, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	4,85,000
(b) Reserves and Surplus	(2)	1,25,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables	(3)	15,000
TOTAL		6,25,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(4)	4,10,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories	(5)	70,000
(c) Trade Receivables	(6)	30,000
(d) Cash and Cash Equivalents	(7)	1,15,000
TOTAL		6,25,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Capital :	
... Equity Shares of ₹ 10 each	?
... 12% Preference Shares of ₹ 10 each	?
	?
Issued and Subscribed Capital :	
31,000 Equity Shares of ₹ 10 each fully paid	3,10,000
17,500, 12% Preference Shares of ₹ 10 each	1,75,000
(Of the above shares, 11,000 equity shares and 7,500, 12% preference shares have been issued for consideration other than cash)	
	4,85,000

(2) Reserve and Surplus

Particulars	₹
General Reserve (30,000 + 65,000)	95,000
Profit and Loss Account (20,000 + 10,000)	30,000
	1,25,000
(3) Trade Payables	
Sundry Creditors (10,000 + 5,000)	15,000
(4) Fixed Assets	
Tangible Assets :	
Land and Building (2,50,000 + 1,60,000)	4,10,000
(5) Inventories (30,000 + 40,000)	70,000
(6) Trade Receivables	
Sundry Debtors (10,000 + 20,000)	30,000
(7) Cash and Cash Equivalents	
Cash and Bank (70,000 + 45,000)	1,15,000

Illustration 2

On 31st March, 2018, Thin Ltd was absorbed by Thick Ltd., the latter taking over all the assets and liabilities of the former at book values. The consideration for the business was fixed at ₹ 4,00,000 to be discharged by the transferee company in the form of fully paid equity shares of ₹ 10 each, to be distributed among the shareholders of the transferor company, each shareholder getting two shares for every share held in the transferor company. The Balance Sheets of the two companies as on 31st March, 2018 stood as under :

Balance Sheet of Thick Ltd. and Thin Ltd. as at 31st March, 2018

Particulars	Note No.	Thick Ltd. (₹)	Thin Ltd. (₹)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	9,00,000	2,00,000
(b) Reserves and Surplus	(2)	2,12,502	71,900
(2) Share Application Money Pending Allotment :			
(3) Non-current Liabilities :			
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables — Sundry Creditors		58,567	30,456
(c) Other Current Liabilities		—	—
(d) Short-term Provisions	(3)	22,500	9,000
TOTAL		11,93,569	3,11,356
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets	(4)	4,92,000	1,30,000
(ii) Intangible Assets — Goodwill		2,00,000	60,000
(2) Current Assets :			
(a) Current Investments		—	—
(b) Inventories — Stock of Finished Goods		2,65,500	60,000
(c) Trade Receivables — Sundry Debtors		2,21,200	46,000
(d) Cash and Cash Equivalents	(5)	14,869	8,656
(e) Short-term Loans and Advances		—	—
(f) Other Current Assets	(6)	—	6,700
TOTAL		11,93,569	3,11,356

Notes to Accounts :

Particulars	Thick Ltd. (₹)	Thin Ltd. (₹)
(1) Share Capital		
Authorised Capital :		
Equity Shares of ₹ 10 each	15,00,000	5,00,000
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each fully paid	9,00,000	2,00,000
(2) Reserve and Surplus		
General Reserve	1,80,000	50,000
Profit and Loss	20,502	12,900
Workmen's Compensation Fund	12,000	9,000
	2,12,502	71,900
(3) Short-term Provisions		
Provision for Taxation	12,300	5,000
Staff P.F.	10,200	4,000
	22,500	9,000
(4) Tangible Assets		
Plant and Machinery	4,12,000	1,00,000
Furniture	80,000	30,000
	4,92,000	1,30,000
(5) Cash and Cash Equivalents		
Cash in Hand	869	356
Cash at Bank	14,000	8,300
	14,869	8,656
(6) Other Current Assets :		
Prepaid Insurance	—	700
Income Tax Refund	—	6,000
	—	6,700

Amalgamation expenses amounting to ₹ 1,000 were paid by Thick Ltd.

You are required to : (i) pass the necessary journal entries in the books of Thick Ltd.; and (ii) prepare the Balance Sheet of Thick Ltd after the amalgamation in the nature of merger.

Solution

(i) In the books of Thick Ltd.

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 Mar. 31	Business Purchase A/c	Dr.		4,00,000	
	To Liquidator of Thin Ltd A/c				4,00,000
	(Being the amount payable to liquidator of Thin Ltd as per agreement dated . . .)				
	Goodwill A/c	Dr.		60,000	
	Plant and Machinery A/c	Dr.		1,00,000	
	Furniture A/c	Dr.		30,000	
	Stock A/c	Dr.		60,000	
	Sundry Debtors A/c	Dr.		46,000	
	Prepaid Insurance A/c	Dr.		700	
	Income Tax Refund Claim A/c	Dr.		6,000	
	Cash A/c	Dr.		356	
	Bank A/c	Dr.		8,300	
	General Reserve A/c (Working Note 1)	Dr.		1,28,100	
	To Sundry Creditors A/c				30,456
	To Staff Provident Fund A/c				4,000
	To Provision for Taxation A/c				5,000
	To Business Purchase A/c				4,00,000
	(Being the incorporation of all the assets, liabilities and reserves of Thin Ltd at book values on amalgamation. The difference between share capital issued and the amount of share capital of Thin Ltd., adjusted against General Reserve and Profit and Loss Account)				

Liquidator of Thin Ltd A/c Dr. To Equity Share Capital A/c (Being the allotment of 40,000 equity shares of ₹ 10 each, fully paid up in discharge of consideration for business take-over of Thin Ltd.)		4,00,000	4,00,000
General Reserve A/c Dr. To Bank A/c (Being the payment of amalgamation expenses)		1,000	1,000

Thick Ltd
Balance Sheet as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	13,00,000
(b) Reserves and Surplus	(2)	83,402
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(4) Current Liabilities :		
(a) Other Current Liabilities	(3)	89,023
(b) Short-term Provisions	(4)	31,500
TOTAL		15,03,925
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(5)	6,22,000
(ii) Intangible Assets	(6)	2,60,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories	(7)	3,25,500
(c) Trade Receivables	(8)	2,67,200
(d) Cash and Cash Equivalents	(9)	22,525
ef) Other Current Assets	(10)	6,700
TOTAL		15,03,925

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Capital :	
1,50,000 Equity Shares of ₹ 10 each	15,00,000
Issued and Subscribed Capital :	
1,30,000 Equity Shares of ₹ 10 each fully paid	13,00,000
(Of the above shares, 40,000 equity shares have been issued for consideration other than cash)	

(2) Reserve and Surplus

General Reserve (Working Note 2)	50,900
Profit and Loss Account	20,502
Workmen Compensation Fund	12,000
	83,402

(3) Trade Payables

Sundry Creditors	89,023

(5) Fixed Assets

Particulars	₹
Tangible Assets :	
Plant and Machinery	5,12,000
Furniture	1,10,000
	6,22,000

(6) Intangible Assets

Goodwill	2,60,000

(7) Inventories

Stock of Finished Goods	3,25,500

(8) Trade Receivables

Sundry Debtors	2,67,200

(9) Cash and Cash Equivalents

Bank (14,000 + 8,300 – 1,000)	21,300
Cash	1,225
	22,525

(4) Short-term Provisions		(10) Other Current Assets	
Provision for Taxation	17,300	Prepaid Insurance	700
Staff P.F.	14,200	Income tax Refund Claim	6,000
	31,500		6,700

Working Notes : **(1) Calculation of the Amount Adjusted in General Reserve**

Particulars	₹	₹
Share Capital Issued for Thin Ltd.'s business		4,00,000
Less: Equity Share Capital of Thin Ltd.		2,00,000
		2,00,000
Less: Thin Ltd.'s General Reserve	50,000	
Thin Ltd.'s Profit and Loss Account	12,900	
Thin Ltd.'s Workmen Compensation Fund	*9,000	71,900
		1,28,100

* Alternatively, the Workmen Compensation Fund Account may be incorporated as such which will increase the amount to be debited to General Reserve by ₹ 9,000.

(2) Balance of General Reserve of Thick Ltd.

Particulars	₹	₹
Thick Ltd.'s General Reserve before Amalgamation		1,80,000
Less: Debit as per above (Note 1)	1,28,100	
Amalgamation expenses debited to General Reserve	1,000	1,29,100
Balance after Amalgamation		50,900

Illustration 3

The following were the Balance Sheets of P Ltd and V Ltd as at 31st March, 2018 :

Balance Sheets of P Ltd. and V Ltd. as at 31st March, 2018

Particulars	Note No.	P Ltd. (₹ in Lakhs)	V Ltd. (₹ in Lakhs)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	15,000	6,000
(b) Reserves and Surplus	(2)	15,370	4,285
(2) Share Application Money Pending Allotment :			
(3) Non-current Liabilities :			
(a) Long-term Borrowings — 12% Debentures		—	1,000
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables	(3)	1,200	463
(c) Other Current Liabilities		—	—
(d) Short-term Provisions — Sundry Provisions		1,830	702
TOTAL		33,400	12,450
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets	(4)	22,304	6,700
(2) Current Assets :			
(a) Current Investments		—	—
(b) Inventories — Stock of Finished Goods		7,862	4,041
(c) Trade Receivables	(5)	2,120	1,100
(d) Cash and Cash Equivalents		1,114	609
TOTAL		33,400	12,450

Notes to Accounts :

Particulars	P Ltd. (₹ in Lakhs)	V Ltd. (₹ in Lakhs)
(1) Share Capital		
Authorised Capital :		
Equity Shares of ₹ ... each	?	?
Preference Shares of ₹ ... each	?	?
	?	?
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each fully paid	15,000	6,000
(2) Reserve and Surplus		
Securities Premium	3,000	—
Foreign Projects Reserve	—	310
General Reserve	9,500	3,200
Profit and Loss	2,870	775
	15,370	4,285
(3) Trade Payables		
Bills Payable	120	—
Sundry Creditors	1,080	463
	1,200	463
(4) Tangible Assets		
Land and Building	6,000	—
Plant and Machinery	14,000	5,000
Furnitures, Fixtures and Fittings	2,304	1,700
	22,304	6,700
(5) Trade Receivables		
Debtors	2,120	1,020
Bills Receivables	—	80
	2,120	1,100

All the bills receivable held by V Ltd were P Ltd.'s acceptances. On 1st April, 2018 P Ltd took over V Ltd in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business, P Ltd would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in V Ltd. It was also agreed that 12% debentures in V Ltd would be converted into 13% debentures in P Ltd of the same amount and denomination. Expenses of amalgamation amounting to ₹ 1 lakh were borne by P Ltd.

You are required to : (i) pass journal entries in the books of P Ltd; and (ii) prepare P Ltd.'s Balance Sheet immediately after the merger.

[C.U.B.Com. (Hons.) — Adapted]

Solution

In the books of P Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹ (lakhs)	Cr. ₹ (lakhs)
2018 April 1	Business Purchase A/c (Note 1)	Dr.		9,000	
	To Liquidator of V Ltd. A/c				9,000
	(Being the amount payable to the liquidator of V Ltd as per agreement dated . . .)				
	Plant and Machinery A/c	Dr.		5,000	
	Furniture, Fixtures and Fittings A/c	Dr.		1,700	
	Stock A/c	Dr.		4,041	
	Debtors A/c	Dr.		1,020	
	Cash at Bank A/c	Dr.		609	
	Bills Receivable A/c	Dr.		80	
	To Foreign Project Reserve A/c				310
	To General Reserve A/c (Note 2)				200

	To Profit and Loss A/c (Note 3)			775
	To 12% Debentures in V Ltd. A/c			1,000
	To Sundry Creditors A/c			463
	To Sundry Provisions A/c			702
	To Business Purchase A/c			9,000
	(Being different assets and liabilities taken over from V Ltd. and the difference between shares issued and share capital of V Ltd. has been adjusted against reserve and profit and loss account)			
	Liquidator of V Ltd. A/c Dr.		9,000	
	To Equity Share Capital A/c			9,000
	(Being the purchase consideration discharged by issue of 900 lakhs equity shares of ₹ 10 each)			
	12% Debentures in V Ltd. A/c Dr.		1,000	
	To 13% Debentures A/c			1,000
	(Being the issue of 13% Debentures for discharge of 12% debentures)			
	General Reserve A/c Dr.		1	
	To Bank A/c			1
	(Being the amalgamation expenses paid)			
	Bills Payable A/c Dr.		80	
	To Bills Receivable A/c			80
	(Being the adjustment for mutual acceptances)			

P Ltd
Balance Sheet as at 1st April, 2018

Particulars	Note No.	Amount (₹ in Lakhs)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	24,000
(b) Reserves and Surplus	(2)	16,654
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	1,000
(4) Current Liabilities :		
(a) Trade Payables	(4)	1,583
(b) Short-term Provisions	(5)	2,532
TOTAL		45,769
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(6)	29,004
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories	(7)	11,903
(c) Trade Receivables	(8)	3,140
(d) Cash and Cash Equivalents	(9)	1,722
TOTAL		45,769

Notes to Accounts :

(1) Share Capital

Particulars	₹ in Lacs
Authorised Capital :	
... Equity Shares of ₹ ... each	?
Issued and Subscribed Capital :	
24 crore Equity Shares of 10 each fully paid	24,000
(Of the above shares, 9 crore equity shares have been issued for consideration other than cash)	

(2) Reserve and Surplus

Particulars	₹ in Lacs
Securities Premium	3,000
Foreign Projects	310
General Reserve (95,000 + 2,000 – 1)	9,699
Profit and Loss Account	3,645
	16,654

(3) Long-term Borrowings

Particulars	₹ in Lacs
Secured	
13% Debentures	1,000

(4) Trade Payables

Particulars	₹ in Lacs
Bills Payable	40
Sundry Creditors	1,543
	1,583
(5) Sundry Provisions	2,532
(6) Fixed Assets	
Tangible Assets :	
Land and Building	6,000
Plant and Machinery	19,000
Furniture, Fixtures and Fittings	4,004
	29,004
(7) Inventories	
Stock of Finished Goods	11,903
(8) Trade Receivables	
Sundry Debtors	3,140
(9) Cash and Cash Equivalents	
Cash at Bank	1,722

Working Notes : (1) Calculation of Purchase Consideration

It was agreed that three equity shares of P Ltd will be given for every two shares of V Ltd. Therefore, the Purchase Consideration will be : 600 lakh shares × 3 / 2 × ₹ 10 = **₹ 9,000 lakhs**.

(2) Calculation of the General Reserve of V Ltd.

Particulars	₹ (lakhs)	₹ (lakhs)
Balance of General Reserve as per Balance Sheet		3,200
Less: Adjustment for difference between share capital issued by P Ltd. and share capital of V Ltd. :		
Share Capital issued by P Ltd.	9,000	
Share Capital of V Ltd.	6,000	3,000
		200

Criticisms of Pooling of Interests Method

1. By ignoring the fair value of the assets of the transferor company, the transferee company has a lower depreciation and amortisation charge and therefore higher return on capital employed and earnings per share.
2. Pooling of interests method does not record any acquired asset, or liabilities that were not previously recorded and thus masks their presence.
3. Pooling of interests method may lead to "instant earnings" when combinations are consummated late in the fiscal year, because the earnings of the pooled companies are combined for the entire year.
4. Additional earning could be created if assets acquired in the pooling are sold at amounts considerably greater than their book values.
5. Under the pooling of interests method, readers of financial statement cannot tell how much was invested in the transactions, nor can they track the subsequent performance of the investment.
6. Some consider that there are no true mergers; one company inevitably dominates another.
7. All costs associated with amalgamation, e.g., accounting, legal and appraisal fees, are capital expenditure in nature. But without capitalising, these are adjusted against reserve. Therefore, the basic accounting principle is violated.
8. Whether the pooling of interests method or purchase method is used, the future cash flows are the same. The boost in earnings under pooling method reflects artificial accounting differences, rather than real economic differences.

Purchase Method

This method of accounting is applicable for ***Amalgamation in the Nature of Purchase***. The following points are important :

1. The assets and liabilities of the transferor company should be incorporated in the books of the transferee company either at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values on the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.
2. The reserves of the transferor company, ***other than statutory reserves***, are not incorporated in the financial statements of the transferee company.
3. If the purchase consideration is greater than the net assets taken over of the transferor company, it should be treated as goodwill and debited to Goodwill Account.
   This goodwill will be amortised over a period ***not exceeding five years*** unless somewhat longer period can be justified.
   On the other hand, if the purchase consideration is less than the net assets taken over of the transferor company, it should be treated as Capital Reserve and credited to Capital Reserve Account.
4. Statutory Reserves of the transferor company (e.g., Development Allowance Reserve, or Investment Allowance Reserve) retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.
5. Statutory Reserves are recorded in the financial statements of the transferee company by passing the following entry :

Amalgamation Adjustment Account	Dr.	[with the amount]
To Statutory Reserve Account		

Amalgamation Adjustment Account will be shown in the Balance Sheet of the transferee company as follows:

Reserve and Surplus :

Statutory Reserve Account	***	
Less: Amalgamation Adjustment Account	***	Nil

When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid accounts are reversed as follows :

Statutory Reserve Account	Dr.	[with the amount]
To Amalgamation Adjustment Account		

Accounting Entries in the Books of the Purchasing Company (Transferee Company)

Journal

1. On acquisition of the business

Business Purchase Account	Dr.	[with purchase consideration]
To Liquidator of Transferor Company Account		

2. For assets and liabilities taken over

(i) ***If the net acquired asset is equal to purchase consideration***

Assets Account	Dr.	[Individually, at agreed values]
To Liabilities Account		[Individually]
To Business Purchase Account		[Purchase consideration]

(ii) ***If the net acquired asset is more than the purchase consideration***

Assets Account	Dr.	[Individually, at agreed values]
To Liabilities Account		[Individually]
To Business Purchase Account		[Purchase consideration]
To Capital Reserve Account		[Difference]

(iii) ***If the net acquired asset is less than the purchase consideration***

Goodwill Account	Dr.	[Difference]
Assets Account	Dr.	[Individually, at agreed value]
To Liabilities Account		[Individually]
To Business Purchase Account		

3. When purchase consideration is satisfied

Liquidator of Transferor Company Account	Dr.
To Equity Share Capital Account	
To Securities Premium Account	
To Preference Share Capital Account	

4. When liquidation expenses are incurred

Goodwill Account	Dr.
To Bank Account	

5. When formation expenses are incurred

Preliminary Expenses Account	Dr.
To Bank Account	

6. When there are both goodwill and capital reserve, it can be set off against each other with lower value — only net amount will appear in the new Balance Sheet.

Capital Reserve Account	Dr.
To Goodwill Account	

7. When new shares/debentures are issued

(i) Bank Account	Dr.
To Share Application Account	
To Debenture Application Account	
(ii) Share Application Account	Dr.
Debenture Application Account	Dr.
To Share Capital Account	
To Debenture Account	

Note : We assume that all money is payable on application and shares are issued at par.

Illustration 4

The following is the summarised Balance Sheet of A Ltd as at 31st March, 2018 :

Balance Sheet of A Ltd. as at 31st March, 2018

Particulars	Note No.	(₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	2,00,000
(b) Reserves and Surplus	(2)	1,20,000
(2) Share Application Money Pending Allotment :		
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 10% Debentures		1,00,000
(4) Current Liabilities :		
(a) Trade Payables — Sundry Creditors		10,000
TOTAL		4,30,000

II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	1,90,000
(2) Current Assets :		
(a) Inventories — Stock-in-trade		20,000
(b) Trade Receivables — Sundry Debtors		30,000
(c) Cash and Cash Equivalents	(4)	1,90,000
TOTAL		4,30,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Issued, Subscribed and Paid-up Capital :	
20,000 Equity Shares of ₹ 10 each	2,00,000
(2) Reserve and Surplus	
Reserve	90,000
Profit and Loss Account	30,000
	1,20,000
(4) Tangible Assets	
Land and Building	1,00,000
Plant and Machinery	50,000
Furniture	10,000
	1,60,000

On 1st April, 2018, B Ltd took over the business of A Ltd. The terms and conditions are as under :

(a) Debentures are to be discharged at a premium of 5% by B Ltd.

(b) Creditors are to be paid-off by B Ltd.

(c) B Ltd. will issue 5 equity shares of ₹ 10 each (market value ₹ 11) for every 4 equity sh. of A Ltd.

(d) Cost of liquidation of ₹ 5,000 is to be paid by B Ltd.

You are required to :

(i) Close the books of A Ltd.;

(ii) Pass opening journal entries in the books of B Ltd., assuming that the amalgamation is in the nature of (a) merger; and (b) purchase.

Solution

It should be noted that the Accounting Standards—14 deals with the accounting mechanism only in the books of ***Transferee Company***. The books of account of transferor company will be closed in the usual manner, whether it is an amalgamation in the nature of merger or purchase.

Calculation of Purchase Consideration

Equity Shareholders = 20,000 / 4 × 5 × ₹ 11 = ₹ **2,75,000**.

In the books of A Ltd.

Dr. **(i) Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Land and Buildings A/c	1,00,000	2018	By Creditors A/c	10,000
April 1	To Plant and Machinery A/c	50,000	April 1	By 10% Debentures A/c	1,00,000
"	To Furniture A/c	40,000	"	By B Ltd. A/c	2,75,000
"	To Stock A/c	20,000	"	By Sundry Equity Shareholders A/c	45,000
"	To Debtors A/c	30,000			
"	To Bank A/c	1,50,000			
"	To Cash A/c	40,000			
		4,30,000			4,30,000

Dr. **B Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Realisation A/c	2,75,000	2018 April 1	By Equity Shares in B Ltd. A/c	2,75,000
		2,75,000			2,75,000

Dr. **Equity Shares in B Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To B Ltd. A/c	2,75,000	2018 April 1	By Sundry Equity Shareholders A/c	2,75,000
		2,75,000			2,75,000

Dr. **Sundry Equity Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Realisation A/c	45,000	2018 April 1	By Equity Shares Capital A/c	2,00,000
	To Equity Shares in B Ltd. A/c	2,75,000	"	By Reserve A/c	90,000
				By Profit and Loss A/c	30,000
		3,20,000			3,20,000

(a) Amalgamation in the Nature of Merger

Purchase consideration = 20,000 / 4 × 5 × ₹ 10 = ₹ **2,50,000**. [See Tutorial Note]

In the books of B Ltd.

(ii) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 April 1	Business Purchase A/c	Dr.		2,50,000	
	To Liquidator of A Ltd A/c				2,50,000
	(Being the amount payable to the liquidator of A Ltd as per agreement dated . . .)				
	Land and Building A/c	Dr.		1,00,000	
	Plant and Machinery A/c	Dr.		50,000	
	Furniture A/c	Dr.		40,000	
	Stock A/c	Dr.		20,000	
	Debtors A/c	Dr.		30,000	
	Bank A/c	Dr.		1,50,000	
	Cash A/c	Dr.		40,000	
	To 10% Debentures in A Ltd. A/c				1,00,000
	To Creditors A/c				10,000
	To Reserve A/c [₹ 90,000 – (₹ 2,50,000 – ₹ 2,00,000)]				40,000
	To Profit and Loss A/c				30,000
	To Business Purchase A/c				2,50,000
	(Being the different assets and liabilities taken over. The difference between the share capital issued and the amount of share capital of A Ltd. adjusted against reserves)				
	Liquidator of A Ltd. A/c	Dr.		2,50,000	
	To Equity Share Capital A/c				2,50,000
	(Being the purchase consideration discharged by issue of 25,000 Equity Shares of ₹ 10 each)				
	Creditors A/c	Dr.		10,000	
	To Bank A/c				10,000
	(Being the creditors paid-off)				
	10% Debentures in A Ltd. A/c	Dr.		1,00,000	
	Premium on Redemption of Debentures A/c	Dr.		5,000	
	To Debentureholders A/c				1,05,000
	(Being the amount payable to debentureholders on redemption)				
	Debentureholders A/c	Dr.		1,05,000	
	To Bank A/c				1,05,000
	(Being the amount paid to debentureholders)				
	Reserve A/c	Dr.		5,000	
	To Premium on Redemption of Debentures A/c				5,000
	(Being the premium on redemption of debentures adjusted against reserves)				
	Reserve A/c	Dr.		5,000	
	To Bank A/c				5,000
	(Being the liquidation expenses paid)				

(b) Amalgamation in the Nature of Purchase

Purchase consideration = 20,000 / 4 × 5 × ₹ 10 = ₹ **2,50,000**. [See Tutorial Note]

In the books of B Ltd.

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018	Business Purchase A/c	Dr.		2,50,000	
April 1	To Liquidator of A Ltd A/c				2,50,000
	(Being the amount payable to the liquidator of A Ltd as per agreement dated . . .)				
	Land and Building A/c	Dr.		1,00,000	
	Plant and Machinery A/c	Dr.		50,000	
	Furniture A/c	Dr.		40,000	
	Stock A/c	Dr.		20,000	
	Debtors A/c	Dr.		30,000	
	Bank A/c	Dr.		1,50,000	
	Cash A/c	Dr.		40,000	
	To Creditors A/c				10,000
	To 10% Debentures in A Ltd. A/c				1,00,000
	To Business Purchase A/c				2,50,000
	To Capital Reserve A/c (Balancing figure)				70,000
	(Being the different assets and liabilities taken over. The difference between the net assets taken over and shares issued transferred to Capital Reserve)				
	Liquidator of A Ltd. A/c	Dr.		2,50,000	
	To Equity Share Capital A/c				2,50,000
	(Being the purchase consideration discharged by the issue of 25,000 equity shares of ₹ 10 each)				
	10% Debentures in A Ltd. A/c	Dr.		1,00,000	
	Premium on Redemption of Debentures A/c	Dr.		5,000	
	To Debentureholders A/c				1,05,000
	(Being the amount payable to debentureholders)				
	Debentureholders A/c	Dr.		1,05,000	
	To Bank A/c				1,05,000
	(Being the amount paid to debentureholders)				
	Creditors A/c	Dr.		10,000	
	To Bank A/c				10,000
	(Being the creditors paid-off)				
	Capital Reserve A/c	Dr.		5,000	
	To Premium on Redemption of Debentures A/c				5,000
	(Being the adjustment of premium on redemption of debenture against Capital Reserve)				
	Capital Reserve A/c	Dr.		5,000	
	To Bank A/c				5,000
	(Being the liquidation expenses paid)				

Tutorial Note : B Ltd. will issue shares to the liquidator of A Ltd. at par. Therefore, purchase consideration from the viewpoint of B Ltd. will be ₹ **2,50,000**.

Illustration 5

The following are the abridged Balance Sheets of P Ltd and S Ltd as on 31st March, 2018 :

Balance Sheets of P Ltd. and S Ltd. as at 31st March, 2018

Particulars	Note No.	P Ltd. (₹ '000)	S Ltd. (₹ '000)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	8,000	4,000
(b) Reserves and Surplus	(2)	5,563	1,460
(2) Share Application Money Pending Allotment :			
(3) Non-current Liabilities :			
(a) Long-term Borrowings — 10% Debentures		—	250
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables		—	—
(c) Other Current Liabilities		1,437	990
(d) Short-term Provisions		—	—
TOTAL		15,000	6,700
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets — Land and Building		11,000	4,730
(2) Current Assets :			
(a) Current Investments		—	—
(b) Inventories		—	—
(c) Trade Receivables		4,000	1,970
TOTAL		15,000	6,700

Notes to Accounts :

Particulars	P Ltd. (₹ in '000)	S Ltd. (₹ in '000)
(1) Share Capital :		
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each fully paid	8,000	3,000
10% Preference Shares of ₹ 100 each fully paid	—	1,000
	8,000	4,000
(2) Reserve and Surplus		
General Reserve	4,610	980
Statutory Reserve	390	125
Profit and Loss	563	355
	5,563	1,460

On 1st April, 2018, P Ltd takes over S Ltd on the following terms:

(i) P Ltd. will issue 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of S Ltd.

(ii) P Ltd will issue 11,000, 10% preference shares of ₹ 100 each at par to the preference shareholders of S Ltd.

(iii) The debentures of S Ltd will be converted into an equal number of 12.5% debentures of the same denomination.

You are informed that the statutory reserves of S Ltd are to be maintained for two more years. You are required to show the Balance Sheet of P Ltd., immediately after the above-mentioned scheme of amalgamation has been implemented assuming that : (a) the amalgamation is in the nature of merger; and (b) the amalgamation is in the nature of purchase.

[C.S. (Inter) — Adapted]

Solution (a)

Before preparation of Balance Sheet of P Ltd. (In the case of amalgamation in the nature of merger) the following points are worth noting :

(1) Assets, liabilities, reserves and surplus of S Ltd are to be incorporated at book value.

(2) The difference between the shares issued by P Ltd. (₹ 35,00,000 + ₹ 11,00,000 = ₹ 46,00,000) and the amount of share capital of S Ltd ₹ 40,00,000 (₹ 30,00,000 equity shares + ₹ 10,00,000 preference shares) will be adjusted against General Reserve, i.e., ₹ 6,00,000 (₹ 46,00,000 – ₹ 40,00,000).

A Ltd
Balance Sheet as at 31st March, 2018

Particulars	Note No.	Amount (₹ '000)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,26,00
(b) Reserves and Surplus	(2)	64,23
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,50
(4) Current Liabilities :		
(a) Other Current Liabilities	(4)	24,27
(b) Short-term Provisions		—
TOTAL		2,17,00
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(5)	1,57,30
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		—
(c) Trade Receivables	(6)	59,70
TOTAL		2,17,00

Notes to Accounts :

(1) Share Capital

Particulars	₹ ('000)
Authorised Capital :	
... Equity Shares of ₹ ... each	?
... Preference Shares of ₹ ... each	?
	?
Issued and Subscribed Capital :	
11,50,000 Equity Shares of ₹ 10 each fully paid	1,15,000
11,000, 10% Preference Shares of ₹ 100 each	11,00
(Of the above shares, 3,50,000 equity shares and 11,000 preference shares have been issued for consideration other than cash)	
	1,26,00

(2) Reserve and Surplus

Particulars	₹ ('000)
Statutory Reserve	5,15
General Reserve (Note 1)	49,90
Profit and Loss Account	9,18
	64,23

(3) Long-term Borrowings

Particulars	₹ ('000)
Secured	
12.5% Debentures	2,50

(4) Other Current Liabilities

Particulars	₹ ('000)
(4) Other Current Liabilities	24,27

(5) Fixed Assets

Particulars	₹ ('000)
Tangible Assets :	
Land and Building :	
P Ltd	1,10,00
S Ltd	47,30
	1,57,30

(6) Trade Receivable

Particulars	₹ ('000)
P Ltd	40,00
S Ltd	19,70
	59,70

Working Note : **(1) Calculation of Balance of Reserve**

Particulars		₹ ('000)	₹ ('000)
General Reserve : P Ltd.		46,10	
S Ltd.		9,80	55,90
Less: Share Capital Issued : Equity Shares	35,00		
Preference Shares	11,00	46,00	
Less: Share Capital : Equity Shares	30,00		
Preference Shares	10,00	40,00	6,00
			49,90

Solution (b)

Before preparation of Balance Sheet of P Ltd (In the case of amalgamation in the nature of purchase) the following points are worth noting :

(1) Assets and liabilities of S Ltd taken over are to be incorporated in the Balance Sheet of P Ltd at ***agreed value***.

(2) Ignore reserve and surplus of S Ltd. These are not incorporated in the Balance Sheet of P Ltd.

(3) For legal compliance, the statutory reserve of S Ltd (₹ 1.25 lakhs) is to be carried forward in the Balance Sheet of P Ltd. Amalgamation Adjustment Account is to be debited and Statutory Reserve Account is to be credited. In the Balance Sheet of P Ltd., Amalgamation Adjustment Account will be shown under '***Reserve and Surplus*** by deducting from Statutory Reserve.

(4) The difference between net assets taken over (₹ 54.60 lakhs) and purchase consideration (₹ 46 lakhs), i.e., ₹ 8.60 lakhs will be shown as Capital Reserve in the Balance Sheet of P Ltd.

A Ltd
Balance Sheet as at 31st March, 2018

Particulars	Note No.	Amount (₹ '000)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,26,00
(b) Reserves and Surplus	(2)	64,23
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,50
(4) Current Liabilities :		
(a) Other Current Liabilities	(4)	24,27
(b) Short-term Provisions		—
TOTAL		2,17,00
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(5)	1,57,30
(b) Other Non-current Assets	(6)	—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		—
(c) Trade Receivables	(7)	59,70
TOTAL		2,17,00

Notes to Accounts :

(1) Share Capital

Particulars	₹ ('000)
Authorised Capital :	
... Equity Shares of ₹ ... each	?
... Preference Shares of ₹ ... each	?
	?

(3) Long-term Borrowings

Particulars	₹ ('000)
Secured	
12.5% Debentures	2,50

(4) Other Current Liabilities 24,27

Issued and Subscribed Capital :		**(5) Fixed Assets**	
11,50,000 Equity Shares of ₹ 10 each fully paid	1,15,000	Tangible Assets :	
11,000, 10% Preference Shares of ₹ 100 each	11,00	Land and Building :	
(Of the above shares, 3,50,000 equity shares and		P Ltd	1,10,00
11,000 preference shares have been issued for		S Ltd	47,30
consideration other than cash)			1,57,30
	1,26,00	**(6) Other Non-Current Assets**	—
(2) Reserve and Surplus			
Capital Reserve (Note 1)	8,60	**(7) Trade Receivable**	
Statutory Reserve 5,15		P Ltd	40,00
Less: Amalgamation Adjustment A/c 1,25	3,90	S Ltd	19,70
General Reserve (Note 1)	46,10		59,70
Profit and Loss Account	5,63		
	64,23		

Working Note : **(1) Calculation of Goodwill / Capital Reserve**

Particulars	₹ ('000)	₹ ('000)
Assets takenover		67,00
Less : Liabilities taken over :		
12% Debentures	2,50	
Current Liabilities	9,90	12,40
		54,60
Less : Purchase consideration :		
Equity Shares	35,00	
10% Preference Shares	11,00	46,00
Capital Reserve		8,60

Illustration 6

The Balance Sheet of A Co. Ltd. as at 31st March, 2018 was as under :

Balance Sheets of A Co. Ltd. as at 31st March, 2018

Particulars	Note No.	(₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital		6,00,000
(b) Reserves and Surplus — Retained Earnings		2,80,000
(2) Share Application Money Pending Allotment :		
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 15% Debentures		1,00,000
(4) Current Liabilities :		
(a) Trade Payables — Sundry Creditors		20,000
TOTAL		10,00,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets — Land and Building		6,40,000
(ii) Intangible Assets — Goodwill		1,00,000
(2) Current Assets :		
(a) Inventories		1,68,000
(b) Trade Receivables — Sundry Debtors		36,000
(c) Cash and Cash Equivalents		56,000
TOTAL		10,00,000

Note : Contingent liability in respect of a pending suit ₹ 10,000.

On 1st April, 2018 B Co. Ltd. absorbed the business of A Co. Ltd. The purchase consideration was agreed as :

(1) A cash payment of ₹ 2.50 for every ₹ 10 share in A Co. Ltd.
(2) The issue of 1,35,000 equity shares of ₹ 10 each fully paid in B Co. Ltd.
(3) The issue of such an amount of fully paid 14% debentures in B Co. Ltd. at 96% as is sufficient to discharge 15% debentures in A Co. Ltd. at a premium of 20%.

B Co. Ltd. valued land and building at ₹ 12,00,000; stock at ₹ 1,42,000; and debtors at book value subject to 5% provision for doubtful debts. B Co. Ltd. also agreed to take over the contingent liability, which ultimately materialised but for ₹ 7,000.

Prepare Ledger Accounts in the books of A Co. Ltd. and pass journal entries in the books of B Co. Ltd.

Solution

It is an amalgamation in the nature of purchase because the assets of A Co. Ltd. are not taken over at book value and purchase consideration will be satisfied by issue of shares and cash payment.

(1) Calculation of Purchase Consideration

Particulars	₹
For Equity Shareholders :	
Cash (₹ 2.50 x 60,000)	1,50,000
Equity Shares (₹ 10 x 1,35,000)	13,50,000
Purchase Consideration	15,00,000

Issue of 14% debentures to pay-off 15% debentures in A Co. Ltd. is not to be included while calculating purchase consideration. Such debentures will be taken over by B Co. Ltd. and then discharged.

(ii) Calculation of Goodwill / Capital Reserve

Particulars	₹	₹
Assets taken over :		
Land and Building	12,00,000	
Stock	1,42,000	
Debtors (₹ 36,000 – 1,800)	34,200	13,76,200
Less: Liabilities taken over :		
15% Debentures at a premium of 20%	1,20,000	
Creditors	20,000	1,40,000
Net Assets taken over		12,36,200
Less: Purchase consideration		15,00,000
Goodwill*		(–) 2,63,800

(* Since purchase consideration is more than the net assets taken over.)

In the books of A Co. Ltd.

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Goodwill A/c	1,00,000	2018 April 1	By 15% Debentures A/c	1,00,000
	To Land and Building A/c	6,40,000		By Sundry Creditors A/c	20,000
	To Inventories A/c	1,68,000		By B Co. Ltd. A/c (Purchase consideration)	15,00,000
	To Sundry Debtors A/c	36,000			
	To Cash A/c	56,000			
	To Sundry Equity Shareholders A/c (Profit)	6,20,000			
		16,20,000			16,20,000

Dr. B Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Realisation A/c	15,00,000	2018 April 1	By Equity Shares in B Co. Ltd. A/c	13,50,000
				By Cash A/c	1,50,000
		15,00,000			15,00,000

Dr. Equity Shares in B Co. Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To B Co. Ltd. A/c	13,50,000	2018 April 1	By Sundry Equity Shareholders A/c	13,50,000
		13,50,000			13,50,000

Dr. Sundry Equity Shareholders Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 April 1	To Equity Shares in B Co. Ltd. A/c	13,50,000	2018 April 1	By Equity Share Capital A/c	6,00,000
	To Cash A/c	1,50,000		By Retained Earnings A/c	2,80,000
				By Realisation A/c	6,20,000
		15,00,000			15,00,000

In the books of B Co. Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 April 1	Business Purchase A/c	Dr.		15,00,000	
	To Liquidator of A Co. Ltd A/c				15,00,000
	(Being the amount payable to the liquidator of A Co. Ltd as per agreement dated . . .)				
	Goodwill A/c (Balancing figure)	Dr.		2,63,800	
	Land and Building A/c	Dr.		12,00,000	
	Inventories A/c	Dr.		1,42,000	
	Debtors A/c	Dr.		36,000	
	To Provision for Doubtful Debts A/c				1,800
	To 15% Debentures in A Co. Ltd. A/c				1,20,000
	To Creditors A/c				20,000
	To Business Purchase A/c				15,00,000
	(Being the different assets and liabilities taken over as per agreement dated . . . and the difference between the net assets and purchase consideration transferred to Goodwill)				
	Liquidator of A Co. Ltd. A/c	Dr.		15,00,000	
	To Equity Share Capital A/c				13,50,000
	To Cash A/c				1,50,000
	(Being the purchase consideration discharged by the issue of 1,35,000 equity shares of ₹ 10 each — the balance by the payment of cash)				
	15% Debentures in A Co. Ltd. A/c	Dr.		1,20,000	
	Discount on Issue of Debentures A/c (Note 1)	Dr.		5,000	
	To 14% Debentures A/c				1,25,000
	(Being 15% Debentures in A Co. Ltd. discharged by the issue of 14% Debentures at a discount of 4%)				
	Goodwill A/c	Dr.		7,000	
	To Cash A/c				7,000
	(Being the contingent liability paid-off)				

Tutorial Note : Discount on Issue of Debentures will not be shown in the Balance Sheet. It will be adjusted with ***'Reserve and Surplus'***.

Illustration 7

The summarised Balance Sheets of A Ltd and B Ltd as at 1st April, 2018 are as under :

Balance Sheets of A Ltd. and B Ltd. as at 1st April, 2018

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
(1)	(2)	(3)	(3)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital		1,25,000	1,00,000
(b) Reserves and Surplus — Profit and Loss		10,000	(23,000)
(2) Share Application Money Pending Allotment :			
(3) Non-current Liabilities :			
(4) Current Liabilities :			
(a) Trade Payables		15,000	30,000
TOTAL		1,50,000	1,07,000
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets — Land and Building		1,00,000	45,000
(ii) Intangible Assets — Goodwill at Cost		—	27,000
(2) Current Assets :			
(a) Trade Receivabless		50,000	35,000
TOTAL		1,50,000	1,07,000

On the above date, A Ltd decided to absorb B Ltd under the following conditions :

1. A Ltd will take over all the assets of B Ltd.
2. The entire purchase consideration will be satisfied by the issue of shares of A Ltd of ₹ 10 each.
3. For the purpose of absorption, the value of each share is agreed at ₹ 12 and ₹ 6 for A Ltd and B Ltd respectively.
4. Trade Payables are to be paid-off in cash only.

You are required to : (i) close the books of B Ltd.; (ii) pass journal entries in the books of A Ltd.; and (iii) prepare the Balance Sheet of A Ltd after absorption.

Solution

Calculation of Purchase Consideration

Equity Shareholders : 10,000 x ₹ 6 = ₹ 60,000

Based on issue price, B Ltd will get 5,000 shares (₹ 60,000 / ₹ 12). A Ltd will issue 5,000 shares of ₹ 10 each **at a premium of ₹ 2 per share**.

In the books of B Ltd.

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Apr. 1	To Goodwill A/c	27,000	2018 Apr. 1	By A Ltd. A/c (Purchase consideration)	60,000
	To Land and Building A/c	45,000		By Equity Shareholders A/c	47,000
	To Trade Receivables A/c	35,000		(Loss on realisation)	
		1,07,000			1,07,000

Dr. **A Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Apr 1	To Realisation A/c	60,000	2018 Apr 1	By Equity Shares in A Ltd. A/c	60,000

Dr. **Equity Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Apr. 1	To Profit and Loss A/c	23,000	2018 Apr. 1	By Equity Share Capital A/c	1,00,000
	To Realisation A/c	47,000			
	To Equity Shares in A Ltd. A/c	30,000			
		1,00,000			1,00,000

Dr. **Equity Shares in A Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Apr. 1	To A Ltd. A/c	60,000	2018 Apr. 1	By Bank A/c (Sold)	30,000
				By Equity Shareholders A/c	30,000
		60,000			60,000

Dr. **Trade Payables Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018 Apr 1	To Bank A/c	30,000	2018 Apr 1	By Balance b/d	30,000

This is an acquisition in the Nature of Purchase because all the assets and liabilities have not been taken over by A Ltd. Therefore, purchase method of accounting for acquisition has to be adopted.

(ii) In the books of A Ltd.

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

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 Apr. 1	Business Purchase A/c	Dr.		60,000	
	To Liquidator of B Ltd. A/c				60,000
	(Being the amount payable to B Ltd. as per agreement dated . . .)				
	Land and Building A/c	Dr.		45,000	
	Trade Receivables A/c	Dr.		35,000	
	To Business Purchase A/c				60,000
	To Capital Reserve A/c (Balancing figure)				20,000
	(Being the assets taken over as per scheme of absorption. The difference between the net assets taken over and purchase consideration)				

Liquidator of B Ltd. A/c Dr.		60,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			10,000
(Being the purchase consideration satisfied by the issue of equity shares at a premium of 20%)			

A Ltd
Balance Sheet as at 1st April, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,75,000
(b) Reserves and Surplus	(2)	40,000
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables	(3)	15,000
(c) Short-term Provisions		—
TOTAL		2,30,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(4)	1,45,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		—
(c) Trade Receivables	(5)	85,000
TOTAL		2,30,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Capital :	
... Equity Shares of ₹ ... each	?
Issued and Subscribed Capital :	
17,500 Equity Shares of ₹ 10 each fully paid	1,75,000
(Of the above shares, 5,000 equity shares have been issued for consideration other than cash)	
(2) Reserve and Surplus	
Capital Reserve	20,000
Securities Premium	10,000
Profit and Loss Account	10,000
	40,000
(3) Trade Payables	15,000

(4) Fixed Assets

Particulars	₹
Tangible Assets :	
Land and Building :	
A Ltd	1,00,000
B Ltd	45,000
	1,45,000
(5) Trade Receivables	
A Ltd	50,000
B Ltd	35,000
	85,000

Illustration 8

Ganesh Limited agreed to acquire the business of Kartick Limited as on 31st March, 2018. The Balance Sheet of Kartick Limited as on that date was as under :

Balance Sheet of Kartick Limited as at 31st March, 2018

Particulars	Note No.	(₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	6,00,000
(b) Reserves and Surplus	(2)	70,000
(2) Share Application Money Pending Allotment :		
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 9% Debentures		2,00,000
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables — Creditors		3,00,000
TOTAL		11,70,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	6,00,000
(2) Current Assets :		
(a) Current investments		—
(b) Inventories		—
(c) Trade Receivables — Debtors		4,00,000
(d) Cash and cash equivalents		1,00,000
(e) Short-term loans and advances		70,000
(f) Other current assets		—
TOTAL		11,70,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
Equity Shares of ₹ ... each	?
Preference Shares of ₹ ... each	?
	?
Issued, Subscribed and Paid-up Capital :	
40,000 Equity Shares of ₹ 10 each fully paid-up	4,00,000
20,000 Preference Shares of ₹ 10 each fully paid	2,00,000
	6,00,000
(2) Reserve and Surplus	
Reserve	10,000
Profit and Loss Account	60,000
	70,000
(3) Tangible Assets	
Plant	4,00,000
Land and Building	2,00,000
	6,00,000

The consideration payable by Ganesh Limited was agreed as under :

(i) The preference shareholders of Kartick Limited were to be allotted 10% preference shares of ₹ 2,20,000.

(ii) Equity shareholders to be allotted six equity shares of ₹ 10 each issued at a premium of 10% and ₹ 6 in cash against every five shares held.

(iii) 9% Debentureholders of Kartick Limited are to be discharged at 8% premium by 10% Debentures of Ganesh Limited issued at 10% discount.

While arriving at the agreed consideration the directors of Ganesh Limited valued Land and Building ₹ 5,00,000; Stock ₹ 4,40,000; and Debtors at their book value subject to an allowance of 5% to cover doubtful debts. Debtors of Kartick Limited included ₹ 10,000 due from Ganesh Limited.

It was agreed that before acquisition Kartick Limited will pay dividend at 10% on equity shares. Liquidation expenses were ₹ 5,000.

Close the books of Kartick Limited and show the opening journal entries in the books of Ganesh Limited.

[C.U.B.Com. (Hons.) — Adapted]

Solution

Calculation of Purchase Consideration

Particulars		₹
(i) Preference Shareholders :		
10% Preference Shares in Ganesh Ltd.		2,20,000
(ii) Equity Shareholders :		
(a) Equity Shares (40,000 / 5 x 6 x ₹ 11)	5,28,000	
(b) Cash (40,000 x 5 x ₹ 6)	48,000	5,76,000
		7,96,000

Tutorial Note : As per AS—14, amount payable to debentureholders will not be taken into consideration for calculating purchase consideration.

In the books of Kartick Ltd.

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Plant A/c	4,00,000	2018	By 9% Debentures A/c	2,00,000
Mar. 31	To Land and Building A/c	2,00,000	Mar. 31	By Creditors A/c	3,00,000
	To Stock A/c	4,00,000		By Ganesh Ltd. A/c	7,96,000
	To Debtors A/c	1,00,000			
	To Bank A/c	25,000			
	To Bank A/c (Liquidation Expenses)	5,000			
	To Sundry Preference Shareholders A/c	20,000			
	To Sundry Equity Shareholders A/c (Profit)	1,46,000			
		12,96,000			12,96,000

Dr. **Sundry Preference Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To 10% Preference Shares in Ganesh Ltd. A/c	2,20,000	2018	By 8% Preference Share Capital A/c	2,00,000
Mar. 31			Mar. 31	By Realisation A/c (extra payment)	20,000
		2,20,000			2,20,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Balance b/d	70,000	2018	By Dividend in Equity Shares A/c	40,000
Mar. 31			Mar. 31	By Realisation A/c (Expenses)	5,000
				By Realisation A/c (Trans. to Ganesh Ltd.)	25,000
		70,000			70,000
	To Ganesh Ltd. A/c (Purchase consideration received in cash)	48,000		By Sundry Equity Shareholders A/c	48,000

Dr. **Sundry Equity Shareholders Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2018	To Equity Shares in Ganesh Ltd. A/c	5,28,000	2018	By Equity Share Capital A/c	4,00,000
Mar. 31	To Bank A/c	48,000	Mar. 31	By Reserves A/c	10,000
				By Profit and Loss A/c (₹ 60,000 – 40,000)	20,000
				By Realisation A/c (Profit)	1,46,000
		5,76,000			5,76,000

Dr. Ganesh Limited Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2018 Mar. 31	To Realisation A/c	7,96,000	2018 Mar. 31	By 10% Preference Shares of Ganesh Ltd. A/c By Equity Shares of Ganesh Ltd. A/c By Bank A/c	2,20,000 5,28,000 48,000
		7,96,000			7,96,000

It is an Acquisition in the Nature of Purchase because all assets are not taken over at book value. Therefore, purchase method of accounting for amalgamation is to be adopted.

In the books of Ganesh Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2018 Mar. 31	Business Purchase A/c	Dr.		7,96,000	
	To Liquidator of Kartick Ltd. A/c				7,96,000
	(Being the amount payable to the liquidator of Kartick Ltd. as per agreement dated . . .)				
	Land and Building A/c	Dr.		5,00,000	
	Plant A/c	Dr.		4,00,000	
	Stock A/c	Dr.		4,40,000	
	Debtors A/c	Dr.		1,00,000	
	Bank A/c	Dr.		25,000	
	To Creditors A/c				3,00,000
	To Provision for Doubtful Debts A/c (Note 1)				4,500
	To 9% Debentures in Kartick Ltd. A/c				2,00,000
	To Business Purchase A/c				7,96,000
	To Capital Reserve A/c				1,64,500
	(Being the different assets and liabilities are taken over at agreed value. The difference between the net assets taken over and purchase consideration transferred to Capital Reserve Account)				
	Liquidator of Kartick Ltd. A/c	Dr.		7,96,000	
	To Equity Share Capital A/c				4,80,000
	To Securities Premium A/c				48,000
	To 10% Preference Share Capital A/c				2,20,000
	To Bank A/c				48,000
	(Being the issue of 48,000 equity shares of ₹ 10 each at a premium of 10% and 22,000, 10% preference shares of ₹ 10 each at par and payment of cash ₹ 48,000 to satisfy the purchase consideration)				
	9% Debentures of Kartick Ltd. A/c	Dr.		2,00,000	
	Premium on Debenture Redemption A/c	Dr.		16,000	
	To Debentureholders of Kartick Ltd. A/c				2,16,000
	(Being the amount payable to the debentureholders of Kartick Ltd.)				
	Debentureholders of Kartick Ltd. A/c	Dr.		2,16,000	
	Discount on Issue of Debentures A/c (Note 3)	Dr.		24,000	
	To 10% Debentures A/c				2,40,000
	(Being the issue of 2,400, 10% debentures of ₹ 100 each at discount of 10% to satisfy the debentureholders of Kartick Ltd.)				
	Securities Premium A/c (Note 2)	Dr.		40,000	
	To Premium on Redemption of Debentures A/c				16,000
	To Discount on Issue of Debentures A/c				24,000
	(Being the adjustment of premium paid on redemption of debentures and discount on issue of debentures against Securities Premium Account)				
	Creditors A/c	Dr.		10,000	
	To Debtors A/c				10,000
	(Being the adjustment for mutual indebtedness)				

Working Notes :

(1) Provision for doubtful debts has been credited @ 5% on ₹ 90,000, i.e., after adjustment of ₹ 10,000 due to Kartick Limited. Therefore, provision for doubtful debts will be : 5% of ₹ 90,000 = ₹ **4,500**.

(2) As per the provision of Section 55(2)(c) of the Companies Act, 2013, securities premium can be adjusted against discount on issue of debentures and premium on redemption of debentures.

(3) Total amount payable to the debentureholders of Kartick Limited = ₹ 2,00,000 + 8% of ₹ 2,00,000 = ₹ 2,16,000.
10% Debentures in Ganesh Limited will be issued at 10% discount. Therefore, face value of debentures to be issued
= ₹ 2,16,000 / 90 × 100 = ₹ **2,40,000**. Discount on issue = 10% of ₹ 2,40,000 = ₹ **24,000**.

Acquisition of Shares / Stock

Many companies acquire shares of other companies. Some companies acquire shares to earn good return. Others acquire shares to :

(1) take control of the management of other companies;
(2) enter new market through companies established in those market;
(3) access new technology;
(4) assure a supply of raw materials;
(5) diversify;
(6) reduce competition.

Case Study : Tata takeover of Corus

"Indian company Tata Steel has won the battle to buy its Anglo-Dutch rival Corus.
Tata Steel's 608p per share offer, which values Corus at £5.75bn ($11.3bn), beat that of its takeover rival Brazilian firm CSN.
The deal is the largest Indian takeover of a foreign company, and creates the world's fifth biggest steel company.

- **Why did Tata want Corus** ?
  There is a recognition that for the Indian economy to continue its growth, its companies must look to compete on a global scale.
  Tata is currently just the 56th biggest steel producer globally.
  Buying Corus leapfrogs it to fifth place in the world steel-making rankings.
  The takeover also gives it access to Corus technology as well as its production sites.
  The Indian firm says it will be able to make savings on costs, from marketing to buying materials.

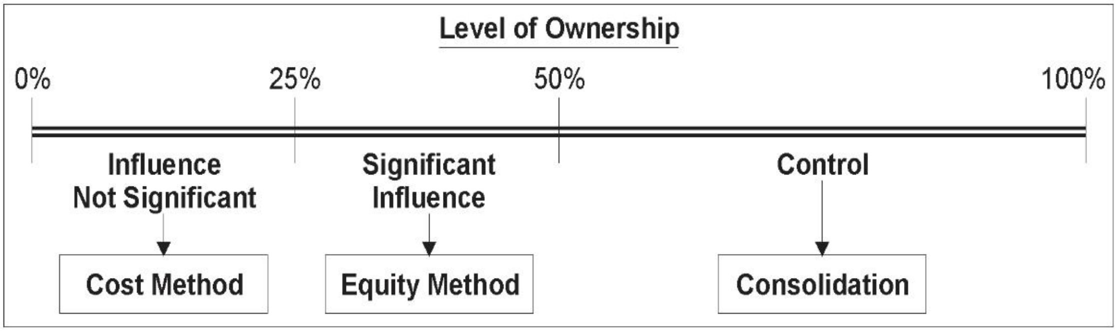
- **Why was Corus keen to be taken over** ?
  In order to survive, Corus needs to extend its global reach just as much as Tata does. A tie-up with Tata gives it, among other things, access to markets in India – one of the fastest growing economies in the world – as well as access to low-cost materials. If Corus had been bought by CSN, the same would have applied regarding Brazil.

[Source : news.bbc.co.uk]

Method of Recording Acquisition of Shares / Stock

There are a number of aspects of accounting for inter-company investment in equity shares that differ from accounting for other types of investments.

The method of accounting depends on the level of influence or control that the purchasing company is able to exercise over the investee company.



Accounting Procedures under the Cost Method

The cost method is used when the purchasing company lacks the ability either to control or to exercise significant influence over the investee company.

At the time of acquiring shares, the purchasing company records it ***at cost***. Investment classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

Income from investment is recognised by the purchasing company as dividends are declared by the investee company.

Example : X Ltd. purchases 15% of Y Ltd.'s equity shares for ₹ 100 crores on 1st April, 2017. During the year 2017-18, Y Ltd.'s net profit is ₹ 150 crores. Y Ltd. paid ₹ 100 crores as dividend for the year 2017-18.

X Ltd. will record the following entries relating to its investment in Y Ltd.

(1) Investment in Equity Shares of Y Ltd.	**Dr.**	**100 crores**	
To Bank A/c			**100 crores**
(Being the purchase of 15% equity shares of Y Ltd.)			
(2) Bank A/c	**Dr.**	**15 crores**	
To Dividend Received A/c			**15 crores**

In the Balance Sheet of X Ltd. investment will be shown at cost of ₹ 100 crores.

Here, it should be noted that the retained earning of Y Ltd. (₹ 150 crores – 100 crores) = ₹ 50 crores will not be shown in the financial statements of X Ltd.

If the dividend is received from pre-acquisition profit, it should be deducted from the cost of the investment. It will not be credited to Profit and Loss Account.

Accounting Procedures under Equity Method

In majority cases, acquisition of 20% to 49% of equity shares is reported under ***equity method***. The equity method is a method of accounting whereby the investment is initially recorded at cost; identifying any goodwill / capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post-acquisition change in the investor's shares of net assets of the investee. The consolidated statement of profit or loss reflect ***the investor's share of the results of operations of the investee***.

In using equity method for accounting for investment in an associate, unrealised profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.

The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of investment, such reduction being determined and made for each investment individually. [For details see AS—23 "***Accounting for Investments in Associates***"]

Accounting Procedures under Consolidation Method

Consolidation method is adopted when the purchasing company acquires more than 50% of the voting shares of the investee company. Purchasing company is referred to as the ***parent*** and the ***investee*** company is called ***subsidiary***.

Both subsidiary and parent company will prepare their financial statement in the usual manner as a separate entity. However, the parent company, in addition, will prepare consolidated Balance Sheet, Consolidated Profit and Loss Account and Consolidated Cash Flow Statement. The purpose of consolidated statements is to present, primarily, for the benefit of the shareholders and creditors of the parent company, the results of the operations and the financial position of a parent company and its subsidiaries as a whole.

[For details see AS—21 "***Consolidated Financial Statements***"]

Key Points

- Business acquisition is a continuing and frequent phenomenon in the business environment. By expanding into new markets or acquiring other companies already in those markets, companies can develop new earning potential, and those in cyclical industries can add greater stability to earning through diversification.
- In a statutory acquisition, the acquiring company will survive and the acquired company loses its separate legal identity. The assets and liabilities of the acquired company are transferred to the acquiring company, the acquired company will be liquidated.
- A share acquisition occurs when one company acquires the voting shares of another company and two companies continue to operate as a separate legal entity. Neither of the companies are liquidated.
- Sometimes one company acquires another company's assets and liabilities through direct negotiations with its management. The transferor company (selling company) will get shares and other securities of the transferee company (purchasing company). These shares and securities are distributed amongst the shareholders of the transferor company. The books of accounts of the transferor company will be closed for ever. The transferee company will record different assets taken over and liabilities assumed, and the consideration given in exchange.
- Many companies acquire shares of other companies. Some companies acquire shares to earn good return. Others acquire shares to :
  (1) take control of the management of other companies;
  (2) enter new market through companies established in those market;
  (3) access new technology;
  (4) assure a supply of raw materials;
  (5) diversify; and,
  (6) reduce competition.

THEORETICAL QUESTIONS

1. What do you mean by organic growth and inorganic growth ?
2. What do you mean by statutory acquisition ?
3. What are the different methods of recording acquisition of shares / stock ?
4. Distinguish between pooling of interest method and purchase method.
5. What are the limitations of pooling of interest method ?

PRACTICAL QUESTIONS

1. The following is the Balance Sheet of X Ltd. as at 31st March, 2018 :

Balance Sheet of X Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	10,00,000
(b) Reserves and Surplus	(2)	3,90,000
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 12% Debentures		1,50,000
(4) Current Liabilities :		
(a) Trade Payables — Creditors		2,10,000
TOTAL		17,50,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	10,20,000
(2) Current Assets :		
(a) Inventories		4,50,000
(b) Trade Receivables		2,50,000
(c) Cash and Cash Equivalents		30,000
TOTAL		17,50,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
Equity Shares of ₹ ... each	?
Preference Shares of ₹ ... each	?
	?
Issued, Subscribed and Paid-up Capital :	
10,000 Equity Shares of ₹ 100 each fully paid	10,00,000
(2) Reserve and Surplus	
General Reserve	3,70,000
Profit and Loss Account	30,000
	4,00,000
(3) Tangible Assets	
Land and Building	3,50,000
Plant and Machinery	6,70,000
	10,20,000

On 1st April, 2018, Y Ltd. took over the business of X Ltd. in an amalgamation in the nature of merger. Y Ltd. will issue 1,00,000 equity shares of ₹ 10 each at par. Y Ltd. redeemed the debentures at par and paid ₹ 10,000 as expenses of amalgamation. Prepare necessary Ledger Accounts to close the books of X Ltd. Also pass the required journal entries in the books of Y Ltd.

2. The summarised Balance Sheet of X Ltd. on 31.3.2018 is as under :

Balance Sheet of X Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	10,00,000
(b) Reserves and Surplus	(2)	52,000
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 10% Debentures		50,000
(4) Current Liabilities :		
(a) Trade Payables		13,000
TOTAL		2,15,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets		1,56,000
(2) Current Assets :		
(a) Inventories		40,500
(b) Trade Receivables	(3)	17,100
(c) Cash and Cash Equivalents		1,400
TOTAL		2,15,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
Equity Shares of ₹ ... each	?
Preference Shares of ₹ ... each	?
	?
Issued, Subscribed and Paid-up Capital :	
10,000 Equity Shares of ₹ 10 each fully paid	1,00,000
(2) Reserve and Surplus	
General Reserve	40,000
Profit and Loss Account	12,000
	52,000
(3) Trade Receivables	
Sundry Debtors	18,000
Less: Provision for Doubtful Debts	900
	17,100

On the above date, X Ltd. is absorbed by Y Ltd. on the following conditions :

(1) All the assets and liabilities are taken over at book value.

(2) An exchange of 6 shares in Y Ltd. of ₹ 10 each at par for every 5 shares in X Ltd.

(3) 10% debentures are to be redeemed at a premium of 10%.

Prepare Ledger Accounts of X Ltd. to close the books. Also pass journal entries in the books of Y Ltd. The expenses of liquidation paid by Y Ltd. amounted to ₹ 3,000.

3. The summarised Balance Sheets of A Ltd. and B Ltd. as on 31.3.2018 are as under :

Balance Sheets of A Ltd. and B Ltd. as at 31st March, 2018

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	1,50,000	1,00,000
(b) Reserves and Surplus	(2)	50,000	60,000
(c) Money Received against Share Warrants			—
(2) Share Application Money Pending Allotment :			—
(3) Non-current Liabilities :			
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables — Sundry Creditors		20,000	10,000
(c) Other Current Liabilities		—	—
(d) Short-term Provisions		—	—
TOTAL		2,20,000	1,70,000
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets — Plant and Machinery		1,20,000	1,00,000
(2) Current Assets :			
(a) Current Investments		—	—
(b) Inventories		20,000	25,000
(c) Trade Receivables — Sundry Debtors	(4)	50,000	25,000
(d) Cash and Cash Equivalents		30,000	20,000
(e) Other Current Assets		—	—
TOTAL		2,20,000	1,70,000

Notes to Accounts :

Particulars	A Ltd. (₹)	B Ltd. (₹)
(1) Share Capital		
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each fully paid	1,50,000	1,00,000
(2) Reserve and Surplus		
General Reserve	30,000	30,000
Profit and Loss Account	20,000	30,000
	50,000	60,000
(4) Trade Receivables		
Sundry Debtors	50,000	30,000
Less: Provisions for Doubtful Debts	—	5,000
	50,000	25,,000

On the above date, A Ltd. decided to absorb B Ltd. under the following conditions :

(1) A Ltd. will take over all the assets and liabilities of B Ltd., subject to the following adjustments in order to ensure uniform accounting policies —

(a) A Ltd. does not make any provision for doubtful debts. To bring B Ltd.'s value of sundry debtors in line with those of A Ltd., provision for doubtful debts of B Ltd. has to be eliminated.

(b) Advertisement suspense of B Ltd. is being written off over 3 years. Similar amount of advertising suspense has already been fully written off by A Ltd. in 2016.

(2) The entire purchase consideration will be satisfied by the issue of equity shares of ₹ 10 each of A Ltd. A Ltd. will issue 12,000 equity shares at par to B Ltd.

You are required to :

(i) close the books of B Ltd.;

(ii) pass journal entries in the books of A Ltd.; and

(iii) prepare the Balance Sheet of A Ltd. after absorbtion.

4. The summarised Balance Sheets of A Ltd. and B Ltd. on 1.4.2018 are as under :

Balance Sheet of A Ltd. and B Ltd. as at 1st April, 2018

Particulars	Note No.	A Ltd. (₹)	B Ltd. (₹)
(1)	(2)	(3)	(4)
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds :			
(a) Share Capital	(1)	1,50,000	1,00,000
(b) Reserves and Surplus	(2)	75,000	50,000
(2) Share Application Money Pending Allotment :			—
(3) Non-current Liabilities :			
(4) Current Liabilities :			
(a) Short-term Borrowings		—	—
(b) Trade Payables — Creditors		25,000	50,000
TOTAL		2,50,000	2,00,000
II. ASSETS			
(1) Non-current Assets :			
(a) Fixed Assets			
(i) Tangible Assets — Plant and Machinery		1,40,000	1,25,000
(2) Current Assets :			
(a) Inventories		30,000	60,000
(b) Cash and Cash Equivalents		80,000	15,000
TOTAL		2,50,000	2,00,000

Notes to Accounts :

Particulars	A Ltd. (₹)	B Ltd. (₹)
(1) Share Capital		
Issued, Subscribed and Paid-up Capital :		
Equity Shares of ₹ 10 each fully paid	1,50,000	1,00,000
(2) Reserve and Surplus		
General Reserve	60,000	20,000
Profit and Loss	15,000	30,000
	75,000	50,000

On the above date, A Ltd. decided to absorb B Ltd. under the following conditions :

(1) A Ltd. will take over all the assets and liabilities of B Ltd.

(2) The entire purchase consideration will be satisfied by the issue of equity shares of ₹ 10 each at par of A Ltd.

(3) For the purpose of absorption, the value of each share of B Ltd. was agreed at ₹ 11.55.

You are required to : (i) pass journal entries in the books of A Ltd.; (ii) prepare the Balance Sheet of A Ltd. after absorption.

5. On 31st March, 2018 the Balance Sheet of X Ltd. stood as follows :

Balance Sheet of X Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	15,00,000
(b) Reserves and Surplus	(2)	9,60,800
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		3,60,740
TOTAL		28,21,540
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	18,04,400
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		7,05,500
(c) Trade Receivables		1,98,440
(d) Cash and Cash Equivalents		1,13,200
(e) Other Current Assets		—
TOTAL		28,21,540

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
2,00,000 Equity Shares of ₹ 10 each	20,00,000
Issued, Subscribed and Paid-up Capital :	
1,50,000 Equity Shares of ₹ 10 each fully paid	15,00,000
(2) Reserve and Surplus	
Securities Premium	1,50,000
General Reserve	6,25,500
Profit and Loss	1,85,300
	9,60,800
(4) Tangible Assets	
Plant and Machinery	16,10,000
Furniture and Fixtures	1,94,400
	18,04,400

On this date, X Ltd. took over the business of Y Ltd. for ₹ 6,60,000 payable in the form of its fully paid equity shares of ₹ 10 each at par, shareholders of Y Ltd., getting 110 shares of X Ltd. for every 100 shares held in Y Ltd. The scheme of amalgamation also provided that 11% debentures of Y Ltd., would be converted into equal number of 12% debentures of X Ltd. of ₹ 100 each. The Balance Sheet of Y Ltd. on the date of amalgamation was as follows:

Balance Sheet of Y Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	6,00,000
(b) Reserves and Surplus	(2)	1,22,180
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 11% Debentures		3,00,000
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		1,82,480
TOTAL		12,04,660
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	6,85,200
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		3,15,800
(c) Trade Receivables		1,29,300
(d) Cash and Cash Equivalents		74,360
TOTAL		12,04,660

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Issued, Subscribed and Paid-up Capital :	
60,000 Equity Shares of ₹ 10 each fully paid	6,00,000
(2) Reserve and Surplus	
Capital Reserve	13,000
Foreign Project Reserve	9,700
General Reserve	75,350
Profit and Loss	24,130
	1,22,180
(4) Tangible Assets	
Machinery	5,50,000
Furniture	1,35,200
	6,85,200

You are required to : (i) pass journal entries in the books of X Ltd. assuming that the amalgamation is in the nature of merger; and (ii) prepare Realisation Account and Equity Shareholders Account in Y Ltd.'s Ledger.

[C.S. (Inter) — Adapted]

Amalgamation in the Nature of Purchase

6. B Co. Ltd. was absorbed by A Co. Ltd. on 31st March, 2018 on which date the Balance Sheet of B Co. Ltd. was as follows :

Balance Sheet of B Co. Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,00,000
(b) Reserves and Surplus	(2)	1,27,500
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		—
(4) Current Liabilities :		
(a) Trade Payables		30,000
(b) Other Current Liabilities		20,000
TOTAL		2,77,500
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	1,30,000
(b) Non-current Investments		60,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		27,500
(c) Trade Receivables		50,000
(d) Cash and Cash Equivalents		10,000
TOTAL		2,77,500

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Issued, Subscribed and Paid-up Capital :	
10,000 Equity Shares of ₹ 10 each fully paid	1,00,000
(2) Reserve and Surplus	
General Reserve	80,000
Profit and Loss	27,500
Dividend Equalisation Fund	20,000
	1,27,500
(4) Tangible Assets	
Building	70,000
Plant and Machinery	60,000
	1,30,000

The terms and conditions were :

(a) that A Co. Ltd. took all the liabilities, and assets except investments which B Co. Ltd., sold at ₹ 55,000.

(b) that A Co. Ltd. issued 2 fully paid equity shares of ₹ 8 each at a premium of ₹ 5 per share and paid ₹ 3 in cash to the shareholders of B Co. Ltd. in exchange for each of its shares held by them.

(c) A Co. Ltd. paid the cost of absorption ₹ 2,000 in addition to purchase consideration.

Show the Journal Entries required in giving effect to the above transactions in the books of both the companies.

7. X and Co. Ltd. absorbed the business of Y and Co. Ltd., as a going concern as at 31st March, 2018 the assets and liabilities of the latter company on that date being as under :

Balance Sheet of Y and Co. Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	4,00,000
(b) Reserves and Surplus — Profit and Loss Account		(15,000)
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables	(2)	80,000
TOTAL		4,65,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	3,00,000
(ii) Intangible Assets — Goodwill		50,000
(2) Current Assets :		
(a) Inventories		30,000
(b) Trade Receivables		50,000
(c) Cash and Cash Equivalents		35,000
TOTAL		4,65,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Issued, Subscribed and Paid-up Capital :	
30,000 Equity Shares of ₹ 10 each fully paid	3,00,000
1,000, 5% Preference Shares of ₹ 10 each	1,00,000
	4,00,000
(2) Trade Payables	
Sundry Creditors	30,000
Bills Payable	50,000
	80,000
(4) Tangible Assets	
Land and Building	2,00,000
Plant and Machinery	1,00,000
	3,00,000

The terms of the agreement were :

(a) that, for every 10 equity shares of Y and Co. Ltd., X and Co. Ltd., issued 12 fully paid equity shares of ₹ 10 each and paid ₹ 10 in cash;

(b) that, the preference shareholdes of Y and Co. Ltd. were paid at a premium of 5% by the issue of 6% preference shares of X and Co. Ltd. at par;

(c) that, all assets and liabilities were taken over except cash to the extent of ₹ 3,000 which was left for meeting realisation expenses;

(d) that, plant and machineries were only re-valued at ₹ 1,83,000 other assets and liabilities remaining at their book values.

You are required to give the closing journal entries in the books of Y and Co. Ltd. and opening journal entries in the books of X and Co. Ltd.

8. Mary Bula Ltd. agreed to acquire the goodwill and assets other than cash of Narayan Ltd. as on 31st March, 2018. The summarised Balance Sheet of Narayan Ltd. as on that date was as follows :

Balance Sheet of Narayan Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	3,00,000
(b) Reserves and Surplus	(2)	1,40,000
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 12% Debentures		50,000
(4) Current Liabilities :		
(a) Trade Payables		20,000
TOTAL		5,10,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(3)	3,20,000
(ii) Intangible Assets — Goodwill		50,000
(2) Current Assets :		
(a) Inventories		80,000
(b) Trade Receivables		30,000
(c) Cash and Cash Equivalents		30,000
TOTAL		5,10,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
... Equity Shares of ₹ ... each	?
Issued, Subscribed and Paid-up Capital :	
30,000 Equity Shares of ₹ 10 each fully paid	3,00,000
(2) Reserve and Surplus	
General Reserve	1,00,000
Profit and Loss	50,000
	1,50,000
(4) Tangible Assets	
Land and Building	1,00,000
Plant and Machinery	2,20,000
	3,20,000

The consideration payable by Mary Bula Ltd. was agreed as follows :

(a) A cash payment equal to ₹ 3.50 for each share of ₹ 10 each in Narayan Ltd.

(b) The issue of 45,000 ₹ 10 fully paid share of Mary Bula having an agreed value of ₹ 12.50 per share.

(c) The issue of such amount of 14% Debentures of Mary Bula Ltd., at 4% discount as is sufficient to discharge the 11% Debentures of Narayan Ltd. at a premium of 20%.

The liabilities of Narayan Ltd. other than the Debentures were discharged by that company. When computing the agreed consideration the management of Mary Bula Ltd., valued the land and building at ₹ 1,68,000. Plant and machinery at ₹ 4,50,000, Stock-in-trade at ₹ 70,000, and the Debtors at their face values subject to an allowance of 4% to cover doubtful debts.

Show the necessary Ledger Accounts in the books of Narayan Ltd. and draft Journal Entries required in the books of Mary Bula Ltd. Show details of purchase consideration.

9. Atma Ram Ltd. is agreed to acquire the business of Kumbat Ltd. as on 31st March, 2018. The summarised Balance Sheet of Kumbat Ltd. on that date was as under :

Balance Sheet of Kumbat Ltd. as at 31st March, 2018

Particulars	Note No.	Amount (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	3,00,000
(b) Reserves and Surplus	(2)	1,40,000
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings — 6% Debentures		50,000
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		10,000
TOTAL		5,00,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets — Land, Building and Machinery		3,20,000
(ii) Intangible Assets — Goodwill		50,000
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		84,000
(c) Trade Receivables		18,000
(d) Cash and Cash Equivalents		28,000
TOTAL		5,00,000

Notes to Accounts :

Particulars	(₹)
(1) Share Capital	
Authorised Capital :	
... Equity Shares of ₹ ... each	?
Issued, Subscribed and Paid-up Capital :	
30,000 Equity Shares of ₹ 10 each fully paid	3,00,000
(2) Reserve and Surplus	
General Reserve	85,000
Profit and Loss	55,000
	1,40,000

The consideration payable by Atma Ram Ltd. was agreed as follows :

(i) Cash payment equivalent to ₹ 2.50 for every share of ₹ 10 in Kumbat Ltd.

(ii) Issue of 45,000 (₹ 10) shares fully paid, in Atma Ram Ltd., having an agreed value of ₹ 15 per share.

(iii) Issue of such an amount of fully paid 5% Debentures of Atma Ram Ltd., at 96% as is sufficient to discharge the 6% debentures of Kumbat Ltd., at a premium of 20%.

(iv) The directors to Atma Ram Ltd., valued land, building and machinery at ₹ 6,00,000; the stock-in-trade at ₹ 71,000 and the debtors at their book value subject to an allowance of 5% to cover doubtful debts. The cost of liquidation of Kumbat Ltd., was ₹ 2,500.

Atma Ram Ltd. also issued to the public 5,000 shares of ₹ 10 each at ₹ 15 per share. The shares were fully subscribed and paid for.

You are required to prepare the Ledger Accounts in the books of Kumbat Ltd. and prepare opening Balance Sheet of Atma Ram Ltd., after the acquisition. ***[C.S. (Inter) — Adapted]***

Guide to Answers

Practical Question

1. **Realisation Loss — ₹ 3,90,000; Balance of Reserves ₹ 3,60,000 after adjusting ₹ 10,000 for amalgamation expenses. Balance of Profit and Loss Account — ₹ 20,000 after deducting preliminary expenses.**
2. **Realisation Loss—₹ 32,000; Purchase consideration—₹ 1,20,000; Bal. of reserve ₹ 12,000 (₹ 40,000–₹ 20,000–₹ 5,000–₹ 3,000).**
3. **Realisation Loss — ₹ 45,000; Balance Sheet total — ₹ 3,95,000; Balance of Reserve ₹ 50,000 (₹ 30,000 + ₹ 20,000).**
4. **Purchase consideration — ₹ 1,15,500. Balance Sheet total ₹ 4,50,000; Balance of reserve (₹ 60,000 + ₹ 4,500 = ₹ 64,500); Share capital — ₹ 2,65,500.**
5. **Purchase consideration — ₹ 6,60,000; Loss on realisation — ₹ 62,180; Amount of general reserve — ₹ 15,350 (adjusted).**
6. **Purchase consideration — ₹ 2,90,000; Loss on sale of investment — ₹ 5,000 is to be charged to Realisation Account.**
7. **Purchase consideration — ₹ 4,95,000. Realisation Profit — ₹ 1,05,000.**
8. **Purchase consideration — ₹ 7,27,500; Profit on realisation — ₹ 2,37,500.**
9. **Purchase consideration — ₹ 5,10,000; Profit on realisation — ₹ 3,07,500; Goodwill — ₹ 1,03,900.**
   Balance Sheet total — ₹ 8,22,500.

12

Conversion of Partnership into a Limited Company

Conversion into a Company

Introduction

As a partnership continues to grow, the partners may decide to convert the partnership business into a limited company (Private or Public) in order to :

(a) limit their personal liability;
(b) have access to additional equity financing;
(c) obtain selected tax advantages;
(d) explore other sound business opportunities;
(e) continue business for a long time.

At the time of conversion, the partnership is dissolved and a new company is floated

Dissolution of the Partnership

The books of account of the partnership firm will be closed in the usual manner.

To close the books of account of the partnership firm, the following steps are generally followed :

Step 1 Prepare the Balance Sheet of the partnership firm on the ***date of conversion***.

Step 2 Open a Realisation Account and transfer all assets and liabilities (excluding fictitious assets) to this account.

Step 3 Calculate purchase consideration on the basis of terms and conditions agreed upon.

Step 4 Credit Realisation Account with purchase consideration.

Step 5 Calculate profit or loss on realisation.

Step 6 Transfer realisation profit or loss to Partners Capital Accounts in the profit sharing ratio.

Step 7 Transfer all reserve and surplus / fictitious assets to Partners' Capital Accounts in the profit sharing ratio.

Step 8 Receiving of purchase consideration in the form of shares / debentures of the new company.

Step 9 Distribution of shares / debentures amongst the partners.

In the absence of any agreement, share received from the new company should be distributed among the partners in the same ratio as profits and losses are shared.

Accounting Entries in the Books of Partnership Firm

1. For transferring different assets to realisation account
Realisation Account Dr.
To Sundry Assets Account (Individually)

2. For transferring different liabilities to realisation account
Liabilities Account Dr.
To Realisation Account

3. For purchase consideration due
New Company Account Dr.
To Realisation Account

4. For assets taken over by the partners
Partners' Capital Accounts Dr.
To Realisation Account

5. For realisation of assets not taken over by the company
Bank Account Dr.
To Realisation Account

6. For recording unrecorded assets
Assets Account Dr.
To Partners' Capital Accounts

7. For realisation of unrecorded assets
Bank Account Dr.
To Assets Account

Note : If unrecorded assets are taken over by the company, it is also transferred to Realisation Account along with other assets.

8. For payment of liabilities not taken over by the Company
Realisation Account Dr.
To Bank Account

9. For recording unrecorded liabilities
Partners' Capital Accounts Dr.
To Liabilities Account

10. For payment of unrecorded liabilities
Liabilities Account Dr.
To Bank Account

Note : If the unrecorded liabilities are taken over by the company, it is also transferred to Realisation Account along with other liabilities.

11. Liabilities assumed by the partners		
Realisation Account	Dr.	
To Partners' Capital Accounts		
12. For realisation expenses		
Realisation Account	Dr.	
To Bank Account		
13. For profit on realisation		
Realisation Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
14. For Loss on realisation		
Partners' Capital Accounts	Dr. (profit-sharing ratio)	
To Realisation Account		
15. For accumulated profits/reserves		
Reserve Account	Dr.	
Profit & Loss Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
16. For accumulated Loss		
Partners' Capital Accounts	Dr. (profit-sharing ratio)	
To Profit and Loss Account		
17. For transferring partners' current accounts to capital accounts		
Partners' Current Accounts	Dr.	
To Partners' Capital Accounts		
18. For Settlement of purchase consideration by the new company		
Shares in New Co. Account	Dr.	
Debentures in New Co. Account	Dr.	
Cash Account	Dr.	
To New Company Account		
19. For final adjustment		
Partners' Capital Accounts	Dr.	
To Shares in New Co. Account		
To Debenture in New Co. Account		
To Cash Account		

Accounting Entries in the Books of the New Company

The new company will record 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 acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

For assets and liabilities taken over

Assets Account	Dr.	(Acquired Value)
Goodwill Account	Dr.	(Balancing figure)
To Liabilities Account		(Assumed Value)
To Share Capital Account		(Face value of shares issued)
To Securities Premium Account		(if any)

Illustration 1

Ranjit, Manjit and Paramjit are equal partners of Hindal & Co. The Balance Sheet of the firm as on 31.12.2017 was as follows :

Liabilities	₹	₹	Assets	₹	₹
Capital Account :			**Fixed Assets :**		
Ranjit	50,000		Land	50,000	
Manjit	1,00,000		Building	70,000	
Paramjit (Debit Balance)	(30,000)	1,20,000	Plant and Machinery	2,00,000	3,20,000
Loan from Bank		5,00,000	**Current Assets :**		
Creditors		1,00,000	Stock	3,00,000	
			Debtors	1,00,000	4,00,000
		7,20,000			7,20,000

On that date, it is decided to convert the partnership into Limited Company called Hindal Limited on the following terms :

(1) Land to be revalued at ₹ 1,50,000.
(2) Plant and Machinery to be revalued at ₹ 2,50,000.
(3) Depreciation amounting to ₹ 20,000 to be written off on building.
(4) A provision of 10% of book value to be made for obsolete stocks.
(5) A provision for doubtful debts to be made at 10% of the debtors.
(6) A discount of 6% would be earned on creditors when paid out.
(7) The new company will issue 12,000 equity shares of ₹ 10 each credited as fully paid up, such share capital being valued at ₹ 1,50,000 and the balance payable is to be discharged by issue of 10% debentures of ₹ 100 each.

Show the necessary Ledger Accounts to close the books of Hindal & Co and show the opening Balance Sheet of the new Company. All partners are solvent and have sufficient cash resources as may be necessary to settle the respective accounts, shares and debentures are divided equaly among the partners. ***[C.U.B.Com. (Hons.) — Adapted]***

Solution

In the book of Hindal & Co.

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Land A/c	50,000	By Loan from Bank A/c	5,00,000
To Building A/c	70,000	By Creditors A/c	1,00,000
To Plant and Machinery A/c	2,00,000	By New Company A/c	2,16,000
To Stock A/c	3,00,000	(Purchase consideration)	
To Debtors A/c	1,00,000		
To Partners' Capital A/cs :			
Ranjit	32,000		
Manjit	32,000		
Paramjit	32,000		
	8,16,000		8,16,000

Dr. Partners' Capital Accounts Cr.

Particulars	Ranjit	Manjit	Paramjit	Particulars	Ranjit	Manjit	Paramjit
To Balance b/d	—	—	30,000	By Balance b/d	50,000	1,00,000	—
To Equity Sh. in New Company	50,000	50,000	50,000	By Realisation A/c (Profit)	32,000	32,000	32,000
To 10% Debentures in New Co.	22,000	22,000	22,000	By Bank A/c (cash brought in)	—	—	70,000
To Bank A/c (final payment)	10,000	60,000	—				
	82,000	1,32,000	1,02,000		82,000	1,32,000	1,02,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Paramjit Capital A/c	70,000	By Ranjit Capital A/c	10,000
		By Manjit Capital A/c	60,000
	70,000		70,000

Hindal Limited
Balance Sheet as at 31st December, 2017

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,20,000
(b) Reserves and Surplus	(2)	30,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	5,66,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables — Creditors		94,000
(c) Other Current Liabilities		—
(d) Short-term Provisions		—
TOTAL		8,10,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(4)	4,50,000
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		2,70,000
(c) Trade Receivables — Debtors		90,000
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		8,10,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
12,000 Equity Shares of ₹ 10 each	1,20,000

(3) Long-Term Borrowing

	₹
(i) Secured Loans :	
10% Debentures	66,000
(ii) Unsecured Bank Loans	5,00,000
	5,66,000

(2) Reserve and Surplus

Particulars	₹
Secities Premium	30,000

(4) Fixed Assets

Tangible Assets :	
Land	1,50,000
Building	50,000
Plant and Machinery	2,50,000
	4,50,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	(₹)	(₹)
Assets Takenover by the New Company		
Land	1,50,000	
Building (₹ 70,000 – 20,000)	50,000	
Plant and Machinery	2,50,000	
Stock	2,70,000	
Debtors (₹ 1,00,000 – 10,000)	90,000	8,10,000
Liabilities Taken Over by the New Company		
Loan from Bank	5,00,000	
Creditors (₹ 1,00,000 – 6,000)	94,000	5,94,000
Total Purchase Consideration		2,16,000

(2) Discharge of Purchase Consideration

Particulars	(₹)
Equity Shares (12,000 of ₹ 10 each issued at a premium of ₹ 2.50 each)	1,50,000
10% Debentures of ₹ 100 each (Balancing figure)	66,000
	2,16,000

Illustration 2

Nandan and Parijat were partners in a firm sharing profits and losses in the ratio of 3 : 2. The firm was following calendar year as its accounting year. The following is the Balance Sheet of the firm on 31st December, 2017 :

Liabilities	₹	Assets	₹
Partners' Capital :		Goodwill	30,000
Nandan	2,40,000	Land and Buildings	1,00,000
Parijat	2,18,000	Plant and Machinery	2,10,000
Bills Payable	35,000	Furniture and Fittings	1,00,000
Creditors for Goods	25,000	Stock-in-trade	65,000
Creditors for Expenses	40,000	Debtors	25,000
		Cash and Bank Balance	28,000
	5,58,000		5,58,000

On 1st January, 2018 a new company, Nap Ltd. was formed to take over the business of the firm on the following terms:

(a) The company would not take over creditors for expenses to the extent of ₹ 17,000.

(b) Assets are to be valued as follows :
Goodwill ₹ 50,000; Land and Buildings ₹ 1,68,000; Plant and Machinery ₹ 50,000 above book value; Furniture and fittings to be depreciated by 10%; ₹ 5,000 of Debtors to be treated as bad and of the balance 5% is to be treated as doubtful of recovery. Cash and Bank balance to be taken over in full except to meet the creditors for expenses not taken over by the company.

(c) The purchase consideration is to be satisfied by issuing 20,000 equity shares of ₹ 10 each at a premium of 20%, ₹ 1,50,000 by issuing 8% preference shares of ₹ 100 each at par and the balance in the form of 6% debentures issued at 5% discount.

Pass necessary journal entries in the books of the company and prepare the Balance Sheet after acquisition.

Solution **In the books of the Nap Ltd.**

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

Date	Particulars		₹	₹
2018	Goodwill A/c	Dr.	50,000	
Jan. 1	Land and Buildings A/c	Dr.	1,68,000	
	Plant and Machinery A/c	Dr.	2,60,000	
	Furniture and Fittings A/c	Dr.	90,000	
	Stock-in-trade A/c	Dr.	65,000	
	Debtors A/c	Dr.	20,000	
	Cash and Bank A/c	Dr.	11,000	
	Discount on Issue of Debentures A/c	Dr.	10,000	

	To Provision for Bad Debts A/c		1,000
	To Bills Payable A/c		35,000
	To Creditors for Goods A/c		25,000
	To Creditors for Expenses A/c		23,000
	To Equity Shares Capital A/c		2,00,000
	To 8% Preference Shares Capital A/c		1,50,000
	To 6% Debentures A/c		2,00,000
	To Securities Premium A/c		40,000
	(Being the assets and liabilities of the firm taken over at agreed value and the purchase consideration has been satisfied by issue of 20,000 equity shares at a premium of 20%; 8% preference shares of ₹ 1,50,000 at par and the balance amount was paid by issuing 2,000, 8% Debentures of ₹ 100 each at a discount of 5%)		
	Securities Premium A/c Dr.	10,000	
	To Discount on Issue of Debentures A/c		10,000
	(Being the discount on issue of debentures adjusted against securities premium)		

Nap Ltd
Balance Sheet as at 1st January, 2018

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	3,50,000
(b) Reserves and Surplus	(2)	30,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,00,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables	(4a)	60,000
(c) Other Current Liabilities	(4)	23,000
(d) Short-term Provisions		—
TOTAL		6,63,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(5)	5,18,000
(ii) Intangible Assets	(5)	50,000
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—

(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		65,000
(c) Trade Receivables		19,000
(d) Cash and Cash Equivalents		11,000
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		6,63,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
20,000 Equity Shares of ₹ 10 each fully paid	2,00,000
1,500, 8% Preference Shares of ₹ 100 each	1,50,000
	3,50,000
(All the shares have been issued for consideration other than cash)	

(2) Reserve and Surplus

Particulars	₹
Securities Premium	30,000
(3) Long-term Borrowing	
Secured Loan :	
2,000, 6% Debentures of ₹ 100 each	2,00,000
(4) Other Current Liabilities	
Creditors for Expenses	23,000
(4a) Trade Payables	
Bills Payable	35,000
Creditor for Goods	25,000
	60,000

(5) Fixed Assets

(i) *Tangible Assets* :	
Land and Building	1,68,000
Plant and Machinery	2,60,000
Furniture and Fittings	90,000
	5,18,000
(ii) *Intangible Assets* :	
Goodwill	50,000

Working Notes

(1) Calculation of Purchase Consideration

Particulars	(₹)	(₹)
Assets Takenover by Nap Limited		
Goodwill	50,000	
Land and Buildings	1,68,000	
Plant and Machinery	2,60,000	
Furniture and Fittings	90,000	
Stock-in-trade	65,000	
Debtors (₹ 25,000 – 5,000 – 1,000)	19,000	
Cassh and Bank Balance (₹ 28,000 – 17,000)	11,000	6,63,000
Liabilities Taken Over by Nap Limited		
Bills Payable	35,000	
Creditors for Goods	25,000	
Creditors for Expenses (₹ 40,000 – 17,000)	23,000	83,000
Total Purchase Consideration		5,80,000

(2) Discharge of Purchase Consideration

Particulars	(₹)
Equity Shares (20,000 x ₹ 12)	2,40,000
8% Preference Shares (15,000 x ₹ 10)	1,50,000
6% Debentures (2,000 x 100 x 95%)	1,90,000
	5,80,000

Illustration 3

A, B and C carried on business in partnership sharing profits and losses in the ratio of 1 : 2 : 3. They decided to form a private limited company, AB (P) Ltd. and C is not interested to take over the shares in AB (P) Ltd. The authorised share capital of the company is ₹ 12,00,000 divided into 12,000 equity shares of ₹ 100 each. The company was incorporated and took over goodwill as valued and certain assets of the partnership firm on 31.3.2017. The Balance Sheet of the partnership firm on that date was as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			**Fixed Assets** :	
A		1,00,000	Machinery	1,20,000
B		2,00,000	Land	1,74,000
C		3,00,000	Motorcycles	30,000
Current Accounts :			Furniture and Fittings	11,000
A		39,420	**Current Assets** :	
B		60,580	Stock	2,35,000
A's Loan A/c	28,000		Debtors	43,000
Add: Interest accrued	2,000	30,000	Cash in Hand	87,000
Current Liability :			C's Overdrawn	1,00,000
Creditors		70,000		
		8,00,000		8,00,000

C who retired was presented by the other partners (A and B) with one motorcycle valued in the books of the firm ₹ 9,000. The remaining motorcycles were sold in the open market for ₹ 13,000. C also received certain furnitures for which he was charged ₹ 2,000. The debtors which were all considered good were taken over by C for ₹ 40,000. A and B were charged in their profit sharing ratio for the book value of motorcycle presented by them to C.

It was agreed that C who is not willing to take the shares in AB (P) Ltd. was discharged first by providing necessary cash. A and B should bring cash, if necessary.

AB (P) Ltd. took over the remaining furniture and fittings at a price of ₹ 13,000, the machinery for ₹ 1,25,000, the stock at an agreed value of ₹ 2,00,000 and the land at its book value. The value of the goodwill of the partnership firm was agreed at ₹ 88,000. The creditors of the firm were settled by the firm for ₹ 70,000. A's loan account together with interest accrued was transferred to his capital account.

The purchase consideration was discharged by the company by the issue of equal number of fully paid-up equity shares at par to A and B.

Prepare Realisation Account, Capital Account of the Partners and Cash Account. Also draw the Balance Sheet of AB (P) Ltd.

Solution

In the book of the Firm

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Machinery	1,20,000	By Creditors	70,000
To Land	1,74,000	By AB (P) Ltd.	6,00,000
To Motor Cycles	30,000	By Cash (Sale of Motor Cycles)	13,000
To Furniture and Fittings	11,000	By C Capital (Assets takenover) :	
To Stock	2,35,000	Furniture	2,000
To Debtors	43,000	Debtors	40,000
To Cash (Payment to Creditors)	70,000	By A Capital (Motor Cycle Presented)	3,000
To Partners' Capital A/cs :		By B Capital (-do-)	6,000
A	8,500		
B	17,000		
C	25,500		
	7,34,000		7,34,000

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	87,000	By Realisation (Payment to Creditors)	70,000
To Realisation A/c (Sale of Motor Cycles)	13,000	By C Capital A/c	1,83,500
To A Capital A/c	1,25,080		
To B Capital A/c	28,420		
	2,53,500		2,53,500

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Current A/c	—	—	1,00,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To Realisation A/c	3,000	6,000	42,000	By Current A/cs	39,420	60,580	—
To Shares in AB (P) Ltd.	3,00,000	3,00,000	—	By A Loan A/c	30,000	—	—
To Cash (Final Payment)	—	—	1,83,500	By Realisation A/c	8,500	17,000	25,500
				By Cash (Brought-in)	1,25,080	28,420	—
	3,03,000	3,06,000	3,25,500		3,03,000	3,06,000	3,25,500

AB(P) Ltd
Balance Sheet as at 31st March, 2017

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	6,00,000
(b) Reserves and Surplus		—
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings		—
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		—
(d) Short-term Provisions		—
TOTAL		6,00,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(2)	3,12,000
(ii) Intangible Assets	(3)	88,000
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		2,00,000
(c) Trade Receivables		—
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		6,00,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
12,000 Equity Shares of ₹ 100 each	12,00,000
Issued and Subscribed Capital :	
6,000 Equity Shares of ₹ 100 each fully paid	6,00,000
(All the shares have been issued for consideration other than cash)	

(2) Fixed Assets

Particulars	₹
(i) *Tangible Assets* :	
Land	1,74,000
Machinery	1,25,000
Furniture and Fittings	13,000
	3,12,000
(ii) *Intangible Assets* :	
Goodwill	88,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	(₹)
Assets Takenover by AB (P) Ltd.	
Furniture and Fittings	13,000
Machinery	1,25,000
Stock	2,00,000
Land	1,74,000
Goodwill	88,000
	6,00,000

Total 600 Equity Shares of ₹ 100 each will be issued by AB (P) Ltd. A will get 300 shares and B will get 300 shares. All shares will be issued at par.

Illustration 4

A, B and C were partners in business sharing profit and losses in the ratio of 2 : 1 : 1. Their Balance Sheet as at 31.3.2017 is as follows :

Balance Sheet as at 31.3.2017

Liabilities		₹	Assets		₹
Fixed Capital :			Fixed Assets		3,00,000
A	2,00,000		Investments		50,000
B	1,00,000		Current Assets :		
C	1,00,000	4,00,000	Stock	1,00,000	
Current Accounts			Debtors	60,000	
A	40,000		Cash & Bank	1,50,000	3,10,000
B	20,000	60,000			
Unsecured Loans		2,00,000			
		6,60,000			6,60,000

On 1.4.2017, it is agreed among the partners that BC (P) Ltd, a newly formed company with B and C having each taken up 100 shares of ₹ 10 each will take over the firm as a going concern including goodwill but excluding cash and bank balances. The following points are also agreed upon :

(a) Goodwill will be valued at 3 years purchase of super profits.

(b) The actual profit for the purpose of goodwill valuation will be ₹ 1,00,000.

(c) Normal rate of return will be 15% on fixed capital.

(d) All other assets and liabilities will be taken over at book values.

(e) The purchase consideration will be payable partly in shares of ₹ 10 each and partly in cash. Payment in cash being to meet the requirement to discharge A, who has agreed to retire.

(f) B and C are to acquire capital interest in the new company.

(g) Expenses of liquidation ₹ 40,000.

You are required to prepare the necessary Ledger Accounts.

Solution **In the book of the Firm**

Dr. **Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
To Fixed Assets A/c	3,00,000	By Unsecured Loans A/c	2,00,000
To Investment A/c	50,000	By BC (P) Ltd (Note 2)	4,30,000

To Stock A/c	1,00,000	By Partners' Capital A/cs :		
To Debtors A/c	60,000	A	20,000	
To Goodwill A/c (Note 1 & 3)	1,20,000	B	10,000	
To Bank A/c (Expenses)	40,000	C	10,000	40,000
	6,70,000			6,70,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Realisation A/c	20,000	10,000	10,000	By Balance b/d	2,00,000	1,00,000	1,00,000
To Cash A/c	2,80,000	—	—	By Current A/c	40,000	20,000	—
To Cash A/c (Note 6)	—	10,000	—	By Goodwill A/c (Note 3)	60,000	30,000	30,000
To Shares in BC (P) Ltd A/c	—	1,30,000	1,30,000	By Cash A/c (Note 6)	—	—	10,000
	3,00,000	1,50,000	1,40,000		3,00,000	1,50,000	1,40,000

Dr. BC (P) Ltd Account Cr.

Particulars	₹	Particulars	₹
To Realisation A/c (Purchase consideration)	4,30,000	By Cash A/c (Note 4)	1,70,000
		By Shares in BC (P) Ltd A/c	2,60,000
	4,30,000		4,30,000

Dr. Cash and Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance c/d	1,50,000	By Realisation A/c (Expenses)	40,000
To C Capital A/c (Note 6)	10,000	By B Capital A/c (Note 6)	10,000
To BC (P) Ltd A/c (Note 4)	1,70,000	By A Capital A/c	2,80,000
	3,30,000		3,30,000

Working Notes :

(1) Calculation of Goodwill	₹	(2) Calculation of Purchase Consideration	₹
Capital Employed (Fixed Capital)	4,00,000	Goodwill (Note 1)	1,20,000
Actual Profit	1,00,000	Fixed Assets	3,00,000
Less: Normal Profit @ 15% of capital employed	60,0000	Investments	50,000
Super Profit	40,000	Stock	1,00,000
Goodwill = ₹ 40,000 x 3	1,20,000	Debtors	60,000
			6,30,000
		Less: Unsecured Loans	2,00,000
			4,30,000

(3) Goodwill has been recorded in the books by debiting Goodwill Account and crediting Partners' Capital Accounts in the profit sharing ratio of 2 : 1 : 1. After recording goodwill in the books, it is transferred to Realisation Account by debiting Realisation Account and crediting Goodwill Account.

(4) Amount payable to A is ₹ 2,80,000. After meeting realisation expenses cash in hand is ₹ 1,10,000. Therefore, ₹ 1,70,000 must be received from BC (P) Ltd to discharge A in full.

(5) Purchase consideration was agreed at ₹ 4,30,000. ₹ 1,70,000 (Note 4) was paid in cash and the balance ₹ 2,60,000 will be paid in shares in BC (P) Ltd
B's share in BC (P) Ltd will be ₹ 1,30,000 and C's share in BC (P) Ltd will be also ₹ 1,30,000.

(6) C's Capital Account of the firm is showing a balance of ₹ 1,20,000 (₹ 1,00,000 + ₹ 30,000 – ₹ 10,000). therefore, he will bring ₹ 10,000 in cash to make up the deficit.
B's Capital Account of the firm is showing a balance of ₹ 1,40,000 (₹ 1,00,000 + ₹ 20,000 + ₹ 30,000 – ₹ 10,000). Therefore, B will take away ₹ 10,000 from the firm.

Illustration 5

Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd with an authorised share capital of ₹ 2,00,000 divided into 40,000 equity shares of ₹ 5 each.

On 31st December, 2017, the respective Balance Sheets of Star and Moon were as follows :

Particulars	Star (₹)	Moon (₹)
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875

	4,81,000	2,66,375
Less: Current Liabilities	2,98,500	90,125
Representing Capital	1,82,500	1,76,250

Additional information :

(a) Revalued figures of Fixed and Current Assets were as follows :

Particulars	Star (₹)	Moon (₹)
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875

(b) The debtors and creditors include ₹ 21,675 owned by Star to Moon.

The purchase consideration is satifsied by issue of the following shares and debentures :

(i) 30,000 equity shares of Neptune Ltd, to Star and Moon in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

Particulars	Star (₹)	Moon (₹)
2013 Profit	2,24,788	1,36,950
2014 (Loss) / Profit	(1,250)	1,71,050
2016 Profit	1,88,962	1,79,500

(ii) 15% debentures in Neptune Ltd, at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 2017 after revaluation of assets.

You are requested to :

(1) Compute the amount of debentures and shares to be issued to Star and Moon.

(2) A Balance Sheet of Neptune Ltd, showing the position immediately after amalgamation.

Solution **Computation of Amount of Debentures and Shares to be Issued**

Particulars		
(i) Average Profit : ₹ (2,24,788 – 1,250 + 1,88,962) / 3	1,37,500	—
₹ (1,36,950 + 1,71,050 + 1,79,500) / 3	—	1,62,500
(ii) Equity Shares Issued :		
(a) Ratio of Distribution	1,375	1,625
(b) No. of Shares	13,750	16,250
(c) Amount : 13,750 @ ₹ 5	68,750	—
16,250 @ ₹ 5	—	81,250
(iii) Capital Employed (after revaluation of assets) :	₹	₹
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875
	5,04,750	2,73,875
Less: Current Liabilities	2,98,500	90,125
	2,06,250	1,83,750
(iv) Debentures Issued :	₹	₹
8% Return on Capital Employed	16,500	14,700
15% Debentures to be issued to provide equivalent income :		
Star : ₹ 16,500 x 100 / 15	1,10,000	
Moon : ₹ 14,700 x 100 / 15		98,000

Neptune Ltd

Balance Sheet as at 31st December, 2017

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,50,000
(b) Reserves and Surplus	(2)	32,000
(c) Money Received against Share Warrants		—

(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,08,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		3,66,950
(d) Short-term Provisions		—
TOTAL		7,56,950
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets		5,50,000
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		—
(c) Trade Receivables		—
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		2,06,950
TOTAL		7,56,950

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
40,000 Equity Shares of ₹ 5 each	2,00,000
Issued and Subscribed Capital :	
30,000 Equity Shares of ₹ 5 each fully paid	1,50,000
(All the shares have been issued for consideration other than cash)	

(2) Reserve and Surplus

Particulars	₹
Capital Reserve (Note 2)	32,000

(3) Long-term Borrowing

Particulars	₹
Secured Loan :	
15% Debentures	2,08,000

Working Notes

(1) Calculation of Purchase Consideration

Particulars	Star (₹)	Moon (₹)	Total (₹)
Equity Shares Issued	68,750	81,250	1,50,000
15% Debentures Issued	1,10,000	98,000	2,08,000
	1,78,750	1,79,250	3,58,000

(2) Calculation of Capital Reserve

Particulars	Star (₹)	Moon (₹)	Total (₹)
(a) Net Assets taken over :	3,55,000	1,95,000	5,50,000
Fixed Assets	1,49,750	*57,200	2,06,950
Current Assets	5,04,750	2,52,200	7,56,950
	**2,76,825	90,125	3,66,950
Less: Current Liabilities	2,27,925	1,62,075	3,90,000
(b) Purchase Consideration	1,78,750	1,79,250	3,58,000

(c) Capital Reserve [(a) – (b)]	49,175	—	—
(d) Goodwill [(b) – (a)]	—	17,175	—
(e) Final figure of Capital Reserve [(c) – (d)]	—	—	32,000

* ₹ 78,875 – ₹ 21,675   ** ₹ 2,98,5000 – ₹ 21,675

Illustration 6

Avinash, Rohit and Madwesh were carrying on business in partnership sharing profits and losses in the ratio of 5 : 4 : 3 respectively. The Trial Balance of the firm as on 31st March, 2017 was the following :

Particulars	Dr. (₹)	Cr. (₹)
Plant and Machinery at cost	1,05,000	—
Stock	60,200	—
Sundry Debtors	85,000	—
Sundry Creditors	—	1,05,200
Capital A/cs :		
Avinash	—	70,000
Rohit	—	50,000
Madwesh	—	30,000
Drawings A/c :		
Avinash	30,000	—
Rohit	25,000	—
Madwesh	20,000	—
Depreciation on Plant and Machinery	—	35,000
Trading Profit for the year	—	1,29,800
Cash at Bank	94,800	—
	4,20,000	4,20,000

Additional Information :

(a) Interest on Capital Accounts at 10% on the amount standing to the credit of Partners' Capital Accounts at the beginning of the year was not provided before preparing the above Trial Balance.

(b) On 31st March, 2017 they formed a Private Limited Company Anagha (P) Ltd. to take over the partnership business.

(c) You are further informed as under :

(i) Plant and Machinery is to be transferred at ₹ 80,000.

(ii) Equity Shares of ₹ 10 each of the company are to be issued to the partners at par in such numbers to ensure that by reason of their share holdings alone, they will have the same rights of sharing profits and losses as they had in the partnership. Balance, if any in their Capital Accounts, will be settled by giving 7.5% Preference Shares at par.

(iii) Before transferring the business, the partners withdrew by cash from partnership the following amounts over and above the drawings as shown in the Trial Balance :
(a) Avinash — ₹ 20,000; (b) Rohit — ₹ 10,600; (c) Madwesh — ₹ 14,200.

(iv) All assets and liabilities except Plant and Machinery and the Bank Balance are to be transferred at their value in the books of the partnership as at 31st March, 2017.

You are required to prepare :

(a) Profit and Loss Adjustment Account for the year ending 31st March, 2017.

(b) Capital Accounts showing all the adjustments required to dissolve the partnership.

(c) A statement showing the number of shares of each class to be issued by the company to each of the partners to settle their accounts.

(d) Balance Sheet of the company Anagha (P) Ltd. as on 31.03.2017 after take over of the business.

Solution — **In the book of the Firm**

Dr. (a) Profit and Loss Adjustment Account for the year ended 31st March, 2017 Cr.

Particulars	₹	Particulars	₹
To Interest on Capital :		By Net Profit b/d	1,29,800
Avinash	7,000	By Plant and Machinery	10,000
Rohit	5,000		
Madwesh	3,000		

To Partners' Capital A/cs :			
Avinash	52,000		
Rohit	41,600		
Madwesh	31,200		
	1,39,800		1,39,800

Dr. (b) Partners' Capital Accounts Cr.

Particulars	Avinash	Rohit	Madwesh	Particulars	Avinash	Rohit	Madwesh
To Drawings (as per Trial Balance)	30,000	25,000	20,000	By Balance b/d	70,000	50,000	30,000
To Drawings (after Trial Balance)*	20,000	10,600	14,200	By P&L Adjustment A/c	52,000	41,600	31,200
By Balance c/d	79,000	61,000	30,000	By Interest on Capital	7,000	5,000	3,000
	1,29,000	96,600	64,200		1,29,000	96,600	64,200
To Equity Shares	50,000	40,000	30,000	By Balance b/d	79,000	61,000	30,000
To 7.5% Preference Shares	29,000	21,000					
	79,000	61,000	30,000		79,000	61,000	30,000

(c) Statement Showing the Number and Classes of Shares Issued to the Partners

	Avinash	Rohit	Madwesh
Capital balance after adjustment	79,000	61,000	30,000
Taking Madwesh's Capital as base for ensuring same rights of sharing profits and losses —Equity Shares allotted	50,000	40,000	30,000
7.5% Preference Shares issued	29,000	21,000	—

Anagha (P) Ltd
Balance Sheet as at 31st March, 2017

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,70,000
(b) Reserves and Surplus		—
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings		—
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		1,05,200
(d) Short-term Provisions		—
TOTAL		2,75,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets	(2)	80,000
(i) Tangible Assets		—
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—

(b) Non-current Investments			—
(c) Deferred Tax Assets (Net)			—
(d) Long-term Loans and Advances			—
(e) Other Non-current Assets			—
(2) Current Assets :			
(a) Current Investments			—
(b) Inventories			60,200
(c) Trade Receivables			85,000
(d) Cash and Cash Equivalents			50,000
(e) Short-term Loans and Advances			—
(f) Other Current Assets			—
TOTAL			2,75,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
12,000 Equity Shares of ₹ 10 each fully paid	1,20,000
7.5% Preference Shares	50,000
	1,70,000
(All the shares have been issued for consideration other than cash)	

(2) Fixed Assets

Particulars	₹
Tangible Assets :	
Plant and Machinery	80,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	₹
Plant and Machinery	80,000
Stock	60,200
Debtors	85,000
Cash at Bank (₹ 94,800 – ₹ 44,800*)	50,000
	2,75,200
Less: Sundry Creditors	1,05,200
	1,70,000

* Drawings (₹ 20,000 of Avinash + ₹ 10,600 of Rohit + ₹ 14,200 of Madwesh.)

Illustration 7

A, B and C were partners sharing profits and losses in the ratio of 5, 3 and 2 respectively. The trial balance of the firm on 31st March, 2017 was the following:

Debit balances	₹	**Credit balances**	₹
Machinery at cost	1,00,000	Sundry Creditors	64,700
Stock	68,700	Bills Payable	20,000
Sundry Debtors	62,000	Capital A/cs :	
Drawings A/cs :		A	68,000
A	25,000	B	45,000
B	23,000	C	23,000
C	17,000	Depreciation on Machinery	40,000
Cash at bank	89,300	Profit for the year ended 31.03.2016	1,24,300
	3,85,000		3,85,000

Interest on capital accounts at 10% p.a. on the account standing to the credit of Partners' Capital Account at the beginning of the year, was not provided before preparing the above trial balance. On 1st April, 2017 they formed a Private Limited Co, viz., ABC (P) Ltd. with an authorised share capital of ₹ 2,00,000 in shares of ₹ 10 each to be divided in different classes to take over the business of partnership.

You are informed as under :

(1) Machinery is to be transferred at ₹ 70,000.

(2) Shares in the company are to be issued to the partners, at par, in such numbers, and in such classes as will give the partners, by reason of their share holdings alone, the same rights as regards interest on capital and the sharing of profits and losses as they had in the partnership.

(3) Before transferring the business, the partners wish to draw from the partnership profits to such an extent that the bank balance is reduced to ₹ 50,000. For this purpose, sufficient profit of the year are to be retained in profit sharing ratio.

(4) All assets and liabilities except machinery and the bank are to be transferred at their book values as on 31.3.2017.

You are required to prepare :

(a) Capital Accounts showing all adjustments required to dissolve the partnership.

(b) Statement showing the workings of the number of shares of each class to be issued by the company to each of the partners and a statement of additional drawings in cash.

(c) The Balance Sheet of the company immediately after acquiring the business of the partnership and issuing of shares.

Solution

Dr. Profit & Loss Appropriation Account Cr.

Particulars	₹	Particulars	₹
To Interest on Capital A/cs :		By Net Profit b/d	1,24,300
A – ₹ 6,800; B – ₹ 4,500; C – ₹ 2,300	13,600		
To Share of Profit A/c :			
A – ₹ 55,350; B – ₹ 33,210; C – ₹ 22,140	1,10,700		
	1,24,300		1,24,300

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
31.3.2017	₹	₹	₹	1.4.2016	₹	₹	₹
To Drawings A/cs :	25,000	23,000	17,000	By Balance b/d	68,000	45,000	23,000
To Bank A/c –				31.3.2017			
further drawings	27,150	8,710	3,440	By Int. on Capital A/c	6,800	4,500	2,300
To Balance c/d	78,000	51,000	27,000	By Share of profit A/c	55,350	33,210	22,140
	1,30,150	82,710	47,440		1,30,150	82,710	47,440
To 10% Pref. Sh. A/c	68,000	45,000	23,000	By Balance b/d	78,000	51,000	27,000
To Equity Shares A/c	15,000	9,000	6,000	By Realisation A/c	5,000	3,000	2,000
	83,000	54,000	29,000		83,000	54,000	29,000

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Machinery A/c	1,00,000	By Sundry Creditors A/c	64,700
To Stock A/c	68,700	By Bills Payable A/c	20,000
To Sundry Debtors A/c	62,000	By Provision for Depreciation A/c	40,000
To Bank A/c	50,000	By New Company A/c	1,66,000
To Partners' Capital A/cs (profit)			
A – ₹ 5,000; B – ₹ 3,000; C – ₹ 2,000	10,000		
	2,90,700		2,90,700

(i) Statement Showing the Workings for the Number of Shares of each Class to be Issued by the Co.

	₹	₹
Net assets taken over by the company :		
Machinery	70,000	
Stock	68,700	
Sundry Debtors	62,000	
Bank	50,000	2,50,700

Less: Sundry Creditors	64,700	
Bills Payable	20,000	84,700
Net assets taken over or purchase consideration		1,66,000

The above purchase consideration is to be satisfied in such a fashion that will give the partners same amount of interest as they were getting in the firm. Therefore, 10% preference shares to be issued to the partners to cover the amount of interest and the balance in equity shares in the profit sharing ratio. Therefore, the shares to be issued are as under :

	₹	
10% Preference shares of ₹ 10 each :		
A – ₹ 68,000; B – ₹ 45,000; C– ₹ 23,000	1,36,000	
Equity shares of ₹ 10 each :		
A – ₹ 15,000; B – ₹ 9,000; C – ₹ 6,000	30,000	₹ 1,66,000.

(ii) Statement of Additional Drawings in Cash

	₹
Amount already withdrawn ₹ (25,000 + 23,000 + 17,000)	65,000
Add: Available bank balance for drawings ₹ (89,300 – 50,000)	39,300
	1,04,300
Less: Drawings against interest on capital : ₹ (6,800 + 4,500 + 2,300)	13,600
Maximum amount to be withdrawn	90,700

	A	B	C
Maximum amount to be drawn by each partner	₹	₹	₹
(₹ 90,700 to be shared in the ratio 5 : 3 : 2)	45,350	27,210	18,140
Add: Drawings against interest to be allowed	6,800	4,500	2,300
Total allowable drawings against profit and interest	52,150	31,710	20,440
Less: Amount already withdrawn	25,000	23,000	17,000
Additional drawings to be made	27,150	8,710	3,440

ABC (P) Ltd
Balance Sheet as at 31st March, 2017

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,66,000
(b) Reserves and Surplus		—
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings		—
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		64,700
(c) Other Current Liabilities		20,000
(d) Short-term Provisions		—
TOTAL		2,50,700
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(2)	70,000
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—

(b) Non-current Investments			—
(c) Deferred Tax Assets (Net)			—
(d) Long-term Loans and Advances			—
(e) Other Non-current Assets			—
(2) Current Assets :			
(a) Current Investments			—
(b) Inventories			68,700
(c) Trade Receivables			62,000
(d) Cash and Cash Equivalents			50,000
(e) Short-term Loans and Advances			—
(f) Other Current Assets			—
TOTAL			2,50,700

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
20,000 Equity Shares of ₹ 10 each	2,00,000
Issued and Subscribed Capital :	
13,600 10% Preference Shares of ₹ 10 each	1,36,000
3,0500 10% Preference Shares of ₹ 10 each	30,000
	1,66,000
(All the shares have been issued for consideration other than cash)	

(2) Fixed Assets

Particulars	₹
Tangible Assets :	
Machinery	70,000

Illustration 8

Ram, Rahim and Rogers carry on business in partnership under the style of M/s R & Co. sharing profits and losses in the ratio of 5:3:2. They have floated R (Pvt) Ltd for the purpose of take over of their business. The following is the Balance Sheet of the firm as on 31st December, 2017:

Liabilities	₹	Assets		₹
Creditors	50,000	Cash		6,000
Capital Accounts :		Bank		14,000
Ram	1,01,000	Debtors	60,000	
Rahim	1,51,000	Less: Provision for bad debts	2,000	58,000
Rogers	1,33,000	Stock		42,000
		Fixed Assets at W.D.V.		3,00,000
		Expenditure in relation to R. Pvt Ltd :		
		Formation Expenses	12,000	
		Bank Account (Note 1)	3,000	15,000
	4,35,000			4,35,000

Note 1 : (In the name of R. Pvt Ltd) Deposit of par value of 300 equity shares of ₹ 10 each, subscribed equally by the partners as subscribers to the memorandum and articles of association.

On that day R Pvt Ltd took over the business for a total consideration of ₹ 5,00,000 (excluding 300 shares allotted as subscribers of memorandum). The purchase consideration was to be discharged by the allotment of equity shares of ₹ 10 each at par in the profit-sharing ratio and 15% debentures of ₹ 100 each at par for surplus capital.

The Directors of R Pvt Ltd revalued fixed assets of R & Co. as ₹ 4,00,000.

You are asked to :

(a) State the number of equity shares and debentures allotted by R. Pvt Ltd to Ram Rahim & Rogers.;

(b) Show Journal Entries in connection with the above transactions in the books of R. Pvt Ltd Show your workings.

[C.A. (Inter) — Adapted]

Solution

Statement Showing Distribution of Purchase Consideration Among the Partners

	Ram	Rahim	Rogers
Balance of capital accounts	1,01,000	1,51,000	1,33,000
Add: Profit on realisation (Note 2)	59,000	35,400	23,600

Final balance in capital accounts	(A)	1,60,000	1,86,400	1,.56,600
Profit-sharing ratio	(B)	5	3	2
Capital/Profit-sharing ratio	(A/B)	32,000	62,133	78,300
Capital in profit-sharing ratio (taking Ram's capital as the basis)		1,60,000	96,000	64,000
Total equity shares to be issued including initial allotment of ₹ 3,000	(C)	1,60,000	96,000	64,000
Less: Initial allotment		1,000	1,000	1,000
Further issue of shares		1,59,000	95,000	63,000
Allotment of debentures for the balance	(A – C)	—	90,400	92,600
Number of equtiy shares issued		16,000	9,600	6,400
Number of debentures issued		—	904	926

In the books of R (Pvt) Ltd
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Bank A/c	Dr.	3,000	
	To Equity Share Capital A/c			3,000
	(Being the allotment of 300 Eq. sh. of ₹ 10 each for Ram, Rahim, Rogers as subscribers to Memorandum)			
	Goodwill A/c (Balancing figure)	Dr.	18,000	
	Fixed Assets A/c	Dr.	4,00,000	
	Stock A/c	Dr.	42,000	
	Sundry Debtors A/c	Dr.	60,000	
	Bank A/c	Dr.	14,000	
	Cash A/c	Dr.	6,000	
	Preliminary Expenses A/c	Dr.	12,000	
	To Sundry Creditors A/c			50,000
	To Provision for Bad Debts A/c			2,000
	To Equity Share Capital A/c			3,17,000
	To Debentures A/c			1,83,000
	(Being the various assets and liabilities taken over and the issue of 31,800 equity shares and 1,820 debentures in settlement of purchase consideration)			

Working Notes :

Dr. **(1) Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
To Cash A/c	6,000	By Provision for Bad Debts A/c	2,000
To Bank A/c	14,000	By Sundry Creditors A/c	50,000
To Sundry Debtors A/c	60,000	By R Pvt Ltd A/c	5,00,000
To Stock A/c	42,000		
To Fixed Assets A/c	3,00,000		
To Formation Expenses A/c (Note 2)	12,000		
To Partners' Capital A/cs : (profit)			
Ram : ₹ 59,000; Rahim : 35,400; Rogers : 23,600	1,18,000		
	5,52,000		5,52,000

(2) Formation expenses is an asset to R Pvt Ltd and it is to be taken over by the company.

(3) In the books of the firm, the Bank Account (Deposit for shares in R Pvt Ltd) to be closed by passing the following entry :

Shares in R Pvt Ltd	Dr.	₹ 3,000	
To Bank Account (Deposit for shares)			₹ 3,000

Sale to a Company

Introduction

Sometimes, partners may decide to sell their partnership firm to an existing limited company. In this case, the company will take over different assets and liabilities of the firm and the partners will get the shares/debentures of that company and will become the shareholders/debentureholders of the company.

The books of account of the partnership firm will be closed in the usual manner as done in case of conversion of a company.

Illustration 9

P, Q, R and S were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2 : 2. Their Balance Sheet as on 31st March, 2012 stood as follows :

Liabilities	₹	Assets	₹
Capital Accounts :		Goodwill	20,000
P	60,000	Machinery	90,000
Q	40,000	Debtors	16,000
R	6,000	Stocks	8,000
Creditors	10,000	Capital Accounts :	
Accounts Payable	20,000	S	2,000
	1,36,000		1,36,000

S did not have any private assets or liabilities. The firm was dissolved and the partners agreed to sell the fixed assets to ABC Ltd. which allotted 4,500 fully paid equity shares of ₹ 10 each (at the market value of ₹ 15 each) and paid cash ₹ 15,000. Stock and Debtors were realised at book value and the cost of realisation amounted to ₹ 2,500. R was settled off in cash and P and Q were distributed shares in ABC Ltd in their capital ratio.

Prepare Ledger Accounts to close the books of the firm.

[St. Xavier's College (Kolkata) — Semester II, 2012]

Solution

In the book of the Firm

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c	20,000	By Creditors A/c	10,000
To Machinery A/c	90,000	By Accounts Payable A/c	20,000
To Debtors A/c	16,000	By ABC Ltd A/c	82,500
To Stock A/c	8,000	By Cash A/c (₹ 16,000 + 8,000)	24,000
To Cash A/c (Expenses)	2,500	(Realisation of Debtors and Stock)	
To Cash A/c :		By Partners' Capital A/c :	
Creditors	10,000	P (₹ 30,000 x 5/12)	12,500
Accounts Payable	20,000	Q (₹ 30,000 x 3/12)	7,500
		R (₹ 30,000 x 2/12)	5,000
		S (₹ 30,000 x 2/12)	5,000
	1,66,500		1,66,500

Dr. ABC Ltd Account Cr.

Particulars	₹	Particulars	₹
To Realisation A/c	82,500	By Shares in ABC Ltd A/c (4,500 shares @ ₹ 15)	67,500
		By Cash A/c	15,000
	82,500		82,500

Dr. Shares in ABC Ltd Account Cr.

Particulars	₹	Particulars	₹
To ABC Ltd A/c	67,500	By P Capital A/c (Note 2)	40,500
		By Q Capital A/c (Note 2)	27,000
	67,500		67,500

Dr. Partners' Capital Accounts Cr.

Particulars	P	Q	R	S	Particulars	P	Q	R	S
To Balance b/d	—	—	—	2,000	By Balance b/d	60,000	40,000	6,000	—
To Realisation A/c (Loss)	12,500	7,500	5,000	5,000	By P Capital A/c	—	—	—	3,962
To S Capital A/c	3,962	2,642	396	—	By Q Capital A/c	—	—	—	2,642
To Shares in ABC Ltd A/c	40,500	27,000	—	—	By R Capital A/c	—	—	—	396
To Cash A/c (Note 2)	3,038	2,858	604	—					
	60,000	40,000	6,000	7,000		60,000	40,000	6,000	7,000

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To ABC Ltd A/c (Purchase Consideration)	15,000	By Realisation A/c (Payment of liabilities)	30,000
To Realisation A/c (Assets sale)	24,000	By Realisation A/c (Expenses)	2,500
		By P Capital A/c	3,038
		By Q Capital A/c	2,858
		By R Capital A/c	604
	39,000		39,000

Working Notes :

(1) S Capital Account is showing a debit balance of ₹ 7,000. S is insolvent. Therefore, P, Q and R will share the ***debit*** balance in their capital ratio, i.e. : 60 : 40 : 6 or 30 : 20 : 3

	₹
P's share = ₹ 7,000 / 53 × 30	3,962
Q's sjhare = ₹ 7,000 / 53 × 20	2,642
R's share = ₹ 7,000 / 53 × 3	396
	7,000

(2) Statement Showing the Distribution of Shares in ABC Ltd

Particulars	P (₹)	Q (₹)	R (₹)
Opening Balance	60,000	40,000	6,000
Less: Realisation Loss	(12,500)	(7,500)	(5,000)
Less: Share of Deficiency of S	(3,962)	(2,642)	(396)
Net Balance due	43,538	29,858	604
Less: Shares in ABC Ltd in the ratio of capital between P and Q, i.e., 6 : 4	40,500	27,000	—
Amount to be settled in Cash	3,038	2,858	604

Accounting Entries in the Books of Purchasing Company

The purchasing company 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, the following entry is passed:

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Share Capital Account		[Purchase consideration]

2. If the net acquired assets is more than the purchase consideration, it represents capital reserve. The following entry is passed :

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Share Capital Account		[Purchase consideration]
To Capital Reserve Account		

3. Conversely, if the net acquired assets is less than the amount of purchase consideration, it represents goodwill. The following entry is passed :

Assets Account	Dr. [Acquired value]
Goodwill Account	Dr. [Purchase consideration *minus* net assets]
To Liabilities Account	[Assumed value]
To Share Capital Account	[Purchase consideration]

Illustration 10

P and Q were in partnership sharing profits in the proportions 3:2. On 31st March 2017, they accepted an offer from S. 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.

The purchase consideration of ₹ 7,20,000 consisted of cash ₹ 3,60,000, debentures in S. Ltd (at par) ₹ 1,80,000 and 12,000 Equity Shares of ₹ 10 each in S. Ltd. P will be employed in S. Ltd but, since Q was retiring, P agreed to allow him ₹ 30,000 in compensation, to be adjusted through their Capital Accounts. Q was to receive 1,800 shares in S. Ltd and the balance due to him in cash.

Balance Sheet as at 31.3.2017

Liabilities	₹	Assets	₹
P Capital Account	1,20,000	Fixed Assets	4,80,000
Loan : P	2,10,000	Stock	45,000
Bank overdraft	1,50,000	Debtors	75,000
Creditors	1,80,000	Q Capital Account	60,000
	6,60,000		6,60,000

The sale of the assets to S. Ltd took place as agreed; the debtors realised ₹ 60,000 and creditors were settled for ₹ 1,71,000. The partnership then ceased business.

You are required to pass necessary Journal Entries and show:

(a) Realisation Account (b) Bank Account (c) Partners' Capital Accounts, in columnar form, showing the final settlement.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017	Realisation A/c	Dr.	6,00,000	
Mar. 31	To Fixed Assets A/c			4,80,000
	To Stock A/c			45,000
	To Debtors A/c			75,000
	(Being different assets transferred to Realisation Account)			
	Creditors A/c	Dr.	1,80,000	
	To Realisation A/c			1,80,000
	(Being creditors account transferred to Realisation Account)			
	P Loan A/c	Dr.	2,10,000	
	To P Capital A/c			2,10,000
	(Being P's loan transferred to his Capital Account)			
	S Ltd A/c	Dr.	7,20,000	
	To Realisation A/c			7,20,000
	(Being purchase consideration due from S Ltd)			
	Bank A/c	Dr.	3,60,000	
	Debentures in S Ltd A/c	Dr.	1,80,000	
	Shares in S Ltd A/c	Dr.	1,80,000	
	To S Ltd A/c			7,20,000
	(Being purchase consideration received)			
	Bank A/c	Dr.	60,000	
	To Realisation A/c			60,000
	(Being realisation of debtors)			

Realisation A/c	Dr.	1,71,000	
To Bank A/c			1,71,000
(Being payment to creditors)			
Realisation A/c	Dr.	1,89,000	
To P Capital A/c			1,13,400
To Q Capital A/c			75,600
(Being the profit on realisation trans. to Partners' Capital Accounts in the ratio of 3 : 2)			
P Capital A/c	Dr.	30,000	
To Q Capital A/c			30,000
(Being adjustment for compensation)			
P Capital A/c	Dr.	4,13,400	
To Shares in S Ltd A/c			1,53,000
To Debentures in S Ltd A/c			1,80,000
To Bank A/c			80,400
(Being the final settlement of accounts)			
Q Capital A/c	Dr.	45,600	
To Shares in S Ltd A/c (See note)			27,000
To Bank A/c			18,600
(Being the final settlement of accounts)			

Dr. **Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
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 S Ltd A/c (purchase consideration) :	
To Bank A/c (creditors payment)	1,71,000	Cash	3,60,000
To P Capital A/c (profit)	1,13,400	Debentures in S Ltd	1,80,000
To Q Capital A/c (profit)	75,600	Shares in S Ltd (See note)	1,80,000
	9,60,000		9,60,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (Debtors realised)	60,000	By Balance b/d	1,50,000
To S Ltd A/c (purchase consideration)	3,60,000	By Realisation A/c (Creditors payment)	1,71,000
		By Capital A/c — P	80,400
		By Capital A/c — Q	18,600
	4,20,000		4,20,000

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

Date	Particulars	P	Q	Date	Particulars	P	Q
	To Balance b/d	—	60,000		By Balance b/d	1,20,000	—
	To Capital A/c — Q	30,000			By Loan A/c	2,10,000	—
	To Shares in S Ltd A/c	1,53,000	27,000		By Realisation A/c (profit)	1,13,400	75,600
	To Debentures in S Ltd A/c	1,80,000	—		By Capital A/c — P	—	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 : The ₹ 10 equity shares in S Ltd have a value of ₹ 15 each placed upon them.

Illustration 11

Somsons Ltd. agreed to purchase the business of a firm consisting of two brothers, K. Som and D. Som as on 31st March, 2017. The Balance Sheet of the firm on that date was as follows :

Liabilities	₹	Assets	₹
Capital Account :		Land and Building	47,000
K. Som	76,000	Plant and Machinery	28,000
D. Som	58,000	Furniture and Fixtures	7,000
General Reserve	30,000	Stock-in-Trade	62,000
Sundry Creditors	37,000	Sundry Debtors	55,000
Outstanding Expenses	3,000	Cash	5,000
	2,04,000		2,04,000

The company agreed to take over the liabilities and all the assets with the exception of cash, the agreed purchase price being ₹ 1,80,000 to be satisfied as to 1/4 in cash and 3/4 by the issue of fully paid equity shares of ₹ 10 each at an agreed value of ₹ 12.50 per share. The company made the following revaluations of the assets taken over when bringing them into books : Land and Building ₹ 62,000; Plant and Machinery ₹ 25,000; Furniture and Fixtures ₹ 5,000; Stock-in-trade ₹ 58,000; Sundry Debtors ₹ 50,000.

Give the entries necessary to record the acquisition of the business in the books of the company.

[C.U.B.Com. (Hons.) — Adapted]

Solution **In the books of the Somsons Ltd.**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017	Goodwill A/c (Note 1)	Dr.	20,000	
April 1	Land and Building A/c	Dr.	62,000	
	Plant and Machinery A/c	Dr.	25,000	
	Furniture and Fixtures A/c	Dr.	5,000	
	Stock-in-trade A/c	Dr.	58,000	
	Sundry Debtors A/c	Dr.	50,000	
	To Sundry Creditors A/c			37,000
	To Outstanding Expenses A/c			3,000
	To Business Purchase A/c			1,80,000
	(Being different assets and liabilities of the firm taken over at agreed value. The difference between purchase consideration and net assets has been transferred to Goodwill Account)			
	Business Purchase A/c	Dr.	1,80,000	
	To Cash A/c			45,000
	To Equity Share Capital A/c			1,08,000
	To Securities Premium A/c			27,000
	(Being the purchase consideration paid off by issuing 10,800 equity shares of ₹ 10 each at a premium of ₹ 2.50 each as per Board's Resolution No. ... dated ...))			

Working Note: **(1) Calculation of Goodwill / Capital Reserve**

Particulars	(₹)	(₹)
Assets Takenover (at agreed value)		
Land and Building	62,000	
Plant and Machinery	25,000	
Furniture and Fixtures	5,000	
Stock-in-trade	28,000	
Sundry Debtors	50,000	2,00,000
Liabilities Taken Over (at agreed value)		
Sundry Creditors	37,000	
Outstanding Expenses	3,000	40,000
(A) Net Assets Taken Over		1,60,000
(B) Purchase Consideration Paid		1,80,000
Goodwill (B – A)		20,000

Illustration 12

A and B were in partnership sharing profits and losses in the ratio of 2 : 1. Their Summarised Balance Sheet as on March 31, 2017 was as under:

Liabilities	₹	₹	Assets	₹	₹
Fixed Capital Accounts :			Fixed Assets		70,000
A	50,000		Current Assets:		
B	40,000	90,000	Stock	35,000	
Current Accounts :			Debtors	65,000	
A	20,000		Bank	15,000	1,15,000
Less : B	10,000	10,000			
Loan — B		30,000			
Creditors		55,000			
		1,85,000			1,85,000

The fixed assets included two motor cars having book values at ₹ 8,000 and ₹ 6,000 respectively. The partners, desiring to retire from business, accepted the offer of Western Indian Limited to acquire the stock and fixed assets, other than the motor cars, at an agreed purchase price of ₹ 1,60,000. The purchase consideration was to be satisfied by a cash payment of ₹ 56,000, the allotment by the company to the partners of 400, 5% preference shares of ₹ 100 each, and the balance by the allotment by the company to the partners of 900 equity shares of ₹ 100 each.

The debtors realised ₹ 61,000 and the creditors were settled for ₹ 51,000. The partners agreed that the following should be the basis of distribution on dissolution of the partnership:

(1) A to take over one car at a valuation of ₹ 12,000 and B the other at ₹ 8,000.
(2) B to be allotted preference shares to the value of his loan, the remainder to be allotted to A.
(3) The equity shares to be allotted in proportion of fixed capitals.
(4) Both the preference and equity shares to be valued at ₹ 80 per share.
(5) The balances to be settlled in cash.

You are required to prepare :

(a) The Realisation Account;
(b) The Partners' Capital Accounts showing the final settlement between them; and (c) The Bank Account.

Solution

In the book of the Firm

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Fixed Assets A/c	70,000	By Creditors A/c	55,000
To Stock A/c	35,000	By Western India Ltd A/c (purchase consideration)	1,60,000
To Debtors A/c	65,000	By A Capital A/c – car taken over	12,000
To Bank A/c (creditors)	51,000	By B Capital A/c – car taken over	8,000
To A Capital A/c	50,000	By Bank A/c (Debtors)	61,000
To B Capital A/c	25,000		
	2,96,000		2,96,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
	To B Current A/c – transfer	—	10,000		By Balance b/d	50,000	40,000
	To Realisation A/c – cars taken	12,000	8,000		By A Current A/c (transfer)	20,000	—
	To Pref. Sh. in West. (I) Ltd A/c	2,000	30,000		By B's Loan A/c (transfer)	—	30,000
	To Eq. Sh. in West. (I) Ltd (5:4)	40,000	32,000		By Realisation A/c (profit)	50,000	25,000
	To Bank A/c	66,000	15,000				
		1,20,000	95,000			1,20,000	95,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	15,000	By Realisation A/c (Creditors)	51,000
To Realisation A/c (Debtors)	61,000	By A Capital A/c	66,000
To Western India Limited A/c	56,000	By B Capital A/c	15,000
	1,32,000		1,32,000

Working Notes : The purchase consideration is satisfied by Western India Ltd as under :

Bank ₹ 56,000 + Preference shares (400 x ₹ 80) ₹ 32,000 + Equity shares (900 x ₹ 80) ₹ 72,000; Total = ₹ 1,60,000.

Illustration 13

X and Y carrying on business in partnership sharing profits and losses equally, wished to dissolve the firm and sell the business to X Limited Company on 31.3.2017 when the firm's position was as follows :

Liabilities	₹	Assets	₹
X's Capital	1,50,000	Land and Building	1,00,000
Y's Capital	1,00,000	Furniture	40,000
Sundry Creditors	60,000	Stock	1,00,000
		Debtors	66,000
		Cash	4,000
	3,10,000		3,10,000

The arrangement with X Limited Company was as follows :

(i) Land and Building was purchased at 20% more than the book value.

(ii) Furniture and stock were purchased at book values less 15%.

(iii) The goodwill of the firm was valued at ₹ 40,000.

(iv) The firm's debtors, cash and creditors were not to be taken over. But the company agreed to collect the book debts of the firm and discharge the creditors of the firm as an agent for which services, the company was to be paid 5% on all collections from the firm's debtors and 3% on cash paid to firm's creditors.

(v) The purchase price was to be discharged by the company in fully paid equity shares of ₹ 10 each at a premium of ₹ 2 per share.

The company collected all the amounts from debtors. The creditors were paid off less by ₹ 1,000 allowed by them as discount. The company paid the balance due to the vendors in cash.

Prepare the Realisation Account, the Capital Accounts of the partners and the Cash Account in the books of the partnership firm.

Solution

In the book of the Firm

Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Land and Building	1,00,000	By Sundry Creditors	60,000
To Furniture	40,000	By X Ltd. A/c (Note 1)	2,79,000
To Stock	1,00,000	By X Ltd. A/c (Collection from Debtors)	66,000
To Debtors	66,000		
To X Ltd. A/c (Payment to Creditors)	59,000		
To X Ltd. A/c (Commission)			
Collection of Debtors	3,300		
Payment to Creditors	1,770		
To Partners' Capital A/cs :			
X	17,465		
Y	17,465		
	4,05,000		4,05,000

Partners' Capital Accounts

Dr. **Cr.**

Particulars	X	Y	Particulars	X	Y
To Shares in X Ltd. (Note 4)	1,39,500	1,39,500	By Balance b/d	1,50,000	1,00,000
To Cash A/c	27,965		By Realisation A/c (Profit)	17,465	17,465
			By Cash A/c	—	22,035
	1,67,465	1,39,500		1,67,465	1,39,500

Cash Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	4,000	By X Capital A/c (final payment)	27,965
To X Ltd. A/c	1,930		
To Y Capital A/c	22,035		
	27,965		27,965

Working Notes

(1) Calculation of Purchase Consideration

Particulars	₹
Land and Building	1,20,000
Furniture	34,000
Stock	85,000
Goodwill	40,000
	2,79,000

Dr.	(2) X Ltd. Account		Cr.
Particulars	₹	Particulars	₹
To Realisation A/c —		By Realisation A/c —	
Purchase Consideration	2,79,000	Payment to Creditors	59,000
Collection from Debtors	66,000	Commission (Total)	5,070
		By Equity Shares in X Ltd.	
		(23,250 shares @ ₹ 12 each)	2,79,000
		By Cash A/c (Balancing figure)	1,930
	3,45,000		3,45,000

Dr.	(3) Shares in X Ltd. Account		Cr.
Particulars	₹	Particulars	₹
To X Ltd. A/c	2,79,000	By X Capital A/c	1,39,500
		By Y Capital A/c	1,39,500
	2,79,000		2,79,000

(4) Shares received from X Ltd. has been distributed among X and Y in the profit sharing rato.

X : 1/2 of 23,250 shares = 11,625 shares @ ₹ 12 = ₹ **1,39,500**.

Y : 1/2 of 23,250 shares = 11,625 shares @ ₹ 12 = ₹ **1,39,500**.

Illustration 14

A and B were carrying on business sharing profits and losses equally. The Firm's Balance Sheet as at 31.12.2016 was:

Liabilities		₹	Assets		₹
Sundry Creditors		60,000	Stock		60,000
Bank overdraft		35,000	Machinery		1,50,000
Capital A/cs :	₹		Debtors		70,000
A	1,40,000		Joint Life Policy		9,000
B	1,30,000	2,70,000	Leasehold Premises		34,000
			Profit & Loss A/c		26,000
			Drawings Accounts :	₹	
			A	10,000	
			B	6,000	16,000
		3,65,000			3,65,000

The business was carried on till 30.6.2017. The partners withdrew in equal amounts half the amount of profits made during the period of six months after charging depreciation at 10% p.a. on machinery and after writting off 5% on leasehold premises. In the half year, sundry creditors were reduced by ₹ 10,000 and bank overdraft by ₹ 15,000.

On 30.6.2017, stock was valued at ₹ 75,000 and Debtors at ₹ 60,000; the Joint Life Policy had been surrendered for ₹ 9,000 before 30.6.2017 and other items remained the same as at 31.12.2016.

On 30.6.2017, the firm sold the business to a Limited Company. The value of goodwill was fixed at ₹ 1,00,000 and the rest of the assets were valued on the basis of the Balance Sheet as at 30.6.2017. The Company paid the purchase consideration in Equity Shares of ₹ 10 each.

You are required to prepare :

(a) Balance Sheet of the firm as at 30.6.2017;

(b) The Realisation Account; and

(c) Partners' Capital Accounts showing the final settlement between them.

[C.A. (Inter) — Adapted]

Solution

Workings : (1) Ascertainment of Profit for the 6 Months Ended 30th June, 2017

Closing Assets :	₹	₹
Stock		75,000
Sundry Debtors		60,000
Machinery less depreciation		1,42,500
Leasehold premises less written off		32,300
		3,09,800

Less: Closing liabilities :		
Sundry Creditors	50,000	
Bank overdraft	20,000	70,000
Closing Net Assets		2,39,800
Less: Opening combined capital :		
A – ₹ (1,40,000 – 13,000 – 10,000)	1,17,000	
B – ₹ (1,30,000 – 13,000 – 6,000)	1,11,000	2,28,000
Profit before adjustment of drawings		11,800
Add : Combined drawings during the 6 months (equal to profit)		11,800
Profit for the 6 months		23,600

(2) Ascertainment of purchase consideration :

Closing net assets (as above) ₹ 2,39,800 + Goodwill ₹ 1,00,000 = ₹ 3,39,800.

Balance Sheet as on 30.06.2017

Liabilities		₹	Assets		₹
Capital Accounts :	₹		Machinery	1,50,000	
A – Balance as on 1.1.2017	1,17,000		Less : Depreciation @ 10% p.a.	7,500	1,42,500
Add : Profit for 6 months	11,800		Leasehold premises	34,000	
	1,28,800		Less: written-off @ 5% p.a.	1,700	32,300
Less: Drawings for 6 months	5,900	1,22,900	Stock		75,000
B – Balance as on 1.1.2017	1,11,000		Sundry Debtors		60,000
Add : Profit for 6 months	11,800				
	1,22,800				
Less: Drawings for 6 months	5,900	1,16,900			
Sundry Creditors		50,000			
Bank overdraft		20,000			
		3,09,800			3,09,800

Dr. **Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
To Machinery A/c	1,42,500	By Sundry Creditors A/c	50,000
To Leasehold Premises A/c	32,300	By Bank Overdraft A/c	20,000
To Stock A/c	75,000	By Purchasing Company A/c	3,39,800
To Sundry Debtors A/c	60,000	(purchase consideration)	
To A Capital A/c	50,000		
To B Capital A/c	50,000		
	4,09,800		4,09,800

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

Date	Particulars	A	B	Date	Particulars	A	B
1.1.2017	To Profit & Loss A/c	13,000	13,000	1.1.2017	By Balance b/d	1,40,000	1,30,000
	To Drawings A/c	10,000	6,000	30.6.2017	By Profit and Loss Appropriation A/c	11,800	11,800
30.6.2017	To Drawings A/c	5,900	5,900				
	To Shares in Purchasing Co. A/c	1,72,900	1,66,900		By Realisation A/c	50,000	50,000
		2,01,800	1,91,800			2,01,800	1,91,800

Key Points

- The partners may decide to convert the partnership business into a limited company (Private or Public) in order to: (a) limit their personal liability; (b) have access to additional equity financing; (c) obtain selected tax advantages; (d) explore other sound business opportunities; (e) continue business for a long time.
- At the time of conversion, the partnership is dissolved and a new company is floated.
- To close the books of account of the partnership firm, the following steps are generally followed:
  Step 1 : Prepare the Balance Sheet of the partnership firm on the date of conversion.
  Step 2 : Open a Realisation Account and transfer all assets and liabilities (excluding fictitious assets) to this account.
  Step 3 : Calculate purchase consideration on the basis of terms and conditions agreed upon.
  Step 4 : Credit Realisation Account with purchase consideration.
  Step 5 : Calculate profit or loss on realisation.
  Step 6 : Transfer realisation profit or loss to Partners Capital Accounts in the profit sharing ratio.
  Step 7 : Transfer all reserve and surplus / fictitious assets to Partners' Capital Accounts in the profit sharing ratio.
  Step 8 : Receiving of purchase consideration in the form of shares / debentures of the new company.
  Step 9 : Distribution of shares / debentures amongst the partners.
- The new company will record 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 acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

THEORETICAL QUESTIONS

1. What are the accounting implications of conversion of a partnership firm to a company ?
2. Explain the process of conversion of a partnership to a company.
3. What are the advantages of conversion of a partnership firm into a company ?
4. How shares of the new company is distributed amongst the partners ?
5. Why realisation account is prepared in place of revaluation account at the time of conversion of a partnership to a company ?
6. Why a partnership firm is sold to a company ?

PRACTICAL QUESTIONS

Conversion to a Company / Sale to a Company

1. A and B are partners sharing profits & losses in the ratio of 3 : 2. Their Balance Sheet as on 31.12.2016 was :

Liabilities	₹	Assets	₹
A's Capital	30,000	Goodwill	5,000
B's Capital	20,000	Other Fixed Assets	30,000
Reserve	15,000	Joint Life Policy	20,000
Current Liabilities	30,000	Other Assets	40,000
	95,000		95,000

On 30.6.2017, AB Ltd. was formed to take over the partnership business upto that date, a net profit of ₹ 10,000 was made after charging depreciation on fixed assets @ 10% p.a. For the purpose of transfer, Goodwill was valued at ₹ 30,000. The joint life policy was surrendered for ₹ 15,000 and nothing was withdrawn by the partners. Purchase consideration was paid by shares of ₹ 10 each. The company also issued 15,000 shares of ₹ 10 each to the public as fully paid. All shares were sold.

Close the books of the firm and prepare the opening Balance Sheet of AB Ltd.

2. Mr Brown had been trading under the name of BS. On 1st January, 2017 a company, X Limited, was formed with an authorised share capital of ₹ 8,00,000. On the same date the entire business of BS, except investments but including cash was transferred to X Limited.

   From the information given below you are required to prepare:

   (a) a Profit and Loss Account for BS for the year ended 31st December, 2016 and a balance sheet at that date;
   (b) a realisation account showing the transfer of the business of BS at 1st January, 2017;
   (c) a capital account of Mr Brown at 1st January, 2017;
   (d) a balance sheet of X Limited on the completion of the takeover of the business of BS on 1st January, 2017. (Taxation is to be ignored and workings must be shown).

   1. All assets taken over by X Limited were transferred at book values except the following, which were taken over by the company at the following valuations:
      Land and buildings at ₹ 4,00,000; Plant and machinery at ₹ 1,00,000;
   2. Investments were valued at ₹ 40,000 and were taken over by Mr Brown at that value.
   3. The shares of the new company, X Limited, were of ₹ 10 each and issued at par. Mr Brown received 8,00,000 shares in the new company and gave his wife one of these shares so that she would be a shareholder in X Limited.
   4. The trial balance of BS as at 31st December, 2016 was as follows:

Debit Balances	₹	Credit Balances	₹
Land and Buildings	4,40,000	Plant Depreciation	2,20,000
Plant and Machinery	4,00,000	Fixture Depreciation	16,000
Fixtures & Fittings	40,000	Bad debts provision	6,000
Investments	20,000	Trade creditors	1,70,000
Stock	96,000	Capital – Mr Brown	7,66,000
Debtors	1,80,000	Sales	12,00,000
Cash	66,000		
Drawings – Mr Brown	1,56,000		
Purchases	8,18,000		
Wages	1,40,000		
Rates & Insurance	10,000		
Heat and Light	7,000		
Travel	3,000		
Sundries	2,000		
	23,78,000		23,78,000

   5. The following adjustments were still to be recorded :
      (a) Depreciation was to be charged at 5% straight-line on plant and machinery and 10% straight line on fixtures and fittings;
      (b) At the year end a bad debts provision of ₹ 20,000 was thought necessary;
      (c) Accrued expenses at 31st December, 2016 were:
          Wages — ₹ 5,000; Head and light — ₹ 3,000; Travel — ₹ 2,000;
      (d) Stock at December, 2016 was ₹ 1,14,000.

3. Abraham, Benjamin and Chapman are in partnership sharing profits and losses in the proportion of 5 : 3 : 2 respectively. Their Balance Sheet as on March 31, 2017 was as follows:

Liabilities	₹	Assets	₹
Capitals :		Sundry assets	1,88,400
Abraham	94,000	Cash	2,700
Benzamin	61,000	Bank balance	5,500
Chapman	26,000		
Creditors	15,600		
	1,96,600		1,96,600

   On April 1, 2017 they sold their business including the bank balance to ABC Ltd, on the following terms:

   (a) The company to satisfy the purchase consideration by issue of ₹ 25,000 6% debentures; 9,600 equity shares of ₹ 8 each at a premium of ₹ 2 per share; and ₹ 72,000 8% preference shares of ₹ 100 each.
   (b) The partners will draw cash before transfer to the company and divide the same equally among them.

(c) Out of the purchase consideration the debentures and the preference shares are agreed to be divided as follows: Debentures : Abraham – ₹ 16,000; Benzamin – ₹ 9,000.
Preference Shares – To be shared by all in proportion to original capital amounts after adjustment of debenture value as above.
Draw up Realisation Account and the Partners'Capital Accounts showing distribution of shares amongst them.

4. Lion and Tiger were in partnership sharing profits and losses in the ratio of 3 : 1. The following is the Balance Sheet of the partnership as on March 31, 2017.

Liabilities	₹	Assets	₹
Capital Accounts:		Fixed assets	21,000
Lion	24,000	Stock	11,200
Tiger	8,000	Debtors	19,600
Current Accounts :		Cash at bank	3,720
Lion	4,200		
Tiger	2,000		
Loan – Tiger	3,000		
Creditors	14,320		
	55,520		55,520

Elephant Ltd agreed to take over stock and fixed assets, excluding the value of motor car ₹ 4,100 for a consideration of ₹ 48,000 which is to be satisfied by payment of cash ₹ 16,000, allotment of 160 preference shares of ₹ 100 each valued at ₹ 75 per share, and the balance by allotment of 1,600 equity shares of the face value of ₹ 10 each. The debtors realised ₹ 19,200 and the creditors were settled for ₹ 14,000.
The following were agreed between the partners.
(a) The equity shares should be allotted in the ratio of the Partners' Capital Accounts as per the Balance Sheet.
(b) Lion to take over the motor car at an agreed value of ₹ 4,200.
(c) The preference share to be allotted to Tiger to the value of his loan and the remainder to be allotted equally between the partners.
(d) Balance remaining to be settled in cash.
You are required to show :
(i) The Realisation Account;
(ii) Partners' Capital Accounts;
(iii) Bank Account;
(iv) Statement showing distribution of shares.

5. Mr B and Mr E are partners sharing profits and losses in the ratio of 3 : 2. On 30th September, 2016, they admit Mr C as a partner, and the new profit ratio is 2 : 2 : 1. C brought in Fixture ₹ 3,000 and cash ₹ 10,000, the goodwill being (i) B and E ₹ 20,000 and (ii) C ₹ 10,000 but neither figure is to be brought into the books.
On 31st March 2017, the partnership is dissolved. B retiring and the other two partners forming a company called BC Limited with equal capitals, taking over all remaining assets and liabilities, goodwill being agreed at ₹ 40,000 and brought into books of the company. B agrees to take over the business car at ₹ 3,700; Plant was sold for ₹ 3,000 being in excess of requirements. The profits of the two preceding year were ₹ 17,200 and ₹ 19,000 respectively and it was agreed that for the half year ended 30th September 2016, the net profit was to be taken as equal to the average of the two preceding years and the current year. No entries had been made when C entered, except cash. No new book being opened by BC Company Ltd, B agreed to have ₹ 50,000 as loan to the company, secured by 12% Debentures. the following is the Trial Balance as on 31st March, 2017 :

Heads of Account	Dr (₹)	Cr (₹)	Heads of Account	Dr (₹)	Cr (₹)
Capital Accounts :			Debtors and Creditors	31,000	12,000
B	—	35,000	Plant (B.V. of plant sold ₹ 4,000)	23,000	—
E	—	20,000	Fixtures	7,000	—
C	—	10,000	Motor Car	2,700	—
Drawing Accounts :			Stock on 31st March 2017	13,000	—
B	6,000	—	Bank	16,300	—
E	5,000	—	P&L Account for the year	—	29,800
C	2,800	—		1,06,800	1,06,800

Prepare :
(a) Goodwill Adjustment Account;
(b) Capital Accounts of Partners;
(c) Profit and Loss Appropriation Account;
(d) Balance Sheet of BC Ltd as on 31st March, 2017.

6. Riu, Inu and Sinu were running partnership business sharing profits and losses in 2 : 2 : 1 ratio. Their Balance Sheet as on 31st March, 2017 stood as follows : (all figures in ₹ '000)

Liabilities	₹	₹	Assets	₹	₹
Fixed Capital :			Fixed Assets		400
Riu	300		Investments		50
Inu	200		Current Assets :		
Sinu	100	600	Stock	100	
Current Accounts :			Debtors	275	
Riu	60		Cash and Bank	125	500
Sinu	40	100			
Unsecured Loans		100			
Current Liabilities		150			
		950			950

On 01.04.2017, they agreed to form a new company RIS (P) Ltd. with Inu and Sinu each taking up 200 shares of ₹ 10 each, which shall take over the firm as a going concern including Goodwill, but excluding Cash and Bank balances.

The following are also agreed upon :
(a) Goodwill will be valued at 3 year's purchase of super profits.
(b) The actual profit for the purpose of Goodwill valuation will be ₹ 2,00,000.
(c) The normal rate of return will be 18% per annum on Fixed Capital.
(d) All other assets and liabilities will be taken over at book values.
(e) The Purchase Consideration will be payable partly in shares of ₹ 10 each and partly in cash. Payment in cash being to meet the requirement to discharge Riu, who has agreed to retire.
(f) Inu and Sinu are to acquire interest in the new company at the ratio 3 : 2.
(g) Realisation expenses amounted to ₹ 51,000.

You are required to prepare Realisation Account, Cash and Bank Account, RIS (P) Limited Account and Capital Account of Partners.

7. C & R and K & T are two partnerships, trading separately as steel stockholders. The leasehold premises of C & R are due to revert to the freeholders in five years time. K of K & T who is nearing his 70th birhday wishes to retire. It is agreed to amalgamate the two firms as at 1st April 2017 and to form a new company S Limited.

You are required, using the information given, to :
(a) prepare Journal Entries closing the books of the two partnerships;
(b) show in columnar form the Capital Accounts of the partners to include the final cash payment and shares received;
(c) prepare the opening Balance Sheet of the new company after the various adjustments have been made.

The Balance Sheet of the partnerships prior to amalgamation were (all figures in rupees) :

Liabilities	C & R	K & T	Assets	C & R	K & T
Capital Accounts :			Goodwill	4,000	—
C	7,100	—	Freehold Premises	—	15,000
R	4,800	—	Leasehold Premises	1,500	—
K	—	24,200	Plant and Equipment	1,200	2,700
T	—	10,000	Vehicles	2,500	4,000
Provision for Dilapidations	2,200	—	Investment (at cost)	—	2,600
Creditors	4,200	8,400	Stock	3,900	8,000
Bank Overdraft	—	1,700	Debtors	5,000	12,000
			Balance at Bank	200	—
	18,300	44,300		18,300	44,300

All the profits of the two firms, whether revenue or capital, were shared in the ratios : C : R – 5 : 3; K : T – 4 : 3.

You are given the following information :

1. C & R immediately surrendered the lease to the freeholder, who agreed to waive his right to dilapidations and pay them ₹ 1,000.
2. The amounts agreed for the assets and liabilities taken over by S Limited were :

	C & R	K & T		C & R	K & T
Goodwill	8,000	12,000	Stock	3,700	7,500
Freehold premises	—	25,000	Debtors	4,500	11,000
Plant and equipment	1,000	2,500	Creditors	4,100	8,300
Vehicles	2,500	3,500			

3. The investments were taken over by K at an agreed value of ₹ 6,400.
4. T agreed to pay off the bank overdraft and the final balance at the bank of C & R were shared equally between the partners.
5. C, R and T paid in such amounts as were necessary to enable K to be paid in full, so that their respective shareholders were finally C — 30%; R — 30%; T — 40%.
6. S Limited allotted shares of ₹ 10 each at par as consideration for the assets taken over.

8. On 31st December, 2016 Fairway Ltd. was incorporated with an authorised share capital of ₹ 10,00,000 in shares of ₹ 10 each to take over the business on that date by the partnership X Y and Z.

The Balance Sheet of the partnership on 31st December, 2016 showed the following position

Dr. Partners' Capital Accounts Cr.

Capital & Current A/cs	X	Y	Z	Total	Represented by	Cost	Dep.	Total
Capital Accounts	1,20,000	90,000	75,000	2,85,000	**Fixed Assets** :			
Current Accounts :					Freehold land and buildings	1,30,000	—	1,30,000
Balance as on 31.12.2014	59,700	42,400	30,000		Plant and Machinery	2,10,000	1,10,000	1,00,000
Add: Int. on capital accounts	3,600	2,700	2,250		Motor Vehicles	98,500	23,500	75,000
Add: Sh. of profit for the year	30,630	30,630	20,420			4,38,500	1,33,500	3,05,000
	93,930	75,730	52,670		**Current Assets** :			
Less: Drawings	44,630	43,630	20,320		Stock		1,12,000	
	49,300	32,100	32,350	1,13,750	Debtors		61,000	
					Balance at bank		98,750	
							2,71,750	
					Less: Creditors		1,78,000	93,750
				3,98,750				3,98,750

You are also given the following information :

(i) Freehold land and buildings are to be transferred to the limited company at a valuation of ₹. 1,50,000 and Plant and Mchinery at ₹ 75,000. Stocks, debtors and creditors are to be transferred to the company at book value as on 31st December, 2016.

(ii) The motor vehicles are to be withdrawn from the business by the partners at the following valuation: X ₹ 24,500; Y ₹ 17,500; and Z ₹ 18,000.

(iii) It is estimated that the company will require an opening balance at bank of ₹ 75,000.

(iv) Sufficient 9% Unsecured Debentures is to be issued by the company to the partners so that they will receive the same interest as they received on capital in the partnership for the year ended 31st December, 2016.

(v) Equity Shares are to be issued at par to each partner in proportion to their shares in the partnership profits.

(vi) Any surplus or deficiency on partners' accounts on realisation after taking into account debentures and shares issued is to be withdrawn or paid in, whichever the case may.

Required :

(a) Your computation of the Shares and Debentures in Fairway Ltd. to be issued to each partner.

(b) Partners' Capital Accounts in columnar form; and

(c) A Balance Sheet of the company upon completion.

9. Stern, Bow and Kell have carried on partnership for several years, sharing profits and losses equally after allowing salaries of :Stern – ₹ 10,000 p.a.; Bow – ₹ 6,000 p.a.; Kell – ₹ 6,000 p.a.
They decided to convert the partnership into a limited company, Amidships Ltd., as at 31 October 2016 (the mid-point of their financial year) on the following terms :
(a) Goodwill to be valued at ₹ 45,000;
(b) Other assets to be revalued as follows :
Freehold property – ₹ 90,000; Equipment – ₹ 8,000; Motor vehicles – ₹ 20,000.
(c) Shares are to be issued to each partner at par in respect of the amount of their equity holding at 31 October. The company is incorporated on 1 November.
(d) Each partner is to become a director of the Company at a similar salary to that previously allowed in the partnership and drawn out by the partners.
(e) Bow's loan is to be converted into share capital at par.
No action has been taken to carry out the terms of the conversion of the partnership into the limited company in the books of account.
At 30th April, 2017 a Trial Balance showed the following position :

Trial Balance of Amidships Ltd. as on 30 April, 2017

Debit Balances	₹	Credit Balances	₹
Drawings during the year :		Capital A/cs at 1 May, 2016 :	
Stern	10,000	Stern	60,000
Bow	6,000	Bow	30,000
Kell	6,000	Kell	20,000
Stock on 30 April, 2017 :	48,000	Sales	2,00,000
Cost of Sales	1,20,000	Accumulated Depreciation — Equipment	12,000
Administration Expenses	20,000	Accumulated Depreciation — Motor Vehicles	12,000
Selling and Distribution Expenses	10,000	Trade Creditors	24,000
Financial, Legal and Professional Expenses	4,000	Accruals	1,000
Expense of conversion to company	2,000	Loan — Bow (10% p.a. interest)	30,000
Freehold property at cost	75,000	Bank A/c	4,000
Equipment at cost	20,000		
Motor vehicles at cost	40,000		
Trade Debtors	30,000		
Prepayments	2,000		
	3,93,000		3,93,000

Additional Information :
1. The sales during the second half of the year were 60% of the total sales through the gross profit percentage remained the same through the year.
2. The selling and distribution expenses were in proportion to the sales for each period. All other overhead expenses were incurred evenly throughout the year.
3. There were no purchases or sales of fixed assets during the year.
4. Depreciation is to be provided on original cost as follows : Equipment 10% p.a.; Motor Vehicles 20% p.a.
5. The drawings were made evenly. Drawings made after incorporation are to be considered as directors' salaries.
6. No dividends are paid or proposed but it is decided to write off the preliminary expenses and also ₹ 5,000 of the goodwill.

You are required to prepare :
(a) the Trading and Profit and Loss Account of the partnership for the period ended 31 October, 2016;
(b) Partners' Capital Accounts showing final adjustment to close the books of account of the partnership firm;
(c) a Balance Sheet of Amidships Ltd. as at 30 April, 2017.

Guide to Answers

Practical Questions

1. **Profit on realisation ₹ 20,000.**
2. **(a) Gross Profit ₹ 4,00,000; Net Profit ₹ 1,90,000; (b) Profit on realisation ₹ 40,000**
   (c) Balance Sheet of B as at 31.12.2016: Land & Building ₹ 40,000; Plant ₹ 1,60,000; Fittings ₹ 20,000; Investments ₹ 20,000; Stock ₹ 1,14,000; Debtors ₹ 1,60,000; Cash ₹ 66,000; Capital ₹ 8,00,000; Creditors ₹ 1,70,000; Accruals ₹ 10,000, Total ₹ 9,80,000.
   (d) Balance Sheet of X Ltd: Goodwill ₹ 1,20,000; Land & Building ₹ 4,00,000; Plant & Machinery ₹ 1,00,000; Fixtures and Fittings ₹ 20,000; Stock ₹ 1,14,000; Debtors ₹ 1,60,000; Cash ₹ 66,000; Share Capital ₹ 8,00,000; Creditors ₹ 1,70,000; Accruals ₹ 10,000; Total ₹ 9,80,000.
3. **Profit on realisation: Abraham ₹ 7,350; Benjamin ₹ 4,410; Chapman ₹ 2,940.**
4. **Profit on realisation ₹ 19,920.**
5. **Profit for 1st half : ₹ 22,000 (B : ₹ 13,200; E : ₹ 8,800); Profit of 2nd half : ₹ 7,800 (B : ₹ 3,120; E : ₹ 3,120; C : ₹ 1,560). Balance Sheet total : ₹ 1,24,680.**
6. **Realisation loss : ₹ 51,000; Goodwill : ₹ 2,76,000; Purchase consideration : ₹ 8,51,000.**
7. **Purchase consideration — C & R : ₹ 15,600; K & T : ₹ 53,200. Profit on Realisation — C & R : ₹ 4,800; K & T : ₹ 23,600. Shareholding in S Ltd. : C — ₹ 20,640; R — ₹ 20,640; T — ₹ 27,520.**
8. **Realisation Loss — ₹ 20,000; Balance Sheet Total — ₹ 4,73,000.**
9. **Total of Balance Sheet — ₹ 2,33,000.**

CALCUTTA UNIVERSITY
Financial Accounting – II
Suggested Answers of Short Questions

2012 [General]

Group - A

Answer the following questions :

1. (a) What is the basis of allocation of 'rent' and 'depreciation on assets' in Departmental Profit and Loss Account ?

Answer

(a) Expenses	Basis of Allocation
(i) Rent	Floor Area of each department
(ii) Depreciation on Assets	Value of assets in each department

1. (b) What are the advantages of preparing Departmental Profit and Loss Account ?

Answer

The ***main advantages of preparing Departmental Profit and Loss Account*** are as follows:

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.
4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organisation.

1. (c) Mention two differences between Hire Purchase and Ordinary Purchase.

Answer

Difference between Hire Purchase and Ordinary Purchase

	Hire Purchase	Ordinary Purchase
1.	The title of the goods passed on to the buyer after payment of the ***final installment***.	The title of the goods passed on to the buyer immediately. The payment may be made immediately or after certain time.
2.	The buyer cannot hire out, sell, transfer, destroy or pledge the goods.	The buyer can hire out, sell, transfer, destroy or pledge the goods.

1. (d) Mention two differences between Hire Purchase and Instalment Payment System.

Answer

The differences between the hire purchase system and the instalment payment system are as follows:

	Hire Purchase System	Instalment Payment System
(i) Nature of Contract	It is an agreement of hiring of goods.	It is an agreement of sale of goods.
(ii) Passing of Title	The title of the goods is passed on to the buyer after the payment of the final instalment or as agreed by the parties.	The title of the goods is passed on to the buyer at the time of signing the agreement.

1. (e) What is the purpose of Branch Adjustment Account ?

Answer

Branch Adjustment Account is prepared with a view to ascertain the gross profit of the branch. This account summarises the "loading" on all transactions. This account is credited with the "stock reserve" on opening stock and loading on net goods sent to branch. It is also credited with the loading on surplus in stock. This account is debited with the loading on shortage- in-stock; spoilage, pilferage, theft, loss by fire, loss in transit and "stock reserve" on closing stock. The balance of this account is transferred to ***Branch Profit and Loss Account***.

1. (f) What will be journal entries for 'Cash-in transit' and 'Goods-in transit' in the books of Head Office ?

Answer

In the books of the *Head Office*

(i) For cash in transit :

Cash-in-transit Account	Dr.
To Branch Account	

(ii) ***For goods-in-transit :***

Goods-in-transit Account	Dr.
To Branch Account	

1. (g) Mention two circumstances under which a firm is dissolved.

Answer

A partnership firm may be dissolved in the following circumstances :

(i) The sudden death or retirement of a 'key partner' may force other partners to dissolve the firm.
(ii) The business of the firm have become illegal and it may be required to dissolve the firm.
(iii) All partners, except one, have become insolvent.

1. (h) What do you mean by 'Garner vs. Murray' rule in the case of insolvency of a partner ?

Answer

The '***Garner vs. Murray***' rule is applied to share the loss due to insolvency of a partner. The following points are important in this respect :

1. Garner Vs. Murray is applicable only when there is no agreement among the partners for sharing the deficiency in capital account of insolvent partner.
2. Realisation loss should be divided in the profit sharing ratio in the usual manner.
3. The solvent partners should bring in cash to make good the loss on realisation.
4. Final debit balance (after debiting realization loss) of insolvent partner should be shared amongst the solvent partners in proportion to their last agreed capital.
5. A solvent partner having ***debit balance*** in Capital Account will not share any loss due to insolvency of a partner.

2013

Group A

1. (a) What do you mean by insolvency of a partner ?

Answer

A partner will be treated as insolvent when :

(i) he is unable to pay his debt or liabilities to the partnership firm.
(ii) his assets are insufficient to pay-off his debts / liabilities to the third party.

Where a partner in a firm is adjudicated an insolvent, he ceases to be a partner of the firm from the date of declaring him insolvent.

1. (b) Mention two circumstances under which a firm may be dissolved.

Answer

A partnership firm may be dissolved in the following circumstances :

(i) The sudden death or retirement of a 'key partner' may force other partners to dissolve the firm.

(ii) The business of the firm have become illegal and it may be required to dissolve the firm.

(iii) All partners, except one, have become insolvent.

1. (c) What is the purpose of Branch Adjustment Account ?

Answer

Branch Adjustment Account is prepared with a view to ascertain the gross profit of the branch. This account summarises the "loading" on all transactions. This account is credited with the "stock reserve" on opening stock and loading on net goods sent to branch. It is also credited with the loading on surplus in stock. This account is debited with the loading on shortage- in-stock; spoilage, pilferage, theft, loss by fire, loss in transit and "stock reserve" on closing stock. The balance of this account is transferred to ***Branch Profit and Loss Account***.

1. (d) What are the different types of branches ?

Answer

From an accounting point of view, the branches can be divided into the following main classes:

(1) Home Branches :

(a) Dependent branches (where the ***head office*** maintains all the accounts)

(b) Independent branches (where the ***branch*** keeps its own accounts)

(2) Foreign Branches :

They almost invariably trade independently and record their transactions in ***foreign currency***.

1. (e) What do you mean by Hire Purchase System ?

Answer

Hire purchase system is a special type of purchase and sales. Under this system, payment is made in installments. The hire vendor (seller) transfers only the possession of the goods to the hire purchaser immediately after the contract for hire purchase is made. The hire purchaser generally makes a down payment (initial payment) on signing the agreement and the balance of the amount along with interest is paid in installments at regular intervals (monthly, quaterly or yearly) for a specific period of time.

The property in goods is to pass to the hire purchaser on the payment of the ***last installment***. Till final payment, each installment including down payment (if any) is treated as ***hire charges***.

1. (f) What do you mean by Instalment Payment System ?

Answer

An instalment payment system is a credit sale in which payments are made in installments over a certain period. The seller transfers the ***ownership and possession*** of the goods to the purchaser immediately after the contract is made for sale of the goods.

In the event of non-payment of installment by the buyer, the seller cannot repossess the goods. The total amount paid by the buyer is ***not forfeited***. The seller can bring a suit against the buyer for the ***unpaid installments***.

1. (g) What are the objectives of preparation of Departmental Accounts ?

Answer

The main objectives of preparation of Departmental Account are the following :

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.

4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organisation.

1. (h) How would you allocate 'Discount Allowed' and 'Staff Welfare Expenses' between different departments of a departmental organisation ?

Answer

'***Discount Allowed***' should be allocated on the ***basis of sales*** of each department excluding inter-departmental transfer and sales return.

'***Staff Welfare Expenses'*** should be allocated on the ***basis of number of employees*** in each department.

2014

Group A

1. (a) What do you mean by dissolution of a partnership firm ?

Answer

The process of breaking-up and discontinuing a partnership business is called '***Dissolution of a Partnership Firm***'. The partnership firm may be dissolved by the partners mutually or the court may dissolve a firm if any partner files a suit for dissolution. The court may pass an order for dissolution of the firm if there is sufficient ground for that.

1. (b) What is Realisation Account ?

Answer

Realisation Account is a 'special account' used at the time of dissolution of the partnership firm. It is used for closing the different accounts related to assets and liabilities. The main purpose of preparing this account is to find out the profit and loss on realisation of assets and settlement of liabilities.

1. (c) State any two reasons of a firm's dissolution.

Answer

A partnership firm may be dissolved for the following reasons :

(i) The sudden death or retirement of a 'key partner' may force other partners to dissolve the firm.
(ii) The business of the firm have become illegal and it may be required to dissolve the firm.
(iii) All partners, except one, have become insolvent.

1. (d) Mention any two methods of accounting for branch transactions.

Answer

The accounting arrangement of a branch depends upon its size, the type of activities, the method of operation and the degree of control to be exercised by the head office. There are two main methods of accounting for branch transactions, ***viz.***

1. Debtors System
2. Stock and Debtors System

1. (e) What is meant by 'down payment' in hire purchase transactions ?

Answer

'Down payment' means the initial payment made at the time of signing the hire purchase agreement. No interest element is included in the down payment. Down payment varies from transaction to transaction. At the time of determining the amount of installment, 'down payment' is first deducted from the cash price of the goods.

1. (f) What do you mean by 'Repossession of Stock' ?

Answer

In a hire purchase agreement the hire purchaser has an obligation to pay up to the last instalment so that the ownership of goods passes to him. If the hire purchaser fails to pay any of the instalments, the hire vendor has the right to take the asset back in its actual form without any compensation to the hire purchaser. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the asset is termed as ***repossession***.

1. (g) What do you mean by inter-departmental transfer of goods ?

Answer

When goods are transferred by one department to another department it is called Inter-department Transfer'. The transfer may be at 'cost price' or 'market price'. Since each department is treated as a profit centre, it is necessary to have separate records for such transfer. The transfer is recorded by passing the following entry :

Receiving Department Dr. (Transfer price)

To Supplying Department

1. (h) Mention two advantages of preparation of Departmental Profit and Loss Account.

Answer

The ***main advantages of preparing Departmental Profit and Loss Account*** are as follows:

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.

2015

Group A

1. (a) What is the purpose of preparing a Realisation Account ?

Answer

Realisation Account is prepared generally at the time of dissolution of the partnership firm. It is prepared for the following purposes :

(1) To close the Assets Account which are to be realized in cash, e.g., land and building, plant and machinery, stock etc.

(2) To close the Liabilities Account which are to be settled.

(3) To calculate the profit or loss on realization of assets and settlement of liabilities.

1. (b) What do you mean by insolvency of a partner ?

Answer

A partner will be treated as insolvent when :

(i) he is unable to pay his debt or liabilities to the partnership firm.

(ii) his assets are insufficient to pay-off his debts / liabilities to the third party.

Where a partner in a firm is adjudicated an insolvent, he ceases to be a partner of the firm from the date of declaring him insolvent.

1. (c) What do you mean by 'Garner vs. Murray' rule in case of insolvency of a partner ?

Answer

The '***Garner vs. Murray***' rule is applied to share the loss due to insolvency of a partner. The following points are important in this respect :

1. Garner Vs. Murray is applicable only when there is no agreement among the partners for sharing the deficiency in capital account of insolvent partner.
2. Realisation loss should be divided in the profit sharing ratio in the usual manner.

3. The solvent partners should bring in cash to make good the loss on realisation.
4. Final debit balance (after debiting realization loss) of insolvent partner should be shared amongst the solvent partners in proportion to their last agreed capital.
5. A solvent partner having debit balance in Capital Account will not share any loss due to insolvency of a partner.

1. (d) How a branch is related to its head office ?

Answer

A branch may be defined as a section of an enterprise, geographically separated from the rest of the business, controlled by a ***head office***, and generally carrying on the same activities as of the enterprise. As a business grows, it may open up branches in different towns and cities in order to market its products/services over a large territory and thus increase its profits. For example, Bata Shoe Co. Ltd. has branches in various cities all over the country. The same example holds good for a commercial bank also.

It should be mentioned that a branch is ***not a separate legal entity***; it is simply a segment of a business. From an accounting standpoint, a branch is a clearly identifiable ***profit centre***.

1. (e) Mention two diffrences between Hire Purchase and Ordinary Purchase.

Answer

	Hire Purchase	Ordinary Purchase
1.	Under hire purchase, the ownership of goods is transferred to the buyer after the payment of last installment.	Under ordinary purchase, the ownership of goods is transferred immediately.
2.	Purchase consideration is paid in installments which includes interest on balance due.	Purchase consideration is paid immediately or after certain time as per the terms and conditions of sale.

1. (f) What do you mean by the word 'Instalment' in hire purchase ?

Answer

In the hire purchase sale, some amount is paid at the time of signing the agreement. The balance amount along with future interest is paid part by part. The part payment is called 'Installment'.

For example, the cash price of a motor cycle is ₹ 65,000. However, the hire purchase price is ₹ 75,000. Down payment is ₹ 15,000. As per agreement the balance amount to be paid in 12 monthly installments., Here 'installment' is calculated as follows :

Hire Purchase price	₹ 75,000
Less: Down payment	15,000
Balance due	60,000

Amount payable in each installment = 60,000 ÷ 12 = ₹ 5,000.
This ₹ 5,000 is ***one*** installment.

1. (g) Why 'inter-departmental transfer of goods' is not usually considered as a sale ?

Answer

When goods are transferred from one department to another department, the ***ownership*** is not transferred. It is an internal transaction. In case of actual sale, ownership of goods is transferred for some consideration. Because of this, departmental transfer is not a sale. However, Receiving Department's Trading Account is debited and Sending Department's Trading Account is ***credited*** with agreed value of the goods transferred.

1. (h) What are the objects of preparation of Departmental Accounts ?

Answer

The main objectives of preparation of Departmental Account are the following :

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.
4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organisation.

2016

Group A

1. (a) Mention two circumstances when a firm may be dissolved.

Answer

A partnership firm may be dissolved in the following circumstances :

(i) The sudden death or retirement of a 'key partner' may force other partners to dissolve the firm.

(ii) The business of the firm have become illegal and it may be required to dissolve the firm.

(iii) All partners, except one, have become insolvent.

1. (b) What is the purpose of Branch Adjustment Account ?

Answer

Branch Adjustment Account is prepared with a view to ascertain the gross profit of the branch. This account summarises the "loading" on all transactions. This account is credited with the "stock reserve" on opening stock and loading on net goods sent to branch. It is also credited with the loading on surplus in stock. This account is debited with the loading on shortage- in-stock; spoilage, pilferage, theft, loss by fire, loss in transit and "stock reserve" on closing stock. The balance of this account is transferred to ***Branch Profit and Loss Account***.

1. (c) Mention the different types of branches.

Answer

From an accounting point of view, the branches can be divided into the following main classes:

(1) Home Branches :

(a) Dependent branches (where the head office maintains all the accounts)

(b) Independent branches (where the branch keeps its own accounts)

(2) Foreign Branches :

They almost invariably trade independently and record their transactions in foreign currency.

1. (d) Mention two methods for distribution of assets on dissolujtion of a partnership firm.

Answer

(d) The assets of the partnership firm can be distributed in the following manner :

(i) Surplus Capital Method

(ii) Maximum Loss Method

Surplus Capital Method is suitable where the following two conditions are satisfied :

(a) The partners' profit sharing ratio and capital contribution ratio are different.

(b) All partners are solvent and are likely to remain so.

Maximum Loss Method is suitable when a partner or partners is known to be insolvent.

1. (e) State two features of Hire Purchase System.

Answer

(1) The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.

(2) The goods should be delivered by the hire vendor on the condition that a hire purchaser should pay the agreed amount in periodical instalments.

1. (f) State the journal in relation to Repossession of stock in the books of the owner.

Answer

(f) In the books of the Owner (Hire Vendor)

Goods Repossessed Account Dr. [Agreed value]

To Hire Purchaser Account

1. (g) Write two differences between a General Profit and Loss Account and a Departmental Profit and Loss Account.

Answer

	General Profit and Loss Account	Departmental Profit and Loss Account
1.	It is prepared to calculate the 'overall' profit or loss of the organisation.	It is prepared to calculate the profit or loss of each department of the organisation.
2.	Departmental profit or loss is transferred to General Profit and Loss Account.	General profit or loss is not transferred to Departmental Profit and Loss Account.

1. (h) How will you allocate staff welfare expenses between different departments of an organisation ?

Answer

Staff welfare expenses are allocated between departments on the ***basis of number of employees*** in each department.

2017

Group A

1. (a) What is meant by dissolution of a firm ?

Answer

The process of breaking-up and discontinuing a partnership business is called '***Dissolution of a Partnership Firm***'. The partnership firm may be dissolved by the partners mutually or the court may dissolve a firm if any partner files a suit for dissolution. The court may pass an order for dissolution of the firm if there is sufficient ground for that.

1. (b) What is the object of invoicing goods to the branch at selling price ?

Answer

Sometimes, the head office may prefer to send goods to the branch at a higher price than cost (termed as invoice price). Method of sending goods at invoice price is excellent from the point of view of stock control. As the goods are invoiced at selling price, the head office can dictate pricing policy to its branches, as well as save work at the branch because prices have already been decided. Invoicing at selling price is generally done where goods are of standard type, pre-packed and unlikely to fluctuate in price. Where head office has little control over selling prices (as for example, with perishable goods like fruits, fish, milk, etc.) the most suitable method is that of invoicing at cost price. In addition, goods may be invoiced at selling price to keep the margin of profit a secret from the branch manager.

1. (c) State the journal entry for cash-in transit in the books of head office.

Answer

In the books of the Head Office

Cash-in-transit Account Dr.

To Branch Account

1. (d) What is the difference between Sale on Hire Purchase basis and Credit Sale ?

Answer

	Sale on Hire Purchase Basis	Credit Sales
1.	The hire vendor (seller) transfers only possession of the goods but not the ownership of the goods.	The seller transfers both the possession of the goods and ownership.
2.	As the hire vendor is the owner of the goods, the buyer cannot hire out, transfer, sell or pledge the goods.	The buyer can hire out, sell, transfer or pledge the goods.
3.	The payment is made in instalment along with interest at agreed rate.	Payment is made after some time as agreed by the parties.
4.	The hire vendor can take back the goods for non - payment of instalment.	The seller has no right to take back goods. However, he may file a suit for the recovery of the dues.

1. (e) Why Hire Purchase Trading Account is maintained ?

Answer

Hire Purchase Trading Account is prepared for the purpose of determining the profit from sale of 'small value' goods on hire purchase. It is similar to Consignment Account. It is prepared at the end of the year at ***invoice price*** generally.

The proforma of a Hire Purchase Trading Account is given below:

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d :			By Cash A/c A/c	
	Hire Purchase Stock (at H.P. price)			By Goods Repossessed A/c	
	Hire Purchase Debtors			(Instalments due but not paid)	
	To Goods Sold on H.P. A/c (H.P. price)			By Stock Reserve A/c	
	To Loss on Goods Repossessed A/c			(Loading on opening H.P. stock)	
	To Expenses A/c			By Goods sold on H.P. A/c	
	To Stock Reserve A/c			(Loading on goods sold)	
	(Loading on closing H.P. stock)			By Balance c/d:	
	To Profit & Loss A/c			H.P. Stock (at H.P. price)	
				H.P. Debtors	

1. (f) What is meant by Inter Departmental Transfer ?

Answer

Each department is treated as a separate profit centre. In many cases, one department may transfer some goods to another department. ***For example***, Cloth Department of an organisation may transfer some clothes to Tailoring Department. In this case, the value of the clothes will be treated as ***sale of the Cloth Department*** and ***purchase of Tailoring Department***. This transfer should be accounted for the purpose of determining the true profit of each department.

1. (g) What do you mean by unrealised profit in departmental accounting ?

Answer

Unrealised profit in departmental accounting arises when goods are transferred by one department to another department at a profit and some of the goods are still in stock at transferred price.

If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods are still unsold stock, an appropriate adjustment must be made for unrealised profit on stock.

The entry is :

General Profit and Loss Account Dr.
To Provision for Unrealised Profit on Stock Account

At the beginning of the next year reverse entry will be passed.

Provision for Unrealised Profit on Stock Account Dr.
To General Profit and Loss Account

1. (h) What do you mean by 'Garner vs. Murray' rule in case of insolvency of a partner ?

Answer

The '***Garner vs. Murray***' rule is applied to share the loss due to insolvency of a partner. The following points are important in this respect :

1. Garner Vs. Murray is applicable only when there is no agreement among the partners for sharing the deficiency in capital account of insolvent partner.
2. Realisation loss should be divided in the profit sharing ratio in the usual manner.
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4. Final debit balance (after debiting realization loss) of insolvent partner should be shared amongst the solvent partners in proportion to their last agreed capital.
5. A solvent partner having ***debit balance*** in Capital Account will not share any loss due to insolvency of a partner.